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Financial Inclusion In India Status, Determinants & Roadmap

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Abstract

Financial inclusion, as the name suggests, is a process ensuring access to financial services to the weaker sections of the society at affordable cost. It is very important in a country like India where millions of people at the grass roots level suffer from poverty, hunger and illiteracy. Agriculture is the main source of income for most of the people living in rural areas. But of late, agriculture has become un-remunerative. Given a chance, many farmers are ready to quit agriculture. It is believed that financial inclusion would improve the socio-economic living of the common masses by offering them access to banking, skill/ education and scope for taking up economic activities. Based on the available information, the paper tried to establish a relationship between financial inclusion and a set of independent variables.

Financial inclusion is a process ensuring access to financial services such as savings, loans, insurance, payments and remittance facilities to the underprivileged segments of population at affordable cost. It assumes greater importance as our country continues to suffer from the problem of poverty, unemployment and insignificant progress in various socio-economic indicators. As the financial inclusion programme offers financial services such as savings, credit, remittance and insurance to low-income people at an affordable cost, it is vital for inclusive growth. Keeping this in view, an attempt has been made in this paper to understand the status of financial inclusion in India, initiatives taken by different agencies and key determinants of financial inclusion. Finally, based on the outcomes, a set of policy suggestions have been offered to improve the situation.

Indian economy – an overview

According to the Census 2011, 68.9 per cent of the total 1210.2 million population live in rural areas and more than half of the population depend on agriculture for their livelihood. The Gross Domestic Product (GDP) of the country is found to be unstable. For instance, the growth rate of GDP of the country remained around 9 per cent between 2005-06 and 2010-11 and thereafter, it declined. The major factors influencing on the GDP are global market instability and unstable domestic production base. Of late, agriculture has become non-remunerative for millions of farmer households. It is unfortunate that the share of agriculture including forestry and fishing declined from 19.5 per cent in 2005-06 to 13.7 per cent in 2012-13. A modest growth in GDP has been observed in the share of services sector from 54.1 per cent in 2005-06 to 59.3 per cent in 2012-13. However, the share of industry in the overall GDP remained around 27 per cent during the period between 2005-06 and 2012-13. Figure 1 presents the growth in sector-wise growth in GDP from 2005-06 to 2012-13.

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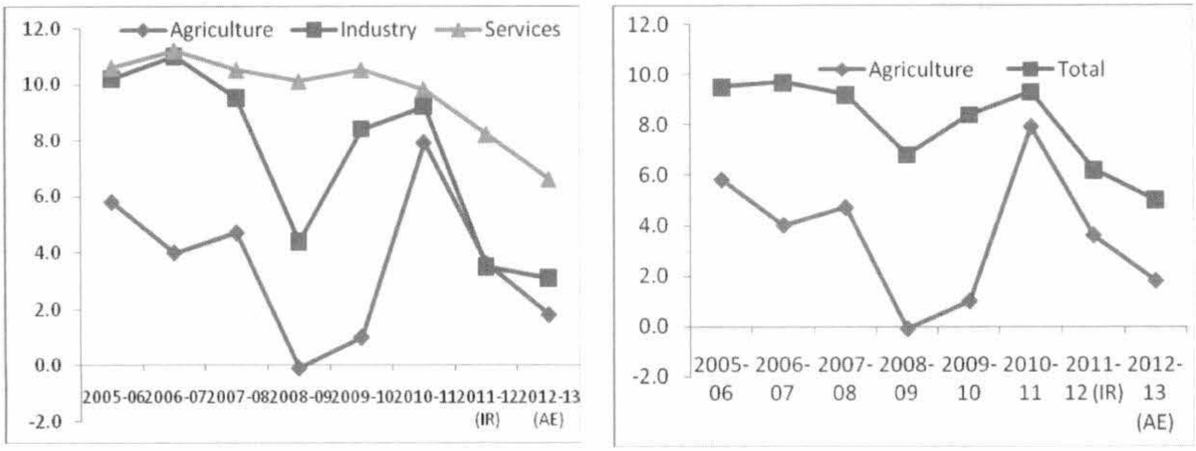
Figure 1: Sector-wise growth in GDP from 2005-06 to 2012-13

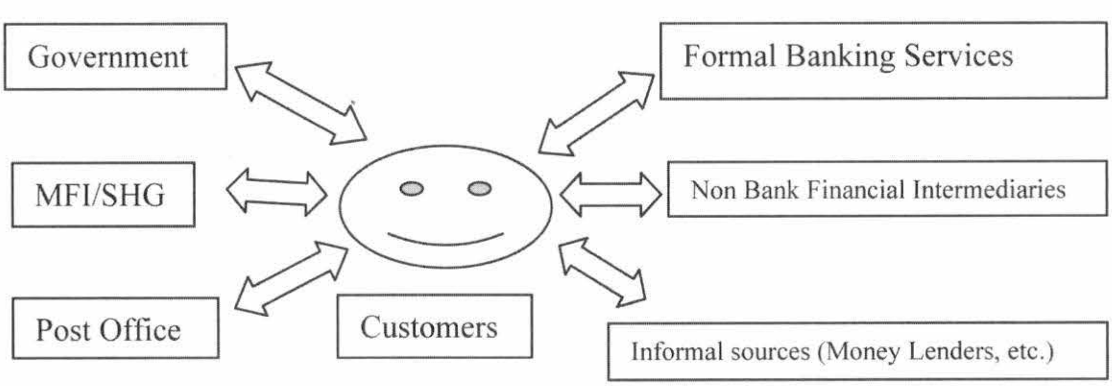


Source: Estimated based on the information available in Monthly Economic Report, Ministry of Finance, Government of India, Various Issues

Growth of financial sector in India

Until 1969, the commercial banks were largely urban-centric catering to the needs of trade and industry. Nationalisation of commercial banks in 1969, interventions by the Government and the Reserve Bank of India for regulating and controlling the functions of commercial banks during 70s and 80s and introduction of financial reforms and prudential norms, i.e., income recognition, asset classification and provisioning norms, during the 1990s became instrumental in putting increased thrust on efficiency and viability of the banks through rationalization and consolidation. As a result, many rural branches of commercial banks were either relocated or closed. The primary sources of formal credit are commercial banks, Regional Rural Banks and cooperative banks. Money lenders, relatives and others constitute the sources of informal sources. Figure 2 shows the various financial sources available to common customers.

Figure 2: Financial Sources & Services to Customers



Flow of Institutional Credit to Agriculture Sector

Table 1 presents the details of year-wise and agency-wise flow of agricultural credit for the last five years. At the same time, an attempt has been taken to estimate per hectare credit flow in different years. The Gross Sown Area for 2010-11 and 2011-12 are assumed to be the same as that in the year 2009-10. It is evident from the table that the flow of institutional credit in favour of agriculture increased from Rs.2,54,658 crore in 2007-08 to Rs.5,11,029 crore in 2011-12 at an annual rate of 20.1 per cent. However, during the same period, the Gross Sown Area declined at an annual rate of 0.5 per cent. Therefore, per hectare agricultural credit increased at an annual rate of 20.7 per cent from Rs.13,050 in 2007-08 to Rs.26,588. It is disheartening to observe that the share of cooperative banks in the total institutional credit flow has declined from 19 per cent in 2007-08 to 17.2 per cent in 2011-12.

Table 1: Year-wise and Agency-wise Flow of Institutional Credit to Agriculture and the Gross Sown Area

(Rs.Crore)

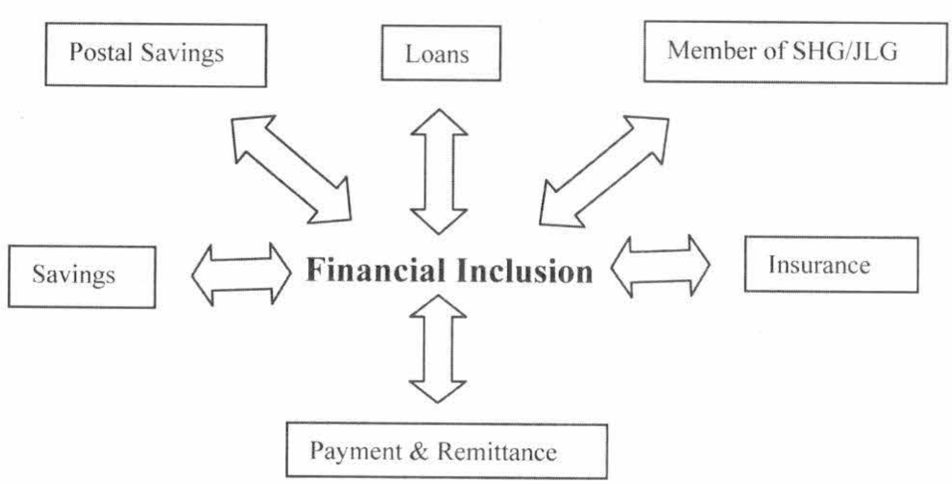
Year	Flow of Institutional Credit				Gross sown area & Per Hectare credit flow	
	Commercial Banks	Regional Rural Banks	Cooperative Banks	Total	Sown Area (Million Ha)	Credit/Ha (Rs.)
2007-08	181088	25312	48258	254658	195.14	13050
2008-09	228951	26765	46192	301908	195.36	15454
2009-10	285800	35217	63497	384514	192.2	20006
2010-11	345877	44293	78121	468291	192.2	24365
2011-12 (P)	368616	54450	87963	511029	192.2	26588
CAGR-%	20.1	22.6	18.8	20.1	-0.5	20.7

Source: Agricultural Statistics At A Glance 2012, Table 14.9, Page 293, Government of India

Status of Financial Inclusion

Financial inclusion is a mechanism/process of ensuring access to credit and financial services to the disadvantages and other weaker sections of the society at an affordable cost. Therefore, the process of financial inclusion is complete when the consumers at the grass roots level access and use financial services at affordable cost and to their needs. In Indian context, financial inclusion implies the provision of affordable financial services, i.e., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who need it. Financial inclusion is a two-step procedure: (i) opening of the financial services, and (ii) use of these services by the customers. Thus, the basic objectives of financial inclusion are to help disadvantaged sections of the society to open No Frill Accounts or Savings Bank Account and to avail bank credit. The entire gamut of financial inclusion/services may be explained as shown in Figure 3.

Figure 3: Products of various Financial Services



Banking outreach

As on 31 March 2012, there were 97,111 branches of the Scheduled Commercial Banks and out of the total, 63.1 per cent (61,289 numbers) of the branches were located in rural and semi-urban areas. The number of new bank branches opened in 2011-12 at 6,491 was 22.6 per cent higher than that in 2010-11. Similarly, the number of ATMs deployed during 2011-12 at 95,686 was found to be 28.4 per cent higher than that in 2010-11. According to Census 2011, only 58.7 per cent households are availing banking services in the country and a large number of the households, especially in rural areas, are still outside the formal fold of the banking system.

The position of households availing banking services can be known from Table 1. According to Census 2001, about one-third of the total population was getting the banking services. But according to Census 2011, it increased to 58.7 per cent. In absolute term, the total number of people left out from the process of financial inclusion was 101.91 million. That means, 41.31 per cent of the total 246.69 million households do not get banking services in the country.

Table 2 : Area-wise position of households availing banking services in the country

Area	As per Census 2001			As per Census 2011		
	Total HHs	HHs availing banking services	Per cent	Total HHs	HHs availing banking services	Per cent
Rural	138.27	41.64	30.11	167.83	91.34	54.42
Urban	53.69	26.59	49.53	78.86	53.44	67.77
Total	191.96	68.23	35.54	246.69	144.78	58.69

Source: Ministry of Finance, Government of India: Note on Financial Inclusion, Visited the site on 13.06.2013

Initiatives under Financial Inclusion

To extend the reach of banking to those outside the formal banking system, Government and Reserve Bank of India are taking various initiatives from time to time. Some of such initiatives are as follows:

Opening bank branches

There has been a significant growth in the number of bank branches in the country. While the overall annual growth rate in the number of bank branches was 6.07 per cent from 72,242 in the year 2007 to 97,111 in the year 2012, they were 3.3 per cent in rural areas, 8.98 per cent in semi-urban areas, 7.41 per cent in urban areas and 6.9 per cent in metropolitans. Understanding the importance of credit access by the people, the Government of India and the Reserve Bank of India have taken certain steps to increase the number of ATMs under technology drive, appointment of Business Correspondents, No-Frill accounts, Self Help Groups and Kisan Credit Cards. For instance, the number of ATMs installed by the scheduled commercial banks increased from 27,088 in 2007 to 95,686 in 2012 at an annual rate of 29.01 per cent.

New bank branches

The initiatives of the Government of India and the Reserve Bank of India paved the way for opening a number of new bank branches. It is interesting to observe that while the number of new bank branches in rural areas and semi-urban areas increased at an annual rate of 39.85 per cent and 20.71 per cent from 2008 to 2012, they were negative at 4.45 per cent and 0.92 per cent for urban areas and metropolitans. Table 3 presents year-wise new bank branches of scheduled commercial banks in India.

Table 3 : Details of the number of new bank branches Opened during the last five years

(Number at the end of March)

Year	Rural	Semi-Urban	Urban	Metro	Total
2008	521	1255	1240	954	3970
2009	690	1295	1022	937	3944
2010	971	1704	1394	1099	5168
2011	1275	2185	885	951	5296
2012	2050	2476	1061	904	6491
CAGR-%	39.85	20.71	-4.45	-0.92	13.63

Where, CAGR = Compound Annual Growth Rate

Source: Handbook of Statistics for Indian Economy (Table 66), Reserve Bank of India, 2012

Financial Inclusion Programme (FIP)

All public and private sector banks were advised to draw a three-year Financial Inclusion Plan (FIP) starting from April 2010. The banks were also advised to allocate at least 25% of the total number of branches to be opened during a year in rural centres where there are no banks. Further, they were asked to draw up a road map under the Swabhiman Scheme of financial inclusion to provide banking services in every village, not having a bank, with a population of over 2,000 by March 2012 either through brick and mortar branches or through Banking Correspondents.

Table 4 presents the details of the progress made on Financial Inclusion Programme. It is evident from the table that as on 31 March 2011, out of the total 72,721 villages allotted to Public Sector Banks, the achievement was only 36.62 per cent. In other words, a total of 46,087 villages constituting 63.37 per cent of the total villages remained unattended. Further, 19,820 Business Correspondents were appointed and a total of 90.49 lakh FI accounts were opened as on 31 March 2011. In contrast to this, as on 31 March 2012, 74,194 out of the total allotted 74,398 villages were covered under the programme. Further, 62,468 Business Correspondents were appointed and a total of 316.37 lakh FI accounts were opened.

Table 4 : State-wise progress on achievement of Financial Inclusion Programme

	31.03.2012	31.03.2011	% Change
Total villages covered	74398	72721	2.31
Achievement*	74194	26634	178.57
No of BC agents appointed	62468	19820	215.18
No of FI a/c opened	31637553	9049544	249.60

Source: Ministry of Finance, Government of India:
Note on Financial Inclusion, Visited the site on 13.06.2013

Business Correspondent Model

In 2006, the RBI permitted banks to use the services of intermediaries in providing financial and banking services through the use of Business Facilitators and Business Correspondents. The BCs and BC Agents represent the bank and enable the bank to expand its outreach and offer select banking services at low cost. The introduction of this model is an integral part of the business strategy for achieving greater financial inclusion. According to the Ministry of Finance, Government of India, as on 31 March 2012, the progress of the appointment of BCs as on 31 March 2012 was 62,468, which was 215.18 per cent higher than that on 31 March 2011. The banks are permitted to engage individuals and entities as BC like retired bank employees, teachers and Government employees, ex-servicemen, individual owners of kirana/ medical/fair price shops, individual Public Call

Office (PCO) operators, etc. Since September 2010, banks are permitted to engage 'for profit' companies registered under the Indian Companies Act, 1956, excluding Non Banking Financial Companies (NBFCs), as BC in addition to the individuals/entities permitted earlier.

Setting up Ultra Small Branches (USB)

Of late, steps have been taken for close supervision and mentoring of the BCA by the respective banks and to ensure that a range of banking services are available at the close door, Ultra Small Branches are being set up in all villages covered through BCAs under Financial Inclusion. The special feature of USB is that it is comprised of a small area where the designated officer/agent will be available on pre-determined days. By December 2012, a total of over 43,000 USBs have been set up in the country.

Banking Facilities in Unbanked Blocks

In July 2009, all the 129 unbanked blocks were identified and they were provided banking facilities either through Brick and Mortar Branch or Business Correspondents or Mobile Van.

No-Frill accounts

The RBI gave this facility to banks in November 2006. Under this programme, the account holders may not maintain any balance. Under the Financial Inclusion Drive, the number of No Frill Account increased manifold. Similarly, for easy credit facility, in January 2006, RBI asked banks to introduce General purpose Credit Card (GCC) facility, under which, the card holders get a credit facility up to Rs.25,000 at their rural and semi-urban branches. The limit for the purpose can be set based on assessment of household cash flows.

SHG-Bank Linkage (SHG-BL) Programme

The Self Help Group and Bank Linkage Programme found to be a necessary mechanism for reducing poverty, increasing the pace of financial inclusion and achieving rural prosperity, skill updation and wider knowledge dissemination. This programme can be made more useful for influencing farmers for effective commercialization and taking up market-driven agricultural production. In this connection, the initiatives of NABARD in formation and nurturing SHGs, Self Help Promoter Institutes, Farmers' Clubs, and Joint Liability Groups will go a long way for effective financial inclusion. Similarly, under the Kisan Credit Card (KCC) Scheme, the financial agencies have issued 11.76 million cards and sanction credit of an amount of Rs.9,168 crore as at the end of March 2012.

Determinants of Financial Inclusion

An attempt has been made to identify the causal factors influencing financial inclusion by using secondary data from different sources such as National Sample Survey Organisation (NSSO), Centre for Monitoring Indian Economy (CMIE), Economic Survey, Census Report and Various reports published by Reserve Bank of India (RBI) and National Bank for Agriculture and Rural Development (NABARD). Although opening savings bank account, no-frill account, Kisan Credit Card, etc., is the first step in the process of financial inclusion, access to credit is its key ingredient. In the absence of relevant information on the range of services offered, in the present case, financial inclusion has been studied from two angles, i.e., credit widening and credit deepening. While credit widening is defined as the increase in number of credit accounts in the name of low income people, credit deepening is defined as the increase in the volume of credit of the low income people. For estimating the determinants of financial inclusion, 20 major states in the country are considered and the data used for the analysis pertains to rural areas only. The reference year of the study is 2004-05. When 'credit widening' aspect of financial inclusion is studied, the number of credit accounts has been taken as the dependent variable and when 'credit deepening' aspect of financial inclusion is studied, the amount of credit has been taken as the dependent variable.

In this way two sets of regression equations of the form $Y = = \alpha + \beta 1\ X1 + \beta 2\ X2 + \beta 3\ X3 + \beta 4\ X4 + \beta 4\ X5 + u$ was used. While Yw refers to the number of credit accounts of scheduled commercial banks for every 100 households (Dependent variable 1), Yd refers to the amount of credit outstanding (Rs. Thousand) of scheduled commercial banks for every 100 households (Dependent variable 2).

To understand the influence of various factors over financial inclusion, the following six independent variables were considered:

- → X1 = Irrigated area to Gross Sown Area (Per cent)
- → X2 = Persons employed to total population (Per cent)
- → X3 = Persons above secondary level education to total population (Per cent)
- → X4 = No of SHGs for every 100 persons (Number)
- → X5 = No of scheduled commercial bank offices for every 100 persons (Number)
- → X6 = Savings deposit with scheduled commercial banks for every 100 persons (Rs. lakh)

The word 'Population' used in the analysis means 'population of age between 15 & 59 years of age'. One of the limitations of this exercise is that it is restricted to scheduled commercial banks only.

Results & Discussion

Table 5 presents the results of the regression analysis. It is evident from the table that out of the five selected variables, three variables, i.e., Irrigated area (X1), Higher education (X3) , Membership of SHG-Bank Linkage programme (X4) and No of bank branches (X5), have significant influence on financial inclusion. Among the selected variables, 'number of bank branches, followed by higher education has the dominant influence on the size of financial inclusion. Collectively, these five variables explain 71 per cent of the variation in the size of financial inclusion. F test is found to be significant at 1% level, which suggests that there exists a strong association between the size of financial inclusion and the selected set of independent variables.

Table 5 : Results of Regression Analysis

Variables	Credit widening (Yw)		Credit deepening (Yd)	
	Coefficients	Std. Error	Coefficients	Std. Error
Intercept	2.31	--	(-) 4.66	--
X1	0.029*	0.010	0.03***	0.01
X2	(-) 0.021	0.048	0.07	0.07
X3	(-) 0.026	0.048	0.14**	0.07
X4	7.326*	0.722	0.07	0.98
X5	0.23*	0.068	0.18***	0.09
R2	0.92	0.71		
F value	Fc (34.22) > Ft (4.69) at 1% level	Fc (7.002) > Ft (4.69) at 1% level		

Significance level:: * at 1%, ** at 5% and *** at 10%

The analysis revealed the following:

- Irrigation facility decides cropping pattern and crop productivity and it is taken as the proxy for real sector. It is also assumed that real sector influences financial inclusion. Therefore, irrigated area (X1) has been taken as a variable determining financial inclusion. The empirical exercise also confirmed that irrigation has a significant positive influence on financial inclusion. Therefore, it needs to be recognized that growth in real sector is a necessary condition for successful and sustainable growth of financial inclusion.
- Self Help Group- Bank Linkage programme has shown that by merging the strengths of formal and informal systems, cost effective mechanisms for serving even small clients can be built. Therefore, SHG-BL programme, where the members take up effective economic activities, can improve the pace of financial inclusion.
- Education is found to be an important factor influencing financial inclusion. The majoir sub-elements under education are awareness creation, skill updation & capacity building exercise and financial literacy. It is

believed that education empowers the poor by improving their socio-economic living.

- When the number of bank branches increases, the number of households under financial inclusion increases and vice versa.

Challenges & Roadmap

There has been a long history of concern regarding financial exclusion. The increase in share of institutional credit has been rather slow. The dependence of small and marginal farmers is still very high on non-institutional sources. Lack of awareness, low income/assets and small-sized loan demand in the demand side and distance from the bank branch, branch timings, cumbersome documentation and procedures, unsuitable products, language and staff attitude in the supply side are the major constraints faced by the formal banking system in extending rural credit. Further, large number of villages (more than half a million villages), lack of infrastructure, vast geographical spread, high transaction costs and poor recovery are some other problems faced by banks. In the absence of any alternative, the poor and other weaker sections of the rural society depend on unorganized financial system, which utilizes local knowledge, offers credit for a wide variety of purposes and operates quite flexibly, though at a high cost. Due to increased expenditure on seed, irrigation, fertilizer and borrowed money, the cost of cultivation is increasing, but crop yield and so the net income does not commensurate with the increased expenditure. As a result, the farmer thinks of an alternate occupation. The 59th round survey of the National Sample Survey Organisation (NSSO) has also reported that 40 per cent of the farmers wished to quiet farming, while 27 per cent considered it unprofitable, 8 per cent deemed it too risky. The other challenges that need careful attention are the following:

- Expanding financial inclusion and promoting economic growth;
- Integrating technology with bank operation to build up a reliable credit information system and database on customers
- Reducing transaction cost, facilitate better pricing of risk and thereby increase the access of un-banked rural people
- Ensuring easy flow of public information to rural citizens
- Developing financial products and services that are adapted to the needs of the majority of people at affordable prices
- Taking steps to reduce cost of funds, transaction costs and the risk costs
- Involving informal agencies such as Micro Finance Institutions (MFI), Non Governmental Organisations (NGO) and Self-Help Groups (SHG) for increasing the banking outreach

The roadmap for effective financial inclusion is as under:

- Strengthen the rural financial system by integrating both formal and informal systems to benefit the weaker sections of the society
- Update the skill of the SHG/JLG members, encourage them to take up economic activities and link them to the market
- Encourage SHG/JLG members to add value to their produce before marketing
- Create wide public awareness on the importance of financial inclusion
- Strategise the provision of bank credit to the rural households

Empirical evidence shows that economic growth follows financial inclusion and economic growth depends on equity, which in turn depends upon rural infrastructure, both physical and social. Therefore, for meaningful financial inclusion, rural infrastructure in agriculture, connectivity, banking and social networking need to be improved.