FINANCIAL INCLUSION IN INDIA – A FORWARD PATH

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Abstract

While holding cash in hand has its convenience and liquidity benefits, the security and interest payment benefits of depositing cash in banks cannot be argued with. Banks provide a safe place to store the "medium of exchange", accept deposits and make loans. People naturally want to store their hard earned money in a location safe from theft, fire and other hazards. Developed and developing countries have been taking massive steps to ensure 100% financial inclusion. The ability of the masses to not only have access to banks but also use their facilities efficiently so as to maximize their benefit leads to satisfaction and growth. This paper explores the growth of the financial inclusion phenomena in the Indian context.

Key Words: Financial Inclusion, organized sector, unorganized sector, micro-credit.

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Introduction

The Indian money market which is classified into the organized sector and the unorganized sector exists with the dominance of and dependence on the unorganized sector. Micro-credit, the use of collateral substitutes and self-help groups (SHGs) are still preferred over traditional banks in rural and sub-urban areas, especially for non-productive purposes i.e. those which are not directly involved in the production of a good or a service or does not generate any income- like marriages and other ceremonies and short duration loans, but hardly for educational purposes such as meeting the fees requirements of the children's schools. A major reason for this could be the amount of time it takes to complete transactions in corporate banks or that rural residents feel intimidated to approach such institutions. Hence, despite the large size and depth of India's financial system the majority of the rural poor do not make use of formal financial services. Financial services can be adapted to meet the needs of poor provided households contribute in the fight against poverty in a financially sustainable way.

According to the Financial Inclusion 2014 report from the World Bank, globally about 50 percent of adults have a bank account while the rest remain unbanked, meaning they do not have an account with a formal financial institution. The poor, women, youth, and rural residents tend to face greater barriers to access. Among firms, the younger and smaller ones are confronted by more binding constraints in the sense that banks are unwilling to provide loans to firms that they feel are relatively new or small, and those investments that might turn out to be risky.

It is proven that a higher saving rate leads to an improved growth performance of any country and for this reason, financial inclusion is peripheral to India for inculcating the habit of saving among the residents of the nation. Once people move away from traditional modes of investing their funds in land, buildings, bullion or borrowing from friends, family and money lenders along with the materialization of financial inclusion measures capital formation is expected to undergo a boost.

A World Bank working paper (2012) indicated that 65% of adults in India had no access to a Bank account. Looking at the population of India of over 1.23 billion, this figure is huge and provides a major cause for concern. It implies that a significant proportion of the population lives in deprivation, often falling prey to fraudulent money lenders who trap them in a vicious cycle of debt.

Sometimes it may happen that money meant for the poorest of the poor does not reach them. Because of slow pace of government bureaucracy much of it is leaked out of the transfer and does not reach the intended parties. For this reason, direct cash transfers to beneficiaries through their bank accounts have become of utmost importance rather than subsidizing products and making cash payments. This reduces the government subsidy bill. However a strong banking system is required which calls for the need and dependence on financial inclusion.

Review of Literature

V. Leeladhar in an article in the RBI Bulletin (2006) writes about how financial exclusion can potentially lead to social exclusion. Consequences of financial exclusion will vary depending on the nature and extent of services denied. It may lead to increased travel requirements, higher incidence of crime, general decline in investment, difficulties in gaining access to credit or getting credit from informal sources at exorbitant rates, and increased unemployment, etc. The small business may suffer due to loss of access to middle class and higher-income consumers, higher cash handling costs, delays in remittances of money. According to certain researches, financial exclusion can lead to social exclusion.

S. Thyagarajan and JayaramVenkatesan (2008) chose Cuddalore, a district situated in the state of Tamil Nadu with the Indian bank as its lead bank for their case study as a project on Financial Inclusion. The lead bank collected basic information on village wise household details and furnished the same to the district coordinators of all the banks. Each branch surveyed the villages and recorded information of each household such as, name, age and profession of all members of the household. It was decided that the progress and completion of the financial inclusion drive would be measured based on the number of households covered and not the number of adult persons covered. The financial inclusion project resulted in opening of 186935 new no frills savings accounts in the district and helped to bring in 144975 households into the banking net which formed 28 percent of the total households. 53 percent households reported willingness to open bank accounts whereas 47 percent households reported unwillingness to open bank account. The fact that such a large population in a fairly advanced district reported unwillingness to open bank accounts was intriguing. It was observed that no bank except Indian Bank, Vridachalam branch had attempted Information and Communication Technology (ICT) interventions, like rural ATMs, Smart Cards, Mobile Phone banking, etc. during the implementation of the financial inclusion project. No bank had implemented the business facilitator or business correspondent models in the district so far.

Ben. S. Bernanke (2006) referred to the role of community based financial institutions in minimizing neighbourhood and information externalities and other types of market failure that tend to prevent competitive conditions from maximizing social welfare. He spoke about the role of community development financial institutions in solving collective action problem and countering information externalities by developing financial products and services that better fit local needs and provide coordinated development activities and community specific information. In dealing with scale and using technology, banks tend to adopt highly standardized and automated processes. But financial inclusion requires substantial efforts in understanding the needs of the customer, counselling, financial literacy, screening & monitoring. In his speech the Chairman focused on role of the local organizations in acting as information brokers and facilitators.

Najeeb Jung, Vice-Chancellor, JamiaMilliaIslamia (2013) believes it is often said that those who do not learn from history are condemned to repeat it; and the one certain lesson from history is that, despite aberrations and hiccups, the human species prefers a life of harmony and peace. So while dictators or groups professing specific and rigid beliefs may rule from time to time, such success is not sustainable. To rule for long periods, governments must be inclusive and prove that they work for the majority of the people, including the weakest of the weak and the poorest of the poor.

Dr RaghuramRajan, Governor of the Reserve Bank of India (2014) talks on Financial inclusion as being about (a) the broadening of financial services to those people who do not have access to financial services sector; (b) the deepening of financial services for people who have minimal financial services; and (c) greater financial literacy and consumer protection so that those who are offered the products can make appropriate choices. The imperative for financial inclusion is both a moral one as well as one based on economic efficiency. Should we not give everyone that is capable the tools and resources to better themselves, and in doing so, better the country?

The United Nations Secretary-General's Special Advocate (UNSGSA) defines financial inclusion as universal access to, and use of, to a wide range of reasonably priced financial services, provided by a variety of sound and sustainable institutions. While financial inclusion alone cannot bring people out of poverty, it can help people build better lives. It can help individuals to start businesses, and help small businesses grow into larger ones. Financial services can help small farmers tap into the formal economic system for two-way flow of information and income. Entire economies can grow more quickly and in ways more favourable to poor people. (http://www.unsgsa.org/about/financial-inclusion, retrieved on 3/07/2014).

Objectives of the Research

- To trace the history and origin of Financial Inclusion in India
- To understand the current scenario with respect to Financial Inclusion
- To identify problems associated with the implementation of Financial Inclusion and its limitations
- To offer recommendations

History of Financial Inclusion in India

As opposed to popular belief, financial inclusion is not a recent phenomenon or strategy. Under the socialist regime during Indira Gandhi's rule in 1969, also known as the Golden Age of Capitalism, efforts were being made to nationalize banks in the country mostly with the intent of increasing the reach of credit. 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. This showed one of the earliest signs of the spirit of financial inclusion in the country. The Khan Commission set up in 2004 was mainly mirrored this motive and based on its recommendations, the RBI through the Business Facilitator and Business Correspondent with Information and Communication Technology support prepared rules and guidelines to be followed to ensure the pervasive reach of banking services. In order to make accounts more accessible to the common folk such as low-middle income groups, residents of rural areas and to provide them with incentives for doing so, 'no frills' accounts were made available. A No Frills account is one which require either NIL or minimum balances as well as charges mainly to make accounts more accessible to vast sections of the population. In short, the Khan Committee urged banks to look into their existing practices and align them with the goals and aims of financial inclusion.

Other important changes such as the expansion of the brick and mortar infrastructure, increase in number of bank branches from a meagre 8000 in 1969 to 99000 that it is today, show that to an extent, it has been possible to actually financially include the masses. More recently, in September 2013 RBI set up a high level committee in September 2013, on 'Comprehensive Financial Services for Small Business and Low Income Households', headed by Nachiket Mor. The committee has set an ambitious target of providing every adult Indian with access to proper financial services by 2016, a plan which hopes to be propelled by Aadhaar-linked bank accounts. The panel has also recommended setting up of Payment Banks, a new category of banks, dedicated to drive financial inclusion.

Current Scenario of Financial Inclusion in India

The current situation of Financial Inclusion in the country has both a negative as well as a positive side. Comparisons with some countries show that India is at a better position but comparisons with other stronger powers show that India has a lot of work to do in order to achieve 0% Financial Exclusion.

Comparisons between other countries such as China, United States and Pakistan help to get a better picture of the status of India when it comes to Financial Inclusion.

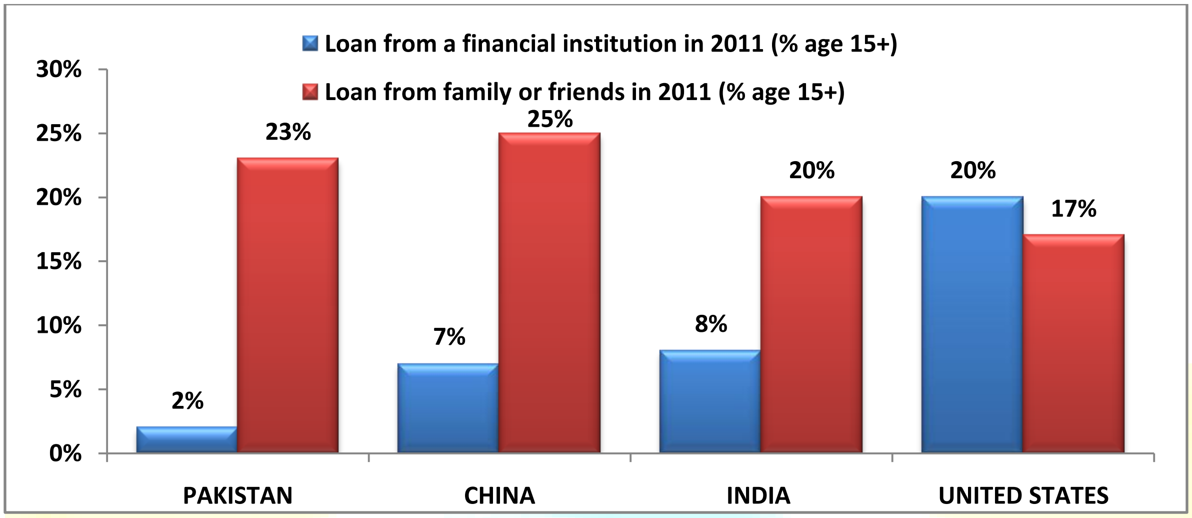

Figure1: Loans taken from Financial Institutions vs Family – A Comparison

Source: Industry Sources

Figure 1 shows the percentage of loans taken from financial institution vsthose taken from a family or a friend in the year 2011. In all countries except for the United States, the percentage of loans taken from family or friends is higher than those taken from financial institutions. India faces a large gap between the two entities in this context. This validates the claim of the large amount of dependence of people on their families and friends and shows the adverse effects of having the lack of sufficient formal institutions in the country. The need for 0% financial exclusion is highlighted and immediate steps should be taken to reduce this dependence on sources other than formal financial institutions.

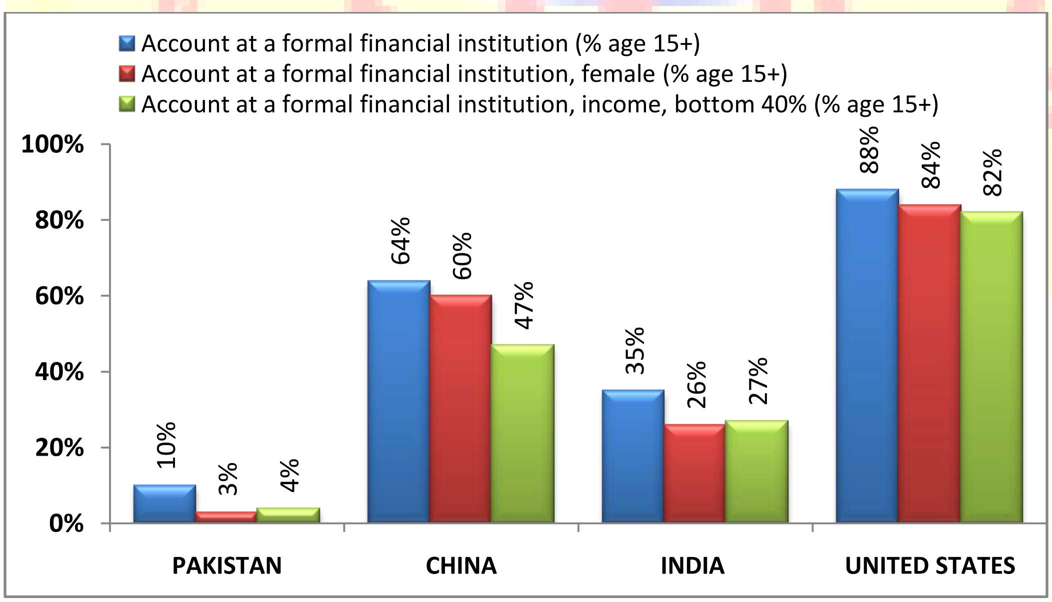

Figure 2: Percentage of people having an account at a formal financial institution – A Comparison

Source: Industry Sources

In a comparison between the 4 countries (Figure 2) based on the percentage of people having an account at a formal financial institution, India ranks third after United States and China, with only 35% of the people engaging in transactions at formal banks/ other institutions. In terms of proportion of women having a bank account at a financial institution, roughly 26% of the women in India are formal account holders. United States holds first in this regard with 84% of women holding accounts and Pakistan lags at the fourth position with a mere 3%. Around 27% of people in India belonging to the bottom 40% income group hold an account at a formal financial institution.

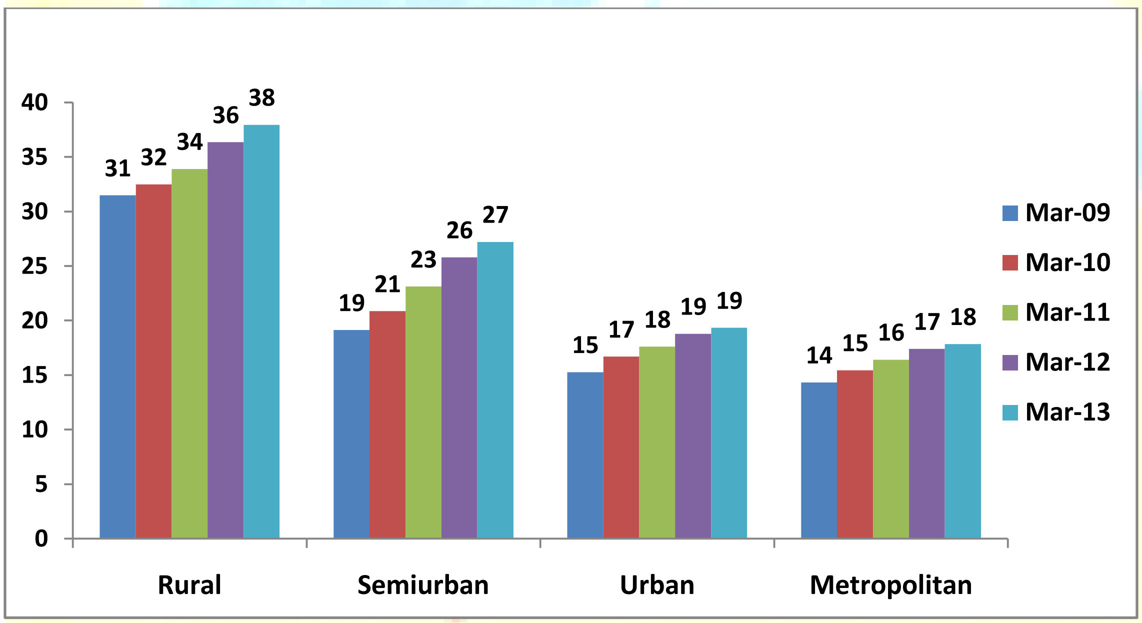

Figure 3: Number of functioning branches of Scheduled Commercial Banks (SCBs) during the last 5 years

Source: Industry Sources

The above data shows the number of functioning branches of Scheduled Commercial Banks (SCBs) during the years 2009-2013 for the Rural, Semi-urban, Urban and Metropolitan areas in India. Itis clearly visible that the proportion of banks has increased over the years in the following areas.In March 2009 the number of functioning branches of SCBs in the Rural areaswas 31, the highest among all the sectors, the lowest number being for the Metropolitan areas at 14 branches. The numbers then increased to 38 and 18 for Rural and Metropolitan areas respectively in 2013. However, despite the increase in the number of banks over the years, the number of bank accounts that people maintain has not increased with the same proportion. The problem of incomplete financial inclusion still persists, despite the increase innumber of bank branches.

Problems associated with the implementation of Financial Inclusion and its limitations

Despite the remarkable figures and available data on the issue, it cannot be successfully concluded that banking has reached all sections of the society alike. The extent of financial exclusion that had been opposed by the likes of V. Leeladhar who vehemently speak against it due to fear of social exclusion is vast and depressing. Only 36,000 out of 600,000 habitations in the country have bank branches. 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.

Although it has been many years since the financial reforms of 1991 had been implemented, the financial sector is still not efficient in its working and faces many challenges. Under the rule of Indira Gandhi, foreign investment in banks were limited only to a certain amount, thereby insuring minimum invasion from foreign companies and maintaining status of domestic banks. This was applicable to other fields and products as well. But with the liberalization reforms and opening of markets the needs of global world have often been put before the local ones, the latter being constantly ignored. The fact that foreign investment shows a strong backing to banking, pension investment, capital markets and insurance segments and led to the prioritizing the needs of foreign individuals and firms over the domestic ones. Added to this is the competition from private sector banks and insurance companies. With the face-off between global companies and local private companies, public sector banks have seen fluctuations in their output, profits and financial standing only the stronger ones surviving and weaker ones perishing.

Studies conducted under the World Bank Report 2014reveal that even with the increasing amount of banking sector privatization, today only 35% of people in India have formal bank accounts as opposed to 41% in developing economies.In a country where nearly 70% of the population lives in villages, a significant segment of about 650,000 villages do not have a single bank branch. This implies a huge proportion of people dependent on money lenders charging high rates of interest and other means of micro finance with increasing demands for collateral provided. The high rates of farmers' suicides, depression and poverty can be attributed to this fact. And it plays a primary reason for the same. Agriculture has played and still plays a big role in contribution to the GDP of the country. With unavailability of income and inability of people to take up loans from high interest rate charging moneylenders, the agricultural situation in the country has largely depreciated.

For the above mentioned reasons, it is necessary that Financial Inclusion should be taken more seriously as an agenda by policy makers. However, one of the many challenges faced them would be the removal of the fear that those belonging to the low income groups such as the urban poor or the rural villager face in approaching bank branches. Most of the people in the country do not understand the importance of saving. One of the major reasons for this is that the income of most of the people in question is transitory.Technically one would argue that for a person whose income is inconsistent, his savings would be more in fear of a future rainy day. However in most cases he finds it unable to do so mainly because his entire income goes into fulfilling his daily needs such as purchasing food for the family, children's education or rent payable to landlords. The condition of income management is very poor.

Recommendations for Financial Inclusion

The need of the hour is the creation of awareness amongst the people. For this, we have to look at the broader picture which not only involves direct improvement of the formal institutions engaged in inclusion practices but also indirectly implies improvement in the education levels of people and literacy rate. This is mostly to ensure that people realize the importance of saving and its role in boosting the rate of growth of a nation. Although saving only temporarily increases the growth rate of a nation but at the same time it increases the steady state level of capital stock and hence the steady state output as well. Either way, this is good for the nation. Saving not only boosts economic performance, it enables people to become self-dependent and not run to money lenders or other forms of micro credit in times of crisis that diminish their incomes by way of excessive interest rates on the loans taken.

If a person is vigilant from the beginning and maintains a judicious attitude towards his income, he will be self-sustaining in the long run and does not require much help from an external party in the short run. If he suffers a temporary loss in income, he can turn to his savings and overcome the loss effectively. It lessens the need for him to take loans for his children's wedding, education, health requirements and other needs if he simply keeps some amount of his hard earned money aside and does not use it for everyday purposes. Saving even 10% of monthly income has proven to be a helpful and stress free habit that enables people to be prepared for adverse circumstances be it inflation, fall out between labour unions and the firm, unforeseen layoffs by the companies, sudden illness among the members of a family, accidents or other reasons that contribute towards a sudden fall in the income. This is where the role of kiosks or branches set up by parties engaged in financial inclusion comes to play. It is important to remember that this is solely for people belonging to the low or middle income groups, rural residents and those whose incomes surface just above or below the poverty line. These are the people who face problems in approaching bank branches or other formal institutions of handling credit. Just like a bank, people who invest their savings receive a rate of interest which provides an added incentive other than the money staying safe with the branch.

Apart from increased savings, there is another important reason why people find kiosks and branches extremely useful. We take the case of Mumbai- the fifth most populous city in the world. With a population of roughly 12.65 million, Mumbai witnesses an inflow of migrants from all over the country. Being the financial capital of India, and thanks to the film industry setting its mark here, the City of Dreams is a prime attraction for anyone who is looking for a job and dreams of making it big. People from all over the country leave their homes and families behind in search for employment in this city as a means to earn their livelihood as well as support their families back home. The "families back home" usually consist of parents of the workers, mostly in the above 51 age group performing odd jobs to somehow meet the needs of the family, a wife and kids. As a whole, the family is largely dependent on the male member as being their sole source of income. The worker working in Mumbai as a casual labourer, black smith, cobbler, construction site worker (on a contract basis) or performing other odd jobs would want to send some money home. Looking at the work performed by him, the money to be sent might not be of such a great value. However, it could make a large difference to the meagre income received by his family members. The worker might find it too tedious to go to a bank or might be too intimidated.

Also almost all banks have minimum balance requirements for all those who deposit money in their bank accounts for short term or long term purposes. A daily wage labourer or farmer will find it very difficult to maintain such a balance. Such problems need to be curbed and it is essential that the gap between people from different income groupsbe reduced as soon as possible. A good solution to this would be opening up of a smaller bank branch or kiosk in association with a well-known bank which enables below poverty line people to make transactions involving small amounts of money as opposed to the requirements of banks and their policies.

For this being successful, efforts have to be made to make financial inclusion branches and kiosks more user friendly, the mangers of which should possess the required amount of skill when dealing with the interested people. The task does not really require a prodigious amount of knowledge or skill, just the basic know-how of dealing with a computer and keeping track of transactions. Apart from contributing towards the goal of financial inclusion, this even helps in creating employment to those who might find it difficult to find a job in these extremely competitive times. The family of the worker receives the amount sent to them by him in a short period of time with improved accessibility and efficiency.

This process requires a massive increase in the availability of banking facilities to people not residing in the metropolitan areas. Increased accessibility and awareness improves the rate of banking transactions, self-dependence and hence is a definite step towards achieving 100 per cent financial inclusion. Some steps could include policies to expand account penetration—such as enabling people to maintain low fee accounts that require lower minimum balances as opposed to the substantially high requirements that are in most banks today, reducing the time and effort taken to actually indulging in the banking process by way of decreasing the number of documents required and formalities to be completed, allowing correspondent banking. Direct government interventions on the other hand such as directed credit, debt relief, and lending through state-owned banks tend to be less efficient and successful and must be discouraged.

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