Financial Inclusion in India – An Analysis

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Abstract:

The financial inclusion is meant for to ensure a range of appropriate financial services is available to every individual and enable them to understand and access those services. Financial inclusion not only mean that opening of saving bank account but imply creation of awareness about the financial products, education and guidance on money management, offering debt counseling, etc. by banks. In rural areas revolutionary step taken place by the government through introducing the micro credit facility in two ways those are 'Self Help Groups-bank linkage' and 'Microfinance institutions'. Rural development requires this type of provision that is formation of Self help groups. In the rural areas it has created remarkable change. In the recent phase of globalization, self help groups have given answer to the poverty. This has created self-reliance, self-respect, entrepreneurship among poor rural people, not only in India but also in all developing countries.

Key words: Financial Inclusion, Micro-credit, Regional rural banks (RRBs), Reserve Bank of India (RBI), SHGs, GCC

INTRODUCTION

Financial inclusion refers to delivery of banking services at an affordable cost to the vast sections of disadvantaged and low-income groups who tend to be excluded from the formal banking channel. Despite widespread expansion of the banking sector during the last three decades, a substantial proportion of the households, especially in rural areas, are at present outside the coverage of the formal banking system. The Reserve Bank's broad approach to financial inclusion aims at 'connecting people' with the banking system and not just credit dispensation; giving people access to the payments system; and portraying financial inclusion as a viable business model and opportunity. Efforts towards 'financial inclusion' include sensitising the banks to the banking and financial needs of the common person and ensuring access to basic banking facilities. In consonance with the above approach, the Reserve Bank has undertaken a number of measures in recent years for attracting the financially excluded population into the formal financial system. The

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Annual Policy Statement for 2006-07 urged all banks to give effect to the measures announced by the Reserve Bank from time to time on financial inclusion at all their branches.

NEED FOR FINANCIAL INCLUSION:

Out of 19.9 crore households in India, only 6.82 crore households have access to banking services. As for as rural areas are concerned out of 13.8 crore 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. There are a number of factors affecting access to financial services by weaker sections of the society in India. The lack of awareness, low income and assets, social exclusion, illiteracy is the barriers from demand side. The distance from bank branch, branch timings, cumbersome banking procedure, and requirements of documents for opening a bank account, unsuitable banking products/schemes, language, high transaction costs and attitude of bank officials are the barriers from supply side. Hence, there is a need for financial inclusion to build uniform economic development.

PROBLEMS OF FINANCIAL INCLUSION

Financial Inclusion is imperative for inclusive growth of India, with more than1/4th of its population living in poverty. Government's role towards their growth and development is huge, and inclusive finance is one such measure to solve the severe problems of poverty and unemployment. Like any other schemes in India application of financial inclusion have many problems.

INDEBTNESS OF FARMERS AND OTHER VULNERABLE GROUP:

The most important problem in Indian economic set up, the driver of the economy is always under a severe burden of indebtness. Credit to farmer households is one of the important elements of financial inclusion. Here we must take a note of number of household who are denied credit in spite of demand in order to know the extent of credit inclusion. As it is a difficult task to obtain relevent data and not much data is availabe from the secondary sources, the basic problem at the lowest level, i.e indebtness of farmers has been taken into account. The latest survey report of the National Sample Survey Office (NSSO) further confirms India's worsening agrarian crisis. More than half of the agriculture households are in debt, and the worst affected states are southern states like Andhra Pradesh, Telangana, and Tamil Nadu, says the 70th round of NSSO survey. survey report says about 52 per cent of the agricultural households in the country are estimated to be in debt. Among the major states, Andhra Pradesh had the highest share of indebted agricultural households in

the country (92.9 per cent), followed by Telengana (89.1 per cent) and Tamil Nadu (82.5 percent). The report states nearly 40 per cent of households take loan from non- institutional sources like money lenders. Nearly 60 per cent of total outstanding loan is taken from institutional sources. The banks' share is (43 per cent), followed by cooperative societies (15 per cent). The survey also showed that a very small segment of agricultural households utilised crop insurance because of lack of awareness.

SUPPLY AND DEMAND SIDE PROBLEM AND SOLUTION.

Supply side problem in financial inclusion during 1990s have been 1.Narrowing of the branch network in rural areas. 2. Fall in credit-deposit ratios in rural areas. 3. Disproportionate decline in agricultural credit to small and Marginal farmers 4. Cripplings of RRBs. One issue is whether we need separate institutions for promoting financial inclusion. Existing formal institutions may be sufficient for this purpose. It is true that commercial banks have their own problems. Man power shortage, unfavourable attitude towards rural services, infrastructure and technology problems in rural areas etc. Rural banking has to be friendly to small and marginal farmers and other vulnerable groups. It requires a specific type of organizational ethos, culture and attitude (Rangarajan, 2005). The cadre of officers in rural branches has to develop this attitude and promote financial inclusion of low income groups treating it both a business opportunity as well as social responsibility. There is a need to remove the supply side problems of commercial banks, RRBs and co-operative banks. As the last year's Budget admits, 'the cooperative banks, with few exceptions, are in shambles'. This institution has to be revived as many farmers are dependent on the credit from these banks. Vaidyanathan committee's recommendations may be helpful to revive cooperative sector.

On the demand side, some of the constraining factors for financial inclusion have been 1.Low productivity and risk and vulnerability of small and marginal farmers 2. Low skill and poor market linkages for rural non-farm and urban workers 3. Vulnerability to risk for rural landless and urban poor and 4. Inadequate awareness and low financial literacy. In order to improve demand, the suitability of existing financial products for the farmers/poor must be assessed. For example, rural poor do not have even safe place to keep their savings let alone thinking about demand for credit. Suitable mechanisms have to be explored for addressing the risks of the farmers and other poor such as weather, price, yields, technology etc. Moreover, financial instruments have to be in such a way that they undertake economically viable activities. The financial institutions have to educate the poor and vulnerable by giving wide publicity to their financial instruments e.g. no frills bank account.

Several steps have been taken by Reserve Bank of India and Government to bring the financially excluded people to the fold of formal banking services. They include the following:

‘No-Frills’ Accounts:

As announced in the Annual Policy Statement for the year 2008-09, and in order to give further impetus to financial inclusion, banks were advised in May 2008 to classify overdrafts up to Rs.25,000 (per account) granted against ‘no-frills’ accounts in the rural and semi-urban areas as indirect finance to the agriculture sector under the priority sector with immediate effect. ‘No-frills’ accounts (accounts with low or nil minimum balances as well as charges) were introduced in November 2005 to expand the outreach of banking services to vast sections of the population. To ensure that persons belonging to low income groups, both in urban and rural areas, did not encounter difficulties in opening bank accounts, the KYC norms for opening accounts with balances not exceeding Rs.50,000 and credits thereto not exceeding Rs.1,00,000 in a year, were also simplified. The simplified procedure allowed customers on whom the full KYC drill had been followed, to introduce new customers.

General-purpose Credit Cards (GCC):

In December 2005, all SCBs, including RRBs, were advised to introduce a GCC scheme for their constituents in rural and semi-urban areas with a view to providing them with credit card like facilities with limited point-of-sale (POS) and automated teller machine (ATM) facilities. The GCCs could be issued based on the assessment of income and cash flow of the household as is done for normal credit cards. In May 2008, banks were advised to classify 100 per cent of the credit outstanding under the GCCs as indirect finance to agriculture sector under the priority sector as against the earlier limit of 50 per cent of the credit outstanding.

Credit Counselling Centres (CCC):

The Working Group (Chairman: Professor S.S. Johl) constituted by the Reserve Bank to suggest measures for assisting distressed farmers had recommended financial and livelihood counselling as important for increasing the viability of credit. Further, the Working Group constituted to examine procedures and processes for agricultural loans (Chairman: Shri C.P. Swarnkar) had also recommended that banks should actively consider opening of counselling centres, either individually or with pooled resources, for credit and technical counselling with a view to giving special thrust for credit delivery in the relatively underdeveloped regions. In the light of the recommendations of these two Groups, in May 2007, convenor banks of SLBCs were advised to set up a financial literacy-*cum*-counselling centre in any one district on a

pilot basis and extend it to all other districts in due course, based on the experience gained. As reported by SLBC convenor banks, as on July 31, 2008, 109 credit counselling centres had been set up/proposed to be set up in 19 States, on a pilot basis. In accordance with the announcement made in the Mid-term Review for 2007-08, the Reserve Bank placed on its website a concept paper on 'Financial Literacy and Credit Counselling Centres' on April 3, 2008. Based on the feedback received, a model Scheme for Financial Literacy and Credit Counselling Centres is being conceptualised.

Pilot Project for 100 per cent Financial Inclusion:

The convenor banks of the State Level/ Union Territory Level Bankers' Committees (SLBC/UTLBC) in all States/Union Territories were advised in April 2006 to identify at least one suitable district in their respective jurisdiction for achieving 100 per cent financial inclusion by providing 'no-frills' accounts and issue of GCCs and gradually extending the endeavour to other areas/ districts. The SLBCs/UTLBCs were further advised to allocate villages to various banks operating in the State for taking the responsibility of ensuring 100 per cent financial inclusion and also to monitor financial inclusion in the meetings of the SLBC/UTLBC from September 2006 onwards. 342 districts have been identified for 100 per cent financial inclusion so far and the target reported to be achieved in 155 districts in 19 States and six Union Territories with Haryana, Himachal Pradesh, Karnataka, Kerala, Uttarakhand, Puducherry, Daman and Diu, Dadra and Nagar Haveli, Goa and Lakshdweep reporting achievement of 100 per cent financial inclusion in all districts.

Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF):

In June 2006, the Government constituted the "Committee on Financial Inclusion" (Chairman: Dr. C. Rangarajan). The Interim Report of the Committee had recommended the establishment of two funds – the FIF for meeting the cost of developmental and promotional interventions for ensuring financial inclusion and the FITF to meet the cost of technology adoption. The Union Budget for 2007-08, announced the constitution of the FIF and the FITF, with an overall corpus of Rs.500 crore each with NABARD. For the year 2007-08, the Government fixed an initial contribution of Rs.25 crore each in the two funds by the Central Government, the Reserve Bank and NABARD in the ratio 40:40:20.

Financial Literacy

Recognising lack of awareness about financial services as a major factor for financial exclusion, the Reserve Bank has taken a number of measures towards financial literacy. The Reserve Bank started "Project Financial Literacy" with the objective of disseminating information regarding the central bank and general banking concepts

to various target groups such as school and college going children, women, rural and urban poor, defence personnel and senior citizens. The target audience is reached through banks, local government machinery and schools/colleges through the use of pamphlets, brochures, films and also the Reserve Bank's website. The 'For the Common Person' link on the Reserve Bank's website facilitates access to information in Hindi, English and 11 regional languages.

Relaxed and simplified 'Know Your Customer'(KYC) norms:

To facilitate easy opening of bank accounts, especially for small accounts with balances not exceeding Rs. 50,000 and aggregate credits in the accounts not exceeding Rs. one lakh a year. Further, banks are advised not to insist on introduction for opening bank accounts of customers. In addition, banks are allowed to use Aadhar Card as a proof of both identity and address.

National Rural Financial Inclusion Plan(NRFIP):

A National Rural Financial Inclusion Plan (NRFIP) may be launched with a clear target to provide access to comprehensive financial services, including credit, to atleast 50% of financially excluded households, say 55.77 million by 2012 through rural/semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and non-cultivator households per branch per annum, with an emphasis on financing marginal farmers and poor non-cultivator households.

Business Correspondent Model

Extending outreach on a scale envisaged under NRFIP would be possible only by leveraging technology to open up channels beyond branch network. Adoption of appropriate technology would enable the branches to go where the customer is present instead of the other way round. This, however, is in addition to extending traditional mode of banking by targeted branch expansion in identified districts. The Business Facilitator/Business Correspondent (BF/BC) models riding on appropriate technology can deliver this outreach and should form the core of the strategy for extending financial inclusion. The Committee has made some recommendations for relaxation of norms for expanding the coverage of BF/BC. Ultimately, banks should endeavour to have a BC touch point in each of the 6,00,000 villages in the country.

Steps for Financial Inclusion

Expansion of public sectors banks' network.

Over a period of five year (2003-04 to 2007-08), institutional credit to agriculture has trebled from Rs. 86,981 crore to Rs. 2,50,000 crore. However it is not clear 'how much' financial inclusion has taken place as a result of this massive expansion of institutional credit to agriculture. In fact, without the expansion of the rural branch network by the financially strong and dominant public sector banks with appropriately qualified staff for diversified agriculture and micro enterprises, the objectives of rapid credit expansion are sure to be stifled.The banking system requires a more broad-based and strong institutional structure reasonably widespread regionally and fuctionally. In this respect the financial strength of RRBs and Co-operative structure are weak. Therefore, in such a rural credit structure catering to the needs farm and non-farm enterprises alike,the public sector banks have to take a lead, expand their branch network even as they co-opt co-operatives and other local agencies to supplement and support their banking business, appoint qualified staff for farm and non-farm lending and undertake to expand their credit base amongst the informal sectors.

SGH-bank linkage programme(SBLP):

In the last two decades, the major institutional innovation in India for expanding financial system access and usage for the poor and marginalized sections of thepopulation has been the SHG-Bank Linkage Programme (SBLP). This was an outcome of pilot projects during the 1980s for improving access of rural poor to formalinstitutional financial services. For the banks, it was a way of reducing their transactioncosts by dealing with groups of people rather than individuals, reducing the credit risksthrough peer pressure and making people save. Subsequently in the year 1992, theNational Bank for Agriculture and Rural Development (NABARD) started a pilot projectof linking SHGs with branches of banks across the country. The project provided a cost-effective SBLP model for providing financial services to the underserved poor. Being a 'savings first, credit later' model, credit discipline became a norm for SHGs and 'socialcollateral' made them bankable. The model was also successful in providing solution to the twin problems faced by banks, i.e., low recovery of loans in rural areas and hightransaction costs in dealing with small borrowers at frequent intervals. One of themajor positive impacts of the SBLP was social and economic empowerment of themembership.

The revised NABARD guidelines, popularly known as SHG2 have sought to address some of the shortcomings of the earlier version. The major features of SHG2 are : (a) more focus on voluntary savings; (b) cash credit system of lending over three to five

years cycle to minimize the problem of inadequate finance and non-availability of repeat loans; (c) enabling creation of Joint Liability Groups (JLGs) within SHGs to scale up economic activities by more entrepreneurial members of the group;(d) improving risk mitigation systems by bringing in third party audit; (e) building second tier institutions; (f) strengthening the self-monitoring mechanism and (g)meeting the training/capacity building requirements of the SHGs.

Micro-finance Institutions- NBFCs:

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. The Committee has, therefore, recommended that greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but also eventually enable them to take and use savings as a low cost source for on-lending.

There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. Such MF-NBFCs may also be recognized as Business Correspondents of banks for providing only savings and remittance services and also act as micro insurance agents.

Conclusion:

Inclusive growth attainment depends a great deal on equitable distribution of growth opportunities and benefits and financial inclusion is one of the most crucial opportunities which need to be equitably distributed in the country in order to attain comprehensive growth. It needs to be understood by the state that in order to bring orderly growth, order needs to be developed with regard to inclusive finance. The percentage of financial inclusion in the different states of the country varies differently. The importance of financial inclusion in improving the living conditions of poor farmers, rural non-farm enterprises and other vulnerable groups arid discuss a few important issues and challenges. The concept of financial inclusion covers wider financial services such as credit, savings, insurance, etc. Banks should look at financial inclusion both as a business opportunity and as a social responsibility. Apart from formal banking institutions, the role of the self-help group movement and MFIs is important to improve financial inclusion of people. However, some regulatory

procedures for MFIs may have to be evolved by having consultations with MFIs, consumers and the government. Depoliticisation of the financial system is needed for maintaining the viability of formal financial institutions. The risk elements of small and marginal farmers and other vulnerable groups have to be taken into account in framing policies for financial inclusion. For improving the productivity of small and marginal farmers and improving the skills of rural non-farm workers, the Inclusive growth attainment depends a great deal on equitable distribution of growth opportunities and benefits and financial inclusion banking system may have to undertake credit plus advisory services.

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