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An Empirical Analysis of Financial Inclusion In India

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Abstract

As the economy matures, it is important for the government to ensure that growth becomes more inclusive. An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. In addition, use of proper financial services can significantly improve the day to-day management of finances. Financial inclusion ensures delivery of banking services and credit at affordable cost to the various sections of disadvantaged and low income groups.The paper primarily looked to find out the extent and spread of financial inclusion in India. Since the study is based on macro level parameters such as number of bank branches and number of Automated Teller Machines (ATMs) and availing of banking services by Indians, the secondary data readily available from database of Reserve Bank of India (RBI), National Sample Survey Organization (NSSO),World Bank & other establishments of Indian government were used.We noted that financial exclusion in terms of access to credit from formal institutions is high for small and marginal farmers and some social groups. Driving away rural and urban poverty in India can help in achieving inclusive growth. Financial institutions and government together can bring the most awaited change of almost 100% inclusion.

Key WordS: Financial inclusion, GDP, social and economic empowerment

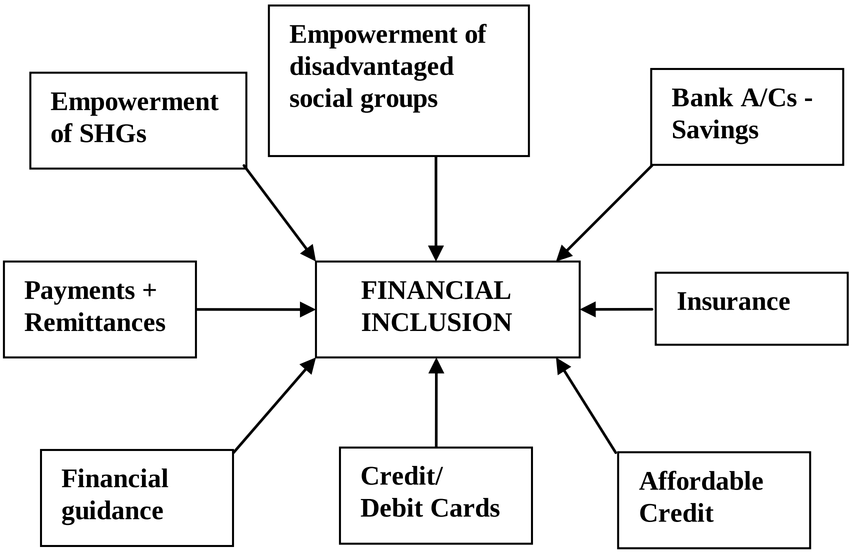
Introduction

There are many factors distressing access to formal banking system in any country. They include traditions, financial literacy, gender, earnings and assets, evidence of identity, isolation of residence, and so on. Today India has the proud distinction of being world's largest and fastest increasing free market democracy with impressive growth in different socio-economic parameters over the years. It has achieved around 9% GDP growth for last 9 years starting with 2003-04.As the economy matures in terms of growth dimensions, it is important for the government to ensure that growth becomes more and more inclusive. Here, Inclusive growth means overall growth & expansion of the economy by government implementing the reforms to empower the poor & marginalized to make the most of the rising livelihood opportunities by investing in their health, nutrition, education, promoting fair access to banking and market. Inclusiveness is vital for enabling a country to reach its full potential – economically, socially and politically. It is important to note the fact that economic growth should be pro-poor, should have a humane face and more importantly should be inclusive. India has more or less achieved the first two milestones hence the third aspect i.e. inclusiveness has become the centre stage of the present economic growth structural design.

The growth with exclusion is curse that tends to cut off a sizeable population from the economic mainstream and hence it needs to be replaced by "inclusive growth" which ensures equitable distribution of nation's wealth that leads to redistributive justice. In crux, the vicious sequence of overlapping inequality has to be turned into righteous sequence of perpetual equity and growth. Thus, each & every individual should be provided with affordable institutional financial products/services popularly called “Financial Inclusion”.

By **Financial inclusion**, we mean delivery of banking services and credit at affordable cost to the various sections of disadvantaged and low income groups. Various financial services include reserves, loans, indemnity, expenses, remittance facilities and financial counseling / advisory services by the formal financial system. In other words provision of affordable financial facilities like savings account, loans, remittance, and insurance facilities to vast number of low income and disadvantaged sections of the society is called Financial Inclusion.

An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cosof capital. In addition, use of proper financial services can significantly improve the day to-day management of finances. Financially excluded people are exposed to the informal sources of credit with high interest rates and often have to face harsh and unethical recovery practices. Thus, an all-inclusive financial system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services.



In the first-ever Index of Financial Inclusion (IFI) prepared by a New Delhi-based organization, ICRIER (Indian Council for Research on International Economic Relations), to find out the extent of the reach of banking services in 100 countries worldwide pointed out that Spain has occupied the top position in IFI, which is based on data from 2004, followed by Canada and Portugal, whereas countries including Zimbabwe, Nepal and Botswana are at the end of the list. Among the main countries, Germany has been placed at 4th rank, the UK 17th, USA 21st and Japan 22nd. India has been ranked poorly at 50th position, much above Russia but below China, even below African countries such as Kenya and Morocco. Similarly, the report pointed out that domestic deposit as percentage of GDP was 54.9 per cent in India, against 123.9 per cent in Malaysia.

Literature Review

Banks would have to evolve specific strategies to expand the outreach of their services in order to encourage financial inclusion. One of the ways in which this can be done in a cost-effective manner is through forging linkages with micro finance institutions and local communities. Banks should advertise the wide publicity of no frills account. Banks need to redesign their business plans to incorporate specific plans to promote financial inclusion of low income group treating it both a business opportunity as well as a corporate social responsibility(V.Leeladhar, 2005).Access to finance may become a good sign of economic and social change that improves governance structure decreasing some of the reasons of poverty. Micro finance organizations are working properly in meeting the objectives of providing credit and channelizing the small saving practice of the poor. Adequate and subsidized credit to the small and micro industries would help in raising employment opportunities and reducing poverty and thereby increasing accessibility. (Avgouleas, 2008, Das-2006, Sehgal-2006, Muralikanan-2006)

In recent years, Indian banking sector is facing the problem of financial exclusion. But, it is not altogether a new exercise. Financial inclusion was envisaged and entrenched in Indian credit policies in the earlier decades also, though in a hidden form and lacking the same categorization. (Rao, 2007)

In many countries, procedures connected with transactions at formal financial institutions are so complex, burdensome and intimidating for most low income clients particularly with low literacy level and poor women that they hesitate to go there. They observed that poor people in many countries get deposit facilities but the quality of services and other financial access to them by the formal and semi-formal institutions is highly disputed. (Fernando,2007, Joshi, 2006)

Having a bank account or insurance coverage not only enhances the economic position of the holder but also acts as a facilitator for further social and economic empowerment. Ever since independence, flow of credit to the poorer sections of the society has been a key concern, despite a number of institutional measures to recover the condition over several years. Between two conflicting objectives of profitability and serving the needs of the real economy and society, the banks have more tilted toward the former. Micro finance institutions have also not been successful to improve saving habits of the poor in rural area and provide particular services like remittance facilities and credit facilities. It was suggested that working through open, participatory process with multiple stake holders to develop policy, strategy & national action plan and finally executing them in true spirit would only solve the problem. (National Conference on “Financial Inclusion & Beyond, 2006) Micro-finance offers significant potential for achieving financial inclusion. The experience of the bank in this segment has been quite encouraging. In the words of Prof. C.KPrahalad “If we stop thinking of the poor as victims or as a burden and start recognizing them as resilient and creative entrepreneurs and value conscious consumers, a whole world of opportunity will open up”. (K.C.Chakrabarty, 2008)

Financial inclusion, as a subject of academic interest and a tool of policy measure is not very old. United Nations published ‘Blue Book’ defining a set of policy measures to improve financial inclusion around the world through Micro finance in 2005 after consultation with delegates from different countries and different forum. Then World Bank also organized a conference in 2006 to find out ways to build a society supported by ‘Inclusive Growth’. After that only, the subject of financial inclusion got the attention of the government and world over to be treated as a policy objective in the direction of building an inclusive society for sustainable development.

Research Methodology

For all practical purposes holding a bank account, it opens the account holder to access the facility of transfer, payment and financial guidance from the concerned financial institution. It also displays a sense of identity, status and empowerment .Therefore, having a bank account becomes a very important aspect of financial inclusion. Financial inclusion, in a great sense, may be achieved by opening an account. On the other hand, funds are the primary requirement for anybody to meet day to day needs, for business purpose or for potential developmental purpose. Getting credit from a formal financial institution in time and at reasonable cost not only makes a customer financially empowered but also socially strengthened. Further, a person having deposit account in bank can easily avail credit from that concerned bank. So, having a deposit account in a bank is a healthy sign of financial inclusion.

Hence, financial inclusion is to be defined and analyzed under two heads i.e. anyone having a bank account (Saving & Current or both) and availing credit from any formal financial institution. In other words anyone is said to be financially included if he/she is having a bank account or if he/she is having a loan account in a formal financial institution. Formal financial institution refers to banks, RRBs, Co-operative banks and Micro Finance Institutions like NGOs, Self Help Groups etc.Therefore, the study primarily looked to find out the extent and spread of financial inclusion in India. Since the study is based on macro level parameters, hence the secondary data was used. The data quarterly & annually published by the Reserve Bank of India, NSSO, NABARD, World Bank & other establishments of Government of India was deployed to prepare the research work. The data extracted from the aforesaid websites was analyzed and only the relevant data has been explained here (meaning thereby the data required for understanding the current scenario of financial inclusion).

Findings and Analysis:-

Based on the above methodology, followings are some findings stating the rate of exclusion, reasons for the low rate of inclusion (or high rate of exclusion), Measures taken by the Govt., and Suggestive Measures.

1. Scenario of Financial Inclusion (Source:- RBI)

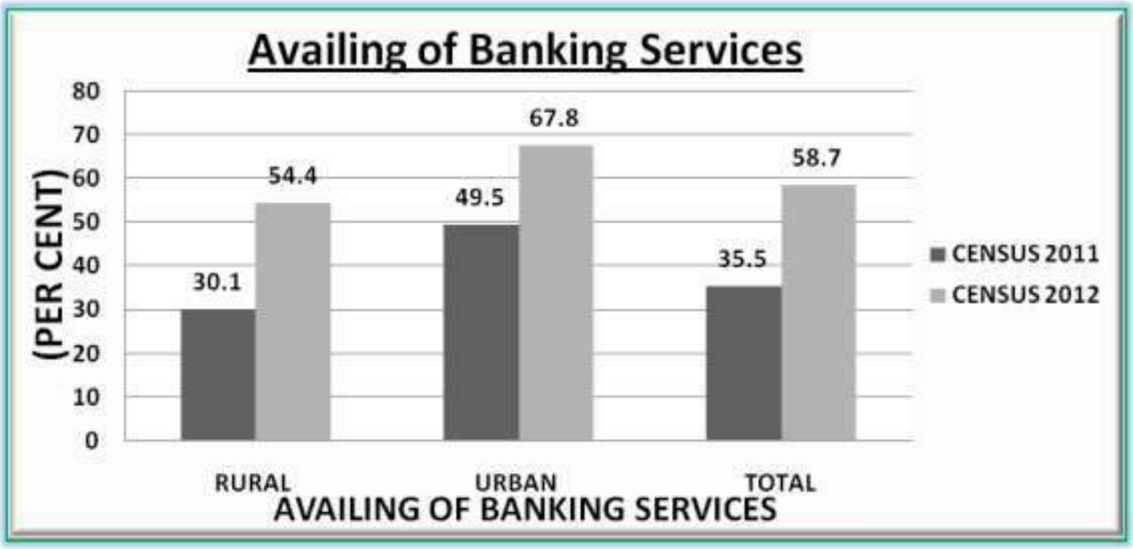
- Firstly, an inter country comparison is done based on the two parameters i.e. Number of bank branches and No. of ATMs per 1000 Km. And per 0.1 million respectively. These parameters show the level of financial inclusion of a particular country in the sense that higher the no. of bank branches per 1000 km, higher will the coverage of banking services leading to more bank account holders which ultimately means higher will be the financial inclusion. Now, Table – I shows the data presenting the scenario of India based on the aforesaid parameters in comparison to other countries.

Table – I: - Level of Financial Inclusion in India and its comparison with other countries based on selected parameters

S. No.	Country	Number of Bank Branches	Number of ATMs	Number of Bank Branches	Number of ATMs
		Per 1000 KM		Per 0.1 Million	
1.	India	30.43	25.43	10.64	8.9
2.	Indonesia	8.23	15.91	8.52	16.47
3.	Mauritius	104.93	210.84	21.29	42.78
4.	Mexico	6.15	18.94	14.86	45.77
5.	Thailand	12.14	83.8	11.29	77.95
6.	Malaysia	6.32	33.98	10.49	56.43
7.	Switzerland	84.53	166.48	50.97	100.39
8.	China	1428.98	2975.05	23.81	49.56
9.	Brazil	7.93	20.55	46.15	119.63
10.	South Africa	3.08	17.26	10.71	60.01
11.	Korea	79.07	-	18.8	--
12.	UK	52.87	260.97	24.87	122.77
13.	USA	9.58	-	35.43	-
14.	Sri Lanka	41.81	35.72	16.73	14.29
15.	France	40.22	106.22	41.58	109.8

As per census 2011, only 58.7% of households are availing banking services in the country. However, as compared with earlier census 2001, availing of banking services augmented considerably largely on account of increase in banking services in rural areas (as shown in Figure I).

Figure I :- Availing of Banking Services



2.Extent of Exclusion in Rural Area or households (Source :- 59th NSSO Survey)

a) General:-

• 51.4% of farmer households are financially excluded from both formal / informal sources (459 lakh out of 893 lakh).

• Of the total farmer households, only 27% access formal sources of credit; one third of this group also borrow from non-formal sources.

• Overall, 73% of farmer households have no access to formal sources of credit.

b) Region-wise:-

• Exclusion is most acute in Central, Eastern and North-Eastern regions – having a concentration of 64% of all financially excluded farmer households (from formal sources) in the country (415.61 lakh households out of 649.54 lakh households). Largely indebtedness to formal sources of finance alone is only 19.66% in these three regions (4.09% for North-Eastern Region, 22.41% for Central Region and 18.74% for Eastern Region).

c) Occupational Groups:-

• Marginal farmer households constitute 66% of total farm households. Only 45% of these households are indebted to either formal or non formal sources of finance (small farmers – 51%, medium farmers – 65.1% and large farmers – 66.4%).

• About 20% of indebted marginal farmer households have access to formal sources of credit (medium farmers – 57.6% and large farmers – around 65%).

• Among non-cultivator households nearly 80% do not access credit from any source.

d) Social Groups:-

• Only 36% of ST Farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.

While NSSO reveals critical exclusion as obvious in certain regions and social / economic groups, there are other sets of data which show a different scenario. As per CMIE (March 2006), there are 11.56 crore land holdings and 5.91 crore Kisan Credit Cards have been issued as at the end of March 2006, which translated into a credit area of more than 51% of land holdings by formal sources. Moreover, data with NABARD on the replication of agricultural credit indicates that agricultural loan disbursements during 2006-07 roofed 3.97 crore accounts.

Thus, there are different estimates of the extent of inclusion through formal sources. Further, the reference period of the data is also not uniform – the BSR figures follows 2004 as the base, CMIE 1995 (published March 2006), while NSSO covers situation during 2003. Consequently, this has had an effect on quantifying the scope of levels of exclusion. RBI / NABARD should look into this aspect and study the reasons for such large differences arising in the estimate of levels of exclusion.

However, in spite of such differences in the data available, what can be stated with certainty is that exclusion exists – to a great extent among specific occupational groups, specific social groups and in specific regions, either in isolation or in combination.

3. Reasons for the low Inclusion or high Exclusion :-

- Lack of observation of the value of availing of formal goods and services.
- Lack of information and facts about services hence inadequate access to services.
- Personal and social factors influence access to financial services.
  - "Cultural norms matter."
  - "Gender matters."
  - "Age matters."
  - "Legal identity matters."
  - "Where you live matters."
  - "Level of income matters."
  - "Type of occupation matters."
- Types, attractiveness and availability of financial products influence and limit consumer choices.
- Cost of operating small sized transactions.
- Inadequacy of financial infrastructure and weaknesses of financial sectors can limit access.
- Lack of proper technology and its coverage.
- Remote, mountainous & lightly populated areas with poor infrastructure and difficult physical access.
- Lack of awareness, small income, social exclusion and illiteracy.
- Distance to the nearest branch of the bank, branch timings, cumbersome documentation/procedures, unsuitable products, language, staff behavior are common reasons – Higher transaction cost.
- Ease of availability of informal credit but at a very high rate as compared to the Bank Rate
- Complex KYC norms – documentary proof of identity/ address.

So, Based on above reasons, following can be counted as the Drivers of Financial Exclusion:-

Most frequent

- Low income
- Nil or low savings
- Lack of assets
- Unemployment
- Under employment
- Use of inappropriate products
- Financial illiteracy

- Poor financial habits

Less Frequent

- Psychological/disability issues
- Feeling of being excluded
- Indigenous/ethnic issues
- Geographical remoteness
- Lack of time
- Lack of PC/Internet Access
- Availability of alternative products and suppliers

4.Govt. And RBI Measures Taken So Far :-

Several steps have been taken by the Reserve Bank of India and the Government to bring the financially excluded people to the fold of the formal banking services or under the category of financially included people. The steps are as follows:-

- Introduction of 'No-Frills' account
- Relaxing 'Know Your Customer' (KYC) norms
- General Purpose Credit Card (GCC) Schemes
- Role NGOs, SHGs and MFIs
- Business Facilitator (BF) and Business Correspondent (BC) Models.
- Nationwide Electronic Financial Inclusion System (NEFIS)
- Project Financial Literacy
- Financial Literacy and Credit Counselling Centres (FLCC)
- National Rural Financial Inclusion Plan (NRFIP)
- Financial Inclusion Fund (FIF)
- Financial Inclusion Technology Fund (FITF)
- Basic Saving Bank Deposit (BSBD)
- Simplified Branch Authorization Policy
- Compulsory Requirement of Opening Branches in Un-banked Villages.

Conclusion

The concept of financial inclusion covers wider financial services such as credit, savings, insurance, etc. We have noted that financial exclusion in terms of access to credit from formal institutions is high for small and marginal farmers and some social groups. Moreover, in achieving inclusive growth in India, it will play a vital role and help the nation to drive away the not only rural poverty but also urban poverty in India. The financial system in India has grown quickly in the last three decades and more. The functional and geographical range of the system is truly remarkable. Nevertheless, data do show that there is exclusion and that poorer sections of the society have not been able to access adequate financial services from the organized financial structure. There is a vital need to modify the credit and financial services delivery system to achieve larger inclusion. Creating an appropriate credit delivery system is only a necessary condition. This needs to be supported by efforts to improve the productivity of small and marginal farmers and other entrepreneurs so that the credit made available can be efficiently and effectively employed. While banks and other financial institutions can also take some efforts on their own to enhance the absorptive capacity of the clients, it is equally important for Government at various levels to initiate actions to improve the earnings capacity of the poorer sections of the society. The two together can bring about the most awaited change of almost 100% inclusion quickly.

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