CHAPTER THREE

FINANCIAL INCLUSION: INITIATIVES UNDERTAKEN AND NEW FORMS OF FINANCIAL SERVICE PROVIDERS

3.1 In the backdrop of the huge significance that financial inclusion has in the present day world and the level of financial exclusion in the country, it becomes pertinent to look into the initiatives undertaken to promote the objective of financial inclusion in the country. Moreover, the failure of the formal financial system network to include the underprivileged and weaker sections of the society into its fold also necessitates looking into some new forms of financial service providers who can assist the formal financial institutions in fulfilling the goal of financial inclusion.

In this chapter an attempt has been made to outline the initiatives undertaken by the Government of India and the Reserve Bank since Independence. It also looks into some of the new forms of financial service providers and analyzes its role in the promotion of financial inclusion.

3.2 Outline of the Initiatives Undertaken

3.2.1 Financial exclusion is a concern even in developed countries and efforts are being made to study its causes and design strategies to ensure the inclusion of the poor and disadvantaged. The reasons of exclusion vary from country to country and location to location and so, there is a need to formulate strategies accordingly. The approach to financial inclusion in developing countries like India is to a certain extent different

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1 Mostly references have been taken from various RBI Circulars, speeches and reports.
from the developed countries because of the huge variations in the extent of financial exclusion (Thorat, 2007).

The institutionalization of systems for financial inclusion in India started with the establishment of credit cooperatives, following the enactment of the Cooperative Societies Act in 1904. After Independence, these efforts were intensified following the recommendations of the All India Rural Credit Survey Committee of 1954 (Kelkar, 2008). Although the Government of India and the Reserve Bank of India (RBI) have been making the efforts to increase banking penetration in the country since Independence, financial inclusion in its present form with its particular emphasis found a place in policy documents only very recently. Various initiatives undertaken in this regard could broadly be categorized into three phases. In the first phase starting since Independence up to 1991, the focus was on channelling of credit to the neglected sectors of the economy. Special emphasis was also laid on weaker sections of the society. In the second phase spanning the early 1990s through March 2005, the focus was mainly on strengthening the financial institutions as part of financial sector reforms. Financial inclusion in this phase was encouraged mainly by the introduction of SHG-bank linkage programme in the early 1990s and Kisan Credit Cards (KCCs) for providing credit to farmers. In the third phase, beginning in April 2005, ‘financial inclusion’ was explicitly made as a major policy objective (RBI, 2008).

The phase-wise initiatives undertaken are presented below. However, the major thrust has been given to the Third and recent phase.
3.2.2 The First Phase (The Post-Independence Period up to 1991)

Although the initiatives for bringing more and more people into the ambit of formal financial institution were started before Independence, the Government of India and RBI intensified the efforts to increase banking penetration in the country since Independence. Since Independence up to 1991, several initiatives were undertaken for enhancing the use of the banking system for sustainable and equitable growth which are mentioned below.

- Extensive network of rural cooperative banks was established in the 1950s with the intention of leveraging country-wide deposits and savings towards agriculture and small-scale cottage industries.
- The State Bank of India was created in 1955 following the recommendation of the All India Rural Survey Committee to create a state sponsored bank.
- Nationalization of 14 major commercial banks in 1969, followed by another six banks in 1980 was aimed at extending the reach of organized banking services to rural as well as neglected sectors of the society and it marked a paradigm shift in banking sector i.e. from class banking to mass banking. Nationalization was a major step that facilitated the rapid expansion of the banking system to hitherto unbanked areas, bestowing on them the special responsibility of stepping up advances for all the areas identified as ‘priority sector’ areas.
- Lead Bank Scheme was introduced in Dec’ 69.
- The priority sector guidelines were also issued to the banks by the Reserve Bank to increase the flow of bank credit to hitherto neglected sectors.
- Differential Rate of Interest (DRI) Scheme was instituted in 1972 to provide credit at concessional rate to low income groups in the country.
• Branch licensing policy was initiated during the 1970s and the 1980s.

• Regional Rural Banks (RRBs) were set up in 1975 exclusively to cater to the credit demands of the hitherto neglected segments of the rural economy who need simple, flexible and small-sized financial products in very large numbers.

• In 1977, 1:4 license rule was established which dictated that a bank could open a branch in a banked location only after opening four branches in unbanked locations to increase the number of bank branches in unbanked areas.

• National Bank for Agriculture and Rural Development (NABARD) was established in 1982, as an apex-level institution to deal with all issues related to agriculture and rural development.

• The Service Area Approach scheme was announced to provide new approach to rural lending whereby each rural and semi-urban branch of a SCBs (including RRB) would be assigned a designated area in which it could make planned efforts towards area development in co-ordination with all the extension and development agencies of the State Government.

The rapid development which followed these initiatives from 1969 till 1991 included increased number of bank branches, decreased average population per bank offices (APPBO) and increment in deposits, advances, lending to the priority sectors, etc. The significance of the informal sector also declined with the spread of the banking system to rural areas.

3.2.3 The Second Phase (Post-Reforms Period 1991-2005)

The focus of banking policy during the 1990s and up to the mid of the first decade of twenty-first century was more on creating a strong and efficient banking system.
Financial inclusion in this phase was encouraged mainly by introducing a Self-help Group (SHG) - Bank Linkage Program in 1992 and formulating the Kisan Credit Cards (KCCs) scheme in 2001 for providing credit to farmers. Some of the important steps taken during this phase were:

- To bring financially excluded people within the fold of formal financial sector, special focus was given to micro-finance.
- In 1992, NABARD, with policy support from the Reserve Bank, launched the SHG-bank linkage programme to facilitate collective decision making by the poor and provide ‘door step’ banking.
- In 1998, banks were advised to open savings bank accounts of the SHGs that were engaged in promoting the savings habits among their members.
- During year 1998-99, NABARD introduced the Kisan Credit Card (KCC) scheme in conjunction with co-operative banks, commercial banks and RRBs to smoothen and strengthen the credit delivery system and more particularly, to make available timely and hassle-free crop loans to the farmers.
- The Swarozgar Credit Card (SCC) scheme was introduced by NABARD in 2003 for facilitating hassle free credit for meeting investment and working capital requirements of small borrowers and rural micro-entrepreneurs like small artisans, handloom weavers, fishermen, self employed persons, rickshaw owners, SHGs, service sector, etc.

Notwithstanding these improvements, financial inclusion has found a place in policy documents only very recently.
3.2.4 The Third Phase (Recent Initiatives 2005 onwards)

The Reserve Bank in its Annual Policy Statement for 2005-06 explicitly used the term ‘financial inclusion’ for the first time in India and renewed emphasis on the objective of bringing financially excluded people within the fold of the banking sector. The important attribute in the recent focus on financial inclusion was the adoption of market oriented approach that recognizes the importance of business consideration of banks and other financial institutions for the long-term sustainability of the process.

Most of the policy initiatives in India are initiated /undertaken by the Government of India and the Reserve Bank and hence, are divided into two heads:

3.2.4.1 The Government of India

The Government of India from time to time announced several initiatives and issued several directives to the Reserve Bank of India for promoting financial inclusion in the country.

Committee on Financial Inclusion

The Government of India constituted a ‘Committee on Financial Inclusion’ in June 2006 under the chairmanship of Dr. C. Rangarajan to look into the problem of exclusion of rural poor from access to financial services and frame guidelines for enhancing financial inclusion in the country. Based on the recommendations of the Interim Report of Dr. Rangarajan Committee, the Government has constituted two funds viz., Financial Inclusion Fund (FIF) for meeting the cost of developmental and promotional interventions of financial inclusion and Financial Inclusion Technology Fund (FITF) to meet the cost of technology adoption.
**High Level Committee on Financial Sector Reforms**

In 2007, the Planning Commission constituted a High Level Committee on Financial Sector Reforms under the Chairmanship of Dr. Raghuram G. Rajan. While its focus was on identifying emerging challenges in meeting the financing needs of the Indian economy as a whole, several of its recommendations also emphasized the need for and strategies for achieving financial inclusion (FICCI, 2011).

**Revival of Rural Co-operative Credit Institutions**

Based on the recommendations of the Task Force on Revival of Rural Co-operative Credit Institutions under the Chairmanship of Shri A. Vaidyanathan and in consultation with State Governments, the Government of India approved a package for revival of the short-term rural co-operative credit structure to strengthen the rural credit delivery system. The revival package for long-term rural co-operative credit structure has also been announced.

**Interest Subvention**

The Government provides interest subvention of 2 per cent to all public sector banks in respect of short-term production credit up to Rs.3 lakh extended to farmers at 7 per cent per annum.

**Adoption of Electronic Benefit Transfer (EBT)**

Adopting the recommendation of the Rangarajan Committee that the State Governments should make payments under NREGA and Social Security Payments through technology based solutions, the Government of India announced several measures in this regards in the Union Budget 2008-09. The Reserve Bank also requested the State Governments to explore the possibility of routing/transferring
government benefits electronically (Electronic Benefit Transfer) through banks directly to the bank account of the beneficiary by leveraging ICT based solution and deliver it at their doorstep, thereby reducing dependence on cash and lowering transaction costs.

**Road Map for Providing Banking Services in Unbanked Villages with a Population of More than 2000**

After the announcement of this scheme in the Budget Speech of 2010-11, banks were advised to draw up a road map to provide banking services in every unbanked village having a population of over 2000 by March 2012. RBI advised banks that such banking services need not necessarily be extended through a bricks and mortar branch, but could also be provided through any of the various forms of ICT-based models. About 73,000 such unbanked villages were identified and allotted to various banks through state-level bankers’ committees.

**Swabhiman**

One of the flagship programmes of the UPA II government, *Swabhiman*, which aims at providing branchless banking through use of technology, was launched on 10th February, 2011. In this scheme, banks are supposed to provide basic services like deposits, withdrawals and remittances using the services of Business Correspondents (BCs). The initiative enables government subsidies and social security benefits to now be directly credited to the accounts of the beneficiaries, who would be able to draw the money from the Business Correspondents in their village itself.

**Unique Identity Number (UID)/Aadhaar**

In 2009, the Government of India constituted Unique Identification Authority of India (UIDAI) to provide a unique identity number of each resident of country. The UID is to
leverage existing technological links to reach out to the unbanked population and is actually promising bank accounts to the residents if they indicate consent to open one. By providing proof of resident and identity the *Aadhaar* number has the potential of transforming the delivery mechanism of social welfare programmes by making them more inclusive and efficient in reaching out to the intended beneficiaries, who are presently let out due to their lack of identification. Potentially, it would enable the government to shift from indirect to direct benefits and help verify whether the intended beneficiaries actually receive the welfare benefits by using the biometric online authentication services to be facilitated by the UIDAI (Khound, 2012).

**Direct Cash Transfer (DBT)**

The government started a new scheme, Direct Cash Transfer Scheme, from January 1, 2013 to transfer 29 welfare programmes - largely related to scholarships and pensions for the old and disabled – operated by different ministries. In this the benefits or subsidies due are be transferred to the bank accounts of the ultimate beneficiaries directly, taking advantage of the *Aadhaar* scheme for electronic identification of all individuals. In due course the scheme will be expanded to cover 42 benefits, and will cover the whole country. Cash transfer scheme will help in better targeting of subsidies and reducing delay in delivery of benefits besides curbing wastages and leakages.

**3.2.4.2 The Reserve Bank of India**

The Reserve Bank of India (RBI) as the major policy maker in the banking sector has laid special emphasis on financial inclusion since 2005 when it used the term for the first time in India in its Annual Policy Statement for FY 2005-06 and urged banks to review their existing practices to align them with the objective of financial inclusion. Pursuant to this, the Reserve Bank has undertaken a number of measures with the
objective of attracting the financially excluded population into the structured financial system.

**No Frills Accounts**

In November 2005, RBI insisted the banks to make available a basic banking ‘no frills’ account either with ‘nil’ or very low minimum balances and charges with a view to make such accounts accessible to vast sections of the population. The nature and number of transactions in such accounts would be restricted and made known to customers in advance in a transparent manner. Banks have also been advised to provide small overdrafts in such accounts. Regional Rural Banks have also been advised to allow limited overdraft facilities in ‘no frills’ accounts, without any collateral. All banks have urged to give wide publicity to the facility of such no frills account so as to ensure greater financial inclusion. The banks have also been advised to print all bank materials in regional languages. The low cost or free of cost account is considered to be helpful in expanding the access of banking services, particularly to the low income groups.

**Simplification/Relaxation on KYC Norms**

Further, ‘Know Your Customer’ norms have also been simplified to enable the persons belonging to low-income groups, both in urban and rural area to open the bank accounts with balance not exceeding Rs. 50000 and credit limits not exceeding Rs. 100000 in a year without any procedural hassles. KYC norms have also been revised to accommodate the UID card as well as the job card issued by NREGA as ‘officially valid documents’ for opening small accounts.
**General Credit Card (GCC)**

With a view to help the poor and the disadvantaged with access to easy credit, banks were advised to issue general purpose credit card (GCC) akin to Kisan credit card (KCC) in the nature of revolving credit up to Rs.25000 without insisting on security or purpose at deregulated interest rates to bank customers at their rural and semi-urban branches. Fifty percent of the GCC loans are treated as part of the banks’ priority sector lending.

**100% Financial Inclusion Drive**

State-Level Bankers’ Committee (SLBC) conveners in all states have been assigned the responsibility of reaching 100% financial inclusion in at least one district in their area. The responsibility is given to the banks in the area for ensuring that all those who want to have a bank account are provided with one by allocating the villages to the different banks. In Assam, initially Sonitpur district and later Barpeta district was selected for this purpose. A special drive has been initiated for cent per cent financial inclusion in the districts with maximum concentration of Scheduled Castes/ Scheduled Tribes and minorities.

**Business Facilitator (BF)/Business Correspondent (BC) Model**

In January 2006, RBI had given permission to banks to use services of NGOs/SHGs, micro-finance institutions (MFIs), NBFCs not accepting public deposits, post offices and other civil society/community based organizations as intermediaries in the form of its business facilitators and business correspondents for a better outreach of financial and banking services to the needy and deprived sections of the society to augment the client base. It is to help in moving towards 100% financial inclusion. Considering the
high transaction cost and low profitability, the banks are increasingly relying on such intermediaries based on business facilitator and business correspondent model to fund borrowers in rural areas (Chakravarty, 2006; Dev, 2006).

The scope of entities eligible to be engaged as Business Correspondents by the banks has been enlarged by RBI from time to time. Banks have been permitted to engage retired bank employees, ex-servicemen and government employees, individuals, kirana/medical/fair price shop owners, individual public call office (PCO) operators, agents of small savings schemes and insurance companies, individuals who own petrol pumps, retired teachers and SHGs linked to banks as BC by banks. With effect from September 2010, ‘for-profit’ corporate entities have also been allowed to be engaged as BCs. Banks are also entering into agreements with Indian Postal authorities for using the enormous network of post offices as BCs, thereby increasing their outreach. The BC model allows banks to do ‘cash in - cash out’ transactions at a location much closer to the rural population, thus addressing ‘the last mile problem’. With a view to ensuring the viability of the BC model, banks have been permitted to collect reasonable service charges from the customer, in a transparent manner under a Board-approved policy.

**Simplified Branch Authorization/ATM Expansion**

To address the issue of uneven spread of Bank branches, since December 2009, domestic scheduled commercial banks (SCBs) are permitted to freely open branches in Tier 3 to Tier 6 centres with population of less than 50,000 under general permission, subject to reporting. Banks are also freed from prior authorization for location of ATMs. In the North Eastern States and Sikkim, domestic SCBs can now open branches
in rural, semi urban and urban centres without the need to take permission from RBI in each case, subject to reporting.

**Opening of Branches in Unbanked Rural Centres**

To further step up the opening of branches in rural areas so as to improve banking penetration and financial inclusion rapidly, the need for opening of more brick and mortar branches, besides the use of BCs, was felt. Banks have been mandated to allocate at least 25 per cent of the total number of branches to be opened during a year in unbanked rural (Tier 5 and 6) centres. PSBs and RRBs have been urged to open more bank branches in North Eastern Region.

**Use of Information Technology**

The Reserve Bank considers that IT-enabled services can be used to meet the challenges such as lack of adequate infrastructure, higher transaction costs and low volumes of transactions. According to Leeladhar (2005), technology can be a very valuable tool in providing access to banking products in remote areas. ATMs, cash dispensing machines can be modified suitably to make them user friendly for people, who are illiterate, less educate or do not know English. The role of technological innovations is much more important in bringing down the dependency on informal sources. These technological advancements should incorporate the features of informal agencies that attract the poor and can be implemented in the formal agencies (ISED, 2006).

Recognizing that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, banks are encouraged to
make effective use of Information and Communication Technology (ICT) to provide doorstep banking services (for making payments to rural customers and receiving cash from them) through their BCs or others where the accounts can be operated by even illiterate customers by using bio-metric smart cards and mobile hand electronic devices, thus ensuring the security of transactions and enhancing confidence in the banking system. Banks have been urged to scale up IT initiatives for financial inclusion speedily while ensuring that solutions are highly secure, amendable to audit, and follow widely accepted open standards to ensure eventual inter-operability among the different systems (Chakrabarty, 2011).

**Mobile Banking**

The Reserve Bank of India issued the guidelines for Mobile Banking transactions in October 2008. The guidelines permit banks to provide mobile banking transactions and mandates that all transactions have to originate from one bank account and terminate in another bank account. The guidelines also permit banks to extend this facility through their business correspondents.

**Financial Literacy**

Recognizing that lack of awareness is a major factor for financial exclusion, the Reserve Bank is taking a number of measures towards financial literacy and credit counselling. The Reserve Bank has undertaken a project titled ‘Project Financial Literacy’ with an objective to disseminate information regarding the central bank and general banking concepts to various target groups, including, school and college going children, women, rural and urban poor, defense personnel and senior citizens. RBI has launched a multilingual website (link ‘Financial Education’) in 13 Indian languages on all matters concerning banking and the common person in June, 2007. RBI has also
come out with its first comic book in 2007, titled *Raju and the Money Tree*, published in 13 languages and has posted on its website to create awareness about basic banking among common people and children. Many more comic books have been published and are also in the pipeline. Financial literacy programmes are being launched in each State with the active involvement of the State Governments and the SLBC.

**Financial Literacy and Credit Counselling Centres (FLCCs)**

Each SLBC convener has been asked to set up a credit counselling centre in one district as a pilot and extend it to all other districts in due course. These centres are expected to provide free financial education to people in rural and urban areas on the various financial products and services. As on March 2011, banks have reported setting up 225 credit counselling centres in various States of the country. A model scheme on financial literacy and credit counselling centres (FLCCs) was formulated and communicated to all scheduled commercial banks and RRBs with the advice to set up the centres as distinct entities maintaining an arm’s-length relationship with the parent bank so that the FLCC’s services are available to even other banks’ customers in the district.

**Financial Curriculum in Schools and Colleges**

The Reserve Bank is furthering the financial literacy drive by collaborating with state governments across the country to include financial literacy curriculum in the school syllabus. The pilot project has been launched in Karnataka.

**Financial Inclusion Plan for Banks**

In January 2010, RBI advised all public and private sector banks to submit a Board approved three years Financial Inclusion Plan (FIP) starting April 2010 to achieve
sustained, planned and structured financial inclusion. Banks were advised to integrate Board approved FIPs with their business plans and to include the criteria on financial inclusion as a parameter in the performance evaluation of their staff. The implementation of these plans is being closely monitored by the Reserve Bank.

**Priority Sector Lending**

To mitigate the growing perception of inadequate flow of credit to the traditionally preferred sub-sectors of the priority sector such as agriculture and small industries because of the expanded eligible sectors for treatment as ‘priority sector’ in the post-reform period, RBI issued revised guidelines on the priority sector in April 2007 and restricted its coverage to advances to highly employment intensive sectors such as agriculture, small enterprises, retail trade, educational loans, micro-finance and low cost housing. Further, to give an impetus to microfinance, the same was categorized under priority sector lending and lending to SHGs was brought under the weaker sections of the priority sector. Banks have been advised to provide adequate incentives to their branches for financing the SHGs.

**Special Package for North Eastern States**

- To improve banking penetration in the North-East, particularly in unbanked blocks, the Reserve Bank has introduced Special Dispensation Scheme under which RBI will fund the capital and running costs for five years provided the concerned state government is willing to make available necessary premises and put in place appropriate security.

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2 Taken from the presentation on ‘RBI Perspective on Financial Inclusion’ made by Shri R. C. Bal, AGM, RBI
To overcome network connectivity issues in the North Eastern states, RBI launched the Satellite Connectivity Scheme in 2009 to provide 100 per cent subsidy to bank branches in NER subject to a maximum of Rs. 12,000 per month or the actual expenditure, whichever is less subject to condition that the branches would offer services of electronic fund transfer free of charges to their customers. A large number of branches and off-site ATMs have taken satellite connectivity after the launch of the scheme.

PSBs and RRBs have been emphasized to open more bank branches in North Eastern Region. After finding that out of the 129 unbanked blocks identified in India in July 2009, there are 69 unbanked blocks in North East, RBI has taken up with the concerned banks to open branches in these blocks. The Ministry of Finance (MoF) is monitoring progress periodically and encouraging banks through the State Level Banker’s Committee (SLBC) mechanism to provide bank branches or/and branchless banking facilities in these unbanked blocks.

RBI has conducted 21 outreach programmes, three each in all North East states to convert those villages into Model villages giving focus on four areas, i.e., one account per household, one credit to eligible borrower in the village, no shortage of notes and coins and banking grievances redressal mechanism in place.

In every state a Task Force has been formed to look into suitable technology and innovative e-payment products to reduce transaction costs and provide alternative mode for accessing banking and payment services for every segment of the society.
It can be said that a multi-pronged strategy has been adopted in India to promote financial inclusion. However, its success will depend on how all the stakeholders are adopting these measures. For example, although no-frills accounts are supposed to be provided along with overdraft facility, it has been found that most of the banks have not only shown their disinterest in creating awareness in this regard but also restricted the use of overdraft facility. Therefore, it is of utmost importance that all the initiatives are adopted in its true spirit.

3.3 Various New Forms of Financial Service Providers

3.3.1 India has a wide network of financial institutions to provide access to financial services to the wider sections of the population. These includes, the organized/formal financial system comprising commercial banks, regional rural banks (RRBs), cooperative banks, primary agricultural credit societies (PACS) and post offices catering to the needs of financial services of the people. Besides, microfinance institutions (MFIs) and self-help groups (SHGs), which are the part of semi-formal system, also meet the financial service requirements of the poorer segments. In recent years, development of the institutional framework has focused on new models of expanding financial services through business facilitators/correspondents model using multiple channels such as civil society organizations (CSOs), non-government organizations (NGOs), post offices, farmers’ clubs, panchayats, individuals, etc. (RBI, 2008).

This section mainly deals with the some of the important new forms of non-conventional banking partners/financial service providers who are tipped to be the important vehicles in promoting financial inclusion in the country.
3.3.2 New Forms of Financial Service Providers in Rural Areas

3.3.2.1 Inadequacies in rural access to formal finance and the seemingly extortionary terms of informal finance for the poor provide a strong need and ample space for innovative approaches to serve the financial needs of India’s rural poor (Basu and Srivastava, 2005).

3.3.2.2 Microfinance Channel

According to Tripathy (2012), the inherent limitations of the formal and informal financial sectors in providing financial services to the needy and poor have led to the emergence and extension of microfinance programmes in the developing world including India. Microfinance programmes combine the safety and reliability of formal finance with the convenience and flexibility of informal finance (Basu and Srivastava, 2005).

Planners and development practitioners has been advocating the provision of microfinance to bridge the gap between the supply and demand for rural credit services because of its favourable impact on household welfare and poverty alleviation. In India, the microfinance movement started with the introduction of an SHG-bank linkage programme in the early 1990s (Tripathy, 2012).

Microfinance is defined as provision of thrift, credit and other financial services and products of very small amount to the poor in rural, semi-urban or urban areas for enabling them to raise their income levels and improve living standards (Thingalaya et al, 2010).
Microfinance is considered as the natural vehicle for promoting financial inclusion as its penetrative outreach enables it to expand credit facilities to the poorest of the poor, the hardcore and assetless poor, in remote and unbanked regions (Joshi, 2011). Since many of MFIs operate in a limited geographical area, they have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele (Rangarajan Committee, 2008).

According to Tripathy (2012), microfinance is characterized by low cost of loans and a high degree of repayment. The thrust of the microfinance initiative is to organize the poor into small and cohesive self-help groups (SHGs) and channelize both production and consumption credit in multiple doses. Microfinance interventions are expected to inculcate banking habits necessary for economic development and self-reliance.

Although there are several models of microfinance which are prevalent in India, two, the SHG-Bank Linkage Programme (SBLP) and Microfinance Institutions (MFIs) – Bank Linkage programme are the most prominent. Under SBLP, financing banks extend services like savings and credit to the groups directly while other stakeholders like NABARD, banks, NGOs, government, insurance providers, etc. extend support services including organization and nurturing of groups, capacity enhancement of their members, etc. In MFI model, lending to SHG members is done through microfinance institutions.

**SHG-Bank Linkage Model (SLBP)**

Among the various model of microfinance prevailing in India, the SHG-Bank Linkages Model is the most prominent one. SHG-Bank linkage programme was started
by NABARD in 1992 to link the poor with formal financial system. Initially started as a pilot project to link 500 SHGs with banks wherein the banks will provide access to the group members for their savings on regular basis while also providing credit to the group to meet the emerging credit requirements of its members in proportion to the savings of the group, the programme has become one of the most cost effective and fastest growing micro finance initiatives in the world, enabling 97 million poor household’s access to banking system (NABARD, 2011).

The SHG-Bank Linkage Programme has been accepted as an effective tool for inclusive growth by extending various financial services to the hitherto excluded category of poor rural households. According to Tripathy (2012), the linkage programme combines the flexibility, sensitivity and responsiveness of the informal credit system with the technical and administrative capabilities and financial resources of formal financial sector. This process of financing relies heavily on the collective strength of the poor backed by their effective social mobilization, which contributes to an overall empowering process at the end-beneficiary level.

SHG represents a unique approach of financial intermediation. The approach combines access to low cost financial services with a process of self management and development for SHG members (Arunachalam, 2008). Mostly SHGs are informal association of up to 20 women, formed and supported usually by NGOs or government agencies, who save small amount regularly and then linked to bank. The group borrows from the bank using its group saving and group guarantee as the collateral.
The programme has grown exponentially during the last two decades and over 9.7 crore rural households have now access to regular savings through 74.26 lakh SHGs linked to different banks, of which around 48 lakh are credit linked. Nearly 12 lakh SHGs were extended fresh loans to the extent of over Rs. 14500 crore during 2010-11 with total loan outstanding to SHGs reaching over Rs. 31,220 crore. More than 80 per cent beneficiaries of this programme are women (NABARD, 2011). NABARD (2011) estimated that 53.4 per cent of the total households are members of SHG-Bank linkage programme.

Despite the huge success of the linkage programme, the area of concern remains the spread of linkage programme in India which has been uneven with southern states accounting for the major chunk of credit linkages. However, the situation has started improving with other regions also showing growth trends in this movement.

Empirical studies show that the programme indeed helped in the social and economic empowerment of rural folk, especially women, by up-scaling of social capital significantly and delivering crucial financial services (Kelkar, 2008). However, despite such significant progress in facilitating social mobilization in rural areas, there are some concerns like absence of regular inter-loaning activities within the SHGs, low access to formal finance, inappropriate product quality and inadequate product appraisal which have raised questions about the sustainability of this method of door-step financing (Tripathy, 2012).

**Microfinance Institutions (MFI)-Bank Linkage Programme**

Microfinance institutions (MFIs) act as an important channel in India for extending financial services to microfinance sector by raising resources from banks and other
Primarily four categories of MFIs are operating in India:

- NGO MFIs: They are registered either under the Societies Registration Act 1860 or the Indian Trust Act 1880 and are not for profit entities with wider development agenda.

- Cooperative MFIs: They are registered under the State Cooperative Societies Act or Mutually Aided Cooperative Societies Act or Multi State Cooperative Societies Act.

- NBFC MFIs: They are incorporated under Section 25 of Companies Act, 1956 and are working ‘not for profit’ but on sound business principles by complementing the efforts of the banking system to extend the outreach of microfinance and help in financial inclusion.

- NBFC MFIs incorporated under the Companies Act, 1956 and registered with RBI as NBFC and work on purely business lines laying emphasis on return on investment.

Though most of the MFIs entered the microfinance sector much after the SBLP was well established, the turnover of these institutions grew at a much larger scale than SBLP because of their aggressive and innovative approach. Total loan disbursed to MFIs by all banks including SIDBI during 2010-11 was around Rs. 8500 crore which recorded a decline of over 21 per cent from the previous year on the aftermath of Andhra crisis. As on March 2011, total outstanding to these MFIs stands at Rs. 13,700 crore (NABARD, 2011).
According to Tripathy (2012), factors that led to the growth of MFIs are the incentives for penetration of banking into unbanked areas, lack of adequate formal banking in rural areas and unexplored lending potential in rural area. However, of late, the functioning of these institutions (mostly ‘for profit’ NBFCs) is being subjected to closer scrutiny on account of alleged unethical business practices and questionable recovery practices (NABARD, 2011). Tripathy (2012) also highlighted the same issue and mentioned few malpractices adopted by MFIs. Due to profit motive, some MFIs pursue unhealthy competition and provide credit support to borrowers without assessing the absorption capacity and sometimes follow multiple lending to the same borrower thereby affecting creditworthiness of the borrowing clients.

Over the years, microfinance and its impact have received considerable attention, with most studies confirming a positive impact on the customers. However, Augsburg (2008) argues that the studies only consider the effect of credit whereas microfinance nowadays incorporates much more than just credit. Augsburg in his study found that customers who choose to take extra services have a negative effect on their income as compared to customers who only avail themselves of credit. Similarly, Tripathy (2012) also argues that the impact of microfinance on the lives and livelihoods of borrowing clients have not been conclusive. While some researchers found that the microfinance is an effective tool for reducing rural poverty, others felt that micro-credit can be ineffective and sometimes counter-productive for clients trapped in chronic food insecurity with no asset base to protect themselves from the myriad web of shocks. While a study on microfinance intervention in India indicated negligible income impact on the beneficiaries, other found that fundamental peer pressure and social sanctions
against defaulting borrowers in a borrowing group, leads to bitterness among members, deterioration in social ties, and weakening of group cohesion. It has also been feared that the profit-seeking attitude of microfinance institutions (MFIs) and commercialization of microfinance services in developing nations like India can undermine their goal of economic and social value creation in a rural set up (Tripathy, 2012).

Similarly, there are contrasting views on the role played by RBI in the development of MFIs. According to Joshi (2011), the enabling provisions made by the Reserve Bank, are major steps which created facilitating environment and led to the promotion and growth of microfinance sector in India. RBI advised banks to participate in the SHG-bank linkages programme of NABARD whole heartedly and categorized microfinance under priority sector lending and lending to SHGs under the weaker section of the priority sector. On the other hand, Majumdar (2012) blames RBI for becoming insensitive to the problem of small borrowers. According to him, RBI becomes the co-conspirator in the metamorphosis of MFIs into glorified money-lenders charging usurious interest rates of 30 to 40 per cent. RBI’s blessings came in the form of public sector support to the sector.

According to Majumdar (2012), micro finance is something like sub-prime lending in India as the same incentives are operating here. The only difference is that it was securitization and derivatives that operated in the US while here it is priority sector lending by banks which is pushing in the money. He was especially critical of for-profit MFI and said that in the business of financial inclusion, there is enough space for not-for-profit MFIs but not for rouge MFIs.
Even with some limitations, microfinance service delivery models have great potential not only of enhancing credit facilities to the poor and the needy, but also creating social entrepreneurs at the grassroots level. The Government of India needs to regulate MFI activities by introducing an appropriate formal statutory and regulatory framework. In this regard, recently the Microfinance Institutions (Development and Regulation) Bill 2011 was introduced which have attempted to create a prudent and strong legal framework for all types of MFIs.

**3.3.2.3 Business Correspondent/Business Facilitator Model**

In January 2006, RBI permitted banks to utilize the services of various agencies as intermediaries in the form of its business facilitators (BF) and business correspondents (BF) for a better outreach of financial and banking services to the needy and deprived sections of the society. It was meant to augment the client base and thereby help to move towards 100 per cent financial inclusion. BC-BF model is a paradigm shift in banking as it increases the scope of service providers to include non-traditional providers such as NGOs/SHGs, MFI and other civil society organizations, informal retailers, individuals, etc. It is also believed to have basic strengths that can provide solution to the problem of ensuring spatial coverage at a low and affordable cost.

According to Bernanke (2006), community based financial institutions can play an important role in minimizing neighbourhood and information externalities and other types of market failure, by developing financial products and services that better fit local needs. Again, the local organizations may also act as information brokers and facilitators.
The banking needs of the financially excluded people are restricted to limited transaction of low value in nature. Operating a full-fledged rural branch is a not considered viable proposition due to high operational costs and limited business volumes initially. The BC/BF model is considered as the alternative viable business model to reach out to rural clients in far-flung areas with reduced costs (Karmakar et al, 2011). According to Sa-Dhan (2012), commercial bank branch network in India covers only 5.2 per cent of the 638,000 village (with population share of 72.2 per cent) constituting 39 per cent of the total branch network. The role of BC/BF model has an added importance in the light of such a statistics.

As on March 2011, there were 80802 banking outlets opened through BCs in India, and the number of banking outlets in villages reached almost 115,000. Although the growth under BC/BF model is commendable and laudable, there is apprehension that the BC system is not delivering the intended results. Today, opening of the customer service points (CSP) and no-frills accounts have been taken as the indicators for financial inclusion. However, a study conducted by Sa-Dhan (2012) reveals that while new CSPs are getting opened at one end, the CSPs opened earlier are getting closed or becoming dormant on the other. Even in NFAs, the dormant accounts ranged between 88-96 per cent.

The most serious challenge the BC system is facing is its commercial viability. It has been experienced that the banks are using BCs for opening no-frills accounts. The whole compensation structure is so meager that it will not be sustainable for BCs with a single product like NFA. For BC model to become viable, the range of services to be delivered through this channel should be enhanced with additional services like small
savings, overdraft facility, micro-credit, micro-insurance, small value remittances, financial awareness programme and so on (Karmakar et al, 2011; Sa-Dhan, 2012).

The study also found that 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, frequent changes in rules, etc.

According to Chakrabarty (2011), the success of the BC model is highly dependent on the kind of support provided by base branches, especially for cash management, documentation and redressal of customer grievances. Hence, it is necessary that a bricks and mortar structure is available to support about 8-10 BCs at a reasonable distance of 2-3 km. These branches can be low-cost intermediary simple structures comprising minimum infrastructure for operating small customer transactions and can act as an effective supervisory mechanism for BC operations.

The success of India’s financial inclusion programme depends to a large extent on the performance of BC model. Still more than 500000 villages are to be provided banking services and this can only be done with the help of BC model. The issues which are hindering the real growth of BC model need to be addressed before it gets too late.

Microfinance and other approaches like BC model have emerged as significant components of financial inclusion. The problem of financial exclusion in India in general and Assam in particular is so vast that it needs joint efforts by all the
stakeholders, be it formal financial institutions like banks, or semi-formal institutions like MFIs. And there is enough space for all the stakeholders to flourish.

3.4 Summing Up

The Chapter attempted to outline the initiatives undertaken by the Government of India and the Reserve Bank since Independence. Although some of the initiatives towards financial inclusion in India started before Independence, the efforts have intensified since late 1960s. Only since 2005, ‘financial inclusion’ was explicitly made as a major policy objective with renewed emphasis on the objectives of bringing financially excluded people within the fold of the banking sector. A multi-pronged strategy has been adopted in India to promote financial inclusion. The chapter also looked into the various new forms of financial service providers and analyzed its role in the promotion of financial inclusion.