Inclusive Finance India Report 2021

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sourced from Livelihoods Asia Photo competition 2014

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List of Abbreviations

3ie	International Initiative for Impact Evaluation
AAIF	Assam Agribusiness Investment Fund
AEFI	Feedback and After-Effects of Immunization
AePS	Aadhaar-Enabled Payment System
AIF	Alternate investment fund
ANBC	Adjusted net bank credit
AP	Andhra Pradesh
APB	Aadhaar Payment Bridge
APIs	Application Programming Interfaces
APS	Affordable private schools
APY	Atal Pension Yojana
AQR	Asset quality review
ATMs	Automated teller machines
B2P	Business-to-person
BAP	BHIM Aadhaar Pay
BBPS	Bharat Bill Pay System
BC	Business Correspondent
BSBD	Basic savings and bank deposit
BSBDA	Basic savings bank deposit account
CAGR	Compound annual growth rate
CASA	Current account savings account
CCL	Cash credit limit
CGTMSE	Credit Guarantee Fund Trust for Micro and Small Enterprises
CICO	Cash-in/cash-out
CICs	Credit information companies
CIF	Community investment fund
CMIE	Centre for Monitoring Indian Economy
CPHS	Consumer Pyramids Household Survey
CRAR	Capital to risk-weighted assets ratio
CRP-EP	Community resource persons-enterprise promotion
CRPs	Community resource persons
CRR	Cash reserve ratio
CSC	Common Service Centres
DAY-NRLM	Deendayal Antyodaya Yojana–National Rural Livelihoods Mission
DBT	Direct benefit transfer
DFIs	Development finance institutions
DFS	Digital financial services
DHM	Digital Health Mission
DIBs	Development impact bonds
DSCB	Domestic Scheduled Commercial Bank
DWCRA	Development of Women and Children in Rural Areas
ECLGS	Emergency Credit Line Guarantee Scheme
FI	Financial inclusion
FIP	Financial inclusion plans
FL-CRPs	Financial literacy CRPs
FPCs	Farmer producer companies
FSR	Financial Stability Report
FY	Financial year
G2P	Government-to-person
GAO	Government Accountability Office
GNPAs	Gross non-performing assets
GOI	Government of India

GP	Global Partnerships
GRM	Grievance redress mechanism
GST	Goods and Services Tax
HFCs	Housing finance companies
HNI	High net worth individuals
IFI	Inclusive Finance India
IIC	Impact Investors Council
JLGs	Joint liability groups
LABs	Local area banks
LIC	Life Insurance Corporation
LMI	Low- and moderate-income
LTROs	Long-term repo operations
MACS	Mutually Aided Cooperative Societies
MDR	Merchant discount rate
MFIs	Microfinance institutions
MGP	Matching Grant Program
MP	Madhya Pradesh
MPC	Monetary Policy Committee
MSC	MicroSave Consulting
MSDF	Michael & Susan Dell Foundation
MSMEs	Micro, small and medium enterprises
MUDRA	Micro Units Development and Refinance Agency
NABARD	National Bank for Agriculture and Rural Development
NBER	National Bureau of Economic Research
NBFCs	Non-banking financial companies
NDUW	National Database of Unorganized Workers
NE	North-eastern
NGOs	Non-governmental organization
NHB	National Housing Bank
NIBR	Nomura India Business Resumption Index
NIM	Net interest margin
NNPA	Net non-performing asset
NPAs	Non-performing assets
NPCI	National Payments Corporation of India
NPS	National Pension System
NSAP	National Social Assistance Programme
NUE	New Umbrella Entity
NULM	National Urban Livelihoods Mission
OCEN	Open Credit Enablement Network
ODEs	Open Digital Ecosystems
P2B	Person-to-business
P2G	Person-to-government
P2M	Person-to-merchant
P2P	Person-to-person
PAN	Permanent Account Number
PAR	Portfolio at risk
PB	Payment Bank
PDP	Personal Data Protection
PFP	Public Provident Fund
PFS	Pay-for-success
PGs	Producer groups
PLF	Primary-level federations
PMFBY	Pradhan Mantri Fasal Bima Yojana
PMGKY	Pradhan Mantri Garib Kalyan Yojana

PM-JAY	Pradhan Mantri Jan Arogya Yojana
PMJDY	Pradhan Mantri Jan Dhan Yojana
PMMY	Pradhan Mantri MUDRA Yojana
PMSBY	Pradhan Mantri Suraksha Bima Yojana
PM-SYM	Pradhan Mantri Shram Yogi Maandhan
PMUY	Pradhan Mantri Ujjwala Yojana
PoS	Point of Sale
PSB	Public sector bank
PSL	Priority sector lending
PSLCs	Priority sector lending certificates
PSSF	Priority Sector Shortfall Fund
PVBs	Private sector banks
QR	Quick Response
RBI	Reserve Bank of India
RRBs	Regional rural banks
SBA	Small borrowal accounts
SCBs	Scheduled commercial banks
SEBI	Securities and Exchange Board of India
SFB	Small Finance Bank
SGSY	Swarnjayanti Gram Swarozgar Yojana
SHG	Self-help group
SIBs	Social impact bonds
SIDBI	Small Industries Development Bank of India
SLF	Secondary-level federations
SLTRO	Special three-year long-term repo operations
SMEs	Small and medium enterprises
SPDP	Social Protection Delivery Platform
SSA	Sukanya Samriddhi Yojana
SSSM	Samagra Samajik Suraksha Mission
SVF	Social venture fund
THR	Take home ration
TL	Term loans
TLTROs	Targeted long-term repo operations
TNRTP	Tamil Nadu Rural Transformation Project
UAM	Udyog Aadhaar Memorandum
UCBs	Urban cooperative banks
UNDP	United Nations Development Programme
UPI	Unified Payments Interface
USAID	United States Agency for International Development
WCIF3	WaterCredit Investment Fund 3
YoY	Year-over-year

Foreword

For the last two years, COVID-19 has wreaked havoc across the world, shattering economies, causing mayhem, across nations—unparalleled. Many people are in peril. The crisis has required a monumental effort and urgent need to confront the dire situation and challenges, needing to save lives as well as livelihoods. Yet, it is also the grind of life's day-to-day hardships, compounded by the pandemic's effects and prolonged uncertainty, that is taking a serious toll on populations—especially vulnerable groups such as the poor, women, smallholder farmers and small businesses and microenterprises, all of whom continuously remain challenged for access to financial services, good coping mechanisms and resources. These population segments lack sufficient savings to safeguard them in a time of extended unemployment. They lack access to adequate credit and investments to keep their businesses afloat and solvent, or to expand them. They lack insurance to protect them against costly medical bills if a family member falls ill. And they lack the opportunity to build financial health and resilience to improve their lives.

A silver lining in all this chaos, was perhaps that in India, early investments in digital public infrastructure—digital identity, interoperable payment rails, high mobile penetration and access to basic banking accounts—yielded great results in ensuring emergency transfers and social entitlements delivery in a timely manner. The year witnessed significant surge in digital payments—a whopping 55.54 billion digital transactions in FY 2021 against 45.72 billion in FY 2020; scrapping the layer on who is driving these transactions, it is evident that vulnerable customer groups, such as women and the rural population, who often have comparatively low literacy rates and lack of exposure and access to technology, are being left behind. Women are also typically secondary users of mobile phones, late adopters of technology and are often excluded from having official government IDs. Usage, in truly inclusive manner and quality of services provided, continues to be a growing material concern. There is a significant need for leveraging the current digital infrastructure to drive universal financial inclusion as well.

With several bold and timely initiatives taken by government, public sector banks, regulator and supply side service providers (and many more are on the anvil), I'm sure there will be equal policy nudges to spur the demand as well. Given this overall emergent scenario, there hasn't been any important articulation of plans to take the incredible success of the government's great impetus to financial inclusion forward through new incremental ideas.

The Inclusive Finance India (IFI) Report 2021 attempts to collate emerging trends in the financial inclusion sector, highlights policy perspectives, achievements and grey areas for action. The mainstay proposition of this report is to provide rich information for learners, practitioners, researchers, policymakers and public administrators who are committed to furthering the cause of financial inclusion in India.

IFI report is one of the flagship efforts of ACCESS, perhaps the only such effort in the country, that tracks the advancement of financial inclusion on a year-on-year basis. ACCESS has been publishing IFI report since 2008, which has become an important reference document for all stakeholders engaged with matters related to financial inclusion. The raison d'être of this report largely emanates from the need for a single reference book that would summarize the important advancement made in the financial inclusion space in the last one year.

All the accomplished authors have made an excellent effort in succinctly capturing all the important happenings in the Financial Inclusion space during the year, several of these as a response to the pandemic. More importantly, the authors mostly highlighted the positive initiatives of the government for the alacrity in its response to the shifting scenario. Poring through the report, it gives an excellent balance of efforts well made, as also of a few shortcomings, mostly given the unpredictability of how the pandemic situation evolved. IFI report can be considered as both the telescope and microscope of the Indian Financial Inclusion landscape. The report has given the microscopic and telescopic view across and also within chapters. Authors have covered both the policy-relevant aspects and operational aspects of different dimensions of Financial Inclusion. To give the overarching view of financial inclusion, the report also touched upon some of the issues in the overall financial sector. Specifically, the report has compiled and analysed the major findings from important reports released by reputed organizations (like NABARD, RBI, among others), reports released by government departments about the performance of flagship schemes and authors' views on important issues based on their interactions with policymakers.

I am glad that N. S. Viswanathan, former Deputy Governor of the Reserve Bank of India, agreed to shoulder the editorial responsibilities for this year's IFI report. The authors have assiduously put together the report for 2021, analysing policy, poring through scattered data and secondary literature, consulting with key stakeholders, and undertaking interviews. I am fully aware of the enormous arduous effort that goes into bringing such a report together, collating disparate strands within the financial ecosystem. All the authors of the report are keen researchers of international repute and astute analysts of policy. I am sure this effort will present great new insights into financial inclusion advancement in the country. It is now 15 years since ACCESS first conceived of the need to have an annual review of financial inclusion, as it evolves in the country, through a well-analysed report. I am happy that, over the years, it has evolved into an important reference document, eagerly awaited each year, and I thank all the authors for agreeing to take on the challenge.

I take this opportunity to thank our key supporters to the report. At the outset, I would like to thank Dr G. R. Chintala, Chairman NABARD, for his continued conviction that the IFI report brings good insightful value for a large audience. His support to our endeavours has been very encouraging. I take this opportunity to thank Dr Pawan Bakhshi and the Bill & Melinda Gates Foundation for their continued support to the report. Besides the Gates Foundation support for several years now, Pawan, each year, specifically provides very valuable new perspectives for the report, which helps to enrich its contents. I take this opportunity to also thank Mr Ravi Aurora, Division President, South Asia, Mastercard, and his team comprising of Ms Latika and Mr Rohan for the continued association with the report, for the fourth year now. I am very thankful to Mr Sivasubramanian Ramann, Chairman and Managing Director, SIDBI, and Mr Arup Kumar, CGM, SIDBI, for their continued support. I am also thankful to Mr Arindom Datta, ED, Rabobank Foundation, and IDFC First Bank for their support and guidance in shaping the report. Without this incredible support, it would not have been possible for ACCESS to mount this complex task of bringing together the report.

Finally, the small team at ACCESS, guided by Mr Vipin Sharma, as always, anchored the full responsibility of ensuring that the IFI report is released at the IFI Summit. Coordinating with the authors on their chapters, coordinating with the publishers, poring over copyeditor's corrections, grappling with other related requests—somehow this small brigade manages this task, unflustered and undaunted. Congratulations Priyank, Priyamvada, and Lalitha for an incredible job, well done.

I would strongly recommend this report for the financial sector policy actors, practitioners and others who think financial sector is relevant to them, specifically those who view it with an inclusion lens.

Happy reading!

Aryasilpa Adhikari
Vice President
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access

Preface and Overview

The *Inclusive Finance Report* (IFR) is a unique initiative of ACCESS Development Services to make a holistic assessment of financial inclusion initiatives in India both in terms of policy measures and their impact. Over a period of time it has evolved into a report contributed to by eminent academicians, practitioners and experts. This year's report, which is the 15th, is being brought out at a time when the world in general is coming out of one of its worst crises that severely hurt human lives and livelihoods. While the Great Recession was an economic crisis that had its origins in the financial sector, the COVID-19 pandemic hurt the financial sector through the real economy. It was so devastating in its impact and had conflicting solutions that left policymakers with having to make a Hobson's choice between saving lives and providing livelihoods. Saving lives required lockdowns but that could lead to cessation of economic activity. Stoppage of labour-intensive activities like construction, where the more vulnerable people are employed, meant snatching away their livelihood, exposing them to greater impoverishment and misery. In India, the construction activities employ migrant labour, and a host of economic activities revolve around them. The pandemic saw a reverse migration with its attendant economic and health consequences. Many small-time businesses like eateries and even higher end restaurants witnessed stoppage of business though the more organized ones among them moved to alternate delivery channels to keep their business going.

India witnessed a very severe second wave of the pandemic that crippled economic activity due to complete and partial lockdowns over a long period of time. Emotional distress caused by mortalities attenuated the economic misery due to loss of income. The Central Government came with a series of measures under the umbrella of the Atmanirbhar Bharat programme to provide financial and other support to address the economic impact of the pandemic and provide succour to the most vulnerable sections of the population. More importantly, thanks to the massive vaccination drive of a scale that beat global achievements by a mile, the dreaded third wave of the pandemic has so far been, and possibly for good, averted. The economy is slowly getting back to normalcy. While growth projections portend robust recovery, the fear of the pandemic raising its head again imparts a sense of fragility. As the Governor of the Reserve Bank of India (RBI) put it in his address at this year's SBI Annual Conclave, the growth impulses are uneven. Notwithstanding the debate on the future trajectory of economic activity, there is no gainsaying the fact that the interregnum has been extremely grim and apart from the central government, the state governments, regulatory authorities, more particularly the RBI, as well as several market players, intervened in both conventional and unconventional ways to make life for people in general and the more vulnerable in particular as less difficult as possible. Of course, given the scale of the problem, one could say, nothing was enough.

The central government took a host of steps under the Atmanirbhar Bharat banner. These included direct cash benefit transfers, providing cereals and pulses from its buffer stock, credit guarantee schemes for the MSMEs, etc. The RBI took several regulatory measures to ensure there was adequate liquidity in the system and used the targeted long term repos to ensure that liquidity reached the intended segments of the economy. Sensing the role of non-banking finance companies (NBFCs) in purveying credit to the economic operators that the banking system is less likely to lend to, RBI extended the priority sector tag to bank loans to NBFCs for on-lending to specified sectors/activities. These measures were adopted in tandem with facility for one-time restructuring of debt that were defaulted on due to the pandemic.

In this backdrop, this edition of the IFR too, like the last year's, focuses on the pandemic and its impact so much so that the writ of the pandemic can be felt through the entire report. The pandemic severely hit the lives of the more vulnerable and consequently a significant segment of, if not the entire, target of inclusive finance efforts. It brought to the fore how the increased access to formal financial services, which got impetus with the opening of the Pradhan Mantri Jan Dhan Yojana (PMJDY) accounts, is important in such times. Similarly, penetration of credit from the formal financial services segment gave to the borrowers in the bottom of the economic pyramid better opportunities and instrumentalities to tide over loss of income led debt defaults.

The role of financial inclusion in fostering economic growth and ensuring that the benefits of growth percolate to those in the lower strata of the economic pyramid can hardly be overemphasized. Most research, if not all, affirm the positive impact of financial inclusion on economic growth. The proponents of the positive impact of financial inclusion on growth argue, among others, that by making finance available and affordable for all economic agents, it will leave a positive impact on growth of economic activities that will, in turn, increase output. Some of these studies emphasize the role of financial development in economic development to postulate that financial inclusion fosters economic growth. Though there may not be complete consensus on the economic growth or financial stability effects of financial inclusion, there is a general agreement on its impact on reducing poverty and providing a better quality of life to those at the bottom of the economic pyramid. Which is why, financial inclusion is part of the Millennium Development Goals. As IMF Deputy Managing Director Mitsuhiro Furusawa once remarked, financial inclusion is the bridge between economic opportunity and outcome.

Generally, financial inclusion has three facets—penetration of formal financial services, access to financial services and use of financial services by those who have access. Normally access to financial services is assessed in terms of banking penetration, because ability to avail simple savings products is the first outcome of access, which generally banks provide. In India, efforts to make banking services available in the less banked centres have been made through various instrumentalities. The nationalization of banks, was among others, premised on the argument that banks in the private sector are less likely to venture into areas where commercial opportunities are perceived to be low. The branch licensing policy adopted over a period of time showed a clear tilt towards encouraging banks to open branches in unbanked centres through various means. The Financial Inclusion Plans made a pitch for graded penetration of banking services based on population criteria. More recently, the regulator prescribed that at least 25% of branches opened in a financial year should be in unbanked rural centres.

Undoubtedly, making banking services available to all parts of the country is important, but facilitating access to banking services required opening of bank accounts for all. While various efforts through enhancing financial literacy, monitoring of account opening at various forums and the like were made in this direction, one of the most defining moments in the inclusive finance journey of India has been the opening of PMJDY accounts, which was a case of opening of bank accounts for all households in camp mode. Now the target of the programme has been expanded to cover all adults. The number of PMJDY accounts has gone up from 179 million in August 2015 to 430.4 million in August 2021. Between August 2020 and August 2021, the incremental PMJDY accounts were more than 25 million (Ministry of Finance, Government of India). The Jan Dhan accounts, as PMJDY accounts are often referred to, along with Aadhar (a unique biometrics based identity database) and mobile telephony, referred to as the JAM trinity, form the bedrock of the current efforts at enhancing inclusive finance in India.

On the front of making banking services available in the hinterland, two important policy developments need mention. First, the introduction of the concept of business correspondents facilitated the use of a more formal agent structure that enabled banks to provide minimum banking services at a low cost. Second was the decision of the RBI to move away from the concept of brick and mortar branches as the only formally accepted structure of presence to treating a banking outlet which can be managed by a Business Correspondent (BC) as a mode of bank presence. As a result, apart from a total of 55,073 branches in villages, there were 1,236,809 banking outlets served through BCs as at the end of December 2020.[1] While this may not yet have seen a commensurate increase in transactions through non-branch interface points, the outlets do serve an important purpose. Perhaps streamlining the enrolment and functioning of BCs can have a salutary effect on this mode of bank presence getting more popular.

The use of BCs as an accepted mode of banking intermediation by the regulator was possible only because of technological innovations. While the role of technology in furthering financial inclusion, more particularly in the payments space, is dealt with in some detail later, it needs to be emphasized here that technological advances have helped improve access to financial services, notably by lowering costs and extending services into areas where bank branches may not exist or it may not be economically viable to open a branch.

Undoubtedly, access to financial services is not necessarily the same thing as active participation in the financial system. It is important to take affirmative steps including financial literacy measures so that the newly included persons are able to take advantage of the services the access opens up for them. Nevertheless, the mere fact of the Jan Dhan accounts having been opened enabled the government to make direct cash transfer benefits available to the account holders seamlessly. The direct cash benefits transfer was an important policy intervention to ameliorate the financial distress caused by the pandemic to the persons at the bottom of economic pyramid. Had it not been for the Jan Dhan accounts, directing the benefits to the targeted persons would have been extremely difficult. There is also a significant increase in the balances in the Jan Dhan accounts which stood at Rs 1.46 trillion in August 2021 against Rs1.02 trillion in Aug 2019 and Rs 1.30 trillion in August 2020 (Ministry of Finance, Government of India).

While access to deposit products is normally linked to penetration of banking services, availability of credit from the formal financial services sector is not bank-driven alone. In India, banks and NBFCs including NBFC-MFI form part of the regulated financial services providers purveying credit to the economically vulnerable segments of the society. The commercial banks including the government-owned banks are mandated to lend at least 40% of their loan portfolio to the borrowers in the priority sector, comprising agriculture, MSME, affordable housing, exports, etc. Over the years, the activities forming part of the priority sector and sub-targets have been revised and refined. A system of trading of priority sector lending (PSL), where a bank having a PSL portfolio larger than the regulatory mandate could transfer the PSL benefit for a fee to a bank that has fallen short of the target has been put in place by the RBI. The loan portfolio and the underlying credit risk remains with the originating bank and the acquiring bank can only claim the PSL benefit. In the year 2020–2021, trading volume in priority sector lending certificates recorded a growth of 25% over that in 2019–2020 and stood at Rs 5.89 trillion.[2]

The issue with PSL targets for the mainstream commercial banks is that given their cost efficiency considerations they tended to cater to the relatively upper end of the borrowers in the specified segments except where there are mandated sub-targets. Nevertheless, there existed a large segment of population which fell outside the comfort zone of such banks. Creating an ecosystem conducive to inclusive financial services is an important element of the process of reaching formal financial services to those at the bottom of the pyramid. Efforts to create localized institutions— regional rural banks in the 'public sector' and local area banks in the private sector—could not succeed commercially for different reasons. Recognizing the problems of limited geographical jurisdiction, the differentiated licensing system introduced in 2014 allowed for the establishment of small finance banks (SFBs), having pan-India jurisdiction, with a clear mandate to majorly lend to the smaller borrowers and those falling in the priority sector. The SFBs had a higher PSL target of 75% and were also mandated to keep the ticket size of half their total number of loans at Rs 2.5 million or less. The SFBs were thus banking institutions with a mandate to do business with the inclusive finance segment. The performance of the SFBs in furthering the goal of financial inclusion is mixed in the sense that while the credit portfolio targets have been achieved, their branch outreach leaves scope for progress. Also, while the SFBs have a large number of small loans, the weight of the small loans in the overall portfolio in terms of amount is coming down. All said and done, the significant role of SFBs as instruments of making credit available to the less-included cannot be overlooked.

The financing of MSMEs is a crucial element of PSL. Banks and NBFCs are involved in catering to the need of this sector. This sector by nature is significant for the economy due to its contribution to employment, GDP and exports. But many entities in the sector are more vulnerable to economic shocks and were badly affected by the pandemic. The regulatory measures such as moratorium, restructuring of credit facilities and the government support under the Emergency Credit Line Guarantee Scheme have helped the sector to smother the adverse effects of the pandemic. The decision of the RBI to provide PSL status to loans granted by banks to NBFCs for on-lending to the MSME sector and the strengthening of the co-lending arrangement between banks and NBFCs are expected to boost the flow of credit to this economically crucial sector.

Borrowers in the microfinance segment are a significant part of the access to credit hierarchy. Traditionally, these are borrowers who get upgraded from being part of the informal credit market to the regulated market players. For these borrowers, access to formal credit is seen as more important than cost and the lending in this space is characterized by higher interest rates. The microfinance institutions (MFI), both in the 'for profit' and the 'not-for-profit' categories provide credit to this segment. While banks were more comfortable to lend to the microfinance segment borrowers through wholesale lending to the MFIs, which incidentally is treated as part of their PSL portfolio, more recently some banks have ventured directly into this space through BCs. The MFI sector does off and on witness a crisis situation, but it has also displayed a fair degree of resilience. The delinquencies in the MFI sector may be a source of concern. While the portfolio at risk measured at greater than 90 days has declined from December 2020 through to June 2021, that measured on 30 day basis declined from close to 14% in December 2020 to sub 10% levels in March 2021 but has gone up substantially to 15.6% in June 2021.[3] It is however important to note from an inclusive finance perspective that getting the borrowers in the vulnerable segment to borrow from the regulated entities provides them greater protection against sharp practices and also the benefit of regulatory forbearances like moratorium during difficult situations as the pandemic.

Among the early measures to bring the financially excluded persons to the mainstream financial services was the setting up of self-help group (SHG)–bank linkage programme which has now segued into the National Rural Livelihood Mission and its urban counterpart. This programme has played a crucial role in empowering the economically excluded, particularly the women. Like many other such efforts, there is need for more innovation in this area as well. Further, many of the efforts at reaching financial services through the SHG programme and lending by MFIs are specifically designed or have become instruments to empower women. While all MFI lending is targeted at women borrowers, the exclusive women SHGs as at end of March 2021 were 9.72 million out of 11.22 million bank-linked SHGs.[4] Similarly, 56% of PMJDY accounts are in the name of women beneficiaries. These are significant statistics from the women empowerment perspective. Nevertheless, how much the women centricity of these programmes have helped address gender inequality in the form of a qualitative improvement in the position of women in a household or the society needs to be assessed qualitatively.

Another area where financing the credit requirements of those at the bottom of the economic pyramid requires innovation is the way the institutions financing them are funded. When the choice is between access and no access, the former relegates cost to a lower priority. But finding funding options that give a commensurate risk–reward mix to the providers of risk capital—be it equity or debt, and yet lowering the cost of funds for the ultimate beneficiaries is necessary to enable them to improve their quality of life. This will be possible if the financial intermediaries involved in extending credit to those at the bottom of the pyramid have access to blended finance which will be a mix of financial reward-seeking and social objectives promoting sources of funds.

The importance of technological advances in furthering financial inclusion cannot be overstated. As mentioned earlier, the use of BCs as the extended arm of banks and making payments available to a large number of accounts are the outcomes of information technology developments. In India, digital payments space has witnessed significant innovations to put India in the top bracket in this regard globally. Supportive polices pursued by the RBI, innovation by private players and the JAM trinity have facilitated this. The unified payments interface (UPI) brought a landscape changing impact to the payments ecosystem, and the fear of contact-based infection during the pandemic deepened and widened the market for contactless payments. The rate of growth of volume of digital transactions decelerated followed by a negative growth in the initial phase of the pandemic, but after June 2020, it vaulted upwards substantially. An important feature of the digital transaction trajectory was the increased adoption of UPI in retail credit transfers. UPI accounted for only Rs 8.76 trillion out of Rs 260.90 trillion of credit transfers in the retail segment, thus representing just 3% thereof in 2018–2019. In the year 2020–2021, the share of UPI in retail credit transfers went up to 12% clocking a value of Rs 41.03 trillion out of Rs 335.22 trillion.[5] Digital transfers through QR code and other UPI transfers gained currency as the pandemic drove people to embrace contactless payments leading to its adoption even by small business operators such as vegetable vendors, the neighbourhood grocery shops and the like.

While access to financial services such as deposits and credit products is sine qua non for deepening financial inclusion, access to insurance—life and health—is no less significant. The pandemic underscored how important this is for the economically marginalized persons. Several insurance schemes have been introduced as a part of the social security network. These are generally low-premium coverages and require state support. There is scope and need for innovation in this area.

This year's IFR through 11 chapters written by different authors look at these aspects more closely. It is evident from these chapters that India has made long strides in bringing a vast section of the society into the formal financial services fold. This is buttressed by the jump in the financial inclusion Index introduced by RBI recently. The pandemic provided a test-bed for assessing the efficacy and effectiveness of the measures to deepen the reach of formal financial services. The general finding is that while a lot has been done, there is still a lot more to be done. Similarly, although many of the institutional mechanisms and structures are strong, there are fault lines too and therefore designing proper structures to reach social security measures needs attention.

Inclusive finance will undoubtedly continue to grab policymakers' attention. Achieving financial inclusion will require public policy push, support from the civil society players and continual innovation. A recent initiative that can push the pace of financial inclusion is the account aggregator ecosystem which has gone live with a few major bank and non-bank participants embracing it. It has the potential to change the way MSME financing is done and deepen the making the formal financial system available to those without adequate credit history. RBI's Regulatory Sandbox, which is now in place and working, could be a test-bed for experimenting and mainstreaming many innovative ideas for effective and efficient financial inclusion.

I hope this year's edition of the IFR too will make an interesting and useful reading to academicians, sector experts, practitioners and policymakers and pave the way for path-breaking ideas to further accelerate the pace of financial inclusion.

Before signing off, I must thank the authors for the scholarly written chapters and the entire Access Development Services team for the support provided to me to edit this year's IFR.

N S Vishwanathan

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The Microfinance Industry: Towards a New Order

N. Srinivasan

1

1.1. MICROFINANCE IN A PANDEMIC YEAR

When the theme of financial inclusion gets discussed, its often that policymakers focus on providing savings and payment services to the people. Thrift and savings provide a medium through which households at the bottom of the pyramid can put away their small infrequent surpluses for the future. Having a safe and reliable mechanism to save this hard-earned money is a priority requirement in the theme of financial inclusion. Similarly given that people at the bottom of the pyramid migrate in search of livelihoods, they tend to send money back to their families and also are required to make other payments. An efficient and low-cost payments mechanism is a boon to those who have to make frequent payments and remittances. On account of the apparently high use-case for savings and payments, policymakers have tended to focus their efforts on these two aspects. Considerable effort went in to getting savings accounts opened for all adults in the country through products such as 'No Frills Accounts', 'Basic Savings Bank Deposit Account' and the Jan Dhan Yojana campaign.[1]

Credit inclusion of marginalised people is a higher order need in inclusion. The money to save and the money to pay arises only when viable livelihoods start generating incomes. People with low or no capital to invest need external resources mostly in the form of a loan in order to kickstart their livelihoods. However, financial inclusion as seen by policymakers initially did not have credit inclusion as a priority. It is here that the microfinance sector found a mission worth pursuing. In the Indian context, microfinance institutions (MFIs) both in the for-profit and not-for-profit forms commenced their work of providing credit access to marginalised households more than 30 years back. After a long interval, the banking system also joined hands in direct and indirect provision of credit to microfinance clients. Today the coverage of the marginalised community is at a level which gives great hope that financial inclusion especially on the credit side need not be a policy-driven supply side offering but can be a private sector initiative built upwards from the ground.

In the broad microfinance sector which includes banks, small finance banks (SFBs), MFIs, non-banking financial institution (NBFCs) and non-governmental organization (NGOs)/non-profit firms, the number of active loans are about 112 million and the gross loan portfolio amounted to Rs 2,530 billion[2] (Table 1.1).

Across the country, the average number of loans per client which was about 1.65 in FY 2017 had steadily increased to 1.85 in FY 2021 indicating deepening of credit at individual levels.

Table 1.1. The Broad Microfinance Sector

	2017–2018	2018–2019	2019–2020	2020–2021
Outreach—loan a/cs million	76	96	110	112
Outreach—unique clients million	46	56	63	60
Loan Outstanding in INR billion	1,373	1,885	2,342	2,538
Amount disbursed in INR billion	1,416	2,075	2,411	1,733
PAR 30+ days %	7.73	5.6	6.6	9.7

Delinquencies measured by portfolio at risk (PAR) were declining from the demonetisation effect of FY 2017, but started increasing in FY 2020, primarily on account of the last two weeks of March 2020 facing a lockdown in many key states. In FY 2021, the PAR increased further during the year, before moderating to 9.7%, highest year end level in the history of the microfinance sector.

The sector has been witnessing a structural change in the last few years. A large major change was about five years back when leading MFIs became banks and SFBs, reducing the footprint of MFIs. In the last five years, the MFI segment has gained lost ground. A discernible shift is the interest of banks to have a larger direct exposure in the sector. Banks have, in addition to bulk funding of MFIs, sought to create portfolio in their own books[3] (Table 1.2).

Table 1.2. Banks Aim for Higher Direct Exposure[4]

	Share of OutstandingLoans			
	2018	**2019**	**2020**	**2021**
Banks	30.4%	32.8%	39.4%	42.0%
SFBs	21.3%	18.8%	19.1%	16.4%
MFIs	36.8%	36.3%	30.1%	30.6%
Others	11.5%	12.2%	11.5%	11.0%

The portfolio generated through business correspondents by banks increased from 21.1% of total outstanding loans in 2018 to 23.3% in 2021. This change in the mindset of banks is attributable to the high net interest margin, resilience of the sector to crises and the priority sector tag. A second factor is that seven SFBs and one universal bank, having been MFIs earlier, continue to expand their portfolios with full understanding of the potential of microfinance clients as future graduated clients. Over the last four years, banks gained an additional share of about 11.6%, while SFBs and MFIs lost about 5% and 6%, respectively. With the proposed changes in regulation of microfinance that seek to level the playing field between banks and MFIs, one has to see whether MFIs will recover lost share.

While the microfinance sector grew at a good pace during the period 2006 to 2010, the Andhra Pradesh (AP) crisis of 2010 did slow down its spread for a couple of years (Figure 1.1). A faster growth rate was witnessed for the next three years (2013–2016) and again the sector was severely impacted in 2016–2017 on account of demonetisation of high value notes.[4] The impact then was severe as for the first time the problems were faced across the country and the sector contracted in terms of both unique clients and outstanding loans. From 2018, high growth rates resumed, but the Assam crisis from 2019 and the COVID pandemic in 2020

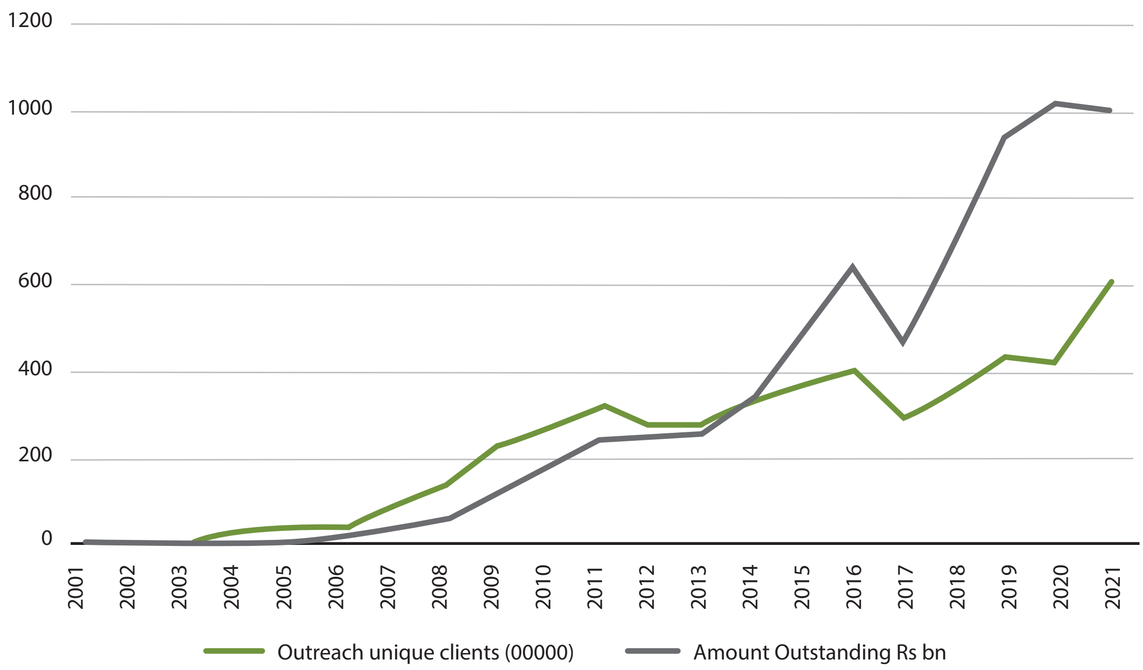

Figure 1.1: Two Decades of MFIs[5]

Table 1.3. Progress of Microfinance Institutions[7]

	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2021
Unique clients (million)	267	317	275	275	330	371	399	295	351	429	423	599
Loan outstanding (₹ billion)	183.4	243.3	246.1	256.7	335.2	488.8	638.5	468.4	687.9	943.9	1016.6	999.9
Loan disbursed (₹ billion)	293.30	351.76	226.35	257.96	385.58	568.60	723.45	524.47	817.37	1098.04	1064.04	930.99
PAR 30+ days %	0.4	3.671	1	0.4	0.02	0.13	0.29	1.32	0.81	0.65	0.56	6.72

had an impact. In FY 2020–2021 (more particularly in the last quarter), the sector had put behind the COVID-related concerns and resumed its growth. The most impressive aspect of the sector is its resilience and ability to bounce back from local, regional and national disruptions of business. In a year that was adversely impacted by the pandemic the delinquencies for the MFIs (Table 1.3) measured by PAR of 30 days was around 6.72% in March 2021, which was much lower than the broader industry level of 9.7%.

MFIs have made steady progress after the AP crisis in 2010 (Table 1.3). The sector had been responding to large crises typically by reducing exposure both in terms of clients and loans. But this response was influenced by the funders and investors who had a much higher risk perception and low risk tolerance towards a sector that had proved to be far better in collection efficiency and delinquency management. While in the aftermath of demonetisation not only disbursements declined, outstanding loans also declined sharply, during 2020–2021, despite the COVID impact and the spike in PAR, outstanding loans have not declined sharply, mainly on account of the moratorium and higher disbursements in the last quarter of 2020–2021.

While the MFIs started providing small ticket loans to people of small means in remote locations, both urban and rural, the realisation that this can become a scalable model even for banks to adopt came in much later. While the MFIs lent money and recovered it efficiently with high profitability, their ability to attract equity from different sources (especially from abroad) was very high. Banks provided the bulk loans needed by MFIs for retailing. After a point of time, banks realised that the microfinance assets could be taken on their own books rather than being passed on to a retailer's book. The introduction of business correspondents in the banking system by the regulator provided the space and the instrument required by banks to take direct exposures in microfinance. So today we see different players and different channels through which microfinance flows to the ground. Commercial banks (both in public and private sectors), regional rural bank (RRBs), cooperative banks, small finance banks, NBFCs and NBFC-MFI are all into microfinance. A few trusts and societies also have microfinance portfolios. Direct origination of loans, purchase of securitised pools of microfinance loans, channelling loans through business correspondents and purchase of priority sector lending certificates (PSLCs) are some of the ways in which different institutions participate in creating/backstopping microfinance portfolios. The subscribers to microfinance-originated debt papers include insurance companies and mutual funds, fully reflecting that microfinance loans have become a prime asset class.

1.2. PERFORMANCE OF MFIS IN THE LAST YEAR[8]

Despite the pandemic-induced problems that lasted almost throughout the year in different parts of the country, MFIs posted a reasonably good growth in terms of outreach and portfolio parameters. The number of branches increased by about 5% and there was a net increase in staff employed by about 7%. The portfolio outstanding in the books of MFIs increased by more than 10%, while the managed portfolio increased by 8%. The Business Correspondent (BC) portfolio recorded the best growth rates during a year in which both MFIs and banks wanted to reduce risks. Most significant part of improvements was in the average cost of funds which declined from 11.9% in FY 2020 to 10.9% in FY 2021. To a large extent this was the result of a favourable dispensation from the RBI and Government of India (GOI) that enabled bulk loans at lower effective cost through the different facilities created to deal with the COVID-induced liquidity stress. A large part of additions to clients, accounts and loan disbursements happened in the last quarter of the year when the lockdowns were lifted gradually in different states.

The expectation at the onset of COVID was that the operating cost might increase as lenders might spend more time and effort on dealing with loan delinquencies. In reality, there was a net reduction in operating costs of MFIs compared to the previous year by more than 50 basis points. The suspension of field activities during successive, prolonged lockdowns and the use of virtual meetings for a variety of purposes in place of physical visits contributed to the cost reduction. The average interest charged to members also decreased by about 50 basis points in FY 2021 compared to FY 2020. However the impact on profitability was severely negative. The return on assets decreased from 3% to 0.67%. Similarly the return on equity declined from 13.17% in FY 2020 to 1.44% in FY 2021. The most significant cause of reduced profitability was obviously the higher provisions and write-offs that became necessary in the face of defaults.

The large MFIs continue to progress at the top of the table (Table 1.4). SKDRDP, acting as a BC for many banks in the State of Karnataka led the table with highest outreach to clients and highest gross loan portfolio by end March 2021. SKDRDP accounted for 10% of clients of microfinance and that too from operating in one state. The top 10 MFIs accounted for two thirds of all clients and 75% of outstanding loans.

Table 1.4. Top MFIs in Outreach

Name of MFI	Clients (Million)	Name of MFI	GLP (₹ Billion)
SKDRDP	3.2	SKDRDP	149.6
CA Grameen	2.9	CA Grameen	113.4
Satin Creditcare	2.6	Spandana	81.4
Spandana	2.5	Satin Creditcare	72.8
Asirvad	2.4	Asirvad	59.9

The changes in geographical spread[9] have been rapid. The last five years have seen a shift in concentration of portfolio and incremental acquisition to the eastern region. While the wider geographical spread helps to reduce the concentration risk in the southern region, the vulnerabilities are increasing in the East and Northeast.[10] Assam has been a significantly soft underbelly of the sector over the last three years, requiring State support and haircuts for a resolution (more coverage on this later). Between 2016 and 2021, South lost 12% share in clients and 14% share in loans (Figure 1.2). During the same period, East and Northeast gained 14% share in clients and 19% share in loan portfolio. Currently, the East and Northeast with a share of 41% of outstanding loans seem to carry high concentration risk. The relatively slower growth leading to declining share of Central region in both loans and clients needs a separate study.

In terms of state-wise distribution of microfinance, the top 5 states accounted for 54% of outstanding loans (Table 1.5) and 12 states listed in the bottom (excluding union territories) accounted for less than 2% of the overall outstanding loans. Very clearly the spread of microfinance has been to the better connected states (barring AP and Telangana) with a more evolved banking network. The 12 states which had a very low share of loans were in the Northeast and states such as J&K and Uttarakhand. Telangana and AP had about 0.5% each of the overall loans portfolio but this low share is on account of historical reasons stemming from the 2010 crisis which introduced a law that made it difficult for MFIs to operate in these states.

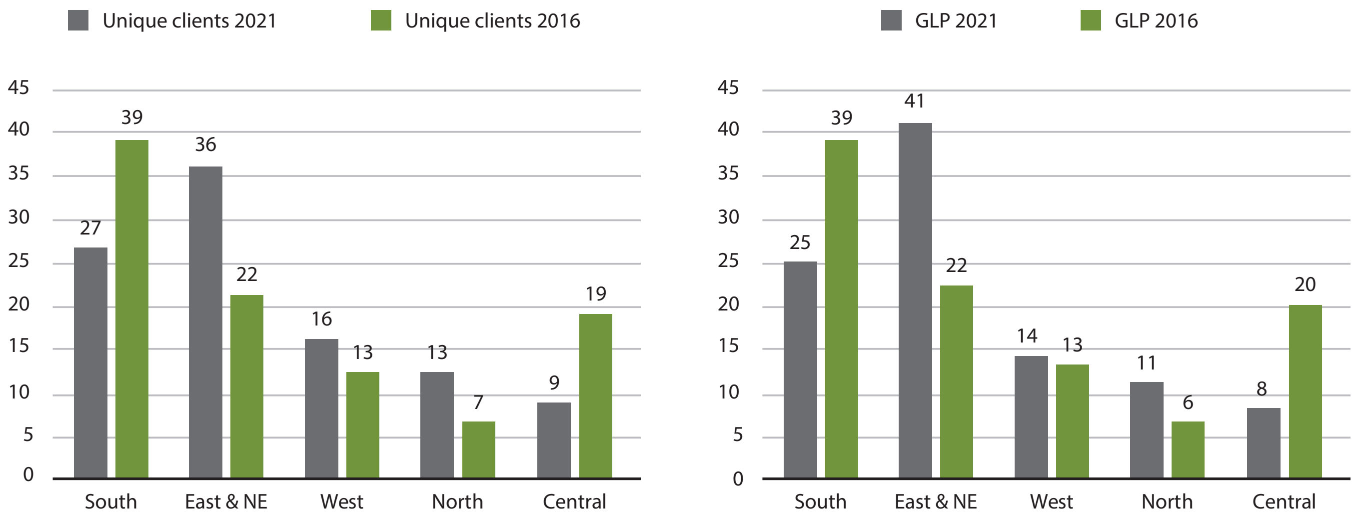

Figure 1.2: Changes in Regional Shares

Even in the high-penetration states, the client outreach is not proportional to the population of the states (Table 1.6). The assumption that a large underlying population constitutes effective demand for microfinance loans is not a valid one (Tables 1.7 and 1.8). Despite competition in the market, lenders tend to focus on geographies that offer 'addressable demand' as defined by them. The significant difference between the client outreach ratios between Bihar and UP warrants a study. The differences between states in South and northern parts of the country are attributable to a well-developed banking backbone, an existing credit and enterprise culture and the fact that microfinance started early in the South.

While the RBI had tweaked the priority sector lending (PSL) norms to improve the credit penetration in underserved regions of the country, the costs of doing business in new and relatively remoter geographies prove an impediment. While the larger MFIs have the financial muscle to expand, infrastructure issues relating to digital connectivity, reliable internet bandwidth, skilled local manpower and certain ground-level negative externalities seem to weaken their intent and slow down their pace of expansion. When the market in the mainstream states is still vibrant and offers scope for expansion and improved earnings, MFIs may not strategize stretching their managerial capacity to the extremities of the geography on account of higher operational costs as also operational risks.

Major part of loans from the MFIs is for agriculture and allied activities (about 56% of GLP). Anecdotal evidence from several institutions points to dairy sector loans being the most popular on account of cashflows easily aligning to the EMI servicing structure. About 37% of loans were provided to borrowers in service and trade sectors. Rural borrowers accounted for 74% of loans and the remaining went to urban borrowers. The predominantly women clientele and focus on rural areas bring out the inclusive finance dimension of the microfinance sector in the hardest segment of financial services—credit. Women centricity of microfinance in India has been seen as a driver of the high levels of credit discipline as also the high collection efficiency witnessed by the sector.

Table 1.5. **High Penetration States—Clients**[11]

	Unique Clients Share %	Population Share %	Penetration Ratio[12]
Tamil Nadu	13.4	5.7	2.4
Bihar	12.7	9.1	1.4
Uttar Pradesh	8.5	17.4	0.5
Karnataka	8.5	4.9	1.7
Maharashtra	7.2	9	0.8

Table 1.6. **High Penetration States—Portfolio**

	Portfolio Share %
West Bengal	15
Tamil Nadu	12.7
Bihar	11.6
Karnataka	8.2
Uttar Pradesh	7.2

Table 1.7. **Low Penetration States—Clients**

State	Unique Clients Share %	Population Share %	Penetration Ratio
Himachal Pradesh	0.05	0.54	0.1
Uttarakhand	0.49	0.82	0.6
Telangana	0.79	2.87	0.3
Andhra Pradesh	0.96	2.06	0.5
Haryana	1.95	3.93	0.5

Table 1.8. **Low Penetration States—Portfolio**

State	Portfolio Share %
Himachal Pradesh	0.03
Telangana	0.27
Andhra Pradesh	0.51
Uttarakhand	0.53
Haryana	1.72

1.3. QUALITY OF LOAN PORTFOLIO

Traditionally the collection efficiency has been above 99% for the sector as a whole in most years in the last two decades. The net non-performing assets have also been less than 1% through the last 20-year period barring spikes in some years on account of external developments[13] and events beyond the control of stakeholders in the sector. The PAR (30+ days) increased from 0.56% in March 2020 to 6.72% in March 2021). PAR (180+ days) increased from 0.14% to 2.58% during the same period. This drastic change in default levels caused a lot of concern but at the same time effective measures taken by the RBI in dealing with borrower level stress have been a significant positive influence. With the combination of moratorium and restructuring offered with RBI's guidance in the first and second wave of the pandemic, the MFIs were able to deal with their assets in a manner that did not severely impact their books; the regulatory forbearance shown by the RBI for the treatment of COVID-impacted loans was very appropriate and timely.

In terms of portfolio quality, states such as Assam, J&K, West Bengal, Meghalaya, Himachal Pradesh and Maharashtra had a much higher proportion of PAR compared to the national average. The problems in Assam are covered separately in a later section. The high levels of PAR in J&K and Meghalaya may not be a matter of major concern at the sector level on account of a very small proportion of the overall loans outstanding in these states compared to the national count. The high levels of PAR (both 30+ and 90+) in states like Maharashtra and West Bengal are a cause of concern. Especially West Bengal with almost 15% share of the loans outstanding in the country has a PAR 30 of 17.22 %. Similarly Maharashtra has about 7% of the national level of loans but the PAR 30 within the state is about 10.8%. The sector has to deal with concentration risks in West Bengal and credit culture issues in Maharashtra.

The MFIs had the lowest level of PAR 30. Banks had a much higher PAR of 10.66% of their PAR 30 compared to NBFC-MFIs which had 7.21%. A positive development is the decline in the PAR over the year with the overall PAR declining from 13.23% as at the end of March 2020 to 9.12% by March 2021. This is set to decline further as noted by several MFI CEOs as also commentators. The larger lessons from this and the previous incidences of disruptions in the microfinance sector is that while the impact is both immediate and severe, the vulnerable borrowers return to normalcy much earlier than in the case of other types of borrowers. Secondly, MFIs have learned to live with these disruptions and are able to factor in the losses arising from loans that might never be repaid as some of these borrowers have no means except their own livelihood incomes which also are disrupted as seen in the case of demonetisation, localised droughts or floods and as was the case during COVID pandemic also. MFIs that are able to deal with these kinds of disruptions better typically have high net worth and have business models that are well rooted in the local communities where the business is done. The pricing of loans in microfinance are well adjusted for the default risks and must continue to be so. Ongoing supply of liquidity to continue to lend is a critical need in ensuring that people have hopes of reviving their economic activities with the continued loan support from the institutions. If the continued presence of the MFIs and their ability to lend on an ongoing basis is disrupted for any reason, then such MFIs might face significant problems of retaining customer loyalty and recovering the past loans.

An analysis of quarterly movements in PAR ratios is revealing (Table 1.9). Between March 2019 and March 2020, PAR ratios doubled. While the spike in PAR was not steep in the first two quarters of FY 2021, with the lifting of moratorium, the clock ran out on the unserviced EMIs, increasing the PAR rates. With livelihood incomes being partially restored and restructuring being offered by the lenders for eligible loans, the PAR ratio started declining in the last quarter of FY 2021. The positive news that the declining trend is continuing in the subsequent two quarters in FY 2022 as well gives the confidence that unless there is a severe next wave of the pandemic, the clients and lenders will return to normalcy.

There are other factors in relation to portfolio quality at the borrower level such as multiple borrowing from different institutions as also ability to service the loans. CRIF High Mark in their analysis have brought out that multiple borrowing has been on the rise. There are 36.3% of unique clients who have three or more loans. Of which 12.1% have more than five lenders. Tamil Nadu, Odisha, Karnataka and Madhya Pradesh seem to have fragilities on account of large proportion of borrowers with multiple loans. With the proposal by the RBI to harmonise the guidance on avoidance of excessive debt across all microfinance providers including banks, this problem is likely to come under a measure of control.

Table 1.9. Movements in PAR

	Mar 2019	Mar 2020	Jun 2020	Sep 2020	Dec 2020	Mar 2021
PAR 30+	0.92	1.78	1.89	4.48	13.23	9.12
PAR 90+	0.41	0.86	0.43	0.63	4.98	4.15

1.4. CHALLENGES DURING THE YEAR

Most MFIs faced problems of delayed or defaulted servicing of EMIs by the borrowers. The borrowers for the most part faced disruptions to their livelihoods and incomes. During the first wave of the pandemic migrant labour and tiny entrepreneurs (both seasonal and long-term) found, apart from a stoppage of their livelihoods, that the host towns can be hostile and returned to their place of origin which resulted in loss of incomes. Those who had small businesses suffered from lockdowns. Some had to find cash to deal with treatment costs for COVID-related ailments. The uncertainty about the period for which the lockdown will continue (and the consequent loss of incomes) led people to conserve cash rather than service their other liabilities. The preservation of cash at the national level led to a consistent rise in currency in circulation as noted by the RBI in its annual report. 'The pandemic-induced dash for cash was superimposed on the usual seasonal spurt in currency demand in Q1:2020-21 which is associated with rabi procurement and kharif sowing. In the following quarter, despite an overall slowdown in economic activity and the seasonal slack in demand from cash-intensive sectors such as construction and agriculture, the fear of virus kept CiC at an elevated level.'[14] A combination of loss of incomes, need for cash conservation and increased expenses at the borrower level resulted in a challenging situation for MFIs.

On their part, MFIs faced liquidity constraints on account of EMIs not being serviced—with moratorium becoming operative for an overwhelming majority of current loans. While regulatory forbearance reduced the load on classification and provisioning for these delayed EMIs, the liquidity stress was real. The bulk lenders to MFIs stayed away for a period of time from fresh sanctions to MFIs and some lenders did not allow drawal from sanctioned limits. The first quarter witnessed disbursal of Rs 42.5 billion to MFIs compared to Rs 141.39 billion in the last quarter of FY 2021. MFIs in turn reduced fresh disbursements drastically in the initial three quarters. The moratorium announced by RBI did not become applicable automatically to MFIs. Sa-Dhan wrote to RBI pointing out that only 40% of lenders offered moratorium to the MFIs.[15] MFIs sought to raise resources through different means and carried liquid assets at far higher levels than they usually did in normal times, just to keep up the schedule of servicing of their loans. This entailed a higher negative cost of carry and impacted profitability.

According to Sa-Dhan,[16] the largest MFIs (more than Rs 20 billion GLP) had easier access to funds than the medium and small MFIs. A total of 8 large MFIs received Rs 35.9 billion in loan disbursements in the first quarter of FY 2021 compared to Rs 6.66 billion by 30 other MFIs; 85 MFIs did not receive any funding. More analysis about the sources of funds is carried later.

The larger MFIs managed the situation better with access to capital and loan funding. They were also preferred customers of banks and FI for the concessional funding facilities set up by the RBI/GOI. Smaller MFIs had a tough time dealing with employee retention, juggling finances and keeping the customers engaged. Many MFIs had to invest in increasing digitisation of transaction processes and persuade customers to use the different payment channels for repayment. The base rate based cap on customer level interest rates squeezed margins of MFIs as the base rate of banks declined significantly. But the MFIs were unable to access bulk loans aligned to the base rate of banks. Sa-Dhan requested the RBI for removal of the base rate linked interest rate cap and substitution of the same with a margin cap based interest rate with an overall ceiling on interest rate at 26%.

The COVID crisis in some ways was a catalyst for operational improvements and accelerated integration of IT processes in MFIs (see Box 1.1). The crisis accelerated digitalisation in business processes and enhanced efforts to address longstanding concerns such as liquidity management, cash management, diversification of funding sources, etc. Moreover, the crisis highlighted the importance of customer connect and the need for clear and continuing communication to borrowers.

Two medium sized MFIs, Sambandh Finserve and Margdarshak Financial Services had defaulted on their obligations to bulk lenders. Sambandh Finserve, with headquarters in Orissa, had borrowings of Rs 4.3 billion from several lenders. The company was alleged to have fraudulently diverted funds to other entities/purposes to the extent of more than Rs2.5 billion. After a forensic audit, criminal cases and debt recovery action have been initiated by the lenders against the company. The RBI had cancelled its NBFC-MFI registration. Margdarshak Financial Services, Lucknow, with loan obligations of Rs 5.3 billion has been rated 'D' by Brickwork rating for non-cooperation in submission of periodic information. Defaults have been reported by the lenders to Margdarshak. The reasons for Margdarshak's problems are not formally known, but attributed to COVID-led liquidity stress.

BOX 1.1. STORY FROM THE FIELD—IN COVID TIMES

Setting overarching goals to support rural growth story

Rathna, a resident of Kanakapura in Karnataka, among 3.8 million customers closely associated with CreditAccess Grameen, recalls the role of the MFI and its services in boosting the prospects of her tailoring and livestock business. 'CA Grameen gives me loans based on my needs; I can repay the loan amount as well as interest from the business without feeling the burden.'

The largest microfinance institution of India has taken numerous efforts to provide millions of women customers affordable credit for small ticket size loans to help unleash their economic potential. The institution charges 19.15% interest rate, the lowest in microfinance industry, and has reduced it from 21% charged two years back.

The challenging times demanded social distancing, detrimental to small-scale businesses. As a solution, the institution adopted same day disbursement services to help tide short-term economic disruption smoothly.

The MFI had introduced this service of disbursing up to Rs 15,000 on the same day without borrower having to visit the branch, avoiding risky travel. Rathna was particularly happy about the same-day disbursement service, 'This is a boon as I do not have to spend time in travel, queues in bank branch.' The customer-friendly services has yielded rich results to CA Grameen in form of 87% customer retention rate, one of the highest in the microfinance industry.

Digital initiatives have been an integral part of the institutions inclusive journey. Unified Payment Interface (UPI) based cashless collections and Aadhaar enabled Payment System (AePS) based cash withdrawal services are provided free of cost. Every customer is provided a unique QR code to repay instalments at the centre meeting, in addition to traditional model of repaying through cash.

Grameen Pay, AEPS-based cash withdrawal mechanism, is provided to customers with the help of a tablet, scanner and mini printer. The customers are trained thoroughly by the loan officer (LO). The LO provides the requested amount through the collected pool from customers, helping reduce cash in hand and transit risk involved.

Lakshmi, a resident of Marigowdanadoddi in Karnataka, who runs a dairy and sericulture business, explains the Grameen Pay benefits, 'The LO explains the process and generates a mini balance statement of my account first. It enables me to know about the available balance before withdrawing the cash and helps to manage my money.'

The digital initiatives are marked by certain challenges in the form of low network connectivity in rural India, transaction refusal by banks involved in the merger process or device setup challenges. The problems posed will help in identifying root causes and will lead to improvements in services over the coming years.

1.5. RESOLUTION OF ASSAM CRISIS

For more than two years, the spike in default rates in Assam had been a cause of concern for the stakeholders. The state government's action in legislating a microfinance law with some similarities to the 2010 AP law was seen to impact the sector negatively. Both the industry associations (Sa-Dhan and M-Fin) worked actively to engage with the state government to find a solution. In August 2021, a final resolution was arrived at between the government of Assam and 37 microfinance lenders. The resolution involved waivers funded by government of Assam and haircuts for lenders for writing off irrecoverable loans. Assam had 1.4 million clients and a portfolio of about Rs 120 billion was involved when the agreement was reached. The state government has come forward with a Rs 72 billion budget to provide relief to borrowers who have defaulted or who are unable to service their loans and incentives for those who have been servicing their loans promptly. In this agreement, a number of banks are also signatories along with MFIs.

The crisis in Assam seems to have risen from excessive and competitive lending. The banks and MFIs had significant lending in the state especially to plantation labour force, who had no other incomes to service the EMIs. CRIF High Mark had in its periodic reports been highlighting the credit concentration in Assam. While MFIs are subject to the ' debt limits and number of lenders limits', the banks are not subject to the same. With both banks and MFIs competing in the Assam market, the guidelines issued by RBIs to MFIs did not prevent banks from offering a third or

Table 1.10. Assam Microfinance[17]

	Sep 2017	Dec 2017	FY 2018	FY 2019	FY 2020	FY 2021
Loans outstanding (Rs billion)	54	61	78	120	118	118
States' share of loans (%)	4.87	5	5.7	6.36	6.11	4.7
Outreach—clients (million)				2.4	2.5	2.5

fourth loan or exceeding the cap set on the quantum of loans to individual microfinance borrowers. The loan portfolio in Assam had been increasing steadily since 2017 (Table 1.10). During 2018 and 2019, the growth in number of borrowers and loans amounts was sharp. When the problems unravelled in 2019, lenders moderated their exposure, reduced disbursements and concentrated on collections. The portfolio which saw robust growth rates in FY 2018 and 2019, tended to remain stagnant over the two-year period 2019–2021.

The Assam crisis is a classic case of unbridled competition, entities arbitraging within the differing regulatory guidelines, failure to adopt robust client selection principles and market conduct deviant from the high standards set by the industry. While the resolution has provided a measure of relief to all stakeholders, further progress of the industry in the State will be muted. The only positive to emerge from Assam is the reinforcement of the critical role that industry associations play in crisis situations.

1.6. SOURCES OF FINANCE FOR MFIS

The year was tough for the microfinance sector from the resource point of view, especially so for small and medium MFIs. The large MFIs after initial problems were able to overcome liquidity issues and managed their resources well to avoid defaults to banks and FIs. But this came at a cost (carrying expensive surplus liquidity). Loans raised from different sources during FY 2020 was at Rs 476.27 billion. The corresponding resources flow during FY 2021 was only Rs 368.7 billion,[18] indicating a reduction of about 21% YOY. Disbursements made by MFIs to clients during FY 2021 declined by only 12.5% compared to the previous year indicating that MFIs raised equity, recycled reflows of loans and redeployed surpluses of previous year in business to keep the lending operations going. According to NABARD,[19] 56 banks are providing bulk funds to MFIs—these include 25 commercial banks, 19 cooperative banks, 10 RRBs and 1 SFB. Banks continued to have a major share of funds provided to MFIs (Figure 1.3), the priority sector tag being a clear attraction. In case of SFBs too lending to medium and small MFIs can result in tradable PSLCs.

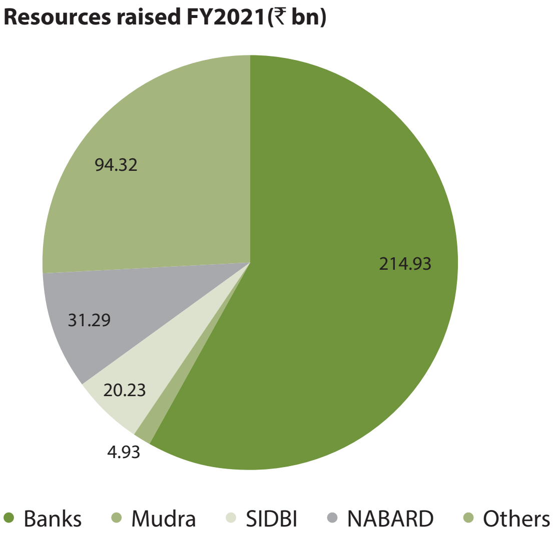

Figure 1.3. Sources of Funds for MFIs

NABARD has been providing wholesale funds to MFIs since 2014–2015. NABARD's existing lending policy requires MFIs in company form to have a grading of not less than MFR2/MF2[20] and be in profits for the last three out of preceding four years. During 2020–2021, NABARD had disbursed Rs 47.9 billion to 29 MFIs. Of this, Rs 35.2 billion was under special liquidity facility to NBFC-MFIs. By end March 2021, outstanding refinance provided by NABARD to 34 MFIs amounted to Rs 72.4 billion. SIDBI and Mudra together accounted for 7.8% loans provided compared to 9.3% by NABARD. A large part of other sources include NCD issuance, bought by a number of foreign entities. MFIN reported that as of June 2021, Euro Commercial Borrowings constituted 3.8% of outstanding loans of MFIs.[21]

Table 1.11. Quarterly Flow of Resources (₹ billion)22

	Loans Provided to MFIs	Loans Provided to Large MFIs
Quarter I	42.56	35.90
Quarter II	91.02	73.27
Quarter III	93.73	78.60
Quarter IV	141.39	110.74
Total	368.70	298.51

The business of MFIs was impacted in the first three quarters of FY 2021 (Table 1.11) and the low resource flows clearly indicate the extent of the problem. The first quarter saw hardly 12% of the annual flow reaching MFIs. More than 80% resources went to large MFIs (with assets exceeding Rs 20 billion), leaving the smaller ones starved of resources. Smaller MFIs tend to work in remoter areas and with highly marginalised sections of people; scarcity of resources in their hands has a severe impact on such livelihoods.

1.7. POLICY AND REGULATION

The RBI was active throughout the year, having its fingers on the microfinance pulse and setting in motion remedial action to deal with loss of incomes, involuntary default, liquidity stress and balance sheet effects of the crisis. Globally, the RBI was one of the earliest movers among Central Banks in COVID response (not just for the microfinance sector). The regulatory response was built around two dominant themes: the first was to smoothen cashflows at the ultimate borrower level through EMI moratorium, restructuring of loans, reduced/subvented interest rates and relief from interest on interest[23]; the second was to strengthen liquidity in the hands of MFIs through moratorium on their loan service, and augmenting fresh loan flows and lowering the cost of loans.

In the Last week of March 2020, the RBI instructed all banks and FIs,

> *[To] allow a moratorium of three months on payment of instalments in respect of all term loans outstanding as on March 1, 2020. Accordingly, the repayment schedule and all subsequent due dates, as also the tenor for such loans, may be shifted across the board by three months.*

This was intended to deal with borrower level burdens in debt service. To negate the adverse effects this can have on loan classification, the RBI had further advised,

> *The rescheduling of payments will not qualify as a default for the purposes of supervisory reporting and reporting to credit information companies (CICs) by the lending institutions. CICs shall ensure that the actions taken by lending institutions pursuant to the above announcements do not adversely impact the credit history of the beneficiaries.*

In May 2020, the RBI advised the banks and FIs that the moratorium can be extended by another three months till end of August 2020. A resolution framework for COVID stressed assets was brought into force in December 2020. The RBI, in a move to augment funds flow to smaller MFIs, allowed SFB loans to MFIs with an asset base of up to Rs 5 billion to be classified as PSL in the books of the SFBs. In July 2021, the Ministry of Finance introduced a credit guarantee scheme[24] to facilitate banks to obtain risk cover for their loans to MFIs. The guarantee scheme requires that banks utilize the scheme to lend to small institutions and those rated MFR 2 at least to the extent of 50% of disbursements under the scheme. The slew of measures and moral suasion by the RBI contained the distress at borrower level and provided support to MFIs to continue their business. With a time lag, many MFIs could gain access to funds, but still a significant minority continues to struggle. RBI's assumptions on how the portfolio exposures and risks will play out turned out to be valid. Repayments seem to be returning to normalcy and banks also were seen inclined to resume lending as seen in the last quarter disbursements of FY 2021. MFIs, barring liquidity support and forbearance on loan classification and provisioning, did not need any other bailout packages as was feared by a number of industry watchers.

The RBI also placed for public consultation a document on regulation of microfinance. The document has proposed a new framework (and not tweaks to the existing regulatory regime).

The focus of the framework is on avoidance of excessive debt and moderation in loan pricing. The significant departures in the proposal are the greater autonomy to MFIs in client eligibility assessment, a focus on debt levels rather number of loans and flexibility in pricing. The regulations will be activity-centric, moving away from the existing form/entity-centricity. All regulated entities including banks will be subject to microfinance regulations including client selection, size of loans, pricing etc. A common definition of microfinance clients and loans applicable to all regulated entities will address the concerns related to the regulatory arbitrage and uneven playing field that places MFIs at a disadvantage. In addition, some MFI-specific regulations such as qualifying assets and loan pricing have been proposed to be changed. Several MFIs and industry bodies have communicated their feedback to the RBI. The important aspects of feedback are to (a) use disposable household income rather than gross income so that loan servicing ability is reckoned well, (b) ensure that all

RE boards adopt an income assessment and lending policy, (c) make loan pricing simpler by relating to cost of funds in the hands of the MFI rather than external reference rates and (d) allow financing tiny and nano-enterprises through a broadening of qualifying assets definition. The sector is now awaiting the final version of the new regulatory framework, with MFIs hoping to gain significant space and operational freedom.

1.8. CONCLUSION

The 20 year history of microfinance is witness to the resilience of the sector to external and internal shocks, both man-made and otherwise. Severe cyclones and droughts had impacted different states[25] during the period with adverse effects on repayment of loans, which proved to be temporary. The sector has learnt to deal with significant events that impact loan repayments, recognise such adversities as a normal part of their business and build resilience to carry on business in the face of adversities. The important aspect of growth of the sector is that it does not enjoy subsidies and does not offer concessional terms to the borrowers.[26] It has proved that the bottom of the pyramid has credit-worthy customers that are able and willing to borrow on commercial terms and keep up a healthy track record of repayments. The superior quality of assets generated in the sector both in terms of credit costs and margins have made the banks to take microfinance clients into their own books directly. The existing PSL benefits available have ensured that bankers' appetite remains strong. While microfinance seems to have arrived at a good place, where can it go from here?

The RBI has given an avenue for good performers to transition into a small finance bank, and presently the licenses are on tap. Is becoming an SFB is the only aspirational destination for MFIs? There are institutions that might choose to remain NBFCs. Their expertise and skillsets in dealing with the vulnerable, small-ticket customers is invaluable. They can extend this expertise to provide larger loans to micro and tiny enterprises. The existing caps on loan size prevents MFIs from making enterprise loans, even in case of existing customers who graduate to a higher scale of operations. It must be possible to find policy space for well-governed MFIs to expand lending to enterprises that do not get support from the banking system. This will be a natural progression for MFIs from the kind of financing they do currently. For the customers this would be a great option as they are familiar with MFI and its processes. For some years Bangladesh had permitted MFIs to lend up to 50% of their portfolio to enterprises (higher ticket sizes compared to normal microfinance loans) with good results. The RBI currently has the qualifying asset clause under which a maximum of 15% of assets can be for loans outside microfinance. This cap can be increased to 50%, subject to the condition that only micro and tiny enterprises can be financed.

Customer protection measures need intensification, with greater autonomy for the MFIs. The regulatory objectives of optimal debt burden, lending according to debt servicing capacity and appropriate pricing should be embedded in the mission of MFIs and their policies. Regulator should not intervene in the processes, products and HR practices, leaving it to the MFIs to best organise their business to meet regulatory objectives. Deviant market conduct and compromising customer protection should be dealt with severely so the MFIs actively implement the related policies.

Continuing problems of small and medium MFIs with regard to resources—both equity and bulk funds—need a sustainable solution. The liquidity support provided through RBI interventions during the last 18 months and the guarantee scheme announced by GOI are good pointers towards a solution. NABARD and SIDBI should be charged with creating and operating a fund base that is specifically for small and medium MFIs, regardless of the credit rating/grading. High collection efficiency runs across the sector, regardless of the size and rating of the MFIs (with some exceptions). A key matric for bulk funder is whether the intermediary can efficiently lend, recover and return the loan. Even medium and small MFIs do this very effectively. The new fund facility should be open to all MFIs with a two-year track record of less than 1% PAR 30 days; with the resulting expansion of their portfolio, the MFI can hope to access greater equity and qualify for better ratings over time.

MFIs need to do soul searching on the products that they offer. The EMI-based loans are suitable for activities with regular cashflows. Over the last three decades there has been no serious attempt to introduce products for microfinance clients that are more closely aligned to their livelihood activities. There are loan demands for investments in capital assets for livelihoods, affordable housing, education and health. All these loans cannot run on EMIs, unless the borrowing household has multiple sources of incomes that are regular. Loans of different tenor and repayment schedules are needed. MFIs have limitations in product design on account of the terms under which they receive bulk loans. Bulk lenders to MFIs stayed away from fresh sanctions for a period of time.

Digitisation of transaction and operational processes in MFIs has increased over the last year or so. But the progress varies across different categories of MFIs. The small and medium MFIs might need one-time support to upgrade their systems and software. Where the MFIs are BCs of banks, the changes would be facilitated by the principal bank. In case of other medium and small MFIs, support for this purpose may be extended considering the benefits that accrue to marginalised customers. In the past, primary agriculture credit cooperatives were supported by the government for computerisation and upgradation of infrastructure. With MFIs' loans almost reaching the level of PACS in agricultural credit, and the 60 million borrowing members that is more than borrowing members of PACS, a public funded effort to upgrade their technology of operation is well deserved.

The credit bureaus have proved to be an important part of financial sector hygiene infrastructure. In Microfinance they still capture delinquency that is filtered by group performance. Since the microfinance sector gradually seems to be moving towards individual loans, the credit information should capture individual defaults, without reckoning the repayments that may have been made by the group on behalf of the defaulter. MFIs should cooperate in this shift, in their future interests.

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5. Data from Sa-Dhan reports from several years. The numbers are that of MFIs only.
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9. This section relating to geographical concentration and penetration is based on the broad sector data—not MFIs alone.
10. While the region comprises all states in East and Northeast, only Assam in the Northeast has a significant presence. Other northeastern states have very low share of outreach and portfolio.
11. Microfinance penetration is usually seen as resulting from supply-side effort. There are many other factors on the demand side as well, such as local economy and sociocultural environment. A detailed discussion on the subject has not been carried out here.
12. The ratio calculates the proportionality of the share of clients to the share of population of the state. Equitable distribution is 1 at which value the state is having a normal level of penetration—ratio value of more than 1 indicates that state has higher level of penetration and value less than 1 indicates lower level of penetration, meaning fewer people in the state will have access to credit.
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[24] The scheme will be operated through the National Credit Guarantee Trust.

[25] Cyclones Vardah, Ockhi, Gaja, Fani, Amphan, Tauktae to name a few.

[26] Agricultural loans and SHG loans enjoy interest subvention. SHGs enjoy subsidies in different forms under NRLM for their formation and nurturance.

Financing in Times of Pandemic: One Step Forward, Two Steps Backward

Tamal Bandyopadhyay

2

2.1. SUMMARY

The COVID-19 pandemic has changed every rule of the game of finance. This piece takes a close look at the challenges faced by the financial intermediaries and the opportunities staring at them. It attempts to offer a 360-degree view of everything that's happening on the financial turf—the measures of the RBI and the government to tide over the once-in-a century crisis, the existential crisis being faced by the banks, new pastures for the NBFCs, technology, products and process. And, of course, financial inclusion. Even in the worst of times, none has taken their eyes off from inclusive finance. If at all, the drive has been intensified. Amid all these, the RBI has introduced a Financial Inclusion Index (FI Index), an annual exercise to capture the extent of financial inclusion across India.

As I write this chapter in the second week of October, for the first time in financial year 2022, credit growth in the Indian banking sector turned positive year-to-date, though just 0.1 per cent, in September. In the corresponding period of last year, it had shrunk 1 per cent.

Finally, the impact of the second wave of the COVID-19 pandemic seems to be receding. The bankers are smiling. The body language of those who have been in the business of giving micro-loans to the people in the so-called bottom of the pyramid is also changing. They are seeing better collection of loan instalments and fresh disbursements have started. Some of the banks which were stingy in giving them money have also started opening the tap.

Global rating agency Moody's Investors Service is seeing moderation in fresh slippages and credit cost coming down for banks, adding to their profits.

Be that as it may, the credit market is undergoing a radical transformation.

Early last decade, in the aftermath of the Global Financial Crisis, triggered by the fall of US investment bank Lehman Brothers Holdings Inc., Indian banks, swimming in liquidity, had splurged in indiscriminate lending. That had led to a serious mispricing of risks. The pile of bad assets rose, forcing the Reserve Bank of India (RBI) to launch the first-of-its-kind asset quality review (AQR) of banks, a unique clean-up drive. Such an exercise was also undertaken selectively for very few non-banking financial companies (NBFCs) discreetly.

2.2. MISPRICING OF RISKS

Most banks have been able to absorb the shock of the first wave of the COVID-19 pandemic with relative ease because of their balance sheet strength post-AQR, but a different kind of mispricing of risks is emerging in search of credit growth. This could land them in trouble. Banks are discounting bills and offering short-term money at rates unheard of.

They were grabbing with both hands any opportunity to earn more than the reverse repo rate (3.35%) till the variable rate reverse repo auction started absorbing liquidity at 3.99 per cent, just below the repo rate (4%). The risk premium is being compressed; the difference in the cost of money for good and not-so-good borrowers has been narrowing.

To be sure, this is a global phenomenon—junk bond yields in the USA have never been so low.

The struggle for most banks at this point is pushing credit growth to earn more. How do they plan to do it? As most corporations are staying away from bank loans, they are chasing retail loans, even though some of the borrowers are losing jobs or seeing pay cuts. In search of credit growth, the banks—both universal banks and small finance banks (SFBs)—are reaching out to the bottom of the pyramid and giving home loans and small retail loans, jostling with the NBFCs. This gives a push to the inclusive finance movement, though by default.

The microfinance sector is seeing increased formalization, and demands from the consumers in this segment are widening. This theory is vetted by what one of the SFBs, Jana SFB Ltd, is seeing—huge demand for home construction and repairing. The loan amount varies between Rs 0.1 million and Rs 0.7 million, payable over 6–10 years. The top end of the sector (roughly one-third of the borrowers) is ready to graduate to an asset building mode and their income supports the same. The demand for loans for home construction is rising from tiers two, three and four locations.

Of course, there are many challenges for the lenders. One of them being getting the right property documents and ensuring that the family income can support as their employment is in informal segments and business is often vulnerable. The other challenge is that there is no refinance available for home repairs, including adding a room or two or cementing the home or making a boundary wall or a toilet. Such an activity is very important as families grow and the existing dwelling is modified.

Also, the same segment is using their existing properties as collateral to borrow for business needs.

Another important need emerging in the post COVID-19 world is slum redevelopment. This has been happening, but it can get a boost if it gets support from the state governments in the form of allowing mortgage, repossession and sale. The micro-lenders can play a significant role here both for sourcing and financing such needs.

The demand for loans for low-cost housing has been on the rise. The Pradhan Mantri Awas Yojana housing scheme has been playing the role of the catalyst for this. In the first week of October, Prime Minister Narendra Mode said that under this scheme, about 0.03 billion houses have already been built in the country. It enables home loan borrowers buy or construct their first pucca house, and subsidy gets credited into their accounts for loans taken from banks, housing finance companies (HFCs) and NBFCs.

Banks are also aggressively chasing mortgage customers, charging the lowest ever interest rate seen during the festive season.

As of 30 July, corporate loans have grown just 1 per cent over the past year, but loans to large businesses have shrunk 2.9 per cent. In contrast, retail loans have grown 11.2 per cent during this period. In this segment, gold loans glitter. They are growing at 77.4 per cent, though on a low base.

2.3. THE CREDIT GROWTH CHALLENGE

For now, the concerns over bad loans have taken a back seat; a bigger challenge for both banks and NBFCs, including microfinance institutions (MFIs), is credit growth.

Chasing credit, they are venturing into new pastures. One of them is supply chain financing. It's safe as loans are typically backed by invoices usually paid in weeks or months. Financing supply chain, a big business in China is based on genuine transactions; it offers financial solutions besides money.

The pandemic has changed the way business is done in India. While suppliers to large manufacturing companies and fast-moving consumer goods outfits continue to wait for weeks and months for their payment, dealers who buy the finished goods do not get credit anymore. Most companies have introduced the cash-and-carry model; dealers need to pay manufacturers upfront.

Banks see a big opportunity here. While manufacturers are cutting down exposure to banks, dealers need money, that is, working capital. Bankers are supporting both suppliers and buyers of finished goods, covering the entire supply chain.

Banks are reaching out to the fund-starved micro, small and medium enterprises (MSMEs) through this route. They are also tapping the small and medium enterprises (SMEs) through the co-lending model where two lenders—a bank and an NBFC—come together to disburse loans.

Such exposures as well as export credit, which have been growing well, are part of the priority sector loans which, under the RBI norms, must be at least 40 per cent of a bank's credit.

Under pressure to boost earnings, Indian banks are exploring new avenues to lend but there are bigger challenges.

What are they?

Indian corporations are on a deleveraging spree.

2.4. THE DELEVERAGING

The CEO of a large bank says that between the last financial year and the first half of financial year 2022, corporate India has cut its debt burden by at least Rs 2 trillion. A large portion of this is done by refineries, steel makers, fertilizer producers and those companies that produce mining and mineral products and textiles. They are replacing high-cost debt with cheap money, raised from the market and sale of assets.

In the financial year 2021, corporations had raised Rs 14.87 trillion from the market through bonds—40 per cent higher than what they had raised in the previous year. Money raised through equity was Rs 5.91 trillion in 2021.

To be sure, not the entire chunk goes to the companies since part of equity, raised through initial public offers and follow-on offers, is an 'offer for sale' through which promoters and investors in listed companies reduce their holdings. Both the streams—corporate bond issuances and the equity issues—have gained further momentum in the current year.

Bonds are secured instruments, which allow funds to be raised for the long term, or even forever (in case of perpetual bonds). If a bond holder wishes to exit, the instrument can be sold in the market, depending on how liquid the secondary bond market is. Trading volumes in debt markets are much higher than in stock markets across most developed countries. India has been laggard, but things have started changing.

Since 2016, the RBI has been insisting on big corporations raising part of long-term borrowings from the corporate bond market. In fact, companies with large exposures must raise one-fourth of fresh borrowings from there. The regulations also ask every company that plans to raise at least Rs 2 billion from the bond market to issue electronic instruments. Finally, they seem to be listening.

As corporations are shying away from raising money from the banking system, banks are looking at the retail segment closely and exploring new credit opportunities. But here, they are facing a different challenge. Fintechs have an advantage over banks.

2.5. EXISTENTIAL CRISIS

For banks, the tale of woe does not end here. At least some of them have started experiencing an existential crisis.

Banks are allowed to raise deposits from the public and hence their cost of money is cheaper than the NBFCs. Since they raise cheap money, they must have an exposure to the weaker section of society or the 'priority sector' up to at least 40 per cent of the loans they give. Besides, they also need to keep 4 per cent of their deposits with the regulator in the form of cash reserve ratio (CRR), on which they do not earn any interest, and buy government bonds to the extent of at least 18 per cent of deposits. That's the Grand Bargain.

The deluge of liquidity has changed all equations. It's advantage is well-run NBFCs now. How? The cost of money for the best managed banks is between 4 per cent and 4.5 per cent. Add to this at least 2 percentage points fixed cost (for branches, technology, wage bill and others). This makes the cost 6–6.5 per cent.

In contrast, the best rated NBFCs have around half a per cent fixed cost, and they have been raising one-year money at around 4.2 per cent. Indeed, banks can do many things which NBFCs cannot do, but when it comes to lending, banks today have clearly a 1.5–2 per cent disadvantage on cost of money vis-à-vis the best NBFCs. This is excluding the cost of reserve requirements.

If you are running a sweetmeat shop, will you manage a dairy for milk supply or buy milk from the market? Banks are running a dairy (which has its cost for processing milk), while NBFCs are buying milk from the market.

2.6. STRONG HEADWINDS

The banking industry is being hit hard by strong headwinds—the power of the market and the power of technology. While greater disintermediation is eroding banks' advantage as deposit mobilizers, technology is throwing up new challenges. The use of technology is no longer confined to the payments space and loans. It has spilled over to the liability turf. One can book fixed deposits on the platform of Google Pay and Amazon Pay.

Amazon Pay has tied up with wealth management platform Kuvera, which is offering its 'services, products and technology know-how to create an exclusive experience for Amazon Pay's users to facilitate investments into mutual funds, fixed deposits, and more over time'. To start with, Kuvera has listed fixed deposits of Bajaj Finance Ltd.

Another tech firm, Setu, is offering a similar facility for Google Pay users to open fixed deposits with Equitas SFB.

While opening such deposits, more than the banks whose deposits are sold, the platforms that sell such deposits typically grab the depositors' mind space. Once the popularity of such platforms grows among the savers, they can start dictating terms on interest rates on fixed deposits. Any bank offering lower rates than those offered on such platforms may have to fine-tune its rates or lose deposits. For better earnings and convenience, people may start preferring such platforms over banks.

2.7. THE BATTLE LINES

Simply put, the business model of banks is under threat. The battle lines are clearly drawn.

While banks need to reinvent themselves, both the banking and market regulators must take a close look at the evolving landscape.

For instance, the sale of mutual funds and insurance policies at virtual marketplaces is fine as it cuts the cost of brokerage and benefits the customers, but should the core banking products be sold on such platforms? Could it snowball into a threat to the financial sector stability?

It's also time to take stock of the Grand Bargain. As banks have access to public money in the form of deposits, they have many obligations. Should the RBI have a fresh round of debate on the evergreen topic of interest on CRR? Those banks that are not able to meet their priority loan targets either buy such loans from others who have excess exposure or keep the shortfall with certain agencies at an interest rate that is far lower than their cost of money.

One may argue that the RBI should lower the priority loan target but that will hurt the very spirit of financial inclusion. The banks need to see the priority loans through a different prism not as compulsion but as an opportunity. Since the loans of this segment can fetch higher interest rates (yes, NBFCs and MFIs charge much higher thank banks for such loans) and boost banks' net interest margin. For the borrowers in this segment, accessing credit is a far bigger challenge. They do not mind paying a bit higher rate as the margin in their business is high and cash flow regular in normal time. Since such loans are mostly unsecured, banks cannot charge the same interest rates which they offer for, say, home buyers and car buyers.

In other words, banks can make money disbursing such loans. And that has started happening through the co-lending model.

2.8. THE CO-LENDING MODEL

In 2018, the RBI had put in place a framework for co-origination of loans by banks and a category of NBFCs for lending to the priority sector, subject to certain conditions. Now it has been extended to all NBFCs, including HFCs, in respect of all eligible priority sector loans, and allow greater operational flexibility to the lending institutions. This 'co-lending model' is expected to leverage the comparative advantages of banks and NBFCs in a collaborative way and improve the flow of credit to the unserved and underserved sectors of the economy.

The banks and NBFCs involved in the business of co-lending share the risks and rewards between them; the NBFCs that source such loans take at least 20 per cent exposure to the borrowers. They cannot take loans from the partnering banks to finance their share of loans.

The NBFC identifies the borrowers, does credit appraisals and disburses a small part of the loan amount. The partner bank lends the rest, but the NBFC collects repayment of instalments and earns a fee, besides the interest income. Banks are also joining hands with fintech firms for co-lending.

Indeed, different banks are dealing with the pandemic differently. A few have stopped growing, while others are growing with caution. Also, after giving a cold shoulder to the corporate sector for the past few years, a few banks have started growing their corporate loan books for de-risking the balance sheets as more retail loans are turning bad.

These are the business trends. How has the pandemic affected the customers?

An internal study, jointly conducted by the credit risk management department and the economic research department of the State Bank of India, tells that story. This study does not cover only those who take micro-loans and keep very little money with banks as deposits but also many of the respondents covered by the study belong to the bottom of the pyramid, particularly in rural India.

The only Indian bank in the list of the world's 50 largest banks by assets, the State Bank of India, is a proxy for Indian economy. It represents little less than one-fourth of India's GDP. Roughly one out of every three Indians banks with the State Bank of India.

During the first wave of pandemic, when there was a nationwide lockdown, the banking sector's deposit portfolio rose as people stopped spending. But the most affected districts saw an outflow of deposits as the customers took out money from banks to meet medical emergencies. Of the 711 districts surveyed, 112 witnessed a Rs 1.07 trillion deposit outflows between April and December 2020. The other 599 districts, however, saw an inflow of Rs 11.20 trillion.

Nine districts in Maharashtra accounted for more than 50 per cent of the outflow: Rs 557.61 billion. Two other states that saw major deposit withdrawal are Gujarat (Rs 182.37 billion in 17 districts) and Karnataka (Rs 117.60 billion; 15 districts). Incidentally, the same 112 districts had seen close to Rs 500 billion inflow a year ago between April and December 2019.

2.9. CHANGING CUSTOMER BEHAVIOUR

More interesting facts have come out from an analysis of customer behaviour of the State Bank of India during the second wave of the pandemic, particularly in rural India, which had 16.7 per cent share of GDP in the financial year 2021. The State Bank of India's data from this phase establishes the links among outflow of bank deposits, COVID-19 death, deterioration in the quality of loan assets and emergence of a new loan product.

Between April and May 2021, when the second wave hit India, the number of districts that saw outflow of bank deposits almost doubled as compared to the first wave. Maharashtra, Uttar Pradesh and Rajasthan have seen at least 60 per cent of the pandemic cases in rural pockets.

At its peak in August–September 2020, rural India had seen 2.28 million COVID-19 cases; this number jumped to 7.61 million in April–May 2021. Similarly, in August–September 2020, little over 28,000 COVID-19 deaths were reported in rural India. The comparable figure for April–May 2021 is 83,683 (these are being continuously revised).

Analysis of the State Bank of India's business data for 735 districts across the country shows that the bank recorded deposit outflow in 213 districts in April–May 2021. In at least five of these 213 districts, the outflow is Rs 10 billion or more. These are East Delhi, Mumbai, Sambalpur, Thiruvananthapuram and Bengaluru. A year ago, in April–May 2020, barring East Delhi, other districts had witnessed deposit accretion, led by Mumbai. Most of the State Bank of India's 16 divisions (called 'circles') saw savings bank deposit withdrawal.

The top 20 districts that had seen deposit outflow include Gandhinagar, Raipur, Jaipur, Sagar, Akola and a few others, along with the big metros. In all these places, the death rate was higher than the national average.

In two months between April and May 2021, the State Bank of India's term deposit portfolio, in line with the industry trend, witnessed premature withdrawal. States having high per capita income such as Maharashtra and New Delhi—and even Jharkhand, with low per capita income—witnessed the trend. The entire banking system might have seen premature withdrawal of close to Rs 1.4 trillion term deposits.

The correlation between withdrawal of deposits and COVID-19 death rate is stark.

In 189 of the 735 districts where the State Bank of India is present, the death rate was higher than the national average during the second wave. At least 27 districts in 13 states witnessed up to 2 per cent premature withdrawal of term deposits.

Along with the outflow of deposits, the most COVID-19-affected districts have shown a spike in non-performing assets (NPAs) in the bank's mortgage portfolio. For the purpose of analysis, the bank has focused on 84 districts that have at least Rs 1 billion mortgage portfolio.

In this group, 27 districts with much higher death rates have shown more than 3 per cent bad loans.

Thirty districts that have shown between 1.5 per cent and 3 per cent home loan NPAs also have death rates higher than the national average; many of them have also seen outflow of deposits. Maharashtra and Karnataka dominate this list.

Another 27 districts, which are at the bottom of this list with home loan NPAs between 1 per cent and 1.5 per cent and higher than national average death rate (in some cases beyond 2%) are fairly well spread out across geographies, though Gujarat's contribution is more than other states.

Finally, in all high-mortality rate districts, loan against gold jewellery emerged as a popular loan product, the currency of last resort. Historically, raising money by pledging family gold has been a southern India phenomenon, but during the pandemic the trend spread across geographies. People raised gold loans to meet emergency medical needs and even to arrange for funerals.

The pandemic has also seen employees withdrawing money from provident funds. Going by data from the Ministry of Labour & Employment, the Employees' Provident Fund Organisation has settled 7.244 million claims, disbursing Rs 248.97 billion in three months between April and June 2021.

Among all places, the most varied trends are seen in Delhi, mirroring the national scene. While East Delhi has shown a rise in bad loans and deposit outflow, the highest in any single district, the affluent South, South East Delhi and South West Delhi have shown no major deterioration in asset quality. They also saw new deposit accretion. The death rate in East Delhi was far higher than in the other three parts.

Clearly, the pandemic has affected the affluent class less than others. This is also the story of India. The gap between the haves and have-nots has widened. Addressing this will be the biggest challenge in the post-COVID-19 world. One important way of facing the challenge is a renewed focus on financial inclusion.

2.10. EPICENTRE OF THE PROBLEM: MSMES

The epicentre of the problem is the informal sector—the SMEs. How big is this chunk?

As on 26 March 2021, the outstanding bank loan to micro and small enterprises in the manufacturing sector was Rs 3.84 trillion. For the medium enterprises, both in manufacturing and service sectors, it was Rs 1.36 trillion. The banks had Rs 2.98 trillion exposure to retail trade.

Apart from these, within the so-called priority sector, the banking system had given Rs 11.07 trillion as loan to the micro and small enterprises and another Rs 2.06 trillion to medium enterprises. The priority norms require banks to give 40 per cent of their loans to agriculture, small enterprises and many other pockets of the formal and informal economy.

These are provisional RBI data sourced from banks, which cover 90 per cent of loans in the system. A large part of this is being affected by the second COVID-19 wave.

How important are MSMEs for Indian economy?

The 2020 annual report of the Ministry of MSMEs states that there are 63.4 million MSME units, employing 111 million people. Going by a recent Confederation of Indian Industry report, MSMEs contribute around 6.11 per cent of the manufacturing GDP and 24.63 per cent of the GDP from service activities as well as 33.4 per cent of India's manufacturing output.

According to the Directorate General of Commercial Intelligence and Statistics, the share of MSME-related products in total export from India during 2018–2019 was 48.10 per cent.

At a conference in April 2021, MSME minister Nitin Gadkari said the overall contribution of the sector in the economy would be raised from 30 per cent to 40 per cent in the coming years, adding that work is in progress to increase exports from these units.

There has been no national lockdown during the second wave, but Indian states have clamped down on people's movement, trade and business to fight it out, disrupting the supply chain. The Nomura India Business Resumption Index (NIBR), a weekly dashboard of ultra-high frequency data, dropped to 75.9 for the week ending April 25—a level last seen in the final week of August 2020. It had fallen 25 points in March–April, reflecting the disruption created by the second wave (as I am taking a final look at the copy, the NIBR rose to an all-time high of 108.8 for the week ending 17 October).

Consumer research firm Kantar Worldpanel has found that India's rural market expanded 3 per cent in January–March 2021 quarter, sharply down from 7 per cent in the December 2020 quarter. This shrank further as, unlike in the first wave of COVID-19, which did not attack the hinterland, the second wave hit the rural India hard. It is also widely believed that the actual number of people being affected as well as the number of deaths are far higher than reported.

The cumulative effect of this? The MSME segment is gasping for oxygen.

The government, on its part, has offered a Rs 3 trillion, fully guaranteed emergency credit line to MSMEs.

How has the banking regulator responded to the pandemic and prepared the financial sector to meet the challenges?

2.10.1. The RBI Measures

Since its outbreak of the pandemic, till October 2021, RBI governor Shaktikanta Das has made 12 statements, two of which have been outside the Monetary Policy Committee (MPC) cycle—one in April 2020 at the outbreak of crisis and the other in May 2021 at the peak of the second wave.

On two occasions—March and May 2020—the MPC meeting were advanced to take pre-emptive actions.

Over this period, the RBI has taken more than 100 measures, including many unconventional one, which have changed the landscape of the finance sector. On top of cutting the policy rates, the RBI has opened many liquidity taps, imposed a six-month moratorium on repayment of loans and allowed restructuring of stressed accounts under the supervision of a committee, headed by K. V. Kamath. As Das has pointed out, the RBI has not been a prisoner of any rulebook.

The measures include auctions of long-term repo operations (LTROs) as well as on-tap LTROs and targeted long-term repo operations (TLTROs), a cut in CRR, a moratorium on payment of instalments of term loans and special refinance facilities to the National Bank for Agriculture and Rural Development (NABARD), the Small Industries Development Bank of India (SIDBI) and the National Housing Bank (NHB) to be on-lent to the regional rural banks (RRBs), cooperative banks, HFCs, smaller NBFCs and MFIs, among others.

Besides, the MSME loans have been restructured. To further support the funding requirements of smaller MSMEs and other businesses, including those in credit deficient and aspirational districts, the SIDBI has also been given a special liquidity facility for on-lending/refinancing through novel models and structures.

These measures have continuously been fine-tuned, deadlines for different schemes extended and more and more money flowed through the LTRO, TLTRO and refinance windows for different sectors.

For instance, the on-tap scheme was initially meant for the banks but later the NBFCs got the fund support for incremental lending to the specified stressed sectors. The RRBs have been allowed to access the so-called liquidity adjustment facility and marginal standing facility of the RBI as all as the overnight call money market.

Recognizing the key role played by NBFCs in making credit available to the last mile, bank lending to registered NBFCs (other than MFIs) for on-lending to agriculture, MSME and housing are being permitted to be classified as priority lending. Also, the SFBs have been allowed to reckon fresh lending to smaller MFIs (with asset size of up to Rs 5 billion) for on-lending to individual borrowers as priority sector lending.

To provide further support to small business units, micro and small industries, and other unorganized sector entities adversely affected during the pandemic, the RBI also decided to conduct special three-year long-term repo operations (SLTRO) for the SFBs.

Through this period, the RBI has never taken its eyes of the MSME entrepreneurs. To ensure the flow of credit to the MSME borrowers, in February 2021, the banks were allowed to deduct credit disbursed to new borrowers in this segment from their net demand and time liabilities, a loose proxy for deposits, for calculation of the CRR. In order to further incentivize the inclusion of unbanked MSMEs into the banking system, this exemption—available for exposures up to Rs 2.5 million and for credit disbursed up to the fortnight ending October—has been extended till December 2021.

2.10.2. The Financial Inclusion Index

Finally, the RBI has constructed a composite FI Index to capture the extent of financial inclusion across India. It has been conceptualized as a comprehensive index incorporating details of banking, investments, insurance, postal as well as the pension sector in consultation with government and respective sectoral regulators.

The index captures information on various aspects of financial inclusion in a single value ranging between 0 and 100—0 representing total financial exclusion and 100 per cent inclusion. It takes into account financial literacy, consumer protection, and inequalities and deficiencies in services.

The FI Index—to be published annually in July every year—does not have any base year. The first annual FI Index for the period ending March 2021 is 53.9 as against 43.4 for the period ending March 2017.

2.10.3. New Norms for Microfinance

Meanwhile, India's microfinance industry is set to see better days ahead, thanks to the RBI proposal of radically changing the regulations for the industry.

Following the Andhra Pradesh law in October 2010, which was put in place to curb the alleged excesses by the industry, the RBI set the stage for the entry of a new genre of financial intermediaries—the NBFCs in the business of giving micro-loans, the NBFC-MFIs. This was done in December 2011, based on the recommendations of a committee headed by revered chartered accountant Y. H. Malegam. A decade later, the RBI is set to change the rules of the game.

The NBFC-MFIs no longer dominate the microfinance turf. Even though there are 86 NBFC-MFIs among 197 micro-lenders, their share in the outstanding loan portfolio is less than 31 per cent in contrast to commercial banks, which have 41 per cent share. But when it comes to loans, the share of banks and NBFC-MFIs is almost equal at little over 35 per cent.

Clearly, banks are more liberal in giving money to micro-borrowers than the NBFC-MFIs. It's a free market for banks but the NBFC-MFIs are constrained by regulations.

Currently, no more than two NBFC-MFIs can lend to the same borrower and at least 85 per cent of their loan portfolio must consist of such micro-loans against which borrowers do not need to offer any collateral. The household income of a rural borrower should not exceed Rs 0.125 million and of urban borrower Rs 0.2 million. The loan amount is capped at Rs 75,000 for the first cycle; it can be raised to Rs 125,000 subsequently. But such rules are only meant for NBFC-MFIs; banks are free from such shackles.

Also, for the NBFC-MFIs, both the pricing of the loan and processing fees are regulated. The relatively large NBFC-MFIs can charge their borrowers either a 10 percentage points spread over their average cost of funds or 2.75 times the average of five banks' base rate, whichever is lower. Banks, however, are free to set their loan rates.

Essentially, there is no level playing field. The RBI is planning to address this through a new set of regulations. What are they?

- The limit that not more than two NBFC-MFIs can lend to one borrower is being waived. It's not the number of lenders but the amount one can borrow that's important now. The focus is being shifted from who is lending and how much to the capacity of the borrower to repay the debt. All lenders will be clubbed together; the total indebtedness of a borrower will be linked to the capacity to pay.
- The deciding factor will be the debt–income ratio. The payment of interest and principal for all outstanding loans by a borrower is capped at 50 per cent of the household income at any given point of time. The lenders will need to assess the household income with diligence and must have a board approved policy on factors to be considered for assessing this income.
- With this, the limit on loan amount and minimum tenure of loans, currently applicable to only NBFC-MFI, will cease to exist. If a family is capable of servicing higher debt, an NBFC-MFI will be able to offer that.
- The collateral-free nature of the micro-loans remains, but this is being extended to banks as well; they cannot demand collateral for micro-loans. All lenders should allow the borrowers to pre-pay loans without any penalty; they must have a board-approved policy to offer flexibility of repayment schedule for the convenience of the borrowers.
- The so-called Section 8 or not-for-profit companies, which have been in the business of micro-lending and have a relatively large loan book (say, Rs 1 billion and more), will be treated the same way as the NBFC-MFIs. They will require Rs 0.05 billion capital. Around 80 per cent of Section 8 companies have less than Rs 1 billion loan book.
- The RBI proposal is also in favour of doing away with the prevalent norm that 50 per cent of the loans must be for income generation (again, applicable to only NBFC-MFIs). The wall between income-generating and consumption loans is being pulled down. The lenders can give loans for education, medical expenses, household assets, consumption and even repayment of high-cost loans taken from moneylenders.
- Finally, the RBI wants to do away with the cap in loan rates. That will be left to the market. The NBFC-MFIs, like banks, will be allowed to fix the loan rates.

This has huge implications. Even though banks have access to cheap money in the form of deposits, they charge relatively high rates as the NBFC-MFI loan rates serve as the benchmark. For instance, if an NBFC-MFI charges 21 per cent from its borrowers, a bank can rush and grab the borrowers, offering 19 per cent. That's cheaper than what an NBFC-MFI is charging but a bank's cost of funds is far less than that of NBFC-MFIs.

Once it is left to the market, competition will decide the loan rates. Large NBFC-MFIs, with better liability–management capability, may bring down the loan rates. If that happens, banks will be forced to pare their rates. More importantly, the NBFC-MFIs will not be required to offer the same loan rate to all borrowers, irrespective of their business models and capacity to pay. Like the banks, they will be able to charge different rates to borrowers even in the same geography, based on the credit ratings of the customers.

What's the net result of a uniform regulation of NBFC-MFIs and banks, and allowing the market to decide on interest rates? The micro-loan industry will expand in new geographies and bring in new borrowers under its umbrella.

Over the past few years, a few banks have been fishing in the same pond, exploiting the regulatory loopholes. That's lazy banking. The game of flooding the borrowers with more debt than what they can service will stop. All lenders will have to look for new pastures to grow. The new norms, when in place, will usher in a new era for microfinance and give a fillip to financial inclusion.

2.11. THE MUDRA STORY

While the well-managed MFIs are set to see better days ahead, little over six-year-old MUDRA, a wholly owned subsidiary of SIDBI, launched by Prime Minister Narendra Modi in April 2015 could have done better.

Its goal is to develop the micro-enterprise sector by extending various kinds of support, including financial, to MFIs, banks and others who lend to micro-units.

There's also a scheme for such loans: Pradhan Mantri MUDRA Yojana (PMMY). Three types of PMMY loans—Shishu (up to Rs 50,000), Kishore (Rs 50,001–Rs 500,000) and Tarun (Rs 500,001–Rs 1,000,000)—are given for income-generating non-farm sector activities, including dairy and poultry. The catch is that such loans do not need to be financed or refinanced by MUDRA. Any and every loan, given by banks and NBFCs, including MFIs, can get the MUDRA tag.

In the first year, ending March 2016, close to 34.9 million MUDRA accounts were opened and the outstanding loan portfolio was Rs 1.09 trillion. Shishu led the way with 32.4 million accounts and Rs 468.11 billion loan kitty; Kishore had 2.07 million accounts (Rs 366.12 billion) and Tarun 0.41 million accounts (Rs 258.69 billion).

Going by the RBI data for small loans up to Rs 200,000 in 2015, there were close to 35 million borrowers and Rs 792.09 billion outstanding loans with banks and MFIs, given for purposes similar to those covered by MUDRA. A year later, the PMMY loan portfolio below Rs 500,000 (Shishu and Kishore) was Rs 834.24 billion, distributed among 35.1 million accounts. If 80 per cent of Kishore loans were up to Rs 200,000, then there were 34.06 million customers with Rs 761.01 billion loan outstanding.

So, even after tagging all micro-loans as MUDRA loans, the credit flow at the lower tier, up to Rs 200,000, dropped in 2016 from the previous year.

Since then, the growth has been uneven. From 34.9 million accounts and Rs 1.09 trillion portfolio in 2016, the number rose to 39.7 million accounts and Rs 1.38 trillion loan outstanding in 2017. In 2018, the number of accounts rose to 48.1 million and the loan book grew by over 46 per cent to Rs 2.02 trillion.

The growth story continued in 2019, but the pace slackened and, in 2020, the loan book grew less than 3 per cent (Rs 2.67 trillion). In COVID-19-hit 2021, there was a sharp drop in both loan accounts and disbursements. The outstanding loan data for the financial year is not yet public but the disbursements show close to a 6 per cent drop from Rs 3.3 trillion in 2020 to Rs 3.11 trillion.

Public sector banks, with 4.92 per cent bad loans in the MUDRA basket, are not excited about hawking the scheme since borrowers have the tendency to default on loans given under a government scheme. But there is no escape. This is true of MFIs too. In 2020, Rs 578.65 billion for 19.6 million MFI loan accounts was classified as MUDRA loan. Most borrowers are not aware of this, while the MFIs wonder why such loans are called MUDRA when they hardly get any funds from MUDRA.

SIDBI launched MUDRA as an NBFC, following the February 2015 budget announcement. The plan was to position it, in due course, as a development financial institution and a refinancing agency combined—a la SIDBI, NABARD and NHB—through an Act of Parliament. The draft MUDRA bill also envisaged it as a regulator for the MFIs but that did not happen.

By January 2016, the government decided that it should be a bank and not an NBFC, but the RBI shot down the proposal as an NBFC cannot wear a bank's robe without a licence.

2.11.1. Not a Flattering Track Record

As a refinancing agency, MUDRA's track record is not flattering. In 2016, out of Rs 33.37 billion refinance, the MFIs got around 18.5 per cent. In 2017, their share rose to 22 per cent but dropped to less than 5 per cent in the next two years before rising to 23.3 per cent in 2020 when MUDRA refinanced Rs 40 billion. In five years, till 2020, it disbursed Rs 254.9465 billion of which Rs 30.185 billion, or 11.84 per cent, flowed to the MFIs. During this period, MUDRA's refinance was just 2.13 per cent of the loans disbursed by all lenders under PMMY.

Banks are to channel 40 per cent of their loans to the SMEs, agriculture and other segments under the so-called priority sector norm. The shortfall in meeting the priority loans target, which the banks used to keep as deposits with NABARD and SIDBI, is given to MUDRA.

A 2019 RBI inspection found that MUDRA was allotted Rs 400 billion under Priority Sector Shortfall Fund (PSSF) since its inception but only Rs 225 billion had been drawn by it. '…It is lacking in achieving its objective/mandate to provide refinance support to banks, NBFCs and MFIs for loans under PMMY and ultimately support to micro/small enterprises,' the inspection report states.

By 2021, the total amount drawn from the RBI under PSSF dropped to Rs 200.84 billion. In a pandemic year, when the RBI and the government went all out to ensure easy flow of funds to grease economic activity, MUDRA should have done better.

2.12. A Resilient System

Among all these, the good news is that the banking system is far more resilient today. It can withstand the impact of COVID-19 and the bad loans may not rise as much as the RBI has been estimating.

The macro-stress tests conducted by the central bank and outlined in its Financial Stability Report (FSR) of July 2020, a biannual health check of the industry had estimated that the gross bad loan ratio of all scheduled commercial banks might increase from 8.5 per cent in March 2020 to 12.5 per cent by March 2021. It was conducted in the thick of the first COVID-19 wave.

By September 2020, it actually fell to 7.5 per cent. The January 2021 FSR had estimated the gross bad loans increasing to 13.5 per cent by September 2021 under the baseline scenario. Under severe stress, it could rise to 14.8 per cent. But the July 2021 FSR toned it down. It estimated the gross bad loans rising to 9.8 per cent by March 2022 under the baseline scenario and 11.22 per cent, under a severe stress scenario. The actual figures are likely to be better than the FSR estimates.

Most banks are well capitalized and the provisional coverage ratio has also been rising. The health of the banking system is the key to the health of MFIs and NBFCs as these intermediaries raise money from the banks. They complement the banks by reaching out to a class of borrowers whom the banks find difficult to bring under their fold. Also, there is collaboration through the co-lending model.

The proposed RBI regulations for microfinance will also act as a booster dose for financial inclusion. An equally important and even more exciting role is being played by technology in the post COVID-19 world. It is changing every rule of the game of finance and inclusion. But that's a different story.

Banking System and Financial Inclusion

M. S. Sriram

The Indian financial system is still dominated by banks. While the banking system continued to be the pivot of inclusive finance efforts, a more nuanced role is emerging for their customer touch points as digital payments gather momentum.

3

3.1 REVIEW OF THE BANKING SYSTEM

This is a review of the banking system a year after COVID-19 hit us. The effects of the pandemic are still being felt. The pandemic put not only the transactions of the banking system out of gear but also the schedule of data release from the Reserve Bank of India (RBI). This should be seen as an exceptional year from the perspective of the type of data and also about how we could make sense out of the patterns. However, as we move towards a regime of direct transfers of aid and subsidy, the need for access to formal banking system and the leverage that the access can provide during times of crisis cannot be understated in any manner. Programmes were predicated on bank accounts being present: The PM Kisan Yojana where 'The scheme…where an amount of ₹6000/- per year is released by the Central Government online directly into the bank accounts of the eligible'.[1] and Garib Kalyan Yojana which transfers ₹500 each to 200 million poor women having Jan Dhan accounts—₹1,000 for 30 million poor senior citizens put directly into their accounts. All these were possible thanks to a strong initiative of a mission mode account opening campaign run under the Pradhan Mantri Jan Dhan Yojana (PMJDY) in the past years. While the impact of the pandemic on the lives, livelihoods and credit availability is to be assessed, it is evident that the architecture served well for benefit transfers.

The physical infrastructure for banking continued to grow but two distinct trends are evident in how the banking infrastructure is panning out. The most significant development is in the increase in the banking touch points on the branchless mode—largely represented by business correspondents, including in villages that had population of less than 2,000. However, neither this dramatic increase in the number of touch points, nor the direct benefit transfer resulted in any dramatic change in the other numbers. The number of basic savings and bank deposit (BSBD) accounts went up and the balance in the accounts also went up, but both did not reflect the dramatic improvement in the presence of banking outlets (see Table 3.1). Surprisingly, the number of accounts opened through branches saw the biggest jump. Even these did not result in a great increase in the total balance retained in the banking system by these customers, nor did it result in dramatically high levels of other services being offered such as overdraft or other added facilities.

The other aspect that is to be noted is the approach of the banking system towards automated teller machines (ATMs). The regulation is requiring ATMs to be more and more sophisticated—to be compatible to read Europay, MasterCard, Visa chip cards, to be friendly to people with disabilities—and even having an option of audio facility to operate the machine and installing greater number of cash recyclers. All these increase the fixed cost of the machine making it viable only with greater number of hits. On the other hand, the last mile settlements are happening through mobile cashless transactions—represented by the increase in United Payments Interface and Bharat Interface for Money transactions, making ATMs unviable. With the regulator permitting the withdrawal of cash from touch points with a Point of Sale (PoS) machine, and Aadhaar Enabled Payments System and Micro ATMs in the form of business correspondents, the need for bank-owned or banking-system-operated ATMs is falling.

It is therefore not surprising that the number of ATMs was falling. This possibly represents the disintermediation of cash with mobile to mobile transactions. With policymaking it possible to use the settlement network provided by the National Payments Corporation of India without any interchange charges for small ticket transactions, the digitization project is moving ahead fast. The biggest signal about ATMs came towards September 2021 when Suryoday Small Finance Bank (SFB) formally announced that they would be closing down all bank-owned ATMs.[2] The customers could continue using the cards through other bank ATMs and white label ATMs, indicating that an incremental investment in the physical infrastructure was not worth it. This is a space that we need to watch as we go forward.

Table 3.1. Financial Inclusion: Summary of Progress (Including Regional Rural Banks)

Particulars	Year Ended March 2017	Year Ended March 2018	Year Ended March 2019	Year Ended March 2020	Period Ending December 2020
Banking outlets in villages—branches	50,860	50.805	52,489	54,561	55,073
Banking outlets in villages—branchless mode[3]	543,472	513,742	544,666	544,656	1,236,809
Of which, BCs in villages less than 2000 population	438,070	414,515	410,442	392,069	851,272
Banking touch points, other modes				3,472 (Dec 19)	3,440
Banking outlets in villages—total	598,093	569,547	597,155	599,217	1,295,322
Urban locations covered through BCs	102,865	142,959	447,170	635,046	324,345
BSBD a/c through branches (no. in million)	254	247	255	262	289
BSBD a/c through branches (amt in ₹billion)	691	731	877	958	1259
BSBD a/c through BCs (no. in million)	280	289	319	339	360
BSBD a/c through BCs (amt in ₹billion)	285	391	532	726	771
Total BSBD a/c (no. in million)	533	536	574	600	649
Total BSBD a/c (amt in ₹billion)	977	1,121	1,410	1,684	2,030
OD facility availed in BSBDAs (no. in million)	9	6	6	6	6
OD facility availed in BSBDAs (amt in ₹billion)	2	4	4	5	5
KCCs (no. in million)	46	46	49	47	49
KCCs (amt in ₹billion)	5,805	6,096	6,680	6,391	6,791
GCCs (no. in million)	13	12	12	20	20
GCCs (amt in ₹billion)	2,117	1,498	1,745	1,940	1,740
ICT a/cs BC transaction during the year (no. in million)	1,159	1,489	2,101	3,231	3,518
ICT a/cs BC transaction during the year (amt in ₹billion)	2,652	4,292	5,913	8,706	8,288
ATMS of banks (public, private foreign banks)	214,554			249,515	213,348
India Post	982			1,000	1,000
ATMs of small finance banks, LABS and payment banks	724			2,120	2,358
ATMS of co-operative banks (both urban and rural)	5,829			8,067	8,241
ATMs of regional rural banks	1,038			1,328	1,031
White label ATMs	14,447			24,195	25,995
Total ATMs	237,574			286,225	251,973

Source: Annual report of 2017, 2018, 2019, 2020 and 2021 Reserve Bank of India. Mumbai: RBI. ATM statistics as of June 2021 from NPCI. https://www.npci.org.in/what-we-do/nfs/product-statistics/member-banks-list-atm-count (accessed on 10 August 2021).

Note: BSBD—basic savings and bank deposit, GCC—General Credit Card, KCC—Kisan Credit Card.

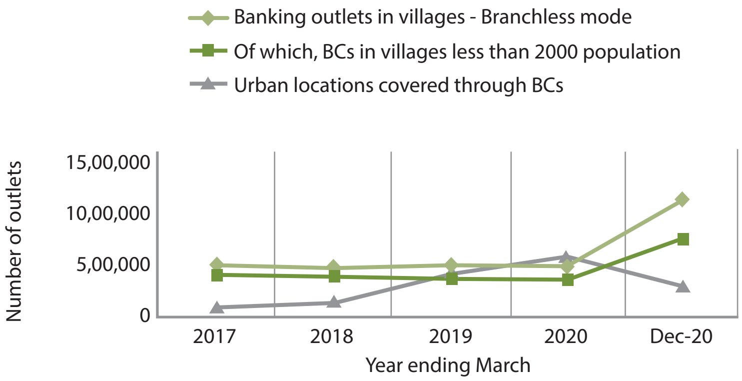


Figure 3.1. Branchless Outlets in Rural and Urban Areas

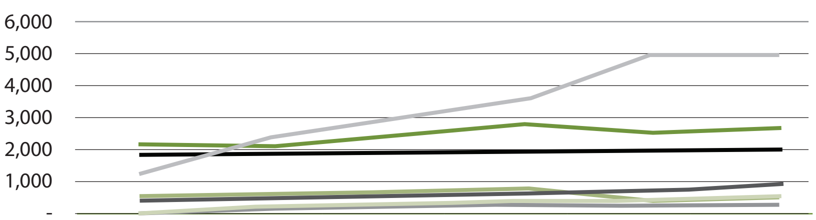
3.1.1. REDEFINING INCLUSION: TRANSACTIONS

This is where we may have to look at redefining the concept of financial inclusion. RBI has already included services beyond just a bank account in its redefinition of inclusion. It may be time that we move beyond these, where we look at branches not as transaction points, but as points that generate business both on the savings and the loan book side. What do we mean by a redefinition and enhancing the bank branch from a transaction point to a business point? Let us elaborate.

We have to realize that it is the banking system that manages the physical cash logistics of the economy as a whole. As the importance of cash in transactions goes down with mobile to mobile digital payments gaining currency, the significance of logistics of handling cash goes down and so does the importance of a bank branch as a manager of physical cash. Have we reached an inflection point where the importance of cash is diminishing and the digitization of the payments is increasing? Possibly the first signs of these are actually happening. While there is never a correct time to call a phenomenon, we need to look at the data trends and events and connect the dots.

When the withdrawal of specified bank notes (demonetization) happened in 2016, there was much discussion on whether this would lead towards a cashless and completely digital economy. Roadmaps for digitization were laid out and some predictions of how fast the digitization process could happen were made. However, the aggressive plan did not seem to work as the total cash in circulation quickly returned to the pre demonetization levels. Even now, the total cash in circulation is significant and we do not see clear patterns from that. Also dealing in cash, settlement of transactions in digital form, etc., are habit-forming and it takes a while before alternative modes of transactions are adopted. With COVID-19, the need for maintaining a distance as well as the need for contactless transactions increased. Both demonetization and COVID-19 may have provided the nudge points for a fundamental change.

Figure 3.1 represents the pattern of changes over the years. How do we interpret these? The fact that the number of business correspondents are going up and they are helping in the settlement of last mile cash transactions (withdrawals and deposits) continues to indicate that there are a section of people who continue to prefer transacting in cash. These seem to be belonging to the areas that are not connected on a stable basis to a network—villages below population of 2000.



	2016	2017	2018	2019	2020	2021
Atms ('00)	1,990	2,080	2,080	2,020	2,110	2,130
PoS ('000), including micro ATMs	1,385	2,526	3,083	3,722	5,138	5,124
Number of cards (million)	662	772	861	906	829	898
ATM transactions (million)	732	710	775	891	556	602
PoS transactions (Million)	113	271	319	408	363	377
ATM Tx value (billions)	2,246	2,259	2,664	2,890	2,677	2,846
PoS Tx values (billions)	135	357	419	530	476	668

Figure 3.2: Digital Journey

From the data it is apparent that the preferred mode of transacting is moving away from branches and from cash. The indicators of last mile cash settlement is strictly reflected by ATMs. We can see that while the number of ATMs and the number of cards issued remained flat, the number of PoS devices deployed is going up drastically. Although this has remained flat during the past year, we can see that the transaction numbers and values are really going up. One of the most important data points given in the statistics this year is the number of locations that have the Bharath Quick Response (QR) code that allows customers to just scan the QR code to make a payment through smart phones. This number straightaway has gone up to 3.6 million locations (see Figure 3.2).

Therefore, it may be a good time for the banks to look at branches more as business units than transaction units. This would still mean that one would need access to a physical branch to carry out larger transactions—other than payments—on a physical mode, because these transactions cannot necessarily be on a self-help electronic mode. These are transactions where there may be an element of financial education as well as counselling for the customer, and an element of assessment for the banker. If this means that transaction business is mostly moving to the digital mode, then the physical presence may still be needed, albeit in much fewer numbers than would otherwise have been the case. This would call for a move towards rationalization of urban branches and spread of rural and semi-urban touch points. We need to look at the branch network from this view point.

3.2. BRANCH NETWORK

On the banking side, there was a net fall in the number of branches both in metropolitan and urban locations a bit more sharply than in semi-urban locations. The rural branches showed an uptick. Part of the explanation for the fall in branches would be the consolidation in the public sector banks space where we saw a spate of mergers. Integration of Bank of Baroda with Dena Bank—both the banks having a significant presence in western India—and integration of Syndicate Banks with Canara Bank—both having similar branch footprints—would most likely have led to some rationalization of their branch networks. This also reflects the beginning of the trend that we identify in the earlier section. From a total of 148,402 outlets that were reported in March 2017, the number increased to 156,350 by March 2020 only to fall to 150,207 in 2021. The information on the number of branches is given in Table 3.2.

While these numbers provide for a particular narrative, it is important to look at the areas where multiple banks have not reached or where multiple branches of the same bank have not been opened. These would be locations where banks might not find enough business and therefore might be areas where there is hardly any competition. If we look at unique locations, 64% of the branches in rural areas have a single branch and only 6% of the semi-urban areas have a single branch, with no other bank having a branch in the location. What is important to track is the new locations that are attractive to the banks. Table 3.3 provides the data. As we can see from the table, there has been a far higher growth in the north and the north-eastern regions compared to the other regions of the country in case of rural branches. A large part of the growth may be explained by the new SFBs established in the region, particularly the North East SFB that has added more than 200 branches. Similarly, there have been AU SFB, Capital SFB and Utkarsh SFB that would have added branches to bolster the numbers.

Table 3.2. Branches of Scheduled Commercial Banks (Including Administrative Offices, for the Financial Year Ending March 31)

Branches of SCBs	2017	2018	2019	2020	2021
No. of reporting offices					
Rural	49,900	50,844	51,622	52,425	52,538
Semi-urban	39,467	40,137	41,579	42,790	42,389
Urban	27,452	27,792	28,667	29,794	27,232
Metropolitan	29,663	29,629	30,178	31,341	28,048
Total	148,402	148,402	152,046	156,350	150,207

Source: Quarterly statistics on deposits and credit of SCBs. RBI. from https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications (accessed on 10 August 2021).

Table 3.3. Number of Unique Rural and Semi-urban Locations that Are Served by Banks

	Rural						Semi-urban					
Year	2017*	2018	2019	2020	2021	Growth	2017*	2018	2019	2020	2021	Growth
North	6,671	6,858	6,957	7,013	7,048	6%	801	806	806	813	818	2%
N. East	1,334	1,346	1,357	1,541	1,564	17%	163	163	163	174	180	10%
East	8,169	8,221	8,254	8,552	8,646	6%	1,453	1,455	1,455	1,474	1,482	2%
Central	9,338	9,563	9,658	9,813	9,823	5%	1,388	1,393	1,394	1,406	1,404	1%
West	4,751	4,831	4,895	4,952	4,935	4%	967	971	971	971	971	0%
South	8,146	8,428	8,541	8,652	8,721	7%	2,879	2,893	2,902	2,944	2,963	3%
Total	38,410	39,247	39,662	40,523	40,737	6%	7,651	7,681	7,691	7,782	7,818	2%

Source: https://dbie.rbi.org.in/BOE/OpenDocument/1608101727/OpenDocument/opendoc/openDocument.faces?logonSuccessful=true&shareId=0 (accessed on 10 August 2021).

*The classification of areas into rural and semi-urban for 2012–2016 was based on population data of census 2001. The classification for 2017 is based on population census 2011. As a result of the change in the census base, several rural areas have been reclassified as semi-urban and therefore the 2017 numbers are strictly not comparable to the earlier numbers on a trendline.

As indicated earlier, the rate of growth of branches in locations where there already are branches may plateau over a period of time, if we assume that the transactions move away from the bank branch due to digitization and technology. Then the branches may be used purely for transacting business—applying for loans, opening savings accounts, counselling and grievance redressal. However, we need to recognize that even though we may be at an inflexion point, the change—which is more of a habit-forming change—is going to be slow and gradual.

While we can see significant movement in the transaction side and some data that indicate a positive movement in physical infrastructure and a very significant change in the last mile transaction settlement particularly on the payments side, we do not see the same level of progress when it comes to the meaty numbers. The next section analyses the progress on the portfolio of small borrowal accounts (SBA) and small deposit accounts.

3.3. SMALL BORROWAL ACCOUNTS: AN ANALYSIS

Each of these initiatives, whether it is PMJDY, or opening of branches or digitization, appears impressive when looked at in isolation. However, what is important is whether this has resulted in any material change in the composition of the bank credit to the 'inclusive' customers. The good news is that the inclusion agenda is not falling off the cracks. The absolute number of low-ticket accounts is on the rise, the amount of loans given has also been on the rise. However, the proportion of small accounts and loans outstanding in case of accounts with loan ticket size less than ₹200,000 has been somewhat flat. They represent about 75% of the total number of accounts and about 8% of the portfolio (down from 8.3% in 2017). The significant difference is that in the sub-classification of SBAs of the range of account sizes below ₹25,000 there is an increase in the proportion (see Table 3.4). Similarly, when we look at the gender divide, we still see a skew towards lending to men. While there is a betterment in the ratio where about 73% of the accounts given were to men (down from 75% in 2015), this divide has still a long way to go. The split between the number of accounts and the amount outstanding is given in Figure 3.3.

In the past years, the SBAs were largely expected

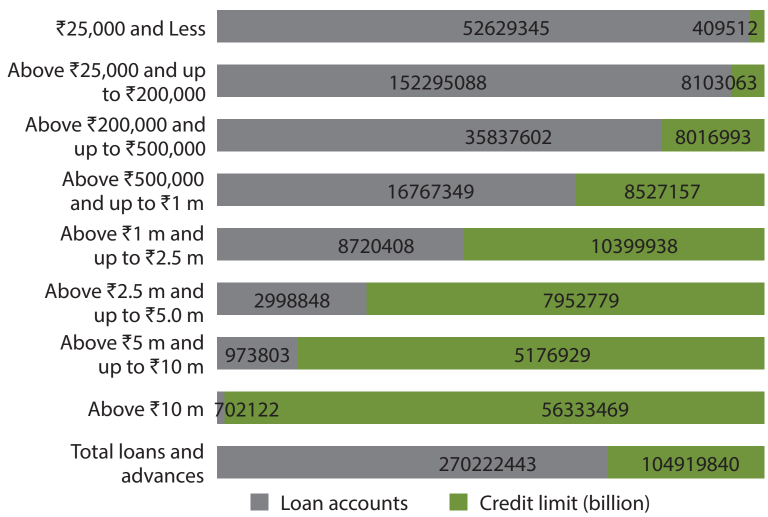


Figure 3.3. Outstanding Credit According to Size of Loan

Source: Quarterly BSR1. https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications (accessed on 7 October 2021).

to represent the poorer sections of the society given the loan ticket size. However, as we see the emergence of private sector banks and the share of the private sector banks increases significantly in the SBAs, it is important to look at the data carefully. In raising this issue, we are not trying to stereotype the performance of private sector banks as serving the elite and not the poor, but are basing the insights on the other part of the performance—the relative share they have in BSBD and PMJDY accounts. When we look at that data, and also juxtapose the relative share between the SBAs in rural and urban areas, we may find some explanation. Overall, the private sector banks have about 50% of the SBAs. However, only 24% of their SBAs come from rural areas, while a significant chunk comes from metropolitan areas. Therefore, it appears that a large number of SBAs of the private sector banks may be loans in the consumer finance segment. The new SFBs have a share of 10% of all the SBAs, but those are also evenly distributed across all areas (see Table A3.1). It is largely the public sector banks and Regional Rural Banks who have a greater share of these accounts in the rural areas. The analysis of SBA, therefore, needs to be done carefully as we go forward.

We need to look at this data with slightly longer term, going back to years between 2010 and 2015. Here, we find that the accounts of the ticket size of ₹25,000 and less have been—both in terms of numbers and amounts—tapering off till about 2015 even on an absolute scale and relative to the total number of accounts and amounts outstanding of the banking system. The rest of the portfolio was increasing faster than the sub 25,000 bucket. In the next bucket of Rs.25,000 to Rs.200,000 the absolute amounts were increasing, while the overall proportions have remained constant.

This brings us to the question whether private sector microfinance is crowding out the bank finance as indicated in a recent article.[4] While on the face of it, it does not appear to have made a material difference, there may be some nuance in the quality of the portfolio between the 'inclusive' customers and other customers who happen to take small ticket loans. Is this a product of greater inclusion or a product of sachetization of loan products is a question we need to ponder on.

However, an examination of the split of the small borrowal accounts on various occupational categories seems to indicate that it is largely deployed in direct loans to agriculture and personal loans (see Table 3.5). What we need to watch out are the number of personal loans in urban areas and a break up of whether there is a difference in the portfolio of the private sector and the public sector banks.

Table 3.4. Details of Credit to Small Borrowal Accounts over the Years

Year Ending March 31	2017	2018	2019	2020	2021
Loan amount Less than ₹25,000					
No. of a/cs (million)	33.25	36.51	42.46	47.18	52.78
% to total a/cs	19.30%	18.50%	18.30%	17.30%	19.43%
Outstanding (₹million)	412,941	439,837	521,412	463,011	410,860
% to total outstanding	0.50%	0.50%	0.50%	0.40%	0.38%
Loan amount ₹25,000 to ₹200,000					
No. of a/cs (million)	97.01	112.04	134.35	162.44	152.48
% to total a/cs	56.3%	56.9%	57.8%	59.6%	56.0%
Outstanding (₹million)	61,733,228	6,863,220	7,959,219	8,775,303	8,114,940
% to total outstanding	7.80%	7.80%	8.00%	8.30%	7.55%
Total up to ₹200,000					
No. of a/cs (million)	130.27	148.55	176.81	209.62	205.26
% to total a/cs	75.60%	75.40%	76.10%	76.90%	75.53%
Outstanding (₹million)	6,586,264	7,303,057	8,480,632	9,238,315	8,525,800
% to total outstanding	8.30%	8.30%	8.50%	8.70%	7.93%

Note: The gender wise break-up of the accounts and the amounts indicate that 69.9% of the loan accounts and 73.1% of the loan amounts have been made to men.

Source: Basic Statistical Returns for the years, 2017, 2018, 2019. Mumbai: RBI. Data for 2020 and 2021 is from the quarterly BSR1 outstanding credit of SCBs accessed from https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4 (accessed on 11 August 2021).

Table 3.5. **Purpose-Wise Break up of Small Borrowal Accounts as of 31 March 2021 (Accounts in Million, Amounts in ₹Billion)**

Details	Accounts of up to ₹0.025 Million				Accounts between 0.025 Million and ₹0.2 Million				Total Small Borrowal Accounts	
	Accounts	% of Total	Outstanding	% of Total	Accounts	% of Total	Outstanding	% of Total	Accounts	Outstanding
Agriculture	15.01	28%	179	44%	67.37	44%	4634.21	57%	985	12,885
Direct	13.42	25%	160	39%	62.09	41%	4378.18	54%	909	11,462
Indirect	1.60	3%	18	4%	5.27	3%	256.03	3%	76	1,423
Industry	3.13	6%	31	8%	6.30	4%	272.77	3%	118	30,991
Transport operators	0.55	1%	6	1%	1.82	1%	101.44	1%	40	2,286
Professional and other service	3.09	6%	24	6%	6.78	4%	265.59	3%	118	7,969
Personal loans	23.04	44%	100	24%	53.57	35%	2052.66	25%	1,154	28,229
Housing	6.01	11%	23	6%	1.39	1%	85.20	1%	101	14,782
Trade	6.44	12%	63	15%	12.07	8%	600.13	7%	222	11,578
Wholesale trade	0.41	1%	4	1%	1.11	1%	56.69	1%	23	5,772
Retail trade	6.04	11%	59	14%	10.96	7%	543.44	7%	199	5,806
Finance	0.16	0%	1	0%	0.95	1%	41.03	1%	14	10,571
All others	1.35	3%	8	2%	3.62	2%	147.12	2%	64	2,876
Total	52.78	100%	411	100%	152.48	100%	8114.94	100%	2,715	1,07,384

Source: Quarterly BSR1: Outstanding Credit of Scheduled Commercial Banks. https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!19 (accessed on 30 September 2021).

3.3.1. Priority Sector Lending

The data on priority sector lending (PSL) is available only for the financial year ending 2020. It appears from the statistics that all the banks have been routinely achieving their PSL targets. There have been significant changes in the PSL norms in the previous year, which we had discussed in the last report. These changes are applicable not only to the commercial banks but now have been extended to urban cooperative banks as well. Overall, it appears that the targets were met by the banking system, except for a gap that we see in case of SFBs. Given that SFBs were designed for achieving a higher PSL targets and the fact that they cannot even purchase PSL notes, this data may have to be re-examined to see if there are some problems in definition. Data pertaining to PSL is given in Table 3.6.

During the year, the RBI started implementation of its policy of calculating the achievement of PSL targets after applying the weights assigned based on the districts where credit has been purveyed, in order to reduce regional disparity in the credit flow. It also implemented the new PSL norms of increased requirements to lend to small and marginal farmers and micro-enterprises. These are niche targets that may be difficult to achieve for all the banks and, therefore, an opportunity is provided to trade the obligations through PSL certificates. The total volume of trading was around ₹6 trillion that represented about 15% of the total priority sector obligations. Of this trading, a significant proportion of ₹2.26 trillion came from trading of PSLC pertaining to small and marginal farmer obligations.

The changes in the priority sector that were brought about included finance for start-ups, installation of solar power plants for solarization of grid-connected agricultural pumps and higher limits for Farmer Producer Organizations; some changes in limits for education loans were also introduced. However, the most important change was the convergence between banks and non-banking finance companies (NBFC) by recognizing co-lending. The focus as per RBI was to 'improve the synergy between banks and NBFCs considering the lower cost of funds from banks and greater reach of the NBFCs'.[5] The idea was to reduce the cost of borrowing to the ultimate consumer. The experience of the banking system in this regard will have to be reviewed going forward.

Table 3.6. Achievement under PSL Advances by Categories of Banks March 2020 ₹in Billion

	Public Sector	Private Sector	Foreign Banks	Small Finance Banks	Total
ANBC	57,947	32,550	3,978	728	95,203
Off balance sheet exposure	3,348	4,485	1,863	7	9,703
Total agriculture	9,758	5,746	528	157	16,189
% of ANBC	17%	18%	13%	22%	17%
Weaker sections	7,319	3,830	309	329	11,787
% of ANBC	13%	12%	8%	45%	12%
MSME	9,281	6,692	776	210	16,959
% of ANBC	16%	21%	20%	29%	18%
Housing	3,720	1,753	34	36	5,544
Educational	575	41	1	1	618
Total priority sector	23,603	13,694	1,943	460	39,699
% of ANBC	41%	42%	49%	63%	42%

Source: Statistical Tables Relating to Banks in India STRBI: https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4 accessed on 30th September 2021

Note: ANBC—adjusted net bank credit. MSME—micro small and medium enterprises.

3.3.2. Non-Performing Assets in PSL

Data on non-performing assets under PSL was not provided by RBI and this data has not been updated since March 2017. It would be useful if the data was provided in the standard format to help analysts understand the movement.

3.4. CONCLUDING NOTES

The analysis brings to the fore a few questions, particularly on the relevance, manner and form of bank presence. As we go forward, should we continue to look at the physical presence of banks, given that technology allows people to make payments without the intermediation of a banking outlet? We then will have to redefine what a banking touch point offers. If we limit the conception of a touch point to accessing payments services and deposits and withdrawals, then it makes sense not to focus on branches. This is because while these were important functions that traditionally a bank branch was performing besides being the repository of the residual cash of the economy, they may get relegated to the background with digitization. A consequential issue is the designing of a customer–bank interface mode appropriate to the new functionalities of that interface and ensuring that the new design is inclusion-friendly.

There are several important takeaways from the review of the banking system with special reference to inclusive finance. In summary, we could say the following:

- The National Strategy on Financial Inclusion provides a vision and a roadmap for bank-led inclusion resting on six comprehensive pillars.
- The physical touch points have significantly grown. The nature of touch points for transactions are getting to be more technology-driven and cashless.
- There is a secular trend of a fall in the number of ATMs which is the most important indicator that cash withdrawal for transactions is no longer seen as essential while the other modes of settlement are picking up. It is important to leapfrog aggressively into the digital payments technology.
- The BSBD accounts were effectively used for direct benefit transfers and the importance of having a bank account was highlighted during the pandemic to make seamless benefit transfers to marked beneficiaries. However, the overdraft facility in the BSBD-PMJDY accounts has not taken off as the outstanding amount has largely remained flat.
- The performance under SBA needs to be reviewed in detail. The significant increase in the share of the private sector banks and the location of SBAs shifting from rural to urban centres many indicate a crowding out of the poor from the banking system to the alternate microfinance structure that is available. This needs to be studied carefully.
- The framework of PSL is changing and the banking sector has to gear up to develop better models of delivery to reach the target.

In general, the banking sector is moving ahead on an optimistic note.

APPENDIX A

Table A3.1. Progress of Commercial Banking at a Glance

Important Indicators	June 1969	March 2018	March 2019	March 2020	March 2021	June 2021
No. of commercial banks	89	149				
SCBs	73	149	147	141	133	131
Of which: regional rural banks	–	56	53	45	43	43
Non-scheduled commercial banks	16					
Number of offices of SCBs in India*	8,262	146,011	149,986	150,745	150,182	
1. Rural	1,833	50,799	51,565	52,346	52,649	52,737
2. Semi-Urban	3,342	39,672	41,106	42,313	42,628	42,208
3. Urban	1,584	25,358	26,300	27,258	27,436	27,217
4. Metropolitan	1,503	26,407	27,040	28,069	28,032	28,020
Population per office (in thousands)	64	8.15	8.28	8.06	8.06	8.06
Deposits of SCBs in India (₹billion)	46	114,344	126,309	137,486	141,275	155,393
of which: 1. Demand	21	48,546	53,015	57,896	59,339	68,037
2. Time	25	65,798	73,314	79,592	81,936	87,355
Credit of SCBs in India (₹billion)	36	87,670	98,976	105,188	103,332	104,986
Deposits of SCBs per office (₹million)	5.6	770	865	916	941	1,034
Credit of SCBs per office (Rs million)	4.4	591	678	701	689	720
Average per account deposits of SCBs (Rs)	88	59,819	64,069	66,449	72,966	
Average per account credit of SCBs (Rs)	68	45,523	42,606	38,598	41,692	39,600
SCBs' advances to PSL (Rs billion)	5	32,200	37,399	37,540	39,586**	
Share of PSL in total credit of SCBs (%)	14	40	42	41	41**	
Share of PSL in total non-food credit of SCBs (%)	15	30.82	31.73			
Credit deposit ratio	78	74.16	75.34	76.0	70.5	71.5
Investment deposit ratio	29	34.99	33.52	33.54	33.56	
Cash deposit ratio	8	6.19	5.42	5.42	5.51	

Source: RBI, Basic Statistical Returns of Commercial Banks in India (Mumbai: RBI, 2019), vol. 48; and quarterly returns at https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4 (accessed on 9 October 2021). PSL numbers are from the annual report of RBI, 2021.

Note: *Excludes administrative offices. **Up to December 2021. The numbers pertaining to 2016 and 2017 are on population statistics based on census 2011, the other years are based on census 2001.

Table A3.2. Outstanding Credit to Small Borrowal Accounts According Population Group, March 2021 (Numbers in Million; Amount in ₹Billion)

Population Group	Up to ₹0.025 Million			Between ₹0.025 and ₹0.2 Million			Above ₹0.2 Million		
	No. of Accounts	Credit Limit	Amount Out-standing	No. of Accounts	Credit Limit	Amount Out-standing	No. of Accounts	Credit Limit	Amount Out-standing
Rural	17	229	185	56	4,277	3,741	13	10,051	6,467
Semi-urban	12	173	137	46	3,671	3,138	18	15,501	11,674
Urban	8	105	70	26	1,951	1,407	14	23,173	16,187
Metropolitan	19	228	82	43	3,417	1,359	25	107,637	66,334
All India	57	735	473	171	13,315	9,645	71	156,361	100,662

Source: Basic Statistical Returns (BSR1) of Commercial Banks in India (Table 2.8). Mumbai, RBI (2021).

Table A3.3. Percentage Distribution of Outstanding Credit to SBA of SCBs According to Broad Category of Borrowers March 2021 (%)

Population Group	Individual				Other		Total	
	Male		Females					
	No. of Accounts	Amount Outstanding	No. of Accounts	Amount Outstanding	No. of Accounts	Amount Outstanding	No. of Accounts	Amount Outstanding
Rural	46.1	59.6	47.0	35.1	6.9	5.3	100.0	100.0
Semi-urban	48.0	58.2	38.8	34.7	13.2	7.0	100.0	100.0
Urban	49.4	57.3	36.9	34.2	13.8	8.5	100.0	100.0
Metropolitan	72.3	66.4	19.3	24.1	8.3	9.5	100.0	100.0
All India	54.3	59.8	35.8	33.3	9.9	6.9	100.0	100.0

Source: Basic Statistical Returns of Commercial Banks in India (Mumbai: RBI, 2021), Table 1.12.

Table A3.4. Outstanding Credit to Small Borrowal Accounts According to Occupation

Population Group-wise Outstanding Credit of SBAs of SCBs According to Occupation March 2021
(Number in '000s; Amount in ₹Billion)

Occupation	Rural			Semi-Urban		
	No. of Accounts	Credit Limit	Amount Outstanding	No. of Accounts	Credit Limit	Amount Outstanding
1. Agriculture	50,524	3,333	3,066	34,466	2,469	2,311
a. Direct finance	47,934	3,183	2,939	31,215	2,310	2,188
b. Indirect finance	2,590	150	127	3,251	159	123
2. Industry	2,739	120	96	2,614	113	88
3. Transport operators	320	20	17	529	33	27
4. Professional and other services	3,631	139	99	2,083	104	73
5. Personal loans	5,500	392	271	9,963	706	454
1. Loans for Housing	813	54	38	406	35	26
VI. Trade	8,348	382	292	5,738	283	230
1. Wholesale Trade	339	20	16	425	24	18
2. Retail Trade	8,009	362	275	5,313	260	211
VII. Finance	478	51	33	725	45	27
VIII. All Others	1,226	69	52	1,909	90	66
Total Bank Credit	72,766	4,506	3,927	58,028	3,844	3,275
Occupation	**Urban/Metropolitan**			**All India**		
	No. of Accounts	**Credit Limit**	**Amount Outstanding**	**No. of Accounts**	**Credit Limit**	**Amount Outstanding**
1. Agriculture	14,337	849	733	99,327	6,651	6,110
a. Direct finance	12,905	784	685	92,054	6,278	5,811
b. Indirect finance	1,432	64	48	7,273	373	299
2. Industry	4,513	185	141	9,866	418	325
3. Transport operators	1,544	97	66	2,393	151	110
4. Professional and other services	4,396	194	129	10,110	437	302
5. Personal loans	62,685	3,905	1525	78,148	5,002	2,250
a. Loans for housing	587	50	39	1,805	139	103
6. Trade	6,194	304	233	20,281	969	755
a. Wholesale trade	782	38	28	1,547	82	62
b. Retail trade	5,412	266	206	18,734	887	692
7. Finance	284	17	11	1,487	113	71
8. All others	2,654	151	78	5,789	309	197
Total bank credit	96,607	5,701	2,917	227,401	14,051	10,118

Source: Basic Statistical Returns of Commercial Banks in India (Mumbai: RBI, 2021), Table 1.13.

Table A3.5. **Bank Group-wise Credit According to Loan Size and as of March 2020 (Accounts in '000s, Amounts in ₹Million)**

Bank Group	Population Group	Less than ₹0.025 Million			₹0.025–0.20 Million			Above ₹0.20 Million		
		No. of Accounts	Credit Limit	Amount Out-standing	No. of Accounts	Credit Limit	Amount Out-standing	No. of Accounts	Credit Limit	Amount Out-standing
Public Sector Banks	Rural	4,243,039	58,192	51,824	23,467,204	2,139,788	1,932,722	8,693,581	7,276,386	4,476,985
	SUrban	3,736,863	47,689	41,664	21,067,095	2,034,771	1,841,061	12,140,289	9,698,789	7,485,968
	Urban	1,836,570	20,999	17,201	7,205,934	726,191	614,967	8,011,202	13,309,132	9,712,154
	Metro	1,274,521	12,803	9,592	3,560,012	364,120	286,842	6,738,958	553,09,085	36,162,841
	All India	11,090,993	139,683	120,282	55,300,245	5,264,870	4,675,592	35,584,030	85,593,392	57,837,948
Foreign Banks	Rural	13,673	255	260	61,519	5,004	5,082	12,027	39,659	21,175
	SUrban	9,995	196	199	93,372	8,386	8,476	28,536	72,690	40,112
	Urban	4,393	73	94	41,031	3,900	3,288	34,170	518,477	269,011
	Metro	861,251	6,507	1,942	3,937,110	383,607	80,359	2,174,410	7,506,520	3,973,949
	All India	889,312	7,030	2,493	4,133,032	400,898	97,205	2,249,143	8,137,346	4,304,246
Private Sector Banks	Rural	9,283,585	116,749	83,748	18,134,232	947,595	708,760	1,626,928	1,264,451	933,881
	SUrban	5,918,509	79,733	60,746	13,768,981	931,251	701,113	4,619,150	4,892,295	3,485,097
	Urban	5,284,997	65,049	40,356	13,527,324	963,044	604,730	5,701,359	8,788,629	5,777,517
	Metro	16,479,222	195,940	62,549	31,725,251	2,492,239	877,452	15,528,803	44,386,833	25,881,009
	All India	36,966,313	457,470	247,399	77,155,788	5,334,129	2,892,055	27,476,240	59,332,208	36,077,504
Regional Rural Banks	Rural	2,725,471	43,472	43,389	12,483,323	1,101,494	1,038,497	3,004,752	1,444,923	1,014,459
	SUrban	1,013,681	16,478	16,184	4,843,437	431,339	416,114	1,256,211	635,688	500,658
	Urban	174,678	2,599	2,362	751,147	71,174	64,112	349,796	306,494	227,151
	Metro	24,011	348	288	131,401	12,971	11,615	81,286	87,080	61,258
	All India	3,937,841	62,897	62,222	18,209,308	1,616,978	1,530,337	4,692,045	2,474,186	1,803,527
Small Finance Banks	Rural	507,643	9,962	5,951	1,846,629	83,167	56,293	34,302	25,434	20,369
	SUrban	,640,704	29,151	17,919	5,935,551	265,094	171,647	310,924	201,186	162,017
	Urban	904,198	16,129	9,683	4,120,163	186,284	119,601	332,869	250,592	201,361
	Metro	776,839	12,852	7,130	3,986,868	164,017	102,548	254,074	347,137	255,165
	All India	3,829,384	68,094	40,683	15,889,211	698,562	450,090	932,169	824,349	638,913
Total	Rural	16,773,411	228,629	185,172	55,992,907	4,277,049	3,741,355	13,371,590	10,050,853	6,466,869
	SUrban	12,319,752	173,246	136,713	45,708,436	3,670,841	3,138,411	18,355,110	15,500,649	11,673,852
	Urban	8,204,836	104,848	69,695	25,645,599	1,950,594	1,406,698	14,429,396	23,173,324	16,187,194
	Metro	19,415,844	228,451	81,501	43,340,642	3,416,954	1,358,815	24,777,531	107,636,655	66,334,222
	All India	56,713,843	735,174	473,080	170,687,584	13,315,437	9,645,280	70,933,627	156,361,481	100,662,138

Source: Basic Statistical Returns of Commercial Banks in India (Mumbai: RBI, March 2020), Table 2.8. https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications (accessed on 9 October 2021).

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[3] The branchless mode outlets include BCs, ATMs, PoS points, USB, mobile vans and any other mechanism that provides a touch point for the customer of the bank.

[4] https://www.thehindu.com/opinion/lead/rbi-microfinance-proposals-that-are-anti-poor/article36848338.ece (accessed on 9 October 2021).

[5] RBI, Reserve Bank of India Annual Report 2020–21 (Mumbai: RBI, 2021).

Small Finance Banks: Coming of Age

Annapurna Neti

4

4.1 INTRODUCTION

The provision of access to financial services has been identified by policymakers and practitioners as one of the key initiatives to achieve equitable economic growth and has been on the development agenda in India for many decades now. Starting with the cooperative movement, nationalization of banks and expansion of branch network, establishment of regional rural banks (RRBs), self-help group bank linkage programme or microfinance institutions (MFIs), there has been both a push and demand for establishing a variety of financial service providers and intermediaries catering to the financial needs of low-income households and micro, small and medium enterprises (MSMEs) that have been excluded from or underserved by the formal sector. Rural cooperative banking institutions, urban cooperative banks (UCBs), RRBs and local area banks (LABs) have all dotted the landscape of financial service providers alongside public sector banks (PSBs) and private sector banks (PVBs) and development finance institutions such as National Bank for Agriculture and Rural Development (NABARD) and Small Industries Development Bank of India. Along with priority sector lending (PSL), lead bank scheme, Pradhan Mantri Jan Dhan Yojana (PMJDY) and the business correspondent (BC) model, these measures and institutions have extended the boundaries of financial inclusion and financial services have percolated to many households and small businesses that were hitherto excluded. This was also made possible due to establishing National Payments Corporation of India, the use of technological innovations and adoption of technology-enabled channels such as ATMs and micro-ATMs, satellite branches, point of sale (POS) terminals, mobile banking and others.

Most of these financial inclusion efforts in India have been predominantly bank-led with support from the Reserve Bank of India and the government. For instance, banks have implemented two phases of financial inclusion plans (FIP) to provide doorstep banking services first to villages with a population of more than 2,000 and later to villages with a population of less than 2,000. The two phases of FIP (phase 1 from 2010–2013 and phase 2 from 2013–2016) and the PMJDY led to the creation of extensive banking network and opening of new bank accounts. Efforts have also been made to reduce dormancy in accounts and increase the transaction volumes.

As Table 4.1 shows, FIPs have helped in significantly scaling up the banking network during 2010–2020. The number of banking outlets[1] has increased exponentially, largely due to the growth in the number of BC outlets. The growth in the number of bank branches has been noteworthy too. The multi-fold growth in the number and amount of basic savings bank deposit account (BSBDA) accounts, small farm sector and non-farm sector credit illustrates the expanded boundaries of financial inclusion during this period. Establishment of ATMs, micro-ATMs and POS terminals, e-wallets, mobile and online banking have furthered and complemented these efforts and considerably narrowed the gap between the financially included and excluded.

Table 4.1. Progress under Financial Inclusion Plans

Category/Year	2010	2013	2016	2020
Number of banking outlets (million)	153	361	773	1,384
Of which				
Number of bank branches	85	107	136	150
Number of BC outlets	68	254	637	1,234
Number of BSBDA accounts (million)	74	182	469	600
Savings in BSBDA accounts: Total (₹billion)	55	183	638	1,684
Small farm sector credit (KCC) accounts (million)*	40	53	69	97
Small farm sector credit (₹billion)*	164	2,952	4,135	5,677
Small non-farm sector (GCC) credit accounts (million)*	61	50	56	113
Small non-farm sector credit (₹million)*	198	2,196	3,229	3,562

Source: Based on Table 6 'Progress under Financial Inclusion Plans', statistical tables relating to banks in India, RBI Database on Indian economy; Chapter IV on credit delivery and financial inclusion from RBI annual report FY 2021 and *data from the address delivered by Shri S. S. Mundra, Deputy Governor, Reserve Bank of India at the BRICS Workshop on Financial Inclusion in Mumbai on 19 September 2016.

According to the All-India Debt and Investment Survey 2019,[2] 84% households in rural India and 85% in urban India have a deposit account in a bank. At least 95% of households (96% in rural areas and 95% in urban areas) reported ownership of a financial asset.[3] This is a notable improvement over the findings from NSS 70th round[4] which reported 69% of rural households and 80% of urban households having a deposit account. Percentage of households reporting ownership of a financial asset in the 70th round was 74% in rural areas and 86% in urban areas. The share of financial assets as a percentage of wealth and the share of household debt from institutional sources has also increased marginally in both rural and urban areas (Table 4.2).

Although commercial banks provided loans to the priority sectors since the 1970s and the 1980s, the gaps in coverage persisted. The provision of a range of financial services crafted to suit the needs of millions of vulnerable households required capabilities that conventional banking system was not geared for. Assessing the needs of the financially excluded households with unpredictable, uncertain and variable incomes, lack of assets and credit histories coupled with providing and monitoring large volumes of small-sized loans and savings accounts required capabilities that did not fully align with the existing banking norms and business models. Against this backdrop, two committees (one headed by Dr Raghuram Rajan and the other by Dr Nachiket Mor) provided the impetus for a renewed focus on financial inclusion efforts in the country. The Committee on Financial Sector Reforms headed by Dr Rajan called for a 'paradigm shift' away from 'large bank-led, public sector-dominated, mandate-ridden, branch expansion-focused strategy for inclusion'[5] and proposed alternative institutional models and low-cost structures called 'small finance banks' (SFBs).

This was followed by a 'Comprehensive Committee on Financial Services for Small and Low-Income Households' headed by Dr Mor[6] which proposed a framework for financial inclusion and financial deepening in India. The committee's recommendations included a framework for horizontally and vertically differentiated banking systems with differentiated capabilities and niche interests based on regional, sectoral, product and service focus, interaction with capital markets and use of agents.

The recommendations of these committees as well as those of the Committee on Banking Sector Reforms chaired by Mr Narasimham[7] formed the basis for RBI's guidelines released in 2014 for licensing of new banks in the private sector called SFBs.

However, differentiated banking systems are not a new idea; RRBs, LABs, rural and UCBs are all variants of banking structures with differentiated regional or sectoral focus, scope of activities, size of loans, customer base or capital requirements. Table 4.3 shows the number of branches, number of savings and credit accounts and amount outstanding of RRBs, LABs and UCBs. While these banks helped the financial inclusion goals by extending the coverage to the unbanked areas, target sectors and customers, the financial health and operational viability of these entities (cooperative banks and RRBs) were called into question due to their geographical or functional concentration,[8] undercapitalization, high non-performing assets (NPAs), inadequate management capabilities and

Table 4.2. Some Key Findings on Financial Inclusion from All-India Debt and Investment Surveys 2013 and 2019

Category	NSS 70th Round (2013)		NSS 77th Round (2019)	
	Rural	Urban	Rural	Urban
Households having a deposit account (%)	69	80	84	85
Households reporting ownership of financial assets (%)	96	95	74	86
Share of wealth in financial assets (%)	2	5	5	9
Share of debt from institutional sources (%)	56	85	66	87

Source: Fifth and sixth All-India Debt and Investment Surveys, NSS 70th round (2013) and NSS 77th round (2019).

Table 4.3. Brief Overview of RRBs, LABs and Cooperative Banks

	RRBs	LABs	Cooperative Banks (State and District Central Cooperative Banks)	UCBs
Number as on 31 March 2021	43	3	384	1,539
Number of branches as on 31 March 2021	21,847	81	15,661	11,195
Savings accounts (billion)	2.66	Not available	13.85	Not available
Savings (in ₹billion)	4,785	8.14	556	501
Credit accounts (billion)	0.025	Not available	1.62	Not available
Credit (₹billion)	2,982	6.61	479	305

Source: Data as on 31 March 2020 from Report on Trend and Progress in Banking (RBI); *branch data on RRBs from NABARD annual report, March 2021.

poor governance, among others. Several measures (recapitalization, amalgamation, etc.) taken to improve the viability of the cooperative banks and RRBs met with mixed results thus amplifying the need for an alternative banking structure with better governance.

SFBs are scheduled commercial banks (SCBs) that are similar in approach and objectives to RRBs and LABs but have higher capital requirements as well as wider scope with respect to geographical focus and products offered. The following section describes the mandate of the SFBs, key policy changes since 2014 and the key differences in regulation between SFBs and the other SCBs.

4.2. SMALL FINANCE BANKS

SFBs are registered as public limited companies under the Companies Act, 2013, and licensed under Section 22 of the Banking Regulation Act, 1949. SFBs are envisioned as vehicles for furthering financial inclusion in the country by provision of savings and credit to underserved population, small and marginal farmers, micro and small businesses in the unorganized sector through high technology and low-cost operations.[9]

The RBI guidelines (2014) specified the eligibility of promoters, scope of activities, capital requirement, promoter's contribution, prudential norms, corporate governance and other conditions for SFBs, key features of which are summarized below.

Eligibility

1. Existing non-banking financial companies (NBFCs), MFIs and LABs owned and controlled by residents are eligible for conversion into SFBs subject to compliance with legal and regulatory requirements.

Scope of activities of SFBs

1. Basic banking activities of deposits and lending to the financially excluded segments such as small and marginal farmers, micro and small enterprises and entities in the unorganized sector.
2. Distribution of other financial products such as mutual fund units, insurance and pension products with prior approval from the RBI and meeting the compliance requirements from the appropriate regulator.
3. Category II authorized dealers in foreign exchange business for their clients.
4. 25% of SFB branches should be opened in unbanked rural centres with population up to 9,999. Prior approval of the RBI is required for branch expansion.
5. 75% of SFB's adjusted net bank credit (ANBC) will be extended to priority sectors.
6. A minimum of 50% of the loan portfolio of the SFB should comprise loans and advances of up to ₹2.5 million.

Capital requirement

1. Minimum paid-up equity capital of ₹1 billion.
2. Minimum capital adequacy ratio and Tier I capital at 15% and 7.5% of its risk-weighted assets and Tier II capital at a maximum of its Tier I capital, subject to percentages prescribed by the RBI from time to time.

Promoter's contribution

1. Promoters' contribution to paid-up equity capital to be a minimum of 40% initially which is locked in for a period of five years from commencement of business. The promoters' contribution should be brought down to 30% in 10 years and 26% in 12 years.
2. Individuals and entities other than promoters cannot have more than 10% shareholding.
3. Maintenance of cash reserve ratio and statutory liquidity ratio and other such prudential norms as applicable to commercial banks are also applicable to SFBs.

Other conditions

1. SFBs cannot operate as BCs of other banks but can have their own BC network.
2. SFBs' operations should be technology driven right from the commencement of operations.

After notifying these licensing guidelines, in-principle approvals were given to 10 applicants for setting up SFBs and detailed operating guidelines for SFBs (RBI 2016 and 2017) were issued which specified guidelines for prudential regulation, risk management, corporate governance, banking operations, financial inclusion, etc., as applicable to SFBs. Of the 10 entities that received in-principle licence in 2015, two SFBs commenced operations in 2016 and eight started operations in 2017 (Table 4.4). Of these 10 SFBs, eight were NBFC-MFIs, one was an LAB, and one was an NBFC. From 2018, the RBI also permitted UCBs with good track record to transition voluntarily into SFBs, subject to compliance with requirements as specified by the RBI. UCBs with a minimum net worth of ₹500 million and capital to risk-weighted assets ratio (CRAR) of 9% and above are eligible to apply for the SFB licence. The guidelines require UCBs to have a minimum net worth of ₹1 billion as on the date of commencement of business as SFBs and increase their paid-up capital to a minimum of ₹2 billion within 5 years from the commencement of operations. Pursuant to these guidelines, Shivalik SFB came into existence in 2021 after 23 years as a UCB.

After reviewing the performance of these SFBs, with a view to encourage competition, the RBI issued further guidelines in 2019 for 'on tap' licensing of SFBs.[10]

- The guidelines require SFBs to have a minimum net worth of ₹2 billion as on the date of commencement of business (with the exceptions being transitioned UCBs).[11]
- NBFCs and NBFC-MFIs that apply for conversion to SFBs are given 18 months from the date of in-principle approval or date of commencement of operations, whichever is earlier, to achieve a net worth of ₹2 billion.
- Further, MFIs that transitioned into SFBs are given a period of 3 years to align their banking network to the extant guidelines.
- The guidelines also include a provision for SFBs that have demonstrated a satisfactory track record for at least 5 years to transition to a universal bank after due diligence exercise by the RBI.

The requirement of prior approval from the RBI for branch expansion has also been relaxed in 2020; SFBs now have general permission to open banking outlets provided at least 25% of their outlets are in unbanked rural centres. They were also exempted from seeking RBI's prior approval for undertaking non-risk sharing simple financial service activities, which do not require any commitment of own funds after three years of commencement of business.

Table 4.4. List of Small Finance Banks in India

S. No.	SFB	Grant of SFB License from the RBI	Commencement of Operations	Previous Legal Form
1	Capital SFB	March 2016	April 2016	Capital LAB Ltd since 2000
2	Equitas SFB	June 2016	Sep 2016	Equitas Microfinance Pvt Limited, Chennai since 2007; NBFC-MFI
3	Suryoday SFB	Aug 2016	Jan 2017	Suryoday Microfinance Pvt Ltd since 2009; NBFC-MFI
4	Utkarsh SFB	Nov 2016	Jan 2017	Utkarsh Microfinance Pvt Ltd since 2009; NBFC-MFI
5	Ujjivan SFB	Nov 2016	Feb 2017	Ujjivan Financial Services Pvt Ltd since 2005; NBFC-MFI
6	ESAF SFB	Nov 2016	March 2017	ESAF Microfinance and Investments Private Ltd., since 2005; NBFC-MFI
7	AU SFB	Dec 2016	April 2017	AU Financiers (India) Ltd since 1996; NBFC
8	Fincare SFB	May 2017	July 2017	Future Financial Services Pvt Ltd and Disha Microfinance Pvt Ltd; both NBFC-MFIs
9	North East SFB	March 2017	Oct 2017	RGVN Microfinance Ltd since 2008; NBFC-MFI
10	Jana SFB	April 2017	March 2018	Janalakshmi Financial Services Pvt Ltd since 2000; NBFC-MFI
11	Shivalik SFB	Jan 2021	April 2021	Shivalik Mercantile Cooperative Bank Ltd since 1998; UCB

Source: Websites and annual reports of SFBs.

Table 4.5. Population Group-wise and Bank Group-wise Number of Functioning Offices of SCBs as of 31 March 2021

	Rural	Semi-urban	Urban	Metropolitan	Total
SBI and its associates	7,970	7,174	5,279	4,526	24,949
Nationalized banks	20,954	17,828	14,096	14,770	67,648
Foreign banks	127	187	167	440	921
RRBs	15,387	4,829	1,637	439	22,292
LABs	8	42	17	14	81
PVBs	7,423	11,429	7,792	10,031	36,675
SFB	887	1,927	1,312	976	5,102
Payments bank	33	295	331	89	748
Total	52,789	43,711	30,631	31,285	158,416

Source: Branch banking statistics, RBI March 2021.

4.3. CURRENT LANDSCAPE OF SFBS

There are 11 SFBs in India as on the date of which 10 banks have been in operation for more than three years. As of 31 March 2021, there are more than 5,000 banking outlets of SFBs in India, with 64% of these branches in semi-urban and urban areas (Table 4.5 and Figure 4.1). The banking outlets comprise liability branches, asset centres and outlets operated by BCs. The number of branches of SFBs has grown by a modest 12% over the previous year with a higher proportion of branches being opened in semi-urban and urban centres.

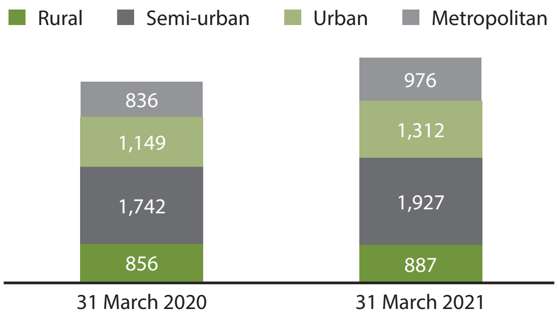


Figure 4.1. Population Group-wise Number of Functioning Offices of SFBs as on 31 March 2020 and 2021

Source: Branch banking statistics, RBI March 2020 and 2021.

Table 4.6. Key Business Segments, Products and Services of SFBs

Asset Side	Liabilities Side	Fee-based Products and Services Including Third-party Services	Digital Banking
Micro-loans to individuals	Current account	Life and general insurance	Mobile and Internet banking
Loans to MSMEs (term loans and working capital)	Savings and salary accounts	National pension scheme and social security	Digital onboarding of customers
Housing loans	Term deposit account	Payments via national electronic funds transfer, real-time gross settlement and Bharat Bill Pay	
Personal loans	Current account for institutions	Mutual funds	
Vehicle finance	Bulk account for institutions	Credit cards	
Secured business and terms loans to financial intermediaries	Debit cards	POS	
Gold loans		Locker facilities	

Source: Annual reports and websites of SFBs.
Note: Indicative, not an exhaustive list.

4.4. BUSINESS SEGMENTS AND PRODUCT MIX

Many of the SFBs were offering a limited range of asset-side products in their previous form as NBFCs or NBFC-MFIs. On transitioning to an SFB, they have diversified the product range on the asset and liabilities side. All SFBs now offer a range of retail and wholesale products on the assets and liabilities side in addition to fee-based third-party products and digital banking (Table 4.6). The customers they cater to are individuals, joint liability groups, small businesses, corporates and non-profits.

4.5. FINANCIAL PERFORMANCE OF SFBS

4.5.1. Assets and Liabilities[12]

As on March 2021, the SFBs had cumulative assets of ₹1,636 billion, recording a lower growth of 23% over FY 2020 as compared to 34% year-over-year (YoY) growth in FY 2020. The total deposits of ₹1,095 billion and advances of ₹1,086 billion have grown at 33% and 20%, respectively, over the previous year. Borrowings have declined by 8% over the previous year which reinforces the decreasing dependence of SFBs on borrowings. However, the asset growth appears to have been driven not by advances, but by balances with banks, cash and balances with the RBI and investments (Table 4.7)

Deposits of SFBs account for 67% of total liabilities (or assets) (Figures 4.2 and 4.3). However, the composition of deposits shows a clear deceleration in term deposits and a doubling of savings deposits. This could be attributed to the COVID-19 crisis due to which customers would have preferred savings deposits over term deposits due to the greater liquidity in difficult times (e.g., non-salaried low-income or middle-class households who could not work for long periods of time). Three SFBs, namely AU SFB, Equitas SFB and Ujjivan SFB, account for 60% of total deposits of SFBs during the last two years (Figure 4.5).

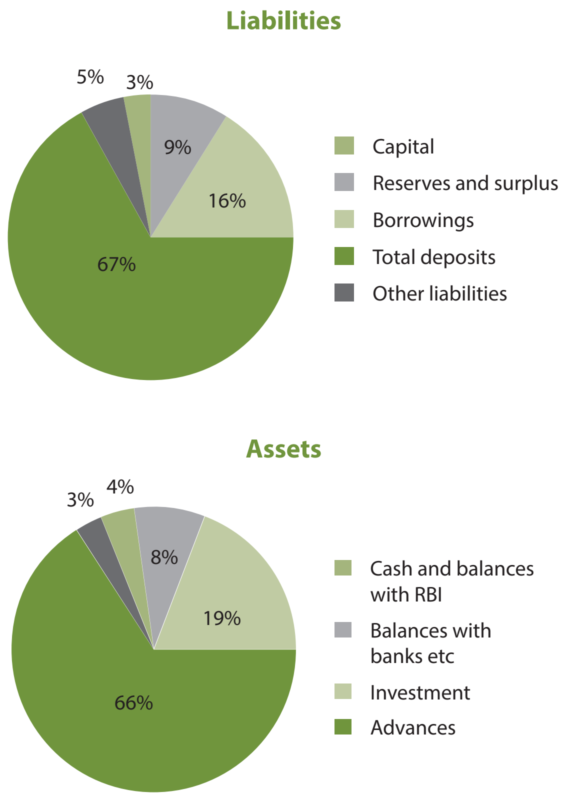


Figure 4.2. Composition of Assets and Liabilities of SFBs as on 31 March 2021

Source: Author's calculations from annual reports and audited financial statements of SFBs for FY 2021.

Table 4.7. Consolidated Balance Sheet of SFBs (₹ Billion)

Liabilities	FY 2020	FY 2021	YoY Growth	Assets	FY 2020	FY 2021	YoY Growth
Capital	52	54	4%	Cash and balances with the RBI	51	69	37%
Reserves and surplus	110	147	34%	Balances with banks, etc.	87	123	41%
Borrowings	288	266	–8%	Investments	242	307	27%
Total deposits	825	1,095	33%	Advances	906	1,086	20%
Other liabilities	54	75	40%	Other assets	42	50	19%
Total liabilities	1,327	1,636	23%	Total assets	1,327	1,636	23%

Source: Compiled by the author from annual reports and audited financial statements of SFBs.

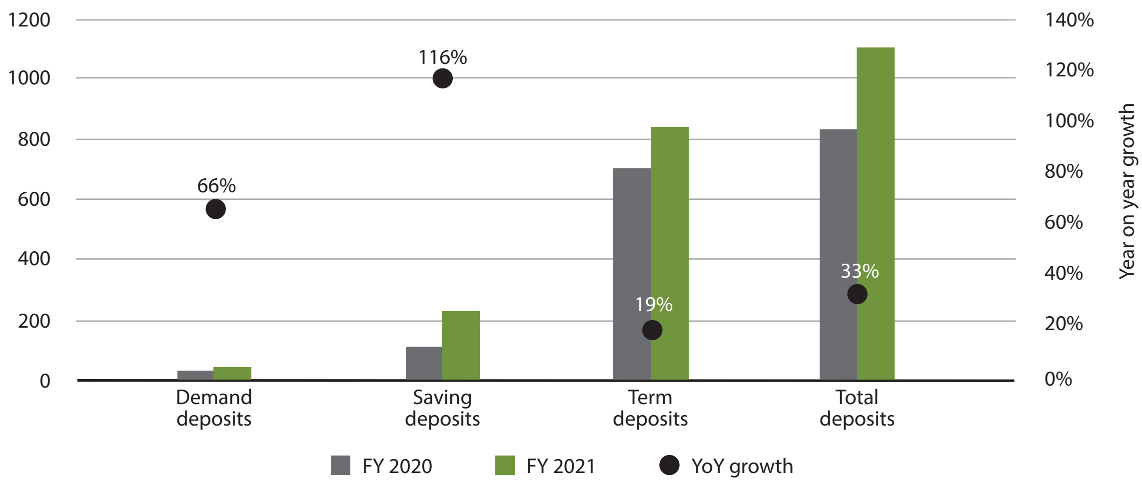


Figure 4.3. Growth in Deposits of SFBs

Source: Author's calculations from annual reports and audited financial statements of SFBs for FY 2021.

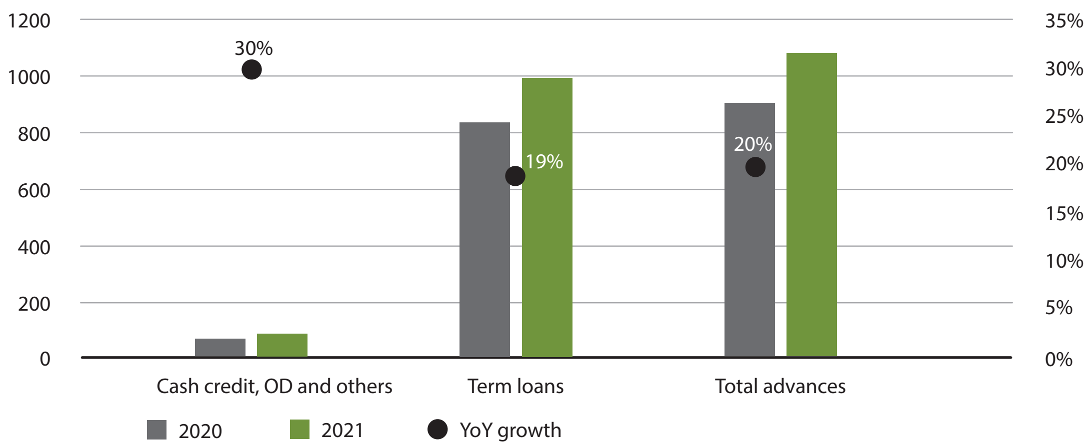


Figure 4.4. . Growth in Deposits of SFBs

Source: Author's calculations from annual reports and audited financial statements of SFBs for FY 2021.

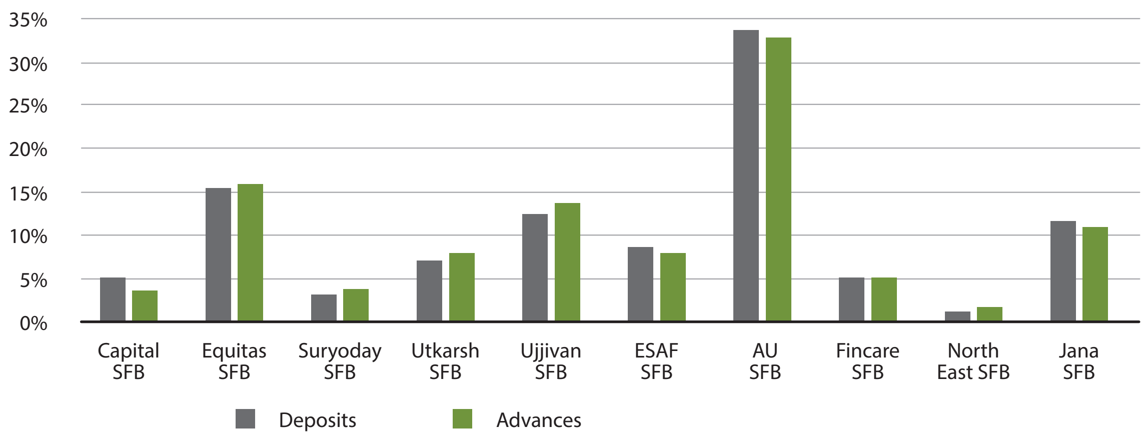


Figure 4.5. Share of SFBs in Total Deposits and Advances of SFBs

Source: Author's calculations from annual reports and audited financial statements of SFBs for FY 2021.

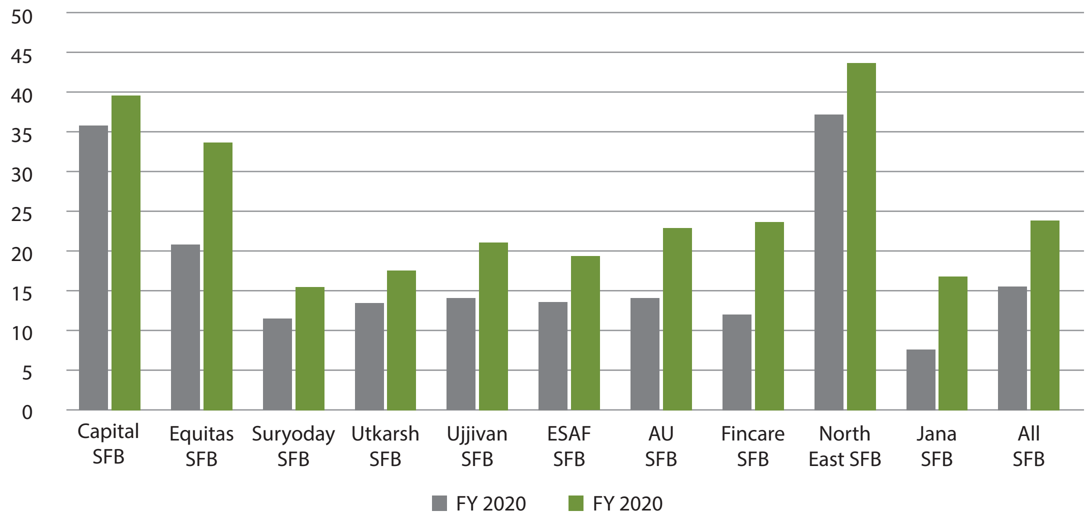


Figure 4.6. CASA Ratios of SFBs for FY 2020 and FY 2021

Source: Author's calculations from annual reports and audited financial statements of SFBs for FY 2021.

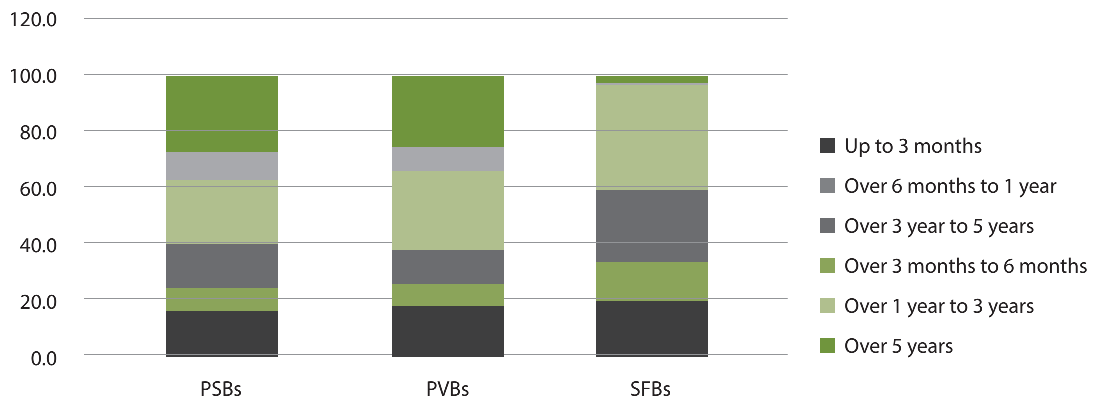


Figure 4.7. Maturity Profile of Term Deposits of SFBs as of 2020

Source: Based on Table 9 on maturity profile of select items of liabilities and assets of SCBs from statistical tables related to banks in India as on March 2020, RBI database on Indian economy.

On the asset side, advances contribute to 66% of total assets of SFBs (Figure 4.4). The advances comprise term loans and cash credit, overdraft and other loans. Term loans comprise 92% of total advances of SFBs. YoY growth of cash credit, overdraft and other loans was higher (30%) compared to the growth in term loans (19%). AU SFB, Equitas SFB and Ujjivan SFB and account for 60% of the term loans of SFBs.

Both deposits and assets have registered lower growth rates (33% and 20%) in FY 2021 as compared to previous year (48% and 30%).

The current account savings account (CASA) ratios of all SFBs have increased over the previous year (Figure 4.6). As CASA deposits offer lower rates of interests compared to term deposits, this helps in lowering the cost of funds for SFBs. The CASA ratios for FY 2021 vary from 15% (Suryoday SFB) to 44% (North East SFB) with average CASA ratio for SFBs at 24%. However, there does not appear to be a correlation in CASA ratios of SFBs with the size of total deposits; Equitas and Ujjivan with similar amounts of total deposits (of ₹107 billion each) have CASA of 34% and 21%, respectively. Similarly, AU SFB has the highest total deposits of ₹360 billion among SFBs but has a lower CASA ratio of 23%. Commensurate with the increase in CASA ratios, the cost of funds for SFBs has decreased in FY 2021 compared to FY 2020. Other reasons for the decrease in cost of funds are the stimulus measures by the government and availability of refinance at concessional rates. However, SFBs with lower CASA ratios (Suryoday, Jana and Utkarsh) may have to depend on borrowings and refinance leading to an overall higher cost of funds (all three have more than 8% cost of funds). Capital SFB has the lowest cost of funds of 5.83% among all SFBs followed by AU SFB at 6.50%. The average cost of funds for SFBs in FY 2021 is 7.38%.

The maturity profile of term deposits of SFBs clearly shows a reliance on shorter maturity deposits as compared to PSBs and PVBs. Nearly 60% of the term deposits of SFBs have a maturity profile of up to 1 year and 37% between 1 year and 3 years. Further, the proportion of deposits with a longer maturity of over 3 years is insignificant in the case of SFBs as compared to PSBs and PVBs (Figure 4.7).

For many SFBs, micro-loans and microfinance remain a focused business segment with small borrowal accounts comprising 95% of the total credit accounts and 43% of total amount outstanding of SFBs as of 31 March 2021. This is comparable to RRBs and is much higher than PSBs and PVBs (Figure 4.8). As most of these loans are unsecured,

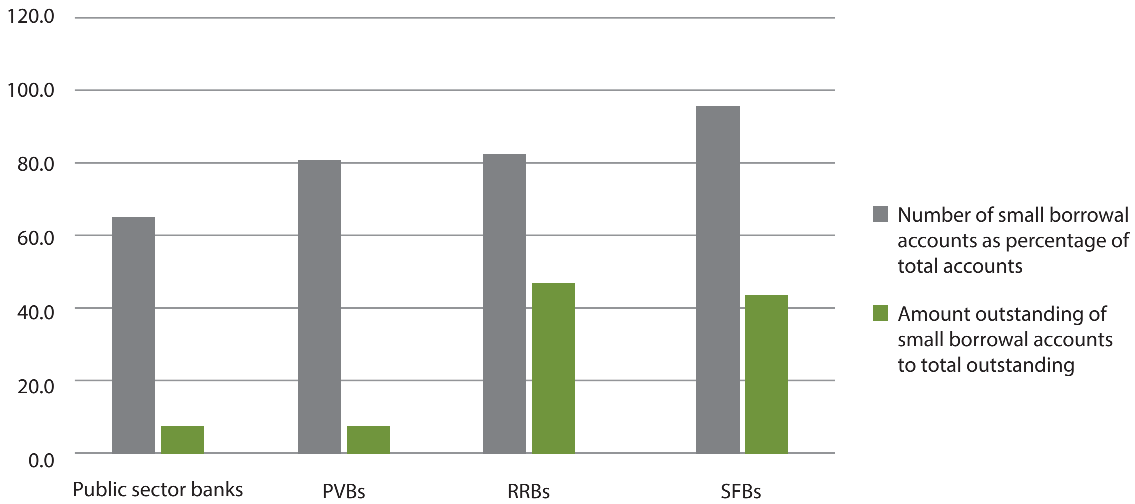


Figure 4.8. Share of SFBs in Small Borrowal Accounts

Source: Compiled from Table 2.11 on population group and bank group-wise credit of SCBs, basic statistical returns of SCBs as on 31 March 2021, RBI database on Indian economy.

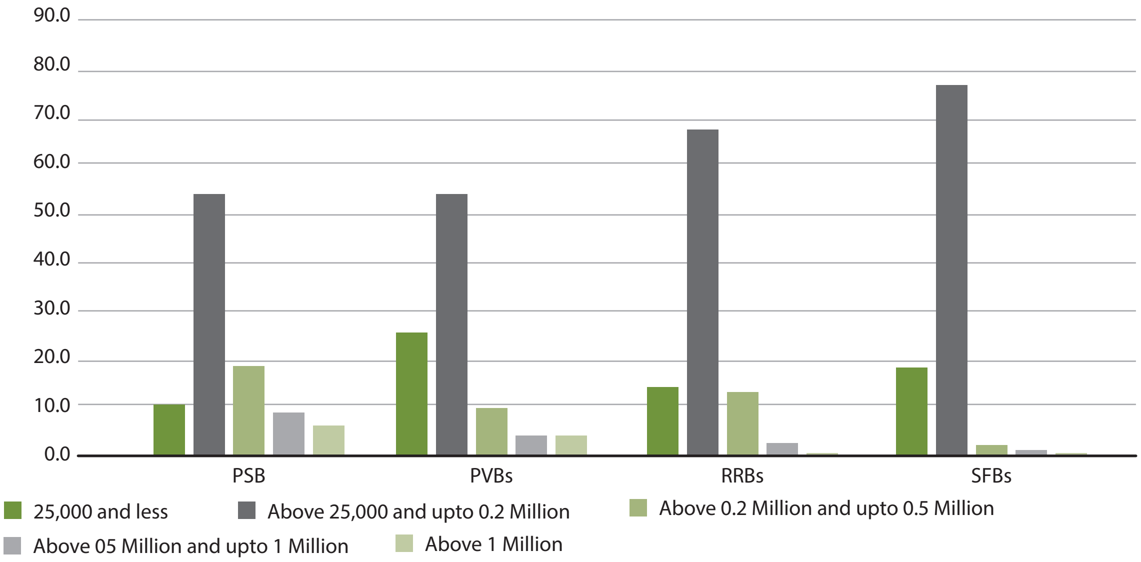


Figure 4.9. Bank Group-wise Outstanding Credit Accounts as a Percentage of Total According to Credit Limit

Source: Compiled from Table 2.7 on bank group-wise outstanding credit of SCBs, basic statistical returns of SCBs as on 31 March 2021, RBI database on Indian economy.

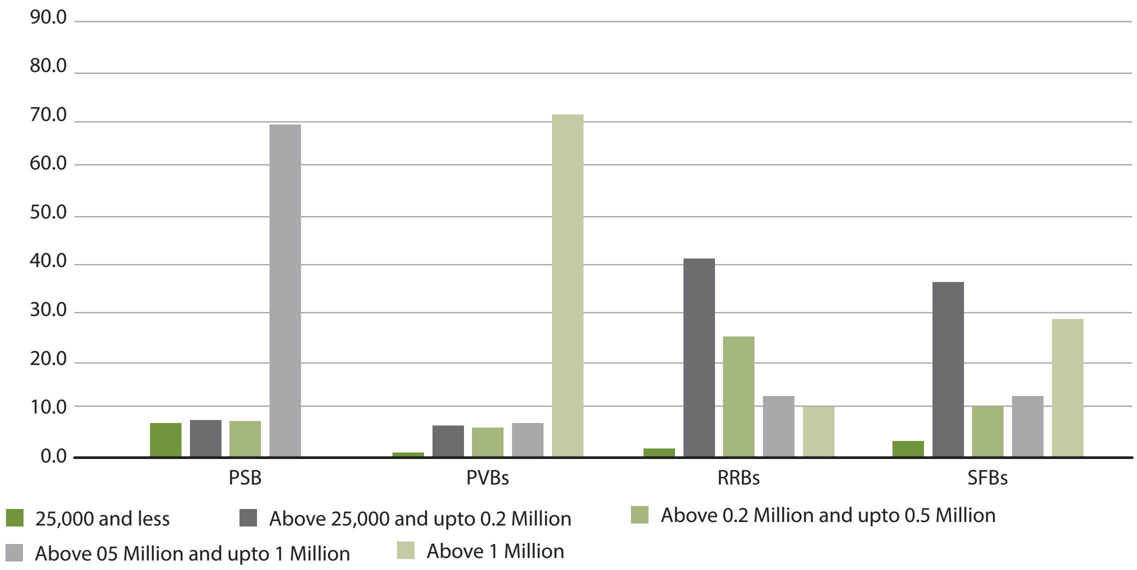


Figure 4.10. Bank Group-wise Outstanding Credit as a Percentage of Total According to Credit Limit

Source: Compiled from Table 2.7 on bank group-wise outstanding credit of SCBs, basic statistical returns of SCBs as on 31 March 2021, RBI database on Indian economy.

SFBs have significant exposure to unsecured loans. In FY 2021, 41% of the advances were unsecured and 58% were secured as compared to 47% unsecured and 53% secured advances in FY 2020.[13]

A scrutiny of outstanding credit of SFBs categorized according to credit limit shows that 77% of loan accounts of SFBs are comprised of loans between ₹25,000 and ₹0.2 million which is the highest across all categories of banks (Figures 4.9 and 4.10); the amount outstanding is the highest (40%) for credit limit between ₹25,000 and ₹0.2 million. This highlights the MFI origins of SFBs and corroborates their contribution to financial inclusion. It is interesting to note, however, that the loans above ₹1 million account for 31% of the total amount outstanding of SFBs.

A further examination of the composition of SFB loans for the last three years based on the credit limit shows that there is a decline in loans of ₹25,000 or less and growth in loans between ₹0.5 million and ₹1 million. This is the only category that has recorded a significant growth both in the

Table 4.8. YoY Growth in the Number of Accounts and Loan Amount Outstanding of SFBs According to the Size of Credit Limit

	FY 2020	FY 2021	FY 2020	FY 2021
Category of credit limit	YoY growth in number of accounts	YoY growth in number of accounts	YoY growth in amount outstanding	YoY growth in amount outstanding
₹25,000 and less	–0.13	–14.32	–1.49	–8.65
Above ₹25,000 and up to ₹0.2 million	108.72	10.67	110.72	2.15
Above ₹0.2 million and up to ₹0.5 million	28.12	32.80	29.98	27.80
Above ₹0.5 million and up to ₹1 million	26.94	40.65	32.44	37.87
Above ₹1 million and up to ₹2.5 million	65.78	36.13	65.03	34.74
Above ₹2.5 million and up to ₹5 million	67.43	30.63	64.44	29.84
Above ₹5 million and up to ₹10 million	54.63	23.82	49.90	24.99
Above ₹10 million	54.83	8.48	31.74	13.49

Source: Compiled from Table 2.7 on bank group-wise outstanding credit of SCBs, basic statistical returns of SCBs for FY 2019, FY 2020 and FY 2021, RBI database on Indian economy.

number of accounts and amount outstanding as compared to the previous year. Loans above ₹1 million have also shown similar growth compared to the previous year. SFBs appear to be catering to the 'missing middle' segment even as the number and amount of smaller loans (₹0.2 million and less) has decreased (Table 4.8). The smaller loan accounts mostly comprise informal, unincorporated non-agricultural enterprises (as own account enterprises and establishments) which have been severely impacted by the COVID-19 crisis. It is estimated that worldwide 76% of the 2 billion workers in the informal sector have been affected severely due to the lockdowns imposed in the wake of COVID-19 crisis. Of these, the own-account workers[14] constitute 47% of the affected informal workers[15] and have been most vulnerable. As the impact of COVID-19 continues, it is likely that the loans with higher credit limits will continue to grow compared to smaller loans. The decline in proportion of smaller and unsecured loans could also be due to the increase in the investment and turnover limits of micro-enterprises from ₹2.5 million to ₹10 million.[16] Banks can now achieve their PSL targets with larger, secured loans which can skew the lending in favour of larger loans.

4.5.2. Income, Expenditure and Profitability of SFBs

The overall financial performance of SFBs in terms of income, profitability and asset quality has been impacted due to the COVID-19 crisis. Lending and collection activities have been curtailed due to travel restrictions and lockdown. Collection efficiency of SFBs was volatile, dropped to single digits during the first wave of lockdown, picked up with easing of restrictions and dropped again due to the resurgence of the pandemic. YoY growth of income was 17% as compared to 45% the previous year and the growth in operating profit was 40% as compared to 129% the previous year. The total net profit of SFBs registered a modest growth of 4% in FY 2021 (Table 4.9).

Four out of the 10 SFBs, namely AU, Equitas, Ujjivan and Jana SFB, account for 69% of the interest income of SFBs and 69% of interest expenses during FY 2021. In FY 2020, staff expenses of SFBs accounted for 25% of their total expenses which is high compared to PSBs (17.4%) and PVBs (12.3%). This metric has come down to 21% for SFB in FY 2021 (Table 4.10).

Staff expenses of SFBs have always been higher as compared to PSBs and PVBs due to increased demand in trained manpower as multiple SFBs were setting up their banking operations at the same time. The existing manpower of NBFC-MFIs that were transitioning to an SFB were experienced in the providing credit to low-income households but were not trained or equipped to handle a wider range of financial services. SFBs therefore had to pay higher salaries to attract experienced banking professionals. Capital, AU and ESAF SFBs have the lowest staff expenses as a percentage of total expenses.

The ratio of intermediation costs to total assets (operating expenses to total assets) is higher for SFBs compared to other SCBs. Among SFBs, this ratio is lower for Capital and AU SFB as compared to other SFBs. Capital SFB has been in operation for nearly two decades as an LAB with a wider scope of operations than an MFI. Similarly, AU SFB was in existence for nearly 25 years as an NBFC in secured

Table 4.9. Consolidated Income and Expenditure of SFBs

	2020 (₹Billion)	YoY Growth FY 20201 (%)	2021 (₹Billion)	YoY Growth FY 2021 (%)
Income	192	45	225	17
Int income	169	43	195	15
Other income	23	60	30	31
Expenditure	173	25	205	19
Int expenses	79	44	91	15
Operating exp	72	25	75	6
Of which staff expenses	38	28	43	13
Provisions and contingencies	22	-14	38	75
Op profit	42	129	58	40
Net profit	19.7	–	20.4	4
Total assets	1,327	34	1,636	23

Source: Author's calculation based on annual reports of SFBs.

Table 4.10. Key Expense Ratios of SFBs

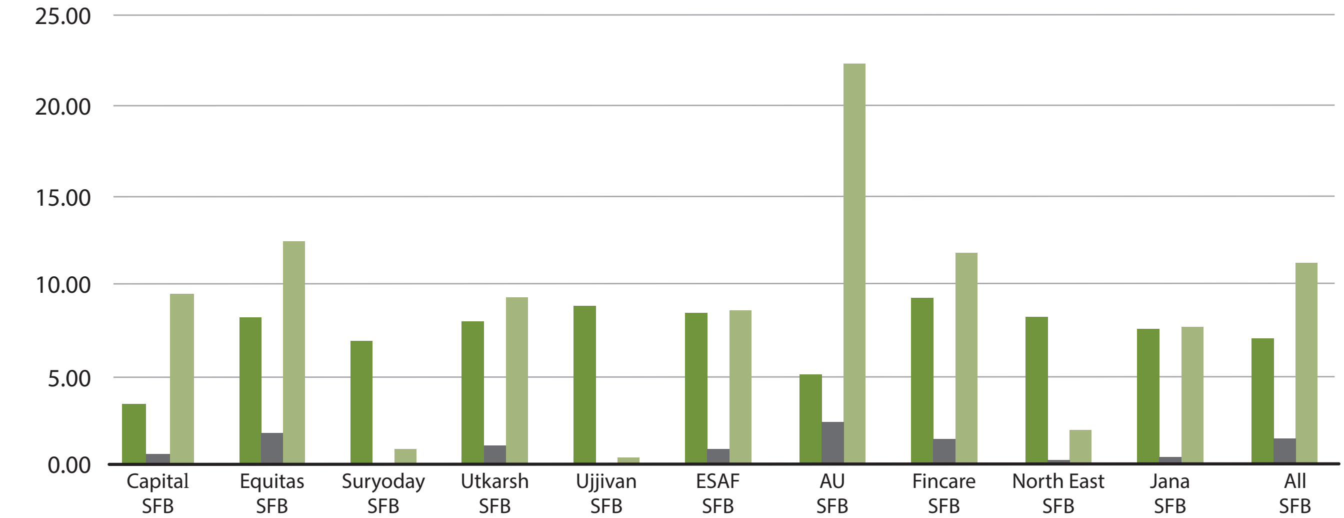
S. No.	SFB	Staff Expenses as a Percentage of Total Expenses	Intermediation Cost as a Percentage of Total Assets
1	Capital SFB	17.50	2.96
2	Equitas SFB	24.52	6.04
3	Suryoday SFB	21.51	5.44
4	Utkarsh SFB	20.22	5.06
5	Ujjivan SFB	24.09	6.34
6	ESAF SFB	11.30	5.79
7	AU SFB	18.74	3.54
8	Fincare SFB	22.86	6.14
9	North East SFB	25.95	6.57
10	Jana SFB	23.32	6.30
	All SFBs	21.02	5.10

Source: Author's calculations from annual reports and audited financial statements of SFBs for FY 2021.

retail lending (vehicle loans and loans for small businesses) which could have helped in bringing down the costs. One way in which the operating costs can be further brought down in the coming years is through the expansion of digital channels and initiatives. Although the contribution of digital banking in terms of number of accounts and volume of business is currently small, SFBs are enhancing their digital capabilities to extend digital banking in the coming years.

4.5.3. Profitability of SFBs

The net interest margin (NIM) of SFBs is higher than that of PSBs or PVBs, presumably due to the higher rates of interest charged by SFBs. The NIM of PSBs was 2.37 in FY 2020, while the NIM of SFBs was 8.34. The NIM of SFBs fell to 7.02 in FY 2021 but continues to remain higher than other bank groups. 8 out of 10 SFBs (excluding Capital and SFB) recorded NIM greater than 7%. Return on assets and return on equity are also higher for SFBs as compared to other two bank groups (Figures 4.11 and 4.12). However, as the asset sizes of SFBs are much smaller compared to PSBs and PVBs, it is difficult to draw any meaningful inferences from such comparison.



	Capital SFB	Equitas SFB	Suryoday SFB	Utkarsh SFB	Ujjivan SFB	ESAF SFB	AU SFB	Fincare SFB	North East SFB	Jana SFB	All SFB
NIM	3.39	8.17	6.80	7.79	8.91	8.45	5.05	9.29	8.11	7.60	7.02
ROA	0.70	1.75	0.20	1.04	0.04	0.97	2.50	1.50	0.33	0.51	1.38
ROE	9.51	12.51	0.89	9.39	0.26	8.65	22.31	11.78	1.95	7.77	11.30

Figure 4.11. Profitability Ratios of SFBs

Source: Author's calculation from annual reports of SFBs for FY 2021.

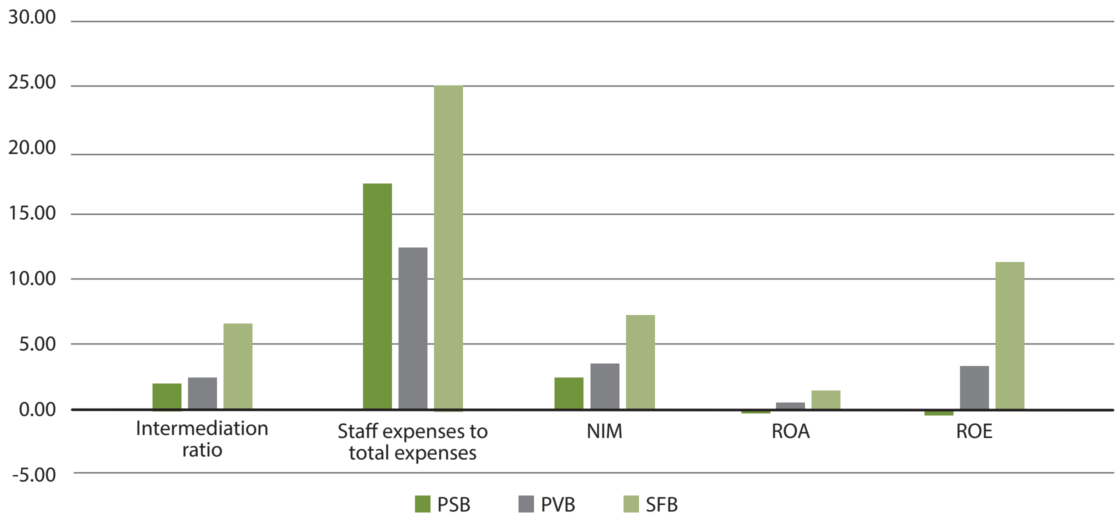


Figure 4.12. Select Profitability and Expense Ratios of Banks for FY 2020

Source: Based on Table 10 on bank group-wise select ratios of SCBs from statistical tables relating to banks in India for FY 2020, RBI database on Indian economy.

Table 4.11. Margins and Spreads of PSB, PVBs and SFBs

	PSB		PVBs		SFBs	
	FY 2019	FY 2020	FY 2019	FY 2020	FY 2019	FY 2020
Cost of deposits	5.01	4.96	5.14	5.26	7.03	8.2
Cost of borrowings	4.81	4.56	6.64	6.17	9.79	9.84
Cost of funds	4.99	4.92	5.4	5.41	8.02	8.66
Return on advances	8.07	8.16	9.78	10.1	17.77	19.87
Return on investments	7.2	6.92	6.99	6.59	7.55	7.54
Return on funds	7.79	7.76	9.01	9.17	15.63	17.32
Spread	2.8	2.84	3.61	3.76	7.61	8.66

Source: Report on trend and progress of banking in India 2019–2020.

The overall spread (return on funds minus cost of funds) for banks increased from FY 2019 to FY 2020. The highest spread was for SFBs followed by PVBs and PSBs (Table 4.11). As Figure 4.14 shows, SFBs share of lending to small traders, transport operators and others is higher compared to other bank groups. They have a higher share of small borrowal accounts, priority sector advances, microfinance portfolio and underbanked segments than other banks and therefore their cost of borrowings and deposits is higher. However, the high cost of funds is offset by their higher lending rates compared to other bank groups.

4.5.4. Asset Quality

RBI's regulatory package for COVID-19 (announced in March, April and May 2020) granted a 6-month moratorium for borrowers affected by the pandemic. As on 31 August 2020, borrowers of all bank groups availed moratorium amounting to 40% of outstanding loans. MSME borrowers availing moratorium was higher than borrowers from other sectors. As SFBs' portfolio accounts for a higher share of MSME than other category of banks, the share of moratorium availed was highest for SFBs, followed by UCBs. 80% of MSME customers and 81% of individual borrowers of SFBs (accounting for 67% and 60% of total outstanding in the category) have availed the moratorium.[18]

Following the Supreme Court's interim order in September 2020, SFBs have not declared as NPAs the accounts that have not been NPAs as on 31 August 2020. The Supreme Court order has since been vacated in March 2021 as a result of which the gross non-performing assets (GNPAs) of many SFBs registered an abrupt increase in March 2021 as compared to the previous quarters. SFBs made contingency provisions for all such loans leading to a steep growth provision and contingencies at 75% as compared to previous year. The overall asset quality of SFBs therefore has declined in FY 2021 (Table 4.11). The GNPA and net non-performing asset (NNPA) ratios for SFBs in FY 2021[19] was higher than in FY 2020 (Table 4.12). The overall GNPA ratio for SFBs in FY 2020 is 1.87 which is significantly lower as compared to 10.25 for PSBs and 5.45 for PVBs.

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The Resolution Framework[20] announced by the RBI in August 2020 and the version 2 of the framework announced in May 2021 will influence the asset quality parameters of SFBs in the coming years.

Table 4.12. GNPA, NNPA and Provision Coverage Ratios of SFBs for Last Two Years

		GNPA		NNPA		Prov Coverage Ratio	
S. No.	**SFB**	**FY 2020**	**FY 2021**	**FY 2020**	**FY 2021**	**FY 2020**	**FY 2021**
1	Capital SFB	1.76	2.08	1.25	1.13	29.5	46.14
2	Equitas SFB	2.72	3.59	1.51	1.52	45.22	58.59
3	Suryoday SFB	2.8	9.4	0.6	4.7	84.7	63.9
4	Utkarsh SFB	0.71	3.75	0.18	1.33	75.16	65.49
5	Ujjivan SFB	1.1	7.1	0.2	2.9	79.96	60.34
6	ESAF SFB	1.53	6.7	0.64	3.88	79.93	52.77
7	AU SFB	1.7	4.3	0.8	2.2	52.8	49.8
8	Fincare SFB	0.9	6.42	0.41	2.8	91.14	73.68
9	North East SFB	**	**	1.2	6.81	**	**
10	Jana SFB	**	**	1.41	5.33	**	**

Source: Annual reports of SFBs.
Note: **Data not available.

Table 4.13. **Bank Group-wise Share in Total Banking Business, FY 2020**

	PSBs	PVBs	SFBs	RRBs	UCBs
Capital	33.86	12.63	2.42	3.69	6.64
Reserves and surplus	43.23	43.35	0.82	2.00	2.52
Deposits	60.50	27.81	0.55	3.20	3.35
Borrowings	40.38	47.08	1.71	3.09	0.41
Other liabilities	38.63	24.53	0.42	2.64	7.00
Cash and balances with RBI	54.08	33.76	0.63	2.43	2.28
Balances with banks	53.88	24.52	1.00	0.88	8.61
Investments	57.65	25.35	0.47	4.88	3.17
Loans and advances	56.53	33.28	0.83	2.63	2.80
Other assets	49.96	27.45	0.27	1.90	4.06
Total liabilities/assets	56.07	30.33	0.69	3.08	3.24

Source: Based on report on trend and progress of banking in India, March 2020. RBI Database on Indian economy.

4.5.5. Share of SFBs in the Banking Business

SFBs contribute to 0.69% of total banking business in the country and their share has been slowly increasing over the years (Table 4.13). While SFBs are not high contributors (1.02%) to total credit outstanding (Figure 4.13), they contribute moderately (7%) to total number of credit accounts. However, given the mandated PSL of 75% and 50% of the loan portfolio restricted to maximum loan size of ₹2.5 million, it would not be reasonable to compare them with SCBs on the size of business or gross loan outstanding alone.

As mentioned previously, SFBs have the highest proportion (95%) of small borrowal accounts (of credit limits less than ₹0.2 million) among all bank groups, which is higher than that of RRBs. 43% of the total amount outstanding of SFBs is from small borrowal accounts.

The average amount outstanding per account is the lowest for SFBs signalling their reach to small borrowers. This is not surprising given their origin as MFIs and the current PSL mandate. What is unexpected, however, is the sharp decline in YoY growth of both number of accounts and amount outstanding for SFBs. The number of credit accounts of SFBs grew only by 1% in FY 2021 as compared to 68% in the previous year. The growth in credit amount outstanding fell to 20% in FY 2021 from 60% in FY 2020 (Table 4.14). This is an indication that small borrowers may have been more severely impacted due to COVID-19 as compared to larger borrowers.

Table 4.14. **YoY Growth (%) in Credit Accounts and Amount Outstanding**

	YoY Growth in Credit Accounts 2020	YoY Growth in Credit Accounts 2021	YoY Growth in Credit Outstanding 2020	YoY Growth in Credit Outstanding 2021	Average Credit Amount Outstanding 2021 (₹)
PSBs	2%	10%	4%	3%	614,206
RRBs	– 1%	6%	6%	13%	126,535
PVBs	30%	11%	9%	9%	276,959
SFBs	68%	1%	61%	20%	54,704
All SCBs	17%	9%	6%	5%	371,329

Source: Calculated from Table 1.1 of basic statistical returns, 1, RBI for FY 2021.

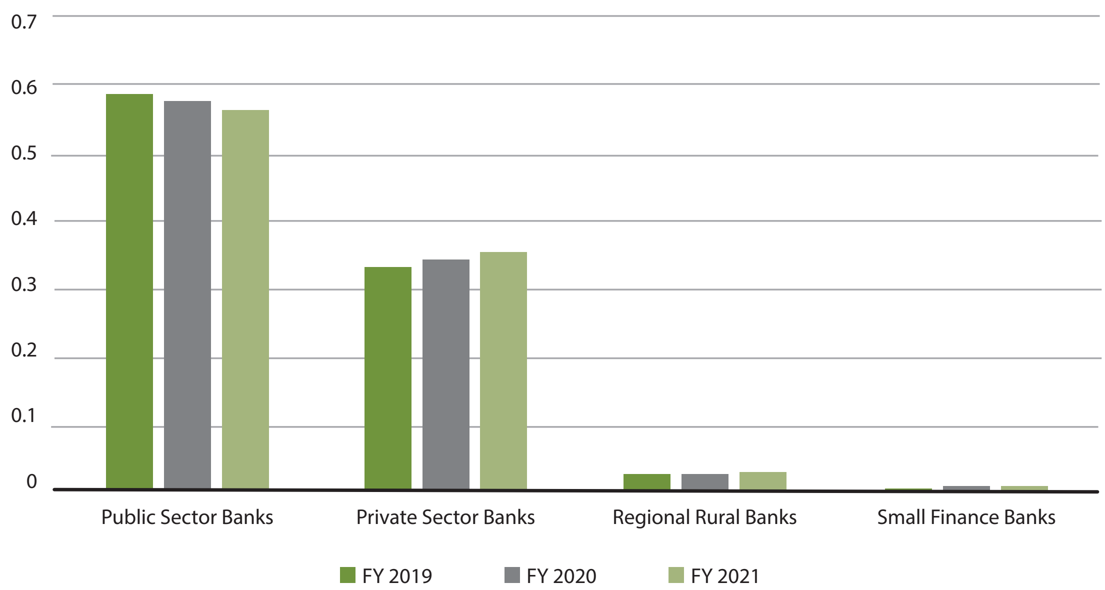

Figure 4.13. Share of SFBs in Credit Amount Outstanding for Last 3 Years

Source: Based on Table 1.1 of basic statistical returns, 1, RBI for FY 2019, 2020 and 2021.

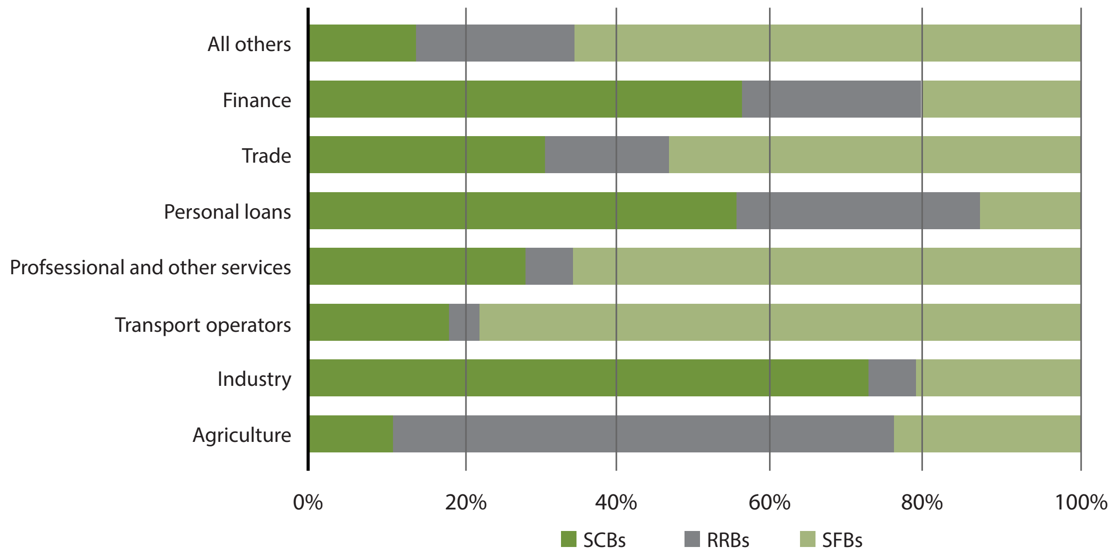

Figure 4.14. Bank Group-wise Sector-wise Distribution of Outstanding Credit in FY 2021

Source: Basic statistical returns, 1 FY 2021, RBI database on Indian economy. In this graph, SCBs include PSBs, PVBs and foreign banks only.

Table 4.15 Priority Sector Lending of SFBs

	Agriculture	MSMEs	Education	Housing	Total Priority Sector
2019	158.64 (32.85)	208.99 (43.28)	0.25 (0.05)	19.04 (3.94)	482.89
2020	157.40 (34.23)	209.93 (45.65)	0.97 (0.21)	35.87 (7.80)	459.86

Source: Table 4 on PSL in statistical tables relating to banks in India March 2019 and 2020, RBI database on Indian economy. Figures in brackets indicate percentage to total priority sector advances.

Although all bank groups managed to achieve PSL targets in FY 20, PSL advances declined in FY 2020 compared to FY 2019 both across bank groups and constituent sectors. Priority sector advances of SFBs were 88% of ANBC in FY 2020, thus exceeding their PSL targets of 75%. The composition of PSL by SFBs shows that credit to MSME and agriculture loans contribute to 80% of total PSL of SFBs in FY 2020 (Table 4.15). However, SFB loans to agriculture and MSMEs stagnated in FY 2020 even though they continue to be net sellers of PSL certificates while PSBs and PVBs are net buyers.

Overall, bank groups fell short in achieving sub-targets for sectors such as micro-enterprises, small and marginal farmers both in FY 2019 and FY 2020. As the priority sectors (especially MSMEs, small and marginal farmers and weaker sections) were most vulnerable to COVID-19 crisis, one can expect a further decline in FY 2021 as well. As the revised PSL guidelines issued in September 2020[21] are going to increase the sub-targets for weaker sections and small and marginal farmers in a phased manner, this may help counter the decline in lending to these sectors.

4.5.6. Capital Adequacy

The threshold capital to risk-weighted assets ratio (CRAR) has been fixed at 15% for SFBs and tier I ratio at 7.5%. All SFBs have exceeded the CRAR and Tier I ratios. The CRAR for individual SFBs ranges from 15.51 for Jana SFB to a very high rate of 51.57 for Suryoday SFB. Seven SFBs have the CRAR between 20 and 30 (Figure 4.15). Although higher levels of CRAR indicate lower levels of leverage, given the prolonged impact of the pandemic, high CRAR augurs well for stability of SFBs.

4.6. CONCLUSION

Over the last 5 years, SFBs have emerged as specialized banks to address key gaps in financial inclusion. Since inception, SFBs have shown considerable growth in branch network, product range, deposits and advances. All the 11 SFBs are existing financial institutions that have transitioned and, so far, they have focused on the core strengths acquired in their previous *avatars* while building a diversified range of financial products and services. The diversified portfolio helps in reducing the risk that was inherent in the erstwhile single product NBFC-MFIs. Given their mandate of PSL and restriction on ticket size of the loans, they have performed well during the last three years on indicators such as number of small borrowal accounts, unsecured loans and PSL signifying their relevance for financial inclusion. While there is no doubt that the presence of SFBs has expanded the choice of well-regulated and reliable institutional sources of finance for the underbanked customers, it may be difficult to ascertain how many of the customers covered by SFBs are new to formal banking. SFBs are also managing to straddle the seemingly contradicting goals of financial inclusion and adherence to sound banking principles and prudential regulations. The operating expenses have been declining (both as a percentage of total expenses and percentage of total assets), NIM and asset quality of SFBs has been higher than that of other SCBs.

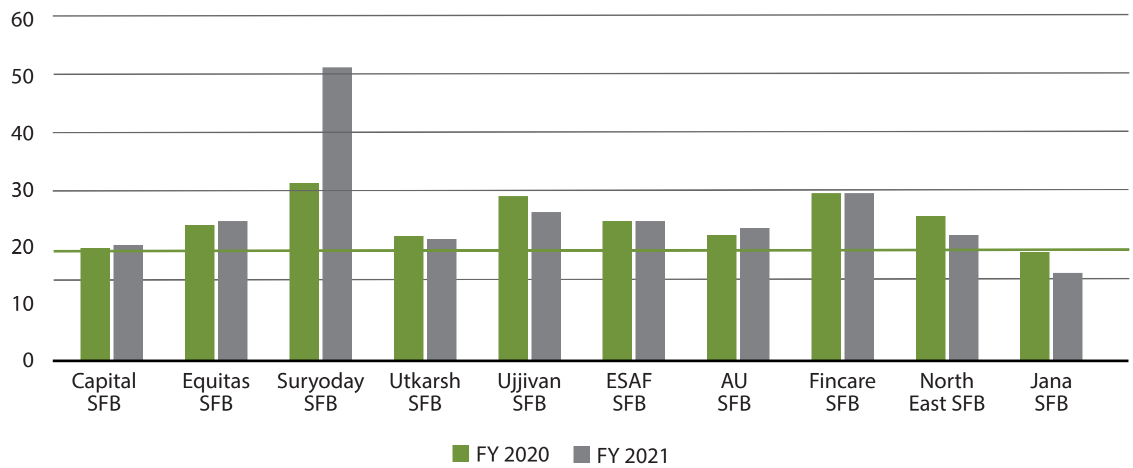

Figure 4.15. CRAR of SFBs for FY 2020 and FY 2021

Source: Compiled by the author from annual reports of SFBs for FY 2020 and FY 2021.

However, the COVID-19 crisis that has impacted financial institutions all over the world has also subdued the operations of SFBs and derailed their momentum. While SFBs registered an overall decline in growth in deposits and advances compared to the previous year, the overall profitability and capital adequacy remained strong, though lower than previous year. Asset quality of SFBs have declined in FY 2021 as compared to FY 2020. Nevertheless, stimulus measures and policy support induced easy liquidity and financing conditions that provided some cushioning to Indian banks including SFBs.

While the deterioration has not been alarming, it should be noted that the economic sectors that are served by the SFBs have been most severely affected first by demonetization and now by COVID-19. These sectors are likely to take longer than others to return to pre-COVID-19 levels of activity, thus dampening the growth of SFBs. The crisis has also opened up new opportunities in digital banking for SFBs. The analysis of performance of SFBs over the next 2–3 years will reveal how individual SFBs have weathered the crisis and capitalized on the opportunities.

The crisis has induced perceptible changes in the composition of customer base and outstanding loans in certain credit limit categories and these changes are likely to continue in the near term raising a few questions:

1. Will SFBs continue to be the financial institution of choice for small borrowers and micro-entrepreneurs seeking unsecured loans?
2. Will small borrowers and depositors continue to be the key market segments for SFBs as they grow, or will they gradually move to wholesale lending and wholesale deposits?

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[1] A ‘banking outlet’ for a domestic SCB, a payment bank or an SFB is a fixed-point service delivery unit, manned by either bank’s staff or its BC where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for at least five days a week.

[2] National Sample Survey (NSS) 77th round 2019.

[3] Financial assets included in the All India Debt and Investment Survey are receivable on loans advanced in cash or in kind, shares in companies and cooperative societies, banks, etc., national saving certificates and the like, deposits in companies, banks, post offices and with individuals.

[4] National Sample Survey (NSS) 70th round 2013.

[5] GoI, *A Hundred Small Steps: Report of the Committee on Financial Sector Reforms* (chaired by Dr Raghuram Rajan; New Delhi: Government of India, 2009).

[6] RBI, *Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income Households* (chaired by Dr Nachiket Mor; New Delhi: Reserve Bank of India, 2013).

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[11] Given their differentiated status, the minimum net worth for SFBs is lower than that for other SCBs (which is ₹5 billion).

[12] This section is based on the annual reports and financial statements of 10 SFBs. Shivalik SFB has started its operations only in April 2021 and has not been included in the analysis.

[13] Total banking business based on SCBs, RRBs and UCBs. Does not include rural cooperative banking business. Data have been compiled from the *Report on Trend and Progress of Banking in India 2019–2020* (New Delhi: RBI). Available at https://www.rbi.org.in/Scripts/AnnualPublications.aspx?head=Trend%20and%20Progress%20of%20Banking%20in%20India (accessed on 18 November 2021).

[14] ‘An own account enterprise is an undertaking run by household labour, usually without any hired worker employed on a “fairly regular basis”. “Fairly regular basis” means the major part of the period of operation(s) of the enterprise during the last 365 days’; concepts and definitions used in NSS, Ministry of Statistics & Programme Implementation, Government of India.

[15] *Source:* Table A3 on number and percentages of informal workers, ILO Monitor: COVID-19 and the world of work. Third edition Updated estimates and analysis, 29th April 2020.

[16] MSME classification has been revised w.e.f. July 2020. Investment in plant and machinery and annual turnover limits have been increased. Revised investment limit of micro-enterprises—up to 10 million; small enterprises—up to 100 million and medium enterprises up to 500 million.

[17] Concepts and definitions used in NSS, Ministry of Statistics & Programme Implementation, Government of India.

[18] Pages 23 and 24 of *Report on Trend and Progress of Banking in India 2019–20*. RBI circulars dated 17 April 2020 and 23 May 2020 on 'COVID 19 Regulatory Package—Asset Classification and Provisioning'.

[19] GNPA ratio for North East and Jana SFB was not available for FY 2021.

[20] The RBI announced a set of measures vide its circulars on resolution framework for COVID-19-related stress announced on 6 August 2020 and Resolution Framework 2.0: Resolution of COVID-19-related stress of individuals and small businesses announced on 5 May 2021. The Resolution Framework 2.0 pertains specifically to individuals and small businesses.

[21] RBI, *Master Directions—Priority Sector Lending—Targets and Classification* (New Delhi: RBI, 2020). Available at https://www.rbi.org.in/Scripts/NotificationUser.aspx?Id=11959&Mode=0 (accessed on 18 November 2021).

MSMEs Remain the Bulwark of the Economy: Need to Build Back Better & Bigger

M S Sriram

5

5.1 REVIEW OF MICRO, SMALL AND MEDIUM ENTERPRISE FINANCE

The period under the pandemic has been stressful not only for individuals and informal and formal enterprises under the Micro, Small and Medium Enterprises (MSME). A study undertaken by Krea University amongst women entrepreneurs found that a third of the businesses run by women were shut either temporarily or permanently and they suffered a revenue loss of more than 70%.[1]

The state has also responded with multiple initiatives that are aimed at supporting and providing succour to the sector. While the Reserve Bank of India (RBI) had redefined the obligations of the banking sector towards financing the micro enterprises in particular, it was also working on the basis of the recommendations of the *Report of the Expert Committee on Micro, Small and Medium Enterprises*.[2] Of the recommendations made by the expert committee, several were implemented and some were under consideration.[3] Significant among those implemented were the facilitation for co-lending model for non-banking finance companies (NBFC) and creation of a payment infrastructure development fund that helped in creating a digital payments architecture for rural MSMEs. There were some issues that emanated out of the changed classification of trade which was moved from the MSME ministry to the Ministry of Commerce and classified as trade making it ineligible for registration as an MSME under the Udyog Aadhaar Memorandum (UAM), a step that was essential for banks to claim the achievement of targets under the priority sector lending (PSL) obligations.

Table 5.1. Definition of an MSME

Classification	Old Definition		Amended Definition
	Manufacturing enterprise (investment in plant and machinery)	Service enterprise (investment in equipment)	All enterprises
Micro	Up to ₹2.5 million	Up to ₹1 million	Investment in plant and machinery or equipment does not exceed 10 million rupees and turnover does not exceed 50 million rupees
Small	Above ₹2.5 million to ₹50 million	Above ₹1 million to ₹20 million	Investment in plant and machinery or equipment does not exceed 100 million rupees and turnover does not exceed 0.5 billion rupees
Medium	Above ₹50 million to ₹100 million	Above ₹20 million to ₹50 million	Investment in plant and machinery or equipment does not exceed 0.5 billion rupees and turnover does not exceed 2.5 billion rupees.

Source: Old definition[4]; new definition.[5]

The new definition was announced as a part of the Aatmanirbhar Bharat package in the series of announcements made as a part of the reform post COVID-19. The new definition was effective from July 2020. The objective of the re-definition was, amongst other things, to provide for growth of these enterprises that started small and still keep them as a part of the procurement schemes of the Government of India (GoI) where a special dispensation was given for MSMEs. While this move was widely welcomed as a step towards improving the ecosystem for ease of doing business, there were some concerns expressed on whether the smaller units would be crowded out. There was also much angst amongst the bankers as the advances to wholesale and retail trade were not classified under the MSME unlike till then. This anomaly of excluding wholesale and retail trade was corrected only in July 2021 after multiple representations were made by the banking sector.

From the perspective of inclusive finance, it was argued that the caps being liberalised would encourage the bankers to lend at the upper end of the re-defined limits and achieve their PSL targets more easily. This may result in the lower end of the limits being crowded out. This may result the in the sole proprietary enterprises and unincorporated partnerships being crowded out from the formal system. The mandatory registration requirements that made it imperative to specify the Permanent Account Number (PAN) and the Goods and Services Tax (GST) registration number made it difficult for a large number of firms that operate in the cusp or formal and informal sector to now establish that they were indeed firms and eligible for finance under the norms. Both these issues, it was argued, were working against the larger cause of inclusion.[6]

As per the survey by the National Sample Survey Organisation, there were an estimated around 63.4 million unincorporated non-agricultural enterprises and these were employing 111.27 million persons.[7] As on December 2020, a total number of 5,37,677 enterprises have registered under manufacturing category and 8,65,058 enterprises registered under service sector category.[8]

At the same time, the government took many proactive measures to ensure that the MSMEs were protected. The ministry launched a portal during the year under the name MSME SAMADHAAN to record and resolve the complaints regarding delayed payments. This was over and above the earlier initiatives to ensure that MSMEs are not unduly harassed by their clients who could be large listed corporates. In addition, the MSME segment gets a priority in the government procurement programme, thereby helping them to bid for contracts and supplies with/to the state departments and state-owned enterprises.

5.2. MEASURES TO COPE WITH THE PANDEMIC

One significant measure announced as a part of the Aatmanirbhar announcement was about the Emergency Credit Line Guarantee Scheme (ECLGS). This scheme, with four variations, was aimed at providing immediate liquidity support to the MSME—in the first instance for enterprises which had an outstanding of less than ₹500 million, in the second instance for enterprises in sectors that were identified as stressed by an expert committee (Kamat Committee) for having outstanding of up to ₹5 billion and two other schemes aimed specifically at hospitality and travel, tourism, aviation sector and the health/medical sector.

While the scheme provided for top-up loans that were guaranteed by a special arrangement, it also had adequate moratoriums, and the interest rates had a ceiling pegged to the bank's policy. Overall, the scheme provided additional liquidity and assistance to the MSMEs that were under stress during the pandemic. This scheme was seen as an initiative that had an immediate relief, but was not seen as something that would help in reviving the business that were in deep stress.[9] While the initial limits for the guarantee specified by the package was at ₹3 trillion and expanded to ₹4.5 trillion by September 2021, the utilisation of the facility was only up to ₹2.86 trillion by September 2021.[10]

The RBI announced the second resolution framework to cope with the second wave, which provided for restructuring of loans up to ₹250 million, fresh lending programme for this segment

Table 5.2. Bank Credit to MSMEs (Number in Million; Amounts in Billion)[11]

Year	Micro Enterprises		Small Enterprises		Medium Enterprises		MSMEs	
	A/cs	Amt O/S	A/cs	Amt O/S	A/cs	Amt O/S	A/cs	Amt O/S
Dec 2019	32.89	7,042.78	2.38	6,359.33	0.31	2,081.34	35.58	15,483.44
Dec 2020	39.45	7,631.09	2.32	6,522.92	0.53	2,709.24	42.30	16,863.25

with concessions to the lenders, by providing measures to boost liquidity facility for the banks. The total bank credit to MSMEs as of December 2020 is given in the Table 5.2.

From this table it is evident that the deployment of credit to the sector went up during the year, as compared to the past year. However, the data of the two years may not be strictly comparable, given the change in the definition of MSMEs. Given the marginal increase of outstanding, it would not be out of place to assume that the increase happened largely due to the changed and liberal definition of MSMEs.

While RBI data captures the deployment of credit to MSMEs from the banking sector, data from the credit bureaus would give us a better idea of the deployment of credit from the financial sector as a whole including the NBFCs. While the banking sector exposure was in the ballpark of ₹17 trillion in March 2020 (see Table A5.4), the credit union data provided by TransUnion CIBIL indicated that the total exposure of the financial system to the MSME sector was around ₹19 trillion, indicating a ₹2 trillion exposure by the NBFC and the co-operative banking sector, which was not captured by the RBI statistics. The data from TransUnion CIBIL also indicates that the Aatmanirbhar package and the ECLGS helped the sector to grow from an outstanding of ₹18.95 trillion in 2019–2020 to ₹20.21 trillion in 2020–2021. While the non-performing asset levels were 12.6% in 2020, they grew significantly by March 2021 after the easy period and moratoriums were lifted in December 2020.[12] The TransUnion CIBIL report also indicates that both new-to-bank and existing-to-bank customers have picked up to pre-COVID levels indicating a smart recovery in this sector.

When we look at the sectoral credit deployment over the past three years, it is evident that the pandemic has had an impact, particularly on the MSME sector (see Table 5.3). While in the year 2018–2019, the overall non-food credit deployment grew at 12.3%, the micro and small enterprise credit grew at 0.7% and the medium enterprise credit grew at 2.6%. In the next two years, we see the growth rates drastically fall in terms of deployment of non-food credit, but the deployment for the micro ad small enterprises increases in 2019–2020 and the growth rate slows down in the next year. In the case of medium enterprises, we see a drastic growth of near 29% in the last year. These intra group fluctuations may be largely because of the redefinition that has moved the credit limits based on the size of turnover. The table also indicates that the growth in deployment to services sector has also drastically fallen.

During the year, apart from the special measures the RBI continued its initiative of harmonising the PSL targets across ownership categories of banks, particularly between small finance banks (SFBs), regional rural banks (RRBs) and urban co-operative banks (UCBs). The data provided above does not capture the numbers pertaining to UCBs. Not only were the targets increased and harmonised, RBI also notified the scheme of the co-lending model in November 2020. The thrust of the scheme was to improve the flow of credit to the sector.

Table 5.3. Credit Deployment to Select Sectors[13]

Sectors	Outstanding as on 26 March 2021 (₹Billion)	Year-on-Year Growth (%)		
		2018–2019*	2019–2020#	2020–2021##
Non-food credit (1–4)	96,620.22	12.3	6.7	4.9
1. Agriculture & allied activities	12,999.14	7.9	4.2	12.3
2. Industry (micro & small, medium and large)	29,180.28	6.9	0.7	0.4
2.1. Micro & small	3,838.54	0.7	1.7	0.5
2.2. Medium	1,360.54	2.6	–0.7	28.8
2.3. Large	23,981.21	8.2	0.6	–0.8
3. Services	26,305.66	17.8	7.4	1.4
4. Personal loans	28,135.13	16.4	15.0	10.2

*March 2019 over March 2018. #March 2020 over March 2019. ##March 2021 over March 2020. Data are provisional.

5.3. MUDRA AND PMMY: REVIEW OF PROGRESS

Micro Units Development and Refinance Agency (MUDRA) was launched as an NBFC on the 8 April 2015. It manages both the Pradhan Mantri MUDRA Yojana (PMMY) as well as the refinance function. MUDRA is a wholly owned subsidiary of Small Industries Development Bank of India (SIDBI). The criticism that the redefinition of the MSMEs would lead to crowding out of credit to the micro units is somewhat addressed by the focus given by PMMY.

PMMY consists of three loan products—Shishu pegged at ₹50,000, Kishor pegged at amounts ranging above ₹50,000 up to ₹500,000 and Tarun for loans ranging above ₹500,000 and up to ₹1 million. These three loan products were targeted at non-corporate small businesses and micro enterprises and did not require a registration in the portal. While this portfolio qualifies under the PSL norms, MUDRA also refinances other players in the market, the NBFCs and the microfinance institutions (MFI), basically targeting the unfunded smaller enterprises. The expert committee on MSMEs while examining MUDRA made an observation,

> *MUDRA would require enhancement of in-house (or outsourced) capabilities, including underwriting, risk management, fund raising based on its own AAA rating and sharper focus on emerging trends in the market. Hence, a reimagining of MUDRA is necessary including assessing the rationale for continuing it as a subsidiary of SIDBI.*[14]

In addition to the above recommendation, the committee also recommended that the loan limits under PMMY/MUDRA be enhanced to ₹2 million from the current limit of ₹1 million and have enterprises run by self-help groups also under the purview of the scheme. It appears that the recommendations have not been considered yet.

As of March 2020, MUDRA had extended total loans on its own books to the extent of ₹3,297.15 billion. Of this about a quarter ₹798 billion has been given to new enterprises. While there is significant growth in the activity, there needs to be convergence in the definition across institutions, so that understanding and monitoring of the data becomes efficient. For instance, the limits applied on SFBs to define 'Small' in their nomenclature is pegged at ₹2.5 million ticket size. That will give us a better understanding of the progress on the ground. The ever-changing limits and innovations make it difficult to understand the progress over the years.

The region-wise performance of PMMY is shown in Table 5.4. We can see from the data that the loan offtake in the smaller limit size of Shishu is significantly high not only in the number of borrowers but also in the overall amounts disbursed. It is only in the northern region that the exposure to the Tarun category is higher than the Shishu category. This shows that the demand for small ticket loans is there across the region and it is resulting in greater enterprise and commerce. The state-wise and bank-wise detail of disbursements under the PMMY is given in **Appendix A**.

When we look at the regional spread indicated in Table 5.4, the southern region is leading overall in terms of the amounts disbursed. However, Shishu loans are much larger in number in the East.

A large proportion of the MUDRA loan accounts come from the MFI and the private sector banks. While the number of accounts are much greater than the public sector banks (including SBI) the total

Table 5.4. PMMY: Region-Wise Performance of Accounts ('000s) Serviced and Amounts Disbursed (₹in Billion)

Region	Shishu		Kishor		Tarun		Total	
	Accounts	Amount	Accounts	Amount	Accounts	Amount	Accounts	Amount
North	5,234.33	158.71	825.64	150.41	233.32	160.14	6,293.29	469.26
N. East	2,053.31	64.05	184.41	24.46	21.12	14.93	2,258.84	103.43
East	16,875.88	498.50	1,337.80	161.22	136.31	100.04	18,349.98	759.75
Central	9,637.89	268.22	1,106.62	167.18	237.88	143.62	10,982.38	579.02
West	5,900.29	175.60	778.72	115.72	231.12	123.41	6,910.13	414.73
South	14,788.93	463.06	2,238.69	295.29	425.37	212.61	17,452.99	970.95
Total	54,490.62	1,628.13	6,471.87	914.27	1,285.12	754.75	62,247.61	3,297.15

Source: Data from MUDRA website at http://www.mudra.org.in/ accessed on 22 October 2021.

Table 5.5. Details of Accounts and Disbursals by Institutional Form (as of 31 March 2020 Accounts in '000s and Amounts in ₹Billion)

Type of Organisation	Shishu		Kishore		Tarun		Total	
	A/cs	Amount	A/cs	Amount	A/cs	Amount	A/cs	Amount
MFIs	18,891.43	529.82	728.43	46.17	1.73	2.66	19,621.58	578.65
NBFCs	4,628.17	170.70	275.20	81.90	191.33	148.49	5,094.71	401.09
SFBs	5,849.97	188.45	991.89	78.46	318.55	27.49	7,160.40	294.40
Public sector banks	5,618.67	137.82	1,808.72	378.12	553.78	425.85	7,981.17	941.79
Private sector banks	18,780.71	577.98	1,906.70	216.27	179.34	119.37	20,866.75	913.62
Foreign banks	–	–	0.09	0.03	0.05	0.04	0.13	0.07
RRBs and co-ops	721.67	23.36	760.85	113.32	40.35	30.85	1,522.87	167.54
Total	54,490.62	1,628.13	6,471.87	914.27	1,285.12	754.75	62,247.61	3,297.15

Source: https://www.mudra.org.in/Home/ShowPDF accessed on 22 October 2021.

amount outstanding is almost on par—indicating that the private sector banks are giving smaller ticket loans to the segment. This may be a function of several private sector banks having acquired MFIs and therefore having a greater ability to reach the smaller borrower. A large number of the borrowers belong to the Shishu category reinforces this line of argument. Over a period of time, it appears that the ability to reach the last customer has been taken up by the MFI model, which is a high interest, mutual guarantee model with transaction efficiency coming from group lending and standardisation. It appears that over the years the private sector banks have also adapted this methodology. The challenge would be if these institutions will graduate their borrowers to larger ticket size, lower interest rate individual loans without the intermediation of groups.

Overall, from the data in Table 5.5 it appears that both MUDRA and the PMMY have enhanced the availability of credit to what was traditionally referred to as the 'missing middle' and have provided a bridge between the classic MSME loans that are refinanced by SIDBI and the MFI loans that were being made by institutional borrowing from the banking system. Given that MUDRA has some requirements of interest caps and the need to provide unsecured loans, it may have tried to fill in the gap that was not fully being met by the MFI system. It is good to see that more and more formal banks and large NBFCs are downscaling their portfolios to serve this segment. Unfortunately, we do not have the data for 2020–2021. If that data were available, we would have been able to check out if the impact of the pandemic had hit the sector significantly.

In conclusion we could say that the PMMY segment seems to have grown smartly, while the data on the MSME segment needs to be looked at somewhat carefully with the changing definitions of the sector. This sector has also got adequate policy attention in the post-COVID package.

APPENDIX A

Table A5.1. Borrower Category-Wise Performance of PMMY for 2016–2017 (Accounts in '000s; Amounts in ₹Billion)

Category	Shishu		Kishor		Tarun		Total	
	A/cs	Amount	A/cs	Amount	A/cs	Amount	A/cs	Amount
General	27,614.43	866.60	3,776.21	673.32	1,106.87	696.20	32,497.51	2,236.12
SC	9,531.60	273.26	715.83	60.64	34.12	12.72	10,281.55	346.62
ST	3,580.40	100.87	281.59	28.28	27.71	8.79	3,889.70	137.94
OBC	13,764.19	394.86	1,698.25	193.54	116.41	65.88	15,578.85	654.28
Total	54,490.62	1,635.59	6,471.87	955.78	1,285.12	783.59	62,247.61	3,374.96
Of the above								
Women	35,717.22	1,096.60	2,988.31	264.77	397.83	90.45	39,103.35	1,451.82
New A/cs	9,660.06	282.30	1,825.48	387.10	428.37	323.23	11,913.90	992.63
Minority	5,635.94	160.80	720.65	94.48	70.52	53.96	6,427.12	309.24

Source: Data from MUDRA website at http://www.mudra.org.in/ accessed on 22 October 2021.

Table A5.2. Source-Wise Performance of PMMY (Number of Accounts in '000s and Amounts Disbursed in ₹Billion)

Type of Institution	Shishu		Kishor		Tarun		Total	
	A/cs	Amount	A/cs	Amount	A/cs	Amount	A/cs	Amount
NBFC MFIs	16,832.31	499.81	728.43	46.17	1.73	2.66	17,562.46	548.65
NBFCs	4,628.17	170.70	275.20	81.90	191.33	148.49	5,094.71	401.09
SBI	3,072.30	93.23	398.37	96.71	205.54	159.84	3,676.22	349.78
Public sector banks	2,546.36	44.59	1,410.35	281.41	348.24	266.01	4,304.95	592.01
Private sector banks	18,780.71	577.98	1,906.70	216.27	179.34	119.37	20,866.75	913.62
State co-op banks	0.06	0.29	0.06	0.64	-	-	0.12	0.93
Foreign banks	-	-	0.09	2.95	0.05	3.61	0.13	6.56
RRBs	721.61	23.36	760.79	113.32	40.35	30.85	1,522.75	167.53
Non NBFC MFIS	2,059.12	30.01	-	-	-	-	2,059.12	30.01
Small finance banks	5,849.97	188.45	991.89	78.46	318.55	27.49	7,160.40	294.40
Total	54,490.62	1,628.42	6,471.87	917.82	1,285.12	758.32	62,247.61	3,304.57

Source: http://www.mudra.org.in/ accessed on 22 October 2021.

Table A5.3. State-Wise Performance of PMMY (Number of Accounts Serviced and Amounts Disbursed in ₹Billion)

	Shishu		Kishor		Tarun		Total	
State	A/cs	Amount	A/cs	Amounts Disbursed	Accounts	Amounts Disbursed	Accounts	Amounts Disbursed
Northern region	5,234.33	158.71	825.64	150.41	233.32	160.14	6,293.29	469.26
Haryana	983.71	29.65	139.50	23.53	32.71	23.05	1,155.92	76.23
Himachal Pradesh	46.06	1.27	47.35	10.12	14.46	10.88	107.87	22.26
Jammu and Kashmir	43.86	0.83	94.87	21.83	16.42	12.04	155.15	34.71
Punjab	1,083.17	33.19	163.45	25.43	34.69	27.43	1,281.31	86.06
Rajasthan	2,598.20	81.56	295.39	53.40	100.95	58.70	2,994.53	193.66
Chandigarh	14.79	0.41	6.92	1.53	2.60	1.96	24.31	3.90
Delhi	463.97	11.78	74.28	13.65	30.34	25.27	568.60	50.69
Ladakh	0.58	0.01	3.87	0.92	1.15	0.82	5.60	1.75
Northeastern region	2,053.31	64.05	184.41	24.46	21.12	14.93	2,258.84	103.43
Arunachal Pradesh	20.09	0.57	2.44	0.35	0.77	0.59	23.29	1.51
Assam	1,516.05	47.98	138.23	17.67	14.06	10.07	1,668.35	75.72
Manipur	81.86	2.01	7.07	1.05	1.24	0.88	90.18	3.93
Meghalaya	38.75	0.94	4.33	0.78	1.34	0.95	44.42	2.66
Mizoram	13.78	0.63	5.51	1.10	1.14	0.64	20.44	2.36
Nagaland	11.36	0.41	2.75	0.59	0.97	0.69	15.08	1.70
Tripura	371.42	11.51	24.07	2.92	1.61	1.12	397.09	15.55
Eastern region	16,875.88	498.50	1,337.80	161.22	136.31	100.04	18,349.98	759.75
Bihar	6,168.24	180.75	503.39	51.59	43.02	31.13	6,714.66	263.47
Jharkhand	1,563.10	43.81	136.22	18.36	21.17	15.50	1,720.49	77.67
Odisha	3,410.03	99.99	279.46	32.11	27.08	19.48	3,716.58	151.58
Sikkim	14.59	0.37	4.30	0.65	0.98	0.70	19.86	1.72
West Bengal	5,719.62	173.58	413.59	58.25	43.46	32.76	6,176.67	264.58
A&N Islands	0.30	0.01	0.84	0.25	0.60	0.47	1.73	0.73
Central region	9,637.89	268.22	1,106.62	167.18	237.88	143.62	10,982.38	579.02
Chhattisgarh	1,115.56	31.48	120.94	16.76	24.52	18.67	1,261.02	66.92
Madhya Pradesh	3,063.44	91.30	391.33	51.73	103.18	42.74	3,557.95	185.78
Uttar Pradesh	5,222.32	138.02	542.25	88.06	96.86	71.93	5,861.42	298.01
Uttarakhand	236.57	7.41	52.10	10.62	13.32	10.27	302.00	28.30
Western region	5,900.29	175.60	778.72	115.72	231.12	123.41	6,910.13	414.73
Goa	26.34	0.77	9.65	1.86	3.05	2.17	39.04	4.80
Gujarat	1,738.93	53.62	263.10	40.97	94.37	40.71	2,096.39	135.30
Maharashtra	4,132.68	121.14	505.15	72.69	133.20	80.15	4,771.03	273.98
Dadra & Nagar Haveli	2.03	0.07	0.57	0.14	0.30	0.22	2.90	0.43
Daman and Diu	0.31	0.01	0.25	0.06	0.21	0.16	0.77	0.22
Southern region	14,788.93	463.06	2,238.69	295.29	425.37	212.61	17,452.99	970.95
Andhra Pradesh	529.00	13.78	253.89	43.34	61.61	43.79	844.50	100.91
Karnataka	4,738.83	140.19	861.22	98.51	133.63	58.34	5,733.68	297.05
Kerala	1,788.71	56.04	353.00	46.41	36.16	26.79	2,177.87	129.24
Tamil Nadu	6,405.14	212.16	574.39	77.72	141.46	56.38	7,120.99	346.26
Telangana	1,213.41	37.08	176.70	26.94	45.51	25.85	1,435.63	89.87
Lakshadweep	0.53	0.01	0.25	0.04	0.02	0.01	0.80	0.06
Pondicherry	113.31	3.80	19.25	2.34	6.97	1.43	139.52	7.57
All India Total	54,490.62	1,628.13	6,471.87	914.27	1,285.12	754.75	62,247.61	3,297.15

Source: http://www.mudra.org.in/ accessed on 22 October 2021.

Table A5.4. Region-Wise Distribution of Select Items of Scheduled Commercial Banks' Advances to Priority Sector (Accounts in Million, Amounts in Billion)

Year	2016				2017				2018				2019				2020			
	Total Priority Sector		MSMEs		Total Priority Sector		MSMEs		Total Priority Sector		MSMEs		Total Priority Sector		MSMEs		Total Priority Sector		MSMEs	
Region	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal	A/cs	Bal
North	99	5,117	25	2,277	102	5,267	28	2,345	113	5,582	29	2,667	139	6,478	37	3,215	158	6,622	43	3,139
N. East	31	311	8	155	34	349	11	171	30	364	5	176	46	480	19	256	47	475	19	269
Central	146	3,301	30	1,281	155	3,621	35	1,349	167	4,018	36	1,593	205	4,702	51	1,941	227	4,722	62	1,996
East	182	2,331	46	1,082	172	2,453	51	1,164	172	2,641	35	1,286	253	3,178	83	1,656	301	3,478	107	1,766
West	137	7,506	36	2,677	138	8,369	38	3,031	143	9,813	36	3,641	178	11,810	44	4,548	186	12,933	54	5,279
South	401	8,949	58	3,077	418	9,244	68	3,252	496	9,782	79	3,778	573	10,752	86	4,285	607	11,468	100	4,510
Total	996	27,515	203	10,548	1,018	29,302	231	11,313	1,121	32,200	219	13,142	1,394	37,400	321	15,901	1,526	39,699	384	16,959

Source: Statistical Tables Relating to Banks in India STRBI: https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4 accessed on 30 September 2021.

Table A5.5. Achievement under PSL Advances by Categories of Banks March 2020 Amounts in Billion)

	Public Sector	Private Sector	Foreign Banks	Small Finance Banks	Total
ANBC	57,947	32,550	3,978	728	95,203
Off balance sheet exposure	3,348	4,485	1,863	7	9,703
MSME	9,281	6,692	776	210	16,959
% of ANBC	16%	21%	20%	29%	18%
Total priority sector	23,603	13,694	1,943	460	39,699
% of ANBC	41%	42%	49%	63%	42%
ANBC: Adjusted net bank credit, MSME: Micro, Small and Medium Enterprises					

Source: Statistical Tables Relating to Banks in India STRBI: https://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4 accessed on 30 September 2021.

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SHG–Bank Linkage: Fostering the Financial Inclusion and Empowerment Agenda

Alka Upadhyaya

6

By 2030, India would need an estimated 400 million jobs for women alone; self-help groups can significantly contribute towards creating this employment opportunity for women.

6.1 OVERVIEW—A JOURNEY OF THREE DECADES

Nari tu narayani—Swami Vivekanand's much acclaimed phrase, echoed by the finance minister in her budget speech in 2019, rightly describes the role women play in progress of a society. The self-help group (SHG) programme aptly embodies this essence. The SHG–Bank Linkage Programme will reach an important milestone next year, formally completing a journey spread over three decades. What started as a modest pilot, over the years, has emerged as the largest community managed financial inclusion effort in the world. While it is difficult to pinpoint triggers for the SHG programme, the recognition of women as 'economic beings' by India's policy planners from the Sixth Five-Year Plan (1980–1985) onwards possibly shaped its early designs. The action research project funded by the National Bank for Agriculture and Rural Development (NABARD), way back in 1987, laid the initial foundation. In 1992, NABARD formally launched a pilot project paving the way for banks to lend directly to informal entities like SHGs. The model, synthesizing 'formal financial system' and 'informal sector', evolved as a movement and eventually became the common vehicle for fostering broader development process. It is also considered a precursor to the commercial microfinance in the country. The recognition of lending by formal financial institutions to informal groups as a part of priority sector lending and normal banking business provided a window for formal financial institutions in India to venture into this hitherto 'unbanked segment'. It opened avenue to access formal credit for low-income households, who otherwise relied solely on informal sources and moneylenders. With this, SHGs became a critical channel for credit flow to otherwise credit-starved areas. It further gained prominence with Swarnjayanti Gram Swarozgar Yojana (SGSY) adopting SHGs recognizing women's greater managerial and entrepreneurial skills and their potential contribution as 'micro-entrepreneurs' and 'managers' of household finances. In the late 1990s, another aspect was added to the programme in the form of federations—a higher tier for SHGs. Many NGOs and even government agencies started promoting SHG federations to monitor and strengthen the quality of SHGs, facilitate bank linkage and aggregate demand for critical support services. SHG as the core unit of mobilization has been adopted by Deendayal Antyodaya Yojana–National Rural Livelihoods Mission (DAY-NRLM) too. Government endorsement immensely contributed to mainstreaming of the SHG model. Since 2014, the Government of India attached high priority to accelerating financing inclusion announcing Pradhan Mantri Jan Dhan Yojana (PMJDY) and other flagship schemes on insurance and social security. In many areas, SHGs played a pivotal role in popularizing the schemes by spreading awareness and mobilized people to avail benefits. Post-demonization, SHGs and SHG members have started adopting digital transactions.

All these are critical demand-side responses to important schemes for which the SHG programme is rightly positioned. During the pandemic, SHGs and their federations became the institutions of choice for the government machinery and other agencies to reach out and support the needy in far-flung areas. This portrays the immense value of SHGs not only as informal financial institution but also as valuable social infrastructure, which can be relied upon and be an active partner in broader development goals.

All through these years, the SHG–Bank Linkage Programme has enticed practitioners, donors, researchers and policymakers, and has been a compelling topic in development discourse. Volumes have been written on multifarious aspects of the SHG programme, its performance and efficacy measured on dimensions of women's empowerment, targeting vehicle for anti-poverty programmes, channels for delivering public goods and services and, above all, delivering financial services and promoting entrepreneurship. What stands out across all paradigms is the 'bottom-up' view of the programme and deriving legitimacy of being 'self-managed'. While there are ardent believers who swear by the SHG programme, a cult of very vocal critics of the programme also emerged, both contributing to its refinement and evolution. Concerns are also being raised on quality, graduation and sustainability of the programme, dwindling role of civil society organizations, long-term promotional investments and increasing political influence on the programme.

As the programme is completing three decades, it is important to consolidate its achievements, analyse the impact of changing regulatory scenario, reassess the institutional structure making it future ready aligning with the emerging priorities and policy landscape.

This chapter will attempt to analyse the progress of the programme based on relevant statistics from reliable sources, capture efforts and perspectives of leading organizations and individual experts and draw up a commentary on aspects pertinent to the programme.

6.2. SHG–BANK LINKAGE: A REVIEW OF 2020–2021

During the year, restrictions imposed following the onset of the COVID-19 pandemic have adversely affected almost all sectors. Progress in the programme during this period needs to be analysed and understood in this context.

6.2.1. Number of SHGs

In the absence of any other reliable information on the number of SHGs, the number of bank accounts opened by SHGs as the proxy. This of course has limitations as explained later. Data sourced from NABARD (Table 6.1) show that as on 31 March 2021, cumulatively over 11.22 million SHGs have opened their accounts with banks. What is interesting to note is the pace of growth in the number of SHGs who have opened their bank accounts during the last financial year, which was several times higher compared to the previous year despite the prevailing

Table 6.1. SHGs with Savings Accounts with Banks

	2015	2016	2017	2018	2019	2020	2021
Total no. of SHGs (million)	7.69	7.9	8.57	8.74	10.01	10.24	11.22
Y-o-Y growth	(3.59%)	(2.68%)	(8.53%)	(1.95%)	(14.52%)	(2.29%)	(9.57%)
Total no. of exclusively women SHGs (million)	6.65	6.76	7.32	7.39	8.53	8.83	9.72
% of all women SHGs	86.41%	85.58%	85.37%	84.52%	85.19%	86.22%	86.65%
Y-o-Y growth	(6.38%)	(1.68%)	(8.27%)	(0.93%)	(15.44%)	(3.53%)	(10.11%)
SHGs under DAY-NRLM (million)	3.05	3.45	3.74	4.18	5.58	5.78	6.47
% of SHGs under DAY-NRLM	39.65%	43.74%	43.65%	47.85%	55.72%	56.52%	57.72%
Y-o-Y growth	(34.92%)	(13.27%)	(8.30%)	(11.75%)	(33.37%)	(3.75%)	(11.90%)
SHGs under DAY-NULM (million)	0.43	0.44	0.54	0.42	0.43	0.46	0.52
% of SHGs under DAY-NULM		5.64%	6.37%	4.86%	4.38%	4.58%	4.71%
Y-o-Y growth		(3.00%)	(22.42%)	(–22.16%)	(3.29%)	(6.83%)	(12.79%)

Source: : NABARD (2021).

abnormal situation. During the year 2020–2021, growth in SHGs opening their accounts was 9.57% compared to just 2.29% in 2019–2020. This growth can be largely attributed to the high pace of account opening by SHGs under DAY-NRLM.

Over years, DAY-NRLM has emerged as the single largest promoter of SHGs, accounting for nearly 44% of the total SHGs. In 2020–2021, the proportion of DAY-NRLM SHGs has seen further upswing over the years contributing to 57.7% of the total SHGs and nearly 67% of the exclusively women SHGs. However, what remained unchanged is the predominance of exclusively women SHGs, with them accounting for nearly 87% of all SHGs, and the distinct rural character of the programme with over 95% of SHGs being located in those areas.

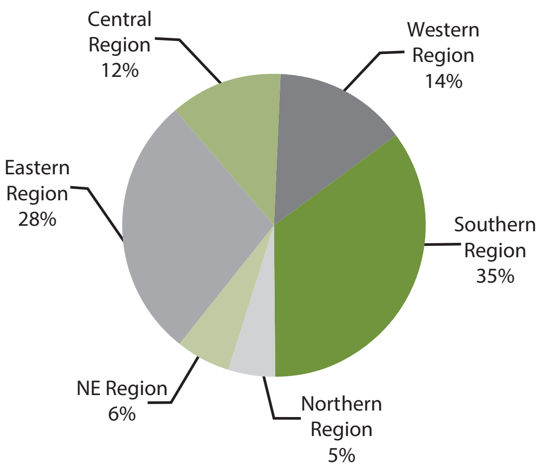


Figure 6.1. Regional Share of SHGs with Bank Accounts

Source: : NABARD (2021).

Figure 6.1 depicts the regional distribution of SHGs. Southern region still holds the top spot in terms of total number of SHGs with over a third (35%) of all SHGs, followed by eastern region with 28% of the SHGs. During the year 2020–2021, the eastern, southern and central regions significantly contributed to the growth in number of SHGs opening their accounts. During the year 2020–2021, 6 states and UTs have seen negative growth reflecting high number of SHGs getting disintegrated. Karnataka at 9% has seen one of the highest negative growths consecutively for two years.

The cumulative number of savings accounts opened with banks does not present a true picture on the number of SHGs. A large number of SHGs formed over the years may have actually stopped operation without formally closing their bank accounts. Information sought from banks indicate that as on March 2021, out of 9.72 million accounts of exclusive women SHGs, only 7.67 million accounts (79%) are operative, meaning in over 2 million SHG accounts, there has not been any customer-induced transactions in last two years. It is likely that many of these SHGs are either dormant or defunct. Further, insights from DAY-NRLM reveal that 10% of SHGs do not have a savings account with any bank. Estimations based on these trends indicate that as on March 2021, there are about 9.74 million operational SHGs, of which about 8.4 million are exclusive women SHGs. This however can at best be an estimate and further emphasize the need for an authentic SHG repository.

Estimated Number of Operational SHGs

- Total SHG accounts: 11.22 mn
- Exclusive women SHGs with accounts: 9.72 mn
- Operative women SHGs a/c: 7.67 mn
- Proportion of operative women SHG a/c: 79%
- Proportion of SHGs without bank a/c: 10%

Likely scenario

- Total Operative SHGs with bank a/c: $11.22 \times 79\% = 8.86$ mn [A]
- Estimated SHG without bank a/c: 0.88 mn [B]
- Total operational SHGs: [A + B] = 9.74 mn [C]

6.2.2. Savings of SHGs

The importance poor attach to savings is evident in the ingenious ways they adopt to save. These include investing in assets such as livestock, household utensils and jewellery, hiding money in secure places, savings in informal chit funds or at times even lending to friends and relatives. These efforts underscore the importance of secure savings facilities that poor need, but financial institutions for long could not meet requirements of the poor. SHGs emerged as a promising option available with the poor to save. Accumulating savings is usually the first collective task and financial transaction taken up by any SHG after its formation. Most SHGs have a practice of agreeing upon a fixed amount contribution often referred to as 'compulsory savings' for every member in the group which also acts as quasi-equity and inculcates behaviour of regular savings among them. Higher accumulation of compulsory savings by members and high velocity of internal lending within SHG was basic premise for SHGs. However, the SHG model initially envisaged as 'savings first' model over the years seems to have undermined the importance of savings as a service to poor and prioritized credit.

As on March 2021, cumulative deposits of all SHGs with banks rose to nearly ₹375 billion, posting a growth of over 43% compared to previous year. Deposits of all women SHGs grew by over 40% to ₹326.8 billion contributing 87% of total deposits with banks. SHGs under DAY-NRLM which account for nearly 58% of all SHGs also have seen a rise in deposits with banks by 35% to ₹193.5 billion contributing about over 51% of the total deposit with banks. State-wise and agency-wise savings are given in Appendix 6.1. Figure 6.2 depicts the regional distribution of SHGs' deposits with banks.

In 2020–2021, average bank deposit per SHG grew by 31% on Y-o-Y basis, the fastest in last five years. As on March 2021, the national average deposit per SHG stands at ₹33,392, with Andhra Pradesh (₹103,332), Telangana (₹59,320) and Puducherry (₹48,587) being the top three. During the year, however, in at least 11 states and UTs, there has been a net decline in the per group bank deposits. However during 2020–2021, a spurt in deposit by over 40% is observed in spite of the fact that the number of SHGs grew by just 9.5% (exclusively women SHGs grew by 10%). In the northern region, deposit of SHGs grew by over 192% in last one year. Western and NE regions also saw an overall jump in SHG deposit with banks by over 70%. Basic operations and meeting of SHGs being hampered during the year, a large number of SHGs resorted to just collection of compulsory savings amount and depositing it with banks without any internal lending. Further, during the year, DAY-NRLM as part of the mission's COVID-19 assistance package also released a large amount of community funds to SHGs. It is possible that a significant proportion of such funds is still unutilized and remains parked in bank accounts contributing to a higher deposit accumulation with banks. Although the consequent disruption in SHG meeting due to COVID-19 pandemic may have resulted in sudden spike in deposit by SHGs with banks during 2020–2021, a closer look at SHG deposit with banks over the years reveals a growing trend that precedes the pandemic period. This may be indicative of a distortion in group practices where SHGs ignore the meticulous planning and utilization of the savings accumulated and rather focus on bank loans. Due to a lack of authentic MIS, actual savings accumulated by SHGs cannot be correctly estimated. Insights from DAY-NRLM indicate that about 41% of the savings accumulated by SHGs are held in their bank accounts which translated to accumulated savings of ₹914 billion.

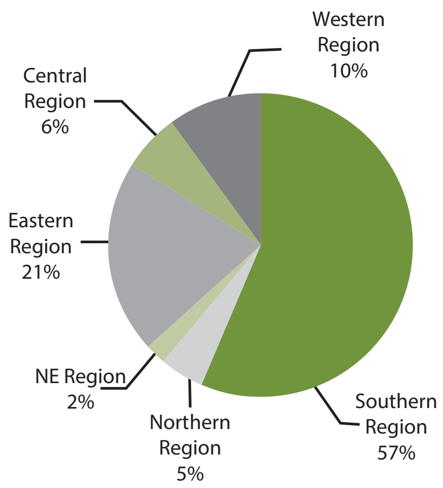


Figure 6.2. Regional Distribution of SHGs Deposit with Banks

Source: : NABARD (2021).

6.2.2.1. Challenges of Savings in SHG

SHGs mobilized on the foundation of savings could have played an important role for the poor to accumulate and manage their savings over time. However, SHGs have been unable to evolve into strong savings-based institutions. There is a need for deeper analysis on the challenges of savings in SHGs. Unpredictable income of SHG members and restriction on savings deposit in SHGs only on designated meeting days, absence of regulatory protection, lack of liquidity in savings with SHGs, low or at times even negative returns on savings with SHGs and equity concerns among promoters—a combination of these factors has discouraged members from saving higher amounts with SHGs. Further with the preponderance of credit, SHGs have started using the savings instrument merely to fulfilling the eligibility criteria to leverage external credit. Promoters and bankers also did

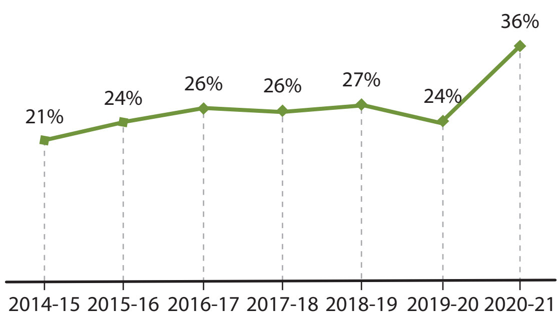


Figure 6.3. Proportion of SHG Bank Deposit to Bank Loan OS

Source: : NABARD (2021).

not pay much consideration to this aspect. SHG credit being collateral-free, over time bankers have started insisting SHGs to deposit their savings with bank instead of internal lending, construing it as kind of collateral to loans disbursed. This is clearly evident from the increasing proportion (Figure 6.3) of savings to the gross loan outstanding with SHGs.

The underplaying of importance of savings in SHGs has not only disrupted the accumulation of potential savings through SHGs but has also impacted the saving behaviour of members. Now with most households having a PMJDY account, and women constituting over 55% of the account holders, there are increased saving avenues. But the behavioural pattern on savings will have a bearing on meaningful utilization of these accounts.

6.2.3. Loans Disbursed

The ability of an SHG to leverage credit from formal financial institutions is the biggest driver of the programme and is probably the most important parameter to assess its performance.

Data reported by NABARD (2021) indicated a decline in overall disbursement during 2020–2021. However, several banks that have undergone a merger have under-reported disbursement figures. To address this anomaly in reporting, analysis of disbursement is done based on reports submitted by public sector bank (PSB)[1] to DAY-NRLM. Reports submitted by PSBs to DAY-NRLM are primarily for women SHGs in rural areas. Disbursement to total SHGs is likely to be higher and limitation in analysis to that extent remains.

During the year 2020–2021, 4.8 million SHGs have availed total credit of ₹886.07 billion. As reflected in Table 6.2, there has been a significant growth of 52% in number of SHGs availing credit, while loan amount disbursed improved by 14% on Y-o-Y basis. Details of loans disbursed to SHGs are given in Appendix 6.2.

The growth in the number of fresh credit among exclusive women SHGs saw a higher increase of 65%, while the disbursement amount grew by 15%. Average loan size per SHG which maintained a steady increase over past few years came down to ₹0.184 million as on March 2021 at the national level, a net decline of over 25% (Figure 6.4). The decline in average credit among exclusive women SHGs seem to be higher, with average loan size of ₹0.177 million, reflecting a decline by over 30% compared to previous year.

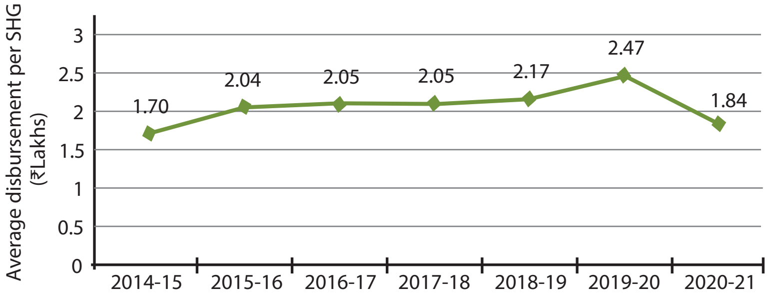


Figure 6.4. Disbursement per SHG over the Years

Table 6.2. Credit Disbursement to SHGs

	2015–2016		2016–2017		2017–2018		2018–2019		2019–2020		2020–2021*	
	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount	No. of SHGs	Amount
Total SHGs	1.83	372.87	1.89	387.81	2.26	471.86	2.69	583.18	3.14	776.59	4.80	886.07
% growth	13%	35%	4%	4%	19%	22%	19%	24%	17%	33%	52%	14%
Exclusively women SHGs	1.62	344.12	1.71	361.03	2.07	445.59	2.36	532.54	2.88	732.97	4.75	840.79
% growth	13%	41%	5%	5%	21%	23%	14%	20%	22%	38%	65%	15%
SHGs under DAY-NRLM	0.82	167.85	0.89	173.36	0.12	250.55	1.65	333.98	2.04	521.83	4.75	840.79
% growth	27%	77%	9%	3%	43%	45%	30%	33%	24%	56%	132%	61%
SHGs under DAY-NULM	0.012	26.2	0.01	26.76	0.01	24.24	0.013	34.19	0.0159	34.06	NA	NA
% growth	6%	40%	-5%	2%	0%	-9%	22%	41%	23%	0%	NA	NA

Source: NABARD. (*) For FY 2020–2021, data pertaining to disbursements by PSBs are sourced from DAY-NRLM; disbursement pertaining to private sector banks, RRBs and cooperative banks is sourced from NABARD (2021).

6.2.3.1. Regional and State Analysis

The regional share in terms of volume of loans disbursed is given in Figure 6.5. As on March 2021, the southern region still dominates in terms of total volume of loans disbursed during a year commanding over 69% of the loans value of loans and nearly 52% of the SHGs availing loans. While all other regions have improved their share in annual credit disbursal, during 2020–2021, the southern and northern regions saw a marginal decline in their share of total loans. Even in terms of number of SHGs availing credit, there is a decline in both regions.

As depicted in Figure 6.6, during the year 2020–2021, there has been positive growth across all regions in terms of SHGs availing credit amount of loan disbursed. The north-eastern (NE) region, albeit on a lower base, posted the highest growth rate both in terms of number of SHGs availing loans and amount of loans disbursed. Western region where there has been significant decline in previous year also had a positive growth figure though marginal. A state-wise analysis of the Y-o-Y growth pattern indicates that in as many as 9 states and UTs, there is a net reduction in flow of credit to SHGs.

Coverage of SHGs seeking fresh disbursement during a year also indicates maturity of the programme. During the year, at a national level, only 26% of the existing SHGs were able to avail fresh credit from banks, compared to 31% the year before. Region-wise coverage of SHGs seeking bank loans during the year is depicted in Figure 6.7.

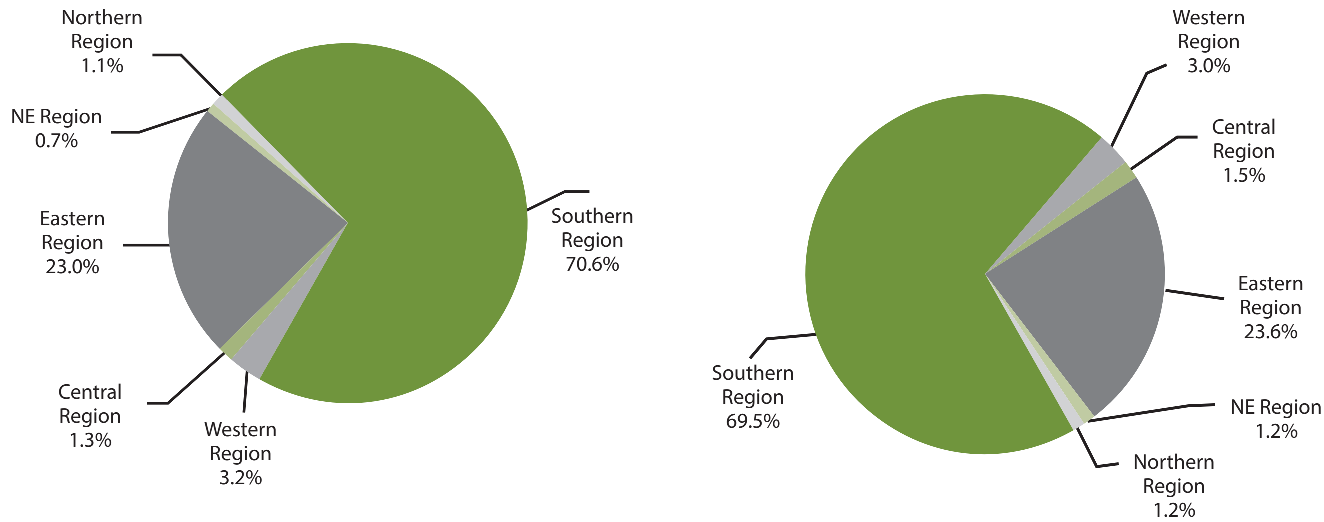


Figure 6.5.Regional Share of Loans Disbursed to SHGs

Source: NABARD (2021); for FY 2020–2021, data pertaining to disbursements by PSBs is sourced from DAY-NRLM.

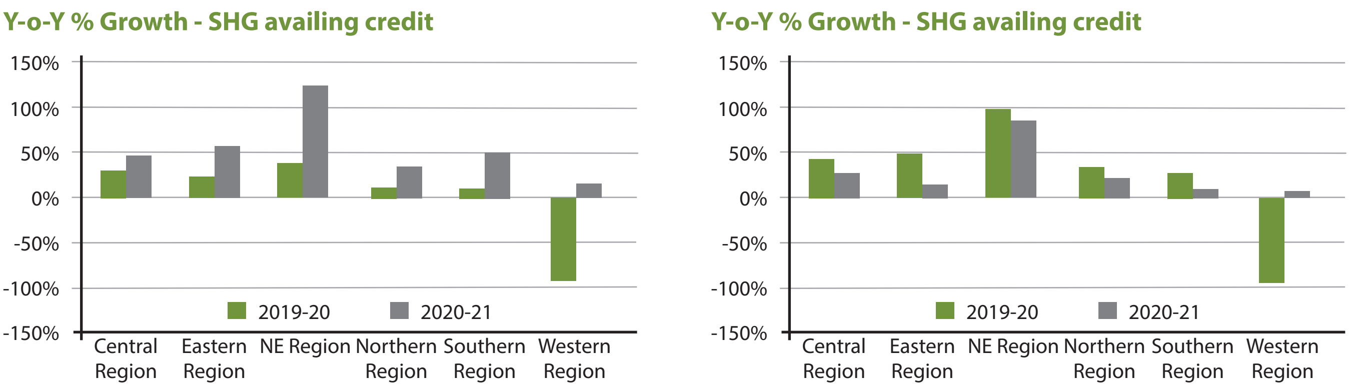


Figure 6.6. Region-wise Growth Pattern in Disbursement of loans to SGHs

Source: NABARD (2021);

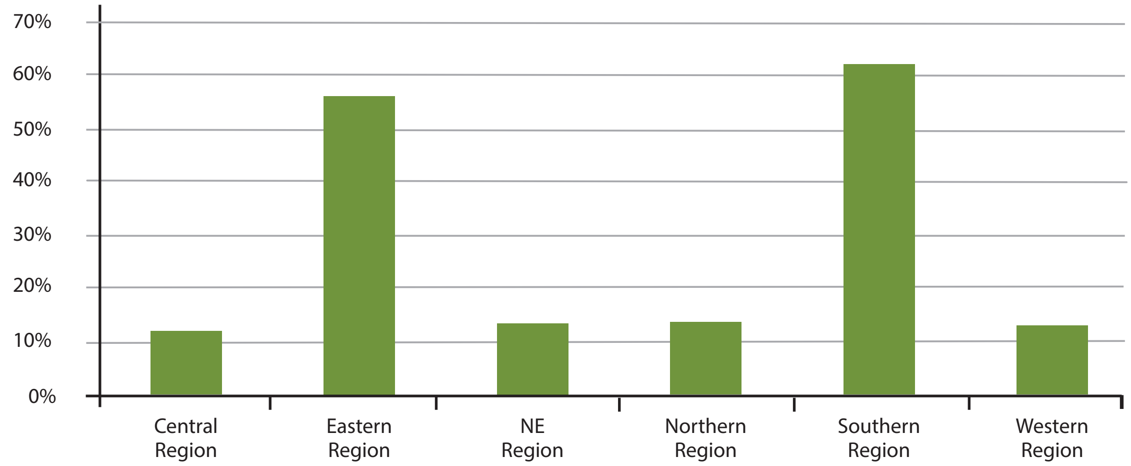


Figure 6.7.Region-wise Percentage of Existing SHGs Availing Credit

Source: NABARD (2021) loans.

The national average on loans per SHGs has always been boosted by the southern region on account of high volume of credit disbursal by banks in the region. Analysis of region-wise disaggregated data indicates that average loans to SHGs in regions other than southern region stand at ₹100,638, a reduction of 33% compared to previous year. Average loan exclusively in southern region also came down to ₹245,712, a reduction of over 26% compared to previous year.

As depicted in Figure 6.8, during 2020–2021, the average loans to SHGs reduced across all regions. The central region which includes a large number of predominantly tribal districts, particularly in Madhya Pradesh, Chhattisgarh and Uttarakhand and poverty-stricken pockets in Uttar Pradesh, has the lowest average loan of around ₹80,000 per SHG.

6.2.4. Loan Outstanding

As on March 2021, 5.78 million SHGs have loan outstanding of ₹1.03 trillion. 92% of the loan is primarily concentrated in two regions: southern (67%) and eastern (25%). Although the number of groups having loan outstanding grew marginally by 1.8%, the amount of loan outstanding declined by over 4% compared to a high growth rate of over 24% the year before. Overall, as at end of March 2021, 52% of the SHGs having savings bank account

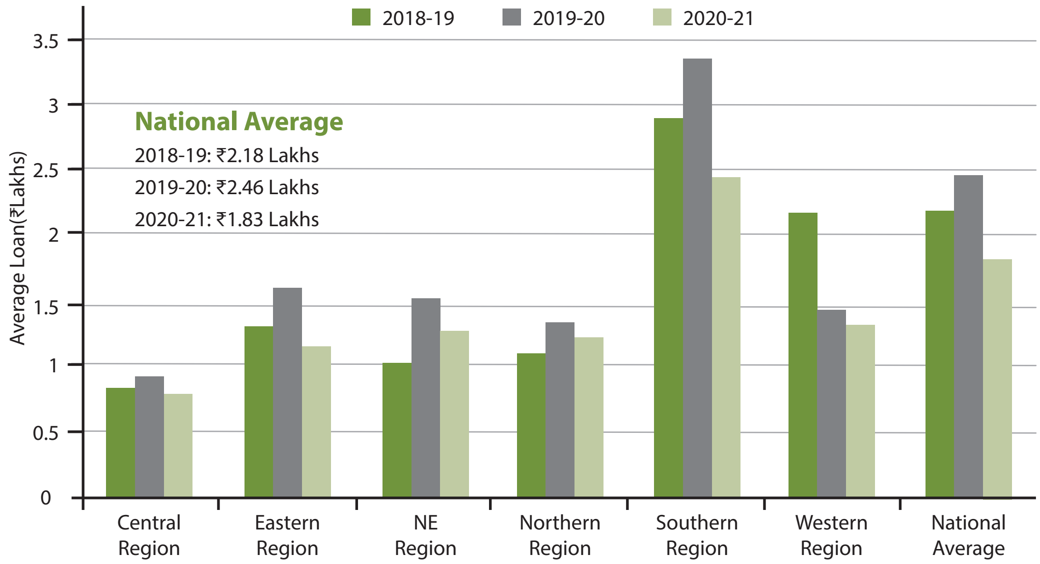


Figure 6.8. Region-wise Average Loan per SHGs as on March 2019, March 2020 and March 2021

Source: NABARD (2021).

have active loans. State-wise and agency-wise loan outstanding with SHGs are given in Appendix 6.3. Regional analysis indicates that all regions recording positive growth except southern region where, in the past one year, there has been a net decline in outstanding amount by over ₹119 billion (a decline of over 11%). Andhra Pradesh tops the chart on negative growth in loan outstanding with a reduction of nearly ₹6,000 billion, followed by Karnataka and Telangana. Other key states which posted negative growth in loan outstanding are Uttar Pradesh, Punjab, Nagaland and Sikkim. A dip in the net loan outstanding across several states in spite of fresh disbursements indicates that fresh loans being disbursed are of much smaller size which are being repaid within a shorter period of one year. Lack of repeat loans with higher amount also restricts the growth of the portfolio in several states.

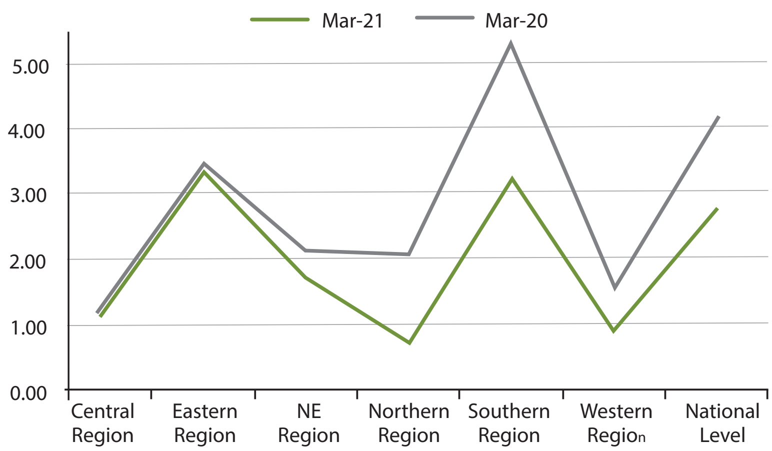


Figure 6.9. Region-wise Credit Multiplier as on March 2020 and March 2021

Source: NABARD (2021).

6.2.4.1. Credit Multiplier

Credit multiplier is the ratio of loan outstanding to accumulated savings. It indicates the leverage potential of SHGs and also, is, in a way, indicative of banks' involvement in the programme. A higher number indicates higher leverage potential of SHGs and should ideally be above '1'. Figure 6.9 depicts comparative region-wise credit multiplier over two years. As on March 2021, all regions have seen a dip in the credit multiplier in the face of high accumulation of SHG deposits at banks during the year. Credit multiplier in northern and western regions has fallen below 1. Low credit multiplier may be a consequence of banks not being able to build their portfolio by extending subsequent higher doses of loans to SHGs. Further, in a large number of cases, SHGs after the initial one or two doses of credit even slipped and never received next higher doses. This also reflects the demand side issue in absorbing higher credit by SHGs or challenges in routing high value loans for enterprises through the SHG.

6.3. REVIEW OF PERFORMANCE OF BANKS

PSBs, regional rural banks (RRBs), private sector banks, cooperative banks and recently involved small finance banks are all critical partners to the whole SHG–Bank Linkage Programme. Over the last 7–8 years, banks have extended tremendous support to the SHG–Bank Linkage Programme. The year 2021 has been unusually tough for the banking sector. As many as 9 PSBs initiating the merger process added responsibility of delivering banking facilities to public amid the pandemic and dealing with concerns arising out of economic slowdown. Table 6.3 shows the overall performance by various banks in SHG–Bank Linkage Programme during 2020–2021.

Table 6.3. Performance of Banks in SHG–Bank Linkage Programme (No. of SHGs in Millions; Amount in ₹Billion)[2]

Banks	Deposit of SHGs with Banks (As on Mar 2021)		Loans Disbursed to SHGs during 2020–2021		SHG Loan Outstanding with Banks as on March 2021		NPA on SHG Loans as on March 2021	
	No. of SHGs	Deposit amount	No. of SHGs	Loan amount disbursed	No. of SHGs	Loan amount outstanding	Gross amount of NPA	% NPA
Commercial banks	6.13	225.96	3.37	584.89	3.22	597.86	30.33	5.07%
% Share	55%	60%	70%	66%	56%	58%	62%	
RRBs	3.60	95.12	1.18	244.94	20.33	359.23	14.34	3.99%
% Share	32%	25%	25%	28%	35%	35%	29%	
Cooperative banks	1.49	53.69	0.25	56.24	0.53	75.80	0.42	5.55%
% Share	13%	14%	5%	6%	9%	7%	9%	
Total	11.22	374.77	4.76	886.07	5.78	1032.89	48.89	4.73%

6.3.1. Saving Deposit of SHGs with Banks

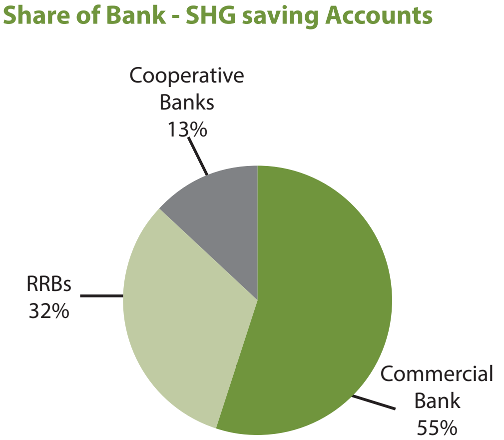
As on March 2021 (Figure 6.10), out of the 11.22 million SHGs having opened their savings account, nearly 55% of them are with commercial banks. In the NE and central regions, however, bulk of the accounts (60% and 53%, respectively) are with RRBs. 67% of the 980,000 new SHG accounts opened were done by commercial banks. 60% of the total bank deposit of ₹375 billion is with commercial banks. During 2020–2021, the share of commercial banks remains unchanged at 60% even though deposit by SHGs with commercial banks increased to nearly ₹226 billion, an increase of 44% over last year. Nearly 335,000 fresh accounts were opened by RRBs. Although the cumulative deposit with RRBs rose to ₹95 billion, their share in overall SHG deposit declined to 25% from 30% in the previous year. While there has been a marginal decrease in number of SHGs (9,329 SHGs) with cooperative banks, cumulative deposits with cooperative banks increased to nearly ₹94 billion, improving their share in SHG deposits from 10% to 14% as on March 2021.

6.3.2. Loan Disbursed by Banks to SHGs

Maintaining the trend, commercial banks led the loan disbursement to SHGs. During 2020–2021, commercial banks cumulatively disbursed loans worth ₹584.89 billion to 3,372,323 SHGs. Commercial banks account for 70% share in terms of number of SHGs credit linked and 66% in terms of amount disbursed. As depicted in Figure 6.11, there is a substantial increase of over 85% in the number of groups availing loans from commercial banks and modest growth of about 18% in terms of amount disbursed.

Private sector banks cumulatively disbursed credit to SHGs worth ₹55.8 billion in 2020–2021, with a decline of 4% compared to previous year.

While commercial banks were able to augment their share in SHG loans during the year, there has been a decline in the share of RRBs from 35% to 31%



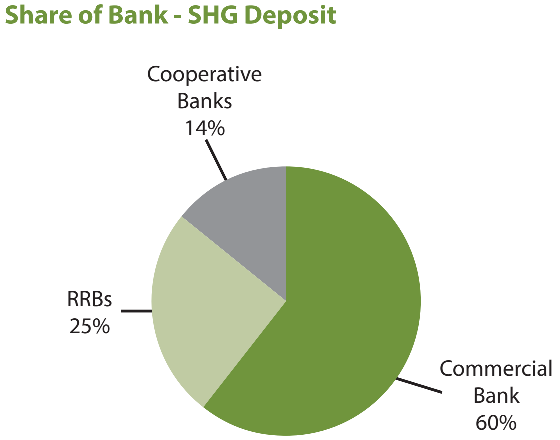
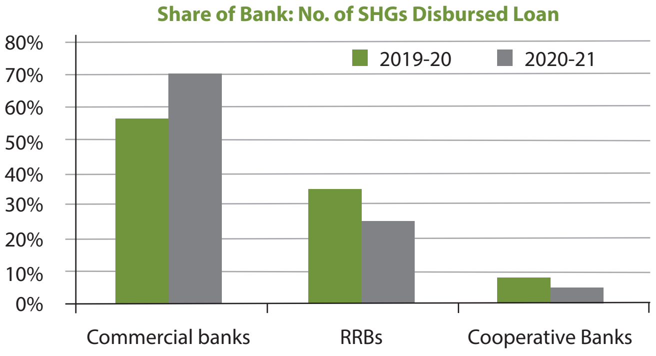


Figure 6.10.Bank-wise Share of SHGs Savings Accounts as on March 2021

Source: NABARD (2021).



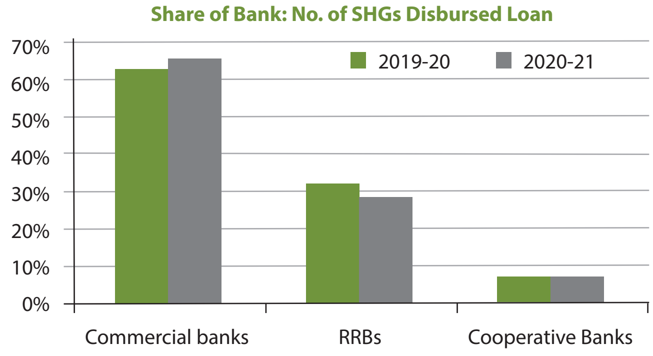


Figure 6.11. . Bank-wise Share in Credit Disbursement during 2020–2021

Source: NABARD (2021).

in terms of number of SHGs credit linked, and from 31% to 28% in terms of volume of loans disbursed. RRBs made cumulative disbursements worth ₹244.94 billion to 1,184,775 SHGs. Although cooperative banks improved upon their disbursement figures by nearly 13% over the previous year disbursing credit of ₹56.23 billion, there is a decline in year-on-year number of SHGs provided credit.

The average credit disbursed per group during 2020–2021 was ₹173,438 by commercial banks; ₹206,742 by RRBs and ₹229,277 by cooperative banks.

6.3.3. Loan Outstanding

Commercial banks hold the lion's share of the loan outstanding both in terms of number of groups and amount with a total loan outstanding of ₹597.86 billion as on March 2021. Commercial banks account for 58% of the total loan outstanding followed by RRBs and cooperative banks contributing to 35% and 7%, respectively. Although there has been marginal increase in the number of SHGs having live loans, by the end of year 2020–2021, loan outstanding reduced by ₹47.85 billion.

The number of SHGs having loan outstanding with commercial banks declined by 76,342 SHGs, while amount of loan outstanding reduced by ₹114.3 billion: a decline of 16%. RRBs, however, consolidated their position with a net increase of 183,509 SHGs having loan outstanding with total loan outstanding of ₹359.23 billion gaining by over 18%. Among cooperative banks, the number of

A CASE FOR STRENGTHENING THE RRBS

RRBs have played a pivotal role in accelerating credit flow to SHGs in some of the most remote and underserved areas. Although RRBs account for 35% of the total loan outstanding with SHGs, a regional analysis of contribution of RRBs reflects that the same proportion of RRB in lending to SHGs surpasses other banks, particularly in central, eastern and NE regions, which have some of the poorest pockets in the country. The region-wise contribution of RRBs in terms of annual credit disbursement and total loan outstanding with SHGs are given in Figure 6.12. The SHG portfolio quality of the RRBs is relatively better than their commercial counterparts.

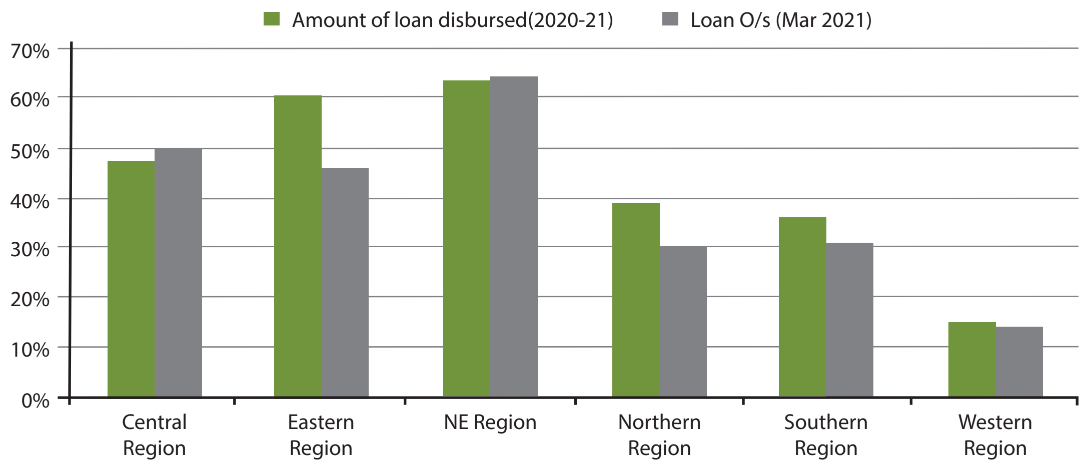


Figure 6.12. Contribution of RRBs 2021

Source: NABARD (2021).

The constructive role RRBs have played in this SHG–Bank Linkage Programme in some of the demographically and geographically toughest regions in the country is clearly evident. However, many RRBs are faced with challenges of capital adequacy, non-availability of refinance facility on account of higher NPA rates, etc. RRBs have not been offered a level playing field. Although it is mandatory for RRBs to ensure higher proportion of their portfolio in the priority sector, they have not received the much desired support in terms of capital infusion or funding the viability gaps faced for operating in difficult circumstances. RRBs are an important tenet not only for the SHG programme but for the overall flow of credit to rural areas. It's high time government and regulators take a sensitive view and take up effective measures to strengthen the RRBs.

SHGs having loan outstanding reduced by 3,995 SHGs, but the amount of loan outstanding grew by 16% to ₹75.8 billion.

As on March 2021, RRBs had the highest credit multiplier at 3.7 followed by commercial banks and cooperative banks at 2.6 and 1.4, respectively. Coverage, that is, the ratio of SHGs having loan outstanding to total SHGs, is 57% for RRBs, followed by commercial banks at 53% and cooperative banks at 35%.

6.3.4. Review of NPA on Loans to SHGs

Loans extended to SHGs are 'clean loans' meaning they are unsecured loans with no primary or secondary security. Further, no credit guarantee facility is available to banks extending loans to SHGs. Stringent asset classification norms under which banks operate are required to make higher provisioning in the event of deteriorating asset quality eroding bank's profitability. SHGs are mostly located in closed geographic proximity.

A study on NPA in SHGs by BIRD Lucknow[3] identifies a set of factors which led to a default among SHGs. Primary among them are (a) deteriorating quality and intensity of handholding and monitoring SHGs by promoters, (b) lack of support services such as training and federating, (c) delay in opening of savings account, (d) delay in first credit linkage, (e) absence of repeat doses of credit to SHGs, (f) banks not playing active role in monitoring and handholding SHGs as they were severely constrained due to inadequate staff and work pressure and (g) lack of initiatives on promoting economic activity. Apart from these, several factors such as (a) disruption in normal economic activity or loss of assets due to natural disasters and (b) demise of active borrower within an SHG with no social security support may also lead to a default among SHGs. Political announcement on loan waivers often plays a spoilt sport damaging a prudent credit culture established over time. A combination of these factors which varies across regions may consequently give rise to default among SHGs.

Gross NPAs on SHG loans as on March 2021 stand at ₹48.89 billion, forming 4.73% of the total loan outstanding. Consecutively for two years in a row, there is a decline in the percentage of NPA to total loan outstanding. Figure 6.13 depicts the gross amount of NPA and percentage of NPA to total loan outstanding over last four years. During the year, NPA further reduced by 0.19% points from

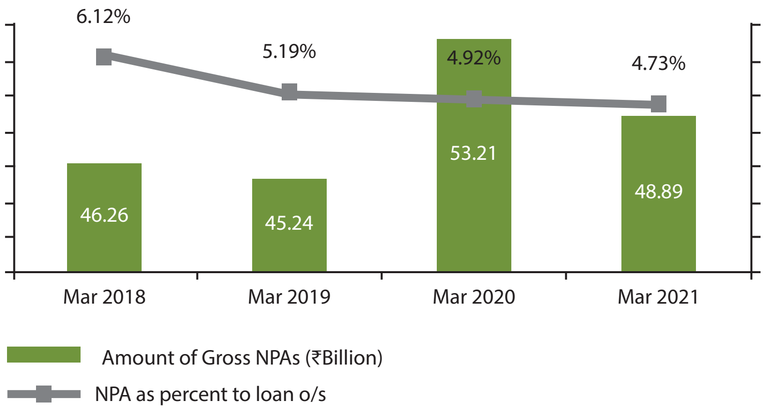
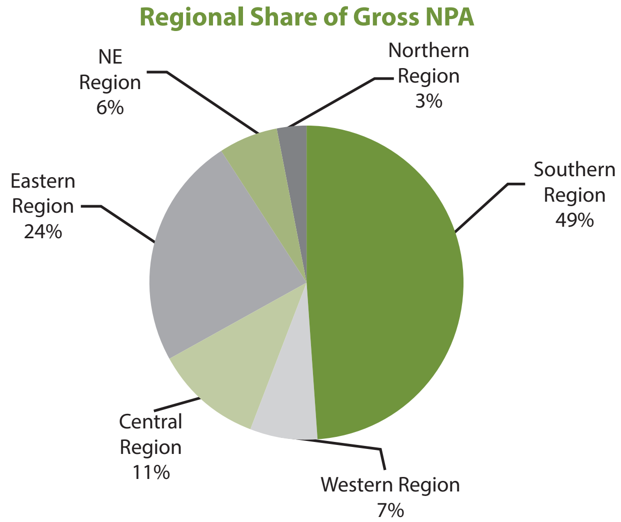


Figure 6.13. CNPA on SHG Loans in Last 4 Years
Source: NABARD (2021).



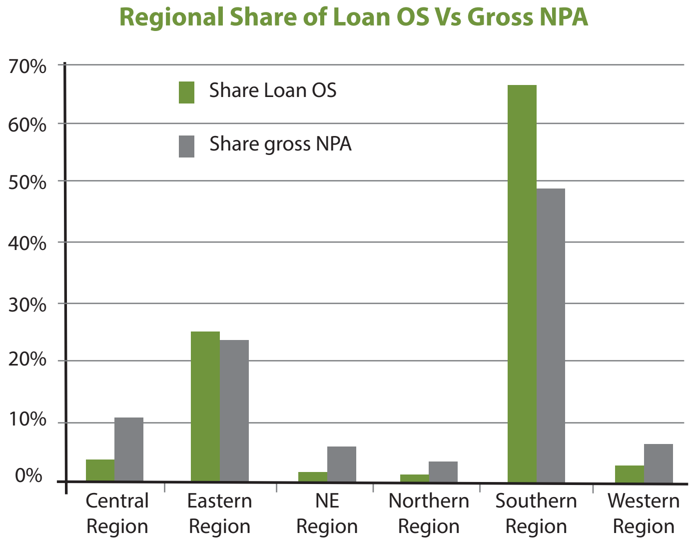


Figure 6.14. Regional Share of Gross NPA
Source: NABARD (2021).

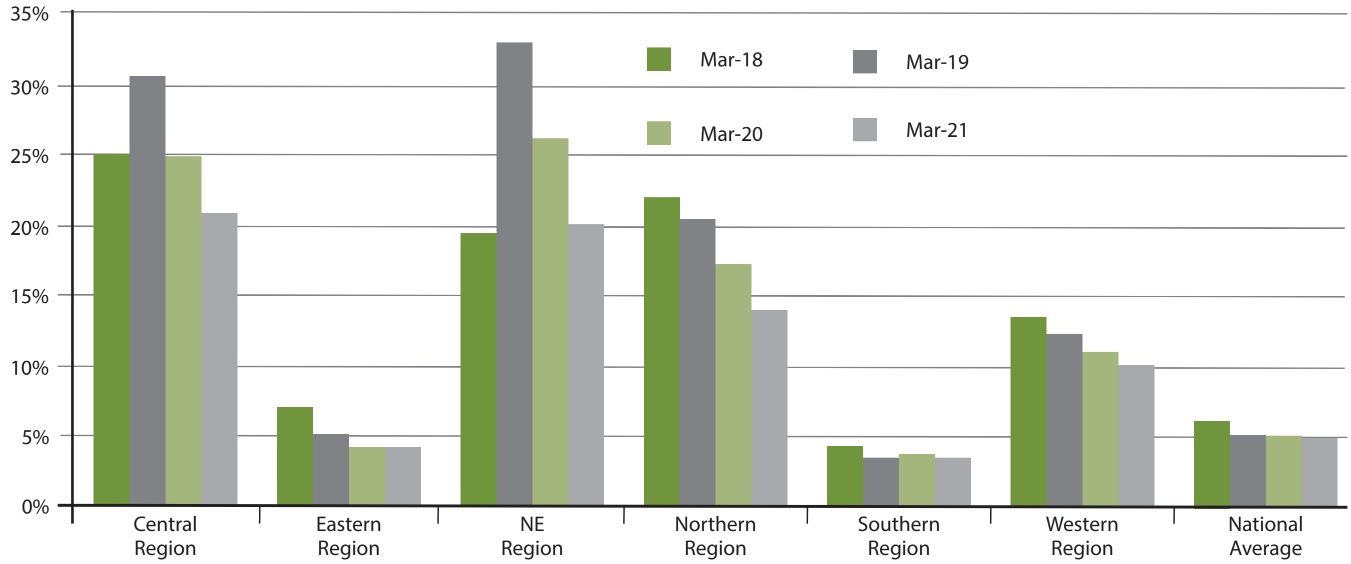


Figure 6.15. Regional Trend on NPA % over 4 Years

Source: NABARD (2021).

4.92% the previous year. Amount of gross NPA also reduced by ₹4.32 billion, a Y-o-Y reduction of over 8%. Reduction of NPA on SHG loans both in terms of gross amount and percentage of total outstanding is a very positive development, more so in the light of the fact that there has been a net decline of ₹47.85 billion (4.4% decline) in loan outstanding with SHGs. State-wise and agency-wise particulars are given in Appendix 6.4.

Figure 6.14 depicts the region-wise and agency-wise distribution of NPA. Southern region has the highest share contributing 49% in gross NPA, followed by eastern region with 11%. The central region, which accounts for just 2% of the total loan outstanding has disproportionality higher share of 11% in gross NPA.

The southern region continues to outperform with the lowest levels of NPA percentage among all regions. All regions, except southern and eastern regions, have higher NPA percentage compared to national average of 4.73%. During 2020–2021, all regions reported net decline in gross NPA except eastern and NE regions where there has been a growth in gross NPA by 14% and 5%, respectively.

Figure 6.15 depicts the trend in NPA % across regions over last 4 years. Analysis of trends indicates that, since last three years, there is a declining trend in percentage NPA across all regions. However, the central, NE and western regions still have disproportionately high NPA compared to their shared in loan outstanding. The top five states with high NPA are UP, Assam, Uttarakhand, Tripura and Arunachal Pradesh.

Agency-wise share of gross NPA is shown in Figure 6.16. As on March 2021, the commercial banks continue to hold the largest share with 62% of the gross NPA. Private sector banks outperform with the lowest NPA at just 1.69%. Percentage NPA has declined across all categories of banks except PSBs, where it has seen an increase of 0.28 percentage point.

Both RRBs and cooperative banks have seen a y-o-y increase in gross NPA by 8% and 7%, respectively. RRBs, except in the eastern and NE regions, have been able to reduce their gross NPA on SHG loans. Cooperative banks across all regions

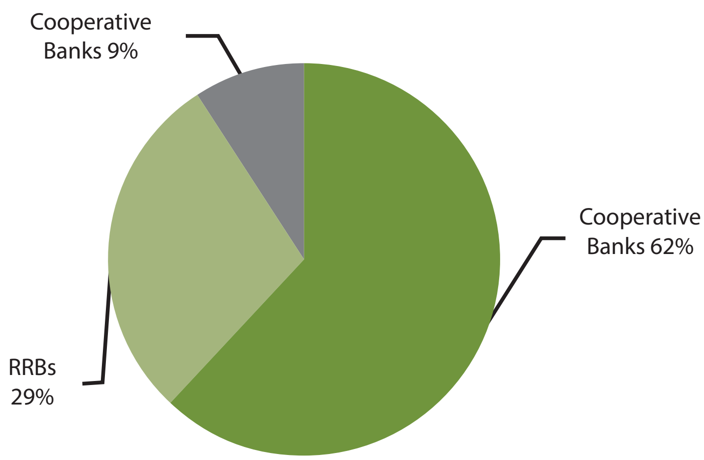


Figure 6.16. Share of Banks in Gross NPA on SHG

Source: NABARD (2021).

Table 6.4. Outreach under DAY-NRLM

	As on March 2018	As on March 2019	As on March 2020	As on March 2021
Districts under implementation	706	706	706	706
Blocks under implementation	4,458	5,250	6,104	6,521
Total SHGs formed (million)	4.17	5.22	6.14	6.90
Total members (million)	48.99	59.43	67.88	75.20
SHGs having account with banks (million)	4.87	5.5	6.07	6.39
% SHGs with bank account	86%	86%	88%	90%
Total primary-level federations (PLF)	222,091	274,303	330,740	366,814
No. of member SHGs	3.16	3.69	4.24	4.53
% SHGs in PLF (informal federations)	56%	57%	62%	64%
Total secondary-level federations (SLF)	18,849	22,648	26,458	29,245
No. of member SHGs	2.58	2.93	3.31	3.57
% SHGs in SLF (formal federations)	45%	46%	48%	50%

Source: DAY-NRLM MIS.[4]

improved their SHG portfolio quality except in the southern region which witnessed an increase in gross NPA by 31%.

6.4. PROGRESS UNDER DAY-NRLM

6.4.1. Outreach and Institutions

The NRLM or 'Aajeevika' is a leading poverty alleviation programme of the Government of India. Table 6.4 presents a summary of outreach under DAY-NRLM. The mission over the years has emerged as the single largest promoter of SHGs in the country. Given the outreach, scale and capital support provided, the mission is a crucial mover of the entire SHG–Bank Linkage Programme.

6.4.2. Social Inclusion and Empowerment

Women often bear an unequal burden of poverty. Over the years, both government and grassroots development agencies have tried to address the societal inequalities affecting women through SHGs. Participation of women in SHGs leads to their empowerment due to improvement in savings and incomes as well as enhanced skills acquired due to higher exposure and training. Women also accumulate social capital while regularly participating in SHG meetings due to their solidarity with other women of similar background and improved social network. But often the basic assumptions underpinning SHGs promoted through programmes or government scheme is that giving women access to credit and technical support can increase their ability to exercise bargaining power and generate more choices. Although economic empowerment has a bearing on the overall empowerment of women, there is a need to broaden the lens to define the empowerment process and resist standardizing or generalizing the empowerment processes. In all measures, the SHG programme needs to be assessed not only by the quantum of services it delivers but also the value it creates in the form of social capital. This has aptly been demonstrated during the COVID-19 crisis.

6.4.2.1. Women SHGs Leading COVID-19 Response

The COVID-19 pandemic and subsequent lockdowns have affected everyone, but its impact has been severe particularly on women shouldering disproportionate work burden. In the initial days of the outbreak, women SHG members under DAY-NRLM led the COVID-19 relief efforts from the front raising awareness on personal hygiene such as hand washing, use of mask and behavioural change to maintain social distance and curbing rumours leveraging the incredible reach of the SHGs. When lockdown measures were in place, around 0.5 million SHG leaders and community resource persons (CRPs) worked alongside government machinery to ensure food security of most vulnerable households in fur-flung areas. At one point of time, these SHGs were managing over 12,000 community kitchens across 75 districts in three states: Jharkhand, Kerala and Odisha distributing over 0.06 billion meals.

With supply lines getting disrupted and consequent shortage of basic protection gears such as masks and PPE kits even with hospitals, women SHG members across various states cumulatively produced and supplied over 0.22 billion masks, more than 3.5 million protective gears, 0.48 million litre sanitizer and 0.1 million litre of hand wash. This ensured that rural areas got a steady supply of these essential items. The BC Sakhis (business correspondent) deployed under the mission ensured that rural households had access to cash, disbursing over ₹62.78 billion. More recently, the women SHG members are collaborating with the Department of Medical Health and Family Welfare in spreading awareness on COVID-19 vaccines and assisting the department in conducting vaccination drives. These SHG women have been the unsung COVID-19 warriors of rural India.

The pandemic has emphasized the need for localized and decentralized response in event of a disaster of this magnitude. Under trying circumstances, the women SHGs have proven their importance as a key social infrastructure on which governments and other agencies can trust and rely upon to act and implement the best solutions. It's time the SHG women of India are recognized for their efforts.

6.4.2.2. Building Access to Financial Services

6.4.2.2.1. Capitalization of SHGs and Bank Linkage

Cumulatively, ₹43.31 billion have been disbursed to 3,006,172 SHGs as revolving fund as on March 2021. This covers 54% of eligible groups. NRLM also provides community investment fund (CIF) which forms a corpus for federations and is envisaged to be a capital in perpetuity meeting the credit need of members as on March 2021, cumulatively, 1,668,681 SHGs (32% of eligible SHGs) have been provided CIF to the tune of ₹90.97 billion.

The success of the mission depends on its ability to enable SHGs leverage external capital from banks and other formal financial institutions for smoothening consumption and investment in economic activities for creating gainful employment. Table 6.5 illustrates the progress of SHG–bank linkage over last 3 years.

During 2020–2021, 4.75 million SHGs were disbursed credit to the tune of ₹840.8 billion. This marks a significant increase of 39% over last year in terms of number of SHGs credit linked and 19% in terms of volume of credit disbursed. Average credit per SHG at ₹176,645 as on March 2021, however, saw a drop of nearly 15%. Under NRLM too, southern states dominate in credit linkage. In 2020–2021, the share of southern region, however, remains more or less same as last year at 50% in terms of number of SHGs and 70% in terms of volume of credit. 11 priority states[6] which account for nearly 84% of the deprived households in the country have seen high credit offtake accounting for 36% in terms of number of SHGs and 28% in terms of volume of credit. The loan outstanding with SHGs increased to ₹1,180 billion with a growth of 26% over previous year. NRLM has been able to maintain the NPA at the national level within manageable limits. As on

Table 6.5. Progress of SHG–Bank Linkage under DAY-NRLM in Last 3 Years

No. of SHGs in Millions; Amount in ₹Billion

	2018–2019	2019–2020	2020–2021
No. of SHGs credit linked	3.14	3.42	4.75
Y-O-Y % Growth	14%	9%	39%
% of SHGs getting credit linked	57%	56%	74%
Credit disbursed during the year	614.54	708.76	840.81
Y-O-Y % Growth	39%	15%	19%
Average disbursement per SHG	195,457	207,179	176,645
No. of SHGs having loan outstanding	4.43	5.23	6.54
Loan outstanding as at end of FY	785.18	937.79	1,180.54
Y-O-Y % growth	26%	19%	26%
Average loan outstanding per SHG	177,270	179,448	180,473
Gross amount of NPA	16.48	21.76	26.81
NPA as % of loan outstanding	2.10%	2.32%	2.27%

Source: DAY-NRLM.[5]

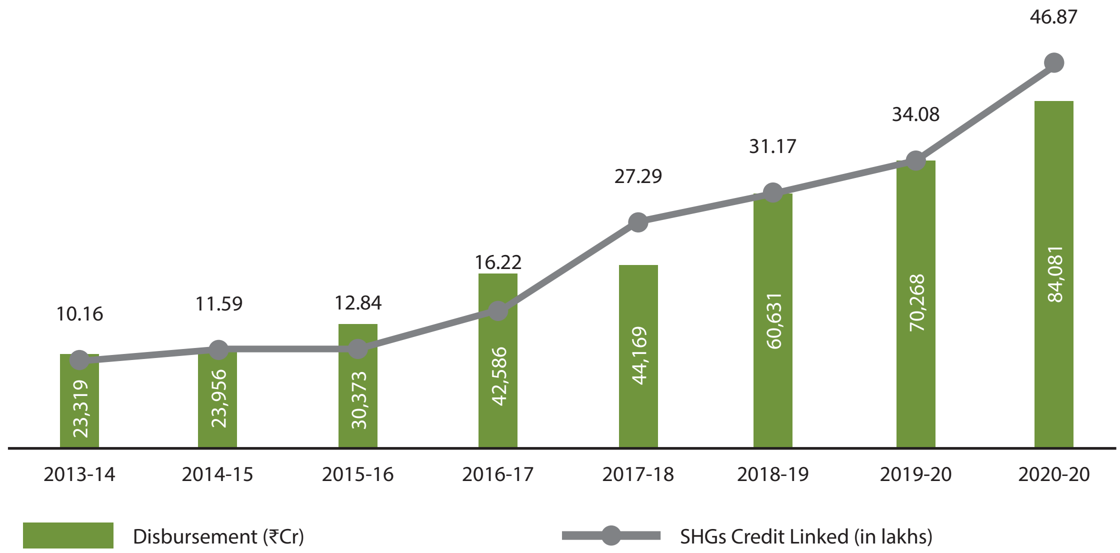


Figure 6.17. SHG–Bank Linkage under NRLM over Years

March 2021, the gross NPA on loan to SHGs stands at ₹26.8 billion which is about 2.27% of the total loan outstanding.

As depicted in Figure 6.17, there has been a steady increase in credit disbursement to SHGs under NRLM mobilizing cumulative loans worth ₹3.98 trillion. Among the states, the performance of West Bengal and Bihar in last few years stands out. While the southern states had the advantage of a strong SHG programme as legacy, both states have been able to consolidate and make rapid progress in credit linkage with 91% and 74%, respectively, of the SHGs credit linked in respective states. Concerns still remain for states such as Uttar Pradesh, Madhya

WHAT WEST BENGAL AND BIHAR DID RIGHT?

When it comes to SHG–Bank Linkage, traditionally southern states have always outperformed. However, in last 7–8 years, 2 states, West Bengal and Bihar, broke away from the league to establish a new hotspot for SHG–Bank Linkage in the eastern part of the country. West Bengal, with annual credit disbursement of just ₹6.26 billion in 2013–2014, witnessed annual credit disbursement of ₹107.93 billion in 2020–2021, a growth of over 16 times. Similarly, in Bihar, annual credit disbursement which was just ₹1.46 billion in 2013–2014 grew to ₹34.79 billion in 2020–2021, a growth of nearly 23 times in 8 years. The question is what have these two states done right? A careful examination of the developments in these two states reveal certain similarity in approaches: (a) large-scale deployment of Bank Sakhi. Most rural bank branches are suffering from acute shortage of staff which restricts branch officials to timely process, sanction and monitor retail loans to a large number of SHGs. The support offered by the mission in form of Bank Sakhi provided the much-required respite to banks, who used them to establish, monitor and nurture a relationship with women SHGs. The close monitoring support by banks through Bank Sakhis also ensured that the NPA levels in SHGs are within acceptable limits. As on March 2021, NPA on SHG loans in West Bengal and Bihar is 2.02% and 1.92%, respectively. This in turn encouraged banks to lend further to SHGs; (b) close engagement with banks by SRLMs. Both SRLMs maintained an open and continuous dialogue and engagement with banks at all levels interspersed by involvement of senior officials and even political leadership. This helped build trust among banks about the programme. Issues cropping up were dealt and proactively resolved at the local level resulting in the creation of a conducive environment; (c) in both states, the political leadership never attempted any announcement like loan waivers or large subsidies for SHGs. This ensured that the programme never got disrupted by political interference and matured on its own merit. The experience of West Bengal and Bihar has tested and prescribed the right recipe for accelerating bank for other states to emulate.

Pradesh, the NE region and some of the Himalayan states where SHG credit linkage, though happening, has not been able to pick up pace over the years. Although NPA figures at the national level seem to be within manageable limits, there are several states with smaller portfolio, where the NPA is exceeding double digit rates.

6.4.2.3. Credit Sanction Pattern and Utilization of Credit

In loans sanctioned by banks to SHGS, in terms of number of accounts, 79% are in form of cash credit limit (CCL), while 21% are in from of term loans (TL). In terms of amount, 85% of loan amount to SHGs are in form of CCL and just 11% in form of TL. During 2020–2021, more than 63% of the loans are sanctioned to SHGs during the third and fourth quarters, with the fourth quarter alone accounting for more than 33% of the total loans. A similar credit sanction pattern is also seen during the previous years.

Although the SHG programme is often evaluated on volume of credit leveraged, prudent utilization of credit by members of SHGs is an equally important factor in path to realize the vision on dignified livelihoods for all. There is a dearth of data on the usage pattern of credit by SHG members, though a few studies do reflect upon this. As depicted in Figure 6.18, an internal assessment of 10.27 million loan transactions done in SHGs indicate that 57% of the credit is being used for livelihoods. About 55% is being used in agriculture and allied sectors. Just 2% of the credit is being invested in non-farm enterprises including the service sector. The impact evaluation study of DAY-NRLM by International Initiative for Impact Evaluation (3ie) done with 27,000 respondents across 5,000 SHGs in 9 states[7] indicates that about 44% of the credit is utilized for productive[8] purposes. Further analysis on credit usage pattern across SHGs groups based on the capital available indicates that SHGs having higher capital tend to invest higher proportion of the credit towards productive purposes. As depicted in Figure 6.19, SHGs having capital over ₹0.2 million have reported utilizing over 56% of credit towards investment in economic ventures compared to just 26% in SHGs with less than ₹50,000 capital.

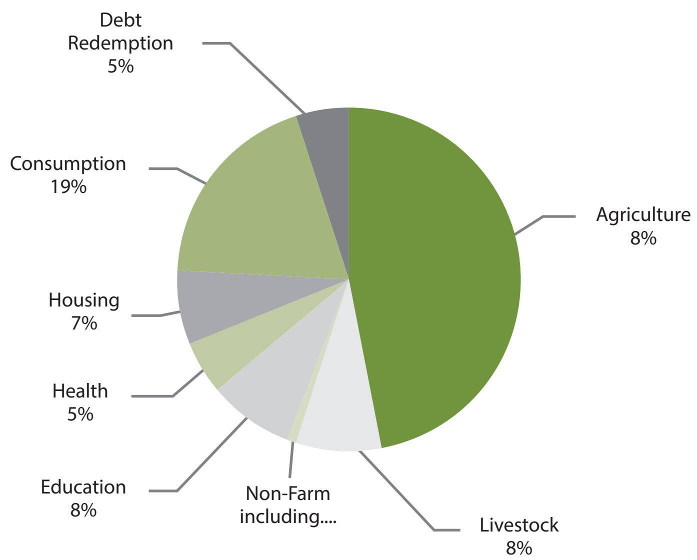


Figure 6.18.Credit Utilization Pattern of SHGs under NRLM

Source: DAY-NRLM.

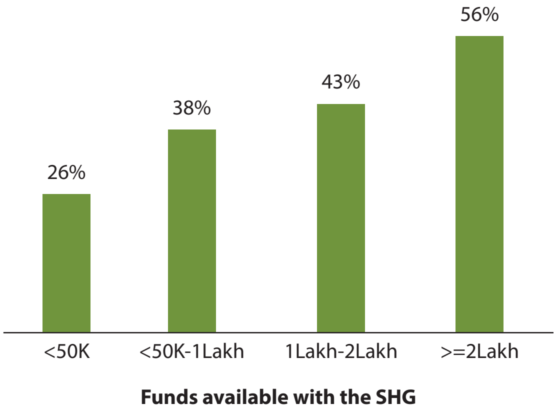


Figure 6.19.Credit Utilization Pattern of SHGs with Varied Capital Availability

6.4.2.4. Interest Subvention to Women SHGs

In order to make bank credit affordable for women borrowers, NRLM provides interest subvention on loans to women SHGs, for up to ₹300,000 per SHG. In 250 identified category I districts, banks lend to women SHGs at 7% interest per annum; SHGs repaying promptly also get additional interest subvention of 3%, reducing the effective rate of interest to 4%; in remaining category II districts, SHGs borrow from banks at a regular rate; SHGs repaying promptly are provided subvention to the extent of difference between lending rate and 7% subject to maximum 5.5%. The first part of the scheme is implemented directly by the Ministry and is centrally funded. The second part of the scheme is implemented by respective state missions and has state share in funding the scheme. In 250 category I districts, ₹58.08 billion has been provided as interest subvention compared to just ₹5.38 billion in category II districts. 8 states (Andhra Pradesh, Telangana, Tamil Nadu, Karnataka, Kerala, West Bengal, Bihar and Odisha) absorb almost 96% of the subvention provided. Subvention benefit provided to an SHG against bank loans borrowed accrues at the group level. No system has been institutionalized to pass on this benefit to individual members.

6.4.2.5. Other Financial Inclusion Efforts under NRLM

Financial inclusion is not mere access to credit. Other inputs and services such as financial literacy, coverage of SHG members under insurance and social security products and adoption of digital transactions play a critical role in addressing financial exclusion.

6.4.2.5.1. Financial Literacy

NRLM has created a pool of over 28,000 field-level cadres called financial literacy CRPs (FL-CRPs) regularly supported by nearly 1,500 master trainers. These cadres provide ongoing financial literacy inputs to SHG members at village-level camps covering key topics such as importance of savings, responsible borrowing, insurance and risk mitigation, digital transaction and household financial planning. As per information available with DAY-NRLM, over 8.7 million SHG members were provided such inputs during 2020–2021. Efforts are being made by NRLM to integrate these efforts at the local level and coordinate with financial literacy centres managed by various banks.

6.4.2.5.2. Insurance and Social Security

NRLM has initiated efforts to ensure universal coverage of SHG members and their family with basic minimum risk coverage through schemes such as Pradhan Mantri Jeevan Jyoti Bima Yojana and Pradhan Mantri Suraksha Bima Yojana (PMSBY). A total of 21.8 million SHG members have been provided life insurance coverage, while 26.1 million SHG members have been insured against any potential occupational risks. Old-age poverty being a major concern, NRLM has been educating SHG members aged 40 or below to subscribe for pension schemes such as Atal Pension Yojana and Pradhan Mantri Shram Yogi Maandhan. A total of 2 million SHG members have opted for subscription in these schemes. Under PMSBY, of the 10,012 claims registered, 6,871 claims have been settled, while under PMSBY of the 2,537 claims reported, 1,669 claims have been settled.

6.4.2.5.3. BC Sakhis—The Last-mile Delivery Agents

BC Sakhis under NRLM has been instrumental in facilitating faster adoption of digital transaction among women SHG members. This model finds greater acceptance among women who are still not very conversant with self-service financial apps. For further augmenting the pool of BC Sakhis, during the year 2020–2021, NRLM embarked on a focused initiative to train and certify 50,000 women SHG members as BCs. A total of 54,391 SHG members were trained at various rural self-employment training institutes and cleared certification process by the Indian Institute of Banking and Finance. They are now being deployed as full-fledged BCs with banks and as pay points through common services centre e-governance. A total of 31,932 such BC Sakhis have been deployed providing critical banking services in difficult-to-reach areas across various states. During 2020–2021, the BC Sakhis have

Figure 6.20.. Digital Transactions Performed by BC Sakhi

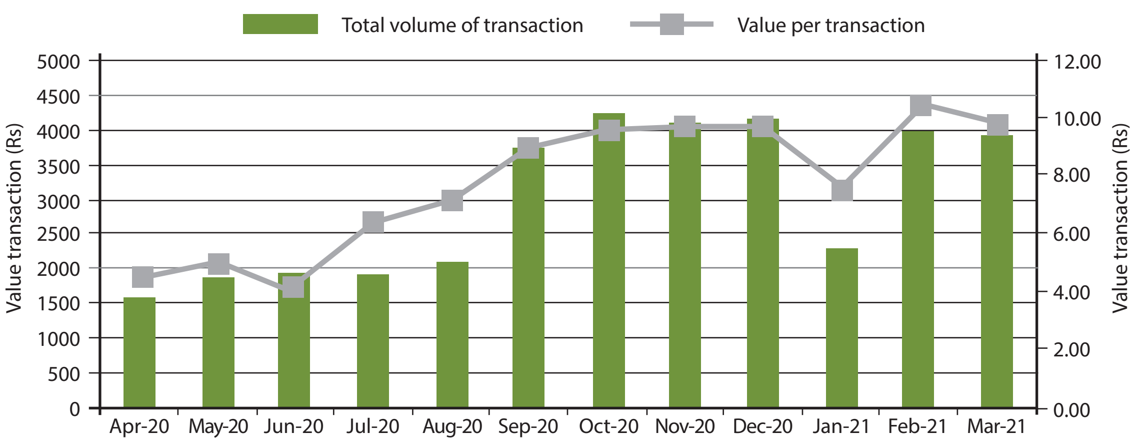


Figure 6.20. Digital Transactions Performed by BC Sakhi

Source: DAY-NRLM.

cumulatively performed 26.39 million transactions valued at ₹85.97 billion. National average per transaction is ₹3,257. The monthly transactions by BC Sakhi during the year is presented in Figure 6.20. In spite of high potential of the BC Sakhi model in expanding banking services, particularly targeting women, challenges such as reluctance of banks in deploying them as BCs still remain. Issues such as connectivity black spots in several areas, cash management for the BC Sakhis, particularly serving in the tribal pockets and difficult geographies like the NE region affect performance.

6.4.3. Promoting Enterprises among SHG Members

NRLM has launched the Start-up Village Entrepreneurship Programme to assist SHG members set up small enterprises in the non-farm sector. A total of 164,805 enterprises in the non-farm space has been set up with a total investment of ₹3.53 billion and are provided handholding and critical business development support through trained community resource persons-enterprise promotion (CRP-EP). Enterprises with annual turnover of ₹0.3–0.8 million are being supported through dedicated centres called 'one-stop facility centres', while incubators like the Indian Institute of Management Calcutta Innovation Park have been roped in to guide higher order enterprises with annual turnover exceeding ₹1.2 million. In convergence with the Ministry of Food Processing Industries, NRLM has established 22,617 enterprises in the food processing sector. Initiative to further develop about 100 artisan clusters investing in different segments of the value chain has been taken up. Intervening in the farm sector, NRLM has promoted over 0.105 million informal producer groups (PGs) at village level and 180 large-sized women-owned producer enterprises at block/district level involving 0.75 million and 0.343 million, respectively. These collectives are engaged in aggregation and marketing of agri-produce to realize higher price. 13 large-scale value chain development projects covering 0.254 million women members across 27 districts in 6 states with an investment of ₹2.62 billion has been taken up. Specialized agencies such as NDDB Dairy Services and Foundation for Development of Rural Value Chains are providing technical advice to these projects. NRLM is also promoting 1,646 organic clusters in partnerships with FAO and other ministries.

Table 6.6. **Progress of SHG–Bank Linkage in Urban Areas**

Particulars	2018–2019	2019–2020	2020–2021
Total no. of SHGs ('000)	4.39	4.69	5.29
Saving deposit of SHGs with banks (₹billion)	16.14	15.23	19.54
No. of SHGs credit linked	1.299	1.59	1.13
Loans disbursed during the year (₹billion)	34.19	34.06	21.12
Loan outstanding (₹billion)	41.1	54.66	40.56
NPA on loan SHGs (%)	5.04	4.42	5.75

Source: NABARD.

6.5. SHG–BANK LINKAGE IN URBAN INDIA

The SHG programme in the country largely assumed a rural face. However, since 2013, the National Urban Livelihoods Mission (NULM) under the Ministry of Housing and Urban Affairs has been spearheading the SHG programme in urban areas. Addressing more complex matrix of issues in urban poverty, NULM has adopted a three-pronged strategy: (a) mobilizing poor into SHGs, (b) providing technical and credit support to enable setting up of viable economic enterprises and (c) skill building of urban poor in market-oriented trades to enhance potential for job placements.

During the year, 67,669 new SHGs have been promoted under the mission. About 113,000 SHGs were extended credit worth ₹21.12 billion by banks. An analysis of the trend indicates that the pace of credit linkage has declined by nearly 38% during the year (Table 6.6). Loan outstanding to SHGs also reduced by 26%, while NPA percentage increased to 5.75%. While deliberating on the issues of SHG–Bank Linkage in urban area, mission director, NULM, pointed out that the absence of an apex institution like NABARD which can involve and drive banks in urban areas is a critical missing link.

The mission is also implementing the PM SVANidhi scheme announced as a relief measure to address the credit requirement of street vendors adversely impacted by the COVID-19 pandemic. The scheme provides for interest subvention of 7% per annum on prompt repayment of loan and also pays incentives to vendors adopting digital payments. Street vendors repaying on time are also provided with a higher dose of ₹20,000 in the second cycle and up to ₹50,000 in the third cycle. During the year, of the 3.43 million[9] applications submitted under the scheme, 1.78 million applications were sanctioned. An amount of ₹12.94 billion as credit has been disbursed. The scheme plans to cover about 5 million street vendors by March 2022.

In the face of rapid urbanization in various pockets of the country, concerns about growing urban poverty and its implication are real. There are arguments made if urban poverty conceptually differs from poverty in general. The multitude of factors and issues affecting urban poverty actually stretches across domains of various departments and agencies. But nonetheless, it is an important area where a more concerted action is desired. The best case in point is probably the migrant crisis that emerged immediately after the lockdowns were announced. Even today, a large programme like NULM does not cater to migrants. The question is how prepared are we to handle a similar situation again?

6.6. EMERGING TRENDS, CHALLENGES AND PROGNOSIS

The SHG movement completing a journey of three decades has touched the lives of over 100 million people, primarily women. Conceived to end the perils of perpetual dependence on moneylenders, build financial resilience, limit fragility of households and restore sustainable and inclusive growth by creating more livelihood opportunities, symbolizing an enduring relationship between the deprived and the formal financial system, often promulgated as being the silver bullet to address poverty. Community action and financial intermediation intertwined into a single framework earned this model a unique position in development practice over last three decades. Scanning through its chequered history, the SHG movement or specifically the SHG–Bank Linkage Programme has gone through visibly three phases—'demonstration phase' from the late 1980s to the mid-1990s when the model emerged through various experimentation and pilots getting formalized through structured guidelines from regulators; 'growth phase' which was the period from the mid-1990s to mid-2000s when the programme found acceptance in several bilateral and multilateral agency-funded poverty elimination projects. This phase also saw the early instance of state patronage, led by states such as Tamil Nadu and Andhra Pradesh. The 'acceleration phase' which was introduced with the adoption of the model in state-sponsored large-scale poverty elimination programme like SGSY, which saw a rapid increase in the number of SHGs across the country, further exacerbated with its adoption under DAY-NRLM.

Three decades is a fairly long time in the history of a nation which itself is just seven decades old. Women who may have joined the SHG movement in its early years by now possibly have made way for next generation as members. As we analyse the progress and performance of the SHG–Bank Linkage Programme through last year, it is about time that we ask ourselves a set of more fundamental questions. What have we really achieved? Is the programme now sustainable and viable enough to carry on its own? Are we on track to realize the vision of securing quality life for those who participated in the programme?

The growth pattern of SHG–Bank Linkage Programme in the last few years, including the previous year, indicates that the programme has steadily grown in terms of size, outreach and volume of credit mobilized. The portfolio quality also reflects improvement with declining trends in the NPA. But if one looks at the nature of issues still concerning the sector, it seems they are almost similar to the ones a decade back: (a) bankers are still not responsive enough to the requirements of the communities, (b) bank branches still hesitate to extend higher dose of loans to SHGs or extend loans primarily to comply with priority sector requirements, (c) impounding of savings and low financing to SHGs and (d) low credit demand or low credit absorption ability of SHGs. Over the years, promoters seem to address these issues locally and on one-on-one basis without much improvement at a systemic level.

Although the programme has immensely contributed towards the empowerment of women, at present, it is faced with contradictory trends. While the programme has achieved legitimacy as an alternate banking model, assumed impressive scale, growing at a steady pace and well recognized by all stakeholders for its role in improving access to finance particularly for the low-income underserved segments, its relevance in addressing poverty at a fast pace is dwindling. This is also reflected in the regional skewedness of SHG–Bank Linkage. From the perspective of channelizing credit for augmenting livelihood opportunities, it appears to be stuck in a trajectory of low value credit without any significant breakthrough in mobilizing adequate financial support for enterprises which is critical to enable SHG members to climb up the poverty ladder. The graduation path of a woman from just being an SHG member to emerging as an entrepreneur through the SHG–Bank Linkage Programme is also unclear. In an effort to streamline support function and ensure the sustainability of a large number of PLFs and SLFs also has been promoted. Coupled with these are purpose-specific institutions such as joint liability groups (JLGs), PGs and farmer producer organizations, all with overlapping membership. This has created debris of community institutions many a times without much clarity in functions or roles. For communities navigating through this quagmire of institutions, transaction costs have increased substantially. The question is has it really added value?

On top of this, in pursuit of convergence, SHGs and their higher institutions are being co-opted to channelize or implement government-sponsored schemes. There are several instances across the country where SHGs have been given the responsibility to run fair priced shops or supply take home ration (THR) to Anganwadis. SHGs have also been guided to invest their corpus or loans taken from banks to construct toilets and make up for the delay in release for government funds for such schemes. All these have been eulogized as best practices on several forums and media. But have the SHGs really gained from running fair priced shops or supplying THR or similar enterprises which probably is more of a promoter's enthusiasm than a genuine demand from members. Are departments shedding their responsibility for delivering schemes by making SHGs (beneficiaries) directly responsible for their implementation?

The SHG programme is still low on its digital footprint. When other sectors have embraced digital transactions in a big way, the SHG programme has lagged behind in integrating digital financial technologies. The processes have largely remained manual and tardy. As a result, credit assessment for SHGs is still a matter of trust for banks rather than being data backed. Reporting member-level information to credit bureau is still caught between regulatory compliance and operational complications. There are also concerns on long-term funding for the programme and its sustainability.

As the programme moves to the next decade, some of these issues need to be settled conclusively with the larger vision of ensuring dignified livelihood and ease of living for all. And this has to be done within the tenure of current members in SHGs. The programme would be said to not have served the purpose if the next generation is also required to be mobilized into similar institutions.

6.7. SHG–BANK LINKAGE: A DISCUSSION ON THE FUTURE AGENDA

Looking ahead, in order to move the programme to the next phase of growth which may be termed as the 'graduation phase', there is an urgent need for a clear road map. As a future agenda, the following key areas of action emerge.

6.7.1. Graduation of SHG Members

For a programme three decades old, it is not a matter of pride that many potential members within SHGs have still not been able to emerge as entrepreneurs and continue to perform at a suboptimal level. Although it may vary with regions and location, it is estimated that about 20% of the SHG members have the potential to grow fast and emerge as true entrepreneurs.

Although there have been attempts to secure enterprise loans through SHGs, it is fraught with many challenges. In most regions, average size of loans is still small, just enough to meet the immediate and emergency needs of SHG members. The very structure of SHG is designed to offer simple credit products to their members for meeting their small credit requirements for a short duration. Further, as a principle, risk of loan to a SHG is borne equally by all members. All members do not like to stand guarantee to large loans given only to a few. Enterprises, particularly those in the growth spiral, need credit products, which are large in size, for longer duration and customized to their requirements, making them much more complex. Appraisal of such loans, customizing such products and maintaining prudent accounting requires higher capacity and technology backstopping which is currently not available with SHGs.

Many of these potential members are 'first-to-credit' customers for the formal banking system having no recorded credit history. They cannot offer meaningful collaterals and their enterprises are largely informal with very little financial information making them to be perceived as high-risk borrowers. Due to this, banks are often reluctant to extend them individual loans. In the absence of predictable credit for enterprise, members resort to borrowing from multiple sources at times at higher costs making their venture unviable. NABARD has toyed with the idea of promoting JLGs of enterprising members within an SHG seeking higher larger loans for these members. However, JLGs could manage average incremental loan of about ₹167,300,[10] still insufficient to funds potential entrepreneurs.

Going forward, there is a need to explore alternate models for financing of enterprises. A possible option may be facilitating individual enterprise credit from formal financial institutions while credit for emergency and immediate loans are sourced by the member from respective SHGs.

6.7.2. Harmonization of Community Institutional Structure to Accelerate Graduation of Members

Although credit is an essential element to enable graduation of SHG members, other services such as business development inputs, aggregation for procurement and marketing, inputs related to technology, designing and branding are indispensable. Currently, there is a matrix of institutions—SHGs, primary federation at village or gram panchayat level, secondary federations at cluster or block level, JLGs, PGs at village levels, farmer producer companies (FPCs), etc. It creates multiple challenges in the form of overlapping role, leadership crisis and also viability issues. In order to ensure uninterrupted access to such services, it is vital to consolidate structure and align the community institutions with the purpose. For example, the primary federations of SHGs can dual the role of PGs engaged in aggregation and marketing of produce. Secondary-tier federations can easily take up the roles of FPCs with appropriate legal framework. Only when it is absolutely essential, separate institutional structure may be conceived. Such reorganization will safeguard members' interest and enhance efficiency in operations.

6.7.3. Redefine Ways of Engaging with Banks

Banks traditionally are oriented towards individual lending based on proven cash flow and backed with tangible collateral. However, under the SHG–Bank Linkage Programme, banks have adapted processes to ride on the embedded knowledge within an SHG about its members which acted as collateral for banks to lend. However, overtime, as the needs and aspiration of the members have grown, banks are no longer able to solely base their credit decision exclusively on information which is internal to the group. This has restricted higher lending to SHGs. There is a need for coordinated efforts towards digitizing transaction records of SHGs. At present, there is little convergence in efforts between NABARD's implementation of eShakti and NRLM developing SHG transaction system. Reporting transaction of SHGs to credit bureau is another area which requires systematic implementation. In interest of the sector, the RBI should make appropriate modification in the CIC Act to allow the promoters of SHGs report member-level transactions information to credit bureau. This will enrich the entire credit decision-making process for financial institutions.

The current practice of SHGs aggregating the loan demand of individual members while seeking loans from banks also needs further improvisation. The RBI in its master circular for NRLM has already specified that at least 50% of loans above ₹0.2 million, 75% of loans above ₹0.4 million and at least 85% of loans above ₹0.6 million be used primarily for income-generating productive purposes. Although the details of the member-wise requirement are captured in the micro-credit plans submitted, many banks do not have any provision in their core banking solution to record the same. Taking cues from practices adopted by few private sector banks, the RBI should mandate banks to record the member-wise demand submitted by SHGs. This can be further supplemented by directly transferring the loan amount to individual members of SHG as has been done by few banks in Telangana.

There is also negligible innovation in credit products offered by banks to SHGs. There is an urgent need to offer credit product customized to the need of individual members subject to the overall ceiling for an SHG. This will guide higher investment towards setting up enterprises.

6.7.4 Ensuring Sustainability of Institutions and the Programme

The SHG programme has reached stupendous scale and now the programme is faced with complications of managing scale. Processes such as weekly meeting, compulsory attendance and savings which have been the core of the programme often get ignored as a trade-off to higher numbers and outreach. The fact that nearly 30% of the savings account of SHGs being defunct tells the story. The analysis of NPAs among SHGs across several states indicate higher incidence of NPA among mature SHGs. Several SRLMs are now constrained with inadequate staff to manage the programme at such scale. To maintain the quality of the programme, SRLMs should forge partnerships with credible civil society organizations and resource agencies to maintain the desired intensity of support to the SHGs.

Federations of SHGs can emerge as the fulcrum for achieving sustainability in the programme. NRLM provides substantial capital support in form of CIF to federations to attain sustainability. However, this can only be achieved when federations operate along prudent business plans and generate enough revenue. This requires continuous capacity building. In an internal assessment of federations done by NRLM, it was found that large amount of CIF still remained unutilized affecting the operational viability of federations. The processes adopted for sanction of loans by federations are also layered and dawdling. Leadership is another issue which needs meticulous nurturing. The programme invests heavily on the initial set of leaders, but systematic investment on creating a second line of leaders is missing. In all these, credible CSO can play an active role and supplement the functions of SRLMs in further strengthening the federated structure.

One of the key assumptions for achieving sustainability in the SHG programme has been the financial intermediation role performed by SHG federations. Although federations of SHGs have taken up financial intermediation with their own corpus and funds made available under NRLM, regulatory acceptance of this financial intermediation role for federations is yet to come by. The RBI has been rather reluctant in permitting banks to lend to federations. Although concerns of the regulator in allowing lending activities by unregulated entities and the inherent systemic risks therein are not unfounded, the RBI needs to come out with plausible alternatives rather than complete denial of opportunity.

6.8 CONCLUSION

SHGs are not merely channels for credit and financial service delivery but also a vital social infrastructure which can play a constructive role in the entire development process. The SHG programme over last three decades has gone through several peaks and troughs. It is the strength and resilience the members involved in the programme, which have seen them through. Although gains of the programme are immense in terms of empowerment of women and ensuring access to basic financial services, it is also important to now take one big leap forward and graduate to the next orbit. Why is this graduation process paramount for this programme? SHGs are probably the only institution of the poor, managed by the poor and working for the poor. It has become a powerful enabler to bring equity in many spheres, enhance quality of life and also strengthen grassroots democracy.

Appendix 6.1. Savings of SHGs with Banks—Region-wise/State-wise/Agency-wise (as of 31 March 2021)

(Amount in ₹Million)

Name of Region	Name of the State	Commercial Banks		RRBs		Cooperative Banks		Total	
		No. of SHGs	Savings	No. of SHGs	Savings	No. of SHGs	Savings	No. of SHGs	Savings
Central Region	Chhattisgarh	133,136	2,485.403	251,424	2,451.155	18,916	219.922	403,476	5,156.48
	Madhya Pradesh	203,837	4,361.16	195,147	3,532.265	8,168	89.041	407,152	7,982.466
	Uttarakhand	26,248	482.376	27,746	562.779	11,665	253.134	65,659	1,298.289
	Uttar Pradesh	222,807	4,902.081	238,085	1,722.349	8,396	125.312	469,288	6,749.742
		5,86,028	**12,231.02**	**712,402**	**8,268.548**	**47,145**	**687.409**	**1,345,575**	**21,186.977**
Eastern Region	Andaman & Nicobar	1,124	23.513			5,815	137.622	6,939	161.135
	Bihar	4,31,434	10,337.515	486,682	4,640.987	35	0.343	918,151	14,978.845
	Jharkhand	174,457	3,358.724	105,463	485.7	2,261	13.288	282,181	3,857.712
	Odisha	438,306	11,771.027	277,090	5,732.487	94,043	1,114.166	809,439	18,617.68
	West Bengal	600,569	16,826.2	303,819	15,618.189	201,326	7,431.475	1,105,714	39,875.864
		1,645,890	**42,316.979**	**1,173,054**	**26,477.363**	**303,480**	**8,696.894**	**3,122,424**	**77,491.236**
NE Region	Arunachal Pradesh	3,290	48.601	3,507	67.971			6,797	116.572
	Assam	172,102	2,337.211	296,269	3,025.32	26,499	28.735	494,870	5,391.266

	Manipur	8,473	65.638	2,729	12.409	1,829	7.288	13,031	85.335
	Meghalaya	5,052	78.65	27,980	480.811	6,921	160.936	39,953	720.397
	Mizoram	1,073	35.294	11,999	187.857	1,020	14.241	14,092	237.392
	Nagaland	6,733	101.294					6,733	101.294
	Sikkim	4,949	195.646			1,567	44.67	6,516	240.316
	Tripura	10,687	290.224	38,164	671.634	2,871	458.173	51,722	1,420.031
		212,359	**3,152.558**	**380,648**	**4,446.002**	**40,707**	**714.043**	**633,714**	**8,312.603**
Northern Region	Chandigarh	398	6.58			50	0.559	448	7.139
	Haryana	39,891	558.411	25,381	317.372	4,622	67.161	69,894	942.944
	Himachal Pradesh	21,268	313.362	11,960	221.624	27,065	305.913	60,293	840.899
	Jammu and Kashmir	2,204	19.92	3,969	65.164	929	3.646	7,102	88.73
	New Delhi	3,305	163.232			255	8.088	3,560	171.32
	Punjab	30,737	10,956.309	15,283	103.381	7,962	68.953	53,982	11,128.643
	Rajasthan	178,734	2,145.329	155,839	1,658.591	79,956	450.885	414,529	4,254.805
		276,537	**14,163.143**	**212,432**	**2,366.132**	**120,839**	**905.205**	**609,808**	**17,434.48**
Southern Region	Andhra Pradesh	801,848	75,940.302	236,758	18,775.565	19,447	14,614.628	1,058,053	109,330.495
	Karnataka	309,873	11,124.354	209,927	1,674.605	265,015	5,250.359	784,815	18,049.318
	Kerala	328,570	15,495.714	65,025	1,635.146	65,767	1,034.225	459,362	18,165.085
	Lakshadweep	674	10.261					674	10.261
	Puducherry	19,336	1,140.777	6,328	121.466	1,015	34.008	26,679	1,296.251
	Tamil Nadu	622,866	19,013.755	96,594	845.166	183,642	2,992.626	903,102	22,851.547
	Telangana	394,891	15,366.741	323,189	27,518.598	10,938	360.223	729,018	43,245.562
		2,478,058	**138,091.9**	**937,821**	**50,570.546**	**545,824**	**24,286.069**	**3,961,703**	**212,948.519**
Western Region	Daman and Diu	144	4.52					144	4.52
	Dadra and Nagar Haveli	1,250	36.797					1,250	36.797
	Goa	5,558	290.499			3,874	115.296	9,432	405.795
	Gujarat	223,187	2,725.291	63,419	864.052	39,651	411.02	326,257	4,000.363
	Maharashtra	699,376	12,950.589	116,955	2,124.202	396,762	17,880.056	1,213,093	32,954.847
		929,515	**16,007.696**	**180,374**	**2,988.254**	**440,287**	**18,406.372**	**1,550,176**	**37,402.322**
Grand Total		**6,128,387**	**22,5963.3**	**3,596,731**	**95,116.845**	**1,498,282**	**53,695.992**	**11,223,400**	**374,776.137**

Source: NABARD (2021).

Appendix 6.2. Loan Disbursed to SHGs—Region-wise/State-wise/Agency-wise (as of 31 March 2021)

(Amount in ₹Million)

Name of Region	Name of the State	Commercial Banks		RRBs		Cooperative Banks		Total	
		No. of SHGs	Loan Amount Disbursed	No. of SHGs	Loan Amount Disbursed	No. of SHGs	Loan Amount Disbursed	No. of SHGs	Loan Amount Disbursed
Central Region	Chhattisgarh	39,279	3,517.946	4,469	579.391	2,735	251.288	46,483	4,348.625
	Madhya Pradesh	31,300	2,981.597	40,344	2,750.679	38	1.24	71,682	5,733.516
	Uttarakhand	19,360	971.403	3,407	254.7	2,438	268.023	25,205	1,494.126
	Uttar Pradesh	4,216	271.362	17,019	1,422.138	4	0.42	21,239	1,693.92
	Total	**94,155**	**7,742.308**	**65,239**	**5,006.908**	**5,215**	**520.971**	**164,609**	**13,270.187**
Eastern Region	Andaman & Nicobar	90	22.969			132	30.041	222	53.01
	Bihar	256,261	21,970.483	167,439	31,389.4	0	0.00	423,700	53,359.883
	Jharkhand	69,782	5,187.665	33,156	3,229.636	379	39.895	103,317	8,457.196
	Odisha	171,277	19,324.482	84,565	11,528.732	14,375	2,280.723	270,217	33,133.937
	West Bengal	608,626	57,583.382	300,113	44,156.769	57,683	8,636.768	966,422	110,376.919
	Total:	1,106,036	104,088.981	585,273	90,304.537	72,569	10,987.427	1,763,878	205,380.945
NE Region	Arunachal Pradesh	198	18.454	144	15.472			342	33.926
	Assam	41,924	3,596.231	26,761	4,945.647			68,685	8,541.878
	Manipur	301	31.333	332	51.433	144	20.04	777	102.806
	Meghalaya	241	26.68	2,520	482.733	324	22.48	3,085	531.893
	Mizoram	122	21.483	1,969	327.671	140	16.87	2,231	366.024
	Nagaland	383	46.094					383	46.094
	Sikkim	955	148.597			22	3.48	977	152.077
	Tripura	2,201	162.478	5,238	765.983	1,107	148.095	8,546	1,076.556
	Total:	**46,325**	**4,051.35**	**36,964**	**6,588.939**	**1,737**	**210.965**	**85,026**	**10,851.254**
Northern Region	Chandigarh	6	0.481			0	0.00	6	0.481
	Haryana	9,887	940.079	2,828	460.945	159	13.534	12,874	1,414.558
	Himachal Pradesh	2,746	334.483	1,025	180.3	2,339	390.743	6,110	905.526
	Jammu and Kashmir	765	148.398	1,499	298.895	0	0.00	2,264	447.293
	New Delhi	33	2.279			0	0.00	33	2.279
	Punjab	1,990	130.802	991	92.651	105	9.862	3,086	233.315
	Rajasthan	34,985	4,624.923	24,169	2,650.764	832	102.652	59,986	7,378.339
	Total	**50,412**	**6,181.445**	**30,512**	**3,683.555**	**3,435**	**516.791**	**84,359**	**10,381.791**

Southern Region	Andhra Pradesh	719,546	173,408.709	160,418	72,841.954	13,754	5,553.108	893,718	251,803.771
	Karnataka	591,982	124,762.065	23,361	6,234.417	34,111	12,143.099	649,454	143,139.581
	Kerala	168,073	38,546.516	9,093	5,021.76	16,933	3,895.569	194,099	47,463.845
	Lakshadweep	3	0.19					3	0.19
	Puducherry	2,986	603.297	2,006	487.301	27	18.143	5,019	1,108.741
	Tamil Nadu	181,919	45,714.099	17,710	7,443.7	46,156	14,199.595	245,785	67,357.394
	Telangana	270,607	59,616.571	231,543	43,850.32	11,728	4,878.632	513,878	108,345.523
	Total	**1,935,116**	**442,651.447**	**444,131**	**135,879.452**	**122,709**	**40,688.146**	**2,501,956**	**619,219.045**
Western Region	Daman and Diu; Dadra and Nagar Haveli	108	4.299					108	4.299
	Goa	891	223.618			56	25.939	947	249.557
	Gujarat	24,561	1,657.068	3,493	475.814	931	137.883	28,985	2,270.765
	Maharashtra	114,719	18,289.226	19,163	3003.806	38,634	3,150.548	172,516	24,443.580
	Total	**140,279**	**20,174.211**	**22,656**	**3479.620**	**39,621**	**3,314.37**	**202,556**	**26,968.201**
Grand Total		**3,372,323**	**584,889.742**	**1,184,775**	**244943.011**	**245,286**	**56,238.67**	**4,802,384**	**886,071.423**

Source: NABARD; (*) For FY 2020–2021, data pertaining to disbursements by PSBs is sourced from DAY-NRLM; disbursement pertaining to private sector banks, RRBs and cooperative banks sourced from NABARD (2021).

Appendix 6.3. Loan Outstanding with SHGs—Region-wise/State-wise/Agency-wise (as on 31 March 2021)

(Amount in ₹Million)

Name of Region	Name of the State	Commercial Banks		RRBs		Cooperative Banks		Total	
		No. of SHGs	Loans O/S Amount	No. of SHGs	Loans O/S Amount	No. of SHGs	Loans O/S Amount	No. of SHGs	Loans O/S Amount
Central Region	Chhattisgarh	45,047	3,970.071	42,102	3,232.001	2,244	220.098	89,393	7,422.17
	Madhya Pradesh	64,343	4,224.784	57,864	4,058.609	494	29.614	122,701	8,313.007
	Uttarakhand	5,770	360.463	6,908	281.82	5,172	335.965	17,850	978.248
	Uttar Pradesh	43,187	3,298.548	93,468	5,159.324	1,672	56.905	138,327	8,514.777
	Total	**158,347**	**11,853.866**	**200,342**	**12,731.754**	**9,582**	**642.582**	**368,271**	**25,228.202**
Eastern Region	Andaman & Nicobar	232	36.781			824	97.94	1,056	134.721
	Bihar	349,139	38,701.392	437,761	40,372.322	0	0.00	786,900	79,073.714
	Jharkhand	87,116	5,974.816	50,709	4,580.173	677	34.877	138,502	10,589.866
	Odisha	200,856	21,544.176	142,073	17,481.931	36,262	3,231.629	379,191	42,257.736
	West Bengal	512,804	59,910.101	306,481	55,980.519	127,105	11,518.549	946,390	127,409.169
	Total	**1,150,147**	**126,167.266**	**937,024**	**118,414.945**	**164,868**	**14,882.995**	**2,252,039**	**259,465.206**
NE Region	Arunachal Pradesh	279	29.863	279	18.555			558	48.418
	Assam	53,396	4,291.922	73,035	6,794.196			126,431	11,086.118
	Manipur	730	48.142	1,842	149.639	662	49.912	3,234	247.693
	Meghalaya	343	32.696	4,535	388.405	951	43.127	5,829	464.228
	Mizoram	226	30.787	3,320	434.93	207	26.634	3,753	492.351
	Nagaland	916	87.509					916	87.509
	Sikkim	1,077	146.914			50	3.951	1,127	150.865
	Tripura	3,887	235.645	16,295	1,414.018	2,391	218.703	22,573	1,868.366
	Total	**60,854**	**4,903.478**	**99,306**	**9,199.743**	**4,261**	**342.327**	**164,421**	**14,445.548**
Northern Region	Chandigarh	27	1.086			0	0.00	27	1.086
	Haryana	12,381	847.554	6,698	767.392	1,118	53.008	20,197	1,667.954
	Himachal Pradesh	4,193	452.736	4,076	380.6	5,098	617.478	13,367	1,450.814
	Jammu and Kashmir	1,286	185.775	2,689	377.447	98	4.707	4,073	567.929
	New Delhi	169	18.244			1	0.011	170	18.255
	Punjab	3,655	234.365	3,188	177.283	1,169	62.471	8,012	474.119
	Rajasthan	60,421	5,568.098	28,476	2005.48	8,532	549.677	97,429	8,123.255
	Total	**82,132**	**7,307.858**	**45,127**	**3,708.202**	**16,016**	**1,287.352**	**143,275**	**12,303.412**

Southern Region	Andhra Pradesh	485,242	160,396.441	230,477	76,402.833	15,652	5,897.58	731,371	242,696.854
	Karnataka	257,841	69,670.968	99,401	22,825.953	76,055	16,293.901	433,297	108,790.822
	Kerala	227,953	49,204.634	21,290	6,826.103	81,940	6,967.406	331,183	62,998.143
	Lakshadweep	12	1.371					12	1.371
	Puducherry	16,609	3,556.504	2,973	535.995	627	166.028	20,209	4,258.527
	Tamil Nadu	307,077	70,767.372	34,722	8,405.819	100,849	19,864.285	442,648	99,037.476
	Telangana	246,510	69,208.574	313,090	95,553.584	21,005	6,030.815	580,605	170,792.973
	Total	**1,541,244**	**422,805.864**	**701,953**	**210,550.287**	**296,128**	**55,220.015**	**2,539,325**	**688,576.166**
Western Region	Daman and Diu	0	0.00					0	0.00
	Dadra and Nagar Haveli	94	4.553					94	4.553
	Goa	1,628	286.097			270	54.79	1,898	340.887
	Gujarat	31,327	2,386.441	11,672	703.96	1,861	167.704	44,860	3,258.105
	Maharashtra	192,529	22,141.547	37,310	3,923.334	36,222	3,210.123	266,061	29,275.004
	Total	**225,578**	**24,818.638**	**48,982**	**4,627.294**	**38,353**	**3,432.617**	**312,913**	**32,878.549**
Grand Total		**3,218,302**	**597,856.97**	**2,032,734**	**359,232.225**	**529,208**	**75,807.888**	**5,780,244**	**1,032,897.083**

Source: NABARD (2021).

Appendix 6.4. NPA on SHGs—Region-wise/State-wise/Agency-wise (as of 31 March 2021)

(Amount in ₹Million)

Name of Region	Name of the State	Commercial Banks		RRBs		Cooperative Banks		Total	
		Amount of Gross NPAs against SHGs	NPA as % to Loan OS	Amount of Gross NPAs against SHGs	NPA as % to Loan OS	Amount of Gross NPAs against SHGs	NPA as % to Loan OS	Amount of Gross NPAs against SHGs	NPA as % to Loan OS
Central Region	Chhattisgarh	323.353	8.14%	747	2.31%	30.526	13.87%	428.579	5.77%
	Madhya Pradesh	786.717	18.62%	419.936	10.35%	24.021	81.11%	1,230.674	14.80%
	Uttarakhand	77.625	21.53%	26.055	9.25%	67.173	19.99%	170.853	17.47%
	Uttar Pradesh	2,061.743	62.50%	1,306.914	25.33%	56.383	99.08%	3,425.04	40.22%
	Total	**3,249.438**	**27.41%**	**1,827.605**	**14.35%**	**178.103**	**27.72%**	**5,255.146**	**20.83%**
Eastern Region	Andaman & Nicobar	2.19	5.95%		0.00%	7.589	7.75%	9.779	7.26%
	Bihar	1,733.162	4.48%	1,772.513	4.39%	0	0.00%	3,505.675	4.43%
	Jharkhand	338.515	5.67%	246.089	5.37%	8.315	23.84%	592.919	5.60%
	Odisha	1,473.354	6.84%	1,864.023	10.66%	317.523	9.83%	3,654.9	8.65%
	West Bengal	1,813.454	3.03%	1,534.617	2.74%	477.536	4.15%	3,825.607	3.00%
	Total	**5,360.675**	**4.25%**	**5,417.242**	**4.57%**	**810.963**	**5.45%**	**11,588.88**	**4.47%**
NE Region	Arunachal Pradesh	8.142	27.26%	0	0.00%		0.00%	8.142	16.82%
	Assam	749.254	18.83%	1,544.461	22.73%		0.00%	2,293.715	21.29%
	Manipur	11.962	24.85%	36.432	24.35%	2.689	5.39%	51.083	20.62%
	Meghalaya	3.219	9.85%	8.996	2.32%	6.927	16.06%	19.142	4.12%
	Mizoram	2.538	8.24%	34.145	7.85%	0.519	1.95%	37.202	7.56%
	Nagaland	8.741	9.99%		0.00%		0.00%	8.741	9.99%
	Sikkim	1.552	1.06%		0.00%	0.49	12.40%	2.042	1.35%
	Tripura	107.598	45.66%	308.537	21.82%	0.442	0.20%	416.577	22.30%
	Total	**893.006**	**19.46%**	**1,932.571**	**21.01%**	**11.067**	**3.23%**	**2,836.644**	**20.07%**
Northern Region	Chandigarh	0.698	64.27%		0.00%	0	0.00%	0.698	64.27%
	Haryana	161.229	19.02%	353.831	46.11%	39.629	74.76%	554.689	33.26%
	Himachal Pradesh	48.097	10.62%	24.7	6.49%	53.083	8.60%	125.88	8.68%
	Jammu and Kashmir	6.004	3.23%	14.413	3.82%	4.558	96.83%	24.975	4.40%
	New Delhi	7.176	39.33%		0.00%	0	0.00%	7.176	39.31%
	Punjab	97.907	41.78%	18.723	10.56%	32.92	52.70%	149.55	31.54%
	Rajasthan	362.653	6.51%	99.861	4.98%	387.851	70.56%	850.365	10.47%
	Total	**683.764**	**9.36%**	**511.528**	**13.79%**	**518.041**	**40.24%**	**1,713.333**	**13.93%**

Southern Region	Andhra Pradesh	2,670.662	1.67%	420.57	0.55%	81.966	1.39%	3,173.198	1.31%
	Karnataka	2,948.69	4.23%	2,071.31	9.07%	246.783	1.51%	5,266.783	4.84%
	Kerala	1,498.551	3.05%	78.663	1.15%	367.88	5.28%	1,945.094	3.09%
	Lakshadweep	0	0.00%		0.00%		0.00%	0	0.00%
	Puducherry	157.306	4.42%	52.365	9.77%	44.542	26.83%	254.213	5.97%
	Tamil Nadu	7,358.92	10.40%	479.493	5.70%	1,402.179	7.06%	9,240.592	9.33%
	Telangana	3,084.333	4.46%	1,087.104	1.14%	155.096	2.57%	4,326.533	2.53%
	Total	**17,718.46**	**4.19%**	**4,189.505**	**1.99%**	**2,298.446**	**4.16%**	**24,206.41**	**3.52%**
Western Region	Daman and Diu	0	0.00%		0.00%		0.00%	0	0.00%
	Dadra and Nagar Haveli	0.53	11.64%		0.00%		0.00%	0.53	11.64%
	Goa	18.367	6.42%		0.00%	5.664	10.34%	24.031	7.05%
	Gujarat	135.646	5.68%	59.47	8.45%	41.547	24.77%	236.663	7.26%
	Maharashtra	2,278.664	10.29%	408.117	10.40%	343.713	10.71%	3,030.494	10.35%
	Total	**2,433.207**	**9.80%**	**467.587**	**10.10%**	**390.924**	**11.39%**	**3,291.718**	**10.01%**
Grand Total		**30,338.55**	**5.08%**	**14,346.04**	**3.99%**	**4,207.544**	**5.55%**	**48,892.13**	**4.73%**

Source: NABARD (2021).

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2 NABARD, 'Status of Microfinance in India 2020–21'.

3 Bankers Institute of Rural Development (BIRD), 'Study on Non-performing Assets (NPAs) in Self Help Groups' (Mangalore: BIRD, 2018).

4 Source: DAY-NRLM MIS.

5 https://daynrlmbl.aajeevika.gov.in/5

6 Uttar Pradesh, Bihar, Madhya Pradesh, West Bengal, Odisha, Chhattisgarh, Maharashtra, Jharkhand, Rajasthan, Assam and Gujarat6

7 Bihar, Chhattisgarh, Jharkhand, Madhya Pradesh, Maharashtra, Odisha, Rajasthan, Uttar Pradesh and West Bengal

8 Investment in economic ventures for acquiring assets or working capital

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Digital Financial Services: Exponential Growth, But Many Still Out of its Ambit

Akshat Pathak
Graham A. N. Wright*

7

7.1 CURRENT INFRASTRUCTURE

Over the past decade, concerted efforts from India's public and private sectors have driven innovation for various digital financial services (DFS), transformed the delivery of these services and created a user-centric experience. Several factors have enhanced the country's digital ecosystem — including improvements in payments infrastructure, disruptions in information and communications technology, a responsive regulatory framework, a conducive policy environment and a greater focus on customer-centricity. This transformation also stems from increased adoption of smartphones, greater access to the internet, growing comfort with using technology and improved financial capabilities of users.

Initiatives, such as the Pradhan Mantri Jan Dhan Yojana (PMJDY) and the direct benefit transfer (DBT) mission, have created a base for universal access to accounts and their subsequent usage, in the process furthering financial inclusion

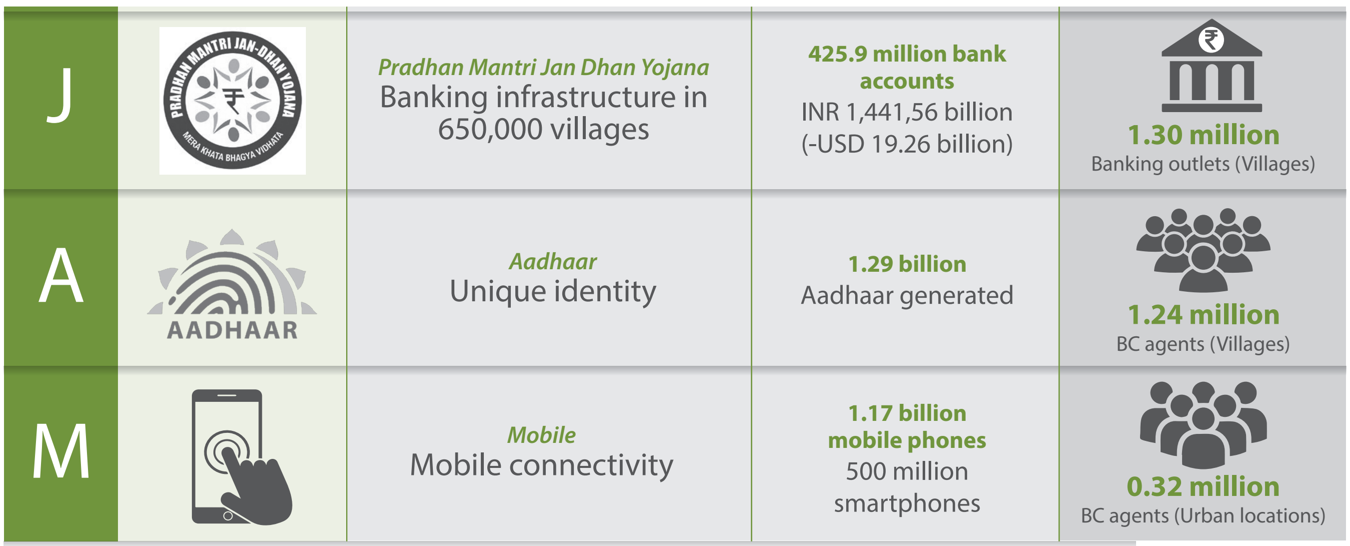

Figure 7.1: India's JAM Trinity: Jan Dhan, Aadhaar and Mobile

Source: Reserve Bank of India, 'Annual Report 2021,' rbi.org.in. May 27, 2021, https://www.rbi.org.in/Scripts/AnnualReportPublications.aspx?Id=1317 (accessed 25 October 2021). Unique Identification Authority of India, 'Aadhaar Dashboard,' uidai.gov.in, https://uidai.gov.in/aadhaar_dashboard/ (accessed 25 October 2021). Telecom Regulatory Authority of India, 'Highlights of Telecom Subscription Data,' Trai.gov.in, 31 October 2020, https://www.trai.gov.in/sites/default/files/PR_No.101of2020.pdf (accessed 25 October 2021).

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in the country. The 'Digital India Campaign' has fuelled the government's vision to transform into a digitally empowered nation. Innovations, such as Aadhaar and the IndiaStack coupled with licensing of differentiated banks have helped service providers offer seamless digital payment experiences to their users at much lower costs. These innovations have brought together the JAM trinity (Figure 7.1): Jan Dhan accounts for store value, Aadhaar for identification and authentication and mobile for communication and self-initiated transactions.

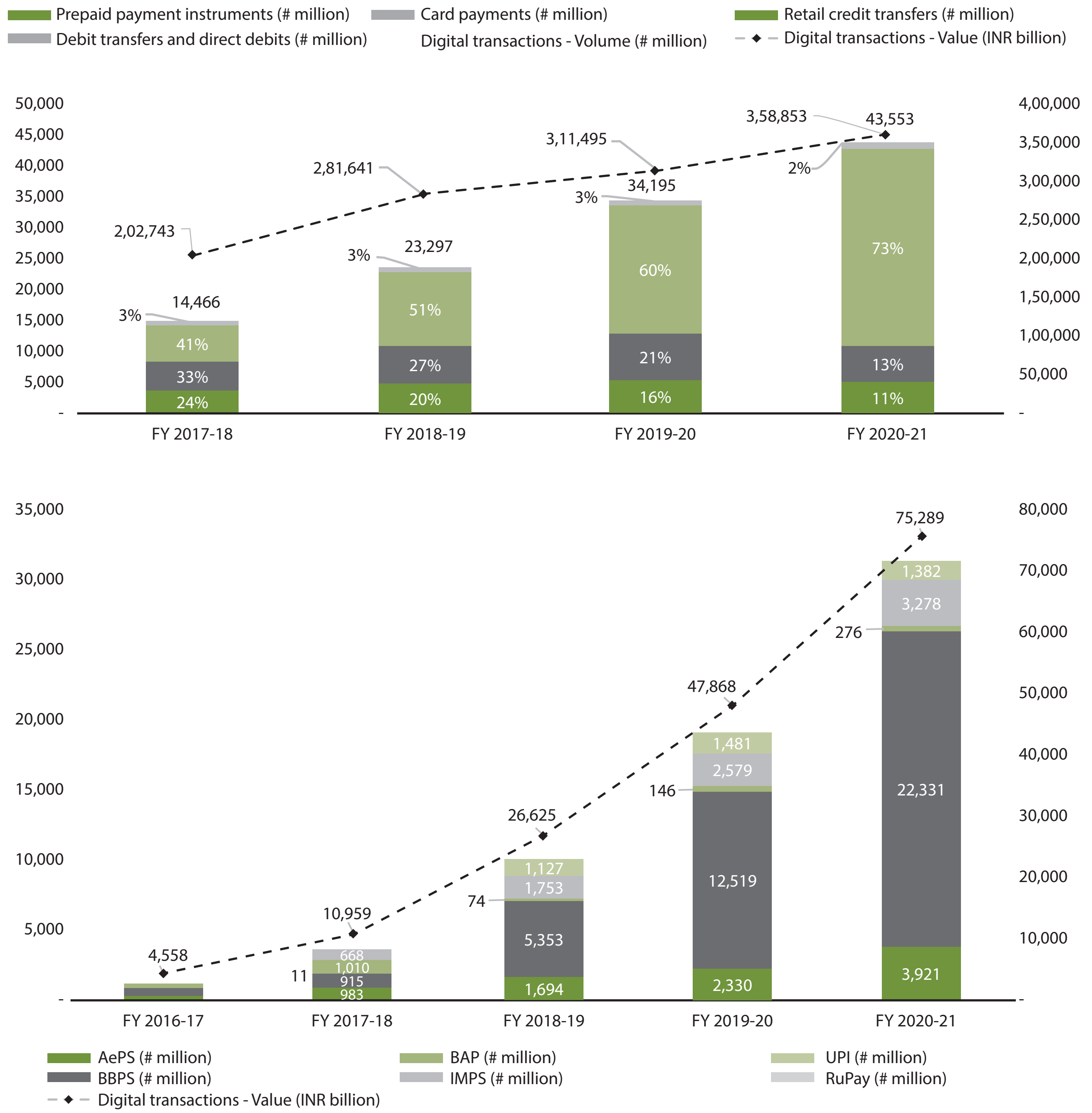


Figure 7.2: Growth in Digital Transaction Volume (# Million) and Value (₹ Billion)

Source: Reserve Bank of India, 'Payment and Settlement Systems and Information Technology,' RBI.org.in, 27 May 2021, https://www.rbi.org.in/scripts/AnnualReportPublications.aspx?Id=1322 (accessed 31 August 2021).

To use this infrastructure, India has also laid down digital highways. These highways allow various financial service providers, including third parties, to provide inter-operable payment services to customers through specified protocols. India clocked close to 150 million digital transactions in financial year (FY) 2020–2021, and retail payments in India are witnessing a hockey-stick curve. Figure 7.2 showcases the growth trajectory for digital transactions in India. Though COVID-19 initially reduced transaction levels for a few months in Q1 2020/21, thereafter it turbo-charged the use of digital services as people sought to avoid physical contact. As a result, from Q1 2020/21 transactions grew rapidly and soon surpassed earlier levels. A large part of this growth comes from Unified Payments Interface (UPI), typically used by people with smartphones, and Aadhaar-Enabled Payment System (AePS), used by people through business correspondent (BC) agents for banking transactions.

7.2. WOMEN AND DIGITAL FINANCIAL SERVICES

Despite these advances, India lags in the digital financial inclusion of women. Findex 2017 estimates that 77% of Indian women owned a bank account against 43% in 2014 and 26% in 2011. More women appear to be financially included based on this primary measure. This inclusion is mainly due to the PMJDY mission, which was crucial to reduce the gender gap in bank account ownership. The gender gap shrank to 6.4% in 2017 from 19.8% in 2014. However, the use of these accounts remains limited across the country, especially among women from low- and moderate-income (LMI) segments. Women face relatively higher barriers to using financial services at the bank or the agent point due to their limited mobility and counter-productive gender-based norms.

DFS can help women overcome these barriers by offering solutions that they can access remotely in a safe and cost-effective way. DFS could catalyse women's economic empowerment. However, a substantial gender gap persists in access to DFS and its adoption. Limited adoption of DFS among women results from the blanket approach that providers take in targeting the masses.

Several government departments have undertaken initiatives to enhance the use of financial services by women, including DFS—mainly through Bank Sakhi agents. In February 2020, 6,094 Bank Sakhis across 12 states collectively completed 748,454 transactions worth more than ₹ 2.7 billion ($ 37 million). The Targeted Financial Intervention Inclusion Programme launched by the Department of Financial Services of the Ministry of Finance also worked to ensure an access point within 5 km of each village, especially in the 112 aspirational districts.

7.3. KEY CHANGES IN REGULATION AND POLICY

The RBI issued a key Notification in May 2017[1] that enabled banks to move from brick and mortar outlets to 'banking outlets'. It noted,

> *A 'Banking Outlet' for a Domestic Scheduled Commercial Bank (DSCB), a Small Finance Bank (SFB) and a Payment Bank (PB) is a fixed point service delivery unit, manned by either bank's staff or its Business Correspondent where services of acceptance of deposits, encashment of cheques/ cash withdrawal or lending of money are provided for a minimum of 4 hours per day for at least five days a week. It carries uniform signage with name of the bank and authorisation from it, contact details of the controlling authorities and complaint escalation mechanism. (emphasis in the original)*

This notification provided impetus for the roll out of the BC-based cash-in/cash-out (CICO) services into underserved areas, thus enabling recipients of DBTs from the government access to their payments.

7.3.1. Policy Direction on Direct Benefit Transfers (DBT)

Cash transfer is a significant component of social protection programmes. The Government of India (GoI) currently spends ₹ 7,000 billion ($ 97 billion) on cash transfers, subsidies and social transfers, either 'in cash' or 'in kind'.

The central government has made tremendous progress in moving towards cash-based schemes. The benefit is credited directly into the bank accounts of beneficiaries for many old programmes, such as wage subsidy schemes, social pensions and scholarships. Under new schemes, such as income support for farmers (PM-KISAN) and maternity benefits, money flows directly into the beneficiaries' bank accounts through the DBT ecosystem. Table 7.1 provides a summary of the amount of cash released by the GoI under various social protection programmes in the past six years.

Table 7.1: Amount Released through DBT in the Last Six Years under Central Sector Schemes and Centrally Sponsored Schemes of Various Ministries/Departments

Year	2013–2014 & 2014–2015	2015–2016	2016–2017	2017–2018	2018–2019	2019–2020
Amount (in billion rupees)	₹ 470	₹ 620	₹ 750	₹ 1,900	₹ 3,300	₹ 3,800
Amount (in billion $)	$ 6.51	$ 8.6	$ 10.4	$ 26.3	$ 45.7	$ 52.6

Source: Government reply in the Lok Sabha: Government of India, Ministry of Finance, Department of Expenditure, 'Lok Sabha Unstarred Question No. 1183,' Finmin.nic.in, 19 September 2020, http://164.100.24.220/loksabhaquestions/annex/174/AU1183.pdf.

However, about 75% of the DBT budget that touches 70% of poor households is still 'in kind'. It primarily includes food and fertiliser subsidies. Both subsidies have been digitised and are thus transitioning towards direct cash transfer. The graduation of in-kind schemes to the direct cash transfer mode is challenging and demands interventions to make a sustainable change across the ecosystem.

7.4. IMPACT OF COVID-19 ON FINANCIAL INCLUSION

7.4.1. PMGKY and DBT Schemes

In response to COVID-19 and the resulting lockdown in March/April 2020, the GoI announced the Pradhan Mantri Garib Kalyan Yojana (PMGKY) to support the poor and the vulnerable. It included welfare payments, such as new government-to-person (G2P) payments, advance or additional payments of existing G2P programmes and in-kind assistance.

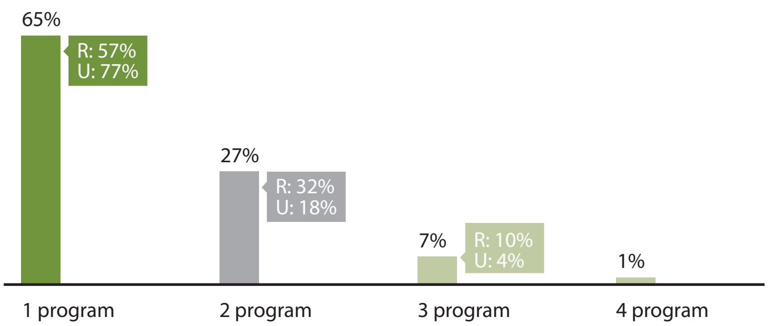


Figure 7.3: Rural Households Were Enrolled in a Greater Number of Social Welfare Schemes than Urban Households (R = Rural; U = Urban)

Source: Centre for Global Development and MSC (Microsave Consulting), 'Social Assistance and Information in the Initial Phase of the COVID-19 Crisis: Lessons from a Household Survey in India,' cgdev.org and microsave.net, July 2021, https://www.cgdev.org/sites/default/files/social-assistance-and-information-initial-phase-covid-19-crisis-lessons-household-survey.pdf
https://www.microsave.net/wp-content/uploads/2021/08/social-assistance-and-information-initial-phase-covid-19-crisis-lessons-household-survey.pdf (accessed 25 October 2021).

1. **Most beneficiaries received their PMGKY payments:** According to the government, 100% of PMJDY, 98% of Pradhan Mantri Ujjwala Yojana (PMUY), 97% of the National Social Assistance Programme (NSAP) and 92% of Pradhan Mantri Kisan Samman Nidhi Yojana (PM-Kisan) beneficiaries received their payment during the lockdown.
   According to MicroSave Consulting's (MSC) study,[2] 65% of the households were eligible for at least one cash transfer scheme under PMGKY. The remaining 35% of households were eligible for more than one scheme (Figure 7.3).
2. **These payments increased transactions at BCs:** Most beneficiaries visited bank branches to withdraw their payments during May (67%) and September (71%). However, 13% of beneficiaries visited BCs in May compared to 9% in September. Still, this is a significant jump from the lower single-digit numbers reported in the previous studies by MSC and others. BCs saw higher footfall during the lockdown because bank branches were far away, and travel restrictions were in place due to the lockdown. Once the travel restrictions were lifted, beneficiaries flocked to bank branches to withdraw their payments.

Data from the National Payments Corporation of India (NPCI) also suggests a decline in AePS transactions post lockdown. AePS transactions peaked near 400 million per month from April to June 2020 and declined after that (Figure 7.4).

CICO agents play a pivotal role in the financial services ecosystem. The pandemic affected these agents on multiple fronts:

- CICO operations: While the DBT payments under PMGKY increased transactions at agent outlets, the pandemic-induced lockdowns dampened the increase as more than 50% of households are located more than 5 km from a BC outlet. Additionally, the DBT payments into the people's accounts increased cash-out transactions—a low-commission product.

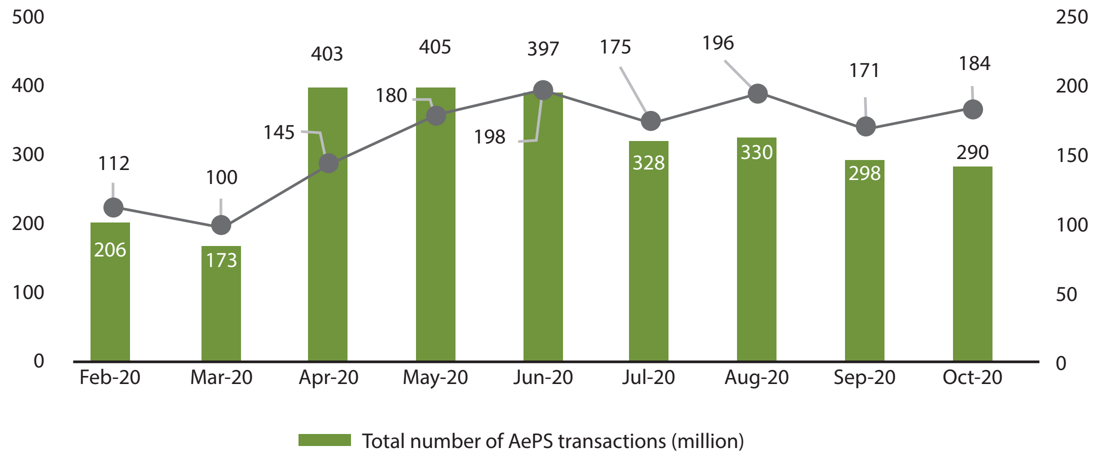


Figure 7.4: AePS Monthly Transaction Trends: Volume (#Million) and Value (₹ billion)

Increased cash-outs led to an overall decrease in the commissions earned by the CICO agents.

- Income and expenses of CICO agents: Overall, monthly commissions for CICO agents either reduced or remained constant. MSC's study highlights that CICO agents suffered a drop of ~24% in their income due to the pandemic. Agents in rural geographies saw a greater increase in cash-out transactions due to the DBT payments than their urban counterparts. Due to this abrupt impact on their operations, income and expenses, some banks provided incentives to their active agents to provide services to the customers.
- Gender-driven impact on the CICO agents: MSC's study highlights that female agents witnessed a larger increase in commission by ~5% compared to male agents for whom commissions remained the same. This increase may be because most female agents operate in rural areas to where many had migrated from the towns and cities.

7.4.2. Impact on Digital Payments

Digital payments witnessed tremendous growth during the pandemic. However, people also held on to hard cash in the face of mass uncertainty throughout 2020. When contactless and Aadhaar-based payments increased by 10%, the public retention of currency increased by 22%. Digital payments displayed the following two prominent trends.

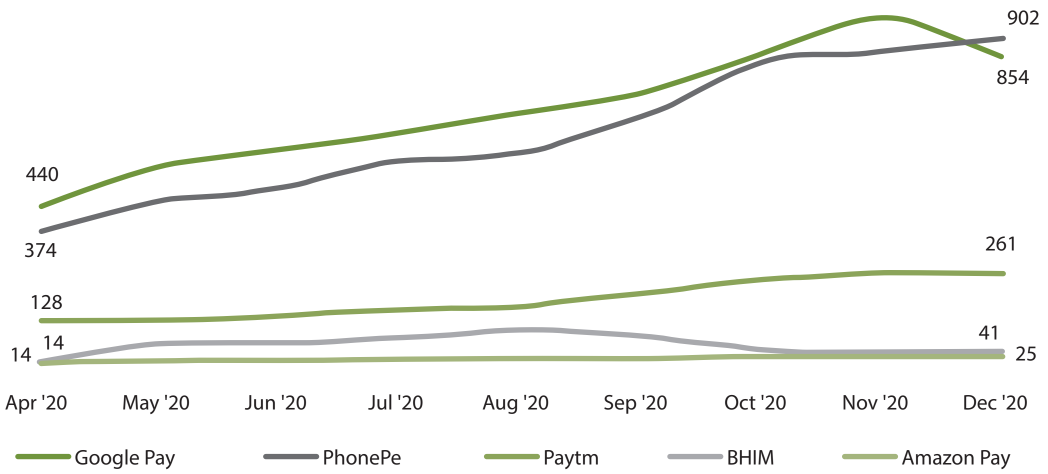


Figure 7.5: Transaction Volume of the Top-Five UPI Apps (in Millions)

Source: MSC, 'Analysis of India's Payment System Indicators in 2020,' microsave.net, March 2021, https://www.microsave.net/wp-content/uploads/2021/03/Analysis-of-India%E2%80%99s-payment-system-indicators-in-2020.pdf (accessed on 25 October 2021).

1. **Overall demand increased:** UPI had more than 150 million users transacting on the platform and grew by 50% y-o-y. Customers also shifted their cash spend to cards (debit and credit cards witnessed an 11% y-o-y increase standing at 953 million cards), attributed to the e-commerce boom, specifically e-retail.
2. **Increased supply of digital payment platforms:** The surge in contactless payments as a safer payment option led to a remarkable increase in the overall Bharat QR code-based transactions. It reached 3.05 million, a 61% y-o-y increase. Point-of-scale (PoS) terminals also complemented the increase in debit and credit cards, and driven by the fear of using ATMs, reached 0.5 million in number—a 20.5% y-o-y increase. Figure 7.5 highlights the growth in transactions of the top-five third-party UPI apps in India.

7.4.3. Impact on FinTechs

1. FinTechs that offer insurance: The pandemic has created greater awareness around insurance and provided the sector with the much-needed significance it sought for many years. In early 2020, more Indians signed up for private health insurance as they faced the prospect of hospitalisation due to COVID-19 alongside soaring medical costs. This led to a 115% y-o-y growth in premiums collected. Figure 7.6 showcases the growth in investments received by InsurTechs in India.
2. **FinTechs that offer credit:** Credit FinTechs were the hardest hit. The tapering trend in collecting repayments and the introduction of moratoriums impacted sustainability and weakened investor sentiment towards this space. However, a few credit FinTechs with sustainable business models gained investor traction (Figure 7.7). Indian credit and lending FinTechs received funding worth ₹ 69.8 billion (~$ 939 million) in FY 2021, showing 16.5% y-o-y growth in investment from the previous year. This increase can primarily be attributed to the more prominent, established and sustainable FinTechs, since smaller and newer FinTechs suffered losses.

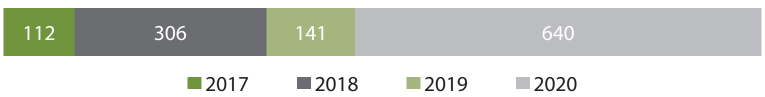


Figure 7.6: Investments Received by India InsurTechs (USD Million)

Source: MSC, 'Impact of COVID-19 on FinTechs,' microsave.net, April 2021, https://www.microsave.net/wp-content/uploads/2021/06/Impact-of-COVID-19-on-FinTechs-India-1.pdf (accessed on 25 October 2021).

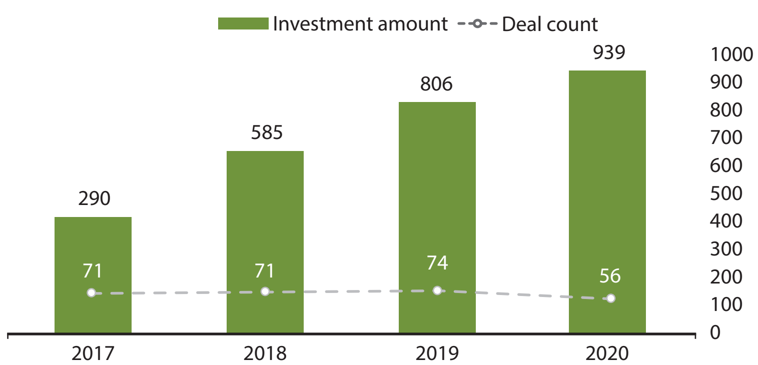


Figure 7.7: Investments Received by Credit FinTechs in India in USD Million

Source: MSC, 'Impact of COVID-19 on FinTechs,' microsave.net, April 2021, https://www.microsave.net/wp-content/uploads/2021/06/Impact-of-COVID-19-on-FinTechs-India-1.pdf (accessed on 25 October 2021).

7.5. DIGITAL TRENDS IN FINANCIAL INCLUSION

Financial inclusion is usually defined as the access to appropriate, affordable and timely financial services including payments, loans, savings and insurance. In this section, we examine how DFS in India have enhanced, or could enable, financial inclusion.

7.5.1. Payments

Digital payments in India proliferated, with transactions increasing from 23.4 billion in 2019 to 34.3 billion in 2020. Several improvements have transformed India's payments ecosystem. These gains are in payments infrastructure, disruptions in information and communications technology, a responsive regulatory framework, a conducive policy environment and a greater focus on customer-centricity.

7.5.2. Payment Channels

Four payment channels have a tremendous potential to be digitised—person-to-business (P2B), person-to-government (P2G), person-to-person (P2P) and business-to-person (B2P). Targeted interventions through digital payment solutions across these channels will help address the specific financial needs of the unserved and underserved LMI customer segments. Promising examples include digitalising domestic remittances, house rental payments, cash on delivery payments in e-commerce, offline merchant payments, repayment of microfinance loans, recurring payments in agriculture and allied value chains, utility bill payments and transactions in the public transit system. Figure 7.8 provides examples of retail payment use-cases that are currently underserved and can be impacted.

	Person	Business	Government
Person	P2P use-cases: 1. Domestic remittances Market size: **₹ 700 mn ($ 9.45 bn)** 2. House rental payments Market size: **21.72 mn households** **Percentage of digital payments across P2P use-cases: <10%**	B2P use-cases: agri payments (FPOs and cooperatives), salaries Market size: ₹ 3 bn ($ 40 mn) transactions annually Percentage of digital payments across B2P use-cases: 20%–25%	
Business	P2B use-cases: 1. Online and offline merchant payments Market size: **₹ 4.25 tn ($ 56 bn)** 2. MFI loan repayments Market size: **5.8 bn repayments** **Percentage of digital payments across P2B use-cases: 15%–20%**	These are large value transactions dealing with institutions and government. In most cases, they are already digitized and are well served by financial players.	
Government	P2G use-cases: 1. Utility bill payments Market size: **~35 billion bills annually** 2. Public transit system payments Market size: **35 bn trips** **Percentage of digital payments across P2G use-cases: 10%–12%**		

Figure 7.8: Potential Use-Cases

Source: MSC analysis.

Note: See Appendix A for an analysis of how the market offering and share of leading players evolved.

7.5.3. 30% Cap (of Total Volume) Imposed by NPCI

The NPCI declared a 30% market cap on the total volume of UPI transactions for all third-party app providers on 5 November 2020. The cap is calculated on a rolling basis per the total volume of UPI transactions during the preceding three months, starting on 1 January 2021. NPCI will inform players over an email alert once their total UPI transaction volume reaches the 25% to 27% threshold. Players will receive a second alert on crossing the 27% threshold, and on crossing the 30% threshold, players will have to cease on-boarding any new customers immediately.

PhonePe and Google Pay continue to dominate the UPI market. They collectively hold about 79% of the total UPI transactional volumes, which amount to 2.16 billion transactions worth ~₹ 4,300 billion (~$ 58.09 billion) as of March 2021. This new policy on market cap was formulated and implemented to ensure that the UPI infrastructure offers a positive customer experience and that few players do not monopolize the digital payments landscape.

7.5.4. Consumer and Retail Credit

In the past half-decade, $ 2.4 billion worth of venture capital flowed into Indian lending tech start-ups in the lending business as investments. Complemented with a four-fold rise in EPFO accounts from $ 44 million in 2015 to $ 161 million in 2021, the Indian consumer is fast becoming the low-hanging fruit for many of India's digital lenders. Open Credit Enablement Network (OCEN), launched in July, 2020 is poised to revolutionise digital lending by acting as a common language, connecting lenders and marketplaces to create and use innovative financial credit products at scale. Among other benefits, OCEN will help to:

1. Reduce the costly and time-consuming custom integrations and manual processes to connect customers with lenders, especially for marketplaces
2. Reduce the high turnaround time to deposit loans into customers' accounts
3. Facilitate identification of creditworthy borrowers

7.5.5. New Savings Initiatives from Banks

Indian household financial savings touched an unprecedented high of 21% of the GDP in the April–June quarter of FY 2021 (Figure 7.9). Once the lockdowns eased and economic activities resumed, spending rebounded in the second quarter of FY 2021. The personal savings rate dipped to 10.4% in the July–September quarter of 2020, almost equalling the pre-pandemic saving rate of 9.8%.

Household financial savings in deposits with banks increased during the July–September quarter of FY 2021, reflecting people's faith in the banking system.

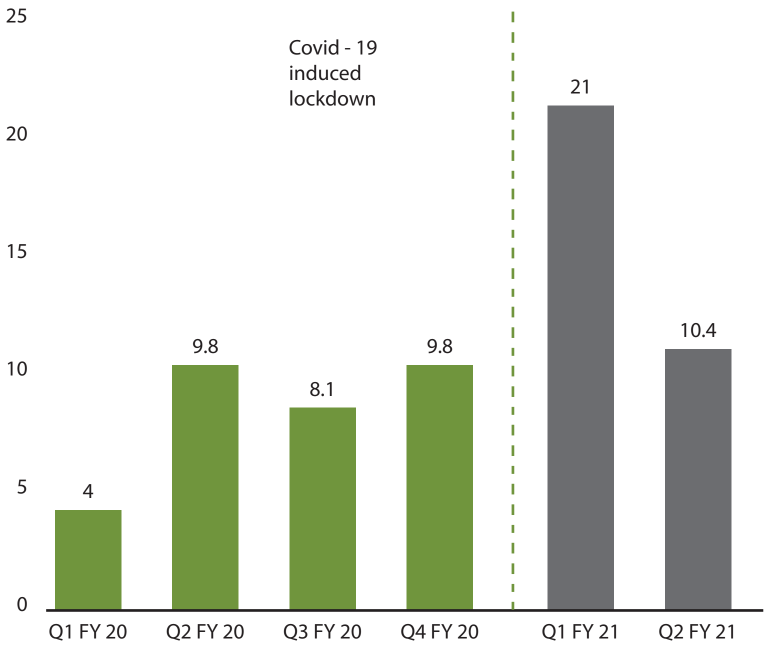


Figure 7.9: Saving Percent to GDP

Source: Reserve Bank of India, 'Q2:2020–21 Estimates of Household Financial Savings and Household Debt–GDP Ratio,' RBI.org.in, https://rbidocs.rbi.org.in/rdocs/Bulletin/PDFs/04AR_190320212E0855E3FD1C4C47A98B1F47EDE0FA44.PDF (accessed 25 October 2021).

7.5.6. Insurance, Pensions and Mutual Funds

Most formal financial institutions, such as banks, NBFCs and insurance companies, do not find it feasible to reach the LMI segment with their existing product offerings and operating model. The industry, too, lacks suitable financial products that can address the many financial needs of the LMI segment. Many government-sponsored schemes also have tried to address the lack of savings, insurance and pension products. While these government schemes are doing well, much can improve. See Appendix B for a quick analysis of the relevant schemes.

7.6. KEY OUTSTANDING ISSUES

7.6.1. Infrastructure

Payment services often have multiple steps for registration, and only a handful of services are available in regional languages. Most products with UPI solutions demand specific prerequisites from their customers. These customers are expected to own a smartphone, email address, active debit card for on-boarding, and have the ability to navigate the digital product with ease. These conditions prevent smooth customer adoption. A lack of appropriate infrastructure in many areas means that the merchant ecosystem fails to offer customers the chance to pay digitally, thereby maintaining the dependency on cash.

Reports indicate that 72% of India's total consumer transactions still occur in cash, highlighting the tremendous opportunity for payment service providers to digitise transactions. Payment players can access opportunities in scaling up services, improving products and increasing capacity to accommodate the growing demand for digital transactions expected due to the pandemic. This opportunity for payment players is also in line with the RBI's target of increasing the current number of digital payment users from 100 million to 300 million by 2025.

7.6.2. Merchant Discount Rate

Merchant discount rate (MDR) is a cost-recovery mechanism for the banks that serve network providers and payment gateways. It is proportional to the transaction amount. With the launch of RuPay cards, UPI and the government's push to increase the uptake of digital payments, the MDR was reduced to zero.

Through zero MDR, the government intended to on-board more small merchants and increase the uptake of RuPay cards and UPI. The pandemic catalysed digital payments, specifically UPI. However, zero MDR leads to some issues. First, zero MDR offers no incentive for banks to upgrade their technology infrastructure without a mechanism to recover the cost. Second, a large number of small-value transactions by users intent on gaming the system by splitting transactions choke the infrastructure. Third, the acceptance of RuPay cards by the banks remained low, and RuPay cards saw higher usage at ATMs than at PoS terminals.

7.6.3. CICO Agents

1.2 million BC agents spread across the country currently serve the financial needs of around 1 billion LMI customers. However, the BC network has been struggling for operational and financial sustainability for years. BC agents face several issues. These include problems with profitability, liquidity management, high costs of setting up and operating, poor internet connectivity, limited capacity of potential agents and limited range of product offerings.

Multiple studies conducted by MSC on agent networks across India suggest stress in the economics of traditional BC agents. The revenue they earn from the commission for services provided is limited, faring adversely against the high cost of setting up and managing operations, which leads to little motivation for the agents to continue their business. The challenges in the traditional BC model forced many new players, such as Spice Money, PayNearby and Pay1, to innovate and explore alternate models. These new-age BCs have made operations more efficient by using better technology and effective processes. The improvements led to improvements, such as an agile agent on-boarding, focused training, sharper product focus, better cash management and lower costs for BC agents.

7.6.4. Mobile Phone Ownership

India has around 1 billion LMI people. They typically do not have a phone or have a feature phone at best—only 15% of women and 34% of men in the country own smartphones. Low smartphone ownership and inadequate internet availability in rural areas are among barriers that prevent customers from adopting digital payments.

The lower penetration of phones in rural areas results in high failure rates of digital transactions and hurts the customer experience. Vulnerable customer groups, such as women and the rural population, often have comparatively low literacy rates and lack exposure to technology. Women are also typically secondary users of mobile phones, late adopters of technology and are often excluded from having official government IDs. Therefore, these groups are unfamiliar with digital payments, and this leads to low adoption of services.

7.6.5. Direct Benefit Transfer Failure Rates

In the FY 2020–2021, the failure rate in DBT was 1.52%. Of 3 billion DBT transactions, about 47 million transactions failed (Figure 7.10). As per the government's directive, all DBT transactions need to be routed through the NPCI.

Failure rates in DBT may differ in terms of the scheme and state. Some media reports suggest it may be as high as 2.5% for seven schemes of the

Figure 7.10: DBT Transactions and Failure Rate

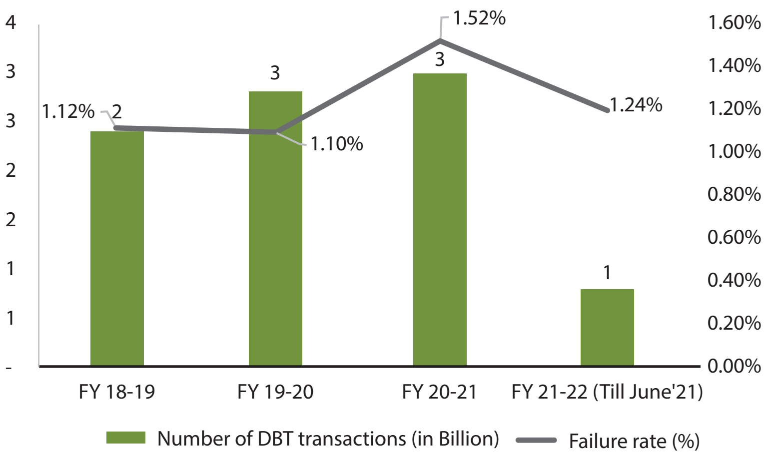


Figure 7.10: DBT Transactions and Failure Rate

Source: NPCI—NACH Analytics 20–21-YTD.

Ministry of Labour and Employment. In another instance, the government cited a failure rate in DBT of 5% in FY 2019–2020 and 4.6% in FY 2020–2021 in West Bengal. DBT failure is attributed primarily to mismatched bank details of beneficiaries, dormant or closed accounts, inactive Aadhaar and non-mapping of accounts with Aadhaar.

7.6.6. Digital and Financial Capability

In 2019, only an estimated 27% of Indians were financially literate, despite an overall literacy level of 77.7%. International literature highlights the ineffectiveness of traditional financial education approaches. India's current approach to financial literacy propagated through camps involves additional challenges. These include the following:

1. Lack of effective targeting, especially of the population **that is excluded from the fold of financial services;**
2. **Ineffective mediums of literacy—a higher use of non-intuitive material like text-heavy posters instead of using audiovisual material, demonstration services; and**
3. **Lack of supporting infrastructure to conduct these camps—like access to electricity, laptops and proj**ectors, as well as transportation to remote locations.

These challenges also affect how excluded people can build their capabilities to use DFS. In addition, inadequate literacy, exacerbated by limited support structures and mentors, degrades the experience of these segments around using DFS. These gaps offer a significant opportunity to redefine how these people's digital and financial capabilities are developed. A more product-focused, activity-based training approach delivered alongside community influencers at 'teachable moments' could improve outcomes substantially.

7.6.7. The Gender Gap

Findex 2017 shows a significant estimated gender gap in account ownership and usage. DFS, a pivotal opportunity to accelerate usage, is also underutilised, especially among women in India. The low utilisation is mainly a result of operational factors and limitations placed by sociocultural norms. Key recommendations to help ensure improved participation of women include the following:

1. Enhancing effective access to financial services at the last mile for women by ensuring that access points are gender-centric and help women overcome constraints that limit their physical mobility;
2. Enhancing the effectiveness, relevance and gender-intentionality of communication used by financial service providers; and
3. Enhancing the relevance of financial products for women through more customised products.

7.6.8. Orality and User Interface

In India, 287 million adults aged 15 or more are illiterate. The country has millions of 'neo-literate' individuals with weak reading and writing skills. Illiterate and neo-literate individuals together form the 'oral' market segment, of which in India, nearly two-thirds are women. However, traditional financial literacy modes and mediums depend significantly on the ability of the individual to reach or process languages. User interfaces across DFS platforms also tend to ignore the oral segment and rely heavily on icons that these people find more familiar and relatable.

7.7. REMAINING POLICY AND REGULATORY CHALLENGES

7.7.1. Lack of Unified Database and Exclusion

A digitised, dynamic and integrated database is essential for any successful G2P programme. Such a database enables the automatic inclusion and exclusion of beneficiaries in real time. Currently, the on-boarding of G2P beneficiaries is pull-based, where beneficiaries need to apply for a programme to a particular department by submitting documents and proof. The same beneficiary will need to submit similar documentation if they apply for another G2P programme. Due to this need for documentation, multiple scheme servers host digitised beneficiary data, such as financial and demographic information and other scheme-specific details, which multiple agencies manage subsequently.

The lack of a unified database and real-time beneficiary data leads to exclusions and uncertainties around eligibility. Integration of scheme databases creates benefits for both the government and the beneficiaries. The government would have a single, dynamic beneficiary database free of fictitious or 'ghost', dead and duplicate beneficiaries. The beneficiaries would not have to resubmit documents at multiple places.

7.7.2. Communication

Social protection programmes often ignore communication as a core design principle, and it remains an afterthought for implementers. MSC's assessment of the Indian government's social protection response to COVID-19 suggests that only 41% of the programme recipients knew the benefits they are eligible for. Further, the research highlights the need for ongoing gender-responsive communication in social protection programmes and government policies. According to the study, 63% of women respondents did not know the correct entitlement details under the COVID package against 57% of male respondents in India. Only 35%–40% of women are active in accessing their entitlement against 60%–65% of their male counterparts.

7.7.3. Grievance Redress Mechanism and Exception Management

The DBT ecosystem in India is yet to implement a beneficiary-centric recourse mechanism. While toll-free numbers to report grievances or queries are offered by the government, they do not find much use. A user-friendly system to report, record and track beneficiaries' grievances or queries is absent. Much of the DBT beneficiaries' grievances or queries are not reported and monitored. These grievances include lack of information on where and when to collect benefits, suspension or denial of service, server downtime and connectivity issues, exclusion and entitlement theft. Beneficiaries also face issues due to poor behaviour from agents or dealers, poor service and discrimination, overcharging and quantity-linked fraud.

Further, DBT beneficiaries do not have visibility and control of payments. They lack clarity on the date of payment, the amount they will receive, the reason for the delay, among others. Therefore, the government and banks must implement exception handling protocol to ensure 'no service denial' and a strong grievance redress mechanism (GRM). A robust GRM and exception management protocols should be an integral part of the design of any G2P digitisation programme, rather than a procedure developed in haste to deal with glitches in implementation.

7.8. LOOKING FORWARD

7.8.1. Direct Benefit Transfers

The GoI needs to use technology further to overcome the remaining issues of payment failures, grievance handling, communication and exclusion. In parallel, it must work on the next level of DBT reforms that include moving 'in-kind' subsidies to cash, creating a unified database through a social registry, offering choice to G2P beneficiaries and ensuring universal basic income. At the same time, the GoI is experimenting with new technology to manage schemes better. The latest innovation is e-RUPI, an electronic voucher redeemable for a specified purpose. The e-RUPI concept is promising and can be an effective tool to administer health and fertiliser subsidies.

7.8.2. NPCI

The NPCI provides a backbone for India's retail payment and settlement systems. NPCI's efforts to build an open-source and safe digital ecosystem have led to a paradigm shift in delivering digital payment solutions to the masses. The ecosystem will continue to play a pivotal role in enabling India's 1.3 billion mobile phone users to adopt and access digital payments. We foresee the need to strengthen partnerships and forge new relationships with FinTechs, payment service providers, regulators, banks and other institutions for NPCI to address the country's growing needs. Concerted efforts are now required to augment digital payment solutions by developing tailored use-cases for each customer segment in the country.

7.8.3. New Umbrella Entity (NUE)

The exponential increase in smartphone users coupled with the widespread adoption of new-age digital payment solutions, such as UPI, has positioned India as one of the fastest-growing digital payment economies. The acceleration towards digital payments has come about quicker than planned during the pandemic. PWC and Payments Council of India expect India to contribute ~2.2% of the global digital payment market by 2023. Digital transactions in India, by 2025, are expected to rise to 167 billion in volume and ₹ 238 trillion (~$ 3.21 trillion) in value. It presents substantial business opportunities for existing and new players in the digital space.

7.8.4. Merchant Discount Rate

Policy initiatives, such as the waiver of MDR charges to promote digital payments, show the government's intent to further financial inclusion through digital pathways. However, the zero MDR hurt the payments ecosystem. It threatened the survival of several payment gateway entities, hampered innovation efforts and led to a slowdown in India's expansion of the digital payments infrastructure. The government should either reconsider the MDR and charge a minimal fee instead of a flat zero-fee or identify ways to reimburse the MDR to payment players for merchant transactions. The government needs to look at a balanced approach to ensure that all the players in the payments ecosystem are incentivised and motivated to promote digital payments.

7.8.5. QR Code-Based Payments

QR code-based payments can potentially create significant growth in digital payments, especially among customer segments with low financial literacy across India. With low infrastructure requirements, two-way transaction flows, secure transactions and overall simplicity, QR codes offer an easy on-ramp to digital payments. QR codes offer multiple use-cases in P2P and person-to-merchant (P2M) transactions, including toll tax payments, payments at grocery stores, mobile app downloads and utility bills. They present a broader opportunity to increase the number of use-cases, which will allow more customers to make payments using QR codes.

Besides the advantages that QR codes offer, the regulatory environment in India currently focuses on open banking and making all QR codes interoperable. Such interoperability will allow customers to pay across different FSPs, wallet players and other platforms.

7.8.6. Iris-Based Authentication Payments

Currently, one out of every five AePS transactions fails, with around 17% failures due to biometric mismatch using fingerprint-based authentication. The high failure rates in fingerprint-based AePS transactions have created a need for alternate modes. Iris authentication provides a safe and secure alternative since irises are difficult to forge. Iris authentication is also hygienic as it is contactless.

It offers convenience as it takes fewer attempts to scan compared to fingerprints. Authentication through iris has a false rejection rate of 0.1%–0.2% compared to 2%–3% for fingerprint authentication, highlighting the mode's accuracy.

7.8.7. FinTech (Including Neobanks)

While traditional banks have robust core systems and extensive data about their customers, they find it challenging to provide a digital experience that new-age customers demand. Banking at large is transforming into a demand-side-driven industry where the customer is now at the centre. Yet many banks struggle with legacy processes, red tape, regulatory compliance and older IT systems.

The technological focus, agility and flexible business models of FinTechs and neobanks have revolutionised the way customers use banks in India. Their business and operational models are building products and services around customer convenience and their behaviour. While these institutions can move to offer products by tapping emerging customer needs, they are constrained by the scale of their operations and outreach. Both incumbents and new players have specific enablers and certain dependencies. A co-opetition model that uses critical strengths of banks, neobanks and FinTechs can make financial services omnipresent through multiple channels across all geographies.

7.8.8. AgTech

Agriculture is vital for India from the perspective of food security, economy and livelihoods. During 2020–2021, agriculture employed 43% of India's workforce and contributed 19.9% to the GDP. Despite massive government investments, resource deployment and efforts, the sector has lagged for more than 75 years. This situation has started to change with the emergence and growth of AgTechs. Investments in AgTechs have grown exponentially over the past five years, from ₹ 11.89 billion (~$ 160 million) in 2016 to ₹ 48.73 billion (~$ 656 million)

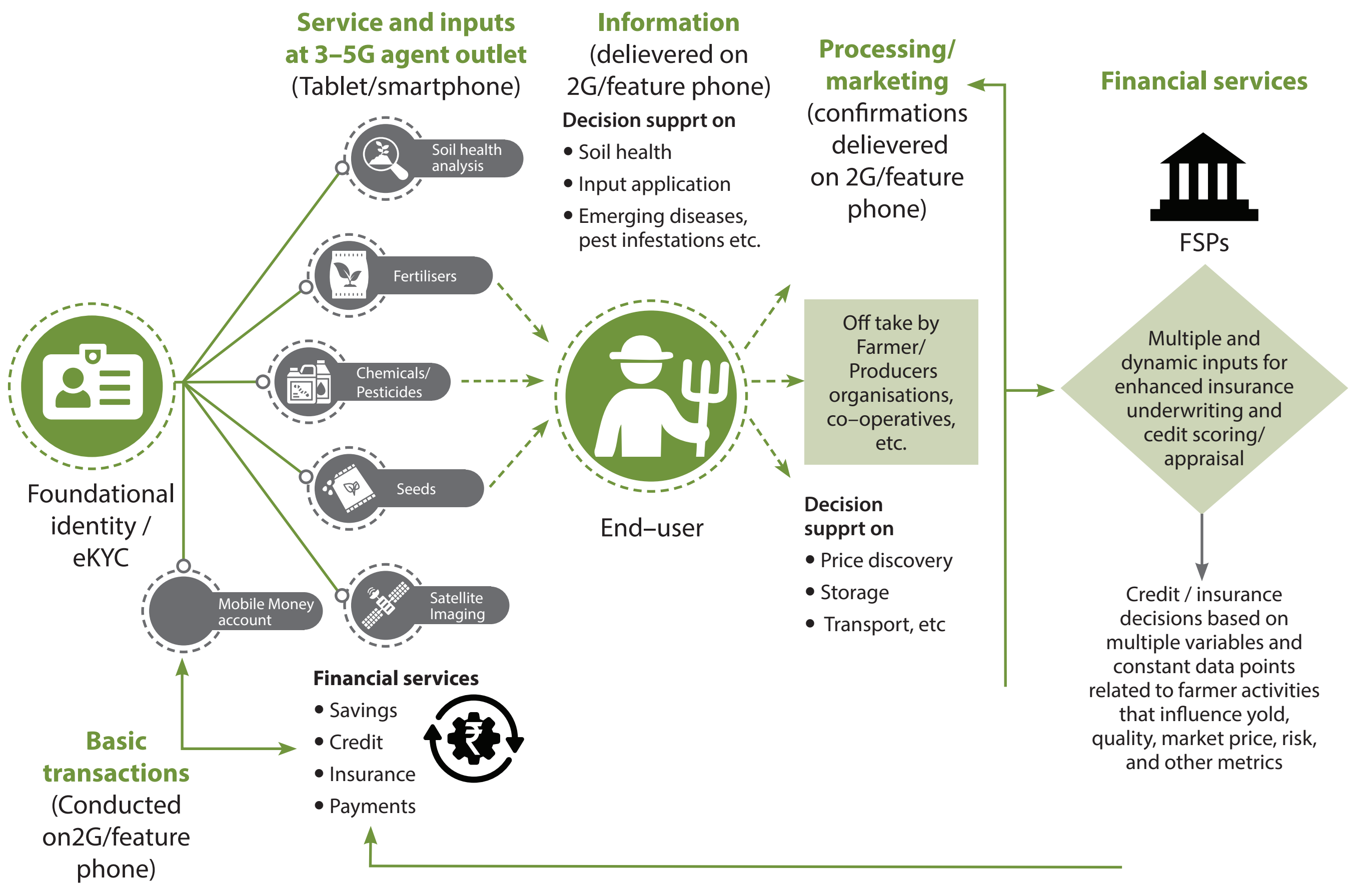


Figure 7.11: Technology Will Revolutionize Agriculture in India…and Everywhere

Source: MSC analysis.

in 2019. Though investments in AgTechs dipped during 2020 due to the pandemic and other factors, the trend is likely to reverse during 2021 and beyond. The AgTech segment is estimated to be valued at ₹ 1,783 billion (~$ 24 billion) by 2025.

AgTech innovations have transformed upstream in inputs, pre-production and production as well as downstream in post-harvest management, primary and secondary processing, wholesale and retail. These innovations transform traditional agriculture practices and methods, reduce intermediaries and introduce accuracy, quality and efficiencies. Besides the potential for employment opportunities at scale, they show the promise potentially to reverse the trend of flight of youth, from agriculture to alternate sectors and livelihoods. AgFinTechs continue to challenge traditional financial service providers and their models.

In the days ahead, we can expect a greater collaboration between AgTechs working in different parts of the ecosystem towards solutions to the diverse problems that smallholder farmers and low-income segments face (Figure 7.11). In the next decade, AgTechs will have an influential role in agriculture in India and beyond. They will catalyse the speed of transformation in the sector. Alongside other financial service providers, agri-MSMEs or entrepreneurs and medium to large corporates, and with support from government policies and programmes, AgTechs can impact smallholder farmers and low-income segments—at a velocity and scale impossible in the past.

APPENDIX A: MARKET OFFERING OR SHARE OF LEADING PLAYERS—THE EVOLUTION OVER TIME

The major digital payment products available in India are Aadhaar-based payments (AePS and BHIM Aadhaar Pay [BAP]), contactless payments (UPI and Bharat Bill Pay System [BBPS]) and card-based payments (RuPay debit card):

- AePS transactions have skyrocketed at a compound annual growth rate (CAGR) of 80% over the past five years. It has boosted DBT payments in rural geographies with 333 million monthly transactions. Higher DBT payments have led to the inclusion of users who do not own smartphones and require assisted services. Transactions grew considerably to support cash withdrawals that resulted from the domestic remittances and governments' emergency cash transfer programmes.
- UPI has seen an exponential CAGR of 476% by volume since its inception in 2016. It currently drives India's digital payments with 150 million users and 1.57 billion monthly transactions. UPI offered one of the safest payment modes for P2P and P2M transfers and outstripped all other payment platforms. Daily transaction volumes reached an all-time high of 72 million in December 2020.

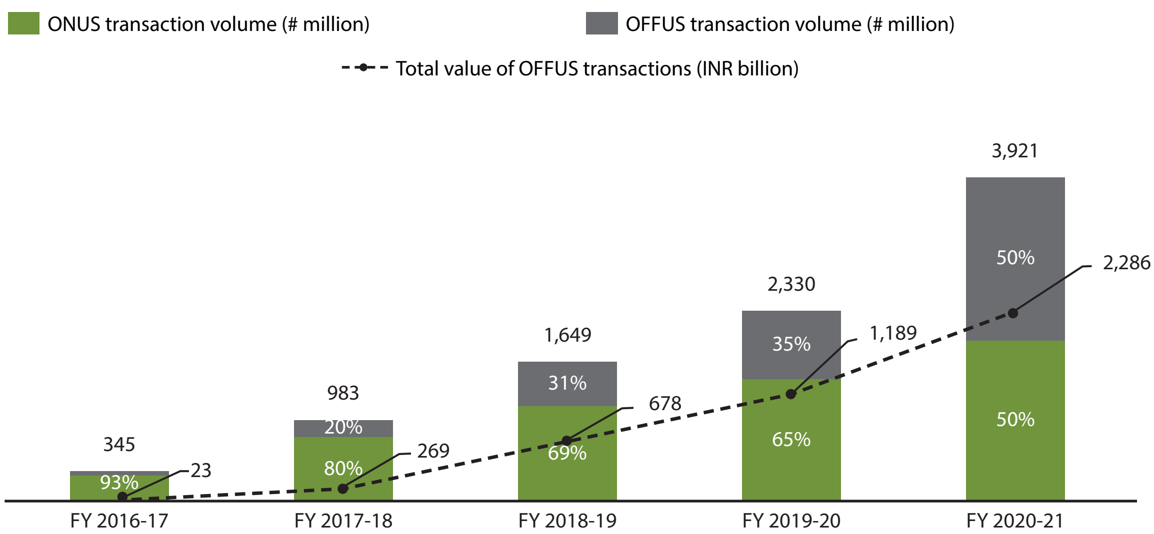


Figure A7.1. Growth in Aeps transaction volume (# million) and value (₹ billion)

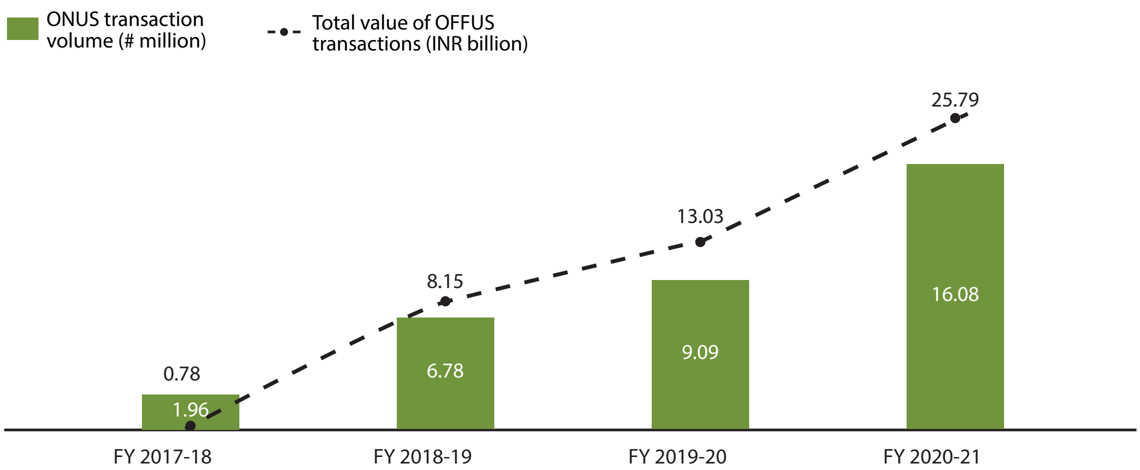


Figure A 7.2. Growth in BAP transaction volume (# million) and value (₹ billion)

- BHIM Aadhaar Pay is the merchant version of AePS. Compared to UPI, it enables merchants to receive digital payments from customers through Aadhaar authentication, which requires a smartphone, UPI ID and a PIN to transact. BAP transactions have grown at a CAGR of 96% by volume in the past four years. The average transaction value has risen steadily from ₹ 398 (~$ 5.38) in FY 2017–2018 to ₹ 1,510 (~$ 20.40) in FY 2020–2021, which indicates that people are increasingly using BAP for large ticket-size transactions. The push from the acquiring banks and the cashback earned on transactions drove merchants and consumers to adopt BAP widely across semi-urban and rural India.
- Bharat Bill Pay System (BBPS) has consolidated India's recurring bill payments industry under one payment system. It provides the convenience of round-the-clock bill payments to multiple billers from a single platform. Transactions have grown significantly at a CAGR of 183% by volume over the past four years, which indicates a rise in customer preference for using BBPS for bill payments. By integrating recurring payments, BBPS has added 19,500 unique billers across 19 additional categories over utility bills and recharges, such as education fees, loan repayments, insurance, fees to book cooking gas, municipality taxes and subscription fees.
- RuPay is a home-grown card payment network. It offers low processing fees and wide acceptance at ATMs, PoS devices and e-commerce across India. RuPay's market share in total debit cards issued increased from 17% in 2017 to 60% in 2020. More than 1,158 banks have issued 602.63 million RuPay debit cards, of which 308 million cards reached PMJDY beneficiaries. Transactions have grown at a CAGR of 45% by volume over the past five years. Merchant payments (offline and online purchases) continue to remain a significant use-case for consumers.

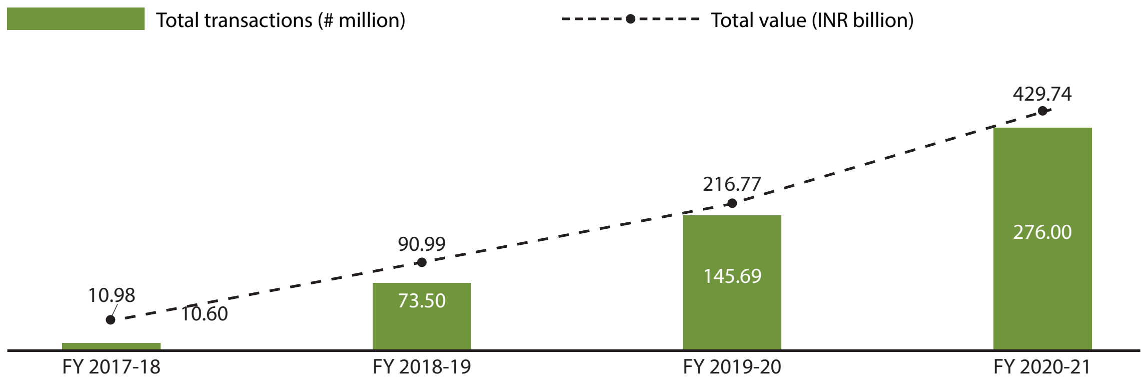


Figure A 7.3. Growth in BBPS transaction volume (# million) and value (₹ billion)

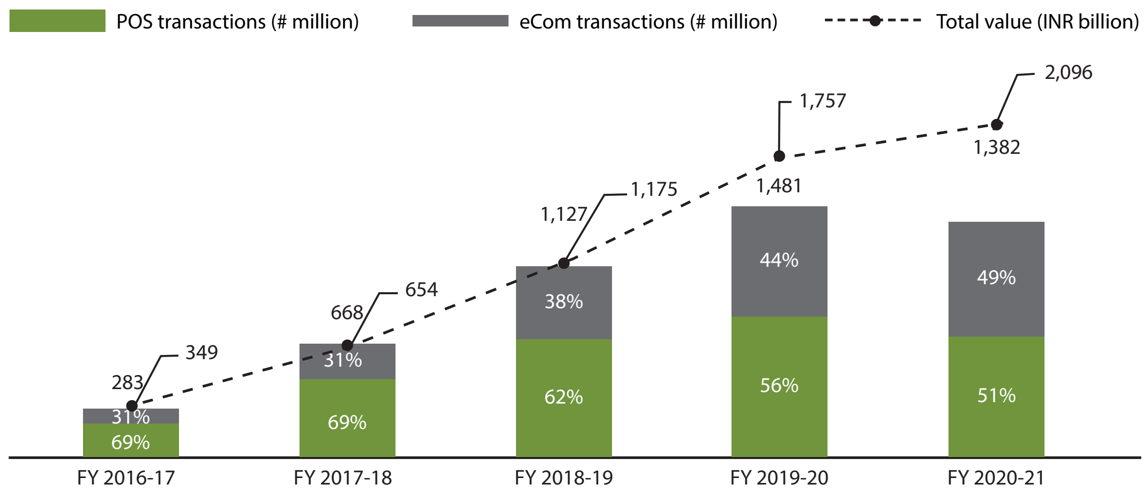


Figure A 7.4. Growth in RuPay card transaction volume (# million) and value (₹ billion)

APPENDIX B: GOVERNMENT SAVINGS, INSURANCE AND PENSION SCHEMES

Insurance Schemes	Features, Impact and Outreach	Challenges
Pradhan Mantri Jan Arogya Yojana (Ayushman Bharat) • **Objective:** Universal health coverage	• **Risk coverage:** Health cover of ₹ 500,000 ($ 6,950) per family per year • **Impact and outreach** (as of August 2020): ○ 125.5 million e-cards issued, households covered ○ 10.9 million hospital admissions as of August 2020 ○ 22,796 hospitals empanelled	• Low utilisation despite enrolment • Lack of awareness among beneficiaries • Exclusion due to usage of outdated data (SECC 2011) • Information asymmetry between patients and medical experts • Low empanelment of hospitals • High outpatient care costs
Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY) • **Objective:** To increase insurance penetration	• **Risk coverage:** ₹ 200,000 ($ 2,800) in case of death for any reason • **Impact and outreach:** 106.5 million individuals enrolled and 257,744 claims settled (as of July 2021) • Witnessed upsurge in enrolments post COVID-19	• Lack of financial literacy and futuristic planning
Pradhan Mantri Suraksha Bima Yojana (PMSBY) • **Objective:** To provide life insurance cover to the poor and low-income segments	• **Risk coverage:** ₹ 200,000 ($ 2,800) for accidental death and full disability and ₹ 100,000 ($ 1,400) for partial disability • Enrolments stand at 240.3 million and the number of claims settled is 48,634 (as of July 2021)	• The premium amounts are deemed insufficient to cover the costs of servicing claims effectively • Pricing may not be sustainable in the long run
Pradhan Mantri Fasal Bima Yojana • **Objective:** To provide insurance coverage for loss of crops	• **Risk coverage:** for loss of crops due to natural calamities—between 1.5% to 5% of the sum insured for various types of crops • **Coverage:** Loss due to natural calamities • 290 million farmers enrolled, and claims worth ₹ 900 billion ($ 12.5 billion) disbursed (as of July 2021)	• The use of crop-cutting experiments to determine crop loss is cumbersome and time-consuming • Challenging to make assessments and forecast rain and other weather conditions accurately • The poor density of government's Automatic Weather Stations (AWS) and lack of trust among farmers in private AWS

Pension Schemes	Features, Impact and Outreach	Challenges
Atal Pension Yojana (APY) • **Objective:** Financial security to unorganised sector workers	• **Coverage:** Guaranteed pension on the attainment of 60 years of age. Upon the death of the subscriber, the spouse will receive the pension. On the death of both, the nominee shall receive the pension corpus back as accumulated at age 60 • **Impact:** 32.1 million enrolments (as of July 2021)	• Regular payments are burdensome for people with interrupted employment periods • Pension amounts are insufficient to meet future needs considering the growing rate of inflation
Pradhan Mantri Shram Yogi Maandhan Yojana • **Objective:** To provide social security to the unorganised sector, not covered under other schemes	• **Coverage:** Minimum assured pension of ₹ 3,000 ($ 42) per month after attaining the age of 60 years, and if the subscriber dies, the spouse of the beneficiary shall be entitled to receive 50% of the pension as family pension • Matching contribution by the central government • 45,08,714 enrolments (as of July 2021)	• Defined benefit schemes become fiscally unmanageable in the long run • Overlaps the mission of APS, creating duplication and confusion • Pension amount insufficient to meet the future needs considering the growing rate of inflation

Pension Schemes	Features, Impact and Outreach	Challenges
National Social Assistance Scheme (NSAP) • **Objective:** A bundle of five schemes to ensure the financial welfare of the elderly, widows and persons with disabilities	• Schemes covered: 1. Indira Gandhi National Old Age Pension Scheme 2. Indira Gandhi National Widow Pension Scheme 3. Indira Gandhi National Disability Pension Scheme 4. National Family Benefit Scheme 5. Annapurna Scheme	

Savings and Investment Schemes	Features, Impact and Outreach	Challenges
Pradhan Mantri Jan Dhan Yojana (PMJDY) • **Objective:** Financial inclusion	• **Features and benefits:** Zero requirements of minimum balance, interest on deposits, RuPay Debit card, accident insurance cover of ₹ 100,000–200,000 ($ 1,400), overdraft facility up to ₹ 10,000 ($ 140) to eligible account holders • Impact and outreach (as of August 2020): ○ Total accounts: 403.5 million ○ Rural accounts: 63.6% ○ Women PMJDY accounts: 55.2% ○ Total deposit balances stand at ₹ 131 trillion ($ 1.8 billion) ○ Average account balance ₹ 3,250 ($ 45)	• Lack of proper mobile, internet connectivity, issue of power cuts • Lack of financial literacy • Customer account duplication • Keeping the dormant accounts alive to overcome the account management charges (banks spend ₹ 100–150 [$ 1.40–2] to on-board each customer) • Insufficient incentives (commission, skills) to business correspondents • Non-transparent pricing: Hidden charges levied on customers • Ineffective monitoring of BCs and non-distribution of debit cards
Pradhan Mantri Sukanya Samriddhi Yojana (SSA) • **Objective:** Promoting saving for the financial well-being of a girl child	• **Features, benefits:** ○ Low annual premium requirement of only ₹ 250 ($ 3.50) ○ Attractive interest rate on deposits ○ Maturity either at 21 years of age or at the time of marriage after the age of 18	• The long lock-in period discourages deposits • Lack of effective communication and thus awareness
Public Provident Fund (PFP) • **Objective:** To mobilise savings among Indian households, enable them to build a retirement corpus	**Features, benefits:** ○ Low annual premium requirement—only ₹ 250 ($ 3.50) ○ Attractive interest rate on deposits ○ The minimum lock-in period of 15 years ○ Tax benefits ○ Loan against PPF	• The long lock-in period acts as a deterrent for the low-income segments • Premature withdrawals are not readily available • Positioned more for the salaried population, limited efforts on promotion to other segments

REFERENCES

1 https://rbi.org.in/SCRIPTs/NotificationUser.aspx?Id=10972

2 MSC conducted two rounds of a demand-side national study in 2020 to assess the impact and effectiveness of the PMGKY across 18 states. MSC covered 5,081 respondents in each round. MSC conducted the first round in April (during the lockdown period) and the second round in September.

The Promise of Blended Finance for Financial Inclusion

Ramraj Pai
Vedant Batra

8

8.1 THE POWER OF NON-BANKING FINANCIAL COMPANIES TO DRIVE THE FINANCIAL INCLUSION AGENDA

With almost 200 million adults outside the financial net, India has the world's second largest unbanked population.[1] This unenviable scenario is the outcome of a society plagued by poor financial literacy, unreliable credit history and an insufficient rural banking infrastructure. The ongoing COVID-19 pandemic has further underlined the importance of strengthening financial security in India. In particular, ensuring the timely delivery of credit to revive stagnating business activity and falling wages. Given the absence of a deeper geographic and socio-economic penetration of the formal banking system, non-banking financial companies (NBFCs) need to play a central role in driving India's financial inclusion agenda. In the past few years, NBFCs have come a long way in terms of their scale and diversity of operations to provide liberal access to credit. The NBFC model has evolved to focus on three key dimensions.

8.1.1. NBFC Potential Constrained by Structural Infirmities

Despite the advantages and immense potential to drive financial inclusion and rural growth, the NBFC sector has been facing multiple challenges in the past few years. After witnessing a double-digit balance sheet growth for 3 consecutive years, 2019–2020 marked a significant shift in the NBFCs' financial performance. A challenging macroeconomic environment has resulted in substantial deceleration in NBFC asset growth, while portfolio quality has deteriorated across the sector. The ongoing COVID-19 pandemic has only exacerbated these systemic challenges. In particular, NBFCs are facing two major predicaments.

1. *Capital constraints:* NBFCs rely heavily on commercial banks and institutional investors for refinancing and funding the expansion of their portfolios. However, as reflected in Figure 8.1, because of recent economic shocks, equity investments into NBFCs have fallen by almost 50% since 2018. These constraints on sourcing capital highlight the need to use innovative financing models to recapitalize the sector.

1. *Last-mile impact creation:* Given their operations in the informal economy, NBFCs provide secure lines of credit to underserved population groups. In effect, facilitating last-mile lending by reaching beyond metro cities and tier 1 markets.
2. *Product innovation:* NBFCs embrace technology to serve diverse customer segments, such as first-time borrowers and seasonal farmers, who require innovative financial products to cater to their distinct needs.
3. *Maximizing efficiency:* NBFCs maximize impact per rupee spent through an effective use of leverage, allowing them to service a larger pool of beneficiaries using limited resources.

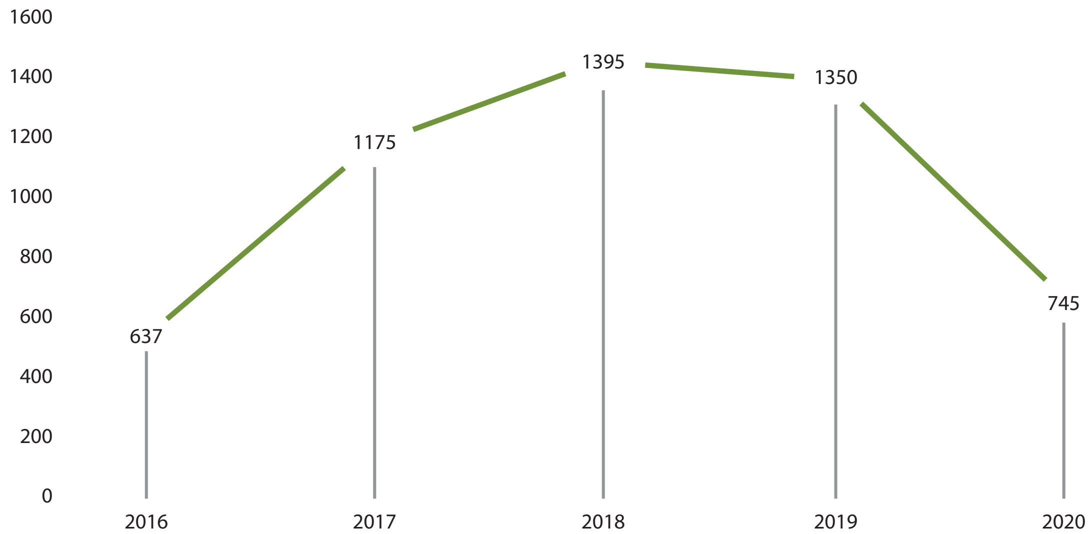


Figure 8.1. Estimated Annual Equity Investments in NBFCs (US$ Million)

Source: Impact Investors Council (IIC) Database.

2. *Balance sheet risks:* For NBFCs to facilitate the financial inclusion agenda, they need to expand their portfolio of low-income customers and first-time borrowers. However, the recent downturn in the economy has made lending to such riskier borrowers much more challenging and a gloom of risk aversion has set in. Hence, it is imperative to 're-balance' the risk–return continuum of NBFCs to allow more credit to comfortably flow towards rural India.

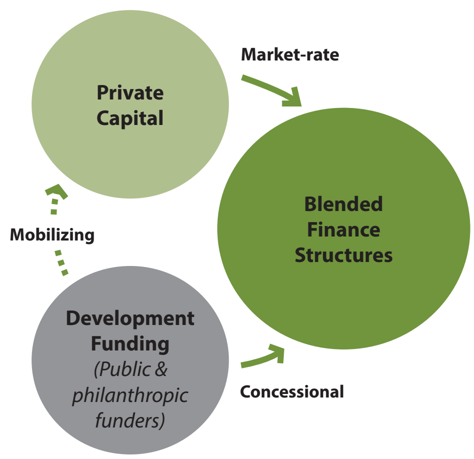
Given these economic bottlenecks, there is a need to look beyond traditional financing models to revitalize India's NBFC sector. Embracing innovative financial structures such as blended finance can not only augment the flow of commercial capital for financial inclusion but also boost the impact of development funds through leverage. In essence, blended finance can help make NBFCs an attractive proposition for investors while de-risking the flow credit to those who need it the most.

8.2. BLENDED FINANCE: AN OVERVIEW

'Blended finance is the use of catalytic capital from public or philanthropic sources to increase private sector investment in sustainable development.'[2]

—Convergence

As outlined by the definition above, blended finance enhances the impact of philanthropic and government funding by the following:



1. Leveraging the funds to unlock the trillions of dollars of commercial capital available in global markets
2. Mobilizing the commercial capital to finance socio-economic development

Blended finance structures are used to re-balance the risk–reward profiles of pioneering, high-impact investments that would otherwise be deemed too risky to fund. The catalytic nature of such transactions allows governments and foundations to address market failures by utilizing their corpus of funds more efficiently and judiciously. As delineated in Figure 8.2, blended finance structures have been gradually gaining momentum over the past decade. To date, more than $150 billion in capital has been cumulatively deployed through over 4,000 blended finance deals across sectors and geographies.

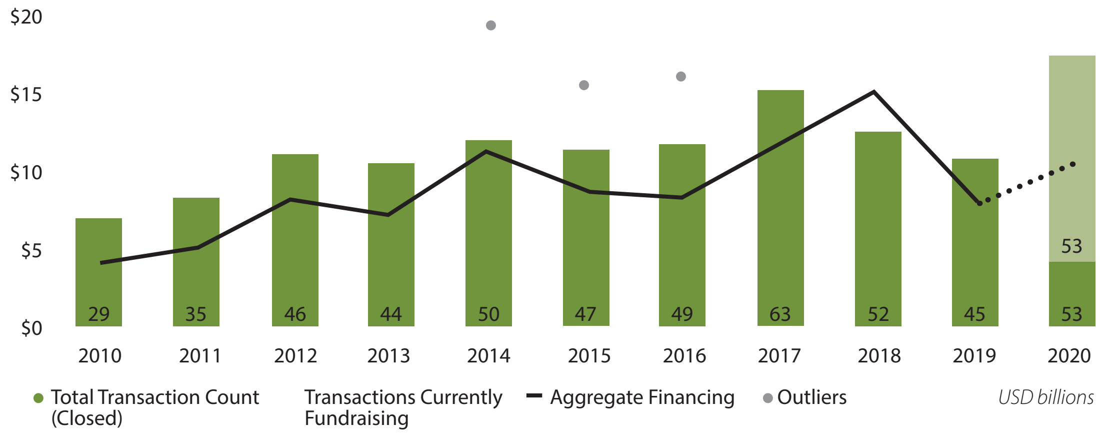


Figure 8.2. Overall Blended Finance Market (2010–2020)

Source: Convergence State of Blended Finance 2020 (https://www.convergence.finance/resource/3902657f-693e-453a-ba75-ca3bf7d2448e/view).

The blended finance ecosystem in India has also witnessed sustained growth, and is now at a tipping point, poised for accelerated adoption. While the pandemic has compounded the demand for development funding, the supply has been constrained by economic shocks. There is now mounting pressure to demonstrate greater impact using a limited pool of resources. In such a scenario, the importance of using blended finance to leverage commercial capital becomes pivotal, paving the path to a rich ecosystem on a high-growth trajectory.

8.2.1. Blended Finance for Financial Inclusion

Blended finance offers promising potential to not only support NBFCs but also provide substantial additional gains to bottom-of-the-pyramid beneficiaries such as farmers and micro, small and medium enterprises (MSMEs). The innovative structuring approach has a number of key advantages that make it a powerful tool to further India's financial inclusion agenda.

1. *Promoting flexibility:* Blended finance provides NBFCs the flexibility to innovate and explore novel funding models, structure diverse financial products and undertake asset experiments (such as packaging loans with different interest rates).
2. *Mitigating risks:* Blended finance structures help facilitate risk-sharing, allowing lenders to disburse credit to customer segments that fall outside the risk appetite of traditional funding channels.
3. *Crowding-in capital:* Blended finance allows NBFCs to leverage risk-embracing funds from foundations, which can accommodate below-market returns, to crowd-in more commercial capital for financial inclusion.

8.3. BLENDED FINANCE MODELS TO ENHANCE NBFC EFFICIENCY IN INDIA

Blended finance principles can be adopted to solve pressing challenges in critical sectors such as MSME and agriculture where a lack of credit is hampering India's economic growth. In particular, the use of catalytic structures, as demonstrated by the case studies[3] delineated, can strengthen NBFC balance sheets through asset and liability-based interventions along with more novel pay-for-success (PFS) models.

8.3.1. Asset-based Intervention

An asset-based intervention seeks to help expand an NBFC's loan book and thereby improve access to credit in underserved communities. In essence, catalytic capital is used to mitigate the risks associated with lending to first-time rural customers. This de-risking allows NBFCs to lend to a larger pool of borrowers and promote last-mile financial inclusion.

A powerful asset-based blended finance intervention is that of first-loss guarantees. This structure allows public and philanthropic investors to use their capital for risk insurance by covering an initial tranche of defaults on an NBFC's loan portfolio outstanding. By reducing potential downside, first-loss guarantees allow more risk-averse capital from NBFCs and last-mile lenders to enhance the availability of credit for low-income customers. The structure also optimizes the use of funds, as the amount guaranteed is only disbursed in the case of a loss.

Figure 8.3: depicts how a simple first-loss guarantee to catalyse greater capital flow towards financial inclusion can be structured.

Figure 8.3. Basic First-Loss Guarantee Structure for NBFCs

Source: Author.

In this structure, a foundation leverages its grant capital and agrees to pay an NBFC partially or fully to fund an initial set of delinquencies in the NBFC's portfolio of loans. On the basis of this promise, the NBFC is able to provide loans at competitive interest rates to borrowers because the guarantee de-risks the investment through loss insurance, thereby reducing the cost of capital for beneficiaries. This 're-balancing' by leveraging grant capital increases the availability of funds to borrowers such as MSMEs and farmers, and consequently creates an exponential impact. Furthermore, market efficiency is augmented as the guarantee is only invoked in the case of non-payment by the borrowers.

The catalytic nature of asset-based blended finance interventions provides foundations a worthwhile adjacency to their traditional grant financing models. For instance, there is a philanthropic fund with $ 1 million in capital to spend. The fund can either expense the amount out as charitable grants or use the capital as a first-loss guarantee to make credit disbursements in the financial inclusion sector more palpable for NBFCs. In this model, the same base of $ 1 million can be leveraged to crowd-in a larger pool of funds from the financial sector and create much greater impact relative to the traditional grant model.

Addressing the NBFC's Moral Hazard

A key area of concern that foundations and development agencies have when partnering with NBFCs is ensuring that their funds are being earmarked for social impact, that is, the NBFCs are demonstrating intentionality towards using blended finance structures to drive credit to underserved segments of the population. If the leveraged philanthropic capital is not supporting marginalized beneficiaries as intended, it would be in violation of the very principals that blended finance structures are designed to uphold. Therefore, it is often necessary to address NBFCs' moral hazard by creating frameworks and processes that incentivize lenders to utilize funding appropriately and create measurable impact. This can include the following:

- Having a strong programme-related agenda to ensure coverage of defined target segments while designing blended finance structures
- Periodic due diligence of NBFC portfolios to ensure that capital is being lent to the identified target groups
- The use of appropriate impact metrics to quantify the social impact made by the loans (e.g., tracking the percentage of female borrowers in the portfolio)
- Exploring structures that only facilitate risk mitigation once certain impact targets are met. For example, in the case of asset-based interventions, second-loss guarantees generally incentivize NBFCs to lend more prudently (as opposed to first-loss structures).

Case Study 8.1. Credit Guarantee Fund Trust for Micro and Small Enterprises

Objective: To facilitate access to credit for underserved borrower segments. The fund aims to support first-generation entrepreneurs and underprivileged sections of society who lack collateral security and/or third-party guarantees for supporting their enterprises.

The Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) implements the credit guarantee scheme. The funds for the guarantees are promised by the government of India and Small Industries Development Bank of India in the ratio of 4:1. The scheme seeks to reassure lenders that, in the event that an MSME unit, which availed collateral-free credit facilities, fails to discharge its liabilities to the lender, the Guarantee Fund Trust would make good the loss incurred by the lender (such as a scheduled commercial bank) up to 50/75/80/85% of the credit facility.

As of 2021, guarantee coverage has been made eligible to select NBFCs and small finance banks (SFBs). During FY 2020, CGTMSE registered 23 NBFCs (bringing the total to 29 NBFCs). This has allowed for a greater flow of capital to small-scale MSMEs that are largely financed by NBFCs and are responsible for a substantial portion of rural employment. The extent of the guarantee cover is 85% for such micro-enterprises (for credit up to Rs. 0.5 million), providing NBFCs more flexibility in terms of growing their loan books.

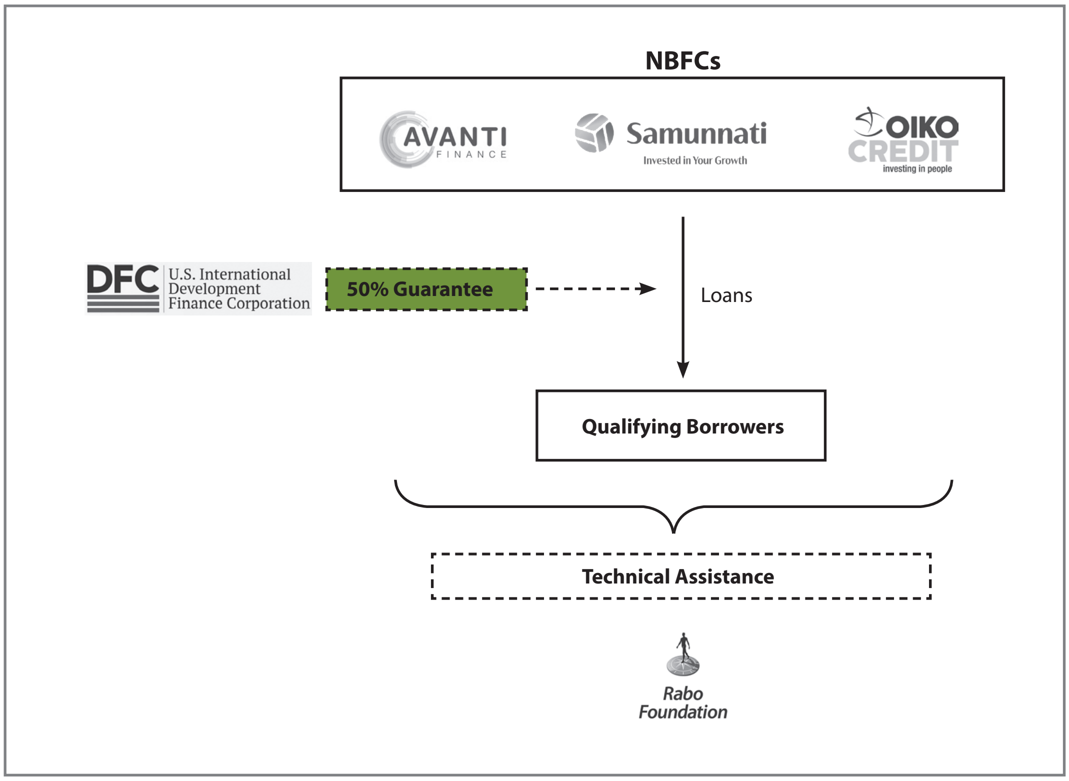
Impact: During the last 18 years of operations, CGTMSE has approved over 3.4 million guarantees covering loans amounting to over Rs. 1.75 lakh crore on cumulative basis.

Case Study 8.2. COVID-19 Response Fund for Agriculture Transition

Objective: To provide loans that enable a transition towards green and inclusive agriculture in India. The credit will help build the resilience of farmers and MSMEs in dealing with the ongoing pandemic and facilitating climate change adaptation.

Launched in September 2021, the India Covid Response Program for Agriculture Transition is a $ 55 million financing facility through which three NBFCs—Samunnati Financial Intermediation & Services, Maanaveeya Development & Finance and Avanti Finance—will lend to qualified borrowers in the agriculture sector to the following:

- Address the issue of food loss
- Facilitate digitization of smallholder farmers
- Transition low carbon farm practices using renewable energy
- Capitalize women-focused farmer producer organizations



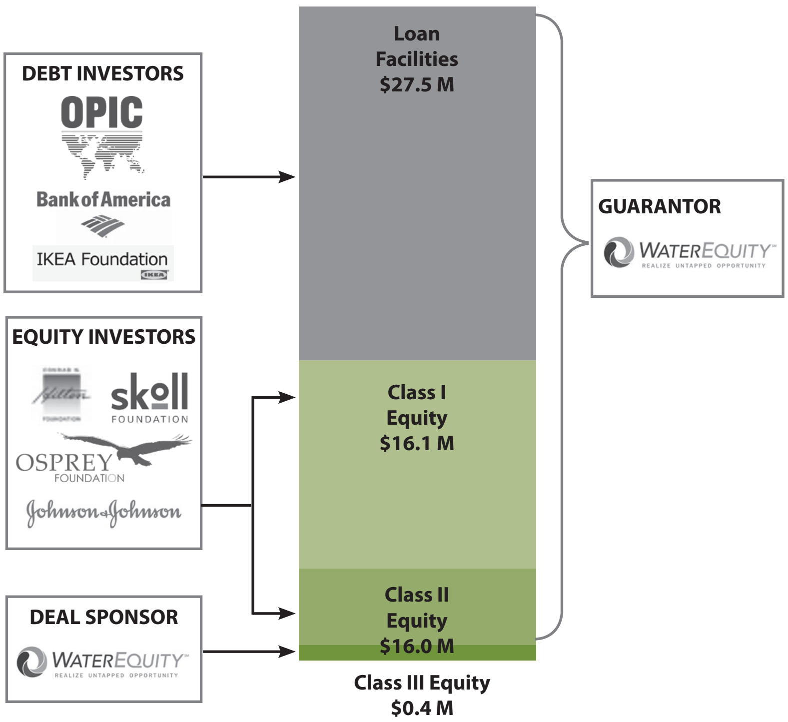
As part of this structure, the US Development Finance Corporation and United States Agency for International Development (USAID) will provide a partial credit guarantee up to 50% of total loans disbursed through the programme. This guarantee will help mitigate potential downsides for the NBFCs through risk-sharing. Furthermore, Rabo Foundation will provide technical assistance funding to facilitate capacity building efforts for the borrowers. The fund aims to reach 1 million smallholder farmers by 2025.

Case Study 8.3. WaterCredit Investment Fund 3

Objective: To invest in financial institutions, including microfinance institutions, and enterprises providing water and sanitation loans, products or services to families living in poverty in India and Southeast Asia.

WaterCredit Investment Fund 3 (WCIF3) provides debt financing and first-loss guarantees to financial institutions and enterprises serving the water and sanitation needs of families living in poverty in South and Southeast Asia. Further, WCIF3 also benefits from a first-loss guarantee on all three classes of shareholder capital as well as the loan facilities to provide assurance to senior capital providers given the assumed underlying risks on the portfolio. The guarantee covers the fund's principal and returns up to $ 5 million, via philanthropic funding raised by WaterEquity.

WCIF3 achieved its final close at $50 million in March 2019, attracting investments from a range of impact investors, including foundations, high net worth individuals (HNI) and development finance institutions (DFIs). WCIF3 began disbursing capital immediately after close, deploying seven loans to microfinance institutions, resulting in 60,000 micro-loans to families living in poverty.



Investment sizes: Minimum $ 250,000 for enterprises and $ 500,000 for financial institutions

Capital structure: Equity = $ 22.5 million, debt = $ 27.5 million, first-loss guarantee = $ 5 million
Impact to date: 60,000 micro-loans made by investees; 93% of borrowers are women; 224,100 people with access to sanitation; 39,700 people with access to water; 37,300 with access to water and sanitation.

Case Study 8.4. Tamil Nadu Rural Transformation Project

Objective: To facilitate liberal disbursement of credit to underserved borrowers, incentivize timely repayments of loans and promote last-mile lending among financial institutions.

The government of Tamil Nadu is setting up a Matching Grant Program (MGP) under the $ 100 million Tamil Nadu Rural Transformation Project (TNRTP) with the support of the World Bank. Through this innovative financing mechanism, financial institutions will provide loans to select borrowers in the micro-enterprise segment, with a focus on women. If the borrowers repay 70% of the loan amount back on time, they will be eligible for a (complete or partial) waiver on remaining 30%. This waiver will be funded by catalytic grants through the World Bank supported TNRTP. The grants will be offered to the lenders upfront at the time of loan disbursal to reduce the blended cost of funds for borrowers *but will be conditional on the timely repayment of credit.* The MGP will thus help accelerate financial inclusion by incentivizing risk-taking and greater capital flows to underserved population groups such as women.

Case Study 8.5. Michael & Susan Dell Foundation Credit Guarantee Company

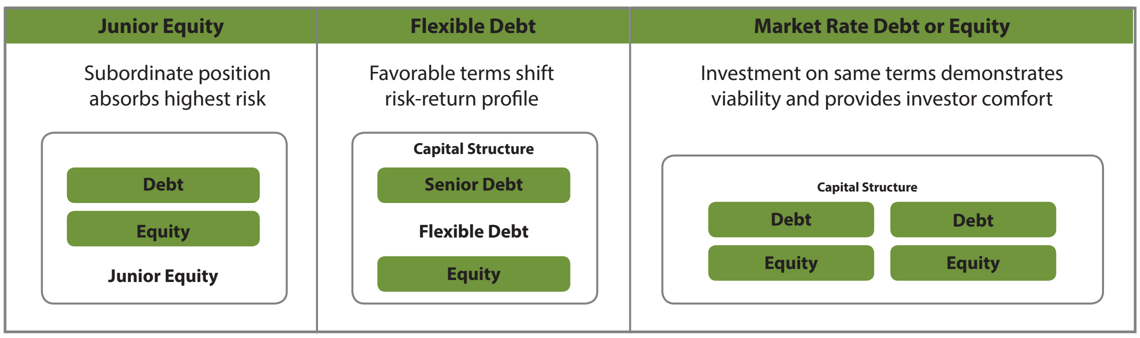
Objective: To enable a greater flow credit towards low-income households and micro-enterprises.

The Michael & Susan Dell Foundation (MSDF) has recently undertaken a Partial Credit Guarantee programme with Caspian Impact Investments to enable loans to NBFCs for on-lending to revive COVID-19-affected micro-enterprises. Building on this experience, MSDF is now working with select partners to offer a suite of credit guarantee products directly to NBFCs and SFBs. These innovative asset-based interventions will facilitate the scaling up of small, impact-focused NBFCs and help extend credit to the underserved micro- and nano-entrepreneurs. The foundation is working with a services facilitator for designing and rolling-out the product.

8.3.2. LIABILITY-BASED INTERVENTION

A liability-based intervention seeks to unlock additional sources of funding for NBFCs and other last-mile creditors. Such structures allow NBFCs to leverage concessional capital in order to raise a multiple of commercial capital at more favourable terms than normally possible. The new-found liquidity is further passed on by these lenders to end beneficiaries through benefits such as more liberal lending policies, flexible loan terms and lower interest rates.

The catalytic interventions are made possible by the introduction of concessional philanthropic financing into a fund or company's capital structure through market rate, flexible or junior debt/equity. The blending of concessional capital helps bring the risk–return profile of an investment opportunity to an acceptable level for investors. This 'risk-sharing' in turn incentivizes more capital to flow into NBFCs that would be considered too risky for purely commercial investments.



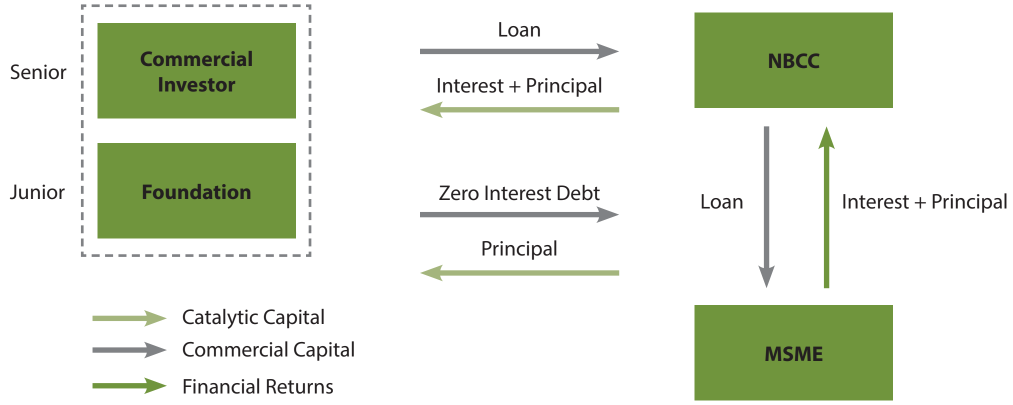


Figure 8.4. Blending Commercial and Catalytic Debt for NBFCs

Source: Author.

Figure 8.4 delineates how a liability-based structure can drive more liquidity towards NBFCs. In this model, foundations and development agencies provide loans at favourable terms or rates (such as a zero-interest loan) and package them with senior commercial debt from investors seeking market returns. The 'blending' minimizes the overall cost of capital for NBFCs and other last-mile lenders, promoting a greater flow of investments for financial inclusion. The subordinate concessional debt helps act as a sponge for any defaults that may arise, protecting the senior commercial investors. Furthermore, the fresh liquidity also leads to positive outcomes for borrowers through lower interest rates and more liberal disbursement of credit.

Similarly, other innovative structures, such as the use of flexible debt, can provide additional benefits to NBFCs. This includes the mitigation of future cash flow risks by offering dynamic interest rates and repayment schedules that meet the needs of borrowers such as farmers who have seasonal revenue schedules. Such flexibility helps lenders improve coverage ratios and therefore allows them to attract even more capital from commercial investors.

Case Study 8.6. REVIVE

Objective: To provide accessible and affordable capital to previously employed or self-employed workers and at-risk MSMEs with the goal of helping them either sustain their work or find alternative business opportunities.

REVIVE is an initiative of Samhita, the Collective Good Foundation, USAID and Omidyar Network India. The facility partners with NBFCs to deliver financial assistance in the form of *returnable grants*. A returnable grant is funding that comes with zero interest for the beneficiary. It is structured so that repayment only begins once the individual/entity is earning an income and is financially stable. The repaid money is then recycled and used to fund another beneficiary in need, leading to sustainable and exponential impact. The fund is targeting a total commitment of $ 13.7 million (INR 1 billion) from partners.

REVIVE also helps individuals apply for government financial support programmes and offers training, employment opportunities and capacity building resources to beneficiaries to strengthen their businesses. From textile workers to street vendors to artisans, REVIVE is expected to impact more than 100,000 MSMEs as well as self-employed and previously employed workers.

Impact to date: The platform has funded almost 40,000 beneficiaries as of today and has a 93% repayment rate on its grants. REVIVE has also raised around $ 6 million or 50% of its target fund size.

Case Study 8.7. Assam Agribusiness Investment Fund

Objective: To increase access to long-term risk-capital for growth MSMEs in the agriculture sector in Assam.

The government of Assam is collaborating with the World Bank to set up a multimillion-dollar Assam Agribusiness Investment Fund (AAIF) to support the growth of MSMEs in the agriculture sector. The fund will be governed by Securities and Exchange Board of India's (SEBI) alternative investment funds regulation and will have up to $ 15 million in anchor capital from the World Bank supported Assam Agribusiness and Rural Transformation Project to help crowd-in additional commercial capital. The AAIF will provide equity, quasi-equity and debt-financing ranging from $ 100,000 to $ 2 million to help investees achieve accelerated growth of their enterprises. The investment fund will be complemented by a technical assistance facility that will provide pre- and post-investment support to investees. The AAIF will therefore help contribute to improved productivity and job growth in Assam, where a significant portion of the population (~75%) is dependent on agriculture for livelihood.

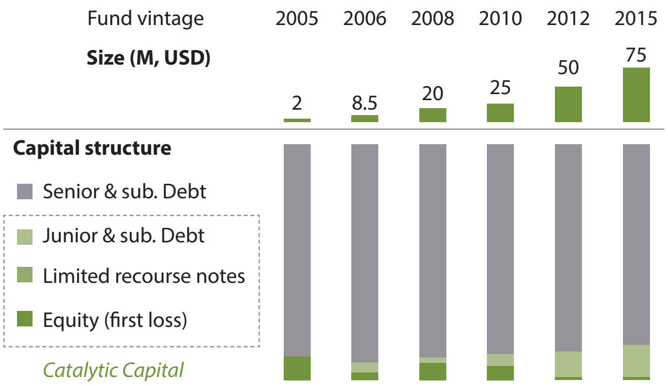
Case Study 8.8. Global Partnerships' Investment Fund

Objective: To expand livelihood opportunities for people living in poverty while delivering fixed income-level financial returns. GP extends loans to social enterprises mainly in the microfinance, agriculture and energy sectors in Latin America, Caribbean and East Africa.

Global Partnerships (GP) is a non-profit impact-led investor whose mission is to expand opportunity for people living in poverty. In 2005, building on a decade of grant-based programming, GP launched its first investment fund. Since 2005, GP has designed, launched and managed six debt funds. Through these funds, GP has extended $ 232 million in loans to over 100 social enterprises across 14 developing countries.

GP raised subordinated philanthropic funding to attract private investment and development finance in the form of senior debt. Through its funds, GP demonstrates that philanthropic capital can be deployed strategically to attract additional commercial investment and demonstrate proof of concept.

Capital structure: Multiple funds designed ranging from $ 2 million to $ 75 million in size using catalytic capital in the form of junior debt, first-loss equity and limited recourse notes, with senior debt raised from commercial investors.



Investment sizes: Debt Investments ranging from $ 250,000 to $ 1 million

Impact to date: GP has reached 825,000 clients through investees, of which 88% were females. In total, 1.79 million lives have been impacted by GP's investment funds. GP reached 68,000 farmers, of which 21% were females, who sold 93,000 tonnes of chia, coffee and sesame. In total, over 2 million solar units have been sold by GP investees.

Case Study 8.9. Vivriti Samarth Bond Fund

Objective: To provide debt to financial institutions that promote last-mile inclusion and support small businesses.

In June 2021, Vivriti Asset Management announced the close of its Rs 2.65 billion Samarth Bond Fund with a 6-year tenure. The alternate investment fund (AIF) utilizes a tiered blended finance structure with subordinate philanthropic funding (~20% of the committed capital) from impact foundations and HNIs being used to crowd-in senior commercial debt for financial inclusion. Loans of Rs 0.25–0.75 billion with tenures ranging from 2–4 years are offered to NBFCs and other lenders that extend last-mile finance to micro-entrepreneurs and low-income households. Samarth Bond Fund is India's first AIF to be rated AA+ (SO) for capital protection by Credit Rating Information Services of India Limited.

Impact to date: The fund has already deployed over 90% of its corpus across 15 investments, financing the livelihood of over 25,000 women micro-entrepreneurs and business needs of over 2,000 MSMEs.

8.3.3. Pay-for-success Contracts

PFS is an outcome-focused innovative financing mechanism that allows governments, foundations and other funders of social good to create positive impact through an efficient use of their funds.

As depicted in Figure 8.5, in traditional PFS models such as that of social impact bonds (SIBs), the financing mechanism shifts the financial risk from a government agency to a new risk investor. This investor provides capital upfront to scale up an evidence-based social programme with the goal of improving outcomes for targeted population groups. An independent evaluator conducts periodic assessments to determine whether the intended outcomes are being met or not. If the evaluator shows that the programme achieved agreed-upon outcomes, then the investment amount is repaid by the outcome funder (in this case, the government) to the risk investor with added interest proportional to the level of the programme's success. If the outcomes are not met, the risk investor generally takes a loss. As the government only makes payments if the programme is successful, it ensures that public spending is routed only to the most impactful projects.

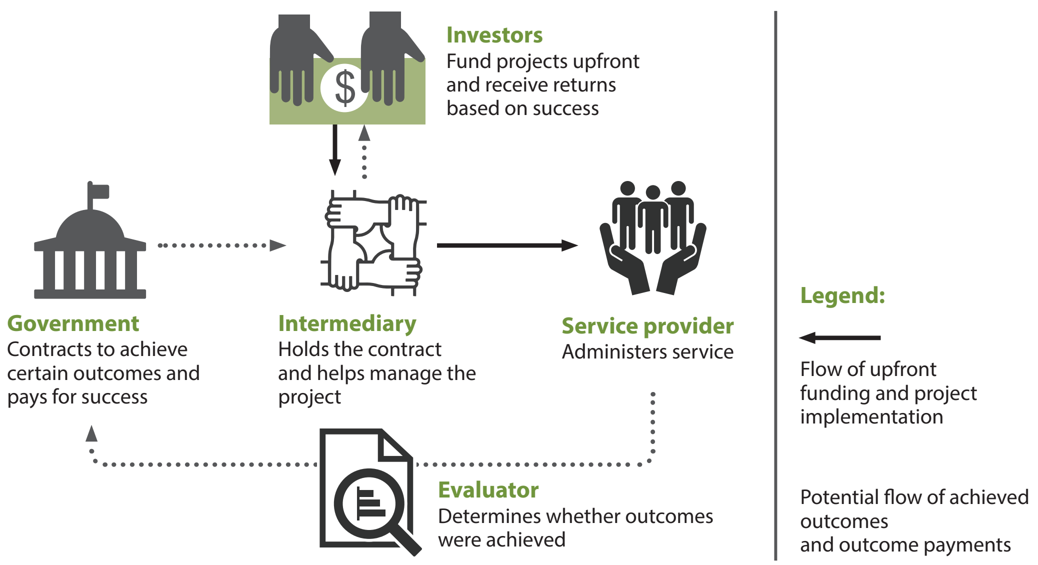


Figure 8.5. Visualizing Social Impact Bonds (SIBs)

Source: US Government Accountability Office (GAO) (https://www.gao.gov/products/gao-15-646).

There are currently around 200 such impact bonds active globally with almost $ 500 million in total outcome funding committed.[4] SIBs are largely concentrated in developed markets where governments have the financial security to take part in such pioneering transactions. However, over the past few years, PFS structures have evolved to cater to a wide variety of stakeholders across the value chain, a phenomenon that has also benefitted the financial inclusion sector. Filling in the void left open by a lack of government participation in emerging markets, foundations in India have increasingly taken on the role of outcome funders from governments in contracts known as development impact bonds (DIBs). Through such DIBs, foundations have designed innovative structures that can mobilize their grants to be utilized by NBFCs and other last-mile lenders. Such structures not only help drive accessibility to credit but also support key areas such as education and healthcare that are often considered too risky to be funded by purely commercial investors, particularly in the context of low-income beneficiaries. Furthermore, in doing so, DIBs have allowed foundations to meet their development objectives by leveraging their corpus judiciously and providing NBFCs a new avenue to raise cheap capital, thereby creating more impact per rupee spent than traditionally possible.

Case Study 8.10. MSDF and Varthana—Leveraging Financial Inclusion for Education

Objective: One of the biggest challenges that affordable private schools (APS) in India face is the lack of access to credit. This isolation from formal financial markets leads to poor school infrastructure and substandard pedagogy, thereby harming the learning outcomes of low-income students. In order to help overcome this dilemma, MSDF partnered with Varthana, an NBFC that provides loans to APS to increase the quality of education offered. The foundation designed a novel PFS financing mechanism that linked learning outcomes to financial incentives for such APS.

Through this resourceful impact-linked debt instrument, MSDF and select commercial investors provide capital upfront to Varthana. The NBFC then further lends this amount to APS through loans that mature in 2–4 years. At the beginning of this loan programme, an independent agency assesses students' learning outcomes and sets a baseline for the schools, thereafter conducting periodic assessments for a period of 2 years. Based on the improvements in learning outcomes, the schools receive a rebate on the interest of their loans from Varthana up to a maximum of 10% of the loan amount. This rebate is funded by a further rebate in the interest on MSDF's loan to the NBFC. In addition, Varthana also receives a bonus financial reward linked to the school's performance relative to the baseline established. This innovative design ensures that the foundation pays only for demonstrated outcomes (as MSDF absorbs the cost of the rebate only when learning targets are met), while incentivizing the APS sector to prioritize learning improvements. In case none of the targets are met, MSDF, the commercial investors and Varthana still end up making net gains through the transactions.

Impact to date: So far, MSDF has committed $ 3 million while commercial investors have committed $ 6 million as part of this $ 9 million impact-linked funding instrument. Through the application of blended finance principles, learning outcomes for over 200,000 low-income students have been improved in 337 APS in 11 cities across India.

8.4. THE PATH FORWARD: A FLOURISHING BLENDED FINANCE ECOSYSTEM FOR NBFCS

The intention behind this chapter has been to demonstrate that blended finance can play a key role in the collective responses of governments, foundations and investors by accelerating India's socio-economic development. Despite the challenges, be it regulatory or financial, the specific models and interventions[5] that have been outlined can help India create an enabling and collaborative environment to drive last-mile financial inclusion by revitalizing the NBFC sector. Re-imagining grants and charity to help mobilize commercial capital would not only augment the government's developmental efforts but also foster a sustainable ecosystem that can revolutionize the way we think about credit. Such a path forward would require all stakeholders to strive towards a common goal and three key recommendations to do so are outlined below.

8.4.1. Support the Creation of an Industry-level 'Blended Finance Credit and Refinance Fund'

While bespoke one-to-one structures to enhance the use of blended finance for financial inclusion can be powerful, a large institutional arrangement at an industry-wide level could well be the catalyst the sector needs. Such an overt initiative towards providing refinancing, risk-sharing, as well as funding facilitation, particularly for small-scale NBFCs, can prove to be powerful tool to reinvigorate the sector's financial health. The initiative could operate much like a traditional fund structure and receive funding in the form of market rate as well as concessional equity, debt and grant financing. A fund of funds model could also be considered for targeted interventions in newer avenues (equity for MSME finance), specific sectors (debt for climate finance) and uncharted geographies (financially excluded districts).

The legal structure may need some tweaks given the wide range of domestic and international institutional capital that could flow in through such a fund. Therefore, this would need to be a national initiative run by our leading Development Finance Institutions (DFIs), attracting a variety of private, government and concessional capital across asset classes. The philanthropic funding could be structured to support the higher risk segments and other pioneering asset experiments to maximize the availability of commercial capital for the fund.

8.4.2. Build the Social Impact Narrative of Small NBFCs and Increase Their Participation in Blended Finance Transactions

In general, there is a lack of awareness around the role played by smaller NBFCs in the financial inclusion agenda. Furthermore, there is a perception that if governments are actively engaged in the financial inclusions agenda, private sector interventions may not be as important. As a consequence, development foundations are relatively less active in this space, hampering the capacity and scope of blended finance opportunities for financial inclusion. There is, therefore, a pressing need for the stakeholders in the blended finance market to build a strong narrative around how the use of leverage in NBFCs allows for amplification of social impact. Furthermore, the nature of blended finance transactions allows for grant funding to support commercial capital leading to an even higher capacity for leverage. Policy advocacy to support blended finance in NBFCs would enable a wider base of participants to become grant providers and risk investors, a scenario that is necessary for the maturity of the sector.

8.4.3. Pursue Regulatory Intervention to Allow for a More Vibrant Blended Finance Ecosystem

The IIC has recently undertaken a detailed study to facilitate the development of a more active blended finance market.[6] While an in-depth exposition is outside of the scope of this write-up, outlined below are two structural challenges that, if mended, will allow a wider variety of blended finance transactions to be adopted.

1. Provide legal sanction to the concept of returnable grants, particularly from a tax perspective. The blending of grants typically involves the usage of grant capital from a risk mitigation angle. Therefore, there is a possibility that the grants may not be used (and therefore need to be returned, wholly or partially) should the risk in a specific transaction not manifest itself. However, this is a concept that has regulatory ambiguity from a tax perspective and may be construed as a profit-seeking activity, leading to a likely implication on the tax-exempt status of certain foundations.
2. A social venture fund (SVF) is an agile structure that can allow for efficient blending at the fund level to support a variety of blended finance transactions. However, the present SVF initiatives in India have a variety of challenges including uncertainty around the ability of the SVF to accept charitable donations and payback returns to commercial investors. This lack of policy clarity begets predicaments in terms of structuring a blended finance vehicle efficiently. An overhaul of the SVF framework to permit the inflow and outflow of a wide variety of equity, debt and grant funding from both domestic and offshore[7] sources can catalyse the development of India's blended finance market.

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[3] The branchless mode outlets include BCs, ATMs, PoS points, USB, mobile vans and any other mechanism that provides a touch point for the customer of the bank.

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Digital Highways for Social Protection: Delivering Entitlements on the Doorsteps

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Dvara Research[1]

9

THE EMERGENCE AND SIGNIFICANCE OF WATER SUPPLY AND SANITATION LENDING

9.1. Introduction

The social protection landscape in India is transforming at rapid speed owing to the digitization of the various systems that are involved in the process flow of social protection delivery. Especially in the aftermath of COVID-19, this phenomenon has gained even greater momentum. In this chapter, I describe this phenomenon, which is unfolding around the world, with India leading the way in many respects. I also describe the constitutive elements of an evaluation framework that various stakeholders could use to assess the performance of these newly emerging tech systems.

9.2. Social Protection for the Informal Sector

The state of the informal sector in India and its need for social protection are articulated in this author's chapter contribution to the IFI Report of 2020.[2] In this section, I briefly recall the contents of that chapter, as they will be relevant for this chapter. The first thing to note is that according to some estimates, as of 2017–2018, the non-farm informal sector had grown by 34% since 2004–2005.[3] The COVID-19 pandemic has produced even further 'informalization'. According to a World Bank report,[4] more than 30% of the labour force that could be categorized as formal in December 2019 had transitioned to informal status by April 2020. Perhaps reproducing the experience of the previous 15-odd years, much of this recent growth would most likely have happened at the micro-end of the small-business sector (solo, nano, etc.).

These trends are of concern because employers in the informal sector are not subject to the Code on Social Security, 2020, which would otherwise have held them responsible for providing certain forms of social protection to their employees. The Unorganized Workers' Social Security Act, 2008, provided for registration of unorganized workers, but did not make specific provisions for social security measures, which is a failing that in fact does not incentivize unorganized sector workers to register in the first place. There is, instead, a mélange of schemes for the informal sector, but not designed for that sector per se (they are meant to cover any person outside the scope of organized sector employment). Also these schemes are not coherently conceived to offer comprehensive protection. Indeed, most of them are formulated via executive order which often seems to traverse an arbitrary course via the politics of representation as the political landscape appears to shift from one electoral cycle to the next.

Yet, informality brings with it specific forms of vulnerability that are deeply problematic from a poverty alleviation perspective, if not just a humanitarian one. Informal sector workers do not have steady and assured employment and income. Data from the May–August 2020 wave of the Centre for Monitoring Indian Economy's (CMIE) Consumer Pyramids Household Survey (CPHS) indicate that (a) almost the entire informal sector is dependent on daily or weekly payment of wages, (b) informal laborers suffered substantial pay cuts in the immediate aftermath of COVID-19, (c) the majority of informal sector households carried negative surpluses during May 2020, (d) the proportion of informal sector households below the poverty line increased by 2 percentage points (from 13% to 15%)

between May 2019 and May 2020. At times of income stress, informal sector households are unable to liquidate financial assets, because they hardly own any – instead, most of their wealth is locked up in illiquid real assets.[5] Likewise, the CPHS data also reveal that informal sector households have limited access to basic risk protection mechanisms such as life insurance, health insurance and pensions (income during retirement). This is particularly troubling since informal sector workers are often employed amidst the most hazardous workplace conditions, and a serious workplace injury to the primary income earner in an informal sector household is one of the most common reasons for such a household to slide into poverty.

The difficulties faced by the informal sector during times of severe income strain became all too evident during the pandemic-induced lockdown. In order to understand how households coped during the lockdown, Dvara Research added some questions to the CMIE CPHS survey wave of May–August 2020. The survey indicated that among households that suffered an income loss, more than 10% had members looking for additional sources of income. Other coping strategies were borrowing in kind from social networks, reduction in consumption and use of savings by households to manage liquidity crises. Of these coping strategies, reductions in consumption were used by 60% or more households that were surveyed. This would have imposed long-term costs on household health (and, therefore, household finances) as both quantity and quality of food intake were most likely compromised.

Wave 1 of the pandemic and its attendant lockdowns were accompanied by announcements in March 2020 and May 2020 of a slew of government programmes intended to provide relief to the informal sector. Many of these programs involved direct transfers of cash to beneficiaries through digitized modes. This is the new face of Direct Benefit Transfers (DBTs), wherein cash entitlements under welfare schemes are directly transferred into the bank accounts of registered beneficiaries. This brings us to the theme of this chapter, which is the digitized delivery of social protection. Dvara Research has documented several forms of exclusion that continued to happen in the implementation of DBT schemes during the COVID-19 pandemic underscoring the equal, if not greater, importance of avoiding erroneous exclusion vis-a-vis preventing erroneous inclusion. Indeed, exclusion was found to occur at every stage of the delivery chain from the first step of identification all the way through to the last step of cash-out, even as the digitization of social protection has continued apace in India, as elsewhere in the world.

It is against this background that an assessment of these newly emergent social protection tech systems becomes a matter of timely reckoning. If we are locked in on an irreversible course towards a future where all manner of social protection programs are to be digitally administered and implemented, for the most part, then the following questions arise: What is the nature of such systems? What are some examples of these systems? What challenges and risks do these systems pose? Is it possible to articulate a set of normative criteria against which the performance of such systems could be evaluated? These are the questions that I take up for investigation in the subsequent sections of this chapter.

9.3. The 'Platformization' of Social Protection, or SP-ODEs

The digitization of social protection is one aspect of a broader change sweeping the globe. This is the digitization of governance itself. Pope cites India Stack as a prominent example of this new phenomenon. IndiaStack is 'a set of Application Programming Interfaces (APIs) that allows governments, businesses, start-ups and developers to utilize a unique digital infrastructure to solve India's hard problems toward presence-less, paperless, and cashless service delivery'.[7] Pope also offers examples from the United States, Estonia, UK, Italy and Argentina. In each of these cases, critical aspects of the government establishment are being re-conceptualized and re-instated as a 'platform', which is a 'whole ecosystem of shared APIs and components, open-standards and canonical datasets, as well as the services built on top of them and governance processes that (hopefully) keep the wider system safe and accountable'[8] The users of such a platform could be the team developing it, politicians and senior government officials, administrators, procurement managers, designers, developers and the general public. Argentina's MiArgentina is a service delivery platform that offers a host of public services, one of these is digital driving licenses. In 2019, the country's then Undersecretary of Digital Government, Daniel Abadie, was quoted as saying that the next areas MiArgentina would look to cover are car insurance, vehicle ownership and disability certificates[9].

Platforms for governmental services are also variously referred to as GovTech systems, digital government systems, and Open Digital Ecosystems (ODEs). In what follows, I will use the last of these terms (ODEs) to describe government platforms. According to a 2020 report by Omidyar Network India and Boston Consulting Group, ODEs are 'open and secure digital platforms that enable a community of actors to unlock transformative solutions for society, based on a robust governance framework'.[10] The ODE approach is to create a shared technology infrastructure for service delivery by both public and private entities, in accordance with a set of design principles such as interoperability among disparate systems and datasets and an explicit and heightened concern for data protection and data security. In what follows, I use the term social protection tech systems, or social protection ODEs, SP-ODEs in short, to characterize the harnessing of such ODEs for the delivery of social protection.

In the context of social protection delivery, openness has the following meanings: (a) 'open' to engaging non-government actors such as non-governmental organizations, civil society and payment delivery players across all processes supported by the ODE for social protection, (b) the presence of 'open-source' building blocks to prevent vendor lock-in, and (c) 'open' to innovation that leverages data for citizen-centric use-cases. The first of the above requirements will become clearer further when I lay out the functional processes that an SP-ODE is designed to execute, and we will also see, in the form of a diagram, how these various actors feature in an SP-ODE. The second of the above requirements refers to building blocks which are 'packages of functionality designed to meet business needs'.[11] Essentially, they are built using open standards and to serve a specific technological or business purpose. They can function independently while also having cross-functional usage. Most importantly, they are interoperable with other building blocks and systems through open APIs. For instance, the Aadhaar ID could be a building block for an SP-ODE that wishes to identify beneficiaries in an efficient, pan-India manner. The third of the above requirements implicates the idea of 'citizen-centricity', to which I return later when I discuss the evaluation of SP-ODEs.

At this point, it will be useful to define the term 'social protection' to mean something specific. In accordance with scholars Stephen Devereux and Rachel Sabates-Wheeler, I take it to mean 'public initiatives that provide income or consumption transfers to low-income households and individuals, protect them against livelihood risks, and enhance their social status and rights'.[12] The end-to-end design and delivery of these public initiatives consist of various elements, each one essential to the composite function of social protection. This composite function is shaped by a comingling of financial budgets, political economy, scheme design, delivery systems and legal frameworks (among other aspects) aimed at providing support to the vulnerable households in the country. These are the various essential elements that together constitute social protection.

An SP-ODE is, then, a delivery mechanism for social protection as defined above, that is constructed using building blocks according to an ODE approach. The delivery of social protection involves multiple functional processes, and an SP-ODE may also be thought of as an assemblage of multiple moving parts primarily designed to support these processes. As mentioned earlier, an SP-ODE is also intended to host a wide range of stakeholders (citizens, government departments, service providers, etc.) who play various roles in each of the processes of delivery that the ecosystem supports. While different SP-ODEs may end up being different combinations of these elements, I present further, in Figure 9.1, a schematic representation of how a fully fitted SP-ODE may be understood. This schematic representation is derived mostly from ongoing SP-ODE formations in India, which is in many respects a world-leader in building these systems, and I will therefore focus on the Indian experience from here on in this chapter.

The flowchart in Figure 9.1 may be read in order of five functional processes.

1. **Identification and enrolment:** Primarily connecting the citizen with the concerned government department, this process pertains to the enrolment of citizens into social protection schemes as well as the verification of their identities, and eligibility as per scheme rules. This function may be enabled by the 'Citizen Module' of a digital platform, further supplemented by an 'Assisted-Access Module' for citizens to directly (albeit with assistance, if needed) enrol themselves for social protection schemes, submit requisite documentation, etc. This enrolment may sometimes end in the creation of a beneficiary registry, a comprehensive database of all citizens and their eligibility status. This database may be further enriched with data from other state-level databases. Typically, in such exercises of combining several databases into 'a single source of truth', a process of de-duplication is necessary to ensure that a single entry in the registry maps to a single individual in the real world.

2. **Coordination and orchestration:** The second functional process facilitated by the SP-ODE has to do with the back end, administrative aspects of social protection delivery. This may be supported by an 'Administrator Module', for government officials at various levels to discharge their scheme-related responsibilities. The module may be utilized to target citizens for various schemes, with the help of the registry created under the first process. It may also include monitoring and analytical capabilities to empower government officials with information regarding scheme performance.
3. **Payments:** This function is primarily activated for schemes that involve some element of cash transfer, and permits government departments to update information on eligible, enrolled beneficiaries (possibly powered by the registry, if one exists) whose payments are due. Payment channels may follow the DBT or non-DBT routes and optionally be supplemented by an alternate payment method. For example, in Andhra Pradesh, social protection payments were delivered door-to-door by a network of volunteers recruited at the Gram Panchayat level[13].
4. **Delivery of benefits:** To truly understand social protection delivery end to end, it is essential to understand how citizens may access benefits after transfers have been made to their bank accounts. The Delivery of Benefits process is a crucial component of access to social protection, and its efficacy may be determined by various factors such as the existing infrastructure of banks/ATMs, or even by the network of agent-led service delivery models (e.g., Common Service Centres, or CSCs) that exist today.
5. **Service provisioning:** The Service Provisioning process plays a key role in allowing the SP-ODE to host the gamut of social protection schemes that have a non-cash element. The key stakeholder in this function (Service Providers) will be private or public actors that provide the unit of social protection directly to the citizen. Service providers may be hospitals (in the case of health insurance schemes), financial service providers (in the case of, say, crop insurance or loan schemes), gas agencies (for LPG reimbursements), etc.
6. **Grievance redressal:** Finally and perhaps the only function that is crucial to any SP-ODE, no matter the context, is the presence of robust grievance redressal mechanisms supplemented by the requisite feedback loops. As the flowchart below depicts, grievance redressal modules may be located at various parts of the social protection delivery chain and interact differently with various stakeholders. For instance, grievance redressal may be accessible to citizens through the Citizen Module, grievances visible to administrators in the second function and service providers may collect and/or resolve grievances as well. This final function is a bedrock element in any SP-ODE and its influence pervades all other functions. While other processes may be more well-defined linear processes, the grievance redress mechanisms underpin the functioning of the entire delivery ecosystem.

As already mentioned, Figure 9.1 represent a fully fitted SP-ODE. Most real-world SP-ODEs are still in formation and, therefore, will not conform to this representation in toto. Nevertheless, the full picture is essential for gaining an appreciation of how these emerging tech systems are coming into formation. I turn to this next.

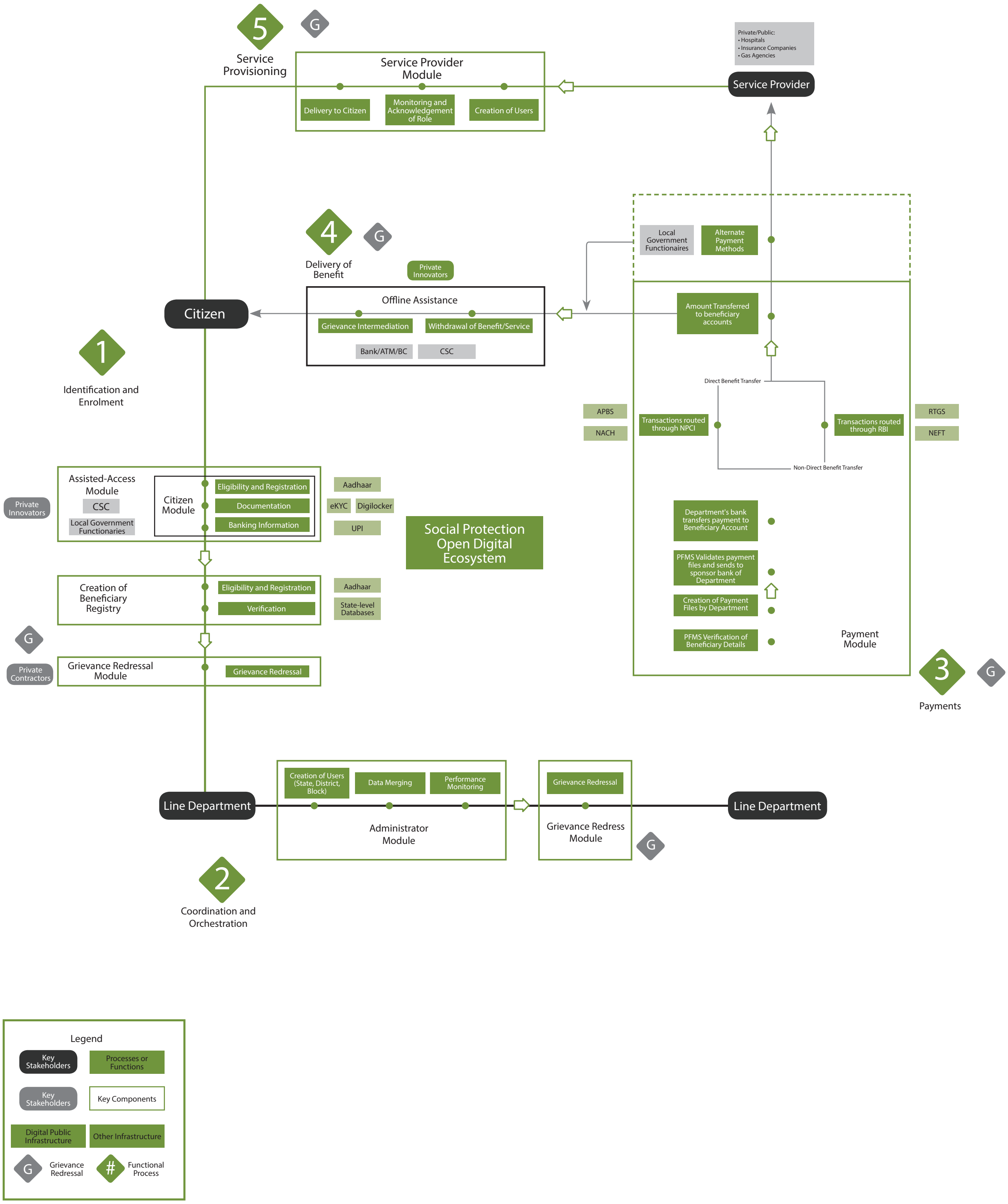

Figure 9.1. Schematic Representation of an SP-ODE

9.4. Some Use-Cases of SP-ODEs

I start with the use-case of the CoWIN ecosystem for booking vaccination appointments. It might be argued that this is a non-obvious use-case in that the service it offers does not exactly map to the definition of social protection advanced earlier. Yet, there are several reasons to include it in this section. Firstly, we can map the CoWIN ecosystem to the schematic of Figure 9.1, and this allows the reader to understand the schematic better. Secondly, the CoWIN ecosystem is a very contemporary example and, therefore. will be of considerable natural interest to the reader. Finally, given the highly contagious nature of the COVID-19 pandemic, it is not difficult to appreciate the attribution of a social protection element to the functioning of this ecosystem.

Figure 9.2 depicts this ecosystem, and we notice that functions/processes 3 and 4 from the generalized schematic are suppressed since they are not relevant for this use-case.

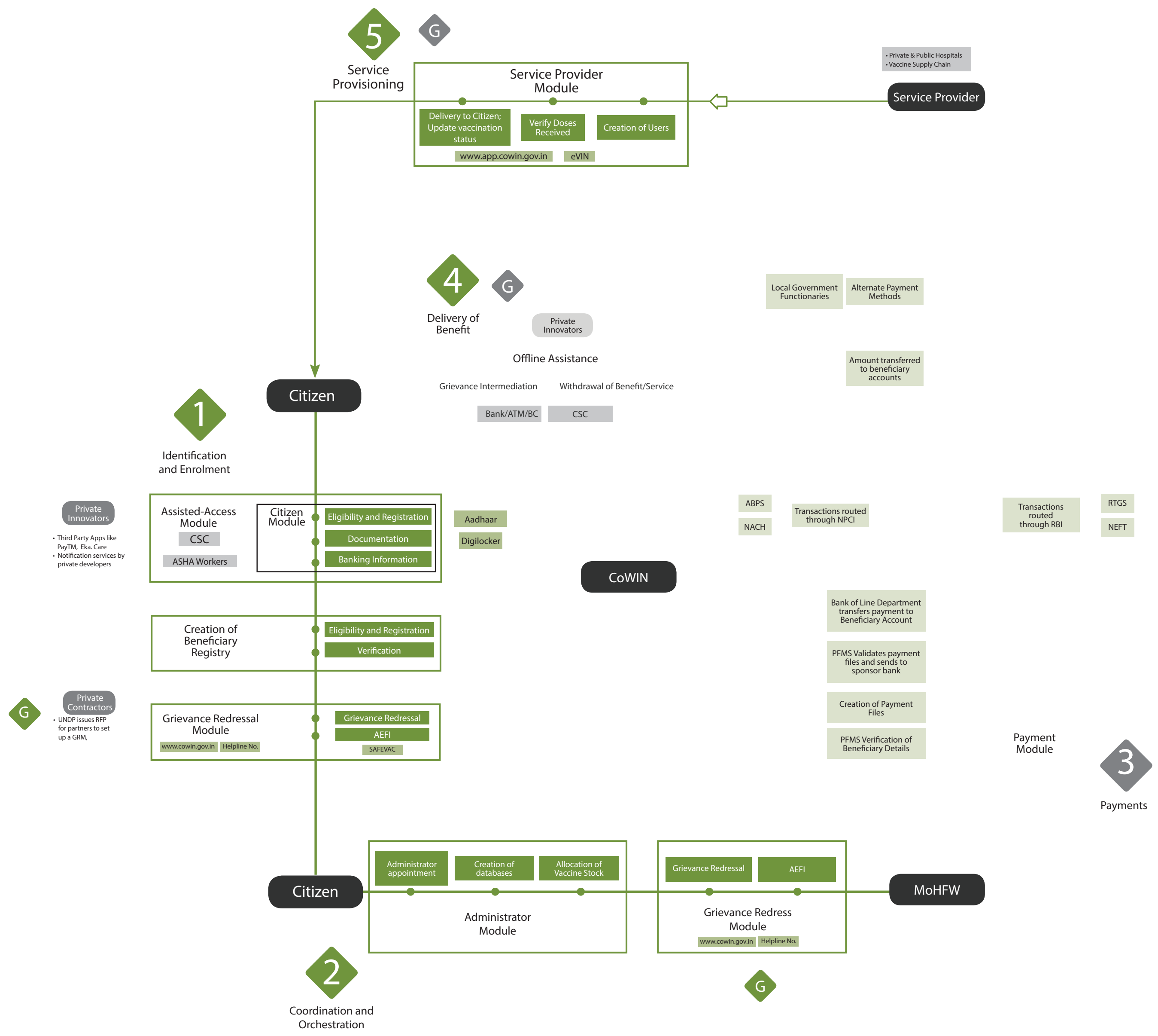

Figure 9.2. The CoWIN Ecosystem

The CoWIN ecosystem was announced in December 2020 as the platform that would facilitate India's vaccination effort.[14] The ecosystem acts as a 'cloud-based IT solution for planning, implementation, monitoring, and evaluation of Covid-19 vaccines in India.'[15] It has been conceptualized to provide 'end-to-end' support for the Covid-19 vaccination delivery system.[16] Managed by the Ministry of Health and Family Welfare, it was developed by the United Nations Development Programme (UNDP) on the ministry's behalf.[17]

The ecosystem is made up of four modules each performing a particular function in the vaccine delivery chain. It can assist in administrative management (through the 'Orchestration Module'), monitor vaccine supply chains (Vaccine Cold Chain Module), onboard citizens as vaccine recipients (Citizen Module), and update their vaccination status (Vaccinator Module), and issue certificates after inoculation (Certificate, Feedback and After-Effects of Immunization [AEFI] Module). The orchestration module creates administrators at the national, state and district levels to be high-level coordinators: creating databases, allocating roles to other system users, managing inventory and tracking registered beneficiaries (through www.app.cowin.gov.in). The vaccine cold chain module supports the procurement and supply chain logistics for vaccine stocks with a repurposed version of an existing web-based vaccine management system—Electronic Vaccine Intelligence Network. The tool digitizes COVID-19 vaccination stock and permits the real-time, remote monitoring of storage temperatures by vaccine and cold chain handlers through a mobile application and works in tandem with the citizen registration module. The vaccinator module is operated by vaccination officers to verify citizen identity and update citizens' vaccination status at the session site. The citizen registration module permits citizens to enrol themselves as vaccine beneficiaries and book appointment slots through one of the following access points: the www.cowin.gov.in website, the Aarogya Setu application or the UMANG application. The final module of CoWIN provides a second layer of ex-post interaction between the citizen and vaccine administrator for three purposes: issuance of vaccine certificate, collection and management of feedback and grievances and, finally, the reporting of relevant AEFI.

The remaining use-cases, eight of them, are collected in Table 9.1 below with brief descriptions of their various elements that should be self-explanatory. They represent a seven state-level and one centre-level SP-ODEs, some of them still in formation or under construction.

TABLE 9.1. SP-ODE USE-CASES

State/Centre and Implementing Department/ Ministry	Name of Project	Status	Key Features and Objectives	Nature of Benefit	Digital Infrastructure/s Created/Used
Haryana, Citizen Resource Information Department	Parivar Pehchan Patra (Family Database Project)	Implemented	Create authentic, verified and reliable data on all families Issue family identity cards to every family (an 8-digit unique ID number) Ensure automatic delivery of various benefits and services	Cash, in kind, services	Created: Family Database Registry
Haryana, State Government	Antyodaya Saral	Implemented	Make all schemes and services available on a single integrated online platform Ensure end-to-end processing of applications in an online and paperless manner Reengineer process flows to make them user-friendly Establish state-of-the-art service delivery centres at district, sub-division and tehsil levels Ensure all schemes and services are delivered within clearly stipulated time limits Provide clear visibility to citizens (and officials) at all stages of the status of applications	Cash, in kind, services	Created: Antyodaya Saral Portal

Madhya Pradesh, Social Justice Department	Samagra Samajik Suraksha Mission (SSSM) [Samagra Social Registry & Integrated Social Protection System]	Implemented	Provide IT support and databases Rationalize rates of scheme and assistance amount Simplify rules and procedures Make computerized information available on the website (transparency) Provide all facilities to the beneficiary at one place as far as possible Disseminate information about plans and programs	Cash, in kind, services	Created: Samagra Family ID & Individual ID, Samagra Portal State Population Registry Used: Aadhaar
Odisha, State Government	Social Registry & Social Protection Delivery Platform (SPDP)	Under construction	Monitor the well-being of beneficiaries of several state and central welfare schemes while weeding out ineligible claimants Super database in which databases of all departments would be integrated	Cash, in kind, services	Created: Social Registry & SPDP Used: KALIA database, Aadhaar, DBT infrastructure
Rajasthan, State Government	Jan Aadhaar Yojana	Implemented	Unify the state's service-delivery ecosystem on the basis of a single-card, single-number, single-identity philosophy Serve as the sole vehicle for delivery of all kinds of cash and non-cash benefits and services through an intertwined network of e-Mitra kiosks	Cash, in kind, services	Created: Jan Aadhaar ID, Jan Aadhaar Mobile App
Telangana, ITE&C Department	Samagra Vedika	Implemented	Create a 360-degree profile of every citizen to plug all possible loopholes in its welfare programmes Alternative approach without using Aadhar or any other ID All records in all data sources have name, address; some records also have DoB, phone number, father's name, photo A combination of the above attributes which are already available in every record will be used to identify an entity, with a hoped-for accuracy nearer to Aadhar-based linkage with no manual intervention	Cash, in kind, services	Created: Samagra Vedika Database, Samagra Platform, Samagra Vedika Search Software
Uttar Pradesh, Social Welfare Department	Integrated Pension Portal	Implemented	Receive applications for pensions under old-age, widows, divyang and leprosy state pension programs Process applications and transfer to the PFMS (Public Fund Management System) after electronic approvals for necessary payments directly to the bank accounts of the beneficiaries	Cash	Created: Integrated Pension Portal
Centre, Ministry of Labour and Employment	National Database for Unorganised Workers & eSHRAM Portal	Implemented	Include all unorganized workers from all over India and help link them to social security schemes (e.g., accidental insurance cover) of the Government of India Boost last mile delivery of the welfare schemes	Cash, in kind	Created: eSHRAM portal, eSHRAM card with 12 digit UAN, National Database of Unorganized Workers (NDUW) Used: Aadhaar, DBT infrastructure

9.5. Evaluating SP-ODEs

In this section, I will draw exclusively on Dvara Research's recent efforts to construct an assessment or evaluation framework for SP-ODEs.[18] The framework is a long checklist of questions that seeks to discover whether actual (real-world) SP-ODEs manifest certain desirable attributes. The framework is itself an extrapolation of Dvara Research's earlier work on last mile delivery of social protection benefits (in collaboration with Gram Vaani, Tika Vaani and University of Montreal). That work highlighted several shortcomings in the current social protection delivery systems in much of India.[19] Since the promise of social protection tech systems or SP-ODEs is to address and resolve these shortcomings, it is possible to leverage Dvara Research's work on last mile delivery to extrapolate a set of desirable attributes that 'good' or 'citizen-centric' SP-ODEs should manifest. These attributes serve as normative criteria against which the performance of actual SP-ODEs may be measured.

Before I proceed to the attributes, a disclaimer is in order. It is to be noted that the evaluation framework serves to evaluate the delivery of social protection schemes and not to evaluate the schemes themselves. That is, questions about the delivery of social protection may be separated and treated distinctly from questions about the design of social protection. Therefore, the normative criteria are not those that one could readily use to evaluate the efficacy or adequacy or appropriateness of this or that particular social protection scheme. This is important to keep in mind as we move forward since the qualitative attributes listed further could easily be mistaken for attributes that social protection schemes should possess, whereas my intention is to single them out rather as attributes that the delivery systems should possess.

In what follows, I delve deeper into the attributes expected of a citizen-centric SP-ODE, and I explain the meaning and conceptual content of these attributes.

9.5.1. Inclusive

An essential feature of an effective social protection delivery system is its inclusivity, or its ability to reach the intended population and include vulnerable populations.[20] In 2019, the UN *Special Rapporteur on Extreme Poverty and Human Rights* submitted to the General Assembly that digital social protection systems should 'devise new ways of caring for those who have been left behind', formally acknowledging the need to address exclusion.[21] In the social protection literature, exclusion errors are defined as being the proportion of those wrongfully excluded from beneficiary lists created using some targeting methodologies.[22] This has resulted in an understanding of exclusion limited to the identification and targeting stage of any social protection scheme, but it ignores the potential for exclusion to arise downstream from successful identification and targeting. Dvara Research calls this latter type of exclusion 'incidental', not because it is less frequent or less important than exclusion in identification and targeting, but because it implicates the breakdown of downstream processes during their everyday functioning, for a host of reasons that escape obvious categories of error classification at the system level.[23]

Constructing a digital social protection delivery platform that is truly inclusive will require acknowledging the risks of incidental exclusion, which may manifest in the form of cash shortages, machine failures at citizen access points, breakdowns of communication channels for the citizen, the requirement of inaccessible documents or even errors in data entry causing payments to stall. Furthermore, incidental exclusion can also be sourced to structural issues that result in inequitable access to SP-ODEs, such as demographic barriers (illiteracy), economic limitations (low-income), social barriers (gender, religion, caste) and administrative bottlenecks (absence of citizen touch points), all of which may exclude beneficiaries at various stages of their interaction with the social protection delivery system.

Another dimension of exclusion is the disposition with which the citizen is addressed during their interactions with the SP-ODE. When the citizen is treated in a dismissive or disrespectful manner, it reduces their likelihood of attempting to interact with the SP-ODE in the future, thereby complicating access and adding to exclusion. Especially since some of these interactions are at the last-mile and may be outsourced to agents, the concern of poor conduct of service providers or even government functionaries at the last mile arises. Indeed, a guiding principle is to design SP-ODEs such that they work well for the most marginalized. It is then doubly essential to prioritize that all citizens (in their interaction with the SP-ODE) are treated with respect and their needs are held in high regard. While such requirements are not specific to an SP-ODE, the transition to a digital delivery system must not result in additional stigma or hardship for the citizen.

9.5.2. Responsible

An SP-ODE is a type of digital delivery architecture that leverages a digital information system or a social registry/integrated database. This information system facilitates the flow of information within and from the SP-ODE to other sectors. The system enables governments and other service providers to deliver social protection benefits by providing 'dynamic and real-time data' relating to all the processes within the social protection delivery chain such as registration, identification, assessment and enrolment of beneficiaries.[24] For example, Rajasthan collects real-time data from 28,000 service points under its food subsidy program.[25] Similarly, Andhra Pradesh collects 'all service delivery data generated through Aadhaar-based transactions in real-time, analyses it and provides dashboards for monitoring implementation'.[26]

To complete the processes within the social protection delivery chain, beneficiaries submit substantial amounts of data such as their name, address, phone number, gender, bank account details, identification proof among many others. All such data points have been identified as sensitive personal data in the Personal Data Protection (PDP) Bill (2019) and they must be protected to preserve citizens' informational privacy.[27] Hence, there is a strict requirement for all data flows to and from the SP-ODE to be managed responsibly.

A responsible SP-ODE will handle data in a manner that protects the personal data of the users while preserving their autonomy and trust in the use of their data, aggregated for delivering social protection benefits. The attribute of responsibility implicates measures and provisions that protect the personal data of citizens and that preserve their digital rights. Data protection specifically relates to the legal rules that regulate to what extent and under which conditions citizens' personal data may be collected, processed, shared and stored. Autonomy refers to the individual's capacity to make informed decisions, or in other words to maintain control over certain aspects of one's data. Finally, trust refers to active trust which presupposes a decision, namely, the choice to expose oneself to risk toward the counterpart, in the expectation that the counterpart will not unduly profit from the situation. These three priorities together lead to an 'ethic' of data protection that complies with the laws of the land, affords controls to citizens over their data and protects them from harms that they cannot foresee.

In the current form, the PDP Bill contains principles and clauses that ensure responsible data management. However, artificial intelligence technologies such as automated systems, Big Data and machine learning are also rapidly being adopted in digital social protection delivery systems, introducing new forms of risks that the provisions of the PDP Bill, as it is currently stated, are inadequate to deal with.[28] These are risks of exclusion, data breaches, discrimination, deception and frauds, trust deficits and the lack of transparency for citizens.[29] A responsible SP-ODE will use automated systems and machine learning responsibly by (a) mitigating exclusion, (b) piloting for the development, testing and validation of new algorithmic systems so as to ensure that the data powering the algorithms is representative, (c) putting in place mechanisms to ensure that decisions taken by automated systems are sufficiently explainable, (d) designing automated systems to be transparent and auditable and (e) permitting users to contest automated decisions.

Until the PDP Bill becomes law, the creation of a responsible SP-ODE would require 'clear governance structures, privacy protocols, data access and sharing protocols, and grievance redressal systems' to minimize privacy harms and to encourage responsible innovation.[30]

9.5.3. Efficient

An SP-ODE is capable of realizing efficiencies of time, cost and effort for all parties involved in the platform. But it is the efficiency gains for citizens that should be of first importance in evaluating the performance of an SP-ODE. This is required by the overall criterion of citizen-centricity that the SP-ODE is supposed to conform to.

An SP-ODE would minimize the citizen's search cost and effort required for enrolment and registration into schemes. For instance, the onboarding of various schemes onto a single citizen-facing digital platform would enable citizens to access multiple programmes through a single window. If the platform is so designed, citizens may be able to avoid the re-submitting of documents each time they seek enrolment into a different program.[31] Some platforms may support the functionality of providing citizens with a comprehensive view of scheme eligibility, documentation requirements, timelines, etc., which would be an improvement over the status quo in which prospective applicants often run pillar to post in pursuit of accurate information.

On the side of administrators, an SP-ODE can facilitate the optimization of bureaucratic processes in social protection schemes. By streamlining the efforts of various departments responsible for various social protection schemes, an SP-ODE can eliminate process inefficiencies.[32] For instance, common procedures such as payments, grievance redressal, etc., may be made applicable across multiple programmes. Intake and registration processes across schemes may also be shared, rather than collecting similar information multiple times from the citizen.[33] While such efforts of streamlining do primarily benefit the administrator, the benefits also cascade down to the citizen who experiences thereby an improved quality of service delivery and smoother interaction with the delivery platform.

An SP-ODE also permits evidence to inform decision-making and management. The improved availability of regularly updated data and robust grievance mechanisms (among other things) allows programs to incorporate feedback loops to constantly keep improving those elements of process design that are not working well for citizens.[34]

SP-ODEs will allow non-public actors to participate in social protection service delivery in various fashions. One example is the innovation of solutions for citizens, built upon the digital platforms of an SP-ODE. Such 'service delivery innovations' may help government departments efficiently utilize their resources to deliver social protection services, realize better outcomes and enhance citizen satisfaction. For instance, civil society organizations such as Gram Vaani (which facilitates collection of citizen grievances through a simple IVR helpline) may be able to plug into the ecosystem to assist in grievance mediation. It is to be noted that this form of innovation is categorically different from the kind of innovation described under the responsibility attribute. There, innovations are undertaken not to enhance the efficiency of the social protection delivery process, as they are here, but rather to create new value-added services for commercial purposes.

9.5.4. Accountable

The design of an SP-ODE should uphold a two-fold structure of accountability: to the taxpayers by virtue of them paying for the SP-ODE and to the beneficiaries by virtue of them receiving the benefits. In the first instance, the public exchequer will need information in order to evaluate the performances of the social protection delivery platform and of the community of actors participating on the platform to serve citizens. An important performance metric will be the degree to which the SP-ODE facilitates the disclosure of information to citizens in a manner that is transparent, accessible and easy to understand. To this end, the exchequer may also find it necessary to encourage the participation of civil society and media organizations on the platform.[35] Some examples of mechanisms include publishing annual reports in the public domain, disseminating data on the case-load management of the platform, financial audits, performance audit reports of the platform and the services built on top of it.

In the second instance (accountability to the beneficiary), an SP-ODE should consist of accountability mechanisms that will strengthen the beneficiary's voice (especially that of marginalized communities) when they either receive or are excluded from services. In addition, such mechanisms will ensure transparency in the processes of an SP-ODE and provide redress to beneficiaries who face hurdles while accessing the SP-ODE. Modern feedback systems leverage digital technology to collect and process data in real time that enable beneficiaries to monitor services and administrators to improve service delivery. Mittal et al. describe the role of digital feedback loop systems such as text messages, robocalls, performance surveys and embedded ratings (for service providers), all of which encourage beneficiary participation and involvement. They also help administrators to identify and 'take action' on the feedback in real time. For example, Andhra Pradesh actively solicits feedback from beneficiaries through quality surveys and robocalls whenever they draw ration from ration shops. Beneficiaries with negative feedback are then contacted by a manual feedback loop system to register complaints. The complaint is then transferred to the appropriate administrative department where they must be resolved within the specified time period. Hence, soliciting feedback represents only the first step in the feedback loop mechanism; it ought to be followed by a mechanism to ensure that action is taken to incorporate beneficiary feedback to improve the system. Digital feedback loop systems combined with effective grievance redressal mechanisms will ensure ex-ante and ex-post accountability of the platform and its service providers to the beneficiaries.

This concludes my discussion of attributes and the evaluation framework, and it also brings the chapter to a close. I have attempted in this chapter to provide the reader with an understanding of the newly emergent technological forms that are transforming the social protection landscape in India, and to articulate a set of normative criteria by which one might evaluate the performance of these new forms. It is hoped that as SP-ODEs come on stream, the evaluation criteria in this chapter will be further developed and sharpened through a reiterative process of application and reflection. The design and performance of SP-ODEs are also expected to improve alongside such a process. And in the final instance, the enhanced performance of SP-ODEs is expected to benefit all stakeholders, foremost among them citizen beneficiaries.

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Mitigating Risk through Micro and Rural Insurance

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10

The trends of enhanced technology innovation-led inclusion are also beginning to have an impact on the insurance sector. Besides the traditional government and PSU players' focus on social protection for the excluded population, several new private players are also beginning to view the sector with a renewed interest as a profitable growth market.

10.1. DEFINITIONS: COVERAGE UNDER MICRO-INSURANCE AND RURAL INSURANCE

Access to insurance products and services is critical not only for the efficient functioning of the economy but also for the social mobility of large parts of the population, particularly in the lower income segments, which otherwise would not be able to withstand the adverse impact of the losses and the resultant economic vulnerability. Micro-insurance thus is a critical element of the financial inclusion framework.

It is interesting to note that, as pointed out in a study by Lloyd's of London,[1] while insurance penetration has improved globally and in India over the last several years, with growing incidence of new risks related to climate change and the cyber world, the insurance gap (or underinsurance) has increased.

Micro-insurance is a mechanism designed to protect the low-income individuals against risks such as death, accidents, illness and natural disasters upon payment of insurance premiums tailored to their needs, income levels and risk. The focus of these covers is to provide protection to the financially vulnerable strata of the society; it acts as a critical poverty alleviation measure.

A dimension that is often missed out from being considered under the ambit of this term is micro-pension. This is gaining increasing criticality in India due to the increasing longevity of the population which, in turn, becomes a risk for the low-income individuals since they require means to sustain their lives beyond their earning and productive years.

Another dimension that gets missed out in the (typically) individual focus of the micro-insurance market is the large segment of the micro, small and medium enterprises (MSMEs) with very specific asset insurance requirements that are different for different industry sectors and additionally require the creation of standard bundled coverage for effective targeting.

10.2. CURRENT STATUS AND DEVELOPMENTS

This section examines the performance of the various insurance schemes, both the social insurance schemes launched by the government and those targeted to the micro-insurance and rural markets, by the public and private sector insurance companies.

10.2.1. Social Insurance Schemes

There are several social insurance schemes launched by the Government of India that seek to provide subsidized covers to the lower income groups. These include the Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), the Pradhan Mantri Suraksha Bima Yojana (PMSBY), the Pradhan Mantri Shram Yogi Maandhan (PM-SYM) and the Pradhan Mantri Jan Arogya Yojana (PM-JAY) also known as Ayushman Bharat.

The PMJJBY, launched on 9 May 2015, offers a renewable one-year term life cover of INR 200,000 to all subscribing bank account holders in the age group of 18 to 50 years, covering death due to any reason, for a premium of ₹330 per annum per subscriber. The scheme is offered/administered through Life Insurance Corporation (LIC) and other life insurance companies willing to offer the product on similar terms.

Table 10.1. Progress of the PMJJBY Scheme (Cumulative)

Financial Year	Cumulative No. of Persons Enrolled (in Billion)	Total No. of Claims Received	Total No. of Claims Disbursed
2016–2017	31	62,166	59,118
2017–2018	53.3	98,163	89,708
2018–2019	59.2	145,763	135,212
2019–2020	69.6	190,175	178,189
2020–2021	102.7	250,351	234,905
2021–2022 (on 26 May 2021)	103.4	260,547	244,197

Source: As reported by banks.

Clearly, as can be seen from Table 10.1, there has been a significant increase in the enrolment in the last two years. This is both because of the government's thrust to the banks to increase coverage and due to the increased awareness due to COVID-19.

Launched on 9 May 2015, PMSBY offers a renewable one-year accidental death cum disability cover of INR 200,000 to all subscribing bank account holders in the age group of 18 to 70 years for a premium of INR 12 per annum per subscriber. The scheme is offered/administered through public sector general insurance companies and other general insurance companies willing to offer the product on similar terms.

Table 10.2. Progress of the PMSBY Scheme (Cumulative)

Financial Year	Cumulative No. of Persons Enrolled (in Million)	Total No. of Claims Received	Total No. of Claims Disbursed
2016–2017	99.5	12,534	9,403
2017–2018	134.8	21,137	16,430
2018–2019	154.7	40,749	32,176
2019–2020	185.4	50,328	39,969
2020–2021	232.6	58,540	45,472
2021–2022 (on 26 May 2021)	234	59,461	45,992

Source: As reported by banks.

Very recently as well, the central government has asked the public sector banks to aggressively target financial inclusion and expand pension and insurance coverage. For the operative accounts, the banks have been told to identify PMJDY beneficiaries up to 40 years of age and cover them under the PMJJBY, the PBSBY and the Atal Pension Yojana (APY). Account holders above 50 years of age would be covered under the PMSBY. Similar growth trends have also been in evidence in the pensions arena. The annual report of the National Pension System Trust has indicated that the APY has emerged as the most popular social security scheme under the National Pension System (NPS) with more than 28 million subscribers, mostly from the non-metro centres. Of the 42 million NPS subscribers, more than 66% have opted for the APY at the end of 2020–2021.

Another scheme, the PM-SYM, which is contributory scheme for the informal sector workers has seen the enrolments stagnating in the current year due to the better branding and visibility of the APY as well as the income impact on the target segment as a result of COVID-19. The scheme caters to the unorganized sector workers who are in the 18–40 age group and are earning less than INR 15,000 per month. While on a cumulative basis 4.51 million workers have been enrolled under the scheme since its launch in 2018–2019, fresh enrolment in the first four months of the current financial year is only around 15,000 according to reports that quote data from the Ministry of Labour & Employment.

While all these schemes highlighted above are an important ingredient of the social insurance thrust in that they provide insurance covers to the target low-income segments in the rural and the urban markets at a discounted rate, the presence of these schemes, does, in fact, become a deterrent for the uptake of the micro-insurance products. The target population finds the micro-insurance products too expensive and is not keen to purchase these covers; most of the insurance companies too find it more convenient and expedient to sell these covers through the banking channels in order to meet with their rural and social sector obligations rather than create new, innovative products and channels to sell micro-insurance products.

The experience on the ground also has been that these covers have seen an adverse claim ratio due to the low premium rates associated with them. For example, the PMSBY which provides a cover at INR 12 is reportedly seeing a loss ratio of more than 250%. This is, in fact, used as a benchmark for the insurance companies to arrive at the appropriate rates for the coverage that they offer; most private insurance companies provide this cover at INR 25–30. Similarly, the life insurance cover at INR 330 for a sum insured of INR 200,000 has also not been profitable and hence has seen lower push from the insurance companies.

10.2.2. Life Insurance

The life insurance covers comprise a significant proportion of the overall micro-insurance business written in the Indian market. A large proportion of these covers continue, however, to be group insurance covers. The IRDA Annual Report for the year 2019–2020 highlights that while the individual new business under the micro-insurance segment for the year 2019–2020 stood at 1.028 million new policies with a premium of INR 2.2666 billion, the lives covered under group business were 0.1407 billion with a premium of INR 44.2645 billion. Further, a large part of the contribution to the individual insurance has come from the LIC. The private sector contributed just 0.169 million policies and INR 0.456 billion premium in the individual business in 2019–2020.

The group policies reported above are, for a large part, social insurance schemes which are offered at significantly low rates of premium, while the individual covers are commercial insurances that are offered in the same terms as any other insurance product. It is expected, however, that the introduction of the standard pure term cover with effect from 1 Jan 2021 will increase the penetration of life insurance; COVID-19 has brought in increased awareness among the consumers which will positively impact the traditional life insurance businesses like term and endowment insurances.

10.2.3. Health Insurance

Universal health coverage remains a distant dream in India despite the positive impetus that the sector has received due to COVID-19. The factors at the root of the low adoption rate span both the buyers of the insurance cover—lack of awareness, affordability, etc., as well as the insurance companies—paucity of underwriting information, high loss ratios, etc.

According to the IRDA, only 498 million of the population (around 35%) had health insurance in 2019–2020. Of this, 362 million were covered via the Pradhan Mantri Jan Arogya Yojana. The remaining 136 million (around 10% of the population) were covered under the corporate or the individual health insurance schemes of the insurance companies.

In 2020–2021, as suggested by the data from the General Insurance Council, the individual health insurance segment has seen a sharper increase thus suggesting an increased propensity of this segment to buy insurance cover directly. Another trend suggests a shift in the channels of purchase—the share of the online channel in terms of premium amount increased from 5% in 2018–2019 to 7.9% in 2020–2021.

> **Claims Innovation in Cattle Insurance**
>
> *An interesting innovation that has been recently introduced by IFFCO-Tokio General Insurance in the cattle insurance space aims to create a unique ID for each insured cattle through a 'muzzle print' taken at the time of the commencement of the insurance cover. This seeks to replace the traditional brass/PU ear tags and the RFID tags that have earlier been used for the identification of the cattle. The process involves taking a close-up picture of the cattle's muzzle and uploading it in the mobile application. This picture is then compared with another picture of the muzzle taken in the event of the death of the cattle to confirm that this was indeed the cattle that was originally covered under the insurance.*

10.2.3.1. Health Insurance: COVID-19 Impact

Various estimates suggest that just on COVID-19, the non-life insurance industry took a hit of ₹300 billion. In the long term, however, the industry hopes that it has created significant awareness and demand for health insurance with the sector showing highest ever growth rates. It is hoped that this would be a sustainable structural shift making this into a pull rather than a push product.

In order to increase the coverage and ensure adequate protection of the population, the regulator has brought in many standardized health products such as Arogya Sanjeevani, and two COVID-19-specific products—Corona Kavach and Corona Rakshak. Very recently, the government has announced a free health insurance of INR 500,000 for ages up to 18 years under the Ayushman Bharat scheme. The premium in respect of this free cover would be paid from PM CARES.

The standard COVID-19 covers have seen a good uptake; several of the non-life insurance companies have struggled, however, with the non-COVID-19 health insurance policies. The traditional health insurance policies had not priced in the impact of the COVID-19 cover and that led to adverse claim ratios.

10.2.4. Crop Insurance

Agriculture insurance is an important risk mitigation tool; in India, this has been provided in the form of subsidized micro-insurance schemes such as the Pradhan Mantri Fasal Bima Yojana (PMFBY), the National Crop Insurance Programme and the Livestock Insurance Scheme. Additionally, the private insurance companies also offer their micro-insurance products such as weather insurance and cattle insurance to these markets.

The PMFBY was created with the aim to cover at least 50% of the farmers; estimates suggest, however, that due to a variety of product and awareness-related issues, the current penetration is only around 40%. While it does provide a comprehensive coverage in terms of covering a wide range of risks from the pre-sowing to post-harvest damage, some of the issues around delays in claims settlement stemming from the time taken to compile the crop data have led to a lower penetration.

Moreover, over the last few years, the crop insurance scheme of the Government of India, PMFBY, has seen a mixed response from the various states. A few states opted out of the scheme on account of the consistently good trend in rains and the steady crop yields in the last several years. In some states such as Gujarat and Madhya Pradesh (MP), the enrolments into the scheme have gone down since the farmers are unwilling to pay the premium in the absence of a 'return' on their payments.

This has led some states like MP to contemplate new schemes that are profit sharing in nature. These schemes have been launched by the Agriculture Insurance Corporation and have come to be known as the '80-110'. These schemes provide that a reduced premium would be payable in respect of the crop insurance cover, but the claims payout from the insurer would be capped at 110% of the premium. Any loss over and above that would be paid by the state government from an escrow account created for this purpose; this account would get funded from the insurers' contribution into it in the event that the loss ratio is below 80%. The insurer would, for example, transfer the difference between the actual claim ratio (say 30%) and 80%, that is, it would pay 50% of the premium for the year in the form of a refund into the state's escrow account. It is expected that more states may adopt these models at least till the monsoon continues to be favourable and there are no major crop failures.

Another set of innovations in crop insurance has been in the form of the use of technology in assessment of claims and crop losses. Many of the insurance companies are now working through intermediaries who deploy remote-sensing technology and drones to assess crop status. In actual practice, the experts suggest that this works well in the assessment of localized claims, for example, flooding in a particular area and in ascertaining incidence of sowing failures and drought. It has not been very successful in mapping the crop growth stages and prediction of crop yields. In this space, it is felt that there is no substitute for actual assessment on the field. Technology can still play a role here in the form of identifying homogenous locations and reducing the number of locations for the collection of field samples.

There is also a strong view that the current set of products that are targeted at the farmers and administered through the state governments need to be supplemented with meso-level insurance where insurance is provided to institutions such as the FPOs/FPCs and the NGOs associated with the financing of agriculture. Since in the recent years these entities are more structured and play a more active aggregation role in the sector and also play an important role in the rehabilitation efforts in the event of a loss, these may be in a position to enhance the awareness of various insurance schemes and also ensure an adequate claim payout to the community and the individual farmer.

These have the potential to address some of the issues with the traditional micro-insurance schemes such as lack of awareness and issues of trust in the insurance products. These would also enhance the level of data gathering at an aggregate level and ensure better reinsurance protection in respect of several of the risks.

10.2.5. Cattle Insurance

Cattle insurance is another important cover among the rural insurances. While this has seen an increased impetus from several of the private insurance companies such as Tata AIG, ICICI Lombard and Reliance General Insurance besides the PSU insurance companies, it is estimated that less than 2% of the cattle are actually covered under insurance. This stems from the fact that insurance is seen as important only from the point of view of obtaining bank funding for the cattle purchase. Additionally, some of the experts suggest that the schemes of the NDDB have seen lower uptake and participation due to the fact that the premium rate is mandated at 3% while the approximate mortality rate is around 3.5%. The cattle owners hence see limited incentive to purchase the insurance cover.

10.2.6. Aquaculture and Apiculture Insurance

Both these are again insurance covers of interest to the rural market and have seen a significant growth in the current year. Apiculture, for example, has seen a significant uptake in states such as Himachal Pradesh, Uttarakhand and J&K through the SHG model being financed by the MFIs. Aquaculture insurance has also seen an increased interest but has been beset by a practical issue; the current policy requires white spot disease to be excluded from the coverage since the reinsurers insist on this as a requirement for the grant of the cover. This, however, is the most prevalent cause of the losses thus making the insurance cover less effective. A solution needs to be found to this conundrum for further increasing the penetration and effectiveness of this insurance cover.

10.2.7. MSME Sector

The experience in the last two years has led to an increased appreciation of the need for insurance among the SMEs and the MSMEs especially due to the link to the provision of finance to this sector and due to the increased need for health insurance for their employees. There is still, however, a significant lack of awareness of the various relevant insurance covers. It is estimated that only around 5% of the MSMEs are covered adequately for their risks. There are several products including group term life, group personal accident and group health that take care of the health- and life-related risks and the new package insurance products such as 'Sookshma Udyam Suraksha' and 'Laghu Udyam Suraksha' providing coverage in respect of the business assets and liability including workman compensation.

As seen in the foregoing section, there are several innovative covers that have been introduced by the insurance companies to target the micro-insurance and rural insurance markets. The following section highlights some of these product and process innovations.

10.3. INNOVATIONS AND NEW INITIATIVES

Innovation introduced by the insurance companies span (a) product and process innovations, (b) structural changes in the form of new entity structures, for example, mutuals in health insurance and (c) technology interventions and digitalization initiatives to better target and service the customers.

10.3.1. Product Innovation

A recent example of product innovation in health insurance has been the rural-centric products launched by some of the companies; these provided for lower cost insurance covers but mandated that the treatment would be confined to the rural centres. These also included coverage for home care during the quarantine for COVID-19. In case of the hospitalization and treatment being taken at the urban (and hence more expensive) centres, there is a provision of a copay thus limiting the claims outgo for the insurance company. While these products were relevant during the COVID-19 phase, it remains to be seen whether they continue to be popular once the lockdowns are lifted especially in view of the poor state of infrastructure at most of the rural healthcare facilities.

10.3.2. Process Innovation

The rural and micro-insurance sector has seen significant process innovation in the recent past; this has been facilitated by the increased mobile penetration and made necessary due the prevailing COVID-19 situation. It was recognized that there was a need to introduce paperless transactions in the granting of insurance covers and the IRDA approved these policies. These involve the entire process—proposal form, quote generation and acceptance, policyholder consent, premium payment and policy issuance—being done digitally through the mobile phone of the insured. This process has been followed for the whole range of insurance covers including health insurance, cattle insurance, micro-personal accident and automobile (two-wheeler) covers.

10.3.3. Intermediation Innovation

As the digital payments firms, fintechs as well as players such as Amazon and JioMart equip the small traders including the kirana shops across the country with a digital platform, easy access to lending and the ability to accept digital payments, they also provide access points as well as valuable transaction and financial data for the insurance companies to be able to offer customized insurance covers to them.

10.3.4. Technology Platform Innovation

Moreover, with the recent launch of the Ayushman Bharat Digital Health Mission (DHM) the access to healthcare and also health insurance will get an impetus, especially for the poor and the middle class. Based on the JAM trinity model, the DHM will create a seamless online platform for health-related personal information; this will include the creation of a health ID/health account to which the personal health records can be linked and viewed with the help of a mobile application with the citizens' consent. This framework, while easing the access to healthcare, would also take care of a significant issue of lack of health history that was preventing the health insurance companies from targeting this market effectively.

10.4. INTERNATIONAL TRENDS

The successful experiences in the international markets stem from appropriate interventions in a combination of several areas, some of them being the following:

1. Technology-led interventions like the mutual aid programmes launched by the internet companies in China
2. Innovative entity structures like the cell captives of South Africa that allow the micro-insurance groups created for the coverage to operate without an insurance license of their own and buy insurance covers from the insurance companies
3. Policy and regulatory support such as the mutual insurance companies and the risk-based capital regimes from markets such as the Philippines and South Africa
4. Innovations in distribution channels, including the use of banks and telcos as well as other rural and lower income segments focused players such as pharmacies, supermarkets and remittance companies in several markets including Peru, Nigeria and Ethiopia.

Among the significant success stories worldwide are organizations such as BIMA and MicroEnsure which operate through a mobile phone platform and offer a range of micro-insurance products including life, health and accident insurance besides some simple asset insurance covers.

The prevailing view in several of the international markets is that the future success of micro-insurance initiatives is largely predicated on the availability of appropriate technology platforms. In the absence of these, a large part of the insurance premium collected would be allocated towards management expenses, distribution and intermediation costs and prudential margins. This, even in a mutual insurance construct, would leave a small part of the premium to be paid towards the claims, thus defeating the very purpose for which the construct was created.

In this context, the initiative in the Indian market of distribution of insurance through the Common Service Centres (CSC) is extremely relevant since they allow easy digital access to insurance products even in rural areas.

10.5. ISSUES FACING THE MICRO AND RURAL INSURANCE MARKETS

While awareness of the insurance and pensions, and their affordability are the main reasons for the under-penetration of these products, there are several other factors that will need to be addressed appropriately for enhancing the coverage and acceptability of these products.

1. *Demand-related barriers:* The largest constraint to inclusion in insurance comes from the low-income levels of the target population and the seasonality of their income generation.
2. *Customized products and high lapse rates:* The target segments require easy-to-understand products being made available to them through simple and convenient processes. The products also need to be made simpler in terms of payment methods and periodicity. Further, it is understood that the high lapse ratios of the micro-insurance products (as high as 80%–90% for some companies) also lead to lack of focus on this segment from the insurance companies.
3. *Ticket size and transaction costs:* The small ticket size of the products leads to the transaction costs being high in proportion of the premium thus making the products unviable. High digitalization and low documentation would help manage these costs, but most insurers are still experimenting with these to varying degrees of success.
4. *Claims settlement experience and trust:* Delays in claim settlement, often due to cumbersome settlement procedures, and the non-payment of some claims due to coverage mismatch and data issues, for example, mismatch between the proposal form and the actual data at the time of the claim often lead to trust issues thus driving the target segments away from purchasing these covers.
5. *Product and process literacy:* Often, the low-income target customers do not understand the

coverage available due to issues both in product design and the inability of the intermediaries to explain these. Also, the purchase process and the associated documentation requirements are often cumbersome leading to low uptake of the products.

6. *Effort–remuneration mismatch for the intermediaries:* These products are not attractive enough for the traditional intermediaries to sell; the low ticket sizes and the increased awareness creation and documentation efforts make the agents and brokers stay away from these segments. Some insurance companies have used banks to target this market, but this has still left large gaps to fill. This issue is further compounded by the fact that the insurance companies may refuse to accept certain risks on account of perceived adverse selection.
7. *Supply-side issues:* The paucity of data especially relating to mortality and morbidity pertaining to this market impacts product innovation and leads to more stringent underwriting norms by the insurers for this segment. Additionally, the launch of schemes such as PMJJBY, PMSBY and PM-SYM and the easy enrolments under these schemes, while ensuring at least some coverage for the hitherto uninsured population, also have an indirect impact on the micro-insurance market. The feeling among the target segments that they now have some insurance, coupled with their overall lack of awareness about the need for and adequacy of the cover, makes it more difficult to target them with the standard micro-insurance products.

10.6. FACILITATORS FOR FUTURE GROWTH

Some initiatives to address the issues highlighted above and ensure greater penetration of these products are highlighted in this section; these are certain to give an impetus to growth in these covers.

10.6.1. Non-traditional Players

Some non-traditional players have recognized the need for an intervention in this space and stepped in to bridge the gaps. These have been in the form of 'mutuals' that have sought to create groups of the low-income individuals or families and set in place a framework for the group itself to manage the risk of the group members; Uplift, Annapurna and VimoSEWA are a few examples of this model. There is another set of players which operate as distributors of the products of the existing insurance companies; DHAN and BASIX are some of the players that operate through this construct. Table 10.3 that has been taken from the recent IRDA report on micro-insurance highlights the coverage areas and the impact that these players have been able to have in offering the rural and micro-insurance products.

While these models have been able to address the needs of their members and are able to facilitate efficient and adequate claims settlement, they face a challenge of scaling up effectively due to the large capital requirements where they to seek scale by operating as an insurance organization. As a result, most of them remain highly localized in their operations and their remit. Those that operate through the existing insurance companies face the challenges highlighted in the previous section and are hence not able to scale up their operations and customer base.

10.6.2. Product Innovation

It has been seen that the successful micro-insurance products tend to have some common characteristics including a simple product design, low cost, high volume, short duration, group-based pricing, basic claims administration, parametric trigger, technology-driven distribution models and technology-driven models (including mobile) for policy application, underwriting and issuance, premium payment and claims reporting and management.

For example, an issue with the health insurance penetration has been the fact that the specialized plays have been limited; there are several innovations that are possible in the products that would enhance this coverage.

- *Micro-insurance:* Benefits-based coverage for a nominal daily or monthly fee
- *Disease-based cover:* Customized covers for chronic ailments and seasonal diseases
- *Low-cost basic cover:* With effective underwriting through the use of analytics and deployment of fraud algorithms to manage loss ratios, a no-frills, low-cost basic cover can be introduced in the market.

10.6.3. Policy and Regulatory Changes

Further to the changes regarding product innovation and enhanced use of technology, the experts are also of the view that some product and policy/structural changes are needed to make the micro-insurance products more effective. Some of the key areas for consideration include the following:

Table 10.3. Key Details of Microinsurance Offered by NGOs

	VimoSEWA	Shepherd	BASIX	Uplift	Annapurna	SKDRDP
Business Model	Master policy-holder, partner-agent and mutual model	Partner-agent and mutual model	Composite corporate agent	Mutual model	Mutual model	Partner-agent model
Microfinance	No	Yes	Yes	No	Yes	Yes
Location/ districts covered	Gujarat, Madhya Pradesh, Bihar, Rajasthan and Delhi with 20 partner organizations	Tamil Nadu (10 districts)	Pan-India operations, covering 26 states during its peak	Mumbai, Pune, and tribal villages in Rajasthan	Mumbai, Pune	Karnataka
Companies whose products are distributed	LIC, New India Assurance Company Ltd, India First Life Insurance Company Ltd	LIC and United India Insurance Company Ltd	Aviva and Royal Sundaram	Risk-pooling by SHGs; Claims that will not be paid decided upfront	Risk-pooling	LIC, New India Insurance Company, Oriental Insurance, National Insurance, Universal Sompo
Type of product	Health, life, credit shield, endowment product, mutual hospicash product, assets	Life, health, property	Group cover: credit shield, hospicash, livestock. Retail individual policies: Life, health, personal accident and agriculture	Cashless in-house outpatient department cover and reimbursement, in-patient department cover	Health, credit shield, life, asset	Health, livestock, life, asset and credit shield
Max limit	Health – ₹25,000 Mutual hospicash - ₹3,000, Assets - ₹10,000 Life – ₹2 lakh	Life - ₹10,000, Accident – ₹25,000 Health – ₹10,000 Hospitalisation due to road accident – ₹50,000 Property – ₹5 lakh	Group Life Insurance: 1.5X loan disbursed or maximum ₹75,000 Hospitalisation: ₹300/ day or maximum of ₹1,500. Livestock: ₹50,000 and Enterprise Insurance: maximum of ₹1 lakh	8 cashless in-house OPD and IPD floater of ₹12,000	₹40,000 for health Outstanding loan write-off up to ₹5 lakh + ₹20,000 as assistance (in case of death of borrower), ₹10,000-25,000 (in case of death of spouse), ₹5,000- 7,000 (in case of loss of asset)	Life and Asset - ₹5 lakh, Health - ₹1 lakh, Livestock – ₹2 lakh, Bundled product - ₹10 lakh Agriculture - ₹2 lakh
Age group covered	18-70 years	18-70 years	18-55 years	No exclusion	No exclusion	18-60 years
Claim time	Mutual product - 5-8 days Other products - 25-45 days	60 days	Health and other general insurance - 30 days Life - 50 days	24 hours	45 days Post-Covid - 24 hours	75 days
Claim ratio	Varies at 90-95% for health and 85-90% for life	60% health and 50% life	Average claim ratio 60-70 %. For agriculture insurance, in a couple of instances it shot over 100%	OPD claim ratio - 45% IPD claim ratio – 19%	65% as medical expense reimbursement and 30% medical service and administration	Credit shield - above 95% Health - about 91%
Scale	84,000 members as on December 31, 2019	40,000 members as on December 31, 2019	NA	20,608 members in 2019	2.52 lakh clients at start of 2020	87.12 lakh members in 2019

Source: IRDA Report of the Committee on the Standalone Microinsurance Company, 2020.

- Creation of separate micro-insurance entities with a lower initial capital requirement and risk-based capital norms
- Formation of a Microinsurance Development Fund proposed by the Committee on Microinsurance; this would be consistent with the development mandate of the IRDA and, like in the case of the promotional funds set up by NABARD, provide impetus to the sector.
- Formalization of the 'mutual' structure and community-based schemes for micro-insurance, especially for life and health insurance
- Increase in the cap on sum insured to INR 500,000
- Rationalization of the copays and the deductibles under the various policies (e.g., for fire and health insurance covers)
- Central collection of relevant data to enable the industry to negotiate appropriate covers from the reinsurance market (e.g., for the aquaculture covers)

10.6.4. Account Aggregator—A Connected Financial Ecosystem

The account aggregator is a connected ecosystem to aggregate all financial assets-related information of an individual/business customer in a standardized, machine-readable format with the customer's consent. The new system would make it possible for various financial entities to get a better understanding of their potential customers, make informed product and service-related decisions and ensure smoother transactions. Breaking huge data in proprietary silos to create a centralized API-based repository could dramatically increase the addressable market for various financial services players including insurance and pension providers. This would facilitate an efficient coverage among the 'next billion'.

In the health insurance space, the under-insurance is on account of coverage gaps, for example, the ambit of health insurance needs to be expanded beyond just hospitalization covers to also include OPD and dental covers—as well as gaps in segment coverage—while the upper socio-economic segments are aware of the need for health insurance, and the lower income segments are covered by the government schemes like Ayushman Bharat, the 'missing middle' is today not adequately targeted by insurance players.

In addition to increased awareness and appropriate designed products, this segment needs an assurance of prompt service; the industry is creating a framework for providing that assurance. IRDA, for example, is planning to set up a common portal for the settlement of health insurance claims; this would standardize the settlements and make them time-bound besides providing the industry access to rich data on the health insurance market which can be used for more effective product development and underwriting. Such a repository functioning under the aegis of the Insurance Information Bureau can also assist in curbing frauds at the aggregate industry level. This, coupled with a micro-insurance fund under the IRDA, would provide a significant impetus to the segment.

Thus, in order to ensure a sustainable growth in the rural and micro-insurance covers, concerted efforts are needed that span several areas: (a) institutional/policy measures, several of which have been initiated through the financial inclusion policy of the Ministry of Finance, the IRDA report on stand-alone micro-insurance, infrastructure development measures that provide greater amounts of data, the planned initiatives under the NDHM, etc.; (b) simplification and bundling of the insurance products and offering these through innovative and relevant channels; and last but not the least (c) initiatives in financial literacy including process literacy and those that remove the gender disparities in literacy as well as adoption of these covers.

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Financial Inclusion and Gender Equality: An Evolving Story

Nidhi Bansal

11

11.1. CONTEXT

Gender inequality is a pressing global issue with huge ramifications not only for the lives and livelihoods of girls and women but also for their families, communities and nations. Closing the gender gap in economic participation can act as an enabler for human development, productivity, GDP growth and social inclusion. Unequal gender roles have implications for the most basic aspects of self-determination, dignity and freedom for women, which in turn influence their financial inclusion (FI) or lack thereof.

While FI is a necessary precursor to women's empowerment and their participation in the economy, there is global recognition of the persistent gender gap in financial services. There is also an acknowledgement that by paying attention to the gender dimensions of access, usage and quality of financial services, the aims of full FI can be better achieved.[1] Addressing gender disparities in terms of FI is important as previous studies indicate that improving gender parity may result in significant economic dividends. Also, economic equity between genders has the potential to increase the world GDP by over US$ 5 trillion.[2]

11.2. GENDER DYNAMICS OF FINANCIAL INCLUSION

To achieve equitable FI, specific demand- and supply-side barriers that women face need to be addressed. These barriers stem from long-standing gender inequalities and discrimination that has negatively impacted women, eroding their personal, social and material assets and limiting their opportunities to participate in processes that impact their lives and livelihoods. Broader policies as well as specific FI pathways, therefore, need to be designed, keeping in view the prevailing norms that constrain women's uptake and usage of financial services as well as ensuring that women are able to actually benefit from and control the outcomes of any initiatives.

11.2.1. Gendered Barriers to Financial Inclusion

Women's exclusion from mainstream financial services can be attributed to barriers that have their genesis in gender norms that have shaped the socio-economic and political aspects of our lives.

- *Lack of self-confidence:* Traditionally, women are expected to play the roles of homemaker and caretaker, while men have been assigned the role of breadwinner. This is single-handedly responsible for excluding girls from opportunities of learning skills for remunerative work, moving around and interacting with people in public spheres, handling finances and taking decisions related to money and assets. Over ages, this division of roles has been 'normalized', so much so that we need to put in place specific measures to build women's confidence to handle money, assets, take decisions and pursue economic activities of their choice to enable women to participate in and benefit from FI initiatives.
- *Restrictions on mobility:* Rigid division of roles, accompanying taboos about women who move and interact with 'strangers', and the fear of violence in public spaces, all add up society and families restricting women's mobility. Burden of domestic responsibilities is a key practical factor that restrict women's ability to go far from the household. When designing FI services, it becomes important to acknowledge and address this constraint if women are to be included in the initiatives.

- *Lack of literacy and numeracy:* Once again, gendered assigning of roles results in girls being denied education; thus, a large number of women are not able to acquire basic literacy and numeracy. This extends into lack of confidence in acquiring skills such as digital literacy and understanding financial transactions, even if women have been handling complex household finances for ages. Therefore, financial literacy and simple digital operations are critical for ensuring inclusive financial products and services, as well as ensuring that services once made accessible will be used by women.
- *Lack of access to resources and assets:* Women seldom have access to and control over productive assets and resources. As the services become driven by technology, requiring access to digital devices, it is once again likely to exclude women, who may not have ownership of a 'smartphone'.
- *Lack of decision-making:* When it comes to making financial decisions, we often find women making way for men. This gender norm has significant implication for actual benefits of FI services and products being enjoyed by women. Often times, we find that women are made the front to gain access to the credit, insurance or direct benefits, but then those are either diverted towards men's enterprises or used into household. Many a time, women do not know or do not have a say in these decisions.

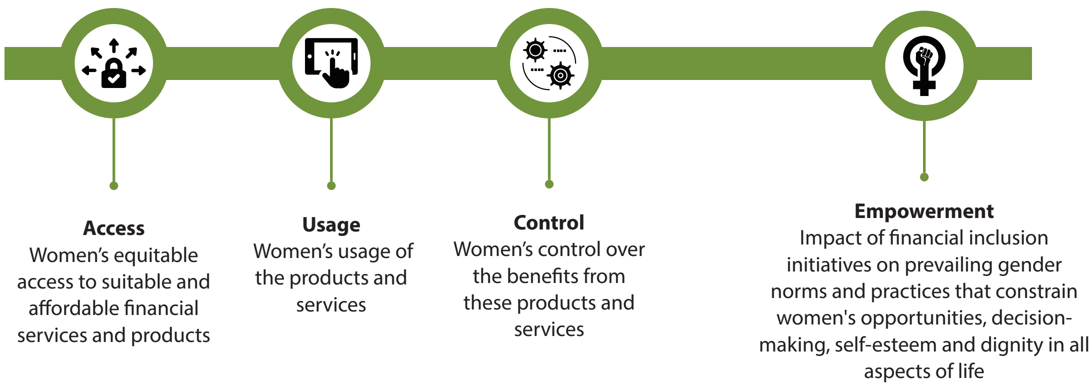
Among the FI practitioners, there is an agreement that women's empowerment and full participation is the bedrock of all FI work in India. Also, most believe that women form the majority of beneficiaries of most FI interventions. Numbers do bear out this belief, especially for primary interventions such as outreach (through self-help groups [SHGs], microfinance institutions [MFIs] and NRLM), and savings bank account holding. The numbers start going south for access to other financial products and services.

It is equally important to note that gender is not synonymous to women. While ensuring parity in reach and access is a critical first step in the journey towards gender equality, it is in no way sufficient. To assess if FI has indeed been a driver of gender equality, we would need to look at objectively substantiated data along the following continuum.

Of the above, there are good data available to support the claim on women's increased access to FI products and services. However, there is limited or no data available to assess how far this access has resulted in equitable usage and control over benefits for women, or if these initiatives indeed have the potential to transform underlying discriminatory norms and practices, paving the way for full realization of women's economic potential. Without sex-disaggregated data on all aspects of FI, it will be impossible to tell how far we've come and how far we still have to go. The case for gender-disaggregated data in banking and financial sectors is a first step towards closing the gender gap in India.

It is the first time that Inclusive Finance India report is attempting to look at the gender dimension of FI; therefore, it is pertinent to celebrate the achievements, as well as take a gendered look at the FI journey so far, and the path ahead.

This chapter is an attempt to assess not only how the FI initiatives have worked for women in terms of numbers but also go a bit deeper. On one hand, this is an analysis of how responsive various FI initiatives have been to the gendered barriers that women face in accessing and realizing full benefits of being financially included. On the other hand, it is also an attempt to assess, how far has, being financially included, helped women challenge and change gender norms and practices in other aspects of their life.



11.3. ACCOMPLISHMENTS SO FAR

11.3.1. The SHG–Bank Linkage Programme

The SHG–Bank Linkage Programme launched by NABARD in 1992 has blossomed into the world's largest microfinance project. *The SHG–Bank Linkage Programme has crossed the 0.01-billion group mark in the FY 2020 which is an important milestone in the FI history of the nation.*[3] This number is especially important from women's FI perspective, as the SHG–Bank Linkage model has been the primary vehicle through which marginalized women got recognized and engaged in the formal financial system.

Table 11.1 extracted from NABARD's annual Status of Microfinance in India Report (2020–21) shows that 0.0112 billion SHGs are saving linked with banks. *86.65% (9.725 million) of these SHGs that are savings linked with banks are exclusive women SHGs.* These women exclusive SHGs have a total accumulated savings of over ₹ 326.86 billion (87.21% of the total savings of the SHGs).[4]

This data point clearly indicates that *SHGs have been an important vehicle for engaging women and channelling financial services to them.* These numbers also show that there is a slight skew in favour of women exclusive SHGs, with *the loan size for exclusive women SHGs being slightly larger than that for other groups* (13.35% groups [other groups: men's groups and mixed groups] accessing only 6.28% of loan amount).

Beyond the hard data for number of members, loan offtake and loan outstanding, the sector has not systematically collected data to objectively assess impact of SHG movement on transforming underlying gender norms. While everyone has heard of powerful stories and anecdotes, empirical evidence is missing to establish gender transformative impact of SHGs on women's lives.

While there are smaller studies that indicate that SHGs have tremendous social impact, *there is a need to undertake empirical studies to establish the gender transformative impact of SHGs* on practical aspects such as enhanced girls' education, improved health and well-being of women and girls, reduced gender-based violence, increased women's and household's income and enhanced participation of women in public sphere as well as on strategic areas such as improving women's status in society and in the family leading to improvement in their socio-economic condition and enhanced self-esteem.

11.3.2. The Microfinance Institutions

The MFIs emerged in India in the late 1980s in response to the gap in availability of banking service for the unserved and underserved in rural population. These institutions operating in the country follow a variety of credit methodologies. The work of MFIs commenced around the same time as the SHG–Bank Linkage Programme was evolving. Like the SHGs, the MFI industry has shown an equally promising growth. As per Sa-Dhan's Bharat Microfinance Report, the reported 202 MFIs with a branch network of 19,073 and 0.152 million employees have reached out to over 42 million clients with an outstanding loan portfolio of ₹ 101.63 billion. *Women borrowers constitute 98% of the total clientele of MFIs.*[5]

Table 11.1. **Women Exclusive and Total SHG Outreach under SHG–Bank Linkage Programme**

S. No.	Particulars	Total			
		Physical (# in Million)	%	Financial (₹ in Billion)	%
1	Total number of SHGs saving linked with banks	11.223		374.7761	
	Out of total SHGs: exclusive women SHGs	9.725	86.65%	326.8608	87.21%
2	Total number of SHGs credit linked during the year 2020–2021	2.887		580.7068	
	Out of total SHGs: exclusive women SHGs	2.59	89.71%	544.2313	93.72%
3	Total number of SHGs having loan outstanding as on 31 March 2021	5.78		1,032.8971	
	Out of total SHGs: exclusive women SHGs	5.311	91.89%	965.966	93.52%

Source: Extracted from Table 2.1: Progress under SHG–Bank Linkage Programme (2018–19 to 2020–21) of the Status of Microfinance in India 2020–21, NABARD Report.

11.3.3. Basic Savings Bank Deposit Accounts

Having an account in a mainstream financial institution has been agreed to be a key determinant of FI. With the government's flagship Pradhan Mantri Jan Dhan Yojana (PMJDY), there has been a tremendous growth in the number of bank accounts opened, with a threefold increase in PMJDY accounts from 0.1472 billion in March 2015 to 0.437 billion as on 20 October 2021. *55% Jan-Dhan account holders (0.243 billion) are women.* There is a total of ₹ 1,462.3236 billion balance in beneficiary accounts.[6]

World Bank's Global FINDEX 2017 database also shows that 83% males and 73% females (over 15 years age) have an account in a financial institution. This is a sharp rise from 26% in 2011 and 43% in 2014. *The gender gap in terms of account ownership has also effectively reduced from 20% in 2014 to just 6% in 2017.*[7]

While the number of women having bank accounts has increased dramatically since 2011, this has not automatically converted into usage. According to the Global FINDEX database 2017 released by the World Bank, roughly one out of two bank accounts in India remains inactive, which is about twice the average of other developing economies. Worse, the gender gap in these inactive accounts is notable: *42% of women account holders report not using their account, as opposed to 35% male account holders.* Also, while 77% women have an account in an institution, *only 17% women saved in a financial institution*. Account usage, financial literacy, savings and institutional borrowing have shown little improvement.

11.3.4. Credit

World over, the focus of microfinance has always been on serving women. In India, as an alternate vehicle of credit, microfinance serves a large segment of people from excluded sections including women, Scheduled Castes, Scheduled Tribes and minorities.

Women clients constitute 98% of the total clients of MFIs. This number has seen a gradual increase from 94% in 2011 to reaching 98% in 2020. A trend analysis of women borrowers, SC/ST borrowers and minority borrowers is reproduced from Sa-Dhan's Bharat Microfinance Report 2020 in Table 11.2.

Over time, the shares of both women and men in total bank credit have increased. The increase in women's share, however, has been much slower than men's, widening the gender gap. In 2017, women accounted for only 7% of total bank credit as compared to 30% for men. Even if we are to include credit to MFIs, SHGs and joint liability groups as part of 'women's credit', women's share in total credit was only 8%. Figure 11.1 depicts the credit-to-deposit ratio by gender. *According to this, in 2017, the credit received by women was 27% of the deposits they contributed as compared to 52% for men, further underlining the gender gap.*[8]

Table 11.2. Composition of Borrowers—Category Wise

	% to Total Borrowers								
Year	Women Borrowers	SC/ST Borrowers	Minority Borrowers	Disabled Borrowers	Borrowers having Aadhaar Card	BC Borrowers	Individual Borrowers	Borrowers having personal Bank A/C	Borrowers having BPL Card
2011	94%								
2012	95%	20%	23%						
2014	97%	19%	14%						
2015	97%	28%	18%	0.05%	10%				
2016	97%	30%	27%	4%	18%	15%	3%		
2017	96%	20%	10%	0.012%	52%	23%	3%	22%	11%
2018	96%	33%	17%	2%	98%	20%	4%	87%	65%
2019	99%	32%	18%	1%	99%	15%	4%	92%	67%
2020	98%	24%	15%	1%	85%	15%	14%	88%	57%

Source: Reproduced from Bharat Microfinance Report 2020 (Sa-Dhan).
Note: Data for SC/ST and Minorities is being collected from 2012; data for Differently abled borrowers and Borrowers having Aadhaar Card is being collected from 2015, data for BC Borrowers and Individual Borrowers is being collected from 2016 whereas data for borrowers having personal Bank A/c and borrowers having BPL Car started from 2017.

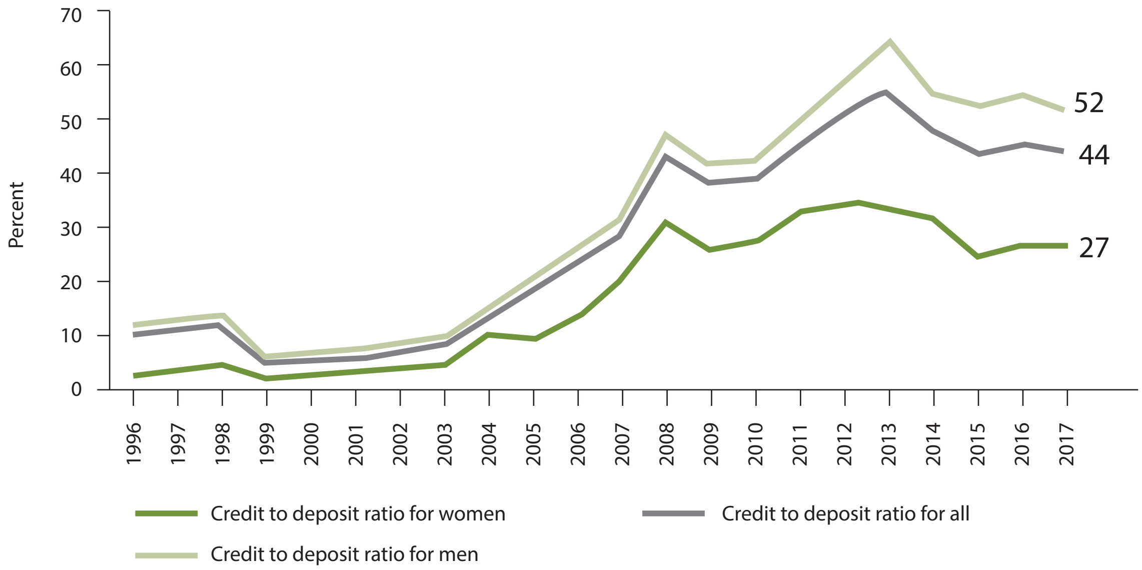


Figure 11.1. Credit-to-deposit Ratio by Gender, India, 1996–2017 (in %)***

Source: Basic Statistical Returns of Scheduled Commercial Banks in India, RBI, various issues.[9]
Note: ***Reproduced from Women's Access to Banking in India: Policy, Context, Trends and Predictors.

Despite a number of measures undertaken by various stakeholders to enhance FI in the country, there are still critical gaps existing in an objective assessment of the usage of financial services. There are reports that indicate pilferage and diversion of benefits of the FI provisions. There are reports of women being used as a front to access credit with the funds being diverted to household or men-owned enterprises, with women having little or no say in the matter.

11.3.5. Direct Benefits Transfer

The government, over the years, has introduced a number of government-sponsored, socially oriented insurance, pension and other welfare schemes. These schemes are aimed at different segments of the society, addressing specific challenges they face. One of the key challenges in implementation of the schemes was ensuring that benefits reach the intended beneficiaries, without any pilferage on the way. The IndiaStack infrastructure with the JAM trinity has been a big leap forward in the identification of deserving beneficiaries and seamless transfer directly to them.

Last year, as the country reeled under the impact of pandemic, with the poorest being hit the hardest, the government announced and transferred ₹ 500 per month for three months of lockdown to women through their PMJDY accounts under the PM Garib Kalyan Yojana. *Under PM Garib Kalyan Yojana, a total of ₹ 309.45 billion have been credited in accounts of women PMJDY account holders during COVID-19 lockdown*. About 0.051 billion PMJDY account holders receive direct benefits transfer (DBT) from the government under various schemes. This seamless transfer of money was made possible by the centre's DBT-PMJDY linkage but, more importantly, this could happen because the government had information on which accounts were held by women and the account being linked to Aadhaar enabled the identification of poor women among women account holders. Unfortunately, this gender and poverty disaggregated data were only used from the PMJDY database and not from the banking sector overall, resulting in only PMJDY account holders receiving the benefit and many other deserving women being left out.

The following are some of the prominent government-sponsored socially oriented schemes providing financial products and services such as credit, insurance and pension that could potentially benefit women with the PMJDY accounts:

- RuPay debit card and insurance linked with the PMJDY account
- Pradhan Mantri Fasal Bima Yojana and Restructured Weather Based Crop Insurance Scheme
- Pradhan Mantri Ujjwala Yojana
- Pradhan Mantri Surakshit Matritva Abhiyan
- Pradhan Mantri Garib Kalyan Yojana

- Atal Pension Yojana
- Pradhan Mantri Kisaan Samman Nidhi Yojana
- Pradhan Mantri Jeevan Jyoti Bima Yojana
- Pradhan Mantri Suraksha Bima Yojana
- Pradhan Mantri Vaya Vandana Yojana
- Pradhan Mantri Jan Arogya Yojana

Of the above, only PM Ujjwala scheme and PM Surakshit Matritva Abhiyan involve direct transfers to women only and, for others, sex-disaggregated data are not easily available.

DBTs, coupled with training, could be a powerful driver of social norm change and women's increased participation in work, as demonstrated by the 2019 research conducted by the National Bureau of Economic Research (NBER), Massachusetts. In collaboration with Indian government partners, the NBER researchers provided rural women with individual bank accounts and randomly varied whether their wages from a public workfare programme were directly deposited into these accounts or into the male household head's account (the status quo). Women in a random subset of villages were also trained on account use. In the short run, relative to women just offered bank accounts, those who also received direct deposit and training increased their labour supply in the public and private sectors. In the long run, gender norms liberalized: women who received direct deposit and training became more accepting of female work, and their husbands perceived fewer social costs to having a wife who works. These effects were concentrated in households with otherwise lower levels of, and stronger norms against, female work. Women in these households also worked more in the long run and became more empowered.[10]

11.3.6. Access to Micro-life and Non-life Insurance Product

A brief analysis was made by IRDAI in its annual report 2019–2020[11] on the share of women in life insurance business. They found that out of a total of 0.0288 billion policies sold in the year 2019–2020, 9.3 million policies were bought by women. *The share of women in the year 2019–2020 has decreased to 32% in number of policies and 34% in first-year premium compared to 36% and 37%, respectively, in the year 2018–2019*. The proportion of women policies in case of private life insurers was 27% and that of LIC was 34%.

11.3.7. Financial Literacy

Besides supply-side barriers, there are also demand-side challenges that the system has failed to adequately address. *Only 11% respondents were found to have 'good' financial literacy*—defined as a combination of sound financial knowledge, positive financial attitude and behaviour—as per the All India Rural FI Survey 2017 conducted by NABARD.[12] Financial literacy challenges for women stem from their lack of exposure to the formal institutions and their ways of working as well as a lack of trust in the system. While NABARD, MFIs, banks and NGOs have invested in enhancing financial literacy among the poor and marginalized, there is a lot more to be done in this particular area. Average financial literacy scores in India are low—at 11.9 out of 21—as calculated by Standard & Poor's for its Global Financial Literacy Research.[13]

11.3.8. Digital Financial Services

The advent and use of digital solutions to provide financial services has been instrumental in pushing the enrolment for Jan-Dhan accounts. e-KYC facility and UPI are the two APIs that have considerably reduced the need for women to travel long distance to open the account as well as conduct any transaction. One of the important components of the JAM trinity, Aadhaar, the world's largest initiative to provide biometric identity, has facilitated FI through innovative digital platforms. The NACH Aadhaar Payment Bridge (APB) System and PMJDY together have been instrumental in enabling an effective usage of available banking facilities, which came to the fore during the pandemic, with cash benefits under Pradhan Mantri Garib Kalyan Yojana being disbursed to these accounts.

Although the digital financial service will surely be an enabler for FI in the long run, with a gender gap in ownership of digital devices and in usage of digital platform, it can prove to be a barrier in the short term. While the mobile penetration in India is significant, GSMA's Mobile Gender Gap Report 2020 concludes a *20% gender gap in mobile ownership and 50% gender gap in Internet usage*.[14] The Global FINDEX Database 2017 also revealed that there is a *13-percentage point gap between men (35%) and women (22%) in making or receiving digital payments in the year before 2017*. The gap has narrowed as compared to 2014, when it was 16%.

Availability and affordability of digital devices and data is a key factor, along with ease of operating in a digital environment. It will take time and effort to build the capability of the banking correspondents, as well as the users to confidently use the digital platforms to fully leverage all products and services.

11.3.9. Business Correspondents

From a gender equality standpoint, introduction of the business correspondent (BC) model by the RBI in January 2006 can be termed as one of the most progressive policy decisions with far-reaching impacts for FI of women. *As of March 2020, total BC portfolio of MFIs stood at ₹ 208.42 billion, a growth of 5% over 2019.*

The Bank Mitras have played a significant role in enhancing enrolment—80% of the customers came to know about PMJDY through BMs; financial literacy—even though limited in numbers, a large percentage of customers have received financial literacy training from the BMs; facilitating transactions—BMs are the first choice over ATM and bank branches.

Beyond account opening and financial literacy, MFIs are finding the BC model increasingly attractive to carry out their activities on the credit side and to spread it to deposit taking activities. According to Sa-Dhan's Bharat Microfinance Report 2020, *72 MFIs had an exposure to a BC loan portfolio of 208.42 billion through linkage to 36 banks and 28 other financial institutions*. Apart from this, 11 MFIs were undertaking deposit-related activities for 23 banks. *The deposit portfolio of BCs amounted to ₹ 18.9 billion.*[15]

The top reasons for such high preference for the BC model are proximity and location of outlet, ease of transaction and timings/availability of the person. By bringing the bank to their doorsteps, the BC model also addresses women's time poverty constraints. At the same time, problems faced by customers while transacting at a BC outlet are server downtime, technical issues and insufficient liquidity with the BC.

Further, RBI's recommendation to include authorized functionaries of well-run SHGs which are linked to banks, as BC was another step in the right direction as, to some extent, this contributed to addressing the issue of lack of female workforce in the FI sector.

As per the current policy directive, banks are allowed to charge a nominal fee in a transparent manner for the services brought to their doorsteps through the BC model. This could potentially become a deterrent for women, who do not have access to or control over financial resources but in the absence of empirical data and research into this topic, it is difficult to make a conclusive statement. Perhaps, this could be a topic for formative research.

A linked issue and a reported barrier to women's full participation post account opening is the low ratio of female staff in the FI workforce. The Bharat Microfinance Report 2020 by Sa-Dhan reveals that *the total microfinance workforce stood at 0.152 million personnel, out of which only 11% are women*.[16] Evidence shows that women tend to use their bank accounts, and save and borrow more if they are served by female bankers and financial intermediaries.

In the life insurance industry also, only 27% of the total individual agency force as on 31 March 2020 were women.[17]

Introduction of the BCs, Bank Mitras and a network of last-mile agents were meant to address the access and usage barriers. While women account holders constitute 55% of the total PMJDY portfolio, *less than 10% of BCs are women*. Therefore, the desired change in women's engagement and usage of financial products and services is yet to materialize.

The reasons for low ratio of female BCs to women customers include adverse selection criteria, higher need for ongoing support, limited mobility and their reduced ability to work extended hours. All the above add up to the cost of hiring, onboarding and managing women BCs. On the other hand, women aspiring to become BCs face multiple barriers such as lack of support from family, limited capital, low computer and financial literacy, limited mobility, and limited bank and supervisor support in scaling their business.

In 2015–2016, the *National Rural Livelihoods Mission adapted a gender-focused variant of the traditional BC model called the 'Bank Sakhi' model*, which was further piloted across seven low-income states in India. By February 2020, 6,094 Bank *Sakhis* across 12 states had collectively completed 748,454 transactions worth ₹ 2,663.5 million. This reflected that while the Bank Sakhi model was an innovative strategy to achieve FI, it was women banking agents who were poised to deepen the last-mile delivery of financial services, especially for women customers, in hard-to-reach rural areas and would go on to play a sustainable role in driving women's FI.[18]

To move FI beyond enrolment for bank account opening, it is therefore imperative to invest in and build a strong network of well-informed women BCs. Affirmative actions are also needed to correct the current under-representation of women BCs. Entry barriers could be addressed by taking affirmative actions, such as providing equipment and rental support (rather than requiring women to make upfront capital investments), adding incentives such as an initial stipend for the first year, solving mobility issues, offering flexible hours of operation and providing protection to women BCs and their families, on the lines of health insurance. Finally, creating a supportive environment for women BCs through training, mentoring, ensuring ongoing support (through dedicated officials) and creating women agent communities will help them thrive for long term.

11.3.10. Beyond Finance to Enterprise Development

Over the past year, the COVID-19 pandemic has thrown existing inequalities into sharp focus. While the nation's attention has been drawn to the plight of migrant workers and farmers, the worsening gender gap has not received similar attention. Analysis of the Centre for Monitoring Indian Economy's Consumer Pyramids Household Survey data by researchers at Azim Premji University showed that women were seven times more likely to lose their jobs during last year's lockdown, and 11 times more likely to not return to work. An ongoing survey[19] on micro, small and medium enterprises by Global Alliance for Mass Entrepreneurship and LEAD at Krea University shows that women-owned small businesses were hit more badly by the pandemic; 43% of women-owned enterprises surveyed reported monthly profit less than ₹ 10,000, compared to just 16% of units owned by men.

The Pradhan Mantri MUDRA Yojana, aimed at funding the unfunded micro-enterprises and small businesses, extended a cumulative amount of 1,230 billion to 0.2448 billion loan accounts, since its inception in 2015 till 2020. *Of these, 68% loan accounts belong to women beneficiaries.*[20] While the number of share of women borrowers of enterprise loans is an encouraging sign, there are significant differences in the average loan size as the loan category goes from *Shishu* to *Kishor* and *Tarun* loans. Table 11.3 from the 2019–2020 Annual Report of the PM Mudra Yojana shows that the number of loan accounts for women entrepreneurs in *Shishu* category is almost two-thirds (65.55%) with a comparable share in loan disbursed (67%) and outstanding loan amounts (66%); hence, in this category, the average loan sizes for men and women entrepreneurs are almost similar, with a slight advantage for women. However, in the *Kishor* and *Tarun* categories, the number of loan accounts for women entrepreneurs drops to 46.17% and 30.96%, respectively. More noticeable is the difference in average loan size between men and women entrepreneurs in these categories. In the *Kishor* category, the overall average loan size is ₹ 190,227, whereas women's loan size is less than half of what men get at merely ₹ 84,194. This gap widens further in *Tarun* loans with men's average loan amounts being 755,231 and women lagging behind at ₹ 212,731 average loan. In other words, women are only getting 28 paisa to a man's ₹ 1 loan in the *Tarun* category.

There is no credible data source to further examine how many of the loans disbursed to women are actually used by women themselves and how much say do women have over the income from the enterprises for which loans are disbursed in their names. Anecdotally though, practitioners report numerous stories of women being used by households, as an instrument to access the benefits of government schemes. In many a case, women are not even aware that they have a loan outstanding in their name.

Table 11.3. Subcategories of Borrowers: Sanctions (FY 2019–2020)[21]

(₹ in crore)

Category	SHISHU		KISHOR		TARUN		TOTAL	
	No. of A/Cs	Amount	No. of A/Cs	Amount	No. of A/Cs	Amount	No. of A/Cs	Amount
General	27,614,426	86,660	3,776,211	67,332	1,106,869	69,620	32,497,506 (52%)	223,611 (66%)
SC	9,531,602	27,326	715,832	6,064	34,119	1,272	10,281,553 (16%)	34,662 (10%)
ST	3,580,397	10,087	281,585	2,828	27,714	879	3,889,696 (6%)	13,794 (4%)
OBC	13,764,192	39,486	1,698,245	19,354	116,414	6,588	15,578,851 (26%)	65,428 (20%)
Total	54,490,617	163,559	6,471,873	95,578	1,285,116	78,359	62,247,606	337,495
Out of the above:								
Women	35,717,217	109,660	2,988,307	26,477	397,825	9,045	39,103,349 (63%)	145,182 (43%)

11.4. JOURNEY OF FINANCIAL INCLUSION WITH LANDMARK MOMENTS THAT PROMOTED WOMEN'S INCLUSION

Age-old social structure in India has a specific caste designated for all financial activities, including moneylending. Like any social structure, over the ages, several ills pervaded the system, urging the need to find alternatives. At the same time, the notion of nation state, with a dominant role as an all-pervasive entrepreneur and financier of private businesses, bringing poor people into the mainstream of the economy and thereby ensuring their participation in the process of nation building came to be a prescribed role for the formal financial sector.

An important milestone that later paved the way for formal micro-credit was the nationalization of banking operations of commercial banks in two phases (1969 and 1980). 1969 also saw the initiation of the Lead Bank Scheme, starting a process of district credit plans and coordination among different financial intermediaries. According to Sa-Dhan, these initiatives resulted in the share of the formal financial sector in total rural credit usage rising from 30% in 1971 to over 60% in 1981.[22]

All these initiatives, while critical in shaping today's FI landscape, were mostly gender neutral, designed to address a need to provide low-income people with financial services that can positively influence their personal financial health. Prevalent social norms saw rigid role division, with men being the bread-earners and financial managers of the family and women were seen as the caretakers and homemakers. Consequently, women were not seen to be a segment needing access to formal finance.

FI landscape, as seen today, is dominated by two pathways: the SHG–Bank Linkages and the MFIs. Following is an outline of key milestones in the evolution story of the two pathways and a commentary on its importance of promoting gender equality/women's empowerment.

Year	Milestones	Significance for Gender Equality/Women's Empowerment
Decade of the 1970s	The genesis of SHGs in India, formation of SEWA and MYRADA groups RBI initiatives: Laying down priority sector lending requirements for banks, Lead Bank Scheme Establishment of regional rural banks	• Women recognized as economically active individuals • Collectivization as a strategy to strengthen women's access and voice • Government recognizing the need to have specific focus on poor people's access to mainstream financial services
Decade of the 1980s	Establishment of NABARD Development of Women and Children in Rural Areas (DWCRA) scheme as a part of IRDP MYRADA started forming and linking SHGs to banks NABARD supports MYRADA and other NGOs for SHG/SAG promotion	• Institutional response for development of rural areas and agriculture • State's recognition and institutional response to enhance women's participation in development • Experiments in graduating grassroots women's groups to access larger financial resources from mainstream institutions
Decade of the 1990s	RBI accepted the SHG strategy as an alternative credit model. The Tamil Nadu Women's Empowerment Project, implemented through the Tamil Nadu Women's Development Corporation, was the first project in the country, to incorporate the SHG concept into a state-sponsored programme. SHG–Bank Linkage Programme launched SHGs permitted by the RBI to have savings accounts in banks Andhra Pradesh Mutually Aided Cooperative Societies (MACS) Act passed RBI included financing SHGs as a mainstream activity of banks under their priority sector lending Small Industries Development Bank of India (SIDBI) set up a Foundation for Microcredit with an initial corpus of ₹ 1 billion	• Institutionalization of the SHG model—established women's bankability, beyond doubt • Mainstream banks' first foray into dealing with women as a customer base, but not yet seen as a financially viable market segment, hence supported with external impetus to engage • Larger volumes of financial resources available to women's groups, opening possibilities for enterprise development, viable business investment • Women's collectives' confidence and status got a boost as they handled larger sums of money and dealt with the world of formal finance that demands certain discipline • Enhancing confidence of grassroots civil society organizations in their solutions

Year	Milestones	Significance for Gender Equality/Women's Empowerment
Decade of 2000s	The private and commercial banking sector led by ICICI Bank showed interest in microfinance as a viable commercial opportunity. ICICI Bank developed an innovative partnership model with MFIs which allowed for risk sharing between the two. RBI issues guidelines for institutionalization of the framework of BCs Mandating banks to open at least 25% of their new branches in unbanked rural centres Equity investments in the MFI space Transformation of not-for-profit MFIs into commercial NBFC-MFIs SKS IPO raised more than US$ 350 million, first IPO from an MFI Andhra Pradesh crisis	• Financial viability of banking with poor/women established with the entry of commercial players in the sector • Realization that addressing demand-side barriers is critical in enabling women to benefit from supply-side initiatives • The AP crisis highlighted the continued vulnerability of poor/women in the commercial space, hence the need to put in place consumer protection measures
Decade of 2011–2020	NPCI launched APB and Aadhaar-enabled payments Phase 1 (2010–2013), Phase 2 (2013–2016): Encouraging banks to develop Board approved FI plans UIDAI launched e-KYC which allows businesses to perform KYC verification process digitally using biometric or mobile OTP Direct bank transfer launched PMJDY giving an extra push to the supply-side efforts Established Micro Units Development & Refinance Agency (MUDRA) to refinance collateral-free loans of up to ₹ 1 million, granted by lending entities to non-corporate small borrowers NPCI launches Unified Payments Interface, the most advanced public payments system in the world to revolutionize digital payments in India RBI allowed NBFCs to become BCs for commercial banks National strategy for FI Advent of fintechs	• FI firmly established as a priority agenda of the government and women as priority focus group • Developments in the digital space successfully leveraged to take initiatives to scale • Focus away from collective to individual • As efforts got focused on scale and innovation, dilution of time and resource investment in foundational pieces such as collectivization, incubation of groups to graduate to participate in mainstream financial space and financial literacy • Focus on products and services instead of outcomes such as gender equality, empowerment (in most cases, access got equated with empowerment)

11.5. LOOKING AHEAD

As stated earlier, FI is a critical component for achieving gender equality, but simply focusing on the numbers in terms of outreach and access to products and services will not automatically translate into gains for gender equality. There is a need to deliberately work towards converting the access into meaningful usage and further to asserting equitable control over the benefits of financial products and services.

- *Back to basics:* As the sector moves forward, there is an urgent need to go back and embrace the basics. Addressing gender equality is a tedious process and requires dismantling deep-seated norms and long-held practices, shrouded in tradition, faith and social sanctions. On one hand, the focus will need to be brought back to the collectives and, on the other, innovative solutions will need to be devised to deliver the foundational pieces such as financial literacy, discipline of saving and internal lending before foraying into commercial spaces and building soft skills such as negotiation, communication, decision-making and self-confidence. The power of collectives needs to be harnessed once again to constructively challenge and change deep-seated gendered attitudes and beliefs.
- *Looking beyond access:* As the supply-side initiatives are stabilizing, the dial needs to be moved to next stages of the continuum, that is, usage, control and empowerment. As the practitioners celebrate the hard-earned successes, there is a risk of a complacency setting in that the task of FI is achieved. This is the next inflection point in the FI journey, and hence there is a need for clear messaging from thought leaders that the task is far from finished. Rather, we have only arrived at the first milestone and access does not automatically lead to ensuring usage of resources and opportunities by women.
- *Build the missing middle:* FI initiatives are the main vehicle for women to enter into economic activities. While the current regulations regarding loan size and credit limit per borrower have merit from consumer protection perspective, there is also a risk of creating a glass ceiling for women who have the potential to go beyond. Small finance banks, which should have been the next

stage actor between NBFC-MFIs and commercial banks, are mostly non-differentiated from NBFC-MFIs, as evidenced in the average loan sizes and proportion of loans for women entrepreneurs falling drastically below that of their male counterparts in the *Kishor* and *Tarun* categories. Building this missing middle would be important as more women graduate to establish ventures requiring more than ₹ 50,000.

- *Gender balance in the FI workforce:* In an industry where women are claimed to be the primary customer, it is unfair as well as defies good business sense to have a workforce that does not represent the customer base. Increasing women's participation in FI workforce is important as women customers are more comfortable dealing with a woman BC or loan officer and likely to share problems in usage with her. Once brought into the workforce, women will need training and handholding to succeed as BCs. The BC model will need to be further supported to make it a viable source of income for those opting to go for it.
- *Embracing technology responsibly:* The FI landscape has changed irreversibly with the introduction of digital technology. It comes with its own set of good and bad. While leveraging the power of digital, it is important to acknowledge the constraints that women face in participating fully in a digital world. Investment is needed in hardware and soft skills to ensure that women get a level playing field.
- *Sex-disaggregated data:* Lack of sex-disaggregated data on usage and control is the biggest constraint in establishing the gender transformative impact of FI initiatives. To be able to claim the impact that practitioners see in inspiring stories of empowered women, it is crucial that all information is collected and presented in sex-disaggregated numbers. Other aspects of marginalization such as caste, class, faith, ability and age should also be included in the collection and analysis to inform targeted interventions. The responsibility of lending institutions does not end at recording loan disbursement and repayment but also extends to monitoring its usage by the client. Simple additional monitoring questions asked by the loan officers would yield this information. These data can then be collated by industry associations such as Sa-Dhan and MFIN in their annual publications—Bharat Microfinance Report and Micrometer and by NABARD and RBI in its annual report. Once collated, this data point could give valuable insight into actual difference all FI initiatives are making in women's lives and specific areas where new interventions need to be designed and rolled out.
- *Information beyond access/service delivery:* Currently, all reports focus on the supply-side data, that is, how many clients were reached, how many accounts opened, how many clients trained, how much credit, insurance, pension or other products and services delivered. Empirical evidence on gender transformative aspects of FI initiatives is missing. Having achieved substantial maturity, the FI sector needs to assess itself against higher order outcomes and impact. Women's empowerment and gender equality would be two such areas that require thorough examination. There is a need to develop commonly agreed framework for monitoring and measuring these nebulous concepts vis-a-vis FI. This would be best developed through consultative processes that could be led by industry think tanks such as DVARA, ACCESS and/or academic institutions interested in FI, social development and women's empowerment.

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One of the exciting projects she has been involved with is the use of Plastic waste in construction of Rural Roads, along with promotion of other local materials for building ecologically sustainable roads. Her current focus is on developing robust asset Management System in the country.

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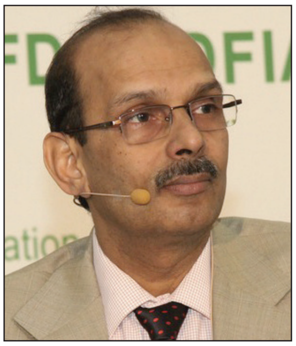

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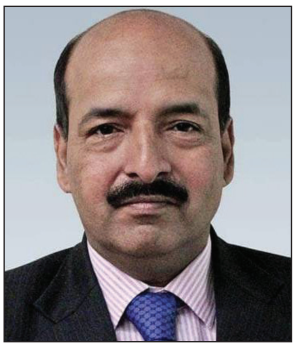

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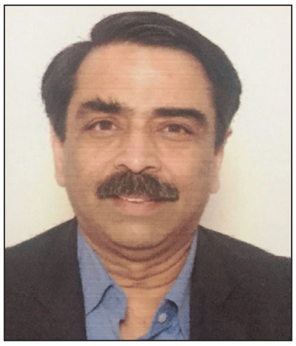

Samir Bali is a management consulting and insurtech professional with more than 25 years of experience across management consulting including management of large-scale business set-up and transformation engagements in the FS space. He has led several strategy and business transformation, cost management, and channel efficiency initiatives in banking and insurance both in India and overseas. In his last corporate position, he was the consulting lead for the FS practice and the sector lead for insurance at Accenture in India. He currently focuses on the area of data strategy and data sciences; he also mentors technology and distribution start-ups in FS besides assisting social impact initiatives in insurance. He has a management degree from IIM Calcutta and a degree in Law and Economics from Delhi University.

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