

FINANCIAL INCLUSION – “A ROAD INDIA NEEDS TO TRAVEL”

Dr.Ch. Praveen

Associate Professor,

Trinity College of Engineering & Technology

Karimnagar, T.S.

ABSTRACT

Inclusive growth is possible only through proper mechanism which channelizes all the resources from top to bottom. Financial inclusion is an innovative concept which makes alternative techniques to promote the banking habits of the rural people because, India is considered as largest rural people consist in the world. Financial inclusion is aimed at providing banking and financial services to all people in a fair, transparent and equitable manner at affordable cost. Households with low income often lack access to bank account and have to spend time and money for multiple visits to avail the banking services, be it opening a savings bank account or availing a loan, these families find it more difficult to save and to plan financially for the future. This paper is an attempt to discuss the overview of financial inclusion in India. This paper also examines the initiatives of RBI and provides recommendations for achieving financial inclusion in India. It also provides recommendations and policy choices for successful financial inclusion for inclusive growth in India.

Key Words: Financial Inclusion, Inclusive Growth, Reserve Bank, Financial Services.

INTRODUCTION

Amartya Sen (2000) convincingly argued that poverty is not merely insufficient income, but rather the absence of wide range of capabilities, including security and ability to participate in economic and political systems. Today the term ‘bottom of the pyramid’ refers to the global poor most of whom live in the developing countries. These large numbers of poor are required to be provided with much needed financial assistance in order to sail them out of their conditions of poverty. Accordingly, there is felt a need for policy support in channeling the financial resources towards the economic up-liftment of resource poor in any developing economy. 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 consensus is that finance promotes economic growth but the magnitude of impact differs. Financial inclusion is intended to connect people to banks with consequential benefits. Ensuring that the financial system plays its due role in promoting inclusive growth is one of the biggest challenges facing the emerging economies. We therefore advocate that financial development creates enabling conditions for growth when access to safe, easy and affordable credit and other financial services by the poor and vulnerable groups, disadvantaged areas and lagging sectors is recognised as a pre-condition for accelerating growth and reducing income disparities and poverty. Access to a well-functioning financial system, by creating equal opportunities, enables economically and socially excluded people to integrate better into the economy and actively contribute to development and protects themselves against economic shocks.

FINANCIAL INCLUSION IN INDIA

The Reserve Bank of India setup a commission (Khan Commission) in 2004 to look into Financial Inclusion and the recommendations of the commission were incorporated into the Mid-term review of the policy (2005-06). In the report RBI exhorted the banks with a view of achieving greater Financial Inclusion to make available a basic "no-frills" banking account. In India, Financial Inclusion first featured in 2005, when it was introduced, that, too, from a pilot project in UT of Pondicherry, by Dr. K. C. Chakraborty, the chairman of

Indian Bank. Mangalam Village became the first village in India where all households were provided banking facilities.

FINANCIAL INCLUSION IN THE CONTEXT OF POVERTY

- ❖ Tendulkar panel claims every third Indian is poor!
- ❖ An expert group headed by former Suresh Tendulkar chairman of Prime Minister's Economic Advisory Council submitted its report on the 8th.Dec. 2009.
- ❖ If it is accepted by the government, the below poverty line population would jump by nearly 10 crore from 27.5% (as was estimated in 2004) to 37.2%.
- ❖ Tendulkar Committee report says Bihar and Orissa are the worst affected states in term of poverty.
- ❖ Poverty in rural India is at 42 per cent and overall poverty figure is 37 per cent! The current poverty line is estimated at per capita expenditure of Rs 12 per day!
- ❖ The World Bank estimates that 456 million Indians (42% of the total Indian population) now live under the global poverty line of \$1.25 per day (PPP). This means that a third of the global poor now reside in India!
- ❖ Half of India's children malnourished, says Action Aid in the context of World Food Day report on 16th.Oct.2009.
- ❖ India, with 47 percent of its children under the age of six malnourished, ranks below countries like Bangladesh and Nepal on the state of hunger;

FINANCIAL AND HUMAN DEVELOPMENT INDEX

- ❖ Our rank in the Hunger Index is at 94, while China is at 47 and Pakistan at 88.
- ❖ 27% of all primary school dropouts all over the world are from India, while Child Labour is the norm rather than the exception.
- ❖ 157 districts are Naxalite affected while 25% of population (280 million) is assessed as Below Poverty Line (BPL).
- ❖ The NREGS is yet to succeed and land, water, forest resources are at critical levels of exhaustion.
- ❖ There is unending migration to the urban areas and 30% of the population is now urbanized.
- ❖ Rural poverty, under-employment, starvation and lack of safe drinking water and sanitation, poor education and medical facilities, all take their toll of the rural population.
- ❖ Financial Development Index rates the lack of financial inclusion in 119 economies, measuring the extent to which households and firms have access to financial services by analyzing use of formal financial intermediaries, eligibility for and affordability of financial services.
- ❖ Amongst developing economies, India ranks 81, Brazil: 73 and China 67 who all are rated as Medium Risks.
- ❖ In Human Development Index (HDI) India ranked at 132. At rank 132, India also lags behind war ravaged Congo,
- ❖ Botswana, and Bolivia. Another neighbour Sri Lanka has been devastated by war for over two decades still lags in at 104 -28 rungs above India. Vietnam clocks in at 114 and China at 94.
- ❖ While the country ranked amongst the first three developing countries, on the indicator for social protection, because of poor implementation over 30 million Indians have joined the ranks of hungry since mid 1990s, the study revealed.
- ❖ In 1981, 84% of China's population was below the poverty line of \$1.25 a day (in 2005 prices); in 2005 the share was just 16%
- ❖ Brazil's share of those in poverty fell by half from 17% to 8%, an annual reduction of 3.2%.
- ❖ India did least well, cutting the share below the poverty line from 60% to 42% between 1981 and 2005. This implies an annual reduction of 1.5% a year, though there are problems with Indian statistics;

POVERTY & FINANCIAL EXCLUSION-INCLUSION CYCLE

- ❖ 61% of rural population lives in un-banked areas. Thus a majority are excluded from the formal financial system.
- ❖ Only 7.61% of Gross Bank Credit is lent to rural India and Rural Bank Deposits constitute 9.23%
- ❖ NSSO survey revealed that nearly 40% of farmers would like to quit farming, if they have the option to do so. There has been large scale migration to urban areas where they neither have the survival skills nor a distinctive competence.
- ❖ Financial exclusion is the experience of poverty which affects people who have low incomes, and who may have no access to affordable credit, bank accounts, savings, insurance cover or access to important debt advice. As estimated by RBI that over 60% people in India are financially excluded.
- ❖ Exclusion could occur when products are unaffordable – (Pricing issues)
- ❖ Exclusion could occur when clients cannot be reached easily and at low transaction costs;

INITIATIVES OF RBI FOR FINANCIAL INCLUSION IN INDIA

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.

General Purpose Credit Card (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 Rs.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 centres: 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 centres.

Road map for providing banking services in unbanked villages with a population of more than 2,000: Banks were advised to draw up a road map to provide banking services in every unbanked village having a population of over 2,000 by March 2012. RBI advised banks that such banking services need not necessarily be extended through a bricks and mortar branch, but could also be provided through any of the various forms of ICT-based models. About 73,000 such unbanked villages were identified and allotted to various banks through state-level bankers' committees.

Financial inclusion plans of banks for three years: RBI advised all public and private sector banks to submit a board-approved, three-year financial inclusion plan (FIP) starting April 2010. These plans broadly include self-set targets in respect of rural bricks and mortar branches opened; BCs employed; coverage of unbanked villages with a population above 2,000 as also other unbanked villages with population below 2,000 through branches; BCs and other modes; no-frills accounts opened, including through BC-ICT; KCCs and GCCs issued; and other specific products designed by them to cater to the financially excluded segments.

LONG WAY TO GO

As indicated above, while India has made enormous strides towards greater financial inclusion, there is a long way to go, about 500,000 villages are yet to be provided with banking services. The financial inclusion for the underprivileged will lead to hosts of downstream opportunities with an estimated 500,000 jobs for the participants to work as BCs at remote villages. Crisil Inclusix, an index to measure the progress of financial inclusion across the country, shows that India still has a long way to go to ensure that its 1.2 billion population gets access to banking services. For instance, in rural areas, against a population of 830 million, there are only 210 million savings bank accounts.

In a networked India in which banking services are extended to all villages, ultimately, a so-called model will emerge where customers will have the option to transact with the bank of their choice in any village by using UID (unique identity)-enabled micro-ATMs (automated teller machines), reducing the dependence on cash and lowering transaction costs. The task is gigantic, but definitely achievable 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 the BC model is highly dependent on the kind of support provided by base branches, especially for cash management, documentation and redressal 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.
- ❖ As mentioned earlier, 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.
- ❖ Banking technology has progressed fast enough and more importantly the realization that the poor is bankable has arrived. The government of India should implement immediate measures or which are under implementations but should be executed in a more effective and efficient manner.

RECOMMENDATIONS AND POLICY CHOICES

Twenty One Steps for Twenty First Century Financial Inclusion

There are Twenty One recommendations and policy choices for successful financial inclusion for inclusive growth in India.

Step 1: A New Financial Architecture to Suit the Needs of Inclusive Growth

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 present system which was enshrined in the late 70s greatly needs a rigorous relook.

Step 2: Coordination with UIDAI

Government of India's ambitious programme of issuance of multi-purpose Unique Identity Cards by UIDAI should be of great help for achieving financial inclusion. There needs to be proper systematic coordination with UIDAI in order to make the best use of it for the purpose for financial inclusion.

Step 3: Formation of National Financial Inclusion Mission

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.

Step 4: Involvement of Education Sector for furthering 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.

Step 5: Establishment of Financial Counseling Centres

Financial Inclusion drive should not be short-lived; instead a systematic effort should be structured by establishing FCCs (Financial Counseling Centres) on the lines of e-Seva centres in Andhra Pradesh for providing financial services.

Step 6: Building Client Capacities

As the saying goes “teach him to fish instead of giving him fish”, it should be the effort of all the concerned (particularly the financial institutions) to develop these poor people as prospective customers. Building client capacities would definitely help all the stakeholders and would to a vibrant financial system.

Step 7: Partnership with Dedicated NGOs and MFIs

Partnering with trustworthy and acclaimed people's organisations would definitely accelerate the process of financial inclusion especially in the rural areas. Specific financial as well as non-financial incentives have to be designed for the spirited involvement of such organizations.

Step 8: Financial Inclusion as a Part of Course Curriculum in High Schools

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.

Step 9: Digitise the Documentation Process for Opening of Bank Accounts

One of the often stated reasons for slow pace of financial inclusion has been the hassles involved in opening of bank accounts and availing 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.

Step 10: Strategize the Provision of Bank Credit

Need is felt to strategize the provision of bank credit to the rural farmer households. 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.

Step 11: Exclusive Focus on the Socially Excluded and the Poor

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.

Step 12: Extensive use of Co-operatives

PACS (Primary Agricultural Cooperative Societies) could provide valuable services to their members with a sense of belongingness. Accordingly, there is a need to revitalize these cooperatives as per the Vaidyanathan Committee recommendations and use them extensively for financial inclusion in the rural areas.

Step 13: Undoubtedly a Greater Role for NABARD

NABARD has to play a pro-active role by partnering with the rural credit institutions in the field and identify new initiatives that will contribute to effectively improving the extent of financial inclusion involving SHGs, MFIs, etc.

Step 14: Procedural / Documentation Changes

It is inevitable on the part of the regulators to find out an easy way of procuring the documents for opening of bank accounts and availing loans. The present guidelines are more tedious and result in huge costs for the poor in accessing the banks for any kind of services. Simplifying Mortgage Requirements, Exemption from Stamp Duty for Loans to Small and Marginal Farmers, Saral Documentation for Agricultural Loans.

Step 15: Proactive Role of Government

State Governments should be asked by the Central Government to play a proactive role in facilitating Financial Inclusion. Issuing official identity documents for opening accounts, creating awareness and involving district and block level functionaries in the entire process, meeting cost of cards and other devices for pilots, undertaking financial literacy drives are some of the ways in which the State and district administration have involved themselves.

Step 16: A Role for Rural Post Offices

Post Offices in rural areas can be asked to provide their services in accelerating the financial inclusion activity. In view of the postman's intimate knowledge of the local population and the enormous trust reposed in him post offices can be good use in the process of financial inclusion

Step 17: Effective Use of Information Technology Solutions

The use of IT enables banks to handle the enormous increase in the volume of transactions for millions of households for processing, credit scoring, credit record and follow up. The use of IT solutions for providing banking facilities at doorstep holds the potential for scalability of the Financial Inclusion initiatives.

Step 18: Adequate Publicity for the Project of Financial Inclusion

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.

Step 19: Financial Inclusion as a Corporate Social Responsibility of all the Banks and Financial Institutions

It should be the endeavour of all the financial institutions to adopt financial inclusion as a corporate social responsibility and chalk out strategies in tune with the national policy on financial inclusion.

Step 20: Role of RBI

Reserve Bank needs to take a pro-active role in the accelerating financial inclusion by involving all the stake holders in the financial system by using its power of moral suasion as well as regulatory powers.

Step 21: Political Will

Political will is an all important aspect in any developmental effort. Political leadership should accord adequate importance for financial inclusion in order to motivate and mobilise all the weaker sections of the society in favour of financial inclusion for their economic upbringing.

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. Our dream of inclusive growth will not be complete until we create millions of micro-entrepreneurs across the country. All budding entrepreneurs have to face these challenges and find solutions. People working in the social sector should work for filling up the deficit existing in the economic and social arena. 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. Inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process. Further, the real rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. 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.

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