

Financial Inclusion in India: Challenges and Opportunities

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Abstract— An all- inclusive financial system is essential because it enhances efficiency and welfare by providing scope for secure and safe saving practices and by facilitating a wide range of efficient financial services. A robust and strong financial system is an essential pillar of sustainable development, economic growth, and progress of an economy because it helps in meeting national objectives of creating a market-driven, productive, and competitive economy. Inclusive growth of an economy is possible only with the help of proper mechanism which channelizes all the resources from top to bottom. The present study will focus on the challenges and opportunities of financial inclusion in India.

Index Terms— Efficiency, banking habits, rural areas, financial inclusion

INTRODUCTION

The concept of financial inclusion, extending financial services to those who typically lack access, has been a goal for the Government of India since the 1950s. The nationalization of banks, which occurred from the mid-1950s to the late 1960s, culminating in 1969 with the nationalization of 14 commercial banks by Prime Minister Indira Gandhi, brought banking facilities to previously unreachable areas of the country. The “branching” of banks into rural areas increased lending for agriculture and other unserved rural populations and Indira Gandhi spoke of it as a tactic to “accelerate development” and to address poverty and unemployment. The Lead Bank Scheme followed nationalization as a way to coordinate banks and credit institutions by districts to more comprehensively ensure that rural areas had their credit needs met. In 1975, the Government of India followed this with efforts to specifically reach rural areas by establishing Regional Rural Banks (RRBs) meant to exclusively meet demand in the rural economy and the number of RRBs has significantly increased over the years.

By the early 2000's, the term 'financial inclusion' was being used in the Indian context. In 2004 the Khan Commission, created by the Reserve Bank of India (RBI), investigated the state of financial inclusion in India and laid out a series of recommendations. In response, RBI Governor Y. Venugopal Reddy, expressed concern regarding the exclusion of millions from the formal financial system and urged banks to better align their existing practices with the objective of financial inclusion in both his annual and midterm policy statements. The RBI has continued in its efforts in conjunction with the Government of India to develop banking products, craft new regulations, and advocate for financial inclusion.

Since financial inclusion was established as a priority for the GOI and RBI, progress has been made. Mangalam, Puducherry became the first village in India where all households were provided banking facilities. States or union territories such as Puducherry, Himachal Pradesh and Kerala announced 100% financial inclusion in all their districts. The Indian Reserve Bank vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on IT. However, illiteracy, low income savings, and lack of bank branches in rural areas remain a roadblock to financial inclusion in many states, and there is inadequate legal and financial structure.

OBJECTIVES OF THE STUDY

The present study will focus on the challenges faced and opportunities presented by financial Inclusion in India and also on various steps taken by Reserve bank of India to facilitate financial inclusion.

RESEARCH METHODOLOGY

The study is mainly descriptive in nature. The data is mainly collected from secondary sources like magazines, internet websites, journals etc. Various studies on this subject have also been referred in this study.

LITERATURE REVIEW

Michael Chibba (2009), “Financial Inclusion is an inclusive development and poverty reduction strategy that manifests itself as part of the emerging FI-PR-MDG nexus. However, given the current global crises, the need to scale-up Financial Inclusion is now perhaps more important as a complementary and incremental approach to work towards meeting the MDGs than at any other time in recent history”.

Raghuram G. Rajan (2009), “A Hundred Small Steps -Report of the Committee on Financial Sector Reforms” Financial Inclusion, broadly defined, refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products, but also other financial services such as insurance and equity products.

RBI, 2006a, “Financial inclusion has been defined as the “provision of affordable financial services” to those who have been left unattended or under-attended by formal agencies of the financial system. These financial services include “payments and remittance facilities, savings, loan and insurance services”

Mandira Sharma and Jesim Paise (2008) suggest that the issue of financial inclusion is a development policy priority in many countries. Using the index of financial inclusion developed in levels of human development and financial inclusion in a country move closely with each other, although a few exceptions exist. Among socioeconomic factors, as expected, income is positively associated with the level of financial inclusion. Further physical and electronic connectivity and information availability, indicated by the road network, telephone and internet usage, also play a positive role in enhancing financial inclusion.

Oya Pinar Ardic et al (2011) explained that using the financial access database by CGAP and the World Bank group, this paper counts the number of unbanked adults around the world, analyses the state of access to deposit and loan services as well as the extent of retail networks, and discusses the state of financial inclusion mandates around the world. The findings indicate that there is yet much to be done in the financial inclusion

arena. Fifty-six percent of adults in the world do not have access to formal financial services.

RBI POLICY INITIATIVES AND PROGRESS IN FINANCIAL INCLUSION

RBI has adopted a bank-led model for achieving financial inclusion and removed all regulatory bottle necks in achieving greater financial inclusion in the country. Further, for achieving the targeted goals, RBI has created conducive regulatory environment and provided institutional support for banks in accelerating their financial inclusion efforts.

FINANCIAL INCLUSION INITIATIVES

Advised all banks to open Basic Saving Bank Deposit (BSBD) accounts with minimum common facilities such as no minimum balance, deposit and withdrawal of cash at bank branch and ATMs, receipt/ credit of money through electronic payment channels, facility of providing ATM card.

Relaxed and simplified KYC norms to facilitate easy opening of bank accounts, especially for small accounts with balances not exceeding Rs. 50,000 and aggregate credits in the accounts not exceeding Rs. one lakh a year. Further, banks are advised not to insist on introduction for opening bank accounts of customers. In addition, banks are allowed to use Aadhar Card as a proof of both identity and address⁹. Simplified Branch Authorization Policy, to address the issue of uneven spread bank branches, domestic SCBs are permitted to freely open branches in Tier 2 to Tier 6 centres with population of less than 1 lakh under general permission, subject to reporting. In North-Eastern States and Sikkim domestic SCBs can open branches without having any permission from RBI. With the objective of further liberalizing, general permission to domestic scheduled commercial banks (other than RRBs) for opening branches in Tier 1 centres, subject to certain conditions.

Compulsory Requirement of Opening Branches in Un-banked Villages, banks are directed to allocate at least 25% of the total number of branches to be opened during the year in un-banked (Tier 5 and Tier 6) rural centres.

Opening of intermediate brick and mortar structure, for effective cash management, documentation, redressal of customer grievances and close supervision

of BC operations, banks have been advised to open intermediate structures between the present base branch and BC locations. This branch could be in the form of a low-cost simple brick and mortar structure consisting of minimum infrastructure such core banking solution terminal linked to a passbook printer and a safe for cash retention for operating larger customer transactions.

Public and private sector banks had been advised to submit board approved three-year Financial Inclusion Plan (FIP) starting from April 2010. These policies aim at keeping self-set targets in respect of rural brick and mortar branches opened, BCs employed, coverage of un-banked villages with population above 2000 and as well as below 2000, BSBD accounts opened, KCCs, GCCs issued and others. RBI has been monitoring these plans on a monthly basis.

Banks have been advised that their FIPs should be disaggregated and percolated down up to the branch level. This would ensure the involvement of all stakeholders in the financial inclusion efforts.

In June 2012, revised guidelines on Financial Literacy Centres (FLCs). Accordingly, it was advised that FLCs and all the rural branches of scheduled commercial banks should scale up financial literacy efforts through conduct of outdoor Financial Literacy Camps at least once a month, to facilitate financial inclusion through provision of two essentials i.e. 'Financial Literacy' and easy 'Financial Access'. Accordingly, 718 FLCs have been set up as at end of March 2013. A total of 2.2 million people has been educated through awareness camps, seminars and lectures during April 2012 to March 2013.

OPPORTUNITIES

- Financial inclusion provides a unique opportunity to construct a sustainable financial system. The opportunities for the government as well the financial service providers are plenty. It accelerates growth in the real sector and triggers overall economic development.
- To begin with, the micro-insurance could be an important mechanism for mitigating risk. If the regulators are able to induce trust regarding the product and reduce liquidity constraints, this could help the rural population to ease their vulnerability to risk. The micro-finance institutions and self-help group movements

improved credit availability in rural areas. As a result, there is an increase in agricultural productivity and other rural activities that generate income. The increase in income leads to higher consumption, higher saving, and higher investment. The poverty levels are declining and are bound to decline further if this trend continues. The reduced poverty level will accelerate the rate of integration with the formal banking system. Access to finance will further attract global market players thereby increasing business and employment opportunities.

- The introduction of remittance corridors for the migrant population is an enormous opportunity for the migrants from rural areas, to exercise easy and cheap remittance facilities. As of now, migrants are not adequately covered and are facing difficulties in opening bank accounts. Further, it opens an opportunity for the unbanked/underserved community to raise their levels of financial literacy and bring about a greater awareness about their rights. Financial inclusion in a holistic sense provides not only safe savings but also offer many other allied services like insurance cover, entrepreneurial loans, payments, and settlement facilities etc.
- There are plenty of opportunities for financial institutions as well. Though the Indian banking credit relished a significant growth since 2003, credit penetration is still below global benchmark. By aiding the inclusive growth process, banks and other financial institutions have greater scope to widen their customer base and improve their performance. A large resource base can help reduce the transaction cost, thereby improving the overall efficiency of the system. Further, with the help of simpler KYC norms and UID, banking process can become easier, which will then help to reduce the cash and non-cash costs. Banks and other financial institutions can achieve low-cost solutions also by partnering with non-industry organizations and NGOs to perform certain functions. Given their deeper understanding of the local communities, the risk of default can be reduced by integrating with them.
- Banks need to introduce low-cost, customer-oriented innovative products to turn the process of financial inclusion to the next big business

opportunity. It is an opportunity for private sector banks to expand their base to the rural areas. A strategic expansion in technology can be of advantage as it enables easier and accurate banking process. For instance, mobile money reduces households' transaction costs and improves their ability to share risk [4]. In rural India, there were 323.27 million mobile subscribers as of March 2012 [5]. To explore such opportunities, RBI has constituted a committee headed by B. Sambamurthy to explore the options including the feasibility of using encrypted SMS-based funds transfer.

- The combination of IT and IT-enabled services have emerged as a sustainable solution for greater financial inclusion. This will minimize the need for setting up physical branches at all locations. It allows the servicing banks to improve efficiency and provides for use of multiple channels to work together as an integrated system. Banks have to make effective use of information and communication technology (ICT) to provide doorstep delivery of financial services. Enabling more technologically trained banking correspondents for doorstep banking in rural areas will enhance the confidence of consumers and make the process convenient. An improved version of the BC the model will definitely help as the older model has a success story to tell (Figure 1). Banking on the reliability and efficiency of trained business correspondents, the number of BC's employed by the banks nationwide has increased 78 percent in just three years (2010 through 2013).
- It is wise to tie up with telecommunication companies to deliver financial, health and other development services as the technology has the potential to address the issues of outreach and credit delivery in rural areas. Financial inclusion provides opportunities to the banking sector to cut across various layers of people, regions, gender, and income and encourage the public to inculcate banking habit.
- Thus, financial inclusion offers plenty of opportunities for growth and development in India.

CHALLENGES

The main hurdles for policymakers to achieve a higher rate of financial inclusion include:

1. The Need to Improve Financial Literacy

Based on studies on remittance services among migrants and surveys conducted by the World Bank Group in Morocco and Mozambique, it has been found that the lack of awareness among the study group prevented them from utilizing the right products and services that suited their particular needs. By improving the financial literacy rate among these individuals, this will lead to better financial decisions and the selection of the right products that best suits the needs of these individuals. It will also lead to knowing how to better utilize the various channels that are available for their banking needs. In other words, more effective and lower cost measures can be utilized to improve the uptake of new bank accounts which will ultimately result in increased savings.

2. Lack of Formal Identification Documents

One of the key factors which prevent the unbanked from getting access to basic banking services is the lack of formal identification documents. In most countries, a proper ID is required before an individual can open a bank account. IDs are also needed for claiming social benefits and the transfers of funds. Hence in order to improve access to banking services for the unbanked, authorities need to simplify and streamline the process for obtaining a formal ID card.

3. Consumer Protection

Although there has been a proliferation of financial services such as mobile money and virtual currencies designed to expand financial inclusion, there is a lack of trust among consumers as to the security and reliability of these newly established platforms. In order to promote confidence in these new methods of payment services, authorities must release clear guidelines and regulations that will ensure that the consumers are adequately protected and have access to key product information to allow them make informed decisions.

4. The Rural Poor and Gender Inequality

According the latest data from Findex, approximately 1.1 billion of the 2 billion unbanked individuals around the world are women. In developing countries, the rural poor and women in general face unique obstacles when trying to access financial services.

Based on research conducted by the World Bank, even though women form a larger share of the self-employed category in developing countries, they have a lower chance of securing credit from banks. IFC research has shown that this is largely due to a lack of collateral or poor credit history which leads to more women being denied credit by the financial institutions.

Even if these women were able to secure formal credit from the banks, they often have to pay higher interest rates than the men. In order to expand financial inclusion among the rural poor and women, stakeholders must come up with ways which will remove the impediments that these two demographics face in trying to gain access to financial services. These efforts can include providing this target group with an ID which they can use to open a saving account to build up a credit history from an early age. Other measures can include more investment into financial awareness programs to help reinforce the ability of the women and the rural poor to make better-informed financial decisions.

5. Promoting the Use of the Transaction Account

Most initiatives by policymakers have been targeted to increase the uptake of new bank accounts among the unbanked. However, it should be remembered that opening an account is just the first step rather than the ultimate objective. It has been noted that of the 355 million adults in developing countries that reported having a bank account, still resort to remitting money by cash or over the counter. For a bank account to be relevant in these people lives, it must be useful and function as a gateway to other financial services which can improve their overall economic welfare.

FINDINGS AND RECOMMENDATION

1. With the help of financial inclusion, banking technology has progressed at a faster rate and realized that even poor sector can contribute towards a pool of financial resources.
2. Due to the RBI's concerted efforts since 2005, the number of branches of Scheduled Commercial Banks increased manifold from 68,681 in March 2006 to 1, 02,343 in March 2013, spread across the length and breadth of the country.
3. In rural areas, the number of branches increased from 30,572 to 37,953 during March 2006 to

March 2013. As compared with rural areas, number of branches in semi-urban areas increased more rapidly.

4. Poor people usually avoid going to banks because of complicated forms, procedures, formalities etc. This simple structures and procedures will lead to higher savings in the banks.
5. In rural areas, ATM Network accounted for only 10.1% of total ATMs network in the country as on March 31, 2013. So, banks should enhance their ATM network among the rural and un-banked areas so as to serve poor villagers. But while doing so, proper care should be taken regarding safety and security issues.
6. Migrants are facing many difficulties in opening their bank accounts. So commercial banks should take care of the needs of the migrant population in their financial inclusion plans.
7. To deal with poor villagers, banks should initiates training programmes to train the frontline staff and managers as well as BCs on the human side of banking.
8. In rural areas, post offices (POs) are closest to the rural population as compared to bank branches. As on March 31, 2011, there are 1, 54,866 post offices in India, of which 1, 39,040 (89.8%) were in rural areas. Thus, more POs should be engaged to become BCs of banks due to well-known advantages.

CONCLUSION

The concept of financial inclusion has gained substantial importance in the Indian context. Financial Inclusion can be defined as the wide range of financial products and services to which everybody can have an access which allows them to efficiently manage their finances, regardless of their level of income or social status. For achieving the financial inclusion people need to have a minimum and, some basic financial literacy, financial skills, product knowledge and understanding. Bank nationalization was the first step towards financial inclusion in India. Regional rural banks are created to take the banking and financial services to the rural people.

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