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ISSUES AND CHALLENGES IN FINANCIAL INCLUSION IN INDIA

DR. NISHAD K. P.
Head of the Department of Economics,
City College International, Ajman **UAE**

ABSTRACT

Access to finance by the poor, disadvantaged and underprivileged group is a prerequisite of poverty alleviation on one hand and the economic growth on the other. In the struggle against poverty, the financial inclusion is a crucial element. Large sections of the rural population have no access to financial services and their only recourse is to borrow from moneylenders at the exorbitant charges causing exploitation. The main reason why the large section of the rural population still remains under below poverty is financial exclusion, which is proving to be a major obstacle in the path of India's economic growth. This paper critically addresses all concerned issues involved in achieving the national objective of achieving the complete financial inclusion and critically evaluates the initiatives taken by the Banks in financial inclusion and the efforts made for IT enabled financial services, on the basis of the objective data derived from the RBI'S reports and other empirical studies.

INTRODUCTION

Financial exclusion is the main cause of poverty. Lack of opportunities and access to finance besides financial illiteracy are the main causes of financial exclusion. Financial exclusion is proving to be a major thorn in the path of Indian economic growth. Access to finance by the poor, disadvantaged and unprivileged group is a prerequisite for poverty reduction and social upliftment. One of the main reasons why the large section of the rural population still remains under below poverty line is lack of opportunities and access to finance besides financial illiteracy.

Large sections of the rural population have no access to financial services and their only recourse is to borrow from money lenders, who charge exorbitant rates. Also, ignorance is widespread, with concepts like insurance virtually unheard of. One of the main reasons why mass poverty is persisting in India is that the problem of financing the poor still remains unresolved.

1.1 Nature and cause of financial exclusion

Financial exclusion is broadly defined as the lack of access by certain segments of the society to suitable, low-cost, fair and safe financial products and services from mainstream providers. Thus the essence of financial inclusion is to ensure that a range of appropriate financial services is available to every individual and enable them to understand and access those services. Apart from the regular form of financial intermediation, it may include a basic no frills banking account for making and receiving payments, a savings product suited to the pattern of cash flows of a poor household, money transfer facilities, small loans and overdrafts for productive, personal and other purposes, insurance, etc. 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 is susceptible to irregular cash flow. Second, lack of financial planning and security in the absence of access to bank accounts and other saving opportunities for people in the unorganized sector limit their options for providing for themselves for their old age.

Broadly, the issue of cost of financial exclusion may be conceived from two angles, which are intertwined. First, the exclusion may have cost for individuals/entities in terms of loss of opportunities to grow in the absence of access to finance or credit. Second, from the societal or the national perspective, exclusion may lead to aggregate loss of output or welfare and the country may not realize its growth potential. Access to a bank account, credit and insurance are now widely regarded as essential supports for personal financial management and for undertaking transactions in modern societies.

The financial exclusion can impose significant costs on individuals, families and society as a whole. These include (i) barriers to employment as employers may require wages to be paid into a bank account; (ii) opportunities to save and borrow can be difficult to access; (iii) owning or obtaining assets can be difficult; (iv) difficulty in smoothening income to cope with shocks; (v) exclusion from mainstream society. The principal barriers in the expansion of financial services are often identified as physical access, high charges and penalties, conditions attached to products which make them inappropriate or complicated and perceptions of financial service institutions which are thought to be unwelcoming to low income people. So, the lack of accessibility to financial services to the poor and

disadvantaged class has been identified as one of the serious threat for including the poor in the process of inclusive growth.

1.2 Review of literature

A review of literature suggests that there is no universally accepted definition of financial inclusion. The definitional emphasis of financial inclusion varies across countries and geographies, depending on the level of social, economic and financial development; the structure of stake holding in the financial sector; socio-economic characteristics of the financially excluded segments; and also the extent of the recognition of the problem by authorities or governments. Broadly, financial exclusion is construed as the inability to access necessary financial services in an appropriate form due to problems associated with access, conditions, prices, marketing or self-exclusion in response to discouraging experiences or perceptions of individuals/ entities. The poor need financial services mainly for three purposes, all of which call for equal attention (**Rutherford, 2001**):

- Firstly, to defray expenses related to education, house-building, invariably go in for loans.
- Secondly, there are emergencies such as serious illnesses, death in the family, and property loss due to accident, and
- Thirdly, there are investment needs to buy or build income-earning assets.

Over the years, several definitions of financial inclusion/exclusion have evolved. The working or operational definitions of financial exclusion generally focus on ownership or access to particular financial products and services. The focus narrows down mainly to the products and services provided by the mainstream financial service providers. Such financial products may include money transmission, home insurance, short and long-term credit and savings. The review of literature suggests that the most operational definitions are context-specific, originating from country-specific problems of financial exclusion and socio-economic conditions. The operational definition of financial inclusion, based on the access to financial products or services, also underscores the role of financial institutions or service providers involved in the process (**Rabha, 2012**).

The scope of financial inclusion can be expanded in two ways:

- Through state driven intervention by way of statutory enactments.
- Through voluntary effort by the banking community for evolving various strategies to bring within the ambit of the banking sectors the large strata of society. When banks do not give desired attention to certain areas, the regulators have to take remedial

measures. This is the reason why the Reserve Bank of India (RBI) is placing a lot of emphasis on financial inclusion.

1.3 Indian approach to financial inclusion

Broadly, the policy approach adapted to financial inclusion in India can be divided in two categories as given below:

- The minimalist approach: it focuses on the provision of a bouquet of basic financial products and services.
- The expanded approach: it focuses not only on the provision of the basic banking products but also other important ancillary financial products, which would also entail focus on consumer protection and education, particularly financial literacy for the new entrants to the formal financial system.

1.4 Importance of financial inclusion

In majority of the developing countries, access to finance is now being perceived as a public good, which is as important and basic as access, say, to safe water or primary education. A question that arises is whether financial inclusion can be interpreted as a public good. A good is considered a public good if it meets the conditions of 'no rivalry' in consumption and non-excludability. Financial inclusion meets these two criteria. One of the important effects of financial inclusion is that the entire national financial system benefits by greater inclusion, especially when promoted in the wider context of economic inclusion.

1.5 Financial inclusion: India's position compared with other countries

The extent of financial exclusion in India is found to be higher as compared with many developed and some of the major emerging economies. The wide extent of financial exclusion in India is visible in the form of high population per bank branch and low proportion of the population having access to basic financial services like savings accounts, credit facilities, and credit and debit cards. State wise percentage of households availing Banking Services in clearly show that there still remain a large number of households which do not avail banking services, resulting to financial exclusion.

Table 1.1 helps to compare the position of India with some other countries. The table shows that just South Africa lies underneath India in the inclusive development index with an overall position of 70 and most of our neighbouring countries have better positions contrasted with India in the inclusive development index.

Table 1.1The IDI ranks of few selected countries

Economy	Rank (overall)	Growth rank	Inclusion rank	Integration equity rank
Russian Republic	13	12	21	20
China	15	6	53	2
Nepal	27	26	56	1
Brazil	30	9	42	40
Bangladesh	36	28	61	4
Srilanka	39	43	33	31
Pakistan	52	71	44	53
India	60	65	67	43
South Africa	70	75	70	54

Source: The Inclusive Growth & Development Report 2017; **Note:** IDI scores are based on a 1-7 **scale:** 1=worst and 7=best. Trends are based on percentage change between 2011 and 2015(using indicators available during both years)

1.6 Measuring financial inclusion

The Rangarajan Committee (2008) has defined Financial Inclusion as "Financial Inclusion is 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."

One of the measures of the level of financial inclusion is the Financial Inclusion Index. This index is based on three basic dimensions of an inclusive financial system namely banking penetration, availability of the banking services and usage of the banking system. Banking penetration is definitely the most critical parameter for measuring the depth of financial inclusion and is measured as a ratio of bank accounts to the total population. Availability of banking services provides an indication to the number of bank outlets available per 1000 people to deliver financial services. The bank outlets may include the brick and mortar branches, ATMs, business correspondents, etc. Usage of banking services going beyond mere opening of accounts. Therefore, this is evaluated on the basis of outstanding deposits and

credits. Accordingly, the volume of outstanding deposit and credit as proportion on the net district domestic product is used for measuring this dimension.

Table 1.1 demonstrates the top and bottom scoring states and union territories on CRISIL Inclusix. When we consider top scoring states on CRISIL Inclusix, six of the top 10 states/union territories are Kerala, Goa, Karnataka, Andhra Pradesh, and Chandigarh. The table demonstrates obviously the disparities in the distribution of financial services in India.

Table 1.1 Top and bottom scoring states/UTIs on CRISIL Inclusix in 2016

Top scoring states/ union territories on CRISIL Inclusix	
Large states	**Small states/union territories**
Kerala	Goa
Karnataka	Puducherry
Andrapradesh	Chandigarh
Bottom scoring states/UTIs on CRISIL Inclusix	
Large states	**Small states/union territories**
Bihar	Manipur
Uttar Pradesh	Nagaland
Assam	Meghalaya

Source: CRISIL Inclusix, February 2018/Volume 4

The second part of the table shows that the bottom scoring states on CRISIL Inclusix, 6 out of the 10 states/union territories, are Bihar, Uttar Pradesh, Assam, Manipur, Nagaland, and Meghalaya and every one of them belong to either north or northeast region of India. It shows the disparity in the dispersion of different financial services in India and underlines the requirement for serious projects from the government and RBI to quicken financial inclusion program.

1.7 Financial inclusion and inclusive growth: what the empirical evidence suggests?

Inclusive growth as a strategy of economic development has received renewed attention in recent years owing to rising concerns that the benefits of economic growth have not been equitably shared. Growth is inclusive when there is equality of economic opportunities.

Financial inclusion makes growth broad based and sustainable by progressively encompassing the hitherto excluded population. Financial inclusion is no longer a policy choice but a policy compulsion. Empirical evidence shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. The inclusive growth country analytics has a distinct character focusing on the pace and pattern of growth. Rapid pace of growth is unquestionably

necessary for substantial poverty reduction, but for this growth to be sustainable in the long run, it should be broad-based across sectors, and include a large part of the country's labour force. This analytics of inclusive growth implies a direct link between the macro and micro determinants of growth. Some of the important factors determining the level of financial inclusion in a country are per capita GDP, income inequality, adult literacy and urbanization. Further, physical and electronic connectivity and information availability such as telephone and internet usage also play positive role in enhancing financial inclusion.

The empirical findings strengthen the argument that financial exclusion is indeed a reflection of social exclusion, as countries having low GDP per capita, relatively higher levels of income inequality, low rates of literacy, low urbanization and poor connectivity appear to be less financially inclusive. Financial inclusion, therefore, assumes importance as a policy objective.

1.8 Major issues, challenges and strategies in financial challenges

There are several issues, challenges and strategies to achieve the target of complete financial inclusion; however, for restricting to the theme of the paper and space constraints, only major issues, challenges vis-à-vis strategies have been dealt with.

1. Change in the approach of Banks: It is often noticed that mere opening a Bank Account is taken or claimed as achieving the target of financial-inclusion. Many empirical studies and Usage Analysis reveal that after opening such bank accounts, hardly there are any transactions take place in such bank accounts. Banks must genuinely strive to provide the directed services under the category or scheme of financial inclusion to the rural population, since they are the main pillars for the desired success. On this backdrop, the claims of policy-makers, banks, etc., the illusions created and mythical success stories spread must be tested on the basis of parameters enumerated on the background of the RBI's norms and expectations. Basically, though, the financial inclusion is meant to include all the sections of the society, who are mainly out of the net of the financial institutions, yet, financial inclusion does not mean merely opening of saving bank account but signifies creation of awareness about the financial products, education and advice on money management, offering debt counseling, etc. by banks. Every society should ensure easy access to public goods. Therefore, banking service being a public good should also be aimed at providing service to the entire population. However, empirical studies show that:

- Some banks have no desire to achieve the complete financial inclusion.
- Some banks have formed opinion that the complete financial inclusion is not possible and/or it is an empty and useless exercise.

- The Banks are ready or eager, but their branch employees are reluctant or give lame excuses to implement the scheme of financial inclusion.
- Those who, unwillingly and reluctantly implement the scheme of achieving financial inclusion, assume that merely opening a bank account is the implementation of scheme of financial inclusion.
- Affordable credits are made available only as compulsions.
- Only in rare cases some of the banks make attempts to provide financial advice to the poor or disadvantaged people.
- The costs of serving the poor can be significant in the short-term, thereby, impacting profitability.

This attitude or mindset reflects a very narrow approach to tackling the problem of financial inclusion. Bankers should, therefore, change their mindsets, view financial inclusion as a viable business proposition and adopt innovative methods and low-cost delivery models to reach out to the poor. They should study the different markets across India thoroughly and offer region-wise customized products and services riding on the higher levels of trust enjoyed by them over the other financial service providers in rural India. It was in the context of financial inclusion of the excluded and to facilitate the electronic benefit transfer that banks were directed to ensure opening of one bank account per family. In order to accomplish the objective and to have proper monitoring of the progress various modalities have been suggested.

2. Relaxation in regulatory framework: The RBI, initially, in November 2005, set the population benchmark for taking its financial inclusion drive to the next level, mandating all Banks to reach out the villages, all habitations with population in excess of 2000, as per the 2001 census, either through the Bank Branches or through Business Correspondent (BCs). However, since 2011-12, the population benchmark is reduced to 1600 and above. The RBI asked Banks to drop the 'no-frills' tag from the basic savings accounts in 2012 as the nomenclature has become a stigma. The RBI asked Banks to provide the 'zero-balance' facility in the basic banking accounts along with ATM-cum-Debit Cards without extra charge. The Finance Ministry directed the Banks to reach out to villages with population of 2000, as the population benchmark that all habitations with population in excess of 1600 must have a bank branch, which helped to take financial inclusion drive to the next level. The Finance Ministry directed all state-run Banks to ensure that every household has at least one savings bank account by end of June 2012, a move seen as a precursor to direct transfer of benefits under the government's financial inclusion plan. **3. Self Help Group-Bank Linkage Programme (SLBP):** In the last two decades, the major institutional innovation in

India for expanding financial system access and usage for the poor and marginalized sections of the population has been the SBLP. The project provided a cost-effective SBLP model for providing financial services to the underserved poor. Being a 'savings-first, credit later' model, credit discipline became a norm for Self Help Groups (SHGs) and 'social collateral' made them bankable. The model was initially successful in providing solution to the twin problems faced by banks, i.e., low recovery of loans in rural areas and high transaction costs in dealing with small borrowers at frequent intervals, with a major positive impact of generating social and economic empowerment of the membership. However, despite the noteworthy accomplishments of SHGs certain issues, such as, inadequate outreach in many regions, delays in opening of SHG accounts and disbursement of loans, impounding of savings by banks as collateral, non-approval of repeat loans by banks even when the first loan was repaid promptly, multiple membership, borrowings by SHG members within and outside SHGs, adverse consequences of unhealthy competition between NGO promoted SHGs and Government promoted/subsidy oriented SHGs and limited banker interface and monitoring continued to affect the programme in many areas. While the basic tenets of the SHGs being savings led credit product remain true even today, recent developments have given rise to the need for crucial changes in the approach and design of SBLP to make it more flexible and client friendly

4. Microfinance Institutions (MFIs): The MFIs have served the underserved/unserved populace in the last few years and improved access to credit though there have been quite a few debatable issues on the style of corporate governance and ethics of conducting business on part of some of the MFIs. However, it has been often realized that the MFIs do help in financial deepening and can remain an important segment of the Indian financial market keeping in view the present level of penetration of the banking system. The conceptual framework underlying MFIs requires a change. MFIs will have to revisit the mission and business strategy and reinvent the sector to remain relevant in the system. The NBFC-MFIs has got some relief from the RBI, which issued revised 'Directions cum Modifications' in August 2012. NBFC-MFIs will have to work hard in pursuit of transparency and responsible finance, shaking off the perception that their motto is profiteering at the cost of the poor but not profitability for sustainable and viable growth on one hand and take initiatives to retool the product redesign for garnering new customers and acquiring more share of the market on the other.

5. Business Facilitators (BFs)/Business Correspondents (BCs): The ICT based agent bank model through BFs/BCs for ensuring door step delivery of financial products and services, prescribed by the RBI to act as intermediaries for providing financial and banking services and ultimately bridging the connectivity gap between the under-served populace and the banks. Viability of the BFs/BCs model in general has remained a critical issue for which the model has not taken off as expected. Further, banks and their BFs/BCs also exposed to huge risk of cash management, particularly as cash dependence of the economy continues to be

very high. The success of BFs/BCs model also hinges on adoption of technology, which in turn, is dependent on the degree of compatibility and integration of technology being used by the banks and their BFs/BCs.

6. Product Initiatives: To ensure that more and more people come within the banking fold, the banks should offer all the customers a 'basic savings deposit account' with certain minimum common facilities and without the requirement of minimum balance. The services provided in this account should 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. Innovation of products for the specific needs of the poor is necessary for achieving the ultimate objective of inclusive growth.

7. Mobile Banking: With the rapid growth in the number of mobile phone subscribers in India, banks in collaboration with telecom companies are seeking to develop an alternate channel of delivery of banking services. Keeping in view the issues relating to diversity of network providers in India, remittance centric approach of such model and Know Your Customer (KYC) related concerns, the RBI has advocated bank-led mobile banking model and issued operative guidelines to banks for effecting mobile-based banking transactions. The empirical studies indicate that banks are yet to fully exploit this technology even for their existing customers. The banks and the mobile operators reach a workable understanding while protecting their mutual interests. Such an approach would result in a 'win-win' situation for both and, more importantly, serve the larger cause of public good of financial inclusion.

8. Aadhaar-enabled Payment Systems (AEPS): The AEPS having the ability to service customers of many banks based on the unique biometric identification data stored in the Aadhaar database is expected to empower a bank customer to use Aadhaar as his/her identity to access the respective Aadhaar enabled bank account and perform basic banking transactions like balance enquiry, cash withdrawal and deposit through the BC.

9. Innovative product lines and processes: Banks have to look at their policies and procedures to develop new product lines rather than merely adopting the complex products of urban India in the rural milieu.

10. Financial literacy and awareness: There is a strong concern about the pathetic attitude of the banks to arrange regular campaigns for spreading awareness about financial inclusion and financial literacy need to be intensified. Banks need to do efforts in this area through innovative dissemination channels including films, documentaries, pamphlets and road shows.

11. Customer service and consumer protection: Customer service is another issue that needs closer attention. Mindset, cultural and attitudinal changes at the grass root levels and user friendly technology at the level of branches of banks and BC outlets are needed to extend holistic customer service to the new entrants to the banking system. Government, regulators like Reserve Bank of India, banks, service providers and consumers themselves have to play important role in developing a comprehensive approach to consumer protection.

12. Issues and Challenges in ICT based Financial Services: Banks need to make significant investments in technology based applications, related research and development efforts, comprehensive Management Information Service (MIS) and monitoring and evaluation systems on one hand and collaborate with technology service providers (TSPs), mobile network operators (MNOs), corporate houses and various categories of BCs to develop efficient delivery models with a strategy aiming to create a facilitating eco system, leveraging on technology and promote partnerships of brick and mortar branches including ultra-small branches with the ICT-based BC outlets for evolving an effective financial inclusion delivery mechanism. Technology holds the key to providing models for efficient delivery of small value transactions in large volumes while reaping economies of scale. Today, both the service providers and service seekers have a number of technology options, such as, smart cards, micro-ATMs, ATMs, mobile technology, Aadhaar Enabled Payment Systems (AEPS), etc. to choose from to provide financial services irrespective of their geographic locations. For the success of the ICT-based models, resolving technology related issues is the key.

13. Financial Inclusion as a Profitable Model for Financial Inclusion: Financial inclusion initiatives would provide banks with a low cost and stable source of funds, helping them improve their asset liability management (ALM). Rural India presents a remarkable opportunity for banks and financial institutions to seek their fortunes and bring prosperity to the aspiring poor through financial inclusion. In a fast growing economy like India the poor are the middle class of tomorrow and banks could, therefore, ill afford to ignore this segment. Banks, however, argue that while the benefits of financial inclusion can be easily understood, the costs of serving the poor can be significant in the short term, thereby impacting profitability. Banks, therefore, need to take bold decisions and reach out to rural India with strategies and business models which are beyond the realm of conventional thinking. Banks should refrain from deliberately adopting a uniform business model. Banks need to build its own strategy in line with its business model and comparative advantage.

1.9 Suggestions for further improvement

Profitable models for financial inclusion could, therefore, have the following features (These are concluding compilation of various options guided/suggested on this theme to the banks by various authorities, experts and authors on this theme):

1. Offering a clear customer proposition and customized bouquet of products: To succeed in their financial inclusion initiatives, banks would need to offer customers a clear proposition and a customized bouquet of product offerings which include advice on monetary issues, problems, needs and plans, savings cum Overdraft account, remittance-products, micro-Credits as per Bank's own schemes, Govt. directed Priority sectorial lending, Entrepreneurial Credit, Micro-Insurance. etc.,

2. Scalable business model with simple, user friendly low-cost technologies: Profitable business models would need to be scalable and incorporate simple, user-friendly and low-cost technologies so that investments would be recouped and profits begin showing up as the number of people serviced by a particular branch or outlet increases over time.

3. Collaborate with local agents and for profit companies: The basic problem of 'last mile access' can be solved if banks can team up with retail outlets (business correspondents) in low income, often hard to reach areas to offer financial services to rural masses, thereby, creating value both for themselves and their customers.

4. Banks need to learn from both corporate India and the informal sector: Banks need to innovate and improve service levels in order to provide the same level of accessibility as the local money lender, friend or relative and open branches in villages as inclusive banking goes beyond the conventional notions of commercial banking.

5. Subsidiary model to drive down costs: Indian banks should explore the subsidiary route to drive down distribution costs in their financial inclusion drive.

1.10 Concluding remarks

The problem of financial exclusion needs to be tackled with urgency if we want our country to grow in an equitable and sustainable manner. Traditional and conventional banking solutions may not be the answer to address the problem of financial inclusion in India. Banks, therefore, need to innovate and think 'out-of-the-box' for solutions to overcome the problem of financial exclusion in India. They need to deploy new technologies and create financially viable models to take forward the process of financial inclusion in an effective manner. This way banks in India would be doing a great service to the cause of financial inclusion and make their name in history. Financial inclusion may be a social responsibility for the banks in the short run but will turn out to be a business opportunity in the long term. Financial Inclusion is no longer an option, but it is a compulsion.

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