

## **FINANCIAL INCLUSION FOR INCLUSIVE GROWTH IN INDIA (ISSUES AND CHALLENGES)**

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### **Abstract:**

India is one of the largest and fastest growing economies of the world, but what has been the most disturbing fact about its growth is that its growth has not only been uneven but also discrete. It has been uneven in the sense that there has been no uniformity in its growth performance and it has been discrete and disconnected with regard to growth and distribution of growth benefits to certain sectors of economy. And thus the need for inclusive growth comes in the picture of Indian economic development. However for attaining the objectives of inclusive growth there is a need for resources, and for resource generation and mobilization financial inclusion is required. It plays a very crucial role in the process of economic growth. Inclusive growth is the buzz word for developing economies and key to inclusive growth is financial inclusion. The government has also set up Committee on Financial Inclusion to study the pattern of exclusion, identify barriers, review international experience and provide recommendations for achieving the objectives of financial inclusion. The main objective of this paper is to understand the relevance of financial inclusion for inclusive growth and also to study various initiatives taken by Reserve Bank of India for financial inclusion. The study also focus on the major concern areas that need to be addressed for the success of the financial inclusion measures taken by the government and Reserve Bank of India.

**Key Words:** Financial inclusion, Inclusive growth, Economic development, RBI etc.

### **INTRODUCTION**

Inclusive growth is the buzz word for developing economies and key to inclusive growth is financial inclusion. Financial inclusion measures the delivery and reach of banking services at reasonable cost to the vast sections of low income and disadvantaged groups. Strong inclusive financial systems allow people with limited funds, an access to invest in their education and small entrepreneurs chance to pursue promising growth opportunities, thus promoting income equality and higher economic growth. This is the reason why even developed nations are concerned about those excluded from the financial system. Financial Inclusion aims at providing financial services to the vulnerable section of the society at an affordable cost. It aims at promoting banking habits by the deprived or poor strata of the society by providing them accessibility to the financial services. Importance of financial inclusion arises from the problem of financial exclusion of nearly 3 billion people from the any formal financial services across the world. With only 34% of population engaged in formal banking system for their financial need, India has, 135 million financially excluded households, the second highest number after China. Further, the real rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. Financial Inclusion has far reaching consequences, which can help in poverty alleviation. It provides formal identity, access to payments system & deposit insurance. The objective of financial inclusion is to extend the scope

of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty. There is a need for coordinated action between the banks, the Government and others to facilitate access to bank accounts amongst the financially excluded.

### **NEED FOR THE STUDY**

For attaining the objectives of inclusive growth there is a need for resources, and for resource generation and mobilization financial inclusion is required. It plays a very crucial role in the process of economic growth. Financial inclusion through appropriate financial services can solve the problem of resource availability, mobilization and allocation particularly for those who do not have any access to such resources. Thus in the current paper an effort is made to study the role of financial inclusion in inclusive growth.

### **OBJECTIVES OF THE STUDY**

1. To understand the relevance of financial inclusion for inclusive growth.
2. To study various initiatives taken by Reserve Bank of India for financial inclusion
3. To study the role of financial inclusion in inclusive growth.
4. To know the extent of financial exclusion/inclusion in India.

### **RESEARCH METHODOLOGY**

Keeping in view the objectives of this study, research design was adopted to have greater accuracy and in depth analysis of the research study. Available secondary data was extensively used for the study. The investigator procures the required data through secondary survey method. Different news articles, Books and Web were used which were enumerated and recorded.

### **CURRENT STATUS OF FINANCIAL INCLUSION**

Numerous initiatives has been taken for augmenting banking services to the vulnerable section of the society residing in rural as well as urban areas. Accessibility to the financial services by the under privileged will help in bringing the financial stability and reduce the imbalances in distribution of the income and the resources that ultimately results in Inclusive Growth. To accelerate economic growth, financial inclusion is an explicit strategy and is critical for the inclusive growth of a developing nation. Accessibility to basic financial services such as savings, insurance and remittances are extremely importance for poverty alleviation and economic development and upliftment of the society. In order to achieve the goal of complete financial inclusion, the policy makers, MFIs, NGOs and regulators have to work together in synchronization. India had invested considerable amount of resources in expanding its banking network with the objective of reaching to the unbanked strata of the country. During the last four decades huge infrastructure has been created in the banking sector. However, this large infrastructure that has penetrated even remote rural areas has been able to serve only a small part of the potential customers. While India is on a very high growth path, almost at the two-digit level, majority of the people are still not the part of the growth process. This is neither desirable nor sustainable for any developing nation. It is known that one of most important driving forces of inclusive growth is institutional finance. In spite of serious efforts made by the

RBI and government agencies the results are still not very appreciable. Six hundred million people of India are still unbanked. Not only the rural sector lack the basis financial services but also the large segment of urban dwellers, migrants and informal sector workers also lack accessibility to basic financial or banking services.

## **MAJOR ISSUES, CHALLENGES & STRATEGIES IN FINANCIAL CHALLENGES**

### **1. Change in the approach of Banks:**

Only access to credit or banking is NOT the financial inclusion: Achieving complete Financial Inclusion: It is often noticed that mere opening a Bank Account is taken or claimed as achieving the target of financial-inclusion. Many empirical studies and Usage Analysis reveal that after opening such bank accounts, hardly there are any transactions take place in such bank accounts. Banks must genuinely strive to provide the directed services under the category or scheme of financial inclusion to the rural population, since they are the main pillars for the desired success. On this backdrop, the claims of policy-makers, banks, etc., the illusions created and mythical success stories spread must be tested on the basis of parameters enumerated on the background of the RBI's norms and expectations, (NABARD, 2012). Basically, though, the financial inclusion is meant to include all the sections of the society, who are mainly out of the net of the financial institutions, yet, financial inclusion does not mean merely opening of saving bank account but signifies creation of awareness about the financial products, education and advice on money management, offering debt counseling, etc. by banks. Every society should ensure easy access to public goods. Therefore, banking service being a public good should also be aimed at providing service to the entire population. However, empirical studies show that :-

- (a) Some banks have no desire to achieve the complete financial inclusion;
- (b) Some banks have formed opinion that the complete financial inclusion is not possible and/or it is an empty and useless exercise;
- (c) The Banks are ready or eager, but their branch employees are reluctant or give lame excuses to implement the scheme of financial inclusion.
- (d) Those who, unwillingly and reluctantly implement the scheme of achieving financial inclusion, assume that merely opening a bank account is the implementation of scheme of financial inclusion.
- (e) Affordable credits are made available only as compulsions.
- (f) Only in rare cases some of the banks make attempts to provide financial advice to the poor or disadvantaged people.
- (g) The costs of serving the poor can be significant in the short-term, thereby, impacting profitability.

### **2. Relaxation in Regulatory Framework:**

The RBI, initially, in November 2005, set the population benchmark, which will help it, for taking its financial inclusion drive to the next level, mandating all Banks to reach out the villages, all habitations with population in excess of 2000, as per the 2001 census, either through the Bank Branches or through Business Correspondent (BCs). However, since 2011-12, the population benchmark is reduced to 1600 and above. Very recently, on 11 August 2012, the RBI asked Banks to drop the 'no-frills' tag from the basic savings accounts as the

nomenclature has become a stigma. The RBI asked Banks to provide the 'zero-balance' facility in the basic banking accounts along with ATM-cum-Debit Cards without extra charge. The Finance Ministry directed the Banks were directed to reach out to villages with population of 2000, as the population benchmark that all habitations with population in excess of 1600 must have a bank branch, which will help it take its financial inclusion drive to the next level. The Finance Ministry, very recently, directed all state-run Banks to ensure that every household has at least one savings bank account by end of June 2012, a move seen as a precursor to direct transfer of benefits under the government's financial inclusion plan.

For this purpose, the Banks have been asked to launch a campaign to ensure that opening of new accounts and changes required in existing accounts are completed by June 2012, (Khan, 2011).

### **3. Microfinance Institutions (MFIs):**

The MFIs have served the underserved/unserved populace in the last few years and improved access to credit though there have been quite a few debatable issues on the style of corporate governance and ethics of conducting business on part of some of the MFIs. However, it has been often realized that the MFIs do help in financial deepening and can remain an important segment of the Indian financial market keeping in view the present level of penetration of the banking system. The conceptual framework underlying MFIs requires a change. MFIs will have to revisit the mission and business strategy and reinvent the sector to remain relevant in the system. A new category of 'Non Banking Financial Company-Micro Finance Institutions' (NBFC-MFIs) prescribed by the Malegam Committee (2011), created in December 2011 by RBI, is also facing difficulties primarily into micro financing. The NBFC-MFIs has got some relief from the RBI, which issued revised 'Directions cum Modifications' in August 2012, (RBI, 2012). On this background, these institutions have to revisit their business models to support the income earning ability of the borrowers and, at the same time, they remain economically viable. NBFC-MFIs will have to work hard in pursuit of transparency and responsible finance, shaking off the perception that their motto is profiteering at the cost of the poor but not profitability for sustainable and viable growth on one hand and take initiatives to retool the product redesign for garnering new customers and acquiring more share of the market on the other.

### **7. Financial literacy and awareness:**

There is a strong concern about the pathetic attitude of the banks to arrange regular campaigns for spreading awareness about financial inclusion and financial literacy need to be intensified. Banks need to do efforts in this area through innovative dissemination channels including films, documentaries, pamphlets and road shows.

### **8. Self Help Group-Bank Linkage Programme (SLBP):**

In the last two decades, the major institutional innovation in India for expanding financial system access and usage for the poor and marginalized sections of the population has been the SBLP. The project provided a cost-effective SBLP model for providing financial services to the underserved poor. Being a 'savings-first, credit later' model, credit discipline became a norm for Self Help Groups (SHGs) and 'social collateral' made them bankable. The model was initially successful in providing solution to the twin problems faced by banks, i.e., low recovery of loans in rural areas and high transaction costs in dealing with small borrowers at frequent

intervals, with a major positive impact of generating social and economic empowerment of the membership. However, despite the noteworthy accomplishments of SHGs certain issues, such as, inadequate outreach in many regions, delays in opening of SHG accounts and disbursement of loans, impounding of savings by banks as collateral, non-approval of repeat loans by banks even when the first loan was repaid promptly, multiple membership, borrowings by SHG members within and outside SHGs, adverse consequences of unhealthy competition between NGO promoted SHGs and Government promoted/subsidy oriented SHGs and limited banker interface and monitoring continued to affect the programme in many areas. While the basic tenets of the SHGs being savings led credit product remain true even today, recent developments have given rise to the need for crucial changes in the approach and design of SBLP to make it more flexible and client friendly. The revised NABARD guidelines, popularly known as SHG2 (version 2), have sought to address some of the shortcomings of the earlier version.

#### 9. **Product Initiatives:**

To ensure that more and more people come within the banking fold the banks should offer all the customers a 'basic savings deposit account' with certain minimum common facilities and without the requirement of minimum balance. The services provided in this account should include deposit and withdrawal of cash at the bank branches as well as ATMs, receipt/credit of money through electronic payment channels or by means of deposit/collection of cheques drawn by Central/State Government agencies and departments. Innovation of products for the specific needs of the poor is necessary for achieving the ultimate objective of inclusive growth.

#### 10. **Financial Inclusion as a Business Opportunity *vis-a-vis* Profitable Models for Financial Inclusion:**

Financial inclusion initiatives would provide banks with a low-cost and stable source of funds, helping them improve their asset-liability management (ALM). Rural India presents a remarkable opportunity for banks and financial institutions to seek their fortunes and bring prosperity to the aspiring poor through financial inclusion. In a fast growing economy like India the poor are the middle class of tomorrow and banks could, therefore, ill-afford to ignore this segment. Banks, however, argue that while the benefits of financial inclusion can be easily understood, the costs of serving the poor can be significant in the short-term, thereby impacting profitability. Banks, therefore, need to take bold decisions and reach out to rural India with strategies and business models which are beyond the realm of conventional thinking. Banks should refrain from deliberately adopting a uniform business model. Banks need to build its own strategy in line with its business model and comparative advantage. A successful model should also represent a better way than existing alternatives and also answer management guru Peter Drucker's age-old questions: (a) Who is your customer? (b) What does the customer value? & (c) How do you deliver value at an appropriate cost?

A profitable business model should consist of four elements:

- **a customer value proposition**
- **a profit formula**
- **key resources**
- **key processes.**

### 11. Customer service and consumer protection:

Customer service is another issue that needs closer attention. Mind-set, cultural and attitudinal changes at the grass-root levels and user friendly technology at the level of branches of banks and BC outlets are needed to extend holistic customer service to the new entrants to the banking system. Government, regulators like Reserve Bank of India, banks, service providers and consumers themselves have to play important role in developing a comprehensive approach to consumer protection.

### FINANCIAL INCLUSION INITIATIVES OF RBI/ GOVERNMENT OF INDIA

For ensuring complete financial inclusion host of initiatives were taken by Reserve Bank of India/ Government of India and various policy measures were announced from time to time to keep the momentum. The concept of financial inclusion is not new to India. It could be trace back in 1969 when fourteen major banks were nationalized to expand the availability of banking service from class to mass. Soon after nationalization lead bank scheme and priority sector lending were introduced to ensure that adequate credit flows to the vital sector of the economy for economic development. In the year 1975 Regional Rural Banks were set up for enhancing the banking service to the Rural India. Soon in the year 1982 NABARD was established to provide agricultural related credit facilities to the farmers. Self Help Group Bank Linkage programme was launched by NABARD in 1992 to expand the reach of banking services to the unbanked rural segment. The focus of financial inclusion was majorly on the inclusiveness of rural India by including all the villages with population greater than 2000. SIDBI was established in the year 2000 for providing micro credit to the small entrepreneurs. In spite of series of initiatives the goal of financial inclusion was not satisfactory.

In January 2006 Reserve of India has permitted the banks to use the services of the NGO/SHG, micro finance corporations and other civil society organization as intermediaries for expanding the reach of banking and financial services to the rural unbanked regions. Above all Reserve Bank of India has taken following major initiative for achieving some concrete results on Financial Inclusion.

- Opening of No Frill Accounts
- Simplification of Know Your Customer (KYC) norms
- Engaging Business Facilitators and Business Correspondents as intermediaries
- Enhanced usage of Information and Communication technology (ICT)
- Usage of Electronic Benefit Transfer services by the banks
- Mandatory opening of 25% branches in the rural unbanked regions.
- Financial Literacy and Credit Counseling Centers (FLCC)
- Usage of Regional languages
- Constitution of Financial Advisory Committee by RBI
- Introduction of General purpose credit card (GCC) and Kisan credit card (KCC).
- Provision of Overdraft facilities on Saving Bank Account (No frill account)

### CONCLUSION

Financial inclusion is still a long road ahead. For achieve inclusive growth, financial inclusion plays a very important role. The recent development in the Banking sector to include

the excluded strata has transformed the banking services availability from traditional brick and mortar model to branchless banking through internet and mobile banking, direct money transfers etc by the usage of upgraded technology. But the accessibility to such services and technology is limited to certain segment of the society. Non accessibility to the basic financial services is major hindrance in the process of Inclusive growth and economic development. Inclusive growth attainment depends a great deal on equitable distribution of growth opportunities and benefits. And financial inclusion is one of the most crucial opportunities which need to be equitably distributed in the country in order to attain comprehensive growth. It needs to be understood by the state that in order to bring orderly growth, order needs to be developed with regard to inclusive finance. The percentage of financial inclusion in the different states of the country varies differently. Undoubtedly the issue of expanding the geographical and demographic reach poses challenges from the viability/sustainability perspectives and appropriate business models are still evolving and various delivery mechanisms are being experimented with by the various government agencies at the central and state level. But somewhere the efforts taken are not good enough to encounter this staggering issue of financial exclusion.

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