FINANCIAL INCLUSION IN INDIA –
THE WAY FORWARD

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ABSTRACT

The Government and the Reserve Bank have taken several initiatives to bring the underprivileged and weaker sections of the society within the banking fold, which have had a favourable impact. However, the magnitude of the problem is enormous and still a sizeable portion of the rural and urban low income population has very little access to financial services. These groups pay a high premium for accessing credit from moneylenders and other informal sources. There is, thus, a need to expand the outreach of the formal financial system to include rural and urban poor. In the Indian context, financial inclusion has been described as the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who are excluded. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution. The major causes of financial exclusion often cited include relatively low extension of institutional credit in rural areas due to perception of high risk, high operating costs, lack of rural infrastructure, and vast geographical spread of the country with more than half a million villages, some sparsely populated. The micro factors, which are perceived to inhibit credit flow to disadvantaged groups, mainly include factors such as lack of awareness of financial products and services, the procedures for obtaining agricultural non-farm loans, staffing and human resources, and lack of effective legislation for regulating money lending. This paper describes the future perspective of financial inclusion in India and also explains how technology plays a vital role in application.
KEYWORDS: Entrepreneurial Credit, Self Help Groups, Micro Finance Institutions, IT, Simputers.

INTRODUCTION

Financial inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of disadvantaged and low income segments of society. Unrestrained access to public goods and services is the sine qua non of an open and efficient society. It is argued that as banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of public policy. The term "financial inclusion" has gained importance since the early 2000s, and is a result of findings about financial exclusion and its direct correlation to poverty. Financial inclusion is now a common objective for many central banks among the developing nations.

Financial Inclusion is a Nation wide initiative to include the BPL (Below Poverty Line) citizens into the banking system, under the Private Public Partnership (PPP) model. Financial Inclusion brings banking services to the financially excluded, economically weak sections, of the society. According to Dr. K.C.Chakrabarty, Deputy Governor, Reserve Bank of India, prior initiatives like Co-operative Movement, setting up of State Bank of India, Nationalization of banks, Lead Bank Scheme, RRBs (Regional Rural Banks), Service Area Approach, Self Help Groups have failed to significantly reduce the financially excluded population in India. About 40% of its citizen has a bank account. The lack of previous generation financial inclusion schemes is mainly attributed by him to lack of technology applications in banking, this technology barrier have been overcome in the current initiatives.

Financial Inclusion includes accessing of Financial Products and Services like,

- Savings facility
- Credit and debit cards access
- Electronic fund transfer
- All kinds of commercial loans
- Overdraft facility
- Cheque facility
- Payment and remittance services
- Low cost financial services
- Insurance (Medical insurance)
- Financial advice
- Pension for old age and investment schemes
- Access to financial markets
- Micro credit during emergency
- Entrepreneurial credit

As the Financial Inclusion initiative is growing at a rapid pace, with the participation of 96 banks with each bank having about 70 outsourcing partners, the technology diversity and interoperability are an issue. Also, there is a need for inter-bank customer transactions that is one customer of a bank must be able to transact with another bank's customer. The conventional channels like Visa/Master credit-card networks, ATM networks and RTGS (Real Time Gross Settlements) are not suitable for low value with high volume tractions. Thus RBI has encouraged formation of multilateral transaction system for financial inclusion. This establishes an urgent need for a Financial Inclusion Transaction Switch.

FINANCIAL INCLUSION IN INDIA

The Indian economy is growing at a steady rate of 8.5% to 9% in the last five years or so. Most of the growth is from 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 unorganised 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 Reserve Bank of India has set up a commission in 2004 to look into financial inclusion and the recommendations of the commission were incorporated into the mid-term review of the policy (2005–06). In the report RBI exhorted the banks with a view of achieving greater financial inclusion to make available a basic "no-frills" banking account.

In India, Financial Inclusion first featured in 2005, when it was introduced, that, too, from a pilot project in UT of Pondicherry, by K C Chakraborthy, the chairman of Indian Bank. Mangalam Village became the first village in India where all households were provided banking facilities. In addition to this KYC (Know your Customer) norms were relaxed for people intending to open accounts with annual deposits of less than Rs. 50,000. General Credit Cards (GCC) were issued to the poor and the disadvantaged with a view to help them access easy credit. In January 2006, the Reserve Bank permitted commercial banks to make use of the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions and other civil society organizations as intermediaries for providing financial and banking services.
These intermediaries could be used as business facilitators (BF) or business correspondents (BC) by commercial banks. The bank asked the commercial banks in different regions to start a 100% financial inclusion campaign on a pilot basis. As a result of the campaign states or U.T.s like Pondicherry, Himachal Pradesh and Kerala have announced 100% financial inclusion in all their districts. Reserve Bank of India’s 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 and the low income savings and lack of bank branches in rural areas continue to be a road block to financial inclusion in many states. Apart from this there are certain in Current model which is followed. There is inadequate legal and financial structure. India, being a mostly agrarian economy, hardly has schemes which lend for agriculture. Along with microfinance we need to focus on Micro-insurance too.

- In its platinum jubilee year, the Reserve Bank of India (RBI) wants to connect every Indian to the country's banking system.

- RBI is currently working on a three-year financial inclusion plan and is discussing this with each bank to see how to take this forward, KC Chakrabarty, deputy governor, RBI said.

- "Nearly forty years after nationalization of banks, 60% of the country's population does not have bank accounts and nearly 90% do not get loans," he pointed out.

- Despite heightened focus on financial inclusion, Indian banks still somewhat failed to bring the under- and un-banked into the mainstream banking fold.

- India has currently the second-highest number of financially excluded households in the world. Approximately, 40% of India's population have bank accounts, and only about 10% have any kind of life insurance cover, while a meager 0.6% have non-life insurance cover.

- According to UNITED NATIONS, "A financial sector that provides 'access to credit for all "bankable" people and firms and to savings and payments services for everyone. Inclusive finance does not require that everyone who is eligible use each of the services, but they should be able to choose use them if desired.

- REPORT OF THE COMMITTEE ON FINANCIAL INCLUSION IN INDIA (Chairperson: C. Rangarajan) (2008) "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."

- As per “TREASURY COMMITTEE, HOUSE OF COMMONS, UK, (2005) “Ability of individuals to access appropriate financial products and services.”

India has about 1.2 Billion people, and has 70 million income tax payers (PAN card holders), 60 million passport holders and 90 million driving license holders. India has in excess of 450 million mobile phones and around 240 million bank accounts. India has 150 million BPL (Below Poverty Line) identifications. Most of its citizen do not have access to formal system of
banking and therefore either resort to taking very high rate loan. Thus there is an urgent need for financially include maximum number of its citizen. The un-banked citizens resort to very high interest loans from local money lenders who charge as much as 60% interest per annum.

The MFI (Micro Finance Institutions) has stepped in to help the BPL citizens. They follow the Mohd. Yonus's Grameen Bank model. In this model the MFI organizes the villagers into SHG and empower them to form a group of 10 to 12 persons make savings; Based on the saving history, the group members' loan repaying capacity is estimated. The member can avail loan from the MFI and the load is guaranteed by the SHG. The loan repayment record has been excellent, in tune of 98.8%. MIX (Micro-finance Information Exchange) data shows than India has 130 MFIs, US$ 2.1 billion loan portfolio with 16.1 million borrows and they have deposits US$ 88.6 million from 1.2 million depositors.

However, RBI has taken an exception of the fact that even though the default rate is negligible, around 1%. MFI charge interest as high as 35% per annum, equivalent to the credit card balance charges, which has a very high default rate of 10%. To promote Financial Inclusion, RBI has relaxed certain norms like KYC (Know Your Customers) and has allowed outsourcing of banking activities to agencies called Business Correspondents or BC and allowing mobile banking transactions. RBI has mandated public sector banks to include BPL citizen in the banking system. NABARD (National Bank for Agriculture and Rural Development) is also promoting disbursement of loans related to rural enterprise and thus also promotes Financial Inclusion.

OPERATING COST OF FINANCIAL INCLUSION

One of the most challenging issues in the case of financial inclusion is the operational viability and sustainability of the process of providing financial services. Several countries have attempted to expand financial services coverage through control over financial institutions and by providing subsidies. This has, however, resulted in mounting fiscal costs making it fiscally unsustainable. Another approach is to assign the responsibility of financial inclusion to financial institutions. Though financial inclusion provides an opportunity to financial institutions to expand their business by enlarging their customer base, the operating cost of expanding the coverage of financial services could be a major factor inhibiting banks and other financial institutions from extending various services to the public at large, particularly to low income groups living in rural and remote areas.
Credit delivery in rural areas is often believed to be expensive for banks on account of a large number of small loan accounts to be serviced. The experience of many banks in India as well as in other countries, however, suggests that the appropriate use of information technology can help in reducing the cost of providing financial services and make it operationally viable to expand the coverage of financial services. The appropriate technology combined with an effective use of banking correspondents has the potential of creating a banking outpost/ATM in every village, as has been observed in the case of Andhra Pradesh, which has successfully implemented mobile phone technology for providing banking services in remote areas in coordination with the Reserve Bank and IDRBT.

There are several other instances, both within and outside the country, where it has been observed that technology has the potential to overcome the problem of high operating cost. The need, therefore, is to increase the use of technology to expand the outreach in the hitherto untapped areas. A wide range of technologies is available. However, while selecting a technology, banks need to ensure that the solutions are highly secure, amenable to audit, and follow widely accepted open standards to ensure eventual inter-operability among the different systems as was highlighted in the Reserve Bank’s Annual Policy Statement for the year 2007-08.

FINANCIAL INCLUSION AS AN OPPORTUNITY

The operating cost of financial inclusion is perceived to be high as compared with returns from the services extended to low income groups. Banks, therefore, are generally averse to
voluntarily extending financial services to such segments. Several pilot projects and experience of SHGs have, however, proved that such a perception is unfounded. There is a need to perceive financial inclusion as an opportunity for expanding business in the medium-term, notwithstanding some initial costs. There is also a need to recognize the vast potential for investment in agriculture and allied activities and the entire supply chain.

Given the market imperfections in various aspects of the rural economy, the return on investments could be significant. Large local industrial corporate are already engaging in contract farming and direct marketing of rural products. Moreover, services and manufacturing activities have also been growing faster in rural areas. There is also growth in newer activities such as horticulture, floriculture, organic farming, and genetic engineering, besides a range of supply chain activities like sorting, grading, storage, transportation, processing, and packaging. All these emerging activities are credit intensive and have enormous financing potential. Besides, the potential of the rural markets of items for mass consumption is immense as population is moving laterally in the higher income brackets.

In view of the evidence of a pick-up in consumer financing in rural areas, there is also a need to streamline the supply chain to deliver credit at the lowest cost to the ultimate user in the rural areas, to the benefit of both the bank and the borrower. Furthermore, there are huge opportunities in the area of farmer’s insurance as farmers adopt new and untried technology and increase input intensities, they face larger risks. All these point to the vast scope for enhancing business opportunities for banks and financial institutions in the rural areas. Banks also need to explore and exploit the avenues in the urban areas.

FINANCIAL INCLUSION – NEED FOR TECHNOLOGY APPLICATIONS

The recent developments in banking technology and expansion of telecommunication network in the hinterlands of the country have provided the perfect launch pad for extending banking outposts to remote locations without having to open bank branches in the area. The Committee feels that this could be achieved by leveraging technology to open up channels beyond branch network and create the required banking footprints to reach the unbanked so as to extend banking services similar to those dispensed from branches. In short, technology has to enable the branch to go where the customer is present, instead of the other way around.

Further, RBI’s Annual Policy for 2007-08 also urged the banks to scale up efforts for IT-based financial inclusion and develop technologies that are highly secure, amenable to audit and follow widely accepted open standards to allow inter operability among the different systems adopted by different banks. The enabling provisions and support of RBI has facilitated successful pilot projects in use of IT for extending the banking outreach for the “excluded”. These projects are premised on technology which uses hand-held devices and connectivity with host computers through General Packet Radio Service (GPRS) / Global System for Mobile Communications (GSM) / Code Division Multiple Access (CDMA) / landline networks.

The devices also come in several forms like Simputers (Simple Inexpensive Multi-lingual Computers) / personal digital assistants, programmed mobiles, etc. There are also rural biometric ATMs which have been introduced by banks and found to be very popular among rural
masses. Some major banks are introducing low cost rural ATMs for cash dispensing and other services in rural areas. The Committee took cognizance of the fact that the RBI has set up an advisory group for IT-enabled financial inclusion to facilitate development of IT solutions for delivery of banking services. It is understood that the group will advise certain minimum parameters and standards that are essential for setting up robust interoperable systems on open platforms.

**TABLE 1: PROS AND CONS OF VARIOUS TECHNOLOGIES**

<table>
<thead>
<tr>
<th>Connectivity</th>
<th>Pros</th>
<th>Cons</th>
</tr>
</thead>
<tbody>
<tr>
<td>Short Message Service (SMS)</td>
<td>1. Easier to build applications</td>
<td>1. Still unreliable – delivery of message is not guaranteed</td>
</tr>
<tr>
<td></td>
<td>2. Already a popular medium to communicate</td>
<td>2. Requires user to remember codes/keywords</td>
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<tr>
<td></td>
<td>3. Billing activities can be automated by tight integration</td>
<td>3. Data size per message is restricted to 100 characters</td>
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<tr>
<td></td>
<td>with operator’s systems</td>
<td>4. Multiple SMS based transactions can cause user resistance</td>
</tr>
<tr>
<td>General Packet Radio Service (GPRS)/Code Division Multiple Access (CDMA)</td>
<td>1. Provides ability to build advanced features</td>
<td>1. GPRS / CDMA still not popular</td>
</tr>
<tr>
<td></td>
<td>2. User interacts with a well designed user interface (UI)</td>
<td>2. GPRS in particular requires separate hardware and is not present</td>
</tr>
<tr>
<td></td>
<td>and does not require training</td>
<td>wherever GSM connectivity is available</td>
</tr>
<tr>
<td></td>
<td>3. Can integrate seamlessly with e-commerce scenarios</td>
<td>3. Both in turn do not have a pan India presence</td>
</tr>
<tr>
<td></td>
<td>4. Development skillset for GPRS are widely available</td>
<td>4. CDMA requires specialised skillset which is not widely available</td>
</tr>
<tr>
<td>Handset Technologies</td>
<td>1. Ensure availability of application as and when customer buys a new SIM card</td>
<td>1. Requires operator’s assistance in replacing existing SIM cards</td>
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<tr>
<td></td>
<td>2. Operator is closely associated with the mobile banking project and hence the task of delivery of service is easy</td>
<td>2. Operator lock-in for banks</td>
</tr>
<tr>
<td></td>
<td>3. Technology may not be inter-operable in multiple operator scenarios</td>
<td>3. Technology may not be inter-operable in multiple operator scenarios</td>
</tr>
<tr>
<td>Mobile Application Development</td>
<td>1. Operator independent</td>
<td>1. Development skillset is rare for CDMA</td>
</tr>
<tr>
<td></td>
<td>2. Development skillset is widely present for GPRS</td>
<td>2. Data security is a concern</td>
</tr>
<tr>
<td></td>
<td>3. Ability to design and deliver better features and user interface</td>
<td></td>
</tr>
<tr>
<td>Emerging Technology</td>
<td>1. Ease of use</td>
<td>1. Still in nascent stages, various pilots being conducted across the world</td>
</tr>
<tr>
<td></td>
<td>2. Experience similar to credit card usage</td>
<td>2. Mobile phones still costly</td>
</tr>
<tr>
<td>Mobile Phone as a device</td>
<td>1. Round the clock availability with customer</td>
<td>1. Not built for mobile transactions</td>
</tr>
<tr>
<td></td>
<td>2. Always on and always connected</td>
<td>2. Compared to Point of Sale (PoS)/Automated Teller Machine (ATM) devices which are built and certified for banking activities</td>
</tr>
<tr>
<td></td>
<td>3. More handsets, than bank accounts</td>
<td>3. Primarily Personal Identification Number (PIN) based authentication, concerns on ability to remember pin numbers (Efforts are on to integrate biometric scanners with phones)</td>
</tr>
</tbody>
</table>

The Committee, while concurring with this approach, is of the view that nearly all models converge on certain essential components and processes to be followed in a technology application. The essence of all the models under consideration features the issue of a smart card to the farmer on which all his transactions are recorded, a hand-held terminal with the BC at the village level and a Central Processor Unit (CPU) linking the smart cards and BC terminals with the banks. The precautions taken ensure that every transaction made is accompanied by a print-out being provided to the farmer. There are also other models where smart cards are dispensed with and mobile telephones, etc. are used.

Essentially, the starts up costs are the initial investment costs comprising cost of the smart card, terminals to the BC and the CPU. The Committee is of the view that the Financial Inclusion Technology Fund can provide the necessary support for defraying technology application and hardware costs of technology adoption. As the technological capability for achieving outreach has been satisfactorily proved in the ongoing projects at Andhra Pradesh, Karnataka, Mizoram, etc., banks are urged to scale up the projects all over the country to achieve financial inclusion.

FINANCIAL INCLUSION – THE WAY FORWARD

i. One of the major challenges under Financial Inclusion has been addressing the last mile connectivity problem. For addressing this issue and for achieving the goals set, experts have recommended the Business Correspondent/Facilitator (BC/BF) model. Though the BC model at the initial stage may not be commercially viable due to high transaction costs for banks and customers, the appropriate use of technology can help in reducing this. The need is to develop and implement scalable, platform-independent technology solutions which, if implemented on a large scale, will bring down the high cost of operation. Appropriate and effective technology, thus, holds the key for financial inclusion to take place on an accelerated scale.

ii. Banks need to perfect their delivery and business model. A number of different models involving handheld devices with smart cards, mobiles, mini ATMs, etc are being tried out and it is necessary that they are integrated with the backend CBS system for scaling up. A good delivery model is also needed and, perhaps, even more so if there is a glitch and customer grievances needs to be resolved expeditiously. Thus, the time is approaching when these various experiments with different models are taken to their logical conclusion and banks start scaling up their implementation. At the same time, banks must also have an integrated business model. These hold the key to the success and failure of the financial inclusion efforts.

iii. In addition to this, RBI has advised banks to focus more towards opening of Brick & Mortar branches in unbanked villages. These branches can be low cost intermediary simple structure comprising of minimum infrastructure for operating small customer transactions and supporting up to 8-10 BCs at a reasonable distance of 2-3 kms. This will lead to efficiency in cash management, documentation and redressal of customer grievances. Such an approach will also act as an effective supervisory mechanism for BC operations. Another very important thing is that banks have to realise that for Business
Correspondent (BC) model to succeed, the BCs, who are the first level of contact for customers, have to be compensated adequately so that they too see this as a business opportunity.

iv. As mentioned earlier, banks should strive to provide a minimum of four basic products and, in addition, design new products tailored to income streams of poor borrowers and according to their needs and interests. Banks must be able to offer the entire suite of financial products and services to the poor clients at an attractive pricing. Though the cost of administering small ticket personal transactions is high, these can be brought down if banks effectively leverage ICT solutions. This can be supplemented through product innovation with superior cost efficiency. Mobile banking has tremendous potential and the benefits of m-commerce need to be exploited.

v. It is important that adequate infrastructure such as digital and physical connectivity, uninterrupted power supply, etc. are available.

vi. All stakeholders will have to work together through sound and purposeful collaborations to ensure appropriate ecosystem development. This would include government, both Central and State, Regulators, Financial Institutions, Industry Associations, Technology Players, Corporates, NGOs, SHGs, Civic Society, etc. Local and national level organizations have to ensure that these partnerships look at both commercial and social aspects to help achieve scale, sustainability and desired impact. This collaborative model will have to tackle exclusion by stimulating demand for appropriate financial products, services and advice with appropriate delivery mechanism and by ensuring that there is a supply of appropriate and affordable services available to those that need them.

vii. Mindset, cultural and attitudinal changes at grass roots and cutting edge technology levels of branches of banks are needed to impart organizational resilience and flexibility. Banks should institute systems of reward and recognition for personnel initiating, ideating, innovating and successfully executing new products and services in the rural areas.

CONCLUSIONS

In the Indian context, financial inclusion has been described as the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who are excluded. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution. The major causes of financial exclusion often cited include relatively low extension of institutional credit in rural areas due to perception of high risk, high operating costs, lack of rural infrastructure, and vast geographical spread of the country with more than half a million villages, some sparsely populated.

Financial inclusion is the road which India needs to travel towards becoming a global player. An inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process. Banks that have global ambitions must meet local aspirations. Financial access will also attract global market players to our country that will result in increasing employment and business opportunities. As we have all recognized,
technology is a great enabler and has to act as a ladder to achieve the ultimate goal of providing financial services to the financially excluded. A line of caution here is that in order to serve millions of our poor villagers, what we need is “Technology with a human touch”. Banks should, therefore, take extra care to ensure that the poor are not driven away from banking because the technology interface is unfriendly.

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