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Financial Inclusion: Unshackle the Impediments to Growth

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Abstract:
Financial inclusion is the process of provision of financial services to the unbanked section of the society. Developing and underdeveloped nations have innovated and adopted various models through decades for inclusiveness of the unbanked section of the society and achieve inclusive and sustainable growth. "Financial Inclusion" as a term was formally introduced in India in the year 2005. However, Indian government has been working in this regard through decades. In era of 1950-1980, Banks were striving for profitability and Money lenders for higher interest income. Indian Economy at that time was characterized by low investment and saving rate and "Hindu growth rate". All these factors lead Banks to resort to lending only to the Industrialist and high net worth individual with the expectation of profitability and to avoid assets to turn sour on the other hand moneylender had a greater share in credit disbursement to the rural household. Indian government has since then adopted series of reforms to boost inclusiveness of unbanked population of the economy. Present study attempts to explain policy measures adopted by Indian Government for financial inclusion and financial innovations done by various developing countries in this respect.

Keywords: *Financial inclusion, economy, Inclusive growth.*

1. Introduction

According to Reserve bank of India, Financial inclusion is the process of ensuring access to financial services and timely and adequate credit availability to the vulnerable groups such as weaker sections and low income group at affordable cost. Financial inclusion thus plays a pivotal role in the sustainable economic development of a nation. Financial inclusion was formally introduced in 2005 (K C Chakraborthy) when the first pilot project was introduced in Managalam Village, Pondicherry. The village became the first in India where all households were covered under the ambit of financial services. The initiatives for inclusive growth were however taken prior to the era of globalization. An All India rural credit survey (AIRCS) was conducted in the first year of planning period i.e. 1951-52 to study the credit penetration of banking Industry; results reflected higher dependence of rural household on informal sector. About 70% credit requirement was fulfilled by moneylenders whose cost of financing was way higher than that of the commercial banks. However, commercial banks whose primary motive was to generate profit resorted to lending only to high net worth individual and Industrialist. Untill early 1980's Indian economy's growth beards the status of "Hindu growth rate" characterized by low savings and investment rate. The higher dependence on informal sector lead to introduction of series of reforms in the banking sector which includes lead bank scheme, social control of banks, nationalization of banks in 1967 and 1980, set up of Regional Rural banks and micro finance institutions, introduction of Basic Saving Bank deposit account (BSBDA),business correspondents, mobile banking etc. The present study attempts to explain the initiatives taken by various developing nations towards financial inclusion and what impact did those measures had on their respective economies.

2. Literature Review

C Rangarajan (2009) defined financial exclusion as restricted access to financial services to certain segment of economy which includes individuals or family belonging to low income group who cannot access basic banking like bank accounts, credit, insurance, financial advisory and payment services. Financial inclusion has been the backbone of the banking sector through last seven decades. Although the word was officially used in 2005 in India, however many historic measures support the initiatives taken by Government of India to reach unbanked areas of the economy. A lot of literature support this preposition according to Dan Radcliffe and Rodger Voorhies, Bill & Melinda Gates (2012) poor's immersion in physical cash creates considerable frictions in their financial lives. Cash is considered to be advantageous due to highly liquid however idle cash carries opportunity cost, storage cost, storage risk, transport cost. The study suggested the many developed countries pension saving rate is high when saving is the default option via automatic enrollment in pension. Charan Singh et.al. (2014) Reserve bank of India and Government of India initiated many measures since 2005 but many measures produced unsatisfactory results. Mobile banking, banking technologies, Indian post office, fair price shops and business correspondents are the key resources for to provide financial inclusion facilities in efficient and user friendly ways. Garg, Agarwal (2014) categorized initiatives taken by government and RBI into various approaches which includes Product based approach to financial inclusion includes no-fill accounts, Kisan credit card, general purpose credit card, saving account with overdraft facility; bank lead approach includes SHGs and Business correspondents; regulatory approach includes KYC, Bank branch authorization; Technology based approach includes mobile banking, branchless banking, kiosk, Aadhar enabled payment services and Knowledge based approach includes financial stability development council and financial literacy centers. The Brooking report by John d. Villasenor, et.al. (2015) made a comparative study of developing countries in terms of financial inclusion services and their penetration around the globe. The results showed Kenya, South Africa, Brazil, Rwanda /Uganda, Chile, Colombia and Turkey to be the highest performing countries in terms of financial inclusion. They also analysed that digital financial services will accelerate financial inclusion in the years to come. Global Financial Development Report (GFDR, 2014) the proportion of individuals and firms that use financial services varies widely across the world, the report suggested that more than 2.5 billion adults or half of the world's adult population do not have access to bank accounts. The major reasons behind this are no demand for accounts and other barriers like cost, travel distance and increased amount of paper work. It could thus be concluded from literature that developed and developing countries are taking steps towards financial inclusion however developing countries still have proportionately higher number of financially excluded people. Overcoming this barrier will help reduce poverty, generate savings, improve flow of credit and thus will contribute to development and growth of economies.

3. Objective of Study

1. To study various financial inclusion models adopted by various developing countries.
2. To analyze the success rate of measures undertaken by the government post 2005.

4. Research Methodology

This research paper is descriptive in nature and is based on the secondary data attained from the various secondary resources such as government data, e-journals, websites, newspapers, working paper, annual reports etc.

5. Financial Inclusion Model from around the World

5.1. No Frill Banking: South Africa Model

No frill banking is where banks do not charge minimum fee for opening accounts with a set number of free transactions. South Africa in 2004 started the services with the name of Mzansi Accounts. The account was associated with debit card facility, one free cash deposit transaction per month and clients were identified and verified however verification of physical address was exempted since many clients did not had verifiable address. According to Finmark Trust Finscope 2004, 42.3% of people never banked while 12.3% and 45.5% of total adult population previously banked and banked respectively. By 2008 access to banking services increased from previously 45.5% to 62.7%, while this percentage was 75% in 2014. Although Mzansi account has been a major contributor in penetration of banking services in country with around 4.5million (Fig 2) accounts till 2010 with a population size of 50.9 million of whom adults represent 69.8% however many accounts were classified as dormant account due to less active users.

Mzansi Account opened vs Active account (in Millions)

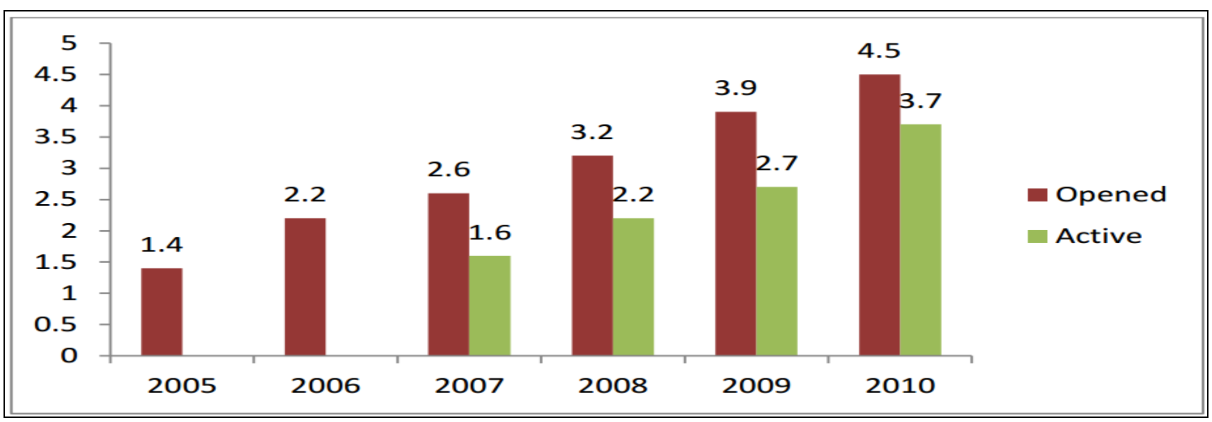

Figure 1: Source: The banking association of South Africa (2011); Mzansi story and beyond by National Treasury South Africa and AFI Financial Inclusion (2014)

5.2. Branchless Banking/ Business Correspondent: Brazil Model

According to Central Bank of Brazil, Correspondent banking is a measure aimed at extending services to bank clients in areas where banks do not have a branch. BC's were introduced in 1970s; however the range of services offered by them widened after 1999. During 1997, 65% of population did not had access to financial service. However, since 2003 range of methods have been adopted in this respect like Bolsa Familia, A social welfare program which effected cash transfer through banking system. By 2004, every municipality in Brazil had access to formal financial services, and about 1,600 (one in four) were served only by the correspondent network (Alberto Chaia, Robert Schiff, and Esteban Silva, 2010). Banks played predominant role in bill payment using Boletos. In addition to this banks and financial institutions partnered with retail establishments, including public tie up with post office and lottery agencies. Financial institutions like Banco Bradesco have developed riverboat banks to reach distant communities along with Amazon (Global Financial Development Report, 2014). Thus, banking system was used for transactions between G2C, C2C, C2B etc. Branchless banking has been effective due less cost of setting up of infrastructure, lower labour cost.

5.3. Mobile Banking: Kenya Model

Mobile banking denotes access to banking services and financial services like payment of bills, usage of account in an electronic form and other services using a mobile phone. According to financial inclusion insight survey 2013, 69% of rural households own mobile phones and 92% of rural households own and can borrow sim card while just 22% of rural household own a bank account of which 16% are active account users. This penetration of mobile phone banking is credited to the introduction of Safaricom-Vodafone's scheme M-PESA which was introduced in 2007 and In 2010, Safaricom started providing deposit facility too by linking with equity bank named M-KESHO saving account. Thus it was a revolution of "M" (Mobile). This revolution not only lead to a growth in number of accounts but also helped mobile companies fetch greater business due to increase in customer base. Thus it was dual benefit scheme for banking sector and telecom sector. As on 2014, the mobile money provider base has increased to a total of five companies namely Airtel Money (Bharti Airtel), M-Pesa (Safaricom), Orange Money (Orange), Tangaza pesa (Mobile Pay) and YuCash (YuMobile), While M-Pesa is the market leader among all the service providers.

5.4. Inter-country comparison and Success Rates

According to Report by Brooking Report (2015) Kenya, South Africa and Brazil are the major developing countries with overall development in penetration of financial and banking facilities. Kenya represents 90% of its population to be financially and digitally connected while the rate is around 80% and 78% for South Africa and Brazil respectively. However among all developing nations, India has the highest commitment towards banking penetration. However there is still wider scope available in form of connecting people digitally. According to global financial development report 2014, there are various reasons cited by various individuals for not having bank account.

Reasons for not having bank accounts

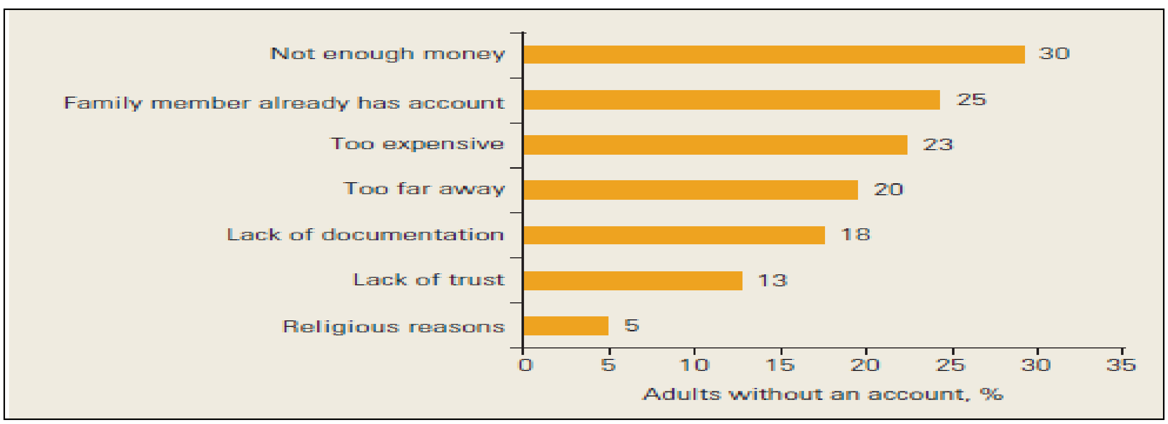

Figure 2: Source: Global Financial development Report, 2014

Major reasons for exclusion is lack of enough money (30%), maintaining a bank account is too expensive (23%), larger distance(20%), lack of documentation (18%), lack of trust in banking facilities (13%) and religious reasons (5%) mainly in the middle east and South Asian economies since large population argue that financial products are not compatible with the religious sentiments or are not as per sharia law (Islamic banking) (Fig 3.) . The law prohibits collection of interest on monetary transactions, charging fees and interest on loaned capital.

6. Initiatives by India

6.1. Mobile Banking

Mobile banking is one of the key elements to achieve financial inclusion. It is an innovation that is spreading through entire globe. The significant advantage of mobile banking is there is no requirement of banking cartel to make and receive payments. The RBI has approved 32 banks to provide this facility to customers, out of which 21 banks are operational with this service subject to a daily cap Rs 50,000 per customer for transfer and transaction of funds. The transactions over mobile phones in recent months increased as banks are creating awareness among customers and businesses to manage their finances. As per RBI, number of mobile banking transactions has risen from 16.8 million in December 2014 to 39.5 million in December 2015 and transactions jumped 46% to Rs.49,029 crore in December, 2015. The value of such transactions surged 82% over the September-December period. India has easily adopted the mobile technology and about more than 70% of the population uses a mobile. The mobile technology is low cost medium which is used by rural mobile users. The pre paid instruments in the mobile is a new acceptance of cashless transactions.

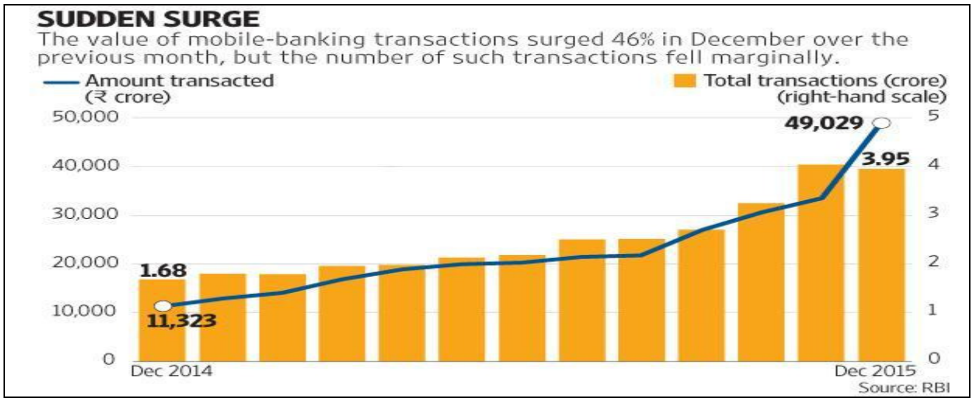

Figure 3: Source: RBI Annual Report

It has been found that in coming years the mobile banking users will increase upto 257 millions.

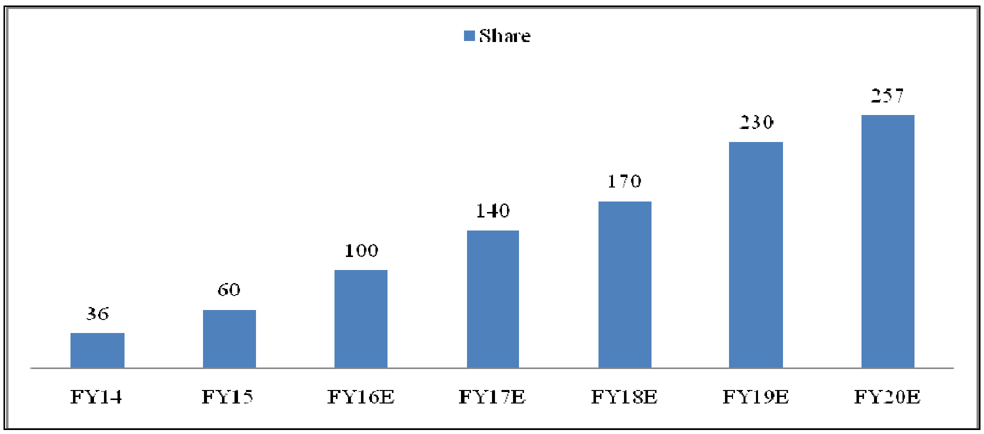

Figure 4: Mobile Banking Users
Source : KPMG

6.2. Pradhan Mantri Jan Dhan Yogna

It is a scheme for Financial Inclusion launched in year 2014, to ensure access of financial services for low income group. The financial services include credit, savings, insurance and payments and remittance facilities. The scheme can achieve financial inclusion in two phases by 2018. The first phase included Basic Banking Accounts and RuPay Debit card with accident insurance coverage of 1 lakh, connecting accounts with Aadhar to make DBT payment. The second phase is involved in sanctioning of Overdraft facility up to Rs 5000/- after checking six months past history, Credit Guarantee Fund for covering of defaults in A/Cs with overdraft limit up to 5,000, and delivering Micro Insurance and Pension scheme.

Bank Name	Rural	Urban	Total	No. of RuPay cards	Aadhaar	Seeded Balance in Accounts	% of Zero Balance Accounts
Public Sector bank	11.42	9.10	20.51	16.07	11.59	58165.94	23.11
Regional Rural bank	3.82	0.63	4.45	3.28	2.11	13697.94	19.98
Private banks	0.52	0.34	0.86	0.81	0.37	2745.61	34.92
Total	5.76	10.07	25.82	20.16	14.07	74609.50	22.96

Table 1: Source: PMJDY Website (DEC, 2016)

There is drop in zero balance accounts from76.8 % to 31.8 % which makes it clear that because of central and state government grant through these account, account holders have started saving also.

6.3. Interest Subvention Scheme

This scheme focuses on lending scheme by the government for a particular industry. This states that the person who has taken loan from the bank does not have to pay total interest on loan taken, and whatever is remaining is paid by the government. It is a kind of subsidy on the interest for the public. This will aid for lower sections of the country. Cabinet Committee On Economic Affairs approved an interest subvention to help promote housing for all in the country. This was under the affordable housing section category. Thus from time to time the government would intervene to provide such subsides, depending on the sector and the need. 6.5% interest intervention would be given for housing loans for weaker sections. The Government has different schemes for various sectors like agriculture, education, handlooms where funds are allocated to these sectors. In the agriculture sector, the scheme is used for loan repayment by farmers along with incentives to farmers. In the housing sector, government has given incentive where EMI is brought down by percentage of interest subvention which is beneficial for customers and end users. The scheme is announced for farmers. They can avail short term crop loans of upto Rs 3 lakhs, with a subsidy interest rate of 4 per cent.

6.4. Small Banks

Small banks are an effective link in the process of financial inclusion. This has helped India's system, with regional rural banks, united community banks, and local area banks. The funds are attained local deposit base. In the year 2012–13, regional rural bank offices were more than 17,000, most of them were opened in rural areas. They were dependent on lower capital adequacy norms. Only four banks are licensed by RBI in India, are working, rest of them are closed due to mismanagement. Small banks have benefits like low-cost, customized services as per needs and contagion effects are absent, they have risk, due to their operations and political influence (RBI 2014). Moreover, small banks cannot be used to measure economies of scale, as they work within limitations. They cannot finance big projects. 8 of the 10 entities are given a license for small finance banks by RBI, recently are MFIs. A small finance bank is offer a wider range of loan products to customers.

6.5. Business Correspondents

The significant change in financial inclusion is to ease the norms for business correspondents. The rural and underbanked locations are connected for financial services are connected through business correspondents. Business correspondents are microbankers and are protected by capital of a sponsor bank, but risky lending becomes a distinct possibility. Banks in Brazil and India have do not provide capital to business correspondents to lend. There has been some remedies where business correspondents are allowed to hold capital against the loans that they sanction.

Particulars	End-March 2010	End-March 2015	End-March 2016
Banking Outlets in Villages – Branches	33,378	49,571	51,830
Banking Outlets in Villages – Branchless Mode	34,316	504,142	534,477
Banking Outlets in Villages –Total	67,694	553,713	586,307
Urban Locations covered through BCs	447	96,847	102,552
BSBDA-Through branches (No. in million)	60	210	238
BSBDA-Through branches (Rs. billion)	44	365	474
BSBDA-Through BCs (No. in million)	13	188	231
BSBDA-Through BCs (Rs.billion)	11	75	164
BSBDA-Total (No. in million)	73	398	469
BSBDA Total (Rs. billion)	55	440	638
OD facility availed in BSBDAs (No. in million)	0.2	8	9
OD facility availed in BSBDAs (Rs. billion)	0.1	20	29
KCCs -Total (No. in million)	24	43	47
KCCs -Total (Rs.billion)	1,240	4,382	5,131
GCC-Total (No. in million)	1	9	11
GCC-Total (₹ billion)	35	1,302	1,493
ICT-A/Cs-BC-Total Transactions (No. in million)	26.5	477.0	826.8
ICT-A/Cs-BC-Total Transactions (Rs. billion)	6.9	859.8	1,686.9

Table 2: Financial Inclusion Plan – A Progress Report
Source: RBI Annual Report, 2016

7. Conclusion

Financial inclusion is the route map to growth for developed and developing countries. While in developed countries there are proportionately higher numbers of people under the ambit of banking and financial services than in developing countries largely due to trust factor, better connectivity, availability of adequate infrastructure and higher literacy rate. Large part of people do not avail basic banking facilities across the world largely due to lack of knowledge, inadequate infrastructure, additional cost involved, misconception about safety of funds with banks and lack of trust in branchless banking and business correspondents. Thus, Government need to address all these issues in order to encourage financially excluded section of the society to avail banking facilities. Many South Asian and Middle East nations also sighted lack of compatibility of banking products with religious beliefs. According to Brookings, India has been ranked highest among developing countries to take initiatives in this regard. Although a series of measures have been taken by India since independence to provide "banking for all", it has been successful at some aspects while failed on some. The positive impact of measures have been in terms of higher deposits, higher credit, expansion of bank branches, expansion of banking network not just in terms of banking infrastructure but also enhancement of branchless banking, increase in the number of bank accounts, contribution of banking sector towards growth, cheaper availability of finance and increased flow of liquidity into the economy. However what has been the challenge yet is the high rate of illiteracy, lack of trust, better infrastructure and connectivity this is evident from high dormancy rate of large number of bank accounts in India and improper implementation of schemes. Although banks have undertaken steps to address these issues but a high success has not been received yet. The literacy rate of male adults in India is still 82.14% while that of females is 65.46% according to 2011 census. This differential still depicts lack of knowledge among women to save, borrow, invest and grow. Thus literacy, initiatives and connecting are the core to the success for "inclusion". Higher literacy programs and digital initiatives will help more number of people to avail banking and financial services and thus contribute towards overall development of economy in terms of reduction of poverty, generation of employment and promoting growth and development.

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