FINANCIAL INCLUSION AND THEIR ROLE IN INCLUSIVE GROWTH

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Abstract

The academic literature has advocated the close relation amid financial expansion and growth of economy. The importance of a well-structured financial system is widely recognized globally, and the financial inclusion is seen as a policy priority in many countries. The increased emphasis on financial inclusion reflects a growing realization of its potentially transformative power to accelerate development gains. This paper recognizes the role of financial inclusion in inclusive growth in India.

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Introductory Perspective

The relationship between financial inclusion and economic growth has receivedconsiderable attention by the policymakers in many countries. Financial inclusion hasmoved up the global reform agenda, and has become a topic of great interest for policymakers, regulators, researchers, market practitioners, and other stakeholders. Theincreased emphasis on financial inclusion reflects a growing realization of its potentiallytransformative power to accelerate development gains. The global interest reflects abetter understanding of the importance of financial inclusion for economic and socialdevelopment. It indicates a growing recognition of the fact that access to financialservices has a critical role in reducing extreme poverty, boosting shared prosperity, andsupporting inclusive and sustainable development. The interest also derives from agrowing recognition of the large gaps in financial inclusion. Access to safe, easy, andaffordable financial services by the vulnerable sections of the society is a pre-conditionfor accelerating growth and eradicating income disparity and poverty. The theories ofdevelopment also advocate this. Therefore, in order to make growth process moreinclusive ‘financial inclusion’ of poor and vulnerable sections of society is critical.

Researches that have been carried out in the last decade help us in concluding thatsustainable and equitable growth is directly related to a system that is well functioning and financially inclusive (Honohan, 2003). A number of studies have been conducted on the relationship between financial inclusion and economic growth, and these studies advocate that financial inclusion is important for productivity, growth, and economic development. This study evaluates the impact of financial inclusion on the operation of the government and different bodies particularly in relation to their development goals of reducing poverty among poor households and in affecting change in their socioeconomic status.

Methodology

In order to pursue the objectives, this study relied on secondary; already published; information and data sources. A review of the literature provided a theoretical underpinning for the study and also helped the researcher gain a sound understanding of the subject matter. Accordingly, research papers appearing on the theme in prominent development economics and related journals were reviewed.

Financial Exclusion and the Efforts to carry out Financial Inclusion in India

Both rich (non-poor) and poor people of developing economies face financial exclusion and in turn cause problems in decreasing income inequality and create hurdles for growth and development. Value creation and efficient, proper distribution of resources is ensured via finance (Beck and Demirgüç-Kunt, 2008). The concept of access to credit as an individual's right needs to be examined because the planning commission of India feels that the poor and under privileged may be benefitted by access to financial services but it may also cause increased indebtedness among them (Hudon, 2009). Some of the most crucial reasons for financial exclusion in India are decreased population in the hilly regions having poor infrastructure, lack of consumer awareness, social exclusion, increased illiteracy and decreased incomes (Thorat, 2007).The Indian context of financial inclusion mentions that access to financial services should primarily focus on three areas like credit, wealth creation and contingency management. Provision of a wide variety of financial services like savings account, insurance, and remittances are also required along with credit. Credit as an entity is considered good and healthy if it is self-liquidating and can be used to create units that generate a price in the market. It also helps to increase the borrower's and the household's employment. The credit requirements of the backward and under privileged households must be met by credit to encourage emergency and consumer loans, entrepreneurial livelihood and residential mortgages. Under financial inclusion poor people must work towards wealth generation via savings and investment plans as this will enable to lessen poverty. Contingency planning consists of retirement plans to avail pension benefits, crop insurance, asset protection, insurable contingencies for health care and finally buffer savings.

In January 2008, the committee on financial inclusion appointed by the Government of India submitted its final report to the finance ministry. This committee defines Financial Inclusion as, "a process that ensures ease of access to financial services along with timely and adequate credit at a reasonable price, whenever required by the weaker, vulnerable and low-income sections of the society." The committee recommends establishing two separate funds along with NABARD, which is the coordinating agency for all initiatives pertaining to financial inclusion. The funds are Financial Inclusion Fund (FIF) and Financial Inclusion Technology Fund (FITF). Various forms of financial agencies offer microcredit. To ensure complete financial inclusion various unnecessary services are being provided by different trusts and institutes like national level domestic,

commercial banks in the public and private sectors, Regional Rural Banks (RRB), registered & unregistered non-banking finance corporations (NBFC) and cooperative banks. 95% salaried class people and 14% agricultural labor force have access to bank accounts, 79% lower income group citizens receive aid in the form of credit from money lenders. The state creates unwanted interference and intervention in the form of blanket moratoriums, interest subsidies, and non-commercial interferences and due to these factors the Indian financial system has failed to reach out to the backward sections of the nation. The sustainability, future growth and potential of rural finance is under severe threat because the credit for development in rural areas are extremely low in collection and this results in limited disbursals given to the needy and the low-income groups (Rao et.al., 2005). The Planning Commission of India states that around 16,400 non-governmental organizations (NGOs) are voluntarily engaged in searching and procuring sustainable development for the backward class people.PRIA, an International Center for learning and promotion of participation and democratic governance, conducted a research in 2002 along with the Institute for Policy Studies at Johns Hopkins University, USA and calculated that approximately 1.2 million non-profit organizations (NPOs), had operational funds worth $4 billion primarily generated by domestic homes were present in India in 2000.These mostly invisible NPOs had widespread impact as they were private, self-governing, voluntary and non-profit sharing (Tandon and Srivastava, 2002). Various multinational companies (MNCs) are enabling the government, aided bodies and NGOs in decreasing poverty by providing and generating increased trade opportunities, e.g. Unilever, Proctor & Gamble (P&G) and CEMEX have imbibed social innovations and methodologies into their business procedures and operations (Stefanovic, 2007).Unilever along with few other NGOs formed Shakti, a rural network employing 31,000 women and also selling goods and products to rural people in approximately 10,000 villages. Various national and regional level programs are present in India such as Self Employed Women's Association (SEWA), Swarnajayanti Gram SwarozgarYojana (SGSY) and Society for Helping Awakening of Rural Poor through Education (SHARE).

Committee Recommendations on Financial Inclusion

Dr. C. Rangarajan Committee Report

Extent of Exclusion

As per NSSO data, out of a total of 89.3 million farmer households in our nation, 51.4% (45.9 million) farmer households don't have access to institutional or non-institutional credit. Despite a vast array of bank branches, 27% of the farmer households borrow from formal sources and 1/3 out of these are also indebted to informal sources. In few parts of our country, the farmer households not using credit from legal and formal sources as a proportion to the entire farmer households is extremely high. It is 95.91%, 81.26% and 77.59% in the north eastern, eastern and central regions respectively. Hence, the fact remains that exclusion is very large in number and it also differs widely across various regions, asset holdings and different social groups and strata. Higher the poverty, greater the exclusion.

Demand Side Factors

Improving and enhancing the delivery or the supply chain mechanism can significantly improve financial inclusion. Though many parts, regions, segments, and sub-sections of the Indian economy and society have very limited and reduced demand for different financial services. In order to increase their level of inclusion, measures to increase their demand need to be undertaken. This can be achieved via improving human and physical resource endowments, increasing productivity, reducing risks and strengthening market ties and relationships.

National Mission on Financial Inclusion

The assignment of bringing about financial inclusion must be addressed as a mission to achieve financial inclusion at the national level. Representatives of different stakeholders must form the National Mission on Financial Inclusion (NMFI) and they should focus on achieving global/universal financial inclusion in a stipulated time frame. This mission should suggest all the required policy changes to achieve the targeted level of inclusion, for supporting a wide range of stakeholders from the public, private and NGO sectors for undertaking and enabling promotional initiatives.

A National Rural Financial Inclusion Plan (NRFIP) can be launched, which will enable to gain access to comprehensive financial services and credit to at least 50% of households that are financially excluded. Accordingly, it means by 2012, roughly 55.77 million households will have access to financial services through rural and semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households need to be covered by 2015 with shifts that may be encountered in the rural and urban population. Semi-urban and rural branches of commercial banks and RRBs may set up for achieving a minimum target of completing 250 new cultivator and non-cultivator households per branch every year, with special emphasis on providing finance to marginal farmers and backward, low-income cultivator households.

Development and Technology Funds

The massive task of providingfinancial services to the remote and secluded segments of human existence involves a huge cost.Increase in business services and their expansion eventually thus reduce these costs. Though the beginning stages of such extensive projects do involve some form of funding for promoting and developing various activities and initiatives, which create higher credit absorption capacity among the poor and low-income sections and will also lead to increased use of technology for enabling the required levels of inclusion. Hence, the committee has suggested the formation of two funds along with NABARD, having an initial amount of Rs.500 crore each, to be provided in equal proportion by GoI/ RBI/ NABARD.

Business Correspondent Model

Enabling technology to set up channels beyond branch network would enable to extend outreach on a huge and massive scale under NRFIP. Use of proper technology will help the bank branches to go to the customer, this will be done in addition to extending the conventional banking methodology by specified branch expansion in identified regions. The Business Facilitator/Business Correspondent (BF/BC) models based on proper and latest technologies can help in delivering this concept and form the basis of the strategy for spreading of financial inclusion. The committee has relaxed certain norms for expanding the BF/BC coverage and each bank should aim to have a BC touch point in each of the country's 6,00,000 villages.

Procedural Changes

Procedural changes will foster increasedfinancial inclusion. Some of these changes are simplifying mortgage requirements, stamp duty exemption for loans provided to small and marginal farmers, and also providing agricultural services in the farm and business development services in the non-farm sectors.

Role of RRBs

The outreach ofRRBs, post-merger, as compared to other scheduled commercial banks in areas and populations, which face the wrath of financial exclusion is commendable and therefore they constitute a very powerful tool for bringing about financial inclusion. 91% of RRBs workforce is employed in rural and semi-urban areas and 37% of the total rural offices of all scheduled commercial banks are RRBs. They have a strong and a large presence in areas having increased financial inclusion and constitute 31% of deposit and 37% of loan accounts in the rural areas. RRBs account for 34%, 30% and 32% of all the branches of north eastern, eastern and central regions respectively. It was very impressive to observe that 33% linkages out of a total of Rs. 22.38 lakhs SHGs credit linked by the banking industry as on 31st March 2006, were by RRBs. RRBs have a 56%, 48% and 40% share in the north-eastern, central and eastern regions respectively, which implies that the more backward the area the higher is the share of RRBs.

SHG – Bank Linkage Scheme

Post-independence this initiative is the most effective, rapidly growing and potent program for providingfinancial services to the low-income households on a timely and sustainable manner. As of 31st March 2007 there were 29.25 lakh financed SHGs. The southern states of the nation have the highest number of credit linkages and it has been observed that the spread of the credit linkages program has been highly uneven. Many states with increased poverty levels, showed decreased participation in this program and NABARD has listed 13 states with increased low-income populations, showing such decreased performance in the implementation of the credit linkage scheme. NABARD is trying to promote a lot of initiatives to carry out the program efficiently but these efforts need a new and engaging stimulus. The committee has suggested that NABARD can open specific project offices in these 13 low-income states to upscale the credit linkage program. It also states that the state government and NABARD can allocate dedicated funds from the budget

and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of encouraging credit linkages in areas with increased inclusion levels. There is an increased need to involve the SHG model highly specific to the local area especially in the north-east region of the country.

Extending SHG – Bank Linkage Scheme in Urban Areas

The number of people in urban areas having no access to organized financial services is not clear, partly because of the migratory nature of the urban poor. The urban poor population primarily consists of migrants from the remote and rural areas. The committee has made changes to the NABARD Act to encourage it to provide micro finance services to the urban poor as even money lenders refuse to lend them some money.

Joint Liability Groups

There are sections within the low-income population such ascroppers/oral lessees/tenant farmers, who have an increased loan requirement but they don’t have any collaterals that can successfully fit into the conventional banking sector approaches.SHG-bank linkage has created an effective credit delivery mechanism for such under privileged people. Joint Liability Groups (JLGs) is an upgraded SHG model, which enables to serve such clients in an effective manner. During 2004-05, NABARD started a project for the creation and linkage of JLGs in 8 Indian states via 13 RRBs. The scheme was very well received and therefore another scheme financing JLGs of tenant farmers and oral lessees has also been sanctioned. Mid-segment clients such as small, marginal and tenant farmers can be highly benefitted by the adoption of the JLGs concept and this could be another method for providing credit to them and in turn reducing their dependency on informal sources.

Micro Finance Institutions – NBFCs

Micro Finance Institutions (MFIs) have a significant role and a unique position in reaching out to the rural poor populations and hence in turn facilitating financial inclusion. Most of them are located in small and limited geographical areas, have a higher understanding of the local issues specific to that indigenous population, are better accepted amongst the local poor people, and have an increased flexibility in terms of operations that provides a huge sense of comfort to their local clients. Hence, the committee has suggested that higher legitimacy, accountability and

transparency will encourage the MFIs to create sufficient debt and equity funds and also enable them to procure savings as a reduced cost source for on-lending.

In micro finance, Non-Banking Finance Companies (MF–NBFCs) is a separate category without any relaxation on initial capital and it is also subjected to the regulatory procedures meant for NBFCs. MF-NBFCs can provide thrift, credit, remittances, micro-insurance and various other financial services up to a certain amount to the poor and the low-income households in the rural, semi-urban and urban areas. These MF-NBFCs act as micro insurance agents and are recognised as Business Correspondents for banks for providing savings and remittance services.

Revitalising the Cooperative System

Compared to cooperatives, thereach of commercial banks and RRBs in rural areas in terms of their number of clients and ease of accessibility to the small, marginal farmers and other low-income households is very low. The network of commercial banks and RRBs has increased rapidly and they currently have approximately 50,000 rural/semi-urban branches. The Short Term Cooperative Credit System (STCCS) has 50% more agricultural credit accounts than those of commercial banks and RRBs put together. On an average 6 villages have one PACS. STCCS is one of the largest rural financial systems in the world as these societies have a total membership of more than 120 million rural people. Though the state of affairs and the overall quality of a huge chunk of these rural credit cooperatives have significantly reduced and deteriorated.

Micro Insurance

For people lying at the bottom of the financial pyramid, micro-insurance is the primary and a very important element in thefinancial services package. The low-income households and poor people encounter greater challenges and increased risks than the rich communities. Micro-insurance needs higher encouragement and guidance from the government and the regulators. The committee believes that micro credit needs to be linked to micro-insurance because practising these two separately won't yield any favourable result and will prove to be self-defeating.

Our country is currently experiencing a significantly higher growth trajectory and to be able to sustain and foster this momentum, the increased participation of the financially and economically weaker sections of the society is an integral process. Financial inclusion of the low-income households and the poorer segments of the society is an extremely crucial part of this inclusion

process and it is believed and hoped that if the recommendations suggested in this report are implemented they will help to achieve this financial inclusion at a much faster pace.

Visions for full financial inclusion and deepening in India:

1. *Universal Electronic Bank Account (UEBA):* Indian residents above eighteen years of age would be provided with an individual, full-service, safe and completely secure electronic bank account. Each Indian resident, above the age of eighteen years, would have an individual, full-service, safe, and secure electronic bank account.
2. *Ubiquitous Access to Payment Services and Deposit Products at Reasonable Charges:* Indian residents would also be provided with amenities that would allow them to access payment services with such service provide points within fifteen minutes of walking distance.
3. *Sufficient Access to Affordable Formal Credit:* Easy access for low-income household and small-business operatives to authorised lenders deputed to meet their credit needs and also qualified enough to assess the same. Such lenders would also have to be able enough to provide them with a complete range of suitable credit products at reasonable prices.
4. *Universal Access to a Range of Deposit and Investment Products at Reasonable Charges:* Suitable investment and deposit products should be easily accessible by low income households and small-business operatives, which would be provided to them at reasonable charges.
5. *Universal Access to a Range of Insurance and Risk Management Products at Reasonable Charges:* Providers with the ability to offer suitable insurance and risk management products should be made accessible to low-income households and small business operatives. The services provided by them should arrange for protection from risks related to: (a) commodity price movements; (b) longevity, disability, and death of human beings; (c) death of livestock; (d) rainfall; and (e) damage to property.
6. *Right to Suitability:* it is also required to arrange for legally protected rights for such groups to be provided with only suitable financial services. The groups as such, would be provided with legal help in case the process fails to follow the proper procedure to establish suitability.

Financial Inclusion Initiatives in India

NABARD (1992) launched SHG-bank linkage programme with thepolicy support from the Reserve Bank of India to facilitate collective decision making by the poor and provide 'door step' banking.

RBI (Nov 2005)advisedbanks to make available a basic banking 'no-frills' account with low or nil minimum balances as wellaschargestoexpandtheoutreachofsuch accounts to vast sections of the population.

RBI (January 2006)permittedbankstoutilisetheservicesofNGOs/SHGs,MFIs(otherthanNBFCs)andothercivil societyorganisationsasintermediariesfor providing financial and banking services through the useofbusinessfacilitator(BF)andbusiness correspondent(BC)models.

RBI (2009)"The high-level committee constituted by the Reserve Bank of India to review the Lead Bank Scheme (LBS) has come out with its several recommendations with view that, a sharper focus on facilitating financial inclusion rather than a mere review of the government sponsored credit schemes."

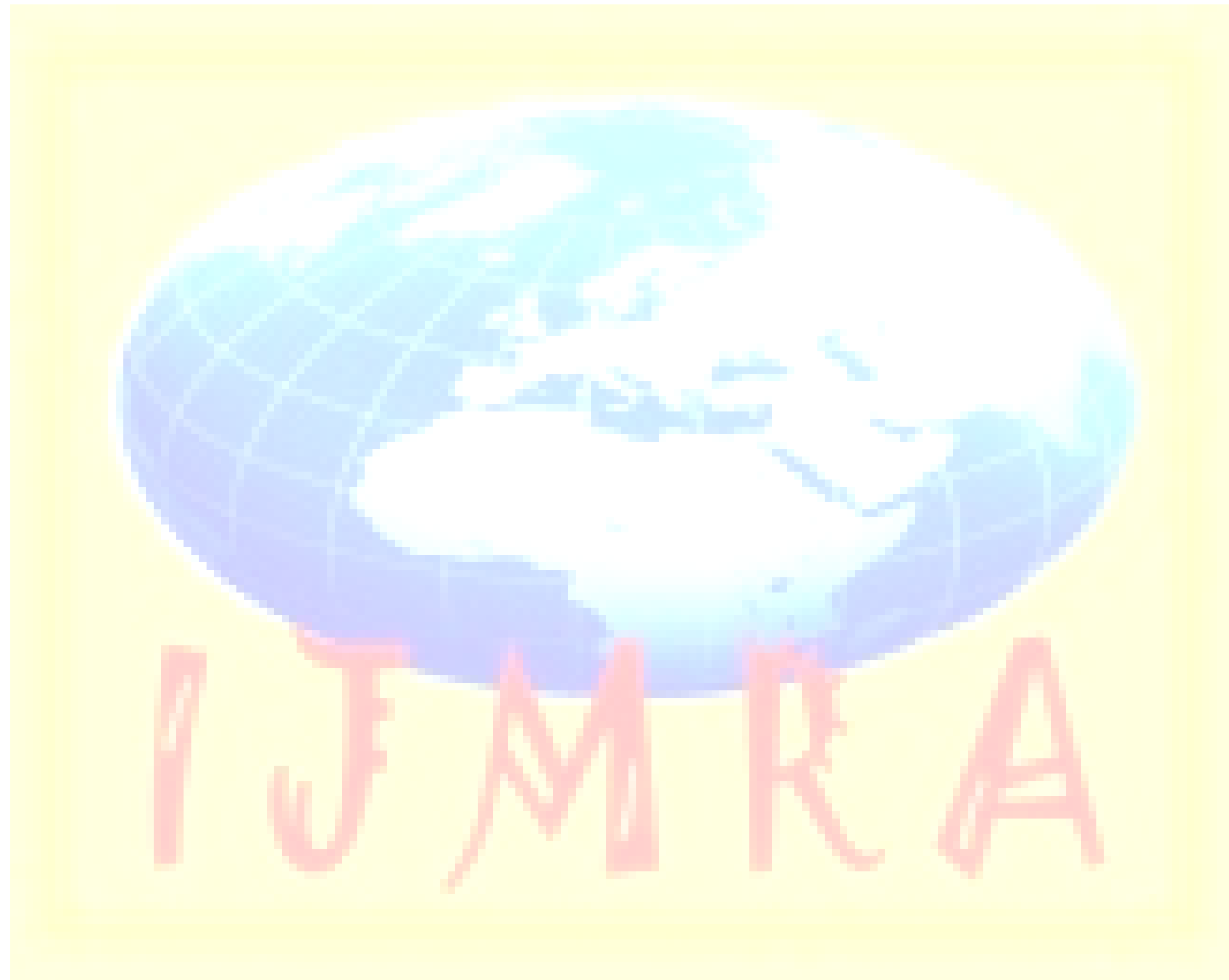
Usha Thorat (2009)"The review on Lead Bank Scheme (LBS) has been made with a focus on financial inclusion and in view of the recent developments in the banking sector. The scheme has been found to useful to promote financial inclusion in the country. Hence it should be continued."

Indian economy review (2011)"A key facilitator for enabling the country's banking system to spread its reach in the coming days can be the unique identification (UID) number. UIDAI (Unique Identity Authority of India), targets to provide unique identity to 600 million residents in next five years, which will address many of the current challenges faced by the banks in delivery of financial services. UIDAI have identified financial inclusion as the main driver for UID and enabling e-governance."

Conclusion

Financial exclusion hurts individuals, disrupts families, and burdens society. It makes living on a low income more troubling, unstable and stressful than it otherwise would be, and acts as a barrier to personal development and economic growth. Financial exclusion exists due to a range of different causes. On the demand side, these causes include a lack of trust in financial institutions

and low skills. On the supply side, these causes include the way that financial products are designed and marketed. Financial inclusion initiatives need to be firmly embedded within policies that aim at improving access to financial services more broadly rather than isolated initiatives. The policy should be multidimensional and joined-up approach between different stakeholders to improve feasibility of financial services



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