Financial Inclusion in India: Opportunities and Challenges

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ABSTRACT

Financial inclusion plays an important role in economic development of the country. It helps in the empowerment of the underprivileged, poor and women of the society with the mission of making them self-sufficient and well informed to take better financial decisions. Financial inclusion is the delivery of financial service at affordable costs to sections of disadvantaged and low-income segments of society. A strong financial system is required in not only in under-developed countries and developing countries but also developed countries for sustainable growth. Lack of access to financial services for weaker sections of the society has been recognized as a serious threat to economic progress, especially in developing countries. In the present paper an attempt has been made to study challenges faced by financial inclusion system and to identify the opportunities available for financial inclusion in India.

Keywords
Financial Inclusion, Financial Stability, Economic Development and Financial Services

INTRODUCTION

Financial inclusion plays an important role in economic development of the country. It helps in the empowerment of the weaker section and women of the society with the mission of making them self-sufficient. Financial inclusion takes into account the participation of vulnerable groups such as weaker sections of the society and low income groups, based on the extent of their access to financial services such as savings and payment account, credit insurance, pensions etc. Also the objective of financial inclusion exercise is easy availability of financial services which allows maximum investment in business opportunities, education, save for retirement, insurance against risks, etc. by the rural individuals and firms (Singh et. al, 2014).

Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income group. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy. The purpose of financial inclusion is to provide equitable opportunities to every individual to avail the facility of formal financial channels for better life, better living and better income. It is crucial to innovate and provide means to include the financially excluded by way of ensuring access to financial services, and timely and adequate credit. Financial inclusion is not an end in itself, but rather a gateway, a process. Financial inclusion can be described as the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who are excluded. The micro credit movement is global phenomenon. Generally, the micro credit movement is criticized for its nearly 100% focus on credit and absolute neglect of extending saving opportunities. However, since credit re-payment is on a daily or weekly basis, it amazes many about the earning and saving capabilities of vulnerable sections of society, even if it is of small amount.

The government of India recently announced “Pradhan Mantri Jan Dhan Yojna,” a national financial inclusion mission which aims to provide bank accounts to at least 75 million people by January 26, 2015. The financial system serves as a catalyst to economic development. The formal financial channels collect savings and idle funds and distribute such funds to entrepreneurs, businesses, households and government for investment projects and other purposes with a view of a return. This forms the basis for economic development in modern economic theory.

The financial system plays the role of inter-mediation and acts as a buffer in the mobilization and allocation of savings for productive activities in an economy. Managing the financial liquidity to avoid inflationary pressures and to flush out enough liquidity to sustain the growth are the functions of financial systems. It also assists in managing the risks faced by firms and businesses, improvement of portfolio diversification, availability of variety of financial instruments to suit the varied needs of the businesses , people and shock absorbing capacity from external economic changes. Additionally, the system provides linkages for the different sectors of the economy and economies of scale. “A financial system is in a range of stability whenever it is capable of facilitating (rather than impeding) the performance of an economy, and of dissipating financial imbalances that arise endogenously or as a result of significant adverse and unanticipated events.”
DEFINITION OF FINANCIAL INCLUSION

Rangarajan’s committee on financial inclusion defines it as:
“Financial inclusion may be defined as the process of ensuring the access of financial services and timely and adequate credit was needed by vulnerable groups such as weaker sections and low income groups at affordable cost”.

Financial inclusion has been defined by United Nation as under:
“A financial sector that provides access for credit for all bankable people and firms and saving and payment services to everyone. Inclusive function does not require that everyone is eligible to use each of services but they should be able to choose them if desired.

RBI defines Financial Inclusion as “a process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated mainstream institutional players”.

CURRENT STATUS OF FINANCIAL INCLUSION INDIA

The Indian banking industry has been able to penetrate to less than half of the population over the last few decades. The Reserve Bank of India (the regulator) has taken a number of steps to further expedite the process of financial inclusion. Broad based financial inclusion is a must, as there is hardly any instance where transition from an agrarian system to a post industrial modern society has happened in any economy without the setting up of a robust financial system. Despite the aggressive growth in most financial segments since 2001 coupled with the successfully absorbing of the global recession of 2008, under penetration of banking facility and of most financial products/services is widespread in both rural and urban areas of India.

Even though Indian banking credit has enjoyed a significant growth since 2003, credit penetration remains well below global benchmarks, which is suggestive of healthy growth potential on one side and failure to achieve equitable distribution in society on the other. In India too, the household sector generates more savings in comparison to the private corporate and public sectors. A significant proportion of household financial savings is routed through the banking system.

The statistics on financial exclusion in India provides a very depressing picture. Out of over 600,000 rural habitations in the country, only about 30,000 or just 5% have a commercial bank branch. Just about 40 per cent of the population across the country have bank accounts and this ratio is much lower in the north-eastern part of the country. The proportion of people having any kind of life insurance cover is as low as 10 per cent, and the proportion having non-life insurance is an abysmally low 0.6 per cent. People having debit cards comprise only 13 per cent and those having credit cards a marginal 2 per cent. However staggering these figures may seem, they still convey only part of the extent of financial exclusion in India.

Out of the total number of saving bank accounts the vast majority are dormant. Status of active ‘no frill accounts’ is altogether alarming. All across India, less than 10% of the ‘no frill accounts’ are active. In the absence of financial literacy, very few conduct banking transactions and even few receive credit from formal financing channels. Millions of people across the country are thereby denied the opportunity to increase their earning capacity and entrepreneurial talent and continue to struggle with their limited resources.

Things are changing in the country. 15 years ago, nobody would have thought that big corporates like ‘Novelis’, ‘Arcelor’, ‘Jaguar Land Rover’, ‘Corus’ will be taken over by Indian entrepreneurs. The world has also seen how the population explosion became a blessing in disguise and has now been transformed into the great Indian domestic consumption story.

OBJECTIVES

• To study an overview of financial inclusion in India.
• To identify the opportunities available for financial inclusion in India.
• To study the challenges faced by financial inclusion in India.

RESEARCH METHODOLOGY

The present study is descriptive in nature. The data used for the study is secondary in nature and has been collected from RBI bulletin, annual reports of RBI and Ministry of Finance, various reputed journals, and newspapers.

CHALLENGES

The broad challenges involved in financial access to low income families are as follow:

• High transaction cost

The income of poor people is low and unpredictable which make difficult for them to bank with formal institutions. It also increase the transaction cost for banks because they
have to maintain a high number of accounts with a low volume of financial transaction.

- **High operational costs**
  It is another main problem faced by the people. Most financial service providers are wary of providing products and services appropriate to low income families on account of the high transaction costs intrinsic to small value accounts with limited numbers of transactions.

- **Absence of reach and coverage**
  Most of bank branches are located far from the villages. There are 6 lakh villages in India while, rural branches of scheduled commercial banks including RRBs only 33,495. Due to the distance of community from the bank, the expenses of travelling ads to the transaction cost.

- **Inadequate banking products**
  Studies infrastructure coupled with remoteness and of no frills accounts show that poor people prefer to transact with banks only if the latter provide overdraft facilities to meet emergency needs. Their needs are more often met by remittances and entrepreneurial credit such as KCC, GCC.

- **Lack of financial literacy**
  Low literacy rate has been a great impediment for financial inclusion as ignorance caused low levels of awareness causing difficulty to communicate the necessity for banking habits and what savings can do to enrich their living standards. With little knowledge it turns out to be difficult task to make them understand the product features and second the complex legal terminologies.

- **Regulation policies**
  Regulation policies are barrier to broader financial inclusion. For example banks often require identity proof of individuals to register themselves with bank; so that regulation related to money laundering can be meeting. But poor people particularly women, lack birth certificate and formal identity card.

### OPPORTUNITIES

Few opportunities that are hot today include:

- **Developing Next generation payment systems**
  - Financial inclusivity deals with high volume but small ticket transactions. Existing payment gateways are too expensive and not built grounds-up to deal with the complexity & nature of this business. Therefore there is an acute need for a new payment gateway that is low cost and based on either Aadhaar or biometrics.

- **Financial Applications**
  - Various financial applications be it in insurance, in capital markets or banking could be developed to be able to reach out to the rural masses. All these applications must be able to support Aadhaar, Biometrics & be able to work thru Business Correspondents.

- **Services**
  - Setting up efficient BCs & training them to be able to conduct multiple businesses in another massive area of opportunity.

- **Mobile technology**
  - Could be leveraged in various ways as there are over 700 Million people in India who have mobile phones. Today mobiles can do almost everything, from biometrics to even IRIS & document scanning. There are limitless applications one can think of.

### FINANCIAL INCLUSION AND ECONOMIC DEVELOPMENT

The world as also seen how the so called weak banks and financial institution of India came triumphant during recession of 2008. The way some of the things happen here are like miracles. Despite policy constraints, poverty traveling by side to growth, handicraft happening side by side with technology and many more.The Indian growth story is being increasingly felt and admired with each passing year.

Poverty levels are declining and are bound to decline further. With this households will have greater levels of incomes and at the same time the number of first time savers, consumers and entrepreneurs are bound to increase. This segment will require easy access to formal financial systems to get into the banking habit. Banks need to innovate and devise newer methods to absorb such customers into their fold as these new prospective customers will turn into commercially viable customers. That is to say that the supply side should take the initiatives.

These are early times for micro credit, MFI’s and the self help group movements in India. Though they are gathering momentum, they still need support to spread to the length and breadth of India and to penetrate to different parts of India. If their greed remains under control, they will be able to successfully replace moneylenders (who are more harmful).

Monetary – (to provide outreach of savings and credit to all sections of society ). Some broadly suggested measures which can improve the quality of life are:

- **Human capital** – Stress on health and education;
- **Natural capital** – Better utilization of natural resources;
- **Physical capital** – More investment infrastructure;
• Social capital – Develop institutions like Gram Panchayats, etc.

It is under the fifth measure that financial inclusion plays a prominent role.

STEPS TO MEASURE THE FINANCIAL INCLUSION AND STABILITY

Opening of no-frills accounts: Basic banking no-frills account is with nil or very low minimum balance as well as charges that make such accounts accessible to vast sections of the population. Banks have been advised to provide small overdrafts in such accounts.

Relaxation on know-your-customer (KYC) norms: KYC requirements for opening bank accounts were relaxed for small accounts in August 2005, thereby simplifying procedures by stipulating that introduction by an account holder who has been subjected to the full KYC drill would suffice for opening such accounts. The banks were also permitted to take any evidence as to the identity and address of the customer to their satisfaction. It has now been further relaxed to include the letters issued by the Unique Identification Authority of India containing details of name, address and Aadhaar number.

Engaging business correspondents (BCs): In January 2006, RBI permitted banks to engage business facilitators (BFs) and BCs as intermediaries for providing financial and banking services. The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions, thus addressing the last-mile problem. The list of eligible individuals and entities that can be engaged as BCs is being widened from time to time. With effect from September 2010, for-profit companies have also been allowed to be engaged as BCs.

Use of technology: Recognizing that technology has the potential to address the issues of outreach and credit delivery in rural and remote areas in a viable manner, banks have been advised to make effective use of information and communications technology (ICT), to provide doorstep banking services through the BC model where the accounts can be operated by even illiterate customers by using biometrics, thus ensuring the security of transactions and enhancing confidence in the banking system.[14]

Adoption of EBT: Banks have been advised to implement EBT by leveraging ICT-based banking through BCs to transfer social benefits electronically to the bank account of the beneficiary and deliver government benefits to the doorstep of the beneficiary, thus reducing dependence on cash and lowering transaction costs.

GCC: With a view to helping the poor and the disadvantaged with access to easy credit, banks have been asked to consider introduction of a general purpose credit card facility up to `25,000 at their rural and semi-urban branches. The objective of the scheme is to provide hassle-free credit to banks’ customers based on the assessment of cash flow without insistence on security, purpose or end use of the credit. This is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned.

Simplified branch authorization: To address the issue of uneven spread of bank branches, in December 2009, domestic scheduled commercial banks were permitted to freely open branches in tier III to tier VI centres with a population of less than 50,000 under general permission, subject to reporting. In the north-eastern states and Sikkim, domestic scheduled commercial banks can now open branches in rural, semi-urban and urban centres without the need to take permission from RBI in each case, subject to reporting.

Opening of branches in unbanked rural centres: To further step up the opening of branches in rural areas so as to improve banking penetration and financial inclusion rapidly, the need for the opening of more bricks and mortar branches, besides the use of BCs, was felt. Accordingly, banks have been mandated in the April monetary policy statement to allocate at least 25% of the total number of branches to be opened during a year to unbanked rural centres.

CONCLUSION

Financial inclusion is an emerging issue that has global relevance, because the extent to which a financial system is developed is dependent on how it can provide access to financial services to the public, particularly the unbanked. Financial inclusion has a positive impact on economic growth and development. Moreover, lack of awareness and financial literacy among rural population are primarily responsible for low penetration of financial services. More incentives for the BCs, utilizing existing network for banking such as post offices, creating awareness for the use of banking technologies as well as mobile phones etc. will help in creating a big difference in the economy. The growth and development of a country is significantly dependent on the expansion of banking and financial services to the currently financially-excluded class of citizens in the economy.

REFERENCES


