Banking and Financial Inclusion in India – A Need for Innovation

N. Santosh Ranganath

Faculty Member
Dept. of Commerce & Management Studies
Dr. B.R. Ambedkar University
Srikakulam, Andhra Pradesh

Prof.(Dr.) G. Tulasi Rao

Head and Dean
Dept. of Commerce and Management Studies
Dr. B.R. Ambedkar University
Srikakulam, Andhra Pradesh

Abstract

In India, the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills to all. Internationally, financial inclusion has been viewed in a much wider perspective. The recent financial crisis has shown that financial innovation can have devastating systemic impact. International standard setters' and national regulators' response has been a global concerted effort to overhaul and tighten financial regulations. The need was felt for more innovative, cost effective and easily accessible delivery channel which would take financial services to the nooks and corners of India. The paper attempts to analyze contribution of Indian banking sector as a whole under the supervision and guidelines of RBI in implementing the financial inclusion through 'No frill accounts', etc. The objectives of the paper are to study financial inclusion in banking sector, reasons for low inclusion and role of technology in banking services and to assess the performance of the banks.

Keywords

Globalization, Financial Services, Biometric ATM, No-Frills, Micro-Credit

Introduction

Globalization has enabled the rise of global trade leading to wealth generation in developed as well as developing countries. Wealth can be created in any part of the world with a single click of the mouse. Developing nations, like India have immensely benefited from the globalizing economy. Wealth has been pouring into the country as investments (both direct and institutional). Wealth has also been generated by Indian companies from global trade. This has directly affected the lives of many citizens in the country. For many, there has been a dramatic increase in the disposable income. The savings, consumption and investment patterns have changed in the past few years. This has meant that there has been an increase in demand for many financial services from different financial firms.

The market has responded to the soaring demand with making attractive offers and services for the customers at affordable rates. The liberalization of the economy in the 1990s has brought in new players into the field. This has not only brought in some much needed fresh air to the stagnant financial sector but also competition for the same market space which was relatively unknown in the financial sector till then. Since then, there have been progressive reforms in the financial sector allowing for better and easier facilities and options to the consumer. An increasing financially aware middle class has realized the importance of financial services. Banks have streamlined and rationalized themselves to meet up with the changing demands of the people. Banks have become partners in growth for many offering them a safer and secure future. Table 1 below provides a set of summary statistics relating to the penetration of various categories of financial products as a snapshot from 2010 to 2011.

Table -1

Financial Inclusion – A Snapshot

Particulars	March 2010	March 2011	June 2011
Total villages covered	54258	100183	107604
Through banks	21475	22662	22870
Through BCs	32684	77138	84274
Through other modes	99	383	460
Urban locations cover through BCs	433	3757	4524
No frill accounts	4.93 crore	7.39 crore	7.90 crore
No frill accounts (Amount in Rs. Crore)	4257.07	5702.94	5944.73
No frill accounts with overdraft	1.31 lakh	6.32 lakh	9.34 lakh
No frill accounts with overdraft (Amount in Rs. Crore)	8.34	21.48	37.42

Source: Reserve Bank of India

The need for incorporating financial inclusion in India hopes to bring social inclusion which is much felt in order to improve the econometrics of India. The Government of India's Committee (NABARD 2011) on Financial Inclusion (released by NABARD) in India reports on financial inclusion as the "process of ensuring to be critical" in solving this challenge. Financial products / services are identified as basic banking services like deposit accounts, institutional loans, access to payment, remittance facilities for life and non life insurance services. The following list is the denotation / connotation of financial inclusion in India. Affordable credit

- Savings bank account
- Payments & Remittance
- Financial advice
- Credit/debit cards
- Insurance facility
- Empowering SHGs (self help groups)

Financial services have failed to adequately reach poorer population for a number of reasons, which includes inadequate infrastructure, perceptions that lending to the poor is too risky to be commercially viable, inhibiting regulatory/ legal environments and limited understanding of governmental situation and awareness of financial services by the poor.

Financial inclusive system facilitates efficient allocation of productive resources as well potentially reduce the cost of capital incurred. 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 Government of India as well as the banking industry has recognized this imperative and has undergone certain fundamental changes over the last two decades.

Literature Review

According to Stephen Sinclair, et al. (2011), financial inclusive system facilitates efficient allocation of productive resources as well as potentially reduce the cost of capital incurred. 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.

Biswas (2010) mentioned to boost micro financing initiatives and financial inclusion program banks are deploying Biometric ATM solutions to its rural customers helping illiterate or barely literate folks to become part of the banking user community.

Cole et al. (2009) concluded that financial literacy program has no effect on the likelihood of opening a bank savings account, but do find modest effects for uneducated and financially illiterate households. In contrast, small subsidy payments have a large effect on the likelihood of opening a savings account. These payments are more than two times more cost-effective than the financial literacy training.

Gupta and Gupta (2008) explained that the increasing proliferation of mobile services and ATMs in rural areas of India has created a new opportunity to attain financial inclusion and thus an effective tool to provide financial services to the un-banked areas with reduced overheads with providing access to banking services in remote rural destinations of India.

The Reserve Bank of India setup a Commission (Khan Commission) in 2004 to look into Financial Inclusion and the recommendations of the commission were incorporated into the Midterm 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, from a pilot project in Union Territory of Pondicherry, by K C Chakraborthy, the Chairman of Indian Bank.

Table - 2

Banking and Financial Inclusion - Statistics

Measures	Values (for the Year 2009-10)	Values (for the Year 2010-11)
No-Frill Accounts	4.15 Cr	7.43 Cr
Rural Bank Branches	31,727	32,683
ATMs	47,953	49,258
POS	5,22,148	7,27,761
Cards	173 million	184 million
Kisan Credit Cards	76 million	73 million
GCC issued by PSBs	6,68 lakh	9.5 lakh
Mobile phones	403 million out of which 187 million (46%) don't have a bank account	929 million out of which 293 million (31%) don't have a bank account

Source: Reserve Bank of India

Financial Inclusion and Banking Sector in India

The growth of banking industry during last decade (2000-2010) in various population segments presents not so comforting a picture of financial inclusion efforts during the last few years. Following snapshot analysis would unfold interesting inferences. Based on the recommendations of the C Rangarajan Committee Report on Financial Sector Reforms, the government created the Financial Inclusion Fund (FIF) for meeting the cost of developmental and promotional interventions for ensuring financial inclusion, and the "Financial Inclusion Technology Fund (FITF)" to meet the cost of technology adoption with an overall corpus of Rs 5 billion each.

To address the problem of high transaction cost and outreach, the RBI advised the banks to migrate all their branches to the computer-based core banking solutions that allow real-time transactions, as also to increase use of information technology based solutions, such as smart cards, mobile phones and hand-held devices to extend the reach. Measures were taken to simplify account opening; these included banks being mandated to offer basic banking 'no-frill' accounts, with low or zero minimum balance, and simpler 'Know Your Customer' (KYC) norms for the low income groups in urban and rural areas for accounts with balances not exceeding Rs 50,000.

The reach of banking while ensuring that the government social security payments reach the rural beneficiaries on time, at low cost and without leakages, the government and the RBI are encouraging state governments and banks to disburse such benefits through bank transfers into the beneficiaries' accounts. Presently, RBI is giving an incentive of Rs 50 per smart card account opened by banks under this scheme to partly meet the cost. The Indian Banks' Association has also constituted technology committees in order to formulate uniform open standards for the technologies at play so as to ensure interoperability between banks and other service providers for the benefit of the customers. The interoperable systems will facilitate the transfer of domestic and international remittances to the villagers in a seamless manner.

New initiatives in Financial Inclusion

Nationalisation of banks in India in 1969 and 1980 marked a paradigm shift in the focus of banking from class banking to mass banking. The multi-agency approach consisting of cooperatives, regional rural banks (RRBs), commercial banks, non-banking financial institutions, etc has played a key role in catering to the credit needs of rural population. Most of these agencies have been acting not merely as financial intermediaries but also playing a key developmental role. In the post nationalisation era, launching of SHG-Bank linkage programme in 1992 and its success as one of the largest micro-credit programmes in the world could be considered as a landmark programme can be regarded as the most potent initiative since independence for delivering financial services to the poor in a sustainable manner.

More recently, and perhaps as a negative reaction to the distortion of priorities implied by the term 'micro-credit', attention has turned to 'financial inclusion' as an appropriate policy goal. This may best be understood by considering its opposite, 'financial exclusion'. This occurs when particular social groups are excluded from access to the formal financial system. Financial exclusion exists in all economies, developed and developing countries. Households may be excluded by remoteness from facilities, by inability to satisfy collateral or documentary requirements, or by transaction costs and the service policies of financial institutions. An appropriate definition of financial inclusion would be 'the condition of having access to relevant and sustainable financial services'.

The term 'financial inclusion' does not supersede the term 'micro-finance'. However the exclusion of people from financial services is a more general problem, to which micro-finance is one of a number of possible solutions. The need to consider not just the creation of new specialized 'micro-finance institutions' (MFIs), but to think about how far orthodox financial institutions, including commercial banks, credit unions and savings and loan cooperatives, might be able to reach out to lower income and isolated households currently suffering exclusion. It is need to think in a more 'systemic' manner, to consider how financial *systems* might be made more inclusive.

This brings us to an important distinction: that between micro-credit 'schemes' and systemic changes designed to increase financial inclusion. Efforts at constructive financial system development are always and everywhere preferable to micro-credit 'schemes'. The latter are usually short term in focus, are sometimes politically inspired, and are often designed as 'add ones' to activities in other sectors, such as agriculture, community welfare, poverty alleviations rather than as ends in themselves.

In India the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills, to all. Internationally, the financial exclusion has been viewed in a much wider perspective. Having a current account / saving account on its own, is not regarded as an accurate indicator of financial inclusion. There could be multiple levels of financial inclusion and exclusion. At one extreme, it is possible to identify the 'super-included', i.e., those customers who are actively and persistently courted by the financial services industry, and who have at their disposal a wide range of financial services and products. At the other extreme, it may have the financially excluded, who are denied access to even the most basic of financial products. In between are those who use the banking services only for deposits and withdrawals of money. But these persons may have only restricted access to the financial system, and may not enjoy the flexibility of access offered to more affluent customers.

RBI's initiatives for financial inclusion in India

- No Frill Accounts
- Simple KYC Norms
- Engaging business correspondents
- Use of technology
- Adoption of EBT
- Simplified branch authorization
- Opening of branches in unbanked rural centers
- Road map for providing banking services in unbanked villages with a population of more than 2,000
- Financial inclusion plans of banks for three years
- Other Rural Intermediaries
- Usage of Regional Language
- Easier Credit Facilities

Financial Inclusion and Information Technology

Technology is a key enabler in increasing financial inclusion. In India the use of smart cards and ATM machines is helping to overcome issues such as lack of adequate infrastructure, high transaction costs and low volumes of transactions. Nowadays ICTs (Information and Communication Technologies) are being used in many fields to improve the efficiency, reliability and ease of operation. One of the sectors where ICTs are being used extensively is banking. They are widely used in the form of mobiles, ATMs, intelligent core banking systems and so on. India has a large section of society which is very traditional and people have the habit of saving money. In most cases they save the money in their house itself. And the cash transfer takes place personally by hand. So there is a need for proper banking facilities to manage the money and make cash transactions at affordable price. And recent statistics show that more than seventy five percent of India's population does not have access to banking. So there is a huge need for financial services i.e. banks which can deliver the banking services at affordable costs. This process of delivering banking services at cheaper costs to the unbanked is called Financial Inclusion.

"ICT solutions are required to capture customer details, facilitate unique identification and to ensure reliable and uninterrupted connectivity to remote areas and across multiple channels of delivery," says Usha Thorat, Deputy Governor of the Reserve Bank of India. "They can offer multiple financial products (banking, insurance, capital market) through the same delivery channel while ensuring consumer protection, as well as develop the comprehensive and reliable credit information system so essential for efficient credit delivery and credit pricing." To support this development, in 2008 the Indian Finance Minister set up a Financial Inclusion Technology Fund of around US$125 million to meet the cost of technology adoption, including evolving industry-wide standards for IT solutions.

The banking system has grown enormously in the last five years keeping pace with and in some cases leading the country's remarkable economic growth. Simultaneously, the banking system has improved its strength, efficiency and resilience. There have also been significant improvements in the payments and settlements system and electronic payments and RTGS is now much more in use. IT has played a major role in these achievements. Today banks have centralized operations, more and more banks and branches are moving to CBS , network based computing, new delivery channels such as networked ATMs, internet banking, smart card based products, mobile access etc and are using IT for customer relationship management, customer transaction pattern analysis, credit profiling and risk management.

At the same time, a large number of households continue to be excluded from the formal banking system and as per some recent surveys their share has increased. The extent and reasons for exclusion are many and have been well documented in the Rangarajan Committee (RC) report and more recently in the very comprehensive and analytical section on financial inclusion in RBI's latest Currency and Finance (RCF) released a few days ago. The RCF points out that despite the broad international consensus regarding the importance of access to finance as a crucial poverty alleviation tool, it is estimated that globally over two billion people are currently excluded from access to financial services.

Many people are financially excluded because of various reasons like lack of information, insufficient documentation, lack of awareness, high transaction charges, lack of access and illiteracy. So the main objectives of the financial inclusion should take care of all the above problems with the help of ICTs. One of the key barriers to access to financial services to the poor and particularly to those living in remote rural areas is the price of being banked and the access to banks. The costs include both the fees charged by the financial institutions and the time and money required to access the bank. So there is need of a system where the services can be delivered to the remote areas at low cost, which can be done through mobile banking i.e. banking services on mobiles.

Conclusions and Recommendations

Broadly, financial exclusion is construed as the inability to access necessary financial services in an appropriate form due to problems associated with access, conditions, prices, marketing or self-exclusion. The working or operational definitions of financial exclusion generally focus on ownership or access to particular financial products and services. There is no single comprehensive measure that can be used to indicate the extent of financial inclusion across economies. Specific indicators such as number of bank accounts, number of bank branches, that are generally used as measures of financial inclusion, can provide only partial information on the level of financial inclusion in an economy.

Poor households face many constraints in trying to save, invest, and protect their livelihoods. They take financial intermediation very seriously and devote considerable effort to finding workable solutions. As a result, the informal sector in India teems with lenders of different sorts and mechanisms offering widely varying ways to save and insure. The informal sector has, until recently, offered low income households convenience and flexibility unmatched by formal intermediaries. But the informal sector also has many weaknesses and cannot do what a well functioning formal sector institution can.

1. Instead of focusing on micro-credit, or even micro-finance, governments would do better to focus on 'financial inclusion' as an overriding policy goal. They should attempt to measure the proportions of their populations with access to financial services, as a yardstick of progress over time towards greater financial inclusion.

2. Diversity is desirable: a wide range of approaches and institutions will be needed to eliminate financial exclusion. Governments need to think in a more 'systemic' manner, to consider how the whole financial *system* might be made more inclusive.

3. Pessimism about the sustainability of voluntary sector initiatives, including Grameen Bank replications, may prove overdone. However rigorous market surveys should precede the establishment of such schemes if they are to qualify for government or external assistance

4. Private sector investments and public/private partnerships have great potential and government should facilitate such initiatives

5. Some public initiatives do more harm than good. Governments should avoid 'packaging' ill conceived micro-credit schemes into other sectoral projects

6. Innovations in information technology are cutting micro-finance transaction costs in other regions. Telecoms reform in Forum island countries will increase the potential for sustainable micro-finance in the region using new information technologies

7. Governments may support micro-finance directly, through support for financial system building at the grassroots, or indirectly by providing an enabling policy and regulatory environment

The solution proposes common infrastructure for the rural data collection and information management and processing and sharing of the delivery channel by the banks with a view to substantially reducing the transaction costs and improving the speed and quality of delivery. The elements involved in the solution are the establishment of a data center and ensuring its two way connectivity to the mobile multi service delivery system available at the villages for providing the banking, extension and other services as well as connectivity to all the concerned banks and other service providing agencies. The solution involves the outsourcing of data management as well as of the delivery channel establishment and operations with required safeguards regarding the data ownership and operations. To sum up, banking and financial inclusion is the road that India needs to travel toward becoming a global player. Financial access with innovative measures taken by the banks will attract global market players to our country and that will result in increasing employment and business opportunities.

References

Bell, C. (2001): 'Post-independence India: A Case of Finance-led Industrialisation', *Journal of Development Economics* 65, 153-75.

Government of India: *Economic Survey* (various years), Government of India New Delhi.

Honohan, P. (2005) Measuring Micro-finance Access: Building on Existing Cross Country Data. Washington: World Bank. (Policy Research Working Paper 3606).

King, R.G. and R. Levine (1993): Finance and Growth: Schumpeter might be right, *Quarterly Journal of Economics* 108, 717-37.

Mohan, R. (2006): 'Agricultural Credit in India: Status, Issues and Future Agenda', *Economic and Political Weekly* (March), pp.1013-23.

Rajan, R.G. and L. Zingales (1998): 'Financial Dependence and Growth', *American Economic Review* 88, 559-86.

Santosh Ranganath N., Tulasi Rao G., (2011), Financial Inclusion In Indian Banking Sector - Emerging Models, The International Research Journal of Science and IT Management, pp. 28-37.

Santosh Ranganath N., Tulasi Rao G., (2012), Inclusive Growth in India: A Challenging Tool for Banking and Financial Sector, International Journal of Marketing, Financial Services & Management Research, pp. 42-48.

Sharma Anamika, (2009), "Challenges: For Building Financial Inclusive India, ICFAI Reader, pp 14-20.

Siva Kumar B., Santosh Ranganath N., (2012), Financial Inclusion in India - The Way Forward, Asia Pacific Journal of Research in Business Management, pp. 71-81.

Smt. Usha Thorat, Deputy Governor, Reserve Bank of India, Keynote address on 'Financial Inclusion and Information Technology' on 12.09.2008.

Sudha V, Kalidas K, Sampath Kumar R, (2009) edited, 'Financial Inclusion- Aspects, Issues and the Way Forward", Himalaya Publishing House Thorat Usha , 'Financial Inclusion- The Indian Experience', RBI Bulletin , pp 1165-1172.