FINANCIAL INCLUSION IN INDIA'S DIGITAL AGE

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Report for: Sub-K; Basix Sub-K iTransactions Ltd

TABLE OF CONTENTS

EXECUTIVE SUMMARY

This report focuses on Financial Inclusion in India, which is defined, by The Reserve Bank of India (RBI), as the process of ensuring access to financial products and services needed by vulnerable socio-economic groups at an affordable cost in a fair and transparent manner by mainstream institutional players. More specifically, the analysis focuses on the delivery, or lack thereof, of services to the most vulnerable populations and the policies that influence this service provision. The nine chapters of the report, though tied together by this common theme, are meant to act as standalone briefs or case studies, building a focused analysis on a specific theme. The first five chapter read as policy briefs while the remaining four chapters focus on a specific case or topic.

Chapter 1 probes the Pradhan Mantri Jan Dhan Yojana scheme, which is deeply ingrained in all relationships in the delivery of services to vulnerable populations. It analyses the current disconnect between the technical capacity of BCs and the centrality of an Aadhaar card to India's inclusive finance model. To address this gap, is recommends working with the Unique Identification Authority in India (UIDAI) to provide greater access to Aadhaar enrollment processes through the Customer Service Point, a branch of the BC model.

Chapter 2 investigates the challenges niche banks will face in India's financial future. These include, human resource and trust issues, technology challenges and risks associated with concentrated loan portfolios. However, there is an opportunity to surmount these challenges through partnerships with local actors and collaboration, both vertically and horizontally, enabled by policy change.

Chapter 3 identifies challenges and opportunities that arise as India continues to leverage digital technology for financial inclusion. BCs remain as central players in providing access to digital services in rural communities but structural challenges such as poor server connectivity and low digital literacy reduce the scope of technology uptake. However, collaborations between institutional financial or telecommunications service providers and BCNMs can mitigate these challenges at the last mile.'

Chapter 4 gives an overview of India's social insurance or security schemes. These include policies commonly exist in the form of social insurance, social transfers, labour standards, minimum savings plans, and risk-mitigation strategies. This chapter considers whether insurance schemes are reaching the bottom 20% and provides recommendations based on observations in the field.

Chapter 5 discusses the Micro Units Development and Refinance Agency (MUDRA). More specifically, its relation with formal credit enhancement for micro, tiny, and small businesses. Both of th verticals are explained, but focus on remains on the Pradhan Mantri Mudra Yojana (PMMY), or 'Mudra scheme'. The early findings show some promising results but there remains concerns regarding account segmentation and lending patterns across states.

Chapter 6 reports on field observations regarding the possible model integration of loan focused agents with financial inclusion focused business correspondents. This integration affords potential gains in efficiency while also offering a larger population a wider variety of financial services.

However, challenges remain around incentives, service area assignments, contractual obligations with banks and accountability.

Chapter 7 explores the future creation and implementation of a Code of Conduct for Business Correspondents (BCs). This is one of the mandates for the Business Correspondent Federation of India (BCFI). This code is necessary for moving forward with the BC model as the primary form of last mile delivery for Indian financial services. It argues the need for a cohesive understanding of the BC model before a code is created and provide a number of themed questions, which must be answered in order to achieve that goal.

Chapter 8 describes the demonetization policy utilizing from an on the ground perspective supported by rigorous research inputs. The policy was implemented on November 8 2016 by the current administration. The chapter investigates the potential rationales behind the bold policy move, its poor implementation, its immediate economic and political consequences; and provide some of expert facts and figures.

Chapter 9 examines the operations of Akhuwat Islamic Microfinance Institution in Pakistan to evaluate the sustainability and viability of interest free microfinance. It describes the success of Akhuwat's training program for loan officers that allows Akhuwat to actively increase their annual outreach. Joint loan application from families encourages household accountability of loan repayment and also ensures high rates of recovery and borrower satisfaction. It posits the question – can MFIs in India can potentially increase their clientele by providing interest free financial products for population groups who are opposed to servicing interest?

The report concludes with a forward-looking chapter which attempts to bring the diverse topics together. In addition to a summary, it provides some unanswered questions that the research team’s hope will be explored in future research.

ACKNOWLEDGMENTS

This project has been a very meaningful and enjoyable experience for our entire team. It would not have been possible without the support and help of many individuals and organizations. We would like to extend my sincere thanks to all of them.

We are highly indebted to BASIX, Sub-K and the Master of Public Policy and Global Affairs (MPPGA) program at the University of British Columbia for working together to facilitate this project. Specifically, within the MPPGA program we would like to thank Dr. Milind Kandlikar who worked with us to administer our survey in India and Dr. Cesi Cruz who provided key advice when we were first designing the survey instrument.

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We would also like to express our gratitude to Sub-K and other members of the BASIX and ILRT team whose expertise and passion for livelihood promotion was an invaluable to our data collection and general learning about the Indian financial inclusion environment.

Within BASIX we would specifically like to thank Vijay, Shashi, Anoop and those from Institute of Livelihood Research and Training (ILRT) who assisted us in the field: Sonakshi, Navin, Venu, Anitha, Sainath, Vera, and Parmod. In addition, this project would not be possible without the involvement of every single BC, CSR, CRO and consumer who provided us with stories and perspectives.

For the research conducted in Pakistan we would like to sincerely thank Dr. Amjad Saqib, the Executive Director of Akhuwat Islamic Microfinance, and his team. The collection of the data would have been impossible without the constant supervision and dedication of Mariam Shakir, Aleem Emmanuel, and Shahid Safdar. The entire team of is wholly committed to Akhuwat's cause of empowering marginalized communities by providing them with the tools to realize their potential. The energy of the staff at Akhuwat head office has no bounds and it has been an absolute pleasure to experience.

ABOUT

BASIX - SAB KE LIYE SAMRUDDHI LAYE (SUB-K)

BASIX is a livelihood promotion institution established in 1996, working with over a 3.5 million customers, over 90% being rural poor households and about 10% urban slum dwellers. BASIX works in 18 states.[1] Basix Sub-K iTransactions Ltd., is a subsidiary company under BASIX Social Enterprise Group. Basix Sub-K iTransactions Ltd started in 2010 with the vision to promote sustainable livelihoods through the provision of financial services and technical assistance. Sub-K is a service company that offers a technology platform that enables digital transactions of funds for the unbanked population. This technology is used by the Business Correspondents Sub-Agents (BCSA) in the field for whom Sub-K recruits, trains, and monitors as they function like human ATMs and provide last-mile delivery to their communities.

UBC MPPGA RESEARCH TEAM PROFILE

This report was produced by a team of five UBC students in the Masters of Public Policy and Global Affairs (MPPGA) program upon the request of Sub-K. The MPPGA program is a highly challenging and rewarding graduate program that equips future leaders to navigate complex policy problems while driving positive global change. Talia Ahmad, Corrin Bulmer, Zameena Dadani, Fernando Roderiguez and Chad Rickaby completed this research assignment researching Financial Inclusion in India as part of their global policy project towards their completion of a graduate degree in May 2017. The diverse background of these students proved fruitful upon research and analysis. Through the skills and research acquired during the completion of this project the students were able to gain a global perspective on complex political, socioeconomic, and cultural challenges faced in India as well as develop applied skills in policy design, implementation and analysis.

[1] "BASIX India - BASIX Social Enterprise Group." BASIX Equity for Equity. http://www.basixindia.com/index.php?option=com_content&task=view&id=37&Itemid=51.

ACROYNMS

AADHAAR - Aadhaar is a 12 digit unique-identity number issued to all Indian residents based on their biometric and demographic data
BCFI – Business Correspondent Federation of India
CBGA – Centre for Budget and Governance Accountability
CRISIL - Credit Rating Information Services of India Limited
DBT – Direct benefit transfer
DFI – Development Finance Institutions
FI – Financial Inclusion
FIU – Finance Intelligence Unit
GoI – Government of India
JAM - Jan Dhan Yojana, Aadhar, Mobile numbers
JSA – Jan Swasthya Abhiyan - Indian circle of the People's Health Movement
IFC – International Finance Corporation
IMPS – Immediate Payments System
IRDA – Insurance and Development Authority
LAMP – Livelihood and Microfinance Promotion Fund
KYC – Know Your Customer
MFI – Microfinance Institution
MGNREGA - The Mahatma Gandhi National Rural Employment Guarantee Act
MICROSAVE – International FI Consulting Firm
MNIS - Modified National Agricultural Insurance Scheme
MSBY - Mukhya Mantri Swasthya Bima Yojna – health insurance scheme
MSME – Micro, small, medium enterprises
MUDRA – Micro Units Development & Refinance Agency Ltd (bank
NABARD – National Bank for Agriculture and Rural Banking
NABFINS – NABARD Financial Servies Ltd.
NAIS - National Agricultural Insurance Scheme
NBFCs – Non-Banking Financial Companies
NFSS – National Food Security Scheme
NHB – National Housing Bank
NHPS - National Health Protection Scheme
NITI – National Institution for Transformation India
NPA – Non-performing Asset
NPS – National Pensions Scheme
NPCI – National Payments Corporation of India
NREGS – National Rural Employment Guarantee Scheme
NRLM – National Rural Livelihoods Mission
PaHaL - Pratyaksh Hanstantrit Labh (PaHaL)
PMFBY - Pradhan Mantri Fasal Bima - Crop Insurance Scheme
PSL – Priority Sector Lending
PMAY – Pradhan Mantri Awas Yojana – Housing for All
PMJDY - Pradhan Mantri Jan-Dhan Yojan

INTRODUCTION

"FINANCIAL INCLUSION MEANS THAT INDIVIDUALS AND BUSINESSES HAVE ACCESS TO USEFUL AND AFFORDABLE FINANCIAL PRODUCTS AND SERVICES THAT MEET THEIR NEEDS – TRANSACTIONS, PAYMENTS, SAVINGS, CREDIT AND INSURANCE – DELIVERED IN A RESPONSIBLE AND SUSTAINABLE WAY. – THE WORLD BANK "[2]

Financial inclusion is a continuing priority for policymakers, regulators and development agencies globally; since 2010, more than 55 countries have made commitments to financial inclusion, and more than 30 have either launched or are developing a national strategy.[3] The government of India, in conjunction with the Reserve Bank of India (RBI), has emphasized the need to create strategies to address poverty alleviation through socio-economic strategies since 2005. The Reserve Bank of India (RBI) defines 'financial inclusion' as the process of ensuring access to financial products and services needed by vulnerable socio-economic groups at an affordable cost in a fair and transparent manner by mainstream institutional players.[4] The inclusion-focused efforts of the Indian government emphasize developing policies and mechanisms that address the challenges and implications of a cash reliant economy as well as provide the most vulnerable and poor of India with access to financial services.

Close to 90% of Indian small businesses have no link to the formal financial sector and 60% of rural and urban populations do not have a functional bank account.[5] There is continued financial exclusion of India's bottom 20% from accessing affordable financial services which limits their ability to generate sustainable livelihoods. This population is often referred to as the "unbanked" and "under-banked." This term has been commonly entrenched in the financial service industry referring to the consumers as "un-profitable" therefore resulting in a lack of infrastructure investment due to the high transaction cost and high levels of risk to engage in financial services with the bottom 20%.

Recent national policies explored in this report are all based on an acknowledgement that traditional financial institutions, those exclusively reliant on national level scheduled commercial banks, are not ideal for creating comprehensive access to financial services for low-income households. Within this acknowledgement is the assumption that these households are in fact "bankable," just not in the traditional way. In 2015, alone the government of India initiated 5 major policies:

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[2] The World Bank (2016). Financial Inclusion. http://www.worldbank.org/en/topic/financialinclusion/overview#1
[3] Ibid.
[4] Joshi, Deepali Pant (2011). "Financial Inclusion & Financial Literacy." In *BI OECD Seminar*. India: Reserve Bank of India, https://www.oecd.org/finance/financial-education/48303408.pdf.
[5] Subbarao, Duvvuri (2013). "Responsible Innovation and Regulation in the Financial Sector." Keynote Address presented at the IDRBT Banking Technology Excellence Awards Function, Hyderabad, August 2, 2013. https://rbi.org.in/Scripts/BS_SpeechesView.aspx?Id=827.

- Jan-Suraksha – Social security program
- JAM for DBT – government benefits will involve all three - a bank account under Jan-Dhan, Aadhaar number or biometric ID and a mobile phone and number
- PaHal – digitized Direct Benefit Transfer (DBT)
- Micro Units Development Refinance Agency (MUDRA Bank) – refinancing and guaranteeing credits for micro, tiny and small non-farm business units
- Unified Payments Interface (UPI) – between operability between different payment systems

Much of the financial inclusion conversation during the project focused on ensuring the last mile delivery of services and the implementation of national level policies. This started in 2008, when the Committee for Financial Inclusion reported inaccessibility, distance and lack of proper infrastructure as the reasons for the financial exclusion of India's vast rural population. The report underscores the need for expansion of geographical coverage and ensuring outreach of various financial services to the entire population without any demand and supply constraints.[6]

In response to expanding financial services in India, in 2006 RBI adopted the technology based agent bank model through Business Correspondents (BCs). This model attempts to address one major failing of traditional banking institutions; that those institutions are not accessible to many rural communities because the cost of getting to the nearest physical bank is too high. Per the RBI guidelines, the BCs are permitted to carry out financial transactions on behalf of a bank as agents, which is called branchless banking. This model is being aided by technology oriented tools, such as point of sale handheld devices, mobile phones and biometric scanners.

BC's are local members of the community who are recruited by banks or social enterprises like Sub-K, also known as a BC network manager (BCNM), to deliver financial services within a certain jurisdiction. BCs are great providers of last mile service, especially to rural and under banked populations. However, their business operates in a policy environment that is constantly changing. Many of these policies directly relate to the operations of BCs. To analyze the policy environment in which BCs operate this report focuses on five major financial inclusion policies, which play a significant role in the current financial ecosystem in India:

1. Pradhan Mantri Jan Dhan Yojana (PMJDY): Universal bank accounts
2. Social Insurance Schemes: Pradhan Mantri Fasal Bima Yojana (PMFBY) Farm Insurance and Rashtriya Swasthya Bima Yojana (RSBY): Health Insurance
3. Niche Banks: Payment Banks and Small finance banks
4. Micro Units Development and Refinance Agency Bank (MUDRA)
5. Digital Financial Inclusion: Mobile/Digital Banking Technology

[6] Report of the Committee on Financial Inclusion, Chaired by Dr. C. Rangarajan, January 2008. URL: http://www.nabard.org/reportcomfinancial.asp

The following report will highlight these policies, which are currently facilitating financial inclusion in India, as well as identify major themes and events to provide a more complete understanding of this ecosystem. This understanding will be based on a foundation of extensive secondary research, a series of interviews with relevant stakeholders, and three sets of field interviews, one with BCs and the two with Indian and Pakistani consumers. These points of data collection emphasize certain realities, but also point to assumptions and miscommunications within the financial inclusion landscape. One example of an assumption was that issues with connectivity experienced by BCs was related to the spread of telecommunication towers, however, this imminent challenge is caused by disruptions between the multiple interlinked servers required to process a transaction.

Analysing this data is essential because the current financial policies and programs in India fail to adequately address the needs of the bottom 20% and are thus impeding the achievement of India's financial inclusion goals.

STAKEHOLDER MAP

Below a simple map demonstrating the major players involved in a branchless banking model with two main regulators telecom and financial. This simplistic model aims to provide an undertanding of the basic interaction between institutions prior to deliverying financial services to the customer.

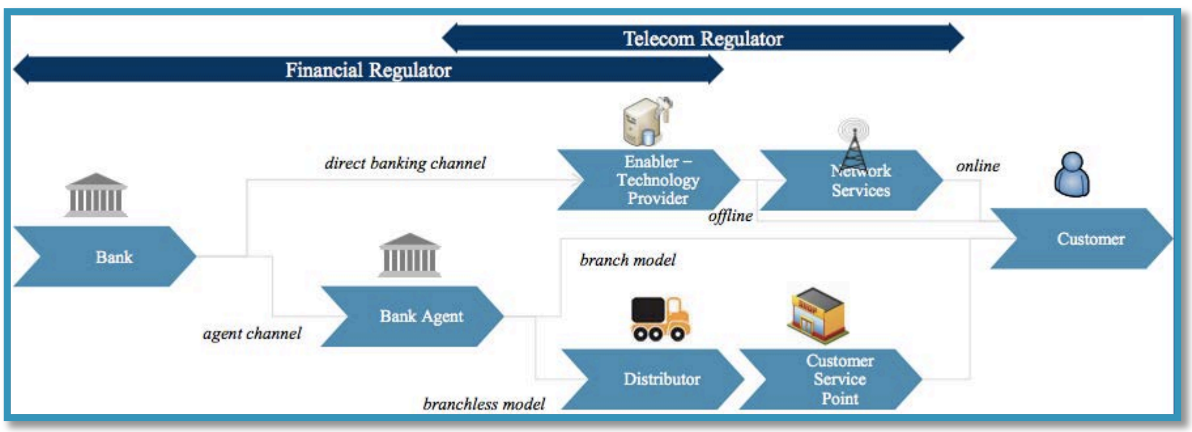

Figure 1: Branchless Model
Source: Kumar Kabir, CGAP Business Models 2009

RESERVE BANK OF INDIA

India's central banking institution, responsible for the monetary policy of the country. State, regulators, and central banks have a vital role to play in financial inclusion. They are the primary actors who need to create an environment that encourages and enables the viability of a market led approach while staying objective towards the financial inclusion mandate.

Figure 2 demonstrates the major stakeholders in last mile delivery. Sub-K would be represented as a Business Correspondent Network Manager that trains and facilitates Business Correspondent Sub Agents. It is important to note that the financial inclusion model goes beyond simple withdrawal and deposit transactions with a bank as shown below in Figure 3.

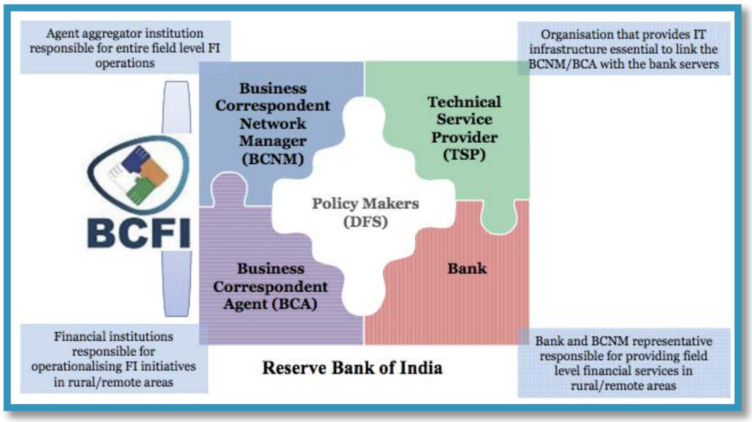

Figure 2: Major Stakeholder
Source: MicroSave, 2012

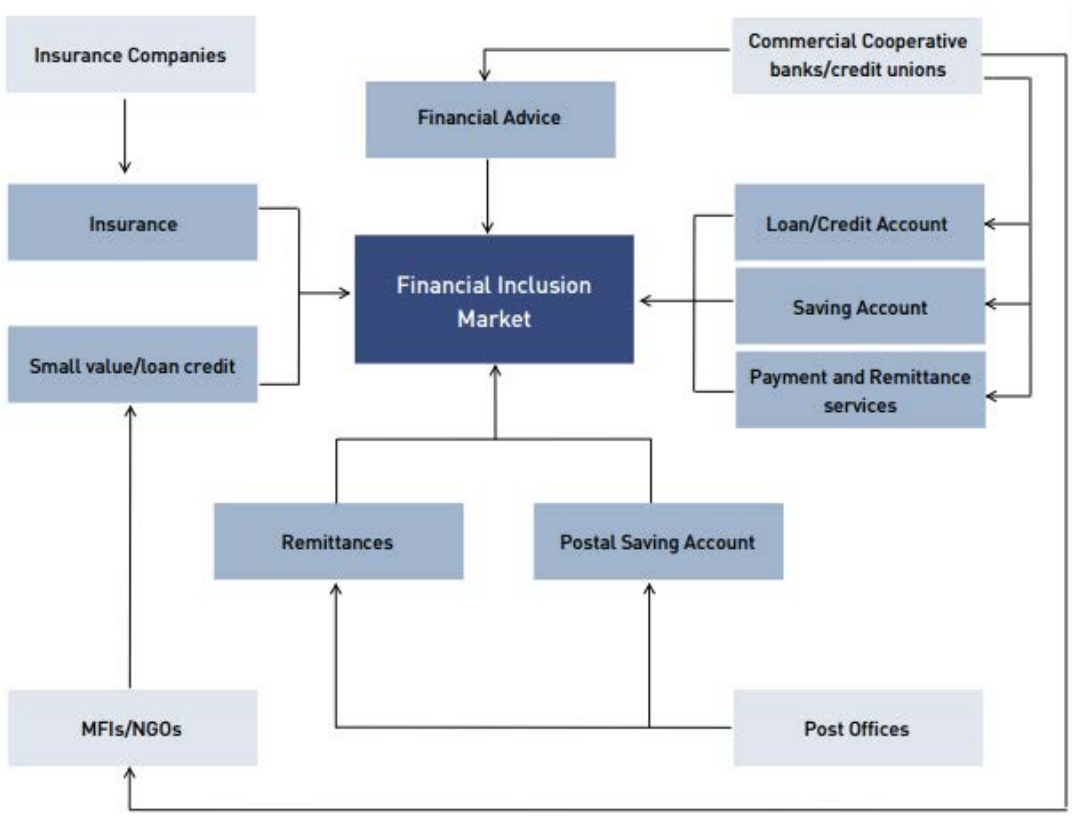

Figure 3: Institutional Structure and Financial Products
Source: RBI Report on Currency and Finance, 2008

CHAPTER 1

INDIA'S UNIVERSAL BANK ACCOUNT PRADHAN MANTRI JAN DHAN YOJANA

"THE PRADHAN MANTRI JAN-DHAN YOJANA PROVIDES A PLATFORM FOR CHANGING THE ECONOMIC CONDITION OF OUR PEOPLE." - PRIME MINISTER MODI[7]

BACKGROUND

The Pradhan Mantri Jan Dhan Yojana (PMJDY) account scheme was launched in August 2014 and currently holds the title as the largest financial scheme in India. These accounts are accessible through the BC model and provide vehicles for receiving private and public payments, saving small amounts, sending remittances, and acts as a gateway to accessing other financial products, such as loans. As of March 15th, 2017, 280,200,000 PMJDY accounts have been opened. Out of the thirty-six Indian states only nine do not report 100% household coverage. The lowest level of household coverage is 99.71%.[8] This policy is considered a great success by the government, however, there remain critiques who focus on the reporting of opening accounts, the levels of use, and the implementation of this policy in rural communities.

The goal of the scheme, like many before it, is to provide "unbankable" Indians with access to the formal financial sector through bank accounts with significantly lowered barriers to entry. One such barrier addressed by the PMJDY account scheme is the stringent requirements of Know Your Customer Forms (KYCs), which involve a level of documentation that is difficult or impossible for many "unbankable" customers to meet due to their propensity to lack of the appropriate kind or amount of formal identification.

The scheme is implemented due to RBI policies that mandates all public sector banks and the majority of participating public sector banks to open a certain number of accounts per month. This pressure to open accounts was one of the first big pushes for banks to become involved with BCs and BCNMs. The benefits of this pressure have been an increasing number of bank accounts in India, an increased awareness about saving in banks, and banks viewing groups of people previously thought of as bankable as customers. There have been some draw backs, however, concerning the reliance of BCs on the compliance of a bank. We spoke to four BCs from a specific private bank that refused to provide signup forms for any more customers after they had reached their monthly quota. It is important to understand that even though BCs are a primary nexus of delivery of financial services in India those services are still provided by banks and consumers are very much customers reliant on those banks.

[7] The Times of India (2015). Next phase of Jan-Dhan to offer a range of insurance, pension services. http://timesofindia.indiatimes.com/india/Next-phase-of-Jan-Dhan-to-offer-a-range-of-insurance-pension-services/articleshow/46007131.cms

[8] PMJDY (2017). Progress Report. https://pmjdy.gov.in/account

The emphasis placed on opening accounts is part of the reason for two of the biggest criticisms against the PMJDY account scheme in the media and the literature all surrounding this one question: Does a large number of accounts translate to a large number of people using accounts? One element of this question is usage of accounts. How many accounts are zero-balance accounts? As of December 2016, almost 25% of all accounts have zero balances.[9] This number has been decreasing over time but is coupled with a concern over low balance accounts with one to ten rupees in them, which are being funded out of the pockets of bank staffers.[10] The most recent concern to emerge out of doubting the amazing story of the PMJDY accounts numbers is the question of people having multiple accounts. The last estimate places 33% of PMJDY account holders as having another account; this has increased dramatically from the 14% when the scheme was first evaluated four months after it began.[11] Is the emphasis placed on opening accounts and then the later emphasis on not having a high number of zero-balance accounts incentivizing banks to significantly bolster their numbers?

The Data Debate Continued

The most contentious element of the PMJDY scheme is its level of success. As you can see the numbers paint a very compelling story. Too compelling for many stakeholders in India to believe these numbers are accurate.

Every single stakeholder we spoke to in India had an opinion on the validity of the government's numbers. Can claims of household penetration in the high ninetieth percentiles really be accurate? Is there any money in the accounts? Is the level of money significant? Do the people whose names are on the accounts know they have them? Do people have multiple accounts?

In 2005 the Basic Savings Bank Deposit Account (BSBDA) was introduced and had 240 million accounts opened in March 2014. How are these accounts counted?

An 100% bank account penetration rate is based on the census numbers of households in that district. What are the ramifications for migrants, equal access of women and men to accounts, and undocumented workers?

Through our stakeholder engagement, the criticisms of the accuracy provided through the official data on the number of PMJDY accounts were rampant, as was comments about dormant accounts, but what we did not hear an awareness of how the BCs were going about opening these no-frills accounts. The policy brief responds to an observation in our data and from speaking to BCs and their mangers in the field.

PROBLEM STATEMENT

In practice, signing up for a PMJDY account necessitates having a pre-existing Aadhaar account, which is something BCs are not set up to open for customers. The absence of this ability creates a barrier to entry that the purpose of the scheme is to correct.

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9 Mission FI, Department of Financial Services, Government of India, "Zero Trend," *PMJDY*, accessed March 31, 2017, https://pmjdy.gov.in/trend-zero.

10 Jay Mazoomdaar and Shyamlal Yadav, "The One-Rupee Trick: How Banks Cut Their Zero-Balance Jan Dhan Accounts," *The Indian Express*, September 13, 2016, http://indianexpress.com/article/business/banking-and-finance/how-banks-cut-their-zero-balance-jan-dhan-accounts-one-rupee-trick-3028190/.

11 Ibid., 29.

ANALYSIS

The PMJDY website clearly states that if a customer does not have an Aadhaar card then other forms of identification are acceptable. Those forms include: Voter ID Card, Driving License, PAN Card, Passport, NREGA Card, and under special circumstances an identity card with the applicant's photo or a letter issued by a gazette officer with an attached photo.

The interviews included asking BCs what forms of identification they have accept when opening bank accounts for new customers? The response was staggering because it became apparent that BCs did not understand the question due to their assumption that an Aadhaar card was necessary to open a PMJDY account. Only one of the BCs we spoke to did not declare having used Aadhaar cards to open accounts for their customers. When asked why this was the case the answer frequently was: either this is what the banks asked for or this is just how it is?

It is unclear if banks are telling BCs this directly or BCs are implementing this policy due to the ease of opening an account when the client already has an Aadhaar card. The behaviour of the banks, as mentioned earlier, has a significant impact on the BC landscape because without support from bank managers the BC model does not function. One of the questions we asked BCs was about how they are treated by the manager of the bank when they deposit customer funds. All the BCs we asked this question to responded that the relationship was either normal or good.[12]

As of November 2015, 63-62% of PMJDY accounts were linked with Aadhaar accounts.[13] This number had been increasing steadily since the implementation of the PMJDY scheme, as. four months after it began only 36% of accounts were linked.[14] Clearly, Aadhaar accounts are becoming a more and more central part of the PMJDY scheme's implementation. This is not how the scheme was designed, and in 2013 the Supreme Court of India issued an interim order stating that no person could be denied service because of lacking an Aadhaar card.[15] Despite this policy reality, BCs and banks are implementing the PMJDY identification rules differently in practice. This is supported by MicroSave's 2016 report, which states that 37% of the reasons banks reject a PMJDY application form is because of an issue with the identification provided by the consumer; either the bank rejected a type of identification or only took Aadhaar cards.[16]

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[12] Talia Ahmad, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. (2017). "Business Correspondent Survey." University of British Columbia.

[13] BCFI (2016). Assessment of Bank Mitrs (BMs) Under Pradhan Mantri Jan Dhan Yojana (PMJDY) — Wave III. http://bcfi.org.in/wp-content/uploads/2017/02/Assessment-Report-on-Business-Correspondent-Bank-Mitra-under-Pradhan-Mantri-Jan-Dhan-Yojana-Wave-III-Microsave-1-1-16.pdf

[14] MicroSave, "Assessment of Bank Mitrs (BMs) Under Pradhan Mantri Jan Dhan Yojana (PMJDY) - Wave III" (New Delhi, India: MicroSave, January 2016), http://bcfi.org.in/wp-content/uploads/2017/02/Assessment-Report-on-Business-Correspondent-Bank-Mitra-under-Pradhan-Mantri-Jan-Dhan-Yojana-Wave-III-Microsave-1-1-16.pdf.

[15]The Hindu (2013). Don't tie up benefits to Aadhaar, court tells Centre. http://www.thehindu.com/todays-paper/tp-national/dont-tie-up-benefits-to-aadhaar-court-tells-centre/article5162837.ece

[16] Manoj Sharma, Anurodh Giri, and Sakshi Chadha, "Pradhan Mantri Jan Dhan Yojana (PMJDY) Wave III Assessment" (Mumbai, India: MicroSave: Market-led solutiosn for financial services, January 2016), 27, http://www.microsave.net/files/pdf/PMJDY_Wave_III_Assessment_MicroSave.pdf.

Given the necessity of Aadhaar cards for the PMJDY scheme, the question then follows: should BCs be responsible for creating Aadhaar cards? How does one set up an Aadhaar account?[17]

How to Set-up an Aadhaar Account

1. Find an Enrolment Center and book an appointment
2. Meet with an agent registered with UIDAI who has access to the internet, a Windows computer, an iris scanner, a digital camera, a printer and a finger slap device
3. Provide the following: proof of address, a phone number, an email, a maximum of four pieces of identification from an extensive list of types of documents or provide proof of relationship to an Introducer or Head of Family who has an existing Aadhaar account.
4. Submit biometric data from your iris and your fingerprints.
5. A current photo will be taken and attached to the application.
6. An enrollment receipt will be produced so you can check the status of your application online
7. It can take a number of months for the card to be physically sent to you or you can download and print the card once it is processed.

There are a number of technical barriers laid out in this process that BCs cannot overcome with their current limitations for accessing digital technology. Only 20% of the BCs we interviewed used a smart phone and 21% had no phone at all.[18] Of those BCs 14% were illiterate or had no education at all. [19] Given that 42% of the BCs we interviewed did not even have smart phones, expecting them to be the primary vehicles for a service that requires operating a Windows computer system is a serious policy gap.

The geographic placement of a consumer can be a large barrier for providing access to financial inclusion. Recent RBI data indicates that although 40% of the unbanked population of India resides in urban settings 61% resides in rural settings. [20] All of those illiterate BCs interviewed in December were found in rural settings.[21] The BC model capitalizes on existing community structures and bypasses the need for brick and mortar banks through its implementation. Without the last mile delivery provided by BCs obtaining an Aadhaar account involves the same barriers that have typically faced those currently not involved in formal financial structures.

Setting up an Aadhaar account for a customer cannot be achieved by a standard BC operating out of their grocery store. They need to have a Common Service Point (CSP) to even consider providing this service. We did interview one BC who was in a unique situation but did have the facilities to run an enrollment center. He was running his NGO ASSEEM as a BC with multiple staff who work to sign up customers for bank accounts and ensure that those accounts remain active. His office had multiple computers, cameras, and scanners all used to create bank accounts for

[17] Bank Bazaar (2017). How to Apply for Aadhar Card. https://www.bankbazaar.com/aadhar-card/aadhar-card-application-process.html

[18] Talia Ahmad, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. (2017). "Customer of Business Correspondent Survey." University of British Columbia.

[19] Talia Ahmad, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. (2017). "Business Correspondent Survey." University of British Columbia.

[20] Bank of India (n.d.). "Financial Inclusion" Priority Sector Credit & Rural Development Department. Mumbai, India. http://www.bankofindia.co.in/FI-BOI/images/FI%20presentation.pdf

[21] Talia Ahmad, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. (2017). "Business Correspondent Survey." University of British Columbia.

customers and perform other tasks related to the NGOs goals. His was the only BC set up we encountered that can provide the services of an enrollment center and his is clearly an anomaly.

RECOMMENDATIONS

1. In the creation of a BCFI/RBI Pan-Indian Code of Conduct for BCs it should clearly state that the opening a PMJDY account without an Aadhaar account is permissible.

2. To ensure access to Aadhaar accounts to rural Indians CSPs should be positioned at central points and run by BCs will be trained to set up Aadhaar accounts.

3. Work with the Unique Identification Authority in India (UIDAI) to address the gaps in their own service delivery through these CSPs.

CHAPTER 2
NICHE BANKS

"INDIA IS OVER BANKED BUT UNDER SERVED." - VISHWAVIR AHUJA, CEO AND MANAGING DIRECTOR OF RELIANCE BANK LIMITED

BACKGROUND

In 1996 India issued its first private niche banking licenses. The objective of the 'Local Area Bank' (LAB) was to mobilize rural spending and make them available for investment in local areas. This was intended to reduce the credit gap in rural areas, and generally increase financial inclusion in underserved regions of India. Moreover, the Local Area Banks proposal was to focus on the participation of the private sector to address issues that had been largely addressed by the State for almost a century. As of 2014, only four LABs remained functioning, and three of them have applied for new small finance bank licenses[22].

In July of 2014, the guidelines were released for the licensing of two new kinds of niche banking, Payments Banks and Small Finance Banks. For the first time in the history of India's banking sector, RBI is allocating differentiated licenses for specific activities.

> "RBI will create a framework for licensing small banks and other differentiated banks. Differentiated banks serving niche interests, local area banks, payment banks etc. are contemplated to meet credit and remittance needs of small businesses, unorganized sector, low income households, farmers and migrant work force". – Alpana Killawala, Principal Chief General Manager, RBI. [23]

Payments Banks are vertically differentiated banks – specializing in one or more of the building blocks of payments, deposits and credit.[24]These have been created to address the stated need for India's financial system to provide access to bank payment services for small businesses and low-income households. These banks will provide access to payment services such as remittances, utility bills and school fees. They also have the ability to sell third-party financial services such as insurance policies and mutual funds. Additionally, they can issue ATM cards and foreign exchange services at potentially cheaper rates than banks. Importantly, these banks cannot offer loans or credit cards but can raise deposits of up to Rs.1 lakh, and pay interest on these balances just like

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[22] RBI. (2015). Releases Names of Applicants of Small Finance Banks and Payments Banks https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=33164

[23] RBI . (2015).Releases Guidelines for Licensing of Payments Banks in the Private Sector. https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32615

[24] ADB, 2016.

a savings bank account does. Additional details, including the requirements for application and service provisions can be found in Table 1.

Small Finance Banks are horizontally differentiated banks, in which the basic design remains similar to that of a full service bank, combining the three building blocks. Instead, it is differentiated primarily on size, geography or sector. Their main purpose will be to provide credit to underserved population. These banks build on decades of small bank experiences in India. Like LABs, the small finance banks are private banks, continuing the expansion of private players in a more decentralized banking system. However, unlike LABs the small finance banks will be scheduled banks in India[25], allowing them to access formal capital markets. This addresses a massive problem for LABs, who were forced to raise capital strictly through deposits.

Both of these banks have the potential to become productive actors in the journey for financial inclusion in India. However, there are many challenges that will need to be surmounted if they are to become sustainable models for providing financial services in India’s previously unbanked populations.

PROBLEM STATEMENT

The addition of more niche banks in India, in their current form may simply add more players to the game while continuing to under serve the bottom 20% of India’s population.

ANALYSIS

The first challenge these banks will face is directly related to the population they are intending to serve. When dealing with the underserved portions of society, literacy will be an issue; especially relevant to these banks will be digital and financial literacy. Furthermore, the RBI has mandated that at least one quarter of access points for Payments Banks and branches for Small Finance Banks need to be in rural or previously unbanked areas[26], where digital and financial literacy rates are even lower. Reducing the sentiment that banks are "Good for educated people they give speedy service; for us they are slow and don't respond"[27] will be critical for the success of these new banks in reaching the the truly underserved population of society.

Micro Finance Institutions (MFIs) have dominated the Small Finance bank application process – 8 out of 10 the SFB licenses have been granted to MFIs[28]. The biggest advantage for these MFI’s is the new access to deposits. In fact, current interest rates being offered by SFBs are higher than that of the traditional institutional banks in an attempt to attract these deposits (in some cases 2 percent higher than SBI)[29]. It remains to be seen if they can maintain these rates. In

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[25] RBI . (2015).Releases Guidelines for Licensing of Small Finance Banks in the Private Sector. https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32614
[26] Ibid.
[27] Ahmad, Talia, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. (2017). “Customer of Business Correspondent Survey.” University of British Columbia,
[28] Barua, Abheek, Kathuria, Rajat and Malik, Neha. (2016). “The Status of Financial Inclusion, Regulation, and Education in India.” Asian Development Bank Institute. https://www.adb.org/sites/default/files/publication/183034/adbi-wp568.pdf
[29] Bloomberg. (2017). “Small Finance Banks: Differentiated Banking of Just Small Large Banks?” https://www.bloombergquint.com/business/2017/02/07/small-finance-banks-differentiated-banking-or-just-small-large-banks

addition to attracting deposits, these MFIs will also be able to add other more traditional financial services to their offerings.

Competing with the traditional banks for the provision of these services will be difficult. It requires a lot of brand trust, which the big banks have through well-established brands. As Alok Prasad of Micro Finance Insititutions Networks has expressed, "building a retail deposit portfolio is a big challenge where existing public and private sectors banks have an advantage because of their strong brands."[30]

In addition to trust problem, the lack of banking experience also creates a human resource challenge. Traditional MFI employees have the know how to loan money and collect it. They do not necessarily have the knowledge to operate more traditional banking services, which will be especially difficult as many are operating in previously unbanked areas. This may result in the need to appoint bankers for deposit mobilization and to help provide new financial services. In order to attract the bankers needed for deposit mobilization it may be required to offer higher wages than MFI employees have been receiving. This has the potential to "create resentment amongst existing MFI employees that have been with the organizations for years". [31]

Full financial inclusion fundamentally requires access to credit. Small Finance Banks will also be able to offer this and will be under loan portfolio requirements to ensure they are reaching target populations. These regulations will provide a third challenge for Small Finance Banks. These requirements include extending 75 percent of its adjusted net bank credit to sectors eligible for priority sector lending. Additionally, at least 50 percent of their loan portfolio should constitute loans and advance of up to Rs.25 lakh[32] ensuring a focus on small loans. In developing countries around the world, including India, small banks have suffered from solvency issues.[33] Their localization exposes them to risks of capture, and especially to the localized risk associated with farming based loans such as weather vagaries and commodity price volatility. These localized limits also have the potential to limit their ability to finance big projects. [34] While these small finance banks should be well equipped to manage this risk, given their access to capital markets and experience in lending, they may need some support to ensure they can loan to the populations they are intended to serve. Coordination between banks and government organizations, both vertically and horizontally has the potential to mitigate these risks. Some of these options will be explored in the recommendations.

[30] Adhikari, Anand. (2015). "Small is fanciful" Business Today India http://www.businesstoday.in/magazine/money/small-finance-bank-licences-rush-lenders-face-challenges/story/218898.html
[31] Bandyopadhyay, Tamal (2017). "Big challenges before small finance banks" Live Mint. http://www.livemint.com/Opinion/15VqxfZbstYuERy8yp19WN/Big-challenges-before-small-finance-banks.html
[32] RBI . (2015).Releases Guidelines for Licensing of Small Finance Banks in the Private Sector. https://rbi.org.in/scripts/BS_PressReleaseDisplay.aspx?prid=32614
[33] Barua Abheek, Kathuria, Rajat and Malik, Neha. (2016). "The Status of Financial Inclusion, Regulation, and Education in India." Asian Development Bank Institute. https://www.adb.org/sites/default/files/publication/183034/adbi-wp568.pdf
[34] Ibid.

RECOMMENDATIONS

To address these challenges this brief will propose three, challenge specific, recommendations. While there is a significant digital aspect to these new banks, especially the Payments Banks, these recommendations will focus on the challenges stated above, leaving the digital aspects for chapter 3. This has resulted in this chapter also focusing slightly more on the Small Finance Bank model.

SERVICE STARTS WITH UNDERSTANDING: UTILIZE NEW BANKS TO FACILITATE IMPROVEMENTS IN FINANCIAL LITERACY

PMJDY has increased peoples' knowledge about savings, but there remains a gap in knowledge about investment. Only half of rural consumers feel adequately informed and of those that do feel informed 84% received their information through trusted community members, family or friends.[35] Our consumer survey showed a near unanimous understanding of the benefits of putting money in the bank but when it came to investment most preferred local risk sharing methods such as chit funds. A gap in understanding or awareness around insurance was also identified.[36] Where consumers did have some access

Payment banks will be allowed to offer third party investment services like mutual funds or insurance policies. This could be the perfect opportunity for payments banks to take on some responsibility for educating on the benefits of additional financial services. Small Finance Banks can offer traditional financial literacy services such as explaining the advantages and disadvantages of different financial services or simple interest rate calculation, which our survey found only 6 percent were able to calculate. SFBs can build on the experiences of Ujiiven who runs financial literacy courses, live demonstrations and various programs to get more people into the financial services system.[37]

Financial literacy initiatives should be encouraged or even mandated for future license applications. It is in the best interest of the bank and the RBI to have a population that is aware of and able to use different services. This could be done through mandating the 2% CSR requirements to be invested into financial literacy initiatives or mandated as part of the licensing application. Without a push for this it is unlikely these banks will be reaching the previously unbanked populations they were indeed intended to.

UTILIZE LOCAL TRUST: SEEK LOCAL CHAMPIONS OR PARTNER WITH LOCAL BUSINESS CORRESPONDENT NETWORK MANAGERS (BCNMS)

Our survey showed that Business Correspondents are trusted members of the community and have a dedication to customer service, "Clients' needs to come first, I am proud to be called a BC."[38] Given the importance of local, community based information sharing, local actors are

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[35] Ahmad, T., Bulmer, C., et al. (2017)
[36] Ibid.
[37] Andreayson, Tanya. (2016). "Ujjivan converts into small finance bank; picks FSS for "payments in a box." Baking Technology. http://www.bankingtech.com/615202/ujjivan-converts-into-small-finance-bank-picks-fss-for-payments-in-a-box/
[38] Ahmad, Talia, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. "Business Correspondent Survey." University of British Columbia, December 2016.

critical in the current provision of financial services. In order to compete with the trusted brands of the established banks, new players will need to partner with local leaders. For SFBs this will help mitigate not only the brand and trust problems but especially the human resource problem. BCs have the experience in deposit mobilization that many of these new SFBs are lacking. This will be a much more cost friendly way of filling the banking experience gap, and should mitigate the risk of resentment amongst MFI employees who have been there for years. Partnership potential for Payments Banks will be discussed specifically in chapter 3.

FACILITATE INCLUSIVE SERVICE: MITIGATING LOCAL RISK PORTFOLIOS TO SERVE THE BOTTOM 20%

As discussed in the analysis, the localized nature of many SFB has the potential to pose solvency risk. Establishing a credible coordination between SFBs may be able to reduce the risk on their portfolios. Without some ability to diversify risk portfolio's it is possible the SFBs will avoid risky or new types lending and may result in the goal of serving the unorganized sector, low income households, farmers and migrant work force to go unrealized.

This could take the form of horizontal coordination by establishing mechanisms for different banks to group risk portfolios to mitigate localized risk. It could also take the form of vertical integration by, for example, affording these small finance banks the same access to Micro Units Development and Refinance Agency. These banks are under pressure to meet portfolio requirements; they should also be provided the support to ensure they can serve the bottom riskier 20% consumers as well.

Our survey identified the lack of customized loans as the biggest problem for the rural farmer that the SFB intends to serve as one its target populations.[39]. Small finance banks have the benefit of acting as last mile service delivery and utilize a technological focus[40]. Because of their close contact with the consumer and the potential for massive data collection and customization, the SFB has the potential to offer special customized loans. Delivery to the target population can be further facilitated by making regulatory space for customized loans and encouraging SFBs to use their comparative advantage to lead on innovative loan design, disbursement and collection methods.

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[39] Ahmad, Talia, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. "Customer of Business Correspondent Survey." University of British Columbia, February 2017..

[40] Singh, Harmohit. (2016). "Small Banks, Big Opportunities." Transorg
http://transorg.com/assets/sitesfile/whitepaperpdf/pdf/aboutusmanagement_791664877.pdf

CHAPTER 3

DIGITAL FINANCIAL INCLUSION
EMPOWERING LAST MILE DIGITAL PAYMENT CHANNELS

"CAPACITY BUILDING IS CRITICAL FOR THE SUCCESS OF THE DIGITAL INDIA PROGRAM. AS OF MID-2016, DIGITAL LITERACY IN INDIA IS LESS THAN 10%." – HERMANT JOSHI[41]

BACKGROUND

Using mobile technology to provide banking services to India's unbanked population has been a key policy initiative of the Government of India's Digital India campaign. While formal financial services are not widely accessible for the bottom of India's population pyramid, extensive nationwide cellular subscriptions indicate the effectiveness of linking mobile numbers to bank accounts as an alternative banking model. The routing of Direct Benefit Transfers (DBT) digitally further directs consumers towards digital banking. Meanwhile the recent "demonetization" episode has also encouraged people to transfer their cash into bank accounts.

Digital banking is a successful alternative to conventional banking and business correspondents serve as central actors to facilitate last digital financial service delivery. As India further advances towards a cashless economy BCs will continue to play a defining role in last mile delivery. Yet visible challenges such as overall limited connectivity and continuous server disruptions, along with inadequate digital literacy among consumers can limit the success of digital banking in advancing financial inclusion in India. The emergence of payment banks offers a unique opportunity to increase the scale of BC operations by increasing integration at the last mile.

PROBLEM STATEMENT

Lack of digital literacy, poor connectivity and restricted technology access for low income and rural consumers creates barriers for inclusive adoption of digital banking in the short to medium term.

ANALYSIS

The current policy framework enables for a broad variety of service providers, from banks to telecommunication companies, to utilize digital technology to drive financial inclusion in India. Digitizing financial services reduces operational costs for service providers and increases access to financial services for marginalized consumers, especially in previously underserved areas. Since 616 million phone subscriptions are actively used in India (June 2016), public schemes, such as PMJDY, increasingly encourage account holders to transfer funds and check balances digitally.[42]

Digital India has also enhanced the digitization of public services to increase outreach and reduce

[41]Deloitte. (2016) Digital India: Unlocking the Trillion Dollar Opportunity. Where is the link?

[42] CGAP. (2017). India's Push For Financial Inclusion.. http://www.cgap.org/sites/default/files/Brief-Indias-Push-for-Financial-Inclusion-Feb2017.pdf

inefficiencies in service delivery. Accepting payments through a digital channel connects the end user to a digital platform and provides a better transaction record. The number of digital transactions has doubled from 3.5 billion in 2014 to almost 7 billion in 2015, indicating the fast pace with which digital banking has taken off in the country.[43]

Prime Minister Narendra Modi's decision on November 8, 2016 to remove 500 INR and 1000 INR notes from circulation, in an event dubbed as "demonetization," forced rural and urban consumers to shift their cash savings into a bank account. The credibility of emerging recent figures may be questioned as they indicate deposits in PMJDY accounts surged to over $11 billion.[44] Regardless, "demonetization" has undoubtedly signaled the Indian government's commitment to reduce the economy's reliance on cash.

LIMITED CAPACITY OF RURAL HOUSEHOLDS TO INDEPENDENTLY CARRY OUT DIGITAL TRANSACTIONS MAKES BCS VITAL FOR LAST MILE SERVICE DELIVERY.

There is a visible need to expand and strengthen the BC network in rural areas to ensure rural Indians are able to access and avail digital services. Through our survey, conducted in early 2017, we found that 75 percent of rural consumers receive some form of payments, such as government subsidies or personal remittances, through a digital channel. Despite of the high volume of digital transactions coming to rural areas, 91 percent of rural consumers indicated they do not independently carry out digital financial transactions.[45]

A certain degree of technical proficiency is required to carry out digital banking, whereas of mid-2016 digital literacy in India was less than 10 percent.[46] As rural India gradually becomes more acquainted with digital technology a larger number of the Indians will be able to independently transact through digital banking. However in the near future, to service the growing digital needs of consumers a continued dependence on BCs will persist, especially in the rural areas.

The growth of BCs as efficient service providers is dependent on mitigating current challenges in service delivery. Further training and continued monitoring is essential to ensure compliance standards are met. In this regard, BC network managers (BCNM), such as Sub-K, will simultaneously serve as important players in the continuous growth of the BCs.

THERE IS A PREVALENCE OF FEATURE PHONE TECHNOLOGY IN RURAL AREAS LIMITING DIGITAL PRODUCT OFFERINGS FOR RURAL CONSUMERS.

The National Economic Survey 2016/2017 indicates that mobile subscription is widespread in the country making digital banking as an attractive tool for the government to realize financial inclusion in the country.[47] Even though mobile subscription is high among rural consumers, the majority of rural consumers own a feature phone (standard mobile phone without the applications of a smart phone). Our survey also reflects this reality as only 15 percent of the rural consumers

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[43] Deloitte. (2016) Digital India: Unlocking the Trillion Dollar Opportunity. Where is the link?
[44] "CGAP, 2017
[45] Ahmad, Talia, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and BASIX India LLRT. (2017). "Customer of Business Correspondent Survey." University of British Columbia,
[46] Deloitte. 2016
[47] Rasmussen, Stephen et al. (2017). Will Basic Income Replace Safety Net Payments. . http://www.cgap.org/blog/will-universal-basic-income-replace-safety-net-payments-india

reported owning a smart phone. [48]

Feature phones offer reduced operability of digital applications which discourages widespread adoption. While current initiatives strive to leverage financial technology (Fintech) to develop digital products to facilitate financial inclusion, the scope of innovation is limited due to low digital literacy and sparse smart phone penetration. Moreover the majority of rural India relies on a middle channel, the BCs, to carry out digital transaction; it is unclear how readily newer technologies can be spread to this market.

This indicates a digital gap in which rural consumers are not fully equipped to participate in digital financial transactions and require additional support. Product development and distribution must cater to this reality otherwise digital banking risks remaining an urban phenomenon and will not achieve widespread adoption in the rural areas. Since communities across India are digitizing at vastly different rates, this disconnect needs to be addressed.

LACK OF ADEQUATE CONNECTIVITY AND SERVER DISRUPTIONS LIMIT THE SCOPE OF MOBILE TECHNOLOGY TO REACH THE REMOTE AREAS.

The attractiveness of a service lies in its accessibility and operability to facilitate quick transactions. However digital transactions are continuously interrupted due to connectivity issues as servers face constant disruptions. Rural connectivity remains an issue as currently 55,000 villages have no mobile connectivity.[49] Sparsely populated regions with limited mobile usage render the cost of providing mobile connectivity higher than the anticipated profits. Limited connectivity creates significant barriers for effective participation in digital banking in the peripheral regions and reduces the generation of new markets within the country.

In addition to limited mobile connectivity in the peripheral regions, the existence of multiple interlinked servers to process transactions between financial institutions causes continuous server disruptions. During the field research in India in December 2016 only 2 out of 23 attempted transactions at a BC agent location were able to be processed. Though this was a unique time as "demonetization" put considerable pressure on non-cash payment and savings channels, the lack of continuity indicates the current infrastructure is unable to handle large volumes. Meanwhile as more and more consumers being to take up digital banking, in rural and urban areas, the infrastructure will need to support such large volumes. Constant server disruptions undermine the purpose of digital banking servers and reduce customer retention. Consumers who conventionally transact and save in cash are gradually being routed towards digital and formal banking practices and it is vital to build and maintain consumer confidence during this transitional phase. While insufficient connectivity is a nationwide occurrence, these service gaps and constant disruptions in digital transactions from intermediaries can greatly undermine efforts to bring financial services to already underserved areas.

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[48] Ahmad, T., Bulmer, C. et al, 2017
[49] Deloitte, 2016

PAYMENT BANKS CAN SOLVE LIQUIDITY AND CONNECTIVITY ISSUES AND OFFER AN OPPORTUNITY FOR COLLABORATION WITH BCNMS TO ACCELERATE AND ENSURE LAST MILE DELIVERY.

Payment Bank licenses have been certified and 2017 will see the emergence of payment banks which will further increase the scope of digital banking. These banks will also boost rural access to financial services as they are mandated to situate part of the branches in rural areas.[50] Bharti-Airtel has launched a pilot program in Rajasthan and plans to open 100, 000 locations by the end of the 2017.[51] As payment banks are headed by large institutional players they have the capacity to play a prominent role in digitally enhancing financial inclusion in India.

RECOMMENDATIONS

AS MORE PAYMENTS, ESPECIALLY GOVERNMENT TRANSFERS, ARE ROUTED DIGITALLY, BCS WILL CONTINUE TO PLAY AN IMPORTANT ROLE IN FACILITATING THE TRANSITION TO A CASHLESS ECONOMY.

In order to meet the needs of the vast population, a robust and larger network of BCs is needed to service the needs of consumers who are unable to carry out digital transactions independently. Between December 2014 and December 2015 the number of BCs actively providing services increased from 48 percent to 79 percent.[52] Consistent government led efforts to digitize payments will increase the agent uptake. It may be too soon to determine if "demonetization" will continue to encourage urban and rural consumers to shift from cash to digital in the long run but in near future the Indian population has been routed to the digital platform. The scale of the digital model required for India to achieve financial inclusion creates greater risks for management of such an expansive network of BCs at the last mile.

As digital banking becomes a leading feature of India's financial sector it is important to ensure that the agents at the front line are well equipped and trained to handle such a large volume of transactions. Policy directives that create uniformity in conduct and service delivery among BCs can provide coherence and quality in monitoring. Public support for BCNMs can increase the capacity of these institutions to empower the BCs to efficiently and effectively deliver services at the last mile on a large scale.

DIGITAL LITERACY CAN BE FURTHER ACCELERATED THROUGH THE USE OF BCS AS PRIMARY SOURCE OF INFORMATION AND TRAINING FOR RURAL CONSUMERS.

As members of the same communities where they serve, BCs have significant personal networks and are a valuable resource for outreach at the last mile. BCNMs can build the capacity of BCs to provide community education of digital literacy and their positioning reduces the cost of installing additional resources to carry out such a campaign. Stronger outreach can lead towards greater adoption of newer digital products as they enter the market and increase the BCs.

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[50] Economic Times..(2016). How to make the most of payments bank. L://economictimes.indiatimes.com/wealth/persoper-finance-news/how-to-make-the-most-of-payments-banks/articleshow/55704502.cms

[51] Taneja, Mansi. (2017). "Bharti-Aitrtel rolls out India's first payment bank." . https://www.vccircle.com/bharti-airtel-rolls-out-indias-first-payments-bank/

[52] CGAP, 2017

Public investments can be strategically routed to Fintech for greater product development of cost effective smart phone technology for the rural and low-income consumer market. Even though Fintech companies are continuously developing products to operate offline and through feature phones, the growth of these projects is challenged by low tech adoption in rural areas. [53] Increasing collaboration between BCNMs and Fintech through public funding can be a viable option to increase uptake of new technology.

WITHOUT ADEQUATE ATTENTION TO THE NEEDS OF THE RURAL CONSUMERS UPCOMING DIGITAL PRODUCTS CAN POTENTIALLY BECOME DOMINATED BY THE URBAN CONSUMERS.

Contemporary digital innovations cater to the sensibilities of the urban, educated consumer and remain vastly inaccessible for the rural consumer. The operability of the products is crucial as rural consumers require a middle channel to use digital financial products. In addition to outreach, partnerships between BCNMs, who specialize in last mile delivery, and Fintech companies can ensure that product development is relevant to both urban and rural consumers.

POOR NETWORK CONNECTIVITY WILL LIMIT THE REACH OF DIGITAL PAYMENT CHANNELS AND CONSTRAIN RURAL UPTAKE.

Constant technical hurdles due to poor connectively and server disruptions can potentially halt the growth of digital banking in the rural areas. As high cost and low profit margins may deter private companies to increase network coverage in rural areas, the government can step in to ensure service to the periphery. Increasing network coverage can further encourage mobile ownership in these remote locations. Secondly the capacity of the digital banking infrastructure needs siginicant development to ensure smooth transactions and build customer confidence. Also as the digital market continues to grow it is vital to ensure the system is able to handle extremely large loads, especially during peak times.

Poor connectivity not only delays payments but also impedes information sharing. Rural customers require a more sound and consistent channel to receive information of payments and promotional offers.[54] This puts extra pressure on last mile delivery agent as they are the primary contact point for rural consumers.

NEED FOR INTEGRATION OF THE LARGER PAYMENT BANKS WITH THE LAST MILE DELIVERY AGENTS SUCH AS BCNMS.

New policy developments, such as payment banks, provide an opportunity to further enhance the effectiveness and growth of the BC model through possible integration and or collaboration with the larger institutional players. The larger players can improve connectivity and potentially increase the products offered, as they can bring in more liquidity.

Payment banks are mandated to operate in rural areas and they will rely on their current agent networks to deliver services. Yet in order to effectively penetrate remote areas, experts in last mile delivery can ensure better outreach. Integrating BCs with payment banks can allow these

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[53] Pani, Priyanka. (2017). Fintech companies go offline to cash in rural areas. http://www.thehindubusinessline.com/news/national/fintech-companies-go-offline-to-coin-cash-in-rural-areas/article9416325.ece

[54] Sharma, Misha and Suraj Nair. (2016). Digital Social Payment: Can Challenges be overcome? http://www.cgap.org/blog/digital-social-payments-india-can-challenges-be-overcome

community experts to offer more services to meet their clients' needs and increase their own profitability. In order to mitigate risk and ensure compliance with regulated banking standards at the last mile, BCNMs can provide significant support to the larger players by reducing the transactional cost of managing an expansive network of agents. Integration and collaboration are vital to increase the reach of digital banking to rural and remote areas.

CHAPTER 4
SOCIAL INSURANCE SCHEMES

"I TOLD THE POOR, THIS NATION, THIS GOVERNMENT AND OUR BANKS ARE FOR YOU... POOR DO NOT WANT 'SAHARA'. WE NEED TO CHANGE HOW WE THINK. THE POOR NEED 'SHAKTI'."[55] – PRIME MINISTER NARENDRA MODI

BACKGROUND

Social protection plays a key role in enhancing the social, economic and political development of a country. It can be defined as "policies and actions which enhance the capacity of poor and vulnerable people to escape from poverty and enable them to better manage risks and shocks."[56] Such policies commonly exist in the form of social insurance, social transfers, labour standards, minimum savings plans, and risk-mitigation strategies. Social insurance or social security schemes are those where the government underwrites the risk itself, without involvement of any insurance entity.[57] These methods of risk mitigation aims to increase livelihood security; in particular health coverage and crop insurance are important anti-poverty tools in India. India has achieved an insurance density of US$46.61 (144% over 2003) and an insurance penetration of 4.7% (36% over 2003) in 2008. However, 90% of the Indian population, and 88% of the Indian workforce (the majority of unorganized workforce) are still excluded from any kind of insurance cover and pension cover respectively.[58]

RASHTRIYA SWASTHYA BIMA YOJANA (RSBY)

The Rashtriya Swasthya Bima Yojana (RSBY) is a National Health Insurance Programme that was launched in 2008. Globally, it has been recognized for its scale and aim to protect the informal worker below poverty line. The scheme is largely funded by the central government, financing 75 percent, and state governments putting in 25 percent. A total of 21 states and 11 insurance companies have enrolled.[59] In India more than two thirds of expenditure on health is through Out of Pocket (OOP) which not only flawed but has proven to impede the livelihood security of India's bottom 20% population. Therefore, RSBY aimed at reducing OPP expenditures by offering cashless insurance for hospitalization in public as well as private hospitals. The scheme covers hospitalization charges up to about USD 634 (Rs 30,000) for up to five members of a family for a year. The scheme also provides transport allowance, up to USD 21 (Rs 1,000) per year. However, it does not cover outpatient care or the cost of medicines.[60] Beneficiaries are given a biometric health card and required to pay USD 0.63 (Rs. 30) to enroll while the government pays up to USD 16 (Rs 750) per family per year. In 2015 RSBY reported 35.31 million households are covered.[61] Though on paper the scheme seems efficient and there is a demand and willingness to pay for health insurance, much of the need is not covered into demand due to poor health

[55] *Press Trust of India. PM Narendra Modi Launches 3 Social Security Schemes.* May 09, 2015.
[56] OECD/DAC (2009). The role of employment and social protection, Making economic growth more pro-poor in Promoting pro-poor growth: Social protection. Paris, 11-15
[57] Jansuraksha. (2015). India's New Tryst with Mass Insuranc
[58] Mukherjee, Premasis. *Trends of Microinsurance in India.* MicroSave. August 2010.
[59] Mukherjee, Premasis. *Trends of Microinsurance in India.* MicroSave. August 2010.
[60] WIEGO (2012). Health Insurance in India: The Rashtriya Swasthya Bima Yojana.
[61] RBSY Website, March 10, 2017

service coverage and imperfect implementation plans.[62]

PRADHAN MANTRI FASAL BIMA (PMFBY)

The rural poor develop adaptation practices to cope with threats linked to climate variability, but the success of these practices depends on the nature of prevailing formal and informal institutions.[63] The Pradhan Mantri Fasal Bima (PMFBY) is a Crop Insurance Scheme launched on January 13th 2016. It aims to boost the India's agriculture sector by strengthening their crop insurance scheme which will be administered by the Ministry of Agriculture and Farmers' Welfare, Government of India. The PMFBY replaced earlier schemes such as the National Agricultural Insurance Scheme (NAIS) and Modified National Agricultural Insurance Scheme (MNAIS). PMFBY is intended to be implemented by private and public insurance companies, with the central government and the states shouldering most of the cost. Currently those farmers who have taken loans from the government are only eligible for insurance of their crops. With the successful implementation of the new scheme, all farmers, whether they have taken a loan or not, will be eligible for this new crop insurance scheme.

PROBLEM STATEMENT

Social insurance or security schemes by the Indian government are not adequately disseminated or monitored to the underserved populations. As a result, many government services, including the Rashtriya Swasthya Bima Yojana (RSBY) and Pradhan Mantri Fasal Bima (PMFBY) insurance policies, are not serving the populations they are designed for.

ANALYSIS

Insurance is a critical aspect of social protection and one of the five cornerstones of financial inclusion. Social protection programs often have a straining factor in addition to the already prevailing fiscal management, which prevents the governments from improving the scale and scope of social protection programs. Penetration of such programs is very low and underdeveloped. Unless the public is aware of the process and benefits of the insurance schemes offered there is little possibility that the scheme will be subscribed too. Actual subscription and usage of the scheme is a direct indicator of awareness. In the first year alone almost two thirds of the insurance villages recorded zero claims and individual states recorded a claim ratio on hospitalization ranging from 0.1% (for Assam) to 5.2% (Keral) including huge variance in awareness about the RSBY scheme.[64] With such a low usage and awareness it is evident that these schemes are not adequately disseminated to the targeted subscriber.

A RSBY survey reported that 69 percent of RSBY patients first learnt of RSBY through a friend or family member and even learnt of about the hospitals that were empanelled through family members or friends.[65] This coincides with our survey results and field interviews which revealed

[62] Mukherjee, Premasis. *Trends of Microinsurance in India.* MicroSave. August 2010.
[63] Datta, Sankar, Kandarpa, Rama, and Mahajan, Vijay. Resource Book for Livelhood Promotion. Fourth Edition. Institute of Livelhood Research and Training. 2014.
[64] Jansuraksha, 2015
[65] WIEGO, 2012

an information gap amongst consumers in rural areas. In fact, 84% of respondents admitted to receiving their financial service information through word of mouth rather than government, media or formal sources of information. Furthermore, only half of the surveyed population felt they were adequately informed about the financial services and government programs that were available to them.[66] Capitalizing on word of mouth and community engagement the government has the potential of dissenting information that will increase the implementation of security schemes.

Insurance products can be segmented based on two criteria's:

1. Ease of selling insurance is determined by:
   - Affordability of premiums for target clientele
   - Linking insurance policies with other high demand financial demand financial products
   - Regulator obligations
   - Tangible of benefits
2. Complexity of the product is determined by:
   - Number of covered events in same policy
   - Underwriting complexity
   - Documentation requirement
   - Ease of claim settlement process
   - Specialization of the product

Figure 4: How to Segment Products
Source: MicroSave, 2012

Microfinance in India has largely been driven by credit products of microfinance institutions (MFIs), and micro insurance has remained a secondary choice for financial inclusion.[67] Micro insurance has the opportunity to protect a large amount of the vulnerable population in India and to expand financial inclusion and social security in the rural areas. As of March 13th 2015 Insurance Regulatory Development (IRDA) has revised their regulation of Microinsurance regulation including to the guidance on product development, adjusting the risk coverage levels, permitting more entities to distribute microinsurance products and the training of microinsurance agents and their specified personnel.[68] This new regulation prohibits insurance companies to include social security schemes as microinsurance to meet their rural and social sector mandatory targets. As microcredit begins to build-up again in India so will the demand for micro-insurance.

RECOMMENDATIONS

FOCUS ON THE DEMAND

Creating products that suite the client and needs of the bottom 20% is important. Some factors to consider:

1. Design products with simple features. With low financial literacy rates it is the interest of the service provider to keep commitment contracts simple and easy to understand will build trust with the client and introduce the poor into essential financial services for livelihood security.
2. Create easy to understand information and community champions. Dissemination of information is key and in country with such a diverse population this should be carefully considered. Information should be advertised in all vernacular languages. There should also be trustworthy community leaders or champions who can answer questions and help with enrollment.
3. Create hassle free claim settlement. This can be an effective tool to promote and raise awareness on how the product works. Making it easy and convenient for clients to claim their settlements will be seen by other community members.

[66] Ahmad, T., Bulmer, C., et al, 2017
[67] Mukherjee, Permasis. *Trends of MicroInsurance in India.* MicroSave. August 2010.
[68] *India adopts a new IRDA microinsurance regulation.* Access to Insurance Initiative.

PARTNER WITH LOCAL BUSINESS CORRESPONDENTS

Business Correspondence are emerging as the preferred conduit to bridge the gap between financial services and poor populations. As local community members BCs have the potential to alter this perception of "unbankable" customers, as information is passed on more effectively to the consumer. While speaking to BC's we heard a repeated desire to play a central role in helping their community through providing access to financial services. The government should capitalize on their position equipping them with the knowledge needed to pass on information to their communities. The BC's current cash-in and cash-out transactions on basic savings account is not financially attractive; the introduction healthy incentives for BC's to promote and enroll the public in social insurance schemes would result in higher enrollment, awareness, and renewals. This can be expanded to other insurance schemes that would benefit the bottom 20%. Providing insurance as a stand alone product can be challenging however having a product-mix of different financial services would be an investment in capacity building for the agents. In addition, BC's can beyond social insurance schemes encouraging banks to view a diverse product mix as an opportunity to cross sell products. For insurance company's agents mean inexpensive and voluminous point of sales. However, training and code of conduct will need to be considered to ensure client protection

STRENGTHEN MICRO INSURANCE AND ENCOURAGE PRIVATE AND PUBLIC PARNTERSHIPS

Micro insurance had proven to be a fast-gaining instrument in reaching the unreachable. Currently the model is still driven by supply-led interventions. Moreover, the insurance providers, still, seek government subsidies and donor funding in order to achieve financial viability in preference to designing market-led, sustainable schemes. Hence, a strategic perspective towards microinsurance together with innovations in technology and assessment of client demand, probably holds the key to the future of microinsurance in India.[69] More collaborative effort toward product with different expertise will lead to a sustainable model.

[69] Mukherjee, Permasis. *Trends of MicroInsurance in India.* MicroSave. August 2010.

CHAPTER 5

MICRO UNITS DEVELOPMENT AND REFINANCE AGENCY (MUDRA)

"PEOPLE THINK IT IS BIG INDUSTRIES AND CORPORATE HOUSES THAT PROVIDE HIGHER EMPLOYMENT. THE TRUTH IS, BIG CORPORATE HOUSES, AGAINST 120 MILLION BY THE MSME SECTOR, EMPLOY ONLY 12.5 MILLION PEOPLE. WE NEED TO UNDERSTAND THE ENERGY OF THE BOTTOM OF THE PYRAMID OF INDIVIDUALS AND PROVIDE THEM WITH MEANS FOR UPLIFTMENT."[70] – PRIME MINISTER MODI

BACKGROUND

Non-farm entrepreneurs, especially those living in rural and interior parts of India, have been excluded from the benefits of a formal financial system, and from some financial inclusion initiatives. Due to high transaction costs and prohibitive associated loan risks, they have never had access to insurance, credit, loans and other financial instruments to help them establish and scale their businesses.

Although micro finance in India is well established, a great amount of micro entrepreneurs still depend on local moneylenders for credit. These loans often amass high interest debt and unsustainable conditions, which make these individuals fall in a debt-trap for generations. When micro businesses fail, the borrower becomes susceptible to the lender's coercive tactics for repayment.

MUDRA is the government's answer for this situation. There are two aspects of MUDRA, Mudra Ltd. a refinance agency, and Pradhan Mantri Mudra Yojana (PMMY) a scheme to provide credit guarantees to non-farm entrepreneurs that is not a direct lending institution. The most important aspects of MUDRA/PMMY are the increase in funds for credit allocation, the risk reduction by guaranteeing the loans under the scheme and the decreasing transaction costs by using intermediaries operating in cities and rural communities to allocate the funds of the refinance provision under the RBI rules.

MUDRA refinance mechanisms and PMMY schemes are provided through State level institutions, and loans are delivered through NBFCs, MFIs, Rural Banks, District Banks, Nationalized Banks, Private Banks, Primary Lending Institutions and other intermediaries to provide finance to Last Mile Financer of small/micro business enterprises. MUDRA/PMMY is the policy response by the Federal Government of India to solve the mismatch between supply and demand of formal credit in the non-farm sector.

In the context of financial inclusion, the endeavour of MUDRA/PMMY is to provide credit access to those small, micro, and tiny enterprises that are unable to offer collateral assets to secure loans, business accounts records, or convincing proposals to banks, as well as provide right

[70] MUDRA. (2016). Annual report 2015 – 2016 http://www.mudra.org.in/Default/DownloadFile/Annual_Report_Of_Mudra_2015-16.pdf.

incentives for banks to lend to these enterprises at market rates.

PROBLEM STATEMENT

Non-farm entrepreneurs at the bottom 20% of the Indian population have not had the opportunity to access formal credit to start and/or scale their micro business, due to high transaction costs and prohibitive associated loan risks.

VERTICALS

REFINANCE

MUDRA Ltd refinances lending portfolios through the deficit in priority sector lending. "RBI allocated Rs. 20,000 crore out of priority sector shortfall of banks as Mudra Refinance Fund (MRF). This allocation, along with its own share capital, formed the working funds of MUDRA[71]". This system is only available to lenders meeting rating benchmarks[72]. Since the refinance is available during banking hours, Mudra card allows borrowers to withdraw money in the morning and use it as working capital; this way they can obtain the materials necessary for their business, and deposit it back making sales during the day. No interest is payable on the entire transaction as the money is not borrowed overnight[73].

"As partners enrolled by MUDRA, all PSBs and 17 private sector commercial banks may avail refinance for loans extended to micro enterprises. As per RBI guidelines for MRF, scheduled commercial banks (SCBs) need to lend to the ultimate borrowers at their base rate to avail MUDRA refinance[74]."

PRADHAN MANTRI MUDRA YOJANA

Pradhan Mantri Mudra Yojana (PMMY)—also known as Mudra loan scheme—has a triple purpose, (1) bridge the funding gap to micro, tiny and small entrepreneurs, (2) increase the confidence of new entrepreneurs, and (3) assist existing businesses scale their operations.

"The non-corporate small business sector (NCSBS) and Own Account Enterprises (OAEs) including proprietorship and partnership firms engaged in small manufacturing units, service sector enterprises, shop keeping, fruits and vegetable vending, trucking, operating food services, repairing and maintenance, operating machines, running small industries, food processing, handicraft making (artisans) among others in both rural and urban areas are potential Mudra borrowers under PMMY[75]."

PMMY offers Mudra scheme loans to income generating micro, tiny and small operations involved in non-farm activities (manufacturing, trading and services) up to Rs.1,000,000. MUDRA scheme loans are divided into three categories based on the business life-cycle of the borrower. These

[71] Mudra, 2016
[72] Kochhar, S. (2016). Mudra the dark horse of Modi government. http://inclusion.skoch.in/story/767/mudra-the-dark-horse-of-modi-government-1067.html
[73] ibid
[74] Mudra, 2016
[75] Ídem

three categories are designed to fulfill the growth, development and funding needs of the beneficiaries.

- Shishu: up to Rs. 50,000
- Kishore: from Rs.50,001 to Rs. 500,000
- Tarun: from Rs.500,001 to Rs.1,000,000

Additionally, the overdraft amount of Rs. 5000 sanctioned under PMJDY has been also classified as a Mudra loan.

ANALYSIS

The performance of PMMY from the 2015 – 2016 annual report indicates that MUDRA is indeed delivering on its mandate; guaranteeing more than 1.3 trillion rupees worth of loans between 34 million accounts – 3 percent of the total population of the country. Over 68 per cent of account holders have borrowed from MFI and NBFC-MFI, while PSBs stand at 19 per cent and private banks around 9 per cent[76]. As shown in table below, 93 per cent of accounts belong to the Shishu category, which means that the vast majority of accounts have been opened by micro enterprises with a median loan amount of Rs.19, 000.

This means that MUDRA is indeed a policy that is delivering on "funding the unfunded". We even conducted an analysis with the goal of finding out if MUDRA was being used by the incumbent's party to generate political clienteles. Our finding shows that there is a correlation between the amount of credits sanctioned and the federal parliamentary elections in every state, in other words, states with a majority of BJP members in parliament tend to ssanction more credits under the MUDRA scheme, but without statistical significance. However, as we dug deeper into the weeds of the lending patterns of the MUDRA scheme, we found some facts that would be helpful to point out.

First, the accounts under the Shishu category are 93 percent of all the accounts, but only 46 percent of the total amount disbursed; the accounts under Tarun are only 1 percent of the whole portfolio, but 23 percent of the total amount disbursed. This might sound obvious, since the minimum average credit from Shishu is close to RS.20, 000 and for Tarun is near Rs.700, 000. However, what makes this point worth mentioning is that Tarun accounts are only 400 thousand entrepreneurs (0.03 percent of the population), and Shishu accounts are 32 million (2.7 percent of the population), but to serve the latter, MUDRA guarantees Rs.13 billion, and Rs.6 billion for the former. In other words, the opportunity cost of having a category like Tarun takes away the prospect of serving 16 million average Shishu accounts (1.3 percent of the population), or 1.5 million average Kishore accounts (0.13 percent of the population) – assuming that the demand for these accounts exists.

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[76] [76] Kochhar, 2016

	PMMY National			
	No. Accounts	Disb. Amt. (Crore)	No. Accounts (%)	Disb. Amt. (%)
Shishu	32401047	$60,073.70	93%	46%
Kishore	2069461	$41,073.28	6%	31%
Tarun	410417	$29,808.76	1%	23%
Total	34880925	$130,955.74		

Table 1: PMMY National
Source: Author's with information from Mudra's annual report 2015-2016

Second, Tarun accounts make up only 1 percent of all accounts, but almost a quarter of the total amount disbursed, this could set a malicious incentive for lenders to increase their numbers with guaranteed amounts without achieving the fundamental target of MUDRA. This pattern occurs in states and territories with small populations such as Arunachal Pradesh, D.& N.Haveli and Daman & Diu, where Tarun represents between 8 percent and 14 percent of total accounts, but a staggering 50 percent to 58 percent of total disbursement. Hence only 0.5 percent of these states' population has access to credit under the MUDRA scheme, significantly below the national average of 3 percent. An odd case in the same situation is Jammu and Kashmir, with a significantly larger population than that of the aforementioned states. Jammu and Kashmir presents the same dynamics (only 0.5 percent of the population has access to these kind of loans), as presented in the table below.

	Jammu & Kashmir			
	No. Accounts	Disb. Amt. (Crore)	No. Accounts (%)	Disb. Amt. (%)
Shishu	19057	$62.32	33%	5%
Kishore	34388	$738.18	59%	64%
Tarun	4529	$351.65	8%	31%
Total	57974	$1,152.15		

Table 2: PMMY Jammu & Kashmir
Source: Author's with information from Mudra's annual report 2015-2016

Two states that have truly reached the unfunded entrepreneurs would be Odisha and Karnakata, with a population of almost 42 million people and 61 million people respectively; the loans under the MUDRA scheme have reached up to 7% of the population, twice the national average. This is due to the fact that in both states only 13 percent to 16 percent of total disbursed amounts have been directed towards Tarun accounts, while the rest have been allocated to Shishu and Kishore.

	Odisha			
	No. Accounts	Disb. Amt. (Crore)	No. Accounts (%)	Disb. Amt. (%)
Shishu	2281495	$3,753.86	97%	69%
Kishore	51401	$977.75	2%	18%
Tarun	10365	$704.65	0.4%	13%
Total	2343261	$5,436.26		

Table 2: PMMY Odisha
Source: Author's with information from Mudra's annual report 2015-2016

It is clear that there are very wide asymmetries present in the lending dynamics in different states and territories. Demographics could be a factor, as well as urbanization, development, etc. We currently don't have the data to perform a deeper analysis, but it could be an interesting exercise.

Finally, there is an inherent risk about the actual use of the loans. We couldn't find any document that presented the monitoring mechanisms to do this; rather, the only mechanism that appears to fulfill this role is the creation of a credit bureau for loans under the MUDRA scheme.

RECOMMENDATIONS

1. PMMY could reconsider having three loan categories. Suppressing Tarun would be advisable is the demand for more Shishu and Kishore loans exist.

2. Asymmetries between lending patterns in different states need to be addressed. Understanding this patterns and adopting practices from states that are reaching a larger number of entrepreneurs could potentiate the results of MUDRA across the country.

3. A monitoring mechanism for the actual use of the loan needs to be implemented. The implementation of a credit bureau is a significant achievement, but it only shows a partial part of the whole story. There is a remarkable difference between a failed loan due to lack of knowledge, literacy, or market cycles; and a failed loan that was used to buy food instead. A monitoring mechanism could solve this problem and MUDRA could implement various responses accordingly.

CHAPTER 6
INTEGRATION OF LAST MILE DELIVERY ACTORS

POLICY CONTEXT

In response to expanding financial services in India, in 2006 RBI adopted the technology based agent bank model through Business Correspondents (BCs). This model attempts to address one major failing of traditional banking institutions; that those institutions are not accessible to many rural communities because the cost of getting to the nearest physical bank is too high. Per the RBI guidelines, the BCs are permitted to carry out financial transactions on behalf of a bank as agents, which is called branchless banking. This model is being aided by technology oriented tools, such as point of sale handheld devices, mobile phones and biometric scanners.

BC's are local members of the community who are recruited by banks or social enterprises like Sub-K, also known as a BC network manager (BCNM), to deliver financial services within a certain jurisdiction. BCs are great providers of last mile service, especially to rural and under banked populations.

FIELD OBSERVATIONS

Our field research schedule afforded us the opportunity to witness both models; credit in Raipur and financial inclusion in, and around, Hyderabad. After our visit we understood the need to provide access to all essential financial services: savings, credit, insurance, transaction, payments. In our interviews, consumers and BC's noted the need for seamless transactions and a demand for individual micro-loans for working capital.

Consumers expressed a fear of formal institutions, lack of knowledge of product, and discomfort in accessing these services[77]. BCs have proven to be a conduit for these financial services. BCs recognize and respect their consumer needs, they are familiar with cash management, digital and financial transaction, and are established members of community therefore have gained consumer trust[78]. As an agent BCs are the perfect influencers to deliver and pursue the success of financial inclusion in India.

Sub-K is a network manager of these BCs and utilizes two distinct operational verticals, serving two different purposes:

1. Credit BC Model or Customer Service Representative (CSR) Model – Facilitating loan disbursement and collection.
2. Financial Inclusion (FI) BC Model – Facilitating basic transactions utilizing mobile phone technology.

CREDIT BC MODEL OR CUSTOMER SERVICE REPRESENTATIVE (CSR) MODEL

[77] Ahmad, T., Bulmer, C., et al, 2017
[78] Ahmad, T., Bulmer, C., et al, 2017

We witnessed the Credit CSR Model in Raipur, a model that has carried over from, the once much larger, BASIX MFI. Figure 1 demonstrated the hierarchy of operations, which includes area mangers and CSR who have similar characteristics to BC's. However, their sole income is Sub-K and they are mobile employees that acquire customers and collect payments. The financial institution was only one bank: Rathnakar Bank Ltd; which has a long-standing relationship with Sub-K including their FI BC model. Loans are provided for income generating activities or general consumption purposes with a 25 percent diminishing interest rate, offered with credit life insurance for client and spouse. The steps in gaining a loan through this Credit CSR model is as follows:

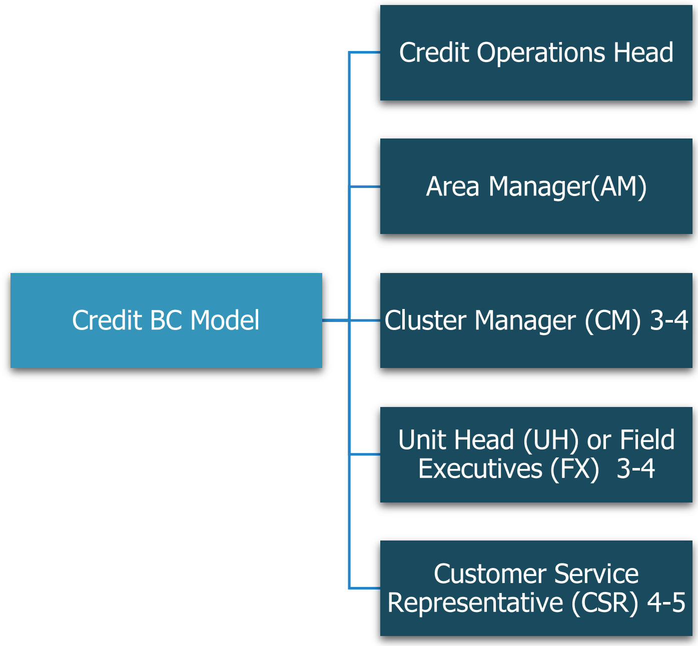

Figure 5: Credit BC Model (Sub-K)

1. Acquiring consumers who need loans
2. Forming a Group: Joint-liability group - 4-6 people max and only women
3. Credit appraisal: CSR and Bank evaluate the eligibility of the local
4. Training: JLG must under-go basic training
5. Disbursement: The loan is disbursed to the head of the JLG who disburses the loan and is also responsible of holding the monthly repayment meetings
6. Repayment: CSR has scheduled visits to conduct the payment from the entire JLG. [79]

[79] Sub-K. (2016). Sub-K Operations Policy 2016-17 Link?

Financial Inclusion (FI) BC Model

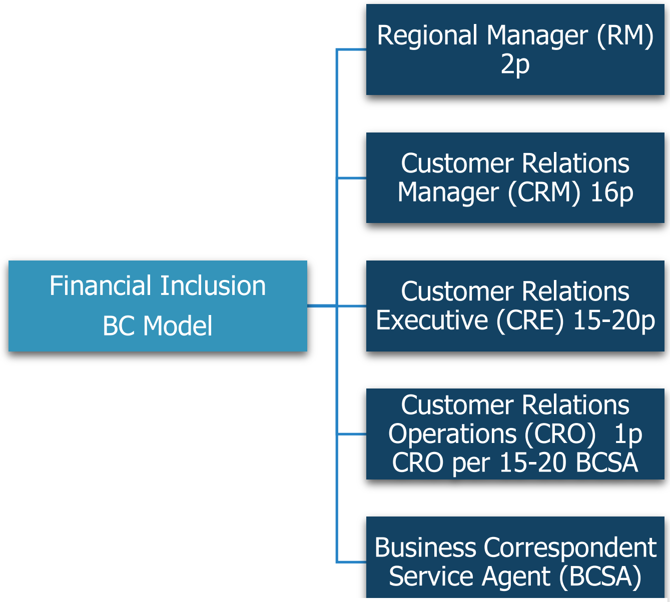

Figure 2: Financial Inclusion BC Model (Sub-K)

"The Business Correspondent (BC) model has been an appealing financial inclusion strategy to serve and service excluded segments of the population, especially those living in remote areas. Therefore, it is imperative that banks have appropriate due diligence processes in place to select and monitor their BCs, so that clients are adequately protected." [80] Sub-k's Financial Inclusion BC Model are generally local members of the community who own a business, though this is not formally required. They act as agents to represent Sub-k and a specific bank. They undergo 3-day training, a field in which Sub-K has been recognized as a leader and are part of a well-structure hierarchy as seen in Figure 2. These BC's primarily offer: account opening, withdrawals, and deposits.

The BC model aims at developing and strengthening the relationship between unbanked people and the formal financial system. The salient features of this model include identifying the borrowers, collection and verification of loan applications, creating awareness on various financial services, products and transactions; collection of small value deposits etc. The best advantage of the BC model is, on the one hand, banks get vast exposure to the rural population without its physical presence in terms of branches; while on the other the unbanked people belonging to the remote areas get easy access to basic banking facilities at their doorstep by the person among themselves.

There is a case to be made to enable BC's to be a one-stop-shop for all financial services and Sub-k has the resources in place to merge these two models; but a major challenge is infrastructure and showcasing the value to banks. Traditional banking is very labor and capital intensive. When considering the bottom 20 percent access to financial services, Sub-K plays an important role as a network manager: managing and monitoring BC's, cultivating and maintaining the partnerships with Banks, and protecting the under-banked and unbanked consumer. MFIs and Banks will reduce their transaction costs in repayments and risk of cash transaction during transportation, therefore, improving efficiency and accountability and resulting in additional

[80] Smart Campaign. (2014). Client Protection in Business Correspondent Model http://www.smartcampaign.org/storage/documents/Tools_and_Resources/Client_Protection_in_the_BC_Model_2014_v1.0_EN.pdf

revenue stream.

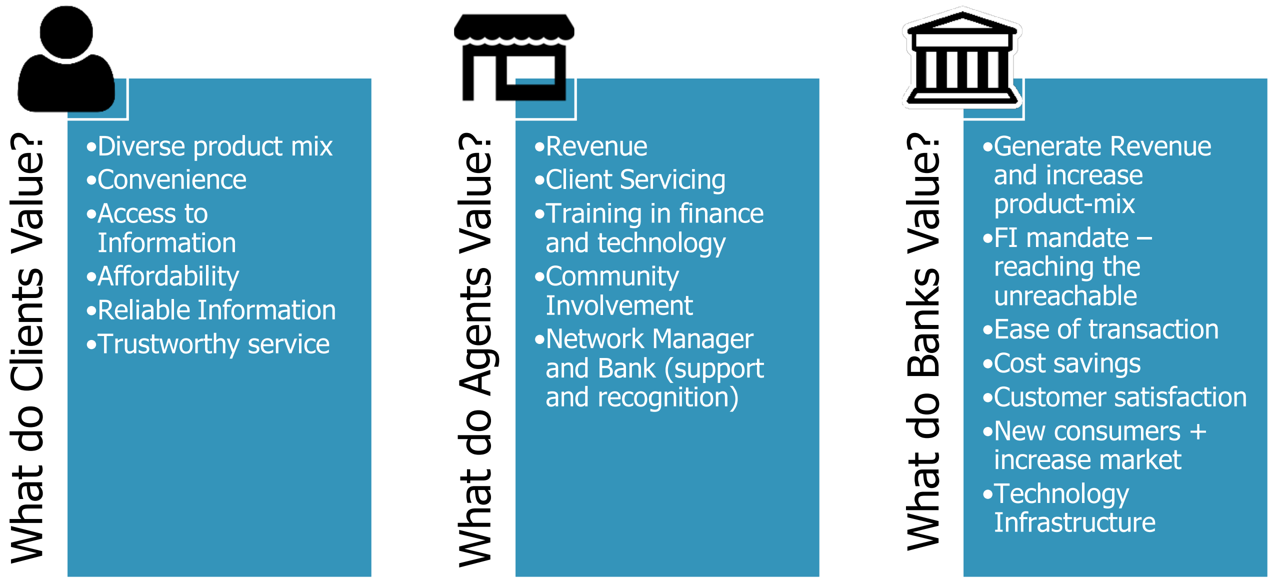

Figure 6: Value Map of Actors in Financial Inclusion

RECOMMENDATION: INTEGRATE THE TWO VERTICALS

The current financial industry is craving competition, which influences client expectations and, at times, crisis situations are forcing finance institutions to re-evaluate their strategy towards clients, products offered, organization structure, and processes. As India moves towards a digital economy and an increase of consumer trends change there is a need to consider strategies to make the BC model viable and beneficial for all parties. An integrated model would result in more efficient processes and less transaction costs for Sub-k and Banks.

BCSA who are under the Financial Inclusion mandate already have access to an established client base, with experience in cash management, training with BCNM systems and financial/digital tools, existing relationship with staff and banks, and more insight on the consumer needs.

Offering the right product mix is a key to a viable business model; therefore, extending the FI model to include credit could lead to a more sustainable pathway to financial inclusion. However, this proposes a slow integration of the two models, one in which existing FI BCs operating in or close to CSR service areas will slowly integrate into the existing CSR credit model. This will happen over time as the BCSA by slowly takes on responsibilities to increase the efficiency of loan disbursement and collection.

A newly integrated hierarchy could accommodate both operations by Sub-K (credit and FI). The relationship between CSR and BC would be a partnership where BC's can act as a consistent, trusted, local presence for the CSR, who currently shows up only month to collect repayment. The BCSA will work with CSR to slowly gain understanding of both Full Service Model (FSM) required in pre-loan services and Recovery & Collection Model (R&C).[81] This will also allow the CSR's to garner trust for allowing others to help with their credit businesses. Our CSR focus group revealed that the biggest challenge for the CSR's was the travel time to and from villages to fulfill their duties under the FSM and R&C guidelines. Slowly integrating the BCSA into the day-to-day operations has the potential to reduce the number of trips that CSRs will have to make to villages.

As part of the FSM, a CSR is responsible to do the initial assessment; they are required to fill out a "Village Information Sheet", including information such as total number of households, literacy rate, sources of income, villagers' main business activities, their financial dependency, irrigation facility, major threats etc. They should not depend on a single source for the data. Rather, they should triangulate the information from multiple sources;[82] local BC's can act as a primarily source of this information and can identify potential customers as well as their needs. In addition to reducing the trips to villages, it also has the benefit of potentially increasing the customer base of the CSR by providing a local outlet for people to inquire about the potential for a loan and aid potential customers create JLGs.

On the Recovery and Collection side, the BCSA could be instrumental in streamline the collection process. Given their local presence they can make repayment more flexible for the customers. While in Raipur we observed two collection processes, both processes had inefficiencies in addition to the long trip the CSR had to make to get there. One meeting was not even able to begin (and thus, repayment was delayed, meaning another trip for the CSR). One problem was timing, the CSR wants to come during their workday, however, this is often the customers work hours as well. A BCSA also has the potential to help set up meetings to make it more efficient when the CSR arrives and even take repayment and relay to the CSR on the day of using Sub-K technology. It would be much more realistic to host a meeting at a time outside of 'working hours.'

A slow integration of the two models that already have strong operation systems in place will also allow Sub-K to adapt and consider different mechanisms for facilitating further coordination and integration of the models. Initially Sub-K will need to facilitate coordination between possible future partners. Clearly expressing the mutual benefits for both will be critical. Setting clear standards around profit sharing between BCSA and CSR working on the same 'file' will also be important in the early stages. Moving forward, Sub-K will need to consider the possibility of upward mobility for BCSA's that show potential and a desire to be offer more than the current services offered by

Another barrier will be the current structure of contracts that Sub-K signs with banks, where some are using the BCs to simply fulfill a FI mandate, and others use the CSRs to acquire customers. However, moving forward, Sub-K could try to sell banks on the benefits of the model, especially selling FI focused banks that serving previously underserved areas could actually be profitable by facilitating loans.

[81] Sub-K, 2016
[82] Ibid

This simple coordination between last mile delivery actors from both operating verticals has the potential to benefit both actors. Given that the BC model is recognized as an economically feasible and customer-friendly banking model for the poor[83] finding ways to streamline the process and offer more services is also beneficial for India as it continues its journey towards an inclusive financial future.

Banks and Sub-K would need to consider adequate incentives and training to enable CSR's and BC's to act as the point of contact for credit. As the JLG loaning system of shared liability and risk has proven to be successful this can be continued but expanded to include both genders. Furthermore, accountability issues will be critical in for the continuity of the last mile delivery systems. Many of these issues will be explored in the next chapter, discussing the need for a BC Code of Conduct.

[83]Kolloju, Naveen. (2014). Business Correspondent Model Vis-à-vis Financial Inclusion in India: New practice of banking the poor http://www.ijsrp.org/research-paper-0114/ijsrp-p2556.pdf

CHAPTER 7

CREATING A CODE OF CONDUCT FOR LAST MILE DELIVERY

BACKGROUND

The Business Correspondent model in India has been part of the Reserve Bank of India (RBI) official policy since 2006. Local agents known as business correspondents (BCs), accounted for 51% of total banking outlets in March 2010 (representing 34,316 of a total of 67,694 outlets). Just 5 years later, by March 2015, the number of banking outlets had increased dramatically to 553,713. Of this, as many as 91% represented branchless outlets, primarily business correspondents.[84] Despite over 10 years of existence and an increasing number of agents in the field, there is still no formal monitoring or supervisory framework for the BCs or BCNMs. Currently, guidelines are set by BCNM in partnership with banks on operational and general service conditions; however, they vary depending on the institution. Since BCs act on behalf of banks that they represent, the bank's reputation and credibility rests on the agent that represents them. As a conduit between customer and banks, BCs are also responsible to adhere to checks and balances that protect client information and confidence. There has been growing discussion and consensus that as BC's become a part of the formal financial ecosystem their behaviour towards customers and banks needs to be monitored and regulated through a standardized code of conduct.

The Business Correspondent Federation of India (BCFI) is a not-for-profit federation; founded in 2014 BCFI aims to promote responsible finance by the delivery of financial services to the poor through BCs.[85] They are currently undergoing work on five projects related to the standardization of the BC model across India:

- Training, certification and BC registry
- Standards
- Code of conduct (COC)
- Grievance redressal mechanism (GRM)
- Technology platforms (web and app)

This section of our report provides policy recommendations for the BCFI to aid in the creation of a pan-India BC Code of Conduct. It draws on observations from our time speaking to stakeholders in the financial inclusion ecosystem, which include a range of actors: BCNMs representatives, BCs, bank employees, research organization, government representatives and most importantly consumers. This code of conduct acts as a preventative measure for protecting customers and the reputation of BCs, BCNMs, MFIs, and banks that are all important contributors to financial inclusion projects in India. Our aim is to contribute to the ongoing dialogue to create a sustainable BC model that provides services to the bottom 20 percent, and we believe the investment in a standardized code of conduct will cultivate better relationships and financial culture within the market, protect customer information, and adequately equip the right individuals to be BCs.

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[84] Singh, A. and Nair, S. Agent Banking: Need for Code of Conduct for Business Correspondents. http://ifmrlead.org/wp-content/uploads/2016/12/Agent%20Banking-%20Need%20for%20Conduct%20of%20Conduct.pdf

[85] BCFI (2017)..About BCFI. http://bcfi.org.in/what-is-bcfi/.

Overall, this code makes the BCs accountability structure more focused on the customer instead of focused on the bank or the BCNM.

There have been numerous attempts at creating standards, regulations, and policy recommendations for managing BC operations. Below is a list of recent documents relevant to the Indian context, which can be used for inspiring the creation of a code of conduct:

- Policy on Engagement of Business Correspondents & Business Facilitators published by the Central Bank of India in April 2016
- Code of Conduct for the Microfinance Industry published by the Sa-Dhan: The Association of Community Development Finance Institutions in December 2015.
- Collection Code of Conduct published by Airtel India for their telecommunications operations in Pakistan
- Code of Conduct for Delivery of Credit through Business Correspondents published by Inclusive Finance India in December 2016

MOVING TOWARDS A CODE

When reviewing the existing literature, speaking to various stakeholders, and observing the practices and management of a BC, we have concluded that there is a lack of consensus about how BCs should be regulated and by whom. One of the reasons for this is by the differences in how banks, BCs, and BCNMS relate to each other in different settings. The variation is quite large depending on where in India the BC is set up, which bank they are working for, if they are urban or rural, and what the policies of the BCNMs. This is one of the largest barriers to the creation of a pan-Indian code of conduct for BCs.

To address this issue, we have compiled a list of questions that need to be considered as a Pan-India code develops. These questions fall under six key themes:

1. RESPONSIBILITY AND MANAGEMENT: THE LEVELS OF ACCOUNTABILITY

The BCFI is a membership based organization with 73 Corporate BC's also known as BC Network Managers (BCNM) varying from telecom to retail to MFI and 58,000 individual BC's.[86] This number does not consider the difference between active versus dormant BC's. As a non-profit membership organization how will it gain legitimacy amongst stakeholders?

- Who is legally responsible for the behaviour of BCs?
- Who creates and updates the national list of BCs?
- What kind is identification system should be put in place to prevent imposter or fake BCs?
- Who is responsible for the enforcement of the code of conduct?
- Who provides information and training to BC's? Is the training standardized?
- What is the responsibility structure between Bank, BC, BCNM, and BCFI?

2. MONITORING: DETERRING AND IDENTIFYING ISSUES

In the Inclusive Summit 2016 Conference, ideas on secret shoppers or self-regulation officers circulate the discussion as liability and risk is high and unknown in the areas that BCs operate in.

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[86] Meeting with BCFI I don't know how to cite this

An assessment of the environment is needed before we talk code of conduct; thinking about the customer's impact and protection.

- How do you ensure that BCs provide their services only within their service areas?
- What are the incentives for a BC to behave inappropriately and appropriately?
- How can a BC's behaviour be monitored remotely or in person for indications of inappropriate or illegal activities?
- How do you prevent rent-seeking behaviour?

3. AWARENESS AND TRANSPARENCY: THE ROLE OF BCNMS

While conducting our field research we found that only one out of fifteen BCs were familiar with the BCFI organization and none of them knew of the code of conduct being developed. This is to be expected because BCFI is a new organization with an evolving mandate but, this lack of awareness is a barrier to fruitful future stakeholder engagement. As the front-line distributors, BCs should be a part of the dialogue surrounding creating a code of conduct.

- How do you ensure regular contact between BCs, bank managers and BCNMs?
- How should BCFI create a platform for BCs to report grievances with their managers and potentially their customers?
- Who is responsible for the initial and updated training of a BC?
- How can policies of advertising be implemented so customers are not mislead by how services are framed?

A Multi-BCNM BC

On our trip one example of the need for a Code of Conduct was observed in an urban setting where two BCs were set up perhaps 20 meters apart. When speaking to the two BCs about their proximity they were not even aware of each other and felt that because they were serving two different customer bases, college students and works sending remittances back home, it was not a concern. Later, we learned that they both reported to the same CRO who had approached the newer BC to compensate for the low quality of service provided by the other one.

The service provided by this BC was not necessarily low quality, but was instead preferential towards one of the two BCNMs whose services he provided. This points to one of the concerns that would emerge if competition increased in the BC model.

In Canada, currently employers are hesitant to work with employment service companies to provide training for new entrants into the job market. They are avoiding participating despite complaints about lack of skilled workers. The fear comes from being hesitant about spending money training someone when they could just go work for a competitor. This is an issue of mismatched incentives, which can be seen in this example of a multi BCNM BC.

An urban BC makes their money by receiving a percentage of the profits from each service provided. They therefore, are incentivised to provide services with higher percentages of return and not necessarily services, which best meet the needs of a customer. In a model with more competition between BCNMs for BCs this disconnect between the goals of a customer and BC will need to be addressed.

4. INDUSTRY STANDARDIZATION: INTEGRATING THE MARKET AND ACTORS

Creating industry standard would avoid chances of fraud and misappropriation which was a concern raised by IFC and other organizations. Such as disclosure of all terms and conditions associated to the product should be a must including service fees, taxes and interest rate.

- What are the minimum qualities for a BC? Should these qualities, such as level of education, be standardized?
- How can conflict of interest situations be mitigated and responded to?
- Should the training be industry standard and performed by the same institution?
- Should there be industry standards in how BCs are compensated and incentivized? What role does the bank and BCNM play?
- Should agents be restricted by a certain local area/proximity?

5. CONSISTENCY OF SERVICE AND CONSUMER PROTECTION

As local members of the community BC's pride themselves for providing financial services to others: "It makes me happy" one BC told us, this service is targeted to the unbanked and under-banked, and to ensure customers needs come first, the code must consider the impact towards consumers.

- Should there be a shortlist of BCs in a given area who can take over a larger service area if a BC has to temporarily stop working?
- What should a BCNM do when there is no one in the service area who has the qualifications for becoming a BC?
- What guidelines are in place to protect the customer, perhaps including an ombudsman?
- What are the conditions for terminating contracts with BCs?
- How do you address grievances and complaints of BCs?

6. LONG TERM PLANNING - A SUSTAINABLE BC MODEL

Current policies deter a competitive market for BCs, as the current goal remains focused on ensuring services are provided to every village. National banking policies have divided rural India into service areas, which are assigned to a single bank, resulting in the creation of regional monopolies. As the market opens and more players are interacting with BC's checks and balances should be put in place if there are changes in the BC assignment structure where multiple BCs operate in one area.

- Should there be standardization of the technological platform that BCs are using?
- Should there be differentiations in the code of conduct for urban and rural BCs?
- Is the Common Service Point the long-term ideal format for the BC? If so that format should be the basis for this code of conduct.
- How are BCs to interact with different financial and digital institutions - payments banks,
- small finance bank, telecom companies etc..

The current trends within the behaviors of BCs have developed organically over time, but for a unified code the future of the model needs to be agreed upon by many of the existing stakeholders or implementation, regulation, and adherence will be a significant hurdle.

CHAPTER 8
DEMONETIZATION
INDIA CASE STUDY

SHOW ME THE (BLACK) MONEY!

In early November 2016, Prime Minister Narendra Modi surprised the Indian population by demonetizing 500 and 1,000 rupee bank notes. Effectively taking 86% of cash out of circulation, in an economy where cash transaction account for almost 90% of total transactions[87]. Other countries have decided to go the same way in the past, Singapore stopped printing $10,000 notes[88], and the European Union will not print the $500 banknote anymore[89], however, in both cases the existing notes will remain legal tender indefinitely.

The strongest motivations for taking this step was the belief that a huge portion of illegally obtained income through tax evasion ("black money") would be recovered by forcing people to deposit cash in bank accounts.

An afterthought that emerged after taking implementing the demonetization policy was the alleged realization that Pakistan was producing counterfeit rupee notes[90].

According to the Institute for Business in the Global Context, "Black money remains a well-documented failure of governance in India with profound consequences for tax revenue, corruption, and law enforcement in general"[91].

The size of the shadow economy in India, estimated by the World Bank in 2010, was around 20.7 percent of the GDP in 2017[92]. Black money has some pervasive effects, but perhaps the most important one is that the government can't collect revenue that could be used for productive or development actions. Economists indicate that personal income tax compliance in India is lower than 29%, or less than one third the revenue the government could collect. In other words, formalizing the shadow economy would improve India's fiscal situation tremendously[93].

Efforts to collect revenues from black money were previously followed; an amnesty program that ended in September 2016 resulted in the declaration of 652.5 billion rupees in unaccounted money, or a meagre 0.5 percent of GDP[94].

The government had initially estimated that one third (5 trillion rupees, $2 trillion stashed overseas[95]) of the 15.4 trillion rupees rendered worthless by the policy would continue undeclared. However, sources cited by Bloomberg, indicate that banks have received 14.97 trillion

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[87] Chakravorti, 2016. https://hbr.org/2016/12/indias-botched-war-on-cash?utm_source=facebook&utm_medium=social&utm_campaign=HBR
[88] Reuters. (2015). Singapore to stop issuing S$10,000 banknote to prevent money laundering. http://www.reuters.com/article/singapore-regulations-idUSL4N0PD2M120140702
[89] WSJ. (2016). 500-Euro Banknote Being Phased Out. https://www.wsj.com/articles/500-euro-banknote-being-phased-out-1462381987
[90] The Diplomat. (2016). India's Fight Against Fake Currency. http://thediplomat.com/2016/11/indias-fight-against-fake-currency/
[91] IBGC, 2014. India's Cost of Cash. http://fletcher.tufts.edu/~/media/Fletcher/Microsites/Cost%20of%20Cash/COC-India-lowres.pdf
[92] Bloomberg. (2016). India Scrambles to Switch 23 billion Banknotes. https://www.bloomberg.com/news/articles/2016-11-15/india-s-scramble-to-switch-23-billion-banknotes-quicktake-q-a
[93] IBGC, 2014
[94] Bloomberg, 2015.
[95] Chakravorti, 2016.

rupees[96] (97%) as of Dec. 30, the deadline for handing in the old bank notes. This is just one tenth of the government's estimations, based on the assumption that illicitly held money would've simply been left undeclared. In other words, it appears that one key goal of Modi's — to deal a financial blow to people using the cash for illegal purposes — simply didn't bear fruit[97].

Apparently, the government's strategy does not consider imposing new controls to the sources of black money. If this is the case, it would not be a surprise that the old shenanigans to profit from tax evasion could be repeated in the future: under-invoicing, fake purchase orders and bills, reporting of non-existent transactions, and blatant bribery, all of which generates a new store of black money[98].

POINTLESS, NEEDLESS SUFFERING AND PAIN?

India had recently surpassed China as the world's fastest-growing economy, but this status has been clearly imperilled by the loss of economic output and the risk that the currency devaluate further. The International Monetary Fund recently cut its projected growth rate for India by one percentage point for the current fiscal year, to 6.6 percent.

Analysts estimated that if 12-13 trillion rupees were taken back into the system, it would defeat "the whole theory of black money." In such a situation the gains of the demonetization policy are not evident for the population, who have suffered tremendously since it took place. A slump in demand due to the cash shortages has hurt company revenues and will affect tax collections, widening the budget deficit and ultimately weakening the rupee[99].

A Stanford PhD candidate in economics suggested to Vox that "The best indicator of slowing growth is prices — inflation is at record lows, indicating reduced demand for goods and services in a largely cash-based economy. Anecdotally, ordinary people living in India can attest that prices for everything — from auto-rickshaw rides to vegetables to real estate — have fallen since demonetization."[100] The sharp fall in prices means there's been a huge drop in demand for those items, since people don't have the money in hand that they need to buy them. The New York Times reported that "demand for vegetables is declining because people don't have the money to pay for them, for example, and some service industries are reporting steep job losses."[101] Apparently the drop in vegetable demand is so sharp that the prices of eggplants, potatoes, cauliflower and tomatoes dropped between 42% and 78%, according to the NCDEX Institute of Commodity Markets and Research[102].

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[96] Bloomberg. (2017a). India Said to Get 97% Banned Notes in Setback to Graft Crackdown. https://www.bloomberg.com/news/articles/2017-01-04/india-said-to-get-97-banned-notes-in-setback-to-graft-crackdown

[97] See: India Demonetization cash Ban – Vox: http://www.vox.com/world/2017/1/25/14375372/india-demonetization- Vox. (2017). India Demonetization cash Banhttp://www.vox.com/world/2017/1/25/14375372/india-demonetization-cash-ban-modi-economy

[98] Project Syndicate. (2016). India's Demonetization Disaster. https://www.project-syndicate.org/commentary/india-demonetization-policy-consequences-by-shashi-tharoor-2016-12?barrier=accessreg

[99] Livemint. (2017). Black money estimates overshot as 82% of cash deposited in banks. http://www.livemint.com/Industry/SmaP4M0Q6lf2nrpjnQTgGO/Black-money-estimates-overshot-as-82-of-cash-deposited-in-b.html

[100] Vox, 2017

[101] NYTimes. (2017). In Its Third Month, India's Cash Shortage Begins to Bite. https://www.nytimes.com/2017/01/24/world/asia/in-its-third-month-indias-cash-shortage-begins-to-bite.html?_r=0

[102] Ibid

One month after the demonetization policy took place, micro and small-scale service industries cut staff by 35 percent, according to the All India Manufacturers' Organization, that also released a study this in January 2017 affirming that job losses in various industries, including automobile parts, infrastructure and construction, would recover to as much as 35 percent by March[103]. While the net impact for the economy is still hard to determine, the immediate impact for people across the board, specially the poor in rural communities with no near access to a bank. Our own data shows that 57% of the people interviewed were affected by the policy; all those who were not affected mentioned that they are too poor, hence they did not have cash stored.

Although many in India support the policy, most agree that the implementation was incompetent[104]. "But the truth is that its design was fundamentally flawed. There was no policy skeleton, no cost-benefit analysis, and no evidence that alternative policy options were considered. Judging by the blizzard of policy tweaks since the announcement, it seems clear that no impact study was carried out."[105] In fact, the Reserve Bank of India changed the rules for withdrawal several times[106]:

- November 13: The limits for exchange of cash, daily and weekly withdrawal limits were increased
- November 14: The cash withdrawal limits for current account holders were increased
- November 21: The withdrawal limits for expenses related to weddings scheduled before 30th December were increased.

The withdrawal limits were one part of the problem; a clear indication of the unfortunate implementation of the policy was the fact that not enough currency notes from other denominations were printed before the announcement. The government decided to print new 2000 rupee notes, which didn't fit in the ATMs at the beginning, causing money supply decrease even more.[107]

One of the many things that are unclear is the decision to print a new high denomination note (2000 rupee note) since, at least in theory, would make the storage of black money even easier, that was the reason why the bank of Singapore and the European Central Bank decided to stopped printing high denomination notes.

IN A WORLD WHERE VOWS ARE WORTHLESS…

Prime Minister Modi won the 2014 election, between many things, by promising to give poor Indians up to 2 million rupees each from back money stashed abroad[108], but now that most of the old notes have been deposited to bank accounts, constituents will start to wonder the government will be able to fulfill this promise. Modi gambled his political capital on a huge speculation. According to Reuters in a cabinet meeting shortly before the move was announced,

[103] Ibid
[104] Project Syndicate, 2016.
[105] Ibid
[106] Scroll.In. (2016). Flawed and fickle: RBI's frequent changes to cash withdrawal rules fuel prevailing uncertainty. http://scroll.in/article/823049/flawed-and-fickle-rbis-frequent-changes-to-cash-withdrawal-rules-add-to-prevailing-uncertainty
[107] Project Syndicate, 2016.
[108] Bloomberg, 2016

Modi told cabinet members, "I have done all the research and, if it fails, then I am to blame."[109] With demonetization pains felt acutely across the board in the whole country, elections became a test to measure if and how political preferences have been impacted, especially in the rural areas of the country.

Uttar Pradesh, a state of 200 million people, 77% of them in rural areas, sends more representatives to India's upper house than any other region, voted in seven phases between Feb. 11 and March 8. Punjab and three other states also voted during this period to select a local government. The results were announced on March 11[110]. The results for the election showed huge wins for Modi's coalition at the local level. In Uttar Pradesh, the BJP coalition won 277 out of the 403 available seats of the local assembly. The results are similar in Uttarakhand were BJP won 26 out of 70 in the local assembly[111].

Some political analysts were cautious against assuming that the failed rollout of Modi's demonetization program, and the costs it has had on the country's poorest citizens, would exact a political price. The idea of cracking down on black money is highly appealing to many Indians fed up with systemic corruption[112]. "There is even a sense of civic engagement in waiting in long ATM queues as part of the effort to stick it to a corrupt and wealthy elite (….) It is telling that elections in India's largest state, Uttar Pradesh, are coming up, yet demonetization is not a central campaign issue."[113]

WILL WE REALIZE THE OPPORTUNITIES OF THE DIGITAL WORLD?

Digital visionaries argue that demonetizing the economy is necessary to decrease the reliance on cash and introduce modern systems of digital payments. This drastic shift to digital payments in the Indian economy could be very helpful for a society with the highest costs of cash. The benefits of following this path could be

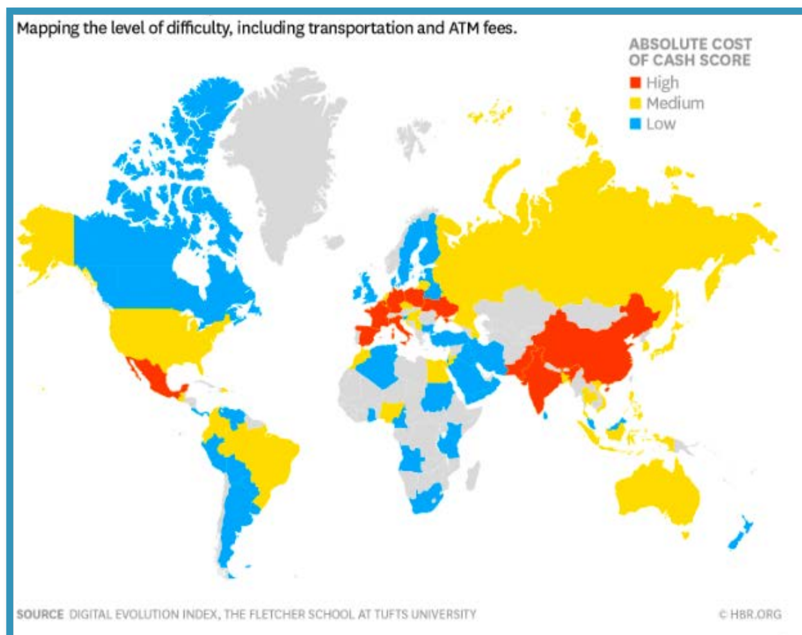

Figure 7: The Cost of Cash around the World.
Source: HBR. 2016

[109] Reuters. (2016). Who knew? Modi's black money move kept a closely guarded secret. http://in.reuters.com/article/india-modi-corruption-insight-idINKBN13X2PY
[110] Bloomberg, 2016
[111] NDTV. (2017). Modi Super-Wave Brings Saffron Holi For Uttar Pradesh. http://www.ndtv.com/elections
[112] Vox, 2017
[113] Ibid

immense[114][115]. Not only considering the vast amount of inefficiencies from using cash, such as transit time and cash access costs; but also the tax avoidance gap that usually exists in many developing countries[116].

"Countries in the developing world tend to have a greater tax gap and a greater degree of uncertainty about the reliability of the estimate of the gap. Developing countries have the largest tax gaps, with their shadow economies as large as 30%-44% of GDP. In India, for example, the tax gap could be as large as two-thirds of overall taxes owed."[117]

However, transitioning to a cashless economy without a strong understanding of the necessary steps to follow and a policy framework that is measurable and manageable is a recipe for defeat. "Countries that are highly digitally evolved are best positioned to unlock value by focusing on migrating to digital alternatives to cash. For those countries lagging in their digital evolution, the path to cashless nirvana is through investing in digital inclusion first. This sequencing is crucial to success."[118]

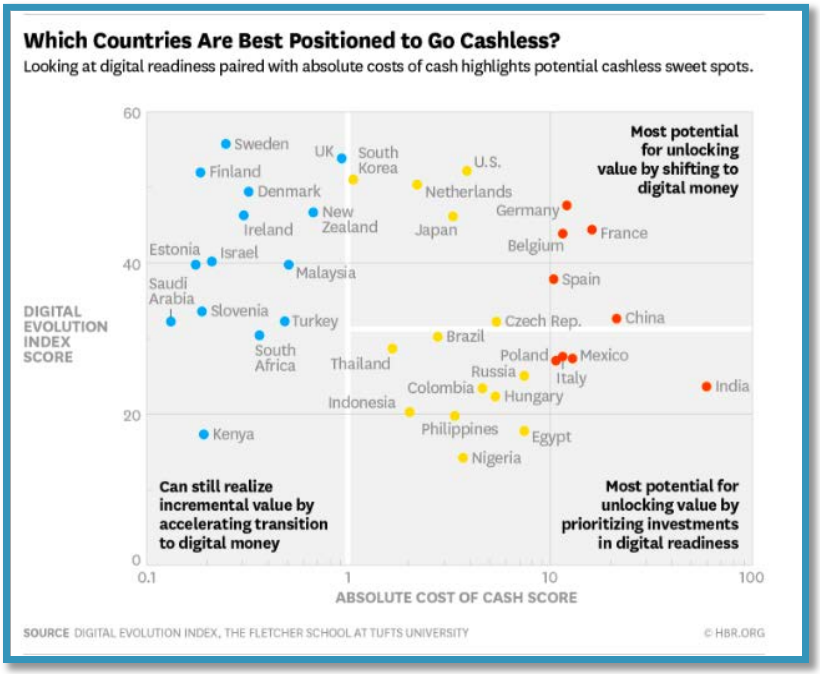

Figure 8: Best positioned to go Cashless
Source: HBR, 2016

In the case of India, "to go cashless is putting the cart before the horse. The horse in this case is the digital infrastructure and establishing a threshold of trust in the system; beefing up this digital ecosystem should come first."[119] According to the Institute for Business in the Global Context India is a cash intensive economy, even for a developing country: "The ratio of money held in bills and coins (M0) to the amount held in demand deposit and savings accounts (M2) in India is 51%, which is higher than Egypt (29.3%), South Africa (8.9%), and Mexico (8.7%)."[120]

Most Indians currently lack the means to use non-cash payments, even if they want to. Our data shows that in the particular rural area where we worked, only 15% of the participants owned a

[114] HBR. (2016). The Countries That Would Profit Most from a Cashless World – HRB: https://hbr.org/2016/05/the-countries-that-would-profit-most-from-a-cashless-world

[115] Chakravorti argues that the biggest beneficiaries of this disruption, arguably, would be the incumbents, i.e. Reserve Bank of India, India's central bank, and the banking institutions. According to our study, the Cost of Cash in India, these institutions spend $3.5 billion annually in currency operations costs.

[116] Chakravorti, 2016

[117] Ibid

[118] Ibid

[119] Ibid

[120] IBGC, 2014

smartphone, 65% owned a feature phone and 21% didn't owned a phone at all. Moreover, an overwhelming majority (91%) of the participants had no experience at all using their mobile devices for financial transactions. The 9% who used the phone for financial transaction were educated men, over 20 years of age.

The picture for the country as a whole is not very different, even with the high penetration of mobile subscriptions; only 30% of subscribers use smartphones. A third of the population has access to the Internet. The country still has an infrastructure deficit to be able to expand Internet access. Furthermore, connections are erratic and unreliable. Also there is a great urban-rural disparity in connectivity: "70% of those with mobile internet access are in cities; only 17% of Indian women use the internet, according to the Pew Research Center. With women responsible for much of household purchases, this does not provide a strong foundation for the spread of digital payments where it really counts"[121].

> "Like most of the 40 countries surveyed in 2015, there are big demographic differences in Internet access. Younger, more-educated and higher-income Indians are more likely to use the web than older, less-educated and lower-income Indians (relative to the median household income within India). Men are also more likely to have access than women, as are Indians residing in the wealthier North and West regions of India where major cities like Delhi and Mumbai are located compared with the less prosperous South and East. Overall, these patterns hold true among India's smartphone users as well."[122]

According to Google India and The Boston Consulting Group, by 2020, digital transactions will happen at 10 times the current level[123]. It's possible that demonetization will serve as the initial spark. But in the absence of a systematic and concerted investment in digital infrastructure and Internet access, cash will stubbornly resist wholesale digital displacement[124]. Digital payments market leader, Paytm, had added 20 million new customers since the demonetization begun[125]. A recent report in CNN shows snack-seekers in a street market buying samosas via QR code. Yet digital wallets, and their effect on local vendors, are just the beginning. In the background, digital wallets are helping to construct an infrastructure that will better support credit and e-commerce, two areas in which India has been lagging behind[126].

The push for a cashless economy has also boosted Paytm's reach into rural villages. A source cited by Bloomberg said that revenue contribution from towns with a population of less than

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[121] Ibid

[122] PEW Research Center. (2016). Global tech companies see India's vast offline population as untapped market. http://www.pewresearch.org/fact-tank/2016/04/06/global-tech-companies-see-indias-vast-offline-population-as-untapped-market/

[123] BCG. (2016). Google-BCG study reveals Indian digital payments industry to grow to $500 billion by 2020, contributing to 15% of GDP. https://www.bcg.com/en-in/d/press/25July2016-digital-payments-2020-making-500-billion-ecosystem-in-india-39417

[124] Chakravorti, 2016

[125] FastCompany. (2017). India's Demonetization Is Having A Domino Effect On Credit, E-Commerce. https://www.fastcompany.com/3067364/new-money/indias-demonetization-is-having-a-domino-effect-on-credit-ecommerce

[126] Íbid

100,000 people has jumped to just under 20 percent so far from 2 percent in the last two months[127].

CONCLUSION

Extinguishing black money is a goal that governments around the world are pursuing; however, the policies implemented to achieve this goal have been far less radical than the one implemented in India. There is a wide consensus about the terrible implementation by the government to take out of circulation almost 90% of the monetary base. At the same time, it became clear that the benefits the government was expecting to achieve were not realized. Demonetization could be categorized as a failed policy, by most standards, except political standards. If we consider that the recent elections in some Indian States could have been a referendum on Modi's government, we can conclude that the discontent in almost non-existent.

Finally, on the technology front, it is clear that India would abate a lot of costs by demonetizing its economy, but at the same time, it's also clear that before doing so, the country needs to invest heavily in its communications infrastructure. The divide between rural and urban is staggering in this front, meaning that the rural population would need an even bigger push. Empowering financial inclusion models like BCs could serve as an strategy to close the gap for rural populations as well.

[127] Bloomberg. (2017). After Demonetisation, Payments Bank The Next Big Push For Paytm. https://www.bloombergquint.com/business/2017/01/16/after-demonetisation-payments-bank-the-next-big-push-for-paytm

CHAPTER 9

INTEREST-FREE MICROFINANCE PAKISTAN CASE STUDY (AKHUWAT)

"INDIA IS OVER BANKED BUT UNDER SERVED." - VISHWAVIR AHUJA, CEO AND MANAGING DIRECTOR OF RELIANCE BANK LIMITED

INTRODUCTION

Access to credit is central to increasing the productive output of individuals; yet countless individuals in Pakistan struggle to acquire credit through non-exploitative and socially acceptable channels. Despite of the presence of several microfinance institutions (MFIs) only 16 percent of Pakistan's adult population was banked in 2015.[128] Many financially deprived Pakistanis looking for credit are faced with the dilemma of choosing between a corrupt moneylender or an MFI providing high interest backed loans. While moneylenders use coercive tactics to extract repayments, the relatively higher interest rates charged by MFIs not only reduces the saving capacity of the borrower but also violates the religious obligations of Muslim borrowers. Within this financial market Akhuwat Islamic Microfinance offers Pakistan's unbanked population an alternative.

Started in 2001 as the brainchild of Dr. Amjad Saqib, a former civil servant, Akhuwat provides interest free Islamic microfinance. According to Islamic sharia law the charging or servicing of interest is forbidden as one cannot make a profit off of capital in itself. Dr. Saqib identified a need among the unbanked urban and rural poor for a socially acceptable form of banking. Determined to create an alternative to conventional microfinance, Dr. Saqib began his organization by lending 10,000 rupees to a widow to begin her business at no additional cost. After six months the woman returned the amount and reported an increase in her earnings. Dr. Saqib realized his model of interest-free microfinance could be replicated at a larger scale.[129] Through mobilizing his personal network of friends, Saqib raised an adequate pool of resources to formally begin Akhuwat.

Akhuwat Islamic Microfinance has become one of the premier microfinance institutions in the country. In 2015 Akhuwat was recorded among the top three largest MFIs, in terms of active borrowers with a portfolio of 406, 000 active borrowers.[130] The success of Akhuwat has been a product of a well-designed loan disbursement and recovery system that continuously replenishes its resource pool. Akhuwat also generates a spirit of altruism among its staff by reinforcing a collective commitment to social good. Special emphasis on family cohesion through their micro-financing activities allows for equal participation of women in intra household loan allocations.

[128] Access to Finance Portal 2015. "Pakistan Highlights". http://www.a2f2015.com/highlights
[129] Akhuwat. (2017). "History." http://www.akhuwat.org.pk/History.asp
[130] Pakistan Microfinance Network. (2015) "Pakistan Microfinance Review 2015: Annual Assessment of the Microfinance Industry." http://www.pmn.org.pk/assets/articles/31f52030bd8d766abf95b80d2d35aeaf.pdf

Furthermore the extensive training program for the loan officers increases the institution's capacity to further outreach and effectively deliver services at the front line of its operations.

GUIDING PRINCIPLES OF AKHUWAT

The term 'Akhuwat' means brotherhood and the organization considers itself to be in a partnership with its borrowers to collectively increase the potential of the socially marginalized and economically deprived of Pakistan. While Akhuwat has been able to expand its mandate to include multiple social support programs, its core operation of microfinance is guided by four principles.[131]

1. INTEREST FREE LOANS

Akhuwat is committed to providing interest free loans to ensure borrowers are able to utilize the loan amounts to increase their productive capacity rather than service high interest rates.

2. LINKAGES WITH RELIGIOUS PLACES

As Akhuwat began to increase its operations, the use of space within mosques to serve as branch offices cut operational costs. Secondly forming monetary transactional contracts in religious places, such as mosques and churches has a behavioral effect on the borrowers as well. A contract arranged in a place of worship cultivates a moral responsibility in the borrower to repay the loan as it connects Akhuwat to the spiritual setting.

3. VOLUNTEERISM

Akhuwat greatly promotes the values of volunteerism and the majority of its board members serve on a voluntary basis. The loan officers are paid a market rate salary but they express a personal commitment to their work and willingly work beyond their designated responsibilities.

4. BORROWERS TO DONORS

Loan applicants and borrowers are encouraged to contribute to the resource pool. They are also encouraged to save a portion of their profits to donate to Akhuwat. Through this practice the resource pool continues to grow and borrowers are empowered to recognize their capacity to help others like them.

REQUIREMENTS FOR LOAN APPLICATIONS

Contrary to conventional microfinance, Akhuwat does not require an applicant to provide group guarantees. Instead applicants can apply for a loan with a guarantee provided by two guarantors, one of whom may be a family member and a co-signer. The loan officers are trained to visit the applicant's neighborhood and inquire about his or her social standing. Applicants pay a nominal fee of 200 PKR for the application and upon approval of the loan they can make a voluntary payment of one percent of the loan amount as accidental death insurance[132]. After receiving the

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[131] Akhuwat. (2017) "Guiding Principles of Akhuwat." http://www.akhuwat.org.pk/principles.asp
[132] Deloitte. (2016). "Akhuwat End of the Year Financial Statement." http://www.akhuwat.org.pk/pdf/AuditReportfortheyearendedJune302016.pdf

application the loan officer is tasked to assess the viability of the business venture and assist the applicant in creating an operating budget.

Borrowers in their first loan cycle are loaned between 10, 000 PKR to 50,000 PKR depending on the identified need and repayment capacity of the applicant.[133] The joint co-signing of the loan is meant to encourage household ownership of the loan amount and to ensure that family members are aware of their family member's debt. Akhuwat actively provides loans to all applicants who indicate a financial need, regardless of their religion, gender or sexual orientation. Individual loans are disbursed on a monthly basis to all the borrowers in a geographical region at the same time. During the loan disbursement ceremony Akhuwat officers give a talk to the borrowers reminding them of Akhuwat's guiding principles as well as they promote healthy lifestyle choices. The loan disbursement ceremonies take place at a mosque or a church to further emphasis the religiosity within their mission.

SUSTAINABILITY OF THE MODEL

Conventional MFIs borrow from commercial lending institutions at the market interest rate and the subsequent loaning they provide includes the cost of capital the MFI is charged by the commercial bank. Akhuwat's lending operations are funded through public donations and do incur any capital interest costs. Though relying on philanthropy can be a volatile endeavor for long term growth; capital investment is also subject to market volatility as experienced during the 2008 Global Financial Crisis.[134]

Since its inception, Akhuwat has managed to generate a vast pool of resources and through its operational strategy it is able to ensure the pool is continuously replenished and recycled. Moreover it is unlikely that a predominantly Muslim majority country like Pakistan will see a significant reduction in its charitable giving. Islamic principles decree, *zakat* and *sadqa*, mandatory and voluntary donations as primary qualities of practicing Muslims.

Within a social setup that encourages charity Akhuwat offers an innovative portal for donors as the donated funds enter a continuously revolving fund. The donated funds are routed towards lending operations that increase sustainable livelihoods. As the funds are recycled upon repayment of the loans, donors are satisfied their donations are repeatedly employed in increasing the productive output of the institutionally deprived.

PERFORMANCE

Despite of its humble beginnings Akhuwat has become the largest provider of Islamic microfinance in Pakistan with an asset base large enough to places it among the top ten largest MFIs in the country.[135] In 2015 the asset base of all of the MFIs increased by 81 percent which was largely due to the increase in Akhuwat's asset base. During the same time period, Akhuwat

[133] Akhuwat.(2017). "Lending Methodology." http://www.akhuwat.org.pk/lending_methodology.asp
[134] Harper, Malcolm. "Akhuwat – It Sometimes Makes Sense to Break the Rules." *Friends of Akhuwat.*
[135] Pakistan Microfinance Review 2015.

increased its outreach to 170,000 new borrowers.[136] The bulk of the increase in outreach for the entire microfinance industry was driven by Akhuwat's outreach efforts.[137] Even though a Family Enterprise Loan is Akhuwat's credit product, loans for financing marriages, household needs and loan liberation are also available. All of the loans are based on the principle of qard-e-hasan (literal translation: "beautiful loan") that decrees that a person who gives charity to improve someone's welfare is lending to Allah (Quran, Verse 57:11). Since Akhuwat applies this uniform principle to its lending methodology it ensures that its staff, borrowers and donors have clear and consistent understanding of the organization's purpose[138].

Following Akhuwat's success in sustaining an interest-free lending model, the federal and provincial governments have adopted the model to disburse public funds through the Akhuwat network. Based on the Akhuwat qard-e-hasan model, in 2014 Prime Minister Nawaz Sharif allocated 3.5 billion PKR for disbursement of interest-free loans in amounts up to 50,000 PKR.[139] In addition to the PM's Interest Free Loan scheme, Akhuwat is also a partner in the Chief Minister's Self Employment Scheme in the provinces of Punjab and Gilgit Baltistan.[140] Both of these schemes have had an increase in fund allocation due to their success rate. In October 2015 the federal government selected Akhuwat to disburse 500 million PKR worth of interest free loans in the Federally Administered Tribal Areas.[141] Akhuwat is also a partner of the Technical Education and Vocational Training Authority (TEVTA) which provides skill building for young graduates and allocates 500 million PKR for them to use for setting up independent enterprises.[142] Akhuwat is continuously increasing its outreach and has 666 branches in urban and rural areas distributed throughout Pakistan. As of February 2017, Akhuwat has a total outstanding loan portfolio of 10.5 billion PKR and the total amount disbursed to date is 36.6 billion PKR.[143]

Through the concept of a "self-replenshing" resource pool, along with the guiding principle of turning borrowers into donors Akhuwat has been able to not only create a sustainable lending model but also expand its scale of operation. The outreach efforts of Akhuwat volunteers and staff have also allowed for Akhuwat to establish complementary social support programs, such as a health clinic.

HOUSEHOLD ACCOUNTABILITY FOR LOAN REPAYMENT

Pakistan is a country marked with significant gender inequality limiting women's access to resources to increase their earning potential. Operating in this social structure Akhuwat as of February 2017 has been able to provide loans to more than one million men and 754, 897 women

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[136] Ibid.
[137] Ibid.
[138] Gates Foundation. (2015). "Islamic Microfinance: Context, Culture, Promises, Challenges." https://docs.gatesfoundation.org/Documents/Islamic%20(Micro)%20Finance%20Culture,%20Context,%20Promise,%20Challenges.pdf
[139] Akhuwat. (2014). "All power to the PM's program." http://www.akhuwat.org.pk/newsletters/Issue-5.pdf
[140] Akhuwat. (2016). "Philosophy – Programs – Progress – 2016." http://www.akhuwat.org.pk/pdf/a2_akhuwat_symbolising.pdf
[141] FATA Development Authority. (2017) "Interest-Free Micro-Lending Scheme for small-scale entrepreneurs in FATA." http://fatada.gov.pk/project/governor-fata-interest-free-loan-scheme/
[142] Akhuwat 2016.
[143] Akhuwat. (2017) "Progress Report February 2017." http://www.akhuwat.org.pk/progress_report.asp

borrowers with interest-free loans.[144] Akhuwat identifies its primary Family Enterprise Loan as a "household loan" due to the joint applicant clause in the application process. The purpose of having co-signees from the same household (preferably of the opposite genders) is to encourage joint accountability for expenses within the household.

Through a survey conducted in 2017 among 29 male and 19 female current or potential borrowers of Akhuwat a high degree of satisfaction over the household allocation of the loan amount was identified.[145] Out of the total 44 respondents who identified themselves as Akhuwat borrowers 26 of them indicated they had the sole accountability for loan repayment. All of the 44 borrowers indicated that they were satisfied with allocation of the loan amount between household and productive expenses. Furthermore all of the 44 borrowers also reported that they believed that expecting household accountability for an individual loan was fair. Even though Akhuwat requires limited guarantee as surety for loan repayment, it is evident that household accountability is adequate to ensure borrower accountability as reflected in Akhuwat's high recovery rate.[146]

COMPREHENSIVE TRAINING PROGRAM ENSURES QUALITY SUPPORT AT LAST MILE

Loan officers are the main agents responsible for increasing outreach, carrying out due diligence during application review and maintaining borrower engagement after the loan disbursal. During our field work at Akhuwat, the Chief Training Officer explained that before the loan officers are sent to the field they undergo an intensive training program. For the length of the training session, which spans a few days to a week, the trainees reside at hostels provided by Akhuwat. In addition to learning technical skills such as reviewing application and monitoring borrowers after loan approval, the trainee learn about Akhuwat's main values and principles of charitable giving. The trainees are taught to ensure fairness and compassion in their dealings with borrowers and to self-monitor their behavior according to Akhuwat's ideology.

In a survey conducted in early 2017 among 15 loan officers, all of the officers reported they had each undergone a high degree of training before assuming their positions. Out of the 15 loan officers, 12 of them indicated they have been able to independently answer all incoming inquires from borrowers and applicants. While the remaining three 3 loan officers indicated they readily received support from their managers.[147] Akhuwat's intensive training workshops provide capacity building for the officers who are then further able to perform their tasks with expertise and effectively support the borrowers. A study conducted by Pakistan Microfinance Network in 2015 to understand the working conditions and perspectives of loan officers throughout the microfinance industry found that loan officers overall lacked a coherent understanding of microfinance and its purpose.[148] The 2017 survey with Akhuwat loan officers received positive

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[144] Ibid.
[145] Ahmad, Talia, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and Akhuwat http://www.akhuwat.org.pk/pdf/a2_akhuwat_symbolising.pdfIslamic Microfinance. "Akhuwat Borrower and Non Borrower Survey." University of British Columbia, February 2017.
[146] "Progress Report February 2017."
[147] Ahmad, Talia, Corrin Bulmer, Zameena Dadani, Chad Rickaby, Fernando Rodriguez, and Akhuwat Islamic Microfinance. "Akhuwat Loan Officer Survey." University of British Columbia, February 2017.
[148] Pakistan Microfinance Network. (2015). MicroNote: Loan Officers' Voices: Perspectives and Lessons from the Foot Soldiers. http://www.microfinanceconnect.info/assets/articles/ffeb576797d248de614409e9b327b8bd.pdf

feedback from the loan officers as the officers described the Akhuwat model "as unique" and that they were part of a mission that "did not take advantage of the poor." The survey feedback indicates that Akhuwat loan officers considered themselves in a partnership to uphold values of altruism to increase social welfare.

Clear communication and feedback is a strong feature in Akhuwat's operational strategy that allows for effective outreach and support for the borrowers. Moreover 14 out of the 15 loan officers indicated they actively provided feedback to their managers who also respond to the feedback in an adequate manner.[149] The survey responses indicate a high level of employee satisfaction as many of the loan officers suggest they are driven by as sense of altruism. All of the loan officers in the survey expressed they have a personal responsibility to provide information regarding financial services to the borrowers. Through extensive training and constant communication Akhuwat ensures that their staff at the front line sincerely adopts the guiding ideology.

Akhuwat serves as a compelling example of a thriving microfinance organization that has challenged the norms to provide services that are relevant to the needs and sensitive to the sensibilities of the underprivileged populace in Pakistan. Akhuwat's success is widely recognized as its ability to sustain its operations and increase scale without charging interest; yet, its true success lies in its commitment to demonstrate that credit must be used as a tool to uplift the extremely destitute and not to further impoverish them.

SCOPE FOR ISLAMIC MICROFINANCE IN INDIA

Institutionalizing Islamic banking and microfinance can potentially further financial inclusion in India as groups who are opposed to conventional banking with interest would be able to access credit and saving products, as well as invest through formal channels. An annual report by RBI in 2016 identified that some segments of India's population voluntarily remained unbanked due to a lack of availability of interest-free banking options and proposed that adequate research be directed towards introducing an interest free banking model in India.[150] While the adoption of an interest-free model of banking in India's conventional banking sector may be unlikely, MFIs working in regions with high concentration of Muslim population can consider developing loan products that comply with citizen's religious obligations.

[149] Akhuwat Loan Officer Survey."
[150] The Hindu. (2016). "Sharia Banking: RBI proposes 'Islamic window' in banks." http://www.thehindu.com/business/Industry/Sharia-banking-RBI-proposes-%E2%80%98Islamic-window%E2%80%99-in-banks/article16669006.ece

Branchless Banking in Pakistan: Benefits and Challenges of a Large Scale Operational Model

To extend the scope of our report we carried out research in Pakistan to assess cross country variations in digital banking or branchless banking, as it is referred to in Pakistan. Branchless banking in Pakistan is primarily provided by large institutional players and through our research we have been able to identify the benefits and challenges of providing banking services through large scale operations at the last mile. Since the inception of Branchless Banking Regulation in 2008 Pakistan has been one of the fastest growing markets for branchless banking globally. The State Bank of Pakistan has continuously revised the regulations to provide a strong regulatory and enabling policy environment to support the sustainable growth of the branchless banking sector. The branchless banking sector is comprised of telecommunications companies (Telcos) who, in partnership with commercial banks, have leveraged their existing mobile customers and distribution networks to provide mobile banking services.

According to the SBP 2016 third quarterly report for branchless banking a total of 210, 536 active agents were operating in the country.[1] During the time of our research the Telco Telenor and Tameer Bank's branchless banking service, Easypaisa, was offered at almost 85,000 agent locations whereas Mobilink and Mobilink Microfinance Bank's Jazzcash was offered by almost 65,000 agents. As agent sharing is common, many of the agents offer branchless banking services of multiple service providers.

Through interviews with stakeholders we identified that the large resource base of the Telcos allows them to increase the scale of their operations. The established Telcos have an expansive telecommunication infrastructure that ensures connectivity to limit disruptions for customer transactions. The competitive business model increases incentives for the Telcos to develop new products and expand agent outreach. Branchless banking allows customers to receive government cash transfers as well as make payments to public institutions, such as for bill payments for utilities and passport fees. The scale of operations enables Telcos to readily resolve liquidity issues at the agent level to support agents in carrying out large monetary transactions. Agents can rely on the distribution network to have required amounts transferred into their accounts by the end of the day. The competition for market outreach between the Telcos increases product development and creates strong incentives for customers and agents. While over-the-counter transactions still make up the bulk of branchless banking transactions a significant increase in mobile wallet transactions has also been witnessed due to improvements in product offerings.

Through our field work we found that the management of the agent network to ensure compliance to SBP regulations at the agent level is a significant challenge for the Telcos. The vast network requires significant monitoring and compliance checks to reduce the risks of money laundering and agent misconduct through the branchless banking channel. Lack of digital literacy and consumer trust in branchless banking is also a challenge that limits product uptake on the demand side. However continuous policy revisions and investments in Fintech are increasing the capacity of the branchless banking sector to push financial inclusion in Pakistan.

CONCLUSION AND LOOKING FORWARD

The journey towards a financially included India is a long one. Much progress has been made since the first use of the term in 2005, though there is a long way to go.[151] The project team's journey through India has revealed to them the complexity of actors and different initiatives working towards a goal of financial inclusion in India. Many of the initiatives of these actors have occurred recently, which makes it hard to decipher the outcomes of those policies. However, this report has aimed to build on local interactions and observations, interview data and analysis, as well as extensive literature reviews to provide forward looking analysis and recommendations on:

- Pradhan Mantri Jan Dhan Yojana (PMJDY): Universal bank accounts
- Social Insurance Schemes: Pradhan Mantri Fasal Bima Yojana (PMFBY) Farm Insurance and Rashtriya Swasthya Bima Yojana (RSBY): Health Insurance
- Niche Banks: Payment Banks and Small finance banks
- Micro Units Development and Refinance Agency Bank (MUDRA)
- Digital Financial Inclusion: Mobile/Digital Banking Technology

More specifically, this report has focused on how different these different government initiatives and additional players can focus on serving the bottom 20% or previously underserved populations of India. In addition, our observational case studies focused the effects of demonetization, the potential for a BCFI code of conduct, an attempt at an integrated BC model and a case study with on financial inclusion in Pakistan.

Our research identified that one of the most successful ways of serving this population has been the BC model. Looking ahead, demand for the financial is likely to only go as far as the consumer is informed and has access to the services. BCs and their BCNMs can influence demand for financial services through the following.[152]

- Product: the financial services provided should be appropriate for the consumer-base. They have limited resources, lack knowledge, and do not have the luxury to "test out a product." Having a variety of products and understanding the product offered to the consumer.
- Price: not only does the price of consumers need to adequately represent their financial capability but also agents should be incentivized to continue the longevity of the business. This not a charity service!
- People: the right people as agents with the right training. Sub-k has done a diligent process in selecting their agents and employees within both the credit and FI hierarchy.

[151] Reddy, Y. Venugopal. (2005). Annual Statement on Monetary Policy for Year 2005-2006. https://www.rbi.org.in/scripts/BS_ViewMonetaryCreditPolicy.aspx?Id=2217
[152] Financial Inclusion 2016 Summit. Panel on the BCFI Code of Conduct

Training is essential as it teaches agents about finance, digital, motivation, retention, and trusted local personal support (full-service).

- Process: This is a key function of the entire operation. Ensuring efficient effective enhanced customer support. Limitation include infrastructure, connectivity, and adequate guidelines for agents.
- Promotion: Gaining trust and building relationships between agents and consumers. 84% of consumers indicated receiving information on financial services through word of mouth; rural bottom 20% demographics are community oriented and agents that are in the proximity and well known in the community are more likely to gaining trust to engage in financial transactions
- Place: agents act as an extension of formal finance institution – branding and community leader acknowledgment; having too many agents in one area could cause a risk
- Physical Evidence: To build trust consumers (especially bottom 20%) prefer interacting face to face with someone and it is an advantage if it is someone in their community. However, this also is risky on customer and agency protection. Liability issues.

In conclusion, there are many unknowns going forward for financial inclusion in India. However, we believe that the BC model will be a critical player for the implementation of new government policies and schemes and play a critical role in partnering with new players such as payments banks, small finance banks, and telecommunication companies. Utilizing their local presence and position a community leader will be important in transitioning the previously unbanked into the formal banking system.

Despite the extensive research done by this project team, the scope and breadth of the financial inclusion problem in India leaves many unanswered questions and potential avenues for future research:

1. Expand on the data collected by conducting a broader survey of Sub-K operations, especially focusing on collecting more consumer data. This will give Sub-K a better understanding of customer's behaviour and needs and thus, allow for better services by Sub-K BCs.
2. Explore future uses for the data that may be collected as transactions are becoming increasingly digital. The use of this data has the potential to aid in the design, disbursement and collection of innovative loan types that may be more customized for the needs and profiles of their consumers.
3. Research into potentially innovative uses to use low-tech mobile phone technology for financial services. As a leader in this field Sub-K could lead research into other uses for feature phones in financial inclusion
4. Explore best practices in digital literacy campaigns. As India moves into a digital age, digital literacy, especially among the bottom 20% will be critical to ensure that these innovations are available to all sections of the population.
5. Gain a better understanding of woman BCs. Our survey identified a larger than expected woman BCs and the gender dynamics of BC operations should be explored further.

METHODOLOGY

The quantitative data employed throughout this report is based on three sets of structured interviews administered in India and Pakistan between December 2016 and February 2017.

FIELD WORK IN INDIA

These interviews were administered in the rural, peri-urban, and urban areas surrounding Hyderabad by members of the UBC team in conjunction with members of ILRT, the knowledge management institute at BASIX. In total 17 Business Correspondents were interviewed, and 49 Indian consumers. The surveys featured questions structured so answers were provided through: multiple choice selection, rankings, and open ended text boxes. The majority of the interviewees spoke Telugu as their mother tongue and had varying levels of familiarity with Hindi and English.

The Business Correspondents all work for Sub-K and were selected based on their ability to come to central locations where the interviews could be administered. This interview consists of 46 questions. Because of this small sample size, a variety of interview style, variance of respondents and a slightly changing questionnaire is us, our BC data is utilized for qualitative purposes only. Our personal interaction made this qualitative contribution very valuable for understanding the BC.

The consumers came from a variety of communities. The interviewee sample was determined by accessibility. The respondents were selected if they visited a BC while the enumerators were present, or if they agreed to participate when the enumerators went door to door. Interviews were performed with current and potential customers of Sub-K. The interview for consumers consisted of 91 questions.

A policy was put in place to ensure a balance of male and female voices in the survey. If the enumerators had not been able to interview a representative sample of women in a community, then they were to organize a focus group with the female community members. However, in the field they had easier access to women than men and at the end of their visit they were seeking men to participate in the survey to ensure a gender balance.

The ideal sampling for these interviews would include consumers within the bottom 20% of the Indian population and those outside of that financial category for clarity. Unfortunately, there was no way to ensure this distribution of sampling given our limited resources and also the great difficulty of measuring when speaking to an individual where they fall into such categories.

The results of the interviews were recorded through offline tablets and stored on the QuickTap© servers. Privacy concerns were addressed as the survey respondents remained anonymous. Our aim was to conduct interviews to gain a better understanding of the accessibility of the BC model and financial services to the bottom 20%. This will contribute to developing a comprehensive understanding of the financial inclusion policies, which have influenced the availability of financial services to the Indian public.

FIELD WORK IN PAKISTAN

These interviews were administered in the rural, peri-urban, and urban areas surrounding Lahore by members of the UBC team in conjunction with members of Akhuwat Islamic Microfinance and graduate students from the University of Central Punjab. In total 15 loan officers were interviewed and 48 borrowers in Pakistan. The Loan Officers are all employed at Akhuwat Islamic Microfinance and were selected based on their geographical spread across Lahore.

The surveys featured multiple formats for the participants to answers through: multiple choice selection, rankings, and open ended text boxes. The majority of the interviewees spoke Urdu or Punjabi as their mother tongue.

The participants in the borrower or non-borrower survey came from a variety of communities. The interviewee sample was determined by accessibility. The research team went door to door in the communities served by an Akhuwat branch office. Interviews were performed with current and potential borrowers of Akhuwat Islamic Microfinance.

To remain mindful of the social context the enumerators were instructed to ensure that a gender balance be maintained in the survey. In the event that there was an underrepresentation of women in the sample group then the enumerators would ask the participants to identify if they knew of any women in the community who would be willing to perform the survey.

The ideal sampling for these interviews would include consumers within the bottom 20% of the Pakistan population and those outside of that financial category for clarity. Unfortunately, there was no way to ensure this distribution of sampling given our limited resources and also the great difficulty of measuring when speaking to an individual where they fall into such categories. The range of occupations the participants held are aggregated in the following survey tables.

The results of the interviews were recorded through offline tablets and stored on the QuickTap© servers. Privacy concerns were addressed as the survey respondents remained anonymous. The aim of the survey was to identify the utilization of financial services, apart from interest free credit, by Akhuwat borrowers and to identify the latter's perception of the household accountability clause of the loan. The loan officer is a tool to identify the effectiveness of the intensive training program for loan officers. Through this cross-country case study our report can identify an alternative delivery framework for a key financial service, such as credit, that addresses the religious and social obligations of minority communities in India.

ANNEX: SURVEY RESULTS

The percentages in this report may not add up to 100% due to respondents selecting multiple answers, rounding errors, or incomplete responses.

ANNEX A: BC SURVEY

Our interactions with BCs provided a series of qualitative results which includes focus groups and field interviews. While it is difficult to use them to make broad generalizations, they certainly cast some light on the role of BCs and their relationship with customers. For example, during the complicated days of demonetization, we found that BCs played a strategic role in providing banking services for clients. Our focus group revealed that, in some places, deposits had gone up as much as 300 percent since the policy was implemented. In the field, one BC mentioned that he had taken the old notes from people in his community, recorded the amounts, went to the bank to make the deposits for each of them, and brought back the receipts.

Some of the BCs feel the need of having more training in order to provide a better service; they even mention the willingness to pay out of their own pocket for the additional training, especially digitally focused training. A majority of the BCs mentioned that this activity is only supplementary to their main source of income, as we presupposed; there were some who asserted that being a BC was actually their only economic activity. In general, BCs are people with a better than average education, and above average incomes. But in terms of occupation and gender there is no homogeneous composition.

The number of deposits that BCs take ranges from 20 to 600, as mentioned before, this number grew up to three times during demonetization. The population in their Service Areas ranges from a 1,000 to 24,000. Most BCs have to visit bank branches multiple times per month; for most they said that the cost of getting to the bank is negligible, but was time consuming. There was a general feeling that the personnel at the bank treat them fairly.

Finally, most BCs mentioned that informal moneylenders are present in their communities, and people need and use their services due to the lack of access to formal loans. These informal lenders are able to offer very flexible and customized loans, with which formal loans cannot.

ANNEX B: CONSUMER SURVEY RESULTS

The survey results brought interesting but also foreseeable results. Forty-eight people responded the survey, 27 were men and 21 women, between the ages 22 to 70 -the medians is 40 years of age. Most participants have very little education, however, a couple had 15 years (university) - unsurprisingly, they are the only ones engaged in financial banking.

One third of the participants (35 percent) responded that agriculture is their main occupation, followed by Beedi (19 percent), and Mix labourers (17 percent). From the same sample, a majority responded they receive payments digitally (49 percent), a third receive payments by cash, and 12 percent receive them both ways.

Most participants had bank accounts (96 percent), and also most of them have visited a bank (92 percent). When asked about the benefits of having a bank account, 43 percent responded that access to basic transactions -deposits and withdrawals) was the main benefit, while 18 percent responded that access to pensions (withdrawals) was the most salient. Perhaps surprisingly, 89 percent responded that they never faced problems accessing their funds, and also mentioned that they were treated well in the banks the visited.

When asked about the main reasons for picking a bank, all participants mentioned that location was the most important, followed by quick processes and low borrowing costs. This is one of the man reasons why the BC model is so successful, the average distance to a bank from home was 6 kilometers, while the average distance to a BC was 350 meters; greatly reducing the transaction costs associated to banking.

In fact most participants (85 percent) have heard about the BCs, and almost the same amount (81 percent) have used their services with a high degree of satisfaction, 19 percent feel "very happy" with the service provided by their BC, while 60 percent feel "happy" with the service.

When asked about savings, half responded that their low income was the main barrier to save, while the other half responded that they did not find barriers to save. 25 percent responded no to have savings, 25 percent also responded that they save using various methods -banks, SHG, Gold, etc.- 18 percent use a bank account to save, and just one person used cash to store savings.

The survey took place in a rural area; unsurprisingly 91 percent of participants received remittances but did not send them. What was very surprising -and challenged our previous beliefs- is the fact that 73 percent responded that the purchasing decisions made at home were made collectively. Our assumption was that men and elders' opinion would be prevalent, but only 8 percent responded that the husband decided, and 4 percent that the parent decided.

The participants were asked about their propensity to use loans in a productive activity, 42 percent responded that they would use the loan in a farming activity, and 2 percent would use it in a productive non-farm activity. A quarter responded they would use the loan to buy food, and 11 percent would use it to pay for education or training. A couple of them, the most educated, responded they would use it to buy new smartphones.

Even when 69 percent responded that they received information about financial services from their BC, most people responded that they receive or seek for financial advice from family, friends, the community, or all of them.

Most respondents asserted that their family and friends would be the primary source of funds for a crisis (73 percent), capital for new assets (56 percent), and working capital (66 percent).

Moneylenders were mentioned in these categories, but not in the high numbers that we expected, 13 percent, 19 percent, and 16 percent, respectively. Also banks and BCs are not relevant in these categories.

Financial literacy was one aspect that we wanted to understand, specially related to credit. We asked participants whether they knew what interest was, 83 percent responded that they did. In the next question we asked if they were familiar with the concept of interest rate, and only a third responded correctly. Lastly, we asked if they could solve a simple calculation involving interests, and only 3 people was able to answer correctly -16 tried to answer but did not get the right answer.

Finally, we were interested in the effect that demonetization had in the area. Most people (57 percent) responded that they were affected, especially by the long lines and waiting time, the other 43 percent responded that they were not affected, some of them because they were too poor: "no money, no problems".

In fact, we believe that BCs played a strategic role in this matter. Through our focus group with BCs we found out that deposits had gone up even 300 percent since the policy took place. When we were in the field, one BC mentioned that he had taken the old notes from people in his community, recorded the amounts, went to the bank to make the deposits for each of them, and brought back the receipts.

ANNEX C: AKHUWAT BORROWER AND NON-BORROWER SURVEY (LAHORE, PAKISTAN)

The survey was conducted in some of the urban and peri-urban areas around Lahore, Pakistan. The survey consisted of 48 participants who resided near to an Akhuwat's branch office region. Hence these participants were either Akhuwat borrowers or could potentially apply to become a borrower. The number of total collected responses is 48 and represented a sample of 29 men and 19 women. As the survey was voluntary and the participants were given the option of skipping a question; thus some of the questions do not have a 100 percent response rate. The following table summarizes the findings from the most relevant questions with an adequate response rate.

The average years of education varied among the respondents and the average years of education acquired among the respondents was eight years. The age range of the participants varied from 23 to 58 years of age. The mean age of the participants was around 40 years. The majority (92 percent) of the respondents were married.

The occupations varied for the participants as well but most of them were engaged in non-agricultural activities. Thirty-five percent of the participants indicate they operate a general store or mobile repair shop. Meanwhile 25 percent of the participants were tailors or embroiders and nine percent of the participants served in tradesmen, such as electricians or auto mechanics. About 10 percent of the participants were employed as rickshaw or personal drivers.

The use of formal financial services was significantly low. While eighty-five percent of the participants had taken a loan from Akhuwat, only 10 percent of the participants had a bank account. Only two participants indicated ownership of health insurance. The use of formal savings was also not widespread. Around 48 percent of the participants saved in cash and 17 percent of the participants indicated another option of saving. Fifty-four percent of the participants indicated that they were unable to save a desired amount and 29 percent of the participants indicated a limited income as a reason for their inability to sufficiently save.

There was a lack of trust indicated by participants in formal banking as well. Twenty five percent of the participants indicated they do not trust bank officials with financial transactions. There was also limited use of mobile banking agents. While there was almost 100 percent mobile ownership, only 10 percent of the participants indicated using mobile banking. Thirty-eight percent of the participants indicated limited to no knowledge of mobile banking services.

ANNEX D: AKHUWAT LOAN OFFICER SURVEY

The second survey was conducted in 2017 with 15 loan officers from Akhuwat Islamic Microfinance in Lahore, Paksistan. The sample consisted of 12 male and 3 female officers with the mean age of 30.6 years. The majority of the participants, around 53 percent identified themselves as single. The average years of education acquired by Akhuwat loan officers are 11.4 years. The survey indicates that the majority of Akhuwat loan officers, who are responsible for the outreach in the field, are young individuals with a high school education.

All of the loan officers indicated that they had a bank account and only three loan officers served a non-urban area. Almost fifty- four percent and hence a majority of the loan officers in the survey indicated that they had prior experience in handling money before becoming a loan officer. The loan officers in the survey sample served a range between 2, 000 to 70, 000 people under their individual branch offices. The loan officers indicate they feel a responsibility in sharing information about financial services to the borrowers.

All of the loan officers indicated they had been well trained and had adequate capacity to provide services. However sixty percent of the loan officers indicated that they have encountered questions or technical issues for which sought senior support. All of the loan officers indicate they receive the desired support from their managers and 80% indicate they regularly communicate feedback to their seniors. Eighty percent of the loan officers indicate their feedback is acknowledged and address in a respectable manner and none of the loan officers indicated that this did not happen.