Rural Management - Rural Finance

Rural Management

Rural Finance

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Where there is Rural Wellbeing there is Universal Prosperity

About the Book

Rural finance is concerned with variety of services. It is not only restricted to Agriculture rather there are many other services which are non- agricultural in nature as well. Rural finance helps the people living in rural areas to overcome their financial issues. It helps to smooth out the uneven distribution of income. Rural finance needs are met by an elaborate structure of Rural Financial Institutions. National Bank for Agriculture and Rural Development (NABARD) has been acting as the apex institution as well as principal refinancing agency for RFIs. Reserve Bank of India (RBI) acts as principal monetary authority and has retained few powers related to directing and regulating agricultural credit, though most developmental functions in agricultural sector have been ceded to NABARD. Scheduled Commercial banks, Regional Rural Banks (RRBs) and Cooperative banks are the three principal rural financial agencies.

This book is divided into five chapters and each chapter focuses on various aspects of Rural Finance. This book gives an overview of various forms of credit which are made available to the people living in rural areas. The first chapter introduces Rural Financial system. The second chapter is focused on financial inclusion. The third chapter discusses the challenges and prospects in Rural banking. The fourth chapter is focused on Micro finance. The fifth chapter describes Rural Insurance and Finance Schemes at local level.

This book has many figures, tables and graphs to make explanation easily understood by the readers. At the end of each unit 'To Do Activities' have been mentioned which will help the reader in learning by doing. At the end of each chapter, questions have been mentioned to help the reader to evaluate the topics which have been mentioned in this book. The growth of rural credit depends on funds which are available from one interval to the other interval, for understanding the high rise productivity in agricultural and non-agricultural areas. Interval gap from sowing seeds to understanding of the post-production revenues is comparatively very long, farmers need money from various fronts for matching primary investment of buying seeds, tools, fertilizers and for expenses.

I thank Ms. Meghna Jain, Assistant Professor MBA Department, Gyan Ganga Institute of Technology and Sciences, Jabalpur for contributing to this book and for her outstanding insights. I would like to thank MGNCRE Team Members for extending extreme support in completing this book.

Dr W G Prasanna Kumar
Chairman, MGNCRE

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Introduction

The rural credit needs of people in India are met by elaborate structure of the Rural Financial Institutions (RFIs). National Bank for Agriculture and Rural Development (NABARD) has been acting as the apex institution as well as principal refinancing agency for RFIs. Reserve Bank of India (RBI) acts as principal monetary authority and has retained few powers related to directing and regulating agricultural credit, though most developmental functions in agricultural sector have been ceded to NABARD. Scheduled Commercial banks, Regional Rural Banks (RRBs) and Cooperative banks are the three principal rural financial agencies. There are many other institutions which are state-sponsored as well as Non-Governmental Organizations (NGOs) have been established for the development of special sections of population or particular regions, these institutions also provide credit to rural population.
Cooperative banks have been catering to long term and short-term needs of the semi-urban and rural areas. Few of these banks, which are mainly in smaller states, have been operating directly through their bank branches. Those banks which are located in larger states have been operating through intermediary level. The semi-urban and rural branches of commercial banks at regional level are controlled by regional offices and these regional offices are coordinated at zonal level by zonal offices, having headquarters of banks responsible for the overall supervision and control. Commercial banks also act as a sponsor in collaboration with central and state governments, local district level banks, known as the Regional Rural Banks (RRBs).

NABARD have been playing a very important role in augmenting credit flow for promoting agriculture, cottage and small scale industries, handicraft and various other rural crafts and other allied activities in the rural areas. NABARD does not directly help farmers and rural people, rather it flows credit to people in rural areas through Commercial Banks, RRBs, Co-operative banks etc. NABARD is an apex body which deals with planning, policy and other operational aspect of rural credit for all-round development of the rural economy.

Objectives of the Chapter

- To understand role of banking system in rural areas
- To identify functions and policies of NABARD in rural banking
- To understand the lead bank approach
- To identify the role of Rural Credit Institutions
- To understand the role of Commercial banks in rural finance

Chapter Structure

- 1.1. Rural Credit and Role of Banking System
- 1.2. Functions and policies of NABARD in Rural Banking
- 1.3. Lead bank approach
- 1.4. Rural Credit Institutions
- 1.5. Role of Commercial Banks in rural finance

1.1 Rural credit and Role of Banking system

Rural credit

The growth of rural credit depends on funds which are available from one interval to the other interval, for understanding the high rise productivity in agricultural and non-agricultural areas. Interval gap from sowing seeds to understanding of the post-production revenues is comparatively very long, farmers need money from various fronts for matching primary investment of buying seeds, tools, fertilizers and for expenses.

Rural credit is a very important part of development of the economy. Being a key component sector of Indian economy, RBI has historically located priority to delivery of agricultural credit. The RBI Act, 1934 envisage a developmental role for Reserve Bank in agricultural credit with the responsibility particularly towards financing for seasonal operation and marketing of crops. The Rural Banking Enquiry Committee (Thakurdas Committee, 1950) stressed importance, for having an efficient agricultural finance system, of sound co-operative credit structure which is capable of developing closer relations with Bank. A survey was conducted by RBI and it indicated that there existed insignificance of co-operatives while providing rural credit. For ensuring success on the co-operative credit institution and enabling them for becoming self-supporting, there was a requirement of 'deliberate and positive' measure instead of 'small administrative, functional or other changes'. The tendency of the State in past has been to 'over administer and under finance' co-operative movement, but Report pointed out that there is an existence of need for integrated system rural credit and co-operation. The RBI Report envisages key role for RBI i.e. coordination of proposed network of co-operative institutions and for the Agricultural Credit Department to oversee their functioning. The RBI occupies a 'strategic position' in co-operative credit sector, while the other principal participants play a major role in the rural co-operation, viz., co-operative economic activity and training of the co-operative personnel. During the period of post-independence, money lenders and traders took advantage of the landless workers as well as poor peasants by lending them money on high-interest rate which would influence their accounts and used to trap them.

In year 1969, India started social banking and various agencies which provided funds for satisfying requirements of the rural credit. Later, in 1982, National Bank for Agriculture and Rural Development (NABARD) was formed as apex body for regulating and organizing all financial activities concerned with the system of rural finance. This became more concrete with Green Revolution coming in, which began and changed credit system of country, which resulted in productive lead of rural credit.

Origin of NABARD

NABARD came into existence on July 12, 1982 by transferring agricultural credit functions of RBI and refinance functions of the then Agricultural Refinance and Development Corporation (ARDC). NABARD was dedicated towards serving the nation by late Prime Minister Smt. Indira Gandhi on November 5, 1982. Set up with initial capital of Rs.100 crores, its' paid up capital was at Rs.12,580 crores as on March 31, 2019. Consequently composition of the share capital was revised between RBI and Government of India. Today, NABARD is fully owned by Government of India.

Source : www.nabard.org

In the current scenario, rural banking include various financial institutions like Regional Rural Banks (RRBs), Cooperatives, Commercial banks, Self-Help group and Land development banks. These Institutions are assigning sufficient credit at lower rate of interest.

The rural credit system in India is divided into following two segments

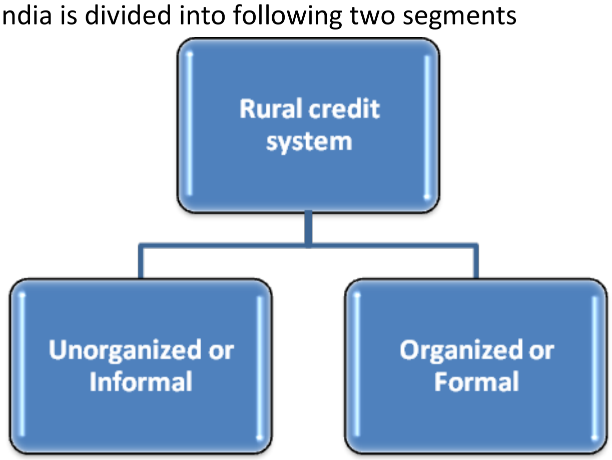

Figure 1.1 Segments of Rural credit system

The rural credit system of India is divided into two segments: the Unorganized or Informal segment i.e. money lenders, input suppliers and traders and the Organized or Formal segment i.e. Commercial Banks, Regional Rural Banks, Cooperative banks and NBFCs.

a) Unorganized or Informal Segment

Informal finance market is legal but is unrecorded officially and is comprised of the unregulated financial activity i.e., activities which are outside orbit of the officially regulated financial intermediary. Informal financial transactions could include the lending and borrowing among relatives and friends occasionally and this is not a part of informal market.

Characteristics of informal groups:

- Voluntary in nature
- Usually among equals
- No outside support or interference

The informal groups which are formed in the rural credit system are formed voluntarily by the people in rural areas, it is usually among people having equal status and there is generally no support from outside nor is there any kind of interference. Informal financial markets include the Institutions who are outside orbit of the officially regulated bodies. At policy level, general approach towards informal market has not been positive as the informal debt markets has been equated with either money lender or landlord. Transactions in the rural credit segment is expensive due to high interest rates. It finances unproductive expenditures as consumption needs. Sometimes, unequal and even exploitative arrangement exists between landlord and tenant or the agricultural laborer. The informal segment is not desirable as they are not regulated. Many poor people do not have access to Institutional credit. The arrangement for credit in the informal debt market is flexible and it also possesses some inbuilt risk sharing arrangement.

b) Organized or Formal Segment

Formal segment caters to borrowings having lesser risk as compared to the informal segment and they serve a purpose. The formal segment provides various benefits due to which it has been popular and attractive i.e. high reserve ratio, directed credit, branch licensing, ceiling in interest rate etc. Perhaps, one way of reconciling the conflicting views on usefulness of informal credit is to recognize some emerging realities of both formal and informal markets. There has been a requirement to strengthen the formal credit institutions because there was a requirement of modern input in the rural credit segment and because of the unfair money lending practice which could not have been countered effectively. RBI and NABARD have been promoting the Institutional credit in the rural areas, though the role being played by the informal finance is significant. Idea of promoting micro financing and Self-Help Group (SHG) is indirect admission of necessity of informal finance. There is a need that the role of formal as well as informal credit market needs and linkage between them is understood, as this will create the future of banking in rural areas.

Types of Rural Credit

There are three types in rural credit:

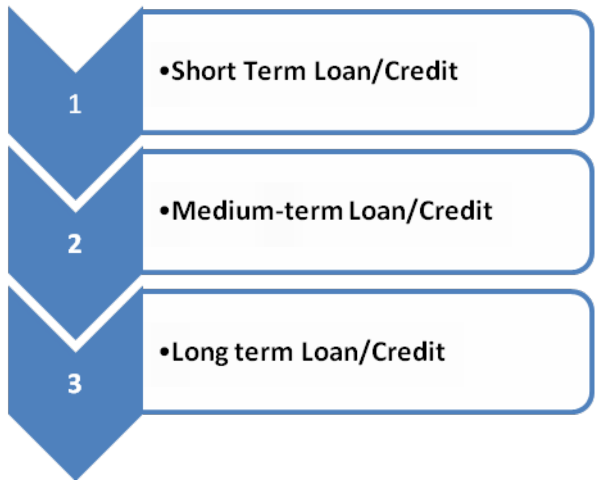

Figure 1.2 Types of Rural credit

(1) Short Term Loan/Credit

It is a kind of rural credit which is taken for holding private or business capital requirements. It is type of credit in which amount of principal and interest has to be paid on given date. The loan duration is up to one year. It is an expensive option for people, in particular for start-ups or small companies who are unable to get loan from bank. Short term loan is required to buy agricultural input like fertilizers, insecticides, pesticides, seeds etc. Such loans are payable once the crops are actually ready and are sold out.

(2) Medium-Term Loan/Credit

It is a kind of loan in which the repayment period is between 2 to 5 years and this period is lesser than 10 years. These loans are excellent option for the small firm who are planning to take a loan through a traditional way. Individuals can get loan amount of different amount, which varies with credit rating, cash as well as other factors. Such loans are required for various purposes like digging wells, buying bullocks, fencing fields etc. Medium term loan is required for such purposes wherein more than one year is required for making payment hence more time period is required for loan.

(3) Long Term Loan/Credit

It is a loan in which the repayment period is generally 5 to 20 years and sometimes even more than that in certain cases. In business, this type of loan is required to own permanent assets which would generate returns over period. When a farmer borrows money for buying land or tractor, or for paying ancestral debts, loans for longer duration is required. In case of agricultural sector, long-term credit is required for land leveling, sinking well, fencing, heavy machinery acquisition like tractor, permanent land repairs and other such requirements. Large amount of money is required for the above requirements. The farmers dealing in private farming might have a potential to earn profits in future through acquisition of assets. The small farmers do not have sufficient funds of their own for making costly investments as they do not have much of savings or their savings is very little.

Rural Credit is required for following reasons:

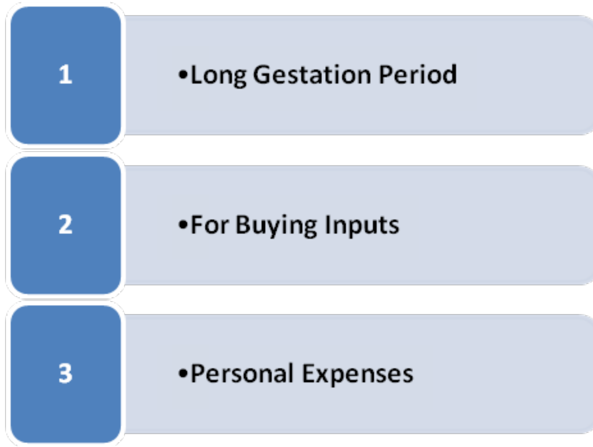

Figure 1.3 Requirement of rural credit

(1) Long Gestation Period

The farmer requires loan for facing the gestation period between crop sowing and realizing the income after the agricultural production and the sale which is long. Farmer needs credit for bearing expenses during the gestation period.

(2) For Buying Inputs

Farmers need fund for buying agricultural inputs like fertilizers, tools, seeds etc.

(3) Personal Expenses

Farmers require funds for meeting personal expenses such as religious ceremony, repaying old debts, marriages, death etc.

Role of Banking System in Rural Areas

The banking system in India has been playing a very important role in economic growth of India since the 18th century. There are many categories of banks which have been functioning in the rural areas and providing support to the people in rural areas for becoming a part of the banking system. RBI is main authority of the public sector banks, the private banks, the financial and non financial institutions. The Banking system could be classified into the Scheduled banks and Non-Scheduled banks. Banks have been operating towards development of the rural areas. The operation area of majority of Regional Rural Banks (RRBs) is actually limited to notified area and this area comprise of few districts in state. The working of Regional Rural Banks would be better suited than commercial banks and co-operative banks for meeting needs of the rural areas. State Bank of India has been playing a very important role in the rural areas. There are many other commercial banks which are providing banking products and services to people who have been staying in rural and semi-urban areas. The Co-operative banks are very important constituent in the Indian financial system and play a very important role in rural areas and this could be understood by the role that is assigned to these banks, expectations which they need to fulfill, the number of co-operative banks as well as their offices which are operating in the financially excluded area in India.

The Co-operative banks are providing finance to people in rural areas under the following:

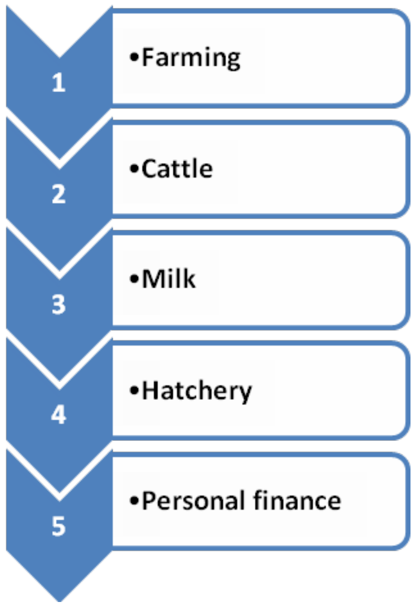

Figure 1.4 Financing by Co-operative banks in rural areas

Micro-finance is a novel approach for providing banking services to the poor since they combine higher degree of repayments and lower transaction cost. Major thrust of the micro-finance initiatives has been through setting of Credit unions, Non-governmental organizations (NGOs), Self Help Groups (SHGs) etc. Kisan credit card (KCC) which is being provided to the farmers has been playing an instrumental role in rural areas. The purpose of KCC is facilitating credit which is short term in nature to the farmers. KCC scheme has been implemented successfully and have been taken up by RRBs, Central Co-operative banks and Commercial Banks.

In the current state, there are many areas in the rural segment of our country, many people are not even aware about the schemes which have been launched by the Indian government. Banking industry is best delivery channel for making awareness about schemes for educating the uneducated people in rural area. In the rural area, there are many people, who are having a normal savings account, many of these people are not aware about latest technologies like ATM, Mobile banking, Internet Banking etc.

Greatest impact by banking sector in the rural India is as mentioned below:

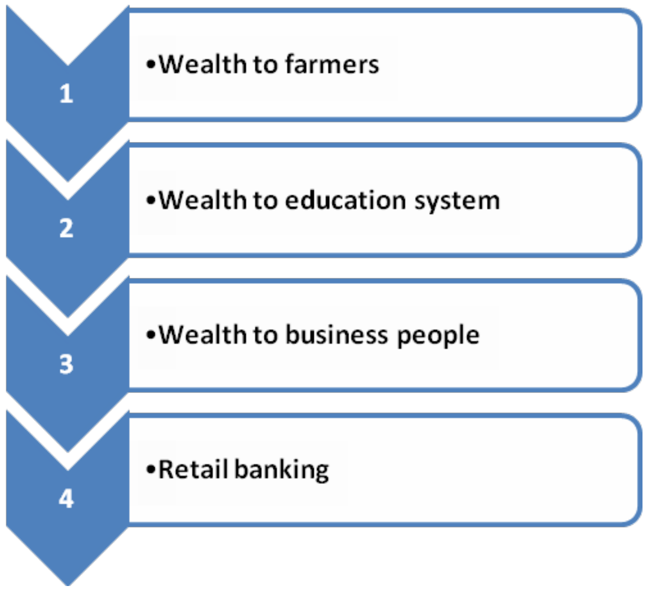

Figure 1.5 Impact by banking sector in the rural India

1. Wealth to Farmers

Bank announced various schemes to farmers to develop their financial status and the economic growth in rural areas in India. Bank provides loan amount with a lower interest for developing the agricultural officers to guide the farmers regarding loan facilities and scheme provided by the bank.

2. Wealth to Education System

Educational loan is being provided by banks and this has made a positive impact on lower level and middle level people's children education. Through this loan, the people in the rural area can give good education level to their children. Education is one of the main developments of the rural area made by the banking sector.

3. Wealth to Business People

There have been various schemes introduced for the promotion of business of people living in the rural areas. People who have their own small start-ups or micro units also require loans so that they could make enough money for the household needs and could also save for the future needs. There have been various schemes introduced by banks which could help the business people in rural areas. Rural indebtedness has taken deeper roots in the nation. It contributed to serious political, economic and social problems. Banks have been helping the rural people and gave them a new feeling of dignity. Many development projects and schemes have been introduced in the rural areas in which banks have been involved directly. Banks have achieved targets to a great level for the priority sector advance which is fixed for the rural areas in previous few years. Banks are providing loans to purchase tractor, seeds, digging wells etc and also participating actively for bringing new technology for the farmers and also educating them in using the latest technology.

4. Retail Banking

Banks are providing various products and services through retail banking to the people in rural areas. These products are helping out the middle income and lower income level people in getting financially included in the banking sector. Decline in the dependency ratio and also increase in non-farm income sources have triggered the increased savings flow to banking system and the demand for retail banking products/ services. Demand for the housing in the rural areas is on rise over years. Majority rural housing is self-financed, except the weaker section's housing. There is an existence of ample opportunities for banks to enter the housing segment in the rural areas. Affordable housing can be regarded as need-of-the-hour and this would require great deal of financial and technological innovation.

Banking Opportunities in Rural areas

1 •Farm mechanization

2 •Agro based industries

3 •Ware housing

4 •Retail banking

5 •Educational loans

Figure 1.6 Banking opportunities in rural areas

1. Farm Mechanization

Inflation in the agricultural sector has increased consistently due to gap in demand supply gap and there is an upcoming need for improving productivity through the use of extensive farming mechanization. There is opportunity for inviting major investments for the banks for considering higher technological agricultural production such as agricultural biotechnology and farming mechanization even besides continuing with traditional lending like production loan.

2. Agro Based Industries

Consumption boom may lead to high demand of food products like meat, milk, fruits, eggs, pulses, vegetables, etc which would necessitate expansion in supply. This could be achieved through expansion in farming production activities which coupled with the encouraging entrepreneurs for setting up the agro based industry. The next generation belongs to millions of the younger entrepreneurs who are planning to set up the agro based industries at small or medium scale. These industries will accompany employment opportunity in the rural areas and will also supplement income of rural households.

3. Warehousing

India is the largest producer of vegetables and fruits in the world but the availability of storage facilities which is required post harvest and transportation facility are inadequate and there have been problems faced by farmers due to these issues. Construction of rural goes down, cold storage and setting up of agro process units not only helps the farmers to income besides providing employment opportunities to many in rural areas. This invites huge investment and entrepreneurs are looking forward to banks for the required guidance and financial support.

4. Retail Banking

There is spurt in the middle class segment and is expected to grow at an accelerated pace in ensuing years with distinct features like education, employability and bankability. Declining dependency ratio and an increase in the non-farm income source are triggers for increased flow of saving to banking system and demand for retail banking services. Demand for housing in the rural area has increased over years. Except housing facility to the weaker sections, majority of rural housing is being self-financed. There are many opportunities for the banks to tap this segment. As such, affordable housing is need of the hour and this requires a great deal of financial and technological innovation.

5. Educational Loans

Increase in literacy rate amongst the rural masses is positive factor. As per a recent government initiative, i.e. waiver of entire interest on educational loan during period of study to the students is being given; this is subjected to a condition that the parent's income should be below a certain limit. This scheme of government has made loan scheme more attractive and it has enabled banks to improve the retail lending. In this scheme, there is an interest subsidy given during moratorium period i.e., course period and one more year on the Education Loan which is taken from Scheduled Banks under Model Education Loan Scheme of the Indian Banks Association for students who are belonging to the economically weaker section whose annual parental income upto Rs. 4.5 from all the income sources. Subsidy is allowed for students to undergo a recognized technical/ professional course from recognized Institutions in India.

To Do Activity

Ask the students to form groups of 2 – 3 students and discuss in detail about any of following forms of credit:

- Short term credit
- Medium term credit
- Long term credit

1.2 Functions and Policies of NABARD in Rural Banking

About National Bank for Agriculture and Rural Development (NABARD)

NABARD is Apex Development Financial Institution in India. The Bank has been entrusted with "matters concerning Policy Planning and Operations in the field of credit for Agriculture and other Economic activities in Rural areas in India". NABARD has been active in development of the Financial Inclusion policy.

NABARD had been established on recommendations of B. Sivaramman Committee through Act 61, 1981 of the Parliament, on 12th July 1982 by implementing the NABARD Act 1981. This replaced the Agricultural Credit Department (ACD) and the Rural Planning and Credit Cell (RPCC) of Reserve Bank of India (RBI) and the Agricultural Refinance and Development Corporation (ARDC). It is a premier agency which provides developmental credit in the rural areas. NABARD is India's specialized bank focusing on Agriculture and Rural Development in India. Initial corpus of NABARD was Rs. 100 crores. Consequently with revision in composition of the share capital between Indian government and RBI, paid up capital as on 31st May 2017, was Rs.6,700 crores with holding of Government of India as Rs.6,700 crores (i.e. 100% share). Authorized share capital is actually Rs.30,000 crores.

There are some International associates of NABARD which include World Bank-affiliated organizations and various global developmental agencies which have been working in field of rural development and agriculture. These organizations have been helping NABARD by giving and advising monetary aid for upliftment of people in rural areas and optimizing agricultural process. NABARD is known for the 'Self Help Groups (SHGs) Bank Linkage Programme' that encourages India's banks for lending to the SHGs. SHGs are composed mainly of poor women in the rural areas and this has evolved into important Indian tool of microfinance.

Objectives of NABARD

NABARD have been established with following objectives:

1. Giving an undivided attention and a purposeful direction for integrated rural development
2. Acting as centre piece for entire rural credit system at national level.
3. Acting as provider of the supplemental funding for the rural credit institution
4. Arranging investment credit to village, cottage and small industries, handicrafts, other rural crafts, farmers and artisans
5. Improving a system of credit distribution system through institution building, credit institutions' rehabilitation as well as training of the bank personnel
6. Providing facilities of refinance facilities to the State Land Development Banks (SLDBs), State Co-operative Banks (SCBs), Regional Rural Banks (RRBs) and commercial banks for developing the rural areas.
7. Coordinating working of the different agencies which are engaged in the developmental work in the rural areas at regional level and also to liaison with Indian government, RBI, State Government and the other Institutions engaged in policy making at national level.

8. Inspecting, monitoring and evaluating projects in getting refinance from NABARD.

Roles of NABARD

1. It serves as apex financing agency for institutions through production and investment credit for promoting various developmental activities in the rural areas
2. Taking measures toward institutions building to improve absorptive capacity of credit delivery system which includes formulation and monitoring of various rehabilitation schemes, restructuring of the credit institutions, personnel training etc.
3. Coordinating working of the different agencies which are engaged in the developmental work in the rural areas at regional level and also to liaison with Indian government, RBI, State Government and the other Institutions engaged in policy making at national level.
4. Undertaking evaluation and monitoring of the projects refinanced by NABARD
5. NABARD refinances financial institutions which further provide finance to rural sector.
6. NABARD takes part in developing institutions that help rural economy
7. It keeps check on the client institutes
8. It regulates institutions that provide financial help to rural economy
9. NABARD provides training facilities to institutions which are working in field of the rural upliftment
10. It supervises and regulates RRBs and Cooperative banks throughout the country.

Functions of NABARD

The functions of NABARD have been divided into three categories:

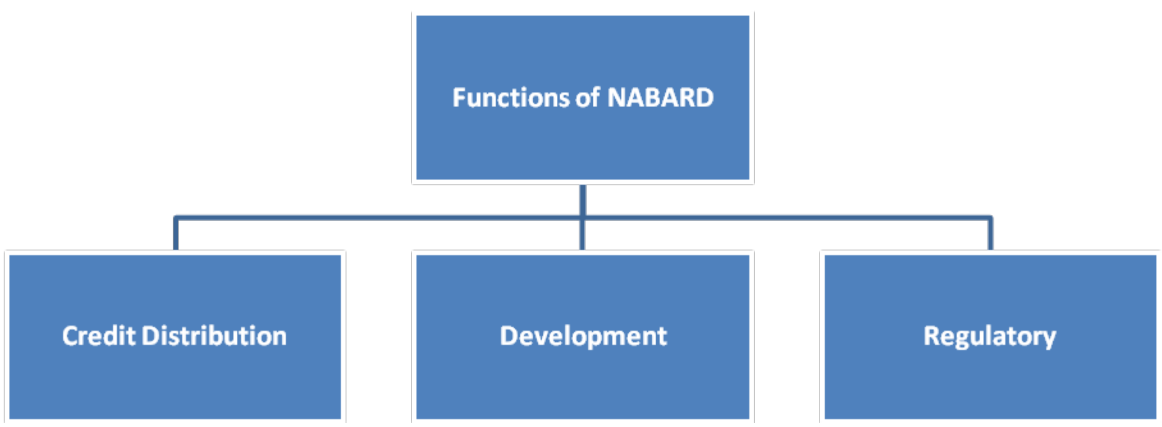

Figure 1.7 Functions of NABARD

(A) Credit Distribution

NABARD provides refinance to various financial institutions like RRBs, SCBs, LDBs, Commercial banks and various other approved financial Institutions. The purpose and the duration could be different. NABARD also provides refinance facility to RRBs and SCBs in event of rearrangements and changes of credit whenever there are droughts, famines or in case of any other natural calamity, enemy operations, army operations, etc. These facilities are provided for giving loans to small industries, artisans etc. NABARD provides refinancing facility to cottage, village and small industries in the rural areas.

Types of Refinance

Types of refinance are different based on the time duration for which they are provided.

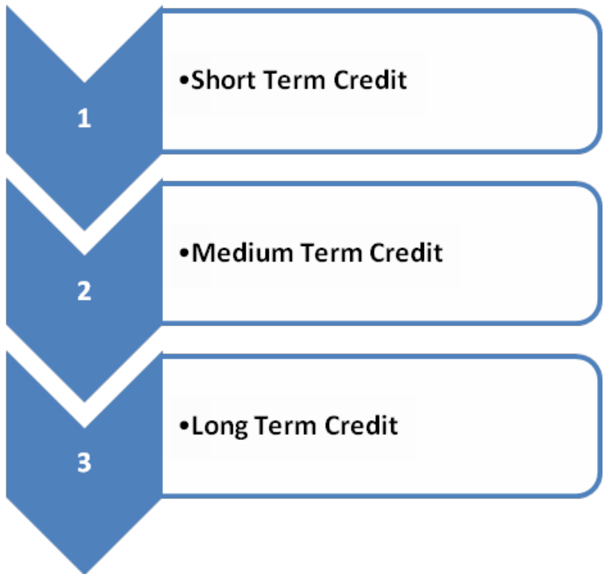

Figure 1.8 Types of refinance to various Institutions

(1) Short Term Credit

NABARD provides short term credit to following Institutions:

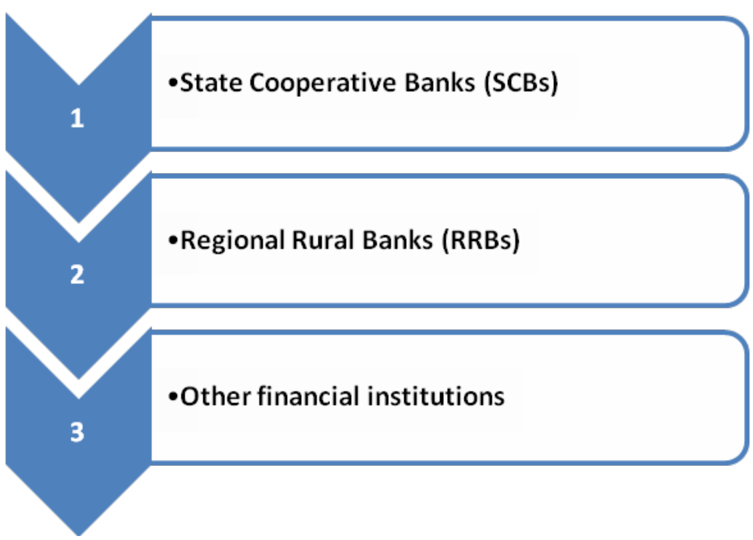

Figure 1.9 NABARD provides short term credit to various Institutions

It provides short term credit to SCBs, RRBs, and other financial institutions which are approved by RBI for following purposes:

i. Seasonal agricultural operation
ii. Marketing of the agricultural production
iii. Distribution and marketing of various inputs like fertilizers, pesticides etc.
iv. Various other activities which are related to the agriculture/ rural sector
v. Other activities related to commercial trade
vi. Production as well as marketing of various other activities such as small industries, handicrafts, cottage and village industries, silk industry, artisans, etc. Duration this type of credit is upto 15 months.

(2) Medium Term Credit:

NABARD provides medium term credit to following Institutions:

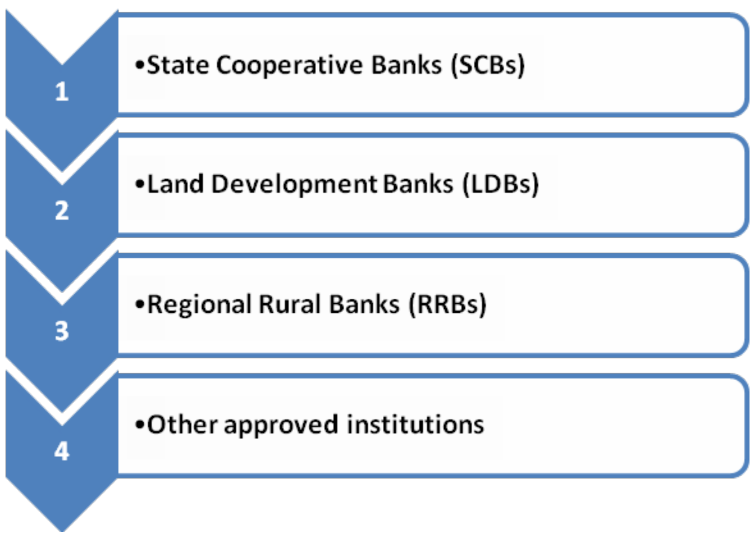

Figure 1.10 NABARD provides medium term credit to various Institutions

NABARD has been providing medium term credit to SCBs, LDBs, RRBs, and various other approved institutions for period which ranges from 18 months to 7 years. Medium term loan is given for various investment schemes related to rural and agriculture sector.

(3) Long Term Credit:

NABARD provides long term credit to following Institutions:

1. State Land Development Banks (SLDBs)
2. Regional Rural Banks (RRBs)
3. Commercial Banks
4. State Cooperative Banks (SCBs)
5. Other approved institutions

Figure 1.11 NABARD provides long term credit to various Institutions

NABARD has been providing long term credit to SLDBs, RRBs, commercial banks, SCBs and many other approved financial institutions. Duration of this type of loan is for period of 25 years.
NABARD has been providing long term credit for investment in following activities:

1. Minor irrigation, land development and soil conservation
2. Dairy development, sheep rearing, poultry farming, pig rearing
3. Farm mechanization
4. Fish farming
5. Storage and market yard
6. Agricultural operations through biogas and other alternative sources of energy
7. Silk production
8. Beekeeping
9. Cattle and cattle driven carts
10. Compost equipment
11. Other agricultural related activities

Figure 1.12 Long Term credit for various activities

(B) Developmental Functions:

NABARD performs following developmental functions:

i. Coordinating with the rural credit institutions
ii. Taking measures toward institution building for improving capacity of the credit delivery system
iii. Developing specialization for solving problems related to villages and agriculture
iv. Helping RBI, Government, RBI and the other institutions in efforts for their rural development
v. Acting as agent of RBI and Government to monitor working in the areas which are related to agriculture
vi. Providing facilities for training and research to staff of LDBs, RRBs, SCBs etc. and promoting research in rural development and agricultural activities out of Research & Development (R & D) Fund.
vii. Providing training facility in fields of agriculture, rural development and rural banking, NABARD have established their own Institute at various centres i.e. Banker Rural Development Institute and National Bank Staff Colleges at Bolpur, Lucknow and Mangalore and College of Agriculture Banking (CAB) at Pune
viii. Spreading information related to rural development and banking
ix. Helping State Governments for subscribing to share capital of the State Cooperative Banks
x. Providing direct credit in some cases which are approved by Central Government connected with rural and agriculture development
xi. Maintaining Easy Credit Aid Fund out of profits so that the entrepreneurs in getting refinance facility for cottage, village and other small industry could be provided margin money. Such help is provided free of interest and recovered through yearly installments after loan has been repaid.

(C) Regulatory Functions

NABARD performs following regulatory functions:

(i) Inspecting working of the RRBs and Cooperative banks of various types except primary cooperative banks

(ii) Inspecting apex cooperative marketing federation, state handloom weaving society etc. that are financed on a voluntary basis

(iii) All the applications for the opening of branch by RRBs or Cooperative banks, other than primary cooperative societies, are required for submission to RBI through NABARD

(iv) RRBs and various Cooperative banks submit returns to RBI and a copy is also submitted to NABARD

(v) NABARD is empowered for obtaining statement or information from RRBs and the cooperative banks

Policies of NABARD in Rural Banking

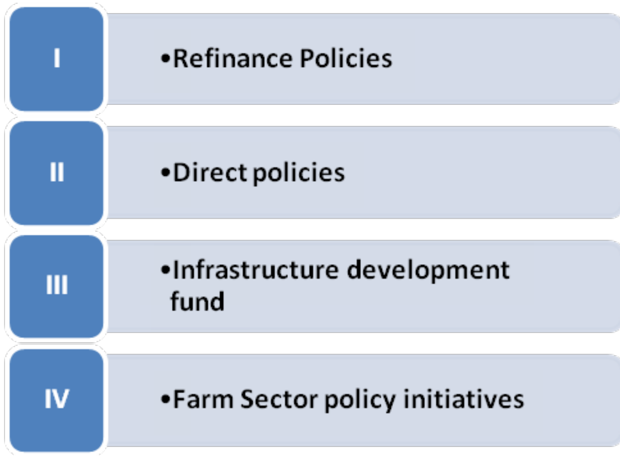

Figure 1.13 Policies of NABARD in rural banking

(I) Refinance Policies

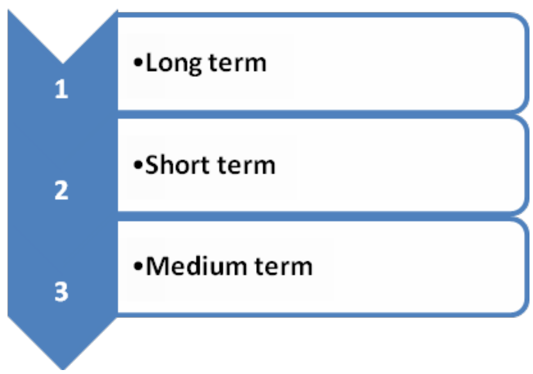

Figure 1.14 Refinance policies introduced by NABARD

(1) Long-Term Refinance

The formation of capital assumes the overriding priority in context of the policy since it acts as indicator of growth of economy. NABARD has laid emphasis since the inception on investment credit since it lead to formation of capital through creation of assets and in this way develops the rural areas. NABARD has been providing long term credit to SLDBs, RRBs, commercial banks, SCBs and many other approved financial institutions.

Long Term Rural Credit Fund (LTRCF)

A LTRCF was set up in the NABARD in the year 2014-15 out of shortfall in the priority sector lending by the scheduled commercial banks. An amount of Rs.15,000 crores was allocated for year 2018-19.

A LTRCF is being used for the following :

- Ensuring an uninterrupted and increased credit flow to the farmers
- To give boost to formation of capital in the agriculture sector

- For avoiding high cost of market borrowings by NABARD to provide refinance to RRBs and Cooperative banks, at reasonable interest rate
- for extending of concessional term loans to the farmers for various agricultural activities.

Table 1.1 Current Norms of Net NPA are as under:

Agency	Maximum Net NPA Norm
Public Sector SCBs	9%
Private Sector SCBs	6%
SFBs	5%
NBFCs	4%
NBFC-MFIs	4%
StCBs	20%
RRBs	15%
PUCBs	3%

Source: NABARD website

v. For State Cooperative Agriculture and Rural Development Banks (SCARDBs), in respect of portfolio which is covered under the LTRCF, outstanding beyond 5 years, will be eligible for refinance under the Normal LT refinance.

vi. The exposure norms will have to be adhered to while sanctioning of refinance

vii. Banks which are receiving refinance from NABARD should put aside all assets to NABARD for which refinance has been provided by NABARD.

(2) Short-Term Refinance

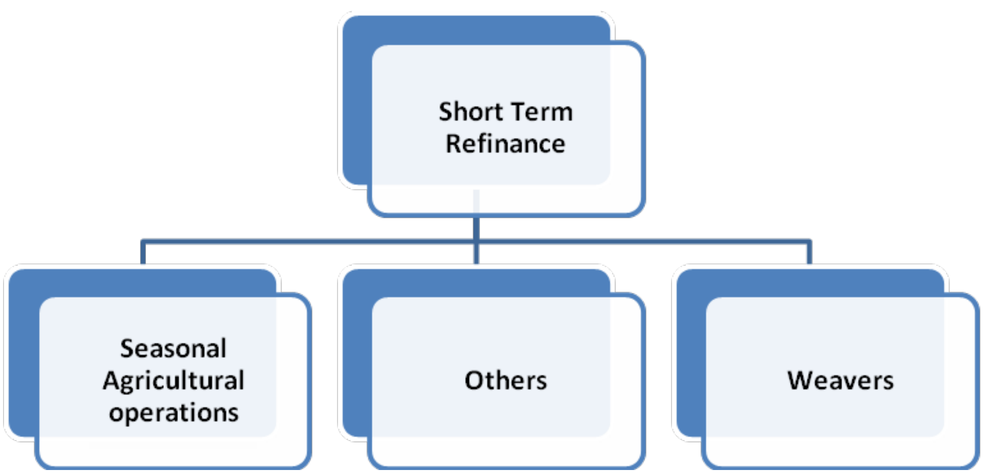

Figure 1.15 Short term refinance

(i) Short Term (Seasonal Agricultural Operations)

Refinance has been provided for the production purposes at a concessional interest rate to SCBs and

RRBs through a way of sanctioning credit limits. Each withdrawal which is against sanctioned credit limit will be repayable within a period of 12 months.

Short Term Cooperative Rural Credit (STCRC) - STCRC (Refinance) Fund have been setup in NABARD for providing Short Term refinance to the Cooperatives for lending of crop loan. Allocation to this fund for year 2018-19 is Rs. 45,000 crores.

Short Term RRB (Refinance) Fundhas been setup in NABARD for providing Short Term refinance to RRBs for lending of crop loan. Allocation for this fund for year 2018-19 is Rs.10,000 crores.

(ii) Short Term (Others)

The Short term (Others) limit would be provided for different purposes like for Agriculture and Allied Activity, Crop's marketing, Fisheries Sector, Industrial Cooperative Societies (besides weavers), Labour contract and Forest Labour Cooperative Society which also includes collection of minor forest produce. Short term credit is also given to rural artisan that includes weaver members of Primary Agricultural Cooperative Societies (PACS)/ Large Area Multi-Purpose Societies (LAMPS), distribution and stocking of chemical fertilizers and various other inputs of agricultural inputs on basis of bank wise Realistic Lending Programme (RLP) for the respective purpose. Limit is sanctioned to RRBs and SCBs.

(iii) ST (Weavers)

Support for refinance is available under the ST (Weavers) as follows:

1. Requirement for Working Capital of Primary/ Apex/ Regional Weavers Co-operative Society through the State Co-operative Banks/ DCCBs
2. Requirement of Working Capital of the Primary Weavers Co-operative Society through the Scheduled Commercial Banks
3. Requirement for Working Capital of State Handloom Development Corporation through the Scheduled Commercial Bank and the State Cooperative Bank
4. Requirement for Working Capital as well as marketing of the Individual Weavers, Handloom Weaver Groups, the Master Weavers, the Mutually aided Co-operative Society, Societies that are outside Co-operative fold and Producer Group Company through the Scheduled Commercial Banks & RRBs.

(3) Medium Term Conversion

NABARD has also been providing medium term credit for converting short term loans for crops advanced to finance SAO to RRBs and SCBs to provide relief to farmers whose crops have been damaged because of the occurrence of some natural calamity.

Major changes made in the refinance policy for the year 2018-19 are as under:

(i) All State Co-operative Banks (StCBs) and District Central Co-operative Banks (DCCBs) should maintain minimum Capital to Risk weighted Asset Ratio (CRAR) of 9% for becoming eligible for getting refinance from NABARD.

(ii) All the Scheduled commercial Banks except RRBs and Small Finance Banks (SFBs) are required to maintain CRAR of 10.25% as per the Basel III, for being eligible for getting refinance.

(iii) All StCBs/DCCBs and the RRBs in low risk category would be eligible for the unrestricted refinance.

(iv) For changing the domestic economic environment and changing quality of assets, Net NPA norms to be eligible for refinance have been relaxed across all the financial Institutions.

(v) Quantum of refinance for additional Short Term (Seasonal Agricultural Operations (SAO)) for the State Cooperative Banks has increased from 50% to 60% of Realistic Lending Programme (RLP) and for RRBs from 40% to 50% of RLP. Above limit would also include Short Term (SAO) credit limit which is sanctioned to Banks.

(vi) Under Short Term (Others) for the RRBs, the eligibility criteria in respect of Net NPAs have increased from 5% to 6% for making more RRBs eligible for refinance. The acceptable level of NPA for cooperatives for Short Term (Others) continues to be 10%.

(vii) For widening financing scope of banks and to diversify loan portfolio, loan is being given for working capital requirements to self employed, professionals and for social infrastructure project and also to Micro, Small and Medium Enterprises (MSME).

Source : www.nabard.org

(II) Direct Policies

There are some policies which could be referred to direct policies through which NABARD provides credit facility to various marketing federations, Cooperative banks and providing infrastructural development assistance.

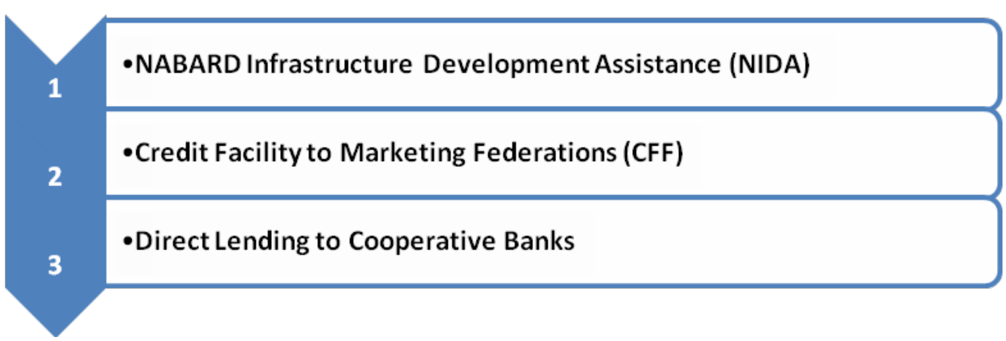

Figure 1.16 Direct policies of NABARD

(1) NABARD Infrastructure Development Assistance (NIDA)

For development of the agricultural sector, rural infrastructure plays a very important role. There are certain limits defined for the State Government and they cannot borrow more than their limit of borrowing. Their corporations may not have excess funds, hence rural India does not have critical infrastructure. Due to this reason, NIDA have been designed for complementing Rural Infrastructure

Development Fund (RIDF). This credit line has been opened for the state owned corporations and institutions having sustained income stream.

(2) Credit Facility to Marketing Federations (CFF)

For strengthening arms of the Marketing Cooperatives/ Federations, NABARD has established separate credit line viz. credit facility toward federations that promote marketing of the agricultural produce and various other farming activities. Eligible institutions for getting this facility are Marketing Corporations and Federations, registered Companies as well as other Cooperatives. NABARD has been providing credit facility to various state entities that are engaged in procuring food grains, aggregation, value and storage additional, marketing which helped farmers in the marketing of produce at remunerative price.

(3) Direct Lending to Cooperative Banks

In continuation of our efforts to invigorate the co-operative sector, Short-Term Multipurpose Credit Product was designed for financing Central Cooperative Banks (CCBs) directly. In sync with the overarching aspirations of the Vaidyanathan Committee for revival of cooperative credit structure, this product has enabled CCBs to raise financial resources from sources other than the State Cooperative Banks (StCBs).

(III) Infrastructure Development Funds

NABARD has been providing funds for various purposes. The purposes were like rural infrastructure, irrigation, food processing, warehouse, housing, dairy processing, etc.

Following funds were being provided by NABARD

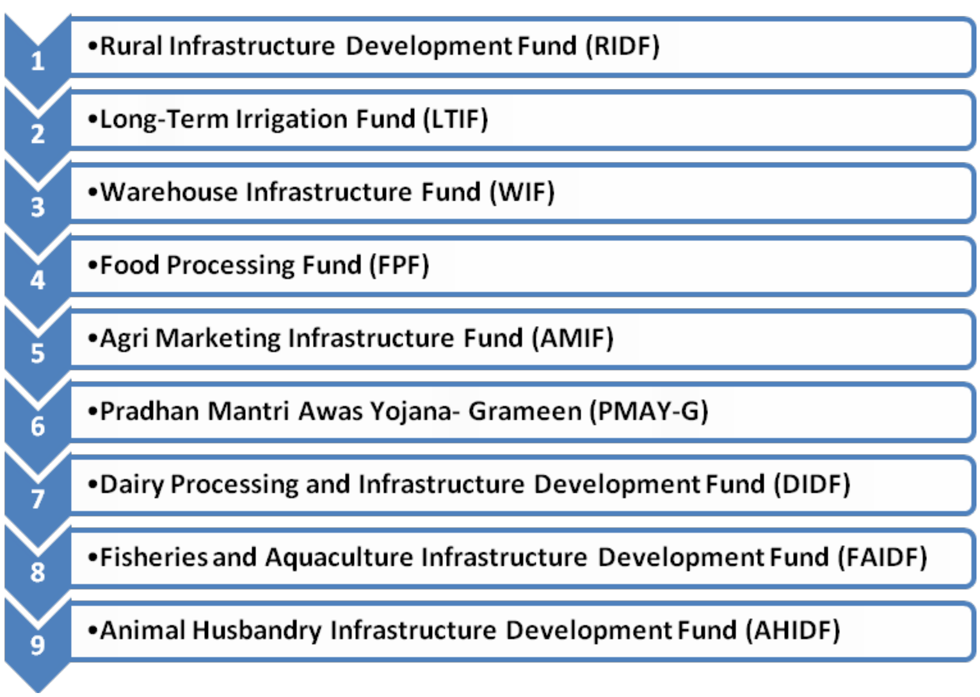

Figure 1.17 Infrastructure development funds provided by NABARD

The above funds were provided as per the requirement of the rural areas. There is a need that the rural areas should be developed. Through these funds the agricultural sector and other allied activities would be progressed and the people in the rural areas could actually work hard in their profession and will be able to work towards their betterment and also provide support for their families.

(IV) Farm Sector Policy Initiatives

There are many policy initiatives which have been taken up by NABARD:

- National Level Farmers' Consultative Group (NLFCG) was instituted during the year 2017-18 as forum for interaction with the farmers in national level. The first meeting of NLFCG was held on 9th Feb. 2018 having participation of the farmer members from 20 states.
- Consultation workshop with the Commodity Board was organized for facilitating coordinated effort towards enhancement of farmer's income.
- Centre for climatic change was conceptualized and has been established in Bankers institute of Rural Development at Lucknow.
- For facilitating the revival of millets especially as a part of the climatic resilient agriculture for the dry lands action research project was initiated in Madhya Pradesh and Karnataka.
- Krishak Sarathi portal for digitization of the Farmers' clubs was initiated for facilitating development of farmer's database, aid in the monitoring activities of Farmers' clubs and ensuring their sustainability during long run.
- Policy related to Farmers Club was revised and also came into operation from 2017-18 through broadening of functions of the Farmers' clubs for facilitating growth.
- Krishak Samriddhi which is an initiative for enhancing income - five action research projects were initiated in five states i.e. Assam, Odisha, Gujarat, Bihar and Gujarat
- Unit cost of all states was uploaded on NABARD website for guiding bankers, agri-preneurs etc.
- Meeting of Regional Advisory Group was organized in every state for encouraging interaction between the stakeholders and facilitating the coordinated approach toward development of the agricultural and the allied sectors.

To Do Activity

Ask the students to form groups of 4 – 5 and discuss in detail about any one of the topics about NABARD:

- Objectives
- Role
- Functions
- Policies

1.3 Lead Bank Approach

Lead Bank approach was introduced by RBI in the month of December 1969. This scheme aimed to coordinate banks activity and other developmental agency for achieving the objective to enhance flow of the bank finance to priority sector and various other sectors and for promoting banks' role in overall development of rural sector.

Genesis of Lead Bank Scheme (LBS)

Genesis of Lead Bank Scheme (LBS) could be traced to Study Group which was headed by Prof. D. R. Gadgil on Organizational Framework for Implementation of social objectives that submitted report in the month of October, 1969. This Study Group drew the attention to a fact that the presence of commercial banks was not adequate in the rural areas and lacked required orientation towards rural areas. This Study Group recommended adoption of 'Area Approach' for evolving programmes and plans for development of adequate credit and banking structure in rural areas. A Banker's Committee on Branch Expansion Programme of public sector bank appointed by RBI under Chairmanship of Shri F. K. F. Nariman i.e. Nariman Committee that endorsed idea of 'Area Approach' in report of November 1969, they recommended that for enabling Public Sector Bank for discharging their social responsibility, every bank should concentrate on a certain districts where it will act as 'Lead Bank'.

Source: www.rbi.org.in

For coordination of activities in district, assignment is given to a particular bank to function as a 'Lead Bank' for the district. It is expected from a Lead Bank to perform the role of leadership for coordinating efforts of credit institutions and Government. Taking into consideration several changes which took place in financial sector, scheme of Lead Bank was reviewed by High Level Committee which was headed by Smt. Usha Thorat, Deputy Governor of RBI in 2009. There were many discussions with various stakeholders and the Committee and it was noted that scheme was useful for achieving the original objectives of deposit mobilization, improving branch expansion and priority sector lending in semi urban and rural areas. Envisaging a greater role for the private sector bank, the Lead Banks were given advise for ensuring that the private sector bank are closely involved in implementation of Lead Banks Scheme. The private sector bank should get involved more actively through leverage on Information Technology through their expertise in the strategic planning.

Fora under Lead Bank Scheme

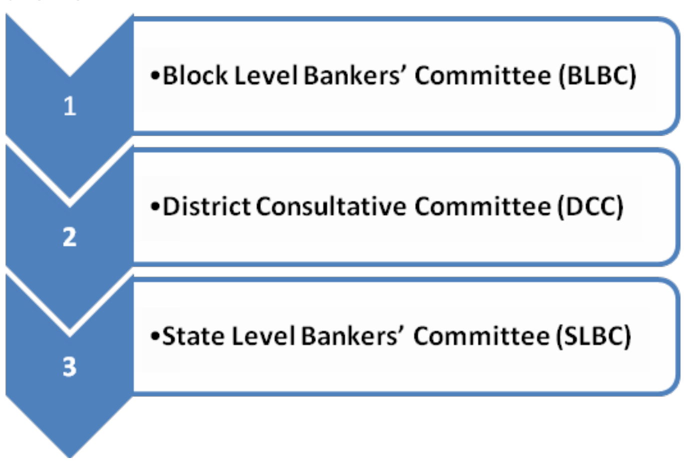

Figure 1.18 Fora under the Lead Bank scheme

(1) Block Level Bankers' Committee (BLBC)

BLBC is forum to achieve coordination between field level development agencies and credit institutions at block level. This forum reviews and prepares implementation of Block Credit Plan and resolves the operational problems in implementation of credit programmes in the banks. Lead District Manager (LDM) of district is Chairman of Block Level Bankers' Committee. All banks operating in block including Small Finance Banks, District Central Co-operative Banks, RRBs, block development officer, technical officers in block, such as extension officers for co-operatives, agriculture and industries are members of Committee. BLBC meeting are generally held at quarterly interval. For strengthen BLBC forum that operates at base level of Lead Bank Scheme, it's necessary that all the branch managers attends BLBC meeting and enrich discussions with valuable inputs. The controlling head of Banks could also attend few of BLBC meeting selectively.

Participation by District Development Manager (DDM) of NABARD in the BLBCs would ensure a more meaningful and better discussion for development of Block. NABARD has advised that the DDMs are required to attend all BLBC meetings in district and actively participate in review meetings and credit planning exercises at block level. Lead District Officer (LDO) of RBI selectively could attend BLBC meetings. Representatives of the Panchayat Samitis are also invited for attending meetings at half yearly interval for sharing experience and knowledge on rural development in credit planning exercise. The payments banks should be invited for attending meetings.

(2) District Consultative Committee (DCC)

❖ **Constitution of DCC**

The DCCs were constituted in early seventies as common forum at district level for the bankers and government departments/ agencies for facilitating coordination in implementation of various developmental activities under Lead Bank Scheme. District Collector is Chairman of DCC meetings. RBI, jNABARD, all commercial banks which includes Small Finance Banks in district, co-operative banks which includes District Central Cooperative Bank (DCCB), payment banks, RRBs, various State Government department and the allied agencies are members of DCC. Lead District Officer (LDO) represents RBI as member of DCC. Lead District Manager (LDM) convenes DCC meetings. Director of MSME development Institute in district is invitee in the districts where MSME clusters are located for discussing issues concerning with the MSMEs.

❖ **Conducting DCC Meetings**

- DCC meetings are required to be convened by Lead Bank at quarterly interval.
- At DCC level, sub-committees, as may be appropriate, need to be setup for working intensively on some specific issues and submission of reports to DCC for its consideration.
- DCC should provide adequate feedback to SLBC on various issues which need to be discussed on wider platform, so that they receive sufficient attention at State Level.

❖ **Agenda for DCC Meetings**

While Lead Banks have been expected for addressing problems particularly to concerned districts, some important areas that are common to all the districts which lead banks should invariably discuss are as under:

- Reviewing progress under the financial inclusion plan (FIP).
- Specific issues which inhibit and enable financial inclusion which is IT enabled.
- Issues for facilitating 'enablers' and removing/minimizing the impeders for development of banking for the inclusive growth
- Monitoring of initiatives to providing 'Credit Plus' activities by State Governments and banks such as setting up of Financial Literacy Centres (FLCs) and RSETI which are a type of Training Institutes for providing skills as well as capacity building for managing business
- Scaling up of financial literacy efforts for achieving financial inclusion.
- Reviewing performance of banks under the District Credit Plan (DCP)
- Credit flow to the weaker sections and priority of society
- Doubling Farmers' Income by the upcoming year 2022
- Assistance under the Government sponsored schemes
- Grant of the educational loans
- Progress under the SHG - bank linkage
- SME financing as well as bottlenecks (if any)
- Timely submission of required data by various banks
- Reviewing relief measures (for natural calamities wherever applicable)

List above is just illustrative and it is not exhaustive. Any other agenda could be included by lead banks.

❖ **District Level Review Committee (DLRC) Meetings**

DLRC meeting is chaired by District Collector and also attended by the other members of District Consultative Committee (DCC). The public representatives i.e. the Local MLAs/ MPs/ Zilla Parishad Chiefs are invited for meetings also. DLRC meetings are required to be convened by Lead Banks minimum once in every quarter. DLRC is forum for reviewing quality and pace of implementation of the various programmes under Lead Bank Scheme in district. Hence, the association of the non-officials is considered to be useful. The Lead Banks are required for ensuring presence of the public representatives in the DLRC meetings wherever possible. Hence, the Lead Banks are required to fix date of the DLRC meetings giving due regard to convenience of representatives of public i.e. MLAs/ MPs etc. and involve and invite them in all the functions which are conducted by banks in districts such as Kisan Credit card distribution, opening of new banking outlet, SHG credit linkage programme, etc. Responses to various queries from the public representatives are required to be accorded with highest priority and should be attended promptly. Follow up of DLRC's decision needs to be discussed in DCC meetings.

❖ **DCC/DLRC meetings- Annual Calendar of Meetings**

i) DLRD and DCC are important forums that facilitate coordination amongst government agencies, commercial banks and the others at district level for reviewing and finding solutions to problems hindering the developmental activities. Hence, it is necessary that all members deliberate and participate in these meeting. On review of DCC/DLRC meetings, there are certain reasons which hinder the participation of members in such meetings.

1. •Late receipt of intimation of meeting's date
2. •Non-receipt of intimation of date of these meetings
3. •Clashing of dates with the other events,
4. •Commonality of the dates
5. •Other reasons

Figure 1.19 Reasons that hinder participation in DCC/ DLRC meeting

These reasons thus undermines prime objective for conducting above meetings.

ii) Lead Banks have been advised to prepare Annual Schedule of DLRC and DCC meetings on the Calendar year basis for all the districts in consultation with Chairperson of meetings, LDO of RBI and the public representatives in the case of DLRC. The yearly calendar is required to be prepared in beginning of every year and it should be circulated to the members as an advance intimation to block future date for attending DLRC and DCC meetings and meetings are required to be conducted as per the calendar. While the calendar is being prepared, it has to be ensured that the DLRC and DCC meetings would not be held simultaneously.

(C) State Level Bankers' Committee (SLBC)

- **Constitution of SLBC**

i) The SLBC was constituted in the month of April 1977, in the form of an apex inter-institutional forum for creating adequate coordination machinery in all the States, on uniform basis for the development of State. SLBC is chaired by Chairman or Managing Director or Executive Director of Convener Bank. This comprises of representatives of the commercial banks which includes RRBs, RBI, Small Finance Banks, State Cooperative Banks, Payments Banks, NABARD, head of various Government department including representatives from the National Commission for the Scheduled Tribes/ Castes, National Horticulture Board, Khadi & Village Industry's Commission etc. and the representatives of the financial institutions which have been operating in State, which comes together and sort out the coordination problems at policy implementation level. Representatives from various organizations from different sectors of economy like retail traders, industry bodies, farmers' unions, exporters, etc. are the special invitees in

SLBC meetings to discuss their specific problems, if they exist. SLBC meetings are held on a quarterly basis. Responsibility for convening the meetings would be of SLBC Convener Bank of State.

ii) Recognizing that SLBCs, primarily being a committee of the bankers at State level, plays a very important in development of State, illustrative guidelines for conducting State Level Bankers' Committee meetings has been issued.

- **Conducting SLBC Meetings**

i. SLBC meetings have to be conducted at quarterly interval. These meetings are chaired by Chairman/ Managing Director/ Executive Director of Convener Bank and are co-chaired by development commissioner or Additional Chief Secretary of State concerned. High Level participation in the SLBC meetings ensures desired outcome and effectiveness with meaningful discussion on various issues of the public policy of both RBI and Indian government.

ii. The Finance Minister/ Chief Minister and senior level officers from State/RBI (of Executive Director/ Deputy Governor Rank) could be invited for attending SLBC meetings. Further, State Chief Ministers are encouraged for attending at least one SLBC meeting every year.

iii. SLBC meetings should focus primarily on policy issue with participation of only senior functionaries of Government departments/ banks. All the routine issues might be delegated to the sub-committee(s) of SLBC.

iv. There might be some sub-committees which are constituted for specific issues.

There are many such issues for which sub-committees are formed:

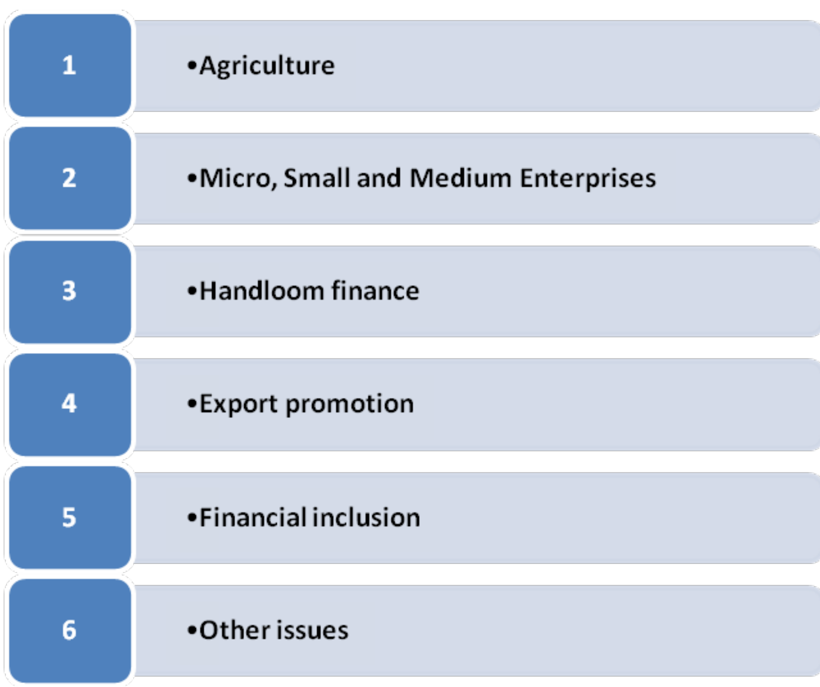

Figure 1.20 Issues for which sub-committees are formed

These issues are discussed in detail and proper recommendations and solutions for adoption are devised by full committee. These committees are expected for meeting more frequently than SLBC. Composition of these committees depends might vary as per the state and depends on specific problems or issues being faced by state.

v. The offices/ secretariat of SLBC should be strengthened sufficiently for enabling SLBC Convener Bank for effectively discharging its functions.

vi. The various fora at lower levels may give adequate feedback to the SLBC on issues that need to be discussed on a wider platform.

❖ **Revised Agenda for SLBC Meetings**

1. Reviewing initiatives related to financial inclusion, financial literacy and expansion of the banking network
2. Reviewing credit disbursements by the banks
3. Doubling Farmer's Income by the year 2022
4. Cash Deposit (CD) Ratio, reviewing districts having CD Ratio lower than 40% and the working of Special Sub-Committees (SSC) of the DCC.
5. NPA's position in respect of certificate cases, recovery of NPA and thematic lending
6. Reviewing restructuring loans in the natural calamities affected districts in State, if any
7. Discussion on the policy initiatives of State/ Central government/ RBI i.e. MSME Policy, Industrial Policy, Start-Up Policy, Agriculture Policy etc) and expected involvement of the banks
8. Discussion on improvement in rural infrastructure and credit absorption capacity
9. Efforts toward skill development on the missions mode partnering with the Krishi Vigyan Kendra (KVK), National Skill Development Corporation, Horticulture Mission, Agriculture Skill Council of India (ASCI), etc. including reviewing functioning of the RSETIs
10. Steps taken for improvement land record, progress in the digitization of records of land and seamless disbursements of loans.
11. Sharing of new initiatives and success stories at district level which could be replicated in any other districts or across state
12. Discussing market intelligence issues like ponzi schemes, illegal activities of the unincorporated bodies, companies, firms soliciting public deposits etc
13. Issues which have remained unresolved at DLRC/ DCC meeting

This list is not exhaustive and it is just illustrative. SLBC Convener banks might include any other item for agenda item as considered to be necessary

❖ **SLBC - Yearly Calendar of Meetings**

i. For improving streamline and effectiveness in the functioning of SLBC/ Union Territory Level Banker's Committee meetings, the SLBC Convener Banks have been given advice for preparing yearly calendar of the programmes (calendar year basis) in beginning of year itself, to conduct meetings. Calendar of the programmes should indicate clearly cut off dates to data submission to the SLBC and acceptance by SLBC Convener. This yearly calendar needs to be circulated to all concerned as advance intimation to block the future dates of the senior functionaries of the various agencies like State Government, Banks, RBI and Central Government etc. The SLBC/ UTLBC meeting needs to be conducted as per calendar under any circumstance. Agenda of the meeting should be circulated in advance without waiting for data from the defaulting banks.

ii. Objectives of preparation meetings calendar in beginning of year for ensuring adequate notice of these meetings and a timely compilation and a dispatch of the agenda papers to all the stakeholders. It ensures clear guidelines for submission of the data to SLBC Conveners by government departments and participating banks. Calendar is expected so that it would save precious time of the SLBC Conveners else lot of time is spent in getting dates from various senior functionaries who attend SLBC meetings.

iii. SLBC Convener Banks are required to appreciate advantages to ensure adherence to yearly calendars. SLBC Convener Banks therefore have been given advice for giving wider publicity to annual calendar in the beginning of year and ensuring that the dates of senior functionaries who are expected to attend meetings are blocked for all the meetings by their offices.

Implementation of Lead Bank Scheme

❖ **Preparation of credit plans**

Planning plays a very important role in implementing Lead Bank Scheme and bottom-up approach is adopted for mapping existing potential for development. Under the LBS, planning starts with identification activity wise / block wise potential which is estimated for the various sectors.

❖ **Potential Linked Credit Plans (PLPs)**

i. PLPs are step toward decentralized credit planning having basic objective of mapping existing potential for the development through bank's credit. PLPs take into account the following :

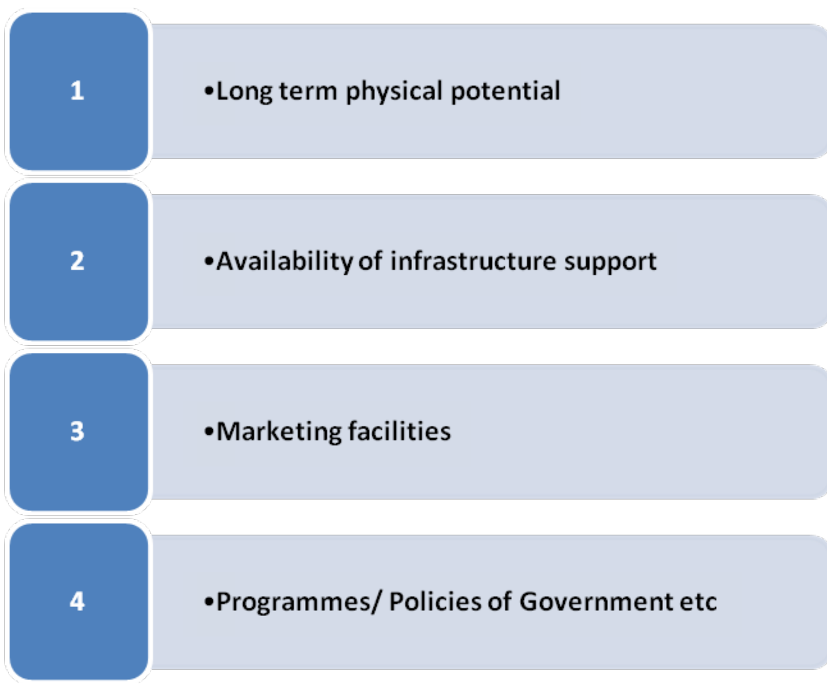

Figure 1.21 Features of PLPs

NABARD takes measures to ensure that the PLPs are required to be more focused and implementable, so that the banks could utilize them in a more gainful way while preparation of Branch Credit Plan. PLPs should emphasize on promoting sustainable agricultural practices which are suitable to the local conditions. While preparing PLPs, focus must be on identification of the following projects and processes that:

a) Reduces carbon foot-print,
b) Prevents overuse of various fertilizers,
c) Ensure efficient utilization of water
d) Addresses various agricultural pollution issues

These plans should also focus on promotion of innovative farming system which has been defined as below:

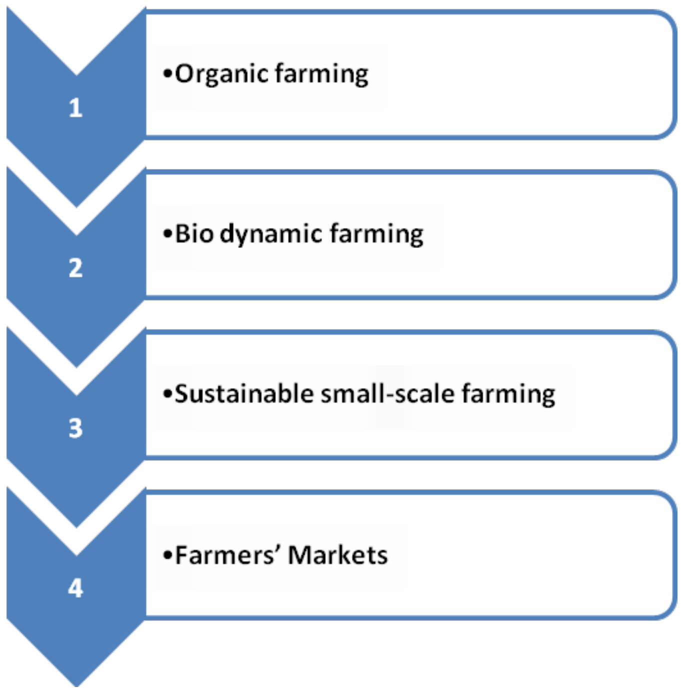

Figure 1.22 Innovative farming systems

Such initiatives are required to be supported by project finance framework and appropriate investments. A pre-PLP meeting is convened by the Lead Development Manager during June every year which has to be attended by the banks, Government agencies, etc., to reflect their views and concerns regarding credit potential (sector/activity-wise) and deliberate on major financial and socio-economic developments in the district in the last one year and priorities to be set out for inclusion in the PLP.

ii. Procedure for preparation of District Credit Plan

Controlling Offices of the commercial banks includes Small Finance Banks and Head Office of RRBs and DCCB/Lead Development Bank (LDB) circulated accepted activity-wise/ block-wise potential to all their branches for preparation of Branch Credit Plans (BCP) by their respective branch managers. Banks should also ensure that exercise of preparation of block/ branch plans is also completed in time by all the branches so that Credit Plans becomes operational in time.

❖ **Monitoring Performance of the Credit Plans**

Performance of credit plans is reviewed in various forums that are created under Lead Bank Scheme as shown below:

a) At Block Level Block Level Bankers' Committee (BLBC)
b) At District Level District Consultative Committee (DCC) & District Level Review Committee (DLRC)
c) At State Level State Level Bankers' Committee (SLBC)
d) Monitoring of LBS by RBI - Monitoring Information System (MIS)

Data on Annual Credit Plan (ACP) is a very important element for reviewing credit flow in State. ACP formats are aligned with extant reporting guidelines on lending to priority sector. Accordingly, ACPs have to be prepared for considering categories of the priority sector which would include the following:

1	•Agriculture
2	•Micro, Small and Medium Enterprises
3	•Export Credit
4	•Education
5	•Housing
6	•Social Infrastructure
7	•Renewable Energy
8	•Others

Figure 1.23 Priority sector lending

Further, it also has been decided that the bank loans to MSME (Services), which are engaged in rendering or providing of services which have been defined as in terms of the investment in the equipment under MSMED Act, 2006, should qualify under the priority sector without any credit cap.

To Do Activity

Ask the students to prepare a small write-up on any one of the following topics:

- Lead Bank approach
- Potential Linked Credit Plans (PLPs)
- District Level Review Committee (DLRC)
- State Level Bankers' Committee (SLBC)
- Innovative farming
- Priority sector lending

1.4 Rural Credit Institutions

Money lender had been enjoying a monopoly position in the villages, with time various Institutions have been extending credit to the people in the rural areas. Due to this extension of credit facilities since by various Institutions since 1950-51, monopoly position of money lenders have been challenged. Due to a progressive institutionalization of credit, the private sources are now meeting only 20% of short and medium-term credit needs of farmers. Institutional sources are now meeting about 80% of rural credit needs.It has been felt that there could be more reliance on the co-operative credit in future since commercial banks, are likely to utilize co-operative system for extending short term facilities mainly for production purpose instead of financing directly for agricultural operations.

The following are the Rural Credit Institutions:

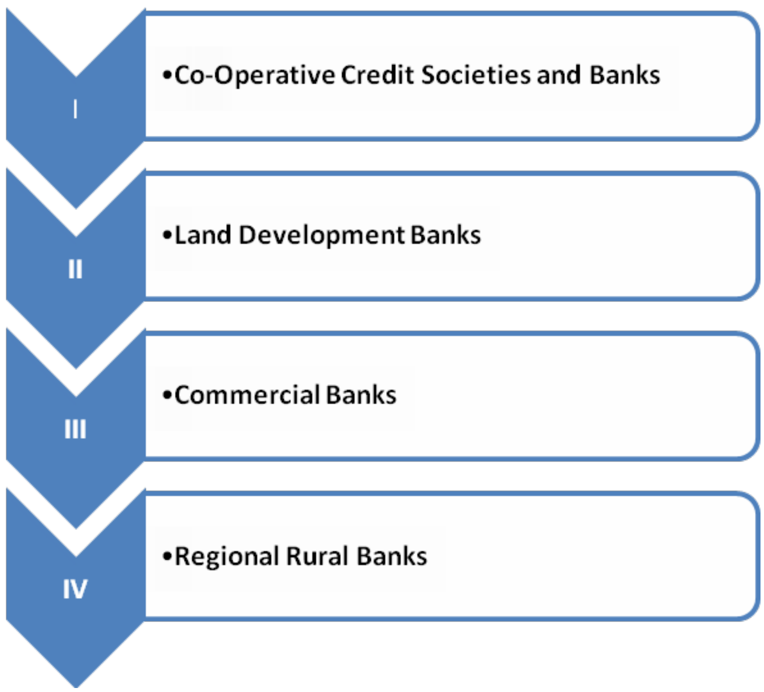

Figure 1.24 Major source of Rural credit in the formal segment

(I) Co-operative Credit Societies and Banks

Cooperative societies are regarded as cheapest and the most important credit source for the rural areas. When the co-operatives were set up for the first time, it was started with the thought that they would further meet credit needs of many small as well as medium farmers. As a result, moneylenders would withdraw lending money to the poor people. But this did not happen. Till 1950-51, the Co-operatives played passive role in rural credit area.

Co-operative societies have made a steady progress and also succeeded in some extent in promotion of thriftiness and also self-help to farmers. Increasing reliance has been placed by Government on the co-operatives as most important institutions to meet credit need of farmers. Due to assistance and encouragement being provided by Government also by NABARD, a notable progress has been made by the co-operatives in certain States i.e. Andhra Pradesh, Tamil Nadu, Punjab, Himachal Pradesh and Karnataka. Since the co-operatives were not able to meet entire credit need of farmers, money lenders still continue to dominate rural financial market. Maximum benefit is being derived by large farmers from co-operative societies. Small farmers were not able to meet their credit need through the co-operative Institutions. This movement has yet not taken roots in most of the eastern states like Orissa, West Bengal, Bihar and also Rajasthan. In most of the areas, unscrupulous money lenders, land owners and rich farmers have been working against movement. Consequently, really deserving and needy farmers have actually been deprived of benefits of the co-operatives.

Co-operative Banks

Advent of Co-operative movement in India

Problem of rural credit was main key reason behind advent of co-operative movement in India. This began with passage of Co-operative Societies Act in 1904. Next addition was Co-operative Societies Act, 1912, which focused on need for regulation of such societies and hence establishment of the appropriate bodies for overseeing their functioning. In India, the co-operative banks have to be registered under States Cooperative Societies Act. They come under regulatory ambit of RBI under two laws i.e. Banking Regulation Act, 1949 and Banking laws)Co-operative Societies) Act, 1955. The Co-operative banks have been brought under the supervision in the year 1966 and this was a move which also lead to problem of dual regulation for Co-operative Banks.

Source: www.moneycontrol.com

Cooperative bank were established on cooperative basis and deals in the ordinary banking business. Like the other banks, Cooperative banks were founded by collection of funds through share, accept deposit and grant of loans.Co-operative banks are the financial entities which were established on co-operative basis and belong to the members. This means that customers of co-operative bank are also owners. The Co-operative banks have been providing wide range of financial and regular banking services.

More than 50% of rural credit has been disbursed by Co-operative Banks and the Regional Rural Banks. NABARD is responsible for regulation and supervision of functions of the Co-operative banks and Regional Rural Banks. In the direction, Department of Institutional Development of NABARD has been taking many initiatives in the association with RBI and Government of India for improving health of the Co-operative banks and RRBs.

The Co-operative banking system is divided into two broad segments as mentioned below:

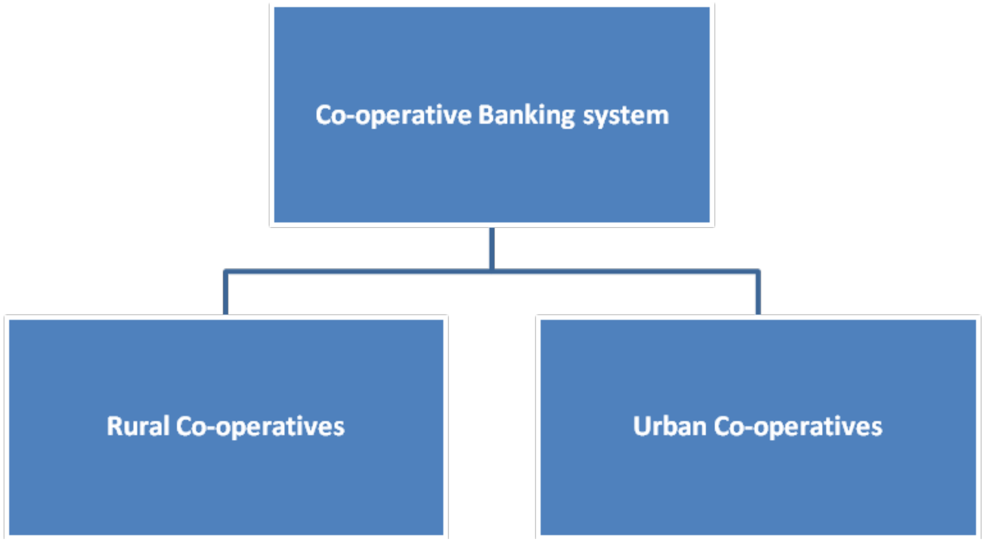

Figure 1.25 Co-operative Banking system

Both the segments Rural as well as Urban form a very important part of the financial system in India. With extensive coverage and wide network, financial institutions which are a part of the Co-operative Banking system has played a very important developmental role in enlarging ambit of the institutional credit through inculcating habits related to banking among poor and people who are residing in remote areas. In the recent times, co-operative banks have been trying to improve the credit delivery through various financial innovations.

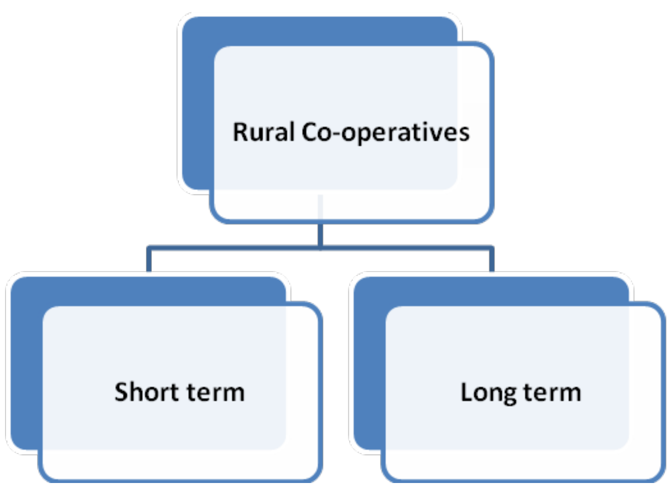

Figure 1.26 Agricultural credit from Rural Co-operatives

Long-term agricultural credit is provided by the land development banks. Short-term agricultural credit institutions cater to financial needs. Short-term co-operative banking system could be further divided as follows in three-tier structure.

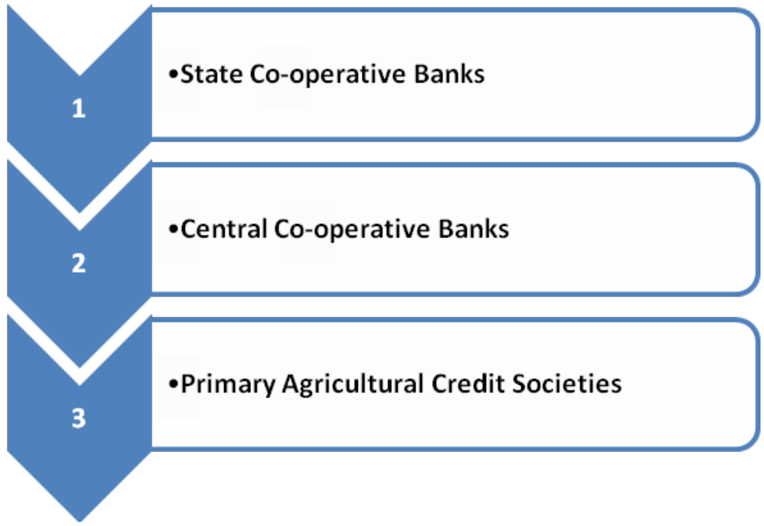

Figure 1.27 Short-term co-operative banking systems

1. State Cooperative Banks (SCBs)

State cooperative banks have following important functions:

a. Providing link through which RBI provide credit to cooperatives and also participates in rural finance
b. Function as balancing center for Central cooperative bank by surplus funds available of Central cooperative bank. There is no permission required for borrowing or lending to the Central cooperative banks
c. They have been financing, supervising and controlling central cooperative bank and also through them primary credit societies.

2. Central Cooperative Banks (CCBs)

Central cooperative banks are of two types:

a. There could be cooperative banking union for which membership is only open to members of cooperative societies. Such co-operative banking union exists in Punjab, Haryana, Rajasthan Kerala and Orissa.
b. There could be mixed central cooperative bank which has membership open to individuals and also cooperative societies. The Central cooperative bank in remaining states is of the mixed type.

The main function of these banks is providing loans to primary cooperative society. Some loan is given to individual and others.

3. Primary Agricultural Credit Societies (PACSs)

The PACSs form base in three-tier cooperative credit structure. It is village-level institution that directly deals with rural people. PACSs encourage saving among agriculturists, accept deposits, gives loan to needy borrower and collect repayments. They serve as last link between ultimate borrowers, i.e., rural people on one side and higher agencies, i.e., Central cooperative banks, State cooperative banks and RBI on the other side. This type of society could be started with 10 people or more in a village. Membership fee is very nominal such that any poorest agriculturist could also become member. Members of society have an unlimited liability that means each member undertakes the full responsibility of entire society's loss in case it fails. Management of society is under control of elected body.

Long-term co-operative banking system could be further divided as follows in two-tier structure.

Figure 1.28 Long-term co-operative banking system

a. At state level, there exists State or the central land development bank, which is known as State Cooperative Agricultural and Rural Development Banks (SCARDBs) now, which is generally one in each state. These were known as the Central land mortgage bank previously.
b. At local level, there exist branches of State land development bank or the SCARDBs and primary land development banks that are known as Primary Cooperative Agricultural and Rural Development Banks (PCARDBs) now. In a few states, there are no such primary land development banks, but branches of state land development bank. In Madhya Pradesh, State cooperative bank functions as state land development bank. In the other state like Kerala, Maharashtra and Andhra Pradesh there exists two or more State land development banks.

Urban Co-operative Banks (UCBs)

UCBs are registered in form of societies under the Co-operative Societies Act of respective State Government and the UCBs which have presence in multi State presence are registered under Multi State Co-operative Societies Act which is administered by Indian government. The following of UCBs are governed by State Co-operative Societies Act:

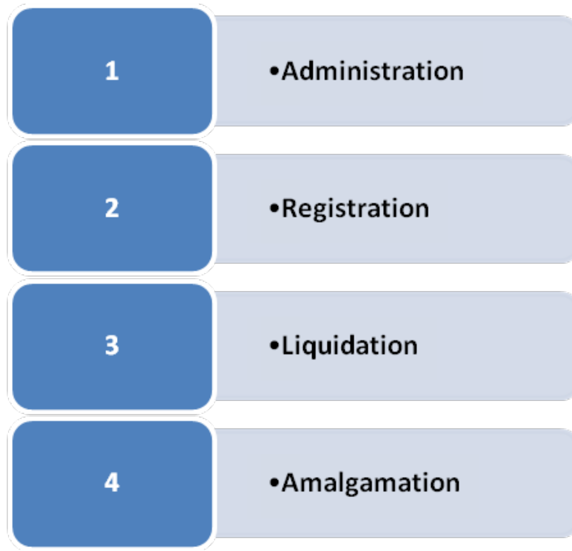

Figure 1.29 Functions of UCBs governed by State Co-operative Societies Act

The banking related functions are governed by provisions of the Banking Regulation Act, 1949.
The UCBs play a very important role as a financial intermediary in the urban and semi-urban areas which caters to needs of non-agricultural sector who are particularly small borrowers. In context of current economic scenario and the problems being faced by co-operative banking sector, there have been several initiatives which were taken into consultation with associations and federations of co-operative banks. RBI has taken many initiatives for addressing regulatory and procedural issues. Consultative process is already in place regarding the UCBs in form of Standing Advisory Committee.

With regards to the structural issues, RBI would encourage growth of viable and strong entities within sector through consolidation. Further, RBI would continue pursuing with State and Central Government regarding issues which arise within their jurisdiction. As per report published by Business Standard, UCBs with deposits of over Rs 100 crores are required to set up Board of Management (BoM). In the financial year ending 2019, there were 647 UCBs that which have deposits over Rs. 100 crores and had deposits of Rs. 4,47,907 crores. If all the UCBs having deposits as per the above criteria and they were to appoint BoM which has minimum of five members, there will be a requirement of 3,235 qualified people who will be required to get nod of RBI.

(II) Land Development Banks (LDBs)

The evolution of the LDBs in India could be put into three distinct phases. The first phase is Land Mortgage Banks (LMBs), that were established and they were mainly confined to the provision of long-term credit to farmers for debt redemption or acquiring ownership rights on land against the mortgage of land based securities that continued up to the mid 1950s.

Second phase started virtually after findings as well as recommendations of All India Rural Credit Survey Committee (1954) that recommended need for separate Long-term Cooperative Credit Structure and also establishment of the LMBs in all the states. This committee gave suggestion that LMBs segment of cooperative credit system is required to be restructured to broaden the base of its activities for providing finance to farmers for acquiring assets which are required for improvement in agricultural productivity. Accordingly, certain steps were taken up by Agricultural Credit Department (ACD) of RBI in consultation with Indian Government for implementation of these recommendations and also allowing LMBs to undertake the financing for investments in the productive purposes related to agricultural activities like purchasing pump sets, sinking wells and also for other agricultural equipments and implements.

After recommendation of All India Rural Credit Review Committee, there was a shift in credit disbursement from conventional functions, viz., and debt redemption and rights ownership toward granting loans for meeting the credit requirements of the agriculturists for investment purpose. It is in this context, the RBI had also set up in 1963 a separate body, i.e., Agricultural Refinance Corporation (ARC) for supplementing of banks' resources. The current phase could be construed as third phase in which Land Development Banks' (LDBs') operations cover virtually all the rural economic activities which include those in non-Farm sector with formation of NABARD in 1982.

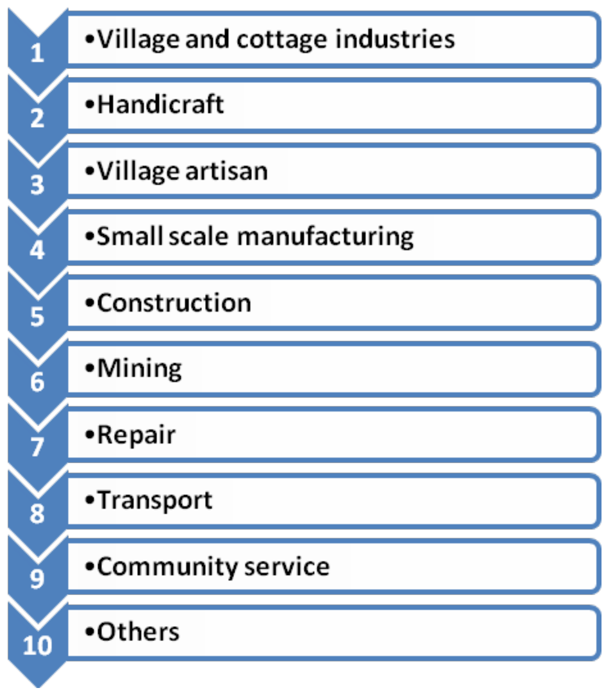

Figure 1.30 Examples of Non-farm sector

With shift in overall functions and coverage of LMBs and later LDBs, to role of encompassing virtually all the rural economic activities, the LDBs came to be known as Agricultural and Rural Development Banks.

There have been progress in such Banks during last few years, but contribution has been insignificant still. These Banks have not yet reached the root of credit problem in rural areas. Many farmers are not even aware about that these Banks exist and how useful can these banks be for them. These banks are increasing in number and these banks are setup by State Government. The rich farmers have been taking benefit from these banks as they have larger land holdings. Marginal and small farmers could not benefit much from these Banks.

Agriculturists need long-term credit to make some permanent improvement in land or repaying debt or for purchasing some agricultural machinery and some other implements. In a traditional way, long-term requirement of agriculturists was mainly met by the money lenders and other agencies. But the credit source was found to be defective and was responsible for farmer's exploitation. The Cooperative banks and the commercial banks are unable to provide long-term loan as their main deposits are demand deposits of short term in nature. There was great need of having specialized institution for supply of long-term credits to the agriculturists. The establishment of CARDBs was an effort in same direction. There is a large untapped business potential which is lying for PCARDBs and SCARDBs.

(III) Commercial Banks

Commercial banks are financial institutions that perform functions of accepting deposits from public and giving loan for investment with an aim of profit earning. Commercial as the name suggests are doing business for seeking profit i.e. they are doing banking business for earning profit. They are generally financing commerce and trade with loans which are short-term in nature. They are charging higher interest rate from borrowers but are paying lesser interest rate to the depositors and this result in profit which is the difference in the interest rates. Commercial banks are borrowing money for lending so that they could earn profit from the difference in rate of interest. Two most distinctive features of commercial banks are mentioned as below:

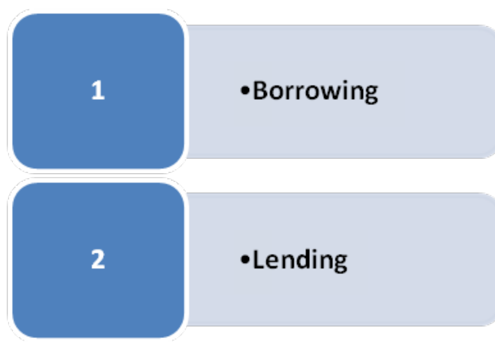

Figure 1.31 Features of Commercial Banks

The interest rate which is offered by banks to the depositors is called borrowing rate and the rate which is offered to the banks for lending out is called the lending rate. Difference between interest rates is called 'spread' that is appropriated by banks.

Types of Commercial Banks

The following chart shows the main types of commercial banks

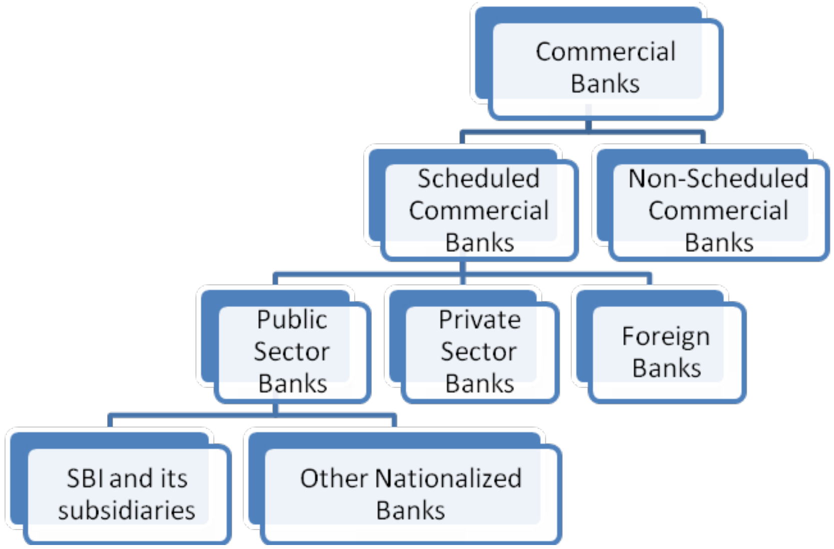

Figure 1.32 Types of Commercial Banks

Scheduled Banks

These Banks are included in the Second Schedule of RBI. There is a requirement for scheduled bank to have paid-up capital and reserves of at least Rs 5 lacs. RBI provides special facilities which also include credit to the scheduled banks. Some important scheduled banks are State Bank of India (SBI) and its subsidiary banks, nationalized banks, foreign banks, etc.

Non-Scheduled Banks

These Banks are not included in the Second Schedule of RBI. A non-scheduled bank has paid-up capital and reserves of lesser than Rs 5 lacs. These banks are small and their area of operation is limited. There are various types of banks which come under the category of Non-scheduled banks. Non-scheduled Banks could be of the following type:

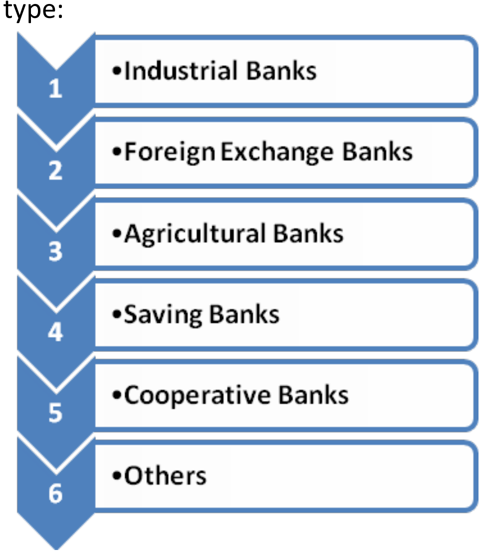

Figure 1.33 Types of Non-Schedule Banks

(1) Industrial Banks

These banks provide finance to the industrial concerns through subscription i.e. buying of debentures and shares of the companies and giving long-term loans for acquiring plants, machinery etc.

(2) Foreign Exchange Banks

These Banks are commercial banks that have branches of the foreign banks and they facilitate international financial transactions by buying and selling of the foreign bills.

(3) Agricultural Banks

These Banks finance agriculture and also provide long-term loans to buy tractors and installation of tube-wells.

(4) Saving Banks

These Banks mobilize small savings of people in their saving account, for example Post office saving bank.

(5) Cooperative Banks

These Banks are organized by people for their own collective benefits. These banks advance loans to their own members at a fair interest rate.

(6) Other Banks

There are some other banks which have not been covered in the list above which are working as Non-scheduled bank under RBI.

(IV) Regional Rural Banks (RRBs)

In the year 1975, Government setup network of RRBs for looking into special needs of marginal and small farmers, rural artisans, poor in rural areas and landless workers. Unique feature of 196 RRBs which were operating since the month of September 1990, they cater exclusively to weaker section of rural community through around 14,800 branches which are spread throughout India. Almost all tribal districts were covered. However, credit amount which was disbursed by the RRBs was smaller as compared to loan issued by the other institutional agency.

Almost all tribal districts have been covered by RRBs. RRBs have been in general lending around Rs. 400 per annum on an average. Atleast 90% of branches of the RRBs have been opened in the unbanked areas and most of advances i.e. around 92% are granted to the weaker sections, average size of advance per account is just Rs. 2,000. However, the amount of credit disbursed by RRBs was very small compared to the loans issued by other institutional agencies.

In the year 2001, RBI constituted Committee under Chairmanship of Dr. V. S. Vyas on "Flow of Credit to the Agriculture and other related Activities from Banking System" which examined RRBs relevance in system of rural credit and alternatives to make it viable. Consolidation process was initiated in 2005 as per the off-shoot of Dr. Vyas Committee's recommendation. The first phase of the amalgamation was initiated Sponsor Banks-wise within State in the year 2005 and second phase was across Sponsor banks within State in the year 2012. NABARD have been involved actively in RRBs amalgamation. This process was initiated with view for providing a better customer service through better infrastructure, experienced workforce, computerization, marketing efforts, common publicity etc.

The amalgamated RRBs benefitted from large area of operation, diverse banking activity and an enhanced limit for credit exposure for higher value. After the successive amalgamation, number of the RRBs in country as on 31 March 2018 stood at 56, having a network of 21,747 branches covering 683 notified districts in 27 States and UT of Puducherry. RRBs do not exist in Delhi, Goa and Sikkim. During 2018-19, recapitalization assistance of Rs.108 crores was released to 4 RRBs by Indian Government as mentioned below: (Source www.nabard.org)

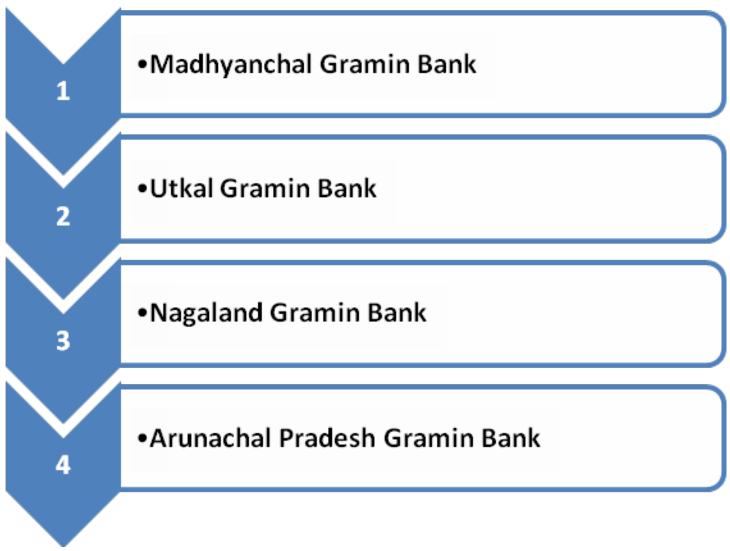

Figure 1.34 Recapitalization assistance released to 4 RRBs by Indian Government

To Do Activity

Ask the students to form group of 4-5 and ask them to prepare a presentation including the following about any one Scheduled Commercial Bank in India:

- Brief history
- One deposit and two loan products being offered to people of rural areas

1.5 Role of Commercial Banks in Rural Finance

Commercial banks play an important role in economic development of country. The modern industrial economy could not exist without the commercial banks. Commercial banks constitute the nerve centre of industry, trade and production of our country. Bank could be referred to central point and heart of the modern exchange economy. Before nationalization of the top 14 commercial banks in the month of June 1969, commercial banks were biased towards urban areas. Commercial banks were accepting deposits from urban people and money was being lent to industry and trade. The industries in rural areas and agriculture were being neglected. Agriculture was being considered as risky venture and the private commercial bank turned far away from the rural areas.

However, one objective of nationalization of the commercial banks was ensuring smooth flow of agricultural credit and credit to small-scale industries and as such these two sectors are the top priority sectors of India. Since nationalization of the commercial banks in the year 1969, there has been stress on strengthening and expanding institutional structure of credit in rural areas. The rural areas are not being served properly by banking institutions. Most commercial banks are feeling shy in blocking their funds in the risky agricultural operations.

There is a little chance of recovering loan in most cases because of high risks which is associated with various natural calamities. The commercial banks have been providing finance for marketing of crops through advancing fund to the traders. Sometimes the banking institutions lend money directly to the rural borrowers. The loan amount of such type of loans which are lent directly to the people belonging to rural areas is small. After nationalization, there have been various changes in attitudes as well as lending policies of the commercial banks.

Significance of the commercial banks

i. Promotion of savings and accelerating rate of formation of capital.
ii. These banks are source of credit and finance for industry and trade.
iii. Promoting balanced regional development by the opening branches in the backward areas.
iv. Bank's credit enables the entrepreneurs towards innovation and investment that accelerates process of the economic development.
v. These banks help in promotion of production on large-scale and growth of the priority sectors like small-scale industry, agriculture, export and retail trade.
vi. They have been creating credit in sense that they give more advances and loans than cash position of depositor's permit.
vii. (vii)They help industry and commerce in expanding field of operation.
viii. They have been making optimum utilization of the resources which are possible.

The semi-urban and rural branches of commercial banks have been controlled at regional level by their regional offices, and these offices are further coordinated at zonal level by their zonal offices, having headquarters of these banks responsible for the overall supervision and control. Commercial banks have sponsored, in collaboration with central and the state government, local district level banks known as RRBs. Progressively a larger share of agricultural credit on ground-level is accounted for by the commercial banks. Remarkable feature of RFIs is the comprehensive coverage that they have in different segment of the rural society, which includes marginal and small farmers. Many households among disadvantaged section of the rural society have now been covered by the RFIs with organizations of the self-help group of poor artisans and farmers with their coordination with banking institutions.

Various forms of agricultural credit being provided by Commercial banks have been mentioned below:

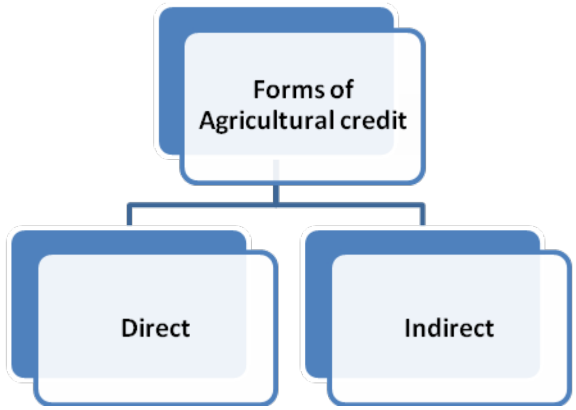

Figure 1.35 Forms of Agricultural Credit given by Commercial banks

Commercial banks have been providing direct as well as indirect finance for agricultural needs.

(1) Direct finance

Commercial banks have been providing short as well as medium terms for enabling farmers carrying out various agricultural operations smoothly.

(2) Indirect finance

Commercial banks have been providing credit for purchasing various inputs like fertilizers and seeds. Indirect loan are also made available through PACs.

Commercial banks have not only providing assistance for various agricultural operations, rather they also extend credit to various service units that provide infrastructural facilities.

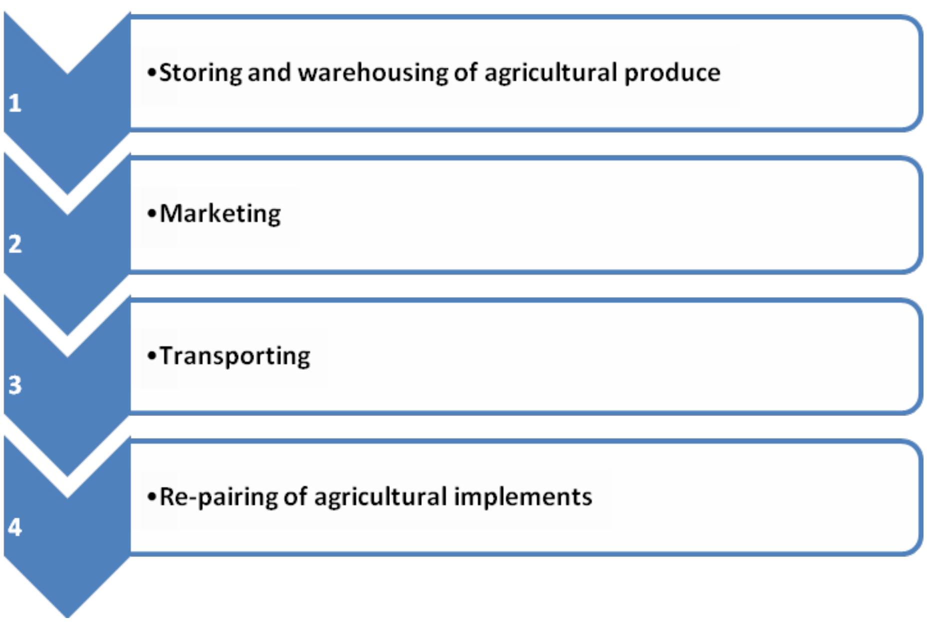

Figure 1.36 Examples of Infrastructural facilities in Agriculture

Farmers get assistance from commercial banks under some schemes as the Small Farmers Development Agencies (SFDAs) and the Marginal Farmers and Agricultural Laborers (MFAL). Commercial banks also sponsor RRBs to extend credit to marginal and small farmers and protecting them from being exploited by the money lenders.

Role of Commercial Banks in Economic Development

Commercial banks have been carrying out various commercial banking functions and have played a very effective role in economic development. In India, majority people are unemployed, poor and engaged in agriculture. There are many problems being faced by people in India and commercial banks are required to play an important role for helping people in facing these issues. Some issues are listed below:

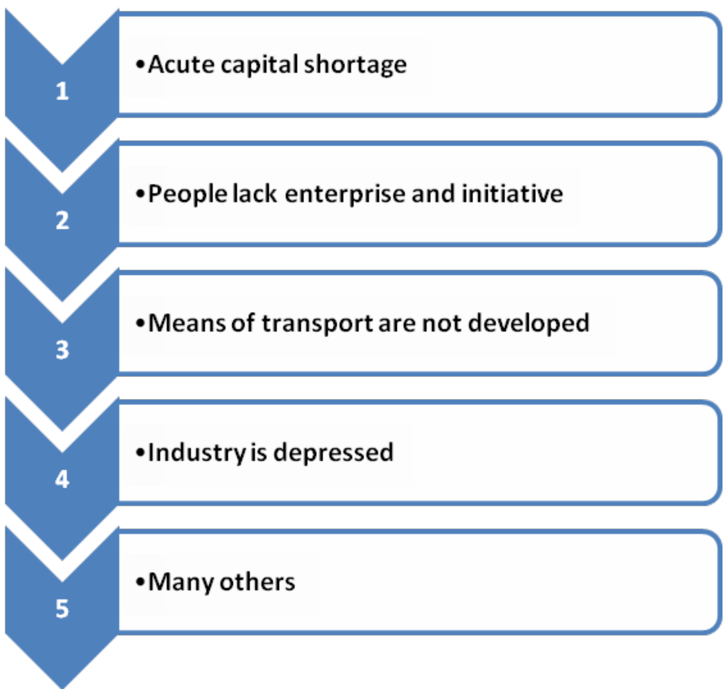

Figure 1.37 Problems being faced by India

Commercial banks have been helping in overcoming the above mentioned obstacles and thus help in economic development.

Role of Commercial Banks in Rural Finance

Our economy is mainly agrarian. Banks have been playing a very important role in the development of rural areas. Rural branches of the banks provide various services to rural farmers, disadvantaged groups as well as businessmen and helping them towards their development. Nationalized Commercial Banks as well as some private sector banks are operating in the rural areas. Specialized banks have been playing a very important role in the rural areas. Foreign banks are not at all interested for opening branches in the rural areas.

Commercial banks are playing a very important role in the development of rural areas. The people in the rural areas are less educated, have lower income, there are lesser employment opportunities and awareness level is also very low. Because of these factors, the people in rural areas are unable to avail facilities from banking sector. There is a need to spread awareness among people in the rural areas, so that they could become a part of the banking system. All the people in the rural areas are not poor and there is a need to make them understand the need of savings. There are some people who need money and there are some people who have extra funds. The people in the rural areas should start saving money in banks, so that these funds would be available for loans for the people who need funds and this will start rotation of funds. Loans could actually help people in the rural areas to develop business which would help in development of the economy and also help them to raise their standard of living and also help them to fulfill needs of their family members. There is a need for the government and commercial banks to work more towards the development of rural areas.

The role of commercial banks in rural finance has been mentioned in detail below:

Figure 1.38 Role of Commercial banks in rural finance

1. Mobilizing Savings for Formation of Capital

Commercial banks have been helping the people in the rural areas in mobilizing savings through a network of many branches of commercial banks. People in rural areas are having low incomes but banks have been inducing them towards savings through introduction of a variety of deposit schemes which would suit needs of the individual depositors. The money of the rich people staying in rural areas which has been idle is also being mobilized into investments for productive purposes. Commercial banks have been motivating people for savings through its various programmes and also collect savings from people. Banks invest these savings in rural economy. Banks play a very important role in formation of capital. Banks distribute loans for various activities which could be productive or any other activity which is self-sufficient economic activity.

2. Financing Industry

Commercial banks have been providing finance to industrial sector in different ways. In India, commercial banks undertake medium term and short-term financing to the small scale industries and also provide hire- purchase finance. Banks have been playing a very crucial role in developing and sustaining small and cottage industries. The cottage and small industries in India are finding it difficult to sustain business because of lack in sufficient capital. Banks could provide the youth who are unemployed with proper training and loans for starting business or for investing in farms. These training and incomes generating projects could make the youth self reliant, reduce intricate problems related to unemployment and also improve living standard among people of rural areas.

3. Financing Trade

Banks have been providing rural small businessmen through loans from the money which has been deposited by other people and this plays very important role in the rural development. Micro credit programs which are being provided by different commercial banks made people staying in rural areas enter into the banking sector. Banks not only provide funds for various industries, rather also provide funds for carrying out trading activities. Some people start their own business of trading or any other economic activity they need funds for running business. Commercial banks provide loans to wholesalers as well as retailers for stocking goods in which they are dealing with.

4. Financing Agriculture

Commercial banks have been helping agricultural sector in many ways. Loans are being provided for trading the agricultural commodities to the traders. There are many branches which have been opened by the commercial banks for helping people in rural areas for providing agricultural credit. Banks provide finance directly to the agriculturists for marketing of their agricultural produce, for modernization and mechanization of their farms, to provide irrigation facilities for development of their land, etc. Loans are being provided for various other agricultural activities like the following:

1. Dairy farming
2. Animal husbandry
3. Poultry farming
4. Sheep breeding
5. Horticulture
6. Pisciculture

Figure 1.39 Agricultural activities for which loan is provided

The marginal and small farmers and the landless agricultural workers, petty shopkeepers and artisans in the rural areas are being provided financial assistance throughRRBs in India. The RRBs operate under a particular commercial bank. Commercial banks have been meeting all types of credit requirements to the people in rural areas. Commercial as well as specialized banks distribute Agricultural loans for the rural people make them able to invest in their lands or firms. Most of the farmers are very poor and they cannot invest sufficient funds for increasing production. Loans from banks help the farmers in increasing production through proper fertilization, irrigation etc. and various other purposes.

5. Financing Various Consumer Activities

In India, many people who are living in the rural areas are very poor and have lower income. These people don't have sufficient funds for buying consumer durable goods like scooter, fan, refrigerator, washing machine etc. Loans help poor people in raising their living standard. People in the rural areas should be encouraged to understand their need for finance and should try to get in touch with commercial banks to find out whether loans could be sanctioned for the required purpose or not. Getting loans from commercial banks has now become easier, the only need is that the people in the rural areas understand the fact that the commercial banks have been trying hard to include the excluded people in the rural areas.

6. Financing Employment Generating Activities

Commercial banks have been providing finance for employment generating activities. Loans are being provided for education of young people for studying under various streams like medical, engineering, vocational institutions of higher learning. Commercial banks advance loans to the young entrepreneurs, engineering and medical graduates and other technically trained people for establishment of their own startup or business. These loan facilities are being provided by many commercial banks. The banks have not only been helping in formation of capital, rather also help in increasing the entrepreneurial activities in the developing countries like India.

7. Help in Monetary Policy

Commercial banks help in the economic development through monetary policy of RBI. RBI depends upon commercial banks for success of monetary policy management as could be possible to be followed in developing economy like India. Commercial banks have contributed towards growth of developing economy through loans to various sectors i.e. trade, industry and agriculture through human and physical formation of capital and through monetary policy of RBI.

Factors Obstructing the Flow of Bank Credit to Agriculture

There are certain factors which have been creating obstruction in the credit flow. The farmers are unable to fulfill certain terms and conditions and hence it becomes difficult for them to avail loan facility from the formal Institutions. The informal segment remains the main source of finance for the people of rural areas. The commercial banks in India are not very effective in development of the rural areas. There are a number of causes which have resulted in this failure. Some causes have been mentioned below:

1. Inability of farmer in providing security
2. Government loans are not being distributed properly
3. Difficulty in loan recovery
4. People not oriented towards investment and savings
5. Lack of up-to-date accounting of agricultural transactions
6. Unable to utilize loan amount properly
7. People find getting loan complex
8. Small amount of loan
9. High cost of transaction

Figure 1.40 Factors obstructing the flow of bank credit to agriculture

(1) Inability of Farmer in Providing Security

The farmers are unable to provide security while availing loan from the formal institutions. Security plays a very important role and this somehow reduces the risk that exists in the loan. Farmers in the rural areas are not having sufficient income for buying assets which in future they could provide for availing loan facility from banks.

(2) Government Loans are not being Distributed Properly

There are certain problems in bank's management which disrupts the process of loan distribution and collection. Government has been providing assistance to people in rural areas through various forms of loans which would help in development of rural areas and this would inculcate the habit of savings as well as investment among people in rural areas. Government loans are not distributed properly in a systematic manner and proper channel.

(3)Difficulty in Loan Recovery

Loan recovery becomes difficult as generally people who residing in the rural areas do not provide a security and sometimes due risk prevailing in the agricultural sector, there is always a risk regarding the output and sometimes because of seasonal fluctuations the output varies and this results in difficulty in loan recovery.

(4) People not Oriented Towards Investment and Savings

People in rural areas do not have an orientation towards savings they are not having mentality of savings as they are not focused on their future. Majority people in the rural areas are having low income and they are focused on current expenditure rather than being aware about their future opportunities. The amount which is available with the poor people is not much that they could even think of enhancing their savings or even investing their small savings for future. There is a requirement that the poor people are encourage and motivated towards saving and investment.

(5)Lack of up-to-date Accounting of Agricultural Transactions

The farmers do not maintain proper record of financial transactions and this result in improper information available with the farmers which they could provide to the financial institutions.

(6) Unable to Utilize Loan Amount Properly

The loan amount which is distributed to the people in the rural areas is not being utilized properly. Getting loans from banks have now become easy for the poor people as there are various types of loans which are being provided by banks to them. Getting loan and utilizing the loan amount is quite different and it is very important that the people who are getting loans also understand the ways in which the amount could be utilized properly. Banks are not undertaking proper training programs for making the rural people in making the best use of funds which have been provided by the banks for a particular need.

(7) People Find Getting Loan Complex

People in the rural areas are not having enough information about availing the banking facility. Many people are still excluded from the banking system. Majority population of India is dealing in the agricultural sector and it is very important that banks focus on providing loans to people in the rural areas. People face serious complexities for getting loans. Rural people find it difficult in understanding the process of sanctioning loans. There is a need to spread awareness among people in the rural areas so that people apply for loans and meet their business needs and also buy loan to consumer durable goods. People are getting loans and are not returning them in time.

(8)Small Amount of Loan

The loan amount is also low which is availed by farmers.

(9)High Cost of Transaction

They consider the cost of transaction to be high.

To Do Activity
Ask the students to write few points about any one innovative activity which has been done by any Commercial bank in India towards rural finance.

Summary

The growth of rural credit depends on funds which are available from one interval to the other interval, for understanding the high rise productivity in agricultural and non-agricultural areas. Interval gap from sowing seeds to understanding of the post-production revenues is comparatively very long, farmers need money from various fronts for matching primary investment of buying seeds, tools, fertilizers and for expenses.

Rural credit is a very important part of development of the economy. Being a key component sector of Indian economy, RBI has historically located priority to delivery of agricultural credit. The RBI Act, 1934 envisage a developmental role for Reserve Bank in agricultural credit with the responsibility particularly towards financing for seasonal operation and marketing of crops.

NABARD is Apex Development Financial Institution in India. The Bank has been entrusted with "matters concerning Policy Planning and Operations in the field of credit for Agriculture and other Economic activities in Rural areas in India". NABARD has been active in development of the Financial Inclusion policy. Lead Bank approach was introduced by RBI in the month of December 1969. This scheme aimed to coordinate banks activity and other developmental agency for achieving the objective to enhance flow of the bank finance to priority sector and various other sectors and for promoting banks' role in overall development of rural sector.

Money lender had been enjoying a monopoly position in the villages, with time various Institutions have been extending credit to the people in the rural areas. Due to this extension of credit facilities since by various Institutions since 1950-51, monopoly position of money lenders have been challenged. Commercial banks constitute the nerve centre of industry, trade and production of our country. Bank could be referred to central point and heart of the modern exchange economy. Before nationalization of the top 14 commercial banks in the month of June 1969, commercial banks were biased towards urban areas. Commercial banks were accepting deposits from urban people and money was being lent to industry and trade. The industries in rural areas and agriculture were being neglected. Agriculture was being considered as risky venture and the private commercial bank turned far away from the rural areas.

Model Questions

- Discuss about various segments of rural credit system in India in detail.
- What are the types of rural credit? Give some examples in support of your answer.
- Discuss the role of NABARD in economic development.
- Discuss the types of refinance being provided by NABARD to various Institutions?
- What do you understand by Lead Bank scheme introduced by RBI?
- Explain the structure of Co-operative Banking system.
- Discuss the features and types of Commercial banks.
- What role do Commercial banks play in rural finance?

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Chapter 2 – Financial Inclusion

Introduction

Majority people in country are not having access to banking as well as financial services and also as a result these people remain excluded from horizon of economic development. Main reason for slow inclusion is absence of appropriate delivery model and products that satisfy financial need of lower income families. There is requirement of affordable and uncomplicated product by banks that help them to mobilize their savings and bringing them in formal financial system. Entire emphasis of RBI, Government and banks is on opening of more accounts. Merely opening account would not help in financial inclusion. People working in the unorganized sector have been dealing through a middleman and they fall into clutches or traps of money lenders. It is very important to include these people under financial inclusion so that they could become a part of the formal system and are safe from the higher rate of interest being charged by money lenders.

Financial inclusion requires consistent effort that would come at cost, since banks are actually profit making organizations. There is a need that government makes budgetary provisions for the cost incurred by banks and then reimburse this amount to the banks accordingly. Government infuses capital in the banks as debt restructuring. Banks should provide doorstep banking services so as to make people become a part of financial system. RBI introduced BC and BF model, so that the areas which remain away from the formal financial system and people staying in rural areas could not be a part of the banking system, since many banks did not have branches in the rural areas. Business Correspondents (BCs) play a very important role to achieve financial inclusion. The BCs act like a bridge between the Bank branches and people in particular area. BC is the first point of contact and front face of bank branch for people. For enabling BCs in being more effective, there is a need that they possess sufficient knowledge to deliver the services required.

In existing system, cash is drawn from BCs drawer and simultaneously account of BC in bank is credited. Once BC model gains popularity, there might be an issue in cash management with BC and there will be a requirement to address this need for making BC model successful. Cash management involves a lot of risk and they face problems as Banks do not share such risks with them. Availability of cash, quality of services delivery and consumer protection could be assured with encouragement and promotion of BCs. For real success of BC model, the charges and salary to BC needs to be rationalized. There is a need for incentivizing BCs for doing a good work. Banks also should show interest for recruiting BCs and this might create employment opportunities for the rural youth which also includes women. There is a requirement for monitoring constantly. The services of BCs are required to be ensured through social audit. There is a restriction that BCs cannot take any kind of charge or commission from persons. One reasons for such slow progress in financial inclusion could be said to be absence of coverage and reach by the banks. This gap could be bridged through users of Information and Communication Technology (ICT).

Objectives of the Chapter

- To understand the role of ICTs in rural banking
- To identify RBI policy initiatives towards financial inclusion
- To understand the role of inclusive growth for rural development banking
- To evaluate the role of business facilitators in financial inclusion
- To understand the role of Business Correspondents in rural financing

Content

2.1 Role of Information and Communication Technologies (ICTs) in rural banking

In India, banking sector has witnessed complete transformation in operations both in the functioning of banks as well as services delivery. In current scenario, technology is main driving force for all businesses and has enabled the banking customer to operate from home or their workplace. Today, customers can easily operate their bank accounts without even visiting the bank branch for any transaction or rather it could be said that for everything. With advancement of the technology in banking, there is an immense usage of internet, online bill payment and mobiles in the banking sector and this has brought new facet in banking altogether. Most banks have become technology enabled, hence focus have shifted to rural banking. Operational expenses of public sector banks has increased a lot and it has become a big problem for public sector banks for opening and running the branches opened in rural areas and making rural banking more profitable.

ICTs are changing each sphere of people's life. ICT holds tremendous potential for development of rural areas in India in field of health, education, banking and agriculture. One main reason for unequal distribution of economic gains among the population in the urban and rural areas is about gap in accessing information. ICTs could contribute towards automation of the Rural Banks, information sharing, networking and provisions of ICTs have enhanced distance learning in the entire country. There are certain issues like unavailability of proper electricity supply, high Cost ICTs Equipment, low Literacy Levels and Lack of ICT Personnel, lack of Telecommunications Services, internet access etc. exist in the rural economy because of which it becomes difficult for the banks to make ICTs function in rural banking.

Implementation of ICTs in Rural banking

ICT plays a very important role in the lives of people in rural areas. Banking could be made easy among the rural areas through implementation of the following:

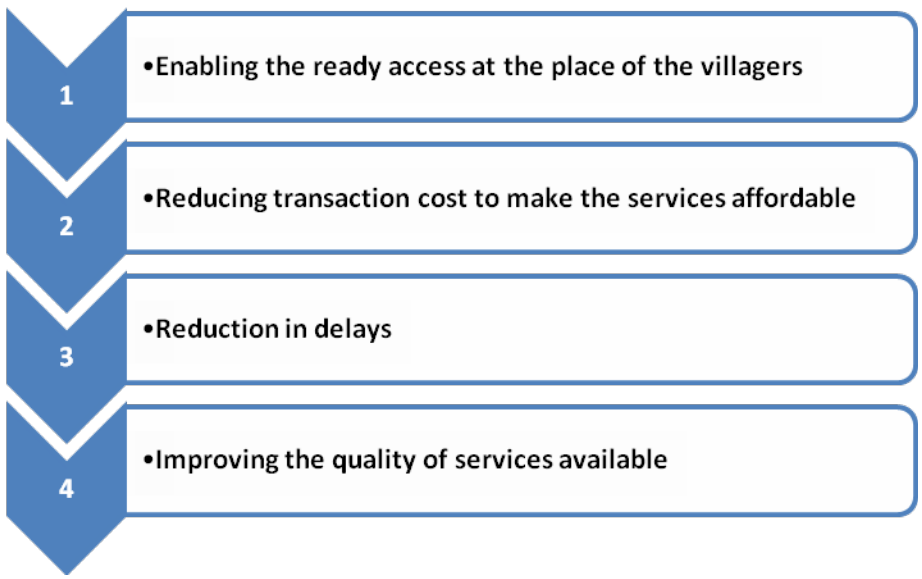

Figure 2.1 Implementation of ICTs in rural banking

(1) Enabling the ready access at the place of the villagers

Banking technologies should be well developed so that people in the rural areas are encouraged to use banking services in an easy manner. Technology has made it very easy to utilize banking services from anywhere and anytime. Banking services should be readily available to the people in rural areas only then they will be encouraged to use them time and again.

(2) Reducing transaction cost to make the services affordable

The transaction cost should be reduced so that people understand the need of technology in banking and start using banking services through different modes which are available nowadays in banking sector. Sometimes people living in rural areas feel that the transaction cost of using technology in banking is more and hence they are afraid of using digital banking services. A Bank charges various charges for doing transactions like cash deposit/ withdrawal, transferring money, using ATM, Internet etc.

(3) Reduction in delays

It is very important that the people in the rural areas are made aware about the utility of banking technology. The delays should be reduced while a banking transaction is being executed. Sometimes due to network failure, electricity issue or any other problems, the transaction gets delayed. Banks having branches in rural areas should try to reduce the delays by finding solution to the problems being faced at the rural bank branches.

(4) Improving the quality of services available

The quality of banking services should be improved. The banking services being provided to the urban and rural areas are different as per the needs of the public like many people in rural areas have smaller savings, need smaller amount of loans etc as compared to people of urban areas. There is requirement that the services being provided to the people in the rural areas should also be analyzed and accordingly banking services should be improved and modified.

Technology and rural banking

New technology in banking has allowed people to use banking services without physical direct recourse towards bank premise by customer. Automated Teller Machines (ATMs) could be the best example which is being used in urban as well as rural areas. Technology-led process is leading to increase in customer base in the urban and rural areas. Now, Banks operating their branches in rural areas are making people aware about using the latest technology while processing various banks' transactions. The Indian Government and the RBI have been putting concerted efforts for promoting financial inclusion. Financial Inclusion and technology are popular coinage in the banking parlance. The main hurdles in financial inclusion have been larger numbers and lower volumes which results in unaffordable costs. Leveraging technology is the only way for improving reach to remotest corner of country and reducing cost to affordable level.Certain technological products like Immediate Payment Service (IMPS), Electronic Know Your Customer (e-KYC), mobile banking could actually help in making banking facilities available throughout the breadth and length of our country. These products could actually act as game changer as in terms of convenience, speed and cost of reaching. Various organizations under RBI's guidance like National Payments Corporation of India (NPCI), Institute for Development & Research in Banking Technology (IDRBT) etc. have been contributing significantly in the introduction of new products based on technology. RBI has been involved actively in harnessing technology for development of the Banking sector in India over last few years. One such major Banking technological development is adoption of Core Banking Solutions (CBS). CBS has enhanced customer convenience through anytime, anywhere banking. CBS adoption has led banking towards various technological products like Real Time Gross Settlement (RTGS), National Electronic Fund Transfer (NEFT), Automated Teller Machine (ATM), Internet Banking, mobile banking, etc. Some of the Technological based products have made significant changes in the banking outreach to the masses are appended. Adopting CBS by Banks, including RRBs have taken branch to a multi-channel and branchless approach through the use of handheld device, mobile, card; micro-ATM and Kiosks could be used.

Role of Technology in Rural Banking

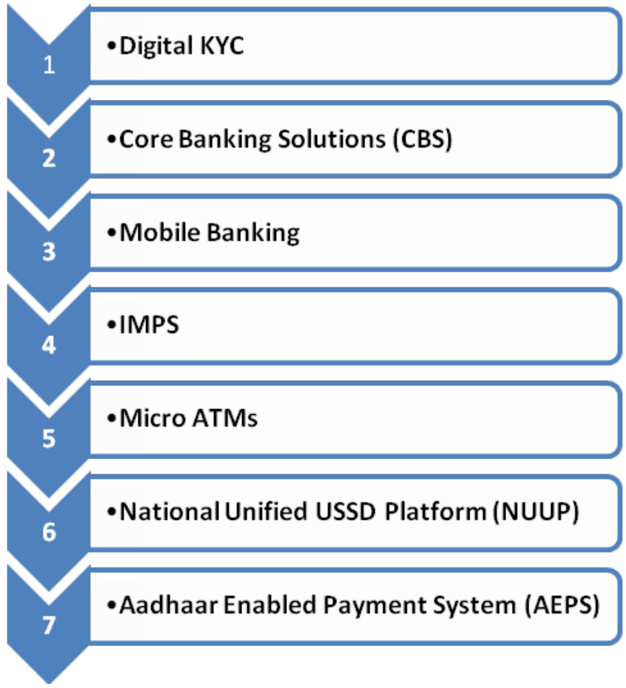

Figure 2.2 Role of Technology in Rural Banking

The current plan of PMJDY under the National Mission of Financial Inclusion has proposed usage of Technology for achieving goal in time bound way. Some major products which have come up due to technology upgradation are :

(1) Digital Know Your Customer (KYC)

In 2013, RBI gave permission for using digital KYC as valid process through which KYC verification could be done under Prevention of Money Laundering (Maintenance of records) Rules, 2005. For reduction of identity fraud, forgery of documents and having paperless KYC verification, the Unique Identification Authority of India (UIDAI) launched Digital KYC or e-KYC services. In this process of digital KYC, under explicit consent from the customer and after obtaining his/ her biometric authentication, basic data is shared from UIDAI database which comprise of gender, age, photograph with the Authorized users like the Banks. This process is being considered as a valid process now for KYC. Digital KYC has made opening of accounts of customers who are having Aadhaar card number easier.

(2) Core Banking Solutions (CBS)

One such major Banking technological development is adoption of Core Banking Solutions (CBS). CBS has enhanced customer convenience through anytime, anywhere banking. CBS adoption has led banking towards various technological products like Real Time Gross Settlement (RTGS), National Electronic Fund Transfer (NEFT), Automated Teller Machine (ATM), Internet Banking, mobile banking, etc. Some of the Technology based products have made significant changes in the banking outreach to the masses are appended. Adopting CBS by Banks, including RRBs have taken branch to a multi-channel and branchless approach.

(3) Transaction through Mobile Banking

Revolution of mobile-phone is transforming the nation and this could turn in to banking revolution as in the terms of transaction and reach. Almost every common man is using mobile and this is a trend in even the small towns or villages. The use of mobile phone by all segments of population could be exploited for extension of financial services among the excluded population. There are various services of banking which could be processed through mobile like Immediate payment service, funds transfer, mini statement, balance enquiry, cheque book request, bill payment, demat account service, etc. There are certain transaction limits while using mobile banking.

(4) Immediate Payment System (IMPS)

This service was launched on 22 November, 2010 by NPCI. It offers instant funds transfer through internet banking and mobile banking. There are four stakeholders who are involved in the transaction i.e. remitter (sender), beneficiary (receiver), banks and National Financial Switch – NPCI. For remitting funds through IMPS, sender should make use of mobile banking for sending money, mobile number of receiver should get registered with bank and money gets credited to the receiver’s bank account instantly. The Remitter must register himself or herself for mobile banking and need to get Mobile Money Identifier (MMID) & also Mobile Banking PIN (MPIN) to initiate a transaction.

(5) Micro-ATMs

Micro-ATM is a biometric authentication enabled device which is hand-held. For making ATMs viable in rural and semi-urban centres, lower cost Micro-ATMs have been deployed at many locations of Bank Mitra. This will help people to deposit instantly or help in withdrawing funds regardless to which the customer is associated with which bank Mitra or Business Correspondent. Customers will be required to get their identity authenticated and put or withdraw money from bank accounts. This money would come from cash drawer of Business Correspondent or Bank Mitra. Micro-ATMs would offer online inter-operable lower cost payment platform for everyone in country.

(6) National Unified USSD Platform (NUUP)

For increasing the banking facilities reach among masses mobile banking has a lot of potential and is one such potent mode. Mobile phone has become household device for using Banking services in India. This service could be initiated through Short Message Service (SMS) which is unencrypted service or through an app for mobile banking. It is an interactive platform, a major problem which is a part of mobile banking is that there is a requirement of downloading and installing mobile banking app on mobile. There is a requirement of Java 2 Platform, Micro Edition (J2ME) handset and also a General Packet Radio Service (GPRS) connection on mobile for using mobile banking. Besides this, another alternative platform is available i.e. Unstructured Supplementary Service Data (USSD). Through USSD, mobile banking app could be installed on any mobile on Global System for Mobile Communications (GSM) network. Customers could avail the USSD solution irrespective of the make and the model of phone. There is no requirement of any such application to be downloaded on the customer's mobile phone and no need for any GPRS connectivity. USSD is also user friendly so people find it easy for communicating and it could educate customer as well.

(7) Aadhaar Enabled Payment System (AEPS)

AEPS is banking product that allows online inter-operable financial inclusion transactions at PoS (Micro-ATMs) or Kiosk Banking through Business Correspondents of any banks using Aadhaar authentication.

Following banking transactions are available that are Aadhaar enabled :

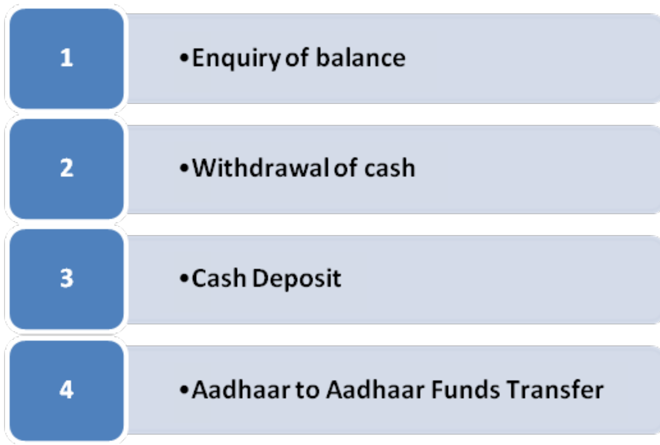

Figure 2.3 Aadhaar Enabled Payment System (AEPS)

For undertaking the Aadhaar Enabled Payment System (AEPS) transaction by customers, two inputs are required i.e. Issuer Identification Number (IIN) (Identification of the Bank with which customer is associated) and the Aadhaar Number.

Digital technologies in credit delivery

Adoption of digital technologies as well as payment methods could help in boosting credit delivery in rural areas. Banking sector and various financial Institutions in India are leveraging digitization and technology in financial transactions. There is a need that the banks should reconsider the business model being followed and should start making use of technology on larger scale. The numbers of adults having bank accounts are growing and this has increased individuals having access to various banking services. There have many initiatives taken by the government towards financial inclusion. These initiatives also include Pradhan Mantri Jan DhanYojna, Aadhaar-enabled biometrics as well mobile phone, which is termed as JAM collectively.

Some of the digital technology being adopted by Banks for credit delivery could be mentioned below:

Figure 2.4 Digital technologies in credit delivery

(1) Mobile Phone Usage and Aadhaar

Majority people in India are using mobile phone and many of them are having smart phones. The number of mobile users is increasing every year. Majority Indians have been given a unique biometrics-based identification i.e. Aadhaar which have given great fillip to cause of financial inclusion and this has created much-needed bridge between consumers and financial institutions. Banking system has initiated a trend which enabled consumers towards access of core banking services like remittances, payments, funds transfer etc. These services should be readily available to the people in the rural areas, as the coverage of bank's branch in the rural areas is low.

(2) Fintech

Fintech or Digital financial technologies have spurred host of mobile applications which have been built for solving specific problems for all those segments of population among whom awareness and literacy levels regarding financial services is very low. One of such significant digital technology in banking is Unified Payments Interface (UPI). UPI is an application which allows a person to conduct online payments through smart phones through unique virtual address, which is not unlike an email address or a phone number. Transactions could be carried out through sending an email or SMS and no other detail is required to be shared like account number, branch code or bank name.

(3) Digital Transformation in Microfinance Sector

In the year 2016, a demonetization drive led to microfinance sector to face a considerable turbulence with low liquidity level and disruption in the cash flows. This resulted in making small as well as mid-sized Microfinance Institutions (MFIs) across country who were not left with any other option than rethinking about cash driven method for lending and MFI As a result, several small and mid-sized MFIs across the country who had to rethink their cash-driven lending methods and they started looking towards the emerging digital payment technologies for lessening their dependence on cash. Since then, digital payment method has brought a much-needed technology-enabled transformation in microfinance sector and this aided microfinance institutions (MFIs) for simplification of loans disbursement to the rural consumers.

(4) Financial Data

Loans are being sanctioned by NBFC-MFIs through cashless means. Cashless micro credit disbursements are increasing every year. Adoption of the digital modes of payment for delivering credit to the clients has enabled greater operating efficiency for the MFIs, this has been in long term as well as short term credit. The recovery of loans has also increased. Sustained usage of the digital payment method, in long run, can be a useful tool for ensuring greater convenience for the consumers in accessing funds and this has also been allowing MFIs to leverage data analytics for better understanding about customer behaviour. The process of underwriting becomes difficult for MFIs wherein the creditworthiness of borrower is determined. The underwriting process gets simplified through digital technology like analytics and reduces time to process loans.

Challenges of ICTs role in rural banking

There have been technological changes in banking. ICTs have been introduced in rural banking. It is not necessary that all the technological changes which have been introduced in the urban areas are accepted as it is by the people in rural areas. There are some challenges which have been faced by banks as well as rural people in accepting ICT in banking. The challenges have been mentioned below:

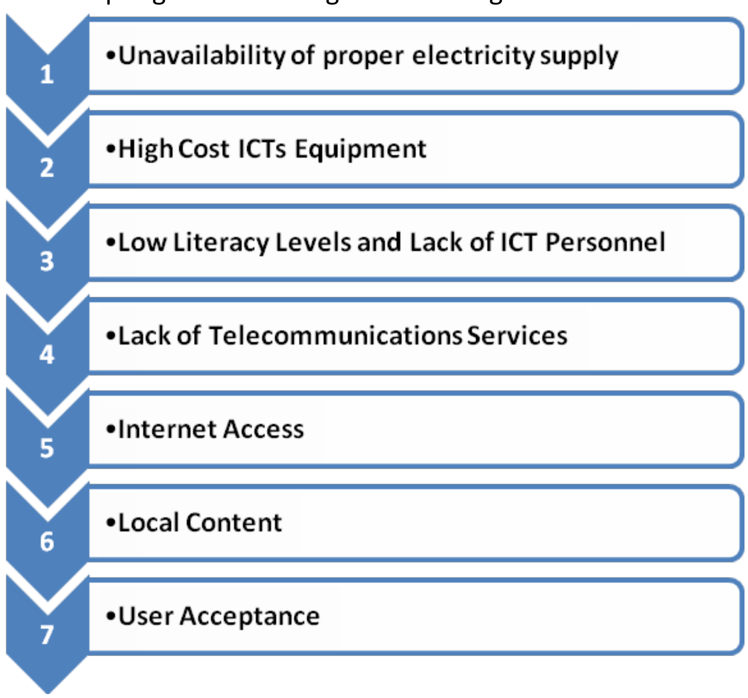

Figure 2.5 Challenges of ICTs role in rural banking

(1) Unavailability of proper electricity supply

ICTs have not being used by majority people in rural areas for banking transactions is due to the unavailability of proper electricity supply. The people in the rural areas are also willing to use banking services through the latest technology in banking. Many banks are having their ICT centres in particular regional capitals and districts. For utilizing the latest technologies which have been introduced in banking sector for financial inclusion, it is very important that there is proper connectivity and proper power supply.

(2) High Cost ICTs Equipment

Another challenge in ICTs for rural development is unavailability and affordability of Computers and other equipment, as well as their maintenance. There are some tele-centres in the rural areas and people approach them for carrying out their banking transactions. ICT centres sometimes face some problem related to break down and it becomes difficult to replace the spare parts of the equipment or even people who could repair the equipment are not easily found.

(3) Low Literacy Levels and Lack of ICT Personnel

The literacy rate in rural areas in India is very low. There are not many people who are having computer literacy. The computer literate people are more in urban areas as compared to rural areas. Majority people in the rural areas are farmers, if they are interested to make a good usage of ICTs, the people who are in ICT centres should be more knowledgeable and also have sufficient skills to help out the farmers. There are many women who are engaged in agriculture, and they are more illiterate as compared to men.

(4) Lack of Telecommunications Services

Provision of ICT in banking for people in the rural areas also requires access towards telecommunication services. Telecommunication companies are hesitant to move to rural areas because of lack of electricity and also fear to incur losses. People in rural areas are having mobiles, but they are unable to use banking services anytime and everywhere because of lack of telecommunication services. The telecom companies have concentrated the services being provided in major towns and cities, where there exists a huge market for their services.

(5) Internet Access

The internet access is not proper in rural areas. Internet access is major prerequisite to provision of telecommunication services effectively to the rural areas. There are lesser internet service providers in the rural areas, hence having access to internet become expensive and it is limited majorly to urban areas and few providers have provided their services in the rural areas. There are a few small businesses known as internet cafes or communication centres provide public access to the Internet services. There is access to internet at some places like school, cyber café or work place. Mostly rural areas are not having access to internet and they are cut off from such services.

(6) Local Content

There should be content available in the rural areas which could help people in using ICT in banking. Sometimes the content is available with some banks in English and it becomes difficult for the employees of the bank branches in the rural areas to explain the latest technology to the people of rural areas. Poor local content as well as unavailability of the instructional manual in the local language is also major challenge in role of ICTs in the rural areas. The banking services which are being made available by the commercial banks in the rural areas should be simplified for the people staying in these areas.

(7) User Acceptance

New technology is introduced in banking sector in the urban and rural areas. It is very important to understand whether any particular technology will be accepted as it is easily accepted in the urban areas as well as rural areas. People in the rural areas have their own traditional ways of doing various things and have a different culture. Sometimes a new technology in banking is not easily accepted by the rural people and it could be because they lack in sufficient income, education, confidence in adopting new technology etc. It is very important that people staying in rural areas are made aware about banking technology, so that they could use the technology for carrying out their banking transactions.

Case analysis : India's first digital village

There is a village names Akodara, it is located in Ahmedabad, in Sabarkantha district in Gujarat. In this village, the anganwadis have CCTVs and schools have audio-visual teaching aid. In the kirana store when someone wants to make payment, there is no need to pay cash rather customer could simply whip out his or her mobile phone for paying the amount. The shopkeeper guides the customers the way to make payment. The shopkeeper waits for the payment to get executed. Even there is wifi connection in this village and people visiting this village can surf internet using village wifi. In the month of January 2015, during high profile launch of Digital India initiative, what 'digitizing' rural India mean or would actually look like, village Akodara represents slice of vision. The village of approx1,200 people has been adopted by ICICI Bank, and is helped by local administration, so that this village could be showcased as example of bank's vision of digital future which awaits India's hinterland. From merely cosmetic, like embellishing archway at village's entrance with ICICI logo, to practical improvement in providing access towards modern banking to villagers, bankers at ICICI have all gone out for showcasing their vision in this village.
First such useful intervention is financial inclusion and accessing modern banking. Almost every adult in this village has savings bank account with ICICI, which she or he could access through local bank branch, or village ATM, or even through mobile phone via SMS. The most important transactions of villagers'are selling of agri-produce at local mandi or selling milk at co-operative society, these transactions have been digitized and are made cashless. This system has made them less susceptible to fraud and corruption.

Source : Chakrabarti S. (July 14, 2015). *At Akodara, India's first digital village*. Retrieved from https://www.thehindu.com/opinion/op-ed/at-akodara-indias-first-digital-village/article7418012.ece

To Do Activity

Ask the students to share some detail about the use of any two of the following in rural banking:

- Digital Know Your Customer
- Core Banking Solutions (CBS)
- Immediate Payment Service (IMPS)
- Real Time Gross Settlement (RTGS)
- National Electronic Fund Transfer (NEFT)
- Automated Teller Machine (ATM)
- Internet Banking
- National Unified USSD Platform (NUUP)
- Aadhaar Enabled Payment System (AEPS)

2.2 Financial Inclusion

Providing universal access to banking services and improvement in the forms of credit delivery, especially for weaker sections of population, forms the basis of RBI's financial inclusion agenda. So as to achieve scalable and sustainable financial inclusion, there are multiple strategies which are being used by the government and banks like appropriate relaxation in the guidelines, provisions of the new products and various other supporting measures.

Financial inclusion has been recognized as key driver towards poverty alleviation and economic growth. Access towards formal finance could boost job opportunities, reduces vulnerability for economic shocks as well as increase investment in the human capital. Without having adequate access towards formal financial services, firms and individuals are required to rely upon their limited resources or have to rely upon costly informal source of finance for meeting their own financial needs and pursue various growth opportunities. At the macro level, greater financial inclusion could support inclusive and sustainable socio-economic growth for everyone.

There has been growing evidence on the way financial inclusion has multiplier effect in boosting the overall economic output, income inequality and reducing poverty at national level. Financial inclusion among women is very important for economic empowerment of women and also for gender equality. Inclusive financial system could support integrity, stability as well as equitable growth.

Empowering women could help themselves and their own families in the following ways:

1	•Coming out of poverty
2	•Reducing their risk of falling into poverty
3	•Eliminate their exploitation from informal sector
4	•Increase their ability for engaging in productive and measurable economic activities

Figure 2.6 Empowerment of women

Definition of Financial Inclusion

Financial inclusion can be defined as process of ensured access towards financial services and adequate and timely credit wherever needed by various vulnerable groups of population like low income group or weaker sections at affordable cost (given by Committee on Financial Inclusion under Chairman: Dr. C. Rangarajan).

Financial Inclusion as defined by RBI, "'Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players".
The core of financial inclusion refers to delivery of financial service that includes - bank account for saving and transactional purpose, credit for production, personal or for any other purpose at low cost, financial advisory service, insurance facility including non-life and life etc.

Importance of Financial Inclusion

- Financial inclusion lead to economical growth through mobilization of saving into productive investment
- Helping in enhancing financial literacy among vulnerable and the weaker sections of society through financial advisory and decrease in dependence on expensive and unreliable finance.
- Financial Inclusion helps in promoting innovative and cost effective delivery of financial products through use of technology
- Helps poor in stabilizing income and also build up productive asset.
- Financial inclusion has been promoting competition and also helps in providing market based incentive delivery of sustainable financial access

Factors affecting access to financial services

Financial Inclusion is process which aims to provide banking services such as saving account, insurance, and credit facility etc to the weaker sections of society. It also includes the objective of providing financial services (like insurance, banking and capital market services) and also adequate and timely credit available to each section of society. A very important aspect of development is having access towards financial services and extending these financial services to the lower income household is being more emphasized since poor people lack in knowledge and education about financial services which are available to them. Lack in financial access actually limits range of credits and services which are available to the enterprises and households. There is some evidence that the access towards financial services is improving but still there are various factors that have affected the access.

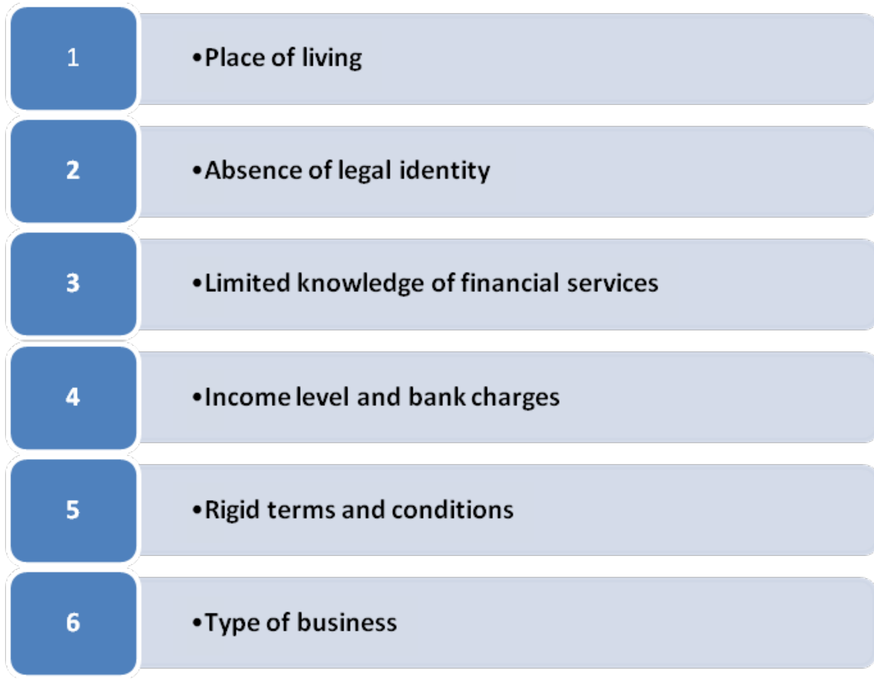

Figure 2.7 Factors affecting access to financial services

(1) Place of living

Most of the commercial banks have been operating in the commercial areas and their branches are situated in profitable areas. Hence, the population living in rural areas are finding it difficult in accessing financial services. Effective distance is dependent upon transportation infrastructure like physical distance, factors such as population density, remote and rural areas, mobility of population (i.e. highly mobile people with no particular formal or fixed address) etc. also have been affecting the access towards these services.

(2) Absence of legal identity

The minorities, political and economic migrants, women and refugee workers are excluded from having access towards financial services since they are not having proper legal identities like identity cards and birth certificates. Women, who do not possess assets and property, are unable to get access towards credit facilities. In case, a woman applies for loan, they require guarantee from a male member as well for getting access towards credit from any bank or financial institutions.

(3) Limited knowledge of financial services

Incomplete financial literacy and basic education are major hurdles so as to have access towards various financial services to individuals. People in rural areas are not aware about the significance of various financial products like bank account, overdraft or loan, cheque facility and insurance. It is very important that people are financially literate it could boost up usage of many financial products through various economic agents like NGOs, MFIs, Business Correspondents etc.

(4) Income level and bank charges

Financial status of the people plays a very important role towards access of the financial services. It is not possible for poor people to have access towards financial services even if these services are available for people whose income level is low. There are certain charges which are levied by banks this makes it difficult for the poor people to avail banking services.

(5) Rigid terms and conditions

People in the rural areas are not much interested in using any such kind of financial services or products which have rigidity in terms and conditions. There are different rules of different banks like people are required to maintain a minimum balance, a number of cash deposit and withdrawals are free of charge, etc.

(6) Type of business

The nature of occupation is very important factor which is required to be considered for availing financial services. The business could be of different forms which are mentioned below:

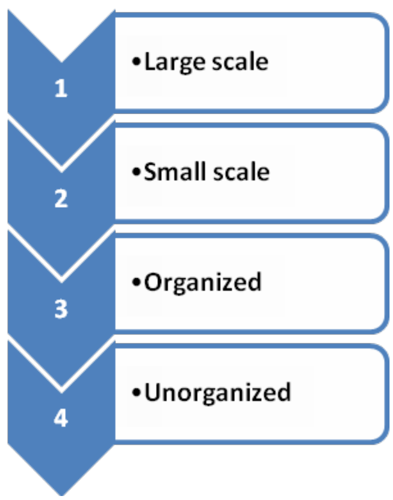

Figure 2.8 Forms of business in rural areas

Most banks are not interested to give loans to small and unorganized enterprises. It is very important that the people in the rural areas are made aware about the various types of products available in banks and financial institutions. The employees in the commercial banks should also provide banking products and services to people belonging to rural areas and no such discrimination should be made while offering the required products and services.

Facilities identified under Financial Inclusion

A target group could be considered as financially excluded if they are not having access towards mainstream formal financial services like credit cards, banking accounts, payment services, insurance, etc. The aim is to support safe and sound spread of new modes of quality yet low-cost financial service delivery capable of reaching the poor and help provide a framework of incentives to banks, insurance and non-bank players while ensuring fair competition. The main essence of financial inclusion is to try that a proper range of financial services are made available to each and every individual and also enabling them to access and understand those services.

Following are the facilities which have been identified under financial inclusion:

Figure 2.9 Facilities identified under Financial Inclusion

Source: Rangarajan Committee Report on Financial Inclusion, 2008, RBI: IMaCS Research

(1) Saving products and accounts

A high part of the population being below poverty line has resulted in low demand for the financial services as poor may not sufficient savings for placing in savings banks. Lower income lead to lower demand of financial products in particular savings account. Likewise, at lower level of development, the investment activity could be low and this could lead to lower demand for bank's credit and from other formal financial Institution. However, as there is decline in the poverty level and various households move in to higher income bracket, their propensity towards savings increases that leads to a higher demand for financial service for saving and investment. In India, saving deposit account is provided by post offices and banks.

(2) Credit facility

There are certain activities like housing, micro enterprises, consumption needs and agricultural operation for which there is requirement for credit. People are facing difficulties while accessing the formal sources for availing credit facility. Poor individuals and the small/ micro enterprises rely on internal sources or personal saving for investment in health, education, housing and other entrepreneurial activity for making use of growth opportunities. The number of accounts of credit has increased in rural and urban areas. There has been growth in retail and consumer finance. Banks and Financial institutions should design tailor-made credit products for the weaker and poor sections of rural areas taking into account their repayment capacity and requirements.

(3) Entrepreneurial credit

There are people in the rural areas that are in need of funds for a small set-up. In the rural areas, clients are generally small farmers and also the others who have been engaged in smaller income generation activities like petty trade and processing of food. Access towards conventional formal financial institution for several reasons is related directly to income; poor people have lesser access towards the financial products. Informal arrangements might not suitably help in meeting certain financial services needs or might exclude anyway. Financial intermediation has expanded entrepreneurial opportunities for the rural entrepreneurs. The people in rural areas are aggregating, adopting improved technology and also other activities which could reduce transaction cost and lead to expansion of value addition. Banks have been playing a very important role in economic development of the country.

(4) Insurance

Insurance companies have designed health products having lower cost to cater to the needs of insurance among the rural poor. There is also a need of providing relief to farmers through weather insurance so that they can face the loss which could be caused due to deficient or excess rainfall. A larger segment of population does not have access to the formal insurance service. Micro insurance service is being provided in rural areas. The Insurance Regulatory and Development Authority (IRDA) have been encouraging the insurance services for the low-income household. In the year 2002, IRDA has established the rural and social sector target for the insurance companies. All the insurers who have entered the business after start of IRDA Act, 1999 are required to comply with obligations toward social and rural sector in phased manner. In India, insurance penetration was relatively high as compared to several other emerging market economies but significantly lower as compared to the advanced economies.

(5) Mortgage

Procedural Changes like simplifying mortgage requirements, exemption from Stamp Duty for loans to small and marginal farmers and providing agricultural / business development services in the farm and non-farm sectors respectively, will help in extending financial inclusion. It becomes difficult for the people in rural areas to mortgage some asset for availing loan facility from banks or any other financial institution. Simplification in mortgage requirements could be to enable the poor people to avail loan facility through acceptance of simple declaratory charge as an equitable mortgage.

(6) Financial advice

The people in the rural areas require advice so that they could manage their financials well. There are many people in the rural areas which are unable to earn much for their livelihood and they are able to just feed themselves and their families currently. It is very important that people in the rural areas start savings small amount for future. Financial advice to these people play a very important role as this could help them in accessing banking services and affordable credit. It is also analyzed by government that face to face financial advice would definitely help poor and needy people. Sometimes they are not even aware about their rights and they are unable to become a part of the financial system.

(7) Payment and remittance services

For achieving financial inclusion, there is a need to cover the unbanked by a channel which could provide financial services, and among these financial services remittance and payment play a critical role. The number of accounts in banks in which mobile number has been seeded is low. Customer can adopt mobile banking through a simple process which is required for mobile banking registration. Huge section of population have been added in formal banking system under PMJDY, banks could provide these account holders with mobile banking with ease and now mobile banking application can be installed on mobiles which are non-smart. Financial transactions that are simple in nature could be performed through non-smart phone also. There is need for transaction and saving accounts for underserved in population.

RBI policy initiatives towards Financial Inclusion

RBI adopted bank-led model towards achievement of financial inclusion. It removed all the regulatory bottle neck so as to achieve greater level of financial inclusion. So as to achieve targeted goals, RBI created conducive regulations in the environment and also provided support to banks to accelerate financial inclusion effort. The following initiatives were taken by RBI :

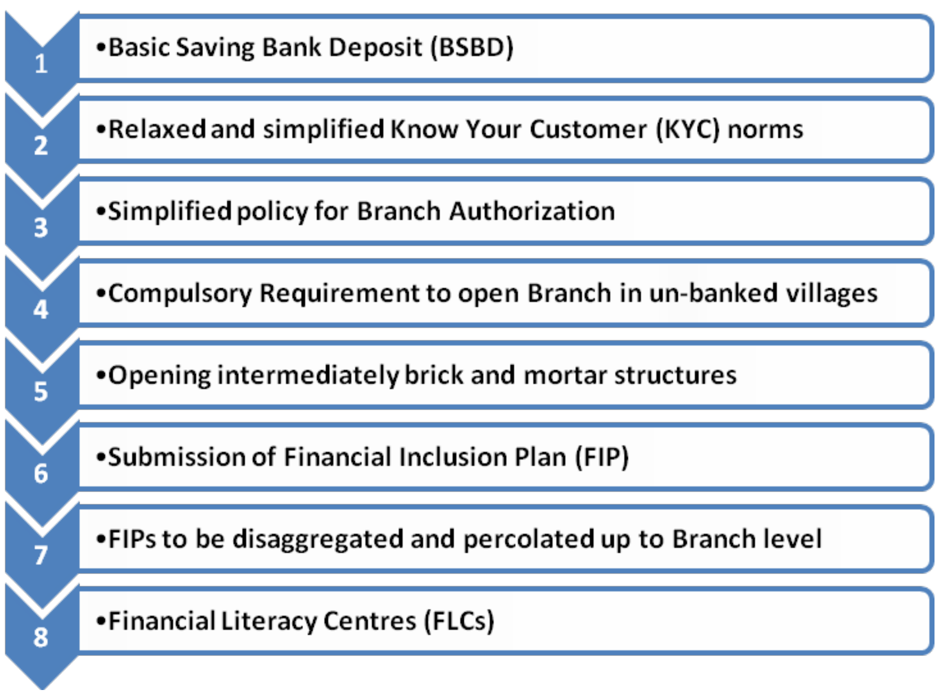

Figure 2.10 RBI policy initiatives towards Financial Inclusion

(1) Basic Saving Bank Deposit (BSBD)

RBI advised all the Banks for opening BSBD accounts having minimum facilities like no requirement of minimum balance, cash deposit and cash withdrawal at the Bank branch/ ATMs, credit/ receipt of money through various electronic modes, facility of ATM card.

(2) Relaxed and simplified Know Your Customer (KYC) norms

For facilitating ease in opening bank account, especially small account having balances less than Rs. 50,000 and also aggregate credit in accounts less than Rs. one lakh in a year. Banks have been advised for not insisting on introduction requirement for opening bank account. Also, instructions have been given to banks for considering Aadhar card for identity as well as address proof.

(3) Simplified policy for Branch Authorization

For addressing the uneven spread of Bank branches, domestic SCBs have been permitted to open branches freely in Tier 2-6 centres having population lesser than 1 lakh under the general permission, subjected to reporting. In the North-Eastern States and Sikkim, the domestic SCBs could open branch without even taking RBI's permission.

(4) Compulsory Requirement to open Branch in un-banked villages

Banks have been directed towards allocation of at least 25% of branches to be opened during a year in the un-banked (in Tier 5 and Tier 6) rural centres.

(5) Opening intermediately brick and mortar structures

RBI has advised Banks for opening immediate structures between present branch and BC location for managing cash effectively, BC operation's close supervision, redressal and documentation of customer's grievances. Such branch can be in form of lower cost structure in the form of brick and mortar consisting of the minimum infrastructure like core banking solutions terminal linked to passbook printer and safe for retention of cash for the operation of larger transactions of customers.

(6) Submission of Financial Inclusion Plan (FIP)

The Private and Public sector banks were advised for submitting three year FIP which is approved by Board from April 2010 onwards. These policies should aim at keeping certain self-set target in relation with opening of rural brick and mortar branch, BCs employed, covering un-banked villages having population above 2000 and below 2000, BSBD account opened, issuance of Kisan Credit Card, and others. These plans are being monitored by RBI on monthly basis.

(7) FIPs to be disaggregated and percolated up to Branch level

Banks were advised to disaggregate their FIPs and percolation down to Branch level. With this there will be involvement of stakeholders in efforts towards financial inclusion.

(8) Financial Literacy Centres (FLCs)

In June 2012, certain revised guidelines related to FLCs were advised. RBI advised that all FLCs and rural branches of SCBs should work on scaling up the efforts towards financial literacy through conducting outdoor camps for Financial Literacy at least once in a month, for facilitating financial inclusion through the provision of two essentials i.e. easy 'Financial Access' and 'Financial Literacy'.

Models for Financial Inclusion

In India, models for financial inclusion which are most widely used are the Business correspondent based model and non-business correspondent model. These models are explained below:

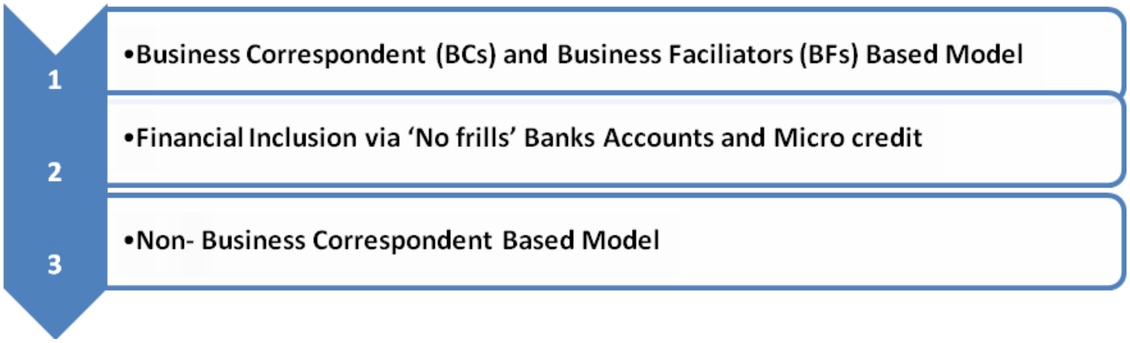

Figure 2.11 Models for Financial Inclusion

(1) BCs and BFs based Model

In the year 2006, RBI permitted various banks for engaging intermediaries for providing banking services and increasing their reach. These intermediaries are called business correspondents (BC) or business facilitators (BF) who were allowed to provide various banking services as an agent of the banks at places where bank premises do not exist. RBI's working group to review Business Correspondent Model also recommended various types of entities or individuals who could act as BCs or BFs in semi-urban and rural areas. The BCs are actually permitted for carrying out transactions on the behalf of banks as agents. The BFs could refer clients, pursue clients' proposal and facilitate banks in carrying out transactions, but cannot transact on behalf of banks.

Operators in BC and BF Models

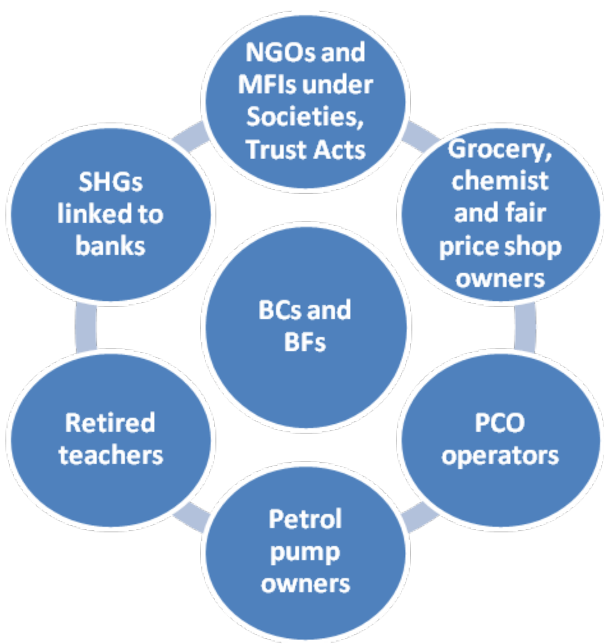

Figure 2.12 Operators in BC and BF Models

SHG: Self-Help group; MFI : Micro-finance Institution; PCO : Public Call Office

Source: RBI Report of the Working Group to Review the Business Correspondent Model, IMaCS Research

BCs and BFs undertake facilitation of following services:

- Identify borrower and fitment of various financial activities
- Collect and preliminarily process application of loans including verification of primary information
- Create awareness about saving and other products
- Educate and advise on money management and debt counseling
- Process and submit applications
- Promote and submit applications
- Promote and nurture SHGs or JLGs
- Post-sanction monitoring and handholding of JLGs, SHGs, credit group and others
- Follow-up for recovery

In India, concept of financial inclusion has gained significance since late 1980s and has drawn attention to role of 'micro-credit' as alternative finance source. India is having one of the largest micro-finance market in world, especially in growth of women's saving and credit group.

(2) Financial Inclusion via 'No Frills' Banks Accounts and Micro credit

- One example of an innovative product for financial inclusion through micro credit and banking services is the Punjab National Bank's (PNBs) Rickshaw Puller's Project
- It could be estimated that there are approx 8 million rickshaw pullers in India, 95 percent of these rickshaw puller's, paid daily rentals for their rickshaws; additional cost is required to be incurred for any accidental damages to their vehicle.
- Lower disposable income restricts their access towards formal banking services like savings, loans and insurance.
- For addressing various concerns, PNB have drawn up convenient schemes for the rickshaw pullers: PNB Jan Mitra Rickshaw Project' and 'PNB Micro –finance Rickshaw Project'.

The PNB Rickshaw Puller's Projects – 'PNB's Jan Mitra Rickshaw Project'

This project was launched on a pilot basis in the city, Varanasi in the month of February 2008. PNB launched this project in association with an NGO i.e. Centre for Rural Development (CRD). Scheme provides rickshaw pullers an access to quality rickshaws, which could be owned by them in three years. Rickshaw puller is required to open a "No frills" account with the bank i.e. PNB. For managing their saving, repair and updates their records of business, Rickshaw pullers organized themselves in group of five from common garage. Subsequently, PNB linked the other product or services with account, thus giving rickshaw puller integrated facility of banking. Other product includes smaller household loan for renovation, buy cooking gadget, housing and education. The rickshaw pullers are also provided health cover.

Another project was launched in the month of March 2008 in Patna, Bihar which was based on micro finance model. This project was launched in association with MFI i.e. SammaaN Foundation which is a Non-profit organization. Rickshaws were given free of cost to rickshaw pullers. They were required to pay maintenance cost of Rs. 10 per day. Surplus earnings from rides go to rickshaw puller. Additional income is generated through various other ways like selling soft drinks, water, simple merchandises etc. to passengers. Profit from these sales used to be shared between SammaaN and rickshaw puller. Rickshaw pullers were given uniforms without any cost, identity card and insurance coverage.

Source: Punjab National Bank, IMaCS

(3) Non –Business Correspondent Based Model

The Non-Business Correspondent based model makes usage of technology for providing banking services to semi-urban and rural areas; technologies like cellular phone, broadband, Information Technology enabled Services (ITeS) as well as mobile banks are used for promoting for delivery of financial services to the unbanked, but potential areas.

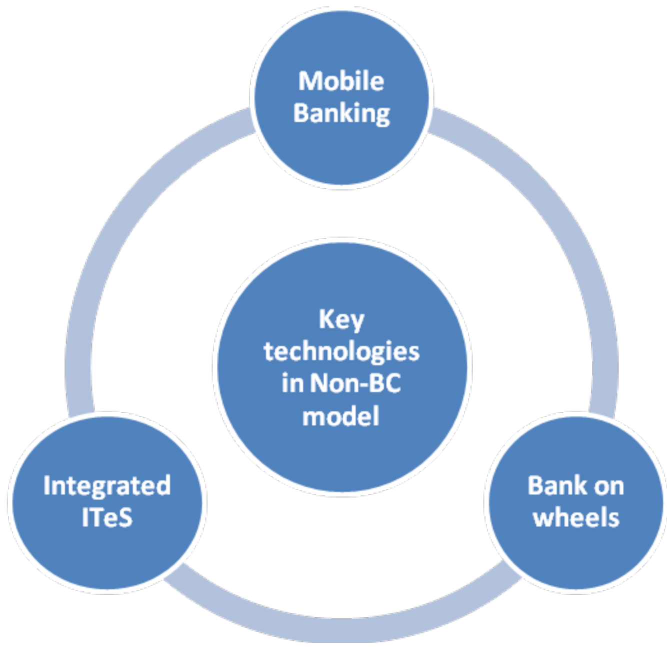

Figure 2.13 Key technologies in Non-BC model

Source : RBI Report of the Working Group to Review the Business Correspondent Model, IMaCS Research

(1) Bank on wheels

In this approach, a van which could provide these services drive from villages to villages and act as temporary branch. Bank on wheels is sometimes also been augmented by ATM on wheels.

(2) Mobile Banking

Mobile banking tool could range in complexity from a simple mobile based payment mechanism to smart phone apps which offers larger suite of banking functions. Mobile banking offers anywhere and anytime banking. There are many banking functions which could be performed through mobile banking and the people are not required to wait for the bank branch to open. It is very important that people in rural areas are made aware about using mobile banking.

(3) Integrated ITeS

Information Technology which enables business through improvement in service quality is ITeS. ITeS is also called remote services or web-enabled services which cover entire operations that exploits Information Technology to improve efficiency of any organization. These services provided wide range of career options which includes opportunities in all the offices like the following:

1. Call centres
2. Payrolls
3. Logistics management
4. Revenue claims processing
5. Medical billing
6. Coding
7. Medical transcription
8. Legal databases
9. Back office operations
10. Content development
11. GIS (geographical information system)
12. Web services
13. Human Resource (HR) services, etc

Figure 2.14 Example of career options in ITeS

To Do Activity

Ask the students to visit any branch of a Commercial bank and try to find out the initiatives which they have taken up towards financial inclusion.

2.3 Inclusive Growth for Rural Development Banking

Inclusive growth is concept which provides equitable opportunities for all the economic participants during economic growth along with benefits incurred by each section of the society. Inclusive growth implies direct link between microeconomic and macroeconomic determinants of economy as well as economic growth. Microeconomic dimensions capture importance of the structural transformation for economic competition and diversification, while macro dimension refers certain changes in the economic aggregates such as country's gross domestic product (GDP) or gross national product (GNP), total factor productivity and aggregate factor inputs.

Sustainable economic growth requires inclusive growth. Maintaining inclusive growth many a times is difficult because as economic growth might give rise to various negative externalities like increase in corruption and this is major problem in the developing countries. An emphasis is on inclusiveness, especially on equal opportunities in term of access to resources, market and an unbiased regulatory environment and these are essential ingredients for successful growth. Inclusive growth approach takes longer-term perspective and focus is over productive employment as a means of income increase of excluded and poor groups and raises their living standard.

Inclusive Growth in Finance Sector

There are demand side and supply side factors which drive inclusive growth. Banks and various other financial services plays a very important role from the supply side by providing access to the basic financial services to disadvantage and poor social group. Access towards many financial products is constrained by various factors.

These factors are mentioned below:

Figure 2.15 Financial products constrained by various factors

Besides supply side factors, there are some demand side factors like low income, lower holding of assets etc also have significant bearing on the inclusive growth. The people in rural areas are finding difficult to access the formal source of credit and the poor individual, small and micro enterprises generally rely on either their personal saving or some internal sources to make investment in education, health, housing as well as entrepreneurial activity for making use of growth opportunity. Financial Inclusion promotes economy and develops savings culture. It enables an efficient mechanism of payment. It is actually not possible to achieve financial stability, inclusive growth and economic stability without financial inclusion. Inclusive growth is possible through proper accessing and allocation of all resources from the top to bottom. Financial inclusion is innovative concept that makes alternative technique for promotion of banking habits among rural people since India has a major portion of population in the rural areas. Inclusive growth is a key objective and strategy for economic development. Financial inclusion is intended to provide banking as well as financial services to all the people whether in urban or rural areas, in a transparent, fair as well as equitable manner at an affordable cost. Banks should encourage people in accessing banking services through no frill account, campaign for financial inclusion as well as business correspondents. Government should encourage banks for adopting financial inclusion by means of awareness programme, advertisement, financial assistance etc. Households with lower level of income often lack access towards bank account and they have to spend money and time for multiple visits for availing banking services, whether is it about opening savings bank account or availing loan. Due to such difficulties, people in the rural areas are finding it difficult to plan and save money for future.

Financial Inclusion: The means of Inclusive Growth

Financial inclusion play major role in inclusive growth of economy. There are many people in India who are excluded from bank and other financial services. The main aim of financial inclusion is access towards various financial services which include credit, savings, insurance, remittance as well as other banking and payment services to all households which are bankable and all the enterprises at a very reasonable cost. In India, financial inclusion was first featured in the year 2005, when this was introduced by Dr. K.C. Chakrabarty, Chairman of the Indian Bank. Mangalam Village becomes first such village in India where banking facilities were provided to all the households. It is very important that quality financial services are made available in the rural areas as it is very important for growth of economy and enables larger number of rural households for funding them for growth of their livelihood. Economy's growth is dependent on growth of rural market in country. Financial inclusion should be promoted in these sections of society as it is very essential for growth of the economy.

Inclusive growth refers to pace as well as pattern of economic growth. Inclusive growth emphasizes on productive employment instead on redistribution of income. Inclusive growth could be termed as long run approach since it helps deprived sections of society to gain some standing of their own. Financial inclusion is part of inclusive growth since it focuses on delivery of financial services at an affordable cost to under-privileged section of society. Strong financial institutions are pillars of economic growth, progress as well as success of modern economics. There is lack of accessibility and appropriateness of financial services in our economy. Financial access could really boost financial condition as well as standards of life of poor. RBI have been constantly encouraging banking sector towards development of banking network both through set up of new branches, ATM installation and implementation of Business Correspondents (BCs) model.

Vision of Inclusive Financial System

The vision of Inclusive Financial System could be characterized by:

1. Access to financial services at reasonable cost
2. Sound Institutions
3. Financial and institutional sustainability
4. Multiple providers of financial services

Figure 2.16 Vision of Inclusive Financial System

(1) Access to financial services at reasonable cost

Financial services are required to be provided to all households as well as enterprises in the rural areas at a reasonable cost so that they could become a part of the financial system.

Financial services could include the following:

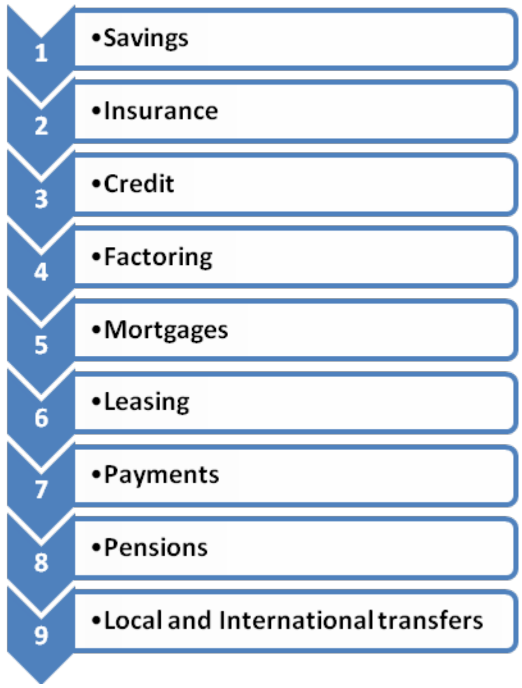

Figure 2.17 Financial services

There are different needs of people in the rural areas and it is very important to encourage them to become a part of the financial system that these services should be provided to them at a reasonable cost. The needs of people in the urban areas as well as rural areas are different and this is very important for the banks to customize various financial services as per the needs of the people in rural areas.

(2) Sound Institutions

The banking and other financial institutions should be sound enough so that they could easily meet the requirements of the rural people and also remain profitable. These institutions should be guided by an appropriate internal management system, performance monitoring by market, industry performance standards and sound prudential regulation as required.

(3) Financial and Institutional Sustainability

The institutions which are part of the financial system have to very active in providing banking products and other financial services to the poor people residing in the rural areas. Some institutions do not consider rural area as a market for their financial products and services, since they don't find them much profitable. It is important for all the banks and financial institutions to recognize the need of people in rural areas and should maintain financial and institutional sustainability. Financial services should be provided over time.

(4) Multiple Providers of Financial Services

There are multiple providers who are dealing in financial services and they are providing variety of products and services. Since there are so many providers, the products are available in wider variety and are also cost effective.

Parameters to Ensure Inclusive Growth

RBI has undertaken various measures with objective of attracting people who are financially excluded into structured financial system. These policy directives for inclusion for including the excluded population would go long way to ensure inclusive growth of India. These parameters are mentioned below:

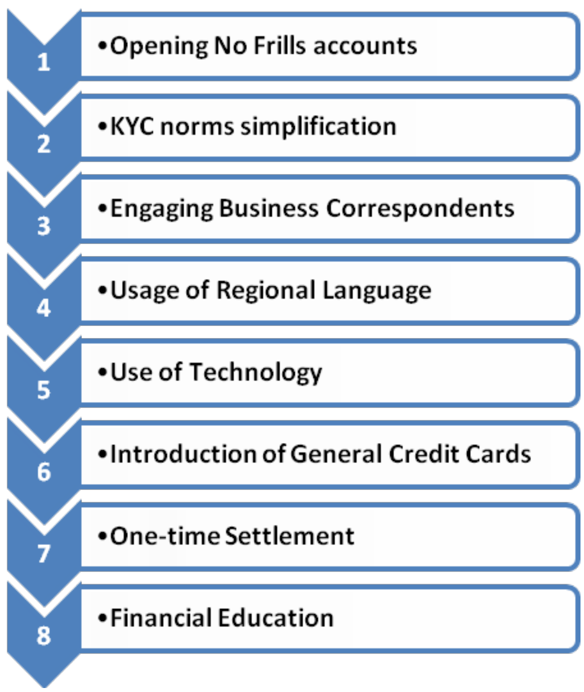

Figure 2.18 Parameters to ensure inclusive growth

1. Opening No Frills Accounts

In the month of November 2005, new concept was introduced in banking known as 'no-frills' account with very low or 'nil' minimum balance for making such accounts easily accessible to vast section of population. In India, there are majority people who are unable to maintain balance in savings account and hence they are not willing to open a savings account with bank. With no frills account, the barrier of maintaining a higher minimum balance was removed and this encouraged many people to open no frills account in the banks. In the year 2012, nomenclature was changed from no frills account to Basic Savings Bank Deposit Accounts (BSBDAs) for all the individuals having zero minimum balance and also having facility of Debit Card/ ATM Card. No charge is levied on deposits in this account and upto four withdrawals are allowed in each month. Every person has right for opening bank account.

2. KYC Norms Simplification

For ensuring that all financial needs of customers are being met, banks have been advised to offer minimum of four basic products to the people in the rural areas for inclusive growth viz.;

- Savings cum overdraft account
- Pure savings account, which is ideally recurring or a variable recurring deposit
- Remittance product for facilitating Electronic Benefit Transfer (EBT) and other remittance
- Various entrepreneurial credit products like Kisan Credit Card (KCC) or General Purpose Credit Card (GCC).

3. Engaging Business Correspondents

In the month of January 2006, RBI permitted banks for engaging Business Correspondents (BCs) and Business Facilitators (BFs) in the form of intermediaries to provide banking and financial services. BC Model allow banks to provide various services through door step delivery especially for doing "cash in - cash out" transactions, and this would help to address "last mile" problem. List of all the eligible individuals or entities which could be engaged in the form of BCs is being widened through adoption of test and learn approach from time to time. In September 2010, RBI have allowed the profit organizations excluding NBFCs also to operate as BCs. Banks could now leverage on penetrative network of the mobile companies. Mobile network companies have also joined hands with the banks for making banking services available India's population which is unbanked. Agents of the mobile companies work as Customer Service Providers (CSPs) and are providing BC services and this has resulted in expansion of bank's outreach.

4. Usage of Regional Language

Option to use regional language for various banking operations have made the local population comfortable with banking services which are being provided. There is no communication gap between the service providers and beneficiaries which has led to greater participation in schemes as well as inclusion in growth of our country. Regional language could actually attract the people in the rural areas for accepting the banking products and services easily and they are able to understand the usage as well as benefits of these services.

5. Use of Technology

Latest technologies are being introduced in the field of banking and financial services sector. Manual factor is being phased out gradually from all fields through new technologies. Technology has increased the level of confidence of beneficiaries in all sectors. Dependency on the individuals is being reduced and this has resulted in efficiency increase as well as productivity.

6. Introduction of General Credit Cards

General Credit Cards were introduced and they have greatly facilitated beneficiaries to get various types of services in banking operations. This has reduced number of visits to the bank branches.

7. One-Time Settlement

One time settlement of the beneficiaries, wherever required, has infused great confidence among public and provide financial resources as required.

8. Financial Education

Financial education to the excluded people in the remote areas has helped them in getting financially included in financial development process for inclusive growth of country. Financial education is very important since the financial products and services are new for the poor people staying in rural areas. For being included financially it is very important that the base about financial products is strong, only then they would be interested in getting included in the financial system. It is very important that the poor people also realize the need of being financially strong and also start saving for future.

Relationship of Inclusive Growth

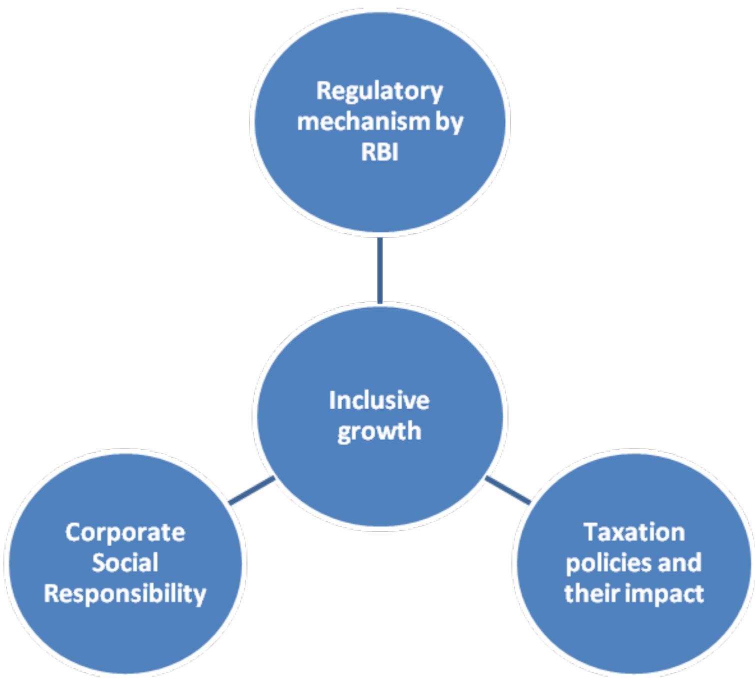

Figure 2.19 Relationship of inclusive growth

1) Regulatory Mechanism by RBI and Inclusive Growth

Apart from efforts made towards inclusion of excluded groups in financial development of country, there is a necessity of having a regulatory mechanism on money supply, credit policy etc. when financial stability of system need to be ensured. For embarking upon appreciable inclusive growth in country, greater emphasis on the economic growth is very essential that could be achieved through sound financial development policies. However, word of caution is required to be exercised for controlling pace of financial development. An uncontrolled and fast pace in financial development could lead towards unsustainable growth and also makes financial system unstable. For ensuring stability in financial system, pace of financial development needs to be controlled by central bank of our country. Controlling pace of financial development could lead to retardation in economic growth and also consequently inclusive growth. This trend is desired till the time sustainable level in economic growth and financial development is achieved. To control financial development, RBI regulates money supply i.e. accessing money through adoption of suitable credit policy. There are various controlling mechanisms that are available with the apex bank for controlling financial development to required level to spur sustainable controlled growth so that financial system is saved from perils of instability. Through suitable regulatory mechanisms, tradeoff is required to be established between financial development coupled with financial stability and economic growth.

2) Taxation Policies and their Impact on Inclusive Growth

Taxation is major factor in financial growth of country. With taxation policies, government makes efforts towards revenue collection from sectors which could afford to pay out taxes from their surplus. This amount is then used for projects which are not economically viable but it is essential to implement them to discharge social responsibility. There are many such projects which are financed through government spending, they might not be viable for ensuring adequate return rate on capital employed, but they are required to be implemented essentially to encourage healthy growth of economy. It depends on collection methods, the taxes could be divided into two major categories.

The categories of taxes could be mentioned below:

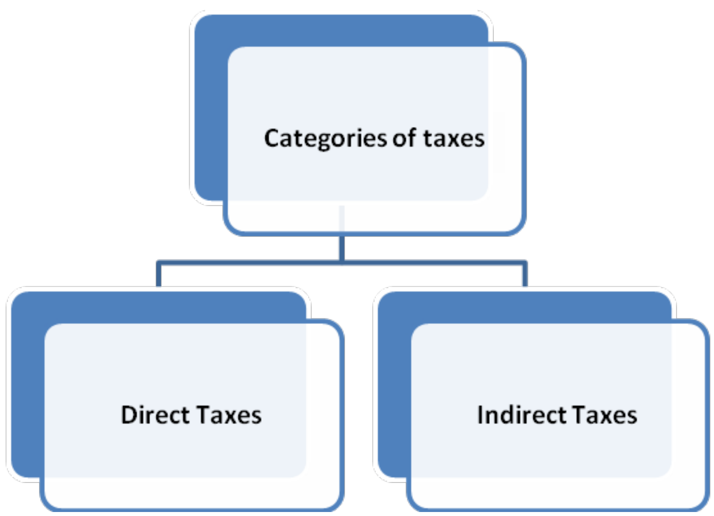

Figure 2.20 Category of taxes

Further taxes could be classified as collected by centre and states in the federal structure of government. The entire gamut of taxes is named as, Income Tax (Individual and Corporate), Goods and Services Tax, custom duty, excise duty etc. Tax which is collected by central government in federal structure is further apportioned among states to meet social liabilities which depend upon prevailing conditions in the particular state. A good percent of such taxes will be spent by central government on projects which are related to public interest and social upliftment and fraction of such taxes is required to be kept to meet situations related to crisis as in case of earthquakes, draughts, floods etc. Tax collection and disbursement of taxes indicates that money collected through taxation contributes towards inclusive growth of country by ensuring development in these sectors where the projects are not viable based on principles of rate of return but are required to implemented essentially to ensure growth in these sectors so that eventually urge in inclusive growth could be achieved.

3) Corporate Social Responsibility and Inclusive Growth

Similar to taxation as mentioned above, a strong source to ensure development in areas of public interest and various projects related to social upliftment are being taken up by the corporate sector wherein a fixed percent of surplus of corporate is required to be spent on projects which would help in upliftment of society. Corporate Social responsibility encourages the organizations which are working on profit or non-profit motive to contribute to the society. It is very important that the backward areas are developed properly so that these areas could become a part of the growing economy. This is very persuasive source towards development of infrastructure in areas which are socially backward where generally no financially viable scheme could be implemented. For inclusive growth in the economy, it is very important that those some amount is spent from the big business houses towards the development of the rural areas. It is very important that people in the rural areas also get a chance to achieve success in life, they also find different ways of living, could save sufficiently for their future. Corporate social responsibility plays a very important in development of the backward groups in the country, since different corporates are contributing in different ways which could be related to different segments like health, education, financial literacy etc. Through infrastructural development in these areas, corporate sector has been contributing in big way towards inclusive growth of country.

Issues and challenges in Financial Inclusion for Inclusive Growth

India currently faces several issues and challenges in the area of financial inclusion for inclusive growth. Salient among them are stated here below:

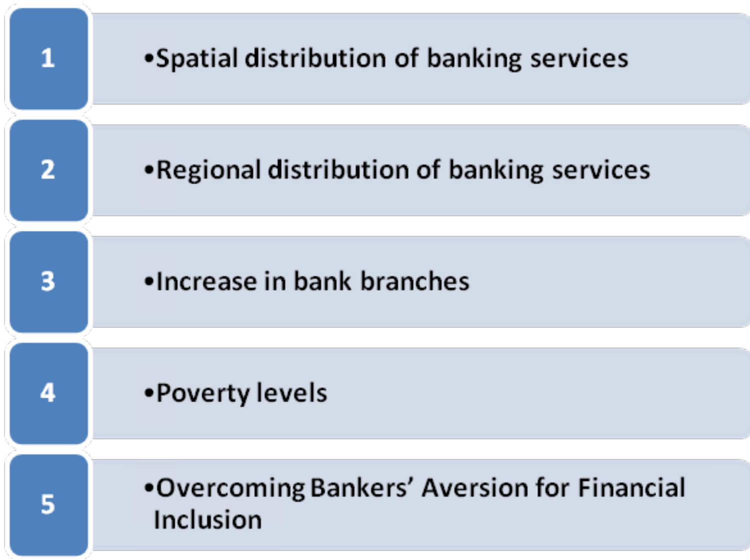

Figure 2.21 Issues and challenges in financial inclusion for inclusive growth

1. Spatial Distribution of Banking Services

There has been emphasized policy intervention by government and concerted effort of RBI as well as public sector banks, there have been significant increase in number of bank's offices in rural areas; but they are not in tune as per large population which is living in rural areas. The number of branches opened up by banks should be in proportion of the people staying in the rural areas. The numbers of branches of banks as well as other financial institutions are lesser in the rural areas which are providing financial services.

2. Regional Distribution of Banking Services

The number of bank's offices in six regions of our country is not distributed properly as per the population in that particular region. The six regions are mentioned below:

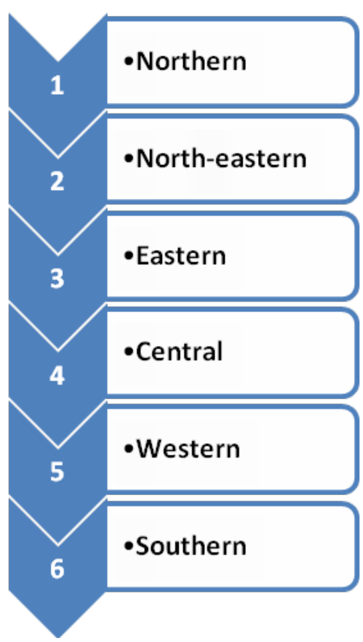

Figure 2.22 Regional distribution

There is a need that all the people living in the urban, semi-urban or rural areas are getting sufficient access towards financial products and services. It is the right of every citizen to be a part of the financial system. Hence, government as well as the commercial banks are working together to include the financially excluded people. It is very important that the bank's offices are distributed evenly among different regions.

3. Increase in Bank Branches

The number of bank branches is required to be increased since they have a direct impact on progress of financial inclusion. The number of accounts would also increase with increase in the number of branches. It is very important that people in the rural areas are encouraged not only to open accounts with banks rather maintain these accounts and save sufficiently for their future as well. Many people in the rural areas are not earning much and they might face difficulties in case of any contingency or any other sudden requirement in future.

4. Poverty Levels

The level of poverty has direct relationship with progress of financial inclusion. A decrease in the level of poverty would increase financial inclusion. The areas in which poverty level is high, there should be more focus on these areas rather a multifold strategic approach is required in these areas for financial inclusion. People who are below the poverty line also have right to be financially get included in the system. It is very important to make these people understand the importance of savings as many of them are not even aware about their future needs.

5. Overcoming Bankers' Aversion for Financial Inclusion

No banker expresses openly his aversion towards the process of financial inclusion. The banker's are not much interested in opening no frills accounts due to the cost aspect which is involved in opening them. Though opening no frills account is very important for encouraging people from rural areas to get associated with banking.

To Do Activity

Ask the students to form group of 4-5 members and prepare a presentation containing details about any one financial product and one service which is being offered to people in rural areas.

2.4 Business Facilitators

Several initiatives were taken by Indian government and RBI for ensuring financial inclusion. Business Correspondents (BCs) play a very important role to achieve financial inclusion. The BCs act like a bridge between the Bank branches and people in particular area. BC is the first point of contact and front face of bank branch for people. For enabling BCs in being more effective, there is a need that they possess sufficient knowledge to deliver the services required.

Financial inclusion is essential part of inclusive growth. It is very important for a nation to work upon inclusive growth. RBI is very passionate about financial inclusion. RBI has given instructions to banks to pursue the financial inclusion goal as passionately as RBI is working upon. Banks being the nerve system, it is very important that they work together towards financial inclusion. RBI devised a model in the year

2006 for increasing outreach of banking facilities in financially excluded areas and amongst financially excluded citizens. The model which is devised by RBI for achieving the goal of financial inclusion, a model comprising of the following representatives was designed:

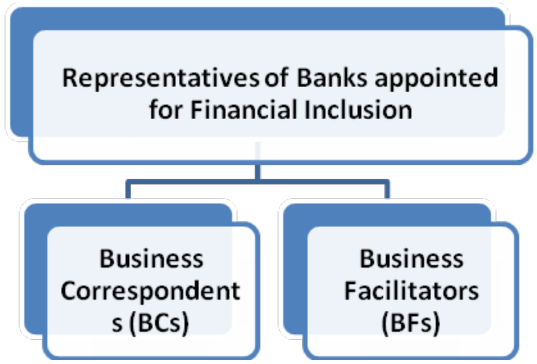

Figure 2.23 Model for financial inclusion

BCs and BFs are representatives who are appointed by the banks for act as their agents and providing banking services in the remote locations where bank does not have presence for promoting financial inclusion. The fundamental difference between the role of BCs and BFs is mentioned below:

(1) BCs

BCs are given permission for carrying out the regular banking transactions for the customers on behalf of bank.

(2) BFs

BFs are responsible only to spread awareness related to banking as well as bank's products, assist banks in activities which are related to business generation and also assist in bad debt recovery. BFs are not allowed to undertake cash transactions.

Initiation of BC/BF Model

Taking signal from international experiences, RBI working group which was headed by H.R. Khan explored many options and innovative approach to link Civil Society Organizations (CSOs) and other entities with banks for expanding bank's outreach. The working group felt that linkages could be established under two broader models.

The two models could be mentioned below:

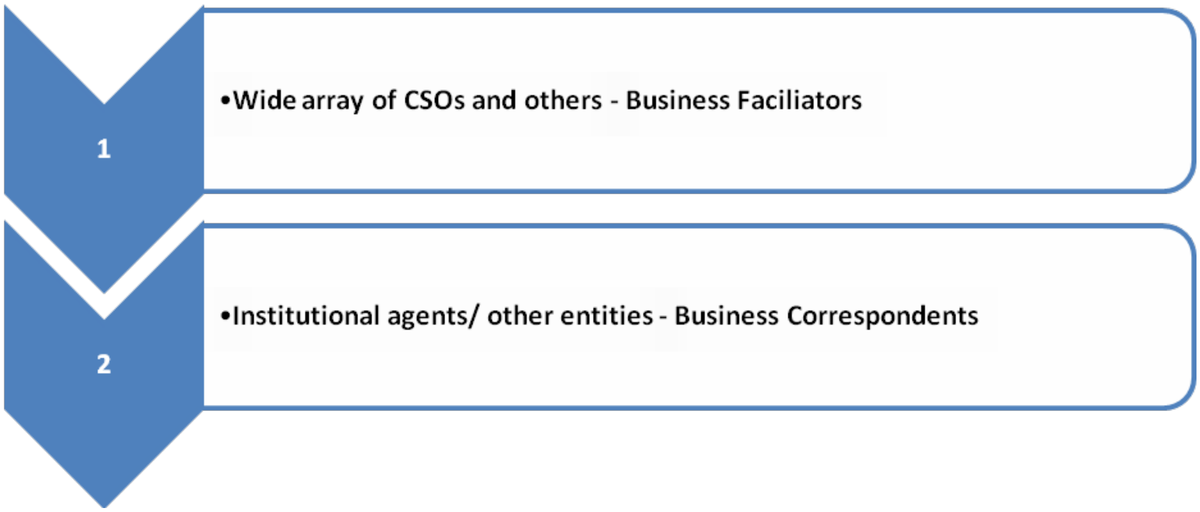

Figure 2.24 Expansion of Bank's outreach

(1) Wide Array of CSOs and Others - Business Facilitators

In this model, a wide array of CSOs as well as others is appointed to support banks by undertaking non-financial services. This model is said to be "Business Facilitator Model".

(2) Institutional Agents/ Other Entities - Business Correspondents

In the other model, institutional agents and other entities supporting banks to extend financial services are appointed. This model is said to be "Business Correspondent Model".

Taking recommendations into account and with objective for ensuring greater financial inclusion and to increase outreach of banking sector, RBI has permitted banks to make use of services of NGOs, SHGs, MFIs and other CSOs as intermediaries to provide financial as well as banking services through usage of BCs and BFs models which is specified in RBI circular dated January 25, 2006. Indian government constituted Committee on financial inclusion which was chaired by Dr. C. Rangarajan, report of this was submitted in the month of January 2008. This committee recommended that National Rural Financial Inclusion Plan (NRFIP) could be launched with clear target for providing access to the comprehensive financial services which includes credit, of at least 50% of the financially excluded households. People in the semi-urban and rural areas are catered with banking and financial services needs through RRBs and branches of commercial banks. Those people, who are not covered by these branches, could be catered by BCs and BFs. The branches which have been set up in semi-urban and rural areas of commercial banks and RRBs could set a particular minimum target for covering new cultivator households as well as non-cultivator households per branch per year, having an emphasis on the financial marginal farmers and the poor non-cultivator households.

Eligible Entities in Business Facilitator Model

Under "Business Facilitator" model, banks could use intermediaries as mentioned below:

1. •NGOs/ Farmers' Clubs
2. •Cooperatives
3. •Community based organizations
4. •IT enabled rural outlets of corporate entities
5. •Post Offices
6. •Insurance agents
7. •Well functioning Panchayats
8. •Village Knowledge Centres
9. •Agri Clinics/ Agri Business Centers
10. •Krishi Vigyan Kendras
11. •Khadi and Village Industries Commission (KVIC)/Khadi and Village Industry Boards (KVIB)

Figure 2.25 Eligible entities in Business Facilitator Model

It depends on the comfort level of banks to provide facilitation services. From supply side, banks might require to outsource many functions so that efficiency of transactions increases. These functions have nature of facilitation support services and could include the following:

Scope of Activities of Business Facilitator

Banks have been operating through various channels through which they could deliver financial services. Bank branches, Internet banking and ATMs are traditional channels. The BF model would offer an effective way to the banks for reaching un-reached population at large.

Scope of activities of the BFs is mentioned below:

i. Borrowers identification and fitment activities
ii. Collecting and preliminary processing of applications of loans which also includes verification of primary data/ information
iii. Create awareness about savings and various products
iv. Educating and providing advice on money management and debt counseling
v. Processing and submitting applications to banks
vi. Promoting and nurturing SHGs/ JLGs
vii. Post-sanction monitoring
viii. Handholding and monitoring of SHGs/ JLGs/ credit groups/others
ix. Follow-up for recovery

For ensuring greater financial inclusion and to increase outreach of banking sector, scheduled commercial banks which includes Local Area Banks (LABs) and Regional Rural Banks (RRBs) and have been permitted for using services of the intermediaries to provide banking and financial services through Business Facilitators/ Business Correspondents Model as per guidelines issued for employing them.

Advantages of Using BFs

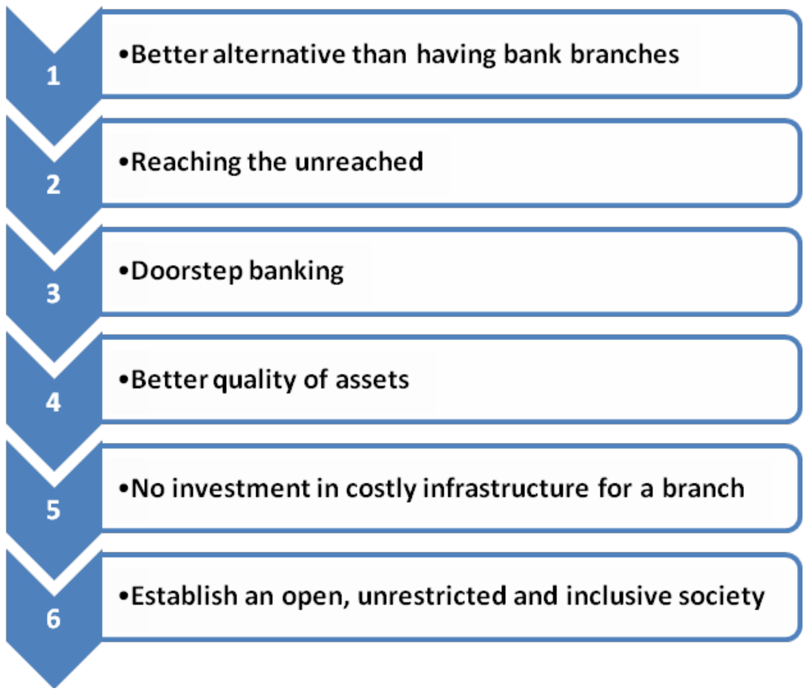

Figure 2.26 Advantages of using BFs

(1) Better alternative than having bank branches

Normally rural bank branch could serve 3000 – 4000 families in around 12 - 15 villages within radius of 15 km. A branch of a Public Sector Bank might require more than 5 years for breakeven in the unbanked areas in India, while Private sector or foreign bank having IT connectivity might require about 5 times more. The process to obtain permission for opening branch is long as well as protracted. Banks through the BF model could help in catering to many people without having much restrictions and this process is faster as well as involves lesser cost.

(2) Reaching the unreached

RF model enables banks to extend financial services to unreached clients who are beyond their branch network since beneficiaries of BF are mainly located in under banked and unbanked areas.

(3) Doorstep banking

Through BF model, loan could be disbursed as well as recovery of loans could be made at doorsteps of beneficiary.

(4) Better quality of assets

The target clients are known to the post offices, local NGOs and other similar local social bodies, thus loan facilitation by NGOs enhances asset’s quality. This model could be scaled up whenever possible within short period of time.

(5) No investment in costly infrastructure for a branch

The banks are not required to make more investment for their branches for reaching un-banked areas while at same time, people who have remained excluded would be assured of having easy access towards financial services and products. For making this happen, large numbers of BFs who are not working as an employee in a bank are outsourced by the banks across country for functioning as their own agents.

(6) Establish an open, unrestricted and inclusive society

This would bring 'excluded' rural population and help them to establish an open, unrestricted and inclusive society in rural areas and making financial inclusion reality within a particular time frame.

Objectives of Business Facilitators

Business Facilitators (BFs) would help banks in the following ways:

1	•Identify potential customers
2	•Counseling/ advising about bank products and services
3	•Help to villages for completing formalities
4	•Educating customers regarding loans
5	•Information about basic and small-value transactions

Figure 2.27 Objectives of Business Facilitators

(1) Identify Potential Customers

It is very important that potential customers are identified and included in banking system. It will not only help an individual rather help their household to save for future and in turn would lead towards development of the nation.

(2) Counseling/ Advising about Bank Products and Services

The people in the rural areas are not much aware about the products being offered by banks and other financial institutions; hence it becomes very important for the Business Facilitators to counsel and advice the people in village about the products and services as per their need.

(3) Help to Villages for Completing Formalities

The people in the rural areas are bit hesitant to become a part of the financial system, since they find the formalities for opening account with banks more complex and as such the employees of the banks and financial institutions are unable to help them in completing these formalities. BFs help people in the rural areas in opening accounts easily.

(4) Educating Customers Regarding Loans

BFs educate customers about the terms which are related to sanctioning, repaying and recovery of loans.

(5) Information about Basic and Small-Value Transactions

BFs help people in rural areas in putting through basic as well as small-value transactions.

Business Facilitators: Emerging Role and Scope of Operations

Role of BFs in extension of banking business is restricted towards promotion of product's awareness, processing loan applications, promoting as well as nurturing SHGs/ JLGs and following-up of loans toward ensuring recovery. Some areas in which BFs have been engaged by banks are mentioned below:

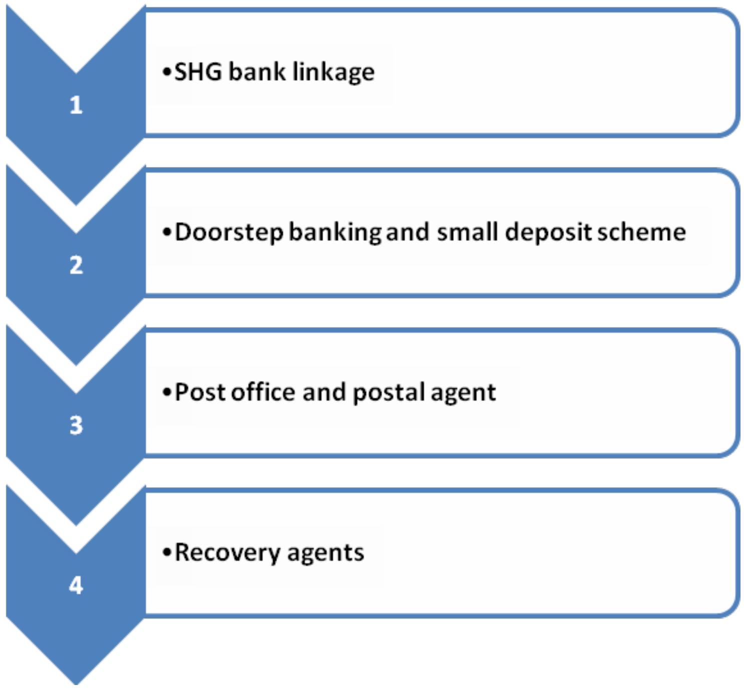

Figure 2.28 Emerging Role and Scope of Operations

(1) SHG Bank Linkage

Major area in which various banks have come ahead for engaging services of NGOs and many other agents is linking them towards well-functioning SHGs. A fee has to be paid to NGOs/ agents for facilitating opening of savings account of SHG and for credit linkage. This is additional to granting assistance that the NGOs could access for SHGs promotion from microfinance development and equity fund of NABARD. Certain amount is paid by the commercial banks to NGOs for linking of SHGs to banks.

Payment is done based on certain landmarks/ stages. There is no provision for suggestion that this money is utilized for campaign of promotion of SHGs or for building up existing SHGs portfolio.

(2) Doorstep Banking and Small Deposit Scheme

Over years most of the public sector banks have implemented many schemes which are designed for extending financial services to rural poor. The usage of agents or BFs, by banks for these tasks is not a new thing. As mentioned in Khan report, pigmy deposit scheme that involved weekly/ daily collection of small deposits at depositors' doorsteps in which the local people are engaged as agents, operated in past by few banks. This was banned for some years due to certain malpractices. Doorstep banking has been probably carried out in an unofficial way over past many years, but this was later allowed by RBI. Banks could offer banking services now to the government departments as well as institutions at bank's premises. For the individuals, permission of bank board and RBI is necessarily required. Risk management of these schemes has remained an issue with the need for necessary check and balance and usage of IT applications for minimizing risk. Banks are now able to use agents of different kinds as BFs, instead of using their employees, for making initiatives like doorstep banking more effective in cost.

(3) Post Office and Postal Agent

Postal department has unique position in providing saving facilities and lower-priced insurance product. The National Savings Institute which was formerly known as National Savings Organization operates through many post offices and around many branches of nationalized banks that are spread throughout the entire country and they are acting as distribution channel. There are many postal agents also include women for providing doorstep services to people. Despite decline in the rate of interest from per annum during previous few years, still there is an increase in deposit mobilization. Postal products carry high level of trust of public since Union government acts as guarantor. Cost of savings mobilization is not much and the postal deposits are being lent without any risk to the State government. Post employees /offices could be considered for BF relationship. Postal agents could become important part of extension of financial services by the banks in future. The postal department is itself potential competitor to banking system in various provisions of financial services, especially for liability products. Life insurance products carry comparatively lower premium for given cover and the savings products bear attractive return. Post office has strong presence in the remittance services which is done in form of money transfer facility.

(4) Recovery Agents

Outsourcing recovery of the overdue loans by banks has become common. The recovery agents are appointed under existing Securitization and Reconstruction of the Financial Assets and Enforcement of Security Interests (SARFAESI) Act 2002. Many banks are using NGOs and also former bank's staff as recovery agents for collecting bad debts (i.e. overdue and written-off loan) for bringing down level of their Non-Performing Assets (NPAs) through payment of some commission on collections for the hard core NPAs. This has been showing a good result and could be lucrative business for agents also. SHGs have been similarly given responsibility by the banks for repayment's collection from delinquent borrower in villages. Hence, BFs have been engaged already by the banks for assisting recovery of loans even before BF circular. There does not appear as such any controversial issue regarding the role of BF. These agents could be appointed even without the permission from RBI. Certain important areas in which banks could involve BFs, as mentioned above, RBI has already mentioned in earlier RBI's decisions.

Role Description of Business Facilitators

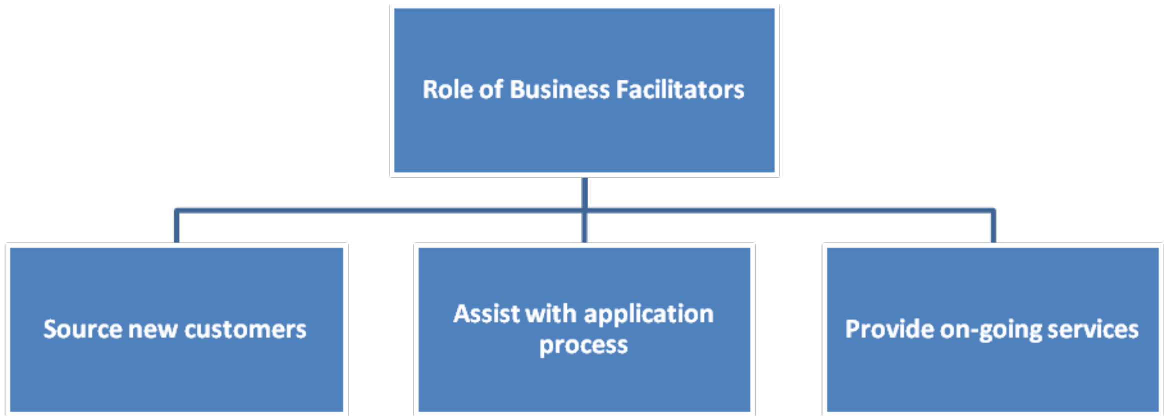

Figure 2.29 Role description of Business facilitators

(1) Source New Customers

This task covers following:

- Spread awareness regarding banking and bank's products
- Understanding prospective customer's requirement and give suggestion about an appropriate product (i.e. savings accounts, loan accounts etc.)
- Informing prospective customers regarding the application process, terms and conditions of products etc.

(2) Assist with Application Process

This task covers following:

- Conducting preliminary/ basic verification of the primary data/ information about customer
- Collecting documents
- Confirming approval for account opening and delivering related documents

(3) Provide On-Going Services

This task covers following:

- Scheduling and executing follow-up session and providing support services
- Advising customers on products and services
- Assisting in recovery

To Do Activity

Ask the students to visit any one who is working as a Business Facilitator (BF) and try to understand the activities which are being performed by them in detail and the benefits which they are enjoying as a BF.

2.5 Business Correspondents (BCs) in Rural Financing

BCs are bank representatives. They help the villagers for opening bank accounts. BCs get commission from banks for account opening of each account, every transaction which is made through them, each loan-application which is processed etc. The BCs carry mobile device and help the villagers in completing

banking transactions like depositing money, taking money out of the savings account, loans etc. Villagers give their thumb impression or the electronic signature and get money.
With objective to ensure greater financial inclusion and to increase outreach of banking sector, RBI have permitted banks for using services of SHGs/ NGOs, MFIs and various other civil society's organizations as intermediaries for providing banking and financial services through use of BC Models vide RBI's circular dated 25 January 2006.

Business Correspondent Model

RBI has taken various initiatives over last few years to increase banking outreach and to ensure greater financial inclusion. Significant step towards financial inclusion was issue of RBI guidelines in the month of January 2006 to engage BCs by the banks to provide banking as well as financial services. Regulatory framework for BCs model have been progressively moving ahead for ensuring that consumer protection is not at all compromised while facilitating the enhanced outreach of banking services. Relaxation in regulatory framework was possible due to rapid changes in the technology, as in terms of Core Banking Solution (CBS) and relatively lower cost biometric handheld devices to ensure fraud prevention and authenticity.

BCs are retail agents who are engaged by various banks to provide banking services at many locations other than bank branch and ATM. Banks which are adopting BC model, have to take full responsibility for acts of commission and omission of BCs which they engage and ensure thorough due diligence as well as additional safeguards to minimize agency risk. Basically, the BCs enable bank towards expansion of outreach and offer a limited banking services range at lower cost, as setting up of brick and mortar branch which may not be viable. BCs are integral part of business strategy to achieve a greater financial inclusion.

Scope of Activities of Business Correspondent Model

Under BC Model, MFIs / NGOs setup under Societies / Trust Act, the Societies are registered under Mutually Aided Cooperative Societies Acts or Cooperative Societies Acts of the States, Section 25 Companies, Registered NBFCs which are not accepting post offices and public deposits may act as BCs. Banks have been advised to conduct due diligence on these entities and ensure that they have been well established, enjoy a good reputation and have confidence of the local people.

Scope of activities of the BCs is mentioned below:

i. Borrowers identification and fitment of activities
ii. Collecting and preliminary processing of applications of loans which also includes verification of primary data/ information
iii. Create awareness about savings and various products
iv. Educating and providing advice on money management and debt counseling
v. Process and submit applications to banks
vi. Promoting and nurturing SHGs/ JLGs
vii. Post-sanction monitoring
viii. Handholding and monitoring of SHGs/ JLGs/ credit groups/others
ix. Follow-up for recovery

x. Disbursal of credit of small value
xi. Recovery of collection/ principal of interest
xii. Collection of deposits of small value
xiii. Sale of micro-insurance/ pension products/ mutual fund products / other third party products and delivery and receipt of small value remittances / various other payment instruments.

These activities are required to be undertaken by BCs would be within normal course of banks' business, but conducted through entities at place other than banks' premises.

Entities Eligible to Act as BCs

In the initial phase of BC model when introduced in the month of January 2006, entities permitted to act as BCs included the following:

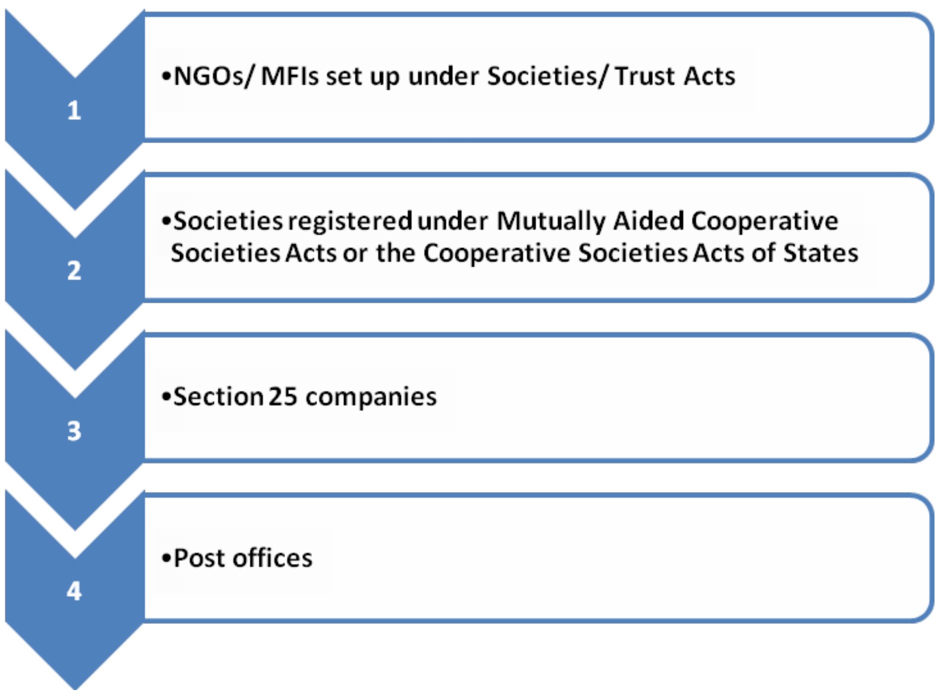

Figure 2.30 Entities eligible to act as BC in initial phase

Regarding Section 25 companies, it was clarified subsequently in the month of April 2008 that the banks could engage such companies as BCs with a condition that the companies are stand-alone entities or are Section 25 companies in which Banks, NBFCs, telecom companies and various other corporate entities or their holding companies do not have holding in excess of 10%.

Committee on financial inclusion with Chairman - Dr. C. Rangarajan observed that due to increase in competition, banks were getting quite cautious of reduction in margins available to them related to financial intermediation and that smaller value clients mainly depositors in the remote locations get little preference to access financial services. Emphasizing on the need to have BC touch-point in each of 6 lacs plus villages in country, Committee recommended individuals like the locally settled retired Government servants like postmasters, ex-servicemen, school teachers etc could be permitted to act as

BCs. Further, Micro Finance –Non Banking Finance Companies (MF-NBFCs) could be allowed for acting as limited BCs of the banks to provide savings as well as remittance services. Committee recognized that technology have to be an essential part for sustaining outreach effort through BC model. The list of people who could be engaged as BCs were further expanded and includes the following individuals as mentioned below:

1. Retired government employees
2. Retired bank employees
3. Ex-servicemen
4. Retired teachers
5. Individual Public Call Office (PCO) operators
6. Individual owners of kirana / medical /Fair Price shops
7. Individuals who own Petrol Pumps
8. Authorized functionaries of well run Self Help Groups (SHGs) that are linked to banks
9. Agents of Small Savings schemes of Government of India/Insurance Companies
10. Any other individual including those operating Common Service Centres (CSCs)

Figure 2.31 Additional list of eligible entities for BCs

Banks' Experience with BCs

Although RBI has permitted many type of individuals/ entities to act as BCs, only few have actually been engaged by the banks. All the public and private sector banks have not engaged BCs, only some have engaged. Mostly banks which have engaged BCs have appointed Section 25 companies/ Societies/ Trusts as BCs. Further, almost all Section 25 companies which are engaged as BCs have been floated by technology service providers who have provided biometric solution or smart card for opening of accounts etc.

There are many technology services providers who have been providing support in BC model. Some of these companies are mentioned:

Figure 2.32 Bank's experience with BCs

(1) FINO

It is a technology firm which is working together with its non-profit partner Fintech Foundation, which acts as BC network manager have opened many accounts on behalf of many banks, Post Offices and government agencies.

(2) A Little World (ALW)

A Little World (ALW) and its non-profit partner Zero Mass Foundation have opened many accounts as BC for many banks.

(3) Eko

Eko is similar technology focused company with Eko Aspire Foundation, which is a parallel non-profit organization which is operating as BC for one of the public sector banks.

(4) Integra Micro Systems (Pvt.) Ltd

Integra Micro Systems (Pvt.) Ltd. have also provided technology solution under BC model to few banks.

While there are many banks who have taken certain steps for adopting BC model, only few of them have scaled-up beyond pilot stage. The difficulty which was experienced by the banks for scaling up have been credited to various factors which includes operational, credit, reputation and legalities faced by the banks for engaging large number of BCs, lower coverage by the individuals who are acting as BCs due to financial and other constraints, difficulty in assessment of integrity of the individuals acting as BCs, lack of professionalism of the BCs in matter of punctuality, regularity, maintenance of various records, delay in processing of loans, disbursement, lower volume of the business by BCs and cost associated with lower volume smaller value transactions.

Operating Norms of BCs

Banks have permission for paying reasonable fees/ commission to BCs, rate as well as quantum of the fees and commission would be reviewed periodically. These costs are required to be borne by banks entirely. Initially, this might affect operational margins, but with time, with incremental business which is brought in, arrangement is expected to become self sustaining and more viable. Further, the banks are given advice by RBI that agreement with BCs should be prohibited from charging any kind of fees from customers directly for the services rendered by the BCs on behalf of bank. It has been clarified by RBI that arrangements with BCs shall specify the following:

1. Suitable limit on holding cash by the intermediaries
2. Suitable limits on individual customer's receipts and payments
3. The transactions are properly accounted by day end or next working day
4. Transactions are reflected in the banks' books by day end or next working day
5. All agreements / contracts with customers shall specify that bank is responsible to customers for acts of commission and omission of BCs

Figure 2.33 Operating norms of BCs

The operating norms for the BCs have been well defined by RBI and it is very important for all the BCs to follow these norms.

Guidelines for engaging Business Correspondents (BCs)

Banks could formulate policy to engage BCs with approval of their Board of Directors. Due diligence could be carried out on entities/ individuals to be engaged as BCs previous to their engagement. Due diligence exercise could cover aspects mentioned below:

1. Market/ reputation standing
2. Financial soundness
3. Corporate and management governance
4. Ability for handling cash
5. Ability for implementing technology solutions to render financial services

Figure 2.34 Aspects of due diligence

The Role and Responsibilities of the BCs

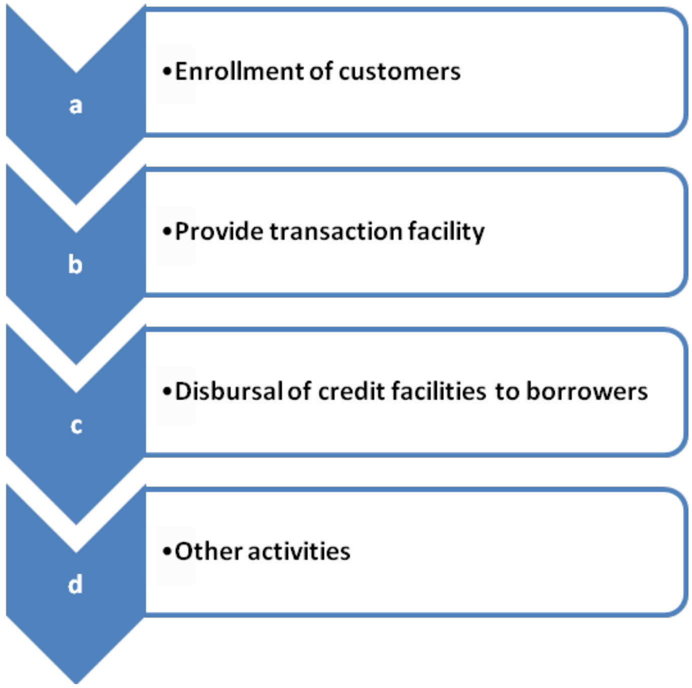

Figure 2.35 Role and responsibilities of BCs

(a) Enrollment of customers

Enrollment of the customers which includes collecting biometric and other details, providing cards (like ID card, credit card, Debit Card), PIN

(b) Provide transaction facility

Other transaction facilities are also provided by BCs which are mentioned below:

(I) Depositing money in account with bank

(ii) Withdrawing money from any account with bank

(iii) Remittance from an account with bank to an account with same or other bank

(iv) Balance enquiry and issue account statement/ receipts

(c) Disbursal of credit facilities to borrowers

Disbursal of credit facility to the borrowers involves smaller amounts strictly as per instructions of Bank.

(d) Other activities

i. Identification of the borrowers and activities classification as per their requirements.

ii. Collecting and prima facie loan scrutiny of applications which includes verification of primary data.

iii. Creating awareness about saving and other products being offered by Bank

iv. Educating and advisory on management of money & debt counseling.

v. Preliminary scrutiny of data and application submission to Bank for its review.

vi. Promoting, nurturing, handholding and monitoring of SHGs and/or JLGs and/or credit Groups and others.

vii. Facilitating repayment of dues owed to bank by its customers.

viii. Marketing of third party financial products.

Products Offered by Business Correspondents

Following products are to be offered by BCs:

Figure 2.36 Products offered by Business Correspondents

Advantages of using BCs

(1) Better Alternative than having Bank Branches

Normally rural bank branch can serve around 5000 – 10000 families in around 15 - 20 villages within radius of 15 km. When a branch of any Public Sector Bank is set up in the rural areas, they might require more than 5 years for breakeven in the unbanked areas in India. While a Private Sector or foreign bank that has IT connectivity might require about 5 times more as compared to Public Sector Banks. The process for obtaining permission for opening branch is long as well as protracted. Banks through BF model can help in catering many people without much restrictions and this process comparatively faster as well as involved lesser cost.

(2) Reaching the Unreached

This model enables the banks to extend the financial services to unreached clients beyond their branch network since beneficiaries of BCs are mainly located at the unbanked as well as under-banked areas.

(3) Better Loan Performance

Since the local stakeholders like post offices, NGOs etc., are involved in process, they know customers at personal level. Personal connections enhance customers' accountability to BCs, which improves performance of loan and rate of repayment.

(4) Doorstep Banking

Disbursement of loan as well as recovery at doorsteps of beneficiary is being made available by the BCs.

(5) Quick Expansion

Scaling up of BCs model is actually possible within short period of time.

To Do Activity

Ask the students to discuss on any one of the following topics about Business Correspondents in a group of 4-5 members:

- Scope of activities
- Entities eligible
- Bank's experience

Summary

In current scenario, technology is main driving force for all businesses and has enabled the banking customer to operate from home or their workplace. Today, customers can easily operate their bank accounts without even visiting the bank branch for any transaction or rather it could be said that for everything. With advancement of the technology in banking, there is an immense usage of internet, online bill payment and mobiles in the banking sector and this has brought new facet in banking altogether. Most banks have become technology enabled, hence focus have shifted to rural banking. ICTs are changing each sphere of people's life. ICT holds tremendous potential for development of rural areas in India in field of health, education, banking and agriculture. Financial inclusion has been recognized as key driver towards poverty alleviation and economic growth. Access towards formal finance could boost job opportunities, reduces vulnerability for economic shocks as well as increase investment in the human capital. Without having adequate access towards formal financial services, firms and individuals are required to rely upon their limited resources or have to rely upon costly informal source of finance for meeting their own financial needs and pursue various growth opportunities. Inclusive growth implies direct link between microeconomic and macroeconomic determinants of economy as well as economic growth. Microeconomic dimensions capture importance of the structural transformation for economic competition and diversification, while macro dimension refers certain changes in the economic aggregates such as country's gross domestic product (GDP) or gross national product (GNP), total factor productivity and aggregate factor inputs.

Several initiatives were taken by Indian government and RBI for ensuring financial inclusion. Business Correspondents (BCs) and Business Facilitators play a very important role to achieve financial inclusion. The BCs act like a bridge between the Bank branches and people in particular area. BC is the first point of contact and front face of bank branch for people. For enabling BCs in being more effective, there is a need that they possess sufficient knowledge to deliver the services required.

Financial inclusion is essential part of inclusive growth. It is very important for a nation to work upon inclusive growth. RBI is very passionate about financial inclusion. RBI has given instructions to banks to pursue the financial inclusion goal as passionately as RBI is working upon. Banks being the nerve system,

Model Questions

- How is ICT implemented in rural banking?
- Discuss the challenges of ICTs role in rural banking.
- Discuss the facilities identified under financial inclusion.
- Explain the factors affecting access to financial services.
- Discuss the vision of Inclusive financial system.
- Explain the issues and challenges in financial inclusion for inclusive growth.
- List out the entities eligible in the business facilitator model.
- What role do business facilitators play for financial inclusion?
- Discuss the scope of activities of Business Correspondents.
- What are the roles and responsibilities of Business Correspondents?

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Chapter 3 – Challenges and Prospects in Rural Banking

Introduction

The Indian economic environment has been witnessing path breaking reform measures. Financial sector, of which banking industry is largest player, has been undergoing metamorphic change. Banking industry is strong and is capable of withstanding competition pressures. With acceptance of prudential norms with transparency and higher disclosures, the Indian banking industry is moving gradually towards adoption of best practices in risk management, accounting and corporate governance. The banking system is developed having different classes of banks like NABARD, Regional Rural Banks, Public Sector banks, Private sector banks, foreign banks, Co-operative Banks etc with RBI as the regulatory authority which has been regulating the entire banking system. In banking field, there have been diversification and unprecedented growth of the industry. During so many years, there have been tremendous changes in banking industry. Banks have moved from traditional banking to modern banking. There has been innovation and improvement and this has helped banking sector to come out with new type of services for catering to emerging needs of customers. There has been massive expansion in the bank branches in rural and the underdeveloped areas, savings mobilization, credit facilities diversification to areas which were before being neglected like agricultural, small scale industrial sectors and other areas like export sector etc has resulted in deepening and widening of financial infrastructure and transferred fundamental character of class banking into mass banking. There have been diversification and innovation in business of major commercial banks.

Financial sector reforms, introduced from 1991 onwards aimed at transformation of credit institutions into organizationally strong, operationally efficient and financially viable units. Lending rate for the institutions has been deregulated. Other measures related to liberalization include allowing of non-target group financing for the RRBs, direct financing for CCBs and SCBs and liberalization in non-fund business and investment policies. Such measures have contributed towards many RRBs in turning around and have become more vibrant institutions.

Many policy initiatives towards advances in the rural banking have been taken. These initiatives includes additional capital contribution towards NABARD by RBI and Indian government, recapitalization and restructuring of RRBs, simplifying lending procedure, preparation of special credit plans by the public sector banks and also launching Kisan Credit Cards. Another scheme that linked SHGs with the banks was launched under aegis of NABARD for augmenting resources of the micro credit institutions. The initiatives enabled a wider network of the rural financial institutions, penetration of formal credit into the rural areas, banking culture development and counter to dominance of moneylenders. The initiatives have financed modernization of rural economies and implementation of self-employment and anti-poverty programmes. However, for focusing on future, generalization on certain concerns regarding current approach towards rural credit and banking would be appropriate.

Digitization in banking industry means making banking smooth and seamless for the bank customers. In the recent years, lesser people approach branches to avail banking services and products and there have been tremendous increase in the consumption of digital banking. Most of the public sector banks and private sector banks are focusing on offering products and services based on new technology to customers like mobile banking apps, e-wallets and mobile banking. Biggest advantage of channeling banking "digitally", is ability for providing new customer specific business model through the banking pattern analysis which explores customer value towards maximum.

Objectives of the Chapter

- To familiarise RBI's approach towards rural banking
- To identify prospects of RRBs in rural areas
- To identify the challenges being faced by Commercial banks in rural areas
- To familiarise the cost involved in providing banking facilities in the rural areas
- To explain the emerging trends in rural banking

Chapter Structure

- **3.1 Approach of RBI towards Rural Banking**
- **3.2 Challenges and prospects of RRBs in rural banking**
- **3.3 Challenges of Rural branches of Commercial banks**
- **3.4 Transaction and risk cost**
- **3.5 Emerging trends in rural banking**

3.1 Approach of RBI towards Rural Banking

Banking in Ancient India

In India, the features of banking practices in ancient times, traces of which are even found now in the isolated rural areas in our country. In various other aspects, a long tradition of banking has been seen. Evidence regarding existence of operations related to money-lending has been found in India in literature of Vedic times, i.e. 2000 to 1400 B.C. Literature of Buddhist period, for examples Jatakas and the recent archaeological discoveries supply evidence of existence of the sresthis, or bankers. From laws of Manu, it is indicated that money-lending and other allied problems have assumed a considerable importance in the ancient India. The role of rate of interest has been recognized in the ancient India.

The rate of interest was prescribed by many Hindu law givers, these are mentioned below:

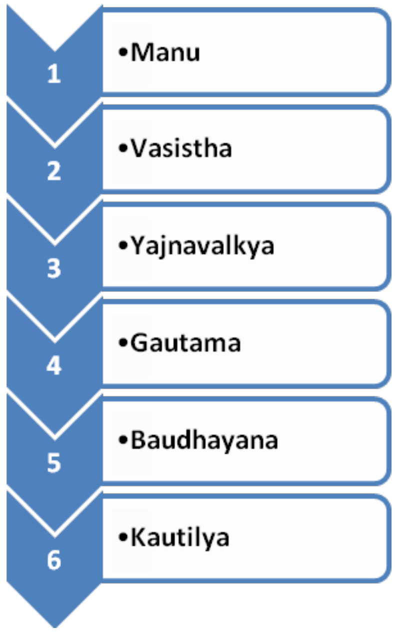

Figure 3.1 Hindu law givers who prescribed rate of interest

Common base number was 15 percent per annum, which was called as Hindu rate of interest by Dr. Thingalaya. This rate is higher than the current Prime Lending Rate (PLR) which is being considered by many banks. Everyone during that period did not get loans at PLR. Only the prime borrowers were given loan at PLR, though the base was different at that time. According to Vasistha and Manu, the rate of interest was not required to vary depending on risk involved or purpose of lending money. But, during the ancient time, loan was classified based on caste classification of borrowers. Brahmins were charged 2 percent, Kshatriya 3 percent, Vaishya 4 percent and Shudra 5 percent per month. Chanakya's structure of interest rate was risk-weighted since interest rate increased with risk involved in business of borrowers. The rates were as below according to Chanakya's structure of interest rate:

Figure 3.2 Chanakya's structure of interest rate

(1) General advances
The rate of interest worked out to be 15 percent annually for the general advances.

(2) Traders
Traders were charged an interest rate of 60 percent annually.

(3) Merchandise passed through forest
Where merchandise was required to pass through the forests, traders were required to pay 120 percent annually.

(4) Export import business (sea-borne)
Those who were engaged in export-import business handling sea-borne cargo were required to pay 240 percent annually.

Everyone was not allowed to enter into the business of banking. Only men who belonged to Vaishya caste could actually take up the profession of money lending. In the ancient times, caste gave licence towards banking and not did RBI.

Approach to Rural Banking
RBI has mandate to be closely involved in the matters related to banking and rural credit by virtue of provisions of Section 54 of RBI Act. Major initiative in pursuance of this mandate was taken with the sponsoring of All-India Rural Credit Survey in the year 1951-52. This study has made an agency-wise estimate of the rural indebtedness and it observed that the cooperation have failed but this must succeed. This Report of Committee on Directions is still being considered as classic on this subject. This was the origin of policy for extending formal credit through various institutions while viewing traditional, informal and local agencies as horrific.

In first stage efforts were concentrated on the development and strengthening of the cooperative credit structures. RBI has made financial contributions to cooperative institutions through the evolving institutional arrangements, especially to refinance credit towards agriculture. While enacting State Bank of India (SBI) Act in 1955, objective was to extend banking facilities on large scale especially in semi-urban and rural areas. SBI became a very important instrument for extension of rural credit for supplementing efforts of the cooperative institutions.

In the year 1969, 14 major commercial banks were nationalized and objective was to control heights of the economy. Nationalized banks became a very important instrument for advancement of rural banking in addition with SBI and cooperatives. Next step for supplementing efforts of the cooperatives and the commercial banks was establishment of Regional Rural Banks in the year 1975 in many states with equity participation in equity from commercial banks, Central as well as State Governments. Till the year

1982, for consolidating various arrangements made by RBI for promoting/ supervising institutions as well as channel credit to the rural areas, NABARD was established. Though many efforts were made for increasing flow of institutional credit for agricultural as well as rural lending, there existed mismatches in production and credit. Field studies were conducted for determining the reason and they revealed that it this was due to absence of an effective planning at local level. This was felt that with establishment of larger networks of the branches, a system could have been adopted for assigning specific areas to each bank branch in which it could concentrate on focused lending and contributed to development of the area. In view of this approach, RBI introduced scheme of "Service Area Approach" for the commercial banks. For further supplementing institutional mechanism, concept of Local Area Banks was taken up in 1996-97 and in-principle approval was given for 8 Local Area Banks. As regard to the cost of credit, for most of the period administered rate of interest regime was not applicable for the bank lending and this also included concessional terms for the priority sector.

In the current period, all the interest rates on advances including in the rural areas have been deregulated and there is as such no link between the priority sector as well as rate of interest. Though there are some regulations related to size of advance as well as rate of interest. There are some restrictions on the banks regarding priority sector lending and in case they do not fulfill, these banks have to contribute towards Rural Infrastructure Development Fund which is set up by NABARD. NABARD provides this fund’s amount to the State Government and state-owned corporations for enabling them to complete various types of rural infrastructure projects.

Financial sector reform, which was introduced from 1991 onwards aimed at transforming credit institutions into an organizationally strong, operationally efficient and financially viable units. These measures which were introduced including reduction in the budgetary support and concession of the resources, preparation of the Development Action Plans and signing Memoranda of Understanding having major controllers, and introducing prudential norms related to income recognition as well as classification of assets for the RRBs and cooperative banks. RBI has taken many initiatives towards development of rural areas. These initiatives have:

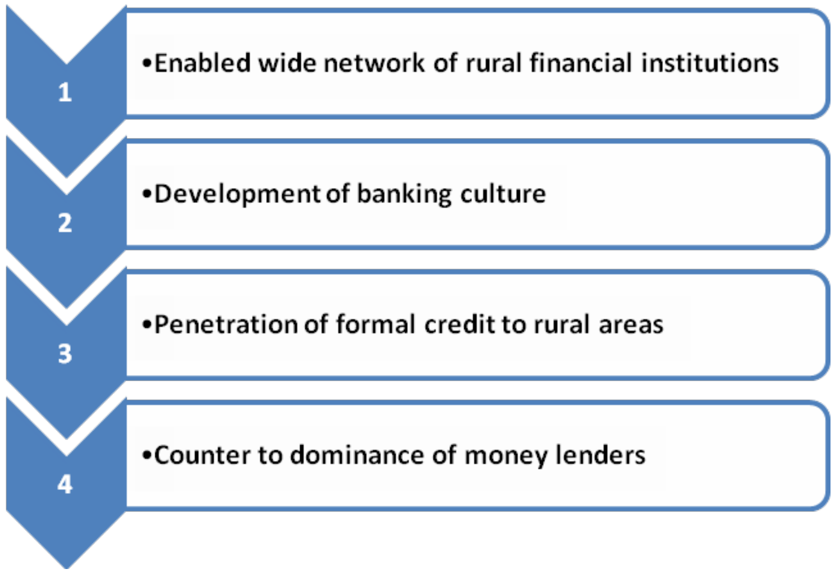

Figure 3.3 Impact of RBI initiatives towards rural development

These initiatives have financed modernization of the rural economies and implementation of self - employment and anti-poverty programmes.

(1) Enabled Wide Network of Rural Financial Institutions (RFIs)

The people in the rural areas are to be encouraged so that they could develop the tendency to save. For this it is very important that there is wide network of RFIs so that more people could be catered with banking products and services. More branches and offices of RFIs in rural areas could make more people open accounts and start depositing money and availing loan facilities from RFIs.

(2) Development of Banking Culture

The people in the rural areas are not having much to save and many of them do not understand the need for saving money for future and some are unable to save due to small income. It is very important that the need of saving is explained to the people in rural areas and they are encouraged to not only open savings account, instead also start saving money on regular basis. Banking culture needs to be developed among the people in rural areas.

(3) Penetration of Formal Credit to Rural Areas

There are some people who are planning to start their own small business or need funds for consumption or production purpose. It is very important for these people to understand that they could get credit from the formal financial institutions as well. Instead of approaching the money lenders and facing higher interest rates and other issues, people from rural areas could avail credit facility easily from formal financial institutions. People belonging to the rural areas should also understand the way the funds could be used and should also understand the need of repaying the loan.

(4) Counter to Dominance of Money Lenders

The money lenders are providing finance to people in the rural areas with lesser documentation and lesser time for providing credit. The formal financial institutions have been providing credit since many years; the people in the rural areas are required to develop a tendency of approaching formal institutions for deposits as well as loans. The formality for availing loans is not much and people can take help from the bank's staff in rural branches and could easily apply for loan.

Dynamics of Rural Economy

It is very important to understand the problems of rural banking and rural credit, it is important to understand dynamics of rural economy.

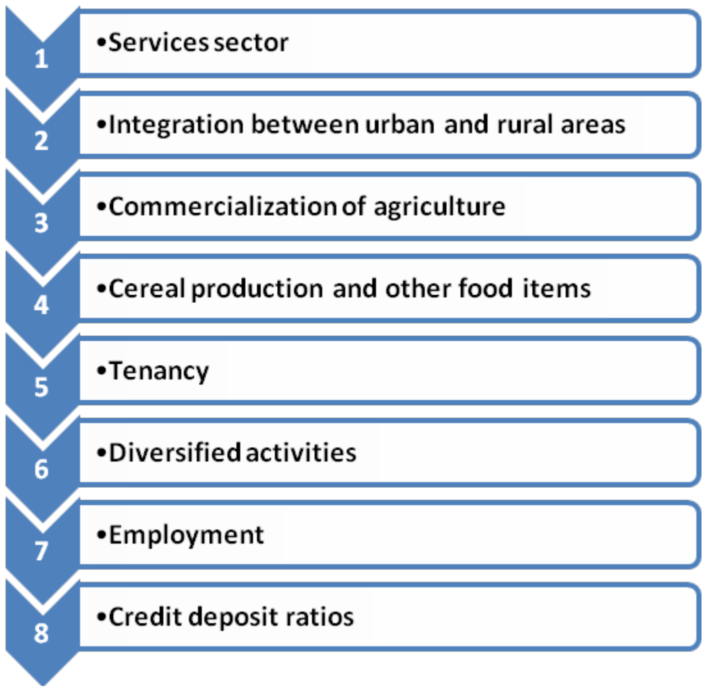

Figure 3.4 Dynamics of Rural Economy

(1) Services Sector

Services sector is now getting an increased importance in rural areas whether it is from coffee shop to cable television operators. Assessment and meeting of needs of credit, it is very important as many people in the rural areas are dealing in services sector.

(2) Integration between Urban and Rural Areas

Integration between urban and rural and urban areas has significantly increased which has resulted mobility of capital, products, labour and even credit between urban and rural areas is increasing.

(3) Commercialization of Agriculture

Commercialization of agriculture, particularly increasing role of various cash crops like cotton has resulted in the substantial role for buyer's and suppliers' credit. Fertilizers and pesticides are being supplied to the farmers on credit, very often on deferred payment basis.

(4) Cereal Production and other Food Items

Compared to cereal production and other food items which include fish and poultry are growing at faster pace. Agriculture is getting diversified in the terms of processes and products.

(5) Tenancy

In the areas where commercialization of agriculture has reached significant levels, traditional landlord-based tenancy has been replaced with commercial-based tenancy. In case of intensive cultivation of various cash crops like cotton, this type of tenancy is quite common. Banking procedures and present credit does not cater to needs of working capital of such commercial based tenancy relationship.

(6) Diversified Activities

With diversified activities as well as large work force in the rural areas, there is an increasing recourse to many occupations for earning decent livelihood. For example, small farmer is also working as petty trader and might also be working as satellite-based cable television operator in village. End use specification and credit monitoring is more difficult in such circumstances.

(7) Employment

To an extent employment as well as incomes can be seasonal, especially for agricultural labour there is a reason for seeking and obtaining consumption loans. Such assurance is possible through prosperity in rural employment. Current arrangements in the formal credit markets are inadequate for meeting such requirements.

(8) Credit Deposit Ratios

Banking system acts as a medium for net transfer of savings from the rural sector to non-rural sector, this is very much clear as per current data of credit deposit ratios. On other hand, major part of the informal markets would be locally and hence the savings would be deployed locally, within rural areas.

Rural Credit Markets

The basic thrust of RBI policy has been the promotion of institutional credit and elimination of informal finance. Though formal credit has expanded its share the presence of informal finance continues to be significantly present in the rural areas. Idea for promotion of SHGs and micro financing is indirect admission of necessity of the informal finance. It is very important that formal as well as informal rural credit is clearly understood and also the linkage between them. The rural credit system of India is divided into two segments: the Unorganized or Informal segment.

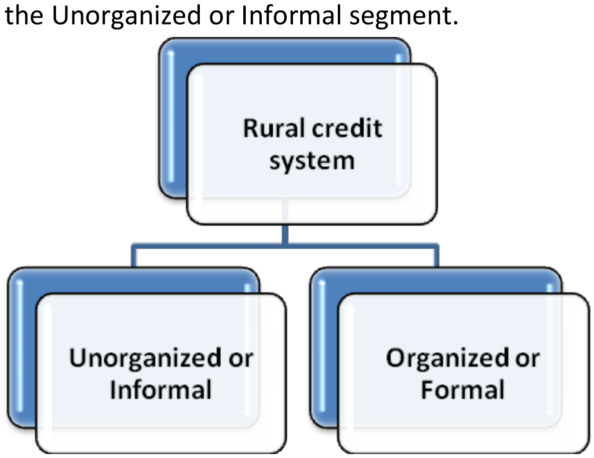

Figure 3.5 Segments of Rural credit system

The rural credit system of India is divided into two segments: The Unorganized or Informal segment i.e. money lenders, input suppliers and traders and the Organized or Formal segment i.e. Commercial Banks, Regional Rural Banks, Cooperative banks and NBFCs. There has been a requirement to strengthen the formal credit institution because there was a requirement of modern input in the rural credit segment and because of the unfair money lending practice which could not have been countered effectively. RBI and NABARD have been promoting the Institutional credit in the rural areas, though the role being played by the informal finance is significant. Idea of promoting micro financing and Self-Help Group (SHG) is indirect admission of necessity in informal finance. There is a need that the role of formal as well as informal credit market needs is understood and also the linkage between them, as this will create the future of banking in rural areas.

a) Unorganized or Informal Segment

Informal finance market is legal but is not unrecorded officially is comprised of the unregulated financial activity i.e., activities which are outside orbit of the officially regulated financial intermediary. Informal financial transactions could include the lending and borrowing among relatives and friends as occasional and this is not a part of informal market. The informal financial transactions could be broadly divided into three categories: well-defined group, tied-lending/borrowing and untied lending/borrowing activities. There are slight variations in each category. The informal segment is not desirable as they are not regulated. Many poor people do not have access to Institutional credit. The arrangement for credit in the informal debt market is flexible and it also possesses some inbuilt risk sharing arrangement. Such arrangement for credit provides smoothening of production and consumption requirement. Transaction costs related to term of certainty, procedural requirements, number of trips, timeliness etc. are negligible even though there could be hidden costs related to tied lending.

b) Organized or Formal Segment

Formal segment caters to borrowings having lesser risk as compared to the informal segment and they serve a purpose. The formal segment provides various benefits due to which it has been popular and attractive i.e. high reserve ratio, directed credit, branch licensing, ceiling in interest rate etc. Perhaps, one way of reconciling the conflicting views on usefulness of informal credit is to recognize some emerging realities of both formal and informal markets.

NABARD infuses Rs 1.46 lakh crores in rural banking system in 2019-20

As on February 28, 2020, Rs 87,069 crores has been extended towards cooperative banks and RRBs in short-term refinance by NABARD. In addition to this, long-term refinance of Rs 59,502 crores has been provided to these banks and other financial institutions, this was shared by NABARD.

As disclosed by NABARD, an amount of Rs 1.46 lakh crores have been infused in rural banking system during current fiscal. NABARD has been extending financial support to banks which are operating in the rural areas for helping them to deploy their resources effectively to meet credit needs of the rural people which includes farmers. In this current fiscal, development finance institution has extended Rs 6,704 crores long-term credit and Rs. 66,397 crores in short-term credit to the rural cooperative banks. RRBs have availed Rs 14,141 crores in the short-term credit and Rs 8,417 crores in the long-term credit. In addition, other banks which includes small finance banks, have obtained long-term refinance of Rs. 37,895 crores. It provided short-term refinance that is essentially for production credit to the banks for allowing farmers to meet their operational costs. Long-term refinance aims at supporting sectors like poultry, dairy, fishery, irrigation, farm mechanization and the non-farm sectors among the others. Development is directing its resources for increasing institutional credit to the rural sectors through Non-banking financial Companies (NBFCs). It has extended Rs 4,638 crores to MFIs and NBFCs so far in FY20.

Source: Economic times (n.d). Retrieved from https://economictimes.indiatimes.com/industry/banking/finance/banking/nabard-infuses-rs-1-46-lakh-crore-in-rural-banking-system-in-2019-20/articleshow/74459281.cms

To Do Activity

Ask the students to form a group of 4-5 and discuss about the dynamics of rural economy and also atleast impact of RBI initiatives on rural banking. Prepare a presentation and present before the class.

people are facing many problems in having adequate credit supply. Major source of credit to the rural households, have been from informal sector. Rural banking is a process of conducting banking transactions where the bank branches are far away and it becomes difficult for people to use financial services. Rural banking is famous for smaller towns as well as farmers who have been living far away from the areas of large population and can't reach to such locations where bank branches exist whenever they need to use services of banking

RRBs plays vital role in agriculture and also rural development of India. In India, RRBs have reached to the rural areas, through their huge network. Success of the rural credit depends largely on their financial strength. RRBs are the key financing institution at rural level that shoulders responsibility related to meeting the credit needs of various types of agriculture credit in the rural areas. Currently, most RRBs are facing problems of recovery, overdue, non-performance and other problems. First recommendation for establishment of RRBs was made by the Banking Commission in the year 1972. As a result of this recommendation, working group which was headed by Mr. M. Narsimham Rao, RRBs came into existence on 26th September, 1975 and RRB Act, 1976 having an objective of ensuring sufficient institutional credit for agriculture and various other rural sectors. RRBs were established for mobilizing rural areas' smaller saving and providing other banking facilities to smaller and backward areas. RRB's are sponsored by the public sector banks. RRBs keep their deposits with the public sector banks and are dependent for loan operations & finance on sponsor banks and NABARD.

Objectives of RRBs (Source : Devi N.Sabitha (2014). Problems and Prospects of Regional Rural Banks in India. International Journal of Managerial Studies and Research (IJMSR) Volume 2, Issue 3, April 2014, PP 69-72 ISSN 2349-0330 (Print) & ISSN 2349-0349 (Online) www.arcjournals.org)

The objectives of RRBs are mentioned below:

- To provide cheap and liberal credit facilities to small and marginal farmers, agriculture labourers, artisans, small entrepreneurs and other weaker sections.
- To save the rural poor from the moneylenders.
- To act as a catalyst element and thereby accelerate the economic growth in the particular region.
- To cultivate the banking habits among the rural people and mobilize savings for the economic development of rural areas.
- To increase employment opportunities by encouraging trade and commerce in rural areas.
- To encourage entrepreneurship in rural areas.

- To cater to the needs of the backward areas which are not covered by the other efforts of the Government.
- To develop underdeveloped regions and thereby strive to remove economic disparity between regions.
- Identify the financial need specially in rural areas
- To enhance banking and financing facilities in backward or unbanked areas
- To provide finance to co-operative societies, primary credit societies, Agricultural marketing societies.
- Enhance & Improve banking facilities to semi urban, rural and other untapped market.

Role of RRBs in Present Scenario

Role of RRBs could be explained through the following:

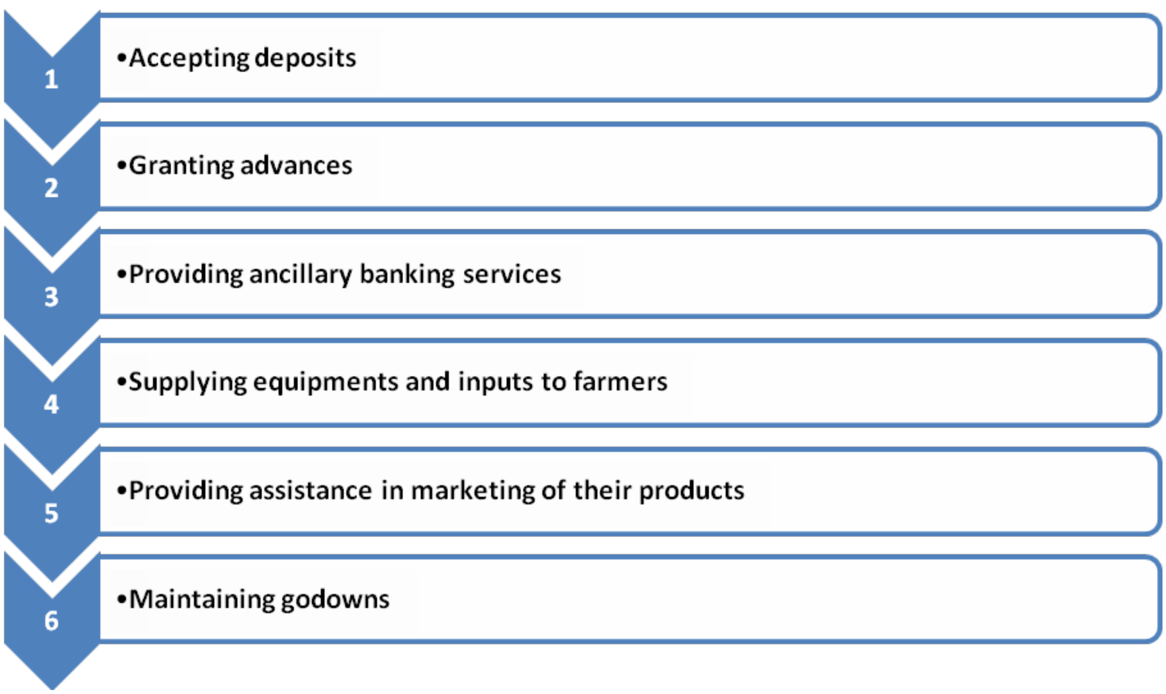

Figure 3.6 Role of RRBs in present scenario

Functions of RRBs

RRBs are authorized for transacting banking business which is defined in Banking Regulation Act and can also engage in various other businesses which are specified in Section 6 (1) of said Act. In particular, RRBs are required for undertaking business of:

1) Granting advances and loans to marginal and small farmers and agricultural laborers, whether in groups or individually and to various cooperative societies which includes agricultural processing societies, agricultural marketing societies, farmers' service societies cooperative farming societies or primary agricultural credit societies for primary agricultural operations or agricultural purpose or

other related purpose.

2) Granting advances and loans to small entrepreneurs, artisans and other persons of smaller means who are engaged in industry, commerce, trade or any other productive activity, within its operational area.

Banking service facilities of RRBs towards Financial Inclusion

As per RBI's guidelines/ advice, RRBs initiated many measures for achieving greater financial inclusion. Some steps are mentioned below:

Figure 3.7 RRBs steps towards financial inclusion

1. Opening No-Frills Accounts

Basic banking no-frills account having nil or a very low minimum balance and low banking charges were made accessible to the people in the rural areas.

2. Relaxation on Know-Your-Customer (KYC) Norms

KYC requirement for bank account opening were relaxed for the small accounts. RRBs are permitted now for taking any evidence as identity as well as address of customers towards their satisfaction. This has been further relaxed so as to include letters issued by Unique Identification Authority of India which contains details of customer's name, address as well as Aadhaar number.

3. General Credit Cards (GCCs)

For helping poor people and disadvantaged rural people to have access to easy credit, RRBs introduced GCCs facility at semi-urban and rural branches. Objective of this scheme is providing hassle-free credit to customers based on cash flow assessment without insistence on security as well as end use or purpose of credit.

4. Engaging Business Correspondents (BCs)

In the month of January 2006, RBI gave permission to scheduled commercial banks for engaging BFs and BCs as intermediaries to provide banking and financial services. BC model allow banks for providing services at doorstep delivery, especially cash in and cash out transactions, which addresses last-mile problems. List of eligible entities and individuals who could be engaged as BCs has been widened with time.

Problems being faced by RRBs

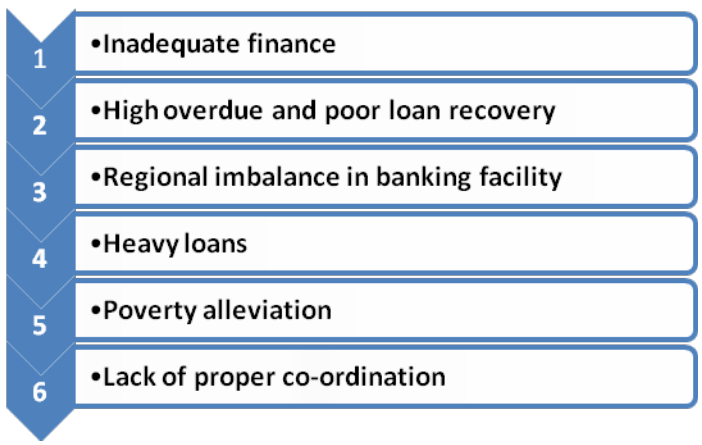

Figure 3.8 Problems being faced by RRBs

(1) Inadequate Finance

RRB's have been facing problem of inadequate finance. They are dependent on NABARD to collect finance for their further operation. Poor rural people are unable to save anything due to poverty and low per capita income. The low level of saving of these customer create obstacle for RRB's to collect sufficient deposits.

(2) High Overdue and Poor Loan Recovery

Higher overdue and poor loan recovery is big concern which affects functioning of the RRB's. The reasons behind these are mentioned below:

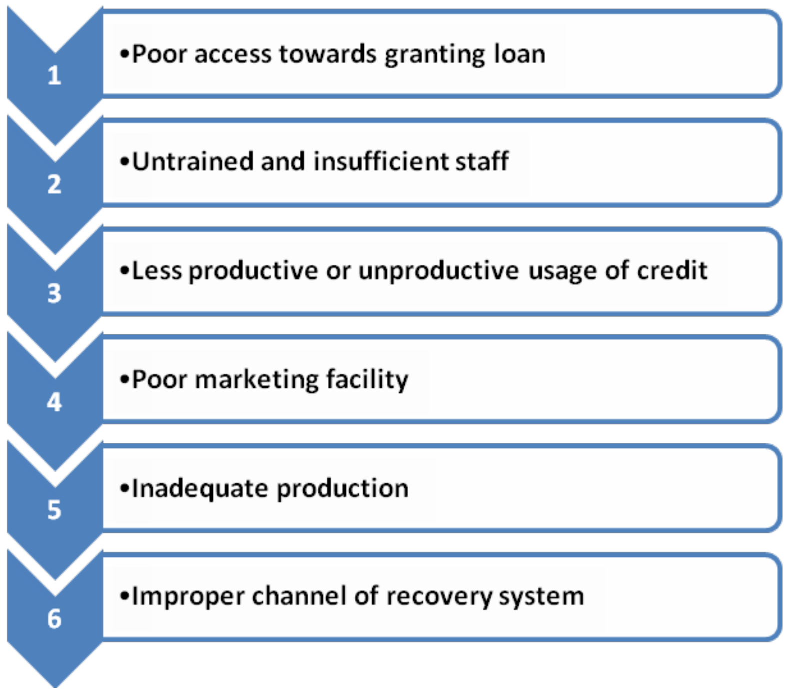

Figure 3.9 Reasons for high overdue and poor loan recovery

(3) Regional Imbalance in Banking Facility

There is a problem of regional imbalance in the banking facilities that are provided by the RRBs. RRBs are concentrating on branches in few specific districts and states and hence they lose the other prospective groups of customers.

(4) Heavy Loans

Many RRBs have been suffering from problem related to heavy loans due to low repaying capacity of customers in the rural areas, not properly trained staff, lower deposit level and heavy loan sanctioning without even checking creditworthiness of the customers.

(5) Poverty Alleviation

RRBs have not played their role significantly in alleviation of poverty in India. Although many efforts are being made related to this but due to certain issues because of which a proper solution towards poverty alleviation has not been proper progress in poverty alleviation:

Figure 3.10 Challenges for poverty alleviation

(6) Lack of Proper Co-ordination

There has been lack in proper co-ordination between the RRBs and the other financial institution like NABARD, Commercial banks and other co-operative banks and this has badly affected performance of RRBs.

Challenges Faced by RRBs

RRBs have a mixed record of performance, they have been successful in attaining some goals and in certain cases have failed in their business and attaining goals. They have faced many challenges while carrying out their operations:

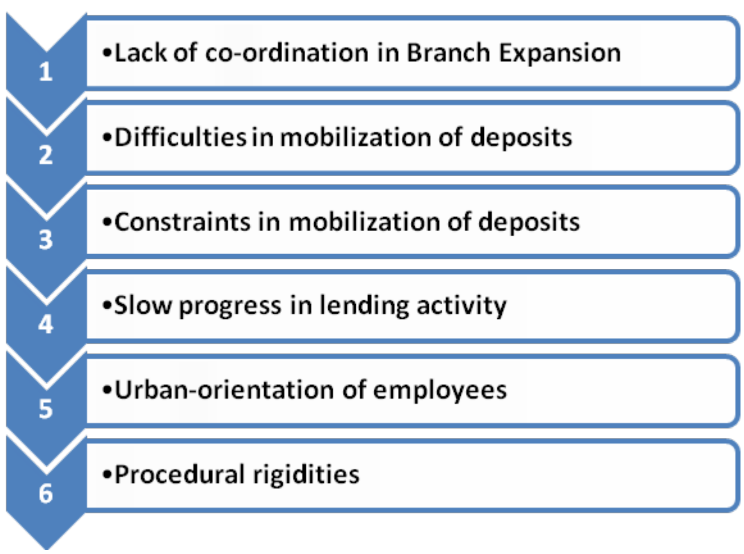

Figure 3.11 Challenges faced by RRBs

1. Lack of Co-ordination in Branch Expansion

Swiftness in the branch expansion programme in certain cases has actually resulted in lopsidedness due to a lack in co-ordination. In several cases, it could not be ensured that the branches of the RRBs are opened at centres where no commercial or co-operative banking facilities were provided.

2. Difficulties in Mobilization of Deposits

RRBs have encountered many practical difficulties in mobilization of deposits. This happened due to their restricted lending policy that excludes richer section of village society and these potential depositors actually show lesser interest in depositing money with RRBs.

3. Constraints in Mobilization of Deposits

RRBs exclude richer section of village society for providing direct financial assistance. These sections have potential savings to deposit. But, they are least interested in depositing them with the RRBs in view of the restrictive credit policy of these banks. Further, the State and Local governments as well as their agencies have not much co-operated by maintaining their deposit accounts with RRBs. RRBs have actually failed to mobilize accounts within themselves.

4. Slow Progress in Lending Activity

RRBs' pace of growth in the loan business has been very slow. The following reasons are responsible for slow growth of RRBs:

i. There is limited scope for RRBs for lending directly in their field of operations
ii. It is difficult to identify potential small borrowers and bank staff is required to make sincere and special and sincere effort in this regard
iii. Most of small borrowers are not much interested in bank formalities and they prefer borrowing from indigenous/ informal source of finance like money lenders
iv. The anomaly in Differential Rate of Interest (DRI) scheme posed special problem to RRBs. While RRBs were charging a much higher rate of interest, Commercial banks charge just 4 percent under DRI Scheme in the rural areas. Hence, no such borrower would like to go to RRBs or Co-operative societies in their area when loan from Commercial banks is made available under DRI scheme to the weaker sections of community who are engaged in productive and gainful activities.
v. There is no effective link between RRBs, Primary Agricultural Credit Society and farmers' service societies
vi. There is a lack of co-ordination between the officials of District credit planning committee and RRBs.

5. Urban Orientation of Employees

A critical practical difficulty which is experienced in their working by RRBs is urban orientation of the employees which is rarely inclined for serving people in the rural areas. There is no such true involvement locally by bank employees in village where they have been serving.

6. Procedural Rigidities

RRBs have been following procedures of Scheduled Commercial Banks related to deposits as well as advancing loans that are highly complicated and also time-consuming from villagers' view point. Rural borrowers have always appreciated the informal ways and the simple procedures which is followed by indigenous bankers and money lenders.

Prospects of RRBs in Rural Banking

1. RRBs have a unique role of providing credit facilities to the weaker sections in villages. RRBs should exist as rural banks of rural poor.
2. RRBs could be given permission to lend money to the richer section of society of village so that they take interest in providing deposits as well which could be further mobilized by RRBs.
3. State Government should take keen interest in growth of RRBs.
4. Participation of the local people in equity share capital of RRBs should also be allowed.
5. There should be appointment of local staff in RRBs as possible.
6. Cooperative societies could be allowed for sponsoring or co-sponsoring with the commercial banks in establishment of RRBs.
7. Uniform pattern of structure of interest rate should be devised for rural financial agencies.
8. RRBs must strengthen an effective credit administration through credit appraisal, monitor progress of loans and also their efficient recovery.
9. Credit policy of RRBs should be based on group approach of financing the rural activities.
10. RRBs might initiate certain new insurable policies like deposit-linked cattle and various other animals' insurance policy, life insurance policy, crop insurance policy for rural depositors.
11. RRBs might relax their procedures for lending and make them much easier for the village borrowers.
12. Co-ordination between the district level developments planning as well as district level credit planning is required to chart out specific role of RRBs as development agency of rural areas.

21 Regional Rural Banks merged in consultation with NABARD

In all, 21 RRBs have amalgamated based on comments from respective sponsor banks and the state governments, Minister of State for Finance Shri Anurag Singh Thakur said in Lok Sabha. With view for enabling the RRBs for minimizing their overhead expenses, optimize technology usage, enhancing capital base and operation area and increasing their exposure, roadmap for amalgamating RRBs within state was prepared in consultation with NABARD. Roadmap proposed for bringing down number of RRBs from 56 to 38. Minister of RBI have informed as on 31st March, 2019, in all 1288 cases related to unauthorized deposit collection was discussed in the State Level Coordination Committee (SLCC) meetings. Sachet portal of RBI, online platform for the SLCCs that facilitate public for lodging complaints related to financial frauds, have received 5,225 complaints (since launch of portal in August 2016) related to deposit's non-repayment and money collected for different kinds of Investment Schemes.

Source: Anurag Singh Thakur (July 8, 2019). Retrieved from https://www.business-standard.com/article/pti-stories/21-regional-rural-banks-amalgamated-says-govt-119070800677_1.html

To Do Activity

Ask the students to form a group of 5-6 and discuss about any one of the following topic related to RRBs and present before the class:

- Objectives
- Role
- Functions
- Problems

3.3 Challenges of Rural branches of Commercial banks

Access to formal banking is being provided to the rural customers, but there is no such guarantee that such services would be used by them. There are many people in the rural areas, which do not prefer to open a bank account since they are engaged more in dealing with cash. Many people are getting wages in cash, they are spending in cash and hence they do not wish to get burdened by maintaining a bank account. People in the rural areas who are having access to banking products and services, are not making much use of them since the product and service mix are not meeting their needs. Financial service needs of the rural customers are not actually confined to saving and credit needs, which are generally assumed by the banks and other financial institutions. The financial needs of the rural people are connected to their life cycle needs, which range from savings to credit to insurance and to remittances. There are various needs related to life cycle in which it becomes difficult for the people in the rural areas to arrange funds that would help them in facing certain situations in life. There are various needs for which people would require funds. The needs related to life cycle are mentioned below:

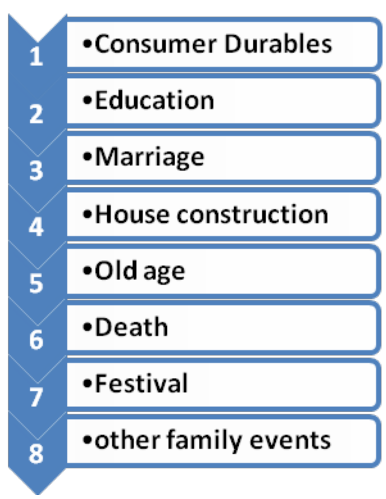

Figure 3.12 Life cycle needs of rural people

People require consumption loan for buying consumer durables as from time to time various consumer durables are need to be bought for themselves and family members. Consumer durables for which loan are taken could be television, refrigerator, appliances, furniture and other electronic items. The need for these consumer durables arise with time as any person proceeds in various stages of life. People might require funds for education as sometimes people do not give importance to education due to lack of funds and it is very important that people get educated only then they will be able to manage their families in future. The expenses during marriage are high and it is very important that a person gets support through any financial institution to face these expenses. Funds are required for construction of house, as it is one of the basic needs of every family to have a house where they could protect themselves and their families from rain, storm, heat and other natural effects.

Construction of house requires a large sum of money and it becomes difficult for the poor people to get loan from traditional source. During the old age, expenses are fixed and generally people do not get sufficient help for facing the old age life. The family members do not support much to people when they reach their old age and life becomes miserable, consumption loan could help in facing such issues which people face in their old age. In the event of death of any family member, people can avail consumption loan which help them to face such a huge loss and complete the rituals which are carried out after death of a person. There are various festivals which are enjoyed by people and it requires funds to celebrate. In the rural areas and the urban areas there are many festivals which have specific date of celebration, though the dates are defined before itself, but sometimes people do not have funds for enjoying the festivals due to various other expenses. There are some other family events also for which people need funds. The savings as well as credit products which are being currently offered to the rural customers do not meet needs of the rural people. Accessing savings as well as investment facility is very critical for poor people. There are two critical needs for rural poor, they are mentioned below:

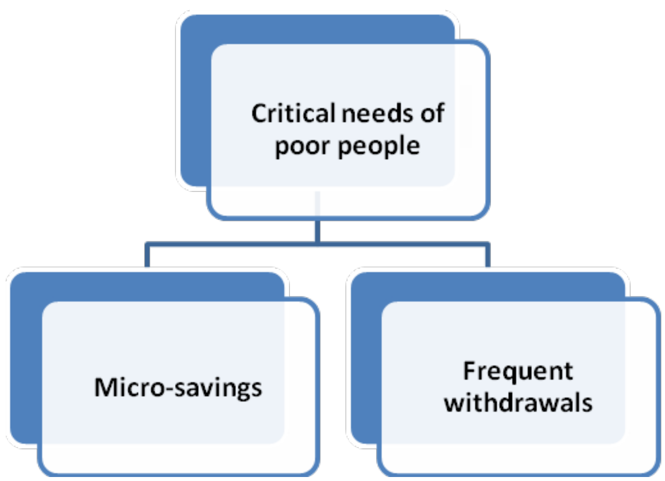

Figure 3.13 Critical needs of poor people in rural areas

There is a need to facilitate customer to build capital over long term and cope with income shocks in near term. Banks are not offering adequate services for addressing the needs of the poor people. There is lack of banking services and this leaves rural poor with a little option than they prefer to transact with informal banking market. The poor people prefer to transact with the informal sector since they accept smaller amounts, provides doorstep service and also ensure easy enrolment. Rural customers need loans for consumption purpose also and not for productive purposes only. Apart from support for agriculture, rural customers also need micro credit for education, consumption and emergencies. Though banks are offering purpose free loans i.e. personal loans as well as credit cards in the urban areas in a liberal manner. In the rural areas, sanctioning of such loans is restricted significantly. Therefore, the poor raise these loans through the informal financial system. Additionally, large households need higher value micro-enterprise loans occasionally for smaller capital investment. Though banks are offering these loans, they require lot of documentation as well as are time-consuming process that discourages customer applications.

Barriers to Access Financial Services

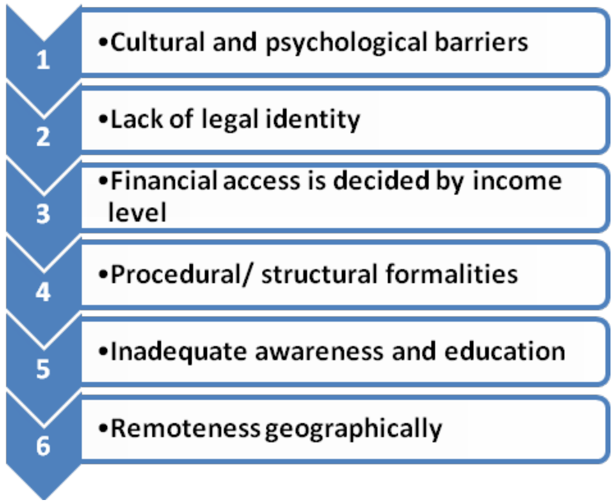

Figure 3.14 Barriers to access financial services

(1) Cultural and Psychological Barriers

There are many such people in the rural areas who have voluntarily excluded themselves because of cultural and psychological barrier and they have been thinking that they are actually excluded from access to financial services. These barriers include lack of trust, religious reasons, family members already have a bank account etc.

(2) Lack of Legal Identity

The people in the rural areas do not possess proper legal identity like the following:

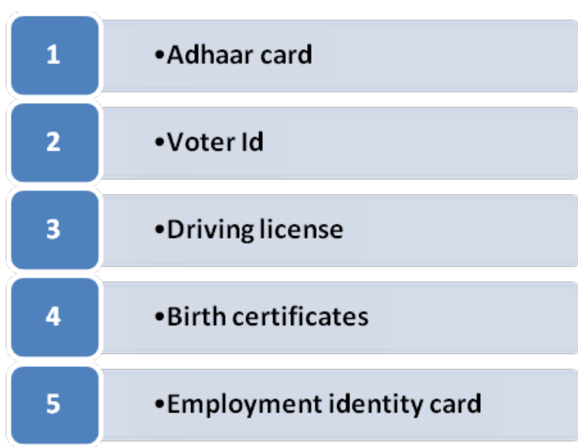

Figure 3.15 Example of legal identity

(3) Financial Access is Decided by Income Level

People with lower income generally feel that banks are for the richer people only. It is very important that the bankers encourage the people in the rural areas to open accounts and should also try to assist them in carrying out banking transactions.

(4) Procedural/ Structural Formalities

The people in the rural areas find it very difficult to read and understand the terms and conditions or read the account opening form since they are not having basic financial education. The employees of banks branches in rural areas should encourage the people in the rural areas so that they find it easy to complete the formalities and also could proceed with banking transactions easily and could continue with the account for longer time.

(5) Inadequate Awareness and Education

Lack in basic education as well as financial literacy prevents people in accessing financial services. Financial literacy concerning usage of various financial products and services should be encouraged through different economic agents like MFIs, NGOs, MFIs, BCs, etc. Significance of financial products like finance, bank account, cheque facility, insurance etc should be informed to people in the rural areas and the need for such products should be explained to them.

(6) Remoteness Geographically

Commercial banks generally tend to operate only in areas which are profitable. Banks locate their offices and branches only in commercial areas. Hence, the people who are living in the under-developed areas actually find it difficult to reach these branches for banking transactions in the other areas repeatedly. Hence generally they do not visit any bank for banking products and services.

Problems Faced by Commercial Banks

The following points highlight major problems which are being faced by Commercial banks:

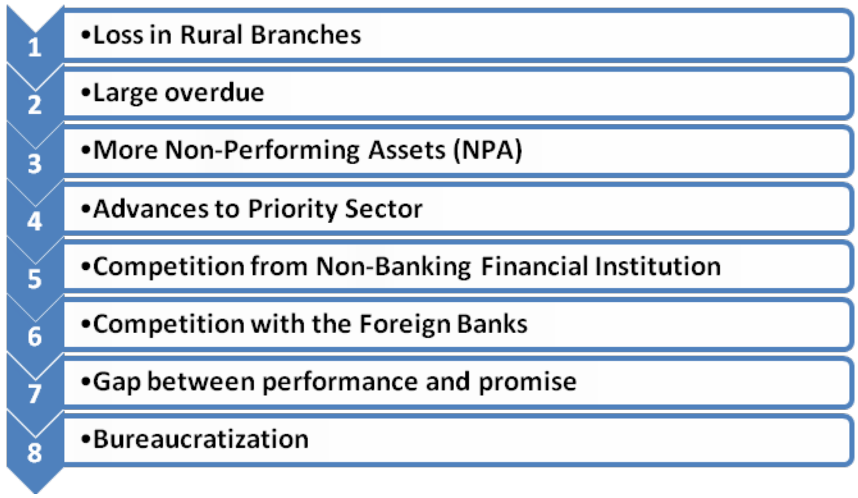

Figure 3.16 Problems faced by Commercial banks

1. Loss in Rural Branches

Most rural branches have been running in loss due to high overheads and also prevalence of barter system in most of the parts of rural areas. People are now using barter system as an alternative to crop financing as it avoids high interest rates and also formalities of applying for loans to banks. They are exchanging their produce for necessary items.

2. Large overdue

Small branches of the commercial banks are facing new problems i.e. large amount of overdue in advances to the farmers. Decision of former National Front Government for waiving all the loans to farmer's upto value of Rs. 10,000 crores have added to dilemma of banks.

3. More Non-Performing Assets (NPA)

Commercial banks presently do not have any kind of machinery for ensuring that their advances and loans are going into a productive use in larger public interest. Due to higher proportion of NPA or outstanding dues to the banks from the borrowers, Commercial banks are incurring heavy losses. Most banks are unable to maintain capital adequacy ratio.

4. Advances to Priority Sector

Progress when measured with respect to priority sector advances has been slow. This is partially attributable to this fact that bank officials from top to bottom are unable to accept nationalization gracefully, viz., and diversion of certain portion of the resources to top priority as well as neglected sectors. This is attributable to poor as well as unsatisfactory loan recovery rate from small and agricultural sectors.

5. Competition from Non-Banking Financial Institution:

Commercial banks are facing challenges from Non-banking financial intermediaries as deposit mobilization is concerned. Some examples of financial intermediaries are mentioned below:

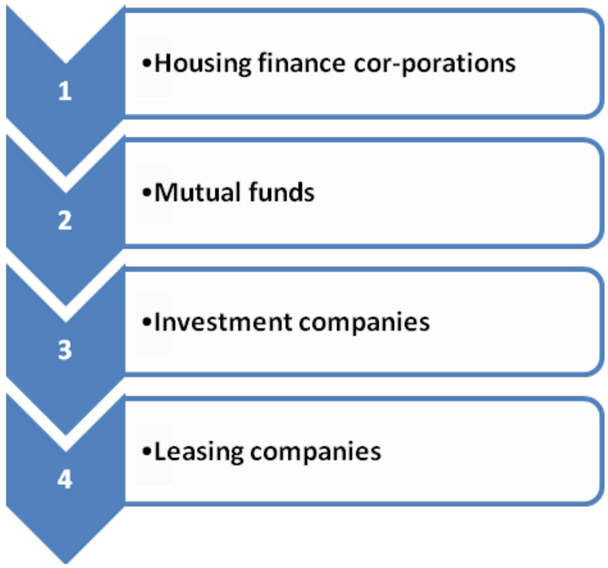

Figure 3.17 Example of financial intermediaries

All the above-mentioned institutions compete closely with the commercial banks for attracting public deposits and offer higher interest rates than paid by commercial banks.

6. Competition with the Foreign Banks

Deposits of Foreign banks and smaller private sector banks have increased. One major reason seems that non-nationalized banks have been offering better customer services. This creates an impression that diversion of the deposits from nationalized banks to the other banks has probably taken place.

7. Gap between Performance and Promise

One major weakness in nationalized banks is failure to sustain desired credit pattern and filling credit gaps in various sectors. Though there has been reorientation of the bank objectives, bank staff have remained virtually static and bank practices and procedures have continued to work in traditional way. Post-nationalization period has seen widening gap between performance and promise. Main reason seems to be failure of bank’s employees to appreciate new work philosophy as well as new social objectives.

8. Bureaucratization

Another problem faced by the commercial banks is bureaucratization of the banking system. This is indeed the result of nationalization. The smooth functioning of banks has been hampered by red-tapism, long delays, lack of initiative and failure to take quick decisions.

Challenges of Rural Branches of Commercial Banks

Figure 3.18 Challenges for Commercial banks

i) Technology

Mobile Banking is the most cost effective as compared to the other channels for reaching the unbanked areas. All the three stakeholders i.e. Banks, telecom operators as well as merchants need to work in tandem with a suitable model for business on the robust technology platform for achieving desired results.

ii) Human Resources

Presence of full-fledged brick and mortar branches, which have newly introduced ultra small branches and the BCs, will be able to capture the rural areas. This new delivery channel should be handled by the staff members in a positive way with positive attitude. At same time there is a requirement of a lot of manpower in the banking industry for serving the unbanked areas which has become a major challenge. There are many young people in the rural areas having average academic background who are waiting for some employment opportunity.

In a similar way, personnel who are handling BCs are required to be trained so that they will be able to help the customers for enabling them in understanding financial products/ services and also in taking informed decision. For achieving financial inclusion, BCs are required to be trained adequately on both the fronts i.e. knowledge about banking domain and technology platform. The issue is required to be addressed on priority through adoption of a suitable recruitment model for attracting the local talent. The banks, government and regulators should pay focused attention on various issues present in the rural areas related to financial inclusion and necessary steps should be initiated for bridging gap through adoption of appropriate recruitment policy for sustained growth of banking industry.

iii) Financial Literacy

Majority prospective customers belong to the under banked/ unbanked population who are not much aware about banking services. There is a requirement that banks should take strategic initiatives for educating customers through awareness and financial literacy programs.

To Do Activity

Ask the students to approach any Commercial bank branch which is located nearby and try to understand the issues and challenges which are being faced by the employees of that particular bank who are working in the rural areas.

3.4 Transaction and Risk Cost

Transaction costs which are incurred by clients could be divided across services which are being availed by people from banks or financial institutions. This includes financial activities like credit and savings as well as non-financial activities such as training programs. Measurement of transaction costs varies due to many terms and conditions and it is very important to compare the transaction cost as per the different models and an effective model is designed for providing finance to the people of rural areas. Comparative study related to estimation of transaction cost, policy makers could also come across methods for reduction transaction costs further through benchmarking the best practices across all models. Transaction cost of banks also includes establishment cost and cost of manpower/ management. Possibilities for reducing transaction cost could be through any one of the following:

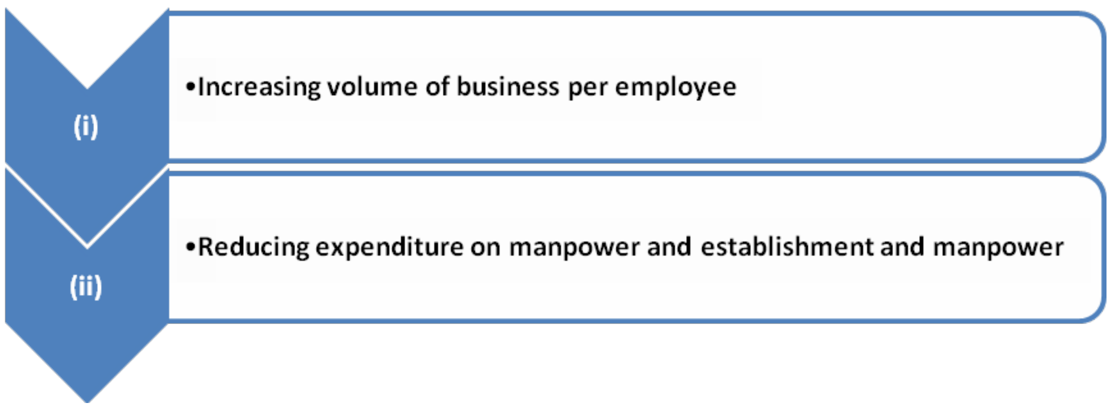

Figure 3.19 Possibilities for reduction in transaction cost

While some commercial banks have taken initiatives for introducing innovative loan product for expansion of loan portfolio, most of RRBs and other banks are yet to take some concrete steps related to this issue. Further loan procedure is being simplified; simple documentation, usage of KCC, approach of single window to meet all credit requirements, including village level plan, consumption credit, project formulation, etc. could contribute towards expansion of credit business and this could bring down transaction cost per unit of employee.

A significant reduction in transaction cost (TC) for the clients have been advocated as main mantra to encourage the people in the rural areas to become a part of formal financial system and this is being used as justification for charging high rate of interest from the borrowers. TCs include real as well as opportunity costs, which could vary with lending methodologies which could individual or group loan. TC for the clients could be dependent upon their location i.e. semi urban or rural area and also could be based on occupation since the opportunity cost of time varies across various occupation of clients. Transaction cost to clients is a very important component of total cost. An increase in the total costs eventually implies the following:

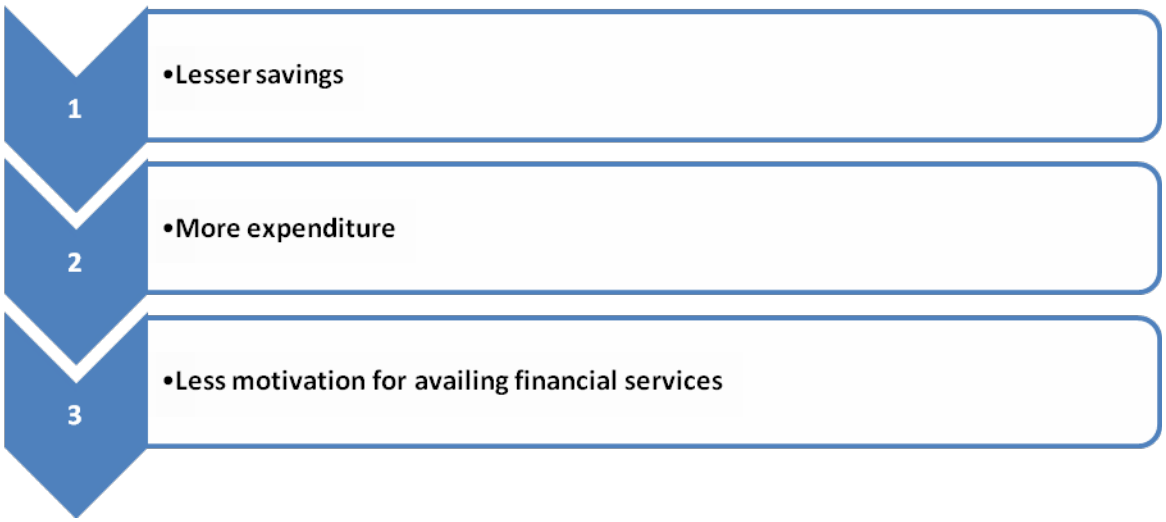

Figure 3.20 Result of increase in total cost

The people in the rural areas are not much interested to be a part of the formal financial system, because of many reasons. The cost of availing banking products and services should be lesser for the people in the rural areas. The amount which is available with the people in the rural areas is not much and many of them feel that instead of keeping their money in the banks and incurring more expenditure in saving money in the bank, they rather feel keeping money at home and for the purpose of lending, they prefer availing credit facility from the non-formal sector. Therefore, a need was felt by NABARD that there is a requirement of a study for analyzing cost to SHG clients when SHG is linked to bank and MFI.

Transaction cost in SHG model

In the SHG-Bank model, bank conducts various financial transactions i.e. savings as well as credit at the group level. Accordingly, a group absorbs a major part of transaction costs on behalf of individual members. Cost incurred at the group level consist of the opportunity cost of time and travelling cost in the visiting bank branch for repayment and borrowing, and documents like stamp paper. This cost incurred at the group level is distributed equally among all members for arriving at the cost incurred by the individual member.

Transaction Cost and Microfinance

In microfinance, transaction cost could be referred to as any costs which arise due to existence of institutions and appearance of economic exchange. There are two parties who are involved in microfinance exchange within institutional framework of “Group”.

The two parties are mentioned below:

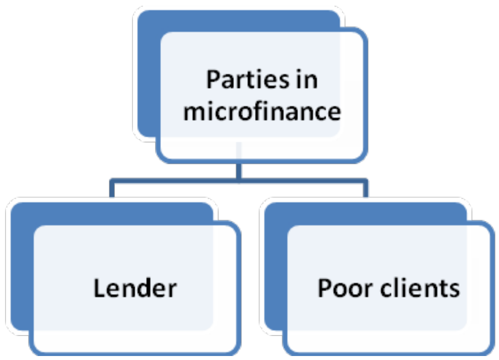

Figure 3.21 Parties involved in microfinance

One party is the lender who could be bank or MFI and the other party is the poor clients. In case of absence of the institution (group), the two parties are required to face some difficulties in conducting financial exchange due to problem related to information asymmetry. Transaction cost is cost which lender and borrower incur over and above direct interest cost to reach out the agreement between the parties for financial transactions. Transaction costs could be referred to a measure of factors in functioning of the financial market. Higher the transaction cost, higher will be the cost of intermediation and thus lesser efficient performance of financial sector. There are three kinds of cost which are incurred by lending institutions while providing loan:

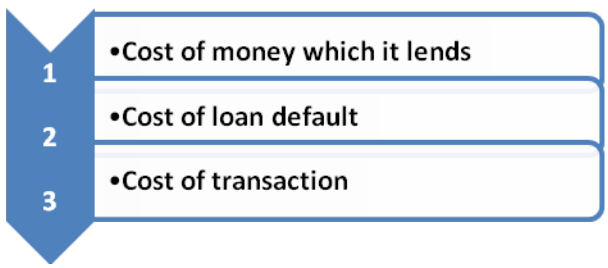

Figure 3.22 Cost incurred by lending institutions

The transaction costs of MFI includes

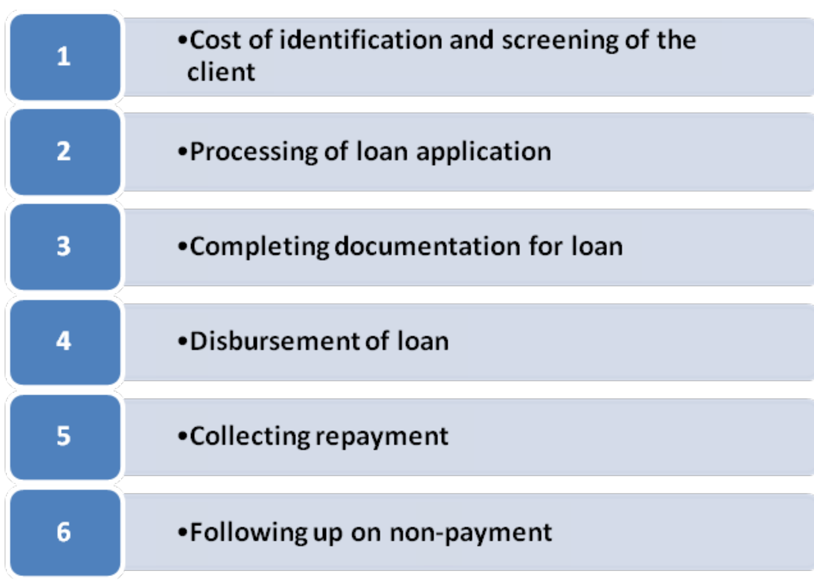

Figure 3.23 Transaction cost for lender in microfinance

Unlike cost of funds and cost of default, transaction cost, is actually not proportional to amount which is lent since there is invariably minimum amount of time which each loan requires for appraisal of loan application, processing loan disbursement and repayment and follow-up monitoring. Average microfinance loan size is smaller than most of the other loans, transaction cost on percentage basis for microfinance loan tends to be higher. Some factors might contribute towards a higher transaction cost for the microfinance loan as compared to the other loans: initial training cost for borrowers (social intermediation), higher supervision, collecting higher frequency of installments (bimonthly or weekly), higher handling of cash and distance of the group from the nearest banking centre.

Transaction costs are part of total transaction cost for the borrowers additionally to interest rate and fee paid to the institution. The main mantra in microfinance is reduction in TCs for the clients and as a result it has been used as justification for higher interest rate charged to the borrowers. In measurement of transaction cost in SHG banking, there are several categories of the transaction costs i.e. cost incurred by the clients for making deposits and getting loans, transaction cost of the SHGs as intermediary between banks and client members and bank's transaction cost. It is assumed that SHGs absorb transaction cost from both poor clients and bank and thereby making the poor bankable.

The borrower transaction cost consists of the following:

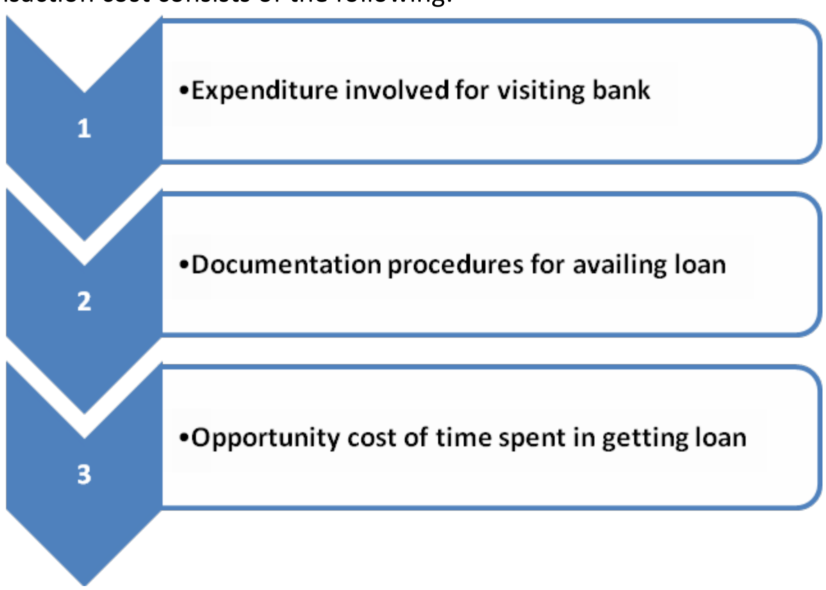

Figure 3.24 Transaction cost of borrower

Client members need to visit bank branch for negotiating loan, submission of documents, submission of security, so this entire process incurs expenditure for travelling, opportunity cost related to travelling and time, documentation cost. As time increases by the bank for lending loan to client member and disbursing, transaction cost keeps on increasing.

Components of Transaction Cost

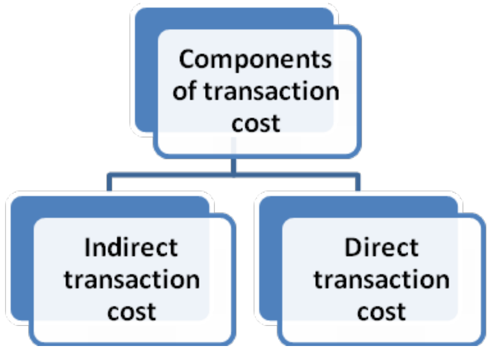

Figure 3.25 Components of transaction cost

(a) Indirect Transaction Cost (Opportunity Cost of Time)

- Opportunity cost of training time i.e. the cost which is related to time spent for attending group trainings
- Opportunity cost of meeting time i.e. the cost which is related to time spent for attending group meetings
- Opportunity cost of time spent in travelling to training place
- Opportunity cost of time spent in Bank/ MFI branch

(b) Direct Transaction Cost

- Travel cost to meeting i.e. cost of return journeys for attending training or group meetings
- Travel cost for getting individual photograph
- Travel cost for buying revenue stamp/ stamp paper
- Travel cost for photocopying documents (i.e. ID proof, resident proof)
- Travel expenses incurred for visiting Bank branch to open group savings bank account
- Travel expenses incurred for visiting Bank/ MFI branch to get loan and its repayment
- Cost of stamp paper, photograph, resident proof and revenue stamp

In India, high transaction cost of rural lending is mainly due to

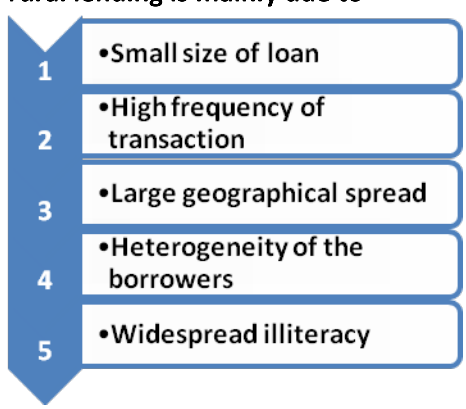

Figure 3.26 Transaction cost of rural lending

For private sector banks, their lack of a rural branch network is an additional problem.

Risk Cost

Risk cost is one of cost drivers, which play a decisive role in the determination of interest rate being charged by the banks to the ultimate borrower in rural areas. Risk cost could be derived from a host of factors which include the following:

Figure 3.27 Factors from which risk cost could be derived

If the credit risk can be disaggregated into factors like rainfall failure, fluctuations in price, poor health of borrower, borrower's death, etc., these factors could be mitigated through some non-credit financial products like derivatives and insurance. These factors can facilitate banks for providing credit at lower rate.Prompt repayment of the loans by borrowers to the banks will enable banks for recycling funds and reduce transaction cost.

There are various factors on supply and demand side like inadequate amount of loan, lack of timeliness, problems of weather aberrations and multiple borrowing seem to have been affecting adversely loan recovery in varying degrees, implementation of interest/ loan waivers announced by the Central and State Governments from time to time has been vitiating repayment culture among borrowers. There is a requirement that a prompt culture of repayment should be inculcated among borrowers. At same time, a proper incentive structure is required to be developed for prompt loans repayment and this structure could be finalized with approval from bank's board. Further, for overcoming some supply side factors that contribute towards non-recovery of loans, the banks could review and revise the project appraisal procedures. The risk could be reduced through proper appraisal of the loan proposals and post disbursement supervision would reduce risk costs. There is a need to further sensitize and train staff of rural branch in this regard.

Risks in Agriculture

The risks faced by farmers could be systemic or covariate i.e. common to large group of producers/ farmers, or they could be individual or idiosyncratic.

Risks in Agriculture

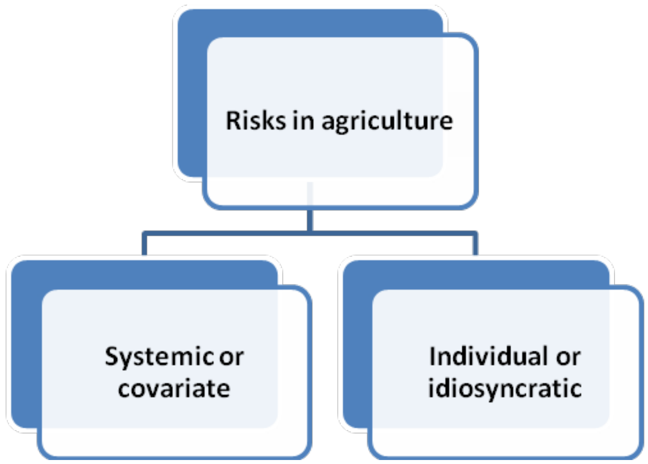

Figure 3.28 Risks in agriculture

(1) Systemic or Covariate Risk

The systemic risk i.e. common to a large group of producers/ farmers can be mitigated through crop insurance. The traditional crop insurance which is based on claims verification has not proved to be very successful except for the case of certain cash crops. In traditional crop insurance, premium which was charged to farmers was not computed on the basis of 'actuarial basis' but at flat rate, this resulted in an increased interest rate on credit availed. While for the crops like wheat and paddy, the rate of premium which was charged as 2 percent due to the subsidy provided by State Governments. While in the present crop insurance scheme, upto some extent, production risk is covered, but there is a need that an innovative and farmer friendly insurance product which does not involve high supervision and overhead cost like index-based rainfall insurance which was being experimented by an insurance company on pilot basis.

(2) Individual or Idiosyncratic Risk

Farmers have adopted certain risk mitigation mechanism for meeting idiosyncratic risks like liquidating assets, selling stored produce, participating in labour market, etc. There are other individual level strategies which include technology adoption pertaining to inter-cropping or drought resistant crops as well as contractual share cropping that reduces income variation. Personal insurance arrangement generally offers protection against the individual risks. Life insurance products which are appropriate to economic condition of agriculturists are not available to many borrowers except the Kisan Credit Card (KCC) holders. There is a requirement of innovative products for facing individual risk. Under the SHG lending model in few states, borrowers enjoy life insurance cover for self as well as her/ his dependents. Insurance products which provide protection against critical illness and accidents could help in retaining borrower's repayment ability.

Other major reasons for impairing repaying capacity of farmers is wide fluctuations in market prices of commodities. Though the Minimum Support Price (MSP) mechanism is aiming towards providing some protection to farmers, there are some limitations of spatial coverage, as this is based on subsidy. Contract farming is one more private mechanism which helps farmers in coping with private risk as this provides guarantee of buying back produce from farmers at predetermined price and transferring market risk to contractors.

Information technology (IT) for reducing transaction cost

IT holds a key to reduce transaction cost and increase business volumes of the banks. Impact of IT is at two levels mentioned below:

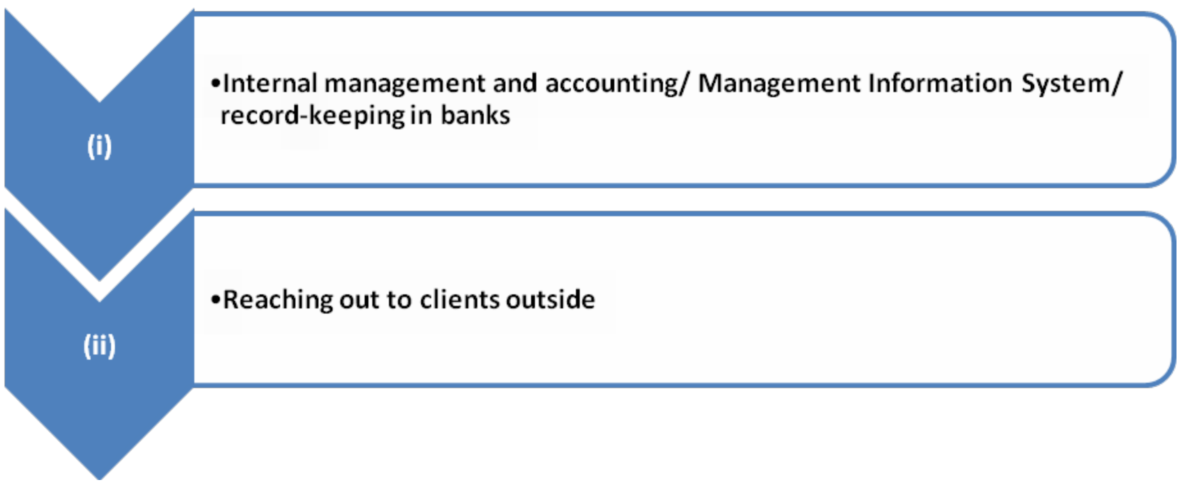

Figure 3.29 Impact of Information Technology

(i) Internal Management and Accounting/ Management Information System/ Record-Keeping in Banks

This would include computerization of operations of the bank branches and connectivity amongst branches through networking.

(ii) Reaching out to Clients Outside

This would include setting up information kiosks etc. in semi-urban/ rural areas that would help the banks to reach out to larger number of potential/ existing customers and providing them with access information at various levels.

Reduction of transaction costs in the metropolis and urban areas through new information technology have facilitated banks for providing banking facilities "anywhere and anytime”. Introduction of this technology to large extent have reduced cost of manpower in these centres. Pace of technology adoption in rural areas, seems to be slow partly since it is cost intensive in nature and partly due to non-availability of basic infrastructure like electricity. However, low cost ATM machines that could be operated on diesel generator set could also be used in rural areas for dispensing cash. Wherever volume of business justifies, computers in rural branches of the banks might be networked for free flow of interbranch and intra-bank information. While providing IT for reducing transaction and risk cost there is a requirement to take care of the following factors:

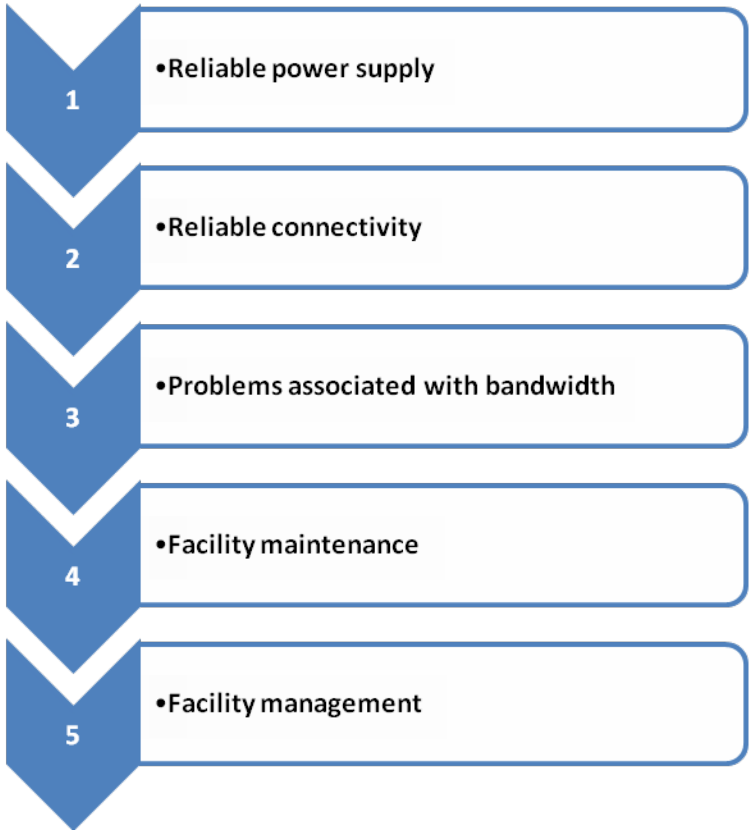

Figure 3.30 Factors related to introduction of IT in rural bank branches

Banks in rural areas must formulate time bound programme for using IT in their branches.

To Do Activity

Ask the students to discuss about the types of costs associated with rural banking. They can form group of 4-5 members and prepare a presentation about the costs with examples and present before the class.

3.5 Emerging Trends in Rural Banking

Banking sector plays a dominant role in building the economy. Banks are having control over larger part of money supply in circulation. Strong financial and banking sector is necessary for any country for emerging as developed one. Banking sector could help in the following:

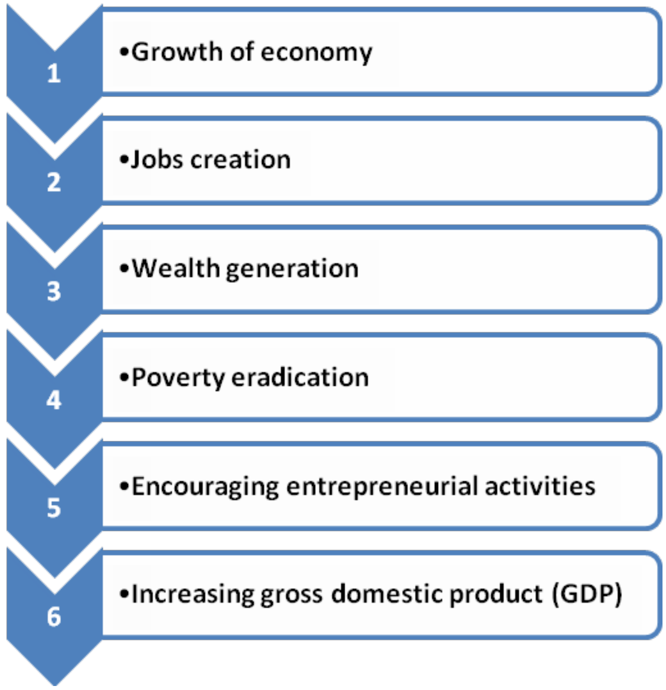

Figure 3.31 Role of Banking in development of economy

Banking Sector has introduced new innovative technology for development. In India, there is a requirement to provide customized and better services to customers and the Banks must be concerned about customers' attitude regarding acceptance of internet banking. The people in the rural areas should also try to understand the latest techniques being introduced in the banking sector and invest money through savings account in any bank. The flow of funds may not be much among the people belonging to rural areas, but it is very important that they understand the need of saving and also help the bank's which are having branches in rural areas to arrange funds through deposits which could help them to provide funds to people who need funds in the form of loans.

Technology plays a very important role in banking, it is not only for the people belonging to urban areas, rather even people from rural areas could make use of technology in banking and make their transactions with banking easy. Information technology has given rise to designing of new and innovative products and their delivery in finance and banking industries. Customer satisfaction and customer services are their prime work. Focus of banking is now shifting from mass banking to class banking with introduction of customized and value-added products. Technology allows banks for creating what looks like branch in business building 's lobby without having hiring of manpower for manual operations. IT has changed the traditional fund movement service in a positive way. With advent of the electronic banking, funds could be transferred electronically and various other similar products are available online. With internet connection and networking, some new challenges have started arising related to confidentiality and security privacy towards transactions.

Finally, banking sector is required to master in new business model through customer services and building management with variety of products and controlled cost for staying in long run and services.

Digitization in the banking industry means making banking seamless and smooth for customers. In recent years, lesser people are going to branches for availing banking products and services and there has been tremendous increase in consumption of digital banking. Most public sector banks and private sector banks are focused on offering products and services based on new technology to the customers like mobile banking apps, mobile banking and e-wallets. Biggest advantage of channeling digitally in banking is the ability to provide new customer specific business model through analysis of banking pattern that explores customer value to maximum. Information Technology has become very important tool for efficient banking system. The 'Digital India' campaign was started by Mr. Narendra Modi for transformation of Indian banking industry. Many rural post office branches were linked into payment banking through this campaign. License has been given towards many new payment banks, and many other regulations and policies would be coming up for bringing paradigm shift in Indian banking industry. The vision of Digital India aims towards transformation of our country into digital economy with participation from businesses and citizens. There have been many accounts opened under scheme of financial inclusion and many of them were zero balance accounts. India is moving from cash to cashless economy with the policy of financial inclusion.

Recent Trends in Banking in Rural Areas

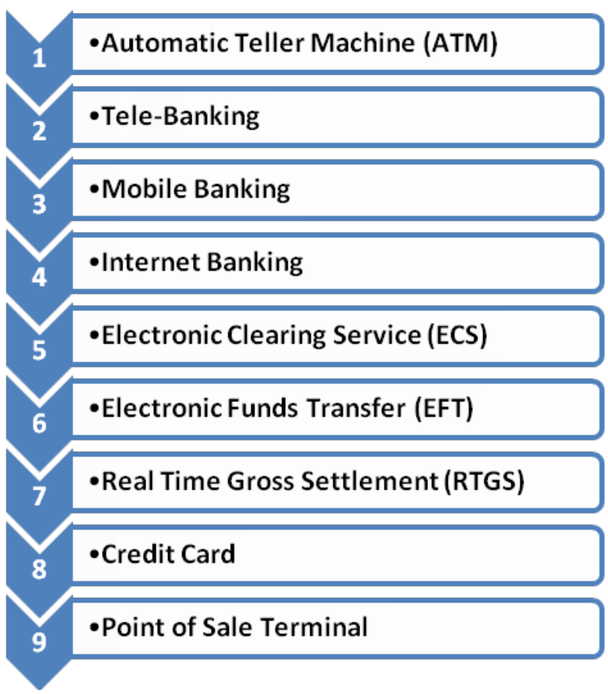

Figure 3.32 Recent trends in Banking in rural areas

1) Automatic Teller Machine (ATM)

ATM is most popular device in banking in India that enables customers for withdrawing their money 24 hours in a day 7 days in a week. This device allows customers to use ATM card for performing routine banking transactions without the need of interacting with human teller.

Example of banking transactions through ATMs

1. •Cash withdrawal
2. •Payment of utility bills
3. •Funds transfer between accounts
4. •Deposit of cheques
5. •Balance enquiry
6. •Many others

Figure 3.33 Services through ATM

ATM's are being used by the banks to make customers in dealing easier.

2) Tele-Banking

Tele-banking facility helps customers in doing non-cash transactions related to banking on telephone. Customer could access information about her/his account through telephone call and the customer needs to share Personal Identification Number (PIN) to bank. Under this device an Automatic Voice Recorder is used for some simpler transactions and queries. For complicated transactions and queries, phone terminals being operated by human being is used. This facility is effective and user friendly.

3) Mobile Banking

Mobile banking has brought a new revolution in realm of electronic banking. Online banking is moving now to mobile world, it gives access to customers to their accounts through the use of mobile phone and the location of the customer is not a matter of concern and customer could access real time banking service through mobile banking. This is new way for picking up information and interacting with banks for carrying out relevant banking business. Mobile banking has limitless potential and it is expected to attain great success. It is very flexible way to transact banking business.

4) Internet Banking

Internet banking involves usage of internet for delivering banking product and services. Banking is not confined to only branches where one person is required to approach a person in branch for processing of banking transactions. In internet banking, banking enquiries or transactions could be processed online without reference to branch and it is anywhere banking at any time.

5) Electronic Clearing Service (ECS)

ECS is a retail payment system which could be used for making bulk receipts or payments which are of similar nature especially where every individual payment is repetitive in nature and relatively of smaller amounts. This facility is mainly used by companies as well as government departments for making/ receiving larger volume of payments rather than transferring of funds by individuals.

6) Electronic Funds Transfer (EFT)

EFT is system in which a person who wants to make payment to another company or person etc. could approach his bank and makes cash payment or give authorization/ instruction to transfer funds directly from her or his own account to bank account of beneficiary/ receiver. Complete details like receiver's name, bank account number, type of account (current or savings account), name of bank, city, branch name etc. is required to be furnished to bank at time of request for these transfers so that amount reaches beneficiaries' account in a correct and faster way.

7) Real Time Gross Settlement (RTGS)

RTGS system was introduced for transferring funds through electronic instructions which are given by a customer to their bank for transferring funds to another person's account in another bank. RTGS system is operated and maintained by RBI and it provides means for faster and efficient funds transfer among banks facilitating financial operations. The transfer of funds takes place on real time basis. In this method, money could reach the beneficiary's account within a shorter period.

8) Credit Card

Credit Card is a "post paid" or "pay later" card which draws from credit line-money which is made available by card issuer (bank) and it provides a grace period to the customer for paying the amount of credit card being used. If amount is not paid fully by end of period, interest is charged on the amount. People should be very cautious of paying the amount on timely basis back to the bank so as to avoid paying higher amount of interest.

9) Point of Sale Terminal

Point of Sale Terminal is computer terminal which is linked online to computerized customer information files in bank and magnetically encoded plastic transaction card which identifies customer to computer. During transaction, customer's account gets debited and retailer's account gets credited by computer for amount of purchase. This is another way being used in many places in India.

Rural Credit Market: New Realties

The formal markets tend to cater towards lesser risky borrowings, informal markets provides for more risky borrowings and thus serves purpose of borrowing among the people in rural areas. Some emerging realities of both the formal as well as informal markets have been explained below:

Figure 3.34 New realities in rural credit market

(1) Money Lender and Informal Financing are not Synonymous

Money lender as well as informal financing is not always synonymous as per dynamics of rural economy which involves buyer's credit, credit for the services sector and supplier's credit.

(2) Informal Markets are less Significant

Informal markets are lesser significant now than before and even they have to face competition or atleast accept the benchmarking related to formal credit. Monopoly of money lender in the rural areas is not actually true in many areas in current scenario.

(3) Link to Socially Undesirable Activities

Whenever informal financial market gets linked to some socially undesirable activities, this is a concern though as per various studies, such activities are more popular in the urban and metropolitan areas rather than in rural areas.

(4) Not Severely Restricted to Productivity

Credit from banks is not severely restricted productive activities, since mostly credit-card financing by banks is financing of consumption and at such interest rates which are comparable to those which are prevailing in rural informal debt market. In current scenario, banks could also finance for consumption through credit card.

(5) Outstanding Debt

Real extent of the informal markets is understated grossly in any survey which views data on the outstanding debt since turnover of debt is admittedly at a much lower level for the public institutions than for the private lending.

(6) Proportion of Informal Credit is more than formal credit

Social significance of the informal credit is comparatively more than proportion in financial terms since poorer sections have been drawing a far larger amount from the informal market as compared to formal markets.

(7) Financial Products being provided by Informal Market

Significant part of the informal market is through hire purchase, leasing, deferred payment, etc. with finance which is often provided by the NBFCs. Informal market is to provide range of financial products, which formal banking system is unable to provide.

(8) Education and Literacy

Expansion of education and literacy tend to increase access of rural folks towards formal credit, reduce informal transaction costs in the dealings with formal credit institutions and improve their resistance for malpractices attributable to the money lender or landlord.

Developments in the Indian Banking Sector in Financing Poor

Financial sector reforms that were introduced from the year 1991 onwards aimed at transformation of credit institutions into financially viable, organizationally strong and units which are operationally efficient. There were various measures that were introduced included reduction in the budgetary support, concession of resources, preparing development action plans and signing Memoranda of Understanding with major controllers and introducing prudential norms related to asset classification and income recognition for cooperative banks and RRBs. Lending rates for RRBs and cooperative banks were also deregulated. Various other measures related to liberalization include allowing of non-target group financing for the RRBs, direct financing for State Cooperative Banks (SCBs) and Central Cooperative Banks (CCBs), and liberalization in the investment policies and the non-fund business. There was great contribution of these measures towards RRBs and cooperative banks in turning around and becoming a more vibrant institution.

Recently, there have been many changes in policy initiatives towards advances in rural banking. These initiatives would include an additional capital contribution to NABARD by RBI and Indian government, recapitalization and restructuring of RRBs, simplifying lending procedure, preparation of special credit plans by the public sector banks and also launching Kisan Credit Cards. Finally, another scheme which linked SHGs with banks was launched under aegis of NABARD for augmenting resources of the micro credit institutions. These initiatives enabled wider network of rural financial institutions, banking culture development, penetration of formal credit into the rural areas and counter to dominance of the moneylenders. These initiatives have financed modernization of the rural economies and implementation of self-employment and anti-poverty programmes. However, for focusing on future, generalization on certain concerns regarding current approach towards rural credit and banking would be appropriate. There are certain issues which are being faced by financial institutions which are a part of the credit market in the rural areas. Such issues are mentioned below:

Current Approach towards Banking and Rural Credit in Rural Areas

These initiatives have financed modernization of the rural economies and implementation of the self-employment and anti-poverty programmes. For purpose of focusing on future, generalization on few concerns regarding current approach towards banking and rural credit would be appropriate.

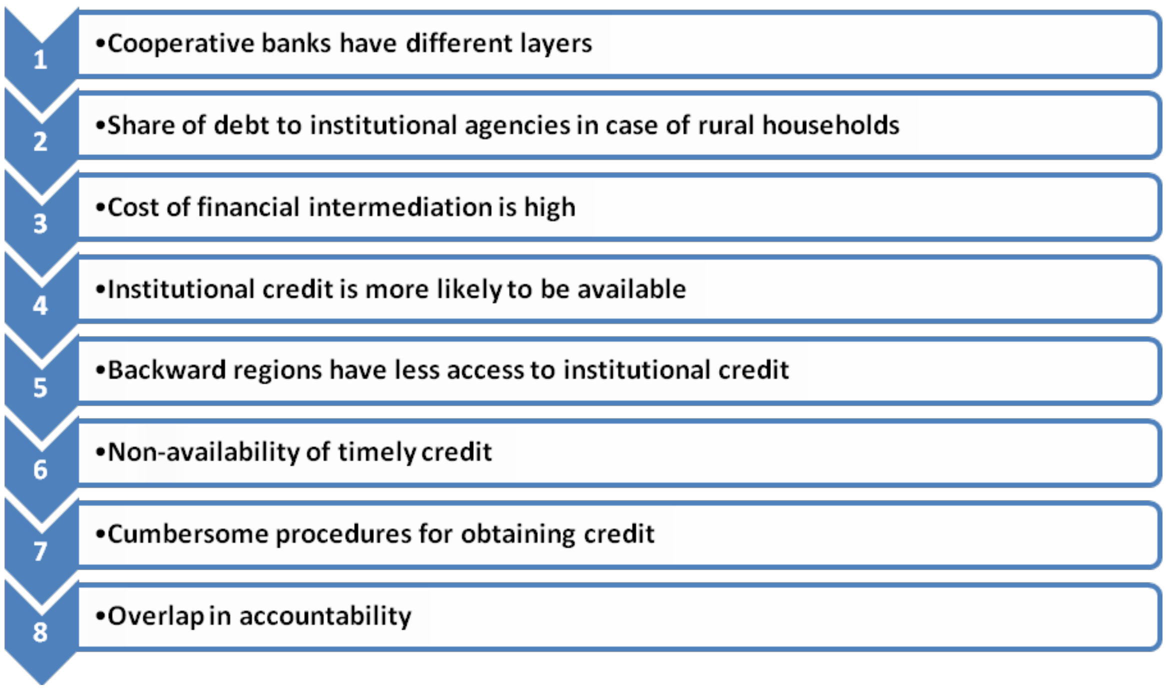

Figure 3.35 Current approach towards Banking and rural credit in rural areas

(1) Cooperative Banks have Different Layers

Cooperative bank has different layers and a lot of them have significantly larger non-performing assets (NPAs). Many cooperatives are undercapitalized. Public sector banking system exhibits NPAs and few of them have been provided with recapitalized funds. RRBs exhibit NPAs and these have been recapitalized from government of India so far, that would imply a total recapitalization of doubling amount provided by government of India.

(2) Share of Debt to Institutional Agencies in Case of Rural Households

Share of debt to institutional agencies in case of rural households have increased marginally.

(3) Cost of Financial Intermediation is High

Cost of the financial intermediation by various rural financial institutions is being considered to be on higher side. Difference between cost of resources which is made available to the NABARD by RBI and commercial interest rates at which cooperative banks lent for agriculture in deregulated rate of interest regime is considered to be on high side.

(4) Institutional Credit is more likely to be Available

Empirical studies have indicated that the institutional credit is likely to be more for well to do among rural community.

(5) Backward Regions have less Access to Institutional Credit

The people belonging to backward region have lesser access towards institutional credit than the others have.

(6) Non-Availability of Timely Credit

Non-availability of timely credit has attributed towards functioning of financial institutions, though this valid equally for urban and rural areas. Many a times credit is not available when it is required. People in the rural areas are not having security so that they could easily avail credit. Many people are dependent on agriculture for their income and it becomes difficult for them to repay the principal and interest back.

(7) Cumbersome Procedures for Obtaining Credit

Cumbersome procedures for obtaining credit has attributed towards functioning of financial institutions; though this valid equally for urban and rural areas. The poor people find procedure for applying for loan very cumbersome. The formalities are bit complex for them and hence poor people prefer to borrow funds from money lenders.

(8) Overlap in Accountability

Regarding government sponsored schemes there have been overlapping in the accountability in as much as beneficiaries are identified on joint basis. Banks indicate that NPAs are proportionately more because of overlapping.

Another development in formal segment of rural financial markets is growing significance of non-banking financial companies (NBFCs), in particular, in leasing and hire purchase operations. They finance traders of agricultural outputs and inputs. The NBFCs have only recently been brought under RBI's regulatory regime. While their importance is recognized in financing of diversified rural agriculture, its scope and extent of operations have not been taken into consideration much.

To Do Activity

Ask the students to discuss about atleast two emerging trends in rural banking taking examples from any public sector bank.

Summary

In India, the features of banking practices in ancient times, traces of which are even found now in the isolated rural areas in our country. In various other aspects, a long tradition of banking has been seen. Rural banking is a process of conducting banking transactions where the bank branches are far away and it becomes difficult for people to use financial services. Rural banking is famous for smaller towns as well as farmers who have been living far away from the areas of large population and can't reach to such locations where bank branches exist whenever they need to use services of banking

RRBs plays vital role in agriculture and also rural development of India. In India, RRBs have reached to the rural areas, through their huge network. Success of the rural credit depends largely on their financial strength. RRBs are the key financing institution at rural level that shoulders responsibility related to meeting the credit needs of various types of agriculture credit in the rural areas. Many people are getting wages in cash, they are spending in cash and hence they do not wish to get burdened by maintaining a bank account. People in the rural areas who are having access to banking products and services, are not making much use of them since the product and service mix are not meeting their needs. Financial service needs of the rural customers are not actually confined to saving and credit needs, which are generally assumed by the banks and other financial institutions. The financial needs of the rural people are connected to their life cycle needs, which range from savings to credit to insurance and to remittances.

Transaction costs which are incurred by clients could be divided across services which are being availed by people from banks or financial institutions. This includes financial activities like credit and savings as well as non-financial activities such as training programs. Measurement of transaction costs varies due to many terms and conditions and it is very important to compare the transaction cost as per the different models and an effective model is designed for providing finance to the people of rural areas. Banking sector plays a dominant role in building the economy. Banks are having control over larger part of money supply in circulation. Strong financial and banking sector is necessary for any country for emerging as developed one.

Model Questions

- Explain banking in the ancient India.
- Discuss the impact of RBI initiatives towards rural development.
- Discuss the role and objectives of RRBs in rural banking.
- Explain the problems being faced by RRBs while providing banking facilities in the rural areas.
- Identify the life cycle needs of the people in the rural areas. Discuss with example.
- What are the problems being faced by branches of Commercial banks while operating in the rural areas?
- What are the components of transaction cost in rural banking?
- Discuss the factors from which risk cost could be derived.
- Explain the current approach towards Banking and rural credit in rural areas.
- Discuss new realities in rural credit market.

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Chapter 4 – Micro Finance

Introduction

In India, microfinance is a dynamic space having multitude of players which are offering various products and services to people having low income with different approach. Banking system along with various other legal forms like NBFCs, Cooperatives, Section 25 companies and NGO-MFIs all have approached rural markets. Many newer forms of relationship are emerging among the entities for leveraging on each other's strength. There have been new developments, though penetration of microfinance still remains low. There are sufficient gaps which are required to be filled and this would lead to certain further changes in microfinance in future. Microfinance which is a powerful tool for addressing challenge of eradication of poverty, raising caution regarding the overwhelming push for MFIs for becoming financially self sustainable, greatly transparent and more public awareness. Microfinance in India is dynamic and multifaceted industry. Unique economic circumstances in mid-1980s created situation which was ripe for commercialized microfinance industry. With support and help from international organizations, government and local businessmen, microfinance sector in India have evolved into highly commercialized and profitable industry. As sector began to flourish, few MFIs proved to lead way with regards to profitability and innovation. The path which these institutions paved eased road for the other institutions which followed. Competition provoked more efficient operations that lent with lower costs and more options for the customers; in addition, the outreach expanded and there was increase in profits.

Therefore, commercialization produced successful and effective financial institutions which positively contributed towards banking system. Competitive forces helped to integrate lower income population into more formal financial sector. Thus, while microfinance industry in India promotes development of country's financial system, informal sector is both empowered and included. New challenges and opportunities are being felt in field of microfinance.

In addition, Indian government must take initiative for monitoring microfinance system that would assist lower income micro-entrepreneurs, resulting in improvement in the income earnings and expenditure leading them towards enjoyment with higher standard of living. Microfinance industry made gains coverage of the rural poor population with financial services. Microfinance evolutionary growth have given great opportunity to rural poor for attaining reasonable social, cultural and economic empowerment, leading to a better standard of living and quality of life for participating households. Microfinance institutions need to educate villagers on ease of procedures for availing loans. Access to microfinance help the poor people in improving their living standards.

Objectives of the Chapter

- To explain the evolution and growth of Micro – finance in India
- To evaluate the relationship between Micro – finance and social security
- To familiarise the impact of Micro – finance on livelihood of poor people
- To know more about the models of Micro – finance

- To explain the challenges and prospects of Micro-financing

Chapter Structure

- 4.1 Micro Finance - Evolution and Growth
- 4.2 Micro- Finance and Social Security
- 4.3 Micro-Finance and Livelihood approach
- 4.4 Different models of Micro-Finance
- 4.5 Challenges and Prospects of Micro Financing in Rural India

4.1 Micro finance – Evolution and Growth

Microfinance is considered as a tool towards economic development which has objective of assisting poor people so as to reduce poverty. Microfinance covers many services which includes savings, money transfer, insurance, counseling etc apart from credit provision. In India, Micro finance started in the early 1980s. It involves Non-Government Organizations (NGOs) and self-help groups (SHGs) that come together to provide credit and savings service to people who do not have access towards formal banking system. Micro finance organizations have been undertaking activities from perspective of development in various areas and they do not focus on profit. These organizations are getting support by government bodies like Small Industries Development Bank of India (SIDBI) and National Bank for Agriculture and Rural Development (NABARD). There are some trusts which are set up specifically for making funds available to people who are in the lowest level in the society.

Provision of credit to Microfinance sector is actually based on following:

a) It addresses concerns of alleviation of poverty through enabling poor to work their way out of poverty.
b) It enables empowerment of women through routing of credit directly to the women; this enhances status within families of women, community and also society at large.
c) Making credit access easier is much more important for poor than getting cheaper credit which could involve a lengthy bureaucratic procedure and delay.
d) Poor people are not generally in position of offering collateral for securing credit.

e) The market is imperfect in this sector and size of loan is also very small in size. The transaction cost is higher and they are unavoidable. However, when community set up their own institutions like cooperatives and SHG federation, the transaction cost could become low.
f) Transaction cost could be reduced through economy of scale. The increase in the scale could not be achieved for both individual operations as well as sector as whole in absence of recovery of cost and also profit incentive.

Many people think that microfinance means to provide small loans i.e. microcredit to families which are very poor for helping them to engage in productive activity or nurturing their own small businesses. Micro finance now includes many financial services including savings, credit, insurance etc. It has been realized with time that the poor and very poor require diversity of financial product, specifically those who lack in accessing traditional or formal financial institution.

Micro credit became prominent in 1980s, though there were earlier experiments in this field which could be dated back to a period 30 years back in Brazil, Bangladesh and other countries. Micro credit avoided pitfalls of previous generation related to development lending which was targeted, through insistence on repayment, charging rate of interests which could cover credit delivery cost and through focus on the client group whose alternative credit source was informal sector. The emphasis got shifted from the rapid disbursing of the subsidized loans for supporting the targeted sector towards building of a local and sustainable institution for serving the poor. Microcredit was largely a private (non-profit) sector initiative which avoids becoming of overtly political. This has consequently outperformed virtually in all other ways for development of lending. In a traditional way, microfinance has focused on helping the poor in getting access to credit products which are standardized. Poor people also need a diverse range in financial instruments for building asset, stabilizing consumption and protecting themselves against various risks. Concept of microfinance is to provide some reliable and efficient way for providing a variety of financial products.

Evolution of MFIs Industry

Microfinance has built solid track record as critical tool for fighting against poverty and have entered financial mainstream. Rapid growth of industry over past many years has reached millions of clients. Microfinance has reached lesser population as compared to the population who actually needs a lot of support for reducing or removing poverty. There are many people who are not having access or a little access towards formal financial services. Financial services can actually help in changing the life of the poor people in many ways. Some of these ways are mentioned below:

1. Reducing poverty
2. Enabling poor people in building assets
3. Increasing incomes
4. Reduction in their vulnerability towards economic stress
5. Invest in enterprises
6. Better nutrition
7. Improved living conditions
8. Improved education and health of their children

Figure 4.1 Ways how financial services could help poor people

Microfinance has been powerful catalyst in empowering women. Evolution of microfinance industry is driven by many factors. Some of these factors are mentioned below:

1. Transformation of microfinance providers
2. Sizable supply gap for the basic financial service
3. Expansion of funding sources supporting this industry
4. Usage of technology

Figure 4.2 Factors of microfinance evolution

As this industry has developed, there is a shift from specialized NGOs to increasing number of licensed and regulated MFIs which stresses that impact and sustainability go hand in hand.

Evolution of Microfinance sector could be divided into distinct phases broadly:

Phase 1	•The cooperative movement (1900-1960)
Phase 2	•Subsidized social banking (1960s – 1990)
Phase 3	•SHG-Bank linkage program and growth of NGOMFIs (1990 – 2000)
Phase 4	•Commercialization of Microfinance: The first decade of the new millennium

Figure 4.3 Phases of evolution of Microfinance sector

- **Phase 1: The Cooperative Movement (1900-1960)**

During this phase, credit cooperatives were vehicles to extend subsidized credit to villages under government sponsorship. For instance, up to mid 1900's microcredit essentially turned to the support of the agricultural sector, with low interest rates, strong government subsidies and institutions for the most part not sustainable. During the last years, the sector has been characterized by a fast evolution and a commercialization process: reduction of grants and increment of equity investments; the approach moved to sustainability in terms of operational and financial self-sufficiency.

- **Phase 2: Subsidized Social Banking (1960s – 1990)**

In 1960's, credit delivery system in rural India was largely dominated by cooperative segment. The period between 1960s and 1990s is referred to "social banking" phase. With failure amongst the cooperatives, government focused on measures like the following:

1	•Nationalization of private commercial banks
2	•Expansion of rural branch network
3	•Establishment of RRBs
4	•Setting up of apex institutions like NABARD and SIDBI

Figure 4.4 Subsidized social banking

While these steps have helped in reaching larger population, this period was characterized by misuse of credit on large-scale, created negative perception about credibility of micro borrowers among the bankers, thus this lead to hindering access towards banking services for low-income people.

- **Phase 3: SHG-Bank Linkage Program and Growth of NGOMFIs (1990 – 2000)**

After 1990s, India witnessed second phase 'financial system approach' of credit delivery. This concept held great appeal for NGOs which are working with the poor, prompting them for collaborating with NABARD in this programme. Failure of the subsidized social banking triggered paradigm shift in the delivery of rural credit with NABARD which initiated Self Help Group (SHG) Bank Linkage Programme (SBLP), which aims to link informal women's groups towards formal banks. This program helped to increase banking system outreach towards the unreached people and initiate change in bank's outlook towards the families having low income. During this period there was an extension of credit at the market rates. This model generated lot of interest amongst newly emerging Microfinance Institutions (MFIs), which are largely of a non-profit origin, for collaborating with NABARD under this program. Macroeconomic crisis in early 1990s led towards introduction of Economic Reforms of 1991 which resulted in greater autonomy to financial sector. This led to emergence of private sector banks which are new generation would become important players in microfinance sector a decade later.

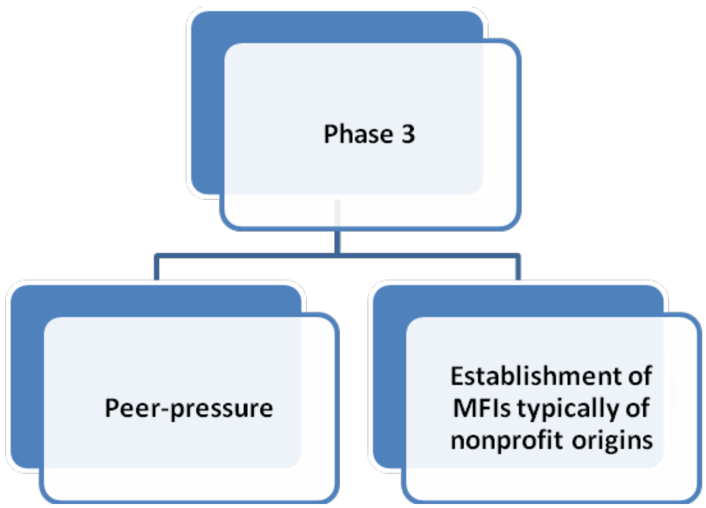

Figure 4.5 Financial Systems Approach

- **Phase 4: Commercialization of Microfinance: The First Decade of the New Millennium**

Post reforms, the rural markets emerged as new growth drivers for Banks and MFIs. Banks are taking interest in sector not only as a part of their corporate social responsibility (CSR) but also as new business line. On demand side, NGO-MFIs increasingly began transformation of themselves into more regulated legal entities like Non Banking Finance Companies (NBFCs) for attracting commercial investment. MFIs set up after the year 2000, saw themselves lesser in developmental mould and more as businesses in financial services space, which caters to untapped market segment while also created value for their shareholders. This overriding shift brought changes in institutions' capital structures, legal forms, growth strategies, strategic alliances and sources of funds.

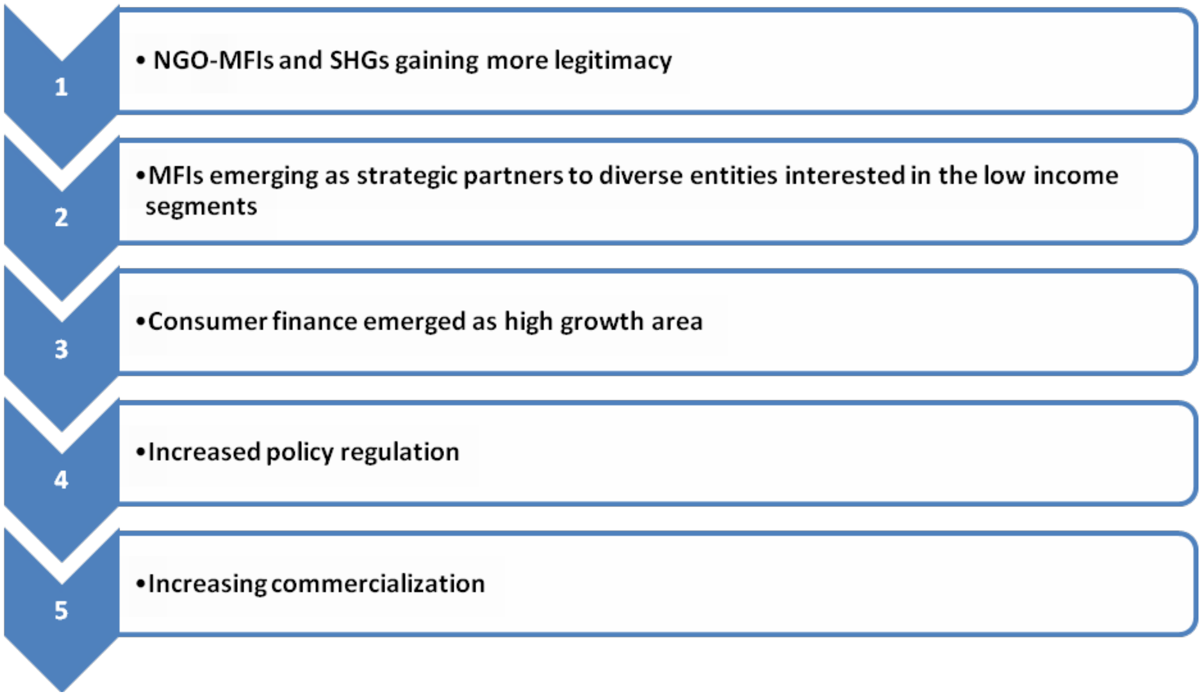

Figure 4.6 Phase 4 of evolution of microfinance in India

In India, Microfinance started evolving in early 1980s with formation of informal Self Help Group (SHG) to provide access towards financial services to needy people who are not having access towards credit facilities.

Growth of Microfinance in India

Indian Government have considerably enhanced the allocation for provision of education, sanitation, health and other facilities that promotes well being and capacity building of poor. Indian government puts emphasis to provide financial services to underprivileged and poor since independence. Commercial banks were nationalized in the year 1969 and were directed towards lending 40% of their loan at a concessional rate to the priority sector. Priority sector included agriculture and other rural activities and weaker sections of society in general. The aim of microfinance was providing resources for helping the poor for starting their micro enterprise for attaining self sufficiency. Indian government also launched various poverty alleviation programs as mentioned below:

1	• Small Farmers Development Scheme (SFDS) 1974-75
2	• Twenty Point Programme (TPP) 1975
3	• National Rural Development Programme (NRDP) 1980
4	• Integrated Rural Development Programme (IRDP) 1980
5	• Rural Landless Employment Guarantee Programme (RLEGP) 1983
6	• Jawhar Rozgar Yojna (JRY) 1989
7	• Swarna Jayanti Gram Swarojgar Yojana (SGSY) 1999
8	• Many other programs

Figure 4.7 Poverty alleviation programs initiated by Indian government

But all these programs could not achieve their desired goal because of poor execution and malpractices on part of the government officials. Public funds meant for poverty alleviation are being diverted or misappropriated through manipulation by locally powerful or corrupt people. For supplementing efforts of the micro credit government of India have started very good scheme viz. Integrated Rural Development Programme (IRDP) in the year 1980. But the supply side programs could achieve partially. It involved the commercial banks in giving loans of less than Rs 15,000 to poor people and in nearly 20 years, resulted in financial assistance of around Rs 250 billion to roughly 55 million families.Problem with IRDP was that the design incorporated substantial element of subsidies (i.e. 25-50% of each family's project cost) and it resulted in extensive misuse of funds and malpractices. This situation led bankers for viewing IRDP loan as motivated handout and there was a failure in following up with the borrowers. This resulted in estimation of the repayment rates in IRDP to range between 25-33%. Two decades of IRDP experience in 1980s and 1990s affected credibility of the micro borrowers in view of bankers and ultimately this hindered access of less literate poor towards banking services. This act of government had serious long term impact on development of micro entrepreneurship among the underprivileged people of the society. These programme failed because of political interference and poor execution. Programmes suffered from various issues which are mentioned below:

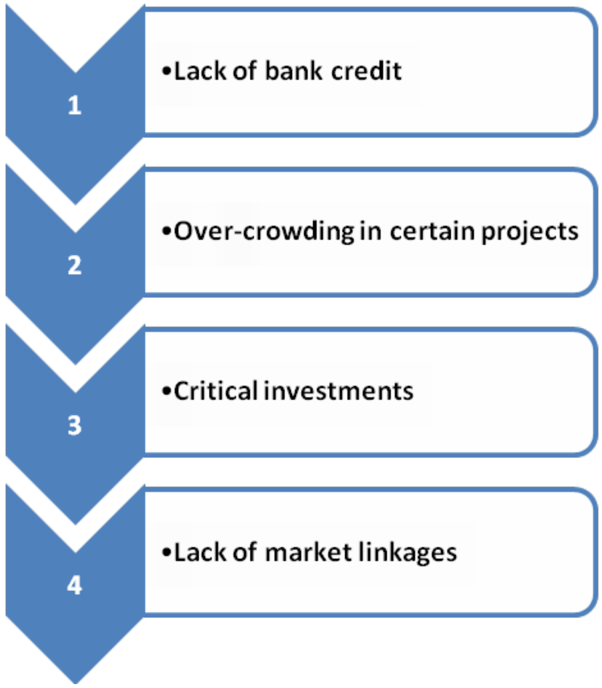

Figure 4.8 Issues with poverty alleviation programmes

These programmes were basically subsidy driven and they ignored process of social intermediation which was necessary for success of the self-employment programmes. One-time provision of credit without follow-up action and lacking continuing relationship between the borrowers and the lenders also contributed towards failure of programmes. The planning commission constituted committee in the 1997 for reviewing effectiveness of wage employment and self-employment programmes. The committee recommended merger of all the self employmentprogrammes. The committee also recommended shift of the importance from the individual beneficiary approach to group based approach. It emphasized on identification of the activity clusters in specific areas and stronger marketing linkages and training. Indian government accepted recommendations of committee.

On April 1st, 1999, new programme called Swarnajayanti Gram Swarojgar Yojana (SGSY) was launched through the amalgamation programmes like IRDP (Integrated Rural Development Programme) and number of allied programmes such as TRYSEM (Training of Rural Youth for Self Employment), DWCRA (Development of Women and Children in Rural Areas), SITRA (Supply of Improved Toolkits to Rural Artisans), GKY (Ganga Kalyan Yojana) and MWS (Million Wells Schemes).

About Amalgamation programmes

(1) Training of Rural Youth for Self-Employment (TRYSEM)
This Scheme is a facilitating component of the IRDP that aims to provide basic entrepreneurial and technical skills to rural poor aged between 18 to 35 years for enabling them in taking up an income generating activity. The Eighth Plan emphasized importance of proper assessment of training needs among rural youth related to self and wage-employment opportunities, group training and training quality. During Eighth Plan, 15.28 lakh youth have been trained under TRYSEM, of whom 34.16 percent took up self-employment and 15.05 percent took wage-employment; while remaining 50.79 percent have remained unemployed.

(2) Development of Women and Children in Rural Areas (DWCRA)
This special scheme aims to strengthen gender component of IRDP. This started in 1982-83, on pilot basis, in 50 districts and has extended to all districts of India. DWCRA scheme is directed to improve living conditions of women and children through provision of opportunities for self-employment and accessing basic social services. Main strategy which was adopted under this programme is about facilitating access for the poor women towards employment, training, skill upgradation, credit as well as other support services.

(3) Supply of Improved Toolkits to Rural Artisans (SITRA)
It was launched in July 1992, as sub-scheme of IRDP in few selected districts. This scheme has later extended to all districts of India. Under this scheme, variety of craftsman, except the weavers, needle workers, beedi workers and tailors were supplied with an improved hand tool kit within financial ceiling of Rs.2000. Out of this amount, the artisans are required to pay 10 percent and remaining 90 percent is subsidy from Indian Government. Supply of the power driven tools was subjected to ceiling of Rs.4500 under this scheme.

(4) Ganga KalyanaYojana (GKY)
Irrigation facility is provided to agricultural land through lift irrigation scheme which utilizes perennial source of water (rivers) and lifting water through pipe lines. Wherever the perennial water sources are not available, bore wellis drill on water points identified by expert geologists.

(5) Million Wells Schemes (MWS)
This scheme would continue in Ninth Plan for providingmaximization of the agricultural output. Simultaneously, level of ground water would be required to be maintained by adopting suitable recharging practices so that small and marginal farmers could derive maximum benefits from small holdings. Until recently, focus under MWS was on employment creation, with secondary objective to provide source of irrigation. This situation has been modified by delinking MWS from JRY and repositioning it as beneficiary-oriented scheme of irrigation to enhance agricultural productivity levels of small as well as marginal farmers.

Source :NitiAyog (n.d.). Poverty Alleviation in Rural India :Programes and Strategy. Retreved from https://niti.gov.in/planningcommission.gov.in/docs/plans/planrel/fiveyr/9th/vol2/v2c2-1.htm

This is a holistic program covering all aspects of self-employment such as formation of SHGs, credit, training, technology, marketing and infrastructure. This programme aimed at establishment of large number of microenterprises in the rural areas. SGSY is credit-cum-subsidy programme. It lays emphasis on the activity clusters. This programme got tremendous response from beneficiaries. SHGs benefitted a lot under this programme. In a similar way, entire network of RRBs and primary cooperatives were established for meeting needs of rural sector in poor and general in particular, have proved to be huge failure.

RRBs faced the burden of directed credit and restrictive interest regime, due to which position of RRBs deteriorated quickly while the cooperatives suffered from mismanagement, corruption and privileged leadership. Microfinance initiative in private sector in India could be traced back to the initiative undertaken by Shri Mahila SEWA (Self Employed Women's Association) Sahakari Bank in the year 1974 to provide banking services to poor women employed in unorganized sector in Ahmadabad in the state, Gujarat. This Bank was established at initiative of 4000 self employed women workers who contributed share of Rs. 10 each with specific objective to provide credit to these women for empowering them and freeing them from the vicious circle of debt. As in March 2009, SEWA Bank had over 318,594 account holders with a total working capital of Rs 1291.89 million.

Microfinance industry groups seek PM Modi's help to secure repayment Moratoriums on term loans

Microfinance industry group has sought PM Narendra Modi's help for securing repayment moratoriums on the term loans, as they have failed earlier for convincing their lenders for giving them grace period. There are many smaller MFIs who have defaulted in their loan repayments and others have been facing liquidity squeeze as most banks as well as financial institutions have

They said that a couple of smaller MFIs have already defaulted their loan repayments last week, while others are facing a liquidity squeeze, since most banks and financial institutions have refrain from extension of moratorium benefit despite RBI's advisory on this issue. "Time is running out. This is a situation when urgent action is required. As RBI did not communicate anything to clarify the issue of moratorium so far, we wrote to the PM for his intervention," Sa-Dhan Executive Director P Satish told Economic Times.

Both Sa-dhan, India's largest microfinance industry body having 212 members, and Microfinance Institutions Network (MFIN), industry grouping for NBFC-MFIs, have separately urged to the prime minister for taking action.

MFIs borrow from development financial institutions (DFIs), Banks as well as other non-bank lenders for on-ending to support the small entrepreneurial activities like tea stall, cattle rearing, tailoring etc. MFIs passed on moratorium benefit to many borrowers after RBI came out with regulatory package for fighting economic impact of corona virus outbreak. MFIs have Rs 53,853 crores of outstanding borrowing as on March end. Around two-third of this amount was from the banks while balance was from the non-bank lenders which includes DFIs like SIDBI. As per the letter from Sa-Dhan, there have been misinformation and even outright denial by few DFIs, NBFCs and few financial other institutions, but not all the banks that moratorium would not cover microfinance. Not extending moratorium would cause MFIs to face significant cash-flow issues, in absence of any kind of collections even for the operating costs. About 56 million poor women across 620 districts borrowed micro loans worth Rs 2.16 lakh crores. Out of these, borrowers have received Rs 66,159 crores from 85 NBFC-MFIs and another Rs 2,395 crores from 18 NGO-MFIs. Banks, other NBFCs and small finance banks also have microfinance exposure, with the retail deposits as source of funds.

Source :

Ray A. (2020). Microfinance industry groups seek PM Modi's help to secure repayment moratoriums on term loans. Retrieved from https://economictimes.indiatimes.com/ industry/banking/finance/microfinance-industry-groups-seek-pm-modis-help-to-secure-repayment-moratoriums-on-term-loans/articleshow /75147007.cms

To Do Activity

Ask the students to choose any one poverty alleviation programme which has been initiated by the government and discuss about the achievement of that programme with the class.

4.2 Micro-Finance and Social Security

Microfinance is provision of loans and various other financial services to poor. Microfinance has evolved due to efforts of the committed individuals and many financial agencies for promoting self-employment and contribution towards poverty alleviation and provisioning of social security. India has developed its own model of microfinance organizations in form of savings and credit groups which are known as Self Help Group (SHGs) that are bank-linked. These SHGs are formed and managed by poor people and these bring social change and lead to empowerment. In India, most microfinance institutions attempt in going beyond savings and credit groups for providing microfinance services which could be in the form of insurance and savings. Many people believe that microfinance is about providing smaller loans (microcredit) to families who are very poor for helping them to get engaged in productive activities or nurturing their tiny businesses. With time, microfinance has included broader range of financial services i.e. credit, savings, insurance, etc. and this has been a development as it has been realized that poor people lack in access towards traditional financial institutions which are formal in nature and even poor people require a variety of financial products.

Specific Loans from Micro Finance Institutions (MFIs)

Microfinance is a way through which access is provided to people towards loans, insurance, credit, savings accounts and transfer of money. These facilities are provided for owners of small business and the entrepreneurs in underdeveloped part of India. Beneficiaries of the microfinance are basically those who do not have access to the traditional financial resource. Interest rate on the microloans is generally high than as compared to the traditional personal loan.

The working of MFIs is not standardized across the nation and MFIs in different areas might have uniquely structured loan for different purpose.

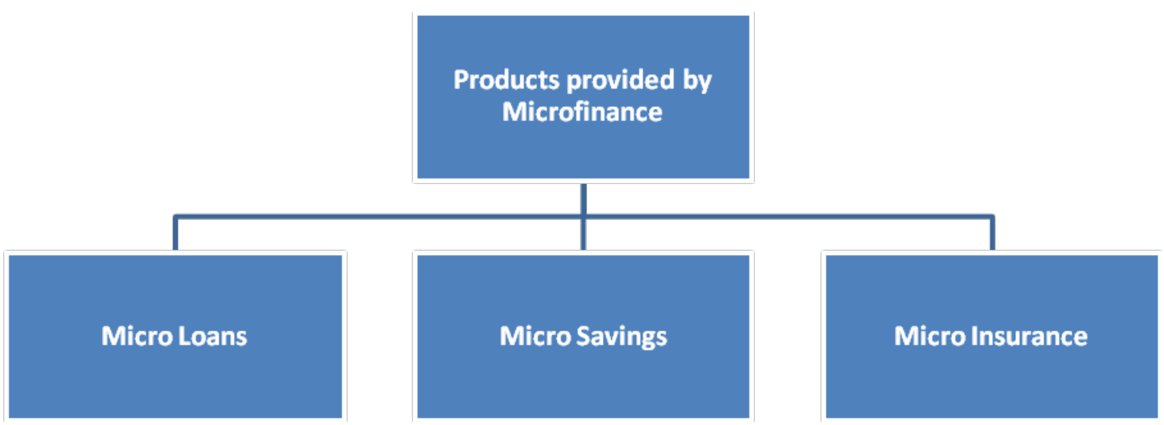

Figure 4.9 Products provided by Microfinance

Microfinance include following products

(1) Micro Loans

Microfinance loans are provided to the borrowers without any collateral. End result of the microloans should have been the recipients to outgrow smaller loans and making them ready for the bank loans which are traditional in nature.

(2) Micro Savings

Micro savings account allows the entrepreneurs to operate the savings accounts without any minimum balance. This account helps the users in inculcating financial discipline and developing an interest in savings for future.

(3) Micro Insurance

This is a type of coverage which is provided to the borrowers of micro loans. This insurance plan has a lower premium than the traditional insurance policy.In certain situations, the recipients of micro loans are required to undergo various training courses related to management of cash flow or book-keeping.

Traditionally, microfinance has also focused to provide a standardized credit product. The poor, just like the other people, also need diverse range of financial instruments so that they could build assets, for stabilizing consumption and protecting themselves against various risks. Social security is very important for the people who are residing in the rural areas.

Social Security

How does microfinance help the poor?

Experience shows that microfinance can help the poor to increase income, build viable businesses, and reduce their vulnerability to external shocks. It can also be a powerful instrument for self-empowerment by enabling the poor, especially women, to become economic agents of change. Poverty is multi-dimensional. By providing access to financial services, microfinance plays an important role in the fight against the many aspects of poverty. For instance, income generation from a business helps in not only expanding the business activity but also in contributing to household income and its attendant benefiting on food security, children's education, etc. Moreover, for women, who, in many contexts, are secluded from public space, transacting with formal institutions can also build confidence and empowerment. The extent to which individuals around the poverty line are vulnerable to shocks (like illness of a wage earner, weather, theft, or other such events) produce a huge claim on the limited financial resources of the family unit, and, absent effective financial services, can drive a family so much deeper into poverty that it can take years to recover.

Needs of poor people for credit facilities

The poor people require credit facilities for many reasons. Few reasons are mentioned below:

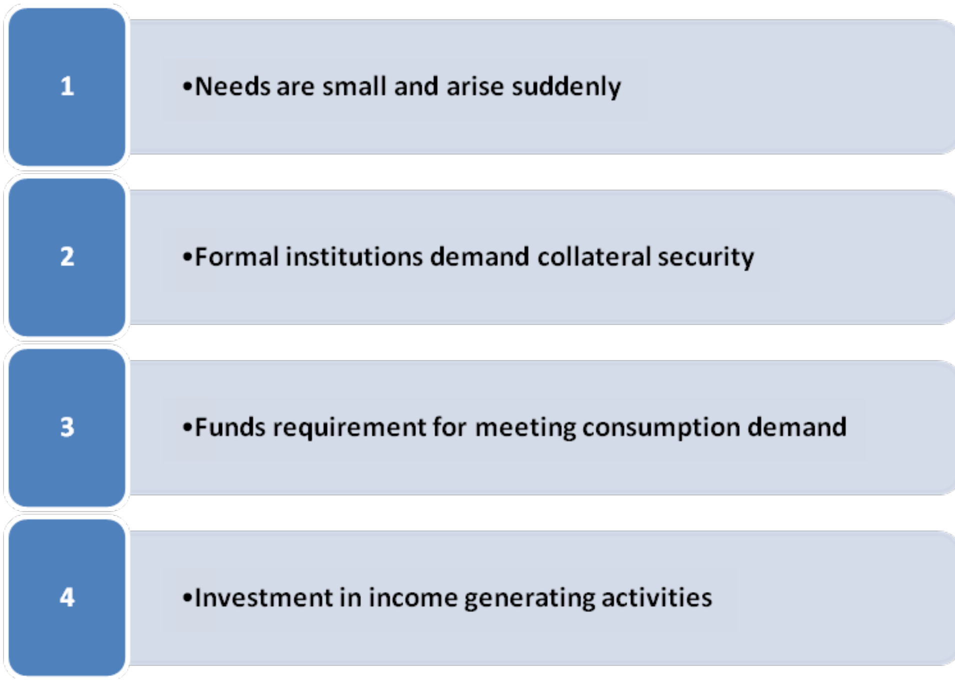

Figure 4.10 Needs of poor people for credit facilities

(1) Needs are Small and Arise Suddenly

The poor people need smaller amounts for fulfilling their needs and it becomes difficult for them to approach the formal financial institutions for smaller amounts more frequently. The poor people are not much aware about saving money so that they could apply for a certain amount of loan and could later utilize the remaining amount which was unused for a particular current need. The need also sometimes arise suddenly and due to the time required for applying to banks and other financial institutions is more, poor people prefer to get funds from the money lenders.

(2) Formal Institutions Demand Collateral Security

The poor people are unable to provide collateral security to the formal financial institutions to get loans. Many poor people do not own assets in their name which they could provide as collateral. People residing in the rural areas, many of them have been struggling to fulfill their daily needs of their families and it is not possible them to save money so that they could buy assets.

(3) Funds Requirement for Meeting Consumption Demand

Poor people need funds for meeting their consumption demands. Many a times, it becomes difficult for them to obtain finance from formal institutions. There could be different consumption needs for which poor people might require funds.

Few of the consumption expenses are mentioned below:

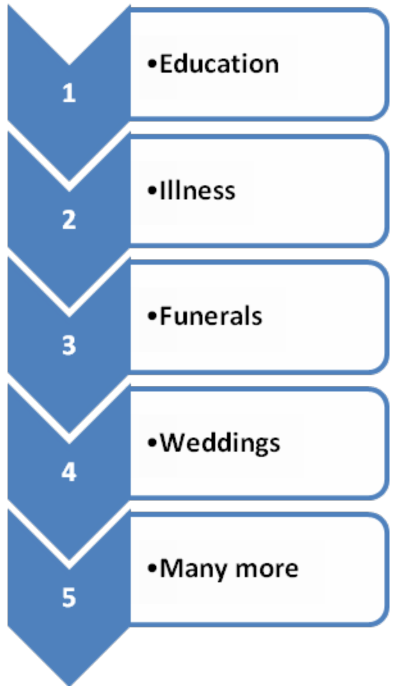

Figure 4.11 Consumption needs of poor people

(4) Investment in Income Generating Activities

The poor people require funds so that they could secure the future of themselves and also of their families. Sometimes people belonging to the rural areas are also willing to save money for future, but they are unable to get funds from the banks or other financial institutions since there are various formalities which they are unable to fulfill. Many poor people are not even aware of income generating activities, rather they are more focused on current consumption.

Social Security of Microfinance Consumers

Figure 4.12 Social security of microfinance consumers

(1) Avoidance of Over-Indebtedness

There can be two perspectives in this issue. On one hand, lower-income borrowers would take more credit and could end up being over-indebted and may not be able to repay. On other hand, due to market competition, lenders might seek to increase risk at cost of providing more credit than borrowers would be able to repay. Credit risk is the biggest risk which is being faced by MFIs. The problem of over-indebtedness of the clients is continuously a major problem in micro-finance sector.

(2) Transparent Pricing

Transparent pricing is very important and it is the moral responsibility of MFIs that the cost and rates which are involved in credit are clearly disclosed to the poor people explicitly since micro-finance is devised for protecting vulnerable and poor people. Until now, consumer protection awareness was lesser among the poor people. But, now more people are aware about the transparency and as such transparency and fair treatment of the clients is a key towards good lending practices. Today, extensive technology applications are being used, so it has become very important for every financial institution to follow transparency practices.

(3) Appropriate Collection Practices

Debt collection practice should be carried out with proper diligence. It is very important that the customers are aware about the products and practices which are posing risk. The approach that is adopted by the financial institutions should be complimented by financial education also. Collection practices should vary with the customer. Collection practice which is adopted should be appropriate to the customer.

(4) Privacy of Client Data

There is requirement for respecting privacy of the client data and permission should be the taken from the customer before the data is being used for any other purpose. There is a threat to the customer's data and it is very important that the customers need to be encouraged for using the latest technology in a proper way. With advancement of microfinance sector in terms of business, there are many other entities who are interested in getting data so as to market their products and services. It is the duty of all the entities to maintain privacy of customer's data and encourage them to use various online services which are being provided.

(5) Mechanisms for the Redress of Grievances

It is crucial that the MFIs have a proper mechanism for handling problems and complaints. The mechanism should be responsive and timely in nature. It is very important that the poor customers have proper access towards the redressal mechanism and the grievances are timely dealt with. There is a requirement of a protective approach on part of the supervisory authorities for establishing and enforcing fair standards. In the absence of a simple and practical means for redressal of issues, the inexperienced MFI customers are left vulnerable towards balance of power which unduly favors MFIs.

According to RBI, the redressal cell should be the first reference point for a consumer to register a grievance or lodge complaint.

(6) Ethical Staff Behaviour

The staff members of MF institutions should behave ethically and it is responsibility of management of MFIs for ensuring adequate measures so as to detect and curb corrupt and unethical behaviour. It is necessary for the MFI that poor people are encouraged to take the help of MFI in meeting their productive and consumption purpose. MFI staff should take proper precaution to help the poor people that they are not misguided and they are able to understand the rule and regulations of the MFI. The staff members of the MFI should help poor people in coping up with their financial issues and help them with financial products and services.

Micro Insurance – A Tool for Social Security

Micro-insurance envisages protection of the low-income people against debt traps which often imperil their livelihood and their lives. This is an outgrowth of the micro-finance, with MFIs being leading providers of micro-insurance. Ordinary life risks can completely wipe out the entire savings of a family. Vulnerability and poverty reinforce each other. Often, trigger for poverty becomes an illness. Illnesses are severe risk and could even eat away most of hard-earned savings in the lower income communities. This results in bankruptcy. Many poor people prefer to avail health insurance facility instead of life insurance. Many people who belong to rural areas are driven away by the cost which is levied by hospitals for health issues. Poor people could manage risks and avoid debt if they have taken micro-insurance policies for protecting accumulated wealth, generate income and even get fair chance for rescuing themselves and families out of poverty.

Use of Digital Technology to further the Reach

The insuring cost against an unforeseen development is lower as compared to self-insurance through savings and is smaller relative to household budget. Government, donors, and various other development actors who are engaged in combating poverty and also responsible for designing social protection measures need insurance as a weapon for eradicating poverty. Key challenge for micro-insurance is high cost of administering it. The poor people have been living off the banking grid. The poor families are scattered across countryside, which makes physical access difficult, and even transaction costs for issuance of smaller policies to millions through service agents is also very high.

Rapid advances in the system of digital payment are creating opportunities for connecting poor households for affordable and reliable financial tools through various digital interfaces. Insurance coverage could be widened through coupling services with the existing mobile financial products or through creation of new mobile solutions which bring insurance services directly to consumer's phone.
Micro-insurance is developed segment in India now.

Understanding micro-insurance products

Micro-insurance is crucial strategy on range of risk management options. Increasing access of the poor households to insurance could prevent them from relying on publicly funded support for coping with the environmental and economic shocks. It helps them to adopt an alternative or a more productive livelihood (for example, cultivate higher-yield crop insured against risk of drought) which could help to lift them out from poverty.

There are three major types of micro-insurance products.

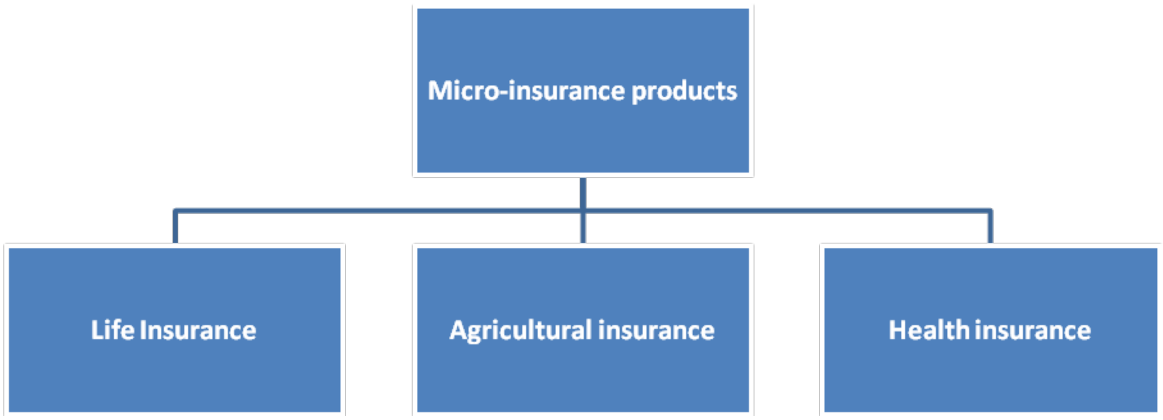

Figure 4.13 Types of micro-insurance products

(1) Life Insurance

It is most common form of micro-insurance which is facilitated by extension of micro-finance model into coverage area. However, life insurance provided by the MFIs is mainly way of insuring loans i.e. credit life insurance rather than to provide income support in case of death of policyholder.

(2) Agricultural Insurance

It mainly consists of crop insurance which covers farmers against multiple shocks and pay out against the losses that insurer assesses by observing the harvest yields. Index-based insurance pays out fixed sum to the farmers when independently observed trigger (i.e. often rainfall levels, crop yield or livestock mortality rate) show that an insured event have occurred.

(3) Health Insurance

Many countries have been developing private, public and community-based health insurance program for pooling risks associated with the health shocks. Coverage of the programmes remains quite low, particularly among poor, but there is some growth in the community health insurance for the lower-income population.

Need for Assessment and Providing Guidance by Micro Insurance Companies

For poor people for reaping real benefits of micro-insurance, there is a requirement that the insurance companies function with sense of responsibility. Because of lack of proper awareness and failure of the institutions for properly guiding them, people buy insurance policies without sufficient planning and give up a midway because they do not have money for paying premium. The micro insurance companies should not aggressively push out their products without adequate assessment of consistency in the income streams of buyers for servicing their policies as this could harm the poor more. Customers might end up in losing heavily in the form of penalties in case the poor people are not having sufficient funds as required by the insurance plans. The customers who are uninformed might face huge risk, hence it is very important the poor people try to evaluate an insurance product and also the insurance providers should keep their customers well informed about the cost which are involved in insurance. Important determinant for financial products for seeking enrolment of poor is how far providers produce trust. The greatest challenge which exists in micro-insurance schemes is striking right balance between affordability and adequate protection for delivering real value to insured. Micro-insurance provides a way for ending poverty cycle through safety net which families require. If poor people are aware that they have been covered under insurance plan, they will be able to plan for their future, invest for expanding their businesses, diversification of crops and will be able to send their children to schools without having any fear that they would lose their savings in case something happens to them.

Success Story of Brihaspati Bag under MCDF (Micro-finance) Program

Brihaspati Bag, is a resident of UttorKonkondighi is member of MCDF (MUKTI Community Development Fund) that has been built for supporting livelihood amongst rural women entrepreneurs of India. Her story is success story of woman entrepreneur who borrowed money as a part of social and microfinance investment in India.

Brihaspati and her husband were living in absolute poverty. Against all the odds, they were managing education of their younger daughter. They have one a son and two daughters. The elder daughter got married and younger one was studying in the 8th standard. Their only son used to work as a motor mechanic. After joining MCDF there family had some relief.

Brihaspati took a loan of Rs. 10000/- initially for setting up rice processing business. Later, she started earning around Rs. 5000/- pm after repayment of installments and then she could repay the loan in a period of one year. Later she possessed a capital of Rs. 50,000 for enlarging business. Brihaspati wished to set motor garage for his son and continue her daughter’s education which could make her daughter eligible for higher education.

MCDF program helped Brihaspati in building up confidence and proved her as woman entrepreneur. Her success story is example for other women too of the rural SHG.

Source :Success Story of Brihaspati Bag under MCDF (Microfinance) Program. (2015). Retrieved from https://muktiweb.org/success-story-of-brihaspati-bag-under-mcdf-program

To Do Activity

Find any one success story related to Microfinance and discuss with the class in detail.

4.3 Microfinance and Livelihood Approach

Livelihood

Livelihood is a means of support, it is something which provides income for living, especially a paid work for securing necessities of life. Livelihood activities are economic activities which people know, undertake and own for earning today and in to future. Sustainable livelihood is one which could cope with, and recover from, shocks and stresses maintain or enhance its capabilities and assets while not undermining existing resource base.

Livelihoods activities are undertaken by the people are actually shaped by the following:

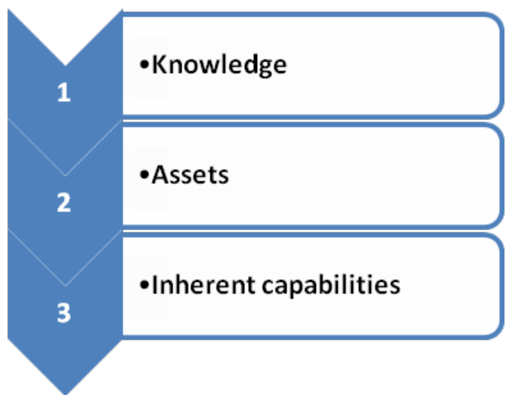

Figure 4.14 Livelihood activities

(1) Knowledge

People take up livelihood activities on the basis of the knowledge that they have. There are many tasks or jobs available which people could take up as their livelihood. The only thing required is to search for that particular task which is known to a person and then such a task could be taken up for the purpose of earning a living. Knowledge plays a very important role in helping a person to start earning more in their life. Training could also be obtained for doing a specific job but still there is a requirement that people should have some basic knowledge for doing a particular job.

(2) Assets

Assets owned by people could help them to earn for their livelihood. All assets are not earning in nature means they may or may not help in earning. But still there are some assets like owning a house, land, machinery, furniture, etc, these assets could help people in earning as they could be given on rent for some or the other purpose and people could earn for their livelihood. It is very important for people to buy assets so that they could utilize from the assets in future whenever they face any financial issue.

(3) Inherent Capabilities

The inherent capabilities within a person could also help them in earning a living. Some people are born with inherent capabilities which could be taught by them to others in the form of training or it could be used further in their own small business. The way a person works is different from the other people, so in case a person has a good art which could be related to any particular sector, it could be further developed and people could earn for a living from it.

These livelihood activities could be enhanced further by five basic assets which have linkage to each other. These basic assets are mentioned below:

Figure 4.15 Basic assets available to people

(1) Natural Capital

The natural resource stocks that people could draw on for their livelihood which includes forest, land, air, water, etc.

The following are the examples of natural capital:

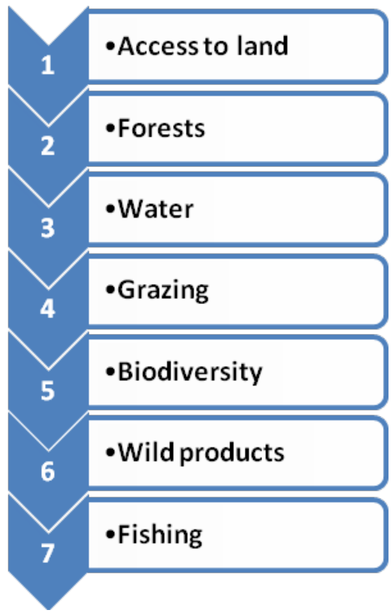

Figure 4.16 Example of Natural capital

(2) Social Capital

Social capital is taken to mean the social resources such as networks, social claims, social relations, affiliations, associations. In particulars, the poor they access within the networks and connectedness that increases people's trust and ability to work together and expand their access to wider institutions, such as political or civic bodies. Like the human capital, social capital also has intrinsic value; good social relationships are not only a means, but they are an end in themselves.

The following are the examples of social capital

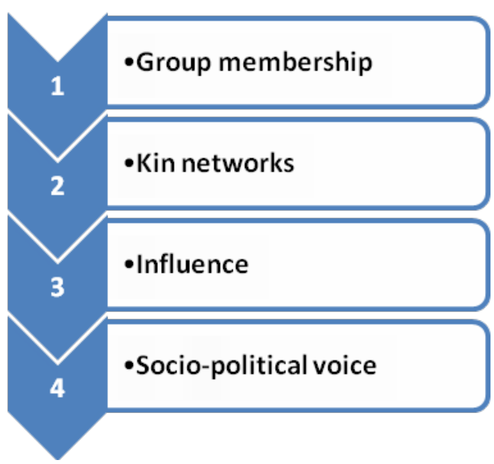

Figure 4.17 Example of Social capital

(3) Human Capital

Human capital involves the knowledge, skills, good health and working ability. Good health is not simply means to earn a livelihood, but it is an end in itself.

The following are the examples of human capital

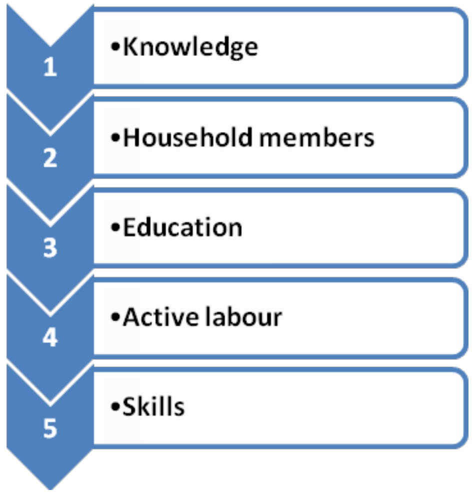

Figure 4.18 Example of Human capital

(4) Physical Capital

The basic infrastructure which people need for making a living, equipment and tools which are being used by people.

The following are the examples of physical capital:

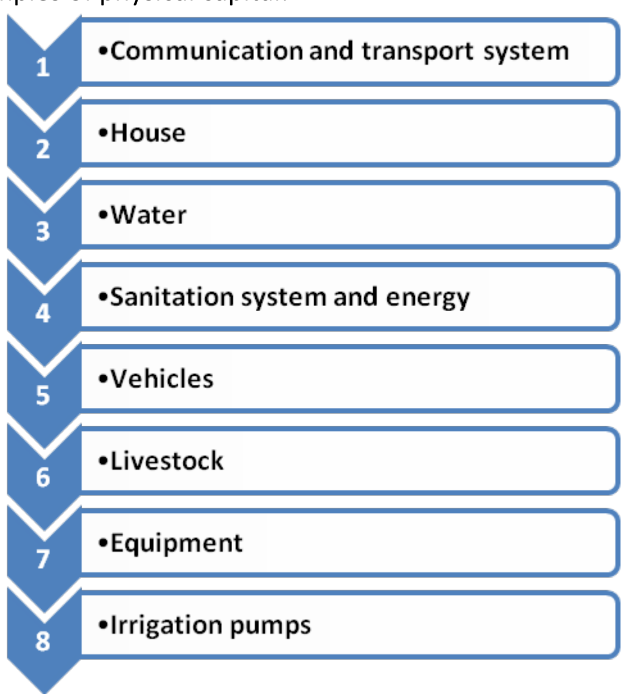

Figure 4.19 Example of Physical capital

(5) Financial Capital

Financial capital includes savings which could be in any form, access to financial services and regular money inflows. The following are the examples of financial capital:

1. Savings
2. Gold/ Jewelry
3. Debt
4. Credit
5. Income
6. Insurance

Figure 4.20 Example of Financial capital

An increase in one type of capital would lead to increase in other the amounts of capital, for example, as the education level (increase in human capital) of people increases, they might get better job and this would increase his or her earnings (increase in financial capital). Increase in financial capital would lead to upgradation of their home as well as facilities (increase in physical capital). Sometimes, however a form of capital could also decrease with the increase in another capital. For example, when a person or household sell their land for migrating to another city, in this case there is a decrease in physical capital and increase in financial capital.

Impact of Microfinance on Livelihood

Microfinance has a significant positive impact in changing of livelihood through reduction of poverty and this brings positive shift in attitude toward life and improvement in living standard. Through microfinance, people have gained in the following ways:

1. Increase their household income
2. Greater empowerment
3. Decrease economic vulnerability
4. Better nutrition
5. Better health facilities
6. Gain opportunity for pursuing education
7. Reduce or remove poverty

Figure 4.21 Impact of Microfinance on livelihood

MFIs are working towards betterment of people and supporting them in improving their livelihood. Microfinance is an important component of livelihoods approach that helps poor in improving their livelihoods through strengthening of natural, social, human, physical and financial capital. This approach includes the following:

- Giving salaried job to people and other opportunities for earning.
- Providing savings, loans and other financial services
- Providing training in jobs and business skills
- Developing alliances, institutions and networks for advance economic interest
- Promotion of social and policy changes which improves people's livelihood prospect

The Sustainable Livelihood Approach

The sustainable livelihood approach helps in improving the understanding about livelihoods of poor. It organizes factors that enhance or constrain livelihood opportunities, and show the way they are related. It could help in planning development activities and assessing contribution that the existing activities have made for sustaining livelihoods. Sustainable livelihoods approach improves the understanding of livelihoods of poor. It is a way of thinking about scope, objectives and priorities for the development activities. This approach is based on evolving thinking about the way poor people have been living. It helps in formulation of development activities which are the following:

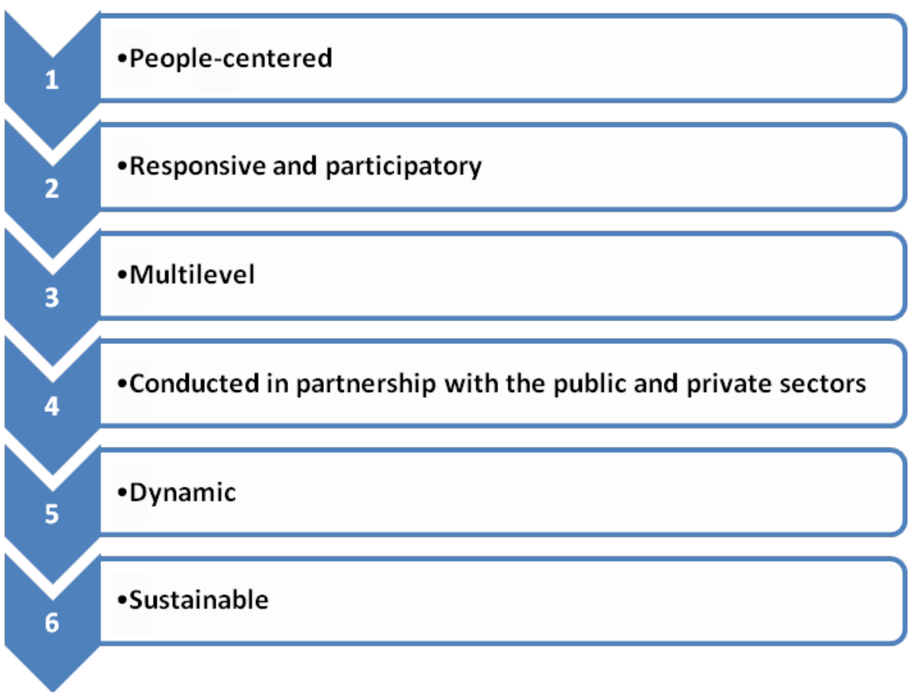

Figure 4.22 Features of activities which are part of Sustainable livelihood approach

Sustainable livelihood approach facilitates identification of the practical priorities for actions which are based on interest and views of those who are concerned.

Figure 4.23 The sustainable livelihoods framework

(1) Capital Assets

Sustainable livelihoods framework helps in organizing the factors which enhance or constrain the livelihood opportunities and show the way they are related to each other. It is a central notion that different households have access to different livelihood assets that sustainable livelihood approach aims towards expansion. Livelihood assets, which poor must often make choices about include natural, social, human, physical and financial capital.

(2) Vulnerability Context

Vulnerability could be characterized as insecurity in well-being of the following in facing changes in external environment:

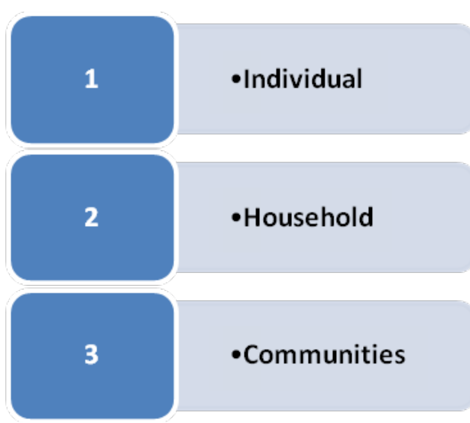

Figure 4.24 Vulnerability context

People are moving in and out of poverty and concept of vulnerability captures process of change better than measurement of poverty line. Vulnerability has two facets mentioned below:

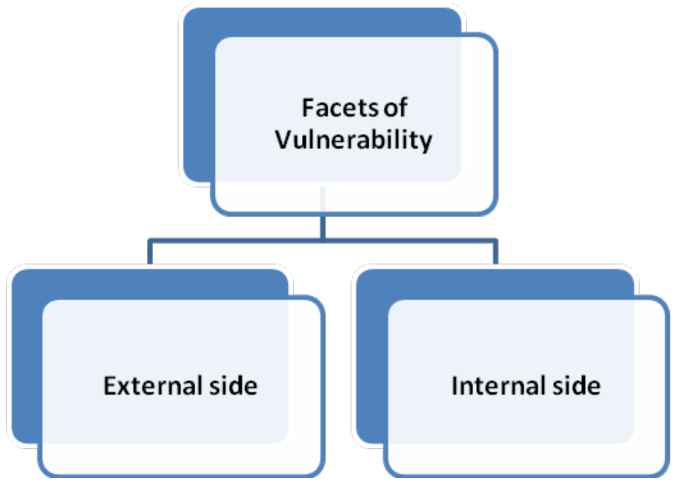

Figure 4.25 Facets of Vulnerability

(a) External Side

It is related to seasonality, critical trends and shocks.

(b) Internal Side

It is related to defenselessness which is caused by lack in the means and ability so as to cope with them. The vulnerability context includes the following

- Shocks like illnesses, conflict, storms, floods, pests, droughts, diseases
- Seasonality like employment opportunities and prices
- Critical trends like environmental, economic, demographic, technological trends and governance

(3) Policies and Institutions

Livelihood outcomes and strategies are not only dependent on access towards capital assets or constrained by vulnerability context; they are transformed by environment of processes and structures. Structures are public and private sector organizations which set and implement legislation and policy; deliver services; and trade, purchase, and perform all manner of the other functions which affect livelihoods. Processes embrace the regulations, laws policies, agreements, operational arrangements, societal norms, agreements and practices that in turn determine the way in which the structures operate. Policy-determining structure cannot be effective in absence of the appropriate institutions and processes through which policies could be implemented. Processes are very important in every aspect of livelihood. They provide incentive which stimulates people in making better choices. They deny or grant access towards assets. They enable people in transformation of one type of asset in to another through the markets. They have strong influence on the interpersonal relations. One main problem, the poor people and the vulnerable ones face is that processes which frame their livelihoods might systematically restrict them unless government adopts some other policy, in turn, filter down to the legislation and even to the lesser formal processes.

(4) Livelihood Strategies and Outcomes

Livelihood strategies aim towards achieving livelihood outcomes. Decisions related to livelihood strategies might invoke activities based on natural-resource, non-natural resources-based and the off-farm activities, remittances and migration, grants and pensions, diversification versus intensification, and long term versus short-term outcomes, some of these might compete with each other.

Potential livelihood outcomes could include the following:

1. •Increased well-being
2. •More income
3. •Improved food security
4. •Reduced vulnerability
5. •More sustainable use of natural resource base
6. •Recovered human dignity

Figure 4.26 Potential livelihood outcomes

Success Story - How Yashoda, Laxmi, and Prema became entrepreneurs thanks to microfinance

smaller amount of loan from organizations like Inditrade could often make big difference in lives of rural people i.e. Yashoda of Periyavoor, Tamil Nadu. She was concerned about her increasing household expenses and wanted to supplement her husband's income while taking care of children and her house. She realized that she could open small provisional store at her own residence. She knew many people around her; she actually knew what should be sold. At same time, she thought of taking care of the responsibilities she had at home. All she required was some financial support. Then she heard about Inditrade and approached company for loan. With loan of Rs 30,000 to Yashoda, she does an average business of Rs. 1500-2000 per day, which could provide her daily income of Rs. 300 - 800. Her children and her husband also helped her in managing the store. Yashoda had a dream of sending her children to good school. Her dream of providing good school education to her children came true with finance. From tasty pickle from Allepey or lac bangles from Hyderabad, most of the people are using products from small businesses of villages and smaller towns of India. More and more women are starting new ventures and this was possible due to loan given by micro-financing firms. For supporting small but ambitious women entrepreneurs, Inditrade Capital launched their micro-financing arm. This organization was catering to Tamil Nadu and Maharashtra in March 2017. This organization aimed towards expansion into other geographies like Kerala, Chhattisgarh, Karnataka and many other states in future. Inditrade (erstwhile JRG) is leading player in agri-commodity financing business in the southern India and it was incorporated in the year 1994. Over years, company forayed into the lending business (NBFC), insurance broking, commodity trading and microfinance.

Source : Sharika Nair (2017). How Yashoda, Laxmi, and Prema became entrepreneurs thanks to microfinance. Retrieved from https://yourstory.com/2017/11/yashoda-laxmi-prema-became-entrepreneurs-thanks-microfinance

To Do Activity

Visit website of any MFI and prepare a presentation about the products and services being offered by them and also about the impact that it has made on the livelihood of poor people.

4.4 Different Models of Micro-Finance

Micro finance is provision of credit and other financial services and products which are of small for the poor people to enable them in raising their level of income and improve their living standard. It has been recognized that microfinance helps poor people in meeting their needs for smaller credit and other financial services. The flexible and informal services offered to the lower-income borrowers to meet their modest livelihood and consumption needs have not only made the movement of microfinance grow at rapid pace, but also impacted lives of millions of poor people in a positive way.

In India, banking sector witnessed branch expansion on a large scale after the nationalization of banks in the year 1969, which facilitated shift in focus of banking from class banking to mass banking. It was realized that, notwithstanding wide spread of the formal financial institutions, these institutions could not cater to frequent and small credit needs of many poor people. This resulted in a search for some alternative reforms and policies to reach out poor people for satisfying their credit needs.

Beginning of micro finance movement in India can be traced by Self-help group (SHG) - bank linkage programme (SBLP) which was started as pilot project in the year 1992 by NABARD. This programme came out to be very successful and popular model of microfinance in India. Other approaches like micro finance institutions (MFIs) have also emerged subsequently.

Micro Finance Delivery Models

Non-availability of banking and credit facilities to underprivileged and poor segments of society have always been major concern. Accordingly, both Government and RBI the Reserve Bank have taken many initiatives from time to time as mentioned below:

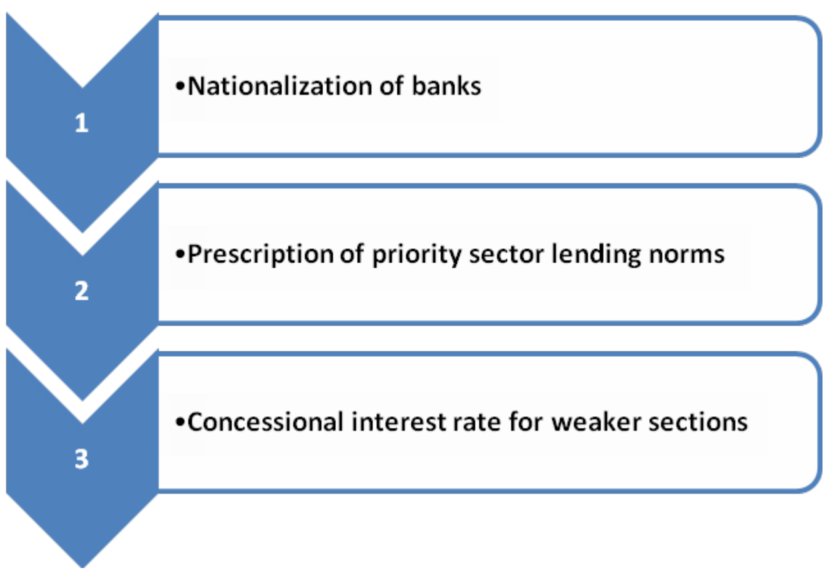

Figure 4.27 RBI and Government initiatives towards microfinance models

It was realized that further there was requirement of direct efforts for addressing credit needs of the poor people. In response to requirement of the poor, micro finance movement started with introduction of SHG-bank linkage programme in early 1990s. The SBLP model has emerged as dominant model in terms borrowers and loans outstanding. In terms of the coverage, this model has been considered as the largest micro finance programme. The RBI, SIDBI and NABARD have taken many initiatives for providing momentum to micro finance movement in India.

Various Micro finance delivery models have been mentioned below:

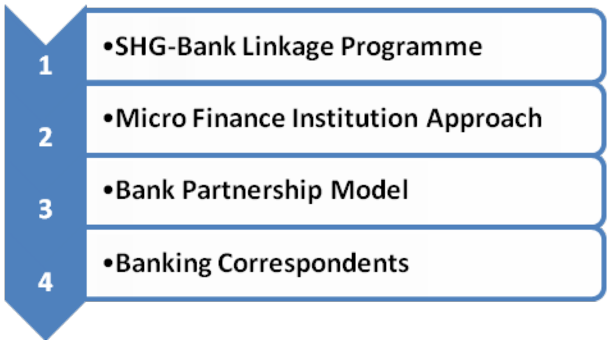

Figure 4.28 Micro finance delivery models

(1) SHG-Bank Linkage Programme

With SBPL, micro finance sector got recognized in India. Internationally, lots of consultative effort and groundwork was in progress since 1980s and this set a backdrop for microfinance efforts in India. The field of microfinance is diversified and is still evolving. There is no such single model or approach which fits in every circumstance. Concept of microfinance implies to flexible and informal approach to credit needs of poor. Every model is required to be tailored as per the local needs and circumstances.

Sixth General Assembly of Asia-Pacific Rural and Agricultural Credit Association (APRACA) which was held at Kathmandu, Nepal in the month of December 1986 considered project proposal on 'promotion of linkages between banking institutions and SHGs in rural savings mobilization and credit delivery to the rural poor'. It was decided at that moment that every member country was required to form a Task Force for conducting survey of the SHGs and thereafter suitable national level programmes were formulated. Consequent upon this, Task Force was setup in India in Ministry of Agriculture, for identifying existing SHGs, undertake survey of groups and draw an action plan for channeling flow of savings and credit between rural poor and banks through the SHGs and identifying concrete projects for action research. Accordingly, in the month of February 1987, it was decided that study team which was led by NABARD and comprised representatives from various financial institutions, were required to be constituted for undertaking survey. Survey was undertaken in the month of September 1987 and report discussed at 18th Executive Committee Session and 10th Foundation Anniversary of APRACA which was held at New Delhi in November 1987. This survey report actually laid foundation of SHG-bank linkage programme in India launched as pilot project in the year 1992.

NABARD launched a pilot after extensive consultation with RBI, commercial banks and non Governmental Organizations (NGOs) with following objectives:

i. Evolving supplementary credit strategies to meet credit needs of poor by combining sensitivity, flexibility and responsiveness of informal credit system with strength of administrative and technical capabilities and financial resources of formal credit institutions
ii. Building mutual trust and confidence between bankers and rural poor
iii. Encouraging banking activity, both on thrift and credit sides, in segment of population that formal financial institutions find usually difficult to cover

SHGs were expected for facilitating collective decision making by poor and providing 'doorstep banking', Banks as wholesalers of credit, were required to provide resources, while NGOs were to act in the form of agencies for organizing poor, building their capacities and facilitating process of empowering them.
This programme has come long way from pilot project for financing many SHGs across country. This model has proved its efficiency as mainstream programme for banking with poor people who come under different categories mentioned below:

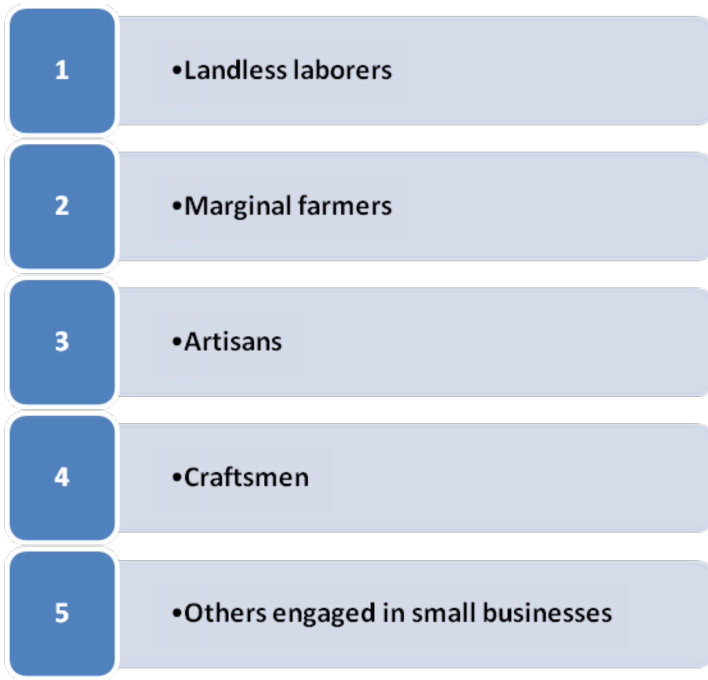

Figure 4.29 Categories of poor people for SHG-Bank Linkage programme

Other small category of poor people could include vending and hawking in rural areas.
This programme has various advantages, the main advantages are mentioned below:

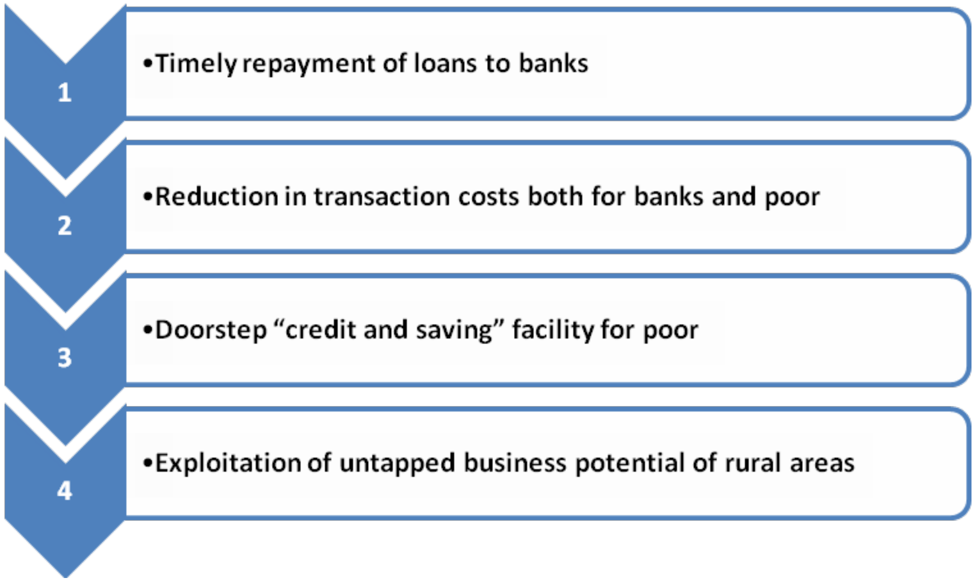

Figure 4.30 Advantages of SHG-Bank Linkage programme (SBLP)

This programme started as an outreach programme not only aimed to promote thrift and credit, but it also immensely contributed towards empowerment of rural women.
Under the SBLP, following three different models have emerged:

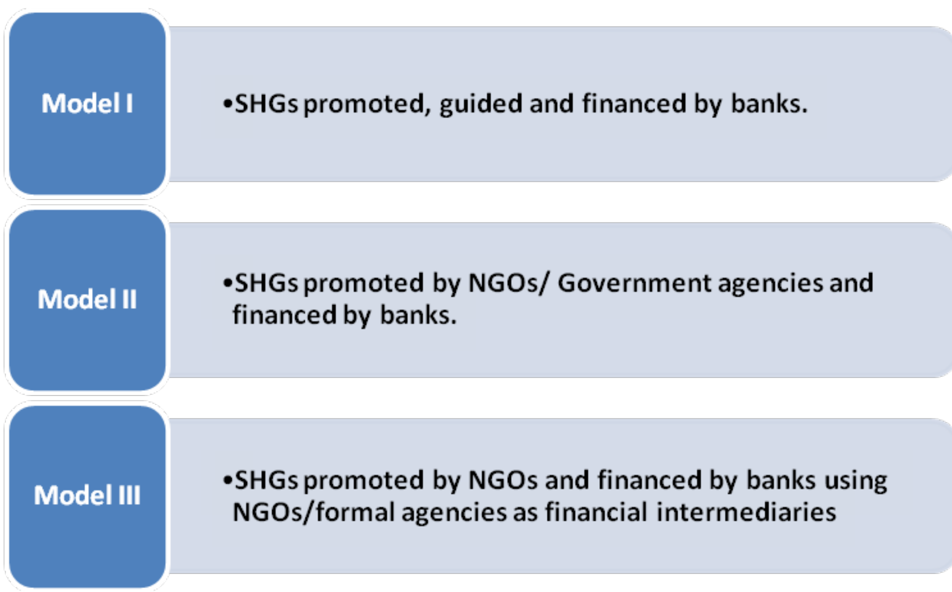

Figure 4.31 Models under SBLP

Model II has emerged as most popular model under SBLP programme. Regional Rural Banks, Commercial banks and co-operative banks have been actively participating in SBLP.

(2) Micro Finance Institution Approach

While SBLP model has remained most widely used microfinance model in India, MFI model has also gained momentum. MFI model in India is characterized by diversity of legal and institutional forms. Broadly, approach of RBI is emphasizing on informality of micro-finance and focusing on developmental aspects. Regulatory dispensation put in place by RBI seeks towards enabling enhanced credit flow from the banks through MFIs and could be refined further by RBI, as required. For bringing micro-finance entities under regulatory system through separate legislation, RBI felt that the microfinance movement across country which involved common people has benefited immensely through its flexibility and informality. Hence, their organization, methods of working and structure is required to be simple and any regulation would be inconsistent with core-spirit of movement. It was felt that ideally, NABARD or banks should devise appropriate safeguard locally in their own relationship with MFIs, taking into account different organizational forms of these MFI entities. The MFIs have been providing other non-credit services also like training, capacity building, products marketing of SHGs, micro-insurance, etc.

MFIs in India exist in various forms based on registration as mentioned below:

1. Trusts registered under Indian Trust Act, 1882
2. Public Trust Act, 1920
3. Societies registered under Societies Registration Act, 1860
4. Co-operatives registered under the Mutually Aided Cooperative Societies Acts of the States
5. NBFCs-MFIs registered under Section 25 of Companies Act, 1956
6. NBFCs registered with RBI

Figure 4.32 Forms of MFIs based on registration

These MFIs are actually scattered across country and due to multiplicity of the registering authorities, there is not much reliable estimate of number of MFIs which are existing.

Characteristics of Microfinance Institutions (MFIs)

1	•Increasing size and growth
2	•Delivery of non-credit financial services
3	•Varied organizational forms
4	•Different State Governments take varying approach
5	•Significant part of current microfinance activity is related to credit
6	•Technological development provides window for opportunity

Figure 4.33 Characteristics of Microfinance Institutions (MFIs)

(1) Increasing Size and Growth

The size of MFIs has been increasing and also growing, this seems to warrant clearer policy framework for covering operations in the financial services additionally to credit, in respect of both Bank-and NABARD-led micro-finance through SHGs and MFIs.

(2) Delivery of Non-Credit Financial Services

Delivery of the non-credit financial services like mutual funds and insurance by MFIs seem to be possible but as pre-condition, there is need for clear framework for approaching different regulators for the non-bank financial services by MFIs.

(3) Varied Organizational Forms

The organizational forms of MFI appear varied, though activities in many cases include non-financial services. The different forms of MFI have different legal framework and this is due to their organizational form.

(4) Different State Governments take Varying Approach

Different State Governments take varying approach towards MFI including subsidizing the interest rate. The spread and nature of micro-finance movement differ across States significantly.

(5) Significant Part of Current Microfinance Activity is Related to Credit

A significant part of the microfinance activity is actually related to credit, that is perhaps attributable towards both felt credit needs and absence of conscious policy thrust regarding non-credit related financial services.

(6) Technological Development Provides Window for Opportunity

Development in technology has been providing a window of opportunity for reducing transaction costs and thus enables microfinance in becoming a profitable activity and commercially viable.

Five Organizational Forms of MFIs

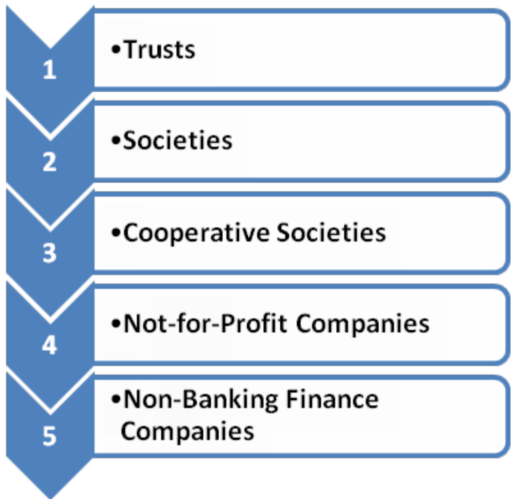

Figure 4.34 Organizational forms of MFIs

Under the NBFC model, NBFCs encourages villagers to form a Joint Liability Groups (JLG) and give loan to the individual members of JLG. Individual loans are jointly and severally guaranteed by other members of Group. Many NBFCs operating under this model started off in the form of non-profit entity which provides micro-credit and various other services to poor. However, since they found themselves unable in raising adequate resources for rapid growth of activity, they converted themselves into for-profit NBFCs. The others entered the field of microfinance as for-profit NBFCs, as they saw profit NBFCs more viable business proposition.

(3) Bank Partnership Model

Banks could use MFIs as their agent for the following activities of banks:

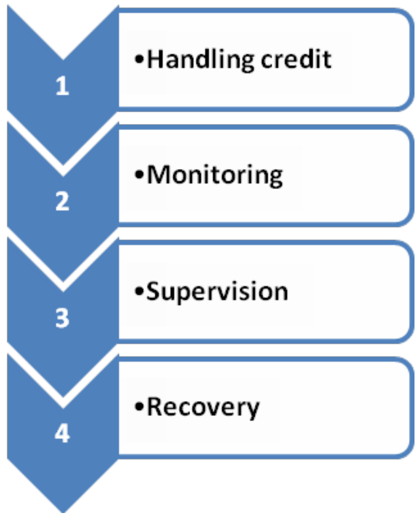

Figure 4.35 Bank activities handled by MFI under Bank partnership model

In this model, Bank is lender and MFI acts as agent to handle work items related to monitoring of credit, supervision as well as recovery, while borrower is an individual. MFI acts like an agent and it takes care of all the relationships with client, from the first contact through the final repayment. Another variation in this model is where MFI, an NBFC, holds an individual’s loan on it and books for a while, before securitizing and selling them to bank. Such refinancing through securitization enables MFIs greater funding access. In this system, banks use reach and viability of the MFIs for disbursal of loans to targeted population. MFIs as well as similar agencies act as mediator between bank and the end consumer. In this model MFIs for larger funding access hold borrower’s loan on its account for a certain period and refinance through means of securitization.

(4) Banking Correspondents

RBI has taken various initiatives over last few years to increase banking outreach and to ensure greater financial inclusion. Significant step towards financial inclusion was issue of RBI guidelines in the month of January 2006 to engage BCs by the banks to provide banking as well as financial services. Regulatory framework for BCs model have been progressively moving ahead for ensuring that consumer protection is not at all compromised while facilitating the enhanced outreach of banking services. Relaxation in regulatory framework was possible due to rapid changes in the technology, as in terms of Core Banking Solution (CBS) and relatively lower cost biometric handheld devices to ensure fraud prevention and authenticity.

BCs are retail agents those who are engaged by various banks for providing banking services at various locations besides bank branches and ATM. Banks those are adopting BC model are required to take complete responsibility for the acts of omission and commission of BCswhich they engage and ensure thorough due diligence as well as additional safeguards to minimize agency risk. Basically, the BCs enable bank towards expansion of outreach and offer a limited banking services range at lower cost, as setting up of brick and mortar branch which may not be viable. BCs are integral part of business strategy to achieve a greater financial inclusion.

To Do Activity

Discuss any one of the following organizational form in detail by forming groups of 4-5 students :

- Trusts
- Societies
- Cooperative Societies
- Not-for-Profit Companies
- Non-Banking Finance Companies

4.5 Challenges and prospects of micro financing in Rural India

There are many microfinance institutions who have been serving people in the rural areas. Some of these families are very poor and some could manage their livelihood in a better way. There are some challenges which are being faced by micro finance in India:

(1) Lack of information

There are many sources of credit information in our country, but none of them focus on small and rural borrowers. It becomes difficult for obtaining information about Credit information on these borrowers since majority of them rely on money lenders and other informal lenders for credit. Such lenders generally do not share information about the borrower’s record of good credit repayment to the other finance providers.

(2) Financial illiteracy

One major challenge in India toward growth of microfinance sector is the illiteracy of poor people. Due to illiteracy it becomes very difficult to create awareness related to microfinance among them and it becomes difficult to serve them in the form of microfinance clients.

Figure 4.36 Challenges of micro financing in India

(3) Heavy Dependence on Banks and Financial Institutions

MFI's are dependent on borrowings from banks and financial institutions. For most MFI's, the sources of funding are restricted to apex MFIs and private banks. In these banks which are available, the funds are typically for short term. There is tendency among some of lending banks and financial institutions for sanctioning and disbursing of loans to MFIs around end of accounting year due to their targets.

(4) Regional Imbalances

The growth of SHGs and MFIs is unequal geographically. There is concentration of SHG credit linkages more in the southern states. States which are having more number of poor people, the coverage of SHG is low. The regional imbalances are due to the following factors:

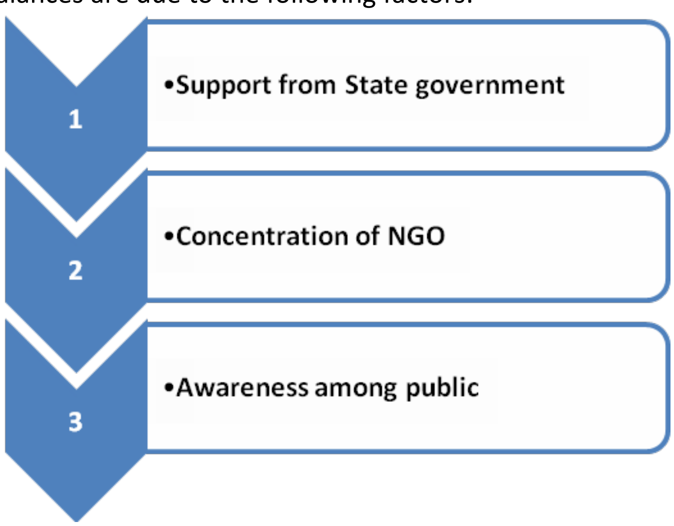

Figure 4.37 Reasons for regional imbalances of MFIs and SHGs

(5) Inability to Generate Funds

MFIs do not have the ability for raising sufficient funds in microfinance sector and this is a challenge. Though the NBFCs could raise funds through private equity investment as they are having profit motive, MFIs are restricted to accept public deposits.

(6) Interest Rate

MFIs charge very high rate of interest, which becomes difficult for the poor to pay. MFIs are private institutions and therefore there is a requirement that they remain economically sustainable. MFIs do not get any type of subsidized credit for lending activities and this is the reason why they require recovering even their operational cost from the borrowers.

(7) Weak Governance

There are many MFI's which are not willing to convert to corporate structure; hence they remain closed towards transparency and also improved governance, thus they are unable to attract capital. MFI's have been facing challenge to strike balance between business and social goals. Management need to adapt business models which are based on increased transparency and changing scenarios; and this would enable them to attract private equity fund and capital infusion.

Measures to Overcome Challenges

There are some measures which could help in overcoming challenges faced by MFIs while providing micro finance services for having sustainable development. These measures are mentioned below:

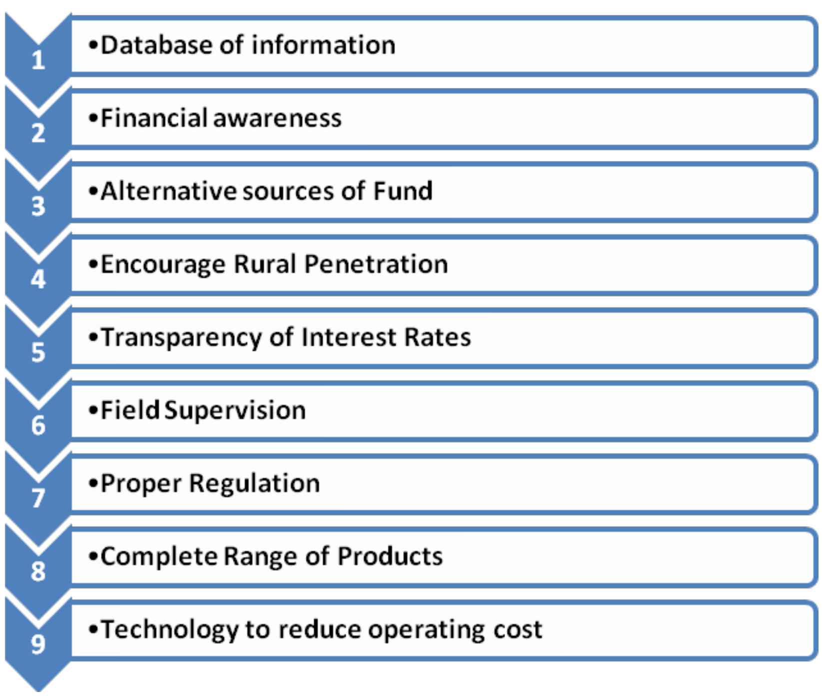

Figure 4.38 Measures to overcome challenges

(1) Database of Information

Data about the credit worthiness of the poor people should be well maintained. MFIs should help poor people in getting loans so that they do not need to go to the money lender for any kind of credit requirement. The people in rural areas tend to approach the money lenders, since they get funds easily from the money lenders without much documentation. The MFIs are formed for providing support to the poor people. It is a responsibility of the MFIs to ease out the procedure of sanctioning loans to the poor people.

(2) Financial Awareness

People living in the rural areas have lesser financial awareness. They are not self sufficient since their income is very low, some even find it difficult to meet their consumption needs. For requirement of funds, many of them approach informal way. It is very important that they are made aware about the formal ways so that they could easily take and manage their finances.

(3) Alternative Sources of Fund

In the absence of adequate funds, growth and reach of MFIs becomes restricted and for overcoming this problem MFIs should also try to find out some other sources of funds for funding their portfolio of loan. Various alternative sources of funds for MFIs might be created through conversion into for-profit company i.e. Portfolio Buyout, NBFC and Securitization of Loan etc.

(4) Encourage Rural Penetration

MFIs are opening branches in places where few MFIs are already in operation instead of focusing on reducing the initial cost. Encouraging MFIs for opening new branches in areas of low microfinance penetration by providing financial assistance will increase the outreach of the microfinance in the state and check multiple lending. This would increase the rural penetration of microfinance in state.

(5) Transparency of Interest Rates

MFIs have been employing different patterns to charge interest rate and few of them are charging additional charges and interest free deposits (which is a part of loan amount that is kept as a deposit on which no such interest is paid). All these conditions make pricing very confusing and hence borrower feels incompetent in bargaining power. So there should be a common practice to charge interest rate which should be followed by all the MFIs so that this makes sector more competitive and beneficiary gets freedom for comparing different financial products and services before buying them.

(6) Field Supervision

Field supervision could be adopted as medium to monitor conditions on the ground and corrective action should be initiated wherever required. This would keep an eye on performance of the ground staff of MFIs and also on their recovery practices. This would encourage MFIs for abiding by a proper code of conduct and work in an efficient way. However, problem of feasibility and also the cost involved in physical monitoring of microfinance sector remains an issue.

(7) Proper Regulation

When microfinance was in the growing stage and the individual institutions were free for bringing in innovative operational models, the need for regulatory environment was not much of concern. However, in the current stage, when there have been years this sector has been working and has been performing well, there is a need of regulatory environment for protecting interests of stakeholders and promotion of growth.

(8) Complete Range of Products

The MFIs functioning in India should provide variety of products as mentioned below:

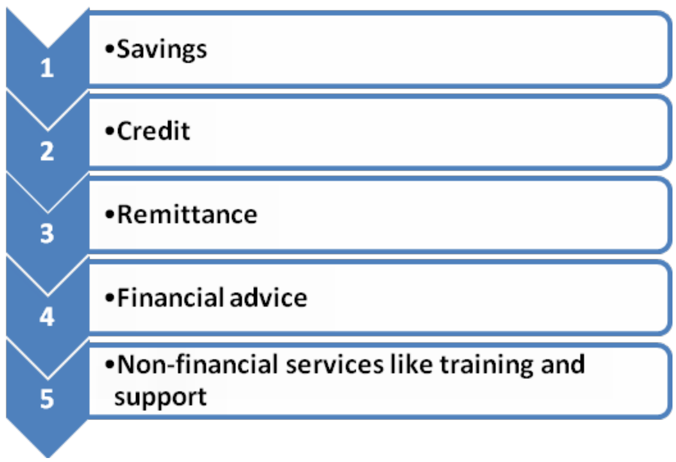

Figure 4.39 Range of products of MFIs

MFIs are acting as substitute to banks in different areas where people are not having access towards banks, have been providing a complete range of products which would enable poor people for availing all services.

(9) Technology to Reduce Operating Cost

MFIs should use IT tools, applications and new technologies for reducing their operating costs. MFIs should be encouraged for adopting cost-cutting measure for reducing their operating costs. Also initiatives such as development of common Management Information System (MIS) and other software for MFIs could be taken for making operations more efficient and transparent.

Prospects of Microfinance

Microfinance programmes have witnessed phenomenal growth in past years. These programmes have been helping the poor people in many different ways. However, focus of most of microfinance service providers have remained on expansion of outreach of microfinance programmes with little attention related to quality, depth and viability of financial services. Besides removal of these problems there is lot which could be done in this field for making this programme more effective. Some future prospects of micro financing have been discussed below:

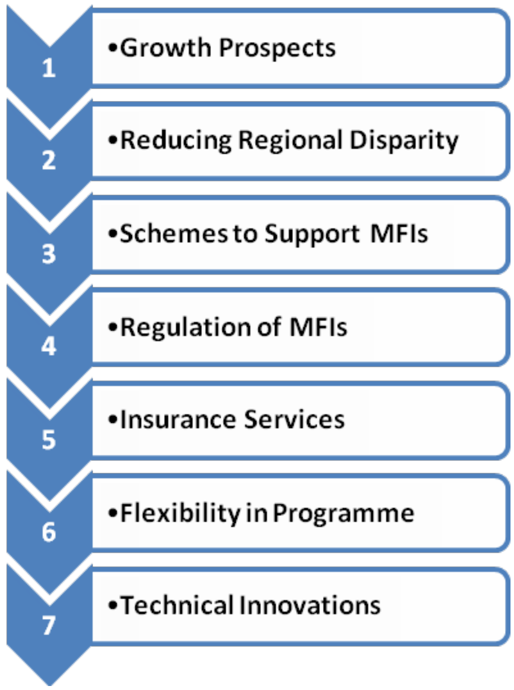

Figure 4.40 Prospects of Microfinance

(1) Growth Prospects

Microfinance programmes have wider prospect towards expansion both about depth and outreach of the services provided. Microfinance has covered many households through its microfinance programmes, but still there are poor households to be covered. Still there is ample scope for covering the unreached people belonging to the poor households. The average amount of loan being provided to SHG members under its various schemes is not a bigger amount and this amount could meet only the liquidity requirements and are not sufficient in helping people to start productive activities. There is lot of demand for credit among the poor people and there is a vast demand which is still unmet, hence there is lot of scope for growth of MFIs and also microfinance service providers. For expansion of microfinance

Programmes; the SHGs may be linked with post offices for credit disbursement to rural poor by utilizing vast network of post offices in the rural areas.

(2) Reducing Regional Disparity

Spread of the microfinance programme is not equal among various regions and the spread is limited in poorer states. So, there could be ample scope for spreading microfinance programmes in unreached areas which includes poorer states. However, taking steps towards this direction, NABARD has identified few states for scaling up microfinance programmes so as to reduce regional disparity. These priority states are mentioned below:

1. Assam
2. Bihar
3. Chhattisgarh
4. Gujarat
5. Himachal Pradesh
6. Jharkhand
7. J & K
8. Maharashtra
9. Madhya Pradesh
10. Odisha
11. Rajasthan
12. Uttrakhand
13. Uttar Pradesh
14. West Bengal

Figure 4.41 Priority states as defined by NABARD

These states have a large number of poor people and these people could not be reached by microfinance programmes. There were special efforts put in by NABARD which resulted in increase in number of SHGs credit linked in these states. Growth rate in the states is much higher as compared to growth at the national level but is not increasing as compared to previous years. Therefore there could be some other measures which could be taken up by NABARD for eradicating regional disparities in coming future.

(3) Schemes to Support MFIs

MFIs play a very important role for reaching poor people who have not been served by formal financial institutions. But there are many such institutions which are restricted by RBI for collecting savings from their own members and raise public funds. It becomes difficult to determine financial health of these institutions since they don't publish their financial reports annually. Therefore, formal financial institutions hesitate in providing loans to these institutions. As a result, MFIs face paucity of funds and this becomes a hurdle for them to expand microfinance programmes. For tackling problem, there are some schemes could be adopted for providing help and support for capacity building of the MFIs for expansion of various microfinance programmes.

(4) Regulation of MFIs

There are various entities like mutual benefit societies, co-operative societies or mutually aided societies etc. which are engaged in microfinance activity. These entities are guided by different laws under which these are registered. Lack of single regulatory authority restricts orderly growth of the microfinance sector. Keeping regulatory problems in view, Indian government has proposed legislation and formulated bill for regulation and development of microfinance sector. The MFIs should be regulated under the same regulatory authority, so that they could be regulated properly. In case of any kind of offence by the microfinance organizations, redressal mechanism as well as disputes settlement is very important and this is possible in case all the MFIs are regulated by single regulator.

(5) Insurance Services

In India, penetration of the insurance services among the rural poor people is limited and there is great potential for same. Moreover, the poor people are very much vulnerable to natural uncertainties and insurance plays a very important role for them. Network used for the microfinance programmes could be used for tapping potential of insurance in the rural markets. Microfinance Institutions, Self-Help Groups and Non-Government Organizations can be used as micro-insurance agents. They could offer target specific insurance products at relatively lower cost, for lower coverage of the amount. Micro-insurance would facilitate penetration of insurance to remote and rural areas. However, some NGOs are providing accident, crop and life insurances in our country, but there is a requirement that these services are expanded.

(6) Flexibility in Programme

Some main features of microfinance programme include regular group meetings, compulsory savings, record maintenance etc. These bindings lead to exclusion of the core poor people from joining microfinance programmes. Therefore, for expansion of outreach of programme to poorer people, there is need for introducing more flexible system. A Project in Orissa enabled poor for saving in kind and raising resources against such savings and providing access towards participative food, self-managed and security system. Under this project, SHG members could save and get credit both in the form of cash and kind which depends on their convenience. Such flexibilities in microfinance programmes might increase affordability and access of rural poor.

(7) Technical Innovations

For improving quality of the microfinance services there is a requirement of technical innovations. Electronic devices are also being used for expansion of outreach and improve functioning of microfinance.

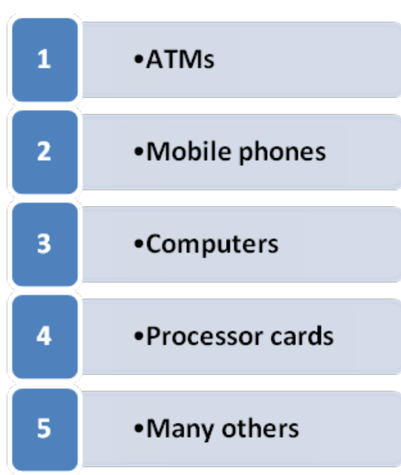

Figure 4.42 Technical innovations in microfinance

(1) ATMs

ATMs are very helpful in facilitating saving, loan and payment transactions in remote rural areas where it becomes difficult for opening bank branches.

(2) Mobile Phones

Mobile phone provides rural poor borrowers with the communication facility.

(3) Computers

A computer with operator helps illiterate group members in maintaining records of group's financial activities. Computers can be used for providing important information which is related to crop inputs, weather conditions, land records, products prices, etc. in villages.

(4) Processor Cards

Processor cards are being used to keep records of the group activities like loans, savings and other financial transactions. They help in reducing paper work and save time for bank officials. These innovative techniques in the microfinance sector have been playing a very important role and have improved the functioning of the microfinance sector.

To Do Activity

Ask the students to form group of 4-5 members and ask them to select any one challenge and any one prospect of micro-financing and present them before the class using examples.

Microfinance covers many services which includes savings, money transfer, insurance, counseling etc apart from credit provision. In India, Micro finance started in the early 1980s. It involves Non-Government Organizations (NGOs) and self-help groups (SHGs) that come together to provide credit and savings service to people who do not have access towards formal banking system. Micro finance organizations have been undertaking activities from perspective of development in various areas and they do not focus on profit. These organizations are getting support by government bodies like Small Industries Development Bank of India (SIDBI) and National Bank for Agriculture and Rural Development (NABARD). There are some trusts which are set up specifically for making funds available to people who are in the lowest level in the society. Microfinance has evolved due to efforts of the committed individuals and many financial agencies for promoting self-employment and contribution towards poverty alleviation and provisioning of social security. India has developed its own model of microfinance organizations in form of savings and credit groups which are known as Self Help Group (SHGs) that are bank-linked. These SHGs are formed and managed by poor people and these bring social change and lead to empowerment. In India, most microfinance institutions attempt in going beyond savings and credit groups for providing microfinance services which could be in the form of insurance and savings. Many people believe that microfinance is about providing smaller loans (microcredit) to families who are very poor for helping them to get engaged in productive activities or nurturing their tiny businesses. Livelihood is a means of support, it is something which provides income for living, especially a paid work for securing necessities of life. Livelihood activities are economic activities which people know, undertake and own for earning today and in to future. Sustainable livelihood is one which could cope with, and recover from, shocks and stresses maintain or enhance its capabilities and assets while not undermining existing resource base. Micro finance is provision of credit and other financial services and products which are of small for the poor people to enable them in raising their level of income and improve their living standard. It has been recognized that microfinance helps poor people in meeting their needs for smaller credit and other financial services. The flexible and informal services offered to the lower-income borrowers to meet their modest livelihood and consumption needs have not only made the movement of microfinance grow at rapid pace, but also impacted lives of millions of poor people in a positive way. There are many microfinance institutions who have been serving people in the rural areas. Some of these families are very poor and some could manage their livelihood in a better way.

Model Questions

- Discuss the phases of evolution of microfinance sector.
- Which poverty alleviation programmes were initiated by the Indian government?
- What are the products provided by MFIs to poor people?
- Discuss the needs of poor people for credit facilities.
- Discuss the features of activities which are part of Sustainable livelihood approach.
- What are the basic assets available to poor people? Discuss in detail.
- Explain Micro-finance delivery models in detail.
- Discuss about the different organizational forms of MFIs.
- Explain the challenges being faced by the micro-finance industry.
- Discuss the prospects of micro-financing in rural India.

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Chapter 5 – Rural Insurance and Finance Schemes at local level

Introduction

Institutional innovation is promoting insurance among the lower income people. Although current reach of 'micro-insurance' is limited and early trends in, suggested that insurance companies, both private and public, that are operating with commercial consideration could insure significant percent of poor. Serving the low-income people who could pay premium certainly makes sound commercial sense for the insurance providers. Imposing rural and social obligations by the insurance regulator i.e. Insurance Regulatory and Development Authority (IRDA) have been helping all the insurance companies in appreciating vast untapped potential for serving lower end of market. However, it has become increasingly clear that the micro-insurance need further push as well as guidance from government and regulator. The income of the poor people is irregular and uncertain they need flexibility in collection for extending micro-insurance net widely. Moreover, the MFIs play significant role for improving lives of the poor households. Linking the micro-insurance with micro-finance makes a better sense since it helps in bringing the lending cost down. There is a need to strengthen the link between micro credit and micro-insurance.

Micro insurance is protection of people who belong to the lower income group against some specific perils in exchange for the regular premium payment proportionate to their likelihood and cost of risk involved. Lower income people could use micro insurance which is available as one such tool which is designed for the people belonging to the poor families.SHGs have been promoting smaller savings among the members. The savings of SHGs are generally kept with bank. The common fund is kept in bank in SHG's name. SHGs utilize their common fund for giving smaller loans to the members. SHG is informal group and it is registered under the Societies Act or State cooperative Act.

NGOs have played a very important role in promotion of SHGs which includes conception of its design. SHGs have been associated with many development programmes. This resulted in creation of social capital as well as promotion of the social auditing process through SHGs. Despite this association, understanding of NGOs on role of SHGs seems to be limited mainly because grant-in-aid project of NABARD and government have visualized limited role for them as well as financial support was accordingly provided. However, SHGs act as vehicles for promotion of savings and delivery of credit. They also appreciate and recognize their strength for taking up development challenges in our country. When SHGs are provided with a comprehensive input and vision by NGOs, they have shown positive impact which has been encouraging on economic, political and social life of target communities. Thus, role of NGOs is very crucial in entire process of promotion, strengthening and development of SHGs in making them into proactive, self-sustainable, people's institutions and thus sustain democratic process of development.

Objectives of the Chapter

- To explain need, purpose and importance of Rural Insurance

- To familiarize various types of micro insurance policies being offered to rural people
- To know about Micro Finance credit schemes
- To comprehend the working of Self Help Groups and Non-Government Organizations
- To evaluate the SHG-Bank Linkage Programme

Chapter Structure

5.1 Rural Insurance

5.2 Micro Insurance scheme

5.3 Micro Finance credit

5.4 Self Help Groups and Non-Government Organizations

5.5 SHG - Bank Linkage Programme

5.1 Rural Insurance

Rural insurance ensure that the people living in the rural areas have secure and safe future so that they could have happy life. Insurance helps them in covering risks which is related to different aspects of their lives. Rural Insurance policies which are being offered to the poor people are available at affordable premium and they have faster claim processing. Rural insurance is created for rural public for insuring their businesses like farming, cattle, poultry etc. Individuals could claim benefits, if there is crop loss or when their animals die.

The people residing in the rural areas are suffering from financial instability. It becomes very difficult for them to face such a huge loss when there is crop loss or some problem occurs in their small businesses. Considering the financial instability of people, there are many schemes launched by government so as to help people in securing their current as well as future. Such schemes are integrated with Rural Development Programme and they are funded by Central and State governments. According to section 32 B and section 32 C of Insurance Act, 1938, the insurance companies are expected that they provide a certain percentage of businesses to the people belonging to the following sectors:

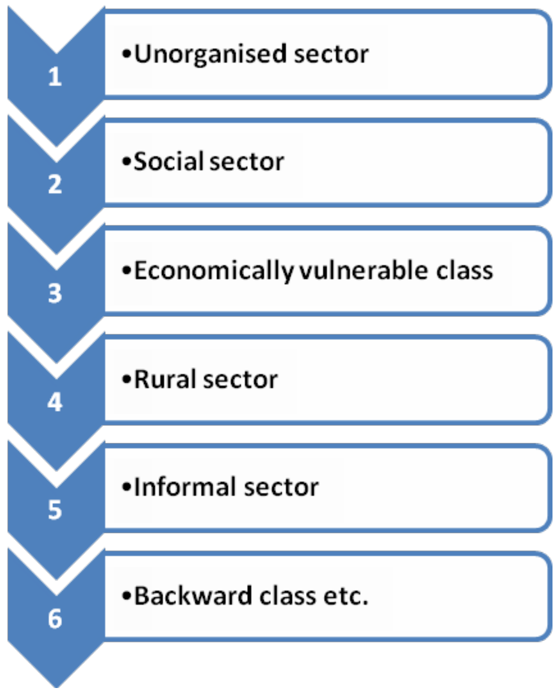

Figure 5.1 Sectors to be focused for providing insurance by Insurance companies

It is mentioned by Insurance Regulatory and Development Authority of India (IRDAI) as per section 32 B and 32 C, the insurance companies are required to underwrite their business equal to a minimum of 2% of total gross premium for the first fiscal year, at least 3% of the total gross premium for the second fiscal year, and at least 5% of the total gross premium from the third fiscal year onwards in the rural sector.

In India, Insurance is not much bought by people of rural areas. Often general insurance is bought due to some compulsions under law or from financiers since they ask for insurance as a collateral security. There is lesser compulsion in case of life insurance. The people in the rural areas should also consider buying life insurance policy. There is a need that people in the rural areas are made aware about the problems that would occur in case of death of a person. Generally families in the rural areas are dependent on agriculture for their livelihood and in many families there might be just one earning member and the death of the only earning member could result in huge problems for the families after his or her death. Majority population in the rural areas are not having life insurance cover and they are also subjected to weaker social security and also pension systems which do not have much security for old age. This indicates that there is growth potential for insurance sector in the rural areas. Though Government have taken steps for promoting rural insurance for many decades in this field, still there are many who do not have any insurance policy in the rural areas.

One of the priorities to forecast expansion of the rural insurance is to identify productive potential and also specific insurance needs in rural areas which have not yet been reached by the insurer and enhance cooperation between rural credit, insurance and rural credit institutions or agencies. Buying behavior of the rural consumers is influenced by income levels, distributions and the marketer's efforts on the promotional activities. The marketing of rural insurance should be different for the people in the rural areas as compared to the urban areas.

Need and Purpose of Rural Insurance

The purpose and need of insurance as method of transferring risk for providing economic protection against losses which may be due to various uncertain events. Example of some uncertain events is given below:

1	•Death of cattle
2	•Death of poultry
3	•Property loss due to burglary, theft etc
4	•Health issue
5	•Failure of crop
6	•Flood
7	•Lightning
8	•Fire
9	•Earthquake
10	•Any other economic losses

Figure 5.2 Need of Insurance for rural sector

The risk or loss may or may not occur during operative time of insurance contract. People opt for insurance mainly for reasons of uncertainty in their life. Insurance helps people in reducing tensions, since the quality of being efficient would improve when fears and tensions of rural people involve risks are shifted to insurer and financial status of the farmers and other rural people remain unaffected by losses caused by risks insured. The rural working population enjoys a better credit standing as risks are transferred to insurance company. Insurance also provide an opportunity for investment since life insurance policies provide maximum benefit of investment and protection since event which is insured is sure that it will happen thus life insurance investment has been offering attractive returns. Insurance sector has been playing a crucial role in tackling unemployment problem through which employment opportunities are being offered to many educated people living in rural areas. There are many people in the rural areas who have been working as insurance agents. Some rural insurance schemes are also offering attractive returns on savings that helps to increase regular savings of the people and it also provide funds to meet various needs like child's education, marriage, and many others.

Importance of Rural Insurance

The economy is very dynamic in nature and situations are changing very quickly, this indicates that future is unpredictable, immeasurable and uncertain. Though the needs of the people could be different in the urban and rural areas, needs of people in the rural areas should be covered through various types of insurance plans. There are various risks which are being faced by people in the rural areas like farmers and other people in the rural community. Insurance plays a very important role in handling risks and is accepted universally. Rural insurance provide protection against the occurrence of various uncertain events like loss from rain, flood, crop failure, drought etc. Rural insurance helps in elimination of risk and also sharing losses. It is not necessary that the risk which is covered under the insurance plan will actually happen. But insurance plays a very important role in reducing stress related to the occurrence of the event like when a person is engaged in farming, there are many risk involved in it and due to any natural or unnatural uncertainty the crops could get damaged. There are many types of insurance schemes which are available and are being provided by many insurance companies.

People in the rural areas are engaged are different business like fishing, poultry, farming, cattle rearing and there could be many other small businesses. Different types of insurance plans are available which covers different business and people could buy these insurance plans as per their business. The risk may not happen but the policy holders pay premium regularly and share burden of loss. Thus, loss which is suffered by a person spreads over whole insured community. The occurrence of risk could not be prevented, but the impact of risk could be minimized through the spread of loss among many policyholders.

Factors Affecting Life Insurance Purchase

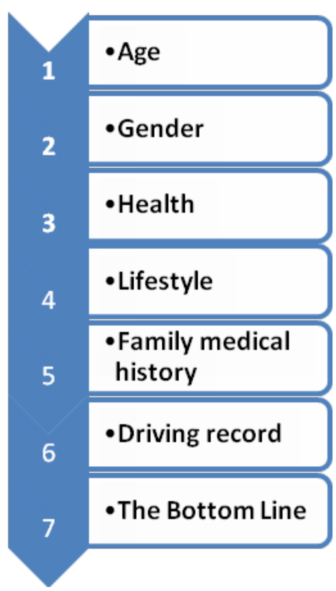

Figure 5.3 Factors affecting purchase of Life Insurance

(1) Age

A person should invest in any insurance plan at the right age. The amount of premium varies with the age and when a person is young, the chances are more that the premium will be paid for a long run to the insurer rather than getting the amount back. Insurance policy should be bought at the right age, and it is very important for a person to buy an insurance policy when he or she is the only earning member rather than when a person is just studying and does not have any financial dependents. There are many types of insurance policies which are available and it depends upon the reason for which the policy is being taken. The same person could invest in insurance policy at different ages for different purposes.

(2) Gender

Insurance premium also varies with the gender. In many families in the rural areas, the male of the family might be the only earning member and it becomes very important for the person to invest in Insurance plan, as their family is dependent on them. Many a time people who belong to poor families do not realize the value of insurance and do not invest in it, and they later realize when some mishap happens in their surroundings. The insurance companies should encourage people to understand the reason of getting insured, so that atleast the earning member of the family could get insured at the right time and right age.

(3) Health

Underwriting process in the insurance policy for most carriers include medical examination in which company records various characteristics of the following:

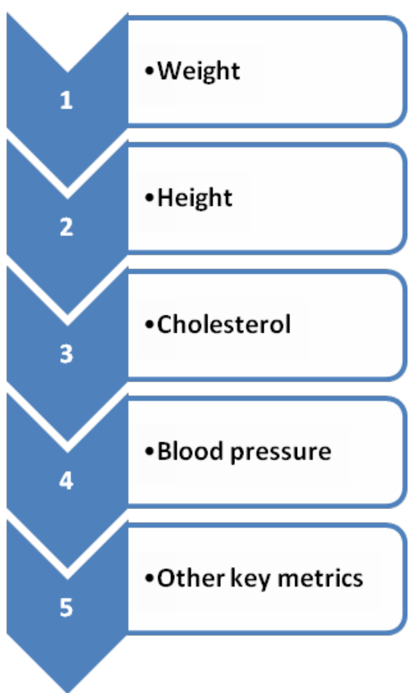

Figure 5.4 Characteristics of individuals recorded during medical examination

There are some tests which could be a part of medical examination like EKG or ECG for checking about heart in certain cases. It is very important to understand whether a person who is willing to get insurance policy is suffering from any serious condition like diabetes and high cholesterol. Medical checkup is very important before a person is applying for an insurance plan.

(4) Lifestyle

The lifestyle also plays an important role in decision related to insurance premium. In case a person is engaged in a high risk job, then the chances of an early end will be more, in such a case an insurance company might charge more premiums as compared to a person who is engaged in less risky job. Some insurance companies might charge a higher premium from people engaged in fishing, mining or transportation.

(5) Family Medical History

The family medical history also plays an important role. Though a person could not do much about the risk which a person is exposed to due to family history, but the amount of insurance premium might vary with the ailments as mentioned in family history. Family history of cancer, stroke or any other serious medical condition might predispose to various ailments and could also lead to higher premium. The insurance companies are interested in knowing the conditions which have been faced by parents or siblings or are being faced, since this will indicate the problems or health issues that the person who is being insured might face in future. Insurance companies are keener in knowing in case any health issue has caused any kind of premature death in their family. Some companies put more emphasis on knowing family's health than the others and this would impact on the premium amount which will be required to be paid.

(6) Driving Record

Many life insurance companies also look at the driving record during underwriting process. The companies check whether a person who is getting himself or herself insured regarding the violations related to traffic rules. Sometimes even the motor vehicles records are checked to understand whether there is any record registered against a person. In case there is any case registered, the companies check whether the driving habits have been improved or not.

(7) The Bottom Line

The life insurance premium is based on many factors. Some of these factors are even beyond a person's control. When a person is buying an insurance policy, a person should try to compare the policies which are available and then should choose the policy which best fits a person based on the factors.

Functionality of Rural Insurance

It is very important that people of rural areas should also understand the way insurance functions. The following points indicate the functionality of rural insurance:

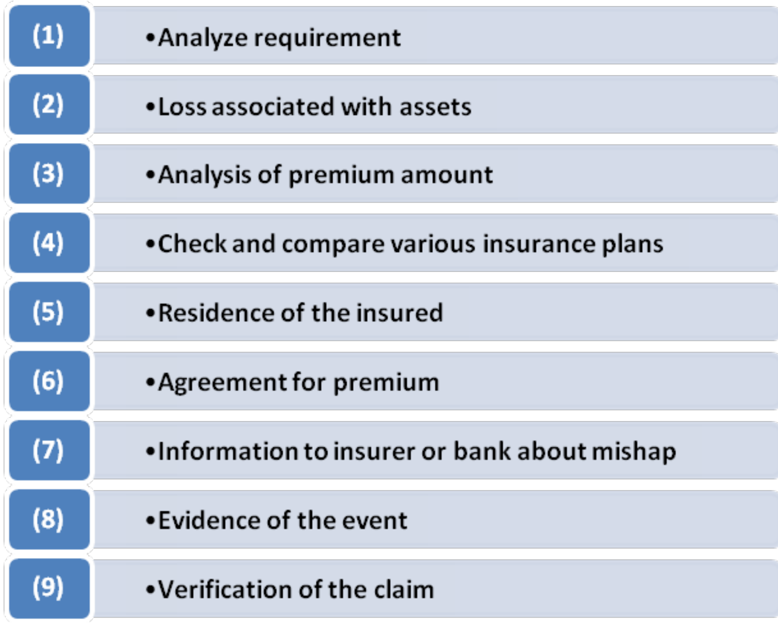

Figure 5.5 Functionality of Rural Insurance

(1) Analyze Requirement

A person should analyze the requirement that he or she has before opting for any insurance plan. The different insurance companies are offering various plans having different type of cover, and the amount of premium also varies with the cover the policy covers. It is very important that the person who is interested in buying any insurance plan should actually understand the requirement and then only a person should choose from the options of policies available.

(2) Loss Associated with Assets

Loss associated with the assets also plays an important role while choosing an insurance policy. The loss may be more or less associated to an asset. People deal with different assets and every asset is exposed to a different level of risk.

(3) Analysis of Premium Amount

The amount of premium which is required to be paid also matters a lot as a person has to pay insurance premium for a long time. Different insurance companies are charging different premium and hence a person should choose amongst the plans being offered by the insurance companies. The premium amount also varies due to the cover of the policy and it is very important that the insurance policy is chosen wisely.

(4) Check and Compare various Insurance Plans

The insurance companies are offering various plans which have a different objective for the people. It is very important that the companies who are offering rural insurance should create some kind of awareness among the people and should also try to train their employees to help the people belonging to the rural areas in deciding the best plan that suits their current and future needs. A person who is interested in buying an insurance plan should actually check the plans being offered not only by a single company rather by all the companies and also should compare the plans which could be best suited for them.

(5) Residence of the Insured

The residence of the applicant is checked before providing any insurance policy, whether the area of residence comes in rural area, else rural insurance policy could not be offered to the applicant.

(6) Agreement for Premium

The premium amount of the insurance plan needs to be agreed mutually by the insured and the insurer. The amount of premium also depends on livestock and property details of the insured and accordingly the premium amount is fixed.

(7) Information to Insurer or Bank about Mishap

The insured should inform about the mishap immediately to bank or the insurer so that further action could be taken within a sufficient time period. It is very important that the insured while taking a plan should be informed about all the formalities that will be required before applying for a claim. Sometimes due to ignorance, people find it difficult to claim for the sum assured as they inform late or they are not aware about the way to inform.

(8) Evidence of the Event

For claiming the amount of sum assured, it is very important that the evidence of the event is provided to the insurer. The documents required as evidence of event could include duly filled claim form, FIR report or any other document as required needs to be submitted to the insurer.

(9) Verification of the Claim

The claim is required to be verified by the bank officials. If the claim is found authentic, then it gets settled else it could get rejected. Some documents which are required to be submitted to insurance company for making claims are mentioned below:

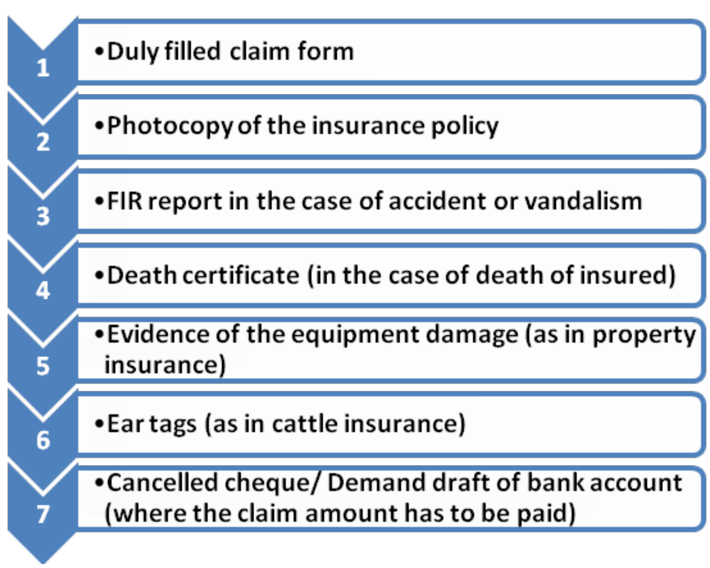

Figure 5.6 List of documents for making claims to insurance company

Advantages of Buying Rural Insurance

Insurance is social device where policy holders shift the specific risks to which they are exposed to the insurer.

Figure 5.7 Advantages of Buying Rural Insurance

(1) Encourages Savings

The rural insurance plans encourage savings, since the insurance policy would collapse in case the insurance premium is not paid on time. Thus, life insurance policy could be considered as a compulsory form of savings. Policies like pension scheme, child's education provides a sense of security to poor policyholder and these ensure social welfare.

(2) Supply of Money

The amount of premium which is paid by people helps in supply of money. The amount collected as premium from the policy holders narrows down the inflation gap in economy.

(3) Improving Credit Standing of the Farmers

Rural insurance helps the farmers in improving the credit standing of the farmers as crops and the other agriculture assets which are insured are accepted easily as securities for loans by the commercial banks as well as other financial institutions.

(4) Easy to Understand Plans

The plans which are being offered to the people in the rural areas are actually very easy to understand. It is very important for the insurance companies to design easy policies for the people in the rural areas and should also train their employees to make extra efforts in helping poor people in understanding the policies which are being offered.

(5) Low Premium

The amount of premium of rural insurance is low so that people in rural areas could afford to pay the amount. Insurance is important for all the people whether they are living in the urban areas or the rural areas.

(6) Compensate for Monetary Losses

The insurance plan helps in compensating the monetary loss which is covered under the plan. Insurance plays a very important role and it is not only important to buy life insurance but also to buy general insurance, as it will help in protecting the asset which is a part of earning of the household.

(7) Make People Independent

The insurance plans are also helping people of the rural areas in becoming independent. People who are engaged in whichever business can take an insurance plan and this will reduce the amount of stress that they might feel their business could bring in. Insurance plans encourage them to work independently.

(8) Customized Needs

The plans which are being offered by the insurance companies are customized as per the need of the customers. The needs of people in the urban area are different as compared to the rural areas. Insurance plans are designed by keeping in mind customized needs of the rural India.

(9) Useful for Agriculture and other Associated Activities

It is very useful for the people who are involved in agriculture and other associated activities.

To Do Activity

Ask the students to form a group of 2-3 members and visit website of an insurance company and try to find out the features of the rural insurance policy being offered by that company.

5.2 Micro Insurance Scheme

Micro insurance is protection of people who belong to the lower income group against some specific perils in exchange for the regular premium payment proportionate to their likelihood and cost of risk involved. Lower income people could use micro insurance which is available as one such tool which is designed for the people belonging to the poor families. Micro finance schemes are designed based on certain features as mentioned below:

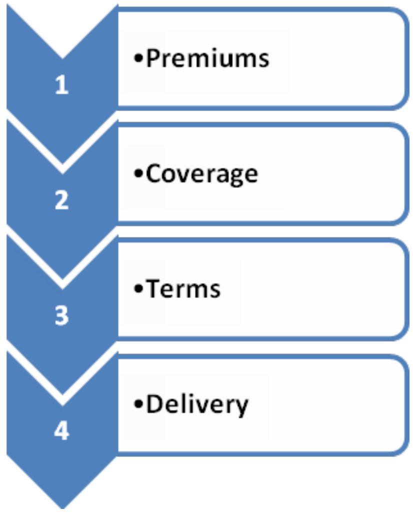

Figure 5.8 Features of Micro Insurance

Micro insurance helps people in managing risk being faced by them. Generally, micro insurance is understood as a low premium policy which is being offered to poor people, but there are many factors which are being faced by the people residing in the rural areas who actually need insurance to save their future. Micro insurance policies are designed taking into consideration the following characteristics of the rural population:

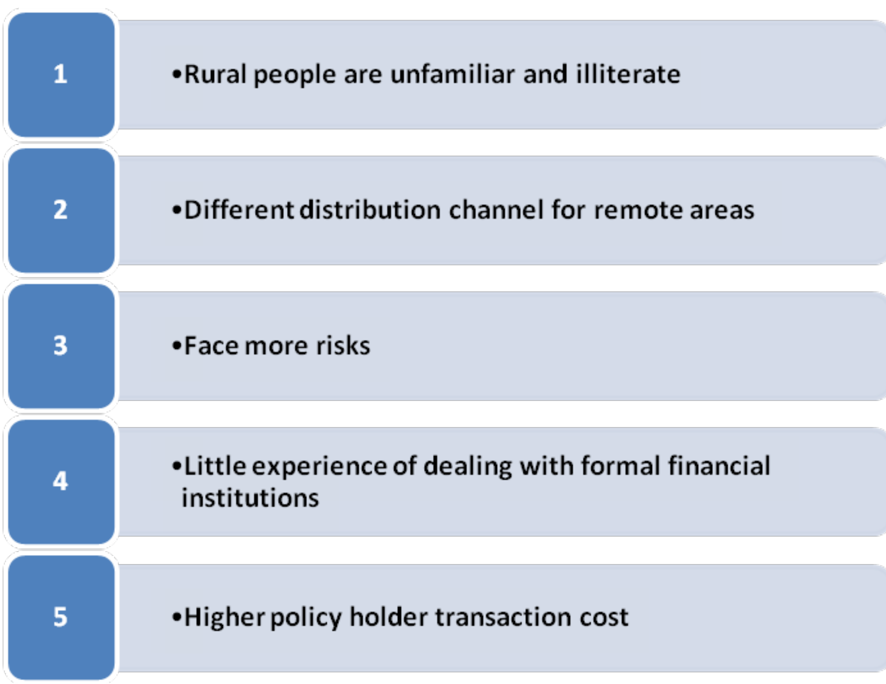

Figure 5.9 Characteristics of rural population which impact designing of insurance policy

(1) Rural People are Unfamiliar and Illiterate

The people living in the rural areas are mainly unfamiliar and illiterate. They are not aware about the concept of insurance. It becomes very important for the insurance companies offering micro insurance to adopt a new approach for marketing of insurance policies among the people who belong to the lower income group.

(2) Different Distribution Channel for Remote Areas

The people who are living in remote areas are different in terms of many factors like education, living standard, paying capacity and many others; hence the distribution channel which is being adopted in the urban areas should be different as compared to the rural areas.

(3) Face More Risks

The people in the rural areas face a lot of risk as compared to the wealthy people since they could not face the same defense. People in the rural areas are more prone to illness, some of them work under hazardous conditions, do not have medical checkups regularly and there are many others risks which exist in the rural areas.

(4) Little Experience of Dealing with Formal Financial Institutions

The people in the rural areas are not much experienced in dealing with the formal financial institutions with exception to NABARD linkage banking programme. The formal financial institutions should also try to approach the people of the rural areas in a different way, and even their employees should be well trained so that they could assist the people of rural areas to invest in micro insurance, as it is very important for them and even people in the rural areas could be safe and secure from any mishap.

(5) Higher Policy Holder Transaction Cost

For a person belonging to the rural areas, taking an insurance policy might involve higher transaction costs. There are many formalities which are required for claiming an amount from the insurance company. A person belonging to middle or upper class, find it easy to send claims form, making a call quickly to the insurance company, receive claims through post, and then completing any other formality as well. It becomes difficult for a poor person to complete all these formalities with ease as they involve extra cost besides the real cost involved in the insurance policy. The micro insurance policies are designed as per the requirement of the poor people and it requires a lot of intensive work.

Socio-Economic Profile of the Micro Insurance Clients

The profile of micro insurance clients which is socio economic in nature could be described through points mentioned below:

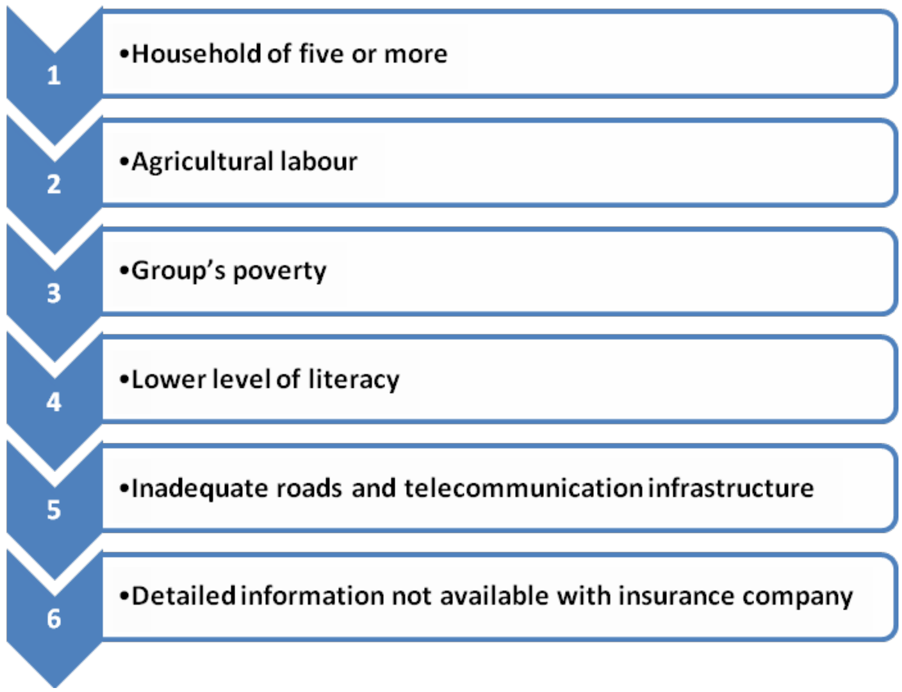

Figure 5.10 Socio-economic profiles of the micro insurance clients

(1) Household of Five or More

The people in the rural areas are having five or more members in their family. They share income and also access towards financial services. This has a very important implication on access towards micro insurance. One member, who is having access to the insurer, could purchase policies on the behalf of another member of household.

(2) Agricultural Labour

The main source of income in many rural households is agriculture. The agricultural income is seasonal and irregular. All the households in rural areas are not engaged in agriculture, they are also engaged in multiple livelihood activities which have off-farm income as one of the components. The premium which is collected for micro insurance should also take into account the variance in seasonal income as it will become difficult for the people to pay premium on regular basis without having a regular income.

(3) Group's Poverty

Group's poverty means that the people in the rural areas are having a higher than the average risk profiles various types of insurance. There are many other causes of higher rate of disease and death in the rural areas:

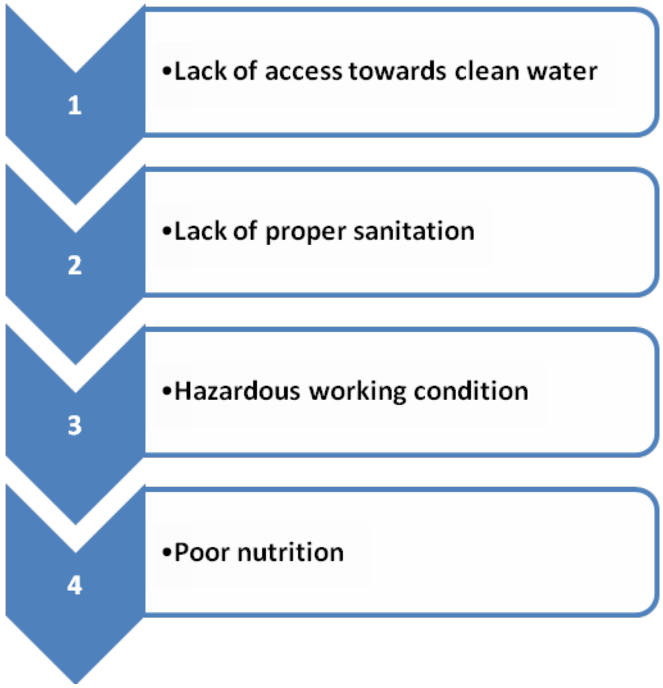

Figure 5.11 Causes of higher rate of disease and death in rural areas

(4) Lower Level of Literacy

Lower level of literacy implies that marketing is required to be done without written media; instead other mass media should be used as mentioned below:

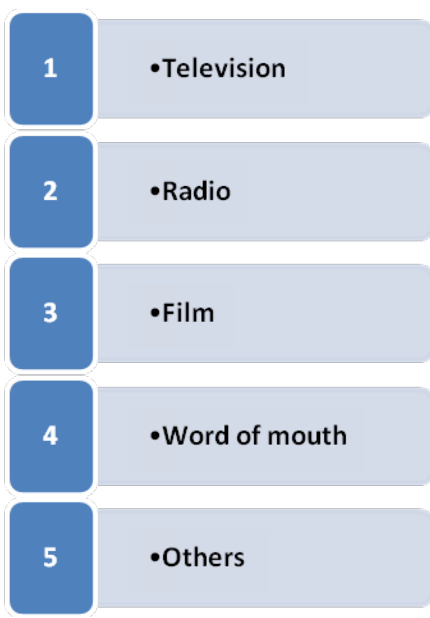

Figure 5.12 Preferred mass media for people in rural areas

(5) Inadequate Roads and Telecommunication Infrastructure

The people in the rural areas often do not have adequate facility of road and telecommunication infrastructure, which increases cost of servicing and selling policies. The other crucial implication of this is massive gap in specific socio-economic data about this target group. This makes rate-making very difficult.

(6) Detailed Information not Available with Insurance Company

The insurance providers are trying to find out data from the current insurance companies which are dealing in insurance in the rural areas for their own assessment. As such sufficient data is not available for assessing specific situations being faced by the lower income and poor people.

Classification of Micro Insurance

Insurance companies have been offering different kind of policies for covering various kinds of loses and for providing security against different risks. The insurance policies could be further classified into Life and Non-life insurance.

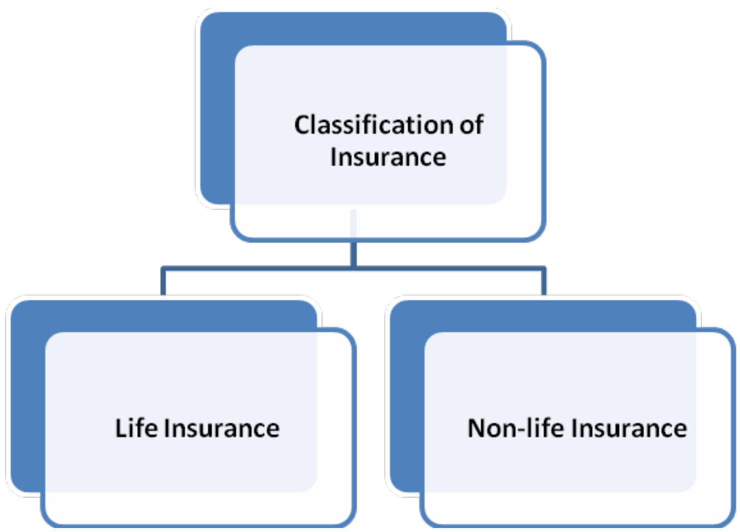

Figure 5.13 Classification of Insurance

(1) Life Insurance

Life insurance is agreement between the policy holder and insurer, wherein the insurer promises to pay a particular sum of money in exchange for premium, upon death of insured person. Life Micro-Insurance product can be referred to as term insurance contract with or without the return of premium, any kind of endowment insurance contract or there are various other types of plans which are being offered by the insurance companies. The insurance plans could be with or without any accident benefit rider and it could be based on either individual or group basis. There is flexibility in the regulations for the insurers. Life insurance pays benefit to the designated beneficiary upon death of insured. Life Insurance policy could be further classified into the following:

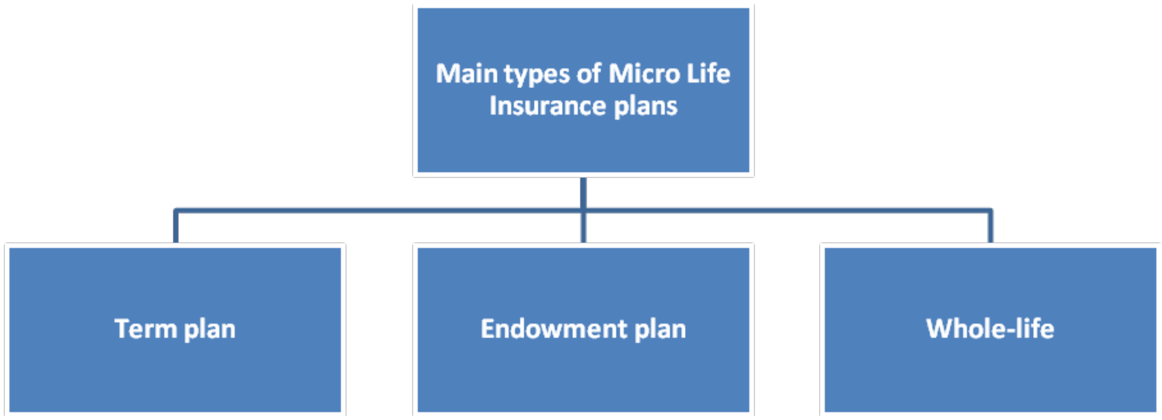

Figure 5.14 Main types of Micro Life Insurance plans

(a) Term Plan

Term life insurance policy provides set amount of insurance coverage over specified time period like one, five, ten, or twenty years.

(b) Endowment Plan

In this policy, the face value of insurance policy is paid in case death of the policy holders occurs within a certain specified period.

(c) Whole-Life Plan

In this type of insurance plan, the cash-value of the policy provides protection for lifetime. This is hardly offered in the low-income market in developing countries.

(2) Non-Life Insurance

Non-life insurance is agreement between the policy holder and insurer, wherein the insurer promises to pay a particular sum when some mishap happens to the item which gets destroyed or damaged and the reason needs to be as per the terms and conditions of the policy. The most frequent micro insurance products have been mentioned below:

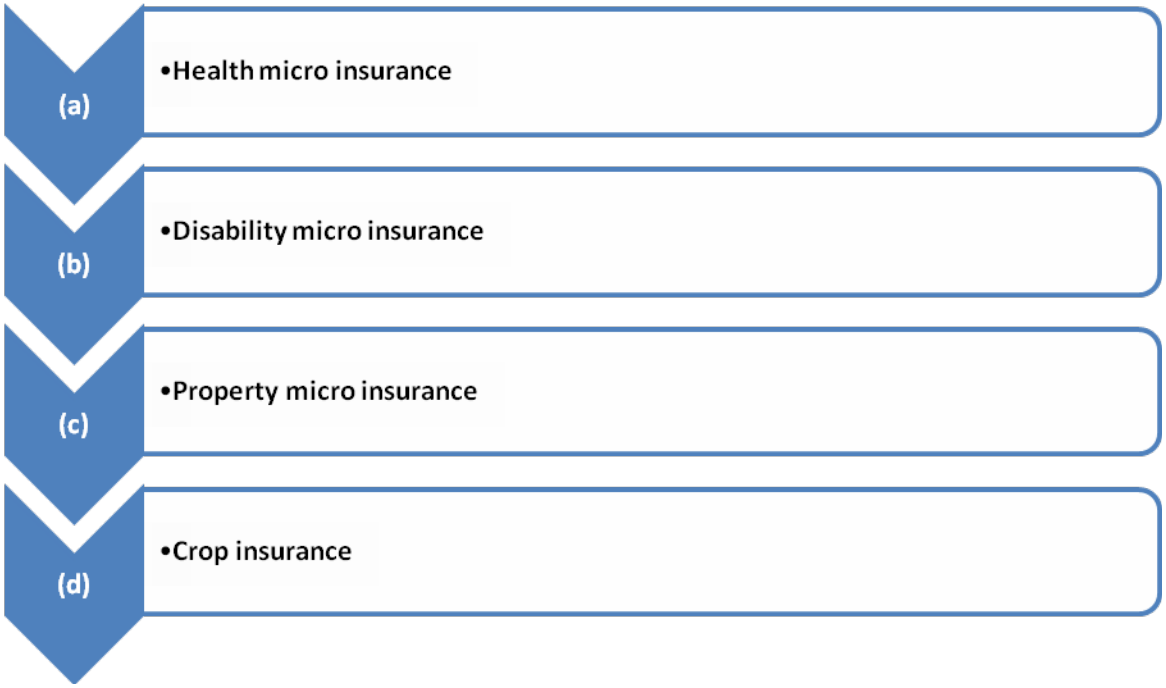

Figure 5.15 Non-life insurance products

(a) Health Micro Insurance

Health insurance policy is agreement between insurer and policy holder, in which insurance company agree to provide a specified health insurance benefit to the insured in consideration of fixed price which is called premium payable which is payable either at regular intervals or in lump sum. Health insurance could provide coverage against illness as well as accidents resulting in physical injuries. MFIs have realized that the expenditures which are related to health problems have been significant cause for defaults and the people's inability to continuously improve their economic conditions. Many MFIs have either started their own health insurance plans or they have linked their clients to the existing programs.

Health micro insurance includes insurance for the following:

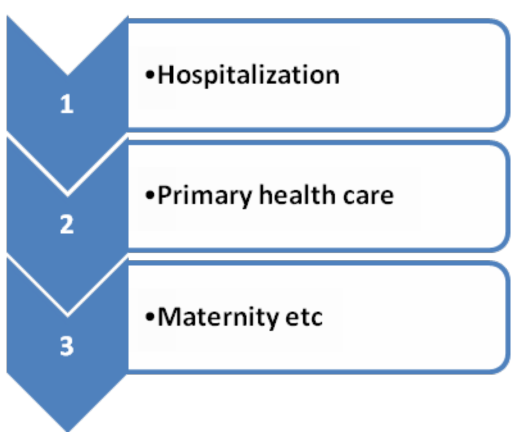

Figure 5.16 Health micro insurance

(b) Disability Micro Insurance

Disability insurance in most of the cases is actually tied to the life insurance products. This plan provides protection to policy holder and his or her family once the insurer or the family member suffers from any kind of disability. Suicides are excluded and it reduces the moral hazard problems. Mortality rate is often easier to be obtained than the rates of various types of illnesses. Death certificate or identification of corpse makes claim verification very easy. With one-time payout, system becomes relatively easier for administration. Vast majority of all the micro insurance products are related to life. Poor people are exposed frequently towards hazardous jobs and hence there is significant demand for disability insurance in India.

(c) Property Micro Insurance

Property micro insurance includes the following types of micro insurance:

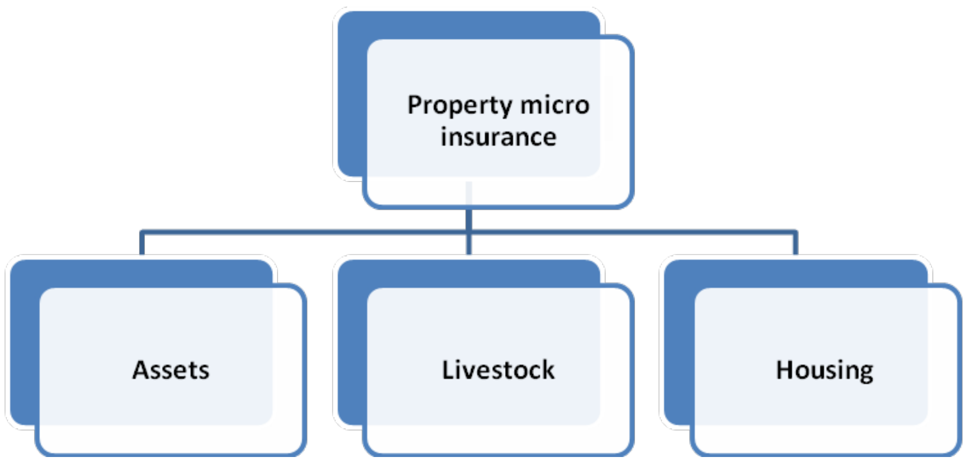

Figure 5.17 Property micro insurance

(i) Assets

Property insurance provides insurance against insolvency and it also covers loss in property due to theft, burglary or house-breaking or for any other criminal act. Property insurance provides coverage against damage or loss of assets. It is difficult to provide such insurance because there is a need for verification of extent of damage and determining whether loss has occurred actually or not.

(ii) Livestock

Livestock insurance has fared better in India. This type of insurance has not been very successful as livestock is slaughtered by the insured and there is more chance of fraud in livestock insurance. Sometimes the farmer kills the animals owned by him and then tries to get claim from the insurance company. Another major difficulty of livestock insurance is a moral hazard. One defense against moral hazard is a veterinarian should be used for checking the health of animals on regular basis or for conducting an autopsy after the death for ensuring whether the animal is being looked after in a proper way.

(iii) Housing

Housing is where a person's heart, mind, body and our soul reside. It is place of peace, happiness and warmth and a place where every individual spends most of their time. Housing insurance policy is a way to protect from the unexpected dangers. A good housing insurance policy protects your home externally and it also covers assets and valuables owned by an individual along with structure.

(d) Crop Micro Insurance

The agricultural producers purchase a crop insurance policy for protecting themselves against loss of their crops due to some natural disaster or loss in revenue due to fall in prices of agricultural commodities. Crop insurance provides protection to the policy holders in event their crops get destroyed by certain natural calamities like droughts or floods. For improving ability of the rural farmers for repaying loans from the agricultural development banks (ADBs), certain crop insurance plans were developed by the government also. Crop insurance is also sold through NABARD which is an apex institution. There are very few private insurance companies who have been providing crop insurance to the lower income consumers.

Initiatives by Government in the field of Micro-Insurance

Schemes from Jan Dhan to Jan Suraksha

For creation of universal social security system for all the Indians and especially focusing on poor and under-privileged, the Hon'ble Prime Minister launched three Social Security Schemes in Insurance and Pension sector on 9th May 2015.

Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY)

The PMJJBY is available for people in age group of 18 - 50 years who are having bank account and give their consent for joining / enabling auto-debit. Aadhar is primary KYC for bank account. Life cover is of Rs. 2 lakh is for one year period stretching from June 1st to May 31st and is renewable. Under this scheme, risk coverage under this particular scheme is Rs. 2 lacs in case of death of insured. Premium is Rs. 330 per annum which gets auto-debited in one installment from subscriber's bank accounts as per option given by him on or before May 31st of each annual coverage period under this scheme. The scheme which is being offered by LIC and all other life insurers who are interested in offering products on similar terms with approvals necessary and tie up with the banks for this particular purpose. As on March 31st, 2019, the cumulative gross enrollment as reported by the banks subjected to verification of eligibility, etc. was over 5.91 crores under PMJJBY. 145763 claims were registered under PMJJBY out of which 135212 have been disbursed.

Source: https://financialservices.gov.in/new-initiatives/schemes

Pradhan Mantri Suraksha Bima Yojana (PMSBY)

This Scheme is available to people who are aged between 18 to 70 years with bank account who gives consent for joining / enabling auto-debit on or before May 31st for coverage period from June 1st to May 31st on annual renewal basis. Aadhar would be primary KYC for bank account. Coverage of risk under this scheme is Rs. 2 lacs for accidental death and full disability and Rs. 1 lakh for the partial disability. Premium of Rs.12 per annum gets deducted from account holder's bank account through an 'auto-debit' facility through one installment. As on March 31st, 2019, cumulative gross enrolment reported by the Banks subjected to verification of eligibility, etc. was over 15.47 crores under the PMSBY. 40,749 Claims were registered under the PMSBY out of which 32,176 which have been disbursed.

Atal Pension Yojana (APY)

This scheme is open for all savings bank/post office savings bank account holders aged between 18 - 40 years and contributions differ, which is based on pension amount chosen. Subscribers would receive guaranteed minimum monthly pension of Rs. 1,000 or Rs. 2,000 or Rs. 3,000 or Rs. 4,000 or Rs. 5,000 at age of 60 years. Under this scheme, monthly pension would be available to subscriber, and after him, his spouse will be eligible to his spouse and on their death, the pension corpus, which gets accumulated at the age of 60 of subscriber, will be returned to nominee of subscriber. Minimum pension would be guaranteed by Government. In this scheme, if accumulated corpus which is based on contributions earns a lower return than the estimated return on investment and it is inadequate for providing minimum guaranteed pension, Central Government would fund such inadequacy. Alternatively, in case the returns on investment are higher, subscribers would get an enhanced pension benefit. As on March 31st 2019, 149.53 lacs subscribers have been enrolled under this scheme with total pension wealth of Rs. 6,860.30 crores.

To Do Activity

Ask all the students to select any one form of micro insurance available for the rural people and explain the date of introduction of that policy, coverage, eligibility and the other details about the plan. This task needs to be done individually and not in groups.

5.3 Micro Finance Credit

Microfinance has been regarded as tool towards economic development having an objective to assist poor people so that they could work their way out of poverty. Microfinance covers many services including savings, insurance, money transfer, counseling etc apart from provisioning of credit. The micro finance institutions have been working for the betterment of poor people and have been providing them credit for various purposes. People belonging to the low income group hesitate to apply for credit in the formal financial institutions and it becomes very important that they get assistance from the MFIs for getting support for their credit needs. People in the rural areas are also having various needs like productive needs as well as consumption needs.

The main clients of MFIs are lower income people who are not having access toward formal financial institution for their credit needs. Microfinance clients could be either self-employed or they own a small household based small business. In rural areas, clients could be small farmers and also others who are engaged in small income generation activities like food processing or petty trade. Access towards the conventional formal financial institutions for various reasons is directly related to income and the poor people do not have much access towards the financial products being offered by the formal institutions. MFIs could help the poor people in increasing their income, helping them to build viable business and also reduce their vulnerability towards an external shock. It could act as a powerful instrument for empowering people who belong to poor families and even MFIs have been helping women to become an agent for economic change. Microfinance plays very important role to fight against various aspects of poverty through access towards financial services. Income which generates from business not only helps in expansion of business, rather also contributes towards household income, betterment of standard of living and also provides other benefits like education of children, security of food etc.

Features of Loans being Provided by MFIs

The following are the features of the loans which are being offered by MFIs:

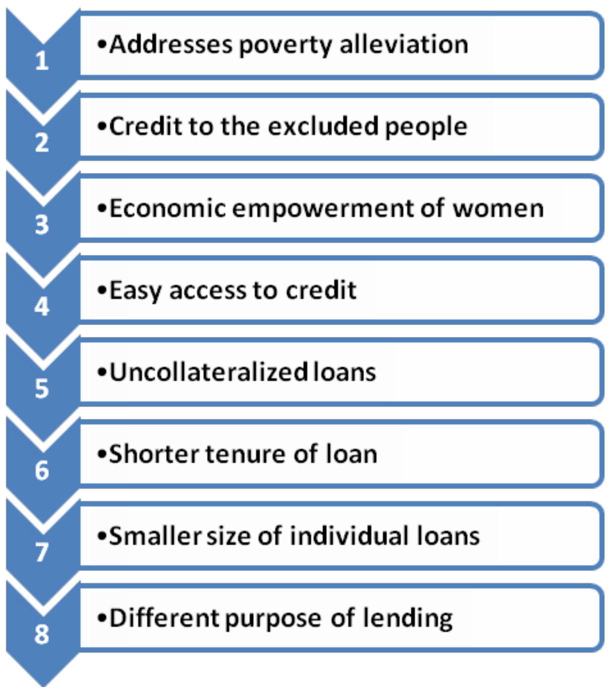

Figure 5.18 Features of loans being provided by MFIs

(1) Addresses Poverty Alleviation

The loans being provided by MFIs help in addressing poverty alleviation. The people in the rural areas have been striving hard to earn their living. They need support from MFIs so that they could get funds which could help them in beating poverty. Many families in the rural areas are earning their living through farming or any other seasonal business. It is very important that they get a chance to improve their income and in turn their living standard.

(2) Credit to the Excluded People

MFIs provide credit to those people who are excluded from the formal financial system. They do not find it easy to get funds from the traditional source of finance. Though finance would be available for them from the formal source, still the rate for obtaining credit would be high and even certain formalities would be required to be fulfilled for getting credit. MFIs provide credit to these people at reasonable rates.

(3) Economic Empowerment of Women

MFIs have been providing credit to women applicants. This enables in empowering women through the routing of credit to them directly. There are many women who are coming forward in the rural areas for availing credit facility. Empowering women could help in the enhancement of their status in their household, their community as well as society. The credit provided to women is being utilized by them to start their own small business or through some or the other earning opportunity. MFIs have been providing support to the women and women are getting encouraged by looking at the success stories around them in their community.

(4) Easy Access to Credit

The access towards credit has become easy. The poor people in the rural areas are finding it easy to get credit from MFIs. The initial formalities for applying for getting credit in the formal financial institutions are very complex and this discourages the poor people in approaching the formal institutions. For the poor people getting cheaper credit is of lesser importance than getting credit easily without involvement of lengthy procedures as well as delays.

(5) Uncollateralized Loans

The loans being provided by MFIs is not based on collateral security. The poor people find it very difficult to provide collateral security for getting loans. There are many people in the rural areas who could not even earn regular income. Many of them are not even having sufficient funds to meet their daily requirements. The MFIs are providing credit to poor people without any collateral security.

(6) Shorter Tenure of Loan

The loans offered by MFIs are for a short duration. The duration is generally not more than 24 months. Frequency of repayment is greater as compared to traditional commercial loans. The amount of loan is also small and the tenure for the loans is also shorter.

(7) Smaller Size of Individual Loans

The MFIs are offering loans of small size to the people in the rural areas. The people in the rural areas are not having collateral to be provided for loans, hence it becomes difficult for the MFIs also to provide bigger amount of loans to them. The size of loan is small and this results in higher operating and transaction cost.

(8) Different Purpose of Lending

The purpose of credit could be different for different people. The needs may be different of the poor people and accordingly they apply for loan. The loan is mainly utilized for any one or more of the following ways:

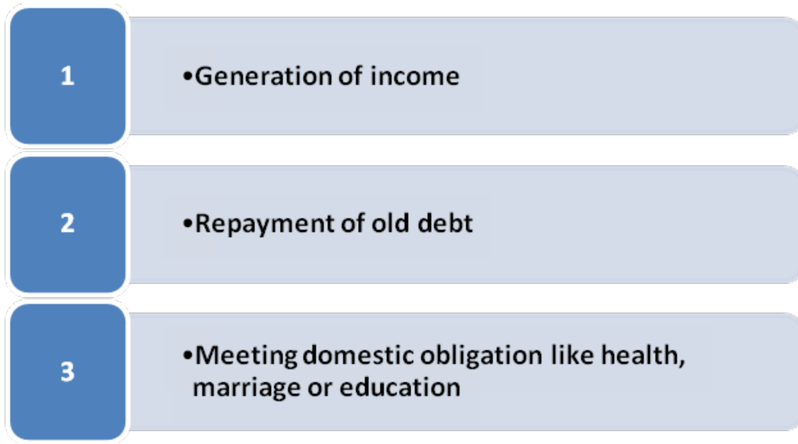

Figure 5.19 Purpose of credit

Funding of MFIs

The MFIs get funding from many sources. The sources are mentioned below:

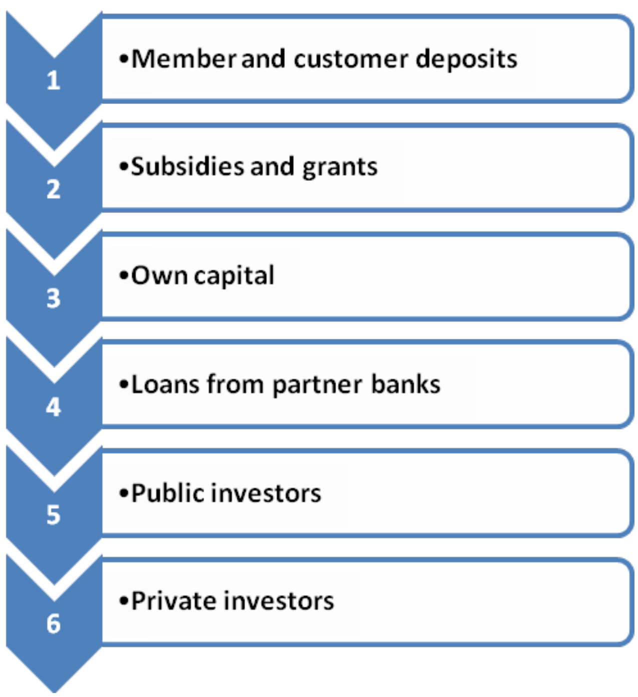

Figure 5.20 Funding of MFIs

(1) Member and Customer Deposits

This applies to MFIs which are organized as cooperatives, mutual funds and micro finance banks which are offering saving products. Deposit mobilization is considered as an alternative source of funds which was being neglected by most MFIs few years back. As per this perspective, voluntary deposit mobilization has been helping MFIs in achieving independence from the donors as well as investors.

(2) Subsidies and Grants

MFIs get subsidies and also grants, through which they could get funding. Grants are prominent when MFIs are being setup. Subsidies and grants include outright donor grant, subsidies from Government etc.

(3) Own Capital

The MFIs also have their own capital which is contributed for providing funds to the borrowers.

(4) Loans from Partner Banks

MFIs could raise funds from the partner banks and this amount could be further lent to people who are applying for loans to MFIs.

(5) Public Investors

There are some multilateral and bilateral organizations that offer funds to the MFIs. This is source of long-term funding for MFIs.

(6) Private Investors

Funds are provided by private investors directly to MFIs or through the investment funds which specialize in microfinance. This is long-term source of funding for MFIs.

Traditional Banks versus Micro Finance Institutions

MFIs function differently as compared to traditional banking. The factors of comparison are mentioned below:

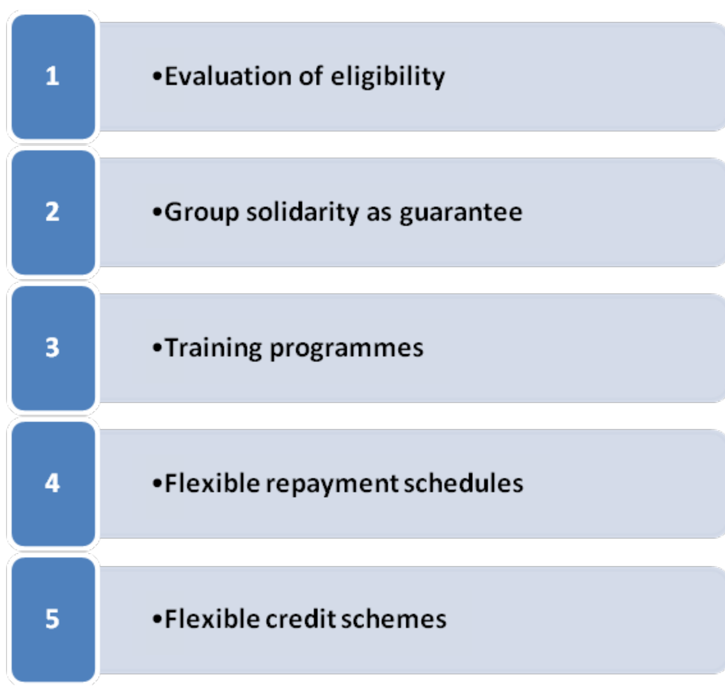

Figure 5.21 Traditional Banks versus Micro finance Institutions

(1) Evaluation of Eligibility

When loan is provided by MFIs, borrower's eligibility is scrutinized, but it is not scrutinized very strongly as is done in traditional loans. In case of traditional loans, the base is of strong financial guarantee. The mainstream banks assesses' salary as well as assets of loan applicant before the loan is granted to them.

MFIs rely more on “human” criteria. If loan helps in setup of new activity which brings income to borrower, chance that the loan will be sanctioned will be higher. Viability evaluation of loan would include discussion with the borrower, and not only review of loan application form.

(2) Group Solidarity as Guarantee

While in traditional banking, hypothecation is considered as a guarantee for few loans, MFIs has replaced this practice with a mechanism of group solidarity. MFIs provide finance to Self Help groups (SHGs), wherein the borrower serves as guarantor for the other members in the group.

(3) Training Programmes

MFIs build a bonding with beneficiaries who are availing credit from them; this is not the case in traditional banking. MFIs offer a strong support to borrowers. Since the motive before MFIs is clear it is about helping borrowers succeed in their projects, MFIs undertake training programme which focus mainly on educating beneficiaries on budgeting of project.

(4) Flexible Repayment Schedules

MFIs usually configure the repayment method for microloans in such a way that is suits the financial capabilities of the target customer base. Thus, there are MFIs that are likely to provide loans with weekly repayment dates, unlike traditional banks.

(5) Flexible Credit Schemes

Micro lending has many products which are usually adapted for suiting repayment capabilities of the borrowers. This is one such main difference between traditional lender and MFI. An MFI requests the borrowers for constituting a group and then grant them single loan to that particular group. These loans are mainly offered to poorest of the borrowers. These microloans do not require any kind of guarantee; it relies on solidarity of group members i.e. kind of social guarantee. Each member in group therefore becomes responsible to MFI and co-borrowers.

Different Types of Loans which are Given through Microfinance Companies

These products cover needs of people who need cash immediately, the products also includes loans that are given to women for increasing generation of income. Loans of higher amounts are also being given to groups which are dependent on MFIs. Even appliances such as mobile phone which is essential for business have also been bought using loans from the MFIs.

Different MFIs provide different loans and some of the types of loans are listed below:

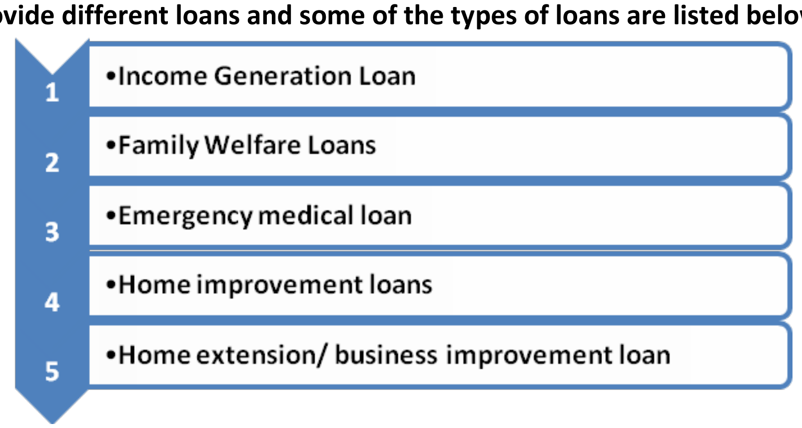

Figure 5.22 Different type of loans provided by MFIs

(1) Income Generation Loan

This loan is given for supporting business enterprises and enhancing income generation activities of clients like for purchase of fixed asset to installation of additional machine etc. Such loans help in meeting additional requirement of working capital in client's businesses. The loan tenure might range from 52 weeks to 104 weeks and this tenure is dependent on amount of loan. Individuals, those who are not having access to credit through the formal system of banking, could get help financially through this loan. The poor people those who are involved in the micro business for supporting their families are identified and are provided credit assistance. The amount of loan depends upon repaying capacity of the borrower.

(2) Family Welfare Loans

These loans provide support for all the activities which help in improving the quality of life and these include loans which are provided for genuine consumption need like purchase of cook stoves, LPG connection, bicycle, solar light, water purifier, meeting education requirement of the borrower's children, for covering medical expense and catering specific need which arise during various festivals. The amount of loans might range from Rs. 1000 to Rs. 15000. The tenure of loan varies from 12 weeks to 52 weeks and it depends upon the amount of loan.

(3) Emergency Medical Loan

These loans are given to people for meeting shorter term emergency and also short term cash flow constraint. Financial assistance when provided timely refrain members from resorting from any other informal source of money that are expensive. This loan amount could be upto Rs. 1000 and any individual could apply for availing the loan amount for helping them in dealing better with a sudden crisis situation. The maximum tenure could be 3 months.

(4) Home Improvement Loans

This loan is provided for funding poor people those who are interested in repairing or extending their house. In this scheme, customers could get funding of amount ranging between Rs. 20,000 to Rs. 1.5 lacs. This loan could be utilized in building a lower cost house which could be sufficient for a comfortable living. The repayment period could be upto 48 installments. These loans could also be availed for availing water connection, construction of toilets, beside extension and improvement of the existing houses, i.e. repairing or replacing roof, monsoon proofing, addition of kitchen or room etc.

(5) Home Extension/ Business Improvement Loan

Loans that are of high amount are generally given in groups that are dependent on the micro finance company. Cross-selling by MFIs has focused on innovative market oriented products. Even various appliances like mobile phone, television, kitchen storage item, etc which is essential for business has been bought through micro finance loans.

MFIs Technique for Enhancing Repayment

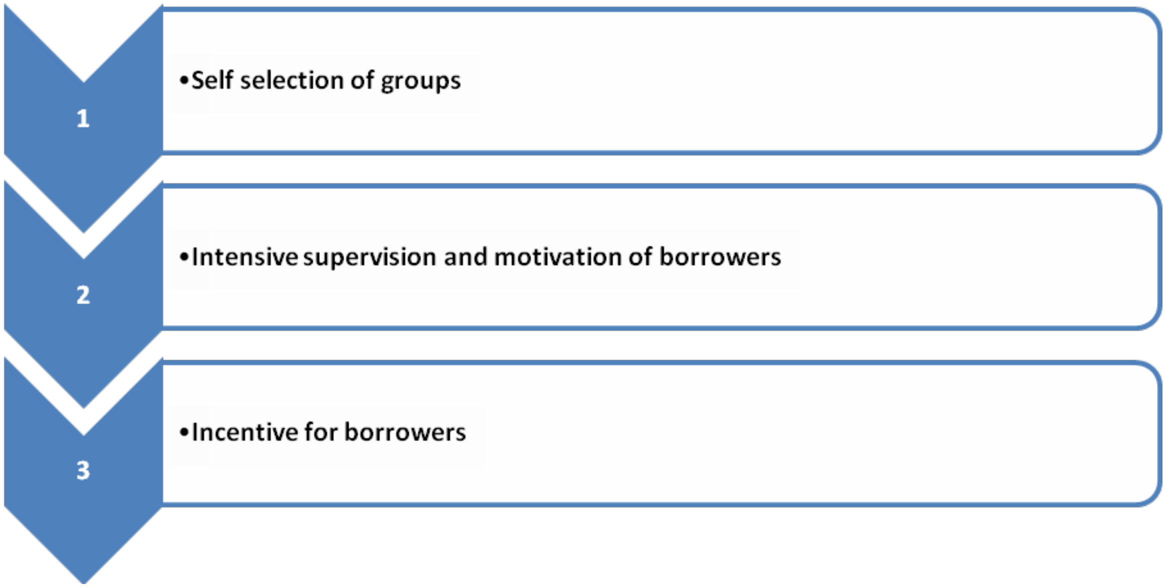

Figure 5.23 MFIs technique for enhancing repayment

(1) Self Selection of Groups

The MFIs are aiming to enhance repayment, so that they do not face heavy losses due to non-repayment. The MFIs thus, go for self selection of groups in which the members are guaranteeing each other's loan. When the members guarantee for each other's loans, then the chances of default reduces, since in case a member is unable to pay the amount, then the other group members help in repayment.

(2) Intensive Supervision and Motivation of Borrowers

The borrowers who apply for loan in MFIs are given loan after proper check and proper supervision is carried out by the MFIs which could be during different frequency as mentioned below:

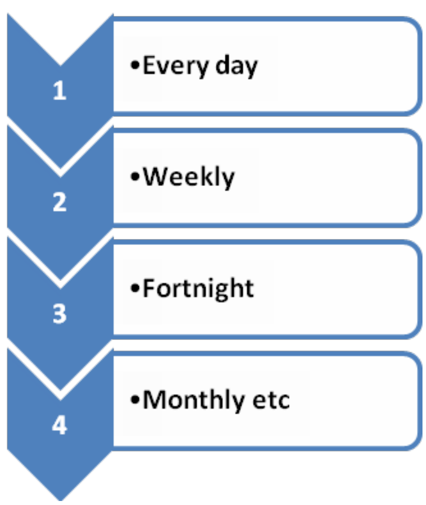

Figure 5.24 Frequency of visit by MFIs

The poor people take loan for a specific purpose and are not much aware about the way to make best use of it. Supervision is required and even the people should be motivated so that they could make proper use of funds and also repay the loan in time.

(3) Incentive for Borrowers

For enhancing repayment by the borrowers, they are given incentives for repayment, borrowers are also given offers of progressively larger loans and there is compulsory savings requirement for them too. The borrowers are not much aware about the usage of the amount taken as loans many of them are not experienced of doing any productive activity. Sometimes, the borrowers find it difficult to use the credit amount wisely and hence land up in default hence the MFIs provide incentive to borrowers who make payment during the required period.

Microfinance Companies in India

Some microfinance companies which offer loans to unbanked and the under-banked population in our country are mentioned below:

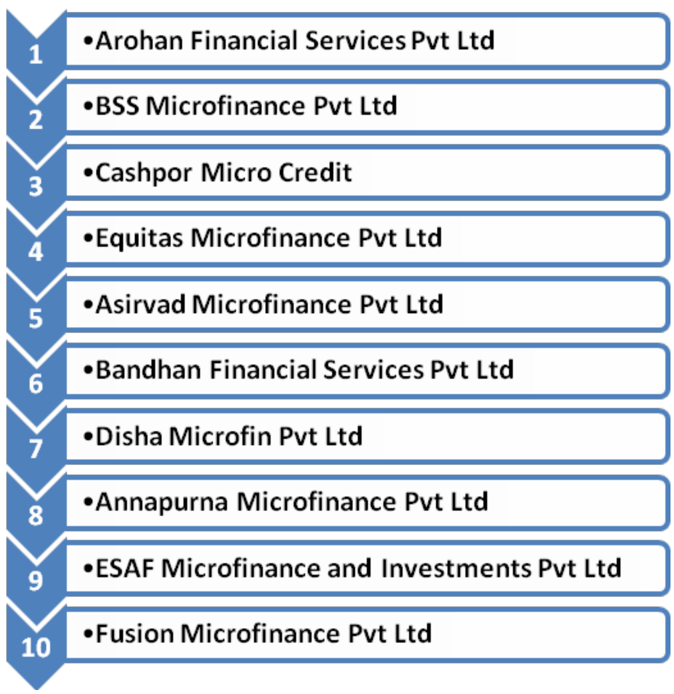

Figure 5.25 Microfinance Companies in India

To Do Activity

Ask the students to compare the working of MFIs and traditional banking. Give atleast two examples.

5.4 Self Help Groups and Non-Government Organizations

Self Help Groups (SHGs) are smaller group of people who are poor. A small group is of 15 to 20 members they are formed voluntarily and related by affinity for a specific purpose. In this group the members use savings, credit as well as are involved socially. SHGs are also an instrument of empowerment. The problems being faced by the members of SHG are similar. Members in SHG help the other group members for solving their own problems.

SHGs have been promoting smaller savings among the members. The savings of SHGs are generally kept with bank. The common fund is kept in bank in SHG's name. SHGs utilize their common fund for giving smaller loans to the members. SHG is informal group and it is registered under the Societies Act or State cooperative Act.

Functions of SHGs

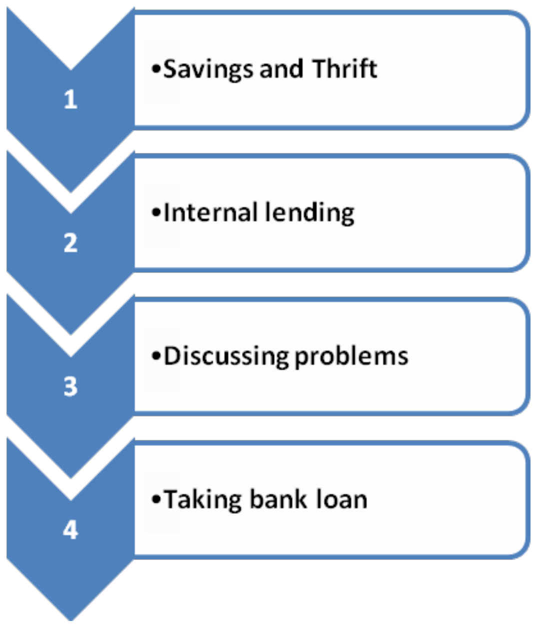

Figure 5.26 Major Functions of an SHG

(a) Savings and Thrift

All the members of SHG save small amount regularly. The amount could be smaller, but savings are required to be a continuous and regular habit among all members. Every SHG member should have the motto of Saving first and credit later. The SHG members can take step toward self dependence when each of them starts saving money in small amounts. Members learn discipline financially through internal lending and savings.

(b) Internal Lending

The SHGs should use the amount of savings for providing loans to its members. Decision regarding the loan amount, interest rate, purpose, repayment schedule etc should be taken by group itself. Proper accounts are required to be maintained by SHG.

(c) Discussing Problems

In each meeting, SHGs should actually discuss and the members should try to solve the problems which are being faced by the other group members. Poor and weak people lack resources for solving the problems. When group try to help the members, it actually becomes very easy for them in facing difficulties and coming up with solution.

(d) Taking Bank Loan

SHG take loan from bank and give this amount in the form of loan to the members.

Common Objectives of SHG

The SHGs are formed with following common objectives:

1	•Change in socio-economic status
2	•Habit of savings
3	•Maintain good inter-personal relationship
4	•Save people from middlemen
5	•Develop leadership quality
6	•Income generating activities
7	•Improve awareness and literacy
8	•Function as interface
9	•Exchange ideas

Figure 5.27 Common objectives of SHG

(1) Change in Socio-Economic Status

One of the objectives of SHGs is to bring a change in the socio economic status of poor people and they mainly work for the members in overcoming the issue of poverty. The poor people find it difficult to approach the formal financial institutions when they are in need of funds. Sometimes the amount of fund required is also very small and it becomes difficult for them to get such a meager amount from elsewhere. The SHGs work for their members and help them out when they are in need of funds.

(2) Habit of Savings

The poor people need a lot of guidance so that they could start saving. Many people in the rural areas are not having regular income and they do not think about saving money for their future. The SHGs inculcate habit of saving among the villagers which includes village women.

(3) Maintain Good Inter-personal Relationship

SHGs have been working towards maintaining good inter-personal relation and linkage with various banks & other financial institutions. SHGs build self-confidence among the rural community. SHGs have helped many people to stand on their feet. People in the rural areas have been getting benefitted from SHGs and have started their own small business.

(4) Save People from Middlemen

SHGs save villagers from the clutches of middle men. The middlemen many a times charge extra amount from the underprivileged and the poor people. SHGs help the poor people in arranging for loans. The poor people find it difficult to approach to formal financial institutions as the process of applying for loan seems to be very complex.

(5) Develop Leadership Quality

Poor people are less confident and they find it difficult to start their own business or lead a group of people for some common objective. SHGs support people and this makes people ready to accept a challenge in their business and even could lead other people towards a common business plan.

(6) Income Generating Activities

SHGs run and manage income generating ventures or activities and common commodity or activity based group. All the members have a common objective and they deal with the same product, this creates lesser differences of opinion.

(7) Improve Awareness and Literacy

The SHGs try to improve the level of awareness among people, try to improve the literacy level and also work for right to equality among the people of rural areas. The level of awareness among the people in rural areas is low related to many aspects. For development of the rural areas, it is very important that the awareness level is increased so that the people could make proper decisions on their own and also could decide what is good or bad for them.

(8) Function as Interface

The SHGs function as interface between extension system and the farmers for transferring technology, sharing market information etc. Whenever a new technology is introduced, it is very important that there is an interface which makes it reach to many people so that they could utilize the new technology and make their tasks simpler. SHGs act as an interface and help people in using latest technology.

(9) Exchange Ideas

SHGs provide a platform to the people to interact among each other and exchange ideas which could lead to innovation. With discussion sometimes new ideas and products get initiated. It is very important for people having similar objectives to meet together so that there could be exchange of ideas and people could also share their experience about using a particular product.

Characteristics of a Sustainable SHG

SHGs require a great deal of abilities, skills and attributes among the group members for the formation and running of sustainable and strong SHGs. These characteristics include the ability to:

- Listen to each other instead of carrying on dominance of a few people and non-representation of the others
- Encouraging group members for discussing, exploring, firming up ideas and developing workable proposals
- Communicating opinion/ ideas to the others and facilitating support
- Taking along everyone or atleast majority while any decision is being taken
- Meeting regularly and observing set rules and regulations while conducting meeting
- Recording proceeding and important decisions
- Regular follow up of action proposed for being taken by group
- Drawing immediate and long-term objectives of group
- Selecting with consensus office bearers i.e. Chairperson or leader, secretary and cashier/treasurer
- Taking up activities which have a common interest and emerging as commodity based group

Role and Functions of Non Governmental Organizations (NGOs) in India

NGOs are organizations that are involved in carrying out wide range of activities for benefit of the underprivileged people as well as society at large. NGOs work independently, without any aid financially from the government, though they might work in a close coordination with government agencies for execution of their projects.

NGOs take up and execute project for promoting welfare of community they are working with. They have been addressing various issues and concerns which are prevailing in society. NGOs are not-for-profit bodies that mean they are not having any commercial interest. NGOs are running on donations which are made by institutions, corporate and individuals. They are engaged in fundraising activities for raising money to carry out work which they do. Since independence, NGOs have been playing a crucial role for helping needy people, providing aid to distressed people and elevating socio-economic status of millions.

Some Causes for which NGOs are working in India

In India, NGOs are utilizing the funds which have been raised through donations for a variety of causes. Few such causes are mentioned below:

1. Child rights
2. Social Injustice
3. Care for elderly people
4. Women Empowerment
5. Human Rights
6. Animal Rights
7. Humanitarian Relief
8. Wildlife Conservation
9. Sanitation and Hygiene
10. Refugee Crisis
11. Literacy and Education
12. Health and Nutrition
13. Disease Control and others
14. Poverty
15. Environment Conservation

Figure 5.28 Some Causes for which NGOs are working in India

NGOs are composed of expert having many years of experience in execution of social welfare activities. Before a project is rolled out, a detailed analysis of situation is done and then possible solutions are contemplated. Collaboration with the civic agencies and various other government agencies at different levels is done as mentioned below for carrying out the work of NGOs:

1. District level
2. State level
3. National level

Figure 5.29 NGOs function at different levels

NGOs go to the ground for addressing the prevailing issues; they undertake massive campaigning activities for generating awareness on various issues. In the current scenario, the NGOs are efficiently leveraging power of social media for disseminating information about the work which they are doing and reaching more people.

The Importance of NGOs in India

India has made rapid progress in socio-economic sphere in previous decades. There are millions of people who have benefited and have overcome poverty, the life expectancy has increased, literacy rate among poor people has increased and even people are having better access towards healthcare services. In India, demographically there are many people who are still away from the benefits of leading a decent life. There are still many people who struggle for getting education, health, shelter and food. The benefits of economic progress of India have not been uniform. There is widespread economic inequality. NGOs play a very important role in bridging the gap and help the poor people in overcoming the problems which are being faced by them.

In India, NGOs have been undertaking a variety of activities; most of them aim at improvement of socio-economic status of the communities which are having limited means. From provision of direct benefit (like distribution of nutritious food to the malnourished children) for empowering and enabling people (like making community realize importance of sending their kids to school), the working of NGOs has far-reaching impact to help the underprivileged as well as deprived people to march ahead in their life.

Orientation of NGOs

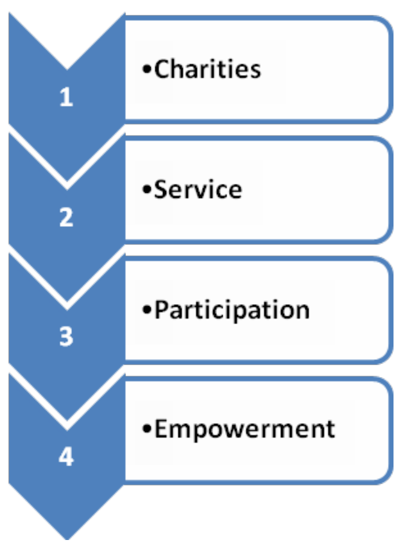

Figure 5.30 Orientations of NGOs

(1) Charities

There is a top down effort in which people of the upper class provide charities for the poor class people. There is no participation from the beneficiaries in this effort. There are many NGOs who have been working towards the need of the disadvantaged group of people.

(2) Service

There are NGOs which provide various services to those people who are unable to afford them like Education, healthcare etc. People in the rural areas have been facing many issues related to education and they are unable to provide food properly to their families. NGOs are working in this regard and they make an effort to provide the basic necessity to people belonging to the underprivileged and the poor people.

(3) Participation

NGOs are working on self-help projects with the local involvement in form of tools, money, materials, land or labor. There are many people who are not having sufficient funds and they are willing to put some extra efforts in starting their own business or to utilize their skills so that they earn a better living for their household. NGOs are working in this field and they are providing the items that are necessary for self help projects.

(4) Empowerment

NGOs aim towards helping the poor people in understanding the economic, social and political factors which could affect their lives and towards increase in awareness of their power for controlling their lives. With a maximum involvement by beneficiaries, NGOs act as facilitators.

Role of NGOs in promoting SHGs

The role being played by NGOs is very crucial in entire process of development, promotion and strengthening of the SHGs for making them into a proactive, self-sustainable, people's institution and thus sustaining democratic process towards development. From this perspective, role of NGOs could be classified as:

Figure 5.31 Role of NGOs in promoting SHGs

(1) Promoters, Facilitators and Organizers of SHGs

NGOs are involved in mobilizing as well as organizing the disadvantaged group of people in the various communities for achieving desired changes in people's lives. Acknowledging such expertise, Government of India and RBI have considered NGOs as one such partners' for providing credit to the poor for alleviating poverty which is the goal of India's development plan through the SHGs. In process of strengthening and promoting SHGs, there are few other stakeholders also who are working towards the betterment of SHGs.

1. Government
2. NABARD
3. Banks
4. Potential target groups
5. Development donor agencies
6. Many others

Figure 5.32 Stakeholders working towards upliftment of SHGs

Thus, NGOs which were involved purely in credit provisioning were helped through grants for this purpose. Though the goal of NGOs is not profit-driven, their involvement has been considered as 'contract' by both government staff as well as banks. Many NGOs believed in restricted role. This resulted in many NGOs becoming microfinance institutions. For understanding the field level tasks and commitment of NGOs toward nurturing SHGs, the following steps related to SHG development cycle are to be considered:

a. Creating awareness
b. Communities get sensitized towards SHGs formation
c. Educating SHG members
d. Formulation of economic development plan
e. Emphasizing SHG linkages with banks
f. Monitoring of SHGs towards utilization of loan
g. Orientation and training to members
h. Build capacities of various stakeholders
i. Documentation of the detailed progress
j. Networking with other NGOs
k. Providing inputs
l. Responsibility of marketing products of SHGs

Figure 5.33 Steps related to SHG development cycle

(a) Creating Awareness

The first step towards SHG development is creating awareness, disseminating information and mobilization of people in community for the formation of SHGs.

(b) Communities get Sensitized towards SHGs Formation

As the communities get sensitized and agree for forming SHGs, NGOs help in organizing the groups, framing rules and regulations which are required for managing groups, facilitating selection of the leaders and other related task and opening bank account for the SHGs.

(c) Educating SHG Members

NGOs have been educating the SHG members on various aspects which pertain to regular functioning of group like conducting meeting, book-keeping, managing saving, and internal lending of loans and so on.

(d) Formulation of Economic Development Plan

NGOs help groups in formulating economic development plan, identification of various needs of the groups and providing input as per requirements. This enhances the capacity of the group members for being purposeful and effective.

(e) Emphasizing SHG Linkages with Banks

Next step is to emphasize SHG linkages with the banks, development in skills among groups for effective usage of loans and other resources, which group acquire in due course.

(f) Monitoring of SHGs towards Utilization of Loan

Groups are monitored and guided for utilization of the loans and identification of activities which could generate income.

(g) Orientation and Training to Members

Orientation of the members is done and training is given to them as per requirement and building capacities. Through development of collaboration between network of SHGs or SHG federations, a robust people's organization could be developed which could be transformed into a dependent institution.

(h) Build Capacities of various Stakeholders

NGOs provide training and help to build capacity of the stakeholders i.e. staff of government and banks which work as SHGs, SHG members and leaders — on different issues which are of concern like entrepreneurship, livelihood, business planning, marketing, insurance, income generation etc.

(i) Documentation of the detailed Progress

Proper documentation is done of detailed progress of each and every SHG based on the field experience as taken up by the NGOs. This documentation is further useful for planning strategies for future and for conducting research. However, many NGOs do not properly carry out proper documentation of the SHGs.

(j) Networking with other NGOs

There is a need for networking with the other NGOs which are working in the same field that would result in sharing of experiences amongst SHGs and this in turn results in their development. Simultaneously, these networks could function as effective pressure groups for bringing about change, which could contribute towards development of the SHGs.

(k) Providing Inputs

Next step is to provide inputs for credit, microenterprise, micro insurance and micro pension so that a holistic and comprehensive development of SHGs as organization could be achieved.

(l) Responsibility of Marketing Products of SHGs

SHGs launch their income generation as well as microenterprise activities, the products and services which are the output of SHGs require market opportunities so that both the business and production cycles continue towards providing employment and income to SHG members. Currently, responsibility of marketing products which are produced by SHGs is largely shouldered by NGOs.

(2) Microfinance Intermediaries

Since there used to be delay in the availability of loans as and when required, since banks and other financial institutions generally take time for releasing loans, some NGOs took up the role of financial intermediaries for the SHGs. Some NGOs have formed MFIs and they have started financial delivery of the products to the SHGs. Some NGOs have been advocating this approach, thus they added a non-traditional role. Further, the NGOs which take up such activities like delivering of financial products seem to develop the tendency of being commercial in nature and besides, different kind of human resource is required for managing these services. Some banks which finance SHGs collaborate with the NGOs as business partners. This model could be regarded as a more practical method and it enjoys equal partnership, and helps in maintaining the autonomy and having due respect for other's expertise.

(3) Builder of People's Institutions Leading to Creation of Social Capital

Currently, few NGOs are aware or they have an understanding of potential of SHGs in long-term development of the social capital and building peoples' institutions. Once SHGs start functioning in a stable way and their systems are right in place, their dependency on the NGOs must be reduced at appropriate time. For enabling this, the NGOs should build SHG federations which are independent as well as could be effectively managing their day-to-day operations. These federations in the form of people's institutions should get support from Government and NABARD for capacity building project. Further, such federations should be linked with the other federations as well as stakeholders such as banks in their own geographical area. NGOs could play role of a guide, catalyst, supporter, advisor and trainer for building confidence amongst the federations for becoming independent as well as interdependent on organizations in their own communities. These federations could play a very important role for building capacity for SHGs for functioning as useful people's institutions. Due to globalization, responsibilities of government toward the public and challenges being faced in field are bit complex. Hence, the autonomy for NGOs is very crucial in today's scenario as compared to the previous situation.

To Do Activity

Ask the students to form group of 4-5 members and visit any NGO in the city, try to find out the following about them:

- The way they are working
- What all activities have they carried out for their city during last one year?
- How are they helping the SHGs?
- Any challenges they have been facing in helping the SHGs.

5.5 SHG-Bank Linkage Programme

The major effort for providing banking services to weaker and unorganized sector was Bank's SHG Linkage Programme which was launched in the early 1990s. This programme was started at initiative of NABARD in the year 1992 for linking unorganized sector with formal banking sector. Self Help Groups have potential to bring together formal banking structure as well as rural poor for mutual benefits. Studies were conducted by NABARD in some states for assessing impact of linkage project, this has brought out some positive and encouraging features, some of these are mentioned below:

- Increase in the volume of loan of SHGs
- A definite shift in loaning pattern of members from the non-income generating activities towards production activities
- Majority SHGs have shown very good recovery performance
- A significant reduction in transaction costs for both banks and borrowers etc.

Besides, the above mentioned, linkage programme led to gradual increase in level of income of SHG members. The studies indicated that majority SHGs which were linked with banks were exclusively formed by women. Government has given advice to the banks that the entire credit requirement of SHGs members should be met by the banks. SHG Bank linkage programme plays a very important role and it has made the functioning of SHGs easier, as they do not need to struggle now for getting funds from any other formal source. Government has requested all the scheduled commercial banks to embrace concept of Total Financial Inclusion and follow the example which is set by the Public sector banks through various measures:

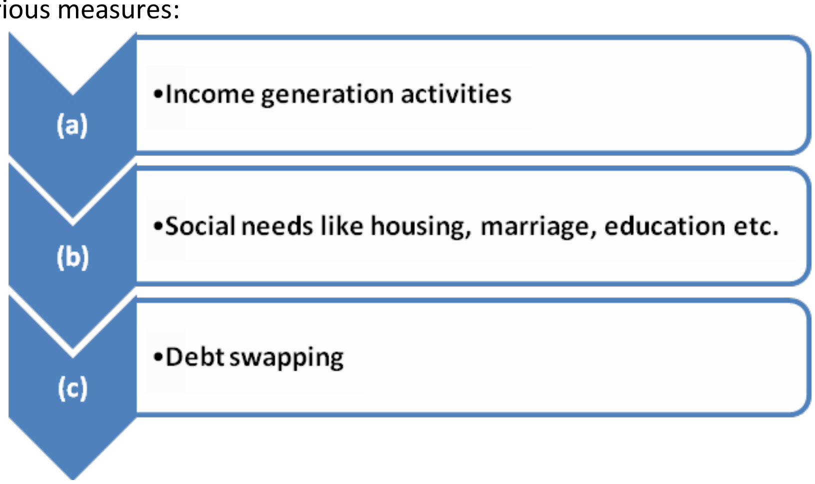

Figure 5.34 Total Financial inclusions for SHGs

Linking of SHGs with the banks has been emphasized in Monetary Policy statement of RBI and also Union Budget announcements from time to time and various other guidelines have also been issued to the banks in this regard. Banks should provide incentives adequately to their branches for financing SHGs and establishing linkages with them and also make procedures easy and simple. The group dynamics of working of SHGs should not be regulated nor there should be any formal structures insisted or imposed upon. Approach towards financing of the SHGs should be hassle-free totally and might also include expenditures for consumption.

Guidelines for SHGs Bank Linkage

RBI has issued guidelines which need to be adhered for enabling effective linkage of SHGs with banking sector (as per Master Circular on SHG-Bank Linkage Programme dated July 02, 2018):

1	•Opening of Savings Bank A/C
2	•Lending to SHGs
3	•Interest rates
4	•Service/ Processing charges
5	•Separate Segment under priority sector
6	•Presence of defaulters in SHGs
7	•Capacity Building and Training
8	•Monitoring and Review of SHG Lending
9	•Reporting to CICs

Figure 5.35 Guidelines for SHGs bank linkage

(1) Opening of Savings Bank A/C

The SHGs, unregistered or registered, that are engaged in promotion of savings habits amongst their members are eligible for opening savings bank accounts with the banks. It is not necessary that SHGs have already availed credit facilities from the banks before opening a savings bank account. The instructions of Department of Banking Regulation in Master Direction on Know Your Customer (KYC) pertaining to the SHG members (Part VI-Paragraph 43) are required to be adhered to, while completing the Customer Due Diligence (CDD) process.

Accordingly, the current instructions under Simplified norms SHGs mention that CDD of all members of the SHGs as mentioned in above Direction will not be required while opening of saving bank account of SHG. CDD of all office bearers would suffice. No separate CDD of members or the office bearers shall be necessary at time of linking credit of SHGs.

(2) Lending to SHGs

Bank lending to the SHGs need to be included in various plans of the banks. These plans are mentioned below:

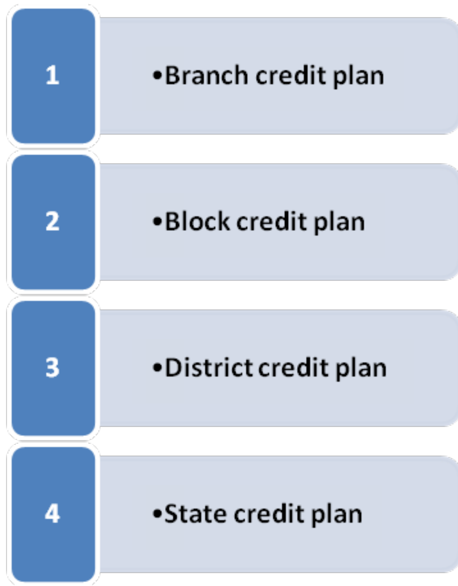

Figure 5.36 Plans for lending in banks

Banks should give utmost priority to this sector in the preparation of such plans. It should form an integral part of bank's corporate credit plan also. As per the operational guidelines which are issued by NABARD, the SHGs could be sanctioned loans linked with savings by the banks which could vary from saving to loan ratio of 1:1 to 1:4. However, in case of the matured SHGs, loans could be given beyond limit of four times of savings as per discretion of bank. Simple system requiring a minimum documentation and procedures is recondition to augment credit flow to SHGs. Banks should strive towards removing all the operational irritants and making arrangements to expedite sanctioning and disbursing credit by delegating adequate powers for sanctioning loans to the branch managers. Loan application forms, documents and procedures should be made simple. This would help to provide hassle free and prompt credit.

(3) Interest Rates

Banks would have discretion for deciding interest rates applicable to the loans given to the SHGs/ members beneficiaries.

(4) Service/ Processing Charges

No charges related to loan, ad hoc services and inspection charges should be levied on such priority sector loans upto the amount of 25,000. In case of eligible priority sector loan to the SHGs, this limit would be applicable per member and not to the whole group.

(5) Separate Segment under Priority Sector

Lending to SHGs should be included by the banks as part of their lending to the weaker sections. As per the RBI's latest (May 2016) Priority Sector Lending norms, bank credit to members of SHGs is eligible for priority sector advance under respective categories viz., Agriculture, Micro, Small and Medium Enterprises, Social Infrastructure and Others.

(6) Presence of Defaulters in SHGs

Default by few members of the SHGs and/or their family members to financing bank should not ordinarily come in way of financing SHGs per se by banks, provided SHG is not at default. However, bank loan may not be utilized by SHG for financing defaulter member to bank.

(7) Capacity Building and Training

Banks could initiate suitable steps to internalize SHGs linkage project and can organize exclusive short duration programmes for field level functionary. Additionally, suitable sensitization/ awareness programmes could be conducted for middle level controlling officers and senior officers. Banks are required to refer to instructions which are mentioned on financial literacy by Financial Literacy Centres and rural branches as per RBI circular issued for conducting tailored programmes which target SHGs.

(8) Monitoring and Review of SHG Lending

Considering potential of the SHGs, banks would closely monitor progress at various levels regularly. For giving boost to ongoing SHG bank linkage programme for flow of credit to unorganized sector, monitoring of the programme shall be regular item on agenda for discussion at District level Consultative Committee (DCC) and State Level Bankers' Committee (SLBC) meetings. SHG lending is required to be reviewed on quarterly basis. Further, progress of programme could be reviewed by the banks at regular intervals.

(9) Reporting to Credit Information Companies (CICs)

Recognizing the importance of credit information reporting related to SHG members for the financial inclusion, banks have been given advice for adhering to guidelines issued by the Department of Banking Regulation.

Working of SHG Linkage Programme

In this programme, banks have been allowed to open saving account for SHGs. SHGs are registered or unregistered entities which have usually a membership of 15 - 20 members which belong to lower income family, who are usually women. They mobilize saving from the members and use pooled funds for giving loans to needy members. Under this programme, the banks provide loan to SHGs against the group guarantee and quantum of loan could be many times of the deposit which has been placed by SHGs with the banks. Banks should consider the credit requirements of the members also.

Lending to the SHGs should be included by banks as a part of their lending to weaker sections. As per RBI's latest norms related to priority Sector lending norms, bank credit to the members of the SHGs will be eligible for priority sector advance under the respective categories as mentioned below:

1. Agriculture
2. Micro, Small and Medium Enterprises
3. Social Infrastructure
4. Others

Figure 5.37 Priority sector advance categories for SHG members

The rate of recovery of loans are good and banks found that transaction cost of reaching poor through the SHGs is considerably low as compared to direct lending by banks.

Uniqueness about SHG Bank Linkage Programme

1. Decision making
2. Supplementary to formal banking
3. Financial services
4. Social agenda
5. Quality clients
6. NPA Savvy
7. Client preparation
8. Peer pressure as collateral
9. No-subsidy-dependence syndrome
10. Exclusive poor focus
11. Voluntary Savings
12. Cash Credit / Overdraft
13. JLGs out of SHGs

Figure 5.38 Uniqueness about SHG Bank Linkage Programme

(1) Decision Making

The members of SHG take decision collectively. SHG concept offers opportunity to all the members for participative decision making, on conducting of meetings, credit and thrift decisions. Participative process makes the entire group responsible borrower.

(2) Supplementary to Formal Banking

SHGs linkage does not supplant existing banking system, but they supplement them. SHGs are taking full advantage of resources and the other facilities of banking system.

(3) Financial Services

Rural poor need different type of financial services i.e. savings, credit (production/ consumption), remittance, insurance etc. at their doorstep. The platform of the SHGs provides possibility towards extension of these services.

(4) Social Agenda

The statistics which are available indicate that many people among the rural household are dependent on the non-institutional source for their credit needs. SHG linkage offers better way to deal with magnitude of the social agenda. Many NGOs/ Government have recognized SHGs as vehicle for deepening and delivering their developmental agenda/ services.

(5) Quality Clients

SHGs are turning out as quality clients for better management of credit, mobilization of savings, lower transaction cost and nearly full repayments.

(6) NPA Savvy

Linkage mechanism has proved to be very good for the repayments and the chance of NPA is very low. SHG Bank linkage programme is NPA savvy.

(7) Client Preparation

Members of SHGs could over a time period graduate to stage of micro entrepreneurs and has been prepared with a requisite credit discipline.

(8) Peer Pressure as Collateral

SHG linkage emphasizes on peer pressure within group as a collateral substitute.

(9) No-Subsidy-Dependence Syndrome

This programme do not envisages any kind of support through subsidy from government in matter of credit. The issue is mainly for building capabilities as well as enterprise of individual members, a blend with group solidarity and cohesion through training which is provided by Self Help Group Promotion Institution (SHPI) for setting ball rolling for SHGs.

(10) Exclusive Poor Focus

SHGs have an exclusive focus on the absolute poor, who have not been included by banking system.

Social banking has meaning only when the lowest strata as well as unreached are serviced.

(11) Voluntary Savings

For facilitating voluntary savings in addition to group savings regularly, a concept of voluntary savings within group was introduced for the enhancement of group's corpus.

(12) Cash Credit / Overdraft

Overdraft/ Cash Credit facility could be sanctioned by the banks to the SHGs for taking care of growing needs of credit of the SHG members on ongoing basis. The amount which is drawable against cash credit limit is however required to be linked to savings of SHGs.

(13) JLGs out of SHGs

Interested group members who are interested in undertaking livelihood activities with the larger credit support could be done through formation of JLGs within the SHGs.

Terms and conditions for ICICI Bank SHG loan

(1) Eligibility criteria for ICICI Bank SHG loan

- SHGs having an existence of atleast 6 months
- A group of 10-20 women
- Minimum saving/ corpus of Rs. 5000
- Should have an acceptable level of administrative and financial discipline in running of SHG

(2) Loan limit for the SHGs

One SHG is eligible for maximum loan amount of Rs. 6, 25, 000 for the loans that are transferred from the other banks and for ICICI Bank cases upto maximum of Rs. 7, 50, 000.

(3) No security to be provided

(4) Interest Rate Range

The rate of interest ranges from 9% – 19.55%.

Source: ICICI Bank website

To Do Activity

Ask the students to form group of 3-4 members and visit any bank branch to understand about SHG Bank Linkage Programme in detail.

Summary

Rural insurance ensure that the people living in the rural areas have secure and safe future so that they could have happy life. Insurance helps them in covering risks which is related to different aspects of their lives. Rural Insurance policies which are being offered to the poor people are available at affordable premium and they have faster claim processing. Rural insurance is created for rural public for insuring their businesses like farming, cattle, poultry etc. Individuals could claim benefits, if there is crop loss or when their animals die. Micro insurance is protection of people who belong to the lower income group against some specific perils in exchange for the regular premium payment proportionate to their likelihood and cost of risk involved. Lower income people could use micro insurance which is available as one such tool which is designed for the people belonging to the poor families. Microfinance covers many services including savings, insurance, money transfer, counseling etc apart from provisioning of credit. The micro finance institutions have been working for the betterment of poor people and have been providing them credit for various purposes. People belonging to the low income group hesitate to apply for credit in the formal financial institutions and it becomes very important that they get assistance from the MFIs for getting support for their credit needs. Self Help Groups (SHGs) are smaller group of people who are poor. A small group is of 15 to 20 members they are formed voluntarily and related by affinity for a specific purpose. In this group the members use savings, credit as well as are involved socially. SHGs are also an instrument of empowerment. The problems being faced by the members of SHG are similar. Members in SHG help the other group members for solving their own problems. The major effort for providing banking services to weaker and unorganized sector was Bank's SHG Linkage Programme which was launched in the early 1990s. This programme was started at initiative of NABARD in the year 1992 for linking unorganized sector with formal banking sector. Self Help Groups have potential to bring together formal banking structure as well as rural poor for mutual benefits.

Model Questions

- Discuss the need and importance of Rural Insurance.
- Explain the functionality of Rural Insurance.
- Describe the main types of Micro insurance schemes being offered by Insurance companies in India.
- Discuss the initiatives taken by government in the field of micro insurance.
- Describe the features of loans being provided by the MFIs.
- How is traditional banking different from MFIs?
- What are the functions and objectives of SHGs?
- Discuss the role of NGOs in promoting SHGs.
- Explain the guidelines for SHG – Bank Linkage Programme.
- How is SHG-Bank Linkage Programme unique?

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Editors' Profile

Dr W G Prasanna Kumar

Dr. W G Prasanna Kumar, Chairman, Mahatma Gandhi National Council of Rural Education (MGNCRE), holds Ph.D in Education with basic degree in Social Work and Master's Degree in Sociology, Public Administration and Political Science. He also has professional education in Environmental Economics, Public Relations, Communication, and Training and Development. Under his leadership MGNCRE has done instrumental work in building rural resilience including rural community engagement and Nai Talim - Experiential Learning.

The several areas of functional work envisaged and implemented successfully by Dr. W G Prasanna Kumar include Curriculum Development Programmes, Course Material Preparation, Faculty Development Programmes, Workshops, Roundtables, Rural Immersion Training Programmes, Swachhta Action Plan Activities, Community Engagement Programmes, Rural Management Programmes, Nai Talim Programmes, WASH Volunteerism Programmes in collaboration with UNICEF and UBA Activities.

The national initiative of reviving Mahatma Gandhi's ideas of Nai Talim, spearheaded by Dr. W G Prasanna Kumar, has met unprecedented success at both national and state levels. The primary objective of this initiative is to promote Gandhiji's ideas on Experiential Learning, Nai Talim, Work Education and Community Engagement, and mainstreaming them in School Education and Teacher Education Curriculum & Pedagogy. The pilot developmental project is a product of intensive workshop based interactions and consultations with Departments of Education in Universities in India, National Council of Educational Research and Training (NCERT), and State Council of Educational Research and Training (SCERTs) across all Indian States/UTs. He considers this initiative as a great tribute to Mahatma Gandhi.

Dr. W G Prasanna Kumar has been instrumental in developing MGNCRE's state-of-the-art e-Learning Centre with infrastructure for conferencing and training facilities which include training programs, skill building sessions and workshops with facility for video linking the entire country and sharing online educational resources for rural community engagement and development. The compilation, development and nationwide release of Swachh Campus and Jal Shakti Manuals are his major contributions to Higher Educational Institutions. These Manuals have been directed by the Ministry to be put into usage by Higher Education Institutions including Universities, Colleges and Polytechnics in developing strategies, action plans and implementation plans for water conservation on the campuses and in the villages with which the campuses are engaged with in National Service Scheme (NSS), Swachhta Action Plan (SAP) and Unnat Bharat Abhiyan (UBA).

As Professor and Head, Centre for Climate Education and Disaster Management in Dr. MCRHRD Institute, he conducts several capacity building and action research programmes in climate education, disaster management and crowd management. He has handled many regional, national and international environmental education programmes and events including UN CoP11 and Convention on Biological Diversity and Media Information Management on Environmental Issues.

As Director in National Green Corps in the State Government for over 11 years and Senior Social Scientist in State Pollution Control Board for 6 years Dr. W G Prasanna Kumar conducted various curriculum and non-curriculum related training programmes in environmental education. He was awarded Best State Nodal Officer of National Green Corps by Centre for Science and Environment, New Delhi in 2008. He was recipient of Jal Mithra Award from Earthwatch Institute of India and Water Aid New Delhi, 2014 and Certificate of Commendation for the services in UN Conference of Parties and Convention for Biodiversity conducted at Hyderabad in 2012. He was a Resource Person for AP Judicial Academy, AP Police Academy, AP Forest Academy, EPTRI, Commissonerate of Higher Education and Intermediate Education, State Council for Educational Research and Training and National Council for Educational Research and Training New Delhi, CCRT, Bharathiya Vidyapeet University Pune, CPR Environmental Education Centre Chennai and Centre for Environment Education Ahmedabad.

Dr W G Prasanna Kumar underwent training in Community Consultation for Developmental Projects in EPA Victoria Australia in 1997; as State Chief Information Officer by IIM Ahmedabad and Dr. MCRHRDI Government of Andhra Pradesh in 2004; and in Environmental Education and Waste Management Techniques at JICA, Japan in 2011.

Dr K N Rekha

Dr K N Rekha, is a PhD Graduate from IIT Madras. She has 14 years of experience in training and education Industry. She works at Mahatma Gandhi National Council of Rural Education (MGNCRE), Hyderabad as Senior Faculty. She is involved in curriculum development on Rural Management and Waste Management. Prior to this, she worked as a researcher at Indian School of Business, Hyderabad, a short stint at Centre for Organisation Development (COD), Hyderabad. She has co-authored a book on “Introduction to Mentoring”, written book chapters, peer reviewed research papers, book reviews, Case studies, and caselets in the area of HR/OB. She also presented papers in various national and international conferences. Her research areas include Mentoring, Leadership, Change Management, and Coaching. She was also invited as a guest speaker at prominent institutions like IIT Hyderabad.

Subject Author's Profile

Ms. Meghna Jain

Ms. Meghna Jain, is pursuing Ph. D. in Management from Rani Durgavati Vishwavidyalaya, Jabalpur. She is having 6 years experience in Banking and 7 years experience in teaching in Management. She has completed certifications in Banking i.e. JAIIB and CAIIB from Indian Institute of Banking and Finance (IIBF). She is Financial Education Trainer with Securities and Exchange Board of India (SEBI). She is also Banking trainer with Bajaj Finserv. She is currently working as Assistant Professor in Gyan Ganga Institute of Technology and Sciences, Jabalpur. She is teaching Finance and General Management subjects. She has worked with Diebold Systems Private Limited, Yes Bank Ltd., Indusind Bank Ltd., and various others Financial Institutions. She has attended various conferences and seminars, presented papers on various topics related to General Management and Finance. She has taken 70+ sessions related to Financial Education among different target segments including School children, house wife, School teachers, Executives and other groups.

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