Journal of Accounting and Finance
Volume 33, No. 1
October 2018-March 2019

Progress and Prospects of Financial Inclusion in India

Sandeep Kumar

Abstract

Financial inclusion is considered as an effective means to sustainable economic growth, and is intended to ensure that each citizen of the country is able to use their earnings as a national financial resource for redeployment in productive sectors of the economy. Such pooled financial resources can be channelized to develop enterprises, fueling the nation's progress. While inclusive banking began, in spirit, with the nationalisation of banks in 1969 and 1980 in India, the real thrust on financial inclusion (FI) came in 2005 when the Reserve Bank of India (RBI) highlighted its significance in its annual policy statement of 2005-06. It urged banks to work towards reaching out to the masses, offering banking services down to the hinterland. RBI began to persuade banks to include FI as a business objective. Accessibility of timely, adequate and transparent credit from formal banking channels will boost the entrepreneurial spirit of the masses to increase outputs enhancing prosperity of the nation. Adequate banking facilities will ensure distribution of government benefits and subsidies through direct benefit transfers to the beneficiaries' bank accounts rather than subsidized products and cash payments. This study is based on secondary data with aim of analyzing the progress and prospects of financial inclusion in India.

Keywords: *Financial Inclusion, Banks, Economic Growth, Financial Stability*

Introduction

Financial inclusion is considered as a critical indicator of development and well-being of a society worldwide. This underlying theme has brought FI in the spotlight and it has come to occupy centre-stage in financial intermediation. The Government and Reserve Bank of India (RBI) have taken various measures to facilitate easy access to finance for Micro, Small and Medium Enterprises (MSMEs). India's first FI index was launched in 2013 based on four critical dimensions: (i) branch penetration, (ii) deposit penetration, (iii) credit penetration, and (iv) insurance penetration. The last dimension was added for the first time to make the index much more comprehensive. CRISIL Inclusix measures progress on FI down to the level of each of the 666 districts in the country in 2013 (as against 717 now). The index is based on data provided by RBI, the MicroFinance Institutions Network (MFIN), and the Insurance Information Bureau of India.

The index readings for fiscal year (FY) 2015-16 (the latest period for which data are available) show that FI has improved significantly, with the all-India score rising to 58 in FY 2015-16,

Dr Sandeep Kumar, Asst Professor, VIG , Gurugram, Haryana, India

compared with 50.1 in FY 2012-13. There has also been a sharp incremental rise in number of people availing credit, to 31.7 million. This figure includes loans extended by banks and microfinance institutions together in the two years up to FY 2015-16, which is the highest since FY 2012-13. Notably, microfinance institutions contributed significantly to the financially under-penetrated regions. The Digital India initiative, payment banks, and small finance banks have all helped improve the outreach of formal financial services to economically disadvantaged sections of the populace and geographically remote regions.

Objective of the Study

- To review the financial inclusion in the context of financial stability and governance in Indian context.

Review of Literature

Kidanemariam and Daniel (2015) make an assessment of financial inclusion in 26 Asian countries using dynamic panel data analysis and find positive and statistically significant contribution of financial inclusion to the gross domestic product (GDP) per capita. Another study by Odhiambo (2015) finds positive impact of financial deepening on economic growth in Kenya.

The conceptual link between finance and growth were highlighted a century back by two seminal contributions (Bagehot, 1873 and Schumpeter, 1911). The classical economic growth theorists, such as Ricardo (1891), focussed on scarcity of physical factors of production such as land and capital (e.g., machinery), as constraints on economic growth, but not the financial intermediation and financial markets. It was Schumpeter who brought financial intermediaries and innovation in the economic growth narrative. Financial markets play an important role in the growth process by channelling funds to the most efficient sectors and fostering entrepreneurial innovation (Schumpeter, 1911). Even after the works of Schumpeter, several development theorists ignored the role of financial markets. McKinnon (1973) and Shaw (1973) advocated the importance of a successful financial system for economic development and, thus, brought back finance into the development theory discourse. Stiglitz (2010) also noted an important contribution of financial markets to economic growth. Robinson (1952) explains that economic prosperity indirectly leads to financial development in response to the growing demand for funds. Lucas (1988) also does not accept the finance-growth nexus and advocates that finance is an 'over-stressed' determining factor of economic growth. Zingales (2015) argues that the excessive growth of finance in the absence of a proper rule-based framework could degenerate into rent-seeking activity affecting long-term growth adversely.

Binswanger and Khandker (1995) and Eastwood and Kohli (1999) investigate the impact of Indian rural banks' expansion programme and find that the programme has resulted into decline in rural poverty and increase in non-agricultural employment. Burgess, Pande and Wong (2005) in India between the 1970s and the 1990s when banks were required to open four branches in unbanked locations for every new branch opened in an urban area. A study by Ghosh (2011) using data for major states in India from 1973 to 2004, finds a significant impact of financial outreach on economic growth with demographic outreach having a stronger impact than geographical outreach.

Apergis, Filippidis and Economidou (2007), using panel integration techniques for a dynamic heterogeneous panel of 15 OECD and 50 non-OECD countries from 1975 to 2000, find the existence of a long-term equilibrium relationship between financial deepening and economic growth. Ndebbio (2004) examines the role of financial development in the African countries and advocates for improvement in financial development/intermediation by increasing real money balances through elimination of fiscal deficit and removal of hindrances in resource allocation by financial institutions in order to promote growth. Ardic and Domar (2006), based on provincial data of Turkey for the period 1996-2001, evaluate the effects of financial sector outreach on economic growth. Bangake and Eggoh (2009), covering nearly 71 countries consisting of both developed and developing economies, find a positive relationship between financial development and economic growth but the degree of such relationship depends on income level.

History of Financial Inclusion

After the recommendations of the Rangarajan Committee in 2008, FI entered the banking glossary as a policy initiative. It began to attract the attention of stakeholders when banks realized the significance of connecting with more people for business growth. One of the broader objectives of FI is to pull the poor community out of the net of exploitative moneylenders. FI became an integral part of the business domain of banks, with RBI advising all public and private banks to submit a board-approved, three-year FI plan (FIP) starting from April 2010. For the dispensation of credit, Kisan Credit Cards (KCC), General Credit Cards (GCC), and other specific products designed to cater to the financially excluded segments, were introduced. Further, banks were advised to integrate FIPs with their business plans and to include the criteria on FI as a parameter in the performance evaluation metrics of their staff. Among associated developments, RuPay - an Indian domestic debit card - was introduced on 26 March 2012 by the National Payments Corporation of India (NPCI). It has been a game changer in creating better digital infrastructure and enabled faster penetration of debit card culture.

The Committee on Financial inclusion headed by Dr. C. Rangarajan defined financial inclusion 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 definition does not encompass delivery of financial services for all at all cost, however it means that the delivery of financial services and products at affordable costs to the excluded sections of the population and lower income groups.

World Bank (2013), financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs transactions, payments, savings, credit and insurance - delivered in a responsible and sustainable way. The definition is specific to the accessibility attribute where a transaction account is a first step toward broader financial inclusion since it allows people to accumulate money, and send and receive payments also a transaction account serves as a gateway to other financial services. OECD enumerates Financial Inclusion as the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent by mainstream Institutional players. The twin objective of this definition was financial literacy and accessibility to credit thus narrowing down the gap between the demand and supply side. All the reported definitions concentrates on the following three indicators for measuring financial inclusion accessibility of financial services, usage of financial services and cost of availing the financial service however it ignores the aspects of financial literacy which is a vital constituent deterring financial inclusion process.

The Progress of Financial Inclusion

Faster implementation of FIPs is seen after 2010-11. Commercial banks opened new rural branches, increased coverage of villages, set up ATMs and digital kiosks, deployed BCs, opened no-frills accounts, and provided credit through KCCs and GCCs. The introduction of core banking technology and proliferation of alternate delivery channels aided the process of inclusion on a larger scale. The statistics on key banking network give a sense of the pace of progress of banking outreach as part of FI.

Table: 1: Progress of Financial Inclusion

Parameter of financial inclusion	*March 2016*	*March 2017*
Number of Bank branches in villages	51,830	50,860
Number of Business Correspondents (BCs)	531,229	543,472
Number of other forms of banking touch points	3,248	3,761
Total number of banking touch points	586,307	598,093
Number of BSBDA* (in millions)	469	533
Deposits in BSBDA (Amount in Rs. billions)	636	977

Source: Annual Report of RBI, 2016-17

Financial Inclusion: The Tectonic Shift

The biggest change came with the roll out of 'Pradhan Mantri Jan Dhan Yojana(PMJDY)' in August 2014. PMJDY has been designed to ensure accelerated access to various financial services like basic savings bank accounts, affordable, need-based credit, remittances facilities, and insurance and pension for excluded sections. Such deep penetration at affordable cost can only be possible with effective use of technology. Hence, the banking ecosystem operating on core banking mode, and ability of NPCI to scale-up issue of debit cards has enabled effective implementation of PMJDY. As a result, the number of new savings accounts opened by the banking system has been phenomenal under the scheme. The progress since its inception is interesting to observe.

Financial Inclusion: Measurement

It is believed that when banks embarked on the formal journey of FI, hardly 40% of Indian adults had savings accounts, with only a small fraction receiving credit from the banking system. Though there is lack of concrete data on the achievement levels, informal data suggest that about 62% of adult Indians are now covered.

Global Findex

World Bank started capturing data on FI in 2011, once in three years. The latest edition of the Global Findex (GFX), which came out in 2017, shows that 515 million adults worldwide opened an account at a financial institution or through a mobile money provider between 2014 and 2017. This means that 69% of adults globally now have an account, up from 62% in 2014, and 51% in 2011. In high-income economies, 94% of adults have an account; in developing economies the figure is 63%. There is also wide variation in account ownership across countries. India's GFX was 35 in 2011, 53 in 2014, and 80 in 2017. This reflects a speedy improvement in FI, suggesting that relevant Indian policies in the last few years have worked well. GFX 2017 stands at 80 for China (79 in 2014), 76 for Russia, 70 for Brazil, 69 for South Africa, 96 for UK, and 93 for US. Given the constraints of poverty, illiteracy, and lack of spread of banking network, the progress under PMJDY is creditable.

In India the financially excluded sections largely comprise of marginal farmers, urban slum dwellers, migrants, women, self-employed and senior citizens. Barriers to financial inclusion can be categorized as income insecurity, socio economic condition, financial illiteracy and technological infrastructure. Today, there are several technologies such as Immediate Payment Service (IMPS), Unified Payment Interface (UPI) and National Unified USSD Platform (NUUP) can enable digital transactions both online and offline to banks. NPCI, a key stakeholder in the payments industry has played an instrumental role in strengthening the retail payments ecosystem through offerings such as RuPay cards, UPI, as well as the newly launched the BHIM (Bharat Interface for Money) application which allows users to make transactions through UPI on their feature phones however transition from the traditional banking to technology based banking will require a formalized and well-designed financial literacy initiatives at the state level streamlining to the Union government agenda. Reserve Bank of India licensed 11 payment banks, entities mandated to facilitate electronic payments. The licenses were awarded to mobile networks, the national postal service and mobile wallets who were expected to leverage their wide geographical networks. RBI also licensed small finance banks that are required to provide the entire spectrum of banking services to the unbanked sector including small businesses and employees in the unorganized sector.

Conclusion

Lack of effective and broad-based financial and digital literacy is inhibiting full-scale implementation of FI. According to Dr. Kanungo, Deputy Governor, RBI, "This illiteracy transcends across all geographies and regions, not just rural or semi-urban, north or south and is equally true of the staff at the front desks of bank branches. Are we doing enough to educate the public? Should it be the responsibility of the regulator alone? The answer is no. Let us all strive to build consumer awareness consciously and rigorously. An informed customer is a crucial cog in the payment ecosystem". Liew (2008) study explains that geographical isolation on demographic dispersion, limited income generating opportunities, financial literacy and traditional socio economic structures had created formidable challenges for the delivery of financial services in Pacific Island countries, similar is the case for Indian economy. Report by Crisil indicates that the major challenges for financial inclusion were high cost of delivery, lack of financial awareness, lack of robust technology and inadequate and reliable data, it further stated that there is a need for coordination between the stakeholders, greater consumer understanding and trust. Barriers to financial inclusion can be categorized as income insecurity, socio economic condition, financial illiteracy and technological infrastructure.

Financial outreach in India has expanded considerably over the last two decades as evident from the rapid improvement in various banking outreach variables as well as the overall banking outreach index across states. Nonetheless, the overall banking outreach index shows increasing divergence across states. The findings of the study point to large potential to accelerate the pace of growth by enhancing financial outreach across states in India. The role of the government in propelling growth is also important as evident from the coefficient of development expenditure.

References

Community Finance Occasional Paper, Bowen Hills, Queensland, Australia: Foresters Community Finance

Financial inclusion summit (2016) "Analysis and Report by Resurgent India"

Kumar Navin H, Manjunath S.J, Kumar Arun G (2012) "Role of Banks in Achieving Financial Inclusion", VSRD International Journal of Business and Management Research, Vol. 2 No. ISSN No. 2231-248X

Chakrabarty, KC (2011), 'Financial inclusion: A road India needs to travel', Reserve Bank of India, 21 September.

Finney, A. and Kempson, E. (2009), 'Regression analysis of the unbanked using the 2006-07 family resources survey', Personal Finance Research Centre Report, University of Bristol.

IFC Report (2015) "Measures of Financial Inclusion - A Central Bank Perspective", Survey conducted by the Irving Fisher Committee on Central Bank Statistics (IFC)

IMF, "World Economic Outlook Report" (March, 2012), International Monetary Fund, Washington D.C., 2012.

Chibba, Michael (2009), "Financial inclusion, poverty reduction and the Millennium Development Goals", European Journal of Development Research, DOI: 10.1057/ejdr.2008.17, April. Available here. CRISIL (2018), 'CRISIL Inclusix: Financial inclusion surges, driven by Jan-Dhan Yojana', Volume 4.

Kanungo, BP (2018), 'Excellence in Payments', Deputy Governor, Reserve Bank of India, Keynote Address, NPCI (National Payments Council of India) National Payments Excellence Awards function, Mumbai, 29 May.

Mundra, SS (2016), 'Financial Inclusion in India - The Journey so far and the Way Ahead', Deputy Governor, Reserve Bank of India, Speech, BRICS Workshop on Financial Inclusion, Mumbai, 19 September.

Reserve Bank of India (2005), 'Annual Policy Statement for the year 2005-06', by Dr. Y. Venugopal Reddy, Governor, Reserve Bank of India.

RBI (2010) RBI bulletin, RBI, Mumbai

Basic Statistical Return (2015), RBI

World Bank Report (2015) "Financial Inclusion: A Foothold on the Ladder toward Prosperity? An Evaluation of World Bank Group Support for Financial Inclusion for Low-Income Households and Microenterprises".

PWC Report (2017) "Fintech Trends India"

Economic Survey (2015-16)

http://www.finmark.org.za/wp-content/uploads/2016

planningcommission.nic.in/reports/genrep/pov_rep0707.pdf

https://www.ideasforindia.in/topics/money-finance/financial-inclusion-in-india-progress-and-prospects.html / K. Srinivasa Rao, Financial inclusion in India: Progress and prospects, Retrieved on 12, April, 2019

https://www.bloombergquint.com/opinion/indias-bq-financial-inclusion-no-more-a-dream-its-a-reality-now

https://www.ibef.org/industry/financial-services-india.aspx

Bagehot, W. (1873). Lombard Street, 1962 ed. Irwin, Homewood, IL.

Balakrishnan, R., Steinberg, C., and Syed, M. M. H. (2013). The elusive quest for inclusive growth: growth, poverty, and inequality in Asia (No. 13-152). International Monetary Fund.

Blackburn, K., Bose, N. and Capasso, S. (2005). Financial development, financing choice and economic growth. Review of Development Economics, 9(2):135-149.