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A STUDY AND ANALYSIS OF FINANCIAL INCLUSION IN INDIA

DIGANTA KR. MUDOI
ASST. PROFESSOR
DEPARTMENT OF ECONOMICS
D.K.D COLLEGE
DERGAON

ABSTRACT

Financial inclusion is an important process to attain the goal of inclusive growth. Accordingly, the Reserve Bank of India has made sustained efforts to increase the penetration of formal financial services in unbanked areas, while continuing with its policy of ensuring adequate but viable flow of credit to priority sectors of the economy. Financial inclusion is delivery of banking services at an affordable cost to the vast sections of underprivileged and low income groups. By financial inclusion we mean the provision of affordable financial services, namely access to payments and remittance facilities, savings, loans, and insurance services by the formal financial system to those who tend to be excluded. Significance of financial inclusion arises from the problem of financial exclusion of nearly 3 billion people from the financial services across the world, with only 34 percent population engaged in formal banking. India has, 135 million financially excluded households, the second highest after China. The present paper is a humble attempt to find out the causes of financial exclusion in India, analyze the extent and magnitude of financial inclusion in the context of India and suggest measures to solve the problem of financial exclusion in India.

KEYWORDS

Financial inclusion, Inclusive growth.

INTRODUCTION

Financial inclusion is an important process to attain the goal of inclusive growth. Accordingly, the Reserve Bank of India has made sustained efforts to increase the penetration of formal financial services in unbanked areas, while continuing with its policy of ensuring adequate but viable flow of credit to priority sectors of the economy. Financial inclusion is delivery of banking services at an affordable cost to the vast sections of underprivileged and low income groups. By financial inclusion we mean the provision of affordable financial services, namely access to payments and remittance facilities, savings, loans, and insurance services by the formal financial system to those who tend to be excluded. In the Indian context, Rangarajan committee defines financial inclusion as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups at an affordable cost. In short according to this committee financial inclusion is timely delivery of financial services to disadvantaged sections of the society.

The general equation of financial inclusion is given by

$$FI = NFA + BC$$

Where, NFA=No frills saving bank accounts with minimum or zero balance.

BC=Business correspondents which includes other financial institutions (OFIs) like insurance companies, mutual funds, pension companies etc. micro financial institutions (MFIs) and Information technology (IT). Thus $BC = Banks + OFIs + MFI + IT$

SIGNIFICANCE OF THE STUDY

Significance of financial inclusion arises from the problem of financial exclusion of nearly 3 billion people from the financial services across the world, with only 34 percent population engaged in formal banking. India has, 135 million financially excluded households, the second highest after China. Further the real rate of financial inclusion in India is very low and about 40 percent of the bank account holders use their accounts not even once a month. According to deputy governor of R.B.I., K.C. Chakrabarty, there is a large gap between the coverage of banking services among the adult population in urban and rural India. In rural India, the coverage among the adult population is 39 percent against 60 percent in urban India. Thus despite widespread expansion of the banking sector, a significant proportion (40 percent) of the households especially in rural areas remains outside the coverage of the formal banking system. In India the financially excluded sections comprise largely rural masses comprising marginal farmers, landless labourers, self-employed and unorganized sector enterprises, urban slum dwellers, socially excluded groups, senior citizens and women. In India alone 560 million people excluded from formal source of finance. Financial inclusion has emerged as a tool for the socio-economic development of the society. The basket of financial services under financial exclusion will create an opportunity for rural people and thereby driving the economic growth of the country. The study of financial inclusion is highly important for the society because consequences of financial exclusion may be quite harmful. It may generate lower investment resulting from difficulties in getting access to credit or gaining credit from informal sector at very high interest rates. The importance of financial inclusion is also very widely recognized in policy circles and has become a policy priority in many countries. Several constraints across the globe now look at financial inclusion as the means to more comprehensive growth, where in each citizen of the country is able to use earnings as a financial resources that can be put to work to improve future financial status and adding to the nations progress.

REVIEW OF LITERATURE

Numerous research as well as general studies has been conducted over the years with regard to financial inclusion and its corresponding impact in India and across the world. An effort has been made to review some of the important works having a great bearing on the present study.

In 1998, Kempson and Whyley, has pointed out that two out of ten households do not have a current bank or building society account. His study demonstrates that financial exclusion is neither a single nor a straight forward process.

In 2006, UNITED Nations estimated that globally over two billion people are currently excluded from access to financial services. In most developing countries, a large segment of society particularly low income people has very little access to financial services both formal and semi formal.

In 2007, RBI launched a multilateral website in 139 Indian language on all matters concerning banking and the common person to promote financial literacy.

In 2008, World Bank pointed out that without an inclusive financial system, poor individuals and small enterprises have to rely on their limited savings and earnings to invest in their education and entrepreneurship to take advantage of growth opportunities.

In 2008, Chairman Dr.C. Rangarajan in the final report of the committee on financial inclusion viewed financial inclusion as a comprehensive and holistic process of ensuring access to financial services and timely and adequate credit, particularly by vulnerable groups such as weaker sections and low income groups at an affordable cost. The same report also observed that in India 51.4 percent of formal households are financially excluded from both formal and informal sources and 73 percent of farmer households do not access formal sources of credit.

In 2008, European Commission studied financial inclusion in 25 European countries and pointed out that the levels of financial exclusion within the European Union. It reported that 1 percent of adults in Denmark and Belgium, 2 percent in France, 3 percent in Austria, and 8 percent in Spain and 28 percent in Greece are financial excluded.

In 2010, Jayo in a report commissioned by the European Microfinance Network, 'Overview of the Microcredit Sector in the European Union 2008-2009' which gathered data from 170 microfinance providers, 63% of micro lenders in Europe define their mission as job creation and 62% as social inclusion and poverty reduction, in addition to their focus on microenterprise promotion (70%). Moreover, 'unbankable' persons, i.e., financially and often socially excluded persons who will remain excluded from the mainstream financial services in the mid to long term, make up 70% of microfinance clients in Europe. Nearly half (47%) of EU

micro lenders explicitly target people excluded from mainstream financial services, 44% target women, 41% immigrants and ethnic minorities and 32% target the rural population.

OBJECTIVES

The study has been undertaken in order to fulfill the following objectives.

1. To find out the causes of financial exclusion in India.
2. To analyze the extent and magnitude of financial inclusion in the context of India.
3. To suggest measures to solve the problem of financial exclusion in India.

CAUSES OF FINANCIAL EXCLUSION

Lack of appropriate supply of services to the needy people and lack of demand for appropriate financial products and services by the people is a major cause for financial exclusion in India. Several causes are responsible for financial exclusion in India. They are discussed below.

1. Gender issues: Access to credit is often limited for women who do not have, or cannot hold title to assets such as land and property or must seek male guarantees to borrow.
2. Legal identity: The primary requirement for opening bank accounts is identity proof and witness. Lack of legal identities like identity card, driving license, birth certificates, or written records often exclude women, ethnic minorities, refugees, migrant workers from accessing financial services.
3. Psychological and cultural barriers: The rural people and low income groups feel that banks are not interested to look into their matter which has led to self exclusion for such groups of people. However cultural and religious barriers to banking have been observed in some of the countries like Pakistan, Bangladesh and England.
4. Limited literacy: In India limited literacy particularly, financial literacy that is basic mathematics, business finance skills as well as lack of understanding often constraint people to have access from financial services.
5. Terms and conditions: Many people are not comfortable using formal financial services because they face difficulties in understanding language, various terms and conditions that come with financial services. The low income people do not understand financial product, usage, operation and management of accounts. It has also been seen that the poor people living in urban and rural areas do not utilize the financial services that available because of high cost. For example to open a bank account in Cameroon, the minimum deposit requirement is over 700 dollars. While no minimum amounts required in South Africa, Switzerland etc. In Bangladesh, Pakistan, Philippines to get a small business loan processed requires more than a month, while the wait is only a day in Denmark.
6. Age factor: Banks usually provides financial service to the middle class and economically active population, often overlooking the design of appropriate products for older or younger potential customers.
7. Supply factors: Such factors take into account a financial institution's criteria for accepting a client, the fees it charges for access to its services and its requirements (e.g., its risk assessment procedures). These can lead a bank to refuse services to a person and can act as a strong deterrent to a potential client seeking a particular financial service. Supply factors encompass the geographic location of the institution, which in several cases is a primary cause of financial exclusion.

Demand side or behavior factors: Apart from the supply side factors, demand side factors can also undermine consumers' willingness to engage with financial services and ability to make effective, informed choices and decisions. These factors have a significant bearing on the extent of financial inclusion. A higher share of population below the poverty line results in lower demand for financial services as the poor may not have savings to place as deposit in savings banks. Thus, low income leads to low demand for financial services, particularly savings products. Likewise, at low levels of development, investment activity may be low and hence, may lead to low demand for credit from banks and other formal financial institutions. However, as poverty levels decline and households move into higher income brackets, their propensity to save increases, which, in turn, leads to higher demand for financial services both for saving and investment purposes.

EXTENT AND MAGNITUDE OF FINANCIAL INCLUSION IN INDIA

Financial inclusion in the context of India implies the provision of affordable financial services, namely, access to payment and remittance facilities, savings, loans and insurance services by the formal system to those who tend to be excluded. In India, the term financial inclusion first featured in 2005, when RBI, in its annual policy statement of 2005-06, while recognizing the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of the population, urged banks to review their existing practices to align them with the objective of financial inclusion. Although the term financial inclusion was not vogue in India then, since the late 1960s both the government and the RBI have been concerned about the non availability of banking facilities to the underprivileged and weaker sections of the society. The government of India's National Rural Financial Industrial Plan (NRFIP) has set a target to achieve complete financial inclusion by 2015. The plan aims to serve 50 percent of the financially excluded 280 million population by 2012 through regional and semi urban branches of commercial and regional rural bank. In the Index of financial inclusion prepared by the Indian council for research on International Economic Relations (ICRIER), India has been placed 50th position in the list of 100 countries. The index of financial inclusion, which measure the availability and usage of bank accounts per 1000 adults, number of ATMs and bank branches per million people and the amount of bank credits and deposits. While economic growth in India has benefited a growing middle class, it has also created great disparities between rural and urban areas, prosperous and lagging states, and between semi skilled and low skilled workers.

The broad strategy for financial inclusion in India in recent years comprises the following elements.

1. encouraging penetration into unbanked and backward areas and encouraging agents and intermediaries such as NGOs, MFIs, CSOs and business correspondents (BCs);
2. focusing on a decentralized strategy by using existing arrangements such as State Level Bankers' Committee (SLBC) and district consultative committee (DCC) and strengthening local institutions such as co-operatives and RRBs;
3. using technology for furthering financial inclusion;
4. advising banks to open a basic banking 'no frills' account;
5. emphasis on financial literacy and credit counseling and
6. Creating synergies between the formal and informal segments (Thorat, 2008).

Various initiatives of financial inclusion undertaken could broadly be categorized into three phases.

1. 1970-1990: Channeling credit to the neglected sectors and special emphasis was laid on weaker sections of the society.
2. 1990-2005: The main focus was mainly on strengthening the financial sector reforms. In this phase financial inclusion was encouraged mainly by the introductions of SHGs-bank linkage programme in early 1990s and Krishan Credit Cards (KCCs) for providing credit to farmers. The SHGs-bank linkage programme was launched by NABARD in 1992 with policy support from the Reserve Bank, to facilitate collective decision making by the poor and provides door step banking.
3. 2005-onwards- In the third phase, financial inclusion was explicitly made as a major policy objective and thrust was on providing safe facility of savings deposits through "no frills" account.

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 rationale for creating Regional Rural Banks was also to take the banking services to poor people. The branches of commercial banks and the RRBs have increased from 8,321 in the year 1969 to 68,282 branches as at the end of March 2005. The average population per branch office has decreased from 64,000 to 16,000 during the same period. In the Indian context, even after the implementation of the new Branch Authorization Policy of Reserve Bank, out of a total of 1,250

new branches that were opened during July 2004-June 2005 only 1.2 % branches were actually opened in the un-banked areas. During the same Corresponding period during 2005-06, 933 new branches were authorized to operate and out of which only 0.21 % were opened in the un-banked areas.

CURRENT SCENARIO OF FINANCIAL INCLUSION IN INDIA

The current scenario of financial inclusion in India reveals a significant variation across the states in the No. of accounts per 100 of total population and per 100 of adult population, No. of banks, Primary Agricultural Credit societies in rural areas (PACs) in rural areas etc. A survey of 14 leading states of India in 2011 reveals that states such as Maharashtra, West Bengal, Punjab, Gujarat have reasonably high No. of financial inclusion, banks and Primary Agricultural Credit societies (PACs) in rural areas. For example Maharashtra has 46 PACs per 100,000 persons while West Bengal has 38 banks. Again, another statistics collected from Indian Institute of Banking and Finance on total No. of branches, total No. of rural branches, new rural branches etc. in India reveals a variation in the period 2010-2011 (Table-1). Out of the total 5165 new branches opened in 2011, only 21.86 percent are rural branches. Currently the No. of accounts per 100 of adult population and the total population in India is 59 and 31 respectively. According to the annual report (2010-2011) of Consultative Group to Assist the Poor (CGAP) and the World Bank the No. of deposit accounts per 100 adults for the period is 747.29 and the value of GDP is 55.03 percent (Table-2). Similarly, according to the same report the No. of outreach total branches per 100,000 adults in urban and rural area is equal to 3.82 and 6.29 percent respectively for the period 2010-11. This report gives highest importance of macroeconomic stability and growth for improving financial access. Now RBI is keen on achieving 100 percent financial inclusion for sustaining equitable growth. To achieve the target of 100 percent financial inclusion, however, 1584 million accounts will need to be opened. But despite the efforts taken by the government there exist a sharp financial exclusion in the country. In fact presently 60 percent of the Indian population does not have access to formal banking facility.

TABLE-1: RURAL BRANCHES IN INDIA (2010-2011)

SL. No.	Particulars	March 2010 No's	March 2011 No's
1	Total No. of branches	6995	75160
2	Total No. of Rural branches	21554	22683
3	Total No. of urban branches	48441	52477
4	Total no of New branches	3192	5165
5	Total no of New rural branches	825	1129
6	Total no of New Urban branches	3354	4036

Source: Indian Institute of Banking and Finance

TABLE-2: FINANCIAL ACCESS: COMMERCIAL BANKS (2009-10)

Financial access	Accounts Per 1000 adults	Value (Percentage) of GDP	Average account Value (/of income PC)
Deposits	747.29	55.03	107.86
Loans	137.46	40.93	436.09
Outreach branches per 100,000 adults	3.82 (Urban)	6.29 (Rural)	10.11 (Total)

Source: Consultative Group to Assist the Poor (CGAP) and World Bank

SUGGESTIONS

RBI has been undertaking financial inclusion initiatives in a mission mode through a combination of strategies ranging from provision of new products, relaxation of regulatory guidelines and other supportive measures to achieve sustainable and scalable financial inclusion. In India, RBI has initiated several measures to achieve greater financial inclusion, such as facilitating no-frills accounts and GCCs for small deposits and credit. Some of these steps are:

Opening of no-frills accounts:

Basic banking no-frills accounts with nil or very low minimum balance as well as charges that make such accounts accessible to vast sections of the population. Banks have been advised to provide small overdrafts in such accounts.

Relaxation on know-your-customer (KYC) norms: KYC requirements for opening bank accounts were relaxed for small accounts in August 2005, thereby simplifying procedures by stipulating that introduction by an account holder who has been subjected to the full KYC drill would suffice for opening such accounts.

The banks were also permitted to take any evidence as to the identity and address of the customer to their satisfaction. It has now been further relaxed to include the letters issued by the Unique Identification Authority of India containing details of name, address and Aadhaar number.

Engaging business correspondents (BCs):

In January 2006, RBI permitted banks to engage business facilitators (BFs) and BCs as intermediaries for providing financial and banking services. The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions, thus addressing the last-mile problem. The list of eligible individuals and entities that can be engaged as BCs is being widened from time to time. With effect from September 2010, for-profit companies have also been allowed to be engaged as BCs.

Use of technology:

Recognizing that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, banks have been advised to make effective use of information and communications technology (ICT), to provide doorstep banking services through the BC model where the accounts can be operated by even illiterate customers by using biometrics, thus ensuring the security of transactions and enhancing confidence in the banking system.

Adoption of EBT:

Banks have been advised to implement EBT by leveraging ICT-based banking through BCs to transfer social benefits electronically to the bank account of the beneficiary and deliver government benefits to the doorstep of the beneficiary, thus reducing dependence on cash and lowering transaction costs.

GCC:

With a view to helping the poor and the disadvantaged with access to easy credit, banks have been asked to consider introduction of a general purpose credit card facility up to ₹25,000 at their rural and semi-urban branches. The objective of the scheme is to provide hassle-free credit to banks' customers based on the assessment of cash flow without insistence on security, purpose or end use of the credit. This is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned.

Simplified branch authorization:

To address the issue of uneven spread of bank branches, in December 2009, domestic scheduled commercial banks were permitted to freely open branches in tier III to tier VI centres with a population of less than 50,000 under general permission, subject to reporting. In the north-eastern states and Sikkim, domestic scheduled commercial banks can now open branches in rural, semi-urban and urban centres without the need to take permission from RBI in each case, subject to reporting.

Opening of branches in unbanked rural areas:

To further step up the opening of branches in rural areas so as to improve banking penetration and financial inclusion rapidly, the need for the opening of more bricks and mortar branches, besides the use of BCs, was felt. Accordingly, banks have been mandated in the April monetary policy statement to allocate at least 25% of the total number of branches to be opened during a year to unbanked rural areas.

Besides the above mentioned initiatives taken by the RBI for financial inclusion we can also definitely achieve the objective of financial inclusion by following a systematic approach.

- Awareness in general, coupled with financial awareness on opening and operating accounts, must accompany the financial inclusion initiative.
- Banks should prepare comprehensive plans to cover all villages, through a mix of branchless banking and bricks and mortar branch banking. They should speed up enrolment of customers and opening of UID-enabled bank accounts. It envisages putting in place a system that enables routing of all social benefits to bank accounts electronically as also seamless cash transfer to the poor, as and when the government replaces the age-old system of subsidy and public distribution system with cash transfers.

The success of financial inclusion is highly dependent on the kind of support provided by base branches, especially for cash management, documentation and redress of customer grievances. Hence, it is necessary that a bricks and mortar structure is available to support about 8-10 BCs at a reasonable distance of 2-3km. These branches can be low-cost intermediary simple structures comprising minimum infrastructure for operating small customer transactions and can act as an effective supervisory mechanism for BC operations.

- Banks must provide a minimum four products—a no-frills savings account with an overdraft facility, a pure savings product, entrepreneurial credit and remittance services, and new products tailored to income streams of poor borrowers and according to their needs and interests. Banks must be able to offer the entire suite of financial products and services to poor clients at attractive pricing.

Though the cost of administering small-ticket personal transactions is high, this can be brought down if banks effectively leverage ICT solutions. This can be attained through product innovation with superior cost efficiency. They must understand and penetrate the rural markets efficiently to cross-sell products and services. Mobile banking has tremendous potential and the benefits of m-commerce need to be exploited.

- It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc., is available. All stakeholders will have to work together through sound and purposeful collaborations. Local and national-level organizations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and impact.

This collaborative model will have to tackle exclusion by stimulating demand for appropriate financial products, services and advice with the appropriate delivery mechanism, and by ensuring that there is a supply of appropriate and affordable services available to those that need them.

- Mindset, cultural and attitudinal changes at grass roots and cutting-edge technology levels of branches of banks are needed to impart organizational resilience and flexibility. Banks should institute systems of reward and recognition for personnel initiating, ideating, innovating and successfully executing new products and services in the rural areas.

CONCLUSION

Empirical evidence shows that economic growth follows financial inclusion. Boosting business opportunities will definitely increase the gross domestic product, which will be reflected in our national income growth. People will have safe savings along with access to allied products and services such as insurance cover, entrepreneurial loans, payment and settlement facility, etc. Public-private partnerships can contribute to financial inclusion, with government offering the appropriate regulatory framework and incentives to service providers, and private operators increasing their institutional outreach and range of services. Models that the banking sector can use to expand financial access include retail banking, wholesale banking in partnership with MFIs, and franchise or agent banking. Microfinance “processing hubs” have the potential to provide “back-end” technology to the industry and assist service providers in overcoming cost hurdles that are holding back the advance of financial inclusion. There is also a need to develop partnerships, and to lower costs to increase the accessibility of certain services for particular groups, such as remittance services for migrant workers.

Our dream of inclusive growth will not be complete until we create millions of micro-entrepreneurs across the country. Microfinance has the potential to widen financial inclusion by bridging the needs and opportunities at the bottom of the economic pyramid and the resources of the financial sector. To sum up, financial inclusion is the road that India needs to travel toward becoming a global player. Financial access will attract global market players to our country and that will result in increasing employment and business opportunities.

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