FINANCIAL INCLUSION: CONCEPTS AND OVERVIEW IN INDIAN CONTEXT

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ABSTRACT

Financial inclusion plays a major role in driving a way the poverty from the country. Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. The main focus of financial inclusion in India is to promote sustainable development and generating employment in rural areas for the rural population. Financial inclusion is a critical for achieving inclusive growth in the country. The objective of this study is to discussed about the conceptual aspects of financial inclusion, point out the reasons for financial exclusion, highlight the measures taken by Reserve Bank of India for promoting financial inclusion and the role of banks towards financial inclusion. The present study is based on secondary data collected from different publications, journals, and news paper and websites. Government of India and Reserve Bank of India has taken various initiatives like opening of no-frills accounts, relaxation on know-your-customer norms, engaging business correspondents for promoting financial inclusion.

Key words: Financial Inclusion; Inclusive Growth; No Frill Accounts; Knows Your Customer Norms

INTRODUCTION

Financial inclusion is a buzzword now and has attracted the global attention in the recent past. In India, it is a new concept. More than 70% of our population lives in the rural areas. Financial inclusion is a necessity for a country where a large chunk of the world’s poor resides. Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction, employment, economic growth 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 and there by facilitate them to break the chain of poverty. Financial inclusion refers to a process that ensures the ease of access, availability and usage of the formal financial system for all members of an economy. An inclusive financial system has several merits. It facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. In addition, access to appropriate financial services can significantly improve the day-to-day management of finances.

The financial inclusion emphasizes on conversion of unbanked area into banked one. Having a bank account does not mean financial inclusion. Financial inclusion is the process of ensuring access to appropriate financial products and services needed by all section of society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost and in a faire and transparent manner by regulated mainstream institutional players. Financial inclusion is a critical for achieving inclusive growth in the country. It can help in reducing the growth of informal sources of credit (such as money lenders), which are often found to be exploitative. Thus, an all-inclusive financial system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services.
An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. This system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services like easy day to-day management of finances, safe money transfer etc. The govt. of India as well as the banking industry has recognized this imperative and has undergone fundamental changes over the last two decades. In fact, in order to address the issues of financial inclusion, the Government of India constituted a “Committee on Financial Inclusion” under the Chairmanship of Dr. C. Rangarajan. Not only in India, but financial inclusion has become an issue of worldwide concern, relevant equally in economics of the underdeveloped, developing and developed nations. Building an inclusive financial sector has gained growing global recognition bringing to the fore the need for development strategies that touch all lives instead of a select few.

LITERATURE REVIEW

Mandira Sarma, Jesim Pais, Sept 2008”Financial inclusion and Development: Across country Analysis” they find out that level of human development and that of financial inclusion are strongly positively correlated, income as measured by per capita GDP is an important factor in explaining the level of financial inclusion in a country. they find that income inequality, adult literacy and urbanization are also important factors.

Prof. N.S Rao, Mrs. Harshita Bhatnagar,”Vol 5, issue3, Sept 2012, Financial Inclusion: Issues and Prospects” they found out that that financial inclusion shows positive and beneficial changes because of intensity change and technology changes.

Josiah Aduda and Elizabbath Kalunda Vol 2, no6, 2012 , “Financial Inclusion and Financial Sector Stability With Reference To Kenya: A Review of Literature” This paper studied that enhanced measures of financial inclusion which include both access and usage should be applied, since access and usage are not the same but supplementary. Informal financial services should also be included as they play a big role in developing countries.

OBJECTIVES OF THE STUDY

1. To discuss about the conceptual aspects of financial inclusion
2. To point out the reasons for financial exclusion.
3. To highlight the measures taken by RBI for promoting financial inclusion

METHODOLOGY OF THE STUDY

Secondary research was conducted to review the present status of financial inclusion in India. The data was collected through secondary sources i.e. published articles, journals, reports, books and websites

Financial Inclusion - An Overview

Financial Inclusion is 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 and in a fair and transparent manner by regulated mainstream institutional players. Simply mean, Financial Inclusion is delivery of basic banking services at an affordable cost to the vast sections of disadvantaged and low income groups. It includes access to formal financial system such as financial institutions, markets and instruments, like savings, loans, remittances and insurance services, at affordable prices.

A committee on financial inclusion was formed under the chairmanship of C.Rangarajan and the committee 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”

The United Nations defines the goals of financial inclusion are:
access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance;

sound and safe institutions governed by clear regulation and industry performance standards;

financial and institutional sustainability, to ensure continuity and certainty of investment; and

Competition to ensure choice and affordability for clients.

Services Extended through ‘Financial Inclusion’

Financial products and services provided to the people through financial inclusion are:

- Service facility
- Overdraft facility
- Payment and remittance services
- Low cost financial services
- Cheque facility
- All kinds of commercial loan
- Electronic fund transfer
- Credit and Debit Cards access
- Access to financial markets
- Financial advice
- Insurance (Medical insurance)
- Micro credit during emergency
- Entrepreneurial credit

Figure 1. An overview of Financial Inclusion Services

Reasons for “Financial Exclusion”

Financial exclusion is a serious concern among the low-income households as well as small businesses, mainly located in semi-urban and rural areas. It is the unavailability of banking services to people living in poverty. According to K. C. Chakraborty “Financial Exclusion” is the lack of access by certain consumers to appropriate, low cost, fair and safe financial products and services from mainstream providers”. There are 3 types of exclusions: (a) people who do not have any access to a
regulated financial system; (b) people who have limited access to banks and other financial services; and (c) individuals who have inappropriate products.

Figure 2. An overview of financial exclusion

Financial exclusion can make poor people vulnerable to loan sharks. It breeds poverty and hinders overall development of a country. It not only widens the “Rich-Poor divide”, it also leads to “Social exclusion”. There are a variety of reasons for financial exclusion. The reasons are:

- Lack of banking facility in the locality (i.e. geographical exclusion including a rural-urban divide);
- Financial illiteracy;
- Nonchalant attitude of the staff;
- Cumbersome documentation and procedures;
- Unsuitable products;
- Language;
- Feeling uncomfortable by a section of population in visiting a bank branch;
- Lack of awareness and initial inhibitions in approaching a formal institution;
- Low incomes/assets;
- Distance from branch and branch timing;
- Fear of refusal.

Who are financially excluded?

The financially excluded sections generally are:

- Marginal farmers;
- Landless labourers;
- Oral lessees;
- Urban slum dwellers;
- Migrants;
- Self-employed and unorganized sector enterprises;
- Ethnic minorities and socially excluded groups;
Senior citizens and women.

Financial Inclusion In India

In India, the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills, to all. Out of 19.9 crore households in India, only 6.82 crore households have access to banking services. As far as rural areas are concerned, out of 13.83 crore rural households in India, only 4.16 crore rural households have access to basic banking services. In respect of urban areas, only 49.52% of urban households have access to banking services. Over 41% of adult population in India does not have bank account.

The Reserve Bank of India (RBI) set up the 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 India, financial inclusion first featured in 2005, when it was introduced by K.C. Chakraborthy, the chairman of Indian Bank. Mangalam became the first village in India where all households were provided banking facilities.

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.

The Reserve bank asked the commercial banks in different regions to start a 100% financial inclusion campaign on a pilot basis. As a result of the campaign, states or union territories like Puducherry, Himachal Pradesh and Kerala announced 100% financial inclusion in all their districts.

Reserve Bank of India has planned Aadhaar-linked bank accounts for all adults of India by January 2016 to meet its commitment on financial inclusion. It will greatly transform India by preventing the poor people falling into debt-traps of unlawful money-lenders, cashless transactions, elimination of poverty and corruption.

Reserve Bank of India’s vision for 2020 is to open nearly 600 million new customers’ accounts and service them through a variety of channels by leveraging on IT. However, illiteracy and the low income savings and lack of bank branches in rural areas continue to be a roadblock to financial inclusion in many states and there is inadequate legal and financial structure.

The RBI recently came up with a State-wise Index of Financial Inclusion. In an Index of Financial Inclusion, India has been ranked 50 out of 100 countries. At present, only 34% of the India’s population has access to basic banking services.

The latest National Sample Survey Organization survey reports that there are over 80 million poor people living in the cities and towns of India and they lack access to the most basic banking services.

Major Milestones in Financial Inclusion in India

1969 Nationalization of Banks
1971 Establishment of Priority sector Lending Banks
1975 Establishment of Regional Rural Banks
1982 Establishment of NABARD
1992 Launching of the Self Help Group Bank Linkage Programme
1998 NABARD sets a goal for linkage one million SHG by 2008
2000 Establishment of SIDBI foundation for microcredit
2005  One million SHF linkage target achieved three years ahead of date 2006 committee on financial inclusion

2007  Proposed bill on Micro Finance Regulation introduced in Parliament

2008  Committee submitted its final report on Financial Inclusion to Union Finance Minister in January

RBI Initiatives for Financial Inclusion

- **Opening of no-frills accounts**: Basic banking no-frills account is with nil or very low minimum balance as well as charges that make such accounts accessible to vast sections of the population.

- **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.

- **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.

- **Use of technology**: 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.

- **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 centers 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 centers without the need to take permission from RBI in each case, subject to reporting.

- **Opening of branches in unbanked rural centers**: 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 centers.

Financial Inclusion Index

The index of financial inclusion is a measure of inclusiveness of the financial sector of a country. It is constructed as a multidimensional index that captures information on various aspects of financial inclusion such as banking penetration, availability of banking services and usage of the banking system. The IFI incorporates information on these dimensions in one single number lying between 0 and 1, where 0 denotes complete financial exclusion and 1 indicates complete financial inclusion in an economy.
State Wise Index of Financial Inclusion

Source: RBI working paper on Financial inclusion in India ; A case study of West Bengal (2010)

Financial inclusion index values was used this RBI working paper, based on that Indian states can be classified into three categories i.e. states having high, low, and medium extend of financial inclusion. According to empirical results, Kerala, Maharashtra and Karnataka having wider extend of financial inclusion as compared to other states of India. The extent of financial inclusion is found to be significantly low in North-Eastern and Eastern states i.e. Assam, Bihar, Gujarat, Manipur, Meghalaya etc.

On June 25, 2013, CRISIL, India’s leading credit rating and research company launched an index to measure the status of financial inclusion in India. CRISIL Inclusix is India’s most comprehensive financial inclusion index. CRISIL Inclusix is a relative index on a scale of 0 to 100, and combines three critical parameters of basic banking services branch penetration, deposit penetration, and credit penetration into one metric. Some key points are:-

1. The all-India CRISIL Inclusix score of 40.1 is low, though there are clear signs of progress—this score has improved from 35.4 in 2009.
2. Deposit penetration is the key driver of financial inclusion—the number of savings accounts (624 million), is almost four times the number of loan accounts (160 million).
3. 618 out of 632 districts reported an improvement in their scores during 2009-2011.
4. The top three states and Union Territories are Puducherry, Chandigarh, and Kerala; the top three districts are Pathanamthitta (Kerala), Karaikal (Puducherry), and Thiruvananthapuram (Kerala).

CONCLUSION

Financial inclusion is the road which India needs to travel towards becoming a global player. An people invest and save more and more will remove vicious circle of poverty and unemployment, it also act as a source of empowerment, better control of finance and allow people to participate more effectively in the economic and social process thereby increase per capita income. More financial access will attract more global market players to our country that will result in increasing employment and business opportunities. There are certain problems like lower financial literacy, lack of awareness, the cost of transaction and customer acquisition is high and it is not at all cost-effective. RBI has taken various initiatives to strengthen financial inclusion. Information and communication technology offers the opportunity for the banks to improve financial inclusion for the unbanked people.
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