The Banking Channel of Financial Inclusion: Credit Where Credit's Due

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'An inclusive financial system is essential infrastructure in every country.'

–United Nations Secretary-General's Special Advocate for Inclusive Finance for Development[1]

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2.1. INTRODUCTION

Financial inclusion is not a new policy measure that the government has suddenly embraced in recent years. Rather it has been a key component of the inclusive growth objectives of the Indian State for decades. Given that the poor suffer from multiple and varying levels of deprivation, a single channel to include the excluded in the formal financial system does not work in a country as vast and diverse as India. Three main channels or models are in operation in the country, led by the banks, microfinance institutions (MFI), and self-help groups (SHG). The focus of this chapter is on financial inclusion via the banking channel while the other two channels will be covered in detail in other chapters.

When it comes to financial inclusion in India, the State and the banks are joined at the hip. Banks with the largest physical network and the highest market share of deposits and credit are owned by the Government of India. Given their size and vast network, the nationalised banks (henceforth referred to as banks) have been subjected to State-directed lending for decades. They have also played a large role in government-to-citizen transfers. Banks via their investments in Statutory Liquidity Ratio (SLR) eligible bonds have also provided much-needed funding for the budgetary deficits.

Over the years, the policy mix with respect to financial inclusion in India has included a wide range of initiatives. It began with the active promotion of cooperative banking in the early years after independence (Roy 2011). This was followed by the nationalisation of several life insurance companies, the formation of the Life Insurance Company of India in 1956 followed by the nationalisation of several commercial banks in 1969 and again in 1980. Several general insurance companies were nationalised in 1972 leading to the formation of four state-owned general insurers.

Gradually, in the late 1960s and early 1970s, priority sector lending norms were introduced and have since remained a key component of financial inclusion through banks. To promote inclusion of the rural poor, Regional Rural Banks (RRB) were set up in 1975 followed by the setting up of the National Bank for Agriculture and Rural Development (NABARD) in 1982. Kisan Credit Cards (KCC) for agriculture credit and zero balance no-frills savings accounts were introduced in 1998 and the early 2000s, respectively. Following the recommendations of the Nachiket Mor Committee (2013–14) on Comprehensive Financial Services for Small Businesses and Low-Income Households, differentiated financial institutions such as payments banks and small finance banks (SFB) were granted licenses.

These measures taken over several decades have had varying degrees of success. The reality is that a large part of the adult population (35%) was financially excluded even in the most basic terms of having a bank account till 2011 as per the Global Findex Database of the World Bank, 2021 (henceforth referred to as Findex) (Demirgüç-Kunt et al. 2022). By 2021, 77% of Indians aged 15 and above had a bank account. Clearly, significant changes occurred during the last decade. Perhaps, a renaissance of financial inclusion. As the analysis in the chapter shows, this renaissance was not only restricted to providing access to bank accounts but also saw a substantial reduction in the cost of making small amounts of domestic money transfers. Some other important aspects of deepening financial inclusion are yet to see similar traction.

Despite the slow growth in agriculture, it continues to be the primary occupation of a large part of the population in rural areas, rural India has always lagged behind urban areas in addressing multi-dimensional poverty. This coupled with a limited network of physical branches, most financial inclusion schemes and branch expansion programs have also had a rural focus in India with later adaptations of such schemes put to work in urban locations. Today, branches in rural and semi-urban areas combined make up slightly less than two-thirds of all bank branches in the country. The Kisan Credit Card (KCC) and the General Credit Card (GCC) have provided millions of small-holder farmers and others in non-farm activities access to credit.

Despite a dense network of branches in urban areas, a large part of the population is not meaningfully financially included. As per the All-India Debt and Investment Survey 2019, the incidence of indebtedness was found to be lower in urban households at 22% vs 35% in rural households.[2] The difference compared to the rural households was starker in the lower deciles of the population based on levels of asset ownership. Households in the first, second, and third deciles in rural India had an incidence of indebtedness of 21.6%, 24.7%, and 28.4%, respectively. For urban India, the first, second, and third deciles had an incidence of indebtedness of 9%, 13.2%, and 18.5%, respectively.[3] This indicates that the poorer households in rural India had greater access to credit than similarly placed households in urban India.

The last census in India was conducted in 2011. The social and economic dataset that policymakers need is more than a decade old. This makes a lot of policymaking and its critical analysis by independent observers similar to driving on a highway with a foggy rear-view mirror. Nevertheless, there are transitions happening in the economy that do not necessarily show up in official statistics. One of these is migration for work, most of which is distress driven. Migration occurs rural to urban as well as rural to rural, both within and inter-state. Migrant workers lead precarious lives with low wages, insecure work arrangements, and poor living conditions (Peter and Johnson 2021). They also face exclusions from the social security schemes of the State due to the lack of proper documentation in their new and often changing work locations.

As per estimates for 2017–18, urban India was home to more than 111 million occupationally-vulnerable migrants (Srivastava 2020) and they have been hit hard by the impact of COVID-19 on their livelihoods. Large numbers are employed as daily wage workers including construction workers, head loaders, domestic workers, drivers, retail workers, etc. These workers tend to migrate from rural areas to escape the lack of livelihood opportunities and end up living in conditions that are just as harsh but with no kinship or community network to lean on for support.

The plight of migrant labourers is one of the strongest arguments for strengthening financial inclusion in urban areas. Indeed, this deserves as much attention as rural and agriculture-focused financial inclusion has recieved in the past. While the analysis in this chapter is based on data for both rural and urban areas, wherever available, issues concerning financial inclusion in urban India have been emphasised.

The following analysis shows that a lot has been achieved by the combined efforts of the trinity— the State (including the government and the Reserve Bank of India or RBI), the banking sector led by state-owned banks, and the National Payments Corporation of India (NPCI) which can be seen as the ecosystem enabler. However, a comparative analysis of data from both the pre-COVID years and the so-called COVID years of 2020–22, and 2023 reveals that a lot of progress has been undone by disruptions in the economy. If new measures are not taken to make formal financial services more convenient, accessible, and relevant to the needs of the poor, those recently included in the formal financial system run the risk of slipping out of the net.

This chapter is organised as follows: section 2.2 puts forward a basic definition of financial inclusion while section 2.3 briefly discusses the importance of banks as a delivery channel in financial inclusion and provides a brief overview of the different kinds of banks in India. Section 2.4 discusses areas where substantial progress has been made while section 2.5 analyses some uncomfortable observations. Section 2.6 concludes with recommendations for the way forward.

2.2. THE SOCIAL CONTEXT OF FINANCIAL INCLUSION

Despite the success achieved so far, the numbers of the poor and indebted in the country highlight the need for speed while working towards financial inclusion. First, it is estimated that 5%–15% of India's population is extremely poor if one considers the globally used poverty benchmark of US $1.9 per day (adjusted by the World Bank to US $2.15 since September 2022).[4,5] However, if one were to consider a benchmark of US $3.2 or higher, derived from the recommended National Minimum Wage, a much higher percentage of the population would be classified as poor.[6]

Second, a large proportion of the population depends on government transfers. The National Food Security Act, 2013 (NFSA) provides for coverage of up to 75% of the rural and up to 50% of the urban population for receiving highly subsidised food grains under the Targeted Public Distribution System (TPDS), which according to the 2011 Census totals about 813.5 million.[7] With the onslaught of COVID-19 and given the increase in population since 2011, this number has likely gone up and many poor are yet to be issued Below Poverty Line (BPL) ration cards.[8] This makes them vulnerable to short-term borrowing in order to feed themselves and their families.

Third, the poor are deprived on many fronts. They lack not just financial capital but also physical, human, and social capital. They do not have access to credit at reasonable interest rates. Fourth, distress-driven migration has been increasing over the years creating an occupationally-vulnerable workforce. Of the estimated 111 million migrant workers in urban India as of 2017–18, 44 million were short-term seasonal and 67 million were long-term/semi-permanent workers. A little less than half of these 111 million workers i.e., 52 million were inter-state migrant workers.

Fifth, for most informal sector workers, the starting point of their work contract (mostly undocumented) is debt i.e., an advance taken from their employer or the recruiting contractor. This is especially true for those working in sectors such as construction and brick kilns. This extension of advance loan traps these workers into low-paying employment in poor conditions which they are unable to escape at will. This is how debt and informal sector employment are closely related.[9]

Finally, there is a positive relationship between access to formal financial sector and economic growth and development. The importance that financial inclusion commands as a tool for development strategy is reflected in its position as an enabler for 7 out of the 17 United Nation's Sustainable Development Goals (SDG)—no poverty (SDG 1), zero hunger (SDG 2), good health and well-being (SDG 3), gender equality (SDG 5), decent work and economic growth (SDG 8), industry, innovation and infrastructure (SDG 9), and reduced inequalities (SDG 10). Therefore, it is important that one lays down at the very beginning key features of financial inclusion—the why, who, what, and how of financial inclusion.

The Why: Financial inclusion is not just about more credit; it lets the poor work towards improving their future and transact efficiently. What does exclusion from the financial system lead to? At a very basic level, it forces individuals and households to save under the mattress and risk losing their hard-earned savings, consume strictly within their budget, and use high-cost informal infrastructure to send money to their loved ones in the form of remittances. RBI's definition of financial inclusion over the years has been rather narrow and mostly focuses on the credit provision role of the banking sector. However, others have defined financial inclusion more broadly to include a range of low-cost financial services that are required by all citizens, more importantly, the poor ones, at various life stages.

The Who: The financially excluded are typically those at the bottom of the income and wealth pyramid. However, for a careful evaluation of the progress in financial inclusion, one must look at the 'bottom' of this so-called bottom of the pyramid. This is a part of the population which is extremely poor. Extremely poor are defined as those with unstable, irregular, and very low incomes, no or limited asset ownership, poor indicators of physical health and nutritional status, etc. The segment of the population that is actively sought after by the billions of dollars in equity investments flowing into the so-called impact firms is the working poor and not these extremely poor.

The What: Financial inclusion is defined by the access to, usage of, variety of, and quality of financial products at different life stages. Access refers to a range of products/bank accounts, savings products, remittances, insurance of different kinds, credit, pensions, financial literacy, and consumer protection. Usage refers to the frequency of account usage, change in behaviour, and take up of other products. The aspect of variety is concerned with whether there are just one-size-fits-all products or some level of need-based availability of financial products and services. Quality is concerned with whether financial inclusion delivers what it is supposed to deliver, i.e., an improvement in the lives of the poor.

The How: This aspect of financial inclusion is concerned with whether the delivery channels are user-friendly and designed keeping in mind those at the 'bottom of the pyramid'. This includes more bank branches, ATMs, mobile and internet banking, and business correspondent (BC)/cash-in-cash-out (CICO) network.

In India, financial exclusion is intricately linked to social exclusion. Discussions around financial inclusion are generally linked to poverty, unstable and low incomes, and lack of assets to offer as security by the poor. What is not adequately discussed is the role of gender, caste, religious minorities, low levels of education, poor health and living conditions, employment in the informal economy, low and unstable incomes, and migration. Another emerging source of exclusion is technology. The increasingly tech-enabled digital financial inclusion agenda runs the risk of exacerbating the divide between the haves and the have-nots.

For context, findings from a survey conducted by researchers at Azim Premji University (APU) are shared in Box 2.1 (Basole and Gupta 2023). The findings highlight the extent of deprivation and exclusion of urban poor communities. This survey was conducted among 3000+ low-income households in 92 slum settlements in Bengaluru in November 2021. The sampling frame included 100,000+ households in 179 settlements. The study focused only on poor and vulnerable households. The survey sample included a higher proportion of the vulnerable sections of society with Muslim and Scheduled Castes (SC) households representing 21% and 37% of the total surveyed households respectively. The livelihoods of these households depended on a wide range of low-paying occupations with insecure work arrangements such as drivers, daily wage workers, domestic workers, factory workers, tradespersons, *agarbatti* and *beedi* workers, workers in retail, street vendors, and those running small shops/ small businesses. The precarity of the lives of these households is reflected not just in their work, but also in abysmal living conditions, and inadequate access to sanitation, education, finance, and social protection as summarised in BOX 2.1.

2.3. CHANGING ROLE OF BANKS AS DRIVERS OF FINANCIAL INCLUSION

India has a bank-dominated financial system as far as credit allocation is concerned. However, most innovations and progress that move the needle for the poor and the (previously) excluded is now happening outside the banking system. This has been made possible by the combined efforts of the government, the NPCI, and the RBI.

The government under the umbrella of the JAM trinity (with JAM standing for Jan Dhan, Aadhaar, and Mobile) has ensured the right policy impetus, and availability of the necessary digital public goods infrastructure to leverage the increasing penetration of mobile phones in the country. The JAM trinity rests on three components: (i) a no-frills/zero-

BOX 2.1. WHAT DOES IT MEAN TO BE POOR (AND EXCLUDED) IN URBAN INDIA?

Findings from the Bengaluru COVID-19 Impact Survey (2023) by APU

All numbers pertain to a typical month in the period immediately preceding the start of COVID-19 in March 2020 in India, unless explicitly stated.

1. Average earnings per worker was ₹ 9,410.
2. Sixty-six percent of households lived below the poverty line (based on the recommended National Minimum Wage of ₹ 430 for a household with 3.6 members as of July 2018).
3. Drivers, daily wage workers including those in construction work, factory workers, and domestic workers made up 57% of the workforce.
4. Thirty-four percent of households did not own a mobile phone.
5. Sixty-one percent of households lived in a house with at most 1 room (other than kitchen, bathroom, and toilet).
6. Seventy-eight percent of households did not have a woman-owned Jan Dhan account.
7. Seventeen percent of households had an outstanding loan pre-COVID averaging ~₹ 75,000; 66% and 41% reported borrowing from formal and informal sources respectively.
8. Twelve percent of households borrowed during COVID-19; more than 50% and ~40% reported borrowing from informal and formal sources respectively.
9. A significant minority of households (12%), wanted to borrow but could not in all three reference periods in the survey before and during COVID-19.

balance bank account in the form of Jan Dhan Yojana accounts; (ii) a unique biometric identifier for all citizens in the form of an Aadhaar card since 2009; (iii) and increasing level of mobile or smartphone penetration in the country. While there are still gaps in access for the marginalised sections of society, slightly more than 1.3 billion Aadhaar cards have been issued as of July 2023 indicating near-universal coverage.[10] There are no official estimates as such, but various estimates indicate that mobile (both smartphone and feature phone) and smartphone penetration in India was 1.2 billion and 600 million respectively in 2022.[11]

It goes without saying that each of the channels i.e., banks, MFI, and SHG benefits from the vision, active participation, and enablement of the RBI. With respect to the banking channel, the NPCI and a vast ecosystem of so-called financial technology firms (fintech) have been critical enablers. Without the work done by NPCI as an ecosystem enabler over the last few years, it is hard to imagine if banks could have provided the leadership and the mind space required for innovation in providing basic financial services to the unbanked (excluded).

What's special about financial inclusion via banks? Inclusion typically begins with providing a no or low-cost avenue for savings and facilitating remittances. All bank deposits up to ₹500,000 are fully insured by the Deposit Insurance and Credit Guarantee Corporation. Therefore, among the previously-mentioned three channels, banks are best placed to provide a safe avenue to save for those who have little to save and were hitherto saving under the proverbial mattress. However, this delivery channel is a relatively high-cost one which is why the other two channels, i.e., MFI and SHG emerged in the first place. Banks also promote financial inclusion with their power to allocate credit using the deposits placed by their customers and provide the necessary infrastructure for delivering social protection through their massive network of physical branches and other touchpoints across the country.

2.3.1. Types of Banks in India and Their Different Roles

The banking landscape in India comprises public sector banks (PSB), regional rural banks (RRB), private sector banks (PVB), small finance banks (SFB), payments banks (PB), cooperative banks, and foreign banks (FB). Cooperative banks, an important institution in the last-mile delivery infrastructure, are the subject of a full-fledged chapter in this report and not discussed here.

To provide a simplified summary, PSBs have the largest market share in rural and urban India with respect to the physical branch/ATM network, deposits, and credit. RRBs are a set of banks focusing exclusively on rural India and are, therefore, an important institution for the financial inclusion of the rural poor. Of the 12 SFBs operating in the country, 10 were erstwhile MFI and continue to have more than 50% of their assets portfolio in the form of small-ticket MFI loans.

Payments banks, as with SFBs, are relatively new institutions granted licenses under RBI's differentiated bank approach. Envisaged to be tech-driven, new-age banks, payments banks already have the largest share of alternate/low-cost delivery channels across the country. Given their small customer base, they still have a low share in new tech-enabled forms of payments (such as Aadhaar-enabled payment system or AePS discussed later) but are driving the rapid increase in micro-ATMs with more than market 50% share of such devices (Figure 2.1).

With respect to priority sector lending (PSL) obligations, commercial banks have a target of 40% of their advances (Adjusted Net Bank Credit or ANBC) to PSL whereas SFBs and RRBs both carry a target of 75%. What further differentiates RRBs from other banks is that their actual achievement of PSL targets is way higher than the minimum requirement. Achievement for Financial Year (FY) 2023 stood at 97.5%, 41%, and 85.6% for overall PSL, direct advances to agriculture, and weaker sections respectively.[12] No other institution comes close to this achievement of RRBs. RRBs also punch above their weight when it comes to overall lending in rural areas as well as in aspirational districts (Gupta 2022).

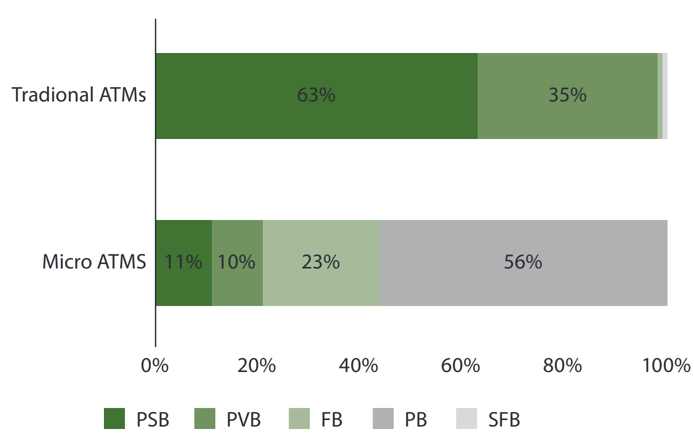


Figure 2.1. Share of Banks- ATM and Micro-ATM Ownership

Source: RBI – Bank wise ATM/POS/Card Statistics

2.4. CREDIT WHERE CREDIT'S DUE

2.4.1. Improving Access to Savings via Bank Accounts: Policy Implementation at a Massive Scale

The Findex database captures vital details of tangible improvements in financial inclusion efforts over the years in India. Up till 2011, certain segments of Indian society were better included in the formal financial system than others. The percentage of men having an account with a formal financial institution was 17% more than the percentage of women in 2011. This gap has been eliminated by 2021, as in Figure 2.2. Similarly, the access gap has been drastically reduced or eliminated for those out of the labour force, not educated beyond the primary level, and the poorest 40%.

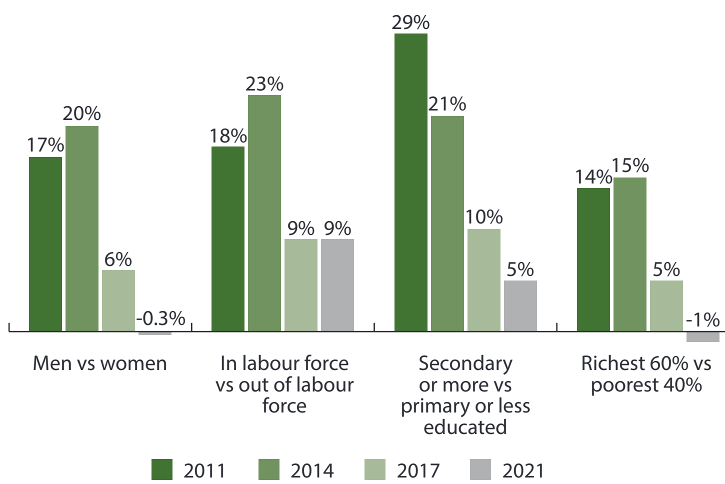


Figure 2.2. Gaps in Account Ownership with a Financial Institution (%, age 15+)

Source: Findex, various editions

The Pradhan Mantri Jan Dhan Yojana (PMJDY) has achieved, in a very short time, what no other variant of financial inclusion policy measures hitherto implemented in India were able to achieve (Figure 2.3). Not only did it aim to provide access to the formal financial system via no-frills bank accounts, but it also provided automatic insurance protection as well as contingent access to overdraft facilities on these bank accounts. The Basic Savings Bank Deposit Account (BSBDA) allows unlimited credits into the account, four withdrawals a month, and has no minimum balance maintenance requirement which had hitherto deterred the poor from opening bank accounts.

Only to account holders who are issued RuPay debit cards, accident insurance cover of ₹200,000 is provided (₹100,000 for accounts opened before August 2018). Penetration of RuPay cards is not universal yet with less than 70% of all PMJDY account holders being issued one as of August 2023. This means approximately 160 million PMJDY account holders are still excluded from the accident insurance cover that comes along with the bank accounts. For PSB, PVB, and RRB, 75%, 80%, and 37% of account holders respectively have been issued RuPay cards. Two-thirds of these accounts have been opened in rural and semi-urban branches of banks.

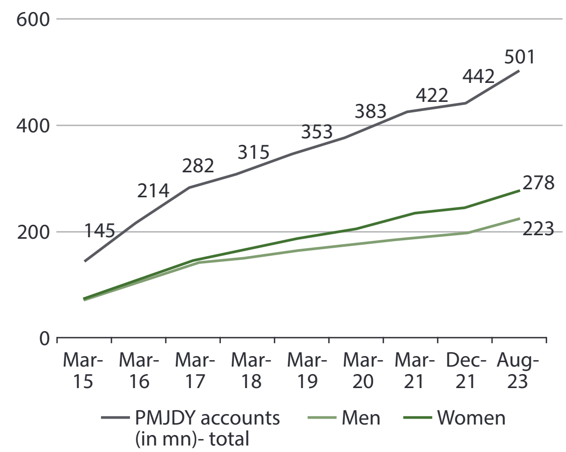


Figure 2.3. PMJDY accounts

Source: Department of Financial Services, Annual Report (various editions)

2.4.2. Branches and the BC Model: Taking the Bank to the Unbanked

There are more than 150,000 bank branches in the country today. While the banks now appear to be in a branch rationalisation mode and very few new branches have been added since 2020, the branch network grew at an annualised rate of 6% between 1969 and 2020.[13]

Garg and Gupta, 2023 in their work using location data of various bank branches in India from 1951 to 2019 demonstrate a substantial reduction in the mean (and median) distance of an unbanked village to a banked village. Considering almost 600,000 villages in India, this distance, which was 43.5 kilometers (median of 34.8 kilometers) in 1951, was found to have reduced to 4.3 kilometers (median of 3.5 kilometers) by the end of 2019. Major reductions happened during the time periods from 1951 to 1969 and from 1969 to 1990. However, it is also important to note that even in 2019 there were approximately 25,000 unbanked villages (albeit down from approximately 100,000 in 2005) which were 10 or more kilometers away from a banked village.

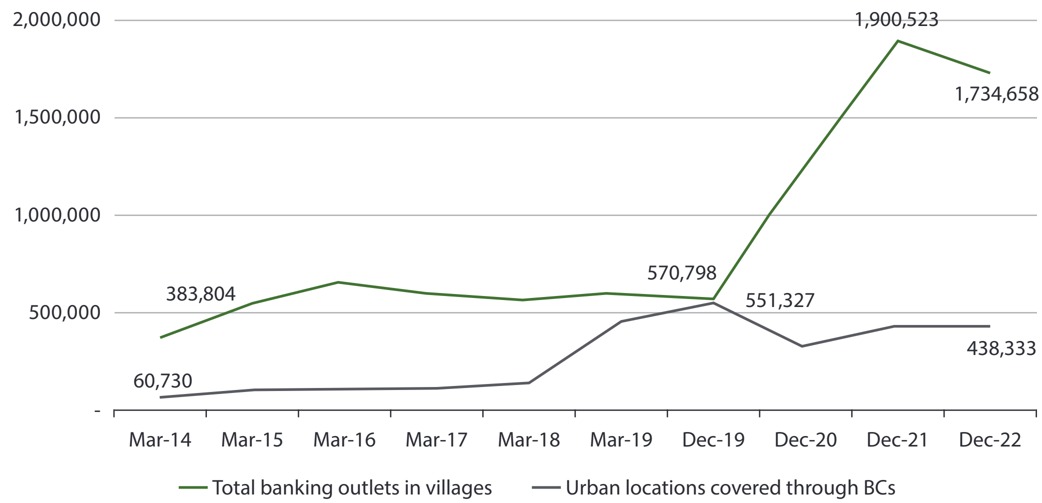


Figure 2.4. Banking Outlets in Rural and Urban Locations

Source: RBI Annual Report, Financial Inclusion Plan (various editions)

Opening branches was never a low-cost option for banks and, with the advent of technology-enabled solutions, is no longer one of the only two channels, along with ATMs, for reaching out to the masses. The increase in banking outlets is now coming via an increase in the BC network. Handheld micro-ATMs, also discussed earlier in this chapter, are used by BCs to provide basic banking services at a hyper-local level. Figure 2.4 shows how rapidly the overall banking outlets have increased in both rural and urban locations. Year-on-year data on these outlets is noisy. However, over a long period from March 2014 to December 2022, banking outlets in villages and urban areas have grown at annualised rates of 19% and 25%, respectively.

2.4.3. Reduction in Gender Gap with Respect to Access to Credit

When viewed from the point of view of the gender of borrowing individuals, the gender gap in access to credit from the financial system has narrowed over the years. Of all the individual borrowers in the banking system in 2014, only 21% were women. As of March 2023, the percentage of women borrowers stood at 34% though it has stagnated around these levels from the onset of COVID-19 in March 2020 (Figure 2.5).

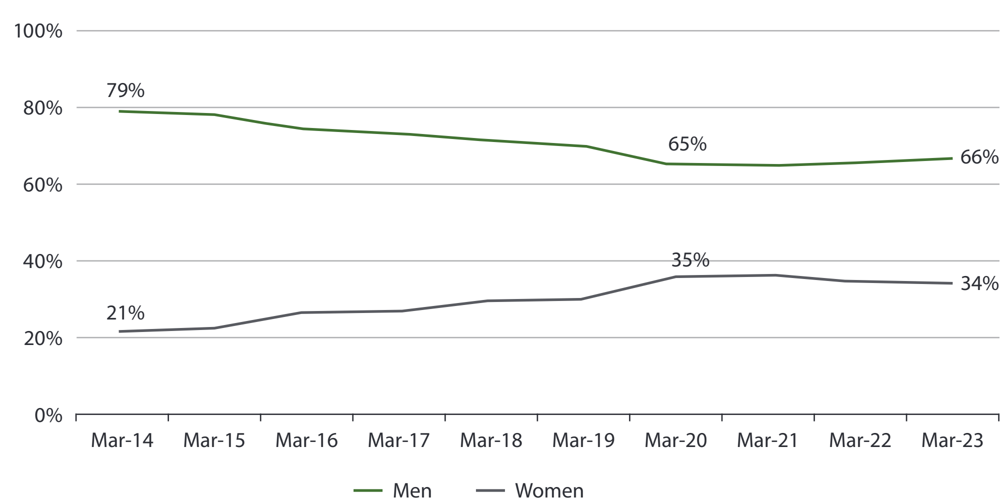


Figure 2.5. Gender Composition of Borrowers in the Banking System

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No. 1.6 – Outstanding Credit of Scheduled Commercial Banks According to Organisation)

2.4.4. Drastic Reduction in Domestic Remittance 'Tax'

'वो भी एक टाइम था जब 1000 पे 100 रूपये एजेंट को इधर देते थे और 100 गांव में कटते थे।'

— गुमनाम प्रवासी श्रमिक

As mentioned in the introduction section, there are an estimated 111 million migrant workers in India mostly employed in low-paying occupations in the informal sector. Most of this migration is distress driven and remittances from the workers to family members back home are an important source of sustenance in villages. Several studies have shown that, till a few years ago, these domestic money transfers (DMT) used to cost anywhere between 5–10%. This was nothing less than a draconian tax on the meager earnings of poor citizens. The cost of DMT has drastically come down in the last few years. In regular times, it now costs 1–2% to remit and withdraw funds. In comparison, it must be noted that post-office money orders still cost 5% but have now become a less important source.

Many more have bank accounts today which can be accessed via the BC network more conveniently. Where customers had to travel long distances to withdraw cash from banks earlier, the BC network of banks has brought the bank much closer home. This indeed was a tax on the poor, informal sector workers with very low earnings, and its elimination can be considered a very big achievement. During COVID-19, however, there is enough anecdotal evidence as well as from rapid surveys by various civil society organisations (CSO) that people had to pay as much as 10% to remit funds.

Box 2.2 compares results from surveys conducted by grassroots organisations in the pre-and-post-renaissance eras to show how the reduction in the cost of domestic money transfers shows up in the preferred channels to send money back home by migrant workers--a clear move away from carrying cash to the available money transfer channels. One of these studies was conducted in 2011 (Thorat and Jones 2011) and the other in 2020 (Welfare Services, Ernakulam and Centre for Migration and Inclusive Development 2020).

2.5. A LONG ROAD TO NIRVANA

2.5.1. Credit Growth Lags the Growth in the Real Economy

Despite all the attention that the financial system and more importantly the banking system receives, what seems to have escaped attention is the dismal real growth rate of bank credit in the last decade since 2014. While bank credit has expanded at a compounded annual growth rate (CAGR) of ~9%

BOX 2.2. HOW DOES A MIGRANT SEND MONEY HOME?

A comparison of findings from two surveys 9 years apart.

2011

National Bank for Agriculture and Rural Development (NABARD) and Gesellschaft für Inter- nationale Zusammenarbeit (GIZ) conducted studies of four different migration corridors in India and analysed the payments system with respect to small remittances of migrant workers. The migration corridors studied were: Uttar Pradesh-Mumbai, Rajasthan-Gujarat, Odisha-Andhra Pradesh, and within Maharashtra. As part of the survey, 200 remittance receivers and 212 migrants were interviewed. With respect to the commonly used method of remitting money, 17%, 91%, 27%, and 90% of workers in these respective corridors either carried cash themselves or used others such as fellow villagers, family members, etc. to carry cash home.

2020

Between December 2019 and January 2020, Welfare Services and the Centre for Migration and Inclusive Development with support from Caritas India conducted a survey of 426 migrant workers in Kerala on the state of inclusion of migrant workers in Ernakulam district, Kerala (Caritas India 2020). These migrants were from Assam, West Bengal, and Tamil Nadu.

When it came to modes of sending remittance home, the main channels reported by workers were as follows (% of workers): money transfer agent (47.7%), bank or post office account (33.6%), cash deposit machine (31.6%), and UPI/payment apps (16.2%). Only 7.6%, 5.8%, and 1.8% reported sending cash through villagers/friends, transferring to the accounts of other workers, and personally taking cash respectively.

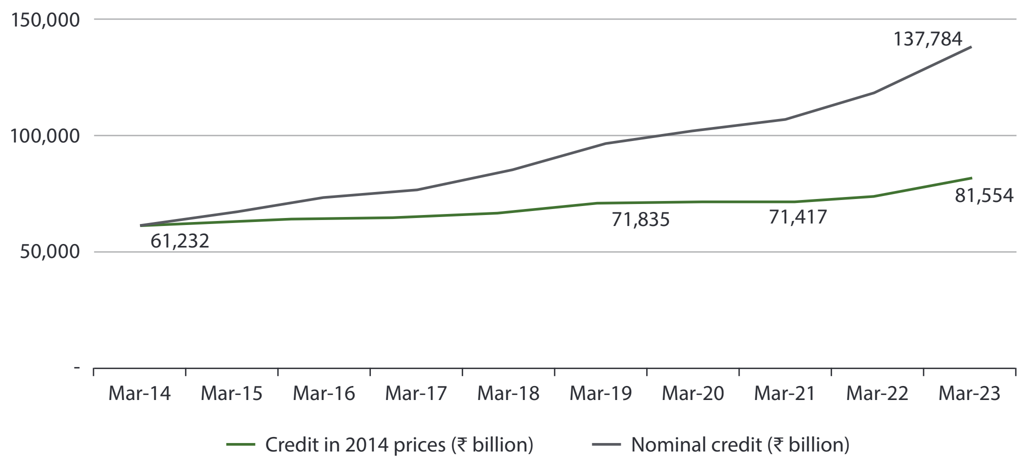


Figure 2.6. Nominal and Real Credit by the Banking System

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No. 1.6 – Outstanding Credit of Scheduled Commercial Banks According to Organisation)

during this period, the real growth rate that excludes the impact of inflation or rising prices was only 3% per annum.[14] In other words, while nominal bank credit grew from ₹61.2 trillion as of March 2014 to ₹137.8 trillion by March 2023, bank credit in March 2023 measured at 2014 prices stood at only ₹81.5 trillion (Figure 2.6). This slow growth rate lags the 6–7% real annual growth rate in the Indian economy over this period.

2.5.2. BSBDA/PMJDY's Weak Performance in Providing Access to Credit

In a previous avatar, the now famous PMJDY accounts were known as BSBDA accounts. The poor, for whom the PMJDY accounts were introduced, have built up steady balances in these accounts. The total balance as of the end of August 2023 was above ₹2 trillion (not shown in Figure 2.7).[15] It must be noted that these are new balances coming into the banking system for the first time, given these account holders were previously unbanked. This is a huge source of low-cost funds for the banking sector. In effect, if one assumes a net interest margin of 5%–7% for the banks in the business of financial intermediation, these balances result in annual earnings to the tune of ₹100 billion to ₹140 billion.

As of the end of December 2022, there were 679 million BSBDA accounts with total savings and overdraft balances of ₹2.4 trillion and ₹5.5 billion respectively. In return for the above-mentioned annual 'subsidy' flowing from the poor to the banking sector, only 1.3% of the BSBDA holders (Figure 2.7) have been granted overdraft facilities. If one assumes a hypothetical scenario where BSBDA savings balances could be given out as credit (overdraft) only to BSBDA account holders, the relevant metric i.e., Credit-Deposit (CD) ratio would be an abysmally low 0.2% in December 2022. This CD ratio of BSBDA accounts was 5.1% in March 2014. The average savings account balance and overdraft balance per BSBDA account in December 2022 were ₹3,543 and ₹613 respectively. This implies a per-account annual growth rate of 12% in savings balances and 16% annual de-growth in overdraft balances between March 2014 and December 2022.

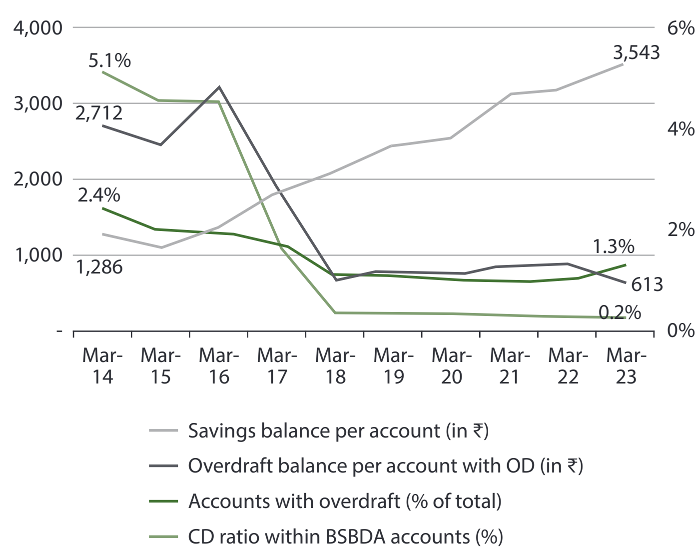


Figure 2.7. Performance of BSBDA Accounts

Source: Department of Financial Services, Annual Report (various editions)

2.5.3. Gender Gap in Per Capita Availability of Credit Remains

Having established that the growth rate in bank credit was indeed slower than the growth rate of economic activity in real terms and the percentage of women among all borrowers was increasing over the 10-year period from 2014 to 2023, we turn our attention to how men and women fared differently in access to bank credit on a per capita basis. As in Figure 2.8, per capita credit from the banking sector to women borrowers de-grew at -1.67% per annum from ₹160,488 in March 2014 to ₹137,948 in March 2023. During the same period, per capita bank credit for men grew 3.14% per annum from ₹178,571 to ₹235,820.

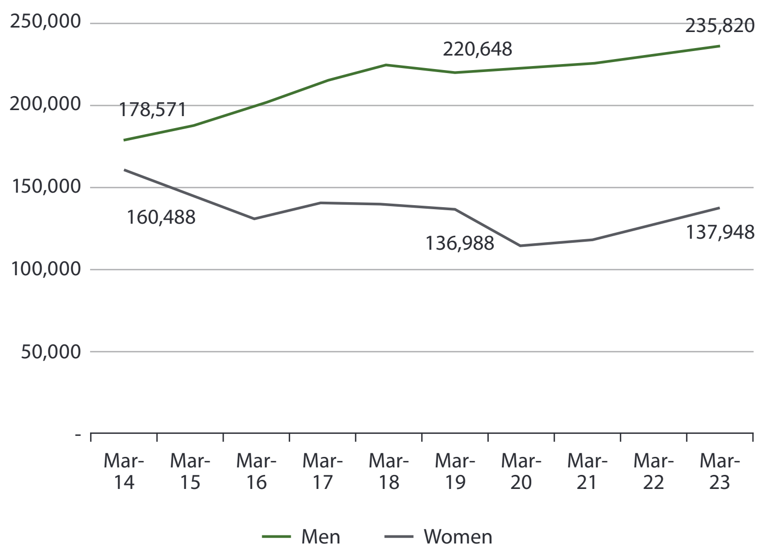


Figure 2.8. Credit Outstanding Per Account, As of End March

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No. 1.6 – Outstanding Credit of Scheduled Commercial Banks According to Organisation)

2.5.4. Gender Gap is More Severe in Metropolitan Cities

In metropolitan areas, the share of women in small borrower accounts i.e., with credit limits of ₹200,000 or lesser, was the lowest among all geographical categories (Table 2.1). As of March 2023, women had 19.8% and 27.1% share in the number of accounts and amount outstanding respectively in metros. This was much higher at 49.6% and 37.5% respectively in rural areas.

2.5.5. Overall Share and Per Capita Availability for Small Borrowers Declining

While there can be multiple ways of defining a small borrower, RBI defines it as any borrower with credit limits of ₹200,000 or lesser. From the RBI data, it is evident that while more individuals have been added to the financial system (borrowers as well as non-borrowers), the share of those with credit limits of ₹25,000 or lesser has fallen from 0.43% in March 2014 to 0.28% in March 2023 (Figure 2.9). During this period, the share of the small borrowers, i.e., those with credit limits of ₹200,000 or lesser grew marginally from 7.1% to 7.4%. In both categories, COVID-19 clearly had a negative impact.

Credit per borrowing account for small borrowers declined 14% between March 2014 (₹48,425) and March 2023 (₹41,451). The decline for borrowers with credit limits up to ₹25,000 was even steeper at -38% from ₹10,234 in March 2014 to ₹6,382 in 2023 (Figure 2.10). Despite the schemes put in place by the central government and the RBI's intent to limit the impact of COVID-19 on the small borrowers, they have been impacted at a time when more support was required.

Table 2.1. Gender and Geography-wise Distribution of Credit to Small Borrower Accounts of Scheduled Commercial Banks (March 2023) (in %)

Attributes	INDIVIDUAL				OTHERS	
	MALE		FEMALE			
	No. of Accounts	Amount Outstanding	No. of Accounts	Amount Outstanding	No. of Accounts	Amount Outstanding
Rural	44.3	57.9	49.6	37.5	6.1	4.6
Semi-urban	48.0	56.3	38.5	37.0	13.5	6.6
Urban	51.0	55.8	35.9	36.4	13.1	7.8
Metropolitan	76.4	67.5	19.8	27.1	3.9	5.4
All-India	57.1	58.7	34.8	35.5	8.0	5.9

Source: RBI Database of Indian Economy, Basic Statistical Returns of Scheduled Commercial Banks in India, March 2023 (Old edition, Table No. 1.12 – Percentage Distribution of Outstanding Credit of Small Borrowal Accounts of SCBs According to Broad Category of Borrowers)

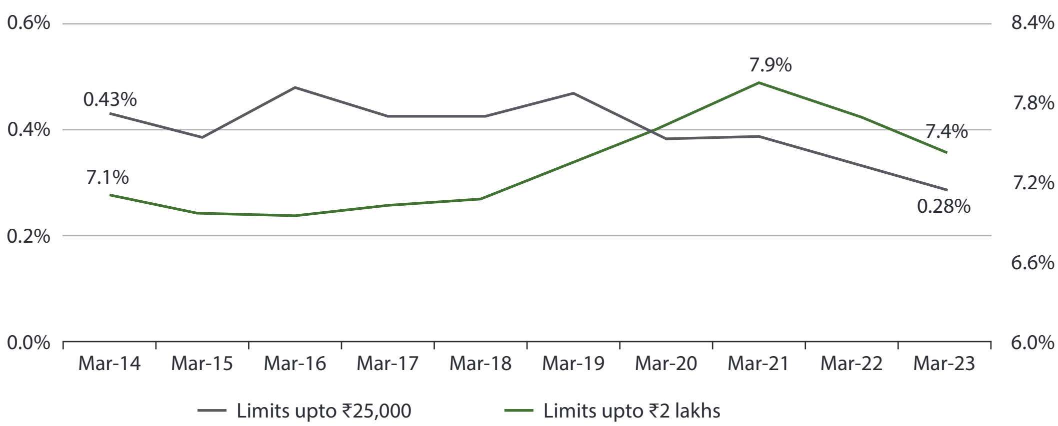


Figure 2.9. Share of Small Borrowers in Overall Bank Credit

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No 1.7 Outstanding Credit of Scheduled Commercial Banks According to Size of Credit Limit)

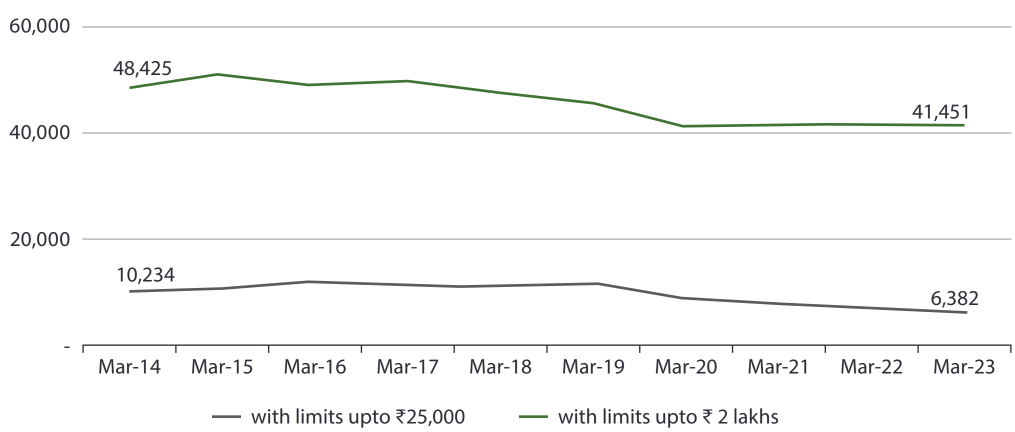


Figure 2.10. Per Account Credit Outstanding for Small Borrowers

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No 1.7 Outstanding Credit of Scheduled Commercial Banks According to Size of Credit Limit)

2.5.6. Declining Number of Borrowers and Share of Bank Credit for Micro and Small Enterprises (MSE)

Micro and small enterprises (MSE) are a more fragile sub-component of the Micro, Small, and Medium Enterprises (MSME) category of firms. They have often been acknowledged to be credit-starved despite their vital contribution to India's gross domestic product (GDP), employment, and exports. When it comes to credit from the banking sector, despite their presence as a sub-category in PSL lending norms, credit to MSE firms as a share of overall bank credit has declined from 13.9% as of March 2014 to 12.9% as of December 2022 (Table 2.2). Surprisingly, the number of MSE borrowers in the banking system from figures put together from various editions of RBI's Annual Report shows an almost 50% decline between March 2021

Table 2.2. Share of Bank Credit for MSE

	MSE borrowing accounts (in ₹ million)	Credit per MSE borrowing account (₹)	MSE share of bank credit (%)
Mar-14	12.6	675,468	13.9%
Mar-15	13.8	696,522	14.4%
Mar-16	20.4	488,446	13.6%
Mar-17	23.2	461,263	13.9%
Mar-18	25.9	443,764	13.5%
Mar-19	27.9	465,589	13.5%
Mar-20	35.3	481,051	13.1%
Mar-21	41.6	420,761	13.8%
Mar-22	26.1	613,845	13.5%
Dec-22	21.0	813,964	12.9%

Source: RBI Annual Report (various editions) and December 2022. If one excludes the abnormal jump with respect to December 2022, the average credit per MSE borrowing account was very low at ₹420,761 and ₹613,845 as of March 2021 and March 2022 respectively, reflecting de-growth when compared with ₹675,468 as of March 2014 even in nominal terms.

2.5.7. Contrary to Perceptions, the Poor and Small Borrowers Are Not Surviving on Subsidised Credit

Figure 2.11 shows the share of the credit (both by the percentage of borrowers and the amount outstanding) at annual interest rates of 13% and above. The data is presented by two different sub-categories of small borrowers—those with credit limits of ₹25,000 or lesser and those with credit limits between ₹25,000 and ₹200,000. Almost 2/3rd of very small borrowers (₹25,000 or lesser), by number of borrowing accounts and by amount outstanding, had borrowed at an interest rate of 13% or above. In comparison, only 1.5% of the amount outstanding from borrowers with credit limits above ₹100 crore (₹1 billion) was at a 13% or higher interest rate. Refer to appendix Figure A2.1 for other categories of borrowers. The small borrowers pay substantially more than the larger borrowers.

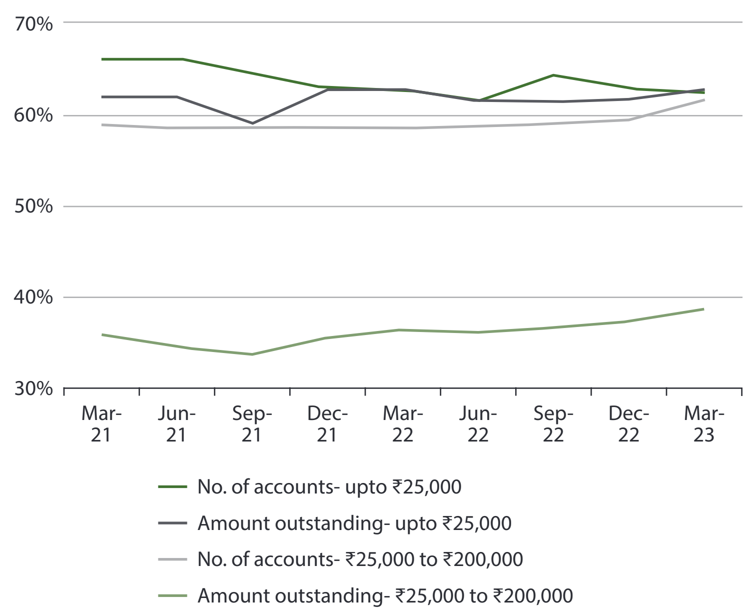


Figure 2.11. Share of Credit at Interest Rates 13% and Above Per Annum

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No 2.5 Size of Credit Limit and Interest Rate Range-wise Classification of Outstanding Loans and Advances of Scheduled Commercial Banks)

2.5.8. High Transaction Failure Rate in AePS Mechanisms

The digital revolution is far from inclusive and so is the case with the digital financial inclusion revolution riding on it. Not everyone has access to an internet-enabled smartphone. Given the low literacy levels of the adult population, watching YouTube videos is one thing but doing banking transactions is a completely different and scary proposition for many.

Certain pockets of the population, as shown in Box 2.1 for 92 slums in Bengaluru, still have low ownership rates for even basic mobile phones let alone smartphones. The onset of COVID-19 intensified the ongoing digital revolution in the country. However, those in rural India continue to fall behind. Here's how things have played out: rural smartphone penetration is low at 28%, the physical touchpoints of banks have not increased in the last 2–3 years and the usage of technologies to access the banking system via feature phones has not taken off.[16] One such technology is Unstructured Supplementary Service Data (USSD) which facilitates Unified Payments Interface (UPI) payments via feature phones. One potential reason for the less-than-desired uptake is that out of 1.15 billion wireless subscribers as of March 2023 in India, Jio had 430 million subscribers (37.6% share) but Jio is not on the USSD platform. Of these 430 million subscribers, 188.7 million are in rural areas.[17]

AePS transactions which are meant to address the requirements of hard-to-access areas with poor literacy have a transaction failure rate in excess of 20% (for both business and technical reasons). PSB and RRB both have a combined market share of more than 90% (Figure 2.12). However, a failure rate this high risks discouraging users from continued usage.

A joint team of researchers at the Foundation for Ecological Security (FES) and LibTech India (LibTech) conducted a rapid survey of 1,066 Mahatma Gandhi National Rural Employment Guarantee Act (MGNREGA) workers in five blocks of Odisha from districts of Koraput, Dhenkanal, Keonjhar, and Angul (Saboo et al. 2021). Findings from this survey with respect to challenges faced by workers while trying to access their wages from payment disbursement agencies including banks, ATMs, Customer Service Points (CSPs), and BCs are presented in Box 2.3.

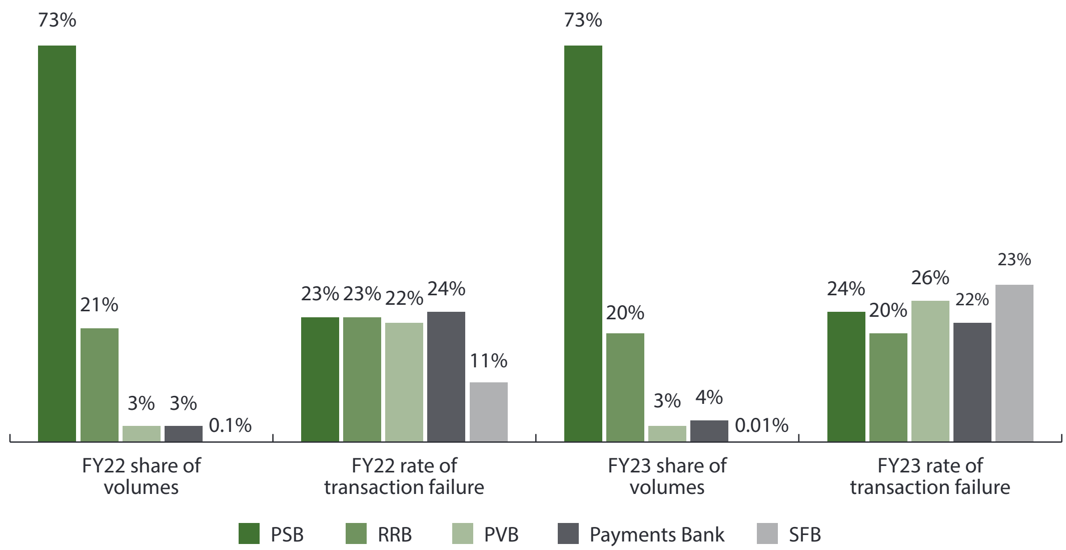


Figure 2.12. Transaction Failure Rate of All AePS-enabled Transactions

Source: Authors calculations based on bank-wise NPCI data on volumes and transaction failure

BOX 2.3. HARDSHIPS IN ACCESSING PAYMENTS IN ODISHA— SURVEY OF LAST MILE CHALLENGES IN MGNREGA WAGE PAYMENTS IN SELECT BLOCKS (MAY 2021)

i. A large majority (74%) of the workers use bank branches as the primary disbursement agency, and 21% primarily use CSPs/BCs.

ii. Half the workers spent more than ₹200 (equivalent to MGNREGA's daily wage of ₹215) on each visit to the disbursement agency.

iii. Half the workers using bank branches to access their wages had to travel more than 10 km. CSPs and BCs were more accessible. Only one-fourth of the workers using them had to travel more than 10 kms to access their wages.

iv. One-third bank users and one-fifth CSP/BC users took more than 6 hours to withdraw their wages. Given the distance and time involved in accessing their wages, some workers had to spend a significant amount on food. Given age and gender, many workers need others to accompany them.

v. Overall, 73% of the workers missed at least one day of work when they went to the disbursement agency.

vi. Sixty-three percent workers reported making multiple visits due to wages not being credited into the account or due to infrastructural issues such as overcrowding (40%), network issues (26%), and lack of electricity (12%).

vii. Transactions tracking mechanisms such as passbook updation, receipts, and SMS notifications were largely missing. While most had a passbook, 35% CSP/BC users reported that their passbooks were never updated. Amongst the workers whose passbooks were updated, 20% said that the balance was written by hand on the last page instead of electronically updating the passbook. As a result, they could not keep a track of their credits and debits, but only the amount of money in their account. Given that more than half the workers did not have a mobile phone, receiving SMS is not even an option for them.

2.5.9. Many Accounts but Limited Usage

As per the Findex survey for 2021, only around 35% of all account holders had a debit card and less than half were using them. More than one-third of the bank accounts was inactive, and females had a higher share of inactive accounts. For those with inactive bank accounts, key reasons listed for inactivity were lack of trust in banks, physical distance, no need for a bank account, and lack of resources to maintain an account (Figure 2.13). Interestingly, 29% of inactive account holders reported being uncomfortable using an account on their own. Clearly, more work is required on the part of banks to make banking services more accessible, convenient, and closer to their customers. Similar reasons are listed by the 20% of those aged 15 and above who did not have a bank account in 2021 (Figure A.2.2).

Figure 2.13. Reason for not Using Their Inactive Account (% with an Inactive Account, Age 15+)

Source: Findex, various editions

2.5.10. Inadequate Inclusion for Risk Protection and Old Age

As has been shown above, the bank account penetration rates are high. There is steady albeit slow growth in credit delivery to the marginalised and visible improvements have been made in transaction banking. However, when it comes to protection against various risks such as death, disability, and the risk of inadequate savings to maintain a minimum lifestyle after retirement from the workforce, a lot is left to be desired. The three major contributory schemes run by the government for such requirements are Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), and Atal Pension Yojana (APY). The distribution and outreach of these schemes is led by banks.

PMJJBY is a life insurance product available to those in the age group 18 to 50 years having a bank/post office account. The coverage is for ₹200,000 with an annual premium of ₹436. This was revised up from ₹330 paid by subscribers in 2022. The policy term is from June to May. While it is claimed that the scheme has 144.3 million cumulative subscribers as of November 2022, the actual subscriber base was much lesser at around 49.6 million as of the end of 2021. This was made available via a public interest litigation filed by a media platform (Newsclick).[18] This implies that roughly less than 10% of PMJDY account holders have insurance on their lives.

PMSBY is an accident insurance available to those in the age group 18 to 70 years having a bank account. Coverage is ₹200,000 for accidental death and full disability and ₹100,000 for partial disability with an annual premium of ₹20. The annual coverage term extends from June to May. As is the case with PMJJBY, it is claimed that the scheme had 313 million cumulative subscribers as of November 2022. However, no information about the actual subscriber base is available. A cumulative subscriber base does not make any sense given it is an accident insurance plan that needs renewal every year.

APY is a contributory monthly pension scheme with benefits in the range of ₹1,000 to ₹5,000 available for those in the age group 18–40 years having bank accounts. Contributions are to be made till age 60 post which the pension starts. There were 48 million (RBI Annual Report 2023) and 49.4 million (Pension Fund Regulatory and Development Authority or PFRDA quarterly newsletter) APY subscribers respectively as of November 2022 and as of March 2023. The market share of banks in enrolling subscribers is as follows: PSB 70%, RRB 19%, PVB 7%, PB 3%, Department of Posts- 0.8%, SFB 0.3%, and cooperative banks 0.2%. A significant majority of the subscriptions are at the lower end of ₹1,000 per month having greater than 80% of new subscribers in FY23. Again, as with PMJJBY, APY has a penetration equivalent of around 10% of PMJDY account holders. Not all or many of the subscribers might be poor and previously financially excluded, so this too might be an overestimation.

2.6. POLICY RECOMMENDATIONS

India's progress on the financial inclusion front, albeit a work in progress, is certainly inspiring and offers valuable lessons for other countries. Leveraging the innovation and technology ecosystem in the country and having the NPCI, instead of the established banks, drive key infrastructural developments helped in achieving transformational change. Importantly, this change was delivered on a massive scale.

The JAM trinity, another example of innovation outside the core banking system, has enabled a lot of what would have previously been thought of as unachievable in India's financial inclusion efforts. The progress made so far needs to be sustained and made more inclusive as the same enabling technology also has the potential of deepening the divide between the haves and the have nots. The poorest of the poor have certainly benefited from Aadhaar-enabled public goods by having to pay a much smaller fraction of their hard-earned income towards remittance costs than was the case a decade ago.

This paper makes a case for redoubling efforts with respect to measures of financial inclusion other than a basic bank account. Women, small borrowers, MSEs, and other marginalised sections have a lot of catching-up to do when it comes to the availability of credit. Penetration of risk protection products and pensions for old-age savings despite being driven with a policy focus have a lot of ground to cover.

The analysis based on the available data as well as on the work done elsewhere makes a case for a policy focus on the urban poor. It does not, however, mean that eyes be taken off financial inclusion-related issues concerning rural India. The changing demographics of urban India with inward migration from rural India to escape poverty and lack of livelihood opportunities necessitates a focus on financial inclusion in urban parts of the country.

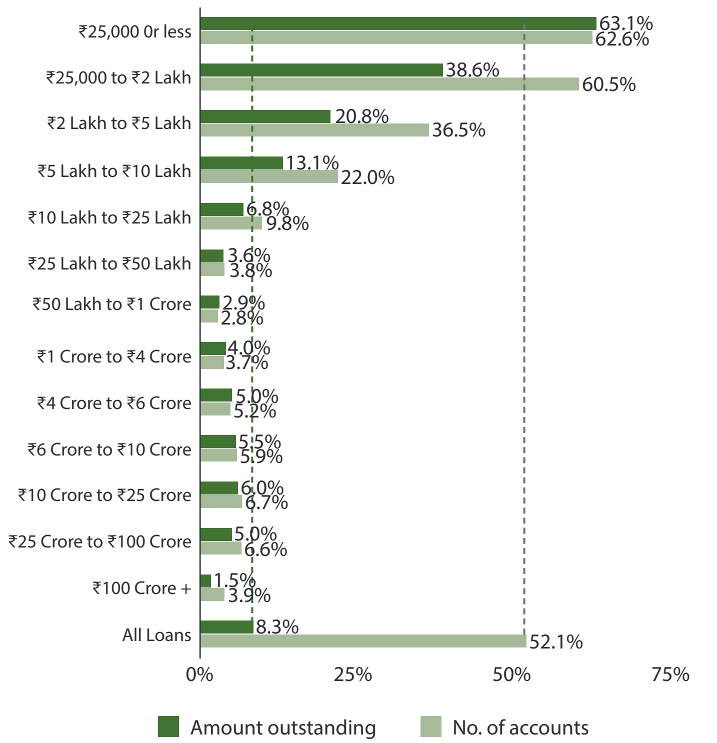
Banks are fearful of lending to the poor which is visible from the very low CD ratio based on savings and overdraft balances in BSBDA/ PMJDY accounts. Given their vast physical network, enrolling large numbers in risk protection and pension schemes already rolled out will do the poor a lot of good. Financial literacy, though not discussed in this chapter, plays a key role and must receive continued focus.

For rural areas, a continued focus on strengthening the RRBs, appropriate product design, consumer protection, and financial literacy is required. New product development leveraging technology should address the technology divide that impacts the low-income and less-educated. For urban areas, the inclusion of informal sector workers, financing of street vendors, consumer protection, and financial literacy should be emphasised.

Overall, the policy prescriptions for the decision makers call for factoring in the changing demographics in rural and urban areas in the design of financial inclusion policy. Financial literacy efforts should be directed towards ensuring that the technology divide is arrested, and technology is used for the benefit of the marginalised. There is clearly a latent demand for financial services as is evidenced by the proliferation of informal savings schemes such as chit funds and other deposit schemes that so often end up in the poor losing their hard-earned savings and the so-called unfree work having its origins in debt given by the recruitment agents to poor workers often in rural areas. The ecosystem must make a sincere effort in bringing down the non-pecuniary costs of dealing with the banking system. Account opening was the first step. It is time now for the banking system to enable and improve the livelihoods of the poor and the vulnerable and make a meaningful contribution to building up their financial resilience.

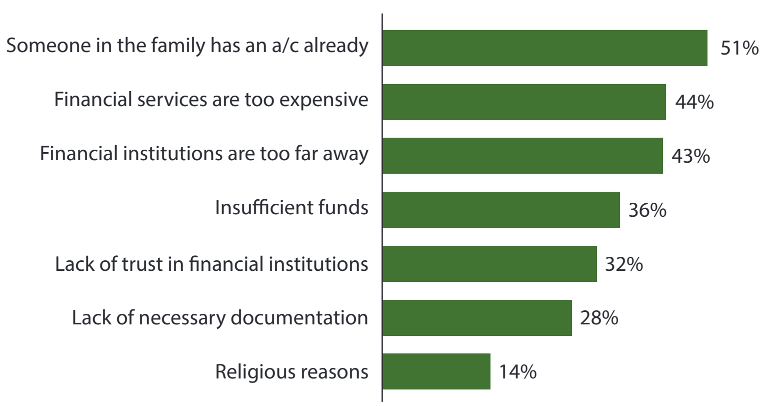
The question is not whether the troika of the State (the government and the RBI), banks, and the ecosystem enabler NPCI, have done enough to promote financial inclusion in the country. A start has been made which has clearly demonstrated that policies can be delivered at scale. Rather the question we must now ask is whether a lot more needs to be done going forward given the complex challenge that financial inclusion of the poor is. The answer is a definite yes.

APPENDICES



APPENDIX Figure A.2.1. Share of Credit at Interest Rates 13% and Above Per Annum

Source: RBI Database of Indian Economy, Quarterly BSR-1 (Old edition, Table No 2.5 Size of Credit Limit and Interest Rate Range-wise Classification of Outstanding Loans and Advances of Scheduled Commercial Banks)



APPENDIX Figure A.2.2. Reasons for not Having an Account (% without an Account, age 15+)

Source: Findex, various editions

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2. https://mospi.gov.in/sites/default/files/publication_reports/Report%20no.%20588-AIDIS-77Rm-Sept.pdf
3. For example, assume that there are hundred households that are made to stand in a line starting with the household with the lowest asset ownership and ending with the household with the highest asset ownership. They are then grouped into 'deciles' starting with the first ten households clubbed into the first decile, followed by the next ten in the second decile and so on.
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14. Year-on-year credit figures are not calculated based on actual inflation for each year. Inflation is consistently assumed to be 6% annually during the period considered.
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