

Financial Inclusion's Role in Equitable Growth

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Abstract

India has seen historic progress and growth in the past decade. While the growth story has been impressive, there are causes for concern on other dimensions. We have a long way to go in addressing concerns of absolute poverty. Low-income Indian households in the informal or subsistence economy often have to borrow from friends, family or usurious moneylenders. They have little awareness and practically no access to insurance products that could protect their financial resources in unexpected circumstances such as illness, property damage or death of the primary breadwinner.

Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players. Financial inclusion has become one of the most critical aspects in the context of inclusive growth and development. An attempt is made to measure role of financial Inclusion for equitable growth.

Key Words: Financial Inclusion, Special Agricultural Credit Plans (SACP), Core Banking Solution.

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Introduction to Indian Economy

India is a country with diverse socio-economic condition along with diverse agro climatic situation. The growth trend of the Indian economy over the last few years appears to indicate the beginning of a new phase of higher growth. India is expected to grow 8.6 per cent in 2010-11 and 9 per cent in 2011-12. This makes the country the second-fastest growing large economy after China. And, more than half the population does not have bank accounts. These are two aspects that throw up two contrasting sides of one country — India.

- Total Population in India est. 119,00,00,000
- Total Scheduled Commercial Bank branches 84604
- One SCB branch serves 16000 people

Though few decades ago, our country' economy was agricultural dependent one, now it more of service dependent and growth rate of agriculture is just above 2% and it contributes less than 22% to our country's GDP with 60% of the population depend on agriculture. Further, this development or growth is not an even one, throughout the country, while urban regions are growing at greater rate; rural areas are

still remaining stagnant. Further, the gap between the rich and the poor households keeps on increasing, thereby condition of the poor worsening further. As per the statistical data, around 26% of the population is below the poverty line. Growth potential in SME sector is enormous but limited access to savings, loans, remittance & insurance in rural/ unorganized sector major constraint to growth Financial inclusion is a great step to alleviate poverty also required for sustainable overall economic growth of India. But to achieve

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.

There are a variety of reasons for Financial Exclusion. In remote, hilly and sparsely populated areas with poor infrastructure, physical access itself acts as a deterrent. From the demand side, lack of awareness, low incomes/assets, social exclusion, illiteracy act as barriers. The main reason for financial exclusion is the lack of a regular or substantial income. In most of the cases people with low income do not qualify for a loan. The proximity of the financial service is another fact. The loss is not only the transportation cost but also the loss of daily

wages for a low income individual. Most of the excluded consumers are not aware of the bank's products, which are beneficial for them. Getting money for their financial requirements from a local money lender is easier than getting a loan from the bank. Most of the banks need collateral for their loans. It is very difficult for a low income individual to find collateral for a bank loan. Moreover, banks give more importance to meeting their financial targets. So they focus on larger accounts. It is not profitable for banks to provide small loans and make a profit.

- From the supply side, distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes are common reasons for exclusion. All these result in higher transaction cost apart from procedural hassles. On the other hand, the ease of availability of informal credit sources makes these popular even if costlier. The requirements of independent documentary proof of identity and address can be a very important barrier in having a bank account especially for migrants and slum dwellers. Thus the above barriers

should be overcome and reaching out to the people lying at the bottom of the pyramid has become the order of the day. So the financial sector is one that has the most important role to play in unleashing this potential and there by comes the role of Financial Inclusion.

Financial Inclusion – Indian Story

The story thus far,

- Out of 6,00,000 habitations only 30,000 have commercial bank branch
- Only 40% of population across country have bank accounts
- Out of the above many are dormant accounts
- Proportion of people with life insurance 10%
- Proportion of people with non life insurance 0.6%
- People with debit cards 13%
- People with credit cards 2%
- 51% of 90 million house-holds did not have credit from institutional/non-institutional sources
- Only 27% had credit from formal financial sources

Who are excluded

Marginal farmers – landless labour – oral lessees – self employed – unorganized sector – urban slum dwellers – migrants – ethnic minorities – socially excluded groups – senior citizens – women – NER, Eastern & Central regions most excluded

(Deposits , Loans , Remittances, Insurance)

- Affordable for the poorest of poor
- Enables beneficiaries of Govt. welfare schemes to enjoy timely payment

What is Inclusive Growth?

- Equal Growth Opportunities rather than skewed at the top
- No Geographical/cast/communal/gender barriers
- Reduction in poverty & disparities of income
- Ensuring basic minimum standard of living (education, health, finance, housing, employment etc.)
- Financial Empowerment

Financial Inclusion

Financial Inclusion is a

- Measures to ensure each house-hold/individual is financially literate
- Each house-holds/individual (urban/rural poor) have access to banking system

RBI is Committed to Make Financial Inclusion :A Success For Inclusive Growth of India

Finance Minister Pranab Mukherjee had last year directed banks to provide appropriate banking facilities to all habitations that have population in excess of 2,000 by March 2012. Banks have, through State-level Banker Committees (SLBCs), formulated their road maps for financial Inclusion and identified approximately 73,000 habitations with population of more than 2000. Financial Inclusion (FI) has been on RBI's policy priority as FI is seen as a tool for inclusive growth ensuring equality of opportunity for all. The focus has been in facilitating the process that a range of appropriate financial products and services is available to underprivileged sections at an affordable cost broad strategy for achieving planned, sustained and structured Financial Inclusion? It is through a planned approach

to the entire gamut of issues whose detailed steps are enumerated below:

1. RBI advised banks to formulate a board approved Financial Inclusion Plan (FIP) for the next three years, not imposing a uniform model so that each bank is able to build its own strategy in line with its Business Model and comparative competitive advantage. Banks have been advised to ensure universal financial inclusion in all villages having a population above 2000 by March 2012 through some form; either a brick and mortar branch or through any of the various ICT-based models.
2. FIPs must be integrated with the normal Business Plans of the banks. RBI has freed interest rates and have also allowed banks to charge their customers for other transactions. RBI believe that banking to the poor is a viable business opportunity but a cost-benefit analysis needs to be done by the banks to make Financial Inclusion congruent with their Business Models. Banks must view Financial Inclusion as a viable Business Model.
3. Banks must view Financial Inclusion as a huge business opportunity and perfect their Delivery Models. BC based delivery model has been made more flexible and inclusive.
4. For effective implementation of the Financial Inclusion strategies, banks must fix technology aspects first including completion of Core Banking Solution (CBS) in all their branches and those of sponsored RRBs, and seamless integration of front-end devices with the back-end systems. Without this, it would not be possible to scale up the activities.
5. There is a need to increase the bouquet of products currently being offering a minimum of four products to the account holder, viz:
 - A savings cum overdraft account
 - A pure savings account, ideally a recurring or variable recurring deposit
 - A remittance product to facilitate EBT and other remittances, and
 - Entrepreneurial credit products like a General Purpose Credit Card(GCC) or a Kisan Credit Card (KCC)

Apart from these minimum basic products, banks can offer any other product like insurance, mutual funds, etc. to the account holders.

6 On the issue of coverage , RBI has clarified that for a village to be considered covered by banking services, either a bank branch has to be present or a BC has to be visiting/present in that village. There must be a bifurcation between villages with more than 2000 population and those with less than 2000 population. The plan needs to cover in an integrated manner both categories of villages. The name of the BC / branch covering a particular village needs to be indicated on the banks website.

7 Special focus on Financial Inclusion at Urban and Metro centers through a functional approach.

8 RBI's efforts have been to remove all regulatory bottlenecks for facilitating greater Financial Inclusion. Pricing has also been made free.

RBI has been very strong in promoting FI. By 2012, all villages with population more than 2000 will have access to financial services through a banking outlet of any one bank. Each Bank to have a board approved policy for rolling out Financial Inclusion.

All banks have been urged to include criteria regarding financial literacy and financial inclusion in performance evaluation of their field staff.

Financial inclusion Phases and Steps Taken

Process of financial inclusion: Phases wise

Phase 1: 1950-70: Consolidation of the Banking sector & Facilitation of Industry and Trade

Phase 2:1970-90: Focus on channeling of credit to neglected sectors and weaker sections

Phase 3: 1990-2005: Focus on Strengthening the financial institutions as part of financial sector reforms

Phase 4:2005 onwards: Financial Inclusion was explicitly made as a policy objective

- Co-operative Movement The Reserve Bank has made a commitment to bank-led model of financial inclusion and will support banks in their financial inclusion initiatives by way of information dissemination, sharing of best practices and also through regulatory incentives

- Setting up of State Bank of India
- Nationalisation of banks
- Lead Bank Scheme- the lead bank in each district has been asked to draw a roadmap by March 2010 for ensuring that all villages with a population of over 2,000 will have access to financial services through a banking outlet, not necessarily a bank branch, by March 2011.
- RRBs
- Service Area Approach
- From 1994-95, public sector banks in India have been formulating Special Agricultural Credit Plans (SACP) with a view to achieve distinct and marked improvement in credit flow to agriculture
- The Kisan Credit Card (KCC) scheme was introduced from 1998-99
- Credit innovations like micro finance have also evolved as socially significant and commercially attractive models of credit delivery
- The early 1990s saw the emergence of the Self Help Group concept -
- The pilot programme started by NABARD in 1992 and actively supported by the

The Reserve Bank has encouraged banks to use IT-enabled financial inclusion by leveraging on the smart cards/mobile technology. Business Correspondents of banks are making extensive use of hand held devices/mobile phones to reach banking services to remote villages, and especially for Electronic Benefits Transfer of NREGA wages and social security payments. This has been very successful in Andhra Pradesh, and a state-wide project has recently been kicked-off in Orissa. In addition, pilot projects are underway in most states of the country.

Steps Taken by RBI- Credit Delivery Focus

Reserve Bank saw the banks taking a key interest in promoting the programme The SHG- Bank linkage programme has so far become the largest microfinance programme in the country Banks were allowed to open savings accounts for Self Help Groups (SHGs), which were neither registered nor regulated. An SHG is a group of 15 to 20 members from very low income families, usually women, which mobilises savings from members and uses the pooled funds to give loans to those members who need them,

with the interest rates on deposits and loans being determined entirely by members. National Bank for Agriculture and Rural Development (NABARD) launched the SHG-Bank Linkage Program in 1992 to forge the synergies between formal financial system and informal sectors. Under this programme, banks provide loans to the SHGs against group guarantee and the quantum of loan could be several times the deposits placed by such SHGs with the banks. The recovery rates of such loans have been good and banks have found that the transaction cost of reaching the poor through SHGs is considerably lower as such cost is borne by the SHG rather than the bank. Interest earned from group members is retained in the group. The penetration achieved through SHGs has been very significant. As per NABARD's report on status of microfinance (2008-09), about 86 million poor households are covered under the SHG-Bank Linkage program with over 6.1 million saving-linked SHGs and 4.2 million credit-linked SHGs as on March 31, 2009. SHGs were having savings bank accounts with the banking system of which the commercial banks had the maximum share (56.0 per cent) followed by the RRBs (28.0 per cent) and cooperative banks (16.0 per cent)

RBI-Other Measures

The Annual Policy Statement for the year 2005-06 that the Bank would implement policies to encourage banks, which provide extensive services while dis-incentivising those, which are not responsive to the banking needs of the community, including the underprivileged

Banks were urged to review their existing practices to align them with the objective of financial inclusion

- **No-Frill Accounts:** In November 2005, RBI asked banks to offer a basic banking 'no-frills' account with low or zero minimum balances and minimum charges to expand the outreach of such accounts to the low income groups
- **Overdraft in Saving Bank Accounts**
- **Relaxed KYC Norms** In order to ensure that people belonging to the low income groups, both in urban and rural areas, do not encounter difficulties in opening bank accounts, the 'Know Your Customer' (KYC) procedure for opening accounts was simplified for those accounts with balances not exceeding Rs 50,000 and credits

thereto not exceeding Rs.100,000 in a year.

- **EBT Through Banks:** The Reserve Bank is in consultation with state governments to encourage them to adopt Electronic Benefit Transfer (EBT) by banks.
- **BC / BF Model** - Possibly the most important initiative of the Reserve Bank has been the Business Correspondent (BC) model. The BC model ensures a closer relationship between poor people and the organized financial system. From Jan 2006 banks were permitted to utilise the services of intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models
- A Working Group constituted to examine the experience of date of the BC model and suggest measures, to enlarge the category of persons that can act as BCs, keeping in view the regulatory and supervisory framework and consumer protection issues

Steps Taken by RBI-Other Measures

- **Liberalised Branch Expansion** 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
- **Introducing technology products and services** Pre-Paid cards, Mobile Banking etc. **Use of Information Technology:** Banks have been urged to scale up IT initiatives for financial inclusion speedily while ensuring that solutions are highly secure, amenable to audit, and follow widely-accepted open standards to ensure eventual inter-operability among the different systems. Two of the important initiatives are:
 - **Smart cards** for opening bank accounts with biometric identification. These help the customers get banking services near their doorstep.
 - **Link to mobile** hand held electronic devices for banking transactions. In October 2008, the RBI advised banks on issues relating to technology, security standards, and customer protection.

- Allowing RRBs' / Co-operative banks to sell Insurance and Financial Products
- Financial Literacy Programs have advised the convenor-bank of each State Level Bankers' Committee to set up a financial literacy-cum-counselling centre in any one district on a pilot basis, and based on that experience, to extend the facility to other districts in due course. So far, 154 credit counselling centres have been set up in various states of the country. These centres are expected to provide free financial education to people in rural and urban areas on the various financial products and services, while maintaining an arm's-length relationship with the parent bank.
- Creation of Special Funds
- 100% Financial Inclusion - The Reserve Bank launched a financial inclusion drive targetting one district in each state for 100% financial inclusion. In the light of the

experience gained, coverage has been extended to other areas/districts. So far, 431 districts have been identified by SLBCs for 100 per cent financial inclusion As on March 31, 2009, 204 districts in 18 States and 5 Union Territories have reported having achieved the target.

To sum up

We have come a long way, especially for a country with a very high population and diverse geographical, cultural barriers. Unless we seriously pursue the literacy programs we cannot create awareness & stimulate demand. Govt. has to take measures to revive Real sectors of economy. From the supply side, we have to constantly improvise & leverage technology to reduce costs. Basic infrastructure such as power & communication should be spruced up. Banking sector has the target of inclusive growth through the effective tool of financial inclusion. In near future, it is a win-win for all stakeholders & the ultimate catalyst for real economic growth.

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