Pillars of Financial Inclusion: Remittances, Micro Insurance and Micro Savings

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The recent developments in banking technology have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines (ATM), credit/debit cards, internet banking, online money transfers, etc. The moot point, however, is that access to such technology is restricted only to certain segments of the society. Various data sources have reported that 51.4% of farmer households are financially excluded from both formal/informal sources. These people, particularly, those living on low incomes, cannot access mainstream financial products. Dr. C Rangarajan Committee on Financial Inclusion defines financial inclusion as under:

“Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.”

02. The essence of financial inclusion is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. Apart from the regular form of financial intermediation, it may include

• small savings product suited to the pattern of cash flows of a poor household
• money transfer facilities
• insurance products (life and non-life),
• small loans and overdrafts for productive personal and other purposes
• a basic no frills banking account for making and receiving payments, etc.

03. Past Efforts at Financial Inclusion in India

Even before the emergence of ‘financial inclusion’ as a part of jargon in the finance and banking arena, the Indian polity had shown tremendous foresight in formulating policies for the same right from mid-fifties to the mid-eighties. The institutionalization of systems for financial inclusion in India started with the establishment of credit cooperatives following the enactment of Cooperative Societies Act in 1904. After independence, these efforts were intensified following the recommendations of All India Rural Credit Survey Committee of 1954. The expansion of the access of the traditional commercial banks in to rural areas commenced with the nationalization of Imperial Bank of India and its conversion to State Bank of India in 1955. In 1969, the review undertaken by the All India Rural Credit Review Committee found that the cooperatives had not reached up to the expectations in mobilizing deposits and dispensing credit at the national level. The Committee therefore, felt that the efforts of the cooperatives had to be supplemented and recommended the adoption of a multi-agency approach to provide credit to rural and
semi urban areas with a role for Commercial Banks. The nationalization of 14 major Commercial Banks in 1969 and another 6 Commercial Banks were in 1980 steps that facilitated rapid expansion of the banking system to hitherto un-banked areas. With the nationalization of major banks, special responsibility of stepping up advances for the entire priority sector was given to them. In 1970 the Lead Bank Scheme was introduced under which each district in the country and each State were assigned to one commercial bank as Lead Bank to coordinate the efforts of financial institutions in meeting the credit needs of the economy.

Unlike many developing countries, India has an extensive and well-organized rural banking system. In the cooperative sector there is a network of more than 1,12,000 Primary Agriculture Cooperative Societies (PACS) at the base level that are federated into 367 District Central Cooperative Banks (DCCBs), affiliated to 30 State Cooperative Banks (SCBs). The DCCBs themselves have a network of 13,635 branches. This cooperative banking sector originally catered exclusively to short-term crop production credit for the farmers but since the last decade, they are gradually diversifying into other agricultural and non-agricultural investments. In the cooperative sector there are also 20 State Cooperative Agriculture and Rural Development Banks (SCARDBs) and 739 Primary Agriculture and Rural Development Banks (PARDBs) which are technically not banks but disburse credit for investment activities in agriculture through their network of 2001 branches.

In India, financial inclusion was the underpinning of the largest subsidy linked credit programme in the world under the banner of the Integrated Rural Development Programme (IRDP). This programme, initiated in 1978, brought nearly 55 million below-the-poverty households under the banking umbrella by provision of capital subsidized loans. Though this programme had been criticized for financial leakages and misutilisation, it was able to take banking services to the remotest corners of India. In 1999 the Swarnajayanti Gram Swarojgar Yojana (SGSY) programme, which follows the SHG pattern, has taken off from the point where IRDP ended, by integrating all anti-poverty subsidy-linked credit programmes.

Present Position

The bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. The branches of commercial banks and the RRBs have increased from 8321 in 1969 to 68,282 branches as at end March 2005. The average population per branch office has decreased from 64,000 to 16,000 during the same period. However, there are certain under-banked States such as Bihar, Orissa, Rajasthan Uttar Pradesh, Chattisgarh, Jharkhand, West Bengal and a number of North-Eastern States, where the branches are unevenly spread. One of the benchmarks employed to assess the degree of reach of financial services to the population of the country is the quantum of deposit accounts (current and savings) held as a ratio to the adult population. In the Indian context, taking into account the Census of 2001 (ignoring the incremental growth of population thereafter), the ratio of deposit accounts to the total adult population was only 59 percent. Within the country, there is a wide variation across the States. For instance, the ratio for Kerala is as high as 89 percent while Bihar is marked by low coverage at 33 percent. In the North Eastern States like Nagaland and Manipur, the coverage was a meager 21 percent and 27 percent, respectively. Northern Region, comprising the States of Haryana, Chandigarh and Delhi, had a high coverage ratio of 84 percent. Compared to the developed World,
the coverage of our financial services is quite low. For instance, as per a recent survey commissioned by British Bankers' Association, 92 to 94 percent of the population of UK has either current or savings bank account.

06. The banking industry has witnessed a tremendous growth in volume and in complexity during the last few decades. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to include vast segments of the population, especially the underprivileged sections of society, into the fold of basic banking services. Internationally also, efforts are being made to study the causes of financial exclusion and design strategies to ensure financial inclusion of the poor and the disadvantaged. The reasons may vary from country to country and hence the strategy could also vary but all out efforts are being made as financial inclusion can truly lift the financial condition and standards living of the poor and the disadvantaged.

07. Extension of Services and the Role of the State

There has been a fierce debate on the role of the State in ensuring services towards Micro insurance, remittance and Micro saving. Over the years in most developing economies, State owned financial institutions have accumulated losses due to loan defaults, and applied inadequate credit technologies, while excessive inflation eroded their capital base. Also, inflexible objectives within an inappropriate policy and legal framework and lack of institutional autonomy contributed to poor financial performance. More specifically, institutional viability was often neglected; risk management measures were inadequate; credit was provided at concessional interest rates, mostly to larger farm enterprises; loans were wrongly and unprofitably allocated or misused; standard credit programmes were not suited to the heterogeneous needs of small farmers; interest rates were directed and subsidized. The State-owned agricultural banks were characterised by inefficiencies, high operating costs, losses and decapitalisation. These banks were inefficient, supply driven and had weak non-market driven management systems. Experience indicates that these institutions required repeated recapitalisation and ultimately a large number of institutions failed, especially in Africa and Latin America. Even where these banks have failed, private sector institutions have not stepped in to fill the vacuum created. A foremost example in this regard is that of Banco Agrario del Peru (BAP). BAP was established and operated in line with the traditional agricultural credit paradigm, compatible with subsidies and government directed operations. With the onset of financial sector liberalisation in Peru, BAP collapsed. And, its collapse left a void in servicing of small farmers and rural households.

08. Despite the seemingly negative role of these interventions, the Indian experience with public sector banks, regional rural banks and a number of cooperative banks as also the experiences in South East Asian banking systems (BPM in Malaysia, BRI in Indonesia and BAAC in Thailand) prove that there still exists a considerable role for the State in financial markets for the poor. These experiences prove that State owned banks could achieve the goal of sustainable outreach and financial inclusion so long as they operate under the sound and best practices principles of the financial sector.

Institutions specifically catering to the needs of agriculture, rural and other sectors are necessary because financial markets have failed the poor. The failures of these markets are due to the following reasons:

- No lender is willing or permitted to pass on the extra costs associated with lending to customers of small means.
- No insurer is willing to compensate for borrowers’ and lenders’ risk by offering insurance against non-payment due to natural calamities.
- Potential borrowers are unwilling to borrow because of risk aversion, even if the expected value of their profits outweighs the expected costs of their investments.
- Social and private values of costs and benefits diverge because of externalities.

09. The fact that credit markets often fail the poor underscores the importance of interventions in rural financial markets. These interventions could take any shape, not necessarily through direct interventions. A broader role for rural finance is the need of the day. Rural finance should encompass credit, savings, and insurance, and improve allocation of assets and income generation. But technologies have to be worked out to reduce transaction costs and risk costs in rural finance. There exists enough empirical data across the countries on how best to do it. Profit and success in business is not necessarily incompatible with public ownership if management is given the right incentives. A review of macroeconomic and financial sector policy framework has shown that the State plays an important role in enabling an environment in which financial institutions can prosper, thus increasing financial deepening and access to financial services. The well-documented failures of the past were based on supply-led approach, which pushed credit to low and sometimes even negative real interest rates, instead of promoting the formation of eventually sustainable financial institutions.

10. It is becoming increasingly apparent that addressing financial exclusion will require a holistic approach on the part of the banks in creating awareness about financial products, education, and advice on money management, debt counseling, savings and affordable credit. The banks would have to evolve specific strategies to expand the outreach of their services in order to promote financial inclusion. One of the ways in which this can be achieved in a cost-effective manner, is through forging of linkages with microfinance institutions, NGOs and local communities. Banks should give wide publicity to the facility of no frills accounts. Technology can be a very valuable tool in providing access to banking products in remote areas. ATMs and rural low-cost cash dispensing machines can be modified suitably to make them user-friendly for people who are illiterate, less educated or who do not know English. The banking correspondents and banking facilitator model, needs to be implemented by the private sector banks especially, as their rural presence is relatively less than the public sector banks.

11. One has also to emphasise that in extending financial inclusion, the State has a facilitating role, especially in developing economies, which cannot be wished away. To sum up, banks need to redesign their business strategies to incorporate specific plans to promote financial inclusion of low-income groups treating it both as a business opportunity as well as a corporate social responsibility. They have to make use of all available resources including technology and expertise available with them, as well as the MFIs and NGOs. It may appear in the first instance that taking banking to the sections constituting “the bottom of the pyramid”, may not be profitable but it should always be remembered that even relatively lower margins on high volumes can be a very profitable proposition. Financial inclusion can emerge as commercially profitable business.
Micro Insurance

India’s complex social security system comprises of seven components- EPFO Schemes, Civil Service Schemes, Public Sector Enterprises Schemes, Occupational Pension Schemes, Voluntary Tax Advantaged Scheme, Schemes for Unorganized Sector, social insurance and Micro pension. As one of the seven components of India’s social security system, micro pensions can play a useful role if they are brought into the mainstream of the financial system. In order to implement the commitment to provide social security to the unorganized sector, the Government of India, among other measures, constituted the National Commission for Enterprises in the Unorganized Sector (NCEUS) under the control of the vide Ministry of Small Scale Industries.

Social Security for the Unorganized Sector:

- Total employment in the Indian economy: 457 million
- Unorganized Sector: 395 million (86% of workforce); Organized: 28 million (14%)(January, 2005, NCEUS)
- More than 85% of all rural workers get wages below the minimum standard of Rs.66 per day. As per a Supreme Court verdict, all those who do not get statutory minimum wage should be presumed to be treated as bonded labor
- Lack of comprehensive protection of minimum work conditions as well
- This has serious repercussions across socio-economic dimensions.
- India currently has more than 260 million people below the Poverty Line, which amounts to around 26.1% of the total Indian population and even they have no social security cover.

Micro-insurance, the term, is used to refer to insurance to the low-income people, and is different from insurance in general as it is a low value product (involving modest premium and benefit package) which requires different design and distribution strategies such as premium based on community risk rating (as opposed to individual risk rating), active involvement of an intermediate agency representing the target community and so forth.

Insurance is fast emerging as an important strategy even for the low-income people engaged in wide variety of income generation activities, and who remain exposed to variety of risks mainly because of absence of cost-effective risk hedging instruments. Although the type of risks faced by the poor such as that of death, illness, injury and accident, are no different from those faced by others, they are more vulnerable to such risks because of their economic circumstance. In the context of health contingency, for example, a World Bank study reports that about one-fourth of hospitalized Indians fall below the poverty line as a result of their stay in hospitals. The same study reports that more than 40 percent of hospitalized patients take loans or sell assets to pay for hospitalization.

Indeed, enhancing the ability of the poor to deal with various risks is increasingly being considered integral to any poverty reduction strategy. Of the different risk management strategies, insurance that spreads the loss of the (few) affected members among all the members who join insurance scheme and also separates time of payment of premium from time of claims, is particularly beneficial to the poor who have limited ability to mitigate risk on account of imperfect labour and credit markets.
In the past insurance as a prepaid risk-managing instrument was never considered as an option for the poor. The poor were considered too poor to be able to afford insurance premiums. Often they were considered uninsurable, given the wide variety of risks they face. However, recent developments in India, as elsewhere, have shown that not only can the poor make small periodic contributions that can go towards insuring them against risks but also that the risks they face (such as those of illness, accident and injury, life, loss of property etc.) are eminently insurable.

13. Development of Micro-Insurance in India

Historically in India, a few micro-insurance schemes were initiated, either by non-governmental organizations (NGO) due to the felt need in the communities in which these organizations were involved or by the trust hospitals. These schemes have now gathered momentum partly due to the development of micro-finance activity, and partly due to the regulation that makes it mandatory for all formal insurance companies to extend their activities to rural and well-identified social sector in the country (IRDA 2000). As a result, increasingly, micro-finance institutions (MFIs) and NGOs are negotiating with the for-profit insurers for the purchase of customized group or standardized individual insurance schemes for the low-income people.

Although the reach of such schemes is still very limited, anywhere between 5 and 10 million individuals, their potential is viewed to be considerable. The overall market is estimated to reach Rs. 25,000 crores by 2008 (ILO, 2004). The IRDA defines rural sector as consisting of (i) a population of less than five thousand, (ii) a density of population of less than four hundred per square kilometer, and (iii) more than twenty five per cent of the male working population is engaged in agricultural pursuits. The categories of workers falling under agricultural pursuits are: cultivators, agricultural labourers, and workers in livestock, forestry, fishing, hunting and plantations, orchards and allied activities. The social sector as defined by the insurance regulator consists of (i) unorganized sector (ii) informal sector (iii) economically vulnerable or backward classes, and (iv) other categories of persons, both in rural and urban areas.

The rural obligations are in terms of certain minimum percentage of total polices written by life insurance companies and, for general insurance companies, these obligations are in terms of percentage of total gross premium collected. Some aspects of these obligations are particularly noteworthy. First, the social and rural obligations do not necessarily require (cross) subsidizing insurance. Second, these obligations are to be fulfilled right from the first year of commencement of operations by the new insurers. Third, there is no exit option available to insurers who are not keen on servicing the rural and low-income segment. Finally, non-fulfillment of these obligations can invite penalties from the regulator.

In order to fulfill these requirements all insurance companies have designed products for the poorer sections and low-income individuals. Both public and private insurance companies are adopting similar strategies of developing collaborations with the various civil society associations. The presence of these associations as a mediating agency, or a nodal agency, that represents, and acts on behalf of the target community is essential in extending insurance cover to the poor.

Typical Business Models for Micro-insurance

There are four general organizational models for delivering insurance services to the poor.
1) Partner-agent model - In the partner-agent model, insurers and MFIs team up to exploit each other’s comparative advantages. Insurers utilize MFIs’ efficient delivery mechanism that provides the sales and basic services to the clients. MFIs benefit from being able to provide insurance to their clients with no risk and limited administrative burden. FINCA International, Uganda has entered such a partnership with American International Group (AIG) to provide its clients insurance.

2) Community-based insurance model - In this model, the policyholders are themselves the owners and managers of the insurance program. This model is used mainly in health insurance. The members themselves design, develop, service and sell the product, and they negotiate with external health care providers. UMASIDA in Tanzania is an example of this.

3) Full-service insurance model – This is similar to the model followed by formal sector insurers, when the provider is singly responsible for all aspects of product manufacturing, sales, servicing, and claims assessment. The insurers are wholly responsible for all insurance-related costs and losses, but they also retain all profits. SEWA in India is an example of a full-service provider.

4) Provider model - under this model, the service provider and the insurer are the same. Like the community-based model this model is also used mainly in health services, where hospitals or doctors offer policies to individuals or groups. Gonoshasthaya Kendra in Bangladesh follows the provider model.

In India, Micro finance institutions are perhaps in a unique position to provide micro insurance as they have extensive networks and are already offering financial services to poor clients. In some cases, MFIs link with formal insurance companies and act as agents for the formal insurer, although the insurer retains all of the risk. MFIs can also form joint ventures with formal insurers and share both risk and management. Some MFIs feel that while they have the networks among the poor, they are not technically proficient to provide insurance services. So, they team up with professional insurance providers who have the technical expertise in the area.

Demand for micro-insurance

The ILO (2004) has recently prepared an inventory of micro-insurance schemes operational in India. Based on this list some of the observations are made below:

- available cover 5.2 million people.
- Most insurance schemes (66%) are linked with micro finance services provided by specialized institutions (17 schemes) or non-specialized organizations (17 schemes). Twenty two percent of the schemes are implemented by community-based organizations, and 12% by health care providers.
- Life and health are the two most popular risks for which insurance is demanded: 59% of schemes provide life insurance and 57% of them provide health insurance.
- Twenty-five out of 37 schemes received some external funds to initiate their schemes. Twenty out of 32 schemes received external technical assistance in the form of advisory services, technical services, training or even referral services for their schemes.
Most schemes (74%) operate in 4 southern States of India: Andhra Pradesh (27%), Tamil Nadu (23%), Karnataka (17%) and Kerala (8%), and the two western States (Maharashtra (12%) and Gujarat (6%)) account for 18% of the schemes.

International Experiences

Poor households in developing countries are vulnerable to a range of risks such as natural disaster shocks, livelihood losses, health problems, food insecurity and other threats. Such events can result in crises, eroding asset bases and savings, and often destroy previous economic gains. At-risk communities can benefit from micro-insurance products, for which low-income households pay a small premium for limited coverage for specific risks. To date, micro-finance institutions (MFIs) and NGOs have provided a spectrum of financial services to impoverished people including small loans, savings plans and insurance. These products are similar to those offered in more developed markets but their modes of delivery are designed to reach low-income clients, with low costs. Micro-insurance is of course not a new development, but this chapter concentrates on its evolving use for natural disaster risk management.

Currently life insurance is the most widely available and profitable type of micro-insurance in developing countries. Health insurance appears difficult to provide to poor households because of frequent claims and associated high administrative and claims monitoring costs.

Property insurance is under examination, but it is a challenge to establish in developing countries where land rights are sometimes restricted and land ownership is often not clearly defined. Asia and Latin America currently experience the most formal insurance activity, while Africa, with multiple and often overlapping risks like AIDS, political instability, famine, extreme poverty, and natural disasters, can be considered the proving ground for micro-insurance.

Current providers of micro-insurance include stand-alone institutions or partnerships between formal insurance and reinsurance companies, national and local governments, international organisations, MFIs, NGOs and community groups. There are many ways to offer micro-insurance products in developing countries, such as through community-based groups in which the policyholders themselves are owners and managers of the program. Another common way of delivering micro insurance is through a partner-agency model. In this structure, an agent like an MFI delivers access and services to the customers, while an insurance company provides financial capacity and technical knowledge to the agent.

Examples of micro-insurance models

The micro finance models evolved over a period of time can be categorized to four models which have addressed the gap between demand and supply for micro-insurance products and are presented below.

(a) Model 1: Government-initiated scheme

In partnership with UNDP and donor governments, Vietnam recently launched a project to design a natural disaster fund. Per-capita premiums amount to about US$ 70 million annually, with the average household paying US$ 1 per annum. The fund covers disaster claims, offering graduated benefits for households that reduce their risk from natural disasters through structural measures or moving to lower-risk areas. The project started at the community level, as rural farmers expressed the need to manage and transfer disaster risks. In response, the national government enlisted the help of partners
to create a federal disaster fund that will eventually be backed by reinsurance. To promote the fund, the program is looking for “champions” to advocate and help develop insurance solutions. Champions in the national government can endorse needed legislation and regulatory frameworks for reinsurance and insurance to function. These champions will persuade national and local governments that household-level risk reduction and risk transfer lowers the public burden of post-disaster financing. The project faces two main challenges: convincing the government and society of the benefits of financial risk transfer, and gaining the interest and involvement of commercial reinsurance. An interesting aspect of this nationwide scheme is the intentional non-use of the term “micro.” It is felt that although the services provided to individuals could be labeled as micro-insurance, given the coverage and scale of the scheme, the term “micro” is both inappropriate and may deter the interests of national and global (re)insurers.

Model 2: Reinsurance-initiated scheme

In this model, a reinsurance company enters into a partnership with an MFI, NGO, or local insurance company. Interpolis Re, a subsidiary of the Rabobank Group, is a reinsurance company involved in a number of micro-insurance schemes in developing countries. Driven by corporate social responsibility and historical solidarity with agricultural mutual in developing countries, Interpolis Re began providing financial and technical assistance to mutual insurance programs in the mid-1990s. Partners in Sri Lanka helped establish an independent mutual insurance company, although local legislation requires that the program be called a mutual benefit program. Since then Interpolis Re has helped establish, technically supported and reinsured micro-insurance programs in various countries.

In India, Interpolis Re uses an agency model with a local NGO, the DHAN Foundation, which among other services helps low-income households organise into community groups for risk management purposes. DHAN currently oversees almost 15,000 community groups, called Kalanjiams, comprised of smaller units of 15 to 20 poor women. Through these units, the DHAN Foundation is able to reach over 250,000 families. To provide insurance for this high volume of low-premium customers, Interpolis Re negotiates with local insurers to develop group policies. Educating potential clients about basic insurance concepts can be a challenge in developing countries. Customers commonly perceive insurance premiums as a savings mechanism, often assuming they will get their premiums back if they do not make claims. It is important for clients to understand how insurance functions, but education is often challenged by limited literacy among low income households. In response, the DHAN foundation developed street plays to illustrate how micro-insurance schemes help solve problems related to disaster risk. Information shared in this way has proved effective in increasing understanding and demand for micro-insurance products for disaster management. For smaller schemes, Interpolis Re works with mutual benefits groups. Through these mutual clients pay an average annual premium of 100 rupees (currently about US$ 2.22) for 10,000 rupees of coverage. Clients are often landless, do not have formal title to the land they utilise or are too poor to demand property insurance, so Interpolis Re offers stock insurance for such items as cattle. The reinsurance company is investigating ways to cover crops, but lack of data is a challenge. If Interpolis Re could access meteorological data, local-scale weather-derivatives for agriculture could be offered.

Local insurance companies often need support to improve the efficiency of their services. Interpolis Re is meeting these needs by providing an information backup system, support in writing annual reports and a training program to develop local
insurance capacity. Interpolis Re however recognises genuine limitations from a business perspective, such as a lack of short-term profits and high labour intensity.

(c) Model 3: Micro-finance-initiated scheme

Institutions like Opportunity International and FINCA (The Foundation for International Community Assistance) provide micro-finance in developing countries. Micro-finance clients often share the responsibilities for paying interest and repaying principal amounts of small loans with other group members. Disability or death can prevent group members from making loan payments, while, in some cultures traditionally elaborate funerals can consume the savings and capital of poor households. Such expenses can drive a household further into debt and undermine the ability to participate in community groups that access micro-finance. Therefore, Opportunity International began designing micro-insurance products to meet this demand and to prevent loan default. For a small premium, group members now receive insurance coverage for disability, death and funeral expenses. Opportunity International pointed out challenges in this model. MFIs are not necessarily experts in designing and providing insurance services but while MFIs may lack the actuarial basis for computing premiums and contributions, they may often still try to offer insurance products. These institutions may attempt to adopt products of formal insurance firms, using copied or adapted premiums and benefits without adjusting these to customer demand in specific markets. Micro insurance provision by MFIs might not always be feasible because they generally work with a small and geographically-limited risk pool, and they lack reserves and reinsurance. MFIs face high covariate risk with disasters affecting all or many of their clients at the same time. To successfully provide insurance, MFIs must achieve a certain scale in numbers of policies in order to increase stability by reducing variability resulting from covariate shocks to their portfolio. Without insurance partners, MFIs can still have difficulty transferring risk once scale is achieved.

(d) Model 4: NGO-initiated scheme

NGOs such as Action Aid International and the Disaster Mitigation Institute (DMI) are developing insurance products linked with disaster risk reduction in order to contribute to poverty reduction. Action Aid International assists MFIs serving approximately 10 million families in Bangladesh, about 70% of which are vulnerable to floods and cyclones. MFIs currently have few global finance sponsors and struggle with solvency when disasters occur, specifically with the high frequency and severity of hazard events common in Bangladesh. A further challenge is a lack of self-organised community groups. Action Aid International explained that well-meaning international organizations have essentially crowded out community groups by providing micro-finance schemes that do not involve local stakeholders. The lack of such involvement makes effective provision of micro insurance difficult.

The NGO DMI in India has involved local stakeholders, and has thus been able to build the trust of their clients. Currently DMI’s disaster insurance scheme “Afat Vimo” covers 1,000 households and micro-businesses, with an additional 5,000 scheduled for coverage in the state of Gujarat by the end of 2004. For a one-time premium of roughly US$ 1.20, clients can purchase US$ 1,500 worth of property, livelihood, and life insurance. For an additional US$ 1.50 in premiums, clients can receive extended coverage.

DMI reaches its clients through community groups organised to manage the impacts of disasters and helps these groups form local business chambers. Members of the business chambers can access interest-free credit through a revolving fund, and pay a
low one-time premium for insurance. The business chambers provide loss prevention services, and clients can additionally receive risk reduction training for a small fee (20 Indian rupees). Customers have expressed satisfaction at DMI’s multi-tiered risk reduction scheme. DMI noted, however, that it is difficult to get the private sector involved because Aflat Vimo is not designed to generate profit per se; rather the disaster insurance is provided first and foremost to help disaster victims escape poverty.

Challenges

The main challenges that must be addressed to successfully provide micro-insurance to poor households are as under;

(i) Client profile: Insurance providers need to know more about potential clients, their specific risk management needs and the types of products for which they would be willing to pay. Insurance penetration in developing countries is very limited or absent often because formal insurance providers have not found ways to reach potential clients. Furthermore, customers may have difficulty paying premiums in a regular and/or timely manner. If the premium charged for micro insurance is a significant percentage of the potential client’s income, customers may not demand the product. Premiums, while needing to be actuarially sound, must be carefully priced so that they do not compromise the ability of clients to pay for essential items such as food, energy, and shelter. Market research must be conducted to help formal insurers and other partners serve customers efficiently.

(ii) Understanding of insurance: Potential micro-insurance clients appear to prefer savings over borrowing as a way to be prepared to cope with emergencies. Potential clients may feel that paying a premium is a form of savings, and expect to receive their premium back if a claim is not made within the coverage period. It can be difficult to conduct market research or serve clients’ needs if potential clients lack the understanding necessary to articulate their demands for the array of possible insurance products.

(iii) Information asymmetries: Formal insurance companies are accustomed to working in well-organised institutional environments with access to literate clients. These clients can provide data and verifiable documentation for underwriting and claims (such as certificates of health or death, or receipts or titles stating value of assets). In contrast, low literacy rates and asymmetric information in developing countries present a major challenge to the functioning of insurance.

(iii) Provision through MFIs: Formal insurance and finance institutions vary in structure and required management skills. While MFIs are generally not designed to manage disaster risk, MFIs may still engage in providing coverage for risks they do not understand well or for which little data is available. Such institutions require maturity to provide insurance products and should view provision of micro-insurance as a long-term business commitment, not a market to move in and out of quickly.

(v) Covariate risk: While MFIs tend to provide to small groups in specific geographic areas, a large client pool is needed to spread the covariate risks of natural disasters. Micro-insurance, like all insurance, requires geographic and peril diversification for sustainability.

(vi) Social protection or market viable product: A significant challenge facing micro-insurance schemes is the current lack of distinction between these schemes and social protection programs. There is a debate about whether insurance should be directly linked to social protection, or complement social protection through market
products. Social protection projects often receive ‘outside’ subsidies and are motivated by humanitarian ideals that do not necessarily consider economic efficiency. Approaching insurance as a social protection program can relax market discipline. Without market discipline providers can overlook risk management guidelines and client demands, thus resulting in unsustainable business practices.

(vii) Regulatory framework: Regulations for micro-insurance currently do not exist in many developing countries. Regulators tend to focus their attention on conventional insurance institutions, which can lead them to set capital requirements too high and place inflexible rules on agents. Policy makers need to obtain a better understanding of the benefits and demands of micro-insurance to promote increased professional, legal and expansive micro-insurance services. Current regulatory structures in some countries also may prevent MFIs from forming partnerships with insurance companies.

(viii) Forming partnerships: Institutions providing micro-insurance can clearly benefit from partnerships. Presently these potential partners often lack common platforms, vocabularies, time frames and objectives. For example, the private sector generally pursues profitability, NGOs and governments seek broader social objectives and the international community focuses on areas specific to the development process, such as poverty reduction. The challenge lies in establishing mutual goals and clearly defining appropriate roles for partners. A practical step would be to establish a clear memorandum of understanding among partners that would establish and delineate roles, policies, and procedures and expected outcomes and deliverables.

(ix) Applicability of Various Insurance Schemes: Innovative products such as local weather-based derivatives should be further investigated. On the other hand, mechanisms such as catastrophe bonds do not provide an optimal risk transfer solution for the lower intensity and higher frequency risks that tend to repeatedly affect low-income households in developing countries.

(x) Opportunities: The identified opportunities exist for insurance providers acting alone or in partnerships with national and local Governments, international organisations, and civil society. While these opportunities can be exploited both in the short and long-term, all involved must have a long-term perspective of sustainability and self-sufficiency.

(x) Community groups: MFIs, NGOs, and insurance companies can better reach low income clients and thus lower their transaction costs by working with community groups. Administrative costs are reduced through local handling of marketing and sales, premium collection and claims payments. Benefits for community groups include reduced disaster risk, increased community solidarity and direct influence on products and scheme management. Community groups, often together with MFIs, can perform needs-analyses and awareness campaigns in a variety of ways, including focus group meetings, street plays, and inviting micro-insurance claims recipients to tell others about the benefits of insurance.

(xii) Risk reduction: Community groups share the costs of losses suffered by individual members; this encourages collective action and risk reduction activities by all group members. By working with and through community groups, micro-insurance can strengthen the solidarity within communities. Micro-insurance schemes can and should offer premium reductions if clients reduce the vulnerability of insured assets, thus linking directly with the broader agenda of risk reduction. Such graduated benefits also give clients an incentive to stay with a given provider (customer loyalty), with provision
through groups allowing members to maintain a sense of ownership of reserved premiums, thus further motivating collective risk reduction through individual action.

(xiii) Governments: Micro-insurance can transfer some of the public burden of disaster financing to the commercial markets, and should thus be fostered through adequate regulatory frameworks and active government support and participation.

(xiv) International community: The international community, through aid and development cooperation, shares in part the financial impacts of disasters in developing countries. As such, it is in the interest of the international aid system to invest in disaster risk management in developing countries, which in turn will reduce their own expenditures for post-disaster relief and reconstruction. Risk transfer mechanisms such as micro-insurance could play a key role in international disaster reduction efforts. International organisations can clearly help lay the foundations and form guidelines for partnerships that involve formal insurance and reinsurance. They can provide technical expertise to pilot projects and support market research defining client demands, especially the gender-specific needs and preferences of clients. It is important to encourage already-existing formal and commercial insurers to become engaged, ideally in partnerships with organisations that have created efficient delivery service mechanisms for low-income markets.

(xv) Insurance and reinsurance companies: The insurance sector can make its vast experience and expertise available to interested partner organisations. Local agents need to learn about the proper management of reserves and premiums, as well as exposure management. Relatively small investments by the private sector can facilitate greater insurance competence in communities and help improve the risk management capacity of societies, which in turn leads to greater insurability and future opportunities in new markets with new products.

(xvi) Market-based products: While insurance education is important, micro-insurance opportunities do not create themselves; the demand needs to exist. Experience so far suggests that poor clients are willing to pay more for a better, more tailored service. In contrast to subsidised schemes for social protection, market-viable products may be more expensive. While not only more likely to provide more customised services and superior benefits for clients, market-based products also have greater chances for long-term sustainability and profitability.

(xvii) Linking Savings, Credit and Insurance: Opportunities exist to link savings, credit and insurance. Insurance premiums can be paid with micro-credit group membership fees. Community groups or mutual benefit groups can deduct premiums from dividends or special accounts which group members replenish. Yet another option is to bundle micro-insurance with savings. In such a packaged service, micro-finance clients agree to receive a slightly lower interest rate for their savings, and the difference is used to pay insurance premiums. A substantial benefit of insurance savings packages is that it can lower the marginal costs for providing services such as paying premiums and receiving interest payments separately.
New Innovation: People Mutuals

Dhan Foundation has devised an innovation in addressing the micro insurance needs. People mutuals have been floated by the organization to address the needs of last mile client. The salient features are as under;

The Kalanjiam Community Banking Programme of DHAN Foundation has over a decade of experience in micro finance. It organises the poorest of the poor women into self help groups called Kalanjiams. The Kalanjiams in turn promote the clusters and federations for networking and solidarity. They are involved in activities related to strengthening the Kalanjiams and enlarging the range of financial services like savings, credit and social security. Social security services are provided as a graduation of savings and credit services. The social security services are also based on the concept of mutuality of members and local management. The federations are independent organisations owned, and managed by 100 - 200 Kalanjiams in a specific geographical area. The programme has been under implementation in Kalanjiam federations since 1992. It is implemented through collaboration with insurance companies or on their own. The products include life coverage for natural and accident death, disability, health coverage for hospitalisation, livestock assets and coverage of houses against damage.

The other major thematic intervention of DHAN Foundation is conservation and development of Tankfed Agriculture. It promotes Tank Farmers Associations called Vayalagams and federates them at district level as independent People federation. Rainfed Farming Development, Information and Communication Technology for Poor and working with Panchayats are the new development innovations of DHAN Foundation for poverty reduction. The people federations promoted by these themes strive to provide social security to their members for addressing the issues of vulnerability.

Federations have developed a system for collection of premium and settling of claims involving the members and leaders. The Federation Executive Committee takes a major role in evolving policies, relevant to the needs of the members.

People Mutuals

The various people federations promoted by DHAN Foundation have come together to promote a new initiative "People Mutuals". The main objective is to provide social security to all the members of different people federations. The people mutuals was launched on 2nd October 2003 and it has been incorporated under the Indian Trusts Act 1882. DHAN Foundation as a promoter of these people federations continues to provide strategic guidance and support for this institution.

The federations of savings and credit groups, Tank Farmers associations, Dry land Farmers Associations etc., promoted by DHAN Foundation with the objective of poverty reduction, would become members of People Mutuals. Trustees elected from member federations, govern the institution. An Advisory Committee constituted with eminent persons in the areas of development, social security schemes, insurance and welfare schemes advises People Mutuals on future directions, product development, new opportunities in the changing scenario, collaborations and areas of research.
People Mutuals is managed by professionals under the leadership of people governance / board of trustees and guidance and support of the advisory committee. The People Mutuals initiative is supported by Oxfam Novib, Rabobank Foundation and Micro Insurance Association Netherlands.

**Guiding principle of People Mutuals**

**Mutuality** : It is the basic belief that a group of people can act more efficiently through cooperation for their mutual benefits than if they act alone. It is an enterprise owned by its members, providing a variety of services for their benefit. Such mutuality exists in self help groups of federations and other people organisations promoted by DHAN Foundation.

**Objectives**

The main objectives of the People Mutuals are :

1. To ensure social security cover to poor either through their mutual programmes or through facilitating linkages with various social security schemes and development programmes of Government, mainstream insurance companies.

2. To build awareness and capacity of the members, leaders and staff of people federations on social security initiatives.

3. To undertake need based studies and researches on social security issues, and to document the grassroots experiences for dissemination and policy advocacy. Organising and participating in various forums and events for advocating pro poor policies in the insurance sector.

**Programmes**

People Mutuals implements the following programmes to achieve its objectives.

1. **Product promotion and development**

   **Promoting the concept of mutuality and social security** : People Mutuals makes every effort along with the federations to make the concept of social security especially the mutuality dimensions of social security understood by the members. It organises social security literacy programmes for the members through appropriate information, education and communication materials and events. In association with the People Academy, an initiative by DHAN Foundation for capacity building of leaders and people staff, it organises training on mutuality and social security for them. It also organises in-house workshops with field workers at different levels such as locations, regions and programmes on various need based topics.

   **Facilitating collaboration** : The People Mutuals works towards forging effective collaboration between the people federations and mainstream insurance companies to make use of the existing mainstream products for the benefit of poor.
Capacity building for the officials of insurance companies: In order to build the perspectives on mutual insurance related to poverty among the officials involved in designing and implementation of insurance products in the insurance companies, People Mutuals organises various capacity building programmes such as exposure visits, training programmes, workshops and seminars. These training programmes would support and strengthen the efforts of the mainstream insurance companies to develop suitable products for poor.

2. Developing database and systems at People Mutuals

People Mutuals maintains a detailed database on the existing insurance coverage by the people organisations. It constantly updates the profiles of insurance products and services offered by the mainstream insurance companies and in turn communicate it to the people federations.

It also extends support to the people federations to streamline the existing systems and set up new systems to keep up with the growth and diversification of social security services offered by the federation. It liaises between the people federations and insurance companies to ensure timely and genuine claim processes. For the benefit of the implementing federations, it publishes manuals and handbooks in English and vernacular languages.

3. Policy Advocacy, Research and Development

People Mutuals focuses on research and development to understand the vulnerabilities and risks faced by poor and to experiment on developing new products on pilot basis. Specific attention is given to undertake micro level studies and market studies to get needed information and create knowledge base to innovate new products for piloting.

Policy seminars cum workshops on the theme of Social Security including pension for poor and crop insurance are organised for addressing the needs of social security on the basis of mutuality and also open up new vistas for effective risk management. It systematically builds a knowledge base in the area of social security, which could be made available for the sector in the long run. The People Mutuals would become a resource centre on mutual insurance.

Money Remittances and Micro Savings

Persistent poverty continues to push poor rural people elsewhere in an effort to improve their life. Money Remittance is the need of migrant working population which itself is intimately related to rural poverty. In recent decades, migration has changed the composition of families in many poor rural communities. The primary income earners of these families can be working in another city like migrant labours from Bihar work in the fields of Punjab. In addition, migration by men results in many households being headed by women. Furthermore, many communities are deprived of a significant part of their labour force within the communities themselves. Communities are extended beyond strict geographic boundaries, and their migrant members are playing an active role — sending remittances, bringing innovative ideas — in the well being of the rural communities they left behind.
In this context, it is essential to recognize the existence of the large migrant populations with strong ties to their communities of origin and provide them financial services for their specific. The financial services are not available to these migrant work force due to small ticket size of the transaction, which most of the banks find to be unviable and also due to among other things, KYC norms. This has lead to emergence of alternative informal system and structures leading to further exploitation of the migrant population. Migrant taxi drivers in metros send there earnings home through money changers. These money changers o have deployed ‘hawala’ system and charge exorbitantly for extending the remittance facility. In places of high rural out-migration, the primary objective should be to enable rural poor people to offset the negative impacts of migration by:

- primarily supporting initiatives that aim to reduce the cost of sending remittances and that promote the diversification of financial services in rural areas;
- at a larger scale encouraging families receiving remittances to participate in projects that generate productive employment and sustainable income.

Micro Savings

The Cooperatives, Commercial Banks and RRBs inspite of persistent interventions have not been able to serve the needs of the poor, completely. There was a gap. Owing to the small size of the transaction the existing systems were unable to address the need for micro savings of the marginalized population. In early 1990’s this lead to emergence of Self-Help Group (SHG) Bank-Linkage movement in India, a movement that has been described as the largest micro finance intervention in the world. Initially, Self-help affinity groups were started by NGOs which were donor funded. These groups are now established by various agencies and are linked to suppliers of credit - bank. Thus reducing the transaction cost of the bank and simultaneously addressing the micro saving needs of the poor. Furthermore, the SHGs are also reported to have very positive impacts in a number of areas such as education, empowerment of women, child mortality and decreased dependency on moneylenders.

However, the SHG-Bank linkage programme faces a number of challenges, like

- the SHGs’ geographical concentration is skewed towards the Southern States of India. In some areas.
- there is a need for better Management Information Systems (MIS), accounting and internal controls.
- the programme has suffered due stiff group formation targets.

Problems of capture of SHGs by local elites has also been reported. SHGs need to graduate to promoting enterprises and factor in livelihood diversification. They also need to increase their access to the supply chain and to the capital market, and to appropriate production and processing technologies. New structures like federations, MFIs are also emerging to plug in the holes in the system. In addition to these policy makers in order to make micro saving a viable product are in the process of

- establishing structures to extend the reach of the formal banking system beyond the conventional brick and mortar model though mechanism like Banking Correspondent and Banking Facilitators.
- establishing regulatory mechanism for which Micro finance Bill is being formulated.
• examining the role of rural informal financial agents, with a view to possibly considering some of these as potential channels for retailing formal micro credit for which a Committee has been constituted by RBI.

The challenges facing rural financial institutions in India are formidable, and there is still a dearth of products to cater to the small ticket need of the poor. With an increasing awareness of the importance of understanding the financial service needs of the rural poor and designing products and processes to address these needs, the opportunities for institutional reform are extensive. Nevertheless, it does seem that financial institutions are beginning to see the rural poor as a business opportunity rather than the recipients of charity, and this will be an important driver of institutional change and provision.

Innovative Approaches

The Money remittance and Micro saving needs of the rural population need to be addressed by innovative approaches as the conventional system has its limitations. Both of these services need to delivered with new strategies, of which some are described below.

Making Financial Services Simple, Hassle-Free And Affordable

(i) Using Group mode for financing

a. High transaction cost of banks in servicing large number of small rural accounts is an issue that needs to be addressed. Use of 'Group Mode' i.e. SHGs, JLGs etc for financing is a proven mode for reducing the transaction cost. Banks are already financing vulnerable sections of rural borrowers through SHGs. The same needs to be further accelerated. Besides, financing JLGs need be given a push. NABARD has already prepared a scheme and circulated the same among banks for financing Tenant Farmers/Oral Lessees/Share croppers through JLGs.

b. Gender-oriented credit could be effected by financing through SHGs, considering the substantial gender coverage through women groups.

(ii) Simplification of lending procedure:

a. The simple format of documentation for small loans upto Rs.1.00 lakh developed by the Core Group of Bankers and circulated by NABARD may be adopted by all banks for all small loans up to Rs.3.00 lakh

b. No margin / collateral security may be insisted upon for agricultural loans up to Rs.1.00 lakh

(iv) Increasing physical outreach

a. Adoption of villages, particularly, in less banked areas, by banks.

b. Utilising the services of civil society organisation, Farmers’ Clubs, NGOs, POs, etc. as 'Business Facilitators' or as 'Business Correspondents'.

c. 'Contract farming' approach has the potential to expand credit outreach, especially to the small / marginal / tenant farmers. However, availability of proper legal framework safeguarding the interest of farmers should be ensured in the State.
Creating Conducive Climate For Lending

(i) Rural Credit Information Bureau (CIB)

Credit information is important to enable the banks to take quick credit decisions. Collection of credit information in respect of individual clients of banks is time consuming as well as costly. Consequently, there is delay in sanction of credit. As per the study conducted by World Bank-NCAER in UP and AP in 2002-03, it takes any time between 24-33 weeks to sanction a proposal. Non-receipt of timely credit is one of the reasons why rural people go to informal sources even though the rate of interest charged is exorbitantly high. Besides, non-availability of quality credit data in respect of prospective borrowers results in failure to assess credit risks and other risks properly, leading to credit delinquencies. As such, availability of quality credit information is important for banks to enable them to sanction loans in time with proper assessment of associated risks.

Establishment of Rural Credit Information Bureaus would ensure availability of data on potential borrowers. The legal framework for setting up of the Credit Information Bureaus has been put in place with the Credit Information Companies (Regulation) Act, 2005 and the necessary amendments to the Banking Regulation Act, 1949.

The Credit Information Bureau aims at providing comprehensive credit information by collecting, collating and disseminating credit information pertaining to borrowers/prospective borrowers to a closed user group of banks, FIs, etc. Data sharing is based on the principle of reciprocity.

The fragmentation of geographical needs for rural credit and other financial information does not lend itself to immediate establishment of Credit Information Bureau to serve the entire rural population. There is need to pilot the concept. Pilot experiment could be tried in a few districts. The existing clients of banks, PACS, SHGs, POs etc, could be covered by the CIB initially. Gradually, CIB may collect data/information in respect of all prospective clients form the rural areas. CIB can facilitate extension of financial services if data in respect of entire adult population in an area is captured along with asset data, through use of unique identification numbers. Provision of smart card/biometric card/unique identification numbers to each adult member will lead to smoother delivery of financial services, especially in rural areas.

Unique identify can link up data of any service provider to the system. Any commercial service provider like bank, insurance company etc., can use the data. The delivery of subsidy can also be targeted by direct electronic credit to the accounts of card holders.

(ii) Ensuring better climate for recovery of bank loans:

a. Loan delinquency is the most important reason why banks hesitate to provide lending facilities to those who, as per their perception, may not be able to repay back the loans. Besides, pronouncements by Central / State Govt. / political parties, from time to time, for loan waivers also vitiate the loan recovery climate in general. The Government should, therefore, refrain from making such announcements. Besides, there has to be a transparent method for writing off the dues of those who deserve the same, because of situations beyond their control.

b. Exclusive and dedicated legal structure needs to be set up on the lines of DRT for the purpose of recovery of rural / farm loans below Rs. 10.00 lakh.

(iii) Risk mitigation measures:
a. Setting up of Agricultural Risk Fund to provide relief to farmers, especially small and marginal farmers, after two three natural calamities, by writing off of a part or entire loan amount in a transparent manner, may go a long way to incentivise the banks to provide agricultural loans to farmers, particularly to the weaker section.

b. Innovative risk mitigation measure like weather-index-based insurance products may help banks to cover more and more small / marginal / tenant farmers.

(iv) Strengthening cooperative institutions

a. The Cooperative Credit structure with their grass roots level presence and vast outreach in rural areas are the most suitable institutions for providing financial services to the small and marginal farmers in India. Strengthening and revitalising the cooperative credit structure is crucial for effective delivery of financial services.

b. The outreach of cooperatives should be wedded to the financial strength of Commercial Banks. Commercial Banks may consider financing good working PACS to build synergy needed between Commercial Banks and Cooperatives.

(v) Improving credit absorption capacity

a. Credit absorption capacity of individuals is linked to the availability of infrastructure, particularly, pertaining to irrigation, connectivity, power, marketing infrastructure, etc. For the purpose, district-wise infrastructure plans may be prepared which may be implemented expeditiously by State Governments out of financial assistance under RIDF.

b. Introducing needed reforms to the outmoded APMC Act by State Government is necessary to encourage private participation in agricultural marketing to enable farmers to get more remunerative prices.

(vi) Increasing awareness / financial literacy level

a. Farmers' Clubs (FCs) can effectively increase the awareness of farmers as regards credit and technologies. Upscaling farmers' clubs can play a very important role in this regard. As already proposed to the Planning Commission, efforts may be made to form 1,00,000 Farmers' Clubs during XI Plan period.

b. Agri clinic and Agri Business Centres also can play effective role in increasing the awareness of farmers. It would be useful to have atleast one ACABC in each district as was the original target set under Farm Credit Package announced by GoI in June 2004.

c. Farmers' Training School being set up by a few Public Sector Commercial Banks also help increase the financial literacy level of farmers.

d. IBA / Banks to design publicity and awareness building campaign among the public.

Use of Innovative Products

(i) Use of innovative products to suit the needs of rural clientele

a. KCC is already a popular product so far as farmers are concerned. However, modification of KCC may still be required to provide for the entire credit requirement of the rural family and KCC may be redesignated as Gramin Credit Card / Gramin Tatkal Card.

b. It could be a feasible proposition to convert KCC into some sort of a smart card / electronic card.
c. Introduction of 'credit plus' approach should be followed by banks for linking finance with technology and other linkage.

(ii) 'No Frills' deposits account

All banks may offer basic banking 'no frills' account either with "nil" or very minimum balance. Also, all banks should allow limited overdraft facility on the same with no questions asked, so that every account holder has a 'line of credit; to fall back upon as and when necessary, instead of going to money lenders when there is an emergency.

(iii) Introduction of micro insurance

Banks may introduce a suitable micro insurance product for their rural clientele in association with Insurance Companies. An integrated product covering life, health and non-life assets in group mode may be a suitable product for the rural masses.

(iv) Widening the ambit of Rural Non Farm Sectors (RNFS):

RNFS is seen as more than a residual sector dependent on agriculture. It includes some high employment sectors such as retail trade in food, hotels, retail trade in fuel, utilities and durables, etc. Credit to this sector needs to be extended on a commercially viable basis with accompanying changes like simplifying procedures, providing non-financial and technical assistance by specialised personnel who are well versed with the basics of the sectors.

Innovative ideas have to overtake the tradition. The concept of commercial cultivation of lemon grass, kewda essence, mint essence etc in India is yet to take place in a big way and farmers in remote areas are yet to understand its importance of agro-processing in enhancing farmers' incomes. Policy issues need to be debated as to how to popularise these products so that the farmer gets maximum benefit.

Processing, transportation, storage and marketing are the areas where more attention is needed. The banking system should be geared up to respond to the changing needs of commercialised agriculture by introduction of innovative scheme that capture the diversity of agro businesses.

If agricultural credit policy has to become inclusive, it has to move away from food grain production to value addition activities in agriculture. The policies in this sector have to be disaggregated, taking into account the regional variation of this activity, the role of technologies, innovation, extension services and various private players in this area.

The vulnerable group comprising of MFs, SFs, wage labourers, informal traders, rural non-farm enterprises need credit for health problems, marriage, death, purchase of small assets, consumption needs, etc. besides, their need for working capital, seasonal crop productions etc. The provision of a packaged credit comprising of support services, recovery and insurance and an in-built flexibility will go a long way for the benefit of the vulnerable group.

Use of Technology for Extending the services

Use of technology will go a long way to reduce the transaction cost of the banks, thereby enabling banks to go ahead with delivery of financial services in hitherto unbanked areas. Extension services have to play a big role in these areas. An effort has been made to establish Common Service Centre (CSR) in rural areas. Advances in information and communication Technology have made it possible today to provide a whole range of high quality and cost effective services. It is possible now for provision of e-commerce, e-governance and information related to weather, marketing pricing, crop
insurance, disaster warning, seed varieties etc. What is needed is the replication of successful service centres all over India.

The Committee's recommendations relating to setting up of a Financial Inclusion Fund and a Financial Inclusion Technology Fund have since been accepted by GoI; Consequent to the announcement in the Union Budget 2007-08, to establish a Financial Inclusion Technology Fund to meet the costs of technology adoption with an overall corpus of Rs.500 crore, with initial funding to be contributed by the Central Government, RBI and NABARD, NABARD constituted In-house Committee on Financial Inclusion Technology Fund to prepare an implementable action plan for next five years

The other new area which may be explored for extending the remittance and micro saving services is the existing networks of government like railways, telegraph and post offices etc. among these post offices seem to offer reasonable possibility for delivery of financial services especially in the areas where the traditional brick and mortar branches of the banks have not been established as they have not found to be viable.

Postal banks and Delivery of Financial Services

Today in a majority of the developing countries, a large percentage of people are excluded from access to basic financial services. A study by the Boston Consulting Group in 2006 reveals that 74% of the rural population in India is financially excluded as against 43% of the urban population. The goal of promoting financial inclusion has moved higher up the policy agenda in many countries, including India, supported by new evidence that increased access to financial services promotes faster economic growth and also reduce poverty and income inequalities. One of the possible alternatives on which policy makers and development experts are focusing their attention in this endeavor to attain financial inclusion, is the vast postal network in developing countries. In many developing countries, postal networks already offer several basic financial services such as, money transfers and savings account as also life insurance facilities. Moreover, postal networks have wide spread coverage even in rural areas which the formal financial sector does not directly reach. How to use and develop the vast postal network for expanding access of financial services is an important question for policy makers to consider. World over, the present institutional organisation of postal financial services has the following models :-

**Model I**

- The Post office is still a part of the Ministry or the Department of Posts and Telegraphs and is not a separate legal entity or structure and is headed by the Minister in-charge of the Department. The provision of financial services, if applicable, is handled as part of the same legal framework. The existing structure in India follows this model.

**Model II**

- The Post Office is a separate legal entity but completely State-owned. A dedicated Department within the post office system, handles the financial services with no distinct Balance Sheet or Profit & Loss Account. The absence of an effective cost accounting system makes it difficult to assess the financial performance and sustainability of each line of business. Handling of financial services is done by one (or more) separate legal entities. Typically, between the post office itself and the postal savings bank, there could be formal cooperative agreements , service level agreements on the quality of services, sharing of costs, payment of commissions,
accountability, staff training, to determine the conditions in which these organisations will work together and share branch network and use the postal brand.

Model III

- The Post office or the postal savings bank is partly or fully owned by private investors. This can turn out to be incompatible with the safeguarding of universal access consideration.

Model IV

- The Post Office focusses on its distinct functions leaving the provision of financial services to a specialised operator, generally one or more commercial banks, as in Brazil, Malaysia and U.K. The financial products are sold either under the brand name of the postal organisation or in the brand name of branch of the specialised operator. An agency agreement binds the postal branch network and the financial institutions. Post Office can select its partners on a competitive basis as was done by Brazil, in case of Brazilian Post Office (Correios) which selected Bradesco through a tender process. In other countries, the post office sells under an agency agreement, treasury bonds and other government bonds and instruments floated by the government like NSCs and KVPs in India.

The Indian Postal System is one of the most wide spread systems of its kind in the world with over 1,35,000 rural post offices out of a total 1,55,000 post offices. The network of post office extends even to remote villages where bank branches or cooperative societies may not be operating. At present, the post offices have extended a range of financial services but these are basically in the nature of deposit services which are extended by the post office savings bank. These savings banks do not extend credit related services.

NABARD has already introduced the Pilot Project for SHG - Post Office linkage in Tamilnadu in the year 2003-04. The salient features of the project are as follows:

Area of operation 5 districts of Tamilnadu viz., Sivaganga, Pudukottai, Tiruvannamalai, Thanjavur & Tiruvarur.

Project Period  upto 31 March 2010

Credit Linkage

The SHGs which are in existence for 6 months, will be provided credit by the PO after the appraisal of SHGs using the rating tool suggested by NABARD.

Repayment Period

The post offices will provide only term loans to the SHGs with a repayment period of two years. The loan would be repayable in 24 monthly instalments.

Interest on loans to SHGs

The PO will charge an interest of 9% pa on the loans given to SHGs on reducing balance method.

Loan Processing charges

The Post Offices are not expected to collect any loan processing charges other than the stipulated interest amounts from SHGs.

Interest sharing
The loans to SHGs are to be given at 9% per annum and the post office is allowed to retain an interest margin of 3 percent out of the interest collected i.e. actual interest collected from the SHGs would be shared between NABARD and PO in the ratio of 2:1. Though the SHGs will start repaying their monthly installments of principal and interest immediately after one month from the date of disbursement of the loan, the Post Office would be allowed to retain the amount paid by the SHGs in trust till the interest amount is passed on to NABARD on half yearly intervals every year.

Progress

Though the project was sanctioned in December 2003, it could not take off immediately, as the Postal Act did not permit opening of Savings Bank Account in the name of SHGs. The issue was resolved in November 2006 and the project was launched in December 2006. 9 Training programmes have been organised for 847 staff of identified POs in the districts. 530 SHGs have opened SB accounts and 46 groups have been provided credit from the Revolving Fund Assistance of Rs. 11.04 lakh, released on 22 February 2007.

This project is functioning satisfactorily and shows potential for further expansion as requests for the replication have come in from Madhya Pradesh, Maharashtra, Manipur, Meghalaya etc. However, for utilising the infrastructure of post offices for financial inclusion, it requires more than just linkage with SHGs. The post office will have to work as banking correspondents in the true sense of the term providing a range of services including savings, affordable credit remittances and possibly insurance. This would be possible only by establishing linkage between post offices and mainstream commercial banks. Recently Post Offices have been allowed to act as SHPIs within the project area. Further, the Board on MFDEF has agreed to earmark Rs. 10 cr out of the MFDEF for expansion of the Pilot Project in 10 states @ Rs 1 cr each State to be implemented in a maximum of 5 districts in each of these 10 States.

The Brazilian Model

One successful example of the postal system acting as correspondent bank is that of Banco Bradesco in Brazil. The Brazilian postal system floated the proposal for linkage with a Commercial bank and this proposal was won by Banco Bradesco in 2002. Bradesco has purchased the right to operate these Banco Postal's franchises for a cost of US$75 mn. In more than half of the post offices in Brazil, Banco Bradesco has set up its correspondent units, under the brand name of Banco Postal. The consequence of the partnership between the Brazilian post office and Banco Bradesco promotes banking inclusion, regional economic development and savings accounts in addition to using technological progress to remote poverty-stricken areas of Brazil.

Banco Postal operates in post offices offering services for opening current account and payment of bills, money transfers, withdrawals and loans with no need for going to bigger towns or cities. The operations of Banco Postal are performed via satellite in real time reinforcing its social character. Its services also offer payment of Brazilian social sector benefits and special loans for retired persons and opening current accounts for the illiterate/disabled.

Nearly 88 percent of those benefiting from Banco Postal are from communities which have monthly income below 3 minimum wages. Approximately, 15 million Brazilians in 1705 townships of all the regions of Brazil have access to the banking system with Banco Postal. After introduction of Banco Postal, population with no access to the banking system has been reduced form 18.7 million to only 2.6 million. The Banco Postal has a total of 5524 points of attendance which can be termed as banking outlets.
through the postal network. Bradesco has exclusive access to 5300 of the 10500 post offices around the country. The Banco Postal client base built by Bradesco is the property of the Bank itself. Thus, customers can also access the parent bank and branch infrastructure which is an additional facility. Bradesco is building up Banco Postal as its brand (without using the term 'Banking Correspondent'). It is always accompanied by the Bradesco logo. The range of products and services offered by Banco Postal are; Deposit accounts, Loans, Bill payments, payment of government benefits and other services. At present a vast majority of the banking transactions relate to bill payments. As a part of the government's banking inclusion strategy, Banco Postal is promoting the simple current account in a big way. This current account is exempt from all taxes and fees with limits in the number of monthly transactions and balance below 1000 Reais. A new legislation permitting consumer lending backed by direct salary deposit has encouraged a large number of poorer members and pensioners to open accounts for the first time. The credit products are gaining importance while insurance and investment products are just being introduced. In the five years since its introduction, Bradesco was able to generate an additional 1.5 million accounts.

Apart from Brazil, the recent significant examples of expanding access of financial sector using the postal branch network, are in Kazakhstan, South Africa and Uganda. In Kazakhstan, the Post Office launched deposit taking activity in 1999 and by 2003, 8,00,000 small depositors which is about 25 percent of the adult rural population had opened accounts. However, despite this progress, the Kazpost has followed an agency route generating revenues from offering other financial services. In South Africa, the Postbank, a separate division of the Post Office participated with major banks in launching a new basic debit card account offering in 2004 under the 'Mzansi' brand. To date, the Post Bank has been the biggest issuer of new Mzansi accounts. A recent study has confirmed that a majority of the more than two million new Mzansi account holders were previously unbanked. In case of Uganda, following the Central Bank mandated restructuring in 2002 and Postbank Uganda is now a tier II deposit taking entity with its own branch network. It has pioneered connections to microfinance entities which are widespread in Uganda as credit providers in order to take deposits from their clients, although, the results have been mixed.

The way forward
While country expectations with the postal financial services is different in nature and outcome, the major lessons learnt from successful postal financial programmes include;

In general the offering of financial services and the operation of postal network should be accomplished by separate legal entities with the regulation and supervision of postal banks conducted by the national banking regulator.

- Public postal banks should concentrate on offering / developing financial products which are not being offered by the private sector and avoid offering similar products to similar markets, including retail credit unless under a well-targeted public-private partnership with microfinance entities of banks.

- Improved governance and accountability are keys to reinforce trust in the postal network. This calls for investments in management and information systems along with significant capacity building in human resources.
The possible course of action in India

- The Indian Post Office has a network of 1,55,000 outlets of which 1,35,000 are exclusively branch post offices which cater to the rural areas. This is the network which can be accessed for increasing financial inclusion. Addition of nearly 1,35,000 outlets to the already existing 1,00,000 outlets of PACS could go a long way in increasing the level of financial inclusion in the country.

- In a model similar to that of Brazil, open bids can be invited for establishing the banking correspondent network in each of the 22 postal circles. The highest bidding bank in each State would get the license to set up the "Postal Bank" in that circle and gradually the Postal Banks could take over all the financial services offered at present by the post office system.

- As a large number of branch post offices will be manned by minimum staff members (single staff member in case of village post offices) and may be located in remote villages, extending services, which require technological support may pase problems. This could be solved by locating the technology related services at branch post office in a bigger village or semi urban center which could be the nodal point for centralising the banking transactions of 8 - 10 branch post offices linked to it, using Wi-max or Wi-fi services for last mile connectivity.

- The "Postal Bank" unit at the Village Post Office level could depend on hand held computers or palm tops as 'points of sale' devices from which data could be transferred to the BPO which would be a full fledged Post Bank.

- In due course of time the "Post Bank" network could be linked to the franchising bank and the customers of both the entities could access each other's services.

Technological requirements

To provide basic financial services through a postal branch network effectively and efficiently on a sustainable basis, several pre-requisites are needed. These include;

- Governments need to develop a policy and vision for their financial sector that takes into account the role of all the players and anticipates the impact of market forces. The provision of financial services through postal networks needs to be included in the national financial sector development programmes. While assessing the role of postal financial services, a distinction needs to be made between the post office, its branch network, postal savings bank and the postal current accounts when they are institutionally separated.

- The next critical point would be to have a motivated and empowered incharge of such project at the bank level as also at the postal service level.

- As privatisation could also be a goal for this sector, focus should be on strengthening corporate governance of the organisation involved. The Board of Directors should be constituted from among independent and experienced directors and should ensure the appointment of a professional management team preferably selected on competitive basis. Internal controls, audits, internals procedures and MIS should be strengthened. In the financial sector, trust and confidence are part of sound corporate governance in banks with a good track record. As running a postal organisation and banking are different businesses with different risks and challenges requiring different know-how and different operating and management skills, both organisations should be transformed into separate legal entities with separate Boards of Directors, supervision, balance sheets and profit and loss accounts. Both
entities should have full autonomy under the supervision of their Boards, regarding their commercial policies and recent strategies, investments and asset liability management, as also clear performance indicators like return on equity, return on investments, minimum market share etc.

Conclusion

Micro Insurance, Money Remittances and Micro Savings are three essential services which are part of financial products which will help bringing in the marginalized population into the mainstream. Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy.

The various research studies have pointed out the unsuitability of existing banking and insurance products to the poor. It is therefore imperative for banks to design/modify the existing products based on market survey or action research project. For instance, poor with meager capital need not just financial capital or services but also a home, good health, education for their children, etc. Therefore, banks have to create specialist cells to study the total requirements of these groups and come out with tailor-made products and services for them. They must also understand that these groups are heterogeneous in nature and, hence, the banking products/services developed for them have to be highly diversified and target specific. The continuous flow of innovations in designing new products and services would produce the desired results on a sustainable basis.

Financial inclusion is also interpreted to mean the ability of every individual to access basic financial services which include savings, loans and insurance in a manner that is reasonably convenient and flexible in terms of access and design and reliable in the sense that the savings are safe and that insurance claims will be paid with certainty. The provision of these services requires adherence to certain core design principles irrespective of whether the provider is a cooperative bank, regional rural bank, scheduled commercial bank, non-banking finance company (NBFC) or a not-for-profit civil society organisation. The Institutions have to prepare themselves to address the issues and find out the enabling factors so that corrective actions are taken for more inclusion.

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