ISBR Management Journal, Volume 1, Issue 4, May, 2019

ISSN (Online)2456 – 9062

# A STUDY ON FINANCIAL INCLUSION & ITS IMPACT ON ECONOMIC EVELOPMENT

**Author**

1. **VARSHINI S K**
   **Lecturer**
   **Seshadripuram College,**
   **Bangalore.**

2. **SANDESH .V**
   **Lecturer**
   **Seshadripuram College,**
   **Bangalor**

**ABSTRACT**

"Financial inclusion is about the broadening of financial services to those people who do not have access to financial services sector, providing greater financial literacy and consumer protection so that those who are offered the products can make appropriate choices. The imperative for financial inclusion is both a moral one as well as one based on economic efficiency".

In India financial inclusion is not new unusual requirement. Out of 248 crores of household
60% of the population in India is unbanked.

- 40% in urban areas
- 60% in rural areas

Objective of financial inclusion is to deliver the banking services at an affordable cost to vast sections of society.The world as also seen how the so called weak banks and financial institution of India came triumphant during recession of 2008. However in recent years Government of India & RBI have been making concerned efforts to promote Financial Inclusion as one of the important national objective for Economic Development. Some of the major efforts made in last few decades includes nationalization of banks, establishment of RRB's and recently zero balance Basic Saving Bank Deposit account i.e, Jan Dhan Yojana.

Increasing commercialization of agriculture and rural activities is bound to result in to cycle of higher income, higher consumption, higher savings and higher investment resulting into higher income. Growth is changing the

face of rural as well as of urban India. Thus financial inclusion is cause as well as outcome of economic development**.**

(***Keywords: Financial inclusion, Economic Development, Recent trends)***

## INTRODUCTION

### HISTORY:

There is a long history of financial inclusion in India. It has traditionally been understood to mean opening new bank branches in rural and unbanked areas. Nowadays, however, financial inclusion is seen to be something more than opening bank branches in unbanked areas to take formal financial services across the length and breadth of the country. In the context of the various shortcomings in delivering subsidies, direct transfers using technology have been thought of. The economic development of India was dominated by socialist influenced policies, state-owned sector, & red tape & extensive regulations, collectively known as "License Raj". It led the country and its economy isolated from the world economy. However the scenario started changing form mid – 1980's, when India begin to opening up its market slowly through Economic liberalization.

*"Financial inclusion is about the broadening of financial services to those people who do not have access to financial services sector, providing greater financial literacy and consumer protection so that those who are offered the products can make appropriate choices. The imperative for financial inclusion is both a moral one as well as one based on economic efficiency"*

### Government of India & RBI:

Finance is a powerful intervention for economic development. Access to finance, especially for the poor, is empowering because financial exclusion often leads to broader social exclusion. Yet, formal finance does not appear to have adequately permeated vast segments of our society, although progress is being made.

To advance the process, the Reserve Bank has granted 'in principle' approval to a multitude of players in the financial eco-system to establish Payments Banks and Small Finance Banks. The recently announced Jan Dhan Yojana by the government marks a landmark in the quest for universal financial access. The government is also focusing on paying benefits directly into these accounts. This will ensure that a big chunk of the accounts opened under various schemes, which are presently dormant, witness 'movement', thereby integrating access with use. These are very heartening developments.

Several Committees in the recent past have opined on our quest for a more inclusive financial regime. The thrust of their recommendations was towards having an enabling regulatory framework, improving delivery systems and exploiting its possible synergies. At the Reserve Bank Conference on Financial Inclusion in April

2015, the Hon'ble Prime Minister urged the Reserve Bank to take the lead in encouraging financial institutions to set concrete targets for financial inclusion to help transform the quality of life of the poor. Against this

backdrop, this Committee on Medium-term Path on Financial Inclusion (CMPFI) was set up to devise a measurable and monitorable action plan for financial inclusion that encompasses both households and small businesses.

The Committee sets a much wider vision of financial inclusion as 'convenient' access to a set a basic formal financial products and services that should include savings, remittance, credit, government-supported insurance and pension products to small and marginal farmers and low-income households at reasonable cost with adequate protection progressively supplemented by social cash transfer besides increasing the access for micro and small enterprises to formal finance with greater reliance on technology to cut costs and improve service delivery, such that by 2021 over 90 per cent of the hitherto underserved sections of society become active stakeholders in economic progress empowered by formal finance. Thus, the financial inclusion initiative as envisaged by the Committee is much broader in scope, going beyond the traditional domain of the Reserve Bank. Meaningful financial inclusion is not feasible without government-to-person (G2P) social cash transfer. There is also an opportunity to usher in next-generation reforms by replacing agricultural input subsidy with income support, which increases the personal disposable surplus of the poor on a regular basis and could place the inclusion effort on a solid foundation.

With the Jan Dhan, Aadhaar and Mobile (JAM)) trinity taking hold, there is an ideal opportunity to seamlessly integrate access and use and, in the process, ensure that leakages in financial transfers are substantially lowered. Innovative delivery channels, such as mobile wallet and e-money coupled with regulatory changes to allow

interoperability across banks and non-banks, seem to hold the key to a more efficient payment system and reduce the fascination for cash. Banks need to integrate the Business Correspondent (BC) model into their

business strategy and with help from technology can develop a low-cost, reliable, 'last mile' delivery channel that could win the trust of the common person. Biometric identification coupled with the provision of credit information to credit bureaus can help build a more robust credit system that can then be used as the basis for obtaining loans at reasonable costs while avoiding the pitfalls of over-indebtedness. For micro and small enterprises, professionals who can evaluate the creditworthiness of these firms by acting as intermediaries with the bank can help alleviate the significant credit gap in this sector.

In agriculture, millions of small farmers live on the precipice, starved of credit. In the absence of bold structural reforms of land digitization and tenancy certification to enable credit to the tiller, the problem is likely to persist. Agricultural distress can only be addressed satisfactorily by instituting universal crop insurance for small and marginal farmers at a heavily subsidized rate by the government, the money for which can be funded by doing away with the current interest subsidy scheme that has distorted the agricultural credit system and seems to have impeded long-term investment.

While financial products have their benefits, there is a clear danger of mis-selling, which could damage marginalized segments who have an uncertain cash flow. Efforts on financial education need to be strengthened, including product-driven financial literacy so that the poor are not short-changed. Grievance redressal for customer complaints in banks needs some imaginative thinking. The overall governance structure would have to be more business-like, focused on delivery. However, the progress is far from satisfactory as evidenced by the World Bank Findex Survey (2012). According to the survey findings, only 35% of Indian adults had access to a

formal bank account and 8% borrowed formally in the last 12 months. Only 2% of adults used an account to receive money from a family member living in another area and 4% used an account to receive payment from the Government. The miniscule numbers suggest a crying need for a further push to the financial inclusion agenda to ensure that the people at the bottom of the pyramid join the formal financial system, reap benefits and improve their financial well-being. **Thus** financial inclusion is cause as well as outcome of economic development **& this is the reason for selecting the topic "FINANCIAL INCLUSION & ECONOMIC DEVELOPMENT".**

## RESEARCH DESIGN

This paper is basically conceptual and analytical in nature. In this paper an attempt has been taken to analyze the various initiatives taken by Banks and Government of India. The data used in it is purely from secondary sources according to the need of this study.

### Statement of the problem

"To analyse the Impact of Financial Inclusion on Economic Development of India"

### OBJECTIVES

- To understand the need of financial inclusion
- To understand the impact of financial inclusion on economic development
- To study the initiatives of GOI and RBI
- To study the constraints to financial inclusion
- To study the recent developments in financial inclusion

### NEED

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

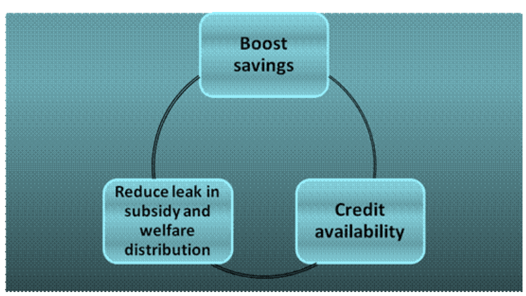
1. Creating a platform for inculcating the habit to save money – The lower income category has been living under the constant shadow of financial duress mainly because of the absence of savings. The absence of savings makes them a vulnerable lot. Presence of banking services and products aims to provide 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.

2. Providing formal credit avenues – So far the unbanked population has been vulnerably dependent of informal channels of credit like family, friends and moneylenders. Availability of adequate and transparent credit from formal banking channels shall allow the entrepreneurial spirit of the masses to increase outputs and prosperity in the countryside. A classic example of what easy and affordable availability of credit can do for the poor is the micro-finance sector.

3. Plug gaps and leaks in public subsidies and welfare programmes – A considerable sum of money that is meant for the poorest of poor does 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 laudable effort is expected to reduce government's subsidy bill (as it shall save that part of the subsidy that is leaked) and provide 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.

**Why is financial inclusion needed in India(a graphical representation)**



**SCOPE :**

Financial Inclusion should include access to financial products and services like,

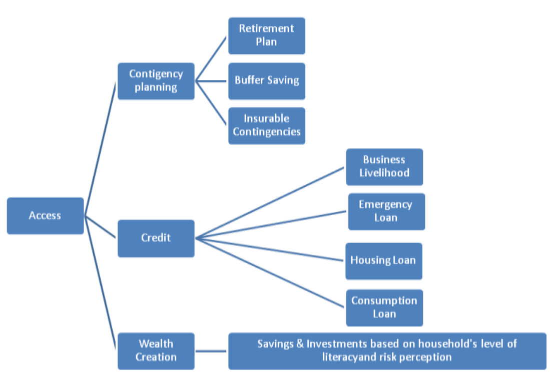
- Bank accounts – check in account
- Immediate Credit
- Savings products
- Remittances & Payment services
- Mortgage
- Financial advisory services
- Entrepreneurial credit

Out of 248 crores of household 60% of the population in India is unbanked.

- 40% in urban areas
- 60% in rural areas

North Eastern(7%) , Eastern regions (8%). This state led to generation of financial instability, poor economic development in developing countries like India.

**Household access to financial services**



**FINDINGS**

**1) Constraints to Financial Inclusion**

1) The three big challenges are- high cost, lack of robust technology, and lack of awareness.

- The banks are faced with high operating cost in extending the financial services to the remote areas.
- High maintenance cost of these accounts as well as small ticket size of the transactions is also adding to the problem.

**2) Possible way forward for promoting Financial Inclusion**

With the arrival of banking technology and realization that poor are bankable with good business prospects, financial inclusion initiatives will strengthen financial deepening further and provide resources to the banks to expand credit delivery. The banking technology initiatives
meant for financial inclusion should be collaborative and innovative with an objective to reduce the transaction costs. Thus, financial inclusion along with the Governmental developmental programmes will lead to an overall financial and economic development in our country and as in the case for most developing countries ,extending the banking services to everyone in the country will be the key driver towards an inclusive growth.

**3) Role of financial inclusion on economic development**

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.

**4) Banking reforms for promoting Financial Inclusion & recent development**

With a view to covert banking services from the "class phenomenon" to the "mass phenomenon", the Central government nationalized fourteen major commercial banks in 1969. It was considered that banks were controlled by business houses and thus failed in catering to the credit needs of poor sections such as cottage industry, village industry, farmers, craft men, etc. The second dose of nationalization came in April 1980 when six more banks were nationalized. The broad objectives of nationalization of banks were-

- Social Welfare
- Controlling Private Monopolies
- Expansion of Banking
- Reducing Regional Imbalance
- Priority Sector Lending
- Developing Banking Habits

To further the goal of financial inclusion, the government launched the Lead Bank Scheme in 1969 itself. It was based on the recommendation of the Gadgil Study Group. The basic idea was to have an "area approach" for targeted and focused banking. Under the scheme a cluster of villages were to be allotted to public sector banks for serving to their credit needs. Thus, the RBI has adopted a bank-led model for achieving financial inclusion and removed various regulatory

bottle necks in achieving greater financial inclusion in the country. Further, for achieving the targeted goals, RBI has created conducive regulatory environment and provided institutional support for banks in accelerating their financial inclusion efforts. In more specific terms,

following were some of the initiatives taken by the RBI for promoting Financial Inclusion in the country-

(a) **Priority Sector Lending:** It is an important role given by the Reserve Bank of India (RBI) to the banks for providing a specified portion of the bank lending to few specific sectors like agriculture or small scale industries. This is essentially meant for an all round development of the economy as opposed to focusing only on the financial sector.

(b) **Setting up of the "Ultra Small Branches":** These are non brick-mortar branches, the purpose of which is to reduce the infrastructural costs in setting up branches in rural areas. Under this initiative, the banks will appoint banking correspondent who will deal with all cash transactions and other routine work in that area. A bank officer will visit this ultra small branch once a week and connect this business correspondent to the banks' core banking solution (CBS) through a secured network enabling data access and transfer between the small branch and the bank.

(c) **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.

(d) **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. 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.

(e) **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.

(f) **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.

(g) **General-purpose Credit Card (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 Rs 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.

(h) **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 urban centers, subject to reporting. In the north-eastern states and

Sikkim, domestic scheduled commercial banks can now open branches in rural, semi-urban and urban centers with out the need to take permission from RBI in each case, subject to reporting.

(i) **Opening of branches in unbanked rural centers:** 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 to allocate at least 25% of the total number of branches to be opened during a year to unbanked rural centers.

(j) Opening of intermediate brick and mortar structure, for effective cash management,

documentation, and redressal of customer grievances and close supervision of BC operations. Banks have been advised to open intermediate structures between the present base branch and BC locations. This branch could be in the form of a low cost simple brick and mortar structure consisting of minimum infrastructure such core banking solution terminal linked to a pass book printer and a safe for cash retention for operating larger customer transactions.

(k) **The concept of differential banks:** The RBI introduced the concept of “Payment Banks” and “small banks” to attract serious players and push financial inclusion. It allowed corporate houses, including telecom players and retail chains, to set up payment banks, and also gave them the option of forming joint ventures with commercial banks. The guidelines had expanded the scope of activities for providing third-party products and services, such as mutual funds, insurance and pension. This would open avenues to earn fee income. The guidelines have also allowed sending and receiving remittances from multiple banks and international remittances and

permitted payment banks to function as business correspondents of other banks. We will discuss this sub-topic in the subsequent section.

**Measures taken by GOI, RBI and NABARD**

| GOI | RBI | NABARD |
|---|---|---|
| Customer Service Centres<br>Credit Counselling Centres<br>Adhaar Scheme<br>The National Agricultural Insurance Scheme<br>No-frill Account<br>Know Your Customer<br>General Credit Card<br>Project on Processor Cards<br>Micro Finance Development Fund | Role of NGOs, SHGs and MFIs<br>BF and BC models<br>Micro Pension Model<br>Nationwide Electronic Financial Inclusion System<br>Project Financial Literacy<br>National Rural Financial Inclusion Plan<br>Financial Inclusion Fund<br>Project on “e-Grama”<br>SHG-Post Office Linkage | Financial Inclusion Technology Fund<br>Separate Plan for Urban Financial Inclusion and Electronic Benefit Transfer Scheme<br>Financial Literacy through Audio Visual medium - Doordarshan<br>Support to Cooperative Banks and RRBs for setting up of Financial Literacy Centres<br>Farmers’ Club Program<br>Rural Volunteers as Book Writers |

## CONCLUSION

Despite all these initiatives, still there are millions of households which are outside the ambit of financial system. Though, the banking system has penetrated into the rural and remote areas, but still a large percentage of our villages are without any bank branches. This may be attributed to the lack of viability of operating a bank branch in such areas, lack of business opportunities for banks etc. Over the last few years a number of committees have been set up for reviewing the working of banking system in India.

**SUGGESTIONS FOR POSSIBLE WAY TO FORWARD**

RBI and Government as part of their development role, NABARD, which is spearheading this programme, and banks who are the main promoters of the program, may initiate the following effective steps to overcome these shortcomings:

- **Promotion of Federation structure:** The long term sustainability of the SHG model may require a federal structure, without severing the linkages that the SHGs have with the local bank branches. The assumption that the federation structure should not be supplanted on the SHGs and can be addressed when the demand emerges needs reconsideration.
- **Maintenance of National Database on SHGs and MFIs:** At present, NABARD is maintaining the database on SHGs. It publishes annual hand book on microfinance in India with focus only on SHG Bank linkage programme. It is suggested that NABARD be assigned the responsibility of collection of data involving the entire sector, their compilation and dissemination.
- **Comprehensive regulatory framework:** Presently, there is no distinctive regulatory framework for the MFIs in India. Therefore, there is a need of an exclusive regulation to regulate MFIs in India.
- **Contribution to the MFDEF (Micro Finance Development and Equity Fund) by Banks:** The corpus may be built up on an ongoing basis. A portion of profits of the bank may be contributed to the fund. The Government may provide tax relief to Banks for the contributions made.
- **An integrated package of services ('a credit-plus' approach) rather than just providing credits**: When access to credit is combined with savings facilities, non-productive loan facilities, insurance, enterprise development and welfare-related services, the adverse effects discussed above can be diminished.
- **Role of Corporate in Micro Finance:** Corporate India, of late, shown keen interest in the SHG movement as it provides an alternative business opportunity for them besides being a means to actualize its corporate social responsibility objectives. Many corporates have realized that the people at the bottom of pyramid can be brought into their business model. The group also sees a critical role of the corporate sector in providing market linkage to the products of the rural areas on a sustainable basis. The following are the examples.

- ❖ ITC (through e-choupal model).
- ❖ Hindustan Lever Ltd (through Stree sakti project).
- ❖ Mahindra & Mahindra (through Mahindra Subh labh).
- ❖ Tata Group (through Tata kisan sansar)

**REFERENCES**


- Reserve Bank of India (RBI). Data Releases. https://www.rbi.org.in/Scripts/ Statistics.aspx statistical database
- 2013b. *A Profile of Banks, 2012–13*. Mumbai.
- 2014a. *Annual Report 2013–14*. Mumbai.
- 2014b. *Report of the Committee on Comprehensive Financial Services for Small Businesses and Low Income*. Mumbai. *India*. Mumbai.
- 2015. *RBI Grants "In-Principle" Approval to 10 Applicants for Small Finance Banks.* Press
- Vishwanathan, N. S. 2014. *Non-Banking Financial Company-Micro Finance Institutions*
- *(NBFC-MFIs)—Directions—Modifications in "Pricing of Credit."* http://rbi.org.in/ scripts/NotificationUser.aspx?Id=8734&Mode=0