CHAPTER 1

INTRODUCTION

The financial inclusion plays an important role in the mobilisation and allocation of the savings. Financial institution, instruments of borrowing and lending, financial market, which comprise the financial sector, act as a facilitator for the transfer of funds from those who spend less than they earn to those who spend more than they earn.

According to UN financial inclusion is 'The stark reality is that most poor people in the world still lack access to sustainable financial services, whether it is savings, credit or insurance. The great challenge before us is to address the constraints that exclude people from full participation in the financial sector. Together, we can and must build inclusive financial sectors that help people improve their lives.'

According to the United Nations the main goals of inclusive finance are as follows; access at a reasonable cost of all households and enterprises to the range of financial services for which they are 'bankable,' including savings, short and long-term credit, leasing and factoring, mortgages, insurance, pensions, payments, local money transfers and international remittances, Sound institutions, guided by appropriate internal management systems, industry performance standards, and performance monitoring by the market, as well as by sound prudential regulation where required.

As defined by RBI 'Financial Inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker sections and low income groups at an affordable cost in a fair and transparent manner by mainstream Institutional players'.[1]

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; the availability of banking and payment services to the entire population without discrimination is the prime objective of this

[1] K.C Chakarverty (2011), 'Financial Inclusion', Reserve Bank of India.

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.

Indian financial system today has an impressive network of banks, financial institutions and a wide range of instruments. In the beginning, provision of short term credit was entrusted primarily to commercial and co-operative banks. But, later commercial banks have diversified into several new areas of business such as, merchant banking, mutual funds, and leasing, factoring, and other services. Also there is wide network of co-operative banks and co-operative land development banks in India. There are few apex agencies like; Industrial Development Banks (IDBI), EXIM Bank and National Housing Bank serve with a wide network of national institutions to provide long and medium term loans. The prophecy of Millennium Development goals of U.N. i.e. ‘growth with equity’ clearly envisages that the growth spree of the globe in the 21st century has left some people behind the time. Handful of the global populace are still languishing in the vicious circle of poverty & are cast aside by those who are economically stronger & swifter in the sway of globalization & liberalization. For sustenance/better growth of the world, the deprived sections should be brought into the main stream of growth. This is because of the fact that poverty anywhere is a grave threat to prosperity everywhere. Financial services actively contribute to the humane &economic development of the society. These lead to social safety net & protect the people from economic shocks. Hence, each & every individual should be provided with affordable institutional financial products/services popularly called ‘Financial Inclusion.’ Financial products& services are identified as basic banking services like deposits accounts, institutional loans, access to payment, remittance facilities & also life & non-life insurance services. The following are the denotation & connotation of financial inclusion in India: affordable credit, Savings, bank accounts Payments & Remittance, Financial advice, Credit/debit cards, Insurance facility and Empowering SHGs (self-help groups).

An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. An all-inclusive financial system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services like easy day-to-day management of finances, safe money transfer etc. The govt. of India as well as the banking industry has recognized this imperative and has undergone certain fundamental changes over the last two decades. In fact, in order to address the issues of financial inclusion, the Government of India constituted a ‘Committee on Financial Inclusion’ under the Chairmanship of Dr. C. Rangarajan. Not only in India, but financial inclusion has become an issue of worldwide concern, relevant equally in economies of the underdeveloped, developing and developed nations. Building an inclusive financial sector has gained growing global recognition bringing to the fore the need for development strategies that touch all lives instead of a select few.

Meaning of Financial Inclusion

The financial services include the entire gamut - savings, loans, insurance, credit, payments etc. The financial system has to provide its function of transferring resources from surplus to deficit units but both deficit and surplus units are those with low incomes, poor background etc. By providing these services, the aim is to help them come out of poverty. So far, the focus has only been on delivering credit (it is called as microfinance but is microcredit) and has been quite successful. Similar success has to be seen in other aspects of finance as well.

Typically, the need for promoting financial inclusion in India is evident from the following observations; Lower outreach by financial institutions/MFIs/SHG Bank Linkage Programmed in comparison to below poverty line (BPL) and low income population, Priority Sector lending norm of 18% advances to agriculture is notmet in many states. Also, agriculture’s share in Priority Sector Lending has been declining in some states; financial inclusion is characterized primarily as either general access to loans (mostly consumption or consumer loans rather than livelihood loans) or access to savings accounts. Very few risk management and vulnerability reducing products are available to small holder producers; access to finance is primarily a bridging resource for many low income groups.

Households in developing countries such as India require finance for many reasons such as consumption, meeting lump-sum expenses like as during a marriage or illness and most importantly for income-generating activities. Since credit is essential for meeting critical needs, access to credit is crucial for maintaining and improving social and economic condition of households. Therefore, adequate credit at reasonable cost is important for economic development. Only formal agencies of credit are able to fulfil both conditions to meet the need of demand of credit for household at adequate level at low cost. So the term financial inclusion was introduced to include the people in the fold formal finance services. A person may be said to have access to financial services if he or she is able to use formal or semiformal financial services in an appropriate form at reasonable prices when such services are required.[2] Although efforts were started with the Nationalization of banks in 1969 to financially include the people, but the greater emphasis was given on financial inclusion from last few years. Many studies defined that Financial Inclusion is delivery of financial services at an affordable cost to the vast sections of under privileged and low income groups. Financial inclusion implies provision of affordable financial services, such as access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded. It is important to recognize that in the policy framework for development of the formal financial system in India, the need for financial inclusion and covering more and more of the excluded population by the formal financial system has always been consciously emphasized.[3]Another study introduced financial inclusion as the delivery of banking services at an affordable cost to the vast section of the disadvantaged and low income groups.[4] A slightly broader definition refers to it as provision of affordable financial services, access to payments and remittance facilities savings, loan and insurance services by the formal financial system to those who tend to be excluded.[5] Another study on financial inclusion defined that credit is the most important component to say anyone financially included, side by side it also covers various financial services such as savings, insurance, payments and remittance facilities by the formal financial system to those who tend to be excluded.RBI defined financial inclusion as the 'provision of affordable financial services' to those who have been left un-attended or under-attended by the formal agencies of the financial system.[6] So we can define financial inclusion as a process to provide the formal financial services, at affordable cost, to the vast section of the society. Since financial inclusion and financial exclusion are complementary concepts, the discussion is couched in terms of both concepts.

Importance of Financial Inclusion

There are number of studies indicating that a well-developed financial system can be an effective poverty alleviation tool and it also uplifts the living standard of the people. It ensures that poor

[2]Fernando, 2007, 'Financial Inclusion and Fragility: An Empirical Note'. mpra.ub.uni-muenchen.de/24252/
[3]Agrawal (2007) 'Fiancial inclusion through Mobile Phone Banking' www.cab.org.in/.../Financial_inclusion_through_mobile_phone_banking.
[4] V. Leeladhar (2005) , 'Taking banking services to the common man-financial inclusion', BIS Review, vol. 83 2005.
[5]UshaThorat, Financial inclusion and information technology, 2006: 239.
[6] Reserve Bank of India (2006a), ' Financial Inclusion in India'.

households and small entrepreneurs need not depend on middlemen. Financial inclusion helps to develop the financial system and facilitate the people with the flowing benefits.The expansion of financial services to all over the economy is very important because it leads to the promotion of the economic development and growth. It will include poor sections in rural and urban areas like farmers, small vendors, agricultural and industrial labourers, people engaged in unorganized sectors, unemployed, women, children, old people, physically challenged people who can be benefited through the banking inclusion. The poor people belonging to all sections of the society will get opportunity to come into banking fold. They will be able to open accounts and become savers and also able to use the credit facilities. The deposits of the poor people also help to increase resources of banks. Banking habit will help the people to avoid risks associated with holding of cash and cash transaction. Banking inclusion will create opportunities for banks to increase the number of their savings bank accounts. It will help banks to increase their size of business. Lending programs of banks and micro credit will empower people at the bottom and this will enable them to get rid of their poverty themselves. The concept of money banking is bound to become a useful business in the coming years, while providing livelihood to the new financially included. The sustainability will be brought in economic and social life of the people by including them in the mainstream of the financial services. Access to credit, financial assets and deposit products will empower the poor and vulnerable people. It also provides a chance to the people to empower themselves by using bank credit for productive purposes and becoming a part of inclusive growth. Financial inclusion can really lift the financial condition and living standards of life of the poor and the disadvantaged. This policy will facilitate banks to create many opportunities for them in a big way.[7]

In a broad sense financial inclusion refers to delivery of financial system of an economy to its members. Since most of the financial services are coordinated through banks, we can approximate financial inclusion by banking inclusion

It is now widely acknowledged that financial exclusion leads to non- accessibility, non-affordability and non-availability of financial products. Limited access to funds in an underdeveloped financial system restricts the availability of their own funds to individuals and

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[7]NigamanandaBiswas(2010); Financial Inclusion in India: Strategic Approaches and Significant Benefit, Vanijya, Department of Commerce, Dibrugar University, ISSN 0972 – 6594,Vol. 20,

also leads to high cost credit from informal sources such as moneylenders. Due to lack of access to a bank account and remittance facilities, the individual pays higher charges for basic financial transactions. Absence of bank account also leads to security threat and loss of interest by holding cash. All these impose real costs on individuals. Prolonged and persistent deprivation of banking services to a large segment of the population leads to a decline in investment and has the potential to fuel social tensions causing social exclusion. Thus, financial inclusion is an explicit strategy for accelerated economic growth and is considered to be critical for achieving inclusive growth in the country.

Reasons of financial exclusion

Financial exclusion is the denial of access to the most basic financial services and products. In the narrower terms it is the restrictive access to financial services, through merely banking services for deposits and withdrawal of money.[8] A person's bank account is dead or inactive due to absence of transaction for as considerable specified period, under these circumstances it is considered as financially excluded person. Even the non-issuance of the pass-books to the small customers of savings bank account by the bank can indirectly lead to their financial exclusion. Another study defined that financial exclusion signifies the lack of access by certain segments of the society to appropriate, low-cost, fair and safe financial products and services from formal sources of finance.[9]The literature on financial inclusion also define that there are five major forms of financial exclusion – access exclusion, where segments of population remain excluded from the financial system either due to remoteness or due to the process of risk management of the financial system; condition exclusion, when exclusion occur due to conditions that are inappropriate for some people; price exclusion, when the exclusion happens due to unaffordable prices of financial products; marketing exclusion, when exclusion occurs due to targeted marketing and sales of financial products and self -exclusion, that takes place when certain groups of people exclude themselves from the formal financial system owing to fear of refusal or due to psychological barriers.[10]There are several reasons for financial exclusion. In remote hilly, desert and less populated areas, the physical and communication infrastructure are insufficient. As a result accesses to financial services institutions are severely restricted. The barriers of financial inclusion on demand side are illiteracy, lack of awareness and financial literacy, low

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[8]V. Leeladhar(2005), 'Taking banking services to the common man-financial inclusion,' www.bis.org/review/r051214e.pdf pp2
[9]Mohan Rakesh(2006),'Economic growth, financial deepening and financial inclusion'.
[10]Kempson and Whyley (1999a).

income, pre-owned collateral /assets and social exclusion. The reasons for exclusion from the supply side are long distance of branch from the residence, adjustable timings of the branch, complicated procedure and complexities of documentation, unfamiliar language, unsuitable products and staff attitudes. The requirements of documentary proof of identity and residential address are the most important barriers in opening not only the bank account but also in post offices for availing the financial services.[11]

Consequences of Financial Exclusion

Consequences of financial exclusion vary depending on the nature and extent of services denied. It may lead to increased travel requirements, higher incidence of crime, general decline in investment, difficulties in gaining access to credit or getting credit from informal sources at exorbitant rates, and increased unemployment, etc. The small business may suffer due to loss of access to middle-class and higher-income consumers, higher cash handling costs, delays in remittances of money. According to certain researches, financial exclusion can lead to social exclusion.[12]

SEBI, RBI for financially aware and empowered India: Financial sector regulators, including RBI and SEBI, proposed a nationwide survey for assessing financial inclusion and literacy in the country and educate 500 million adults, besides providing financial education to school children. The draft 'National Strategy for Financial Education' seeks to ‘create a financially aware and empowered India’ and convert savers into investors. It pitches for a five-year action plan for financial literacy with initial focus on four sectors -- banking, securities market, insurance and retirement planning. The strategy, the draft said, is to undertake a massive financial education campaign to help people manage money more effectively to achieve financial well-being by accessing appropriate financial products and services. In India, we need to convert savers into investors, the draft, pared under the aegis of the Sub Committee of the financial stability and development council (FSDC) and simultaneously released for comments by all financial sector regulators.[13]

[11]DuvvuriSubbarao (2009), ‘ Financial Inclusion: Challenges and Opportunities’. pp4
[12]V. Leeladhar(2005), www.bis.org/review/r051214e.pdf.
[13] Economic Times 16th july, 2012

On more participation of domestic retail investors in securities market, the draft said it will reduce dependence on foreign investors and domestic savers reaping benefits of corporate growth and reducing strain on government for investment in national infrastructure.Acknowledging that increasing range and complexity of products has made it very difficult for an ordinary person to take an informed decision, the draft said financial literacy will help in protecting society and individuals against exploitative financial schemes and exorbitant interest rate charged by moneylenders. Financial education will help to avoid over-indebtedness, improve quality of services and make wise financial decisions, the draft said.

Statement of Problem

In countries with a large rural population like India, financial exclusion has a geographic dimension as well. Inaccessibility, distances and lack of proper infrastructure hinder financial inclusion. Vast majorities of population living in rural areas of the country have serious issues in accessing formal financial services. Another facet of exclusion which needs to be addressed is 'Social Exclusion'– which is an extreme consequence of what happens when people do not get a fair deal throughout their lives, often because of disadvantages they face at birth, and this can be transmitted from one generation to the next. Social exclusion is about more than income poverty. It is a short-hand term for what can happen when people or areas have a combination of problems such as unemployment, discrimination, poor skills, low incomes and poor housing. These problems are linked and mutual. Non-price barriers**:** Access to formal financial services also requires documents of proof regarding a persons' identity, Income etc. The poor people do not have these documents and thus are excluded from these services.

Objectives of the Study

- To construct a composite index of financial inclusion in India and analysis the interstate disparities in respect of financial inclusion.

- To identify and estimate the effects of the determinants of the extent of financial inclusion in India.

Chapterisation Scheme:

The entire subject matter of present work has been organized in six chapters. First chapter defines financial inclusion, its importance and need, reasons of financial exclusion, consequences of financial exclusion, brief results of the study and statement of the problem.

The second chapter deals with the survey of literature. Itplays an important role for a researcher in finalisation and delimitation of a research problem. Survey of literature introduces the researcher to alternate methods of analysis. It also familiarises the researcher with the scope and limitations of different studies and may provide guidance to new areas of research. A brief description of some of the selected studies is presented in this chapter.

The third chapter includes the profile of financial system in India in which the history and performance ofbanking system for pre liberalisation and post liberalisation has been explained. It also includes present scenario of baking services in India.

The forth chapter deals with methodology and data description that is in three fold. To find out the interstate extent of financial inclusion coefficient of variation, index of financial inclusion and least square method has been used. Source and data description have also defined.

The fifth chapter explain the empirical analysis of financial inclusion. The effect of socio economic factors on financial inclusion has been presented. This chapter includes tables also.

Sixth chapter sets out the conclusions and policy implications which flow from the material presented in the previous five chapters.

Limitation of the Study

Financial inclusion includes many institutions such as banking services, micro finance, insurance and self-help groups etc. But I have taken banking services.

This study is mainly based on secondary data to check the financial inclusion at state level and the factors which determine the inclusiveness of people. Financial inclusion involves the different financial services such as saving, credit, payment and remittance facilities, amount and account credited and deposited, no of the offices, etc. Although, study involves the amount and account, no of the bank offices facilities, but it is not able to cover the payment and remittance dimension of the financial inclusion. The study uses index of financial inclusion (IFI) to investigate the financial depth at state level. The data on per capita income on constant prices of 2010-11 of some union territories is not available so the data on literacy, urbanisation and poverty are also taken same states so that the data can be done uniform to estimate the result properly through OLS method. No of the state wise ATM is also not available. That's why because of unavailability of the data some factors that also determine Financial Inclusion are omitted.