Financial Inclusion & its Implication on the Indian Economy

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Abstract

The term "Financial Inclusion" has gained importance since the early 2000s, and is a result of findings about financial exclusion and its direct correlation to poverty. According to Rangarajan's committee on 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".

A well-developed financial system brings poor people into the mainstream of the economy and allows them to contribute more actively to their personal economic development. In India 47 % of the population does not have access to any kind of financial services therefore in an attempt to improve access to this service the Reserve Bank of India (RBI) promulgated a drive for financial inclusion, where banks take the lead in providing all 'unbanked' households in a district, with savings accounts.

In the context of banks, financial inclusion is spreading of banking activities among different sections of the population. A significant part of bank credit in countries like India should be directed towards priority sectors such as agriculture and economically backward sections of the country. It is also necessary to ensure that persons belonging to low income groups do not face any difficulty in opening bank accounts because of procedures involved in the process.

The issue of financial inclusion is especially important today as India's rural economy has shifted towards more commercialized agricultural and non-agricultural activities, both of which require banking facilities. The evidence on financial inclusion is mixed. The situation is not as poor as has been asserted in recent analyses. There appears to be relatively healthy access to secure formal facilities for savings, but access to credit in rural areas has not grown as might be expected. In particular, resort to informal sources for credit has increased for emergency and consumption purposes. Improvement in financial inclusion will help the further development of India's financial system and accelerate economic growth.

The paper attempts to analyze & discuss the work done towards financial inclusion by various institutions in India & its importance & implications for the Indian economy. The paper also provides pointers to what can be done to increase inclusion as an important component of India's overall economic growth strategy.

Introduction

As India's economy continues to grow and incomes rise, there is an increased need for financial services. There has been considerable improvement in the deepening of the financial system through growth in bank credit and the spread of deposit facilities. However, it is important to examine access to credit in both urban and rural areas and deposit services of small and medium enterprises to determine the true reach of the financial sector. Credit is one of the critical inputs for economic development. Its timely availability in the right quantity and at an affordable cost goes a long way in contributing to the well-being of the people especially in the lower rungs of society. Thus access to finance, especially by the poor and

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vulnerable groups is a prerequisite for employment, economic growth, poverty reduction and social cohesion. Further, access to finance will empower the vulnerable groups by giving them an opportunity to have a bank account, to save and invest, to insure their homes or to partake of credit, thereby facilitating them to break the chain of poverty. But India is lagging behind in this respect so it has become the matter of concern.

Due in no small part to the stimulus provided by the United Nations Year of Micro Credit 2005, policymakers across the world have begun to pay closer attention to increasing financial inclusion. Financial inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. Research in the last decade leads us to believe that a well-functioning and inclusive financial system is linked to faster and equitable growth (Honohan, 2004).

"Inclusive growth" is one of the important objectives of eleventh five year plan in India. Inclusion of each and every section of the society in the process of economic development and achieving growth with equity is the basic objective of "inclusive growth". Financial inclusion is conceived as a major driving force to achieve self-sustained inclusive economic growth.

However, despite the attention paid to financial inclusion and policies devoted to enhancing access to finance, there is a dearth of information regarding access to finance. The problem of inadequate information is compounded by the fact that access does not always lead to usage. This knowledge gap poses a significant challenge in designing effective policy interventions.

Since 2005, the Reserve Bank of India (RBI) has promulgated a drive for financial inclusion, whereby banks promote the participation of every household at the district-level via savings accounts for the 'unbanked.' In India, there are approximately 400 million people in nearly six million villages and semi-urban areas are waiting for small loans and other banking services. There is scope for lending Rs 45,000 crores to these people. Against this potential, only about 20 million have been served so far by the organized financial sector, with total disbursements of about Rs 3,900 crore.

The objective of the paper is to study and depict the status of financial inclusion in India. This paper is an attempt to comprehend and distinguish the significance of Financial Inclusion in the context of a developing country like India wherein a large population is deprived of the financial services which are very much essential for overall economic growth of a country. The present paper attempts to examine the work done towards financial inclusion by various financial institutions in India. The empirical result demonstrated a positive impact of financial institutions on financial inclusion. The study defines that financial Inclusion efforts should offer at a minimum, access to a range of financial services including savings, long and short term credit, insurance, pensions, mortgages, money transfers, etc. and all this at a reasonable cost.

The Concept of Financial Inclusion

Inclusive Growth & Financial Inclusion are not only the new buzz words being heard & talked over worldwide, they are also an issue of major concern for everyone. This is the reason which has led governments of various countries to take initiative like the G-20 has launched a Financial Inclusion Expert Group; the U.N. has appointed Princess Maxima of the Netherlands as Special Advocate for Inclusive Finance; and policy makers from Brazil to Mexico are publishing papers and holding conferences about how to get more services to more people.

While there is a growing consensus on the importance of financial inclusion, the same consensus does not exist around its definition. From "banking the unbanked" to "branchless banking," a variety of catch phrases are being used as near synonyms for financial inclusion, when in fact they describe specific aspects of a broader concept.

The Centre for Financial Inclusion Accion International defines financial inclusion as "A state in which all people who can use them have access to a full suite of quality financial services, provided at affordable prices, in a convenient manner, and with dignity for the clients. Financial services are delivered by a range of providers, most of them private, and reach everyone who can use them, including disabled, poor, rural, and other excluded populations".

Dr K.C Chakrabarty, Deputy Governor, Reserve Bank of India defines Financial Inclusion as "The process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular at an affordable cost in a fair and transparent manner by mainstream institutional players".

The Committee on Financial Inclusion in India defines Financial Inclusion 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".

While in advanced economies, Financial Inclusion is more about the knowledge of fair and transparent financial products and a focus on financial literacy. In emerging economies like India, it is a question of both access to financial products and knowledge about their fairness and transparency.

Though the consciousness of existing inequality & the effort to eradicate it has been present from time immemorial, however it was in the early 2000's that the imperativeness of Inclusive Growth & Financial Inclusion has gained so much of importance.

Evolution of Financial Inclusion in India

Indian economy by 2005, has witnessed a strong and steady economic growth in the past two decades. However, this robust growth had by passed the poor or marginalized groups, resulting in increasing inequality. Reducing this inequality has become a major concern for our countries policy makers, a concern that has generated interest in the concept of Inclusive Growth.

The concept of Inclusive Growth which was introduced in the Eleventh five year plan in 2007 - emphasizes that the economic opportunities created by growth should be available to all particularly the poor to the maximum possible extent is currently the biggest challenge for our country as it concerns integrating 600 million people living in rural India and several millions living in urban slums, into the mainstream economy.

While working on the path of Inclusive Growth the government of India discovered that more than half of the Indian population is unbanked with only 55 per cent of the population have a deposit account and 9 per cent have credit accounts with banks. India has the highest number of households (145 million) excluded from Banking & has only one bank branch per 14,000 people.

It was then that the policy makers realized that if they want to achieve their objective of Inclusive Growth they first have to achieve another objective that is of 'Inclusive Finance or Financial Inclusion".

As it is a well functioning financial system that helps to empowers individuals, facilitates better integration with the economy, actively contributes to development and affords protection against economic shocks. Inclusive finance through secure savings, appropriately priced credit and insurance products, and payment services helps vulnerable groups such as low income groups, weaker sections, etc., to increase incomes, acquire capital, manage risk and work their way out of poverty & into Inclusive Growth.

Financial Inclusion and Indian Economy

Financial sector development and deepening helps mobilise savings, leading to increased investment in an economy's productive sectors. The institutional infrastructure of the financial system contributes to reducing information, contracting and transaction costs, which in turn accelerate economic growth and promote pro-poor growth. Financial deepening can address concerns of growth with equity and ensure pro-poor growth and financial inclusion is a necessary condition for financial deepening. In fact, increasing financial inclusion reduces the economic vulnerability of households promotes economic growth, alleviates poverty and improves the quality of peoples' lives. Thus, expansion of banking leads to increasing availability of finance to spur economic growth and alleviate poverty.

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.

Financial Inclusion: Steps taken in the Past

The words 'Financial Inclusion', though have now become, the latest buzz words for the Banks in India but if we go through the Indian Banking history we can analyze how RBI & government of India have been constantly making efforts right after independence.

In times gone by, the Reserve Bank of India (RBI) and the Government of India (GOI) have been making efforts to increase banking penetration in the country. Some of these measures include the creation of State Bank of India in 1955; nationalisation of commercial banks in 1969 and 1980; initiating the Lead Bank Scheme in 1970; establishing Regional Rural Banks (RRBs) in 1975; introducing a Self-Help Group (SHG)-Bank Linkage Programme in 1992 and formulating the Kisan Credit Card scheme in 2001. In November 2005, banks were advised to make available a basic banking 'no-frills' account with low or nil minimum stipulated balances as well as charges to expand the outreach of such accounts to vast sections of the population. In order to ensure that persons belonging to low income group, both in urban and rural areas do not encounter difficulties in opening bank accounts owing to procedural hassles, the know your customer (KYC) procedures for opening accounts has been simplified. The Reserve Bank has directed banks to make available all printed material used by retail customers in English, Hindi and the concerned regional language.

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In the First Five Year Plan in 1951 itself the development of rural India was given the highest priority. Later on when it was realized that the commercial banks of the country including the Imperial Bank of India had till then confined their operations to the urban sector and were not equipped to respond to the emergent needs of the rural areas. In order, therefore, to serve the economy in general and the rural sector in particular, the All India Rural Credit Survey Committee recommended the creation of a state-partnered and state-sponsored bank by taking over the Imperial Bank of India, and integrating with it, the former state-owned or state-associate banks. An act was accordingly passed in Parliament in May 1955 and the State Bank of India was constituted on 1 July 1955 with the main objective of serving the rural India.

Similarly the main reason of Nationalization in 1968 was felt because government believed that private commercial banks were lacking in fulfilling the social & developmental goals of banking.

The Lead Bank Scheme 1969 which was based on "Area Approach" was also launched with the objective of providing banking services to the rural poor.

Regional Rural Banks were established under the RRB Act, 1976 with an objective to ensure sufficient institutional credit for agriculture and other rural sectors.

In 1985 the first Self-help groups (SHGs) emerged in MYRADA in 1985 by the87 there were some 300 SHGs.

In 1990 RBI accepted the SHG strategy as an alternative credit model. NABARD (1992) issued guidelines to provide the framework for a strategy that would allow banks to lend directly to SHGs & in 1992 the SHG-Bank Linkage Programme was launched.

In 1999 to help farmers access timely and adequate credit the Kisan Credit Card was launched by the Government of India & NABARD.

This Card allows farmers to have cash credit facilities without going through time-consuming bank credit screening processes repeatedly. Repayment can be rescheduled if there is a bad crop season, and extensions are offered for up to 4 years. The card is valid for 3 years and subject to annual renewals. Withdrawals are made using slips, cards, and a passbook.

The public banks could not contribute much in the schemes prior to the year 2000 mainly due to the lack of technology & the private sector did not contribute as they did not find it as a profitable business venture. In November 2005, banks were advised to make available a basic banking 'no-frills' account with low or nil minimum stipulated balances as well as charges to expand the outreach of such accounts to vast sections of the population. In order to ensure that persons belonging to low income group, both in urban and rural areas do not encounter difficulties in opening bank accounts owing to procedural hassles, the know your customer (KYC) procedures for opening accounts has been simplified. The Reserve Bank has directed banks to make available all printed material used by retail customers in English, Hindi and the concerned regional language. However things have changed now not only have a majority of banks (if not all) have become technology driven they have even realized that bottom of the pyramid is where the future lies.

Role of Financial Institutions in Enhancing Financial Inclusion

Banking sector and the Financial Institutions play very significant role in the Indian economy, in the form of catering to the need of credit for all the sections of society. Rural sector in a country like India can grow only if cheaper credit is available to the farmers for their short and medium term needs. Bank should encourage greater interaction between financial sector and rural development staff to ensure that financial sector expertise is included on any rural project that has a finance component. Hence the whole process of financial inclusion will not be possible without the contribution of banks.

India in last 20 years has witnessed unprecedented growth in financial services, unfolded by liberalization and globalization of financial services due to adoption of Information Technology and unlocking of the regulatory framework. The banking sector responded quickly to the new technology; diversified in multiple services and thus the share of finance & related services in the gross domestic product was 18.29% in 2010-11 (RBI, Annual Report 2010-11). But alongside this positive development there are evidences that the formal financial sector is still excludes a large section of population.

SBI and Financial Inclusion

In a bid to give back-end support to business correspondents operating in rural areas and also exercise administrative control on them, State Bank of India has decided to set up 600 financial inclusion centers across the country. The objective behind this is to ensure financial inclusion of the whole population irrespective of areas and sectors and to provide basic and affordable banking services to 12,421 out of the 72,315 unbanked villages (identified according to 2001 census) having a population of over 2,000 by March-end 2012, as said by Mr M.I. Dholakia, Deputy General Manager, SBI.

According to the Government and the Reserve Bank of India's directive, banks, especially from the public sector, between them have to ensure that all identified villages have appropriate banking services by March-end 2012. These services have to be provided using the business correspondent (BC) and other models with appropriate technology back-up. Deepening penetration and increasing outreach can be done by two ways: i) through the brick and mortar rural branches, ii) outsourcing all the functions to a business correspondent in a particular area, viz., a state or with the help of business facilitators at a local level.

To ensure banking services are attractive to those with low incomes, SBI banking products have features that meet the needs of this group of consumers. For this, the bank is developing : Basic banking Account, Low cost bill payment systems, Technology driven products, Pre-paid Cards, Deposit accounts-which offer an overdraft and an easy route to debt, Affordable insurance products (for individuals, for business enterprise, for agricultural activities such as, weather/ cattle / poultry), Retail Loans at all centers with simplified documentation and procedures through (Self Help Groups, Micro Finance Institutions and Loans to Small Medium Enterprise), Giving advisory services, etc. Large scale roll out and rapid scaling up again is not possible without suitable technology intervention, therefore SBI is providing the facility to rural India, which is easy to use, robust, dependable and, at the same time, cost-efficient.

Financial inclusion through branch network may adversely affect customer service at branches due to increased traffic and larger numbers of people to be attended within the limited hours of banking. Therefore, the bank is providing technology driven products such as, ATMs, internet kiosks for successfully implementing financial inclusion.

The involvement of Self Help Groups and Micro Finance Institutions is also must for development of effective financial inclusion models by banks. In the context of India becoming one of the largest micro finance markets in the world, especially in the area of women's savings and credit groups (SHGs) and the sustaining success of such institutions as demonstrated by the success of SEWA bank in Gujarat, low cost banking is not necessarily an unviable proposition. SBI alone, as on date, has credit linked over 8850,000 Self Help Groups, lending approx. Rs.4, 000 crore to these groups.

SHG- Bank Linkage Scheme

In spite of Indian banking sector having witnessed a spectacular progress in spread of banking networks and extending financial outreaches across the country in the recent past, the relative decline in the supply of credit in rural areas poses the biggest challenge to achieve hundred percent financial inclusion before Indian formal financial system. In this context, self help group bank linkage model launched by NABARD (1992) can be conceived as an alternative model to bridge the gaps which could not be filled up by formal banking system. It facilitates extending financial services to unbanked vulnerable section of society. NABARD led SHG bank linkage model is widely accepted as one of the largest and successful micro finance model in the world.

The branch network and banking education are the most important variable especially for credit inclusion, and further, women are the least included in terms of even saving accounts. Therefore any bank-linked approach like self-help groups/ micro finance institutions, which adds to the existing, banking network with focus on women, can play a pivotal role in financial inclusion. The World Bank Report on South Asia (2007) highlights that the micro finance groups since 2000 have come up in big way in India and the programme has focus on women.

So far, the SHGs with dominance of women (86 %) and the poor sections of the population are linked with bank through one or another facilitator. The banking education is the philosophy of SHG approach and hence it is apt to the objectives of Financial Inclusion. However, all the members may not be having the individual saving accounts due to lack of awareness about benefits of bank account and the constraints like illiteracy, higher cost in accessing the branch/ATM, no surplus to pay initial deposits. The Central and State governments can contribute in minimizing some of these constraints by providing initial matching grant for opening saving account and technological support to access through mobile phones and increasing number of rural ATMs in government establishment like post offices, schools and hospitals. The objective of providing at least one touch points for banking operations can be achieved with support of government for initial capital investment, banks and community organizations like NGOs & SHGs which have focus on financial inclusion of low-income population. The SHG - Bank Linkage Programme can be regarded as the most potent initiative since Independence for delivering financial services to the poor in a sustainable manner. The programme has been growing rapidly and the average loan outstanding per SHG has increased from Rs. 57,795/- in March 2010 to Rs. 65,224/- in March 2011.

ICICI Bank and Financial Inclusion

ICICI Bank has taken up specific initiatives to ramp up financial literacy as well as intermediation to the underserved and under-banked segments in both rural and urban areas. ICICI Bank's financial intermediation models, both through the microfinance institutions and business correspondents have been designed to build a repository of information with regard to financial behavior of the customers. Through Financial Information Network and Operations Limited (FINO) the technology platform it has helped conceptualize, and the biometric card by which the Bank is able to collect demographic information of the customers. It would be possible to trace details such as credit history, savings habit and investment patterns of individuals. This information would be useful to incentivize those with good credit history and to discourage willful default, at the same time developing better-suited financial products. ICICI Bank works closely with MFIs and NGOs to adapt its products to suit consumer needs.

The Bank has been actively looking at technology solutions to scale up the micro finance portfolio. Further, the Bank has been considering adopting a 'Core Banking System' (CBS) for managing the loan portfolio generated under the partnership model. In this regard, the Bank has found an able partner in FINO to provide technology solutions to the micro finance sector. The technology solution comprises of core banking and smart card systems. In light of the technology solutions available through FINO, the Bank has designed a new process for delivering loans under the partnership model.

Conclusion

To conclude, the financial system in India has grown rapidly in the last three decades and more. The functional and geographical coverage of the system is truly impressive. Corporate profitability has exhibited sustainable trends at a high level and consumer incomes are increasing rapidly, riding on the growth momentum. All of these developments suggest that the demand for financial services, for savings, production as well as consumption purposes, will be greater than in the past, and there will be many new entrants in need of financial services who have not hitherto been served.

At present our financial depth is much lower than that of other Asian countries, though it has picked up in the recent past. While there is evidence of an increase in financial deepening, particularly during the present decade, the increase in the breadth and coverage of formal finance can clearly undergo substantial further improvement. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present stage of development of our country.

As poverty levels decline and households have greater levels of discretionary incomes, they will be first time financial savers. They will, therefore, need to have easy access to formal financial systems to get into the banking habit. Financial inclusion has far reaching consequences, which can help many people come out of abject poverty conditions. Financial inclusion provides formal identity, access to payments system & deposit insurance. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be must be to lift the poor from one level to another so that they come out of poverty. There is a need for coordinated action between the banks, the Government and others to facilitate access to bank accounts amongst the financially excluded.

There is an imperative need to modify the credit and financial services delivery system to achieve greater inclusion. Our banking system must be prepared to deal with the opportunities of higher growth, and the challenges of ensuring more equitable growth. In dealing with the needs of rural enterprises and of small and medium enterprises in urban areas, banks have to look for new delivery mechanisms. These must economize on transaction costs and provide better access to the currently under- served. To serve new rural credit needs, innovative channels for credit delivery will have to be found. A key requirement of greater "financial inclusion" would be a reduction of transaction costs.

While banks and other financial institutions can also take some efforts on their own to improve the absorptive capacity of the clients, it is equally important for Government at various levels to initiate actions to enhance the earnings capacity of the poorer sections of the society. The two together can bring about the desired change of greater inclusion quickly.

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