Research Paper Management

Financial Inclusion: The Indian Perspective

Barun Kumar Jha Research Scholar, Patna University, Patna

Shilpa Sureka UGC- NET-JRF

ABSTRACT

A well-developed financial system brings poor people into the mainstream of the economy and allows them to contribute more actively to their personal economic development. In India, in an attempt to improve access to financial services or financial inclusion, the Reserve Bank of India (RBI) promulgated a drive for financial inclusion, where banks take the lead in providing all 'unbanked' households in a district, with savings accounts. As India's economy continues to grow and incomes rise, there is an increased need for financial services. There has been considerable improvement in the deepening of the financial system through growth in bank credit and the spread of deposit facilities. The issue of financial inclusion is especially important today as India's rural economy has shifted towards more commercialized agriculture and non-agricultural activities, both of which require banking facilities. This paper analyses the Indian approaches of financial inclusion, rational for financial inclusion, scope of financial inclusion, initiatives for financial inclusion in India etc.

KEYWORDS Financial Inclusion, Inclusive Growth, Banks.

Introduction

Financial inclusion can be described as the delivery of banking and other financial services at affordable costs to the vast sections of disadvantaged and low income groups. Unrestrained access to public goods and services is essential for an open, inclusive, and efficient society. Banking services are in the nature of public services. As such it is essential that availability of banking and payment services to the entire population without discrimination is adopted as one of the prime objectives of public policy. Therefore, all countries have widely acknowledged the fact that improving the access to financial services is a very effective strategy for development of rural areas. Hence, it is important that financial inclusion of the excluded households of rural areas is being accorded high priority by the governments in the developing countries.

A stronger and better financial system can also lift growth by boosting the aggregate savings rate and investment rate, speeding up the accumulation of physical capital. Financial development also promotes growth by strengthening competition and stimulating innovative activities that foster dynamic efficiency. According to Demirgüç-Kunt and Levine (2008), the overall function of a financial system is to reduce information and transaction costs impeding economic activity, and its five core functions are to (i) produce extant information about possible investments and allocate capital; (ii) monitor investments and provide corporate governance after providing finance; (iii) facilitate the trading, diversification and management of risk; (iv) mobilize and pool savings; and (v) ease the exchange of goods and services.

Causes of Financial Exclusion in India

Access to formal banking system is affected by several barriers such as culture, financial literacy, gender, income and assets, proof of identity, remoteness of residence, and so on. Over a period of time several measures are being taken by the banks in India to improve access to affordable financial services through financial education, leveraging technology, and generating awareness. There are number of factors affecting access to financial services by weaker section of society in India. The lack of awareness, low incomes and assets, social exclusion, illiteracy are the barriers from demand side. The distance from bank branch, branch timings, cumbersome banking procedure and requirements of documents for opening bank accounts, unsuitable banking products or schemes, language, high transaction costs and attitudes of bank officials are the barriers from supply side. Hence, there is a need for financial inclusion to build uniform economic development, both spatially and temporally, and ushering in greater economic and social equity.

Financial Inclusion

The Rangarajan Committee on Financial Inclusion defines financial inclusion as "a comprehensive and holistic 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". Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. It means extending the banking habits among the less privileged both in urban and rural areas.

The main objectives of financial inclusion are to connect people with banking system and to give people access to payment & credit system. Financial Inclusion is important not only from the perspective of the benefit it provides to the poor but also from the perspective of overall stability of the social and economic system of the country. Financial Inclusion of the poor has a multiplier effect on the economy as a whole, through higher savings pooled from the vast segments of the population present at the bottom of the pyramid. There is a potential for transforming the lives of these excluded groups by providing access to formal savings arrangements and extension of credit by banks for emergency and entrepreneurial purposes, thereby enabling the poor to create assets, generate stable income, build resilience to meet macro-economic and livelihood shocks and bring about an improvement in their financial condition and living standards.

Two major factors have often been cited as the consequences of financial exclusion. First, it complicates day-to-day cash flow management - being financially excluded means households, and micro and small enterprises deal entirely in cash and are susceptible to irregular cash flows. Second, lack of financial planning and security in the absence of access to bank accounts and other saving opportunities for people in the unorganised sector limit their options for providing for themselves for their old age. From the macroeconomic standpoint, being without formal savings can be problematic in two respects. First, people who save by informal means rarely benefit from the interest rate and tax advantages that people using formal methods of savings enjoy. Second, informal saving channels are much less secure than formal saving facilities. Those who can afford it least suffer the highest risk. The resultant lack of savings and saving avenues means recourse to non-formal lenders, like money lenders. This, in turn, could lead to two adverse consequences – a) exposure to higher interest rates charged by formal lenders; and b) the inability of customers to service the loans or to repay them. As loans from non-formal lenders are often secured against the borrower's property, this raises the problem of inter-linkage between two apparently separate markets. Judged in this specific context, financial exclusion is a serious concern among low-income households, mainly located in rural areas.

Indian approaches to financial inclusion

Financial inclusion can be construed in two ways. One is countering the exclusion from the payment system that is, not have an access to a bank account. The second is countering the exclusion from the formal financial services. The Indian approach in recent years has been to establish the basic right of every person to have access to a bank account. Reserve Bank of India adapted this approach based on the fundamental principle of 5A's of ensuring Adequacy and Availability of financial services to all sections of the society through the formal financial system covering savings, credit, and remittance, insurance. And also an important strategy is increasing Awareness of such financial services and ensuring Affordability and Accessibility of the appropriate financial products. All these as sequence of network through a combination of conventional and alternative delivery channels and technology enabled services and processes.

Moreover, it can see large variance in the level of financial inclusion among the states, but majority from North-East states in the country. The Reserve Bank had provided a multi-pronged strategy for enhancing the outreach of financial services including the delivery channels across all sections. The entire variety of the financial system which comprises commercial banks, regional rural banks (RRBs), urban cooperative banks (UCBs), primary agricultural credit societies (PACS), and post offices is, therefore, geared for this purpose. Besides, self-help groups (SHGs) and Micro Finance Institutions (MFIs) also meet the financial service requirements of the poorer segments. Additionally, all the banks have been encouraged to use a combination of strategies which include provision of new products and relaxation of processes coupled with leveraging ICT for efficient handling of low ticket large volume transactions.

Financial Inclusion in India

With 135 million financially excluded households, India faces a severe financial inclusion crisis. Only 34 percent of the Indian population is currently engaged with the formal financial sector. If usage intensity of a savings account is considered as a true indicator of financial inclusion rather than mere ownership, then the financial inclusion percentage will certainly be much lower.

The following is a summary of the key national financial inclusion initiatives over the last four decades.

Year	Initiatives
1960s, 70s	• Focus on increasing credit to the neglected economy sectors and weaker sections of society • Development of the rural banking ecosystem including RRBs, rural and semi-urban branches etc • Implementation of the social contract with banks • Lead bank scheme launched for rural lending
1980s,90s	• Branch licensing policy to focus on expansion of commercial bank branches in rural areas • Establishment of National Bank for agriculture and Rural Development (NABARD) to provide refinance to banks providing credit to agriculture. • SHG-Bank linkage program launched by NABARD
2000s	• The term 'Financial Inclusion' introduced for the first time in RBIs Annual Policy Statement for 2005-06. • Banks asked to offer 'no-frills account', General credit card facility at rural and semi-urban branches • Know Your Customer (KYC) norms simplified • Banking Correspondent and Banking Facilitator concept introduced to increase out-reach • 100 percent financial inclusion drive launched • Restrictions on ATMs deployment removed

Conclusion

Importance of financial inclusion arises from the problem of financial exclusion of nearly 3 billion people from the formal financial services across the world. With only 34% of population engaged in formal banking, India has, 135 million financially excluded households, the second highest number after China. Further, the real rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. Financial Inclusion has far reaching consequences, which can help many people come out of abject poverty conditions. Financial inclusion provides formal identity, access to payments system & deposit insurance. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty. There is a need for coordinated action between the banks, the Government and others to facilitate access to bank accounts amongst the financially excluded.

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