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Financial Inclusion – The Outlook, the Concerns and the Road Ahead

Rohit Bansal[1]
Rahul Garg[2] **Rakesh Kumar**[3]

Abstract

According to Rangarajan Committee, Financial Inclusion may be defined as the 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. This paper broadly covers 3 dimensions of financial inclusion. Firstly, the outlook of financial inclusion; to find out existing structure, policies and practices after looking from both demand and supply side factors like penetration, availability, cost, usage, timeliness, social aspects etc. Secondly, the concerns regarding current situation of financial inclusion, citing facts from different surveys, researches etc. Finally, the Road Ahead for 100% financial inclusion taking clues from Rangarajan Report, UNDP Report, UNCDF-DESA Report and World Bank Report mentioning roles for regulators, development, banks, government etc. and ending the note with the contextual recommendations for improvements in various context of current situations of financial inclusion.

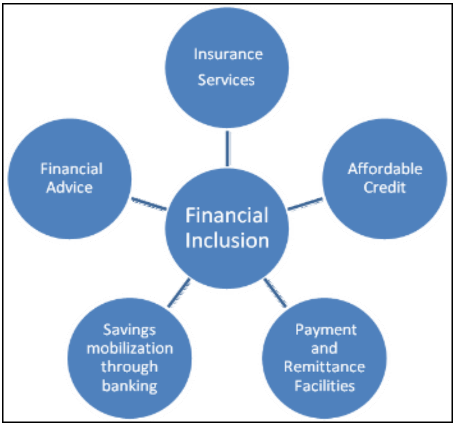
Keywords: Financial Inclusion, Insurance

What is Financial Inclusion?

"Financial Inclusion may be defined as the 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." - Rangarajan Committee on Financial Inclusion

[1] Lecturer, Department of Management Studies, Vaish College of Engineering, Rohtak
[2] Student, Department of Management Studies, Indian Institute of Technology, Delhi.
[3] Student, Department of Management Studies, Indian Institute of Technology, Delhi.

Figure1: Elements of Financial Inclusion



Source: Rangarajan Committee on Financial Inclusion

Usually financial inclusion is misinterpreted as providing bank accounts but if we will see clearly from abovementioned figure, we can analyse that financial inclusion is not only related to deposit/savings side but also facilities like credit, insurance, remittance, advisory services etc.

Policies

In context of financial inclusion policy makers have played a major role to bring trickledown effect. Commercial banks have been encouraged by RBI to open branches in rural areas. Priority sector lending was instituted to provide loans to small and medium enterprises and agricultural sector. Further special banks were set up for rural areas like Rural Cooperative Banks, Regional Rural Banks. The government also set up national level institutions like NABARD, SIDBI to empower credit to rural areas and small and medium enterprises.

The key points regarding the policies pertaining to financial inclusion can be summed up as follows:

RBI has framed guidelines 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 vast sections of the population.

The Banks are required to provide all the information related to opening accounts, disclosures etc in the regional languages to build reliability and trust among people.

The procedures for opening bank accounts have been simplified for persons belonging to low income group both in urban and rural areas.

RBI has asked banks to consider introducing General purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi urban branches with complete deregulation of interest rates.

Banks have been permitted in January 2006, to use other rural intermediaries like nongovernmental organizations, self-help groups, micro-finance institutions etc.

Use of Information Technology has been encouraged for providing innovative solutions (like smart cards, connecting through mobile phone etc) to problem of financial exclusion.
RBI has undertaken a project named "Project Financial Literacy" to enhance financial awareness in the country.

A Committee on Financial Inclusion was constituted to initiate a mission called National Rural Financial Inclusion plan.

A Financial Inclusion Fund of Rs. 500 crore has been established with NABARD for meeting the cost of developmental and promotional interventions.

A Financial Inclusion Technology Fund of Rs. 500 crore has been established to meet the costs of technology adoption.

Micro-insurance: Policy makers have played pivotal in popularizing the micro insurance among bottom of the pyramid to hedge their financial risk.

RBI permitted RRBs to undertake insurance business as "Corporate Agents" without risk participation.

- IRDA has legally recognized NGOs, MFIs and SHGs as "Micro-Insurance Agents.

Outlook

On one hand to oversee the supply situation we will consider penetration, availability, cost, timeliness and advisory functions of financial services and on another hand demand side functions like usage, cost, financial education, social aspects and behavioural aspects will be considered.

Penetration

It can be measured by no. of persons in an area or economy having bank account or no. of household having bank account. We can see in figure below that rural penetration is quite low as of 2005 in deposit/savings, current as well as credit accounts.

Figure 2: No. of deposit and credit accounts in scheduled commercial banks (as % of no. of households)

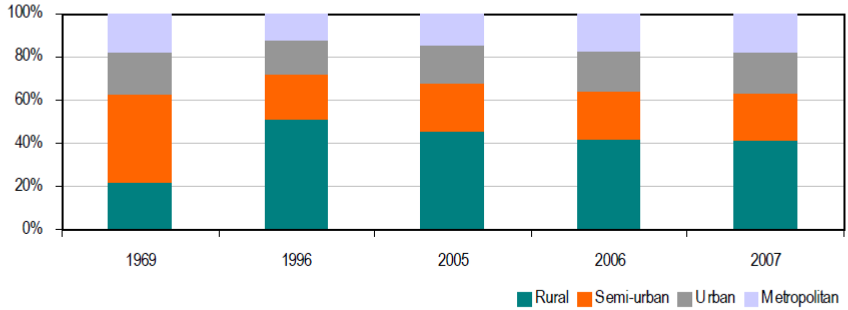
1981			**1991** **1996** **2001** **2004** **2005**	
Deposit Accounts				
Current Accounts	Rural	3.6	5.5	4.7
Urban		15	23.4	24.1
Savings Accounts	Rural 129.8 131.5	59.6 123.3	137 126.8	
Urban		135.5 249.7 206.5	243.7 197.4 213.1	
Current and Savings 134.5 128.2 **Accounts**	Rural 131.1	63.2 136.1	142.6	
Urban		150.5 273.7	267.2 216.6	224
Term Deposits Accounts	Rural	22.9	41.8	45.5
Urban		74.6	96.9	105
Total Deposits Accounts	**Rural**	**86.1**	**184.4**	**180**
Urban		**225.1** **378.7** **337.4**	**364.1** **322.2** **335.4**	
Credit Accounts				
Rural		**18**	**44.3**	**36**
Urban		**15.1**	**29.9**	**27.1**

Source: Rakesh Mohan, RBI

Availability

It can be measured by no. of bank outlets per 1000 population, no. of ATM's per 1000 people and/or by no. of bank employee per customer. If we will analyse the distribution of bank offices in percentage of total no. of bank offices, share of rural region is decreasing over the years as it is evident from figure below.

Figure 3: Distribution of Bank offices



Source: Rakesh Mohan, RBI, IDBI Gilts

Cost

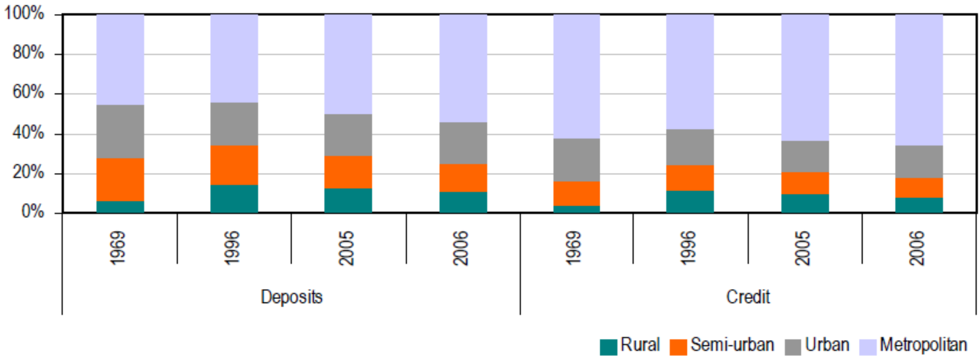
It has been seen that poor living in urban areas find financial services costly. Hence, even if financial services are available, the high costs deter the poor from accessing them. Also suppliers' costs determine the amount of supply.

Timeliness

In case of late timing the excluded population has to rely on informal sector (moneylenders etc) For availing finance that is usually at exorbitant rates. These lead to a vicious cycle of poverty in which farmers get entrapped. First, high cost of finance implies that first poor person has to earn much more. Second, the major portion of the earnings is paid to the moneylender.

Usage It can be measured by two basic services of Banks viz. Deposit and Credit.

Figure 4: Sources of deposits and credits (%)



Source: Rakesh Mohan, RBI, IDBI Gilts

Behavioural Aspects: Research in behavioural economics has shown that many people are not comfortable using formal financial services. The reasons are difficulty in understanding language, various documents and conditions that come with financial services etc.

Social aspects: The rural may not be approaching banks for fear of being looted on the way. Or they would want to keep a low profile and might not approach banks as that would send signal to
the community that they have some money to spare for them . Another problem is that women are better savers than men and financial inclusion is more likely to succeed with

them in the fold. However, in rural areas women are not allowed to move around.

Other barriers: They may subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

Concerns: Various concerns from NSSO survey, RBI analysis, CMIE and Rangarajan report is mentioned below.

Extent of Exclusion

General

51.4% of farmer households are financially excluded from both formal / informal sources.

Out of the total farmer households, only 27% access formal sources of credit; one third of this group also borrows 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 in the country.

Overall indebtedness to formal sources of finance alone is only 19.66% in these three regions.

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.

About 20% of indebted marginal farmer households have access to formal sources of credit.

Amongst 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.

Analysis of data provided by RBI reveal that critical exclusion (in terms of credit) manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95% and above. This is in respect of commercial banks and RRBs.

As per CMIE (March 2006), there are 11.56 crore land holdings. 5.91 Crore KCCs have been issued as at the end of March 2006, which translated into credit coverage of more than 51% of land holdings by formal sources.
Data with NABARD on the doubling of agricultural credit indicates that agricultural loan disbursements during 2006-07 covered 3.97 crore accounts.

Index of Financial Inclusion: Index of financial inclusion is developed at ICIER by Mandira Sharma based on three vital parameters as banking penetration, availability of the banking services and usage of the banking system. It places India at 27th rank (IFI of 0.166) out of 55 countries way below countries like Iran, Brazil and Russia.

The Road Ahead

The Role for Governments

A Government's vision for a well-functioning financial system should include access forall citizens to a broad range of financial products and services. It is critical that inclusive finance become an integral part of any financial-sector development strategy.
Inclusive financial sectors require building and supporting sustainable, local financial institutions and embracing new

technologies and delivery channels.
Governments have critical roles in creating helpful policy environments that can broaden access. When the Government itself becomes a lender, politics almost always negatively affect performance.

Imposing interest-rate ceilings risks hindering lenders' ability to cover the costs of making small loans. Too often, the ceilings limit credit expansion and hurt the populations they are meant to help.

Governments should promote consumer protection, transparent prices, financial education and an open, competitive market.
Governments have a vital role to play in ensuring data collection and reporting on financial access and usage.
Broadening access to financial services is an important policy goal but will not in and of itself eliminates poverty.

The Role for Regulators
Fiinancial inclusion should be a major objective of financial regulation. The role of regulators is to establish conditions that allow a diverse range of institutions to provide a wide variety of financial products and services in a financially stable, apolitical environment.

Successful regulators have been flexible in their approach, mitigating risks and balancing concerns of safety without limiting access to financial services.

An enabling regulatory environment and appropriate supervision are needed both for financial services providers and their supporting industries, such as telecommunications and technology infrastructure.

These industries are bound by the need for a strong, safe and fully accessible payments system.

Bringing more poor people into the formal financial system helps (rather than hurts) law enforcement efforts to prevent money laundering and terrorist financing. Policy-makers should use the flexibility afforded by international standards on money laundering and terrorist financing to ensure that country-level regulations do not inadvertently block poor people's access to finance.

The Role for Development Partners

The quality of funding for inclusive finance is at least as important as quantity. Effective development funding requires technical expertise, coordination among funders and appropriate funding instruments.

The key bottleneck for development partners supporting inclusive finance is the shortage of strong institutions and managers. Building the capacity of institutions should be an urgent goal in supporting microfinance.

Development partners should support the range of financial institutions that are a part of inclusive financial sectors, whether for-profit or not-for-profit. Development assistance should complement private sector activities, not compete with them.

Better information on the financial and social performance of development-partner investment portfolios is essential. What is not measured cannot be managed.

The Role for the Private Sector

The private sector has an important role to play in expanding access to financial services for poor people.

Providing financial products and services to poor people represents a potentially large business opportunity for the private sector. The private sector brings more than capital; it

also brings knowledge and relationships.
Effective engagement typically requires the strong commitment and interest of top-level executives and requires drawing on the competitive skills of core business activities.
To realize market opportunities, it is often necessary for the private sector to engage in establishing appropriate enabling environments.
Private-sector participants in inclusive financial sectors include not only direct providers of financial products and services, such as banks, NGOs, insurers and money transfer companies, but also telecommunications and technology companies, credit bureaus, retailers and other businesses that support the financial services industry. Partnerships have proven effective in fostering innovations and efficiency gains.

Recommendations

Saving: SHGs may be utilized for tapping the small savings by providing incentives to SHGs with suitable back-end technology support. Banks can develop medium and long term savings instruments by issue of pre-printed deposit receipts to SHGs which in turn can be sold to SHG members. Banks could be given the freedom to develop their own products, suited to local requirements and felt needs of the poor
Credit: Credit within a specified limit can be made available in 2-3 tranches, with the second and subsequent tranches disbursed based on repayment behaviour of the first tranche. This is to ensure that the vulnerable groups do not get in to a debt trap; it would also ensure good credit dispensation.

Insurance: Banks can play a vital role in this regard –by distributing suitable micro-insurance products.

With the creation of Financial Inclusion Promotion and Development Fund GOI has ushered in the era of financial inclusion, the need is of effective implementation to promote activities of Self-Help Groups Farmers' Service Centres and Rural Entrepreneurship.

The need is to extend services of RRBs unbanked areas and increase their credit to deposit (CD) ratio. They can play a pivotal role in setting exclusive targets for microfinance and financial inclusion, providing funding support & providing technology support.

There is dire need for enabling legislation of Cooperatives in SHG-Bank Linkage. Federations of SHGs can be registered in all the States under the Cooperative Societies Act or the parallel Self- Reliant Cooperatives Act and availability of funds to these cooperatives for advancing loans may be considered by NABARD, based on objective rating criteria. Encouraging SHG to enhance their presence in excluded regions and their funding can be done by NABARD or GOI.

Banks may appoint ex-servicemen/ retired bank staff as their BFs.
Joint Liability Groups (JLGs) of the poor such as landless, share croppers and tenant farmers is another innovative mechanism towards ensuring greater financial inclusion.
Stamp duty may be waived in respect of loans for small / marginal farmers, tenant cultivators and oral lessees.
Opening of specialized microfinance branches / cells in potential urban centres exclusively catering for microfinance and SHG - bank linkages could be thought of, to address the requirements of the urban poor.
The e-kiosks in villages could be yet another source of

operating a remittance system that is accessible to the poor. Micro-insurance should provide greater economic and psychological security to the poor as it reduces exposure to multiple risks and cushions the impact of a disaster. Micro-insurance in conjunction with micro savings and micro credit could go a long way in keeping this segment away from the poverty trap and would truly be an integral component of financial inclusion.

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