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FINANCIAL INCLUSION IN INDIA: CHALLENGES & OPPORTUNITIES

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INTRODUCTION:

With a huge rural population, that is economically challenged Financial Inclusion is indispensible for the sustainable growth of India.Former *UN Secretary-General Kofi Annan* said:"*The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together, we can and must build inclusive financial sectors that help people improve their lives."*

A holistic financial inclusion could be expedited with the maximum use of information, communication and technology-enabled services supported by an extensive *Financial Literacy* mission.

According to the *UK Financial Inclusion Taskforce*, there are three main concerns in financial inclusion; access to banking, access to affordable credit and access to free face-to-face financial advice. The term *'Financial Inclusion' is defined as an extension of banking and financial services at an affordable cost to unbanked people of the community*. Unlike financial inclusion, 'Financial Exclusion' signifies the lack of access (by the economically poor and unbanked people of society) to appropriate, low-cost, fair and safe financial products and services.

WHAT IS FINANCIAL INCLUSION?

Dr. C. Rangarajan committee on financial inclusion defines it as:

"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."

The financial services include the entire range - savings, loans, insurance, credit, payments etc. The financial system has to provide its function of transferring resources from surplus to deficit units but both deficit and surplus units are those with low incomes, poor background etc. By providing these services, the aim is to help them come out of poverty. So far, the focus has only been on delivering credit (it is called as microfinance but is microcredit) and has been quite successful. Similar success has to be seen in other aspect of finance as well.

Rationale behind Financial Inclusion

Finance has come a long way since the time when it wasn't recognized as a factor for growth and development. It is now attributed as the brain of an economic system and most economies strive to make their financial systems more efficient. It also keeps policymakers on their toes as any problem in this sector could freeze the entire economy and even lead to a contagion. The policymakers have set up their task force/committees to understand how financial inclusion can be achieved including advanced economies like United Kingdom.

India also set up a committee under the chairmanship of Dr. C.Rangarajan to suggest measures to increase financial inclusion (hence called the Rangarajan Committee on Financial Inclusion). The World Bank had organized a conference in March 2007 and has released a report titled "Finance for All" in November 2007.

WHO ARE THE EXCLUDED AND WHY?

Many people across the globe are excluded from mainstream banking. These range from people with low income to people with low information and accessibility to people with no social security or insurance cover. The main reasons behind exclusion are:

Lack of information: Lack of information about the role and function of banks, banking services and products, interest rates, etc. stop people from including themselves in mainstream banking.

Insufficient documentation: Many people (even in metropolis and urban areas) are unable to show their self identification documents during the opening of a bank account or during taking a loan.

Lack of awareness: Many people are unaware of the banking terms and conditions laid down from time to time.

High transaction charges: Various commercial banks across the globe levy transaction charges on credit or debit transactions, on over usage of banking services, on cheque book issuance etc

Lack of access: Accessibility is a problem from all those people who live in geopolitically isolated regions. Moreover, as most of the commercial banks are located in the vicinity of cities, people in rural areas (mainly in developing countries) have a geographical barrier in accessing banks.

Illiteracy: Because of illiteracy, a substantial number of people are unable to take recourse to banking services.

FINANCIAL INCLUSION: INDIA

The Reserve Bank of India setup a commission (Khan Commission) 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). In the report RBI exhorted the banks with a view of achieving greater Financial Inclusion to make available a basic "no-frills" banking account. In India, Financial Inclusion first featured in 2005, when it was introduced, that, too, from a pilot project in UT of Pondicherry, by Dr. K. C. Chakraborthy, the chairman of Indian Bank. Mangalam Village became the first village in India where all households were provided banking facilities.

FINANCIAL EXCLUSION

It has been found that financial services are used only by a section of the population. There is demand for these services but it has not been provided. The excluded regions are rural, poor regions and also those living in harsh climatic conditions where it is difficult to provide these financial services. The excluded population then has to rely on informal sector (moneylenders etc.) for availing finance that is usually at exorbitant rates. This leads to a vicious cycle. First, high cost of finance implies that first poor person has to earn much more than someone who has access to lower cost finance. Second, the major portion of the earnings is paid to the moneylender and the person can never come out of the poverty.

- **High cost**
- **Non-price barriers**
- **Behavioral aspects**

CHALLENGES TO FINANCIAL INCLUSION

Several challenges like large area, cost of small value transactions, weak delivery model, unsuitable products, infrastructure, lack of finances, management support have to be effectively dealt with. The automation of core banking processes with the use of channels such as ATM, IVR based Tele-banking, Internet banking, the banking industry has become more profitable. Banks however, face an uphill task of reaching out to the mass customers in remote areas such as villages. Naxal Movement, low Return –On- Investment (ROI), customer behavior, operating expenses inhibits banks from expansion in rural areas.

FINANCIAL INCLUSION IN INDIA- POLICY PERSPECTIVE

Financial Inclusion has become a buzzword now but in India it has been practiced for quite sometime now. RBI has made efforts to make commercial banks 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.

This RBI focus led to a few key developments:

- **No-Frill accounts**
- **Usage of Regional language**
- **Simple KYC Norms**
- **Easier Credit facilities**
- **Other rural intermediaries**
- **Using Information Technology**
- **Financial Education**

LEAD BANK SCHEME

The ‘Lead Bank Scheme’ targets the ‘Aam Admi’ being crucial to Business Correspondent model for reaching the unbanked rural people and extending microfinance services. With operational modalities not being spelt out, the programme seeks to provide banking facilities to habitations with a population of more than 2,000. Insurance and other services will also be extended which has been the demand of microfinance institutions. The industry is demanding a more liberal and flexible approach with less regulations to make the scheme successful.

RECENT BUDGET ON FINANCIAL INCLUSION & MICROFINANCE

The microfinance programme this year received a boost in terms of more allocation to the twin-funds managed by NABARD for financial inclusion. Set up in 2007-08 the Financial Inclusion Fund and the Financial Inclusion Technology Fund have been the core of government’s actions programme to achieve financial inclusion. With an additional Rs.100 crore (INR 1,000 million) for each of these funds, the government has cleared the decks for functional phase of ensuing Business Correspondent model in rural areas.

In addition, the programme for linking Self Help Groups (SHGs) with the banking system, re-designated as the **‘Micro-Finance Development and Equity Fund’** in 2005-06 with a corpus of Rs.200 crore (INR 2,000 million) has seen doubling of allocation to Rs. 400 crore

(INR 4,000 million) in the current budget. A positive development indeed but the focus is likely to be in the northeastern and eastern region, where many anti-poverty programmes have yielded little result in terms of improving the financial access norms to the poor and rural households.

ACCESS TO BANKING SERVICES

One important point that the finance minister made in his opening remarks was to ensure the growth of banking system to meet the needs of a modern economy, expansion in geographic terms and improve access to banking services. While the RBI is considering giving some additional banking licenses to private sector players, Non Banking Financial Companies (NBFCs) could also be considered, if they meet the RBI's eligibility criteria. While this addresses the long-time demand of NBFCs to raise deposits from the members, it is unlikely to help the microfinance sector's emerging MFI-NBFCs which have been seeking similar privilege.

COMMITTEE ON FINANCIAL INCLUSION (CFI)

Government of India constituted a Committee to enhance financial inclusion in India on 22 June 2006. The Committee presented its report in January 2008. The report has analyzed financial inclusion in detail. CFI has initiated a mission called National Rural Financial Inclusion plan. It has set targets to increase FI in the country across regions and across institutions (banks, rural regional banks etc). It has suggested measures to address both, supply and demand constraints in increasing financial inclusion. The report suggests measures to address demand constraints in all the other forms of capital as well. To address human capital it stresses on health and education; for natural capital - enhance access to land which could provide collateral; for physical capital- improve infrastructure; social capital- develop institutions like gram panchayats etc.

The interim report was presented before the Budget (2007-08). The Finance Minister in the Budget decided to implement, immediately, two recommendations. The first was to establish a Financial Inclusion Fund with NABARD for meeting the cost of developmental and promotional interventions. The second was to establish a Financial Inclusion Technology Fund to meet the costs of technology adoption. The overall corpus for each fund was Rs.500 crore, with initial funding to be contributed by the Central Government, RBI and NABARD. In the 2008-09-budget statement, the Finance Minister proposed two more measures: one to add at least 250 rural household accounts every year at each of their rural and semi-urban branches of commercial banks (including regional rural banks) and two, to allow individuals such as retired bank officers, ex-servicemen etc to be appointed as business facilitator or business correspondent or credit counselor. The Finance Minister also proposed to expand the reach of NABARD, SIDBI and NHB.

IT propelled e-Governance Models for Financial Inclusion

The solution to the problem of Financial Inclusion in India is IT.
The existing infrastructure framework should be made effective use of to speed up the financial inclusion.

- **Postal Network**
- **Mobile Banking**
- **Ubiquitous Technology**

CONCLUSION

Financial Inclusion is needed for rural and downtrodden masses that are the future growth engine of the economy. From the recent initiatives undertaken by the different world governments to foster financial inclusion, one cannot undermine the need to include the economically underprivileged in the mainstream banking sector. The role of various ICT tools and associated technologies in providing financial solutions to the unbanked is also substantial. Rural ATMs, plastic cards (like smart cards, biometric cards, etc.) and mobile payment technologies do have the ability to engage the unbanked sections.

Steps have been taken by the Government for the expansion of banking services and linking of opportunities among various segments of financial sector like capital markets, insurance, etc. to achieve its aim of Inclusive Growth. High GDP growth in India, triggered by an open economy has created job opportunities in urban and semi-urban India and it will go further into rural India, increasing the potential for growth to vast sections of disadvantaged and low income groups.

Commercial banks are making use of the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions, NBFCs, etc. as intermediaries for providing financial and banking services which could be used as business facilitators (BF) or business correspondents (BC) by them. Government initiatives to support FI needs to be backed by progressive policies. This can be achieved only through Public- Private Partnership Model powered by ubiquitous technologies.

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