FINANCIAL INCLUSION – A ROAD INDIA NEEDS TO TRAVEL

Sushma Vohra*

ABSTRACT

Financial inclusion is emerging as new paradigm of economic growth. Financial inclusion refers to universal access to a wide range of financial services at a reasonable cost. It is, in fact, one of the essential conditions for reduction of poverty and socio-economic inequalities in the society. The idea of inclusive growth can be traced back to late 1960's but it gained importance in the early 2000's. Now, financial inclusion has become the main objective of banking sector. Financial inclusion is essential for the development of an economy. Financial inclusion encourages the saving habits. Besides nurturing the habit of saving among the masses, it will remove the apprehensions and fear from their mind towards the financial products and services. This will encourage un/under- banked consumers to enter into or make better use of the financial mainstream. It will also persuade people to take credit for setting up new ventures. In India, financial inclusion was first featured in 2005. The broad strategy in India in recent years comprised of encouraging penetration into un-banked and backward areas and using technology for furthering financial inclusion. This paper reviews the conceptual framework, requirements and beneficial aspects of financial inclusion. This paper further discusses the status of financial inclusion at Indian and Global Level. This paper also gives description of challenges of financial inclusion and recommendation to overcome these challenges.

Keywords: *Financial Inclusion, Socio-economic, Financial mainstream, Ventures*

*Lecturer in Commerce, M.L.N. College, Yamuna Nagar

INTRODUCTION

The issue of financial inclusion is emerging as a new paradigm of economic growth. It refers to delivery of banking services at an affordable cost to the vast section of underprivileged and low income groups. It is, in fact, one of the essential conditions for reduction of poverty and socio-economic inequalities in the society. It is integral to the inclusive growth process and sustainable development of country. So it can be said that in the policy framework for the development of formal financial system in India, the need for financial inclusion and covering more and more of excluded population by financial system has always been emphasized.

FINANCIAL INCLUSION

Financial inclusion refers to delivery of financial services to the vast section of disadvantaged and low income groups at an affordable cost in a fair and transparent terms and conditions. This term basically gained importance in the early 2000's. Now, financial inclusion has become the main objective of banking sector.

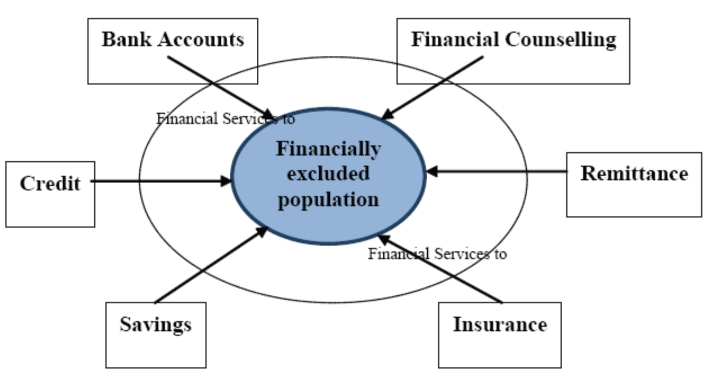
The two committees defined financial inclusion in the following ways:

Rangarajan Committee – Working Definition of Financial Inclusion

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.

Raghuram Rajan Committee's Definition of Financial Inclusion

Financial inclusion, broadly defined, refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products.



Source: Adapted from the Rangarajan Committee Report.

The idea of inclusive growth can be traced back to late 1960's, when banks were brought under the scheme of social control in year 1967, followed by nationalization of 14 major commercial banks in 1969. Banks nationalization in India marked a paradigm shift in focus of banking as it was intended to shift the focus from class banking to mass banking. The rationale of creating regional Rural Banks was also to take the banking services to the poor people. However, large part of population including farmer households still remain unbanked. The new branch Authorization policy of Reserve Bank encourages the banks to open the branches in the under banked states. The new policy also places a lot of emphasis on the efforts made by banks to achieve financial inclusion and other policy objectives. But even after all efforts, the distribution of commercial bank branches shows that the states such as Bihar, Orissa, Rajasthan, Uttar Pradesh, Chattisgarh, Jharkhand, West Bengal and North-eastern states are under banked.

In India, financial inclusion first featured in 2005, when it was introduced from a pilot project in UT of Pondicherry, by K.C. Chakraborthy, the chairman of Indian Bank. Mangalam Village became the first village in India where all households were provided banking facilities. In addition to this KYC (Know Your Customer) norms were relaxed for people intending to open accounts with annual deposits of less than Rs. 50,000. General Credit Cards (GCC) were issued to the poor and the disadvantages with a view to help them access easy credit.

In January 2006, the Reserve Bank permitted commercial banks to make use of the services of non-governmental organizations (NGOs/SHGs) micro-finance institutions and other civil society organizations as intermediaries for providing financial and banking services. These intermediaries could be used as business facilitators or business correspondents by commercial banks. RBI is also working on different plans of financial inclusion. The vision for 2020 is to open nearly 600 million new customer's accounts and service them through a variety of channels by leveraging on IT.

NEED FOR FINANCIAL INCLUSION

It is imperative that inclusive growth without financial inclusion will not succeed in achieving equitable objectives as financial inclusion can truly fortify the economic standards of the poor and the disadvantaged whose enrichment is foremost prerequisite for a nation encumbering growth trajectory. There exists a correlation between financial development and economic growth. And when we are in the process of annexing second generation reforms one cannot imagine that one third of the population is under poverty level. Here financial inclusion will help in striking a balance by channelizing the surplus to deficit units and bring them under the growth metaphor. The more the development larger is the thrust on empowering the low income group. And with experiences of Grameen Bank (Bangladesh) has brought a new paradigm to the banking practices by changing the perception that poor are bankable and given a direction for the world community for diffusing of banking services and a business model which is highly rated and most valued.

ROLE OF FINANCIAL INCLUSION IN ECONOMIC DEVELOPMENT

Financial inclusion is an essential pre-condition to building uniform economic development. There are several government and non-government programmes aimed at reducing poverty and bringing greater equity in country. But few have proved to be inherently productive and sustainable. Financial inclusion can transform them into productive and self-sustainable projects. The micro-credit programme launched through numerous Non Governmental Organizations has found fancy with the banking industry and can prove to be an excellent tool to bring in greater equity through financial inclusion. Financial inclusion encourages saving habits. Besides nurturing the habit of saving among the masses, it will remove the apprehensions and fear from their mind towards the financial products and services. This will encourage un/under-banked consumes to enter into or make better use of the financial mainstream. It will also persuade people to take credit for setting up new ventures. In a way provision of easy credit will encourage the first generation entrepreneurs to initiate new venture ; aggravate the capital formation in the society; create new employment opportunities and thus will help in escalating the economic development of the country. This also will automatically lower the increasing crime rates in the society. As financial inclusion contributes much in the development of our economy; government, RBI and Banks pay more stress on financial inclusion in the form of:

- RBI directed banks to offer a basic ‘no frills’ banking account with low or zero minimum balances and minimum charges to expand the outreach of such accounts to low income groups.
- RBI launched multilingual websites in 13 languages on all matter concerning banking. RBI has also created a sub-site for the common persons to give them the case of access information for use in dealing with banks.

- The community finance learning initiative (CFLIs) were also introduced with a view to promote basic financial literacy among housing association tenants.
- State bank of India has set up 100 centres in Agri-lending branches for agriculture counseling.
- Union Bank of India and Indian Overseas Bank use of handled and biometric cards in village of Tamilnadu.
- Union Bank of India and Dena Bank introduced 98 village knowledge centers for imparting knowledge to farmers. These centers also provide basic infrastructure, internet connection and updated libraries.
- Union Bank of India introduced “Union Mitra Scheme” for providing financial education and debt counseling services to rural population free of cost.
- Banks have also been urged to scale up the use of information technology in their branches to ensure speedy delivery of financial facility.
- Reserve bank in consultation with state governments is encouraging banks to adopt electronic benefit transfer (EBT).
- RBI launched a financial inclusion drive targeting one district in each state based on the experience gained in these districts the coverage has been extended to other districts.

FINANCIAL INCLUSION AT GLOBAL LEVEL

While in developed countries, the formal financial sector comprising mainly the banking system serves most of the population, in developing countries, a large segment of the society, mainly low-income group, has little access to financial services, either formal or semi formal. As a result, many people have to necessarily depend either on their own sources or informal source of finance, which are generally at high cost. Most of the population in developed countries (99 percent in Denmark, 96 percent in Germany, 91 percent in the USA and 96 percent in France) has bank accounts (Peachy and Roe, 2004). However, formal financial sectors in most developing countries serve relatively a small segment, often no more than 20-30 per cent of the population, the vast majority of whom are low income households in rural areas (ADB, 2007).

Recent data shows that countries with large proportion of population excluded form the formal financial system also show higher poverty ratios and higher inequality. Typically, countries with low levels of income inequality are associated with the least equal ones. In Sweden, for example, lower than two percent of adults did not have an account in 2000 and in Germany, the figure was around three percent (Kempson, 2006). In comarision, less than four percent of adults in Canada and five percent in Belgium lacked a bank account (Buckland et al. 2005). Countries with high levels of inequality record higher levels of banking exclusion. To illustrate, in Portugal, about 17 percent of the adult population had no account of any kind in 2000 (Kempson, 2006).

World Bank's FINDEX - Select Indicators on Financial Inclusion - 2011 (Proportion of Population of Age 15+)

Indicator Name	United States	United Kingdom	Germany	Russian Federation	Brazil	China	India
CREDIT:							
Loan from a financial institution in the past year	20.1	11.8	12.5	7.7	6.3	7.3	7.7
Loan from a financial institution in the past year, income, bottom 40%	17.6	11.1	12.3	6.3	3.5	7.7	7.9
Loan from a financial institution in the past year, income, top 60%	22.3	13.2	13.7	8.7	8.2	7.0	7.5
Loan in the past year	44.6	28.8	25.3	31.9	23.8	29.4	30.6
Loan in the past year, income, bottom 40%	45.1	28.1	25.4	32.1	19.7	32.4	35.7
Loan in the past year, income, top 60%	44.2	30.2	24.6	31.7	26.6	27.3	24.9
INSURANCE:							
Personally paid for health insurance	NA	NA	NA	6.7	7.6	47.2	6.8
Purchased agriculture insurance (% working in agriculture, age 15+)	NA	NA	NA	3.7	11.2	7.2	6.6
PAYMENTS:							
Checks used to make payments	65.5	50.1	7.2	5.2	6.7	1.8	6.7
Electronic payments used to make payments	64.3	65.3	64.2	7.7	16.6	6.9	2.0
Mobile phone used to pay bills	NA	NA	NA	1.7	1.3	1.3	2.2
SAVINGS:							
Saved at a financial institution in the past year	50.4	43.8	55.9	10.9	10.3	32.1	11.6
Saved at a financial institution in the past year, income, bottom 40%	32.1	43.5	55.1	8.8	5.8	18.3	10.4

Saved at a financial institution in the past year, income, top 60%	66.5	44.3	60.0	12.4	13.3	41.7	12.9
Saved any money in the past year	66.8	56.7	67.3	22.7	21.1	38.4	22.4
Saved any money in the past year, income, bottom 40%	51.5	56.2	67.1	18.9	12.1	23.3	19.4
Saved any money in the past year, income, top 60%	80.2	57.7	68.1	25.4	27.1	48.9	25.8
NA: Not Available							

IMF's FAS Database - Select Indicators on Financial Inclusion

	United States		United Kingdom		Germany		Russian Federation		Brazil		China		India	
	2005	**2011**	**2005**	**2011**	**2005**	**2011**	**2005**	**2011**	**2005**	**2011**	**2005**	**2011**	**2005**	**2011**
ATMs per 1,000 km	43.2	NA	240.9	NA	NA	NA	1.7	11.2	17.4	20.6	NA	NA	NA	25.4
ATMs per 100,000 adults	168.6	NA	117.9	NA	NA	NA	22.8	152.9	108.9	119.6	NA	NA	NA	8.9
Commercial bank branches per 1,000 km	8.5	9.6	58.0	NA	40.9	NA	2.1	2.7	NA	7.9	NA	NA	23.2	30.4
Commercial bank branches per 100,000 adults	33.1	35.4	28.4	NA	20.2	NA	28.4	37.1	NA	46.2	NA	NA	9.0	10.6
Deposit accounts with commercial banks per 1,000 adults	NA	NA	NA	NA	NA	NA	NA	NA	705.7	1032.7	NA	NA	607.3	953.1
Household deposit accounts with commercial banks per 1,000 adults	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	NA	576.6	853.0
Household loan accounts with commercial banks	NA	NA	NA	NA	NA	NA	NA	NA	NA	747.4	NA	NA	7.4	20.6

per 1,000 adults														
Loan accounts with commercial banks per 1,000 adults	NA	NA	NA	NA	NA	NA	NA	NA	NA	853.7	NA	NA	100.4	142.0
Outstanding deposits with commercial banks(Percent of GDP)	48.0	57.8	356.5	422.8	20.1	27.6	18.7	45.0	34.0	53.3	123.2	159.3	47.3	68.4
Outstanding loans from commercial banks (Percent of GDP)	48.9	46.8	377.6	460.0	24.7	24.2	29.5	63.9	21.2	40.3	85.3	108.7	31.2	51.8

NA: Not Available

Source: IMF's Financial Inclusion Survey July 2012.

FINANCIAL INCLUSION IN INDIA

Growth with equity is one of the main objective in India. Financial inclusion in India has been accessed by various communities in terms of its people access to avail banking services. Bank nationalization in India marked a paradigm shift in focus of banking as it was intended to shift the focus from class banking to mass banking. The Eleventh Five Year Plan (2007-2012) envisions inclusive growth as a key objective. Achieving inclusive growth in India is a challenge as it is very difficult to bring 600 million people living in rural India into a mainstream. One of the best ways to achieve inclusive growth is through financial inclusion.

The Indian Government has a long history of working to expand financial inclusion. Nationalization of the major private sector banks in 1969 was a big step. In 1975 GOI established RRBs with the same aim. It encouraged branch expansion of bank branches especially in rural areas. The RBI guidelines to banks shows that 40% of their net bank credit should be lent to the priority sector. This mainly consists of agriculture, small scale industries, retail trade etc. More than 80% of our population depends directly or indirectly on agriculture. So 18% of net bank credit should go to agriculture lending. Recent simplification of KYC norms are another milestone. Financial inclusion is a great step to alleviate poverty in India. But to achieve this, the government should provide a less perspective environment in which banks are free to pursue the innovations necessary to reach low income consumers and still make a profit. Financial service providers should learn more about the consumers and new business models to reach them.

The broad strategy for financial inclusion in India in recent years comprised different elements as (i) encouraging penetration into unbanked and backward areas and encouraging agents and intermediaries such as NGOs, and business correspondents (BCs); (ii) 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 has co-operatives and RRBs; (iii) using technology for furthering financial inclusion; (iv) emphasis on financial literacy and credit counseling; and (vii) creating synergies between the formal and informal segments.

Progress of banks in Financial Inclusion Plan in India

SR	Particulars	Year ended Mar 10	Year ended Mar 11	Year ended Mar 12	Quarter ended June 12	Progress April 11-March 12
1	Total No. of Branches	85457	91145	99242	99771	8097
2	No. of Rural Branches	33433	34811	37471	37635	2660
3	No. of CSPs Deployed	34532	60993	116548	120098	55555
4	Banking outlets in Villages with population >2000	37791	66447	112130	113173	45683
5	Banking outlets in Villages with population <2000	29903	49761	69623	74855	19862
6	Banking Outlets through Brick & Mortar Branches	33378	34811	37471	37635	2660
7	Banking Outlets through BCs	34174	80802	141136	147167	60334
8	Banking Outlets through Other Modes	142	595	3146	3226	2551
9	Total Banking Outlets	67694	116208	181753	188028	65545
10	Urban Locations covered through BCs	447	3771	5891	6968	2120
11	No Frill A/Cs (No. In million)	73.45	104.76	138.50	147.94	33.74
12	Amount in No Frill A/Cs (Amt In billion)	55.02	76.12	120.41	119.35	44.29
13	No Frill A/Cs with OD (No. in million)	0.18	0.61	2.71	2.97	2.10
14	No Frill A/Cs with OD (Amt In billion)	0.10	0.26	1.08	1.21	0.82

15	KCCs-Total-No. In million	24.31	27.11	30.23	30.76	3.12
16	KCCs-Total-Amt In billion	1240.07	1600.05	2068.39	2094.00	468.34
17	GCC-Total-No. in million	1.39	1.70	2.11	2.29	0.41
18	GCC-Total-Amt In bilion	35.11	35.07	41.84	43.21	6.77
19	ICT Based A/Cs-through BCs (No. in million)	13.26	31.65	57.08	62.77	25.44
20	ICT Based A/Cs-Transactions (No. In million)	26.52	84.16	141.09	45.96	141.09

Trends in banking parameters in India

Items	31st March	2007	2008	2009	2010	2011	2012
1. No. of Commercial Banks		183	173	170	168	167	173
(a) Scheduled Commercial Banks		179	169	166	164	163	169
Of which: Regional Rural Banks		96	90	86	83	82	82
(b) Non-Scheduled Commercial Banks		4	4	4	4	4	4
2. Distribution of New Branches (%)	Total	100	100	100	100	100	100
	Rural	9	14	18	19	24	33
	Semi-urban	31	31	32	33	41	37
	Urban	35	31	26	27	17	16
	Metro	26	24	24	21	18	14
3. Distribution of Deposits Accounts (%)	Total	100	100	100	100	100	..
	Rural	29	29	30	31	31	..
	Semi-urban	26	26	26	26	26	..
	Urban	22	22	21	21	21	..
	Metro	24	24	23	23	22	..
4. Distribution of Loan Accounts (%)	Total	100	100	100	100	100	..
	Rural	33	31	31	31	32	..
	Semi-urban	23	22	23	23	24	..
	Urban	14	13	13	14	14	..
	Metro	30	33	33	33	30	..
5. Average population per branch (in '000s)	Total	15.7	15.1	14.5	13.8	13.3	12.6

6. Number of Banked Centres (Scheduled Commercial Banks)	Total	34399	34426	34636	34801	35151	36391
".." : Not available.							
Note: All the revenue centres (habitations) are classified in to four groups based on their population based on Census 2001 data. These groups are rural (centres having population < 10,000), semi-urban (10,000 <= population < 1,00,000), urban (1,00,000 <= population < 10,00,000) and metropolitan (population >= 10,00,000).							
Source: Reserve Bank of India and Census data.							

CHALLENGES AHEAD

The challenges in financial inclusion are as :

- Lack of legal identity like identity cards, birth certificates or written records often exclude women, ethnic minorities, economic and political refuges and migrant workers from accessing financial services.
- Lack of awareness about financial services and product, limited literacy, especially financial literacy of the populace, and social exclusion.
- Unsuitability of the financial products for the poor and lack of efforts to design products suitable to their needs.
- Unfriendly and un-empathetic attitude of the banks to the customers also plays an important role in undermining the demand for financial services.
- Exorbitant and oftentimes non-transparent fees combined with burdensome terms and conditions attached to the financial products dampen the demand.
- Cultural and religious barriers to banking have been observed in some of the countries.
- Terms and conditions attached to products such as minimum balance requirements and conditions relating the use of accounts often dissuade people from using such products or services.
- High transaction costs that the bankers perceive to be high owning to low volume of business. Banks find that extending financial services in some particular regions and to some particulars class of people is not cost effective.
- Lack of communication due to language barriers.

- Financial service provides usually target the middle of the economically active population often over looking the design of appropriate product for older or younger potential customers.
- Human resource has been the crux for successful endeavors. In all counts trained manpower is a versatile asset which can be harnessed to achieve visionary goals. This has been the void that needs to be plugged from the grass root level as found most of the staff are either semi skilled or trained only for performing regular banking activities, but what needed is versatile manpower with a human touch who can feel the pulse of the consumers and shifting gears as according to circumstances.
- With the liberalization branch opening under new branch authorization policy of RBI which encourages the opening of branches in under banked or unbanked areas. But they are still excluded population in all the parts of the country stretching from North- Eastern Belt, the Eastern and Central zone. Infrastructural deployments are not that enthusiastic to run even a satellite operation which requires power, telecommunication services and roads for geographical access.

RECOMMMEDATIONS

- The attitude of banks should be friendly towards the customers.
- Keeping in view the dynamics of the changing economy, there is a strong need to restructure the financial system particularly the rural financial system.
- The authors recommend formation of National Financial Inclusion Mission on the lines of National Literacy Mission to carry out systematic and coordinated drive for financial inclusion.
- Involving educational institutions, particularly college students for financial inclusion drive would not only be cost effective but also would create wide public awareness.
- Financial Inclusion should be imbibed into the course curriculum in high schools so that the students would understand the importance of financial inclusion for inclusive growth in the economy which in turn would motivate them to automatically participate in the financial system.

- It is difficult to open the bank accounts and avail of loans from financial institutions due to the long process of documentation. To overcome this, there is a need to digitise the public records for dual purpose of easy accessibility and storage.
- Majority of the marginal farmer households are not at all covered by the formal finance. As such public sector banks and the co-operative banks in the rural areas have to sensitize about the need for provision of timely and cheaper credit to these segments. Reserve Bank of India in consultation with NABARD should come out with a comprehensive strategy for revitalizing the quiescent rural credit mechanism.
- It is imminent to encompass the socially excluded sections and the poor like, tenant farmers, oral lessees and share croppers, marginal farmers with small un economical land holdings, agricultural laborers, rural artisans and people involved in making handicrafts and also majority of weavers in handloom Sector.
- Post Offices in rural areas can be asked to provide their services in accelerating the financial inclusion activity.
- In a huge country like India, there needs to be huge publicity for popularizing the concept and its benefits to the common man. In this direction, a comprehensive approach has to be developed involving all the concerned at all levels to impress upon the need for financial inclusion for accelerating the economic growth in the country.
- All the financial institutions should adopt financial inclusion as a corporate social responsibility and chalk out strategies in tune with the national policy on financial inclusion.

CONCLUSION

At present the financial depth in Indian scenario is not that encouraging against Asian countries though it has gained momentum. As deepening financial system and widening its reach is crucial in terms accelerating the growth and achieve equitable objectives. With sudden burst in entrepreneur drive across the country will require additional financial support to nurture them. With pressure for credit delivery will need to mobilize additional resources from a wider deposit base. Thus financial inclusion will help strengthen financial deepening and enable resource mobilization for extending and broadening credit leading to economic development and accelerate growth. So it is the duty of every Indian citizen to ensure that all the Indians will have bank account and everybody should take part actively in achieving 100% financial inclusion in India.

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