



**INDIAN INSTITUTE OF MANAGEMENT CALCUTTA**

**WORKING PAPER SERIES**

**WPS No. 630/ October 2008**

**Financial Inclusion of Rural Markets: Understanding the Current Indian Framework**

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# **Financial Inclusion of Rural Markets: Understanding the Current Indian Framework**

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**October 2008**

**(Preliminary draft- not to be quoted without authors' permission)**

## **Abstract:**

History bears the testimony to the relationship between development of financial markets and economic growth, thus leading to the reduction of poverty on a larger scale. It has become more so crucial for economies like India because the lack of it inevitably prevents people from gaining access to available resources and thus pushes them to an inescapable cycle of poverty. Secondly, access to adequate financing for small, medium and even micro sized enterprises is essential for an economy considering the reach and numbers such markets offer. Also, these enterprises while working closely with the roots are better equipped to reduce poverty in the region through the better inclusion factor. Finally, financial inclusion comes as an omen, a sign for better future and seamless social inclusion because a population that identifies itself best with the rest of the society contributes more positively towards economic progress. Many banks, such as Union Bank of India, Yes Bank etc. have started several programs specially targeted towards rural people in India. But unfortunately, financial systems in India till date have not seen enough in uplifting the lives of the bottom of the pyramid masses because providing basic financial services such as bank accounts, credit, and insurance have a higher cost for those people. Thus a gap is created that inhibits broad based economic growth and helps to perpetuate inequality through the system. The proposed paper attempts to address this gap and also to develop a framework of financial inclusion well within the propositions of the current Union Budget which is expected to work for the Indian scenario. It also tries to hit on several flaws in the current mass debt waiver policy for farmers announced in the Union Budget and its implications. Within such policy frameworks, the paper is an attempt to weave an argument starting from the mismatch of credit and deposit growth of banks, steps taken by the Reserve Bank of India, role of IT as an enabling agent, role of government, future challenges and how all this has shaped the present degree of inclusion in India.

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## **1. Introduction**

An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. In addition, access to appropriate financial services can significantly improve the day-to-day management of finances. It can also help reducing the growth of informal sources of credit (such as moneylenders) which are often found to be exploitative. Thus, an all-inclusive financial system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services (Sarma, 2008). The importance of an inclusive financial system is widely recognized in the policy circle in recent years and financial inclusion is seen as a policy priority in many countries (Kempson et. al. 2004). The Government of India has also expressed its precise concern on the issue of overall inclusion in the development process through its various initiatives such as the Rural Employment Guarantee Scheme, the Bharat Nirman programme, the Sarva Shiksha Abhiyan, among others.

A committee on financial inclusion (FI hereafter) with Dr. C. Rangarajan as its Chairman has also been constituted by the Government of India in June 2006 to recommend a strategy to achieve higher financial inclusion in the country. The 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 comprise of the complete breadth - 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 (Agrawal, 2008).

India's economic growth has averaged around 8.6% (SII, 2008) over the past 4 years. Indian economy in general and banking services in particular have made rapid strides in the recent past. However, a sizeable section of the population, particularly the vulnerable groups, such as weaker sections and low income groups, continue to remain excluded from even the most basic opportunities and services provided by the financial sector. To address the issue of such financial exclusion in a holistic manner, it is essential to ensure that a range of financial services is available to every individual. On the savings front, the gross domestic savings rate has improved from 23.6 per cent of GDP in 2001-02 to 29.1% in 2004-05 making financial intermediation increasingly important. (Mohan, 2006)

## Financial Inclusion Statistics in India

### (a) General :

51.4% of farmer households are financially excluded from both formal / informal sources.

- Of the total farmer households, only 27% access formal sources of credit; one third of this group also borrows from non-formal sources.
- Overall, 73% of farmer households have no access to formal sources of credit.

### (b) Region-wise :

- Exclusion is most acute in Central, Eastern and North-Eastern regions - having a concentration of 64% of all financially excluded farmer households in the country.
- Overall indebtedness to formal sources of finance alone is only 19.66% in these three regions.

### (c) Occupational Groups:

- Marginal farmer households constitute 66% of total farm households. Only 45% of these households are indebted to either formal or non formal sources of finance.
- About 20% of indebted marginal farmer households have access to formal sources of credit.
- Among non-cultivator households nearly 80% do not access credit from any source.

### (d) Social Groups :

- Only 36% of ST farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.

Analysis of the data provided by RBI through its Basic Statistical Returns reveal that critical exclusion (in terms of credit) is manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95% and above. This is in respect of commercial banks and RRBs.

As per CMIE (March 2006), there are 11.56 crore land holdings. 5.91 crore KCCs have been issued as at the end of March 2006, which translated into a credit coverage of more than 51% of land holdings by formal sources. Further data with NABARD on the doubling of agricultural credit indicates that agricultural loan disbursements during 2006-07 covered 3.97 crore accounts. Thus, there are different estimates of the extent of inclusion thru' formal sources, as the reference period of the data is not uniform. Consequently, this has had an impact on quantifying the extent of levels of exclusion.

Financial inclusion is aimed at providing banking/financial services to all people in a fair, transparent and equitable manner at an affordable cost. Households with low income often lack access to bank account and have to spend time and money for multiple visits to avail the banking services, be it opening a savings bank account or availing a loan. These families find it more difficult to save and to plan financially for the future. Thus, the unbanked public is largely cut off from the Banking products/services. It is the endeavor of the Bank to provide the basic banking facility of SB a/cs to all the unbanked.

## **2. Role of financial markets**

In many economies around the world, there is enough evidence of the relationship between the development of financial markets and economic growth, and hence the reduction of poverty. Financial democracy<sup>1</sup> gets expanded through financial markets development. It becomes crucial because, first, the lack of it prevents people from gaining access to the resources that would enable them to make the most of their abilities and thus condemns them to a cycle of poverty that is almost inescapable. Secondly, the small, medium and micro size enterprises are very vital to an economy, and therefore it's even more vital to improve their access to adequate financing. Thirdly, these enterprises have a great degree of social significance - having a big opportunity to reduce poverty in the region by making financial services more inclusive. Finally, financial inclusion also generates more confidence and optimism in the future. A population that finds itself contributing more positively towards the overall economic progress is able to identify with the rest of the society better, a factor very important for social cohesion.

If fortune lies in the bottom of the pyramid, responsibilities should begin right from there itself. Unfortunately, financial systems in India till date have not played a significant role in uplifting the lives of the bottom of the pyramid masses because providing basic financial services such as bank accounts, credit, and insurance have a higher cost for those people. Thus a gap is created that inhibits broad based economic growth and helps to perpetuate inequality through the system. This paper tries to address this gap and attempts to develop a framework of financial inclusion which should work for the Indian scenario.

### **2.1 Why is financial inclusion important?**

Financial inclusion is about ensuring that everyone has access to appropriate financial services, enabling them to:

- Manage their money on a day-to-day basis, effectively, securely and confidently
- Plan for the future and cope with financial pressure, by managing their finances to protect against short term variations in income and expenditure, and to take advantage of longer term opportunities, and
- Deal effectively with financial distress, should unexpected events lead to serious financial difficulty (Treasury, 2007).

People who achieve these objectives will enjoy significantly improved outcomes.

In order to manage the money effectively, people need first, to have access to a transactional bank account, and second, to have the confidence to make full use of it. People who do not have or use a bank account pay more for goods and services, and more to access their money. For example:

- Essential utilities, such as energy and telecommunications, cost less for those who are able to make payments regularly from a bank account, and

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<sup>1</sup> Financial Democracy is the fundamental for achieving greater inclusiveness, improving social cohesion, and generating broad based growth

- Cheques can be paid into a bank account for free, whereas those cashed at a cheque-cashing outlet attract a charge of 10 percent or more

There are a vast number of people, potential entrepreneurs, small enterprises and others, who are excluded from the financial sector, which leads to their marginalization and denial of opportunity for them to grow and prosper. The Reserve Bank has therefore explicitly put 'enabling access to a greater number of the population to the structured and organized financial system' on the agenda of the Reserve Bank since 2004

Affordable credit, savings and insurance products help people plan for the future and manage short term fluctuations in income and expenditure. They can provide a financial buffer - taken for granted by most people - against a range of short term contingencies, both known and unknown. People find it much easier to cope with the pressure of expected and unexpected spending - such as paying for Christmas, or repairing a broken washing machine - if they are able to borrow small sums of money affordably, over a short period of time, or if they have saved even a small sum of money. And insurance can be used to protect against potential losses arising from risks to assets like home contents or a car. People without access to these products are often forced into using high cost sources of lending instead, including home credit or, worse, illegal loan sharks who use fear and intimidation to exhort huge sums from their victims.

In addition to managing the short term financial fluctuations that everyone experience, financial inclusion also enables people to get through the more serious problems that can sometimes arise. Long term sickness, unemployment, or family breakdown can all lead to over indebtedness and financial distress. People finding themselves in this situation need help of a qualified money adviser, which is why the government's strategy for helping people deal with distress has focused on the provision of free face-to-face and telephone money advice. Beyond money advice, access to financial services (such as credit, savings and insurance) can provide a buffer against financial distress by preventing small problems from getting out of control. Financial inclusion can also offer a route out of distress through the help and support of financial services providers. This means that providers also have a responsibility to help people through difficulty.

## **2.2 Micro Lending - Current Industry Trends**

In the Indian context, microfinance is no longer the purview of development institutions. While the rhetoric of development has been retained, banks have embraced it as an extremely profitable business, for two reasons.

First, Indian banks are required to lend a certain percentage (currently 40%) into priority areas – called priority sector lending – which includes agriculture, SMEs, and government securities. Compared to returns on government bonds of 6-7%, MFI lending provides returns of 10-14%. Banks, therefore, have expanded investments in these areas. Second, microfinance lending - as it is currently practiced - is simply not very risky. In the absence of individual credit assessments, MFIs lend to groups or through referral, leading to repayment rates of 95% or more. Banks then get the best of both worlds - higher rates of return with very low risk (Mckinsey, 2007).

The result is massive expansion in micro lending. ICICI Bank, the largest private bank in India, had 1.2 million microfinance clients in 2005 and a portfolio of \$227 million. A year later, ICICI has

multiple partnerships and 3 million clients, targeting 25 million in 3 years. Other banks, such as ABN Amro, and YES Bank have smaller but still sizable operations that generate goodwill benefits for their entire operations. Public sector banks usually operate as integrated micro-lenders, creating self-help groups (SHG) to which they disburse loans directly rather than through an intermediary. Private sector banks, by contrast, operate through a partnership model, contracting with existing MFIs to function as the bank's retail arm to acquire and manage micro-clients. In return, MFIs retain a percentage of the interest earned on loans. Many MFIs are now financially independent of such funds, but high effective rates (of over 30%) have also led to a regulatory backlash.

### **2.3 Mismatch between credit and deposit growth**

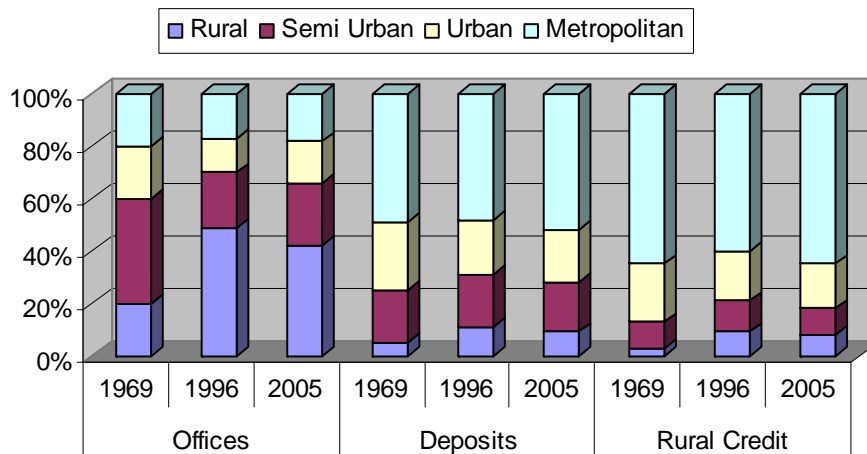
This expansion of rural credit tracks a more general expansion of *retail* credit in India. In 2006, non-food credit expanded by over 30%, up from a growth rate of 28.8% in the 3 years prior. Simultaneously, the share of retail credit in overall credit stood at 46% in 2005-06, up from 6.4% in 1990-91. Interestingly, this growth has not been accompanied by growth of deposits, particularly in rural areas. As a result, Banks have been financing much of the incremental credit expansion by unwinding their surplus investments in government securities. What deposit growth that has been observed is, moreover, concentrated in the larger cities. This could also mean that financial inclusion may have suffered.

The implications of this mismatch are important to understand some of the constraints faced by an expanding microbanking industry. In the absence of deposit growth banks face a liquidity problem which limits further credit expansion. This problem is evident in recent policy changes to reduce the statutory liquidity ratio (SLR) of Indian banks. In other words, the banking system will be expected to increasingly provide larger quantum of funds to existing and emerging enterprises. And without adequate deposit growth, however, credit expansion might not be sustainable over the medium-term, without putting immense pressure on real interest rates and impacting the overall stability of the financial system.

### **3. Policy responses to Financial Inclusion**

Despite the massive growth in micro-credit mentioned previously, there seems a serious concern over financial exclusion in India, backing those concerns with data. For instance, spatial distribution of banking services indicates that rural credit, deposits, and offices as a share of overall services decreased between 1996 and 2005, with most expansion restricted to metropolitan areas (RBI, 2007).

### Offices, Deposits and Rural Credit as a share of overall services



There are two obstacles to greater financial inclusion. The first is simply commercial. Transaction costs for both banks and clients remain high, particularly in disbursing credit, which is essentially a high cost, distributed business. Further, interest rates remain high in the absence of structured credit assessments. The second obstacle is policy requirements such as know your customer (KYC) procedures that limit the geographical reach of financial services beyond physical bank branches. Yet, the importance of financial inclusion becomes important, particularly in the context of doubling agricultural productivity, targeted for India's 11<sup>th</sup> five year plan. Consequently, the RBI has moved to enforce multiple policy and industry changes:

- Banks have been asked to voluntarily make available a “no-frills” account, and all printed bank material has to be made available in regional languages.
- KYC procedures have been simplified for low income groups
- Significantly, since January 2006 banks can provide full range of banking services through ‘business facilitator and correspondent’ (i.e. MFI partnership) models. Previously, MFIs could only provide credit, but not open bank accounts.
- The Credit Information Bureau Act, 2006, will eventually establish a credit bureau that makes available credit histories of individuals and small businesses. This should lower risk for banks, in extending credit further.

### 3.1 Focus on financial inclusion in India

Most of the growth in India in the last few years is from the Industry and Services sector. Agriculture is growing at a little over 2 %. The potential for growth in the primary and SME sector is enormous. Limited access to affordable financial services such as savings, loan, remittance and insurance services by the vast majority of the population in the rural areas and unorganized sector is believed to be acting as a constraint to the growth impetus in these sectors. Access to affordable financial services – especially credit and insurance – enlarges livelihood opportunities and empowers the poor to take charge of their lives. Such empowerment aids social and political stability. Apart from these benefits, FI imparts formal identity, provides access to the payments system and to savings safety net like deposit insurance. Hence FI is considered to be critical for achieving inclusive growth; which itself is



required for ensuring overall sustainable overall growth in the country.

The approach to FI in developing countries such as India is thus somewhat different from the developed countries. In the latter, the focus is on the relatively small share of population not having access to banks or the formal payments system whereas in India, we are looking at the majority who are excluded.

FI can be thought of in two ways. One is exclusion from the payments system –i.e. not having access to a bank account. The second type of exclusion is from formal credit markets, requiring the excluded to approach informal and exploitative markets. After nationalization of major banks in India in 1969, there was a significant expansion of branch network to unbanked areas and stepping up of lending to agriculture, small industry and business. More recently, the focus is on establishing the basic right of every person to have access to affordable basic banking services.

The total number of saving accounts, considered to be a better indicator of banking penetration than other deposit accounts, as per cent of number of households, was 137 in rural areas and 244 in the urban areas on the eve of reforms in 1991.

		(Per cent of Number of Households)					
1	2	1981	1991	1996	2001	2004	2005
		3	4	5	6	7	8
<b>Deposit Accounts</b>							
Current Accounts	Rural	3.6	5.5	4.7	4.9	4.4	4.6
	Urban	15.0	23.4	24.1	19.2	17.5	18.3
Savings Accounts	Rural	59.6	137.0	129.8	123.3	126.8	131.5
	Urban	135.5	243.7	249.7	197.4	206.5	213.1
Current and Saving Accounts	Rural	63.2	142.6	134.5	128.2	131.1	136.1
	Urban	150.5	267.2	273.7	216.6	224.0	231.4
Term Deposits Accounts	Rural	22.9	41.8	45.5	52.0	48.3	45.7
	Urban	74.6	96.9	105.0	105.6	113.4	104.0
<b>Total Deposits Accounts</b>	<b>Rural</b>	<b>86.1</b>	<b>184.4</b>	<b>180.0</b>	<b>180.1</b>	<b>179.4</b>	<b>181.8</b>
	<b>Urban</b>	<b>225.1</b>	<b>364.1</b>	<b>378.7</b>	<b>322.2</b>	<b>337.4</b>	<b>335.4</b>
<b>Credit Accounts</b>	<b>Rural</b>	<b>18.0</b>	<b>44.3</b>	<b>36.0</b>	<b>26.5</b>	<b>28.7</b>	<b>32.2</b>
	<b>Urban</b>	<b>15.1</b>	<b>29.9</b>	<b>27.1</b>	<b>28.4</b>	<b>42.5</b>	<b>50.2</b>

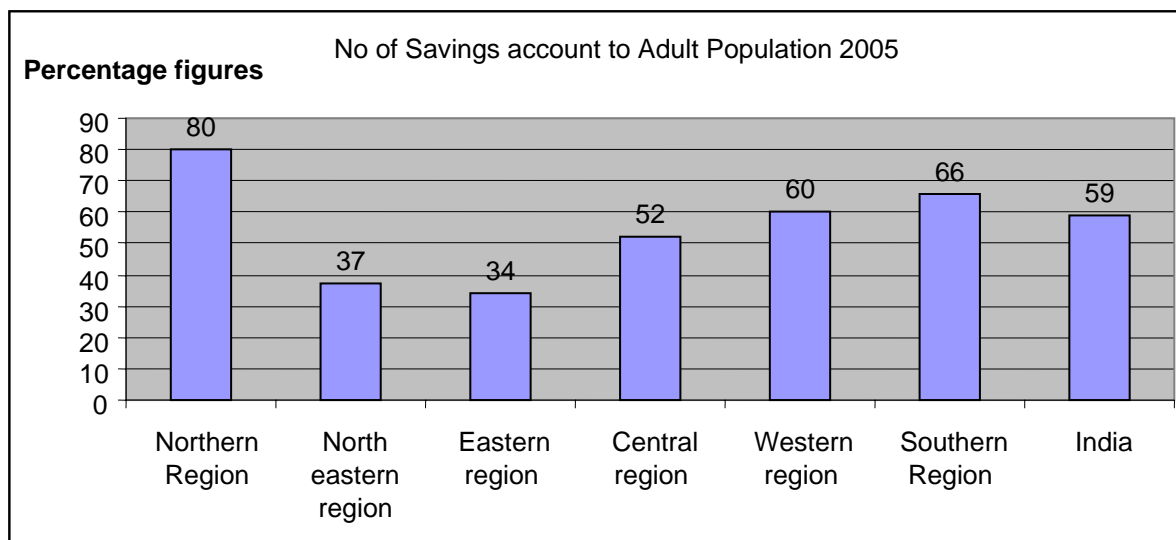
By 2005, despite the reforms, the differential continues to be similar. In the case of credit accounts, the situation have deteriorated for rural households while showing significant improvement in the urban areas (as shown in the table above, Census 2001), corroborating the very significant increase in retail credit.

		(per cent of GDP)				
		1981	1991	1996	2001	2005
1	2	3	4	5	6	7
<b>Deposit Accounts</b>						
1. Current Accounts	Rural	2.6	2.7	2.4	2.9	3.3
	Urban	5.5	7.1	7.0	7.0	8.7
2. Savings Accounts	Rural	9.8	11.2	10.5	13.6	18.6
	Urban	7.2	9.0	7.9	9.8	13.3
3. Current and Saving Accounts (1 + 2)	Rural	12.4	13.9	12.8	16.4	21.9
	Urban	12.7	16.1	14.9	16.8	22.0
4. Term Deposits Accounts	Rural	13.8	18.3	20.5	27.9	25.2
	Urban	16.6	21.2	22.4	29.2	39.1
<b>5. Total Deposits Accounts (3 + 4)</b>	<b>Rural</b>	<b>26.3</b>	<b>32.2</b>	<b>33.3</b>	<b>44.4</b>	<b>47.1</b>
	<b>Urban</b>	<b>29.3</b>	<b>37.3</b>	<b>37.3</b>	<b>46.0</b>	<b>61.2</b>
<b>6. Credit Accounts</b>	<b>Rural</b>	<b>13.0</b>	<b>17.3</b>	<b>14.4</b>	<b>15.8</b>	<b>22.3</b>
	<b>Urban</b>	<b>20.0</b>	<b>24.8</b>	<b>25.5</b>	<b>31.1</b>	<b>45.0</b>

The table above shows the number of deposits and credit accounts in Scheduled Commercial Banks (as a percent of GDP). Total deposits, as per cent of GDP, increased from 32.2 in 1991 to 47.1 in 2005 in rural areas and from 37.3 to 61.2 in urban areas. Similarly, credit extended, as per cent of GDP, increased from 17.3 to 22.3 in rural and from 24.8 to 45.0 in urban areas (RBI, 2007)

### 3.2 Measures of Financial Inclusion

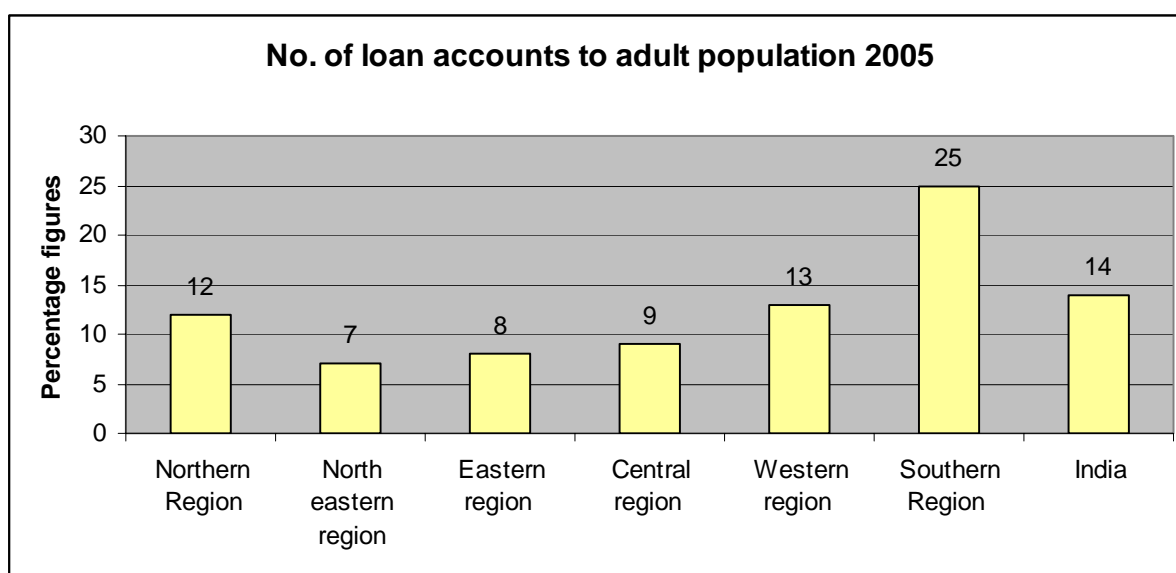
One common measure of FI is the percentage of adult population having bank accounts (shown in chart below). Going by the available data on the number of savings bank accounts and assuming that one person has only one account, (which assumption may not be correct as many persons could have more than one bank account) we find that on an all India basis 59 per cent of adult population in the country have bank accounts – in other words 41 per cent of the population is unbanked. In rural areas the coverage is 39 per cent against 60 per cent in urban areas. The unbanked population is higher in the North Eastern and Eastern regions (RBI, 2007).



The extent of exclusion from credit markets is much more, as number of loan accounts constituted only 14 per cent of adult population (shown in chart below). In rural areas, the coverage is 9.5 per cent

against 14 per cent in urban areas. Regional differences are significant with the credit coverage at 25 per cent for the Southern Region and as low as 7, 8 and 9 per cent respectively in North Eastern, Eastern and Central Regions.

The extent of exclusion from credit markets can be observed from a different view point. Out of 203 million households in the country, 147 million are in rural areas – 89 million are farmer households. 51.4 per cent of farm households have no access to formal or informal sources of credit while 73 per cent have no access to formal sources of credit. Similar data are not available for non farm and urban households. Looking at the different sources of credit, it is observed that the share of non institutional sources reduced from 70.8% in 1971 to 42.9% in 2002. However after 1991, the share of non institutional sources has increased; specifically, the share of moneylenders in the debt of rural households increased from 17.5 % in 1991 to 29.6% in 2002. In urban areas the share of non institutional sources has come down significantly from 40% in 1981 to around 25 % in 2002 (RBI, 2007).



### 3.3 Who are excluded?

The financially excluded sections largely comprise marginal farmers, landless labourers, oral lessees, self employed and unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women. While there are pockets of large excluded population in all parts of the country, the North East, Eastern and Central regions contain most of the financially excluded population. NSSO data reveal that non-institutional sources are still dominant in rural India

Table 1: Relative Share of Borrowing of Cultivator Households\* (per cent)

Sources of Credit	1951	1961	1971	1981	1991	2002**
Non-institutional	92.7	81.3	68.3	36.8	30.6	38.9
of which:						
Money lenders	69.7	49.2	36.1	16.1	17.5	26.8
Institutional	7.3	18.7	31.7	63.2	66.3	61.1
of which:						
Co-operative						

societies, etc.	3.3	2.6	22.0	29.8	30.0	30.2
Commercial banks	0.9	0.6	2.4	28.8	35.2	26.3
Unspecified	-	-	-	-	3.1	-
Total	100.0	100.0	100.0	100.0	100.0	100.0

\*: Borrowing refers to outstanding cash dues.

\*\* : AIDIS, NSSO, 59th Round, 2003.

There are a variety of reasons for FI. In remote, hilly and sparsely populated areas with poor infrastructure, physical access itself acts as a deterrent. From the demand side, lack of awareness, low incomes/assets, social exclusion, illiteracy act as barriers. From the supply side, distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes are common reasons for exclusion. All these result in higher transaction cost apart from procedural hassles. On the other hand, the ease of availability of informal credit sources makes these popular even if costlier. The requirements of independent documentary proof of identity and address can be a very important barrier in having a bank account especially for migrants and slum dwellers.

### 3.4 Strategy for bank credit

There has been a long history of concern regarding agricultural credit. The increase in share of institutional credit to agriculture has been rather slow. It has clearly been found difficult to extend institutional credit in rural areas. Some of the important reasons pertained to risk perception, costs of its assessment and management, lack of rural infrastructure, and vast geographical spread of the rural areas with more than half a million villages, some sparsely populated.

Lending to small borrowers dispersed over vast expenses of geographical areas naturally involve high transaction costs. The strategy that evolved after considerable experimentation was to provide for directed credit to priority sectors that have primarily included agriculture and small scale industries. This was also the key reason for nationalization of banks. That this strategy has been relatively successful is borne out by the data shown in the section above, but it may have reached its limit, as also demonstrated by the deterioration in the reach of formal credit in the 1990s.

The key issue now is how to mainstream rural credit from institutional sources so as to achieve wider coverage, expand financial inclusion and promote economic growth. Increasingly, banks and other financial intermediaries have to see the extension of rural credit as a business opportunity and not as an obligation to do forced directed lending.

One strategy that is achieving great popularity and wide acceptance is that of micro finance, as best exemplified by the success of the Bangladesh Grameen Bank, which has now also achieved even greater recognition through the award of the Nobel Peace Prize to Mohammad Yunus. But most micro finance is not only for crops, but for other lending, in both rural and urban areas. The main issue is that of reducing transaction costs for both the lender and the borrower.

For banks, micro finance agencies and other financial intermediaries to look at rural lending as business opportunities, much more information generation has to be done so that they recognize and understand the many different activities that take place in the rural economy in addition to crop agriculture. Non cereal foods, non-food agriculture, service activities, construction and housing, rural retail activities, will all increasing levels of formal financing channels that are easy to access. This will need innovation in risk assessment, reduction in transaction costs, the search for new credit channels, and the use of cheaper information technology for delivery and collection systems.

The task of policy-makers in designing an appropriate package of measures becomes more challenging considering the fact that the new growth areas of agriculture are characterized by a high degree of heterogeneity, unlike in the case of traditional crops such as rice and wheat. There is a multiplicity of varieties that can be produced in each of these product groups; production is often regionally concentrated; the production and marketing conditions differ significantly; and the input requirements are equally heterogeneous. Hence, policies and programmes that are to be attuned to support higher productivity and production in these areas need to be much more regionally disaggregated and knowledge intensive. A key difference in approach would have to be the much greater involvement of region-specific market participants, and of private sector suppliers in all these activities, and credit suppliers ranging from public sector banks, co-operative banks, the new private sector banks and micro-credit suppliers, especially self-help groups.

To finance all these new activities, which will aid and accelerate economic growth tremendously, banks will clearly need to step up their efforts in generating deposits as well from the many currently underserved households and small businesses.

#### **4. Rural financial inclusion model - Indian Bank**

Indian bank as State Level Bankers' Committee (SLBC), convener in the Union Territory of Puducherry, for the first time in the country has launched a National pilot Project for Financial Inclusion (NPPFI) in 2006 under the rural model involving all banks operating in UTP with the aim of providing at least one Bank account to each household.

Financial inclusion package: To start with, the Bank provided "No frills" SB accounts. As a next step, small overdraft facilities were allowed in the SB accounts in order to cater to the account holder's general purpose or consumption needs, which eventually would provide credit history for the future. Those who are engaged in income generation activities were provided with General Credit Card Facility with a flexibility of rollover facility.

The project was successfully completed within a period of twelve months and declared 100% financially included by mid of December, 2006. Thus UT of Pondicherry became the first state/UT in the entire country where all the families in the Union territory have been provided with a Bank account, besides an overdraft and general credit card facility.

Recognizing the need for providing social security to the unreached persons, the Bank has in association with Insurance companies introduced innovative micro insurance policies at an affordable cost. Janashree Bima Yojna (JBY) for members of the groups such as SHGs, JLGs etc in association with Life Insurance Corporation of India to provide life and disability cover and Universal Health Care Policy (UHCP), a Mediclaim insurance scheme in association with United India Insurance Company Limited aimed at below poverty line families.

#### **Replication of the Rural Model**

After experiencing the success of the project implemented in the UT of Pondicherry by Indian Bank and other Banks, the Governor, Reserve Bank of India in the annual policy statement for the year 2006-07 has called upon the SLBC convenors in all the States/UTs to identify at least one district in their area for achieving 100% financial inclusion on the lines of the initiative taken by Pondicherry. Accordingly, Tamil Nadu, Cuddalore district, lead district of the Bank was the first district chosen to be covered under financial inclusion. Indian Bank has completed the coverage of 100% households

and other banks are in the verge of completion of 100% financial inclusion in Cuddalore district.

Financial inclusion project is also implemented in Kollam, the lead district of the bank in Kerala involving all other banks operating in the district. Now all the households in the District have been brought under the banking ambit. Besides, UTP, Cuddalore and Kollam districts, the Bank is also taken up implementation of 100% financial inclusion project in other 11 lead districts across the country. The Bank has also initiated the process in other districts where it has no lead bank responsibilities. Two sponsored regional rural banks of the Bank have opened “No frills” SB accounts and issued overdraft and general credit with an outlay of 605.10 lacs.

## **5. Recent initiatives by Reserve Bank of India**

The period 1969 to 1991 saw a huge increase in the branch outreach in India as the average population covered by a bank branch fell from 64,000 to 13,711. In 1991 along with reforms for liberalizing and opening the economy, financial sector reform aimed at deregulation, increased competition and strengthening the banking sector through recapitalization and adoption of prudential measures. The Indian banking industry today is quite robust and strong to be able to take on the challenges of achieving greater financial inclusion ( Thorat, 2007)

In the Annual Policy of the Reserve Bank for 2004-05, the Governor, Dr. Reddy observed:

“There has been expansion, greater competition and diversification of ownership of banks leading to both enhanced efficiency and systemic resilience in the banking sector. However, there are legitimate concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in unorganized sector. While commercial considerations are no doubt important, the banks have been bestowed with several privileges, especially of seeking public deposits on a highly leveraged basis, and consequently they should be obliged to provide banking services to all segments of the population, on equitable basis.” (RBI, 2007)

In this context, the RBI has undertaken a number of measures with the objective of attracting the financially excluded population into the structured financial system. In November 2005, banks were advised to make available a basic banking “no-frills” account with low or nil minimum balances as well as charges to expand the outreach of such accounts to vast sections of the population. Banks are required to make available all printed material used by retail customers in the concerned regional language.

In order to ensure that persons belonging to low income group, both in urban and rural areas do not encounter difficulties in opening bank accounts, the know your customer (KYC) procedures for opening accounts has been simplified for those persons with balances not exceeding Rs 50000/- (about GBP 600) and credits in the accounts not exceeding Rs.100000/- (about GBP 1200) in a year. The simplified procedure allows introduction by a customer on whom full KYC drill has been followed

Banks have been asked to consider introduction of a General purpose Credit Card (GCC) facility up to Rs. 25000/- at their rural and semi urban branches. The credit facility is in the nature of revolving credit entitling the holder to withdraw upto the limit sanctioned. Based on assessment of household cash flows, the limits are sanctioned without insistence on security or purpose. 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. In January 2006, banks were permitted to utilise the services of non-governmental organisations (NGOs/SHGs), micro-finance institutions and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. The BC model allows banks to do “cash in – cash out” transactions at the location of the BC and allows branchless banking. Other measures include setting up pilots for credit counselling and financial education. A multilingual website in 13 Indian languages on all matters concerning banking and the common person has been launched by the Reserve Bank on 18 June 2007 (RBI, 2007).

## **6. Strategies and Approach**

At the regional level, a forum called the State Level Bankers’ Committee (SLBC) has been in operation since nationalization. SLBC is a group of bankers and government officials and is convened by a bank having major presence in the State called the SLBC convenor bank. It meets quarterly and reviews the banking developments in the State. At the district level, the district level committee functions; it is headed by the District Commissioner and is convened by a designated lead bank for the district. In early 2006, one district in each State was identified by the SLBC for 100 per cent financial inclusion. So far, SLBCs have reported having achieved 100 per cent financial inclusion in the Union Territory of Puducherry and in some districts in Haryana, Himachal Pradesh, Karnataka, Kerala and Punjab. Reserve Bank proposes to undertake an evaluation of the progress made in these districts by an independent external agency to draw lessons for further action in this regard.

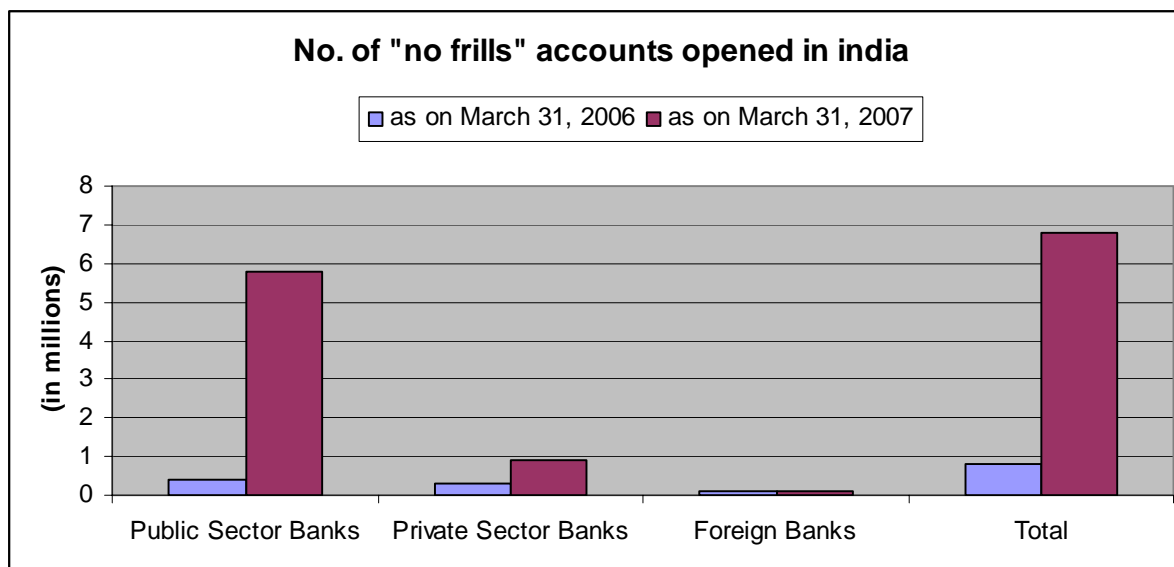
In the districts taken up for 100% financial inclusion, surveys were conducted using various data base such as electoral rolls, public distribution system, or other household data, to identify households without bank account and responsibility given to the banks in the area for ensuring that all those who wanted to have a bank account were provided with one by allocating the villages to the different banks. Mass media was deployed for creating awareness and publicity. The banks used different approaches to communicate the advantages of having a bank account. Bank staff or their agents who are usually local NGOs or village volunteers would contact the people at their households. Ration card / Electoral ID cards of the families were taken for fulfilling the simplified KYC norms. Photographs of all the persons who opened bank accounts were taken on the spot by a photographer accompanying the bank team. In most States, the product used for launching the program for financial inclusion is the “No frills” accounts. In one State the farmer’s credit card or KCC is being used ensuring first to credit rather than savings. In other States no frills account was followed by small overdraft facility or a general purpose revolving credit upto pre-specified limit. Recognizing the need for providing social security to vulnerable groups, in some cases in association with insurance companies, banks have provided innovative insurance policies at affordable cost covering life, disability and health cover.

Cooperative banks and regional rural banks being local level institutions are well suited for achieving financial inclusion. These banks are being revived and strengthened with incentives for better governance. Being local institutions they are ideally suited for achieving FI.

The role of an efficient payments system for FI cannot be overstressed and we efforts are being made to bring about Improvements in the payments system especially in the relatively less developed parts of the country.

## 7. Huge increase in “no-frills” accounts

The following graph shows the comparison between 2006 and 2007 on the no. of “no frills” accounts opened in India. An increase of 6 million new “no-frills” bank accounts opened in this period reflects the outcome of the efforts pertaining to financial inclusion (Thorat, 2007).



In view of their vast branch network (45000 rural and semi urban branches) public sector banks and the regional rural banks have been able to scale up their efforts by merely leveraging on the existing capacity. FI is being viewed by these banks as a huge business opportunity in an overall environment that facilitates enterprise and growth. It provides them a competitive advantage and defines a clear niche for their growth.

## 8. Use of Intermediaries

Use of intermediaries is helpful where the intermediary actually enables reduction of risk, such as use of SHGs where the group discipline and social capital act as credit enhancements. The use of MFIs which engage in capacity building of the group members and also in providing "credit plus" services enable banks to minimize credit risk by improving viability while expanding outreach to large number of poor customers. In India, branchless banking has to be able to ensure effective penetration into underserved areas –an example of this is the SHG-Bank linkage program. Up-scaling this program for financing productive activities and synergizing local entities for providing ancillary and collective services required for improving bankability of activities has to be the focus. While up-scaling the SHG –bank linkage program, care must be taken to ensure integrity of accounting and protection of member’s interest. In addition up-scaling requires knowledge enhancement and capacity building. For example Village knowledge centers set up by a public sector bank at some of its rural branches has enabled more productive lending and increased good business at such branches.

NABARD has played a very significant role in supporting SHG formation, linking them with banks as also promoting best practices. The SHG is given loan against guarantee of group members. The recovery experience has been very good and there are currently 2.6 million SHGs linked to banks touching nearly 40 million households through its members. Banks provide credit to such groups at reasonable rates of interest. However the size of loans is quite small and used mostly for consumption smoothening or very small businesses. In some SHGs, credit is provided for agricultural activities and



other livelihoods and could be several times the deposits made by the SHG. Most of the SHGs have been linked to public sector banks in view of the latter's dominant presence in the rural areas.

The private sector banks have approached the access issue through either setting up relatively lower cost non bank companies for providing small value retail loans or have partnered with MFIs that provide financial services to the relatively higher risk segments of the population. Microfinance has drawn attention to an entire sector of borrowers who had been previously poorly served by the formal financial sector and it also has demonstrated how to make lending to this sector a viable proposition. However the rates of interest charged are quite high, typically 24 to 30 per cent, mainly on account of the high transaction cost for the average loan size that can be quite small. Compared to the informal sector, perhaps the rates are lower, but issues are raised whether these rates are affordable. For commercial banks, the lower cost of funding, advantages of size and scale gives scope for cross subsidization and their interest rates are more competitive compared to the MFIs, but they have not been as successful in dealing with the last mile issue. The partnering with SHGs and MFIs with reasonable cost of funding by the banks has been seen as a more optimal approach till now.

## **9. International Experience**

In general, countries with low levels of income inequality tend to have lower levels of financial exclusion, while high levels of exclusion are attributed to the least equal ones. For instance, in Sweden less than 2% of adults did not have an account in 2000 and in Germany, the figure was around 3% (Kempson, 2006). Similarly less than 4% of adults in Canada and 5% in Belgium did not have a bank account (Buckland, et al., 2005). Countries with high levels of inequality witness higher levels of banking exclusion. To support this claim, in Portugal, about 17% of the adult population possessed no account of any kind in 2000 (Kempson, 2006).

The phenomenon of such exclusion has received varied policy responses worldwide. In Sweden, for example, banks cannot refuse to open a saving or deposit account under Section 2 of the Banking Business Act of 1987; in France, Article 58 of the Banking Act, 1984 recognized the principle of the right to a bank account; in the US, Federal Government introduced the Community Reinvestment Act in 1997, partly in response to concerns about bank branch closures in low-income neighbourhoods. Under this legislation, federal bank regulatory agencies rate banks on their efforts to serve low-income communities. These early legislations were designed to ensure access to a deposit account but did not spell out the nature of banking services that should be on offer. Refinements in this area have actually taken place in the latter half of the 1990s, resulting partly from a wider concern regarding social exclusion (Caskey et al, 2006, Kempson et al, 2000). Financial inclusion is also a concern even in developed countries and legislative or regulatory measure to achieve it is also universal.

## **10. Role of IT as an enabler**

In present day context, IT solutions for providing door-step banking facilities hold the key to scalability of the FI initiatives. Pilot projects have been initiated using smart cards for opening bank accounts with bio metric 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.

In a recent speech<sup>2</sup> by Chairman of the Fed Reserve Board Ben. S. Bernanke referred to the role of community based financial institutions in minimizing neighbourhood and information externalities and other types of market failure that tend to prevent competitive conditions from maximizing social welfare. He spoke about the role of community development financial institutions in solving collective action problem and countering information externalities by developing financial products and services that better fit local needs and provide coordinated development activities and community specific information. In dealing with scale and using technology, banks tend to adopt highly standardized and automated processes. But financial inclusion requires substantial efforts in understanding the needs of the customer, counseling, financial literacy, screening & monitoring. In his speech the Chairman focused on role of the local organizations in acting as information brokers and facilitators. There is also a news item that applications made by Wal-Mart to cash cheques at its 44 stores has been approved by the Division of Banking in Massachusetts mainly on grounds of providing facility to the unbanked. In some jurisdictions, non bank entities are being allowed to provide payment and account maintaining facility without bank account - through e-money- to meet the needs of the unbanked. In developing countries, the added dimension, and the main difference is that the focus of financial inclusion is on promoting sustainable development and generating employment for a vast majority of the population especially in the rural areas.

However the higher growth rate was on account of urban areas. In rural areas, the number of loan accounts went up from 40 million to 47 million (3.3%) whereas the urban areas showed a stronger growth from 14 million to 30 million loan account or growth rate of 16.5%. The growth in the number of small borrower accounts in rural areas was even lower at 2.5 % whereas the growth in the number for urban areas was 13.8 % between 2000 and 2005. There has been hardly any increase in outreach or scale in the last five years except for some growth in branches and loan accounts in urban areas. Number of bank offices in rural areas remained more or less the same - 47253 in 2000 to 47586 in 2005- while they rose from 19808 to 22383 in urban areas. Current and savings accounts per branch in rural areas rose from 3650 to 4202 and from 5965 to 6155 in urban areas. The number of loan accounts per branch rose from 844 in 2000 to 1003 in 2005 while in urban areas the number increased from 731 to 1335. These data bring out the spurt in urban retail lending in recent time –but this has not been matched by similar growth in savings accounts in both rural and urban areas or growth in loan accounts in rural areas. On the other hand, there are 93 million mobile users today –the CAGR since 1999 is 85 %. The number of mobile phones currently is more than the number of borrowers from the banking system. There is a clear need to increase the outreach and scale up operations at existing outlets (Thorat, 2006).

The use of IT is inevitable to improve the usage of existing branch infrastructure. Increasing outreach and up scaling number of accounts at each branch will require bankers to move out of their branches and source clients and then look at low cost delivery alternatives once the account relationship is established. Opening a no frills account with a small overdraft or GCC is only the first step in building the relationship which would require sustained efforts to ensure that the banking relationship with the customer is fashioned to meet his needs. IT can reduce cost and time in processing of applications, maintaining and reconciliation of accounts and enable banks to use their staff at branches for making that critical minimum effort in sustaining relationship especially with new accountholders.

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<sup>2</sup> Speech given at the Opportunity Finance Network's Annual Conference at Washington DC on November 1, 2006

In rural areas customers cannot be expected to come to branches in view of opportunity cost and time and hence banks will have to reach out through a variety of devices such as weekly banking, mobile banking, satellite offices, rural ATMs and use of Post offices. In urban and even in rural areas where mobile phones have penetrated, banks could use mobile technology for facilitating banking transactions. Mobile phones can be used to transfer funds real time from and to bank accounts and could make remittances and payments at very low cost. Once the data base and track record is established, a multitude of financial services can be offered including savings, remittance, transaction banking such as receipt of salaries, pensions and payments for utilities, loan including home loans, insurance and MF products. Here the branches can render more business and variety of products to existing clientele as also source new customers within the area of operation.

Financial inclusion offers a huge potential for business in terms of resources and assets and banks therefore need to take aggressive steps to use technology, business processes and personnel to be able to exploit this potential in innovative and creative ways. In a branch banking model, local community based organizations or respected persons could be used to deal with the information asymmetry problem by leveraging the knowledge about customers available with such entities /persons to reduce credit risk and transaction cost. Even if post offices and post men are not used for actual delivery of services, they can be used for the invaluable information and data they possess for direct marketing. There are a number of such organizations and delivery channels- including retired bankers and school teachers- who can be used for such credit enhancements in the form of reliable information.

In fact use of technology is critical in building up a reliable credit information system, build up data base on customers for a variety of purposes, thereby reducing the transaction cost involved in checking encumbrances and collaterals and also facilitating better pricing of risk. A South African IT initiative worth emulating is the 'MZANSI' account. This account, a National no frills Bank Account (NBA) product that caters to the needs of the un-banked population of South Africa was established to use existing distribution networks of banks, government and other bodies. It was envisaged that NBA will attract 4 million potential customers over period of 5 years. In its first year of operation itself, it garnered nearly two million accounts.

There is a money transfer service associated with the MZANSI account<sup>3</sup> which makes it possible to transfer money between un-banked / banked customers from any participating bank or South Africa Post Office. All banks in South Africa are participants in this unique venture. As it is a very technology intensive product, the transaction costs are very low and thus, what were thought to be as 'too costly to serve areas and people' have become attractive propositions.

State Governments such as in Andhra Pradesh are actively looking at making pension payments as also disbursements under REGP through use of smart cards linked to bank accounts. The same card could be used for social security programs as also banking transactions and can act as a unique identifier card. All relevant details relating to the person can be stored on the card with bio-metric identification. Experiments are under way for low cost ATMs with biometric identification for withdrawal of cash that could enable a low cost and therefore a more sustainable way of financial penetration and outreach while ensuring safeguards against foul play.

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<sup>3</sup> The **MZANSI Account** is a low income transactional banking account that was developed in line with the commitments of South Africa's Financial Sector Charter. The Financial Sector Charter requires banks to make banking more accessible to the nation and, specifically, to increase banking reach to all communities.

RBI is setting up an Advisory Group on IT solutions for financial inclusion and it is hoped that collaborative effort between banks governments and post offices will be facilitated by the deliberations of this Group.

## **11. Role of Government**

State Governments can play a pro-active role in facilitating FI. Issuing official identity documents for opening accounts , creating awareness and involving district and block level functionaries in the entire process, meeting cost of cards and other devices for pilots, undertaking financial literacy drives are some of the ways in which the State and district administration have involved themselves (Thorat, 2007).

India Post is also looking to diversify its activities and leverage on its huge network of post offices, the postman's intimate knowledge of the local population and the enormous trust reposed in him. Banks are entering into agreements with India Post for using post offices as agents for branchless banking.

### **11.1 Work in progress**

The Finance Minister in his budget for 2007-08 has announced the setting up of two funds for FI; the first called Financial Inclusion Fund for developmental and promotional interventions and the other called Financial Inclusion Technology Fund to meet cost of technology adoption of about \$ 125 million each. The scope of these funds is being worked out. Setting up of financial literacy centres and credit counseling on a pilot basis, launching a national financial literacy campaign, forging linkages with informal sources with suitable safeguards through appropriate legislation, evolving industry wide standards for IT solutions, facilitating low cost remittance products are some of the initiatives currently under way for furthering FI.

Moreover, the loan waivers given to farmers in the 2008 budget will also go a long way in enabling financial inclusion to Indian farmers<sup>4</sup>.

Two recommendations of the Committee on Financial Inclusion proposed to be accepted viz (i) to advise commercial banks, including RRBs, to add at least 250 rural household accounts every year at each of their rural and semi-urban branches; and (ii) to allow individuals such as retired bank officers, ex-servicemen etc to be appointed as business facilitator or business correspondent or credit counselor; banks to be encouraged to embrace concept of Total Financial Inclusion; Government to request all scheduled commercial banks to follow the example set by some public sector banks and meet the entire credit requirements of SHG members, namely, income generation activities, social needs like housing, education, marriage etc., and debt swapping.

- (i) Fund of Rs.5,000 crore to be created in NABARD to enhance its refinance operations to short term cooperative credit institutions;
- (ii) Two funds of Rs.2,000 crore each to be created in SIDBI - one for risk capital financing and other for enhancing refinance capability to the MSME sector.
- (iii) Fund of Rs.1,200 crore to be created in NHB to enhance its refinance operations in the rural housing sector.

These funds are to be governed by the general guidelines that are now applicable to RIDF with some modifications.

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<sup>4</sup> Key features of Union Budget 2008-09, Government of India, (<http://indiabudget.nic.in>)

Differential Rate of Interest (DRI) scheme: Borrower's eligibility criteria for loan under the DRI scheme to the weaker sections of the community engaged in gainful occupations enhanced.

### **11.2 Scheme of Debt Waiver and Debt Relief for farmers:**

- Scheme to cover all loans disbursed by scheduled commercial banks, regional rural banks and cooperative credit institutions up to March 31, 2007 and overdue as on December 31, 2007 are covered under the scheme;
- Complete waiver of all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008 for marginal farmers and small farmers;
- one time settlement (OTS) scheme in respect of other farmers for all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008; Rebate of 25 per cent against payment of the balance of 75 per cent under OTS;
- Agricultural loans restructured and rescheduled by banks in 2004 and 2006 through special packages also eligible, either for a waiver or an OTS on the same pattern;
- Implementation of the debt waiver and debt relief scheme to be completed by June 30, 2008; Farmers availing the relief would be entitled to fresh agricultural loans from banks in accordance with normal rules.
- About 3 crore small and marginal farmers and about one crore other farmers to benefit from the scheme; Total value of overdue loans being waived estimated at Rs.50,000 crore and the OTS relief estimated at Rs.10,000 crore.

## **12. Causes of Financial Exclusion**

In general financial exclusion arises from (HM Treasury, 2007):

- Problems with the **supply of** appropriate financial service products and
- Problems with **demand for** financial services among potential customers

### **12.1 Supply problems:**

- The market not supplying products to appropriate consumer needs
- The market not supplying products with adequate consideration of consumers interests
- The market not making appropriate products easily accessible.

A lack of appropriate products is a common supply problem. For example, low income customers often require credit which provides small sums over a short period. Because of the high set-up cost of mainstream credit agreements, it may not be profitable for Banks and other commercial lenders to provide such loans. Similarly, most mainstream insurance products such as home contents or car cover are designed for payment or premiums directly from a bank account automatically excluding unbanked consumers. And some people choose not to engage in financial services for religious or cultural reasons. For example, Islamic Shari'a law prohibits payments or receipts of interest, meaning that most saving or credit products are not appropriate for those who follow Shari'a law. Products may be provided with inadequate consideration of consumers interests. Non-mainstream credit

products providing basic features required by financially excluded customers are available. Accessibility problems can arise in a number of ways. For example, basic bank accounts were created to increase access to appropriate banking products in the UK. But these accounts were inaccessible for many financially excluded customers.

### **12.2 Demand problems:**

Even when financial products do meet the needs of excluded customers, they may be unaware that these products exist, or of the benefits they can bring, and therefore be unwilling to invest the time and effort needed to take them up. Often, lack of demand results from people believing that they will not be served by financial services providers. This belief can be based on prior experience of having been turned down, or on hearsay or prejudice. In many cases it is reinforced by social or cultural preferences or alternatives, such as Christmas hamper saving schemes in US. Finally, lack of demand for financial products may rise because people do not have the financial capability to make well-informed decisions. In these circumstances, many opt out altogether, and operate primarily in cash.

## **13. Challenges for Financial Inclusion**

While there has been real progress, there remains a lot to be done, and key challenges to be met, if the government is to achieve its goals for financial inclusion. Challenges for effective day to day money management include

- Continuing to reduce the number of unbanked people by promoting basic bank accounts
- Ensuring that newly banked people are using their bank accounts effectively
- Continuing to focus on the issue of accessibility of banking services and
- Understanding the impact of developments in the banking market on the government objectives for effective money management

The key challenges for planning for the future and coping with pressures are:

- Increasing the coverage and capacity of third sector lenders so that excluded people nationwide have access to this source of affordable credit
- Making saving work for low income or financially excluded consumers through products that meet their savings needs and through targeted savings incentives
- Investigating the role of insurance as a product for financially excluded customers; and
- Successfully increasing demand for financial services through targeted support, increased financial capability and realizing the potential of bank accounts as a route to wider financial inclusion.

And the challenges to dealing with financial distress effectively include

- Continuing to make progress with the supply of face to face advice
- Establishing the potential of new cost effective, mechanisms for delivery of advice

- Replicating the success of DTI's pilots to date in the nationwide rollout of projects to tackle illegal lending
- Promoting the role of banks and other financial services providers in supporting people out of financial distress,
- Addressing the impact of low financial capability on people's capability to deal with distress

## **14. Conclusion**

The economy is presently in a phase of rapidly rising incomes, rural and urban, arising from an expansion of extant economic activities as well as the creation of new activities. Corporate profitability has exhibited sustainable trends and consumer incomes are increasing rapidly, riding on the growth momentum. All of these developments suggest that the demand for financial services, both for savings as well as production purposes, will be greater than has been the case in the past, and there will be many new entrants in need of financial services who have not hitherto been served. At present our financial depth is much lower than that of other Asian countries, though it has picked up in the recent past. While there is evidence of an increase in financial deepening, particularly during the present decade, the increase in the breadth and coverage of formal finance has been less than adequate. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present stage of development of our country.

There has been a burst of entrepreneurship across the country, spanning rural, semi-urban and urban areas. This has to be nurtured and financed. It is only through growth of enterprises across all sizes that competition will be fostered. A small entrepreneur today will be a big entrepreneur tomorrow, and might well become a multinational enterprise eventually if given the comfort of financial support. But we also have to understand that there will be failures as well as successes. Banks will therefore have to tone up their risk assessment and risk management capacities, and provide for these failures as part of their risk management. Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth.

The Parliament passed the Credit Information Bureau Act last year and the guidelines for its implementation will be released shortly. This should enable, over time, the availability of credit histories of both individuals and small businesses, which will help significantly in reducing transactions and information costs for banks. It will also help in spreading the credit culture among borrowers. It should help banks greatly in assessing and managing risk at low cost.

As poverty levels decline and households have greater levels of discretionary incomes, they will be first time financial savers. They will, therefore, need to have easy access to formal financial systems to get into the banking habit. Banks will need to innovate and devise newer methods of including such customers into their fold. The importance of 'no-frills' account and expanding the range of identity documents that is acceptable to open an account without sacrificing objectivity of the process in this milieu can never be over-emphasized. Banks will need to go to their customers, rather than the other way around.

The micro-credit and the Self Help Group movements are in their infancy but are gathering force. More innovation in the form of business facilitators and correspondents will be needed for banks to increase their outreach for banks to ensure financial inclusion. New entrants to the banking system need households at their doorstep.

To conclude, therefore, we wish to stress that with increasing liberalization and higher economic growth, the role of banking sector is poised to increase in the financing pattern of economic activities within the country. To meet the growing credit demand, the banks need to mobilize resources from a wider deposit base and extend credit to activities hitherto not financed by banks. The trend of increasing commercialization of agriculture and rural activities should generate greener pastures, and banks should examine the benefits of increasing penetration therein. Financial inclusion will strengthen financial deepening and provide resources to the banks to expand credit delivery. Thus, financial inclusion will lead to financial development in India which will help to accelerate economic growth.

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