Chapter -1

INTRODUCTION

The financial system plays an important role in the mobilization and allocation of the savings. Financial institutions, instruments of borrowing and lending, financial market, which comprise the financial sector, act as a mediator for the transfer of funds from those who spend less than they earn to those who spend more than they earn.[1]

Indian financial system today has an impressive network of banks, financial institutions and a wide range of instruments. The institutional structure of financial system characterized as, (a) bankseither owned by the government, Reserve Bank of India (RBI), or the private sector or regulated by the RBI. (b) Development financial institutionsand refinancing institutions setupby a separate statute or owned by the government, RBI, private or other development financial institution under the company ACT and regulated by the RBI and (c) non-bank financial companies owned privately and regulated by the RBI. In the beginning, provision of short-term credit is entrusted primarily to commercial and co-operative banks. But, later commercial banks have diversified in to several new areas of business such as, merchant banking, mutual funds, leasing, factoring, and other services. Also there is a wide network ofco-operative banks and co-operative land development banks at state, district and sub-district levels. Together commercial and co-operative banks hold around two thirds of total assets of Indian financial system. Side by side there are few apex agencies like, Industrial Development Bank of India (IDBI), National Bank for Agriculture and Rural Development(NABARD), EXIM Bank, and National Housing Bank (NHB) serve with a wide network of state level financial institutions to provide the medium and long term loans. Besides these, there are other investment institutions also working at ground level, which include theIndustrial Development Bank of India (IDBI), Life Insurance Corporation (LIC), and General Insurance Corporation(GIC).[2]

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[1]C.Rangarajan, NarenderJadhave: 1992
[2]Uma Kapila, Indian Economy 2010

Even after having, a large range of financial serviceproviders; it is not able to get the significant development in providing financial services. On the other hand, many economists have common thoughtsthat financial development is one of the major factorsinfluencing economic growth. Theoretically, financial development creates enabling conditions for growththrough either a supply-led or a demand-pull process. The financial system development can positively contributes to economic growth.[3]These studiesindicates that various measures of financial development such as stocks, bonds,access to credit, liquidity, assets and liabilities of financial institutions are positively related to economicgrowth.[4]Another study by Rajan and Zingales found a positive relationshipbetween financial development and growth at the industry level.[5] Even therecent literature on growth, emphasizes about the special role of finance in economic development.[6]Although the growth trends of the Indian economy over the last few years appears to indicate the beginning of a new phase of higher growth, the growth is still not inclusive. However there are few people, who are enjoying all kinds of services from saving to net banking, but the another segment of population which lives in villages still does not have adequate access to basic financial services like saving, credit and insurance facilities. They are still depending on informal sources. An inclusive growth is very important to the country like India, because itspared the fruit of economic growth all over the economy and provides a chance to the people to contribute in economic development and improve their living standard. An inclusive growth is also important for poverty reduction.[7]

Since exclusive growth can hinder economic development and create social tensions, the government understands the importance of inclusive growth. So it is necessary to serve the bankable clients as well asthe un-bankable clients by making them bankable. So many initiatives were taken by the Government in the form of Nationalizing of banks(1969), targeting 40 percent of credit to priority sector, opening of Regional Rural Banksin 1975

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[3]In an empirical study, Rajan and Zingales, 2003;MohanRakesh, 2006; Mahindra Sharma, 2008 found positive contribution of financial development in economic growth through various channels.
[4]King and Levine, 1993; Levine and Zervos, 1998
[5]Rajan and Zingales, 1998
[6]RakeshMohan, Economic growth, financial deeping and financial inclusion, 2006.
[7]K. Ravichandran et al, Financial Inclusion- A Path towards India's future economic growth http://ssrn.com/abstrac=1353125

and Co-Operative banks(1958),introducing a Self-Help Group (SHGs)-Bank Linkage Programme in 1992 and formulating the Kisan Credit Card (KCC) scheme in 2001, since last four decades to achieve inclusive growth. Even after these initiatives a large number of rural households do not have access to banking services and remained outside the fold of formal finance. So, as a last door step, Reserve Bank of India(RBI) came up with an initiative of launching National Pilot Project on financial inclusion in Puducherry in 2005.[8]The specialty of this financial inclusion project is that accounts are opened by the bank officials at the door steps of households without insisting on any balance or deposits.

1.1 Concept of financial inclusion

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 fulfill 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 useformal or semiformal financial services in an appropriate form at reasonable priceswhen such services are required.[9] 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 thatFinancial Inclusion is delivery of financial services at an affordable cost to the vast sections ofunderprivileged and low income groups. Financial inclusion implies provision of affordable financialservices, such as access to payments and remittance facilities, savings, loans and insurance services by theformal financial system to those who tend to be excluded. It is important to recognize that in the policyframework for development of

[8]K. Ravichandran et al, Financial Inclusion- A Path towards India's future economic growth(http://ssrn.com/abstrac=1353125).
[9]Fernando, 2007

the formal financial system in India, the need for financial inclusion andcovering more and more of the excluded population by the formal financial system has always beenconsciously emphasized.[10]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.[11] 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.[12] The committee on financial inclusion under the chairmanship of C. Rangarajan gives a still wider definition, which defines financial inclusion as the process of access to financial services, and timely and adequate credit needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.[13]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 financialservices such as savings, insurance, payments and remittance facilities by the formal financial system tothose who tend to be excluded.[14]RBI defined financial inclusion as the “provision ofaffordable financial services” to those whohave been left un-attended or under-attendedby the formal agencies of thefinancial system (RBI 2006a). 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.

1.2 Importance offinancial inclusion

There are number of studies indicating that a well-developed financial system can be an effective poverty alleviation tool and it alsouplifts the living standard of the people. It ensures that poor households and small entrepreneurs need not depend on middlemen. Financial inclusion helps to develop the financial system and facilitate the people with

[10]Agrawal, 2007.
[11] V. Leeladhar, Taking banking services to the common man-financial inclusion, 2005,pp1.
[12]UshaThorat, Financial inclusion and information technology, 2006: 239.
[13]Rangarajan, Report of the Committee on Financial inclusion,2008: 26.
[14]Mahendra, 2006

the flowing benefits.[15]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, smallvendors, agricultural and industrial laborers, people engaged in unorganized sectors,unemployed, women, children, old people, physically challenged people who can be benefitedthrough the banking inclusion.The poor people belonging to all sections of the society will getopportunity to come into banking fold. They will be able to open accounts and becomesavers 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 risksassociated with holding of cash and cash transaction.Banking inclusion will create opportunities for banks to increase the number of theirsavings 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 thiswill enable them to get rid of their poverty themselves.The concept of money banking is bound to become a useful business in the comingyears, 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 toempower themselves by using bank credit for productivepurposes and becoming a part of inclusive growth. Financial inclusion can reallylift the financial condition and living standards of life of the poorand the disadvantaged. This policy will facilitate banks to create many opportunities forthem in a big way.

1.3 Concept of financial exclusion

Financial exclusion is the denial of access to the most basic financialservices and products. In the narrower terms it is the restrictive access to financialservices, through merely banking services for deposits and withdrawal of money.[16] Ifa person's bank account is dead or inactive due to absence of transaction for asconsiderable specified period, under these circumstances it is considered asfinancially excluded person. Even

[15]NigamanandaBiswas; Financial Inclusion in India: Strategic Approaches and Significant Benefit, 2009pp,4
[16]V.Leelahadar,Taking banking services to the common man-financial inclusion, 2005, pp2

the non-issuance of the pass-books to the smallcustomers of savings bank account by the bank can indirectly lead to theirfinancial 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.[17]The literature on financial inclusion alsodefine that there are fivemajor forms of financial exclusion – access exclusion, where segments of population remainexcluded from the financial system either due to remoteness or due to the process of riskmanagement of the financial system; condition exclusion, when exclusion occur due toconditions that are inappropriate for some people; price exclusion, when the exclusion happens due to unaffordable prices of financial products; marketing exclusion, whenexclusion occurs due to targeted marketing and sales of financial products and self -exclusion,that takes place when certain groups of people exclude themselves from theformal financial system owing to fear of refusal or due to psychological barriers.[18]

1.4 Reasons of financial exclusion

There are several reasons for financial exclusion. In remote hilly, desert andlesspopulated areas, the physical and communication infrastructure areinsufficient. As a result accesses to financial services institutions are severelyrestricted. The barriers of financial inclusion on demand side are illiteracy, lack ofawareness and financial literacy, low income, pre-owned collateral /assets andsocial exclusion. The reasons for exclusion from the supply side are long distanceof branch from the residence, unadjustable timings of the branch, complicatedprocedure and complexities of documentation, unfamiliar language, unsuitableproducts and staff attitudes. The requirements of documentary proof of identity andresidential address are the most important barriers in opening not only the bankaccount but also in post offices for availing the financial services.[19]

1.5 Consequences of financial exclusion

Consequences of financial exclusion will vary depending on the nature and extent of services denied.It may lead to increased travel requirements, higher incidence of crime,

[17]Mohan RakeshEconomic growth, financial deepening and financial inclusion, 2006, 5
[18]Kempson and Whyley, 1999a, Kssempson and Whyley, 1999
[19]DuvvuriSubbarao; Financial Inclusion: Challenges and Opportunities, 2009,pp4

general decline in investment,difficulties in gaining access to credit or getting credit from informal sources at exorbitant rates, andincreased unemployment, etc. The small business may suffer due to loss of access to middle-classand higher-income consumers, higher cash handling costs, delays in remittances of money. Accordingto certain researches, financial exclusion can lead to social exclusion.[20]

1.6 Statement and Scope of the Problem

A number of studies stressed that financial inclusion is essential for sustaining equitable growth. There are number of small scale enterprises, cottage industry, and agriculture activities which are in need of adequate and affordable credit. Only formal financial system is able to fulfill both conditions. Not only this, formal financial system also helps the poor to improve their living standard and also protects them from the informal money lender. It also promotes savings by changing saving behavior of the people. Financial inclusion also increases the social inclusion of poor people by uplifting their economic status.Therefore, it is proposed to investigate the extent and variation of financial inclusion in Haryana across districts, taking district as a unit of observation. The present study also pays attention on the present situation of financial inclusion in rural Haryana by way of carrying out a village level study as a case study. The main emphasis is on the extent of financial inclusion and how socio-economic factors influence the financial inclusion.

Objectives of the study

- To study the extent of financial inclusion in Haryana.
- To study the influence ofsocio-economic factors on financial inclusion in rural Haryana.

1.7 Limitation of the study

This study is mainly based on primary data to check the financial inclusion at rural 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.

[20]V. Leeladhar 2005,pp3

Although,study involves the saving and credit facilities, but it is not able to cover the payment and remittance dimension of the financial inclusion.The study also used secondary data to prepare an index to analyze district wise conditionof financial depth in Haryana.The study usesindex of financial inclusion (IFI) to investigate the financial depth at district level, but researcherwanted to check the financial inclusion in rural and urban separately by using index of financial inclusion (IFI) to compare indices for rural and urban.Since the relevant data on number of branches or offices of banks, number of accounts and amount of deposit and credit was not available separately for rural areas at district level, the index for financial inclusion could not be prepared separately for rural and urban areas. This is the limitation of the study.

1.8 Chapterisation Scheme

The entire subject matter of the present work has been organized into the following 6 chapters.

Chapter 1 : Introduction

Chapter 2 : Survey of Literature

Chapter 3 : A Profile of Financial System in India

Chapter 4 : Methodology and Data Description

Chapter 5 : Empirical Analysis

Chapter 6 : Conclusion