Institute for Financial Management and Research

Centre for Micro Finance

Working Paper Series No.22

January 2008

Linking Financial Inclusion with Social Security Schemes

Anant Jayant Natu
Dr. Aashish Bansal
Amrita Kurian
Gurinder Pal Singh Khurana
Tanushree Bhushan

At the time of writing, all the authors were the part of the microfinance practice of the Social Initiatives Group (SIG) of ICICI Bank. The practice has now formed into IFMR Foundation. IFMR Foundation works closely with IFMR Trust in supporting models, strategies and projects for the financial inclusion of poor households. The views expressed in the article are those of the authors' alone and do not reflect the views of the institute with which the authors are associated.

Executive Summary

The paper explores an innovative way of achieving financial inclusion — not just in terms of access but in usage as well. It presents the prospect of coupling financial inclusion with social security schemes. The underlying assumption is that the imposition of financial inclusion drives by banks upon prospective clients who have no reliable income stream will simply yield substandard outcomes. A social security scheme such as the National Rural Employment Guarantee Programme (NREGP) provides a regular and steady stream of income to the poor, although for a limited period of time in a year. We believe that the drive towards financial inclusion as defined by the RBI as "a no-frills account for every individual who wants one" will be more relevant to the beneficiaries if it is tied to schemes such as NREGP that ensures a reliable stream of income.

The proposed model, currently being pilot-tested in Karimnagar district in Andhra Pradesh by Financial Information Network & Operations Ltd. (FINO), a technology provider, tries to facilitate financial inclusion over the channel and reach created by NREGP. This model can be put into practice in a number of ways. In a district where NREGP is operational and there exists a microfinance institution (MFI) or an NGO, we have explored the possibility of the MFI/NGO working as a 'Business Correspondent' for the local bank. The government can partner with the bank in ensuring that the weekly wages are directly credited to the savings accounts that have been created for the beneficiaries. Post offices (POs) as an existing infrastructure can also play the role of a 'Business Correspondent' for this model. A variety of services (both financial and non-financial) can then be provided to the beneficiaries once such a channel of linking financial inclusion with NREGP has been established.

In addition to presenting various ways through which financial inclusion can be tied with NREGP, we also illustrate how technology can facilitate efficient and effective financial inclusion. This is based on findings from the Karimnagar pilot study where the state government, with the help of FINO, has used smart cards, biometrics, and hand-held devices to digitize the disbursement of NREGP wages. Examples of the use of technology in providing various financial and non-financial services have also been assimilated to support our model.

Acknowledgement

The support provided by Jaimon Jose and Annuradha Phougat of FINO and Minakshi Ramji and Yusuke Taishi of the Centre for Micro Finance at IFMR is gratefully acknowledged.

Contents

1. Financial Inclusion

According to a United Nations report, financial inclusion encompasses two dimensions of customer access. First, it refers to a customer with access to a range of formal financial services, from simple ones like credit and savings to more complex ones like insurance and pensions. Second, it implies that customers have access to more than one provider of financial services, thus, increasing access to a variety of competitive options (United Nations, 2006).

The Finance Minister of India in the 2007-08 Union budget speech defined financial inclusion as “the process of ensuring access to timely and adequate credit and financial services by vulnerable groups at an affordable cost” (Chidambaram, 2007). Clearly this definition reveals the bias that has historically existed towards provision of credit services over other financial services. The exclusive focus on credit has meant that policy and practice has thus far ignored the provision of a safe place for savings for rural households (Ghate, 2006).

The Reserve Bank of India (RBI) has advocated financial inclusion in a different manner. This can be better understood by some of the recent speeches by the RBI Governor and Deputy Governor. In a speech recently delivered in a village of Andhra Pradesh, the RBI Governor, Y.V. Reddy, gave a simple definition of financial inclusion as “ensuring bank accounts to all families that want it.” He said it would be the first step towards reaching the goal of bank credit as a human right as advocated by Nobel Laureate Professor Mohammed Yunus (Reddy, 2007).

According to Smt. Usha Thorat, the RBI Deputy Governor, financial inclusion has been defined in terms of exclusion — exclusion from the payments system and exclusion from formal credit markets (Thorat, 2007). Exclusion from the payments system is measured in terms of not having access to a bank account while exclusion from formal credit markets is measured in terms of number of loan accounts.[1]

The RBI Annual Policy Statement of April 2005 first highlighted the issue by stating that "banking policies tended to exclude rather than attract vast sections of the population" (RBI Circular, 2005). Three major moves were thus initiated. First, a "no-frills" basic banking account was extended to all unbanked households where the minimum balance required was nil or extremely low. Second, "Know Your Customer" (KYC) norms were relaxed so that the needs of rural households that could not establish their identity or their address formally could be accommodated. Lastly, banks were urged to ensure that their charges were reasonable and transparent (Ramji, 2007)[2].

The first pilot project that implements these three recommendations, and thus facilitates financial inclusion, was conducted in the Union Territory of Pondicherry, led by Indian Bank and was completed in December 2006. Since then, several projects have been completed in different parts of India. 100 per cent financial inclusion is reported to have been achieved in the state of Himachal Pradesh and in Gulburga district, a backward district in Karnataka.

In her recent speech, Thorat spoke on why financial inclusion is important to India:

> Limited access to affordable financial services such as savings, loan, remittance and insurance services by the vast majority of the population in the rural areas and unorganized sector is believed to be acting as a constraint to the growth impetus [in the primary and SME sector]. Access to affordable financial services — especially credit and insurance — enlarges livelihood opportunities and empowers the poor to take charge of their lives. Such empowerment aids social and political stability. Apart from these benefits, financial inclusion imparts formal identity, provides access to the payments system and to savings safety net like deposit insurance. Hence financial inclusion is considered to be critical for achieving inclusive growth; which itself is required for ensuring overall sustainable growth in the country (Thorat, 2007).

[1] Going by the available data on the number of savings bank accounts and assuming that one person has only one account, we find that on an all India basis 41 per cent of the adult population is *unbanked*. In rural areas the coverage is 61 per cent as against 40 per cent in urban areas. The all India ratio of the number of loan accounts to adult population (2005) constituted only 14 per cent. Regional differences in the number of loan accounts are significant; while the figure is 25 per cent for the southern region, it is as low as 7, 8 and 9 per cent respectively for the North Eastern, Eastern and the Central region.

[2] For more details, see Annex 1.

We adopt the RBI's definition as the initial working condition of financial inclusion – a family is said to be financially included if at least one member of the family has a savings account with a bank. Adopting this definition, we proceed towards linking of financial inclusion with social security schemes such as the National Rural Employment Guarantee Programme (NREGP).

2. Linking Social Security Schemes with Financial Inclusion

Poverty is directly connected to the lack of resources to generate an income that enhances an individual's standard of living. In a poor country like India, social security schemes assume central importance in poverty alleviation programs. They tend to supplement the meager income base of the poor either through direct transfers or through schemes where one's labor can be traded for food or money — the latter also ensures that some community assets are built in the process.

We believe that financial inclusion drives, when linked to social security schemes such as NREGP can complement each other. NREGP can create an opportunity for the poor to save surplus cash. A financial inclusion drive offering no-frills bank accounts can provide the poor a secure interest bearing place to save that surplus cash. We present below the three primary benefits of linking the two.

a) The Supply Imperative: Higher Usage of the Bank Accounts

The Centre for Microfinance (CMF) at the Institute for Financial Management and Research (IFMR) in Chennai, conducted a study on the impact of the financial inclusion drive in Gulbarga district (Ramji, 2007). The experience in Gulbarga (Annex 1) suggests that a financial inclusion drive by itself (defined as opening of no-frills bank accounts by banks) is not received with enthusiasm either by its beneficiaries or by the banks. Banks see it as a social commitment, which they are forced into making, and individuals are not able to comprehend the utility of a savings bank account and hardly ever use it.

In Gulbarga district, it was observed that the usage of accounts was higher when they were linked to NREGP. Also, experiences in the Karimnagar pilot (presented in Section 4) suggest that while the wage earner in NREGP was expected by its design to withdraw the entire earning each week, the ground reality shows that she/he does not want to withdraw the full amount and would rather save part of it.

The findings from the Gulbarga study and the Karimnagar pilot confirm conventional understanding that the imposition of what policy makers think is important for the poor may not necessarily lead to desirable usage unless the poor perceive the benefit or necessity of the program. By coupling the financial inclusion drive with NREGP, it is possible to expect higher usage.

b) The Demand Imperative: Steady Stream of Income for Beneficiaries

A scheme like NREGP creates a steady stream of income, though for a limited number of days. Once the beneficiaries are assured of a fixed payment every week, they can plan their savings. Thus accounts linked to the NREGP would provide higher usage and banks may find maintaining them commercially viable.

The Integrated Rural Development Project (IRDP)[3] could, if properly implemented, have also led to financial inclusion.[4] Large number of people were given credit and linked to banks. However, the scheme did not take off and those linked to banks dropped out of the financial net over time. One of the reasons for its failure was that the credit linkage was not supported by other critical inputs like market linkages and even if they were, poor infrastructure made the businesses unviable. In other words, beneficiaries were not able to generate a steady stream of income for themselves. On the other hand, the income from NREGP comes in the form of direct transfers based on their work on-site, insulated from the inefficiencies of the market and infrastructure bottlenecks.

[3] In IRDP, a massive amount of credit was targeted towards socially excluded groups and women.
[4] Based on a discussion with Ramesh Arunachalam of the Microfinance Consulting Group

c) The Efficiency Imperative

The wide outreach of NREGP, which is soon to be extended to all districts of the country, also makes it a good candidate for coupling with financial inclusion drives. NREGP provides a channel to reach the poorest of the poor. Once this channel is established a number of other services can be superimposed on it to provide other services, financial services being one of them. The physical channel provided by the NREGP coupled with the financial inclusion drive of RBI can aid in bringing formal banking to the poor.

Furthermore, government-led poverty alleviation programs are often criticized for their inefficient targeting mechanism where actual beneficiaries are often better off than those intended. This is partly due to the top-down selection process which leaves space for government officials to use the program as a political tool. NREGP, however, is a self-selection based program. The relatively low wages offered and the physical labor required by these programs act as a self-targeting mechanism and discourage participation of the less-poor households. Such programs attract only those with a low opportunity cost of time.

3. Implementation of NREGP

As mentioned earlier, NREGP is not a targeted programme but seeks to provide a minimum of hundred days of employment to those willing to do manual labor. Those who are willing to participate in the program send an application to the Gram Panchayat of their village. Verification of these households confirms their local residence and number of adults in the household. Verification is followed by registration and every household is provided with a unique registration number. Job cards are then issued to the registered households by the Gram Panchayat. Information on new applications is conveyed once a week to the programme officer at the block level.

Muster rolls provided by the programme officer are maintained by the Gram Panchayat and so is the consolidated household-wise employment data in the employment register. The compensation and the number of days for which payment is made are recorded on the job cards. Coordination of employment data lies with the Gram Panchayat at the Panchayat level and with the programme officer at the block level. The programme officer should make arrangements for the collection of data on the labor employed and material received on a weekly basis from the respective NREGP work sites.

Wages are calculated either on a time-rate or piece-rate basis. Measurements are to be made in a standardized and transparent manner by the supervising authority. They involve a panel of accredited engineers constituted by the state government at the block and district level. Wages are paid in accordance to the minimum wages fixed by the state governments. Wages are to be paid on a weekly basis or in any case within a fortnight from the date on which work was done. The disbursement is made on a pre-specified day of the week.

While wages can be transferred to a bank or post office savings account of individuals, currently, the Gram Panchayat is the most common means of wage disbursement as many beneficiaries do not have a savings account. When wages are disbursed through the Gram Panchayat, money comes to a Gram Panchayat bank account jointly held by the *sarpanch* and the Panchayat secretary. The disbursement of wages is done in a public place and muster rolls are read aloud and displayed at the time of payment.

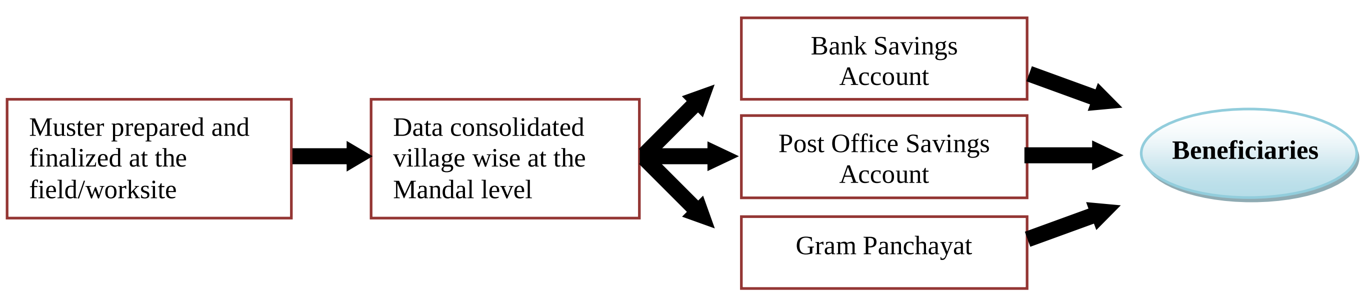

Figure 1: Modes of wage disbursement under NREGP

The diagram below (Figure1) illustrates the existing channels for the disbursement of wages of the NREGP.

4. Use of Technology for the Disbursement of Wages: Case of Karimnagar

Presented below is a pilot project in Karimnagar District undertaken by the government of Andhra Pradesh (GoAP) in partnership with the technology provider, Financial Information Network and Operations Private Limited (FINO). In this project, biometric smart cards are used by the GoAP to disburse wages under NREGP as well as pension schemes. As will be discussed in Section 5, the use of technology is an essential element in our proposed model that seeks to combine financial inclusion drives and NREGP. In this section, we demonstrate the process through which wages from NREGP are disbursed using biometric smart cards, and then, in the section that follows, we will propose our model using this pilot as a prototype.

The channel of disbursement in this pilot project involves a number of players: the GoAP, FINO, Tata Consultancy Services (TCS), Krushi (NGO/MFI), the Village Organization Representative (VOR) and the individual beneficiary. How each of them plays a role in the disbursement process is described below.

Information on those workers who participate in NREGP is sent weekly to a Mandal (block) office. This information is aggregated and uploaded by TCS. This intermediary is required as block offices are currently not capable of sending the data in the required format. Moreover, when there are a large number of blocks, it will become more difficult to manage the data coming in from several blocks. In Karimnagar, TCS has uploaded a patch file both at the Mandal and at the FINO server enabling the Mandal to send data directly to the technology provider (FINO). The Mandal office then issues FINO a cheque worth the total disbursement for the week, and FINO in turn deposits the check in the local bank (UBI in this case). Cash is handed over from FINO to Krushi, and then to VORs appointed by Krushi. Actual disbursements are processed by VORs by swiping an individual's smart card in a hand-held device to verify his or her identity. The data is automatically sent and synchronized with the FINO server.

The technology provided by FINO involves a back-end server where consolidated data from the Mandal is stored and the front-end devices such as the hand-held device and individual smart cards. FINO charges the GoAP a service fee on the basis of the total disbursements. FINO in turn pays a commission to Krushi and VORs for their service of actual disbursement. Average disbursements per week for a village may range from Rs.10,000 to Rs.200,000. FINO provides training to the VOR on the functioning of the hand-held device. Reconciliation of accounts amongst FINO, Krushi and the VOR are done every 3 months. The cost of smart cards (~Rs.120 per card) and the cost of the hand held devices (~Rs.20,000 per device) are partly borne by the GoAP for this pilot.

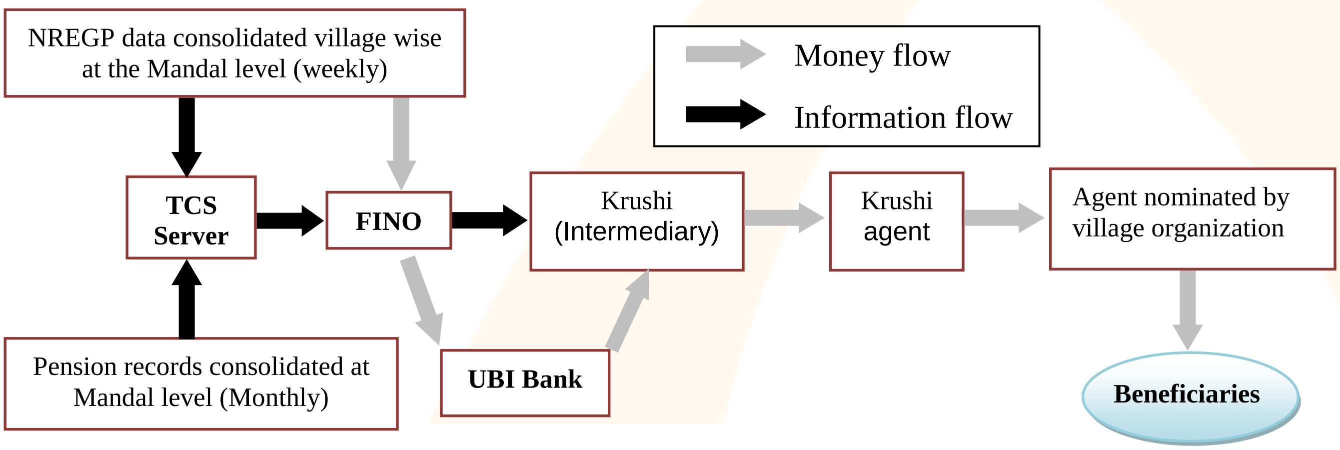

Figure 2: Processes in the disbursement of wages in Karimnagar District

5. Proposed Model: Linking Financial Inclusion with NREGP

In this section, we propose a new model by incorporating lessons from the Gulbarga study and the Karimnagar pilot: wage disbursement through a no-frills savings account. The prospect of coupling social security schemes with financial inclusion is based on our assumption that seeking financial inclusion without a reliable income stream will be of little use to the clients (as CMF's Gulbarga study has shown). The challenge is to facilitate financial inclusion over the 'channel and reach' that has already been created by the NREGP. This, we believe can be done in number of ways:

1. In districts where there is an exclusive MFI presence, one can explore the possibility of having the MFI work as the Business Correspondents (BC). They can open savings banks accounts in a local bank on behalf of the clients. The government can partner with the bank in ensuring that the weekly wages are directly credited to saving accounts thus created.
2. On the other hand, we can explore if post offices (POs) that are being used in some cases for disbursing the weekly wages under the NREGP can be merged with the national banking infrastructure (where post offices can mobilize saving, issue cheques etc.). Alternatively, they can act as a BC themselves. The potential of using POs for financial inclusion will be explored in detail in Annex 5.

5.1. Mechanism of the Proposed Model

The way in which data on individuals is consolidated and uploaded in the server of a technology provider is identical to the Karimnagar pilot. The difference appears in the way money flows to the beneficiaries. In the Karimnagar pilot, wages are first transferred from the Mandal office to FINO, deposited in a local bank, and then handed over to an MFI. In our proposed model, since, by assumption, all beneficiaries hold a savings account in a bank, wages are directly transferred to the individual's account from the Mandal. This process is depicted in Figure 3.

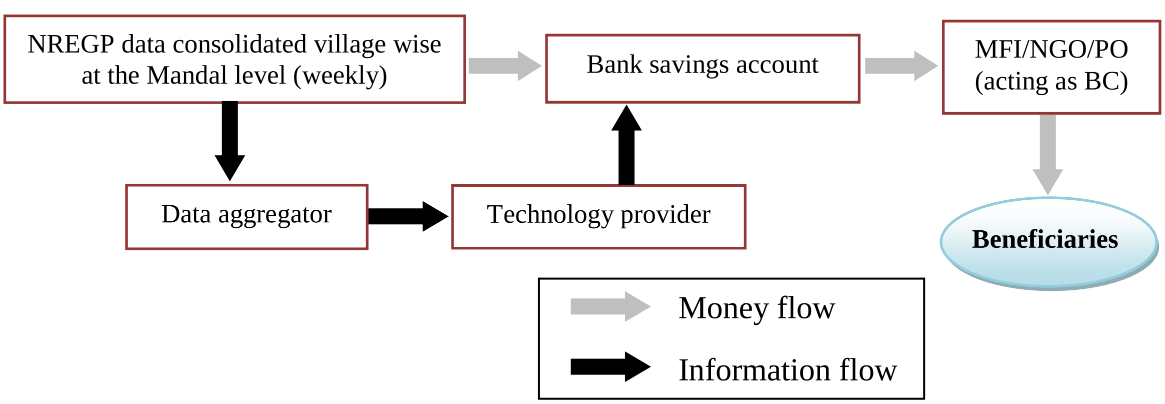

Figure 3: Proposed model for linking Financial Inclusion with NREGP

Another salient feature of this model that is different from the model described in the previous section is that an MFI, NGO, or post office acts as a BC (see Annex 2 for description). This is particularly important as it completes the "last mile" of financial inclusion. While mandatory no-frills accounts help overcome psychological or practical barriers the poor may have with banks, there also exists a physical barrier for people in many parts of rural India – the distance to bank branches. The transportation costs as well as the opportunity cost of time in visiting a bank branch prevent many of the poor from visiting a bank branch on a regular basis. BCs can deliver savings and credit services to the NREGP beneficiaries at their doorstep. The NGO/MFI would be given a commission by the bank for this service. The commission can be direct or indirect. In the case of a direct commission arrangement, the NGO-MFI receives an upfront service fee based on the volume of business. An indirect commission can be provided by the bank in various ways; for instance, it may provide a discount on the interest on loans taken by these MFIs.

5.2. Costs Involved in the Model

There are various costs that are involved in the proposed model. First is the cost of aggregation, formatting, uploading and transmission of data from the block to the technology provider. Secondly, back-end costs such as installation and maintenance of the server also exist. Besides, there exist front-end costs such as the hand-held devices, and smart cards to individual beneficiaries. Other costs include that of financial literacy training for the clients and engaging human resources like the NGO/MFI as well as the commission paid.

5.3. Ownership of the Channel

Once developed, the channel can be owned individually by the bank or the government or jointly by both, based on the initial investments made. In the long run, the channel can be a source of revenue for the owner from the commission. In case the government owns the channel, they can utilize it for other services as well, be it social security schemes, health or education. Once an aggregated database of the beneficiaries becomes available to the government, then multiple utilities, beyond financial services, can be provided. It will also help the government in policy and product design for this particular segment of the population.

5.4. Perceived Benefits

From a macro perspective, the provision of a bank account to the entire population of the country is considered a long-term investment for inclusive financial growth.

There are numerous benefits of using a channel equipped with the state-of-the-art technology. Real time transactions not only increase the overall efficiency of the cash flow, they also provide a secure virtual transfer of money to banks from the government, and thus target money is not lost in the process of reaching the poor, as is often the case in government schemes where funds leak from the system before the beneficiaries can access them. The cash due to absent beneficiaries cannot be usurped by any other person as the verifications are electronically processed leaving minimum possibility of fraud by BC agents or the Panchayat secretary. Physical presence of the beneficiary (biometric identification) is necessary for obtaining the payments against smart cards.

Furthermore, in case the government obtains a digitized record of the poor, they can obtain an official record of an otherwise unmapped population via smart cards which contains not only details of the household but also the authenticating fingerprints of the beneficiary. This can be utilized in extending other services as well as mapping the population in times of crisis such as during droughts, floods, and riots.

Beneficiaries can save transportation cost as well as the opportunity cost of visiting banks, which can be prohibitively high for the poor.

5.5. Potential Problems

There exists the possibility of a conflict of interests between the MFI and the bank. MFIs may want to extend their services to the same clients as those of the bank. An appropriate incentive scheme must be designed so that the commission paid to the MFI for extending the banking services to the doorstep of the poor on behalf of the bank exceeds the profit that the MFI would have earned by servicing the clients itself.

There is another potential source of conflict of interests between the government-promoted SHG savings and the no-frills accounts. Once a personal savings account is created, people can lose incentive to save in SHGs as the personal savings have more flexibility. The weakening of SHGs may not be acceptable to the government or civil society organizations as SHGs are used by these institutions as a channel to deliver various assistance schemes.

6. Role of Technology in Government Programs and Financial Inclusion

6.1. Use of technology for financial inclusion

Technology-based solutions can be used by formal financial institutions to provide a range of financial services to the poor and support the drive for financial inclusion. The effective use of technology can help standardize processes in banking and microfinance as well as reduce the cost of operations. Through technology, banks have the potential to reach out to millions of poor and 'unbanked' people through the use of automated teller machines (ATM) and Point-of-Sale (POS) networks. According to Ivatury:

> Technology appears to be a promising solution to the problem of access. ATM transaction costs are as much as 5 times less expensive (sic) than those of a bank teller…. And inexpensive POS devices which read debit and credit cards can now be used without constant telecommunications and electricity connections (2007, p.38).

A worthy international technology-based initiative is the 'National no frills Bank Accounts (NBA)' initiative implemented in South Africa for its unbanked populations. These are known as Mzansi accounts and are a card-based initiative that uses the existing networks of banks (branch outlets and ATMs), government (such as post offices) and other bodies (such as merchant POS devices). The card is available at an affordable price and provides vital services such as savings and money transfers between South African banks and post offices. The use of technology has lowered transaction costs significantly and made too-costly-to-serve populations and regions "attractive propositions" (Thorat, 2006).

The RBI, in a policy statement, also promotes the use of technology by the banks to manage the "reputational, legal and operational" risks especially when they are working in collaboration with business correspondents (RBI Circular, 2006).

6.2. Use of Technology for Government Schemes and Other Public-Private Partnerships Around the World

In the 11th Five Year Plan of India, the government affirmed that it would make use of modern technology and its applications for achieving governance and delivery efficiency, especially for government-run programs such as the Public Distribution System (PDS) and NREGP (Planning Commission Report, 2006).

The Multi-Application Smart Card (MASCs) is one technology application that is being promoted in India. Setting up the entire system that enables MASCs to work involves much more than just issuing the electronic card to potential beneficiaries. It also involves the setting up of a comprehensive system that consists of a front-end module that includes the 'point of delivery'; the middle offices that update the card periodically and transfer the information from the front-end to the back-end and vice versa; and the back-end module which contains the computerized records and manages the database.

Some recent government initiatives that have adopted this technology include a national level driver's license known as the Smart Card Operating System for Transport Application (SCOSTA) and smart ration cards in Kerala. According to the Planning Commission report:

> The concept of a unique national level citizens' identity number was developed from these initiatives as well as aspirations for a Pan-India e-governance system.... This could also form the basis of a public-private-partnership wherein unique ID-based data can be outsourced to other users, who would, in turn build their smart card based applications (2006, p.2).

Annex 3 lists out pilots carried out in India using smart cards for different kind of services.

Experiments with MASCs have been carried out in various nations around the world. These cards have been used for a variety of purposes and vary in their type as well. An example of this is in the United States where people without bank accounts use pre-paid cards that can be loaded with money and be used as debit cards. These are multi-purpose cards that can store electronic deposits from employers, pay bills and withdraw cash from machines. It is envisaged that in the future these cards will contain features such as loan advances and build credit histories.

In China, the government has started to replace national identification (ID) cards with electronic identity cards that contain an identification number, personal details and information on all government services that the person receives. Similar cards have been issued in other countries, such as Malaysia and Philippines. France has pioneered issuing smart cards for a health insurance system known as Sesam Vitale. It is an innovative dual card system where one card is given to the patient and the other to health care professionals and thus links people with public hospitals, specialist doctors and other health care resources.

7. Conclusion

While the financial inclusion drive promoted by the RBI is remarkable in its objective, evidence suggests that the actual usage of bank accounts provided through the drive is far from what policy makers intended. This indicates that, unless the previously unbanked population has a reliable stream of income, the demand for a bank account will not be generated. It also calls for a review in the current policy.

In this paper, we proposed the financial inclusion drive be jointly implemented with the government's social schemes, particularly the National Rural Employment Guarantee Programme (NREGP). The joint implementation of the drive and NREGP ensures the frequent usage of bank accounts while providing much needed financial products to the poor. Our proposal further included the use of technology such as a smart card to enhance the efficiency and security of the transaction. Last, but not least, the use of MFIs/NGOs/POs through a Business Correspondent scheme was considered. This has a particular relevance when the areas in question do not have sufficient bank branches but have other existing networks of these institutions.

Annex 1: The Gulbarga Study

In 2006-07, the Reserve Bank of India announced that a drive for financial inclusion was to be initiated in every state to achieve 100 per cent bank account ownership in every state. The State Level Banking Committee and the state led banks were to initiate this programme in at least one district in their home state (Ramji, 2007). The process of financial inclusion was to have three phases: the first phase to involve the opening of no-frills savings accounts and the second phase was the extension of credit. Credit was to be disbursed through General Purpose Credit Cards in case of Gulbarga. Channels for credit delivery could vary from state to state. The third phase was envisaged to extend to services like insurance; however, there could exist variations from state to state.

In order to better understand the process through which people become "financially included" and the extent of the progress of the drive, a study was carried out by the Centre for Micro Finance. Gulbarga, a district in northern Karnataka, was selected for the study. In Gulbarga, 33.85 per cent of the population falls below the poverty line. It is one of the most backward districts in Karnataka.

The study, which is preliminary in nature, found that though the leading banks and intermediaries have taken required measures to ensure the execution of the drive, most people were either unaware of or did not use these accounts. There were several reasons for lack of use including the distance to the banks and inability of beneficiaries to save. Among households that did not want a bank account, 81 per cent cited 'inability to save' as the primary reason. However, it should be noted that 87 per cent of the respondents to the survey saved in one form or the other (either at home, with an SHG, using a bank account, etc). Hesitation to save in the bank was due to perceived notions that the savings have to be of a considerable volume each time. While 48 per cent of the respondents who wished to hold bank accounts wanted it for the purpose of saving, 15 per cent wanted it for government assistance.

One of the main findings of this study was that the financial inclusion drive was more successful when coupled with NREGP. The NREGP participants seemed to be more aware of the financial inclusion drive and had opened accounts because it was a channel for wage disbursement. The village Panchayat was responsible for opening the accounts and information dissemination. The savings account utilization was observed to be higher among NREGP workers as compared to others in the district who were equally poor but not enrolled in the NREGP.

Annex 2: Business Correspondent Model

In a policy statement (RBI Circular, 2006), the RBI has legitimized the channel of business facilitator and business correspondent in order to ensure the extension of banking services to previously unbanked regions and populations.

According to the policy statement "[u]nder the Business Correspondent Model, NGOs/MFIs set up under Societies/Trust Acts, societies registered under Mutually Aided Cooperative Societies Acts or the Cooperative Societies Acts of States, section 25 companies, registered NBFCs not accepting public deposits and Post Offices may act as Business Correspondents." This means that MFIs, NGOs, or POs can act as an agent of a bank extending banking services, of the particular bank to which the agent is corresponding, to the public. This presents a huge potential for achieving financial inclusion: Banks, while they have necessary resources to provide financial services, their networks are not sufficient, especially in rural areas, to reach the currently unreached; and MFIs and NGOs in turn have limitations in the kind of financial services they can provide while they have rich networks to serve rural population.

Under this model, it is the duty of the bank to carry out due diligence of the business correspondent they are working with to ensure that they are "well established, enjoying good reputation and having the confidence of the local people" (RBI Circular, 2006). The business correspondent would thus carry out activities that "would be within the normal course of the bank's banking business" but conducted in "places other than the bank premises" (RBI Circular, 2006). These activities include disbursal and recovery of credit, acceptance of deposits, sale of micro-insurance and other financial products as well as delivery of remittances and other payments.

The bank is responsible for paying a reasonable commission or fee to the business correspondent and the latter is prohibited from charging the customer for any services that it renders on behalf of the bank. The RBI in its statement makes it clear that the accountability for the proper conduct of the banking services (including compliance with the KYC norms) undertaken by the business correspondent lies with the bank.

Annex 3: Cases on the Use of Technology

Janalakshmi Social Services, Bangalore

Janalakshmi Social Services, an urban MFI, caters to around 40,000 families. FINO has provided them with technology solutions so that individuals and groups who do not have access to mainstream financial institutions can be included. The partnership involved the deployment of core banking solutions and smart card solutions. Clients of Janalakshmi include small vegetable vendors and traders. The technology solution designed by IBM and FINO facilitates online and offline transactions at affordable cost while reducing paperwork in the bidding process for traders at Safal outlets. With smart cards, traders now have access to the trading floor anytime without having to carry cash and are not compelled to resort to expensive loan arrangements through money-lenders.

Union Bank of India, Uttar Pradesh

Union Bank of India has launched doorstep banking operations in rural areas of Uttar Pradesh using biometric smart cards. The bank has launched a pilot project in Chahania block in Chandauli district with FINO and Cashpor Micro Credit Ltd., an MFI. FINO provides technical support, which enables the bank to leverage technology to service rural customers.

Union Bank of India, Mumbai

Union Bank of India has introduced biometric cards for vegetable vendors through Hawkers' Association of Mumbai and opened 'no-frills' accounts for them, which will help them deposit money and take loans. The bank is working with FINO in issuing the smart cards. These cards store data on the customer and the account. The banking correspondent, Fintech Foundation, appointed by FINO, goes to these hawkers with point of transaction devices. By swiping the card through these hand-held devices, hawkers can deposit their savings or borrow money. The data from the cards, stored on the terminals, is later transferred to the bank's servers.

Punjab National Bank (PNB)

Punjab National Bank is working with FINO to roll out smart cards for the rural population in Rajasthan. FINO would enable PNB's zero-balance savings account customers to carry out transactions by providing FINO smart cards and point of transaction devices. The project aims at catering to PNB's rural clients across the country.

KAS, Orissa

KAS is an MFI working primarily in Orissa. The FINO platform provided them with advanced banking and front-end technologies such as smart cards, biometric Point of Sale (POS) terminals and a core banking solution that connects all its offices. This reduced the chances of fraud and transaction costs.

ICICI Prudential Life Insurance Company

ICICI Prudential Life Insurance Company has launched the use of biometric smart cards for their rural policyholders to pay premiums. Biometric cards contain details of the policyholder such as name, age, address and finger print information. The card enables them to move away from the connectivity and infrastructure barriers and provides real time solutions to policyholders in rural areas.

ICICI Lombard General Insurance Company

ICICI Lombard General Insurance Company is introducing biometric cards in rural and semi-rural areas. ICICI Lombard plans to offer biometric cards to families under group health insurance schemes. The card enables policyholders to get hospital treatment without making any advance cash payment.

Technology for Government Services

FINO issued smart cards for the District Administration of Cuddalore. The FINO smart card services would be used by the Administration along with Indian Bank for disbursement of funds under various central and state level schemes, such as the National Rural Employment Guarantee Act (NREGA) and Old Age Pensions.

Aam Admi Bima Yojna

The central government is using biometric cards for the recently launched insurance scheme '*Aam Admi Bima Yojna*' with LIC.

Annex 4: Post-office savings accounts

(a) Who can open these savings accounts?

- A single adult or two-three adults jointly
- A pensioner to receive/credit his monthly pension
- Group Accounts by Provident Fund, Superannuation Fund or Gratuity Fund
- Public Account by a local authority/body
- An employee, contractor, or agent of a government or of a government company or of a university for depositing security amounts
- A Gazetted Officer or an officer of a government company or corporation or Reserve Bank of India or of a local authority in his official capacity
- A cooperative society or a cooperative bank for payment of pay, leave salary, pension contribution of government servants on deputation with such society or bank

(b) Where can these savings accounts be opened?

- At any post office

(c) Deposits

- Account can be opened with a minimum of Rs. 20
- Maximum of Rs. one lakh for single holder and Rs. Two lakhs for joint holders. If depositors have more than one account (single, pension or joint), the balances or shares of balances in all such accounts taken together should not exceed Rs. one lakh for each of the depositors

(d) Maturity period / withdrawal

- There is no lock-in / maturity period prescribed
- Withdrawals: Any amount subject to keeping a minimum balance of Rs. 50 in simple and Rs. 500 for cheque facility accounts

(e) Interest

- Interest at the rate (s) 'as decided by the Central Government from time to time,' is calculated on monthly balances and credited annually
- Interest rate applicable w.e.f. 1.3.2001 is 3.5 per cent per annum for general public

(f) Pass Book

- The depositor is provided with a pass book with entries of all transactions duly stamped by the Post Office

(g) *Silent Accounts*

- An account, which has been completely idle for three full years, shall be treated as a 'Silent Account'
- A service charge at of Rs. 20 per year is charged on the last day of each year until it is reactivated
- In a silent account, when service charges take down the balance to NIL, the account is automatically closed

(h) Final closure / withdrawal

- Final withdrawal/ closure of an account shall be allowed by Sub Postmaster/Extra departmental Sub/Branch Postmaster on obtaining sanction from Head Postmaster

(i) Tax treatment

- Income tax relief is available on the amount of interest under the provisions of section 80L of Income Tax Act.

Annex 5: Use of Post Offices for Financial Inclusion

Postal networks are one of the oldest deposit-taking institutions in India and offer several basic financial services such as money transfers and savings accounts (see Annex 4). Moreover, postal networks have a widespread coverage in rural areas where the formal financial sector usually does not directly reach. There are more than twice as many post offices (about 1.55 lakh) as commercial bank branches (approximately 70,000) in India. Not only does this coverage present viable opportunities in terms of outreach, it also has a significant implication in terms of cost reduction. Through economies of scale, services provided through the existing postal networks can be offered at more affordable prices to low income clients. Thus, if incorporated, they are considered to have an enormous potential for achieving financial inclusion.

There are three ways in which POs can aid financial inclusion:

a) POs as the banking channel
b) POs as agents for branchless banking
c) Setting up of postal banks

The rest of the section describes each of the above in detail.

POs Providing Banking Services

The first option of using the existing postal networks for financial inclusion is to use them as they are. However, there is a drawback to this. Currently, the post office savings banks (POSBs) cannot provide fund-transfer facilities to customers as they are not linked to the clearing system and the National Electronic Fund Transfer (NEFT). At present, the POs are in the process of computerizing and networking head post offices. Although the Postal Department expects to network 650 of head post offices by the end of 2007, it may take a while for all post offices, especially ones in rural areas, to be plugged into the NEFT system.

Nevertheless, the accessibility of POs outweighs the many disadvantages faced by poor clients who do not have bank accounts. In Anantpur district of Andhra Pradesh, the NREGP wages are directly credited into the PO saving accounts of the beneficiaries. Once these accounts are linked to nationwide clearing system and NEFT, they can create a useful platform from which electronic payments can be made cost effectively.

POs as Banking Correspondents

POs can act as agents under the Banking Correspondent regulation for branchless banking and can open no-frills accounts on behalf of the bank (see Section 5 and Annex 2).

Setting up of a Separate Legal Entity or the Postal bank[5]

The postal financial services may not necessarily be provided *by* the post office. The postal bank can be a separate legal entity which may be either publicly or privately owned. The postal network distributes the financial products of the bank on an agency basis. In this case the regulation and supervision of postal banks would fall under the national bank regulator.

The Brazilian post office, Correios do Brasil, selected a private bank (Bradesco) as a partner to offer postal financial services through its postal outlets by a competitive tendering process. The Brazilian BancoPostal has a high brand rating and has helped to provide points of financial presence for a range of products supported by Bradesco even in remote areas.

In 2004, the Postbank in South Africa, a separate division of the post office, participated with major retail banks to launch the offer of a new basic debit card account under the 'Mzansi' brand. The Mzansi account, a National no frills Bank Account (NBA) product that caters to the needs of the un-banked population of South Africa, was established to use existing distribution networks of banks, government and other bodies. To date, the Postbank has been the biggest single issuer of new Mzansi accounts, and recent research

[5] World Bank Group Newsletter, 2006

has confirmed that a majority of more than two million new Mzansi account holders were previously unbanked.

References

Access Finance. (2006, February). *The World Bank Group Newsletter*, Issue No.16.

Chidambaran, P. (2007, February 28). Speech delivered at the Union Budget 2007-2008 session. Retrieved from http://indiabudget.nic.in/ub2007-08/bs/speecha.htm.

FINO, PNB tie up for smart cards. (2007, October 3). Retrieved from http://www.sify.com/finance/

Ghate, P. (2006). *Microfinance in India: A State of the sector report*. New Delhi: Microfinance India.

ICICI Prudential Life goes the smart way. (2007, October 4). *News Today, Chennai*. Retrieved from http://www.newstodaynet.com/04oct/bu3.htm

Ivatury, G. (2007, June). Microfinance: Future success hinges on technology. *Revue Banque, 692,* 38-40.

Menon, J. (2007, June 12). Bihar shows smart card way to cleaner rural job scheme. *Indian Express.* Retrieved from http://www.indianexpress.com/story/33365.html

Menon. R. (2006, December 9). ICICI Lombard plans biometric health cards. *The Hindu Business Line.* Retrieved from http://www.thehindubusinessline.com/2006/12/09/stories/2006120903880600.htm

Mumbai hawkers to get 'smart' with Union Bank. (2007, August 18). *The Hindu Business Line.* Retrieved from http://www.thehindubusinessline.com/2007/08/18/stories/2007081851231900.htm

Planning Commission, Government of India. (2006). *Report of the Eleventh Plan Working Group on Integrated Smart Card System.*

Post Office may join payment clearance system. (2007, September 22). *The Economic times.*

Ramji, M. (2007). *Financial Inclusion in Gulbarga: Finding Usage in Access.* (Preliminary Draft from the Centre for Microfinance, IFMR for CARE Conference 2007).

Reddy, Y. V. (2007, February). *What RBI means to the common person.* Speech presented at Karamchedu Village, Andhra Pradesh.

Reserve Bank of India. (2005). (RBI Circular No. RBI/2005-06/233 RPCD.RF.BC.54/07.38.01/2005-06)

Reserve Bank of India. (2006). (RBI Circular No. RBI/2005-06/288 DBOD.No.BL.BC. 58/22.01.001/2005-2006)

The Role of Postal Networks in Expanding Access to Financial Services. (2006, November). *The World Bank discussion paper*, Volume 1.

Thorat, U. (2007, June). *Financial Inclusion – The Indian experience.* Speech presented at the HMT-DFID Financial Inclusion Conference 2007, Whitehall Place, London, UK.

Thorat, U. (2006, November). *Financial Inclusion for Sustainable Development: Role of IT and intermediaries.* Speech presented at the Annual Bankers' Conference 2006, Hyderabad, Andhra Pradesh.

Union Bank introduces rural doorstep banking with biometric smart cards. (2007, May 22). Retrieved from http://www.domain-b.com/finance/banks/union_bank/20070522_biometric.htm

United Nations. (2006). *Building inclusive financial sectors for development*. New York: United Nations.

Van De Walle, D. & Nead, K. (Eds.). (1995). *Public spending and the poor - Theory and evidences*. Washington, D.C.: World Bank.

http://www.fino.co.in/

http://www.rbi.org.in/home.aspx

http://www.indiapost.gov.in/