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Microfinance India
State of the Sector Report 2013

Tara Nair
Ajay Tankha

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Microfinance India

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Microfinance India
State of the Sector Report 2013

Tara Nair
Ajay Tankha

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Abbreviations

ABEP Annual Branch Expansion Plan
ACH Automated Clearing House
ADFT Agri Development Finance Tamil Nadu Limited
AEPS Aadhaar-Enabled Payment Systems
AGB Aryavart Grameen Bank
AKMI Association of Karnataka Microfinance
AKRSP Aga Khan Rural Support Programme
ALW A Little World
ANANDI Area Networking and Development Initiatives
AP Andhra Pradesh
APBS Aadhaar Payment Bridge System
APMAS Andhra Pradesh Mahila Abhivruddhi Society
ASCA Accumulating Savings and Credit Association
ASSEFA Association of Sarva Seva Farms
B & DCs Business and Development Correspondents
BC Business Correspondent
BCA BC Agent
BCNM Business Correspondent Network Manager
BF Business Facilitator
BFL BWDA Finance Limited
BIRD Bankers Institute for Rural Development
BISWA Bharat Integrated Social Welfare Agency
BRICS Brazil, Russia, India, China and South Africa
BRLPS Bihar Rural Livelihoods Promotion Society
BSBD Basic Savings Bank Deposit
BSBDA Basic Savings Bank Deposit Account
BSFL Bharatiya Samruddhi Finance Limited
BSNL Bharat Sanchar Nigam Limited
BWDA Bullock-cart Workers' Development Association
CAB College of Agricultural Banking
CAR Capital Adequacy Ratio

CBO	Community-Based Organization
CBS	Core Banking Solution
CBSG	Community-Based Savings Group
CC	Cash Credit
CCB	Central Cooperative Bank
CCL	Cash Credit Limit
CDOT	Centre for Development Orientation and Training
CDR	Corporate Debt Restructuring
CECOEDECON	Centre for Community Economics & Development Consultants Society
CFL	Compact Fluorescent Lamp
CGAP	Consultative Group to Assist the Poor
CIC	Credit Information Company
CIF	Community Investment Fund
CMC	Central Management Company
CMF	Centre for Micro Finance
CMRC	Community-Managed Resource Centres
COCA	Code of Conduct Assessments
CoP	Community of Practice
CPA	Client Protection Assessment
CRISIL	Credit Rating Information Services of India Limited
CRM	Customer Relationship Management
CRR	Cash Reserve Ratio
CSC	Common Service Centre
CSP	Customer Service Point
CSR	Corporate Social Responsibility
CYSD	Centre for Youth and Social Development
DBT	Direct Benefit Transfer
DCCB	District Central Cooperative Bank
DDM	District Development Manager
DFID	Department for International Development
DFS	Department of Financial Services
DHAN Foundation	Development of Humane Action Foundation
DICGC	Deposit Insurance and Credit Guarantee Corporation
DLCC	District-Level Coordination Committee
DPIP	District Poverty Initiatives Project
DRDA	District Rural Development Agency
DWCD	Department of Women and Child Development
E2E	End-to-End
EBT	Electronic Benefit Transfer
ECS	Electronic Clearance Service
e-FMS	Electronic-Fund Management System
ENABLE	National Network Enabling Self-Help Movement
EU	European Union
FBC	Field Business Correspondent
FC	Farmers Club
FFSL	Future Financial Services Limited
FI	Financial Inclusion
FIF	Financial Inclusion Fund
FIP	Financial Inclusion Plan
FI Gateway	Financial Inclusion Gateway
FI Server	Financial Inclusion Server
FITF	Financial Inclusion Technology Fund
FL	Financial Literacy
FLCC	Financial Literacy and Credit Counselling Centre

FLDG	First Loss Default Guarantee
FSP	Field Support Provider
FWWB	Friends of Women's World Banking
G2P	Government-to-Person
GBA	Gramin Bank of Aryavart
GFSPL	Grameen Financial Services Private Limited
GIS	Geographic Information System
GIZ	Gesellschaft fur Internationale Zusammenarbeit
GK	Grameen Koota
GLP	Gross Loan Portfolio
GMSS	Gramin Mahila Swayamsiddha Sangha
GoI	Government of India
HMF	Housing Microfinance
IAY	Indira Awaas Yojna
ICB	Institutional Capacity Building
ICT	Information and Communications Technology
IFAD	International Fund for Agricultural Development
IFAPL	India FinServe Advisors Private Limited
IFC	International Finance Corporation
IFI	Index of Financial Inclusion
IFIF	India Financial Inclusion Fund
IFMR	Institute for Financial Management and Research
IIBF	Indian Institute of Banking & Finance
IIFM	Indur Intideepam MACS Federation
IIMPS	Invest India Micro Pension Services
IIN	Issuer Identification Number
IKP	Indira Kranthi Patham
IMEF	India Microfinance Equity Fund
IMFP	Indian Micro Finance Platform
IMO	Implementing Microfinance Organizations
INGO	International Non-Governmental Organizations
IOB	Indian Overseas Bank
IRCED	Institute of Rural Credit and Entrepreneurship Development
IRCS	IFMR Rural Channels and Services Pvt Ltd
IRR	Internal Rate of Return
IRV	Individual Rural Volunteer
ISMW	Indian School of Microfinance for Women
ITDA	Integrated Tribal Development Agency
IVFA	India Value Fund Advisors
JSLPS	Jharkhand State Livelihood Promotion Society
KCBP	Kalanjiam Community Banking Programme
KCC	Kisan Credit Card
KDFS	Kalanjiam Development and Financial Services
JLG	Joint Liability Group
LAB	Local Area Bank
LAN	Local Area Network
LIC	Life Insurance Corporation of India
LWE	Left Wing and Extremism
MACS	Mutually Aided Cooperative Societies
MAVIM	Mahila Arthik Vikas Mahamandal
M-CRIL	Micro-Credit Ratings International Ltd
MCSL	Mobile Commerce Solution Limited
MDS	Margdarshak Development Services
MEPMA	Mission for Elimination of Poverty in Municipal Areas

MFI	Micro Financial Institutions
MFIN	Micro Finance Institutions Network
MFO	Microfinance Opportunities
MFP	Minor Forest Products
MFT	Mutual Benefit Trust
MGNREGA	Mahatma Gandhi National Rural Employment Guarantee Act
MIS	Management Information System
MIX	Microfinance Information Exchange
MNO	Mobile Network Operators
MoF	Ministry of Finance
MSDF	Michael and Susan Dell Foundation
MSME	Micro, Small & Medium Enterprises
MTNL	Mahanagar Telephone Nigam Limited
MYRADA	Mysore Resettlement and Development Agency
NABARD	National Bank for Agriculture and Rural Development
NABFINS	NABARD Financial Services Limited
NACS	National Automated Clearing House
NBFC	Non-Banking Microfinance Companies
NBFC–ND–SI	Non-Deposit Taking Systemically Important Non-Banking Finance Company
NCD	Non-Convertible Debentures
NCR	National Capital Region
NEFT	National Electronic Fund Transfer
NFA	Non-Frill Account
NFS	National Financial Switch
NGO	Non-Governmental Organization
NIC	National Informatics Centre
NPA	Non-Performing Asset
NPCI	National Payments Corporation of India
NPS	New Pension Scheme
NRLM	National Rural Livelihood Mission
NTFP	Non-Timber Forest Products
OCPS	Optionally Convertible Preference Shares
OMR	Optical Mark Reader
P2P	Person-to-Person
PACS	Primary Agricultural Co-operative Societies
PANI	People's Action for National Integration
PAR	Portfolio at Risk
PEDO	People's Education and Development Organization
PFRDA	Pension Fund Regulatory and Development Authority
PFSPL	Pudhuaaru Financial Services Private Limited
PLF	Primary-Level Federation
PNB	Punjab National Bank
POS	Point of Sale
PPS	Pre-paid Payment Instruments
PRADAN	Professional Assistance for Development Action
PRF	Portfolio Risk Fund
PRI	Panchayati Raj Institution
PSIG	Poorest States Inclusive Growth
PVTG	Particularly Vulnerable Tribal Group
PwD	People with Disability
RBI	Reserve Bank of India
RD	Recurring Deposit
RFP	Request for Proposals
RFIP	Rural Financial Institutions Programme

RGCT	Rajiv Gandhi Charitable Trust
RGMVP	Rajiv Gandhi Mahila Vikas Pariyojana
RGVN	Rashtriya Grameen Vikas Nidhi
RMK	Rashtriya Mahila Kosh
RoA	Return on Assets
RoE	Return on Equity
RRB	Regional Rural Bank
RSBY	Rashtriya Swasthya Bima Yojana
RTGS	Real Time Gross Settlement
RUCHI	Integrated Rural Development through People Centered Environmentally Sustainable Action
SBI	State Bank of India
SBLP	SHG–Bank Linkage Programme
SCB	Scheduled Commercial Bank
SERP	Society for Elimination of Rural Poverty
SEWA	Self-Employed Women's Association
SFNL	Sarvodaya Nano Finance Limited
SGH	Self-Help Group
SHG-BLP	Self-Help Group–Bank Linkage Programme
SGSY	Swarnajayanti Gram Swarozgar Yojana
SHPI	Self-Help Promoting Institution
SIDBI	Small Industries Development Bank of India
SKDRDP	Sri Kshetra Dharmasthala Rural Development Project
SLA	Service-Level Agreement
SLF	State-Level Federation
SLI	Sustainable Livelihood Initiative
SLR	Statutory Liquidity Ratio
SOS	State of the Sector
SPM	Social Performance Management
SPV	Special Purpose Vehicle
SPTF	Social Performance Task Force
SRLM	State Rural Livelihood Mission
SRO	Self-Regulatory Organization
SSP	Social Security Pension
SSSM	Samagra Samajik Suraksha Mission
ST CCS	Short-Term Cooperative Credit Structure
TCPSL	Tata Communications Payment Solutions Limited
TLF	Tertiary-Level Federation
TNA	Training Needs Analysis
TRAI	Telecom Regulatory Authority of India
TSP	Technology Service Provider
UBI	Union Bank of India
UID	Unique Identification
UIDAI	Unique Identification Authority of India
UNDP	United Nations Development Programme
USB	Ultra Small Branches
USSD	Unstructured Supplementary Service Data
VKGB	Vidarbha Kshetriya Gramin Bank
VO	Voluntary Organization
VSLA	Village Savings and Loan Association
WLA	White Label ATM
WLAO	White Label ATM Operators
WSHG	Women Self-Help Group
ZMF	Zero Mass Foundation

Foreword

The dots are just not connecting. Each strand that delivers microcredit in India, largely, is caught in its own vortex of issues. The SHG–bank linkage programme is seeking to reinvent itself as it loses momentum and ennui seems to be setting in. The MFI channel is attempting to rebuild its lost credibility, as it strives to recover from the severe jolt it received from the Andhra Pradesh crisis. The Government of India's ambitious financial inclusion initiative ignores the other two channels; and, leveraging its clout and influence over the formal financial infrastructure, has a defined vision of opening 600 million 'no-frills' accounts through bank branches. Given the enormous inclusion challenge that exists, of bringing very large numbers of unreached population of the country under the ambit of formal finance, convergence and mutual reinforcement between the channels isn't an idea that has caught the fancy of policy makers yet.

The SHG programme, over the years, has lost pace and is sort of plateauing. This two-decade old programme, initiated by NABARD, while starting slow, showed a steady growth over the period. However, in the last three years, the pace of linkage has slowed down. As NABARD conceived it, SBLP did not include subsidies in its scheme of things. However, once the SGSY programme adopted SHG-based lending into its design, the programme suffered due to introduction of subsidies, poor quality of groups, defaults, high dropout rates and several other factors. Inadequate investments in SHG promotion as well as in building SHPI capacities have been a major issue in seriously attracting banks to lend to SHGs beyond the statutory obligation for priority sector lending. And now, with the full roll out of NRLM, matters are likely to get murkier, with no clear consensus between NABARD and NRLM on how the SHG programme will evolve in the future. Although large investments for capacity building are expected to flow, debt funding may suffer. As if, in response, the Government has already cleared the way for setting up of a National Women's bank to fund SHG financing.

While the MFI channel is said to be recovering from the aftermath of the Andhra episode, with debt and equity starting to trickle in, more effort will be required to restore its bruised and battered image. Given the stringent regulatory guidelines issued by the Reserve Bank of India, MFIs have no option but to comply, even if grudgingly. In view of the controversies raised post the Andhra Pradesh crisis, and in the absence of the Microfinance Act, there has been a lot of uncertainty among banks on whether to lend or not to MFIs. While on the one hand the banks are hesitant of being on the wrong side of the government by displaying aggressive intent towards lending to MFIs, they also have compulsion to fulfil their priority sector lending obligations. Except as a consequence of the Andhra Pradesh crisis, the recoveries from loans to MFIs have been near 100 per cent, making them the most secure risk-adjusted priority sector lending avenue. Once the Microfinance Bill is passed, it is expected that the ambivalence towards MFIs will be cleared and that there would be greater legitimacy for the channel and therefore, lessened political risk. Meanwhile, with fresh elections a few months away, it is likely that the jinxed Microfinance Bill will lapse for a second time. And, there's no certainty on what priority a new government will place on the passage of a new bill for the sector.

I met a few parliamentarians a few weeks ago, most of whom largely felt that MFIs were mostly thugs and money-lenders, charging high interest rates and treating their clients badly. If this was a broad-based opinion, it may be difficult for even the next, new government to steer the passage of the Microfinance Bill. SIDBI, IFC, Smart Campaign and SPTF are all engaged in building client-centric practices and a

responsible finance environment. However, unless principles are not fully instilled and entrenched in the work ethos of the MFIs, it may not be easy to influence the skepticism that prevails on the intent of these institutions. In a small way, ACCESS through its India Social Performance Report compiles and communicates good practices in the sector. Much more effort demonstrating the intent and disseminating the evidence will be critical in years to come.

The Government of India and the Reserve Bank of India, particularly in the last half a decade, have put in an enormous effort in advancing the financial inclusion agenda. Much of this effort is through pushing the formal financial institutions to respond more positively to the FI needs, through opening fresh branches in unbanked regions and employing BCs to strengthen last mile connectivity, and helping to open no-frills accounts. While in terms of numbers, significant progress appears to have been made, actual benefits of this linkage are not yet perceptible, with only a very few accounts activated. Importantly, the MFIs, despite their over 25 million outreach, are not seen to be a part of the Government's scheme of things. Ironically, even the SHGs, now being promoted by both NABARD and the Government and having an outreach of over 95 million are not included in the financial inclusion strategy of the Government, denying the opportunity to leverage and optimize the gains of a very large programme. To accomplish financial inclusion for 600 million unbanked, convergence perhaps needs to be seriously viewed. All mechanisms that have the potential to advance financial inclusion must be integrated into the plan. Given the reluctance of mainstream commercial banks to deal with small ticket size loans, particularly in servicing poor women clients, the Government has established a National Bank for Women. And currently, it is also exploring the possibility of establishing a new category of 'small finance' banks. While all these policy initiatives will have impact over time, to hasten outcomes, the Government and the RBI will do well to look at convergence possibilities and potential with all strands of delivery of financial services.

Given that the financial inclusion campaign of the Government is a much larger effort, the State of the Sector Report has a much wider coverage of the FI efforts of the government than in the past. It takes stock of the progress under various FI initiatives, assesses the impediments to their viability, describes the ways of harnessing technology and other opportunities as also critically appraises the performance. This is an important departure from the past format. The Report also critically analyzes the two channels of microcredit, viz. SBLP and MFIS, besides providing a scan of the policy environment.

After the phenomenal contribution of N. Srinivasan for anchoring the author responsibility for four continuous years and raising the prestige of this reference document, we had a real task at hand when he desired to step down from the responsibility. In some manner, we were fortunate in getting Puha (Venugopal Puhazhendhi) to offer his services to write the SOS and we managed to get the 2012 edition out in time, matching the quality and analysis of previous years. This year, we decided to form a team of accomplished researchers as authors who had depth of sectoral knowledge to analyze the full financial inclusion ecosystem and string together a cogent narrative. We were extremely fortunate to identify Ajay Tankha and Dr Tara Nair who agreed to come together and write the SOS. Ajay has studied and critiqued the microfinance models as practised across the world, and has undertaken important research assignments within the country. In fact, last year, he authored the important book on 20 Years of the SHG programme, which has been extremely well received within the sector. Tara, who is currently Associate Professor with Gujarat Institute of Development Research, is equally well known as a senior researcher within the sector, regularly contributing to journals and writing on related issues. This will perhaps be the first year when two authors will have jointly worked on the SOS. I am happy with the strong effort that the two have put in as a team to meet and interview sector experts, participate in consultations, glean through secondary literature and scan relevant data to put together this edition of the SOS. I'd like to thank both Ajay and Tara for coming on board, and helping in bringing out the Report. While I am sure it will have its own distinct flavour, characterizing the authors' styles, the quality of narration and analyses will be of the same high standards that the SOS is known for.

Although the effort of bringing together the State of the Sector Report is anchored in ACCESS, we consider this as a sectoral effort. Several stakeholders contribute to its successful publication. I'm most grateful to SIDBI, NABARD, IFC and UNDP for their continued support to the publication. Their long-term support helps in giving stability to the initiative. Particularly for this, I would like to acknowledge the generous additional contribution from IFC, when we confronted cost overruns. Jennifer Isern was quick to agree to pitch in with additional resources. I'm also thankful to Maneesha and Citibank Foundation, Arindom and Rabobank Foundation and Ranjani and Dia Vikas for their support to the SOS for 2013.

I also take the opportunity to thank Vijay Mahajan for taking time out to provide some fresh ideas and insights on the need to build an inclusive banking structure for India for greater impetus to financial inclusion. The authors have used the Discussion Paper creatively to build a case for the need and significance for a new category of 'small finance banks' for pushing the financial inclusion agenda. As always, Navin Anand provided the tremendous support through the UNDP Solutions exchange to seek inputs for the Report, and also organizing a Consultative Round Table of sector experts. He's been a tremendous support all along. I'd like to also thank RGVN and Amiya Sharma for hosting a Round Table in the North East to help the authors on the challenges the region faces in accessing financial services. Technical inputs from Liz Larson and MIX have always been forthcoming to help strengthen the SOS; and the MIX data source is always an important source for tracking sector trends. Similarly, I can always count on MFIN to provide all their Reports and analysis for the Report. I'd like to extend a special thanks to Alok and Sugandh, who were super cooperative. Similarly, I'm thankful to Sitaram at the World Bank to provide information on NRLM. A whole lot of people from the sector like C. S. Reddy, APMAS; Manoj Sharma, Microsave; CMF, Chennai; Rama and Jonna from GIZ give valuable suggestions and share their work to enrich the SOS, and I'm most grateful for this support. Anurag Jain, JS, Ministry of Finance provided key insights on the status of the jinxed Microfinance Bill and on policy initiatives of the Government. Most importantly, I'm deeply indebted to the Group of Advisors to the Microfinance India Summit for providing important guidance on the flow and structure of the SOS, and I would like to particularly thank Shri Y. C. Nanda, Shri Brijmohan and Srinivasan for their quality inputs. I'd also like to thank Vibhu Arya who came on board as a technical support to the authors, who helped with locating important material for the Report, particularly on financial inclusion and on BCs. His constant support was most valuable.

And finally, I'd like to thank my own colleagues from both ACCESS and ACCESS ASSIST. Led by Radhika, Executive Director ACCESS-ASSIST, and ably supported by Nilesh Arya, Juhi Natu, Deepak Goswami, Ashim and Tushar, who together provided useful information to the authors, organized meetings and consultations, accompanied the authors and streamlined processes. This small team takes on a lot of burden, with a high sense of responsibility and commitment, which I value immensely. From ACCESS, there was a huge support from Lalitha, who smartly provided the logistics support to the authors, always smiling. I'm super proud of the spirited response of the teams to a challenging task.

This will be the 7th edition of the SOS, and without its broad ownership by the whole sector, to bring out a quality document year after year, would have been hugely difficult by ACCESS alone. While I'd like to thank all stakeholders for their tremendous support to this initiative, it's important to emphasize that to enhance the credibility of the sector and to disseminate the issues and challenges it confronts, we need strong documentation to share more widely among policy makers to influence and inform. I'm glad that the SOS has become one such good mechanism. We're glad that the other effort, viz. the India Social Performance Report too has come to be regarded as a credible document of the sector. It's important for all stakeholders to use and share these reports to advance the cause of the sector. I hope the SOS 2013 continues to serve its desired purpose and remains a worthwhile effort.

Vipin Sharma
CEO
ACCESS Development Services

Preface

It has been an honour to be invited to participate in the preparation of *Microfinance India: State of the Sector Report 2013*. Over the years, the SOS Report has come to be recognized as the singular publication that combines data from multiple sources with insights from the worlds of both policy and practice to provide an impartial commentary on the world of Indian microfinance. As first time authors of this report, we have been conscious of the seriousness of this responsibility. Despite our familiarity with the travails of writing evidence-based reports on microfinance, we often were overwhelmed by the enormity of information infirmities—such as missing/inconsistent/non-comparable data, lack of documentation of even the most celebrated and highly process-oriented interventions—that characterize the sector. Following the previous authors, we have tried to transcend these obstacles by soliciting the support of a wide-ranging set of resource persons and institutions. As a result, we have incurred substantial moral and intellectual debt on the way to completing this report.

The advisory group of Microfinance India comprising Y. C. Nanda, Brij Mohan, N. Srinivasan and others had extensive consultations with the authors and helped in creating the initial roadmap for the report. Vipin Sharma's efficient and graceful leadership ensured that the process of production of the report went smoothly even while there were moments of anxiety mainly due to the delay in getting access to some critical data. The support of the ACCESS team—Radhika Agashe, Nilesh Arya, Juhi Natu, Lalitha Sridharan and Ram Narayan Ghatak—was unstinting.

Anurag Jain, Joint Secretary—Ministry of Finance, in an extended discussion shared his views on the microfinance sector and the proposed Bill while highlighting the nuanced aspects of policy making. Vijay Mahajan made a very valuable contribution to the report by preparing a paper on alternative banking structure. The United Nations Solution Exchange hosted two rounds of e-discussions and also arranged a roundtable with practitioners and other stakeholders on SOS 2013. We are indebted to Navin Anand and Mohammad Anas for all the effort made by them in this regard. We are grateful to the many organizations that we visited, and their staff who shared their thoughts and experiences, often through detailed presentations. A fuller list of organizations and individuals is given in Annexure 5. The seven self-help group promoting NGOs covered in the report too generously shared data on their organizations for the report.

MFIN shared all its reports, which formed the substantial database for the MFI sector analysis. We are thankful to Sugandh Saxena for being prompt and supportive. Elizabeth Larson and Amit Mittal of MIX provided enthusiastic support and access to MIX database, apart from being available on several occasions for extended discussions and extensive help in analysis.

Rashtriya Gramin Vikas Nidhi (RGVN), Guwahati, cohosted with ACCESS a roundtable of the issues in microfinance in the north-east region which was very well-attended. We are indeed grateful to Amiya Sharma and team as also to Abhijit Sharma for the warmth of their welcome and for leading the discussions covering a host of issues. The participants represented a range of sector stakeholders—National Bank for Agriculture and Rural Development (NABARD), Small Industries Development Bank of India (SIDBI), non-governmental organization micro financial institutions (NGO–MFIs), Non-Banking Financial Company MFIs (NBFC–MFIs), resource organizations and banks in the region.

Jonna Bickel, Amit Arora and Ramakrishna from GIZ were not only most 'cooperative' in sharing their research and their own ideas but also showed much enthusiasm for the report. Discussions with Mathew Titus

of Sa-Dhan and Vijayalakshmi Das of Ananya Finance were enriching and helped us reflect on some of the critical challenges the sector faces currently.

C. S. Reddy, S. Ramalakshmi and K. Raja Reddy, as always, showed much interest and gave many suggestions and subsequently offered several study reports from Andhra Pradesh Mahila Abhivruddhi Society (APMAS), which have been liberally used. Manoj Sharma and team were a major source of support and provided, as usual, plenty of invaluable material from MicroSave's research and consulting work including a timely policy brief.

Sitaramachandra Machiraju gave a rich and comprehensive insight into the work of World Bank's National Rural Livelihood Project (NRLP) and National Rural Livelihood Mission (NRLM) processes at short notice. Arvind Kumar Chaudhary and Mukesh Sharan took time off from an important meeting to share the work of BRLPS and Jeevika. G. V. S. Reddy patiently shared details of the work of Stree Nidhi and SERP. NABARD officers in Mumbai and other centres offered their own impressions of the SHG–bank linkage programme and MFI issues. Particularly helpful were R. N. Kulkarni, B. S. Suran, G. R. Chintala, Bharath Kumar, Ramesh Tenkil, P. K. Panda, D. K. Mishra and Krishna. P. K. Saha and A. R. Samal of SIDBI, Lucknow, spent a long afternoon discussing the events that led the microfinance sector to where it is now. NABFINS team led by Y. K. Rao provided much information and ideas.

An interaction with Anurag Agrawal of Intellecap was highly informative. Manoj Nambiar of IntelleCash/Arohan was gracious enough to prepare a caselet on Arohan for the report.

Gaurav Singh of Grameen Foundation showed great interest in the report and was generous in sharing the Foundation's own studies and materials. Gaurav Kumar of IFMR Trust has shared some very insightful material from the IFMR stable, which enhanced our understanding of the working of MFIs.

Association of Karnataka Microfinance (AKMI), the wonderful organization that it is, facilitated meetings with many of its members. A special word of thanks to Suresh Krishna (Grameen Koota) who took great interest in making the meetings happen. V. S. Radhkrishnan (Janalakshmi), Samit Ghosh (Ujjivan), V. N. Salimath (IDF), Anand Rao (Chaitanaya) and N. Venkatesh (Samastha) spared their time graciously discussing at length their approach to microfinance and the issues that concern the sector. Rahul Mittra (Margdarshak, Lucknow) provided useful insights into the MFI as BC model.

During the writing of the report, we received assistance from Vibhu Arya, who prepared material on financial inclusion and business correspondents (BCs) for use in the report. In addition, he conducted interviews with private bankers for the report. Sanjay Krishnan, Ishan Vaish and Sanjay Kuberkar supported with thematic notes and material. Deepak Goswami, Ashim Kumar Roy and Tushar Krishna from ACCESS too provided efficient research assistance.

Finally, a special debt goes out to Phani Priya, independent research professional who, as for earlier ACCESS studies, spent long hours with utmost dedication to attend to a wide range of research tasks, from data compilation and analysis and writing up of case studies and briefs to preparing transcripts from the audio files.

It was pleasure working with Rudra Narayan Sharma, Alekha Chandra Jena, Anupam Choudhury and the SAGE team who worked skillfully and cheerfully to bring out this Report in a very short period of time.

While we have tried to present an understanding of the status of microfinance in India on the basis of the latest available data, we are aware of many limitations in the report. Our sincere apologies to those persons whom we may have missed out in the acknowledgements. Notwithstanding the help and support received from many parties, we remain responsible for all the errors and shortcomings in the report.

Tara Nair
Ajay Tankha

Revival and renewal: microfinance in the era of financial inclusion

1
Chapter

The Twelfth Five Year Plan Approach Paper for the first time identifies financial inclusion as a public policy initiative to achieve rural transformation and development.[1] Defined as the process of improving access to organized financial market for ordinary households, especially in excluded and underserved areas, the concept of financial inclusion has become expansive enough over the last couple of years to accommodate the multiple financial sector innovations introduced at varying points of time. This is reflected in the Approach Paper as it asserts that financial inclusion 'should build on the existing positive experience of Self Help Groups (SHGs), Kisan Credit Cards, ongoing experiments with mobile banking and business correspondents, as well as with stand-alone micro financial institutions (MFI)'.[2] This signifies a great transition in the approach to financial inclusion—from opening more and more rural branches to creating an inclusive architecture of financial service delivery by integrating the available social and physical technologies and building–nurturing relationships among them. And this implies greater convergence of policy and regulatory exercises between the government and the central bank.

The overall approach to financial inclusion being what it is currently, microfinance is no longer a sector exogenous to the country's financial system, but a distinct methodology of delivering rather limited financial services. The delivery of microfinance happens under multiple organizational identities that are governed by diverse legal regulations. Thus, the microfinance sector in India is an amalgam of diverse organizations that are critically dependent on the financial system players for their sustenance. They compete among themselves and with the rest of the channels for on-lending resources. This year's State of the Sector (SOS) Report attempts to (*a*) unravel the major patterns of change within three major legal organizational forms: SHGs, for-profit microfinance companies and non-profit microfinance organizations; (*b*) explain the relationship among these forms and between them and the other system players (banks, investors, government, central bank); and (*c*) review the main facets of the recent policy and regulatory changes that have a bearing on financial inclusion in general and microfinance in particular.

MFIs: IN SEARCH OF ORDER IN GROWTH

As the previous two SOS Reports highlighted, the major concern that drives the Indian microfinance sector post the Andhra Pradesh crisis is 'orderly growth'. The Reserve Bank of India (RBI) has made significant headway in putting a set of regulatory guidelines to be followed by the non-banking microfinance companies–micro financial institutions (NBFC–MFIs, as named by the RBI), which account for a dominant share in the MFI clients and portfolio. However, having sculpted a flexible and inclusive framework of legislation for the MFIs, the Ministry of Finance is currently stuck in the process of democratic politics. The passage of a central law is seen vital by the MFIs, especially by the NBFCs, to counter the political risks associated with the provincial states asserting their constitutional competence to rein in MFIs as money-lending agencies.

Despite the stalemate with respect to the enactment of the Microfinance Institutions (Regulation and Development) Bill 2012, the NBFCs are found to be optimistic about the future of microfinance. The shadow that the Andhra Pradesh crisis had cast over the for-profit microfinance entities has been lifted, though it has caused a few MFIs to shrink

themselves. 'The worst is over'—that is the dominant feeling among them. With the RBI stepping in, bank lending back in some shape, investment flows picking up momentum and growth rates settling down to decent levels, the sector seems to be ready to give itself a second chance, to come out with 'a new normal'.

The past couple of years also witnessed the emergence of 'client' as the protagonist in all the major events around microfinance. The self-regulatory initiatives are mainly woven around strengthening the mechanisms of gathering client-level information. Multiple instruments—code of conduct, client protection principles and fair practices code—are being used to reinforce the idea of responsible microfinance. Many lending institutions have started insisting on MFIs' taking membership in credit bureaus to ensure that multiple lending does not happen. It is reported that this has increased the rate of rejection of microfinance loans at the MFI level. How do these initiatives impact the lives of individuals who engage with microfinance? The evidences still are inconclusive.

Globally, the assessments about the sector's ability to sustain itself have turned largely positive. The 'Microfinance Barometer 2013' reported the revival of growth, though at lower rates compared to 2009,[3] whereas the 2012 annual survey of MicroRate indicated the re-emergence of the demand for funds from microfinance institutions reenergizing microfinance investment vehicles and accelerating competition. The global data, however, shows that microfinance is growing as a concentrated industry, structurally and spatially. Also, it is reported that the institutional investors who form about 40 per cent of the investor base, 'have shifted their emphasis decidedly towards financial return'.[4] 'Social investment', a concept that gained currency in the wake of the moral crisis of the microfinance sector in the late 2000s, seems to remain another buzzword sans any substance.

SHGs: THE NEW DILEMMAS

The SHG programme has always enjoyed the pride of place among all the poverty-focused initiatives implemented so far in the country. The progress made by the programme in creating a model of distributed micro financial institutions used and managed by poor women is one of the most widely documented stories of independent India. As the model has passed through the second decade of its advent in the country, concerns are raised about its apparent stagnation over the past few years. The latest National Bank for Agriculture and Rural Development (NABARD) report on the status of microfinance[5] describes quite graphically the situation that SHG–Bank Linkage Programme (SBLP) has been facing in recent years:

> While all the stakeholders of this highly successful micro credit initiative ride on past glory, there are clear signs of the initial excitement turning into pride and then to complacency. The rapid growth of SHG-BLP also led to more aggressive targets.... The result was an overall dilution in the basic premise of Self Help and group cohesion to achieve the subsidy targets set by the Government. Group formation is increasingly perceived as a means to have access to Government Subsidies and entitlements and thus have serious implications for the future of the movement.[6]

NABARD's displeasure with mass promotion of subsidized SHGs by the government is evident. Clearly, there has been very limited convergence between the efforts made by the state in promoting SHGs under the Swarnajayanti Gram Swarozgar Yojana (SGSY) and by NABARD. Even when SHGs are absorbed into government-promoted federated structures, their importance as organic collectives of the poor is seriously undermined. Not to talk about those SHGs which have been formed by non-governmental organizations (NGO)–MFIs/NBFCs as sheer credit delivery structures. The National Rural Livelihood Mission (NRLM), despite its hype and promise of developing SHGs and their federations as the institutional structures of the poor, is yet to demonstrate the merits of its strategy.

Further, there are reports of 'bank fatigue' setting in. The NABARD data bears this out. During the period 2010–13, only 60 per cent of the SHGs with bank accounts, on an average, have received bank loans. This being the case, how far can incremental innovations like the 'SHG 2', which has introduced modified financial products (like voluntary savings and cash credit/overdraft system), be effective is a critical question that does not have a clear answer as yet.

The most intriguing aspect of financial inclusion is that it has completely bypassed the SBLP by positioning itself as an individual-centred and technology-based strategy to link the unbanked with formal financial service providers. According to NABARD, 'no serious attempt was made to leverage the SHG-BLP to achieve the FI goals'.[7] As of now, the focus of financial inclusion (FI) strategy seems narrow

and target-led without much concern for sustainable provision of required financial services or livelihood support of the targeted population. Business correspondent (BC) channels too have shown infirmities and are yet to stabilize.

It is true that stung by the outcomes of the Andhra Pradesh crisis, the microfinance sector is feeling the pressure to form new alliances and ways of doing business. Their efforts are moderated by certain tendencies that have come to characterize the sector. For instance, there seems to be a 'size bias' developing steadily across channels. In the MFI sphere, there is evidence of bias in favour of the 'large and the regulated', while the small and the unregulated find it difficult gain the attention of banks and investors. Within the SHG sector, smaller NGOs find it difficult to raise grant funds for SHG promotion even as government programmes and state-level rural livelihood missions garner much of the funds and gather the staff of NGOs, as they are able to offer better pay and other conditions of employment. Even in the BC space, small seems to be irrelevant. As a consequence of the auctioning of BC partnerships, unrealistically low margins necessitate players with deep pockets working with high volumes. Though the common BC concept appears to have been abandoned, the space for smaller BCs is also circumscribed.

Nevertheless, the financial inclusion project being larger than the MF sector offers enough opportunities for both MFIs and SHGs to enhance the scope of their activities. There are many instances where MFIs and self-help promoting institutions have been successful in forging meaningful partnerships with government agencies and financial institutions to further the agenda of financial inclusion. Indeed, banks such as State Bank of India (which has credit-linked more than half a million SHGs and extended loans worth ₹56,000 million as of 31 March 2013), Canara Bank, Union Bank and Indian Bank continue to repose their faith in SHGs. Notwithstanding the stagnation in the number of SHGs with loans outstanding and the disappointing performance in many states during the last year, there continues to be optimism about the future of SHG bank linkage both among public sector banks as well as the relatively new players from among private banks. There is enough scope within the ongoing financial inclusion/rural development programmes to develop synergies with microfinance. Thus, the lumbering elephant of NRLM, with its measured and idealistic notions of community-based finance, might eventually deal with the potentially nimble crocodile of technology-based BC operations reaching deep into the hinterland.

ABOUT STATE OF THE SECTOR 2013 REPORT

Unlike other regions, Indian microfinance is not monolithic in its structure. Since the time the concept was introduced in the late 1980s, it has evolved by drawing upon the existing institutional architecture of social and cooperative banking as also on newer models and approaches. As a result, the concept of microfinance is more complex to comprehend in the Indian context and the sphere of public policy around it cluttered and inconclusive.

Notwithstanding these challenges, this year's Report is structured in line with the critical themes of current microfinance discourse. The Report locates itself within the financial inclusion debate, as that is the overarching philosophical foundation of microfinance. Similarly it explores the institution of business correspondents, as it runs parallel to the social technologies of microfinance provision raising important questions about the scope and means of their integration, modification and phasing out. The role of technology could not be overlooked, given its catalysing role in making inclusion work in the coming years. Against these broad themes, the status of the two main channels of microfinance provision—the SHG–bank linkage model and the microfinance institution model—over the last one year is discussed in the Report.

The Report is divided into nine chapters. Chapters 2 and 3 look at the current status of and pattern of changes in the SBLP as well as the MFI model. The pattern of flow of funds into MFIs is analysed in detail in Chapter 4. The performance of financial inclusion programme and its links with the microfinance sector forms the theme of Chapter 5, while Chapter 6 is exclusively dedicated to a detailed examination of the working of the BC model, specifically with reference to the trends in SHGs and MFIs acting as BCs. Technology being one of the prime drivers of financial inclusion, Chapter 7 presents some important aspects of technological innovation in the banking and microfinance sectors that have decisively impacted their efficiency and performance. Many argue that the emergence of small finance banks would mark the logical culmination of the financial inclusion programme as it would lead to its institutionalization. Chapter 8 discusses this idea in the context of the recent debates on the restructuring of the banking sector at the behest of the RBI. Some of the prominent policy initiatives and the progress of their implementation are reviewed in Chapter 9.

NOTES AND REFERENCES

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2. Ibid., pp. 65–66.
3. Convergences. 2013. *Microfinance Barometer 2013*. Paris: Convergences.
4. MicroRate and Luminis. 2012. *The State of Microfinance Investment 2012*. Arlington, VA: MicroRate.
5. NABARD. 2013. *Status of Microfinance in India 2012–13*. Mumbai: Micro Credit Innovation Department, National Bank for Agriculture and Rural Development.
6. Ibid., p. 3.
7. Ibid., p. 4.

SHGs and financial inclusion: progress and future prospects for SHG–bank linkage

2

Chapter

The SBLP has now completed more than 21 years of existence. Though SBLP is a savings-led and savings-linked programme, its main thrust has been in the provision of microcredit. During much of this period, credit flow under SBLP grew uninterruptedly on account of support from public sector banks, NGOs and the implementation of government programmes of SHG promotion. However, the SBLP, which followed virtually an exponential growth path for around 18 years or so, has during the past three years shown signs of having levelled off. While the programme consistently performed better in the southern states, where conditions for its adoption were more favourable on many counts, the performance has been affected in these states as well.

This chapter presents an analysis of the growth performance of the SBLP during recent years based on the NABARD status reports on microfinance in India. This is followed by a stocktaking of SHG–bank linkage, financial intermediation models of self-help promoting individuals (SHPIs) and community organizations, the status of SHG federations, the scope and limitations of the SHG 2 initiative of NABARD and NRLM, and the perspective of banks and other stakeholders on the role of SHGs in financial inclusion. This is followed by reporting on some recent studies on SHGs. It concludes with a discussion of the future prospects for SHGs and SBLP in the era of financial inclusion.

PROGRESS OF SBLP

The progress of SBLP since 2009 is given in Table 2.1. The latest NABARD data (NABARD, 2013)[1]

Table 2.1 Growth trends in SBLP

Particulars	2009	2010	2011	2012	2013
No. of SHGs with outstanding bank loans*	4,224,338	4,851,356	4,786,763	4,354,442	4,451,434
Of which in southern region*	2,283,992	2,582,112	2,706,408	2,355,732	2,415,191
Share of southern region (%)	54	53	57	54	54
Loans disbursed to SHGs during the year (₹ billion)#	122.54	144.53	145.48	165.35	205.85
Average loan disbursed during the year per group (₹)#	76,131	91,081	121,625	144,048	168,754
Total bank loan outstanding to SHGs (₹ billion)*	226.79	280.38	312.21	363.41	393.75
Average loan outstanding per SHG (₹)*	53,687	57,794	65,224	83,457	88,455
Incremental groups with outstanding loans (million)	0.60	0.63	(-)0.06	(-)0.43	0.096
Incremental loans outstanding (₹ billion)	56.77	45.90	33.53	57.22	30.35
No. of SHGs with savings accounts with banks* (million)	6.12	6.95	7.46	7.96	7.32
Total savings of SHGs with banks (₹ billion)*	55.46	61.99	70.16	65.51	82.17
Average savings of SHGs with banks (₹)*	9,060	8,915	9,402	8,230	11,229

Source: Srinivasan, N. 2011. *Microfinance in India: State of the Sector Report, 2011*. New Delhi: ACCESS Development Services, SAGE Publications; Puhazhendhi, V. 2012. *Microfinance in India: State of the Sector Report, 2012*. New Delhi: ACCESS Development Services, SAGE Publications; NABARD. 2013. *Status of Microfinance in India 2012–2013*, Mumbai: MCID Department. http://nabard.org/departments/pdf/Micro%20Finance%202012-13.pdf.
Notes: *As on 31 March 2013; #During the year ended 31 March 2013.

shows a small increase of 2 per cent in the number of SHGs with outstanding bank loans on 31 March 2013 as compared to a year earlier. This reversed the decline during 2010–12. However, the number is yet to reach the peak level it had attained with 4.8 million loan clients on 31 March 2010. The share of the southern states in SHG loan accounts remained stable at about 54 per cent in 2012 and 2013.

The volume of fresh loans issued by banks to SHGs during 2012–13 showed a significant growth of 24.5 per cent to reach ₹205.85 billion. The average loan outstanding was ₹88,455 on 31 March 2013 as against ₹83,457 a year earlier. There was a 6.3 per cent increase in the number of SHGs getting fresh loans from banks, suggesting repeat financing and deepening of loans to credible SHGs rather than a significant growth in new SHGs.

Despite significant growth (25.4 per cent) in bank savings of SHGs, the number of savings-linked groups declined between 2012 and 2013, with a consequent increase in average savings. The decline in number of SHGs is explained by the adoption of better reporting standards by banks, such as counting only operative SHG accounts. They also stopped reporting cumulative figures. As in the previous year, State Bank of India showed a reduction (6.35 lakh) in the number of savings-linked SHGs. The number of Swarnajayanti Gram Swarozgar Yojana (SGSY) groups savings-linked with banks came down by 3.6 per cent, signifying its impending closure in 2013.

The growth in SHG loan outstanding (8.4 per cent) during 2012–13 is almost four times that in the number of SHGs having outstanding loans with banks (2.2 per cent). This gap, it is apprehended, could in part be the result of increased non-performing assets (NPAs) of SHG loans with banks.

Annual growth rates of the major indicators of physical and financial progress of SBLP for the three-year period since 2010, the year of the crisis in Andhra Pradesh, confirm the impression of stagnation and decline (Tables 2.2 and 2.3).

It is evident that both physical and financial performance of SHGs suffered during 2010–13. In the case of physical performance, all indicators, except the number of SHGs having bank savings, experienced negative growth or decline during 2010–13 as compared to 2006–10. There was drastic deceleration in

Table 2.2 Growth in physical progress of SBLP (compound annual growth rate [CAGR])

		Change (%)			CAGR (%)	
S. No.	Indicator	2010–11	2011–12	2012–13	2010–13	2006–10
1	Number of SHGs having savings accounts with banks	7.3	6.7	–8.1	1.72	27.5
2	Number of SHGs receiving loans during the year	–24.6	–4	6.3	–8.37	26.4
3	Number of SHGs receiving loans during the year under SGSY	–9.9	–12.9	–13.8	–12.20	12.79
4	Number of SHGs with loan outstanding	–1.3	–9	2.2	–2.83	18.78*
5	Number of SHGs with loan outstanding under SGSY	3.3	–5.4	–1.9	–1.42	21.9*

Sources: NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.
Note: * From 2007 to 2010.

Table 2.3 Growth in financial progress of SBLP (CAGR)

		Change (%)			CAGR (%)	
S. No.	Indicator	2010–11	2011–12	2012–13	2010–13	2006–10
1	Outstanding savings of SHGs with banks	13.2	–6.7	25.4	9.85	26.9
2	Bank loan disbursed to SHGs during the year	0.66	13.7	24.5	12.51	33.8
3	Bank loan disbursed under SGSY	12.8	6.6	–16.5	0.14	16.25
4	Bank loans outstanding with SHGs	11.4	16.4	8.4	11.98	31.3*
5	Bank loans outstanding with SHGs under SGSY	25.2	2.9	6.7	11.21	24.25*

Sources: NABARD. 2010. *Status of Microfinance in India 2009–10*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.
Note: *From 2007 to 2010.

the growth rate of SHGs with bank accounts. As for the financial indicators, the growth slowed down significantly for all indicators between the two periods. The decline was higher in the case of loans under the SGSY. However, the loan outstanding from banks to SHGs between 2010 and 2013 grew by about 40 per cent from ₹280 billion to ₹394 billion (i.e. 10 per cent per year).

SAVINGS PERFORMANCE

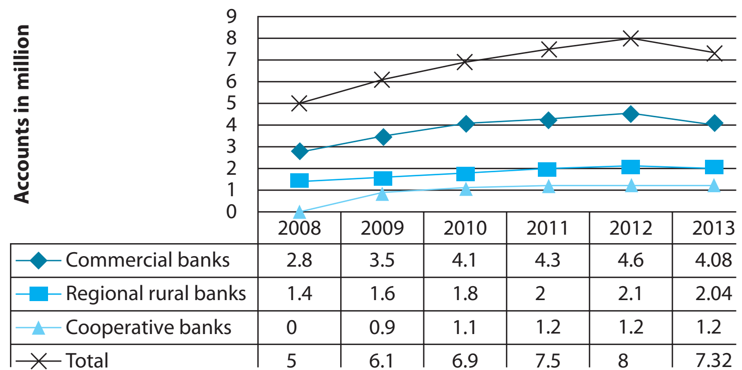
The number of SHGs savings-linked with the banking system grew steadily since 2008 and had peaked at 7.96 million groups in March 2012. The number declined to 7.32 million as at the end of March 2013 (Figure 2.1).

The total savings amount of SHGs in banks had grown consistently between 2008 and 2011. It seems to have picked up momentum again in 2013 after a blip in 2012 (Figure 2.2). Savings constitute nearly 21 per cent of outstanding loans as on 31 March 2013—up from 18 per cent a year earlier. In other words, SHGs are important contributors to the resources being mobilized by banks. It may, however, be noted that banks do use savings deposits as collateral for the loans given to SHG members. Such instances have been reported where banks have recovered loans from the savings of SHG members.

Between March 2012 and March 2013, the number of SHGs accounts declined across states. But most of the states registered reasonable increases in the amount of bank savings of SHGs. The exceptions are Maharashtra, Chhattisgarh and the north-eastern states of Nagaland, Tripura and Sikkim. Data on state-wise performance of SHG savings with banks is given in Appendix 2.1.

Among the financing agencies, commercial banks had the leading share (56 per cent) in the number of groups with savings accounts, while RRBs had 28 per cent of accounts, and cooperative banks 16 per cent (Figure 2.3). There has been no significant change in these shares. Commercial banks accounted for two-thirds of the amount saved by SHGs as on 31 March 2013. RRBs had one-fifth of the SHG savings, while cooperative banks held about 14 per cent (Figure 2.4). Over the years commercial banks improved their share in SHG savings consistently at the expense of cooperative banks; RRBs have more or less maintained their share.

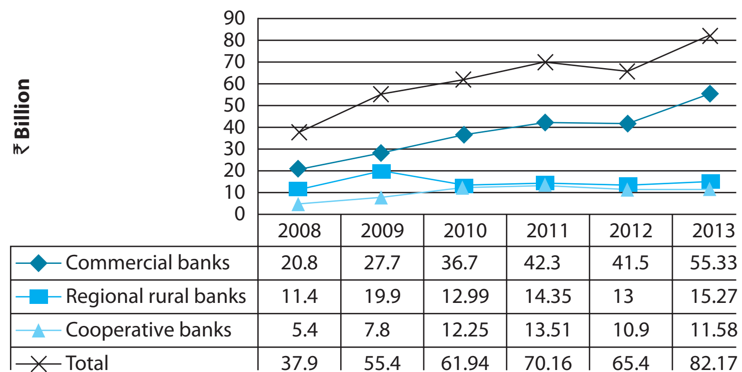
The changes in savings per SHG during 2010–13 do not show any clear pattern. Average savings increased between March 2010 and March 2011 for all types of banks (Table 2.4). It declined in the following year and again increased by March 2013. Cooperative banks showed the highest average



	2008	2009	2010	2011	2012	2013
Commercial banks	2.8	3.5	4.1	4.3	4.6	4.08
Regional rural banks	1.4	1.6	1.8	2	2.1	2.04
Cooperative banks	0	0.9	1.1	1.2	1.2	1.2
Total	5	6.1	6.9	7.5	8	7.32

Figure 2.1 Number of SHGs holding savings accounts: 2008–13

Sources: NABARD. 2008. *Status of Microfinance in India 2007–08*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2009. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2010. *Status of Microfinance in India 2009–10*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.



	2008	2009	2010	2011	2012	2013
Commercial banks	20.8	27.7	36.7	42.3	41.5	55.33
Regional rural banks	11.4	19.9	12.99	14.35	13	15.27
Cooperative banks	5.4	7.8	12.25	13.51	10.9	11.58
Total	37.9	55.4	61.94	70.16	65.4	82.17

Figure 2.2 Savings growth by SHGs: 2008–13

Sources: NABARD. 2008. *Status of Microfinance in India 2007–08*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2009. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2010. *Status of Microfinance in India 2009–10*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

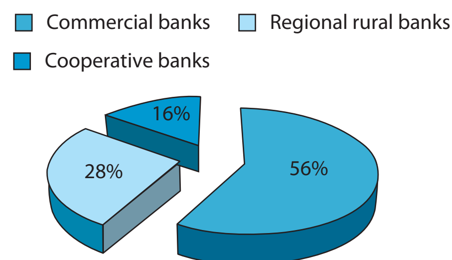


Figure 2.3 Number of savings accounts of SHGs with banks (31 March 2013)

Source: NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

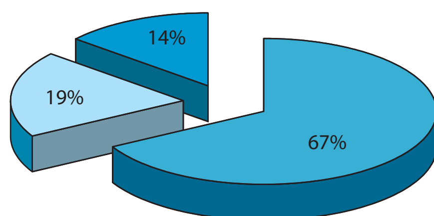


Figure 2.4 Savings amount of SHGs with banks (31 March 2013)

Source: NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

savings in 2010 and 2011, whereas in 2013 commercial banks took that slot.

The decline in the number of SHGs savings-linked to banks was consistent across all regions, including the southern region (by 4 per cent). Among the major states, Karnataka recorded a positive growth of 3 per cent.

While increased savings by SHGs with banks is heartening, especially relative to the loans outstanding, it is not clear whether it represents a longer-term trend or is symptomatic of denial of credit facilities to the groups. Also, it does not reduce the importance of making a variety of savings options and products available to both SHGs and members as part of the wider financial inclusion drive.

REGIONAL SPREAD OF LENDING PROGRAMME

If the regional picture is considered, the shares of the southern and eastern regions in loans outstanding have remained virtually unchanged between 2009 and 2013. Indeed, the marginal increase of less than 2 per cent in the number of SHGs with outstanding loans is spread more or less evenly across the various regions, as can be seen in Table 2.5. Average loan outstanding against SHGs as on 31 March 2013 was ₹88,455, which was marginally up from ₹83,457 as on 31 March 2012. The average loan outstanding ranged from ₹50,000 per SHG in the Western region to approximately ₹114,000 in the southern region. Appendix 2.2 presents the comparative picture of outstanding loans across states over the past two years.

Appendix 2.3 presents the regional shares in fresh loans disbursed over 2011–12 and 2012–13. The southern and central regions improved their shares (by nearly 20 per cent and 10 per cent respectively) over this period, while the north-eastern states recorded a 50 per cent decline. The average loan amount disbursed was about ₹169,000 per SHG during 2012–13. It ranged from ₹70,600 in the eastern region to over ₹200,000 in the southern region.

If we compare the change in the number of SHGs with outstanding loans and fresh disbursements in the 10 leading states, considerable variations can be observed (Table 2.6). In the case of Andhra Pradesh,

Table 2.4 **Average savings of SHGs by agency**

Agency		Commercial banks	RRBs	Cooperative banks	Total
Average savings per SHG (₹)	2010	9,055	7,134	11,348	8,915
	2011	9,784	7,235	11,696	9,402
	2012	8,986	6,111	8,972	8,230
	2013	13,571	7,493	9,629	11,229
Percentage share in savings accounts	2010	58	26	16	100
	2011	58	27	15	100
	2012	58	27	15	100
	2013	56	28	16	100
Percentage share in total savings with banks	2010	59	21	20	100
	2011	60	20	19	100
	2012	63	20	17	100
	2013	67	19	14	100

Sources: NABARD. 2010. *Status of Microfinance in India 2009–10*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

Table 2.5 **Regional share in linkage: SHGs with outstanding loans**

Region	2009 No. of SHGs	2009 Share (%)	2010 No. of SHGs	2010 Share (%)	2011 No. of SHGs	2011 Share (%)	2012 No. of SHGs	2012 Share (%)	2013 No. of SHGs	2013 Share (%)
Northern	166,511	3.9	152,491	3.1	149,108	3.1	212,041	4.9	213,955	4.8
North-eastern	117,812	2.8	133,785	2.8	150,021	3.1	159,416	3.7	143,660	3.2
Eastern	933,489	22.1	1,027,570	21.2	1,105,533	23.1	985,329	22.6	1,020,656	22.9
Central	332,116	7.9	497,922	10.3	358,872	7.5	352,452	8.1	362,521	8.1
Western	393,499	9.3	457,476	9.4	316,821	6.6	289,472	6.6	295,451	6.6
Southern	2,280,911	54.0	2,582,112	53.2	2,706,408	56.5	2,355,732	54.1	2,415,191	54.3
All	4,224,338	100	4,851,356	100	4,786,763	100	4,354,442	100	4,451,434	100

Sources: NABARD. 2010. *Status of Microfinance in India 2009–10*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

Table 2.6 **Number of SHGs with loan outstanding and bank disbursements**

States	Number of SHGs with loan outstanding 2012	Number of SHGs with loan outstanding 2013	Number of SHGs with disbursements 2012	Number of SHGs with disbursements 2013
Andhra Pradesh	1,400,995	1,356,720	378,526	484,292
Tamil Nadu	514,203	511,859	179,902	150,586
West Bengal	382,942	494,166	99,379	95,284
Odisha	314,669	277,954	49,831	47,676
Karnataka	266,978	379,305	87,943	145,733
Bihar	223,033	185,309	39,241	30,574
Maharashtra	214,012	219,651	68,396	54,749
Uttar Pradesh	212,922	228,646	34,497	33,140
Kerala	159,843	153,336	55,242	60,830
Madhya Pradesh	60,815	65,358	8,751	15,182

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

this number marginally declined in 2012–13. It may be noted that the state had witnessed a decline of 17 per cent in SHGs with loan outstanding between 2010–11 and 2011–12. The number of SHGs with loans outstanding increased substantially only in Karnataka and West Bengal, and to a small extent in Madhya Pradesh and Uttar Pradesh. All other major states showed a decline in this number.

However, the number of SHGs receiving loans during the year 2012–13 was up by nearly 28 per cent in Andhra Pradesh over the previous year and by as much as 65 per cent in Karnataka and 73 per cent in Madhya Pradesh. All the other states, with the exception of Kerala, showed a decline in the number.

If we consider the amount of loan outstanding from banks to SHGs as on 31 March 2013 as compared to a year earlier (Table 2.7), again a mixed picture emerges. While loan outstanding has gone up in several states including Andhra Pradesh, Tamil Nadu, West Bengal and Odisha, it has virtually stagnated or declined in the other states. The volume of loans disbursed by banks during 2012–13 has increased significantly over the previous year in the leading states of Andhra Pradesh, Tamil Nadu, Madhya Pradesh and Karnataka by 37 per cent, 41 per cent, 44 per cent and 52 per cent, respectively, while stagnating or declining in the other states. Particularly remarkable is the decline

Table 2.7 Loan outstanding and disbursed amounts to SHGs

	Loan outstanding (₹ billion)		Disbursements (₹ billion)	
States	**2012**	**2013**	**2012**	**2013**
Andhra Pradesh	153.42	174.81	81.71	111.64
Tamil Nadu	46.39	50.40	19.33	29.16
Karnataka	34.70	32.94	16.29	22.99
Uttar Pradesh	20.32	19.57	4.45	4.51
Kerala	17.79	16.78	8.54	8.99
Odisha	16.53	17.97	5.41	4.73
West Bengal	15.70	24.24	5.51	5.14
Maharashtra	11.63	12.29	6.02	5.78
Bihar	10.41	9.32	3.99	2.22
Madhya Pradesh	4.14	4.44	0.95	1.37

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

by 44 per cent in the disbursements to SHGs in Bihar. The latest data on state-wise distribution of credit-savings ratio is provided in Appendix 2.4.

From the patterns observed in the earlier sections, it appears that banks continue to lend to well-established SHG clients in the leading states while holding back in other states where the SHG movement does not enjoy strong institutional support. Some of these states are those where pilots under government programmes and NRLM have been initiated. However, they do not appear to have shown results as yet in terms of financial inclusion through SHGs outside the selected areas of the respective states through the spread of the SBLP. Indeed, the decline in performance in several relatively backward states is a source of much concern.

PERFORMANCE OF BANKS IN SHG LENDING

The number of SHGs with loan outstanding from banks was 4.45 million, up nearly 97,000 over the previous year (Table 2.8). The percentage share of commercial banks in the number of SHGs was 59 per cent, the share of RRBs 30 per cent and of cooperative banks 11 per cent (Figure 2.5), representing virtually no change over the previous year's shares in loan outstanding.

The loan outstanding by banks to SHG was ₹393.75 billion as on 31 March 2013 (Figure 2.6). Of this, ₹266.39 billion was accounted for by commercial

Table 2.8 Loan outstanding by agency

	Number of SHGs		Loan outstanding (₹ billion)	
Agency	**2012**	**2013**	**2012**	**2013**
Commercial banks	2,617,199	2,643,971	258.10	266.39
Regional rural banks	1,293,809	1,327,367	86.14	105.21
Cooperative banks	443,434	480,096	19.16	22.15
Total	4,354,442	4,451,434	363.40	393.75

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

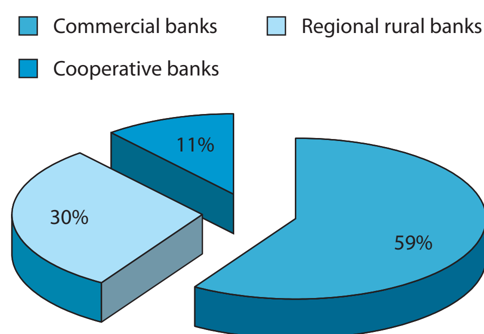
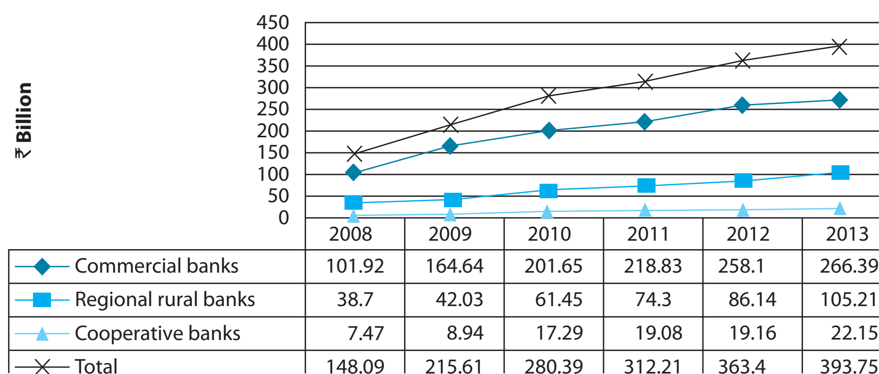


Figure 2.5 Number of SHGs with outstanding loans

Source: NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.



	2008	2009	2010	2011	2012	2013
Commercial banks	101.92	164.64	201.65	218.83	258.1	266.39
Regional rural banks	38.7	42.03	61.45	74.3	86.14	105.21
Cooperative banks	7.47	8.94	17.29	19.08	19.16	22.15
Total	148.09	215.61	280.39	312.21	363.4	393.75

Figure 2.6 Loan amount outstanding with various agencies (2008–13)

Sources: NABARD. 2008. *Status of Microfinance in India 2007 -08*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2009. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2010. *Status of Microfinance in India 2009–10*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

banks, ₹105.21 billion by RRBs and ₹22.15 billion by cooperative banks, representing 68 per cent, 27 per cent and 5 per cent of total respectively (Figure 2.7 and Table 2.7).

Commercial banks had a share of 60 per cent in the number of loans disbursed during 2012–13, followed by regional rural banks (RRBs) at 26 per cent and cooperative banks at 14 per cent (Table 2.9). The share of commercial banks went up from 52 per cent during 2011–12, while that of cooperative banks declined significantly from 21 per cent in 2011–12. The share of RRBs remained virtually unchanged.

As far as the volume of loans disbursed was concerned, commercial banks had a share of 65 per cent during 2012–13, RRBs 27 per cent and cooperative banks 8 per cent. The corresponding shares during 2011–12 were 60 per cent, 30 per cent and 9 per cent, respectively (Table 2.10).

Commercial banks Regional rural banks
Cooperative banks

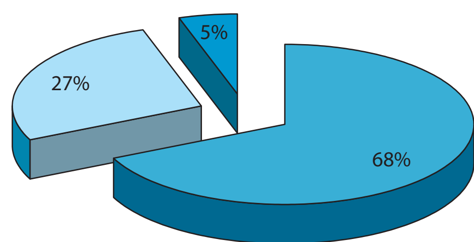


Figure 2.7 Outstanding loan amount of banks with SHGs

Source: NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

Table 2.9 **Percentage of loan outstanding by agency**

	Average loan outstanding per SHG (₹)		Percentage share: Number of SHGs		Percentage share: Amount of loans	
Agency	2012	2013	2012	2013	2012	2013
Commercial banks	98,618	100,755	60	59	71	68
Regional rural banks	66,575	79,264	30	30	24	27
Cooperative banks	43,211	46,129	10	11	5	5
Total	83,455	88,455	100	100	100	100

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

Table 2.10 **Average loan disbursed by agency**

	Average loan disbursed per SHG (₹)		Percentage share in number of loans disbursed		Percentage share in amount of loan disbursed	
Agency	2012	2013	2012	2013	2012	2013
Commercial banks	165,477	181,966	52	60	60	65
Regional rural banks	164,890	180,331	27	26	30	27
Cooperative banks	64,682	91,378	21	14	9	8
Total	144,048	168,757	100	100	100	100

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

NON-PERFORMING ASSETS (NPAs)

As reported by NABARD, the overall NPAs of bank loans to SHGs were ₹27.87 billion as on 31 March 2013 against ₹22.13 billion a year earlier, representing an increase of 26 per cent (NABARD, 2013).[2] Gross NPAs, which were 2.94 per cent of outstanding bank loans to SHGs as on 31 March 2010, increased to 6.09 per cent by 2012 and to 7.08 per cent in 2013. The increase in NPAs between 2012 and 2013 was as high as 31 per cent to 65 per cent in regions other than the south and west. Southern region with 5.11 per cent (4.98 per cent in 2012) had the lowest percentage of NPAs, while central region with 17.3 per cent (13.2 per cent in 2012) had the highest. Andhra Pradesh and Karnataka had a little over 3 per cent NPAs. A source of concern was the high NPAs in major states like Madhya Pradesh (21.16 per cent), Uttar Pradesh (18.22 per cent), Odisha (18.27 per cent), Tamil Nadu (10.81 per cent) and Kerala (12.38 per cent).

An analysis of NPAs by type of banks shows that the NPAs of commercial banks and cooperative banks were both over 8 per cent of the total loan outstanding as on 31 March 2013 (Table 2.11). As against this, the NPA percentage of RRBs was comparatively moderate at 4.1 per cent. In fact, the NPA percentage of commercial banks, which was the lowest at 2.6 per cent of total outstanding to SHGs as on 31 March 2010, has steadily risen each year to its present level. Similarly, in the case of cooperative banks, the NPA percentage has more than doubled from under 4 per cent in 2010 to its present level. The NPAs of regional rural banks have been relatively stable at around 4 per cent, with the exception of 2012. The question of banks' NPAs is of the highest concern at the present time. A variety of local and more widespread causes are contributory. Factors in the increase of NPAs range from the poor quality of groups formed, the weak monitoring of loans by banks on account of staff shortages, the effect on SHG repayments of loan waivers and political promises, etc.

PROGRESS OF SBLP IN THE PRIORITY STATES

Despite the overall growth and expansion of the SHG programme across the country, there are states that have been inadequately covered. In the mid-2000s, NABARD had identified 13[3] states with large number of the poor, but SBLP performance lower than the potential. These states have been assigned priority for up-scaling SBLP in partnership with NGOs. The NABARD Status Report 2012–13 provides data on the progress of 10 such states, which is analysed in this section.

Outreach and savings

With respect to SHG outreach Odisha recorded the highest coverage—293 per cent—in 2013 followed by Maharashtra (92 per cent) and Assam (80 per cent). The lowest coverage was recorded by Madhya Pradesh (32.5 per cent). West Bengal recorded the highest average savings of ₹12,388—10 per cent higher than the national average of ₹11,230, followed by Uttar Pradesh (₹9,705). The average savings per SHG were the lowest in Assam (₹3,966).

Number of loans disbursed

West Bengal topped the priority states in terms of number of loans disbursed over 2011–13. However, the number consistently declined in the state from 1.32 lakh in 2010–11 to 0.95 lakh in 2012–13. Similarly, though Madhya Pradesh disbursed the least number of loans in the years 2010–11 (0.08 lakh) and 2011–12 (0.09 lakh), it topped the priority states in terms of SHG loans disbursed during 2011–12

Table 2.11 Non-performing assets of banks and loans outstanding to SHGs

Agency	2010		2011		2012		2013	
	Amount of NPAs (₹ billion)	NPAs to the total loan outstanding (%)	Amount of NPAs (₹ billion)	NPAs to the total loan outstanding (%)	Amount of NPAs (₹ billion)	NPAs to the total loan outstanding (%)	Amount of NPAs (₹ billion)	NPAs to the total loan outstanding (%)
Commercial banks	5.38	2.67	10.67	4.88	16.55	6.41	21.76	8.17
Regional rural banks	2.18	3.55	2.73	3.67	4.26	4.95	4.31	4.1
Cooperative banks	0.67	3.88	1.34	7.02	1.31	6.84	1.8	8.13
Total	8.23	2.94	14.74	4.72	22.13	6.09	27.87	7.08

Sources: NABARD. 2011. *Status of Microfinance in India 2010–11*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

and 2012–13 with growth rates of 67 per cent and 87 per cent respectively. West Bengal recorded the highest average savings in 2012–13, despite experiencing negative growth rate in the number of SHG loans disbursed during the period under review. Assam and Odisha experienced negative growth rate during each of the three years. Chhattisgarh, Jharkhand and Bihar started with a positive growth rate but slipped to a negative growth rate in the years 2011–12 and 2012–13.

Amount of loans disbursed

The highest amount of loans was disbursed by Maharashtra in 2011–12 (601.8 crore) and 2012–13 (578.06 crore). Chhattisgarh disbursed the least amount through the three years. Only Madhya Pradesh experienced the highest growth rate in loan amount disbursed to SHGs during the years 2011–12 (43.8 per cent) and 2012–13 (19 per cent). Odisha and West Bengal which experienced continuous negative growth rates in the number of SHG loans had similar experience in loan amounts disbursed across the three years.

The average bank loan issued was the highest in Uttar Pradesh during 2011–12 and 2012–13—₹131,003 and ₹136,661 respectively. Jharkhand, Madhya Pradesh and Assam recorded continuous negative growth rate across the years. The state of Bihar started with a positive growth rate in 2010–11, which turned to negative in the following two years.

Loan outstanding

Both in 2010–11 and 2011–12, Uttar Pradesh recorded the highest amount of loan outstanding. However, West Bengal topped the list in 2012–13 (₹2,424 crore). All the states except Bihar, Uttar Pradesh and Rajasthan displayed growth in loan amount outstanding across the years.

Non-performing assets

NPAs as percentage of loan outstanding was the highest in Madhya Pradesh in 2011–12 (22.4 per cent) and 2012–13 (21.2 per cent). The situation with respect to NPAs worsened in West Bengal, Uttar Pradesh and Rajasthan over the years, whereas in Assam, Bihar and Chhattisgarh witnessed improvement.

NABARD SUPPORT TO SHGs DURING 2012–13

During 2012–13, grant assistance of ₹45.62 crore was sanctioned by NABARD to 514 agencies, that is, NGOs (489), RRBs (10), CCBs (14) and individual rural volunteers (IRVs) (1) acting as SHPIs for promoting and credit-linking around 97,862 SHGs. In cumulative terms, promotional grants amounting to ₹229.81 was spent on 7.74 lakh SHGs. Cumulatively ₹61.99 crore was released for the formation of 4.49 lakh SHGs, of which 2.83 lakh were credit linked. The NGOs were the most dominant of SHPIs, forming more than three lakh SHGs. The glaringly low levels of grant support as also utilization of the sanctioned support have been critiqued time and again.

Box 2.1 Re-engineering NABARD's financial support to SHPIs

Over a period of more than 15 years up to 2011–12 NABARD sanctioned an amount of ₹184.17 crore for promoting 675,661 SHGs. A further ₹45.62 crore was sanctioned for promoting and credit-linking 97,862 SHGs during 2012–13. However, only ₹55.28 crores (or less than 30 per cent) was released for promoting 417,053 SHGs, at an average of ₹1,325 per SHG as against an estimated promotional cost of more than ₹10,000 per SHG (as per NABARD's Women Self-Help Group [WSHG] scheme and that of Rural Development Department, Government of India [GoI]). As of March 2012, less than 5 per cent of the total number of savings-linked SHGs had been promoted with financial support of NABARD.

Andhra Pradesh Mahila Abhivruddhi Society (APMAS) suggests that NABARD needs to select 'credible' NGOs that have multiple sources of funding. Suggested criteria for NGO selection could be as follows:

- Functional for at least 5 years with experience in promoting SHG/SHG federation and/or producer collectives.
- Large NGOs can partner with NABARD as resource NGOs. Each resource NGO can be sanctioned 1,000 to 5,000 SHGs based on their track record and their future potential.
- Promotional cost per SHG should be ₹10,000 to be released over 3–5 years.
- Capacity building of the SHG members must be seen as a continuous process. For SHGs to become self-reliant institutions, a system of self-regulation (their own system of audit, grading, training and internal controls) needs to be institutionalized.

Source: APMAS. 2013. 'Note on NABARD's Financial Support to SHPIs for SHG Promotion: Certain Suggestions Based on APMAS' Experience' (unpublished note).

During 2012–13, NABARD conducted 5,098 training programmes with about 1.82 lakh participants. Cumulatively, around 30.30 lakh participants have been imparted training on various aspects of microfinance.

Under the WSHG programme, which is being implemented in association with the central government in 150 selected districts in 28 states, NGOs are meant to serve as business facilitators (BFs), tracking and monitoring groups and their loan repayment. As on 31 March 2013, 50,001 WSHGs were savings linked and around 11,100 credit linked. NABARD released ₹16.94 crore as grant assistance out of the WSHG Development Fund for various activities under the scheme. Further grant assistance of ₹60.58 crore was sanctioned for the promotion of 3.17 lakh joint liability groups (JLGs), which form part of the WSHG strategy. During 2012–13, ₹1,819.96 crore was disbursed by banks to around 1.96 lakh JLGs, taking the cumulative loan disbursement to ₹4,665.65 crore for 5.28 lakh JLGs.

NABARD launched three pilots using information and communications technology (ICT)-based solutions to streamline the accounting and bookkeeping in SHGs. A web-based application was also launched for real time updation of the progress made by the assisted SHPIs in the formation and credit linkage of SHGs. As on 31 March 2013, about 2,800 partner SHPIs had registered and updated their progress online.

With NABARD's support, the Rajiv Gandhi Mahila Vikas Pariyojana (RGMVP), a special initiative of the Rajiv Gandhi Charitable Trust (RGCT), in Uttar Pradesh promoted 86,529 SHGs, of which, 29,906 were credit linked as on 31 March 2013. In addition, 2,624 cluster-level federations and 68 block-level federations were also formed under the programme.

SHG 2

The NABARD circular of 27 March 2012 revisited the SBLP and noted some of the issues that are known to affect the programme's successful implementation, such as (*a*) inadequate outreach in many regions; (*b*) delays in opening of SHG accounts and disbursement of loans; (*c*) impounding of savings by banks as collateral; (*d*) non-approval of repeat loans, even when the first loans were repaid promptly; (*e*) multiple membership and borrowings by SHG members within and outside SHGs; and (*f*) limited banker interface and monitoring. It proposed the launching of SHG 2 with the following product level and system changes:

1. SHG members should be allowed to park their surplus fund with the group in the form of voluntary savings.
2. Cash credit/overdraft system of lending for SHGs should be sanctioned to enable SHGs to be flexible in meeting their frequent needs and help them reduce the cost of borrowing.
3. SHG members who are in a position to expand economic activities that require higher levels of loans may be allowed to form JLGs within SHGs.
4. Risk-mitigation systems (such as self-rating tools and SHG-level audits) are to be introduced to strengthen the bankers' confidence in SHGs.
5. Well-functioning SHGs and NGOs may be engaged by banks as BFs.
6. Monitoring and training mechanisms must be strengthened.

The question arises whether SHG 2 addresses policy-level issues or operational requirements, or neither? Seibel[4] noted that NABARD recognizes the need for voluntary savings facilities as a process 'to steadily graduate from community banking to individual banking'. However, he questioned NABARD's suggestions regarding the following: (*a*) overdraft/cash credit facility for SHGs based on projection of internal funds; (*b*) credit for JLGs of the entrepreneurial members among SHGs; and (*c*) business facilitators from among SHGs and NGOs. On account of the declining interest of banks in SHG banking, Seibel finds these suggestions far-fetched, particularly in the light of a complex SHG federation structure evolved for this purpose and which is at the centre of the NRLM, launched in 2011. In fact, neither NRLM nor federations are mentioned in the circular. SHG 2 also does not consider the future of SHGs, particularly the role of primary- and higher-level federations that have been promoted on a large scale. This includes a role for primary federations at village level acting as village banks in providing savings facilities. It would appear that the experience of promotion of SHG federations in Andhra Pradesh, Tamil Nadu, Bihar, Uttar Pradesh and other states has not been brought to bear in planning the SHG 2 framework and products.

The aforementioned reservation about SHG 2 is more widely shared as well by SHG promoters. However, NABARD does not favour a role for SHG federations as financial intermediaries despite supporting those under RGMVP and Gramin Mahila Swayamsiddha Sangha (GMSS), Maharashtra, and providing grants to federations to promote SHGs. In fact, Prakash Bakshi, Chairman, NABARD, in an interview to the *Microfinance State of the Sector*

Report, 2011 (Srinivasan, 2011),[5] pointed to the rise of different means of reducing risk and transaction costs, such as technology and BCs other than SHGs. He indicated that BCs would be used as SHPIs and transaction points for the SHGs. Experienced SHG members can be mobilizers for new SHGs linked with bank branches through BCs, thus eliminating the role of federations completely. However, both the mobilizers and the BCs need to be appropriately incentivised. The SHPIs supported by grants could be considered as BFs to banks. Though NABARD seems to lack conviction with respect to the suitability of federations as platforms for financial intermediation in the future, a few pilots have been launched to create a role for SHG members and for SHG federations within the BC model. These are discussed in Chapter 6.

Other components of SHG 2 have attracted adverse reactions. The proposed voluntary savings facility at SHG level has its critics as it has been introduced without any pilot testing. It would create net savers and creditors within SHGs, with the former assuming primacy and leadership roles. There may be problems related to loaning funds among members collected through such deposits. Similarly, the formation of JLGs from among the SHG members in order to access larger loans is fraught with risk, as members are obliged to act as guarantors for big-ticket loans unlike the case of the modest *grameen*-style operations.

Overall, SHG 2 does not provide a roadmap for SHG development, especially in the face of important state initiatives both in the financial services and livelihoods spaces. At a time when the BC model is taking new strides, NABARD is silent on the role of SHGs and their relationship to the new strategy within or outside the SBLP. It continues with the target-oriented promotion of SHGs even while accepting their eventual inevitable decline as financial intermediaries in view of the universal provision of individual bank accounts and the emergence of the BC channel. Proactive leadership by NABARD is imperative to ensure continued growth and relevance of SHGs.

Box 2.2 A savings group alternative

Elements of the SHG 2 approach are supported by proponents of a relatively small initiative that claims to address some of the shortcomings of the SHGs. According to Wilson,[6] the Aga Khan Foundation and its partners[7] in India have enjoyed success with a method called Community Based Savings Groups (CBSGs), which assists rural and peri-urban women and men in putting their financial resources to work. There were 35,390 members of these groups in Bihar as on 31 March 2013.

Under the CBSG model, a group of 15–20 women meets regularly, usually twice per month, and purchases shares in a group fund. After just a few weeks of meeting, members may request to borrow money from the fund for any purpose they choose. At the end of the year when all loans have been repaid with interest, the group 'shares out' its corpus,[7] distributing share capital and income proportionate to the shares held back to members. The model has the capacity to foster financial flexibility and social inclusion to a greater degree than that offered by SHGs because (*a*) the clarity of the share and passbook system eliminates complicated bookkeeping; (*b*) the flexibility of the share system matches the cash flow of members; and (*c*) the periodic share-out eases important shuffling and reshuffling of membership.

CBSGs are neither financially federated nor clustered structures, which deter easy group formation and dissolution. The members can simultaneously be members of conventional SHGs. The CBSG approach instructs groups to consider the creation of separate social fund, a kind of insurance for members to address household emergencies.

The CBSG approach builds on the philosophy of the pioneers in the SHG movement. It blends well with the provisions of SHG 2 related to voluntary savings and JLGs within the SHG, as the entire group need not guarantee a bank loan. Smaller subgroups or JLGs might borrow with their members guaranteeing.

Source: Adapted from Wilson, Kim. 2013. 'Turning Cold Money Hot: What the SHG Movement Can Learn from an Alternate Approach.' September. http://sites.tufts.edu/feinstein/2013/turning-cold-money-hot (accessed on 22 September 2013).

SHPIs AND SHG-BASED COMMUNITY ORGANIZATIONS AS FINANCIAL INTERMEDIARIES

There are six main financial intermediation models or channels adopted by SHPIs in providing access to loans to the SHGs and their members. Table 2.12 describes these models and provides some examples of organizations that follow them.

Table 2.12 Financial intermediation through SHPIs and community organizations

Model of financial intermediation	Method of provision of loans to SHG	Example
Direct linkage of SHGs to banks through SBLP	Term loan or credit limit from banks at 10–12%	SHGs of PRADAN, MYRADA and other SHPIs
Indirect SHG–bank linkage through parent NGO–MFI	Bank loans intermediated by NGO–MFI	SKDRDP
Through SHPI-promoted MFIs:		
Not-for-profit	Retailing of loans from banks and other financial institutions	Sanghamitra
NBFC		SNFL, BFL
Business correspondent	SHPI acts as agent for bank's loans and savings products	SKDRDP, Chaitanya
Financial federations	Bank loan on-lent by federations to SHGs	Chaitanya/GMSS, GRAM

Source: Compiled from SHPI reports and documents.

Sri Kshetra Dharmasthala Rural Development Project (SKDRDP) has been playing the role of BC for State Bank of India, Union Bank of India, Canara Bank and Corporation Bank for the last four years. CMRCs promoted by Mysore Resettlement and Development Agency (MYRADA) have taken up the role of BCs for NABARD Financial Services Limited (NABFINS) and earn a commission of 2 per cent. NABFINS expects the BCs to provide capacity-building support and other developmental support to the SHGs and hence uses the term 'Business and Development Correspondents' (B & DCs). In spite of the financial intermediation role played by SHG federations, banks are reluctant to recognize them as BCs and instead engage the promoting NGOs for the role. Bullock-cart Workers Development Association (BWDA) and Chaitanya, for example, act as BCs for YES Bank. Chaitanya and GRAM have promoted SHG federations and mobilized savings from groups and members to create a fund.

In view of the legal limitations of societies and trusts in mobilizing savings, a number of NGOs, especially in Andhra Pradesh, have registered their SHG federations under the liberal cooperative act (Mutually Aided Cooperative Societies [MACS] Act). However, MACS generally continue to be managed and controlled by the NGOs supporting them. There are no major instances of NGOs having phased themselves out of involvement in MACS and financial cooperatives promoted by them. Also, studies in Andhra Pradesh suggest that the role of SHGs had become virtually irrelevant—with loans being decided at higher MACS levels, meetings not being held and savings being collected informally.

A common feature in all the financial intermediation models and innovations involving NGO–MFIs or in-house 'not-for-profit' or 'for-profit' entities is that the role of the SHG as financial intermediary is effectively eliminated. Loans to SHGs financed from borrowed funds leave little or no margin for SHGs and are invariably passed on to members at the same rate.[9] This creates a dependency relationship between the NGO and SHGs. Some promoters may continue to encourage SHGs to depend on their own funds and funds directly borrowed from local banks under the SBLP.[10] The BC channel is observed to have begun to find favour with the SHG promoters and NGO–MFIs and even NBFCs.

FINANCIAL INTERMEDIATION THROUGH SHG FEDERATIONS: PROSPECTS

With regard to quality, self-management and sustainability, there is still a long way to go as many SHG federations are dependent on their promoters to meet operational costs. Also, for them to effectively support their members and to grow over a period of time they must become autonomous. In many states, SHG federations are used for channelizing various government schemes and benefits. While these efforts are to be appreciated, there is a danger of federations being co-opted by the government. This will undermine their self-management and sustainability further. There are other challenges such as the appropriate legal form for these federations to become body corporates, effective financial management systems and the availability of advisory services.

Federations of SHGs, where promoted, faced difficulties in leveraging loan funds from banks. In 2006, RBI[11] included registered federations among the agencies eligible to act as BCs/BFs. Though in many parts of India, banks have realized the potential

of federations in facilitating bank linkage and recovery, they have hardly come forward to use federations as BCs/BFs. NABARD also does not recognize MACS as financial intermediaries because of doubts over their governance and management, their limited assets and the past record of credit cooperatives. However, due to the credibility of the promoting NGOs, a significant number of MACS are getting loan funds through their respective parent organizations in different states. In Tamil Nadu also bankers have issued loans to panchayat-level federations. It is likely that the NRLM with its critical role for a federated SHG structure could yet ensure a wider acceptance of federations in financial intermediation.

The RBI circular[12] of 27 June that dealt with the role of banks in NRLM indicates that under the Mission a community investment fund (CIF) will be provided to the SHGs in the intensive blocks, routed through the village-level/cluster-level federations to be maintained in perpetuity by the federations. The CIF will be used to advance loans to the SHGs and/or to undertake the common/collective socio-economic activities. It stops short of indicating a clear role for federations to intermediate borrowed funds over and above this limited facility. However, all federations are to be registered under appropriate state acts. If the instrumentality of federations in recommending loans to SHGs is recognized, then there is nothing that prevents routing of loans through them. The annexure to the circular suggests that federations will play a role in financial inclusion.

STATUS OF SHG FEDERATIONS[13]

According to the estimates made by APMAS,[14] as of March 2013, there were 178,664 federations in the country. These included 171,511 primary-level federations (PLFs), 7,087 secondary-level federations (SLFs) and 66 tertiary-level federations (TLFs). Table 2.13 gives region-wise distribution of federations. Federations are predominant in Andhra Pradesh, Kerala, Tamil Nadu, Rajasthan and West Bengal (state-wise data is given in Appendix 2.5).

In the northern region, more than 99 per cent federations are concentrated in Rajasthan, promoted by the Department of Women and Child Development (DWCD) and State Rural Livelihood Mission (SRLM). People's Education and Development Organization (PEDO), PRADAN, *Ibtada* (*Ibtada* is an Urdu word for 'the beginning'), Centre for Community Economics & Development Consultants Society (CECOEDECON), Srijan and Grameen Development Services were the prominent NGOs that promoted SHG federations in the state. The SHPI Rural Centre for Human Interests (RUCHI) is promoting primary, secondary and tertiary federations in Himachal Pradesh. However, compared to 2012, the number of federations has reduced in the state in 2013 due to their merger across different levels. There is no TLF in this region. In the north-east, Assam SRLM plays the major role in federating SHGs. Data relating to others is not available.

As for the eastern region, majority of the federations in Odisha have been promoted by the state government under the Tripti project of Mission Shakti. These are three-tier structures. In fact most of the tertiary federations in India exist in this region. There is an overall reduction in number of SHG federations in West Bengal in 2013 compared to the previous years. This could be because the data is not updated. Centre for Youth and Social Development (CYSD), PRADAN, Bharat Integrated Social Welfare Agency (BISWA), Nirdesh and Bagnan

Table 2.13 Distribution of SHG federations by region (31 March 2013)

	NGO				Government				Total			
Region	**PLF**	**SLF**	**TLF**	**Total**	**PLF**	**SLF**	**TLF**	**Total**	**PLF**	**SLF**	**TLF**	**Total**
Northern region	395	40	1	436	15,320	0	0	15,320	15,715	40	1	15,756
North-eastern region	300	4	0	304	1,205	0	0	1,205	1,505	4	0	1,509
Eastern region	27,970	2,757	2	30,729	17,180	453	39	17,672	45,150	3,210	41	48,401
Central region	3,611	149	0	3,760	3,459	0	0	3,459	7,070	149	0	7,219
Western region	1,073	4	0	1,077	10,539	315	0	10,854	11,612	319	0	11,931
Southern region	11,147	570	2	11,719	79,304	2,795	22	82,121	90,451	3,365	24	93,840
Union Territories	8	0	0	8	0	0	0	0	8	0	0	8
All	44,504	3,524	5	48,033	127,007	3,563	61	130,631	171,511	7,087	66	178,664

Source: APMAS. 2013. Note prepared for the Microfinance SoS report 2013.

are the major NGO promoters of SHG federations in the eastern region.

The number of SHG federations has increased in the central region as compared to 2012 mainly due to the activities of RGMVP in Uttar Pradesh and SRLM in Uttarakhand. District Poverty Initiatives Project (DPIP)—Madhya Pradesh, PRADAN, People's Action for National Integration (PANI) and Manav Vikas Seva Sangh are the other prominent SHPIs that promote SHG federations in this region.

In the western region, Mahila Arthik Vikas Mahamandal (MAVIM), Sampada Trust, Self-Employed Women's Association (SEWA) and Area Networking And Development Initiatives (ANANDI) are promoting federations. The presence of SHPIs in this region is limited; hence it accounts for only around 7 per cent of the total SHG federations in the country.

The southern region is home to more than half (52 per cent) of the federations in the country. They are supported by the state governments through the Society for Elimination of Rural Poverty (SERP) and the Mission for Elimination of Poverty in Municipal Areas (MEPMA) in Andhra Pradesh, Kudumbasree in Kerala and SRLM (Vazhndhu Kaatuvam and Mahalir Thittam) in Tamil Nadu. MYRADA, Development of Humane Action (DHAN) Foundation, SKDRDP, Outreach and Association of Sarva Seva Farms (ASSEFA) are the prominent NGOs promoting SHG federations in the region.

The number of SHG federations promoted by NGOs grew four-and-a-half times between 2009 and 2010. However, due to variations in SHPI reporting, there is a small reduction in the number in 2012. Due to the support of a few development financial institutions such as Friends of Women's World Banking (FWWB), Small Industries Development Bank of India (SIDBI) and NABFINS, there has been a positive growth in the last year with the figure standing at 48,033 as of March 2013.

Government of India, state governments and their projects implemented with external funding are the major players in promoting SHG federations with Andhra Pradesh in the lead. The number of government-promoted SHG federations has increased from 93,773 in 2009 to 130,631 in 2013. With the impetus given by the NRLM, the total number of SHG federations in the country is likely to reach 500,000 by 2018.

Even though the SHG federation model initiated by the NGOs has widespread acceptance, the scale achieved by them is minimal compared to government programmes. This may further widen if government projects/programmes do not recognize the importance of the role of NGOs in sector development, especially in building models and piloting innovations for livelihoods promotion using federated structures.

As the SHPIs have evolved from promoters of SHG–bank linkage to those of federations and MFIs, including NBFCs, the role of SHGs has been reduced from financial intermediaries in their own right to mere delivery channels or facilitators. The addition of multiple intermediaries in the supply chain for credit has increased the cost of borrowing at the SHG and individual level and has narrowed or eliminated the margin for SHGs.

PRIVATE BANKS AND SHG–BANK LINKAGE

For a long time, direct SHG–bank linkage was dominated by the public sector banks, mainly because of their large network of rural branches. Large private sector banks, which for long have avoided rural India, are now expanding in this market, buoyed by rising wages, increased consumption and higher demand for credit. HDFC Bank Ltd, ICICI Bank Ltd and, most recently, Axis Bank have increased their branch presence in rural areas, as they prepare to tap the large unbanked population. In May 2013, the RBI also asked banks to 'front-load' their expansion in the rural unbanked areas in the financial inclusion plan for 2013–16.[15]

HDFC Bank

The rural business of HDFC Bank started in 2010–11 after a board directive to reach 10 million households or 50 million people in rural India. Of the 3,119 branches of the bank, 53 per cent are in semi-urban and rural pockets.[16] Under its Sustainable Livelihood Initiative (SLI), the bank provides financial services to low-income people through more than 250 rural business hubs attached to its branches, covering over 5,000 villages in over 20 states. In the south, the bank provides financial services through SHGs. In other parts of the country, the field officers of the bank form need-based JLGs. Intensive processes are followed in selection of members, training and credit linkages. As of 31 March 2013, more than 100,000 SHGs and JLGs have been provided credit linkages with outstanding amount exceeding ₹700 crore.

ICICI Bank

ICICI Bank, apart from lending through selected MFIs, is also engaged in SHG–bank linkage since

the beginning of 2012. Its SHG portfolio is currently ₹450 crore. For direct lending to SHGs, it ties up with SHPIs. SHG assessment and other lending norms are set by the bank. Zero balance accounts with chequebook facility are opened to ensure that the SHGs engage with the bank. A dedicated relationship manager visits the groups and helps them complete all the documentation.

The bank has provided credit linkages worth around ₹600 crore to 520,000 individuals, primarily women, through 40,000 SHGs. More than 85 per cent of the bank linked SHGs are in rural and semi-urban areas. A team of 400 people trained and dedicated only for SHG–bank linkage is operating in seven[17] states. There are 200 full-service *grameen* branches at block level and 1,500 semi-urban branches too.

ICICI Bank follows NABARD model guidelines by lending to SHGs of a minimum vintage of 6 months. The rate of interest charged to SHGs is 13.5–14 per cent per annum (as compared to 10–12 per cent charged by public sector banks), of which 2 per cent is passed back to the SHPIs to continue to handhold the SHGs. Of this, 50 per cent is given upfront and 50 per cent on a month-on-month basis, based on loan recovery.

Box 2.3 ICICI–MAVIM partnership

An International Fund for Agricultural Development (IFAD)-supported project in the state of Maharashtra, the Tejaswini Maharashtra Rural Women Empowerment Programme, being implemented by MAVIM (the state's women empowerment agency) has established 67,319 SHGs with about 880,000 members. These are supported by 315 CMRCs.

MAVIM signed an agreement with ICICI Bank on 1 January 2012 for the bank to lend to SHGs. The agreed size of the first loan was ₹50,000 per SHG or up to six times the amount of group savings. ICICI Bank has deployed field credit officers to visit groups and complete all formalities, and within a month of appraisal the loans were disbursed. SHG members say they are happy with the quicker service, adequate size of loans and the minimal transaction time and cost to the group. ICICI Bank has now become the major lender to Tejaswini SHGs. It provided 54 per cent of the ₹1,000 million loans made to SHGs in 2012–13.

Source: MAVIM.

RECENT STUDIES ON SHGs

ENABLE study

In recent years, studies on SHGs have been few and far between. During the past year, apart from limited studies undertaken by and on behalf of NABARD regional offices with a local focus and sporadic research efforts of regional university researchers, no major nationwide studies have been undertaken on various important aspects of the functioning and impact of SBLP. The major banks supporting SBLP too have not undertaken any serious enquiry regarding the viability of this channel. Further, the focus of research has shifted to the financial inclusion and BC channel in which the handful of microfinance research agencies has been more active. An exception was a major study on SHG quality and sustainability conducted in eight states (Andhra Pradesh, Assam, Bihar, Gujarat, Karnataka, Maharashtra, Rajasthan and West Bengal) by National Network Enabling Self-Help Movement (ENABLE)[18] a network of SHG-promoting organizations.

The study found that of the sample of SHGs, 42 per cent had A grade, while B grade and C grade SHGs made up 36 per cent and 22 per cent respectively of the sample. Majority of SHGs held regular meetings, but focused mostly on financial rather than social and livelihood aspects. Poor quality of bookkeeping was found to be one of the challenges for SHGs. There was no leadership rotation in a significant number of SHGs, and only a few strictly adhered to specified group norms.

There was a limited focus on savings and need-based products. Though SHGs had built a good corpus, there was high dependence on external credit. However, a majority of SHGs had not accessed external grants, and most of those with active bank loans were dissatisfied with the loan size, term and timeliness of loans, and delays in loan sanction. At the same time, dependence on moneylenders had come down as had the interest rates of informal credit sources. There was a significant impact of SHGs on women's empowerment, and the majority of women had equal access to family income as their husbands/male heads of family. Though the work burden had increased for a large number of women, the sharing of household work by men had also increased.

NABARD studies and action research

The Rural Financial Institutions Programme (RFIP) is a bilateral German–Indian technical cooperation programme, jointly implemented by German

development agency Deutsche Gesellschaft fur Internationale Zusammenarbeit (GIZ) and NABARD. Its main objective is to increase access to sustainable and demand-oriented financial services through the institution of the rural cooperative credit system, microfinance organizations and banks as well as their BCs.

RFIP has emerged as a major source of research, particularly action research, aimed at developing the potential of the SHG model. Its ongoing SHG-related research focuses on the following:

- Appraising the satisfaction of SHGs/SHG members with the financial services used by them (satisfaction survey) as also assessing the demand for other services/product adjustments that the members require to meet their financial needs (demand assessment);
- Understanding pension schemes from the SHG user's perspective and examining housing finance as a dominant need/demand by SHG members;
- Understanding the diverse arrangements, dynamics and communication structures being practised within SHGs, such as equity and group dynamics, accounts and bookkeeping, savings in SHGs, loan-related transactions and practices, and financial practices of banks in SHG lending, SHPI support and influence on SHGs;
- Developing financial awareness and education toolkit for SHG members;
- Developing training handbook (Training Needs Analysis [TNA]) on SHGP for bankers, federations, SHPIs/NGOs, etc.;
- Pilot testing the role of village organizations in facilitating voluntary savings (SHG 2) products for its SHG members;
- Evaluating the ways to make the BC model viable and effective by using the existing ground infrastructure with SHGs, Primary Agricultural Cooperative Societies (PACS) and MFIs as BCs.

Studies have been commissioned in four states across India to analyse the satisfaction with, and demand for, financial services. Hand in Hand Microfinance Limited has conducted the study in Rajasthan, Tamil Nadu and Odisha while the Bankers Institute for Rural Development (BIRD) has conducted the study in Uttar Pradesh. A total of 1,350 SHG members from 538 SHGs have been interviewed in these studies.

The results of the satisfaction survey[19] clearly bring out that bank loan sizes to SHGs are inadequate, repeat loans are not assured in spite of good repayment performance and product information is not shared by the branch personnel. Thus, even in the existing simple vanilla products of group savings and loans on the basis of savings-to-credit ratio, there is still scope for satisfying the needs of SHGs and their members.

Suggested measures to fulfil SHG member needs and improve the satisfaction levels include the following: (*a*) adequate financing; (*b*) timely financing; (*c*) avoidance/reduction in gap in repeat loans; (*d*) increase the range of banks' savings and other financial products for SHGs; (*e*) improved marketing and design of loan products to meet longer-term needs; (*f*) introduction of insurance and pension products after appropriate financial education measures; (*g*) use of BCs to provide doorstep services; and (*h*) improvement in the attitude of bank staff and amenities at bank branches for SHG members.

The guidelines on SHG 2 allowed voluntary savings to be contributed by SHG members. To ground this concept and study its impact on lifecycle needs of SHGs, an action research pilot on 'Enabling financial planning and facilitating voluntary savings by SHGs' was launched in five states (Chhattisgarh, West Bengal, Maharashtra, Tamil Nadu and Kerala). The project covers 50 matured SHGs in each of the 10 districts and is expected to gather facts related to the propensity of the SHG members to save, keeping in tune with their future financial needs and extent to which the available banking services and products can meet their aspirations. The initial feedback indicates preference of the clients for meeting their future lifecycle needs through investment in banking products such as recurring deposits. Indeed, pilots like this were required before the issuance of the guidelines on voluntary savings in SHG 2.

An action research project titled 'Moving poor households out of poverty' was also sanctioned by NABARD to Range De, a partner organization, to study the impact of repeated doses of microcredit on their financial lives. Under the project, 300 beneficiaries having an annual income of less than ₹40,000 will be given recurring doses of loans over a period of three years. The project will be implemented in three states, namely Bihar, Maharashtra and Madhya Pradesh, covering 100 beneficiaries each. Besides this, NABARD regional offices in Andhra Pradesh and Kerala did exploratory studies aimed at studying the potential for involving SHGs members in the BC channel.

FINANCIAL INCLUSION AND THE FUTURE ROLE OF SHGs

The NABARD Status of Microfinance 2011–12 Report had stated: 'It is widely believed that the SHGs of the poor will be the vehicles leading the march

of India's emergence as a super economic power in the next decade.' Apparently to support this vision, NABARD continued with the pursuit of expanding the numbers of SHGs (and JLGs) by one million groups per year[20] over the next five years. This highly unrealistic assertion is indeed quite disconcerting.[21] SHGs cannot be expected to have the kind of vanguard role in the economy that has been implied in the statement above. The paths of SHG evolution, either by top-down government initiatives and/or association into financial federations, or through NGO-supported in-house and external NBFC and MFI linkages, have generally meant the undermining of the SHGs' role as financial intermediary. The 'new middle women' managing a mini-bank of and for their SHG members have in most contexts effectively become mere facilitators in the delivery chain. This dilution of the financial intermediation role of SHGs appears to have been carried over to the financial inclusion model.

An alternative point of view sees SHGs as having virtually disappeared from the scene in 10 years time, as individual-centred banking is facilitated by the developing banking infrastructure. As on 31 March 2013, there were 183.3 million Basic Savings Bank Deposit Account (BSBDA) holders as against 95 million (obviously overlapping) SHG members with savings in over 7.32 million SHG accounts (down from nearly 8 million SHGs and 103 million members the previous year). With the availability of the basic 'no frills' savings accounts for all by 2014 and introduction of the BC model and IT-enabled doorstep banking through various types of customer service points (CSPs), it would in principle be possible to provide the entire suite of financial products of banks to individual customers. As a result, SHGs, with their limited financial products, could become redundant unless they 'hook on' to the emerging financial services delivery structure.

Undoubtedly, the determining factor in such a scenario is going to be the massive NRLM project that is committed to the SHG model. It is critical how it promotes SHGs and draws upon the proposed infrastructure of SHG federations and other livelihood organizations of the poor and arranges the financial resources for their needs.

It is possible to identify at least four major strands of thinking among the different shades of opinion on the role of SHG-based delivery channels in making financial services available for the poor. At the heart of the financial inclusion thrust of the Department of Financial Services (Ministry of Finance [MoF]) and RBI is the position shared by many bankers that looks at supply-side solutions and favours technological innovation and outsourcing of certain banking functions for cost-effective service delivery. This affects a larger component of their portfolio than merely the SHGs. The specific needs and possibilities of the SHG channel are hardly on the radar screen. In fact, banks operating through BCs can now function as competitors to MFIs and the SHGs in the provision of credit and financial services to poor clients. This would translate into the 'bank–BC–individual' model. A supplementary channel that has re-emerged is that of bank lending through the non-NBFC NGO-promoted Microfinance Opportunities (MFOs) or MFIs as the BC/agent. The return of the 'partnership model' would mean flow of funds to individuals, *grameen* groups and SHGs through the NGO–MFIs. While earlier favoured by private banks without rural branches, this has now found favour with public sector banks as well.

An apparently paradoxical stance is that adopted by NABARD in respect of the place of the SHG in the financial inclusion project. While staying with the SBLP and massively promoting SHGs (and the somewhat inappropriate further articulation of the model into 'JLGs within SHGs'), there is the understanding that BCs along with technology applications and devices will enable the reduction in transaction costs of banks. This argument has further been used to dismiss the possibility of SHG federations as a cost-effective and organizationally viable financial intermediary tier between banks and SHGs. As BCs of banks become common and the model develops, the direct SHG–bank linkage model would now become 'bank–BC–SHG–member' model with the SHG being just another client of the BC. The leading SHG-supporting banks such as State Bank of India and Canara Bank, however, are happy with their performance of SHGs, which they see as continuing to be an important part of their portfolio. They have, accordingly, taken several steps to integrate SHGs within the structure and products of the financial inclusion project. Further, private banks such as ICICI Bank and HDFC Bank see the SHGs as a clientele worth cultivating.

A third position is that of the NRLM which sees SHGs as the building block both for financial federations as well as other cross-cutting livelihoods organizations as part of a broad-based strategy for poverty alleviation. Here the role of SHG federations appears to be still evolving. While the second-tier block/mandal-level federations were initially favoured as the main element in the interface with banks and financing agencies, recent thinking appears to favour cluster/panchayat-level federations for this role instead. This position would tend to

support the bank–block federation–VO–SHG–member or bank–primary federation–SHG–member channels. These could operate along with or even replace the SBLP. SHG federations could either act as MFIs or only as BCs/BFs. Sources of finance for the federations through women's banks and other dedicated funds and channels such as Stree Nidhi in Andhra Pradesh are also planned.

Finally, a range of NGO–SHPI positions on financial services for the poor castigates the supply-driven agenda of the financial inclusion model being promoted by banks and favours demand-driven community MFIs, including SHG federations, along the lines of the NRLM. There are varying viewpoints that emphasize livelihoods and empowerment of SHG members and consider financial services delivery as only one of the several vital inputs in livelihoods development that need not necessarily involve mainstreaming SHGs into conventional banking.

The financial inclusion agenda of the government may thus need to be merged with the SBLP, particularly to form the banking architecture required to implement the SHG-based NRLM. For this, NABARD needs to engage urgently with the latter to protect the space for SHGs and community organizations, even as it may not be entirely convinced of their place in the supply chain for bank finance. It would appear that a campaign for the contested space at the last mile will have to be undertaken on behalf of SHGs and SHG promoters to preserve their important role, especially in the financial and social empowerment of rural women.

APPENDIX 2.1
Comparative performance of savings of SHGs

State	Year 2011–12		Year 2012–13		Growth (%)	
	No. of SHGs	Savings amount	No. of SHGs	Savings amount	No. of SHGs	Savings amount
Andhra Pradesh	1,495,904	14,901.6	1,421,393	25,417.9	–4.98	70.57
Tamil Nadu	925,392	7,903.98	873,012	8,496.68	–5.66	7.5
Maharashtra	827,047	7,236.18	687,717	5,137.04	–16.85	–29.01
West Bengal	685,448	3,769.44	586,821	7,269.49	–14.39	92.85
Karnataka	628,643	10,021.3	645,695	11,561.9	2.71	15.37
Kerala	615,714	4,137.11	581,325	5,175.89	–5.59	25.11
Odisha	540,029	3,613.64	522,837	4,182.78	–3.18	15.75
Uttar Pradesh	471,184	3,682.14	403,932	3,920.08	–14.27	6.46
Bihar	305,113	1,404.24	270,890	1,696.76	–11.22	20.83
Assam	276,565	984.6	271,072	1,075.08	–1.99	9.19
Rajasthan	251,654	1,278.71	231,763	1,576.07	–7.9	23.25
Gujarat	226,626	1,396.32	208,410	1,755.51	–8.04	25.72
Madhya Pradesh	163,588	1,122.91	159,457	1,232.12	–2.53	9.73
Chhattisgarh	129,854	739.45	98,493	613.6	–24.15	–17.02
Jharkhand	89,603	672.18	85,334	768.99	–4.76	14.4
Himachal Pradesh	65,641	328.86	53,242	427.79	–18.89	30.08
Uttarakhand	48,141	591.33	40,316	476.36	–16.25	–19.44
Haryana	44,184	367.84	42,580	403.07	–3.63	9.58
Punjab	37,343	466.26	35,060	363.55	–6.11	–22.03
Tripura	34,021	337.8	10,438	21.93	–69.32	–93.51
Puducherry	17,913	168.29	20,053	173.16	11.95	2.89
Meghalaya	14,091	41.47	9,573	51.57	–32.06	24.33
Manipur	12,711	21.94	12,656	23.52	–0.43	7.23
Nagaland	10,711	37.45	8,478	18.59	–20.85	–50.37
Goa	8,414	86.87	9,889	66.07	17.53	–23.94
Arunachal Pradesh	8,363	18.63	5,033	41.21	–39.82	121.17
Jammu & Kashmir	6,349	43.31	5,796	97.05	–8.71	124.09
Andaman & Nicobar Islands	5,521	13.13	5,217	14.57	–5.51	11.01
Sikkim	5,280	26	3,529	7.95	–33.16	–69.43
Mizoram	4,976	57.29	3,117	61.22	–37.36	6.86
New Delhi	3,536	32.5	3,787	34.81	7.1	7.09
Chandigarh	619	10.21	609	9.51	–1.62	–6.85
Lakshadweep	171	1.25	27	0.72	–84.21	–42.55
Total	7,960,349	65,514.1	7,317,551	82,172.5	–8.07	25.43

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

APPENDIX 2.2
Number of SHGs and outstanding SHG loans by states

State	As on 31 March 2012		As on 31 March 2013		Growth (%)	
	No. of SHGs	Loans outstanding (₹ million)	No. of SHGs	Loans outstanding (₹ million)	No. of SHGs	Loans outstanding
Andhra Pradesh	1,400,995	153,417	1,456,720	174,810	3.98	13.94
Tamil Nadu	514,203	46,393	511,859	50,402	–0.46	8.64
West Bengal	382,942	15,700	494,166	24,245	29.04	54.42
Odisha	314,669	16,534	277,954	17,968	–11.67	8.67
Karnataka	266,978	34,699	379,305	32,936	42.07	–5.08
Bihar	223,033	10,407	185,309	9,323	–16.91	–10.42
Maharashtra	214,012	11,625	219,651	12,290	2.63	5.72
Uttar Pradesh	212,922	20,318	228,646	19,573	7.38	–3.67
Kerala	159,843	17,792	153,336	16,783	–4.07	–5.67
Rajasthan	134,961	7,149	129,571	6,329	–3.99	–11.46
Assam	117,809	6,302	121,490	6,486	3.12	2.91
Gujarat	72,495	1,763	72,671	2,204	0.24	24.98
Jharkhand	63,336	3,596	61,728	3,775	–2.54	4.98
Madhya Pradesh	60,815	4,141	65,358	4,442	7.47	7.27
Chhattisgarh	53,285	2,026	44,037	2,138	–17.36	5.51
Himachal Pradesh	35,872	1,409	40,157	1,382	11.95	–1.95
Uttarakhand	25,430	1,318	24,480	1,616	–3.74	22.59
Tripura	25,174	2,532	6,860	560	–72.75	–77.89
Haryana	21,433	2,058	23,294	2,640	8.68	28.3
Punjab	15,304	841	14,871	858	–2.83	1.95
Puducherry	13,678	1,644	13,959	1,422	2.05	–13.46
Manipur	5,807	230	4,591	209	–20.94	–9.03
Jammu & Kashmir	3,138	165	4,240	191	35.12	15.95
Goa	2,965	249	3,129	181	5.53	–27.23
Nagaland	2,752	179	2,428	179	–11.77	0.23
Meghalaya	2,569	139	2,376	176	–7.51	26.31
Sikkim	2,561	121	2,856	124	11.52	2.45
Mizoram	2,383	400	2,667	195	11.92	–51.38
Andaman & Nicobar Islands	1,349	61	1,499	71	11.12	16.66
New Delhi	1,120	142	1,371	163	22.41	14.75
Arunachal Pradesh	361	29	392	39	8.59	33.2
Chandigarh	213	19	451	44	111.74	131.69
Lakshadweep	35	1	12	0	–65.71	–72.23
Total	4,354,442	363,400	4,551,434	393,753	4.52	8.35

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

APPENDIX 2.3
Disbursement of SHG loans by states

State	2011–12		2012–13		Growth (%)	
	No. of SHGs	Loans disbursed (₹ million)	No. of SHGs	Loans disbursed (₹ million)	No. of SHGs	Loans disbursed
Andhra Pradesh	378,526	81,714	484,292	111,644	27.94	36.63
Tamil Nadu	179,902	19,329	150,586	29,161	–16.3	50.87
West Bengal	99,379	5,514	95,284	5,142	–4.12	–6.75
Karnataka	87,943	16,295	145,733	22,994	65.71	41.11
Maharashtra	68,396	6,018	54,749	5,781	–19.95	–3.94
Kerala	55,242	8,542	60,830	8,989	10.12	5.24
Odisha	49,831	5,410	47,676	4,733	–4.32	–12.51
Bihar	39,241	3,986	30,574	2,220	–22.09	–44.3
Uttar Pradesh	34,497	4,454	33,140	4,510	–3.93	1.25
Gujarat	30,336	1,312	14,756	1,198	–51.36	–8.65
Assam	28,012	1,875	21,497	1,376	–23.26	–26.62
Tripura	19,029	2,314	801	125	–95.79	–94.6
Rajasthan	18,862	1,827	20,161	2,109	6.89	15.4
Jharkhand	12,040	1,274	8,874	754	–26.3	–40.85
Chhattisgarh	10,087	926	7,992	701	–20.77	–24.25
Madhya Pradesh	8,751	954	15,182	1,373	73.49	43.82
Uttarakhand	5,125	759	7,866	405	53.48	–46.66
Himachal Pradesh	4,269	532	4,164	415	–2.46	–22
Haryana	3,865	620	3,241	516	–16.14	–16.78
Puducherry	3,798	738	4,494	850	18.33	15.21
Goa	2,312	199	924	121	–60.03	–39.38
Punjab	2,183	238	2,021	228	–7.42	–4.32
Manipur	1,308	86	659	41	–49.62	–52.68
Jammu & Kashmir	1,013	80	1,196	84	18.07	4.99
Nagaland	862	62	796	97	–7.66	56.83
Andaman & Nicobar Islands	710	57	415	54	–41.55	–5.64
Meghalaya	691	49	400	46	–42.11	–5.49
Mizoram	575	69	544	83	–5.39	19.88
New Delhi	511	51	455	64	–10.96	26.02
Sikkim	396	42	359	21	–9.34	–49.82
Arunachal Pradesh	130	16	112	13	–13.85	–15.94
Chandigarh	48	6	47	7	–2.08	23.63
Lakshadweep	8	0	1	0	–87.5	–13.04
Total	1,147,878	165,348	1,219,821	205,854	6.27	24.5

Sources: NABARD. 2012. *Status of Microfinance in India 2011–12*, Micro Credit Innovation Department (MCID), Mumbai; NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

APPENDIX 2.4
Credit-to-savings ratio by states—2013

State	Loan outstanding per SHG	Savings per SHG	Loans-to-savings ratio (multiples)
Tripura	81,618	2,101	39
Nagaland	73,882	2,192	34
Manipur	45,580	1,859	25
Sikkim	43,342	2,252	19
Andaman & Nicobar Islands	47,513	2,794	17
Meghalaya	74,141	5,387	14
Assam	53,384	3,966	13
New Delhi	118,845	9,191	13
Arunachal Pradesh	98,924	8,188	12
Haryana	113,323	9,466	12
Kerala	109,451	8,904	12
Puducherry	101,899	8,635	12
Tamil Nadu	98,468	9,733	10
Goa	57,938	6,682	9
Madhya Pradesh	67,963	7,727	9
Uttar Pradesh	85,603	9,705	9
Bihar	50,311	6,264	8
Chhattisgarh	48,541	6,230	8
Odisha	64,642	8,000	8
Andhra Pradesh	120,003	17,882	7
Jharkhand	61,152	9,012	7
Maharashtra	55,953	7,470	7
Rajasthan	48,849	6,800	7
Chandigarh	98,630	15,617	6
Punjab	57,673	10,369	6
Uttarakhand	66,023	11,816	6
Karnataka	86,832	17,906	5
Gujarat	30,327	8,423	4
Himachal Pradesh	34,404	8,035	4
Mizoram	72,988	19,641	4
West Bengal	49,062	12,388	4
Jammu & Kashmir	45,042	16,744	3
Lakshadweep	28,000	26,556	1
Total	88,455	11,229	8

Source: NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

APPENDIX 2.5
SHG federations by states (March 2013)

S. No.	Region/state	No. of primary federations	No. of secondary federations	No. of tertiary federations	Total
A	Northern region				
1	Himachal Pradesh	5	1	0	6
2	Rajasthan	15,704	38	1	15,743
3	Haryana	6	1	0	7
4	Punjab	0	0	0	0
5	Jammu & Kashmir	0	0	0	0
	Region total	15,715	40	1	15,756
B	North-eastern region		40		
6	Assam	1,336	3	0	1,339
7	Meghalaya	80	0	0	80
8	Tripura*	0	0	0	0
9	Sikkim*	0	0	0	0
10	Manipur	85	5	0	90
11	Nagaland	0	0	0	0
12	Arunachal Pradesh*	0	0	0	0
13	Mizoram	0	0	0	0
	Region total	1,501	8	0	1,509
C	Eastern region				
14	Odisha	10,952	364	40	11,356
15	Bihar	6,543	103	0	6,646
16	Jharkhand	548	40	0	588
17	West Bengal	27,107	2,703	1	29,811
	Region total	45,150	3,210	41	48,401
D	Central region				
18	Madhya Pradesh	4,215	45	0	4,260
19	Chhattisgarh	62	0	0	62
20	Uttar Pradesh	2,619	104	0	2,723
21	Uttarakhand	174	0	0	174
	Region total	7,070	149	0	7,219
E	Western region				
22	Gujarat	253	4	0	257
23	Maharashtra	11,359	315	0	11,674
24	Goa	0	0	0	0
	Region total	11,612	319	0	11,931
F	Southern region				
25	Andhra Pradesh	50,459	1,428	22	51,909
26	Karnataka	7,731	159	2	7,892
27	Kerala	19,987	1,073	0	21,060
28	Tamil Nadu	12,274	705	0	12,979
	Region total	90,451	3,365	24	93,840

(Continued)

(Continued)

S. No.	Region/state	No. of primary federations	No. of secondary federations	No. of tertiary federations	Total
G	Union Territories				
25	Puducherry	8	0	0	8
	Region total	8	0	0	8
	GRAND TOTAL	171,507	7,091	66	178,664

Source: Data collected through emails, phone calls and Internet.
Note: * Federations exist but information is not available.

NOTES AND REFERENCES

1. NABARD. 2013. *Annual Report*. Mumbai: NABARD.
2. Ibid.
3. Chhattisgarh, Jharkhand, Bihar, Uttar Pradesh, Madhya Pradesh, Rajasthan, Odisha, West Bengal, Maharashtra, Assam, Himachal Pradesh, Uttarakhand and Gujarat.
4. Seibel, Hans Dieter. 2012. 'The Future of SHG Banking in India: What Role for Government and SHG Federations?' http://www.acpeumicrofinance.org/images/actualite/e-MFP_Summer_2012_p6p7.pdf.
5. Srinivasan, N. 2011. *Microfinance in India: State of the Sector Report, 2011*. New Delhi: ACCESS Development Services, SAGE Publications.
6. Wilson, Kim. 2013. 'Turning Cold Money Hot: What the SHG Movement Can Learn from an Alternate Approach.' September. http://sites.tufts.edu/feinstein/2013/turning-cold-money-hot (accessed on 22 September 2013).
7. Partners of the Aga Khan Foundation in India working on CBSGs include Aga Khan Rural Support Programme (AKRSP), NIDAN, Nav Jagriti and Sakhi.
8. The CBSG approach typically does not use the term corpus to described pooled share purchase and deposits. It is used in the paper to draw similarities and differences with the SHG model.
9. The new interest rate 'caps' enable MFIs to lend to SHGs as their clients at 26 per cent per annum as against 11 per cent or so under the direct SHG–bank linkage.
10. As in the case of SKDRDP.
11. RBI Circular (RBI/2005-06/288DBOD.No.BL.BC.58/22.01.001/2005-2006), 25 January 2006.
12. Reserve Bank of India, Circular No. RBI/2012-13/559RPCD. GSSD. CO. No. 81/09.01.03/2012-13, *Priority Sector Lending—Restructuring of SGSY as National Rural Livelihood Mission (NRLM)—Aajeevika*, 27 June 2013. http://rbi.org.in/Scripts/NotificationUser.aspx?Mode=0&Id=8075 (accessed on 22 September 2013).
13. Adapted from a note contributed by APMAS for the report.
14. APMAS has been collecting data related to the spread and growth of SHG federations in India since 2007 through several secondary sources. During the period 2009–13, SHG federation data has been reviewed, revised and updated on an annual basis based on the information collected from various SHPIs from different states of India. However, APMAS has not been able to collect detailed data about the functions of the federations, total funds managed by these federations, how many of these federations registered under an appropriate legal form and about their sustainability.
15. Rebello, Joel. 2013. 'New Private Banks Upbeat on Rural Expansion.' *Mint*, 28 August.
16. Ibid.
17. Maharashtra, Gujarat, Madhya Pradesh, Rajasthan, Tamil Nadu, Karnataka and Kerala.
18. Reddy, K. Raja and C. S. Reddy. 2012. *Self Help Groups in India: A Study of Quality and Sustainability.* Hyderabad: ENABLE.
19. Srinivasan, G. 2013. 'Study on Satisfaction Level of SHGs on Financial Services & Demand for New Products and Services.' GIZ–NABARD draft report.
20. Comprising 800,000 SHGs and 200,000 JLGs.
21. The means of achieving this target was not clear. As announced in NABARD (2013), this appears to have been replaced by a more modest target of 2 million new SHGs to be formed and credit linked by March 2017, or 500,000 SHGs per year.

Trend and progress of MFIs: towards orderly growth?

3

Chapter

Three years since the stalemate in Andhra Pradesh, it is now acknowledged that the impact of the crisis remained largely within the state, sweeping some of the large MFIs with their headquarters and huge chunk of business within the state off their feet in a matter of months. There is, however, some evidence now that the virtual banning of MFIs with the enactment of the Andhra Pradesh MFI Act (2010) has caused the household consumption levels in the state to dip significantly.

The 12 months between August 2012 and July 2013 covered in this review have carried mixed messages for the different segments within the MFI sector. Several of the big, commercially oriented, NBFC–MFIs have regained their confidence during this period as the banks loosened the grip on their vaults to supply funds to MFIs. As the popular press put it, 'the dust in the microfinance industry that began in October 2010 in Andhra Pradesh' had started showing the signs of settling down by the end of the last quarter of 2012–13.[1] Investors regained their interest in them, mainly in those that are located outside Andhra Pradesh, resulting in a rise in the number of investment deals.[2] Thanks to the regulatory guidelines issued by the central bank, the sector began to behave in an orderly fashion that brought in a fresh perspective about it as transparent and less risky.

However, the prominent Andhra Pradesh–based MFIs, except SKS Microfinance, continue to experience negative or negligible business growth even as the moratorium for loan repayment granted by the banks as part of the earlier restructuring deal ended in June 2013.[3] Five MFIs—Bharatiya Samruddhi Finance Limited (BSFL), Spandana Sphoorty, SHARE Microfin, Asmitha and Trident—sought RBI's permission for a second round of restructuring, which was turned down by the central bank.[4]

The NGO–MFI sector, also referred to as the non-profit or community-based microfinance sector, has a different story to narrate. Many sector leaders believe that in the current scenario, these MFIs, majority of which are small and local in terms of their operational focus, have already lost their battle. As the capital has turned its attention almost completely to the 'regulated' NBFC sector, several of the NGO–MFIs are struggling to find their feet. The ensuing sections will delve deeply into the major aspects of the growth and transformation of the MFI sector since the last quarter of 2012.

ASSESSING THE REACH, SIZE AND GROWTH OF MFIs

As pointed out often in earlier analyses of the sector, lack of systematically collected data is a critical constraint to comprehending the complexity and actual dynamics of micro lending through the channel of MFIs. Mainly there are three sets of data on MFIs—the annual data that Sa-Dhan brings out based on the details furnished by its members, the data compiled by Microfinance Information Exchange (MIX) quarterly and annually, and the member data that Micro Finance Institutions Network (MFIN) publishes quarterly. MIX is supported by SIDBI[5] since April 2012 to maintain the Indian Micro Finance Platform (IMFP) that disseminates financial and operational information on MFIs. The purpose of this initiative is to increase data coverage in terms of the number of reporting MFIs as also spatial depth (at the district level, for instance). Institute for Financial Management and Research (IFMR) Capital, Micro-Credit Ratings

International Ltd (M-CRIL) and Credit Rating Information Services of India Limited (CRISIL) are also potential sources of MFI-level information. But they do not bring out data at periodic intervals. The multiplicity of reference periods, inconsistency with respect to the institutions covered as well as the diversity in reporting formats have all made the attempts to use different data sets in combination with each other hugely complicated. The good news is that some efforts have already been made towards enhancing the consistency of the data. For instance, MFIN has started collecting annual data relating to its members in partnership with MIX, which gets published in the MIX platform. We have used in this report multiple data sources relevant to the issue under discussion, of course, with utmost caution and discretion.

How best can one examine the reach, size and growth of Indian MFIs, given the problems with the available datasets? Sa-Dhan database as of July 2013 lists 54 NBFCs and 103 non-NBFCs as its members. It is interesting to note that the number of non-NBFCs on the Sa-Dhan list is almost double that of NBFCs. We could not obtain disaggregated information from Sa-Dhan about them. The MIX (accessed on 9 August 2013) provides basic data (as on 30 June 2013) pertaining to 43 NBFCs and 17 NGOs. The latest MFIN member data (for the quarter ending 30 June 2013) contains information relating to 40 member MFIs and two non-members. We will present analyses based on all the three databases here.

As per the provisional data furnished by S-Dhan[6] for 2012–13, there are 2.75 crore active clients of MFIs—both NBFCs and others—with a loan outstanding of ₹22,300 crore (Table 3.1). Both client outreach and outstanding loans of MFIs have not increased since 2010–11. The number of active clients has remained around 9 crore over the last four years, if one ignores the possible overlapping between the SBLP and MFI models. The loan outstanding was stagnant around ₹21,000 crore, and increased marginally by about ₹1,300 crore between 2011–12 and 2012–13.

Table 3.1 and Figure 3.1 also give insights into the relative performance of the other microfinance model—the SBLP. In 2007–08, SBLP accounted for about two-thirds of the incremental loan amount disbursed within the microfinance system. During the subsequent three years, the period of hyper growth of MFIs, this share came down by about 15 percentage points. In 2011–12, all the incremental lending within the system was due to SBLP. The share of MFIs improved substantially to 31 per cent in 2012–13.

Sa-Dhan data indicates the revival of dynamism in the MF since 2011–12. The data presented in Table 3.2 obtained from MIX for 2012 and 2013 supports this. The analysis relates to 43 NBFC–MFIs and 16 other MFIs (NGOs and cooperatives) who reported their data to the MIX during January 2011 to June 2013. Their combined portfolio increased by about ₹2,900 crore between March 2012 and June 2013, or by 13 per cent. The number of active borrowers rose by 18 lakh, that is, by 7 per cent.

Based on the gross loan portfolio figures reported by MIX, the top five MFIs in 2013 are Bandhan, SKS, Spandana, SHARE and Ujjivan. Both Spandana and SHARE have been affected by the repayment crisis in Andhra Pradesh, which has caused their growth to stagnate and decelerate. In order to arrive at the top 5 MFIs, we have replaced them with Equitas and Janalakshmi, the two MFIs with the largest-sized portfolio after Ujjivan. As Table 3.3 shows, the top five NBFCs together have registered

Table 3.1 Client outreach—SBLP and MFI models

	Number of clients (crore)			Loan outstanding (₹ crore)			
Year	SBLP	MFI	Total	SBLP	MFI	Total	Share of MFIs in incremental micro lending (%)
2006–07	3.8	1.0	4.8	12,366	3,456	15,822	
2007–08	4.7	1.4	6.1	16,999	5,954	22,953	35.03
2008–09	5.4	2.3	7.7	22,679	11,734	34,413	50.44
2009–10	6.0	2.7	8.7	28,038	18,343	46,381	55.22
2010–11	6.3	3.2	9.4	31,221	21,556	52,777	50.23
2011–12	6.1	2.7	8.8	36,340	20,913	57,253	–14.37
2012–13	6.5	2.8	9.3	39,375	22,300	61,675	31.37

Source: Presentation made by Sa-Dhan at the FICCI Workshop on Sustainable Financial Inclusion, 5 August 2013, Mumbai. NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

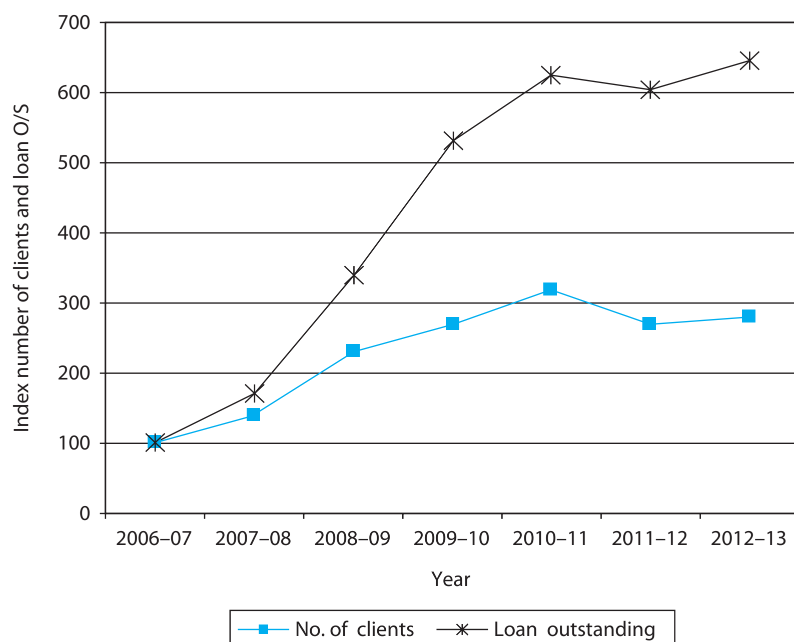


Figure 3.1 Growth in MFI loan outstanding and client outreach

Source: Presentation made by Sa-Dhan at the FICCI Workshop on Sustainable Financial Inclusion, 5 August 2013, Mumbai. NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

Table 3.2 Growth of MFI loans and client outreach: MIX data

	2012 (as of 31 March)		2013 (as of 30 June)		
	Gross loan portfolio (₹ crore)	No. of active borrowers (crore)	Gross loan portfolio (₹ crore)	No. of active borrowers (crore)	Growth rate (%)
NBFC–MFIs (43)	18,835.15	2.31	21,070.28	2.45	11.87
Others (16)	2,896.96	0.36	3,568.11	0.40	23.17
All	21,732.11	2.67	24,638.39	2.85	13.37

Source: http://www.mixmarket.org.

Table 3.3 Top 5 NBFC–MFIs: MIX data

	Gross loan portfolio (₹ crore)			Growth (%)	
MFI	2011	2012	2013 (up to 30 June)	2011–12	2012–13 (up to 30 June)
Bandhan	3,176.93	3,853.41	4,332.06	21.29	12.42
SKS	1,809.64	1,840.38	2,345.24	1.70	27.43
Ujjivan	602.09	935.35	1,212.69	55.35	29.65
Equitas	671.72	1,030.97	1,198.33	53.48	16.23
Janalakshmi	257.07	742.06	1,139.79	188.66	53.60
Total—5 MFIs	6,517.45	8,402.17	10,228.10	28.92	21.73
Total—43 MFIs	16,439.43	18,835.15	21,070.27	14.57	11.87
Share (%)	39.65	44.61	48.54		

Source: http://www.mixmarket.org.

double the growth rate (29 per cent) of all the 43 MFIs we considered (14.6 per cent). As of 30 June 2013, they jointly account for about 49 per cent of the gross loan portfolio of the MFIs. And their share has improved significantly since 2011.

The MIX database has as many as 44 NGOs reporting their data as of 31 March 2012. But all of them did not report consistently in the subsequent quarters. We have focused on 16 NGO–MFIs, who collectively constituted more than 90 per cent of the gross loan portfolio of this subsector as per the MIX to do a comparative analysis. Table 3.4 summarizes the results.

Table 3.4 Growth of NGO–MFIs: MIX data

16 NGOs	As of 31 March 2012	As of 30 June 2013	Growth rate (%)
Gross loan portfolio (₹ crore)	2,896.96	3,568.11	23.17
Client outreach (crore)	0.36	0.41	12.06
Top 2 NGOs			
Gross loan portfolio (crore)	2,254.91 (77.84)	2,905.36 (81.43)	28.85
Client outreach (lakh)	0.27	0.31	15.35
Top 4 NGOs			
Gross loan portfolio (crore)	2,671.69 (92.22)	3,333.51 (93.42)	24.77
Client outreach (lakh)	0.32	0.37	13.09

Source: http://www.mixmarket.org.
Note: Bracketed figures are percentages to the total gross loan portfolio (GLP).

Interestingly, the growth rate of gross loan portfolio of the NGO–MFIs over the period March 2012 to June 2013 has been double that of their NBFC counterparts. However, one organization—the south Canara-based SKDRDP—alone accounted for two-thirds of the loan portfolio and 60 per cent of the active borrowers among the 16 MFIs considered here. The top two non-NBFC–MFIs, SKDRDP and Cashpor, improved their combined share in loan portfolio from 77 per cent to 81 per cent between 31 March 2012 and 30 June 2013. The top four formed as high as 93 per cent of the total loan portfolio of all the 16 NGO–MFIs.

The 37 members of MFIN reported as of 30 June 2013 gross loan portfolio of ₹20,079 crore with an active client base of 2.32 crore (Table 3.5). The members of MFIN overall improved their portfolio growth by 20 per cent. If the MFIs under corporate debt restructuring (CDR) are omitted, the portfolio growth rate increases to 40 per cent. These MFIs

Table 3.5 Growth of NBFC–MFIs: MFIN data

	As of 31 March 2012 (*n* = 45)	As of 30 June 2013 (*n* = 37*)
Gross loan portfolio (₹ crore)	15,443	20,079
Active borrowers (crore)	2.28	2.32

Source: MFIN Micrometer, June 2012; *MFIN Micrometer*, Issue 6 (data as of 30 June 2013).
Note: *Only reporting members.

increased loan disbursals by 67 per cent. Thanks to the Andhra Pradesh MFIs under CDR, there has been a decline in the branch network as well as the staff strength of MFIs.

The sharp decline in disbursals by NBFC–MFIs between 2010–11 and 2011–12 (from ₹32,420 crore to ₹20,620 crore) has been reversed to some extent in the following year due to their significant rise—by 18 per cent—in states other than Andhra Pradesh (Figure 3.2).

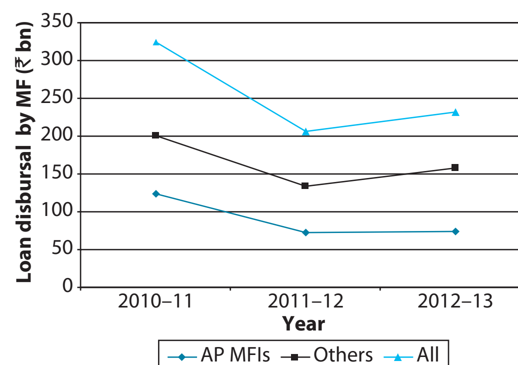


Figure 3.2 Disbursals by MFIs: 2010–11 to 2012–13

Source: MFIN Micrometer, Issue 5 (as of 31 March 2013).

A comparison of all the available data indicates that the gross loan in MFI sector in India is worth about ₹25,000 crore. The NBFCs account for 80 per cent of the GLP and almost 70 per cent of all active clients.

Box 3.1 Three databases: comparison

Source	Gross loan portfolio (₹ crore)	Number of active clients (crore)
MIX	24,638	2.85
Sa-Dhan	22,300	2.80
MFIN	20,597	2.05

THE REGIONAL PICTURE

As Andhra Pradesh continued to register continuous drop in loan disbursals by NBFC–MFIs, they seem to have spread themselves out widely across several states. MFIN member data shows that both the number of disbursals and amount disbursed remained high in states such as Tamil Nadu, West Bengal, Karnataka, Maharashtra and Uttar Pradesh during the quarter ending June 2013 (MFIN, August 2013). The 12 MFIs in West Bengal together reported GLP of ₹2,869 crore. The state also had the highest number of employees (9,984) among NBFCs. Tamil Nadu closely follows West Bengal with a gross portfolio of ₹2,776 crore (19 NBFCs) and 8,890 employees.

However, the dominance of southern states in microfinance continues. MFI headquartered in these states account for about 80 per cent of the gross loan portfolio as of end June 2013. The district-level data on loan outstanding by MFIs obtained from MIX shows how extensive the coverage of southern India is by MFIs compared to other states (Figure 3.3). Of the top 25 districts in terms of loans outstanding, 13 are in Karnataka. Of these, 11 are serviced by SKDRDP, a charitable trust with focused presence in Karnataka. Janalakshmi and Ujjivan are the other two Karnataka-based MFIs that figure in the list. There are nine districts in the list from Andhra Pradesh with loans outstanding due to Spandana and SHARE. Guntur appears twice, thanks to the

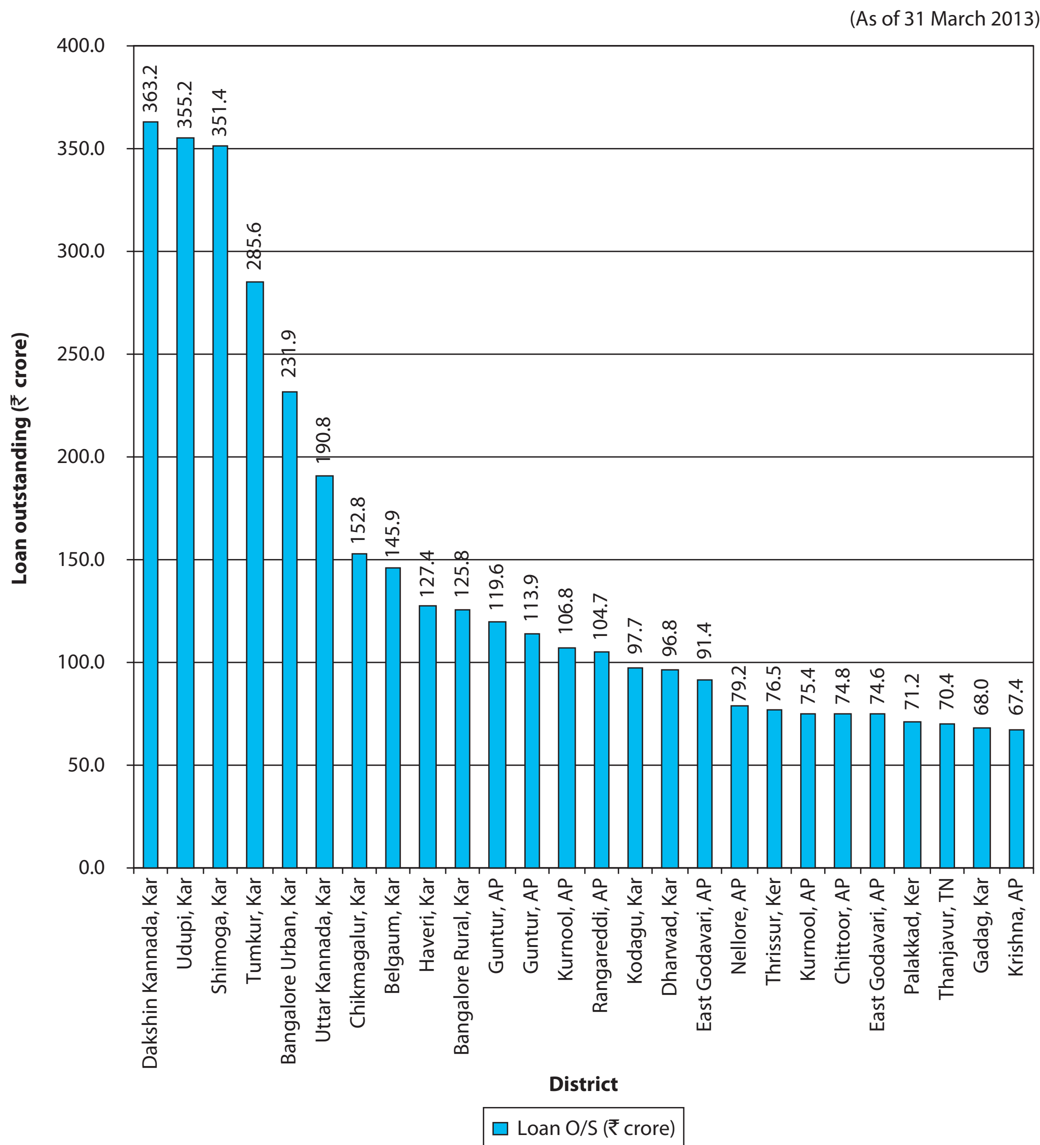


Figure 3.3 Top 25 districts in India by GLP

Source: http://www.mixmarket.org.

outstanding loans that are high for both the MFIs. One district each from Tamil Nadu and Kerala are also in the top 25. The near exhaustion of Karnataka with microfinance is an interesting phenomenon to notice. Despite this, MFIs in the state have been competing with each other in a 'non-rivalrous' manner, thanks to the regional network Association of Karnataka Microfinance (AKMI).

The states in focus in the coming few years are Bihar, Odisha, Madhya Pradesh and Uttar Pradesh, where SIDBI is implementing the special initiative called the Poorest States Inclusive Growth (PSIG) Programme. These states have seen a rise in microfinance activity in post-crisis months. However, given the extent of poverty and financial exclusion, there seems to be significant scope for expansion of microfinance activities further in these states.

Box 3.2 Feeling lost and relegated: MFIs in the north-eastern region

The round table of NGOs, MFIs and support institutions conducted in Guwahati by the State of the Sector (SOS) team[7] reiterated many of their enduring woes. With skewed distribution bank branch network that has completely excluded certain pockets, NGOs and MFIs have a meaningful role to play in the region as financial service providers in the un-underserviced areas. However, their role severely restricted as the support system around microfinance in the region is fragile. The banks have become quite passive as they wait for the enactment of the Microfinance Bill. Even SIDBI has been going slow in terms of lending. Rashtriya Grameen Vikas Nidhi (RGVN) Microfinance Limited, an NBFC that inherits the legacy of one of the earliest microfinance institutions in the country, finds itself in a curious syndrome where bank finance is not forthcoming as its portfolio is not big (₹117 crore as of June 2013). In spite of the fact that RGVN board has adequate representation from institutional promoters, some banks insist on personal promoter guarantee. Another MFI from Manipur said that banks often ask for deposits for sanctioning bigger loans.

PERFORMANCE OF MFIs

With the rising optimism among the players and confidence in the funding and policy environments the NBFC–MFIs appear to have done well

Table 3.6 Indicators of operational performance

Indicators	2012–13 quarter 1	2013–14 quarter 1
Clients per branch	2,354	2,671
GLP per branch (₹ million)	18.61	23.01
GLP per loan officer (₹ million)	4.31	5.21
Clients per loan officer	545	605
Total assets (₹ billion)	177.55	232.30
Total equity (₹ billion)	34	18.55#
Total borrowings (₹ billion)	114.28	154.51
PAR (₹ billion)	37.72	
PAR (%)*	1 (42)	0.4 (0.4)
Loan O/S per client	7,909	8,615
Average loan size (₹)	12,349	13,593
No. of employees	65,375	62,592
No. of branches	9,475	9,269

Source: MFIN Micrometer, June 2012; *MFIN Micrometer*, Issue 6 (data as of 30 June 2013).
Note: (*a*) #Andhra Pradesh–based MFIs under CDR have eroded their equity by 20% due to write-offs; others' equity enhanced by 3%; (*b*) *for the non-Andhra Pradesh MFIs. Bracketed figures show PAR in Andhra Pradesh.

operationally over the last couple of years. This is explained by the overall improvement in their operational parameters between the first quarter of 2012–13 and the first quarter of the current financial year as shown in Table 3.6. The lacklustre performance of MFIs in Andhra Pradesh, however, has dampened some of the parameters like PAR, equity, and number of employees and branches.

The financial ratios of the two categories of MFIs—NBFCs and NGOs—can reveal more about patterns in the growth experience of different size classes of MFIs. The ratios estimated from the MIX database shows that the highest size class of GLP experienced negative returns and profit margin. That the MFIs with bleeding portfolios under CDR in Andhra Pradesh are part of this class explains this phenomenon. The relatively smaller and middle-rung MFIs with portfolio sizes varying between ₹100 crore and ₹500 crore are the ones that demonstrated greatest stability according to these estimates (Table 3.7).

We have calculated the ratios separately for a sample of 15 NGOs who have their financials reported to the MIX. The median values of the ratios presented in Table 3.8 suggest marginal change in all the major indicators of financial sustainability of NGO–MFIs between 2011 and 2012. The comparison among individual organizations does

Table 3.7 Sustainability indicators: NBFC–MFIs

	Indicator[8] →	Median values (%) (*n* = 40)				
GLP size class (₹ crore)	Year	Return on assets (RoA)	Return on equity (RoE)	Profit margin	Operating expenses/ loan portfolio	Financial expenses/ assets
>1,000	2012–13	–21.8	–120.5	–172.0	5.5	7.9
	2011–12	–4.8	–20.5	–38.0	6.3	9.5
500–1,000	2012–13	1.4	6.4	7.9	10.6	10.2
	2011–12	0.3	0.9	0.9	14.0	10.4
200–500	2012–13	0.9	7.4	9.8	10.1	8.6
	2011–12	0.9	8.9	13.6	11.6	10.0
100–200	2012–13	14.0	4.0	5.6	11.2	8.0
	2011–12	10.4	5.1	4.3	13.8	8.2
<100	2012–13	2.0	4.5	12.6	10.5	9.1
	2011–12	0.6	2.8	5.5	12.3	9.1

Source: Estimated by the MIX team from the financial statements of 31 major NBFC–MFIs, except SKS.
Note: RoA—Net operating income less taxes/average assets; RoE—Net operating income, less taxes/average equity; Profit margin—Net operating income/financial revenue.

not indicate any clearer correspondence between outreach and profitability. The NGOs that reported the highest profitability—SKDRDP (42 per cent), Prayas (32 per cent) and Sarala (31 per cent)—belong to distinctly different outreach classes. With more than 25 lakh borrowers (as of 30 June 2013) SKDRDP is the largest NGO–MFI in the country, while Prayas has low borrower base of 15,000. Sarala is a tier II MFI with 77,000 borrowers. The smaller NGOs (<5,000 borrowers), however, are found to have low profitability ratios, which registered some improvement over the two-year period.

The observations with respect to NBFCs are corroborated by the analysis done by IFMR Capital of its MFI partners. It finds that though the microfinance sector suffered a fall in the overall portfolio outstanding in 2012, almost all MFIs in the middle rung (the broad bracket of ₹100 crore to ₹500 crore) have been consistent in their growth, in the financial year 2013–14, maintaining a superior portfolio quality. Table 3.9 clearly suggests that the medium-sized MFIs have performed very well over the past couple of years.

Further, as depicted in Figure 3.4, the percentage of risky portfolio (≥30 days) has been on a steady decline but for the April–June quarter of 2012. As of March 2013 it stood at 0.15 per cent. This is quite comparable to the MFIN estimate of 0.4 per cent (Table 3.7). The message seems to be clear, given the overall anxiety about MFIs in the small and medium segments as steadily turning unviable.

Table 3.8 Sustainability indicators: NGO–MFIs

	Median values (%) (*n* = 15)	
Indicators	2011–12	2012–13
Return on assets	2.1	2.9
Return on equity	18.6	20.0
Profit margin	9.1	9.2
Financial expenses/assets	9.2	8.8
Operating expense/loan portfolio	10.7	10.9

Source: Estimated by the MIX team from the financial statements of 31 major NBFC–MFIs, except SKS.

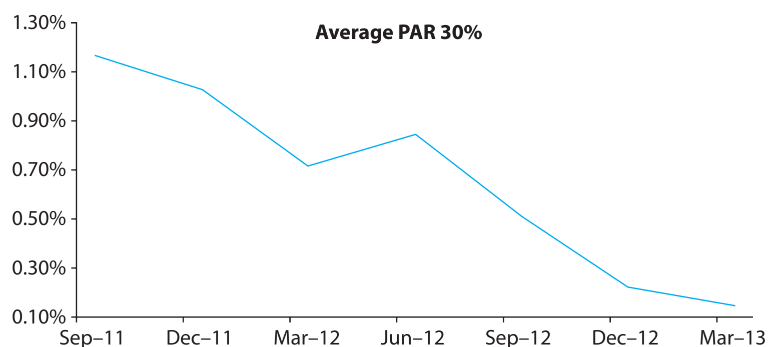


Figure 3.4 Portfolio at risk ratio of IFMR partners

Source: IFMR Capital database.

Table 3.9 Performance of MFIs associated with IFMR capital by asset size

Asset under management (₹ crore)		2012–13			2013–14		
		PAT margin# (%)	Gearing ratio*	Return on asset (%)	PAT margin# (%)	Gearing ratio*	Return on asset (%)
Tier II	500 to 1,000	1.2	1.6	0.3	10.2	4.4	1.9
Tier III	200 to 500	2.8	3.1	0.5	11.0	5.1	2.3
Tier IV	100 to 200	15.3	1.8	4.1	10.6	2.5	2.0
Tier V	<100	3.7	1.5	0.9	3.0	1.8	0.7

Source: Database of IFMR Capital.
Note: (*a*) #After tax profit margin; (*b*) *Ratio of equity to borrowed funds.

Nationally managed portfolio stands at 8 per cent of GLP as of 30 June 2013 compared to 15 per cent during the same period in the previous year. In the case of MFIs under CDR, there has been a decrease of 95 per cent in managed portfolio between the initial quarters of 2012–13 and 2013–14. Others experienced a decrease in such portfolio of 22 per cent.

THE STALEMATE CONTINUES FOR THE TRAILING ANDHRA PRADESH MFIs

In 2011 June, the RBI allowed restructuring of bank loans worth ₹6,473 crore to five MFIs—Share Microfin Limited, Spandana Sphoorty Financial Limited, Asmitha Microfin Limited, Future Financial Services Limited (FFSL) and Trident Microfin Private Limited—whose businesses were the worst hit post 2010.[9] In March 2012, BSFL joined the group with the banks agreeing to restructure its debt worth ₹700 crore.[10]

Close to 30 per cent of the portfolio and 26 per cent of the active clients belonged to these six MFIs in 2011–12. These shares declined to 23 per cent and 21 per cent respectively by 2012–13 as their growth rate slowed down, thanks to the crisis in repayment in the state and the absence of fresh infusion of capital. The impact of these has been reflected in some of the basic growth indices (Table 3.10). It is clear that the MFIs stricken badly by the deterioration in the market discipline in Andhra Pradesh had to contain and restrain their operations.

Their branches came down by 656 and employees by about 6,500 in one year. This seems to have helped them to maintain branch-level business without much reduction. The other MFIs, however, have been able to expand their business volumes during the same period.

Table 3.10 Some indices of the impact on Andhra Pradesh–based MFIs in crisis

Indices	First quarter 2012–13		First quarter 2013–14	
	MFIs under CDR (6)	The rest of MFIs (36)	MFIs under CDR (6)	The rest of MFIs (36)
Branches	3,332	6,426	2,676	6,593
Employees	18,389	49,977	11,895	50,697
Loan officers	10,601	31,525	7,433	33,500
Employee per branch	6	8	4	8
Loan officers per branch	3	5	3	5
Clients per branch	2,307	2,378	2,320	2,814

Source: *MFIN Micrometer*, Issue 6 (data as of 30 June 2013).

Box 3.3 FFSL: tale of a turnaround

Future Financial Services Ltd (FFSL) has presence in Karnataka, Tamil Nadu and Andhra Pradesh. Its overall performance was adversely impacted by the Andhra Pradesh Ordinance in October 2010 as it had exposure in the state of about 23 per cent of its overall portfolio. FFSL restructured all its term liabilities as on March 2011 through the CDR Cell with Small Industries Development Bank of India (SIDBI) as the monitoring institution. It was the first MFI to have been admitted to the CDR process following the crisis in Andhra Pradesh.

India Value Fund Advisors (IVFA), a private equity fund having 18 per cent equity in FFSL (investment made in September 2010), subsequently increased its holding in the company through

multiple rounds of capital infusion. Currently, IVFA holds 45.3 per cent stake in the company. IVFA formed a Central Management Company (CMC)—India FinServe Advisors Private Limited (IFAPL)—which oversees all the key business aspects at FFSL. As of June 2013, FFSL was present in 110 branches spread over 16 districts in the states of Tamil Nadu, Karnataka, and Andhra Pradesh with a portfolio size of ₹201 crore. It has discontinued the operations in Andhra Pradesh, where it has portfolio of about ₹23 crore.

In 2012–13, the company reported a net loss of ₹11.51 crore as compared to a net loss of ₹18.03 crore in 2011–12, primarily on account of high provisioning requirements. The company has fully provided for the portfolio delinquent beyond 180 days as of March 2013. During the first quarter of 2013–14, FFSL reports a net profit of ₹2.49 crore.

Source: http://www.icra.in/Files/Reports/Rationale/Future%20Financial_r_30082013.pdf.

Not many efforts have been made to assess systematically the impact of the developments in Andhra Pradesh over the past three years. The MFIs have found their ways to manage the collateral and nullify damage from the crisis in 2010. Some have been more successful than others while doing this. They rationalized operations, moved to new markets and regions and built regulation compliant managerial structures. 'How has the sudden withdrawal of MFIs affected poor households?' is a more pertinent question. This question is beginning to be raised by researchers and activists. A recent study by Sane and Thomas[11] has found convincing evidence that the household-level incomes in Andhra Pradesh dipped after the crisis.

Box 3.4 How has the contraction of microfinance affected the households in Andhra Pradesh? Recent evidence

In a recent paper, titled 'The real cost of credit constraints: Evidence from micro-finance', Renuka Sane and Susan Thomas attempt to find out whether the average household consumption was affected when microfinance was banned in Andhra Pradesh. They also enquired as to which households have been more affected by the ban and whether the volatility of average consumption changed, indicating a higher inability of households to smooth consumption.

The study finds that consumption expenditure of households in Andhra Pradesh decreased by 19.5 per cent as a consequence of the ban on microfinance, compared with those outside Andhra Pradesh. This decline varied across components of consumption: Andhra Pradesh households spent 16 per cent less on food and 34 per cent less on education as a consequence of the ban. Consumption across all income groups was negatively impacted.

The impact was, however, bigger for households with liquidity constraints, such as those in rural regions with access to fewer sources of credit. There is also some evidence of higher volatility in the expenditure on food in Andhra Pradesh households after the ban, relative to households in the control regions. This suggests greater difficulties by households to smooth consumption as a consequence of the ban.

The researchers point out that their results suggest a fairly large negative impact of the ban on microfinance. According to the researchers, banning an industry is often not the right way to improve things. What is needed is sophisticated thinking on consumer protection. They also argue that government interventions should be much more rooted in research and evidence.

Source: Renuka Sane and Susan Thomas. 2013. 'The Real Cost of Credit Constraints: Evidence from Micro-Finance.' *WP-2013-013*. Mumbai: Indira Gandhi Institute of Development Research, July.

PHASE OF CONSOLIDATION?

In many quarters the expectation seems be that the sector is heading steadily for consolidation to gain from the economies of scale. It is worth noting that majority of the non-NBFC–MFIs have limited outreach and moderate portfolios. The data for 2012 suggests that the outreach of almost half of such MFIs is less than 10,000 with portfolio size in the range of 150 to 700 lakh.[12]

Despite the evidence that we reviewed earlier, relating to IFMR partners, in our formal interactions we heard many argue that a 'bias for large size' is implicit in the new regulatory prescriptions—such as an increase in capital requirement/capital adequacy ratio, insistence on membership in credit information companies/Self-Regulatory Organization (SRO) and interest and margin caps—which creates

incentives for consolidation of MFIs, especially the smaller and medium-sized ones. Consolidation provides the existing investors with 'attractive and practical "exit" and new investment opportunities'. Some microfinance entrepreneurs may even find consolidation with larger organizations as a way to enhance the ability to serve their clients.[13]

The only instance of consolidation so far in the sector is the acquisition of Arohan, an MFI headquartered in Kolkata, by IntelleCash Microfinance Network Company Private Limited (IntelleCash), in September 2012.

Box 3.5 Infusing life into a failing MFI: the Arohan story

Arohan was set up by Shubhankar Sengupta and team in late 2006 with support from Bellwether and later by Michael and Susan Dell Foundation (MSDF) and India Financial Inclusion Fund (IFIF). It grew rapidly to cover the three eastern Indian states of West Bengal, Bihar and Assam. By late 2010, Arohan had grown to have over 150 branches, 1,000 employees and portfolio worth more than ₹120 crore. The crisis in Andhra Pradesh that put a brake on bank funding to MFIs affected Arohan too, though it had no exposure in the state. Sustaining the business levels became difficult, let alone growing the portfolio. It waited for bank lending to start, while its main investor Bellwether tried to work out a plan to consolidate its different investee companies. When both did not materialize, Arohan had to initiate by late 2011 severe measures to rationalize branch and employee costs to stay afloat. For 2011–12, it reported a loss, with the portfolio reduction to under ₹60 crore. In early 2012, Arohan and its investors decided to actively look for new investors and capital to shore up net worth and financial performance.

Arohan approached Intellecap Investment banking team to raise capital. Intellecap, the company set up in 2002 with a mandate to engage with investment banking, business consulting and research, sensed an opportunity for it to work together with Arohan. Its subsidiary, IntelleCash, set up in 2008 as a separate NBFC, was already offering wholesale loans to incubate MFIs to help them develop good credit and repayment track record. By 2010, when the Andhra Pradesh crisis broke out, IntelleCash had set up its own retail lending in Bihar, taken the incubation/capacity-building business overseas and scaled up its services in India. In early 2012, Aavishkaar Goodwell made an investment in IntelleCash to grow its retail lending and capacity-building activities.

Both Intellecap and IntelleCash were keen to play a part in the consolidation, which it expected would happen in the sector.

A new alliance got formed that combined the sector experience of Intellecap; the incubation/capacity-building background of IntelleCash and the distribution network, established processes and procedures; and the banking relationships nurtured by Arohan. There was a strong possibility of creating value working together rather than individually. The investors on both sides supported the concept and the deal was finalized in September 2012.

Between themselves, IntelleCash, Aavishkaar Goodwell II, MSDF and IFIF invested ₹27 crore in Arohan. The first set of challenges of this combine included consolidation of IntelleCash's Bihar portfolio into Arohan, achieving break even on a monthly basis and demonstration of positive financial outcomes for the year 2012–13. The new entity broke even in October 2012, completed the Bihar integration in January 2013, raised over ₹85 crore in debt and posted a small but positive financial result for the entire year 2012–13.

According to the team, this experiment has underscored several learnings: (*a*) the need for promoters to understand, reconcile and adjust to the changing realities in the sector; (*b*) the importance of effectively communicating (often 'over-communicating') with employees during the phase of consolidation; (*c*) the importance of managing the integration process on a day-to-day/week-to-week basis with a dedicated team; and (*d*) the necessity to integrate policies and culture, taking the best of both.

How has the consolidation helped the MFI? From a portfolio size of ₹29 crore and net worth of ₹14 crore in late September 2012, Arohan has increased its portfolio size to ₹127 crore with a net worth of over ₹42 crore by end August 2013. An internal capital-raising exercise is on, which is expected to take the net worth to ₹64 crore by the end of September 2013.

CONCLUSION

The aforementioned review of the trends in the growth of microfinance institutions in India clearly indicates that this subsector is on the path to recovery after the difficult phase that followed the unfortunate events in Andhra Pradesh. The SOS

2012 reported the early signs of this revival. Moreover, during the 12 months since September 2012, the continuation of the tendency towards settling down under the umbrella of regulatory guidelines has been observed. Flow of funds cannot be said to have been smoothened, but banks and financial institutions have become more accessible and responsive. We shall examine this in Chapter 4. However, the delay in the enactment of the MF Regulation Bill has left some ambiguities.

It disturbing to note that lopsidedness in the distribution of microfinance facilities has continued through the years. The south has dominating presence in the sector. While states such as Karnataka seem to have saturated their districts with microfinance, there are other states like Bihar, Chhattisgarh and Jharkhand that have yet to have MFIs reaching their hinterlands. It must be remembered that Bihar has more poor people than all the four southern states are put together. As per the 2011–12 estimates, 358 lakh people in Bihar live below the poverty line, whereas the number of poor in the four southern states together comes to 315 lakh.[14] There are subtle indications that a strong prescriptive, rule-based regulatory system towards which India seems to be heading steadily may eventually lead to the exclusion of regions that are difficult to serve, but badly in need of financial services. If that happens, it will truly be the most unfortunate culmination of the two-decade-long experimentation with the policy and practice of lending to the 'small yet significant' peoples of India.

APPENDIX 3.1
Ujjivan: the journey of an urban MFI

Interview with Samit Ghosh, CEO[15]

Q 1: One sees a real surge of interest in urban microfinance. How did you start Ujjivan and what are your impressions about the possibility of growth in the urban space now compared to five years back?
Answer: We started urban microfinance in 2005. Basically we found that in the rural space even though there was large number of poor, there were too many players. On urban side, they were very few like SEWA in Ahmedabad and Sanghamitra in Bangalore. We decided that the urban space looked more attractive, as it was free from excessive competition. The potential for growth of urban poor was much more than rural. Urban poor were ignored by everyone, even NGOs who largely worked in rural areas. We were the first MFI to focus on the urban poor in a major way. We started a pilot with 13 branches in Bangalore, as people said that the Grameen model works only in rural areas. There is no cohesion among urban community, and hence group lending will not work. We ran the pilot for 18 months and modified the model a bit and expanded across India. Unlike other MFIs which expanded in concentric circles from their head office, we decided that we want a national footprint and opened regional offices in Delhi, Kolkata and Pune and covered as many cities and semi-urban areas in each region. That is how we started. Currently, we have 310 branches across 21 states and union territories. From the point of view of geographical footprint, we are the widest.

Q 2: How did you expand the business?
Answer: Obviously since we started in the southern India, we have the largest exposure here, in Karnataka. We have always tried to diversify our exposure geographically. The second largest presence is in West Bengal, followed by Delhi. We are the largest MFI in Mumbai with 14 branches. We did not go to Chennai since there were many players there. We did not initially go to Kerala too, as there were strong government players operating there. But later we found that there is some scope and so we started operations there.

Q 3: How did Ujjivan face up to the challenges that followed the latest crisis in Andhra Pradesh?
Answer: We had deliberately not gone to Andhra Pradesh in 2007 because of the crisis in Krishna district. We felt that the political atmosphere in the state was not good as there was a tussle between government and MFIs. Since we were not there in Andhra Pradesh, we did not face serious portfolio problems. In certain pockets in West Bengal and Odisha and Vellore district in Tamil Nadu there were problems of over lending, but given that our portfolio was so diverse, it did not affect us that much. Around that time we also had problems in Ramanagara, having spilled over from Kolar though we were not present there. But, overall, it did not affect us from the overall portfolio quality perspective.

Our biggest issue was to operate viably within the new regulatory guidelines, especially relating to the interest rate and the margin caps. Because of our earlier growth strategy we were expanding fast and over 100

branches were less than one year old and, hence, incurring losses in October 2010. Our operating expense ratio was over 17 per cent and the funding cost 12–13 per cent. Given such a cost structure, with an interest rate cap of 26 per cent and margin cap of 12 per cent, how do you run a viable business? Our focus in the last two years was to become more efficient and reduce cost. We cut down our head count, consolidated branches and dropped small loans. We did not retrench people, but did not replace people who left. We reengineered our processes with the help of technology. What we found in urban customers is that their time was valuable. They wanted monthly meetings and not weekly. It helped us on the cost side. Today our operating cost ratio is below 10 per cent. We can reduce it a bit more. But the drop from 17 per cent to 10 per cent is phenomenal.

Q 4: How does Ujjivan view the current drive for financial inclusion?

Answer: Consequently our core business (group lending and insurance) is stable and profitable. There is transformation from a largely single product to multi-product industry. We need to offer a full range of products to promote financial inclusion of our customers. If we are in rural areas, we have to design products for agriculture, animal husbandry, housing and education. For the urban poor we need to provide in addition micro-enterprise loans for working capital and capital goods. We have high demand for higher education loans. We are also working on housing and may set up a separate housing finance company. Along with this, we would like to offer savings directly or indirectly. We are not allowed to be a BC. But we have a sister organization, Parinaam Foundation, which undertakes financial literacy programme for our customers. As part of the financial literacy programme, we end up helping customers to open accounts in banks which are situated around our branches. Without being a BC, we are able to facilitate that process. Our customers are ready to keep ₹500 minimum balance. During the training sessions, we ask them to save the amount required for the minimum balance. Banks give them ATM facility and let them freely operate accounts. Our benefit is that we can progressively move towards cashless loan disbursement and collections. We started the transition towards being cashless a year ago. We encourage our customers to opt for cashless by offering them additional loan of ₹2,000. We are looking at electronic clearance service (ECS) for repayment. Cash has a big operating problem which adds to cost and risk for our staff. Today, 50 per cent of our loan disbursements are done cashless. As we are operating in the urban and semi-urban space, many of our customers have bank accounts. We are also opening accounts though the financial literacy programme. Our life insurance product has never been just credit linked. Our payouts to beneficiaries of life insurance are much more than what we adjust for loans.

We are offering life insurance. We would like offer other insurances products. We had piloted health insurance earlier, but it was a disaster. Hospitals took the people for a ride and every case became a service issue. We are waiting for a more effective version of this insurance, which has great demand. We are piloting a pension product. On savings side, we are setting up a Section 25 company, but will only offer a basic savings account. We are also keen to work in the area of remittance. Over the next few years we would like to offer a range of services, which will provide financial inclusion for our customers. Until a full range of services is available for the poor, they will not be really financially included.

Q 5: Maybe Regulation is providing that confidence and legitimacy?

Answer: Yes. Definitely once the bill gets approved, that will be the way. Even without that we were able to deal with the issues we face in some states other than in Andhra.

Q 6: What are the products that you have innovated?

Answer: We have a product management department. Individual loans, mainly larger loans which are designed to meet the needs of the customers based on end use, is our current focus—loans for animal husbandry, housing, working capital, capital equipment, higher education, etc.

Q 7: What is the real worth of Social Performance Management (SPM) exercise in microfinance?

Answer: When we started making profits, our board decided to allocate an amount for each branch to undertake social development programmes for the community we work in. We focused on Anganwadis and their development. We would buy them whatever they required: drinking water dispensers, cooking utensils, chairs, tables, educational material, etc. Apart from that we have taken up many small projects such as fencing around transformers, putting a pulley system for wells, tube well, bus stands, etc. We let our customers and branch staff survey tell us what the community requires. In the north-east, we paved steps on hillsides. In 2009, during the floods in north Karnataka, our staff contributed one day salary and Ujjivan

made a matching contribution. This has become a practice and we have a fund which provides relief for staff and customers who are affected by any natural or manmade disaster. This not only helps us bind our relationship with our staff but also with our customers. It is well appreciated.

Q 8: Do you agree that the current regulatory architecture encourages consolidation of MFIs?

Answer: I agree. Mr Malegam was pretty open about it. For RBI to regulate 3,000 institutions is not possible. With the margin and interest caps, unless you have the economies of scale, you cannot operate. These caps will bring about consolidation of MFIs. Smaller institutions are facing problems in raising funds whereas the bigger ones are flush with funds. The bigger players may not acquire smaller MFIs; instead the market is going to be captured by bigger MFIs. The industry may come to have only a small number of MFIs (20–30) manageable for the regulator. Very few new MFIs are coming up now owing to the barriers to entry. Consolidation may wipe out excess competition and the phenomenon of over-lending.

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4. Unnikrishnan, Dinesh. 2013. 'MFIs Seek RBI Nod for Another Debt Recast Round'. 17 July, http://www.livemint.com.
5. As part of the Responsible Lending Initiatives under the line of credit from the World Bank.
6. 'Microfinance Regulation and Governance: Industry Perspective', presentation made by Sa-Dhan at the FICCI Workshop on *Sustainable Financial Inclusion—Need for Governance, Regulation and Capacity Building*, 5 August 2013, Mumbai.
7. On 20 July 2013, Hotel Pragati Manor, Guwahati.
8. These terms are defined as follows: Asset—total of all net asset value; Equity—total of all equity accounts less any distribution; Profit margin—net operating income by financial revenue; Operating expense—Expenses related to operations including all personal expenses, depreciation, amortization, or all and administration; Loan portfolio—all outstanding principals due for all outstanding client loans, including current, delinquent and renegotiated loans, but not loans that have been written off and excluding interest receivables.
9. See, State of the Sector Report 2011, Chapter 4, 'Andhra Pradesh—dream turns nightmare' for the details regarding credit restructuring of Andhra Pradesh MFIs.
10. In the circular titled 'Credit Support to Micro Finance Institutions (MFIs)', RBI/2010-11/376, DBOD.BP.BC.No.74 /21.04.132/2010-11, January 19, 2011, the Central Bank has acknowledged the peculiar conditions that led to the AP crisis while spelling out the guidelines for credit restructuring.

    Considering the fact that the current problems afflicting the Micro Finance Institutions (MFIs) sector are not necessarily on account of any credit weakness per se but are mainly due to environmental factors, it has been decided that the special regulatory asset classification benefit could be extended to restructured MFI accounts, which are standard at the time of restructuring, even if they are not fully secured. This relaxation is granted purely as a temporary measure and would be applicable to Standard MFI accounts restructured by banks up to March 31, 2011. The other conditions specified in the above mentioned circular for getting the special asset classification benefits would remain unchanged. It is advised that a consortium approach for restructuring may be preferred and all the banks financing a MFI unit should come together and decide on the course of action to be pursued for that unit.
11. Renuka Sane and Susan Thomas. 2013. 'The Real Cost of Credit Constraints: Evidence from Microfinance.' *WP-2013-013*. Mumbai: Indira Gandhi Institute of Development Research, July.
12. Worked out for the 74 NGO–MFIs that are Sa-Dhan members and whose data are available from the Bharat Micro Finance Report—Quick Data 2012 as reported in http://www.sa-dhan.net/files/Sa-dhan-indian-map.htm.
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Financing of microfinance

4
Chapter

The most promising development in the microfinance sector in recent months has been indicated as the rise in the flow of bank funds to MFIs. The relaxing of funds constraints has been noticeable since the last quarter of 2011–12. During the period under current review, access to debt improved significantly with the public sector banks taking the lead in lending to the sector. Sa-Dhan estimates 11 per cent increase in bank funds during 2012–13 compared to the previous year. Its estimates show that the banks disbursed more than ₹7,500 crore during the year, taking the loan outstanding of public and private sector to ₹16,300 crore. If the other lenders (like SIDBI) are included, the total debt outstanding at MFIs comes to ₹10,000 crore as per Sa-Dhan.[1] As per MFIN data, its member MFIs received bank funds worth ₹788 crore during April–June 2013. Other financial institutions supplied about ₹210 crore.[2]

The monthly credit deployment data compiled from the RBI Bulletins for the period between February 2012 and July 2013 shows considerable variation (Table 4.1 and Figure 4.1). During the first four months of the financial year 2012–13, the amount outstanding declined sharply before it picked up again around the third quarter. It was the highest during the period October 2012–January 2013. It peaked in December 2012 to ₹24,100 crore. It dropped to ₹15,500 crore in February 2013, and did not see any significant improvement in the following six months. In July 2013, the outstanding micro credit stood at ₹16,800 crore (Figure 4.1).

The Status of Microfinance Report 2012–13, published by NABARD in September 2013, provides the data on loans disbursed to MFIs as also loan outstanding against them by financing agency relating to the last four years since 2009–10 (Table 4.2). In the case of commercial banks that account for close to 87 per cent of the loans disbursed over the four years, the pattern is quite clear: the first three years the disbursements declined steadily and substantially. By the end of March 2013, there was impressive

Table 4.1 Monthly deployment of microcredit

Month and year	Microcredit outstanding (₹ billion)	Index (March 2012 = 100)
Feb-12	216	94
Mar-12	231	100
Apr-12	163	71
May-12	157	68
Jun-12	152	66
Jul-12	146	63
Aug-12*	182	79
Sep-12*	182	87
Oct-12	218	94
Nov-12	219	95
Dec-12	241	104
Jan-13	238	103
Feb-13	155	67
Mar-13	165	71
Apr-13	172	74
May-13	179	77
Jun-13	173	75
Jul-13	168	73

Sources: Reserve Bank of India. 2012. *Reserve Bank of India Bulletin*, Vol. 46, Nos. 1 to 7, RBI, Mumbai; Reserve Bank of India. 2013. *Reserve Bank of India Bulletin*, Vol. 47, Nos. 2 to 7 and 10 to 12, RBI, Mumbai.
Note: *Average of October and July as data was not available.

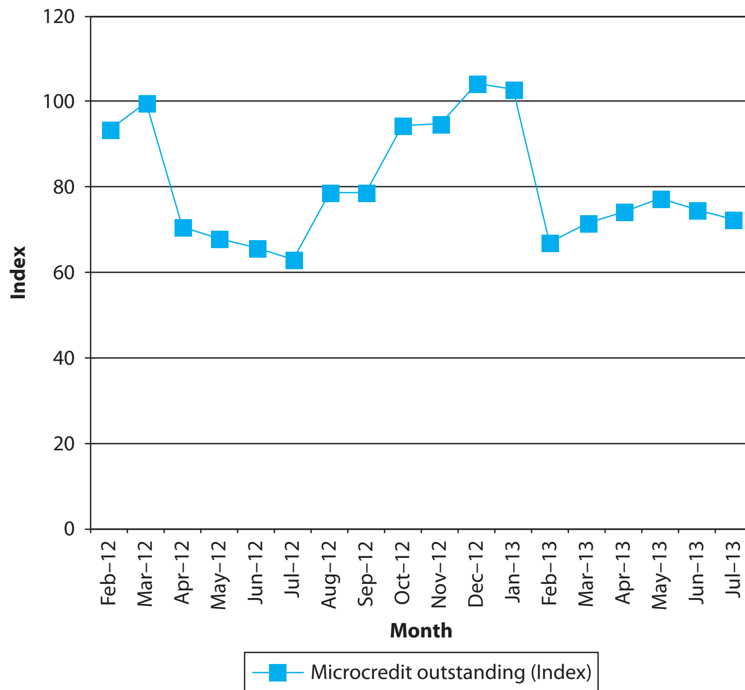

Figure 4.1 Microcredit deployment: 2012–13

improvement in this figure as compared to the previous year. While the pattern is the same for all agencies put together too, the extent of decline was more pronounced. A closer look, however, reveals the role of SIDBI in shaping this scenario. In 2009–10, the year that just preceded the crisis, SIDBI's disbursals stood at ₹2,665 crore, taking the overall figure to ₹10,728 crore. Since then SIDBI has reduced its disbursals. In 2012–13, SIDBI extended loans worth only about ₹400 crore as against the ₹7,422 crore by all commercial banks.

BORROWINGS BY MFIs

We have analysed the borrowings from all sources by the 50 largest MFIs using MIX data (Table 4.3 and Figure 4.2). These estimates show that, as of June 2013, MFIs have borrowed funds worth ₹12,117 crore. Bank loans—from public, private and foreign—formed 79 per cent of these funds or ₹9,546 crore. Public sector banks contributed the most—46 per cent.

The show of faith by the banks in the performance of MFIs has resulted in fresh equity and

Table 4.2 **Loans to MFIs by banks and financial institutions**

Financing agency	Year	Loans disbursed during the year to MFIs	Amount (₹ crore)	Loan outstanding against MFIs	Amount (₹ crore)
Commercial bank	2009–10	645	8,038.61	1,407	10,095.32
	2010–11	460	7,601.02	2,153	10,646.84
	2011–12	336	4,950.98	1,684	9,810.98
	2012–13	368	7,422.66	1,769	12,467.72
RRBs	2009–10	46	24.14	103	52.22
	2010–11	9	4.16	23	42.01
	2011–12	113	13.28	128	37.51
	2012–13	14	4.58	153	70.66
Cooperative banks	2009–10	0	0	3	0.01
	2010–11				
	2011–12	4	1.61	19	4.75
	2012–13	3	4	18	6.83
SIDBI	2009–10	88	2,665.75	146	3,808.2
	2010–11	2	843.78	139	3,041.77
	2011–12	12	239.42	129	1,597.11
	2012–13	41	408.27	102	1,880.63
All agencies	2009–10	779	10,728.5	1,659	13,955.75
	2010–11	471	8,448.96	2,315	13,730.62
	2011–12	465	5,205.29	1,960	11,450.35
	2012–13	426	7,839.51	2,042	14,425.84

Source: NABARD. 2013. *Status of Microfinance in India 2012–13*, Micro Credit Innovation Department (MCID), Mumbai.

Table 4.3 Borrowings by source of the 50 largest MFIs (30 June 2013)

Source	Amount (₹ crore)	% share
Public sector banks	5,615.98	46.35
Private sector banks	3,272.11	27.00
Development finance institutions	907.66	7.49
Foreign banks	657.71	5.43
Equity funds	546.75	4.51
MFI	326.56	2.70
Private finance companies	319.07	2.38
International donor agencies	134.05	1.11
Regional rural banks	88.10	0.73
Trusts and foundations	48.99	0.40
NABARD	23.66	0.20
Multilateral agencies	12.50	0.10
Individuals	4.12	0.03
Others	159.98	1.32
Total	12,117.24	100

Source: MIX data.
Note: (*a*) Borrowings include term loans, secured and unsecured debentures, overdraft and loans; (*b*) The MFIs represented do not include Bandhan and SKS.

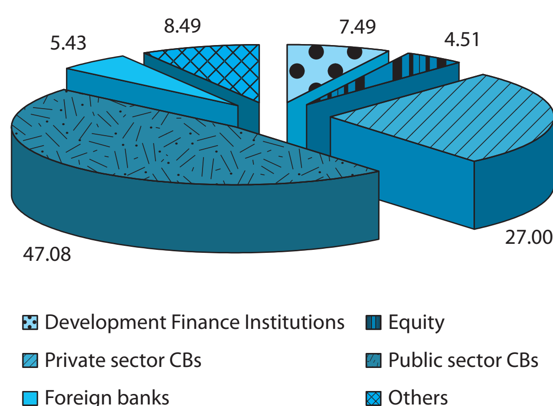

Figure 4.2 Distribution of borrowing by source

debt infusion in the sector. For instance, the leverage ratios of IFMR partners have increased from 2.6 to 3.7 since 2012–13.

There is some evidence that all could not access the increased funds flow from the banking sector equally. Firstly, the distribution of bank funding was skewed in favour of for-profit MFIs as has been noted by Sa-Dhan. As per its estimates, out of the total fund flow of ₹7,448 crore from banks, 89 per cent went to for-profit agencies and a meagre 11 per cent to the non-profits. Secondly, it is the larger MFIs that could access bank funds as compared to smaller and medium ones. MFIN data revealed this imbalance; while the larger MFIs have as high as 91 per cent of their funding coming from banks, the smaller and medium MFIs have only 40 per cent from the banking sector.

OTHER SOURCES OF FUNDING

Equity investment in MFIs during June 2012 to April 2013 is worth ₹4,741 million (Table 4.4).[3] MFIs including Annapurna, Fusion, Grameen Koota, Disha, Saija, Arohan, Sonata, Janalakshmi, Suryoday, Bandhan, Ujjivan, Satin, Utkarsh, Pudhuaaru Financial Services Private Limited (PFSPL), Equitas and Svasti have all raised equity funding. Some like Ujjivan and Utkarsh have gone for multiple equity

Table 4.4 Equity investment 2012–13

Investee	Investor(s)	Amount (₹ million)	Period
Saija	Swarna Pragati Housing Microfinance Ltd Accion	225	Jun-12
Annapurna	Incofin Investment Management	130	Jul-12
Equitas	IFC	900	Oct-12
Suryoday Microfinance	HDFC	70	Oct-12
Arohan Financial Services	Intellecash Microfinance Network	160	Oct-12
Sonata Finance Private Ltd	Creation Investments The Michael and Susan Dell Foundation Swaminathan Aiyar	350	Oct-12
Ujjivan	IFC	450	Oct-12
Ujjivan	Netherlands Development Finance Company	22.8	Oct-12
Equitas	Microventure India India Financial Inclusion Fund	500	Nov-12
Suryoday Microfinance	Aavishkaar Goodwell Lok Capital	200	Jan-13
Grameen Koota	Creation Investments Capital Management	532	Mar-13
Fusion Microfinance	Frontier Fund [Part of NMI] Incofin-Rural Impulse	250	Mar-13
Satin Creditcare	Danish Microfinance Microvest Shore Cap	410	Apr-13
Utkarsh	Aavishkaar Goodwell	85	Apr-13
Utkarsh	IFC	395	Apr-13
Utkarsh	Norwegian Microfinance Initiative	61.5	Apr-13

Source: Compiled by Sanjay Krishnan from VC CIRCLE and MicroCapital deals database and cross-checked with primary sources.

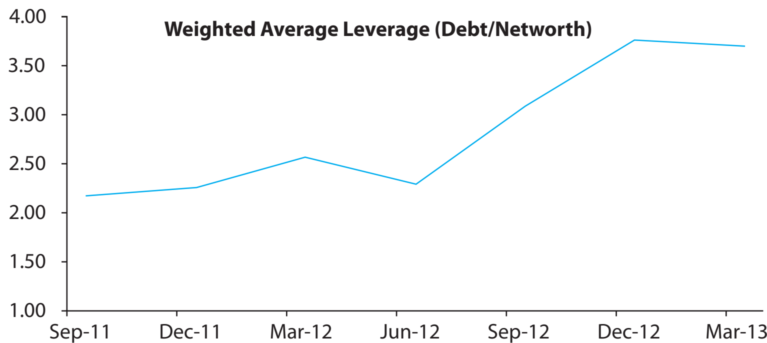

Figure 4.3 Leverage ratio of IFMR partner MFIs

Source: IFMR Capital database.

infusions, while investors like International Finance Corporation (IFC), Creation Investments and Aavishkar picked up stake in multiple MFIs. It may be mentioned that equity investments had somewhat stabilized in 2011–12 itself when they doubled, as the sector started gaining in investor confidence.

IFMR Capital reports that its partners are better capitalized in the current financial year as compared to the previous one. Importantly, equity deals have continued despite the cap on margins. The increased availability of liquidity is evident in the rise in the gearing ratios. The average net worth of IFMR partners has increased by about 60 per cent. Their weighted average leverage has increased from 2.6 to 3.7 (Figure 4.3).

For the smaller MFIs who find it difficult to bring in equity investment, government runs a fund the 'India Microfinance Equity Fund' through the SIDBI with an initial fund size of ₹1,000 million.

A few MFIs has mobilized capital through non-convertible debentures (NCDs). Details of four such deals are given in Table 4.5.

After witnessing a 100 per cent rise in the securitization deals in 2011–12 of about ₹37,000 million[4] (including direct assignments), 2012–13 has not been very good. Table 4.6 provides the details of the major deals made during the first quarter of 2013. During the year 2013–14, the industry is expected to have sold portfolios worth ₹42,000 million to banks and other financial institutions. The changed regulatory provisions guidelines on securitization and direct assignment of loan receivables restrict the number of deals. The last budget imposed a distribution tax of 25–30 per cent on distribution of income from the special purpose vehicle (SPV) involved in the securitization deals. On 7 May 2012, the RBI had put out the final guidelines—no credit enhancement is permitted for securitization transactions and direct assignment of loan receivables. Most of the securitization transactions generally happen towards the end of the fiscal when banks are in a hurry to meet their priority sector lending norms.

Table 4.5 Capital mobilization through NCDs

Organization	Amount (₹ million)	Period
Grameen Koota	250	June 2012
	100	January 2013
IFMR	160	June 2012
Satin Creditcare	500	April 2012
Sahayata Microfinance	195	April 2013
Ujjivan	500	September 2013
Total	1,205	

Source: Compiled by Sanjay Krishnan.

Table 4.6 Securitization deals—2013

Company	Amount (₹ million)	Period
SKS Microfinance	12,070	Apr-13
Satin Creditcare Network Ltd	7,090	Mar-13
ESAF Microfinance	1,020	Mar-13
Suryoday Microfinance	600	Apr-13
Caspian Advisors	525	Apr-13
IFMR	308	Jan-13
Total	21,613	

Source: Compiled by Sanjay Krishnan.

CONCLUSION

The overall investment climate as gleaned from these statistics appears bright and robust for the NBFC–MFIs. Except securitization, the number and value of investment deals have been on the rise. However, this optimism is not shared by the non-profit MFIs. The MFIs that belong to this category are typically small or medium in size, with activities spread across many subsectors. Given their legal constitution, they cannot access all kinds of resources. Bank debt is the principal source of funds, especially for those who do not have access to member savings. In the post Andhra Pradesh crisis months when banks abstained from lending to the sector, this class of MFIs suffered serious problems.

Ananya Finance for Inclusive Growth Private Limited, the NBFC that acts as an intermediary

between banks/financial institutions and MFIs, has been witnessing the difficulties faced by its non-profit partners in accessing bank credit.[5] The situation was really bad during the first half of 2012–13. Between March and July 2012, 31 of its partners reduced their portfolio size by 10 to 20 per cent; 14 among them were non-profit MFIs and 12 had client outreach less than 50,000. During these months, 22 of its partners could not mobilize any bank funds. Two-thirds of these were small MFIs with outreach less than 10,000, and half of them non-profits. The message seems to be that if you are small and not-for-profit, you are almost a non-entity. The question is how to help them find their own space under the financial inclusion umbrella. Until the time the MF Bill gets constitutional approval, this question may also remain unaddressed.

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3. The data does not include equity investments in Bandhan, one of the largest Indian MFIs as the company has not disclosed any information in the public domain.
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Financial inclusion: perspectives and implementation status

5
Chapter

The term 'financial inclusion' has acquired universal acceptance as a kind of entry point for any discussion on the mere access to financial services as well as deeper enquiries into inclusive development. The SOS Reports 2011 and 2012 covered extensively the global perspectives, the financial inclusion architecture in India, the contribution of various stakeholders, the institutional processes involved, and the products and services offered to this nascent clientele of the banking system.[1]

In this chapter, we review briefly the financial inclusion initiatives of the government and banks during the recent years and the related institutional developments. The discussion in the chapter is around the emerging structure of individual-centred banking and the issues and challenges in its implementation.

FINANCIAL INCLUSION IN INDIA: DEFINITIONS AND PERSPECTIVES

While recognizing the concerns in regard to the banking practices excluding vast sections of the population, Y. V. Reddy, the then RBI Governor, urged banks in his Annual Policy Statement of 2005–06[2] to align themselves with the objective of financial inclusion. Financial inclusion was defined as the process of ensuring access to appropriate financial products and services needed by 'all' sections of the society in general and vulnerable groups such as 'weaker sections and low income groups' in particular at an 'affordable cost' in a 'fair and transparent manner' by mainstream institutional players.

The defining statement, however, on financial inclusion in the Indian context was provided by the Report of the Rangarajan Committee on Financial Inclusion (2008),[3] which stated:

> the essence of financial inclusion is in trying to ensure that *a range of appropriate financial services is available to every individual and enabling them to understand and access those services*. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, etc. (Emphasis added)

The Department of Financial Services of the MoF, which steers the financial inclusion plans (FIPs), however, provides a more generic interpretation—extension of financial services to the large hitherto unserved population to unlock growth potential and achieve more inclusive growth.[4]

Considering the public good nature of banking services, the RBI perceives and promotes financial inclusion through the 'bank-led' model.[5] Financial inclusion discourse and strategy, as focused on banks, has envisaged a rapid increase in the outreach of individual-centred banking services through expansion of the banking infrastructure and innovations in outsourcing financial and non-financial operations of banks. There are two major planks of the commercial banks' involvement in the larger financial inclusion: (*a*) outsourcing through different types of agent structures; and (*b*) introduction of IT-based devices and innovations for low-cost operations and for accounting and MIS.

As noted by an European Union (EU) publication, financial inclusion can be expressed as something beyond 'financial access', which is a win–win deal for both sides in financial services delivery.[6] Specifically, it should not pertain merely to providing access to financial services, but also to their usage.[7] Other observers state that real financial inclusion should involve viable business models and should be seen as a long-term process, taking into

account the capabilities of clients to make informed financial choices towards their development. In this sense, apart from banks, it could include the use of financial co-operatives and informal channels such as the SHGs and community-based and managed microfinance institutions built upon them.[8] Positioned as a kind of successor to the (less than successful) earlier attempts at inclusive banking, the current financial inclusion programme does not seem to recognize the on-going programmes and models of financial services delivery to rural areas and disadvantaged sections such as the SBLP, SHGs and MFIs, and the need to integrate them into the larger project.[9] (SHGs, however, may be recognized and serviced as 'individual' clients.)

This and the following chapters address the question whether microfinance, as purveyed through MFIs and SHGs, can be a major financial inclusion initiative. In this chapter we will examine the extent of financial inclusion/exclusion and the recent initiatives by government and the banks taken to remove supply-side constraints. The latter need to be explored for both the promise they hold for cost-effective provision of financial services as also their relevance to people's requirements. The potential for MFIs, SHGs, their promoters and federations to act as BCs and BFs is discussed in greater detail in Chapter 6.

EXTENT OF FINANCIAL INCLUSION: SOME MEASURES

Various estimates of the extent of financial access and inclusion have been made over the years. The All India Debt and Investment Survey 2002 (as quoted in Christabell and Vimal Raj, 2012)[10] estimated that 111.5 million households had no access to formal credit. It also showed that the lower the asset class or income, the higher the degree of exclusion. The World Bank Financial Access Study of 2005 estimated that 59.5 per cent of rural households did not have a savings bank account; the figure was 70 per cent in the case of the landless/marginal farmers' category (Basu, 2006).[11] Only 27 per cent of rural farm households were indebted to formal sources, according to the Report of the Working Group to Review the Business Correspondent Model, Mumbai (RBI, 2009).[12]

According to the World Bank Financial Access Survey (data for the year 2009–10) as reported in Khan (2012),[13] the extent of financial exclusion in India was found to be high as compared with many developed and some of the major emerging economies. The wide extent of financial exclusion in India was in the form of high population per bank branch and low proportion of the population having access to basic financial services such as savings accounts, credit facilities, and credit and debit cards.[14]

As per Census of India 2011, 58.7 per cent of the households in the country avail of banking services (Table 5.1). The proportion of banked households rose by 23 percentage points over the decade 2001–11. The rise was more in the case of the rural sector (24 percentage points) as compared to the urban sector (18 percentage points).

As on 31 March 2013, there are 102,343 scheduled commercial banks (SCBs) in the country, 69 per cent of which are in the public sector. Rural branches form about a third of all public sector bank branches, but they account for only 13 per cent in the case of private sector banks (Figures 5.1 and 5.2).

Between 2008–09 and 2011–12, a substantially large number of rural and semi-urban branches were opened by the SCBs (Table 5.2; Figure 5.3). In addition, 63 per cent (cumulative over the five years) of the new branches were set up in rural and semi-urban areas. This indeed is a great achievement. But it is obvious that sheer increment in numbers would not ensure that people would access and use banking services. Especially in the rural areas access is seriously constrained by physical factors like geographical terrain, distance, and lack of

Table 5.1 Position of households availing banking services

	Census 2001			Census 2011		
	Total no. of households	Number of households availing banking service	Percentage	Total no. of households	Number of households availing banking service	Percentage
Rural	138,271,559	41,639,949	30.1	167,826,730	91,369,805	54.4
Urban	53,692,376	26,590,693	49.5	78,865,937	53,444,983	67.8
Total	191,963,935	68,230,642	35.5	246,692,667	144,814,788	58.7

Source: Government of India. 2013. *An Overview on Financial Inclusion,* Department of Financial Services, New Delhi. http://financialservices.gov.in/Banking/Overviewofefforts.pdf.

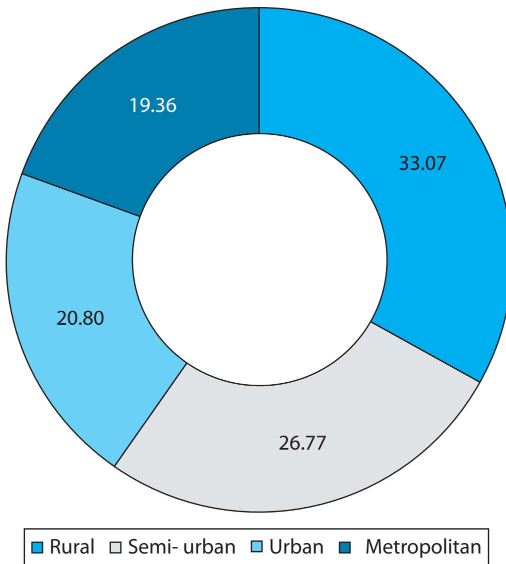

Figure 5.1 Public sector banks: percentage share in number of branches

Source: Government of India. 2013. *An Overview on Financial Inclusion,* Department of Financial Services, New Delhi. http://financialservices.gov.in/Banking/Overviewofefforts.pdf

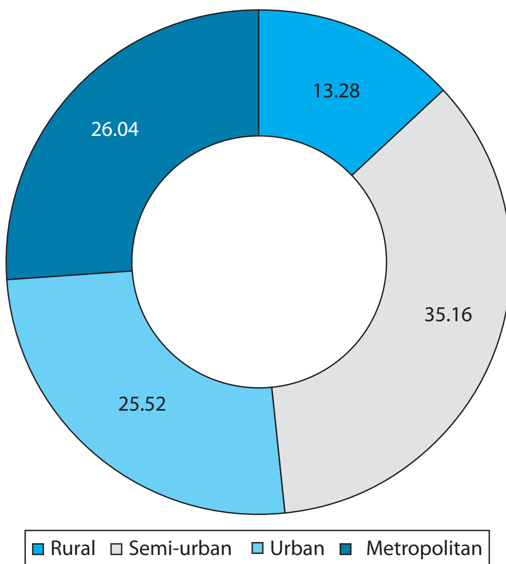

Figure 5.2 Private sector banks: percentage share in number of branches

Source: Government of India. 2013. *An Overview on Financial Inclusion,* Department of Financial Services, New Delhi. http://financialservices.gov.in/Banking/Overviewofefforts.pdf.

transportation. It may be noted that of all the ATMs deployed in the country, only 10 per cent are in rural areas as of 31 March 2013.

Some measures have been developed in recent years to capture financial inclusion with its multiple dimensions. These are discussed here.

Table 5.2 Number of branches opened by SCBs: 2008–09 to 2012–13

Year	Rural	Semi-urban	Urban	Metropolitan	Total
2008–09	706	1,290	1,046	953	3,995
2009–10	1,021	1,729	1,417	1,139	5,306
2010–11	1,422	2,258	919	981	5,580
2011–12	2,453	2,686	1,186	982	7,307
2012–13*	1,598	1,422	546	451	4,017

Source: Government of India. 2013. *An Overview on Financial Inclusion,* Department of Financial Services, New Delhi. http://financialservices.gov.in/Banking/Overviewofefforts.pdf.

Note: *Data is provisional.

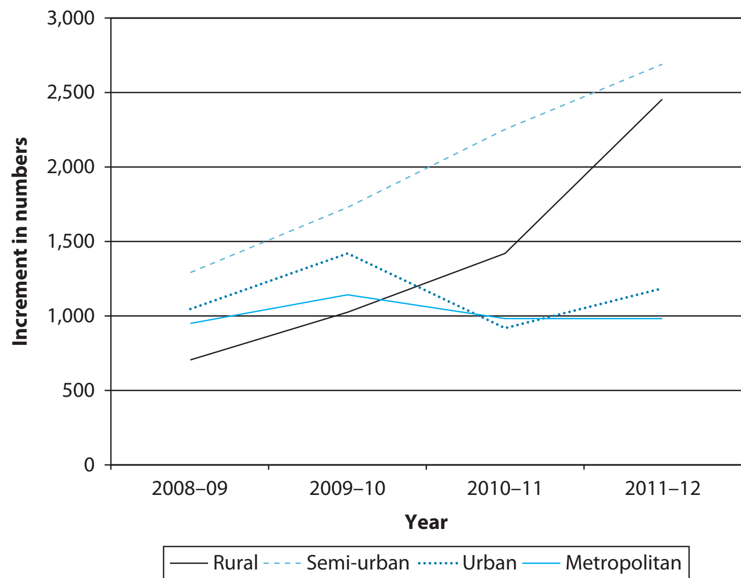

Figure 5.3 Progress in bank branch opening: 2008–09 to 2011–12

Source: Government of India. 2013. *An Overview on Financial Inclusion,* Department of Financial Services, New Delhi. http://financialservices.gov.in/Banking/Overviewofefforts.pdf.

Global financial inclusion (Global Findex)[15]

The Global Findex Database is a project funded by the Bill and Melinda Gates Foundation to measure how people—including the poor, women, and rural residents—in 148 countries save, borrow, make payments and manage risk. The data allows comparison with other South Asian and Brazil, Russia, India, China and South Africa (BRICS) economies as well as within India, where they reveal deep disparities by gender and other individual characteristics in how adults use financial services. The database can be used to track the effects of financial inclusion policies in India and develop a deeper and more nuanced understanding of how people save, borrow, make payments, and manage risk.[16] As per the Global Findex, in India only 35 per cent

of adults have a formal account and 8 per cent a formal loan.

Index of finance inclusion (IFI)

The IFI, developed by Sarma (2008, 2012),[17] combines various banking sector indicators relating to the three basic dimensions of an inclusive financial system: banking penetration (accessibility), availability of the banking services and usage of the banking system. The IFI captures financial inclusion in a single number lying between 0 and 1, where 0 denotes complete financial exclusion and 1 indicates complete financial inclusion in an economy. As per Sarma's estimates (2012), India is a medium IFI country, with the values of the index rising steadily since 2006—from 0.308 to 0.386 in 2010.

Using the IFI estimation method, Chattopadhyay (2011)[18] has worked out state-wise indices and classified them into three categories, that is, states having high, medium and low extent of financial exclusion (Table 5.3).

Table 5.3 **Index of financial inclusion**

Degree of financial inclusion	States
High	Kerala, Maharashtra, Karnataka
Medium	Tamil Nadu, Punjab, Andhra Pradesh, Sikkim, Himachal Pradesh, Haryana
Low	West Bengal, Uttar Pradesh, Gujarat, Tripura, Bihar, Assam, Nagaland, Manipur, Mizoram, Madhya Pradesh, Arunachal Pradesh, Odisha, Rajasthan

Source: Chattopadhyay, Sadhan Kumar. 2011. 'Financial Inclusion in India: A Case Study of West Bengal.' *RBI Working Paper Series, WPS (DEPR) 8/2011*, July.

CRISIL Inclusix

CRISIL released the Inclusix tool in 2013. It has been developed with support from MoF, GoI and RBI to measure the extent of financial inclusion in India, covering 35 states, 632 districts and union territories. It uses a statistically robust and transparent methodology. It is a relative index on a scale of 0 to 100, and combines three critical parameters of basic banking services —branch penetration, deposit penetration and credit penetration—into one metric. The scores denote different levels of financial inclusion: high (>55); above average (40.1 to 55); below average (25 to 40.1); and low (<25). Over time, as consistent and comprehensive data become available, additional services such as insurance and microfinance are planned to be added to the index. Importantly, besides measuring inclusion at the district, state and national levels, the index can be used to compute bank-wise progress on financial inclusion.[19] Thus, Inclusix enables policymakers, regulators, and bankers to identify priorities to improve financial inclusion, design focused initiatives to push the inclusion agenda and, most importantly, measure the progress made.

As it is evident from Figure 5.4, unlike the other available inclusion measures that use monetary aggregates, CRISIL Inclusix uses non-monetary aggregates, such as 'number of people' whose lives have been touched by various financial services, and thus avoids the disproportionate impact of a few high-value figures on the overall index (Table 5.4). Currently the index has been calculated based on the data related to the banking system (SCBs and RRBs) provided by the RBI. Data from a large network of

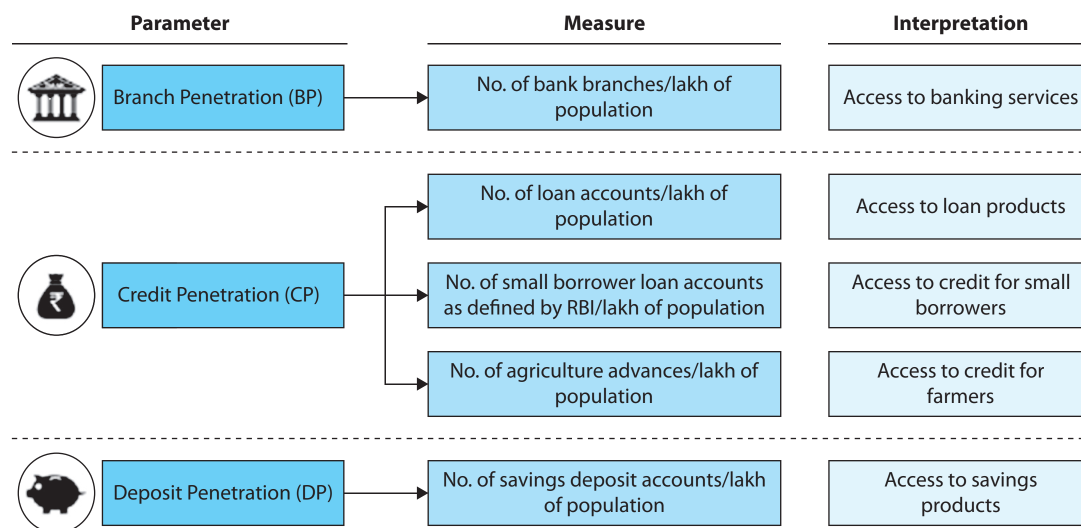

Figure 5.4 CRISIL Inclusix

Source: CRISIL. 2013. *CRISIL Inclusix: An Index to Measure India's Progress on Financial Inclusion*. Mumbai: CRISIL.

Table 5.4 Crisil Inclusix: the position of states and districts

	States/Union territories	Districts
Top 5	• Puducherry • Chandigarh • Kerala • Goa • Delhi	• Pathanamthitta • Karaikal • Thiruvananthapuram • Ernakulam • Kottayam
Bottom 5	• Arunachal Pradesh • Chhattisgarh • Bihar • Nagaland • Manipur	• Kurung • Kiphire • Mon • South Garo Hills • Tamenglong

Source: CRISIL. 2013. *CRISIL Inclusix: An Index to Measure India's Progress on Financial Inclusion*. Mumbai: CRISIL.

NBFCs and MFIs, with over 10,000 branches largely in the rural areas, is not included. However, they cannot be ignored as their client base almost entirely comprises people unserved or underserved by the formal banking network.

Box 5.1 CRISIL Inclusix: key findings

- One out of every two Indians has a savings account.
- Only one in seven has access to bank loan, showing low credit penetration.
- The number of saving accounts (624 million) is almost four times the number of loan account (160 million).
- The overall index in 2011 is 40.1, which is just above average, but notably it has improved from 35.4 in 2009.
  - The southern region leads in financial inclusion (2011) with a Crisil Inclusix score of 62.2.
  - The western region stands second with a score of 38.2, followed by the northern region (37.1), eastern region (28.6), and north-eastern region (28.5).
- The top three states are Puducherry, Chandigarh and Kerala.
- Totally 618 out of 632 districts reported an improvement in terms of financial inclusion.
- However, wide disparities exist across India and within states in terms of access to financial services.
  - The six largest cities have 11 per cent of the country's bank branches, while four districts in the north-east have only one branch each.
  - The bottom 50 districts have just 2 per cent of the country's bank branches.

Source: CRISIL. 2013. *CRISIL Inclusix: An Index to Measure India's Progress on Financial Inclusion*. Mumbai: CRISIL.

Apart from these measures, there were some attempts to visually represent the extent of inclusion/exclusion. The National Informatics Centre (NIC) developed with NABARD support a web-based Geographic Information System (GIS) application for assessing the reach and extent of banking in India and also developing a web-based MIS. The lead banks in all the districts have uploaded the information using the module. Verification of the data is under way.

MIX has recently produced the India map of financial inclusion which visualizes two main facets of financial inclusion at the state and district levels: BCs and MFIs by drawing on the State Level Bankers' Committees 'FIP' data and MIX's own data on MFIs.

Conceptualizing exclusion[20]

A useful scheme to conceptualize financial exclusion has been suggested by Mahajan (2013).[21] As per this scheme, one can define exclusion at least in four ways as shown in Table 5.5.

Mahajan proposes a banking architecture for 2019 that attempts to address the segmented market for financial services.

Box 5.2 Financial inclusion of tribals in Andhra Pradesh

There are one million tribal households in Andhra Pradesh, and about a half of them live in the 5,936 villages in the nine integrated tribal development agency (ITDA) areas. A good number of them are formed into SHGs and credit linked to banks. Mostly, they are small and marginal farmers primarily depending on rain-fed agriculture; labour and minor forest products (MFP)/non-timber forest products (NTFP) collection are the household subsidiary economic activities.

A study covering 189 households whose women members were enrolled with SHGs found that a majority of them have accessed financial services

Table 5.5 Financial exclusion: an alternative conceptualization

Type of exclusion	Major dimension	Some indicators
Spatial	Rural, urban, metro Across regions, states and districts	Share in deposits (2011) of • Rural areas—9.2% • Metros—56.9% • Decline in the rural share over time • Western and southern regions—60% CD Ratio • Tamil Nadu—116% • Bihar—29%
Sectoral	Agriculture, industry, services and sub-sectors within them	Share in credit (2012) of • Agriculture—14% • Industry—46% • Micro and small industry—6%
Segmental	Women, scheduled tribes, scheduled castes, minorities, disabled	• Women with saving accounts—21.2% • Men with saving accounts—58.6% • Priority sector loan outstanding of Muslims (SCBs in 2005)—4.9%
Size and status	Formal, informal Organized, unorganized Marginal, large	Ratio of credit share to operational land share • Marginal farmers—0.35 • Large farmers—3.72

Source: Mahajan, Vijay. 2013. 'Call for an Inclusive Banking Architecture for India by 2019: Fifty Years after Bank Nationalization'. Unpublished paper.

from banks through SHGs and their federations. Nevertheless, nearly one-half of the households were found to depend on high cost informal sources for larger loans, mostly for social needs. Further, the formal institutions could not succeed in meeting the credit demand of the SHG member households for a variety of reasons.

The tribal households borrowed majority of the loans for production—especially for meeting the costs of agriculture inputs, followed by social needs—mainly for health and education. The households had large loans outstanding with formal and non-formal sources. A majority of loans from non-formal sources had 100 per cent of the loan outstanding against the total loan.

These tribals were not able to take advantage of the 'pavala vaddi' and the more recently introduced 'interest-free' loans available from the banking sector with interest subsidy paid by the Government of Andhra Pradesh. To enable them to take advantage of the interest-free loans, the study proposed that banks and Stree Nidhi should adopt a two pronged approach: (*a*) adoption of BC model by using modern technologies, where there is no problem of connectivity; and (*b*) engagement of village organizations as BCs in places with adequate capacity-building inputs on 'strengthening community-based organizations (CBOs)' and 'financial literacy'.

Source: Reddy, K. Raja and T. C. S. Reddy. 2013. *Indebtedness and Financial Inclusion among the Tribals: An Experience of Woman Self Help Group Member Households in Andhra Pradesh*. Hyderabad: APMAS.

Box 5.3 Financial inclusion in hill and mountain areas of north-east region

Mountain-specific factors have not been separately dealt within the diagnosis of broad financial inclusion policy which does not acknowledge any need for specific measures for the hill states or districts. As mountain areas are sparsely populated and villages generally have small population, the physical penetration achieved through financial inclusion has been less in general as compared to the plain areas. While the financial inclusion policy has taken up villages with population above 2,000 for coverage under the FIPs, states such as Himachal Pradesh, Arunachal

Pradesh, Uttarakhand, Meghalaya and Mizoram have less than 2 per cent of their villages with such population level. North-eastern states have over 90 per cent of the villages with population less than even 1,000 persons.

State Bank of India (SBI) piloted the first model called SBI Tiny Scheme in several locations including mountain locations such as Aizawl in Mizoram and Pithoragarh in Uttaranchal. A case study of the SBI Tiny Initiative comparing the performance of the initiative in the hill state of Mizoram and Assam plains underlines the significance of geographical factors in conditioning the impact of FI initiatives. Aizawl, the capital of Mizoram, was among the first places for piloting of SBI Tiny initiative in 2006. The initiative was upscaled to nine outlets while the service rolled out was limited to only a check-in account operated through smart card. However, BC outlets became inoperative after the initial period as a result of problems of connectivity and issues of viability and agency risk. It was understood that BC outlet sub-agents initially taken as staff were not paid the promised salary for more than 24 months.

The authors identify four levels of challenges in ensuring effective financial inclusion in the mountain areas and hill districts: (*a*) ensuring effective penetration; (*b*) ensuring BC outlets are operational and providing comprehensive services; (*c*) ensuring viability of BC operations; and (*d*) ensuring customer protection. These require specific measures such as a cluster approach, investment subsidies in technology, better incentives for BCs and the use of not-for-profit social institutions as BCs and close monitoring of micro branches in hill districts.

Source: Anurag, Priyatam and Abhijit Sharma. 2013. *Mountain Specificity in the Financial Inclusion Policy*. Guwahati: Indian Institute Banking and Finance.

FINANCIAL INCLUSION PLANS: STATUS OF IMPLEMENTATION

As mentioned earlier, the RBI has adopted a bank-led model for financial inclusion which leverages technology and existing banking infrastructure. The central bank believes that the goal of financial inclusion is better served through mainstream banking institutions, as only they have the ability to offer the suite of products required to bring in effective/meaningful financial inclusion. Accordingly, it has sought to use the FIPs as the basis for financial inclusion initiatives at bank level. Banks have been advised to prepare board-approved FIPs for the period 2013–16. Currently domestic SCBs are required to allocate at least 25 per cent of the total number of branches proposed to be opened during a year in unbanked rural (tier 5 and tier 6) centres while preparing their Annual Branch Expansion Plan (ABEP).

FIPs (2010–13): performance of banks

The RBI advised banks to draw up a roadmap to provide banking services through a banking outlet in every village with a population of more than 2,000. Banks were advised that such banking services need not necessarily be extended through a brick-and-mortar branch, but could be provided through any of the various forms of ICT-based models including through BCs. A structured and planned approach was followed under financial inclusion wherein all banks were advised in January 2010 to prepare board-approved FIPs congruent with their business strategies and comparative advantage for a three-year period extending up to 2013. Under the roadmap for providing banking outlets in villages with population above 2,000, banking outlets have been opened in the 74,199 hitherto unbanked villages, comprising 2,493 branches, 69,374 BCs and 2,332 outlets through other modes like ATMs and mobile vans.

The FIP introduced in April 2010 concluded in March 2013. The penetration of banking services in the rural areas has increased to a great extent during this period. Table 5.6 gives the progress made under the FIPs of banks till the period ended March 2013.

Between April 2010 and March 2013, the number of villages with banking connectivity increased by 143,540, and about 5,500 rural branches were opened. There was spectacular rise in the number of BC outlets—by 187,167—creating the basic conditions for branchless banking. It is clear that the activities of the BCs are at the heart of the financial inclusion thrust. But this channel is yet to get stabilized as a viable delivery mechanism for financial services. A fuller discussion of BC models, the viability of BCs, their relationship with existing institutions and channels of financial services for a similar clientele, namely PACS, RRBs, MFIs and SHGs and the prospects for the future is taken up in greater detail in Chapter 6.

The number of credit cards, especially Kisan Credit Card (KCC), did not rise at the same pace as the other parameters. Total number of BSBDAs, the rechristened NFAs, went up by about ₹11 crores. Such impressive increase in their number does not accurately reflect the true picture both regarding

Table 5.6 Progress in financial inclusion under FIPs

	Indicators	2009–10	2010–11	2011–12	2012–13	April 2010 to March 2013
1	Banking outlets—rural branches	33,378	34,811	37,471	40,845	7,467
2	Banking outlets—BCs	34,174	80,802	141,136	221,341	187,167
3	Banking outlets—other modes	142	595	3,146	8,424	8,282
4	Banking outlets—total	67,694	116,208	181,753	270,610	202,916
5	Urban locations covered through BCs	447	3,771	5,891	27,124	26,677
6	Basic Savings Bank Deposit (BSBD) accounts (lakh)	734.53	1,047.59	1,385.04	1,833.30	1,098.77
7	OD facility availed in BSBD accounts (lakh)	1.83	6.06	27.05	39.42	37.59
8	KCCs (lakh)	243.07	271.12	302.35	337.87	82.43
9	GCC (lakh)	13.87	16.99	21.08	36.29	22.28
10	BC–ICT accounts (lakh)	132.65	316.30	573.01	810.38	677.73
11	ICT accounts–BC–total transactions (lakh)	265.15	841.64	1,410.93	2,546.51	4,799.08

Source: Reserve Bank of India. 2013. 'Revving up the Growth Engine through Financial Inclusion'. (Address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the 32nd SKOCH Summit held at Mumbai on June 6, 2013). http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=813 (accessed on 1 October 2013).

the facilities available on these accounts or the usage of these accounts. Nearly half these accounts lie unutilized. Mere renaming would not guarantee access to bank, passbook and ATM card as intended by the account up-gradation and the changed nomenclature.

Share of ICT-based accounts increased substantially. They have come to account for over 44 per cent of the total BSBDAs by March 2013. A total of 480 million BC-based ICT transactions were carried out during April 2010 to March 2013. Relative to the increase in the number of banking outlets, the number of ICT-based transactions still remains low. The focus on monitoring has, therefore, now shifted more towards the number and value of transactions in no-frills, credit and remittance accounts opened through BCs.

SELECTED FINANCIAL INCLUSION MEASURES BY THE STATE

The state initiatives are summarized in Table 5.7. Clearly, the strategies the central government has undertaken to take the commercial banking system closer to the people across the country with the help of agents and technologies have had some results.

Some of these measures like mobile banking and AEPS will be discussed in some detail later in the report. The objective of the DBT Scheme is to ensure that money under various developmental schemes reaches beneficiaries directly and without any delay.[22] The scheme has been launched in the country from January 2013 and has been rolled out in a phased manner, starting with 26 welfare schemes, in 43 districts. The scheme is now being extended to 78 additional districts and three additional schemes from 1 July 2013 and would be extended to the entire country in a phased manner. Banks play a key role in implementation of DBT and this involves four important steps, which are as follows:

1. Opening of accounts of all beneficiaries;
2. Seeding of bank accounts with Aadhaar numbers and uploading on the NPCI mapper;
3. Undertaking funds transfer using the National Automated Clearing House—Aadhaar Payment Bridge System (NACH–APBS);
4. Strengthening of banking infrastructure to enable the beneficiary to withdraw money.

In order to make DBT work effectively the banks will have to ensure that all beneficiaries have a bank account. All public sector banks and RRBs have made provision for Aadhaar seeding in the Core Banking Solution (CBS). However, the process of seeding the bank accounts with Aadhaar numbers is faced with various constraints which could impact the roll out of the DBT initiatives.

All public sector banks have also joined the APBS of NPCI. They are in the process of issuing debit cards to beneficiaries. Efforts are also being made by banks to strengthen banking infrastructure and provide BCs in areas which have hitherto been unserved. Banks have also been advised to provide on-site ATMs in all the branches in identified districts and issue debit cards to all beneficiaries to enable them to withdraw cash as per their convenience.

Table 5.7 Financial inclusion initiatives of the state

Initiative	Coverage	Channels and instruments
Banking facilities in unbanked blocks	Covered 129 unbanked blocks (91 in north-eastern states and 38 in others) between July 2009 and March 2012	Brick-and-mortar branches, BCs, and mobile vans; business correspondent agents (BCAs) and ultra small branches (USBs)[23] are proposed
'Swabhimaan' campaign (launched in February 2011)	By March 2012, banking facilities provided to over 74,000 habitations having population in excess of 2,000; extended in 2012–13 to 40,000 habitations more (with population of more than 1,000 in north-eastern and hilly states and to habitations which have crossed population of 1,600 as per census 2001)	Multiple models and technologies including branchless banking through BCAs
Mobile Banking using Unstructured Supplementary Service Data (USSD)	National Payments Corporation of India (NPCI) created 'Common USSD Platform' for all banks and telecommunications companies (telcos) to help mobile banking. More than 20 banks have joined the platform	Products launched with Bharat Sanchar Nigam Limited (BSNL) and Mahanagar Telephone Nigam Limited (MTNL)
Aadhaar-Enabled Payment Systems (AEPS)	Basic banking transactions at points of sale/ micro ATM using Aadhaar authentication	BCA of any bank
Direct Benefit Transfer (DBT; launched in January 2013)	Transfer of cash assistance under various government schemes; working in 121 districts for 29 schemes	Debit cards and ATMs

The debit cards will also strengthen the withdrawal infrastructure.

Role of NABARD

In order to accelerate the pace of financial inclusion, the central government has entrusted NABARD with the setting up of two funds—Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF)—in 2007–08. While the FIF aims to support development and promotional activities to secure greater financial inclusion, the FITF focuses on enhancing investment in ICT aimed at providing financial inclusion. As on 31 March 2013, the cumulative sanctions under FIF and FITF were ₹1,816.4 million and ₹3,654.9 million respectively, against which disbursements were ₹697.7 million (38.4 per cent) and ₹2,013 million (55 per cent) respectively. NABARD seeks to move all agricultural loans on to the RuPay KCC with a view to bring all members and non-members of PACS within the formal financial system.

Further, NABARD has extended support to the RRBs to implement ICT-based solutions and to integrate with the AEPS. The assistance involved funding of issuance of Aadhaar-enabled KCCs and setting up of point-of-sales devices as well as ATMs. It also assisted RRBs and cooperative banks to widen the network of BCs/BFs by capacitating farmers' clubs and well-run SHGs. It has financed the pilot project 'Invest India Micro Pension Services (IIMPS)—Micro Pension Model', which has enrolled over 20,000 low-income rural workers, mainly SHG members, farmers and daily wagers.

NABARD has been supporting Indian Institute of Banking & Finance (IIBF) to train and certify BCs/BFs and assisting banks in setting up Financial Literacy and Credit Counselling Centre (FLCCs) in excluded and disturbed districts. RRBs and cooperatives have also been extended assistance to set up FLCs.

The impact of these efforts in terms of increase in transactions among the targeted populations is not yet known. Since these are created as public goods accessible to all, it would be vital to monitor the extent of usage of these services by the historically excluded sections—women, minorities, and socially backward groups. Evidence as of now suggests that while access to financial services has improved, the usage of the financial infrastructure continues to be sluggish. As per RBI data, the transactions through the available banking outlets—2.70 lakh of them—across the country still remain low. Nearly half of the BSBDAs have not seen any transactions. 'This not only restricts the potential benefits that could accrue from increased financial access but also reduces the viability of FI activities for banks and BCs. The reduced viability, in turn, impacts the scalability of the model, thereby hampering FI efforts.'[24]

State government initiatives

There are some pioneering experiments undertaken by state governments that aim at evolving effective and cost-efficient means to promote access to and use of financial services by unbanked and poor families. The model of DBT implemented by the Government of Madhya Pradesh, Samvruddhi, is one such initiative (Appendix 5.1). The scheme has three core aspects: (*a*) building up of a common database of the entire population of the state to mark entitlements such as employment, housing, food security, poverty status, etc.; (*b*) ensuring accessibility of financial institutions within every five kilometre radius of unbanked 'shadow' areas, either through USBs of banks or other financial institutions and Common Service Centres (CSCs); (*c*) transfer of funds directly from the government departments to beneficiaries' accounts that are in core or non-core banking facilities (post offices and cooperative banks), by way of electronic-Fund Management System (e-FMS).

The second initiative worth mentioning is the 'Jeevika' programme being implemented in Bihar by the Bihar Rural Livelihoods Promotion Society (BRLPS). Under Jeevika (Appendix 5.2), an integrated model of financial inclusion has been initiated involving SHGs. The model has been extended to 20 blocks in nine districts. It aims at providing financial literacy and credit counselling to SHG members to begin with. The pilot is based on the indigenous model of taking the services of 'Vitta Mitras' or 'Community Resource Persons for Financial Services', who are SHG women members. They reach out to the community by sharing information about financial services on a person-to-person basis.

UNDP initiatives for financial inclusion

With the objective of improving access to financial products and services to reduce risks and enhance livelihoods for the poor, especially women and men from SC and ST groups, minorities and the displaced, UNDP initiated a financial inclusion project with five components: (*a*) design and pilot innovative financial products and services that suit livelihoods of the poor; (*b*) support to district-level demonstration of new products and channels; (*c*) strengthen financial literacy initiatives; (*d*) support knowledge sharing at state and national levels; and (*e*) engage with policy makers and sector experts to strengthen the financial inclusion agenda. The project was implemented from 2008 to 2012. While the first three components of the outputs were jointly managed by UNDP and NABARD, knowledge sharing and policy was directly managed by UNDP. Following an integrated approach, UNDP engaged a range of financial service providers, communities, civil society institutions, training institutes, knowledge, sectoral experts and policy makers. Details of the Project are provided in Appendix 5.3.

CONCLUDING OBSERVATIONS

The financial inclusion drive, apart from developing various elements of the banking infrastructure, succeeded in increasing the penetration of banks to 74,000 villages with a population of over 2,000, and led to the opening of tens of millions of NFAs, later re-designated as BSBAs. However, around half of these accounts have been non-operational, and the vast majority of the remainder only have access to minimal savings facilities with a single bank. The product offered is no-frills savings account, and technology is not interoperable, meaning that the customers can only perform transactions with a single bank.

The commercial banks have generally remained quite indifferent to financial inclusion. They have not benefited from financial inclusion in terms of deposits and have not had the revenues from any appreciable volume of transactions. BC organizations which manage BC agents have made losses and have had to scale down operations while the agents themselves received low salaries and commissions with many of them also opting out of performing this activity.

Over the past two years, the pressure on banks to achieve targets in terms of numbers of villages covered and accounts opened has reduced. Instead, the banks have had the space to upgrade or change their technology. With the change of focus of banks to generate more meaningful business, some innovation in product mix and new channels of delivery, opportunities are emerging to drive financial inclusion across India. Further, Unique Identification Authority of India (UIDAI) and NPCI brought in solutions that enable standardization and interoperability, thus taking away the lock-in that customers and banks used to have previously.

District Central Cooperative Banks (DCCBs) were not allowed by RBI in its initial circular to undertake financial inclusion through the BC model. This was primarily because these banks had not implemented CBS. NABARD took the lead in having DCCBs upgraded onto CBS. Recently RBI has allowed the DCCBs to implement the BC model.

There are 109,000 PACS associated with the DCCBs across India. These societies have physical infrastructure in villages. Further, PACS' personnel have experience in banking services. PACS present a significant opportunity to drive financial inclusion due to these strengths. There is an opportunity to leverage these societies as BCs of the DCCBs by ensuring their financial viability is maintained.

The microfinance institutional network, as pointed out earlier, has so far not been tapped to deepen the reach of institutional financial services. Leading MFIs have professional management and provide services that are truly needed by the customers. The NBFCs, being for-profit entities, are not allowed by RBI to become BCs of banks in view of 'conflict of interest' as they serve the same clientele. Several of the non-profit MFIs act as BFs for banks. Their share is likely to go up as the struggle to raise funds becomes harder for non-profits with the tightening of regulation. Innovative thinking is needed to identify how the MFIs can participate in the process of financial inclusion. Some MFIs have launched not-for-profit affiliates to act as BCs of banks.

With nearly 7.32 million groups and 95 million members as of 31 March 2013, SHGs present a powerful opportunity to drive financial inclusion in India. The members of SHGs are familiar with banking processes, and can become BCs of a bank. An experimental pilot is being run in Uttar Pradesh to try out this concept. These and other BC initiatives are discussed in Chapter 6. As such, it may first be necessary to reposition 'financial inclusion' from its supply-led thrust such that it is seen as a means of enabling poor clients to usefully access financial services and act for their betterment. Indeed the issue of financial services provision may better be seen as one of sustained financial inclusion, an objective which is not fulfilled by the opening of NFAs and other facilities provided along with them. It is then that the relevance of SHGs as people-first institutions may be appreciated.

Besides, it is open to question whether a technical platform through channels and products, such as BCs, NFAs, financial literacy centres, etc., can connect to the people in the way that SHGs can—or even whether financial literacy can 'compensate' for the disconnect between the banking system and the unbanked poor. At a more basic level, it can be questioned whether poor and uneducated clients need 'financial literacy' to understand the products of banking, or is the system obliged to develop simpler products and procedures in keeping with the needs and capabilities of this clientele.

APPENDIX 5.1
Samvruddhi: financial inclusion and direct benefit transfer by the Government of Madhya Pradesh

'Samvruddhi' (meaning prosperity) is an initiative of the Government of Madhya Pradesh to provide banking facilities for the unbanked and to provide DBT. The initiative is founded on the thinking that to ensure transfer of benefits of social schemes executed by the government, a transparent transfer system connected across the villages and hamlets of the state is essential, and technology and formal bank linkage are the best ways to make this happen. The banking system not only acts as a conduit for money transfer, but also brings along scores of other benefits and paves the path for inclusive growth.

Samvruddhi is being achieved through three core activities:

1. Samagra Samajik Suraksha Mission (SSSM) was created in August 2012 under the Social Justice Department and registered as a society. The mission aims to build a common database of the entire population of Madhya Pradesh to mark entitlements such as employment, housing, food security, poverty status, etc. This initiative is promoting convergence of social security schemes of various state and central government departments by ensuring single delivery points for all the entitlements. NIC along with the IT Department of Government of Madhya Pradesh is providing technological support to develop the software. Within a short span of time, data pertaining to 89 per cent of the population has been generated. As of August 2013, SSSM-based pension transfer was tested in 15 out of 50 districts. The data is available on a website called 'Samagra', which contains details of payments and bank accounts of beneficiaries of government grants and subsidies. The Lead District Managers of all the districts have access to this website, which can also provide to bank branches a list of beneficiaries without bank accounts, who can open such accounts.
2. The second initiative aims to ensure accessibility of financial institutions within a five km radius of unbanked areas either through USBs of banks or other financial institutions. Owing to low density of population in the state (196 people per square kilometre), people in rural areas of the state were

forced to travel 20–90 km to avail financial services. An exercise was therefore taken up by District Level Coordination Committee (DLCC) to map the districts and mark the commercial banks, RRBs, cooperative banks, post offices as well as villages that had to cover a distance of more than 5 km. It was observed that 14,676 out of 53,009 villages did not have access to any of the above-mentioned financial institutions in the state. The concept of 'shadow area'[25] thus evolved and 2,998 locations were identified for opening USB/CSC to ensure shadow area villages were catered to. As of August 2013, 1,761 USBs have been set up.

The key to improving BC returns and viability of the whole system is to utilize as BC agents the CSCs which have a physical presence, and computers which are linked to banks' CBS and have the confidence of the people since they are already providing many e-services. The Madhya Pradesh model where about 10,000 CSCs have been opened through investments by government has been found to be worthy of replication elsewhere.

3. The third initiative aims at transferring funds directly from the department to beneficiaries' accounts that are in core or non-core banking facilities (post offices and cooperative banks), by way of e-FMS. There was a problem of devolution of funds to RRBs and post offices that were into core banking and for cooperative banks and post offices that were not in core banking. With the support of NABARD, a shift of RRBs and cooperatives to core banking has been triggered. However, the post offices are yet to initiate the core banking process. In order to ensure quick devolution of funds, intermediate arrangements were made through Sanchaya post. Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) shifted completely to e-FMS mode in all the districts of Madhya Pradesh from 1 April 2013. So far, around ₹385 crore has been devolved through this mechanism.

Source: (*a*) Letter from Aruna Sharma, IAS, Additional Chief Secretary & Development Commissioner, Department of Panchayat, Rural Development & Social Justice, Government of Madhya Pradesh; (*b*) Central Bank of India, 'Report on National Workshop on SAMRUDDHI—through Financial Inclusion and Direct Benefit Transfer'; (*c*) Government of Madhya Pradesh, 'Samagra Samajik Suraksha Mission', 2013.

APPENDIX 5.2
Bihar Rural Livelihoods Promotion Society (BRLPS)—total financial inclusion of the poor

Total financial inclusion is an integrated model of ensuring access to different financial products by providing financial literacy and credit counselling to SHG members. Some of the aspects that have been covered and envisioned under TFI are as follows:

1. Financial literacy and credit counselling of SHG members on various financial services such as savings, credit, remittance, insurance, pension, etc.
2. Ensuring access to banking services (opening of savings bank account for individual members).
3. Utilization of BC model (alternate banking channels) as well besides the branch networks for accessing banking facilities.
4. Insurance for SHG members under Jan Shree Bima Yojana and putting across information about government-sponsored insurance products such as Rashtriya Swasthya Bima Yojana (RSBY).
5. Account opening of individuals who are entitled for social security pensions from the government.
6. Transfer of social security pensions through electronic benefit transfer (EBT).
7. Integration of overdraft and ATM facility for women members.
8. Introduction of pension policy for members under the New Pension Scheme (NPS-Lite).

Based on the concept, a pilot has been initiated in Pilkhi panchayat of Rajgir block. The pilot is based on the indigenous model of taking services of 'Vitta Mitras' or 'Community Resource Persons for Financial Services', who are SHG women members reaching out to community and sharing information about financial services on interpersonal basis. The results and coverage of the pilot are as follows:

1. Total number of SHGs: 111
2. Total number of members: 1,258
3. Total number of accounts opened: 1,113 (89 per cent out of 1,258 members)

4. SHG members insured under Jan Shree Bima Yojana: 513 (which is 42 per cent of the total eligible members, i.e. 1,227)
5. Total members eligible for Social Security Pensions: 361
6. Access of Social Security Pension through EBT: 357
7. Number of members covered under New Pension Scheme-Lite (NPS-Lite or Swavalamban): 58

Considering the impact of the pilot, the decision has been taken to scale up the pilot in 20 blocks across nine districts. Partnership with different banks (utilization of BC model, overdraft facility for SHG members) is under discussion and there is a very positive response from the banks. The scaling-up work is likely to positively impact approximately 25,000 SHGs and around 300,000 SHG members.

Source: BRLPS.

APPENDIX 5.3
UNDP financial inclusion project

Areas of contribution of the UNDP Financial Inclusion Project are given below:

Financial literacy: FINO reached out to 35,724 financially excluded households of which 14,898 opened savings accounts and 1,167 purchased insurance policies. NABARD UP had undertaken more than 2,000 programmes across the state though 46 DDM districts and reached out to about 30,000 households. NABARD and the Indian School of Microfinance for Women (ISMW) implemented such initiatives in other states. NABARD data indicate increase of 32 per cent in SHG membership, 25 per cent in savings bank accounts, 48 per cent in KCCs, and 74 per cent in micro insurance.

Product and delivery innovations: Emmanuel Hospital, a project partner, helped 29,500 individuals adopt Rastriya Swasth Bima Yojana (RSBY). In Bihar, the partnership between ASSEFA, Canara Bank and Grameen Bank enabled opening of 1,600 savings accounts and about 150 insurance/pension accounts.

Leveraging multiple partnerships: The initiative with Jharkhand State Livelihood Promotion Society (JSLPS) in Pakur District involved multiple partnerships (state government, NABARD, nine CSOs, ISMW), and locally appropriate methodologies to reach out to the intended target group. The Project used various activities to understand the clients in developing training and motivation methodologies using local dialects and appropriate pedagogy (such as puppet shows, kalajatha, camps, etc.). An NGO network at the district level (called Parivartan) is developed along with 'Bank Mitras' in every village.

Business facilitator model: Prathama Bank hires business facilitators to promote its products and services. The BFs are paid incentives based on the volume of business they generate.

Business correspondent model with FINO: This initiative developed excellent methodologies and tools to capacitate and motivate BCs to take up financial inclusion effectively. This model also provides opportunities to look to BCs to provide multiple services, which can be delivered effectively locally and also ensure sustainability of BC operations.

Microfinance for livelihood promotion: In collaboration with Bandhan a model was developed to help clients with business planning and access appropriate credit and insurance products. About 2,000 clients were reached, 1,600 business plans were developed, 80 new loans sanctioned, 143 new bank accounts opened and insurance cover extended for all.

Resource centre for opening of accounts: To sustain the work of financial inclusion at the CSO level, a resource centre was established with ASSEFA in Bihar.

Micro pensions: A consultation was facilitated between Invest India Micro Pension Services (IIMPS) and Government of India to share the experience of Vishwakarma initiative of the Rajasthan government. Vishwakarma covered about 60,000 people in the unorganized sector for micro pensions. The central government notified it as a national scheme on 28 February 2010.

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2. 'Annual Policy Statement for the Year 2005–06' by Dr Y. Venugopal Reddy, Governor, Reserve Bank of India.
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4. The objective of financial inclusion is to extend financial services to the large hitherto unserved population of the country to unlock its growth potential. In addition, it strives towards a more inclusive growth by making financing available to the poor in particular (see Government of India. 2012. *State Wise FIP Progress*. Department of Financial Services. http://financialservices.gov.in/Banking/FIP%20DATA%2031.03.2012.pdf).
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7. This is a pertinent issue since several studies have shown that measures such as the opening of NFAs have been largely ineffective since the vast majority of such accounts have remained inoperative.
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    > Community-based institutions allow people to save and use their money. The money, its management, the decision making power and profits are all in the hands of members. They provide a direct route to financial inclusion, poverty reduction, and above all, social and economic empowerment.

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20. This section is drawn from Mahajan, Vijay. 2013. 'Call for Inclusive Banking Architecture for India by 2019, Fifty Years After Bank Nationalization', unpublished note.
21. Mahajan, Vijay. 2013. 'Call for Inclusive Banking Architecture for India by 2019, Fifty Years after Bank Nationalization.' Unpublished note.
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23. A USB would comprise of a small area of 100–200 sq. feet where an officer designated by the bank

would be available with a laptop on predetermined days. While the cash services would be offered by the BCAs, the bank officer would offer other services, undertake field verification and follow up the banking transactions. Nearly 50,000 USBs have been set up in the country by 31 March 2013.

24. 'Revving up the Growth Engine through Financial Inclusion, Address by K. C. Chakrabarty, Deputy Governor, Reserve Bank of India, at the 32nd Skoch Summit, Mumbai, 6 June 2013.
25. A 'shadow area' is an area that does not have any brick-and-mortar financial institution.

Business correspondents and microfinance: emerging relationships

6
Chapter

The guidelines for the outsourcing of financial services by banks through partnering with BFs and BCs were notified by the RBI on 25 January 2006, with the former confined to non-cash operations. In the initial stages it appeared that the public sector banks were mainly looking to increase their outreach through the existing branch networks by introducing BFs in their operations rather than seeking out BC intermediaries for undertaking a range of financial functions. However, private banks with their limited branch network had been expected to use BC–MFIs as part of their business strategy, with ICICI Bank having taken the lead. Under the 'partnership model', MFIs received large and easy funds for lending from private banks, often more than their capacity to absorb. This was a contributory factor to the Andhra Pradesh microfinance crisis of 2006. The partnership model was discontinued around this time.

While pilot projects were also launched for the delivery of liability products—micro savings, micro insurance and micro pensions—the cost of raising small deposits through BCs/MFIs was a deterrent. As a result of this, MFIs were not keen to participate as BCs in savings collection on behalf of banks.

Subsequently, in November 2009, the RBI advised banks to draw up a roadmap to provide banking services through a banking outlet in every village with population of more than 2,000 and the target date was March 2012, extended till March 2013. These services could be extended not only through a brick-and-mortar branch but also through any of the various forms of ICT-based models, including through BCs. CBS would allow banks to network their branches so that customers could operate their accounts and avail other banking services from any branch, regardless of where they maintain their accounts. Subsequently when the BC model took root, the prime movers acting as BCs on behalf of the banks were technology service providers (TSPs) who were expected to provide hardware and software solutions using ICT applications for efficient and economically viable operations.

It also necessitated their involvement in field operations, either directly or indirectly—through their own financial services affiliates or through experienced support organizations—managing BC networks to deliver services to the clients. What emerged as a result was not merely a BC or a BF linked to a rural bank branch to assist in last mile service delivery, but a whole superstructure of stakeholders with specific tasks and roles. Since the opening of NFAs was the starting point of the thrust towards financial inclusion, the process involved beginning with an essentially non-financial role, that is, that of the BF, for the now designated BC agent or CSP. It was only when accounts became operative and transactions effected in them that the CSP would perform the BC role involving financial functions and cash handling. The term BF thus virtually disappeared and became subsumed within the BC and related nomenclature.

Box 6.1 FINO PayTech Ltd: the largest business correspondent

FINO has been in business since July 2006. FINO PayTech is a spin-off from ICICI Bank. It is India's largest BC, catering to 64 million clients. At least 35 million out of this have no-frills savings accounts with a bank. They work in 260 districts and have 45,000 rural/urban transaction points (agents) in 27 states. Investors in FINO include Union Bank of India (UBI), Indian Bank, Blackstone, IFC, apart from ICICI Bank and ICICI

Lombard. FINO's lines of business include no-frills saving accounts, bank-led remittances, account to account, account to cash and cash to account, cash to cash and overdraft accounts. USBs have been organized with UBI. Financial literacy services with ISC and pocket transaction devices that are GPRS enabled, electronic pass book on smart card, mini ATMs which are micro deposit machines are some of the products and services provided by FINO.

Apart from NREGA payments, FINO has covered Rajasthan, Uttar Pradesh, Madhya Pradesh, Maharashtra, and Kerala under RSBY. On the lending side, there are two basic business models—a BC model where debt is on the books of the bank and an MFI that on-lends to JLGs and SHGs.

For the managed portfolio, there is a Section 25 company, FINO Fintech Foundation, through which the entire BC operations are run. The managed portfolio business was started in 2009. FINO also has an NBFC–MFI—Intrepid Finance and Leasing Pvt Ltd—which was started in 2010.

Source: FINO.

As a result of these measures, the penetration of banking services in the rural areas has increased to a great extent. As seen from Figure 6.1, banking connectivity had been extended to 221,341 villages on 31 March 2013 through BCs deployed by banks, increasing from 31,474 on 1 April 2010 at the beginning of the 12th five-year plan period.

PERFORMANCE AND VIABILITY OF THE BC CHANNEL

Several important studies have examined the viability and sustainability of the functioning of the BC model. The findings of the studies undertaken by MicroSave of BC networks were reported in the SOS Report 2012 (Puhazhendhi, 2012).[1] A recent study by APMAS for NABARD regional office in three districts of Andhra Pradesh found that the volume of business generated by the BCs was negligible, with a high proportion (31 per cent) of accounts inactive and that the services provided through the BC outlet/CSP were limited to deposit and withdrawal of savings (Appendix 6.1). However, the services provided reduced transaction costs for the client and helped in the promotion of savings.

Other major studies too confirm the doubts about the viability of this channel. According to the study by Sa-Dhan and Citi Foundation (2012),[2] 'the shortcomings for the BC model are the cost structure, bank's lack of commitment, absence of financial literacy, lack of knowledge between customer service point operators (CSPs) and clients and lack of a grievance redressal system.' The study highlighted several issues with the BC model.

The compensation structure was too fragile to sustain the BC system with a single product like NFA on offer by the banks. The brunt of the burden was being borne by the CSP, who is employed by the BC. At the branch level, the programme was considered an unavoidable part of the work. Even at the corporate level, the business garnered by the BCs was too small to attract attention as a significant

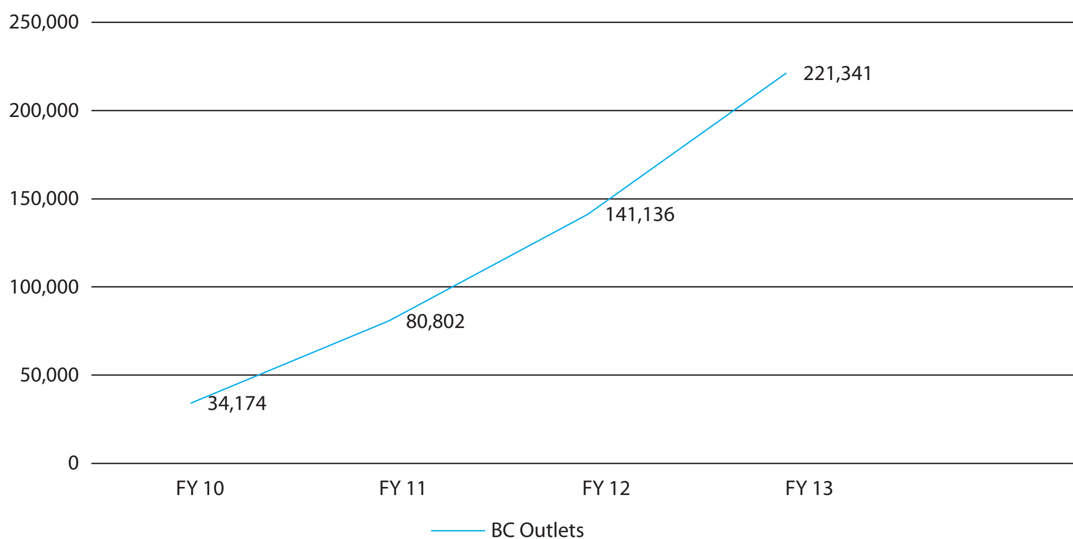

Figure 6.1 BC outlets—villages

business activity. The methodology of selecting BCs was acting against the system. The banks selected BCs through a competitive bidding process and the entity which quoted the lowest (L1) got selected. The dormant accounts under NFAs ranged between 88 and 96 per cent.

The fear of high operational risk in the form of deviation from acceptable norms, frauds and misappropriation was the other major factor that inhibited more products from being offered by the banks. The BCs were not investing in robust systems, procedures and supervisory mechanism to prevent/manage operational risk on account of the low return from operations.

The morale at the CSPs was running low due to low and/or delayed remuneration, poor knowledge of the banking norms, lack of process participation, absence of an effective grievance mechanism, frequent technical snags, low cash-holding capacity and frequent changes in rules. The CSPs of the not-for-profit MFI-led model of BCs were found to function with greater understanding of customer needs.

Most of the clients had little knowledge of the range of services the BCs offered. They appeared to be uninformed of the advantages of dealings with the BCs and also the government's attempt to provide banking services at close proximity. Financial literacy programme, which is a key success factor, was almost missing. There was no proper dedicated customer grievance mechanism or channel for customers of BCs in many banks.

The College of Agricultural Banking–Consultative Group to Assist the Poor (CAB–CGAP) Survey (2012) found that about one-fourth of CSPs were not in a position to put through transactions at the time of the survey. While many CSPs were hopeful about their job, they also felt that their personal objectives in taking up the job were not realized. Revenues fell short of expectations, and most CSPs continued with the service on account of the social relevance and their enhanced reputation. While rural CSPs had fewer transactions and revenues with low business prospects, the transaction volumes and revenues in urban CSPs seemed adequate to make a business case. Many CSPs were not positioned as effective extensions of the banking system. There was a significant mismatch between demand for and supply of financial products. Banks prioritized savings almost to the exclusion of other products. The study concluded that while the business case of CSP network remains to be proved at CSP and bank levels, the motivation to continue remains high on the part of CSPs. Banks would need to make necessary investments to make financial inclusion a part of their core business.

On the basis of the observations, the CAB–CGAP Survey suggested (*a*) increasing the product/service offering through CSPs in locations with potential; (*b*) scaling up of marketing support from banks; (*c*) streamlining of technological capacities; (*d*) greater attention to liquidity management; (*e*) enhancing capacities of CSPs to provide services through training and continued monitoring; and (*f*) introduction of a system to produce customer and CSP feedback for the banks.

It is understood that another survey is being launched with an expanded sample, covering more states and banks than the last year. The study results are expected in early November 2013. While first reports suggest that half the CSPs surveyed earlier were unavailable, the situation could change at the time of the second survey.

Notwithstanding the progress made in financial inclusion, questions remain about the extent of use of financial services by the poor population, the utility of the products and services sought to be provided, the margins available and the profitability of their operations for the proposed partners, agents and intermediaries.

Common BC: a short-lived idea?

A matter of great and immediate relevance was the introduction of the cluster approach towards financial inclusion, whereby India had been divided into 20 geographical clusters, each to be covered by a common (corporate) BC appointed for all public sector banks operating in the cluster. A request for proposals (RFP) was floated for common BCs in March 2012. Tenders for various states that were awarded through reverse auction went for as low as 0.02 per cent[3] to 0.54 per cent for cash management. Given the fact that BC operations had generally been in the red and the viability of BCs themselves was a matter of research and debate, these low bids were quite startling. The unrealistic bids made in four states had to be cancelled and the process restarted (Rajshekhar, 2012).[4] This brought to the forefront the unresolved questions of the feasibility of the bank–BC model, including questions about the cost and effectiveness of the multiple layers of intermediaries in financial services delivery.

There were genuine apprehensions that new monopolies would be created of entities that did not have experience of financial services delivery in rural areas, and which would hardly innovate and provide high quality service to the customers. The

potential incomes for the common BCs were expected to be from the payments system, as transfers from up to 32 government schemes, running into billions of rupees, could be involved. At the same time, the returns from the fixed-charge transaction-based fees for financial services were hardly attractive. There was also concern about the fate of the many BCs and CSPs, or BC subagents, in place under initiatives already undertaken by different banks, which would have to be absorbed in the new arrangements involving the common BCs. Besides, the extremely low bids were suspected to be similar to other forms of sharp business practices akin to the cornering of telecom spectrum for speculative gains.

The cancelling of the bids has stalled the process and banks have been advised to continue with the existing arrangements. Nevertheless, the idea of the introduction of the common BC resulted in a setback to the progress of the BC model, raising concerns about the direction of the initiative and the role of the prospective BC stakeholders. Questions nevertheless remain as to whether the current crop of BCs has the necessary bandwidth for financial services delivery. Initially, banks asked technology companies to take up the role of BCs, and overnight such companies became BC companies. However, they did not have the skills of agency management and several major BCs closed down. Also BCs operating in a relatively small geographical area and with a limited volume of transactions have tended to be squeezed out. Thus, the concern about the creation of monopolies in this space continues to be very real.

BC model: where are we?

According to a MicroSave Policy Brief by Wright et al. (2013),[5] as of March 2013 around 4 lakh villages remain without any banking presence. The number of BC agents reached 221,341 by this date. However, well-functioning BCs are rare. A large proportion of these agents are no longer offering services. In the CAB–CGAP Survey 2012, there was a 37 per cent effective dormancy rate which was in line with 22–43 per cent self-reported dormancy rate from MicroSave's own 2012 survey of Business Correspondent Network Managers (BCNMs). The survey found that over 58 per cent of agents earned less than ₹3,000 per month. Since for rural agents the DBT programme is the main potential source of revenue, until it scales up they are essentially limited to opening and servicing NFAs, which, in turn, have largely become dormant. This has resulted in limited number of transactions and losses for the BC agents.

Wright et al. (2013) suggest that there are eight key requirements for an effective and thriving agent network.

1. One or two anchor products to grow the business and build trust in the agent network. These are typically person-to-person (P2P) remittances and/or government-to-person (G2P) payments. These are appropriate in India as well.
2. Careful selection of agents to ensure trust and convenience. This is important to ensure the users willingness to conduct transactions through an agent.
3. Effective and regular training of both agents and staff.
4. Appropriate commission structures that are transparent and paid on a regular and prompt basis to the agents.
5. Regular marketing support and monitoring by the banks for consistent quality of service.
6. Assistance with liquidity management to avoid risks to the bank and ensuring security of the agent.
7. Integration of BC technology platforms into mainstream banking platforms so that they can access the full range of services.
8. A diverse product/service range with direct access to the core banking system rather than a 'financial inclusion drive' to meet regulatory compulsions or social objectives. Indeed the most successful BC agents typically offer 'kiosk banking' with direct access to their bank's core banking system.

In order to promote high-quality agent networks serving the poor, they specifically highlight eight policy/regulatory issues:

1. Implementation of the recommended 3.14 per cent minimum commission (maximum commission ₹20) per transaction.
2. Setting up of service standards.
3. Encouraging account activity and agent viability through incentives.
4. Removal of confusion over the need to withdraw all benefits credited in DBT accounts.
5. Scrapping the monopolistic structure of single BCNMs for all banks in an entire cluster and to encourage healthy competition.
6. Introduction of standards for integration and interoperability of payment systems.
7. Relaxing the 30-km rule for linking agents to a rural bank branch for outreach in unbanked and under-banked areas.

8. Allowing mobile network operators (MNO) to act as issuers of e-money with proportionate supervision to provide competition to banks in serving poor and unbanked households.

They feel that the massive Aadhaar-enabled DBT programme provides a good platform and anchor product to ensure that every poor household has access to high-quality banking and achieving financial inclusion.

Box 6.2 MicroSave: approach and focus

MicroSave is the leading research agency in the area of market-led financial solutions. It has been working to influence the policy on financial inclusion and the BC and other savings-focused models. It has engaged with government programmes like Velugu, Andhra Pradesh, and local organizations such as BWDA, Tamil Nadu. In the last two years, it has started working with bigger BCs and larger institutions trying to understand technology-propelled financial inclusion such as mobile banking and with the Unique Identification (UID) team trying to see if Aadhaar can become a platform for government transfer and wider financial services.

MicroSave will continue to play a role in inclusion through banking channels. It recently got Phase II of a grant from Bill and Melinda Gates Foundation to focus on financial inclusion through large BCs. It feels that a major source of worry is the bank-level risk. The critical question is who controls the four to five million agents likely to be placed across India? MicroSave's current focus areas are direct benefit transfer, mobile money transfer and savings. It is also working in the area of marketing communications. In Sri Lanka, Philippines and Indonesia, it is working with microfinance with an emphasis on agricultural value chains.

Source: MicroSave—Interviews and documents.

In the context of the sustainability of the BC channel, in addition to the aforementioned measures, practitioners and researchers recommend the opening up of the channel to a wider set of financing agencies, bank partners and stakeholders on the one hand and a wider range of products on the other both to make the services provided meaningful for the clients and revenues for the CSPs and BCs attractive. The Sa-Dhan study (2012) recommended the involvement of MFIs[6] as also a role for SHG federations as BCs.

BC MODEL: MFI EXPERIENCES

While financial inclusion has basically been positioned as an individual-centred initiative of banks through enhanced physical and technological infrastructure and the use of agents, it is necessary and inevitable that existing structures and organizations be involved in the delivery of services. The following section examines the innovations made in the integration of the existing MFI and SHG structures with the BC model in enlarging and enhancing the range of services and products available to the poor and unbanked clients.

Introduction of savings and debt products

Cashpor's BC model—fee-based savings services[7]

Grameen Foundation worked with Cashpor in eastern Uttar Pradesh and Bihar to create a three-way partnership between Cashpor, ICICI Bank and Eko India Financial Services Private Limited (Eko), the technology provider to offer saving bank accounts to Cashpor's customers. Cashpor acts as the BC for ICICI Bank, using its extensive last mile field network to originate and service NFAs.[8] Grameen Foundation has been directly supporting Cashpor in five key areas of its savings operation—project management, change leadership, market research and product design, information technology, and marketing and financial literacy. The existing credit infrastructure was used to offer savings services; only marginal costs were accounted for in the savings operation. Marginal costs comprised of staff incentives, automation of the account opening process, staff training and administrative costs. Cashpor earned its revenues from commissions that the bank paid on account opening, transactions and float (for the balance maintained in the accounts). Cashpor is guided by the 'total customer profitability' concept in offering savings services, whereby the total costs of providing a basket of financial services to the customers are covered through total revenue from that customer.

A case study analysing the financial viability and strengths of Cashpor's business model with BCs found the following results:

1. Considerable expenditure was incurred on staff capacity building, which constituted one-fourth of the total costs in 2012–13. The project has earned lower revenues than costs incurred in the initial 20 months. It is projected that in 2013–14 the incremental revenues generated will be able to meet incremental costs.

2. Leveraging existing infrastructure, rather than creating a parallel BC infrastructure, helped keep the fixed costs low and proved beneficial in acquiring customers for the savings operation. The BC model was a low-return, high-cost model where scale and efficiency would be critical to achieving profits. Financial viability of the model was a major concern. A MicroSave study (Kapoor and Shivshankar, 2012)[9] with leading BCs in the country had found that half of them could not cover their costs and the other half had just started earning nominal profits.
3. Mobile-based technology for BC operations would be most cost-effective and simple to deploy. Also, 20 per cent of Cashpor's customers owned a mobile phone and 60 per cent had access to a mobile phone.

Cashpor utilizes its existing credit infrastructure of branches to offer saving services. Its centre managers double up as CSPs.[10] Customers must also pay transaction charges each time they deposit or withdraw from their savings accounts. For this, they can either pay lump-sum, where an additional ₹50 is charged per customer per year for conducting unlimited transactions. Alternately, customers can pay each time they transact and are charged ₹2. Cashpor earns revenue through commissions paid by ICICI Bank—₹20 for every new account and ₹1 for every transaction undertaken by the customer. In order to motivate and incentivize the CSPs, Cashpor shares a portion of this income with them—₹5 per savings account opening and ₹0.20 per transaction for withdrawal or deposit.

The initiative has helped meet the demand for a reliable and safe place for Cashpor customers to keep their money. The savings service is offered at 131 branches in 8 out of 20 districts where it operates. As of March 2013, more than 120,000 customers had opened accounts with an average savings balance per member of ₹248. According to Sa-Dhan and Citi Foundation (2012),[11] Cashpor figures as a successful example. Captive customers, low-cost technology and usage of existing infrastructure to provide BC services were found as some of the reasons for this success.

However, the discussion paper of the forum of Shore Bank International and Grameen Foundation (2013)[12] found that the market was highly fragmented, and a viable business model offering a full suite of financial services across the country had not developed. Despite ill-formed regulations and BCs' internal challenges in implementing the mandates, the BC aggregator model still has the potential for success. The main challenges identified by the forum included a lack of appropriate products, a need to focus on customer awareness, streamlining back office operations, defining ownership, and building a business case. The account opening fee which is charged by the banks acts as a barrier, particularly for poorer clients.[13]

The savings product too was found to be demotivating to customers as each transaction made them poorer by a certain per cent of the saved amount. Despite assertions to the contrary, large-scale implementation of 'paid for' savings services is still premature in Indian conditions.

Business correspondents as 'business facilitators'[14]—Gramin Bank of Aryavart (GBA), Lucknow

As discussed earlier, after the opening of BSBDAs, there is little income available to most CSPs, given the low volumes of transactions. It would appear also that there has been a blurring of the distinction between the activities of BCs and BFs as the same cadre of persons performs both roles. This also underscores the fact that it is the engagement in the role of BFs that has probably been more remunerative for the CSPs than the income from BC transactions, especially where they are not yet directly involved in loan disbursement and collection. Most banks feel that until such time that transaction levels build up and DBTs and income from a wider range of debt products is available, the CSPs can be usefully engaged in other functions such as loan monitoring and assistance with loan recovery and in the promotion of utility products such as water purifiers and solar lighting systems. Styled as 'BCs as BFs' to highlight the non-cash handling nature of the activities undertaken by the CSPs, the GBA (formerly Aryavart Gramin Bank) has successfully engaged its CSPs in the loan recovery and in the promotion of solar lighting, which has proved to be a very popular scheme with the clients as well. Details of GBA's innovative measures, amenable to wider replication, and their impact are as follows:

1. **Assistance in loan monitoring and loan recovery:** Every GBA branch has one CSP per village with population more than 2,000. Five to six CSPs function per branch. CSPs are able to earn ₹10,000 to ₹12,000, and even ₹25,000. Until transactions build up, other sources of income have been created, for example, the 'BCs as BFs' scheme under which CSPs get good income—a model which NABARD has also commended. Under BC/BF scheme they are used for loan account monitoring—give quarterly report for

each account for which ₹20 is paid—to ascertain whether customer and asset/project are still present, why loans are not being repaid, etc. CSPs serve individuals, not SHGs. (JLGs/SHGs are served by BCs who are given ₹250 per savings account opened and another ₹250 [SHGs] only at time of fixing of cash credit [CC] limit.) Nearly ₹24–25 crore of recovery has also been facilitated by CSPs. They are paid 1 per cent of recovery amount for substandard assets recovered, 2 per cent for doubtful assets, 3 per cent for loss assets, 4 per cent for written-off accounts, and 0.5 per cent is paid even for overdue accounts. The bank's NPAs are down from over 50 per cent to 40 per cent as a result of the activities of BC/BFs. Mainly KCC outstandings were involved as NPAs, which had arisen because of the vitiated atmosphere due to loan waivers.

2. **Promotion of solar home lighting system and loan:** The use of solar energy, for domestic and commercial heating and lighting, has emerged as a viable and sustainable solution to the energy problem. The bank finances 80 per cent of the project cost. Capital subsidy is available at 30 per cent of the benchmark cost, with loan provided for 5 years at 5 per cent rate of interest. It engages the BFs to propagate the scheme, promote financing under it and also to ensure maintenance of the solar home lighting units with a vision to provide partial employment to rural youth.

   The BFs market the solar home lighting system product and bring clients to the branch for the paperwork in connection with the loan. Under the Jawaharlal Nehru Solar Mission Renewal Programme, solar panels of 37 watts to 210 watts are subsidized. For the 37 watt panel (two compact fluorescent lamp [CFL] bulbs) on a unit cost of ₹13,650, about ₹4,000 subsidy is available. This product is very popular. One solar lighting company has installed over 16,000 systems. Many new companies are coming up.

   The solar lighting system was first introduced by Prathama Bank, Moradabad. GBA has so far received carbon credit worth ₹68 lakh ($2 on each set installed) and is set to receive another ₹1.2 crore. The bank has set up a rural development trust for developing awareness of solar lighting. It has appointed 45 solar facilitators and channel partners. An incentive of ₹100 per account is provided by the supplier through the bank as part of its corporate social responsibility (CSR) programme. During the past year, 21,228 sets have been financed by the bank.

Box 6.3 MFIs as field support BCs

Many microfinance organizations registered as societies and Section 25 not-for-profit companies, which belong to the approved list of entities eligible act as BCs, have taken on the role of field support BC and credit intermediary for public sector and private sector banks respectively. The case of Centre for Development Orientation and Training (CDOT) illustrates how a small local MFI functioning as a society in three districts of Bihar has become a major BC providing field support to TSPs in 14 states.

CDOT, Patna

CDOT has been working in microfinance as a society since 2001 in three districts of Bihar. It received support from RGVN and Basix and technical support from M2i Consulting. It now has more than 13,159 women clients being served through the JLG and SHG models and its loan portfolio is more than ₹10 crore.[14] CDOT is working in Nalanda, Patna and Nawada districts.

In November 2007, it got an opportunity to take up the role of BC with Atyati Technologies from Bangalore (taken over later by Genpact), which was eager to work in north India. It started working with them as BC in 26 villages of Banka district of Bihar. Within six months Atyati gave CDOT more than 2,500 villages in 14 states to act as the field support organization. CDOT is working with Punjab National Bank (PNB), Union Bank of India (UBI), UCO Bank (including two RRBs), Bank of India and Allahabad Bank. It has 1,273 BCs and has opened 660,348 NFAs. Savings were initiated, and gradually NREGA payments and social security pensions of GoI were also facilitated.

CDOT is the Field Support Provider (FSP) and Genpact is the TSP. For PNB there is a tripartite agreement and both CDOT and the TSP are BCs. For other banks, the BC is Genpact and CDOT has an agreement with Genpact, but not with the bank. CDOT's role is to mobilize BC agents (BCAs/CSPs) and bring about awareness on financial inclusion in the villages.

CDOT started working directly in 2012. In every state it has appointed a state coordinator, area coordinators (one for every 250 villages) and district coordinators (one for every 50 villages). It works with two models. In the 'fixed model', CDOT receives a fixed amount from the bank and provides the BC agent ₹2,000 to ₹3,000 per

month. In the 'variable model', the payment is based on enrolments and transactions. The BC agent is paid ₹5 per enrolment and ₹2 per transaction. CDOT gets ₹1 per enrolment and ₹0.50 or ₹0.75 per transaction. The BC has to enrol 2,000 bank accounts in two to three months for which he or she receives around ₹10,000. After three months, transactions are started in the accounts.

For NREGA payments it gets the list of beneficiaries and receives the amount through banking channels. CDOT coordinates between the base branch, BCA and end beneficiary. It has started NREGA payments in Manipur, Maharashtra, Bihar, Uttar Pradesh, etc. The system of commission is also per transaction. CDOT now finds the BC operations viable and profitable. At least 500 villages have to be covered for BC operations to be profitable.

NGO–MFIs as BC lending partners of banks

In the early days of bank linkage, the models favoured by NABARD and RBI involved channelling funds with the NGO as financial intermediary. This was not successful as NGOs were reluctant to adopt coercive methods in loan recovery. In the current environment, many NGOs have moved in the direction of supporting in-house MFIs. However, the possibility of the NGO or NGO–MFI as an agent–intermediary in the form of BC/BF is once again up for consideration and is being implemented by various private banks. This could take the form of (*a*) a field support agent responsible for account opening in delivering savings products, as discussed above. Alternatively, (*b*) it could also involve acting as BF/BC in credit operations. The latter allows these NGO–MFIs to generate much needed income for their development activities, even though it is usually accompanied by some form of risk-sharing with the bank.[16] Another model of involvement of NGOs as BFs is to be found in the left wing and extremism (LWE)-affected districts, where NGOs are incentivized through grants for SHG formation along with a commission of 5 per cent of the average portfolio.[17] This type of bank–SHPI relationship could possibly be extended to other areas.

According to the revised guidelines of RBI, issued on 28 September 2010, MFIs registered as NBFCs are still excluded on account of the apprehensions of conflict of interest. However, most MFIs are keen to act as BCs of banks and to enlarge the scope and scale of their operations in serving the targeted clientele. The case for MFIs acting as BCs gains strength following the Andhra Pradesh crisis of 2010 for an important reason. The loans given by MFIs in the past were reflected in their own books and the risk was largely borne by them. Consequently, default to MFIs on loans inevitably led to default by MFIs to the banks. While banks were happy to meet their priority sector lending targets through the MF portfolio, the crisis has shown the downsides of this form of lending. MFIs as BCs of banks not only help the latter to expand outreach but also eliminate the kind of political and operational risks experienced by leading MFIs in Andhra Pradesh. There will be greater supervision by the banking system than in the case of lending through MFIs.[18] MFIs can develop a network of agents offering a wide range of financial services using card or mobile-based technological devices.

In response to the new possibilities, many NBFC–MFIs have set up subsidiary and affiliate organizations to take up BC functions. Such dual functions help the NBFCs reap the gains of economies of scope as also cement the relationship with the partner bank for enlargement of their scale of operations.

As noted earlier, the BC model is not new, having been preceded by the bank–agent partnership model involving MF institutions and organizations. The partnership model is now once again being re-introduced with the enabling guidelines that permit the use of BCs from among the ranks of NGOs acting as MFIs. One of the debatable elements of this type of partnership, both in the past and currently, has the transfer of a part of the lending risk onto the BC/partner NGOs.

Margdarshak, an NBFC–MFI based in Lucknow, first took on the role of field support BC through an affiliate and later transformed itself into credit intermediary BC for a private bank to complement and supplement its MFI operations. In fact, several organizations, such as DISHA Microcredit in Uttar Pradesh, which were struggling to mobilize bank loans for on-lending as part of their MFI operations, have recently found this role and relationship to have provided a lifeline which has ensured their ability to meet their clients' needs. The important development and learning here is that NGO–SHPIs appointed as BCs can serve as the bank's 'feet on the street' or aggregators (e.g. YES Bank group lending plus full-fledged individual basic savings bank accounts).

Box 6.4 BC in bank lending: Margdarshak Development Services

Margdarshak has had experience of two forms of BC relationships through its associate company. They first worked with Atyati Technologies as the field BC. It was to enrol BC agents at the grassroots level. Margadarshak pulled out of this arrangement soon for three reasons:

1. Bankers were uncomfortable about the conflicting roles that Margadarshak played of BC and MFI.
2. Multiple levels of collaborations proved difficult to manage. These collaborations extended to the village–local branch–circle office of banks the technology service providers at grassroots and central levels and the IT teams/back office of banks. Margadarshak had to coordinate these six agencies to get one savings account opened. Though smart cards were provided, neither did savings collection nor the cash management system really develop. The returns to the effort required to get a BC enrolled or open and manage bank accounts was not sufficient and would have made sense only if large volumes were involved.
3. In Jharkhand, Uttar Pradesh and Uttarakhand, BC agents were not very technology savvy and there were major connectivity issues.

Margdarshak then started working as BC for YES Bank through Margdarshak Development Services (MDS), a Section 25 company. This is a typical bank-linkage program, more focused on credit linkage. MDS has given the first loss default guarantee (FLDG) directly to YES Bank to the extent of 7.5 per cent, which will come down to 5 per cent after they cross a certain stage. The section 25 company does the documentation and Yes Bank takes credit-related decisions. Savings accounts are also opened for SHGs. Presently disbursements are done through the company account. Direct disbursement to SHG accounts will eventually start as the volumes increase. Margdarshak receives a commission on principal repayments from YES bank.

With 11 branches of Margdarshak following this model, about 700 groups have been linked to the bank. Margdarshak's total portfolio as on 31 March 2013 is ₹29 crore (₹25 crore of NBFC and ₹4 crore from YES Bank).

YES Bank and Margdarshak together have worked out a loan policy which is compliant with RBI guidelines. The commission being charged by the BC company to YES Bank is 10 per cent on principal repayments plus 0.7 per cent as processing fee. Interest rate charged to SHGs is 26 per cent per annum by both companies. At the grassroots level, the process is the same for Margdarshak NBFC and MDS. The administrative costs under the BC relationship are higher as compared to standard microfinance operations. For example, SHG books of accounts have to be maintained by developing a cadre of paid book writers. The SHGs are credit led rather than savings led. Savings is just an additional service being provided.

This year Margdarshak are implementing mobile collections. They have migrated to web-based software from local area network (LAN)-based one. The whole process of client interaction of frontend services, especially data collection and transactions, will be covered by mobile technology.

BC models involving SHGs[19]

While SHGs themselves cannot act as BCs, SHG members and SHG associations, such as federations, are able to. Some attempts to involve SHG members as CSPs or to channel funds to SHGs using the BC channel have been undertaken. A GIZ–NABARD study by Chhatwal and Gondia (2012),[20] explored the role that SHGs could play in the BC model. A review therein of earlier studies and interviews with various stakeholders of SHGs and the BC model in eastern Uttar Pradesh suggested that SHG members dealing with financial activities, the bank Sakhis, were widely considered to be qualified to act as CSPs. Besides integrating SHG members into the BC model, they could address problems of client and CSP inactivity due to the extensive outreach of SHGs, the good reputation of SHG members in the community and their low expectations of remuneration. Finally SHG umbrella organizations such as federations could act as aggregators between the bank, TSP and CSPs at the village level. However, for this a range of new banking products, new mechanism of revenues and incentives and financial awareness among potential clients would be necessary. In promoting local CSPs as banking officials, in-depth training would also be required, apart from sensitizing local bank branch managers to the needs and problems of low-income households, among others. Examples of various BCs already working with SHG members are provided by the study mentioned above. These

include the initiative of A Little World (ALW) and Zero Mass Foundation (ZMF), SKDRDP, the Vidarbha Kshetriya Gramin Bank (VKGB) in Karnataka and Maharashtra.

ALW and the non-profit organization ZMF act as TSP and BC for different banks in India, appointing individual villagers as CSPs which provide services of payments of government schemes. ALW/ZMF CSPs are usually handled by two women from the community appointed by local SHGs. The SHG members thus vouch for the trustworthiness of the individual CSPs in the BC model. CSPs and SHGs earn commissions on new enrolments and transactions.

SKDRDP acts as a BC of SBI and other banks. SKDRDP staff act as BC to SHG members and provide banking services at the weekly group meetings. Since SKDRDP already has significant outreach and infrastructure, operational costs of BC operations are reduced. In addition, SKDRDP earns commissions for savings and recovery. The SKDRDP BC model for SHGs is discussed in greater detail in Appendix 6.2.

In the *VKGB model,* female SHG members as well as male Farmers Club (FC) members act as BFs and CSPs. However, no SHPI or federation is involved as VKGB's women development cell itself promotes and nurtures SHGs and links them to the bank. Reliable BFs are given the responsibility of CSPs to conduct transactions via micro ATMs and earn greater commissions. A total of 300 BFs had initially been trained from among the FCs (113 men) and SHGs (187 women). Of 63 BCs appointed, 51 were from the ranks of the trained BFs.[21] An amount of ₹1,200 per month was sanctioned as incentive to SHG women acting as BCs/BFs. Micro ATMs and other infrastructure needed for BC activities have to be acquired by the CSPs for about ₹20,000 for which a loan is available for VKGB. Though there is willingness and potential of SHG members to work as CSPs and a large clientele, the Vidarbha model is not yet profitable.

In a model involving Chaitanya and its SHG federations, the BC relationship permits Chaitanya to access loans for its SHGs formed into federations from YES Bank, whereby, though the NGO itself is the designated BC, the federation undertakes the BC functions and the major share of the revenue contributing to its viable functioning. In the case of RGMVP, the SHPI active in eastern Uttar Pradesh, bank Sakhis were appointed to help SHGs in dealing with banks. These bank Sakhis were volunteers who received no remuneration for their work. While bank Sakhis were considered to be honest and reliable, there existed a need for additional training for them on different financial products and banking regulations.

In order to test the potential of SHG members as CSPs, GIZ and NABARD in collaboration with RGMVP, the Aryavart Grameen Bank (AGB; now Grameen Bank of Aryavart [GBA]) with Bartronics as TSP have started a pilot project in 50 village panchayats in three districts of eastern Uttar Pradesh, focusing on villages with a population of less than 2,000 inhabitants. The activities carried out include financial literacy programmes, training and promotion of bank Sakhis as local CSPs, training and facilitation of SHG umbrella structures and sensitization of local bankers interacting with bank Sakhis. The model pilot envisaged the involvement of bank Sakhis as CSPs under the aegis of block-level SHG federations acting as 'super CSPs' and mentored by RGMVP. The super CSPs would act as an aggregator between the bank and CSPs at the village level. As a super CSP, SHG organizations could assist in appointing qualified CSPs, while at the same time taking over training and monitoring tasks, providing an end-to-end solution to the parent bank and the TSP.

This pilot has been on a year now. This experiment would at least on paper overcome two limitations with the existing BC network. One of these is the attrition problem of CSPs. In the case of SHG members as BCs, these are people routed through communities and who understand the needs of communities. Being SHGs, they will be able to lobby and deliver financial services in their respective areas. This pilot is expected to provide models which could be taken throughout the country. GIZ is also trying to take this pilot to four other states, including Madhya Pradesh and Rajasthan. The proposed structure of relationships under this model is as shown in Figure 6.2.

However, some structural and operational issues are to be dealt with in this BC model. These include the issue of liability in the event of cash loss, fraud, etc., whether it is that of the CSP (SHG member) or that of the super CSP (federation). Similarly, whether the BC agreement should be directly with the CSP or the super CSP? With the introduction of the super CSP (as indeed also the SHPI) in the service delivery chain, would this not have implications for the margins available for each stakeholder? Also whether the BC would be in a position to interact with and supervise the work for a number of SHPIs/super CSPs or should it delegate the role of BC to the SHPI/super CSP?

Women functionaries of SHGs have also been engaged as CSPs, notably in Andhra Pradesh[22] and

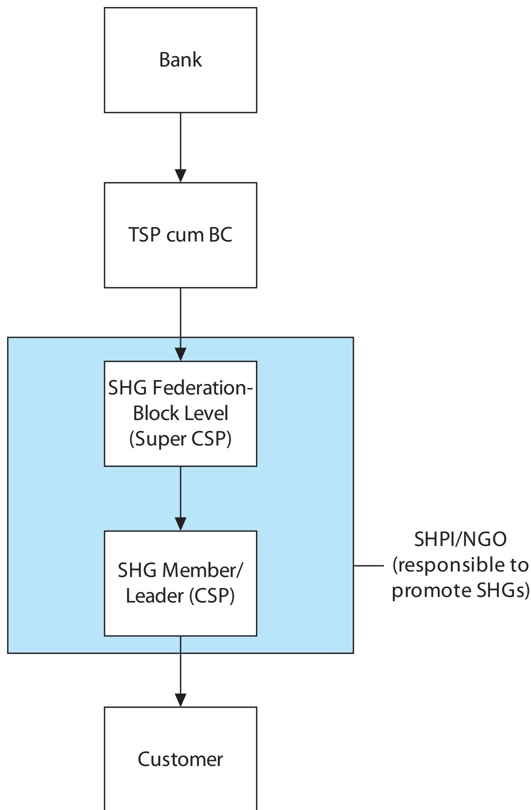

Figure 6.2 GIZ SHG–BC pilot project model

Bihar. A scoping study conducted by MicroSave for GIZ–NABARD found that stakeholders identified SHG members as feasible candidates to be CSPs. Another follow-up GIZ-sponsored study[23] in eastern Uttar Pradesh under the RGMVP programme, while noting that CSPs are commercially unviable, a 'socially sustainable CSP model' has been proposed through the use of *bank Sakhis* drawn from among women functionaries of SHGs. A disquieting feature of the case for such engagement of *bank Sakhis*—the so-called socially sustainable model—is that it is based upon the fact that 'their [the bank sakhis] expected remuneration levels are comparatively low and (their) motivation may partly be derived from non-monetary factors' (Balani et al., 2011).[24]

Lessons learned from these pilots can be summarized as follows:

- Models in which SHG members act as CSPs are yet to stabilize (VKGB–BF activities).
- SHG members functioning as BF can effectively support branches by functioning as their extended arms (e.g. VKGB).
- BF services can supplement CSP income and bridge gaps until transactions reach sufficiently high levels (e.g. GBA).
- There is a need to evaluate the possible role of federations acting as BC/super CSP (e.g. Chaitanya, GBA pilot).

While some of these pilots and studies represent a start in experimenting with a space for SHG functionaries at the bottom end of the supply chain, questions remain about the ability of the BC channel to deliver financial services to the poor as indeed its overlap and relationship with the existing SBLP channel.

Alternative channels of SHG financing using BCs

Looking beyond the products of direct delivery of services by banks to the excluded clientele, two alternative initiatives, one in Andhra Pradesh through the initiative of the SERP, the government organization implementing the IKP and the other NABFINS, promoted by NABARD, government of Karnataka and some commercial banks, have made a beginning in channelling funds to SHGs at reasonable rates of interest as a supplement to SBLP by using BC relationships.

NABFINS

The NABARD subsidiary called NABFINS, which was promoted in 2008, has been uniquely positioned in a field dominated by NBFC–MFI models. Basically, NABFINS runs an NBFC–MFI model that customizes loans and repayment schedules to respond to the diversity of livelihood situations, thereby balancing 'business with inclusion in growth', being focused on the poor and marginalized. It seeks to bring about financial inclusion in a sustained way, with support from a variety of institutions in building skills of the poor. It also invests, at the expense of its own profits, in interventions that require investment to develop a network and support system for pro-poor clients. As a business model which promotes development finance, it levies interest at reasonable rates but also ensures that overall cost to the client remains low by providing doorstep services and quick turnaround. NABFINS and the SBLP are not in conflict, but offer the client a choice.

NABFINS uses BCs (designated as B & DCs) in the form of NGOs and people's own institutions (such as the CMRCs of MYRADA) to assess the eligibility of SHGs and JLGs for loans and for collection of repayments. The BC staff directly distributes cash to SHGs and help to recover loans on commission basis. Personal contact with groups by the BCs helps to maintain mutual trust. At the same time, NABFINS intends to *give priority to*

support the formation and functioning of second-level institutions, since it feels that the provision of credit to SHGs and JLGs to support production is not enough to integrate them into a sustainable growth process.

Stree Nidhi

An initiative which has been launched by the Andhra government is Stree Nidhi, which is an apex cooperative credit society to provide access to credit for women brought together into SHGs. It is a promoter-driven organization and not strictly a CBO. Its equity capital is infused by the Andhra Pradesh government and contributions from federations of SHGs at the *mandal* level. By contracting loans at the base rate or marginally above from banks, it lends to mandal samakhyas which on-lend to village organizations of SHGs and in turn to SHGs/members. Stree Nidhi thus operates on a thin margin of 1.25–1.5 per cent. However, own funds reduce the weighted cost of funds and operating costs are low as Stree Nidhi leverages the existing SHG network with start-up costs having been met by the government.

Stree Nidhi and SERP hold great store by the role of SHGs in binding individuals through savings as an entry point and the bank loan. This enables a holistic approach to poverty alleviation that would not be possible through NFAs and individual-based banking. They feel that whatever initiatives may be taken in the name of financial inclusion, it is important that the SHG structure should not be disturbed. Neither individual nor cooperative functioning can produce the same results. As regards the role of BCs and BFs, it was felt that they are useful only if they service the lower end of the population. As far as disbursement processes are concerned, there are no shortcuts and ultimately the bankers have to bear the responsibility, not the BCs, who cannot be made responsible for recoveries. Stree Nidhi has itself emerged as a common BC of banks in Andhra to serve this clientele. The merits of the Stree Nidhi model is that it takes care of the community's banking needs without requiring their direct interface with bankers, and they are able to get loans within 48 hours into their accounts. This significantly reduces transaction costs on both sides as well.

PACS as BCs

Ordinarily the institution of PACS and the cooperative credit system are not considered to lie within the domain of microfinance. Nevertheless they too serve in part the same rural clientele in the provision small-size, short-term loans as also savings services. Recent changes and proposals designed to enable them to act as BCs of the Central Cooperative Banks (CCBs) are likely to be far-reaching.

As recommended by the Expert Committee to Examine Three-Tier Short Term Cooperative Credit Structure (ST CCS) headed by Dr Prakash Bakshi (RBI, 2013),[25] for providing safety of deposits and efficient loan services to farmers, PACS should work only as BCs on behalf of banks and should not themselves act as financial intermediaries. In addition, PACS should provide a range of other fee-based financial and non-financial products. The immediate consequence of such a change would be that all depositors and borrowers in villages would become direct member clients of the CCBs. RBI could modify the banking licence of any CCB to include additional operational area from which a PACS could work as BC of a CCB. The RBI guidelines already permit PACS to become BCs of commercial banks and RRBs. As and when the CCBs migrate to the core banking platform, it would be ideal for the PACS affiliated to the CCB to become its BC, so that all deposits made at PACS level are accounted directly in the books of the CCB and therefore are covered by the Deposit Insurance and Credit Guarantee Corporation (DICGC) protection, and also major clients of the PACS—the farmers members—are able to get and operate ATM and point of sale (POS)–enabled KCCs.

PACS have been outreach partners of DCCBs. As DCCBs do not have direct outreach to rural clients, hence they have always been refinancing the PACS, and PACS in turn have been engaged in financing. The limitation here is resources available at the level of DCCB. As long as resources at DCCB level are there and there is business at village level, the DCCB will not look at any other BCs other than PACS as partners. The idea of PACS as BCs of commercial banks has not been taken up except in stray cases in Andhra Pradesh. The technical service provider was trying to leverage this with certain commercial banks, but the idea did not pick up. Since PACS are dependent on cooperative network for the bulk of their requirements, if a small portion goes out of cooperative network, then there is uncomfortable feeling in the network. The recommendations of the expert committee mentioned earlier Dr Prakash that PACS should be BCs for DCCB have also been cleared by RBI. It is generally agreed that PACS should definitely be BCs of DCCB as the first option and if this is not available, then PACS should be looking at outside for mobilizing resources and lending as BCs. Thus, if any PACS wishes to function as the BC of a CCB registered in a district other than in which the PACS is located and the CCB is in agreement to provide financial services in the operational

area of that PACS by taking up that PACS as its BC, it is free to do so. In such an event, the RBI would be required to modify the banking licence provided to the CCB for expanding its operational area to that district where such a PACS is located.

GIZ are working with Tumkur DCCB on the idea of PACS as a BC in addition to other operations in order to learn more and to take those learnings to other institutions. An issue is that if PACS are acting as BC for DCCB for disbursing crop loans and are also giving crop loans on their own account, then there could be issues of conflict of interest. Therefore, it is felt that it would be best for the PACS to take up the role of BCs of DCCB primarily in order to mop up rural savings. As clarified by the committee observations mentioned earlier, since individual deposits placed directly with the DCCB are protected, such deposits mobilized by PACS in their function as BCs would be protected.

CONCLUDING OBSERVATIONS

The BC model has generally been seen as being technology driven. However, a good working model that is efficient is required to drive the technology. The necessary outreach of the model will be ensured only by human intervention. At present, BCs serve only about one-third of all villages, and for total financial inclusion perhaps 5 lakh BCs may be required, in which case the institution of the large corporate BC idea (possibly one floated by the banks themselves) may have to be revisited. A few such BC companies may then team up with good retailing companies for effectively covering the various regions.

The idea of BC/BF is based upon the need to lower the transaction cost of banks through outsourcing certain financial and non-financial functions. During the past five years or so of the functioning of the BC model, several issues have emerged that have come in the way of the efficacy of the model. Both public sector and private sector banks have formed partnerships with a variety of intermediaries to implement the model. However, certain issues need to be highlighted: (*a*) there is a mismatch between the revenue and the costs of BC operations, which is resulting in a high degree of attrition among BCs; (*b*) operations of BCs and BFs have generally been limited to the opening of accounts, the majority of which have become inoperative, and to a limited degree of savings collections; (*c*) studies show that people mainly want credit from the financial system, which must be the cornerstone of the delivery of financial services to this segment of the population.

If we consider the question of integration or convergence of SHGs with the financial inclusion model of bank outsourcing through BCs, at least two major issues need to be considered.

1. First, in the BC–CSP model and the banking infrastructure within which it is to operate, that is brick-and-mortar branches, USBs, common services centres, kiosks, etc., it is important to take note of the changes in the conceptualization of the BC relationship with banks that have taken place over the past six years since it was first introduced. While the list of eligible entities that can act as BCs has grown, the BC model has itself grown additional layers of subagents and intermediaries. Instead of a bank branch–BC–individual–SHG relationship, the bank's relationship with the client would now have multiple intermediaries, such as bank–common BC/TSP–BC–CSP–SHG/individual. As discussed, *there is not enough evidence that adequate margins exist to maintain the various intermediary agents involved in this elaborate delivery structure*, especially in low-volume areas and contexts given the proposed level of charges for various services. Indeed the innovation of using commissions from electronic benefits transfers as a source of revenue, though apparently promising, would render financial services delivery hostage to the continuance of these transfers and payments under various government programmes. Hence, the desirability of this arrangement is open to question.
2. In terms of integration of SHGs, their promoters and federations into the BC channel, the range of experimentation has been small and largely confined to the tail end by involving a handful of women SHG members as CSPs. Here too, there could be apprehensions that SHG women are being engaged because of their motivation despite the inadequate monetary benefits being available to them at that level. There is a *fairly large consensus among NGOs and SHPIs that primary/secondary SHG federations could function as BCs/BFs* (or even BC agents if corporate agencies enter as BCs) and SHG members as BC agents or CSPs or BFs. This idea does not seem to find favour with banks which would rather engage with good NGOs and SHPIs. In some respects it is the *SHGs themselves that have the best qualifications to act as BCs or subagents. However, they still do not figure on the list of eligible entities*. A similar situation exists in respect of the NBFC–MFIs which too are not on the list of BCs as they are seen as having a conflict of interest in acting as agents of banks.

The inability of BCs to adequately occupy the last mile in financial services delivery to the rural client has the potential to become a contested space between commercially driven banker–agent combines on the one hand, with the agent itself a player in service delivery, and community-based and community-managed organizations on the other. Community-managed systems, however, have the support of NRLM and government SHG programmes, which see them as an important link in both financial services delivery and wider livelihoods promotion. At the same time, NRLM, which has a demand-driven strategy for financial and other livelihood services, is planning to involve SHG members as subagents, a move the merits of which are still open to question.[26] This could, however, result in some form of complementarity with the BC model, even though at present there is no clear convergence or resolution of these two models of inclusion and the potential space for SHGs and SHG-based associations.[27]

Even as the banks are content to implement the directions of the DFS and RBI on outsourcing and other elements of the financial inclusion infrastructure and product package, there is genuine disquiet among some NGOs and SHPIs about the capturing of space at the last mile by this type of outsourcing partnership, which in turn poses a threat to the established structures and institutions based upon SHGs. Given the inexorable march of technology and the individual banking it makes possible, the need for banks to rely on SHGs could be eliminated and it may even spell the end of SBLP in its present form in the long term. It is possible that 10 years from now individual banking through BCs/agents may be the norm and it may be counterproductive to resist such change. Indeed, even Usha Thorat, former Deputy Governor, RBI, and proponent of the BC model envisaged that banks would be able to compete with MFIs and SHGs in the provision of credit in rural areas at reasonable rates through BCs (Thorat, 2011).[28] However, viable BC structures are yet to emerge while MFIs and SHG institutions continue to stake their own claim for a place in the delivery system.

APPENDIX 6.1
Impact of BCs in Anantapur, Kurnool and Nellore districts of Andhra Pradesh

A study on impact of BCs in Anantapur, Kurnool and Nellore districts of Andhra Pradesh was conducted by APMAS in 2012. The study was sponsored by the regional office of NABARD at Hyderabad. The study covered 100 BCs, 195 account holders and 15 bank branch managers, besides bank officials at district level.

FINDINGS OF THE STUDY

The BCs are more aware of account opening and collection of small value savings or deposit and withdrawal of savings than credit, insurance and remittance services. A low percentage of account holders knew about BC model services, such as (*a*) disbursal of small loans, (*b*) remittances, (*c*) micro insurance, (*d*) sale of third-party products, etc., as most of the BC model activities of sample banks are limited to opening of accounts, promotion of savings and receipts and payments. The participation of banks, TSPs and BCs in creating awareness among villagers on the BC model is minimal. The branch manager and/or the person looking after financial inclusion were not involved in implementation in a significant number of BC villages (43 per cent). There was no presence of TSP staff in 50 per cent of the meetings held at village.

Some of the problems they faced were as follows: (*a*) no support from bankers and TSP in organizing public meeting at village, (*b*) no regular bank branch in a vicinity, (*c*) social factors such as caste, (*d*) lack of confidence/trust on BC, (*e*) low awareness and capacities of BCs, (*f*) location of the BC outlet and (*g*) limited number of financial services through outlets/CSPs.

About 60 per cent of the BCs have been operating from their homes and very few in public places (20 per cent). All the sample banks/TSPs have provided the technology/devices/tool kit to BCs on payment of prescribed amount. Personal loans of ₹20,000 and ₹40,000 were extended by banks to BCs who requested for financial assistance to procure device and accessories.

Most of the BCs were unhappy with small amount of honorarium and commission and its irregular payment (40 per cent of the cases). The average honorarium and/or commission received by the BCs was ₹13,609. About 13 per cent of BCs did not receive even a rupee since joining.

The volume of business generated by the BCs is negligible as the kind of services provided through BC outlet/CSP is limited to deposit and withdrawal of savings. About 31 per cent of account holders have not done any transactions, since opening of the account. However, the account holders have perceived a good number of advantages of the BC model: (*a*) account opening is not expensive, (*b*) banking services at

doorstep, (*c*) convenience and ease, (*d*) time-saving and cost-effective, (*e*) more helpful to the vulnerable and (*f*) promotion of savings.

Source: APMAS–NABARD. 2012. 'Impact of Business Correspondents in Anantapur, Kurnool and Nellore districts of Andhra Pradesh.' Hyderabad: APMAS & Regional office of NABARD, September.

APPENDIX 6.2
SKDRDP's BC model for SHGs[29]

In 2009, SKDRDP adopted the Suvidha model to work as BCNM. The programme is being implemented in 16 districts of Karnataka. As a BCNM, SKDRDP offers savings and credit services to SHGs on behalf of partner banks through a network of field subagents. The organization also undertakes marketing and promotional activities to create awareness about the initiative amongst the general public. The cash officer, or BC agent, conducts field-level transactions for SHGs using a hand-held POS machine supplied by the TSP.

SKDRDP earns regular income from its bank partners for promoting SHGs, processing loans, and enabling savings deposit and withdrawal transactions. The SHGs provide compulsory weekly savings to the bank. As these savings are long term and bundled together into larger sums (other BCs typically deal with smaller sums), they provide a good source of float income to the bank. As of September 2012, SKDRDP has promoted 215,350 SHGs. The relationships between stakeholders are given in Table 6A.1.

Table 6A.1 Relationship between the stakeholders

SKDRDP (BCNM)	Bank	TSP
• Forms SHGs • Opens SHG accounts on behalf of the bank • Processes and recommends loan application forms of SHG members • Cash management–deposit and withdrawal of funds. Loan disbursal and repayment on behalf of the bank • Monitors loan repayments • Trains field staff on bank products, processes and cash handling • Reconciliation of cash collection reports with bank statement	• Opens savings bank accounts for SHGs • Sanctions loans to SHGs • Provides deposit and withdrawal facility to customers • Provides liquidity rebalancing facility to the BC • Pays service fee and commissions to both BC and to TSP	• Provides enrolment data to the bank • Technology hardware support (POS devices and smartcards) • Provides field-level transaction data to the bank • Backend support: hosting of savings account activity for both SHGs and individual members and transaction processing • MIS support: sharing of MIS data with bank and SKDRDP in predefined formats and timelines • Trains the BC/BC agents on POS handling

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2. Sa-Dhan and Citi Foundation. 2012. 'Financial Inclusion: A Study on the Efficacy of Banking Correspondent Model', New Delhi, August. http://www.citi.com/citi/microfinance/data/business_cor_study.pdf (accessed on 10 September 2013).
3. In other words, the BC had offered to charge just 2 paisa to deliver ₹100 to the end-customer.
4. Rajshekhar, M. 2012. 'FINO Becomes Common Banking Correspondent for Jharkhand.' *The Economic Times,* June 7. http://articles.economictimes.indiatimes.com/2012-06-07/news/32101113_1_manish-khera-fino-banking-correspondent.
5. Wright, Graham A. N., Manoj K. Sharma and Puneet Chopra. 2013. *Behind the Big Numbers: Improving the Reach and Quality of Agent Networks in India*. Policy Brief No 9. Lucknow: MicroSave, August.
6. It asserts that the question of conflict of interest, in as much as they serve the same clientele, is not well founded and a start could be made by allowing them to be involved as BCs in savings services since as NBFC–MFIs they do not generally offer these services.
7. Adapted from Grameen Foundation. 2013. 'Building Sustainable Business Models for Providing Financial Services to the Poor: A Study of Cashpor's Business Correspondent Model.' July.
8. The savings function as BC was added to its preexisting role as MFI retailer and BC in loan disbursement for IndusInd Bank. Cashpor Micro Credit. 2013. *Annual Report*. http://www.cashpor.

in/downloads/AnnualReport1213.pdf (accessed on 14 September 2013).

9. Kapoor, R. and V. Shivshankar. 2012. 'State of Business Correspondent Industry in India—The Supply Side Story.' India: MicroSave, April.
10. The CSP is typically a recognizable person in the village who is either stationary (typically an owner of a shop in the village) or mobile (visiting a series of villages on predefined days and providing doorstep services), offering account opening, deposits, withdrawals and balance checking on behalf of the BC.
11. See Note 2.
12. Grameen Foundation. 2013. 'Building Sustainable Business Models for Providing Financial Services to the Poor: A Study of Cashpor's Business Correspondent Model.' July.
13. For instance, Cashpor discovered that many more clients could be brought into the fold if the account opening fee of ₹100 was reduced or removed.
14. Based on discussions with GBA officials. See also Kuberkar, Sanjay. 2012. 'Implementation of Business Correspondent Model in RRBs', report submitted to GIZ, October.
15. As on 31 August 2013. (From CDOT website, www.cdotbihar.org, accessed on 14 September 2013.)
16. The first loss default guarantee imposed on bank partners in the partnership model has been understood to have been retained. Alternately, it has been replaced by the 'second loss default guarantee', under which the first 2.5 per cent of loss is borne by the bank but the subsequent 5 to 10 per cent by the BC. In a presentation at a GIZ workshop in October 2012, the NGO Chaitanya illustrated the various revenue models reflecting options available for facilitating lending to its federations with varying risk exposure. These included (*a*) an interest spread of 6 to 9 per cent with a 10 per cent default risk from a bank: (*b*) a 5 per cent of monthly average loan outstanding as service charge (adjustable against default) as BC under NABARD'S Women's SHG Fund programme; and (*c*) risk-free service fees of 2 per cent of loan outstanding.
17. Government of India has started the Women's SHG Fund with a corpus of ₹500 crores. Of this fund, ₹100 crores were given to NABARD to promote and train SHGs in 150 LWE districts, using NGOs as BFs and to train SHGs in livelihoods. Disbursements were only ₹16.94 crores by 31 March 2103. In addition, NGOs are provided (as indicated in note 21) 5 per cent of monthly average loan outstanding by way of service charges.
18. For a discussion of benefits to MFIs and banks of the BC relationship, see Sharma, Manoj. 2012. 'Microfinance in India—Is Business Correspondent the Way Forward' in *E/M—Banking,* Vol. IV: *Optimising Performance and Efficiency Series*. Lucknow: MicroSave.
19. This section is drawn from various GIZ studies.
20. Chhatwal, Lara A. and Punam Gondia. 2012. 'SHG Members as CSPs in the Indian Business Correspondent Model: Chances and Challenges.' GIZ–NABARD, draft.
21. VKGB. 2012. '"Vidharbha Model"—Pilot Project under Financial Inclusion: SHGs as BC/BFs—A Study Report.' Presentation by bank in GIZ Workshop, New Delhi.
22. Andhra Pradesh is the only state to have mandated that only women be hired as CSPs. Other unique criteria for hiring CSPs include that they should be a permanent member of the village, members of an SHG and preferably belong to the SC/ST community (CAB-CGAP. 2012. 'Financial Inclusion—A National Survey on Functionality and Sustainability of Customer Service Points.' http://www.cab.org.in/Lists/Knowledge per cent20Bank/Attachments/142/RBI per cent20Survey per cent20Report.pdf.)
23. As reported at GIZ SHGs and BCs Workshop on 29 October 2012.
24. Balani, Jitendra, Piyush Kumar Prasoon and Raj Kumar. 2011. 'GIZ–NABARD SHG Business Correspondent Scoping Study.' New Delhi: MicroSave, unpublished report.
25. Reserve Bank of India. 2013. 'Report of the Expert Committee to examine Three Tier Short Term Cooperative Credit Structure (STCCS).' http://rbi.org.in/scripts/PublicationReportDetails.aspx?UrlPage=&ID=697#7 (accessed on 15 September 2013).
26. If such a role were to materialize on a large-scale, it could result in a new consensus in financial services delivery, but one which could further marginalize the position of the SHGs themselves as financial intermediaries.
27. At the National Conference on Community-Based Approaches for Inclusive Growth held in Hyderabad in December 2012, the Minister for Rural Development, Shri Jairam Ramesh expressed enthusiasm for utilizing women SHG members as 'bank mitras' or CSPs under NRLM along the lines undertaken in Andhra Pradesh, Bihar and in Uttar Pradesh as discussed earlier in the chapter. He highlighted the possibility of their earning useful incomes through such engagement at the tail end of BC model delivery structure. This would also help integrate SHG members into the BC model in a limited way. However, given the low remuneration and the resultant need for 'motivated' persons working for non-monetary reasons there are concerns that this could be another instance of the co-option of women into performing unpaid or underpaid roles in microfinance services delivery.
28. Thorat, Usha. 2011. Valedictory address at International Network of Alternative Financial Institutions (INAFI) Conference, on 23 June 2011, Hyderabad.
29. Adapted from MicroSave. 2013. 'Making the Business Correspondent (BC) Model Work for Self-Help Groups (SHGs).' A case study of Shri Kshetra Dharmasthala Rural Development Project (SKDRDP), India.

Technology: catalysing financial inclusion

7

Chapter

In Gaya district of Bihar three recovery agents of the State Bank of India started their BC setup around 2011. The bank gave its CBS to them as the backend and laptops as frontend technologies. They went on to recruit 800 CSPs in two years. The volume of business in 2012–13 was to the tune of ₹120 billion. On a typical day, a CSP does business worth ₹350,000. On weekends this increases to ₹750,000 to ₹800,000. Most of the transactions happen during weekends, when the men working in faraway cities such as Surat, Mumbai and Delhi send money to their families back home.[1] A dramatic story, indeed, of how technology can be harnessed to catalyse the process of effective financial inclusion.

TECHNOLOGY AND INCLUSIVE BANKING

The adoption of CBS marked the first major technological breakthrough in Indian banking (Gupta, 2011).[2] It has revolutionized banking by making it possible for the customers to effortlessly engage with banking activities 'anywhere anytime'. The other major innovation, the automated teller machines (ATMs), has facilitated significant expansion of banking outreach. As per the RBI statistics, their numbers have been increasing at an average growth rate of 23–25 per cent. Between June 2011 and August 2013, the total number of ATMs across regions increased by 65 per cent from 78,386 to 129,671.[3] The value of transactions using ATMs (credit and debit cards together) in 2012–13 amounted to ₹16,664 billion while the volume stood at ₹5,533 million (RBI, 2013).[4] The metropolitan and urban areas accounted for about two-thirds of the increase in the number of ATMs; the increment in ATM deployment in rural areas was only about 11 per cent of the total. In its effort to expand the network of ATMs more widely, RBI has decided to permit non-bank entities incorporated in India under the Companies Act 1956 to set up, own and operate ATMs. These entities, called White Label ATM Operators (WLAO), are authorized to provide services based on bank-issued debit/credit/prepaid cards.[5] They are required to establish technical connectivity with the existing authorized shared ATM Network Operators/Card Payment Network Operators as their role is limited to acquisition of transactions of the customers of all banks. The first White Label ATM (WLA) was set up under the brand Indicash in June 2013 in Chandrapada village in Thane by Tata Communications Payment Solutions Limited (TCPSL), a subsidiary of Tata Communications.[6]

The setting up of the NPCI in 2009 was a critical step towards building the necessary indigenous infrastructure for anytime, anywhere banking. NPCI is the umbrella organization for all the electronic retail payment systems in the country. NPCI also operates the National Financial Switch (NFS) that facilitates routing of ATM transactions through interconnectivity between the banks' switches, thus allowing the customers to use any ATM of a connected bank. NFS has 74 members, 87 sub-members, 36 RRB members and corporate members which together operate 129,671 ATMs in the country.[7]

The payment system has moved progressively towards the electronic mode with the integration of ICT in banking. The retail electronic payment systems (comprising ECS, National Electronic Fund Transfer [NEFT], Prepaid Payment Instruments [PPI], POS terminals/online transactions) registered phenomenal growth between 2003–04 and 2012–13, as shown in Table 7.1 and Figure 7.1. The number of transactions rose nine times from 167 million to 1,558 million, while the volume grew more than 60 times from ₹521 billion to ₹33,850 billion. The growth picked up real momentum after 2008–09.

Table 7.1 Progress of retail electronic payments

Year	Number (million)	Amount (₹ billion)
2003–04	166.94	521.43
2004–05	228.90	1,087.50
2005–06	285.01	1,463.83
2006–07	378.71	2,356.93
2007–08	535.31	10,419.92
2008–09	667.82	5,003.22
2009–10	718.16	6,848.86
2010–11	908.59	13,086.87
2011–12	1,159.80	22,074.40
2012–13	1,558.50	33,849.7

Source: RBI Bulletin, Table No. 9A, November, 2012, p. S 1390; *RBI Annual Report* 2012–13.

Note: Retail electronic payments include transactions through ECS, EFT/NEFT and cards (debit and credit).

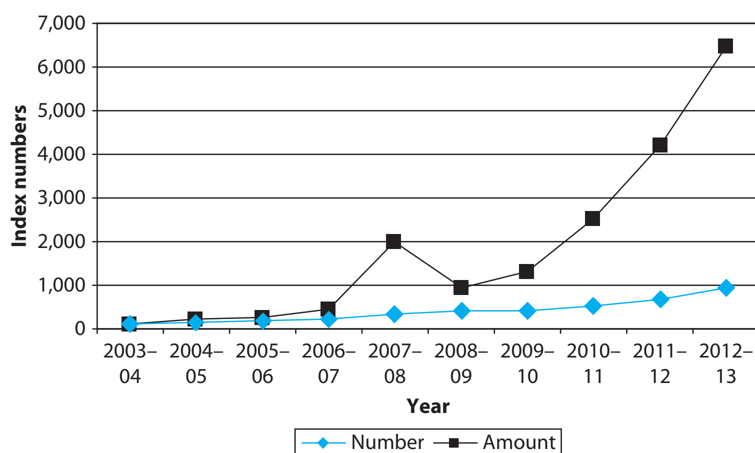

Figure 7.1 Growth in retail electronic payments

Source: *RBI Bulletin*, Table No. 9A, November, 2012, p. S 1390; *RBI Annual Report* 2012–13.

Most recently, the NPCI has demonstrated AEPS transaction that allows online interoperable transaction at micro ATMs through BCs of any bank using the Aadhaar authentication. These transactions facilitate withdrawals and deposits along with funds transfer between Aadhaar card holders. The customer inputs required are issuer identification number (IIN), Aadhaar number and the fingerprint used during her enrolment.

It is clear that the capacity of the banking system to support electronic transactions has improved dramatically over the last five years or so. For a nation keenly looking for ways to reach out to financially excluded populations must leverage the possibility of technology. However, this would require further investments to strengthen the data security systems to prevent identity thefts and other frauds and to prepare and capacitate the illiterate customers, especially, to engage with the technology with complete information and confidence.

Growth of electronic payment: the RuPay cards

RuPay card payment scheme introduced by NPCI in March 2012 aims at 'mass cardification' of customers. It is designed to evolve into an efficient domestic alternative to international payment product facilitators such as MasterCard and Visa. The other objective is to enable all Indian banks and financial institutions to participate in electronic payments.

Since its introduction, the number of card-issuing banks has risen from around 60 to 106.[8] NPCI plans to reach out to 500–600 banks within a year for issuance of RuPay cards. Majority of the rural banks—50 out of 58—have started issuing RuPay cards. However, they are active on about a fifth of the 9 lakh POS only. The coverage can be extended if HDFC Bank, ICICI Merchant Services and Axis Bank, which own 80 per cent of the POS terminals, can be brought on board. The card is active on 85,000 SBI POS terminals. Though the card was launched initially as an ATM only card, it was soon upgraded to debit card for offline payments, thus ushering it to the world of e-commerce. In June 2013, RuPay went online for e-commerce use on its course to finally become a credit card. NPCI has tied up with two banks for e-commerce. The target is to cover all the banks and the 12,000 online merchants.

NABARD has taken the initiative to promote the use of the RuPay Kisan Cards among rural population as ATM-cum-debit cards by helping the cooperative and regional rural banking system implement the CBS, and facilitating the setting up of POS machines and micro ATMs. Up to May 2013, close to 65,300 RuPay Kisan Cards were issued. Karnataka and Maharashtra were the first states to have rolled out the scheme.

Box 7.1 RuPay Kisan Cards: features

1. Unlike Visa and MasterCard networks, RuPay does not charge an entry fee.
2. RuPay is well equipped to handle both the single-messaging and dual-messaging systems.
3. RuPay is a PIN-based product, so it provides enhanced security.

4. It offers complete web-based architecture, so member banks will not have to develop a separate file-based interface.
5. RuPay provides advanced features such as processing of adjustment file to enable tip and surcharge processing on the SMS platform too.
6. Administration costs and quarterly charges are very low when compared to current international schemes.
7. Unlike normal KCC, which serves only as an identity card and facilitates recording of transactions on an ongoing basis, RuPay KCC is actually a smart card that can be used at the nearest ATM/POS for withdrawing cash. It removes the necessity of going to PACS or a bank branch to operate the account.

Source: http://www.nabard.org/.

Mobile banking and funds transfer

In terms of spatial spread and convenience, banking and payment services using the mobile technology platform may be considered superior to others. As a consumer technology, mobile phones have diffused 'at the fastest rate and the deepest level' across the world, while keeping the costs competitive (Jack and Suri, 2011).[9] In India, as on 31 March 2013, there are 868 million wireless subscribers as per the statistics released by the Telecom Regulatory Authority of India (TRAI).[10] The rural subscribers are about 352 million or 40 per cent of the total. In other words, 60 per cent of the mobile subscriber base in the country is urban. Also, the monthly net addition to subscribers in urban areas has been double that of what is observed in rural areas—4 and 2 million respectively. The urban wireless teledensity is estimated as 141 as against the rural teledensity of 40.

The startling paradox of a mobile wielding, yet un- or under-banked population has inspired serious public consultations on the possibilities of exploiting mobile telephony to deepen the reach of the banking services in the country. The RBI recognizes the advantages of mobile banking, which is defined as 'undertaking banking transactions using mobile phones by bank customers that involve accessing/credit/debit to their accounts'. There are 78 banks which are permitted to carry out mobile banking services in India as on 8 July 2013. They may use BCs for extending such services. It is pointed out that mobile-based transactions cost only 2 per cent of the cost of transactions through brick-and-mortar branches and 10 per cent of ATM-based transactions. Compared to banking, they cost just about half (Khan, 2012).[11]

The first set of mobile banking guidelines came out in October 2008, which was made applicable to all commercial banks, RRBs, and cooperative banks which have implemented CBS. Some of the original provisions were amended in the subsequent circulars and a master circular was issued in July 2013.

Box 7.2 RBI guidelines on mobile banking, 2008–13

Date	Guidelines
8 October 2008	The major guidelines related to the following: • Encryption of transactions irrespective of value limit • Ensuring interoperability • Customer complaints and grievance mechanism • Daily cap of ₹5,000 per customer for funds transfer and ₹10,000 per customer for purchase transactions • Involvement of BCs
24 December 2009	• Cap for daily transactions and funds transfer raised to ₹50,000 • Allowed transactions up to ₹1,000 without end-to-end encryption of messages • Permitted cash-out through ATMs and BCs (cap of ₹5,000 per transaction and ₹25,000 per month per customer)
4 May 2011	• Raised the limit to ₹5,000 for transactions without end-to-end encryption
22 December 2011	• Daily caps for purchase transactions removed and left to the discretion of banks • Cash-out limits through ATMs/BCs raised to ₹10,000 per transaction, subjected to the limit of ₹25,000 per month per customer
1 July 2013	• Compiles all the guidelines contained in the previous circulars

Source: Khan, H. R. 2012. RBI/2013-14/116, DPSS.CO.PD.Mobile Banking No./02.23.001/2013-14, 1 July 2013.

The immediate mobile payment system (IMPS) is an interoperable mobile-based remittance system which facilitates instant transfer of funds between customers of different banks anytime. This facility is provided by the NPCI. Till date, 58 banks have signed up for IMPS.

Box 7.3 IMPS: how does it work?

- Registration of remitter and beneficiary with their respective banks.
- Both obtain Mobile Money Identifier (MMID) from their respective banks. Remitter also obtains a Marketing Partner ID Number (MPIN).
- Remitter downloads application software on the mobile.
- Remitter logins, enters the mobile number and MMID of the beneficiary, amount to be remitted and her own MPIN to send money.
- A confirmation SMS informs the remitter and beneficiary of the debit and credit to respective bank accounts.

Source: http://www.npci.org.in.

Between December 2010 and May 2013, the number of MMID issued increased from 4.7 million to 50.75 million and the number of transactions from 2,001 to 0.41 million. The amount transacted rose from ₹4.61 million to ₹2,055.67 million. It was around the second quarter of 2012 that both the volume and value of IMPS transactions started rising rapidly.[12] According to RBI statistics, 53 million non-IMPS mobile banking transactions amounting to ₹59,900 million took place in 2012–13 (RBI, 2013).[13] No doubt, mobile phone–based banking appears to be emerging steadily as a convenient banking channel. However, there are constraints to this growth. As the MD and CEO of NPCI points out,[14] for IMPS to achieve universal coverage even the lower-end handsets must be covered. Such handsets can effect transactions only through Short Message Service (SMS) or Unstructured Supplementary Service Data (USSD, which is the protocol used by Global System for Mobile [GSM] cellular phones to communicate with the computers of service providers). But SMS is not as secure an option as the server-based system (i.e. USSD). The latter, however, would require banks partnering with telecom companies. Such partnerships are difficult to come by as they involve complex negotiations around modes of cost-sharing. India has witnessed some mobile money partnerships with varying degrees of success (Table 7.2).

That mobile technology can be harnessed to provide money transfer service has been proven by M-Pesa in Kenya. Launched in 2007 by Safaricom, the leading MNO in Africa in partnership with Vodafone, M-Pesa is an SMS-based money transfer system that allows the subscribers of Safaricom to deposit, send and withdraw funds using their mobile phones. The services are targeted primarily at the unbanked mobile customers, though a study by Jack and Suri (2011)[15] reports that 'the banked and unbanked have taken to the service in roughly equal

Table 7.2 Mobile money partnerships in India

Partners	Product/service
Banking partnership	
Pallavan Grama Bank, Indian Bank, NABARD, PayMate	Mobile-enabled KCC; one of the pioneering mobile money credit delivery solution; SMS/interactive voice response (IVR) based; works on all handsets; for funds withdrawal and purchase of goods and services
SBI and Eko Financial Services	Tatkal—instant money transfer service; allows customers to deposit cash into any regular SBI branch-based account through CSP
Money transfer service	
Indian Post and BSNL	Money order service
Axis Bank–Bharti Airtel: Airtel Money	No-frills savings bank account is offered to customers who can undertake transactions like remitting, depositing and borrowing
J and K Bank–Bharti Airtel: Airtel Money	Mobile wallet service wherein individuals can load cash on mobile devices and spend it as per need; mobile money offered through Khidmat centres
ICICI Bank–MCSL (Vodafone): 'M-Pesa'	Mobile money transfer service for Vodafone subscribers. Customers are given a mobile wallet issued by MCSL and a Mobile Money Account with ICICI Bank. Both are interoperable

proportions'. They further analysed the extent of reach of M-Pesa thus:

> While the sustained growth in M PESA registrations is notable, the volume of financial transactions mediated through M PESA should not be exaggerated ... the volume of transactions effected between banks under the RTGS (Real Time Gross Settlement] method is nearly 700 times the daily value transacted through M PESA. On the other hand, the average mobile transaction is about a hundred times smaller than the average check transaction (Automated Clearing House, or ACH), and even just half the size of the average Automatic Teller Machine (ATM) transaction. Thus M PESA is not designed to replace all payment mechanisms, but has found and filled a niche in the market in which it provides significantly enhanced financial services. (p. 5)

Two money transfer partnerships that have gained attention in recent months in India are Airtel Money and M-Pesa India. An important target segment for these partnerships is the migrant population. According to the National Sample Survey Organisation report of 2007–08, there are about 326 million internal migrants in India, a significant percentage of whom remit money home regularly. The domestic remittance market is estimated to be US$10 billion.[16] A good part of the remittances do not enter the formal channels as the migrants lack access to them. To begin with, both Airtel and Vodafone have focused their market attention on pockets of in- and out-migration such as Delhi-NCR, Mumbai, Bihar, Jharkhand, Rajasthan and West Bengal.[17] Another niche these companies would look to explore is that of electronic benefit transfers.

Box 7.4 Airtel Money[18] and Vodafone M-Pesa

Airtel Money is the first mobile wallet service to have been launched in India. It runs on any Airtel GSM cell phone through a simple (non-Internet-based, USSD) menu.

There are three variants of Airtel Money account—Express, Power and Super. The Express account allows customers to transfer money to banks and to Airtel Money accounts, and also to pay for utility bills, recharges and for remote transactions such as booking tickets or physical transactions like shopping. A Power account has all the features of the Express account but with higher transaction limits. The Super account is a no-frills interest-bearing savings bank account of Axis Bank on Airtel's mobile platform. The account allows customers to deposit and withdraw cash and transfer money as well as recharge their mobile and DTH connections, while earning savings account interest. A migrant worker who wants to send money home can visit any Airtel Money retailer, load cash on to her Airtel Money wallet and then use her mobile to send money directly to the bank account of her choice.

Initially the product has been made available in the top four remittance corridors involving Delhi and Mumbai on the sending side and Bihar and east Uttar Pradesh on the receiving side. Services are envisaged to be extended to other remittance corridors across the country.

Airtel Money has partnered with MFIs like Swadhaar for promoting micro savings through the small savings bank accounts of Axis Bank. The mobile outlets provide teller service to the customers of Airtel Money, thus taking cash management out of the MFI's domain and helping it to save on time and costs. The service is particularly suitable for women customers who may find the outlets safe and convenient points to pass their savings on to the bank.

M-Pesa is launched in India by Mobile Commerce Solution Limited (MCSL), a group company of Vodafone and ICICI Bank, in April 2013. Using M-Pesa the pre- and post-paid Vodafone subscribers can transfer money from any mobile phone number or any bank account. It is not necessary for the recipient to have an M-Pesa account. A customer registers with an M-Pesa outlet to open an account by depositing a minimum amount and an account activation charge. There are two types of accounts in M-Pesa. With the first one—the Mobile Wallet facility—the customer can make transactions including cash deposit, money transfer to any bank account or another M-Pesa customer's account, recharge mobile phones and television and pay mobile and utility bills. With the help of the second one—the Mobile Money account—she can withdraw cash and send money to any person connected with a mobile phone (up to ₹5,000 per transaction and ₹25,000 per month). The money can be deposited physically by visiting an authorized M-Pesa agent. The customer receives a confirmation of the transformation via SMS. Each transaction carries a charge within given slabs which increases as the transaction amount increases. The unregistered users pay a higher charge.

STATE OF THE TECHNOLOGY IN MICROFINANCE

A study done by CARE India in 2007 found the status of technology in the microfinance sector in India to be fairly commonplace, though interest in and acceptance of technology were clearly on the rise. The MIS was the only widely adopted technology then. Many were involved in pilots, but with limited scope. The outcomes of even these limited technology pilots were not documented and shared to facilitate wider adoption. The MFIs clearly lacked the capability and financial resources to effectively manage the information generated through technology trials. The decision makers within MFIs did not have adequate knowledge of technologies and, as a result, they ended up making inefficient technology choices. At the larger system level, the study found the service providers to be concentrated in southern India, which further reinforced the regional bias in micro finance development. The report apprehended that the peculiar cultural and structural factors that affect the adoption of technology in other parts of the country would most likely to be ignored by south-based service providers.

The SOS Report 2011 (Srinivasan, 2011)[19] also observed that MFIs tended to use standard software—custom developed or bought off the shelf—for most of their business processes. It was also reported that a significant proportion of MFIs use the Excel platform to perform even the key business processes that require frequent reference to archival material. The Report corroborated the observations of the CARE study and identified many factors as creating hurdles on the path of MFIs adopting the right technology, such as inadequate organizational ability, dearth of appropriate applications, infrastructural bottlenecks (erratic power supply, for instance), high cost of technology, and lack of awareness of technological options.[20]

There is noticeable change in the technology orientation of MFIs currently, though the status of technology adoption and preparedness vary among them. The changing regulatory arrangements appear to be a major trigger that prompted the market-focused MFIs for technical upgradation. For instance, in order to report individual data to the credit bureaus, the MFIs must have the necessary technical capabilities to collect, store and retrieve client data continuously. To ensure compliance of codes of conduct and fair practice codes, detailed personal-level information about clients must flow smoothly, securely and regularly between decentralized field locations and the central offices of MFI. Overall, there is a concern for improving efficiency and reducing costs of operation among MFIs, given the interest rate and margin caps. As they are being drawn by the regulatory processes towards the mainstream financial inclusion agenda catalysed by technological innovation, they have no option but to upgrade the technological architecture.

The primary objective of technology adoption for many MFIs in recent years has been to automate the transaction processing activities (Murthy, 2013).[21] This involves deployment of CBS, branchless banking solutions using POS devices and networking the branches to setup a Wide Area Network. This ensures all the transactions are available on-demand in a centralized database. The field staff carrying out the transactions using POS devices will send the information over General Packet Radio Service (GPRS)-enabled network to the data centre. Some of the POS are enabled with biometric devices to enable field staff to do authentication of their customers and facilitate in debit transactions at their doorstep. Some of the MFIs, such as Basix, have deployed biometric-enabled POS devices to offer branchless banking services. Equitas too has deployed an end-to-end core banking software, *T24*, developed by the Swiss company Temeno.

On the frontend of mobile technology, Equitas uses an SMS-based collection tracking software, which helps the field-level functionaries to keep track of the daily centre meetings. The technology also ensures that the head office of the MFI has access to real-time information on the actual physical cash collection at any centre across the country. The system works like this: within 10 minutes of the end of every group meeting, the loan officer sends out a text message (SMS) from his/her cell phone. The message carries information on meeting attendance, loan collections and time when the meeting ended. This information is analysed and a comparative branch-wise report produced. The other technology that Equitas has tried out is the optical mark reader (OMR) solution to electronically scan and capture data which can be stored digitally. This has reportedly led to significant increase in the processing efficiency with given resources. Field officers of Cashpor use handsets to enter and upload client information such as meeting attendance records, amounts collected and requests for new loans. The handsets only access

data for the centres under their jurisdiction which minimizes data transfer needs. Atom Technologies has helped Cashpor develop this mobile-based payment and reporting system.

Ujjivan has deployed mobile-based customer acquisition/transaction applications to enable field staff to process transactions. Now many large MFIs can generate financial statements on demand and evaluate their operational efficiencies and the transaction volumes. Some of the leading MFIs such as Janalakshmi have also deployed customer relationship management (CRM) solutions interfaced with CBS.

Dedicated technology teams are part of the organizational structure of all the major MFI companies that include Janalakshmi, Equitas, Ujjivan, Grameen Koota and SKS. Even the medium and small MFIs seem to have realized the importance of having an exclusive technology function within their organizations. However, their ability to make investments and train personnel in handling technology is largely limited.

Second-generation technologies

The experts argue that MFIs can gain significantly from the adoption of second generation of technologies such as analytics, dashboards and product configurators (Murthy, 2013).[22] Analytics builds on the transactional data to provide MFIs with information about household-level parameters such as the number of dependents, quality of housing, access to sanitation and clean drinking water. Such data can potentially be used to understand client needs and thus deepen societal impact. Analytics can also help MFIs evaluate the market performance of new products.

Another technology option advocated by developers in the field of operations is that of browser-based dashboards. When used in combination with GIS solution, they track the location of customers, particular constraints in each geographical area and the associated risks. The vendors emphasize the significant cost reduction possibility implicit in analytics and dashboards.

Going by the current trends, it is highly likely that the agenda of inclusion becomes increasingly led by savings and technology. MicroSave, for instance, views itself as positioning robustly in the technology-propelled inclusion process driven by the Aadhaar platform and adequately trained and properly monitored network of agents. Given MicroSave's emphasis on savings, it will focus more on banking channels in the coming days.

Box 7.5 Technology-led financial inclusion: findings from the north-east

The POS-based smart card technology was the first financial inclusion technology to be introduced in the north-eastern region. In 2007, the SBI in partnership with A Little World and Zero Mass Foundation brought in this technology through the SBI Tiny initiative in Aizawl (Mizoram) and Jorhat (Assam). Subsequently, Drishtee Foundation started its BC operations in Assam and Manipur as SBI partner and later introduced kiosk banking.

The Centre for Micro Finance Research, Indian Institute of Bank Management, Guwahati, conducted a study covering 12 customer service locations/villages in six districts across three states—Assam, Manipur and Mizoram—to understand the acceptance and adoption of financial inclusion technologies among rural customers. It looked at two kinds of technology—the POS-based smart card technology and kiosk banking technology.

The study results indicate that the customers do not have any clear preference for any one technology if accounts can be opened hassle-free. The researchers, hence, argued that the lack of acceptance of technology cannot be a barrier to financial inclusion. However, half of the respondents lacked any awareness about bank accounts. The unfamiliarity of the technology per se as well as the socio-cultural barriersm such as education, income levels and gender may be overcome if service delivery meets customer purpose and the awareness about account usage is developed through consumer education.

Importantly the study observes lack of clarity among several users about the safety aspects of the use of fingerprint. The level of comfort among them is found to be low in transactions that require multiple authorizations through fingerprints such as withdrawal and depositing money. In areas with poor connectivity, the degree of comfort is particularly high.

There is less satisfaction among customers with transaction advice given as proof of transaction. There is a strong preference among them for passbooks. Passbook is seen as a key feature in branch banking, especially in the rural areas and amongst elderly customers. Service interruptions as a result of connectivity problems are the other major source of dissatisfaction in the region.

Some of these problems can be resolved by better promotion of financial literacy and technology awareness, whereas several are technology related. For instance, allowing single fingerprint verification for multiple transactions done in a one-time log or the use of cable broadband instead of wireless will encourage the account holders to engage with technology more closely. But the larger factors that sustain financial exclusion of the region in general and the remote areas within it still remain to be tackled through political and policy actions.

Source: Sharma, Abhijit and Priyatam Anurag. 2012. 'Preparedness of Rural Populace towards FI related Technologies', Centre for Micro Finance Research and Indian Institute of Bank Management, Guwahati, unpublished report.

There are certain questions that we have not yet reckoned as important. These relate to the links between technology adoption and SHGs. How would the technology-driven inclusion process modify the SHG programme in the coming years? Would it render this unique social innovation that revolutionalized the imaginations of both the banks and the poor households redundant? The answers to these questions would become clearer in the coming days. Some indirect evidences suggest that the new regulatory prescriptions would drive microfinance eventually towards individual lending models. This process would largely be guided by the technological imperatives around client data reporting for effective protection of borrower interests. There is a view that client data reporting requirements must be made applicable to SHGs to enable the lenders to have a realistic picture of individual indebtedness and financial vulnerability at the individual level (Prasad and Arya, 2013).[23] We have come across some instances where SHGs promoted by MFIs were broken up or reorganized into smaller 'utility' groups in the wake of the RBI guidelines regarding client data reporting. At another level, the innovations in the BC arrangement may eventually render SHGs' role irrelevant in financial intermediation.

Inspiring people to migrate suddenly and abruptly to newer technologies of transaction is not easy. This is particularly so in the case of those who have limited or no education and exposure to technology. As per one line of argument, such individuals may initially be linked to BC agent outlets to receive government transfers (such as subsidies, pensions and scholarships) and people-to-people transactions like remittance. The experience would serve as an instant proof of the concept and help build their trust in the technology.[24] And once trust is established, they can be motivated to engage with the banking system more intensely through regular savings. While this argument has considerable merit, it needs to be recognized that investment in sophisticated technology per se cannot lead the intended users to unconditionally and unproblematically accept them as part of their routine financial behaviour. There are many constraints to technology adoption—cultural, institutional and infrastructural—that limit the impact of technology-driven solutions in the financial services sphere. They may be overcome mainly by (*a*) making committed efforts to enhance the financial and technical literacy of the potential users; and (*b*) designing appropriate mechanisms to improve and broad-base the capabilities of the human resources engaged with technology in microfinance operations. The first measure falls in the domain of specific entities, while the second is best undertaken by sector-wide associations.

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Small banks: an idea whose time has come?

8
Chapter

Notwithstanding the phenomenal growth in banking and financial services in India since the late 1960s, a considerable proportion of rural and urban households depend on a variety of non-institutional sources, such as moneylenders, traders, landlords and friends and relatives to meet their demand for credit. The informal credit markets in rural India are fragmented where the transactions are governed by oral agreements based on long-term personal relationship. The loans are generally unsecured and carry usurious interest rates. Moreover, credit markets are intricately linked to other input/output markets (land, labour, crop) making financial transactions complex and skewed in favour of the dominant interests in these markets (Ghosh, Mukherjee and Ray, 1999).[1] Despite such imperfections, informal institutions dominate the credit markets in rural societies. Development economists have argued that predominance of informal sector in the rural credit markets manifests the asymmetric or imperfect information that prevent formal lenders from operating in these markets. Information asymmetry means that the lender cannot distinguish between the risk profiles of his potential borrowers and may end up prescribing an interest rate that attracts the risky borrowers, who may default involuntarily or wilfully. Thus information asymmetry increases for the formal institutions the risk of lending and the cost of monitoring of the use of credit.

The informal lender, on the other hand, has an advantage in that he has a closer understanding of the needs and capabilities of each of his borrowers. This also limits the scope of competition in local markets. He is also in a position to enforce the contract despite the risk of default given his control over the moveable and immoveable assets of the borrower. Many have attributed the high and often usurious interest rates prevalent in the informal markets to factors like the high rates of default, higher probability of covariance in defaults and high screening and delinquency management costs (Stiglitz, 1990).[2]

The formal banks located far from the rural borrowers have to invest substantial resources in screening of applicants in contexts where the credit histories of the potential borrowers are not documented and pooled and where the likelihood of moral hazard is high (Aleem, 1990).[3] All these would lead to rationing of credit—the banks lend to some while rejecting others even when the latter are willing to pay higher interest rates. And there are also groups who will not be extended loans at any interest rates even if there is an excess of credit supply in the system (Stiglitz and Weiss, 1981).[4] The poor (low-income individuals/households possessing meagre or no assets) everywhere are screened out of credit transactions as non-bankable and risky for obvious reasons.

The new set of proposals favouring the setting up of small banks must be seen in this broader historical context. What do these proposals indicate? Do they indicate further consolidation of the efforts so far? Or do they suggest the beginning of a completely new game played by different rules at each level?

The idea that the banking system must be aligned to the needs of all social sections, and thus inclusive, is not a new one. The mainstream banking system in India has been made aware of its own structural–functional rigidities when it comes to serving the needs of the poor and the excluded populations. It must be noted that this awareness has been a major driving force that shaped the institutional policies—concerning the cooperative banking, nationalization of banks, creation of RRBs, and though limited in scale and scope, establishing Local Area Banks (LAB) and, finally, facilitation of

micro-financing experiments—of India's banking system since the late 1960s. Such measures have resulted in the evolution of a multi-institutional banking system and decisively expanded the network of banking facilities. However, the extent of access to the formal banks in India has remained poor, with low penetration levels in certain underdeveloped pockets and high levels of demographic and geographical exclusion. This remained a unresolved paradox since the early 1990s as the regulatory focus got shifted to making the country's banking system stable, efficient and devoid of the ills of behest lending, a corollary to populist democratic politics (Narasimham, 1996–97).[5]

The commercial banking system in India in the 1990s and 2000s assumed an aggressive posture, focusing intently on the emerging market segments while restricting their 'social' orientation to meeting the priority sector targets and haphazardly supporting initiatives such as microfinance. At the same time, the RRBs and cooperative banks could not leverage the market opportunities fully due to their own internal structural deformities. How socially sustainable is the disparate growth experience of the banking system? Are there alternative paths for the banking institutions to grow responding to the needs of the real sector?

THE NEW IMPERATIVES

If the debate around banking in the early 1990s was more about rationalizing its structure and cutting the 'social flab' to make it leaner and more efficient, an important line of discussion in the relatively more liberalized environment of today is about restructuring the sector to make space for more players. The recent RBI Discussion Paper, 'The Banking Structure in India—The Way Forward' argues for encouraging new entrants, mainly of small and medium ones, into the banking system. It suggests that

> the objectives of enhancing competition, promoting higher growth and furthering financial inclusion could be achieved possibly by measures such as putting in place a continuous entry process, creating space for more mid-sized private banks, allowing setting up niche banks through differential licensing and small-sized local banks, encouraging the presence of more foreign banks, rationalizing the policy regarding presence of Indian banks abroad, allowing conversion of UCBs into commercial banks or LABs/small banks and facilitating consolidation of large and mid-sized commercial banks on voluntary basis. (p. 78)[6]

The paper foresees the emergence of a 'reoriented banking system with distinct tiers of banking institutions' (p. 79) as liberalization proceeds.

The paper recommends a banking structure that is layered with each layer catering to the specialized banking needs of a niche segment. The recommended structure is as follows:

> The first tier of International Banks may consist of three or four large Indian banks with domestic and international presence along with branches of foreign banks in India. The second tier of National Banks is likely to comprise several mid-sized banking institutions including niche banks with economy-wide presence. These are capable of offering a broad range of banking products and services to the domestic economy such as investment banking, wholesale banking and funding large infrastructure projects. The third is the Regional Banks tier which may encompass old private sector banks, RRBs, and multi-state Urban Cooperative Banks. The Local Banks that form the fourth tier may embrace many small privately owned local banks and cooperative banks, which may specifically cater to the credit requirements of small borrowers in the unorganised sector in unbanked and under banked areas. (pp. 79–80)

The RBI paper acknowledges that there are many disadvantages to small banks (Table 8.2), for instance their vulnerability to certain kinds of risks that emanate locally. However, as per the report, there 'may be a need for greater tolerance from political economy perspective of higher mortality and a robust resolution framework and quick settlement of deposit insurance claim' (p. 23). It further states:

> The specific risks on account of the business model may have to be addressed by calibrating the prudential regulations together with developing the resolution regime and process reorientation for shortening the time period for settlement of deposit insurance claim. In the deregulated interest rate regime, the small banks will have freedom to decide their lending rates based on the cost of funds. Similarly, the improvement in communication facilities would enable them to reap the efficiency gains driven by technology similar to the medium and large banks. In this context, the emerging cloud computing technology would be very helpful for small banks from cost perspective. (pp. 23–24)

The proposed fourth layer of banks holds special relevance to the discussion of financial inclusion in general and microfinance in particular. These are proposed as banks with small capital, limited area

Table 8.1 Proposed banking structure

First Tier **International Banks**	1. Three or four very large banks 2. Foreign banks in India	• Possible mergers of Associate Banks with SBI. • Voluntary merger of a few large Public Sector Banks having significant overseas presence. • Organic and inorganic growth of one or two large Private Sector Banks. ***Note:*** These will lead to formation of large banks. The issue of competition among them in particular and in the banking system in general will have to be kept in view. • Branches of foreign banks in India.
Second Tier **National Banks**	1. Public sector banks 2. New private sector banks 3. Subsidiaries of foreign banks incorporated in India 4. Specialized banks	• Voluntary merger of banks both in the public and private sectors. • To encourage foreign banks to have subsidiary mode of presence in India. • To grant differentiated licences for specialized banks.
Third Tier **Regional Banks**	1. Old private sector banks 2. Regional Rural Banks 3. Multi-State Urban Cooperative Banks	• To carry forward the process of consolidation of the Regional Rural Banks. • Conversion of a few well-managed, financially sound Multi-State Urban Cooperative Banks into commercial banks.
Fourth Tier **Local Banks**	1. Local Area Banks/small banks 2. Single-State Urban Cooperative Banks/State Cooperative Banks 3. District Central Cooperative Banks	• Well-managed and financially sound UCBs would have opportunities to convert into commercial banks. • Well-managed and financially sound LABs/small banks would have opportunities to expand their area of operations. • Rural cooperatives to be made financially sound to serve the local needs.

Source: Reserve Bank of India. 2013. 'Banking Structure in India: The Way Forward', Discussion Paper, Department of Banking Operations and Development (DBOD) and Department of Economic Policy and Research (DEPR), RBI, Mumbai. http://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/DPBS27082013_F.pdf (accessed on 28 August 2013).

Table 8.2 Pros and cons of small banks

Advantages	**Disadvantages**
Small capital base and lending to small borrowers	Vulnerable to risks of sector/spatial concentration
Limited area of operation, less infrastructure and staff, and low operational expenses	Vulnerable to local economic shocks and need more capital adequacy
Reach in unbanked areas	Inability to finance big investments
Only basic banking services and hence attractive to people of small means	Lack of economies of scope and scale
Better fit with local resources and productive activities	Vulnerable to capture by local players
Simple structures and easy to manage if fail	Increased supervisory pressure on the central bank

of operation (a district or a few contiguous districts), basic banking services, less infrastructure and staff. They would mobilize local savings to deploy credit locally and nurture close relationship with local productive activities. Thus, they 'would lend to small business, agriculture and meet micro credit needs of the local population' (p. 53).[7]

There is no denying the fact that locally relevant financial institutions can create the right kind of synergies of financial inclusion. For instance, as a

former banker explained people recruited locally can understand both the context and language.[8] It is also pointed out that the larger banks neither have the capacity nor the inclination to support small customers. They have developed 'small customer fatigue' as reflected in increasing minimum balance requirements, high transaction charges, barriers for cash handling across bank counters, encouraging customers to shift to ATMs and technology-based banking, etc.[9]

CONCLUSION

Of particular interest to this report is how microfinance intermediaries and the phenomenon of microfinance are addressed in the discussion around small banks. It cannot be ignored that in the overall financial inclusion milieu, notwithstanding the occasional chaos, MFIs have evolved into a class of institutions with intrinsic capabilities to cater to the needs of the otherwise bank-excluded populations. All categories of MFIs, be it federations of MACS/SHGs, non-profit MFIs or NBFC–MFIs, have demonstrated this capability. The RBI discussion paper does not make a mention of MFIs, though by implication they can be part of what is described as 'small privately owned local banks' if they manage to convert themselves into banks. Otherwise, they could remain one of the several channels of credit delivery.

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5. Narasimham, N. 1996–97. 'Banking Sector Reform: The CFS Report and After.' *Prajnan*, 25(3 & 4): 221–38.
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7. Vijay Mahajan (2013) suggests an alternative scheme of restructuring which has five categories of domestic banks—at the levels of community, region, state, zone, nation—and a couple of global banks. Each category would serve different jurisdictions and have different entry-level capital and capital adequacy requirements. At the district level, there should be numerous community microfinance banks (UCBs can be converted into this category). Then there would be regional banks that cut across agro-climatic zones and state boundaries, to minimize co-variant risk arising from climate and political economy (the LABS and the largest UCBS, and NBFCs are likely candidates). The state banks would be created in two ways: (*a*) by merging all the RRBs belonging to one sponsor bank in each state; and (*b*) by merging the licensed DCCBs and SCBs at the state level. Some of the smaller private banks and larger RRBs can become zonal banks. Nationwide banks would be fewer but bigger. Global banks—just one or two mega banks—would have international footprint and large average loan size. Mahajan argues that it would be inappropriate for any single institution to try to address all demand segments. While supply of financial services must increase to meet the rise in demand, multiple institutions and distribution strategies will be needed to reach out to the existing and potential customers. Along with the bank branch network, other networks such as that of the insurance companies, financial product distribution companies, microfinance institutions and business correspondent outlets can play a crucial role in augmenting the supply of financial products and services.
   [Mahajan, Vijay. 2013. 'Call for an Inclusive Banking Architecture for India by 2019: Fifty Years after Bank Nationalization', unpublished paper.]
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Policy environment: status and way forward

9

Chapter

Microfinance activities globally have come under the closer gaze of banking regulators and governments over the past two to three years. While the increasing size and complexity of for-profit microfinance operations have made issues in policy and regulation more vital than ever, there is also a feeling that regulation has improved in its responsiveness and quality resulting in better mutual appreciation of the objectives and constraints of both the microfinance business and the state (CSFI, 2012).[1]

It is now well documented that the regulatory response in India was invoked by a series of developments in Andhra Pradesh in the second half of 2010 that culminated in the state government enacting the Andhra Pradesh Microfinance (Regulation of Moneylending) Act 2010 to regulate MFI operations in the state. As per the state government, the MFIs' lending practices had several anti-poor features, such as multiple lending, over-indebtedness of borrowers, high interest rates and excessive profits. The legislation, among other things, requires MFIs to register themselves at the district level and renew registration annually and prevents lending to SHG members with outstanding loans. The immediate post-crisis months were quite turbulent for MFIs, especially, those with significant business concentration in the state.[2] The businesses of half a dozen market-leading for-profit microfinance organizations started bleeding, affecting the sector's overall performance to some extent in terms of loan disbursals, outstanding and number of borrowers. That this followed a phase of hyper growth (2006–10) made the fall even more dramatic. The banks stopped extending funds support, while investors chose to wait for the 'political risk' to be adequately mitigated. Even the pace of SBLP slowed down as the banks chose to fund lesser number SHGs in many states including Andhra Pradesh (Srinivasan, 2011).[3]

The federal government and the banking regulator responded to the crisis and the provincial action. The Ministry of Finance prepared a draft legislation to regulate the sector nationally,[4] while the RBI came out with a series of steps to guide the working of for-profit companies engaged in microfinance activities.

STATUS OF MICROFINANCE LEGISLATION

After getting the Cabinet approval, the Microfinance Institutions (Regulation and Development) Bill 2012 (the MF Bill 2012 hereafter) was introduced in the Parliament on 22 May 2012. The MF Bill 2012 states its purpose as to provide for 'development and regulation of the microfinance institutions for the purpose of facilitating access to credit, thrift ad other microfinance services to the rural and urban poor and certain disadvantaged sections of the people and promoting financial inclusion through such institutions…'. As per the bill, microfinance institutions include all societies, trusts, companies and other body corporates that provide microfinance services, but exclude banks, cooperatives and individual moneylenders. It is under review with the Parliamentary Standing Committee on Finance.

The MF Bill 2012 provides for (*a*) registration of MFIs (excepting those NBFCs that are registered under the RBI Act, 1934) that are involved in extending services such as credit, thrift, pension and remittance; and (*b*) setting up a layered architecture spanning district, state and national levels vested with advisory, implementation and review functions related to microfinance activities. It confers on RBI the power to 'specify the maximum limit of the margin and annual percentage rate which can be charged by any microfinance institution, sector related benchmarks and performance standards pertaining to methods of operation, fair and reasonable methods

of recovery of loan advanced by the microfinance institutions' as also the authority to inspect and scrutinize MFI records and to direct them in matters that involve transaction of property and assets. The central bank is also vested with the authority to approve/disapprove activities of MFIs such as closure, amalgamation, demerger, division, takeover, transfer of ownership or control.

The architects of the MF Bill 2012 consider it a broad framework for regulating microfinance rather than a prescriptive set of do's and don'ts. It is meant to create an ideal legislative environment for microfinance where the responsibility of regulation is vested with the banking regulator—the RBI—in tandem with specific macroeconomic conditions at any given point in time.[5] The Bill thus abstains from prescribing legal forms or levels of ceilings as has left the responsibility of enforcement to state governments. Further, it reflects the thinking within the government that regulatory provisions should match the extent of liability that underlies different financial services. In the case of non-banking companies, where the organization deploys own equity to provide loans to individuals, and thus bears almost the entire liability, minimum regulation may be the case. Regulation has to be closer and stricter for financial services such as pensions, remittances and insurance, as the provider holds citizens' money on behalf of the principal for a specified period of time. The deposit taking financial agencies should attract the maximum regulatory control as they hold citizens' money for a very long term.

Despite its flexibility, overall acceptance and the 'collective wisdom' that it embodies thanks to the wide-ranging consultations since July 2012, the Bill is yet to be passed by the Parliament. There looms a 'danger' that it will never see the light of the day in its current form if it fails to be tabled during the winter or budget sessions before the proposed general elections in 2014. What the Bill lacks, it appears, is political backing, especially, at the grassroots level.[6]

Some legal tussles are likely to happen around the constitutionality of the Bill even if the draft Bill finally becomes a law. The Andhra Pradesh government has maintained its stance that MFIs are moneylenders and, hence, the state has the legislative competence to regulate them. The draft Bill makes a distinction between for-profit MFIs and moneylenders by legitimizing the former's role not only in extending credit, but in providing a range of financial services including thrift, remittances, pension, insurance and other services. The government of Andhra Pradesh still has the option to legally contest the validity of the legislation when it is finally passed. Incidentally, in February 2013 while dismissing a petition filed by SKS to strike down the Andhra Pradesh MFI Act, the Andhra Pradesh High Court advised the state government to review the Act in the light of the draft Microfinance Bill and the RBI's regulatory measures.[7] SKS appealed against the High Court order in the Supreme Court and got a ruling in March 2013 that allowed it to resume operations in the state and collect repayments on a weekly basis. This is the only instance so far where the APMFI Act has been overridden by the apex court.[8]

As regards the significance of the proposed legislation, Becker (2013)[9] argues:

> [it] has the potential to further the positive aspects of microfinance that allow it to be a social entity while minimizing or eliminating the aspects that cause strife. The Bill provides certainty regarding the industry's capabilities and limitations, defining permissible practices and establishing penalties for unconscionable conduct.… Perhaps most importantly, the Bill limits excessive, purely profit-driven behaviour… (p. 739)

THE RBI INITIATIVES

As the microfinance companies are waiting for the passage of the law that could restore their credibility and legal legitimacy, the central bank has initiated some steps to evolve a framework of prudential regulation of the for-profit microfinance entities. This is a significant development, given the fact that microfinance supervision in the country has so far been non-prudential in character through norms as required by different legal forms they are registered under. Until the early 2000s, there were also no benchmarks available for microfinance institutions to follow. However, the RBI has been facilitating the sector's functioning through regular directives (such as, for instance, the directive to the banks to treat informal collectives like SHGs as bankable) to the banking system.

As of now the RBI seems comfortable to deal only with non-banking companies in the microfinance space. The subsector constituted by non-profit microfinance of diverse forms (societies, trusts, and Section 25 companies) and largely local and small-sized activities continue to be surrounded by a regulatory vacuum. The deliverance of this highly heterogeneous set of institutions depends on the much awaited microfinance legislation.

As the first step towards streamlining the functioning of the for-profit microfinance entities, the central bank created a separate category of

non-banking companies called NBFC–MFIs, following the recommendations of the Malegam Committee Report (January 2011). The first set of regulatory guidelines for the NBFC–MFIs were announced in December 2011, which were amended through subsequent directives and issued as a Master Circular in July 2013 (Table 9.1). The regulatory framework proposed by the RBI 'puts

Table 9.1 RBI regulatory framework for NBFC–MFIs: major elements

Qualifying asset under microfinance	• Without collateral • Extended to borrowers in rural households with annual income less than ₹60,000 and in urban and semi-urban households less than ₹120,000 • Amounting to less than ₹35,000 in the first cycle and ₹50,000 in subsequent cycles • Extended to borrowers with total indebtedness less than ₹50,000 • With tenures not less than 24 months for amount in excess of ₹15,000 with prepayment without penalty
Deployment of microfinance	• At least 70% income generation loans and the remaining 30% for other purposes such as housing repairs, education, medical and other emergencies
Entry norms—existing NBFCs	• Net owned funds ₹2 crore till 31 March 2014 and ₹5 crore w.e.f. 1 April 2014 • For the north-eastern region, ₹1 crore till 31 March 2014 and ₹5 crore w.e.f. 1 April 2014
Entry norms—new companies	• NOF ₹2 crore (for the north-eastern region) and ₹5 crore for others from the beginning
Capital adequacy	• Not less than 15% of the aggregate risk weighted assets
Provisioning	• Loan provision not less than 1% of the outstanding loan portfolio • 50% of the aggregate loan instalments overdue for 90 days to 180 days • 100% of the aggregate loan instalments overdue for 180 days or more
Pricing	• Margin cap 12% for all NBFC–MFIs till 31 March 2014 • From 1 April 2014, 10% for MFIs with portfolio >₹100 Cr and 12% others • Interest cap 26% • Interest cap not applicable to individual loans, but the minimum–maximum variance of rate capped at 4% • Processing charge cap 1% of loan amount (not part of margin/interest cap) • Actual cost recovery for insurance
Fair lending practices	
Transparency in interest rates	• Pricing of the loan has only three components—interest charge, processing charge and insurance premium • No penalty charged on delayed payment • No security deposit/margin from the borrower • Standard form of loan agreement
Multiple-lending, over-borrowing and ghost-borrowers	• One borrower, one SHG/JLG • One borrower, not more than two NBFC–MFIs • Lending to individual borrowers allowed • Minimum moratorium period before repayment begins (not less than repayment frequency) • Sanctioning and disbursement of loans at a central location; more than one individual should be involved; close supervision of the disbursement function • Membership if MFI in at least one Credit Information Company (CIC) • Till CIC data becomes robust, self-certification from the borrowers and local enquiries to ensure compliance including that on annual household income
Non-coercive methods of recovery	• Recovery at a central designated place; recovery at the place of residence or work only for those who cannot come to designated place on two or more successive occasions

Source: 'Master Circular—Introduction of New Category of NBFCs—"Non Banking Financial Company-Micro Finance Institutions" (NBFC–MFIs)—Directions', RBI/2013-14/49 DNBS.(PD)CC.No. 347/03.10.38/2013-14, 1 July 2013.

in place restrictions and safeguards with regard to minimum standards of governance, management and customer protection as well as the financial health of MFIs' (RBI, 2012).[10] Having been framed to encourage growth of NBFCs and ensure protection of borrower interests, these guidelines seem to have streamlined and standardized the operational policies of the for-profit MFIs to a great extent.

As regards the SBLP, NABARD proposed a new set of guidelines—SHG 2—in March 2012. The key components of the guidelines[11] are as follows:

- Banks may encourage SHG members to save voluntarily either as part of the group corpus or otherwise.
- Banks may adopt cash credit/overdraft system of lending to SHGs in order to avoid the situation of groups not getting repeat loans as also to help them leverage loans commensurate with savings. In order to avoid financial indiscipline, over-borrowing and default at the group level, the members themselves may be asked to draw up the terms of availing cash credit/overdraft and service interest monthly. Appropriate prudent mechanisms for continuous review are also needed.
- In cases where a few members of an SHG wish to graduate faster and start or expand economic activities requiring loans higher than what the SHG can provide, a smaller JLG from members of the SHG may be created. The members of JLG will continue to remain members of the SHGs and continue to participate in the activities of SHGs as earlier.

The regulatory focus of the last couple of years has been on NBFC–MFIs with some attention to modifying the SBLP. No framework or guidelines have been evolved for the other important component of the MFI sector in the country—the non-profit MFIs. Many of them have taken to the RBI directives for their NBFC counterparts, while many others continue to be confused about their status and future in the sector. Again the enactment of the MF Bill 2012 is the only way forward for them to feel integrated in the larger ecosystem of microfinance. As we discussed in Chapter 4, this segment of MFIs in general has been struggling to access bank funds.

SELF-REGULATION

Self-regulation is an integral part of the regulatory arrangements that RBI has put forth. RBI has maintained a stand that principle-based regulation, including self-regulation, is better than rule-based regulation as the former is less prescriptive with lesser compliance costs attached. The governance system of MFIs according to Sinha[12] would encompass self-regulation both at the individual entity level and at industry level through the mechanism of SRO. In fact, these two would

> form the first line of defence with the regulatory framework providing the backstop. In the absence of effective self regulation, the regulatory framework becomes more prescriptive which raises costs to regulators and supervisors in administering the regulatory framework and also increases compliance costs to the regulated entities. This clearly is a suboptimal solution.

The RBI had introduced a code of fair practices in 2006 to encourage NBFCs to be transparent in sharing information with the clients and prevent them from using high-handed methods of loan recovery. The enforcement of the code, however, could not be ensured in the absence of a designated SRO.

The most proactive step in the direction of self-regulation during the post-crisis period was taken by the leading industry associations—Sa-Dhan and MFIN—by combining their codes of conduct and aligning them with the broad provisions in the FPC of RBI. These steps along with the anticipation of an imminent law governing microfinance activities in the country have made noticeable changes in the conduct of MFIs in the country. All the MFI leaders and senior managers that we met as part of writing this report believed that the recent efforts at regulating the sector, be it from the RBI or from the associations, have given the sector a great sense of legitimacy.

Would the MFIs behave themselves if the only regulation is through an SRO such as MFIN or Sa-Dhan? How would they conduct themselves if there is no supervisory gaze following them from the central bank or the state? The answers to these questions are not clear. But there is a strong view that what the sector needed right now is a strong sector-managed monitoring–supervisory system focused on good governance and protection of client interests coexisting with a robust regulatory system. In other words, self-regulation is the most effective when it complements direct government legislation and enforcement. Organizations generally behave well when there are proper regulations. Their regulatory compliance improves when there are mechanisms to monitor their conduct. The several code of conduct assessment reports do show that overall there is better compliance among MFIs.

Box 9.1 AKMI: a regional self-regulatory network

The Association of Karnataka Microfinance (AKMI) is a unique example of an MFI network. The organization came into existence in 2006. The mission of AKMI is to build the field of community development finance in Karnataka and to help its members and associate institutions to better serve low-income households, particularly women, in both rural and urban Karnataka and India. The initial proposal was to start a state chapter of Sa-Dhan. However, Sa-Dhan's constitution as it existed then did not allow formation of state chapters. But the founding members were clear that to address the local issues a member-driven organization was necessary. That was how AKMI was born. In 2007, it was registered as a society. Currently it has a membership of 21 MFIs. AKMI wants to be proactive in avoiding crises rather than being reactive and open eyes only when there is a crisis. It believes in engaging all the stakeholders in an open dialogue at all times. Interestingly, most of the microfinance promoters in Karnataka are former bankers. Despite being competitive in the space of business, there is no rivalry among them. Being led by experienced bankers, AKMI has been able to liaison with the bureaucracy and the banking system effectively. Through such liaisoning it could convince the bankers to allow MFIs to be part of the district level coordination committees (DLCC). One MFI is designated as a lead MFI in every district and its does all the documentation and data collection and represents AKMI in the DLCC. They are also invited to the SLBC. This has helped the microfinance industry in the state to diffuse any political problem with the regulators. AKMI organizes several training and exposure programmes for its members on topics such as code of conduct, social performance management and financial literacy. AKMI's brand of self-regulation is highly relevant in the current scenario as it prepares the member MFIs to better adapt to the regulatory environment by building their capacities. That AKMI has been able to create an MFI constituency within the banking system is an important achievement.

Source: Discussions with AKMI members.

During the past couple of years, SIDBI has focused on its agenda to promote responsible microfinance. It started the efforts in this direction under the World Bank supported project, 'Scaling up Sustainable and Responsible Microfinance', launched in 2010 with the objective to scale up access to sustainable microfinance services in the financially excluded and underserved areas of the country. About 98 per cent of the total project cost of US$300 million is earmarked for the scaling up of funding support to MFIs, while the rest is assigned for strengthening responsible finance as also capacity building and monitoring of MFIs.[13] Under this project, a Lenders' Forum was established under SIDBI's leadership with 12 leading banks[14] as members. The main purpose of the Forum is to embed responsible, transparent and sustainable microfinance practices in the MFIs with the help of commonly agreed covenants with respect to reporting, disclosure, and third-party assessment of codes of conduct adherence (parallel to credit ratings). With the help of resource organizations working in the microfinance sector, SIDBI has developed standard tools to assess code of conduct compliance of MFIs. A series of third party Code of Conduct Assessments (COCA) have been funded by SIDBI over the past couple of years. As of June 2013, the direct scaling-up financial assistance to MFIs stood at around US$155 million with a coverage close to 568,000 clients. Indirectly, 12 million clients are believed to be benefited from the adoption of responsible business practices.

The India Microfinance Equity Fund (IMEF) set up by SIDBI in 2011–12 with budgetary support of ₹100 crore aims at making investments in socially oriented NBFCs in Tier II (50,000 to 250,000 borrowers) and Tier III NBFC–MFIs (less that 50,000 borrowers) and all non-NBFC–MFIs. The allocation to the Fund has been increased by another ₹100 crore in the 2013 budget. The Fund is meant to be offered to MFIs to improve their equity base, meet capital adequacy requirements, and leverage additional debt from banks and social investors. The focus of the Fund, thus, is capital conservation.

Three types of instruments are envisaged under the Fund. For non-NBFCs including Section 25 companies, the Fund can offer subordinated debt with a tenure of 6 to 8 years and moratorium period of 4–5 years. It could be converted into ordinary equity shares, if the MFI transforms into NBFC–MFI during the term of the debt. NBFC–MFIs can avail quasi-equity like optionally convertible preference shares (OCPS) or subordinate debt by way of NCDs. The third instrument is equity which can be offered to NBFC–MFIs and Section 25 companies. As of 31 March 2012, SIDBI had invested an amount of ₹59.25 crore to 18 MFIs out of the ₹100 crore fund.

Additionally, SIDBI has entered into an agreement with the MIX Market for setting up of the IMFP, which is a global, web-based microfinance information platform to provide and disseminate valuable information on the Indian MFIs. The MFIs are required to submit financial and operational data, including HR/remuneration expenses, at certain intervals in a standardized format, thus enabling higher degree of transparency/disclosures with ease.

Box 9.2 The Smart Campaign and client protection

The Smart Campaign is a global campaign committed to embedding client protection practices (CPPs) into the institutional culture and operations of the microfinance industry. Appropriate product design and delivery, prevention of over-indebtedness, transparency, responsible pricing, fair respectful treatment of clients, privacy of client data and mechanisms for complaint resolution are the seven CPPs endorsed by the campaign.

The Client Protection Assessment (CPA) examines implementation of the CPPs thoroughly and is conducted only by certified Smart Assessors who have successfully demonstrated their ability to conduct an assessment and maintain the quality of assessment requirement. In India, the Campaign has so far conducted 17 assessments mainly of large to medium-sized MFIs across different geographic regions. The assessments include IFC's partners namely Bandhan, Arohan, Ujjivan, Cashpor, Grameen Financial Services, Sarvodaya, Utkarsh, Uttarayan, SEWA Bank, Equitas, Janalakshmi, Swadhaar, Saija, Sonata, KGFS–IFMR, Fusion and SKS.

Recognizing the substantial overlap between CPP and COCA of SIDBI, the Campaign has worked towards aligning its Smart Assessments and CPP training. Since 2011, the Smart Assessment Report doubles as a COCA assessment as well as the Smart Assessment. While the COCA assessment of the Campaign is not recognized by SIDBI, the Report prepares the MFI on the areas to strengthen before they go in for a full-fledged assessment from COCA-accredited agencies or SMART Certification.

Source: Based on a note by Hema Bansal.

MICROFINANCE AND FINANCIAL INCLUSION

The ambitious financial inclusion programme that has been underway in India since the mid-2000s forms a central component of the architecture created to promote growth with equity. As discussed elaborately in Chapter 5, the approach to financial inclusion advocated by the central bank of the country is described as 'bank-led' in that it is the mainstream banks that drive the goal of financial inclusion. The official approach to financial inclusion is that it is a sustainable and commercially viable initiative led by banks to spread financial services to unbanked areas by leveraging technology and adopting innovative business models and delivery channels.[15] A bank is a single point contact for a customer to avail of a suite of financial products—a deposit account, overdraft facility, micro insurance, and remittance, to mention a few.[16] Thus, there are two major aspects to financial inclusion: (*a*) making a variety of products available to the people, especially those who have been excluded by the financial institutions for long; and (*b*) spatial expansion to broad-base access to financial services. Compared to the social banking decades (the 1970s and the 1980s), when the exclusive emphasis was on credit, this is a significant advancement in terms of concept and strategy.

How have SHGs and MFIs been addressed in the larger discourse on financial inclusion? The SHGs, linked organically with banks for both saving and availing credit, have contributed significantly towards breaking the emotional barrier between the poor and the formal banking system. Though originally designed as a credit innovation to promote formal banking activity among unreached populations and building trust and confidence among bankers, a large part of these groups remain small informal collectives often working in isolation without handholding or capacity-enhancement support. The evaluation exercises of the implementation and impact of SBLP across regions have highlighted several gaps and inefficiencies in the programme. Drawing on these learnings, NABARD announced a major initiative early last year to 'revitalize the SBLP'. A circular issued on 27 March 2012 elaborated on a rejuvenation plan by introducing a separate voluntary saving product to the members that is also cash credit/overdraft system of lending. It also proposed the formation of JLGs within SHG to help the more dynamic members graduate faster and second-tier institutions promoted by SHPIs to ensure longer and more sustained handholding of SHGs. The possibility for SHPIs to act as BFs to help banks better monitor SHGs was indicated in the circular. It is envisaged that the package of proposals, branded SHG 2, could move the members of SHGs further closer to the banks as bankable, individual customers, and thus deepen the process of financial inclusion.

In Chapter 2, we have discussed the reactions to SHG 2. There is some concern that the proposals

that underlie this model appear not to have taken on board the wider lessons from implementing the SHG programme over time and across regions. With banks' interest in SHG funding on a decline, and government on the lookout for cost-effective and technology-driven 'inclusion methods' such as BCs, the SBLP is badly in need of a shot in the arm. There should be more committed and imaginative deliberations among the stakeholders—the state, NABARD, banks, SHPIs and SHGs—as to how to build convergence between the SHG approach and the financial inclusion goal of the state. The rollout of NRLM hopefully would generate better coordination between the various efforts to promote SHGs and would eventually lead to a common approach to financial inclusion and empowerment of the poor households.

The MFIs are imperfect as financial intermediaries as they are credit driven. And compared to the SHGs, they have had a chequered record of association with banks, the nature of which has been influenced seriously by policy and environmental changes. Thus, the flow of bank credit to the MFIs increased substantially during 2006–10, the years of hyper growth of the sector. But following the Andhra Pradesh crisis in 2010, bank funding came to a virtual halt, choking the breath out of many an MFI, especially in Andhra Pradesh. Till recently, MFIs have been talked of mainly as profit-centred, private lending enterprises and not as agents of financial inclusion.

The situation seems to be changing now. After the violent churning about in the state of Andhra Pradesh, with the regulatory umbrella of the central bank over their heads and concerted self-regulation efforts by industry organizations, the MFIs are on the path to regaining their image as entities credible and capable enough to be partners in the process of financial inclusion. There is an increased interest among them to forge alliances with banks to be their BCs/BFs, a business opportunity offered by the RBI[17] to non-profit MFIs in 2006, but did not fancy their imagination then. Over the last couple of years, several of the for-profit MFIs have set up non-profit subsidiaries to carry out the BC function, while the non-profit MFIs have steadily expanded their off-balance sheet portfolios.[18] There indeed are robust signals of a larger convergence between the growth plans of at least some segments of the MFIs and the financial inclusion initiatives. However, as of now, no clear direction is visible.

Licensing of new banks

The intention of the government to grant additional banking licenses to private sector players, including NBFCs, was announced in the budget speech of 2010–11. The major objective was to expand the coverage of and access to banking services. In order to help the cause of inclusion, the new licensees will have to comply with the priority sector lending targets and sub-targets like the other domestic banks. Additionally, they are required to avoid any 'urban bias' and branch concentration by locating not less than 25 per cent of their branches in unbanked rural centres (with population up to 9,999 as per 2001 census). The 26 applicants include two major microcredit players—Bandhan Financial Services and Janalakshmi Financial Services. The other applicants include big public sector players like India Posts, Tourism Finance Corporation of India and LIC Housing Finance apart from a range of business interests.[19] The new bank licenses are expected to be announced by the RBI in January 2014.

The path of transformation from a purveyor of micro credit to a full-service banking institution is not very easy and is fraught with many challenges. For instance, building up the deposit base will take time for the new bank, whereas they have to maintain the statutory liquidity ratio (SLR) and cash reserve ratio (CRR) right from inception. This time gap may strain their resources.[20] The applicants will have to start investing in branch expansion, technology upgradation and capacity building of leadership to face up to RBI scrutiny, leading to some sunk costs with highly uncertain returns. It was reported that at the time of application, Bandhan had already appointed a consultancy firm to prepare the blueprint of its proposed bank, and reconstituted the governing board with experts from the banking sector. It had even started training its 1,200 odd staff members in banking.[21] Some of the bigger MFIs did not apply for bank licenses keeping such factors in view. As per SKS' leadership, there is greater merit now to remain an MFI as

> ... the new banks will have to depend on micro-lenders to meet their priority sector lending target of 40 per cent. This will lead to an increase in the number of securitised transactions. The new banks will also offer term loans to microfinance companies for on-lending to weaker sections of society to achieve their priority sector lending targets till the time they expand their presence in deeper geographies.[22]

Ujjivan said that it prefers a special bank status:

> We believe a regular commercial banking licence would not suit us as our clients' profiles are different from that of banks. We would be more interested in getting 'a specialised banking licence with financial inclusion as the primary agenda' as the format of

regular commercial bank would not suit the profile of clients.[23]

If the idea of small finance banks introduced in the RBI working paper as discussed in the previous chapter fructifies, well-run MFIs may get an opportunity to get into the mainstream banking space.

Addressing regional imbalances

The microfinance sector, right from its early days, has been growing lopsided. Microfinance organizations based in the southern states have claimed a larger chunk of the resources, be it from banks or other private investors, and accounted for majority of the borrowers of microloans as also savers. Those MFIs which follow profit-making business models headquartered in these states have eventually ventured out into the rest of the states and increased their portfolios to leverage more resources. Indian microfinance has almost become coterminous with south Indian microfinance.

The latest NABARD report on the progress of SBLP during 2012–13 indicates that the regional disparity in loan disbursement has actually widened. While the states in the south have been able to increase the extension of fresh loans by 20 per cent, those in the north-eastern regions and the backward states of Chhattisgarh, Jharkhand and Bihar witnessed a negative growth (NABARD, 2013).[24]

Several initiatives were implemented in the past to address the issue of regional disparities in access to financial services. The Poorest States Inclusive Growth (PSIG) Programme is a widely discussed initiative currently. The programme is funded by the Department for International Development (DFID), UK, and aims to enhance income and employment opportunities and reduce vulnerabilities of poor women and men, especially small producers in eight low-income states (Bihar, Odisha, Madhya Pradesh, Uttar Pradesh, Chhattisgarh, Jharkhand, Rajasthan and West Bengal) by helping them access finance and markets. SIDBI is entrusted with the task of implementing the programme, one of the core components[25] of which is financial inclusion and women's empowerment. Under these components it is envisaged that over a period of six years four states (Bihar, Odisha, Madhya Pradesh and Uttar Pradesh) would improve the access for poor men and women to a variety of financial services. These states would, for one, facilitate financial services institutions, including banks and MFIs, to provide services for poor people in geographical areas that are otherwise considered inaccessible or unbankable. They would achieve this by providing patient capital, guarantees, technical assistance, etc. Women will be provided training to improve their knowledge and confidence in financial services. Some funds are allocated for supporting approaches that promote responsible client practices and complement government programmes as also moderate policy and business environments.

The Programme recognizes that multiple channels are necessary to expand financial services to the poor. Thus, it seeks to support banks, BCs, NGOs (especially, those working with RRBs and DCCBs), and SHG federations and local as well as large, multi-state MFIs. The support to MFIs is meant to be in terms of mobilizing loan funds and investments to scale up outreach, helping them leverage equity or quasi-equity from SIDBI, NABARD and other sources, risk or guarantee fund support for incremental lending to poor clients and capacity building and technical assistance support. Of the total project budget, 40 per cent is earmarked for providing support to informal/semiformal financial intermediaries, and 10 per cent to formal sector financial intermediaries.

The Scheme of Micro Finance Programme of the Ministry of Micro, Small and Medium Enterprises has a Portfolio Risk Fund (PRF) component to help MFIs/NGOs in the underserved states, which include the north-eastern states, Bihar, Jharkhand, West Bengal, Odisha, Madhya Pradesh, Chhattisgarh, Uttar Pradesh, Jammu & Kashmir, Rajasthan and Uttarakhand as also the underserved pockets/districts of other states. The Fund (₹150 crore currently) has been in operation since 2003–04 attached to SIDBI's Micro Credit Scheme. With this Fund, SIDBI offers 75 per cent subsidy in the security deposit required from MFIs/NGOs in the target areas which take loans from it. During 2011–12, the Ministry released an amount of ₹16.10 crore towards PRF. As of 31 December 2012, the cumulative loan amount provided to MFIs/NGOs under MFP stood at ₹1,637.72 crore covering approximately 23.47 lakh persons, more than 80 per cent estimated to be women. In the north-eastern region, 11 MFIs received PRF assistance.

Building sector capacities: the way forward for mainstreaming microfinance

The lack of a clear-cut approach to capacity building of microfinance institutions including SHGs, SHPIs, MFIs and self-reliant cooperatives has been a perennial issue of complaint. In the case of SHGs, adequate promotional assistance is crucial as the process of formation of groups is an important determinant of group quality. Based on the experience of APMAS, Reddy (2013)[26] points out that NABARD's promotion support to SHPIs and SHGs has been

grossly insufficient over the past decade and a half. During this period, SHPIs have received only a third of the sanctioned grants from NABARD. The share of SHGs that have been promoted with NABARD grant has been just around 4 per cent.

According to Mathew Titus, the Executive Director of Sa-Dhan,[27] it is high time that we recognize the significance of investing substantial resources in increasing the effectiveness and efficiency of the microfinance sector to facilitate its integration in the mainstream financial market. Such investment has always been lacking for the sector. For instance, Sa-Dhan's efforts to develop and disseminate a code of conduct have been poorly supported. It is an interesting paradox that code of conduct and self-regulation are vital themes in the contemporary microfinance discourse.

It is a matter of concern that the MFIs have stopped investing in training. Training expenditure per head incurred by microfinance players has come down drastically over the years. That this is happening at a time when the sector is in need of specially skilled manpower to deal with banks, regulators and technology is an irony of sorts. The MFIs these days are needed to maintain high standards of compliance. They are expected to make efficient use of credit bureau data. They are supposed to have effective in-house complaint redressal arrangements. They must adopt up-to-date technologies to steer growth and develop client-responsive products and processes. But how do they prepare their human resources—undertrained and inexperienced in most cases—to undertake functions that need fairly sophisticated skills of reflection, analysis and liaising? Sector associations must be called upon to play a crucial role here.

The donor institutions' strategies need to be geared towards locally grounded initiatives, focused on enhancing the overall capacity of the microfinance sector rather than supporting discrete activities of individual entities. And, associations are the best suited to carry out sector-wide capacity-building activities. How to develop the necessary infrastructure for upgrading the capacities of the sector—all channels included—is a question that must bother the policy makers. It may be worth their while to deliberate the ways to leverage the efforts of an organization such as the National Skill Development Corporation which has already set the basic parameters for large-scale skill training.

Some others also shared these views. Vijayalakshmi Das, who heads the Ananya Finance for Inclusive Growth, a wholesale NBFC catering to the capital needs of a good number of medium and small-sized MFIs, both NBFCs and non-profits, observed that capacity-building assistance for the sector has almost completely dried up. The retreat of the social investors after the Andhra Pradesh crisis not only affected the flow of investment capital, but also stopped the streaming in of capacity-building grants. This has affected the non-profits more because most of them are small and cannot face up to the big NBFCs in the market for funds. One major casualty seems to be lesser support for innovations that facilitate financial inclusion of women.

WOMEN AND FINANCIAL INCLUSION

'There is no doubt women are discriminated against in the loan giving process. They have to work harder to establish their credibility as entrepreneurs', says HSBC India country head and FICCI President Naina Lal Kidwai.[28] A recent study (BASIX, 2013)[29] commissioned by the UN Women, the United Nations agency for gender equality and empowerment of women, examined the Indian banking sector policies from the perspective of securing women's rights to financial services. Analysing the data from the scheduled commercial banks, the study reports that women's saving deposits form only 11.5 per cent of the total deposits as against 40 per cent in the case of men. Moreover, there has been a decline in this percentage, more pronounced in rural areas. Similarly, the volume of small credit accessed by women (below ₹2 lakh) in 2010–11 was a fourth of what men could access. The study reports the data from the Small Borrowal Survey 2008 to argue that women are less risky as borrowers with a relatively lower NPA percentage (3.4 per cent) compared to men (4.1 per cent).

As per the data furnished in the Annual Report of the Ministry of Finance 2012–13, credit to women in the books of public sector banks constituted just 7.34 per cent of the adjusted net bank credit (as of 31 March 2012). The share of microcredit in the advances made under priority sector to women was 22 per cent.

Importantly, the BASIX study noted that the marginal gains that women made since 2000 in terms of their share in bank credit have been achieved through the SBLP. Women find it hard to access bank credit, except as SHG members. The financial inclusion programme has not made it easy for them to get 'mainstreamed' as it focuses on inclusion of household.

Microfinance, the SHG model particularly, has brought asset poor women closer to the mainstream financial services. The relationship that evolved between women and banks mediated through SHGs has not been free of conflicts, but has helped both transcend certain historical myths with respect to women's ability to engage with finance. With the

prospect of the SBLP facing an imminent burnout in the face of individual and technology-centric financial inclusion initiatives and the MFIs migrating to for-profit format for better regulatory cover, women's constituency in finance in general and microfinance in particular is likely to lose its significance in the coming years.

A notable aspect of microfinance, the commercial success of which depends apparently on the integrity and credit discipline of women, is the continued underrepresentation of women in the decision making and implementation functions. Of the 28 NBFC–MFIs that reported board composition to the MIX, 11 (39 per cent) had no representation of women on their boards. Only five had more than 33 per cent representation. The rest on average had about 17 per cent women representation in the governing bodies. Women form less than 10 per cent among loan officers and managers in 58 per cent and 49 per cent cases of NBFCs that reported such information. NBFCs with 33 per cent or more women staff as loan officers and managers formed 9 per cent and 5 per cent respectively of the sample we reviewed.

Non-profit MFIs appear to be more gender-balanced. About 40 per cent of the organizations reported 33 per cent or more board positions as held by women. In 26.5 per cent of the NGO–MFIs women formed more than a third of the loan officers. However, when it comes to managers, only 15 per cent of the non-profits had more than 33 per cent women; 39 per cent reported no women managers at all.

In order to improve the figures of women employment in MFIs, conducive working conditions must be created for them. There are some examples where gender-aware MFIs have incorporated additional provisions in their organizational policies to encourage women's participation in management. Unfortunately, the sector-wide policy statements or self-regulation tools like codes of conduct are largely silent about achieving gender justice at the organizational level.

Box 9.3 Gender policy: Grameen Koota

Grameen Financial Services Private Limited (GFSPL), popularly known as Grameen Koota (GK), is an NBFC–MFI operating in 42 districts in three states of Karnataka, Maharashtra and Tamil Nadu. GK is firmly committed towards gender inclusion and aims towards increasing representation of women at all levels of the organization. GK has understood that most of its female staff desire work–life balance and has framed its gender policy accordingly. It also organizes various mentoring programmes for developing women leaders within the organization.

Apart from the provisions as per the labour laws (concerning maternity benefits, paternity benefits, prevention of sexual harassment, etc.), GK has formulated certain enabling provisions within its gender policy.

The additional provisions are as follows:

- In order to ease the transition back to work for new mothers, GK allows them to extend their lunch break from the normal half hour to an hour and a half so that they can go home to nurse their children.
- New mothers are given the option of working from home once a week.
- Women with children are allowed to bring their children to the office in case their school closes before the office hours.
- At the time of promotions, GK works to ensure that qualified women are not affected by the 'glass ceiling'. While promotions are based on merit, GK ensures that there is equal representation of men and women in leadership roles.
- Women who stay back for official work after 7 pm are provided with a company-paid car-drop to their home.
- Realizing the problems women field officers face in travelling to villages early mornings and late evenings, they are posted mainly within the town limits with the maximum working area from the branch capped at 10 km.

Source: Based on write-up by Grameen Koota.

The issue of gender and microfinance governance is more complex. How does the gender composition of governing bodies affect organizational decisions? Does increased representation of women in these bodies necessarily mean better social responsibility? Or for that matter, would all-male boards tend to perpetuate the status quo of patriarchy and patronage within organizations and community? How do organizations structure their governance to circumvent the paradox of having an exclusive or dominant male perspective while dealing with their exclusive women clientele? Some of these questions merit systematic examination.

Three recent initiatives from the central government need to be examined in some detail as they seek to exclusively address women's interests in financial inclusion. The first is the setting up of a

fund for promoting women SHGs in backward regions (women and regional development issues are clubbed here). The second is the proposal to reform an existing institution—the Rashtriya Mahila Kosh—and the third is the move to start a new banking institution exclusively for women—the Bharatiya Mahila Bank.

Women in backward regions: the WSHG initiative

In March 2012, the Government of India announced the setting up of a ₹500 crore fund, 'Women SHGs Development Fund',[30] to be deployed in regions where progress of promotion of women SHGs has been slow. According to the Government of India circular, the funds are meant to be used for promoting SHGs of women, providing refinance to banks against the first time loans given to women SHGs' developmental activities and financing microenterprises they set up. This initiative is expected to progress closely alongside NRLM, but avoiding any overlap with it. The promotion, handholding and monitoring are carried out by anchor NGOs which function as business facilitators for banks. They are also responsible to ensure repayment of bank loans by the SHGs. In a bid to institutionalize the SHG–bank linkage within the financial inclusion logic, the programme promotes district-level mechanisms to ensure sustained credit flow to SHGs from banks. Close to 240 memoranda of understanding have already been entered into between anchor NGOs and banks. By 30 June 2013, about 67,000 groups have been promoted and savings linked. Only a fourth of them, however, could be credit linked.[31]

The attempt to complicate development issues—conceptualizing women's development within the regional development framework—is commendable. However, one is not clear as to how this scheme avoids the inefficiencies observed in the mainstream SHG initiative.

RMK: on the restructuring path[32]

The RMK, established in 1993, is the apex microfinance organization of the Government of India under the Ministry of Women and Child Development. RMK extends loans to NGOs and voluntary agencies which on-lend to SHGs in rural and urban areas. Organizations like Women Development Corporations, women cooperatives, and Women Welfare Boards/Agencies and not-for-profit companies engaged in promoting women's development at the grass-roots level are also eligible for RMK loans. It has been operating a 'franchisee scheme' under which funds are extended to well-established

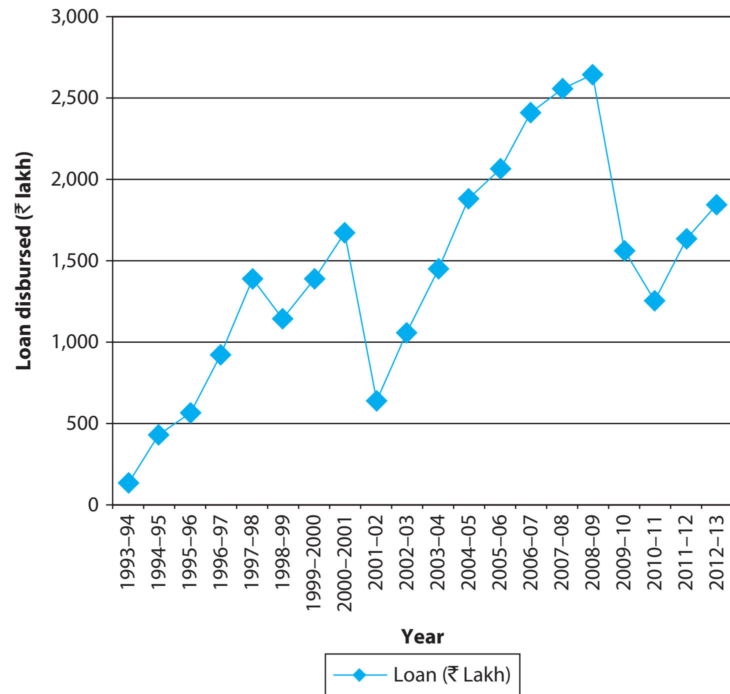

Figure 9.1 Loan disbursals by RMK

Source: rmk.nic.in.

microfinance organizations, which in turn on-lend to smaller NGOs locally. Also, it has been offering a special concessional scheme for the north-eastern states. It has cumulatively lent to more than a million SHGs through 2,600 NGOs or implementing microfinance organizations (IMO). Loans worth ₹5,273 million have been disbursed by RMK by end March 2013.

The loan disbursals from RMK over the two decades of its existence increased overall as shown in Figure 9.1. However, much of the RMK loans were deployed in a few states. For instance, three states—Andhra Pradesh, Tamil Nadu, and Orissa accounted for 63 per cent of total loan outstanding in 2009–10. The default portfolio has also been concentrated in these three states.

In 2010, RMK's Governing Board recommended its reorganization into an NBFC. A proposal has subsequently been moved to restructure RMK from the existing single office society to government-owned Non-Deposit Taking Systemically Important Non-Banking Finance Company (NBFC–ND–SI) under section 617 of the Companies Act with a office network across India. In the process, ₹500 crore was proposed to be infused by the Government of India in a period of five years. A roadmap is being prepared for the new company with focus on increased scale of operations as well as

improved operational efficiency and professionalism.

The Bharatiya Mahila Bank: exclusive bank for women

> Women are at the head of many banks today, including two public sector banks, but there is no bank that exclusively serves women. Can we have a bank that lends mostly to women and women-run businesses, that supports women SHGs (self-help groups) and women's livelihood, that employs predominantly women, and that addresses gender-related aspects of empowerment and financial inclusion?

The Finance Minister shot this provocative question during the budget speech of 2013–14, and answered it by setting aside ₹1,000 crore for the establishment of a women's bank. Quite remarkably, the bank christened as Bharatiya Mahila Bank, acquired all the necessary governmental approvals in about six months and is now ready for formal launching in November 2013. The proposed all-women bank will be the first ever commercial bank to be floated by the central government.[33]

As per media reports, the Bank is expected to start operations in the last quarter of 2013 with six branches—one each in north, south, east, west, central and north-eastern parts of the country.[34] With the goal of bringing bank services to the doorstep of women, the bank will open accounts for women through branches as well as through camps around the country. It is mandated to support and coordinate with SHGs and other relevant institutions to promote lending to women. Other financial services such as insurance and pension will be offered to them through tie-ups with the existing state-run financial institutions. Headquartered in Delhi, the Bank will be scaled up to 39 branches and 33,000 customers at the end of the first year of operation[35] and to about 500 branches by the fourth year,[36] and 778 branches with 55 lakh customer accounts over the next seven years.[37]

There is strong empirical evidence to suggest that financial empowerment of women has a multiplier effect on the well-being of families and, therefore, on the economy. An all-women bank will have significantly greater capacity to fast forward such empowerment. If the bank functions properly, this could be a meaningful step in the right direction. Organizations that provide financial services in rural areas say a women's-only bank could help to overcome the problem posed by cultural restrictions on women and men working together that are still prevalent in certain parts of the country. However, the critics do not see that a 'separate but equal' financial institution could do much to overcome the barriers to banking. According to some experts, the existing schemes that have succeeded in empowering women financially, such as microcredit programmes, should first be strengthened along with passing the proposed legislation on microfinance. For some microfinance companies there is hope that the bank may open up newer avenues to raise additional funding. A media report quotes a microfinance functionary thus:

> Existing banks do not have large number of branches in remote areas. Doubts remain whether the new all women's bank will have significant branch presence in rural centres. We are actually hoping that the new bank will be acquiring securitised portfolios from us. That will give us an additional source of funding.[38]

There is degree of apprehension among MFIs too. The new bank aims to reduce gender bias by offering loans to women-run businesses and SHGs, which is a core business of most microfinance companies. Many of them feel that the new bank will intensify competition and severely affect their businesses. Some micro-lenders also compared the move with Andhra Pradesh government's decision to set up the all-women Stree Nidhi bank that offers loans to women SHGs and aims to keep the borrowers away from private microfinance companies. There is a widespread feeling among bankers and industry analysts that the first women's bank in the country will probably offer similar products and services as existing banks.

THE WAY FORWARD

The policy initiatives introduced in the microfinance sector since 2011 had one major goal—to prevent systemic failure of the sector and to reduce uncertainty. They were also meant to convey that the central government and the central bank are not willing to let the sector be regulated by provincial laws. Importantly, the policy measures have had the effect of restoring order in the sector, except in Andhra Pradesh. However, further delay in the passage of the proposed microfinance regulation act would dull the current enthusiasm as it increases uncertainty in the environment. Self-regulation alone will not be sufficient as without a robust regulatory arrangement with clear-cut enforcement mechanisms, it will be difficult to make MFIs comply with the voluntary codes and client protection principles for

longer periods of time. SROs can at best do routine monitoring of the working of the sector, systematically document major trends and provide periodic advisories to its member MFIs. They cannot be expected to be of enforcers of rules and codes.

As the financial inclusion agenda is getting broad-based and diversified, it seems to be getting progressively closer to the microfinance channels, be it SHGs or MFIs. This has given rise to several process innovations and newer debates in policy, like, for instance, around the suitability of SHGs and MFIs in functioning as BCs/BFs. For the NBFC and NGO–MFIs, the major bottleneck to business growth will continue to be access to capital at affordable cost. Many point out that the issue of cost of capital is clearly related to savings mobilization. Though the MF Bill 2012 has a provision included about savings, the central bank is not likely to endorse this. The system has already suffered significant loss of morale due to the frauds that involved urban cooperative banks and chit funds.

The ideas currently in circulation regarding banking sector restructuring, especially regarding the ideas of small finance banks, have rekindled the interest in conceptualizing microfinance as an extension of the formal financial system rather than independent informal activity loosely connected to the mainstream banking and financial universe. It is important for the sector to further develop this association as the patronage from the domestic banks is strategically more useful for its sustenance in the long run than the fleeting foreign capital lows. It is worth noting that many mainstream banks have started investing their resources in nurturing newer forms of business associations with MFIs, SHGs and federations.

Contemporary India is a land of unfinished institutional innovations. The most glaring example is that of cooperatives. Microfinance to some extent has been able to push itself through a learning cycle thanks perhaps to its ability to generate positive returns over long periods of time. It will be great if the new ideas and proposals to reform the banking sector recognize this.

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   > …to provide for promotion, development and orderly growth of the micro finance sector in rural and urban areas for providing an enabling environment for ensuring universal access to integrated financial services, especially to women and certain disadvantaged sections of the people, and thereby securing prosperity of such areas and regulation of the micro finance organisations not being regulated by any law for the time being in force…

   It designated NABARD as the regulator for all the 'microfinance organizations', which by definition included all registered societies, trusts and cooperative societies that provide microfinance services insurance and pension services, but excluded SHGs and SHG federations. By this definition the Bill made a distinction between the not-for-profit and for-profit NBFC microfinance providers. The latter were left out of the purview of the Bill given their licensed-with-RBI status.
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Annexure

ANNEXURE 1
Organization profile of study NGOs (as on 31 March 2013)

#	Particulars	MYRADA/ Sanghamithra, Karnataka	PRADAN, Rajasthan and others	IIMF Andhra Pradesh	Chaitanya/ GMSS and other federations, Maharashtra	SKDRDP, Karnataka	ASSEFA/ SNFL, Tamil Nadu	BWDA Finance Limited/BFL, Tamil Nadu
1	Legal form	Society/not for profit Section 25 company, federations not registered	Society	Registered under APMACS Act, 1995	Society/ Public trust/ Private Mutual Benefit Trust	Charitable Trust	Society/NBFC (Sarvodaya Nano Finance Limited)	NBFC/ Society
2	Area of operations (states/ districts)	4 states/20 districts (as on Jan 2013)	7 states/41 districts	Andhra Pradesh/ 2 districts	Maharashtra/ 18 districts	Karnataka/17 districts	5 states/23 districts	3 states/11 districts
3	Year of start of SHG promotion	1984	1987	1980	1989	1982	1980	1992
4	Year of start of MF operations	1996 (through Sanghamithra, an independent legal entity)	Not applicable	2002	1991	1992	1991	1999
5	MF methodology followed by SHPA	Primary focus is on SHG–bank linkage. Promoted NBFC Sanghamithra	Small savings and credit in SHGs, subsequently facilitate SHG–bank linkage	Lends through IIMF to MACS who further on lend to SHGs	SHG Bank Linkage, on-lending to SHG through Federation	On lending to the SHG's through borrowing from banks, SHG–bank linkage	Lends through Sarvodaya Nano Finance Limited	On-lend to SHGs, promote SHG bank linkage and promoted NBFC to lend to SHGs, JLG and individual
6	Total number of SHGs promoted	SAGs 12,562, Soukhya groups 512,	18,736	4,802	7,816	234,000	30,155**	26,215
7	Total no. of members	239,482	252,070	46,959	103,442	2,597,000	111,864	469,503
8	Cumulative no. of SHGs linked to banks	12,500	2,887	2,400	383*	Not applicable	Not applicable	811
9	Cumulative amount borrowed by SHGs directly from banks (₹ million)	3,269	Not applicable	12	31.89	Not applicable	Not applicable	3,565.1
10	Number of SHG Federations promoted	479	57	20 MACS and one IIMF	50	6,857		

(Continued)

(Continued)

#	Particulars	MYRADA/ Sanghamithra, Karnataka	PRADAN, Rajasthan and others	IIMF Andhra Pradesh	Chaitanya/ GMSS and other federations, Maharashtra	SKDRDP, Karnataka	ASSEFA/ SNFL, Tamil Nadu	BWDA Finance Limited/BFL, Tamil Nadu
11	Cumulative amount borrowed by SHG federations directly from banks and other sources (₹ million)	Not applicable	Not applicable	780	128.5	Not applicable	58 million (By Sarvodaya Nano Finance Limited)	Not applicable
12	Loan provided to SHGs by the Organization/ Organization promoted NBFC/Federation during 2012–13 (₹ million)	Not applicable	Not applicable	157.75	110.067	81,820	1,626.73	8,237
13	No. of MF field staff	Not applicable	Not applicable	35	175	3,024	671	279
14	Total savings of SHGs to date (₹ million)	5,426 SAG's reporting to MYRADA, total savings 296 million	12,30.61 (Net owned fund of SHGs (saving + interest – expenses)	Not applicable	100 (approx.) internal savings and 24.7 in federation**	6,720	Not applicable	2,603.908
15	Loan outstanding (₹ million)	66	312.8	152.96	105 approx. through internal lending and. 99.9 through federation**	25,930	368.72	Total Loan O/S: 541.926, Loan O/S with SHG: 294.643, JLG: 101.5, Individual: 145.77
16	Current SHG repayment rate (% per annum)	95%	Not applicable	97.49	90%	100	97.45	97.45
17	Rate of interest paid by SHGs (% per annum)	14–21%	10–13%	18–21% (IIMF to MACS 15, MACS to SHG members 21)	21	18% on reducing scales or 10% on flat basis for loans	23.8 reducing for 10 months tenure	26 (on reducing balance)
18	Range of groups internal lending (% per annum)	20–30%	INR 1–2 per 100 per week	18 –24 (lending rate for SHG savings on reducing balance)	24 (on reducing balance)	18% on reducing scales or 10% on flat basis for loans	24 (on reducing balance)	18 to 36 (on reducing balance)

(Continued)

(Continued)

#	Particulars	MYRADA/ Sanghamithra, Karnataka	PRADAN, Rajasthan and others	IIMF Andhra Pradesh	Chaitanya/ GMSS and other federations, Maharashtra	SKDRDP, Karnataka	ASSEFA/ SNFL, Tamil Nadu	BWDA Finance Limited/BFL, Tamil Nadu
19	No. of SHGs and members covered by insurance products	75,609 (80%)	Not applicable	SHG 4,802 members 7,817	4,282	220,189 SHGs and 2,815,612 members	Sarvodaya social security scheme offered by SMBTs	37,758
20	Other financial and non-financial services provided by the organization	Support in education, water management, PPP, local governance, microfinance	Training, TA, gender empowerment, human rights education, business and entrepreneurship development, marketing assistance, linkage with financial/ technical research institutions	Health camps for members; women's dairy producer company, bulk milk cooling units, supply of feed, fodder development, veterinary services, etc.	Capacity building of grassroots institutions, audit and gradation of SHGs, Legal awareness, bank linkages	House construction in flood affected areas pension to destitute, Sujananidhi scholarship for students, SRI, sanitation, gobar gas, solar units, community infrastructure, primary education, Training programs for women	Health & Eye camps, support for dairy industry, Evening classes for drop out students from government schools, community marriages	Capacity building support, Formal educational program with 3 schools & 3 colleges, non-formal education, health & sanitation, R&R, Insurance, National Pension Scheme, Western Union Money Transfer, and PAN Card services
21	New products	NABYUKTI Software	Not applicable		Sanchayan-excess saving product, DAN-health fund	National Pension Scheme		
22	New relationships as such as BC channel, bank mitras	CMRCs as BCs of NABFINS	Not applicable		Chaitanya plays the BC role with YES bank	BC with Union Bank of India, SBI, Canara Bank, Corporation Bank		BC for YES Bank

Source: Data submitted for the study, websites of organizations and MIX market.
* During 2012–13.
** As of March 2011.

ANNEXURE 2
State of the Sector Report 2013

Discussions on Solution Exchange, United Nations

Summary

Query on the State of the Sector Report–Phase I: Structure, style and content of the report; innovations in microfinance products and services (savings, loans, insurance, payments) in rural and urban areas and targeted at different segments (tribal, people with disabilities, minorities) and sectors (farm and non-farm); and SHG–Bank Linkage Programme, National Rural Livelihood Mission and other leading programmes and projects

In response to the first phase of the query posted by the author, 27 members of MF Community of Practice (CoP) enthusiastically participated in the discussion. The summary of discussion is presented as follows:

Query poser: Dr Venugopalan Puhazhendhi

CONTRIBUTORS

Balaji Ramakrishnan, Navin Anand, Sashi Kumar, Smita Premchander, Sachin Kumar, Resham Singh, N. Jeyaseelan, Manab Chakraborty, Prasenjit Sen, Satish Upadhyay, S. K. Anand, H. K. Pradhan, Achla Savyasaachi, Milroy Paul, Hemantha Kumar Pamarthy, Jaipal Singh Kaushik, Subrata Sarkar, Kumar Shailabh, Sanjeev Kumar, Kamlesh Gururani, N Srinivasan, Subhendu Pratihari, Ritesh Dwivedi, Jiwan Sondhi, Mohammad Azhar, Kiran Kulakarni, P. P. Desai

Compiled by: Navin Anand, Resource Person & Moderator and Mohammad Anas, Research Associate, Microfinance Community of Practice, Solution Exchange, United Nations

SUMMARY OF RESPONSES

Responding to the query on 'State of the Sector Report 2013', members focused their views not only on structure, style and content of the Report but also on innovations in microfinance products and services in rural and urban areas; microfinance arrangements for various segments and sectors of microfinance; SHG–Bank Linkage Programme; and National Rural Livelihood Mission and other leading programmes and projects.

Members expressed that the Report has been a great contribution to the sector as it provides valuable inputs for a range of stakeholders of microfinance sector such as donor, microfinance institutions, NGO–MFIs, government, RBI/NABARD and independent researchers/academicians.

Problems related to data collation, consistency and availability: Members highlighted the problem of collecting up-to-date and relevant data within the timeframes. They also mentioned that there is inconsistency of data across sources. There is no single source of getting information on the progress of microfinance sector. The number of SHGs formed by SHPIs, and not linked to banks or NBFCs, is not recorded by any agency. These do not get reflected in the official records, and so SOS Report understates the national data to the same extent.

STRUCTURE, STYLE AND CONTENT OF THE REPORT

Microfinance products, services and delivery mechanism: In this part, savings, credit, insurance and transfer of money/remittances could be covered. This chapter may include new areas like micro-health insurance/health mutuals, mobile phone banking, lease financing, housing finance, etc. Besides products and services, coverage of delivery mechanisms such as BC model, kiosk model, experiments related to e-money transfer will be useful.

Microfinance for various sectors and subsectors of livelihoods: The Report may also cover major livelihood sectors—farm (agriculture and agri-allied) and non-farm sectors, in terms of micro financing. Within the farm sector, coverage of specific subsectors and also in non-farm, coverage of financing for manufacturing, vending and trading, and services will be useful.

Geographical areas: While covering state-wise brief of the microfinance will be useful for various MFIs and SHPIs in their planning process and collaborations, coverage of MF in terms of rural, semi-urban and

urban areas will also add value. It will be worthwhile to cover MF in different regions especially mountain and remote, tribal areas and naxalites-affected areas as the strategies of providing MF services in these areas will be different compared to other areas.

Coverage of various segments of population: Keeping in view the focus on providing microfinance service to the clients, coverage of various groups in context of **occupation**—small and marginal farmers, rickshaw pullers, domestic workers, handloom weavers/artisans, migrant labourers/workers etc.; **vulnerability**—People with Disabilities (PwDs), older persons, disaster-affected people; and **category**—scheduled tribes/particularly vulnerable tribal groups (PVTGs), scheduled castes, minorities, etc., will be highly useful.

Performance of various stakeholders of MF sector: Coverage and analysis of informal, semiformal and formal microfinance institutions such as NBFCs, NGOs–MFIs, cooperatives, companies, and Section 25 companies will help in identifying the factors that are conducive or detrimental for the sector in context of the type of organizations. It will also help in identifying the policy and regulatory issues of different legal entities.

MEMBERS' SUGGESTIONS ON THE COVERAGE IN SOS REPORT

- **Yearly analysis:** Year-wise analysis to understand the impact of MF on poverty level
- **Research studies:** Various research studies conducted in India during 2013 on microfinance and value chain financing
- **Innovative models and practices of microfinance:** Quick highlights on innovative service delivery models of microfinance as well as practices including MF models in north east, in context of operational challenges, transaction costs, up scaling and sustainability
- **Best practices:** Best practices applied in the sector for community-based organizations (CBOs) and microfinance institutions
- **Covering channels of financing:** Analysis of channels—direct, through SHGs, through JLGs
- **Investors' perspective:** Covering the scenario of banks & private equity investors' exposure into microfinance sector and their experiences
- **Financial literacy:** Applied practices on financial literacy as a tool to educate client and impact realized by MFIs/CBOs
- **Data on enterprises:** Data on number of enterprises that are created by NGO–MFIs and NBFC–MFIs through SHGs as well as individuals and grading them on the basis of repayment of loans
- **Convergence:** Case studies on the convergence of government schemes with SHGs
- **Policy and regulatory issues:** Microfinance Regulation and Development Bill, Cooperative Acts, RBI/NABARD regulations, Companies Act, etc.
- **Risk analysis:** A separate section on the risks that are currently existing and those that are emerging both in MFIs and SHGs
- **Experience of direct benefit transfers:** Experience/involvement of MFIs in DBTs and also banks
- **Demand/need–supply gap:** Analysis of demand and supply for financial products like credit, insurance, domestic money remittance, national pension scheme (NPS of Pension Fund Regulatory and Development Authority [PFRDA])
- **Examples of microfinance institutions that managed the crisis situation well:** Strategies adopted to manage the crisis
- **BC model (both MFIs and non-MFIs models):** Coverage of current status, issues and challenges, financial products offered
- **Economic impacts of MF on socially excluded persons**
- **MF services to migrants:** Documenting the existing system and creation of new systems for providing MF services to the people migrated from rural areas but having base in villages

COVERAGE OF OTHER SUBTHEMES OF MICROFINANCE SECTOR

SHG–bank linkage programme: While members suggested continuation of the SHG–bank linkage programme in the Report and also the 'way forward' for the programme, they also advocated for incorporating some quality service issues. Members quoted that in some places SHG savings are used as collateral by the

banks, whereas in some other places banks are charging annual interest rates higher than the prescribed rates. Members especially suggested capturing practices under SHG–bank linkage programme in states like Jharkhand, Odisha, Rajasthan, Madhya Pradesh, Maharashtra and north east. Members quoted various positive examples of the SBLP, including experience of establishing SHGs and JLGs in Maharashtra and Karnataka by an NGO—Institute of Rural Credit and Entrepreneurship Development (IRCED). Members informed that the groups have grounded well and resulting in viable and sustainable CBOs in rural areas.

SHG II pilots: Under SHG II, NABARD has focused on few aspects like voluntary savings, e-bookkeeping and livelihood-based groups/activity-based groups. NABARD has also taken up some pilots in different places. The SOS should capture the results of those pilots so as to learn the lessons and strategies. Members quoted example of Hand in Hand India in context of support received from NABARD and Agri Development Finance Tamil Nadu Limited (ADFT) and also the relevance of activity-based groups as a good strategy to promote credit deepening and livelihood promotion.

Progress of National Rural Livelihood Mission: Members felt that the progress of NRLM and how it engages the existing SHGs and their higher tier organizations is an area of interest to all readers, therefore SOS Report may discuss the scenario of SHGs, SHG clusters and SHG federations in light of NRLM.

Housing microfinance: Appreciating the initiatives taken up on housing microfinance sector in the countries such as Africa and Latin America, members recommended highlighting some examples of housing microfinance for the purpose of learning and replication. They also suggested a quick study of MFIs in context of housing microfinance including some success stories. Some of the nationalized banks are now developing small-size housing loans to cater to the rural and urban poor segment. The SOS Report may provide a list of different stakeholders of housing microfinance—wholesale funders, housing microfinance service providers, low-cost housing technology institutes, etc.

Incorporate a study on the effect of microfinance among the disability sector: A number of organizations are engaged in developmental projects meant for PwDs and many of them have adopted Micro credit assistance to provide self-sustainability, and there are ripple effects of such assistance. Members advocated for incorporating a chapter on the effect of microfinance on disability sector in the SOS Report.

Microfinance for disaster-affected people: Referring to the recent disaster in mountain areas of Uttarakhand, members suggested coverage of microfinance issues of the mountain communities, especially after repeated natural calamities. Members felt that a separate section on micro financing for the mountain region may be included in the Report with case studies of successful experiments undertaken by various organizations in the field of microfinance and microenterprise development. The need of a separate microfinance policy for the mountain areas is also suggested.

Micro, small & medium enterprises (SME) financing: There has been a shift in the focus to livelihood financing and MSME financing. Members felt that incorporating a chapter on MSME financing in India and strategic way forward for wider outreach and impact will be useful.

Micro leasing model: Highlighting about the need of promoting micro leasing, members informed that traditionally the concept was used in the form of shared cropping and livestock. Members shared that 'The Goat Trust' has successfully experimented a livestock leasing model. In this system, the lessor has to bear total loss of mortality, lessee remains safe except loss of labour done in raising goats. This could address twin issues of mobilizing local finance for poor for asset building and risk management of the business. Members suggested that a separate small section of micro leasing can also highlight the local systems of micro leasing and can bring it into debate and discussion to design pro-poor micro leasing products and services.

Islamic banking in India: Highlighting about the importance of Islamic banking in India, members informed that in recent years many countries are promoting Islamic banking. In India also, as per the recommendation of National Commission of Minority, Ministry of Finance has asked RBI to take a fresh

look on the same. Some commercial banks/private banks and NBFCs are already in the process of initiating Islamic Banking. Kerala is the forerunner in pursuing the possibility of Islamic banking in the country. Members quoted the example of BASIX in providing direct capital in the form of Musharaka and Mudaraba in Mewat to help MSEs. There are few others in the country who are providing indirect finance through leasing (Ijara), and sale contracts. The Kerala government has laid down guidelines to ensure better financial discipline and health of investments with the proposed financial institution based on sharia principles. Members recommended for including a comprehensive chapter on Islamic banking with example of best practices across south Asia.

Microfinance through cooperatives: A large number of PACS are doing good work in the area of micro financing and their role is not reflected anywhere under micro financing. Similarly, no official banking agency records the number of mutually aided cooperatives, under the new cooperative law so this information remains unavailable in the SOS Report. If the Report can do some collation of data across states to find out and add the total number of self-reliant cooperatives in India, this would be good value addition too.

In many states, especially in the districts of Integrated Cooperative Development Projects, several PACS are functioning as SHPIs to promote and strengthen SHGs by providing technical and financial assistance and facilitating in bank linkage. Members suggested incorporating a separate chapter on 'Microfinance through Cooperatives', with case studies of successful PACS, urban cooperative banks and SHG federations registered as thrift and credit cooperatives.

Rural microfinance and Regional Rural Banks: Members recommended that RRBs must focus only on financing to SHGs and providing services to the rural poor, under various poverty alleviation schemes. As far as coverage is concerned, rural microfinance should be taken up as a separate chapter in the SOS Report.

Coverage of micro insurance and micro pensions: Members felt that both micro insurance and micro pensions have a huge scope in the country and should be seen as thrust areas. There is a need to look at micro insurance deeply to understand the issues facing its operationalization and impact. We have looked at various models in micro insurance but there is no reporting available on what the stakeholders are facing vis-à-vis micro insurance. The focus should be to look at micro insurance beyond typical credit insurance and see where it is playing an important role in supporting livelihoods. If we can have a small report on the feedback from practitioners on their experience of micro insurance-challenges, issues and possible solutions, it would be of great value to all practitioners. A separate report on insurance is required as issues relating to risk mitigation and insurance are complex and very different from savings and credit.

Regarding micro pensions, members felt that the micro pension scheme of government of India—'Swavalamban/NPS-Lite' do not have large numbers in terms of pensioners. Members suggested that linking micro pension schemes with some of the government development programmes such as MGNREGS will be useful. A chapter on this subject with methods for improvement in both the cases will go a long way in the sector towards total financial inclusion.

Financing for climate change initiatives: One of the market-based mechanisms under the Kyoto Protocol is the 'Clean Development Mechanism'. Under this, they can purchase carbon from developing countries. This provides scope for MFIs to lend for renewable energy technologies (such as solar light, LED lantern, bio-gas energy, etc.). There has been partnership between UNEP, ICICI Bank and Frankfurt School of Finance and Management during 2011 on promoting climate finance products in India. The SOS Report can incorporate list of all the programs and projects undertaken by government; banks (including NABARD and SIDBI); multilateral, bilateral and other donor agencies on climate financing; analysis of some best practices in Climate Finance products segment.

Overall, members identified various aspect and issues that need to be covered in the SOS Report. They also suggested various subthemes and subsectors of microfinance that need to be covered in the report.

Query on the SOS Report—Phase II: Microfinance regulations and status of compliances for NBFC–MFIs and others, role of SHPIs in changed regulatory environment and provision of other financial services like insurance, pension, savings, and remittances.

In response to the second phase of the query posted by the authors, 10 members of MF CoP enthusiastically participated in the discussion. The summary of discussion is presented as follows:

Query posers: Mr Ajay Tankha and Dr Tara Nair

CONTRIBUTORS

C. S. Reddy, Rajan M. Karakkattil, Naveen Kumar Shukla, Devahuti Choudhury, Kumar Shailabh, Resham Singh, Smita Premchander, G. K. Agarwal, Mohammad Azhar and Mohammad Anas

Compiled by: Navin Anand, Resource person & Moderator and Mohammad Anas, Research Associate, MF CoP, Solution Exchange, United Nations

SUMMARY OF RESPONSES

Members of microfinance community realize that microfinance has become a proven tool to empower the economically weak. Both the Reserve Bank of India and the Ministry of Finance, Government of India, clearly recognize the role of microfinance institutions in enabling financial inclusion. Some of the seminal policy announcements in the year 2011–12 also bear evidence to the fact that MFIs are now accepted as an essential component of the mainstream financial sector.

Hence, the members feel that there is a critical need for a comprehensive regulation for the microfinance sector that will enable financial inclusion. The regulation of the microfinance industry is crucial and necessary to protect consumers and stabilize the microfinance sector. Microfinance regulation, however, is not simple process. The microfinance industry encompasses a wide array of institutes that provide a variety of services to many different customers. There has to be a balance between protecting customers and securing the industry.

Generally, microfinance services are provided through wide range of service providers, including for-profit NBFCs, non-profit Section 25 companies, cooperative societies, commercial banks (both state-owned and private) and development banks, NGOs and international NGOs (INGOs). Supervision and regulation is very challenging in developing countries such as India due to the multitude of small institutions and limited supervisory capacity. MFIs also differ in the nature of their business and the services they provide.

Given the breadth of this industry, there is no single body to regulate and supervise the operations of all MFIs. The regulatory requirements and standards for each of these regulatory bodies are different, complicating the regulatory framework. The members hold a mixed opinion on the issue of having a single regulatory authority for all microfinance entities or different regulators for different legal entities. However, the members suggest that regulations should broadly focus on the following:

- **Diverse financial institutions:** NGOs, microfinance institutions, community-based organizations, financial cooperatives and credit unions, postal and non-postal savings banks, commercial banks and state and agricultural banks.
- **Financial and other services** provided by different entities that should not only include credit but savings, insurance, remittances and payment services also.

Members further suggested that SOS Report 2013 should separately focus on following regulatory issues:

- **The NBFC and for-profit MFIs:** The enactment of The Micro Finance Institutions (Development & Regulation) Bill, 2012, for NBFC–MFIs has already provided guidelines for functioning of for profit MFIs and the for-profit industry is now well regulated as per provisions of the Bill. The MF Bill has been able to strike a balance between the interest of clients and the MFIs. However, there is need for a differential set of prudential and capital norms for start-up MFIs to protect their interests and give a level playing field as compared to larger and well-established MFIs and this should be adequately highlighted in the report.
- **Financial cooperatives:** Across India, a large number of SHG federations at different levels (village, cluster, mandal, block, and district) are registered under the cooperative laws (either liberal or otherwise).

Many other microfinance organizations and producer organizations are also registered under the cooperative laws as these are most suited. In the present context, the 97th constitutional amendment and the repealing or amendment of the liberal and other cooperative laws will adversely affect the cooperatives to be autonomous and self-reliant. These policy or regulatory changes have far-reaching implications (negative) for the SHG movement in India and for all the producer organizations in the country. Considering the seriousness of this issue, SOS 2013, should go into the details of the reasons that led to the 97th Constitutional Amendment, the consequences and also the actions taken by the civil society organizations.

- **Mutual insurance programme:** Members suggest that mutual insurance should be looked upon as the primary form of insurance as microfinance is looked upon vis-à-vis formal banking. There should be regulations around solvency needs in proportion to the risk value that mutual covers. It is also felt that the cooperative structure comes very close to the mutual model in India to be used as a vehicle for formalizing community-owned insurance. However, the cooperative bylaws need to cater to the requirements of mutual insurance and this should be highlighted in the SOS 2013 Report.
- **Regulations for the emerging and alternative models:** Members have expressed their concern that emerging business models and products should be given sufficient space for their growth and nurturing by the regulating authorities. The upcoming alternative models of financial inclusion like *Business Correspondence* and Interest-Free Banking models such as *Islamic finance* should be promoted for the larger well-being of the people. Further innovations in branchless banking will be an absolute must for India to achieve financial inclusion. A review of regulations and generation of ideas that will enable branchless banking to grow, without causing a risk to deposit safety, is required. New products such as *Housing Microfinance* especially in the context of rural areas should be given adequate focus in the report.
- **Microfinance issues of hills and remote locations:** Members think that it will be good to separately cover MF issues of mountain and remote areas in the SOS Report 2013. The microfinance institutions in Uttarakhand and other hilly states are proactively contributing towards rural finance. However, even with the well-known success of microfinance to date, formal financial services reach to about 10 per cent of rural areas, and the vast majority of poor men and women have no reliable and secure way to save money, protect and build their assets and transfer funds.
- **Synergy of microfinance regulations with NRLM and other programmes:** The regulation for microfinance should be in synergy with NRLM and other 'Direct Benefit Transfer' of social security schemes/ government schemes. NRLM envisages building strong institutions of the poor, particularly women, and enabling these institutions to access a range of financial services, including lending under priority sector. We have to ensure that the Microfinance Institutions (Development and Regulation) Bill 2012 is in sync with the recently published RBI guidelines related to NRLM. The guidelines are very positive towards SHGs, federations of SHGs, promoting institutions and NGOs. The implications of the same on microfinance sector should be analysed and taken up separately in the report.

Finally, members agree to the fact that regulation of microfinance is a very technical and complex issue. It touches upon the interests of many different stakeholders and is very much embedded in the national context. It is thus extremely difficult to design a set of detailed common guidelines for a diverse country such as India. The policy makers should target the principles of maintaining soundness of financial sectors, protecting savings and expanding access to financing the poor.

ANNEXURE 3
Report of the Roundtable on State of the Sector Report 2013—Microfinance

Date: 19 August 2013
Time: 11:00 A.M. to 2:45 P.M.
Venue: UN Conference Hall, UNDP, 55, Lodhi Estate, New Delhi, 110003, India

BACKGROUND

For the past seven years as part of Microfinance India Summit, State of the Sector Report (SOS) Report—Microfinance has become an important annual initiative. The document covers not only the status of MF in India but also issues, innovations, practices, and models of microfinance sector. This report has consistently been brought out by ACCESS Development Services and considered as an authentic national-level document that describes the state and growth of the Indian microfinance sector. Moreover, this has been a unique and widely referred to document not only in India but also in other parts of the world. The SOS 2012 Report is available at ftp://ftp.solutionexchange.net.in/public/mf/resource/res26081303.pdf

ROLE OF UNDP-FACILITATED MICROFINANCE COMMUNITY OF PRACTICE

Since last five years, Microfinance Community—Solution Exchange, United Nations, has been proactively contributing in the formulation of the SOS Report in the form of holding e-discussions and roundtables, wherein leading MF practitioners of the country participate and contribute. This makes the whole process more democratic, as suggestions on the structure of SOS are also taken from the members and initiatives of both small and big players of MF sector are duly recognized. Full report of roundtable on SOS 2012 is available at ftp://ftp.solutionexchange.net.in/public/mf/resource/res28081201.pdf

ROUNDTABLE ON STATE OF THE SECTOR REPORT 2013

Rationale and objectives of conducting SOS roundtable

While e-discussions have its own importance and relevance, as practitioners from various parts of the country can give their inputs in various forms by sharing views, documents, reports and case studies, etc., roundtable on SOS gives a chance to go deeper into the themes and issues of MF and also provide chance to those who missed contributing to the e-discussions. With this background, following objectives of Roundtable on SOS 2013 were envisaged:

- To strengthen the structure, design, contents and coverage of the Report by getting first-hand information from the practitioners, professional, researchers and policy makers.
- To enhance the ownership of the Report amongst government, RBI/NABARD, UN agencies and other international organizations, NGO/MFIs, various networks, federations, independent thinkers and promoters of MF.
- To provide a platform for a larger audience to contribute to the SOS Report by discussing the issues face to face.

Participants of the roundtable

The SOS Roundtable 2013 witnessed the presence of a good mix of members representing NGOs, MFIs, UNDP, training and research institutions, government and MF-promoting institutions. Besides representatives of a range of organizations, individual experts and practitioners of microfinance sector have also participated in the roundtable.

Welcome note

Welcoming the participants and introducing the roundtable, Dr Navin Anand, Resource Person and Moderator, microfinance community, mentioned that the e-discussion has its own importance as practitioners are able to contribute as per their convenience, whereas roundtable is important to have more in-depth, face-to-face discussions on various issues. He mentioned that everyday new experiments are going on in the microfinance sector, and it is important to capture new initiatives and models in the SOS Report. He

quoted the example of Madhya Pradesh Model of Financial Inclusion, wherein a system of family UIDs and individual UIDs is introduced to have a comprehensive and integrated database for DBTs through ultra-small branches and BCs. He also informed that UNDP's will be undertaking documentation and evaluation of MP model of financial inclusion through a team of experts.

He welcomed authors of both SOS Report 2013 as well as Social Performance Management Report 2013 and informed the participants about the themes/questions of discussion in the roundtable.

Key themes of discussion

- Targeting financial inclusion strategies: microfinance programmes and projects
- Policy and regulatory environment
- Innovative products and services in context of rural and urban, various segments of population and farm and non-farm sectors.

Social Performance Report (SPR) 2013: themes/questions

- In the southern states where the SHG movement is widespread, there is report that a fatigue is setting in SHGs: Is this true? Where is the movement falling short to address the members need and what steps are needed to reengineer the movement?
- Banks are concerned about the falling recovery rates. What measures can build confidence in SHG lending?
- In case of MF, RBI regulation is ensuring customer protection and is undertaking regular review through boards and by a regular regulator, but in case of SHGs how can we ensure customer protection?
- SHG 2 of NABARD: What is the progress made in different aspects of SHG 2, voluntary savings, self-monitoring, JLGs for enterprise loans?
- What are the regulatory issues in micro insurance and micro pensions? Does the regulatory framework adopt responsible financing aspects?

Opening remarks and a brief about the SOS Report—Mr Vipin Sharma, CEO, ACCESS Development Services

Giving the opening remarks, Mr Vipin Sharma, CEO, ACCESS Development Services, welcomed all the participants and thanked UNDP and Microfinance Community, Solution Exchange, for all kind of knowledge support. He mentioned that the SOS Report is in its eighth year now, and SOS 2013 Report will be the eighth volume in the series. Mr Vipin shared his views on the need and relevance of SOS Report and mentioned its following important points:

- SOS Report is not like any other annual reports published by different stakeholders, but it is a holistic report that covers various themes and initiatives of microfinance sector. It is an aggregate of all other reports published by different stakeholders in the sector. SOS Report helps stakeholders to track in totality the way in which the sector has moved over a period of time.
- The Report has now become a reference document for the sector on the achievements of microfinance in the country, as it incorporates all major MF issues and challenges.
- The Report requires a lot of suggestions and inputs from all the stakeholders and practitioners to come in its final form. The feedback received from the members of Solutions Exchange is incorporated in the best possible form in the report.
- The Report provides information on SHGs and MFIs; the crisis that happened in the past; recent developments that took place in Financial Inclusion (FI) domain; and current issues as well as trends and practices.
- Capturing data and other information on such a wide range of subjects is a Herculean task. Therefore, in order to capture wide information and add more quality to the Report, there are two lead authors—Mr Ajay Tankha and Dr Tara Nair—for SOS Report 2013.
- Based on the learning from the criticism which sector got from the crisis in Andhra Pradesh, we have tried to capture the good practices in MF sector in the form of 'India Social Performance Report' for last two years. Ms Girija Srinivasan is authoring this report and she has got lot of support from different stake holders like MIX market, Grameen Foundation, etc. The participants should share their thoughts and experiences on Social Performance Management Report also.

- In addition to SOS 2013 and Social Performance Report another important knowledge product on housing microfinance will also be launched during MF India Summit on 9 and 10 December 2013.
- This is going to be the 10th year of MF India Summit and on this occasion a commemorative publication on the journey of microfinance in India during last 10 years will also be launched.
- This is a very useful forum. There is immense benefit of the roundtable in getting ideas and inputs from diverse stakeholders and practitioners.

Introduction and briefing by Dr Tara Nair and Mr Ajay Tankha—Authors of SOS Report 2013

- SOS 2013 will keep the legacy of previous reports, as these reports are widely used and recognized as a reference document for policy advocacy.
- The overarching theme of the Report will be 'Financial inclusion'.
- As there has been a lot of policy engineering and multiple programmes and projects are being introduced in FI space, therefore there is a need to critically assess the role of microfinance into the process of inclusion.
- The Report will cover SHG movement as well as MFIs role in financial inclusion.
- The Report will critically analyse the significance of BC model for financial inclusion, and provide a glimpse of its present status.
- The Report will also incorporate recent initiatives on the role of technology in facilitating/triggering the financial inclusion process.
- The issue of gender will be reintroduced in the Report. We are planning to reclaim space of gender in MF sector and will reintroduce the theme in a new way. SPM Report will cover gender aspects more comprehensively.
- The Report will capture the innovative work that is going on in the microfinance sector.
- SHG– BC space and financial inclusion are handicapped because of lack of data.
- Documentation of viable models in FI and BC needs a lot of research.
- The key question is—How can both SHGs and MFIs together hook on to the financial inclusion strategies? NABARD and GIZ are working and trying to figure out a way. MFIs are also looking at to reinvent themselves to adopt the old partnership model.

Briefing by Ms Girija Srinivasan, Lead Author, Social Performance Management Report 2013

Ms Girija Srinivasan informed the participants that the Social Performance Report is going to cover five themes, out of which three themes are pre-existing themes of last year with an addition of two new themes. The five themes will be as follows:

- Outreach and social matrix of social performance
- Code of conduct and other external assessments of MF and how far are they contributing in making actual difference by improving best practices on the ground.
- Role of lenders and bankers in promoting responsible finance. How responsive the banks are?
- HR practices in MFIs, how responsible they are to the staff of MFIs?
- Responsible finance practices in SHG–bank linkage programme, where are we and how can we improve it?

VIEWS AND SUGGESTIONS OF THE PARTICIPANTS

Overall structure of the report

- This year, the SOS Report should be shorter and replete with latest updates of the progress that happened in the last one year.
- SOS Report has gained a stature and recognition in the microfinance sector. The Report should be positioned in a manner as the focus remains in microfinance. MF is a strategy for financial inclusion.
- A nicely presented executive summary of 25–50 pages on various themes of MF can be released on quarterly basis as knowledge product.
- The introductory part of the Report should be put in perspective of microfinance. Macro view of demand and supply side of financial services for weaker sections, less privileged regions, SC/STs, minorities, etc., should be discussed in the first 10 pages, as this is missing in every report related to MF. Excerpts of Report, especially the introductory part, would be helpful for the students.

- The Report should discuss positive and good studies whose sample size is large enough to represent the industry. Small studies can be given in the Report, however not for drawing inferences or generalization of any issue. Sample of the studies should be representative.
- The numbers in last two reports show that there is a shift of MF from rural to urban space. Is this shift heading from marginal towards mainstream lending? There is a need to analyse this.
- The Report may incorporate the answers of the questions: How have these MFIs responded after MF crisis? Is this through change in products, services, use of technology, focus on urban MF services, changed funding structure of the company, change in loan size, customer base? How consolidation has taken place?
- Mix market has come up with data of 110 MFIs that can be referred for the report.
- While highlighting the issues related to MF sector, the authors should keep the upcoming elections in 2014 and the new government in mind. There has been a policy paralysis in the government for last two years.
- It is good to focus on single state in financial sector and focus on neglected groups such as migrants. It would be a good idea as migrants are in large number and they face a lot of issues, especially the one related to their identity.
- FI triad as overarched by RBI consists of financial literacy and consumer protection and the report should highlight these in respect of microfinance industry.
- Credit information provided by agencies like High Mark Credit Information Services and CIBIL should be brought to people at ground level and made public for larger good.

Source: Manab Chakraborty, C. S. Reddy, Liz Larson and H. K. Pradhan.

Gender aspects

- Include gender aspects in context of empowerment, management and decision making; promotion of community-based microfinance.
- Focus on gender equity: The ways in which MF loans have been helpful in making the difference and its outcome indicators should be identified. Also how far the access of finance has benefitted the ultra poor women.

Source: Smita Premchander and Veena Pandia.

Financial literacy

- Financial literacy (FL) should be made an integral part of MFIs, and one should also come up with measurable indicators to identify the outcome of FL in order to be meaningful. Different components of FL, both for financial and non-financial products should be undertaken.
- The demand side of financial literacy should also be taken in the report.
- Profiling of MF clients in terms of access to finance for tribal and minorities should be included. A cost-effective implementation scheme for financial literacy under financial inclusion should also be discussed in the report.
- Providing financial literacy is important in the process of SHG formation. Right to borrow from the bank should be given to the poor. Village should be taken as unit to deliver the products.
- Chit fund and other spongy schemes should be highlighted to protect innocent clients. Building financial capability of the clients should be given importance. Backend management of money should be focused and highlighted.
- Financial literacy is another area to be focused and needs to be broad based. Agencies like SEBI through its financial literacy programme are creating awareness on investments. RBI is also taking up financial literacy programmes in a big way. Banks are going to villages and showing films, but what are we delivering? We have to adopt a client-centric approach for this.

Source: H. K. Pradhan, Resham Singh, Avik Kedia, Veena Padia, Sashi Kumar and Smita Premchander.

Microfinance for PwDs, minorities and Dalits

- Inclusion of PwDs is an important issue in the present context. All the delivery models of microfinance have excluded the PwDs. Issues of heterogeneity exists within different types of disabled groups. A research study should be carried on how to include the disabled within different models of MF delivery.

- National Handicapped Finance and Development Corporation lends to NGOs for on-lending to PwDs, but the issues within disabled groups still need a suitable model to serve them. Access to finance for disabled should come at a reasonable cost.
- There should be a culture to mix the disabled with the able-bodied people rather than creating a homogeneous group of disabled. Disability also has a social security side and social security schemes should be leveraged upon.
- People have apprehensions on repayment capacity of the disabled and therefore PwDs are excluded from the mainstream SHGs.
- Tamil Nadu has a special programme for disabled people. Learning of the project can be incorporated in the report.
- Emphasis needs to be given on going beyond credit products such as micro pensions, remittances and savings for the PwDs.
- The level of consciousness towards special categories like disabled, minorities and dalits in the microfinance programmes should be studied.

Source: A. K. Dey, Smita Premchander and Navin Anand.

Micro insurance

- SOS Report so far has not focused much on micro insurance. The government companies such as Life Insurance Corporation of India (LIC) should take initiative.
- RSBY is facing a lot of challenges in operations. Crop insurance also needs a client-friendly product. There has been no product innovation in micro insurance space.
- Role of government is minimal in terms of regulations or promoting micro insurance.
- Now that MFIs cannot charge extra for insurance from their clients, according to new regulations, in such case how far MFIs will be interested to roll it as a product.
- Micro insurance products are very complicated within themselves, with so many riders. In such a situation it is difficult to ensure the right product for the poor.
- CARE India had launched a MF programme for Tsunami-hit people. It worked very well initially but later insurance companies had service cost issues and were trying to cover the cost under the name of training fee. CARE dissociated with companies thereafter.
- Even the simplest product of LIC is usually not accepted by the clients. There is lack of trust in insurance products.
- 'Abhay Hastam' and 'Janashree Bima Yojana' in Andhra Pradesh have covered more than 10-million plus families. We could continue learning good and bad lessons in Andhra Pradesh.
- LIC and other insurance schemes have huge internal rate of returns (IRRs) and do not deliver good returns. Also, the cost of delivery is too high for the poor and this should be communicated to people as a part of financial literacy.

Source: C. S. Reddy, Tara Nair, Sashi Kumar, Girija Srinivasan and H. K. Pradhan.

BC model

- BC model is an effective channel for delivery of wide range of MF services. There are certain challenges on business model part of BC, but a lot of progress has happened in the recent past as various MFIs have been taking up BC model of service delivery. It would be really worth to document their experiences.
- On the remittance part also a lot of progress has taken place. NGOs–MFIs have taken up this initiative. However, urban-focused MFIs have not been able to pick this up.
- Sanchayan's Financial Inclusion Network: Sanchayan Suraksha Solutions Pvt Ltd is a BC with Indian Overseas Bank (IOB). To achieve financial inclusion, Sanchayan has undertaken a field-level mapping of as many BC/CSP outlets across Delhi/National Capital Region (NCR). Sanchayan Suraksha has a database of 1,500 points which are doing remittances (domestic and international). Sanchayan Suraksha is looking at rolling out more than 1,000 SSP outlets and another 2,500 Sanchayan Saathis (individual agents) for financial inclusion in Delhi/NCR.
- Ponzi schemes: We are finding high incidence and prevalence of ponzi schemes in all the slums where Sanchayan is working. This should be checked by the government of India.

- GIZ supported CASH NEFT project: This is a remittance project supported by GIZ and undertaken by Sanchayan Society. CASH NEFT facility allows migrants to send money home using any bank/branch without having accounts at the sending bank. Thus, only the receiver needs to have an account.
- Building the capability of banks and investors to understand the segment should be reflected in the report. BC and banks should be motivated to take up this model and visualize the change and impact it is going to bring down the line. The responsibility of providing FL to people should be taken up at all levels, right from schools. FL should be incorporated as a subject in school curriculums.

Source: Avik Kedia, Sachin Kumar and Chandra Prakash.

Urban microfinance issues

- Urban poverty and MF issues should be highlighted. Urban SHGs and Urban Livelihood Mission should also be mentioned in the report. More than 350,000 SHGs have been linked to banks in Andhra Pradesh. Similar initiative has also started in Bihar with the support from DFID.
- Urban SHGs and federations their issues and challenges could be a subsection in the report.

Source: Subrata Sarkar and C. S. Reddy.

Cost of delivering MF services and need for cross-subsidization

- We should be realistic about the cost of delivery of MF services and the entire spectrum of the cost involved should be taken into consideration. FI model of MP government is a good work done. It is worth replicating in other states; however all other state governments may not be willing to bear the cost of providing financial services to the poor.
- Through BC model MF services are provided at the doorsteps of the poor. It is important to study the value chains of different products and services. It is important to ensure that cost of delivery of MF services is not entirely borne by the poor beneficiaries.
- Is cross-subsidization a solution to meet the cost of delivery? MFIs were delivering the services and charging the customers. Now BCs are also delivering the services but who should actually bear the cost? We need to focus on this important issue. Government agencies and organizations like NABARD should come out with a model that promotes cross-subsidization so that the burden is not on the clients.

Source: Avik Kedia and Navin Anand.

MF products and services

- There is an entire range of products and services ready to get into FI sector, right from credit and insurance to remittances, and we should also consider the cost of providing FL to the customers for the entire range of products available and should not keep it restricted to insurance only. Moreover, the basic fundamentals of FL should be made clear to the customers in order to bring change in their financial behaviour.
- Cash Credit Limit (CCL) in SHGs should be deciphered clearly for policy makers, SHGs and practitioners. In a number of places, the banks have converted the term loans into cash credit facility and the groups are not even aware of this. CCL should be explained and the transition from term loan to CCL should be highlighted as a box item in the report.
- All MF programmes should be under one organization/umbrella. RRBs are one of the most appropriate institutions to promote and work for SHGs in rural areas.

Source: Usha Gopinath, C. S. Reddy and Resham Singh.

Housing microfinance

- Housing microfinance (HMF) is seen as a natural progression to MF loans. Informality of income and tenure are key issues in HMF. Unsecured loans for housing should be backed by surrogate collaterals. In urban areas, lease deeds are taken in notified slums. In case of new dwellings, government schemes based on subsidy such as Indira Awaas Yojna (IAY) should be preferred.
- Lack of clear land/property ownership titles are a big issue in housing microfinance and this excludes rural household from availing mainstream housing finance services. Swarna Pragati Housing Finance Ltd

has created a system of paralegal ownership documentation leveraging on the panchayat system which is a recognized entity to create paralegal documents. This paralegal document is then being used as collateral to mortgage the house, though technically it is not the valid mortgage document. However, a Gram Sabha resolution in the village recognizes the ownership of land/property holder and ensures community consent to it. Transactional cost required for the right mortgage document will be much higher. This is an issue that needs policy and regulation support.

- Community endorsement is much better model in housing finance and such model should not be killed simply because it is not in line with the conventional housing finance practice. Housing finance players coming up with such models in the market should be supported.
- SHPM finances only to the members of SHGs/JLGs interested in housing loan products but the group guarantee policy is followed in this case. Initially only 3–4 members in a group avail this loan based on the demand and when some amount of seasoning happens, other members also avail the product. Swarna Pragati Housing Finance Ltd started in the worst possible region of Vidarbha and now has a portfolio of 18 crores plus spread across three states. SHPM is using partner organizations/NGOs to administer the loan with supervision from SHPM staff. The model gives decent revenue to the partner organizations as well.
- Asset protection is a big risk to financer and community member in HMF. Financial literacy is definitely required and should be inbuilt within the loan product.
- In order to bring the size of SOS Report down, a separate publication on some of the subthemes such as housing microfinance is being taken up.

Source: Radhika Agashe, H. K. Pradhan, Sashi Kumar, Sachin Hirani A. Ramesh Kumar and Shruti Gonsalves.

Voluntary savings

- As there is acute shortage of database on demand–supply gap, it is always good to have feedback from the customers on various microfinance products and services. This feedback will be of great help to MFIs, bankers, regulators and all the organizations on the supply side. NPS Lite is a good pension product, and IIMPS has done good work on FL as well.

Source: Sachin Kumar.

National Rural Livelihood Mission

- National Rural Livelihood Mission should also be featured in the Report. Some good models of partnership need to be shared. We can be positive and critical about it while having a mention in report. Partnership guidelines with NGOs have been finalized under NRLM.
- The report should look and track the following questions: How has entry of NRLM contributed to the existing SHGs on the ground? Good insights and knowledge supported by evidence should be included in the Report. What is the scope of convergence with SHPIs in terms of providing financial services to poor and vulnerable groups?
- As far as interface between NRLM and microfinance is concerned, there is no definite conclusion. Voice of customers should also be taken up.
- It should be noted that there are two types of partnership, MoUs that have been signed between NRLM and PRADAN, one on the implementation in Jharkhand and the other on working as a National Resource Agency on capacity building.

Source: Shashi Sudhir, Tara Nair and Meera Mishra.

Cooperatives

- The 97th Constitutional Amendment has brought some regressive restrictions on self-reliant cooperatives and this will have implications on MF cooperatives. MP and Odisha have repealed the liberal cooperatives acts in the state.
- MF Bill (2012) includes about cooperatives which is at present before the standing committee. According to the present bill—the requirement of net-owned fund (minimum ₹5 lakh), size of individual loan (up

to ₹5 lakh and may be permitted to ₹10 lakh)—is suitable for 'for-profit MFIs'; however, these threshold limits are too high for community-based organizations. It is becoming an important issue of discussion—Whether cooperatives should be excluded from mainstream MF regulations? It should be noted that Malegam Committee and MF Bill 2011 excluded cooperatives from the ambit of this bill. Further the Report of the Sub-Committee of the Central Board of Directors of Reserve Bank of India to Study Issues and Concerns in the MFI Sector, 2011, has recommended that entities where aggregate loan portfolio (including the portfolio of the associated entities) does not exceed ₹10 crores may be exempted from registration with regulator.
- No data on new self-reliant cooperatives is available. SOS Report is not a research capitalization report but topical report about the sector.

Source: C. S. Reddy, Smita Premchander and Arshad Ajmal.

Interest-free microfinance

- Status report on minorities and financial inclusion should be part of the report. There is a need to identify and locate minorities.
- There should be mechanism for interest-free microfinance as an alternate model which is based on fees and risk and profit-sharing principles.
- There are several questions to be answered: Where are minorities located and how to address the question of interest? How to meet the cost if not interest based? How to recover service charge?

Source: Arshad Ajmal.

Responsible financing

- Responsible financing is not only limited to SHGs and banks but government also has to play an important role in this. Views of SRLM directors are also required to be captured to have a clear picture.
- Larger MFIs are growing in urban space but smaller MFIs who were serving in rural areas are not able to serve because of lack of funds. Sa-Dhan report, if comes out, will have some number on smaller MFIs, while MFIN Report focuses on NBFC–MFIs.
- Poorest-of-the-poor programmes are at experiment stage and last year SPM report captures Bandhan's poorest-of-the-poor programme. Good research has been done by professors from Harvard University on the impact of the programme.

Source: Girija Srinivasan.

Regulations—status of microfinance (Development and Regulation Bill)

- Microfinance Bill—what are the positives and negatives and what has been the progress on that needs to be captured in the report.

Rastriya Mahila Kosh

- The Report should have value for the government. As the government is working on policies related to institutional frameworks such as RMK, a comparative analysis of operating models and strategies that works for inclusion can add lot of value.
- RMK is utilizing the existing institutional structures for learning better practices.
- Continuum from FI to empowerment and sustainability of SHGs without the intermediaries should also be tracked and documented.

Source: Rashmi Singh.

Direct Benefit Transfers

- Ongoing programme on DBTs and experience of the role played by SEWA in Madhya Pradesh on unconditional cash transfer can be a part of report as it is related to FI issues.
- Different models of cash transfers including BC model should be analysed in terms of cost.

Source: Shruti Gonsalves.

Employment in MF sector

- MFIs have given large employment opportunities to the people, even better than banks. The data related to employment given by MFIs should be highlighted. Size of employment in the sector should be discussed and the difference it has made in the lives of the rural youth.

Points shared by Dr B. S. Suran, CGM, NABARD, Mumbai on various issues

- SOS Report needs to be much more client centric and not institution centric.
- Microloans and micro-deposits are not merely restricted to SHGs or through MFIs. To get a boarder perspective of the extent of microloans in India, microloans provided by banks (including cooperatives) needs to be mapped. The banks coverage for such microloans (₹50,000) is very high and covers a wide array including small loans for crop cultivation (in small and fragmented landholdings), purchase of a milch animal, etc. There are also good practices, which can be shared from this space as well.
- As regards the summit participants, we have hardly seen bankers at the event, whereas they are the predominant (or only) provider of debt funds to MFIs and SHGs. What we discuss at the summit has a lot to do with the bankers, their perception, their response, and therefore their presence and follow-up action is critical. In the previous meets, banker has been the critical missing link at these events. Therefore, any event of this nature hosted without bankers will have limited post-seminar consequence.
- Convergence model—'insurance and pension in AP': The AP government's administration of these products also needs a closer look, the way it is administered, the settlement process, the role of 'bhima mitras' and the SHGs, etc. NABARD has studied this and finds number of takeaways which other providers can learn.
- Janashree Bima Yojna: It is least understood by the client that 'insurance has to be sold as it is not bought'. There are already many insurance schemes in place, and we have over 5 lakh SHGs availing insurance product—Janashree Bima Yojna (JBY). JBY is a subsidized product and also a low premium product with many features like life and accidental insurance and also a scholarship for children—to entice them and avoid dropouts from school.
- Codification of savings and loan accounts of SHGs by banks: Though loan accounts have special client code for SHGs, in some banks the savings accounts were not codified. NABARD had taken up the issue and Ministry of Finance has issued guidelines to this effect and most banks have complied. In 200 of more than 300 district cooperative banks, the CBs work is near complete.
- Similarly, the data of banks' lending to MFIs is captured by NABARD based on the returns from banks, and we have seen large variation in the data reported by associations of MFIs even in the debt part. In the later case too, the compilation is based on self-reporting by institutions without any cross-verification. Some attention is needed here too.
- NABARD has been mapping SHGs district-wise, and we find SHGs in the rural hinterlands too, however the MFI operations are predominantly in the urban or in the peri-urban areas in limited districts. There are limited MF operations in the conflict-ridden areas; this has been specific focus area for NABARD.
- Tier I and II cities are getting saturated now and it is time to penetrate into villages and blocks.
- Under NRLM, various livelihood initiatives have taken up and national rural livelihood society is proposed to be established.
- Besides savings and credit linkages, voluntary savings through SHGs is also promoted by NABARD under SHG 2. There are several initiatives for promoting voluntary savings. An action research initiative on voluntary savings has taken up in five states in partnership with 10 NGOs/organizations. Through the research, potential of recurring deposits, fixed deposits and other possible savings products is being accessed. For example, savings for education has also identified as a potential area under voluntary savings.
- NGOs are interested in working as BCs. NABARD is implementing programmes in partnership with GIZ, where the focus is on SHGs working as BCs. In Vidarbha, youth groups are undertaking the responsibility of working as BCs. There are some good results, which can be captured in the report.
- In Vidarbha, SHG members serve as BFs, virtually taking up all support activities for facilitating quality credit flow from the bank, namely from filling application for poor household, monitoring, recovery assistance and the SHG members earn reasonable commission from such operations. NABARD has initiated exposure programmes for bankers to facilitate internalization.

- There are many challenges in the BC model. Several successful examples are also identified in the area of BC model. A large number of public sector banks have already taken up BC model. IDBI has also shown interest in BC model.
- The observation that SHGs are redundant after introduction of DBT is far from reality, the growth in credit and SHGs stand testimony to this. Further, SHGs and DBT has different aims and objectives to achieve.

Closing remarks by the authors

- Authentic data is a big problem in Indian MF sector.
- The report will not be very academic and more representative and evidence based.
- All the subsectors may not be covered but most of these will be flagged up in the report and can be picked up later.
- Idea of having short reports on quarterly basis is good but we will try to keep the report short but relevant to its readers.

The roundtable ended with the concluding remarks from the lead author.

PARTICIPANTS' NAMES AND THEIR ORGANIZATIONS

1. A. Ramesh Kumar, Swarna Pragati Housing Finance Ltd
2. A. K. Dey, National Handicapped Finance and Development Corporation, Faridabad
3. Aditi Malhotra, Solution Exchange, UNDP, New Delhi
4. Ajay Tankha, Author, SOS 2013 Report, New Delhi
5. Alok Prasad, MFIN, Gurgaon
6. Arshad Ajmal, Sahulat Microfinance, New Delhi
7. Avik Kedia, Sanchayan Society & Sanchayan Suraksha Solutions Pvt. Ltd., New Delhi
8. Azim Hussain, Sahulat Microfinance, New Delhi
9. B. S. Suran, NABARD, Mumbai
10. C. S. Reddy, APMAS, Hyderabad
11. Elizabeth Larson, Mix Market, Bangalore
12. Girija Srinivasan, Author, SPM 2013 Report, Independent Consultant, Pune
13. H. K. Pradhan, XLRI, Jamshedpur
14. Igor Bosc, UNDP, New Delhi
15. Manab Chakraborty, Consultant, Microfinance, New Delhi
16. Meera Mishra, IFAD Country Office, New Delhi
17. Mohammad Anas, Microfinance Community, SE, UNDP, New Delhi
18. Mohammad Azhar, National Mission for Empowerment of Women/Ministry of WCD, New Delhi
19. Navin Anand, Microfinance Community, Solution Exchange, New Delhi
20. Nilesh Arya, Access Development Services, New Delhi
21. Radhika Agashe, Access Development Services, New Delhi
22. Rashmi Singh, Rashtriya Mahila Kosh/Ministry of Women and Child Development, New Delhi
23. Resham Singh, Punjab Gramin Bank, Punjab
24. Sachin Hirani, ACCION, Bangalore
25. Sachin Kumar, Independent Consultant, New Delhi
26. Sashi Kumar, CARE India, Chennai
27. Shashi Sudhir, UNDP, New Delhi
28. Shruti Gonzalves, Sewa Grih Rin Pvt Ltd, New Delhi
29. Smita Premchander, Sampark, Bangalore/IIM Ahmedabad
30. Subrata Sarkar, Grameen Vikas Trust, Kalyani, West Bengal
31. Tara Nair, Author, SOS 2013 Report, Ahmedabad
32. Usha Gopinath, ACCION, Bangalore
33. Veena Padia, Indian School of Microfinance for Women, Ahmedabad
34. Vipin Sharma, ACCESS Development Services, New Delhi

ANNEXURE 4
Business correspondent model and relationships: a note*

Business correspondent (BC) model has evolved over the past seven years since its launch by RBI. The participants were NGOs and Section 25 companies in the early days, whereas major technology players and other private companies are now present in the market offering a range of services.

The underlying technology, which had started with the use of smart cards, has also evolved, particularly over the past two years when UIDAI and NPCI launched various Aadhaar- and RuPay-based payment systems.

These trends, including the roles of various participants, are reviewed in greater detail below.

NATURE OF BC OPERATIONS

All BC solutions leverage technology for all aspects of the business. Most business activity, however, takes place in the field. Thus, BC operations have the following two components:

1. Field operations: Setting-up and managing day-to-day operations of a BC in hundreds or thousands of villages. These operations are referred to as field BC (FBC) services.
2. Technology operations: Developing and managing the technology infrastructure to enable FBC operations. Typically offered by an organization termed 'Technology Service Provider' (TSP).

Both components require different skills and capabilities. They can be, and usually are, offered by independent companies.

PARTICIPATING ENTITIES

Individual BC

Any individual can be appointed by a bank as a BC. These individuals provide banking services on behalf of the bank. The branch managers directly manage the BCs. Except in few small private sector banks, individual BCs have not succeeded for the following reasons:

- The branch managers or other branch staff are busy and do not have the bandwidth to assume additional responsibility.
- The retired professionals were found not to be flexible or energetic enough to offer small transaction services to wider geographies.
- Compensation levels have been low enough to detract those who could take up these responsibilities.
- It is difficult to educate individual BCs on processes and technologies involved since the branch staff themselves may not be sufficiently familiar with it.

Corporate and Section 25 BC

These are organizations set up specifically to run BC operations. They may offer both FBC and TSP capabilities, and in such case are termed as End-to-End (E2E) Service Providers. Their managements are professional and operations are designed and managed to execute on a large scale (tens of thousands of villages). They act as BCNMs who in turn manage a network of individual BCAs or CSPs.

Some of the prominent examples of these BCs are FINO Fintech Foundation (a Section 25 company), ZERO Mass Foundation (Section 25), Bartronics India Limited and i25 (Section 25).

Technology Service Providers (TSPs)

TSPs are organizations that provide the technology for performing BC operations. Large and established IT organizations such as TCS, Coromandel Infotech and HCL entered this field by leveraging their existing relationships with the banks (they operate the banks' CBS and other technical infrastructure). These organizations developed Financial Inclusion Server (FI Server) and Financial Inclusion Gateway (FI Gateway). Some of these companies also expanded their scope vertically to offer FBC services, thus becoming E2E service providers.

* The contribution of Sanjay Kurbekar in the preparation of this Annexure is acknowledged.

Field Business Correspondents (FBCs)

Several NGOs leveraged their existing field presence to offer FBC services through a tie-up with a TSP or a three-way tie-up with a bank and the TSP. These organizations establish an SLA with the TSP for provision of technology services, and operate their own BC agents. With some exceptions, the reach of these organizations typically is limited to a few districts. Further, due to the lack of management capability, they are not uniformly successful.

TECHNOLOGIES

The BC model rests on the foundation of technology. Over the years, TSPs have innovated and evolved several technology models. The more prominent ones are described below:

Smart Card + MicroATM + Own CBS

The early large-scale rollout of FI took place using a smart card and MicroATM (POS) at customer-end, with the BC organization running its own CBS. The CBS was not integrated with that of the bank. Fingerprints were used as biometrics and stored with the BC. Frequently, the MicroATMs were offline, and transactions were updated to CBS whenever the BC agent connected it to the network. This model was deployed on large scale in AP for payment of MGNREGA and SSP benefits (these accounts have been or are being migrated to the CBS of the respective bank now).

Smart Card + MicroATM + FI Server + Bank's CBS + Online/Offline Connectivity

In 2010, the solution given above emerged as preferred by most banks who issued RFPs. These solutions are presently operating with several commercial banks. The MicroATMs connected to server in offline mode initially, but later deployments were all connected to the server using GPRS connectivity. However, the transaction was more likely in offline mode.

Smart Card + MicroATM + FI Gateway + Online Connectivity

This evolved solution-enabled FI servers of multiple TSPs to connect to a single FI Gateway, which in turn connected to CBS of the bank. This solution was adopted by commercial banks and RRBs in early 2012 when a national-level effort was in progress to deploy cluster-based approach to FI. While the cluster-based approach did not take roots and has faded in most states, the concept of a FI Gateway survived because of the flexibility it offers to IT operations of banks. It is expected that the FI Gateway will become a component of CBS or Switch and managed by the bank's IT operations team.

The model also served as the first step through which the banks started to control some parts of BC technology. Some banks moved away from smart cards to magstripe cards, with biometric authentication being performed online from CBS.

RuPay Card + MicroATM + FI Gateway + Online Connectivity

Presently, this solution which leverages RuPay platform of NPCI is being adopted by most banks, including urban cooperative banks, RRBs and commercial banks. All 371 DCCBs are also in process of implementing it, although it may be a year or more before significant progress becomes visible.

This solution is expected to be the destination solution, except the authentication may eventually be based on Aadhaar (RuPay Aadhaar Card) instead of through PIN. The solution is fully interoperable, enabling customers of all banks to transact on MicroATMs belonging to any other bank.

This model also transitions the entire technology ownership to the bank, thus essentially removing the need to have a TSP in the system. An implication of this model is also that the FBCs will be able to service customers of any bank without the need for additional training.

This is also emerging as a standard platform for technology, thus reducing the risk to those stakeholders who implement it.

Other technologies

Several other technologies are being attempted in addition to the aforementioned models. These include kiosks (with a PC/laptop) and mobile phones on customer side. Most of SBI's BCs use kiosks. Kiosks have an advantage of having a computer with connectivity, but suffer from higher upfront capital expenditure

and multiple components of the solution. SREI offers FI through thousands of CSC in eastern India, in a model similar to kiosks.

Mobile phone–based solutions have been deployed on medium scale by many companies. These devices, once integrated with a printer and biometric reader using Bluetooth networking, have features similar to that of a MicroATM. The challenge is that it is difficult to manage the multiple components for a BC who may not be technologically savvy.

Biometric authentication has also been attempted using voice. These technologies, while being successful on smaller scale, have not been rolled out on large scale yet.

PRODUCTS

Since the government of India has targeted to reach maximum villages and open at least one account per family, the effort of all banks has been to align with these metrics. Specifically, in the years 2010 and 2011, there was intense pressure from various government entities to open as many accounts as possible.

As a result, little innovation actually happened in the area of products—a zero-balance savings accounts with ₹500 overdraft is the dominant product today. Some banks offer remittance (from urban to rural), and few have attempted to offer credit (in urban slums or rural villages), but with mixed results. No credit effort has been significantly scaled up yet.

In the recent past, the banks have given thought to address the real needs of customers, particularly credit. At this time, no FBC organization takes responsibility for recovery of a loan, and hence the banks are hesitant to launch such a product.

Lack of products means the number of transactions remains low, and over a period of time, the customer simply does not use the account. As a result, most accounts opened under FI initiatives remain non-operational with little or zero balance.

DBT is expected to help crack this problem when government benefits will be credited to these accounts. Once there are funds into the accounts, it is hoped that the customers will become more comfortable with use of the account for regular financial management.

BC AS BF

In its earliest circular in 2006, RBI envisaged a role for both BCs and BFs. BC are to provide the banking services offered by the bank's branch *from outside the premises of the branch*. This includes the activity of collecting and dispensing cash on behalf of the bank. The BF, on the other hand, is allowed to undertake activities related to marketing of products and recovery of loans. Cash operations are not allowed by the BF.

There are a few banks which implement this business model wherein the BC also sources BF business for the bank in his/her village, and helps branch staff with other activities such as delivery of notices to customers. This has had an impact for the following reasons:

- **Viability:** Typically, when transactions are low in the first few months of BC launch, earning from BF activities tend to help the BC with cash flows.
- **Relationship with branch staff:** Since the BC has to visit the branch regularly in the course of performing BF activities, he or she develops good relationship with the bank staff. This helps when the BC starts actively performing BC transactions.
- **Knowledge of banking:** By working as BF, the BC's knowledge of banking improves.

It has been observed that the BCs tend to remain engaged with the bank even when there is lack of support from their own FBC organization. 'BCs as BFs' model has been successfully deployed by banks such as Aryavart Kshetriya Gramin Bank (now Gramin Bank of Aryavart) in Uttar Pradesh. There are instances of BFs helping recover ₹10 lakh of loans, and earning up to ₹20,000 in a given month.

If the branch manager is encouraged to treat the individual BC as an additional resource who can help scale up the branch's business, the BC as BF model is likely to succeed.

ALTERNATE BC MODELS INVOLVING MFIs AND SHGs

There have been some experiments wherein the stakeholders have innovated on the implementation of the BC model while offering products and services to customers beyond a no-frills savings account, or tried different channels.

In early 2006 and 2007, a few MFIs in partnership with banks attempted 'Partnership Model' in which the MFI played the role of BC for bank lending, with the assets on the books of the bank. An example of such a model was the partnership between ICICI Bank with Cashpor, and with several other MFIs, with FINO as an enabling technology provider. However, this model did not succeed due to issues related to KYC norms and low recoveries. However, this model is returning with other private banks engaging some existing NGO–MFIs, or new Section 25 companies promoted by NBFCs, to undertake lending as BC agents with wide-ranging responsibilities of loan origination, monitoring and recovery on commission basis.

Since there is a large number of SHGs in India, an attempt is also being made to leverage their members as *bank mitra*s or BC agents by BCs on behalf of a bank. Either a member of the SHG or the SHG Federation can act as a BC/BC agent of the bank. In Uttar Pradesh, a pilot is being run using a member (*bank Sakhi*) of an SHG as the BC. In an unrelated operational model in Maharashtra, SHG Federations act as the BC of a private bank.

OUTLOOK FOR THE FUTURE

The BC model has evolved over the years in several aspects, the product mix, operating model, types of entities involved, and technologies used. The transition has been generally been painful for the stakeholders, particularly banks and their no-frills customers.

Looking forward, as technology becomes standardized, and product mix evolves to include credit and recovery, it is expected that the BC model will take deeper roots, although at a slower pace than targeted initially. Further, credits coming in from DBT will help operationalize the accounts. Implementation of BC as BF model leads to improved viability, and cements the BC–bank relationship.

Efforts from RBI and NABARD to include PACS and district cooperative banks in the ambit of FI will improve the reach to 100,000 villages where PACS are present. These initiatives are in progress, and expected to bear fruit over the next couple of years.

ANNEXURE 5
List of persons met or consulted

Name	Designation	Organization
Abhijit Sharma	Associate Professor	NIBM, Guwahati
Aditya Khandekar	Product Head—Lending, Consumer Services	Umang, Mumbai
Akhilesh Kumar Singh	Specialist	MicroSave, Lucknow
Amit Arora	Technical Adviser, RFIP	GIZ, New Delhi
Amit Gupta	Principal Advisor—India, The Smart Campaign	Center for Financial Inclusion (Accion), Bengaluru
Amit Mittal	Analyst, Asia and the Pacific	MIX, Hyderabad
Amiya K. Sharma	Executive Director	RGVN, Guwahati
Anand Rao	Managing Director	Chaitanya, Bengaluru
Anurag Agrawal	Chief Executive Officer	Intellecap, Hyderabad
Anurag Jain, I.A.S.	Joint Secretary	Ministry of Finance, Department of Financial Services, New Delhi
Arvind Kumar, I.A.S.	Joint Secretary	Ministry of Finance, Department of Financial Services, New Delhi
Arvind Kumar Chaudhary, I.A.S.	Chief Executive Officer	BRLPS, Patna
Ashutosh Kumar	Chief Operating Officer	NABARD Financial Services Ltd, Bengaluru
B. Satish Rao	Deputy General Manager	NABARD Financial Services Ltd, Bengaluru
Bharath Kumar	General Manager	NABARD, Bengaluru
Bibhu Prasad Mishra	Asst General Manager—Operations	NABARD Financial Services Ltd, Bengaluru
C. S. Reddy	Chief Executive Officer	APMAS, Hyderabad
D. K. Mishra	Deputy General Manager, Micro Credit Innovation Department	NABARD, Mumbai
Elizabeth Larson	Regional Manager, Asia and the Pacific	MIX, Hyderabad
Gaurav Singh	Programme Manager	Grameen Foundation, New Delhi
G. Vidya Sagar Reddy	Managing Director	Stree Nidhi, Hyderabad
G. C. Pande	Principal	SBIRD, Hyderabad
G. R. Chintala	Chief General Manager	NABARD, Bengaluru
Girija Srinivasan		Consultant, Pune
Gurumurthy		Processware Systems, Bengaluru
Haripriya Pothineni	Senior Manager	NABARD Financial Services Ltd, Bengaluru
Indrajit Kumar	Assistant General Manager	NABARD Financial Services Ltd, Bengaluru
J. K. Thakar	Deputy General Manager, Corporate Centre, Rural Business (Planning, Performance Management and Product Development)	State Bank of India, Mumbai
A. Murali	Additional CEO	SERP, Hyderabad
Jonna Bickel	Technical Adviser, RFIP	GIZ, New Delhi
K. N. Tiwari	Chief Executive Officer	Disha Microcredit, Saharanpur
K. Raja Reddy	Associate Vice President	APMAS, Hyderabad
K. V. Rao	Executive Vice President, Operations—Member Services	SKS Microfinance Limited, Hyderabad
Kalpana Pant		Chaitanya, Pune

(Continued)

(Continued)

Name	**Designation**	**Organization**
Kishor Kumar	Operation Head	CDOT, Patna
Krishna	Assistant General Manager	NABARD, Mumbai
Manoj K. Sharma	Director	MicroSave, Lucknow
Mathew Titus	Executive Director	Sa-Dhan, New Delhi
Milind Gawaskar		FINO PayTech Ltd, Mumbai
Mukesh Chand Sharan	State Project Manager	BRLPS, Patna
N. Srinivasan		Consultant, Pune
P. K. Panda	Deputy General Manager, A.P. Regional Office	NABARD, Hyderabad
R. K. Panda		BIRD, Lucknow
R. Ramakrishna	Senior Programme Specialist	GIZ, New Delhi
R. P. Verma	Senior Manager (F.I. & M.)	Gramin Bank of Aryavart, Lucknow
Rahul J. Mittra	CEO	Margdarshak, Lucknow
Raj Khaira	Vice President, Relationship Management & Strategic Alliances	FINO Paytech Limited, Mumbai
Ramesh Tenkil	Joint Director	BIRD, Lucknow
S. Rajan Babu	National Mission Manager (Financial Inclusion), National Mission Management Unit	Aajeevika, Ministry of Rural Development, New Delhi
S. Ramalakshmi	Associate Vice President	APMAS, Hyderabad
Samit Ghosh	CEO and MD	Ujjivan, Bengaluru
Saneesh Singh	Executive Director—Investment	Dia Vikas Capital Pvt Ltd, Gurgaon
Sanjay Kasbekar		Consultant, Hyderabad
Sarat Yadav	Assistant General Manager, Rural & Inclusive Banking	ICICI Bank Limited, Mumbai
Sitaramachadra Machiraju		World Bank, New Delhi
Suresh Krishna	Managing Director	Grameen Koota, Bangalore
V. Puhazhendhi		Consultant, Coimbatore
V. N. Salimath	Chairman	IDF Financial Services Pvt Ltd, Bangalore
V. S. Radhakrishnan	Managing Director	Janalakshmi, Bangalore
Venkatesh N.	Managing Director	Samasta, Bangalore
Vipr Raj	Head—Channel & Operations, Consumer Services	FINO PayTech Ltd, Mumbai
Vjayalakshmi Das	Managing Director	Ananya Finance for Inclusive Growth, Ahmedabad
Y. K. Rao	Managing Director	NABARD Financial Services Ltd, Bengaluru

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SAGE Impact

Microfinance India: State of the Sector Report is an annual publication which quantifies the growth and performance of Indian microfinance in addition to documenting recent developments, analyzing critical issues, and identifying policy choices with the overall objective of deepening the understanding of the sector. Besides making available the latest statistical data on growth, performance and expansion across regions and population segments, the document provides a thorough review of the operational climate and the recent innovations in the realms of products, services and processes.

This year's *State of the Sector Report* is structured in line with the critical themes of current microfinance discourse. The report locates itself within the financial inclusion debate, as that is the overarching philosophical foundation of microfinance. Specifically, the report attempts to (*a*) unravel the major patterns of change within three major legal-organizational forms—self-help groups, for-profit microfinance companies and non-profit microfinance organizations; (*b*) explain the relationship among the major channels of microfinance, and between them and the other system players (banks, investors, government, central bank); and (*c*) review the main facets of the recent policy and regulatory changes that have a bearing on financial inclusion in general and microfinance in particular.

This report is a valued reference document for researchers, practitioners and policy makers in the microfinance sector.

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