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Inclusive Finance India Report 2017

M.S. Sriram

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Inclusive Finance India Report 2017

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M.S. Sriram

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List of Abbreviations

AEPS	Aadhaar Enabled Payment Systems
AMES	Aadhaar Mapper Enabled Services
AML	Anti-Money Laundering
ANBC	Adjusted Net Bank Credit
AOVS	Aadhaar OD Verification Service
AP	Andhra Pradesh
APBS	Aadhaar Payment Bridge System
APY	Atal Pension Yojana
APMAS	Andhra Pradesh Mahila Abhivruddhi Society
ATM	Automated Teller Machine
BC	Business Correspondent
BHIM	Bharat Interface for Money
BPL	Below Poverty Line

BPSS	Board for Regulation and Supervision of Payment and Settlement Systems
BSBD	Basic Savings and Bank Deposit
CBDT	Central Board of Direct Taxes
CBLO	Collateralized Borrowing and Lending Obligation
CBS	Core Banking Solution
CCIL	Clearing Corporation of India Ltd
CD	Credit Deposit
CDR	Corporate Debt Restructuring
CERSAI	Central Registry of Securitisation Asset Reconstruction and Security Interest of India
CFT	Countering Terrorist Financing
CIC	Credit Information Companies
CIF	Community Investment Fund
C-PEC	Centre for Professional Excellence in Cooperatives
CPC	Cheque Processing Center
CRAR	Capital to Risk Weighted Adjusted Ratio
CSP	Customer Service Point
CTD	Cumulative Time Deposits
CTS	Cheque Truncation System
DBT	Direct Benefit Transfer
DCB	District Cooperative Banks
DCCB	District Cooperative Central Bank
DFI	Development Financial Institution
DLCC	District Level Coordination Committee
DOP	Department of Post
DOPT	Department of Personnel and Training
DPO	Departmental Post Office
DSA	Direct Selling Agent
eKYC	electronic Know Your Customer
FIAC	Financial Inclusion Advisory Committee
FII	Foreign Institutional Investors
FIF	Financial Inclusion Fund
FSP	Financial Services Provider
FY	Financial Year
G2P	Government-to-Person
GCC	General Credit Card
GDS	Grameen Dak Sewak
GLP	Gross Loan Portfolio
GNPA	Gross Non-Performing Assets
GoJ	Government of Jharkhand
GSM	Global System Mobile
HLP	High Level Principles
IBA	Indian Banks Association
ICT	Information and Communication Technology
IFC	International Financial Corporation
IFSC	Indian Financial System Code
IIBF	Indian Institute of Banking and Finance
IMO	Instant Money Order
IMPS	Immediate Payment System
IPO	Initial Public Offering
IPPB	India Post Payments Bank
IRDAI	Insurance Regulatory Development Authority of India
J&K	Jammu and Kashmir
JAM	Jan Dhan-Aadhaar-Mobile

JLG	Joint Liability Groups
JStCB	Jharkhand State Cooperative Bank
KCB	Kerala Cooperative Bank
KCC	Kisan Credit Card
KYC	Know Your Customer
LAB	Local Area Banks
LIC	Life Insurance Corporation
LWE	Left-wing Extremism
MDR	Merchant Discount Rate
MFI	Microfinance Institutions
MFIN	Microfinance Institutions Network
MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MICR	Magnetic Ink Character Recognition
MMID	Mobile Money Identification Number
MoF	Ministry of Finance
MoRD	Ministry of Rural Development
MP	Madhya Pradesh
MSC	Multi-Service Centers
MSME	Micro, Small, and Medium Enterprises
MUDRA	Micro Units Development and Refinance Agency (Bank)
NABARD	National Bank for Agriculture and Rural Development
NABFINS	NABARD Financial Services
NACH	National Automated Clearing House
NAFSCOB	National Federation of State Cooperative Banks
NBFC	Non-Banking Financial Company
NBFI	Non-Banking Financial Institution
NBFC MFI	Non-Banking Financial Company–Microfinance Institution
NEFT	National Electronic Fund Transfer
NGO	Nongovernmental Organizations
NPA	Non-Performing Asset
NPCI	National Payments Corporation of India
NRLM	National Rural Livelihoods Mission
NRLP	National Rural Livelihoods Programme
OD	Over Draft
PACS	Primary Agricultural Cooperative Society
PAN	Permanent Account Number
PAR	Portfolio at Risk
PB	Payments Bank
PDC	PACS Development Cells
PDS	Public Distribution System
PFRDA	Pension Fund Regulatory Development Authority
PLI	Postal Life Insurance
PMJDY	Prime Minister's Jan Dhan Yojana
PMJJBY	Pradhan Mantri Jeevan Jyoti Bima Yojana
PMLA	Prevention of Money Laundering Act
PMMY	Pradhan Mantri Mudra Yojana
PMSBY	Pradhan Mantri Suraksha Bima Yojana
PoS	Point of Sale
PPI	Prepaid Instruments
PSIG	Poorest State Inclusive Growth
PSL	Priority Sector Lending
PSLC	Priority Sector Lending Certificates
PSP	Payments Service Provider
QoQ	Quarter-on-Quarter

RBI	Reserve Bank of India
RF	Revolving Funds
RRBs	Regional Rural Banks
RSBY	Rashtriya Swastya Bima Yojana
RTGS	Real Time Gross Settlement
SBA	Small Borrowal Account
SCB	Scheduled Commercial Banks
SFB	Small Finance Banks
SGSY	Swarna Jayanti Gram Swarozgar Yojana
SHG	Self-Help Group
SHGBLP	SHG-Bank Linkage Programme
SHPI	Self Help Group Promotion Institution
SIDBI	Small Industries Development Bank of India
SIFI	Systemically Important Financial Institutions
SIMF	Systematically Important Financial Market Infrastructures
SIPS	Systemically Important Payment System
SKDRDP	Shree Kshetra Dharmasthala Rural Development Project
SLBC	State Level Bankers' Committee
SLR	Statutory Liquidity Ratio
SSA	Sub-Service Area
StCB	State Cooperative Banks
StCCS	Short-Term Co-operative Credit System
TN	Tamil Nadu
TRAI	Telecom Regulatory Authority of India
TReDS	Trade Receivables Discounting System
UCB	Urban Cooperative Bank
URC	Unbanked Rural Center
UIDAI	Unique Identification Authority of India
UP	Uttar Pradesh
UPI	Unified Payments Interface
USB	Ultra-Small Branch
USSD	Unstructured Supplementary Service Data
VO	Village Organization
VPA	Virtual Payment Address
WB	West Bengal
WDRA	Warehousing Development and Regulatory Authority
YoY	Year-over-Year

Foreword

Are we finally close to universalizing financial access in India? Recently, on the occasion of the third anniversary of the Prime Minister's Jan Dhan Yojana (PMJDY), Union Minister Shri Arun Jaitley spoke of the "1 billion–1 billion–1 billion" vision. He stated that one billion unique Aadhaar numbers will be linked to one billion bank accounts and one billion mobile phones. He added, "Once that is done, all of India can become part of the financial and digital mainstream." This is an incredible accomplishment indeed, but unless this architecture is fully leveraged, the potential gains will not accrue to the targeted communities. Optimizing from these gains will, however, be a long-drawn process. But things are certainly looking up.

At the center stage of financial inclusion in India is, of course, the PMJDY. Launched 3 years ago, it has continued to build new ambitions. The total number of accounts opened has crossed the 300 million mark. This is an incredible feat by itself. The concern with these numbers, however, has been on the "usage." The *Brookings Financial and Digital Inclusion Report*, too, while according a 100% score to India on country commitment, has given an overall score of 72% on India's financial inclusion drive, largely due to challenges in adoption, which is at 44%. About 70 million accounts are said to be dormant. Post demonetization, there was a significant spike in transactions in the accounts. Further, with the on-boarding of over 250 government entitlements to direct benefit transfers (DBTs), once the cash starts to come in to these accounts, transaction levels are likely to go up significantly. With Aadhaar becoming mandatory, DBT leakages are likely to be harnessed, and de-duplication of accounts will be possible. While not spectacular, there has been some slow and steady progress on social security schemes under PMJDY. While under the PM Jeevan Jyoti Bima Yojana (PMJJBY; life insurance) the coverage is about 31 million, it is about a 100 million under the PM Suraksha Bima Yojana (PMSBY), with only marginal increases from the last year. Atal Pension Yojana (APY) too is yet to make any significant impression.

Since, and even prior to demonetization, digitizing transactions and financial services have been an important obsession, with the government rolling out several strategic and operational initiatives. An intended, or maybe unintended rationale for demonetization was to spur digital transactions in the country. While at the macro level, the government, ever since it came to power, has put Digital India as a priority; post the demonetization, a little by design and a little by default, digital financial inclusion did get a significant boost. Post demonetization, with cash disappearing from the market, the level of transactions spiked up considerably. Fintech companies went into overdrive, besides the government taking several initiatives to bolster the momentum. Important among these was the introduction of unstructured supplementary service data (USSD 2.0), a unified payments interface (UPI), the launch of a pilot on BHIM (Bharat Interface for Money)–Aadhaar Pay, a smartphone-based application, and the launch of Bharat QR Code etc. With the launch of BHIM and UPI, perhaps Jan Dhan-Aadhaar-Mobile (JAM) has become fully operational.

The mushrooming of over 700 fintech start-ups has further strengthened this infrastructure for digital financial services. These fintech start-ups offer the customers easier and speedier ways to pay, save, and borrow. They are more tech savvy, benefit from light touch regulations, are more efficient, and offer lower costs. Although almost all banks have launched their own digital payment channels, they are burdened with complex compliance issues and are not as flexible as fintech companies. Guidelines for P2P lending are in place too. With this digital financial infrastructure in place, now the critical challenge is to expand its usage, less as a compulsion and more as a convenience, particularly at the bottom of the pyramid.

There have been several other initiatives brewing within the financial inclusion ecosystem. The most exciting is the roll-out of the small finance banks (SFBs) and the payments banks (PBs), the newly introduced differentiated banks. The covenants for these banks are such that they have no option but to serve the low-income segments—perhaps a more durable structural policy initiative than a campaign mode. Nine of the ten "in-principle" licensees have commenced operations. While most licensees are reconciled to the broad guidelines within which they will be required to operate, niggling doubts and gray areas still remain to be resolved. As they move from the light touch regulation (when most of them were microfinance institutions [MFIs]) to a more stringent highly regulated regimen, compliance to the regulator will be a critical challenge. Most SFBs, however, seem confident that they have their game plan sorted and, irrespective of their past MFI experience, nature of operations, client base, and products, will manage to transition seamlessly into the new institutional architecture. On the PB front, of the original 11 licensees, now only 7 remain (after the taking over of Vodafone by Idea) in the fray, with only four having rolled out their operations so far. While earlier PBs were seen as game changers, in some sections, there are emerging doubts on the PB business model and its viability. Given the raison d'être that these two categories of banks will contribute to advancing financial inclusion, the government ought to provide them with a level playing field. Including them for government-to-person (G2P) payments could be a good start, bolstering their viability.

The microfinance sector in India is, in some ways, in a flux. Takeover of MFIs by banks and other larger nonbanking financial companies (NBFCs) was a major highlight of the year. While IDFC's acquisition of Gram Vidiyal last year was the big news, RBL acquired 30% stakes in Swadhar Financial Services, Kotak Mahindra Bank bought BSS Microfinance, India Infoline acquired Samasta Microfinance, and Muthoot Finance Ltd enhanced its stakes in Belstar to around 65%. Bharat Financial Inclusion Ltd, has tied up, finally, for a merger with IndusInd Bank. Similarly, SMILE Microfinance too is up for grabs. Essel Finance is in talks to acquire Saija, and it is almost on the verge of being taken over. This trend is likely to continue, I guess. While the private banks are looking at the acquisitions largely to expand their operations and meet the statutory obligations under PSL, the impulse for the large NBFCs to acquire MFIs may emanate from their quest to expand their portfolio and aspire for a universal bank license, which now is on tap.

Despite setbacks, the sector witnessed good growth, dampened a bit by demonetization. The gross loan portfolio (GLP) grew at 29%, and the client base increased by 33% over the last year. Although the smaller MFIs struggled for both debt and equity, the larger ones (including SFBs) attracted significant investments, of about INR 81 billion during the year. The aggregate loan outstanding was over INR 400 billion as on March 2017, compared to INR 337 as on March 2016. Although the growth in the sector has been impressive, demonetization dampened the pace of growth. While last year the sector was showing signs of overheating, this year saw some corrections, bringing moderation to these growth plans as there was no cash available and nonperforming assets (NPAs) started to get out of control after demonetization.

Acquisitions and mergers, then, was the predominant headlines in the sector. Once again, risks and vulnerability associated with the sector were highlighted. The effects of demonetization and farm loan waivers saw a big spurt in NPAs; nine largest MFIs have now become banks and some others are looking for partnerships with banks to become their business correspondents (BCs). Paradoxically, the National Bank for Agriculture and Rural Development (NABARD), the creator of the self-help group (SHG) movement, became the largest lender to MFIs. Indeed, there are some certain shifts in the sector.

I am wondering though, that there is no information on the biggest news of last year—of the establishment of Avanti Microfinance, promoted by Ratan Tata, Nandan Nilekani, and Vijay Kelkar.

This is the silver jubilee year of the SHG movement. Despite several ecosystem changes such as the aggressive growth of the microfinance, adaptation of the SHG methodology by mainstream government programs (Swarna Jayanti Gram Swarozgar Yojana [SGSY] and National Rural Livelihoods Mission [NRLM]), NPAs, hesitant lending by banks, and low capacity of the Self Help Group Promotion Institution (SHPI), the movement has continued to grow, even though at modest levels. As of March 2017, there were 8.5 million SHGs linking over 100 million, mostly poor rural women with mainstream finance. However, only 4.8 million of these are linked to credit. The number is low and erodes the very rationale for which the program was principally designed.

Since the launch of NRLM, increasingly, it seems that the government is taking the leadership role of the program. Convergence between NABARD and NRLM, more at the operational level rather than at the vision level, in some ways has only started in recent years. Paradoxically, when the government launched PMJDY, it did not factor the potential for leveraging either NRLM or the SHG program. If a three-way, intrinsically intertwined, mutually reinforcing strategy could have been cobbled, we could perhaps have seen earlier benefits accruing from this overwhelming financial inclusion campaign. I guess turf issues continued to keep these as distinct tracks.

Given that credit linkage is low within existing SHGs, and for other reasons, new emphasis in NABARD is on SHG data digitization through the E-Shakti software. Starting with two districts, the program has been extended to 23 more districts. Early results show that credit linkage due to digitization has improved. The Reserve Bank of India (RBI) too has been pushing for data reporting of SHG members to credit information bureaus, quite an arduous task. A good development for the program is the entry of private sector banks for SHG lending. Banks such as ICICI and HDFC are designing their own SHG lending programs. NABARD, on the other hand, is looking at several ways in which it wants to give the movement a second burst.

On the cooperative banks front, the big initiative was that of the Kerala government agreeing to the formation of an expert committee to integrate the cooperative structure at the state level. Governments of both Chhattisgarh and Jharkhand have proposed to adopt a two-tier structure. However, at the policy level, the cooperatives are not seriously included in the scheme of things for financial inclusion. On the regional rural banks (RRBs) front, similarly, there is nothing significant to report. Further, after the licensing of the SFBs, besides the competition that RRBs might face from these new-generation FFIs, the RRBs may lose their original rationale. The only way RRBs perhaps can be pulled out of their current ennui is to seriously look at their ownership. To get private players interested in RRB ownership could perhaps be a way out. Micro Units Development and Refinance Agency (Bank) or MUDRA, which was launched 2 years ago, has been much touted by the government as a panacea for providing fund flow to the microenterprise sector. Under the MUDRA Yojana, INR 1.7 trillion has been disbursed. It is inferred that this credit flow has resulted in creating significant new employment.

This year's *Inclusive Finance India Report*, across 15 chapters, is a comprehensive effort to analyze the trends in the advancement of financial inclusion through all available channels and programs. This is the 11th year since ACCESS has been publishing this annual report. I would like to thank Professor Sriram for agreeing to continue to write the report for the third consecutive year. His efforts have significantly contributed to the diversity of contents of the report. His deep understanding of the financial inclusion space and its full complexity has helped make the report more meaningful.

Like last year, Sriram, in partnership with IIM Udaipur, was once again able to bring all the CEOs of the SFBs and the PBs to Udaipur for a full day of frank and forthright interface with Mr N.S. Vishwanathan, Deputy Governor, RBI, in an attempt to help clear the niggling doubts of these new differentiated banks as they start to roll out their operations. While these interactions help the author to add significant insights to the related chapters, this annual meet of the SFB/PB CEOs is developing into a useful institutionalized platform for resolving issues and clarifying doubts. ACCESS would like to continue to work with Sriram and IIM Udaipur to see if this platform can become institutionalized.

Since the *Inclusive Finance India Report* is a mechanism to track the progress of financial inclusion in India, Sriram expanded the idea of RBI Governor interviews and sought to interview four previous governors, namely, Dr Rangarajan, Dr Y.V. Reddy, Dr Bimal Jalan, and Dr Subbarao. The content from these six interviews is so significant and rich that the idea of bringing them together as a book, *Talking Inclusion in Liberalized India: Conversions with Governors of Reserve Bank of India*, edited ably by Sriram has been successful and it will be released at the summit. I am also thrilled that four of these six Governors have agreed to speak at the summit on perhaps what will be a historic panel.

As always, several stakeholders contribute to the bringing together of the report. First and foremost, I would like to profusely thank Mr N.S. Vishwanathan, Deputy Governor, RBI, who, despite his extremely busy schedule, agreed to sacrifice a weekend and travel to Udaipur for the SFB/PB CEOs Round Table. I also take this opportunity to thank Professor Janat Shah, who has been playing the generous host for the CEOs Round Table. This year the conclave was held at IIM Udaipur's new complex, which is coming together as a very impressive infrastructure. I take this opportunity to also thank Pankaj Jain, Jt. Secretary, Ministry of Finance, for sharing the government perspectives. I would like to thank both NABARD and SIDBI for providing incredible support. I would like to thank Manoj Mittal, DMD, and Prakash and Umesh Gaur for their support from SIDBI; as always, both Subrata and Chintala provided all the support and data related to Micro Credit Innovations Department (MCID) and Department of Financial Inclusion and Banking Technology (DFIBT). Dr Harsh Bhanwala, like last year, also gave his valuable time and shared NABARD's perspective. Both Ratna at Microfinance Institutions Network (MFIN) and Satish at Sa-Dhan, as always, provided the MFI-related data and issues. I take this opportunity to thank all the reviewers of various chapters and the group of advisors for their incisive inputs in refining the report. This significant support and contribution of over a decade has helped to enrich the contents and analysis of the report. I am thankful to all of them.

This year, it is a privilege to have inputs from an exclusive interview with Nobel Laurate Professor Muhammad Yunus, which are integrated in the report. We are grateful to Professor Yunus for his interview with Sriram during his India visit this year.

I take this opportunity to thank Mastercard, Bill & Melinda Gates Foundation, IFC, NABARD, and SIDBI for their financial support in bringing out the *Inclusive Finance India Report*. Their long-standing commitment and contribution has significantly helped ACCESS to be able to bring out this report.

Finally, of course, this is to acknowledge the spirited support provided by my small teams in ACCESS and ACCESS ASSIST led ably by Radhika, Keerti, and Lalitha who were always there to support the author in this fairly complex process. I am most happy that Keerti was brimming with far greater sense of confidence as she handled her higher responsibilities this year.

ACCESS feels proud to have continued to put in the efforts in accomplishing this task, and since significant efforts and investments are made in bringing the report together, there is always this overhang of responsibility for making the report valuable to a wide readership base, including policy makers, regulators, apex institutions, researchers, and practitioners. The feedback over the years has been positive and therefore, we stay committed to continue with the report. The *Inclusive Finance India Report* will be released at the 14th Inclusive Finance India Summit on December 11, 2018.

Vipin Sharma
Chief Executive Officer
ACCESS Development Services

Preface

The year 2017 has been eventful and a difficult year to track the inclusive finance sector. The demonetization exercise of November 2016 was an unprecedented one that created a significant impact not only on the operations but also on the flow of data. The event has made it difficult to understand patterns and progress. However, toward the latter half of this year, we saw data coming in and patterns emerging. The advantage of this has been that there has been much analysis elsewhere, from which I could draw the report.

Two other elements mark 2017 as a special year. This was the year where most of the microfinance institutions (MFIs) that had got a license for setting up small finance banks started their operations. As we track their progress, we see that each of these banks will bloom in a different way, treading a different and innovative path, away from the standardized products they were offering as MFIs. There was also a big boost offered to digital finance because of demonetization. It is, therefore, natural that our lengthy chapters in this report pertain to MFIs and digital finance.

This year also marks the 25th year of formalizing the self-help group (SHG) Bank Linkage Programme (SHGBLP), and it is heartening to see how the program has grown to have a footprint across the country.

Most special for the report is a long interview with Professor Muhammad Yunus, who could be considered the father of the microfinance movement in the world. As we in India move toward the mainstreaming of microfinance, with public offerings, listings, private equity investments, and valuations, it is sobering to talk to Professor Yunus and get a reality check as to where the mission of microfinance is headed. While it is topical to have him speak to us at this juncture, it is also important to take a hard look back at the past and reiterate the mission with all this started.

While I have retained the same format as last year in this report, there are two subtle changes. The chapter on the Prime Minister's Jan Dhan Yojana (PMJDY) looks at the challenges of what was set out as a mission of the program in encouraging more and more direct benefit transfers (DBTs) to happen through the accounts. This report looks at the schemes that are listed for the DBT program, identifies the beneficiaries, and highlights the unfinished agenda in the program.

During the past years, one limitation that has always been pointed out is that the report does not cover microinsurance and micropensions. I am thankful to Professor Annapurna Neti of the Azim Premji University for having put together a chapter on microinsurance. Going forward, I hope to include a chapter on micropensions as well.

This report tries to capture all these happenings, and excitement is a considered fashion, putting in data where it is available. On the rural cooperative system, it is well known that this system has the best physical presence and has been generally ignored. It may have been ignored because of the difficulty of getting data and also because the growth rates and innovations are not exciting enough. However, it is important to ensure that we track the sector and ensure that an important piece in the inclusion architecture does not fall by the way side—first from discussions and then from policy engagement.

Two aspects that were given as a feedback based on the past reports need to be discussed here. The first is about some chapters that appear in this report, particularly the ones covering rural cooperatives, urban cooperative banks, and India Post. There have been questions on whether these chapters add value to the report since there is little policy action happening on that front. However, I have retained the chapters only because it makes the picture of inclusive finance much more complete. There was some action as far as the rural cooperatives were concerned, with multiple state governments trying to integrate the upper tier cooperatives. In case of India Post, more than 1,000 ATMs were rolled out and made interoperable with the banking system. However, all the three structures are available, and with adequate policy attention, they could be leveraged to expand the choices in the inclusive finance space. Therefore, I believe it is important to continue reporting on these structures.

The second aspect was about having regional focus as a theme and looking at the developments in the North East. While this was a great idea, I was unable to go through it because of the constraints of time and the uncertainty of when the data would flow.

Amidst the data delays, I need to acknowledge that the National Bank for Agriculture and Rural Development (NABARD)'s report on SHGs came well ahead of time. They were also able to place more recent data on regional rural banks, and I am thankful to NABARD for making this accessible. Thanks are also due to Microfinance Institutions Network (MFIN) for bringing out detailed and regular data on Nonbanking Financial Company–Microfinance Institutions (NBFC MFIs) and Sa-Dhan for bringing out the data once a year on a broad brush of participants in the inclusive finance space, particularly data on NGOMFIs. These two resource books have been immensely helpful in shaping much of the chapter on microfinance. The data made available by CRIF High Mark helped in having a better look at the granular data pertaining to microfinance institutions.

On the broad format, I have tried to be consistent with the format of the previous year and also provided data on the same formats so that it becomes useful for people looking for longitudinal data.

There are several people who work in the ecosystem to make a report of this size, magnitude, and diversity to work. The contributions are both direct in terms of interactions and insights and indirect in terms of the intellectual frames provided in the literature. It is extremely difficult for me to acknowledge each one of their contributions. However, I have tried to acknowledge the inputs that I have received specifically in the respective chapters. Chapters of this report have been reviewed at the draft stage by experts who went out of their way to provide inputs at short notice. However, I would like to specially thank the following persons:

- Professor Muhammad Yunus for sparing time for the interview amidst multiple commitments and agreeing to speak on a car journey between two events.
- Dr Urjit Patel, Governor of the Reserve Bank of India, who willingly gave time for an interview about financial inclusion. I carried excerpts of the interview in this report.
- N.S. Vishwanathan, Deputy Governor, Reserve Bank of India, who was very encouraging and was present in an important roundtable we had for small finance banks and payments banks.
- Sourav Sinha, CGM of the Reserve Bank of India, for being present in the roundtable.
- Dr Harsh Bhanwala, Chairman, G.R. Chintala, U.S. Saha, and Subrata Gupta, Chief General Managers of NABARD, for spending time and making data available.
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- Annapurna Neti for writing Chapter 5, an important chapter on microinsurance.
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I am also thankful to ACESS-ASSIST for providing me with this opportunity to write the report and for their constant support. Keerti Bhandary was a great support, Lalitha Sridharan who cheerfully managed the logistics, Radhika Agashe for being with the project throughout, and of course Vipin Sharma for all his persuasive and organizational skills. It has been a pleasure working with this team.

I would also like to thank my wife, Gowri, and son, Arjun, who were very much a part of this team and who helped me to relax amidst the stress of doing such a time-bound project.

M.S. Sriram

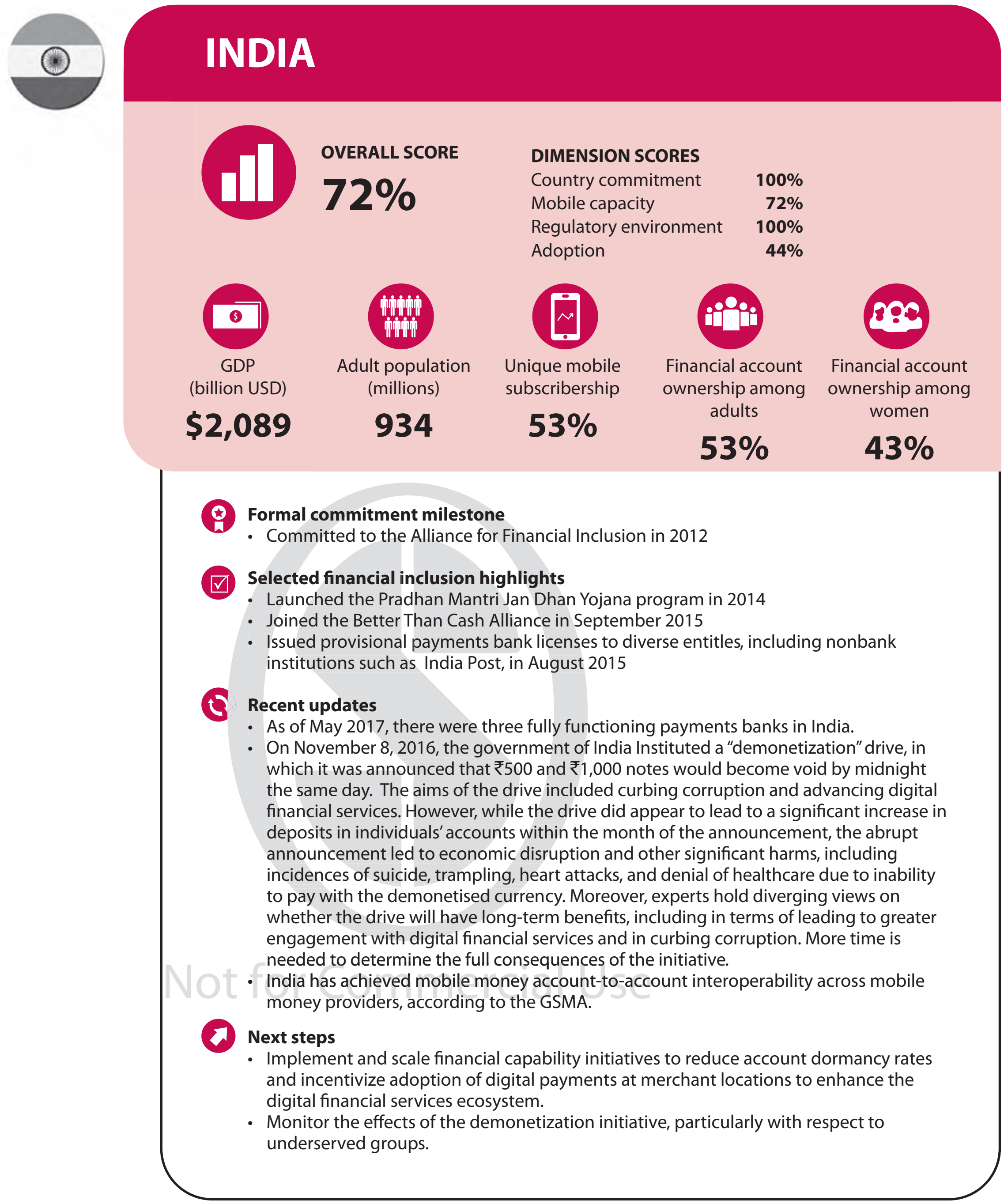


Figure 1.1 Brookings Evaluation of India's Financial Inclusion Program

Source: Lewis, Villasenor, and West (2017).

had started operations. The details of the initiatives taken last year and being implemented this year is discussed in greater detail in Chapters 12 and 13.

During the year RBI clarified the regulatory framework for peer to peer lending activities. A new category of NBFC-P2P was created and the master directions were issued in October 2017. However, there was no progress on the possibility of offering a framework for an architecture for interest-free products in the banking system (as recommended by

Box 1.1 Financial Inclusion Insights from InterMedia

Banks remain the driver of Indian financial inclusion; 99% of all financially included Indian adults (63% of the population) hold a bank account. This share was the same as the number given in the previous tracker.

- Sixty-four percent of Indian adults have used a bank account (either their own or one belonging to someone else). This is the highest rate out of the eight countries where FII tracking surveys are conducted annually.
- The last year's data showed that 42% of adult Indians are active bank account holders. This year, the tracker reported that the majority (64%) of bank account holders are active users (i.e., had used their accounts in the 90 days preceding the survey). This brings the number back to the past year (64% of the 63% who have bank accounts = 40% of adults). This rate is low compared to other FII countries and is likely affected by the number of new accounts opened via the Prime Minister's Jan Dhan Yojana (PMJDY) and related programs.
- The proportion of bank account holders who used advanced services declined in 2016, both as a result of new accounts that are being used only for basic activities (e.g., transfers) and a reduction in the prevalence of certain advanced activities, such as receiving government to person (G2P) payments.
- The respondents reported a lower rate of digital access to their accounts, from over 49% of Indian adults in 2015, to 30% in 2016.
- Less than 1% of Indian adults have used mobile money. Awareness of mobile money providers declined slightly from 10% in 2015 to 8% in 2016.
- While awareness declined, the conversion rate from awareness to use of a mobile money provider increased from 5% in 2015 to 10% in 2016.
- Mobile-based products that do not fit the FII definition of mobile money (e.g., PayUMoney) have supplanted mobile money to a degree. Two percent of Indian adults have used these products compared to the 0.7% of Indian adults who have used mobile money.
- Five percent of Indian adults reported having ever used a non-banking financial institution (NBFI) in 2016 compared to 10% in 2015. This decline was driven by decreases in MFI and Post Office bank access and registered account ownership.
- Four percent of Indian adults reported holding a full-service NBFI account compared to 9% in 2015.
- In 2016, 2% reported having used a Post Office bank account compared to 4% in 2015; 0.5% of Indian adults reported having used a full-service MFI account compared to 2% in 2015; and, 2% reported using a semi-formal savings/lending group compared to 4% in 2015.

Source: Financial Inclusion Insights: India Wave IV FII Tracker Survey (InterMedia 2017).

the Mohanty Committee). The final guidelines for on tap licensing of universal banks were finalized and notified. While data indicates that there has been only one applicant for the license ever since it has been notified, there has been no word on new licenses. The RBI also put out a discussion paper on wholesale and long-term finance banks during the year. None of these initiatives have significant implications for the cause of financial inclusion.

Ecosystem

The RBI's Financial Inclusion Advisory Committee (FIAC) was active during the year, reviewing the progress of the regulated entities on financial inclusion. The FIAC was tasked with the development of a national strategy on financial inclusion. The proposed strategy pillars for the strategy have amongst other aspects examining the physical and digital infrastructure; the regulatory framework, looking at the competitive landscape, examining the level of financial awareness; and having a consumer protection framework for effective grievance redressal mechanism. The committee will also examine the aspects of digital financial inclusion in line with international best practices.

While in the past, the concern was significantly about establishing the identity of the customer to ensure that the institutions in the banking system were in compliance of the Know Your Customer (KYC) norms, the trends seem to indicate that the use of technology is moving toward making the inclusion agenda more focused and meaningful. Two major initiatives got a greater fillip during the year. First, the RBI instructed all regulated entities to upload data on the Central KYC Records Registry.

This initiative is an extension of the Prevention of Money Laundering Act (PMLA). The fact that the identity of all the customers will be on a centralized registry makes it easier for the customers to operate across institutions without having the need to provide the identity documents all over again. While the new specifications have made it difficult for migrant workers because of the need for an officially verified document as address proof, and that there is much legacy data that needs to be updated in the format acceptable to the registry, it is to be acknowledged that this step eases the access to regulated entities and provides greater choices to the customer. The second aspect was the Central Registry of Securitisation Asset Reconstruction and Security Interest of India (CERSAI) where all assets provided as collaterals would be registered. During the year, this was extended to register movable assets as well in a separate registry.

There was a renewed focus on financial literacy, with special emphasis on digital literacy. The RBI took significant initiatives to experiment with digital focus, with financial literacy counsellors during the financial literacy week. There is a need to have a comprehensive study of the initiatives under the literacy initiatives undertaken at various levels to examine if there is some congruence in the approaches. Such a study would provide useful inputs for the national strategy on financial inclusion for the FIAC.

The last-mile transactions have always been an issue that has been sticky. While there have been multiple initiatives to strengthen the business correspondent (BC) network, it has been a challenge right from the time the agency framework was introduced. However, as time progresses, we see that there is a significant learning from the agent network system. During the year, the RBI took some significant steps in strengthening the entire framework. First, there was an initiative of creating a BC registry, where all the BCs would be registered. This could create a good database to understand the viability and sustainability of the system as we go forward. The expectation is that the banks will utilize this database for strengthening the BC infrastructure. The Indian Banks Association (IBA) is in the process of setting up the online registry portal. It will also provide insights into possible churn rate in the BCs. In order to get some systems in place, the RBI also put in place a framework for the certification of BCs following a basic training program. On the basis of a framework, IBA has set up a governing council comprising members each from IBA and NABARD, and two members each from academics and experts from industry. The council is in the process of developing the course curriculum (RBI 2017b).

During the year, the committee on household finances submitted its report (Box 1.2). The report benchmarked the Indian household finances with the global suite of products, analyzed the demographic features, and suggested a suite of products that should be made available for the Indian households. The findings of the committee were significant not only because of the rigor applied in understanding the problem but also because it was a comprehensive report on the alternatives and the institutional architecture it provided for looking at alternatives. While the report was not necessarily focused on inclusive customers, the design features were equally applicable to the poorer households as well.

Box 1.2 Committee on Household Finances

The findings of the committee showed that management of household finances are a combination of behavioral patterns dictated not only by the ecosystem but also by cultural considerations. They find that a large part of the wealth of Indian households is parked in physical assets rather than financial products. The paradox is that while these physical assets are held, it is not easy to use them as collaterals in exchange for financial liquidity because of the nature of documentation. The committee also found that the household debt over the life cycle was hump shaped but occurred later in the Indian households, compared to the international benchmarks. This was a source of concern, particularly in a country that has a weak public social security architecture. An ageing population with a debt burden and no public social security should be sounding a warning bell, as the demographic pattern shifts from being a demographic dividend to a demographic burden. Therefore, the next wave of financial products—for incubation and innovation—should possibly focus on insurance, pension, and other social security products.

The committee observed that having high levels of unsecured and expensive debt from the informal sector traps the poor in a long cycle of repayments and prevents them from escaping from the vicious cycle of indebtedness. Solutions for this need to be found, not only in the financial world but in the real and service world where public investments in aspects that cause stress on the household finances are taken care of—like public investment in healthcare.

The committee noted that there were transaction costs that were both in the nature of financial costs and "nuisance factor" costs that prevented the households from engaging with the formal sector. This included lack of trust emanating from the negative perceptions because of adverse experiences of dealing with the formal sector, particularly amongst the poor. This was a significant finding, because it really addresses the issue head on—providing physical access is not a complete solution, but ensuring that the last-mile exchange is friendly is also equally important.

An interesting take of the committee was that it saw the informal lending for urgent and unforeseen needs of the vulnerable families as a "noninstitutional debt serving as a high-cost, imperfect form of insurance."

Using this, the committee proposed some sector-specific recommendations covering mortgage, collateralized lending, insurance, pensions, and gold markets. The committee observed that the "financial advice regulations are product-specific and vary across regulators" and suggested standardized norms across regulators for financial advice. The committee also addressed the issue of transactional "nuisance" through a combination of digital end-to-end distribution networks, KYC to become completely electronic, seamless switching between service providers, and improvements in electronic collateralized lending registry (CERSAI). The committee described a minimum set of financial products that households should have in order to effectively harness the benefits of formal financial markets.

The most important aspect discussed (and recommended) by the committee was the creation of

> a regulatory sandbox to allow regulators to facilitate small-scale tests by financial technology firms. In such a carefully controlled environment, certain regulations may be temporarily relaxed, and households can be allowed to participate in new products. The goal is to collect empirical evidence, which can ultimately lead to better policy solutions, whilst simultaneously evaluating the risk of any new product or technology.

Source: RBI (2017b).

Physical Infrastructure

On the physical infrastructure, while there was a good spread of automated teller machines (ATMs) both in the rural and urban areas, data indicated that the RRBs have been slow in opening the ATMs even on their premises. During the past year, all RRBs together had added just a net of 12 ATMs to the network. The skew between the number of on-site and off-site ATMs of scheduled commercial banks (SCBs) and RRBs are evident, and there has to be a roll-out of ATMs in the RRBs—at least one on-site ATM per branch—on a mission mode. However, by the end of the year, there were questions being raised about whether further investments should be made in ATMs, or whether this would move toward more point of sale (PoS) devices where the transactions would be settled. A discussion on this can be found in Chapter 6.

Customer Protection

Apart from the usual recourse measures for consumer protection, the issue seen on the field has been that of unregulated entities offering financial services to the poor and the vulnerable (and gullible). While it is possible for the RBI to put in place a consumer protection framework for regulated entities, it becomes extremely difficult to be proactive in controlling the nonregulated entities, particularly those that pretend to be regulated. The RBI launched a mobile-friendly portal Sachet[1] last year. The idea was to ensure that the services were being provided only by regulated entities, particularly on deposit mobilization. The portal is a place where anybody could share information about any new initiative that may not be regulated. During the past year, the complaints relating to unauthorized deposit collection and financial activities that have been lodged in Sachet have been taken up expeditiously with the respective regulators for resolution (RBI 2017).

In June 2016, the Task Force on Financial Redress Agency submitted its report, providing a comprehensive framework for consumer protection with detailed legislative, organizational, and operational framework. The idea of a customer-friendly agency that provides for redressal of consumer complaints cutting across regulators was a good idea, and the recommendations of the committee are still relevant. The envisaged functions of the financial redress agency is given in Box 1.3.

[1] See sachet.rbi.org.in

Box 1.3 Proposed Functions of the Financial Redress Agency

- Use a consumer-friendly mediation and adjudication process to provide speedy and inexpensive redress.
- Facilitate uniformity and convenience for retail consumers by providing one single channel for any complaint against any regulated FSP.
- Minimize consumer confusion as to what the appropriate channel for redress is (e.g., in relation to an insurance product when it is distributed by a bank).
- Provide greater accessibility through consumer-friendly mechanisms, which will cover all regulated FSP and cater to all sections of society, including those who are not literate.
- Provide redress efficiently through the use of technology and by being accountable and transparent.
- Placing stringent legal obligations on FRA will ensure that it is under healthy pressure to provide efficient as well as effective redress through requirements on disclosure and performance review (status updates to complainant, data on time taken at each stage of the redress process, data on appeals against its decisions, analysis of turnaround time, satisfaction levels from helpline, nature of feedback provided to regulators, etc.).
- Provide an independent feedback loop to regulators on complaints, including information on complaints received against unregulated FSPs, with a view to assisting them in strengthening consumer protection regulation and supervision.

Source: GoI (2016).

Policy

The policy of moving toward digitization continued during the year and assumed a greater significance in the light of the demonetization exercise of November 2016. While the Jan Dhan-Aadhaar-Mobile (JAM) framework looked like a centerpiece for government transfers, post-demonetization, the issue of digitization was pushed irrespective of the type of transactions. While the agenda of digitization is much beyond the agenda of financial inclusion, it is important to understand how it impacts this agenda.

While these new strategies unfold, there is a certain encouraging response from the RBI during these years. Unlike in the past where the RBI was extremely conservative and cautious in its approach, there is a certain appetite for experimentation now. This is evidenced by the licenses given to the new banks and the policy documents that are discussing the possibility of new, specialized institutions. However, the new institutions need to be given a chance in more ways than one so that they do not lose business due to the anticompetitive stance taken by the state. We have to remember that in case of the local area banks (LABs), there were multiple constraints by the regulatory ecosystem that made the viability of these institutions difficult. These included adding them in the second schedule, which would help them to access certain types of business, policy of branch licensing (which were different from mainstream banks), and requirements for capital adequacy. While there are norms that are required for maintaining the safety of the depositors as well as systemic stability, the new institutions should also be nurtured and protected from anticompetitive policies.

As the digital financial inclusion agenda rolls out, it is important that the regulator as well as the state looks at some of the institutions that have a suspect revenue stream—like PBs—and recognize their specialized role in remittances. This institution should be naturally qualified to undertake the G2P payments, but for historic reasons, the state has been using the public sector banks for these transfers. Similar is the case with the India Post, where its network is used sporadically rather than regularly. We discuss these issues in a greater detail in Chapter 13.

While the PMJDY accounts had a built in component of a RuPay debit card that facilitated cashless transactions, there needs to be a larger architecture for the cards to be accepted. One possibility is to have a network of ATMs in all the remote areas so that seamless cashless movement could happen till the penultimate stage. Toward this end, the government had directed the banking system (including the RRBs) to cover all branches with an on-site ATM. While the number of on-site ATMs has exceeded 100,000 in number, the ones left out are largely in the rural areas where there is still a problem of connectivity and complexity of logistics. One way to address the issue of cash logistics is to ensure that not only the movement of money up to the penultimate transaction is cashless but even the ultimate transaction happens to be cashless. While the connectivity issues may continue, the logistics issue will be sorted out to an extent. With this background, NABARD initiated a welcome step of providing

200,000 PoS devices in 100,000 villages. This digital push settles the merchant transaction in a cashless mode and obviates the need for withdrawal of cash from the ATMs for regular transactions. NABARD provided a financial assistance of ₹6,000 per PoS device under this scheme.[2] This was also followed up by a campaign to open accounts with the proximate cooperative banks.

A COMPREHENSIVE LOOK AT THE PROVIDERS

There has been progress in the physical outreach of touchpoints. Table 1.1 gives a comprehensive look at the touchpoints that are available across institutional forms. It is important to note that the quality and range of services of each of these verticals vary widely. For instance, the postal network that accounts for slightly less than half the formal sector touchpoints offer only savings, remittance, and insurance services, but not banking and credit services. Similarly, the MFIs offer only some types of loans and not comprehensive services. Most of the self-help groups (SHGs) do not offer scale. However, what is important is to understand the way the network is penetrated and how it could be leveraged for undertaking meaningful financial inclusion.

The story about the regional spread does not significantly change with the southern region having almost 43% (previous year = 44%) of the formal sector touchpoints. A large part of the skew is because of SHGs where the southern region has almost 43% share (previous year = 45%), while the banking and postal network account for about a third of all the outlets. While this brings back the question of a strategy on regional diversity, the new institutions and technology led initiatives could address this issue (see Box 1.4).

While the new generation players such as MFIs and new SFBs are marking their presence in the eastern and the northeastern region, their impact is not significant in comparison to the residual exclusion. Figures 1.2 and 1.3 speak for themselves.

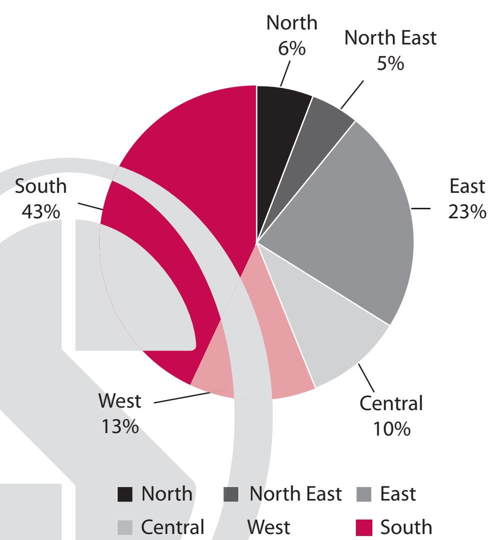


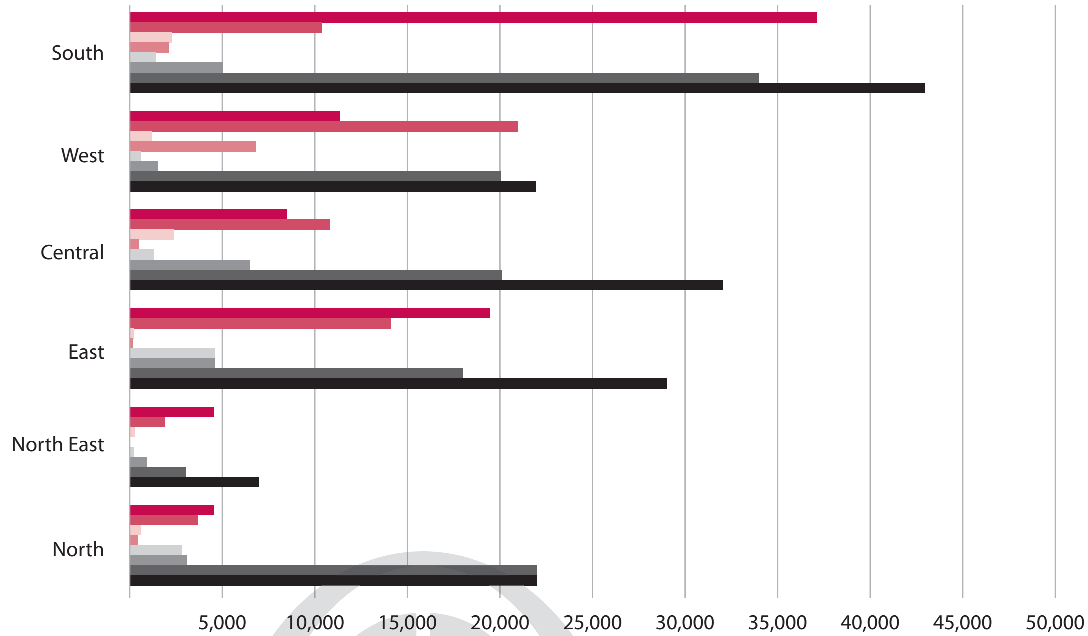
Figure 1.2 Regional Spread of Formal Sector Touchpoints

Table 1.1 **Formal Sector Touchpoints across Regions as of March 2017 (Numbers in Thousands)**

Region	Post Offices	Commercial Banks	RRBs	RRB USBs	UCBs	MFIs	Viable PACS	Total Formal	SHGs	Total Touchpoints
North	22	22	3.1	2.8	0.4	0.62	3.71	55	450	505
North East	7	3	0.9	0.2	0.05	0.25	1.88	13	450	463
East	29	18	4.6	4.6	0.16	0.21	14.1	71	1,950	2,021
Central	32	20	6.5	1.3	0.51	2.37	10.78	73	850	923
West	22	20	1.5	0.6	6.8	1.2	20.98	73	1,140	1,213
South	43	34	5.1	1.4	2.16	2.3	10.42	98	3,720	3,818
Total	155	117	21.6	10.9	10.09	8.81	61.87	385	8,580	8,965

Source: Author's computations.
In addition to this, as of March 2017, there were 376 branches of SFBs, 71 branches of LABs, and 2 branches of PB, which has not been considered as it is too small a number to be rounded off in the statistics.
Post Office and PACS data is for March 2016.

[2] See http://www.business-standard.com/article/economy-policy/nabard-plans-to-provide-rupay-cards-to-over-34-million-farmers-116122000974_1.html, accessed on September 2, 2017.



	North	N. East	East	Central	West	South
SHGs	4,500	4,500	19,500	8,500	11,400	37,200
Viable PACS	3,710	1,880	14,100	10,780	20,980	10,420
MFIs	620	250	210	2,370	1,200	2,300
UCBs	400	50	160	510	6,800	2,160
RRB USBs	2,800	200	4,600	1,300	600	1,400
RRBs	3,100	900	4,600	6,500	1,500	5,100
Comm	22,000	3,000	18,000	20,000	20,000	34,000
Post Offices	22,000	7,000	29,000	32,000	22,000	43,000

SHGs Viable PACS MFIs UCBs RRB USBs RRBs Comm Post Offices

Figure 1.3 Spread of Touchpoints in Various Regions Ordered by Institution Type

Source: Author's computation from various reports.
Note: The data for Post Offices and PACS are for March 2016. The SHG numbers are in thousands.

Box 1.4 Dr Urjit Patel on Regional Disparity

MSS: In terms of geographical spread banking has physically spread to south, west, some extent in northern regions. The central region, eastern region and northeastern region are underbanked….

UP: The banks will go where the business is, and it is not the job of RBI to force banks into certain regions. However, with the spread of technology and innovation, physical presence may no longer be an issue. The upcoming payments banks and telecom networks have wide reach and network, and we need to rethink banking. As long as there are incentives and intermediary structures, banks will go all the way. This issue does not require a regional policy focus of the central bank.

Source: Interview with the author Sriram (2018).

APPROACH AND ORGANIZATION OF THE REPORT

This report broadly continues the same pattern as the last years' report. The report covers all the institutional verticals—banks, RRBs, urban and rural cooperatives, SHGs, MFIs, SFBs, PBs, and India Post. In each section, to the extent possible, we have discussed the implication of the demonetization exercise as well as the emerging new trends and initiatives. We continue the review of the PMJDY and the chapter dedicated to the developments in the area of digital financial inclusion.

This year, the updated data for SHGs was easily available from NABARD. However, the data on cooperatives and RRBs were not available. While in case of most of the verticals we have provided data up to March 2017, on some we were constrained to maintain the data as of March 2016.

The report intends to be a reference document for data and the significant happenings in the financial inclusion space. While there is much research happening that cuts across many years, care has been taken to look at the outputs that came out between October 2016 and September 2017—largely to keep the report current and also to avoid repetitions. Unlike one-off reports, an annual publication will have to take care to stick to a time period, and the report earnestly tries to stick to this time period.

There are many impressions and subjective opinions that are prevalent in the inclusive finance sector. The report tries to incorporate them to the extent that these have been backed by written material. However, the report does not contain the data of individual enterprises or one-off experiments, except to illustrate or demonstrate a point. Therefore, it is quite likely that the report does not discuss large initiatives such as the ones carried out by the Dhan Foundation, Sri Kshetra Dharmasthala Rural Development Programme, or NABARD Financial Services. These data are subsumed in the larger SHG data, and the same applies to MFIs and other verticals.

In the run-up to writing the report, there were two significant interviews conducted—with Dr Urjit R. Patel, the governor of the RBI, and Muhammad Yunus, the founder of Grameen Bank. The report contains the full interview of Yunus. We have used the portions of the interview of Dr Urjit Patel where it is relevant. The full interview of Dr Patel along with the interviews conducted last year with former governors Dr Rangarajan, Dr Bimal Jalan, Dr Y.V. Reddy, and Dr D. Subbarao, and the interview with Dr Raghuram Rajan published in the report of 2015 are all being published in a separate book (Sriram 2018).

Overall, the financial inclusion space in a happening space, with an amalgam of players—start-ups, private sector entities, Nongovernmental Organizations (NGOs), cooperatives, government programs, private and public banks, and niche players, all of whom seem to be wanting to serve the excluded customer in their own unique way. These are possibly the most exciting times, and the report is a small effort to document the journey of inclusive finance.

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Review of the Banking System[1]

Chapter 2

There was a focus on inclusive banking in the past few years, both with the initiative of the government as well as the encouragement of the RBI. With all the banks (including RRBs) getting on to the Core Banking Solution (CBS) platform, the technological base was laid. In the past years, there was a significant change in the approach. With the launch of the PMJDY, the account opening was on a mission mode, and it is claimed that almost all the households are covered with a bank account. While there is much to be done in terms of the roll-out of DBT that will ensure transactions in the accounts, the agenda of getting at least one customer from a household into the banking system seems to be achieved. We discuss the implications of the DBT schemes and its relation to the PMJDY in Chapter 4 in greater detail.

In addition, with the seeding of Aadhaar—the unique identification—number with the accounts, the exercise of de-duplication can be undertaken and the uniqueness of each customer can be established. With a digital trail now available on the transactions, it becomes much easier for the banking system to understand the creditworthiness of the clients and also the diverse requirements of the clients. In this sense, it may a right time to discuss whether the role of the government in pushing financial inclusion at the client level is substantially achieved. At least that is what the current governor Dr Urjit Patel seems to think (see Box 2.1).

While we are reviewing the banking system, it is important to recognize the underlying changes in the way the technology-enabled banking is evolving and how the contact points and the transaction modes with the bank are essentially changing. As a recognition of the changing phenomena, the RBI set up an internal working group that looked at the branch authorization policy. The group made some very interesting definitional changes of what constituted a branch and proactively recognized the

Box 2.1 Dr Urjit Patel on the Future Role of RBI in Financial Inclusion

MSS: You have taken over as governor RBI at a stage where there have been two significant initiatives: the mission mode opening of accounts under the PMJDY and the opening up of banking for differentiated banks. How do you see the agenda of financial inclusion being carried forward in the next few years?

UP: My view about financial inclusion is probably different from that of my predecessors. Going forward, I see that the market will takeover this agenda through technology and innovation. The role of RBI will take a backseat. What was not done in decades was done by PMJDY. The supply side solution was to ensure that everybody had access, not only in physical terms but also in operational terms. With PMJDY, the transaction cost for opening a bank account is already taken care of and the accounts have been opened. This is thanks to the initiative of the government; a very large portion of the excluded households have access to formal banking system.

Now we need to wait and watch on how the market and institutions will take this forward. At this juncture, there is not much that the RBI needs to do in terms of a policy push or regulatory initiative. We assume that with economic growth, the country would prosper in the future and that in itself will lead to more and more forms of intermediation.

One other aspect we have to remember is that with the onslaught of innovation by the players in the markets and with technology evolving there will be disrupting innovations. It will not be too long before suitable financial products are designed and delivered for the poor using this

[1] The author is thankful to Dr Pallavi Chavan for her useful feedback on the draft of this chapter.

platform. I envision the role of the central bank to be limited but significant in ensuring that consumers are protected and that there is no scope for systemic risk. If there are other initiatives required, they will be addressed as and when required.

MSS: If we look at the history of inclusion, we have had four phases: active promotion of co-operatives in the first phase, followed by bank nationalization and regulatory diktats, followed by institutional innovation and experimentation (RRBs), and now by providing regulatory architecture for players to come in. Do you foresee a new/alternate approach as we celebrate our achievement and look at the residual exclusion?

UP: As of now, we are not looking at alternative approaches. We have to follow through and complete what we started. Historically, after nationalization, the public sector banks have not done enough in terms of innovation for achieving inclusion. However, with new banking structures just starting operations, we expect this problem to be addressed in a commercially viable manner. For now, the role of RBI is more or less over as far as this specific aspect is concerned.

Source: Interview with the author (Sriram 2018).

change in the way the last-mile touchpoints are getting transformed.

BRANCH NETWORK

On the banking side, the expansion of branches continued. From a total of 137,587 outlets that were reported in March 2016, the number increased to 137,770 by March 2017. The latest number of branches is given in Table 2.1.

Table 2.1 Branches of Scheduled Commercial Banks

Branches of SCBs	March 2015	March 2016	March 2017
All SCBs	148	149	150
of which, RRBs	56	56	56
No. of reporting offices			
Rural	48,033	49,902	48,232
Semi-urban	33,523	35,704	37,880
Urban	23,522	24,794	24,877
Metropolitan	20,785	22,187	26,781
TOTAL	125,863	132,587	137,770

Source: Quarterly statistics on deposits and credit of SCBs. RBI, https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on June 9, 2017.

There was a change in the branch authorization policy during the year, and this has implications on how we define the banking outlets going forward (Box 2.2). With the advent of technology and the permission to use the premises of third parties to carry out limited banking transactions—including BCs, cash withdrawal at point of purchase locations and installation of micro-ATMs—there is now no clarity on what a banking outlet is. Similarly, with ultra small branches (USBs), customer service points (CSP), and other outreach models, the definition of a branch would also have to be reviewed. The RBI set up an internal working group to examine these issues. The group submitted its report in September 2016 (RBI 2016). The recommendations of the group were considered, and a revised branch policy was notified in May 2017. While the reporting of banking outlets in this report would be on the basis of the extant definition, it is important to note that the RBI has significantly changed the framework of defining the branches as well as the constitution of the quotas for reaching out to underbanked and unbanked rural centers (URCs).

Box 2.2 New Guidelines for Branch Authorization

Definition of a banking outlet:

A "banking outlet" for a domestic SCB, an SFB, and a PB is a fixed-point service delivery unit, manned by either the bank's staff or its BC where services of acceptance of deposits, encashment of cheques/cash withdrawal, or lending of money are provided for a minimum of 4 hours per day for at least 5 days a week. It carries uniform signage with the name of the bank and authorization from it, contact details of the controlling authorities, and a complaint escalation mechanism. The bank should have regular off-site and on-site monitoring of the "banking outlet" to ensure proper supervision, "uninterrupted service" except temporary interruptions due to telecom connectivity, etc., and timely addressing of customer grievances. The working hours/days need to be displayed prominently.

A banking outlet that does not provide delivery of service for a minimum of 4 hours per day and for at least 5 days a week will be considered a "part-time banking outlet."

3.2 Unbanked Rural Centre: An "unbanked rural center" is a rural (Tier 5 and 6) center that does not have a CBS-enabled "banking outlet" of a SCB, a SFB, a PB or a RRB nor a branch of LAB or licensed cooperative bank for carrying out customer-based banking transactions.

N.B.1: Extension counters, satellite offices, part-shifted branches, USBs, and specialized branches, subject to their satisfying the definition given, shall be treated as independent "banking outlets" or "part-time banking outlets," as the case may be.

N.B.2: ATMs, E-lobbies, bunch note acceptor machines, cash deposit machines, E-kiosks, and mobile branches will not be treated as "banking outlets." PoS terminals where limited cash withdrawal facility is allowed by banks in terms of extant instructions without having an arrangement with the concerned entities as "business correspondents" will not be considered as "banking outlets."

Regulations and requirements:

4.2 The opening of "banking outlets" during a financial year (FY) will be subject to the conditions given below:

(a) At least 25% of the total number of "banking outlets" opened during an FY should be opened in URCs, as defined in Para 3.2 earlier.
(b) A "part-time banking outlet," opened in any center will be counted and added to the denominator as well as numerator on pro rata basis for computing the requirement as well as the compliance with the norm of opening 25% banking outlets in URCs.
(c) A "banking outlet"/"part-time banking outlet" opened in any Tier 3 to Tier 6 center of North East states and Sikkim as well as in any Tier 3 to Tier 6 center of Left wing extremism (LWE) affected districts as notified by the Government of India from time to time, will be considered as equivalent to opening a "banking outlet"/"part-time banking outlet," as the case may be, in a URC. A list of 106 LWE-affected districts in 10 states as notified by the government as on February 24, 2016, is being provided in Annex III. As the overall objective of these guidelines is enabling the expansion of banking facilities in these underbanked/underserved centers, each banking outlet opened, irrespective of the banked/unbanked status of the center, will be reckoned as having been opened in a URC.
(d) A full-fledged "brick and mortar" branch opened in a rural (Tier 5 and 6) center that is already being served by a fixed-point BC outlet by any bank will also be eligible to be treated as equivalent to opening a "banking outlet" in a URC. In other words, the first fixed-point BC outlet of a bank as well as the first "brick and mortar" branch of any bank opened in a URC will be reckoned for computing compliance with the 25% norm.
(e) A "banking outlet" opened in a rural (Tier 5 and 6) center that is served by only a banking outlet of a PB will also be eligible to be treated as equivalent to opening a "banking outlet" in a URC. In other words, the first "banking outlet" by a PB as well as the first "banking outlet" by any other bank opened in a URC will be reckoned for computing compliance with the 25% norm.
(f) The time given to a bank for opening an outlet in a URC is 1 year. If a bank fails to adhere to the requirement of opening 25% banking outlets in a year, appropriate penal measures, including restrictions on opening of Tier 1 branches, may be imposed.

Source: https://rbidocs.rbi.org.in/rdocs/Notification/PDFs/NOTI3062319C9C94C33494794C2B5271CF92878.PDF, accessed on August 12, 2017.

During the year, the RBI followed the old mandate that 25% of the new branches have to be opened in URCs. There is a slight fall in the rural branches, and this is to be largely explained by the reclassification of the rural areas as semi-urban areas following the new series of population numbers that have come from census 2011. The growth of outlets according to their location is given in Figure 2.1. It can be seen from the figure that the rural and semi-urban branch networks were growing faster than the other segments, till last year. However, in the year 2016–17, the number of metropolitan branches has grown faster, even though the requirement is now to open only 25% of the incremental branches in URCs.

However, the raw data on the number of branches in rural and semi-urban areas might be misleading because there could be multiple bank branches in a single location, particularly if that location is adequately monetized with ample commercial activity. Therefore, it is important to look at total locations that are banked rather than just the rural branches. The data on unique banked locations in the rural and semi-urban locations are given in Table 2.2.

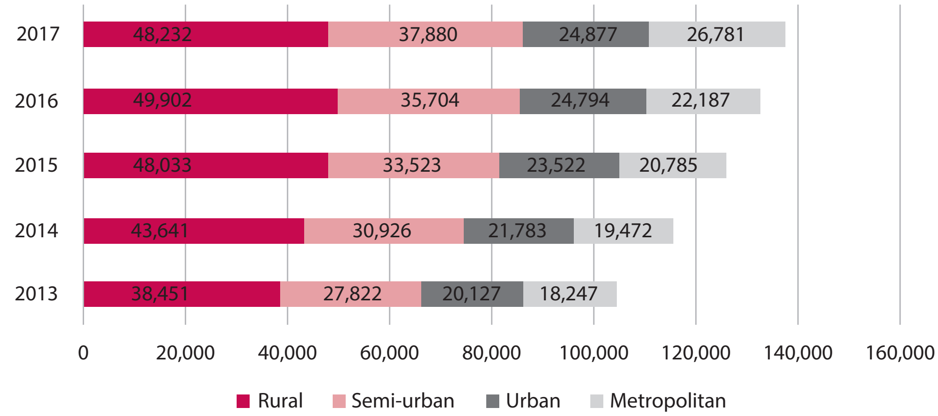


Figure 2.1 Bank Branch Network 2013–17

Source: https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 10, 2017.

Table 2.2 Number of Unique Rural and Semi-urban Locations That Are Served by Banks

	Rural						Semi-urban					
Year	**2012**	**2013**	**2014**	**2015**	**2016**	**2017***	**2012**	**2013**	**2014**	**2015**	**2016**	**2017***
North	4,685	5,111	5,830	6,466	6,664	6,672	624	635	646	655	644	801
North East	1,099	1,127	1,197	1,270	1,312	1,334	146	150	154	154	151	163
East	6,983	7,186	7,671	8,190	8,369	8,169	940	956	989	1,067	1,085	1,453
Central	7,259	7,753	8,716	9,374	9,533	9,338	1,047	1,070	1,094	1,106	1,102	1,388
West	3,566	3,828	4,383	4,713	4,834	4,751	792	800	812	817	818	967
South	6,337	6,803	7,598	8,267	8,270	8,146	2,497	2,534	2,591	2,643	2,577	2,879
Total	29,929	31,808	35,395	38,280	38,982	38,410	6,046	6,145	6,286	6,442	6,377	7,651

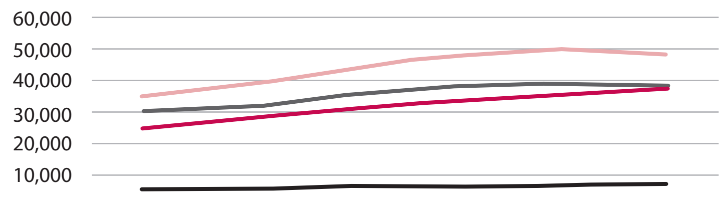
Source: https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 10, 2016.
Note: *The classification of areas into rural and semi-urban for 2012–16 was based on population data of census 2001. The classification for 2017 is based on population census 2011. As a result of the change in the census base, several rural areas have been re-classified as semi-urban and, therefore, the 2017 numbers are strictly not comparable to the earlier numbers on a trendline.

As can be seen in Table 2.2, the growth of unique rural locations is lagging far behind the rate of growth of the rural branches per se while the regulation requires the banks to have a footprint in rural (unbanked) locations and, therefore, it is evident that a larger proportion of the rural branches are unique in their locations. As of March 2017, it can be seen that the rural branch presence is in about 38,000 villages as against a total number of 48,000 rural branches (Figure 2.2). The story of semi-urban branches is somewhat different. The 37,000 plus semi-urban branches were located in about 7,600 plus locations, indicating that these centers attracted banks even without a mandate from the RBI.

BEYOND THE BRANCH NETWORK

The roll-out of technology—both in terms of digitization of the back end and the general development of digital mediums including the telecom network—can now be fully leveraged to reach out to even remote locations. As can be seen from Table 2.3, the past few years have seen a growth in the outreach models, thereby, providing a banking touchpoint almost in the neighborhood of the customer. The physical infrastructure and branchless touchpoints have followed a more aggressive growth path than the traditional channels, and during the past year, thanks to the demonetization exercise, there was a spike in transactions and transaction amounts in basic savings and bank deposit (BSBD) accounts. In case of Kisan Credit Card (KCC) as well as general credit card (GCC) accounts, while the number of accounts did not go up significantly, the transactions in both these accounts were significant.

The numbers that have not shown growth are the numbers pertaining to overdrafts (ODs), KCC, and GCC. The next phase of the government's mission should be to get convergence between the PMJDY



	2012	2013	2014	2015	2016	2017
Rural	35,364	38,451	43,641	48,033	49,902	48,232
Semi-urban	25,076	27,822	30,926	33,523	35,704	37,880
Unique Rural	29,929	31,808	35,395	38,280	38,982	38,410
Unique Semi-urban	6,046	6,145	6,286	6,442	6,377	7,651

Rural — Semi-urban — Unique Rural — Unique Semi-urban

Figure 2.2 Growth Rate of Bank Branches in Rural and Semi-urban Areas

Source: http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications, accessed on July 11, 2017.

Table 2.3 Financial Inclusion: Summary of Progress (Including RRBs)

Particulars	Year Ended March 2013	Year Ended March 2014	Year Ended March 2015	Year Ended March 2016	Year Ended March 2017
Banking outlets in villages—branches	40,837	46,126	49,571	51,830	50,860
Banking outlets in villages—branchless mode*	227,617	337,678	504,142	534,477	543,472
Of which, BCs in villages less than 2,000 population					438,070
Banking outlets in villages—total	268,454	383,804	553,713	586,307	598,093
Urban locations covered through BCs	27,143	60,730	96,847	102,552	102,865
BSBD A/c through branches (No. in million)	101	126	210	238	254
BSBD A/c through branches (Amt. in ₹ billion)	165	273	365	474	691
BSBD A/c through BCs (No. in million)	81	117	188	231	280
BSBD A/c through BCs (Amt. in ₹ billion)	18	39	75	164	285
Total BSBD A/c (No. in million)	182	243	398	469	533
Total BSBD A/c (Amt. in ₹ billion)	183	312	4,440	638	977
OD facility availed in BSBDAs (No. in million)	4	6	8	8	9
OD facility availed in BSBDAs (Amount in ₹ billion)	2	16	20	14.8	17
KCCs (No. in million)	34	40	43	47	46
KCCs (Amount in ₹ billion)	2,623	3,684	4,382	5,131	5,805
GCCs (No. in million)	4	7	9	11	13
GCCs (Amount in ₹ billion)	76	1,096	1,302	1,493	2,117
ICT A/cs BC Transaction during the year (No. in million)	251	329	477	827	1,159
ICT A/cs BC Transaction during the year (Amount in ₹ billion)	234	524	860	1,687	2,652
ATMs of banks (public, private foreign banks)				199,099	214,554
India Post					982
ATMs of SFBs					724
ATMs of cooperative banks (both urban and rural)				4,664	5,829
ATMs of RRBs				1,024	1,038
White label ATMs				14,169	14,447
BSBD: Basic savings and bank deposit					

Source: Annual Report of 2014, 2015, 2016, and 2017, Reserve Bank of India. Mumbai: RBI, ATM statistics as of June 2017 from NPCI.
Note: * The branchless mode outlets include BCs, ATMs, PoS points, USBs, mobile vans, and any other mechanism that provides a touchpoint for the customer of the bank.

Table 2.4 Financial Inclusion Progress: Numbers Unpeeled

Particulars	Year Ended March 2013	Year Ended March 2014	Year Ended March 2015	Year Ended March 2016	Year Ended March 2017
Number of BSBD A/cs per branch	2,468	2,731	4,236	4,592	4,994
Average balance per BSBD A/c (₹)	1,633	2,169	1,738	1,992	2,720
Number of BSBD A/cs per BC	357	346	370	432	467
Average balance per BSBD A/c (₹) (BC)	224	334	397	710	1,017
Percentage of BSBD A/cs availing OD	2.20%	2.43%	1.90%	2%	2%
Average OD balance in BSBD A/cs	400	2,711	2,618	3,222	1,888

Source: Computations by the author based on Table 2.3.

accounts and the KCC accounts—which would cover a large number of small farmers and share croppers who would be poor, and would greatly benefit from this convergence.

A look at Table 2.3 and an analysis of the numbers in Table 2.4 show that the physical outreach of branches and BCs has been moderate compared to the past years. In fact, it shows signs of plateauing, possibly indicating that there is enough penetration and the next step is to drive volumes into those accounts. During the past year, the average number of accounts, particularly at the BC level, grew significantly. The average balances in those accounts also showed a sharp rise. It is important to note that these spikes happened at the BC level, indicating that the most proximate source for undertaking transactions post demonetization was possibly a BC rather than a bank branch.

In addition to the bank branches, a network of 543,472 branchless outlets (including ATMs, PoS points, BCs, USBs, and CSPs) in rural areas and 102,865 urban outlets operated as BCs as of March 2017.

Apart from the physical presence of outlets with human interface, an impressive 214,554 ATMs have been deployed, of which around 110,000 were onsite ATMs and were considered an integral part of the branch, while the other half were counted in the branchless touchpoints discussed earlier.

Credit and debit cards of the banks can be swiped for commercial transactions in 2.52 million PoS locations. In addition to the above, a total of 854 million debit cards and 29.84 million credit cards have been issued by the banks, thereby, allowing the customers the choice of transacting at a time of their choice. A look at the transaction data indicates that, both in terms of number of transactions as well as the amount transacted, the customers are overwhelmingly preferring transactions at the ATM to withdraw cash at the first instance than to use the PoS option in case of debit cards. However, for the first time in several years, the usage at PoS sharply increased, and the number of transactions at the ATM was lower than that in the previous year. The amounts withdrawn from ATMs remained almost at the same level as last year, while the amount spent at the PoS drastically went up. While the legacy habit is to withdraw cash and pay in merchant establishments, this year might well be a year where the disruptive change triggered by demonetization may have moved people to transact at the last mile using technology-enabled products.

SMALL BORROWAL ACCOUNTS: AN ANALYSIS

While there has been a campaign to bring people into the banking system through the PMJDY and related missions, the question to be asked is whether these campaigns are resulting in lasting relations with the banking system. How are all the programs getting embedded in the larger banking system. Clearly the campaign mode of the PMJDY has resulted in people opening a large number of accounts, and there are indications that a part of these accounts are being used. These would further be used for the purposes of benefit transfers, but beyond the mandates and the awards, is it going to result in a relationship? What about smaller loans and deposits from the banking system? If we look at the statistics on the small borrowal accounts (SBA) that the numbers are telling. Earlier, the definition of a SBA was limited to ₹25,000 and was revised in 1999 to the current figure. However, the data is available in both the categories. While the RBI defines SBA as any loan account that has a sanctioned limit of up to ₹200,000, the data is available on a smaller slab of ₹25,000, which was the cut off for a SBA prior to 1999.

To get a perspective, it is important to note that loans less than ₹25,000 form 22% of the total accounts but yield only less than half a percent

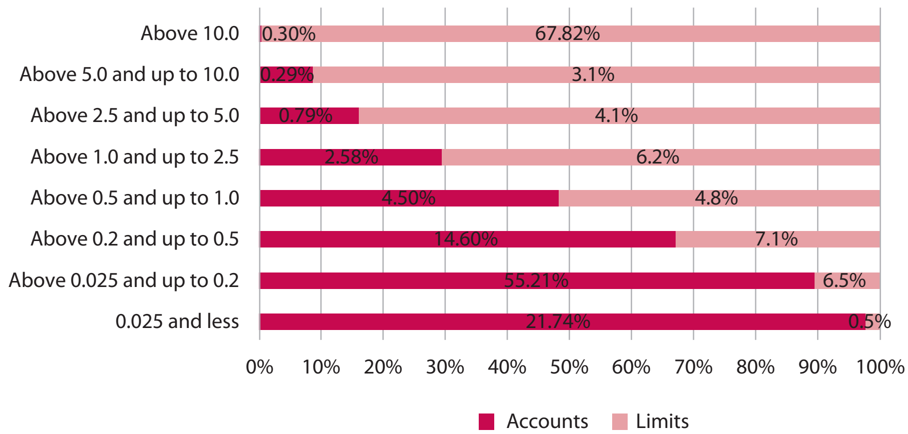


Figure 2.3 Outstanding Credit According to Size of Loan

Source: Data from Basic Statistical Returns of SCBs in India, Volume 45, March 2016.

of the portfolio in Table 2.5. On the other end of the spectrum, more than 70% of the portfolio of banks come from, again, less than half a percent of accounts. Clearly the data is stacked against the poorer customers because this is going to be transaction intensive. While the picture changes when we look at the borrowings in the range of ₹25,000 to ₹200,000, it is still a very small portion of the loan portfolio. An analysis of the accounts of Bandhan Bank will show how a bank could be completely focused on small borrowers, and still be profitable, provided we get the distribution and client identification right.

From the data (see Figure 2.3), it is very evident that not only the PMJDY but all the past efforts in financial inclusion—be it the Swabhimaan scheme or the other livelihood programs—have not resulted in increasing the proportion of loans to the poor or the lower segments. From the data, we see that both the number of accounts and the amount disbursed have been continuously falling as a proportion of the total number of loans and loans outstanding. They are somewhat flat on the absolute amounts of loans given/outstanding. With so much of effort under the various initiatives, one would have expected these amounts to rise a little bit.

Table 2.5 Details of Credit to Small Borrowal Accounts over the Years

Year Ending March 31 →	2012	2013	2014	2015	2016	Sept 2016
Loan Amount Less than ₹25,000						
Number of accounts (million)	44.05	30.88	32.57	29.86	35.29	28.71
Percentage to total accounts	34%	24.1%	23.50%	20.70%	21.7%	19.98%
Limit sanctioned (million)	701,440	428,593	436,318	429,595	519,372	
Percentage to total amounts	0.91%	0.5%	0.50%	0.4%	0.50%	
Amount outstanding (million)	762,160	736,827	436,318	359,945	458,836	336,941
Percentage to total outstanding	1.59%	1.3%	0.60%	0.5%	0.60%	0.46%
Loan Amount ₹25,000 to ₹200,000						
Number of accounts (million)	65.06	71.43	76.66	81.27	89.65	78.25
Percentage to total accounts	50%	56%	55.20%	56.30%	55.20%	54.46%
Limit Sanctioned (million)	5,056,960	5,734,745	6,170,673	6,645,862	7,252,009	
Percentage to total amounts	6.58%	6.90%	6.50%	6.40%	6.50%	
Amount outstanding (million)	3,804,050	4,411,501	4,895,252	5,315,041	5,748,489	4,907,483
Percentage to total outstanding	7.92%	8.00%	7.80%	7.70%	7.60%	6.75%

(Continued)

(Continued)

Year Ending March 31 →	2012	2013	2014	2015	2016	Sept 2016
Total up to ₹200,000						
Number of accounts (million)	109.11	102.31	109.23	111.13	124.94	106.96
Percentage to total accounts	83%	80%	79%	77.0%	76.90%	74.44%
Limit sanctioned (million)	5,758,400	6,163,337	6,606,991	7,075,457	7,771,381	
Percentage to total amounts	7.49%	7.40%	7.00%	6.80%	7.00%	
Amount outstanding (million)	4,566,210	5,148,328	5,331,569	5,674,536	6,207,325	5,244,424
Percentage to total outstanding	9.51%	9.30%	8.40%	7.75%	8.20%	7.21%

Source: Basic statistical returns for the years 2012, 2013, 2014, 2015, and 2016. Mumbai: RBI. Data for 2017 is from the quarterly BSR1 outstanding credit of SCBs accessed from http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!9, accessed on July 13, 2017.
Note: The gender-wise breakup of the accounts and the amounts indicate that 69.9% of the loan accounts and 73.1% of the loan amounts have been made to men. The data for 2016 relates only to commercial banks and does not include data of RRBs.

However, in the other bucket of amounts above ₹25,000 but less than ₹200,000, the accounts and amounts have been growing, and the number of accounts have remained in the same proportion to the total number of accounts of the banking system. This means that the overall number of customers in this segment have kept pace (and grown marginally faster) with the growth of the customer base of the banks. However, while the absolute amounts to this segment have gone up, the proportionality has marginally come down.

These accounts do not strictly represent the accounts of the "poor," because the data has been classified according to the size of the account. But, still, they represent the lower segment of the customers. A large part of this portfolio (about 52% of the total number of SBA and 53% of amounts) represent direct lending to agriculture (see Table 2.6).

The Bandhan Bank portfolio has almost 100% of the portfolio in SBA. However, Bandhan Bank contributes around 164 billion to this number. Given that we have 10 more SFBs that are mandated to have 50% of their portfolio under ₹2.5 million limit, with the thrust of Micro Units Development and Refinance Agency (MUDRA) where the *shishu* loan falls under the SBA limit, it is not unfair to expect that there would be a renewed focus from these new generation banks on the customers who are falling into this category. While Bandhan added around ₹164 billion and all the eight MFI SFBs as well as the two other SFBs may add another ₹400 to 500 billion into this category of loans, next year's figures might show an uptake. However, we have to remember that this addition is on a base of the ₹7.7 trillion portfolio that the entire banking system has. Unless the banking system itself—with all its branch networks—looks at this segment as an interesting segment, it is unlikely that it is going to take off.

Studies by scholars show that when banks are mandated to open branches in remote locations and URCs, the small ticket loans seem to take off (Burgess and Pande 2005; Chavan 2016). It is also argued that the nonagriculture portfolio in rural areas also grows when these mandates are provided. With specialized narrow and differentiated banks, those should also provide some avenues for these numbers to go up. We should also remember that a few banks have acquired nonbanking finance company–microfinance institutions (NBFC MFI) and that portfolio would be added to the books of the banks. Overall, in the next few years, it is possible that we see an uptick in these loans, largely because of the realignments in the inclusive finance market. We also have to recognize that this is being led not by the banks but by the MFIs, and banks are just aligning so that the extension-oriented methodology could be used for the benefits of the banks, thereby, providing formal sector access to the poor and the vulnerable.

The earlier discussion includes the numbers of RRBs as well. However, we will be discussing the specific numbers of RRBs in Chapter 3.

While we are looking at the performance of banks, it is important to remember that banks are not the only set of institutions that are providing the financial services from the formal sector. There is much action happening with the state promoting SHGs and independent NBFC MFIs operating in the field.

While there is enough data at the granular level on the borrowings, the data on the deposit/savings side is a bit sketchy. The cut on deposit size is not available in the current statistics. The performance on the small deposits is no significantly better than the progress on loans. While the RBI does not define

Table 2.6 Purpose-wise Breakup of Small Borrowal Accounts as of March 31, 2016 (Accounts in Millions, Amounts in ₹ Billions)

	Accounts of up to ₹0.025 Million						Accounts between 0.025 Million and ₹0.2 Million						Total Small Borrowal Accounts		
Details	**Accounts**	**% of Total**	**Sanction**	**% of Total**	**Outstanding**	**% of Total**	**Accounts**	**% of Total**	**Sanction**	**% of Total**	**Outstanding (₹ billion)**	**% of Total**	**Accounts (million)**	**Sanction (₹ trillion)**	**Outstanding (₹ trillion)**
Agriculture	17.30	22%	287.16	2.44%	274.77	2.76%	51.56	64%	3,997.00	33.97%	3,824.47	38%	68.86	4.28	4.10
Direct	16.06	21%	264.50	2.55%	255.56	2.86%	49.83	65%	3,867.35	37.25%	3,704.67	41%	65.88	4.13	3.96
Indirect	1.24	37%	22.65	1.64%	19.21	1.89%	1.73	52%	129.64	9.37%	119.81	12%	2.97	0.15	0.14
Industry	1.49	33%	24.62	0.05%	33.59	0.11%	1.44	32%	114.78	0.25%	92.88	0%	2.93	0.14	0.13
Transport operators	0.17	7%	2.79	0.13%	1.86	0.12%	0.98	42%	89.86	4.18%	66.04	4%	1.15	0.09	0.07
Professional and other service	1.20	27%	19.97	0.24%	15.94	0.27%	2.05	46%	150.75	1.83%	121.96	2%	3.25	0.17	0.14
Personal loans	7.92	15%	104.98	0.52%	58.79	0.44%	27.23	50%	2,421.95	12.04%	1,253.14	9%	35.15	2.53	1.31
Housing	0.21	3%	3.35	0.04%	3.31	0.04%	1.55	20%	149.66	1.58%	108.29	1%	1.77	0.15	0.11
Consumer durables	0.17	17%	2.82	1.51%	1.42	1.03%	0.54	54%	47.67	25.52%	33.95	25%	0.71	0.05	0.04
Other personal loans	7.54	17%	98.81	0.95%	54.06	0.93%	25.14	55%	2,224.62	21.32%	1,110.91	19%	32.67	2.32	1.16
Trade	3.43	33%	59.07	0.49%	56.61	0.81%	4.76	46%	337.22	2.80%	281.40	4%	8.19	0.40	0.34
Wholesale trade	0.19	24%	2.72	0.04%	8.07	0.24%	0.29	37%	21.88	0.30%	20.68	1%	0.47	0.02	0.03
Retail trade	3.24	34%	56.35	1.19%	48.54	1.37%	4.47	47%	315.34	6.64%	260.72	7%	7.72	0.37	0.31
Finance	0.07	12%	1.15	0.01%	1.07	0.02%	0.26	44%	25.55	0.29%	17.44	0%	0.32	0.03	0.02
All others	3.72	64%	18.65	0.59%	16.21	0.97%	1.38	24%	114.89	3.63%	91.16	5%	5.09	0.13	0.11
Total	35.29	22%	518.37	0.46%	458.84	0.61%	89.65	55%	7,252.01	6.48%	5,748.49	8%	124.94	7.77	6.21

Source: Basic Statistical Returns of SCBs in India 2016. Mumbai: Reserve Bank of India (2017).

Table 2.7 "Small" (up to ₹25,000) Term Deposits from Customers over the Years

Year Ending March 31 →	**2011**	**2012**	**2013**	**2014**	**2015**	**2016**
Number of accounts (million)	52.62	53.85	55.70	66.80	62.97	73.56
Percentage of total number of accounts	35.80%	32.80%	30.90%	33.30%	32.0%	33.9%
Growth	–1.27%	2.30%	3.32%	16.61%	–5.73%	16.81%
Amount (₹ billion)	1,691.67	1,375.19	1,387.30	1,130.10	421.06	704.16
Percentage of total deposits collected	5.20%	3.60%	3.10%	2.20%	1.4%	2.1%
Growth	16.93%	–23.01%	0.87%	–22.76%	–62.73%	67.2%

Source: Basic Statistical Returns of SCBs in India 2016. Mumbai: RBI (2017).

"small deposit accounts," for the purpose of analysis, term deposits less than ₹25,000 have been considered. If Table 2.7 is examined, it is evident that while the number of accounts has grown marginally in the earlier years, but significantly in 2013–14, the amount of deposits collected has indeed fallen. We can see a spike again in 2015–16, and with new institutions and renewed activity, we expect that these numbers will go up next year.

PRIORITY SECTOR LENDING

From the perspective of inclusion, another cut we could take is to look at the achievements under priority sector lending (PSL). While it is true that all of PSL is not inclusive finance, a significant portion of the portfolio is earmarked for people and segments where credit is difficult to come by. During the past year, the norms for PSL were tightened based on a

Table 2.8 Achievement under PSL Advances by Categories of Banks as of March 2016

₹ in Billions

	Public Sector	Private Sector	Foreign Banks	Total
ANBC	49,178	14,352	3,367	66,897
Off balance sheet exposure	8,069	2,345	1,807	12,222
Total agriculture	18.4%	18.59%	1.94%	17.61%
Weaker sections	11.14%	9.48%	1.19%	10.28%
MSME	14.93%	20.37%	8.55%	15.77%
Housing	5.58%	6.41%	1.06%	5.53%
Educational	7.35%	1.08%	0%	5.06%
Total priority sector	40.37%	46.13%	32.79%	41.22%

Source: Statistical Tables Relating to Banks in India STRBI: Table No. 17, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!3, accessed on July 14, 2017.

Abbreviations: ANBC: Adjusted net bank credit; MSME: Micro, small, and medium enterprises.

report by an internal working group of the RBI. The new norms were made applicable even to foreign banks with more than 20 branches, and the norms were defined sharply to make it more inclusive of certain sections of the society (small and marginal farmers, and microenterprises). Based on the recommendation of the working group, the RBI also notified and opened up a platform for trading of priority sector achievements through priority sector lending certificates (PSLCs).

A look at the achievement under the PSL norms in Table 2.8 shows that each of the categories of banks have achieved their respective targets on the whole. The private sector banks on the whole have done better than the public sector, largely driven by lending in the micro, small, and medium enterprises (MSME) and the housing segment. However, they are falling short in the weaker section sub-target. The nonachievement of targets and hard subtargets would mean that they buy the obligations through the traded certificates or contribute to the bonds specified for the purpose.

The most important development in this was the opening up of trading of PSLCs on the e-Kuber platform provided by the RBI. The recommendations of the internal working group had indicated that the achievements of targets should be reckoned on a quarterly basis, and this recommendation was accepted. The PSLC trading platform was thrown open to the banks in April 2016. The report from the RBI indicates that the trading platform recorded an active participation from all the banks, including the UCBs and SFBs banks during 2016–17. According to the RBI, the highest trading happened in the most difficult part of the portfolio—loans to small and marginal farmers. The RBI reports that the transaction volume in the loans to small and marginal farmer category was ₹229.9 billion, and in the general category was ₹200.2 billion. The RBI also observed an expected cyclical trend that peaked at the end of each quarter. RBI data also indicates that PSLCs traded during the first quarter witnessed higher premiums. The total volume that was on offer was ₹1,265.5 billion, while the amount finally settled was ₹498.0 billion. Clearly, this shows that the banking sector as a whole is overachieving the targets. This is also evident in the data provided in Table 2.8 for March 31, 2017. Given that there is an active market for clearing the obligations, it is possible that eventually the banks would move toward greater specialization based on their strengths and buy off obligations where they are unable to actively participate in the market (RBI 2017).

NONPERFORMING ASSETS IN PSL

One of the important aspects up for discussion during the year was the issue of nonperforming assets (NPA). We do not have the numbers for 2017, which might change fundamentally because of demonetization. However, in general, we find that the NPAs in PSL is usually a few percentage points higher than the nonpriority sector accounts. However, in 2016, we find that there is a significant drop in the quality of the nonpriority sector portfolio. While the PSL portfolio has marginally worsened, the nonpriority sector portfolio of the public sector banks has considerably worsened. If the portfolio of PSL advances were to be reviewed for the past 3 years, it is evident that they have been range bound with some worsening in the year 2015–16 (Table 2.9). But the most important number is the performance of the private sector banks—both on the PSL and the non-PSL loans. The NPAs in the year 2015–16 have worsened by a percentage point only in the non-PSL loans, else they seem to be doing well. However, data in Table 2.9 shows that the private sector banks are achieving targets through lending to MSMEs, housing, and indirect agriculture segments—which carry relatively larger ticket sizes—and falling short on the sub-segments of agriculture direct and weaker section loans. The public sector banks are looking at achieving these tougher targets, even though they may not be as lucrative and may result in a greater NPA. The dilemma of the profit versus inclusion seems to be addressed more easily in state-controlled banks.

Table 2.9 Advances and NPAs of Domestic Banks by Priority and Nonpriority Sectors*

(Amount in ₹ Billions)

	PSL			Non-PSL			Total		
Year	Gross Advances	Gross NPAs	Gross NPAs %	Gross Advances	Gross NPAs	Gross NPAs %	Gross Advances	Gross NPAs	Gross NPAs %
Public Sector Banks									
2013	12,790	669	5%	27,769	890	3%	40,559	1,559	5%
2014	15,193	792	5%	30,712	1,375	4%	45,905	2,167	5%
2015	16,860	937	6%	31,593	1,691	5%	48,453	2,627	10%
2016	18,675	1,271	7%	32,146	3,749	12%	50,822	5,021	5%
Nationalized Banks**									
2013	8,891	405	5%	19,170	554	3%	28,061	959	3%
2014	10,711	530	5%	21,249	877	4%	31,960	1,407	4%
2015	12,507	680	5%	21,718	1,239	6%	34,224	1,919	6%
2016	13,356	979	7%	21,062	2,900	14%	34,418	3,879	11%
SBI Group									
2013	3,899	264	7%	8,599	335	4%	12,498	600	5%
2014	4,482	261	6%	9,463	499	5%	13,944	760	5%
2015	4,353	257	6%	9,875	451	5%	14,228	709	5%
2016	5,320	292	5%	11,084	849	8%	16,404	1,142	7%
Private Sector Banks									
2013	3,157	52	2%	7,309	148	2%	10,467	200	2%
2014	3,831	61	2%	8,287	167	2%	12,117	227	2%
2015	4,428	72	2%	9,946	244	2%	14,373	316	2%
2016	5,620	101	2%	12,297	382	3%	17,917	484	3%
All SCBs (Excluding Foreign Banks)									
2013	15,947	721	5%	35,078	1,038	3%	51,025	1,759	3%
2014	19,024	852	4%	38,998	1,542	4%	58,022	2,395	4%
2015	21,287	1,009	5%	41,539	1,934	5%	62,826	2,943	5%
2016	24,295	1,373	6%	44,443	4,132	9%	68,738	5,504	8%

Source: Statistical Tables Relating to Banks in India (Table 18), http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!9, accessed on July 14, 2017.

Notes: 1. *: Excluding foreign banks.
2. **: Includes IDBI Bank Ltd.
3. Constituent items may not add up to the total due to rounding off.

CONCLUDING NOTES

While it was important for us to look at the overall impact of demonetization on the small accounts, unfortunately, the detailed data from the RBI was available only till September 2016, which was before the demonetization exercise. This was a year where multiple dynamics were happening, and it would have been interesting to look at how it is panning out—the MFIs were moving to be SFBs, Bandhan Bank was having a year more of full-fledged operations, there was demonetization, and the new PSL norms that included small and marginal farmers and microenterprises as a target had run a full year. Unfortunately, we do not have data on any one of these. However, from the data available, we know that the PSLC trading platform has taken off, there is excess supply of PSL achievements, and secondary markets are discovering themselves. The PSLC trading platform would have an adverse impact on the ability to have bonds for NABARD, MUDRA, and Small Industries Development Bank of India (SIDBI), as the banks will primarily square up their obligations through PSLCs. However, the inclusion of SFBs will expand the supply of PSLC, and the inclusion of foreign banks in the obligations will expand the demand. Therefore, it will be interesting to see how this market develops.

The data granularity on deposits does not help us to do much analysis, and if reporting on deposits gets more detailed, there could be enough research to provide policy inputs to both the government and the RBI.

The increase in the penetration with weaker sections and expansion of portfolio to increase the relative share of women has happened, possibly, due to structures that provided aggregation opportunities for the banks to engage with these segments of the population. Therefore, investments in the community ecosystem of formation and strengthening of SHGs and similar such efforts should continue. The digitization effort of both the Primary Agricultural Cooperative Society (PACS) as well as the SHGs undertaken by NABARD might bring more data on the quality of inclusion and, eventually bring these institutions also into the marketplace, where the eligibility for trading in PSLC may be expanded. But that is a while away.

Hopefully, next year, there would be much analysis on the effect of demonetization on the SBA accounts. We also would have an entire year played out to see its longer term effects. It is a bit disappointing that the data was not made available by the RBI as per its calendar. Otherwise, using the quarterly returns with all its granularity, one could have attempted to track the SBA better.

APPENDIX 2A
Progress of Commercial Banking at a Glance

Important Indicators	June 1969	March 2013	March 2014	March 2015	March 2016	March 2017
No. of commercial banks	89	155	151	152	152	152
SCBs	73	151	146	148	149	150
Of which: RRBs	–	64	57	56	56	56
Nonscheduled commercial banks	16	4	5	4	3	2
Number of Offices of SCBs in India^	8,262	105,437	117,280	125,672	132,587	137,770
(a) Rural	1,833	39,195	45,177	48,498	46,577	48,232
(b) Semi-urban	3,342	28,165	31,442	33,703	36,464	37,880
(c) Urban	1,584	19,902	21,448	22,997	23,867	24,877
(d) Metropolitan	1,503	18,175	19,213	20,474	25,679	26,781
Population per office (in thousands)	64	12	11	10	9.4	9.05
Deposits of SCBs in India (₹ billion)	46	69,343	79,134	88,989	96,599	107,514
of which: (a) Demand	21	7,672	8,272	7,801	35,190	44,144
(b) Time	25	61,672	70,862	81,188	61,409	63,370
Credit of SCBs in India (₹ billion)	36	53,932	61,390	64,998	75,209	79,270
Deposits of SCBs per office (₹ million)	5.6	658	675	708	728	780
Credit of SCBs per office (₹ million)	4.4	512	524	517	567	575
Average per account deposits of SCBs (₹)	88	55,445	62,252	68,576	58,316	
Average per account credit of SCBs (₹)	68	43,123	48,294	50,089	46,329	
Deposits of SCBs as percentage of national income (NNP at factor cost, at current prices)	16	84	86	80	102.84	98.83
SCBs' advances to PSL (₹ billion)	5	18,180	21,549	23,782	27,577	

Important Indicators	June 1969	March 2013	March 2014	March 2015	March 2016	March 2017
Share of PSL in Total Credit of SCBs (%)	14	34	35	37	41	
Share of PSL in total nonfood credit of SCBs (%)	15	34	36	37	31	
Credit deposit ratio	78	78	78	73	77.9	73.7
Investment deposit ratio	29	29	28	29	31.45	
Cash deposit ratio	8	6	5	6	5.59	

Source: Basic Statistical Returns of Commercial Banks in India Volume 45. Mumbai, RBI (2017).
Note: ^ Excludes Administrative Offices.
The numbers pertaining to 2016 and 2017 are on population statistics based on census 2011; the other years are based on census 2001.

APPENDIX 2B
Outstanding Credit to Small Borrowal Accounts According to Population Group as of March 2016

Numbers in Million; Amount in ₹ Billions

	Up to ₹ 0.025 Million			Between ₹0.025 and ₹ 0.2 Million			Above ₹ 0.2 Million		
Population Group	**No. of Accounts**	**Credit Limit**	**Amount Outstanding**	**No. of Accounts**	**Credit Limit**	**Amount Outstanding**	**No. of Accounts**	**Credit Limit**	**Amount Outstanding**
Rural	13	210	203	34	2,590	2,389	8	7,623	4,155
Semi-urban	9	147	136	26	2,156	1,970	10	8,331	6,415
Urban	6	76	63	11	919	763	8	16,728	11,132
Metropolitan	8	85	57	19	1,588	628	12	71,541	47,317
All India	35	518	459	90	7,252	5,748	37	104,222	69,019

Source: Basic Statistical Returns of Commercial Banks in India (Table 4.8) Volume 45. Mumbai, RBI (2017).

APPENDIX 2C
Outstanding Credit to Small Borrowal Accounts According to Category of Borrowers

Percentage Distribution of Outstanding Credit to SBA of SCBs According to Broad Category of Borrowers March 2016 (%)

	Individual							
	Male		Females		Other		Total	
Population Group	**No. of Accounts**	**Amount Outstanding**	**No. of Accounts**	**Amount Outstanding**	**No. of Accounts**	**Amount Outstanding**	**No. of Accounts**	**Amount Outstanding**
Rural	72.3	76.7	24.9	20.6	2.9	2.7	100.0	100.0
Semi-urban	64.4	70.4	30.2	26.1	5.4	3.4	100.0	100.0
Urban	59.3	66.4	32.9	27.9	7.8	5.7	100.0	100.0
Metropolitan	79.8	75.2	17.9	17.9	2.4	6.9	100.0	100.0
All India	69.9	73.1	26.0	23.1	4.2	3.8	100.0	100.0

Source: Basic Statistical Returns of Commercial Banks in India (Table 1.14) Volume 45. Mumbai, RBI (2017).

APPENDIX 2D
Outstanding Credit to Small Borrowal Accounts According to Occupation

Population Group-wise Outstanding Credit of SBAs of SCBs According to Occupation March 2016 (Number in '000s; Amount in ₹ Billion)

Occupation	Rural			Semi-urban		
	No. of Accounts	Credit Limit	Amount Outstanding	No. of Accounts	Credit Limit	Amount Outstanding
I. Agriculture	35,922	2,190	2,091	25,075	1,627	1,576
1. Direct finance	34,563	2,118	2,024	23,934	1,567	1,522
2. Indirect finance	1,359	72	67	1,141	59	54
II. Industry	1,068	49	41	826	40	31
III. Transport operators	139	13	10	212	20	16
IV. Professional and other services	1,000	54	45	846	48	39
V. Personal loans	3,825	273	219	5,122	404	308
1. Loans for housing	545	42	33	547	47	34
2. Loans for purchase of consumer durables	214	15	10	205	16	12
3. Other personal Loans	3,066	216	176	4,370	342	263
VI. Trade	3,073	153	130	2,496	123	102
1. Wholesale trade	173	9	8	153	8	7
2. Retail trade	2,899	143	122	2,343	115	95
VII. Finance	163	13	9	101	8	6
VIII. All others	1,140	55	46	1,032	33	28
Total bank credit	46,330	2,800	2,592	35,709	2,303	2,105

Occupation	Urban/Metropolitan			All India		
	No. of Accounts	Credit Limit	Amount Outstanding	No. of Accounts	Credit Limit	Amount Outstanding
I. Agriculture	7,862	467	432	68,858	3,817	4,135
1. Direct finance	7,388	446	414	65,884	3,685	3,992
2. Indirect finance	474	21	18	2,974	131	142
II. Industry	1,035	50	55	2,928	89	122
III. Transport operators	801	60	42	1,152	33	86
IV. Professional and other services	1,408	68	54	3,254	103	152
V. Personal loans	26,199	1,850	785	35,145	677	2,377
1. Loans for housing	673	65	45	1,766	88	132
2. Loans for purchase of consumer durables	289	20	13	708	31	41
3. Other personal loans	25,236	1,766	727	32,672	558	2,204
VI. Trade	2,619	121	106	8,187	275	353
1. Wholesale trade	145	7	14	472	17	22
2. Retail trade	2,473	114	92	7,716	258	331
VII. Finance	61	5	3	324	21	20
VIII. All others	2,922	45	34	5,094	88	119
Total bank credit	42,905	2,667	1,511	124,944	5,103	7,364

Source: Basic Statistical Returns of Commercial Banks in India Volume 45. (Table 1.15) Mumbai, RBI (2017).

APPENDIX 2E

Bank Group-wise Credit According to Loan Size as of March 2016 (Accounts in Thousands; Amounts in ₹ Billions)

Bank Group	Population Group	Less than ₹0.025 Million			₹0.025 to 0.20 Million			Above ₹0.20 Million		
		No. of Accounts	Credit Limit	Amount Outstanding	No. of Accounts	Credit Limit	Amount Outstanding	No. of Accounts	Credit Limit	Amount Outstanding
SBI and Associates	Rural	1,099	20	18	5,797	474	433	1,841	3,415	1,057
	Semi-urban	1,041	18	17	6,807	606	541	3,462	2,409	1,874
	Urban	253	4	3	1,812	183	142	2,367	3,558	2,599
	Metro	100	1	1	563	58	39	1,678	13,016	9,388
	All India	2,494	43	40	14,979	1,321	1,156	9,347	22,397	14,917
Nationalized Banks	Rural	4,403	76	71	15,402	1,217	1,127	3,805	2,747	2,220
	Semi-urban	2,786	47	43	11,658	985	908	4,238	3,739	2,903
	Urban	1,299	19	16	4,657	419	359	3,213	7,882	5,506
	Metro	606	6	25	1,792	172	133	2,568	31,292	21,835
	All India	9,094	148	156	33,508	2,793	2,527	13,824	45,661	32,464
Foreign Banks	Rural	0	0	0	0	0	0	0	28	16
	Semi-urban	0	0	0	0	0	0	0	15	8
	Urban	3	0	0	11	1	1	22	176	110
	Metro	985	8	3	3,164	294	71	1,311	6,432	3,561
	All India	988	8	3	3,176	295	71	1,334	6,650	3,695
RRBs	Rural	4,511	76	82	10,408	777	718	1,685	995	519
	Semi-urban	1,331	22	24	3,651	278	266	674	321	250
	Urban	201	3	3	591	50	45	222	173	132
	Metro	13	0	0	46	4	4	36	33	26
	All India	6,056	102	110	14,696	1,109	1,032	2,617	1,521	926
Private Sector Banks	Rural	2,657	39	32	2,053	123	111	500	438	343
	Semi-urban	4,160	60	51	4,275	287	255	1,654	1,847	1,381
	Urban	3,990	50	40	3,782	265	216	2,159	4,939	2,785
	Metro	5,856	69	28	13,181	1,059	381	5,996	20,769	12,508
	All India	16,663	217	151	23,290	1,734	962	10,308	27,993	17,016
Total	Rural	12,671	210	203	33,660	2,590	2,389	7,831	7,623	4,155
	Semi-urban	9,318	147	136	26,391	2,156	1,970	10,027	8,331	6,415
	Urban	5,746	76	63	10,853	919	763	7,982	16,728	11,132
	Metro	7,560	85	57	18,746	1,588	628	11,589	71,541	47,317
	All India	35,295	518	459	89,650	7,252	5,748	37,430	104,222	69,019

Source: Basic Statistical Returns of Commercial Banks in India Volume 45 (Table 4.8). Mumbai, RBI (2017).

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Regional Rural Banks[1]

3
Chapter

The story of the RRBs has been moving from exuberance to despondency; every few years there is a feeling that the RRBs have stabilized, then some of them slip into losses. While the original plan was to consolidate the RRBs into 46 banks, the process of consolidation has stopped at 56 banks. While it has been possible to merge RRBs within the states, it has been a politically difficult issue to merge RRBs across states because the state governments are not willing to let go. This is particularly an issue in very small states like in the North East region.

These 56 banks were making losses for a couple of years, but during the year 2016–17, six RRBs incurred losses. Overall, 10 RRBs are having accumulated losses of ₹12.33 billion that need to be wiped out. During the year 2016–17, three RRBs were recapitalized.

On the other hand, there was no progress as a result of the amendment carried out to the RRB Act 2 years ago that opened up space for new investors to come in. These changes could have potentially got a set of private sector investors, along with board positions subject to the proviso that the majority control would remain in the government ecosystem. Last year, Tankha (2015) had reported that at least one RRB is trying to get permissions for a public offering of shares. While there was no official document to indicate that there was progress on this issue, it is learnt that some of the sponsor banks are seriously talking to the government about a share offering and about drafting the necessary documents. The year 2018 might, therefore, see some of the successful RRBs testing the markets. The contours of the RRBs might also go through some changes in the future, particularly if they are going to be listed in the markets. While there is no proposal to do a convergence of design between that of the RRBs and the SFBs, Governor Patel indicated that the RBI could examine if it there was a specific proposal from the RRBs (see Box 3.1).

Box 3.1 Dr Urjit Patel on RRBs

MSS: Would it make sense to put SFBs and RRBs on a similar regulatory platform (giving RRBs to go out of their area of operation and have a national footprint—subject to adequate capital and safeguards) and put all other operational conditions (PSL, branch opening, ATM, technology, scheduling) similar?

UP: In general, a large part of regulation is common for all banks, except for incorporation, size, minimum amount of capitalization. I think there is fair amount of convergence and I don't see a reason for explicitly seeking a further convergence.

MSS: Given our concerns about geographical penetration, how did you see the role of RRBs? Should they consolidate further?

UP: There has been no concrete proposal from any RRBs or anyone else, and in case a specific proposal comes up, we could examine this on its merits. But such a proposal, if needed, should come from RRBs and their management, rather than from the RBI.

MSS: Do you see some transformation in RRBs once the SFBs start operating? The RRBs also have portfolio concentration and geographic concentration risk. Is there a way in which we can mitigate them and bring them on par with SFBs?

UP: The solution for this is within the respective governance structures. They have to take a call on how to carry the institution forward with the imperatives of growth and profitability.

Source: Sriram (2018).

[1] The author is thankful to Ajay Tankha for very useful insights and inputs on a draft of this chapter.

The RBI issued in-principle licences for 10 SFBs, thereby, potentially changing the landscape for inclusive finance in India. These licences were given to existing MFIs, a LAB, and a nonbanking finance company (NBFC). The 10 institutions together represent about ₹375 billion (a modest growth from ₹330 billion, possibly due to issues in transition and demonetization). As against this, the RRBs had a total portfolio of ₹2,285 billion. The rate at which the SFBs are growing, it is clear that they would be competing in the markets where the RRBs are operating. While at this time, SFBs may be operating predominantly in the urban areas and may move into the MSME segment and not compete in the agriculture segment where the RRBs seem to have more than 67% of the portfolio, the SFBs may ringfence the MSME, housing, and educational loan segments for competition, making it difficult for RRBs to compete in those areas. This indicates that RRBs cannot wish away the threat of a tough competition from SFBs and have to be completely equipped to take the competition head on.

BRANCH NETWORK

However, what is important is the growth of the RRB touchpoints that have been going up. After remaining flat in terms of number of branches, there was a growth of about 10% by 2015 and a marginal growth in the branch spread in 2016 and 2017. However, what is important is that the RRBs as a group added 5,586 USBs to their network in 2016, and by March 2017, the number had gone up to 10,900. More importantly, USBs have come up in large numbers in the east, north, and central regions (in addition to the South)—areas that were relatively underbanked (Tables 3.1 and 3.2).

Overall, the RRBs continue to be significantly present in the rural and semi-urban areas. During the past 5 years, the RRB branch network grew by nearly 23%, but this was not in sync with the growth of the branch network of the banking system as a whole, which grew by almost 40%. That is the reason we find that the relative share of the RRBs in the total banking network is falling between 2012 and 2017. However, we find that the relative share of RRBs has grown in the non-rural segments, particularly in the semi-urban and metropolitan locations. While a part of the explanation may be due to the fact that the 2017 numbers are based on the classification of rural and semi-urban areas as per the definitions of the 2011 census (the other years being represented by the 2001 census), this could not be a complete explanation as the other public sector banks would also have been uniformly affected by the reclassification of rural areas into semi-urban areas. Therefore, we can surmise that in

Table 3.1 RRB Branch Network over the Years (According to Region)

Region	1996	2012	2013	2014	2015	2016	2017	USBs 2017
North	1,980	2,312	2,469	2,618	2,849	3,014	3,074	2,800
North East	667	696	696	721	822	849	870	200
East	3,610	3,796	3,836	4,057	4,424	4,467	4,616	4,600
Central	4,670	5,127	5,440	5,821	6,146	6,259	6,460	1,300
West	1,022	1,142	1,192	1,294	1,378	1,436	1,469	600
South	2,723	3,556	3,849	4,028	4,644	4,879	5,104	1,400
Total	14,672	16,629	17,482	18,539	20,263	20,904	21,593	10,900

Source: Basic Statistical Returns of SCBs in India. Mumbai: RBI, various years; Regional Rural Banks Key Statistics 2016, Mumbai: NABARD.

Table 3.2 RRB Branch Network over the Years (According to Location)

Location	2012	Share of RRBs in the Banking Network (2012)	2013	2014	2015	2016	2017	Share of RRBs in the Banking Network (2017)
Rural	12,263	36.23%	12,850	13,609	14,644	15,606	14,862	30.45%
Semi-urban	3,192	11.82%	3,362	3,569	4,011	3,846	4,710	12.21%
Urban	1,009	5.06%	1,080	1,153	1,345	1,282	1,595	5.95%
Metro	165	0.74%	190	208	260	170	426	1.44%
Total	16,629	16.11%	17,482	18,539	20,263	20,904	21,593	15.01%

Source: Basic Statistical Returns of SCBs in India. Mumbai: RBI, various years. Regional Rural Banks Key Statistics 2016, Mumbai: NABARD.

Table 3.3 Recapitalization of RRBs: Various Phases

Phase	Number of RRBs Recapitalized	Amount of Recap (₹ billion)
Till January 2000 (six phases)	187 (158 fully, 29 partially)	21.88
2007–08	27	17.96
2012	27 (16 fully capitalized, 11 partially capitalized)	10.00
2013*	10 (new, of which 8 fully capitalized and 2 partially) all the 11 that were partially capitalized were fully capitalized in 2013	12.00
2014	2 (completion of the capitalization process)	
2015–16	3 RRBs	0.15
2016–17	3 RRBs (Manipur RB, Arunachal Pradesh RB, and Ellaquai RB)	

Source: Trend and progress of banking India, various years. Mumbai: Reserve Bank of India, NABARD Annual Report and RRB Key Statistics for March 2017 published by NABARD.

Note: *Total 40 RRBs were identified for recapitalization. Period for completion of the entire process has been extended up to March 2014 with a total outlay of ₹22 billion.

the quest for viability, the RRBs are gradually moving toward urban areas—possibly to diversify their risks and ensure viability. This is a trend that needs to be watched carefully, given the gradual crawl of the RRBs, particularly to the urban and metropolitan locations. On the other hand, it appears that the SCBs continue to grow in URCs, possibly due to the policy of asking banks to open 25% of their incremental branches in URCs (see Chapter 2).

The last report indicated that five RRBs had slipped into losses. During the year, one more RRB slipped into a loss. Ten of the RRBs had accumulated losses (though four of them had current profits). Four of the RRBs had a capital to risk weighted adjusted ratio (CRAR) of less than the stipulated 9%. The government provided share capital assistance to some of these RRBs during the year (Table 3.3).

BEYOND THE BRANCH NETWORK

All the RRBs are completely computerized and interoperable, and they had started setting up ATMs and issuing debit cards. However, during the year, there was hardly any progress in setting up new ATMs with only two RRBs adding three and four ATMs to their tally. The postal network, on the other hand, rolled out more than 1,000 ATMs during the year. The RRBs together had issued more than 28 million RuPay debit cards. Compared to the skew that 3 of the 19 banks had 79% of the ATMs last year, this year two more banks—Andhra Pragathi Grameena Vikas Bank and Karnataka Vikas Grameena Bank—started rolling out their ATMs (see Table 3.4). Together, these five banks had 80% of the ATMs rolled out, and the number was stuck at last year's level.

Table 3.4 ATM Networks of RRBs

S. No.	Name of the Bank	ATMs 2016	ATMs 2017
1.	Allahabad UP Gramin Bank	154	154
2.	Andhra Pradesh Grameena Vikas Bank	3	3
3.	Andhra Pragathi Grameena Vikas Bank	67	67
4.	Baroda Gujarat Gramin Bank	8	8
5.	Baroda Rajasthan Kshetriya Gramin Bank	10	10
6.	Baroda Uttar Pradesh Gramin Bank	9	9
7.	Chaitanya Godavari Grameena Bank	29	33
8.	Deccan Grameena Bank	2	2
9.	Dena Gujarat Gramin Bank	8	8
10.	Karnataka Vikas Grameena Bank	83	83
11.	Kashi Gomati Samyut Gramin Bank	43	43
12.	Kaveri Grameena Bank	1	1
13.	Kerala Gramin Bank	277	280
14.	Maharashtra Gramin Bank	10	4
15.	Malwa Gramin Bank	2	2
16.	Odisha Gramya Bank	25	25
17.	Pragathi Krishna Gramin Bank	250	249
18.	Prathama Gramin Bank	42	42
19.	Rajasthan Marudhara Gramin Bank	5	5
20.	Sutlej Gramin Bank	10	10
Total		1,024	1,038

Source: Data for 2016 from *Inclusive Finance India Report 2016* and for 2017 http://www.npci.org.in/nfsatm.aspx, accessed on July 13, 2017.

BUSINESS

The performance of the RRBs marginally improved in terms of profitability from 2015 to 2016 after seeing a bit of deterioration in the previous year. The demonetization exercise either does not seem to have affected the RRBs in a big way or the effect is not seen because of the forbearance given by the RBI to recognize NPAs. Six banks slipped to losses and five of them have been in losses for 3 years in running. These banks are operating in difficult areas—Jammu and Kashmir (J&K), Bihar, Madhya Pradesh (MP), Nagaland, and Odisha. A detailed analysis of the business potential of these banks needs to be done to see if they would be sustainable in the long run. In the meantime, with the intervention of NABARD, three of them were recapitalized by the government to attain a CRAR of 9%. While the consolidation has led to some vibrancy, the space needs to be watched carefully as the RRBs brace up for competition from the SFBs, which have similar PSL requirements, and the pressure to open rural branches.

Table 3.5 shows the general improvement in the overall financial performance of RRBs from the time the consolidation started to the current year.

A look at the broad numbers of the RRBs show some cause for worry. While the numbers are going up as far as the coverage of weaker sections and agriculture is concerned, as is the branch and staff productivity, the cause for worry is that, as the portfolio gets concentrated in a single type of asset—particularly in agriculture—way beyond the stipulated requirement, any adverse event will hit the portfolio badly. Therefore, it is very important for RRBs to diversify their assets into multiple sectors. The achievements in the PSL area is commendable, and it would be good if the RRBs found a ready market for the PSLCs given that they have substantial surplus in this area. This might add to a bit of the fee-based income. Another cause for concern may be the falling credit-deposit (CD) ratio, which has fallen to 61%, indicating that the deposits raised have not been fully deployed in the loaning, but they have been put away in investments that might not be fetching a great return. There is a dilemma here on whether these numbers are a good balance to have. We have to remember that 48 of the 56 RRBs have a CRAR of less than 15% (the threshold prescribed for the SFB given the nature of the risky assets side of the balance sheet). RRBs being well leveraged (possibly a bit too leveraged) should be good from a profitability perspective because they are using somewhat inexpensive current and savings accounts for building a loan book. However, because of the concentration in PSL, particularly agriculture, it may just as well be that the low CD ratio helps them to invest the resources in safe treasury operations, which obviates the geographic and portfolio concentration risks to an extent. However, with the SFBs coming in, this space will be disrupted and RRBs should gear themselves up to take on the challenge, which includes comprehensively looking at the management of the balance sheet.

Table 3.5 Performance of RRBs over the Years (Figures for March 31 of Each Year)

	2012	2013	2014	2015	2016	2017
No. of RRBs	82	64	57	56	56	56
No. of branches	16,914	17,867	19,082	20,024	20,924	21,593
Net profit (₹ billion)	18.86	22.73	26.94	29.21	22.06	29.49
Profit/loss making RRBs	79/3	63/1	57/0	51/5	50/6	50/6
Deposits (₹ billion)	1,863	2,054	2,333	2,730	3,135	3,718
Loans and advances (₹ billion)	1,130	1,359	1,589	1,810	2,065	2,286
CD ratio (%)	63.3	64.82	66.56	66	66	61
Share of CASA in deposits (%)	58.51	57	56.88	52	51	53
Share of PSA (%)	80	86		84	87	90
Share of agri adv to total (%)	53	63		59.5	64.3	68
Share of adv to SF/MF (%)					42.31	44.97
Advances to weaker sections (%)					52.61	54.73
Gross NPA (%)	5.03	6.08	6.09	6.15	6.58	7.71
Net NPA (%)	2.98	3.59	3.52		3.94	4.73
Branch productivity				226 million	249 million	280 million
Staff productivity				53 million	59 million	60 million

Source: Trend and progress of banking India, various years. Mumbai: Reserve Bank of India, Financial Statements of RRBs, Mumbai: NABARD, Regional Rural Banks Key Statistics 2017, NABARD.

FINANCIAL INCLUSION

RRBs continue to be seen as tools for financial inclusion. However, it is interesting to note that with all the policy push toward inclusion through various schemes and direct benefit transfer, there has been no initiative that puts the RRBs at the center of the action. Even during the PMJDY and later with the digitization thrust, RRBs have been bit players tagging along with the commercial banks. While the finance minister announced that all the banks should have an on-site ATM at all branches within a reasonable time, the RRBs are stuck at a particular level. Their being stuck at the level of around 1,000 ATMs is also reminiscent of how slowly their branch network grew over the years and has stagnated. While we see a great amount of push through the USBs during the year, if this is not backed up with technology, it will not work. In general, RRBs should certainly focus on having on-site ATMs at all the branches, but for the outreach, it might make a better strategy to use the cashless strategy—of using Aadhaar Pay technology where a small portable device could be used to undertake assisted banking transactions either at a USB or at a BC point. Similarly, RRBs should take the initiative of populating their areas of operation with PoS machines so that the customers rely on the on-site ATM only for bulk withdrawal of cash. This needs some strategic thinking on the part of the sponsor bank to see how RRBs could be used as strategic tools in the overall objective of achieving a high level of financial inclusion.

CREDIT

The granular data on the breakup of deployment of credit is available with a 1-year lag, and, as we have discussed in Chapter 2, we discuss the data available for 2016. The data on credit is reproduced in Table 3.6, which has details of loans made by RRBs in the loan categories of less than ₹25,000 and in the category of ₹25,000 to ₹200,000 (defined as SBAs). The numbers show that both the absolute number of accounts and the amount disbursed under the category of amounts up to ₹25,000 has been decreasing over the years. While this trend was observed in the overall banking numbers, that this is decreasing in the RRB segment that is expected to be "inclusive" is worrying. From these accounts representing about half of the total accounts to a quarter is a steep fall in about 5 years. In terms of volumes, the SBAs have shown an even steeper fall from about 11% of the portfolio to about 4%.

One can take some solace in the fact that the fall is not so steep when we look at the limit of ₹200,000 that is the current definition of an SBA. However, the loss from ₹25,000-sized SBA accounts is not fully compensated by the overall increase in the intermediary limit up to ₹200,000. While the intermediary category is growing, the overall number of loans up to ₹200,000 is showing a slight shrinkage over the years. Part of this may be attributed to the real value of the rupee, but nevertheless, specialized institutions like RRBs need to pay attention to the inclusion agenda with a greater sense of purpose.

PRIORITY SECTOR

The brightest spot (and also a source of risk) for the RRBs is the stellar achievement in the PSL sector targets. Not only have they surpassed the increased target of 75%, a closer examination of the purpose-wise breakup of the portfolio of the RRBs shows that a large portion of the portfolio (65%) goes to agriculture, and within that, for direct finance (63%) to agriculture (Table 3.7). About 45% of the finance is for the small and marginal farmers. This is not only a great achievement but also a great opportunity. Direct agriculture and loans to small and marginal farmers is a tough target that has been imposed on the entire banking sector including the foreign banks. That RRBs are surplus in achieving this target means that they can actually sell the obligations in the form of PSLCs on the RBIs e-Kuber platform. The RBI reported that the transaction volume in PSLCs—particularly in the small and marginal farmer category—was ₹229.9 billion in 2016–17, and it was higher than the trades in the general category, which was ₹200.2 billion. This portfolio also commanded the highest premia, and, therefore, it should be seen as a great opportunity for the RRBs to earn some fee-based income. RRBs should possibly also look at expanding their portfolio in the microenterprise segment, which will help them to diversify the portfolio and also sell the obligations to large commercial banks. However, on this segment, the SFBs may be able to give a good competition, and many of the SFBs are looking to scale up to the microenterprise segment. In 2016, 72% of the loan accounts and 65% of the loan balances were for agriculture.

While the deployment of credit to agriculture is commendable, it may also be a source of risk. We have to remember that the RRBs are having not only portfolio concentration but also geographic concentration. None of them have a multistate presence. This means that they could be subject

Table 3.6 Details of Credit to Small Borrowal Accounts over the Years

Year Ending March 31 →	2012	2013	2014	2015	2016
Loan amount less than ₹25,000					
Number of accounts (million)	9.33	7.77	6.89	6.33	6.05
Percentage to total accounts	44.99%	38.32%	32.07%	28.48%	25.92%
Limit sanctioned (₹ billion)	167.43	115.31	115.24	105.71	102.07
Percentage to total amounts	10.80%	5.27%	4.98%	4.84%	3.74%
Amount outstanding (₹ billion)	162.22	142.52	108.92	102.07	109.83
Percentage to total outstanding	13.94%	10.49%	6.86%	5.63%	5.31%
Loan amount ₹25,000 to ₹200,000					
Number of accounts (million)	10.29	10.95	12.60	13.62	14.69
Percentage to total accounts	49.63%	53.98%	59%	61.29%	62.89%
Limit sanctioned (billion)	720.90	794.58	915.14	1,014.79	1,108.58
Percentage to total amounts	46.50%	36.30%	40%	46.42%	40.58%
Amount outstanding (billion)	612.33	696.36	812.91	912.86	1,032.21
Percentage to total outstanding	52.61%	51.26%	51%	50.37%	49.90%
Total up to ₹200,000					
Number of accounts (million)	19.62	18.72	19.49	19.95	20.75
Percentage to total accounts with RRBs	94.62%	92.30%	91%	89.77%	88.80%
Limit sanctioned	888.33	909.89	1,030.37	1,120.50	1,210.64
Percentage to total amounts	57.29%	41.56%	44.52%	51.25%	44.31%
Amount outstanding (million)	774.56	838.89	921.84	1,014.93	1,142.03
Percentage to total outstanding with RRBs	66.55%	61.75%	58.02%	56.00%	55.21%

Source: Basic Statistical Returns of SCBs in India for the years 2012, 2013, 2014, 2015, and 2016 (Table 4.08). Mumbai: Reserve Bank of India, 2017.
Note: The gender-wise breakup of the accounts and the amounts indicate that more than 70% of the loan accounts and amounts have been made to men.

Table 3.7 Purpose-wise Breakup of Credit Accounts of RRBs as of March 31, 2016

Purpose	No. of Accounts (Million)	Relative % to Total	Credit Limit (₹ Billion)	Relative % to Total	Amount Outstanding (₹ Billion)	Relative % to Total
I. Agriculture	16.81	71.92%	1,686.99	61.75%	1,336.27	64.60%
1. Direct finance	16.09	68.86%	1,639.76	60.02%	1,294.32	62.57%
2. Indirect finance	0.71	3.06%	47.22	1.73%	41.95	2.03%
II. Professional and other services	0.53	2.28%	79.52	2.91%	61.09	2.95%
III. Personal loans	1.91	8.15%	329.62	12.06%	265.21	12.82%
1. Housing	0.49	2.11%	142.38	5.21%	118.99	5.75%
2. Consumer durables	0.11	0.47%	20.10	0.74%	14.86	0.72%
3. Vehicles	0.11	0.46%	24.98	0.91%	18.97	0.92%
4. Education	0.10	0.43%	25.11	0.92%	22.79	1.10%
5. Others	1.09	4.67%	117.04	4.28%	89.60	4.33%
IV. Trade	1.63	6.96%	163.42	5.98%	131.13	6.34%
1. Retail trade	1.58	6.75%	154.96	5.67%	125.13	6.05%
V. Finance	0.21	0.91%	157.74	5.77%	31.78	1.54%
VI. All others	1.43	6.12%	204.72	7.49%	156.08	7.55%
Total bank credit	23.37	100.00%	2,732.10	100.00%	2,068.44	100.00%

Source: Basic Statistical Returns of SCBs in India Volume 45 (Table 5.05). Available at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!3, accessed on July 14, 2017.

to local political posturing. If the recent examples of debt waivers by state governments (which had not happened in the past) are to go by, then RRBs will be the most vulnerable institutions because of the political risk. In fact, it may be a good idea to put RRBs on the same regulatory frame as the SFBs and allow each RRB to diversify geographically into multiple states to start with, before the process of multistate consolidation. This may honor the respective state government's pride of holding on to the shares, but also help in growing the business and diversifying the risks.

DEPOSITS

The data on the breakup of deposits by size was not available for RRBs separately. However, the breakup was available according to the location of the branches (Table 3.8). A look at the data indicates that the bulk of the deposits is coming from savings accounts and fixed deposits. While the number of savings accounts expectedly is much larger than the term deposit accounts, the overall resources that are garnered are comparable. The number of current accounts—largely represented by trade—is insignificant both in terms of the number of accounts and the amounts. So, it is seen that by design, RRBs are dealing largely with individuals.

The implications of having a lesser number of institutional customers is clear in the way the CD ratio has panned out. The ownership data of the accounts is available in Table 3.9. Usually in banking, we find that there are many more savers than borrowers, and that there will be institutional borrowers, small in number but borrowing large amounts. Only in the case of Bandhan Bank is this phenomenon turned obverse. In case of RRBs, the numbers show that these deposits have not been fully deployed (modest CD ratio). There is some comfort in the way RRBs are sticking to their inclusive mandate, but at the same time, there might be opportunities that they may be ceding to the sponsor banks who might be grabbing all the lucrative credit opportunities. It would be good from the perspective of both profitability and capability building that RRBs get into partnership with their sponsor banks in doing consortium and syndicated finance deals if the proposals are coming up in the areas covered by RRBs.

Table 3.8 Deposits of RRBs Classified According to the Location of Branches as of March 2016 (Accounts in Thousands; Amounts in ₹ Billions)

Type of Deposits →		Current		Savings		Term		Total	
Population Group	No. of Offices	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount
Rural	15,039	1,121	37	140,044	963	11,618	742	152,782	1,741
Semi-urban	4,066	677	24	38,384	356	4,274	384	43,335	763
Urban	1,329	181	18	7,605	137	1,935	311	9,720	466
Metro	283	24	5	1,158	20	264	60	1,446	85
All India	20,717	2,003	84	187,191	1,475	18,090	1,496	207,283	3,055

Source: Basic Statistical Returns of SCBs in India Volume 45 (Table 3.03). Mumbai: RBI. RBI Datawarehouse at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!9, accessed on July 14, 2017.

Table 3.9 Deposits of RRBs Classified According to the Ownership as of March 2015 and 2016 (Accounts in Millions; Amounts in ₹ Billions)

	March 2015		March 2016		March 2015		March 2016	
Details	Accounts	% of Total	Accounts	% of Total	Amount	% of Total	Amount	% of Total
Male	91	50%	105	50.7%	1,437	54%	1,578	51.7%
Female	49	27%	61	29.6%	510	19%	692	22.7%
Institutions	42	23%	41	19.8%	732	27%	785	25.6%
Total	182	100%	207	100%	2,679	100%	3,055	100%

Source: Basic Statistical Returns of SCBs in India Volume 45 (Table 1.22). Mumbai: RBI. RBI Datawarehouse at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!9, accessed on July 14, 2017.

However, it is important to notice that a change that is happening between 2015 and 2016 breaks the past years' trend. The share of institutions both in terms of number of accounts and amounts deposited has fallen. On the same note, it is also important to note the relative share of women in the number of accounts and deposits has seen an increase. Whether the decrease in the share of institutions is temporary or whether it go back to the past trend needs to be monitored as we move forward. However, the RRBs need to consider how they could deploy greater credit (represented by a better CD ratio) and have a lower level of NPAs that would ensure profitability. Diversification of the portfolio is the key. It would be interesting to see the progress of these institutions now that the next phase of consolidation is concluded.

LOCAL AREA BANKS

At this juncture, with SFBs coming in a big way, and with RRBs consolidating, the natural question that we need to ask is whether anything should be done about the LABs. Of the four LABs that were existing, one Capital LAB got converted into an SFB. The Coastal LAB had applied for a licence to convert into an SFB, but it was not granted. The annual report of KBS LAB has the following statement:

> Following the issuance of new Banking license for 10 SFBs, it became imperative for your bank to gather scale in order to face the likely competition emerging from these set of banks. Therefore, the future strategy of the bank was deliberated at the Board meetings of December 13, 2015 and at the meeting of February 2, 2016 it was recommended by the Board to explore the opportunity for voluntary amalgamation with Coastal LAB of Vijayawada. The Bank had appointed reputed Investment bankers as for due diligence on and valuation of shares of Coastal LAB. The advisors had advised a no cash, 1:1 SWAP ratio of the shares in both the banks. Along with these reports, the proposal was presented to the Shareholders at the EGM of October 1, 2016. The shareholders approved the proposal at the SWAP ratio recommended by the advisors and the proposal was submitted to RBI on 17 October 2016. The RBI has sought some information from Coastal LAB and the final approvals awaited. About the same time of this application of Voluntary Amalgamation, one of the existing shareholder of Coastal LAB had submitted a proposal to RBI for acquisition of shares amounting to 45.76% of the paid-up capital of your bank. (KBS LAB 2017)

There are geographic synergies between these two banks, but as of now, there is no official approval from the RBI. While the area of operation was expanded for the LABs, as of now, they still have many more restrictions than the SFBs. Even if they are not licenced to become like SFBs, it is possible that the RBI might relax many norms to make it functionally nearer to SFBs but granting them a larger area, scheduling them, and easing the branch authorization. But that is a decision for the regulator to take.

There was no mention of LABs in the RBIs annual report of 2016–17. However, the annual *Trend and Progress of Banking in India* report had a small paragraph:

> There were four local area banks (LABs) at the end of March 2016. However, this number reduced to three with the Capital Local Area Bank transforming into a SFB with effect from April 24, 2016. These banks witnessed a growth of 19.6% in assets with their net interest incomes growing by 13.3% during 2015–16. However, their net profits declined by 4.0% resulting in a decline in RoA. As the assets of the erstwhile Capital Local Area Bank Ltd. constituted over 74% of the assets of all LABs, the significance of LABs as a bank-group has diminished further. (RBI 2016)

This statement seems to indicate that the RBI could be thinking about this category of banks and may take a call on these in due course.

Coastal LAB[2]

After the Capital LAB became an SFB, the Coastal LAB was the largest LAB. It had a total business of ₹7.00 billion as of March 2017. While the bank remained profitable, most other details were not available in the public domain.

KBS LAB[3]

KBS LAB had a total business of ₹3.3 billion in 2016–17, with a growth of 4.7% over the previous year. Its gross NPA was 2.74% and the net NPA was 0.83%. It had a comfortable CRAR of more than 23.12%, indicating that it could have leveraged better and accessed more deposits. It had a much better CD ratio than the RRBs at 74.83%. The PSL

[2] Data for this section sourced from the website of Coastal LAB at http://www.coastalareabank.com/, accessed on September 9, 2017.

[3] Data for this section sourced from the website of KBS LAB http://www.kbsbankindia.com/downloads/KBS-AR-2016-17.pdf, accessed on September 9, 2017.

advances of KBS LAB were to the extent of 79.47%, far in excess of the 40% prescribed for LABs. However, most of the advances were classified as general purpose loans.

Subhadra LAB[4]

Subhadra was the smallest bank of the lot. While it crossed a total business of ₹1 billion during the year 2014–15, and increased the business to ₹1.1 billion in 2015–16, the business slumped to ₹568 million during 2016–17. The reasons for this slump are not known, but possibly the bank could have been adversely affected by the demonetization exercise. It had added one branch during the year, taking the total number of branches to 12. The CD ratio that had breached 100% in 2014–15 fell to 68.68% during 2016–17. Subhadra had a capital of ₹224 million and a net worth of ₹328 million by 2016–17. No further data about Subhadra was available on the public domain.

[4] Data for this section sourced from the website of Subhadra LAB at http://subhadrabank.com/decadeof-progress.php, accessed on September 9, 2017.

CONCLUDING NOTES

From the performance of the RRBs, it is evident that the challenges do continue for some RRBs that are working in difficult geographies. While there is scope for consolidation, this has to happen with a political will. On the other hand, the top-end RRBs are performing well, and they may be issuing shares in the market in FY 2017–18. The conundrum of reaching the last person and the sustainability of operations continues to haunt the cause of financial inclusion, and RRBs and LABs best represent these dilemmas both in their offerings and their financials.

APPENDIX 3A

Deposits and Credit (Including Credit of Small Borrowal Accounts) of RRBs as of March 2016
(Accounts in Millions, Amounts in ₹ Billions)

		Deposits (Balance)		Total Credit (Outstanding)		Of Which: Credit to Small Borrowers (Outstanding)	
Region	**No. of Offices**	**No. of Accounts**	**Amount**	**No. of Accounts**	**Amount**	**No. of Accounts**	**Amount**
North	2,967	21.13	397.72	1.76	287.47	1.26	123.62
Haryana	622	4.55	99.02	0.40	69.34	0.26	24.40
Himachal Pradesh	187	1.04	32.77	0.09	11.64	0.06	3.68
Jammu & Kashmir	329	1.48	35.69	0.16	17.21	0.12	6.70
Punjab	393	2.23	60.70	0.23	53.43	0.13	10.22
Rajasthan	1,436	11.83	169.53	0.89	135.85	0.68	78.62
North East	826	12.27	161.96	0.98	80.12	0.87	36.91
Arunachal Pradesh	29	0.14	4.54	0.01	1.21	0.00	0.18
Assam	469	8.37	79.14	0.59	44.45	0.55	25.42
Manipur	21	0.31	2.16	0.02	0.90	0.02	0.48
Meghalaya	79	0.44	12.28	0.04	6.24	0.03	1.58
Mizoram	79	0.60	15.17	0.06	8.65	0.04	2.69
Nagaland	10	0.02	0.68	0.00	0.22	0.00	0.05
Tripura	139	2.38	48.00	0.26	18.44	0.22	6.51
East	4,429	45.74	600.79	5.16	304.81	4.87	194.11
Bihar	2,066	19.96	242.62	2.40	122.97	2.32	97.89
Jharkhand	442	3.53	52.94	0.49	21.52	0.47	14.92
Odisha	961	7.84	130.63	1.10	73.61	1.03	43.71
West Bengal	960	14.40	174.59	1.17	86.71	1.04	37.59

(Continued)

(Continued)

Region	No. of Offices	Deposits (Balance)		Total Credit (Outstanding)		Of Which: Credit to Small Borrowers (Outstanding)	
		No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount
Central	6,272	73.35	908.57	6.02	533.12	5.23	286.69
Chhattisgarh	597	6.83	81.50	0.36	25.45	0.33	15.71
Madhya Pradesh	1,300	10.71	167.86	1.09	104.28	0.95	58.05
Uttar Pradesh	4,083	54.38	627.07	4.45	383.88	3.86	208.45
Uttarakhand	292	1.45	32.13	0.13	19.51	0.10	4.47
West	1,451	10.92	188.42	1.11	122.41	0.97	59.30
Gujarat	727	4.84	95.21	0.42	53.07	0.34	20.83
Maharashtra	724	6.08	93.21	0.69	69.35	0.63	38.47
South	4,772	43.87	797.78	8.33	740.50	7.56	441.41
Andhra Pradesh	1,117	10.07	189.93	2.10	174.33	1.90	110.37
Karnataka	1,659	15.79	304.61	2.09	249.80	1.81	122.90
Kerala	605	5.59	103.32	1.43	119.25	1.33	76.27
Tamil Nadu	518	3.35	69.32	1.16	67.57	1.13	56.77
Puducherry	37	0.18	4.55	0.07	4.33	0.07	3.82
Telangana	836	8.88	126.05	1.48	125.22	1.32	71.28
All India	20,717	207.28	3,055.24	23.37	2,068.44	20.75	1,142.03

Source: Basic Statistical Returns of SCBs in India, Table 2.02, Volume 45. RBI Datawarehouse at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!3, accessed on July 14, 2017.

APPENDIX 3B
Deposits of RRB as of March 31, 2016
(Accounts in Millions, Amounts in ₹ Billions)

Region/ State/Union Territory	No. of Offices	Current		Savings		Term		Total	
		No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount
North	2,967	0.36	8.56	18.94	190.01	1.83	199.15	21.13	397.72
Haryana	622	0.07	2.21	4.23	51.71	0.25	45.11	4.55	99.02
Himachal Pradesh	187	0.01	0.81	0.80	10.83	0.23	21.13	1.04	32.77
J&K	329	0.03	1.48	1.21	17.01	0.24	17.20	1.48	35.69
Punjab	393	0.18	1.31	1.83	24.18	0.21	35.21	2.23	60.70
Rajasthan	1,436	0.06	2.76	10.86	86.27	0.90	80.50	11.83	169.53
North East	826	0.24	9.97	11.28	89.88	0.75	62.11	12.27	161.96
Arunachal Pradesh	29	0.00	0.60	0.12	2.47	0.01	1.47	0.14	4.54
Assam	469	0.15	4.52	7.76	46.95	0.46	27.67	8.37	79.14
Manipur	21	0.01	0.22	0.30	1.30	0.01	0.64	0.31	2.16
Meghalaya	79	0.01	0.34	0.40	6.96	0.03	4.98	0.44	12.28
Mizoram	79	0.00	1.30	0.59	7.76	0.01	6.11	0.60	15.17

Region/ State/Union Territory	No. of Offices	Current		Savings		Term		Total	
		No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount	No. of Accounts	Amount
Nagaland	10	0.00	0.05	0.02	0.34	0.00	0.28	0.02	0.68
Tripura	139	0.07	2.94	2.09	24.10	0.22	20.96	2.38	48.00
East	4,429	0.27	17.10	40.90	322.96	4.56	260.73	45.74	600.79
Bihar	2,066	0.17	10.65	18.32	147.61	1.47	84.36	19.96	242.62
Jharkhand	442	0.01	1.23	3.18	30.19	0.35	21.52	3.53	52.94
Odisha	961	0.02	1.40	6.71	58.80	1.11	70.43	7.84	130.63
West Bengal	960	0.08	3.82	12.69	86.35	1.63	84.42	14.40	174.59
Central	6,272	0.54	25.74	67.82	540.68	5.00	342.15	73.35	908.57
Chhattisgarh	597	0.07	2.99	6.45	51.10	0.31	27.41	6.83	81.50
MP	1,300	0.10	4.14	9.65	76.72	0.96	87.01	10.71	167.86
UP	4,083	0.36	17.81	50.52	397.13	3.50	212.12	54.38	627.07
Uttarakhand	292	0.01	0.80	1.20	15.73	0.23	15.60	1.45	32.13
West	1,451	0.09	4.89	9.93	84.03	0.90	99.49	10.92	188.42
Gujarat	727	0.04	2.43	4.22	35.76	0.58	57.02	4.84	95.21
Maharashtra	724	0.04	2.46	5.71	48.27	0.32	42.47	6.08	93.21
South	4,772	0.51	17.26	38.32	247.82	5.04	532.69	43.87	797.78
Andhra Pradesh	1,117	0.03	4.99	8.69	56.16	1.35	128.78	10.07	189.93
Karnataka	1,659	0.19	8.42	13.60	92.80	2.00	203.40	15.79	304.61
Kerala	605	0.20	2.15	4.91	37.25	0.47	63.92	5.59	103.32
Tamil Nadu	518	0.03	0.30	2.85	20.24	0.48	48.77	3.35	69.32
Puducherry	37	0.00	0.21	0.17	1.07	0.02	3.28	0.18	4.55
Telangana	836	0.05	1.20	8.11	40.30	0.73	84.55	8.88	126.05
All India	20,717	2.00	83.53	187.19	1,475.38	18.09	1,496.33	207.28	3,055.24

Source: Basic Statistical Returns of SCBs in India, Table 3.02, Volume 45. RBI Datawarehouse at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!3, accessed on July 14, 2017.

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Review of PMJDY[1]

4

Chapter

INTRODUCTION

In the previous reports, we had discussed the PMJDY and its launch in detail. The enrollments that were on a mission mode during the past years plateaued during the year 2016–17. Much of the discussion was whether the PMJDY as a scheme was a good precursor for demonetization—of getting the stashed savings of the poor into the accounts—or whether these accounts were being used for money laundering—depositing cash belonging to others in order to get them legalized. On the whole, the data seems to indicate that while the former was true to an extent, there is no evidence of the latter. The deposits that came into the accounts increased the average balance in the accounts, but these were not immediately withdrawn and proved to be sticky.

In this chapter, we look at the performance of the PMJDY on the six pillars that were envisaged in the design. In the past year, we reviewed the progress of the PMJDY in achieving universal coverage by a two-pronged strategy of pushing the system on a mission mode enrolment and the communication strategy of pulling the customers into the banks by offering incentives—direct incentives such as insurance coverage, RuPay cards, and ODs, as well as indirect incentives of DBTs. A section of the chapter focusses on the progress of the DBT initiatives.

The six pillars of the PMJDY were:

- Universal access to banking services
    - Each district to have a sub-service area (SSA) covering 1,000 to 1,500 households
    - Banking service to be available within a reasonable distance of about 5 km radius
- Providing basic banking accounts with OD facilities and a RuPay debit card
- Financial literacy program
- Creation of a credit guarantee fund
- Providing microinsurance
- Providing unorganized sector pension scheme

The first three pillars were to be covered in Phase I, ending August 2015, and the other pillars are to be covered by August 2018 (Table 4.1).

Table 4.1 PMJDY Performance up to September 2017

Bank Category	Rural (No. in Million)	Urban (No. in Million)	Total A/cs Opened (Million)	No. of RuPay Cards (Million)	Balance (Amount ₹ Billion)	Average Balance per Active A/c (₹)
Public sector banks	132.9	110.6	243.5	182.7	524.33	2,153
Percentage share	71%	89%	78%	81%	78%	
RRBs	41.0	7.3	48.3	35.9	117.45	2,431
Percentage share	25%	7%	17%	15%	17%	
Private banks	5.9	3.8	9.7	9.0	20.32	2,094
Percentage shares	4%	4%	4%	4%	5%	
Grand total	179.8	121.7	301.5	227.7	662.11	2,196

Source: PMJDY as on September 6, 2017, http://pmjdy.gov.in/account-statistics-country.aspx, accessed on September 20, 2017.

[1] The author is thankful to Achyuta Shanbhag, student of Boston University, who contributed to the section on DBTs.

While the accounts were opened in mission mode, the criticism levelled against this mode was that though the numbers were achieved in quick time in terms of account opening, it was not checked whether these accounts were being used effectively. One way to track these accounts was to look at the number of zero balance accounts. However, the PMJDY site has stopped tracking these accounts. This follows the press coverage indicating that many banks had drastically reduced the zero balance accounts by transferring a token amount to these accounts to show a positive balance. It is also argued that an account having a zero balance at a given time is not necessarily a dormant account; instead, one should look at the number of transactions that are happening in the account. While we could agree with the argument, in the light of alternative statistics not being available, removing this data does not help in any analysis.

In an interesting study that analyses the 225 million new bank accounts that were opened under the PMJDY, the authors find that people maintain a positive balance, with increases in transactions pertaining to remittances over time. They claim that with familiarity, the usage increases over time, and it would spur the households to move toward demanding more banking products, including loans (Agarwal et al. 2017).

The data from the PMJDY website about the enrolment clearly indicates that from the approach using SSAs and extensive surveys, the mission of enrolling each household into the banking system is almost complete (see Table 4.2), except for some states where there were a marginal proportion of the households left out. This achievement is no mean feat and is phenomenal.

The PMJDY website has stopped putting data not only on zero balance accounts but also on ODs and other associated products. In this chapter, while recognizing the phenomenal success of enrollments, we focus our efforts on how to ensure transactions in the accounts. The issue of commissions for putting in remittances into these accounts, at least from a G2P perspective, has been settled, though there seems to be some ongoing discomfort at the level of compensation. It is now assumed that the BCs will eventually become viable through a series of other activities that will share the fixed costs. Our quest here would be to look at how the DBT could be effectively rolled out using the JAM trinity and the fact that the paper by Agarwal et al. (2017) seems to indicate that remittances are the first trigger point for the account usage.

Table 4.2 State-wise Household Coverage Report

State Name	Allotted Wards-SSAs	Wards-SSAs Survey Done	Wards-SSAs Survey Pending	Total Household	Covered Households	Household Coverage %
J&K	604	604	–	357,340	356,295	99.71%
Himachal Pradesh	2,489	2,489	–	1,298,191	1,298,191	100.00%
Punjab	6,743	6,743	–	4,746,147	4,746,147	100.00%
Chandigarh	136	136	–	193,876	193,876	100.00%
Uttarakhand	2,769	2,769	–	1,136,431	1,136,431	100.00%
Haryana	4,870	4,870	–	4,596,617	4,596,617	100.00%
Delhi	266	266	–	2,696,322	2,696,322	100.00%
Rajasthan	14,169	14,169	–	11,463,959	11,462,956	99.99%
Uttar Pradesh	37,424	37,424	–	31,159,992	31,159,148	100.00%
Bihar	14,640	14,640	–	17,281,831	17,281,831	100.00%
Sikkim	175	175	–	131,086	131,086	100.00%
Arunachal Pradesh	236	236	–	197,861	197,861	100.00%
Nagaland	413	413	–	334,034	333,762	99.92%
Manipur	576	576	–	514,604	513,359	99.76%
Mizoram	228	228	–	181,946	181,806	99.92%
Tripura	767	767	–	755,041	755,041	100.00%
Meghalaya	539	539	–	477,182	477,182	100.00%
Assam	4,925	4,925	–	5,013,404	5,011,228	99.96%

State Name	Allotted Wards-SSAs	Wards-SSAs Survey Done	Wards-SSAs Survey Pending	Total Household	Covered Households	Household Coverage %
West Bengal	13,248	13,248	–	9,261,587	19,261,587	100.00%
Jharkhand	5,147	5,147	–	5,438,679	5,438,679	100.00%
Odisha	7,962	7,962	–	7,432,140	7,420,665	99.85%
Chhattisgarh	6,197	6,138	59	5,189,795	5,188,545	99.98%
Madhya Pradesh	18,410	18,410	–	14,739,932	14,739,932	100.00%
Gujarat	9,831	9,831	–	11,709,247	11,709,247	100.00%
Daman & Diu	24	24	–	22,528	22,528	100.00%
Dadra & NH	35	35	–	59,908	59,908	100.00%
Maharashtra	17,722	17,718	4	16,374,622	16,374,030	100.00%
Andhra Pradesh	11,592	11,592	–	11,855,426	11,855,366	100.00%
Karnataka	11,645	11,645	–	11,178,005	11,175,204	99.97%
Goa	396	396	–	331,457	331,457	100.00%
Lakshadweep	29	29	–	10,189	10,189	100.00%
Kerala	5,582	5,582	–	4,585,375	4,585,375	100.00%
Tamil Nadu	19,987	19,987	–	14,353,828	14,353,794	100.00%
Puducherry	177	177	–	252,105	252,105	100.00%
Andaman	51	51	–	67,287	67,287	100.00%
Telangana	6,193	6,193	–	5,223,218	5,223,218	100.00%

Source: https://www.pmjdy.gov.in/statewise-statistics, accessed on August 9, 2017.

DIRECT BENEFIT TRANSFERS

The launch of the PMJDY resulted in a more aggressive pursuit of the DBT program, under which the government would directly load the accounts of the beneficiaries of various schemes. Although the DBT program for the subsidy for supply of liquefied petroleum gas had already been rolled out in 291 districts in June 2013, slight modifications were made upon review of the implementation of the program, and the program was relaunched in 54 districts in November 2014, and throughout the country by January 2015. Although this may not have resulted in providing customers an incentive to open accounts (since liquefied petroleum gas customers may not necessarily represent the financially excluded segments of society), it provided a proof of concept and the confirmation that the DBT of cash to the accounts of the beneficiaries through Aadhaar linkage would, in fact, work.

Phase II of the PMJDY, on the other hand, intended to provide additional services to accounts opened under the scheme. Phase II would thus cover the remaining three pillars of the financial inclusion agenda: creation of a credit guarantee fund, microinsurance, and unorganized sector pension schemes like Swavalamban. Furthermore, Phase II of the PMJDY intended to expand upon the inclusion agenda by providing coverage to hilly and tribal areas.

Furthermore, since one of the biggest criticisms of Phase I was the lack of significant activity in the PMJDY accounts, Phase II of the PMJDY attempted to boost activity and reduce the number of zero balance accounts through the rollout of DBT to hundreds of government schemes. As of July 2017, 259 government schemes have been on-boarded to the DBT program. Although this does, in fact, bear the potential to boost activity in the PMJDY accounts, it comes with significant drawbacks.

First and foremost, the effectiveness of the DBT program is reliant on the Aadhaar linkage of the accounts of the beneficiaries. Without Aadhaar linkage, there is no effective mechanism to weed out duplicate accounts and ensure that there is no leakage of funds before it reaches the beneficiaries. However, it must be noted that as of July 2017, 76.6% of the beneficiaries of the DBT schemes were Aadhaar-seeded, a significant improvement from the 51.6% in September 2015.

Second, an important drawback of the DBT rollout is the question of whether the disbursed funds will, in fact, reach the intended beneficiaries. This problem arises due to the very objective and approach of the PMJDY—to open one account for every household. However, if we look at the number of schemes where the intention is to provide DBT, we find that there are multiple beneficiaries including, in some instances, organizations. This only means that the agenda of providing one account to each household is about half the agenda done, while the other members of the household may be specifically eligible for benefit transfer and they also would need an account. Therefore, the agenda of opening accounts is actually an unfinished agenda. In such cases where the beneficiaries of certain DBT schemes are women or children, it is unclear how the funds will reach the intended beneficiaries. To highlight the magnitude of this issue, all 259 schemes on-boarded to DBT have been listed and their intended beneficiaries identified (see Appendix 4A). The beneficiaries were then grouped into one of four categories:

1. Student: All schemes targeting students, from primary school to the PhD level
2. Women: All schemes specifically targeted at women and women empowerment
3. General: Schemes aimed at the general population, including men, women, and seniors
4. Organization: DBT schemes where the intended beneficiaries are groups or organizations

Of the four categories of beneficiaries listed, it is safe to assume that students and women will encounter difficulty in accessing the funds dispersed through DBT. Of the 259 schemes on-boarded to the DBT program, 74 were targeted at the "general" category, 106 were targeted at students, 11 were targeted at women, 61 were targeted at organizations, and the beneficiaries of seven schemes could not be identified.

Thus, there are 117 out of 259 (45%) schemes on-boarded to the DBT that are targeted at women and students—groups that may never receive the funds from schemes aimed at them. To further aggravate the issue, these groups are amongst the beneficiaries with the lowest Aadhaar seeding, effectively ensuring room for leakage of the funds aimed at them. For instance, amongst the "scholarship schemes" only 52% of the beneficiaries are Aadhaar seeded, compared to the overall average of 76% amongst all DBT schemes.

The PMJDY is without a doubt an incredibly successful financial inclusion program, unprecedented in magnitude. The intended target of 7.5 crore accounts was quashed within the first phase of the program, with the government having successfully opened 17.5 crore accounts by August 2015. As of July 2017, nearly 30 crore accounts have been successfully opened under the PMJDY, about four times the initial target.[2] However, the *yojana* does have certain drawbacks, particularly regarding the haste to roll out hundreds of schemes under the DBT program. The government must prioritize the interests of the intended beneficiaries of the schemes over the "activity" in the accounts opened under the PMJDY, and put a hold on the rollout of DBT until it can ensure a bank account for each and every individual in the country and also ensure Aadhaar seeding for the same.

That being said, the government has otherwise done an exceptional job with the implementation of the PMJDY on the whole. If certain issues regarding the DBT rollout and Aadhaar seeding are addressed, the government can ensure de-duplication of accounts as well as nonleakage of funds disbursed through DBT. The aforementioned issues, once resolved, will surely compliment the success of the PMJDY in furthering the inclusion agenda in India.

[2] See https://pmjdy.gov.in/account

APPENDIX 4A
State-wise Performance of PMJDY

State Name	Beneficiaries at Rural/Semi-urban Center Bank Branches	Beneficiaries at Urban/ Metro Center Bank Branches	Total Beneficiaries	Balance in Beneficiary Accounts (₹ Billion)	No. of RuPay Cards Issued to Beneficiaries	Average Balance per Account (₹)
Andaman	242	556	798	0.66	703	821.43
Andhra Pradesh	3,850	3,885	7,735	10.82	6,321	1,399.11
Arunachal Pradesh	139	99	238	0.70	178	2,931.28
Assam	9,477	3,145	12,621	26.29	9,388	2,082.64
Bihar	20,496	11,300	31,796	57.33	21,604	1,803.17
Chandigarh	37	186	224	0.85	185	3,807.81
Chhattisgarh	8,659	4,372	13,031	20.02	8,657	1,536.43
Dadra & NH	85	22	107	0.33	70	3,084.20
Daman and Diu	21	17	37	0.14	25	3,633.55
Delhi	459	3,304	3,762	13.43	2,965	3,570.29
Goa	145	50	195	0.81	156	4,137.27
Gujarat	6,039	5,420	11,459	26.95	9,000	2,351.42
Haryana	3,319	2,839	6,158	22.08	5,109	3,585.68
Himachal Pradesh	821	121	942	4.13	772	4,381.16
Jammu & Kashmir	1,693	276	1,969	6.88	1,483	3,493.08
Jharkhand	7,956	2,773	10,728	19.93	7,801	1,857.44
Karnataka	6,080	3,909	9,989	22.22	8,526	2,224.90
Kerala	1,764	2,216	3,980	11.56	2,898	2,903.87
Lakshadweep	10	11	22	0.11	18	4,943.14
Madhya Pradesh	12,984	14,076	27,060	31.17	19,046	1,151.74
Maharashtra	10,568	10,533	21,101	36.97	14,664	1,752.00
Manipur	355	439	794	1.77	683	2,225.10
Meghalaya	343	64	406	1.94	225	4,766.77
Mizoram	120	190	311	0.53	110	1,693.15
Nagaland	122	117	240	0.41	184	1,711.61
Odisha	8,878	3,272	12,150	29.61	9,219	2,436.80
Puducherry	471	1,015	1,486	1.41	1,292	948.43
Punjab	3,149	2,404	5,553	19.87	4,609	3,578.17
Rajasthan	12,537	7,625	20,162	50.19	16,808	2,489.41
Sikkim	81	30	111	0.37	83	3,349.37
Tamil Nadu	4,234	4,731	8,965	15.21	7,672	1,696.79
Telangana	5,009	3,747	8,755	13.02	7,101	1,487.03
Tripura	582	247	829	6.28	712	7,571.85
Uttar Pradesh	27,717	18,938	46,655	105.11	36,001	2,252.85
Uttarakhand	1,377	772	2,149	7.53	1,685	3,506.48
West Bengal	19,941	9,016	28,957	95.52	21,706	3,298.62
Grand Total	179,757	121,717	301,475	662.11	227,659	2,196.24

Source: www.pmjdy.in, accessed on September 14, 2017.

APPENDIX 4B
List of Schemes That Are to Be Implemented through DBT

Ministry/ Department	Scheme	Beneficiary	Category
Rural Development	Indira Gandhi National Disability Pension Schemes	Disabled	General
	Indira Gandhi National Old Age Pension Scheme	Senior citizens (60+)	General
	Indira Gandhi National Widow Pension Scheme	Women	Women
	Mahatma Gandhi NREGA	Men & women	General
	Pradhan Mantri Gramin Awaas Yojana	Men & women (targeted at women)	Women
School Education and Literacy	Inclusive Education for Disabled at Secondary Stage	Disabled student	Student
	National Means-cum-Merit Scholarship Scheme	Student	Student
	National Scheme of Incentive to Girls for Secondary Education	Student (girl)	Student
	Scheme of Support to NGOs, Institutions and SRCs for Adult Education and Skill Development	Men and women	General
Petroleum and Natural Gas	PAHAL	Primarily HoH	General
Women and Child Development	ICDS Training Program	Women	Women
	Maternity Benefit Program	Women	Women
	Protection and Empowerment of Women-Comprehensive Scheme for Combating Trafficking of Women and Children-Ujjawla-Salary	Women	Women
	Rashtriya Mahila Kosh	Women	Women
	Umbrella ICDS-Anganwadi Services-Honorarium to AWW and AWH	Women	Women
Higher Education	BSR Fellowship	Student	Student
	Central Sector Scheme of Scholarship for College and University Students	Student	Student
	Dr D S Kothari Post Doctoral Fellowship	Student	Student
	Dr S Radhakrishnan Postdoctoral Fellowship in Humanities and Social Science	Student	Student
	Emeritus Fellowship	Teachers	General
	Ishan Uday Special Scholarship Scheme for Northeastern Region	Student	Student
	Junior Research Fellowship in Science, Humanities and Social Sciences	Student	Student
	National Research Professorship	Professor (senior citizen)	General
	P.G. Indira Gandhi Scholarship for Single Girl Child	Student (girl)	Student
	P.G. Scholarship for GATE/GPAT Qualified Students for Pursuing M.Tech/M.E./M. Pharma	Student	Student
	P.G. Scholarship for Professional Courses for SC/ST Candidates	Student	Student
	P.G. Scholarship for University Rank Holders	Student	Student
	Post Doctoral Fellowship for Women	Student (girl)	Student
	Post Doctoral Fellowship for SC/ST Candidates	Student	Student
	Pragati Scholarship for Girls in Diploma Institutes	Student (girl)	Student
	Pragati Scholarship for Girls in Degree Colleges	Student (girl)	Student
	Prime Minister's Special Scholarship Scheme for Jammu & Kashmir Students	Student	Student
	Saksham Scholarship for Differently Abled Students of Degree Colleges	Disabled student	Student
	Saksham Scholarship for Differently Abled Students of Diploma Institutes	Disabled student	Student
	Swami Vivekananda Single Girl Child Fellowship for Research in Social Sciences	Student (girl)	Student

Ministry/ Department	Scheme	Beneficiary	Category
Minority Affairs	Maulana Azad National Fellowship for Minority Student	Student	Student
	Merit-cum-Means Based Scholarship for Professional and Technical Course for Minorities	Student	Student
	Nai Roshni	Women	Women
	Padho Pardesh-interest Subsidy on Educational Loans for Overseas Studies	Student	Student
	Post-Matric Scholarship for Minorities	Student	Student
	Pre-Matric Scholarship for Minorities	Student	Student
	Supporting for Students Clearing Prelims Conducted by UPSC, SSC, State Public Service	Student	Student
Labor and Employment	Grants to Dattopant Thengadi National Board for Workers Education and Development—DTNBWED	Men and women	General
	Housing Subsidy to Beedi Workers	Men and women	General
	Housing Subsidy to Iron/Manganese/Chrome Ore Workers	Men and women	General
	Housing Subsidy to Lime Stone and Dolomite Workers	Men and women	General
	Rehabilitation Assistance under the Scheme of Rehabilitation of Bonded Labour	Men, women, children	General
	Scholarship to the Children of Beedi Workers	Student	Student
	Scholarship to the Children of Cine Workers	Student	Student
	Scholarship to the Children of Iron/Manganese/Chrome Ore Workers	Student	Student
	Scholarship to the Children of Lime Stone and Dolomite Workers	Student	Student
	Stipend to Children in the Special Schools under the National Child Labour Project—NCLP	Student	Student
	Stipend to Differently Abled Candidates under Scheme of Vocational Rehabilitation Centre	Disabled	General
	Stipend to Trainees under the Scheme of Welfare of SC-ST Job-seekers through Coaching, Guidance, and Vocational Training	Men and women	General
Tribal Affairs	National Overseas Scholarship Scheme	Student	Student
	Post-Matric Scholarship Scheme for ST Students	Student	Student
	Pre-Matric Scholarship Scheme for ST Students	Student	Student
	Rajiv Gandhi National Fellowship for ST Students	Student	Student
	Scheme of Grant in Aid to Voluntary Organizations Working for Welfare of STs	Organization	Organization
	Top Class Education for ST Students	Student	Student
	Vocational Training Centres in Tribal Areas	Men and women (mainly youth)	General
Social Justice and Empowerment	Central Sector Scheme of National Fellowship for OBC Students	Student	Student
	Central Sector Scheme of National Fellowship for Providing Scholarships to Scheduled Caste Students to Pursue Programs in Higher Education such as M.Phil. and Ph.D.	Student	Student
	Centrally Sponsored Scheme of Dr Ambedkar Pre-Matric and Post-Matric Scholarship for DNTs	Student	Student
	Centrally Sponsored Scheme of Post Matric Scholarships to the Students Belonging to Scheduled Castes for Studies in India	Student	Student
	Centrally Sponsored Scheme of Post-Matric Scholarship for OBC Students for studying in India	Student	Student

(Continued)

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Ministry/ Department	Scheme	Beneficiary	Category
	Centrally Sponsored Scheme of Pre-Matric Scholarship for Scheduled Caste Students Studying in Classes IX and X	Student	Student
	Credit Enhancement Guarantee Scheme for Young and Start-up Entrepreneurs Belonging to Scheduled Castes	Men and women (mainly youth)	General
	Dr Ambedkar Central Sector Scheme of Interest Subsidy on Educational Loans for Overseas Studies for Other Backward Classes (OBCs) and Economically Backward Classes (EBCs)	Student	Student
	Dr Ambedkar Centrally Sponsored Scheme of Post-Matric Scholarships for the Economically Backward Class (EBC) Students	Student	Student
	Pre-Matric Scholarships to the Children of Those Engaged in Occupations Involving Cleaning and Prone to Health Hazards	Student	Student
Empowerment of Persons with Disabilities	Incentives to Private Sector Employers for Providing Employment to Persons with Disabilities	Organization	Organization
	National Fellowship for Students with Disabilities	Student	Student
	National Overseas Scholarship for Students with Disabilities	Student	Student
	Post-Matric Scholarship for Persons with Disabilities	Student	Student
	Pre-Matric Scholarship for Persons with Disabilities	Student	Student
	Scholarship for Top Class Education for Students with Disabilities	Student	Student
Health and Family Welfare	Janani Suraksha Yojana	Women	Women
Financial Services	AABY—CLAIMS	Head of Household	General
	AABY—SCHOLARSHIPS	Student	Student
	Life Insurance linked with PMJDY	Men and women	General
Culture	Artistes Pension Scheme and Welfare Fund	Men and women	General
	Buddhist and Tibetan Culture Art	Organization	Organization
	Cultural Functions and Production Grant Scheme	Individuals/ Organizations	Organization
	Preservation of Cultural Traditions in Himalayas and North East Indian States	Organization	Organization
	Repertory Grant Scheme	Organization	Organization
	Scheme for Financial Assistance to Cultural Organizations with National Presence	Organization	Organization
	Scheme for Promoting International Cultural Relations	Individuals/ Organizations	Organization
	Scheme for Scholarships to Young Artistes in Different Cultural Fields	Student	Student
	Scheme for the Award of Fellowship to Outstanding Persons in the Field of Culture	Men and women	General
	Scheme of Tagore National Fellowship for Cultural Research	Men and women	General
Food and Public Distribution	Direct Cash Transfer for Food Grains	Men and women	General
AYUSH	Rashtriya Ayurveda Vidyapeeth	Student	Student
Sports	Arjuna Awards	Men and women	General
	Dhyan Chand Awards	Men and women	General
	Dronacharya Awards	Men and women	General
	National Sports Development Fund	Organization	Organization
	National Welfare Fund for Sportspersons	Men and women	General

Ministry/ Department	Scheme	Beneficiary	Category
	Pension to Meritorious Sportspersons	Men and women	General
	Rajiv Gandhi Khel Ratna Award	Men and women	General
	Scheme for Human Resource Development in Sports	Men and women	General
	Special Cash Awards to Medal Winners in International Sports Events	Men and women	General
Electronics and Information Technology (MeitY)	Nielit O A B C Scholarship Scheme	Student	Student
	Visvesvaraya PhD Scheme for Electronics and IT	Student	Student
Corporate Affairs	Internship Scheme	Student	Student
Micro, Small, and Medium Enterprises	Credit Linked Capital Subsidy Scheme—CLCSS	Organization	Organization
	Design Clinic Scheme for Design Expertise to Micro, Small, and Medium Enterprises	Organization	Organization
	IC Schemes	Organization	Organization
	Interest Subsidy Eligibility Certificate for Khadi and Polyvastra—ISEC	Organization	Organization
	Lean Manufacturing Competitiveness Scheme for MSMEs	Organization	Organization
	Marketing Assistance and Technology Upgradation—MATU	Organization	Organization
	National Awards	Individuals/ Organizations	Organization
	Performance and Credit Rating Scheme	Organization	Organization
	Technology and Quality Upgradation Support Through MSMEs—TEQUP	Organization	Organization
Water Resources, River Development, and Ganga Rejuvenation	R and D Programme in Water Sector	Men and women	General
Biotechnology	Bioinformatics National Certificate Fellowship	Student	Student
	Biotech Product, Process Development, and Commercialization Award	Men and women	General
	Department of Biotechnology Biology Fellowship	Student	Student
	Distinguished Biotechnology Research Professorship Award	Men and women	General
	Junior Research Fellowship	Student	Student
	National Bioscience Award for Career Development	Men and women	General
	National Women Bio-science Award	Women	Women
	Research Associates	Men and women	General
Agriculture, Cooperation, and Farmers Welfare	Agri Clinics and Agri Business Centres ACABC	Men and women	General
Science and Technology	Alliance and R & D Mission—INSPIRE Scholarship	Student	Student
Scientific and Industrial Research	Consultancy Development Centre	Student	Student
	National S and T Human Resource Development	Men and women	General
	Promoting Innovations in Individuals Start-ups and MSMEs—PRISM	Men and women	General
	Program for Inspiring Investors and Innovators	Men and women	General
Housing and Urban Poverty Alleviation	Credit Link Subsidy Scheme	Men and women	General

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Ministry/ Department	Scheme	Beneficiary	Category
Information and Broadcasting	Journalist Welfare Scheme	Men and women	General
	Scholarship Scheme of Satyajit Ray Film and Television Institute Kolkata	Student	Student
Urban Development	SBM Urban	Men and women	General
Chemicals and Petrochemicals	Bhopal Gas Leak Disaster	Men and women	General
	National Awards for Technology Innovation in Petrochemicals and Downstream Plastic Processing Industry	Men and women	General
Personnel and Training	Annual Grant to GKK	Organization	Organization
	Assistance for Come and Play Scheme	Organization	Organization
	Coaching Academies and Summer Camps by CCSCSB	Men and women	General
	Conduct of Yoga Classes at Grih Kalyan Kendras (GKK)	Men and women	General
Textiles	Amended Technology Upgradations Fund	Organization	Organization
	Carpet Weaving Training Scheme	Men and women	General
	Comprehensive Handicrafts Cluster Development Programme	Organization	Organization
	Comprehensive Handloom Cluster Development Scheme	Organization	Organization
	Development of Other Crafts in Jammu & Kashmir	Organization	Organization
	Direct Benefit to Artisan	Men and women	General
	Handicraft Design and Technology Upgradation Scheme	Organization	Organization
	Handicraft Human Resource Development	Organization	Organization
	Integrated Scheme for Powerloom Sector Development	Organization	Organization
	Marketing Support and Services and Export Promotion Scheme	Organization	Organization
	National Handloom Development Programme—Block Level Clusters	Organization	Organization
	National Handloom Development Programme—Scholarship/Stipend	Students	Student
	Northeastern Region Textile Promotion Scheme NERTPS	Organization	Organization
	Powerloom Group Workshed Scheme	Organization	Organization
	Scheme for Development of Silk Industry	Organization	Organization
	Scheme for In-situ Upgradation of Plain Powerloom	Organization	Organization
Health Research	Fellowship Programs under the Human Resource Development for Health Research	Men and women	General
	ICMR-Emeritus Medical Scientist Scheme	Men and women	General
	ICMR Visiting Fellow Scheme	Men and women	General
	ICMR-Junior Research Fellowship	Student	Student
	ICMR-Post Doctoral Fellowship	Men and women	General
	ICMR-Short-Term Studentship	Student	Student
	ICMR-SRF and RA Fellowship	Men and women	General
Commerce	APEDA		
	Coffee Board		
	MPEDA		
	Rubber Board		
	Spice Board		
	Tea Board		
	Tobacco Board		

Ministry/ Department	Scheme	Beneficiary	Category
Ex-Servicemen Welfare	Assistance for Procurement of Modified Scooter	Men and women	General
	Assistance for Purchase of Tool Kits	Men and women	General
	Assistance for Treatment of Listed Serious Diseases	Men and women	General
	Interest Subsidy on Home Loan up to Max ₹1 Lakh Taken from Nationalized or PSU Banks, etc.	Men and women	General
	Prime Ministers Scholarship Scheme PMSS	Student	Student
	Raksha Mantri Ex-servicemen Welfare Fund RMEWF	Men and women	General
Ministry of Steel	Award Scheme for Writing Books in Hindi	Men and women	General
Environment, Forests, and Climate Change	Biodiversity Conservation and Rural Livelihood Improvement	Organization	Organization
	Centres of Excellence	Organization	Organization
	Conservation of Corals and Mangroves	Organization	Organization
	Forest Survey of India	Men and women	General
	GB Pant National Institute of Himalayan Environment and Sustainable Development	Organization	Organization
	Green India Mission National Afforestation Programme	Organization	Organization
	Indian Council of Forestry Research and Education	Organization	Organization
	Indian Institute of Forest Management	Organization	Organization
	Integrated Development of Wild Life Habitats	Organization	Organization
	National Coastal Zone Management Programme	Organization	Organization
	National Mission on Himalayan Studies	Organization	Organization
	National Museum of Natural History	Organization	Organization
	Pollution Abatement	Organization	Organization
	Project Elephant	Organization	Organization
	R and D for Conservation and Development NNRMS	Organization	Organization
	R and D for Conservation and Development RD	Organization	Organization
	Wildlife Institute of India	Organization	Organization
	R and D for Conservation and Development TCB and ABG	Organization	Organization
Department of Official Languages	Rajbhasha Gaurav Puraskar Yojana	Men and women	General
Department of Animal Husbandry, Dairying and Fisheries	Development of Marine Fisheries, Infrastructure, and Post-Harvest Operation	Men and women	General
	Institutional Arrangement for Fisheries Sector	Men and women	General
	National Livestock Mission-Entrepreneurship Development and Employment Generation	Men and women	General
	National Scheme on Welfare of Fishermen	Men and women	General
Development of Northeastern Region	NERLP-SHG	Men and women (mainly women)	Women
	Scheme of Northeastern Council of Chairman Sport Award for Excellence in National and International Sport Meet	Men and women	General
	Scheme of Northeastern Council of Financial Support to the Student of North East Region	Student	Student
	Human Resource Development ILDP	Men and women	General

(Continued)

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Ministry/ Department	Scheme	Beneficiary	Category
Agricultural Research and Education	AgEdn-ICAR Emeritus Professor	Men and women	General
	AgEdn-ICAR Emeritus Scientist	Men and women	General
	AgEdn-ICAR Junior Research Fellowship	Student	Student
	AgEdn-ICAR National Professor and National Fellow	Men and women	General
	AgEdn-ICAR Senior Research Fellowship	Men and women	General
	AgEdn-India-Afghanistan Fellowship	Student	Student
	AgEdn-Merit Cum Means Scholarship	Student	Student
	AgEdn-National Talent Scholarship PG	Student	Student
	AgEdn-National Talent Scholarship UG	Student	Student
	AgEdn-Netaji Subhas ICAR International Fellowship	Student	Student
	AgEdn-Post-Matric Scholarship	Student	Student
	AgEdn-Students READY	Student	Student
	AS_NDRI_Institute Scholarship for MSc and PhD	Student	Student
	CS-IARI Scholarship	Student	Student
	FS-CIFE-Institutional Fellowship	Student	Student
	IASRI Scholarship for MSc and PhD	Student	Student
	ICAR Headquarter NASF	Organization	Organization
	India Africa Fellowship Programme	Student	Student
Atomic Energy	Advanced Centre for Treatment, Research, and Education in Cancer ACTREC-Phd Programme	Student	Student
	Aided Institutes—Payment of Stipend	Organization	Organization
	Atomic Minerals Directorate for Exploration and Research AMD-AMD Studentship Programme-AMDSP	Student	Student
	IMSc-PhD Programme	Student	Student
	Maths Olympiad	Student	Student
	Olympiad Programme-Physics	Student	Student
	Quiz and Essay Competition	Student	Student
	Raja Ramanna Centre for Advanced Technology RRCAT-Opportunities of Projects in RRCAT for Students	Student	Student
Pharmaceuticals	Scholarship to NIPER Students	Student	Student
Drinking Water and Sanitation	Swachh Bharat Mission Gramin	Organization	Organization
Department of Space	Development and Educational Communication Unit—Scholarships and Stipends	Student	Student
	Indian Institute of Remote Sensing—Scholarships and Stipends	Student	Student
	Indian Institute of Space Science and Technology—Assistanceship and Fellowships	Student	Student
	Indian Space Research Organization Headquarters—Scholarships and Stipends	Student	Student
	ISRO Propulsion Complex—Scholarships and Stipends	Student	Student
	ISRO Satellite Centre—Scholarships and Stipends	Student	Student
	ISRO Telemetry, Tracking and Command Network—Scholarships and Stipends	Student	Student
	Laboratory for Electro-Optics Systems—Scholarships and Stipends	Student	Student

Ministry/ Department	Scheme	Beneficiary	Category
	Liquid Propulsion Systems Centre—Scholarships and Stipends	Student	Student
	Master Control Facility—Scholarships and Stipends	Student	Student
	National Remote Sensing Centre—Scholarships and Stipends	Student	Student
	Satish Dhawan Space Centre-SHAR—Scholarships and Stipends	Student	Student
	Space Applications Centre—Scholarships and Stipends	Student	Student
	Vikram Sarabhai Space Centre—Scholarships and Stipends	Student	Student
Statistics and Programme Implementation	Fellowship to Research Scholars in Indian Statistical Institute	Student	Student
	Stipend to Students in Indian Statistical Institute	Student	Student
External Affairs	Chairs for Promotion of Indian Studies in the Universities Abroad	Men and women	General
	Festival of India Abroad	Organization	Organization
	Horizon Series	Organization	Organization
	Installation of Statues and Busts	Organization	Organization
	Outgoing Cultural Programmes	Organization	Organization
	Outgoing Exhibitions	Organization	Organization
	Promotion of Hindi and Sanskrit Language Overseas	Organization	Organization
	Promotion of Yoga	Organization	Organization
	Publications	Organization	Organization
New and Renewable Energy	Fellowship Component of R and D Projects Sponsored by the Ministry	Men and women	General
	National Biomass Cookstoves Programme	Men and women	General
	National Renewable Energy Fellowship Program and National Solar Science Fellowship Program	Student	Student

Source: Author computations based on the information available in https://dbtbharat.gov.in/scheme/dbtapplicablelist, accessed on August 9, 2017.

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Review of Microinsurance

Annapurna Neti[1]

5
Chapter

INTRODUCTION

There has been significant amount of discourse on microinsurance in the past years, ever since microfinance has taken off. After the RBI defined financial inclusion to have an element of insurance as well, there has been greater focus on not only insurance but also other social security products like pensions. With the insurance sector having their own regulator, there has been an increasing focus on making insurance inclusive over the years. However, unlike banking, which is transactional, insurance is a long horizon product with many complexities in terms of both determining the policy premiums based on actuarials and the claim settlement process. While, broadly, the insurance sector is divided into life and nonlife sectors, the nonlife sector is quite complicated, with a range of products that span health, accident, peril, theft, fire, and any other conceivable risk. For this report, we will try and focus on life, health, and accident-related products and would not be touching upon crop insurance.

While we are talking about insurance reaching out to the low-income consumers on the one hand, we also have to remember that as a country, even the concept of insurance (even amongst the well-to-do) is not widely prevalent. Moving from the safety of social and family networks and savings to financial products with long horizon payoffs is not easy. For instance, the Indian Household Finance Report 2017 finds that Indian households have not adequately invested in long-term insurance (both life and nonlife), and it reports a strong negative correlation between level of household debt from informal sources and participation in insurance. One possible explanation is that borrowing from informal sources ex post is a more common strategy that households employ to cope with risk rather than investing in insurance (Ramadorai et al. 2017). Low-income households in the India historically had limited access to formal financial services of any form and much lesser access to formal insurance services.

When it comes to insurance, India ranks 42nd in the world with insurance penetration (premium collected by insurers as a percentage of GDP) at 3.4%, life insurance penetration at 2.7%, and nonlife insurance penetration at 0.7% (IRDAI 2016a). While insurance penetration has been decreasing from 2010–11, insurance density (the ratio of premium collected in USD to total population, in other words it is per capita premium collected) as marginally improved from USD 47.40 in 2008–09 to USD 55.00 in 2015–16 and places India at 74th position out of 88 countries (Sigma 3/2017). Table 5.1 has the

Table 5.1 Insurance Penetration and Density in India

	Insurance Penetration			Insurance Density		
	Life Insurance (%)	Nonlife Insurance (%)	Total (%)	Life Insurance (USD)	Nonlife Insurance (USD)	Total (USD)
2008–09	4.00	0.60	4.60	41.20	6.20	47.40
2009–10	4.60	0.60	5.20	47.70	6.70	54.40
2010–11	4.40	0.70	5.10	55.70	8.70	64.40
2011–12	3.40	0.70	4.10	49.00	10.00	59.00
2012–13	3.20	0.80	4.00	42.70	10.50	53.20
2013–14	3.10	0.80	3.90	41.00	11.00	52.00
2014–15	2.60	0.70	3.30	44.00	11.00	55.00
2015–16	2.70	0.70	3.40	43.00	12.00	55.00

Source: IRDAI annual reports for various years.

[1] Annapurna Neti is a faculty member at the Azim Premji University, Bengaluru. She is a Fellow of the Indian Institute of Management, Bangalore.

details of penetration and density respectively over the years.

Insurance density in India is very low when compared to the world average of USD 638.3. The per capita expenditure on life insurance accounts for 78% of the total insurance premia, and nonlife insurance accounts for only 22% of per capita expenditure on total insurance as against the world average per capita expenditure on life insurance that is 55% (USD 353) and nonlife insurance that is 45% (USD 285.3) of per capita expenditure on total insurance (USD 638.3).

The penetration of insurance is not only low but is also unevenly spread, as can be seen in Figure 5.1. Given that this is the big picture on insurance, it is possible to imagine the disconnect that the low-income households may have with the insurance world. It has been only recently that even basic banking services have started penetrating to the poorer segments. The latest Financial Inclusion Insights survey by InterMedia survey (Chapter 1) shows how there are large gaps in the poor accessing full-service banking.

It is known that the low-income households in particular are vulnerable to economic, political, health-related, and weather- and natural disaster-related shocks. Life cycle events, loss of livelihood opportunity, medical emergencies leading to hospitalization or death of a family member (placing an additional burden on the household if an income earner falls ill), loss of assets due to fire, flood, drought, or other natural calamities increase vulnerability and severely impair the household's ability to recover from repeated shocks. To cope with risk, low-income households usually dip into their meagre savings' resort to borrowing from informal sources such as friends, relatives, and money lenders, diversify their livelihoods; and reduce their consumption, migration and others (see Figures 5.2 and 5.3). The elderly and the retired people usually depend on the younger generation for their life cycle needs. However, these ex ante and ex post informal coping strategies are often inadequate and push the households deeper into poverty. Access to a range of financial services, specifically formal insurance, helps households to manage risk ex post and build a long-term protection.

The Household Finances Committee had commissioned studies to look at the sources of risk and how the households cope with the risks. Figures 5.2 and 5.3

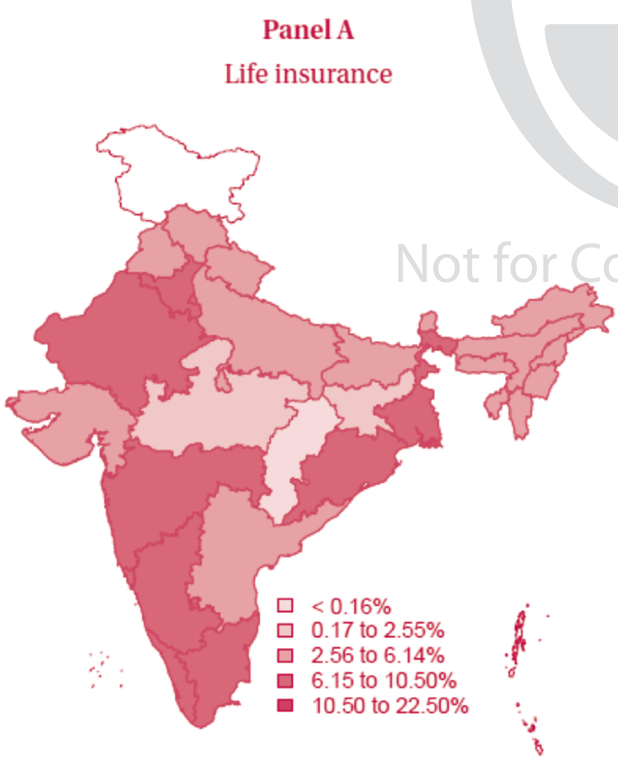

Figure 5.1 Interstate Variation in Life and Nonlife Insurance

Source: Ramadorai et al. (2017, 34).

Note: These maps are not to scale and may not depict authentic boundaries.

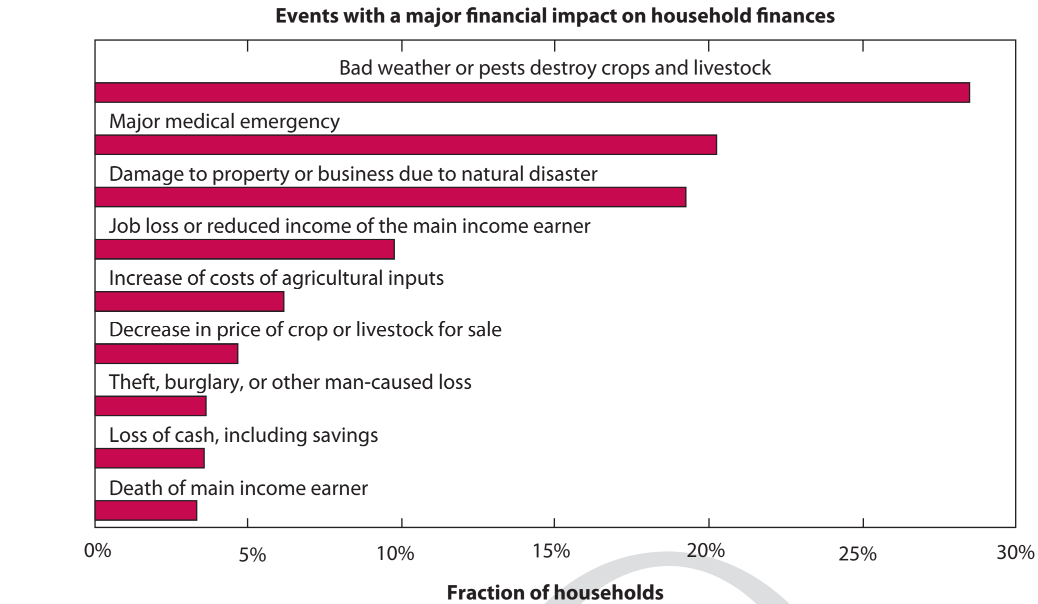

Figure 5.2 Sources of Risk and Sources of Emergency Funds for Households

Source: Ramadorai et al. (2017, 38).

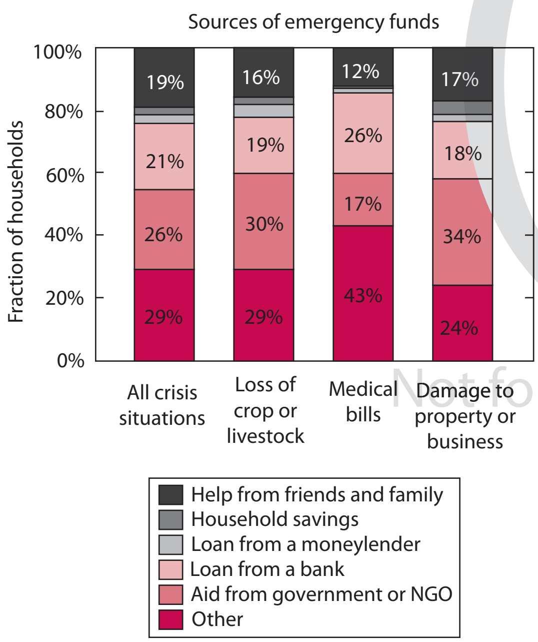

Figure 5.3 Sources of Emergency Funds for Households

Source: Ramadorai et al. (2017, 38).

capture the findings in two panels and this portrays the vulnerabilities of the poorer households.

As we can see from the panel, the formal sources form a miniscule portion of the source of emergency funds, and depending on friends and loans from moneylenders leaves the families very vulnerable. Are the coping strategies of poor households adequate against repeated risks they confront? How can low-income households be protected against risks and shocks they face? The question is whether microinsurance[2] can be made affordable for people whose income is low, unpredictable and uncertain. As the interest in microinsurance grows, these are some of the questions that confront governments, regulators and insurers who are faced with the challenges of designing and delivering microinsurance products that are relevant and affordable to low-income households yet are profitable to the insurers.

MICROINSURANCE SITUATION IN INDIA

In India, microinsurance refers to a special category of insurance policies to promote insurance coverage among economically vulnerable sections of society. It is characterized by low premiums and low coverage limits and is aimed at low-income households who are otherwise excluded from any formal insurance services.

The regulatory function of Insurance is vested with the Insurance Regulatory and Development Authority of India (IRDAI). The IRDAI was established under an Act of Parliament in 1999 as an

[2] Microinsurance is the protection of low-income people against specific perils in exchange for regular premium payments proportionate to the likelihood and cost of the risk involved (Churchill 2006).

autonomous body to protect the interests of policyholders and to regulate and develop the insurance industry. Apart from the other duties and powers, the IRDAI is also charged with "ensuring insurance coverage in rural areas and of vulnerable sections of society" as per Section 14 of the IRDA Act.

Microinsurance in India received an impetus with the microinsurance regulations introduced by IRDAI in 2005 and revised in 2015. The IRDAI regulations define a microinsurance policy as follows:

> A microinsurance policy is a general or life insurance policy with a sum assured of ₹100,000 or less. A general microinsurance product is any:
>
> - Health insurance contract
> - Any contract covering belongings such as hut, livestock, tools or instruments or
> - Any personal accident contract
> - It can be on an individual or group basis
>
> A life microinsurance product is:
>
> - A term insurance contract with or without return of premium
> - Any endowment insurance contract or
> - A health insurance contract
> - They can be with or without an accident benefit rider and
> - Either on an individual or group basis
>
> (IRDAI 2017b).

The origin of microinsurance in India can be traced to the Insurance Act, 1938, that recognized the importance of outreach to rural and social sectors, workers in the unorganized or informal sector, and economically vulnerable or backward classes of the society. Sections 32(B) and 32(C) of Insurance Act, 1938, stipulate that "every insurer shall undertake to provide such percentages of life insurance business and general insurance business in the rural or social sector," as may be specified by the appropriate authority from time to time. Box 5.1 captures the current obligations of the insurers to the rural and social sectors.

Box 5.1 Obligation of Insurers to Rural and Social Sectors

Excerpts from IRDAI (Obligations of Insurers to Rural and Social Sectors) Regulations, 2015.

- "Rural sector" means the places or areas classified as "rural" while conducting the latest available decennial population census (Census of India);
- "Social sector" includes unorganized sector, informal sector, economically vulnerable or backward classes, and other categories of persons, both in rural and urban areas;
- "Unorganized sector" includes self-employed workers such as agricultural laborers, bidi workers, brick kiln workers, carpenters, cobblers, construction workers, fishermen, hamals, handicraft artisans, handloom and khadi workers, lady tailors, leather and tannery workers, papad makers, power loom workers, physically handicapped self-employed persons, primary milk producers, rickshaw pullers, safai karamcharis, salt growers, sericulture workers, sugarcane cutters, tendu leaf collectors, toddy tappers, vegetable vendors, washerwomen, working women in hills, daily wagers, hired drivers and coolies, or such other categories of persons;
- "Economically vulnerable or backward classes" means persons who live below the poverty line;
- "Other categories of persons" includes persons with disability as defined in the Persons with Disabilities (Equal Opportunities, Protection of Rights, and Full Participation) Act, 1995, and who may not be gainfully employed; it also includes guardians who need insurance to protect spastic persons or persons with disability;
- "Informal sector" includes small-scale, self-employed workers typically at a low level of organization and technology, with the primary objective of generating employment and income with heterogeneous activities such as retail trade, transport, repair and maintenance, construction, personal and domestic services, and manufacturing, with the work being mostly labor intensive, and often having unwritten and informal employer-employee relationship.

Source: Insurance Regulatory and Development Authority of India (Obligations of Insurers to Rural and Social Sectors) Regulations, 2015, from IRDAI website, https://www.irdai.gov.in, accessed on September 19, 2017.

It is clear from the regulations that the vulnerable sections of the population are well defined. The obligations toward these sections of the society have been changing over the years. Unlike the priority sector obligations for banking institutions that kick in from their inception, in case of microinsurance, there is a roadmap for achieving penetration. Table 5.2 captures how the obligations are to

Table 5.2 Obligations under Rural Sector for a Life Insurer

S. No.	Financial Year from Inception	Percentage of Number of Policies (2015)	Percentage of Number of Policies (2008)*	Percentage of Number of Policies (2005)*	Percentage of Number of Policies (2002)*	Percentage of Number of Policies (2000)*
1	First year	7%	No change from 2005	No change from 2002	7%	5%
2	Second year	9%	No change from 2005	No change from 2002	9%	7%
3	Third year	12%	No change from 2005	No change from 2002	12%	10%
4	Fourth year	14%	No change from 2005	No change from 2002	14%	12%
5	Fifth year	16%	No change from 2005	No change from 2002	16%	15%
6	Sixth and seventh year	18%	18% in seventh year	18% in sixth year		
7	Eighth and ninth year	19%	19%			
8	Tenth year and every year thereafter	20%	20%			

Source: Circulars on obligations of insurer to rural and social sectors 2000, 2002, 2005, 2008, and 2015, downloaded from IRDAI website at https://www.irdai.gov.in/Defaulthome.aspx?page=H1, accessed on September 18, 2017.
Note: *Given only for first 5 years of an insurer, to be reviewed every 5 years.

Table 5.3 Obligations under Rural Sector for a Nonlife Insurer

S. No.	Financial Year from Inception	Percentage of Gross Premium Written Direct (2015)	Percentage of Gross Premium Written Direct (2008)	Percentage of Gross Premium Written Direct (2005)	Percentage of Gross Premium Written Direct (2002)	Percentage of Gross Premium Written Direct (2000)
1	First year	2%		No change from 2002	2%	2%
2	Second year	3%		No change from 2002	3%	3%
3	Third to Seventh year	5%	5% in seventh year	In the sixth year, 5%	5% thereafter	5% thereafter
4	Eight year	6%	6%			
5	Ninth year and every year thereafter	7%	7% in ninth and tenth financial years			

Source: Circulars on obligations of insurer to rural and social sectors 2000, 2002, 2005, 2008 and 2015, downloaded from IRDAI website, https://www.irdai.gov.in/Defaulthome.aspx?page=H1, accessed on September 18, 2017.

be achieved in case of life insurance companies. It requires that the insurance company achieve a share of 20% of the policies written from rural areas from the 10th year and maintain that number. As we can see from Table 5.2, this target has been getting a bit more stringent from the time it was first introduced in the year 2000.

Similarly, the obligations for a nonlife insurer is captured in Table 5.3.

In addition to the rural coverage, all insurance companies are required to achieve other inclusion targets, particularly to the social sectors. As we have seen earlier, the social sector is defined as that which "includes unorganized sector, informal sector, economically vulnerable or backward classes and other categories of persons, both in rural and urban areas." According to the definition, the requirement as per the 2015 regulation is detailed in Table 5.4.

For insurers existing as on the date of commencement of the IRDA Act (such as Life Insurance Corporation of India [LIC] and other general insurers), the obligations were specified from time to time in consultation with the insurer. Failure to comply with the specified obligations may attract penalty up to ₹25 crore.[3] However, rural and social sector obligations may in practice limit the outreach of individual insurers as they may no longer focus on microinsurance once the targets are achieved. A comparison of the number of microinsurance policies sold in rural areas to the total number of policies sold in rural areas shows most insurers "just achieve the target" (MicroSave 2012). From a regulatory standpoint, there have been some proactive

[3] 105B of Insurance Act 1938 as modified in the Insurance Laws Amendment Act 2015, No. 5 of 2015.

Table 5.4 Obligations under Social Sector for All Insurers (Life, Nonlife, and Stand-alone Health)

Age of the Insurer	"Percentage of Social Sector Lives" Computed on the Total Business Procured in the Preceding Financial Year (2015)	Number of Lives (2008)	Number of Lives (2005)	Number of Lives (2002)	Number of Lives (2000)
1	0.5%	No change from 2005	No change from 2002	5,000	5,000
2	1%	No change from 2005	No change from 2002	7,500	7,500
3	1.5%	No change from 2005	No change from 2002	10,000	10,000
4	2%	No change from 2005	No change from 2002	15,000	15,000
5	2.5%	No change from 2005	No change from 2002	20,000	20,000
6	3%	No change from 2005	25,000		
7	3.5%	25,000			
8	4%	35,000			
9	4.5%	45,000			
10 and above	5%	55,000			

Source: Circulars on obligations of insurer to rural and social sectors 2000, 2002, 2005, 2008 and 2015, downloaded from IRDAI website, https://www.irdai.gov.in/Defaulthome.aspx?page=H1, accessed on September 18, 2017.

measures taken by the IRDAI over the years. This included facilitating a special microinsurance regulation issued in 2005 and revised in 2015.

THE PROVIDERS

There are three types of insurers in India:

1. Life insurers: There are 24 life insurance companies out of which LIC is the sole public sector company and the others are private sector insurers.
2. Nonlife including specialized insurers: There are 29 nonlife insurers out of which six are from the public sector. Of the public sector insurers, two are specialized insurers, namely Agriculture Insurance Company Ltd and Export Credit Guarantee Corporation of India, providing crop insurance and export credit insurance respectively. Of the 23 private nonlife insurers, five are specialized in health, personal accident, and travel insurance.
3. Reinsurers: General Insurance Corporation of India is the sole national reinsurer.

In addition, the insurance sector landscape also includes other stakeholders such as approved insurance agents, licensed corporate agents, brokers, common service centers, web aggregators, surveyors, and third-party administrators servicing health insurance claims.[4]

However, the outreach of insurance services to vast majority of the poor and low-income households is limited, and there is significant scope for improvement. The reasons for low outreach are multifold. The supply side difficulties include:

1. High fixed cost of marketing and administration coupled with low volumes and lower margins.
2. Lack of awareness among clients about insurance products, features, and benefits implies that traditional distribution channels and conventional means of marketing and promotion may not work.
3. Unwillingness of people to pay for something that may or may not yield any future benefits. Often, this may also lead to the lapse of policies and low renewal rates.
4. Challenges of distribution to ensure last-mile access in remote rural areas. This may call for establishing new distribution channels that lead to additional costs.
5. Lack of information about potential clients that could lead to (a) adverse selection and moral hazard, and (b) higher risk weightage of microinsurance products.
6. Designing relevant products for clients whose income is seasonal, uncertain, and varying.
7. High level of customization of insurance products, keeping in view the heterogeneity of households and the diversity of risks they face. This leads to higher costs of transaction.

On the demand side,

1. Clients are often illiterate, lack awareness about insurance, and are intimidated by the documentation,

[4] See www.irdai.gov.in

Table 5.5 New Life Insurance Business under Microinsurance Portfolio

		Individual		Group		
		Policies ('000s)	Premium (₹ Million)	Schemes	Lives Covered ('000s)	Premium (₹ Million)
2011–12	Private total	793	96.42	112	750	115.07
	LIC	3,826	1,060.35	5,461	9,444	983.16
	Industry total	4,620	1,156.77	5,573	10,194	1,098.23
2012–13	Private total	695	101.85	151	757	75.69
	LIC	4,340	994.91	5,325	13,224	2,104.58
	Industry total	5,036	1,096.76	5,476	13,981	2,180.27
2013–14	Private total	561	92.93	164	1,291	159.52
	LIC	2,205	863.58	5,292	11,887	1,258.15
	Industry total	2,767	956.51	5,456	13,179	1,417.67
2014–15	Private total	416	124.92	62	2,531	336.62
	LIC	400	164.02	5,417	20,596	2,819.38
	Industry total	816	288.95	5,479	23,128	3,156.00
2015–16	Private total	458	121.80	153	6,650	481.67
	LIC	452	195.38	4,844	22,603	2,542.64
	Industry total	911	317.17	4,997	29,254	3,024.31

Source: Handbook on Indian Insurance Statistics, various years accessed from https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_List.aspx?DF=Creport&mid=11.2, accessed on September 15, 2017.
For FY 2015–16, the data also includes coverage under the PMJJBY.

jargon, and hostile staff, which leads to low uptake of insurance.
2. Clients face higher transactions costs during claims submission and processing.
3. Shoe-string budgets and uncertain incomes make it difficult for them to pay premiums upfront for a service with perceived low utility.

Provision of microinsurance, therefore, rests on balancing three competing objectives: coverage, costs, and affordability (Churchill 2006). How can large numbers of low-income people be reached at low operating and transactions costs for the insurer and at the same time be affordable in terms of price and transaction costs for the customer?

TRENDS IN MICROINSURANCE

Microinsurance in India is broadly categorized into life insurance and general or nonlife insurance. Tables 5.5 and 5.6 show the trends in microinsurance in the life segment.

From Table 5.5, it is evident that the shift in the microinsurance portfolio is moving from the individual-based policies to group coverage. The group coverage might give better spread, wider coverage as

Table 5.6 Number of Microinsurance Agents under Life Insurance

	Insurer	As on April 01	Additions	Deletions	As on March 31
2011–12	Private	758	541	48	1,251
	LIC	9,724	2,910	1,088	11,546
	Total	10,482	3,451	1,136	12,797
2012–13	Private	1,251	804	231	1,824
	LIC	11,546	3,792	110	15,228
	Total	12,797	4,596	341	17,052
2013–14	Private	1,824	36	204	1,656
	LIC	15,228	3,534	361	18,401
	Total	17,052	3,570	565	20,057
2014–15	Private	1,656	53	233	1,476
	LIC	18,401	1,790	812	19,379
	Total	20,057	1,843	1,045	20,855
2015–16	Private	3,382	6,392	1,307	8,467
	LIC	19,379	997	1,802	18,574
	Total	22,761	7,389	3,109	27,041

Source: Handbook on Indian Insurance Statistics, various years, retrieved from https://www.irdai.gov.in/ADMINCMS/cms/frmGeneral_List.aspx?DF=Creport&mid=11.2, accessed on September 15, 2017.

Table 5.7 Number of Life Microinsurance Products

	Number of Insurers	Individual	Group	Total
2011–12	15	18	12	30
2012–13	17	23	13	36
2013–14	13	13	8	21
2014–15	13	13	8	21
2015–16	13	20	7	27

Source: irdai.gov.in, accessed on September 15, 2017.

well as economies of scale and scope. It is important to understand this in greater detail as to whether this is at the cost of customization and the costs and benefits of this shift for the vulnerable customers.

We can see that given the focus and the thrust on microinsurance, the number of microinsurance agents have more than doubled in the past 5 years, thereby increasing the access for the poorer communities to deal with the agents. However, the total number of agents being in the thousands is hardly a solace for the population to be covered. The number of products available under life insurance reached a peak of 36 in 2012–13 but has now fallen. Table 5.7 gives the details of the number of products over the years.

MICROINSURANCE MODELS

There are three types of micro insurance models in India: partner-agent model, community based model, and in-house model. The partner-agent model is the most widely promoted model in India where insurers can appoint entities as agents such as NGOs, SHGs, or MFIs as microinsurance agents for distribution of microinsurance products. The entities appointed as agents are usually providers of any form of financial services to low-income households. With the revised guidelines in 2015, the category of entities that can be appointed as microinsurance agents has been expanded to include NBFC-MFIs, district cooperative banks (DCBs), RRBs, UCBs, Primary Agricultural Cooperative Societies (PACS), other cooperative societies, and BCs of scheduled commercial banks. However, when we look at the overall insurance premium collected and the number of lives covered by the microinsurance agents, we find that they do about 50% of the microinsurance business. However, we have to remember that the microinsurance business is in itself a very miniscule portion of the total insurance business (IRDAI 2016a and 2017b). The microinsurance agents business in individual life insurance is increasing, while the business in group is decreasing—possibly because of direct marketing and institutional mechanisms that administer the group policies. Similarly, the share of the microinsurance agents in the nonlife business is also decreasing.

Community-based Model[5]

These models are often found in health insurance where a participating community pools funds, identifies and manages a network of healthcare providers and bears the cost of hospitalization of the beneficiary out the funds pooled (Churchill 2006).

In-house Schemes

These are insurance schemes developed and run by MFIs or healthcare providers without any tie-up with a regulated insurance provider. The risk is by the MFI or the entity providing insurance.

Both community based and in-house schemes have innovated in bringing down the costs of insurance for low-income clients and provide a much needed social protection to clients who do not have access to formal insurance services. Such schemes are outside the purview of the IRDA (Microinsurance) Act 2015 and are not regulated by IRDA. However, due to absence of a legal framework, prudential norms, and ombudsman, client protection may be compromised.

Government-sponsored Insurance Schemes

There are a number of government-sponsored social security and social protection schemes targeting specific underprivileged and low-income groups. A few of these are discussed further.

Jan Suraksha

Jan Suraksha is a set of three government-sponsored social security schemes, namely, the Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), and Atal Pension Yojana (APY) for the poor and underprivileged. The schemes were launched in May 2015 (see Box 5.2 which provides the features of the schemes).

[5] International Labour Organization's (ILO) documented 60 community based insurance schemes or in-house insurance schemes in their report *India: An Inventory of Micro Insurance Schemes*, working paper number 2, Strategies and Tools against Social Exclusion and Poverty (STEP) Programme, 2005, Geneva, International Labour Office.

Box 5.2 Features of PMJJBY and PMSBY

	PMJJBY	PMSBY
Term	Life insurance scheme for 1 year, renewable year after year	Accidental insurance scheme for 1 year
Age and eligibility of insured	18–50 years (life cover up to age 55) and having a savings bank account. Account holders have to give their consent to join the scheme	18–70 years and having a savings bank account. Account holders have to give their consent to join the scheme
Life cover	₹200,000	₹200,000 for accidental death and permanent disability, and ₹100,000 lakh for permanent partial disability
Premium	₹330 per annum per member	₹12 per annum per member
Channels through which the scheme is offered	LIC and other Indian private life insurance companies that have tie-up with banks. Participating bank is the master policy holder	Public sector and other general insurance companies that tie up with banks. Participating bank is the master policy holder

Source: http://jansuraksha.gov.in/, accessed on September 19, 2017.

Table 5.8 Gross Enrolment under PMJJBY and PMSBY (Numbers in Millions)

	PMJJBY		PMSBY	
Gross Enrolment Reported by Banks Subject to Verification of Eligibility of Insured*	**As on March 31, 2016**	**As on March 30, 2017**	**As on March 31, 2016**	**As on March 30, 2017**
Rural male	9.14	9.47	29.61	31.67
Rural female	5.65	5.89	19.92	21,18
Urban male	9.42	10.01	28.10	29,39
Urban female	5.34	5.64	16.38	17.26
Total	29.55	31.02	94.02	99.50

Source: Reports as on March 31, 2016 and March 30, 2017, from http://jansuraksha.gov.in/, accessed on September 19, 2017.
*Shown on accumulation basis w.e.f. May 6, 2015.

It can be seen from Table 5.8 that the enrolment in PMSBY has far exceeded than that in PMJJBY. This could be attributed to the low annual premium under PMSBY, which appeals to the Indian customer who is price sensitive and unwilling to pay for something that may or may not yield future benefits. Also the coverage under both PMJJBY and PMSBY is less than one third of the number of the PMJDY accounts,[6] which indicates that a significant percentage of the PMJDY accounts are yet to enroll under the Jan Suraksha schemes.

Rashtriya Swasthya Bima Yojana[7]

Rashtriya Swasthya Bima Yojana (RSBY) (Box 5.3) is a health insurance scheme introduced by the government in 2008 for below poverty line (BPL) families and subsequently extended to cover defined categories of unorganized workers such as:

1. Building and construction workers registered with the welfare boards
2. Street vendors
3. Rickshaw, auto, and taxi drivers

[6] As on March 31, 2016, the number of beneficiaries under PMJDY is 36.66 crore. Data retrieved from https://pmjdy.gov.in/PMJDY_EKYC_Bank_Categorywise.aspx, accessed on September 19, 2017.

[7] Information and data given in this section has been accessed from http://www.rsby.gov.in/, accessed on September 19, 2017.

Box 5.3 Features of RSBY

	RSBY
Term	Health insurance scheme for 1 year, registration on an annual basis
Age and eligibility of insured	No age limit. Up to five members per family (head of the household, spouse and three dependents)
Coverage	Up to ₹30,000 for most diseases (including pre-existing ones) that require hospitalization
Premium	Beneficiaries have to pay an annual registration fee of ₹30. The premium (maximum of ₹750 per family per year) is paid to the insurer by the central and state governments as per their sharing ratio
Channels through which the scheme is offered	Insurance companies and empaneled hospitals

Table 5.9 Coverage under Government-sponsored Health Insurance Schemes Including RSBY

	2011–12	2012–13	2013–14	2014–15	2015–16
Premium (₹ billion)	22.25 (17%)	23.48 (15%)	20.82 (12%)	24.74 (12%)	24.25 (10%)
Number of persons covered (million)	161.2 (76%)	149.4 (72%)	155.3 (72%)	214.3 (74%)	273.3 (76%)

Source: IRDAI (2017b).
Note: Figures in brackets indicate the share in total health insurance business in that year.

4. Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) workers who have worked for more than 15 days during the previous FY
5. Beedi workers
6. Sanitation workers
7. Rag pickers
8. Domestic workers and others

As on March 31, 2017, 278 districts with an estimated BPL families of 59.1 million have been selected, out of which 36.3 million BPL families from 267 districts have been enrolled under RSBY. A total of 8,697 hospitals (of which 4,926 are private hospitals and 3,771 are public hospitals) from 278 districts have been empaneled.

State Health Insurance Schemes

In addition to the Central government-sponsored health insurance schemes, there are many state government-sponsored health insurance schemes for the poor and underprivileged. Some examples are "Chief Minister's Comprehensive Health Insurance Scheme" of Tamil Nadu, "Aarogyasri" of Telangana, Mukhyamantri Amrutum Vatsalya Yojana of Gujarat, and "Mukhyamantri Swasthya Bima Yojana" of Uttarakhand to name a few. Many of these schemes cater to the households who have not been covered under RSBY. However, most of the government-sponsored health insurance schemes only cover hospitalization costs and do not cover the outpatient care costs.

Table 5.9 shows that government-sponsored schemes account for nearly three-fourths of the number of persons covered under health insurance but only around one tenth of the total health insurance premium. Government-sponsored social security schemes such as RSBY where the entire premium is borne by the government are not considered under rural and social sector obligations of insurers.

CONCLUDING REMARKS

A significant progress has been made in bringing low-income households into the formal insurance sector fold. Microinsurance regulations and notifications issued by IRDAI from time to time have been forward looking and are likely to give an impetus to microinsurance in the coming years. The government's thrust on affordable insurance for the poor is also headed in the right direction. However, it can be expected that sustained progress and outreach can be made only if the clients perception and awareness of insurance changes. This calls for adequate training of microinsurance agents, bank mitras, and other channel partners who are the first point of contact for the customers. Technology also plays an important role in bringing down the cost of premium payment and claims settlement.

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6
Chapter

Digital Financial Inclusion[1]

INTRODUCTION: UNDERSTANDING THE DIGITAL INCLUSION SPACE

There is much happening on the fintech space and the digital financial inclusion. While we have discussed one part of the fintech initiative in the chapter on PBs (Chapter 13), there is much more innovation happening elsewhere. There has also been a great quest to understand the customers of digital and look at segmenting them to offer customized services.

During the year, Visa India released a 5-year outlook for accelerating digital payments in India (Visa 2016). The report was released a month before the demonetization exercise, and one wonders if the report would have something else to say post-demonetization as a desirable strategy. However, the report was interesting enough to make a compelling reading on the need for digitization of transactions. The report passionately argued about the cost of cash and how digitization helps in seamless transactions. It identified six factors that perpetuate the use of cash in India

- A high propensity to save in and use cash
- A large shadow- and remittance-based economy
- Gender imbalance in use of digital payments
- High cost of acceptance infrastructure
- Regulatory limitations
- Insufficient focus on financial literacy

The report suggested a three-pronged strategy to accelerate toward a "less-cash" economy:

- Expand acceptance
- Energize innovation, and
- Bolster financial participation

As we see later, the RBI has articulated its views in its own outlook for digital finance, and the strategy covers some of the issues. This would be discussed later in the chapter. The conceptualization of the conundrum between the customer adoption of digital finance and the acceptance infrastructure was brilliantly captured in the report. While the customer adoption would come from providing choices and from literacy, the acceptance penetration is an infrastructure issue and the state will have to make significant capital investments to ensure wide participation (Figure 6.1).

Many of the issues flagged in the report are being addressed in multiple ways. The setting up of PBs, the impetus given to the digital finance after demonetization and the focus on MDRs are all indications that the RBI and the government are serious about this issue. There are some tax breaks and

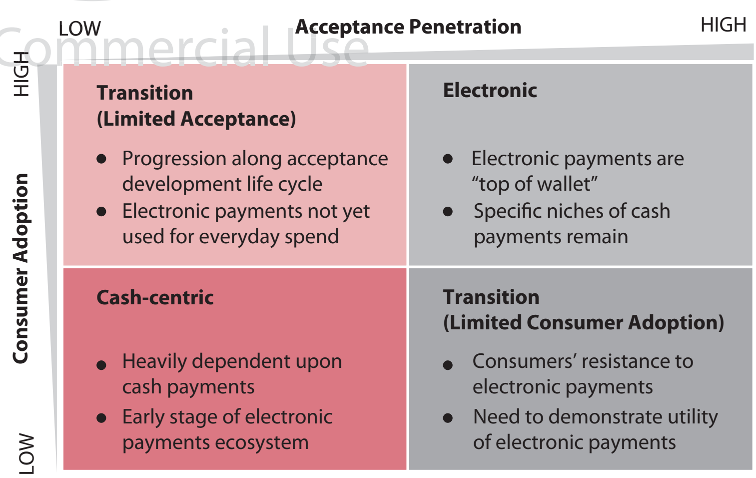


Figure 6.1 Readiness for Electronic Payments

Source: https://usa.visa.com/dam/VCOM/download/visa-everywhere/global-impact/perspectives-on-accelerating-global-payment-acceptance.pdf, accessed on September 11, 2017.

[1] The author is thankful to Shri Anand Raman of C-Gap and Varad Pande of Dalberg for interesting insights provided on the draft of this chapter, and Dilip Asbe for providing some insights about the data from NPCI.

fiscal incentives that the report proposes, which may make it complicated for the state to implement. In a way, this report was prescient in bringing the agenda of digital finance a whole month ahead of the demonetization exercise.

In an interesting study undertaken by Dalberg at the behest of Omidyar Network, there were two aspects that were notable: ten consumer insights and five consumer personas, which helped map the customer space. The details are provided in Box 6.1.

Box 6.1 Profile of Consumers of Digital Finance

Ten Consumer Insights

1. Smartphone aspiration is driving growth in market penetration. However, a sizable population will continue to be content with a basic feature phone.
2. People are highly frugal in their data use. They proactively seek out creative and cost-effective ways to access data.
3. The adoption of mobile apps is driven by data efficiency and social networks.
4. Greater access to digital finance for women requires developing a "safe space" that enables them to own and use mobile phones and data.
5. Digital financial services are viewed as overly complex.
6. Even financially savvy consumers are wary of accessing financial services on their phone and believe that formal financial services are not for them.
7. Some consumers may leapfrog directly to digital financial services based on convenience, relevance, and its alignment with socio-cultural norms.
8. Security and fraud concerns around digital financial services must be clearly addressed.
9. Financial service agents, particularly those visible and active within the community, are critical to inspire trust.
10. Trust must be earned and sustained through continuous reinforcement throughout the consumer journey.

Five Consumer Personas

1. Aspirants
   - Young adults seeking financial independence
   - Desire to own a smartphone
   - Eager to adopt the latest trends
   - Believe in technology to help them improve their lives
   - Find creative ways to save money or borrow smartphones
   - Highly influenced by friends and relatives in aspirational areas
   - Equally at ease with forming their own ideas
2. Collaborators
   - Share a strong drive to take care of their community
   - Rely on their community or trusted agents for guidance and advice
   - Participate in community-based savings and loans programs
   - Lack confidence with banks, believe that banks are not for them
   - Focus on day-to-day needs and saving for occasional basic expenditures
   - Resourceful with finding supplemental income
   - In constant need of credit, often borrowing from multiple sources
3. Conformists
   - Restrained by family and established socioeconomic norms
   - Highly controlled Internet usage by male family members
   - Avoid conflict and happy to follow the rules
   - Happy to explore when restrictions are eased
   - Save money secretly for future family needs
   - Have access to technology, but are hesitant to take advantage of it
   - Focus on their family rather than advancing their own lives or careers
4. Masters
   - Go-to experts in their community, helping to introduce new things
   - Outgoing, social, thrive on community status and being seen as a pioneer

- Ambitious, resourceful, often juggling multiple jobs to earn extra income
- Regularly experiment with new products, services, and technologies
- Some are entrepreneurial, starting new businesses or initiatives
- Appreciate technology that helps them connect and share
- Experts at finding deals, such as free Internet access

5. Pragmatists
   - Proactive and entrepreneurial in many areas of their lives
   - Clear personal and professional goals, continuously looking for ways to grow
   - Prioritize ease, convenience, efficiency, and cost in decision-making
   - Carefully weigh any advice against their own priorities
   - Willing to experiment, but reluctant to commit when they experience challenges
   - Look for cost savings and incentives

Source: Omidyar Network (n.d.).

ECOSYSTEM

The government also set up a committee on digital payments with Ratan Watal as the chair. The committee submitted its report in December 2016, as the remonetisation process was on. It started the report with this statement "Digital payments is to finance what invention of wheel was to transport," a fairly adventurous statement to make. It recognized the fact that the demonetization exercise had pushed the country more toward digitization and it recognized the problems in the process of accelerated digitization of the economy. Unlike the Visa report, the Watal committee report looked at the regulatory angle as well. The committee had 13 major recommendations that are captured in Box 6.2.

Box 6.2 Recommendations of the Committee on Digital Payments

R-1: Make regulation of payments independent from the function of central banking. The committee weighed two options on how best this be implemented: (a) create a new payments regulator or (b) make the current Board for Regulation and Supervision of Payment and Settlement Systems (BPSS) within the RBI more independent. While both the options would serve the intended objective, the committee recommends that the BPSS be given an independent status that it lacks today by being a sub-committee of the central board of the RBI. The statutory status of the new board, within the overall structure of the RBI, called the Payments Regulatory Board (PRB), should be enshrined in the Payments and Settlement Systems Act, 2007. Implementation by MoF: Finalization of the structure of PRB may be done in 30 days.

R-2: Update the current Payments and Settlement Systems Act, 2007, to include explicit mandates for (a) competition and innovation, (b) open access and interoperability, (c) consumer protection including penalties and independent appeal mechanism, (d) regulations on systemic risks, (e) data protection and security, and (f) a process of regulatory governance. The committee has provided drafting instructions for the new Payments and Settlement Systems Act, and this may be initiated at the earliest. Implementation by MoF: Finalization of amendment bill and placing the same before the Union Cabinet may be done in 30 days.

R-3: Promote digital payments and receipts within the government by (a) adopting digital payments for all its needs, (b) withdrawing all charges levied by government department and utilities on digital payments and bearing the cost of such transactions, (c) mandating government departments and agencies to provide options to consumers to pay digitally, (d) incentivizing consumers to make payments (including payment of fines and penalties) to the government electronically by giving a discount or cash back, (e) enabling consumers to make payments (including taxes) to the government through suitable digital means such as cards and wallets, (f) placing special emphasis to promote digital payments for recurring low value transactions, and (g) reducing custom duties on payments acceptance equipment. Implementation agencies listed in recommendation section. Steps may be initiated in 30 days and reviewed fortnightly.

R-4: Create a fund proposed as DIPAYAN from savings generated from cashless transactions to expand digital payments. Build audit capability to measure savings. Implementation by MoF, Ministry of Social Justice, Ministry of Tribal Affairs, and Ministry of Development of North-eastern Region. A time period of 60 days may be considered for initiating implementation by user agencies.

R-5: Create a ranking and reward framework to encourage and recognize government departments, state governments, districts and panchayats and other market participants who lead the reports on enabling digital payments. Implementation by NITI Aayog along with state governments. Development of the framework maybe achieved in 60–90 days.

R-6: Implement other measures to promote digital payments including (a) promoting Aadaar-based electronic KYC (eKYC) and paperless authentication (including where permanent account number [PAN] has not been obtained), (b) providing disincentives for usage of cash, and (c) creating awareness and transparency on cost of cash. Implementation by MoF, Unique Identification Authority of India, CBDT, Telecom Regulatory Authority of India (TRAI), Ministry of HRD, DoPT, and the RBI. May be initiated over 60–90 days.

The RBI may, within the existing regulatory framework of Payments and Settlement Act, 2007, immediately initiate steps to:

R-7: Consider outsourcing the function of operation of payment systems such as Real Time Gross Settlement (RTGS) and National Electronic Fund Transfer (NEFT). While moving RTGS to a separate operator is not envisaged, for now, a cost-benefit analysis may be initiated as an initial step. Overtime, multiple payment system operators should be encouraged and payment systems should be operated by market entities. Consultation paper may be released over 180 days.

R-8: Upgrade payment systems such as RTGS and NEFT to operate on 24×7 basis in due course of time. The RBI should progressively increase their timings over due course. A consultation paper may be released over 90 days.

R-9: Allow nonbank PSPs to directly access payment systems. Regulations may be released for consultation over 60 days.

R-10: Require NPCI, to be payments centric in its ownership and objectives. Ownership of NPCI should be diversified widely to include more banks and to include nonbanks. Its board should be represented by majority public interest directors and should include shareholder-directors. NPCI should be allowed to function independently. Regulations may be released for consultation over 60 days.

R-11: Enable payments to be interoperable between banks and nonbanks as well as within nonbanks. Mobile number and Aadhaar-based fully interoperable payments should be prioritized. NPCI may enable this on its platforms over 60 days.

R-12: Create a formal mechanism to enable innovations and new business models. Consultation paper may be released over 90–120 days.

R-13: Implement other measures to promote digital payments including issuing regulations on systemically important payment systems (SIPSs) and systemically important financial institutions (SIFIs), a growing acceptance network, enabling faster and cheaper credit, and promoting cross border payments. Regulations may be released for consultation over 60–180 days. The RBI may within two weeks of releasing this report, and developing a comprehensive metric to quantitatively measure and monitor the enhancement of digital payment services in India.

Source: Committee on Digital Payments (Chairman: Ratan P. Watal, December 2016). Ministry of Finance, Government of India.

Digital financial inclusion has occupied an important space in the discourse on financial inclusion. It acquired a greater importance after the demonetization exercise of the union government, where one of the end objectives was later stated as digitization.

There is a caveat that we need to observe when we talk about digital financial inclusion. Unlike the other chapters, where much statistics is available on the size of the transactions, in case of digital finance, we are not sure that these transactions pertain to the financially excluded. Even small ticket sizes could not be a good proxy because it is quite possible that the included might be doing small ticket digital transactions. For instance, using a mobile wallet like Paytm for paying an Uber ride does not necessarily mean that the person undertaking the transaction is a new inclusion into the financial system; he or she is only an inclusion into the digital space.

Major initiatives taken during the year to encourage digitization are:

1. NPCI introduced Unstructured Supplementary Service Data (USSD) 2.0 (*99#) version that was a unified payments interface (UPI). It provides a better customer experience for funds transfers even on a feature phone.
2. The RBI issued an in principle approval to NPCI to launch a pilot on BHIM-Aadhaar Pay. BHIM-Aadhaar Pay is a smartphone-based application with a dongle attached to it for the capture of customer's biometric data. The customer will authenticate the payment transaction by providing biometric identification on the merchant device. These transactions are processed as part of the existing AEPS with a separate transaction type assigned to them.
3. The Department of Post (DoP) was granted approval for enabling two-way interoperability of ATMs installed by it, with ATMs connected to the national financial switch being subject to certain conditions such as setting up of a separate vertical within the DoP for handling this work, with subsequent transfer of infrastructure to the India Post Payments Bank (IPPB), and adherence to regulatory instructions of the bank.
4. Bharat QR Code launched in February 2017 (RBI 2017).

In the last report, we had covered the UPI. There was a new app launched by the NPCI called the Bharat BHIM that helped direct payment into any account without the need for the detailed Indian Financial System Code (IFSC) and other registration requirements. This was a simple interface that made peer-to-peer transactions simple, cashless, and without the need for additional props like the card and that needed the account holder to remember only one PIN. The app could attach any source account of the same person to the mobile number registered with their bank. BHIM was a further extension of UPI with more features added (Figure 6.2).

From the BHIM app, the payer can make instant bank-to-bank payments and pay and collect money using just a mobile number or virtual payment address (VPA), and these could be in the form of an account number, IFSC code, Aadhaar number, or a QR code. The app also supported eight regional languages (Tamil, Telugu, Bengali, Malayalam, Oriya, Gujarati, Kannada, and Hindi).

Figure 6.2 NPCI's 5 Step-by-Step Process for Registering on BHIM

Source: NPCI.

From the statistics, it can be seen that while UPI was growing at a certain pace, after the demonetization exercise, where the push toward digital transactions happened, both the number of transactions and the volume picked pace and the movement, though small compared to other digital forms of transactions, has moved significantly upward and has not contracted even after the economy is moving toward full remonetisation levels. However, given that both UPI and BHIM operate on smartphones, it would be difficult to say that most of these transactions relate to the poor (Table 6.1). A study by MicroSave has identified the issues with the roll-out of BHIM app, even though the payment system and the accompanying devices are "good." The study reportedly[2] found multiple problems in the acceptance of the concept. The following were the problems identified:

1. The merchants were not adequately briefed or were unsuitable to carry out transactions
2. Inadequate grievance redressal mechanisms
3. Inadequate access to complete transaction data for the merchant establishments
4. Limited visibility and lack of awareness and
5. The complexity in setting up the account, remembering the PIN, and the language interface.

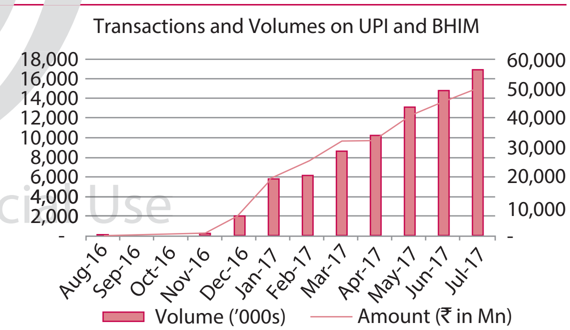
A study conducted by Dalberg also indicated that the onboarding process was perceived to be complicated, and that there were inadequate incentives to use the application, the call charges on mobile phones and the inability to schedule payments (as against the facility available in net banking). Clearly the simplicity of use and the removal of the "fear of unknown" need to be addressed on an urgent basis to ensure that this important application takes off.

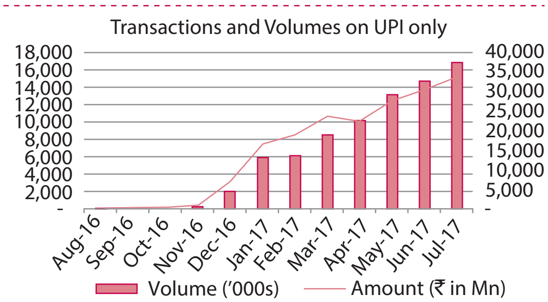
While the earlier mentioned service is available on a smartphone, there is a stripped-down service of USSD that the NPCI is offering that can be used on a feature phone without an Internet connection. However, the transactions on USSD remained at around a tenth of the UPI/BHIM transactions. While relative to the pre-November transactions, it picked up; by July 2017, it was doing less than 200,000 transactions with volumes of about ₹300 million.

During this, time wallet providers such as Paytm and Mobikwik were quick to expand their reach to ensure that cashless payments happen ubiquitously. Paytm received and started operating as a PB recently, and we shall be discussing this new avatar in Chapter 13.

Table 6.1 Growth of Transactions on UPI and BHIM (after Launch in December 2016)

Month	No. of Banks Live on UPI+BHIM	Volume in ('000s)	Amount (₹ in Mn)
Aug-16	21	93	31
Sep-16	25	85	326
Oct-16	26	103	486
Nov-16	30	285	1,005
Dec-16	31	2,010	7,080
Jan-17	35	5,870	20,153
Feb-17	44	6,126	25,252
Mar-17	44	8,621	32,145
Apr-17	44	10,192	32,429
May-17	44	13,143	40,722
Jun-17	49	14,772	45,538
July-17	52	16,877	49,813





Source: Data from NPCI. http://www.npci.org.in/UPI-Analytics.aspx and http://www.npci.org.in/BHIM-Analytics.aspx, accessed on August 19, 2017.

[2] See https://thewire.in/177642/narendra-modi-digital-india-aadhaar-bhim-app/, accessed on September 16, 2017.

TECHNOLOGY-ENABLED TOUCHPOINTS

A look at the numbers on how the technology-enabled transactions are growing gives an idea of the geometric growth that this segment is going to have. While the BHIM and UPI numbers are picking up, in terms of magnitude, the transactions at ATMs and the PoS devices show that they are the most commonly accessed touchpoints. Given the skew of the spread of ATMs and PoS devices toward urban areas, the limited number of ATMs rolled out by the RRBs and the rural cooperative bank network, this data should be seen more as the data on evolution of digital finance rather than digital financial inclusion. However, with more ubiquitous use of the digital financial infrastructure, there is an investment made by the banking structure in the overall infrastructure that will spill over and provide access to the poor and the excluded as well.

Over the years, there has been a continuous increase in the number of ATMs and PoS touchpoints. If we look at the data in Table 6.2, we see almost doubling of PoS devices in 2017, possible post-demonetization, and the growth seems to be continuing beyond March. The growth of ATMs, however, has plateaued. The same trend is seen when we look at the credit card transactions. The number of credit card issuance has grown according to a trendline, the transactions at ATMs have remained range bound but the transactions both in terms of volumes and amounts have grown substantially.

Even debit cards issued and transactions at PoS has substantially gone up in 2016–17. However, the transactions at ATMs have fallen. This is not surprising, given that in the post-demonetization phase, it took time for the ATMs to be operational

Table 6.2 Data on Technology-enabled Touchpoints and Transactions over the Years

Detail	2013	2014	2015	2016	2017	Growth	June 2017
Infrastructure in ('000s)							
Onsite ATMs	56	83	89	102	110	97%	110
Offsite ATMs	58	77	92	97	99	69%	98
Online PoS	841	1,050	1,126	1,385	2,526	200%	2,777
Total touchpoints	968	1,226	1,308	1,585	2,737	183%	2,985
Credit cards (Nos. in million)							
Outstanding Credit Cards	19.54	19.18	21.11	24.51	29.84	53%	31.48
Transactions at ATMs	0.23	0.30	0.44	0.61	0.49	117%	0.55
Transactions at PoS	35.62	46.11	56.91	72.22	107.61	202%	109.47
Amounts ₹billion at ATM	1.49	1.66	2.34	2.80	2.29	53%	2.67
Amounts ₹billion at PoS	111.22	145.49	178.99	226.94	333.90	200%	354.83
Debit Cards (Nos. in million)							
Outstanding Debit Cards	331.20	394.42	553.45	661.82	854.87	158%	793.83
Transactions at ATMs	482.00	571.50	624.21	731.72	710.11	47%	660.91
Transactions at PoS	45.38	56.98	76.11	112.87	271.17	498%	254.66
Amounts ₹billion at ATM	1,556.41	1,796.10	1,987.48	2,245.82	2,259.46	45%	2,220.86
Amounts ₹billion at PoS	66.87	85.77	108.28	134.63	356.99	434%	375.24
Number of ATM txs per card	1.46	1.45	1.13	1.11	0.83		0.83
Number of PoS Txs per card	0.14	0.14	0.14	0.17	0.32		0.32

Sources: ATM/POS/Card Statistics at https://rbi.org.in/scripts/ATMView.aspx?atmid=61, accessed on August 20, 2017. The ATM statistics are available at the NPCI website at http://www.npci.org.in/nfsatm.aspx, accessed on August 20, 2017.

Notes:

1. The numbers pertain to the ATMs of 56 SCBs in the following ownership categories: foreign banks, public sector banks (including IDBI Bank), and old and new private sector banks. However, some foreign banks, RRBs, and all the cooperative banks (both rural and urban) were left out. Totally there were 237,359 ATMs as of August 2017.
2. Of these 1,038 ATMs belonged to RRBs, 4,504 ATMs were with UCBs and district cooperative central banks (DCCBs), and 14,451 were white label ATMs, independent, stand-alone entities providing just the ATM service to the banking sector. The number of ATMs owned by RRBs and cooperative banks are discussed in the respective chapters.

with sufficient cash, and with the dramatic rise in the PoS devices, it was natural that the people may have been forced to shift to a cashless mode. However, the surprising statistic comes from the numbers on debit cards. While the number of outstanding debit cards grew rapidly till March 2017, between March 2017 and June 2017, the number of cards has actually shrunk. This might be on account of a mistake in updating the data of the State Bank group. During the year, the associate banks merged with SBI and the June statistics on debit cards does not seem to have accounted for it accordingly. This looks like a plausible argument because the data shows that the number of transactions at ATMs fell further, while the amounts were somewhat intact, which may be due to nonavailability of cash and, therefore, higher amounts of withdrawal when cash was available. But it also shows that the number of transactions on the PoS devices also fell, while registering a higher value of transaction amount. It means that the active users of debit cards were using it for higher amounts. This is an interesting post-demonetization trend that needs to be unravelled and understood.

The statistics indicate that the number of debit cards outnumbered the credit cards by 25 times, and while credit cards were used more at the PoS, the debit cards were used more in the ATMs. But in spite of the outstanding debit cards far outnumbering the credit cards, the absolute amount of transactions with the PoS points has always been favoring credit cards. This was the first year where the debit card transactions not only grew steeply, but the amount transacted surpassed the transactions of credit cards and continues to grow. Going forward, we may have to celebrate the growth of PoS transactions at the cost of cash withdrawal at ATMs. As of now, the sharp rise in the debit card usage does not indicate that the larger outstanding cards have resulted in greater usage of ATMs. However, the sharp rise in debit card at PoS usage could be a sign that new users have adopted debit card payments, given that the average number of transactions on debit card is showing a sharp rise, even on a larger base. Debit cards are inching to one billion outstanding, which certainly bodes well for financial inclusion. However, it is important to understand the dormancy rates.[3]

One of the impediments in digital transactions could be the merchant discount rates that discourages the commercial establishment from accepting digital modes of payments. This is against cash, which is to be treated as a public good and the cost of printing cash and its logistics is borne by the RBI. With a view to encouraging a wider segment of merchants to accept card payments RBI proposed a turnover-based Merchant Discount Rate (MDR) structure for debit card transactions in place of the existing slab-rate MDR based on transaction value. This change is still under consideration and the circular would be issued after receiving feedback (RBI 2017).

However, there are some interesting and contradictory opinions about how the landscape for ATMs is panning out. We can see from the data that the number of debit card transactions of ATMs has fallen to the levels in 2015. While an article in Economic Times[4] argues that it is because of greater amount of digitization the need to withdraw cash from ATMs is going down. The number of new ATMs has plateaued, and only three of the eight white label ATM operators have put a substantial number of machines. We can also see a concurrent jump in the number of PoS machines deployed as well as a significant spike in the PoS transactions that justifies that transactions are moving the digital way. The interbank charges for transactions Off-Us are a factor to be considered from the perspective of a bank.

During the year RBI encouraged NPCI to launch the Bharat Quick Response (QR) Code. This works as a contact-free alternate channel of payment, where many of the details are embedded in the code and neither the payer not the payee need to remember their account numbers and other details. This code could be stored on the mobile app of the customer and can be scanned at the merchant establishment. Both the payer and the payee receive a notification when the transaction is completed. This reduces the need for investing in a PoS device—in cases like Paytm the merchant does not need a PoS device at all to transact. A paper printout in a plastic sleeve is now widely visible at least in small stores in metros and tier 1 towns. Bharat QR code was launched in February 2017.

At the same time, some more data analysis by scholars from the Centre for Global Development indicated that while people had heavily moved into digital mode of transactions soon after demonetization, they are back to cash economy and trace that the ATM transactions rose back after a sharp dip during the demonetization phase. While there is a

[3] Private communication with Anand Raman in 2017.

[4] http://economictimes.indiatimes.com/industry/banking/finance/banking/why-atms-once-a-symbol-of-liberalised-economy-are-fast-losing-importance/articleshow/60077922.cms, accessed on August 18, 2017.

shift in favor of digital transactions, they argue that the move toward digitization is happening at a pace that he customers are choosing, which is in keeping with the past trendlines and the demonetization has not resulted in a permanent shift of people toward digitization. The paper argues that

> There are several reasons for this: 1) digital transactions have explicit overhead costs; 2) a neighborhood grocery store in India would most likely charge extra for the same product if it is paid by any noncash instrument; 3) India also still has a dominant informal sector; and 4) reliance on cash is inevitable for economic activities to remain outside the tax net. (Mukherjee and Wadhwa 2017)

Similarly, in an article that looks at the effects of demonetization, it is argued that a reason for the dip in the ATM transactions is not so much digitization but because of the nonavailability of adequate cash in the tellers. The article further argues that the linking of accounts with Aadhaar—the unique identity number is also creating problems and preventing people from adequately accessing their own resources (Anant 2017).

GLOBAL EVENTS

Globally, the push for digital financial inclusion continued. Taking off from the G20 meet in 2016 where eight high level principles of digital financial inclusion were enunciated, this was a year to see some of these global principles converted into policy and rolled out in some countries. In a review of the implementation of the eight high level principles, the first four were examined in great detail (see Box 6.3). This high-level attention can be said to be the most important highlight of the year in digital financial inclusion.

Box 6.3 Digital Financial Inclusion: Emerging Policy Approaches

Executive Summary

Digital financial services, together with effective oversight and supervision, can expand the scale, scope and reach of financial services, and are essential to closing the remaining gaps in financial inclusion. Digital technologies also offer affordable and convenient ways for individuals, households and businesses to save, make payments, access credit, and obtain insurance. In 2016, the G20's Global Partnership for Financial Inclusion published *High Level Principles for Digital Financial Inclusion* (HLPs)[5] that aimed to catalyze government actions to drive financial inclusion through a focus on digital technologies. This report outlines examples of how countries are implementing measures in line with the HLPs, with the first four over-arching HLPs providing the report structure.

High Level Principle 1 calls for promoting digital financial services as a priority to drive development of inclusive financial systems, including through coordinated national strategies and action plans. It emphasizes the need for policy leadership and coordination across the public and private sectors as critical for expanding financial inclusion, and stresses the importance of leading by example in the push for digital solutions. The report discusses the wide-ranging, multi-faceted approaches taken by India, China, and other countries, to expand digital financial inclusion in their countries. In particular, India has made extensive efforts to expand its digital infrastructure to expand access to financial services, including through the UIDAI scheme and the Digital India program. China strongly encouraged the growth of nonbank payment players early on, particularly for the burgeoning ecommerce sector, and has made clear that it believes that digital finance can have a positive impact on traditional finance. Another common approach taken by these and many other governments to promote digital financial inclusion is digitizing G2P payments, as illustrated by the experiences in Brazil, Turkey, and an increasing number of other countries.

High Level Principle 2 highlights that, while innovation in financial services is essential for expanding financial inclusion, it also introduces new risks—both individual and systemic—that need to be identified and effectively addressed in a timely fashion. Policymakers are addressing the innovation/risk balance through actions such as: expanded learning and information sharing between regulators and the private sector, including through "test and learn" piloting processes for introducing innovative services; new modes of engagement with industry and consumers, and efforts to better understand consumer experience around new digital distribution channels. The report outlines examples of test-and-learn approaches from the UK, the US and Kenya, as well as how insurance regulators are

[5] https://www.gpfi.org/publications/g20-high-level-principles-digital-financial-inclusion

assessing new distribution channels such as mobile phones.

High Level Principle 3 notes that for digital financial services to flourish, there needs to be a legal and regulatory framework that is predictable, risk-based and fair; that allows for new entrants and is technology-neutral; and that does not impose excessive, non-risk-based compliance costs. Policymakers and regulators also need to ensure that the framework can be effectively and efficiently supervised with the requisite supervisory capacity and resources. Two key themes emerge: one is the increasing use of risk-based regulation and supervision, including a risk-based approach to customer due diligence (CDD) for the purposes of anti-money laundering and countering terrorist financing (AML/CFT). The other is a growing recognition that reporting and monitoring systems need to become more sophisticated, with a greater focus on direct linkages to financial institutions' information systems along with real time monitoring capabilities and appropriate privacy and data protection. We discuss examples of tiered regulation and CDD regimes from China, Mexico, and Tanzania, along with automated data reporting systems that are emerging out of Austria and Rwanda.

High Level Principle 4 emphasizes the need for policymakers and industry to work together to achieve a robust, open and efficient digital infrastructure, including a widely accessible retail payments system and information and communication technology (ICT) infrastructure. Areas of particular focus for national authorities include retail and online payments infrastructure that involve interoperable platforms linked to a wide range of PoS, ATM and agent networks, bill payment platforms, credit reference systems, digital asset registries (particularly for movable assets) and, in some cases, the underlying communications infrastructure needed to support all these systems. The report highlights differing interoperability approaches taken in Peru and Tanzania, along with examples of credit reference systems in China and Mexico. The report also explores efforts by stakeholders in Kenya to expand merchant acceptance of digital payments instruments. Some regulators are also exploring the potential benefits, costs, and risks of issuing digital fiat currencies that could be used in a digital financial services ecosystem.

As is evident in the cases set out in this report, the increasing pace and complexity of innovation and adoption of digital technologies in the financial sector means that policy and regulatory approaches must also evolve and be tailored to country contexts. While no two countries are identical in their approach or their particular market context, there are a number of insights that can be gleaned from the examples highlighted in this report. These include:

- Proactive leadership and political will are cross-cutting success factors, including through integration and coordination across national authorities to address the range of issues relevant to harnessing digital technology.
- More progress on digital tools is needed, to help regulators do their job. As digital innovation is redefining what it is to be a service provider, financial regulators are having to take a more proactive, data-driven approach to engagement with the industry. Supervising digital financial service providers in an era of ever-increasing volumes of transactions (and increased use of fast or real-time payment transactions) calls for more sophisticated and automated systems that can provide real-time monitoring and analysis.
- Promoting interoperable, open technology platforms for digital financial services helps establish a broad-based ecosystem for private and Government entities to better reach consumers and ultimately improve their financial lives. The means and timing of achieving interoperability can vary, but policymakers should make clear that it is an expectation.
- Digital identity forms an important foundation of public digital infrastructure and opens the door for access to services across the economy—including beyond financial services. National governments need to prioritize availability of robust and easily verifiable digital ID, whether biometric or other types of data-based forms, which can be used to facilitate access to digital financial services. There are valid concerns about privacy and civil liberties to be addressed, and emerging examples of effective ways to oversee issues such as data security, quality of service and network reliability.

Source: Digital Financial Inclusion: Emerging Policy Approaches. Sourced from Global Partnership for Financial Inclusion. http://www.gpfi.org/sites/default/files/documents/G20%20High%20Level%20Principles%20for%20Digital%20Financial%20Inclusion%20-%20Full%20version-.pdf, accessed on September 17, 2016.

ECOSYSTEM FOR DIGITAL BANKING

The ecosystem for digital banking has taken off in good earnest. While as we said earlier digital banking does not necessarily translate into digital financial inclusion, it is still necessary to track the ecosystem because that is the architecture that would ease the cause of digital financial inclusion. The demonetization exercise during the year brought in a sense of urgency to this cause with various digital platforms being used to remonetize the economy on a cashless basis. However, we have to recognize that the basic work for digitization was an ongoing process starting with computerization of banks. With the setting up of NPCI and its initiatives there has been a great fillip to the digitization process. Aadhaar has added another layer that makes authentication of the identity possible, and through interlinkages helps in data-based decision making. Notwithstanding of the Supreme Court judgment on the privacy, it appears that Aadhaar would be a significant centerpiece in the digitization process, hopefully with adequate safeguards on privacy and consumer protection (Figure 6.3).

During the year the RBI articulated its vision for digitization for the year 2018. This vision has four strategic pillars: Responsive regulation; robust infrastructure; effective supervision and customer centricity. While the annual report articulated the given pillars (RBI 2017), the Governor emphasized the role of RBI in consumer protection (see Box 6.4).

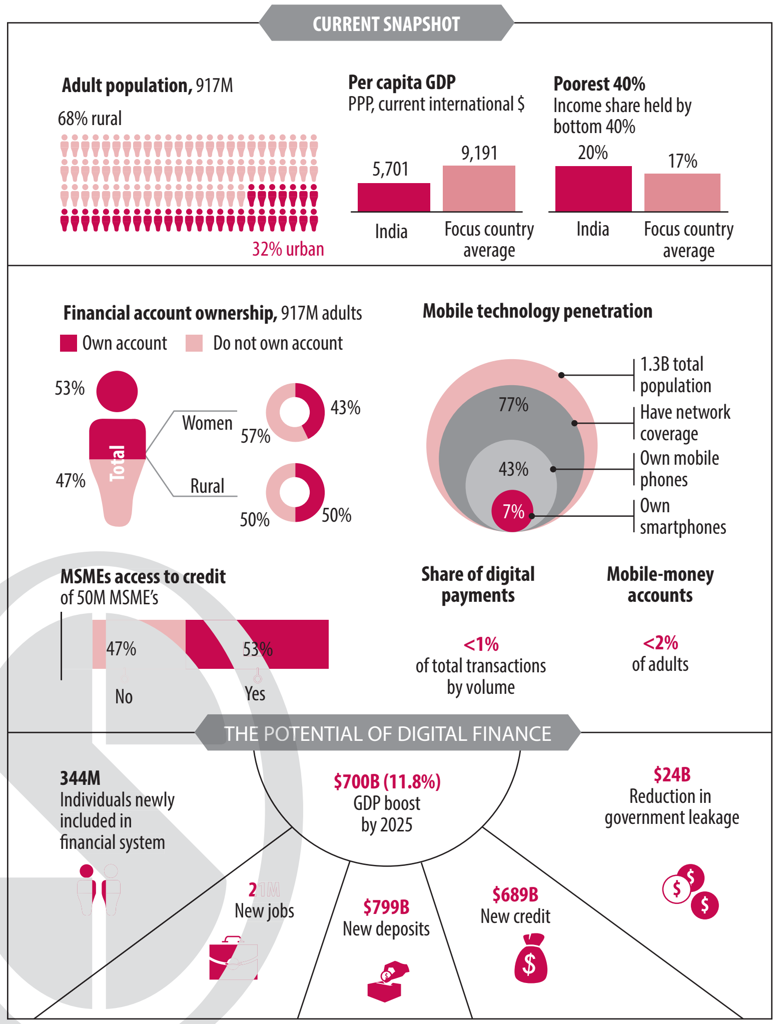


Figure 6.3 Digital Finance: A Snapshot

Source: Digital Finance for All: Powering Inclusive Growth in Emerging Economies (September 2016). McKinsey Global Institute.

Note: 2014 or latest available data for all statistics except GDP boost.

RESPONSIVE REGULATION

As the digital finance platform is picking up, there is growing interest in fintech firms to operate in this space. There have also been requests by the players to comprehensively review the regulations to ensure that the technology is leveraged to the best. As a part of the responsive regulation pillar, the RBI placed the draft master directions on Prepaid Instruments (PPIs) and how they could operate. The draft guidelines also envisage an interoperable environment of PPIs. This contained the definitions of different types of PPIs and the activities that could be undertaken. The RBI has to balance between the requirements of PMLA and identity while opening the space for easy transactions and the master directions do a good job of balancing inclusion, innovation and regulation.[6]

Box 6.4 Dr Urjit Patel on Digital Financial Inclusion

MSS: In the recent past there has been much concern about data privacy—particularly about the data of the poor that may be used for predatory lending practices, like the payday lenders. Is there something proactive that the RBI would do to protect the algorithm-based lending to the vulnerable sections of the society?

UP: Every objective of inclusion or accessibility should be number three. The first two objectives of the RBI in this area are safety and security of the customers. These things cannot be rushed. If

[6] See https://rbidocs.rbi.org.in/rdocs/Content/PDFs/53MD01C4EE0F66D24BCD8D9074B0BC2B9E7F.PDF, accessed on September 6, 2017.

there is a loss of data, it is not only a business risk, but also a reputational risk.

When you are looking at safety, security and data integrity, the first thing you should look at is how your data will be attacked. One needs to be prepared to prevent an attack, but to pretend that the data will never be attacked or hacked is being somewhat naïve. Data will be stolen; vulnerabilities cannot be taken care of completely. Therefore, firewalling and preventing the attack is one part of it, but an equally important strategy should be about how quickly you can bounce back and recover. One needs to be mature and resilient.

MSS: With the push to digital, we are moving from cash as a public good to cash management through the private fee-based providers. How do you think it will impact the agenda of inclusion and the poor?

UP: The government may consider compensating banks for the transaction costs at an appropriate level. On the other hand, if electronic transactions already had a transaction fee, and people were already paying the fee, the market was being created; then offering services completely free is not a good idea. Anything that is free is usually not valued (as, I believe, Gandhiji had implied), and the provider of that service will not have an incentive to invest, expand and innovate.

Source: Sriram (2018).

The RBI is also planning to review the guidelines for white label operators, facilitating the use of dynamic currency conversion for international cards and also permitting cash sourcing from multiple retail outlets than exclusively from sponsor banks. Similarly, RBI is also reviewing the permission for banks to undertake mobile banking provided the minimum security standards are undertaken (RBI 2017).

ROBUST INFRASTRUCTURE

NPCI launched the Bharat Bill Payments System. This system as an integrated platform for connecting the billers and banks and nonbanks on a platform to facilitate bill payments through any channel digital and physical through an interoperable system. The platform has 70 entities, both banks and nonbanks that operate as Bharat Bill Payment Operating Units. Currently 37 billers are operating on this platform and they cover bills pertaining to electricity, gas, telecom, DTH and water.

Also in the ecosystem, though not directly related to financial inclusion was the Trade Receivables Discounting System (TReDS) that was a platform for financial trade receivables of MSMEs. Three entities were permitted to set up and operate TReDS during the year.

EFFECTIVE SUPERVISION

Under the agenda for the next year, RBI is looking at the framework for oversight of both retail and large value payment systems with a focus on offsite surveillance, regular self-assessment and need-based inspection of retail payments. The framework would draw from the principle that the intensity of oversight should be proportionate to the systemic risks or systemwide risks posed by a payment system or operator or participant (RBI 2017). The RBI also changed the frequency of NEFT settlements from an hourly interval to half hourly interval, thus, increasing the number of settlements in a day from 12 to 23. This is recognition of the fact that the number of transactions are significantly increasing on the system.[7]

CUSTOMER CENTRICITY

The RBI is working on a mechanism to harmonize all the mechanisms for ensuring the uniformity in processes of consumer grievances with a specific timeframe for resolution. The RBI is also working toward initiating measures to ensure that the Payment System Operators (Table 6.3) clearly disclose the fees and terms and conditions of their services to the customers (RBI 2017).

PHYSICAL INFRASTRUCTURE AND ECOSYSTEM

While RBI provides the policy architecture, there are many more elements that need to be on the ground for people to switch to digital modes of transactions. MicroSave based on a survey has listed the following aspects that are necessary for an ecosystem to be ready to go deeply digital.

[7] https://rbi.org.in/scripts/NotificationUser.aspx?Id=10958&Mode=0, accessed on September 16, 2017.

Table 6.3 Payment System Indicators

Item	Volume (Million)			Value (₹ Billion)		
	2014–15	2015–16	2016–17	2014–15	2015–16	2016–17
Systematically important financial market infrastructures (SIMF)						
1. RTGS	92.8	98.3	107.8	754	825	982
Total financial markets clearing	3.0	3.1	3.7	752	807	1,056
2. CBLO	0.2	0.2	0.2	168	178	230
3. Government securities clearing	1.1	1	1.5	259	270	404
4. Forex clearing	1.7	1.9	1.9	325	359	422
Total SIMFIs	**95.8**	**101.4**	**111.5**	**1,506**	**1,632**	**2,038**
Retail payments						
Total paper clearings	**1,196.5**	**1,096.4**	**1,206.7**	**85**	**82**	**81**
5. CTS	964.9	958.4	1,111.9	67	70	74
6. MICR clearing	22.4	0.0	0.0	2	0	0
7. Non-MICR clearing	209.2	138.0	94.8	17	12	7
Total retail electronic clearing	**1,687.4**	**3,141.5**	**4,205**	**65**	**91**	**132**
8. ECS DR	226	224.8	8.8	2	2	0
9. ECS CR	115.3	39	10.1	2	1	0
10. NEFT	927.5	1,252.9	1,662.1	60	83	120
11. Immediate payment service (IMPS)	78.4	220.8	506.7	1	2	4
12. National Automated Clearing House (NACH)	304.2	1,404.1	2,057.3	1	4	8
Total card payments	**1,737.7**	**2,707.3**	**5,450.1**	**3**	**4**	**7**
13. Credit cards	615.1	785.7	1,087.1	2	2	3
14. Debit cards	808.1	1,173.6	2,399.3	1	2	3
15. Prepaid Credit Instruments (PPIs)	314.5	748	1,963.7	0.213	0.488	0.838
Total retail payments	**4,621.6**	**6,945.2**	**10,861.7**	**154**	**178**	**221**
Grand total	**4,717.4**	**7,046.6**	**10,973.2**	**1,660**	**1,810**	**2,259**

Source: Annual Report, RBI 2016.

Notes:

1. RTGS system includes customer and interbank transactions only.
2. Settlement of collateralized borrowing and lending obligation (CBLO), government securities clearing and forex transactions are through Clearing Corporation of India Ltd (CCIL). Government securities include outright trades and both legs of repo transactions.
3. Consequent to total cheque volume migrating to the cheque truncation system (CTS), there is no magnetic ink character recognition (MICR) or cheque processing center (CPC) location in the country as of now.
4. The figures for cards at transactions at PoS terminals only.
5. The National Automated Clearing House (NACH) was started by NPCI on December 29, 2012 to facilitate, interbank, high volume, electronic transactions that are repetitive and periodic in nature.
6. Figures in the columns might not add up to the total, due to rounding of numbers.

Prerequisites for customers • Bank account • Aadhaar seeding • Mobile phone • Mobile number seeding • Debit card • Mobile banking application • SMS banking • USSD • BHIM • Net banking facility	Build up activities • Mass enrolment camps • Financial awareness drives • On the spot demonstrations • Local product champion • Training the trainers • Mobile van campaign • Local mass media platforms • Marketing collaterals	Basic infrastructure • Voice connectivity • Data connectivity • Power supply • ATM Prerequisites for Bank BCs • AEPS-enabled micro-ATM • Operational training Prerequisite for merchants • Current account • mPos/PoS machine • Operational training

Source: MicroSave India Focus note # 143, http://www.microsave.net/files/pdf/IFN143_Learnings_from_Transforming_Villages_into_Less_cash_Villages.pdf, accessed on September 10, 2017.

Later in this chapter we examine in detail most of the physical infrastructure available and ready to assess how deep the penetration of digital inclusion could be. The framework was used by MicroSave in association with NPCI to completely digitize a village Karanmangal.[8] As the experience shows, there are several moving parts that need to be put in place before significant amounts of digitization can take place and it is a long journey ahead.

While there are several players wanting to be in the payments space—in the closed, semi-closed and the open payments space, it appears that the enthusiasm to be a PB is not as forthcoming. In 2015, RBI granted in-principle license to 11 players to set up PB (out of which three of them have withdrawn) and as the developments go, it appears that one more may not launch operations, while the licence of one player will devolve as the parent company has merged with another operator and that licence may be integrated. A more detailed discussion on the PB can be found in chapter 13.

Irrespective of the enthusiasm of being a PB, there are many operating in the PPI space and RBI issued further permissions for PPI operators. Last year there were 46 PPI players, which increased to 55 during the year. These players will bring in many innovations that would disrupt the space, particularly with RBI promising a responsive regulation. Also, if RBI accepts the recommendations of Tarun Ramadorai Committee report of providing a regulatory sandbox, then there could be many more controlled innovations in this space (Table 6.4).

Table 6.4 List of PPI Licensees, Payments Bank Licensees, and White Label ATM Operators

	Prepaid Payment Instruments	Payments Banks—Entities
1	Aircel Smart Money Limited	Aditya Birla Nuvo Limited
2	Amazon Online Distribution Services	Airtel M Commerce Services Limited
3	Appnit Technologies Private Limited	Department of Posts
4	Bajaj Finance Limited	Fino PayTech Limited
5	Card Pro Solutions Pvt. Ltd.	National Securities Depository Limited
6	Delhi Integrated Multi-Modal Transit System Limited	Reliance Industries Limited
7	Delhi Metro Rail Corporation Limited	Vijay Shekhar Sharma-Paytm
8	DigitSecure India Private Limited	
9	Edenred (I) Private Limited–nee Accor Services Pvt. Ltd.	**White Label ATM Operators**
10	Eko India Financial Services Private Limited	AGS Transact Technologies Ltd.
11	E-Meditek Global Private Limited	BTI Payments Pvt. Ltd.
12	Freecharge Payment Technologies Private Limited	Hitachi Payment Services Pvt Limited
13	Fino Paytech Ltd.	Muthoot Finance Ltd.
14	Flytech Aviation Limited	RiddiSiddhi Bullions Limited

[8] See http://www.microsave.net/files/pdf/NPCI_Cashless_CaseStudy.pdf, accessed on September 10, 2017.

	Prepaid Payment Instruments	White Label ATM Operators
15	GI Technology Private Limited	SREI Infrastructure Finance Ltd.
16	Hip Bar Private Limited	Tata Communications Payment Solutions
17	Idea Mobile Commerce Services Ltd.	Vakrangee Limited
18	India Transact Services Limited	
19	Itz Cash Card Ltd.	
20	Kedia Infotech Ltd.	
21	LivQuik Technology (India) Private Limited	
22	Mannapuram Finance Limited	
23	MMP Mobi Wallet Payment Systems Limited	
24	Mpurse Services Pvt. Ltd.	
25	Muthoot Vehicle & Asset Finance Ltd.	
26	My Mobile Payments Limited	
27	Neucleus Software Exports Limited	
28	One97 Communications Ltd.	
29	One Mobikwik Systems Private Limited	
30	Oxigen Services (India) Pvt. Ltd.	
31	Paul Fincap Pvt. Ltd.	
32	PayU Payments Private Limited	
33	PayMate India Pvt. Limited	
34	Pine Labs Private Limited	
35	Premium eBusiness Ventures Private Limited	
36	PhonePe Private Limited	
37	Pyro Networks Private Ltd.	
38	QwikCilver Solutions Pvt. Ltd.	
39	Reliance Payment Solution Limited	
40	Smart Payment Solutions Pvt. Ltd.	
41	Sodexo SVC India Pvt. Ltd.	
42	Spice Digital Ltd.	
43	Supreme Securities Limited	
44	Tech Mahindra Limited	
45	Transaction Analysts (India) Private Ltd.	
46	Transcorp International Limited	
47	TranServ Private Limited	
48	Tri-O-Tech Solutions Private Limited	
49	UAE Exchange & Financial Services Ltd.	
50	Virgosoft IT Solutions Private Limited	
51	Vodafone m-pesa Limited	
52	Weizmann Impex Service Enterprise Limited	
53	Y-Cash Software Solutions Private Limited	
54	Yeldi Softcom Private Limited	
55	ZipCash Card Services Pvt. Ltd.	

Source: RBI, https://rbi.org.in/SCRIPTs/PublicationsView.aspx?id=12043, accessed on July 18, 2016.

DIGITAL "INCLUSION"

One part of the digital inclusion story is what we have discussed till now—how the fintechs (including NPCI with its innovations) are entering the inclusion space. However, the other side of the story is about how traditional institutions are embracing fintech. There have been many initiatives that have been undertaken with the digitization and digital inclusion in traditional formal institutions. The initiatives taken by NABARD using the Financial Inclusion Fund (FIF) are listed in Box 6.5.

Box 6.5 NABARD Initiatives Using FIF

- Issuance of EMV chip RuPay Kisan Cards: Cooperative Banks and RRBs are being supported to issue EMV chip and personal identification number-based Cards on mission mode to their farmers. A maximum support of ₹25.00 or 80% of the cost whichever is lower, to be availed by State Cooperative Banks (StCBs)/District Cooperative Central Banks and RRBs within a limited period ending 30 June 2017.
- Deployment of PoS devices in Tier 5 and Tier 6 Centers: With a view to increasing the card acceptance infrastructure in rural areas and enable a less cash payment ecosystem it was proposed to extend support under FIF for deployment of PoS terminals to one lakh villages in Tier 5 and Tier 6 areas, subject to a cap of two PoS devices per village.
- Solar-powered V-SATs: Setting up of solar-powered VSATs to Kiosks/Fixed CSPs in Sub Service Areas having no connectivity/Internet connectivity. Support is being provided to banks for both CAPEX and OPEX models. As on December 31, 2016, 7,625 Sub Service Areas were sanctioned financial assistance to the tune of ₹283.18 crore.
- Connectivity support for opening branches in LWE Districts: Banks setting up branches in "unbanked villages" of notified LWE affect bed districts will also be provided support for capital investment and 50% of connectivity cost for five years.
- CBS customization for Atal Pension Yojana (APY): Support to Cooperative Banks (DCCBs and StCBs) for Customization of APY in CBS. As on December 31, 2016, an amount of ₹1.82 crore was sanctioned, out of which, ₹1.12 crore was disbursed.
- CBS Implementation by Cooperatives: Support to good working licensed Rural Cooperative Banks (RCBs) for implementation of CBS. As on December 31, 2016, an amount of ₹151.96 crore was sanctioned to 165 Rural Cooperative Banks, out of which ₹122.40 crore were disbursed.
- Bank Sakhi: Financial support for upscaling the scheme for SHG/SHG members as Bank Sakhis of RRBs and Commercial Banks would be by way of sensitization/training of stakeholders, purchase of micro-ATM and compensation to project staff for six months.
- Financial Literacy Centers: Extension of support for two years to RRBs and CCBs for maintenance of FLCs already set up. Conduct of Financial Literacy Camps by Primary UCBs in rural areas. A total of 1,665 FLCs were sanctioned, out of which 1,416 FLCs were set up and the amount sanctioned and disbursed in respect of these was ₹7,746.73 lakh and ₹3,104.06 lakh respectively.
- Capacity building of BCs/BFs: Support for capacity building of the BCs/BFs of Banks through training and reimbursement of examination fees @ 90% of course fee for RRBs is now extended to Commercial Banks @ 60% of the course fee.
- Examination fees for BCs/BFs: Support toward reimbursement of examination fees of ₹800 for BC/BF, who pass the examination/test conducted by IIBF, @ 80% for RRBs and 60% for Commercial banks.
- Supporting Aadhaar-enabled biometric transactions: AEPS is one of the modes by which a person can transact on Aadhaar-enabled PoS machines. An incentive of 0.50% subject to a cap of ₹10.00 per Aadhaar-enabled biometric transaction, of ₹2,000 or less, would be reimbursed to the bank for paying to merchants for transactions undertaken by using PoS devices at merchant locations.

Incentivising Digital transactions at customer and merchant level: The government of India seeks to encourage citizens to move toward digital economy by introducing an incentive scheme for individuals and merchants. The scheme envisaged providing cash incentives/prizes to members of the public and merchants undertaking digital transactions using RuPay cards, UPI, USSD and AEPS. The two schemes Lucky Grahak Yojana for individuals and Digi-Dhan Vyapar Yojana for Merchants were launched on December 25, 2016 and will terminate on April 14, 2017 are being implemented by NPCI.

Source: NABARD progress data, http://www.nabard.org/auth/writereaddata/File/Monthly%20Update.pdf, accessed on September 10, 2016.

MOBILE AND INTERNET

Mobile phones, as a medium for extending banking services, have attained great significance. The rapid growth of mobile users in India, through wider coverage of mobile phone networks, have made this medium an important platform for extending banking services especially to the unbanked sections of the society. A look at the numbers shows that we are on an exponential growth trajectory in mobile-based transactions. From a million transactions in 2011 to almost 110 million transactions on mobile; less than a billion Rupees worth of transactions to almost ₹1.7 trillion of transactions shows a steep growth and the rate of growth is increasing by the year. With the simplification of the interface through UPI, launch of BHIM and the strategy of JAM in place, this number is expected to grow even faster (Table 6.5).

Both the number and value of mobile-based transactions have been rising rapidly (see Box 6.6). To understand this growth and its potential it is imperative to look at the physical and regulatory infrastructure of mobile banking in India. However, it is important to note the digital divide between the urban and the rural areas. The urban tele-density is at 148%, indicating almost 1.5 connections per individual where as in case of the rural areas, it is touching 51%. Most likely these subscribers are expected to be men. However, the customers of financial inclusion would equally be women and therefore ownership of mobile phones and transactions by women needs to be tracked more closely if this agenda is to be taken forward (Table 6.6).

The key indicator trends found by the InterMedia tracker survey are given in Figure 6.4.

Table 6.5 Data on Transactions on the Mobile

Year	Volume (Millions of Transactions)	Growth	Value (₹ Billion)	Growth
March 2012	3.12	197%	2.32	176%
March 2013	6.40	105%	9.91	327%
March 2014	10.74	68%	34.07	243%
March 2015	19.76	84%	169.14	396%
March 2016	49.47	150%	572.80	238%
March 2017	113.65	129%	1,730.88	202%

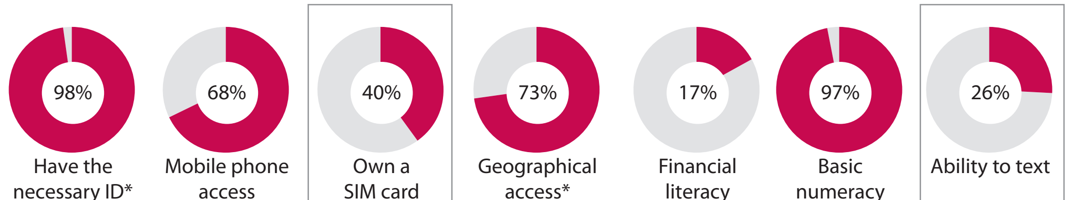
Source: RBI, https://rbi.org.in/scripts/NEFTView.aspx, accessed on September 9, 2017.

Table 6.6 Details of Wireless Connections (Millions)

Detail	March 16	March 17
Wireless subscribers	1,033.63	1,170.18
Urban subscribers	588.79	672.42
Rural Subscribers	444.84	497.76
Urban teledensity	148.73	166.71
Rural teledensity	50.88	56.47
Broadband subscribers	132.77	258.28

Source: Telecom Regulatory Authority of India at http://trai.gov.in/sites/default/files/Press_Release_34_25may_2016.pdf for March 2016 and http://trai.gov.in/sites/default/files/PR_No.37of2017_English_0.pdf for March 2017, accessed on September 9, 2017.

2016 Key indicators of preparedness for digital financial services
(Shown: Percentage of Indian adults, N = 45,540)



	Have the necessary ID*	Mobile phone access	Own a SIM card	Geographical access*	Financial literacy	Basic numeracy	Ability to text
2015	98%	90%	41%	74%	n/a	95%	38%
2014	98%	86%	41%	n/a	n/a	87%	40%
2013	95%	85%	36%	n/a	n/a	75%	n/a

Figure 6.4 Key Indicator Trends

Source: InterMedia (2017).
*Point of service within 5 km from respondent's home.

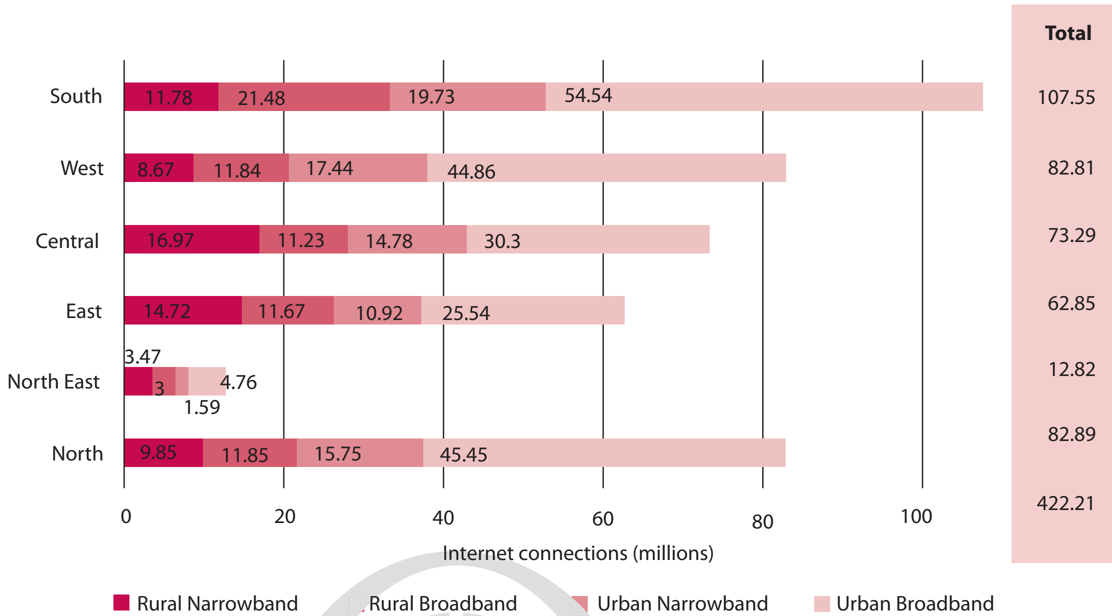


Figure 6.5 Region-wise Penetration of Connections

Source: Telecom Regulatory Authority of India, 2017. http://www.trai.gov.in/sites/default/files/Indicator_Reports_050720174.pdf, accessed on September 9, 2017.

What is interesting to note is the region-wise penetration of Internet (Figure 6.5). Even here we see that the south dominates in terms of overall share. We can see that in the urban areas the share of broadband is more dominant, but in rural areas—particularly in the central eastern and northeastern regions—the broadband connections in rural areas have yet to catch up. The story of financial inclusion that has been discussed in the previous chapters seems to continue to play out even in somewhat unrelated field of usage of Internet, but this certainly has implications for how the digital financial inclusion story will pan out. The thought that digital solutions may be more viable in areas where physical facilities are a challenge need to be checked carefully, as infrastructure for digital inclusion turns out to be critical in remote locations. Conversely, there is little to suggest that physical infrastructure is going to be cheaper or better in remote areas.[9]

While analyzing the status of mobile-supported financial services it is also important to look at the access of Internet as a number of these services are Internet-based. While the number of mobile subscribers in India is quite high, the number of mobile Internet subscribers lags far behind. As of March 2017, the total number of Internet subscribers is

[9] Private communication with Anand Raman in 2017.

Box 6.6 Highlights of Mobile Money Use

Mobile money use and awareness remain low.

- Generally, Indian adults meet the preconditions necessary for progression along the customer journey. Most adults have the ID required to register an account; they possess a high degree of numeracy; and live in proximity to access points. This general readiness may be constrained by low levels of financial literacy. Only 17% are financially literate.
- Progression along the digital customer journey is impeded by a lack of technical ability to use SMS. A substantial portion of the adult population does not have access to a mobile phone or SIM card.
- The growth rate of mobile phone access reversed in 2016 for both genders, while SIM card ownership and the ability to text continued to trend downward or remain flat.
- There are significant differences between men's and women's levels of mobile phone readiness; men are more likely to have access to a mobile phone, own a SIM card and have the ability to send or receive text messages.
- In 2016, less than half of Indian adults were aware of a nearby point of service (<1 km away

from their homes); however, 73% were aware of a point of service within 5 km.

- Awareness of mobile money access points was minimal, as was awareness of MFI or informal saving/lending group access points.
- Awareness of mobile money providers has been declining among the Indian adult population since 2014.
- Awareness of mobile money is patterned along demographic lines. Levels of awareness of mobile money are higher among men, and those above the poverty line, compared to their counterparts.
- There are substantive differences in financial literacy between genders and between urban or rural locales, but there is effectively no difference in financial literacy between individuals living above or below the poverty line.
- The Indian adult population is almost entirely numerate, with minimal substantive differences across the demographic categories.
- Financial literacy lags substantially behind basic numeracy, which could slow the adoption of more advanced financial services.

Source: InterMedia (2017).

400.62 million (TRAI 2017). Internet density is currently low at 32.86 with rural Internet density being 15.49%. While this is growing, the inclusion schemes dependent on Internet have less chances of being effective (see numbers in Figure 6.6). It is evident from the data that where connectivity is not too much of a problem, and in urban areas not only is the density better, more transactions are happening through digital medium. This may be a short to medium term issue and possibly the policy focus should move toward just improving Internet connectivity and penetration in order to drive digital financial inclusion faster.[10] Apart from the physical access there are issues pertaining to the awareness and the usage pattern which is discussed in Box 6.6

NPCI has also introduced an important service: *99# service for mobile banking without Internet. This service was introduced taking into account the need for immediate low value remittances, expanding financial inclusion. Banking customers can avail this service by dialling *99# on their mobile phone and transact through an interactive menu displayed on the mobile screen. It is currently offered by 45 banks and all global system mobile communication (GSM) service providers and can be accessed in 12 different languages including Hindi and English. By

Key Indicators	Year			Base Definition
	2014	2015	2016	
Adults who have active digital stored-value accounts	22%	34%	22%	All adults (15+)
	45,087	45,036	45,540	
Poor adults who have active digital stored-value accounts	17%	29%	21%	Adults (15+) <$2.5/day
	35,511	35,421	29,785	
Poor women who have active digital stored-value accounts	12%	24%	16%	Women (15+) <$2.5/day
	20,691	20,949	16,043	
Rural women who have active digital stored-value accounts	12%	23%	13%	Rural women (15+)
	17,759	18,027	16,808	
Adults who have active digital stored-value accounts and used advanced financial services (beyond basic wallet & P2P)	9%	8%	3%	All adults (15+)
	45,087	45,036	45,540	
Poor adults who have active digital stored-value accounts and used advanced financial services (beyond basic wallet & P2P)	7%	6%	3%	Adults (15+) <$2.5/day
	35,511	35,421	29,785	
Poor women who have active digital stored-value accounts and used advanced financial services (beyond basic wallet & P2P)	5%	5%	2%	Women (15+) <$2.5/day
	20,691	20,949	16,043	
Rural women who have active digital stored-value accounts and used advanced financial services (beyond basic wallet & P2P)	5%	5%	2%	Rural women (15+)
	17,759	18,027	16,808	

Figure 6.6 Key Indicators

Source: InterMedia (2017).

[10] Private communication with Anand Raman in 2017.

March 2017 the transaction volumes were around 200,000 and the amount transacted was around ₹330 million. As we see these numbers have moved down by August 2017. Possibly as the smartphone penetration goes up, the customers may choose UPI/BHIM over this service.

Immediate Payment Service (IMPS) launched by NPCI is one such service offered. To avail of the IMPS service, the customer has to first get a Mobile Money identification number (MMID) and this could be used for instant 24×7 interbank electronic fund transfer service through mobile, Internet and ATMs. There are currently 59 commercial banks, 32 RRBs, 24 PPIs, 128 cooperative banks as members. What is interesting is that the number of MMIDs grew at a normal pace from 120 million in March 2016 to 160 million MMIDs by March 2017. However, the volume of transactions and the amounts transacted went up exponentially. The volumes moved from 2.5 million (March 2016) to 5.4 million (March 2017). Similarly, the amounts transacted went up from ₹212 million (March 2016) to ₹611 million (March 2017).[11]

The launch of UPI by the NPCI is a potential game changer on how payments could be done. UPI has the following features:

- Immediate money transfer through mobile device round the clock 24×7 and 365 days.
- Single mobile application for accessing different bank accounts.
- Single Click 2 Factor Authentication—Aligned with the Regulatory guidelines, yet provides for a very strong feature of seamless single click payment.
- Virtual address of the customer for Pull & Push provides for incremental security with the customer not required to enter the details such as Card no, Account number; IFSC etc.
- Bill Sharing with friends.
- Best answer to Cash on Delivery hassle, running to an ATM or rendering exact amount.
- Merchant Payment with Single Application or In-App Payments.
- Scheduling PUSH and PULL Payments for various purposes.
- Utility Bill Payments, Over the Counter Payments, Barcode (Scan and Pay)-based payments.
- Donations, Collections, Disbursements Scalable.
- Raising Complaint from Mobile App directly.[12]

The pricing models for UPI were given in Tables 6.7 and 6.8.

While the pricing was to be borne by the players, at the consumer end, the P2P transactions were not being charged. However, toward the middle of 2017, there were talks that some of the banks

Table 6.7 Pricing Model for UPI P2P Transactions

Particulars	Amount	Paid By	Paid to
UPI switching fee	25 p	Remitter Bank	NPCI
IMPS switching fee	50 p	Remitter Bank	NPCI
PSP fee	50 p	Remitter Bank	Remitter PSP
Transaction amount	Variable	Remitter Bank	Beneficiary Bank
Interchange fee	IMPS P2P Pricing#	Remitter Bank	Beneficiary Bank

In IMPS:
-Up to a value ₹25,000—Interchange payable is ₹1.
-Upward of ₹25,000 to ₹200,000—Interchange payable is ₹5.
Source: NPCI.

Table 6.8 Pricing Model for Merchant Transactions

Particulars	Amount	Paid By	Paid To
UPI switching fee	25 p	Remitter Bank	NPCI
IMPS switching fee	50 p	Remitter Bank	NPCI
PSP Fee	50 p	Beneficiary Bank	Remitter PSP
Transaction amount	Transaction Value	Remitter Bank	Beneficiary Bank
Interchange fee	IMPS Merchant Pricing*	Beneficiary Bank	Remitter Bank

*In IMPS:
-Up to a value ₹2,000—Interchange payable is 0.40%.
-Upward of ₹2,000—Interchange payable is 0.65%.
Source: NPCI.

[11] See. http://www.npci.org.in/impsVolumes.aspx, accessed on September 10, 2017.

[12] See http://www.npci.org.in/UPI_Background.aspx, accessed on September 10, 2017.

Table 6.9 Transactions under the UPI Platform (Excluding USSD 2.0)

Month	No. of Banks Live on UPI	Volume (Millions)	Amount (₹ in Billion)
Aug-16	21	0.09	0.30
Mar-17	44	6.16	23.91
Aug-17	55	16.61	41.27

Source: https://www.npci.org.in/product-statistics/upi-product-statistics, accessed on October 31, 2017.

may impose a transaction fee on the P2P transactions. Whether the small ticket cashless volumes will really pick up with the pricing model is something that will have to be seen. State Bank of India and HDFC bank were reportedly considering the transaction fee, though State Bank announced that they would withdraw these charges.[13] The transactions under UPI are not only picking up, but are growing rapidly as seen in the Table 6.9. It might take a while before there is some harmonization of the charges at the customer level. For this to happen, there needs to be seamless competition. While the NPCI has been urging banks to moderate their charges to the customers on the small ticket transactions, many of the new players—particularly the PBs seem to be charging a bit more. While a universal bank can cross subsidize its costs, this would be difficult for the PBs whose sole revenue would be coming from remittances. As of now, Airtel Payments banks is charging 0.5%, IPPB is charging ₹4 per transaction up to ₹100,000, Fino Payments Bank is charging between ₹5 to ₹10 while the Paytm Payments Bank has left all P2P transactions free.[14] It is evident that this space will take a while to stabilize before all the players stabilize their delivery model and the cost structures.

Mobile wallet offered by PPI players is yet another important service offered. Moreover the new PBs were all rolling out. The launch of not only UPI but also BHIM has added to the choices in the digital market. During the demonetization exercise all these were tested by the customers. As we go along, it is possible that we see new innovative models emerging, as well as some consolidation happening in this sector. For instance, there are reports that the social media majors and tech majors Google, Facebook, WhatsApp and Uber are all examining the possibility of integrating their platform with UPI. If these companies come on the platform, then the payments space could be very disruptive. Each of these companies has redefined the ease with which the consumer uses their technology. The issue is under consideration with the RBI, which needs to understand the elements of systemic risk this proposal could pose.[15]

While much is happening in the ecosystem, the road to be traversed is much longer than it appears. While much celebration could be had for all the achievements, there are real stories that hide behind the rather impressive numbers. One such insight is available in Box 6.7.

Box 6.7 Rural Digital Financial Inclusion: A Reality Check

"Rural women are much smarter than you" thundered a leading official of the Niti Aayog when a member of a public audience had the temerity to challenge him about the adverse effects of demonetization on low-income rural families. Smarter they certainly are...most people would be roundly flummoxed if faced with a monthly budget under ₹5,000 (US$ 80) and four or five mouths to feed, traditional fuels to cook with, school books to purchase, decent health facilities that are 15 kilometres away and the cost of a niece's wedding to contribute to. Rural Indian women manage somehow and are smart in their sadly deprived environment; if this were not the case, there would not be 1.28 billion Indians around. But to claim that this undoubted smartness translates to universal knowledge about matters digital as well as physical is a travesty of the reality of poorly educated, low-income families.

The reality of the supposedly massive potential of fintech to enable financial inclusion is that everyone is mesmerized and befuddled by the numbers. TRAI (India's telecom regulator) announced in February that the mobile subscriber base in the country had increased to nearly 1.1 billion by the end of November 2016. But did they mean subscribers or did they mean subscriptions?

Recent work by M-CRIL in UP and Bihar shows that less than 50% of rural low-income

[13] See http://www.business-standard.com/article/finance/hdfc-bank-sbi-to-start-charging-for-p2p-payments-on-upi-117060601537_1.html, accessed on September 10, 2017.

[14] See http://www.financialexpress.com/money/sbi-transaction-charges-behemoth-psb-lags-airtel-payments-bank-india-post/781331/, accessed on September 10, 2017.

[15] See http://indianexpress.com/article/technology/tech-news-technology/google-facebook-whatsapp-uber-could-soon-support-upi-based-payments-all-you-need-to-know-4745115/, accessed on September 10, 2017.

families have mobile phones; when they have these, the phone is in the possession of the male head of the family and women have little or no access. Invariably the mobile phones they do have are traditional, ₹500 USSD-enabled feature phones (with no Internet connectivity), covered in dust and with scratched screens that have barely visible displays. Consider the situation even of an urban Gurgaon *mali* (gardener) faced with demonetization, unable to accept his monthly wages by bank transfer because the queues at the bank made it impossible for him to withdraw money while his traditional feature phone was useless for making payments for purchases. This is the urban worker, whose situation the "smart" rural woman actually envies because he could at least leverage his contacts with better off peers or employers to manage somehow when his cash was suddenly rendered useless by government decree.

Ever since the demonetization debacle broke, much has been written about the boost it has given to the fintech economy. When observers made some noise, at the time, about the exclusion of the 700 million or so basic feature phone users from the supposedly incentivized digital economy, the BHIM app (based on the Unified Payments Interface) was launched suddenly without adequate testing and without adequate public information. It would be interesting to see data from the telecom companies, on the use of feature phones to conduct financial transactions.

In practice, that proportion will always remain small so long as the use of feature phones for financial transactions requires a complex set of entries, responses and confirmations. Such actions require a level of numeracy and literacy that is currently inadequate. Therefore, however massive the potential of fintech, its realization will remain a mirage unless a totally different and enlightened level of investment is made to promote digital literacy, in the short term, and overall literacy over the next decade. Educated Indians pride themselves in their access to hardware and their sophistication with software; all manner of supply side solutions exist but the demand side of digital financial inclusion remains largely unaddressed. Demonetization has provided a shock to the system but its ill-preparedness became apparent in its failure to convert that shock into a positive force for development.

Source: Sanjay Sinha: MCril Notes from the Field 3 Fintech and the demand side challenge in financial inclusion.

AADHAAR AND DBT

The Aadhaar platform was not only being used in the Aadhaar-enabled payment systems to ensure regular transactions, there were multiple pilots being carried out to see if the DBT programs could be successfully carried out using the Aadhaar platform. The touchpoints that are being provided the Aadhaar system will potentially be accessible to the populations largely excluded from the financial system, though they could have been included for several of the government social security programs. In a way, the Aadhaar-based DBT that may result in the cash out transaction may achieve the dual purpose of not only de-duplicating and including persons in the program, but converting the benefit into a cash mode, might also significantly include them in the financial system.

Apart from being a document aiding identification, Aadhaar is the key enabler of AEPS. AEPS is a bank led model that allows online interoperable financial inclusion transaction at PoS through BCs of any bank using the Aadhaar authentication. The services offered on AEPS includes balance enquiry, cash withdrawal/deposit, Aadhaar-to-Aadhaar fund transfer, and gateway authentication services.

Yet another important function of Aadhaar is aiding the Aadhaar Payment Bridge System (APBS). The APBS has been successful in channelizing government subsidies and benefits to intended beneficiaries using Aadhaar numbers. The APBS links the government departments and their sponsor banks on one side, and beneficiary banks and beneficiary on the other side. In a sense, the real intent of Aadhaar lies not in providing a proof of identity but rather in targeted delivery of services. This role has become even stronger with the launch of PMJDY and the JAM trinity.

While we can look at the debit and credit card transactions as the transactions carried out by the upper segments and relatively well-off segments of the society, another interesting statistic was being put out by NPCI that is about the number of transactions on the Aadhaar Enabled Payment Systems, which is done largely by BCs using micro ATMs (Table 6.10). The details of these numbers are discussed further.

The data is a beginning and is being introduced into the report this year and will be tracked as we go along. It is interesting to note that there are a lot of transactions that are not being approved for various reasons. The first column shows the number of transactions that were queried, but only about 75% of the transactions are finding an approval.

Table 6.10 Data on Aadhaar-enabled Transactions during the Year (Numbers in Millions)

Month	Total Transaction	Approved Transactions	Approved ONUS Transaction	Approved OFFUS Transaction	Total UID	Authenticated UIDs	Unauthenticated UIDs	Service Delivery	Total eKYC	Successful eKYC	Demo Queried Total	Demo Authenticated
March-16	20.36	15.09	14.95	0.14	4.41	4.10	0.30	93%	2.37	1.45	4.21	2.71
March-17	76.29	51.70	44.26	7.43	35.38	31.54	10.74	89%	10.67	6.58	14.49	7.17
April-17	83.35	56.53	47.10	9.43	38.61	34.49	11.84	89%	0.96	6.07	10.73	5.88
May-17	95.39	68.07	56.69	11.38	44.55	40.88	12.36	92%	13.34	9.12	12.89	8.46
June-17	101.96	75.52	63.64	11.88	49.82	46.56	12.36	93%	18.68	12.61	9.61	6.14

Source: http://www.npci.org.in/product-statistics.aspx#, accessed on August 21, 2017.

The rejects could be for various reasons including unclean biometrics, legacy scanners or non-availability of the record at the UIDAI registry. A customer gets about four attempts to authenticate the biometrics at a go. The statistics show a high failure to get approval—either the database or the technology needs to catch up. We also can see from the breakup of on-us and off-us transactions, a predominant number of transactions are happening in the host bank. Are these cashless transactions? Well, that might not be the case. These are most likely withdrawals from the BC point, which essentially means that these transactions are similar to ATM withdrawals where the last-mile cash transaction is happening. If it is the DBT or any other transaction from the side of the government, this is coming into the account through an instant networked credit, but the customers are not using the amounts in the account to make cashless payments using the architecture. The breakthrough on the cashlessness of these transactions would happen only when there is a possibility of an Aadhaar-enabled payment made to a local merchant establishment from the beneficiary. We may be a little distance from that level of cashlessness.

The next set of data in are not pertaining to financial transactions but are about how the Aadhaar network is being used for identity authentication and verification. For instance, the UID authentication that talks about queries about the authentication of unique individuals is showing a failure rate of around 10%. This is for individuals who are in the system but their identities are not being returned as verified. The next set of data is about whether people are able to use the Aadhaar platform for electronically completing their KYC formality. Even here we see that the acceptance rates are not very good. The last set of data are about verification of the demographic data in the UIDAI database with that of the bank's database in order to seed the bank accounts with the Aadhaar numbers. Here the failure rate is much higher because of many fields that may be prone to errors-style in which the name is written, address, sex, mobile numbers, and email ids. Overall, we can safely say that while the Aadhaar-enabled network is up, the failure rates are significant and the transaction volumes need to pick up.

One of the experiments was to examine the Aadhaar-enabled targeted public distribution system (PDS) that was carried out in East Godavari District in Andhra Pradesh (AP) in 2013. During the past years, multiple schemes have been tried out on the Aadhaar platform including the Pradhan Mantri Ujjwala Yojana, the DBT for fertilizer, and PDS in other locations. As we go forward, there could be multiple learnings from these pilots. It is abundantly evident from the multiple studies carried out in evaluating the pilots that there is much problem to be sorted both with technology and with the way the DBT plans are rolled out. On the technology side, the issue of connectivity, authentication failure, and some element of cutting corners with informal "adjustments" and overriding powers have been seen. On the other hand, beneficiary identification has always been a complex process and is prone to errors of exclusion and inclusion at the margins. However, the experiments Aadhaar-enabled targeted PDS, DBT for fertilizers, Ujjwala Yojana, food coupon experiment in Karnataka, and many more show the potential of many of these schemes to go cashless. Based on multiple studies, MicroSave has designed a seven-step design for carrying out DBT that is depicted in Figure 6.7.

While there are initial results, there is much to be done in the DBT schemes. We have already discussed the complexity of the DBT program and its linkage to PMJDY accounts in Chapter 4.

While we have discussed Jan Dhan (in detail in Chapter 4) and mobile in the JAM trinity, it is important to note the developments on Aadhaar as

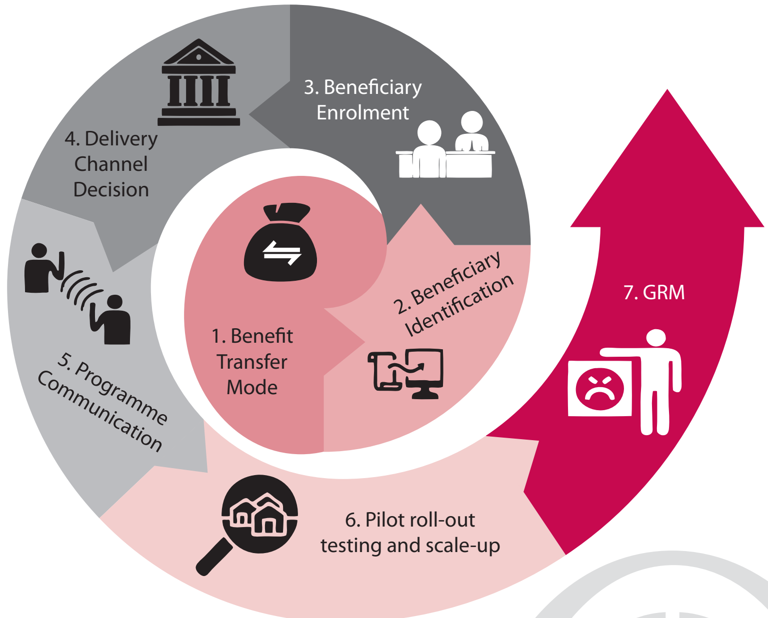


Figure 6.7 Steps in Designing a DBT Program

Source: Designing Beneficiary-Centric "Direct Benefit Transfer" Programmes: Lessons from India, http://www.microsave.net/files/pdf/PB18_Designing_Beneficiary_Centric_Direct_Benefit_Transfer_Programmes_Lessons_from_India_Part_II.pdf, accessed on September 2, 2017.

well. During the past year, the controversies around Aadhaar were discussed. While the Supreme Court decided in a landmark judgment that privacy was a fundamental right, the litigations pertaining to Aadhaar were referred back to a smaller bench, and the verdict is yet to come. However, with the help of the Aadhaar (targeted delivery of financial and other subsidies, benefits, and services) Act, 2016, the government has moved ahead in making Aadhaar a centrepiece of a resident's life. As of June 2017, more than a billion Aadhaar numbers have been assigned, accounting for more than 86% of the total population (Table 6.11).

However, coverage of Aadhaar without the rest of the infrastructure does not naturally result in financial inclusion. Aadhaar is an accepted document for eKYC purposes that enables the opening of an account when the address on Aadhaar is the same as the current address of the customer. However, if the current address is different, which is usually the case with migrant workers, the customer has to produce an officially valid document of residence even at the destination. This makes it difficult for the customers who migrate from one place to the other seasonally to transact. The DBT using Aadhaar is being rolled out in good earnest and we discuss this in detail in Chapter 4.

Table 6.11 Aadhaar Saturation

Aadhaar Saturation as on 15th August 2017	
Number of Aadhaars assigned	1,144, 659,906
Percentage of total population covered	86.70%
Percentage of population (0–5 years) covered	38.80%
Percentage of population (5–18 years) covered	73.30%

Source: UIDAI, https://uidai.gov.in/images/StateWiseAge_AadhaarSat_24082017.pdf, accessed on September 10, 2017.

DIGITAL FINANCE AT THE FRONTIER

The most exciting development in the digital finance space is that of the fintech companies. Every few days there are reports of one company or the other raising capital and getting into business. These businesses try to use digital footprints, prepare an algorithm, and try to score the customers. While this cannot be called inclusion in the classic sense, they have actually been able to touch customers who do not have a credit score from the formal sector and, therefore, are not typically eligible to borrow. However, with machine learning and data and some psychometrics, the companies are able to do an assessment of the customer based on the digital footprint he or she has left.

CreditVidya (CV), a fintech provider, basically works in collaboration with banks and financial institutions. It has a credit scoring model that could use your digital footprint to come out with a credit score that makes the lender comfortable. As of now, CV is working with 20 banks and fintech providers. Currently, a client application takes about 2 days to process, and CV plans to reduce it to just 30 minutes. The customers of CV are mostly from Tier II and Tier III where the provision of formal services may be limited.

Catalyst is a not-for-profit entity that provided an inclusive cashless payments partnership in association with NBFCs or banks. Catalyst undertook pilots in providing 5-minute loans to the poor in association with Capital Float as well as with Axis Bank and showed how the digital footprint could be used in assessing the customers. As we go along, and as rightly identified by the Watal Committee, we would be finding that the agility to reach this market would be possible only by the fintech firms, and not banks. The overall architecture of whether there should be a seamless marriage between the fintech world and banking is something we will have to watch out for.

Many of the fintechs do not target the inclusive customers but are largely targeting salaried people to ensure that they get seamless loans. Organizations like Earlysalary are turning out to be lenders who could help the customers to overcome the month-end liquidity crisis quickly. However, these models raise significant concerns about data privacy and how customers could be targeted at their vulnerabilities. First, most of the data that is used assumes informed consent, which is questionable. Second, if this data that is mined is used to target customers into getting into a debt cycle that encourages consumption behavior that is not matched by the overall growth in the income behaviour, the sector would be pushing the borrowers toward a greater stress. While a greater amount of digitization is going to help in the cause of inclusion, would it create stressed customers due to the aggressive growth of technology-enabled microfinance sector? This has happened in the past and has to be guarded against.

APPENDIX 6A
Retail Payments Statistics on NPCI Platforms: Financial Transactions

	NPCI Operated Systems	FY 2015–16		FY 2016–17	
S. No.	**Financial Transactions**	**Volume (in Mn)**	**Value (in Bn)**	**Volume (in Mn)**	**Value (in Bn)**
1	NFS interbank ATM cash withdrawal	2,837	9,993	3,170	10,818
2	NACH: National Automated Clearing House	1,367	3,706	1,968	7,208
2.1	APBS Cr. (Disbursement based on UIDAI No.)	713	177	949	287
2.2	ACH debit	24	504	88	1,480
2.3	ACH credit	487	879	731	3,844
2.4	NACH credit	115	1,998	1	27
2.5	NACH debit	28	148	198	1,570
3	CTS cheque clearing	920	69,889	1,057	69,837
4	IMPS	221	1,622	507	4,116
5	RuPay card usage at PoS	25	45	195	290
6	RuPay card usage at eCom	10	6	88	59
7	AEPS (Interbank) Txn over micro ATM (e.g., Cash withdrawal/ cash deposit)	0.36	0.86	16	23
	Total financial transactions	5,381	85,262	7,084	92,429

Source: http://www.npci.org.in/stats.aspx, accessed on August 20, 2017.

APPENDIX 6B
Retail Payments Statistics on NPCI Platforms: Nonfinancial Transactions

	NPCI Operated Systems	FY 2015–16	FY 2016–17
S. No.	**Nonfinancial Transactions**	**Volume (in Mn)**	**Volume (in Mn)**
1	NFS Interbank Txn over ATM (e.g., Balance inquiry/Mobile No. registration, etc.)	863.00	1,102
2	AEPS (Interbank) Txn over micro-ATM (e.g., Balance inquiry/Mini statement, etc.)	0.33	10
3	AEPS (Intra Bank) UIDAI authentication over micro-ATM	94.30	319
2.2	eKYC verification (successful Txn)	12.63	48
4	Demographic queries (authenticated UID)	12.98	32
5	Archieval query on CTS (Print+Retrieve request) (NAS)	0.92	1.6
6	Account No. verification Service under ACH	37	38

(Continued)

(Continued)

S. No.	NPCI Operated Systems Nonfinancial Transactions	FY 2015–16 Volume (in Mn)	FY 2016–17 Volume (in Mn)
6.1	Old account confirmation (OAC) service under ACH	7.65	3
6.2	Customer NACH (Earlier ECS) mandate processed	4.53	14
6.3	Aadhaar mapper-enabled services (AMES)	118.11	231
6.4	Aadhaar status verification services	315.62	99
6.5	Aadhaar OD verification service (AOVS)	2.99	2
6.6	UPI (balance enquiry)	28.90	31
7	Total nonfinancial transactions (B)	1,499	1,930

Source: http://www.npci.org.in/stats.aspx, accessed on August 20, 2017.

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Rural Cooperatives[1]

7

Chapter

INTRODUCTION

Every year, writing a chapter on rural cooperatives goes through an existential question—is the sector continuing to be significant enough to have a continued coverage. With NABARD long stopping its data collection about the state of the primary cooperatives and just reporting the statistics of the district cooperative banks and the StCB, the only source of data continues to be the National Federation of State Cooperative Banks (NAFSCOB) from where we get a year-old data. While there is enough focus on the rural cooperative banks at the district and the state level—with the application of the licensing requirements and requirements of capital adequacy, the primaries may not be getting as much attention as they possibly deserve. The cooperatives are generally missing from the policy discourse, whether we talk of agriculture, Jan Dhan, or DBTs. While newer banks are coming into the horizon to manage remittances, the existing infrastructure of the cooperatives is not being talked about.

In this context, there was some action in the cooperatives during the year, all largely led by the respective state governments. The Kerala government set up an expert committee to consider integrating its cooperative structure at the federal level; the Jharkhand government got an in-principle approval for moving to a two-tier structure from the RBI (see Box 7.1); and, following the Kerala example, the Chhattisgarh government has also mooted a proposal for a two-tier structure. None of the three endorse the spirit of the recommendations of the Prakash Bakshi Committee (RBI 2013), which had amongst other things suggested that the PACS that were not commercially viable become agents of the upper tier institutions and work as service delivery points. Each of the state governments are examining continuing the primaries and integrating the upper tiers. While the Kerala experiment has moved substantially ahead—that it has considered the expert committee report and set up a task force for implementation of the integration process—the work is yet to begin in Chhattisgarh. It was reported that the Punjab, Maharashtra, and Uttar Pradesh (UP) governments have also evinced interest in understanding the Kerala model.[2]

Box 7.1 Scheme of Amalgamation of Cooperative Banks in Jharkhand

Background

- Creation of the state of Jharkhand in terms of the Bihar Reorganisation Act 2000. The Government of Jharkhand (GoJ) decided to have a two-tier short-term cooperative credit system (STCCS) as per cabinet decision.
- Amalgamation necessitated owing to STCCS having several structural weaknesses.

Rationale of and benefits from amalgamation

- Proposed two-tier STCCS, namely, StCB at Apex, DCCBs being regional offices of StCBs, and PACS at the bottom level.
- Need for a responsive and vibrant rural cooperative bank to take care of credit needs of farmers in an efficient way.
- Need for simplified management structure and inducting professionals for managing amalgamated entity.

[1] The author is thankful to Mr B. Subrahmanyam, MD NAFSCOB for providing the data on primary cooperatives at a very short notice.

[2] See http://www.livemint.com/Industry/UOD7k-pQvkBWvawSRfqe9wO/Report-on-Kerala-Bank-gets-state-cabinet-nod.html, accessed on August 16, 2017.

- Leading to better administration, branch control, and efficiencies—transformation into a dynamic institution for efficient delivery of financial services.
- Rationalization, and standardization of processes and systems.
- Proposed amalgamation would result in healthy CRAR of amalgamated entity.
- Economies of scale will be available to the new entity.
- Technology is to be leveraged for ensuring financial inclusion.

Sequence of events

- Jharkhand State Cooperative Bank (JStCB) got banking license in August 2013, after which the approval of the RBI was sought for amalgamation of all DCCBs with JStCB for moving to two-tier STCCS.
- Initially, the RBI granted "in-principle approval" for amalgamation of eight DCCBs with JStCB in October 2013, and the final approval was to be accorded subject to fulfilment of specified conditions. Subsequently, due to representation of Dhanbad DCCB before Hon'ble High Court, proposal for amalgamation of seven DCCBs was approved by the RBI.
- GoJ complied with the conditions in January 2017 and recommended for final approval for amalgamation of eight DCCBs with JStCB and sought approval of the RBI.
- GoJ recapitalized R50 crore to JStCB in February 2017 toward complying the minimum CRAR of 9%—NABARD undertook snap scrutiny of proposed amalgamated entity with financial position as on February 28, 2017. Snap scrutiny arrived at CRAR of 22.39% and positive net worth of ₹1.03 billion. Accordingly, NABARD recommended to the RBI for final approval of amalgamation.
- The RBI, vide its letter dated March 30, 2017, accorded final approval of amalgamation subject to fulfilment of certain conditions within a period of 6 months.

Present status

- The GoJ issued a notification on March 31, 2017 amalgamating seven DCCBs with JStCB.
- The new entity came into existence w.e.f. April 1, 2017.

Source: NABARD (2017).

The rural cooperative sector possibly is as important as the postal department in terms of its physical outreach. While PACS were the most powerful and immediate institution that were providing formal financial services, the primacy of the cooperatives has eroded over a period of time, with other institutional innovations—the quotas given to commercial banks to open rural branches, the spread of RRBs, and the explosive growth of the microfinance sector—having displaced the PACS. However, it is still important to track the developments in this sector. One of the important aspects is to ensure that there is continued coverage for the sector to ensure that it does not slip from the policy discourse.

PRIMARY AGRICULTURAL COOPERATIVE SOCIETIES

The data on primary cooperative societies is currently collected and disseminated by the NAFSCOB. The latest data available for the cooperative sector was for the year 2015–16, and this has been organized according to the same zonal classification as the database of the RBI with one exception. Sikkim is classified in the eastern sector in the RBI data and under the northeastern sector in the NAFSCOB data. However, the numbers of Sikkim are relatively small and do not affect the larger set of arguments. While the numbers show significant penetration at over 93,000 PACS, as per the NAFSCOB numbers, only about 61,000 PACS are effective and are in the viable range and may be actually providing some services to the members (Table 7.1).

There were 46,061 commercial and RRB branches in unique rural and semi-urban locations. The postal network operates out of around 25,000 departmental post offices with owned or rented offices, whereas the other postal touchpoints are provided by the *gramin dak sevaks* from other premises including their own residences. Of all the primary cooperatives, 53,257 of them had a *godown*, which qualifies for a substantial asset with a physical footprint. Therefore, even with reduced and weakened outreach parameters, cooperatives still have the best physical reach within the country, and every effort needs to be made to ensure that these institutions are at least protected to the extent that they are operating.

The membership numbers of these cooperatives give another indication of their reach. All the cooperatives were having 126 million members, with a significant proportion of the membership coming from the disadvantaged sections of the society. As

Table 7.1 Number of PACS as of March 2016 (in Thousands)

Region	Total PACS	Viable PACS	Potentially Viable PACS	Dormant PACS	Defunct PACS	Others
North	13.7	3.71	2.32	0.15	0.32	7.2
North East	3.5	1.88	0.44	0.68	0.38	0.12
Eastern	18.57	14.1	2.88	0.59	0.41	0.6
Central	13.39	10.78	1.99	0.39	0.16	0.07
West	29.97	20.98	8.13	0.64	0.15	0.07
South	14.36	10.42	2.97	0.28	0.17	0.52
Total	93.49	61.87	18.73	2.73	1.59	8.58

Source: Performance of PACS 2015–16. Mumbai: NAFSCOB.

Table 7.2 Membership Details of PACS as of March 2016 (Number in Millions)

Region	Membership	Scheduled Castes	Scheduled Tribes	Small Farmers	Rural Artisans	Marginal Farmers and Others
Northern	16.70	1.77	1.01	4.98	0.78	8.16
North East	3.68	0.49	0.70	0.84	0.11	1.53
Eastern	27.83	2.54	3.32	7.57	0.70	13.70
Central	8.00	2.93	1.15	2.34	0.28	1.30
West	17.54	1.11	1.10	4.44	0.40	10.49
South	52.63	6.09	1.59	24.25	3.17	17.53
Total	126.38	14.93	8.88	44.41	5.44	52.71

Source: Performance of PACS 2015–16. Mumbai: NAFSCOB.

shown in Table 7.2, most of the members are small and marginal farmers, with a very small proportion of the membership belonging to the group of rural artisans. On the other hand, the commercial banks have about 107 million SBAs up to a ticket size of ₹200,000, and these cover both the rural and the urban areas. The exposure of the banking system to agriculture (direct) was about 69 million accounts. Even by these standards, the cooperative network has access to a large number of the members of the farming community.

While the outreach and the membership numbers look very promising, the detail of the actual number of borrowers, portfolio performance, and other parameters do not make a very encouraging reading. Overall, the overdue percentage for the PACS across the country is at 19%, with the North East having the worst performance of 48% overdues. These numbers are significantly better than the numbers of March 2015 but it would be interesting to look at the impact of demonetization on the overall numbers of the co-operatives. The numbers for March 2017 were not available, but given that the cooperative sector was left out from the collection of old currencies during the exchange window, it certainly would have affected the repayments significantly. The overall negative impact of demonetization is to be studied and a clearer picture would emerge if we are able to get the numbers of March 2017 (Table 7.3).

While there has been much talk about the computerization of PACS, bringing them on a common platform, this has not resulted in tangible improvement of the performance of the cooperative sector across the board. With the implementation of the reorganization plans in Kerala, Chhattisgarh, and Jharkhand there, might be some data that would emerge in the future years on whether converting the cooperative sector into a two-tier structure, will bring in some rewards that come with the advantage of size. The statistics continue to show that the cooperative sector is a force to reckon with (see Table 7.4).

Overall, PACS continued to perform their role as the basic link with the customer. However, with the increasing concern that the three-tier structure of PACS-DCCBs and StCBs is still an appropriate structure, leading to a question on whether the

Table 7.3 Position of Advances and Overdue from PACS as of March 2016 (₹ in Billions)

Region	Loans Disbursed	Loans Outstanding	Demand	Collection	Balance	Overdue Percentage
Northern	305.16	259.02	182.48	138.06	44.42	24%
North East	0.50	0.61	0.36	0.19	0.17	48%
Eastern	74.32	68.99	80.85	58.13	22.72	28%
Central	55.35	55.14	72.03	49.55	22.47	31%
West	243.96	207.85	316.20	200.63	115.57	37%
South	1,125.23	989.30	1,041.01	947.96	93.05	9%
Total	1,804.52	1,580.91	1,692.93	1,394.51	298.41	19%

Source: Performance of PACS 2015–16. Mumbai: NAFSCOB.

Table 7.4 Details of Performance of PACS and Physical Infrastructure as of March 2016

Region	Profit Making PACS	Loss Making PACS	PACS with Godowns	Number of Villages Covered	Staff Strength	Societies with Full-time Secretary
Northern	9,462	3,608	7,766	72,054	26,004	6,215
North East	653	872	1,192	34,197	8,670	2,141
Eastern	4,246	9,876	11,747	193,505	38,056	11,978
Central	6,689	4,097	12,007	167,153	24,521	4,095
West	14,998	13,576	9,271	46,923	14,638	6,799
South	8,655	5,370	11,274	72,134	64,129	14,234
Total	44,703	37,399	53,257	585,966	176,018	45,462

Source: Performance of PACS 2015–16. Mumbai: NAFSCOB.

entire structure could be viable with thin margins and high defaults leading to imbalances between the structures. While the suggestion to re-designate PACS as BCs and the primary point of contact met with stiff resistance from across the cooperative structure, the restructuring of the upper tiers seems to be finding favor.

As a part of the development activities, NABARD took up the initiative of providing financial support to develop PACS and multiservice centers. The details of the support are reproduced in Box 7.2.

Box 7.2 Financial Support to Develop PACS as Multiservice Centers

With the modernization in agriculture, farmers expect better yield as well as better returns on agricultural produce. In order to live up to the challenges of modernization, farmers should have access to the latest farm technology for increasing agriculture production, productivity, marketing, and storage of produce. PACS are presently reaching out to their members to meet their credit requirements. However, there is an imminent need to develop PACS as a one-stop-shop unit for meeting the overall needs of the farmers. This is also required to increase the business portfolio of PACS so as to make it a self-sustainable entity by providing additional services such as custom hiring of agricultural implements, enabling collective purchase of inputs, having good quality storage capacity as per the Warehousing Development and Regulatory Authority (WDRA) guidelines, processing unit, marketing facilities, etc.

Keeping in mind the wide coverage of PACS at the ground level and the limited products at their disposal, NABARD extended financial support to StCBs/DCCBs/PACS to develop PACS as multiservice centers (MSCs) for meeting the various requirements of the farmers. During 2016–17, 123 PACS were supported with sanction of financial assistance to the tune of ₹63.88 crore, of which ₹588.2 million was the loan component and the remaining ₹50.6 million was toward accompanying measures. The disbursement as on

March 31, 2017 stood at ₹776.5 million (₹742.5 million as loan and ₹34 million toward accompanying measures) and included assistance for establishment of agro service centers, rural retail outlets, agri-marketing infrastructures, rice mills, rural godowns, RO water plants, tent houses and catering business, farm machinery/implements for custom hiring, and transport vehicles for agri-produce and strengthening backward/forward linkages through on-lending to members for agriculture/allied activities.

Source: NABARD (2017, 63).

DCCBs AND StCBs

The Vaidyanathan Committee recommendations were made to strengthen the cooperative sector across tiers, it and recommended that all the upper tier institutions—the DCCBs and the StCBs—should function as proper licensed banks, and the state should infuse capital into these structures to ensure that they had capital adequacy. Last year we had reported that 23 DCCBs continued to be unlicensed. These were in four states (16 in UP, three in Maharashtra, three in J&K and one in West Bengal [WB]). The government had announced a scheme revival of the 23 DCCBs with a package assistance of ₹23.75 billion (GoI share at ₹6.73 billion). Financial assistance under the scheme was extended to enable these DCCBs to achieve 7% CRAR by March 31, 2015.

The status of the developments is given in Box 7.3.

Box 7.3 Progress on Licensing of 23 DCCBs

Progress under the scheme

- A total of 20 DCCBs (out of 23) in three states, namely, Maharashtra (3), UP (16) and WB (1), have been issued license by the RBI.
- In the state of J&K, three DCCBs are yet to be issued license by the RBI. The state government has not yet released its share. The entire share of the Government of India for the state of J&K under the scheme, amounting to ₹111.22 crore, was kept in readiness with NABARD. However, as per the terms of clause 16(a) of MoU, NABARD shall disburse the Government of India's share of assistance only after the Government of J&K disburses its share as per the sharing pattern envisaged in the scheme.
- Monitorable action plans drawn for 20 DCCBs in UP, Maharashtra, and WB.
- State-level implementation committees constituted in UP, Maharashtra, and WB, and monitoring is being done.
- 16 DCCBs in UP and 3 in Maharashtra have reviewed the functioning of PACS and have identified nonviable PACS.
- CBS has been implemented in three banks in Maharashtra and one in WB. The remaining 16 DCCBs in UP are in the process of adopting CBS.
- 16 DCCBs in UP and 3 in Maharashtra have put corporate governance in place.

Source: NABARD (2017).

The broad parameters of the performance of the StCBs and DCCBs were discussed during the previous year for the year ending 2016. During the year, the data was updated for the same period with modified numbers, particularly fresh numbers received from more DCCBs. However, given the demonetization carried out in December 2016, one was expecting that the March 2017 numbers would throw some light on how it affected the cooperative sector, particularly the DCCBs that were kept out of the note exchange program. However, the March 2017 data was not readily available due to noncompilation. Even the NABARD annual report released in the later part of August 2017 had data only for 2016. The updated details are given in the Table 7.5.

Table 7.5 Performance Indicators of StCBs and DCCBs (₹ in Billions)

	State Cooperative Banks		DCCBs	
Particulars	**2014–15**	**2015–16**	**2014–15**	**2015–16**
Number of banks	32	33	370	370
Share capital	53.76	56.46	130.45	160.08
Reserves	69.59	73.33	135.14	143.56
Deposits	1,028.08	1,092.57	2,621.14	2,915.99
Borrowings	687.25	687.74	811.54	818.91
Investments	751.23	535.34	1,360.34	1,534.89
Total loans outstanding	1,145.45	1,228.54	2,229.77	2,368.52
Number of banks in profit	28	28	308	310
Amount of profit	11.06	7.14	17.48	16.27
Number of banks in loss	4	5	62	49
Amount of losses	0.25	1.14	11.03	5.53

Source: NABARD (2017).
Note: Only 363 DCCBs reported profit/loss figure for 2015–16.

From the data, it is clear that the upper tier structures are in much better health with more institutions in profit and having better absolute profit numbers.

ECOSYSTEM INVESTMENTS

The cooperative development fund created to improve the functional efficiency of the entire cooperative credit structure (including long-term cooperative credit structure) continued to be deployed in the form of a grant or a soft loan. During 2016–17, ₹166 million was disbursed to the cooperatives under this scheme. The funds were utilized for conducting training programs as well as other purposes.

The Centre for Professional Excellence in Cooperatives (C-PEC), established in the Bankers' Institute of Rural Development (BIRD), Lucknow, continued to operate, and it continued its functions of accrediting national and regional cooperative training institutions, evolving curriculum for training, and improving the overall ecosystem. According to the *NABARD Annual Report*, as on March 31, 2017, "C-PEC membership stood at 6,657, which include 43 accredited CTIs, 23 StCBs, 186 DCCBs and 5,405 PACS. The C-PEC has standardized 27 training programs for the benefit of CTIs" (NABARD 2017).

The PACS Development Cells (PDCs) created in the DCCBs and StCBs were functional in 96 DCCBs. These have identified 2,525 PACS operating in 21 states to strengthen them through training, handholding, guiding, exposure visits, and other suitable interventions. With the help of PDCs, 1,858 PACS have prepared business development plans (NABARD 2017).

CONCLUDING NOTES

From the data provided by NABARD and NAFSCOB, it is clear that the cooperative system at the primary level is not doing well and much attention needs to be paid. We cannot comment incrementally about the performance of the cooperatives during the year for want of data. It is absolutely important and critical for NABARD to collect organized data at the PACS level to take informed policy decisions. Timely data will help in undertaking appropriate interventions before it becomes too late. The Vaidyanathan Committee had made a strong observation about the data, but that seems to be the weakest link in the cooperative sector. We are looking forward to reporting the improvement both in the quality and the timeliness of the PACS data in particular and the cooperative sector data in general.

The overall trend in the cooperative system seems to be to protect and strengthen the upper tier, so that they are intact and healthy, and using their power and muscle, the primaries could be light-touch member contact points. All investments and energies seem to be going in this direction. While this is the overall movement of the cooperative sector across the country, what should be watched is the experiment being undertaken by the government of Kerala to integrate all the cooperative finance institutions into a single bank—currently called the Kerala Bank (Box 7.4). If this experiment rolls out, it might well be the template for the future of rural cooperatives in India.

Box 7.4 Features of Kerala Cooperative Bank

Full Interview of M.S. Sriram, chairman, expert committee on Kerala Cooperative Bank (KCB), by M.K. Nidheesh, *Mint*.

What is the potential for such a bank?

This could turn out to be a large people's institution. The cooperative structure together holds 30% market share of total banking transactions in Kerala. Primary cooperatives (PCBs) together have a deposit of around ₹831.52 billion and a loan base of around ₹567.06 billion. So, if you want to look at it from banking terms and how the public sector banks calculate their business, the total business size is around ₹1.4 trillion crore at the primary level, and then the DCCBs have another ₹524.56 billion of deposits and ₹279.46 billion of loans.

Part of it will be overlapping, in the sense that the deposits that DCBs have are from the primaries and some of the loans given are also to the primaries. Our own estimate is that if we net if off and treat it as an integrated structure, the structure would have possibly an overall business of ₹1.1 trillion as deposits and about ₹700 billion of loans.

And, also, do not forget the touchpoints. The cooperative system already has nearly an equal number of touchpoints as all the commercial banks put together—around 6,000 branches and offices of primary cooperatives and district cooperative bank branches. These will be fully leveraged to touch the customers.

What will be the USP of such a bank?

If you are a member of the cooperative system at the primary level, then right now you are getting possibly your savings, fixed deposits, and loan services, but not many value-added services. Once the 15 institutions integrate into one unit, you will be able to get many more value-added services, which means that you need not go to some other place for your remittances, cards and other products you are looking for. It is a way of rationalizing costs to run the system. If I am putting a deposit in a primary cooperative, it is in turn putting its money in a district cooperative, which in turn is putting its money in the state cooperative. By reducing one of the tiers, we are reducing significant administrative and intermediation costs, and the benefits would be channeled back to the members.

What will be the challenges?

Huge, huge challenges. First, if they want to pull it out, they need to have a completely integrated, sophisticated technology backbone. Second, there is the issue of legacy staff. They have been doing business in a certain way and there's a certain age profile of them as well. We do not see many retirements coming up in the next 10 years. But the staff are certainly not very young staff.

You mean staff need to be added or reduced?

I would not say reduced. The government has assured that there will be no retrenchment. They need to be retrained and redeployed to adopt to modern banking. Some may be deployed in the tightened supervisory, audit, or regulatory function.

During demonetization, there was a strong buzz that cooperative banks parked a lot of black money in Kerala. This is not an image an emerging bank would want on its back. Comments?

During demonetization, none of the rural cooperatives were allowed to exchange old notes citing either the status of technology or the status of management. Both these need to be addressed, whether you like it or not.

First, the committee has recommended that in the run-up (to create Kerala Bank), their books need to be audited afresh. Second, if there are perceptions that there is a political capture or state capture, or even a perception that they are not professionally run, the perception needs to be addressed, irrespective of what the fact is. Banks are institutions that people trust, and perceptions are important.

Therefore, the committee has recommended two things. One, a two-tier board structure where regional boards will have limited powers and a central board will manage the entire structure. We have suggested that the members on the central board be subject to the fit-and-proper considerations and be approved by the RBI. The two-tier board structure will strike a balance between professionalism and regional and democratic aspirations. Second, we have recommended setting up of a "Kerala State Financial Sector Regulatory Authority" which will not only regulate and supervise primary cooperatives but all financial institutions that fall under the purview of the state government. Kerala is famous for its local financial institutions including chit funds. The regulatory authority will be a statutory authority charged with regulating the entire financial sector. So, the microfinance activities run by not-for-profits; the moneylenders, the SHG federations, all these will have to be regulated by this authority. The authority will also replace the function of the state-level coordination committee which coordinates with the RBI on nonregulated institutions. This is one way in which the state government can signal to the world that it is not a political capture and the bank is adequately insulated from political or state capture.

The cooperatives are very local institutions, and are known for their easy access to loans or deposits. Will a consolidated bank be able to retain this advantage?

While doing this exercise, we should not undermine the primary cooperatives. At this point in time, at some places the district cooperatives are competing with the primary cooperative societies. We have recommended that the new bank under should, under no circumstances be competing with the primary. It should be seen as a part of the structure and whenever the primary is ready to do business, the bank should just let go the business in favor of the primary. The KCB will only do that business that the primary is unwilling to do, or unable to do. KCB will remain thin, it should be a coexistence and convergence of interests, and not conflict of interests.

Has this experimented anywhere else?

Not in India. Some states already had a two-tier structure. Jharkhand is going through a restructuring exercise, but their situation is completely different. But world over, there is a broad trend toward knocking off one layers in cooperative banks. But it has been a challenge everywhere. The Canadians in Quebec are consolidating their cooperative system and they took 7 or 8 years to knock off their middle tier. Rabo (Netherlands-based multinational cooperative bank) for instance did it very quickly, in about a year and a half or 2 years, and they are having their pangs. Here, it has to cross several hoops. Once we start the process and get in-principle approval from the RBI, we could possibly do it in a period of 18 months.

Source: Original interview by Nidheesh, M.K. An edited excerpt was published in *Mint*, May 10, 2017. The report of the Expert Committee on Kerala Cooperative Bank is available at http://prd.kerala.gov.in/pdf/kcbreportfinal.pdf (accessed on August 16, 2017).

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Urban Cooperative Banks[1]

8
Chapter

INTRODUCTION

In terms of policy discourse, there has not been much to report since last year. While one was expecting some action after the submission of the Gandhi Committee Report in the past year, not much action has happened on this front. Historically, the space has been somewhat frozen, even though the Madhav Rao Committee that was set up in 1998, and later the Malegam Committee set up in 2010, had recommended that more licenses be given to UCBs. While there were some issues after the collapse of the Madhavpura Mercantile Cooperative Bank, there have been no fresh licences issued, except for some pending applications that were cleared (Gandhi 2015). This is in spite of the recommendations of the Malegam Committee and the Gandhi Committee, and also the assertion made by the RBI in the paper on the way forward for the banking system (RBI 2013). While, conceptually, the RBI is willing to consider fresh licences, it possibly needs a somewhat greater level of comfort in terms of both the internal governance systems and the external regulatory environment to open up the space for more licences.

By way of concrete developments in the UCB segment of the banking industry in the country, there does not appear to be anything that has happened in comparison to the turmoil in commercial banking segments (Figure 8.1). It must be said that the

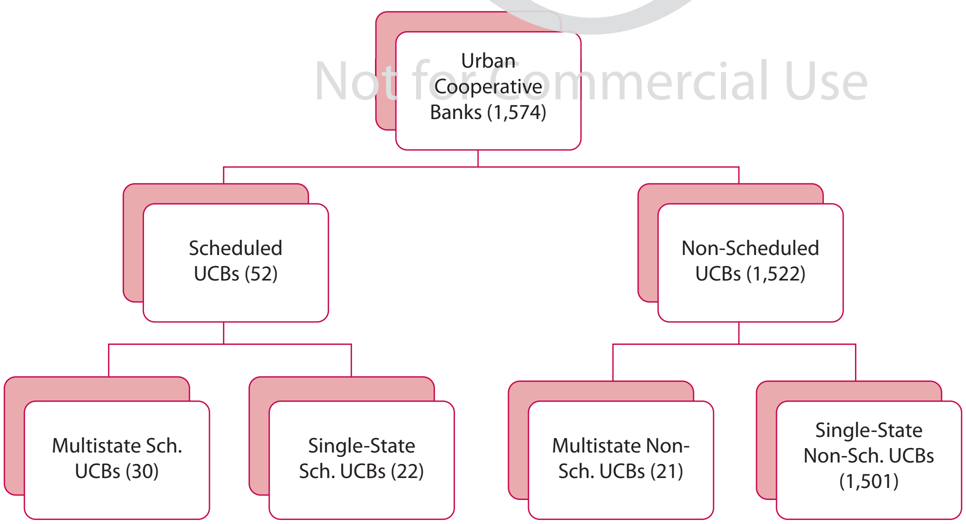

Figure 8.1 Structure of Urban Cooperative Banks in India as of March 31, 2016

Source: RBI (2016).

[1] The author is thankful to D. Krishna, former CEO of the National Federation of Cooperative Urban Banks, for useful comments and inputs on an earlier draft of this chapter.

sense of steadiness seen in the urban banking sector in recent years can be looked upon as an indicator of the maturing of these most grassroots-level banking institutions in the country. In terms of policy discourse, there was not much action in this area. It does not appear that the RBI has been considering issuance of new licences for UCBs, even though there have been multiple committees that have looked into the aspect in the past and recommended that new licences be issued. Similarly, the application of two banks—the REPCO Bank and Guardian Cooperative Bank—for conversion into an SFB was not considered. In a way, the status quo in the UCB sector continues. While there was no policy action, the aspect of whether cooperative banks should be converted into commercial banks was examined in a paper that was published during the year (Khanna and Ramesha 2016).

The paper that considered the recommendations of the Gandhi Committee and examined the aspect of the concept of "too big to be a cooperative" went into the technicality of conversion, examining the provisions in the legal framework, and concluded that the current legal framework does not permit the conversion easily. The paper, however, argued that the financial analysis indicates that the larger cooperative banks are performing on par or better than the old generation private sector banks and, therefore, there was a case for consideration. However, the basic aspect of violation of the cooperative nature of the entity did not get much consideration in the paper.

From Table 8.1, it is evident that the number of UCBs was reduced by five by the end of March 2016, and the deposits and advances had marginally grown, reflecting the rate of growth of the past. There was not much of a dramatic movement in this sector.

Table 8.1 UCBs in the Recent Years

Year	No. of UCBs	Deposits (₹ Billion)	Advances (₹ Billion)
2012	1,618	2,386.41	1,577.93
2013	1,606	2,768.30	1,810.31
2014	1,589	3,155.03	1,996.51
2015	1,579	3,551.35	2,251.06
2016	1,574	3,922.00	2,450.00

Source: Reserve Bank of India: Primary (Urban) Cooperative Banks Outlook. Mumbai RBI 2017.

REGIONAL SPREAD

In terms of regional spread, the UCBs continue to be concentrated in the western and southern parts of India. At 738 UCBs, the western region had the highest number of UCBs, followed by 555 in the southern region (Table 8.2). These regions represented 88% of the branch network of the UCBs across the country. Even in terms of business, ATM roll-out, and coverage, the western region appears to be fully covered, while there is much that could be done in the northeastern region. The Malegam Committee (Malegam 2011) had suggested a different dispensation for licensing banks in the northeastern region, and it may be a good idea for the RBI to actively open up the licensing and encourage people to organize themselves on cooperative principles of banking.

Table 8.2 Region-wise Spread of UCBs as of March 2016

Region	No. of UCBs	No. of Branches (Including HO)	No. of Extension Counters	No. of ATMs	No. of Districts with a UCB Branch	No. of Districts without a UCB Branch	Deposits (₹ Billion)	Advances (₹ Billion)
North	72	405	14	70	68	55	136.64	87.05
North East	16	50	1	2	14	86	13.76	8.04
East	58	167	6	11	32	87	55.44	28.79
Central	135	510	21	128	91	75	138.18	73.42
West	738	6,801	173	2,466	71	3	2,912.79	1,831.96
South	555	2,158	23	284	109	16	664.95	420.85
All India	1,574	10,091	238	2,961	385	322	3,921.35	2,250.12

Source for 2016: Primary (Urban) Cooperative Banks Outlook. Mumbai RBI (2016). Accessed on July 11, 2017 at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4

UCBs AND INCLUSIVENESS

In the 2016 report, it was adequately demonstrated that the UCBs actually represent the smaller customer. As we can see from Table 8.3, UCBs lend more than 50% of their portfolio to the sector. Being urban in nature, they obviously have a lesser exposure to the agricultural sector. Examining the portfolio of the commercial banks where around 18% of the bank credit is targeted for agriculture (and is generally being achieved), it is remarkable that the UCBs have such a great penetration to the sector.

Eventually, as the statistics of the SFBs start coming out, in future years, we would be able to examine and comment on whether the UCBs tend to be more inclusive.

The data available in Table 8.3 also shows that the UCBs are able to deploy about 14% of their portfolio to weaker sections, which is significantly higher than the stipulated 10%. Even the requirement for deployment to weaker sections more is recommendatory than mandatory. Therefore, it is important to recognize the role that the UCBs play in the larger mandate of inclusion, particularly in the urban areas.

The financial performance of UCBs was satisfactory. The average return on assets of the banking system was 0.42 for the year 2015–16. The public sector banks as a class had a negative return on assets. As against this, the UCBs had a return of 0.79%, which could be considered satisfactory. The best returns were obtained by the private sector banks at 1.50%, indicating the scope for improvement of the other players in the banking system, including UCBs. Similarly, the average return on equity of the banking sector was at 6.78%, and the private sector banks had a return on equity of 13.81%. As against this, the UCBs had a figure of 9.26%, which is well above the average return of the banking sector. In general, it can be seen that the nonscheduled UCBs have a better performance (Tables 8.4 and 8.5).

Table 8.3 Composition of Credit to PSL by UCBs as of End-March 2016

Advances of UCBs to PSL and Weaker Section (Amount ₹ Billion)						
	Composition of Total PSL Credit			*Of Which*, Composition of Credit to Weaker Sections		
Sector	March 31, 2015	March 31, 2016	Percentage to Total (2016)	March 31, 2015	March 31, 2016	Percentage to Total (2016)
1. Agricultural credit	56	62	2.54	23	26	1.06
1.1 Direct agricultural credit	21	24	0.97	9	10	0.41
1.2 Indirect agricultural credit	34	39	1.57	14	16	0.65
2. Micro and small enterprises	523	587	23.97	95	106	4.34
2.1 Direct credit to micro and small enterprises	434	487	19.88	74	83	3.40
2.2 Indirect credit to micro and small enterprises	89	100	4.09	21	23	0.95
3. Microcredit	49	55	2.24	19	21	0.85
4. State-sponsored organizations for SC/ST	1	1	0.05	3	3	0.12
5. Education loans	17	19	0.79	7	8	0.32
6. Housing loans	229	257	10.50	79	88	3.61
7. Others	233	262	10.69	86	97	3.94
All priority sectors	1,108	1,244	50.78	311	349	14.25

Source for 2015: Primary (Urban) Cooperative Banks Outlook. Mumbai RBI (2016). Accessed on May 3, 2016 at http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4

Source for 2016: Primary (Urban) Cooperative Banks Outlook. Mumbai RBI (2017). Accessed on July 11, 2017 at https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4

Notes: 1. Percentages are with respect to total credit of UCBs.
2. Components may not add up to the total due to rounding off.

Table 8.4 **Select Financial Indicators of UCBs as of March 31, 2016**

(%)

Financial Indicators	All SCBs	Scheduled UCBs		Nonscheduled UCBs		All UCBs	
	2015–16	2014–15	2015–16	2014–15	2015–16	2014–15	2015–16
(1)		(2)	(3)	(4)	(5)	(6)	(7)
Return on assets	0.31	0.70	0.61	0.97	0.95	0.84	0.79
Return on equity	3.59	8.94	7.77	10.65	10.43	9.91	9.26
Net interest margin	2.60	2.50	2.52	3.39	3.33	2.97	2.95

Source: Mumbai: Reserve Bank of India database, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2017.
Note: Data for 2015–16 are provisional.

Table 8.5 **Nonperforming Assets of UCBs**

As of March 31, Amount in Rupees Billion

S. No.	Items	As on March 31 2015	As on March 31 2016
1	Gross NPAs	138.02	160.56
2	Gross NPA ratio (%)	6.15	6.55
3	Net NPAs	61.05	71.41
4	Net NPA ratio (%)	2.84	3.05
5	Provisioning	76.97	89.15
6	Coverage ratio (%)	55.77	55.52

Source: Mumbai: Reserve Bank of India database, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2017.
Note: Data for 2015 are provisional.

UCBs: THE WAY FORWARD

What is more important to note are some important aspects that should be taken into consideration as the policy moves forward. In the past, we have discussed how local area banks have not been particularly successful. They largely suffer from both portfolio and geographic concentration risks. Also, given that the local area banks were very rural oriented, they possibly did not have adequate density of population to cater to within a limited area and still remain profitable.

The UCBs have demonstrated something that is counterintuitive. Most of them have limited banking facilities, they operate in limited area, the average ticket size of both deposits and loans are much smaller than the commercial banks, and their gross NPAs over the years has remained at around 6%. They are not institutions that grow very fast or that pose a systemic risk. Therefore, there might be a design feature in the UCBs that could show the way forward for urban financial inclusion. All our focus on inclusion, whether it is the SHG movement, the cooperative movement, or the policy intervention in mainstream banking, has come from the prism of solving a rural credit problem. Some of the models, particularly the MFI models, have grown into urban institutions as well. However, it is time that we look at the urban financial inclusion challenge afresh and see if UCBs offer a design proposition.

That a banking institution could be established with low levels of capital, limited area of operation, and limited financial products; grow to get scheduled, add services; get integrated with the payment systems; and become a full-service bank, including offering electronic banking, credit, and debit cards shows that the design principles may work for the urban inclusion. While there could be a geographic concentration, the portfolio could be well diversified and the area could have an adequate density of population to make banking profitable. Therefore, the concept of a limited area neighborhood bank in the urban areas with

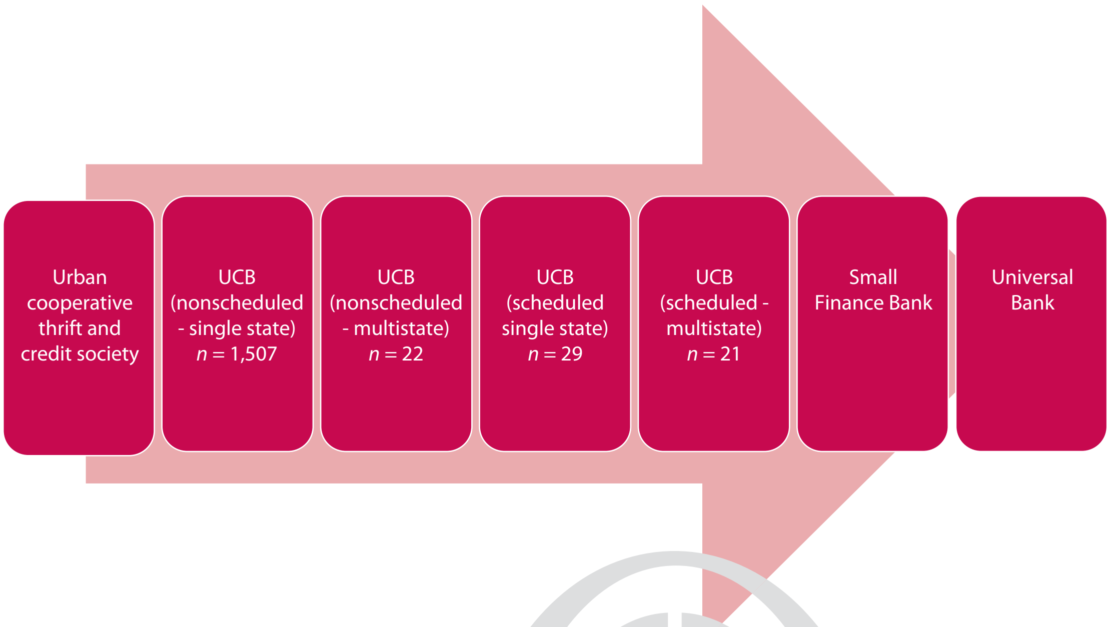

Figure 8.2 Pathways for Urban Cooperatives

Source: Conceptualized by the author based on the Gandhi Committee Report.

a low threshold of capital and adding complexity as it grows should be examined. The UCBs have shown that it is indeed possible.

Of course, the challenge with such a decentralized banking model is going to be about the capture, quality of governance, and supervisory and regulatory load that would entail on the regulator. This can be partly offset by having graded regulation mechanisms—not an idea that has not been tried out—where organizations like NABARD have been supervising cooperatives and RRBs. The KCB suggested a state financial regulatory authority, which could also be a solution for local-level institutions that do not pose a national systemic risk. Surely, there could be adequate coordination mechanisms in place to take care of such a model.

The pathway for urban cooperatives as suggested during the last year is shown in Figure 8.2.

However, the question is whether an SFB is a progression of a UCB or if a UCB could run parallel with an SFB in terms of its size and activities is something that needs to be examined.

We also need to address the rhetorical question on whether a cooperative bank will become "too big to be a cooperative." Possibly, this question should be flipped around to examine the design and organizational features of a large cooperative banking institution. We may have an alternative in the design that embeds the cooperative nature of investment and control and the banking type of functions when these institutions become large.

CONCLUDING NOTES

There is much to be done in the urban cooperative sector, examining the potential of the design for addressing the large problem of urban financial inclusion. The design emanating out of addressing rural financial inclusion may not be appropriate, and this might be a good time to visit this issue.

APPENDIX 8A
Financial Performance of UCBs as of March 31, 2016

Profit and Loss Account of Urban Cooperative Banks (As of March 31, 2016; Amount in ₹ Billions)

Item	Scheduled UCBs		Nonscheduled UCBs		All UCBs		% Growth
	2015	2016	2015	2016	2015	2016	
1. Interest/Discount received [2 + 3 + 4 + 5]	173.39	191.09	232.89	252.65	406.28	443.74	9.22
2. Interest/Discount received on loans and advances (other than from banks)	119.89	132.25	159.56	174.59	279.45	306.83	9.80
3. Interest on market lending (to banks, if any)	1.21	1.20	2.36	2.92	3.57	4.12	15.38
4. Interest on investments	44.40	49.06	61.96	65.92	106.36	114.98	8.11
5. Interest on additional balance with RBI, interbank deposits, placements, and credits	7.89	8.58	9.01	9.23	16.91	17.81	5.36
6. Other income	20.83	16.99	12.81	13.84	33.65	30.83	−8.37
7. Total income [1+6]	194.22	208.08	245.71	266.49	439.93	474.57	7.87
8. Interest paid	124.24	136.03	158.03	172.25	282.27	308.28	9.22
9. Operating expenses	20.02	22.05	30.33	32.29	50.36	54.34	7.91
10. Other operating expenses	20.15	20.57	21.95	24.64	42.09	45.21	7.40
11. Total expenses [8 + 9 + 10]	164.41	178.65	210.31	229.18	374.72	407.83	8.84
12. Operating profit (+)/loss (–) [7–11]	29.81	29.43	35.40	37.31	65.21	66.74	2.35
13. Provision against risks/contingencies	9.23	10.00	7.52	7.53	16.75	17.53	4.63
14. Net profit (+)/loss (–) before taxes [12–13]	20.58	19.43	27.88	29.78	48.46	49.21	1.56
15. Provisions for taxes	6.80	6.10	6.55	6.91	13.35	13.01	−2.53
16. Net profit (+)/Loss (–) after taxes [14–15]	13.77	13.33	21.33	22.87	35.11	36.20	3.11

Source: RBI Data Warehouse, https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2017.

Notes: 1. Data for 2015–16 are provisional. 2. Components may not add up/subtract to the whole due to rounding off. 3. Percentage variation could be slightly different because absolute numbers have been rounded off to rupees billion. 4. Value zero indicates nil or negligible.

APPENDIX 8B
Liabilities and Assets of UCBs

Balance Sheet of Urban Cooperative Banks (As on March 31) (Amounts in ₹ Billion)

Items	Scheduled UCBs 2015	Scheduled UCBs 2016	Nonscheduled UCBs 2015	Nonscheduled UCBs 2016	All UCBs 2015	All UCBs 2016	Growth (%)
Liabilities							
1) Capital	30.81	35.85	68.73	74.2230	99.54	110.07	10.58
	(1.51)	(1.58)	(2.97)	(2.95)	(2.29)	(2.30)	
2) Reserves and surplus	131.47	142.45	142.29	153.50	273.75	295.95	8.11
	(6.46)	(6.28)	(6.14)	(6.11)	(6.29)	(6.19)	
3) Deposits	1,642.21	1,844.08	1,909.13	2,077.71	3,551.34	3,921.79	10.43
	(80.65)	(81.23)	(82.44)	(82.65)	(81.60)	(81.98)	
4) Borrowings	19.01	24.04	3.44	2.11	22.46	26.15	16.46
	(0.93)	(1.06)	(0.15)	(0.08)	(0.52)	(0.55)	
5) Other liabilities and provisions	212.64	223.71	192.25	208.47	404.89	432.18	6.74
	(10.44)	(9.85)	(8.30)	(8.29)	(9.30)	(9.03)	
Total liabilities	2,036.14	2,270.13	2,315.84	2,513.90	4,351.97	4,784.04	9.93
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	
Assets							
1) Cash in hand	10.80	11.89	26.93	30.42	37.74	42.31	12.11
	(0.53)	(0.52)	(1.16)	(1.21)	(0.87)	(0.88)	
2) Balances with RBI	84.30	86.56	12.94	15.07	97.24	101.63	4.51
	(4.14)	(3.81)	(0.56)	(0.60)	(2.23)	(2.12)	
3) Balances with banks	142.37	150.58	216.17	409.17	358.54	559.75	55.96
	(6.99)	(6.63)	(9.33)	(16.28)	(8.24)	(11.70)	
4) Money at call and short notice	7.32	18.27	12.53	14.28	19.85	32.55	63.93
	(0.36)	(0.80)	(0.54)	(0.57)	(0.46)	(0.68)	
5) Investments	515.07	585.12	716.00	623.99	1,231.07	1,209.11	–1.76
	(25.30)	(25.77)	(30.92)	(24.82)	(28.29)	(25.27)	
A) SLR investments	474.49	519.46	677.75	576.90	1,152.24	1,096.35	–4.82
	(23.30)	(22.88)	(29.27)	(22.95)	(26.48)	(22.92)	
i) Investments in approved securities	464.66	519.46	505.87	576.90	970.53	1,096.35	12.96
	(22.82)	(22.88)	(21.84)	(22.95)	(22.30)	(22.92)	
ii) Balances with central/state cooperative banks	9.83		171.87		181.71		–100.00
	(0.48)		(7.42)	(0.00)	(4.18)		
B) Non-SLR investments	40.58	65.67	38.25	47.09	78.83	112.76	43.03
	(1.99)	(2.89)	(1.65)	(1.87)	(1.81)	(2.36)	
6) Loans and advances	1,057.71	1,187.85	1,185.58	1,262.28	2,243.29	2,450.13	9.23
	(51.95)	(52.33)	(51.19)	(50.21)	(51.55)	(51.21)	
7) Other assets	218.56	229.86	145.69	158.71	364.25	388.57	6.60
	(10.73)	(10.13)	(6.29)	(6.31)	(8.37)	(8.12)	
Total assets	2,036.14	2,270.13	2,315.84	2,513.90	4,351.97	4,784.04	9.93
	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	(100.00)	

Source: RBI Data Warehouse, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2017.

Notes: 1. Data for 2016 are provisional. 2. Figures in brackets are percentages to total liabilities/assets. 3. Components may not add up to the whole due to rounding off. 4. Percentage variation could be slightly different because absolute numbers have been rounded off to rupees billion.

APPENDIX 8C
Distribution of UCBs by Size of Deposits and Advances as of March 31, 2016

	Distribution Based on Deposits					Distribution Based on Advances			
	No. of UCBs		Deposits			No. of UCBs		Advances	
Deposits	No.	% Share to Total	Amount	% Share to Total	Advances	No.	% Share to Total	Amount	% Share to Total
1	2	3	4	5	6	7	8	9	10
0.00 ≤ D < 0.10	135	8.58	7.60	0.19	0.00 ≤ A < 0.10	288	18.30	15.62	0.64
0.10 ≤ D < 0.25	265	16.84	45.13	1.15	0.10 ≤ A < 0.25	388	24.65	64.19	2.62
0.25 ≤ D < 0.50	325	20.65	117.22	2.99	0.25 ≤ A < 0.50	288	18.30	102.16	4.17
0.50 ≤ D < 1.00	280	17.79	196.38	5.01	0.50 ≤ A < 1.00	239	15.18	168.92	6.89
1.00 ≤ D < 2.50	305	19.38	470.21	11.99	1.00 ≤ A < 2.50	199	12.64	310.75	12.68
2.50 ≤ D < 5.00	123	7.81	442.00	11.27	2.50 ≤ A < 5.00	85	5.40	285.62	11.66
5.00 ≤ D <10.00	78	4.96	520.86	13.28	5.00 ≤ A < 10.00	52	3.30	352.30	14.38
10.00 ≤ D	63	4.00	2,122.39	54.12	10.00 ≤ A	35	2.22	1,150.56	46.96
Total	1,574	100.00	3,921.79	100.00	Total	1,574	100.00	2,450.13	100.00

Source: RBI Data Warehouse, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2017.
Notes: 1. Data are provisional. 2. Components may not add up to the whole due to rounding off.

APPENDIX 8D
Rating-wise Distribution of UCBs as of March 31, 2016

(Amount in ₹ Billion)

Ratings	No. of UCBs	% Share in Total	Deposits	% Share in Total	Advances	% Share in Total
A	406	25.79	1,318.81	33.63	816.77	33.34
B	824	52.35	2,103.46	53.64	1,349.53	55.08
C	274	17.41	402.38	10.26	235.45	9.61
D	70	4.45	97.14	2.48	48.38	1.97
Total	1,574	100.00	3,921.79	100.00	2,450.13	100.00

Source: RBI Data Warehouse, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2015.
Notes: 1. Data are provisional. 2. Components may not add up to the whole due to rounding off. 3. Ratings are based on the inspection conducted during FYs 2014–15 to 2015–16. 4. Percentage variation could be slightly different because absolute numbers have been rounded off to rupees billion.

APPENDIX 8E
Bank-wise Select Financial Parameters of Scheduled UCBs as of March 31, 2016

S. No.	Bank Name	Average Cost of Deposits (%)	Average Yield on Advances (%)	NII to TA (Spread) (%)	NII to WF (%)	Non-II to WF (%)	Return on Assets (ROA) (%)	CRAR (%)	B/E	P/E
1	Abhyudaya Cooperative Bank Ltd., Mumbai	7.49	10.50	1.90	1.93	0.65	0.02	12.34	61.88	0.01
2	Ahmedabad Mercantile Cooperative Bank Ltd.	7.20	11.39	3.36	3.44	0.33	1.33	29.05	69.26	0.78
3	Amanath Cooperative Bank Ltd. Bengaluru	7.85	10.51	1.34	2.78	3.55	0.00	150.80	17.50	0.78
4	AP Mahesh Cooperative Urban Bank Ltd.	7.90	14.89	3.49	3.50	0.36	1.04	20.55	50.13	39.05
5	Apna Sahakari Bank Ltd	7.93	12.29	2.44	2.56	2.13	0.59	13.16	75.02	4.75
6	Bassein Catholic Cooperative Bank Ltd.	7.82	12.30	2.97	2.97	0.21	1.31	18.06	161.15	1.50
7	Bharat Cooperative Bank (Mumbai) Ltd., Mumbai	8.37	13.54	2.88	2.90	0.85	1.23	13.18	120.35	0.93
8	Bharati Sahakari Bank Limited.	7.71	12.91	2.68	2.82	0.18	0.57	16.95	66.37	0.27
9	Bombay Mercantile Cooperative Bank Limited	5.80	10.85	2.28	2.92	1.23	0.03	12.39	24.30	0.01
10	Citizen Credit Cooperative Bank Ltd., Mumbai	7.19	11.97	2.78	2.80	0.50	0.69	18.97	76.20	0.40
11	Cosmos Cooperative Urban Bank Ltd.	8.01	12.11	2.38	2.50	2.09	0.15	13.62	89.40	0.10
12	Dombivli Nagari Sahakari Bank Ltd.	7.71	12.25	2.70	3.12	1.06	0.89	12.48	88.16	0.50
13	Goa Urban Cooperative Bank Limited	6.98	10.23	2.68	2.85	0.32	0.32	14.40	43.49	0.14
14	Gopinath Patil Parsik Janata Sahakari Bank Ltd	6.34	12.49	3.95	3.97	0.62	1.05	20.43	60.58	0.49
15	Greater Bombay Cooperative Bank Limited	7.38	13.22	2.54	2.57	1.06	0.65	13.36	71.73	0.52
16	Indian Mercantile Cooperative Bank Ltd.	12.95	15.69	4.16	3.67	0.12	9.05	42.89	8.76	0.11
17	Jalgaon Janata Sahakari Bank Ltd.	7.68	13.32	2.97	3.00	0.98	0.58	12.01	52.10	0.21
18	Janakalyan Sahakari Bank Ltd., Mumbai	7.18	11.69	2.24	2.24	0.48	0.05	13.31	82.27	0.05
19	Janalaxmi Cooperative Bank Ltd., Nashik	6.67	7.25	1.39	2.60	2.84	2.18	34.01	9.67	0.97
20	Janata Sahakari Bank Ltd., Pune.	8.34	13.16	2.78	2.85	0.60	0.76	13.90	123.36	1.26
21	Kallappanna Awade Ichalkaranji Janata Sahakari Bank Ltd.	7.85	12.48	2.67	2.76	0.46	0.64	12.48	54.31	0.21
22	Kalupur Commercial Coop. Bank Ltd.	7.37	11.73	2.86	2.96	0.59	1.32	16.22	110.80	1.09
23	Kalyan Janata Sahakari Bank Ltd., Kalyan	7.61	12.65	2.82	2.87	0.91	0.94	12.95	75.17	0.53
24	Karad Urban Cooperative Bank Ltd.	8.30	13.34	2.82	2.87	0.41	0.41	11.22	60.15	0.17
25	Mahanagar Cooperative Bank Ltd., Mumbai	7.66	13.34	3.41	3.59	0.43	0.69	13.51	66.86	0.32
26	Mapusa Urban Coop Bank of Goa Ltd., Mapusa	7.43	13.36	2.12	2.72	0.71	0.00	–10.37	31.85	0.00
27	Mehsana Urban Cooperative Bank Ltd.	8.13	12.77	2.96	2.91	0.29	2.11	12.53	122.02	0.80
28	Nagar Urban Cooperative Bank Ltd., Ahmednagar	8.35	14.93	3.85	4.07	38.77	0.85	15.48	41.25	0.25

(Continued)

(Continued)

S. No.	Bank Name	Average Cost of Deposits (%)	Average Yield on Advances (%)	NII to TA (Spread) (%)	NII to WF (%)	Non-II to WF (%)	Return on Assets (ROA) (%)	CRAR (%)	B/E	P/E
29	Nagpur Nagrik Sahakari Bank Ltd.	6.89	11.33	2.26	2.30	3.52	0.33	21.25	35.28	0.09
30	Nasik Merchant's Cooperative Bank Ltd.	6.90	14.12	4.70	4.83	0.75	2.15	32.27	42.26	0.73
31	New India Cooperative Bank Ltd., Mumbai	7.36	12.02	2.56	2.58	0.55	2.60	12.38	114.01	0.29
32	NKGSB Cooperative Bank Ltd., Mumbai	7.77	12.40	2.58	2.63	0.87	0.66	12.70	90.22	0.39
33	Nutan Nagarik Sahakari Bank Ltd., Ahmedabad	7.27	11.43	2.46	2.44	0.63	0.55	15.21	83.91	0.33
34	Pravara Sahakari Bank Ltd.	7.58	13.93	3.61	3.66	0.28	1.01	13.23	34.74	24.71
35	Punjab & Maharashtra Cooperative Bank Ltd.	8.28	14.52	3.40	3.41	0.51	0.94	12.22	85.26	0.51
36	Rajkot Nagrik Sahakari Bank Ltd.	7.84	12.99	2.11	2.87	0.62	1.31	13.59	60.18	0.60
37	Rupee Cooperative Bank Ltd.	5.28	6.86	–0.09	–0.24	0.08	–2.14	11.34	36.72	–0.50
38	Sangli Urban Cooperative Bank Ltd., Sangli	8.32	13.02	2.27	2.55	0.74	0.07	12.01	31.60	0.02
39	Saraswat Cooperative Bank Ltd., Bombay	7.46	11.39	1.64	1.79	1.07	0.62	12.15	123.89	0.51
40	Sardar Bhiladwala Pardi Peoples Coop Bank Ltd.	6.51	11.00	3.01	3.13	0.16	0.55	19.07	69.85	0.27
41	Shamrao Vithal Cooperative Bank Ltd.	7.92	12.19	2.16	2.41	0.91	0.83	12.46	87.99	0.47
42	Shikshak Sahakari Bank Ltd., Nagpur	7.86	12.80	2.63	2.91	1.04	0.56	14.57	35.31	0.14
43	Solapur Janata Sahakari Bank Ltd.	8.15	14.89	3.91	4.32	0.49	1.00	12.17	66.42	0.45
44	Surat Peoples Cooperative Bank Ltd.	8.10	12.77	3.32	3.34	0.27	0.94	15.55	144.93	0.91
45	Thane Bharat Sahakari Bank Ltd.	7.33	12.40	2.89	3.04	0.87	10.20	12.22	56.42	0.05
46	The Akola Janata Commercial Cooperative Bank Ltd.,	7.52	13.02	2.97	3.06	0.84	1.23	15.32	39.01	0.21
47	The Akola Urban Cooperative Bank Ltd., Akola	7.85	12.09	1.34	1.52	0.42	–1.25	5.74	37.27	–0.33
48	The Kapol Cooperative Bank Ltd., Mumbai	7.09	9.22	0.98	0.86	0.94	–3.91	–25.75	24.59	–0.87
49	The Khamgaon Urban Cooperative Bank Ltd.	6.48	12.57	3.12	3.31	0.75	2.00	19.92	29.75	0.30
50	TJSB Sahakari Bank	7.71	12.56	2.62	2.69	0.73	1.13	13.34	104.54	0.81
51	Vasai Vikas Sahakari Bank Ltd.	7.56	12.22	2.40	2.43	0.56	0.70	11.18	76.66	0.34
52	Zoroastrian Cooperative Bank Ltd., Bombay	7.05	12.45	3.54	3.55	0.46	1.21	17.12	63.47	0.77

Source: RBI Data Warehouse, http://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on July 11, 2015.
Data are provisional.

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India Post and the Inclusion Agenda[1]

9 Chapter

During the current year, there were some changes in the landscape with India Post starting its foray into niche banking through the IPPB. However, the importance of the postal network cannot be undermined, particularly when it collects significant amounts of savings, and all the savings that India Post collects are from individuals. In all, if we add up the savings collected by the banking sector and that of India Post for March 2016, it is to the extent of ₹103.40 trillion, and we find that India Post has a market share of more than 6.58%. India Post is the second-largest player in the savings segment after the State Bank group, which has a share of around 21.0% as of March 2016. The significance of India Post as a collector of savings deposits should be seen in the light of the fact that all the customers of India Post are individuals and that there are no institutional deposits. While 75% of the deposits of the commercial banking sector and 67% of the deposits collected by the State Bank group comes from urban and metropolitan branches, by virtue of the sheer presence in the rural areas, India Post would be collecting a bulk of the deposits from areas where the banking is relatively weak.

Moreover, of the total deposits collected by the entire banking system, only about 1.6% of the deposits (in amount) came from deposits under ₹500,000. This amount adds up to ₹1.6 trillion. As against this number, the India Post figure of ₹6.8 trillion comes predominantly from small deposits from retail investors. In the context of inclusion, it should be granted that India Post is the most significant player in the savings segment, specially catering to the smaller savers.

PHYSICAL OUTREACH OF THE POSTAL NETWORK

During the year, there was some marginal change in the number of outlets of the postal department. While the overall number of postal outlets marginally decreased from 154,939 to 154,910, it continued to be the largest postal network in the world (see Figure 9.1). Nearly 90% of this network is located in rural India. On an average, 8,364 people are served by a post office in the country. In rural areas, a post office serves 6,275 people and in urban areas a post office serves 26,553 people.

The size of the India Post network in terms of physical presence is formidable. However, in terms of the growth of the presence, it seems to have flattened out, with not much of a growth in any of the

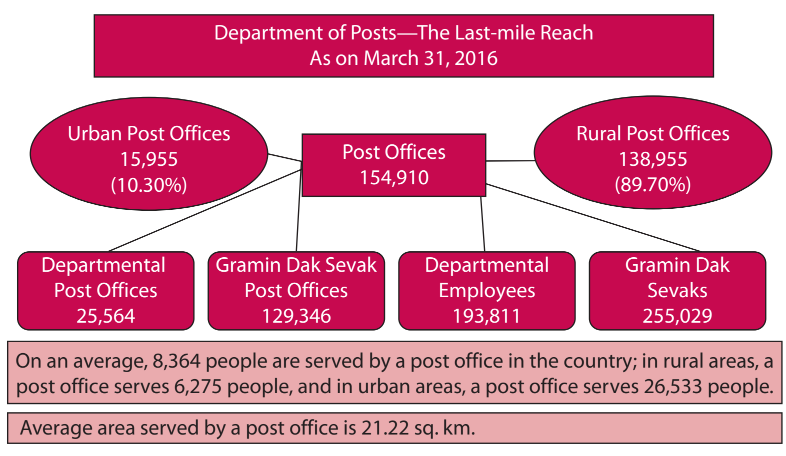

Figure 9.1 India Post—Reach

Source: Government of India (2017) Annual Report 2016–17, New Delhi: Department of Posts, Ministry of Communications and Information Technology, Government of India.

[1] The author is indebted to Madhumita Das, deputy director general, India Post, and Professor Chinmay Tumbe of IIM Ahmedabad for having reviewed the chapter and offered some very useful inputs.

Table 9.1 Number of Postal Outlets as of March 2016

	Departmental Post Offices			GDS Post Offices			Total Post Offices		
Region	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
North	1,684	2,065	3,749	17,968	186	18,154	19,652	2,251	21,903
North East	571	391	962	5,746	227	5,973	6,317	618	6,935
East	2,213	2,269	4,482	24,549	355	24,903	26,762	2,624	29,385
Central	1,500	2,819	4,319	27,104	403	27,507	28,604	3,222	31,826
West	1,676	1,881	3,557	18,062	223	18,285	19,738	2,104	21,842
South	4,534	3,961	8,495	33,348	1,175	34,523	37,882	5,136	43,018
TOTAL	12,178	13,386	25,564	126,777	2,569	129,345	138,955	15,955	154,909

Source: Government of India (2017) Annual Report 2016–17, New Delhi: Department of Posts, Ministry of Communications and Information Technology, Government of India.

numbers. India Post has been looking at reorganizing its network and service delivery, and this space needs to be watched as the department rolls out the synergy between the department and the new IPPB. Table 9.1 gives the details of the reach of the postal network broken down into regions.[2]

Most of the action at the ground level is happening at the level of the GDS, with the department announcing that they would be recruiting more than 11,000 GDS in 2017. Similarly, the department has also called for applications for people to run franchisee outlets. Both these would spread the reach of India Post. In case of GDS, the new recruitments replace the reduction of about 6,000 GDS from March 2015 to March 2016. Last year, it was reported by a study (Fargose and Utkarsh 2016) that in Karnataka about 28% of the workforce is aged below 30 years, while 37% of the GDS are aged over 50 years. With the new recruitments, the age profile of the candidates may change. However, the issue to be examined is whether the services of GDS and franchisees, which are largely oriented toward rendering postal services, are extended to financial services as well, and how it can be dovetailed with the IPPB.

Unlike bank branches where most of the premises are owned or rented by the banks, the outreach of the postal department is largely through the premises that are to be hired by the GDS or the franchisees. These are the necessary pre-conditions for the appointment of these agents. In that sense, the postal department has in place what could technically be called an outsourced model—this is the classic BC model tested over time. However, this model has not been leveraged to scale, and the services offered by these outreach agents are largely related to postal services rather than financial services. The question on how this network could be leveraged in the future years is crucial.

The premises owned and rented by the postal department remained broadly similar to the previous year. The details are given in Table 9.2.

As a part of the modernization project, all the departmental post offices (DPOs) in the country have been computerized. A data center has been established and has started functioning at Navi Mumbai and a disaster recovery center is established in Mysore. As of March 2017, 28,248 DPOs including mail offices and administrative offices were networked under a single wide area network and connected to the data center. CBS was in operation in

Table 9.2 Properties under the Control of India Post (Region-wise)

Region	Owned	Rented	Free	Total
North	805	2,614	377	3,796
North East	264	646	80	990
East	708	3,641	386	4,735
Central	616	3,612	249	4,477
West	690	3,018	175	3,883
South	1,289	6,875	356	8,520
Total	4,372	20,406	1,623	26,401

Source: Government of India (2017) Annual Report 2016–17, New Delhi: Department of Posts, Ministry of Communications and Information Technology, Government of India.

[2] The data is organized into six regions (north, north-east, east, central, west and south) and two classifications (rural and urban), to have a comparison with the banking network that is also organized into six regions. In the earlier chapters where we discussed banking, we consolidated the banking statistics into comparable classifications by merging rural and semi-urban into one basket and urban and metropolitan to another.

more than 23,054 post offices, and ATMs have been installed in 968 locations. The customers of the post office savings bank accounts can operate their debit cards in all these locations. More importantly, any bank customer could use the postal ATMs and vice versa as these facilities have been made fully interoperable.

The modernization project has also focused on the northeastern region. The Assam circle has 717 post offices, the North East circle has 304 offices, and Sikkim has 21 offices covered by wide area network. The CBS is in operation in 507 offices in Assam circle, 127 offices in North East circle, and 7 offices in Sikkim. Of the ATMs, Assam had 26, the North East circle had 10, and Sikkim had 1. In addition, the core insurance solution to bring the postal life insurance (PLI) on a technology platform has also been rolled out in 25,406 post offices including 627 in Assam, 333 in the North East, and 23 in Sikkim.

Extension of CBS increases the scope of inter-post office transactions, increasing their effectiveness. In addition, the ATM facilities as well as Internet and mobile banking services were made available to the customers having post office savings bank accounts. The rural ICT project that was launched in three pilot circles, namely, Rajasthan, Bihar, and UP, was extended to Assam, Karnataka, and Maharashtra and was rolled out in 4,425 branch offices. In the ensuing year, it is planned to roll out this project to 40,000 postal outlets. In addition to rolling the ICT project in branch offices during the year, GDS outlets were also included. As of March 2017, 4,374 GDS outlets had rural ICT rolled out. The rural ICT connects the postal network with the GDS through a handheld device connecting through a sim card.

FINANCIAL SERVICES

Savings

Over the years, India Post has been offering multiple savings products catering to different requirements. The postal department will have to review the balances in the cumulative time deposits (CTD) that are really low and possibly revisit the product to see if it still holds out promise. As the IPPB takes off, a part of these services may be ported to the new technology-enabled bank. The low average balances when compared to average bank account balances and low balance requirements for most schemes indicate that the postal department is serving significantly smaller customers.

The sale of Kisan Vikas Patras (which are bearer-like savings instruments due to the ease of transfers) increased to ₹298 billion. While the Shyamala Gopinath Committee (Gopinath 2011) had recommended the withdrawal of Kisan Vikas Patras, the scheme continues. The only change introduced in 2016 was that the certificates for investment in this scheme moved from paper certificates to electronic receipts.

A new scheme for the welfare of the girl child was launched by the government under the name of Sukanya Samriddhi Yojana in 2015. Under this scheme, India Post collected ₹45 billion from 5.8 million depositors. This is a long-term scheme and the balances are expected to grow as time progresses.

Similarly, two of the flagship insurance schemes of the government—the PMJJBY (life insurance) and the PMSBY (accident insurance), which were launched soon after the PMDJY scheme—were made available to the account holders of the savings bank accounts in post offices as well. Both these schemes have had an enrolment of 1.1 million and 71,918 individuals respectively by December 2016. These numbers are telling given that even after a year of launch of these schemes in about 18,000 post offices, the off-take of the sale of policies even in the limited number of outlets has been around 60 policies per post office for life and around less than four policies per postal outlet for accident.

While there is fair bit of euphoria and buzz around the number of postal outlets and the potential it could achieve if harnessed and leveraged well, it appears that for financial services—particularly for the newly added services—India Post has not achieved significant numbers in comparison to its potential (Table 9.3).

Remittances

India Post is a major player in remittances, both domestic and international. However, it is important to note that the money order business is shrinking. As against total of 135.2 million inland money orders issued last year, the year 2015–16 had 101 million money orders. The value transacted through money orders fell from ₹141.80 billion to ₹117 billion. Clearly, traditional money orders seem to be a sunset product. With the launch of the IPPB, it is expected that a large part of this business will be carried out in a technology-enabled modern architecture. In a way, it is just as well that the department has started a new institution on a clean slate so that all the legacy systems would not drag the new innovations and initiatives. Another financial instrument for remittance the India Post has is that

Table 9.3 Balance Outstanding with India Post on Savings Schemes as of March 2016 (₹ in Billions)

Region	SB	RD	TD (incl. NSS)	PPF	MIS	CTD	Senior Citizen and Sukanya	Total
North	98.55	180.45	161.36	222.85	259.88	(0.02)	63.99	987.06
North East	21.00	27.05	9.36	7.99	41.05	0.01	3.19	109.64
East	122.22	104.92	243.01	48.38	641.21	0.09	52.42	1,212.26
Central	139.67	186.58	126.23	69.83	255.28	(0.07)	29.61	807.15
West	73.28	66.14	119.07	141.01	443.20	0.05	53.52	896.26
South	94.50	193.61	81.14	84.88	293.70	0.03	89.46	837.31
BASE	1.59	3.07	2.68	1.09	3.75	0.00	0.83	13.02
Total	550.82	761.82	742.86	576.04	1,938.06	0.08	293.02	4,862.70
Add NSC* and KVP**								1,529.89
GRAND TOTAL								6,392.59

Source: Government of India (2017) Annual Report 2016–17, New Delhi: Department of Posts, Ministry of Communications and Information Technology, Government of India. (SB = Savings Bank, RD = Recurring Deposit, TD = Term Deposit, PPF = Public Provident Fund, MIS = Monthly Income Scheme, NSS = National Savings Scheme, *NSC = National Savings Certificate. **KVP = Kisan Vikas Patra.)

Table 9.4 Details of Postal Life and Rural Postal Life Insurance Policies

Name of the Scheme	No. of Policies Procured (in '000s)	Sum Assured (₹ Billion)	Aggregate No. of Active Policies (in '000s)	Aggregate Sum Assured (₹ Billion)	Premium Income (₹ Billion)	Claims ('000s)	Claims (₹ Billion)
PLI	198	96.44	4,930	1,099.82	66.57	189	14.67
RPLI	258	26.68	14,915	817.33	20.12	106	3.98
Total	456	123.12	19,845	1,917.15	86.69	295	18.65

Source: Government of India (2017) Annual Report 2016–17, New Delhi: Department of Posts, Ministry of Communications and Information Technology, Government of India.

of postal orders. The business of postal orders reduced to 121,930 instruments with a value of ₹428 million during the past year. With the launch of the IPPB, India Post should seriously consider withdrawing these services from the postal department and transferring this completely to the new PB.

Apart from traditional money orders, India Post also offers an instant money orders (iMOs) that allows the instantaneous remittance of money. Under this service, a person can send an amount from ₹1,000 up to ₹50,000 in one transaction, and the cash will be instantaneously disbursed to the payee at any of the designated iMO Post Office in India on presentation of a 16-digit iMO number and a photo identity proof. The postal department increased the footprint of iMO offices from 16,785 to 16,977 post offices across the country.[3]

[3] Last year's report indicated that the service would be extended to an additional 7,036 post offices. However, this does not seem to have happened.

Insurance

A major contribution of India Post to financial inclusion is the provision of insurance services. The major insurance types offered by India Post are PLIs and rural PLIs. During the year, all the insurance services were completely computerized under the financial services integration project. The numbers on the insurance business is given in Table 9.4.

India Post has taken the responsibility to disburse the wages through post offices by opening savings bank accounts in the names of MGNREGA beneficiaries (in all states with the exception of J&K). As of March 2016, the scheme is operational through 96,000 post offices across the country. However, the trend of marginal increase of the number of accounts has happened and the total amounts disbursed has been at an all-time low, which brings to the fore the question of whether the postal department is indeed capable of leveraging the footprint that it has in the rural hinterland for delivering the

Table 9.5 MGNREGA Accounts and Amounts Disbursed

	Number of Accounts (Million)	Amount (₹ Billion)
2009–10	42.5	79
2010–11	49	91.79
2011–12	53.8	78.65
2012–13	57.4	120.14
2013–14	64.2	114.03
2014–15	68.2	76.88
2015–16	69.7	69.43

Source: Government of India (2017) Annual Report 2016–17, New Delhi: Department of Posts, Ministry of Communications and Information Technology, Government of India.
Note: Includes both live and silent accounts.

financial services. As we can see from Table 9.5 the average number of beneficiaries per postal outlet served is just about 726 households, and the amount of payment made turns out to be around ₹1,000 per account for the entire year. The postal department should think about how this network could be further leveraged for obvious activities like the payment of MGNREGA wages. One of the explanations that could be available is that the banks are having an active role in disbursal, but that defeats the case that the postal department is making about its outreach.

CONCLUDING NOTES

While India Post has the best reach in terms of physical outlets, its ability to convert this reach into very meaningful business propositions does not seem to have translated into effective rendering of services. This report has carried the India Post story for the past 2 years, based on the initiatives that India Post took in terms of their intended agenda of making a foray into inclusive banking. While on the savings side we see that India Post has a significant presence, it is evident that it has not been leveraging this presence to seize the moment and roll out additional services including the selling of third-party products.

One of the reasons for the optimism expressed in the past 2 years and for devoting a chapter to India Post has been because of the signals that we got from the organization—that they applied for a universal banking license, that they set up the TSR Subramanian Committee to look into the business lines that the department could undertake and reform, that they applied for a PB license, and that there was much buzz on leveraging the postal network. However, having tracked the progress on all the value-added services and the approach to leveraging its strength, it does not appear that India Post will take great initiatives beyond what it is doing currently. All the new activities and schemes added have such a marginal presence that it is not significant and substantial to track year on year.

The only development that is really worth tracking for the next few years may be the progress of the IPPB that has been set up as a separate entity, and, therefore, there is a good possibility that it will not suffer from the legacy problems. Even if India Post does not follow any of the agenda that was envisaged in the Subramanian Committee across the country, given its better presence in the North East, it may be a good idea to have at least a regional focus to rolling out modern banking services. Being a state-owned entity, it would be in a position to absorb losses and also undertake the developmental activity that will adequately pace the growth of banking in the northeastern region.

APPENDIX 9A

Scheme-wise/Year-wise Detail of Outstanding Balance of Savings Accounts with India Post as of March 31, 2016 (₹ in Billions)

Scheme	2010	2011	2012	2013	2014	2015	2016
Post Office Savings Bank	264.58	301.01	340.70	378.50	430.17	474.28	615.67
1-year Term Deposit	180.49	182.76	168.69	213.36	273.43	361.53	498.82
2-year Term Deposit	12.30	13.68	13.11	14.75	17.67	20.31	30.29
3-year Term Deposit	37.81	42.68	42.07	39.89	39.15	41.42	47.99
5-year Term Deposit	45.13	45.33	50.04	62.09	76.89	94.31	133.40
Post Office Recurring Deposits	628.18	612.50	626.61	679.62	741.49	745.13	761.79
National Savings Certificate 1987	38.74	42.31	40.58	39.63	38.69	36.89	34.97

(Continued)

(Continued)

Scheme	2010	2011	2012	2013	2014	2015	2016
National Savings Certificate 1992	5.77	4.78	4.07	3.26	2.77	2.32	1.21
Monthly Income Scheme 1987	2,016.93	2,186.74	2,052.88	2,017.87	2,020.85	2,005.57	1,938.08
Senior Citizen	249.89	309.13	267.63	240.93	224.92	179.75	228.76
MGNREGA		0	56	0	0	0	0
Post Office CTD		0	0.06	0	0.06	0.08	0.08
Others	0.44	0.36	0.22	0.22	0.22	0.22	0.22
Total	3,480.26	3,741.28	3,607.22	3,690.12	3,866.31	3,961.81	4,287.13
National Savings Certificate VI	–0.69	–0.66	–0.69	–0.75	–0.77	–0.82	–0.89
National Savings Certificate VII	–0.51	–0.43	–0.49	–0.64	–0.50	–0.53	–0.57
National Savings Certificate VIII	547.76	546.42	550.69	647.19	750.86	856.08	881.39
Indira Vikas Patra	10.22	10.20	8.94	9.07	8.96	8.87	8.91
Kisan Vikas Patra	1,539.33	1,585.84	1,539.60	1,283.75	1,067.54	848.41	648.58
Kisan Vikas Patra 2014						26.71	291.18
Others	56	60	65	20.25	56.49	95.38	113.82
Total	2,096.67	2,141.97	2,098.70	1,958.87	1,882.58	1,834.10	1,942.42
Public Provident Fund	260.96	315.83	359.93	411.21	466.08	527.48	576.03
Grand Total	5,837.89	6,199.08	6,065.85	6,060.20	6,214.97	6,323.39	6,805.58

Source: RBI Monthly Bulletin (Occasional Series, Small Savings), https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4, accessed on June 9, 2017.

APPENDIX 9B
Number of Accounts of Savings Schemes as of March 31, 2016 (Numbers in Thousands)

Circle	SB	RD	TD	FD	CTD	PPF	MIS	NSS 87	NSS 92	Sr. Citizen	Sukanya	Mahila	MGNREGA	Total
Andhra Pradesh	17,182	17,713	476	0.17	1	96	1,005	11	3	54	707	16	25,873	63,138
Assam	4,737	2,049	194	–	1	43	366	2	0	5	149	–	1,387	8,932
Bihar	12,890	3,765	2,041	–	1	50	1,382	2	0	27	253	–	6,708	27,120
Chhattisgarh	2,961	849	75	–	1	31	107	1	0	6	144	–	5,479	9,656
Delhi	1,495	577	177	0.00	9	212	432	24	1	66	110	2	–	3,107
Gujarat	6,884	5,592	2,127	–	6	219	1,814	30	0	102	183	–	2,273	19,227
Haryana	3,314	1,680	1,003	–	84	94	409	11	0	21	170	130	67	6,983
HP	1,984	2,178	496	0.02	5	24	196	1	0	5	129	–	99	5,118
J&K	1,305	272	254	–	6	8	80	1	0	2	104	21	4	2,058
Jharkhand	5,953	3,048	436	–	2	42	423	3	–	18	407	–	3,959	14,292
Karnataka	8,711	5,984	295	0.00	8	109	574	15	2	67	881	–	670	17,316
Kerala	6,457	4,954	220	0.30	(43)	20	414	5	2	9	301	0	479	12,819
MP	11,395	9,501	552	0.06	11	57	556	7	0	23	324	1,108	1,964	25,498
Maharashtra	8,723	20,301	1,475	–	20	477	1,939	74	2	142	385	–	3,569	37,107
North East	1,239	696	59	0.00	1	6	59	1	0	3	51	20	684	2,819
Odisha	7,294	4,120	435	–	9	21	457	5	0	16	292	23	1,732	14,405
Punjab	3,813	1,613	934	0.13	13	176	681	14	1	45	207	32	245	7,772
Rajasthan	11,756	4,271	362	–	3	207	661	7	1	26	297	102	1,974	19,668

Circle	SB	RD	TD	FD	CTD	PPF	MIS	NSS 87	NSS 92	Sr. Citizen	Sukanya	Mahila	MGNREGA	Total
Tamil Nadu	10,896	11,966	767	–	7	192	654	16	5	80	1,226	18	–	25,827
UP	15,608	14,413	1,781	–	24	185	1,637	18	0	104	847	332	375	35,325
Uttarakhand	3,670	1,702	311	–	9	33	164	3	0	10	219	7	212	6,340
West Bengal	14,291	4,536	2,276	–	–	140	5,503	(4)	36	206	551	–	7,034	34,569
Base PO	469	409	4	–	0	16	30	0	0	1	30	–	–	959
Total	163,030	122,190	16,750	0.68	178	2,457	19,543	249	56	1,037	7,968	1,811	64,786	400,055

Source: India Post Annual Report, 2016–17.
Abbreviations: SB = Savings Bank, RD = Recurring Deposit, TD = Term Deposit, FD = Fixed Deposit, CTD = Cumulative Time Deposits, PPF = Public Provident Fund, MIS = Monthly Income Scheme, NSS = National Savings Scheme, MGNREGA = Mahatma Gandhi National Rural Employment Guarantee Act Programme, AP = Andhra Pradesh, HP = Himachal Pradesh, J&K = Jammu and Kashmir, MP = Madhya Pradesh, UP = Uttar Pradesh, PO = Post Office.

APPENDIX 9C
Outstanding Balances in Various Savings Schemes as of March 31, 2016 (₹ in Billions)

Circle	SB	RD	TD	FD	CTD	PPF	MIS	NSS 87	NSS 92	Sr. Citizen	Sukanya	Total
Andhra Pradesh	19.39	35.34	33.38	0.00	0.00	17.07	104.19	0.97	(0.07)	14.90	6.37	231.54
Assam	15.03	16.94	4.15	–	0.00	6.67	29.88	0.12	(0.08)	1.39	0.69	74.79
Bihar	29.68	34.14	67.49	(0.00)	0.01	8.51	75.56	9.49	2.18	0.99	1.16	229.23
Chhattisgarh	8.90	18.94	7.16	(0.00)	(0.04)	6.56	18.39	0.48	(0.10)	3.03	0.62	63.93
Delhi	19.91	24.57	23.31	(0.01)	(0.01)	93.19	72.63	1.30	0.54	26.17	1.67	263.28
Gujarat	33.30	21.58	65.58	(0.00)	0.04	69.24	163.27	2.99	(2.38)	25.58	1.64	380.83
Haryana	14.69	32.51	23.11	–	(0.06)	22.56	34.03	0.75	(0.02)	6.96	2.64	137.17
HP	13.96	30.79	12.61	–	0.01	7.89	25.06	0.11	0.00	2.06	0.98	93.46
J&K	4.69	5.41	13.38	–	0.03	1.73	8.16	(0.08)	0.11	1.35	0.71	35.49
Jharkhand	(2.78)	7.07	18.67	–	0.02	1.55	54.37	(0.02)	(0.21)	4.29	1.36	84.33
Karnataka	30.59	41.45	12.51	(0.00)	0.02	29.44	62.38	0.66	1.35	22.96	9.11	210.49
Kerala	13.04	68.62	3.91	0.00	(0.00)	5.70	24.93	0.48	0.01	4.89	2.82	124.39
MP	37.71	40.97	12.04	0.01	(0.01)	12.28	41.02	0.35	(0.22)	4.76	1.66	150.57
Maharashtra	39.98	44.56	39.95	0.00	0.01	71.77	279.93	13.08	(0.21)	20.41	5.89	515.38
North East	5.98	10.11	5.11	0.00	0.00	1.31	11.17	0.09	(0.03)	0.89	0.22	34.85
Odisha	20.22	24.35	17.87	0.00	–	3.90	34.62	0.17	(0.06)	3.02	1.93	106.02
Punjab	25.52	37.47	59.42	–	(0.00)	57.74	63.57	0.99	0.90	12.91	2.06	260.58
Rajasthan	19.78	49.69	25.16	0.00	0.01	39.74	56.43	0.10	(0.29)	4.49	1.98	197.10
Tamil Nadu	31.49	48.20	25.11	(0.00)	0.00	32.66	102.19	2.52	0.27	18.25	10.17	270.86
Uttar Pradesh	78.95	104.30	91.81	(0.02)	(0.02)	43.91	169.86	0.97	0.37	8.78	6.21	505.12
Uttarakhand	14.11	22.37	13.69	–	(0.00)	7.08	26.01	(0.15)	(0.09)	3.11	1.44	87.59
West Bengal	75.10	39.36	128.31	0.26	0.06	34.43	476.65	(0.17)	(1.05)	36.89	2.77	792.59
Base PO	1.59	3.07	2.59	–	0.00	1.09	3.75	0.07	0.02	0.68	0.15	13.02
Total	550.82	761.82	706.32	0.24	0.08	576.04	1,938.06	35.26	0.95	228.76	64.26	4,862.62

Source: India Post Annual Report, 2016–17.
Abbreviations: SB = Savings Bank, RD = Recurring Deposit, TD = Term Deposit, FD = Fixed Deposit, CTD = Cumulative Time Deposits, PPF = Public Provident Fund, MIS = Monthly Income Scheme, NSS = National Savings Scheme, HP = Himachal Pradesh, J&K = Jammu and Kashmir, MP = Madhya Pradesh.

APPENDIX 9D
Distribution of Postal Outlets

	Departmental Post Offices									Gramin Dak Sevak Post Offices			Total Post Offices		
	Head Post Office			Sub Post Office			Total								
Circle	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total	Rural	Urban	Total
Andhra Pradesh	4	55	59	944	581	1,525	948	636	1,584	8,594	144	8,738	9,542	780	10,322
Assam	–	19	19	385	221	606	385	240	625	3,246	141	3,387	3,631	381	4,012
Bihar	–	32	32	637	386	1,023	637	418	1,055	7,936	46	7,982	8,573	464	9,037
Chhattisgarh	–	10	10	99	239	338	99	249	348	2,789	20	2,809	2,888	269	3,157
Delhi	–	12	12	6	389	395	6	401	407	78	69	147	84	470	554
Gujarat	–	34	34	644	663	1,307	644	697	1,341	7,524	118	7,642	8,168	815	8,983
Haryana	–	16	16	177	309	486	177	325	502	2,138	44	2,182	2,315	369	2,684
HP	3	15	18	353	97	450	356	112	468	2,310	7	2,317	2,666	119	2,785
J&K	–	9	9	94	163	257	94	172	266	1,409	26	1,435	1,503	198	1,701
Jharkhand	–	13	13	229	218	447	229	231	460	2,610	39	2,649	2,839	270	3,109
Karnataka	–	58	58	839	815	1,654	839	873	1,712	7,770	181	7,951	8,609	1,054	9,663
Kerala	6	45	51	977	480	1,457	983	525	1,508	3,224	335	3,559	4,207	860	5,067
MP	–	43	43	327	658	985	327	701	1,028	7,148	110	7,258	7,475	811	8,286
Maharashtra	1	60	61	1,031	1,124	2,155	1,032	1,184	2,216	10,538	105	10,643	11,570	1,289	12,859
North East	–	9	9	186	142	328	186	151	337	2,500	86	2,586	2,686	237	2,923
Odisha	–	35	35	666	500	1,166	666	535	1,201	6,907	61	6,968	7,573	596	8,169
Punjab	–	22	22	328	416	744	328	438	766	3,081	14	3,095	3,409	452	3,861
Rajasthan	1	47	48	722	570	1,292	723	617	1,340	8,952	26	8,978	9,675	643	10,318
Tamil Nadu	–	94	94	1,330	1,406	2,736	1,330	1,500	2,830	8,945	356	9,301	10,275	1,856	12,131
Telangana	1	35	36	433	392	825	434	427	861	4,815	159	4,974	5,249	586	5,835
Uttar Pradesh	–	72	72	877	1,602	2,479	877	1,674	2,551	14,852	259	15,111	15,729	1,933	17,662
Uttarakhand	–	13	13	197	182	379	197	195	392	2,315	14	2,329	2,512	209	2,721
West Bengal	–	47	47	681	1,038	1,719	681	1,085	1,766	7,096	209	7,305	7,777	1,294	9,071
Total	16	795	811	12,162	12,591	24,753	12,178	13,386	25,564	126,777	2,569	129,346	138,955	15,955	154,910

Source: India Post Annual Report, 2016–17.
Abbreviations: HP = Himachal Pradesh, J&K = Jammu and Kashmir, MP = Madhya Pradesh.

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Review of SHG-Bank Linkage Programme[1]

10

Chapter

INTRODUCTION: 25 YEARS OF SHGs

This is a landmark year for the SHG movement. Formally, this year marks the 25th year of the official recognition of the SHG movement. While the circular that recognized SHGs as a legitimate player in the financial inclusion space was issued in 1992, the efforts and experimentation had happened over a period of 6 years starting in 1986. It is important to recognize the importance of SHGs in the financial inclusion market, basically for how it changed the fundamental discourse of financial inclusion. In a way, while SHGs were a precursor for the commercial microfinance movement in India, the discourse has largely shifted away from SHGs. In India, we have a peculiar situation wherein the SHG movement is not referred to as microfinance, and what is referred to as microfinance is the replication of the microcredit model of the Grameen Bank. However, in this important landmark year, it may be useful to understand how the SHG movement fundamentally changed the discourse of financial inclusion in the Indian context.

1. Movement away from credit to savings
   With the introduction of SHGs, for the first time, the discourse moved away from offering "affordable" credit to the poor through a supply side schematic mechanism toward a participatory mechanism based on the principles of mutuality. While cooperatives were in-principle the first institutions to be designed on the principle of mutuality, because of the approach that the state took in fostering cooperatives—through what was termed as the state partnership with cooperatives—they became more statal than mutual institutions. With the amount of leverage on member funds (including the funds provided as capital by the state) they also became credit institutions. With notable exceptions, most cooperatives were not only named as cooperative credit societies but also operated with credit as a pivot. With SHGs, the discourse moved to savings first, and bank and credit linkage later. This was a fundamental difference.
2. Putting women at the center
   The SHG movement put women at the core. By design and practice, SHGs got to be identified as a financial inclusion program targeted predominantly toward women, unlike all the other previous programs that were probably gender neutral in intent, but tended to have more male customers.
3. Involving the mainstream banking system
   While the SHG movement was led by the NGOs, they did not stand alone as a set of institutions that challenged or worked in competition with the existing structure. Instead, they sought to work in collaboration with the existing institutions, particularly with the banking network.
4. Building social infrastructure instead of physical infrastructure
   In case of the SHG movement, for the first time, nobody thought of a physical infrastructure. The meetings and transactions were to be held in public places, in the open. It was a system that has

[1] The author is thankful to Ms Girija Srinivasan and Mr C.S. Reddy who reviewed the chapter. There were significant inputs and insights that came from both of them, some of which could be incorporated but some could not as it required additional field work and the limitations of time did not permit adding that section. In particular the issue of SHG Federations, the larger social impacts through women empowerment and concerns regarding how the program in implemented in certain regions were to be taken on board and that remains a limitation of the chapter.

very low external overheads. It relied and leveraged on existing social relationships and formalized these embedded knowledge systems into the mainstream. It was a blend of principles that were used in the informal system that were codified into the mainstream. It was also for the first time that a group of persons were recognized as an "entity" even though they were not incorporated as an entity, through a process of an internal inter se agreement as a basis.

5. Creating a transactional regularity
   Most of the past efforts had no schedule of meetings or transactions. Even if they had, it was not dictated by the organizational logic but by the product design. Thus, people would turn up at the bank when they wanted a loan or wanted to save. It was purely voluntary. However, by introducing the regular savings as a core activity, the SHG movement brought a nonnegotiable activity to the core and brought regularity to the process that it almost became involuntary to attend an SHG meeting.
6. Breaking the interest rate orthodoxy
   The SHG movement, for the first time, broke the orthodoxy of subsidizing the services to the poor. The only element of subsidy in the SHG movement was the out-of-pocket expenses in forming and training the groups, which was borne by the civil society organizations. From the time the group was organized, it was a self-managed proposition, which charged market rates of interests. It covered costs and the profits that were kept or distributed within the group. This was a classic design of a cooperative, implemented at a micro-level of 10–20 individuals.
7. Finding decentralized solutions with a common design
   The SHG program had customized design at the group level. The frequency of meeting, the amount of savings, the methodology of loan disbursal, and the methodology of profit disbursal, all changed from place to place—depending on the local conditions and the NGO that was promoting the groups. Since the thinking was not centralized, there was no central policy (apart from circulars that aided them to interface with the banking system) and no centralized structure. However, all groups seemed to have common design principles—of formation of groups, regular meetings, savings, and loans. A failure in a particular location did not have a contagion and, therefore, it was a system that could survive in spite of setbacks in some places.

As we can see, the features described are somewhat unique to the experiments undertaken till then. Since it was not a centralized scheme, there was no rush to implement it as per a timeline. People learnt from others' mistakes, and the movement grew organically. It grew faster in areas where it was successful—like in the southern parts. Unlike other state-driven schemes, this program was piloted by the civil society organizations and later co-opted by the banking system and the state. While an institution like NABARD saw the potential of the methodology and actively promoted it, it was much later that the SHGs got embedded in the government's developmental agenda. Now, as we finish 25 years of the official recognition of SHGs, we see that there is a significant involvement of the state, and it has almost become recognized as a livelihood program implementation vehicle. But, it is to be recognized that the movement emerged from outside of the "schemes" of the government.

THE YEAR IN REVIEW

The SHG movement has been growing from strength to strength and has achieved formidable numbers. The year ending March 2017 recorded the presence of over 8.5 million SHGs in the country with a membership exceeding 100 million individuals. Considering that the groups are largely concentrated in rural areas and focused on women, we are talking of a population of around 240 million adult women in rural areas. Even if we were to account for double counting, multiple memberships, and infirmities in the data, the number is still formidable in terms of its penetration and reach. This along with the 174 million accounts of the PMJDY has taken financial services deep into the households. While the PMJDY has largely been framed as an account with a mainstream bank aiding transaction and an OD facility with attached social security schemes, the SHG program offers more meaningful engagement with the financial world. It allows the women to transact by themselves, account for the transactions, and make decisions on who would get a loan (in the group) and on how to use the finances (at the individual level). Therefore, the importance of the SHG program goes beyond just providing financial services and naturally moves on to the realms of financial literacy.

In addition, there was an increasing effort of mainstreaming the SHG data. On the one hand, the NABARD continued its project of digitizing the SHG data so that it is easily accessible to bankers and others for monitoring purposes. The E-Shakti program captures the data of SHGs through an application software that can be loaded on to a tablet or a smartphone. The first phase of this digitization was carried out in two districts of Ramgarh (Jharkhand) and Dhule (Maharashtra). This project is now extended to 23 more districts in various states. The initial pilot of digitization of 130,000 groups has shown a greater amount of credit linkage with the members, thereby, deepening their engagement with the banking system. However, experts believe that we need to see some solid evidence of this phenomenon. In general, there is no convergence between the management information systems piloted by NRLM and NABARD. If NABARD software is superior, is it possible to use the NRLM funds to roll out digitization faster and cover more districts?[2] While the modernization and digitization push is coming from the developmental side, the regulatory side is also accelerating the need to have better digitized information.

The RBI had laid a roadmap for the credit data of individual members of the SHGs to be captured and shared with the credit information companies (CIC) so that the individual-level indebtedness could be monitored. While the details of the data to be uploaded was divided into two phases—one starting with July 2016 and the second starting July 2017—as of now, if the intent was implemented all data pertaining to individuals in the groups has to be uploaded to the CICs in a specified format. This would get some convergence between multiple memberships across groups and across MFIs if a common identity trail is tagged and the data is de-duplicated. While this is a complex and time-consuming exercise, there seems to be significant progress in this direction.

While there was much progress in the PMJDY (discussed in detail in Chapter 4), and there has been significant efforts to ensure that women open the accounts, the policy discourse did not indicate any convergence between the SHG program or the NRLM program with the PMJDY scheme. Neither was there any thought or discussion on integrating the PMJDY accounts with the KCC. Going forward, it would be important to look at the convergence possibilities.

Review of Developments in SHGBLP

In addition to the natural growth of the SHG program, the design of the government program of the NRLM has given a sense of urgency and importance to the growth of the SHG movement. While in the past 2 years, it appeared that the growth of the movement both in terms of numbers and volumes had plateaued out with a growth rate hovering around 3% and the growth was coming with the deepening of the engagement with clients where savings itself was growing at a significantly high rate, it appears that during 2016–17, the growth picked up and the groups grew by more than 8%. The amount of savings too grew by about 18%. This looks like a healthy trend and also proves that the PMJDY, which shifted the narrative to an individual banking relationship, as against the SHG theme of linking to the bank through a group, has not affected the movement. Possibly, this shows the large gaps left by the banking system in trying to satisfy the unfulfilled requirements of financial services to the poor that both the initiatives could have a healthy co-existence without cannibalizing the other. We also have to remember that the microfinance movement is also simultaneously growing at a rapid pace, with a similar set of clienteles. It appears that the rural poor women now have an array of choices to pick from.

While there was growth in the number of groups and a normal growth in the savings of the SHGs, it appears that both the loan disbursals and, consequently, the loan outstanding did not grow proportionately. Table 10.1 gives the numbers on SHGs for the past 4 years, and we can see that while there is action on group formation, but little growth in savings and loaning within the groups.

Progress of SHGBLP under NRLM

While in the past 2 years, the growth of SHGs affiliated with the NRLM drove the growth in the SHGs—the overall numbers of SHGs rising marginally, but most of that increase explained by the growth and promotion by the NRLM—this year showed a reversal in trends—the overall growth of SHGs was high compared to the last few years, but the NRLM induced growth seems to have fallen. The presence of the state in this sector grew with the NRLM, but during the past 4 years, about 45% of all the groups that existed were associated with NRLM is some manner. As we go further, it would be interesting to see if the groups become strong enough for the time-bound NRLM scheme to withdraw from the space, or if the dependence on the state for capital and continued support will continue. If we look at the cooperative movement, there would be lessons to draw—including the lessons about capital provision, interest subvention, and writeoffs, all of which come in the commercial

[2] Personal communication with Girija Srinivasan in September 2017.

Table 10.1 Overall Progress under SHG-Bank Linkage Programme for Last 4 Years (Amounts in Billions, Numbers in Millions)

		2013–14		2014–15		2015–16		2016–17	
	Particulars	**No. of SHGs**	**Amount**	**No. of SHGs**	**Amount**	**No. of SHGs**	**Amount**	**No. of SHGs**	**Amount**
SHG savings in banks	Total SHGs	7.43 (1.53%)	98.97 (20.45%)	7.70 (3.59%)	110.60 (11.74%)	7.90 (2.68%)	136.91 (23.79%)	8.58 (8.53%)	161.14 (17.69%)
	NRLM/SGSY	2.26 (10.46%)	24.78 (36.01%)	3.05 (34.92%)	44.24 (78.56%)	3.46 (13.27%)	62.45 (41.16%)	3.74 (8.30%)	75.53 (20.94%)
	Percentage of NRLM/SGSY	30.45	25.03	39.65	40.00	43.70	45.61	43.65	46.87
	NULM/SJSRY	NA	NA	0.43	10.72	0.45 (3.00%)	10.06 (6.12%)	0.55 (22.42)	11.27 (11.99%)
	Percentage of NULM/SJSRY	NA	NA	5.63	9.69	5.64	7.35	6.36	6.99
	All women SHGs	6.25 (5.27%)	80.13 (22.99%)	6.65 (6.38%)	92.64 (15.61%)	6.76 (1.68%)	120.35 (29.92%)	7.32 (8.26%)	142.83 (18.67%)
	Percentage of women groups	84.15	80.96	86.41	83.77	85.58	87.91	85.36	88.64
Loans disbursed to SHGs in the year	No. of SHGs extended loan	1.37 (12.02%)	240.17 (16.67%)	1.63 (19.03%)	275.82 (14.84%)	1.83 (12.67%)	372.87 (35.18%)	1.9 (3.60%)	387.81 (4.01%)
	NRLM/SGSY/	0.23 (24.56%)	34.81 (57.67%)	0.64 (28.45%)	94.88 (27.26%)	0.82 (26.91%)	167.86 (76.92%)	0.89 (8.58%)	173.36 (3.28%)
	Percentage of NRLM/SGSY	16.52	14.49	39.54	34.40	44.54	45.02	46.69	44.70
	NULM/SJSRY	NA	NA	0.11	18.72	0.11 (5.71%)	26.20 (40.00%)	0.11 (–4.5%)	26.76 (2.12%)
	Percentage of NULM/SJSRY	NA	NA	6.46	6.79	6.06	7.03	5.60	6.90
	All women SHGs	1.15 (11.02%)	210.38 (17.83%)	1.45 (25.69%)	244.20 (16.07%)	1.63 (12.50%)	344.11 (40.92%)	1.72 (5.34%)	361.03 (4.92%)
	Percentage of Women groups	84.3	87.6	89.05	83.53	88.92	92.29	90.42	93.09
SHG loans outstanding	Total SHGs	4.20 (–5.71)	429.28 (9.02%)	4.47 (6.46%)	515.46 (20.06%)	4.67 (4.59%)	571.19 (10.81%)	4.85 (3.74%)	615.81 (7.81%)
	NRLM/SGSY	1.31 (9.55%)	101.77 (18.38%)	1.85 (41.24%)	197.53 (94.08%)	2.19 (18.69%)	266.10 (34.72%)	2.49 (13.69%)	299.94 (12.72%)
	Percentage of NRLM SGSY	31.1	23.7	41.32	38.32	46.89	46.59	51.37	48.71
	NULM/SJSRY	NA	NA	0.32	34.63	0.32 (–1.57%)	39.80 (14.93%)	0.32 (1.60%)	41.33 (3.86%)
	Percentage of NULM/SJSRY	NA	NA	7.12	6.72	7.00	6.97	6.55	6.71
	All women SHGs	3.40 (–9.34)	361.52 (10.08%)	3.86 (13.27%)	459.02 (26.97%)	4.04 (4.61%)	514.29 (12.04%)	4.28 (6.14%)	564.44 (9.75%)
	Percentage of Women groups	81.2	84.2	86.35	89.05	86.37	90.04	88.36	91.66

Source: Status of Microfinance in India 2016–17, NABARD, Mumbai.
Figures in parenthesis indicate growth/decline over the previous year.

relationships between the individual and the group as well as the group and an independent commercial institution.

As we can see from Table 10.2, not only is the NRLM driving the formation of groups, but is providing substantial support in the form of revolving funds (RF) and community investment funds (CIF).

From the data given in Table 10.2 and Appendix 10A, it is clear that the NRLM is monitoring the progress of the implementation of the livelihoods mission through SHGs in great detail. The drill down of data gives the differences between intensive blocks, districts, and states where significant amount of community mobilization is being carried

Table 10.2 Overall Progress under NRLM

Parameter	NRLM	NRLP	OEAP	SRLP	Total
No. of districts with intensive blocks	453	161	50	37	551
No. of Intensive blocks	2,714	564	281	72	3,631
No. of SHGs promoted	2,166,181	625,535	286,950	83,957	3,162,623
No. of SHGs eligible for RF	9,271,483	442,050	231,169	75,935	10,020,637
No. of SHGs received RF	313,927	342,282	191,930	69,244	917,383
Amount of RF disbursed (₹ in million)	4,437	4,875	2,732	503	12,547
No. of eligible SHGs yet to receive RF	8,957,556	99,768	39,239	6,691	9,103,254
Percentage of eligible SHGs yet to receive RF	96	22	16	8	91
No. of SHGs older than 6 months	7,279,719	472,474	225,736	34,346	8,012,275
No. of SHGs received CIF	234,156	205,253	154,816	5,552	599,777
Amount of CIF disbursed (₹ million)	8,977	11,091	10,273	288	30,629
No. of eligible SHGs yet to receive CIF	7,045,563	267,221	70,920	28,794	7,412,498
Percentage of eligible SHGs yet to receive CIF	96	56	31	83	93
No. of village organizations (VO)s promoted	116,950	40,386	19,438	1,348	178,122
No. of SHGs federated into VOs	1,891,616	396,035	215,889	14,207	2,517,747
No. of eligible SHGs yet to be federated into VOs	323,699	243,196	77,964	82,959	727,818
Percentage of eligible SHGs yet to be federated into VOs	14	38	27	85	22

Source: http://nrlm.gov.in/outerReportAction.do?methodName=showIndex accessed on July 27, 2017.
Abbreviations: NRLM—National Rural Livelihoods Mission, the flagship program, NRLP—National Rural Livelihood Program, an initiative in backward districts where focus is more on social mobilization, OELP—Other externally aided livelihoods program, and SRLP—State Rural Livelihoods Programme.

out. There are some issues with the data being put out at the NRLM database. While there are details, some of the numbers do not match. This may be because of definitional issues. For instance, while data in Table 10.3 seems to indicate an overall savings mobilized by the SHG at ₹140 billion, in all other places the data (though it does not exactly match with the data for NRLM put out be NABARD), it is at around ₹70 billion. Even in the NRLM database it appears that the savings amounts mobilized by SHG are around this figure. The divergence between the two numbers may be because of the grant money that is flowing in to the groups in the form of RFs and CIFs. An additional explanation could be that NRLM data may be total savings at the SHG level, while NABARD data may be pertaining to only savings deposited with banks.[3] Even if we were to grant this, still does not add up to doubling of the figures reported by the same database elsewhere.

However, what is coming out very clear is the larger role of the state in promoting the SHG movement and how it is gradually becoming a movement that dispenses the state programs rather than what it originally started with—a voluntary movement promoted by the civil society organizations. In the silver jubilee year of the movement, we need to recognize the significance of a voluntary movement in the first instance co-opted and nurtured through a specialized developmental financial institution (DFI) like NABARD to an almost takeover by a department of the government. A good evidence of this is the number of existing groups that were outside the fold of NRLM being brought into the fold of NRLM and provided funding and other support on noncommercial terms, thereby, weakening the internal financial discipline of the movement.

While, over the years, there has been a greater convergence between the initiatives of NABARD and NRLM, this is a juncture where NABARD through its coordination mechanism should restore the voluntary nature of the movement and help in negotiating subventions in the commercials of transactions and diverting all the subventions toward creating an ecosystem—building a digital network; creating a rating and credit information architecture; providing guarantees to banks; and helping the groups to stand on their own.

[3] Personal communication with Girija Srinivasan in September 2017.

Table 10.3 Progress of SHG Programme as Reported by NRLM (SHG Numbers in Thousands and Amounts in ₹ Billions)

State	Number of Groups				Savings			
	Progress up to March 2016	FY 2016–17 Target	Progress during FY 2016–17	Cumulative Progress	Progress up to March 2016	FY 2016–17 Target	Progress during FY 2016–17	Cumulative Progress
Andhra Pradesh	673.48	–	–	673.48	31.44	–	–	31.44
Assam	62.27	24.73	20.17	82.44	0.65	0.34	0.89	1.54
Bihar	448.48	19.25	189.19	637.67	4.95	0.00	3.30	8.25
Chhattisgarh	23.24	13.09	26.73	49.97	0.19	0.02	0.22	0.41
Gujarat	190.46	14.10	30.84	221.30	2.98	0.07	2.80	5.78
Jharkhand	27.33	17.84	61.40	88.73	0.13	0.17	0.28	0.42
Karnataka	31.62	19.45	3.99	35.60	1.16	0.23	0.79	1.95
Kerala	226.01	8.14	10.94	236.95	26.57	0.01	3.70	30.27
MP	115.67	38.70	42.60	158.27	1.21	0.30	0.73	1.94
Maharashtra	114.26	21.83	35.23	149.49	1.77	0.01	0.84	2.61
Odisha	151.50	13.68	14.40	165.90	1.65	0.03	0.86	2.51
Rajasthan	41.13	19.31	25.24	66.36	0.48	0.13	0.21	0.69
Tamil Nadu	254.38	4.00	15.00	269.38	16.87	0.06	2.15	19.02
Telangana	417.21	–	–	417.21	18.95	–	–	18.95
Uttar Pradesh	39.63	21.62	24.93	64.55	0.10	0.05	0.24	0.34
West Bengal	368.62	120.10	70.35	438.97	10.25	8.29	2.73	12.98
Sub Total	3,185.27	355.83	571.02	3,756.28	119.34	9.70	19.75	139.09
Haryana	4.82	3.43	3.94	8.76	0.09	0.06	0.09	0.19
Himachal	4.75	1.27	1.05	5.80	0.03	0.07	0.02	0.05
J&K	9.72	6.29	8.20	17.92	0.14	0.04	0.12	0.26
Punjab	2.20	2.38	1.93	4.13	0.03	0.00	0.04	0.07
Uttarakhand	3.37	1.95	3.43	6.80	0.02	0.00	0.03	0.05
Sub Total	24.86	15.32	18.55	43.41	0.32	0.18	0.30	0.62
Arunachal Pradesh	1.05	0.34	0.17	1.22	0.06	0.00	0.00	0.06
Manipur	0.08	0.87	0.46	0.54	0.00	0.00	0.01	0.01
Meghalaya	0.76	1.52	1.17	1.93	0.00	0.00	0.01	0.01
Mizoram	0.76	1.19	1.26	2.02	0.00	0.01	0.01	0.01
Nagaland	1.68	2.50	1.22	2.90	0.01	0.02	0.01	0.03
Sikkim	0.29	1.56	0.83	1.12	0.00	0.02	0.01	0.01
Tripura	1.01	2.70	1.67	2.68	0.01	0.00	0.02	0.03
Sub Total	5.63	10.68	6.78	12.41	0.09	0.06	0.06	0.14
Goa	–	–	–	–	–	–	–	–
Puducherry	1.47	–	–	1.47	0.15	–	–	0.15
Sub Total	1.47	–	–	1.47	0.15	–	–	0.15
Grand Total	3,217.23	381.83	596.34	3,813.56	119.90	9.94	20.11	140.01

Source: Website of NRLM at: http://nrlm.gov.in/PromotionOfSHGAction.do?methodName=showDetail&reportVar=total, accessed on July 25, 2017.

While at the ground level, the groups have been converging—as they have been availing the benefits of the schemes offered by the state—it was felt that there was a need for convergence even at the strategic level. Based on the recommendations of the Usha Thorat Committee that examined the need to set up a separate DFI for SHGs, a strategic advisory board having a representation from the Ministry of Rural Development (MoRD), Department of Financial Services from the MoF; NRLM; and bankers and domain experts was set up. This arrangement continued during the year with the board meeting once to review the arrangements for convergence and the progress.

Apart from the large organizations such as the Dhan Foundation, Sanghamithra, NABARD Financial Services (NABFINS) and Shree Kshetra Dharmasthala Rural Development Project (SKDRDP) that continue their work in this area and grow, many of the smaller civil society organizations have over a period of time embraced the MFI model and moved toward commercial microfinance. Of these, the SKDRDP has gradually moved away from direct financing of SHGs to operating as a BC between the banks and the groups, with the group borrowings directly sitting on the books of the banks. In a way this movement moves back to the basics of how SHGBLP was conceived. The only difference between the original model and the current arrangement is that in the earlier model, the SHG Promotion Institution (SHPI) was being funded by an external funding agency, and the group formation expenses could be compensated through the various schemes available in NABARD. However, in the current arrangement, the bank pays a fee to the SHPI for the intermediation arrangements.

There has been a significant churn in the MFI model (discussed in Chapter 11) while it is growing aggressively. As we could see, the growth in the private sector MFIs is worrisomely fast, and the discipline is lacking in the SHGBLP format. This trend is to be spotted in the way the NPAs are panning out in the SHG-BLP program. The growth and developments in the SHGBLP is to be understood keeping the context in mind.

Regional Spread of SHGs

The number of active SHGs (which had some savings) was at a peak of 7.9 million in March 2011. This fell to about 7.32 million in March 2012. But ever since, there has been an increase in active SHGs, and by March 2016, the number of groups with some savings activity has now surpassed the past high achieved in March 2011. On the other hand, the amount of savings collected by the groups has been growing significantly. Whether these increases in the amounts of savings that the SHGs have deposited with the banks are a function of the capital and grant funds given by NRLM, and how much of this is members' contribution, is a matter of investigation so that we can arrive at an appropriate conclusion. However, the fact remains that there has been an increase in the funds that have been deposited with the banks as the savings of the groups.

The bank loans to SHGs also saw a fall both in the number of accounts and the amounts disbursed in 2010–11 and 2011–12. These saw a smart recovery in the following years, up to March 2016. However, during the year under consideration, the loans to the groups have grown at 4%, with the disbursement to the NRLM related groups growing only at 3%. There have been multiple externalities during the past years that included the write off of SHG loans by the Telangana and AP governments in the past years, the contribution to the group funds and the demonetization exercise has intervened in the commercials of the transactions and might have caused a slight setback.

Savings

The data in Table 10.4 shows that the average savings per group is dramatically improving. In the past 4 years, it has almost grown by three times in the eastern sector, and the savings amounts have more than doubled if we look at the average statistics for the country as a whole. The only region where the growth in absolute savings is low is the northeastern and central region.

Table 10.4 Number of SHGs with Savings and Amount of Savings Collected for 2012 and 2017

	March 31, 2012			March 31, 2017		
Region	SHGs (Millions)	Savings (₹ Billion)	Ave Savings/ Group	SHGs (Millions)	Savings (₹ Billion)	Ave Savings/ Group
North	0.41	2.53	6,175	0.45	4.96	10,865
North East	0.37	1.53	4,159	0.45	2.29	5,069
East	1.63	9.47	5,827	1.95	33.65	17,231
Central	0.81	6.14	7,549	0.85	8.38	9,888
West	1.06	8.72	8,210	1.14	13.86	12,160
South	3.58	37.13	10,362	3.72	97.97	26,302
Total	7.86	65.51	8,335	8.58	161.14	18,788

Source: Status of Microfinance in India 2017. Mumbai: NABARD.

While it is possible to acknowledge the growth due to NRLM, what is not evident is that the regional variation continues. The data for 2012 and 2017 on the regional spread is given in Figure 10.1 and the charts are self-evident.

The proportions of the presence of SHGs still favor the south with 44% of the groups belonging to the region. Two percentage points difference between 2012 and 2017 has resulted in the eastern zone relatively gaining, while the west north and the northeastern region continue to have the same proportions.

While this is the story with the physical presence, the data on the business aspect shows that from 2012 to 2017, the amounts of savings generated by the SHGs in the south are relatively greater. The south accounted for 57% of the amounts saved in 2012, and this had gone up to 63% in 2016. In the current year, the relative share has corrected by two percentage points to 61% (Figure 10.2). The eastern zone not only increased the relative share of SHGs but has also been performing smartly on the actual amounts saved. Between 2012 and 2017, the relative share of SHG savings in the eastern sector went up from 15% to 21%. The per member balances in the eastern sector have significantly picked up. The real story of the growth of the balances in SHG savings is coming from the eastern sector. While the relative share of number of groups grew by two percentage points, the relative share of savings amounts grew

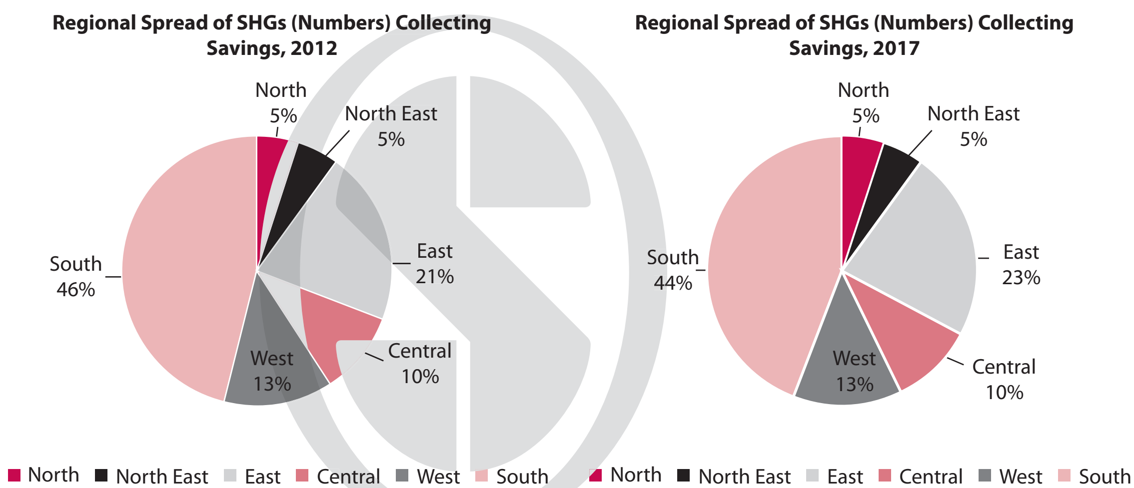


Figure 10.1 Region-wise Distribution of SHGs Collecting Savings for 2012 and 2017

Source: Status of Microfinance in India 2012, 2017. Mumbai: NABARD.

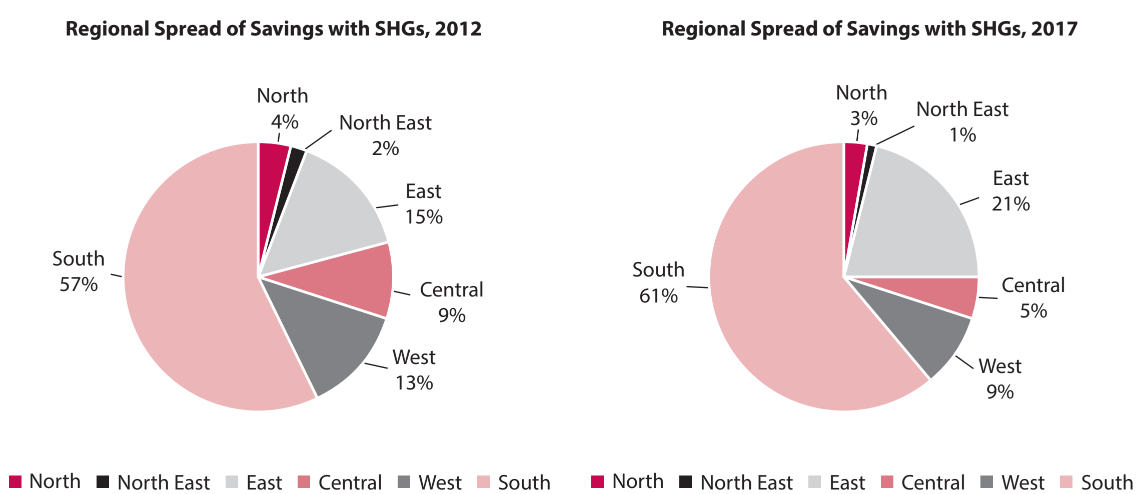


Figure 10.2 Region-wise Savings Balances with SHGs in 2012 and 2017

Source: Status of Microfinance in India 2012, 2017. Mumbai: NABARD.

by nearly six percentage points in the last 5 years. There is some vibrancy in the eastern sector as far as the growth and the health of SHGs are concerned. A large part of the story may be explained by the success of the rural livelihoods programs in the eastern states of Bihar and West Bengal.

Loans

While savings is at the base of the concept of SHGs, the real test of an SHG is when it is linked to the banking system and becomes creditworthy with a mainstream commercial bank, subjecting itself to the usual rigor of assessments. This makes financial inclusion more inclusive. In general, we see that the number of groups having savings with the bank will almost be equal to the number of groups formed. The difference may be attributed to the new groups that were recently formed and have started collecting savings from the members but have not been able to open an account with the bank to deposit the savings amount. There could be significant differences in the savings amount because of inter-lending.

However, in case of loans, the number of groups availing the loan would be a much smaller proportion. In the current year, for instance, while 8.58 million groups had savings, only about 1.9 million groups had availed of a loan. A little less than half the groups that had availed the loans belonged to NRLM program. This number in proportion is similar to the number of groups that had deposited savings with the bank. This only shows that while NRLM has contributed both to group formation as well as revival of the old groups, it has not contributed to the acceleration of the loan linkage program disproportionate to its developmental pace. The banks, irrespective of whether the groups are from NRLM or from the civil society organizations, seem to take their own call and time in financing them. This is quite evident by the attempts made by the MoRD to promote an apex developmental financial institution in the past to accelerate the loan availability to the SHGs. We had covered the recommendations made by the Usha Thorat Committee in the previous years (Thorat 2014). While a national level DFI has not really been set up, at the state level, the governments have promoted their own institutions such as StreeNidhi in AP and Telangana, and the proposed Amma bank in Tamil Nadu (TN).

From Figures 10.3 to 10.6, it is clear that while we can see significant impact of NRLM in the growth of bank linkage and portfolio, the benefit has veered toward the south and is not changing significantly. While the southern region has 60% of the SHG loan accounts (down from 61% in 2012 and 63% in 2016), it has 80% of the loans disbursed. Even in case of the eastern region where there has been a rapid growth in the relative share of the groups, the relative share of loaning is growing, mostly at the cost of the central and northern regions. That is an area where the efforts of forming SHGs and linking, in addition to the focus on the North East needs to be placed. The relative regional share of loan disbursements in 2012 and 2017 are given in the Figures 10.3 to 10.6. One of the insights offered in interpretation of data pertaining to disbursements is contained in the fact that several banks may now be offering cash credit limits rather than term loans. The limits offered could have had an impact on the reported loan amounts.

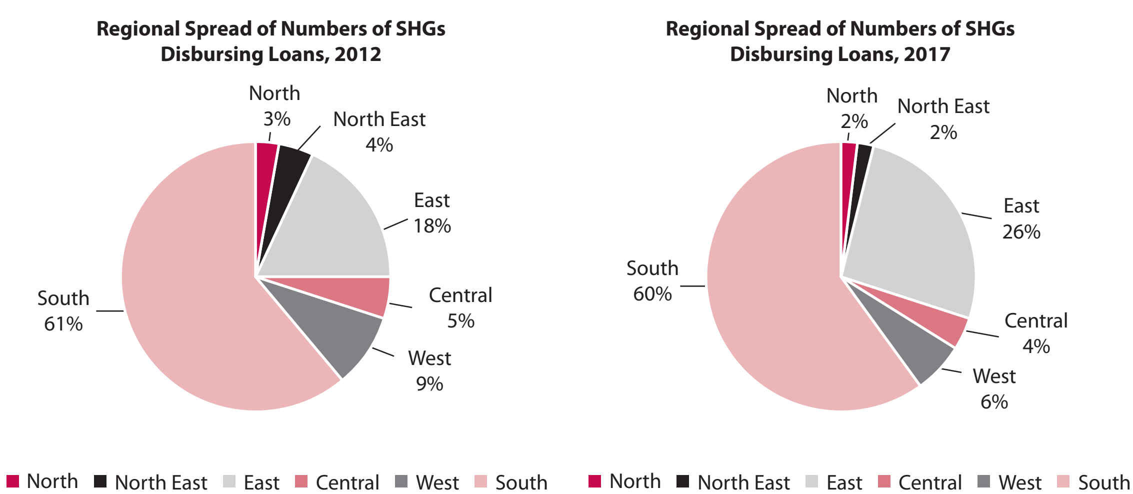


Figure 10.3 Loans Disbursed to SHGs in 2012 and 2017

Source: Status of Microfinance in India 2012, 2017. Mumbai: NABARD.

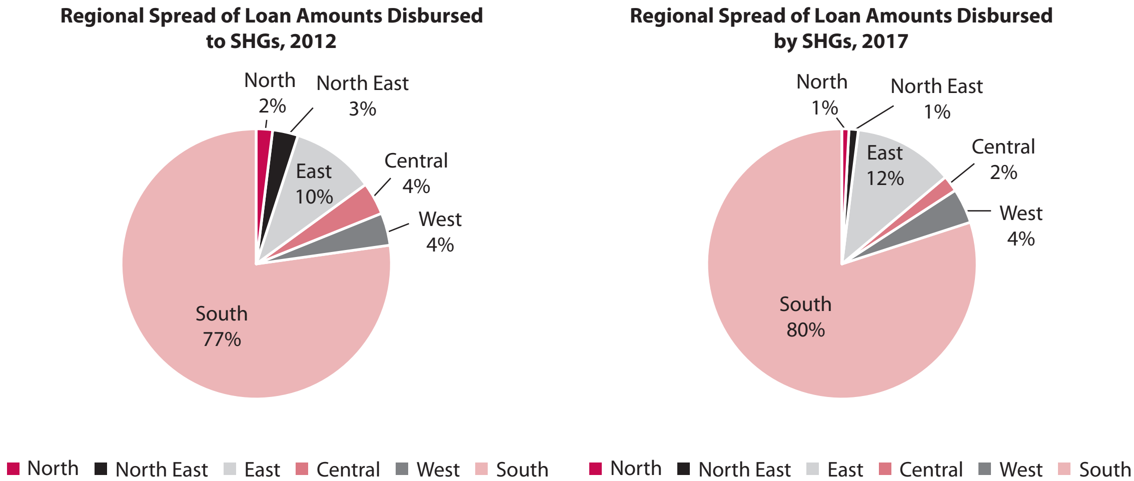


Figure 10.4 Loan Amounts Disbursed to SHGs in 2012 and 2017

Source: Status of Microfinance in India 2012, 2017. Mumbai: NABARD.

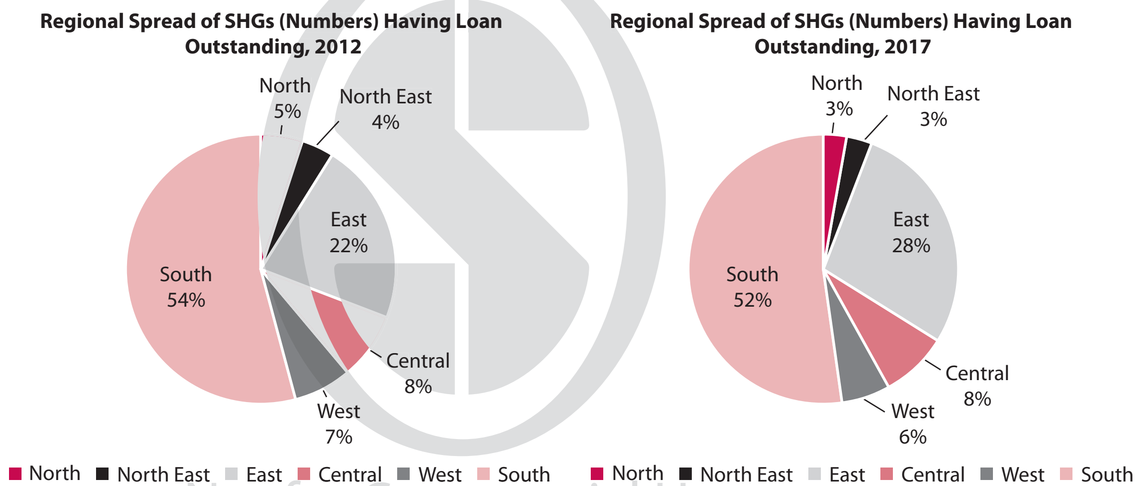


Figure 10.5 Number of SHGs with Loans Outstanding as of March 31, 2012, and 2017

Source: Status of Microfinance in India 2012, 2017. Mumbai: NABARD.

Even when we look at the amounts outstanding, which is a stock figure, we see that the southern region has gained significantly in terms of relative share compared to 2012, and even a percentage point gain from 2016. The relative proportion of SHGs across the regions that have been linked with a loan have remained more or less constant.

When we look at how much leverage (Figure 10.7) the banking system is willing to give on the savings on the poor, the statistics are revealing and continue the trend of the past year. The leverage (or the credit multiplier) has actually reduced between 2012 and 2017. It is getting lower by the year, and even in case of western region where the multiplier was a bit higher last year, it has come down this year. Overall, the same trend continues, where the south gets the largest multiplier, though even there the number is falling. This may be because the savings have grown more aggressively than loans. Part of this may be explained by the funds that were pumped in under the NRLM assistance to the groups. The continuing trend is worrisome from a design perspective because it defeats the purpose of the state pumping in its resources as revolving fund to the SHGs.

The idea of pumping in resources was not to keep those resources in the banking system. It should have resulted in higher loan off take of credit. That is not happening. The eastern sector growth of savings is explained by the growth in the savings in Bihar and WB where achievement of NRLM targets

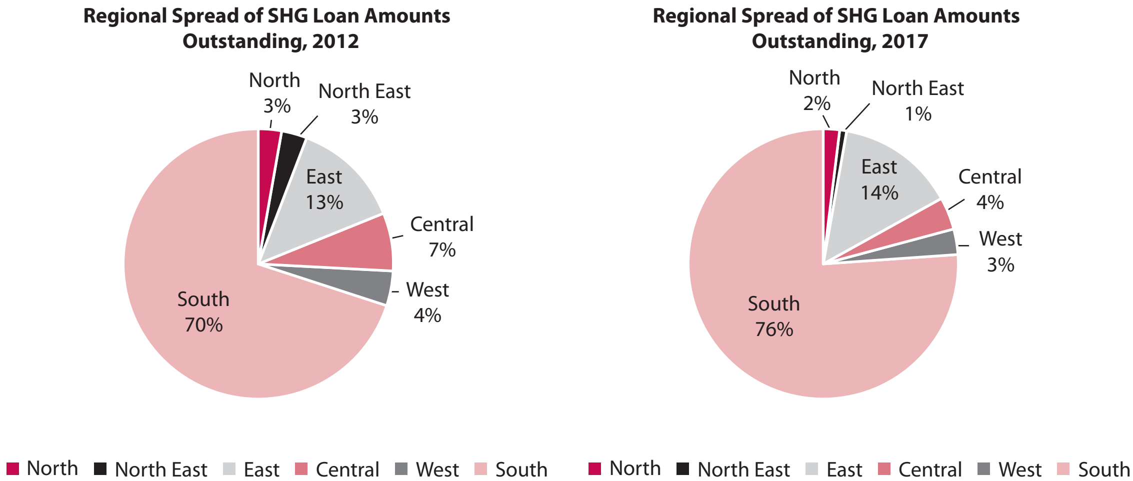
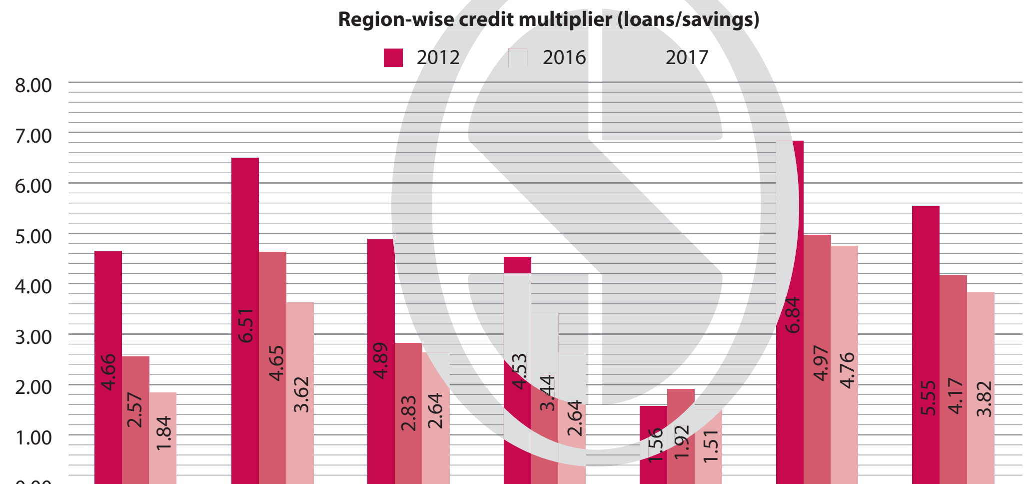


Figure 10.6 Loan Amounts Outstanding with SHGs as of March 31, 2012, and 2017

Source: Status of Microfinance in India 2012, 2017. Mumbai: NABARD.



	North	North East	East	Central	West	South	Total
2012	4.66	6.51	4.89	4.53	1.56	6.84	5.55
2016	2.57	4.65	2.83	3.44	1.92	4.97	4.17
2017	1.84	3.62	2.64	2.64	1.51	4.76	3.82

Figure 10.7 Region-wise Credit Multiple of Savings in SHGs for 2017

Source: Author's calculations from the various issues of Status of Microfinance in India, Mumbai: NABARD.

have been way over 100%. However, the group formation, funding the groups, and the savings of the members may not be concurrently resulting in off-take of credit.

An important aspect that needs to be thoroughly studied is the performance of the North East. While there has been significant number of initiatives to include the northeastern states in the formal financial system, the overall progress could be much better. Has it gone into a vicious cycle of NPAs leading to low growth of the financial system, is it the lack of economic activities, or are there logistical and infrastructural problems? These are issues that need to be examined in a separate study to understand the special features of the northeastern states and how the task of inclusion could be made more effective.

NPA LEVELS IN SHGBLP: A DISCUSSION

An expectation during the year was that the NPAs of the SHGs would significantly go up. The demonetization exercise must have hit the informal sector

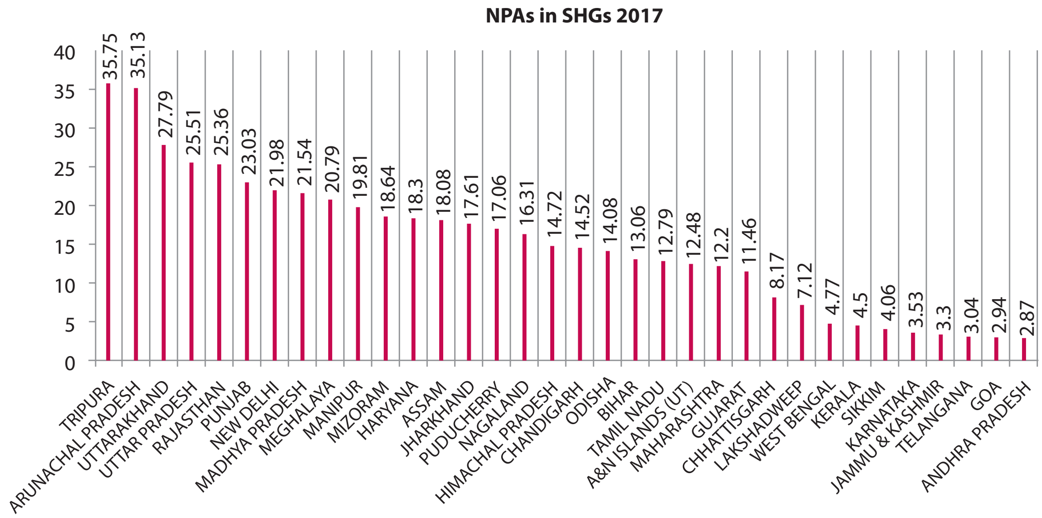


Figure 10.8 NPA Levels in SHGs Stacked According to States

Source: Status of Microfinance in India, 2017. Mumbai: NABARD.

much more than the formal sector, and it is evident that the SHGs operate at the frontier of the informal sector. However, from the statistics made available, it does not appear that the demonetization has had a big impact on the SHG movement, while it does not seem to be true of the microfinance sector, which is discussed in Chapter 11.

One reason why the credit offtake might be low would be because of the levels of NPAs. States such as Tripura, Meghalaya, and Arunachal Pradesh have very high NPAs. The two states in the North East that have a substantial portfolio are Assam and Tripura (see Figure 10.8). While Assam has a better recovery rate, it is still far below the national average. The best performing state in the North East has been Mizoram, but the size of the operations is really small.

Of the larger states, UP and Rajasthan have been consistently having high NPAs. While it was expected that states such as AP and Telangana might suffer because of competitive writeoffs, that does not seem to have had a major impact on the NPAs, and the southern states in general have a better recovery performance.

It is important both for NABARD and NRLM to seriously look at the larger systemic issues of how well structured these groups are and how good their internal working mechanisms are, and possibly take a pause to build robust systems with low NPAs so that these will be lasting institutions managed by the people. The story of microfinance has proved that if the systems are in place with right incentives, it is possible to aggressively grow a healthy portfolio.

From the NPA numbers and the way the progress has been made in other parts of the country, where the SHG movement has grown through a state-driven program and not organically, it is evident that those regions have not exhibited the same performance parameters of the southern states, where the movement grew slowly. The base of the SHG movement is social mobilization and groups functioning on the principles of mutuality. These go through a four-stage cycle of forming, storming, norming, and performing (Kanitkar 2002). This process of getting the processes right and getting the groups to exhibit behavior that keeps the long-term interests in mind takes time. The SHG movement other than in the five southern states might be suffering from the need to grow fast without looking at the merits of organic growth. It may be a good idea to take a pause and build the processes rather than pump in financial resources from the exchequer. From Table 10.5 it can be seen that the NPAs from NRLM loans are in general higher in proportion to the overall NPAs, and the NPAs in the rest of the country are significantly higher than the southern region. Both these numbers seem to be pointing toward a story on how groups are formed and processes are instilled.

One aspect that has not been adequately studied—possibly because of the paucity of publicly available granular data—is the difference between the performance of the portfolio of the public sector banks and the private sector banks. Even a look at Table 10.6 shows that the private banks disproportionately favor MFIs and have lesser exposure to SHGs. If we examine the numbers in greater detail beyond what is reported earlier, it is evident that the private sector banks enthusiastically participate in the

Table 10.5 Regional Spread of NPA by Source of Loan as of March 2017

Source →	Public Sector Banks		Pvt Sector Banks		RRBs		Cooperative Banks		Total	
Region ↓	Total NPAs	NPAs from NRLM Loans	Total NPAs	NPAs from NRLM Loans	Total NPAs	NPAs from NRLM Loans	Total NPAs	NPAs from NRLM Loans	Total NPAs	NPAs from NRLM Loans
North	38%	45%	1%	0.01%	19%	13%	21%	18%	22%	28%
North East	22%	22%	25%	100%	19%	28%	26%	62%	21%	26%
East	15%	12%	0%	12%	6%	6%	6%	7%	9%	8%
Central	22%	22%	2%	34%	27%	28%	44%	36%	23%	26%
West	18%	14%	1%	75%	16%	10%	24%	30%	12%	14%
South	6%	6%	3%	14%	2%	2%	6%	7%	4%	5%
Total	7%	7%	2%	6%	5%	6%	8%	10%	7%	7%

Source: Status of Microfinance in India 2017, MCID, NABARD, Mumbai.

Table 10.6 Loans Disbursed by Financial Institutions to SHGs and MFIs as of March 2017

	SHGs	SHGs under NRLM	MFIs	Total
Public sector commercial banks	198,450	96,698	51,411	346,559
Private sector commercial banks	44,519	205	118,527	163,251
Foreign banks			975	975
RRBs	116,130	70,640	378	187,148
Cooperative banks	28,711	5,818	2,073	36,602
SIDBI			19,679	19,679
Total	387,810	173,361	193,043	754,214

Source: Calculated by the Author from the Status of Microfinance in India 2017, MCID, NABARD, Mumbai.

MFI segment of inclusive finance, not only in terms of bulk loans but also in offering hybrid financial services including securitization and arrangement of bulk debt from the market. Of late many, private sector banks have been buying off NBFC MFIs (discussed in the chapter on MFIs) as well and participating in the segment serving the inclusive customers directly through their books—using MFIs as banking correspondents. However, the private sector players have not shown the same levels of enthusiasm in participating and competing with the public sector banks in the SHG segment.

This trend seems to indicate some reading that the private banks have about the SHGBLP segment: that it is not profitable; or even if the margins are decent the external risks far outweigh the profits; that they see this segment leading to a higher NPA than the MFI segment; or they are transaction cost intensive. We can also see from Table 10.6 that irrespective of the region (except North East), the private sector banks have far lower NPAs than the public sector banks. So, the level of participation of the private sector banks could be taken as a measure of the commercial success of the SHG movement. This aspect needs to be probed well.

OTHER NEW INITIATIVES

The older initiatives undertaken by NABARD continued. The special funds placed at the dispensation of NABARD—the financial inclusion fund, the equity fund, and other funds available of refinance and helping the development of ecosystem—were utilized. In addition, the efforts at financial literacy, providing livelihood opportunities with multiple initiatives including supply of food to the railway passengers in collaboration with Indian Railway Catering and Tourism Corporation, continued. The proposal to operate water vending machines at about 4,000 railway stations and to let the group manage these vending stations on a pilot basis was also implemented.

During the year, APMAS concluded a study on the impact and sustainability of the SHGBLP. This was commissioned by NABARD. In the interest of getting back to the basics, it was felt that the points about the features of the SHGs and practices of the SHGs that the study group found in the six states they studied could be brought out to understand where the movement started from and how it has moved over the years.

APPENDIX 10A
Details of Progress of the SHG Programme under NRLM as of March 2017
(Numbers in Thousands; ₹ in Millions)

Indicators	Progress up to March 2016	Annual Target Current FY	Progress 2016–17	Position March 2017
Coverage of implementations (targeted vs achievement)				
Number of villages in which intensive strategy initiated	189	28	34	223
Number of new SHGs promoted by SRLM	963	215	474	1,438
Number of other SHGs brought into the NRLM fold (after revival/strengthening)	928	93	63	991
Total number of SHGs under NRLM in intensive blocks	1,891	308	537	2,429
Number of predominantly SC-SHGs (SC member >= 50%)	401	65	117	518
Number of predominantly ST-SHGs (ST member >= 50%)	281	75	97	378
Number of predominantly minority-SHGs	168	46	46	215
Number of other-SHGs	1,041	121	277	1,318
Number of predominantly SHGs with PWDs member	20	5	3	23
Number of elderly-SHGs promoted by SRLM	12	1	4	16
Number of SHG become defunct/dormant	84	1	15	99
Number of SHG bookkeepers deployed	791	184	240	1,030
Total amount of saving mobilized in all SHGs	62,798	4,472	16,519	79,317
Total households mobilized into all SHGs	22,589	3,554	6,156	28,745
RF support in intensive blocks (all status under NRLM)				
Number of SHGs provided RF	761	176	259	1,020
Amount of RF provided to all SHGs	10,041	2,480	3,677	13,718
Total number of all SHGs provided CIF	438	104	168	606
Total amount of CIF provided to SHGs	229	50	81	311
Number of Households covered under livelihood activities	1,311	463	1,005	2,316
SHG-bank credit linkage				
Number of SHG members having own savings account	7,452	1,903	2,210	9,663
Members covered under insurance schemes	3,798	1,130	2,054	5,852

Source: Extracted from the NRLM website. Details accessed on July 27, 2017, available at *http://nrlm.gov.in/MonthWiseProgressUnderNRLMAction.do?methodName=showDetail*

APPENDIX 10B
Progress under SHG-Bank Linkage Programme:
Savings of SHGs with Banks as of March 2017 (₹ in Millions)

	Commercial Banks		RRBs		Cooperative Banks		Total	
Region/State	**No. of SHGs**	**Savings Amount**	**No. of SHGs**	**Savings Amount**	**No. of SHGs**	**Savings Amount**	**No. of SHGs**	**Savings Amount**
Northern Region								
Chandigarh	1,255	10	0		37		1,292	10
Haryana	19,930	183	17,187	133	3,498	26	40,615	343
HP	16,913	164	9,941	160	18,881	183	45,735	506
J&K	12,248	43	3,609	173	1,005	3	16,862	218
New Delhi	4,131	104	0	0.00	349	8	4,480	112
Punjab	15,745	158	9,051	73	6,690	82	31,486	314
Rajasthan	134,328	1,720	91,553	1,212	90,848	533	316,729	3,464
Total	204,550	2,382	131,341	1,751	121,308	835	457,199	4,968
North East Region								
Assam	1,962	70	1,672	14	1,826	30	5,460	114
Arunachal Pradesh	85,433	479	236,228	537	25,844	29	347,505	1,045
Manipur	5,282	16	7,644	15	2,544	2	15,470	34
Meghalaya	1,561	12	4,307	57	2,574	27	8,442	96
Mizoram	233	2	7,778	52	726	2	8,737	56
Nagaland	3,747	35	846	7	8,426	86	13,019	128
Sikkim	3,003	137	0		1,208	20	4,211	158
Tripura	10,538	134	29,380	532	10,125		50,043	666
Total	111,759	885	287,855	1,214	53,273	196	452,887	2,296
Eastern Region								
A&N	432	3	0		4,442	84	4,874	87
Bihar	179,544	2,979	261,765	3,287	0		441,309	6,266
Jharkhand	59,548	868	70,577	629	225	2	130,350	1,499
Odisha	234,168	2,912	115,679	2,745	81,640	617	431,487	6,275
West Bengal	302,024	4,303	270,596	7,005	372,436	8,219	945,056	19,527
Total	775,716	11,067	718,617	13,666	458,743	8,922	1,953,076	33,654
Central Region								
Chhattisgarh	59,008	886	99,903	970	20,585	153	179,496	2,009
MP	128,435	1,974	100,365	687	9,696	70	238,496	2,731
UP	15,341	176	24,758	174	6,831	86	46,930	435
Uttarakhand	127,953	1,409	247,619	1,472	8,020	334	383,592	3,215
Total	330,737	4,445	472,645	3,303	45,132	642	848,514	8,390
Western Region								
Daman & Diu	103	1	0		0		103	1
Dadra Nagar Haveli	648	15	0		0		648	15
Goa	3,728	94	0		3,680	100	7,408	194
Gujarat	162,900	1,827	50,658	527	33,464	271	247,022	2,625

(Continued)

(Continued)

Region/State	Commercial Banks		RRBs		Cooperative Banks		Total	
	No. of SHGs	Savings Amount	No. of SHGs	Savings Amount	No. of SHGs	Savings Amount	No. of SHGs	Savings Amount
Maharashtra	400,002	5,364	112,079	1,012	373,339	4,659	885,420	11,034
Total	567,381	7,301	162,737	1,539	410,483	5,029	1,140,601	13,870
Southern Region								
AP	627,659	44,701	205,312	7,426	15,750	786	848,721	52,913
Karnataka	582,100	7,129	220,743	1,853	228,890	4,136	1,031,733	13,118
Kerala	188,129	3,620	56,877	1,004	34,521	502	279,527	5,127
Puducherry	17,086	135	4,381	56	873	31	22,340	222
Tamil Nadu	683,739	7,794	55,870	942	169,883	1,922	909,492	10,658
Telangana	355,568	12,243	269,940	3,564	7,273	121	632,781	15,928
Total	2,454,285	75,622	813,123	14,845	457,190	7,499	3,724,598	97,966
Grand Total	4,444,428	101,700	2,586,318	36,318	1,546,129	23,124	8,576,875	161,142

Source: Status of Microfinance in India 2016–17. Mumbai: MCID, NABARD.

APPENDIX 10C
Progress under SHG-Bank Linkage Programme: Bank Loans Disbursed during the Year 2016–17 (Amounts in Millions)

Region/State	Commercial Banks		RRBs		Cooperative Banks		Total	
	No. of SHGs	Loans Disbursed	No. of SHGs	Loans Disbursed	No. of SHGs	Loans Disbursed	No. of SHGs	Loans Disbursed
Northern Region								
Chandigarh	32	2	–	–	–	–	32	2
Haryana	3,357	488	981	93	131	4	4,469	585
HP	1,285	181	720	87	1,710	234	3,715	501
J&K	2,399	208	990	113	–	–	3,389	321
New Delhi	170	16	–	–	8		178	16
Punjab	1,403	203	701	38	480	9	2,584	250
Rajasthan	18,109	2,720	12,472	1,165	1,619	180	32,200	4,065
Total	26,755	3,818	15,864	1,496	3,948	427	46,567	5,741
North East Region								
Assam	43	3	14	2.11	45	7	102	12
Arunachal Pradesh	6,957	576	19,264	1,897	140	18	26,361	2,490
Manipur	53	6	228	18	–	–	281	24
Meghalaya	37	58	158	10	27	2	222	71
Mizoram	4	1	290	59	18	6	312	65
Nagaland	91	11	18	4	560	88	669	103
Sikkim	160	10	–	–	7	1	167	11
Tripura	596	37	190	22	61	6	847	66
Total	7,941	701	20,162	2,013	858	128	28,961	2,842

Region/State	Commercial Banks No. of SHGs	Commercial Banks Loans Disbursed	RRBs No. of SHGs	RRBs Loans Disbursed	Cooperative Banks No. of SHGs	Cooperative Banks Loans Disbursed	Total No. of SHGs	Total Loans Disbursed
Eastern Region								
A&N	124	20	–	–	307	61	431	81
Bihar	69,326	3,666	86,839	9,564	–		156,165	13,231
Jharkhand	9,632	571	7,799	449	30	17	17,461	1,037
Odisha	43,479	6,556	24,621	2,546	4,320	507	72,420	9,610
West Bengal	87,205	7,748	54,211	7,531	109,170	8,079	250,586	23,358
Total	209,766	18,562	173,470	20,090	113,827	8,665	497,063	47,317
Central Region								
Chhattisgarh	10,726	1,262	8,022	627	10,419	365	29,167	2,253
MP	19,898	1,887	13,688	1,072	168	3	33,754	2,962
UP	1,275	150	332	27	960	67	2,567	244
Uttarakhand	9,685	879	5,916	441	923	17	16,524	1,337
Total	41,584	4,178	27,958	2,166	12,470	452	82,012	6,796
Western Region								
Dadra, Nagar Haveli	83	4	–	–	–	–	83	4
Goa	415	126	–	–	146	53	561	179
Gujarat	10,912	965	13,516	1,056	806	127	25,234	2,147
Maharashtra	56,131	10,493	7,310	930	17,506	1,128	80,947	12,551
Total	67,541	11,588	20,826	1,986	18,458	1,308	106,825	14,882
Southern Region								
AP	255,634	74,261	96,942	27,745	5,189	1,465	357,765	103,471
Karnataka	189,480	38,999	29,361	8,961	46,202	9,261	265,043	57,220
Kerala	66,180	19,174	6,961	2,021	1,949	1,069	75,090	22,265
Puducherry	1,400	377	673	198	566	237	2,639	812
Tamil Nadu	138,797	36,209	13,584	5,003	18,408	5,048	170,789	46,259
Telangana	111,364	35,102	151,739	44,452	2,263	652	265,366	80,206
Total	762,855	204,122	299,260	88,379	74,577	17,732	1,136,692	310,233
Grand Total	1,116,442	242,970	557,540	116,130	224,138	28,711	1,898,120	387,812

Source: Status of Microfinance in India 2016–17. Mumbai: MCID, NABARD.

APPENDIX 10D
Progress under SHG-Bank Linkage Programme: Bank Loans Outstanding as of March 31, 2017 (Loans in ₹ Millions)

Region/State	Commercial Banks		RRBs		Cooperative Banks		Total	
	No. of SHGs	Loans Outstanding	No. of SHGs	Loans Outstanding	No. of SHGs	Loans Outstanding	No. of SHGs	Loans Outstanding
Northern Region								
Chandigarh	106	8	–	–	1		107	8
Haryana	15,700	966	6,451	652	346	18	22,497	1,636
HP	4,217	377	7,464	333	4,805	394	16,486	1,104
J&K	4,585	266	1,420	111	29	2	6,034	379
New Delhi	402	42	–	–	13		415	43
Punjab	4,711	321	5,334	249	1,837	81	11,882	651
Rajasthan	45,939	3,104	18,579	990	21,966	1,201	86,484	5,295
Total	75,660	5,085	39,248	2,335	28,997	1,696	143,905	9,117
North East Region								
Assam	121	13	73	7	45	9	239	28
Arunachal Pradesh	32,641	2,287	65,793	3,980	3,023	72	101,457	6,338
Manipur	592	38	1,168	55	2		1,762	93
Meghalaya	303	73	658	59	304	12	1,265	144
Mizoram	76	6	1,264	179	38	10	1,378	195
Nagaland	788	54	103	26	1,558	161	2,449	242
Sikkim	682	62	–	–	14	1	696	63
Tripura	5,988	384	20,536	561	7,452	268	33,976	1,213
Total	41,191	2,918	89,595	4,866	12,436	531	143,222	8,316
Eastern Region								
A&N	851	57	–	–	871	77	1,722	133
Bihar	127,712	6,597	236,457	9,251	–	–	364,169	15,849
Jharkhand	27,244	1,980	59,974	1,186	56	22	87,274	3,189
Odisha	111,473	10,634	85,186	9,263	24,003	1,372	220,662	21,268
West Bengal	221,105	13,688	215,048	24,483	233,316	10,246	669,469	48,417
Total	488,385	32,956	596,665	44,184	258,246	11,716	1,343,296	88,856
Central Region								
Chhattisgarh	18,938	1,574	70,618	1,862	4,462	107	94,018	3,543
MP	47,753	3,419	43,516	1,641	461	27	91,730	5,088
UP	4,732	314	5,575	161	4,182	235	14,489	710
Uttarakhand	61,407	5,930	133,776	6,738	2,991	128	198,174	12,796
Total	132,830	11,238	253,485	10,402	12,096	497	398,411	22,137

Region/State	Commercial Banks		RRBs		Cooperative Banks		Total	
	No. of SHGs	Loans Outstanding	No. of SHGs	Loans Outstanding	No. of SHGs	Loans Outstanding	No. of SHGs	Loans Outstanding
Western Region								
Dadra, Nagar Haveli	223	7	–	–	–	–	223	7
Goa	1,024	206	–	–	574	92	1,598	298
Gujarat	32,144	1,654	14,435	638	1,785	145	48,364	2,436
Maharashtra	126,808	13,151	38,660	3,270	62,444	1,728	227,912	18,150
Total	160,199	15,018	53,095	3,908	64,803	1,965	278,097	20,891
Southern Region								
AP	567,618	132,507	166,611	39,491	17,128	2,060	751,357	174,058
Karnataka	463,918	57,263	108,056	15,847	77,735	8,384	649,709	81,493
Kerala	120,876	24,837	15,940	2,464	6,107	1,665	142,923	28,966
Lakshadweep	4	1	–	–	–	–	4	1
Puducherry	3,478	536	1,262	243	873	199	5,613	979
Tamil Nadu	277,437	48,024	27,995	4,610	78,875	7,841	384,307	60,474
Telangana	338,708	56,302	259,890	62,848	8,845	1,376	607,443	120,526
Total	1,772,039	319,469	579,754	125,504	189,563	21,523	2,541,356	466,497
Grand Total	2,670,304	386,685	1,611,842	191,199	566,141	37,929	4,848,287	615,813

Source: Status of Microfinance in India 2016–17. Mumbai: MCID, NABARD.

APPENDIX 10E

State-wise and Bank-type-wise NPA Levels of SHGs as of March 2017 (₹ in Millions)

Region/State	Public Sector Commercial Banks			Private Sector Commercial Banks			RRBs			Cooperative Banks			Total		
	Loan Amount OS against SHGs	Amount of GNPA against SHGs	NPA %age to Loan OS	Loan Amount OS against SHGs	Amount of GNPA against SHGs	NPA %age to Loan OS	Loan Amount OS Against SHGs	GNPAs against SHGs	NPA % to Loan OS	Loan Amount OS against SHGs	GNPA against SHGs	NPA %age to Loan OS	Loan Amount OS Against SHGs	Amount of GNPA against SHGs	NPA % to Loan OS
Northern Region															
Chandigarh	8	1	15.12	–	0	0	–	0	0		0	0	8	1	14.52
Haryana	782	230	29.46	184	0	0.13	652	60	9.21	18	9	48.12	1,636	299	18.3
HP	362	61	16.86	15	0	0	333	23	7.03	394	78	19.83	1,104	163	14.72
J&K	39	5	13.43	227	0	0.12	111	7	5.89	2	1	29.94	379	13	3.3
New Delhi	42	9	22.15	–	0	0	–	0	0		0	0	43	9	21.98
Punjab	199	109	54.61	121	0	0.01	249	15	5.94	81	26	32.42	651	150	23.03
Rajasthan	1,610	738	45.82	1,493	30	2	990	335	33.82	1,201	240	20	5,295	1,343	25.36
Total	3,042	1,154	37.92	2,040	30	1.49	2,335	440	18.83	1,696	354	20.86	9,117	1,978	21.69
North East Region															
Assam	2,285	6	43.11	2	0	0	7	2	34.66	9	2	23.54	28	10	35.13
Arunachal Pradesh	13	517	22.63	0	0	24.21	3,980	581	14.59	72	48	67.09	6,338	1,146	18.08
Manipur	38	12	31.92	–	0	0	55	6	11.08		0	100	93	18	19.81
Meghalaya	73	6	8.06	–	0	0	59	13	21.29	12	12	96.83	144	30	20.79
Mizoram	6	4	63.49	–	0	0	179	31	17.27	10	2	15.06	195	36	18.64
Nagaland	54	13	24.68		0	53.7	26	2	7.38	161	24	14.93	242	39	16.31
Sikkim	62	3	4.11	–	0	0	–	0	0	1	0	0	63	3	4.06
Tripura	384	95	24.7	–	0	0	561	289	51.51	268	50	18.59	1,213	434	35.75
Total	2,915	656	22.48	2	0	25.04	4,866	923	18.97	531	137	25.78	8,316	1,716	20.64
Eastern Region															
A&N	57	9	16.54	–	0	0	–	0	0	77	7	9.49	133	17	12.48
Bihar	6,570	1,090	16.6	28	0	0.04	9,251	980	10.59	–	0	0	15,849	2,070	13.06
Jharkhand	1,970	366	18.57	10	0	0	1,186	195	16.44	22	1	3.34	3,189	562	17.61
Orissa	7,682	2,062	26.84	2,952	1	0.02	9,263	759	8.19	1,372	174	12.72	21,268	2,996	14.08
West Bengal	13,434	945	7.03	255	0	0	24,483	838	3.42	10,246	527	5.15	48,417	2,310	4.77
Total	29,713	4,472	15.05	3,245	1	0.02	44,184	2,771	6.27	11,716	710	6.06	88,856	7,954	8.95

Central Region															
Chhattisgarh	1,125	145	12.88	449	3	0.59	1,862	125	6.73	107	17	15.58	3,543	289	8.17
MP	2,596	644	24.81	823	42	5.1	1,641	386	23.51	27	24	86.88	5,088	1,096	21.54
UP	5,377	56	23.44	554	1	1.32	161	31	19.23	235	93	39.67	710	181	25.51
Uttarakhand	239	1,169	21.74	76	1	0.16	6,738	2,300	34.14	128	86	67.13	12,796	3,555	27.79
Total	9,337	2,014	21.57	1,902	46	2.44	10,402	2,842	27.32	497	220	44.17	22,137	5,122	23.14
Western Region															
Dadra & NH	7	0	0.03					–	0.00	–	–	–	7	0	0.03
Goa	145	3	2.11	61	–	0.00	–	–	0.00	92	6	6.16	298	9	2.94
Gujarat	1,194	133	11.18	460	–	0.00	638	69	10.76	145	48	32.87	2,436	279	11.46
Maharashtra	6,156	1,184	19.24	6,996	0	0.07	3,270	572	17.50	1,728	425	24.60	18,150	2,214	12.20
Total	7,502	1,321	17.61	7,517	30	6.45	3,908	641	16.40	1,965	478	24.35	20,891	2,502	11.98
Southern Region															
AP	132,403	3,833	2.90	105	104	99.90	39,491	1,003	2.54	2,060	62	2.99	174,058	5,002	2.87
Karnataka	51,334	1,670	3.25	5,929	129	2.18	15,847	773	4.88	8,384	301	3.59	81,493	2,873	3.53
Kerala	16,610	1,038	6.25	8,226	57	0.69	2,464	84	3.39	1,665	125	7.51	28,966	1,303	4.50
Lakshadweep	1	0	7.12	–	–	0.00	–	–	0.00	–	–	–	1	0	7.12
Puducherry	443	132	29.74	93	0	0.22	243	13	5.24	199	22	11.20	979	167	17.06
Tamil Nadu	32,842	6,336	19.29	15,182	453	2.99	4,610	236	5.12	7,841	710	9.06	60,474	7,736	12.79
Telangana	56,301	2,903	5.16	1	–	0.00	62,848	724	1.15	1,376	42	3.07	120,526	3,670	3.04
Total	289,933	15,912	5.49	29,536	744	2.52	125,504	2,833	2.26	21,523	1,262	5.87	466,497	20,750	4.45
Grand Total	342,442	25,528	7.45	44,243	883	2.00	191,199	10,450	5.47	37,929	3,161	8.33	615,813	40,022	6.50

Source: Status of Microfinance in India 2016–17. Mumbai: MCID, NABARD.

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Review of Microfinance[1]

11

Chapter

MICROFINANCE: PERFORMANCE DURING THE YEAR

Unlike many of the past years, where the microfinance sector had recovered from the shock of the AP crisis and had was having a dream run, this year was a year that saw many events that tested the resilience of the sector. While there were multiple shocks, none of these were so large as to paralyze the sector as in 2010. However, these shocks were a good reality check and showed up the vulnerabilities of the sector. While the microfinance sector grew at a sharp pace during the year, the growth could have been even more but for the demonetization exercise announced by the prime minister on November 8, 2017. The highlights of the growth of MFIs on various parameters are given in Box 11.1. The sector continued to be profitable and, as the numbers indicate, the growth happened with the deepening of the engagement.

The data given in the box has a split between the quarter ending September 2016 and year ending March 2017. From these numbers, it is possible for us to see that the demonetization exercise slowed down the entire sector very significantly. All the parameters that were significantly higher in September—gross loan portfolio (GLP), number of clients, and average loan size—suffered a severe setback.

Box 11.1 Highlights of MFI Performance as of March 2017

As of September 30, 2016, MFIs provided microcredit to over 33 million clients, an increase of 54% over Q2 FY 2015–16.	As of March 2017, NBFC MFIs provided credit to around 27.5 million clients,[2] an increase of 30% over FY 2015–16. (If we take the broader database provided by CRIF High Mark, it shows that the number was 43.7 million unique clients for March 2017 as against 37.8 million unique clients for March 2016, showing a 15% growth year-over-year (YoY).
The aggregate GLP of MFIs was ₹579.41 billion (excluding NPA PAR > 180 days in AP and Telangana). This was a YoY growth of 84% over Q2 FY 2015–16 and an increase of 11% over the last quarter.	The aggregate GLP of MFIs stood at ₹468 billion (excluding NPA PAR > 180 days in AP and Telangana). This represents a YoY growth of 25% over FY 2015–16.

[1] The author is thankful to N. Srinivasan who went through the chapter carefully and offered not only insights about the content but also inputs in organizing the chapter. Parijat Garg, CRIF High Mark not only shared data, but gave useful inputs on the draft of this chapter. P. Satish of Sa-Dhan spent a good hour over breakfast discussing the events that have affected the microfinance sector providing some very useful inputs. He also shared the early draft of some chapters of the Bharat Microfinance Report for incorporating the data of not-for-profit MFIs that Sa-Dhan tracks more closely. Supreeta Nijjar of ICRA helped me with a discussion providing some inputs and also sent very useful comments on the chapter. Likewise, there have been useful inputs from Shri Brij Mohan for which the author is ever thankful.

[2] Includes multiple borrowings from different institutions.

Loan amount disbursed in Q2 FY 2016–17 increased by 50% compared to Q2 FY 2015–16 reaching to ₹189.95 billion	Loan amount disbursed in FY 2016–17 increased by 13% compared to FY 2015–16. The amount disbursed was ₹503 billion.
Total number of loans disbursed by MFIs grew by 20% in Q2 FY 16–17 compared with Q2 FY 2015–16	Total number of loans disbursed by NBFC MFIs grew by 13% in FY 2016–17 compared with FY 2015–16. The number of loans disbursed was 28.3 Million. (The broader CRIF High Mark figures show a different trend of 48.4 million loans in year 2016–17 as against 52.5 million loans in 2015–16 indicating a growth of 7.5%).
PAR figures remained under 1% for Q2 FY 2016–17	PAR 30 has increased considerably from 0.4% in FY 2015–16 to 14.1% in FY 2016–17. This is directly attributed to the impact of demonetization.
Average loan amount disbursed per account is now ₹21,469. The figure for Q2 FY 2015–16 was ₹17,161	Average loan amount disbursed per account reduced to ₹17,779 in FY2016–17 from ₹17,812 in FY 2015–16. (The CRIF High Mark numbers show an increase from ₹21,000 to ₹25,000.)
MFIs cover 30 states/union territories	MFIs now cover 32 states/union territories.
In terms of regional distribution of GLP, south is 31%, east at 16%, north at 28%, and west at 25%	In terms of regional distribution of GLP, south accounts for 31% of the total industry portfolio, north for 27%, west for 24%, and east for 18%. The top five states, namely, Karnataka, TN, UP, Maharashtra, and MP account for 56% of GLP. (The contribution of the eastern sector significantly changes if Bandhan Bank were to be included in the data. The CRIF High Mark data indicates the top shares as TN: 16%; WB: 14%; Maharashtra: 10%; Karnataka: 10%; and UP: 8%.)

Sources: http://mfinindia.org/wp-content/uploads/2016/10/Micrometer-Issue-19_Q2-FY-16-17_Nov-2016_Final1.pdf, accessed on September 17, 2017.

MFIN Micrometer No. 21 accessed from http://mfinindia.org/wp-content/uploads/2017/05/Micrometer-Issue-21_Q4-FY-16-17_23rd-May_Public.pdf, accessed on August 8, 2017.

CRIF High Mark data accessed directly from the company.

GROWTH OF MFIs DURING THE YEAR[3]

The spread of MFIs across the country was impressive. As per the data made available by the Microfinance Institutions Network (MFIN), MFIs were present in 32 states and union territories. As seen from the figures compared between September 2016 and March 2017, this year the sector did not grow to its potential due to demonetization. However, this was a year of change and consolidation where much of the metrices that we have been using in the past is put to question. For instance, many of the new SFBs are distinguishing between the touchpoints—erstwhile branches that the NBFC MFI—and branches. The erstwhile NBFC MFI branches are to be treated as customer touchpoints where only asset-based transactions happen, more in the nature of a direct selling agent. The branches of these banks look and feel like any other bank branch and usually focus on liability products. Therefore, we may now have to track touchpoints rather than branches as we move forward.

However, while demonetization considerably slowed down the business, it did not dampen the enthusiasm toward microfinance, and that is a positive sign. There were increased investments in the sector. There was also consolidation. The growth of

[3] This segment solely relies on the data of the 46 MFIs that form the database of MFIN. The database also includes some SFBs, NBFCs such as ASA, Sarvodaya Nano, and L&T, group lending products of mainstream banks. However, given that this is a transitionary year for the MFIs, the data is to be seen as indicative and may not be strictly comparable to the previous years. This does not cover the data of nonmembers of MFIN. The SHG segment of the business is discussed in a separate chapter.

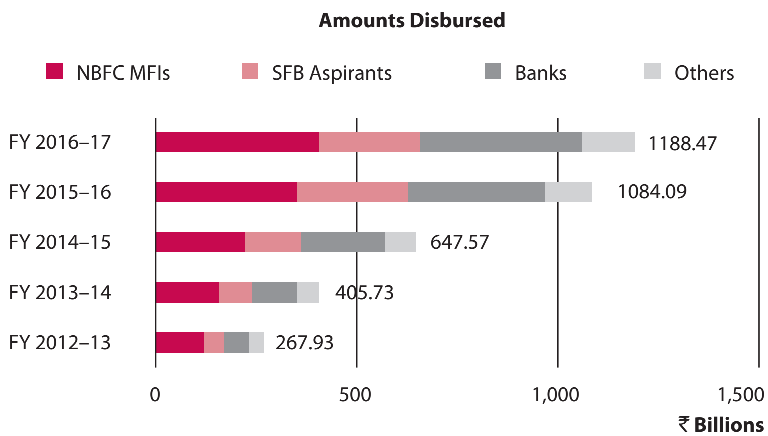

Figure 11.1 Growth of MFI Portfolio Post 2013

Source: CRIF High Mark.

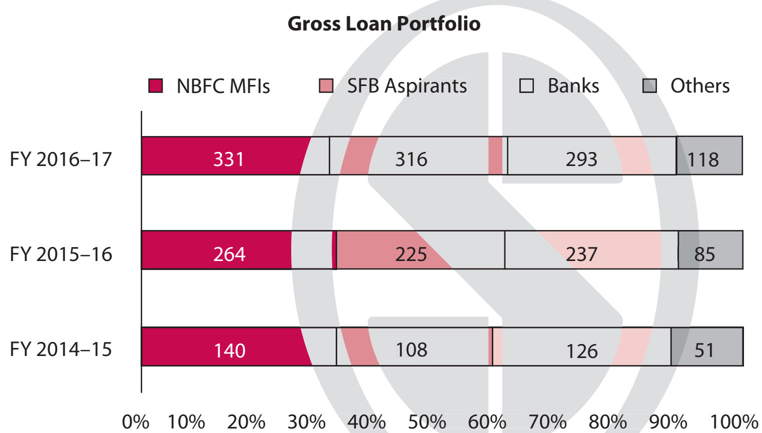

Figure 11.2 GLP by Institutional Form

Source: CRIF High Mark.

the portfolio (both on the books and managed portfolio) is captured in Figure 11.1.

The data (Figure 11.2) shows the magnitude of departure from the MFI base into the banking base. This has happened in phases, with Bandhan moving during the last year, a few MFIs moving in 2016–17, and some moving in the next year. It is also evident that the existing MFIs that did not become banks continue to grow at a healthy pace, which is evident from the growth numbers using the modified new base of exclusive MFIs. The growth numbers between the last year and this year is given in Table 11.1. The elimination of Telangana and AP from the MFIN database is an indication of the complete wipe out of MFIs in those two states following the 2010 crisis. Possibly the AP-Telangana states need to be specially studied and understood to get a picture of the larger role of MFIs and MFI loans in the economy.

STRUCTURAL ISSUES AND INVESTMENTS INTO MFI SECTOR

The year, like the past year, was interesting with much action and investments flowing into the sector. There were more deals of banks taking over MFIs, large NBFCs looking for a presence by taking over mid-level MFIs, and the transition of some MFIs into the banking space. The main highlights during the year were:

- Bandhan continued to operate as a universal bank, but predominantly keeps its portfolio in tact—focused on the inclusive finance segment. While Bandhan's gross loan portfolio on microfinance (GLP) grew by 28% during the previous year, it picked up and grew by 35% during 2016–17. Overall, Bandhan had an outstanding of ₹164 billion toward the inclusive finance customers.

Table 11.1 Year-on-Year Growth Rates of MFI Activities for 2015–16 and 2016–17

State/ Region	MFI (Nos)	GLP	Client	Branches	Employees	Loans Disbursed	Loan Accounts Disbursed	Ave Loan Disbursed per Account
Delhi	6	32%	–69%	100%	27%	–51%	–59%	20%
Haryana	12	21%	109%	59%	53%	–16%	–19%	3%
Punjab	9	29%	46%	45%	57%	–30%	–37%	11%
Rajasthan	16	18%	29%	43%	8%	–4%	–15%	13%
North		24%	22%	51%	34%	–20%	–26%	8%
Assam	9	60%	51%	36%	58%	53%	39%	10%
Meghalaya	5	96%	98%	60%	120%	85%	94%	–5%
North East		61%	51%	37%	59%	53%	40%	10%
Bihar	18	54%	50%	36%	4%	25%	8%	15%
Jharkhand	13	50%	56%	25%	1%	33%	17%	14%
Odisha	13	32%	27%	34%	–7%	33%	9%	22%
W.B.	12	51%	34%	36%	6%	39%	14%	23%
East		46%	38%	34%	1%	32%	11%	19%
Chhattisgarh	17	36%	33%	42%	32%	0%	–6%	6%
MP	21	11%	21%	32%	29%	–21%	–24%	5%
UP	17	0%	23%	25%	14%	–42%	–45%	5%
Uttarakhand	10	–7%	13%	35%	17%	–52%	–53%	3%
Central		7%	23%	30%	21%	–32%	–34%	4%
Gujarat	12	15%	25%	19%	52%	–8%	–18%	12%
Maharashtra	26	20%	27%	14%	31%	–9%	–21%	15%
West		19%	26%	15%	36%	–9%	–21%	15%
Karnataka	16	24%	27%	34%	28%	7%	–16%	28%
Kerala	7	68%	33%	25%	–2%	48%	21%	22%
Tamil Nadu	12	60%	61%	39%	92%	40%	31%	7%
South		41%	40%	35%	44%	22%	–3%	25%
All India		29%	32%	31%	27%	3%	–10%	14%

Source: Computed by the author from the tables in Appendices 11A and 11B.

- In the SFB segment, the only LAB that was granted the final license, Capital LAB, was the first to launch its operation as an SFB. Of the others, eight were erstwhile MFIs and one was an NBFC loan company. Of the MFIs, Equitas and Ujjivan had raised equity in the holding company last year. The others changed their capital structure to ensure that they qualified for the proportion of ownership by Indian shareholders to get a final license. Equitas, Suryoday, Ujjivan, Utkarsh, ESAF, and Fincare (Disha) and RGVN(NE) started operations as a bank; only—Janalakshmi got the final licence but had not commenced operations.
- Last year, IDFC Bank acquired complete stakes in Grama Vidiyal, with a GLP of ₹15 billion. While the assets and liabilities were transferred to the bank, most of the network and staff of Grama Vidiyal were hived into a separate entity as a BC-generating business for IDFC Bank.
- RBL Bank acquired a 30% stake in Mumbai-based Swadhaar Finserve in May 2016. While the company continued its operations, it applied for a de-registration as NBFC with the RBI that was approved in January 2016. The company now works exclusively as a BC and enhances the product offerings of RBL Bank. Swadhaar may be

the first to surrender its license voluntarily and deregister itself as an NBFC MFI.

- In October 2016, Kotak Mahindra Bank bought out BSS Microfinance to expand its presence in various segments of the market. While it retained the company as a subsidiary, eventually, it will have to exit the fund-based business that should move to the bank, while BSS may continue as a BC.
- In November 2016, India Infoline acquired the shareholding of Samasta Microfinance in an all-cash deal. India Infoline is a large nonbanking finance company and has a diversified set of activities in the financial sector through multiple entities. It had applied for a universal bank license as well as an SFB, but failed to make the cut.
- Muthoot Finance Limited (different from Muthoot Fincorp, which owns the Muthoot Microfinance) picked up a significant stake in Belstar Investment and Finance Limited last year. It increased its stake from 46.83% as of June 30, 2016 to 57.16%, and in December 2016 raised it to 64.60%.[4]
- Bharat Financial Inclusion Limited (formerly SKS Microfinance) has been in the news for long looking to be acquired. They were said to be in talks with three banks—IDFC Bank, IndusInd, and RBL Bank.[5] The latest information was that Bharat Financial Inclusion is going to be acquired by IndusInd Bank in an all stock deal.
- In February 2017, there was news that the Chennai-based SMILE Microfinance is looking to be bought over, after the settlement of a dispute between the founders and later investors. However, even after the appointment of an advisor for the sale, no deal had been struck.
- In March 2017, MAS Financial Services filed a draft red herring prospectus with the Securities Exchange Board of India for a proposed equity share issue of around ₹5.5 billion. The issue hit the market recently and was a success.
- Essel Finance, which was said to be in talks to acquire BSS Microfinance last year and lost out on the deal to Kotak Mahindra Bank is said to be in talks to acquire Saija—another microfinance entity.[6]
- Dewan Housing was said to be interested in acquiring a microfinance firm to diversify its portfolio. However, no deals were struck during the year.[7]
- There was much news last year about Ratan Tata, Nandan Nilekani, and Vijay Kelkar coming together and setting up of Avanti Microfinance and entering the inclusive finance segment through a dedicated technology-enabled company. However, there was no news of this enterprise during the year.

It is interesting that the interest in investing in the equity of the microfinance sector as well as the acquisition of businesses is largely coming in from the new private banks and from some players who had aspired to become banks. It is not clear whether these large NBFCs want to be in this space to vertically cover the entire market segment or if these acquisitions may help them to eventually apply for a universal bank license—which is now available on tap—and it is a moot question. Most of the players, such as India Infoline, Muthoot, and Dewan, were all aspirants for a banking license during the past round. These developments have had significant impacts on the business models for smaller MFIs and those in the not-for-profit setup.

The PSL norms that require an exposure to not only the small and marginal farmers but also to microenterprises, and the need to open 25% of the branches in URCs may be driving the new banks toward MFIs, while the older banks can grow organically from their existing base. The availability of MFIs that are working at a low cost and are profitable also enhances the banks' ability to trade obligations across the banking system through the PSLCs.

We can see that the process of microfinance being mainstream is almost complete. The original not-for-profit models have largely transformed into for-profit models; very few are staying in the model that they were conceived. Even in the transformed entities, we find that the promoters are exiting and new investor-led managements are taking over. Table 11.3 gives brief journey of all the registered NBFC MFIs that are listed with the RBI.

[4] See http://economictimes.indiatimes.com/markets/stocks/news/muthoot-finance-ups-stake-in-subsidiary-belstar-to-64-6/articleshow/56272251.cms, accessed on August 1, 2017.

[5] See https://www.vccircle.com/bharat-financial-inclusion-in-talks-with-three-banks-for-stake-sale/, accessed on August 3, 2017.

[6] See https://www.vccircle.com/exclusive-essel-finance-talks-buy-small-microlender/, accessed on August 3, 2017.

[7] See https://www.vccircle.com/exclusive-dewan-housing-finance-seeks-acquire-micro-lending-firm/, accessed on August 3, 2017.

INVESTMENTS INTO MFI SECTOR

During the year (from August 2015 to July 2016), the MFIs raised a significant amount of resources through equity, sub-debt, debentures, and preference shares. The public offerings during the year were of AU Financiers and MAS Finance. Satin Creditcare was listed on the exchanges. At the end of the year, there was news that Credit Access-backed Grameen Koota was readying for a public offering. Bandhan also indicated its plans to go public. Table 11.2 gives the details of the investment deals entered by the MFIs during the year.

Table 11.2 Fund Infusion in MFIs for August 2016–September 2017

Month of Announcement	MFI Name	Infusion (₹ in Million)	Exit*	Investors
December 2016	Madura Microfinance	600	₹200 Exit by Elevar	AV Thomas Group
May 2017		300	₹50 by Tara Thiagarajan in 2017	AV Thomas Group
August 2016	Chaitanya India	470		Equator Capital, Shorecap II
August 2016	Fusion Microfinance	1,620	Exit @ ₹620, Incofin	Equity from Creation Investments; Gawa; Bio and Oiko
December 2016	Muthoot Microfin	1,300		Creation
December 2016	Belstar	72		Muthoot Finance
September 2016	Utkarsh	3,950		Equity from domestic institutional investors, HDFC Standard, HDFC Ergo, ICICI Pru, Shriram Life, RBL Bank, SIDBI, Faring Capital, Arpwood Capital
September 2016	Ujjivan	2,680		Debt from IFC
December 2016	Sonata	850	MSDF and Caspian partial Exit	Equity by Propairco and Triodos Investment Fund
February 2017	Suryoday SFB	1,600		₹1,000 equity through rights issue. Fresh capital from TVS capital
March 2017	Esaf Microfinance	3,300		Commercial Paper**
March 2017	M Power	375		Indinivesh
March 2017	Disha	5,000		Tata Opportunities, Leapfrog, IVFA, TA Associates
March 2017	RGVN (NE)	1,300		Senior Debt from IFC
March 2017	Svasti	120		Poonawala group
October 2016	Satincare	2,500		Equity: QIP
April 2017		725		Equity: ADB+ Trishashna Holdings
June 2017		1,000		Commercial Paper: Mahindra and Mahindra Financial Services
April 2017	Spandana Spoorthy	6,500+ 11,050		Equity: Kedaara Capital Debt: IndusInd, Yes, ICICI Bank.
May 2017	Aarohan	1,550		Equity. Tano Capital, SS Aiyar, and Maj Invest
June 2017	SV Creditline	200		Capital First, Debt
July 2017	Annapurna Microfinance (*Source: Economic Times*, July 19, 2017)	610		Bamboo Capital Partners, Oiko and Bio.
September 2017	Janalakshmi	10,300		TPG, Treeling, Morgan Stanley, QRG and Vallabh Bhansali

Sources: http://www.vccircle.com/search?search_api_views_fulltext=microfinance, accessed on August 3, 2017; https://www.dealstreetasia.com/ accessed on August 1, 2017; http://www.livemint.com/Companies/E0e0hRxzH5q2Ch26hE2T6I/Janalakshmi-Financial-Services-raises-Rs1030-core-equity-ca.html, accessed on September 15, 2017.

Notes: * Exits are neutral on the company as the sellers are replaced with new buyers. It is only an indication of the value that was generated for the investors at the time of exit.

** See http://www.thehindubusinessline.com/money-and-banking/esaf-microfinance-issues-330-cr-commercial-paper/article9574058.ece, accessed on August 1, 2017.

The investments to the microfinance and allied sectors from the estimate was around ₹81.15 billion as against ₹35 billion last year. This amount does not include the payouts that were made to the incumbents, when banks/large NBFCs acquired MFIs. Investments flowed, indicating long-term interest in the sector and bullish valuations. It is now clear from the type of players and the amount of money that is flowing in, that the microfinance business is now established as mainstream, with people specializing in implementing microfinance models, investors understanding the business model, and analysts being able to track the sector. With many microfinance firms becoming banks, we should now treat this as a normal mainstream business.

From the data, we can see that the most significant funding has come into Janalakshmi and Spandana Spoorthy Financial Limited. Both were troubled companies. While Janalakshmi ran into trouble after its meteoric growth last year and had to be significantly recapitalized for bearing the NPA losses before it transformed into a bank, Spandana Spoorthy was a company that went into the brink of bankruptcy following the AP crisis of 2010.

FUNDING BY THE BANKING SYSTEM

During the past years, we have been tracking the funding by the banking system as one important barometer to see how the banking system has been reposing faith on the microcredit clients. However, given that eight of the new SFBs were formerly MFIs, it would be a good time to recognize that we now have a multi-tiered approach to microfinance. Figure 11.3 gives a diagrammatic representation of the various players and the structure of the market that is serving the microfinance client.

During the year, the customers of MF has an outstanding of ₹1.07 trillion, exclusive of the SHGBLP. The banking system exclusive of SFB funded the clients through three different routes: (a) by giving a term loan to the MFIs who in turn managed the clients on their books; (b) by buying out the portfolio of the MFIs through a securitization deal, thereby, freeing up the resources for the MFIs for further lending, while they continued to manage the securitized portfolio, and (c) using both for-profit and not-for-profit MFIs as BCs, thereby, building their own loan books. The greater interest of the banks seemed to veer toward having a control on the entire value chain and, therefore, the sector saw an

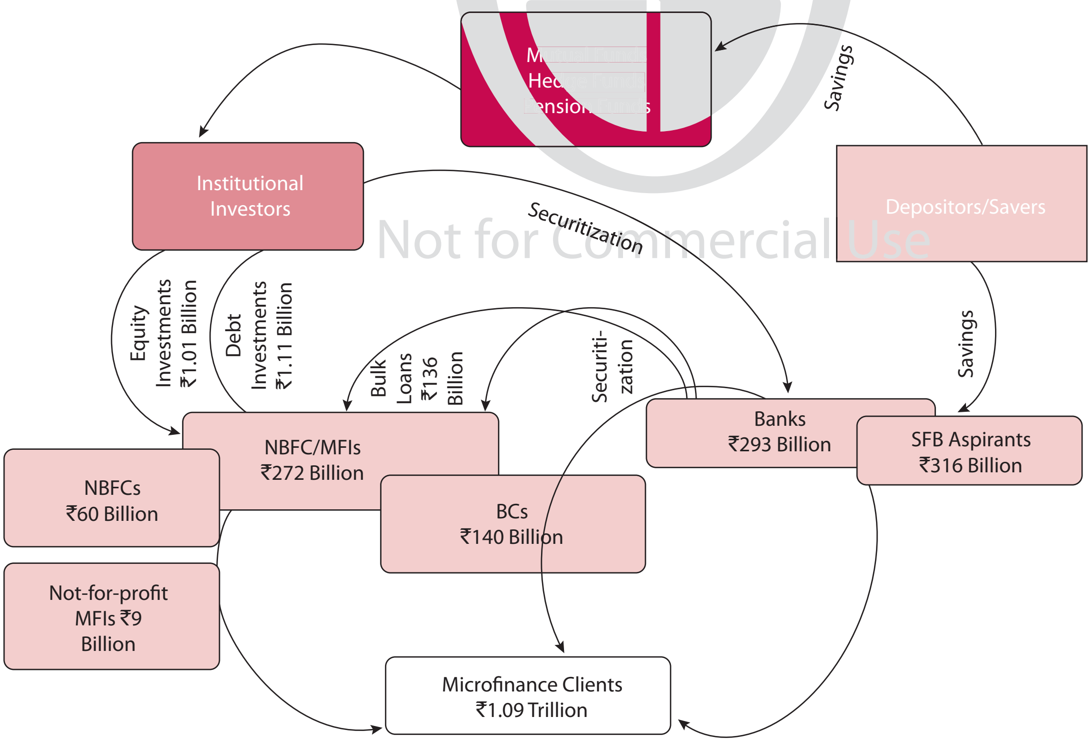

Figure 11.3 How the Current Microfinance Client Is Serviced

Source: MFIN Micrometer No. 21, http://mfinindia.org/wp-content/uploads/2017/05/Micrometer-Issue-21_Q4-FY-16-17_23rd-May_Public.pdf, accessed on August 8, 2017 and information from CRIF High Mark.

Note: The numbers in the figure pertain to the gross loan portfolio outstanding.

increasing interest in buying out medium-sized MFIs that gave access to touchpoints to reach the clients directly.

The SFBs on the other hand were in a transition phase. Part of the book was built using equity investments and part from borrowed long-term funding that needed to be grandfathered and repaid. In addition, SFBs also had off-balance sheet portfolios that they managed on behalf of other banks. And they were transitioning. Overall, this was a category where the numbers were not clear and the numbers stated are an understatement of lending to the microfinance customers.

Going forward, reporting on MFI-type loans will become more and more complicated and uncertain unless the RBI creates a separate category for reporting. The reason is as follows. With eight MFIs becoming banks this year, and Bandhan being a universal bank already, about 60% of the portfolio has shifted from organizations that were specialized. With MFIs, it was safe to assume that almost all of the book comprised of inclusive customers. With banks, and MFIs being taken over by banks and used as special vehicles to build MFI-type of books, the numbers will get subsumed in the larger books of the banks.

As banks, while there is a mandate for reporting the MFI type of loans, it also becomes important that such loans given to customers show up on the credit bureau data when MFIs give a query. While the RBI has mandated that a query should reveal the complete indebtedness of a borrower, the field reports indicate that some credit bureaus are only providing MFI data. This would get sorted out in due course and we would see a regime where the category of the loans, irrespective of institutions would be reported. At that juncture, we need to watch out how the two lender and amount limits—that apply only to NBFC MFIs and not banks (including SFBs)—play out.

During the year 2016–17, the microfinance sector received loans of ₹515 billion as against ₹401 billion last year. The year-end outstanding as on March 2017 was ₹409 billion as against ₹337.06 billion year ending March 2016.

While there are reports that the growth could have been more aggressive, it was pared down by the large MFIs being busy in moving to become a bank and the demonetization that was announced by the prime minister on November 8, 2016. Both these had an impact on growth as well as the health of the inclusive finance portfolio during the year.

The gross portfolio included a ₹72 billion of securitized loans, as against ₹96 billion of loans securitized last year. The fall in securitization is an indication of the short-term negative outlook on the quality of the MFI portfolio. This will be more evident by the fact that the first-half of the year saw securitization deals worth ₹55 billion, while the rest came in the second-half of the year. Not only was there a negative outlook for securitization deals to fall through, but due to the effect of demonetization, the disbursements also fell sharply, and consequently, the demand for funding took a beating. In addition, it is understood that the most significant securitization deals would come from large MFIs that have now become SFBs. Given that the MFIs themselves have a PSL target, they would have to retain the portfolio on their books and, therefore, the availability of the portfolio for deals also were lesser.[8]

SPREAD OF MFI ACTIVITY

By August 2017, there were 77 institutions licensed by the RBI as NBFC MFIs (as against 75 institutions listed last year). While collectively their footprint was across the country, it is interesting to note the regional spread of the headquarters of the MFIs (Table 11.3).

In addition to the 77 NBFC MFIs, there were over 90 other institutions (trusts, societies, and cooperatives) that were undertaking microfinance activities. While this might look like a large and daunting number, it is important to realize that of these

Table 11.3 MFIs in India

Headquarters	Number of MFIs
South (Bengaluru, Srinivasapuram, Haveri, Shivamogga, Chennai, Madurai, Theni, Coimbatore, Hyderabad Thiruvananthapuram)	29
East (Kolkata, Howrah, Bhubaneshwar, Rajgangpur, Patna)	12
West (Mumbai, Latur 1, Ahmedabad, Vadodara)	15
North (Delhi, Jaipur, Jalandhar)	11
Central (Varanasi, Lucknow)	3
North East (Guwahati, Chhaygaon, Thoubal, Sipajhar, Goalpara)	7
Total	77*

Source: RBI. Accessed from http://rbidocs.rbi.org.in/rdocs/content/DOCs/NMFI012014FL.xlsx on May 28, 2017.
Note: *Includes Bandhan, Janalakshmi, Ujjivan, Disha, Suryoday, Equitas, Utkarsh, ESAF, RGVN(NE) all of which are converted to a bank during the year.

[8] See http://www.thehindubusinessline.com/money-and-banking/note-ban-effect-securitisation-transactions-in-microfinance-sector-fall-20-in-fy17/article9644740.ece, accessed on August 12, 2017.

institutions only four institutions had a footprint in more than 15 states; another four had a footprint in 10–14 states, and about 90 MFIs operated in only one state. While there is focus on the larger ones—the ones that are becoming banks—the ones that are being taken over, one also needs to realize that there are a large number of smaller MFIs operating across the length and breadth of the country. However, the concentration in terms of number of MFIs was heavy in Maharashtra and WB that had 41 MFIs each; Tamil Nadu 35, MP 34, Bihar 33, Odisha 28, UP 28, Karnataka 23, Rajasthan 22, and Assam had 21 MFIs that were operating (Sa-Dhan 2017).

The MFIs were operating all across the country and had penetrated the length and breadth of the country. As against 507 districts last year, in 2016 there were 583 districts that had five or more entities giving loans with Joint Liability Group (JLG) as a feature. While most of them were NBFC MFIs (captured by MFIN), there were also other players in the market who uploaded their data to Sa-Dhan and to the CICs. Table 11.4 gives the details of the lender penetration across the country.

Table 11.4 **Number of Districts with Lender Penetration**

No. of Active Lenders		NA (Districts in AP and TL)	0	<=2	3 to 5	>5	Total
MFIN–2017	Number of Districts	44	41	32	48	542	707
All–2017		44	18	42	20	583	707
MFIN–2016		23	84	24	97	448	676
All–2016		23	53	43	50	507	676
All–2015		23	88	50	85	430	676

Source: CRIF High Mark.

BRANCH NETWORK AND CLIENTS

When we look at the regional spread of physical branch network and clients, we find that the south and east continue to dominate in the footprint in the relative share. During the past 2 years, we had Bandhan go out of the database as it became a universal bank. Bandhan continues to have a very strong presence in the eastern sector. During the year ending 2017, five NBFC MFIs converted into SFBs. Two MFIs converted in the year 2017–18. Of them, Ujjivan, Equitas, and ESAF had a strong presence in the southern sector. Ujjivan was also strong in the eastern sector. All these entities reduced the branch network by 1,722 branches as they became banks. As a result, we find that the highest relative share of branch network of MFIs is now in the central region. Utkarsh was the only MFI from the central region that converted to a bank.

On the adjusted base (that eliminated the five SFBs), the largest growth came from the northern sector, with Delhi registering a 100% growth in the numbers of branches. The slowest growth in the number of branches came from the western sector. It is heartening to see that in the north and North East, the branch growth was higher compared to south. The central and eastern region almost kept pace with the growth rate of branch network in the south.

Overall, the relative share of the number of clients shows that there is a high degree of correlation between the number of clients and the number of branches across the country (Figure 11.4). It is not that in some regions the branches cater to a relatively lesser number of clients per branch. This is also an indication of the standardization of the processes of MFIs that might change as they morph into banks.

While the MFIN data is ordered on regional and institutional bases, the data provided by Sa-Dhan breaks up the portfolio into rural and urban. Sa-Dhan calls 2014–15 as a watershed year for microfinance

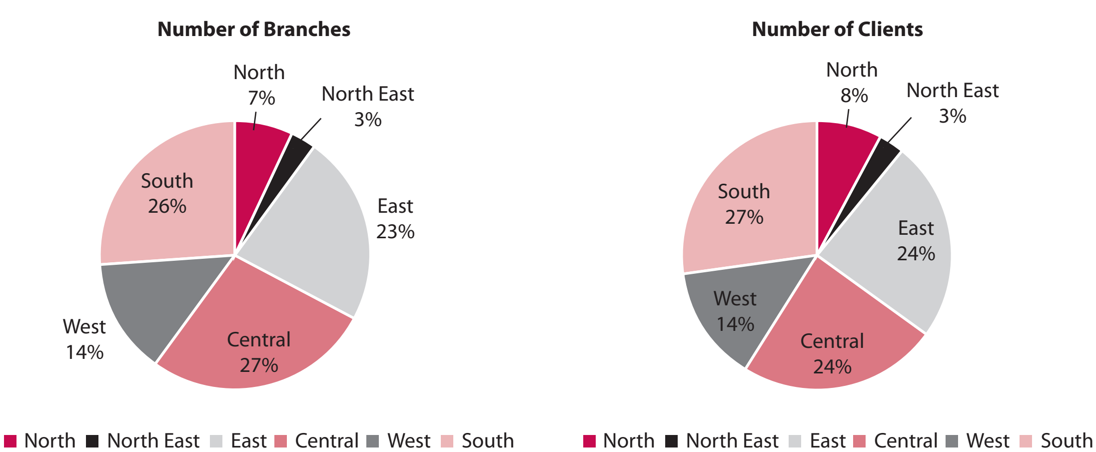

Figure 11.4 Regional Spread of the MFI Branches and Clients

Source: Microfinance Institutions Network (MFIN).

as the urban portfolio overtook the rural portfolio. However, with the larger MFIs getting out of the database, it appears that the pureplay MFIs have a greater deployment of credit in the urban areas. What is important is that Sa-Dhan's research shows that the smaller MFIs tend to be rural centric, but the growth seems to be coming from urban areas. So as the MFIs grow, get mainstreamed, they also get more into serving the urban clients (Sa-Dhan 2017).

PORTFOLIO

The portfolio numbers are in largely sync with the physical outreach and the clients, with little distortions. The southern region has a relatively higher portfolio outstanding compared to its outreach parameters. When we look at the raw numbers, we see that the highest growth rates in portfolio have come from the North East and east, followed by the southern region. This shows that after the exit of Bandhan from the MFI database, the residual MFIs are still able to grow solidly in the region. The central region has had a growth of physical infrastructure (branches and clients) but relatively lower growth in terms of portfolio. This, of course, is a bit distorted because the central region did not suffer a setback in terms of reducing its base drastically. The growth of the physical infrastructure has been modest, but the relative share gone up because the base of the other regions have shrunk because of conversion to SFB.

However, it is important to notice that the overall the disbursements have not moved compared to last year on a revised base. Overall the disbursements during the year have gone up by a mere 3%, with many states and regions recording a negative growth. Part of the explanation would go to the demonetization shock of November. The central region and the northern region suffered a de-growth on loan disbursements and new loan accounts. The reason why the portfolio held was possibly because of the overdue accounts. So, what we surmise is that the MFIs had an aggressive growth plan in these regions, opened branches, and recruited field personnel but did not have adequate opportunity to grow the portfolio due to nonavailability of cash (Figure 11.5).

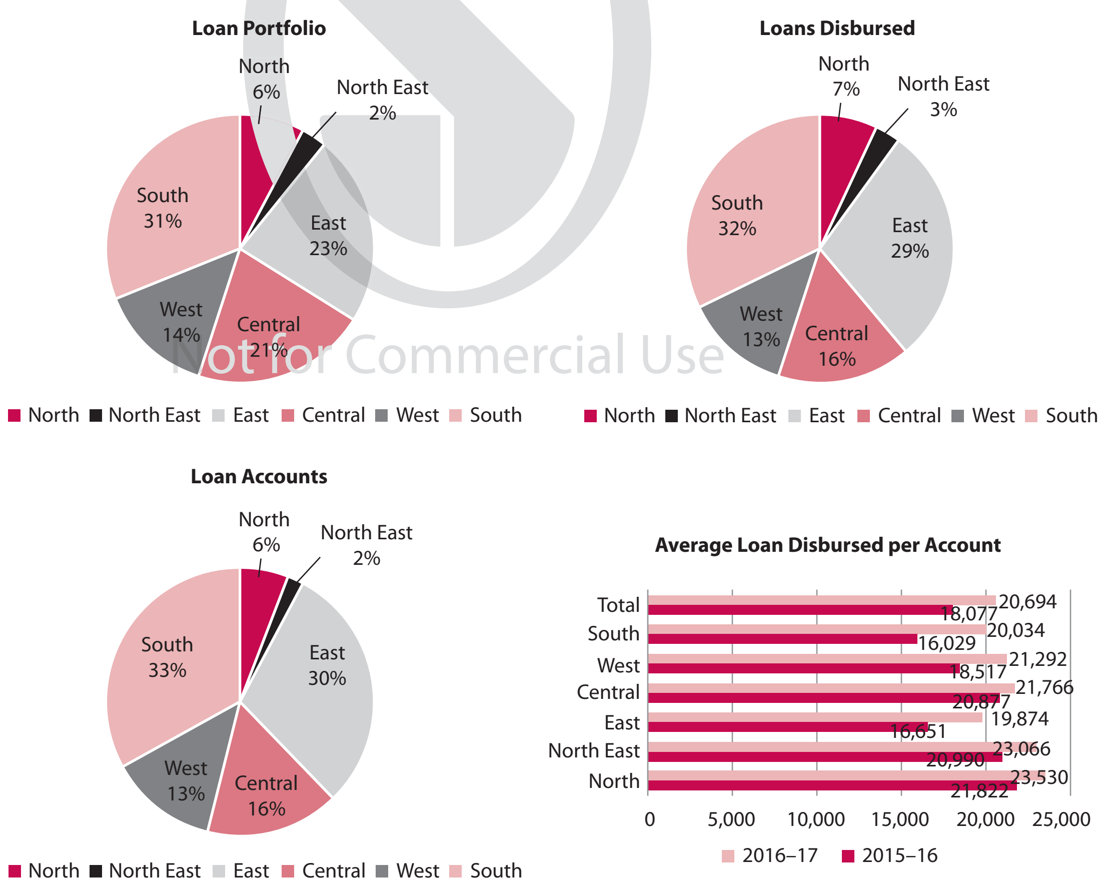

Figure 11.5 Regional Spread of the Loan Portfolio and Loan Accounts

Source: Microfinance Institutions Network (MFIN).

There was only a marginal growth in the loan disbursed per account. Clearly, it appears that the MFIs were careful and possibly topping-up their existing clients and not aggressively canvassing more clients. The overall number of clients who took a loan during the year also fell.

A DEEPER LOOK AT THE DATA

In the past year, there were questions on whether the sector was overheating and there were attempts to find out the hotspots. Last year's report discussed growth rates at some length and identified the trends that the portfolio, the number of clients, and the average loan amount is growing disproportionately to the growth in physical outreach and employees. This year the trend took a U-turn with disbursements and accounts actually falling in comparison to last year (taking the SFB out of the discussion). However, here are the top line numbers of what happened in the sector.

- The overall rate of growth in portfolio was a moderate 29% as against a phenomenal 84% in the year 2015–16.
- This growth in portfolio came with a concurrent fall in disbursements. The loan disbursements during the year grew by a mere 3%, while during the past year of 2015–16 it had grown by 45%.

Clearly the demonetization exercise had an impact on the sector and significantly slowed down the sector, which was otherwise growing too fast for comfort. However, the interesting numbers are the following:

- The number of branches of MFIs grew by 31% (previous year 22%)
- The staff strength of MFIs grew by 27% (previous year 38%)
- The number of clients grew by 32% (previous year 44%) and
- The number of loans fell by 10% (previous year 45%)

These numbers show that the slowdown was not induced by the MFIs or by the general external environment (Figure 11.6). If that were the case, then the employee and branch numbers would also have moderated in sync with the disbursals. The fact that the MFIs continued to expand their footprint but had to suddenly face a hiccup in the form of demonetization is evident in the given data. This may indeed be a blessing in disguise as the MFI sector goes through a phase of correction and the numbers and service capability fall in sync with the growth and management of portfolio.

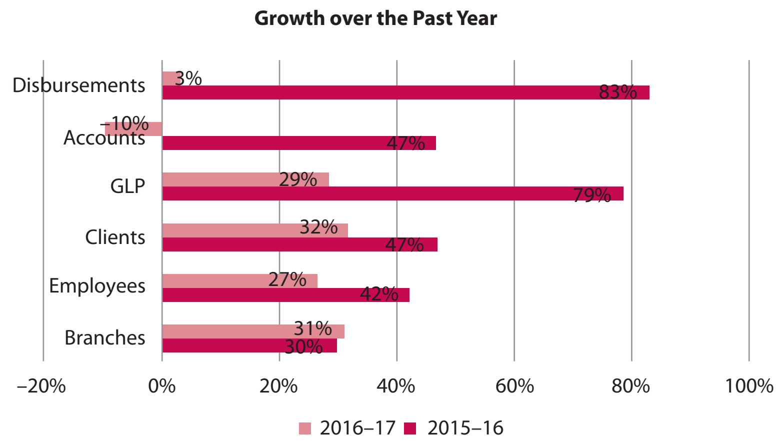

Figure 11.6 Growth of MFIs

Source: Microfinance Institutions Network (MFIN).

CHANGES IN THE LENDING METHODOLOGY AND DEMONETIZATION EFFECT

Every time there is a talk of the sector heating up, growing too fast, or resorting to overlending, there is an external event that puts a hurdle and slows down the microfinance movement. This happened in 2006 when the (undivided) AP government clamped down on some offices of MFIs and they had to take a breather; in 2010 it was the AP Law and in 2017 it was demonetization.

A later section will look at the NPAs as a result of demonetization and see how it has affected particular geographies. However, in this section we will examine the broad trends that are happening in the microfinance sector and discuss how the demonetization could have affected the trends.

With the launch of the PMJDY, last year's report spotted the trend of moving toward dealing with individuals rather than groups. Unlike the SHG movement, where the group was a unit of transaction, in case of MFIs, the group was only a unit of interaction, while the individual was a unit of transaction. With more and more composite players coming into the market and taking over the microfinance clients, the concept of a group is undergoing a subtle redefinition. We have seen this in Grameen Bank of Bangladesh as well, when the model moved from the classic Grameen model to the Grameen II model, the groups only continued aggregation and socialization points rather than for the purposes of interlinked transactions. Similarly, with more and more banks appointing MFIs as agents, MFIs being taken over by large NBFCs, or banks and MFIs themselves becoming banks, the range of services that the customer touchpoint can offer to the customer has undergone a change, and, therefore, the methodology also has to undergo a change.

First, let us examine the MFIs that have become banks. These MFIs have now got to deal with all the regulatory compliances of a bank, have a diversified asset portfolio, and have a suite of liability and third-party products they can offer to the customer. Once it is conceptually possible to have the borrowers' savings in the same institution, conceptually there is a cash margin in the custody of the lender, even though it may not be linked. So the comfort that emanated from the JLG may shift to the stickiness of the customer for other services, thereby, making it difficult for the customer to short-change the bank.

The emergence and maturing of credit bureaus makes it possible to examine the past borrowing behavior more carefully, and as time goes by, the borrowing history over a longer horizon will be available. This helps the banks to make an algorithm-based decision rather than depend on the wisdom of the groups. Therefore, it looks obvious that the existing customers will move toward the individual lending model.

In addition, these institutions no longer have the limit of the loan size for half of their portfolio and a very liberal limit for the other half at ₹2.5 million as against around ₹0.1 million all these days. They will explore other segments of the market to diversify the assets side of the portfolio. This is particularly important because part of the assets side is impounded in the form of statutory liquidity and cash reserve ratios. Therefore, the banks have to look at diversified portfolios that give a good risk adjusted return and avoid all manner of concentration risks. This leads the players toward larger loans, and individual- and relationship/account-based loans.

Equitas, for instance, plans to reduce its exposure to the microfinance segment to about 5% of its total portfolio. Equitas was in any case present in the vehicle, asset, and housing finance market through other entities that have all folded into the bank. Equitas believes that there is too much of political risk in the microfinance portfolio, and it should be small enough as to not materially affect the financials of the entity. The strategy of Equitas is to more aggressively grow the other portfolios and once the mix is achieved, to then grow organically.

The shift away from microfinance is not only in Equitas, but it seems to be more pervasive. In a recent news report, this shift was spotted and covered. The report said that Fincare is looking to reduce its group lending portfolio to about 50% in the next 5 years; Suryoday and ESAF are looking to reduce their individual lending portfolios to 75% of the total in about a year.[9] While Bandhan has not shown signs of moving away from the segment now, this movement would be imperative.

The demonetization announced on November 8 had a significant impact on the microfinance industry. Apart from the fact that it led to defaults, there were several other things that were tested. It led to significant defaults in certain pockets. However, it did not appear to impact the microfinance sector to the extent it was expected.

OUTLOOK FOR THE SECTOR

Increased Headcount, While the Portfolio Is Shrinking

There was much turmoil in the sector due to demonetization. As a result of the demonetization, the numbers for the fourth quarter of 2016–17 have been somewhat difficult to interpret. It appears that the physical outreach and staffing continued to grow as per the normal pace of the MFIs showing a year on year growth of 31% for branches and 49% for employee headcount. However, the growth in these numbers is modest in the last quarter, indicating a slowdown in hiring. There was a growth of 30% increase in the number of clients, 24% increase in the loan accounts, and 25% increase in the gross loan portfolio. The comprehensive database of CRIF High Mark indicates a 15% growth in clients, 20.3% in loan accounts, and 30.4% increase in GLP. However, the last quarter pulled down the complete statistics, resulting in the slowdown of the portfolio growth. It is evident that the headcount and the physical branches could not concurrently go down as this setback was seen as a temporary setback.

Expansion with NPAs

Most of the larger MFIs have, however, started reporting that their disbursements are taking off and the incremental portfolio is doing well. However, the NPAs continue to be a cause for concern. From the CRIF High Mark database, the numbers looked as follows:

- Industry PAR 1–30 for April 2017: 4.8% come down to 3.65% as of June 2017
- PAR 31–180: 10.13%, which is 7.31% as of June 2017

[9] See http://www.business-standard.com/article/finance/group-deaults-cause-worry-small-finance-banks-switch-to-individual-lending-117080400895_1.html, accessed on August 6, 2017.

For the first time, the industry wide NPA numbers have gone up to more than 10%. While the RBI gave a 60-day forbearance for recognition of NPAs,[10] it has only helped the MFIs to declare good March 2017 results. However, this forbearance has not really resulted in helping the recovery of sticky defaults. It is seen that once the MFI loan goes into a default for a continuous period, recovering from that is going to be tricky—particularly as the instalments pile up. A possible way out is to put these customers on a slow track and pull them back as they recover. In fact, it might be the right time for MFIs to seriously consider the Grameen II model at this hour of crisis (see Box 11.2).

Box 11.2 Muhammad Yunus on Individual Lending

Grameen II

MSS: I am curious to know what triggered you to move from Grameen I, which is highly structured and regimented—with a weekly repayment and a 1-year tenor loan—to Grameen II, which is a very flexible system?

Yunus: In the beginning we had no idea how credit and trust will work. So, we made it rigid. It was easy to train staff. We said that the groups have to be five members and they have to repay in one year. But later we realized that if they are paying back regularly how does it matter if they pay in 6 months or 1 year? So, we thought let people decide the duration.

The new method then evolved. As I said we wanted to make it easy and less complicated to our borrowers. Over a period of time we decided to remove those barriers of time/schedule/loan repayment. Of course, there was resistance. People said that once we have agreed on a repayment schedule, we have to go with it or you will be in trouble. I said no, she (the borrower) can change the schedule anytime she wants. My only argument was that if people were paying, we should make them feel comfortable. With technology and computers, it was very easy. All we had to do was to go back change the repayment schedule and then it was fine.

MSS: So in this process you broke down all the rules except 16 decisions, weekly meetings, and five-member group. But the group was a socializing group and not mutual guarantee group.

Yunus: There was never a mutual guarantee ever. But someone wrote something and I did not respond to it. But then that became a fundamental thing from the eyes of the bankers. I never thought of it as social collateral, the group was only to support each other, build friendships, and take each other's responsibilities together.

MSS: But why are they not quickly moving to the Grameen II Model if that is more friendly to the client?

Yunus: Yes, very friendly to the client, but they think again, this is working, why disturb it? If they can manage within organization why not go with it? More than that, we at Grameen have deposits. Always remember deposits are our mainstay. Therefore, it is difficult for a nondeposit taking organization to move to Grameen II.

The general tone and tenor of the analysts' reports indicates that the recovery of would be a long haul and will test out the various models of microfinance. An interaction with the analysts indicated the following possibilities:[11]

- A default makes it difficult for borrowers to recoup and revert back to the regular instalments. However, it is possible that while the borrowers might leave a gap, they may still be able to service the incremental instalments regularly without being able to make good the gap. The loan would be settled with a few weeks longer tenor.
- Multiple defaults of 4–5 installments make it difficult for the borrowers to get back on track.
- Areas having an inherent problem of over lending and political activism would have sticky defaults.
- MFIs with high concentration in such areas are prone to be affected more.
- MFIs that have had a good customer connect and a moderate growth would be able to put their customers back on track.
- The incentive of incremental lending could help the borrowers to repay.
- The concept of JLG would be under test. It would work better in rural areas and in groups that know the members well, but may break down in

[10] See https://rbi.org.in/scripts/NotificationUser.aspx?Id=10723&Mode=0, accessed on August 23, 2017.

[11] The author spoke to Unitus Capital, ICRA, and some bankers.

groups that have been formed functionally. Typically, this could happen in large cities.

- An estimate of around 10% of the portfolio of the MFI sector may have to be written off over time. This would require greater amount of capital infusion in order to maintain capital adequacy and a healthy balance sheet for leverage. However, there has been a good investment into the sector before demonetization, which has put several MFIs in a comfortable position. There have been investments in the sector even after demonetization, indicating that the investor faith in MFIs is intact.
- The SFB, given their ability to diversify the portfolio, may go in for additional and innovative products to de-risk from exposure to MFIs. Equitas has already made its intent clear and most likely Janalakshmi, Suryoday, and Fincare may adopt similar strategies.

DEMONETIZATION IMPACT MFI EXPERIENCES

Overall (estimates for March 2017, based on reported figures),[12]

- The collection efficiencies of past dues show an uptick in the first 30–60 days, and then remains flat. Therefore, the PAR 90 is expected to be sticky. The more the pile up of the instalments for the poor customers the more difficult it is for them to service the loan.
- States where there is a political risk due to waivers and contagion: UP, Maharashtra, Punjab, MP, Gujarat, Haryana, TN, and Karnataka.
- The state-wise collection efficiency as per the report by rating agency CARE based on 14 NBFC MFIs is given in Table 11.5.
- In the given states, the following districts were most affected with less than 40% collections: Bulandshahr, Jyotiba Phule Nagar, Hapur, and Udham Singh Nagar (UP); less than 60% collections: Amravati (Maharashtra), Haridwar (Uttarakhand), Sagar (MP), Bijnor, Saharanpur, Allahabad, and Kushinagar (UP); less than 80% collection: Deoria and Jaunpur (UP), Howrah (WB), Jaipur (RJ), and South Parganas (WB).[13]

Table 11.5 State-wise Collection Efficiency for November 2016 to Mid-December 2016

State	Collection Efficiency
Uttarakhand (UK)	53.53%
Uttar Pradesh (UP)	64.35%
Delhi (DL)	73.50%
Haryana (HR)	77.23%
Punjab (PB)	81.23%
Madhya Pradesh (MP)	84.49%
Rajasthan (RJ)	84.68%
Maharashtra (MH)	88.22%
West Bengal (WB)	90.01%
Himachal Pradesh (HP)	90.23%
Gujarat (GJ)	92.96%
Jharkhand (JH)	94.03%
Others	> 95%
Average	87.43%

Source: CARE Ratings: Impact of Demonetization on the Microfinance Sector.

Equitas:[14]

- Overall, microfinance disbursement down by 25% for the third quarter and has been slow to pick up.
- Collection efficiency down from 99% to 94.4%.
- PAR > 1 gone up to 5.9% of the MFI portfolio.
- Industry average as of March PAR > 0–90 days 12.9% and PAR > 90 8.0%.
- Highest negative impact in Maharashtra, MP, and Karnataka. Most delinquent districts were Bengaluru, Nagpur, Yavatmal, Amravati, Wardha, Akola, and Sagar.

Janalakshmi:[15]

- Overall portfolio quality fell. The collection efficiency was at 79% even in May 2017.
- Significant increase in delinquencies. The delinquency rate at 90 days was 15.9% in March 2017 and 26.1% as of May 2017.
- Stress not only from states where other MFIs have seen a downturn such as UP, Maharashtra, and Karnataka, but also from relatively unaffected states of TN, WB, Jharkhand, and Bihar.

[12] Based on analyst update of MFI/SFBs from Spark Capital, http://mailers.sparkcapital.in/uploads/Banking/4QFY17/MFI%20and%20SFB%20Update%20%E2%80%93%20Down%20with%20%E2%80%98PAR%E2%80%99kinson%E2%80%99s.pdf, accessed on August 14, 2017.

[13] CARE Ratings: Impact of Demonetization on the Microfinance Sector. January 2017.

[14] Based on investor presentation for Quarter 4, from http://www.equitas.in/sites/default/files/Equitas%20Group%20-%20Investor%20Presentation%20-%20Q4FY17_0.pdf, accessed on August 13, 2017.

[15] Based on a rating report of ICRA, https://www.icra.in/Rationale/ShowRationaleReport/?Id=37089, accessed on August 14, 2017.

Of these, the districts of Bengaluru, Nagpur and Wardha were identified as districts to watch out in last years' report. Similarly, there was a flash note by Religare Institutional Research around October warning of stress in Wardha district, much before the announcement of demonetization,[16] Ujjivan had identified UP, Karnataka, Maharashtra, Haryana, Delhi, Uttarakhand, Rajasthan, and Punjab as affected states where the collection efficiency was less than 90%.[17] Equirus Research identified Karnataka and Maharashtra as key affected states in Quarter 3 of 2016–17 and extended the areas where there was incremental stress to states such as TN (14% vs. 1% in December 2016), WB (14% vs. 2% QoQ [quarter-on-quarter]), Gujarat (16% vs. 5% QoQ) MP (17% vs. 7% QoQ), and Jharkhand (10% vs. 3% QoQ).[18]

	PAR 1	**PAR 30**	**PAR 90**	**PAR 180**
Janalakshmi (as of June 2017)[19]			26.1%	12.9%
Ujjivan	9.9%	7.5%	3.7%	
Equitas	5.9%		2.7%	
Bharat Financial Inclusion	9.9%	7.6%		
Satin Credit Care	39%	29%	12.74%[20]	
Industry	20.9%	14.2%	8.18%	0.22%

The clients of MFIs were differently affected; some continued to have cash flows because of the nature of the business, those borrowers who had a business that had an underlying element of discretionary purchase (garments and beauty parlor) showed defaults, whereas business that had an element of essentiality (vegetable vending and plying autorickshaws) were affected to a lesser extent. Several banks that were using MFIs are BCs and, therefore, were able to collect old currency and submit it to the banks as loan repayments; Some did not want to send confusing signals to their borrowers between their own collections and the collections as BCs and suspended collections; in some places, the MFIs went out of the way to say that individuals should pay up their respective amounts, even at the cost of breaking the group liability scheme, in case the others were unable to pay. And during the demonetization, the vulnerability of the MFIs were once again tested on the political risk, where some local politicians—using the forbearance given by the RBI on recognizing NPAs—declared that the loans were waived. This affected the microfinance industry.

This episode has tested MFIs in several ways. It tested the stickiness of the relationships, it tested the robustness of group lending, and it distinguished between the bank-led models and the other models. It appears that the microfinance sector can emerge from this shock relatively safely. The external shock to the group methodology may be welcome in a sense, given that a significant part of the MFI sector is getting to be more with specialized banks. This will help them to test out the individual lending methodology with greater vigor.

Ground reports indicate that, irrespective of the demonetization, the growth pressures were driving the credit officers of the MFIs to compromise on the group methodology, and it is said that some of the defaults post demonetization are also a result of inadequate attention to group processes. However, all these would now be put to test. That there were credit bureaus helped in the process, and we can see the industry moving toward a more mature financial system. The demonetization just punctuated the process and possibly speeded up the process, with a bit of shock, but it was able to test the system.

CRIF HIGH MARK DATA

The database in the public domain for microfinance is put out by the industry associations—MFIN and Sa-Dhan. However, this data is a subset of the type of customers served by the providers, including the mainstream banks. Banks have been lending directly to and through BC networks to customers having similar profiles. The CRIF High Mark data provided exclusively for this report is incisive as it covers the data submitted to the credit bureau and could look at hotspots and specific areas much better. The highlights based on the CRIF High Mark data are discussed below:

- As per the CRIF High Mark report, MFIs are present in 604 districts; about 50% of the entire portfolios of the MFIs are concentrated in 80 districts and 50% of the disbursements are in about 85 districts. This ratio has not changed from the

[16] India Microfinance: On the Brink of a Downcycle, http://www.investmentguruindia.com/BrokingFirm-Views-SectorReport/India-Microfinance---On-the-brink-of-a-downcycle---RCML, accessed on August 13, 2017.

[17] Investor presentation for Q4. Ujjivan Small Finance Bank. April 2017.

[18] Microfinance: Key Takeaways from MFIN Quarterly Update. Equirus Securities Private Limited.

[19] Rating update of Janalakshmi Financial Services by ICRA. August 2017.

[20] Based on gross NPA as indicated in Investor presentation of Satin Creditcare, May 2017.

previous year. These districts represent 13 states/union territories as against the MFI presence in 32 states/union territories.

- Twenty-two districts had a portfolio outstanding of more than ₹7.5 billion, spread across four states and representing 21% of the GLP, 19% of the loan accounts.
- Twenty-nine districts had a portfolio between ₹5 billion and ₹7.5 billion, spread over 11 states (including the 4 states mentioned earlier) and these represented about 16% of the GLP and 17% of the accounts.
- Data as of April 2017 showed that the total GLP was 1.09 trillion with 69 million loan accounts. Of this, about ~50% was concentrated in four states of TN, WB, Karnataka, and Maharashtra. There are the states that have been showing very high growth rates over the years.
- While demonetization had a significant impact, data for April 2017 shows an uptick. The applications for loans had grown by 27–28% YoY in April 2017.
- The average ticket size of the loan that was ₹24,000 in December moved to ₹25,500 by April.

Compared to the previous year, this year's data throws up some rather interesting numbers. Firstly, the districts that had the highest average loan are all concentrated in Assam or WB (see Table 11.6). A small percentage of the borrowers seem to have more than two lenders. However, in a situation where for years the mainstream institutions have been struggling and not finding it worthwhile to operate in these areas, it is surprising that the average loan size is so large. It is not that these averages have come so high because the borrower base is low. If we look at the gross loan portfolio, we find that at least five of the districts (of the 22 listed) having GLP of more than ₹10 billion fall in this region. This portfolio has grown by more than 30% during the past year. These

Table 11.6 Districts Where the Average Loan Size Is High (₹ in Billions)

Previous Rank	District		Portfolio Rank	GLP March 17	GLP March 16	Active Lenders	Active Loans ('000s)	Ave Loan (2016)	Ave Loan (2017)	% Loans for Income Generation	% of Economically Active Women 2016	% of Economically Active Women 2015
44	Nagaon	AS	28	6.65	4.02	18	244	35,000	40,251	0.02	26.5	17.05
87	West Tripura	TR	33	6.06	3.02	11	246	35,000	39,672	0.56	30.18	16.41
73	Sonitpur	AS	72	4.17	3.23	16	150	35,000	37,609	0.04	23.84	14.67
71	Darjeeling	WB	74	4.13	3.29	18	188	35,000	35,172	8.71	21.06	15.59
54	Kamrup	AS	60	4.71	3.74	22	210	35,000	34,848	0.02	42.82	35.54
38	Maldah	WB	42	5.60	4.27	22	261	35,000	34,525	7.6	16.8	14.64
9	Hugli	WB	11	10.05	7.59	29	466	35,000	34,081	5.78	18.8	15.50
13	Koch Bihar	WB	13	9.74	7.13	15	453	35,000	33,903	8.08	39.08	28.27
64	Kamrup Metro	AS	69	4.28	3.54	22	197	35,000	33,855	0.06	48.6	39.68
8	Nadia	WB	6	11.06	7.95	40	516	27,000	33,201	9.18	23.61	19.31
15	Jalpaiguri	WB	5	11.21	7.01	20	540	35,000	33,113	8.64	32.88	21.55
3	South 24 Parganas	WB	3	13.16	10.57	57	650	35,000	33,032	8.22	19.83	17.5
49	Purba Medinipur	WB	54	4.93	3.82	39	236	27,000	32,729	1.68	12.56	11.41
12	Haora	WB	14	9.51	7.22	21	477	27,000	32,252	6.9	20.85	18.42
2	North 24 Parganas	WB	2	16.05	12.11	61	806	27,000	32,250	8.09	15.34	12.67
26	Kolkata	WB	20	8.10	5.31	27	397	27,000	31,904	10.92	25.25	19.3
30	Uttar Dinajpur	WB	41	5.67	4.94	23	314	35,000	31,466	7.37	23.07	20.09
NA	Dakshin Dinajpur	WB	92	3.43	NA	20	183	35,000	30,711	9.01	24.13	NA

Source: CRIF High Mark.

are the districts that we may have to watch out for potential hotspots in future.

Last year we had indicated that heavy exposure in itself is not a problem if it is in places like Bengaluru. However, that argument does not hold for the districts mentioned earlier. Using the CRIF High Mark data of the top 100 districts by GLP size, the areas where there seems to be worrying signs have been identified based on multiple criteria.

In WB, the districts are of south and north 24 Parganas, Nadia, Jalpaiguri, and Hugli. All the districts were red-flagged last year as well. Table 11.6 has the details.

On the other hand, there are a set of districts where the average loan outstanding is not that high, but the levels of penetration, the proportion of economically active women covered by a loan, is very high (see Table 11.7). These are also districts that have a very high exposure from MFIs. The districts are Thanjavur, Thiruvarur Coimbatore, Tiruchirappalli, and Madurai in TN; Wardha in Maharashtra; and Mysore in Karnataka. These are the districts to be watched carefully. Wardha was a district that the report had pointed out during the past year, and it is very evident that the pressure of overpenetration, and high loaning and multiple lenders is playing out this year. The reason why the 2017 GPL in Wardha is less than previous year is directly attributable to large-scale defaults in the Vidarbha region of Maharashtra.

While we have discussed the overall portfolio, the data from CRIF High Mark on the portfolio in troubled states showed the following trends:

PORTFOLIO QUALITY

- PAR 1–30 improving since December 2016; borrowers are able to pay current obligations.
  - UP improved from 29% to 12.3%
  - Karnataka improved from 12% to 6%
  - Maharashtra improved from 14% to 5.6%
  - MP improved from 14% to 7.5%
- PAR 31–180 worsened in the three troubled states
  - Maharashtra 23.8%
  - UP 27%
  - Karnataka 16.7%
- PAR 91–180 has also worsened. Overall ratio was at 5.22%. But in the troubled states the ratio stood at:
  - Karnataka 9.92%
  - Maharashtra 16%
  - UP 13.7%

Table 11.7 Districts Where the Customer Penetration Levels Are High (₹ in Billions)

Previous Rank	District	Portfolio Rank	GLP March 17	GLP March 16	Active Lenders	Active Loans ('000s)	Ave Loan (2017)	Ave Loan (2016)	% Loans for income generation	% of economically active women 2017	% of economically active women 2016
51	Thiruvarur	45	5.36	3.79	35	404	22,870	23K	22.65	88.05	61.82
11	Thanjavur	9	10.32	7.31	38	782	23,478	23K	22.87	86.46	62.27
48	Nagapattinam	49	5.16	3.88	32	418	22,025	20K	23.98	70.52	50.05
32	Cuddalore	19	8.56	5.84	38	634	22,732	20K	21.67	66.83	45.70
NA	Theni	80	3.93	NA	34	284	22,806	NA	29.27	62.66	NA
NA	Chamarajanagar	93	3.36	NA	24	270	21,183	NA	29.21	59.09	NA
94	Pudukkottai	76	4.08	2.92	37	328	22,665	23K	20.6	55.42	38.72
6	Coimbatore	8	10.53	7.98	42	702	25,353	23K	22.42	55.15	43.95
66	Namakkal	62	4.58	3.43	43	351	22,954	23K	25.41	55.03	42.41
92	Wardha	89	3.63	4.74	39	255	22,794	23K	13.81	53.74	47.68
14	Mysore	15	9.47	7.02	27	741	20,931	20K	29.69	53.34	39.58
27	Tiruchirappalli	22	7.58	5.28	45	521	24,433	23K	23.28	53.04	39.52
24	Madurai	24	7.44	5.42	39	581	22,191	20K	27.1	52.74	40.58
63	Dindigul	46	5.31	3.60	38	407	22,130	20K	28.12	50.46	35.33

Source: CRIF High Mark.

In terms of granular details, as per the CRIF High Mark data, collections in some districts was still a concern, such as Bengaluru (nearly 2% of country's borrower population), Nagpur, Amravati, Wardha, Saharanpur, Bareilly, Bulandshahr, and Agra (Table 11.8). It may be recalled that several of the given districts were flagged in the last year's report as sensitive areas. While the demonetization certainly has affected the microfinance sector, it seems to have affected the sector more in places where there was overleveraging and deeper penetration, and larger loan ticket sizes (Table 11.9). Therefore, it appears that while microfinance may still continue without a major default for some time, the most vulnerable areas are the ones that have some of the attributes of overlending, multiple lenders, higher loan ticket

Table 11.8 Details of Default Numbers in Troubled Districts

Districts	PAR 1–30% Apr 17	PAR 31–180% Apr 17	PAR 1–30% Feb 17	PAR 1–30% Jan 17	PAR 31–180% Feb17	PAR 31–180% Jan 17
Bengaluru	10.62%	38.40%	15%	18%	35%	32%
Nagpur	8.78%	41.99%	12%	18%	40%	32%
Belgaum	7.62%	22.10%	11%	17%	22%	15%
Saharanpur	17.90%	34.50%	23%	25%	35%	32%
Amravati	4.50%	79.50%	7%	13%	80%	73%
Yavatmal	10%	47.60%	13%	22%	46%	38%
Wardha	7.40%	71.70%	10%	19%	72%	62%
Meerut	14.30%	45.40%	18%	22%	49%	46%
Sagar	12.90%	47.60%	17%	24%	48%	38%
Agra	16%	47.90%	21%	25%	49%	49%
Bulandshahr	12%	50.80%	16%	24%	56%	46%
Chhindwara	11%	27.80%	13%	18%	26%	21%
Bareilly	13.80%	49.90%	20%	23%	53%	48%

Source: CRIF High Mark.

Table 11.9 Categories of Institutions and Extent Affected by Demonetization

Category	Market Share (GLP)	PAR 1–30%	PAR 31–180%
Overall			
NBFC MFI	37%	4.2%	9.2%
SFB (inc. aspirants)	22%	7.9%	21.7%
Banks + Others	41%	3.8%	4.9%
UP			
NBFC MFI	43%	13.7%	29.4%
SFB (inc. aspirants)	22%	13.6%	46.5%
Banks + Others	34%	9.7%	10.6%
Karnataka			
NBFC MFI	56%	3.7%	10.4%
SFB (inc. aspirants)	24%	10.6%	35.4%
Banks + Others	20%	6.9%	12.3%
Maharashtra			
NBFC MFI	33%	3.6%	21.5%
SFB (inc. aspirants)	31%	8.1%	28.2%
Banks + Others	36%	5.4%	21.8%

Source: CRIF High Mark.

sizes, deeper penetration, and rapid growth. In this context, apart from the southern states of Karnataka and TN, the eastern sector looks vulnerable as we go further.

OVERALL IMPLICATIONS

The overall implications from the detailed analysis done in the last year and the data emerging this year is going on predictable lines. It is indeed possible for MFIs to figure out the hotspots in general. While there could be scope for lending, the question really is where do organizations want to enter, grow, and continue. It was clear during the last year that there were enough signals about particular districts that we had highlighted based on multiple criteria. This year, the demonetization triggered a snap of the loose thread that was holding them together. While the process might have got delayed a bit if the demonetization had not happened, it is important to recognize that some areas would have lost their immunity and are disproportionately susceptible to shocks.

While there is much explanation that both the AP episode as well as the stress in some states and districts happened due to political intervention with is much beyond the commercial contracts between the borrower and the lender, it is also important to recognize that in both these instances, there was enough ground for a political intervention. Whether that intervention happened with merit or not is not the question; the question is that when such an intervention happens, do the customers stick around with the lending institutions. In case of demonetization-related stress, it appears that the customers are willing to overcome the default and build the relationships all over; however, in areas where the indebtedness is high and lending has been reckless, the customers are quite willing to game the lender if provided with an opportunity.

A recent report by the rating agency ICRA paints a rather grim picture for the microfinance sector in the next few years.[21] The ICRA report argues that there might be a permanent behavioral change in the JLG. Some agencies collecting loans from borrowers who could pay and not insisting on the JLG in order to cut losses have demonstrated that the clause could be compromised. This has happened more frequently in the urban areas and in areas where there are multiple agencies. Based on this, ICRA predicts that the new normal for recoveries may permanently shift from 99% toward 97%. In addition, the ICRA report looks at the expected writeoffs based on PAR 90 and PAR 180 and expects that these writeoffs will erode a significant portion of the equity of the MFIs, thereby, requiring substantial amounts of recapitalization to maintain capital adequacy. Also in cases where MFIs are acting as BC for banks with a significant off-balance sheet exposure, they may be affected to a great extent when the banks invoke the first default loss guarantee clause, thereby, disproportionately affecting the MFI. However, the estimate of ICRA is based on the current capital levels where the sector is not fully leveraged. Also, post demonetization, there have been deals that invested into the microfinance sector with decent valuations and, therefore, the flow of investments at the current moment is not really a problem. However, if the estimate of ICRA turns out to be true in terms of writeoffs, then it will make the sector less attractive as one more risk element (political risk with a higher weightage) would be added to the consideration. If the valuations go down, then attracting further capital becomes so much more difficult.

In the last report, we had indicated three possible scenarios for MFIs based on the data that is reproduced:

> Scenario 1: There may be stress in a given MFI because of excessive growth, stress on the loan officers to fulfill both acquisition and collection targets that are incentivized, and inadequate appraisals and default. If the default happens with an isolated MFI, then the contagion should not be too difficult to manage. However, if such an institution happens to be systemically important and its products are difficult to differentiate, then the problem might spread to other MFIs as well. The problem would be worse if the institution in trouble happens to be a license holder of an SFB. The reputational risks are high.
>
> Scenario 2: There may be stress in isolated geographies as was reported in *Wire*, which may be investigated and controlled. For instance, before the 2010 AP crisis happened, we had isolated incidents of default and stress in Kolar, Krishna, and Nizamabad that were brought under control before they spread. However, we also need to remember that Krishna and Nizamabad were precursors of the 2010 AP crisis as well. So any such instance of isolated stress events should ring alarm bells for the MFI sector as a whole.

[21] See http://www.livemint.com/Industry/GX7ykzK-WviYrp7HZWp74IM/MFIs-SFBs-will-need-Rs11000-cr-funding-in-FY18-to-mitigate.html, accessed on August 25, 2017.

Scenario 3: A stress in a geographical area that spreads with a domino effect like the AP crisis. The fact that UP where we have seen an aggressive growth and from where the anecdotal reports have come from is going in for an election in the near future should be under the watch of the MFI sector. Similarly, the sector should be on the watch for any negative news that could have a political or a journalistic fall out. (See Box 11.3.)

Box 11.3 Revisiting AP Crisis 2010

It has been 7 years since the AP crisis hit the microfinance sector, and we are seeing some similar trends during the past few years—rumblings of overheating, fast growth, multiple lending, and possibly microfinance borrower suicides. The one aspect that is behind the crisis is that of interest rates, given that the RBI has put adequate checks and balances in place. There were five large institutions that were AP based that were affected and many smaller ones. The ones like Trident closed down, but of the big five, each seems to have taken a different trajectory for recovery. The most remarkable story is that of Spandana that was a recipient of a fund infusion of ₹17.5 billion—the largest—about 25% of the total estimated ₹70 billion investments (both debt and equity) in the sector.

The five entities—BASIX, SKS Microfinance (now Bharath Financial Inclusion Limited), Spandana, Share, and Asmitha—were not only large but also had a heavy concentration in AP. When the government clamped down on the microfinance sector, making it almost impossible for these entities to operate, they were all in deep crisis, suffering both from loss of business and loss of credibility. As we look back, it is important to check what has happened to these individual entities and the learnings for the microfinance sector as a whole.

SKS Microfinance at that point was the least affected in terms of the effect of the shock. SKS had just emerged from a successful initial public offering (IPO) at a very promising valuation and were flush with cash. Therefore, it was possible for SKS to not only provide for the AP portfolio but also to post profits after seven quarters of losses. The AP Portfolio was to the extent of ₹14.3 billion, of which they were able to recover only about 1.3 billion. However, SKS expanded its portfolio outside the state, grew, and was able to start posting profits in capital in December 2012. They eventually shifted their head office to Mumbai, changed the name to Bharat Financial Inclusion (BFIL), and also applied for a license to run an SFB, but did not make the cut. As of now, BFIL is in a healthy position and is actively looking for buyers to be merged into a bank or a large NBFC. While at the time of the crisis, the share of AP in the SKS portfolio was 29%. One of the decisions that SKS took at that point in time is to geographically diversify and put caps on exposure within states. The recovery was smart and quick for SKS.[22]

BASIX initially did not get into the corporate debt restructuring (CDR) exercise but tried to raise resources to continue—hoping for growth from outside. The performing portfolio fell from ₹18 billion to ₹1.5 billion after the crisis. However, BASIX continued to repay its instalments to the banks as they fell due, from the recoveries of loan amounts from elsewhere and continuously shrinking the book. In 2012, BASIX finally resorted to a ₹6.77 billion CDR deal with the bankers.[23] The strategy adopted by BASIX was to shrink its MFI portfolio and move its attention to other enterprises, like providing BC services and technology solutions and looking at other streams of income for the group through consulting and training services. BASIX soon accelerated its diversification to become a group of more than 20 social enterprises and found painless ways of moving the staff from the MFI to other divisions. The MFI also finally emerged from the CDR process and is a pale shadow of its original as it strives to grow.

The story of Share and Asmitha—both related institutions—is somewhat different. After the AP crisis, they went into a CDR mechanism and together restructured about ₹32 billion in debt.[24] The companies have tried and diversified their portfolio, but have still not been able to come out of the CDR package completely. In 2014, the companies first tried to demerge the AP portfolios from the books and put it into a separate SPV to help the respective companies to continue operations.[25] The efforts possibly did not fructify, but

[22] See also http://www.livemint.com/Industry/hvWN2IbllrX5hXKj3keERL/SKS-Microfinance-The-inside-story.html, accessed on August 18, 2017.

[23] See http://zeenews.india.com/business/news/finance/banks-pick-up-92-in-basix-as-part-of-rs-652-cr-cdr-deal_61235.html, accessed on August 18, 2017.

[24] See http://www.livemint.com/Companies/XofKGqm3kiJjS20izPmA5O/Microfinance-firm-Trident-faces-closure.html accessed on August 18, 2017.

[25] See http://www.business-standard.com/article/finance/share-asmitha-submit-business-reorganization-plan-to-bankers-to-demerge-the-ap-portfolio-114101400772_1.html, accessed on August 18, 2017.

the strategy seems to be continuing. There are reports that they have now planned to demerge the portfolios of AP from the books, transfer all the AP portfolio to Asmitha, and take out the non-AP portfolio and park it in Share, thus, having one completely healthy company while the other could be dealt with as a special vehicle. The case is reportedly seeking clearance with the competition commission.[26]

Of all the five, the most successful turnaround has been that of Spandana Spoorthy Financials Limited (Spandana). Like others, Spandana had a heavy concentration in the then undivided AP state. About 50% of its portfolio under management was in that state, while the rest was from other states. The portfolio was also matched with the staff as well as branches that were concentrated in AP. The company had to restructure about ₹23 billion of its loans that was broken up into around ₹10 billion of optionally convertible redeemable preference shares and the rest as debt to be paid in instalments. Spandana not only grew the portfolio outside AP aggressively, but over the years was also able to recover about ₹10 billion of its AP dues. It was able to get the RBIs forbearance on capital adequacy; retain the limits granted by the banks on term loans to continue business outside AP, and garner substantial amounts of profits that were ploughed back into growth. This year with substantial infusion of capital Spandana has had a very smart turnaround. The company is even thinking of a public offering in the coming years.[27]

Based on the five different experiences, there are multiple takeaways one can draw. Each of the MFIs has had a different strategy in dealing with the crisis, but what is clear is that there is always a political risk in dealing exclusively with the poor as well as having a geographic concentration. While Spandana showed resilience, BASIX diversified into other livelihood activities through a web of group firms, and SKS (BFIL) completely shifted away from the geography. The Share-Asmitha story is yet to unfold fully.

Source: Author conversations with investors, sector experts, and public documents.

[26] See https://www.vccircle.com/share-microfin-asmitha-microfin-swap-certain-businesses/ accessed on August 18, 2017.

[27] See http://economictimes.indiatimes.com/small-biz/startups/from-brink-of-bankruptcy-to-rs-1850-crore-portfolio-amazing-story-of-spandana-sphoorty-financial/articleshow/60086361.cms, accessed on August 18, 2017.

Reading the current situation, it appears more like the Scenario 3 has happened: that it has affected certain deep penetration geographies. It is surprising that the sector has seen these incidents of overexposure, and driven the desire to growth and desire for valuations in the past, and while there is an ecosystem learning from the learning, it has not translated into better behavior by individual MFIs at the field level. There are MFIs like Equitas (now an SFB) responding to the situation by declaring that they will grow their nonMF loan book and restrict the growth in this sector. But there are other organizations that chase the growth and create collateral damage.

However, it is important to note that as a result of the demonetization shock, all MFIs were affected, but those MFIs that caused the overexposure due to aggressive growth are the ones that are facing the brunt. While the first generation ecosystem learnings resulted in conferring the status of a self-regulatory organization to Sa-Dhan and MFIN, evolution of the credit bureaus, and better regulation after the Malegam recommendations being accepted, the next level ecosystem learning should happen with the investment community that rewards moderate responsible behavior rather than growth-at-all-costs—a short-term perspective to boost exit valuations. This episode, we hope, will leave us with a more nuanced and thoughtful investment community.

OTHER SECTOR BUILDING INITIATIVES

While the commercial microfinance world is dealing with its own issues of sustainability and consolidation, the new generation institutions are being nurtured to further the cause of inclusion as the larger ones become more and more professional. During the past year, we had documented how Sa-Dhan has taken the initiative to nurture new generation MFIs with the help of SIDBI. The criterion was that they would have a portfolio of less than ₹500 million and with the following criteria:

1. Whether these organizations are relevant
2. Whether their existence will be sustainable
3. What are the future options for growth and viability
4. What are the areas of growth and transformation

Each of these organizations were then helped with a strategic vision plan. As of now, Sa-Dhan is working with 16 organizations that are into early stage microfinance in four focus states under the Poorest State Inclusive Growth (PSIG) Programme (Box 11.4). While the larger plan was to cover about 25 organizations, these are being partnered carefully

Box 11.4 Midline Review of the PSIG Programme

A midline review of the PSIG project had some interesting findings about the progress of microfinance in these four states. While the report indicates some meta-level policy and ecosystem achievements like for instance: "the environment for financial inclusion in which PSIG operates continues to be highly dynamic with many players, and government and the RBI emphasis on banking and digital finance going forward. In a changing landscape, PSIG has adapted in innovative ways to supporting different schemes (not just MFIs) to be effective and relevant in the PSIG states (such as BCs), as well as pension and financial literacy)," we would focus on the achievements on the field level breakthroughs in the four states as captured in the report.

The report indicates that these four states account for 41% of the national population and now have 36% of total MFI client accounts in the country. Of this, about 54% of accounts in the four states are represented by institutions supported under the program. This growth is supported, apart from PSIG funding, by an increase in bank lending and for some MFIs by bank securitization of their portfolio (whereby the MFI becomes a BC) and can also facilitate bank savings alongside credit).

However, the report flags certain issues affecting sustainable and responsible growth that are:

- Continuing challenges in some areas, including high costs of operation in some less populated and more remote areas of UP and Bihar; weak infrastructure and security particularly in western UP and Bihar; and changes in a state cooperative act leading to the risk of state government interference;
- Multiple lending practices and *side-stepping of Credit Bureau checks* (by some PSIG and non-PSIG MFIs and their clients) in all the states.

The program has not been particularly successful product development/innovation. This is evident not only in the product portfolio but also in the comment where around one half of the MFI field staff interviewed mentioned "all MFIs offer a similar type of [loan] product, with not much difference" *and* stress due to: the pressure of targets. This indicates that even in these states where there is sufficient soft funding, innovation and client responsiveness is yet to pick up. There is a crying need to understand the client requirement that is quite different from the current product offering on a "take it or leave it" basis.

The negative effects captured by the midline evaluation included the face that "8% of PSIG client households had difficulty repaying MFI loans". At midline, there are similar findings, with evidence of clients borrowing from one MFI to repay another, as well as borrowing from a moneylender to pay the instalments on an MFI loan.

Source: Oxford Policy Management and EDA: Evaluation of impacts of the financial inclusion component under the poorest state inclusive growth (PSIG) program Midline Report Revised March 2017.

to ensure the criteria are met. Based on the partnership, Sa-dhan has been undertaking training programs and are also preparing detailed manuals. Going forward, this idea would be replicated in the northeastern region as well.

IN CONCLUSION

Like the past years, this year also has been a roller coaster ride for the microfinance sector. Much has happened, but it is very evident that it is getting more mainstreamed than ever. While the first stage of mainstreaming was in transforming the not-for-profit business models to for-profit models, it was also accompanied by the investments from the mainstream. However, the models were generally managed by the people who were from the field and understood the terrain. The current trend is the takeover of these MFIs with mainstream institutions and institutional processes—NBFCs such as Muthoot, Manappuram, India infoline; banks such as IDFC, Ratnakar and DCB, and IndusInd are interested in directly taking on the portfolios. However, most of the players recognize the merit of the methodology and, therefore, we see that the staff of the MFIs that were in the field being retained in a special vehicle as BCs or DSAs.

In a few years, we will know whether we will find a roadmap for small time start-ups in this space. As of now, we are not seeing interesting and innovative stories of start-ups that are questioning the Microfinance methodology to look at alternative mechanisms and alternative products to reach the poor. That wave might be next.

APPENDIX 11A
State-wise Details of MFIs for 2015–16 and 2016–17 (Part I)

			Gross Loan Portfolio (₹ Billion)			Number of Clients (million)			Number of Branches		
State/ Region	MFIs 2015–16	MFI (Nos) 2016–17	2015–16 Original Base	2015–16 Revised Base	2016–17	2015–16 Original Base	2015–16 Revised Base	2016–17	2015–16 Original Base	2015–16 Revised Base	2016–17
Delhi	8	6	5.82	3.38	4.46	0.56	0.47	0.15	41	20	40
Haryana	14	12	11.65	8.92	10.74	0.49	0.31	0.64	169	122	194
Punjab	10	9	9.88	8.81	11.39	0.56	0.49	0.72	128	108	157
Rajasthan	14	16	12.59	9.48	11.22	0.75	0.52	0.67	217	158	226
North			39.94	30.59	37.81	2.37	1.79	2.17	555	408	617
Assam	10	9	7.73	6.61	10.60	0.53	0.46	0.69	203	181	246
Meghalaya	5	5	0.4	0.08	0.15	0.34	0.00	0.01	22	5	8
North East			8.13	6.68	10.75	0.87	0.46	0.70	225	186	254
Bihar	21	18	29.21	22.58	34.69	1.93	1.46	2.18	629	491	667
Jharkhand	9	13	8.98	7.22	10.84	0.57	0.45	0.70	239	199	249
Odisha	13	13	31.41	24.60	32.56	2.135	1.61	2.0	510	407	546
W. Bengal	14	12	30.75	19.55	29.58	2.191	1.31	1.74	643	445	603
East			100.00	74.00	107.67	6.82	4.82	6.67	2,021	1,542	2,065
Chhattisgarh	17	17	8.77	7.56	10.30	0.586	0.51	0.68	263	226	321
MP	27	21	40.84	31.52	35.02	2.81	2.07	2.51	984	703	931
UP	19	17	56.45	48.91	49.10	3.13	2.62	3.23	988	828	1,032
Uttarakhand	11	10	5.93	4.93	4.59	0.33	0.26	0.30	82	62	84
Central			111.99	92.92	99.01	6.85	5.46	6.71	2,317	1,819	2,368
Gujarat	19	12	20.64	14.37	16.55	1.234	0.78	0.97	433	262	311
Maharashtra	32	26	63.29	40.76	49.07	3.711	2.20	2.78	1,174	782	892
West			83.93	55.13	65.62	4.95	2.98	3.76	1,607	1,044	1,203
Karnataka	24	16	71.65	56.66	70.30	3.82	2.82	3.59	1,198	895	1,197
Kerala	10	7	24.34	9.18	15.47	1.22	0.50	0.67	350	193	242
Tamil Nadu	19	12	86.87	37.30	59.81	5.65	1.94	3.12	1,352	619	859
South			182.86	103.14	145.57	10.69	5.26	7.37	2,900	1,707	2,298
Total			527.20	362.42	466.43	32.55	20.77	27.38	9,625	6,706	8,805

Source: MFIN Micrometer, Issue 17, March 31, 2016 and Issue 21, March 31, 2017, http://mfinindia.org/resource-center/mfin-publications/, accessed on August 10, 2017.

Notes: Original base refers to the numbers given during the past year before some institutions converted as SFBs. The new bases are the March 2016 numbers relating to the MFIs that remained MFIs till March 2017. This will undergo further change next year as some more MFIs move out as they start operating as SFBs.

APPENDIX 11B
State-wise Details of MFIs for 2015–16 and 2016–17 (Part II)

State/Region	Number of Employees			Loans Disbursed (₹ Billion)			No. of Accounts (million)		
	2015–16 Original Base	2015–16 Revised Base	2016–17	2015–16 Original Base	2015–16 Revised Base	2016–17	2015–16 Original Base	2015–16 Revised Base	2016–17
Delhi	1,370	975	1,238	6	4.38	2.13	0.22	0.1	0.1
Haryana	1,670	1,148	1,753	14.48	10.48	8.78	0.65	0.45	0.36
Punjab	1,199	972	1,525	13.42	11.65	8.20	0.65	0.55	0.35
Rajasthan	1,990	1,378	1,492	16.2	12.45	11.97	0.84	0.65	0.55
North	6,229	4,474	6,008	50.27	38.95	31.09	2.36	1.79	1.32
Assam	1,306	1,051	1,665	9.51	7.69	11.76	0.47	0.4	0.5
Meghalaya	152	15	33	0.68	0.09	0.17	0.4	0.00	0.01
North East	1,458	1,066	1,698	10.19	7.78	11.92	0.87	0.37	0.52
Bihar	5,087	3,880	4,052	39.2	30.43	37.99	2.2	1.74	1.89
Jharkhand	1,850	1,480	1,498	12.53	9.95	13.25	0.71	0.58	0.67
Odisha	4,525	3,652	3,412	41.68	33.27	44.27	2.5	2.05	2.23
W. Bengal	5,541	3,603	3,835	43.79	27.80	38.74	2.61	1.72	1.96
East	17,003	12,615	12,797	137.20	101.45	134.25	8.02	6.09	6.76
Chhattisgarh	1,826	1,497	1,969	11.23	9.63	9.65	0.59	0.49	0.46
MP	7,494	5,650	7,262	49.73	38.32	30.46	2.57	1.90	1.44
UP	8,717	7,210	8,211	67.58	58.14	33.68	3.18	2.71	1.50
Uttarakhand	726	558	650	7.18	5.95	2.87	0.32	0.27	0.12
Central	18,763	14,914	18,092	135.72	112.03	76.66	6.66	5.37	3.52
Gujarat	3,360	2,190	3,331	22.41	14.84	13.63	0.98	0.60	0.49
Maharashtra	10,224	6,177	8,062	79.42	52.43	47.74	4.42	3.03	2.39
West	13,584	8,367	11,393	101.83	67.26	61.37	5.40	3.63	2.88
Karnataka	11,475	8,618	10,990	90	71.34	76.43	62.5	5.32	4.47
Kerala	3,630	1,668	1,641	31.02	12.58	18.64	17.3	0.71	0.86
Tamil Nadu	12,665	4,438	8,536	102.65	39.03	54.64	5.51	1.64	2.14
South	27,770	14,724	21,167	223.67	122.95	149.70	85.31	7.67	7.47
All India Total	84,807	56,160	71,155	658.88	450.43	464.99	108.62	24.92	22.47

Source: MFIN Micrometer, Issue 17, March 31, 2016 and Issue 21, March 31, 2017, http://mfinindia.org/resource-center/mfin-publications/, accessed on August 10, 2017.

Notes: Original base refers to the numbers given during the past year before some institutions converted as SFBs. The new bases are the March 2016 numbers relating to the MFIs that remained MFIs till March 2017. This will undergo further change next year as some more MFIs move out as they start operating as SFBs.

APPENDIX 11C
NBFC MFIs* and Their Journey through the Times

<table>
<tr><th>S. No.</th><th>MFI Name</th><th>Description</th></tr>
<tr><td>1</td><td>Bandhan
http://www.bandhanbank.com/</td><td>Started as NGO, converted to NBFC MFI, currently a universal bank. Original promoter still in operational control.</td></tr>
<tr><td>2</td><td>ESAF
http://www.esafmicrofin.com/</td><td rowspan="7">Started as NGO, converted to NBFC MFI, currently operating/licenced to operate as an SFB. Original promoters still in operational control.</td></tr>
<tr><td>3</td><td>RGVN (North East)
http://www.rgvnnemfl.com/
Microfinance Ltd.</td></tr>
<tr><td>4</td><td>Janalakshmi
http://www.janalakshmi.com/</td></tr>
<tr><td>5</td><td>Ujjivan
http://www.ujjivan.com/</td></tr>
<tr><td>6</td><td>Equitas
http://www.equitas.in/</td></tr>
<tr><td>7</td><td>Suryoday
https://www.suryodaybank.com/</td></tr>
<tr><td>8</td><td>Utkarsh
http://utkarshmfi.com/</td></tr>
<tr><td>9</td><td>Disha Microfin
http://www.dishamicrofin.com/</td><td rowspan="2">Disha Started as an NBFC MFI, and has got the final license to start an SFB. Currently operationally controlled by the Fincare group. Future started as an NGO, transformed into an NBFC MFI, and now a part to the Fincare group. Both have folded into the SFB.</td></tr>
<tr><td>10</td><td>Future
http://future.ifapl.com/
http://www.fincare.com/</td></tr>
<tr><td>11</td><td>Grama Vidiyal
http://www.gvmfl.com/</td><td>Started as an NGO, transformed to NBFC MFI, taken over by IDFC Bank to be a wholly owned subsidiary. Had applied for an SFB license.</td></tr>
<tr><td>12</td><td>BSS Microfinance
http://www.bssmicrofinance.co.in/</td><td>Started as an NGO, transformed to NBFC MFI and was taken over by Kotak Mahindra Bank.</td></tr>
<tr><td>13</td><td>Annapurna Microfinance
http://ampl.net.in/</td><td>Started as and NGO, transformed to an NBFC MFI. Currently operationally controlled by promoters. The DCB Bank has taken 5.81% stake in the organization.</td></tr>
<tr><td>14</td><td>Belstar
http://www.belstar.in/
http://www.muthootfinance.com/</td><td>Started as an NGO (Hand in Hand) transformed into an MFI, taken over by Muthoot Finance.</td></tr>
<tr><td>15</td><td>Asirvad Microfinance
http://www.asirvadmicrofinance.co.in/</td><td>Started as an NBFC MFI, and controlling stake taken over by Manappuram, a gold loan company.</td></tr>
<tr><td>16</td><td>Samasta Microfinance Limited
http://www.samasta.co.in/</td><td>Started as an NBFC MFI, taken over by IIFL Finance Limited, a part of the India Infoline group.</td></tr>
<tr><td>17</td><td>S.M.I.L.E. Microfinance
http://www.smileltd.in/</td><td>Promoted by N. Sethuraman as an NBFC MFI. Operational control with the nominees of DWM Investments who hold a majority stake. Not under the operational control of the original promoter.</td></tr>
</table>

(Continued)

(Continued)

S. No.	MFI Name	Description
18	Bharat Financial Inclusion Limited (Formerly known as SKS Microfin) http://www.bfil.co.in/	Started as an NGO, transformed into an NBFC MFI, listed on the exchanges after an IPO. The promoter has exited and is professionally managed. Had applied for an SFB license and is being taken over by IndusInd Bank.
19	Grameen Koota http://www.grameenkoota.org/	Started as an NGO, converted to an NBFC MFI. The company is currently significantly owned by CreditAccess Asia NV and operationally controlled by nonpromoters.
20	Satin Creditcare Network http://www.satincreditcare.com/	Started as an NBFC and later converted to an NBFC MFI. Run by the promoters and listed on the exchanges. Had applied for an SFB license.
21	Arohan http://www.arohan.in/	Set up as an NBFC MFI by a professional. Controlling stake acquired by Intellecap, an NBFC. The stake was acquired with a view to consolidate the two businesses. Had applied for an SFB license.
22	Agora Microfinance http://www.amil.co.in/	Started as an NBFC MFI, continues under the operational control of the promoters and professionally run.
23	Sahayog Microfinance http://www.sahayogmicro.com/	
24	M Power Microfinance http://mpowermicro.com/	
25	Hindusthan Microfinance Limited http://www.hindusthanmfi.com/	
26	Midland Microfin http://midlandmicrofin.com/	
27	Jagaran Microfinance http://www.jagaranmf.com/	
28	Growing Opportunity Finance(India) http://www.gopportunity.net/	
29	Uttrayan Financial Services http://www.uttrayan-mfi.com/	
30	Vedika Credit Capital Private Limited http://www.teamvedika.com/index.php	
31	MSM Microfinance http://www.msmmicrofinance.com/	
32	S.V.Creditline http://www.svcl.in/	
33	Fusion Microfinance http://fusionmicrofinance.com/	
34	Altura Financial Services http://www.alturafinancials.com/	
35	Digamber Capfin Ltd. http://www.digamberfinance.com/	
36	Capital Trust Microfinance Limited http://capital-trust.com/	Started as an NBFC and forayed into Microfinance in 2008.

S. No.	MFI Name	Description
37	Shree Marikamba https://www.tofler.in/companyinfo/U67100KA2014PTC073382/shree-marikamba-micro-finance-private-limited	Not much information available in the public domain.
38	Shroff Capital & Finance https://www.zaubacorp.com/company/SHROFF-CAPITAL-AND-FINANCE-PVT-LTD/U65910GJ1995PTC025418	
39	Vizhuthugal Development Finance https://www.zaubacorp.com/company/VIZHUTHUGAL-DEVELOPMENT-FINANCE-PRIVATE-LIMITED/U65922TN2008PTC069707	
40	Anik Financial Services http://anikfin.blogspot.in/	
41	Janakalyan Consultancy and Services Private Limited https://www.zaubacorp.com/company/JANAKALYAN-CONSULTANCY-SERVICESPRIVATE-LIMITED/U74999WB2016PTC216823	
42	Fino Finance Private Limited (Formerly known as Intrepid Finance and Leasing) https://www.zaubacorp.com/company/INTREPID-FINANCE-AND-LEASING-PVT-LTD/U65921MH1994PTC216496	The company is associated with the Fino group that has obtained the license to run a payments bank. As of now there are no known operations in this company.
43	Grameen Development & Finance http://gdfpl.com/	Developmental activities are carried out by Grameen Sahara and Grameen Development and Finance is a financial inclusion company promoted by the NGO set up in 2002.
44	Svatantra Microfin Limited https://www.svatantramicrofin.com/	Professionally run by Ananya Birla, part of the Aditya Birla family.
45	Inditrade Microfinance	A new company wholly owned subsidiary of Inditrade Capital. Former experience in agri-trade financing.
46	Nabard Financial Services http://nabfins.org/	Subsidiary of NABARD.
47	Madura Microfinance http://maduramicrofinance.co.in/	Started as an NBFC MFI with roots in banking and developmental work. Continues to be with the promoters.
48	Muthoot Microfin http://www.muthootmicrofin.com/	Part of the Muthoot Fincorp (Pappacchan) group.
49	Namra Finance http://www.armanindia.com/	NBFC MFI wholly owned by Arman Finance a mainstream NBFC.
50	Repco Microfinance http://repcomsme.co.in/	Promoted by REPCO bank. Operational control with the promoters. Had applied for an SFB license.

(Continued)

(Continued)

S. No.	MFI Name	Description
51	Saija Finance http://saija.in/	An active NBFC MFIs, they had applied for an SFB license.
52	Light Microfinance http://www.lightmicrofinance.com/	Started as an NGO, transformed to an NBFC MFI. Had applied for a SFB license.
53	Sonata Finance Private Limited http://www.sonataindia.com/	Started as an NGO, transformed to NBFC MFI and is continuing to be operationally controlled by promoters.
54	Village Financial Services http://village.net.in/	
55	Chaitanya India http://www.chaitanyaindia.in/	
56	IDF Financial Services http://www.idf-finance.in/	
57	Shikhar Microfinance http://shikharfin.com/	
58	Nirantara FinAccess http://www.finaccess.nirantara.co.in/	
59	YVU Finance http://www.yvumf.com/about-us.html	
60	Adhikar http://www.adhikarindia.in/	
61	Sambandh Finserve http://www.sambandhfin.com/	
62	Navachetana Microfin http://www.navachetana.in/	
63	Varam Capital http://varam.in/	
64	RORS Finance http://www.rors.in/	
65	Virutcham Microfinance http://www.virutcham.org/	
66	Nightingale Finvest http://www.nightingalefinvest.in/	
67	Arth Microfinance http://www.arthfinance.com/	
68	Margadarshak http://www.margdarshak.org.in/	
69	Share Microfin http://www.sharemicrofin.com/	NGO Background, transformed into an NBFC MFI, was in financial trouble due to the AP crisis and is still operating as an NBFC MFI with significant investments from private equity players.
70	Asmitha Microfin Limited http://www.asmithamicrofin.com/	
71	Spandana Sphoorty http://www.spandanaindia.com/	

S. No.	MFI Name	Description
72	Pahal (Ahmedabad) http://www.pahalfinance.com/	The infrastructure was owned by a NGO, taken over by a NFBC MFI and operationally controlled by the company.
73	Sarala Development and Finance Private limited http://sarala.co.in/	Taken over the portfolio of Sarala Womens' Welfare Society and operates as an NBFC MFI.
74	Satra Development Finance limited https://www.zaubacorp.com/company/SATRA-DEVELOPMENT-FINANCE-PRIVATE-LIMITED/U65923AS1994PTC011614	No information available in public domain.
75	Unnati Microfin Private Limited http://www.unnatimfi.com/	Company licensed newly in the year 2015–16. Not much information in the public domain.
76	Janashree Microfin Limited https://www.zaubacorp.com/company/JANASHREE-MICROFIN-LIMITED/U65923KL2010PLC025691	
77	Adi Chtiragupta Finance Limited https://www.zaubacorp.com/company/ADI-CHITRAGUPTA-FINANCE-LIMITED/U65192BR2015PLC025551	

Source: Data from the respective company websites and associated websites, accessed on August 2, 2017.
Note: *The category NBFC MFI was introduced only in 2011 after the Malegam Committee submitted its report, and a large part of the report was accepted. Prior to 2011, these organizations were classified as just NBFCs.

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MFIs to Banks: The Continuing Story of Transformation[1]

12
Chapter

INTRODUCTION

The last year has been a mixed year of transformation—from microfinance to SFBs. The first entity to convert an in-principle license to a final license and then start operations as an SFB was Capital SFB. Having been a LAB, they had minimal issues, and the transformation was seamless. Capital SFB had to augment some investments and ensure that the promoters did not have any interests in other financial entities. Once these issues were sorted out, they were good to go as an SFB. They also got listed under the second schedule and became a scheduled bank. The other entities had to go through a process of rejig, in terms of both operating models and ownership structures. As it was reported during the last year, most entities had significant holdings of investments from the international investors—as NBFC MFIs they could have had up to 100% foreign holdings—and this had to be reduced to less than 50% to qualify for the licensing condition of Indian promoters and Indian management. At the same time, once the operations started they had to stop working as an NBFC and this meant significant changes in their operating systems.

By the end of the year, all the entities had converted their in-principle license into a final license. Equitas SFB started operations in September last year, and it was quickly followed by Ujjivan operating as a full-fledged SFB. By the time this report goes to press, Suryoday, Utkarsh, ESAF, AU, RGVN(NE), and Fincare (Disha) would all be operating as SFBs. The only entity that would be going live in due course would be Jana.

All the players had to sort out their capital-related issues before they got the final license. Equitas and Ujjivan overcame the issue of having had a very high foreign shareholding by offering an additional issue to public and augmenting the Indian share in the ownership. As a result, both set up a holding company that is listed, and the bank operates as a wholly owned subsidiary of the holding. AU had multiple interests in the finance world and had to go through some strategic sale of its assets, and eventually the SFB went for a public issue that was a thumping success. Suryoday, Utkarsh, and ESAF had to work around their capital but had less complicated structures. Fincare was a merger of two entities—Disha and Future Financial—and had to do some complex re-engineering to meet the requirements of the licensing conditions. Jana went through a complicated multi-tiered structure, and RGVN also has been able to meet the licensing conditions. As of now, we have one entity that is listed on the exchanges, two entities where the holding companies are listed, and the others are privately held. If the response to the public issues of the entities associated with SFBs is to go by, it appears that there is a fair degree of support for the concept of an SFB as well as for the business model.

One of the issues that affect the SFBs as well as the PBs is that while they are the best institutions

[1] A large part of the chapter is based on a half-day round table held with the CEOs of SFBs and the regulators. This was done courtesy of the Indian Institute of Management, Udaipur, and was held at Udaipur. CEOs of all SFBs, except Capital SFB participated in the roundtable. It was also attended by Shri N.S. Vishwanathan, DG of the RBI, and Sourav Sinha, CGM of RBI. The author is also thankful to IIMU, RBI, and all the participants of the roundtable. We also have a special word of appreciation for Anand Raman, Inclusive Markets CGAP for critical comments, insights and feedback on the draft chapter.

to have a direct interface with the poorer customers, they are not one of the preferred institutions for G2P payments. Given the interface with the last mile, the government possibly should look at strategic partnership with these banks for all the DBT payments.

OPERATIONAL ISSUES IN TRANSITION

Branch Licencing

Unlike the NBFCs, the banks need the permission of the RBI for opening branches and banking outlets. While the licensing conditions have been eased, there are still some stringent conditions that need to be met including opening 25% of the branches in URCs. These centers are not just rural branches, but specific locations that are identified by the District Level Coordination Committee (DLCC). These have to be earmarked and allotted, and then a branch has to be opened. For SFBs, (as of now) branch opening including BC outlets requires prior approval of the RBI, while other banks do not need it. An approval for DLCC/SLBC is required before applying for approval from the RBI. One of the problems faced by SFCs is that by the time the approval comes by, outlets of other banks may have been opened in the area. Moreover, the details of location for appointment of BCs as required by branch approval guidelines may not be available at the time of planning of branch expansion. Some flexibility on providing geographical area of BC outlets is being sought by the SFBs.

While there is considerable easing on the specific licences for opening branches, identification and location of branches in URCs is not similar to how the MFI branches were being opened. This not only affects all the NBFC MFIs that have become SFBs but also the AU SFB. During the year, the RBI changed and sharpened the definition of a branch and a banking outlet and notified a revised branch authorization policy (see Box 2.2). A part of the new branch authorization policy was a reflection of the new players coming into the field and also the old players finding new ways of reaching out to the customer through BCs, CSPs, and USBs. Now there is a different definition of a branch and a banking outlet that acknowledges the innovations in the past few years.

For instance, the concern that after identifying a URC, if another bank opens a branch there, whether it would still be considered a URC. The new branch authorization policy clarifies this issue. URCs need to be earmarked in SLBC before seeking RBI approval. If after allocation of an URC to an SFB, another bank opens a banking outlet in the meantime, the SFB can still open the earmarked outlet and count it under its targets.

The RBI has also assured that the permissions to open BC outlets could be made easy by giving flexibility in a larger area without violating the letter and spirit of having to open 25% of the outlets in URCs. However, while there is much ease in opening the branches and banking outlets, closing the banking outlets—particularly in areas that were designated URCs—would need the approval of DLCCs.

Clearly the branch licensing and planning, as the MFIs are discovering, are not as simple as they used to be. This is also posing a challenge to the MFIs that were focused on urban inclusion. Most of the new SFBs are having strategies and plans to roll out their expansion in compliance with the requirements of the RBI.

Priority Sector Lending Requirements

The requirements for achieving the PSL targets should have been simple and one of the easiest to achieve, given that the portfolio of the MFIs were all concentrated in the inclusive finance space. However, as SFBs are rolling out, they are discovering some smaller issues with regard to the PSL. While as MFIs they were accountable to the regulator on the basis of a loan size to qualify to be recognized as an NBFC MFI, now it is necessary for the SFBs to show that at the level of each loan it qualifies to be a PSL—by monitoring the end use and objectively establishing the purpose.

The loans for agriculture (with a hard sub-target on small and marginal farmers) has to be achieved, and this would be a task cut out for those SFBs that were focusing on urban areas in their extant business. However, more than just offering credit for small and marginal farmers, they also have to introduce new products like the KCC. These products are designed by the nature of the loan. For instance, the design of a short-term agricultural loan for cropping could only have a single bullet repayment due date. While the banks may be allowed to collect monthly instalments on the basis of a voluntary payment by the farmer, this cannot be built into the product design as a condition. Therefore, the flexibility of designing the products would be a challenge.

A similar concern was expressed about the small business loans. There are two issues here: First, an objective verification of the fact that the borrower is indeed a small/tiny/microenterprise. This is also not defined by the loan size, but by the capital employed/asset size of the borrower. Records have to be obtained from the borrower to establish that they fall under the category, and this is a challenge for businesses in the informal sector. Second, the stipulation is that loans to this sector should be fully unsecured—even if the customer has a collateral to provide. This stipulation is laid to minimize harassment to vulnerable customers, but at the same time prevents the banks from seeking a collateral when it is available.

Since the SFBs (as extant MFIs) were operating near the informal sector, complying with the requirements may become difficult, and this might push them toward the more organized segment. If that happens, while it would still serve the cause of financing the segment that is inadequately financed, it takes the larger cause of inclusion of poorer individuals away. This is an issue that needs to be urgently addressed so that the SFBs remain to their core strength of serving the informal sector.

A smaller issue that needs to be resolved is about whether trading in PSLCs would attract the Goods and Services Tax. A clarity on this is to be obtained.

Demonetization and Its Impact

The demonetization announced by the government in November 2016 hit the microfinance and the SFB sector very badly. A part of the demonetization impact has been captured in Chapter 11 where we have examined the operating model of MFIs, including SFBs. In this chapter, and this section, we only look at the larger picture on how it affected the SFBs at a design level and the issues that this shock threw up.

First, in terms of timing, it could not have been worse for the SFBs. Most of the players were busy with the process of transitioning when the announcement was made. Only Equitas (and Capital SFB) were operating as banks, and all others were still in the old dispensation. As a result of this, only Equitas was in a position to accept repayments in the old currency. That was just one of the problems, but the fact is that the demonetization actually hit the informal business in a big way and affected the repayment cycles of the borrowers genuinely. As a result of this, the concept of a JLG was under test. Many MFIs encouraged the borrowers who were in a position to pay—irrespective of the group guarantee. This could be a blessing in disguise, because in the process, the individual lending product is being tested.

The general belief is that the concept of JLG works up to a small size of the loan, say around ₹10,000. This size is important but not salient in the household economies of the borrowers. Once the loan size breaches this number significantly, then the instalment becomes significant in the cash flows of the family. Under normal circumstances, it would be possible for the households to continue to service the loans, but the moment the underlying economic activity for which the loan is deployed comes under strain, the instalment also becomes difficult to pay. The cash flow cycles as so precarious that if the instalments pile up for 3–4 weeks, it becomes really difficult to put the loan back on track—particularly to pay up the defaulted instalments. This is when the concept of JLG also starts breaking. The demonetization helped the layers to experience a cash flow shock first hand.

Before demonetization, the MFIs, however, continued to lend higher loan sizes through the same methodology that helped them scale without increasing costs. That, however, led to higher risks for the entire sector. Crisis cannot be predicted, and external shocks have a disproportionate impact on over-penetrated geographies. There were certain geographies that were more affected by NPAs in the aftermath of demonetization including western UP, adjoining pockets of Uttarakhand, Karnataka, Bengaluru (urban), and Vidarbha in Maharashtra. The eastern region mostly is unaffected. Overall, there is a new normal for portfolio quality in the JLG model with repayment rate reduced from the earlier 99% plus to around 97%.

The earlier episode threw up some issues that the SFBs have to grapple with.

1. Recognition and treatment of NPAs is much more stringent in banks as against NBFCs. First, the period that is available to recognize an asset as an NPA is lesser. Second, in case the borrower starts repayment of instalments and has some activity in the loan account, the NBFC MFIs could take the account out of the NPA category (as it has started performing). But in case of banks, it would be taken out of the category only when it is completely set right, which means not only are the prospective instalments serviced as the fall due but also all the past defaulting instalments have to be fully cleared. This is a challenge that the SFBs are learning afresh, particularly because they were not used to default at all.
2. The NPAs eat into the capital adequacy issues. Given that the SFBs have a greater capital adequacy requirement, this becomes an important issue. Every time there is an NPA and it affects the capital, the ability to raise further resources by way of further capital and the valuation at which those resources would come in, would be under stress. This also affects the rating of the bank.
3. Growing NPAs beyond a certain limit make the banks ineligible to seek refinance from SIDBI, NABARD, and MUDRA. While the NPA levels are now under control and are going down, they still range between 3% and 10% for the SFBs.

TRANSITION ISSUES WITH HR

One of the challenges that the SFBs face as they move into the banking space is to recruit specialized personnel from the banking sector, people who understand banking, treasury, compliance, and the complex issues that are incumbent on a highly regulated entity and at the same time ensuring that the legacy employees of the NBFCMFI who were field oriented remain, reorient themselves, and adapt to the new regulatory and compliance requirements.

For instance, there are challenges on filing of returns to go with the codification of the RBI on the banking statistical returns during the transition. Full-fledged branches have no such problems as the transactions are clearly identified with the branch. However, the transactions that are carried out in the extant branches of the MFI now classified as a service center has to be designated to a branch. The staff members have to be trained on credit assessments, documentation, and compliance. The Indian Institute of Banking and Finance (IIBF) has been doing the training exercises to help MFIs to transition into SFBs. There has been significant investments by SIDBI in this space, and these issues need to be accorded due importance.

SFBs agree that the inputs of the training program by IIBF were effective. The challenge is to develop a cost-effective mechanism for delivering the training to SFB staff at local level. In addition, the SFBs will have to manage the issues of work culture and the duality in the staffing as they grow and consolidate.

Deposit Mobilization

One of the main issues that the SFBs have to grapple is about mobilizing deposits as their borrowing book from MFIs are getting grandfathered. Most SFBs have resorted to pricing as a strategy to open up the bank to new customers. However, experience of the large private sector banks show that price may not be a fundamental driver for deposit products. The customers usually prefer the attributes of safety and service in choosing where they would like to deposit their savings. Given that the SFBs would largely cater to the smaller clients, the question is whether the client group would have the resources. The banks will then have to resort to fickle bulk deposits as against the sticky smaller deposits. This is a challenge that each of the banks is grappling with and is finding their own solutions.

It is in this context that the issue of providing comprehensive services to the customers would come in to question. The issue of providing end-to-end solutions to the MSME sector would turn out to be important. Similarly the question of attracting deposits in foreign exchange is also to be addressed. At least two SFBs—Capital SFB and ESAF SFB—are in a position to attract nonresident deposits because of their locational advantage where large portions of the local population migrate to foreign lands. There has also been a proposal from the SFBs that the deposit insurance limits can be raised to ₹500,000 till they are able to garner adequate retail deposits, as till such time, most of the liabilities side will have to be garnered on the basis of bulk deposits, and raising the insurance limit might give a better sense of comfort and safety.

In a way, the challenge for SFBs is about drawing the lines between full banking services and operating as a differentiated bank. While for all the banking operations and obligations and regulations these banks are treated like any other bank, the facilities and services that they can offer are curtailed and differentiated and this hampers the mobilization of deposits.

Some SFBs indicated that they are unable to attract deposits because they were called “small finance” banks, which meant that the potential depositors were a bit confused on whether these were safe. The nomenclature is creating a problem in mobilization of deposits. However, the stand of the RBI has been that if they are a differentiated bank, then the differentiation should be known upfront. Some SFBs have had to compete with extremely aggressive cooperative banks, particularly in Maharashtra, and here being an SFB might have helped them to differentiate themselves from cooperative banks.

Forex

The issue of both dealing with foreign exchange as well as accepting deposits from nonresidents is an issue that needs to be addressed. As indicated earlier, banks such as Capital and ESAF are in areas where there could be substantial deposits. In addition SFBs like Equitas have been working in clusters like Tiruppur where there is significant international connection due to exports by small enterprises. While providing a facility to seamlessly deal with foreign exchange helps, it does not take away from the assets side focus on small enterprises where they are differentiated to the extent of the type of loans they could make and the obligations under the loan size and PSL obligations. As of now SFBs, are provided with the facility of being Category II authorized dealers, which does not help them to provide services in trade and forex. The RBI may have to examine providing them with a proper authorized dealer I facility based on the data and merits of the case.

KYC Norms

Like PBs, SFBs also deal substantially with smaller customers, but the nature is that these customers are significantly different from the usual BSBD customers. The facilities that these customers need breach the limits of BSBD accounts, but at the same time they are not high net worth customers where their transaction sizes would justify provision of a suite of products. This is in particular applicable to migrant workers who remit amounts from their place of work. While the KYC norms accept Aadhaar as an identity document—and Aadhaar as a document is ubiquitous—the need for an address proof not based on self-declaration but on the basis of an officially valid document is a challenge, particularly for migrant workers. Similarly the requirement of mapping the non-BSBD accounts with the income tax PAN adds to costs in onboarding the customers. This is particularly in the case of customers who do not have a PAN, and, therefore, have to give a declaration in Form 60 as per the requirements of the PMLA.

While the agency for specifying these requirements in the union government, the RBI has freedom in changing the definition of BSBD accounts, and it may be time to look at the attributes of a BSBD account in the changing times.

Client Protection Issues

In the light of further talk about multiple lending and overheating in some geographies (discussed in Chapter 11), it is very important for the banks to ensure adequate client protection mechanism. It is quite okay to indicate that the client needs to be careful and watch out, but given that the client group is largely poor and vulnerable, it becomes the responsibility of the lender to be sensitive to how the clients' household economy would perform. This is even more pertinent when the banks now no longer have the upper limits for client exposure and may be moving from the group lending model to the individual lending model. The bank loan is going to become more and more significant and material in the household economy of the client groups.

Since these institutions are no longer treated as MFIs, wherein the two-lender norm does not apply, the responsibility would be on the banks to ensure that they do not push their clients into unsustainable indebtedness. Data on the loans taken by the households are being maintained by the credit bureaus. As of now, with Aadhaar tagging, it is possible to ensure that the database is relatively clean and deduplicated. The credit bureaus also classified the borrower data by the institutional source and in the past were providing information on a need to know basis. However, the clarificatory circular issued by the RBI indicates that that when credit information is pulled, data based on all information/modules must be provided. This will help the banks to be more responsible while they are lending to the clients who are poor and vulnerable.

In addition, there are issues pertaining to the reporting to credit bureaus and the data provided by the credit bureaus. While the RBI guidelines specify that irrespective of which credit bureau the NBFC MFIs have a subscription, the credit data is to be uploaded to all the credit bureaus. Similarly, there is a need to move to a situation where the credit data of each individual borrower is captured in an integrated manner and provided when a query is raised. There are two more bits of this agenda to be completed: complete mapping of the credit information of SHG members and, if possible, linking of individuals to a household through an address tag. With this, there would be enough support from the ecosystem for the lenders to take very responsible decisions.

Other Transition Issues

There are other minor irritants that are so unique to new institutions that need to be sorted out. For instance, for claiming subsidy on cash recyclers and ATMs dispensing lower denomination notes, SFBs as a category of banks are in the circular causing ambiguity on whether it applies, while common sense would indicate that it should be more applicable to them than to others given the nature of clients they would have.

Similarly, there have been requests that the SFBs be made a part of the SLBC as well as the DLCCs where they could be party to the overall planning that happens at various levels. Similar is the demand for membership with IBA as well as a demand to have a say at the consultations that happen at the NPCI, but these are issues that would be ironed out in due course.

ROLLOUT PLANS

Update from Bandhan Bank

In the last report, we carried a big piece on Bandhan and its transformation story. While recognizing the fact that Bandhan is not an SFB in technical terms, in operational terms it continues to perform the functions envisaged by the SFBs and, therefore, a coverage under this section is in order.

Bandhan Bank to a large extent continues to serve its traditional clients. Its portfolio in the year ending 2015 was about ₹100 billion, which has grown to ₹150 billion by financial year 2015–16. The total loan book at the end of 2016–17 was ₹165 billion.[2] This did not include loans originated to the extent of ₹60 billion, which were offered as interbank participation certificates and transferred to the books of other banks while the portfolio was being managed by Bandhan. About 97.6% of the book continued to be PSL, with only about ₹4 billion in assets other than microfinance. While many of the SFBs are moving away from the traditional client group, Bandhan, being the largest bank and with a universal bank license, continues to stick to its core customers on the assets side. On the liabilities side, however, the branches of Bandhan are continuing to collect deposits and provide value-added services.

As of now, Bandhan Bank, by following its traditional model of inclusive finance, also has significant surplus achievements on its PSL targets that can be traded as PSLCs. This could be another smaller source of income for the bank.

Bandhan Bank continues to operate significantly as a bank in the inclusive finance space and needs to be tracked as it evolves its loan book.

Equitas SFB

Equitas, before it became an SFB last year, was a diversified group with three companies having different operations, in asset financing, vehicle finance, and microfinance. With the setting up of the SFB, it has been able to bring all these into a single balance sheet. Over a period of time, Equitas would like to reduce the exposure to the microfinance sector to about 5% of the book size by aggressively growing the nonmicrofinance portfolio at a faster rate. Equitas believes that as a bank they should not be having too much of portfolio concentration risk and that they should move up the livelihoods value chain, apart from continuing to grow the housing and the asset finance portfolio.

As Equitas shifts its own target segment, it finds that the differentiated license given as an SFB to be limiting. For instance, not having a license for dealing with forex limits its meaningful engagement with a large number of small and medium enterprises that are in the export market; the stipulation that all microenterprise loans should be unsecured as they are covered under the credit guarantee trust is also limiting, and they have launched a product called Loan against Property—which by its size could have qualified for the microenterprise loan—but do not want to seek the PSL status because the conditions are limiting. Equitas also believes that the microfinance clients cannot be profitable clients for the purposes of savings, particularly given that their average balances would not justify the use of a debit card on an off-us environment. The interchange charges do not justify offering cards that would be used in a non-Equitas ATM.

Equitas sees promise in micro and small enterprise financing, vehicle financing, direct agriculture, education, and housing. According to Equitas, the political risks emanating out of the microfinance portfolio is disproportionate to the returns it fetches.

The SFB has made investments in branches and IT infrastructure, along with positioning of skilled staff and a team dedicated to liabilities for focused sales push. The interest rate offered on savings is high. Equitas has some product differentiations to offer that are conversation enablers to get customers interested but are not game changers. Digital product options are available, including aspects that dovetail into their vehicle finance business like the FasTag products to have a seamless movement at the toll gates. Equitas' focus on liability side is on retail. Fund requirement currently is not huge since bank loans were repaid and the overall asset base is not growing much.

Ujjivan SFB

Ujjivan was one of the earlier MFIs to convert into an SFB soon after its successful IPO last year. Dr Muhammad Yunus, founder of Grameen Bank, inaugurated the bank and they are now fully operational as a bank and are expecting to receive scheduled bank status in a few days.

In terms of business, Ujjivan expects to continue with its core strength of microfinance loans and gradually grow other businesses. The idea is to moderately grow the microfinance portfolio and limit it to about 50% of the book size in about 5 years. The new products on offer would be personal loans, micro and small enterprises, and affordable housing. It may even offer products linked to the liability side—an OD product on current and savings accounts.

Ujjivan is gradually converting some of its extant branches into full-fledged commercial bank branches and the rest of the smaller ones into microbanking units that are similar to the doorstep centers of Bandhan Bank.

[2] *Annual Report of Bandhan Bank for 2016–17*, https://www.bandhanbank.com/pdf/Financial-Statements-2016-17.pdf, accessed on September 4, 2017.

Ujjivan believes that lending for agriculture is a specialized business and has multiple risks, and with rural outreach as SFB with 25% branches in rural areas, will understand the business and then take a call on how to offer agricultural loans that are mandated by the PSL norms.

On the resources, Ujjivan is focusing on bulk deposits, retail FDs, and savings. As of now, Ujjivan does not find much traction with current accounts. Bulk deposits account for 85% of the resources, and they have to be brought down gradually over time. While Ujjivan is confident that the liability side will be worked out, on the assets side, the microfinance portfolio is causing some concern. Going forward, Ujjivan sees the unregulated entities as more of a competition for the client segment that they want to serve and do not consider the public sector banks as a threat.

The transition of culture and managing human resources are a challenge, and Ujjivan is investing significant resources in reorienting the extant employees into a banking setup, while acculturizing the new employees into Ujjivan. There is a long road ahead, but technology and other bits are falling into place.

Utkarsh SFB

Utkarsh is one of the smaller MFIs that got an SFB license. Apart from the other investors, they also have an investment from RBL Bank, and this might get opportunities in partnership, synergy, and technical inputs. They have been working in a challenging area and have maintained a healthy balance sheet. Their transition into a banking model has been seamless, and they have been live, awaiting the scheduling. As in the case of the other SFBs, even Utkarsh is looking at growing the microfinance portfolio in a controlled fashion so that in next 4–5 years it is 35–45% of the loan book. They expect to grow the rest of the book with MSME loans. They are also looking at affordable housing finance considering that 85 housing companies listed and 18 in waiting, there could be a market to be scaled up, albeit carefully. Utkarsh also thinks that it would be risky and difficult to do direct agriculture lending for at least next 2–3 years.

Utkarsh is uniquely located and will have about 125 new branches, of which 25% will be converted from current MFI branches and the rest would be new. As of now, 98% of their clients are rural and they would like to build on this strength. Most of the branch expansion strategy will depend on how the regulatory forbearance given for satellite branches and service points by the RBI as the guidelines for SFBs evolve.

Suryoday SFB

Suryoday has also had a very low key launch, and they are live as an SFB and awaiting the process of scheduling to culminate. The overall strategy of Suryoday as an MFI was to keep the operations simple and low cost, and they are continuing with the model in the SFB as well. While they are offering a significantly higher rate for deposits as then need to quickly garner resources to retire the grandfathered loan book, they also realize that this needs to be contained. The strongest competition for Suryoday—possibly because of their location—comes from the UCBs, who have been traditionally competing for the deposits on the basis of pricing.

Suryoday believes that there is a lot to be learnt from the cooperative banks and much to be gained by getting employees from these banks if they are good. There is a certain element of customer stickiness to banks because of customer lethargy, but being nimble will help service the customers as well as draw customers from other players. In general, the approach of Suryoday is to wait for others to innovate and test and follow the best practice.

ESAF SFB

ESAF was adequately capitalized with local capital and, therefore, rejigging the capital structure was not the major issue for them. The major challenge was to handle the transition and find a place under the sun, particularly when they were based in one of the most banked districts of the country. ESAF had a good launch, with the chief minister of Kerala inaugurating the bank.

On the business front, the assets side would continue to be predominantly MFI business with new lines in housing, MSME, and agriculture added. With the background of service that ESAF has had, they intend to pursue a triple-bottom-line approach with a significant element of service bundled in.

ESAF being in Kerala where there are significant amount of remittances coming in from migrants—particularly from the Gulf region—can generate deposits. As discussed earlier, the dispensation for dealing in foreign exchange is to be accorded by the RBI. ESAF is also on the verge of being scheduled, which will allow it to garner certain types of deposits.

Fincare SFB

Fincare got the final license and has launched the SFB in August 2017. The back end work of Fincare was significant because it involved the merger of two institutions that had a common investor. The organization had a geographic focus of south and western regions.

Fincare plans to diversify to non-MFI/JLG business through MSME and secured lending, including equipment financing, housing loans, and gold loans. Diversification has become imperative after the demonetization experience where one saw significant political risks. The deposit base is to be augmented using the wholesale channel. Fincare feels that the competition for resources is more with the universal banks rather than with other SFBs. While there is confidence that the deposits could be raised, the concern is more about building the asset book in the right sectors.

AU SFB

AU was not an MFI, but a regular NBFC that was doing asset financing. AU had complex cross-holdings in multiple entities in the financial sector, and one element that was necessary to get a final license was to disentangle these holdings and come out clean and as a single entity in the financial sector. AU followed this up with a successful IPO.

AU SFB has not faced asset quality issues post demonetization. Around 450 centers have been set up, and next phase of expansion in URCs is being done through BCs. The loan portfolio will continue to have vehicle finance, secured business loan, and agri-allied products. AU does not intend to offer KCC. As the portfolio builds up, AU will foray into infrastructure development and affordable housing. Digital banking with through-and-through online loans has been tested. On the liability side, the focus is on retail deposits.

Jana SFB

Janalakshmi had applied to be a universal bank in the last round but failed to obtain a license. Since the roadmap for SFBs also indicate the possibility of moving to be a universal bank in future, they would like to have their structure in a way that the transition becomes easier in future. However, due to the high foreign holding, Janalakshmi had to go through a two-tier structure for holding the operating entity: the Janalakshmi SFB.

During the past year, Janalakshmi saw an unprecedented growth, and we had marked out its performance when we were looking at the hotspots and made a mention about the growth rates. Janalakshmi has been significantly affected by demonetization and was downgraded by ICRA twice within the range of 1 month. There are significant challenges as Janalakshmi moves to be a bank. Firstly the current operations need to recover, further capital needs to be augmented, and at the same time a transition has to be managed. All this has to be done in a reasonable time.

Janalakshmi has recently had a change in leadership, and it is expected that the new leadership will consolidate the recoveries and move the agenda further. Janalakshmi had an outsourced model for building the loan book through accenture. As a bank they will have to think about their strategy both for garnering deposits and opening branches in URCs, given that their current business model is predominantly urban. As it is preparing for the launch of the bank, Jana is testing gold loans and has done individual/MSE lending within the 15% criteria allowed as per MFI guidelines. These products will be scaled up after starting SFB operations. Ajay Kanwal the CEO said: "In three to five years, small batch loans will constitute 50–60% of portfolio while rest will comprise gold loans, affordable housing and entrepreneurs' loans."[3]

Janalakshmi has also set up a specialized vertical on rural finance.

RGVN/North East SFB

RGVN has a peculiar situation of being located in the most underbanked region of the country and, therefore, carries on itself a great burden to demonstrate that banking is possible in the terrain. It has survived as an MFI fairly successfully, and wants to retain the regional flavor as it moves ahead as an SFB. RGVN explicitly wants to remain with its current customer base and does not want to move significantly away from the poor, which would be a challenge given that it is also operating in one of the most difficult regions of the country. The advantage that RGVN has is that apart from its portfolio being entirely in the priority sector, it is likely that most of its branches will be in URCs.

RGVN hopes to continue its portfolio mix. Currently 40% of its outstanding are for agriculture, and there are loan offerings for MSME and housing (home improvement) segments. For RGVN, financing for agri-equipments such as pump sets has worked and would be scaled up, along with funding vegetable cultivation, in addition to agri-allied.

Of late, in Assam, incidences of debt-linked suicides are being reported, which indicates signs of overheating and crisis. Some institutions are resorting to giving fresh loans/greening of loans in case of overdues. While MFIs including RGVN are making efforts for collections, repayments are hampered if

[3] See http://www.livemint.com/Companies/E0e0h-RxzH5q2Ch26hE2T6I/Janalakshmi-Financial-Services-raises-Rs1030-core-equity-ca.html, accessed on September 15, 2017.

clients have multiple loans and in addition top-up loans are given by some institutions. Credit data reporting has gaps since field reality shows that all loans are not reported to credit bureaus.

RGVN would be rolling out its operations amidst this setting, but they are firm in their resolve to remain an inclusive bank.

CONCLUDING NOTES

The new experiment of SFBs will see a full year of operation next year. The statistics for that category of banks would be available separately. Each of the banks seems to be treading their own path in terms of strategy and growth. As we go forward, we will be in a position to see if they are staying on course to be an inclusive finance player, or preparing themselves to be a mainstream banking institution looking for a universal bank license. We can see that Bandhan, a universal bank, is committed to the cause that it has been pursuing. We can also see that several of the SFBs seem to have diverse growth plans of tapping other markets and other underserved segments. All in all, this is a space to watch.

Payments Banks and Their Challenges[1]

13
Chapter

INTRODUCTION

In 2015, the RBI gave in-principle licences for 11 players to operate as PBs. The objectives of launching PBs were multifold. The telecom companies were already showing that they could reach into deep territories and segments, the fintech players were demonstrating the power of technology, and companies like FINO were demonstrating the power of an independent entity being able to reach the last-mile customer. Given that there was significant investment already made in networks, it was possible for these networks to add much value to the customers by offering basic financial services through an efficient, technology-enabled, and proximate channel. That the regulator opened up the space for large industrial houses also to apply indicates that they were looking for investors with deep pockets and staying power for experimenting in this space.

Last year, we had covered the developments in the space and there were eight players left in the fray as three of them withdrew from the process much before they could convert their in-principle license into a final license. These were Cholamandalam Distribution Services, Dilip Shanghvi (in association with Telenor and IDFC Bank), and Tech Mahindra. During the year, the parent companies of two of the players announced their plans to merge. With Idea announcing that it would be taking over Vodafone, the plans of Vodafone as a PB also probably folded into the Idea Payments Bank, and seven were left in the fray. The in-principle licences were converted into final licences, but by the time this report went to press, only four of the seven players had started operations.

There have been continuing doubts about the robustness of the revenue model that this niche bank holds out. As it was indicated in the guidelines and the coverage given last year, the three revenue streams that the players have is that of remittances, arbitrage from collecting savings and investing it in securities, and selling of third-party products. While these are expected to be differentiated banks, most of the regulatory conditions that are applicable to them continue to be those that are applicable to the mainstream banks. While this was known when the licences were put on offer, the implications of several of the guidelines provided in the licensing conditions are beginning to unravel. While some of these are pertaining to how the RBI looks at the space, a large part of them pertain to the larger legislative ecosystem.

To understand the space better, it is important to look at the levers of revenue for PBs and unpeel them in a systematic manner. The first source of potential revenue is from collecting savings from the public—only checkable accounts, and not other forms of savings—and parking them in safe securities. As of now, the guidelines require all the PBs to deposit 75% of the deposits collected in securities that are classified as statutory liquidity ratio (SLR) securities. These are securities that are backed by

[1] A large part of the chapter is based on a half-day round-table held with the CEOs of PBs and the regulators. This was done courtesy of the Indian Institute of Management, Udaipur, and was held at Udaipur. CEOs of all PBs, except NSDL PB participated in the roundtable. It was also attended by Shri N.S. Vishwanathan, DG of the RBI, and Sourav Sinha, CGM of the RBI. The author is also thankful to IIMU, RBI, and all the participants of the roundtable. We also have a special word of appreciation for Pawan Bakshi of Bill and Melinda Gates Foundation for critical comments and feedback on the draft chapter.

the sovereign and have a high level of liquidity, but because of the safety, they would by definition have a low yield. By restricting the pool of securities, the PBs have limited opportunities for earning revenue through this arbitrage. The PBs are demanding that the compulsorily ratio of investments to be in SLR securities be reduced to 50%, which gives them a better headroom to play around with the other portion to enhance the yield. However, the regulator's position has been that, since PBs are seen as an instrument for financial inclusion and it is expected that most of the clients would be poor, excessive risks cannot be taken with the cash of a vulnerable and poor section of the society.

Attracting Customers

The problem with PBs is that with limited services, they are competing with full service providers with little headroom on how they could charge their customers. The advocates of the PB model argue that PBs are expected to go to pockets where the banks cannot go, and there would be little competition in those specific pockets. In order to remain competitive, they also need to pay an interest rate on the savings bank deposits. While it is largely argued that the customers could be indifferent about the interest rates on savings accounts and look only for transaction convenience, there is also a certain amount of stickiness to the bank account and, therefore, attracting new customers who already have a bank account would be a problem, unless the extant account is an inoperative or a shell account.

An attractive interest rate is possibly a good talking point to get the customers to consider transacting with the PB. Of the four PBs that are operating, we already see that the pricing is something they are using as a differentiator. Airtel Payments Bank is paying 7.25% interest on the deposits, which is higher than large banks' fixed deposit rates. Given that the head room available for them in terms of revenue is limited, this pricing at best could be an invitation pricing rather than a sustainable one. The India Post Payments Bank is offering a 5.5% interest rate, and Paytm is offering a 4% interest rate. In addition to these, the PBs have to make their services interoperable, and there will be significant carrying costs for the network and the intermediary systems. The PBs have been asking for a differential charges for ATM interchange and for NEFT/IMPS transactions—particularly on the charges levied by NPCI—because of the limited nature of their services, but in the overall ecosystem, it would be difficult to have a differential pricing for one type of player in the market. Therefore, these banks continue to be challenged in terms of their revenue model, unless they find a killer revenue stream in remittances or in selling third-party products.

One of the biggest player in the remittance market is expected to be the government, with the DBT push that is being articulated on several schemes. However, as of now, the PBs are not a part of the architecture for G2P payments—largely because the governments prefer to transact through public sector banks. They could still be an agency through which last-mile payments to the beneficiaries are paid, but given that RRBs and post offices have found a limited leeway in this space, it essentially boils down to how they could compete with the BCs appointed directly by the commercial banks.

Onboarding Customers

The licensing norms for the PBs allowed for large business houses, and people without an experience in the banking space also apply for a license. This is quite unlike the universal and SFBs where the qualifying norms were quite stringent. The assumption in opening the doors for large players was probably the fact that they would have deep pockets, extensive networks, and other extant businesses by which they could leverage the PB business. In a way, it was trying to get an out-of-the box thinking into the banking space by opening up one part of the banking sector in a risk-free manner to new players. A big assumption in this was that (like the first generation of new private sector banks) these players would be technologically savvy and would bring disruptive technology to the table.

The players who have got the licences also carry the same belief systems. Therefore, like Reliance-Jio disrupted the system in the telecom market by onboarding all their customers using Aadhaar verification in a paperless environment, many of the PBs would also like to beat the cost argument with the efficiency and technology argument. However, these arguments are being defeated due to the fact that they are defined as banks, and all banking institutions are subject to certain norms on customer identity that are more stringent than other players. The issue here is not that this particular model needs the stringency but that due to international agreements on PMLA and the Foreign Account Tax Compliance Act, the norms for knowing the customer has to be adhered to. In addition, there is an element of tax-related compliances as well.

For instance, all PBs can onboard customers using the Aadhaar platform. However, if the address in the Aadhaar database is different from the current address, then a paper document that is officially valid showing the current address has to be produced. Given that the model also looks at remittances as a revenue source, obtaining these for the migrant workers who could be a revenue stream becomes difficult. Similarly, these accounts cannot be classified as BSBD accounts by definition as they would be breaching the limits of the BSBD accounts by way of transactions. The complete identity requirement would require mapping of the income tax PAN or a declaration in Form 60. This would involve paperwork. Given that PBs are classified as banks, they have also to upload all the customer identity data to the Central EKYC Register maintained by CERSAI.

Segmenting and Serving Customers

Given that the services to be offered are limited and the deposit band is also limited, it is difficult for the banks to segment their customers and serve them in a nuanced manner. For instance, it is impossible for the PBs to offer differential interest rates to a segment of the customers, irrespective of their needs. Similarly, it is also difficult for the players to have seamless management of liquidity in the account in terms of sweeping the amounts when the balance exceeds the stipulated limit of ₹100,000. Given that any arrangement with another full-service bank would be an agreement between two institutions, it would be imperative to get the customers' explicit clearance at every instance of such a transaction. This is unlike taking a standing instruction to move resources belonging to the same customer across financial products that a full-service bank could do.

Similarly, all the PBs are not offering all the banking services. Paytm and India Post PB are planning to offer cards at a charge, most electronic transactions will be charged, and most services beyond a threshold including balance inquiry, withdrawal from other bank ATMs, etc. will be charged. There would be charges for cheque books (when customers ask for it) as well. While the customer may initially be attracted to the PB, the revenue model does not allow for any headroom for cross-subsidy against different services because of the limited services. Therefore, these banks cannot have a loss leader to look at a cross-subsidizing revenue.

PHYSICAL PRESENCE

While the expectation is that these banks would be completely technology-enabled entities, the requirements for a physical presence is not significantly different from that of universal banks. To the credit of the RBI, they—in the recent amendment to the branch authorization policy—recognized the nuance that has been built over a period of time, of having banking outlets through BC or CSP and having full-fledged branches. The current branch authorization policy recognizes this nuance, but requires the PB to have at least one nodal officer for each district of their operation to handle the function of grievance redressal as well as currency management. The compromise on technology replacing human resources is to be visited only later when there is compelling evidence that the customers are getting an equally effective solution, and a human interface even for grievance redressal issues is not necessary.

In addition to the requirement of physical presence, the regulator has been treading cautiously, asking the PBs to submit detailed branch plans and product design for the approval of the RBI. This norm does not apply as stringently to the universal banks, thereby, putting the PBs at a relative disadvantage. While the concern of the regulator is the supreme interest of the customer, it adds to the overheads of the PB.

PARTNERSHIP FOR OTHER SERVICES

With the limited nature of services that the PBs can offer on their own, it is important for these organizations to tie up with full service banks not only for sweep facilities for amounts beyond ₹100,000 but also for issues like authorized dealership in Forex. Particularly, if the PBs are going to be present in the remittance space, it is important to have the tie up. Similarly, as these banks offer services only on one side of the balance sheet—offering savings services to the customers—the other side has to be done as an agent of a bank. The loan book has to be built only on behalf of a lender. A PB, being a bank, can only operate on behalf of partner banks. For instance, it is not possible for a PB to be an agent of an NBFC. This is because there is no framework for NBFCs to appoint BCs. The logic is that NBFCs already operate as low-cost financial service providers reaching the last mile; NBFCs have no restrictions and obligations on branch opening. A special dispensation for a bank to be an agent of an NBFC cannot be made. Even if this were to be considered, it will have to be at a policy level applicable to all NBFCs to appoint agents. At this point, it does not appear to be a convincing proposal.

How is the model rolling out?

1. Airtel PB has started the operations: Airtel is using its current telecom base to port customers on to the bank. While it is offering a high interest rate, it acknowledges that people do not just

move their bank account because of the interest rate. The revenue model would be to look at remittances, value-added commercial transactions, and third-party products. Right now, one can access the services of Airtel PB in around 400,000 outlets that include the outlets that sell airtime. There have been significant learnings from the pilot in Rajasthan, and the idea is to try and make the bank as asset light as possible. Using the Aadhaar as the primary KYC document, the company is linking other necessary documents digitally to onboard customers. By making the mobile number as their account number, it is leveraging heavily on the Ecosystem developed by the telecom company, which is an advantage that Airtel has. It has also tied up with Hindustan Petroleum Corporation Ltd to provide all the banking services in all the outlets of HPCL.[2] As the business expands, the company will look for synergies to cut costs and manage to earn profits in the thin margin they have. Reports also suggest that the bank had garnered 15 million customers (largely from the telecom company) in about 7 months of its launch.[3]

2. Idea PB: The bank is in an advanced stage of commencing operations. The company has undertaken a few pilots some of which have shown encouraging results. We have learnt that it is difficult to change the mindset of people to move from cash to digital transactions, and it needs substantial engagement and convincing. Also, pilots in cities have not been as successful as in villages. In general, the post-demonetization era has seen growth in digital transactions, which is a big plus. Idea PB pitches itself as a fintech that can accept deposits and not so much as a bank, since PB design puts us in a restrictive licensing environment.

   The pilot has tried to work intensively in a village in Gujarat, ensuring that the entire payment architecture is cashless. However, it is difficult to completely manage within a ₹100,000 limit. While that limit may be applicable and practical as far as the individual customers are concerned, it the merchants who service the customers who also have to become a part of the cashless ecosystem, and it becomes difficult for the bank to service them, as the limits would be quickly breached. The same argument works for cash management of petty traders and tiny enterprises like *kirana* stores.
3. India Post PB: Post Bank has launched operations on a pilot basis and has generated some initial learning. A high level of Aadhaar coverage will be a huge enabler for PBs. There is a large market of customers who want to keep small deposits and while Post Bank foray has been limited, experience so far indicates that these people are not motivated by high interest rates on accounts. The worry is that there is very little traction for digital transactions among small account holders. Post Bank is now preparing for full-scale rollout operations in a couple of months.
4. Paytm PB: Paytm sees opportunity in innovation in payments. Wherever there is cash, there is an opportunity to convert it including government payments, bill payment, and targeting front-end merchants to become digital. Paytm has close to half a million offline merchants, all of whom may not be active. The target is to reach 1 million merchants by March. The other big opportunity is to offer services to feature phone users.
5. Jio PB: Jio has over 130 million data users through mobile, and it handles data volume of 4 crore gigabytes per day, which is very high. The PB will offer ancillary services around the data to these existing customers. The biggest challenge is to be prepared to manage the scale. Even if Jio PB targets 200 million users, and if they have to pay bills using the technology platform, the volume to be handled will be unprecedented. Testing is being done before going to market to be prepared to handle the high level of volume of payments expected to come through once the payments bank is rolled out.
6. FINO PB: FINO PB has mixed experience so far in the initial 45 days after its launch. A hundred and twenty-five banking branches have been opened. The interest rate does not seem to be a significant motivating factor for clients; they are concerned with services and doorstep banking. FINO has been a BC, and in the last 10 years, the target client has been people with income between ₹2 lakh and ₹6 lakh. Most people already have a bank account, but quality access of banking is missing. To facilitate access with quality, doorstep service is required with some physical network on the ground since banking needs trust, which comes from physical interface. It has been

[2] http://www.business-standard.com/article/companies/airtel-payments-bank-is-taking-cues-from-initial-launch-in-rajasthan-117090400019_1.html, accessed on September 4, 2017.

[3] http://www.livemint.com/Industry/ulSjwyZcuA4NX-Bs9SPSWPI/Airtel-Payments-Bank-looking-at-SME-tieups-UPI-to-boost-cu.html, accessed on September 14, 2017.

How they compare			
	Interest rate on deposits	**Transaction charges**	**Other offers**
Airtel	7.25%	0.65% for cash withdrawal, 0.5% for cash transfer, minimum ₹100 deposit	Equivalent talk time on Airtel mobile network for every rupee deposited, free insurance cover of ₹1 lakh
Paytm	4.0%	Online is free, 3–5 ATM withdrawals free. Post that ₹20 per withdrawal. ₹100 annual fee for debit card	Zero minimum deposit. Cash back of ₹250
India Post	5.50%	3–5 ATM withdrawals free. Post that ₹20 per withdrawal. ₹2.50–5 for online fund transfer via NEFT	Free withdrawals at India Post ATMs and select other bank ATMs

Figure 13.1 Comparison of the Services Offered by Different Players

Source: The Hindu Businessline, http://www.thehindubusinessline.com/money-and-banking/three-payment-banks-have-plans-for-your-money/article9711826.ece, accessed on September 2, 2016.

about 3 years conducting pilots, market surveys, etc. and across rural, peri-urban, and urban locations. People require assisted service at least initially, and eventually move to digital services. Demonetization has led to acceleration; people have become aware of the fact that they need to keep money in bank, but they still feel overwhelmed by dealing with banks, and waiting, queues, etc. are still deterrents to access. At FINO PB, the objective is to assist these clients to a level that they can be digitally included.

A challenge at FINO has been the need to continually raise resources. Investors see PBs as a substandard offering compared to say the SFBs. While PB carries only operational risk which is covered with multiple systems and audits and capital requirement for PBs is same while SFBs carry much higher risk including credit risk. The business case for PBs is a challenge, both from market and investor point of view. When the guidelines were announced, there were a lot of questions around the model, and it is important that we give positive signal to the market that some issues are being taken care of now and some will be resolved later.

A comparison of the services offered by different players is provided in Figure 13.1.

CONCLUSIONS

From the earlier discussion, it is abundantly clear that PB is a completely untested model. From its inception, we have already seen four dropouts even before an attempt was made. The interactions with the players constantly remind us of the trouble that the players are facing, particularly in trying to offer limited services with very limited revenue streams, with little scope for cross-subsidization. Of the six players that we have discussed, three are telecom companies and may be able to use the mobile technology and the sunk costs of the mobile operation to keep the PB floating. The customer acquisition and on-boarding process, therefore, may be somewhat less expensive. However, these entities have to find volumes to ensure that the thin margins add up to covering the fixed costs and provide a revenue stream. In case of India Post, it is expected to ride on the very wide physical network that the postal department has as well as the deep pockets of the sovereign. In case of Paytm, the company was already operating in the prepaid wallet space and has a large family of existing customers. The initial strategy would be to port those customers on to the new bank, and given that Paytm has significant presence in merchant establishments, the revenues are expected to come from commercial transactions. The only player who is a stand-alone player is FINO PB. FINO has had experience in being a corporate BC in the past and has worked for several banks on the basis of a good technology. It also has a good network of brick and mortar branches. In all the models discussed earlier, FINO is one PB that has the highest number of branches, and, thus, possibly has a significant amount of fixed costs.

Amidst these constraints, it would be a miracle if many of these entities survive in the long run. However, experts feel that there is some merit. For instance "PBs are an experiment and several models are being tested, it has to be seen which ones scales and can be profitable. We already know that profitability could be long drawn affair, but given adjacencies in revenue streams we may see some innovative models emerge."[4] While the regulator is unwilling to provide any concessions because of the original licensing conditions, it may be useful to look at relaxing some of those in the interest of the viability of the entities. One way to address this may be to evolve new norms that make the business model viable and open the space up for one more round of licences with the new norms, thereby, providing for an opportunity for all those who want to work under the new norms. It is important for the RBI to seriously look at the viability of PBs before many of them die a premature death.

[4] Private communication with Pawan Bakshi in 2017.

MUDRA and PMMY: Review of Progress

14

Chapter

MUDRA was launched as an NBFC on April 8, 2015. It manages both the Pradhan Mantri Mudra Yojana (PMMY) as well as the refinance function. MUDRA currently functions as the subsidiary of SIDBI.

PMMY consisted of the launching of three loan products: the first, pegged at ₹50,000 called the *Shishu* loan; the second of amounts ranging above ₹50,000 up to ₹500,000 called *Kishor*; and the third, ranging above ₹500,000 and up to ₹1 million called *Tarun*. These three loan products were largely targeted at noncorporate, small businesses, and microenterprises—basically looking to fund the unfunded. The instrumentality through which these products would be rolled out were to use the vast network of bank branches as well as to co-opt microfinance institutions, cooperatives, and other players who were in the business of financing, thereby, expanding the institutional scope of the scheme.

The new priority sector lending norms released by the RBI had a renewed target given to banks that 7.5% (RBI 2015) of their adjusted net bank credit (ANBC) was to be directed toward microenterprises.[1] This has brought some renewed focus on to the smaller loans. This was captured in Chapter 2 where we discussed the trading of PSLCs that was centered around loans to both agriculture (direct and small farmers) and to microenterprises.

PMMY loans fall between the limits prescribed for SFBs (₹2.5 million) and MFIs (up to ₹100,000). MUDRA was set up with a capital of ₹7.5 billion, and it currently has a capital of ₹16.75 billion and a refinance corpus of ₹81.25 billion. The functions of MUDRA were not only to extend refinance but to work more effectively in the ecosystem.

As of March 2017, MUDRA had extended total loans on its own books to the extent of ₹61.13 billion. However, the achievement of MUDRA need not be seen only in terms of the credit enhancement that it has provided, but in the performance of the PMMY for which MUDRA is a monitoring and nodal agency.

The region-wise performance of PMMY is shown in Table 14.1. As against a disbursal of ₹61.13 billion directly from MUDRA as refinance, the scheme itself had disbursed about ₹1.7 trillion both through banking and other channels. The bank-wise and state-wise details of disbursements under the PMMY are given in Appendices 14A and 14B.

From Table 14.1, when we look at the regional spread, we find that the southern region is leading in terms of both the number of accounts that were serviced and the amounts disbursed. This is followed by the East and Central regions. More than half of the MUDRA loans are given through MFIs. The achievement of MUDRA broadly reflects the achievement of the microfinance institutions, which have been refinanced by MUDRA, and, therefore, it is natural that we see focus in these regions where MFIs have grown. This trend of the East and the Central region gaining some focus from the banking system on MUDRA is welcome, particularly because Gujarat and Maharashtra—representing the western region—are usually expected to find more offtake of credit. This, coupled with the growth of MFIs (discussed in Chapter 11), seems to indicate a level of enterprise taking off in these regions that were traditionally underbanked.

While the growth on the books of MUDRA itself has been a modest amount of ₹61.1 billion, the

[1] Microenterprises are defined as enterprises having an investment of less than ₹1 million in equipment for service sector and ₹2.5 million for enterprises in the manufacturing sector.

Table 14.1 PMMY—Region-wise Performance of Accounts (in Thousands; ₹ in Billions)

	Shishu		Tarun		Kishor		Total	
Region	**Accounts**	**Amount**	**Accounts**	**Amount**	**Accounts**	**Amount**	**Accounts**	**Amount**
North	2,522	59.36	404	89.98	117.43	88.98	3,044	238.32
North East	1,513	44.84	55	11.28	10.67	7.82	1,579	63.94
East	11,553	265.09	355	69.59	67.81	52.82	11,977	387.50
Central	6,695	145.62	402	83.82	93.99	71.25	7,192	300.69
West	4,023	94.16	353	78.39	105.69	78.21	4,482	250.76
South	10,189	229.84	1,094	177.56	144.15	104.50	11,427	511.90
Total	36,498	838.92	2,664	510.63	539.73	403.57	39,701	1,753.12

Source: Data from MUDRA website, http://www.mudra.org.in/, accessed on September 13, 2017.

Table 14.2 Details of Accounts Opened and Disbursals by Institutional Form as of March 31, 2017

Details of Accounts (No. in Thousands)	**Banks**		**MFIs**		**Total**
Shishu	14,991	41%	21,507	59%	36,498
Kishor	2,517	95%	146	5%	2,664
Tarun	532	99%	7	1%	540
Total	38,332	64%	21,661	36%	59,993
Details of Amounts Disbursed (₹ in Millions)	**Banks**		**MFI**		**Total**
Shishu	397	47%	442	53%	839
Kishor	492	96%	18	4%	511
Tarun	398	99%	6	1%	404
Total	1,288	73%	465	27%	1,753

Source: http://www.mudra.org.in/, accessed on September 13, 2017.

overall growth to this segment from the banking sector as a whole was substantial. From a comparable figure of ₹561 billion in 2015–16,[2] the disbursement from the public sector banks itself was ₹684 billion. Other banks also contributed significantly, taking the total disbursement by banks to ₹1.28 trillion. The disbursement by institutions other than banks (largely MFIs) was around ₹465 billion. The performance review indicates that about 25% of the accounts that were serviced belonged to new entrepreneurs, about 74% of the customers were women—which was not surprising given that a significant number of accounts in the Shishu category is originated by MFIs—and more than 55% of the accounts belonged to the SCs/STs and OBCs in the society and about 12.5% of the accounts were originated from minority communities.

[2] Based on "Review of Performance of PMMY" published on the MUDRA website, http://www.mudra.org.in/, accessed on August 11, 2016.

From the data, it is also clear that the banks have been largely focussing on Kishor and Tarun loans, while the MFIs had a large share in the Shishu loans (less than ₹50,000). Table 14.2 has the details.

Overall, from the reports available till now, it appears that both MUDRA and the PMMY have enhanced the availability of credit to what was traditionally referred to as the "missing middle." While, MUDRA and the PMMY would have definitely played a credit enhancing role, it is also to be recognized that this portfolio already existed on the books of both the banks and MFIs, and the initiative would have catalysed the growth.

As of now, MUDRA has adequate funds and this sector could grow significantly. While MUDRA had an outstanding book of ₹61 trillion, it has liquid cash as well as investments to the extent of ₹38 trillion. A look at its books show that it almost earned as much from other income as it earned from loans and advances. This clearly indicates that MUDRA could do much more in this area.

APPENDIX 14A

Borrower Category-wise Performance of PMMY for 2016–17 (Number of Accounts in Thousands; Amounts in ₹ Billions)

	Shishu				Kishor				Tarun				Total			
Category	A/cs	Sanc-tioned	Dis-bursed	Out-standing	A/cs	Sanc-tioned	Dis-bursed	Out-standing	A/cs	Sanc-tioned	Dis-bursed	Out-standing	A/cs	Sanc-tioned	Dis-bursed	Out-standing
General	14.84	351.64	346.16	262.89	1.90	408.21	391.35	334.17	0.47	366.01	352.81	295.08	17.20	1,125.85	1,090.32	892.14
SC	6.99	159.76	157.75	109.72	0.14	21.71	20.40	18.31	0.01	7.51	7.09	6.04	7.14	188.98	185.24	134.07
ST	1.73	38.31	37.64	25.52	0.06	10.30	9.54	8.47	0.01	4.12	3.88	3.20	1.79	52.73	51.06	37.19
OBC	12.95	301.30	297.38	205.94	0.57	95.24	89.34	78.31	0.06	41.20	39.79	34.44	13.57	437.73	426.50	318.69
Total	36.50	851.01	838.92	604.07	2.66	535.45	510.63	439.25	0.54	418.83	403.57	338.77	39.70	1,805.29	1,753.12	1,382.09
Of the above																
Women	28.47	669.98	661.86	466.85	0.62	95.42	87.33	159.38	0.05	37.50	33.31	29.18	29.15	802.90	782.50	655.41
New A/cs	8.11	187.21	184.30	132.50	1.59	317.58	300.02	258.41	0.29	224.82	215.42	180.43	9.99	729.60	699.74	571.35
Minority	4.79	113.41	111.87	75.45	0.32	56.91	53.81	47.62	0.04	32.44	29.07	24.88	5.15	202.76	194.74	147.95
PMJDY OD	1.42	4.18	3.13	1.68	0.00	0.00	0.00	0.00	0.00	0.00	0.00	0.00	1.42	4.18	3.13	1.68
MUDRA Card	0.15	3.86	3.56	3.18	0.03	5.50	5.43	4.39	0.01	6.28	6.16	5.12	0.18	15.65	15.16	12.69
NRLM	0.01	0.23	0.22	0.19	0.01	1.55	1.39	1.24	0.00	0.08	0.08	0.07	0.02	1.87	1.69	1.50
NULM	0.07	3.15	2.64	2.30	0.08	12.94	9.57	8.18	0.01	3.96	1.67	1.35	0.16	20.04	13.87	11.82
Other Govt progs	1.04	26.65	26.24	19.69	0.19	33.77	31.41	25.83	0.03	22.02	20.86	17.93	1.25	82.44	78.51	63.44

Source: http://www.mudra.org.in/, accessed on September 13, 2017.

APPENDIX 14B
Source-wise Performance of PMMY (Number of Accounts in Thousands and Amounts Disbursed in ₹ Billions)

	Shishu		Kishor		Tarun		Total	
Type of Institution	A/cs	Amount	A/cs	Amount	A/cs	Amount	A/cs	Amount
NBFC MFIs	20,182	416.06	108	8.56	1	1.01	20,292	425.63
SBI and associates	860	12.52	341	88.10	154	123.24	1,356	223.85
Public sector banks	1,935	43.85	1,287	240.87	235	175.91	3,456	460.63
Private sector banks	8,420	247.29	300	71.12	101	69.32	8,821	387.73
Foreign banks	–	–		0.03		0.12	–	0.15
RRBs	927	27.63	499	69.87	20	14.89	1,446	112.39
Non-NBFC MFIs	1,130	21.05	–	–	–	–	1,130	21.05
Non-MFI NBFCs	195	4.40	38	9.64	6	4.60	240	18.64
Small finance banks	2,849	66.12	89	22.44	22	14.49	2,960	103.05
Total	36,498	838.92	2,664	510.63	540	403.57	39,701	1,753.12

Source: http://www.mudra.org.in/, accessed on September 13, 2017.

APPENDIX 14C
State-wise Performance of PMMY (Number of Accounts Serviced and Amounts Disbursed in ₹ Billions)

	Shishu		Kishor		Tarun		Total	
State	A/cs	Amount	A/cs	Amounts Disbursed	Accounts	Amounts Disbursed	Accounts	Amounts Disbursed
A&N	2	0.03	1	0.31	0.57	0.45	3	0.78
Andhra Pradesh	366	9.65	202	33.14	19	14.53	588	57.32
Arunachal	5	0.13	1	0.28	0.46	0.37	6	0.79
Assam	1,215	35.93	34	7.25	7	5.06	1,256	48.25
Bihar	3,623	82.26	116	19.44	18	14.16	3,757	115.86
Chandigarh	14	0.25	3	0.81	1	1.16	19	2.21
Chhattisgarh	840	17.50	35	7.15	10	7.45	885	32.10
Dadra	2	0.07	0.2	0.04	0.14	0.11	3	0.23
Daman	1	0.01	0.2	0.04	0.09	0.07	0.77	0.12
Delhi	149	4.07	52	15.51	24	17.43	225	37.01
Goa	22	0.72	7	1.56	2	1.44	31	3.73
Gujarat	945	24.27	125	27.27	34	25.38	1,103	76.92
Haryana	653	14.60	48	9.92	16	12.45	717	36.98
Himachal Pradesh	49	0.99	27	5.99	6	5.15	83	12.14
Jammu	23	0.72	59	11.14	7	4.77	90	16.64
Jharkhand	970	21.29	44	10.07	10	7.73	1,024	39.09
Karnataka	3,546	81.67	332	54.03	55	37.21	3,934	172.91
Kerala	775	17.83	189	30.08	18	13.50	982	61.40
Lakshadweep		0.01	0.14	0.03	0.02	0.01	0.5	0.05
Madhya Pradesh	2,532	54.34	121	25.43	30	22.15	2,683	101.92
Maharashtra	3,054	69.09	221	49.47	69	51.20	3,344	169.77

	Shishu		Kishor		Tarun		Total	
State	**A/cs**	**Amount**	**A/cs**	**Amounts Disbursed**	**Accounts**	**Amounts Disbursed**	**Accounts**	**Amounts Disbursed**
Manipur	19	0.58	2	0.47	01	0.37	22	1.42
Meghalaya	20	0.60	3	0.69	0.7	0.57	24	1.86
Mizoram	3	0.15	3	0.53	0.3	0.22	7	0.90
Nagaland	9	0.25	2	0.39	0.6	0.39	11	1.04
Odisha	2,525	51.87	68	13.76	14	10.37	2,607	76.01
Puducherry	122	3.04	8	1.19	0.8	0.63	130	4.85
Punjab	618	14.92	66	13.70	21	16.50	706	45.12
Rajasthan	1,015	23.80	148	32.91	41	31.52	1,205	88.23
Sikkim	18	0.52	1	0.25	0.3	0.20	20	0.97
Tamil Nadu	5,000	108.98	276	42.59	34	26.00	5,310	177.56
Telangana	379	8.67	86	16.51	17	12.62	483	37.80
Tripura	243	7.19	9	1.67	1	0.83	254	9.69
Uttar Pradesh	3,077	67.57	214	43.88	47	36.09	3,338	147.54
Uttarakhand	246	6.22	33	7.36	7	5.56	287	19.14
WB	4,415	109.12	125	25.76	26	19.92	4,567	154.80
Total	36,498	838.92	2,664	510.63	540	403.57	39,701	1,753.12

Source: http://www.mudra.org.in/, accessed on September 13, 2017.

REFERENCE

RBI (Reserve Bank of India). 2015. *Priority Sector Lending Targets and Classification*. Available at https://rbi.org.in/scripts/NotificationUser.aspx?Id=9688&Mode=0#ANN, accessed on August 10, 2016.

Interview with Professor Muhammad Yunus

15

Chapter

UNDERSTANDING THE GRAMEEN MODEL

MSS: You say that the poor are always good, they always pay back. But your early experiments before you stabilized the classic grameen model had its own hiccups, where there were widespread defaults. Similarly, the book by Asif Dowla and Deepal Barua describing Grameen-II starts with a default story. So are the poor always good, or is it necessary for us to provide a framework for the poor to be good? The same poor also default with the mainstream banks. So are the poor inherently good? Or, are they good only when we create conditions for them to be trustworthy?

Yunus: Firstly, we need to make the transactions easy for the poor. If you will make it complicated, they will not understand it. They should not feel threatened by the processes. So we tried to do without written orders and written rules. These rules don't make sense to them. We make it work through communicating through word of mouth. It worked.

MSS: Tell us something about the 16 decisions[1] that are a part of the grameen center meeting ritual, did it evolve over a period of time?

Yunus: I think these decisions came about over a period of 4 years. We did not start with 16. It was four to start with. We did not come up with decisions; our focus was to know the concerns through discussions, and based on that, the conclusions were made.

MSS: If I wear my mainstream hat and examine the 16 decisions, it appears that all these are risk mitigants against defaults. Like not paying dowry ensures that there is no shock in the financial system within the family, having a backyard vegetable patch ensures household food security. So each of these decisions is removing all the financial vulnerabilities, though it sounds like social transformation. Did you think of these as risk mitigants?

Yunus: No, as I said earlier, these decisions came from the community—through discussions. We never looked at these as risk mitigants. It came with a series of workshops where I wasn't even involved. My concern was to find out what's bugging them, to understand their problems.

GRAMEEN II

MSS: I am curious to know what triggered you to move from Grameen I which is highly structured and regimented—with a weekly repayment and a one-year tenor loan to Grameen II, which is a very flexible system?

[1] 1. We shall follow and advance the four principles of Discipline, Unity, Courage, and Hard work in all walks of our lives. 2. We shall bring prosperity to our families. 3. We shall repair our homes and work towards constructing new houses. 4. We shall grow vegetables all year round. We shall eat plenty of them and sell the surplus. 5. We shall plant as many seedlings as possible during the plantation seasons. 6. We shall plan to keep our families small, minimize our expenditures, and look after our health. 7. We shall educate our children and ensure that they can earn to pay for their education. 8. We shall keep our children and our environment clean. 9. We shall build and use *latrines*. 10. We shall drink water from tube wells. If they are not available, we shall boil water or use *alum*. 11. We shall not take any dowry at our sons' weddings, nor shall we give any dowry at our daughters' wedding. We shall not practice child marriage. 12. We shall not inflict any injustice on anyone, nor shall we allow anyone to do so. 13. We shall collectively undertake bigger investments for higher incomes. 14. We shall always be ready to help each other. If anyone is experiencing difficulty, we shall all help him or her. 15. If we come to know of any breach of discipline in any centre, we shall all go there and help restore discipline. 16. We shall take part in all social activities collectively. *Source:* http://www.grameen.com/16-decisions/ accessed on February 15, 2017.

Yunus: In the beginning, we had no idea how credit and trust will work. So, we made it rigid. It was easy to train staff. We said that the groups have to be five members and they have to repay in 1 year. But later we realized that if they are paying back regularly, how does it matter if they pay in 6 months or 1 year? So, we thought, let people decide the duration.

The new method then evolved. As I said we wanted to make it easy and less complicated to our borrowers. Over a period of time we decided to remove those barriers of time/schedule/loan repayment. Of course, there was resistance. People said that once we have agreed on a repayment schedule, we have to go with it, or you will be in trouble. I said, no, she (the borrower) can change the schedule anytime she wants. My only argument was that if people were paying, we should make them feel comfortable. With technology and computers, it was very easy. All we had to do was to go back change the repayment schedule and then it was fine.

MSS: How difficult was it for you to change the culture within the organization? That is completely against the received wisdom of banking.

Yunus: It was a very intensive process, very intensively done. Although we changed rules but people stay with the same notions. So, we insisted that rules have been changed and borrowers should make use of the flexible framework. We insisted to see how many have used it. Because, a structured product looks safe for the staff. The moment you open it they become vulnerable. Okay what happens after that? Then people were suspicious: "Ah he is hiding something. Making this flexible! Oh! he is hiding something, oh there are irregularities inside! Oh, you know why he is showing high repayment rate because he has endless schedules!" So, I said, "Look I am doing it for their benefit and they know and I am not hiding anything."

Then there was this issue of bankers having doubts. We thought, to satisfy tough bankers, we would make provisions. We follow their rules in our books. We are the most liberal provision making organization. It's just a provision; because we know that the money is coming back anyways. So, what's wrong with it?

MSS: So in this process, you broke down all the rules except 16 decisions, weekly meeting, and five-member group. But the group was a socializing group and not mutual guarantee group.

Yunus: There was never a mutual guarantee ever. But someone wrote something and I did not respond to it. But then that became a fundamental thing from the eyes of the bankers. I never thought of it as social collateral; the group was only to support each other, build friendships, and take each other's responsibilities together.

MSS: The replicators of Grameen, including the Indian replicators, have chosen the Grameen I model rather than Grameen II model. Is it because their own level of evolutions is like that?

Yunus: Possibly it is because they were trained on the first model and they were not trained into second.

MSS: But why they are not quickly moving to the Grameen II model if that is more friendly to the client.

Yunus: Yes, very friendly to the client, but they think, again, this is working, why disturb it? If they can manage within organization why not go with it? More than that, we at Grameen have deposits. Always remember, deposits are our mainstay. Therefore, it is difficult for a non-deposit-taking organization to move to Grameen II.

MSS: So, one area in which microfinance is not effectively addressed in India—I don't know whether that the case with Bangladesh as I am not privy to it—is leading to agriculture.

Yunus: I don't know what it is right now. I used to say 40% of the money of Grameen bank goes to one item that is cattle, and if you see next item, then we go to the next that is chicken. So, when you say it's not agriculture, you mean it is not for crop. Crop is a male issue. We don't deal with men.

MSS: Is there a way in which we can address this issue?

Yunus: I know where you are coming from—this is about the regularity of payment of installments, when the income is seasonal. You are coming from Grameen I. With Grameen II you can do anything you want. You can fit anything in Grammen II. That is the beauty.

MSS: But how come we have not heard too much buzz about it? Is there something we need to do to popularize Grameen II?

Yunus: They are not based on savings. They have to be banker of the strict type. So, their investor will not let them away with this. For others is so uncertain. They ask me how do you do your risk management? I said that word risk never occurred to me. I have never written a word about risk. I said the whole world is a risk for me. I deal with it.

OTHER MODELS

MSS: In a way, if we go back and look into the heart of Grameen, it is very much the credit union cooperative model. The users are shareholders, except that you have structured it differently. What is your view of the credit union movement elsewhere in the world and how do you look at it?

Yunus: It was a good idea, but it fell apart. Fell apart because it is left in the hands of very few people. So, it doesn't have kind of absorption of new ideas that you get when you cover almost everybody. With more inclusiveness and more people, a lot of forward-looking things can come in; technology comes in, new ideas come, new products are developed because you are on top of it. If you have only 200 members of the credit union, you may gradually reach 250, but your ability to reach 400 quickly is not there.

MSS: I am sure you know Rabobank is now becoming a unitary institution one single cooperative of Netherlands; Desjardins in Canada has removed the middle tier and has become a two-tier structure. From around 1,200 primary cooperatives, they have reduced to 400 through a process of consolidation. Similarly, Germans have also been consolidating and reason they cite is competition with the mainstream banks. Do you think these institutions are losing their cooperative nature? Are we moving away?

Yunus: I have not paid attention to the European experience. I know there are big organizations like Mondregaon. But in the context of Bangladesh, I decided that they were not relevant. I came to that conclusion very early, before starting. Cooperative in Bangladesh, and in Pakistan—I don't know about India—is a total joke. This is just a way to suck the government money by privileged people. That's all. It has nothing to do with cooperative ideas. These are not self-contained organizations. They are fed by the government. There is cooperative ministry, there is cooperative bureaucracy, and you are always bribing the bureaucracy and they are always cheating the government and not paying back. I said I don't want to get involved in that. The word cooperative is such a dirty name in Bangladesh. If you are in cooperative, you are making money. See the idea was good, but in the implementation, you brought it a level which is incurable, because government's involvement. I don't want to get involved with the government. The moment you form a cooperative, you have to register, the brokers will come for inspection. Bribe them for every time they come, even if you are perfectly okay. So I just did not pay attention to cooperatives.

THE INDIAN CONTEXT

MSS: What do you think of this move by the RBI to offer licences for SFBs and PBs?

Yunus: I have been complaining about it. That license should be given to NGOs who are giving right kind of microcredit so that they can start accepting deposits and don't have to be dependent on external investors. The investors will gradually distort the whole microcredit. They will push it to a paradigm of just making money. There are only few investors who have a social mission and can invest. Very few of them. So all the big investors will come and offer a billion dollars and put constraints on working.

When there is money available locally from the depositors, why should India keep its doors open for external money to come and give their money to the poor? Is India lacking money? I say no. To save the microcredit NGOs, we should just give the key in their hands, open the door and get all the local money. It's all theirs.

MSS: So, do you think it was a good idea for the Indian government to say that the majority will be owned by Indian nationals to start with? In a way putting the foreign capital on the back burner?

Yunus: Why would I take money from outside when I have adequate local capital?

MSS: But the fear that they will move away from microfinance is always there. You talked about it the other day as well.

Yunus: Yes, because this legal framework under which the licencing is done is much larger than what is necessary. Therefore, there is a possibility for the new banks to drift.

MSS: On regulation, you talked about two types of referees—that the mainstream banking regulators do not understand microcredit enough.

Yunus: Yes two kinds of them. I advocate a separate regulator for microfinance.

MSS: A regulator that is more flexible and understands the complexity of this world.

Yunus: And also, it will be proactive. The regulator will also have to nurture development. Not just be restrictive. They can be preventing organizations by saying "You can't do this and you can't do that." They should say "you can do this if you want, if you need any help we will help you. Those kind of things. Encourage and pat on the back, say you did fantastic work because you did something new and innovative" So that is the kind of regulatory framework that we need, not the one with a red eye constantly questioning innovation.

MSS: The last Governor Raghuram Rajan, while he was the most dynamic he did open up and did a lot of things for the cause of microcredit or related activities. He was very much a markets man. And he was doing all while integrate the poor with the mainstream markets or deepening the markets. This included opening up the space for credit derivatives. Do you think that's a good idea integrating the poor into the completely into the global market chain or do we need some insulation?

Yunus: When I say re-design the financial structure one of the thing which I want to hit is the derivative markets. Because derivative is nothing but speculation. So, you are letting people to do and imagine things. Create a fantastic world. You have to get out of the fantastic world. I say you have to get into the reality of the world. So as long as you have the derivative you are building up this fantasy. Keep on flying your kite. Letting poor people into the fantastic world is a wrong move.

MSS: So you believe it should be insulated. There are multiple arguments these instruments give-price discovery, it is deepening of markets and so on.

Yunus: Nothing. It is simply exploitation. Because they don't know how to play this game and some middle men play the game for them.

MSS: So, in terms of if you were to look into the policy push and if you had to look at the government, one you have clearly said that this type of business needs a different regulator to do things differently. Is there anything else that they need to do in the mainstream institutions? You know for example, we have our PSL, weaker section targets, opening branches and so on. Do you think those initiatives help?

Yunus: Because this machine which we call as bank doesn't do all this. Somebody has to keep on poking them to do this. So, every time you poke, you add another piece. This is piece meal solution. You have to redesign so that its works for people. It's not working for them.

MSS: Let me flip it the other way, for example you were talking about Danone in the afternoon, you said "look my target is here, I work for the poor. I am not going to change my pricing but, I am going to find a mechanism to earn that money by selling products in the supermarket and cross subsidize it for my customers." No if we flip it and say that you are selling it to the supermarket but you compulsorily have to sell it at this price for the poor. It is the same thing, but with different sequencing. Except in your case you started with the poor and said that in order to serve the poor I'll earn money. So, do you think putting these quotas is it going to help?

Yunus: When national economies are involved and large banks are involved, that is completely complicated and very uncertain thing because you are doing within your own business. You have one book, within your book you are trying to do that. It is a same store, one part of the store does this and other part does not.

MSS: So is it like cutting a tree here and planting it in Brazilian rain forest and saying we are maintaining ecological balance. So you think that's not a sustainable system? Ultimately when we look at the regional skew that is very very visible that it's going to places where in any case naturally it would have gone and it's getting classified there.

Yunus: Yes, that's not sustainable, and you make a terrible mistake. You cannot judge which part you are balancing.

TECHNOLOGY

MSS: You are quite welcoming about technology and cashless transactions. While we know that it brings in efficiency at the back end, does it take away the essential nature of socialization? Even when Grameen moved from Grameen-I to Grameen-II while it changed a range of things and moved from group loans to individual loans you did not do away with group meetings. It's one thing to have technology at backend to make things simpler, but it another to have technology at the decision-making end, where you use Algorithm, credit bureau records rather than me knowing you, touching you, feeling you and understanding you? Do you think the use of technology at the client end will work?

Yunus: I'll explain that role of technology as I see it. I said today you can do the entire microcredit without any staff. That is the level to which technology has moved. She has a devise you have a devise, she has a need for something you provide. Then she pays back you have whole history. This is there on the fingertips. She shows you graph of what happened in entire 15 years of behavior. Now, whether you want to put money or not its up to you.

MSS: Not only that, people are modeling your Facebook post and whatsapp messages.

Yunus: Everything, you integrate besides those, integrate her habits what she buys. Even if you focus on your performance, you have all information you make decisions. And you don't have to take decision on your own. The machine makes it for you.

MSS: Isn't it scary?

Yunus: No. It's possible. It reduces the cost, it is very efficient, etc., etc. The loss is in the social context, where people are meeting together, interacting, exchanging new ideas on what can be done, what is happening. That information goes missing.

MSS: That bonding itself was a big strength in Grameen.

Yunus: See Grameen is a social organization.

MSS: Because even when you moved from Grameen-I to Grameen-II you did not take away the group concept.

Yunus: Yes the center meeting is still there everything is there. Because there are so many places we are together and we know each other, face to face, eye to eye we understand that. So, the mechanization and technology may remove entire social context. And that will be a big damage. It's a social movement; we have to realise that it's not as simple as taking a loan.

MSS: Infact I remember, I had to gone to Frampton in Canada, and the branch manager was told that you should train the customer to go and use the ATM and not come to the counter. And the customer would come & say I don't want to go to the ATM, I want to talk to you.

Yunus: Human touch, See that's exactly what's happening in USA, these are women hundreds and thousands of women who never knew who's their neighbor, because they are so narrow they are protecting themselves. Suddenly Gramin encourages them to come together and request them to meet each other, form groups. Whom should I form group with I don't know anybody? Knock at the door of your neighbor, she may know somebody introduce yourself and then they are like can I join too. And then she finds her in the same problem. Even if you do everything, change everything don't change your central meeting. That's the only thing that we don't give up at all.

MSS: That's non-negotiable in the model.

Yunus: Even in US this is what what people told us. No matter what you do in US you cannot have a center meeting. People are so individualistic, but everything just turned around. The members love meeting their friends, and then we talked about monthly meetings and they would say "NO, NO, weekly meeting is fine".

ENTREPRENEURSHIP

MSS: Let me come back to social business. When you inaugurated Ujjivan bank and later as well, you have been saying that human beings are not meant to be employees, they are meant to be entrepreneurs. You also expresses some discomfort with polarization of wealth.

Yunus: Not only discomfort, it is a horrifying thing!

MSS: Essentially you mean that that creating large corporations and huge employment is not a desirable model for you. So, are you espousing Gandhian principles of decentralization—broadly, no difference between how you look at it and how Ela Bhatt approaches it? The question I was asking is: Are you and Ela Bhatt packaged differently, possibly?

Yunus: I have no idea what she is doing.

MSS: She recently came out with a book. She studied six essential services: food, clothing, shelter, financial services, medical services, and health to see if these services were available locally or how far do they come from—she had a 100-mile theory. Of course she is more about localization, but you are basically a espousing a small enterprise.

Yunus: I didn't say small enterprise. There are two things—one is social business which can be global business—it doesn't matter. All business I have done is only for the sake of the poor. My business is global. I serve cheap meals to every single person in an affordable, delicious, and healthy way. So, I have done this business all over the world. So I am about doing business that benefits the poor, not necessary about localization.

MSS: So let's get back to your first foray. As a professor you went off and started the three share farm?

Yunus: No, we are doing it Colombia. It's a joint venture.

MSS: What about Bangladesh?

Yunus: Bangladesh is still a difficult country for me.

MSS: But in Colombia there is a three share farm? So, you did not give up your idea….

Yunus: No. No. It comes back. It will come back to Morocco and many other countries. It's our joint venture with McCain Foods.

MSS: So no idea goes waste. It will come back even if its 30 years later.

Yunus: That will spread in all agriculture. Wherever I do social business, they say how do you do it? I say this is it, share it with them. Give them the guarantee that I will take care of everything else, you just work.

MSS: But in the Indian context and Bangladeshi context it is a bit difficult.

Yunus: No it's not difficult. For me it was difficult because the government is very hostile. It is such a hostile element in that country. People are afraid to talk to me in Bangladesh.

MSS: So the other thing is I spent a lot of my formative years in Anand, Gujarat. I was a student. Have you ever met Dr Kurien?

Yunus: Many times. He came to Bangladesh. I visited him. We were very good friends.

MSS: I see a very perfect dovetail between the kind of activity he was doing and microcredit. But he kept the credit totally away from it. Do you think it was a right decision?

Yunus: You can hear me again and again—this is oxygen. So, no matter what you do, you have to pay attention. So if you are missing that, something will go wrong in this and you get be stuck somewhere. You have to give economic oxygen to the people.

MSS: Is there any model which you have seen, which you have admired a lot outside of your Grameen which fascinates you that you have seen? Whether its Anand pattern types of Dairy cooperatives?

Yunus: Anand is very good example; out of nowhere its built it up, its sustainable; and the business runs well—makes all the members understand the principles. This is great accomplishment, so, there are many such examples; this is not just big ones, even the small ones, the very concrete examples are there. So what I am saying is that why don't you be in all those things and have a system build it, so that people who don't have to go and study every single one of them, you got the principle of it. So I tried to bring it and put it into social business format, this is one way, you can design your own thing and run every other social business.

NAVIGATING OPPOSITION

MSS: What were the biggest challenges that you faced when you started Grameen?

Yunus: The most difficult period was the initial period. That is the time people were making all kinds of opposition. The Mullahs were creating lots of problems, politicians were making it difficult. The ideological left were saying that we are trying to bring capitalism to our country and build capitalist system at the grass root level. They said that the people will smell profit and get addicted to it. I said you figure it out. I used to joke that we are only in 200 villages of Bangladesh and you are already screaming. There are 80,000 other villages where we are not there, so why don't you bring your revolution first? I would say, don't sit there and just scream.

MSS: And what happened with the article written by Daniel Pearl which appeared in the *Wall Street Journal*?

Yunus: Yes, that was a result of misunderstanding, total misunderstanding. He had some conceptions he built it up on that. So we had to protest.

MSS: Did that affect your international reputation?

Yunus: Of course, it was *Wall Street Journal*, front page news, because at that time Grameen was only thing that people knew. So, this demolished the whole thing, it was all negative things going around, and we had to protest that. And we did.

MSS: But it took a year or two to rebuild all your reputation back again.

Yunus: No, not just 2 years. It was a slow process. People always say what about Daniel pearl? After all you do they will still ask what about Daniel Pearl. See in the media once you bring it in it never disappears.

PERSONAL

MSS: Let me ask some personal questions. So how has your life changed after Nobel?

Yunus: See people have been talking about it, that you are going to get Nobel Prize, for many, many years. Every year the time comes and all will say this time you will get it. And after a while they talk as if something is wrong. I would be like I didn't say anything and now you are blaming me. So don't want to talk or discuss about it. Then suddenly when everyone had forgotten about it the announcement comes. Boom! And then it perks up the enthusiasm. Then in Bangladesh, and also in WB, everybody is filled with enthusiasm. So, that brought a lot of sense of pride. And that made Grameen and microcredit become the buzz word everywhere. Grameen bank is also a recipient of Nobel Prize, so this made us easy to explain to people who were making lots of debates, discussions, thoughts now that were kind of muted. So that has helped.

MSS: Also in your own discourse, I think though, you know all your businesses in cases where social businesses, you started talking about social business after that in a big way after Nobel.

Yunus: Because in my Nobel speech, I particularly focused on social business. See this is strange thing. There are many people who read the Nobel speeches very carefully, particularly young people, so they become familiar with that. Some started saying, "oh he stared social business after Nobel" because it is mentioned. It was there right from the beginning because I didn't see anything different what I was doing in finance or in solar energy. It feels the same way! So, it was part of us. It came to more attention because the prize happened. Another thing was that I started writing books on social business. At that time, I was doing social business but I didn't write anything, I had not theorized it. That theorization came with by arguments—by asking and answering questions. Then, I thought, why don't I write it down so that people can read it and understand it. So I wrote two books in the meantime and these books clarified things.

MSS: So, tell me you lead such a public life, do you get any private moments at all and what are your other interests?

Yunus: I really don't have much of others interests. I am kind of a one subject man and I enjoy that.

MSS: Do you have a concept of vacation at all?

Yunus: One way I try to explain my vacation is I say I am in a permanent vacation because I enjoy it and when you enjoy something, for example if you're a painter and takes a vacation he paints more, so for him job and recreation is the same thing.

MSS: One last personal question. You have made brief foray in to politics and came out of it. Another person I know who made a similar brief foray is Nandan Nilekani who ran for last elections for Member of Parliament. So, I bring this up to understand whether it triggers a totally different mindset to get into electoral politics? You would have been a great person to be in electoral politics as a leader because you have best thoughts and best design. So what happened?

Yunus: See I didn't want to join politics but we were in special circumstances at that time—there was military rule going on and all the politicians were in jail. Military rulers said they will hold elections. Since all the leaders were in jail about to be punished. Everybody was saying yes they should be punished, and if everybody is being punished how do you hold election? Who runs it and get elected?

So people came to me saying, "you are the only one; people recognize you; they admire you; you need to run and make politics clean." I said no, this is not my job, this is not what I do and I am not good as a politician. But they said "No no no … you have to do it and it's your responsibility." So they turned the issue as if I was avoiding responsibility and I just want to kind of bask in my glory, without seriously doing things. They accused me saying you have done your part and got Nobel Prize and so don't care what's happening.

So that made me think if I was escaping from responsibility. At one point, unilaterally, without discussing with anybody, I simply talked to the press and said I am going to join politics and I will create a party. I asked colleagues to pass on information through internet asking for people's opinions if I am doing the right thing or the wrong thing. Many said it's just the right thing, we need your leadership. Some said you are stupid and politics is not your job and somebody is manipulating you, may be army has put you in this. Even now there are people who think that army has put me in this thing.

MSS: And there was also a theory that you were backed by the American imperialists…

Yunus: Each one comes out with their versions; this is the way politicians think—they needed some conspiracy. I just did it on the spur of the moment. There was lot of enthusiasm lot of news and I said its fine. When the time came, people and press kept asking me when are you announcing the party, you said you will form a party and you have not done it yet. I said I will do it in my time.

I thought of the organization and did some serious thinking of how do I announce it and who should be with me when I announce the party. So I started talking to colleagues and friends and asked them if they were interested and if they would join me. The answer I get is "oh! no no"…. But, they are the one who pushed me.

I would get answers like "You know I am a professor I shouldn't join politics but I support you but I can't do that." Next, guys said "Oh! I am an editor my job is to edit the news properly, so but it's the right thing to do for you, but I can't join politics, thank you and I wish you success and I will be behind you". I got several such responses. Every one of them avoided to join as they were nonpolitical people.

Then something else happened. All the politicians who were in politics for a long time were coming to me from all directions because the army was hunting them and they were being put in jail. They felt if they come under shadow of this guy then army will not bother them because the army must be sympathetic to me and so they will be protected. So, to save their skin there were coming to me.

I saw that, and after several weeks, I said: "My God if I have to announce the party with them, people will ask if this was the party I was forming!!?" I could not do this. So I simply went to press again, not discussing with anyone. I announced that I am not going ahead and not forming a party and I stopped there. So I never formed a party. This is the transition I have gone through.

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About the Author

M.S. Sriram is a faculty at the Centre for Public Policy, Indian Institute of Management Bangalore (IIMB), Bengaluru. He is also a Distinguished Fellow at the Institute for Development of Research in Banking Technology set up by the RBI. In the past, he was the ICICI Bank Lalita Gupte Chair Professor of Microfinance at Indian Institute of Management Ahmedabad; was on the faculty of Institute of Rural Management, Anand; and was the Vice President (Finance and Information) at BASIX. He has also taught at IIM Udaipur, SP Jain Centre for Management in Dubai and Singapore, Solvay Brussels School of Business and Economics, and the Azim Premji University, Bengaluru.

Sriram is the co-author of three books—*Beyond Microcredit* (SAGE Publications) and two other books on flow of credit to small and marginal farmers. He also authored the *Inclusive Finance India Report* 2015 and 2016. His latest book is *Talking Financial Inclusion in Liberalised India: Conversations with Governors of Reserve Bank of India*.

Sriram has served on several committees set up by the GoI, RBI, and NABARD. He served on the External Advisory Committee of the RBI for granting licences to small finance banks and was the Chairman of the expert committee to set up the Kerala Cooperative Bank. He also writes regularly in the financial press. He is currently on the board of NDDB Dairy Services, Indian Dairy Machinery Company, Micro Credit Ratings International, and Centre for Budget and Policy Studies. He is also a trustee of Pratham Books and Dastkar Andhra.

SAGE Impact




Inclusive Finance India Report 2017 provides in-depth, well-researched, and well-analyzed evidence on how the financial inclusion agenda has progressed at various levels.

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M.S. Sriram is a faculty at the Centre for Public Policy, Indian Institute of Management (IIM) Bangalore. He is also a Distinguished Fellow at the Institute for Development of Research in Banking Technology set up by the RBI. In the past, he was the ICICI Bank Lalita Gupte Chair Professor of Microfinance at IIM Ahmedabad; on the faculty of the Institute of Rural Management Anand, Gujarat; and the Vice-President (Finance and Information) at BASIX, New Delhi. He has also taught at IIM Udaipur, SP Jain Centre for Management in Dubai and Singapore, Solvay Brussels School of Business and Economics, and Azim Premji University, Bengaluru.

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