MicroSave India Focus Note 104
Can UIDAI Be A Saviour Of Financial Inclusion?
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Background

Financial inclusion efforts in the last six years have yielded disappointingly little. The vast majority of the accounts opened have never been used.[1] Business correspondent (BC) agents are unable to earn a livelihood and a large percentage have closed or gone dormant.[2] Even large corporate BC network managers (BCNMs) are reporting massive losses and/or have decided to shut-down their FI business units.[3] Why is this occurring in spite of the massive efforts by the government, the regulator, banks and BCNMs? And will this ever change for the better? This Note examines the vital role Unique Identification Authority of India (UIDAI) and direct benefit transfers are starting to play.

The BC model, despite its promise as a vital tool for financial inclusion and for G2P payments, has several implementation drawbacks. Current installations are unable to offer a vast majority of the products, services and facilities available to mainstream consumers (for example recurring deposits or access to ATMs), even where (a few) banks are willing to provide them. Fewer banks have attempted to tailor their products for the poor and/or the BC channel. The costs remain high due to lack of scale and use of diverse proprietary technologies, despite the clear universal standards in the banking sector. This is compounded by the widespread use of offline solutions; and replication of capture and storage of biometric information in multiple (often local) systems, causing duplication of efforts and driving costs up. The bottom-line is that the proposition for the unbanked poor is far from compelling.

UIDAI and *Aadhaar* – The Potential

The good news is these deficiencies are now well understood. Amongst other progressive steps undertaken,[4] the *Aadhaar* platform from the UIDAI[5] is increasingly recognised as a way of overcoming many of the barriers.

UIDAI has been working towards creating an enabling environment. UIDAI believes there are three fundamental pillars of its approach that would enable the *Aadhaar* platform to address the challenges outlined above. These are[6]:

(a) An online system built on the assumption that reasonable quality wireless data connectivity would be available to most rural areas in India over the next few years. MNOs and their tower companies have already provided about 80% to 85% of the infrastructure needed for universal coverage in India.[7] With various initiatives undertaken by the Department of Telecommunication (DoT) using the funds under the universal service obligation (USO), comprehensive mobile coverage should be possible within the next few years.

(b) Cloud-based storage and computing will rapidly become universal and cheaper, and hence storing and accessing biometric or account information from, or processing transactions in, cloud-based environments using online access will increasingly become a reality. This will allow solutions that can provide consumers' the choice of being able to access services anywhere (ATMs, bank branches or through agents, instead of being dependent on a single agent in their village).

(c) Following Moore's law, the cost of front-end device such as micro-ATMs, handheld devices, mobile phones and computers would continue to come down, while their computing power and performance would continue to improve.

UIDAI and *Aadhaar* – The Advantages

UIDAI has rolled out (and is developing) applications that would enable easier, faster and cheaper enrolment of beneficiaries by banks or other institutions involved with the delivery of government benefits transfer. One such application is electronic KYC (e-KYC), which re-uses the KYC information previously captured during enrolment for *Aadhaar*, and makes it available electronically to banks or enrolling institutions. This can significantly speed-up KYC, increasing efficiency, reducing errors and lowering costs.[8]

UIDAI's online *Aadhaar* authentication system can be accessed by banks and other service providers to verify an individual's details anytime from anywhere. This can be a replacement for smart cards, leading to substantive cost saving for the banking system, in addition to the enhanced security the system offers.

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[1]See Reserve Bank of India's Annual Report 2011-12; *MicroSave* report: "No Thrills Dormancy in NFA Accounts", May 2011; and Skoch Report:

[2]See *MicroSave* Policy Brief 2: "The State of Business Correspondence - Agent Networks in India" ; and Policy Brief 6: "Assessing Agent Profitability: MicroSave's Agent Journal Studies"

[3]See *MicroSave* report: "State of Business Correspondent Industry in India – The Supply Side Story"

[4]RBI directive for conversion of NFAs to basic savings bank accounts and some aspects of the cluster approach

[5]See *MicroSave* India Focus Note 69: "UID and Financial Inclusion – Solution or Not?"; and India Focus Note 70: "Leveraging Unique Identification (UID) for Mobile Banking in India"

[6]UIDAI Chairman Nandan Nilekani's speech at the workshop on 'Direct Entitlements Transfer', at the MoRD/UNDP workshop in Delhi, 29th November 2012

[7]In fact 60% of the telecom towers are in rural areas, the gaps remain in terms of back-haul infrastructure.

[8]UIDAI to allow e-KYC pre-paid cards soon, The Business Standard Newspaper, October 2012

There are indirect advantages for financial service providers from *Aadhaar* enabled services. With *Aadhaar* as the common reference for various products and services, a comprehensive and informed view of customers' portfolio is possible. Adoption of *Aadhaar* by financial institutions can provide significant impetus to creation and use of integrated credit bureaus.

Aadhaar can play a vital role in the creation of a unified payment infrastructure to drive targeted and direct distribution of subsidies, reduce use of cash and lower the fiscal deficit.

The national committee on direct transfer of benefits, under the chairmanship of Prime Minister, announced an ambitious programme for transfer of entitlements to beneficiaries under various programmes using *Aadhaar* authentication. The programme is now live to disburse scholarships and a few other G2P schemes in 43 districts. There are plans to include many other schemes and to take the programme nationwide.

Several pilots across the country are showing early success, demonstrating how *Aadhaar* can be leveraged effectively for financial inclusion, and even for complex services such as public distribution of subsidised food grains.[9]

> *MicroSave's* [case studies on *Aadhaar*](.)-enabled pension payments in *Aurangabad* and public distribution system in *East Godavari* identified the key success factors. These are:
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> *Ownership by the district administration:* In each case the District Collector took charge, owned the programme and drove it with commitment, passion and personal involvement.
>
> *Process innovations, re-engineering and optimisation:* The district administration planned meticulously and brought several innovations into difficult and complex processes, such as digitising databases, seeding of *Aadhaar* numbers and account opening.
>
> *Smart use of simple technology:* Technology capabilities in the state/district administration were used by developing low cost, yet smart, interventions. For example, an NIC developed web based application was used to verify the beneficiary details and prevent duplication in *Aurangabad*. Management systems employed in *East Godavari* helped improve transparency in the flow of the public distribution system, and the elimination of duplicate and ghost cards.
>
> *Effectively leveraging partnerships:* The skills and capabilities of BCNM staff were effectively put to use in *Aurangabad*. The efforts of an in-house technology team in *East Godavari* were channelled to address the technological problems related to the POS machines.
>
> *Training and knowledge management:* Both the districts focused efforts on effective training and capturing knowledge for wider dissemination.

UIDAI and *Aadhaar* – The Challenges

There are however many operational challenges that need to be addressed before the vision of financial inclusion using UIDAI platforms can become a reality. There are encouraging lessons from the various pilot projects of UIDAI currently underway across parts of the country. However:

- State and district governments are slow to map *Aadhaar* numbers of beneficiaries to the programme databases (e.g. Mahatma Gandhi National Rural Employment Guarantee Scheme [MGNREGS] muster rolls). The current processes are complex, error prone and need considerable manual interventions – all of which can be improved upon, optimised and partially automated relatively easily and inexpensively.

- The government staff entrusted with the task of automation lack familiarity with technology and new processes to be adopted. They are inadequately trained and need support and monitoring.

- Beneficiary details under several programmes continue to be decentralised in paper format and are yet to be digitised.

- Banks and BCs do not receive adequate compensation from the Government departments for opening beneficiary accounts or for processing payments.

- Customers are not aware of how they can use their *Aadhaar* number to open a bank account and access financial services.

- Despite considerable overlap between them, most programmes are operated independently of one another (such as requirement of different accounts for direct benefit transfer programmes and for the financial inclusion programme; or the need to use MGNREGS accounts as conduits for withdrawals rather than as place where recipients can also store their savings).[10] This causes duplication of efforts, confusion amongst banks, service providers and consumers, raises costs and makes administration difficult.

- Cash distribution by agents frequently fails for want of *Aadhaar* authentication due to poor connectivity, coupled with the need to distribute the entire amount credited to beneficiary accounts within a short period. Agents often opt for alternate approaches such as manual authentication or offline payment to overcome such operational challenges, defeating the very purpose of *Aadhaar* linkage.

- There is a pressing need for the concurrent evaluation of the various *Aadhaar* based pilots and rollouts in the country to ensure that the issues and challenges are identified on a timely basis, and solutions found. This is essential for the success of the programme.

Conclusion

In summary, UIDAI can, and will, play a very vital role in making financial inclusion real and impactful. Nevertheless, considerable front-end work must be done, and many barriers removed, before unbanked poor can realise the impact.

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[9]See *MicroSave* case studies on [distribution of pensions in *Aurangabad* district](.) and [PDS distribution in East *Godavari* district](.).
[10]This is beginning to change with the recent [circular](.) on the subject