

Preface

Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. This has to become an integral part of our efforts to promote inclusive growth. In fact, providing access to finance is a form of empowerment of the vulnerable groups. Financial inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The various financial services include credit, savings, insurance and payments and remittance facilities. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty.

Extent of Exclusion

NSSO data reveal that 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Further, despite the vast network of bank branches, only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). Farm households not accessing credit from formal sources as a proportion to total farm households is especially high at 95.91%, 81.26% and 77.59% in the North Eastern, Eastern and Central Regions respectively. Thus, apart from the fact that exclusion in general is large, it also varies widely across regions, social groups and asset holdings. The poorer the group, the greater is the exclusion.

Demand Side Factors

While financial inclusion can be substantially enhanced by improving the supply side or the delivery systems, it is also important to note that many regions, segments of the population and sub-sectors of the economy have a limited or weak demand for financial services. In order to improve their level of inclusion, demand side efforts need to be undertaken including improving human and physical resource endowments, enhancing productivity, mitigating risk and strengthening market linkages. However, the primary focus of the Committee has been on improving the delivery systems, both conventional and innovative.

National Mission on Financial Inclusion

The Committee feels that the task of financial inclusion must be taken up in a mission mode as a financial inclusion plan at the national level. A National Mission on Financial Inclusion (NaMFI) comprising representatives from all stakeholders may be constituted to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors - in undertaking promotional initiatives.

A National Rural Financial Inclusion Plan (NRFIP) may be launched with a clear target to provide access to comprehensive financial services, including credit, to at least 50% of financially excluded households, say 55.77 million by 2012 through rural/semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and

non-cultivator households per branch per annum, with an emphasis on financing marginal farmers and poor non-cultivator households.

Development and Technology Funds

There is a cost involved in this massive exercise of extending financial services to hitherto excluded segments of population. Such costs may come down over a period of time with the resultant business expansion. However, in the initial stages some funding support is required for promotional and developmental initiatives that will lead to better credit absorption capacity among the poor and vulnerable sections and for application of technology for facilitating the mandated levels of inclusion. The Committee has, therefore, proposed the constitution of two funds with NABARD – the Financial Inclusion Promotion & Development Fund and the Financial Inclusion Technology Fund with an initial corpus of Rs. 500 crore each to be contributed in equal proportion by GoI / RBI / NABARD. This recommendation has already been accepted by GoI.

Business Correspondent Model

Extending outreach on a scale envisaged under NRFIP would be possible only by leveraging technology to open up channels beyond branch network. Adoption of appropriate technology would enable the branches to go where the customer is present instead of the other way round. This, however, is in addition to extending traditional mode of banking by targeted branch expansion in identified districts. The Business Facilitator/Business Correspondent (BF/BC) models riding on appropriate technology can deliver this outreach and should form the core of the strategy for extending financial inclusion. The Committee has made some recommendations for relaxation of norms for expanding the coverage of BF/BC. Ultimately, banks should endeavour to have a BC touch point in each of the 6,00,000 villages in the country.

Procedural Changes

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.

Role of RRBs

RRBs, post-merger, represent a powerful instrument for financial inclusion. Their outreach vis-à-vis other scheduled commercial banks particularly in regions and across population groups facing the brunt of financial exclusion is impressive. RRBs account for 37% of total rural offices of all scheduled commercial banks and 91% of their workforce is posted in rural and semi-urban areas. They account for 31% of deposit accounts and 37% of loan accounts in rural areas. RRB's have a large presence in regions marked by financial exclusion of a high order. They account for 34% of all branches in North-Eastern, 30% in Eastern and 32% in Central regions. Out of the total 22.38 lakh SHGs credit linked by the banking industry as on 31st March 2006, 33% of the linkages were by RRBs which is quite impressive to say the least. Significantly the more backward the region the greater is the share of RRBs which is amply demonstrated by their 56% share in the North-Eastern, 48% in Central and 40% in Eastern region.

RRBs are, thus, the best suited vehicles to widen and deepen the process of financial inclusion. However, there has to be a firm reinforcement of the rural orientation of

these institutions with a specific mandate on financial inclusion. With this end in view, the Committee has recommended that the process of merger of RRBs should not proceed beyond the level of sponsor bank in each State. The Committee has also recommended the recapitalisation of RRBs with negative Net Worth and widening of their network to cover all unbanked villages in the districts where they are operating, either by opening a branch or through the BF/BC model in a time bound manner. Their area of operation may also be extended to cover the 87 districts, presently not covered by them.

SHG – Bank Linkage Scheme

The SHG - Bank Linkage Programme can be regarded as the most potent initiative since Independence for delivering financial services to the poor in a sustainable manner. The programme has been growing rapidly and the number of SHGs financed increased to 29.25 lakhs on 31 March 2007.

The spread of the SHG - Bank Linkage Programme in different regions has been uneven with Southern States accounting for the major chunk of credit linkage. Many States with high incidence of poverty have shown poor performance under the programme. NABARD has identified 13 States with large population of the poor, but exhibiting low performance in implementation of the programme. The ongoing efforts of NABARD to upscale the programme in the identified States need to be given a fresh impetus. The Committee has recommended that NABARD may open dedicated project offices in these 13 States for upscaling the SHG - Bank Linkage Programme. The State Govts. and NABARD may set aside specific funds out of the budgetary support and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of promoting SHGs in regions with high levels of exclusion. For the North-Eastern Region, there is a need to evolve SHG models suited to the local context of such areas.

NGOs have played a commendable role in promoting SHGs and linking them with banks. NGOs, being local initiators with their low resources, are finding it difficult to expand in other areas and regions. There is, therefore, a need to evolve an incentive package which should motivate these NGOs to diversify into other backward areas.

The SHG - Bank Linkage Programme is now more than 15 years old. There are a large number of SHGs in the country which are well established in their savings and credit operations. The members of such groups want to expand and diversify their activities with a view to attain economies of scale. Many of the groups are organising themselves into federations and other higher level structures. To achieve this effectively, resource centres can play a vital role. Federations of SHGs at village and taluk levels have certain advantages. Federations, if they emerge voluntarily from amongst SHGs, can be encouraged. However, the Committee feels that they cannot be entrusted with the financial intermediation function.

Extending SHG – Bank Linkage Scheme to Urban Areas

There are no clear estimates of the number of people in urban areas with no access to organized financial services. This may be attributed, in part at least, to the migratory nature of the urban poor, comprising mostly of migrants from the rural areas. Even money lenders often shy away from lending to urban poor. The Committee has recommended amendment to NABARD Act to enable it to provide micro finance services to the urban poor.

Joint Liability Groups

SHG-bank linkage has emerged as an effective credit delivery channel to the poor clients. However, there are segments within the poor such as share croppers/oral lessees/tenant farmers, whose loan requirements are much larger but who have no collaterals to fit into the traditional financing approaches of the banking system. To service such clients, Joint Liability Groups (JLGs), an upgradation of SHG model, could be an effective way. NABARD had piloted a project for formation and linking of JLGs during 2004-05 in 8 States of the country through 13 RRBs. Based on the encouraging response from the project, a scheme for financing JLGs of tenant farmers and oral lessees has also been evolved. The Committee has recommended that adoption of the JLGs concept could be another effective method for purveying credit to mid-segment clients such as small farmers, marginal farmers, tenant farmers, etc. and thereby reduce their dependence on informal sources of credit.

Micro Finance Institutions - NBFCs

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. The Committee has, therefore, recommended that greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but also eventually enable them to take and use savings as a low cost source for on-lending.

There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. Such MF-NBFCs may also be recognized as Business Correspondents of banks for providing only savings and remittance services and also act as micro insurance agents.

The Micro Financial Sector (Development and Regulation) Bill, 2007 has been introduced in Parliament in March 2007. The Committee feels that the Bill, when enacted, would help in promoting orderly growth of microfinance sector in India. The Committee feels that MFIs registered under Section 25 of Companies Act, 1956 can be brought under the purview of this Bill while cooperative societies can be taken out of the purview of the proposed Bill.

Revitalising the Cooperative System

Though the network of commercial banks and RRBs has spread rapidly and they now have nearly 50,000 rural/semi-urban branches, their reach in the countryside both in terms of the number of clients and accessibility to the small and marginal farmers and other poorer segments is far less than that of cooperatives. In terms of number of agricultural credit accounts, the Short Term Cooperative Credit System (STCCS) has 50% more accounts than the commercial banks and RRBs put together. On an average, there is one PACS for every 6 villages; these societies have a total membership of more than 120 million rural people making it one of the largest rural financial systems in the world. However, the health of a very large proportion of these rural credit cooperatives has deteriorated significantly.

For the revival of the STCCS, the Vaidyanathan Committee Report has suggested an implementable Action Plan with substantial financial assistance. The implementation of the Revival Package would result in the emergence of strong and robust cooperatives with conducive legal and institutional environment for it to prosper. A financially sound cooperative structure can do wonders for financial inclusion given its extensive outreach.

Micro Insurance

Micro-insurance is a key element in the financial services package for people at the bottom of the pyramid. The poor face more risks than the well off. It is becoming increasingly clear that micro-insurance needs a further push and guidance from the Regulator as well as the Government. The Committee concurs with the view that offering micro credit without micro-insurance is self-defeating. There is, therefore, a need to emphasise linking of micro credit with micro-insurance.

The country has moved on to a higher growth trajectory. To sustain and accelerate the growth momentum, we have to ensure increased participation of the economically weak segments of population in the process of economic growth. Financial inclusion of hitherto excluded segments of population is a critical part of this process of inclusion. We hope that the recommendations made in this Report, if implemented, will accelerate the process of financial inclusion.


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Chairman

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List of Abbreviations

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| Ag/BDS | Agricultural and Business Development Services |
| AIRCS | All-India Rural Credit Survey |
| APMACS | Andhra Pradesh Mutually Aided Cooperative Societies |
| ASA | Association for Social Development |
| ATM | Automated Teller Machine |
| BBA | Basic Bank Account |
| BC | Business Correspondent |
| BDS | Business Development Service |
| BF | Business Facilitator |
| BI | Bank of Indonesia |
| BIRD | Bankers Institute of Rural Development |
| BISFA | Building Inclusive Financial Sector in Africa |
| BKD | Badan Kredit Desa |
| BPL | Below Poverty Line |
| BPR | Bank Perkreditan Rakyat |
| BRAC | Bangladesh Rural Advancement Committee |
| BRI | Bank Rakyat Indonesia |
| BSA | Basic Share Draft Account |
| CB | Commercial Bank |
| CDA | Cluster Development Association |
| CDF | Credit and Development Forum |
| CDMA | Code Division Multiple Access |
| CD-Ratio | Credit to Deposit Ratio |
| CGAP | Consultative Group to Assist the Poor |
| CEPS | Common Electronic Purse Specifications |
| CESS | Centre for Economic and Social Studies |
| CGFSI | Credit Guarantee Fund Scheme for Small Industries |
| CMRC | Community Managed Resource Centre |
| CPU | Central Processor Unit |
| CRAR | Capital to Risk-Weighted Assets Ratio |
| CSP | Customer Service Point |
| DCCB | District Central Cooperative Bank |
| DDM | District Development Manager |
| DLCC | District Level Consultative Committee |
| DNBS | Department of Non-Banking Supervision of RBI |
| ECS | Electronic Clearing System |
| EGS | Employment Guarantee Scheme |
| EMI | Equated Monthly Instalment |
| EMV | Electromagnetic Compatibility |
| FIC | Financial Inclusion Customer |
| FIPB | Foreign Investment Promotion Board |
| FSC | Farmers' Service Centre |
| GCC | General Credit Card |
| GoAP | Government of Andhra Pradesh |
| GoI | Government of India |
| GPRS | General Packet Radio Service |
| GSM | Global System for Mobile Communications |

| | |
|---------|---|
| HR | Human Resources |
| ICAI | Institute of Chartered Accountants of India |
| IKP | Indira Kranthi Patham |
| IRDA | Insurance Regulatory and Development Authority |
| ISO-IEC | International Organisation for Standardisation - International Electrotechnical Commission |
| IT | Information Technology |
| JLG | Joint Liability Group |
| KCBP | Kalanjiam Community Banking Programme |
| KCC | Kisan Credit Card |
| KYC | Know Your Customer |
| LAB | Local Area Bank |
| LDKP | Lembaga Dana dan Kredit Pedesaan |
| LIC | Life Insurance Company of India |
| MACS | Mutually Aided Cooperative Societies |
| MDG | Millennium Development Goals |
| MFDEF | Micro Finance Development and Equity Fund |
| MFI | Microfinance Institution |
| MF-NBFC | Microfinance – Non-Banking Financial Company |
| MIS | Management Information System |
| MoRD | Ministry of Rural Development |
| MoU | Memorandum of Understanding |
| MRRU | Microfinance Research and Reference Unit |
| MS | Mandal Samakhyas |
| MW | Movement Worker |
| NABARD | National Bank for Agriculture and Rural Development |
| NAFSCOB | The National Federation of State Cooperative Banks |
| NBFC | Non-Banking Financial Company |
| NDDB | National Dairy Development Board |
| NDP | National Dairy Plan |
| NEFT | National Electronic Funds Transfer |
| NRFIP | National Rural Financial Inclusion Plan |
| NFC | Near Field Communication |
| NGO | Non-Government Organisation |
| NIBM | National Institute of Bank Management |
| NIRD | National Institute of Rural Development |
| NPA | Non Performing Assets |
| NSSO | National Sample Survey Organisation |
| NREGA | National Rural Employment Guarantee Act |
| NREGP | National Rural Employment Guarantee Programme |
| OBC | Other Backward Classes |
| ODI | Organisation Development Initiatives |
| OTS | One Time Settlement |
| PACS | Primary Agricultural Credit Society |
| PAIS | Personal Accident Insurance Scheme |
| PCARDB | Primary Cooperative Agriculture and Rural Development Bank |
| PFP | Popular Finance Partnership |
| PKI | Public Key Infrastructure (for Digital Signatures) |
| POCA | Post Office Card Account |
| POS | Point of Sale |

| | |
|--------------|--|
| PRI | Panchayati Raj Institution |
| RFA | Revolving Fund Assistance (Related to SGSY) |
| RFI | Rural Financial Institution |
| RFID | Radio Frequency Identification |
| RIDF | Rural Infrastructure Development Fund of NABARD |
| PKSF | Palli Karma Sahayak Foundation |
| RPCD | Rural Planning and Credit Department of RBI |
| RTGS | Real Time Gross Settlement |
| RUSETI | Rural Development and Self Employment Training Institute |
| SABA | South African Bank of Athens |
| SARFAESI Act | The Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act |
| SBI | State Bank of India |
| SC | Scheduled Caste |
| SCARDB | State Cooperative Agriculture and Rural Development Bank |
| SCB | State Cooperative Bank |
| SERP | Society for Elimination of Rural Poverty |
| SGSY | Swarnajayanti Gram Swarojgar Yojana |
| SHG | Self-Help Group |
| SHPI | Self-Help Promotion Institution |
| SIMPUTER | Simple Computer or Simple Inexpensive Multi-lingual Computer |
| RKBY | Rashtriya Krishi Bima Yojana |
| SLBC | State Level Bankers' Committee |
| SLRFIP | State Level Rural Financial Inclusion Plan |
| SSI | Small-Scale Industries |
| ST | Scheduled Tribe |
| STCCS | Short-Term Cooperative Credit Structure |
| TFFI | Technology Fund for Financial Inclusion |
| UK | United Kingdom |
| UN | United Nations |
| UNCDF | UN Capital Development Fund |
| UN DESA | Department of Economic and Social Affairs of the UN |
| URN | Unique Relationship Number |
| USA | United States of America |
| UT | Union Territory |
| VO | Village Organisation |