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# Challenges to Financial Inclusion in India: The Case of Andhra Pradesh

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**Abstract**

*Although attempts to expand the scope of formal financial services to the "unbanked" has a long history in independent India – going back to the first bank nationalisations of 1969, if not earlier –, the relatively much newer concept of "financial inclusion" has become central to the Indian policy making over the past few years. When it became clear in the early 2000s that fruits of the reform measures since the economic liberalisation of the early 1990s were not flowing to the disadvantaged, the Reserve Bank and the Government of India began to emphasise access to the formal banking system for the excluded sections of the society as an important instrument of inclusive growth in 2005. Since this change in policy required the expansion of the formal banking sector, especially in the rural and semi-urban areas through branch and branchless banking, formal banking outreach has grown significantly after 2005. Despite this growth, however, the banking sector has not been able to meet the latent demand for various financial services (especially for savings) from the poorer sections of society. We focus on the institutional challenges to financial inclusion in Andhra Pradesh (AP) as they are symptomatic of the problems that the expansion of financial inclusion faces in India. We argue that it is the inability of the formal financial institutions to meet the need for these services that has enabled informal service providers to fill the vacuum in AP. We conclude that without a paradigm shift, especially on the part of the banks, financial inclusion will fall short of expectations despite political support. We propose that the banking sector should look at the efforts to expand inclusion not as a capital cost nor as a charitable expense, but as a long-term investment in the future. The soundness of such an investment is borne out in the success of the individual business correspondents in some districts of AP, as we document in the paper.*

***Key Words: Financial Inclusion, Banking, Elimination of Poverty, Rural areas,.***

## 1. Introduction

Financial inclusion has become central to the Indian policy making over the past few years and various attempts to expand the scope of financial inclusion have been made. Despite these attempts, however, challenges to financial inclusion remain formidable. These attempts and challenges have to be examined in the context not only of an increasingly globalised economy, of expanding markets and of growing state intervention, but also of local variations. Equally daunting is the sheer magnitude of the task that requires regulating the activities of service providers to millions of illiterate poor spread across culturally disparate groups. Taking this approach, this paper attempts to elucidate some of these challenges, based on the experiences in Andhra Pradesh (AP), as a study of the problems faced by financial inclusion in AP illustrates the larger problems that the expansion of financial inclusion encounters in India.

[1] The views expressed in this paper are those of the authors and do not necessarily reflect views at the Centre for Advanced Financial Research and Learning.

After analysing some of the attempts to expand financial inclusion within and beyond the formal banking sector, which yielded mixed results and a number of spectacular failures, we propose that an optimal strategy to expand financial inclusion would be through the expansion of the formal banking sector, especially the public sector banks. Although both the public and private sector banks are subject to the same prudential norms, that give incentives to prevent adverse selection, we emphasise the public sector banks because:

a) Public sector banks have much larger branch presence in the "unbanked" areas, especially if their regional rural bank branches are also included;

b) Despite its potential problems, political presssure, especially at the district level, is much higher on the public sector banks than on the private sector banks;

c) Public sector banks play a much larger role in government sponsored schemes, especially those that are subsidy linked.

We then argue that the success of this strategy would rest on the success and ability of the public sector banks to quickly expand their reach into "unbanked" areas by putting in place strategies and policies that facilitate these expansion attempts. We argue further that the success of this expansion would depend also on the ability of the formal banking sector to introduce a suite of financial products and solutions while concurrently expanding their network to meet the needs of the poor.

We organize the rest of the paper as follows: In Section 2, we give a brief account of the evolution of the banking sector since the Indian independence in 1947. In Section 3, we turn our attention to Andhra Pradesh and describe some of the financial inclusion attempts since the early 1990s. In Section 4, we analyse some of the challenges in AP and, in Section 5, propose some alternatives to expanding financial inclusion. Finally, in Section 6, we present our concluding remarks.

## 2. Growth of the Banking Sector after Independence

The attempts to expand the scope of formal financial services to the "unbanked" has a long history in independent India. In the years immediately after independence, the formal banking sector was underdeveloped: the bank branches to population ratio was one branch per 136,000 persons in 1950[2] compared to 13,000 in 2011[3], while the population of the country increased slightly more than three-fold during the same period.

The process of expanding the scope of formal financial services was inaugurated with the Reserve Bank of India (RBI)'s *All India Rural Survey Committee* in 1951-1954. Their report pointed out that the commercial banks provided only 0.9 percent of the total credit to the farmers (estimated at Rs.750 crores) in 1951-52. By contrast, agriculturalist[4] moneylenders provided 24.9 percent, while professional moneylenders provided 44.8 percent of the total credits to the farmers in the same year[5].

The banking statistics presented in Table 1 reflect the unbalanced nature of bank lending to the other sectors, despite the fact that agriculture constituted 55 per cent of the Indian Gross Domestic Product (GDP) in 1950.

When compared with 5012 bank branches that existed in 1961[6], the present size of the Indian banking sector is impressive. Assiduous attempts have been made, since the first bank nationalisations in 1969, to expand the formal banking sector and, as depicted in Figure 1, the number of Indian (scheduled) bank branches grew rapidly from 8262 in 1969 to 60,220 in 1991. But the growth slowed after the start of economic liberalisation in 1991 until the mid 2000s, and the number of bank branches stood at 68,355 in 2005. The renewed and welcome emphasis on financial inclusion among policy makers since the mid 2000s, among other reasons, led to the accentuated spread of the formal banking sector in 2005, and the number of bank branches reached 99,884 as of March 2012.

The need to increase efficiency and reduce leakages in the delivery of government welfare programs has become instrumental in the increased financial inclusion efforts and the expansion of the formal banking sector in recent years. Consequently, the banking system has become central in expanding financial inclusion, as the recent developments in Andhra Pradesh demonstrate. In the summer of 2012, the AP government has decided to transfer such government subsidies as drought relief, student fee reimbursements, and others directly to the bank accounts of the beneficiaries. This is in addition to pensions and National Rural Employment Guarantee benefits – introduced by the Government of India in 2005 – that are currently distributed through smart cards linked bank accounts. This required the opening of bank accounts by the beneficiaries in order to access government benefits. We discuss the recent history of the financial inclusion efforts and the expansion of the banking system in AP in detail in subsequent sections.

### 3. Financial Inclusion: The Andhra Pradesh Experience

Andhra Pradesh has witnessed various attempts at financial inclusion – including the creation of a commoditised microfinance market, presumably to address the financial needs of those at the bottom of the pyramid, that is, the poor – over the past two decades. These attempts may be broadly divided into two categories: a) government attempts at financial inclusion, and b) private attempts at financial inclusion, particularly to include the bottom of the pyramid through the spread of microfinance institutions (MFIs).

The Andhra Pradesh experiment in a fairly unregulated microfinance – led by the private sector and supported by the RBI imposed priority sector lending requirements for banks – clearly demonstrates the limitations of a model dependent on private equity and other equity investors in expanding financial inclusion. It is evident from the AP experience with microfinance described below that the potential of this model for creating moral hazard and larger systemic problems were underestimated, at least, until the AP crisis. In the following subsections, we provide a brief account of some of the government attempts at financial inclusion in AP, first, and, then, elaborate some of the private attempts and the resulting MFI crises in the subsequent subsection.

### 3. a. Government Attempts

The government attempts to expand the reach of the formal banking sector to the under-privileged and "unbanked" sections of the society started with various governmental initiatives to help build the extensive Self Help Group (SHG) movement[7] in AP. Their growth received a fillip with the early initiatives under South Asia Poverty Alleviation Programme (SAPAP) funded by United Nations Development Programme and started in 1994. Initially, it was implemented in three districts, namely, Mahabubnagar, Anantapur and Kurnool from 1995 to 2000. This was subsequently expanded to comprise the Andhra Pradesh District Poverty Initiatives Project (APDPIP) and was launched with a wider and expanded scope in June 2000. By the end of 2006, nearly 9.6 million households are reported to have been covered after the state government's efforts. Andhra Pradesh now has over the years established an elaborate network of more than 1.05 million[8] SHGs that attempt to operate autonomously of the formal state structures. The programme enables the state government to document the socio-economic conditions of the poor as long as they reside with the confines of the village community covered through the SHG network, Indira KranthiPatham (IKP) under the administrative supervision of Society for Elimination of Rural Poverty (SERP).

The importance of the SHG movement in AP comes from the government's increasing use of the SHGs as conduits for various developmental initiatives and poverty alleviation programmes. Among the more successful of these programmes has been the effort to link the SHGs to a bank through the SHG-Bank Linkage programme. The SHG-Bank Linkage programme had disbursed more than Rs. 7,800 crores in 2011-12 against approximately Rs. 1,000 crores in 2000-01[9]. When the SHGs were classified as a priority sector and included in the Priority Sector Lending programme of the RBI through which banks are required to make a certain percentage of their disbursals to the priority sectors, making loans to the SHGs through the SHG-Bank Linkage programme proved to be "profitable" to the banks in more than one way. An unintended offshoot of nurturing this extensive network of SHGs was the increased realisation that the poor comprise a profitable, albeit an unmapped and nascent, market, especially when they are organised effectively. This period coincided with a period of unprecedented growth, which served to increase the credit needs of the poor.

### 3.b. When Markets Failed: The MFI crisis in Andhra Pradesh

Microfinance as a business proposition in AP dates back to 2005, although it has existed in the non-profit format since the 1980s. The MFIs in AP started as non-profit organisations and were registered under the Societies Registration Act of 1860 back in the 1980s. In 2005, most of them converted themselves to non-bank finance companies (NBFCs) to gain legitimacy through registration with the RBI, and be able to access to capital as donors and institutional lenders were less willing to provide significant amounts of money to a non-profit organisation. Started in 1989, Share Microfinance is one of the earliest such organisations. In 1996, BASIX was established, and was followed by SKS Microfinance and Spandana in 1997.

In spite of being extolled as a tool for poverty eradication, microfinance loans were high cost loans that could be accessed by anybody able to form a group either in the form of an SHG or a Joint Liability Group (JLG). Microfinance companies facilitated this easy access through a system that had few prudential norms for borrowers and lenders, with little oversight of the end use of funds. Their business logic, which is a typical of example of moral hazard arising in similar settings, for example, in the U.S. prior to the onset of the subprime crisis, was based on making multiple loans to already highly indebted borrowers and was geared to the recycling of debt rather than aiming to facilitate growth of incomes. Multiple loans in excess of ability to service the debt forced the poor into a vortex of debt from which it was difficult to exit. Inability to repay was often accompanied by coercive recovery practices by MFI employees and some of the JLGs.

By 2010, the MFI business in AP thrived on a combination of ever-increasing quantum of credit aided by incentives of commission based on volumes, and increasing ability of the SHGs and JLGs to borrow from several MFIs. In the mean time, increased profitability of the MFIs fuelled growing investor interest, especially from global private equity players, which culminated in the listing of SKS Microfinance Limited on the stock exchanges in 2010. The success of the initial public offering (IPO) of SKS Microfinance – over-subscribed by institutional investors 13 timesreinforced the investors' thinking that lending to the poor was a high return investment with charitable ends.

However, the increased lending by MFIs often did not lead to any growth in the incomes of the borrowers, since only a small component of this debt was channelled into income generating activities. The survey results from Ananth (2011), highlight the end use of loans from MFIs, most of which went to meet consumption needs. The purpose of these loans were essentially to pay for a) old loans; b) medical care; c) daily needs; d) house repairs, and e) education. When it became clear that the MFIs became another source of high cost credit to the poor and the inability to service these debts led to coercive recovery practices culminating in deaths of some borrowers, the AP government intervened in late 2010.

The AP crisis and the subsequent government intervention forcefully drew attention to the structural problems in the MFI business. Three structural problems stood out in the AP crisis: a) a remarkable absence of any form of arbitration that may have served as a "safety valve"; b) an incentive to default in the case of Joint Liability Groups as the loan size increased, and c) the inelastic nature of interest rates on loans to the poor. While in the early years, the JLGs facilitated social reference thereby increasing the creditworthiness of the borrowers in AP and in other places, as theoretically modelled and empirically demonstrated by Gine et al. (2011), over a period they encouraged strategic defaults. As is well-known, a frequent claim of the microlenders is that the interest rates charged were high due to high transaction costs. However, the recent history of the MFI business in AP shows that the interest rates paid by the poor were largely unchanged after the increased economies of scale. That is, the borrowers did not benefit from the increased return on - investment that accrued to the companies from the increased economies of scale. Rather the increased return on -investment was used to grow the volumes even more. Put differently, the increased return on capital did not get passed onto the borrowers through reduction in interest rates, a typical moral hazard well studied in the economics literature.

To sum up, the above described MFI based market solution to financial inclusion in AP, combined with the associated regulatory oversight, led to moral hazard issues that are not essentially different from those that we have observed around the globe since the trigger of the global financial crisis in the U.S. in 2007, and its spread to Europe and the rest of the world in 2008. It, therefore, comes as no surprise that the subsequent increase in systemic risks led to usual market failures in AP, similar to those that we have observed around the globe.

The challenges to financial inclusion in AP include a combination of structural economic peculiarities (the nature of the informal economy, internal migration and financial illiteracy among others) and last mile issues including banking bottlenecks (the limited network of the banks, lack of relevant products, lack of will amongst the banks, etc). We draw on field evidence from AP to illustrate these challenges faced by the regulators in expanding financial inclusion in the next section.

## 4. The Role of Migration and the Informal Sector

The experience of AP draws attention to the broader complexities in expanding financial inclusion, especially related to the nature of the informal sector and to an increasingly mobile population. One of these complexities is the internal migration of the poor from rural areas to urban areas, which creates a precarious line between informal, quasi-formal and formal structures. An example best illustrates this salient feature of the AP economy:

Recall that the SHG members are linked to various banks through the SHG-Bank Linkage programme, thereby forming part of a “quasi-formal” sector in AP. However, the nature of the local economy is such that a section of the rural poor are often forced to migrate to find work, often to major cities like Mumbai, Hyderabad, Vijayawada and Visakhapatnam. The proportion of rural poor migrating to the towns in search of employment varies from 25 percent to over 65 percent, for example, in some Mandals of Mahabubnagar district. Once the poor move to a city, they are forced into a large informal economy, and become unable to access any of the formal structures such as government welfare and the SHG network mainly because of identification problems arising from lack of legal documents such as identity cards and the manner in which government welfare programmes are structured. This movement between the quasi-formal and informal sectors through back and forth migration between villages limits the effectiveness of a programme to expand financial inclusion unless a link between rural and urban areas is established.

In addition, participation of the poor in the informal sector gives rise to pervading and powerful stereotypes such as that the poor do not have any assets and savings, and, therefore, although they need credit, there is no need for other financial services for the poor. These stereotypes are aggravated by the historic inability of the formal banking sector to meet the latent demand for financial services among the poor. In AP, this inability of the formal banking sector created a vacuum that was adroitly filled by quasi-legal or informal business entities. Our field studies indicate that the demand for savings products and remittances services is very large. Indeed, we have observed that while the spread of banking technologies like ATMs has enabled the banks to rapidly replace agents in the remittance services segment in parts of AP, the banking system has not been able to meet the demand for savings products that meet the requirements of the poor.

One of the major challenges facing a regulator in AP in the realm of financial inclusion is the complexity in regulating consumer finance, especially in regulating savings: The rural poor can neither find nor understand financial information as financial literacy is non-existent across most of the state. In a number of districts, it is common for the poor (those below the poverty line) to save small amounts – varying from Rs. 10 to Rs. 50 – on a daily basis. The absense of saving products offered by formal financial institutions, coupled with financial illetracy, allows the plantation and real estate companies to fill the vacuum and collect deposits from the poor, in complete contravention of the RBI guidelines. The plantation companies offer a return of about 8 percent on savings that are modelled on a recurring deposit product of the banks (for example, Figure 5.a). These companies mask this deposit collection under such pretense as receiving advances against the sale of land, which rarely exists.

Pyramid and Ponzi schemes, widely prevalent in the poorer regions (especially in the “underbanked” districts) are routinely marketed as savings schemes. Apart from plantation and real estate companies that solicit deposits from the poor, it is common for fly-by-night companies to seek weekly deposits/investments from the poor with the promise that they will offer high value household utensils after some weeks. These entities, often unregistered bodies that claim to be companies, solicit investments usually with a maturity period of 17-18 weeks, but usually vanish after 13 weeks of collecting deposits.

The modus operandi of the above described deposit collection entails house-to-house visits of company agents as a first step. The agent is a member of the community invariably, and the fact that the agent is known and trusted allows these schemes to spread and succeed. This deposit mobilisation requires further attention because of that these practices are widely accepted without the understanding of their questionable legal status and downside risk. These deposits are mobilised in all districts of the state and anectodal evidence indicates that in certain areas the participation can be as high as 60 percent of the village and the amount of deposits mobilised could be as high as Rs. 3,000 crores.

An even more sophisticated "savings" scheme is where the company's agents, usually the relatives of the village elite (like headmen or dominant landlords), claim that they are better than banks since the banks do not offer doorstep services.

Clearly the banks are missing out on a large market. The poor, on the other hand, find these schemes attractive and do not understand that they are in contravention of the law. Convenient doorstep service with flexible timings and the possibility of saving small amounts are the primary reasons for the success of these schemes. On the other hand, the banks often come through as being unresponsive to the needs of the poor and, in the process, forego an opportunity to raise low cost deposits.

The above are examples of some of the challenges in regulating consumer finance at the bottom of the pyramid in a vast country like India where even basic financial literacy in the rural areas is nonexistent. Another challenge to financial inclusion is associated with the following problem faced by the poor, not only in AP, but in almost every part of India: The poor invest substantial resources to build houses, often without titles or on land allotted by the government or on encroached land. The poor constantly invest a substantial part of their income in housing and related assets. A substantial portion of the investment in such housing assets is by assuming debt. Similarly, pledging these assets to raise cash for their consumption needs is common.

The problem with investments in assets like housing (or house repairs in popular parlance) is two-fold: a) housing is always a leveraged investment, and b) the property titles are not acceptable to the banks. Banks refuse to accept these as mortgageable assets and therefore refuse to fund these investments, despite the existence of a liquid, dynamic market (both mortgage and sale) for such assets amongst the poor themselves. It is this non-acceptance of these housing assets as collateral by the banks, among other reasons, that forces the poor to approach other categories of high cost lenders, that is, the MFIs or informal lenders. Borrowing from high costs providers like the MFIs to meet the housing needs was common in AP. Ironically, the banks lent money to the MFIs to fill the vacuum that was created by their refusal to lend money to the poor.

## 5. "Last Mile" issues

We have argued in previous sections that the ability to expand financial inclusion largely relies on the ability of formal banking institutions to meet the needs of the poor. As we have documented, however, the formal banking institutions have been unable to meet this challenge to date, at least, in AP. Instead, the informal providers have filled the vacuum created by the formal banking institutions in AP. Our field experience in AP points to that the formal banking sector has a remarkable lack of specialised knowledge of the needs of the rural poor and to that the success of the informal providers to fill that vacuum has been mainly because of their familiarity with the local communities.

One possible explanation to this lack of knowledge of the formal banking institutions may be that the formal banking sector relies on business models that are built on an ever-increasing economies of scale which require standardised credit scoring models. This obsession with economies of scale, which necessitates the additional obsession with standardised credit scoring models, among other things, creates a tension with the utmost need of the formal banking institutions for an intimate knowledge of their potential clients to assess their creditworthiness.

It is our belief that it is possible to address the information asymmetry problems associated with the last mile delivery of financial services through innovative strategies. The Business Correspondent (BC) strategy of the banks (introduced in 2005), when combined with the SHG model we have discussed earlier, has the potential to build a framework for an alternative last mile credit delivery mechanism, especially in rural India. Furthermore, the expansion of the banking system through the BCs is an attempt that deserves greater attention because the size of the market at the "bottom of the pyramid" is very large: one NABARD estimate places the amount of revenues that the BCs and Business Facilitators (BFs) are likely to generate at Rs. 66,000 crores and of deposits they are likely to collect at Rs. 30,000 crores annually.

The attempt to expand the presence of the BCs is currently based on two different technological platforms in AP. They include a) banks deploying biometric smart cards using Point of Sale (PoS) machines, and b) the kiosk banking model through an online system. Figure 7 is a snapshot of these technology platforms. It is our belief that the kiosk banking strategy operated through the BCs has a potential to create a viable alternative channel for delivery of banking services in rural areas. Although our field experience indicates that individual BCs have rapidly expanded the reach of the banking sector in a number of regions in AP, it appears that further expansion of the BCs in AP is hindered mainly by the inability of the banking system to introduce suitable financial products to meet the needs of the poor.

However, it would be a mistake to think that the banks have completely failed in their ability to expand the scope of the banking sector in rural AP. The unintended consequences of recent advances in banking technologies have clearly discernible benefits in rural AP, especially in the realm of remittances. The below brief overview of the changes facilitated by the advances in banking technologies would be important to understand their potential for transformation in rural areas of AP:

In a large number of districts such as Warangal, Karimnagar, Mahabubnagar and Kurnool, it is common for migrants to combine informal social networks with banking to remit their earnings in a way that has supplanted the former informal money transfer systems. In a short time, the formal sector has quickly displaced the informal sector players, thanks to technology. The migrants, often working as daily wage earners or as low ranked employees in urban service sectors, presently deposit money at the State Bank of India (SBI) through the SBI's "online services" in the accounts of their friends and relatives to send money home, as is common among migrants from AP to Mumbai. The "recipients" withdraw the money from ATMs in their nearest towns. This ingenious method has completely replaced the previous informal system of money transfer through human agents and has reduced the costs drastically (down to the SBI "online" service charges) while concurrently reducing the time needed to transfer the money to a few hours. The human agents of the past charged commissions as much as 5 percent and they took at least 4-5 days to deliver the money to its destination. As our interaction with local bankers indicate, there is further potential to optimise the efficiency of these transfers through BCs. We have learned from the local bankers that the "non-home" branch transactions has been in the rise for quite some time. In some rural branches these transactions comprise nearly 30 percent of daily transactions. Although some local bankers complain that this rise has destroyed their once vibrant demand draft business, it is consistent with our observation that the use of the formal banking channels for remittances has been growing.

Any discussion of the challenges faced by financial inclusion would be incomplete without a discussion of why banks may be uninterested in this project. Recall that shortly after the economic liberalisation that started in 1991, shares of most Indian banks, public or private, had been floated at the Indian exchanges, albeit at different percentages. Given this, three reasons for the lack of enthusiasm of the banks in their financial inclusion attempts come to mind. First, because of the well-known short term focus of the stock markets, short-term profitability concerns of the banks might have discouraged businesses that create a "viability gap", arising from that the cost of providing these services is larger than the benefits from these services, at least, in the short run because of associated initial high fixed costs. Hence, banks might have tended to frown on financial inclusion or, at best, begrudgingly considered these as "social" or "holding" costs. Second, the nature of present day financial inclusion means that this component of the bank balance sheets is often miniscule when compared to the total portfolio of the banks. In a capital deficient country such as India, where the banks invariably have an endless list of borrowers, credit to large numbers of poor, spread over vast tracts of land, seems less efficient/more costly than providing credit to a few large borrowers in concentrated areas. Third, banks find recovery of defaulted loans in rural areas a problem unless the institutional structures become more efficient.

To sum up, banks, like most formal for-profit institutions, are not willing to spend inordinate amounts of time and resources to create a market because of the associated high establishment costs, especially if they are to satisfy the needs of their non-stake holding shareholders. Historically, the large formal financial institutions have found it more convenient to move into markets that have already been built and nurtured by smaller companies or by informal players[16]. While the opportunities at the bottom of the pyramid are exceptionally fecund, so are the accompanying complexities. This nascent, emerging market provides an opportunity to the banks to decisively expand the scope of the formal bank system into new markets. Rather than seeing financial inclusion as a forced capital expenditure on an unprofitable business thrust on them by the government, banks should view financial inclusion as a long term investment that can help create a new market. This is a long-drawn process that requires substantial investments in capital and human resources. Unless banks are willing to take the long view, they will not be able to take part in creating these new markets, which are presently serviced by informal and quasi-formal providers.

## 6. Conclusion

Any attempt to expand financial inclusion is essentially a small step in a longer journey. Thus, financial inclusion is by nature incremental. This means among other things that expanding financial inclusion requires a paradigm shift that goes beyond opening bank accounts and facilitating direct cash transfers through government subsidies to the financially excluded. We argue that the banking sector, especially the public sector banks, should lead the efforts to expand inclusion as private sector initiatives to expand financial inclusion are unlikely to be effective because of their dependence on maximising shareholder profits rather than optimising stakeholder value. We note that, in addition to the public banks, the cooperative banks may be brought into the efforts to expand financial inclusion, as it is the case that the shareholders of the cooperative banks are also their stakeholders. This would, of course, require a substantial overhaul of the corporate governance of cooperative banks in India, especially to avoid political capture of the cooperative banks by crony capitalists and corrupt politicians.

As we mentioned in the introduction, and reiterate here, although both the public and private sector banks are subject to the same prudential norms, the reason for our emphasis on public sector banks is three-fold:

a) Public sector banks have much larger branch presence in the “unbanked” areas, especially if their regional rural bank branches are also included;

b) Despite its potential problems, political presssure – especially at the district level – is much higher on the public sector banks than on the private sector banks, and

c) Public sector banks play a much larger role in government sponsored poverty aleviation schemes, especailly those that are subsidy linked.

As we have discussed, the challenges to expand financial inclusion are structural in India. Thus far, these structural challanges have often negated various incremental measures to expand financial inclusion. Motivated by the challenges we have discussed at length in previous sections, we then conclude with that the ultimate success of financial inclusion would depend on

a) measures that expand the scope of the formal banking sector;

b) overcomingall pervading information asymmetries;

c) expanding financial literacy through state programmes (as neither the public banks nor the private sector can bear the costs, given their current objectives);

d) mandating appropriate agencies to lead the efforts that expand financial inclusion, and

e) creating a relevant suite of financial products that would meet the needs of the financially excluded.

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