
Pravara Rural Education Society's

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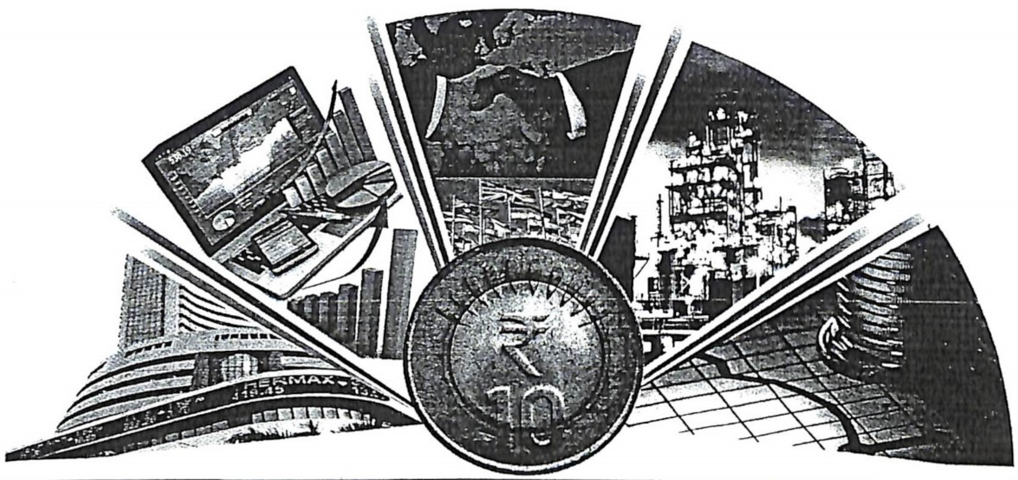

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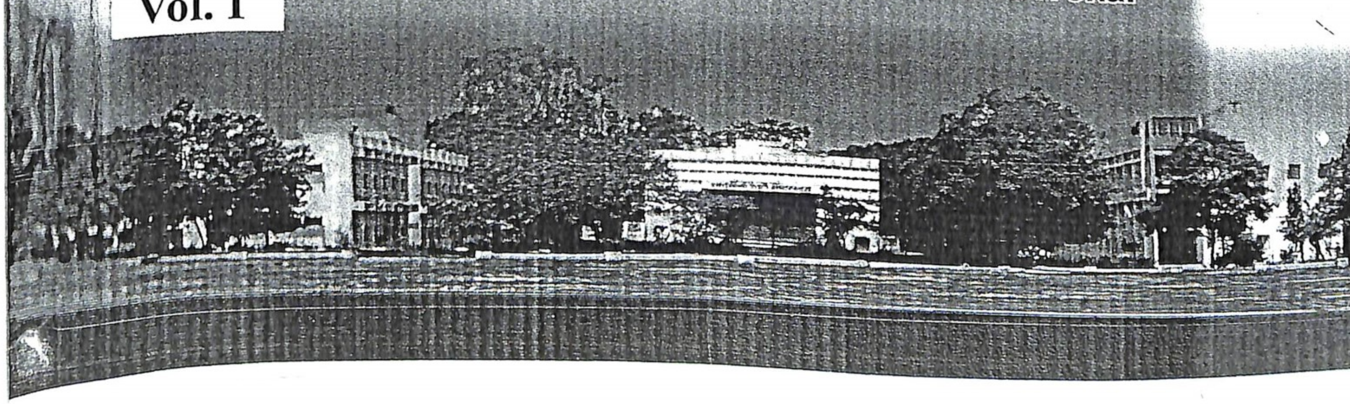

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# Financial Inclusion : Solution for Banking Shadow

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**Introduction:**

The dark and enormous banking shadow depriving the poor of economic opportunities in India can only be removed through Financial Inclusion. Rain shadow is a dry area, where because of its topography, there is very little rainfall while areas around it get abundant rain. Similarly, there are a very large number of low-income families, particularly in rural areas, who are in a banking shadow, i.e., they are not served at all or served well by the formal banking system. They are thus deprived of the opportunities of economic advancement enjoyed by the middle-income and upper-income families. The disparities caused by this banking shadow are increasing the income gap between the rich and the poor, which is likely to exacerbate social tensions. It is estimated that nearly half of our population does not have operating bank accounts or access to bank credit. Only 10% of our six lakh villages have a bank branch. Despite extensive efforts by the government over the past several decades, the availability of financial services to the poor families has not improved.

**Financial Inclusion:**

Financial inclusion refers to delivery of banking services and credit at an affordable cost to a vast section of disadvantaged and low income groups. Rangarajan's committee on financial inclusion defines it as, "The process of ensuring access to the financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."

**Financial Exclusion:**

Financial exclusion could be looked at in two ways:

1. Lack of access to financial services which could be due to several reasons such as:

* Lack of sources of financial services in our rural areas, which are popular for the ubiquitous money lenders but do not have (safe) saving deposit and insurance services.
* High information barriers and low awareness especially for women and in rural areas.
* Inadequate access to formal financial institutions that exist to the extent that the banks couldn't extend their outreach to the poor due to various reasons like high cost of operations, less volume and more number of clients, etc. among many others.
* Poor functioning and financial history of some beleaguered financial institutions such as financial cooperatives in many states which limit the effectiveness of their outreach figures.
* Primary Agricultural Cooperative Societies (PACS), which number around one lakh are also often exclusionary, as their membership is restricted to persons with land ownership. Even to their members, not many PACS offer saving services.

2. Lack of access to formal financial services in of both rural and urban areas, but is a larger issue in cities and small towns. The distinction between access to formal and informal services is crucial to understand, as informal financial markets suffer from several imperfections, which the poor pay for in many ways.

Some attributes of informal financial services, due to which there is exclusion, are:

a. High risks to saving: loss of savings is an easily discernible phenomenon in low income neighbourhoods in urban areas.

b. High cost of credit and exploitative terms : credit against collateral such as gold is even more expensive than the effective interest rates, similarly, rates paid by hawkers and vendors who repay on daily basis are very high.

c. High cost and leakages in money transfers : the delays in sending money home through all informal channels add to these.

d. Near absence of insurance and pension services : life, asset, and health insurance needs.

**Who are financially excluded?**

People who are financially excluded include those who:

* Are unable to acess affordable loans and are dependent on high interest credit by sub prime lenders, pawn brokers and loan sharks.
* Do not have insurance, making them vulnerable in the event of a burglary, major repairs to their home, flood, etc.
* Have not accumulated savings which particularly contributes to poverty in old age.
* Do not have a bank account and are unable to pay by Direct Debit, leading to increased charges for utilities and other services.
* Are in fuel poverty, i.e., spending more than 100% of their household income on fuel because of house conditions and/or other factors (eg. Income, disability, credit rating)

**Why is Financial Inclusion gaining currency in India?**

It has been largely accepted that inclusive growth cannot take place through financial inclusion. With the UPA government stressing on inclusive growth, especially in its second stint in power, there is a lot of focus now on how to go about improving financial inclusion in the country.

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The above table captures the extent of financial inclusion in Indian states.

**Role of government:**

Government has been taking steps from time to time to bring about an inclusive growth. Establishment of SBI in 1955, nationalization of commercial banks in 1969 and 1980, Lead Bank Scheme of 1970, RRBs in 1976, establishment of NABARD in 1982 has regulated the institutional credit for agricultural and rural development. RBI has taken number of steps for inclusive growth. In Nov 2005, RBI asked banks to offer no-frill accounts, which enable excluded people to open a saving account. The banks were required to provide all the material information related to opening accounts, disclosure etc in the regional languages. Also the KYC procedures for opening accounts have been simplified. Also RBI has taken number of measures to increase financial literacy in country.

Also, credit alone may not help in improving the income and productive capacities of the rural poor as the credit absorptive capacity would depend upon various other factors such as appropriate infrastructure and supply chain facility. The government has an important role in building adequate infrastructure such as roads, electricity, public transport and marketing facilities that would facilitate production and distribution of output by the people residing in rural and remote areas. Government expenditure on social services such as health, education, water and sanitation would also enhance credit absorptive capacity of the borrowers as they relieve households from this expenditure that they currently have to incur. Thus, borrowing from non-institutional sources to a significant extent could be reduced if the health care, education and other services are provided to rural households at reasonable cost. The government, therefore, has a crucial role in strengthening the rural infrastructure and providing enabling conditions.

**Microfinance and Financial Inclusion**

If over half the adult population of India is excluded from formal financial services, there has to be something in the manner of design and delivery of financial services which doesn't match with the needs of the currently excluded segments. The growth of microfinance over the last decade is proof of the fact that financial services can be delivered to the poor and underserved, albeit the starting point is a 'different mindset'. The idea is not to critique the present financial system for its failures, but to build on the advances in banking systems and information technology and synergize these with the core learning's of microfinance. This will help us build a model for near universal financial inclusion.

**Conclusion**

It is clear that we need an alternative to the commercial banking system to provide financial service to nearly half of India's population living in banking shadow. Some of these alternative delivery systems, sometimes referred to as 'shadow banking' systems, are already in place and working effectively. These include non-banking financial companies (NBFCs) focused on serving low-income families and small businesses (like kirana shop owners, truck drivers, tailors, repair shops, agriculturists), MFIs, chit funds, credit cooperatives, etc. However, alternative delivery systems need to be strengthened and significantly expanded to reduce the banking shadow.

*To do this, the government and the Reserve Bank of India will have to:*

Accept the reality that the current banking system cannot serve low-income families and small businesses effectively and profitably. The banking system should collaborate with the

**Financial Inclusion in India;**

In the first ever index of Financial Inclusion prepared by a New Delhi based organization ICRIER (Indian Council for Research on International Economic Relations) to find out the extent of reach of banking services in 100 countries worldwide pointed out that Spain has occupied the top position of banking in IFI, which is based on data from 2004, followed by Canada and Portugal, while countries including Nepal, Zimbabwe and Botswana are at the bottom of the list. Among the important countries, Germany has been placed on 4th position, the UK 17th, USA 21st and Japan 22nd. India has been ranked poorly at 50th position, much above Russia but below China, even below Kenya. This data itself is sufficient to point out that we are far behind in terms of financial inclusion. India is estimated to have the second largest number of financially excluded households, i.e., 13 millions. Of the six lakh villages only 30,000 villages have bank branches. Despite having amongst the world's largest network of about 79,000 banking outlets we still have just 15 crore saving bank accounts for a population of 118 crore. Access to a saving bank account is the very basic (but sufficient) indicator of financial inclusion. So we can clearly make out the position of India in terms of financial inclusion.

**Financial Inclusion- the present scenario in India:**

One common measure of financial inclusion is percentage of adult population having bank accounts. According to the available data on the number of savings banks, we note that on an all-India basis 59% of adult population has bank accounts. In other words, 41% of the population is unbanked. In rural areas, the coverage is found to be 39% as against 60% in urban areas.

**Table No.1**

**Number of functioning branches of Public Sector Banks - Population Group wise**

| As on | Rural | Semi Urban | Urban | Metropolitan | Total |
|---|---|---|---|---|---|
| **31.03.2011** | 20658 | 16217 | 13450 | 12612 | 62937 |
| **31.03.2012** | 22379 | 17905 | 14322 | 13244 | 67850 |
| **31.03.2013** | 24243 | 19642 | 15055 | 13797 | 72737 |
| **31.03.2014** | 27547 | 21952 | 16319 | 14644 | 80462 |
| **31.03.2015** | 29634 | 23549 | 17387 | 15325 | 85895 |

**Source: http://financialservices.gov.in/**

The above table indicated that rural and semi-urban offices constitute a majority of the commercial bank offices in India. Rural bank offices have increased from 20658 in 2011to 29634 in 2015. It is observed that the share of deposits and credit in rural and semi-urban areas is on the decline. In contrast, the share in metropolitan areas is rising. Further, it can be noted that the share of credit is lower than that of deposits in all regions, except metropolitan, implying that resources get intermediated in metropolitan areas.

| **Extent of Financial Exclusion in Indian States** | |
|---|---|
| **Extent of Financial Exclusion** | **States** |
| Above 75% | Meghalaya, Arunachal Pradesh, Uttarakhand, Assam, Mizoram, Mainpur, Jharkhand |
| 50% to 75% | Bihar, Chhattisgarh, Himachal Pradesh, Jammu & Kashmir, Nagaland, Odisha, Sikkim, Tripura, Uttar Pradesh |
| 25% to 50% | Karnataka, Kerala, Madhya Pradesh, Maharashtra, Punjab, Rajasthan, Tamil Nadu, West Bengal |
| Below 25% | Andhra Pradesh |

alternative delivery systems for last-mile delivery of financial services, particularly credit delivery to the poor.

The government should establish a financial inclusion organisation charged with the responsibility of developing and expanding alternative delivery systems without excessive regulatory impediments and price controls. At present, less than 1% of the total bank credit is availed by the low-income families and small businesses. The goal should be to increase it to 5% in the next five years through alternative delivery systems.

The regulatory framework and capital requirement for low-risk NBFCs serving the poor should be lighter as compared to high-risk NBFCs promoted by business houses, foreign banks, private equity firms engaged in promoter financing, M&A financing, mezzanine financing, real estate and commodity financing.

The financial inclusion organisation should proactively monitor and be accountable for the growth and health of alternative delivery systems and its effectiveness in serving the poor.

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