Financial Inclusion and Indian Banking System – The way ahead

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Abstract: 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 in a fair and transparent manner by mainstream institutional players. In other words, financial inclusion is the availability of banking services at an affordable cost to disadvantaged and low-income groups. In India the basic concept of financial inclusion is having a saving or current account with any bank. In reality it includes loans, insurance services and much more. The importance of an inclusive financial system is widely recognized in policy formulation and recently financial inclusion has become a policy priority in many countries. Initiatives for financial inclusion have come from the financial regulators, the governments and the banking industry. Legislative measures have been initiated in some countries. AmartyaSen (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 channelling the financial resources towards the economic upliftment 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.

Keywords*:* Inclusive Growth & Financial Inclusion, Financial Exclusion, RBI, Economic Growth.

Introduction

India is one of the largest and fastest growing economies of the world, but what has been the most disturbing fact about its growth is that its growth has not only been uneven but also discrete. It has been uneven in the sense that there has been no uniformity in its growth performance and it has been discrete and disconnected with regard to growth and distribution of growth benefits to certain sectors of economy. The Indian economy, though achieved a high growth momentum during 2003-04 to 2007-08, could not bring down unemployment and poverty to tolerable levels. Further, a vast majority of the population remained outside the ambit of basic health and education facilities during this high growth phase. In recent decades, economic and social inequalities have increased alongside high growth rates which have increased regional inequalities. Over 25% of Indians continue to live in abject poverty. As a result, Inclusive growth has become a national

policy objective of the Union Government. And thus the need for inclusive growth comes in the picture of Indian economic development. In context of Indian growth planning it is a relatively new terminology which got the attention of policy makers in the Eleventh Five Year Plan.

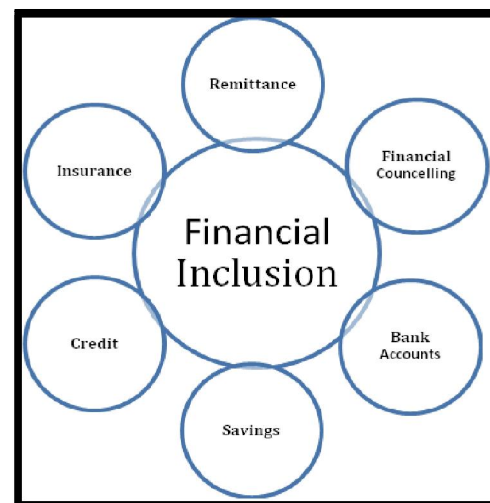
The history of financial inclusion in India is actually much older than the formal adoption of the objective. The nationalization of banks, Lead Bank Scheme, incorporation of Regional Rural Banks, Service Area Approach and formation of Self-Help Groups - all these were initiatives aimed at taking banking services to the masses. The brick and mortar infrastructure expanded; the number of bank branches multiplied ten-fold - from 8,000+ in 1969, when the first set of banks were nationalized, to 99,000+ today. Despite this wide network of bank branches spread across the length and breadth of the country, banking has still not reached a large section of the population. The extent of financial exclusion is staggering. Out of the 600,000 habitations in the country, only about 36,000+ had a commercial bank branch. Just about 40 per cent of the population across the country has bank accounts. The proportion of people having any kind of life insurance cover is as low as 10 per cent and proportion having non-life insurance is abysmally low at 0.6 per cent. People having debit cards comprise only 13 per cent and those having credit cards only a marginal 2 per cent of the population.

A more focused and structured approach towards financial inclusion has been followed since the year 2005 when Reserve Bank of India decided to implement policies to promote financial inclusion and urged the banking system to focus on this goal. Our focus has, specifically, been on providing banking services to all the 600 thousand villages and meeting their financial needs through basic financial products like savings, credit and remittance.The objectives of financial inclusion, in the wider context of the agenda for inclusive growth, have been pursued through a multi-agency approach.

By financial inclusion, we mean the delivery of financial services, including banking services and credit, at an affordable cost to the vast sections of disadvantaged and low-income groups who tend to be excluded. The various financial services include access to savings, loans, insurance, payments and remittance facilities offered by the formal financial system.

Rangarajan Committee (2008) viewed 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” In simpler terms financial inclusion is about including the excluded in the financial system of the country, and to ensure that their financial & social security needs are taken care of through appropriate financial service providers. Given below is the diagram which briefly describes the essential contents of financial inclusion:

Figure No.1 Contents of Financial Inclusion



Source : Rangarajan Committee Report

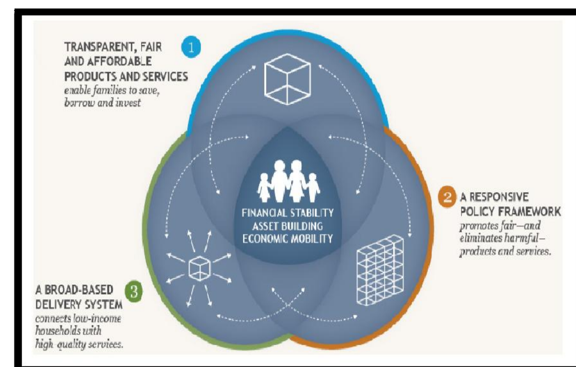
Rangarajan's committee on financial inclusion defines it as, the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. By financial inclusion we mean the provision of affordable financial services, viz., access to payments, remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded. It is important to recognize that in the policy framework for development of the formal financial system in India, the need for financial inclusion and covering more and more of the excluded population by the formal financial system has always been consciously emphasized. Bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. The rationale for creating Regional Rural Banks was also to take the banking services to poor people.

Role of Financial Inclusion

Financial Inclusion is imperative for inclusive growth of India, with more than 25 % of its population living in abject poverty government's onus towards their growth and development is huge, and inclusive finance is one such measure which if targeted and attained in right manner will provide an apt solution to the severe problems of poverty and unemployment. Providing access to financial services has significant potential to help lift the poor out of the cycle of poverty. Financial inclusion promotes thrift and develops culture of saving and also enables efficient payment mechanism strengthening the resource base of the financial institution which benefits the economy as resources become available for efficient payment mechanism and allocation.

Poors are typically more vulnerable to financial exclusion this is simply because their major problems arise from the need for finances. The formal banking services, by exploiting economies of scale and making judicious use of targeted subsidies may reduce or remove market imperfections and facilitate financial inclusion of the poor, ultimately leading to higher incomes. The access to financial services by poors would lead to their consumption smoothing and investments in health, education and income generating activities, thus expanding growth opportunities for them. Inclusive growth if targeted systematically may lead to financial stability, asset building and economic mobility and empowerment of the low income group people. Following **(Figure.-2)** is the diagrammatic presentation of how inclusive finance can be used for the same.

Figure 2 Dimensional Approaches of Financial Inclusion



Source: Ford Foundation, US Strategies; How High-Quality Financial Services Help Low-Income

The above mentioned diagram clearly prescribes the three dimensional approach which is required for financial inclusion and its outcomes. Thus if we are talking about inclusive growth with stability, it is not possible without financial inclusion. However one need to understand that inclusive finance is a long run phenomenon which can not be achieved overnight, especially with regard to

developing country like India where the access to financial products is constrained by several factors such as lack of awareness, unaffordability, high transaction costs, and inconvenient, inflexible and low quality of products. In the further section of the paper we will try to find out the extent of financial inclusion in India.

Magnitude of Financial Exclusion India

- In India, almost half the country is unbanked.
- Only 55 per cent of the population has deposit accounts and 9 per cent have credit accounts with banks.
- India has the highest number of households (135 million) excluded from Banking.
- There was only one bank branch per 16,000 people.
- In India, there are only 33495 rural branches in around 6 lakh villages.
- Only a little less than 20% of the population has any kind of life insurance
- Just 18 per cent of the population had debit cards and less than 2 per cent had credit cards.

Present Indian Scenario

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. Internationally, the financial exclusion has been viewed in a much wider perspective. Having a current account or savings account on its own is not regarded as an accurate indicator of financial inclusion. Bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. The rationale for creating Regional Rural Banks was also to take the banking services to poor people. The new Branch Authorization Policy of Reserve Bank encourages banks to open branches in these under-banked states and the under-banked areas in other states.

After independence the Government of India (GOI) adopted planned economic development for the country (India). Accordingly, five year plans came into existence since 1951. This economic planning basically aimed at social ownership of the means of production. However, commercial banks were in the private sector those days. In 1950-51 there were 430 commercial banks. The Government of India had some social objectives of planning. These commercial banks failed helping the government in attaining these objectives. Thus, the government decided to nationalize 14 major commercial banks on **19th July, 1969**. All commercial banks with a deposit base over Rs.50 crores were nationalized. It was considered that banks were controlled by business houses and thus failed in catering to the credit needs of poor sections such as cottage industry, village industry, farmers, craft men, etc. The second dose of nationalisation came in **April 1980** when banks were nationalized.

The nationalisation of commercial banks took place with an aim to achieve following major objectives.

1. **Social Welfare** : It was the need of the hour to direct the funds for the needy and required sectors of the Indian economy. Sector such as agriculture, small and village industries were in need of funds for their expansion and further economic development.
2. **Controlling Private Monopolies**: Prior to nationalisation many banks were controlled by private business houses and corporate families. It was necessary to check these monopolies in order to ensure a smooth supply of credit to socially desirable sections.

3. **Expansion of Banking**: In a large country like India the numbers of banks existing those days were certainly inadequate. It was necessary to spread banking across the country. It could be done through expanding banking network (by opening new bank branches) in the un-banked areas.
4. **Reducing Regional Imbalance**: In a country like India where we have a urban-rural divide; it was necessary for banks to go in the rural areas where the banking facilities were not available. In order to reduce this regional imbalance nationalisation was justified:
5. **Priority Sector Lending**: In India, the agriculture sector and its allied activities were the largest contributor to the national income. Thus these were labeled as the priority sectors. But unfortunately they were deprived of their due share in the credit. Nationalisation was urgently needed for catering funds to them.
6. **Developing Banking Habits**: In India more than 70% population used to stay in rural areas. It was necessary to develop the banking habit among such a large population.

The main reason behind financial exclusion is the lack of regular or substantial income which leads to a disqualification for granting a loan. The proximity of the financial service providers and the residence of the unserved people is another fact for financial exclusion. Apart from the above factors the non-awareness of banking products among the persons, easier access to the local moneylenders, stringency of banking norms etc. can also be triggered as a reason for financial exclusion. There is currently a perception that there are a vast number of people, potential entrepreneurs, small enterprises and others, who are excluded from the financial sector, which leads to their marginalization and denial of opportunity for them to grow and prosper. Financial inclusion is not only essential because of its implications for the welfare of citizens but it needs to be stressed that it has to be an explicit strategy for fostering faster economic growth in a more inclusive fashion.

The Government of India has expressed its explicit concern on the issue of overall inclusion in the development process through its various initiatives such as the National Rural Employment Guarantee Scheme, the Bharat Nirman programme, the SarvaShikshaAbhiyan, and the like. A committee on financial inclusion (Chairman: Dr. C. Rangarajan) was also constituted by the Government of India in June 2006 to recommend a strategy to achieve higher financial inclusion in the country. Unlike several central banks, which focus solely on inflation, many developed and emerging economies, including ours, focus also on growth.

Initiatives for financial inclusion in India

The broad strategy for financial inclusion in India in recent years comprisesthe following elements: (i) encouraging penetration into unbanked and backward areas and encouraging agents and intermediaries such as NGOs, MFIs, CSOs and business correspondents (BCs); (ii) focusing on a decentralised strategy by using existing arrangements such as State Level Bankers' Committee (SLBC) and districtconsultative committee (DCC) and strengthening local institutions such as cooperatives and RRBs; (iii) using technology for furthering financial inclusion; (iv) advising banks to open a basic banking 'no frills' account; (vi) emphasis on financial literacy and credit counselling; and (vii) creating synergies between the formal and informal segments.

Extent of Financial Inclusion in India

Several countries across the globe now look at financial inclusion as the means for a more comprehensive growth, wherein, each citizen of the country is able to use his/her earnings as a financial resource that they can put to work to improve their future financial status and simultaneously contribute to the nation's progress. Financial inclusion has always been accorded high importance by the Reserve Bank and Government of India to aid the inclusive growth process for the economy, the history of financial inclusion in India is actually much older than the formal adoption of the objective.

The nationalization of banks, Lead Bank Scheme, incorporation of Regional Rural Banks, Service Area Approach and formation of Self-Help Groups - all these were initiatives aimed at taking banking services to the masses. The brick and mortar infrastructure expanded; the number of bank branches multiplied ten-fold - from 8,000+ in 1969, when the first set of banks were nationalized, to 99,000+ today.

It can be clearly observed from the above given data that there has been tremendous growth in the spread of banking network in the country since 1969. However despite this wide network of bank branches spread across the length and breadth of the country, the extent of financial exclusion in India is staggering.

Table-1 below provides a glimpse of the manifold expansion of bank branches in India with their percentage distribution in rural areas as well.

Table 1 Expansion of Branches in India

BANK BRANCHES

Year	Rural	Semi-Urban	Urban & metropolitan	Total	Rural share (%)
1969	1,833	3,342	3,087	8,262	22
1970	3,063	3,718	3,350	10,131	30
1975	6,807	5,598	6,325	18,730	36
1980	15,105	8,122	9,192	32,419	47
1985	30,185	9,816	11,384	51,385	59
1990	34,791	11,324	13,637	59,752	58
1995	33,004	13,341	16,022	62,367	53
2000	32,734	14,407	18,271	65,412	50
2005	32,082	15,403	20,870	68,355	47
2010	32,554	21,053	34,834	88,441	37
2011	33,813	23,236	36,750	93,799	36
2012	35,653	25,542	38,698	99,884	36

Source: RBI

* Keynote Address by Dr. K. C. Chakrabarty, Deputy Governor, Reserve Bank of India at the BIS-BNMWorkshop on Financial Inclusion Indicators at Kuala Lumpur on November 5, 2012.

Out of the 600,000 habitations in the country, only about 36,000+ had a commercial bank branch. Just about 40 per cent of the population across the country has bank accounts. The proportion of people having any kind of life insurance cover is as low as 10 per cent and proportion having non-life insurance is abysmally low at 0.6 per cent. People having debit cards comprise only 8 per cent and those having credit cards only a marginal 2 per cent of the population*. The idea about the exclusion can be clearly made on the basis of data given in **Table-2,** which talks about the indicators of financial inclusion in India, China, Germany and world.

Table 2: Indicators of Financial Inclusion

S. No	Indicators of Financial Inclusion	India (%)	China (%)	Germany (%)	World (%)
1	Account at a formal financial institution (% age 15+)	35	64	98	50
2	Account at a formal financial institution, female (% age 15+)	26	60	99	47
3	Account at a formal financial institution, income, bottom 40% (% age 15+)	27	47	98	41
4	Account used to receive wages (% age 15+)	8	19	46	NA
5	Account used to receive government payments (% age 15+)	4	7	62	NA
6	Account used to receive remittances (% age 15+)	2	9	17	NA
7	Saved at a financial institution in the past year (% age 15+)	12	32	56	22
8	Saved using a savings club in the past year (% age 15+)	3	2	4	5
9	Loan from a financial institution in the past year (% age 15+)	8	7	13	9
10	Loan from family or friends in the past year (% age 15+)	20	25	9	23
11	Debit card (% age 15+)	8	41	88	NA
12	Credit card (% age 15+)	2	8	36	15

Source: Demirguc-Kunt and Klapper, 2012, NA- Indicates non Availability of Data on the Mentioned Field

Sadhan Kumar Chattopadhyay in a working paper for RBI on Financial Inclusion in India: A case-study of West Bengal, August 2011, has developed an index of financial inclusion **(IFI)**, which is able to capture information on several aspects of financial inclusion in one single number (IFI). In this, he considered three basic dimensions of an inclusive financial system – banking penetration (BP), availability of the banking services (BS) and usage of the banking system (BU). Below given data in **Table-3** shows the State-wise Index of Financial Inclusion, GDP per capita, literacy rate and rate of unemployment in the different states of India.

On the basis of IFI developed it can be clearly identified that which are the states where there is need forincreasing banking penetration (BP) such as Assam, Nagaland, Manipur, Madhya Pradesh, Bihar, etc., as well as the states where there is need for increasing availability of banking services and need to push usage of banking system. Moreover it is felt that there is need of a comprehensive financial inclusion plan for India as a whole along with region specific inclusion plans targeting its typical requirements based on its existing level of financial inclusion.

Table 3: State-Wise Index of Financial Inclusion

State	D1 (Penetration)	D2 (Availability)	D3 (Usage)	IFI	*IFI Rank	**GDP (Per Capita)	**Literacy Rate	Unemployment Rate
High Financial Inclusion (0.5-1)								
Kerala	0.70	0.81	0.28	0.54	1	83,725	93.9	2.5
Maharashtra	0.62	0.29	1	0.53	2	101,314	80.1	2.6
Karnataka	0.72	0.47	0.46	0.53	3	68,374	75.6	2.4
Medium Financial Inclusion (0.3-0.5)								
Tamil Nadu	0.70	0.43	0.38	0.48	4	94,796	80.3	2.1
Punjab	0.45	0.69	0.29	0.45	5	74,606	76.7	1.6
Andhra Pradesh	0.56	0.30	0.41	0.41	6	71,480	67.7	NA
All-India	0.27	0.22	0.55	0.33	7	60,603	74.04	NA
Himachal Pradesh	0.42	0.40	0.18	0.33	8	74,899	83.8	1.3
Sikkim	0.28	0.33	0.34	0.32	9	121,440	82.2	NA
Haryana	0.39	0.50	0.12	0.32	10	108,859	76.6	NA
Low Financial Inclusion (<0.3)								
West Bengal	0.24	0.38	0.23	0.28	11	54,830	77.1	NA
Gujarat	0.32	0.30	0.16	0.26	12	81,400	79.3	0.9
Uttar Pradesh	0.28	0.31	0.15	0.24	13	30,052	71.7	2.2
Meghalaya	0.21	0.28	0.14	0.21	14	52,971	75.5	1.5
Tripura	0.31	0.22	0.08	0.20	15	50,750	87.8	
Orissa	0.26	0.23	0.11	0.20	16	46,150	73.45	2.4
Rajasthan	0.25	0.22	0.12	0.19	17	47,506	67.1	1.4
Arunachal Pradesh	0.20	0.16	0.14	0.17	18	62,213	67	NA
Mizoram	0.13	0.26	0.09	0.16	19	48,591	91.6	NA
Madhya Pradesh	0.18	0.21	0.08	0.16	20	38,669	70.6	2.1
Bihar	0.15	0.24	0.08	0.15	21	23,435	63.8	NA
Assam	0.17	0.17	0.07	0.13	22	33,633	73.2	NA
Nagaland	0.03	0.04	0.07	0.05	23	56,638	82.9	NA
Manipur	0.00	0.01	0.01	0.01	24	32,284	79.8	2.5

Source: Financial Inclusion in India: A Case-Study of West Bengal, 2011**- Census-2011

From the data given in the above table it is quiet evident that the states which have high to medium degree of financial inclusion also account for literacy rates and GDP per capita (per annum) higher than the country's average i.e. 74.04 % & Rs.60,603 respectively, Andhra Pradesh being the only exceptional state to be with medium degree of financial inclusion with literacy rate 67.7 %, less than the country's average.

The way forward

The banks should come out of inhibited feeling that very aggressive competition policy and social inclusion which are mutually exclusive. As demonstrated elsewhere, the mass banking with no-frills etc. can become a win-win situation for both. Basically, banking services need to be "marketed" to connect with large population segments and these may be justifiable promotional costs. The opportunities are plenty:

- In the context of India becoming one of the largest micro finance markets in the world, especially in the growth of women's savings and credit groups and the sustaining success of such institutions which has been demonstrated by the success of SEWA bank in Gujarat, low cost banking is not necessarily an unviable venture or proposition.
- It may be useful for banks to consider franchising with other segments of financial sector such as cooperatives, RRBs etc. so as to extend the scope of financial inclusion with minimal intermediation cost.
- Since large sections of low income groups' transactions are related to deposits and withdrawals, with a view to containing transaction costs, simple to use, cash dispensing and collecting machines akin to ATMs, with operating instructions and commands in vernacular would greatly facilitate financial inclusion of the semi-urban and rural populace.

Conclusion

These days, it is difficult for central bankers like us to stop talking about financial inclusiononce we start, I would nevertheless restrain myself. To sum up, financial inclusion is the road which India needs to travel towards becoming a global player. An inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process. Banks that have global ambitions must meet local aspirations. Financial access will also attract global market players to our country that will result in increasing employment and business opportunities. As we have all recognized, technology is a great enabler and has to act as a ladder to achieve the ultimate goal of providing financial services to the financially excluded. A line of caution here is that in order to serve millions of our poor villagers, what we need is "Technology with a human touch". Banks should, therefore, take extra care to ensure that the poor are not driven away from banking because the technology interface is unfriendly. This requires training the banks' frontline staff and managers as well as Business Correspondents on the human side of banking. Sufficient provisions should be in built in the business model to take care of customer grievances. It can be summarized that the "***The future lies with those who see the poor as their customers***" as commerce for the poor is more viable than the rich.

Undoubtedly the issue of expanding the geographical and demographic reach poses challenges from the viability/sustainability perspectives and appropriate business models are still evolving and various delivery mechanisms are being experimented with by the various government agencies at the central and state level. But somewhere the efforts taken are not good enough to encounter this staggering issue of financial exclusion. Financial literacy and level of awareness continue to remain an issue with regard to usage of financial services/products. It calls for coordination of all the stakeholders like sectoral regulators, banks, governments, civil societies, NGOs, etc. to achieve the objective of financial inclusion. Challenges of financial exclusion are faced by most of the states of the country and in order to solve it states have to develop its own customized solutions drawing upon its own experiences and features and those of its peers across the country.

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