Financial Inclusions: A Pavement towards the Future Growth

Dr. Chitra Rathore*

Abstract:

India's economic growth rates higher than most developed countries in recent years, a majority of the country's population still residue unbanked. Financial Inclusion is a relatively new socio-economic concept in India that aspire to change this dynamic by providing financial services at affordable costs to the underprivileged, who might not otherwise be aware of or able to afford these services. Global trends have revealed that in order to achieve inclusive development and growth, the expansion of financial services to all sections of society is of utmost importance. As a whole, financial inclusion in the rural as well as financially backward pockets of cities is a win-win opportunity for everybody involving – the banks/NBFC's intermediaries, and the left-out urban population. Banks will handle core infrastructure and services while intermediaries known as Business Correspondents (BC's) will be the executors and act as the face of these banking & financial institutions in dealing with end-users. Therefore, it is assumed that financial inclusion can initiate the next revolution of growth and prosperity. In the 21st century, India has been pulling all the right levers to advance financial inclusion and economic citizenship by channelling its own transactions to lubricate the system. India's journey towards economic ascension relies on how the 65% unbanked population of India (conservative 2012 estimate by World Bank) is enabled with financial infrastructure.

Key words: *Pavement, Financial inclusion, Population, Infrastructure.*

Financial inclusion is the delivery of financial services at affordable costs to vast deprived sections and low income groups. Nicholson report (1895) was the first to highlight the need to establish "LAND BANKS" as an alternative to dominance of money lenders. Resulting, the cooperative credit societies Act, 1904 was passed to provide, amongst other things, a legal basis for cooperative credit societies.

* *Assistant Professor, Department of EAFM, S.S.Jain Subodh P.G.(Autonomous) College, Jaipur*

Even after 70 years of independence, a large section of Indian population still remains unbanked. This has led generation of financial instability and pauperism among the lower income group who do not have access to financial products and services. Financial inclusion is expected to make noteworthy alterations in the economy; especially the rural economy which will operate through the banking system will also ensure regularity of flow of liquidity in households and thus opportunities for investment.

Significance of Financial Inclusion

The policy makers have been concentrating on financial inclusion of Indian rural and semi-rural areas primarily for three most important pressing needs:

- **Generating a platform for inculcating the habit to save money –** The lower income category has been living under the constant shadow of financial duress primarily because of the absence of savings. The absence of savings makes them a vulnerable lot. Presence of banking services and products intends to provide a critical tool to inculcate the habit to save. Capital formation in the country is also expected to be boosted once financial inclusion measures materialize, as people move away from traditional modes of parking their savings in land, buildings, bullion, etc.
- **Providing formal credit avenues –** As far as the unbanked population has been vulnerably dependent on informal channels of credit like family, friends and moneylenders. Accessibility of adequate and transparent credit from formal banking channels shall permit the entrepreneurial spirit of the masses to increase outputs and prosperity in the countryside. A classic example of how easy and affordable availability of credit can do for the poor is the micro-finance sector.
- **Plug gaps and leaks in public subsidies and welfare programmes –** A substantial sum of money that is meant for the poor do not actually reach them. While this money meanders through large system of government bureaucracy much of it is widely believed to leak and is unable to reach the intended parties. Government is therefore, pushing for direct cash transfers to beneficiaries through their bank accounts rather than subsidizing products and making cash payments. This commendable effort is expected to reduce government's subsidy bill (as it shall save that part of the subsidy that is leaked) and offered relief only to the real beneficiaries. All these efforts require

an efficient and affordable banking system that can reach out to all. Therefore, there has been a push for financial inclusion.

Committees Framed on Financial Inclusion by RBI

Khan Commission: RBI set up in 2004 to look into financial inclusion and the recommendations of the commission were incorporated into the mid-term review of the policy (2005–06) and urged banks to review their existing practices to align them with the objective of financial inclusion. RBI also exhorted the banks and stressed the need to make available a basic banking 'no frills' account either with 'NIL' or very minimum balances as well as charges that would make such accounts accessible to wide sections of the population of the many schemes and programmes pushed forward by RBI the following need special mention.

Rangarajan Committee

There are four major reasons for lack of financial inclusion

- Inability to provide collateral security
- Poor credit absorption capacity,
- Inadequate reach of the institutions
- Weak community network

There is need to systematize Urban/Semi-Urban poor people into Neighbourhood Groups (NHGs) on the same pattern as has been adopted for the rural poor.(Need to extend the mandate of NABARD to cover beyond rural areas)

2nd ARC (Administrative Reforms Commission) on Financial Inclusion

- Innovation is critical for financial inclusion. This would mean developing newer financial products in terms of loans, savings, and insurance services etc. which are tailored to the needs of the poor.
- Currently, most public sector Banks and micro-finance institutions have a limited product offering, which limits the choice of the SHGs and also constrains them in terms of utilizing the loans productively.

- Extension of the RRB network to the remaining non-financed areas would considerably speed up the process of inclusive banking and assist in extending micro-finance to local SHGs.
- High saturation of telecom connectivity in India, together with the latest mobile technology could be used to enhance financial inclusion in the country.
- MFIs should handle thrift /saving and money transfer only as business correspondents of Scheduled Banks, but not in their individual capacity as a micro-finance lender as it involves hard earned savings of the poorest of the society

4 Models of SHG-Bank Linkage

- SHG-Bank linkage promoted by a mentor institute (eg. Self-Help Promotion Agencies & NGOs) – SHPAs provide the seed money. 2nd ARC believed that this is an appropriate model to be replicated on large scale.
- SHG-Bank direct linkage – Very less frequent because of meagre initial savings of SHGs
- SHG-Mentor Institution linkage (indirect linkage) – SHPAs act as financial intermediaries. SHPI accepts the contractual responsibility for repayment of the loan to the Bank unlike in case 1
- SHG-Federation model – Cluster of SHGs forming a federation to attain economic sustainability. This federation acts as an intermediary. Some federation are even capable of accessing credit from large MFIs.

Nachiket Mor Commitee

Committee on Comprehensive Financial Services for Small Businesses and Low Income Households" was set up by the RBI in Sep 2013 under the chairmanship of Nachiket Mor, an RBI board member.

Key Recommendations

1. Providing a universal bank account to all Indians above the age of 18 years by January 1, 2016. To achieve this, a vertically differentiated banking system with payments banks for deposits and payments.

2. Wholesale banks for credit outreach: These banks need to have Rs.50 crore by way of capital, which is a tenth of what is applicable for new banks that are to be licensed.

3. Aadhaar will be the prime driver towards rapid expansion in the number of bank accounts. Monitoring at the district level such as deposits and advances as a percentage of gross domestic product (GDP).

4. Adjusted 50 per cent priority sector lending target with adjustments for sectors and regions based on difficulty in lending.

5. Increase the Priority Sector Lending Mandate**:** The Mor committee has recommended that the priority sector lending mandate for banks should be raised from the current 40 per cent to 50 per cent. At the same time, the banks must be freed from all pricing and other restrictions.

6. Allow differentiated Licenses: The committee has taken ahead the case of differentiated banking licences. It has proposed that three new categories of banks viz. payment, wholesale investment and wholesale consumer should be allowed. At the same time, the regulations for non-banking financial companies, or NBFCs should be streamlined. The biggest problem here would be the business viability of such banks. One example of differentiated banking license is Regional Rural Banks, which were started off with great promises but ultimately broke down.

7. Meaningful Financial Inclusion: The Nachiket Mor committee has suggested two specific district-level penetration metrics viz. the credit- GDP and life cover-GDP ratios to monitor the meaningful financial inclusion. This is a slight departure from the number of accounts formula of financial inclusion. It is a meaningful recommendation and must be taken ahead.

Deepak Mohanty Committee

The Reserve Bank of India (RBI) on 15 July 2015 constituted a committee to work out a five-year (medium-term) action plan for financial inclusion. The 14-member panel will be headed by RBI executive director Deepak Mohanty.

1. The Committee will work to spread the reach of financial services to unbanked population.
2. To review the existing policy of financial inclusion including supportive payment system and customer protection framework taking into account the recommendations made by various committees set up earlier.
3. To study cross country experiences in financial inclusion to identify key learnings, particularly in the area of technology-based delivery models, that could inform our policies and practices.
4. To articulate the underlying policy and institutional framework, also covering consumer protection and financial literacy, as well as delivery mechanism of financial inclusion encompassing both households and small businesses, with particular emphasis on rural inclusion including group-based credit delivery mechanisms.
5. To suggest a monitorable medium-term action plan for financial inclusion in terms of its various components like payments, deposit, credit, social security transfers, pension and insurance.

Other Efforts

A. BCs — 110,000 business correspondents employed through the business facilitator and business correspondent (BC) models and set up goals for banks to provide access to formal banking to all 74,414 villages with population over 2000.RBI also adopted the information, communication, technology-based agent bank model through BCs for door-step delivery of financial products and services since 2006.Minimum infrastructure for operating small customer transactions and supporting up to 8-10 BCs at a reasonable distance of 2-3 km.

***B. Initiation of no-frills account* –** These accounts provide basic facilities of deposit and withdrawal to accountholders makes banking affordable by cutting down on extra frills that are no use for the lower section of the society. These accounts are expected to provide a low-cost mode to access bank accounts. RBI also eased KYC (Know Your Customer) norms for opening of such accounts.

C. Banking service reaches homes through business correspondents – The banking systems have started to adopt the business correspondent mechanism to facilitate banking services in those areas where banks are unable to open brick and mortar branches for cost considerations. Business Correspondents provide affordability and easy accessibility to this unbanked population. Armed with suitable technology, the business correspondents help in taking the banks to the doorsteps of rural households.

D. EBT – Electronic Benefits Transfer – To plug the leakages that are present in transfer of payments through the various levels of bureaucracy, government has begun the procedure of transferring payment directly to accounts of the beneficiaries. This "human-less" transfer of payment is expected to provide better benefits and relief to the beneficiaries while reducing government's cost of transfer and monitoring. Once, the benefits starts to accrue to the masses, those who remain unbanked shall start looking to enter the formal financial sector.

India had scored poorly on financial inclusion parameters when compared with the global average as per Reserve Bank of India in its annual report. The report quoted a World Bank study in April 2012, which had shown half of the world's population held accounts with formal financial institutions. The study said only nine per cent of the population had taken new loans from a bank, Credit Union or microfinance institution in the past year. In India, only 35 per cent have formal accounts versus an average of 41 per cent in developing economies. In the past five years, RBI has worked harder than many central banks in developing countries to offer at least limited financial services, especially in rural villages, and to coerce retail banks to comply with financial inclusion directives. Nevertheless, RBI's recently released Mor Committee Report referred to above, reveals new and worrisome realities:

- **Almost 90 percent of small businesses** in India still have no links with formal financial institutions.
- **60 percent of the rural and urban population** do not have a functional bank account.
- **Bank credit to GDP ratio** in the country as a whole is 70 percent, but in a large, very poor state such as Bihar, it is dramatically less at 16 percent.

- **Savings,** even for the not so very poor, are declining and, in certain areas, moving away from financial to physical assets. And less than fully regulated savings often include less than fully scrupulous providers.
- Reasons cited for this trend include lack of positive real return and difficulties in quick, direct access to savings accounts.
- Savings as a proportion to GDP have fallen from 36.8 percent in 2007-08 to 30.8 percent in 2011-12 (most recent figures available) and household financial savings declined from 11.6 percent of GDP to 8 percent during the same period.
- **Credit** and access to equitable financing for low-income households and small businesses is, in very poor areas, even less encouraging.
- Many retail banks fail to comply with RBI's Priority Sector Lending (PSL) guidelines, which require a full 40 percent of their lending to these sectors, for the simple reason that their non-performing assets (NPAs) are almost double
- Independent, external sources fail to paint a rosier picture. The World Bank's research says that only 65% population is using banking services, and note that only 4 percent use formal bank accounts to receive welfare payments. In theory, all beneficiaries of India's many, various welfare and pension must have a basic savings account. The reality is that many districts still use CICO (cash in/cash out) agents for distribution. A *MicroSave* overview explains some of the reasons why.
- Of the 182 million-plus such accounts that are on RBI's books, at least half- possibly far more—are either dormant or "pass-through" accounts only. (Beneficiaries pull out their full government disbursement each month and fail to save in small increments or invest in micro-insurance policies).
- So, if full financial inclusion is NOT happening in India, and probably not even progressing by most important metrics, why is this case and how might things improve?
- Micro Save has spent the last several years trying to answer these questions by talking directly to the financially excluded all over India, to the bankers required by RBI to serve their needs, to the "business correspondent" managers and agents in both urban

and rural locations who actually do serve their needs, and to the RBI and other policy-makers who are in fact trying hard to make this work.

In a survey of 2,932 villages with a population of greater than 1,000, only 39% are covered through customer service points (CSPs) according to State Level Bankers' Committee (SLBC). Field work reveals that only 7% of the villages have transaction ready CSPs; only 4% have CSPs available to transact every day.1, 2 A little over 2% of the appointed CSPs are doing more than 10 transactions a day, and less than 4% are earning more than Rs. 2,000 a month; with a median monthly income as low at Rs.1,500 – and so quite likely to quit the business soon.

What more is to be done for Financial inclusions?

Financial inclusion of the unbanked masses is a critical step that requires political will, bureaucratic support and dogged persuasion by RBI. It is expected to unleash the hugely untapped potential of the bottom of pyramid section of Indian economy. Perhaps, financial inclusion can begin the next revolution of growth and prosperity

THE need of the hour is to involve the small savings of the rural mob and mobilize it towards the development of the nation. It's a kind of dual development, development of the nation as well as of the people. The trust in the Indian Banking system *has to be* developed so that people may prefer to keep their savings with the banks instead of their lockers.

The approach and the reach of the banking network has to be extended up to the extreme rural areas. India is the country of villages and without involvement of rural and villagers the development of Indian Economy cannot take place in real sense.

India is not alone in needing to address these and related problems—and, no, technology, mobile operators, and global credit-card brands are not the all-purpose solutions some would have us believe. As the world's largest democracy and second most-populous nation, India has a certain responsibility to think more creatively and implement more effectively for full financial inclusion. If and when it does, the rewards will also be that much more noteworthy and gratifying for all involved.

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