

DEPOSIT ASSESSMENT IN INDIA



MARCH 2011

Commissioned by



MicroSave
Market-led solutions for financial services



Ministry of Foreign Affairs

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MicroSave has over a decade of experience in providing practical, client-responsive, market-led solutions to assist financial service providers and institutions working with low income clients succeed and achieve their mission and business objectives. It has a history of working alongside financial institutions, telecom operators and FMCG companies, livelihood institutions and development agencies of varied institutional forms and sizes throughout Africa and Asia. It has undertaken assignments in Afghanistan, Bangladesh, Cambodia, Cameroon, China, Colombia, Egypt, Ethiopia, Ghana, India, Indonesia, Kenya, Malawi, Nepal, Nigeria, the Philippines, Sierra Leone, South Africa, Sri Lanka, Sudan, Tanzania, Uganda and Vietnam.

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This report is the result of the ideas and hard work of many people at many organisations, especially the microfinance institutions, cooperatives, non-bank financial corporations, banks and insurance companies that were part of this study. *MicroSave* is also grateful to the wide variety of sector experts who gave their time and support to the study. Above all we thank the clients who patiently gave us their time during the extensive market research for the report. Their contributions regarding savings products and services, and the way in which they manage their finances without many options provided invaluable insight.

We hope and believe that the future for financial inclusion is bright, and that this report will play a role in informing the overall direction, products, and the delivery channels for broadening and deepening the outreach of formal financial systems.

MicroSave Team

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1. BRIEF BACKGROUND OF THE STUDY

IFC’s Access to Finance (A2F) department caters to both policy and project-related advisory work on financial markets, financial institutions and financial infrastructure. Microfinance is a core product of A2F, and expanding small-scale deposits is a flagship initiative. Microfinance is well established in South Asia, with numerous large, successful, and internationally-known institutions in Bangladesh, India, Nepal and Sri Lanka. For a variety of reasons, however, most institutions focus on microcredit, and the development of savings services has lagged seriously behind. This paper surveys the current supply and demand for microdeposit services in India.

2. MACROECONOMIC ENVIRONMENT

India has always been described as a country of contrasts. The same is true for the economic conditions. On one hand, it is one of the fastest growing economies, while on the other it is home to the largest number of poor in the world.

The Gross Domestic Product of India in 2008 was USD 1.16 trillion.

- It increased at a rate of 9.5%, 9.7% and 9.2% in 2005-06, 2006-07 and 2007-08 respectively, but is estimated to have slowed down to 6.7% and 7.2% for the years 2008-09 and 2009-10.
- The share of agriculture and allied sectors in GDP at factor cost declined gradually from 44% in 1970-71 to 18% in 2008-09. During the same period, the share of industry remained almost the same at about 22% to 26%, while that of services went up from 34% in 1970-71 to 56% in 2008-09.
- Sixty percent of India’s population is directly engaged in agriculture and another 200 million landless workers are indirectly involved.
- In 2008, India’s share of world trade was about 1.68%.
- Exports to Europe, US and Japan stand at 36%, 18% and 16%, respectively, of India’s total exports of USD 168 billion in 2008-09.
- India’s exports declined by almost 30% in the first 10 months of FY 2009-10 due to global recession.

Figure 1: Sector Share in Domestic Saving 2008-09

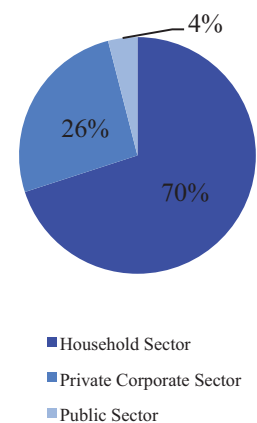


Figure 2: Distribution of GDP (1970-71)

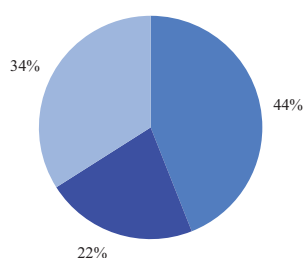
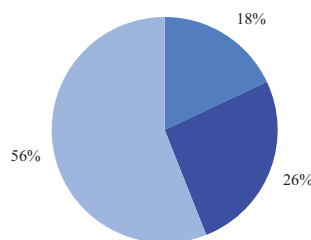


Figure 3: Distribution of GDP (2008-09)



■ Agriculture and Allied Activities ■ Industry ■ Services

India's human population indicators demonstrate its emergence as an economic force:

- India's aggregate poverty is 37.2%; 41.8% of the rural population and 25.7% of the urban population live below the poverty line.
- Whereas the growth in per capita income recovered to 5.3% in 2009-10 after falling to 3.7% in 2008-09, the per capita consumption growth continued to fall over the last two years, decreasing to almost one-third of that in 2007-08 due to the slowdown in GDP growth.
- The share of expenditure on food, beverages and tobacco declined to 35.3 % in 2008-09 from 39.6% in 2004-05. The same period saw growth in the share of transport, communication and miscellaneous goods and services.

A 2007 Goldman Sachs report projected that “from 2007 to 2020, India’s GDP per capita will quadruple,” and that the Indian GDP will surpass that of the United States before 2050, but India “will remain a low-income country for several decades, with per capita incomes well below its other BRIC (Brazil, Russia, India and China) peers.” Although the Indian economy has grown steadily over the last two decades, its growth has been uneven when comparing different social groups, economic groups, geographic regions, and rural and urban areas.

Figure 4: Per Capita Income and Consumption 2004-05 Prices

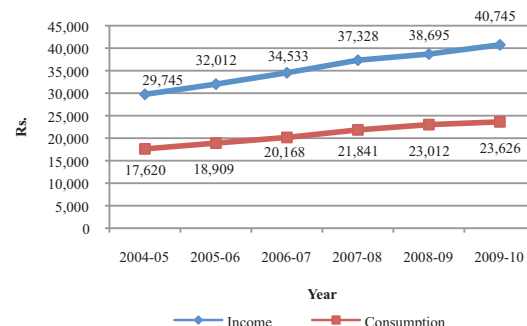


Figure 5: Per Capita Income & Consumption % Growth 2004-05 Prices

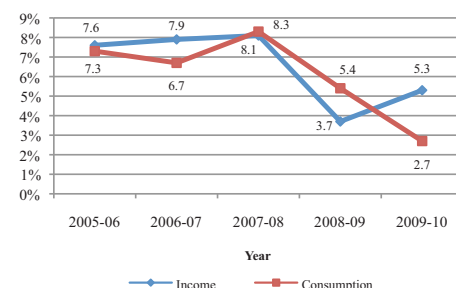
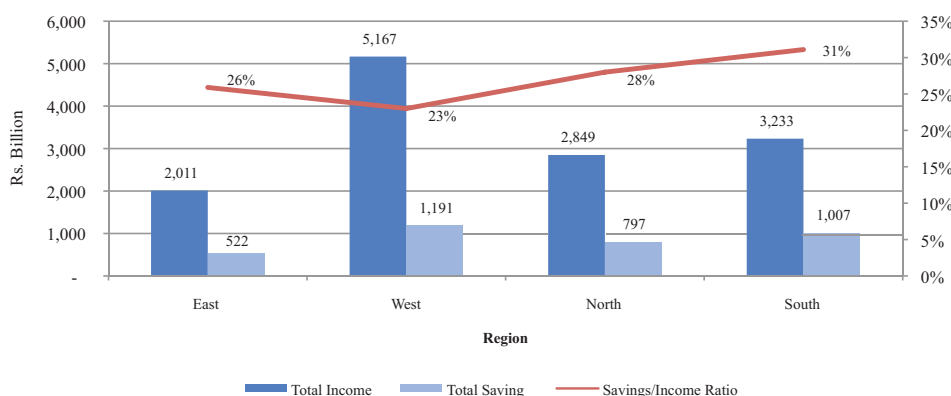


Figure 6: Regional Difference in Savings/Income Ratio in India



Due to financial deepening, the deposits to GDP ratio rose from 16.4% in 1971-75 to 36.1% in 1989-90 and further to 60% in 2004-05. Gross domestic savings (GDS) in 2008-09 were estimated to be 32.5% of GDP at current market prices, compared to 34.6% in the year 2007-08. This has been mainly due to a fall in the rates of savings of the public sector (from 5.0% in 2007-08 to 1.4% in 2008-09) and that of the private corporate sector

(from 8.7% in 2007-08 to 8.4% in 2008-09). For the same period, the rate of savings of the household sector remained at a constant 22.6%.

There are region-wide differences in savings within India. While in absolute terms Western India has the highest income, it proportionately saves the least compared to other regions. The states that save the most are in Southern India, with a saving rate of 31% of their income. The West, which includes Rajasthan, has the lowest saving rate at just 23%.

2.1 TRENDS IN THE BANKING SECTOR

As a result of ample liquidity in the banking system and corporates resorting to non-bank domestic funding and external financing, the interest rates on deposits offered by banks saw a steep decline from the peak levels at the end of 2008. The interest rates offered by public sector banks on term deposits for a period of over three years came down from a range of 8.50-9.75% (December 2008) to 6.25-7.75% (December 2009).

- In 2008-09, bank credit increased by 17.5% compared to an increase of 22.3% in 2007-08.
- The growth in aggregate deposits was 22.4% in 2008-09 and just over 19.9% in 2007-08. This resulted in a fall in the credit deposit ratio from 72.4% (end March 2009) to 70.9% (15 January 2010).
- Higher market borrowing by the Government, low credit growth and sufficient liquidity in the system led to banks' investment in statutory liquidity ratio (SLR) securities.
- While the stipulated SLR level was 24% (raised to 25% with effect from 7 November 2009), the commercial banks held close to 30% of their net demand and time liabilities (NDTL) in such securities. Consequently, the investment-deposit ratio increased from 30.4% at the end of March 2009 to 32.5% on 15 January 2010.

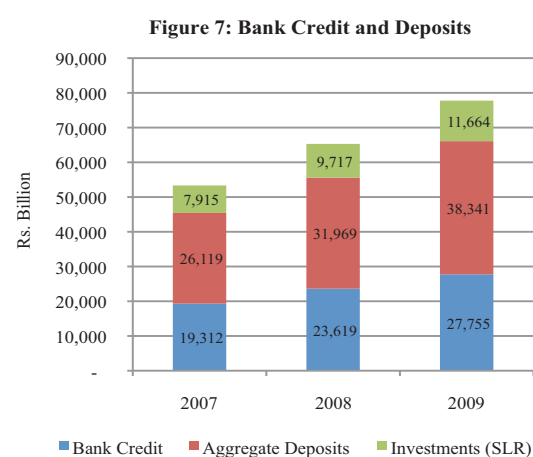


TABLE 1: CURRENCY, INFLATION AND INTEREST RATES — INDIA

Macroeconomic Indicators	2004-05	2005-06	2006-07	2007-08	2008-09	2009-10
Currency Stability (Local to USD exchange rate)	44.81	44.14	45.14	40.27	46.14	47.42
Inflation	6.5%	4.4%	5.4%	4.7%	8.4%	N/A
T-Bill (91 days)	4.89%	5.51%	6.80%	7.11%	6.96%	3.57%
Interbank Lending Rate	5.28%	6.46%	7.98%	8.92%	9.60%	4.87% ¹

Source: RBI Reports

¹ Estimated figure

The Indian Rupee has been quite stable over past few years against other major currencies, especially the US Dollar, mainly due to good foreign currency reserves that stood at \$281.9 billion (in the week ending 19 July 2010) and a good capital inflow. Inflation that was in the range of 4.5% to 6.5% for some time has rapidly increased in the past two years. In the first half of July 2010, inflation was 10.5%. The main factors contributing to the inflation were the comparatively high levels of liquidity with the banks, rising prices of food items and more disposable income within households. The Central Government recently decided to decontrol fuel prices starting with petrol and diesel, while still subsidising kerosene and LPG (liquefied petroleum gas). This has also contributed to the rise in inflation.

The strong liquidity position of banks brought down the interbank lending rates as well as the interest rates offered on retail savings. This has not been accompanied by a proportionate fall in lending rates, as the banks want to play safe in order to contain bad debts and NPAs and are therefore not lending all the money available with them.

2.2 DEMOGRAPHICS

- The proportion of population living in rural areas has continuously declined over the decades from 89.2% in 1901 to 72.6% in 2001. The 2011 census is expected to show this trend continuing.
- There are 638,000 villages, more than 5,100 towns and 380 urban agglomerations in India according to the 2001 census. The number of large towns and cities is rising not only due to increase in population but also due to migration from villages.

TABLE 2: MAJOR DEMOGRAPHIC FACTORS - INDIA

Factor	Census 2001
Population	1.03 billion
Population Density (persons/ sq. km)	325
Rural Population	72.2%
Urban Population	27.8%
Sex Ratio (females per thousand males)	933
Houseless Population	1.00%
Literacy Rate	64.8%

The Human Development Index (HDI) for India in 2007 was 0.612 on the basis of which India is ranked 134 out of 182 countries in the world, placing it at the same rank as in 2006. The HDI is based on three indicators: GDP per capita (Purchasing Power Parity in USD), life expectancy at birth, and education as measured by adult literacy rate and gross enrolment ratio (combined for primary, secondary and tertiary education). The value of

Rising inflation forced the Reserve Bank of India (RBI) to tighten the monetary policies. In April 2010, the apex bank hiked its repo and reverse repo rates (lending and borrowing rates) to 5.25% and 3.75%, from 5.0% and 3.5% respectively; while the cash reserve ratio (CRR), or the portion of deposits banks park with the RBI, rose to 6% from 5.7% - primarily to suck the excess liquidity out of the system.

HDI for India gradually increased from 0.427 in 1980 to 0.556 in 2000 and went up to 0.612 in 2007. The movement in the index value of some comparable countries indicates that India's improvement in HDI in recent years has been better than most. This trend of improvement in the HDI (largely powered by per capita income growth) still places India in the Medium Human Development category below Thailand, Sri Lanka and Indonesia. The gap between the health and education indicators of India and those in the developed world remains very large. According to the HDI report, life expectancy at birth in India was 63.4 years in 2007 compared to 80.5 years in Norway, 81.4 years in Australia, 74.0 years in Sri Lanka and 72.9 years in China. The adult literacy rate (aged 15 and above) in 1999-2007 was 66.0% in India compared to nearly 100% in many developed nations, 93.3% in China and 92.0% in Indonesia.

2.3 A BIRD'S EYE VIEW OF KEY STATES: BIHAR, MADHYA PRADESH, UTTAR PRADESH AND RAJASTHAN

India is a union of 28 states and seven union territories. There is a vast difference between states when compared to country level socioeconomic indicators. Some states like Bihar, Madhya Pradesh (M.P.), Rajasthan and Uttar Pradesh (U.P.) – referred to as the BIMARU states – are poor on many developmental indicators. (See *Table 3* below). These states, while significantly large in terms of geographic area and population, present a challenge. Many of the poorest states also have many marginalised communities, such as *Dalits* (lower castes in the caste system prevalent in India), tribal communities and other minorities who often have very low life expectancy.

While Rajasthan seems to be well placed on some of these indicators, it remains one of the most backward states in India. This is in part because it is largely comprised of the highly drought prone 'Thar' desert, making a major portion of the state a very hostile place for human life. Agriculture is confined to the eastern and southern parts of the state and the rest of the districts are dependent on the rains during monsoons (between the months of June and August). For rest of the year, the agricultural activities are minimal, and due to lack of other economic activities, migration to neighbouring states is very high.

Figure 8: Human Development Index Trend (Average Annual Growth Rate)

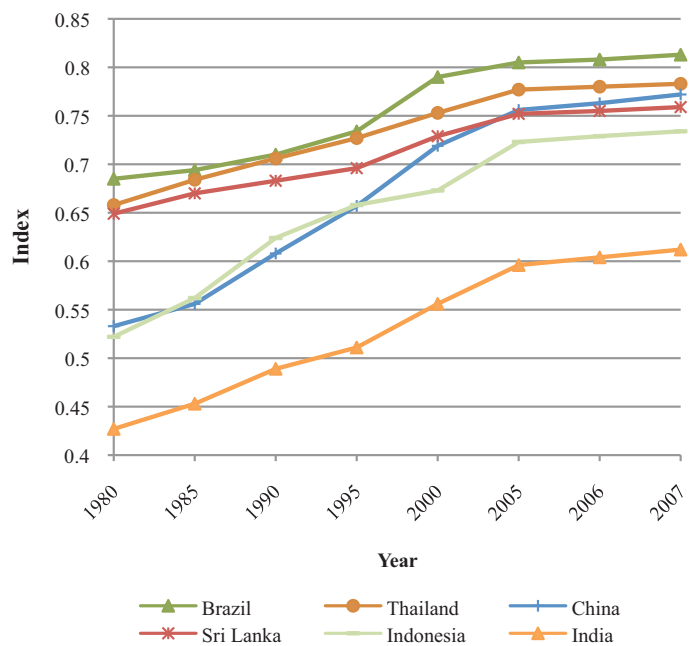


TABLE 3: KEY INDICATORS FOR BIMARU STATES

Parameters	Bihar	M.P.	Rajasthan	U.P.	India	World
Population ² (in millions)	82.8	60.3	56.5	166.2	1,028.7	6,697.2 ³
Population Density (persons per square kilometre)	880	196	165	689	325	N.A.
% Below Poverty Line ⁴	41.4%	38.3%	22.1%	32.8%	37.2%	40.0% ⁵
GDP (for the states, NSDP) ⁶ in Rs./USD million	983,730 / (\$21,321)	1,232,300 / (\$26,708)	1,451,250 / (\$31,453)	3,032,280 / (\$65,719)	\$1,300.5 billion ⁷	\$ 69.9 trillion ⁸
Per Capita Income (Rs./USD)	6,610 / (\$143)	12,566 / (\$272)	19,806 / (\$429)	10,637 / (\$231)	22,483 / (\$487)	\$8,200 ⁹
Literacy Rates ¹⁰	47%	63.7%	60.4%	56.3%	64.9%	82.0% ¹¹
% of Population with a Bank Account ¹²	17%	20%	23%	28%	31%	N.A.
Homeless Population ¹³	0.05%	0.38%	0.25%	0.12%	0.19%	N.A.

2.4 THE BUSINESS ENVIRONMENT IN INDIA

India is the fourth largest economy in the world in terms of purchasing power parity. It has a federal system of government with clear demarcation of powers between the Central Government and the State Governments. India has one of the more liberal and transparent policies on foreign direct investment (FDI) among major economies of the world. One hundred percent of FDI is allowed under automatic route in all sector/activities except in a few areas, which require prior approval of the Government. Under the automatic route, investors are required to only notify the RBI within 30 days of receipt of inward remittances.

India has liberalised and simplified foreign exchange controls. The rupee is freely convertible on current account and almost fully convertible on capital account for non-residents (some restrictions exist for resident Indians on capital account on incomes earned in India). For FDI, profits earned dividends and proceeds out of sale of investments can be fully repatriated. The Government of India accords high priority to the development of infrastructure: highways, ports, railways, airports, power, telecom, etc. But when it comes to overall business climate and opportunity for growth in the

Doing Business in India

India is ranked 169th among 183 countries for starting a business, according to the World Bank's Doing Business Rankings. On average, an entrepreneur in India has to follow 13 procedures before launching a business. This is significantly higher compared to averages of other South Asian countries (only 7.3).

² Census of India, 2001

³ World Development Indicators, as updated on 8 May 2010

⁴ Data of the four States compiled from planning commission of India: <http://www.tn.gov.in/dear/tab06/a127.pdf> and is for the year 2004-05. The national data is gathered for 2008-09 from the Expert Group Report on Methodology of Estimation of Poverty, Planning Commission of India (http://planningcommission.gov.in/eg_poverty.htm), pp24.

⁵ <http://www.globalissues.org/article/26/poverty-facts-and-stats>, figures pertain to poverty level measured at incomes of less than \$2 per day

⁶ For NSDP, Table 17, Economic Survey, 2009-10

⁷ Estimates for 2009-10 (current prices); www.eximbankindia.com/ind-eco.pdf

⁸ Estimated figures for 2009 on Purchasing Power Parity method, taken from 'The World Fact Book', CIA. <https://www.cia.gov/library/publications/the-world-factbook/geos/xx.html>

⁹ Figures for 2003, calculated by the PPP method. Source: <http://www.success-and-culture.net/articles/percapitaincome.shtml>

¹⁰ Census of India, 2001

¹¹ <http://world.bymap.org/LiteracyRates.html>, figures are estimates for 2005

¹² No. of accounts per 100 of population (savings and current), reference taken from Commemorative Lecture by Shri V.Leeladhar, Deputy Governor Reserve bank of India at the Fedbank Hormis Memorial Foundation at Ernakulam on December 2, 2005. Figures mentioned in the lecture are as of 31 March 2004

¹³ Base reference Census of India, 2001. Taken from the website: <http://finder.geocommons.com/source/Office%20of%20the%20Registrar%20General%20and%20Census%20Commissioner,%20India>

country, India generally lags behind its peers. A comparison of various parameters on which the World Bank has ranked the countries is shown in the table below:

TABLE 4: DOING BUSINESS RANKINGS (JUNE 2008- MAY 2009)

Economy	Ease of Doing Business Rank	Starting a Business	Employing Workers	Registering Property	Getting Credit	Protecting Investors	Paying Taxes	Enforcing Contracts	Closing a Business
Brazil	129	126	138	120	87	73	150	100	131
China	89	151	140	32	61	93	125	18	65
India	133	169	104	93	30	41	169	182	138
Russian Federation	120	106	109	45	87	93	103	19	92

Source: *Doing Business.org/ World Bank*

It is comparatively difficult to start or conduct business in India, as is paying taxes, enforcing contracts or closing a business. According to the rankings given by the World Bank, the country fares well in terms of ease of employing workers, registering property, getting credit and protecting investors.

3. LEGAL AND REGULATORY FRAMEWORK

3.1 INSTITUTIONS ACCEPTING DEPOSITS OR PROMOTING DEPOSIT-LINKED PRODUCTS

Banks were not originally governed by Company Law, but were governed by the Royal Charter of the East India Company. The apex regulatory institution for the banking sector in India – the Reserve Bank of India (RBI) – was formed in 1935. In 1949, the Banking Companies Act was passed (later renamed the Banking Regulation Act in 1966). Through this Act, the Reserve Bank of India (RBI) was entrusted with the responsibilities related to the licensing of banks, branch expansion and liquidity of their assets, management and methods of working, mergers, reconstruction and liquidation.

As the central bank of the country, the RBI performs a wide range of functions. In particular, the RBI:

- Acts as the currency authority
- Controls money supply and credit
- Manages foreign exchange
- Serves as a banker to the government
- Builds up and strengthens the country's financial infrastructure
- Acts as the banker of banks
- Supervises banks

The Indian financial system consists of commercial banks, co-operative banks and non-banking financial companies (NBFCs). The State Bank of India and its associates, nationalised banks and regional rural banks (RRBs) are constituted under respective enactments of Parliament. The co-operative credit institutions can be broadly classified into urban credit co-operatives and rural credit co-operatives.

India Post and insurance companies selling unit linked or endowment products are overseen by other regulatory bodies.

In addition, there are semi-formal and informal mechanisms such as self help groups (SHGs) and rotating savings and credit associations (ROSCAs) through which the poor also access financial services. For the purpose of this study, the service providers are grouped into formal, semi-formal and informal institutions, based on the type of regulation by which they are governed.

TABLE 5: SUMMARY OF REGULATIONS IN THE FINANCIAL SYSTEM IN INDIA

Institution Type	Regulated By	Applicable Acts	Basic Services Provided / Scope of Activities Allowed
Commercial <ul style="list-style-type: none"> • <i>Schedule Commercial Banks</i> • <i>Private Sector Banks</i> • <i>Regional Rural Banks</i> 	RBI and Registrar of Companies	<ul style="list-style-type: none"> • Banking Regulation Act • Companies Act 	All banking services – credit, deposits (recurring, fixed, savings and current), sale of third party products (insurance, mutual funds, gold coins), remittance, bill payments, etc.
Co-operative Banks	Registrar of Co-operatives, NABARD and respective State Government	<ul style="list-style-type: none"> • Banking Regulation Act • Co-operative Societies Act, 1912, or the relevant state Co-operative Societies Act (as the case may be) 	All banking services – credit, deposits (recurring, fixed, savings and current), sale of third party products (insurance, mutual funds, gold coins), remittance, bill payments, etc.
NBFC	RBI and Registrar of Companies	<ul style="list-style-type: none"> • Companies Act • Section 45 I (a) of the RBI Act, 1934 • Prudential norms issued by the RBI 	Credit and deposits (latter applicable to only limited NBFCs).
India Post	Department of Posts (Under Ministry of Communications and Information Technology, Government of India). Financial activities carried out on behalf of Finance Ministry as an agency function.	<ul style="list-style-type: none"> • India Post Office Act 	Banking products like savings account, recurring deposits, pension, remittance, fixed deposits, postal insurance. Also distributor of mutual funds and bonds.
Insurance Companies	Insurance Regulatory and Development Authority (IRDA) and Registrar of Companies	<ul style="list-style-type: none"> • Insurance Act, 1938 • The Life Insurance Corporation Act, 1956 • General Insurance Business (Nationalisation) Act, 1972 • Insurance Regulatory and Development Authority (IRDA) Act, 1999 	Term insurance and endowment insurance

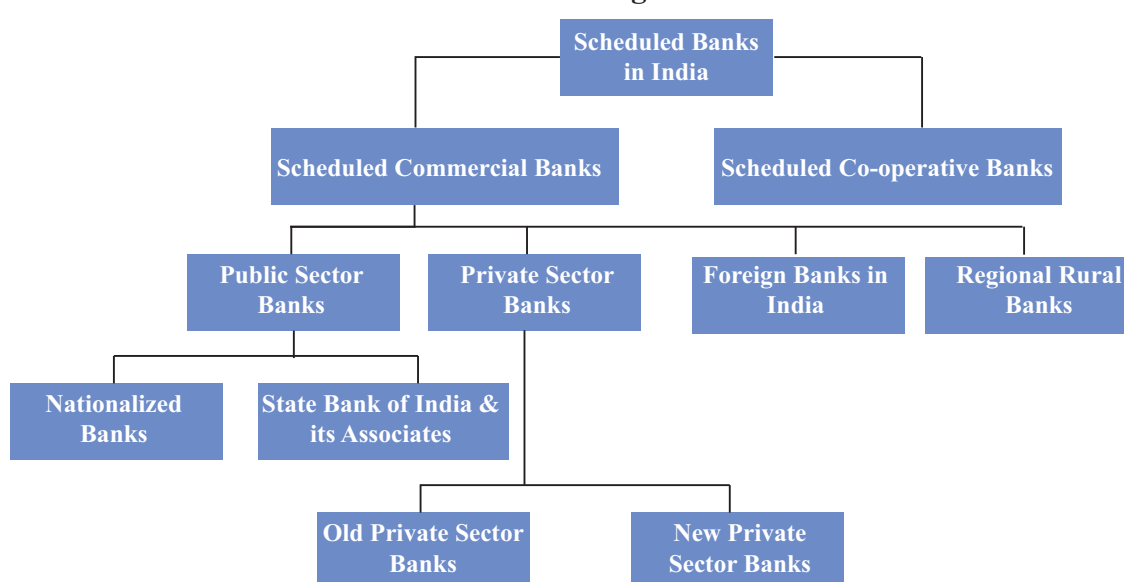
3.2 FORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN INDIA

3.2.1 BANKS

(i) Scheduled Commercial Banks

Scheduled banks in India constitute those banks which have been included in the Second Schedule of Reserve Bank of India (RBI) Act, 1934.¹⁴ The paid capital and reserves of a bank should not be less than Rs.500,000 and any activity of the bank should not adversely affect the interests of depositors. Every scheduled bank becomes eligible for debts/loans on bank rate from the RBI and automatically acquire membership of the clearing house. The scheduled commercial banks in India include the State Bank of India and its associates, nationalised banks, foreign banks, private sector banks, co-operative banks and regional rural banks.

Figure 9



The banking sector is governed by the provisions of the Banking Regulation Act, 1949, which gives powers to the RBI for regulation, control and inspection of banks in India. The existing regulatory framework under the Act can be categorised as follows:

- Business of banking companies
- Licensing of banking companies
- Control over management
- Acquisition of the undertakings of banking companies in certain cases
- Restructuring and resolution including winding up operation
- Penal provisions

¹⁴ RBI in turn includes only those banks in this schedule which satisfy the criteria laid down vide section 42 (6) (a) of the Act, pertaining to norms of paid up capital and reserves and defining certain activities as prerequisite for a bank to be included in the Second Schedule. If these requirements are not met, the bank can still carry on its normal business as a bank, but will not be considered a Scheduled Bank.

TABLE 6. BREAK-UP OF BANK BRANCHES (AS OF 30 JUNE 2009)

Type of Bank	1969	2004	2009	Rural Branches	Rural Branches as % of All Branches
SBI & Associates	2,462	13,621	16,294	5,619	34.4
Nationalised Banks	4,553	33,359	39,703	13,425	33.8
Regional Rural Banks	N.A. ¹⁵	14,486	15,199	11,644	76.6
Total Public Sector Banks	7,015	61,466	71,196	30,688	43.1
Other Scheduled Commercial Banks	900	5,807	8,979	1,126	12.5
Foreign Banks	130	218	295	4	1.4
Non-Scheduled Commercial Banks	217	32	44	11	25.0
Total (All Commercial Banks)	8,262	67,523	80,514	31,829	39.5

Source: *Commercial Banking in India: A Beginner's Module*, National Stock Exchange of India Ltd.

There are stringent norms for obtaining a banking license like minimum net worth of Rs.3,000 million with a maximum shareholding of 10% of the paid up capital by any single entity.

(ii) Private Sector Banks

In this type of bank, the majority of share capital is held by private individuals and corporates. The private banks which were not nationalised (in 1969 and 1980) are collectively known as the old private sector banks and include banks such as The Jammu and Kashmir Bank Ltd., Lord Krishna Bank Ltd., etc. Entry of private sector banks, however, was prohibited during the post-nationalisation period. In July 1993, as part of the banking reform process and as a measure to induce competition in the banking sector, the RBI permitted the private sector to enter into the banking system. This resulted in the creation of a new set of private sector banks, which are collectively known as the new private sector banks. A private bank is registered as a company under the Companies Act, 1956, but has a banking license and is directly supervised and regulated by the RBI. There are 23 banks operating as private banks in India.

(iii) Regional Rural Banks (RRBs)

Regional rural banks were established between 1976 and 1987 under the provisions of an ordinance passed in 1975 and the RRB Act, 1976, with the objective of ensuring sufficient institutional credit for agriculture and other rural sectors. The RRBs mobilise financial resources from rural/semi-urban areas and grant loans and advances primarily to small and marginal farmers, agricultural labourers and rural artisans. The area of operation of RRBs is limited to the area as notified by the Government of India, in consultation with NABARD and the sponsor bank, covering one or more districts in the state. RRBs are jointly owned by the Government of India, the concerned state government and a sponsor bank, having 50%, 15% and 35% ownership respectively.

In 2004, the Central Government initiated the process of structural consolidation of RRBs by amalgamating RRBs sponsored by the same bank within a state, as per the recommendations of the Vyas Committee. The amalgamated RRBs were expected to

¹⁵ Not applicable as RRBs existed from 1976 onwards.

provide improved customer service due to improved infrastructure, computerisation of branches, pooling of an experienced work force, common publicity/marketing efforts, etc., and also derive the benefits of a large area of operation, enhanced credit exposure limits and more diverse banking activities. As a result of the amalgamation, the number of RRBs reduced from 133 as of 31 March 2006 to 84 as of 1 January 2010.

3.2.2 NON-BANKING FINANCE COMPANIES (NBFCs)

A Non-Banking Finance Company (NBFC) is a company registered under the Companies Act, 1956, and engaged in the business of loans and advances, acquisition of shares/stock/bonds/debentures/securities issued by the Government or by a local authority, or is in the business of leasing, hire-purchase, insurance or chits. This does not include any institution whose principal business is that of agriculture, industry, or the sale/purchase/construction of immovable property. NBFCs are governed by the Non-Banking Financial Companies Prudential Norms Directions, 1998, and regulated by the Reserve Bank of India.

The NBFCs can be classified as a:

- Asset Finance Company (AFC)
- Investment Company (IC) or
- Loan Company (LC)

However, an NBFC is different from a bank because it cannot accept demand deposits, it is not a part of the payment and settlement system and it cannot issue cheques drawn on itself. Furthermore, NBFCs also do not have access to a deposit insurance facility through the Deposit Insurance and Credit Guarantee Corporation (DICGC).

For an NBFC, it is mandatory to register with the RBI to commence or carry on its business under section 45I (a) of the RBI Act. To register, an NBFC must have a minimum net owned fund of Rs.20 million. The RBI has prescribed stringent norms for collection of public deposits for such NBFCs, requiring them to comply with other directions of the RBI such as investing part of the funds in liquid assets, maintaining additional reserves, undergoing regular rating, etc.

A minimum level of liquid assets must be maintained by NBFCs – 15% of public deposits outstanding – as on the last working day of the second preceding quarter. Of this 15%, NBFCs are required to invest no less than 10% in approved securities, and the remaining 5% can be invested in unencumbered term deposits with any scheduled commercial bank.

RRBs are jointly
owned by the Government of India, the concerned state government and a sponsor bank having 50%, 15% and 35% ownership respectively.

The number of RRBs reduced from 133 as of 31 March 2006 to 84 as of 1 January 2010 due to amalgamation.

There is another class of NBFCs called Residuary Non-Banking Companies (RNBCs). The principal business of such NBFCs is to receive deposits. These companies are required to maintain investments, as per the directions of the RBI, in addition to maintaining a minimum level of liquid assets. The functioning of these companies is different from those of NBFCs in terms of methods of mobilisation of deposits and requirements of deployment of depositors' funds as per RBI's directions. Prudential norms as specified by the RBI are applicable to these companies. There is no ceiling on the raising of deposits by RNBCs, but every RNBC must ensure that amounts deposited and investments made by the company are not less than the aggregate amount of liabilities to the depositors. To secure the interests of depositors, such companies are required to invest in a portfolio comprised of highly liquid and secure instruments viz. Central/State Government securities, fixed deposits or certificate of deposits with scheduled commercial banks (SCB) or Public Financial Institutions, units of mutual funds governed by SEBI, etc.

3.2.3 CO-OPERATIVES

The incorporation, regulation and liquidation of co-operative societies (other than those operating in more than one state) is a state matter and is governed by individual state laws on co-operative societies. Co-operatives operating in more than one state are regulated by the Multi-State Co-operative Societies Act, 2002. The State Government and the Registrar of Co-operative Societies appointed by the state are the main regulatory authorities for co-operative societies.

Co-operative societies that are engaged in banking activities must also register under the Banking Regulation Act, 1949; however, the Banking Regulation Act limits the extent of the RBI's regulatory power. Not all co-operative societies are regulated by the Banking Regulation Act as the Act does not apply to Primary Agricultural Credit Societies (PACS) and Land Development Banks, thus leaving them under the regulatory purview of the state.

For banking companies that are registered under the Companies Act and governed by provisions of the Banking Regulation Act (BRA), BRA rules supersede those of the Companies Act if there is a conflict. However, this is not the case with co-operative banks. Although they are required to obtain a license under the BRA, they are subject to less regulatory oversight under the modified provisions of the Act. There is a provision in which banking laws supersede the law governing co-operative societies in cases of conflict. For the purpose of providing deposit insurance coverage under the DICGC Act, the RBI has been given powers (by amending state laws on co-operatives) to issue direction to the Registrar for liquidating, recapitalising and taking over the Boards of insured banks when necessary.

3.2.4 INDIA POST

The Department of Posts comes under the administrative control of the Ministry of Communications and Information Technology. In addition to the main business of postal delivery, the postal department is also engaged in the business of banking. The Post Office Savings Bank Scheme is an agency function performed by India Post on behalf of the Ministry of Finance, Government of India. Very recently, post offices have been allowed to become banking correspondents (BCs) to enable them to provide financial services to under-served populations or to establish outreach to unbanked areas. India Post holds nearly 206 million savings accounts, with outstanding balances of Rs.5.6 trillion (USD 125.56 billion) under all national savings schemes as of 31 March 2009.

A post office can appoint authorised agents to bring potential customers to its nearest office in order to open a post office savings account. In an informal manner they also collect small deposits from individuals and deposit the amounts in the respective accounts, which saves customers' the time and effort of travelling to the post office. It is not stipulated as part of their duty and they are not authorised to do so, but it is also true that many of the customers prefer the savings services of India Post because of these agents who have very personal relationships with customers and double up as their financial advisors. India Post has a host of microsavings and life insurance products, some of which are not available to general public.

In a Nutshell

From a regulatory perspective, banks (especially commercial banks) and NBFCs are the most highly regulated entities in the Indian financial sector. State co-operative banks and district co-operative banks are in most cases managed and run by officers appointed by the respective state governments. For banking business they are governed by the RBI, but face frequent political interference as far as management is concerned. India Post is under control of the Central Government and functions more like a government department than a business entity. The majority of banks and insurance companies focus more on urban high ticket business and microinsurance is offered by most only to achieve the mandatory targets stipulated by the regulators, and not as a remunerative business. However, from case studies developed by *MicroSave*, it is clear that some of the market leaders in the insurance industry believe that microinsurance can also be a viable proposition and are trying to scale up the business.

3.3 SEMI-FORMAL INSTITUTIONS FOR DEPOSIT MOBILISATION IN INDIA

There are a number of institutions that do not directly accept deposits but do play a great role in the mobilisation of savings. These institutions do not face stringent regulations as other forms of deposit taking institutions. Generally, semi-formal institutions are governed by state-specific acts. While semi-formal institutions are not allowed to directly collect savings/deposits, over the years they have managed to build an impressive structure by promoting what are known as self help groups (or SHGs) and by linking them to banks. The SHG movement in India receives support from the Government of India and State Governments and their agencies. The Government has included allowing

There are 155,015

post offices in India, of which 139,144 (89.7%) are in rural areas. Based on the projected population in 2006, the population served by one post office branch in a rural area was 5,682, while in urban areas a post office branch served 20,262 people. (The average for the country was 7,174 people per post office).

deposit mobilisation by these institutions in the proposed framework of the microfinance bill but with stricter rules. A brief overview of the present legal and regulatory framework governing semi-formal institutions is given below.

3.3.1 SOCIETIES

Societies in India are governed by the principal Societies Registration Act of 1860. Under this federal act, only those organisations that are formed for certain purposes of public good or for charitable purposes can be registered as societies. Several states have their own societies' registration legislation, and these state specific acts have amended the stated purposes from time to time. However, *charitable activities* continue to be the principal element of the act in these cases.

- The main instrument of any society is the memorandum of association as well as the rules and regulations, wherein the aims and objects and mode of management (of the society) should be enshrined.
- A society needs a minimum of seven managing committee members; there is no upper limit to the number of managing committee members.
- The Board of Management is in the form of a governing body or council.
- Registration can be done either at the state level (i.e., in the office of the Registrar of Societies) or at the district level (in the office of the District Magistrate or the local office of the Registrar of Societies).

In India, microfinance was initially started under the Societies Act and a majority of microfinance institutions (MFIs) are still registered as societies (although, most of the larger MFIs have now registered as NBFCs, and the majority of clients are served by these larger institutions).

Societies are not allowed to accept equity investments, which limits their ability to grow through financial leverage. According to the current law, societies are also not allowed to collect savings from their clients.

3.3.2 TRUSTS

Trusts are allowed to be formed under the Indian Trusts Act, 1882. All exemptions and restrictions that apply to societies apply to trusts as well, such as the exemption on taxation and an embargo to raise equity investments.

- A public charitable trust is usually floated when there is property involved, especially in terms of land and building.
- Different states in India have different Trusts Acts in force, which govern the trusts in the state.

Societies are not allowed to accept equity investments, which limits their ability to grow through financial leverage.

- In the absence of a Trusts Act in any particular state or territory, the general principles of the Indian Trusts Act, 1882, are applied.
- The main instrument of any public charitable trust is the trust deed, wherein the aims and objects and mode of management of the trust should be enshrined.
- The trust deed should clearly spell out the aims and objects of the trust, how the trust should be managed, how trustees may be appointed or removed, etc.
- Unlike in the registration of a society, the trust deed should be executed on non-judicial stamp paper, the value of which would depend on the valuation of the trust property.
- A trust needs a minimum of two trustees; there is no upper limit to the number of trustees.
- The Board of Management is comprised of the trustees.

Just as with societies, the law currently prohibits trusts from collecting savings from their clients or beneficiaries.

A large number of trusts are also in the business of organising the SHGs and linking them to banks. Trusts facilitate access to financial resources, including grants under various government schemes, without actually participating in the financial transactions themselves. The cost of promotion and organising the people into SHGs is generally borne by the Government or promoting/donor agencies.

3.3.3 CHIT FUNDS

Chit funds are the Indian equivalent of the rotating savings and credit associations (ROSCA). Chit funds were typically informal associations of traders and households within communities, wherein the members contributed some money in return for an accumulated sum at the end of the tenure. Many informal chit funds continue in India today, but others have been incorporated and grown to a very significant size.

The first act to regulate the chit funds came in the year 1961 and was amended subsequently in the year 1982 (Central Act). Chit funds are a common means for small and medium enterprises (SMEs) and for entrepreneurs and housewives to fulfil the need for small investments required from time to time. For such needs they do not want to approach the formal channels like banks and neither will the banks be interested in lending such small amounts, usually in the range of a few thousands of rupees.

Chit funds are the primary financial instrument for those who participate in the funds, as 67% of them are used mainly for savings. Around 58 million households have participated in chit fund schemes. Chit funds provide an opportunity for small business houses to save their excess cash on a daily or monthly basis and, at the same time, to have access to easy finance. Generally, the funds are used as either working capital, for expansion of

Since 28 August 2009,
the RBI has prohibited chit funds from accepting deposits from the public, though they can accept deposits from their shareholders.

a business or as emergency funds. There are currently approximately 9,900 chit funds operating in the country.

It is estimated that the chit fund industry in India generates 3.4% of household savings (or Rs.188 billion or USD40 billion), compared to 4.92% invested in shares and debentures.

Though there have been frauds and scandals by some chit funds, the business is still thriving and people continue to use the services of chit fund companies. The Rs.61.1 billion (USD 1.3 billion) Chennai-based Shriram Group, which runs the largest chit fund business in the country, manages a corpus of Rs.32 billion (USD 0.7 billion) annually.

3.4 INFORMAL MECHANISMS FOR DEPOSIT MOBILISATION IN INDIA

3.4.1 OTHER INFORMAL MECHANISMS

Middle class households organise what is commonly called a 'kitty' wherein the members – usually women – pool in a certain amount of money every month. The amount is either auctioned or is given in full to members in turn through the drawing of lots. If it is auctioned, the members who need the money call out their bid and the highest bidder gets the amount minus the bid amount. The bid amount is either paid in cash to the other members or the monthly instalment amount is reduced by that amount. A similar pooling system is very popular among small businessmen and is known as the 'committee' or 'lottery' system.

Since by definition these are not regulated, there is no legal framework or regulations under which these institutions are run.

3.5 INSURANCE COMPANIES

The insurance sector in India is a booming sector of the economy and is growing at the rate of 15-20% annum. Together with banking services, it contributes to about 4.6% of the country's GDP. Insurance is a federal subject in India and is governed by the Insurance Act of 1938, the Life Insurance Corporation Act of 1956, the General Insurance Business (Nationalisation) Act of 1972 and the Insurance Regulatory and Development Authority (IRDA) Act of 1999.

The insurance sector in India was liberalised in March 2000 with the passage of the Insurance Regulatory and Development Authority (IRDA) Bill, lifting all entry restrictions for private players and allowing foreign players to enter the market with some limits on direct foreign ownership. With the rapid growth trajectory in recent years, India achieved in 2008 an insurance density of USD \$46.6 (144% over 2003) and an insurance penetration of 4.7%¹⁶ (36% over 2003). However, 90%¹⁷ of the Indian population, and 88%¹⁸ of the Indian workforce – the majority of the unorganised workforce – are still excluded from any kind of insurance cover and pension cover respectively.

The insurance sector

in India is a booming sector of the economy and is growing at the rate of 15-20% annum.

Together with banking services, it contributes to about 4.6% of the country's GDP.

¹⁶ IRDA Annual Report 2007-2008, http://www.irdaindia.org/annual_report/annual_rep_2007_08.pdf

¹⁷ Mare Socquet, October 2005, ILO/STEP, Microinsurance workshop, India

¹⁸ "Pension Reforms for Unorganised Sector", ADB, TA IND-4226, 2006

With the opening up of the market to private and foreign players around a decade ago, the insurance market has seen unprecedented growth. The Associated Chambers of Commerce and Industry of India (ASSOCHAM) predict that the Indian insurance sector is likely to realise a growth of 200% and attain a size of Rs.2 trillion (USD 44.84 billion) by 2009-10.²⁰

Industry	Unit Linked Business (% growth) ¹⁹		
	2005-2006	2006-2007	2007-2008
Private	82.3	88.8	90.3
LIC	29.8	46.3	62.3
Industry	41.8	56.9	70.3

Legal, regulatory and capital requirements for an insurance company:

- An insurance company should be a company registered under the Companies Act, 1956.
- The aggregate equity participation of a foreign company in the applicant company should not exceed 26% of the paid-in capital of the insurance company. There is a proposal to increase this limit to 49%.
- The applicant company can carry one line of insurance business: life insurance, general insurance or re-insurance. Separate companies are required if the intent were to conduct more than one line of business.
- Minimum paid-in capital of one billion rupees for applicants seeking to offer life or general insurance. Minimum paid-in equity capital of two billion rupees for entities seeking to offer reinsurance.
- The promoter of the company cannot hold more than 26% of the paid-in capital.
- Detailed limits also exist on investments by insurance companies.

3.5.1 RURAL AND MICROINSURANCE BUSINESS

In order to ensure that insurance companies serve rural and neglected populaces, IRDA requires minimum levels of business in rural and underserved (or social) sectors. A minimum proportion of business sourced by any life or general insurance company has to be from the rural areas and the life insurance companies have to fulfil a mandate of insuring a minimum number of people from the underserved categories. These proportions increase each year and are fixed after 10 years of the company's operations.

TABLE 8. OBLIGATIONS TO RURAL AND SOCIAL SECTORS (INCLUDING THE 4TH AMENDMENT)

Operations Year	Life Rural	General Rural	Social (Underserved) ²¹
1	5%	2%	5,000 lives
10	20%	7%	55,000 lives

¹⁹ IRDA Annual Report 2007-2008, http://www.irdaindia.org/annual_report/annual_rep_2007_08.pdf

²⁰ <http://www.asiaeconomywatch.co.uk/2008/04/21/indias-insurance-sector-poised-for-200-growth-by-2010/>

²¹ For LIC of India, the rural sector obligation was 24% in 2007-08 and 25% in 2008-09, 2009-10 of the total policies issued in that year. This is 2.5 million lives in 2007-08, 2008-09, and 2009-10 in the social sector. For general insurers in the public sector, the rural sector obligation was 6% in 2007-08, and 7% in 2008-09 and 2009-10. The social sector obligation has also increased to the higher of the average of 2002-03 and 2004-05 or 550,000 lives for the year 2007-08. For 2008-09 and 2009-10, the increase was 10% over previous years. IRDA has also provided relief to companies that start in the second half of a financial year to meet only 50% of the obligations to the rural and social sectors.

A consultative group on microinsurance was set up by IRDA in 2003 to look into the issues of microinsurance, which highlighted the:

- Non-viability of standalone microinsurance programmes;
- Apathy of insurance companies towards microinsurance; and
- The potential of alternative channels for microinsurance.

In 2005, IRDA facilitated regulation that:

- Stipulated the product boundaries in terms of minimum and maximum sum assured, the term of product, the allowable age group and the maximum commission to agents;
- Allowed SHGs and societies to become microinsurance agents (MIA), a status that has a simple agency clearance process and sustainable long-term earning potential (later trusts and Section 25 companies were also allowed to become MIA); and
- Facilitated insurance companies meeting their rural and social sector obligations through microinsurance products.

The regulation was an important accelerator for the Indian microinsurance industry. By 31 March 2009, 7,250 MIAs were registered with IRDA. However, the regulation has certain restrictive aspects, for example:

- Non-banking financial companies were not allowed to become MIAs;
- Service tax was imposed on all commissions earned by the MIAs;
- Lack of clarity about MIA status of regional rural banks and co-operatives; and
- The restriction to one life and one non-life partner for each MIA.

According to IRDA and RBI guidelines, NBFCs are allowed to participate in the insurance business either by setting up their own business, or as corporate agents of an insurance company registered with the IRDA. Until recently, an NBFC (and other legal forms like societies, trusts, co-operatives and Section 25 companies) could also become a referral agent of the insurance company. In the referral agent model, the agent used to get a front loaded commission for the first year premium as remuneration for referring a client from their own database. Since the regulation did not allow MIAs to earn a front loaded commission (MIAs can get a maximum of year on year commission of 20% of annual premium), most of the MFIs preferred to become referral agents of the insurance

Moving Towards Insurance as Savings Mechanism?

According to the preliminary estimates released by the RBI on household financial savings for 2007-08, insurance funds constituted 17.5% of the total gross financial savings of the households in 2007-08 - an increase in the share of insurance funds in the total household savings. A similar increase was also observed in mutual funds. This shift in preferences towards insurance was mainly on account of households preferring to invest in the Unit Linked Insurance Products (ULIPs) of life insurers in the background of a bullish stock market. However, another reason could be the incentive structure of the agents who sold these policies to clients promising them higher returns, in order to earn the higher incentives they got on selling ULIPs compared to other insurance policies.

companies. Recently, however, the IRDA has stipulated strict guidelines for becoming referral agents (see “Changes in Microinsurance Due to Recent Regulatory Changes” below). The RBI has also implemented very strict regulations for NBFCs and co-operative banks to carry out the business of insurance as corporate agents of insurance companies.²²

3.6 THE ROLE OF THE GOVERNMENT OF INDIA IN DEPOSIT MOBILISATION

Changes in Microinsurance Due to Recent Regulatory Changes

In the Gazette of India 10th July 2010, IRDA has re-stipulated certain aspects of corporate agency and referral agency model and product specifications. The probable implications of the regulatory changes in micro-insurance are:

1. **Distribution:** Most of the alliances between insurers and micro-insurance distributors are of referral partnership, where the impact of new regulation will be felt the most. All the NBFC-MFIs will have to become necessarily corporate agents (CA) as they are regulated by the RBI and engaged in the lending business. Where the distributors of microinsurance are NGOs, SHGs or co-operative societies, they must convert into microinsurance agents (MIA) as most of them are not meeting either the customer database or revenue guidelines.
2. **Income:** Most of the distributors enjoy high commission by being a referral partner. Once they migrate to either CA or MIA, the commission rates will be reduced which will result in significantly reduced non interest income.
3. **Product:** Most of the microinsurance products sold in India are pure term plan; unit linked insurance policies (ULIPs) and endowment policies have not been successful in this space. With the new regulations, most insurers are likely to continue with the credit life plans to meet their rural and social sector obligation in the short to medium term, and at the same time focus on group savings linked insurance (GSLI) plans to bring in viability to microinsurance business.

The Government of India has always focused on low income households for various schemes and programmes it develops and runs. For over four decades since independence in 1947, the Government followed a socialist approach towards development, with the aim of equitable distribution of the fruits of economic growth. Even after the liberalisation era that commenced in the 1990s, most financial sector activities have either been under direct or indirect control of the Government (through regulatory bodies and government departments) or there are strict guidelines in place to serve the low income segments of society.

Some of the steps taken by the Government of India to provide banking services to the underserved are listed in the table below. The different phases starting just after the

²² For more details on NBFCs being able to offer insurance refer to: <http://rbidocs.rbi.org.in/rdocs/Notification/PDFs/51301.pdf>

independence of the country of recent years, shows a slow graduation to looking at the financial sector as fulfilling a fundamental need for inclusive growth, rather than being just a provider of financial services.

PHASE	PERIOD	INITIATIVES/PROCESSES
Phase-I	1950-70	Consolidation of the banking sector & facilitation of industry and trade
Phase-II	1970-90	Focus on channelling of credit to neglected sectors and weaker sections
Phase-III	1990-2005	Focus on strengthening financial institutions as part of financial sector reforms
Phase-IV	2005 onwards	Financial inclusion was explicitly made a policy objective

3.6.1 GOVERNMENTAL INITIATIVES TO IMPROVE FINANCIAL INCLUSION

- In the 1990s, the Government experimented with new models for improving financial access to the poorest segment.
- The Government focused on strengthening institutions for the poor with a pilot programme started by NABARD in 1992. Starting from a target of linking 500 SHGs to banks for credit services in the pilot phase, the SHG-Bank Linkage programme now has more than three million SHGs linked with banks.
- In November 2005, the RBI asked banks to offer a basic banking ‘no-frills’ account with low or zero minimum balances and minimum charges to expand the outreach of such accounts to low income groups.
- Further in 2006, the RBI permitted banks to use the services of non-governmental organisations, microfinance institutions (but not those registered as NBFCs), retired bank employees, ex-servicemen, retired government employees, Section 25 companies, and other civil society organisations as Business Correspondents (BCs) in providing financial and banking services.
- In November 2009, the RBI further enlarged the scope of the BC model by permitting banks to appoint a wider range of individuals as BCs.
- Earlier in April 2009, the RBI had increased the maximum distance permitted between the place of business of a BC and the link bank branch, from 15 kilometres (kms) to 30 kms, further facilitating the expansion of BCs.
- In November 2009, the RBI permitted banks to charge customers “reasonable fees” for using services through BCs. Whatever the bank proposed to charge needs to be approved by the respective bank’s Board. This is a recent change that improves the business case for banks and should enable better compensation for BCs, particularly as they expand the range of services offered.

- As per operative guidelines for Mobile Banking Transactions in India notified on 8 October 2008, RBI permitted banks to offer Mobile Banking Transaction facility to their customers subject to a daily cap of Rs. 5000/- per customer for funds transfer and Rs.10, 000/- per customer for transactions involving purchase of goods/services.
- In early 2009, the RBI did away with the need for procuring a license for setting up ATMs.
- In December 2009, the RBI took another big step towards financial inclusion by doing away with the need for a license for opening a bank branch in towns and villages with populations below 50,000. For other towns and cities, a license from the RBI is still required except for North Eastern states and Sikkim. Domestic scheduled commercial banks (other than RRBs) are now free to open branches in towns and villages with a population of less than 50,000 and are required to set up at least one third of new branches within under-banked districts of under-banked states.
- The RBI is in consultation with state governments to encourage adoption of Electronic Benefit Transfers (EBTs) by banks. It has also launched a financial inclusion drive targeting one district in each state for 100% financial inclusion.

These efforts have yielded positive results. A research study conducted in Karnataka concluded that financial inclusion efforts of opening no frills accounts resulted in nearly 60% of the adult population opening a bank account. This is high when compared with other developing countries such as South Africa (32%), Tanzania (6%) or Colombia (39%), but low when compared with Denmark (99%), the UK (88%) or the US (91%). An additional 584 million accounts, however, must be added for India to reach its 100% inclusion target.

Though the Government of India's role in directly deciding the deposit rates is limited, (except for customer deposits with India Post and in certain pension funds), it works closely with the regulatory bodies – especially the RBI – and influences the rates in times of stress. Otherwise, it is the RBI that decides deposit rates. At present, the deposit rates for savings accounts are pegged at 3.50% per annum, while rates for term deposits are decided by the banks. Even the term deposit rates are kept under check by the RBI through its monetary policies. Banks are required to maintain a cash reserve with the RBI, and a certain level of liquidity in various approved securities or as cash or assets like gold, etc., proportionate to the deposits with them. By changing the cash reserve ratio (CRR) or the statutory liquidity ratio (SLR), the RBI controls the liquidity available with the banks which in turn decides what rates the banks offer customers for deposits.

The RBI, as a banker to the banks, offers loans to banks at a rate called “repo rate” and borrows from banks at a rate called “reverse repo rate”. By changing these rates, the RBI is able to influence the rates that banks offer to their customers. Industry experts believe that interest rates may not increase due to competition, since banks are already feeling the additional burden of having to pay more interest to savings account customers because of

Since 1 April 2010, interest on savings accounts is calculated on a daily basis. Earlier the interest was calculated on the minimum balance of the month between the 11th and the last day of the month. This has increased the interest burden on banks, affecting their margins.

the recent introduction of interest calculation based on average daily balance rather than the earlier system of interest calculation on minimum balance between the 11th and the last day of the month.

The Government can divert savings from one particular instrument to another by incentivising in the form of tax savings on principal or earnings/dividends. For instance, the interest and principal repaid on a home loan reduces the tax burden of the borrower, since these amounts can be deducted from taxable income to a maximum of Rs.150,000 for the interest paid and Rs.100,000 for the principal paid. Similarly, by tweaking the rates of the public provident fund (PPF), post office saving schemes, etc., it can attract or keep away investors.

In recent months, the Government of India has been considering deregulating the interest rates on small savings schemes like PPF and post office deposits and linking them to the prevailing market interest rates for savings deposits in banks. At the same time, the RBI is considering deregulating interest rates on savings accounts (which is fixed at 3.5% per annum at present and cannot change like with term deposits banks). This will allow banks to directly compete with each other on the basis of interest rates they offer to retail customers, which is not possible at present.

The RBI places no stipulations on lending. Since 1 July 2010, the RBI has asked banks to decide their lending rates based on each one's own base rate, and the banks cannot offer loans below this rate to any customer (though the lending rates for three categories has been delinked from base rate). The base rate is to be decided by each bank individually based on any methodology of its choosing, which should be consistently followed and has to be made available to the RBI for scrutiny when asked for. With this change in place, banks are finding it difficult to lend to large corporates who used to get loans at very low rates under the earlier benchmark prime lending rate (BPLR) system. But at the same time, the new system has brought in more transparency for customers.

Premiums Charged and Claims Paid by DICGC

The premium rates charged by DICGC were raised to Re 0.10 per deposit of Rs.100 with effect from 1 April 2005.

	PREMIUMS RECEIVED		CLAIMS PAID	
	RS. BILLION	USD BILLION	RS. BILLION	USD BILLION
2006-07	23.2	0.5	3.2	0.07
2007-08	28.4	0.7	1.8	0.04
2008-09	34.5	0.7	9.1	0.20

Source: DICGC - Annual Report 2009

3.7 PROTECTING THE CUSTOMERS: CONSUMER PROTECTION MEASURES IN INDIA

The Government of India is not only focusing on increasing banking penetration, but it also has well laid out plans for protecting deposits of customers. The Deposit Insurance and Credit Guarantee Corporation of India (DICGC) is responsible for insuring deposits and guaranteeing credit. The deposit money of all depositors within a bank covered under the scheme²³ is insured up to a maximum of Rs.100,000 (including both principal and interest amounts). The deposit insurance facility is not available for customers of deposit taking NBFCs.

²³ All commercial banks including branches of foreign banks functioning in India, local area banks and regional rural banks are insured by the DICGC. All co-operative banks other than those from the States of Meghalaya, and the Union Territories of Chandigarh, Lakshadweep and Dadra and Nagar Haveli are covered under the deposit insurance system of DICGC. Primary co-operative societies are not insured by the DICGC.

For an individual with deposits in two or more banks, the insurance is applicable to deposits in all the banks separately. But on the other hand, if the individual has multiple accounts in the same bank, the balances in all these accounts are aggregated and the maximum insurance cover available is up to Rs.100,000 (USD 2,109).

Besides protecting the savings of the depositors, the Government also protects the customers from deficient banking through numerous consumer protection measures. These measures range from the voluntary internal redressal mechanisms of the financial institutions, to the external mechanisms provided by regulators.

TYPE OF PROTECTION MEASURES	BODY/AUTHORITY
Internal Protection Measures	Banks' own grievance redressal mechanisms
External Protection Measures	Code of Banking Practices and Model code adopted by banks, framed by the Indian Banks Association (IBA)
	Banking Ombudsman Scheme set up by the Reserve Bank of India
	Consumer courts at district, state and national levels

The Banking Ombudsman Scheme and Others

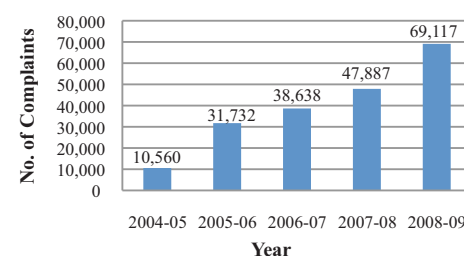
The RBI introduced the Banking Ombudsman Scheme in 1995. The scheme was revised in 2002, mainly to cover regional rural banks and to permit review of the Banking Ombudsmen's awards against banks by the RBI. This in turn was superseded by the present scheme, which came into force on 1 January 2006.

The scheme is applicable to all commercial banks, RRBs and scheduled primary co-operative banks. The scheme, as further amended on 3 February 2009, also includes complaints for deficiencies arising out of internet banking, non-adherence to the provisions of the Fair Practices Code for lenders or the Code of Bank's Commitment to Customers issued by the Banking Codes and Standards Board of India (BCSBI) and non-observance of the Reserve Bank guidelines on engagement of recovery agents by banks.

An increasing number of complaints have been received from the rural and semi urban areas mainly due to increased awareness and easy accessibility of the offices of Banking Ombudsmen.

Additionally, there are bodies like the Indian Banks Association (IBA) formed in September 1946 and the Banking Code and Standards Board of India (BCSBI) set up in 2005 that act as a bridge between banks and other stakeholders. IBA has more than 159 members comprised of public sector banks, private sector banks, foreign banks with offices in India and urban co-operative banks. BCSBI has developed a Code of Bank's Commitment to Customers which has been adopted by all member banks. It also has a web-based helpline for handling customer complaints.

Figure 10: No. of Complaints Received During the Year



*Source: The Banking Ombudsman Scheme 2006, Annual Report 2008-09: RBI

While the Banking Ombudsman does not look into the systemic issues on matters that come forth for redressal, the BCSBI as an independent and autonomous watch dog monitors and ensures that banking codes and standards are adhered to by the member banks. On the other hand, the IBA promotes the banking industry through coordination and exchange of ideas between members and is a lobbying body for the industry as a whole.

3.8 EDUCATING THE CUSTOMERS: FINANCIAL AWARENESS/LITERACY CAMPAIGNS

The ‘National Study on Speeding Financial Inclusion’ by the Skoch Development Foundation reports that financial inclusion is simply not happening in the country. It suggested financial literacy as critical in the efforts to increase financial inclusion and recommends taking certain measures, including:

- Education campaigns to showcase banking sector advantages and how to use them
- Providing training packages at Customer Service Centres (CSCs) and other e-kiosks
- Using Panchayati Raj Institutions to mobilise the people
- Increasing the role for NGOs in creating financial awareness
- Inculcating financial literacy in schools, and
- Financial literacy and credit counselling centres can be linked to the Rural Development and Self Employment Institute (RUDSETI).

RBI, the regulator in India, initiated a project named “Project Financial Literacy” in 2007, with the objective of disseminating information regarding the central bank and general banking concepts to various target groups. The information is available in 13 languages on RBI’s website. It offers the basics of banking, finance and central banking for children of all ages. In a series of comic book initiatives, the RBI has sought to simplify the complexities of banking, finance and central banking, with the goal of making the learning fun and interesting. The RBI has also required that all banks set up credible financial literacy and credit counselling functions in their frontline branches.

But these offerings are available to the literate high-end customer who has internet access. For the low income customer, especially the rural poor, there is little that is available in terms of financial literacy.

Financial awareness will perhaps come through experience, when a larger number of people are actually able to use the services provided by banks and other financial institutions. Many NGOs and MFIs are making efforts in this direction, especially for those customers who directly deal with SHGs or individual members either as service providers or as facilitators (for SHG-bank linkage, etc.). But such efforts are limited

Some Facts on Banking Ombudsman Scheme

Overall complaints received from rural areas increased by 65%, semi urban areas by 48%, urban areas by 36% and metropolitan areas by 43% during 2008-09. While the percentage of complaints against nationalised banks and the SBI group has decreased from 45% to 22% and 29% to 27% respectively, those against private sector and foreign banks has increased from 16% to 32% and 5% to 17% percent respectively between 2004-05 and 2008-09. Most complaints were filed for credit card related issues (17,648), followed by ‘failure to meet commitments’ (11,824), loans and advances (7,331), deposit accounts (6,706) and others.

“Financial literacy

and education play a crucial role in financial inclusion, inclusive growth and sustainable prosperity and is also being increasingly recognised and acknowledged globally.”

-Pranab Mukherjee,

Finance Minister of India.

to areas where these organisations are active, while there remains a large population that has yet to understand the basics of financial services or banking. At the same time, there is also a feeling that unless the poor understand and appreciate the importance of financial services, they are unlikely to avail the services even if made accessible to them. Perhaps a good way to start is that both activities - that of awareness creation and of providing financial services to both low income segments and in rural areas - be performed simultaneously for a greater impact.

There are several government programmes offered to improve financial inclusion across India including the national level SHG Bank linkage programme of NABARD, the *Swarna Jayanti Gram Swarajgar Yojana* (SGSY) of the Ministry of Rural Development, as well as state specific programmes like Kudumbashree of Kerala and Velugu (now *Indira Krathi Patham*) of Andhra Pradesh.

Several policy documents including the 11th five-year plan highlight financial inclusion as a major agenda for growth and initiatives, like banking correspondents, banking facilitators, opening of no frills accounts with zero balance, introduction of the microfinance sector bill and many more. In addition, special funds such as the Microfinance Development and Equity Fund (MFDEF) with a corpus of Rs.4 billion, the Financial Inclusion Fund and Financial Inclusion Technology Fund (each with a seed capital of Rs.5 billion) have been created to improve financial inclusion in India. Furthermore, banking through mobile phone technology has started. The Government of India also proposed to set aside Rs.1.0 billion during the current year as a one-time grant-in-aid to ensure provision of at least one centre/Point of Sales (POS) for banking services in each of the unbanked blocks in the country.

In addition, there are different ministries such as the Ministry of Minority Affairs and the Ministry of Women and Child Development that have their own finance wings (National Minority Finance Development Corporation and Rashtriya Mahila Kosh respectively) which promote easy access to finance through various development programmes in collaboration with financial institutions and NGOs.

3.9 PAYMENT SYSTEMS FOR BANKS

India's payments industry has revenues of nearly USD 14 billion and is poised for a major growth. The rapid advancements in the field of information technology (IT) have contributed to the emergence of new products as well as methods of payment and settlement. In recent years, the use of electronic payments has witnessed manifold increase, partly reflecting increased adoption of technology.

The retail payment system includes cheque clearing, retail electronic fund transfer and card payment. The Cheque Truncation System (CTS) was implemented in the National Capital Region in February 2008 to enhance the efficiency of the paper based clearing system. Between the end of March 2009 and the end of September 2009, the branch network of national electronic funds transfer (NEFT) enabled banks increased from 54,200 to 60,839, and the RTGS enabled branches increased from 55,000 to 60,144. As

India's payments

industry has revenues of nearly USD 14 billion and is poised for a major growth. The rapid advancements in the field of information technology (IT) have contributed to the emergence of new products as well as methods of payment and settlement.

of the end of September 2009, 114 banks with 30,780 branches were participating in national electronic clearing service (NECS) which was introduced in September 2008. Electronic payments can be made through the Electronic Funds Transfer (EFT) System, the Electronic Clearing Service (ECS) System for small value repetitive payments and through the Real Time Gross Settlement (RTGS) System for large value payments.

SCBs and non-bank entities are now permitted to issue pre-paid payment instruments. In August 2009, other entities were also permitted to issue mobile phone based semi-closed system pre-paid instruments to a maximum value of Rs.5,000. Since 8 October 2008, the RBI has granted approval to 32 banks to provide mobile banking facilities to their customers (as of 31 July 2010). Cash withdrawal from Automated Teller Machines (ATMs) of the banks was made free of charge with effective 1 April 2009.

3.10 BUILDING CAPACITIES OF INSTITUTIONS

Viewing education and training as important factors in serving bank customers' effectively and efficiently, many training institutions have been established in India.

Most banks also have established their own training centres across the country. For example, the State Bank of India has its Staff College, State Bank Academy, State Bank Institute of Information Communication Management, and the State Bank Institute of Rural Development at different locations in India. There are also specialised institutions such as the Bankers Institute of Rural Development (BIRD), established by NABARD and targeting RRB personnel to provide training, research and consultancy services in the field of agriculture and rural development banking in India.

In the areas of co-operative training, there are both national and state level institutions, such as the National Council for Co-operative Training and the National Centre for Co-operative Education under the National Co-operative Union of India, which provide training on various aspects of co-operatives, and operate at a national level. At the state level, organisations such as MP State Co-operative Union Ltd, Bhopal, provide education and training information and publicity in co-operative sector.

There are private initiatives from the non government sector as well. For example, Andhra Pradesh Mahila *Abhivruddhi Society* (APMAS) provides technical support and consultancy services to SHGs. It coaches SHG members in management techniques and capacity building, and links them to organisations that are able to provide financial and structural support. In addition, there are other private specialised companies in the field like *MicroSave*, BASIX and EDA which provide training and consulting services. *MicroSave* has more than a decade of experience on issues related to the delivery of market-led financial services with a particular focus on deposit mobilisation.

4. (MICRO) DEPOSIT SERVICE PROVIDERS, PRODUCTS, METHODOLOGIES AND THEIR SCALABILITY

Various financial institutions cater to different segments of the society and overlap to varying degrees. Mapping of a particular kind of institution to a particular segment can be done on the basis of the geography in which the institutions operate (urban, semi-urban or rural); a demographic profile of the population (whether the institution caters

The RBI has six recognised training institutes. Three of these, the College of Agricultural Banking, Bankers Training College and Reserve Bank of India Staff College, are part of the RBI, while the others, National Institute for Bank Management, Indira Gandhi Institute for Development Research (IGIDR) and Institute for Development and Research in Banking Technology (IDRBT), are autonomous.

only to women or also to men, tribal or non tribal, etc.); and the socio economic strata that the institution primary targets (only poor households, landless labourers, slum dwellers, etc.). The institutions have differences in reach, product offerings, price, size and the regulations and laws applicable to them. *Table 9* below shows how dominant a role scheduled commercial banks play in the overall provision of savings services. However, this analysis of course includes all savings in India.

TABLE 9. DISTRIBUTION OF SAVINGS ACROSS ENTITIES IN INDIA²⁴

Entity	Total Deposit (Rs. Bn.)	% of Total Deposits	Demand Deposit	% of Total that is Demand Deposit
SCB	45,592	81%	11,717	26%
RRB	1,180	2%	7	57%
UCB	1,587	3%	8	50%
StCB	530	1%	2	32%
DCCB	1,030	2%	7	70%
NBFCs	216	0%	2	100%
India Post	5,637	10%	2	4%
Chit Funds	188	0%	2	100%
SHGs	55	0%	1	100%
Total	56,014		11,747	

Table 10 gives some details about the various formal institutions providing deposit services to the public. Scheduled commercial banks (SCB) are the most important and biggest deposit mobilisers in India with total deposits of Rs.45,591.8 billion (USD 961.4 billion) through 164 banks. RRBs have a greater focus on microsavings with more than half of their total deposits being in the form of microdeposits. The role of NBFCs in deposit mobilisation has been limited by the stringent regulations of RBI.

TABLE 10. DEPOSIT MOBILISATION BY FORMAL SECTOR INSTITUTIONS IN INDIA²⁵

Institution	Number of Entities	Total Deposits (Rs. Bn.)	Demand Deposits as % of Total Deposits	No. of Branches	% Rural Branches
Scheduled Commercial Banks	164	45,591.8 ²⁶	25.7%	80,514	39.5%
RRBs	86	1,179.8	56.7%	15,199	76.6%
Urban Co-operative Banks	1,721	1,587.3	N/A	N/A	N/A
State Co-operative Banks ²⁷	31	529.7	31.9%	953	N/A
District Central Co-operative Banks ²⁸	371	1,029.8	N/A	12,858	70-80%
NBFCs	12,740**	215.5	0%	N/A	N/A
Postal Department	1	5,636.9	4.0%	155,015	89.7%

*Including Bank Internasional Indonesia which has since wound up operations in India.

** Deposit taking NBFCs were 336 in end June 2009. LAB is dropped from this list as the number of entities and volume of business is negligible as compared to any of the other categories; there are only four LABs operating in India.

²⁴ Table compiled from various sources published in the year 2009 and 2010.

²⁵ Table compiled from various sources published in the year 2009 and 2010.

²⁶ Table 1, RBI Bulletin, July 2010, Vol. LXIV, No.7

²⁷ Report on Trends and Progress in Banking in India 2008-09, RBI

²⁸ *ibid*

4.1 SCHEDULED COMMERCIAL BANKS

The banking system in India is the major provider of financial services for the majority of the population. It is a highly regulated sector with functions under strict monitoring by the RBI. Public sector banks are among the most popular, accounting for more than half of the aggregate deposits, excluding SBI and its associates (that account for another 23.4%). This shows the level of trust these government owned banks enjoy over ‘other scheduled commercial banks’ which had a share of 17.1% (as on 25 December 2009). Even in the credit business there is a clear dominance by government owned banks over private sector and foreign banks. Some contribution to this skewed distribution may be attributed to the unpopular recovery practices once followed by many private sector banks that have, to some extent, kept the general public away from some of these banks.

Figure 11: Share in Aggregate Deposits-Bank Group-Wise

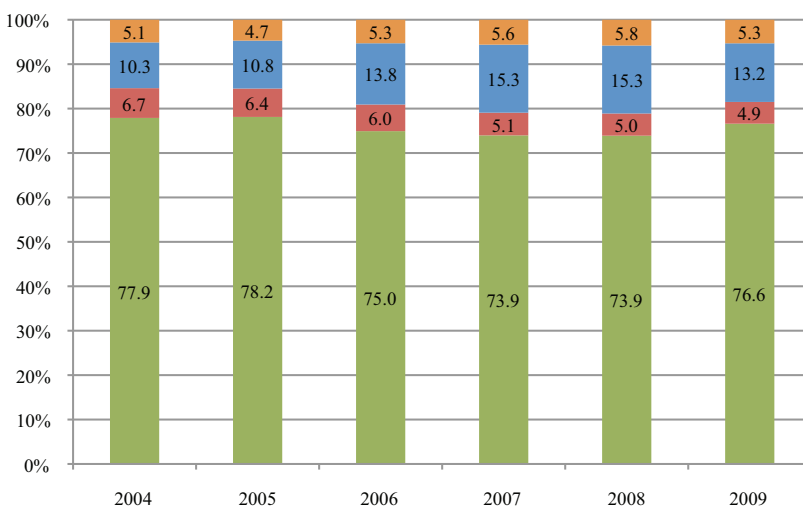
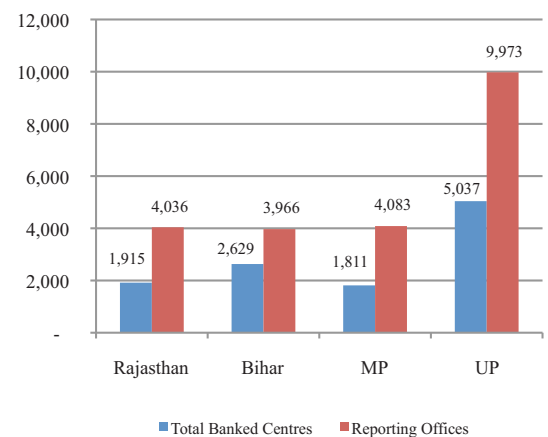


Figure 12: State-Wise Total Banked Centres and Reporting Offices (Dec. 2009)



As of 25 December 2009, the number of banked centres²⁹ served by SCBs in India stood at 34,731, of which 28,021 were single office centres. Sixty-four centres had 100 or more bank offices. Rajasthan and Madhya Pradesh have almost similar numbers of banked centres (1,915 and 1,813 respectively) and also similar number of reporting offices (4,036 and 4,083). Bihar has marginally more banked centres at 2,620, but a lesser number of reporting offices (which means the banked centres have fewer branches on average). Uttar Pradesh, due to its size and population with 70 districts and over 16 million in population, has the highest number of banked centres (5,037) and reporting offices (9,973), not only among the four BIMARU states, but across all of India.

In terms of aggregate deposits across all SCBs in the four states, U.P. had the highest deposits at Rs.2,899.7 billion (USD 62.8 billion), followed by M.P. with Rs.1,089.4 billion (USD 23.6 billion); Rajasthan with Rs.995.6 billion (USD 21.6 billion) and Bihar with Rs.903.5 billion (USD 19.6 billion). The composition of these deposits varies across states by the type of location, i.e., rural, semi urban, urban and metropolitan.³⁰ It is interesting to note that U.P. has more deposits from rural locations than semi urban locations, whereas Rajasthan and M.P. have

“...the reach of commercial banks is quite low given the size of India. Out of the 600,000 habitations in the country, only about 30,000, or just 5%, have a commercial bank branch. Just about 40% of the population across the country have bank accounts, and this ratio is much lower in the northeast of the country. The proportion of people having any kind of life insurance cover is as low as 10%, and the proportion having non-life insurance is an abysmally low 0.6%”.

*-D. Subbarao,
RBI Governor*

²⁹ Locations with at least one branch of any scheduled commercial bank

³⁰ RBI classification on the type of location is by population: rural is less than 10,000; between 10,000 and 100,000 is semi-urban; between 100,000 and 1 million is urban and more than 1 million is metropolitan

the least contribution from rural locations. Bihar has almost equal deposits from rural, semi-urban and metropolitan locations with the least from urban locations. When one looks at the contribution of deposits to the all India aggregates (location-wise) from these four states, U.P. contributes 14.6% to the total rural deposits in India (Rs.3,934.4 billion or USD 85.3 billion) from all SCBs. At the same time, while in absolute terms the deposits from urban and metro locations in U.P. are almost the same (Rs.905.2 billion or USD 19.6 billion and Rs.978.8 billion or USD 21.2), the proportion of their contribution to all India aggregates is very different, at 10.4% and 4.2% respectively.

Maharashtra is the state with the largest aggregate deposits at Rs.10,731.6 billion (USD 232.6 billion), followed by Delhi with Rs.5,402.7 billion (USD 117.1 billion). As for U.P., despite its size and huge population, it has deposits similar to West Bengal, Karnataka and Tamil Nadu. This clearly shows that the four states, which are among the largest in India by geographical coverage and population, have a huge untapped potential for deposit services, though many other factors like per capita income, work opportunities, employment rate and presence of banking facilities will also affect the deposit figures.

The share of current and saving accounts (CASA) deposits significantly influence the cost structure of commercial banks. Current accounts are primarily meant for companies, public enterprises and entrepreneurs with numerous daily transactions. On the other hand, savings accounts are the most common operating account for individuals and others for non-commercial transactions. Banks pay no interest on current accounts and an interest rate of 3.5% on savings accounts. Thus, compared to other modes of deposits, such as fixed deposits, CASA deposits represent the cheapest mode of raising money.

Figure 13: State-Wise Aggregate Deposits in All SCBs as Percentage of All India (Dec. 2009)

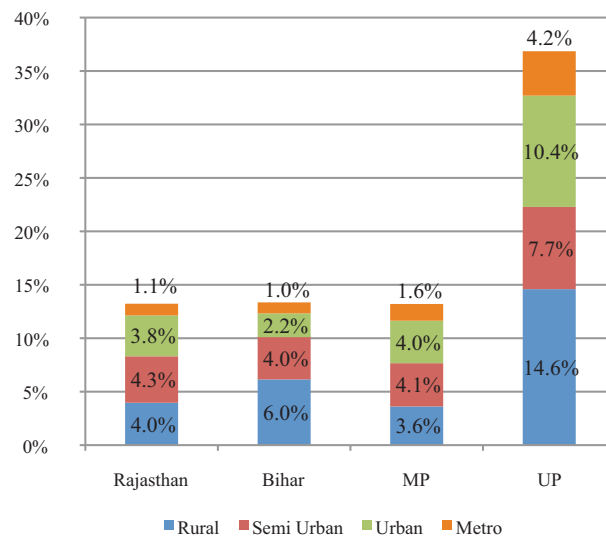


Figure 14: State-wise Aggregate Deposits in All SCBs (Dec. 2009)

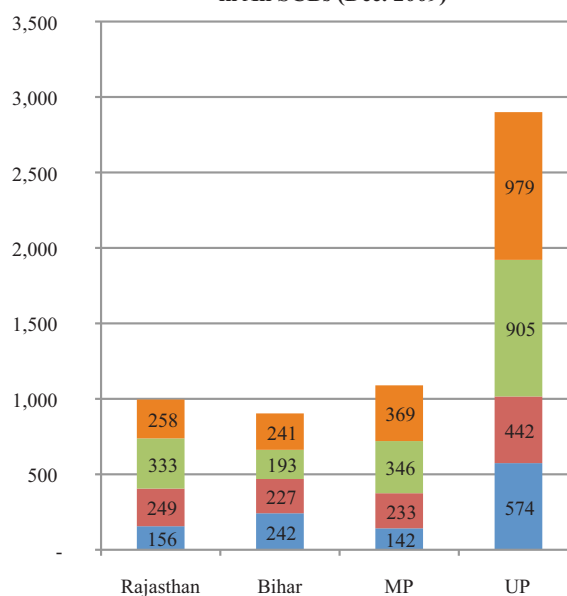
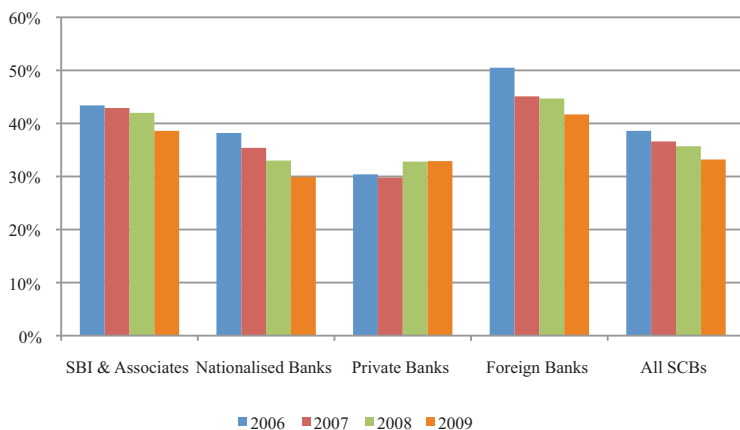


Figure 15: Bank Group-Wise Composition of CASA



In the Indian context:

- The CASA deposits constitute more than a third of total deposits.
- Foreign banks have the highest share of CASA deposits in total deposits, followed by SBI and its associates, nationalised banks, and private sector banks.
- There was a consistent decline in the share of CASA deposits at the consolidated level for SCBs from March 2006 to March 2009. The share of CASA deposits in total deposits of all bank groups declined from March 2006 to March 2009, except for private sector banks which witnessed an increase in its CASA deposits share, due to aggressive targets by branches and retail banking teams for mopping up CASA deposits.

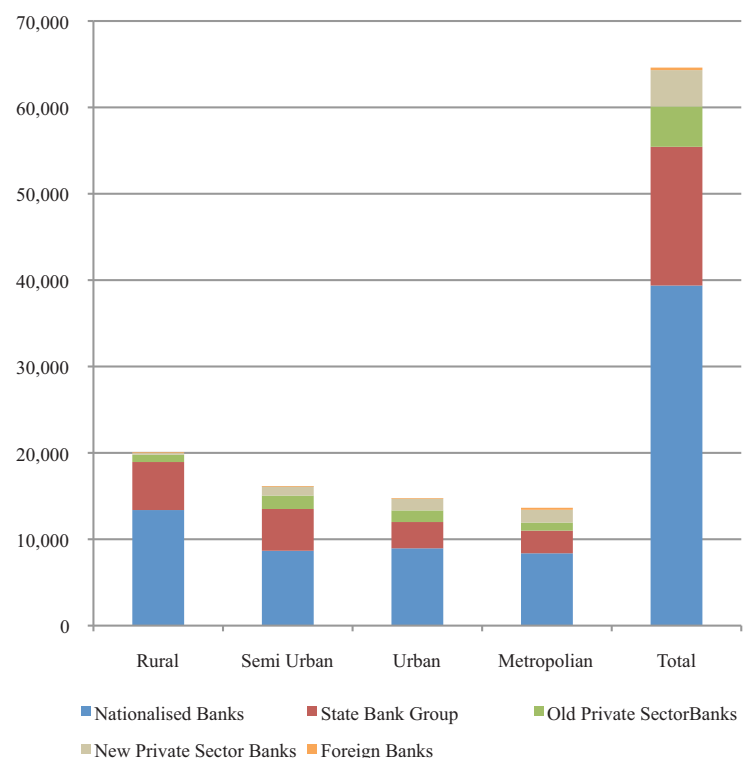
If this source reduces further, alternate sources may be not only difficult but also prove expensive. In the context of an impending revival of economic growth, with the commensurate increase in the credit needs of the economy, the banking industry may need to take initiatives to attract more CASA deposits.

The increase in the number of branches has been more rapid in metropolitan areas than in rural or semi-urban areas. This reflects the undeclared bias of commercial banks towards more affluent classes. It is also because they can find easy business in areas with high population density and concentration of commercial and industrial activities. People living in rural and semi-urban areas are dependent on RRBs and co-operative banks most of the times, but these banks have limitations in their reach (since they operate in a limited geography) and more often use outdated technology.

4.1.1 PRODUCTS

Banks provide a range of financial services to customers including third-party products like insurance and mutual funds. Depending upon the infrastructure of the facilities and the potential demand for certain services, banks classify their branches into various categories. Branches located in metros and big cities offer almost all services, while the ones located in smaller towns and semi-urban/ rural areas offer only basic banking services (savings accounts, term deposits and money transfer facilities). Services like foreign exchange, mutual funds, personal banking, etc., are not provided in all the branches located in the semi-urban/ rural areas.

Figure 16: Branches of SCBs (end March 2009)



For the low income segment, banks typically offer stripped-down versions of savings accounts and normal term deposits (fixed and recurring deposits). For example, some banks (such as SBI, the largest bank of India) do not provide cheque books for no-frills savings accounts (NFSAs). Most other banks do provide ATM cards and cheque books with the no-frill accounts, but do not offer internet banking for this customer segment. There are restrictions on free transactions at non-base branches (branches other than where the account is opened). To compensate for fewer features on a no-frills account, the banks do not stipulate any minimum balance that the customers are required to maintain in the account. Therefore, the customer has an option of choosing between a cheap account with fewer options and a costlier account with more options.

Savings Bank Account: A demand deposit account without any restrictions on time of withdrawal is one of the most popular basic banking products, yielding interest of 3.5% per annum. There are generally no upfront charges on opening this account or on the number of transactions in most of banks, though some banks charge for withdrawals beyond a certain number of transactions. If the withdrawal is through an ATM, there is a daily limit on the amount that can be withdrawn. (Depending on the bank and type of account, the daily limit varies between Rs.15,000 or USD 316 and Rs.25,000 or USD 527).

Term Deposit Products: These can be in the nature of recurring deposits (RD), in which a fixed amount has to be deposited on a monthly basis, or a fixed deposit (FD), in which a one-time deposit at the time of opening the account is required. In these types of products, there is a lock-in period within which withdrawals are not allowed without a penalty. The interest rate varies from bank to bank and is higher in comparison to normal savings bank accounts. Some banks also offer loan facilities against term deposits to their clients. Generally there is no upfront fee charged for opening this account. It is a very popular medium of risk free savings in India with good returns.

Current Account: This account is suitable for day-to-day business payments. There are no restrictions on the frequency of withdrawals or deposits. Banks do not pay any interest on deposits held in current account due to the high cost of maintaining these accounts. A relatively high minimum balance is generally required by most of the banks, which ranges from Rs.25,000 for the very basic facilities of a cheque book ATM card and other services charged on per usage basis, to Rs.500,000 for many services free of charge such as getting Demand Draft, free cheque or cash pick-up from the office. The average balance to be maintained can be customised according to the expected usage of services by the account holder in consultation with the Relationship Manager of the bank.

No Frills Account: This generally is a stripped down version of a normal savings bank account (see above). Know your customer (KYC) requirements have been simplified for the benefit of poor customers with limited documents available. Also, there are restrictions on the frequency and value of transactions allowed in a month. The bank does not charge any upfront fee for opening this account.

4.1.2 METHODOLOGY

Banks usually target people with regular and stable incomes, like salaried employees and people with well established businesses. This also helps to gain efficiencies as most of these clients conduct high value and less frequent transactions, resulting in lower operating costs. Banks service most customers from branches, while facilitating certain transactions from outside the branch premises, through ATMs (cash withdrawal and deposit) and internet and mobile banking (cheque book request, bill payments, funds transfers, and balance enquiries). Customers are required to be present at the time of account opening, as the bank authorities have to conduct KYC formalities to ascertain the identity of the person through photos, signatures, address and identity proof.

The system of opening a bank account can be centralised or decentralised, depending upon the bank and its CBS facility. In most private banks, this procedure is centralised and a specialised team is responsible for checking all the documents and opening the account. Typically in a branch-based system, the account is opened same day, while in a centralised system it can take anywhere between 48 hours to a week (or more). Transactions can be done at any branch in case of an account with a CBS branch of a bank, whereas it is possible only at the base branch in case of an account with no CBS branch.

Banking Through Banking Correspondent (BC) and Business Facilitators (BF)

BC/BFs were promoted to extend the reach of the banks to distant areas where there was no financial rationale to open a separate bank branch. In 2006, the RBI allowed banks to use the services of following entities as agents in providing financial and banking services by paying reasonable commission/fees:

- NGOs/MFIs set up under Indian Societies/Trust Acts
- Societies registered under Mutually Aided Co-operative Societies (MACs) Act or the Co-operatives Acts of states
- Section 25 companies
- Post offices
- Retired bank employees
- Ex-service men
- Retired government employees

Based on the suggestion of a working group, constituted by Reserve Bank of India to examine the experience to date of the Business Correspondent (BC) model and suggest measures, to enlarge the category of persons that can act as BCs, keeping in view the

RBI's Instructions on the Distance Criteria for BC Channel

The distance between the place of business of the BC and the base (link/branch) should not exceed 30 kms. in rural/semi urban areas. In case the distance is more than 30 kms. in rural/semi urban areas, the District Coordination Committee (DCC)/SLBC must approve the same. If the DCC/SLBC does not give any decision within three months, the request will be treated as approved, and DCC/SLBC notified by the linked branch accordingly.

regulatory and supervisory framework and consumer protection issues, following additional entities have been allowed to act as BC: (i) individual kirana/medical/fair price shop owners (ii) individual public call office (PCO) operators (iii) agents of small savings schemes of Government of India/insurance companies (iv) individuals who own petrol pumps (v) retired teachers and (vi) and authorised functionaries of well-run SHGs linked to banks. A recent RBI discussion paper suggests some forms of organised for profit entities will be allowed to act as BCs in the near future.

BCs are allowed to do the following activities on behalf of the bank:

- Disbursal of small value credit
- Recovery of principal/collection of interest
- Collection of small value deposits
- Sale of microinsurance/mutual fund products/pension products/other third party products
- Receipt and delivery of small value remittances/other payment instruments.

This model has been very successful in opening no frills accounts for a large number of people. The number of such accounts has risen from 489,497 in March 2005 to at least 33 million by March 2009, primarily driven by public sector banks. Yet, many of these accounts are not functioning. A 2010 study by Skoch Development Foundation found that approximately only 11% of the 25.1 million basic banking accounts opened between April 2007 and May 2009 were operational.

4.1.3 STRATEGIES (MARKETING, PROMOTION, ETC.) OF BANKS

Historically, a banks products and services have been designed to target middle and high income households. Banks still do not directly reach to low income households. However, recent innovations in supply chains (for example BCs with No Frills Accounts and MFIs with portfolio buy outs) have allowed banks to expand their outreach. For the BC channel, banks have adopted a largely below-the-line marketing strategy, channelled through the partner BC. Banks advertise with banners and pamphlets, flanges and boards at partner BC locations. In some instances, aggressive BCs/Bank Managers have used local meetings, street plays and stalls to promote banking using BC. Banks use the promotional material in vernacular languages so that a literate person is able to understand. In addition to banks supporting BCs with various promotional activities, they also sponsor rural fairs, set up stalls during festival gatherings, etc. Thus, rural marketing to the low income segment is largely driven by person-to-person strategies.

The demand for financial products mainly depends upon user awareness, which further depends upon the literacy levels of the rural investors. Financial literacy enables users to make informed financial decisions. BCs and banks have involved themselves in financial literacy programs. One such series is “Money Kumar” by the RBI. Banks have also initiated “credit plus” services such as setting up of rural training centres for small



Picture 1: An illustration of RBI's awareness drive

enterprises, farmers’ clubs, knowledge centres and credit counselling centres to educate the semi-urban and rural population.

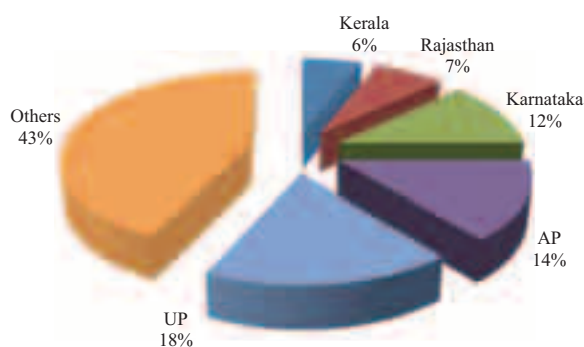
While the strategies for mobilising bank deposits vary from bank to bank, one common feature is to maximise the share of CASA deposits. The other common features generally observed are as follows:

- Staff members posted at branches are adequately trained to offer efficient and courteous service to customers and to educate them about their rights and obligations.
- A bank often offers a personalised banking relationship for its high-value customers by appointing a Customer Relationship Managers (CRMs).
- Senior citizens/pensioners have become an important category of customers targeted by a bank. Products are developed by banks to meet the specific requirements of this group.
- While banks endeavour to provide services to the satisfaction of customers, they put in place an expeditious mechanism to redress the complaints of the customers.

4.2 REGIONAL RURAL BANKS

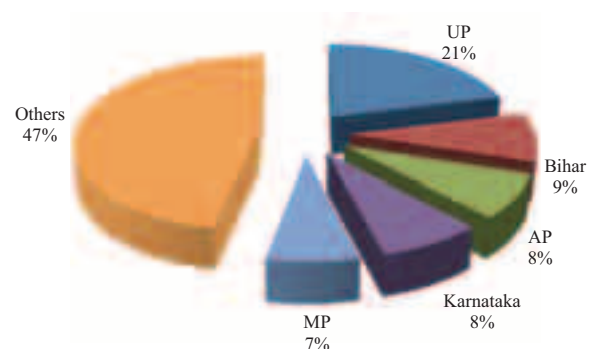
- RRBs account for 12% of all deposit accounts, and only 3.5% of deposits of scheduled commercial banks.
- However, in rural areas, RRBs’ share in deposit accounts is a significant 31% (around 19% of total deposits).
- More than half of the deposits in the year 2008-09 for RRBs came from the five states of Uttar Pradesh, Bihar, Andhra Pradesh, Karnataka and Madhya Pradesh (MP).
- Rajasthan and Kerala replaced Bihar and MP in the top five states for loan advances, implying that lending in these states is proportionately higher than deposit mobilisation.

Figure 17: Regional Spread of Loans and Advances



Source: NABSTATS, NABARD Quarterly Bulletin of Statistical Information, Issue no.8, April-June, 2009

Figure 18: Regional Spread of Deposits



Source: NABSTATS, NABARD Quarterly Bulletin of Statistical Information, Issue no.8, April-June, 2009

Microfinance services provided through the SHG-bank linkage programme has been the most successful initiative in financial inclusion for RRBs. Of the total SHGs linked to banks, almost 33% are linked to RRBs, which have played an especially useful role in reaching out to SHGs in more remote areas. For example, the share of SHG coverage for RRBs in the North Eastern Region is 56%, in the Central Region 48%, and in the Eastern Region 40%.

4.3 NON-BANKING FINANCIAL COMPANIES (NBFCs)

In the early 1990s when NBFCs were at their peak, they offered competition to banks in terms of a range of products and services, service levels and customer satisfaction. They were characterised by their ability to provide tailor-made services relatively faster than banks and other financial institutions. This enabled them to build up a wide-ranging clientele from small borrowers to established corporations.

The relatively relaxed regulatory environment that enabled these NBFCs to provide a wide range of services subsequently led to many unhealthy practices, and several instances of ‘fly-by-night’ operators. In response to these practices, the RBI tightened its supervisory and regulatory framework for NBFCs in 1998. Most of these regulations restricted NBFCs from falling short of standards like minimum net owned fund or NOF (which was Rs.2.5 million), and imposed minimum investment ratings for taking public deposits. In addition, NBFCs were totally barred from taking public demand deposits. Thus, to meet the minimum standards for accepting deposits, NBFCs could only offer term deposits.

The combined effect of factors like stringent restrictions, loss of faith among the clients (often due to agent fraud), as well as increasing competition from a rejuvenated banking sector (which to some extent opened up to private players in the early 1990s), had an adverse impact on NBFCs. Many of the smaller NBFCs could not withstand the pressure and closed down.

Data on outreach of the NBFCs and RNBCs are given in *Table 11* below:

Year (31 st March)	No of Reporting Companies	NBFC		RNBC	
		Public Deposits Rs. billion (USD billion)	No of Reporting Companies	Public Deposits Rs. billion (USD billion)	Total Public Deposits
2004	774	43.2 (1.0)	3	153.3 (3.5)	196.4 (4.5)
2005	700	39.3 (0.9)	3	166.0 (3.7)	205.3 (4.6)
2006	432	24.5 (0.6)	3	201.8 (4.6)	226.2 (5.1)
2007	371	20.8 (0.5)	3	226.2 (5.0)	246.9 (5.5)
2008	335	20.4 (0.5)	2	223.6 (5.6)	243.9 (6.1)

RBI Tightening Screws on RNBCs

For the two RNBCs, viz., Sahara India Financial Corporation Ltd. (SIFCL) and The Peerless General Finance and Investment Company Ltd. (PGFI), the RBI has taken a very strict stance on their method of taking public deposit and investing it in avenues other than those allowed by the RBI. In June 2008, the RBI prohibited Sahara from accepting public deposits due to violation of various guidelines and directions, particularly those on investment of funds raised through deposits, non payment of minimum interest and Know Your Customer (KYC) norms. Similarly, PGFI has also been asked by the RBI to exit from the deposit taking business by March 2011.

The figures in *Table 11* clearly show the quick rate at which NBFCs were closed down in this period. As of 30 April 2010, 310 NBFCs were permitted by the RBI to accept public deposits. This is a clear indicator of the cautious approach which the RBI follows in regulating the Indian financial market and how NBFCs find it difficult to carry on business especially in dealing with public deposits.

4.3.1 STRATEGIES (MARKETING, PROMOTION, ETC.) OF NBFCs

Social networking and agent networking are the two major channels of marketing and promotion used by semi formal institutions. Among the clients of NBFCs and MFIs, the most common reason for using the service is introduction to the group/company by a friend or relative who already uses or has used the service. Thus, institutions are promoted through word of mouth by their clientele. In addition, field officers or agents continuously visit existing and potential areas of operation. In the process, they conduct marketing and promotional activities. They talk to opinion leaders, village sarpanch (village heads) and local shop owners who then extend the information to others. Some MFIs also conduct village meetings to introduce their products and services. With regular contact, gradually information percolates to the masses. The agents often carry brochures and pamphlets in local languages for distribution and support their explanations. In the face of competition it is also seen that MFIs are trying to build a brand image with operational effectiveness and adding more products to their product line. In order to promote itself, KGFS has included a range of products and systems to match client preferences, thus adopting a customer-centric approach. NBFCs like Sahara and Peerless advertise the company using customised bags, advertisement vans and through the agent network.

4.4 CO-OPERATIVES

Co-operatives in India were originally envisaged as a mechanism for pooling the resources of people with limited means and providing them with access to a variety of financial services. The entire co-operative structure is divided into urban and rural networks of institutions.³¹

As of 30 April 2010,
310 NBFCs were permitted by the RBI to accept public deposits. This is a clear indicator of the cautious approach which the RBI follows in regulating the Indian financial market and how NBFCs find it difficult to carry on business especially in dealing with public deposits.

TABLE 12. STRUCTURE OF CO-OPERATIVES IN INDIA

State Co-operative Banks	District Central Co-operative Banks	Primary Agriculture Credit Societies
Loans and advances constitute more than half of the total assets of these institutions. StCBs are apex level institutions, and a major portion of loans are allocated to lower tier institutions in the short-term credit structure. Aggregate deposits is the most important component of liabilities, the bulk received as deposits from DCCBs.	The balance sheets of District Central Co-operative Banks (DCCBs) mirror those of StCBs. Loans and advances constitute the most important form of assets for DCCBs at 56.4% at FYE ³⁰ 08. Investments were next in line at 27.4% of assets. Similarly, deposits made up the largest portion of the total liabilities of DCCBs at about 63.6% at FYE08.	Primary Agricultural Credit Societies are the ultimate grass-roots level organisations that deal directly with individual members. A large proportion of PACS also serve as outlets for inputs and for the public distribution system for food and other essential items.

31 FYE = Financial Year End (31 March in India)

4.4.1 RURAL CO-OPERATIVES

The state, district and primary co-operative credit institutions cater primarily to the various short/medium-term production and marketing credit needs in agriculture. The short-term credit structure accounts for approximately 99% of the total deposits mobilised for the industry and 88% of total credit.

Co-operatives have 50% more accounts than scheduled commercial banks (including RRBs). Of these, 70% of account holders are estimated to be marginal and sub-marginal farmers. However, it is a fact that in terms of deposits, rural and semi-urban branches of commercial banks have nearly six times more deposits than co-operatives. It is primarily due to policies encouraging co-operatives to be treated as “refinance windows” instead of incentivising them to become genuine thrift and credit institutions. During 2007-08, there was a fall in the total number of rural credit co-operatives by 2,282; this was attributable primarily to the fall in the number of Primary Agriculture Credit Societies (PACS), the smallest unit in the co-operative financial structure.

Deposits in StCBs increased from Rs.485.6 billion (USD 10.8 billion) to Rs.529.7 billion (USD 13.2 billion) between 2006-07 and 2007-08. The rise in deposits in 2006-07 was 6.9% and in 2007-08 was 9.1%. As a major portion of business for StCBs comes from DCCBs, sources of non-interest income are relatively limited for StCBs.

Further, there was a considerable deterioration in the asset quality of co-operative institutions during 2007-08.

The overall ratio of NPAs to loans outstanding for all co-operatives moved up to 25.9% at FYE08 from 19.8% at FYE07. Also, the number of loss making co-operatives far exceeded the number of profit making entities at FYE08, with cumulative losses of Rs.39.5 billion (USD 0.98 billion).

Except in isolated cases, co-operative banks have not shown impressive results. Although they have unparalleled outreach, continuous political interference and misuse of funds has made them the last choice of the common man - at least for banking purposes. Results of the revival package provided to the states that agreed to the terms laid down by the Vaidyanathan Committee are yet to be seen. Only time will tell whether huge sums of money provided to the co-operative sector will bear positive results.

4.4.2 URBAN CO-OPERATIVE BANKS (UCBs)

The term urban co-operative bank (UCB), though not formally defined, refers to co-operative banks located in urban and semi-urban areas. Until 1996, these banks were allowed to lend money only for non-agricultural purposes. Today, their scope of operations has widened considerably. Urban co-operative credit societies were originally organised

Table 13. Performance Primary Agriculture Credit Societies (PACS)

Particulars	2003	2004	2005	% change 2003-05
No. ('000)	112	106	109	-3%
Members (million)	124	135	127	2%
Borrowers (million)	64	51	45	-30%
Equity (Rs. billion)	81.98	83.97	91.97	12%
Deposits (Rs. billion)	191.20	181.43	189.76	-1%
Borrowings (Rs. billion)	302.78	342.57	404.29	34%
Loans issued (Rs. billion)	339.96	351.19	392.12	15%

on a community basis to meet the savings and credit needs of their members. Salary earners' societies that stressed the virtues of thrift and self-help played a significant role in popularising the movement, especially amongst the middle class, as well as organised labour.

Over the years, primary UCBs have registered a significant growth in number, size and volume of business handled. As of December 2009, there were 53 scheduled UCBs and 1,643 non-scheduled UCBs. About 80% of UCBs are located in five states - Andhra Pradesh, Gujarat, Karnataka, Maharashtra and Tamil Nadu. At FYE09, 20 (1.2%) of UCBs controlled 33.6% or Rs.532.8 billion (USD 11.5 billion) of the total deposits of Rs.1,587.3 billion (USD 34.4 billion) held by UCBs.

The state-wise distribution of advances and deposits of UCBs was even more skewed with Maharashtra alone accounting for over 60% of total advances and deposits of all UCBs. In the four BIMARU states, the presence and performance of UCBs are shown below:

Figure 19: State-Wise Distribution of UCBs-BIMARU States (March 2009)

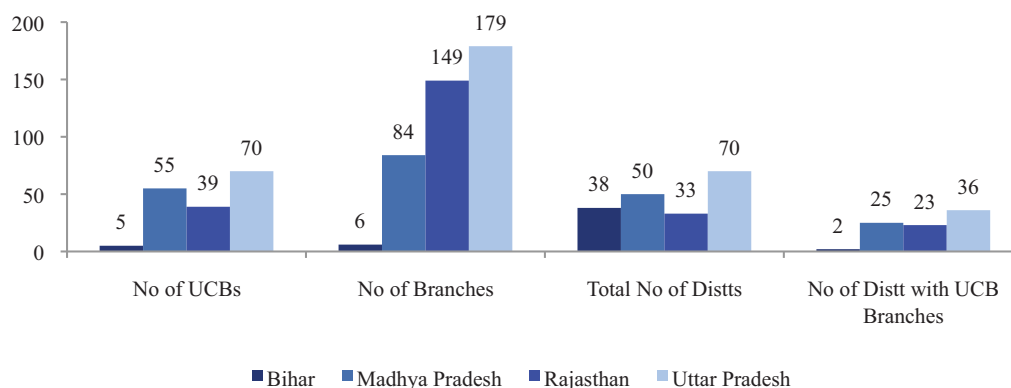
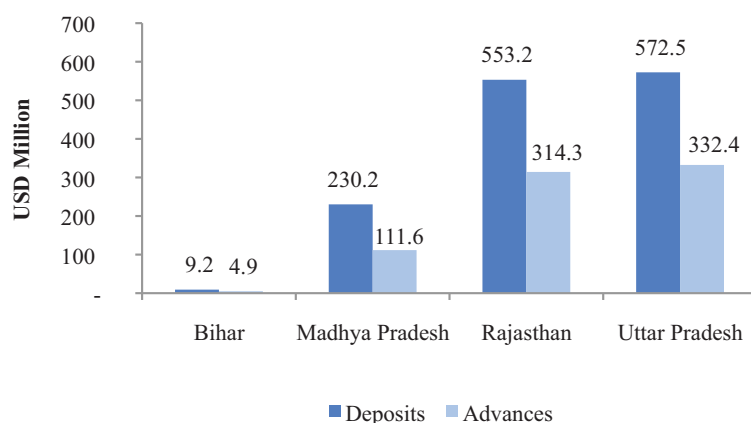


Figure 20: Deposits and Advances in UCBs-BIMARU States (March 2009)



Uttar Pradesh has 70 districts, which is the largest number of districts in a state, but only around half of those have a UCB present. The ratio of districts with a UCB in Madhya Pradesh is also almost 50%, whereas in Bihar only one district out of the 38 in the state has a UCB. The amounts held in deposits by UCBs in Rajasthan and Uttar Pradesh are comparable, while Madhya Pradesh has lower deposits in its UCBs and Bihar has negligible deposits.

4.5 INDIA POST

India Post has a broad suite of products, many of which are popular in rural areas. Nearly 160 million people use India Post to save, and the aggregate savings at FYE07 was Rs.3,237.8 billion (USD 71.7 billion). Of this, deposits in the savings bank account product were just Rs.167.9 billion (USD 3.7 billion), clearly demonstrating that India Post saving accounts are not as popular as those of banks, and that most of the money deposited in Post Offices is in term deposits and other tax saving instruments. There are 155,035 post office branches in India out of which 139,173 (90%) are in rural areas. The adjacent graph depicts the number of savings accounts held by people in post office branches of the BIMARU states. Taking into account all savings schemes of India Post, such as the savings account, recurring deposits, term deposit, public provident fund (PPF), national saving certificate (NSC) and the senior citizen special account, the total number of accounts was 175 million and total deposits were Rs.3.5 trillion (USD 77.4 billion) at FYE08. This rose to 206 million accounts, with total deposits of Rs. 5.6 trillion (USD 126.4 billion), by FYE09. This is an 18% increase in the number of accounts and 63% in the value of deposits, reflecting the popularity of its tax-free fixed deposit products, etc. Features of all these various type of products are described below.

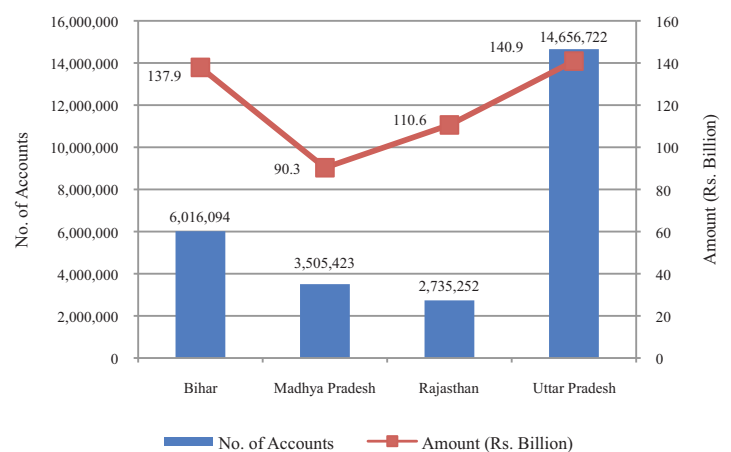
4.5.1 POSTAL SAVINGS PRODUCTS

Post Office Saving Account: This is similar to a normal saving bank account, providing 3.5% annual interest on deposits. It has a deposit limit of Rs.50-100,000 for individual accounts. Interest earned is tax free and cheque facilities are available.

Recurring Deposit Account: This provides an interest rate of 7.5% per annum for deposits maintained for five years. The monthly deposit amount is Rs.10 or in multiple of Rs.5 with no upper cap. One withdrawal of up to 50% of the balance is allowed after one year, i.e., after one year the customer can withdraw up to 50% of the money deposited till that time, and is allowed to do so only once.

Post Office Time Deposits: This has a minimum investment limit of Rs.200 with no upper limit and yields an interest rate that varies from 6.25% to 7.50% (depending on the term) for a period of one to five years. Accounts may be opened by individuals. Two, three and five year tenured accounts can be closed after one year at a discount. Accounts

Figure 21: Post Office Saving Bank Business 2007-08



can also be closed after six months but before one year without interest. The investment under this scheme qualifies for the benefit of Section 80C of the Income Tax Act, 1961. Section 80C of the Income Tax Act allows certain investments and expenditure to be tax-exempt. The total limit under this section is Rs.100,000 (USD 2,109). From 1 April 2010, an additional limit of Rs.20,000 (USD 422) is included in 80C provided that the amount is invested in infrastructure bonds.

Monthly Income Account: This provides an interest rate of 8% that is paid each month. Investment is allowed in multiples of Rs.1,500 (USD 31.6), to a maximum of Rs.450,000 (USD 9,490) in a single account and Rs.900,000 (USD 18,980) in joint accounts. The maturity period is six years. The account can be closed after one year but before three years at a discount³² of 2% of the deposit, and after three years at a discount of 1% of the deposit. A bonus of 5% on the principal amount is available upon maturity.

15 Year Public Provident Fund: This provides an interest rate of 8% per annum that is completely tax free. Investments of a minimum of Rs.500 (USD 10.5) to a maximum of Rs.70,000 (USD 1,476) can be made in a financial year. Deposits can be made in a lump sum or in twelve instalments. Withdrawal is permissible every year after the seventh financial year. Loan facility is available from the third financial year.

Kisan Vikas Patra: This provides an interest rate of 8.4% (compounded yearly). There is no investment limit. A single holder certificate may be issued to an adult for himself or on behalf of a minor, or to a minor, and can also be purchased jointly by two adults.

National Saving Certificate: Deposits earn an interest rate of 8% compounded half yearly, payable at maturity. Investments have a lower cap of Rs.100 but no upper cap. A single holder type certificate can be purchased by an adult for himself or on behalf of a minor or for a minor. Deposits qualify for tax rebate under Section 80C of the IT Act. The interest accrues annually, but is deemed to be reinvested and so will also qualify for a deduction under Section 80C of the Income Tax Act, 1961.

Senior Citizens Saving Scheme: Deposits under this scheme provide a 9% interest rate per annum, payable quarterly. The maturity period is five years, and a depositor may operate more than one account in an individual capacity or jointly with spouse. The depositor should be more than 60 years old, or (if retired with benefits) more than 55 years old on the date of opening the account, subject to the condition that the account is opened within one month of receipt of retirement benefits.

4.6 SHG-BANK LINKAGE

Self help groups (SHG) are informal groups of 10-20 individuals formed by like-minded people coming together for mutual help and cooperation on various activities including financial matters. Like accumulating savings and credit associations (ASCAs), they pool in small amounts of thrift money and lend it to group members who need credit. Formal registration of SHGs is not required, and they are more often attached to some co-operative federation or a society. SHGs can have their own savings account with a

SHGs can have their own savings account with a bank, and often this linkage with a bank is facilitated by an NGO working in the area.

³² Penalty calculated on the deposit value

bank, and often this linkage with a bank is facilitated by an NGO working in the area. The SHG-bank-NGO model is widely supported by the National Bank for Agriculture and Rural Development (NABARD).³³ The account is operated by the SHG's authorised signatories, and most banks provide the SHGs with a loan that is in proportion to the savings of the group. A snapshot of SHG-Bank linkage business is given in *Table 14*. Not only has the number of SHGs linked to banks and the savings amount of these SHGs increased over the years, but even the average balance per SHG account increased. There is, however, substantial evidence to suggest that SHG members save only a limited amount in their SHGs because they do not fully trust the mechanism, and would prefer an individual account with a bank, or in a client-responsive post office. The average savings amount held by SHGs in the banks was Rs.9,061 (USD 192.8) at the end of March 2009. This linkage is beneficial to both parties, as banks get access to low cost funds.

TABLE 14. SAVINGS OF SHGs WITH BANKS

Agency	No of SHGs in '000		Savings of SHGs (In Rs./USD million)	
	2007-08	2008-09	2007-08	2008-09
Commercial Banks	2,811	3,550	20,780 / USD 516	27,730 / USD 601
RRBs	1,287	1,629	11,660 / USD 290	19,900 / USD 431
Co-operative Banks	812	943	5,410 / USD 134	7,830 / USD 170
TOTAL	5,010	6,121	37,850 / USD 940.1 billion	55,460 / USD 1,202

Source: *Trends and Progress in Banking 2008-09: RBI, pp 148*

TABLE 15. REGION-WISE PROGRESS OF SHG-BANK LINKAGE PROGRAMME (AS ON MARCH 31 2008)

Region	No. of SHGs	Loans to SHGs (Rs./USD million)	Average Loans per SHG (Rs./USD)	% of SHGs	% of Loans to SHGs	SHGs per 100,000 Population
Northern	230,740	8,510 (USD 191)	36,899 (USD 827)	6.6	3.8	156
North Eastern	119,520	3,270 (USD 73)	27,364 (USD 613)	3.4	1.5	283
Eastern	672,626	23,720 (USD 532)	35,268 (USD 790)	19.3	10.7	274
Central	405,707	15,010 (USD 336)	36,990 (USD 829)	11.7	6.7	142
Western	374,561	13,200 (USD 296)	35,254 (USD 790)	10.8	5.9	229
Southern	1,674,811	158,960 (USD 3,563)	94,915 (USD 2,127)	48.2	71.4	703
All India	3,477,965	222,680 (USD 4,992)	64,027 (USD 1,435)	100	100	310

Source: RBI³⁴

³³ SHG-Bank Linkage Model: www.nabard.org/pdf/report_financial/Chap_VII.pdf

³⁴ Bank Penetration and SHG-Bank Linkage Programme: A Critique- Pankaj Kumar and Ramesh Golait: http://www.rbi.org.in/Scripts/bs_viewcontent.aspx?id=2029

Though the SHG-Bank linkage programme has progressed well over the years since its inception in 1995,³⁵ the states of Uttar Pradesh, Madhya Pradesh and Bihar (as seen on *Table 16*) have the lowest SHGs to population ratio (<200 SHGs per 100,000 of population) as well as the highest percentage of poor population (>30 per cent). The spread of the SHG-Bank Linkage programme in different regions has been uneven on account of various factors like pro-active role of state governments, presence of well performing NGOs, socio-cultural factors, better performance of SHGs, etc.

TABLE 16. MATRIX MAPPING STATES ACCORDING TO POVERTY AND SHG SPREAD

Poverty (%) of population	# of SHGs per 100,000 Population		
	<200	200-400	>400
0-15	1. Haryana	1. Mizoram	1. Himachal Pradesh
	2. Jammu and Kashmir	2. Kerala	
	3. Punjab		
	4. New Delhi		
	5. Goa		
15-30	1. Arunachal Pradesh	1. Rajasthan	1. Andhra Pradesh
	2. Manipur	2. Assam	2. Karnataka
	3. Meghalaya	3. West Bengal	3. Tamilnadu
	4. Nagaland	4. Pondicherry	
	5. Tripura		
	6. Sikkim		
	7. A & N Islands		
	8. Gujarat		
>30	1. Bihar	1. Chhattisgarh	1. Orissa
	2. Jharkhand	2. Uttaranchal	
	3. Madhya Pradesh	3. Maharashtra	
	4. Uttar Pradesh		

4.7 INSURANCE COMPANIES

By the end of March 2009, there were 44 insurance companies operating in India, of which 22 were in life insurance business, 21 were in general insurance business and one was a national re-insurer. Of these 44 companies, eight are in the public sector (two are specialised insurers, namely ECGC and AIC, one is in life insurance, four are in general insurance and one is a re-insurer). The remaining 36 are private sector companies.

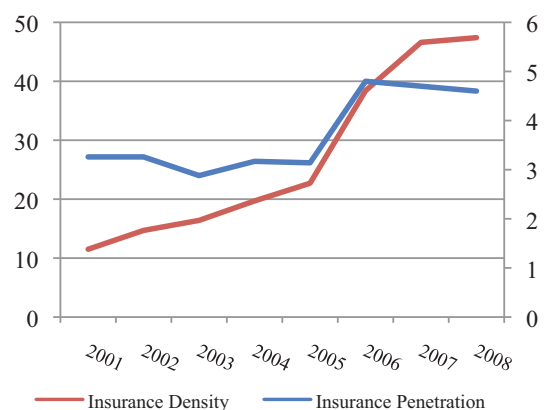
Despite the best efforts of successive Indian governments, which included opening up the insurance sector in 2000-01, only 15% out of a population of 1.3 billion are insured.³⁶ According to a joint study by Swiss Re and IRDA, India is ranked 14th among the world

³⁵ *ibid*

³⁶ *IRDA Journal, Feb 2010*

countries in terms of insurance market (based on premium volume), 31st in terms of insurance penetration (excluding cross border business) and 78th in terms of insurance density.³⁷ The insurance penetration³⁸ and insurance density³⁹ are at only 4.6% (4% for life business and 0.6% for non-life business) and USD 47.4 (41.2 for life and 6.2 for non life); this is much lower than many other countries⁴⁰ as of 31 December 2009. However, since private investment in the insurance industry was permitted in 2001, the industry has seen major growth in terms of both insurance density and penetration. This growth of the Indian insurance industry can be highly attributed to unit linked insurance products (ULIPs).

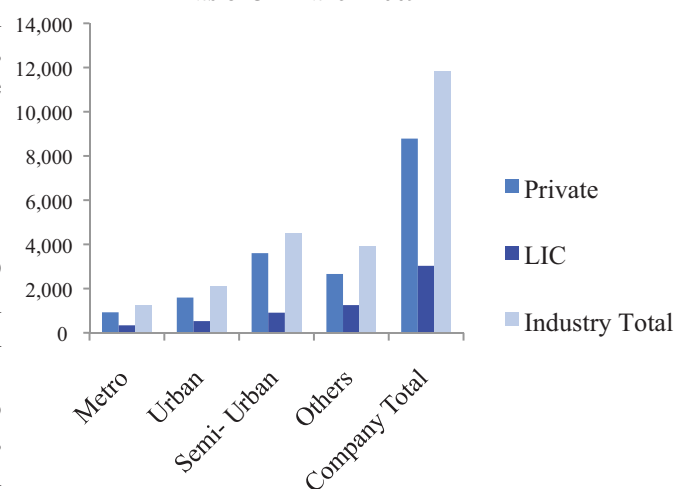
Figure 22: Insurance Density and Insurance Penetration



4.7.1. EXPANSION OF OFFICES

Over the last five years, the number of offices of private insurers has almost doubled every year. However, during 2008-09, the number has gone up only by 28%. The number of offices of life insurers rose 33% from 8,913 to 11,815 in the year to 31 March 2009. Around 70% of the offices of life insurers (both private and public sector) are located either in semi-urban areas or in small towns not listed in the HRA classifications of the Ministry of Finance.⁴¹

Figure 23: Distribution of Offices of Life Insurers as of 31 March 2009



4.7.2. PERFORMANCE ON PREMIUM COLLECTION⁴²

The life insurance industry recorded a premium income of USD 497.17 billion during 2008-09 as against USD 451.36 billion in the previous financial year, a growth of 10.15%. Premium income from unit linked products, was USD 203.2 billion. This resulted in a fall in the share of unit linked premium to 40.87% in 2008-09 from 46.14% in 2007-08. The decline was observed both in the case of LIC and private insurers and can be attributed to the subdued Indian equity market. The share of ULIP premium to total premium fell to 22.06% and in the public life insurer LIC of India from 31.61% in 2007-08.

4.7.3. GROWTH AND MARKET SHARE⁴³

The size of the life insurance market, although recording positive growth in 2008-09, witnessed retardation in the growth.

- The LIC has grown its business by 5.01% in 2008-09 compared to an increase of 17.19% in 2007-08.

³⁷ Swiss Re Sigma No. 03/2009

³⁸ Measured as insurance premiums as a percentage of GDP

³⁹ Measured as premiums to total population

⁴⁰ IRDA Annual Report-2008-09 (Dec 2009)

⁴¹ Based on the HRA classification of places done by the Ministry of Finance; Metro: Delhi, Mumbai, Chennai, Kolkata, Hyderabad and Bangalore; Urban : A, B-1 and B-2 class cities of the HRA classification; Semi-urban : C class cities of the HRA classification; Others : Places not listed in the HRA classification.

⁴² IRDA Annual Report 2008-09, Performance reports of insurance companies and IRDA Journals

⁴³ IRDA Annual Report '2008-09

- The private insurers increased their premium income by 25.10% in 2008-09 compared to a higher rise of 82.50% in 2007-08. In terms of premium income collected, the market share of private life insurance companies continued to rise in 2008-09, to 29.08% from 25.61% in 2007-08.
- The market share of private insurers in first year premium income (i.e. new business) increased to 38.88% in 2008-09 from 35.98% in the previous year.
- Meanwhile, there has been an increase in market share on the regular premium of private life insurers, rising to 61.23% in 2008-09 from 52.23% in 2007-08. In contrast, the share of single premium of private life insurers fell to 9.56% from its previous year's level of 13.01%. On the other hand, the market share of LIC in single premium has increased to 90.44% in 2008-09 as against 86.99% in 2007-08.

4.7.4. PROFITS OF LIFE INSURERS

The life insurance industry is capital intensive, and insurers are required to inject capital at frequent intervals to maintain growth in premium income. It is very difficult for life insurers to earn profits in the initial seven to ten years of their operations - particularly in times of rapid expansion because of the following costs:

- Setting up operations;
- Training to develop and expand the agency force;
- Creating niche markets for products;
- Dispersing high rates of commissions payable in the first year;
- Achieving reasonable levels of persistency;⁴⁴
- Providing for policy liabilities; and
- Maintaining solvency margins.

Types of Microinsurance Products in India

The microinsurance products in India can be classified into five different types:

1. **Products registered as microinsurance products:** There are 23 such products, registered by 15 life insurance companies. These products are offered by insurance companies mainly to achieve the rural and social sector requirements of IRDA and are sold as pure term credit-life products by the MFIs.
2. **Rural and social products not registered as microinsurance products comprise:**
 - i. Life insurance products registered before the 2005 microinsurance regulation and still continued by the companies, since they do not wish to invest in designing new microinsurance products;
 - ii. Savings linked microinsurance products offered by life insurance companies, and delivered using innovative distribution models;
 - iii. Individual and group general microinsurance products; and
 - iv. Group term life insurance products, which are more suitable for a credit-life model and are profitable for LI companies.
3. **Community-based products in partnership with insurance companies,** where MFIs partner with several insurance companies.
4. **Independent community-based microinsurance products,** which are predominantly health insurance schemes run by health service providers.
5. **Innovative pension products conceived by large NGO networks.**

⁴⁴ The proportion of policies remaining in force at the end of the period out of the total policies in force at the beginning of the period.

Unsurprisingly, therefore, at the end of March 2009, the life insurance industry reported a total loss of USD 10.94 billion, 42.95% higher than the previous year's total loss of USD 7.65 billion. Out of 22 life insurers, only four reported profits. Many of the market leaders have been unable to book a profit even after 9-10 years of operation. The major reasons for this are:

- The private players had to invest heavily on creating infrastructure (including agent bases) to compete with public insurers like the LIC of India, which has enjoyed absolute monopoly for decades.
- Any insurance company can earn profit only if the policies are persistent for a long-term period. The private players were dependent mainly on ULIPs, where mis-selling by agents was common, making the persistency of the products fall beyond sustainable limit.
- The personnel cost of the companies was higher since their focus, until recently, was on growth and less on financial consolidation.

At the end of March 2009, the life insurance industry reported a total loss of USD 10.94 billion, 42.95% higher than the previous year's total loss of USD 7.65 billion. Out of 22 life insurers, only four reported profits.

4.7.5 MARKETING AND PROMOTION OF INSURANCE PRODUCTS

The insurance companies of India are primarily dependent on a commission agent based distribution model, commonly known as "Tied Agency Channel". The acquisition of customers is primarily done by agents, and the branches only process the documents, issue policies and settle claims. These agents (known as "advisors") seek out potential clients, collect the necessary documents, such as ID and address proof, and help them in filling out forms. When underwriting proposals, the company considers certain factors such as the policyholder's state of health, income and other relevant information. In case of settlements or withdrawals, the company is responsible for processing the entire payment. An agent can only facilitate the process of depositing the relevant forms and documents. The commission of the agents/advisors are usually frontloaded, i.e., the first year commission is higher compared to consequent years.

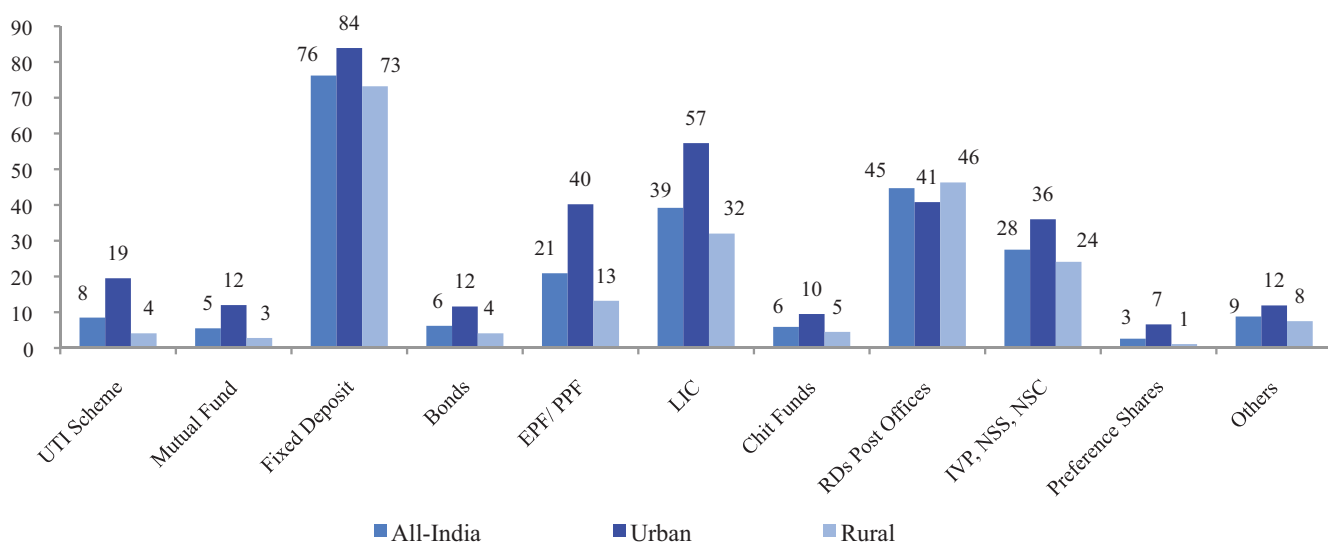
Some of the private insurers have also started doing business through newer channels, including:

- Bancassurance, where a bank is made a corporate agent of an insurance company;
- Corporate agency channel, through which independent companies and financial intermediaries can offer insurance products of the insurance company;
- Broker channel, where insurance brokers are offered commission for referring the products of any insurance company; and
- Multi-level marketing channel, where a customer can further refer another client directly and earn commission for the referral.

4.8 WHERE DO PEOPLE SAVE?

Estimating about individuals' saving methods has always been an intriguing proposition, even more so in developing countries where informal channels of lending and savings are as strong and ubiquitous as ever. Money matters are not discussed openly, and researchers/surveyors have always found it difficult to gather reliable information from households about their income and savings. At the aggregate levels, especially for formal institutions with proper reporting mechanisms in place, there are certain indicators that provide a fair idea of where the money is flowing; this is not the case in the informal sector.

Figure 24: Distribution of All Households by Type of Instruments



Source: SEBI-NCAER Survey of Indian Investors, June 2000.

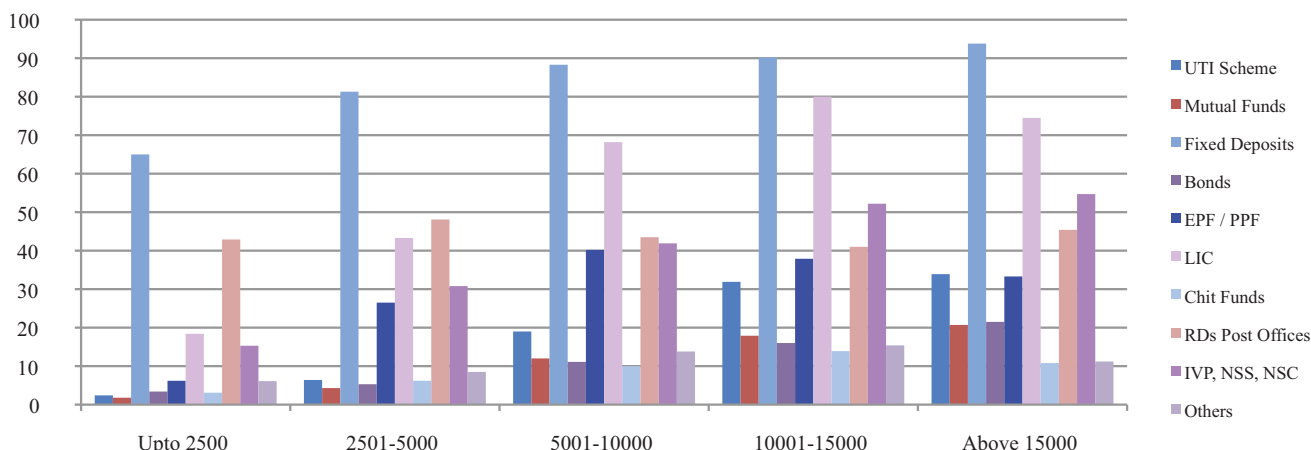
*Since one household may invest in more than one instrument, percentage distributions of households will add up to more than 100

As can be seen from graph above, the majority of savings in the formal sector goes into relatively less risky investments: fixed deposits, Post Office recurring deposits, provident funds, *Indira Vikas Patra* (IVP), National Saving Certificate (NSC) and life insurance policies.

Two factors are responsible for this pattern. First, the four products listed above save tax. Investment in these products up to a maximum of Rs.100,000 (USD 2,109) per annum leads to tax saving. Second, the outreach of channels selling these products (banks, post offices, LIC agents, postal agents) is far more than that of the channels selling other products.

The choice of instrument depends upon the household income. Lower income households prefer fixed deposits and Post Office recurring deposits, while as income grows LIC along with IVP, NSC (available through Post Offices) and provident funds are added to the portfolio; LIC remains a common choice.

Figure 25: Distribution of All Households by Income Class



Source: SEBI-NCAER Survey of Indian Investors, June 2000.

*Since one household may invest in more than one instrument, percentage distributions of households will add up to more than 100

Sector-wise domestic savings shows a trend of increasing household savings whereas corporate savings have more or less been constant over the years. Public sector savings have been erratic and during the period 1999-2000 to 2002-03 it was actually negative. Within household savings, the proportion of financial savings and physical savings⁴⁵ has been almost equal, with a nearly cyclical nature of shift between the two.

Figure 26: Sector-Wise Domestic Savings (At Current Prices)

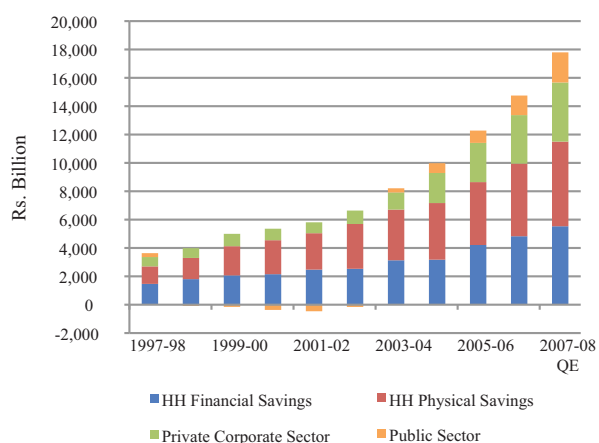
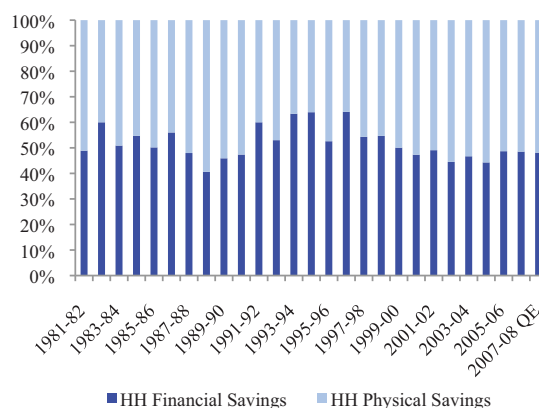


Figure 27: Savings in Household Sector



⁴⁵ Household savings is composed of both financial and physical savings. Financial savings in the household sector comprise savings in the form of currency, net deposits, shares and debentures, net claims on government, life insurance funds and PFs and pension funds. Savings in physical assets consist of net addition to physical assets of the household, comprising investment in construction, machinery and equipment and change in stocks.

5. CLIENTS' NEEDS AND PREFERENCES

5.1 OUTCOMES OF CASE STUDIES

Ten organisations in India were studied in detail for understanding about their products, channels, client segments, promotion strategies, success stories and challenges currently or previously faced in their endeavour to take financial services to the low income segment. These organisations are involved in different aspects of business. Five of them are microfinance institutions (MFIs), two are technology service providers, two are insurance companies and one is a public sector scheduled commercial bank.

The common learnings from the case studies are:

- All these organisations strongly believe that there is huge potential at the bottom of the pyramid.
- Conventional products, usually targeting high end or middle class segments, are not sufficient to fulfil the needs of this segment.
- Products, as well as processes, need to be modified and new ones need to be designed in order to harness the potential.
- Technologies available at present can meet most requirements, but will need continuous improvement and innovation to meet the demand of more complex products and also to keep pace with the growing business.
- Most organisations are finding it difficult to make the proposition viable at present. Regulations need to be more enabling for this segment to actually grow; this is beginning to happen.
- Microinsurance products are readily taken up by this segment as they are more vulnerable to uncertainties of income and work in more hazardous jobs than the better off.
- Customer awareness campaigns, marketing and promotions are required to reach out to the low income segment, especially in the rural areas.
- Not entering into this market segment is not an option; pressure from the RBI to do so is increasing, and there are growing opportunities to do so on a profitable (or at least break even) basis.

Products as well as processes need to be modified and new ones need to be designed in order to harness the potential (at the bottom of the pyramid).

5.2 EXPERTS' OPINIONS

MicroSave interviewed many industry experts and practitioners about savings related matters - the current scenario and future expectations. Through discussions *MicroSave* also tried to explore possibilities and various options that could be followed to make a

viable business opportunity out of the whole exercise. Some salient points are mentioned below:

- The poor need savings services more than anyone else. At the same time, mobilising savings from a large number of people spread across wide geographies has its own challenges and risks.
- Getting low income segments into the regular financial sector is beneficial both for the people belonging to this segment and the financial institutions. Customers get access to formal financial products and services, better returns on their savings and safety of their money; financial institutions get access to cheap funds and an opportunity to increase their top-line and bottom-line.
- Regulators need to differentiate deserving and genuine players in the market from others. Presently all private organisations (NBFCs, NGOs who are registered as society, trust or Section 25 company, etc.) are not allowed to accept deposits from the public. This distortion needs to be rectified.
- Skilled and trained manpower for reaching out into hinterlands with financial products and services is a challenge that needs to be tackled in advance.
- Cost of delivery and lack of proper infrastructure are the main reasons for financial institutions taking a cautious approach for this customer segment, especially rural poor.
- Institutions similar to DICGC and a credit bureau for MFIs (NGOs and NBFCs) can take care of regulator's concerns of customers' deposits to a great extent.

5.3 SAVINGS BEHAVIOUR

Respondents across all the areas and communities studied saved in order to meet planned and unplanned expenses that required them to create a significantly large lump-sum. Savings were made to meet long-term requirements like a child's marriage, education and building a house; medium term needs like house repair and investments in a business; and short-term needs like unforeseen emergencies.

In spite of the clearly articulated long and short term needs, people find it difficult to save. This difficulty in planning to save a significant lump-sum can be attributed to their own socioeconomic factors and due to gaps in the services offered by the service providers (both formal and informal, though largely formal).

“...there are two categories of clients- dragged in clients and walk in clients. So since it is difficult to assess who is a walk in client and who is a drag in clients, given the area of operation it is difficult to assess the actual gap between the demand and supply.”

-S.G. Anil

CEO, IFMR Rural Finance

“There will be no need (for people to access financial services) at the doorstep, but at the cross-roads.”

-E.V. Murray

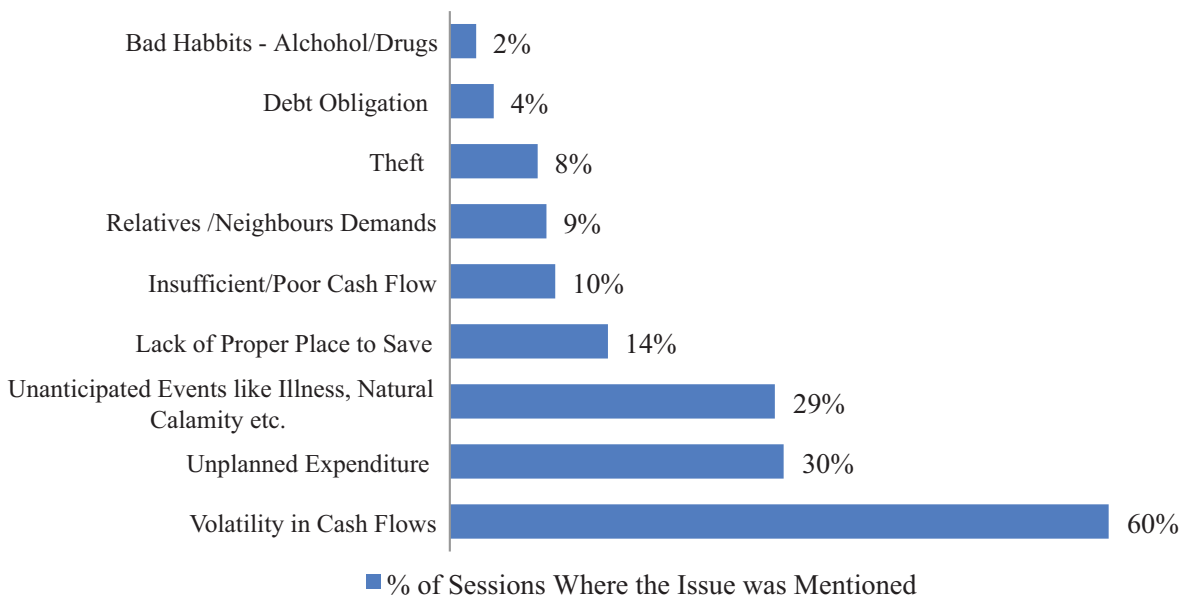
GM, NABARD

“NBFCs ran away with deposit money because they were not lending to the same clients, rather were investing the deposits elsewhere. MFIs are lenders first and savers next.”

-Mukul Jaiswal

MD, Cashpor

Figure 28. Difficulties in Savings: Non-Channel Issues



Of the respondents, there was a large segment which saved in a planned manner, and for this they had used the services of different mechanisms at their disposal. There was also a large segment which did not plan the savings in advance, and saved as and when there was enough surplus to save.

Figure 29: Nature of Savings

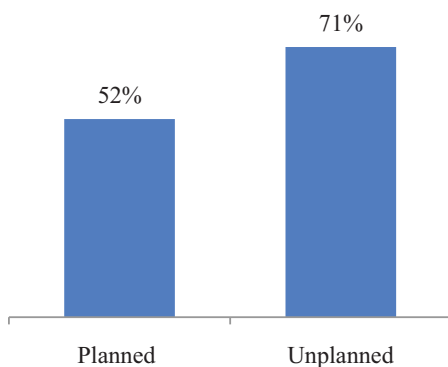
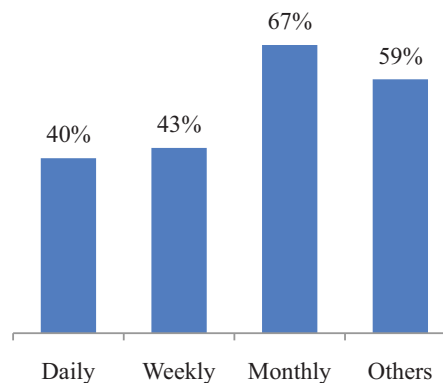
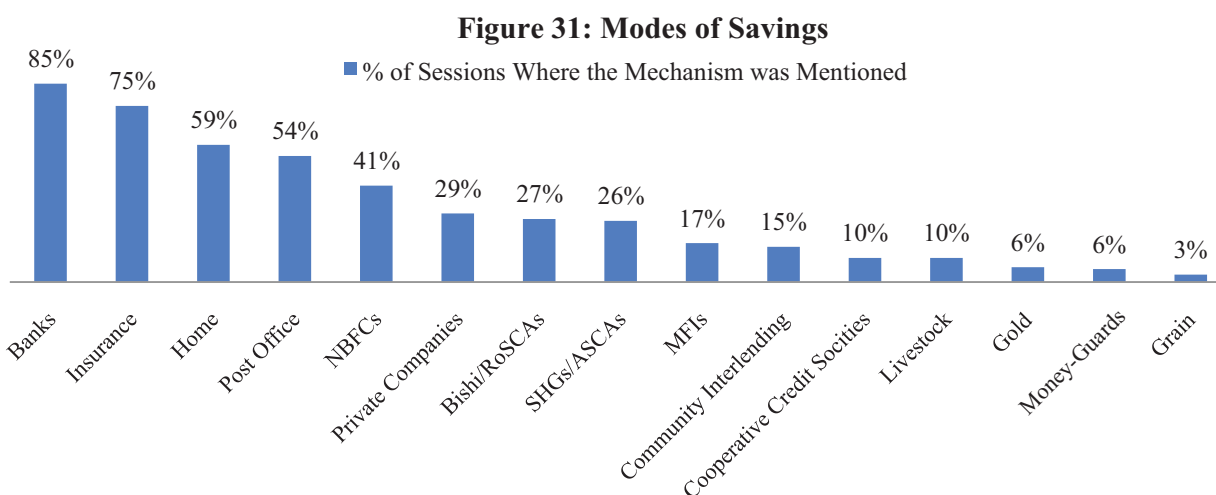
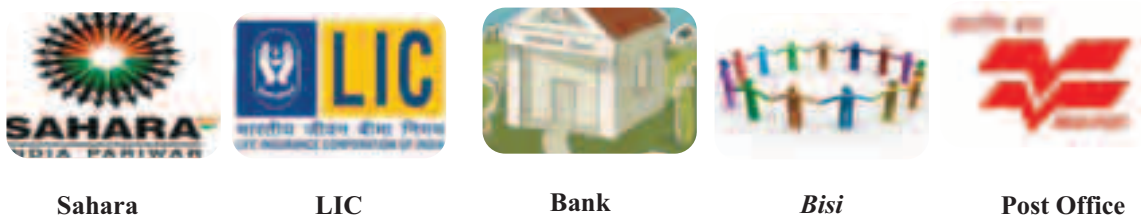


Figure 30: Frequency of Planned Savings



In as many as two-third of the sessions, respondents confirmed that they have enrolled in to a monthly savings plan. Still, a large section does not plan its savings and saves as and when sufficient surplus is generated.

The research highlighted the large number of mechanisms that people use to save. They include institution based mechanisms and informal mechanisms.

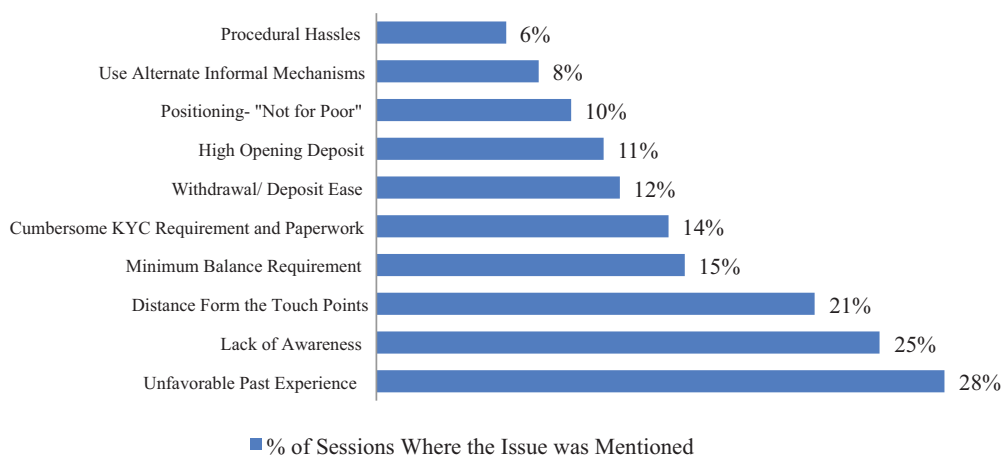


Formal sector banks along with post offices and insurance policies seem to be the most widely used formal savings mechanism. Saving at home, community inter-lending and saving in-kind (livestock, gold and grain) seem to be amongst the frequently used informal mechanisms.

5.4 SAVINGS PREFERENCES

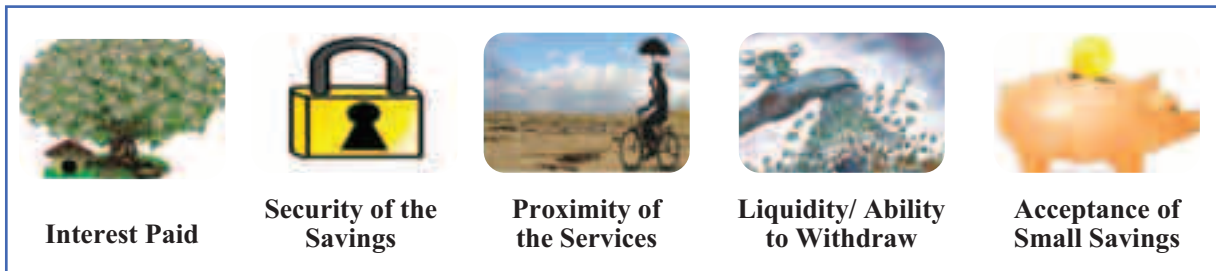
Though, formal banking services have a deep penetration and large base of clientele, there are others who either deliberately stay away from banks, or who are excluded by the system itself. The reasons offered were as follows:

Figure 32: Reasons of Not Using Formal Channels



In addition to the likes and dislikes, there are certain features that clients expect from their savings service providers. The five key attributes that figured across the researches are shown in the figure below.

Figure 33: Features of Savings Service Providers



The performance of the different categories of service providers on seven key attributes is as follows:

Attributes	Banks	Post Office	NBFC-Sahara	Insurance
Security of the Savings	Banks are considered safe for saving money as they are considered to have government backing. Also, detailed entries of every transaction in the passbook create a sense of comfort in client’s mind regarding the seriousness of banks.	Deposits are considered safe as POs are government owned. This trust has been further reinforced by the NREGA payments which have been smoothly executed by them in most areas. Also, the post master is known to everybody in a rural area. Even ladies seem to carry none of the inhibitions they have for banks when it comes to visiting POs.	Sahara has been able to generate trust amongst the community due to many years of service and being a reputed business house in India. But clients are wary as finance companies are notorious for frauds and stories of ‘fly-by-night’ agents having duped people are not uncommon.	As a government entity, deposits in LIC are considered safe. Furthermore, people have seen instances of LIC claims being settled which reinforced their trust in LIC.
Interest Paid	Interest rate offered by banks on long-term deposits are lower than other available options of savings especially NBFCs.	The interest at the PO is perceived to be low as compared to banks and private companies.	The interest rate of yearly schemes is low but the people considered the rate on long-term schemes to be one of the highest. But many felt that interest rates are not clearly communicated to the clients.	Insurance companies pay low interest on small deposits for short duration maturity schemes.

Attributes	Banks	Post Office	NBFC-Sahara	Insurance
Proximity of the Services	At the branch, thus often far away.	POs are typically in the village itself and people have seen them present for years. But doorstep delivery of services is not provided. Also, because of mobile phones, people do not need to visit post offices as often as they did earlier.	Doorstep Collection Service. Respondents liked the prompt doorstep service provided by the Sahara agents. Hence the travelling cost is saved.	People appreciate the fact that agents collect the premium from their home and that they are available at short notice. LIC has a very good network of agents. Since the money is handed over to the agent and the client does not visit LIC premise in person, success of the model is hinged in the amount of trust that people have in agent.
Liquidity/ ability to Withdraw	People in semi-urban areas with access to an ATM find it easier to withdraw money as and when required without any restrictions on number of withdrawals.	Long lock-in periods at the post office was explained as the basic reason why people prefer banks for liquidity over post offices.	Lack of facility to withdraw money before the maturity of the scheme. In case the money is withdrawn, no interest is paid (i.e. client has to forego the interest) and a penalty is also charged.	People did not appreciate the fact that in case they withdraw/close the policy before the end of the full term, they stand to lose the entire interest part due after maturity.
Acceptance of Small Savings	Banks are preferred only when the respondents have huge lump-sums. They do not go to banks for saving small amounts because of three main reasons: minimum deposit requirements, minimum balance requirements, and significant opportunity cost of transacting with banks (may cost as much as a day's labour).	Small savings are permitted, but since doorstep service is not available people do not go to post offices for saving small sums of money. Also in some environments, post office employees are not viewed as customer-friendly.	Savings as small as Rs.1 per day is accepted.	Premiums can be as low as Rs.25 per week.
Deposit Term	Banks are seen as stable, making people more likely to place their funds in banks for long-term tenures.	The long terms of PO products are its USP. In fact, POs RD services are a very popular instrument to save for a child's marriage.	Varying term options are available; there are annual and five year schemes. Varying FD options are available for periods from 18 months to 10 years.	The term of the policy ranged between 5-15 years.
Frequency of Saving	Some people felt that they can deposit any amount in savings/ current account according to feasibility.	Depends on the product, but usually monthly.	Extremely client-centric. Client decides the frequency of savings. Further, people felt that compulsory savings induces discipline to save regularly and hence liked this feature.	Premiums are payable yearly, half-yearly, quarterly, or monthly (even weekly and fortnightly in some cases) as decided by the client.

6. CONCLUSIONS AND RECOMMENDATIONS

Given the size of the population and the limited reach of formal financial institutions, the Indian financial market holds a huge opportunity at the bottom of the pyramid. The challenge is reaching out to this population.

- **Self help groups** are an indigenous model and have been the primary channel through which government agencies (with the exception of SIDBI) have contributed to and engaged with microfinance. However, as a community led model, it has inherent limitation on the quantum of savings that it can mobilise and maintain. This limitation can only be addressed if members also have access to personal savings accounts, outside the group model, where they can save with the confidence that not everyone in the village will come to know of their savings balance and where savings will not be at the risk of group dynamics.
- **Co-operative banks**, like SHGs, are great in term of community participation and ownership, but do not have the capacity to reach out to hundreds and millions of clients. Moreover, historically, these have been hubs of political activity and have therefore turned into instruments of political games - not the most ideal foundation for building up a long lasting and enduring financial structure.
- **Regional rural banks**, mandated by the government to become the banking arm of public sector institutions in rural areas, have had serious limitations in delivery. Though there are RRBs that are successful, by design they cannot expand outside the area earmarked for them and hence one can see only sparse success stories. In most other places, it can take a poor person up to a day to make a simple deposit/withdrawal transaction in some of the branches.
- **Local area banks**, a great experiment by the RBI, has remained just that. The LAB covered as part of this study demonstrated that despite many years of sustained inputs, including grants, break-even has remained elusive. This point is substantiated by the very limited number of LABs in the country and that no major players are applying for a license under this category.

EKO

EKO's technology is mobile phone based. The account is opened through a Customer Service Point (CSP) - the BC outlet and the account number are linked to the mobile number of customer.

If a transaction involves a cash deposit or withdrawal, the customer has to visit the CSP. Other transactions that do not involve cash (like money transfer) can be carried out by the customer directly on the mobile phone handset.

There are different strings of characters and numbers for different kind of transactions. Instructions from customer's/CSP's mobile handset flow to EKO's server (via a mobile network operator), which in turn is linked to the bank's server.

Authentication of a customer is done by the EKO server against pre-generated PIN numbers (called Okekey), which are part of the string that the customer has to type for a transaction. One PIN number can be used one time only.

- **Post offices** offer a phenomenal network with a reasonable bouquet of products which can be strengthened to better reflect market needs. However, as an extension of the Government, post offices perhaps do not have a market led mandate and can be best left for interventions from the government ministries. That is unless the Government can be convinced to re-engineer the governance, systems, products and processes to empower the post offices (perhaps as an independent Postal Bank regulated by the RBI as is under discussion) as an important channel for financial inclusion.
- **Microfinance institutions** have the possibility of offering savings as a service to their credit clients. The outreach of MFIs will ensure that a large number of clients can be accessed and only incremental costs will accrue to the savings product. While regulation has been offered as a reason, the absence of a profitable model of savings delivery is also hindering MFI interest in responding to this client need.

Thus, a variety of banks and other financial institutions have been trying to reach out to the under banked and unbanked segments of the society in different ways, sometimes on their own, and at other times under pressure from regulator or from the Government. Results so far have been mixed with few success stories (and these too largely in pilots and small scale experiments rather than a full fledged roll-out). A significant number of challenges and issues that need to be resolved remain.

- In response to banking correspondence and no frills accounts, the most recent Government push for financial inclusion, the banks to date have largely indulged in passive resistance – opening accounts to achieve the given targets by the regulator and letting them lapse into dormancy because every transaction was a loss-making proposition for them.
- The RBI wants banks to use the BC model to deliver financial services to the urban and rural poor, and has become even more keen on this in its growing disenchantment with the large NBFC MFIs, which are perceived as making excessive profits on the backs of the poor. It is reasonably clear that the RBI would like to see banks challenge the NBFC MFIs in rural areas through the BC model.
- While Indian ingenuity and technology has led to the development of impressive delivery platforms (see boxes on FINO and Eko by way of examples), for users of financial services through the BC channel or other innovative methods, the experience has not been very encouraging. There have been issues with technology and processes, including:
 - » biometric reader devices rejecting finger prints of the customer;
 - » text messages sent from mobile phones not reaching the server of the BC/bank, thereby delaying or aborting the transaction;

- » liquidity problems at the BC agent outlet - customers not able to withdraw cash when needed; and
 - » selection, management and quality control of BC agents.
- But above all, banks have not been able to see a clear path to creating profitable (or even break-even) operations under the regulations governing the BC model and no frills accounts (NFAs).

On the other hand, there are a growing number of essential ingredients in the socio-political milieu that seem set to create an enabling environment. Some of these are:

- The Government is determined to see a massive increase in real financial inclusion (savings, loans, insurance and remittances) in the next five years and is taking help from the RBI to keep banks involved in achieving this end.
- With the introduction of “reasonable fees” linked with the RBI’s continued focus on financial inclusion, there is a growing belief that financial inclusion delivered through the BC model could indeed become a viable proposition. In response, public sector and private banks are testing options to offer savings and other financial services to a far great proportion of the urban and rural poor population. These are often tied to processing the payment of various government schemes like NREGA payments, which will increasingly be delivered through no frills accounts.
- Some banks are working on a variety of innovative products using mobile phone or smart card-based systems, believing that a diversified product mix and the delivery of multiple products to individual clients will allow these systems to break even and eventually turn profits. *Annexure 1* gives a brief summary of such initiatives.

Most of the insurance companies feel that the current microinsurance regulation is biased towards partner-agent model and credit-life products, which cannot yield sustainability for the companies. Several experiments are being carried out by offering savings linked group microinsurance products, which are cost-effective as well as easy to operate. However, the success of any savings linked microinsurance would primarily depend on:

- Understanding the market segment suitable for savings linked microinsurance, rather than simply stripping down existing products as is currently the norm;

FINO

Formed in July 2006, FINO is one of the early entrants into the market for financial inclusion. The technology is based on the biometric smart cards, wherein the demographic (name, age, address, photograph etc.) and biometric (finger print scan) details of customers are captured on a chip embedded in the plastic card during the enrolment process.

To transact, the customer has to bring the card to a BC outlet for authentication. The data flow is between the Point of Sale (POS) device and the FINO’s server, which is ultimately linked to the corresponding bank’s server.

Authentication and transaction is carried out by the BC personnel (over the POS device) manning the outlet, who is also responsible for maintenance of accounts, cash register, complaint book, the cash that is deposited or withdrawn by customers and depositing excess cash in bank.

- The nature of demand of the respective market segments from a savings and insurance product; and
- Offering the product through an optimum distribution channel that can generate enough outreach, suit the existing transaction patterns of the target clientele and serve the clients on a long-term basis.

6.1 THE WAY AHEAD

To date, microfinance in India has effectively been a one-legged race with only credit services and, to some extent, tied life insurance services made available to clients. Even SHGs' savings is limited by mistrust of the SHG mechanism, and deposits at the banks are above all made to leverage loans. This situation has to be addressed if India is to ensure genuine high quality financial inclusion for its poor.

The role IFC and other donors can play in facilitating and accelerating this revolution is by providing support for the development and design of new products and processes. Most banks are not used to serving the poor and have (to date at least) largely delivered stripped down versions of their existing products to this segment. In addition to challenges with product design, process optimisation and agent network development and management, uncertainties remain around the right mix of products for the poor.

The technology is already essentially available. Mobile phone-based technology in particular looks promising, given the mobile penetration (more than 500 million users) combined with tremendous growth in new mobile customers every month. Moreover, the transactions can be made in real time by a direct link to the bank's server. The RBI has demonstrated a willingness to allow reasonable pricing for delivery of financial services and has since given a green signal for appointing agents with 'for profit' legal formats. This landmark change in approach could eventually allow banks to deliver a suite of services through the BC system on a profitable basis.

The demand side analysis conducted, as part of this study, and all of *MicroSave's* other studies in India have suggested massive pent-up demand for savings. FGDs and interviews have strongly suggested that domestic remittance is also one of the needs that is not being met adequately through formal mechanisms. Two or three new or modified products designed based on client needs and preferences, delivered through the channels that are easily accessible, cost effective, reliable and easy to use could lead to large scale uptake in deposit mobilisation in India. Internationally, M-PESA is a well known name in the mobile banking domain. It is a telco-led remittance service that has scaled great heights and is presently the most well known mobile based money transfer solution worldwide. M-PESA is not a typical savings platform but it has learnings for mobile banking platforms elsewhere because of its rapid growth and its acceptability amongst Kenya's poor. *Annexure 2* gives presents a brief profile on the M-PESA model and its critical success factors.

Poor people involved in trade and service sectors have a regular cash flow. They can save in a planned fashion at a regular frequency (usually daily or weekly). On the other

The role IFC and other donors can play in facilitating and accelerating this revolution is by providing support for the development and design of new products and processes.

hand, people involved in primary and secondary activity tend to get income irregularly. Thus their pattern of savings is more unplanned and happens at times of surplus cash. From a product development point-of-view, this presents a huge opportunity for recurring deposits in case of traders and people involved in the service sector; and for mobilising voluntary savings or opening fixed deposits for people involved in primary and secondary activities.

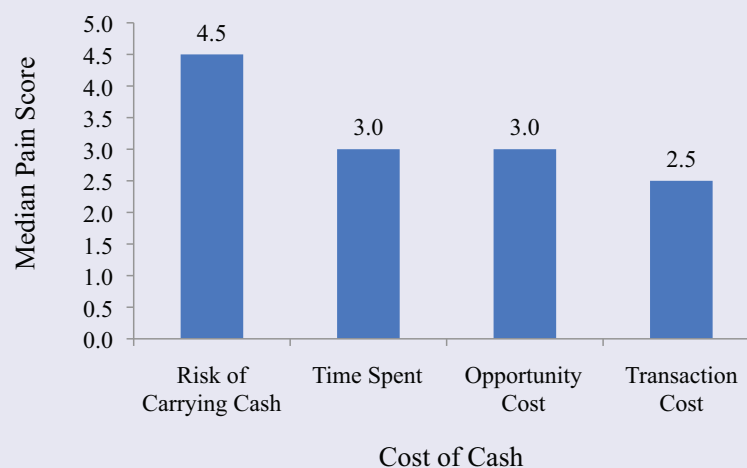
Continuous monitoring of pilot tests along with prompt required modifications in product features, processes and the right kind of marketing and promotion to generate trust in agent networks and technology could lead to the development of a scalable and viable business model in the next two to three years.

Annexure 1

Financial Inclusion Through Mobile Phone/Smart Card Based Platforms

Rural India has 18% of bank penetration to serve 74% of the population and a share of 30% deposit accounts out of a total of 428 million in the country. Over 30% of the new mobile subscriptions every month are registered in villages, yet about 200 million mobile phone users are still without a bank account. Banks and customers have to incur relatively high costs for accessing financial services in rural areas. A study conducted by *MicroSave* on reasons for dormancy of No Frills Accounts (NFA), brought out the following as pain points for the customers of NFAs:

Cost of Cash Pain Score, Rural (Median)



Conventional banking services are often inaccessible to the rural bottom of the pyramid customers, as brick and mortar branch structures can be far away from villages. The low value of transactions coupled with poor connectivity and infrastructure in rural areas makes it difficult to service the bottom of the pyramid; even through ATM networks. The problem of inaccessibility becomes more pronounced for this segment because of the high opportunity cost of transactions; access in many cases means loss of wages. The distant transaction points require the rural poor to choose between earning income for the day or going to a bank branch to transact. The former is more often the chosen option. Risk of carrying cash and transaction costs are deterrent for the rural as well as urban bottom of the pyramid customers.

In such a scenario, what is needed for ensuring financial inclusion of this segment of customers is a banking solution that is simple, economical and available in the vicinity. The fast expanding outreach of mobile phones has the potential to offer such a solution. A mobile phone can be used to enter, display, process, store and transmit information as is done by computers, ATMs, and Point-Of-Sales [POS] devices, which are the electronic network end-points that banks use today to service customers in urban and metropolitan centres. A branchless banking channel using mobile phones can greatly reduce travel time and time spent in queuing up for transactions and in the process save precious time and money. Given below are brief details of mobile phone based initiatives that are aimed at financial inclusion of the bottom of the pyramid segment:¹

[1] Corporation Bank initiated pilot projects on branchless banking in Karnataka, Andhra Pradesh, Tamil Nadu and Goa, surveying villages, assisting rural households to open bank accounts and issuing smart cards. It operationalised branchless banking units in 1,200 villages during 2009-10 and mobilised deposits of Rs. 259.7 Million by opening "no-frill" accounts of about 547,000 customers who were issued smart card keeping in view RBI's requirements of KYC/AML.

[2] Indian Bank, Andhra Bank, State Bank of India, State Bank of Hyderabad, Union Bank of India, Axis Bank, HDFC Bank and Canara Bank are other banks using smart card-based technology solutions.

[3] SBI conducted pilot projects in Mizoram, Meghalaya, Andhra Pradesh and Uttarakhand and developed a mobile banking kit called “bank in a box” that comprises of a cell phone acting as a Point-Of-Sale [POS] machine, a finger print reader and a tiny printer. This is used for opening “no-frills” accounts on smart cards.

[4] HDFC Bank’s “Anywhere Bank Terminal” at locations of Business Correspondents, besides “Bank on Wheels” launched in 13 States [including Bihar, M.P., Rajasthan and U.P] exclusively for the rural market facilitates low-income unbanked and underprivileged households to access financial services at affordable cost at their doorsteps using biometric ATMs. The Bank reached more than six hundred thousand customers beyond 200 km from its branches using the technological platform.

[5] Grameen Financial Services piloted m-banking in Bangalore with 100 borrowers in partnership with mChek [Bangalore-based technology provider]. After two years, it served more than 330,000 rural clients and planned to reach out to two million by 2012. GFS incorporated technology, using Mifos an open source software customised for this application.

[6] Integra offers iMFAST [Integra Mobile Financial Applications Secure Terminal], a portable teller machine that performs simple banking functions in rural areas. Operated by BCs in villages, the iMFAST solution, a hand-held terminal handling transactions concerning deposit, RD, withdrawal, loans, insurance, bill payments and booking train/bus tickets in rural areas, is currently used in over 500 locations by 15 banks [including Bank of Baroda, Canara Bank, Central Bank of India, Indian Bank and Vijaya Bank]. Integra has issued ATM cards to 300,000 customers in Karnataka, Madhya Pradesh, Tamil Nadu, Kerala, Andhra Pradesh, Maharashtra, Uttar Pradesh, Sikkim and Jharkhand.

[7] Union Bank of India added thousands of customers in remote villages through its BCs, such as Infrastructure Leasing and Financial Services, Drishti and Basix.

[8] Under the Mahatma Gandhi National Rural Employment Guarantee Scheme (NREGS), banks in Andhra Pradesh conducted pilot projects to test “leakage proof” routing of government to people payments directly to the beneficiaries’ accounts using smart cards-based savings accounts.

[9] Zero Mass Foundation in Karnataka launched a new generation biometric fingerprint authentication-based solution, which has reached five million customers including beneficiaries of social security, pension scheme, NREGS, and SHG members in 18 States. The product suite, “ZERO” is an end-to-end payment system to serves customers with small-value transactions including cash-in/cash-out, cashless transactions and remittances leveraging the security and connectivity of new generation mobile phones.

[10] Mchek, provides services such as bank deposits, withdrawals, loan repayments, account balance and *kirana* shop payments. MCheck has a vision to bring together the entire eco-system of partners across the banking sector, banking service providers, as well as telecom operators to serve the base of users.

[11] In 2009, MYRADA with the support of NABARD developed NABYUKTI, a software to generate simplified MIS for promoting and linking SHGs.

[12] Ekgaon technologies offer software for accounting and MIS in case of SHG-based financial intermediation.

¹ Patel, A. “Harnessing M-Banking Potential by Banks in Rural India: Learning from International Experiences”, 10 Dec 2010, Retrieved Feb 11, 2011, <http://www.microfinancegateway.org/p/site/m/template.rc/1.9.49026/>; b 11, 2011, <http://www.microfinancegateway.org/p/site/m/template.rc/1.9.49026/>.

Annexure 2

M-PESA: What has Made It Work?²

M-PESA, the Kenyan mobile money service, has seen exceptional growth since its introduction in March 2007. Six million customers have registered with the service, which represents nearly half the customer base of Safaricom, the mobile operator that launched M-PESA.

How it works

M-PESA facilitates a variety of financial transactions through the mobile phone. To access its services, individuals must register at an authorized M-PESA retail agent outlet. They then get an individual electronic money account that is managed by Safaricom, which in turn deposits the full value its customers store in M-PESA accounts at a pooled account in a regulated bank. Thus, the issuer of MPESA accounts is Safaricom, but the value in the accounts is entirely backed by highly liquid deposits at a commercial bank. Customers can use their mobile phones to transfer money to both registered and non-registered users, check their account balance, pay bills, purchase mobile phone credit, and transfer such credit to other users. They can also make deposits and withdraw cash from their M-PESA account by visiting an authorized M-PESA agent.

Success indicators

Six million customers have registered with the service, which represents nearly half the customer base of Safaricom. This is a level of penetration in the mobile base that no other mobile phone based service has achieved, outside of voice and text messaging. The figures for person-to-person (P2P) transfers are equally impressive: over USD 1.6 billion (120 billion Kenyan Shillings [KSh]) worth of such transfers have been made through the M-PESA system. Its agent network has grown in parallel with the customer base, and the service can be accessed at nearly nine thousand retail outlets nationwide, in both urban and rural areas.

M-PESA is not the only mobile money service to be launched in Africa, but it is the most successful. For example, South Africa's WIZZIT has managed to attract 250,000 customers in more than four years of operation. Neighbouring Tanzania launched its own version of M-PESA in April 2008, but it has only recently crossed the 100,000 customer mark.

Factors of success: Environmental factors

A latent demand for money-transfer services has encouraged the growth of M-PESA. This demand is driven in Kenya by migration from rural-to-urban areas. Because of the uneven structure of the Kenyan economy, it is common for a member of a rural household to seek employment in the city. In most cases, the male head of household migrates, while wives and children remain at home. Most urban migrants retain a strong attachment to their rural homes and frequent money transfer is one way to reinforce this attachment.

Poor alternatives for domestic money transfers, particularly in the absence of technology enabled banking or retail channels with a broad network of service points, also has fuelled M-PESA's growth. A majority of low-income Kenyans, till very recently, used informal methods to send money home. Money was generally handed over to friends and family members travelling back to villages. Although this method is the cheapest, it may also be the riskiest, as some or all of the money could be lost on the way. Money is also traditionally transferred through bus and matatu (shared taxi), with all the risks that are inherent in informal channels. PostaPay, a money-transfer service offered by the post office, is another popular option. Although PostaPay has a presence in rural areas, many complain that the service is inefficient and frequent cash shortages are reported at the receiving end. Thus, there was a significant gap in the domestic remittance market when M-PESA was introduced, and it had a significant role in filling this gap.

Safaricom's market dominance in terms of telcom subscribers also played a significant role in the success of M-PESA. Safaricom has a 77 percent market share in voice telephony, with a customer base of 13.3 million Kenyans. It has a strong brand presence and plays on nationalistic sentiments in its marketing campaigns. The company is also associated with people's concept of a modern Kenya, and it has made efforts to negatively portray nepotism, inefficiency, and corruption. Due to Safaricom's size, it not only can offer mobile money service to a larger potential customer base, it also has a larger pre-existing network of airtime resellers that could be converted to cash-in/cash-out points. Moreover, Safaricom, like any other telcom operator, is interested in customer retention, making it easier to justify the business case for the mobile money service.

Factors of success: product features

Strong branding and simple messaging for an easy-to-use service

M-PESA has benefited directly from closely identifying its product brand to Safaricom's strong corporate brand. Many M-PESA retail agents are required to display corporate branding, including painting the entire store "Safaricom green," which makes it much easier for customers to locate the service. Agents are being advised to deal exclusively with Safaricom (not selling products of other mobile operators), which gives the mobile operator greater control over the services provided. This is not required of airtime resellers who do not become M-PESA agents.

From its inception, M-PESA has been communicated as a simple service - "send money home." The simplicity of the message around the usefulness of the service has been matched by the simplicity of product and the user interface.

Frequent and consistent monitoring of retail agents

Safaricom's control over individual M-PESA agents extends well beyond branding and signage. Safaricom has ensured minimum standards on the M-PESA customer experience on services delivered by its retail agents. This has helped build trust on the platform and the agents, and gives customers a consistently positive experience while using the service. Safaricom manages its own agent training programs, although they are delivered by another company. Training is delivered to each agent rather than just relying on agent aggregators or master agents to cascade these programs to participating retail shops. Safaricom's territory managers monitor retail agents on a monthly basis with periodic on-site visits.

Scalable agent distribution structure for liquidity management

Safaricom relies on master agents to facilitate liquidity management. Retail agents are attached to and managed by some three hundred master agents, who buy and sell M-PESA electronic value from / to the retail agents, thus giving the agents the means to balance their relative positions in M-PESA electronic value as well as cash on a day-to-day basis. Master agents either buy or sell M-PESA electronic value for cash directly from Safaricom, based on whether a group of retail agents they manage has a net cash in or cash-out position.

A tangible expression of the service: The agent log

Each transaction made using M-PESA is confirmed via an SMS from Safaricom to both transacting parties. The confirming SMS constitutes an electronic receipt, which can be used in dispute resolution. Safaricom takes the extra step of requiring agents to record all transactions they undertake in a paper-based log book. This log book is branded by Safaricom and all retail agents use the same format. Many customers draw comfort from seeing their electronic transactions recorded on paper. Thus, the log is vitally important to agents in building rapport with their customers.

Customer registration: Easy and quick for customers, rewarding for agents

Safaricom designed a quick and simple process for customer registration, which can be done at any retail agent location. Customers pay nothing to register and the agent does most of the work during the process. Agents are given incentives to register customers.

Simple and transparent retail pricing

M-PESA pricing is made transparent and predictable for users. Fee / charges are subtracted from the customer's M-PESA account, and agents cannot charge fee on cash directly from the customer. Thus, agents collect their commissions from Safaricom (through their master agents) rather than from customers. This reduces the potential for agents abusing customers and overcharging. Customer fees are uniform nationwide, and they are prominently displayed at all agent locations.

Enabling ATM withdrawals

A year after its launch, M-PESA partnered with PesaPoint, one of the largest ATM service providers in Kenya. The PesaPoint network includes over 110 ATMs scattered all over the country, giving them a presence in all eight provinces.

Maintaining a balanced growth of customers and retail agents

While Safaricom considered the spread of the agent network the key to customer growth, it was careful not to flood the market with agents whose profitability could not be maintained or increased over time. This has resulted in an incentivized, committed agent base.

Free deposits, no minimum balance, and ability to send money to non-customers are some of the other features that have contributed to the success of M-PESA.

Conclusion

M-PESA's success cannot be distilled down to any one specific factor. In fact, it is consistency among all the elements of the customer proposition and Safaricom's attentive monitoring of the entire system that best explain its success. Moreover, M-PESA's managers understood from the beginning that the success of the system centered less on the optimal management of mobile network resources than on marshalling retail agents. Customers needed to have a good experience at the cash-in/cash-out points, where the bulk of transactions took place. This meant establishing a significant physical retail presence, reminding customers that they were transacting with Safaricom at all times, ensuring that the retail agents had enough cash to meet customers' transaction requests, and, above all, motivating agents to promote the service.

This focus and determination were built up after a long and rigorous trial run. During the trial process, Safaricom's basic beliefs about the usefulness of the M-PESA service were shaken dramatically. Safaricom initially thought the service would be centered on microcredit repayments, but they reoriented it toward domestic remittances after monitoring transaction patterns during the pilot and assessing customer feedback. The feedback not only helped test the design of the service, it actually helped redefine its basic purpose. The crucial role played by these test customers perhaps set the tone for a listening process that has served Safaricom well ever since.

² Based on: Mas, Ignacio and Morawczynski, Olga, "Designing Mobile Money Services Lessons from M-PESA", *Innovations*, published online spring 2009; Vol. 4, Issue 2, pp. 77-9.

DEPOSIT ASSESSMENT IN INDIA

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