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FINANCIAL INCLUSION IN INDIA: AN ANALYTICAL STUDY ABOUT THE RELEVANCE FOR INDIA

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INTRODUCTION

Financial inclusion mainly focuses on the poor who do not have formal financial institutional support and getting them out of the clutches of local money lenders. As a first step towards this, some of our banks have now come forward with general purpose credit cards and artisan credit cards which offer collateral-free small loans. The RBI has simplified the KYC (Know your customer) norms for opening a „No frill‟ account. This will help the low income individual to open a „No Frill‟ account without identity proof and address proof.

In such cases banks can take the individual's introduction from an existing customer whose full KYC norm procedure has been completed. And the introducer must have a satisfactory transaction with the bank for at least 6 months. This simplified procedure is available to those who intend to keep a balance not exceeding Rs.50,000 in all accounts taken together. With this facility we can channel the untapped, considerable amount of money from the low income group to the formal economy. Banks are now permitted to utilize the service of NGOs, SHGs and other civil society organizations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent models.

RATIONALE FOR THE PRESENT STUDY

Since 1991, the government has intensified its efforts for inclusive growth with its outreach programs. Banks and financial institutions are engaged in massive financial inclusion programs. This research study examines the socio-economic impact of microfinance through self help groups across regions in India and the efforts of the various agencies involved in SHG movement and microfinance.

OBJECTIVES

The objectives of the study are as outlined below:

i) To study the regional disparity in microfinance.
ii) Microfinance and NPAs and their correlation.
iii) Emerging issues for a robust inclusive growth.

IMPORTANCE OF THE STUDY

Studies in microfinance are largely confined to impact analysis of microfinance in different regions across the country, SHG-Bank Linkage Programs, multi-agency approach, etc. Extensive researches are made on SHG – Bank Linkage Programs. MFIs as an alternative channel of providing microfinance are still to take roots in India. This research study examines the structural imbalances in microfinance and its socio-economic impact across regions. Such a study can help understand the facilitating and inhibitive factors for success or failure in microfinance programs in different regions.

DATA ANALYSIS

Statistical analysis of the data and information collected from published sources were made keeping the objectives of the study in mind.

RATIONALE FOR 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.

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. These 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.

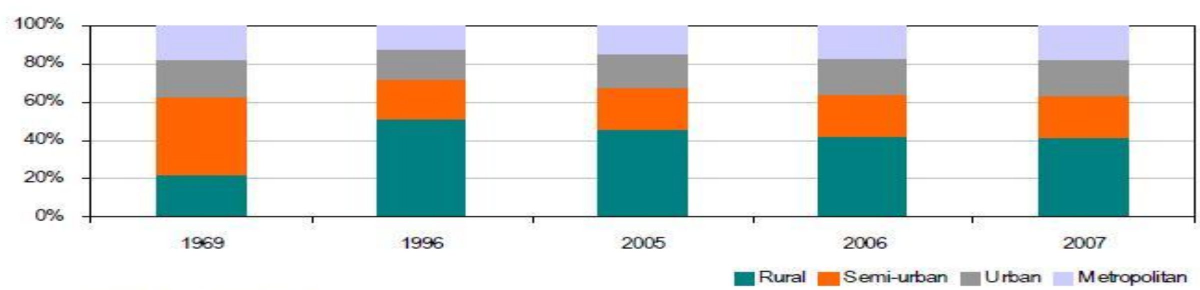
HIGH COST:

It has also been seen that poor living in urban areas don't utilize the financial services as they find financial Services are costly and thus are unaffordable. Hence, even if financial services are available, the high costs deter the poor From accessing them. For example, to open a checking account in Cameroon, the minimum deposit requirement is over700 dollars, an amount higher than the average GDP per capita of that country, while no minimum amounts are required in South Africa or Swaziland. Annual fees to maintain a checking account exceed 25 percent of GDP per capita in Sierra Leone, while there are no such fees in the Philippines. In Bangladesh, Pakistan, Philippines, to get a small business loan processed requires more than a month, while the wait is only a day in Denmark. The fees for transferring 250 dollars internationally are 50 dollars in the Dominican Republic, but only 30 cents in Belgium.

NON-PRICE BARRIERS:

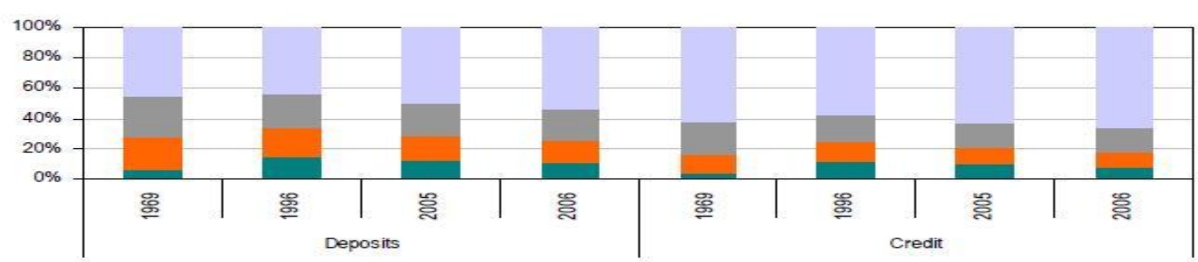
Access to formal financial services also requires documents of proof regarding a persons' identity, income etc. The poor people do not have these documents and thus are excluded from these services. They may also subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

Figure 1: Distribution of Bank offices in India



Source: Rakesh Mohan, RBI, IDBI Gilts Ltd.

Figure 2: Sources of Despoits and Credit in India (in %)



FINANCIAL INCLUSION IN INDIA – IN STATISTICS

Financial inclusion in developing economies is different than that of developed economies. In latter where inclusion is a minority, informer it could be a majority. Elaine Kempson in his research (2006) showed that in Sweden lower than two per cent of adults did not have an account in 2000 and in Germany, the figure was around three per cent. Another research by (Buckland et al (2005) showed that less than four per cent of adults in Canada and five per cent in Belgium, lacked a bank account. Therefore, it is also mentioned in academia that a better way to analyze financial inclusion in developing economies is to actually see financial exclusion.

ALL INDIA LEVEL:

Figure 1 shows that rural and Semi-urban offices constitute a majority of the Commercial Bank offices in India. Rural bank offices as a % of total have increased from 22% in 1969 to 41% in 2007. This is mainly because of the inclusive focus of the policymakers mentioned above. However, that is just one part of the story. If we look at figure 2, it can be seen that bulk of the deposits received and credit allocated is to the urban and metropolitan areas. Infact, the share of rural and semi-urban in deposits and credit has been declining. Table 1 provides further clarity providing a break-up of the deposit accounts. Both the deposit and credit accounts are lower in rural households than urban households. Hence despite the rural-push, the rural population has not come forward and avail even basic banking services (a fact mentioned in the section above - Rationale for Financial Inclusion).

MAJOR FINDINGS OF THE STUDY

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. The government also set up national level institutions like NABARD, SIDBI to empower credit to rural areas and small and medium enterprises. Appendix 1 presents the banking structure in India and one can see the emphasis on having banks in the rural sector. Despite the rural policy-push, above statistics suggest majority of the population continues to be financially excluded. The efforts were further intensified by RBI and its Annual Policy (2005-06) mentioned:

RBI will implement policies to encourage banks which provide extensive services while disincentivising those which are not responsive to the banking needs of the community, including the underprivileged. The nature, scope and cost of services will be monitored to assess whether there is any denial, implicit or explicit, of basic banking services to the common person.

Banks are urged to review their existing practices to align them with the objective of financial inclusion. This RBI focus led to a few key developments:

NO-FRILL ACCOUNTS:

In November 2005, RBI asked banks to offer no-frills savings account which enables excluded people to open a savings account. Normally, the saving account requires people to maintain a minimum balance and most banks now even offer various facilities with the same. No-frills account requires no (or negligible) balance and is without any other facilities leading to lower costs both for the bank and the individual. The number of no-frills account has increased mainly in public sector banks from about 0.4 million to 6 million between March 2006 and March 2007. The number of No-frill accounts in private sector banks also increased from 0.2 million to 1 million in the same period. No significant increases were there in foreign banks. This is understandably so as majority of rural and sub-urban bank offices are in public sector banks.

USAGE OF REGIONAL LANGUAGE:

The Banks were required to provide all the material related to opening accounts, disclosures etc in the regional languages.

SIMPLE KYC NORMS:

In order to ensure that persons belonging to low income group both in urban and rural areas do not face difficulty in opening the bank accounts due to the procedural hassles, the KYC procedure for opening accounts has been simplified for those persons who intend to keep balances not exceeding rupees fifty thousand (Rs. 50,000/-) in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed rupees one lakh (Rs.1,00,000/-) in a year.

EASIER CREDIT FACILITIES:

Banks have been asked to consider introducing General purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi urban branches. GCC is in the nature of revolving credit entitling the holder to withdraw upto the limit sanctioned. The limit for the purpose can be set Based on assessment of household cash flows, the limits are sanctioned without insistence on security or purpose. The Interest rate on the facility is completely deregulated. A simplified mechanism for one-time settlement of overdue loans up to Rs.25,000/- has been suggested for adoption.

Banks have been specifically advised that borrowers with loans settled under the one time settlement scheme will be eligible to re-access the formal financial system for fresh credit.

OTHER RURAL INTERMEDIARIES:

Banks were permitted in January 2006, to use other rural organisations like Nongovernmental organizations, self-help groups, micro-finance institutions etc for furthering the cause of financial inclusion.

USING INFORMATION TECHNOLOGY:

A few Pilot projects have been initiated to test how technology can be used to increase financial inclusion. Usha Thorat in her speech (June 19, 2007) pointed to a few measures: Smart cards for opening bank accounts with biometric identification. Link to mobile or hand held connectivity devices ensure that the transactions are recorded in the bank's books on real time basis. Some State Governments are routing social security payments as also payments under the National Rural Employment Guarantee Scheme through such smart cards. The same delivery channel can be used to provide other financial services like low cost remittances and insurance.

The use of IT also enables banks to handle the enormous increase in the volume of transactions for millions of households for processing, credit scoring, credit record and follow up.

CONCLUSION

Yet, banks are fighting to fulfill the Financial Inclusion dream. The main reason is that the products designed by the banks are not satisfying the low income families. The provision of uncomplicated, small, affordable products will help to bring the low income families into the formal financial sector. Banks have limitations to reach directly to the low income consumers. Correspondents can be considered to be an excellent channel which banks can use to distribute their product information. Educating the consumers about the financial benefits and products of banks which are beneficial to low income groups will be a great step to tap their potential.

Banks are now using new technologies like mobile phones to reach low income consumers. It is possible that the telephone providers themselves will start basic banking services like savings and payments. Indian telecom consumers have few links to financial institutions. So without much difficulty telecom providers can win the battle with banks. Banks should therefore be proactive about transferring this technology into an opportunity.

The Indian Government has a long history of working to expand financial inclusion. Nationalization of the major private sector banks in 1969 was a big step. In 1975 GOI established RRBs with the same aim. It encouraged branch expansion of bank branches especially in rural areas. The RBI guidelines to banks shows that 40% of their net bank credit should be lent to the priority sector. This mainly consists of agriculture, small scale industries, retail trade etc. More than 80% of our population depends directly or indirectly on agriculture. So 18% of net bank credit should go to agriculture lending. Recent simplification of KYC norms are another milestone. Financial inclusion is a great step to alleviate poverty in India. But to achieve this, the government should provide a less perspective environment in which banks are free to pursue the innovations necessary to reach low income consumers and still make a profit. Financial service providers should learn more about the consumers and new business models to reach them.

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