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Financial Inclusion in India: Conceptual Analysis and its Relevance

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Abstract:
Banking sector in India forms the fulcrum of financial system since Independence. It carved out a niche in the public sector by providing a variety of financial services to the people. Beginning with early national plans, successive governments in India have emphasized the role of finance in promoting equitable growth. Accordingly, the banking policies were formulated in order to expand the scope of formal financial services to the 'unbanked' population. These policies envisaged 'social and development banking' to meet the credit needs of the rural people as well as to reduce the role of informal sector in the provision of credit. Despite these efforts, a large number of groups remain excluded from the basic services and products provided by the financial sector. In these circumstances, as a part of financial inclusion drive, Indian government with the help of Reserve Bank of India (RBI) has come up with some initiatives with an objective to include the hitherto financially excluded sections into the banking fold. Against this backdrop, as a conceptual paper, it attempts to introduce the concepts of financial exclusion and financial inclusion, and emphasize its need. It briefly reviews the Indian banking sector, reports the level of financial exclusion in India and highlights the various initiatives aimed at meeting the desired objective. It concludes by emphasizing some of the operational challenges in its functioning and suggests a way forward.

Keywords: *Business Correspondent Model, Financial Exclusion, Financial Inclusion, KYC norms, No-frills accounts*

1. Introduction

Financial inclusion is a global phenomenon that has gained wider currency in the development literature in contemporary times. Given the magnitude of poverty in the Third World economies, wherein a large segment of the population do not have access to basic financial services, the idea of financial inclusion – commonly understood as 'banking to all' – become conspicuous in these economies. United Nations (UN) in one of its recent study observes that financial inclusion of the poor is a global challenge to the achievement of Millennium Development Goals (MDGs). The study reveals a stark reality that a large number of people are not in a state of saving the money as the formal banking services are not within their 'reach'. According to this report, structural barriers prevent the poor from accessing banking facilities, thereby resulting in financial exclusion (2006). The increasing body of literature delves into finding the causes for financial exclusion. A recurring theme in financial exclusion is 'access to institutional finance' and lack of it, which not only leads to income inequality but also results in slower economic growth. Lack of access to adequate institutional credit and other financial services compel the poor individuals and small enterprises to depend on their own limited savings and earnings. This restricts their choice to invest in their small business enterprises and take advantage of growth opportunities (Ellis, 2007; Thorsten, Kunt and Patrick, 2009; World Bank, 2012). Recent estimates show that, globally, over three billion people lack access to basic financial services, of which about 90 percent are from Africa, Asia, Latin America and the Middle East. This has led to a considerable demand from the developing countries for a more inclusive financial system that would cater to the demands of the poor in these regions (John, Julius and Worapot, 2009 and Consultative Group to Assist the Poor (CGAP, 2012). Given this backdrop, in the recent times, inclusion of the financially excluded segments into the ambit of formal banking system, i.e., 'financial inclusion', is increasingly becoming main thrust of the research across the world.

2. Review of Literature

The extant literature on the subject focuses on emphasizing the possibilities and prospects of well-designed financial arrangements. Scholars note that better financial services lead to social and economic development of the rural population. With a view on economic development, scholars argue, a 'well-functioning financial system' access to adequate institutional finance enables the poor to start investing money in various income-generating activities and maximize the returns, and reduce their vulnerability to financial risks that they encounter in their daily lives. It helps to bring poor people into the mainstream of the economy, and allows them to contribute more actively to their personal economic development. While savings in banks enable the poor to invest in education and health that facilitate a better living standard, along with a marked social development (Kirkpatrick, 2000; Ellis, 2007; Beck, et al., 2009; Biju, et al., 2013).

Over the years, the concept of financial inclusion has been defined in several ways, primarily from three different perspectives. First, global perspective in general; second, national perspective with specific reference to India and third, within India, financial inclusion of women is given priority. While looking at the concept from global perspective, United Nations Report views financial

inclusion from the 'customer' point of view. It encompasses two important elements. Firstly, financial inclusion means a customer having access to variety of formal financial services and products, from simple credit and savings to more complex services such as insurance, pensions and remittances. Secondly, customer accessing more than one formal financial service provider, wherein it ensures a variety of competitive options (2006). Further, World Bank in its report titled: 'Financial Services for All? Policies and Pitfalls in Expanding Access' (2008), succinctly puts financial inclusion as 'broad access to financial services'. It also explains that promotion of financial inclusion means 'the absence of price or non-price barriers in the use of financial services'. The report primarily emphasizes two things; (i) greater 'access to financial services and (ii), absence of various barriers in 'utilising those services. In the second point, it highlights that the absence of price barriers such as transaction cost, use of various business models, geographical distance, collateral requirements etc, and non-price barriers such as lack of trust on banks, awareness, limited mobility, lack of knowledge on computerized banking services etc., as some of the main constraints for promoting financial inclusion. Thus, the report emphasizes the need to overcome these barriers. With reference to India, the Rangarajan Report on Financial Inclusion defines financial inclusion as "the process of ensuring access to financial services and timely and adequate credit when needed by vulnerable groups such as weaker sections and low income groups at an affordable cost" (2008). In the same year, the Planning Commission constituted a High Level Committee on Financial Sector Reforms under the Chairmanship of Dr. Raghuram Rajan, primarily aimed to identify the emerging challenges in meeting financial needs of the poor. The Committee defines financial inclusion as "universal access to a wide range of financial services at a reasonable cost. These services include not only banking products but also other financial services like insurance and equity products" (2008). Both the definitions underneath identify the financial vacuum in the banking sector to cater to the financial needs of the low-income and other disadvantaged sections, and significantly emphasize to deliver all the required financial services and products in an subsidized manner to the above said sections. In recent years, the literature on this subject has significantly emphasized on the inclusion of women in the ambit of formal banking system. In this regard, international and national agencies along with academicians have put forward different views on various problems and prospects of financial exclusion/inclusion of women. The Federal Ministry for Economic Cooperation and Development's report (2013) views that the goal of financial inclusion of women could be achieved only when they have easy access to a variety of financial services and products in a sustainable manner. It caters to their small-scale business and household needs. Highlighting the possibilities of gained access to financial services by women, the report notes that this can help improve women's opportunities to earn income or control assets outside the household. It also enables their bargaining power within and outside the family and increases their influence over how money and other resources can be efficiently used. By having access to insurance service, they can reduce the element of risk in their day-to- day businesses such as unexpected expenses or losses in business.

3. Financial Exclusion

Scholars look at financial exclusion in terms of accessibility. Accordingly, financial exclusion is broadly related to lack of adequate access to a range of financial services. People belonging to the lower income strata are unlikely to get access to mainstream financial services and products, and reap the benefits out of it. Further, it prevents the poor and disadvantaged segments in taking key decisions regarding human and physical capital accumulation. Given the above, the repercussions of financial exclusion could be a far-reaching, which not only destabilize the livelihood opportunities but also push them into a complex phenomenon of 'poverty trap'[i] (Leyshon and Thrift, 1995; Sinclair, 2001; Mahmoud et al., 2011; Joshi, 2011). There is another stream of scholars, who extend this argument beyond accessibility dimension by relating financial exclusion to income status of the poor. Income levels of an individual in any country determine the propensity to save from it. Underlining this view, Joshi (2011) observes that majority of population in India neither has savings accounts nor receives credit from formal financial institutions. They seldom make or receive payments through formal financial institutions. Apart from access and income dimension, Sharma (2008) discusses that exclusion can be due to problems related with geographical conditions, transaction cost, lack of experience in marketing or self-exclusion in response to negative experiences or perceptions. It is becoming clear from the above arguments that financial exclusion is primarily due to lack of income, access and limited exposure to the financial sphere. These constraints invariably have serious repercussions on living standards of the poor.

4. Indian Banking Sector and Level of Financial Exclusion

Post independent India (particularly during 1947-1980) has initiated several measures in the banking sector such as state cooperative banks (1955), the Reserve Bank of India (1955), nationalization of banks (1969) and creation of Regional Rural Banks (1976) etc. (Misra et al., 2008). The 1980s had witnessed a significant shift in the Indian rural credit by setting up of National Bank for Agricultural and Rural Development (NABARD). This period was marked by the active involvement of RBI and NABARD in providing microcredit to the rural poor (Basu, 2005). In addition to these, financial reforms were initiated in the banking sector in the early 1990s to create an efficient, competitive and stable financial sector and to enhance the efficiency and profitability of the banking system. During this phase, the banking sector had introduced two innovations in the rural credit structure. These include the initiation of microfinance scheme by the NABARD (1992) and launching of the Kisan Credit Card (KCC) scheme (1998) by RBI (Government of India, 1999).

Despite a well-developed banking system in India, a large number of groups remain excluded from the basic opportunities and services provided by the financial sector for a variety of supply and demand side reasons[ii]. In one of the major and first of its kind, the All India Rural Credit Survey (AIRCS) in 1954 documents that the credit needs of the financially excluded population are often met by the informal, non-institutional sources rather than the formal institutions. The excluded sections are drawn from the small and marginal farmers, women, unorganized sector workers including artisans, the self-employed and pensioners (Mahendra Dev, 2006). A more recent study on financial exclusion in India point out that only 55 percent of the population have deposit

accounts, while only a handful 9 percent have credit accounts with banks. Indeed, India has the highest number of households (145 million) that are excluded from banking system (Biju, 2013). The 59th round survey of National Sample Survey Organization (NSSO) (2003) shows that 45.9 million farmer households in the country (51.4%) (out of a total of 89.3 million households) do not have access to credit, either from institutional or non-institutional sources. A more recent study on financial exclusion in India points out that only 55 percent of the population have deposit accounts, while only a handful 9 percent have credit accounts with banks. Indeed, India has the highest number of households (145 million) that are excluded from banking system (Biju, 2013).

5. Financial Inclusion in India: Recent Policy Initiatives

In the post-1990s, with the launch of banking sector reforms, a distinct shift took place in the banking policy. RBI and NABARD were regarded the prime institutions in providing a policy impetus and execute new policies and programmes. The efforts were further intensified by RBI with a target on rural populace, in particular, farmers and poor women. This is apparently reflected in the policy initiatives taken over the last few years. The following section attempts to make a brief review of these policies and highlights some of the important operational challenges.

5.1. Kisan Credit Card (KCC)

The Government of India (GoI) introduced Kisan Credit Card (KCC) scheme in August 1998. Currently KCC is being implemented by all the District Central Cooperative Banks, Regional Rural Banks (RRBs) and Public Sector Commercial Banks throughout the country. It is a form of cash credit facilities to farmers and tools for delivering agriculture credit. The scheme aims at providing adequate and timely support in a flexible and cost-effective manner to farmers by catering to their cultivation needs, including the purchase of seeds, fertilizers, pesticides and livestock (Frost and Sullivan, 2009). KCC is meant to mitigate the difficulties faced by farmers in accessing timely and hassle-free credit to meet their production credit needs. To make it comprehensive and user friendly, NABARD has further enlarged the scope of the Scheme to cover long-term loans and consumption loans along with crop loans (Karmakar, 2009). As on 31 March 2012, the banking system has issued 11.39 crore KCCs, and the total amount sanctioned is INR. 5, 72,617 crore (NABARD Annual Report, 2011-12)

5.2. Know Your Customer (KYC) norms

With a view to simplify the applying procedures for the customers, the RBI introduced Know Your Customer (KYC) norms in August 2005. According to the RBI norms, banks can accept any evidence to their satisfaction for establishing the identity and address proof of the customer. In other words, these KYC norms simplified the procedures to open an account for those whose financial transactions are of modest amounts (Ramji, 2009). It is understood that the KYC norms are primarily targeted at the low-income groups and rural illiterate people. It emphasize that the persons belonging to low-income group both in urban and rural areas do not face difficulty in opening the bank accounts. Aadhar Card is the identity proof of the illiterate and poor people to open a bank account. A combination of these two factors encourages the hitherto financially excluded sections to come under the ambit of banking system.

5.3. No-Frills Accounts (NFA)

The Reserve Bank of India in its Annual Policy Statement of 2005-06 directed banks to provide banking services to all segments of the population on an equitable basis. It came up with an initiative called 'no-frills' account to expand the outreach of banking services. The 'no-frills account' (NFA) allows financially excluded individuals to access banking services with low or nil minimum balances; and also either with low or no charges. NFA encourages the poor people to save more by providing the credit in the form of overdraft facility. The services provided by NFA include 'deposit and withdrawal of cash at the bank branches as well as ATMs, receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments' (Khan, 2012). The rationale behind introducing 'no-frills account' is to inculcate the habit of saving among the poor and disadvantaged segments and ensure basic banking facilities to them in a uniform manner Ramji (2009). As on June 2011, 7.91 crores No-frills accounts have been opened by banks with outstanding balance of Rs. 5,944.73 crores. These figures respectively, were 4.93 crores and Rs. 4,257.07 crores in March 2010 (Subash, 2013).

5.4. Business Correspondent (BC) Model

In order to provide an alternative banking structure to branch-based banking services, the RBI in year of 2006 adopted the technology based agent bank model through Business Facilitators (BFs)/business correspondents (BCs) model. The model is intended to reach out to the geographically diverse population, particularly those who are financially excluded from the mainstream banking services; and to ensure doorstep delivery of financial products and services (Khan, 2012). The BC model allows banks to do financial transactions with the help of the business correspondent and permits branchless banking. This model is increasingly aided by technology such as point of service handheld devices, mobile phones and a biometric scanner etc. (Karmakar, 2009). One of the significant advantages of this model is it help the people to overcome regional barriers of language and culture, and inadequate infrastructure in rural areas (Frost and Sullivan, 2009). As on March 2011, banks have reported employing 40942 BCs, which covered 78078 villages under BC model. As on March 2012, there are 1,20,355 Customer Service Points (CSPs) established by BCs (Rana et al., 2012).

6. Operational Challenges

Scholars identified some of the major challenges in the process of implementation of the aforementioned initiatives. As far as the Kisan Credit Card scheme is concerned, the absence of record of accomplishment, complex process, inaccessibility of the services

to the poor, ignoring the landless, marginal farmers as well as non-cultivating households etc. are the major bottleneck s to implement this program. Further, the customers have to face problems starting from applying for the KCC card to the entitlement of the credit. In other words, a financially illiterate faces severe problems in availing the credit. These cumbersome procedures compel them to depend on local moneylenders (Frost and Sullivan, 2009). For Know Your Customer (KYC) norms, it is argued that various cumbersome procedures in opening a bank account become a serious constraint in the process of inclusive banking system, i.e. financial inclusion [Ramji (2007); Bhatia and Chatterjee, 2010). Raghuram Rajan, the Governor of RBI, recently expressed that 'one roadblock to access, even to something as simple as a universal basic savings accounts, is stringent procedures followed by some private sector banks. He further adds, the stringent procedures in order to open a bank account keep a large number of sections out of the banking system, and lead to inconvenience for others[iii]. With reference to no-frills accounts (NFAs), mere opening a bank account does not kick start the process of financial inclusion. The bank account has to be in active mode with basic financial transactions being carried out by the account holder. It is argued that these accounts are still in dormant stage and the frequency of access to this facility in most cases is negligible. These accounts do not have linkages with other financial services, i.e., people cannot avail other financial service through this no-frills account (Frost and Sullivan, 2009). Though there is an appreciation due to the efforts of public sector banks, as a part of financial inclusion strategy, in encouraging people to open no-frills accounts, there are some apprehensions in not utilising the same accounts for saving purpose. It is suggested that the public sector banks must offer incentives to encourage savings and ensure that the bank accounts opened by rural communities must be in active mode through promoting appropriate and affordable financial services and products Viswanathan (2014). In addition, distance from banks, lack of dissemination of information about NFAs, irregular and uncertain flow of income etc. are also identified as some of the hindrances in its operation. As far as the Business Correspondent (BC) model is concerned, FICCI's Report (2012) identifies that although RBI permitted variety of individuals to work as BCs, very few have been engaged by banks. Regarding the performance of BC staff, the report throws a light on lack of professional orientation. It identified that they are mostly irregular in maintenance of records and delay in processing of loans, which subsequently generates a low volume of business for banks. With regard to the operational aspects, the report observes that the handling of a large amount of cash is risky, particularly in the hilly regions due to higher security risks, difficult terrain and poor connectivity. Since the BC staff often operates in isolation, there are high chances of fraud and misappropriation.

7. Conclusion

It is clearly reflected that financial inclusion is considered as an important phenomenon in the realm of social and economic deployment of a nation. Ensuring universal access to financial services becomes the crux of the argument. With reference to India, the targeted population is economically marginalized and financially excluded sections. Accordingly, in the recent times, some of the important initiatives are being initiated to foster financial inclusion in India. In the rural credit structure, the Kisan Credit Cared scheme aims at providing loan to the farmers at subsidized interest rates to purchase agricultural needs and livestock as well. Simplified Know Your Customer norms and 'no-frills accounts' enhanced the accessibility of the poor to various financial services and products in an adequate and affordable manner. The financial literacy and financial counselling campaigns serve to address the demand side constraints hindering financial inclusion. With regard to Business Correspondent (BC) model, the study inferred that the model established an alternative formal banking structure to the branch based banking system and further improving banking facilities to the remote regions.

However, it is also apparent from the analysis that addressing the issue of financial exclusion requires a holistic approach on the part of banking sector and clients as well. As far as the public sector banks are concerned, apart from providing various financial services, these formal financial institutions must ensure an optimum utilization of these services by the needy sections. The banks, therefore, ought to play an instrumental role in building an effective credit information system, creating awareness as how to utilize various financial services, promoting financial education and counseling on management of credit, savings, debt repayment etc. As far as the beneficiaries, especially, women and low-income groups are concerned, these segments must cultivate the habit of utilizing all available financial services and reap the perceptible benefits of the same, which are essentially redesigned and aimed at their economic upliftment and meeting the larger goal of financial inclusion.

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9. Notes

It is argued that poverty traps exist and account for the continued existence of poverty in low-income economies, and there are many factors, which contribute to poverty trap in these countries. A poverty trap arises when poor individuals with limited access to credit and capital markets, low income or asset endowments and poor infrastructure (Galvo, Gabriel and Olmo, 2013:45). The Chronic Poverty Report (2008-09) identifies five main traps that underpin poverty. Those are (i) insecurity, (ii) limited citizenship (iii) spatial disadvantage (iv) social discrimination and (v) poor work opportunities. The report analyses that the poor people frequently live in insecure environments and they have limited assets or entitlements to cope with the shocks and stresses. They do not have meaningful political voice and lack effective political representation. Remoteness, lack of political representation, weak economic integration, lack of access to public and private goods and services and work opportunities etc put them under poverty trap. For more details see, The Chronic Poverty Report (2008-09), "Escaping Poverty Traps", Chronic Poverty Research Centre.
In India there are 30,000 rural and semi-urban commercial banks, 14,000 Regional Rural banks (RRBs), around 12,000 District Cooperative Credit Banks (DCCBs) and 1,12,000 Primary Agricultural Credit Societies (PACS) at the village level (however, around 66,000 PACS are stated to be functional; the remaining are dormant) [Report of the Steering Committee on Micro-Finance and Poverty Alleviation, 2007:12].
Keynote address delivered by Dr. Raghuram Rajan, Governor, Reserve Bank of India, on 'Financial Inclusion: Technology, Institutions and Policies' at the NASSCOM India Leadership Forum in Mumbai on Febrauray12, 2014. For more details, see www.rbi.org.in.speeches