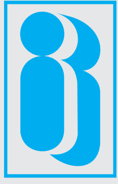

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CONTENTS

From the Editor

Special Features

Financial Inclusion - BC / BF Model - What's new? 05
-- Dr. Prakash Bakshi

Role of Rural Banks in Achieving Financial Inclusion 12
-- Dr. N. K. Thingalaya

Financial Inclusion and FLCC 19
-- M. V. Tanksale

Empowering MSMEs for financial inclusion - Role of Banks 24
-- M. Narendra

Financial Inclusion - Forward step for Micro Finance Sector 30
-- Dr. Venugopalan Puhazhendhi

Financial inclusion framework - is it inclusive? 37
-- N. Srinivasan

Financial Inclusion : Road Ahead 40
-- D. Rama Krishna Reddy

Beyond Hoopla : Simply Financial Inclusion 47
-- Jatinder Handoo

Need for strategic shift in the Management of Non Performing Assets in the Indian Banking industry 50
-- Dr. K. Srinivasa Rao

Book Reviews

Target 3 Billion -- PURA : Innovative Solutions towards Sustainable Development 60
-- V. Raghuraman

Bank Quest Articles - Guidelines 63

SUBSCRIPTION FORM FOR BANK QUEST / IIBF VISION 64

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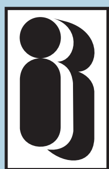

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editorial

Dr. R. Bhaskaran
Chief Executive Officer,
IIBF, Mumbai

The theme for the current issue is 'Financial Inclusion', the most discussed topic in the present day banking.

Between 2006 and today the approach to financial inclusion has seen many policy pronouncements. The BC / BF concept has been continuously expanded and the current thrust is on launching Ultra Small Branches (USB). In a seminar organized by Great Lakes Institute in the year 2009 I had made a presentation about "Village Money Shop". The idea was to have a shop or a business place where villagers can transact banking, insurance and other financial product which will be either through core banking or through RuPay integrated with banks server/data base. The transactions could cover the Kisan Credit Cards the resultant fee to the BC thus enhancing the viability of the venture. Village money shop is a concept akin to a USB organized by a BC which will be more practical than that opened by banks. Possibly USB is a step towards such village money shops.

This issue contains many articles on the subject of financial inclusion. The first article is by Dr. Prakash Bakshi, Chairman, NABARD. He discusses about comprehensive financial inclusion in his article 'Financial Inclusion - BC / BF Model What's new?' He discusses the progress made so far in financial inclusion and cites initiatives of the State Governments of Haryana, Assam and Tripura. The delay in issue of smart cards, stoppage of enrollments, and limited utility of smart cards are certain grey areas in implementation of financial inclusion plan. The paper highlights challenges such as Financial Inclusion efforts being limited to channelizing welfare benefits at higher cost to the state, banks viewing it as target oriented government programme rather than business opportunity, poor viability of the model, problems relating to technology, and stakeholders' orientation. The article also highlights certain initiatives of NABARD such as Mobile Kisan Credit Cards, capacity building of CSPs / BCAs, setting up of Centre for Excellence for Rural Financial Institutions and financial literacy efforts. I had an opportunity to do an evaluation study of the mobile KCC and found that to be an example of how banking can reach the doorsteps of farmers by using technology. Mobile KCC has demonstrated that technology can bring about 'cash less village society'. What is more impressive was that there is visible savings in cost and farmers were able to adopt the technology very quickly.

In his article 'Role of Rural Banks in Achieving Financial Inclusion' Dr. N. K. Thingalaya makes a reference of financial inclusion and rural banking at the Vedic period in India and narrates its evolution over the period. While referring to the ideological framework formulated by the Working Group on Rural Banks, which recommended the setting up of RRBs, he emphasizes that the objective of the Rural Banks is the effective coverage of target group (small and marginal farmers, landless labourers and rural artisans) and the RRBs performance should not be based on the profit they did not make. In view of the RRBs performance in mobilizing deposit accounts, he feels that these banks are to be assigned a strategic role in attaining total financial inclusion, as they are better suited to penetrate deeper into the remote rural areas. He argues that the urban oriented commercial banker cannot easily understand or appreciate the inherent inadequacies of the rural society. He points out that RRBs have comparative advantage over Commercial Banks

in terms of readily available extensive rural base, access to low income groups, good rapport built over the years with small borrowers, and rural oriented human resource base. He suggests adopting branchless banking model through Gramin Banks with practical hints as way forward.

Mr. M. V. Tanksale, Chairman & Managing Director, Central Bank of India in his article 'Financial Inclusion and FLCC' discusses the requirement of financial services by the economically active poor people, extent of financial exclusion, meaning and objective of financial inclusion etc. The article also explains the role and importance of Financial Literacy and Credit Counseling Centres (FLCCs).

Mr. M. Narendra, Chairman & Managing Director, Indian Overseas Bank in his article 'Empowering MSMEs for financial inclusion-Role of Banks' argues that the banks have a major role to play in achieving inclusive growth through financing MSMEs. He emphasizes the need for supporting the first time entrepreneurs in achieving financial inclusion. In order to increase credit flow to MSMEs, he suggests for introduction of single window clearance, centralized processing, online tracking of applications, utilizing the services of NGOs to train micro / tiny sector entrepreneurs, setting up of specialized branches, review of credit flow in SLBCs, revival of potentially viable sick units, micro entrepreneurs gathering through SME welfare associations, and mobile banking services.

The next article 'Financial Inclusion-Forward step for Micro Finance Sector', Dr. V. Puhazhendhi discusses the issue with reference to Microfinance sector and suggests using of SHG federations and MFIs as BCs in extending financial service to the poor. The view has to be seen with reference to the current policy of Bank Led Financial inclusion. As regards BC model, he quotes that the client's prefer BC model due to issues such as convenience and saving on cost with regard to other models. He also raises the concerns of issue of sustainability of the model and cost to be paid to the BCs.

Mr. N. Srinivasan in his article 'Financial Inclusion framework-is it inclusive?' questions the current Bank led financial inclusion model pursued in India. He also discusses the RBI's interventions in terms of product, process, institution, and policy levels in pursuit of Financial Inclusion solution for the people. He says inclusion goes beyond mere access and argues for including institutions such as Post Offices, Co-operatives, SHGs and MFIs, that provide appropriate and adequate services to the vulnerable people in the inclusion framework.

The next article is 'Financial Inclusion : Road Ahead', written by Mr. D. Rama Krishna Reddy. He has given a brief account of financial inclusion with latest information on financial inclusion. This article also brings out important challenges in financial inclusion.

In his article titled 'Beyond Hoopla : Simply Financial Inclusion' Mr. Jatinder Handoo of FINO says that financial inclusion needs direct engagement with the clients, by offering appropriate financial products and services including financial literacy. He also states that the BC model enables banking to the doorstep and argues for support and patience to reach viability.

In addition to articles on 'financial inclusion', this issue also carries an article on 'Need for strategic shifts in the management of non-performing assets in Indian banking industry' by Dr. K. Srinivasa Rao. The article seeks to map the past trends of Non-Performing Assets to form a basis and focuses on the common methodology for their management. This article may be an useful instrument to those who are involved in NPA Management.

The issue also carries review of a book 'Target 3 Billion - PURA : Innovative Solutions towards Sustainable Development' written by Dr. A. P. J. Abdul Kalam and Srijan Pal Singh.

I hope you will enjoy reading the articles. I welcome your valuable suggestions and feedback for improvement.

(Dr. R. Bhaskaran)

Financial Inclusion - BC / BF Model - What's new?

Dr. Prakash Bakshi *

Progress so far and challenges ahead

Arguably, banking services are in the nature of public good and unrestrained access to public goods and services is the *sine qua non* of an open and efficient society.[1]

And, certainly, a well functioning financial system empowers individuals, facilitates better integration with the economy, actively contributes to development and affords protection against economic shocks. Inclusive finance - through secure savings, appropriately priced credit and insurance products, and payment services - helps vulnerable groups to increase income, acquire capital, manage risk and work their way out of poverty.[2]

Thus, at the core of financial inclusion is financial freedom, that is, a sense of financial security equipped with a set of skills and knowledge that helps to make informed and effective choices leading to financial well-being.

'Apart from the regular form of financial intermediation,' according to the Committee on Financial Inclusion 'it (financial inclusion) 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, insurance (life and non-life) etc. While financial inclusion, in narrow sense, may be achieved to some extent by offering any one of these services, the objective of "Comprehensive Financial Inclusion" would be to provide a holistic set of services encompassing all of the above.[3]

In January 2006, Reserve Bank of India (RBI) with the objective of ensuring greater financial inclusion and increasing the outreach of the banking sector decided in public interest to enable banks to use the services of intermediaries in providing financial and banking services through the use of Business Facilitators and Business Correspondents (BF / BC).[4]

The guidelines which initially allowed MFIs, NGOs and other Civil Society Organizations (CSOs) to function as BCs / BFs were revised further to encompass more entities including corporate entities having their Customer Service Points (CSPs) and Business Correspondent Agents (BCAs) in the villages. Presently, any individual can act as BC provided the bank is satisfied and due diligence is done.

For, notwithstanding several bold and ambitious attempts in the past - creation of State Bank of India (1955), nationalization of banks (1969-1980), introduction of Lead Bank Scheme (1970), formation of Regional Rural Banks (1975), Self Help Group (SHG), Bank Linkage Programme (1992) being some of the examples - access to financial services and products remained largely restricted to the upper and middle income groups thus leaving vast sections of the society outside the ambit of formal financial system. The reason being absence of (a) viable delivery mechanism while serving the poor and people

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* **Chairman, NABARD.**

1. *wikipedia.org.*
2. *Report of the Committee on Financial Inclusion p.22.*
3. *ibid p.1.*
4. *RBI circular DBOD. No. BL. BC. 58 / 22.01.001 / 2005-06 dated January 25, 2006.*

living in sparsely populated, far flung areas; (b) suitable technology; and (c) lack of a business model.

Nearly fifty years after the first ambitious attempt, some of the statistics related to availability of formal financial services in India are staggering : (1) almost half the country is unbanked; (2) only 55% of the population has deposit accounts and 9% have credit accounts with banks; (3) 145 million households (and not just farm households) excluded from banking; (4) one bank branch per 14,000 people; (5) only a little less than 20% of the population has any kind of life insurance and 9.6% has non-life insurance cover; (6) just 18% has debit cards and less than 2% has credit cards.[5]

Despite expansion of bank branches post nationalization, the bank branches of commercial banks and Regional Rural Banks (RRBs) till recently stood at 48,000 in a country of 6 lakh villages. Thus, one branch is serving 12.5 villages.

Two years after RBI relaxed norms for outsourcing banking services, in January 2008, the Committee on Financial Inclusion appointed by Ministry of Finance, Government of India with Dr. C. Rangarajan as its Chairman submitted its report.

The Committee used NSSO data which reveals that 45.9 million farmer households in the country (51.4%) out of a total 89.3 million households do not access credit, either from institutional or non-institutional sources.

The Committee identifies 'the recent developments in banking technology (which) have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like Automated Teller Machines (ATM), credit / debit cards, internet banking, online money transfers etc. as the main reason.'

In the same breath, the Committee expresses an alarm at '…some trends, such as increasingly sophisticated customer segmentation technology - allowing, for example, more accurate targeting of sections of the market - have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed "financial exclusion".[6]

Adoption of appropriate technology would enable the branches to go where the customer is present instead of the other way round. This, however, is in addition to extending traditional mode of banking by targeted branch expansion in identified districts. The Business Facilitator / Business Correspondent (BF / BC) models riding on appropriate technology can deliver this outreach and should form the core of the strategy for extending financial inclusion. Ultimately, banks should endeavour to have a BC touch point in each of the 6,00,000 villages in the country.[7]

BCs / BFs are, thus, another banking channel like ATMs, credit / debit cards, internet banking with a human element to it but, unlike the automated channels which mainly cater to the needs of a certain segment of literate population comprising the upper and middle income groups, they are the vehicles meeting the requirements of low income groups through doorstep delivery of financial services.

With only 5% of the nearly 6 lakh villages in the country having brick-and-mortar bank branches, Government of India issued directive to cover all the villages having more than 2000 population either through a bank branch or through BC / BF by March 2012. Accordingly, 73000 villages were identified and the State Level Bankers' Committees allotted the villages to various banks - public sector ones, Regional Rural Banks and, in a limited scale, to private sector banks - to open branches or appoint BCs.

Progress So Far

According to the latest information available,[8] the summary of villages covered by Public Sector Banks (PSBs) and Regional Rural Banks (RRBs) under FIP as on 30th November 2011 is given below :

5. *Presentation made by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India on 06 September 2011 at the St Xavier's College.*
6. *ibid p.1.*
7. *ibid Preface p.ii.*
8. *www.financialservices.gov.in (http://financialservices.gov.in/banking/fiplan.asp).*

Category	Total villages allotted	Villages covered	Percentage of villages covered	Villages yet to be covered	Total BCs appointed	Total FI accounts opened
PSBs	49,731	40,422	81.28	9,309	34,826	2,39,25,867
RRBs	23,528	11,173	47.49	12,356	8,046	52,66,538
Total	**73,259**	**51,595**	**70.43**	**21,665**	**42,872**	**2,91,92,405**

If the above progress is any indication, then the banks have almost covered the allotted villages by March 2012 (latest figures are yet to arrive). Further, with nearly 80% of the villages having been covered through BC model, it makes this model one of the most preferred channels for the banks in the given policy environment.

There is little doubt that most of the banks in most of the states have made significant strides in opening of no-frills accounts either through the BC model or through brick-and-mortar branches. One of the reasons is the decision of the governments - both central as well as state - to transfer payment under various government schemes like NREGA and social benefit schemes through bank accounts for transparency in transfer of benefits, to avoid pilferage and for quicker implementation. For example, in Haryana, welfare benefits amounting to ₹130 crore are paid every month to 21 lakh registered beneficiaries comprising senior citizens, widows, destitutes and the disabled. As the success of the programme depends on the timely disbursal of the benefits without leakages and to catalyze quicker implementation, the state started electronically transferring benefits directly into the two million bank accounts under BC model of branchless banking known as Electronic Benefits Transfer (EBT).[9]

Similarly in Assam, it's the schemes like Majoni, Mamoni, Bidei etc of the state government in which incentive paid to women (for example, delivering their babies in a hospital) are routed through bank accounts which has driven opening of no-frills accounts.

Tripura presents an example where a proactive state government, apart from covering all the villages (with above as well as less than 2000 population) in the first phase itself gives an incentive of ₹100/- per no frill account opened per job card under MGNREGA. This incentive is given only to Tripura Gramin Bank (TGB) - the only RRB in the state - and to Tripura State Cooperative Bank (TSCB). Riding on this incentive which TGB shares in the ratio of 10:90 with its company BCs, the bank has gone for a massive drive for opening of no frill accounts thus covering nearly all households in the unbanked villages having more than 2000 population. Hence, in the parlance of bankers in Tripura, no frill accounts are known as NREGA accounts.

But, then, as mentioned above, the objective of the Committee was 'Comprehensive Financial Inclusion' and offering a 'holistic set of services'.

For none of the stakeholders involved - either on the supply side or on the demand side - the need and importance of banking products other than no frills accounts are on offer. Though, on the supply side, relaxation of KYC norms, simplification of account opening form, availability of the BCs / CSPs / BCAs in the village itself has given a boost to opening of accounts, a study conducted by Financial Inclusion Department of NABARD in Bulandsahar in Uttar Pradesh and Mewat in Haryana has identified, among others, the following grey areas in implementation of FIP :

- Inordinate delay in issuing of smart cards (nearly four to seven months) which is causing high level of frustration among the account holders as well as BC agents.
- In view of delay in issuing of smart cards, the BCs have been advised not to take further enrollments even though many eligible excluded poor are yet to be covered under the facility.
- Limited utility of biometric smart cards as limited services have been loaded into the cards and services like remittance, pension, scholarships are yet to be loaded.

9. Ashok Khemka, Director General, Social Justice & Empowerment, Government of Haryana, The Economic Times, Tuesday, 13 March 2012 p.14.

Challenges

In spite of the policy push, or because of it, the entire FIP is seen by various stakeholders as just another government programme to be implemented and the targets set to be achieved and the FIP is limited to opening of no frill accounts only most of which either become inoperative soon or the transactions of government payment leave very little balance in these accounts. Banks, the most important stakeholder apart from the account holders are yet to see it as a business opportunity. There is no doubt that the supply side has been strengthened through various policy measures, but then, in actual fact, none of the products important for a financially secured life has been offered to the account holders by the banks.

Financial inclusion is, thus, limited to channeling welfare benefits through bank accounts at high cost to the state. While the cost of distribution through normal channels of Panchayati Raj Institutions (PRIs) are hardly 0.15%, channeling benefits through bank accounts cost the state nearly 15 times at 2.206%.[10]

This leads us to viability of the model. Banks generally prefer companies as BCs who, in turn, carry out the business through Customer Service Points (CSPs) or BC Agents (BCAs) with whom the revenue is shared. Though working out business viability at this moment may be premature, nevertheless, without a long term viability strategy there is the chance of the channel withdrawing from the programme thus the FIP getting derailed.

The Governor of Reserve Bank of India, in a paper[11] presented, points out three main challenges to the BC model : (a) the cost; (b) lack of robust technology; and (c) lack of awareness.

The entire FIP being technology-driven, it's the same technology which has been a major constraint. The two types of technology in use are : GPRS enabled mobile phone connected to a POS device and internet based technology kiosk banking through smart cards. While the former technology is faster and more efficient, the TSPs are unable to supply the devices matching demand. On the other hand, internet connectivity and server snag (owing to compatibility issue of FI server of the company BC and that of the bank) plagues efficient transaction in remote areas.

But the issue remains: how to make technology cost effective. At present, the services offered are limited to payment, and to some extent receipts, but other products such as credit, remittance, insurance, pension which are vital for financial security of an individual are yet to be offered through the BCs.

The FI servers of the company BCs store vital information like finger prints of the account holders which cannot be accessed by the link branch through the bank's server. While the server snag and internet connectivity problem can last up to a week, the account holders cannot do transactions in the branch. Treating the no frill account holders - notwithstanding the relaxed KYC norms and restrictions imposed on transactions - as regular clients at the branch will go a long way in confidence building.

Though the idea behind using technology at Customer Service Points is to do online real time transactions which is safe from the point of view of both the customers as well as banks, some of the banks use the 'offline' method, that is, carrying out the transactions and then uploading the details on to the bank's server at the end of the day at the branch. This helps avoid the issue of internet connectivity problem and server snag.

As per RBI guidelines, 'the banks should adopt technology-based solutions for managing the risk, besides increasing the outreach in a cost effective manner. The transactions should normally be put through ICT devices (handheld device / mobile phone) that are seamlessly integrated to the Core Banking Solution (CBS) of the bank. The transactions should be accounted for on real time basis and the customers should receive immediate verification of their transactions through visuals (screen based) or other means (debit or credit slip) …(and) that all off-line transactions are accounted for and reflected in the books of the bank by the end of the day.'[12]

10. Ashok Khemka ibid.

11. Financial Inclusion : Challenges and Opportunities by D. Subbarao p.11. web link : http://rbidocs.rbi.org.in/rdocs/Speeches/PDFs/ IFFG091209.pdf

12. DBOD. No. BL. BC. 43 / 22.01.009 / 2010-11 dated September 28, 2010.

Technology is a means to FIP and not vice versa. Using offline method subject to above guidelines should not be ruled out as it helps faster transactions.

The integration of FI server of the BCs and the CBS server of the banks would pave the way for speeding up the financial inclusion efforts.

NABARD has so far disbursed ₹139.87 crore towards Core Banking Solutions (CBS) for 26 out of 28 identified weak RRBs. Further, support is also available for RRBs for ICT solutions and, out of a total of 82 RRBs in the country, 53 RRBs have been disbursed a total amount of ₹41.07 crore for ICT solutions under BC model.

One of the most important challenges is stakeholders' orientation. First, the corporate BCs. Profit, and not just viability is their only objective. There is no identification with the larger cause.

Banks, on the contrary, are yet to see FIP as a business opportunity - it's just another government programme at worst and a Corporate Social Responsibility at best - and find it more convenient to disburse government payment in the villages rather than having the account holders crowding the branches disturbing normal business.

State governments, in their urgent need to eradicate pilferage of expenditure on welfare measures, find account credit payment a transparent way. Beyond that, they need to see FIP as a larger cause of economic upliftment of the poor and the vulnerable.

And, finally, the CSPs / BCAs, normally village youngsters who are excited about the job of handling banking and the social respectability that comes with it. It would not be farfetched to say that the entire FIP is riding on the CSPs / BCAs who are yet to be spoiled - unaware of the policy push or profitability or targets, it's the responsibility of all involved to protect this breed that is the ultimate vehicle of FIP at the lower most level. They should be compensated reasonably to see to it that they find it remunerative and sustainable.

A study report[13] jointly by Centre for Microfinance Research (CMR), BIRD, Lucknow and Indian Institute of Bank Management, Guwahati points out that :

- corporate BCs are not providing any critical support other than providing the license
- the on-going support provided by the BCs is not commensurate with the share in commission they take
- the BCs are passing on the entire service tax to the CSPs
- they're overcharging on the equipment

The real challenge in financial inclusion covering normal banking, which includes all types of deposits, transfers and payments, pension and insurance services to unbanked citizens is to afford him real choice to choose the BC as well as the bank. There must be real competition among the banks and their correspondents for every citizen's account.[14]

What's New?

Department of Financial Services, Ministry of Finance, Government of India, through a series of circulars[15] called 'Strategy and Guidelines on Financial Inclusion' has now given new direction to the FIP in general and through BC model in particular which are summed up below :

- As per the recommendations of the Task Force set up by the Government, subsidies on LPG, Fertilizers and Kerosene as well as 32 other schemes to be transferred directly to the beneficiaries through EBT.
- Service area approach to be adopted for the coverage of the entire country for financial inclusion and since gram panchayats are at the centre of the various developmental and welfare schemes and would play an important role in the electronic benefit transfer, service area of the banks needs to be defined in terms of the gram panchayats.
- Banks to open regular brick-and-mortar branches within their service area in larger habitations in the under banked districts with population of 5000 and above by September 2012. In other districts, regular branches to be opened in habitations having population of 10,000 and above by September 2012.

13. Can BC-BF Model bring about Financial Inclusion in North Eastern Region? paragraph 21.2, p.58.
14. Ashok Khemka ibid.
15. F. No. 21/13/2009-FI dated 21 October 2011, 28 December 2011 and dated 09 February 2012.

- BCs / CSPs / BCAs to deal with 1000 - 1500 households or cater to a population of about 5000 - 8000 and the BCA / CSP is available within a radial distance of 2 km.
- At places where the opening a conventional brick-and-mortar branch is presently not viable, the bank may set up Ultra Small Branches in an area of 100 - 200 square feet from where the BCA / CSP will operate and once the bank reaches the desired level of business, the Ultra Small Branch can be upgraded into a regular bank branch.

The Way Forward

1. Financial Literacy

This is the single most important aspect which is lacking among all the stakeholders - especially the local banks and state governments - and a convergence of channel orientation with the larger objective in mind is of prime importance and needs to be addressed to give the demand side a boost.

The financial literacy efforts - through Financial Literacy Credit Counseling Centres (FLCCs) or otherwise - by the banks, though innovative at times, have been sporadic. For example, one bank screens the film 'Lagan' in the villages which is popular among the villagers and, in the intervals, the bank staffs talk about various banking products which are available for the people. Similarly, another bank advertises its products through scrolls on television screen using local cable operators. Some of the banks have opened Village Knowledge Centres (VKCs) and have released FAQ pamphlets for creating awareness among the people as well as the CSPs.

NABARD is planning to converge all such efforts by the banks as well as its regional offices and launch a nation-wide financial literacy campaign by using multiple sources in local languages by using print as well as audio-visual medium.

2. Develop viable BC Channels

Viability and sustainability of the BCs and CSPs / BCAs is the prime most important thing for achieving the objective. Though it may be premature to talk of viability at this stage of implementation of FIP, to achieve viability in the initial period and long term sustainability, CAPEX and OPEX support along with offering diversified products which would increase the volume of transactions in the accounts and would generate revenue may be considered.

3. Robust Technology

More than the financial viability of the banks, BCs and CSPs, it's the viability and feasibility of the technology which needs focused attention at this stage of implementation. A robust switch similar to the National Financial Switch (NFS) located for the purpose in the National Payments Corporation of India (NPCI) or Institute for Development Research in Banking Technology (IDBRT) may fulfill the long felt requirement of nationwide remittance system for the country.[16] That is, improved coordination and interoperability between servers by banks and BCs will lead to efficient transactions as well as confidence building.

NABARD has formed a Centre of Excellence for Rural Financial Institutions (please see box) which will collaborate with Unique Identification Authority of India (UIDAI) and NPCI for enabling the onboarding of RRBs onto the Aadhaar Enabled Payment Services (AEPS) and Aadhaar Payment Bridge (APB) platforms. With an objective of implementing it across the country to all RFIs, NABARD has initiated a pilot project with five RRBs in the first phase followed by another five RRBs in the next phase.

NABARD has set up a Centre of Excellence for Rural Financial Institutions (CERFI) with a central theme of embedding Aadhaar number into the CBS platform of RRBs for bringing about higher accountability and transparency in last mile banking. A dedicated team of officers has been brought together in the Bank to collaborate with UIDAI and National Payments Corporation of India (NPCI) for this purpose.

CERFI will undertake a complete technical profiling of the RRBs in the country for understanding their preparedness for onboarding Aadhaar Enabled Payment Services (AEPS) / Aadhaar Payment Bridge (APB). The Centre will also design a training programme for the RRBs which will cover all technical and regulatory aspects of this onboarding. The first Pilot for test-checking the AEPS model is scheduled to be launched shortly. The pilot will also covercashless transactions and KCC as smart card.

16. D .Subbarao ibid p.12.

4. ***Capacity Building of the CSPs / BCAs***

The training of CSPs / BCAs generally consist of how to handle POS devices and they have little knowledge about banking and banking products. It's essential that they should learn about the banking products so as to diversify their business which will lead to higher transaction volume and better remuneration.

NABARD, jointly with Department of Financial Services (DFS), Ministry of Finance (MoF), Government of India has developed a training module for state level trainers who would be trained by Indian Institute of Banking & Finance (IIBF) and who, in turn, will train district level trainers.

5. ***Mobile Kisan Credit Cards (m-KCC)***

NABARD recently launched a pilot project m-KCC in Villupuram district in Tamil Nadu (please see box) enabling farmers having KCC accounts with Pallavan Grama Bank to transact their loan accounts without visiting the bank branch by using their mobiles as the interface. The objective of the project is to provide banking facilities to the KCC holders at their doorstep in a safe, secure, quick and reliable method through mobile phones thereby ensuring anywhere and anytime banking and reducing the transaction costs of the farmers in terms of time and travel. The technology introduced in the project enables farmers to do their transactions like purchase of agricultural inputs without cash as the merchants with their bank accounts are also registered with the service provider. Cash withdrawals and cash deposits are also possible where the registered merchants are also engaged by the bank as BCs.

A pilot project, m-KCC, was launched in Villupuram district in Tamil Nadu on 2nd October 2011 enabling farmers having KCC to transact on their loan accounts without visiting the bank branch by using their mobiles as the interface.

The technology introduced in the project enables farmers to do their transactions like purchase of agricultural inputs without cash as the merchants with their bank accounts are also registered with the service provider. Cash withdrawals and cash deposits are also possible where the registered merchants are also engaged by the bank as BCs.

The key features of the project are :

- Enables enquiry about required agricultural inputs over the mobile including negotiation of prices and placing order linked to assured payment against the sanctioned KCC limit
- Allows cash withdrawals through BC up to amounts permitted by RBI
- Facilitates withdrawals of funds or payments for purchases as per requirement in small chunks at convenient times and locations, thus saving interest cost to the farmers
- Real time status of account balance as also last 5 transactions
- Secure PIN & IVR / SMS based transactions
- Works on all handsets. No GPRS or Smart phone required
- No need to visit the bank with a passbook each time
- No need to handle cash, saving on risks and costs for the farmers, input dealers, as well as banks

The essential requirements are :

- The merchant should have a bank account with the bank and his mobile number should be registered with the bank for transactions through mobile
- The farmer should have a KCC limit sanctioned with the bank and his mobile number should be registered with the bank for transactions through mobile
- The PayMate platform should be given access to the CBS platform of the banks where the merchants and the customers have their accounts

Conclusion

The entire Financial Inclusion Programme is based upon some premises : (a) the SHG experiment shows that the poor are bankable and credit to the poor rates as better quality of assets; (b) access to formal banking services should be considered as a right rather than a privilege; (c) for a well functioning financial system, vast segments of the society can not be left out of the ambit; (d) use of ICT can make banking more accessible in a cost effective manner.

While there is little doubt about the premises, what is important is achieving the larger objective : financial inclusion should lead to financial security for the poor and the vulnerable. That is, at some stage, the focus is bound to shift to the quality and not the quantity of inclusion.

Role of Rural Banks in Achieving Financial Inclusion

Dr. N. K. Thingalaya *

Rural banking in India has a chequered history. Banking has been essentially an urban-oriented service since its inception. Only a few smaller towns and a couple of villages in the South had banking facilities since the introduction of the Swadeshi movement during the first decade of the last century. With the dawn of the Planning era in the fifties, the need for extending institutional credit facilities to the rural sector was recognized. Expansion of rural branches was rightly conceived by the Planners, therefore, as a strategy for augmenting rural credit. Banks in the private sector were concentrating in urban areas for obvious reasons. Immediately after bank nationalisation, the policy adopted was to goad the banks to go rural. After pursuing this goal relentlessly in the 70s and 80s, there was a total change in the emphasis since the 90s, when the new generation banks came into being.

The Financial Sector Reforms, which were introduced during 90s have retarded to a great extent the expansion of rural banking. The shift in emphasis from mass banking to class banking and placing profit on high pedestal have curbed the ground staff's interest in rural development. The original conceptual framework of the priority sectors has been instrumental in directing the flow of credit to the strategic sectors like agriculture in the past, ushering in the green revolution. The aversion of the authors of financial sector reforms towards directed lending was a misplaced policy ingredient in the Indian banking set up, where some sort of rethinking is an imperative need.

The latest trend in branch banking is the emergence of branchless banking model, with the tacit support of the regulator. After more than half a century of public sector banking, it was realized that a large section of the population, more so in rural India, remained unreached by the banking system. Financial inclusion, therefore, became the focal point of banking operations, with ambitious targets fixed for covering the entire population in a time-bound programme.

Rural Banking :

Though emphasis on financial inclusion has gained strategic importance in the Indian banking sector only recently, it is often not realized that it has a long historical reference, going back into the Vedic period. No lesser than the All India Rural Credit Survey Report, which was the first report recommending bank nationalisation in 1955, had quoted a Sanskrit saying, which had recognized the crucial role of village money lender. An ideal village is defined as "one that has a perennial stream, a priest to administer to soul, a vaidya to heal in case of sickness and a money lender from whom to borrow money, when needed". A perennial stream is required to irrigate land, so that enough food grains and other farm products could be grown in the village. The presence of a priest symbolizes the availability of a teacher in the village. Health facilities are provided by the village vaidya. One notable addition is the existence of a money-lender in the village from whom money can be borrowed when in need. Manu, the Vedic law-giver, also has considered money-lending as a lawful occupation. He has stipulated the role of the state in allowing the smooth operations of the money-lending transactions. Interest rates are stipulated by him, quoting the rates prescribed by sage Vashista.

Rural banking, however, was not considered as an important plank of banking policy until the nationalization of 14 major banks in 1969. The only exception was the

* Former CMD, Syndicate Bank.

mandate given to State Bank of India to open 400 branches during the 50s, 'particularly in the much neglected rural and semi-urban areas'. Later in the 70s public sector banks came under great pressure to open rural branches in the districts allotted to them under the Lead Bank Scheme. The branch licensing policy was made rural-oriented by directing banks to open four rural branches in order to get a license for opening one metropolitan or urban branch. The number of bank branches, has increased from 8,262 branches in 1969 to 90,147 branches as on June 2011. The rural bank branches increased from 1,833 to 33,513 during this period. The share of rural branches in the total branch network has increased from 22 percent in 1969 to 37 percent in 2011.

Another innovative institutional initiative undertaken in the field of rural banking during this phase was the formation of Regional Rural Banks - gramin banks as they are popularly called - under the sponsorship of nationalized banks. By their constitution, they were designed as low cost rural credit agency to cater to the credit needs of the target groups of weaker sections - the marginal farmers, agricultural labourers, petty traders and families below the poverty line. Between 1975 and 1987, as many as 196 gramin banks came into existence in 540 districts. Since September 2005, these banks have been amalgamated at the state level, reducing their number from 196 to 82. As on September 2011, they have 15,770 branches, out of which, 11,815 (75 percent) are rural based.

One of the notable features of the expansion of service outlets of the banking sector is the increase in the number of ATMs and particularly those installed in off-site locations. The number of ATMs installed in rural areas is 7,155 at present, accounting for a little less than 10 percent of the total ATMs in operation. The average number of population per branch is 13,466 and that for per ATM remains at 16,243. Gramin banks are yet to take up the installation of ATMs in rural areas. So far, only a few among them have ventured to install bio-metric enabled ATMs, whose number is less than 25, according to the available data, which may not be complete. (Thingalaya 2010)

Rural Penetration :

Though over 33,000 villages have appeared on the banking map of the country as a result of the thrust on rural banking, more than five lakh villages are yet to be covered by banks. One of the indicators of reaching out to the rural population, though crude, is the number of deposit accounts handled by the rural branches. For a total rural population of 83.31 crore according to the 2011 Census, the number of rural deposit accounts is not more than 22.41 crore as on March 2010, the latest available data. The number of borrowing accounts is much less at 3.62 crore. According to a recent circular of the Reserve Bank of India, there are 1.12 crore bank accounts, which have remained inoperative for more than ten years. This revelation reduces the impact made by banks in reaching out.

Sketchy as these details are, they indicate the tardy progress made by the banking sector in reaching out to the rural population so far.

A more reliable set of data indicating the penetration of banking into the lives of people in India is available in the Census, though a decade old. For the first time, Census 2001 has generated authentic data relating to the number of households in India availing banking services. The definition used here was “The household was considered availing banking services, if its head and or any other member in the household was availing banking services provided by the bank or post office bank as a holder of any type of bank account. This covers all types of commercial banks such as nationalised banks, private banks, foreign banks and the cooperative banks”. A household is “usually a group of persons, who normally live together and take their meal from a common kitchen, unless the exigencies of work prevent any of them from doing so”. (Census 2001)

According to this Census data, the percentage of rural households availing banking services was only 30.1 in 2001. The penetration ratio was higher at 49.5 percent for the urban households and the national average for all households was 35.5 percent. Inter-state variations were very conspicuous particularly in the case of rural households. The lowest penetration ratio was 6.3 percent

in Manipur followed by Nagaland - 11.5 percent and Meghalaya - 12.7 percent. On the higher end it was Goa having 69.0 percent. It is interesting to note that banking operations in Goa have begun only after its liberation in 1961.

One of the committees appointed by the Reserve Bank of India has identified 256 districts in India out of the 622 districts as financially excluded districts. Districts, where the rural and semi-urban per branch population is more than 19,272 and their corresponding credit gap is more than 95 percent, are considered as financially excluded. In Bihar, 37 out of its 38 districts are among the financially excluded districts. Uttar Pradesh and Madhya Pradesh are the other two states, which have larger numbers of districts of this category.

Progress made so far :

During the last ten years, much progress has been made by the banking sector in reaching out to the rural population. The number of rural branches has increased from 32,640 in 2001 to 33,513 in 2011, adding 873 new rural branches. The number of rural deposit accounts has increased from 13.17 crore to 22.41 crore, while the number of borrowing accounts has increased from 2.24 crore to 3.62 crore during the same period. Promotion of Self-Help Groups (SHGs) was adopted as a strategic move to reach out to small borrowers in a cost-effective manner. Taking advantage of the progress made by computerisation of banking operations, branchless banking model was introduced on a trial basis to begin with. Very little progress, however, has been made in the financially excluded districts till date in expanding the branch network.

Promotion of Self-Help Groups :

Self-Help Groups in good number appeared in the rural economy due to the promotional efforts made by NABARD. As per the operational guidelines, SHGs are informal groups formed on voluntary basis to attain certain collective goals, both social and economic. In April, 1996, the Reserve Bank of India advised the banks to consider lending to the SHGs as a segment of priority sector advances and integrate it with the mainstream credit operations. Operational guidelines based on the findings of pilot project and approved by Reserve Bank of India, centered on group formation, size of group, criteria for selection, mode of linkage with banks, linkage models, financial and administrative operations of SHGs and dynamics of group lending. Banks have found SHGs as a dependable and cost-effective conduit for extending small credit to a large number of small borrowers.

There are more than 69.53 lakh savings linked Self Help Groups and more than 48.51 lakh credit linked SHGs covering 9.7 crore poor households as on 31th March 2011. This is a good indicator of the indirect efforts made by banks to reach out to the unreached, particularly to the women.

Opening No-Frills Accounts :

With a view to expand the reach of banks to the unreached, banks were directed to open no-frills savings bank accounts to bring into the banking fold even without any initial amount of deposits. There was a time in the past, when banks in the private sector were insisting upon fairly large amount of money to be brought in as initial deposit. Now, savings bank account can be opened without any deposit. Through this procedure, banks have been able to reach out to people having very low income also to become bank customers.

The banking sector has 7.5 crore no frills accounts, while the total number of savings bank accounts has increased to 55.95 crore, of which 18.46 crore accounts are in the rural sector as on March 2010.

Evolution of Branchless Banking Model :

An innovation in branchless banking has been adopted by the public sector banks, by appointing business correspondents in selected villages to deal with customers of the bank using smart cards. The business correspondents are the local persons, who are familiar with the local households. Simplicity of operations is the hall mark of branchless banking process. The small electronic gadget identifies the finger prints of the customer and facilitates the transactions like depositing and withdrawing cash. This facility replaces the brick and mortar branch effectively. An added attraction is that after completing the operations, the gadget thanks the customer in the local language.

Besides the business correspondents, there are also the business facilitators appointed by the banks, who play an important role in reaching out to the prospective customers. Banks also have opened Counseling centres for spreading financial literacy in almost all of their lead districts, appointing mostly the retired bank staff. More details of the operations of these centres are not available.

Rural Financial Inclusion :

Some details pertaining to the progress made by the banking sector in enhancing financial inclusion in rural areas are available in the Reserve Bank's Report on Trend and Progress of Banking in India : 2010-11. The progress made so far is not very impressive, when compared to the extent of financial exclusion which continues to exist. A few indicators of the progress made in this area are furnished in Table-1.

Table - 1 : Progress Made in Financial Inclusion in the Rural Sector

Indicators	2009-10	2010-11
Total Villages Covered	54,757	99,840
Villages Covered - with population >2000	27,743	53,397
Villages Covered - with population <2000	27,014	46,443
Villages covered through Branches	21,499	22,684
Villages covered through Business Correspondents	33,158	76,801
Villages covered through other modes (Mobile van and ATM)	100	355
Kisan Credit Cards (million)	20	23

Source : Reports on Trend and Progress on Banking in India, 2010-11.

With all the efforts made to reach out to the rural population, so far only about one lakh of villages could be covered by the banking sector. More than five lakh villages are yet to see the banking operations. The brick and mortar branches of banks are in existence only in 22,684 villages in 622 districts. The number of villages covered through the much talked about business correspondents is not more than 76,801. The number of villages covered through other modes like mobile vans and ATMs is not very significant; it is only 355 as on March 2011.

Evidently, banks have a long way to go to attain 100 percent financial inclusion. The 'Task Force on the Aadhaar-enabled Unified Payment Infrastructure' headed by Mr. Nandan Nilekani has suggested that 10 lakh business correspondents have to be appointed to ensure that social sector schemes' benefits reach the intended beneficiaries in about six lakh villages. This recommendation anticipates that these ten lakh "mini ATMs" could be used to make payments to beneficiaries in 2.25 lakh gram panchayats covering six lakh villages besides serving the urban poor. This is a challenging task indeed.

Commercial banks have their own inherent inadequacies in taking up the sole responsibility of achieving the desired goals in rural financial inclusion. No doubt, they have made their presence in the rural sector quite visible. As their core competence is not essentially rural banking, they can play only a secondary role in the rural arena. The gramin banks may be more effective in reaching out to the last family in the villages, if they are properly supported, financially and organizationally.

Role of Gramin Banks :

The Working Group on Rural Banks, which recommended the establishment of regional rural banks, has formulated the ideological framework of this new credit agency as follows : "One of the most important objectives of the rural banks would be to attempt **effective coverage** of small and marginal farmers, landless labourers, and rural artisans. The performance of these banks will be judged primarily by their success in coverage of such categories of borrowers towards meaningful productive activity and recovery of their advances **rather than by the profit they make**" (emphasis added) (Government of India 1975).

Though the major stake-holder of these banks could not formulate a consistent long term policy for their development during the last 37 years, they have emerged as a strategic credit agency in rural India. After under going periods of stagnation and neglect, their amalgamations at the state level has given them

a strong base in the rural credit space. (Thingalaya 2010). They have been running in a handicapped race along with the bigger commercial banks. Their amalgamations in the recent years have expanded their areas of operation and thereby improving their viability considerably. There was an embargo on their staff recruitment for some time, as a result of which they could not expand their branch network. The absence of a promotion policy till recently has crippled the efficiency of the human resources.

The recent changes in their operations have proved their utility as a low cost rural credit agency. Migrating into the Core Banking Solutions with the support of the sponsoring banks, they have grown stronger. They have expanded their reach of the rural customers steadily during the last decade specially in canvassing deposit accounts. The details of their performance in enlarging the deposit accounts as well as the credit accounts in the rural areas *vis-à- vis* that of all banks in the rural sector are given in Table-2.

Table - 2 : Rural Operations of Gramin Banks and All Banks

Year	Deposit Accounts (No. in crore)		Credit Accounts (No. in crore)		Branches (number)	
	Gramin	All Banks	Gramin	All Banks	Gramin	All Banks
2001	3.81	13.17	0.94	2.24	12,106	32,640
2002	3.83	13.30	0.98	2.51	13,760	32,443
2003	4.08	13.67	1.00	2.55	11,999	32,283
2004	4.26	13.87	0.98	2.54	11,914	32,107
2005	4.35	14.19	1.09	2.82	11,824	31,967
2006	4.33	13.96	0.97	2.85	11,393	30,610
2007	4.71	14.97	1.09	3.22	11,348	30,393
2008	5.34	16.80	1.17	3.27	11,374	30,898
2009	6.48	19.97	1.22	3.33	11,538	31,549
2010	7.35	22.41	1.33	3.62	11,629	32,320

Source : Basic Statistical Returns of Scheduled Commercial Banks in India : various issues

Gramin banks have increased their share of the rural deposit accounts in the total deposit accounts handled by the banking sector from 28.9 percent to 32.8 during the last ten years. There are cases of some gramin banks having over 50 percent of their deposits emanating from the savings bank accounts. Their record of performance in reaching out to small depositors is quite revealing. Opening a savings bank account with a small amount is the first step in bringing to the banking fold the hitherto unreached people.

In the case of rural borrowing accounts, the gramin banks' share has not increased rapidly, though many of them operate with a credit-deposit ratio of more than 80 percent. Small borrowing accounts up to ₹25,000 constitute about 74 percent of the total borrowing accounts handled by the gramin banks in the rural sector. These accounts are usually of shorter duration and hence variations in their number over the years by closure are quite common. As on March 2010, there are 70.06 lakh borrowing accounts of less than ₹25,000 with the gramin banks.

There appears to be some variations in the number of rural branches both of the gramin banks as well as of all banks, which are not adequately explained in the related Reserve Bank publications. The data available in the Basic Statistical Returns of Scheduled Commercial Banks in India as presented in the table above gives an impression of the total stagnation in the expansion of rural branches during the last ten years. Upgrading the rural branches into semi-urban branches based on the latest Census data is one the factors altering their number at some point of time. Another factor is the relocating of some of the rural branches in more remunerative locations. The closure of rural branches, however, is very rare.

An Action Programme :

The regional rural banks have to be assigned a strategic role in attaining total financial inclusion, as a part of the overall programmes of the banking sector. For penetrating deeper into the remote rural areas they are better suited than the commercial

banks. Financial inclusion, it must be reiterated, is not the end in itself; it is one of the means for enabling specially the rural poor to improve their economic conditions. The manner in which some of the banks are announcing their achievements in broadening financial inclusion, measured usually by the increase in the number of no-frill accounts opened, gives an impression that they have already accomplished the challenging task. Enlisting the hitherto unreached people as bank customers is only the beginning. Their credit needs have to be sympathetically and realistically studied by the bankers at the grass root level. Saving habits have to be inculcated among them. Banking schemes have to be suitably modified to match their requirements. This is a time consuming job and cannot be completed overnight. The urban-bred banker cannot easily understand or appreciate the inherent inadequacies of the rural society, their fears of uncertainties and inability to articulate their aspirations.

Gramin banks have the following advantages in reaching out to rural population and in becoming a part of the whole process of rural development.

- Readily available extensive rural base;
- Ready access to low income groups;
- Rapport built up with small borrowers;
- Rural-oriented human resource base

They have built up a reliable rural base, which has to be expanded. Even to adopt the branchless banking model, there is the need for opening more base branches. This is necessary to reduce the distance between the locations of the business correspondents and the base branches. Instead of compelling the banks to cover up all the villages having population less than 2000, it would be worthwhile to assign this task to the gramin banks. But this task has to be supported by meeting the cost of the new brick and mortar branches. In Jharkhand, it was reported that the state government has formulated a plan to build 300 panchayat bhavans in the selected villages, where accommodation would be provided to rural branches. (Thingalaya, 2011). The state governments being shareholders of gramin banks, such a gesture on their part would be very helpful to the gramin banks to expand their reach. This issue should be taken up in the State Level Bankers' Committee meetings to insist upon the state government to play its role in enabling the banks to attain total financial inclusion. Rural branches have to be considered as an important segment of the rural financial infrastructure. Like the village roads, on which the government budgetary provision every year, investment on constructing branch premises in the remote villages devoid of housing facilities, should be the concern of state governments. They can accommodate the village panchayat office, post office and primary health centre in such buildings, wherever necessary. Nominal rent may be collected from the banks after they establish themselves in the rural settings.

Gramin banks have built up ready access to low income groups, from whom they have mobilised low cost funds like the savings bank deposits. They have developed the workable strategies to bring to the bank small depositors in the villages. They did not start with zero-balance savings accounts, as the big banks are currently busy with. By providing the facility to save, even small amounts, they have raised their deposit base. In the branchless banking operations, it was observed that the villagers are depositing with the business correspondent even the small amount of bus fare, which they save because of the banking facility available in the village. (Corporation Bank 2011). The creation of facility to save emerges as important as the capacity to save and the willingness to save.

Having over 74 percent of their credit lent to the small borrowers - borrowing less than ₹25,000 - their level of comfort with small borrowers is very high. This is a positive factor in improving their accessibility and acceptability to the people of very small means. From the beginning, the gramin banks were catering to the credit needs of the marginal farmers, agricultural labourers and rural artisans. Their lending apparatus is, therefore,

attuned to small borrowers. As the prime objective of financial inclusion is to reach out to these groups, gramin banks are cut for the job.

Gramin banks have fostered rural-oriented human resources since their establishment in 1975. Recruiting the staff from within the state, where they operate, these banks have their staff, who have lived in the villages and grown with the bank. They understand the rural ethos much better than those coming from the cities. According to the available published data, there are 63,822 employees working in gramin banks as on March 2008. Out of them, 42,378 are working in the rural branches. It appears that the Reserve Bank of India has stopped since 2009, publishing in the Statistical Tables relating to Banks in India, the data relating to the staff working in regional rural banks. It is unfortunate that the official publications do not consider it necessary to publish annually the consolidated data of the gramin banks, except some selected details.

There is no doubt that the staff working in the gramin banks have played a positive role in reaching out to the target groups in the villages within their reach. As many of their branches were opened in the identified villages not considered good for branch opening by commercial banks, the branch staff had to undergo many hardships in the initial stages. If rural banking could become a viable proposition over the years, the human endeavours were as important as policy measures. Deploying such persons in the currently unbanked areas would yield better results in achieving financial inclusion on a sustainable basis than by directing the newly recruited staff of commercial banks to take up the task of reaching out to the unreached.

Since most of the gramin banks have already migrated to Core Banking Solutions (CBS), they should be able to adopt the branchless model without difficulty. They have to open simultaneously more rural branches and then go for the appointment of business correspondents in villages, where the brick and mortar branch cannot be opened from the cost of operations angle. The recent directive of the Reserve Bank permits the Business Correspondents (BC) to take up the banking transaction work relating to all banks, instead of confining to the bank appointing them. This would enable the branchless banking model to become viable. The gramin banks can train their BCs to imbibe the ethos already developed by them.

Reserve Bank of India has to permit the gramin banks to open rural branches more liberally and the state governments, which are the stake-holders, have to provide the accommodation for the branches. It is also necessary that the gramin banks have to be strengthened by infusing more capital into their capital base. It is time that these banks are given an autonomous status.

Financial inclusion cannot be achieved in isolation from the other developmental measures. Besides the bankers, the developmental authorities also have a major role in developing the supportive infrastructure, both physical and social. Literacy, health and communication are some of the essential ingredients needed for inclusive growth. Banks cannot provide these pre-requirements. Proper synchronization of the efforts of various government agencies and banks is necessary to achieve the desired benefits.

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Financial Inclusion and FLCC

M. V. Tanksale *

The majority of the working poor in India, especially those working in the informal sector like small and petty vendors, home-based workers, artisans, labourers, maid servants, desperately need financial services from formal financial institutions. The reason is that they are involved in economic activities in which they need working capital. They also need credit or term loans to buy business equipment like sewing machines or cutting machines or livestock or handlooms. There is also a need for credit for improving their huts or houses, for adding water and drainage services in their living place, or for getting electric connections.

These are all their needs for running economic activities, mainly because they are self-employed or working on their own. Because of their nature of work (mostly manual labour), poor living and working conditions, and low income level, they are very vulnerable and susceptible to many types of risks, i.e., personal risks like sickness, accident, death, or natural disasters like floods, cyclone and fire. They need to be protected under these risks. They also want to build little savings for their future needs. Women want to "save for rainy days". Vulnerability during their entire working life does not allow them to build or plan for their old age.

The poor need credit, insurance, savings and pension services. But because of lack of access to these financial services from formal sector, they have to depend on informal financial sources, i.e., private money lenders. Not only are these informal sources exploitative, they provide only credit services and do not provide other financial services like savings, insurance, pensions and remittances. As a result, the poor are caught in a debt trap; they borrow at very high interest rates for all types of life-cycle needs, whether it is a business need or a personal need like sickness or accident, or a social need like marriage. If our objective is to bring these economically active poor out of the vicious cycle of poverty and help them build their own capital assets and business, we need to ensure that they get access to integrated financial services, and that too from formal financial institutions at a reasonable price.

Extent of Exclusion :

- 51.4% of farmer households are financially excluded from both formal / informal sources.
- Of the total farmer households only 27% access formal sources of credit; one third of this group also borrow from non-formal sources.
- Overall, 73% of farmer households have no access to formal sources of credit.
- Exclusion is most in Central, Eastern and North Eastern regions - having a concentration of 64% of all financially excluded farmer households in the country.
- About 20% of indebted marginal farmer households have access to formal sources of credit.
- Among non cultivator households nearly 80% do not access credit from any source.

Financial Inclusion :

Financial Inclusion is delivery of banking services at an affordable cost to vast section of disadvantaged and low income group. The key focus of Financial Inclusion includes four products :

- A pure savings product with inbuilt overdraft facility
- A Recurring Deposit product
- A Remittance product and
- Entrepreneurship credit in the form of KCC / GCC

* Chairman & Managing Director, Central Bank of India.

Key Objective of Financial Inclusion :

- Extending formal banking system among less privileged in urban & rural India.
- Weaning them away from unorganized money markets and moneylenders.
- Equipping them with the confidence to make informed financial decisions.

Financial empowerment is not only about financial inclusion but it also means financial literacy. Being in the social sector, one becomes aware of the disadvantages poor face for accessing financial services. Many a times they are not even aware of the various benefit schemes introduced by Govt. A major reason for this existing scenario is information gap. In these terms, financial literacy assumes paramount importance.

Financial literacy is a prerequisite for effective financial inclusion, which will ensure that financial services reach the un(der) banked sections of the society, leading to consumer protection through self-regulation. By making people aware of the exsiting products and services and the ways and means to utilise them to their advantage, financial literacy helps in stimulating the demand side of financial markets.

In recent years, as the financial markets have become increasingly complex with the risk shifting from governments/corporations to individuals, managing risks require individuals to be able to access information that enabled comparison of the various available choices. Both developed and developing countries, therefore, are focusing on programmes for financial literacy/education. In recent times, the financial landscape in our country has undergone significant transformation shaped by the forces of globalisation, advances in technology, greater market orientation and financial innovation. Retail Lending has increased phenomenally as Commercial Banks shifted their focus from traditional, need-based lending to broad-based portfolios. As a result, there has been a rapid growth in Consumer Loans, Housing Loans, Personal Loans, Credit Cards etc. We are now living in an era of consumerism. The purchasing capacity of the working people in general and educated youth in particular, has of late been boosted enormously, thanks mainly to the easy availability of credit through various personal loan schemes and credit cards marketed aggressively by the financial institutions. However, very often the beneficiaries are found to have availed of credit facilities without proper understanding and analysis of financial market products. Faulty judgment of their repayment capacity leads them to a Debt Trap. In India the need for financial literacy is intently felt in view of the low level of literacy and large section of population remaining out of the formal financial set up.

Financial Inclusion and financial literacy are twin pillars. Financial literacy stimulates the demand side - making people aware of what they can and should demand. Financial inclusion acts from the supply side - providing in the financial market what people demand. While we have traditionally focused more on addressing financial exclusion through many supply-side measures so as to help “connect people” with the banking system, we have come to recognize the demand side imperative also - that financial literacy and education should be developed hand in hand with improving access to financial services.

Steps taken by Government and RBI

Initiatives have also been taken by the Government of India and RBI for furthering the reach of banking services and financial inclusion. Financial Literacy and Credit Counselling Centres - each SLBC convenor 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. As on March 2011, banks have reported setting up of 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 from the bank so that the FLCC's services are available to even other banks' customers in the district.

Financial Literacy and Credit Counselling Centres (FLCCs)

1. Objectives

The broad objective of the FLCCs will be to provide free financial literacy / education and credit counselling. The specific objectives of the FLCCs would be :

(i) To provide financial counselling services through face-to-face interaction as well as through other available media like e-mail, fax, mobile, etc. as per the convenience of the interested persons, including education on responsible borrowing, proactive and early savings, and offering debt counselling to individuals who are indebted to formal and / or informal financial sectors.

(ii) To educate the people in rural and urban areas with regard to various financial products and services available from the formal financial sector.

(iii) To make the people aware of the advantages of being connected with the formal financial sector.

(iv) To formulate debt restructuring plans for borrowers in distress and recommend the same to formal financial institutions, including co-operatives, for consideration.

(v) To take up any such activity that promotes financial literacy, awareness of the banking services, financial planning and amelioration of debt-related distress of an individual.

FLCCs should not, however, act as investment advice centres/marketing centres for products of any particular bank/banks. Counsellors may refrain from marketing/providing advice regarding investment in insurance policies, investment in securities, value of securities, purchase/sale of securities, etc., or promoting investments only in bank's own products.

Roles and Activities

Discussion / Awareness programme on

(A) General Banking and their advantage

(i) Deposits : Importance of saving/deposit, opening of account, KYC norms, nomination facilities, type of accounts, available/applicable rate of interest, mode of withdrawal/credit, customers right & obligations towards bank, fair practice etc.

(ii) Credit : Availability of different forms of Credit for various activities and assistance available from different Govt. agencies for self employment and employment generation through various Central & State Govt. sponsored scheme / programmes such as SGSY, SGRY, PMEGP, IAY, BSKP, SCP,FFDA, USKP,NRLM etc.

(iii) Agriculture : Important information relating to cropping pattern, scale of finance, proper marketing of produce, storage, Govt. priorities and programmes for Agriculture growth.

(iv) Availability of different assistance from agencies like NABARD, NHB, CGTMSE, RSETI, DRDC, DIC, NAIS etc.

(v) Formation of SHG, JLG, Farmers club and benefits there on, Agri clinics/Agribusiness and other women and child development schemes.

(vi) Support from various Govt. institutions / agencies by way of subsidy, grant reimbursement etc.

(vii) Importance of interest subvention announced by Central & State Govt and its availability under various schemes.

(B) Insurance : Various products of insurance in Life & Non-Life offered by Govt. and Insurance Companies beneficial to the people of the area.

(C) Financial Inclusion : Awareness about the seriousness and importance being given by the Govt. to cover all the villages and families under the purview of banking and benefits to rural / urban people and awareness on various activities and products coming under financial inclusion plan.

(D) Debt Restructuring : To make aware to distressed borrower about the recourse available for resolving unmanageable debt portfolio arising out of natural calamities/unforeseen circumstances beyond the control of borrower with effective debt restructuring plans in- consultation with bank branch.

(E) Coverage : While credit counselling services may be provided in rural, semi urban, urban and metropolitan areas, banks may adopt a segmented approach specific to different categories of borrowers, rather than broad-based generalized one. For instance, the centres in rural and semi

urban areas could concentrate on financial literacy and counselling for farming communities and those engaged in allied activities. The centres in metro / urban areas could focus on individuals with overdues in credit cards, personal loans, housing loans, etc. In the initial phase, considering their network and reach, Public Sector Banks and Regional Rural Banks could consider focusing on the rural areas, while the private and foreign banks could consider setting up counselling centres in urban areas. In order to have maximum coverage, FLCCs may need to be set up at all levels viz. block, district, town and city levels. SLBCs may discuss and coordinate with banks, both in public and private sectors, and arrive at a plan for setting up of FLCCs at different levels in a phased manner. However, to begin with, lead banks may take the initiative for setting up FLCCs in the district headquarters. The SLBCs could oversee the activities of FLCCs and provide support and guidance wherever required. FLCCs may not take up cases of wilful defaulters. Counselling and debt management services may be provided free of charge to the customers so as to put no additional burden on them.

(F) Infrastructure : Proper infrastructure would have to be put in place by banks with adequate communication and networking facilities. Separate cubicles could be set up to maintain the privacy / confidentiality of the discussions with the clients.

Types of Credit Counselling

Debt counselling/credit counselling can be both preventive and curative. In case of preventive counselling, the centres could provide awareness regarding cost of credit, availability of backward and forward linkages, where warranted, etc. The clients could be encouraged to avail of credit on the basis of their repaying capacity. Preventive counselling can be through the media, workshops and seminars. FLCCs may consider introducing a generic financial education module in vernacular languages. Broadly, the module content can include the need for savings, budgeting, advantages of banking with formal financial institutions, concept of risk and rewards and time value of money, various products offered by banks, insurance companies, etc. The module may also cover aspects relating to deposits and various other financial products, the method of calculation of interest on S.B A/c, fixed deposits, etc., and method of compounding. Time value of money could be emphasized in the module. Since promoting awareness is one of the primary objectives, the FLCCs should give due emphasis to customers' rights under fair practices code, benefits of nomination facilities, operation of accounts, etc.

In the case of curative counseling, the clients may approach the counseling centres to work out individual debt management plans for resolving their unmanageable debt portfolio. Here, the centres could work out effective debt restructuring plans that could include repayment of debt to informal sources, if necessary, in consultation with the bank branch. Preventive counselling may be made mandatory for individual borrowers based on their income level or size of loan. Such mandatory credit counseling could be made a part of fair lending practice of banks. While the FLCCs centres would provide financial literacy and credit counselling, the activities of the Rural Development and Self Employed Training Institutes (RUDSETI) towards skill development / capacity building could be dovetailed with FLCCs initiatives, for increasing the earnings / debt repaying ability of the distressed borrowers' families.

Mechanism for Credit Counselling and Debt Settlement

Banks may encourage their own customers in distress or customers of any bank to approach the FLCCs set up by them. Information about such FLCCs can be provided through the various fora available under the Lead Bank Scheme. Banks may evolve trigger points to refer cases, where there are early warning signals, to the counselling centres before taking measures for recovery. Timely intervention will help to arrest any further financial deterioration of the borrower. The counsellors should be mandated to refer cases to banks and work out Debt Management Plans for distressed borrowers with a view

to facilitating restructuring / rescheduling their debts. The FLCCs may conduct open-house seminars either at the centre or at various places in the district for group counselling. Banks operating in the district can sponsor, wholly or partly, such seminars in areas predominantly covered by them. For single-creditor-debts, the FLCCs could assist the borrower in negotiating with the bank concerned. In case of multiple credits availed of by individuals, the FLCCs may negotiate with the bank/s having the largest exposure to restructure the debt and the recoveries to be shared on a pro-rata basis. For the above purpose, and if deemed necessary, the FLCCs may call for a joint meeting with the concerned bank / banks for putting forward their concerns / proposals for restructuring of debts. The bank/s, on review of the recommendations / proposal made by the FLCC, may make their independent and informed decision to accept the proposal in its original form or in such other modified form as deemed fit.

The choice of finally accepting or rejecting a debt restructuring proposal suggested by the FLCCs may be left to the bank / banks concerned. However, in case of non-acceptance or rejection of restructuring proposals forwarded by FLCCs by banks, they may give the reasons in writing to FLCC in the interests of transparency. The FLCCs would, however, not involve themselves in recovering and distributing money. This may be left to the bank concerned, or the bank having the largest exposure to act on behalf of all the banks.

Qualification and Training of Counsellors

As FLCCs are expected to play a crucial role in assisting and guiding the distressed individual-borrowers, it is necessary that only well qualified / trained counsellors are selected to man the centre on a full time basis. The FLCCs could consider appointing people with domain knowledge in agriculture for counselling related to agriculture and allied activities.

Types of interface

Counselling centres should be equipped to deal with requests received in person, by phone, e-mails, post, etc. They should have a toll free line, e-mail and fax facilities for easy contact. To maximize the outreach of the counselling centre, mobile units should also be set up to service all the blocks in the districts.

Publicity

A great deal of emphasis needs to be given by all institutions to educate the public of the various schemes / facilities. All forms of publicity, viz. press conferences, workshops, publications, websites, road shows, mobile units, village fairs, etc. should be actively explored. A suitable budget needs to be provided by all banks for the purpose. As part of ongoing measures for publicity, banks may ensure that the list of counselling centres is appropriately publicised.

Support from Government Agencies

Support to Financial Literacy and Credit Counseling Centres (FLCCs) from Financial Inclusion Fund (FIF)

It has been decided to support establishment of FLCCs by Lead Banks in 256 excluded districts and 10 disturbed districts from FIF. As on 30 September 2011, ₹46 lakh sanctioned to 3 Lead Banks to set up FLCCs in 9 districts of 3 states viz. Assam, Bihar and Rajasthan.

Financial Literacy through Audio Visual medium - Doordarshan

A project has been sanctioned with grant assistance of ₹3.28 crore to Doordarshan on producing and directing a half an hour financial literacy programme in Hindi to be telecast by six centres (DD Kendras of Lucknow, Bhopal, Patna, Jaipur, Raipur and Ranchi).

Support to PFRDA for Financial Literacy

Grant assistance of ₹50 crore sanctioned to Pension Fund Regulatory and Development Authority (PFRDA) as support for promotional and developmental activities for enrollment & contribution collection under New Pension System (NPS) managed by PFRDA under which people from the un-organized sector will be encouraged to voluntarily save for their retirement.

Empowering MSMEs for financial inclusion - Role of Banks

M. Narendra *

What Financial Inclusion is all about?

Financial inclusion is universal access at a reasonable cost to a wide range of financial services for everyone needing them, provided by a diversity of sound and sustainable institutions. Financial tools help entrepreneurs start and expand small businesses which are a source of local job creation, growth and poverty reduction. Financial inclusion has become a national and a government imperative in the last few years. The discussions towards financial inclusion have definitely reached a crescendo this year with increased focus from the government, various policymakers and some genuine progress by the private sector and financial institutions. A well developed, inclusive financial sector is like a good transport system. It is basic infrastructure that everyone in the country - from individuals to governments to business of all sizes - depends upon. New technologies such as mobile phones, smart cards, ATMs and business correspondents, coupled with strong banking institutions hold promise of dramatically expanding access by reducing costs for providers and clients alike. Financial inclusion is a win-win proposition. This is further aggravated with a lack of awareness and trust amongst the financially excluded regarding the benefits of the banking system. Hence, reaching out to over 700 million citizens across six lakh villages who don't have access to the formal banking system appears to be a Herculean task. The Government has taken several major initiatives by laying a financial inclusion roadmap to cover villages with population of over 2000 by March 2012, 25% of new branches to be set up in unbanked rural areas, simplification of KYC norms etc. Technology also plays a major role in financial inclusion in the sense that mobile telephony has reached far flung areas and has facilitated fund transfers even to a village bank through electronic mode / mobile phone.

However, while there is a growing awareness and agreement on the importance of financial inclusion, it is also important to appreciate that the objective of providing affordable access of suitable financial services to the financially excluded is to ensure 'economic development and progress of the financially excluded and that inclusion of the excluded' is only a means to an end and not the end in itself. Banks could play a major role in inclusive growth through financing of MSMEs, especially in rural and semi-urban centres in a big way.

MSMEs, a part of inclusive growth

- The Industries Promotion and Development Act 1951 laid basic framework for Industries
- Smaller manufacturing units came under SSI
- The process of combining Non Manufacturing segments to create an integrated segment named SME started in 2005
- MSME Development Act came into existence in 2006
- RBI replaced SSI and Other Priority Sectors by adopting SME concept
- Scope of SME widened in phases
- Latest activity to be brought under MSME is Retail Trade in 2009

* Chairman & Managing Director, Indian Overseas Bank

What determines SME?

- USA - Companies with headcounts less than 100 are typically labeled as "small" and head counts with less than 500 are considered as "medium".
- Canada - Firms with less than 500 employees and less than $50 million in annual revenues are considered as small and medium sized enterprises.
- India has altogether a different definition of SME, based on original investment in Plant & Machineries for a manufacturing unit and original investment in Equipments for a service enterprise.
- Each sector is further classified as Micro, Small and Medium Enterprises. Micro sector is further divided into Micro-I and Micro-II on the basis of investments in Plant & Machinery or Equipments, as the case may be.

Sector	Manufacturing	Service
	Original investment in Plant & Machinery	**Original investment in Equipments**
Micro	Upto ₹25 lacs	Upto ₹10 lacs
Micro Level-I	Upto ₹5 lacs	Upto ₹2 lacs*
Micro Level-II	Above ₹5 lacs and upto ₹25 lacs	Above ₹2 lacs and upto ₹10 lacs
Small	Above ₹25 lacs and upto ₹5 crores	Above ₹10 lacs and upto ₹2 crores
Medium	Above ₹5 crores and upto ₹10 crores	Above ₹2 Crores and upto ₹5 crores

MSME'S CONTRIBUTION TO INDIAN ECONOMY

The traditional village and cottage industry which were generally clubbed under SSI, provide vital means of living to artisans, sustain the vitality and viability of countless number of villages and towns, enrich the quality of life in society by providing fine handicrafts and pieces of art. A large number of MSMEs are engaged in the manufacture of consumer goods of mass consumption. The employment generation capacity per unit of capital of MSME was found to be at least eight times higher than that of large industries while the output generating capacity per unit of capital was three times larger than that of large industries. In a country like India with large population and increasing unemployment, the role of MSMEs needs hardly to be reemphasised. The encouragement of MSMEs with their higher output capital ratio and employment - capital ratio has become a stabilising force in the Indian economy. Of all the elements that go into business, credit is perhaps the most crucial. The best of plans can come to a naught if adequate finance is not availble at the right time. In general MSMEs operate on tight budgets, often financed through owner's own contribution, loans from friends and relatives and some bank credit. Despite this given situation, let us have a look at the contribution of MSMEs to the economy.

The MSME segment, constituting around 26 million units, contributes 45% of industrial output, 40% of exports, employs 60 million people and creates 1.3 million jobs every year and ensures balanced regional and socially-inclusive growth. Commercial banks, globally, are the main source of finance for MSMEs. In India, it is estimated that nearly 95% of the Micro units are financed by the unorganised sector. The Banks thus have a daunting role to devise ways and means to put all these Micro units into commercial banking domain which will be a true financial inclusion since most of these units avail finance from money lenders and other unorganised sector at usurious rates of interest. The solution lies in unleashing the untapped potential of the micro, small and medium enterprises (MSME) and unorganised segments by improving their bankability and thereby, the competitiveness of this large segment. This is effectively a 'multiplier impact' model, with focus on economic development and progress.

CONTRIBUTION of MSMEs - GLOBAL *vis-a-vis* India

According to World Bank data, the percentage contribution of SMEs to GDP is as under :

- 50 to 55% in advanced economies like USA, UAE, Singapore, UK, Germany, Denmark, France, Norway, Qatar.

- 20 to 40% of GDP in Middle Income or developing nations like China, Brazil, India, Mexico, Russia, Malaysia, Philippines and Thailand.
- Less than 15% in under-developed economies like Bangladesh, Cambodia, Kenya, Uganda, Zimbabwe etc.,
- In Europe, SMEs are economically important with 98% of an estimated 19.3 million enterprises defined as SMEs, providing around 65 million jobs. Again almost all of these are small enterprises with 18 million enterprises (93.2%) employing less than ten people and only 35,000 enterprises employing more than 250 people. The average European business provides employment for four people, including the owner / manager.

When SMEs from countries like US, UK, Germany, France contribute 40 to 60% of GDP of those countries, SMEs from India contribute between 15 to 20% towards its GDP. No doubt, Indian SMEs are direly in need of funding and there is a huge untapped potential.

MSMEs and INCLUSIVE GROWTH

MSMEs provide a natural habitat for entrepreneurs. Through this platform, the latent / raw talent available locally can hone their skills and talents, experiment, innovate and transform their ideas into goods and services needed by the society. When the entrepreneurial talent is allowed to grow in different regions and areas, the income is also distributed instead of being concentrated in the hands of few. This helps in solving a larger social issue of bridging the gap between rich and poor.

The question one needs to answer is not only 'how to provide banking services to the financially excluded' but 'how to ensure economic progress of the financially excluded' through Banking. Addressing the first question, where the predominant focus and efforts are underway, it is restrictive and with a limited vision. This 'direct intervention model of banking the unbanked' through either branchless banking, Business Facilitators (BFs) or Business Correspondents (BCs), etc, model is fraught with challenges for financial institutions including high barriers to entry, long gestation period and high go-to market and servicing costs.

A Micro Enterprise of today can blossom into a big Corporate, if given adequate financial support and capacity building. Many small enterprises of today employing between 25 to 50 workers were originally a tiny unit employing 2 or 3 workers including the proprietor. MSMEs are the best vehicle for inclusive growth which create local demand and consumption, provide employment to millions of freshers. Even under a global recession, because of the huge demand locally, these units have the ability to sustain and the impact will not be too severe on them. MSMEs primarily rely on bank finance. The mandatory targets in place for commercial banks for credit to Micro & Small sector has shown a steady and consistent growth over the past few years. MSE sector witnessed a growth of 26.3% during 2010-11 and stood at ₹4,575 billion as of 31.3.2011. Despite exponential growth, the sector feels that not enough is being done for them by the Banks.

ISSUES OF MSME SECTOR IN ENABLING GROWTH

According to Fourth Census of MSME sector, only 5.18% of both registered and unregistered units has availed finance through institutional sources, 2.05% from non-institutional sources and 92.77% of the units were self-financed through unorganised or domestic channels. This status evidences the extent of financial exclusion and MSMEs are not alien to this. Many of the Micro sector entrepreneurs are first-timers and reluctant to approach a bank for financing them due to fear of the banks insisting on collateral security. RBI has now made it mandatory that no collateral security or guarantee one to be obtained by banks for credit limits upto ₹10 lacs.

Location of many MSE units are vulnerable to power shortage water scarcity and inadequate' - infrastructure like - roads, transportation, etc. Low technology levels is an added woe to many units who are afraid to tread into these areas due to sheer lack of awareness. Right man for the right job

is another deficit area faced by MSE units and right skill sets in manufacturing service; and marketing are not available barring a few exceptions, HR. problems are further aggravated by low retention rate.

Growing incidence of sickness is another area of concern which reduces employment opportunities affecting inclusive growth. Major attributes to sickness are lack of adequate financial resource. Lack of management skills and expertise and non-availbifity of raw materials in time inadequate power, obsolete technology etc.

Government / RBI Initiatives

Our economy has shown resilience even during adverse situations like increasing crude prices and rising inflation. Our GDP growth fell from 9% in 2008 to 7% in 2011-12 yet we are fairly insulated from global meltdown. To enhance the credit flow to MSE sector, Prime Minister's Task Force on MSME sector has prescribed mandated growth targets for this sector, which are briefly as under :

- 20% YOY growth of credit to MSE sector
- 10% annual growth in number of Micro Enterprises accounts
- Credit flow to Micro sector alone out of total credit to MSE to reach 50% in 10-11, 55% in 11-12 and 60% in 12-13.

Monitoring the above growth through Empowered Committees and directing the banks which are in deficit for low performance to improve is an ongoing exercise in this direction.

CGTMSE scheme is being promoted in a big way so as to bring large number of Micro and Small enterprises within the ambit of institutional finance.

Units facing temporary problems are advised to - take advantage of the restructuring policies in place at various banks. Banks have been advised to formulate liberal policies to facilitate units so that they come out of their genuine cash flow problems at the soonest possible time.

Union Cabinet approved a new public procurement policy for the various arms of the central ministries, departments and public sector undertakings, requiring them to source at least 20% of their respective annual purchases from Micro, Small and Medium Enterprises within a period of three years and also 20% of this procurement (i.e. 4%) should be from units owned by Scheduled Caste and Scheduled Tribes. The Central ministries / Public sector enterprises will continue to procure 358 items from MSMEs which have been reserved for exclusive purchase from them. This step is a right direction for promoting inclusive growth which will encourage linkages between MSMEs and large enterprises.

Another important area is to build up a strong SME database and regularly updating the same. Certain countries like Malaysia have built a reliable and strong database to regularly trap information about their finance performance and problems faced by them in accessing loans etc. It will also be a very useful repository of information for the banks and government to evaluate their effectiveness.

Most of all, MSMEs need simple and clear Policies and Acts to understand and utilise them in the best possible manner.

ROLE OF BANKS IN EMPOWERING MSMEs

Financing of first time entrepreneurs is a MUST for financial inclusion. When Late Dhirubhai Ambani sought finance from banks in the initial stages for his business entity, M/s. Reliance Industries Ltd, most banks turned a blind eye. So is the case with Infosys. Today both these enterprises which commenced as small enterprises have grown manifold and both the companies have offices and units well spread out. Both are good examples of inclusive growth. Hence first time entrepreneurs need to be supported and banks have been doing this but still there is a large gap in this area of financial inclusion.

OTHER FACILITATORS TO INCREASE CREDIT FLOW TO MSMEs

Single-widow clearance of credit facilities

Centralised processing Cell with single point appraisal and sanction.

Developing cluster based approach to financing of MSME units will go a long way in promoting inclusive growth.

Technology set-up by accepting, tracking (by borrowers) and sanctioning credit proposals online after quick processing.

Scheme for utilising NGOs to train Micro / Tiny sector entrepreneurs could be considered. While Rural Self Employment Training Institute (RSETIs) of Banks are engaged in this line, the impact of RSETIs in inclusive growth is yet to be verified and established. It is reported that only 15 to 20% of the trained youths take up self-employment.

SLBC convenor banks to review institutional arrangements for delivering credit to MSME sector. Clusters identified by UNIDO spread over 21 states to be taken up for financing on selected areas by establishing a specialised branch.

Timely remedial measures identifying sickness among MSME units, segregating viable units for implementation of revival plans should be an area of major attention. Otherwise it will have serious after-effects in income, employment and overall productivity of the sector.

SME welfare associations play a major role in promoting inclusive growth by conducting melas for large number of Micro entrepreneurs who have been deprived for banking finance and bankers from the service area can be called for to interact with the budding enterpreneurs. Asymmetry of information, reliability of data and lack of transparency have been areas of major concern for organisations dealing with MSME sector and SME associations should play a proactive role in empowering MSMEs for Financial Inclusion.

SMEs gain from the use of mobiles especially in mainstream operations like marketing and sales, information flow and provision of customer services. Banks can facilitate mobile banking services to every Micro enterprise as a policy so that the entrepreneur is in touch with his bank all the time for all his needs. This will attract many Micro sector units to avail bank finance in remote rural areas.

Banks to act as friend, philosopher and guide to MSMEs

Bank staff could be trained to advise MSMEs on their diverse needs like market strategies, use of technology etc. Counselling and guidance should be integral part of a banker's role apart from the conventional lending activity. In a way bankers should act as advisory partners in their business. Many entrepreneurs know nothing beyond their technical skills in manufacturing which is only one of the issues for the success of an unit.

ROLE OF MSMEs TOO IN INCLUSIVE GROWTH

MSMEs themselves have a major role to play in their upliftment. Bankers, while supporting MSMEs have to safeguard the interest of their depositors and shareholders and other stakeholders. So MSMEs should take efforts to run their business on sound principles and ethics, function in a 'transparent manner, repay loans promptly, maintain proper books of accounts, submit data and information to bankers promptly and correctly. Most important is sharing information in a timely manner and facts with the banker whenever they are facing problems and in distress and take the banker alongwith him in guiding him to safe waters. Many entrepreneurs feel that it is profit that matters most in a business. It is cash flow that matter and not profits alone. You can make loss in one deal and profit in three others. Every business has ups and downs and one should learn to take it in his stride and move along.

Secondly new entrepreneurs cannot afford to keep a strong management team. This team needs to be built over a period of time and not bought. It is necessary to identify the core competencies of the people working with a unit and nurture them. Once the business grows and stabilises, the boss needs to think what next to innovate, expand and build up the business further. This will bring out more investments, employment, savings and again growth. This is a business cycle which every entrepreneur would like to enjoy in his path of stewardship.

MSME credit information bureaus play a significant role in enhancing credit flow to MSMEs. A sound financial information infrastructure should improve transparency and disclosure for MSMEs in a cost-effective way and help MSMEs build a credit history paving way for quicker disposal of their credit needs from bankers.

SME Exchange as a part of BSE Exchange has commenced operations and well performing MSMEs should take this opportunity to raise equity and set up shops in rural and semi-urban areas and promote inclusive growth.

To conclude, the four pillars of inclusive growth are productivity, employment, financial inclusion and infrastructure development. Banks have a major role to play in all the above areas and financing a MSME triggers all the above areas. Role of banks is to look for new delivery mechanisms and provide better access to hitherto unserviced clientele from this sector. In the process they should not lose sight of economising transaction costs by introducing innovative channels for credit delivery. On a broader level, MSMEs have the capacity to deploy the surplus resources in the agricultural sector by turning the under-employed agricultural labourers into entrepreneurs who in turn can increase agricultural productivity resulting in increased rural income and provide a fillip to industrial growth.

Dynamic Provisioning

Under historic cost accounting, provisions are made for losses recognised at the balance sheet date. However, experience shows that some advances which are in fact impaired at the balance sheet date, are recognised as non performing only sometime in the future for certain technical reasons. To cover the impaired advances which will only be identified as such in the future, a general provision should be made. One alternative approach to the current method of measuring bank loan losses and income is 'dynamic provisioning'. The rationale for dynamic provisioning is related to the statistical probability of losses attached to any credit portfolio, and is therefore incurred at the time the loan is granted although it may (or may not) materialise later. The fundamental principle underpinning dynamic provisioning is that provisions are set against loans outstanding in each accounting time period in line with an estimate of long-run, expected loss. Generally, the level of provisioning on this basis would be less subject to sharp swings stemming from the strength of economic activity than the current approach. Loan losses would impinge on banks' profit and loss accounts and balance sheets more smoothly than at present, because of the primacy of expected, rather than actual, losses in a dynamic provisioning approach.

The Spanish dynamic provisioning method, also referred to as the statistical provisioning, involves two types of provisions - general and specific. The general provision has two parameters, and The dynamic provisioning model takes the form of;

Change in General Provision = C_t C_t - Specific Provision,

Where C_t is stock of loans, covers the latent or inherent loss in each unit over the cycle and is the average specific provisioning rate over a long estimated period. Both the parameters are based on historical data on credit impairment. During periods of strong credit growth and low levels of specific provisions, the beta component is positive because it recognises the increase in incurred losses, and during recessions those losses quickly translate into specific losses and so the beta component becomes negative. Though backward looking in nature, dynamic provisioning is a transparent rule based approach that can work as a countercyclical tool.

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Source : Financial Stability Report, December 2011, RBI.

Financial Inclusion - Forward step for Micro Finance Sector

Dr. Venugopalan Puhazhendhi *

I. Introduction

The process of economic growth, especially when it is on high growth trajectory, must strive to encompass participation from all sections of society. Lack of access to finance for small farmers and weaker sections of the society has been recognized as a serious threat to economic progress especially in developing countries. Moreover, prolonged and persistent deprivation of banking services to a large segment of the population leads to a decline in investment and has the potential to fuel social tensions causing social exclusion. Access to finance, especially by the poor and vulnerable groups is a prerequisite for employment, economic growth, poverty reduction and social cohesion. This will be providing them an opportunity to have a bank account for saving as well as investment purposes and thereby facilitating them to break the chain of poverty.

Recognizing the contributory impact of the financial inclusion for achieving the inclusive growth, a series of efforts are being undertaken by the Government of India and Reserve Bank of India during the last few decades for greater inclusion. However, the seriousness of financial exclusion of poor was brought out in the report of National Sample Survey Organization (NSSO, 2005) based on which greater attention was focused on this aspect. While assessing the contributory factor for such exclusion, it was recognized that in spite of a large network of the institutional credit system, it has not been able to adequately penetrate the informal rural financial markets and the non-institutional sources continue to play a dominant role in purveying the credit needs of the people residing in rural areas. As a complementary to this, during the last two decades, the microfinance sector has made significant progress in terms of higher outreach through several innovations in credit delivery and terms of lending. Self Help Group (SHG) bank linkage programme being implemented by the banking sector facilitated, to certain extent, for greater financial inclusion. In this context, Micro Finance Institutions (MFIs) are also emerging as a structural addition in the financial system. Though there are different models for purveying micro-finance, the Self-Help Group (SHG)-Bank Linkage Programme has emerged as the major micro-finance programme in the country. It is being implemented by commercial banks, Regional Rural Banks (RRBs), and co-operative banks (Annual Report RBI, 2011). Since the micro finance sector is primarily focusing on providing financial services to the poor and vulnerable section of the population, financial inclusion is becoming the underlying principle to achieve. An attempt has been made in this paper to review the efforts made by the banking sector for achieving greater financial inclusion along with emerging issues and explore the alternative approaches feasible especially in the gamut of micro finance sector.

II. Extent of Financial Exclusion

An attempt to assess the extent of financial exclusion indicated that out of the total 89.3 million farmer households in the country, only 51.4 percent of the total households were non-indebted. Further, out of the total 43.4 million indebted households, 20.3 million (46.8%) households had availed financial services from informal sources. Banking data revealed that credit exclusion is severe in 139 districts of the country. In these districts, only 10 per cent or less, out of 100

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persons have access to credit bears the fact that the exclusion is not only large, there is also a wide variation across regions, social groups and asset holdings. The poorer the group, the greater is the exclusion (Rangarajan, 2007). The estimates of financial inclusion index revealed the wide variation in the status of financial inclusion was observed among the regions and districts with the regions and inadequate branch networking was observed to be one of the contributing factors for the greater exclusion (Nirupam Mehrotra et. all, 2011). This situation called for appropriate institutional arrangements to bridge the gap between the existing bank branches and poor clients. Though several initiatives were undertaken for deepening and widening the process of providing financial services to the poor and vulnerable groups, in the recent periods, still there exists greater potential for qualitative and quantitative additions in the ongoing efforts.

III. Initiatives towards Financial Inclusion

The elements of financial inclusion focused in the recent initiatives by RBI includes, saving cum overdraft account, remittance facility, an access to credit through instruments like a general credit card. Performance of providing these services depends on the institutional network coverage of bank branches in the remote areas. The RBI had pursued the financial inclusion agenda more closely and now the banks have prepared plans in each and every State targeting 72,800 villages with the population of more than 2000 that are not covered by main stream financial institutions. Progress and issues in the implementation of the selected initiatives towards financial inclusion which are having direct bearing on micro finance sector progress are discussed in this section of the paper.

No frills Accounts

Taking the view that access to a bank account can be considered a public good, in 2005, RBI directed all banks to offer at all branches the facility of 'No Frills' Account (NFA) to any person desirous of opening such an account. These accounts have nil or low minimum balances and charges and have limited facilities. As at the end of the year 2010-11, 74.4 million NFAs had been opened by the banking system. The impressive performance in terms of growth in number of NFA may not be contributory unless and otherwise, these accounts are considered to be active in operation. At the ground level, it was observed that most of the NFAs were non-operative and clients were not even aware of the terms of use of these accounts. There are certain barriers that inhibit the active operation of such accounts like the time and cost involved in reaching the nearest branch where the accounts have been opened. Concerted efforts by the implementing authorities by providing appropriate financial literacy with the innovations in use of technology will certainly improve the impact of these efforts to a greater extent.

Business Correspondents (BCs)

Concerted efforts are being made by the financial institutions, under the direction and supervision of the Reserve Bank of India (RBI) and the Ministry of Finance (MoF), in using the Business Correspondent model as an effective linkage between the banking net work and the unreached clients. Forward looking and innovative banks have taken partnership with their BCs to new levels over the past year. Future strategies for improving the effectiveness of BC model will have to address innovations in attracting new customer segments especially low income customers, enhanced product portfolio including providing client oriented transaction accounts, remittance / payment services and suitable credit products. Once banks start leveraging BCs as their extended arms, regular banking products can be channeled through this model. The proposal of implementing the social sector schemes through the banking system with the support of Unique Identification (UID) provides enormous scope for being BC as intermediary between banks and clients.

Over the period of time, the implementation of BC model has made significant progress in terms of coverage as well as value addition at grass root level. As at end-March, 2011, domestic commercial banks have reported deploying 58,361 BCs / Customer Service

Providers (CSPs), providing banking services in 76,801 villages (RBI, 2011). A number of participants have emerged and several innovations were adopted in the banking system for facilitating the banking system to accept the BC model. However, there exists greater potential in terms of outreach and coverage. However, the issue of sustainability of the model is one of the major concerns for both banks and BCs, which calls for in depth understanding on the clients' preference to BC model. The study conducted by Micro Save, revealed that convenience is the major factor that influenced the clients in preferring the use of BCs (45%) followed by cost savings (both direct (37%) and opportunity costs (42%)) (Table-1) (Akhand Tiwari et. all, 2011). Induced saving behaviour and trust were the other factors motivating the clients to use the BCs. Thus proximity and costs advantages need to be given utmost priorities in the future strategies of BC model implementation.

Table - 1 : Preference of Clients for using BCs

Sr. No.	Particulars	Client response (%)
1.	Convenience	45
2.	Save Opportunity Cost	42
3.	Saved Direct Cost	37
4.	Induced saving Behaviour	22
5.	Trust	16
6.	Emergency Withdrawal	13

Another concerning issue in the BC model is determining the costs to be paid to the BCs. The arising question is whether BCs expectation on potential earnings is unrealistic or the clients are willing or unwilling to pay for the services provided by BCs. The study by Micro Save has quantified that 69 per cent of the respondents were willing to pay for the BCs and another 13 per cent of them agreed to pay the fees though, initially they responded negatively. Reduced number of visits to the bank branches thereby saves time and loss of wages was the major contributory factor (69%) for enhancing the willingness to pay BC charges followed by increased access of financial services such as savings and withdrawals (Table-2). Thus majority of customers are willing to pay a fee for a convenient banking facility close to their homes provided a range of products suiting to their needs are offered.

Table - 2 : Factors influence Willingness to pay

Sr. No.	Particulars	Client response (%)
1.	Saved opportunity Cost	69
2.	Convenient Banking	49
3.	Saved Direct costs	47
4.	Induced Banking	25
5.	Economics of bank	23
6.	Free Government Facilities	17
7.	Cash Risk	16

Customers have also understood that the banks also have to incur costs to provide these services in the villages and BCs need to recover their cost. Recent policy changes by RBI suggest that banks can levy a “reasonable fee” on the customers for various services provided through the BC channel. Banks are still struggling to identify what is a “reasonable” fee. Customers response based on MicroSave study has brought out interesting observations. Accordingly, they are more comfortable in paying 1 - 2% of the transaction amount than a flat fee or an annual charge. The rationale for preferring such transaction based charges was under the presumption that they mostly transact very small amount which is expected to be less than the current direct and indirect bank visit costs and worth the greater convenience and flexibility that BCs offer. However, in-depth analysis on the perception and expectations of BCs with reference to the cost aspects is needed to arrive at reasonable fee structure.

Technology assumes greater importance in the financial inclusion process especially in reaching the remote areas with reduced delivery cost of different financial services. The challenge lies in making the technologies friendlier to the illiterate clients from the poor segments of the society, who are normally excluded from the financial system. There are several innovative technology driven models that are being experimented and the initial responses are quite encouraging both from bankers as well as customer's perspectives. Bio metric enabled ATMs with operating instructions in vernacular language facilitate easy access of financial services to poor and illiterate customers thereby bringing them in to the banking system.

Mobile banking is the current innovation included in the recent initiatives towards achieving greater financial inclusion by banks and the service providers in the banking sector. The guidelines issued by Reserve Bank of India during 2008 for mobile banking transactions has accelerated the process of mobile banking operation in the country. There are several successful experiments in mobile banking. Further, RBI has given banks a clear lead against non banks, particularly mobile network operators, by allowing only banks to offer mobile banking services. Mobile banking in India has, so far, not reached the poor and illiterate customers. The potential to link banking services to the most widely used gadget by all sections of the society is huge. The number of mobile subscribers in India is more than 860 million or 72 per cent of the population, where as the proportion of the banked population is only around 50 per cent. From the customer's perspective, mobile banking complemented by the BC channels can offer a mix of benefits and risks (Mukesh Sadana, (2011)). Making transactions at BC outlets, balance enquiry, bill payment etc., can be performed by customers without the need to go to BC outlets or bank branches. However, mutual trust and managing technology failure if any, need to be adequately addressed while wide spreading this channel of operation. Though, restrictive regulations are contributing factors for slow off take of mobile banking services, absence of strong value proposition of the customer is equally responsible for such progress. Pricing based on geography will provide incentives for the service providers as well as banks to focus on remote areas.

Thus, from the perspective of facilitating financial inclusion 'mobile banking' offers immense opportunities for the banks. Mobile phones have been successful in providing retail and other services in rural areas. Hence, given the simplicity of their operations, it has the potential to be a preferred interface of choice in rural areas. The telecom and the banking industry along with RBI has recently constituted a Mobile Payment Forum of India (MPFI) to examine technological, regulatory and business constraints related to the scaling up of mobile banking in India. However, if the full potential of mobile banking is to be realised then further development of real time inter-bank transactions would be essential. For making mobile banking profitable, the costs of this system need to be very low. Apart from the fact that RBI in consultation with IDRBT can initiate a common payments platform, private initiative in this area needs to be encouraged to foster innovation and bring down costs.

IV. Financial Inclusion through Micro Finance Sector

The Micro Finance Sector over the period has evolved two different delivery models, one focused on Self Help Group (SHG) and its federations based on community participation and other one based on commercially oriented market driven Micro Finance Institutions (MFIs). The former one (SHG channel) is termed as non profit and non commercial with perfect integration of the existing financial structure where as the latter one (MFIs) has emerged as a profit oriented entity as a consequence of slow progress of SHG bank linkage model. The issues on financial inclusion for the above two channels in Micro Finance sector is discussed in this section.

i. SHG Bank Linkage Model

An important regulatory dispensation that facilitated financial inclusion was given in the early 90s, when banks were allowed to open savings accounts for SHGs, which were neither registered nor regulated. The impressive progress of SHG bank linkage programmes in reaching the poor clients by providing financial services led to greater financial inclusion. At the end of March 2011, 7.54 million groups had been linked with the banking system. Commercial banks had a share of 60 per cent of the amount saved by SHGs and 64 per cent of all the groups with outstanding loans. Further, the federation of SHGs is emerging as intermediary institutional set up between the groups and bank branches and varying degree of success is being observed in several States. Under National Rural Livelihoods Mission (NRLM) Programme being implemented by Government of India, many States are in the process

of setting up higher tier institutions of SHGs. These federation structures are expected to play mainly non financial role such as training, auditing, etc. However, there is greater potential for banks to use the matured and well trained federations as financial intermediaries as this model may be cost effective and wider coverage of clients with minimum efforts. Ownership of the institutions by the members is the strength of this model from client perspectives.

The design feature of NRLM emphasises the active role of federation of SHGs and hence the banks need to recognize it as potential intermediary in extending financial service to poor clients. Selecting the well established and matured federation of SHGs and using them as Business Correspondent may be a viable proposal for ensuring speedy financial inclusion. However, cautious approach is essential while entrusting BCs role to federations in terms of its selection based on clear and rigid standards to have greater sustainability.

ii. Micro Finance Institutions

The rapid growth of MFIs and the consequent changes in regulatory environment in Andhra Pradesh led to serious crisis in the sector which has the client outreach of 3,104 million. The direct group lending methodology, under which MFIs borrow bulk loans from banks and in turn lend to small loans to people in the low income segment, has its own demerits (Puneet Chopra, (2012)). The MFIs were, until recently, a highly profitable as the demand from the low income groups are price inelastic. Accordingly, the MFIs could charge reasonably high interest rates and generate return of 25 per cent and above on their equity. This situation of sellers market with limitless possibility of growth was hampered due to nonpayment of dues by the clients and rising defaults. This will be aggravated further when the defaults are soon loaded to banks by the MFIs. The regulatory initiatives by RBI in the recent time on NBFC - MFIs are aiming to have corrective measures in streamlining the credit delivery through MFIs. MFIs are also in the process of adopting self regulated code of conducts. Assuming that these initiatives adopted in true spirit by all the stake holders, the MFIs must have another opportunity to emerge as renewed model in micro finance. In this context, banks having MFIs as agents of banks operating as Business Correspondents (BCs) may be considered as alternative approach for greater financial inclusion. In this model, the banks can make use of the extensive MFI network established in remote areas as their extended arms. Further, as an off-shoot of banks, the model can be used to offer a much wider range of products - savings, credit, insurance, pension and remittances. From the MFI's perspective, acting as BC to a greater extent insulate from political and operational risk and brought under regulation of RBI (Manoj K. Sharma, (2001)). At the same time, MFIs as agents of banks will be able to offer clients with a wider range of products. In a multi-product environment, it will be difficult for any section of the stakeholders to suddenly put brakes on the operations of MFIs. The MFIs would not only be offering credit but would also be the front end for savings deposits and withdrawals, as well as for pension and for insurance services - thus broad-basing their relationships with clients.

V. Conclusion

Despite the laudable achievements in the field of rural banking, issues such as slow progress in increasing the share of institutional credit, high dependence of small and marginal farmers on non-institutional sources, skewed nature of access to credit between developed regions and less developed regions loom larger than ever before. Therefore, the key issue now is to ensure that rural credit from institutional sources achieves wider coverage and expands financial inclusion. For achieving comprehensive financial inclusion, though, the first step is to achieve credit inclusion, broad based demand driven innovative financial products with cost effective delivery mechanism assumes greater significance for future strategies. Micro finance being a sector that serves very large number of small clients distributed over wide geographical area could be a highly cost intensive

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proposition. The adoption of appropriate technological solutions both in hardware and software platforms has ensured so far that the cost remain within the reasonable limits. This further enhances the value proposition for banks, BCs and, above all, customers. Better integration of platforms and technology deployed for Financial Inclusion purposes with those for mainstream banking is essential to fully reap the benefits of BCs as a new channel.

As discussed earlier the customers especially from the poor and vulnerable groups for whom the institutional credit structure was inaccessible till recently are willing to pay for the better services. Hence there is greater scope for the BC model which is emerging as a strong intermediary between the customers and banks in the financial inclusion strategy, to reinvent more players including MFIs and SHG federations with reinvented customer driven financial products.

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Developments in overnight money markets

Traditionally, central banks have relied on the unsecured overnight money market to implement monetary policy. However, the balance sheet policies pursued in many jurisdictions have led to substantial changes in market dynamics. To the extent that these new dynamics are not well understood or self-reversing, they may pose challenges for the eventual exit and lead to changes in the operational frameworks.

The expansion of central bank balance sheets has led to a substantial increase in central bank reserves. These excess reserves have driven overnight interbank rates towards their lower bounds, i.e. the rates at which central banks remunerate deposits. In other words, central banks have abandoned their usual practice of keeping the overnight rate close to a target - often the midpoint of the corridor spanned by the rates at which banks can borrow from and lend to the central bank, respectively. In the United States and the United Kingdom, the overnight rate has even moved below the rate at which reserves are remunerated. In both instances, the overnight market includes non-bank entities that do not have direct access to the central bank deposit facility. Such market segmentation, as well as limits to arbitrage, allows banks (with access) to offer low bids for funds from these entities and consequently drive reported market rates below the rate the central bank offers to banks.

In addition, unsecured market volumes are falling as banks have less need to borrow reserves from one another to offset daily liquidity shocks. For example, in the United Kingdom the unsecured trading volumes that form the basis for the SONIA fixing have fallen by more than half since 2008. In the euro area, the EONIA trading volumes have fallen similarly. Moreover, counterparty concerns and regulatory changes have increased the attractiveness of secured markets. In contrast to the SONIA, the trading volumes that underlie the secured RONIA fixing in the United Kingdom have, on average, remained around the levels that prevailed in 2008. Similar trends are reportedly seen in other jurisdictions as well.

Furthermore, there is evidence that the dynamics of overnight rates are changing. In the United States, the pass-through from the unsecured overnight rate to secured rates - a crucial link in the transmission of the monetary policy - has weakened during the period of near zero rates. In Sweden, the volatility of the overnight rate (tomorrow-next) has been higher than before the crisis since the Riksbank's exit from its balance sheet policies.

With a view to controlling the overnight rate in an exit scenario, central banks need to have in place properly tested tools for controlling reserves. Moreover, they may need to reconsider whether the pre-crisis practice of targeting a short-term unsecured market rate is still the most effective.

Source : 82nd Annual Report, 2011-12, BIS.

Financial inclusion framework - is it inclusive?

N. Srinivasan *

The ongoing Financial Inclusion effort over the last six years driven by RBI with policy support from Government of India pursues the objective of providing effective and affordable access to savings, credit, remittance and insurance services to people that have remained outside the formal banking channels. The RBI has operated on product, process, institution and policy levels in its pursuit of a bank-led financial inclusion solution for people, especially in rural areas.

Aspect of intervention	Specifics
Product	No Frills Acounts, General Credit Cards, Overdrafts bundled with NFAs
Process	Simplified account opening, Disbursement of government payments such as NREGS wages through bank accounts, electronic payment solutions
Institution	Business Correspondent and Business Facilitator arrangements, BC network management companies, BC technology service providers, Payments systems agents, micro branch kiosks
Policy	Relaxed KYC norms for NFAs, Relaxed rural branch licensing policy, mobile banking guidelines, Financial Inclusion Plan through SLBCs, incentives for mainstreaming EBT for banks, support from FITF and FIF for banks

The efforts at different levels had yielded results in terms of increased number of people linked to the banking system. The report card shows more than 100 million NFAs, 22 million households linked to EBT, 97000 barefoot bankers (BC / BF) and banking connectivity to 1.47 lakh villages by March 2012. But whether the results reflect 'inclusion' is a point to ponder. Of the 74.4 million no frills accounts as at end March 2011, 80% might be dormant.[1] Even in the other accounts, transactions are minimal with very low average balances in the accounts. The accounts opened for payment of NREGS wages are usually fully draw down within days of government crediting these accounts. When an overwhelming majority of accounts are not used and most of the remaining accounts see one-way transactions without any visible savings, are we meeting objectives of financial inclusion?

The efforts so far have resulted in access to a bank account for many people. But the willingness and capacity to transact on these accounts - both on the part of the bank and the customer - has been severely limited. There are several reasons for people not operating the accounts. The physical distance to the branches as also the psychological distance are impediments to transactions taking place. The current network of commercial bank branches at 80,000 is too low for a country with the geographical spread and large population. The proportion of villages connected to banks through BCs is about 25%. With staffing in most rural branches being thin, the ability to handle the additional accounts is very low. The costs of creating infrastructure and staffing are too high and the business case[2] weak. The psychological distance between the new customers and the bank staff is wide mostly on account of attitudes of those posted for short tenures to rural branches. The tendency to limit risks by doing as little incremental business as possible during the rural posting has resulted in customers being hassled with frequent and vexatious demands for documentation, collateral and other requirements that are seen as dilatory. This has led to a perception among people that banks

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1. *Studies by Microsave in several locations found that the level of dormancy of NFAs is about 80%.*
2. *Based on existing products that are offered to the new customers.*

have a negative mindset in offering services to new areas and customers. In the midst of these problems, it is difficult to believe that banks alone will complete the mammoth task of financial inclusion, despite the massive mobilisation seen in the Business Corespondent space through the financial inclusion plans.

At corporate levels of banks, whether Financial Inclusion is seen as a commercially feasible proposition that is pursued and marketed as a business line is a question. Most banks seem to be in a compliant mode to a mandate given by RBI and Government of India. The emphasis is on reporting increased numbers of NFAs, declaring 100% financial inclusion districts, etc. These reported successes are of dubious quality and of little relevance to the local areas. A few banks have sought to make a business case of inclusion effort and have come up with good scalable models, but the breakeven period even in such cases will be long. Patience and persevereance will be prime virtues in converting these opportunities in to viable revenue models.

The question that looms large is whether there are no alternatives to banks in ensuring that people get sustainable access to financial services? The answer is yes and we do not need to look far in to the horizon to recognise such institutions.

What remains to be included[3]

No of adults	840 million[4]
No of deposit accounts - Banks (March 10)	734.9 million
No of NFA accounts with - Banks (March 11)	74.4 million
No of deposit accounts - Post office (March 10)	88.6 million
No of NREGS accounts - Post office (October 10)	46.7 million
No of accounts - Primary co-operatives (March 10)	126.4 million
No of borrowers - Primary Co-operatives (March 10)	59.8 million
No of loan accounts Banks (March 10)	118.6 million
No of loan accounts MFIs (March 11)	31.4 million
No of saving SHG members (March 11)	98.1 million
No of borrowing SHG members (March 11)	62.5 million

If the number of NFAs opened with the mandate of the government is 100 million over the last six years, post office has opened more than 46 million accounts specifically for NREGS payments. There were 98 million SHGs that offered savings services to their members. Primary cooperative credit societies had 138 million members who could potentially save with their societies. In terms of loans banks had 118 million accounts (of all types, not necessarily of newly included customers who had very limited access to credit). Cooperative societies and MFIs put together had more than 90 million accounts. SHGs had more than 62 million borrowing members. The point to note is that the borrowing members of Primary cooperatives, SHGs and MFIs have a qualitatively superior financial service as they were able to transact on their accounts and make a difference to their livelihoods which was not the case in NFAs. Why should we then define financial inclusion in narrow terms, limiting it to banks who offer a product reluctantly and fail to back it up with quality service? Why not expand the concept of inclusion to all institutions that offer effective financial services which their customers find easy to access, transact and benefit from? By not recognising the people that already have to access to services in these other institutions, we incur higher costs in creating infrastructure and building HR cadres to offer a parallel service with no significant advantages. One wonders about the cost of establishing credit access to about 90 million customers and how the same can be justified in economic terms when they already enjoy credit facilities. If the other institutions are reckoned as having a role to play in financial inclusion the number of people covered by credit presently will almost double. The other institutions are perhaps in a position to better accelerate the pace of inclusion in remoter areas than banks; policy and funding support will speed up their effort.

Regardless of how we define financial inclusion, the customer is likely to approach those institutions that

3. Table reproduced from Microfinance India State of the Sector Report 2011 - Population data based on census 2011 estimates, Government of India; banking data from RBI - Basic statistical Returns 2010; Post office data from India Post Annual report 2011; No of members of PACS - database of National Federation of State Cooperative Banks (NAFSCOB); MFI data collated from MIX market data and Sa-dhan, SHG data from NABARD.

4. Census of India estimates the population at 1210 million people in 2011. The national Population commission estimates that the adults of 15 years and more will be about 71% of total population in 2011. The adult population is taken at about 70% of population.

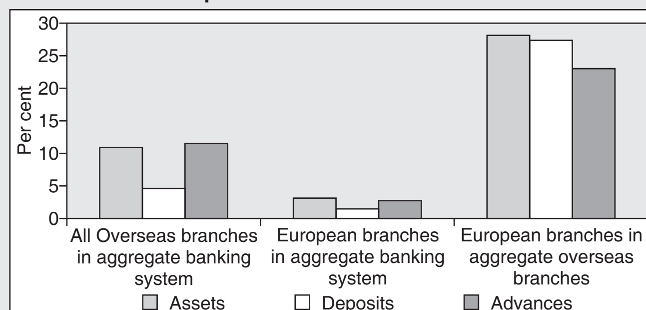
offer easy access, invest in customer friendly systems and ensure that such customers make a business case. If it is perceived that other institutions are inefficient, exploitative are weak governance then those problems should be attended to. Ignoring such institutions will jeopardise the interest of the people that avail services from such flawed institutions. The profile of those customers that avail services through SHGs and MFIs shows that many of these will never get access to banks' services in the near future. Their requirements are too small to be of interest to banks. Inclusion goes beyond mere access. After gaining access to financial services the customer should be able to use the service to make a difference to her life. This is possible only when apart from savings, they are able to access credit. Banks are not comfortable with small ticket loans to large numbers of people. The high risk perceptions, high costs and limited bandwidth in terms of staff for monitoring make it dificult for banks to do retailing of tiny loans. A better approach would be to use those institutions that can provide such localised, tiny credit products and banks supporting the retailers with bulk loans. Banks can provide the expertise on credit decisions, loan monitoring and risk management along with bulk loans for retailing to the retailers. This is what emerged as a practical solution in the initial phase of MFI expansion.

The current inclusion framework is in itself not inclusive as it keeps out institutions that provide appropriate and adeqaute services which vulnerable people find easy to access. Let us recognise that despite definitions, institutions other than banks play an active role in providing financial services to vulnerable and excluded people. Their role should be appreciated, their capacities strengthened and their expansion plans supported through an inclusive policy and funding from banks. The task of financially including all households with an effective demand is not an easy one. We need all partners that can help us achieve this objective. Our objective should be 'financial inclusion of people - not banking inclusion'.

Euro Zone Crisis and Impact on Indian Banks

The first-order impact of the on-going Euro-zone debt crisis on Indian banks may be limited, on account of negligible exposure to the vulnerable countries. Firstly, there are only 37 branches and three subsidiaries of Indian banks in the European Union, none of which are in Portugal, Italy. Greece and Spain. Out of the 37 branches, 30 branches are in the UK, 3 branches in Belgium and 2 each in Germany and France while all of the 3 subsidiaries are in the UK. Their combined share in the aggregate banking sector assets stood at 3 per cent as at end September 2011 (Chart-3.2).

Chart - 3.2 : Share of Overseas Branches (Including Subsidiaries) of Indian Banks - September 2011



Source : RBI Supervisory Returns

Secondly, none of the Indian banks have any exposure to bonds issued by Portugal. Greece and Spain while exposures to Italian bonds are negligible. Outside these countries, investment exposure (of a sample of the major Indian banks) to banks in Ireland, Germany and France were not significant, even if exposures to corporates in Germany and France are added. Thirdly, outstanding nostro balances of Indian banks maintained with banks in Europe have been falling over the last few months. Funding dependence of overseas branches of Indian banks (sample of five major banks) on European entities, except for UK. is also not very significant.

There could, however, be second-order impact on the Indian banks through various channels including trade. In the event of the European crisis worsening through contagion and in consequence, global financial markets, especially in Europe freezing, funding constraints for Indian bank-branches operating overseas may emerge. Besides, the cost of borrowing may also rise. Some signs of market tightness are, in fact, already visible. In such a case, both banks and corporates could face challenges in refinancing their foreign currency liabilities. In addition, domestic liquidity (of which the banking sector is a major provider) would need to fill in to refinance the shrinking overseas debt of Indian firms.

Source : Financial Stability Report, December 2011.

Financial Inclusion : Road Ahead

D. Rama Krishna Reddy *

Financial Inclusion Definition

The Committee on Financial Inclusion under the Chairmanship of Dr. C. Rangarajan has defined Financial Inclusion "as the process of ensuring access to financial services and timely and adequate credit as needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."

Why is Financial Inclusion Important?

- Equitable growth is achievable only through the financial inclusion. There are hardly any instances of an economy transiting from an agrarian system to a post-industrial modern society without broad-based financial inclusion.
- Accessibility of public goods and services is a necessary condition of an open and efficient society. Banking services are like public goods, it is essential that the availability of banking services to the entire population is ensured.
- Financial access is essentially meant for the economically backward as it provides them opportunities to build savings, make investments and avail credit. Importantly, access to financial services also helps the poor insure themselves against income shocks and equips them to meet emergencies such as illness, death in the family or loss of employment. Needless to add, financial inclusion protects the poor from the clutches of the usurious moneylenders.
- It is now well understood with the experiences of FMCG companies, LIC, Microfinance companies that commerce with the poor is more viable and profitable, provided there is ability to do business with them. The availability of uncomplicated, small, affordable products can help bring low-income families into the formal financial sector. Taking into account their seasonal inflow of income from agricultural operations, migration from one place to another, and seasonal and irregular work availability and income, the existing financial system needs to be designed to suit their requirements. Mainstream financial institutions such as banks have an important role to play in this effort.
- Financial Inclusion benefits banking sector in two ways. First, financial inclusion provides an avenue for bringing the savings of the poor into the formal financial intermediation system and channels them into investment. Second, the large amount of low-cost deposits offer banks an opportunity to reduce their dependence on bulk deposits and help them to better manage both liquidity risks and asset-liability mismatches.

Financial Inclusion - Globally

- Financial inclusion has become one of the most significant aspects in the present era of inclusive growth and development all over the world.
- All over the World the importance of an inclusive financial system is widely recognized in policy circles and has become a policy priority in many countries. Globally many countries now look at financial inclusion as the way to more inclusive growth, wherein each citizen of the country is able to use earnings as a financial resource that can be put to work to improve future financial status and adding to the nation's progress.
- Financial regulators, governments and the banking industry have taken several initiatives for Financial

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Inclusion all over the world. The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have been initiated in some countries. For example, in the US, the Community Reinvestment Act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighborhoods. In France, the law on exclusion (1998) emphasizes an individual's right to have a bank account.

- The German Bankers' Association introduced a voluntary code in 1996 providing for a so-called "everyman" current banking account that facilitates basic banking transactions.
- In the UK, a Financial Inclusion Task Force was constituted by the government in 2005 in order to monitor the development of the process.
- In South Africa, a low-cost bank account, called Mzansi, was launched for financially excluded people in 2004 by the South African Banking Association.
- Several Asian & African countries have harnessed the unique strengths of mobile banking to drive financial inclusion.

Financial Inclusion - India

- India long time back recognized that broader financial inclusion is vital for social and economic growth and introduced innovative ways to empower the economically backward. Nationalization of banks, priority sector lending requirements for banks, lead bank scheme, establishment of Regional Rural Banks (RRBs), service area approach, self-help group-bank linkage programme, etc., are the various path breaking initiatives over the years to increase access to banking for the poorer segments of society.

Financial Inclusion - Banks

- Banking in India existed since ancient times. The journey of formal Banking in India started in 18th century. From there it has been long journey to the modern Indian banking Industry of today.
- Nationalization of Banks in 1969 and liberalization in 1991 laid the foundation for development of banking sector in India. The most remarkable thing about Indian Banking is its reach to the length and breadth of the country and especially remote corners of the country.

Scheduled Commercial Banks branches (population group wise) as on 31st March, 2012	
Rural Branches	34,671 (37.02%)
Semi Urban Branches	24,133 (25.77%)
Urban Branches	18,056 (19.28%)
Metropolitan Branches	16,799 (17.93%)
Total	**93,659**

Scheduled Commercial Banks branches (Bank category-wise) as on 31st March, 2012	
Public Sector Banks	64,805
Private Sector Banks	12,417
Foreign Banks	321
Regional Rural Banks	16,116
Total of all Commercial Banks	**93,659**

No. of villages and Average Population per Bank Branch (APPB)	
Number of villages in India as per the 2001 Census	600,000 (approx.)
(APBB) as on 31.3.2012	12,921

No. of bank branches of SCBs over the years	
Number of scheduled commercial bank branches as on 31st December, 1969	8,826
Number of scheduled commercial bank branches as on 31st March, 1990	59,762
Number of scheduled commercial bank branches as on 31st March, 2012	93,659

- India has seen tremendous progress and growth in the past decade. Banking sector presence increased from 8,826 branches in 1969 to 93,659 branches in 2012.
- Despite all these efforts, a significant proportion of the households, especially in rural areas, still remained outside the coverage of the formal banking system.

Challenges in the way of Financial Inclusion

- The major barriers for financial inclusion, apart from socioeconomic factors such as lack of regular income, poverty, illiteracy, etc.,.
- Lack of reach, higher cost of transactions and time taken in providing those services.
- In a vast country like India viable models for remote areas are difficult to design.
- Appropriate Business Model to suit urban poor and rural people.
- Efficient Delivery Mechanism need to be identified.
- Financial Literacy and financial education need to be taken up on large scale.
- Lack of ownership by banks in implementation of Financial Inclusion.
- Lack of co-ordination among different entities
- Information and Communications Technology (ICT) based BC Model - Yet to stabilize.
- Infrastructure Problems - Premises, Roads, Power, etc.
- Fewer transactions - Non-operational accounts - High volume small value transactions - High Cost - Viability issues.
- Technology issues- availability of handheld devices, cards, technology partners, operational glitches, Digital connectivity, Turnaround time.
- Engaging BCs - Associated risks - Lack of professionalism of BCs.
- BC attrition

Steps Taken by RBI

RBI has initiated several measures to achieve greater financial inclusion, such as facilitating no-frills accounts and GCCs for small deposits and credit, relaxation in Know-Your-Customer (KYC) norms : Engaging Business Correspondents (BCs) etc.,

Use of technology : Recognizing that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, RBI encouraged the Information and Communications Technology model which would enable banks to circumvent the barriers of geography and ensure efficient Financial Inclusion.

Simplification of branch authorization - Domestic Scheduled Commercial Banks have been permitted to freely open branches in Tier-2 to Tier-6 centres. Banks have been mandated to open 25% of all new branches in unbanked rural centers.

Electronic Benefit Transfer for routing social security payments and other entitlements through the banking channel. Interest rates on advances totally deregulated.

Financial inclusion plans of banks for three years - Achievements for 2 Years

Particulars	Year ended March '10	Year ended March '12	Progress April '10 - March '12
No. of BCs / BC Agents Deployed	33,042	96,828	63,786
Banking Outlets through Branches	21,475	2,4701	3,226
Banking Outlets through BCs	32,684	1,20,355	87,671
Banking Outlets-Through other Modes	99	2,478	2,379
Total Banking Outlets	**54,258**	**1,47,534**	**93,276**
No Frill A/Cs (No. in Millions)	49.33	103.21	53.88
Overdraft- No Frill A/Cs (No. in Millions)	0.13	1.52	1.39
BC- ICT based A/Cs (No. in Millions)	12.54	52.07	39.53
EBT A/Cs-through BCs (No. in Millions)	7.48	21.76	14.28
KCC (No. in Millions)	17.63	22.34	4.71
GCC(No. in Millions)	0.45	1.27	0.82

National commitment

- Moving towards universal financial inclusion has been both a national commitment as well as a public policy priority for our country. To achieve the ultimate objective of reaching banking and formal financial services to all the villages, financial inclusion has to become a viable business proposition for the financial institutes especially banks.
- For this to happen, the delivery model needs to be devised carefully so as to move from a cost-centric model to a revenue-generation model. This will help in providing customers with quality banking services at their doorstep and at the same time generating business opportunities for the banks. This is sustainable only if delivery of banking services, at the minimum, includes the following four products :
  - i. A savings-cum-overdraft account
  - ii. A remittance product for Electronic Benefits Transfer (EBT) and other remittances
  - iii. A pure savings product, ideally a recurring deposit scheme
  - iv. Entrepreneurial credit in the form of a Kisan Credit Card (KCC) or a General Credit Card (GCC)

The task of financial inclusion to cover all the villages is gigantic, but definitely achievable by following a systematic approach :

- Government - Bank Co-ordination : The two pillars on which Financial Inclusion rests are : a) Government and b) Banks. It is therefore essential that the two pillars should not only be strong enough but they should reinforce each other. In other words, both the implementing agencies should work in tandem while progressing towards fuller Financial Inclusion.
- Financial awareness on opening and operating accounts, must accompany the financial inclusion initiative.
- Conceptual Clarity : The concept, scope and role of Financial Inclusion should be crystal clear to both the Government and the banks so that there should not be any confusion and they do not work at cross purposes.
- Unique Objective : The objective of Financial Inclusion should be unique and that is, bringing into the fold of financial sector those who have hitherto been financially excluded. This objective should not be crowded out by imposing simultaneously other objectives like bringing the beneficiaries above poverty line or giving them employment, etc. Many poverty alleviation programmes in the past have gone astray because of pursuance of multiplicity of purposes.
- Sound Planning : The Government and the banks should not function on ad hoc basis. They should work within a well-defined, planned model so that the professed objectives of Financial Inclusion are smoothly realized. The corporate framework should be transmitted to the grassroots level of operating units.
- Infrastructure facilities : Availability of adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc., is available. All stakeholders will have to work together through sound and purposeful collaborations. Local and national-level organizations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and impact.
- Proper Selection of Financially Excluded : Selection of beneficiaries should be done in an objective manner. Financial Inclusion programme should focus on those people who do not have any access or inadequate access to banking. RBI prescribes at least four products : a no-frills banking account with no requirement for minimum balance and OD facility, a remittance product for EBT, a pure savings product, and entrepreneurial credit such as GCC and KCC. The agents of Financial Inclusion should not be guided by target fulfilment philosophy and open several accounts for already financially included people.

- Proper Selection of Un-banked or Under-banked Areas : Similarly, selection of un-banked or under-banked areas should be done in an objective fashion. Banks should go progressively beyond the financially included areas to the financially excluded areas. The Government should play its due role by providing supportive infrastructure facilities to enable bankers to foray into un-banked and under-banked areas.
- Good Publicity Campaign : The success of Financial Inclusion programme would depend a lot on publicity aimed at creating awareness among the people in the financially excluded areas. There are various modes of communicating with the villagers starting from puppet dances to films to TV shows.
- Adequate Technology : Technology plays a pivotal role in ensuring success of Financial Inclusion programme. Opening and maintaining brick-and-mortar branches in financially excluded areas is not only a costly affair for banks but it also leads to industrial relations problems. Therefore, technology should play the role envisaged for human beings in the whole exercise. Today we have one of the best available technologies at our doorstep and that is the 'mobile technology.' The implementing agencies should use this platform to promote Financial Inclusion as also keep abreast of evolving technologies from time to time in the country and abroad.
- Agent-driven Financial Inclusion : Since the implementing agencies cannot post their regular employees to take such technologies to the remote areas due to the reasons cited above, they should depend upon agents who would work for them on commission basis. Rural India is full of such agents, the most prominent ones being the LIC agents, the cooperative societies' agents and postal agents. Banks should leverage this strength to their advantage by paying adequate commission. Here, it needs to be underscored that India Post can play pivotal role in reaching out to the financially excluded as in some other countries.
- Well Thought-out Commission Plan : Commission structure should be competitive and structured in such a manner so as to ensure viability of the agents for Financial Inclusion work on one hand and banks on the other. Banks should compare their viability of opening branches vis-à-vis appointing agents on commission basis. If banks find that the latter is unviable, they might as well open branches instead.
- Right Attitude : The implementing agencies should possess the right kind of attitude for Financial Inclusion. They should not consider Financial Inclusion as another burden or another routine job for them but realize that Financial Inclusion can be a facilitator to their business.
- Proper Selection of Financial Inclusion Agents : The agents for FI should be from the same or nearby villages so that the people of those villages recognize them and can trust them to part with their hard earned money. Thus, the trust deficit that would otherwise arise in case of strangers becoming agents would diminish and villagers would come forward to do business with the agents.
- Proper Allotment of Villages to Financial Inclusion Agents : The Financial Inclusion agents should be allotted a rational number of villages which they can service and such villages should be contiguous so that time and cost effectiveness can be *ab initio* ensured.
- Accounts to Remain Live : Just opening accounts with banks does not guarantee Financial Inclusion; the accounts should remain active. This brings forth a lot of responsibility on the implementing agencies and their agents to maintain continuous relationship with the villagers.
- Monitoring Activities of Financial Inclusion Agents : In order to keep a tab on the functioning of the agents the implementing agencies should regularly and closely monitor their performance against some rationally determined targets.

- Training to Financial Inclusion Agents : The Financial Inclusion agents should be adequately trained on a continuous basis about the products and services provided by banks from time to time.
- Women Empowerment : Last but not least, women empowerment is another sine *qua non* for the success of Financial Inclusion movement.
- Banks should prepare comprehensive plans to cover all villages, through a mix of branchless banking and bricks and mortar branch banking. They should speed up enrolment of customers and opening of UID-enabled bank accounts. It envisages putting in place a system that enables routing of all social benefits to bank accounts electronically as also seamless cash transfer to the poor, as and when the government replaces the system of subsidy and public distribution system with cash transfers.
- 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.
- As mentioned earlier, banks must provide a minimum four products - a no-frills savings account with an overdraft facility, a pure savings product, entrepreneurial credit and remittance services, and new products tailored to income streams of poor borrowers and according to their needs and interests. Banks must be able to offer the entire suite of financial products and services to poor clients at attractive pricing.
- Though the cost of administering small-ticket personal transactions is high, this can be brought down if banks effectively leverage Information and Communications Technology solutions. This can be attained through product innovation with superior cost efficiency. They must understand and penetrate the rural markets efficiently to cross-sell products and services. Mobile banking has tremendous potential and the benefits of m-commerce need to be exploited.
- It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc., is available. All stakeholders will have to work together through sound and purposeful collaborations. Local and national-level organizations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and impact.
- This collaborative model will have to tackle exclusion by stimulating demand for appropriate financial products, services and advice with the appropriate delivery mechanism, and by ensuring that there is a supply of appropriate and affordable services available to those that need them.
- Mindset, cultural and attitudinal changes at grass roots and cutting-edge technology levels of branches of banks are needed to impart organizational resilience and flexibility. Banks should institute systems of reward and recognition for personnel initiating, ideating, innovating and successfully executing new products and services in the rural areas.
- Greater collaboration is also imperative to mitigate the numerous other risks arising out of this new form of banking, such as brand protection; preventing frauds and delinquencies by BC staff or agents; preventing mis-selling; protecting consumer data; and ensuring business continuity and disaster recovery.

Conclusion

Empirical evidence shows that economic growth follows financial inclusion. Boosting business opportunities will definitely increase the gross domestic product, which will be reflected in our national income growth. People will have safe savings along with access to allied products and services such as insurance cover, entrepreneurial loans, payment and settlement facility, etc.

Our dream of inclusive growth will not be complete until we create millions of micro-entrepreneurs across the country. All budding entrepreneurs have to face these challenges and find solutions. People working in the social sector should work for filling up the deficit existing in the economic and social arena.

To sum up, financial inclusion is the road that India needs to travel towards becoming a global player. Financial access will attract global market players to our country and that will result in increasing employment and business opportunities. Inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social purpose.

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The Set of Proposed Policy Reforms for G-SIBs

The Financial Stability Board (FSB) and the Basel Committee have finalised a set of proposals for managing crises at SIFIs and reducing their impact. The policy measures include :

- A new international standard as a point of reference for reforms of national resolution regimes, to strengthen authorities' powers to resolve failing financial firms in an orderly manner and without exposing the taxpayer to the risk of loss;
- Requirements for resolvability assessments, recovery and resolution plans and institution-specific cross-border co-operation agreements for G-SIFIs;
- Requirements for additional loss absorption capacity above the Basel-III minimum for G-SIBs; and
- More intensive and effective supervision through stronger supervisory mandates and higher supervisory expectations for risk management functions, risk data aggregation capabilities, risk governance and internal controls.

The Basel Committee has proposed a methodology for identifying G-SIBs and prudential safeguards designed to decrease the probability of distress and failure by increasing their loss-absorbing capacity. The indicators selected reflect the size of banks, their interconnectedness, their degree of substitutability (i.e. the presence or lack of readily available substitutes for the services they provide), their global (cross- jurisdictional) activity and their complexity. The methodology was applied initially to a set of 73 banks and an initial group of 29 has been identified as global systemically important (the list has since been published by the FSB). Going forward, the list of G-SIFIs will be updated each year in November.

The G-SIBs identified by these parameters will then be divided into four categories ('buckets') in increasing order of systemic importance and subjected to capital surcharges ranging from 1 per cent for the first category to 2.5 per cent for the fourth. A fifth 'bucket', currently empty, is also envisaged with a surcharge of 3.5 per cent, to provide an incentive for banks to avoid becoming more systemically important. The judgement of the supervisory authorities plays a role in the banks' classification, but only in exceptional cases can such judgement override the indicator-based measurement approach.

The additional loss absorbency requirement must be met out of common equity tier-1 capital only. However, contingent capital instruments can be used to meet any national loss absorbency requirements set above the global level at the national supervisors' discretion.

The new rules on the surcharge will come into effect in January 2019 following a transition period beginning in 2016. These will be applicable to those banks identified in November 2014 as G-SIFIs. The resolution-related requirements will, however, be applicable to the initial set of 29 banks and will need to be met by end-2012.

Source : Financial Stability Report, December 2011.

Beyond Hoopla : Simply Financial Inclusion

Jatinder Handoo *

Financial Inclusion : A Policy Priority or Chaotic Confluence?

What next of financial inclusion? This seems to be an obvious question when there is a deceleration in the momentum for engaging different segments of un(der) banked customers at bottom of the pyramid, primarily because different stakeholders in financial inclusion value chain have different answers to the common question of financial exclusion. Public Policy vouches financial inclusion as a national priority and the mainstream financial institutions in India carry the baton (albeit with a caution). In-spite of the proclaimed priority of financial inclusion, financial exclusion in India seem to be widening and the on going efforts hurtling amid theatrical debates and confabulations over multiple front end devices, ultra-low cost delivery models, razor thin transaction costs and innovative pilots. If all this has helped anything, it is the confusion and chaos in attempt of reinventing the wheel and therefore aided the 'inclusion hiatus' which a developing country like India can ill afford. A quick snapshot of status of financial exclusion explains the story. (Table below)

FI Parameter	Percentage
Account at formal financial Institution	35%
Account at a formal financial institution, income, bottom 40%	27%
Accounts used to receive wages	8%
Accounts used to receive Govt. payments	4%
Loans from a financial institution in past year	8%
Loans from family or friends in past one year	20%
Source : The World Bank, FIndex 2012.	

Merely 35% of the Indian adults (above the age of 15 years) have a bank account and the percentage is even low in the bottom 40% says recently released World Bank FIndex 2012. According to the FIndex 2012 report, prominent barrier to use formal bank accounts (globally) is not the absence of ultra low cost technology or absence of identification documents but having “not enough money” to save.

This may be due to erratic cash-flows of poor households or simply the absence of financial literacy among end customers. This has little to do with the innovative authentication systems, front end related debate and online-offline model talks which seem to be flavor of the inclusion parleys at the highest echelons of business and policy. If financial inclusion needs anything, it is direct engagement with the last mile customer by offering appropriate financial products and services including financial literacy.

* Manager of Strategic Alliance, FINO.

Beacon of Financial Inclusion : Reserve Bank of India - "The Liberal Regulator"

In the year 2005, the then RBI Governor Dr. Yaga Venugopal Reddy coined the term financial inclusion and the vision of social inclusion of un(der) banked poor and vulnerable masses gained momentum. The idea was to handhold un(der) banked into mainstream banking network, link them with the grid of formal financial system and offer them access to finance through a bouquet of multiple products and services including savings, insurance, Electronic Benefit Transfers (EBTs), credit and not just popular services like P2P remittances.

In order to realise this goal, RBI in 2006 allowed banks to utilize services of Business Correspondents (BCs) and Business Facilitators (BFs) which was a watershed step in accelerating financial inclusion agenda in India, as in history of the Indian banking system, financial institutions never went to the doorstep of customer (particularly rural customers) to offer banking services; RBI made it happen!

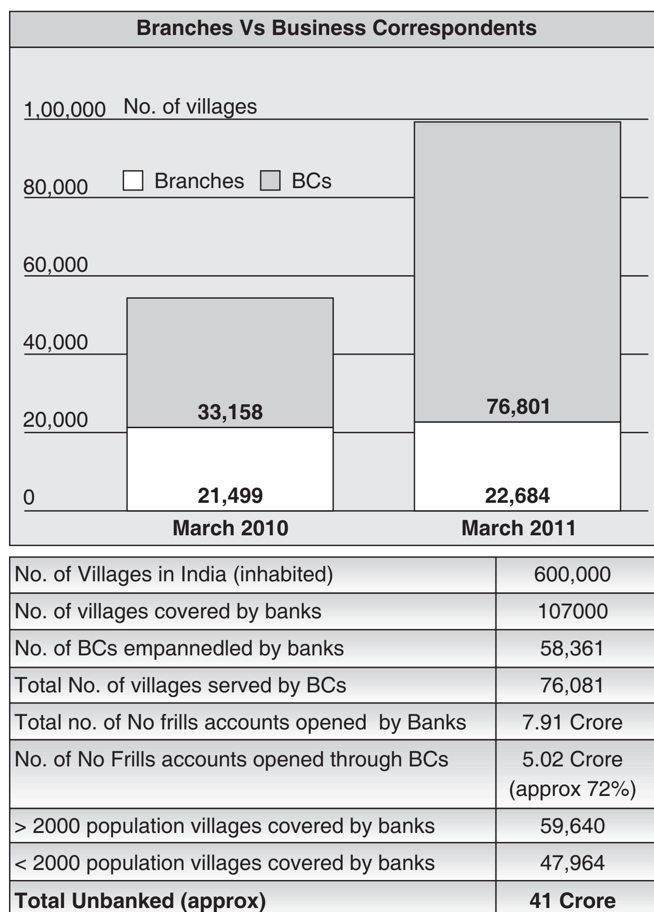
RBI played the role of a proactive and liberal regulator over the period of time. It facilitated and even expanded scope of BC guidelines from time to time. RBI's response was dynamic and accommodating, particularly in 2010 when it permitted for-profit business entities to offer BC services.

All the good intentions of RBI along with policy push from Government of India have yielded results and BC's have put up an impressive show. However, ironically before the model (BC) could stabilize, a chaotic confluence of devices, technology, usability and viability debate has besieged the model and has created an inclusion vacuum in the system. Most of the mainstream financial institutions are being too cautious and follow compliance related objectives of financial inclusion which primarily involves offering No Frills Savings Accounts (NFAs) to end customers.

Interestingly a NFA in itself is not just a financial product but a financial menu card with a purpose to connect end customers with customized financial products & services. Unfortunately, in the current scenario menu is available not products, making it uninteresting for end-customers which ultimately has resulted into increased dormancy levels.

Last Mile Changemakers : Business Correspondents in India

Business Correspondent model as an alternate banking channel has brought a conspicuous change in the financial inclusion landscape of India. For the last five years, agent based BC model has played a pivotal role in furthering agenda of financial inclusion across nooks and corners of the country. From just 30,000 banking outlets in about 600,000 villages in India (5% penetration), BCs have helped in increasing the banking penetration to more than 1.07 lakh villages (around 20%). Out of around 80 million No Frills Accounts (NFAs) opened by banks, BCs have opened 50 million (around 72% of total NFAs). The table below shows the status of financial inclusion in numbers.



No. of Villages in India (inhabited)	600,000
No. of villages covered by banks	107000
No. of BCs empannedled by banks	58,361
Total No. of villages served by BCs	76,081
Total no. of No frills accounts opened by Banks	7.91 Crore
No. of No Frills accounts opened through BCs	5.02 Crore (approx 72%)
> 2000 population villages covered by banks	59,640
< 2000 population villages covered by banks	47,964
Total Unbanked (approx)	**41 Crore**

Source : RBI, 2011.

At a time when reams are being written on viability part of BCs and various players are toying with multiple ideas it is worth mentioning that the target populations for which BC model has been designed have proved themselves as "bankable and profitable". Illustrations could be borrowed from microfinance model of Grameen Bank of Bangladesh and Prof. Prahlad's theory of Gold at Bottom of the Pyramid for FMCG products.

On the issue of viability, we should not forget Regional Rural Banks (RRBs) story in India. RRBs were established as vehicle of financial inclusion in 1976, with the purpose to support credit led model of financial inclusion and support green revolution. Even though RRBs were jointly funded by Central and State Governments and sponsored by lead banks, break even period for RRBs was envisioned six to seven years, what are the reasons for us being impatient in case of BC model? In case of BCs such a support and patience seems to be vanishing.

It needs to be appreciated because of the fact that BC model is the only (non-community based) savings based model with an inbuilt functionality to offer diversified bouquet of financial services and products at door-step of last mile customers.

In India the BC model has a deeper and wider role-play in enabling total inclusion. However the actions which would expedite universal financial inclusion are changes in outlook of mainstream financial institutions from compliance based objectives to business based objectives. This means directly engaging end customers by offering multiple products over NFA menu and finally, a coherent scheme of implementation in tandem with vision of social inclusion without re-inventing the wheel.

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Foreign exchange instruments

FX volume surveys report turnover by instrument. Instrument types include the following :

Spot transactions are single outright transactions that involve the exchange of two currencies at a rate agreed to on the date of the contract for value or delivery within typically two business days.

Outright forwards involve the exchange of two currencies at a rate agreed to on the date of the contract for value or delivery at some time in the future. This category also includes forward Foreign Exchange Agreement (FXA) transactions, Non-Deliverable Forwards (NDFs) and other forward contracts for differences.

Foreign exchange swaps involve the exchange of two currencies on a specific date at a rate agreed to at the time of the conclusion of the contract, and a reverse exchange of the same two currencies on a future date at a rate agreed to at the time of the contract. For measurement purposes, only the long leg of the swap is reported, so that each transaction is recorded only once.

Currency swaps involve the exchange of fixed or floating interest payments in two different currencies over the lifetime of the contract. Equal principal based on the initial spot rate is typically exchanged at the beginning and close of the contract.

Currency or foreign exchange options are contracts that give the right to buy or sell a currency with another currency at a specified exchange rate during or at the end of a specified time period.

Source : BIS Quarterly Review, March 2012.

Need for strategic shift in the Management of Non Performing Assets in the Indian Banking industry

Dr. K. Srinivasa Rao *

Lending is one of the strategic business verticals of banks. Therefore logically the management of recovery of loans also becomes an integral part of bank's operations. Thus credit management has two critical dimensions, lending and recovery. The level of dud loan assets at any point of time reflects the operational efficiency of banks in managing the quality of loan portfolio. The asset quality is a function of the economic situation. For example, in a rising interest rate curve, the asset quality in banks has been assuming more significance. The performance results of banks in Q3 of FY 12 announced recently indicate that the gross and net Non Performing Assets (NPAs) of the Banks are going northwards, causing concern to the mandarins of the financial sector. Earlier, one of the driving factors for downgrading the rating of SBI has been the higher delinquency in the loan portfolio that eats into profitability and return to the stake holders. The government and the regulators have also been airing their views on the need to tone up monitoring and follow up mechanism to improve the quality of assets. Restructuring and rescheduling of loans, extending the repayment period, have gained attention to ensure that the quality of assets is maintained.

Introduction :

The financial stability and soundness of banks in the long term depends on the quality of assets. The profitability and stake holder value will also depend upon the breakup of asset quality. The better the quality of the assets, the lesser the provisions. Lesser the provisions, more the profits. Hence from the point of sustainability of profits, asset quality becomes more important. Therefore a serious review of the present methods and measures to manage the asset quality has assumed much more significance.

Status of NPAs in banks :

Across the banking industry, the quantum of NPAs is rising at a faster pace at a time when the growth in Asia's third largest economy shows sluggishness. The gross NPAs of 34 listed banks have increased to ₹76,644 crores as at 31/12/2011 effectively raising the incremental NPAs by a whooping 30.51 per cent y-o-y. It shows an increasing trend. The incremental rise in NPAs for this set of banks has been 17.81 per cent in March 2011 that went up to 19.14 in June, 2011 and 28.29 per cent in September 2011 showing steep rise quarter after quarter calling for more provisions at the cost of profitability. SBI, the biggest bank had posted a gross NPA level of 4.61% and net NPAs of 2.22% in Q3 of FY12. High inflation and successive rate hikes have raised interest burden on the corporate sector making it difficult for them to service loans pushing up the NPA levels. Such upsurge in NPA levels is a cause of concern for all calling for better asset management strategies.

The impact of the economy on the asset quality :

In an increasingly globalising economy, the quality of assets in the banks is influenced by the events and happenings in the economy and peaks and lows of business cycles. Banks can take cue from every such influencing event to upgrade the follow up systems to maintain better quality of assets, more so in times of recession.

In order to illustrate the impact, it can be recalled that the collapse of Lehman Brothers in 2008 led

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to a historic global recession that sparked turbulence in banking system too. The economic downturn led to business slowdown that perhaps eventually contributed to higher delinquency rates in some of the banks aggravating the concern for quality of assets. Though the impact of recession has been low in India, the Gross Domestic Product (GDP) fell from an average of 8.8 percent during 2003-08 to 6.7 percent in 2008-09. Though it rose to 8.6 in 2010-11, it may again fall to around 6.9 to 7 per cent in 2011-12. The downward trend is due to high inflation; higher interests rates and slow down in the capex and productivity levels in certain sectors. In this background, keeping in view the significance to strengthen the monitoring mechanism of NPAs, the paper seeks to study the prudential measures, trends of NPAs, present mechanism of managing NPAs in banks and to suggest strategic shift to improve the quality of assets in banks.

The study is bifurcated into five broad sections. Section-I deals with the review of prudential guidelines on NPA management. Section-II discusses the trends of NPAs in banks and maps the quality of loans. Section-III discusses the challenges and dynamics in the management of NPAs. Section-IV highlights strategic shift to more effectively manage the quality of assets. Section-V focuses on concluding thoughts and limitations of the study.

Section - I

Macro perspectives of prudential norms :

The theoretical aspects of prudential standards call for asset classification, provisioning and income recognition. While classification of an asset is vital to determine the level of provisions, the income recognition system which is now shifted from 'accrual basis' to 'realisation basis' is important from the profitability angle. In India, the prudential standards in respect of asset classification have been gradually made more stringent and dynamic by RBI in line with the international standards. As a result, banks have begun to implement these stringent regulatory prudential standards to improve their asset quality.

1. Genesis of prudential norms :

A set of prudential norms relating to asset classification was put in place in terms of the recommendations of Narasimham Committee-I (1991) well calibrated to suit the Indian banking system. An analysis of its application in managing the asset quality will be interesting. The implementation of gradually upgraded prudential norms - asset classification, income recognition and provisioning made all the difference in determining the composition of NPAs in banks. Due to the new NPA norms, the financial sector was more legally empowered to enforce recovery of loans with the formation of Debt Recovery Tribunals (DRTs), enactment of SARFAESI Act-2002 and formation of Lok Adalats. Provision for newer avenues for out of court settlements of loans through compromise, discussions and negotiations speeded up recovery process.

In order to create depth of market for secondary sale of NPAs, Reserve Bank of India (RBI) had permitted secondary sale of NPAs. Accordingly, Asset Reconstruction Companies (ARCs) have been formed to take over the NPAs of banks. ARCs manned by experts in law and valuation of assets are well equipped to realise better value from NPA accounts. The upfront realisation of value of NPAs helped banks to improve liquidity and reduce the burden of maintaining capital adequacy ratio. Similarly enforcement agencies have started undertaking the job of taking possession and maintaining securities on behalf of banks till they are disposed of and bank dues are recovered. These developments led to creation of better loan recovery climate. Moreover, the increased awareness to maintain better quality of assets led to more organised follow up systems and an improved alertness that helped banks to better contain NPAs.

2. Asset classification norms :

Post bank reforms, the policy of income recognition has become more objective and is based on record of recovery rather than on any subjective considerations. Likewise, the classification of assets of banks is now

done on the basis of objective criteria which would ensure a uniform and consistent application of norms. Also, the provisioning is made on the basis of the classification of assets based on the period for which the asset has remained non-performing and the availability of security and the realizable value thereof.

Accordingly while granting loans and advances, banks take into account the realistic repayment schedules fixed on the basis of cash flows of borrowers. These norms have now gone a long way to encourage prompt repayment by the borrowers and thus improved record of recovery in advances.

Criteria to assess Non-Performing Assets (NPAs)

1. An asset, including a leased asset, becomes non performing when it ceases to generate income for the bank.
2. A Non Performing Asset (NPA) is a loan or an advance when;
   - i. interest and / or instalment of principal remain overdue for a period of more than 90 days in respect of a term loan,
   - ii. When the bill remains overdue for a period of more than 90 days in the case of bills purchased and discounted,
   - iii. The instalment of principal or interest thereon remains overdue for one crop seasons for short duration crops,
   - iv. The instalment of principal or interest thereon remains overdue for one crop season for long duration crops,
   - v. The amount of liquidity facility remains outstanding for more than 90 days, in respect of a securitization transaction.
   - vi. in respect of derivative transactions, if the overdue receivables representing positive mark-to-market value of a derivative contract, remain unpaid for a period of 90 days from the specified due date for payment.

Banks, as per the above criteria, classify the accounts as NPA.

3. Restructuring facilities for loan accounts :

Following the global financial turmoil experienced in 2007, the RBI issued guidelines in August, 2008 allowing banks to restructure accounts of viable entities classified as standard, sub-standard and doubtful. Though it was prescribed in August, 2008 that accounts classified as standard assets should be immediately re-classified as sub-standard assets upon restructuring, in January, 2009, an exceptional / special regulatory treatment was granted to all accounts, which were standard as on September 1, 2008, permitting them to be treated as 'Standard' subject to certain conditions.

The special regulatory treatment allowed to the standard accounts helped the banking sector to limit the growth of gross non-performing advances. However, there was always a concern that these restructured standard accounts may at any time slip into the substandard category. Data on restructured accounts since September, 2008 indicate a gradual rise in the same.

Table - I : Impact of Restructuring on Asset Quality of SCBs

(Amount in ₹ Crores)

Particulars	March, 2009	March, 2010	March, 2011
Total Gross Advances	27,93,572	32,71,896	40,12,079
Standard Advances	27,25,350	31,90,080	39,17,991
Of which Restructured	60,379	97,834	1,06,859
Total Gross NPAs	68,222	81,816	94,088
Total Gross NPAs to Total Gross Advances	2.44	2.50	2.35
Restructured Standard Advances as % of Gross Advances	2.16	2.99	2.66

(Source : Reports on trend and progress of banking in India for the years 2008-09 to 2010-11, The Annual Publications of Reserve Bank of India, Mumbai)

The data indicate that along with NPAs, the restructured advances have gone up raising the level from 2.16 per cent as on March 2009 to 2.66 per cent as on March 2011. Thus, the banks have been providing relief to the borrowers by restructuring the advances accounts.

4. Provision Coverage Ratio :

Further, as part of RBI agenda to step up prudential standards, it had prescribed a Provision Coverage Ratio (PCR) of 70 per cent of NPAs. There was no prescribed PCR for banks in the past. On the whole, banks had 56 per cent PCR in Sept 2009 which needed an additional provisioning of around ₹13,000 crores to reach the level of 70 per cent, the prescribed benchmark. Looking to the practical difficulties encountered by banks, RBI seems to have decided to review its stand on the PCR norms which are awaited.

5. Tightening of other provisioning norms :

In addition, RBI had increased the general provisioning against standard assets on commercial real estate loans from 0.40 per cent to 2.00 per cent needing substantial additional provisions. Similarly, the home loans of ₹75 lacs and above sanctioned on teaser rates need to have a higher risk weight of 125 per cent. The loan to asset value has been raised to a minimum of 80 per cent to curb indiscriminate lending without adequate margins. RBI has been gradually improving the prudential standards in credit administration to bring a qualitative transformation of assets. Since the loan book is stronger in India, the prudential standards are mostly related to credit governance. A quick review of various prudential measures discussed in this section helps in understanding the macro environment of prudential standards applicable to banks.

Section - II

Track record of asset quality in banks :

A study of the past data, in the background of prudential guidelines implemented in banks so far, shows the magnitude of NPAs and quality of assets. Such assessment will help in carving out newer methods to control NPAs in banks.

1. Data on the trends of NPAs :

In this background, let us analyse the shift in the trends of quality of loans to work out suitable strategies for keeping a close tab on the portfolio in the larger interest of profitability and consistency in the growth. The trends in the NPAs of the last five years are set out in the following tables.

Table - II : Trends of Non-Performing Assets (NPAs) of Banks - Group-wise (2006-07 to 2010-11)

(Amount in ₹ Billion)

	2006-07	2007-08	2008-09	2009-10	2010-11
Scheduled Commercial Banks (SCBs)	502.99	564.35	683.28	846.98	979.22
Public sector Banks (PSBs)	389.68	405.95	449.57	599.26	746.14
Old Private Banks	28.10	25.57	30.72	36.22	36.99
New Private Banks	62.86	104.26	138.54	140.17	145.41
Foreign Banks	22.33	28.56	64.44	71.33	50.68

(Source : Reports on trend and progress of banking in India for the years 2006-07 to 2010-11, The Annual Publications of Reserve Bank of India, Mumbai)

The data clearly indicates that the NPAs in absolute terms are on rise which may be due to the normal growth in advances of banks. Even then attempts are to be made to contain the NPAs. Despite the rise in business levels, banks have to ensure that the pace of increase in NPAs is not more than the tolerable level of risk appetite set against the incremental rise in the portfolio. A tab on the acquisition of new business and slippage in advances has to be relatively monitored to ensure a consistent improvement in the quality of advances.

Table - III : Trends in Gross NPAs / Gross Advances (2006-07 to 2010-11)

(In Percentage)

	2006-07	2007-08	2008-09	2009-10	2010-11
SCBs	2.70	2.40	2.31	2.39	2.25
PSBs	2.80	2.30	2.01	2.19	2.23
Old Private Banks	3.10	2.30	2.36	2.31	1.97
New Private Banks	1.90	2.50	3.06	2.87	2.33
Foreign Banks	1.90	1.90	4.30	4.26	2.54

(Source : Reports on trend and progress of banking in India for the years 2006-07 to 2010-11, The Annual Publications of Reserve Bank of India, Mumbai)

Table-III provides a trend of gross NPAs which are going down except in foreign banks and new private banks, may be due to their different risk appetite. In order to keep the gross NPAs under control, different banks adopt different strategies and set their risk appetite levels accordingly. The SCBs

could reduce the level of gross NPAs by 45 basis points whereas it is dropped by 67 basis points in PSBs in the last five years. This is a good achievement considering the rise in the level of advances. If the loan policy and recovery policy in banks are broadly aligned with the philosophy of keeping the up-trend in the quality of assets and if effective internal surveillance systems are kept in place, the gross NPAs can be more effectively monitored.

As far as the levels of net NPAs are concerned, it depends on provision levels. It has two aspects. Mandatory provisions are maintained as per the RBI guidelines and additional provisions are made as per individual bank's own prudential policy and its ability to maintain them beyond the minimum prescribed levels. This enables banks to bring down their net NPAs, a healthy competitive indicator.

Table - IV : Trends in Net NPAs / Net Advances in Banks (2006-07 to 2010-11)

(In Percentage)

	2006-07	2007-08	2008-09	2009-10	2010-11
SCBs	1.00	1.00	1.05	1.11	0.97
PSBs	1.10	1.00	0.94	1.09	1.09
Old Private Banks	1.00	0.70	0.90	0.78	0.53
New Private Banks	1.00	1.20	1.40	1.08	0.56
Foreign Banks	0.70	0.80	1.81	1.82	0.67

(Source : R*eports on trend and progress of banking in India for the years 2006-07 to 2010-11, The Annual Publications of Reserve Bank of Ind*ia, Mumbai)

The data in Table-IV provides information on net NPAs as percentage to total advances. A marginal drop could be seen in SCBs and PSBs whereas new private banks and old private banks could record steep fall their NPA levels. The banks could thus ensure that the rise in business levels do not lead to rise in delinquency levels. Depending on the bank's ability to make provisions beyond the minimum standards, the levels of net NPAs can be brought down. In order to make provisions beyond the suggested prudential standards, better management of profitability is needed.

In a nutshell, the asset quality is a function of sustained efforts of banks to build a portfolio in the given economic, business and legal environment. It can be recalled that the gross NPAs of the SCBs, which were as high as 15.7 per cent as at 31st March 1997, declined significantly to 2.39 per cent as at 31st March 2010. The net NPAs of these banks during the same period declined from 8.1 per cent to 1.12 per cent. These figures too compare favourably with the international trends and have been driven by the improvements in loan loss provisioning by the banks, as also by the improved recovery climate enabled by the legislative enactment after bank reforms were put in place. It is noteworthy that the NPA ratios have recorded remarkable decline despite the progressive tightening of the asset classification and provisioning norms by the RBI over the years.

The whole set of data on the trends of gross NPAs points out that banks are doing well to keep control on the quality of assets but a lot more needs to be planned to achieve better results. As a measure of best practice, banks can plan to keep the net NPAs below the one percent benchmark and reorient the entire follow up and internal provisioning policy accordingly. But it depends on a combination of factors, more importantly the enabling environment for recovery of loans. Moral suasion and anxiety to protect image and public reputation also reinforces the loan repayment culture. CIBIL, a forum of RBI to share information on the track record of borrowers contributes a great deal in preventing loan defaulters. Similarly, good borrowers do not want their track record of repayment to be interrupted. The trends of recovery by various methods provide the effectiveness of the available methods of recovery.

2. Recovery trends in NPAs :

If all attempts of up-gradation and restoration of NPA accounts fail, banks use different methods for recovery of loans. Depending on the type of loans and underlying security, banks take suitable recovery measures. The pattern of outcome of recovery efforts provides a clue as to the effectiveness of each mode of recovery.

Table - V : NPAs Recovered from various channels (2006-07 to 2010-11)						
(Amt. in Rs. Crores)						
Mode of recovery	**Target amount / Actual recovery**	**2006-07**	**2007-08**	**2008-09**	**2009-10**	**2010-11**
1. Lok Adalat	Target amount	758	2142	4023	7235	5254
	Cash recovery	106(14%)	176(8.2%)	96(2.4%)	112(1.5%)	151(2.9%)
2. Debt Recovery Tribunals	Target amount	9156	5819	4130	9797	14092
	Cash recovery	3463(37.8%)	3020(51.9%)	3348(81.1%)	3133(32%)	3930(27.9%)
3. SARFAESI Act	Target amount Cash recovery	9058	7263	12067	14249	30604
	Target amount Cash recovery	3749(41.4%)	4429(61%)	3982(33%)	4269(30%)	11561(37.8%)
The percentage figures in brackets indicate the portion of amount recovered against the quantum of dues.						
(Source : Reports on trend and progress of banking in India for the years 2006-07 to 2010-11, The Annual Publications of Reserve Bank of India, Mumbai)						

It can be observed from the data in Table-V that invocation of SARFAESI Act - 2002 and use of DRTs could help expedite loan recovery, but a lot needs to be achieved. As soon as an account is classified as sub-standard, all out efforts are made to get it upgraded. If such attempts do not fructify, recovery measures are initiated. Depending on the underlying security and assets charged to the bank, a suitable recovery mode is selected and pursued. The legal mode of recovery is the last resort as it is still very tardy and time consuming. Keeping in view the net present value of money, banks increasingly attempt compromise and out of court settlements which is relatively less time consuming. But looking to the percentage of recovery made through DRT invoking the SARFAESI Act - 2002, they are definitely more effective. Timeliness and steadfast follow up of recovery actions can improve the performance.

3. Provisions against NPAs :

It can be observed from the data that while the gross NPAs and Net NPAs have come down compared to the initial period of bank reforms, of late, they are again looking up putting added strain on the profitability of banks. Banks vigorously follow up after classification of any advance into substandard, doubtful and loss as the case may be, but there could be scope for more action in the management of advances accounts when they are still in the standard category. A more systematic surveillance and more internal review of health of loan accounts at a quicker pace when they are still in standard category can help prevent slippage of assets to a large extent. The provisioning norms of RBI are however set to be tightened in line with the international practices, more particularly in the light of the recent financial crisis. Banking system has been gearing up for more stringent norms and is improving its systemic controls.

We can take a cue from the perception of the central bank. According to Ms. Usha Thorat, Former Deputy Governor, RBI "While RBI has directed banks to achieve at least a PCR of 70 per cent for NPAs, we are also working on a scheme based on the Spanish dynamic provisioning model for evolving norms for provisioning for standard assets in different sectors based on time series and cross sectional data. Such provisions envisage setting aside profits in good times which can be used in down turn and provide greater comfort from financial stability perspective when the economy is pushing forward for higher growth".

The views of RBI provide enough hint that in future banks should be able to work in a dynamic provisioning environment with reference to their exposure to various sectors and their interdependent risk factors. The profitability should be robust enough to absorb enhanced provisioning in future.

Coming to the present context, it will be pertinent to look at the trends of the provision coverage ratio of banking sector that reflects on the preparedness of banks to make additional provisions in line with the RBI policy to reach 70 per cent mark.

Table - VI : Provision Coverage Ratio of Banking Industry (2006-07 to 2010-11)					
(In % to gross NPAs)					
	2006-07	**2007-08**	**2008-09**	**2009-10**	**2010-11**
SCBs	56.10	52.60	52.10	51.50	55.20
PSBs	56.80	52.20	50.50	47.40	49.20
Old Private Banks	66.00	64.90	59.40	61.30	66.70
New Private Banks	49.10	51.40	54.90	62.70	76.20
Foreign Banks	51.10	51.70	53.80	58.70	75.10

(Source : Reports on trend and progress of banking in India for the years 2006-07 to 2010-11, The Annual Publications of Reserve Bank of India, Mumbai)

The trend of PCR has been showing a downward swing in the last five years as there has been no compulsion to maintain a higher ratio. It was up to the individual banks to have their own policy to bring down their net NPAs. The PCR bridges the gap between gross and net NPAs. A higher PCR helps in lowering net NPAs. The global best practice is to move towards 100 per cent PCR to make net NPAs nil, but in a large country like India with a wide divergent portfolio of loans, it will be difficult to move towards it. Even a 70 per cent PCR target is highly challenging. The profits will be badly hurt if future slippages of loan accounts are steep. Hence, it is all the more important to keep a close watch on the quality of assets.

Section - III

Approach of banks in the management of asset quality :

In the current context, though the approach of banks in managing NPAs is focused more after the slippage happens, lot of proactive preventive action is needed to avert the slippage. But the strategic shift in approach calls for more important action in managing quality of assets while they are still performing well. The composition of standard assets of the last five years in banking industry will unfold the trends to work out more striking strategies to tackle the issue of keeping the assets of banks performing.

Table - VII : Trends in Standard Advances of banking industry (2006-07 to 2010-11)					
(In Percentage)					
	2006-07	**2007-08**	**2008-09**	**2009-10**	**2010-11**
SCBs	97.30	97.60	97.69	97.61	97.75
PSBs	97.20	97.70	97.99	97.81	97.77
Old Private Banks	96.90	97.70	97.64	97.69	98.03
New Private Banks	98.10	97.50	96.94	97.13	97.68
Foreign Banks	98.10	98.10	95.70	95.74	97.46

(Source : Statistical Tables relating to Banks in India 2008-09 - RBI Publication : Reports on trend and progress of banking in India for the years 2006-07 to 2010-11, The Annual Publications of Reserve Bank of India, Mumbai)

It can be observed from the data of standard assets of PSBs forming a major part of SCBs that they are on improving track but new private banks and foreign banks are marginally different. Again the concentration of banks depends on their business model. Some banks focus more on non-fund business and fee income. But traditional banks thrive on fund based business and interest income calling for full focus on asset management.

1. Existing approach in the management of assets :

With the spurt in banking business and rise in asset volumes, management of standard assets are becoming more important. The post sale service, care and concern for nurturing a healthy portfolio require concerted efforts and better monitoring systems. Keeping in view the sensitivity of interdependencies of industry and trade with the market dynamics, a broader vision is needed to support borrowers at the right time. A macro view, more sensitive mechanism to capture global / domestic signals will help banks to better monitor the quality of assets.

2. Architecture of credit management System in banks :

Most banks have a well structured Credit Management System. This needs to be further strengthened to manage it more effectively. Both lending and recovery were usually looked after by credit department. But with the onset of prudential norms, banks have made it into two distinct departments' the 'credit' and 'recovery' at the Regional / corporate levels. With the diversification of business profile, there could be a host of subdivisions in

the banks to manage new found lines of business to handle exclusively retail, MSME, agriculture, whole sale credit, international trade etc depending on the volumes of business of each segment and size of the bank.

The structure now needs a review to effectively manage wide and diverse credit portfolio. With borrowers becoming more price and service sensitive, it is necessary to devise a mechanism for handling loans at three distinct stages.

Section - IV

Strategic shift proposed to improve assets quality :

Moving away from the traditional follow up mechanism of asset quality, banks will have to carve out innovative strategies to step up surveillance. When the business volumes are on the rise and complexities of credit structure is changing, the style and approach of managing the portfolio needs improvement. The system driven asset classification did through technology channel (using core banking solutions) makes available a host of data which could be analysed to intervene at the right time.

The strategic shift :

It can broadly consist of 'the pre-sale' (marketing of loan products) before lending is made, 'the post sale' (servicing of standard assets) after lending is made, and the 'recovery' after delinquency is identified. Recovery efforts are also to be graded according to the stage of delinquency such as substandard, doubtful and loss. The approach of 'one action fits all' needs to undergo change. In view of more customised needs of existing and potential borrowers at each stage, different specialised approach and management skills are needed for more effective asset management. This can ensure using optimum synergy of people, deploying them on the right job. With the mounting resource pressure in the banking system, it is very essential to reform the organisational structure of asset management system in banks. While the data part should be driven entirely by technology and application of intelligence, negotiations, decision related activities should be handled by experienced banking personnel.

1. Asset Intelligence Unit :

In order to institutionalise a proactive follow up mechanism, it is suggested that banks have an Asset Intelligence Unit (AIU) to monitor the overall health of the portfolio. Stress tests; back testing, asset quality analysis, in house research on the industry performance, analysis of exposure, implications of industry performance on the portfolio and other surveillance tools be used to monitor quality of assets. Banks should closely interact with the merchant associations, industrial clubs, business houses, participate in their meetings and functions, understand their business cycles, identify pain points with an intention to trigger positive intervention. Such types of relationship bondage and connect with the commercial community and social integration can throw incipient signals critical for banks to act in time.

In the interest of financial stability, it is necessary that banks follow a more stringent internal policy in the asset governance preferably beyond the industry / global bench mark for better sustainability of quality of assets. This will require larger collaborative efforts with the active market players having similar pattern of exposures sharing industry information and developments. The new asset acquisition process at pre-sale stage must be separated from the post sale surveillance.

2. Fast track Rescue Division :

Similarly, the recovery function should have a separate fast track division only to deal with substandard assets having high potentiality for up-gradation. The type of soft skills, persuasive efforts, sometimes timely interventions to help the entrepreneur come out of bad patch should be worked out in the larger interest of the industry, economy and banking system. Banks are never interested in hastening the closure of business units. While the commercial consideration of fast recovery for banks is one aspect, the larger picture to protect the enterprise that supports employment and GDP generation should be kept in mind. This division should be able to apply specialised skills to turn the account into performing by infusing financial and technical support. Banks may avail the services of experts in working out a solution to revitalise the unit with the support of the entrepreneur. Maximum resources should be used to upgrade the account to protect the unit.

In a way hiving off a separate wing in recovery department is the need of the hour. It can be a fast track Rescue Division within the Recovery Division specialised in restoring the health of the unit / borrower. It can be manned by specialists who can help the entrepreneur to work out a suitable rescue plan so that the loan account could be upgraded. If all such supportive actions, persuasions during the one year life of an asset in substandard category do not yield the desired results, the stressed asset could be shifted to the main Recovery Division for further recovery action.

3. Organising granular data on NPAs :

During the time the efforts are on to upgrade the NPA, the data on such assets charged to the bank should be systematically collated into a support MIS. Many times, the recovery enforcing team finds difficulty in identifying the securities charged to the bank. It is necessary to have a location map, description of the unit, contact details of site / borrower / guarantors / co-bankers, latest valuation reports (where necessary), details of enforceability of mortgage, details of action taken by other member banks (if any), last inspection report and so on. Once the chances of revival are ruled out, any time lost in taking action will lead to deterioration in the asset value and its realisability. Therefore a great deal of data preparedness is needed to take prompt legal action.

4. Standardising Recovery action :

Though the recovery action depends on the type of NPA, the Recovery Division should have its own codified policy of Standard Operating Procedure (SOP) indicating a broad framework with defined time lines for each action to avert erosion in the value of underlying assets. Reasons for deviations can be recorded with proper approval of action to maintain consistency in policy. The recovery team should immediately get into suitable action evaluating various legal options such as invocation of SARFAESI Act - 2002, filing cases in DRT, approaching courts, filing recovery certificates etc.

The process of moving against guarantors, attaching personal properties, filing FIR against delinquent borrowers, using services of detectives for identifying linkages of wilful defaulters with other properties, availing services of lawyers, valuers, enforcing agencies, auctioneers and all other related activities need to be fully standardised and made time bound. The service level agreements with all related vendors / service providers for outsourced expertise should be well thought and documented. The actions for recovery should be put on auto mode with least human intervention. Progress of recovery action beyond a cut off limit should be run on mission mode. Each step should be tracked as a project mapping the actions / outcomes on a dash board so that accountability for delay can be identified. The action team can also work in shifts so that intensive follow up for recovery is possible. A view can also be taken to sell the NPAs in the secondary market to ARCs.

5. Quick sale of NPAs to Asset Reconstruction Companies (ARCs) :

This option need not necessarily be the last resort. It can also be considered as a good option to get better value for NPAs where banks are convinced that their own expertise may not be able to fetch the best value. Therefore, banks need to have operating policy to guide when to tap the option of selling the contaminated assets to ARCs. The recovery teams should not be left pondering over when to invoke the option. With the levels of advances going up, the systemic controls on standard advances and quick measures to recover funds from the contaminated assets are very important. Considering the net present value of money, it is more valuable to enforce quick recovery of NPAs today than waiting endlessly to recover more funds tomorrow.

6. Setting up call centres for small / mid size loans :

Similarly, banks may consider centralising of recovery of small / mid size loans. The cut off of amount may be decided by the banks depending on the size of portfolio. The strategy could be to set up call centres either manned by bank staff or outsourced. The moment branches refer the account to the call centre, action for recovery should begin so that staff at branches can continue to be engaged in servicing customers and recovery can be centralized. This will help speed up recovery of small loans and decongest the branches with the retail recovery work.

In accelerating the overall pace of recovery of loans, it is necessary to trigger action gradually but very consistently to achieve better results. In this context it will be pertinent to mention views from a book "The Tipping Point : How Little Things Make a Big Difference", by Malcolm Gladwell. The views of the book suggest that many large changes sometimes happen in a hurry and they may not be the best. Whereas there is usually a step by step, gradual process of little changes taking place which can acquire a tipping point of success. In order to improve the quality of assets, there is need of such change and well laid out SOPs (Standard Operating Procedures) to act in time. Banks are perhaps at the tipping point to reorganise their architecture of asset governance to maintain better quality. The macro management of assets need to be reviewed to meet the current challenges for a sustained asset quality.

Section - V

Conclusion :

The discussions recapitulate the gist of prudential standards, analyses the data of the NPAs in banks in the last few years, reviews the common methodology followed in banks more particularly, in Public Sector Banks to monitor the asset quality. The study also makes a set of strategic suggestions to improve the asset quality. We can observe that banking sector witnessed an average 18 per cent rise in credit in the last few years. Thus the exponential rise in bank credit, spurt in number of loan accounts, diversification in the loan products with predominance of retail loans, home loans, rise in agriculture loans due to financial inclusion and broad based consumer segment clearly points towards massive rise in volumes. The emerging rise in infrastructure loans, more scope for MSME, export credit, corporate loans indicate that the volumes of loans will go up further. Moreover, the prudential norms are getting upgraded calling for better systemic controls and more foolproof surveillance of asset quality.

The government and RBI have in different forums stressed the need for improvement of the asset quality of banks. The challenges of rising volumes also indicate that banks must revisit their asset management systems and procedures to make them more aligned to handle larger and divergent portfolio. Asset quality is fundamental to nurture a strong, sound and robust financial system in the country so critical for sustained economic growth. Banks need to put in place improved asset monitoring architecture with the help of technology, upgraded skill sets, retained legal specialists, lateral hiring of recovery experts supported by well entrenched policy framework to guide the asset quality follow up mechanism.

In a highly competitive environment, the asset quality indicators like gross NPAs, PCRs, net NPAs, incremental delinquencies and so on will be the future barometers of performance of banks in maintaining asset quality. The strategic shift will help in making policy prescriptions to reinforce asset monitoring systems for future sustainability. The potential growth and loan volumes of the decade 2011-20 should always be kept in view in working out durable solutions for better asset quality.

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BOOK REVIEW

Name of Book : Target 3 Billion -- PURA : Innovative Solutions towards Sustainable Development.

Authors : Dr. A. P. J. Abdul Kalam & Srijan Pal Singh.

Publisher : Penguin Books India (P) Ltd., 11, Community Centre, Panchsheel Park, New Delhi 110 017.

Price : ₹ 200/-

Pages : 320

Reviewed by : V. Raghuraman

Sustainable development is the greatest economic challenge facing the world. Billions of people remain mired in abject poverty and need urgent assistance to meet even the most basic needs. They and their myriad problems are at the centre of the above book under review.

The book encapsulates Dr. Abdul Kalam's one mission / goal - eradicating poverty from the world and it offers valuable and innovative solutions for bringing about sustained development for the bottom half of the world's population. The authors' point out that the under-privileged 3 billion humanities in the globe are very important from policy-making, national governance and the corporate sector. The need for ensuring the prosperity and peace of humanity will, indeed, be an onerous task, requiring sustainable models of growth with added focus on employment generation.

Based on their first-hand experience of India's 600,000 villages, authors have attempted to integrate the challenges and opportunities available for the present generation and how they could be harnessed in a profitable way. They have proved the workability of a system whereby the Provision of Urban amenities in Rural Areas (PURA for short) can bring about the real potential of the rural masses. They further aver that in this 21st century we need to discover and have the 'fire of love' for the down-trodden, who incidentally, constitute half of mankind.

According to the authors, the socio-economic developmental issues and experiences of our villages with their 750 million people are " a perfect projection and assessment of what any global effort would reflect on a world-wide scale". Their plea for an integrated action plan for the country is based on the single theme : replace the hesitant, feeble voice of "can we do it?" with the assertive voice of "we can do it".

Elaborating the PURA concept, the authors argue that it is a well-planned drive towards achieving an "all inclusive growth, right from the village household level. All villagers should actively participate in this exercise, befitting their skills and capacities. Even a cluster of villages operating in the same terrain could be thought of. But co-ordination between various PURAs is a must whereby all of them would also benefit. For all the villages to be covered, some 7000 PURAs would be needed. Apart from concentrating on agriculture, PURA would emphasize on allied activities like agro-processing, dairy farming, fishing, developing local handicrafts, etc, so that non-farm income could be generated. The produce of the villages could then be reached

BOOK REVIEW

to the nearby urban towns through improved road transport, electronic and knowledge connectivity.

Citing the case of Gujarat's successful agricultural reforms - which has a high agricultural growth rate of 9 per cent - to prove their point, they add that the main reason for this is : better water management, quality power supply and enhanced electronic knowledge connectivity. By segregating power for domestic consumption from that for agricultural consumption, the government has ensured in reducing power theft and thereby increased its availability to farmers. This way, the state has solved the power problem and ensured power to the villages on a 24/7 basis.

The book should serve ideally as an eye-opener to all the authorities, planners, policy makers, administrators and other officials for its thought-provoking analysis of the main problems ailing the country.

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