International Journal of Business and Management Invention (IJBMI)
ISSN (Online): 2319-8028, ISSN (Print):2319-801X
www.ijbmi.org || Volume 02 Issue 02 || February 2013 || PP 74-79

The role of financial inclusion in the Indian economy

Dr. Krishnanand Tripathi
Department of commerce
Associate Professor Seth P.C.Bagla P.G. College Hathras U.P.

Abstract
Financial inclusion is emerging as a new paradigm of economic growth that plays major role in driving away the poverty from the country. It refers to delivery of banking services to masses including privileged and disadvantaged people at an affordable terms and conditions. Financial inclusion is important priority of the country in terms of economic growth and advanceness of society. It enables to reduce the gap between rich and poor population. In the current scenario financial institutions are the robust pillars of progress, economic growth and development of the economy. The present study aims to examine the impact of financial inclusion on growth of the economy over a period of seven years. Secondary data is used which has been analyzed by multiple regression model as a main statistical tool. Results of the study found positive and significant impact of number of bank branch and Credit deposit ratio on GDP of the country, whereas an insignificant impact has been observed in case of ATMs growth on Indian GDP.

I. Introduction

India is a country of 1.2 billion people, spread across 29 states and seven union territories. There are around 600,000 villages and 640 districts in our country. A vast majority of the population, especially in rural areas, is excluded from the easy access to finance (Gounasegaran, Kuriakose, & Iyer, 2013). Forty per cent of the households having bank accounts, but only 38 per cent of the 117,200 branches of scheduled commercial banks are working in rural areas. Accessibility of financial services at affordable and appropriate prices has been always a global issue. Hence, an inclusive financial system is required widely not only in India, but has become a policy priority in various countries. Financial access can surely improve the financial condition and living standard of the poor and the deprived section. So, RBI has been continuously stimulating the banking sector to extend the banking network both by setting up of new branches and installation of new ATMs (Dangi & Kumar, 2013). Financial inclusion means the delivery of financial services, including banking services and credit, at an affordable cost to the vast sections of disadvantaged and low-income groups who tend to be excluding (Chhabra, 2015). Financial inclusion takes into account the participation of vulnerable groups such as weaker sections of the society and low income groups, based on the extent of their access to financial services such as savings and payment account, credit insurance, pensions etc. (Singh et al., 2014).

The different financial services include access to savings, loans, insurance, payments and remittance facilities offered by the formal financial system. This aspect of financial inclusion is of vital importance in providing economic security to individuals and families (Kelkar, 2014). India is one country where the Financial Stability and Development Council (FSDC) have a specific mandate for financial inclusion and financial literacy. There is a separate Technical Group on Financial Inclusion and Financial Literacy under the aegis of FSDC with representation from all the financial sector regulators. In order to spearhead efforts towards greater financial inclusion, RBI has constituted a Financial Inclusion Advisory Committee (FIAC) under the Chairmanship of a Deputy Governor from RBI.

Research gap

Financial inclusion is an important step towards inclusive growth. It helps in the overall economic development of the underprivileged population. In India effective financial inclusion is needed for upliftment of the poor and disadvantaged people by providing them the modified financial products and services. This leads to inclusive growth encompassing the deprived and marginalized sections. Some studies are done on the financial inclusion by analyzing selected banks and other work has been found on state wise growth of financial inclusion. A few studies have been analyzed the impact of financial inclusion on Indian economic growth and found mixed results. With this backdrop, this research study is an attempt to find out the present scenario of financial inclusion in India and assessing the role of financial inclusion in economic growth of the country.

Objectives

1.To examine present scenario of financial inclusion in India.
2.To investigate the major factors affecting access to financial services.

3.To study the impact of financial inclusion indicators on growth of Indian economy.

Factors affecting access to financial services

Financial Inclusion, on the one hand, is a process aiming at providing banking services like saving account, credit facility, and insurance product to weaker sections of the society. While on the other hand, it refers to the objective of ensuring financial services (banking, insurance, and capital market services) and timely and adequate credit to every section of the society as well as of the economy. Access to financial services has been recognized as an important aspect of development and more emphasis is given to extending financial services to low-income households as the poor lack the education and knowledge needed to understand financial services that are available to them. The lack of financial access limits the range of services and credits for household and enterprises. Although there is some evidence that access is improving but still there are multiple factors which have affected the access to financial services.

Place of living

Most of commercial banks operate only in commercial areas and these banks set their branches in profitable areas. Hence population lives in rural areas find it difficult to access the financial services. Although effective distance is as much about transportation infrastructure as physical distance, factors like density of population, rural and remote areas, mobility of the population (i.e., highly mobile people with no fixed or formal address) etc. also affect access to these services.

Absence of legal identity and gender biasness

Minorities, economic and political migrants, refugee workers and women's are excluded from accessing financial services due to lack of legal identities such as original birth certificates and identity cards. It is generally difficult to access credit facilities for those females, who do not possess property and assets. They also needed male guarantee to access the credit from any financial institutions.

Limited knowledge of financial services

Incomplete basic education and financial literacy are the major hurdles in order to access various financial services to the individuals. They do not Know the significance of different financial products i.e., bank accounts, cheque facility, bank loan or overdraft and insurance. If people having proper financial literacy, it boost up the use of many financial products by different economic agents like Business Correspondents, NGOs and MFIs and etc.

Level of income and bank charges

Financial prominence of people is always plays a pivotal role in accessing available financial services. It is impossible for poor people to access financial services even when these services are made for lower income level group. Moreover in India, a lot of hidden bank charges which has been demotivated poor persons in availing these services.

Rigid terms and conditions

People are also least interested using such type of financial products or services which are attached with some inflexible terms and conditions. Many financial institutions having different rules relating with the use of accounts like minimum balance requirements.

Type of business

Nature of occupation also an important factor in availing the financial services, whether it is small scale, large scale, organized and unorganized firm. Most of the banks do not preferred the small borrowers and unorganized enterprise for giving loans. Hence these loan applications tends to be rejected.

II. Review Of Literature

Many studies (Aghion and Bolton, 1997, Banerjee and Newman, 1993, Banerjee, 2001) discussed that access to finance has been seen as a critical factor in enabling people to transform their production, employment activities and to exit poverty. Researchers have been argued that the very fundamental activity of the banking sector, delivery of credit, are essential to boost any economic activity and enables the generation of capabilities (Sen, 2000). Dangi and Kumar (2013) examined the initiatives and policy measures taken by RBI and Government of India. This study also focused on current status and future prospects of financial inclusion in India. It has been concluded that financial inclusion shows progressive and valuable changes but sufficient provisions should be incorporate in the business model to certify that the poor are not driven away from banking. Suryanarayana (2008) focused on definition of inclusion/exclusion with reference to an outcome scenario for broad-based growth as reflected in estimates of production, income, and consumption distribution. The study helps in drawing a sketch of occupational, social, regional profiles of the excluded in the mainstream growth process. Hence researcher made an attempt to provide a perspective, a measure of inclusion, and finally an evaluation based on the available estimates of consumption distribution for the year 2004–2005 for India. Agrawal (2008) studied the financial inclusion from the behavioural perspective based on both factors supply and demand end. Results revealed that evaluation from the behavioural perspective provided the scope for the policy-makers and marketers to strategically align their approach with the behavioural aspect, without confining their thoughts to the economical evaluations.

On the other hand, in 2003, the RBI policy of financial inclusion was to provide access to financial service to the underprivileged could be earmarked as another bold initiative in serving the rural transects targeting inclusive growth. Committee on financial inclusion in 2008 (Rangarajan Committee) observed that financial inclusion to hitherto excluded segments of the population was critical to sustain and accelerate growth momentum. For achievement of the objective, the committee had put forward multi-pronged strategies include establishment of National mission on financial inclusion, revitalizing the RRBs and Cooperatives, introducing MFI model (SHG-bank linkage) and Business Facilitator and Business Correspondents Model. Mukherjee and Chakraborty (2012) studied the role and efficiency of the commercial banks in Jharkhand state with their capacity and role of institutions like regional rural banks (RRBs), self-help groups (SHGs), non-banking financial companies (NBFCs) for the purpose of promoting financial inclusion. The results of analysis shown that banks were not able to achieve the desired aims and study suggested that every bank should reports to the RBI on its achievement on financial inclusion more frequently. Uma and Rupa (2013) made an attempt to examine the role of SHGs in financial inclusion and reflected the positive relationship between SHGs membership and financial inclusion. The study revealed that after the membership to SHGs there was increase in the number of bank accounts, credit availed by the members and annual repayment of the loan also shown positive trend.

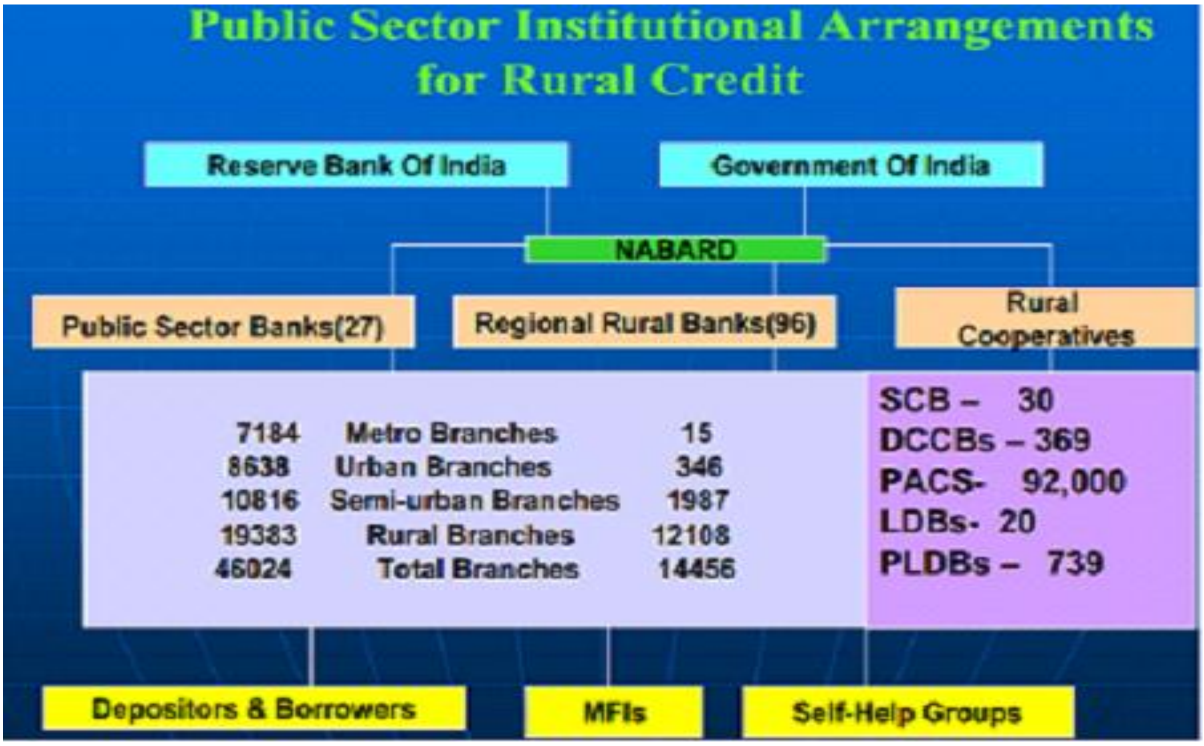
Joseph and Varghese (2014) analyzed the effect of financial inclusion on the development of Indian economy by bank growth rate in terms of number of bank branches, usage of debit card and credit cards. It has been observed that the usage of debit cards increased tremendously throughout the study period and decreased the number of people with access to the products and services offered by the banking system continues to be very limited, even years after introduction of inclusive banking initiatives in the country. Ravikumar (n.d.) made an attempt to assess the role of banking sector in financial inclusion process from different viewpoints namely branch penetration, ATM penetration, population per branch, distribution of banking branches, credits, deposits of SCBs and Co- operative banks in India. This study revealed that banking is a key driver for financial inclusion/inclusive growth but large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. Paramasivan and Ganeshkumar (2013) discussed the overview of financial inclusion in India and concluded that branch density has a significant impact on financial inclusion. Julie (2013) analyzed the relationship between financial inclusion and economic growth in Kenya and found that both have a strong positive relationship. Economic growth has a strong positive relationship with branch networks and a weak positive relationship with the number of mobile money users/accounts. The study also concluded the weak negative relationship with the number of automated teller machines in the country and a strong negative relationship with the bank lending interest rates. Study conducted in India by Kamboj (2014) found out the positive relationship between number of bank branch networks and number of ATMs in the country with the GDP growth rate of the country.

Financial Inclusion Strategies

- **BC-model**
- **PoS(Point of Sale)**
- **No-frills accounts** (With very little or no minimum balance), simplification of KYC norms
- **KCC – Kisan Credit Card** – from the year 1998-99 –to meet production credit requirements and short-term credit needs in a timely and hassle-free manner credit for crop production
- **Lead Bank Scheme -**1969 aimed at forming a coordinated approach for providing banking facilities. To enable banks to assume their lead role in an effective and systematic manner, all districts in the country (excepting the metropolitan cities of Mumbai, Kolkata, Chennai and certain Union Territories) were allotted among Public Sector Banks and a few Private Sector Banks The Lead bank role is to act as a consortium leader for co-coordinating the efforts of all credit institutions in each of the allotted districts for expansion of branch banking facilities and for meeting the credit needs of the rural economy. For the preparation of District Credit Plans and monitoring their implementation a Lead bank Officer (LBO) now designated as Lead District Manager was appointed in 1979
- **Local Area Banks** (1996) –are expected to bridge the gap in credit availability and strengthen the institutional credit framework in the rural and semi-urban areas Although the geographical area of operation of such banks will be limited, they will be allowed to perform all functions of a scheduled commercial bank Licences are given out in under-banked or unbanked areas of the country. Some of these local area banks could eventually become full-fledged banks at some stage the local area banks are likely to have a capital adequacy ratio higher than 15% to offset higher risk arising from being geographically focused.. The scheduled

commercial banks are required to have a capital adequacy ratio — ratio of capital fund to risk weighted assets expressed in percentage terms — of 12%

- **Swabhiman** – Opening of Bank accounts covering the habitations with minimum population atleast through Business correspondent model providing cash services.Habitations with population more than 1600 in plain areas and 1000 in north-eastern and hilly states as per 2001 census are covered.
- **Ultra small Branches** with Bank officers offering other services , undertake field verification and follow-up banking transactions.
- **Direct Benefit Transfer** : Cash transfer through Aadhar payment Bridge requires Bank accounts which leads to financial inclusion.
- **Interest subvention scheme :** facilitates access to cheap credit from the banks indirectly through interest subsidies from the govt. It is a subsidy of interest given by Government to certain sectors like Textiles, Farm .. For eg. Textile company borrow from Bank at 10% and Government gives subvention of 2%. Hence net bank takes interest from textiles companies 8%. Other sectors have to pay 10% to the bank. Likewise, Farm or Agriculture sectors borrows from Bank at 10% and they will get 4% subvention from the govt. Certain sectors are covered by the system of Differential rate interest(DRI) which is less than base rate.Eg : Educational loans, export credit, agriculture, credit to weaker sections.
- **Priority Sector Lending** – target of 40% of Net Bank Credit to select few sectors for all banks including foreign private ones;
- **RashtriyaMahilaKosh (RMK)-** to facilitate credit support to poor women for their socio-economic upliftment;
- **Dedicated bank for Women(**National Bank for Women) proposed in 2013-14 budget. Objective of broadening the SHG-bank linkages.



Committee on financial inclusion

Khan Commission

RBI set up 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) and urged banks to review their existing practices to align them with the objective of FINANCIAL inclusion. RBI also exhorted the banks and stressed the need to make available a basic banking 'no frills' account either with 'NIL' or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population Of the many schemes and programmes pushed forward by RBI the following need special mention.

Rangarajan Committee

4 major reasons for lack of financial inclusion

- *Inability to provide collateral security*
- *Poor credit absorption capacity,*
- *Inadequate reach of the institutions*
- *Weak community network*
- there is need to organize Urban/peri-Urban poor people into Neighbourhood Groups (NHGs) on the same pattern as has been adopted for the rural poor.(Need to extend the mandate of NABARD to cover beyond rural areas)
- alter the emphasis somewhat from the large Bank led, public sector dominated, mandate ridden and branch-expansion-focused strategy to Micro Banks.

2nd ARC(Administrative reforms commission) on Financial Inclusion:

- Innovation is critical for financial inclusion. This would mean developing newer financial products in terms of loans, savings, insurance services etc. which are tailored to the needs of the poor.
- Currently, most public sector Banks and micro-finance institutions have a narrow product offering, which limits the choice of the SHGs and also constrains them in terms of utilizing the loans productively.
- extension of the RRB network to the remaining non-financed areas would considerably speed up the process of inclusive banking and help in extending micro-finance to local SHGs.
- high penetration of telecom connectivity in India, together with the latest mobile technology could be used to enhance financial inclusion in the country.
- MFIs should handle thrift / saving and money transfer only as business correspondents of Scheduled Banks, but not in their individual capacity as a micro-finance lender as it involves hard earned savings of the poorest of the society

4 models of SHG-Bank Linkage:

- SHG-Bank linkage promoted by a mentor institute (Eg: Self-Help Promotion Agencies & NGOs) – SHPAs provide the seed money. 2nd ARC believed that this is an appropriate model to be replicated on large scale
- SHG-Bank direct linkage – Very less frequent because of meagre initial savings of SHGs
- SHG-Mentor Institution linkage(indirect linkage) – SHPAs act as financial intermediaries. SHPI accepts the contractual responsibility for repayment of the loan to the Bank unlike in case 1
- SHG-Federation model – Cluster of SHGs forming a federation to attain economic sustainability. This federation acts as an intermediary. Some federation are even capable of accessing credit from large MFIs.

Nachiket mor commitee

Committee on Comprehensive Financial Services for Small Businesses and Low Income Households" was set up by the RBI in Sep 2013 under the chairmanship of Nachiket Mor, an RBI board member.

Key Recommendations

1. Providing a universal bank account to all Indians above the age of 18 years by January 1, 2016. To achieve this, a vertically differentiated banking system with payments banks for deposits and payments
2. **wholesale banks for credit outreach.** These banks need to have Rs.50 crore by way of capital, which is a tenth of what is applicable for new banks that are to be licensed.
3. Aadhaar will be the prime driver towards rapid expansion in the number of bank accounts. Monitoring at the district level such as deposits and advances as a percentage of gross domestic product (GDP).
4. Adjusted 50 per cent priority sector lending target with adjustments for sectors and regions based on difficulty in lending.
5. **Increase the Priority Sector Lending Mandate** The Mor committee has recommended that the priority sector lending mandate for banks should be raised from the current 40 per cent to 50 per cent. At the same time, the banks must be freed from all pricing and other restrictions.
6. **Allow differentiated Licenses —**The committee has taken ahead the case of differentiated banking licences. It has proposed that three new categories of banks viz. payment, wholesale investment and wholesale consumer should be allowed. At the same time, the regulations for non-banking financial companies, or NBFCs should be streamlined. The biggest problem here would be the business viability of such banks. One example of differentiated banking license is Regional Rural Banks, which were started off with great promises but ultimately broke down.
7. **Meaningful Financial Inclusion —**The Nachiket Mor committee has suggested two specific district-level penetration metrics viz. the credit- GDP and life cover-GDP ratios to monitor the meaningful financial

inclusion. This is a slight departure from the number of accounts formula of financial inclusion. It is a meaningful recommendation and must be taken ahead.

DEEPAK MOHANTY

The Reserve Bank of India (RBI) on 15 July 2015 constituted a committee to work out a five-year (medium-term) action plan for financial inclusion. The 14-member panel will be headed by RBI executive director Deepak Mohanty.

1. The Committee will work to spread the reach of financial services to unbanked population.
2. To review the existing policy of financial inclusion including supportive payment system and customer protection framework taking into account the recommendations made by various committees set up earlier.
3. To study cross country experiences in financial inclusion to identify key learnings, particularly in the area of technology-based delivery models, that could inform our policies and practices.
4. To articulate the underlying policy and institutional framework, also covering consumer protection and financial literacy, as well as delivery mechanism of financial inclusion encompassing both households and small businesses, with particular emphasis on rural inclusion including group-based credit delivery mechanisms.
5. To suggest a monitorable medium-term action plan for financial inclusion in terms of its various components like payments, deposit, credit, social security transfers, pension and insurance.

III. Conclusion

Importance of financial inclusion arises from the problem of financial exclusion of nearly 3 billion people from the proper financial services across the world. With only 34% of population occupied in formal banking, the second highest number after China, India has 135 million monetarily expelled households. Further, the actual rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. Financial Inclusion has far attainment results, which can help many people, come out of miserable dearth conditions. Financial inclusion provides formal individuality, access to expenses system and deposit insurance. The aim of financial inclusion is to expand the scope of activities of the organized financial system to comprise within its realm people with low incomes. Through graduated credit, the effort must be to lift the poor from one level to another so that they come out of poverty

To conclude, the researcher wish to stress that with increasing liberalization and higher economic growth, the role of banking sector is perched to increase in the financing pattern of economic activities in the country. To assemble the growing credit demand, the banks need to organize resources from a wider deposit base and extend credit to activities previously not financed by banks. The trend of growing commercialization of agriculture and rural activities should produce greener pastures, and banks should examine the benefits of increasing saturation therein. Financial inclusion will strengthen financial deepening and provide resources to the banks to increase credit release.

References

[1]. Schumpeter JA (1911) The Theory of Economic Development: An Inquiry into Profits, Capital, Credit, Interest and the Business Cycle. Harvard University Press, Cambridge.
[2]. King RG, Levine R (1993) Finance and growth: Schumpeter might be right. Q J Econ 108: 713-737.
[3]. Honohan P (2004) Financial sector policy and the poor: Selected issues and evidence. World Bank Working Paper, p: 43.
[4]. Beck T, Demirgüç-Kunt A, Levine R (2007a) Finance, inequality and the poor. J Econ Growth 12: 27-49.
[5]. Robinson J (1952) The generalization of the general theory. The Rate of Interest and Other Essays. Macmillan, London, pp: 67-146.
[6]. Goldsmith RW (1969) Financial Structure and Development. New Haven, CT: Yale University Press
[7]. Mckinnon RI (1973) Money and Capital in Economic Development. Brookings Institute, Washington Shaw.
[8]. Boyd JH, Prescott E (1986) Financial intermediary-coalitions. J Econ Theory 38: 211-232.
[9]. Diamond DW (1984) Financial intermediation and delegated monitoring. Rev Econ Stud 51: 393-414.
[10]. Aghion P, Angeletos G-M, Banerjee A, Manova K (2004) Volatility and growth: The role of financial development. Harvard University.