

FINANCIAL INCLUSION WITH ASYMMETRIC INFORMATION: A FEASIBLE OPTION FOR INCLUSIVE GROWTH?

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Abstract

The concept of inclusive growth is multifarious and has financial inclusion as one of its foremost foundation blocks. India needs inclusive growth in order to clinch expeditious disciplined growth for sustainable, steady, secure and equitable distribution of wealth, prosperity and development. Financial inclusion is providing integrated services to all the sections of the society by curbing the threats to economy. Facilitating access to financial services accelerates thrift and promotes habit of saving. Greater financial inclusion by expansion of bank branches, strengthening of financial literacy, better access to finance, rapid credit growth, eased transactions and diversification of bank deposits reduces income inequality and poverty, generates employment and stimulates economic development and socio-political stability. But at the same time, financial inclusion clients are considered as opaque and risky. Inclusive growth if targeted systematically can positively accord with financial health and soundness, asset building and economic mobility, emancipation and empowerment of the vulnerable section. The present paper is an attempt to comprehend and understand the feasibility of financial inclusion under asymmetric information in an advancing country like India wherein 'financial inclusion' is perceived as a counterpart and strategy for 'inclusive growth'.

Keywords: Financial inclusion, inclusive growth, asymmetric information.

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1. Introduction

Inclusive growth and financial inclusion are among the sustainable and millennium development goals. The term ‘inclusive growth’ has recently become modish, but the promotion of equity had always been the onus of India’s policy goals. Inclusive growth meant to trickle down the benefits of economy to all the weaker sections, low income groups, women, children, minority groups, poor in remote areas, migrants, human made and natural made disaster sufferers. Since independence impressive achievements have been bagged, but still India has the largest number of poor and under- nourished children. The GDP percent change per annum and the growth of real GDP per head per annum has followed a rising trend, at the same time, consumption inequality has also rapidly increased. Although the poverty has reduced, trend is not substantial. For India being a socialist, democratic, republic, it is necessary for policy makers to eradicate poverty and unemployment and nourishes equitable growth for all the sections of the economy.

Financial sector is apparently the only sector that not only facilitates services but also multiplies the growth of the overall economy. For a long time, financial inclusion is the hot topic of policy spheres because of its efficacy in catalyzing the economic growth. Financial inclusion attempts to connect all the sections of the society to market economy and mitigates risk by facilitating access to services, access to savings, loans, insurances, remittances and payments among others. Among the key financial services, risk mitigation services vis-à-vis economic shocks are of inordinate relevance. But India is facing an opposition in assuring ‘inclusive and equitable growth.’

1.a. The concept of Financial Inclusion

‘Financial inclusion’ is perceived as a counterpart also as a strategy of ‘inclusive growth’. Rangarajan Committee (2008) elucidated 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 particular, there are two sides of financial inclusion: demand side and supply side. Demand side explains usage of financial services by the customers and supply side explains availability and accessibility of timely financial services at an affordable rate of interest by formal financial institutions.

Financial inclusion needs to concentrate on:

- An approach to provide access to diversified financial services at a reasonable affordable rates and not just credit or deposits alone.
- Meet the needs of marginal farmers, migrant population, small firms, and vulnerable sections of the society.
- Deprived segments of population on the basis of incomes, gender, remoteness, etc.

Financial inclusion can be termed as a quasi- public good since it meets the conditions of ‘non-rivalness’ and ‘publicness’. Financial inclusion is able to reap the benefits of network externalities as the value of the whole financial system rises. The full active participation of all the citizens in the financial system makes regulatory policies more effective and thus advances the prospects of non- inflationary growth. Hence, it is incumbent upon the government to provide it in partnership with other agencies

2. Rationale and Objective of the Study

Financial inclusion and inclusive growth are the main agendas of the national and international policy makers. Since financial sector is considered as the only sector that can foster the overall growth and stability of economy, it becomes imperative to understand financial inclusion, inclusive growth and the role of financial inclusion in effectuating inclusive growth. Also, the multiple global actions to advance financial inclusion compel to analyze the feasibility of financial inclusion in India with asymmetric information of target customers.

3. Methodology

The present research study has been initiated using analytical analysis of the available financial intermediary theories, various research publications and fair effort of deals taken by the government.

4. Inclusive Growth

Inclusive growth is the most stubborn challenge of the time that nation faces. It is the need of the hour to ensure while Indian economy grows in leaps and bounds; all segments of the society are part of it, without depriving any section or region and preventing regional imbalances from derailing such growth. Brisk growth in rural areas, sustainable urbanization, infrastructural development, revamping of education system, remodeling of health facilities, fortifying future

energy needs, a well established public-private partnership, making all sections of society equitable and above all good governance will rampart India's growth. The main thrust areas for the need of inclusive growth are:

- Eradication of poverty and unemployment
- Obliteration of income inequalities
- Agricultural and rural development
- Dilution of regional disparity
- For social sector development
- Safeguarding environment

However, to ensure these objectives, there is an obligation for generation of resources which can possibly be attained by financial inclusion.

5. Role of Financial Inclusion in Inclusive Growth

The concept of inclusive growth is multifarious and has financial inclusion as one of its foremost foundation blocks. India needs inclusive growth in order to clinch expeditious disciplined growth for sustainable, steady, secure and equitable distribution of wealth, prosperity and development. Financial inclusion is indispensable for disciplined inclusive growth in India. Financial deepening endeavours to invigorate creation of ample social security nets that shall provide a variety of financial products like pension, insurance and saving instruments. Facilitating access to financial services accelerates thrift and promotes habit of saving, which has notable unrealized potential to uplift poor from the vicious circle of poverty. Finance is such a measure that can hit two birds with one stone; one it can enable efficient payment mechanism, regulate monetary policies, provide diversified stable retail funding base that can strengthen the roots of a financial system, other if it is used and targeted judiciously by exploiting economies of scale, removing market imperfections, optimally utilizing tools like direct benefit transfer, subsidies etc., it would be an apt and prompt solution to severe problems like poverty and unemployment.

6. Feasibility of Financial Inclusion under Market Imperfections

6.a. Theoretical background: George Akerlof, Michael Spence and Joseph E. Stiglitz have contributed their efforts to analyze different markets with asymmetric information. Asymmetric information deals with the study of situation/transactions where one party has more or complete

knowledge than the other party. Authors have explained the theory using the example of car market or lemon market problem, insurance market, finance market. Due to asymmetric information, the problem of adverse selection and moral hazard may arise which may lead to reduced profitability and stability of banks. In finance, there is problem of good or bad borrowers, and borrowers have advantage as over lenders as borrowers have better information about the investment projects or the expected returns. So lender will advance loan at an average quality of borrowers. Here, good quality borrowers will suffer as they will pay higher rate of interest and bad quality borrowers will be at advantages they will pay lower rate of interest. Thus, good quality borrowers may be driven out of the market.

6.b. Descriptive analysis: Available literature has elucidated that greater financial inclusion by expansion of bank branches, strengthening of financial literacy, better access to finance, rapid credit growth, eased transactions and diversification of bank deposits reduces income inequality and poverty, generates employment and stimulates economic development and socio-political stability.

But there is a risk of asymmetric information. Financial inclusion clients are assumed to be unknown, opaque, inexperienced, numerous, less informative, lack collateral and characterized by frequent small value transactions with high operating costs, thus are considered as risky clients who can deplete bank profits and eventually can lead to bank instability. The distance between lender and borrower undermines efficacy of banking services through intensification of asymmetric information problem. This has been clearly explained by Dr. R. Rajan, in regard to subprime crisis, 'easy credit' as a mechanism to reduce income inequality can create a 'fault line' along the financial system undermining the banking stability owing to enormous stresses.

6.c. Major obstacles to financial inclusion: The first question comes to mind why financial inclusion is not feasible in a developing country like India, when it is one of the main onus and concern of the policy makers.

- **Financial Exclusion:** Migrants, slum dwellers, daily wage earners, marginalized majority, and economically deprived regions rely mostly on informal sector lending (covetous

moneylenders) for availing financial services at exorbitant rates. This leads to vicious circle of poverty.

- **High Costs:** It has been observed that a large segment of population dwells in rural areas which have generally low saving habits, small loan requirements; frequent minuscule value transactions are accompanied by high transaction costs which, in turn, discourages service providers to expand branches in rural areas. At the same time, migrants and slum dwellers find financial services costly which deters to have access to them.
- **Non-price barriers:** A customer is unable to have access to financial services if he/she fails to produce basic required documents like proof of identity, income certificate, lacks awareness etc. Even those who are able to cross these hurdles and successfully subscribe services remain inactive because of poor infrastructure facilities, low penetration of service providers, financial illiteracy, distance between banks and their place, etc.
- **Behavioral aspects:** Research has portrayed that a large segment of population is not comfortable in availing financial services as they find it difficult to understand norms, policies, official language and complicated and lengthy documentation process. They feel safe to approach traditional moneylenders and hesitate to adopt advanced technological methods irrespective of the fact that banks are more trustworthy than covetous moneylenders.

7. Externalities of Inclusive and Financial Growth

Access of finance to vulnerable sections can contribute to consumption smoothing and investments in health, education and income generating activities, thus widening growth options for them.

Financial inclusion is a blessing in disguise. Amplified financial inclusion has the power to drastically minimize the farmers' indebtedness and mechanize Indian agriculture. An enhanced security net to rural farmer mitigates risks and encourages them to adopt new technologies at a swift rate.

By facilitating easy access to educational loans at reasonable rates to all sections of society will improve financial inclusion and will also be harmonious with inclusive growth since education is one of the pre-condition for providing equal opportunities to all citizens of India.

Financial inclusion will boost micro-venture capital funds, untapped innovation and promote entrepreneurship. Inclusive growth if targeted systematically can positively accord with financial health and soundness, asset building and economic mobility, emancipation and empowerment of the vulnerable section.

8. Conclusion

The aspiration of achieving inclusive growth will not be possible without co-ordinating with financial inclusion. However, one also needs to understand that financial inclusion is a long run phenomenon because even after a big boom launch of Pradhan Mantri Jan Dhan Yojana, India had been unsuccessful in removing financial untouchability. Since India is shackled by lack of awareness, unaffordability, poor banking infrastructure, financial illiteracy, high transaction costs, inflexible quality of products, among others, it is a tremendous task first to remove stated threats then fast-track the initiatives to attain inclusive growth along with financial inclusion. Inclusive growth is must in regard to globalization, sustainable structural transformation and the need for a regionally equitable steady growth within a country.

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