FINANCIAL INCLUSION AND INDIAN BANKING SYSTEM- A COMBO OF INTEGRAL AND INCLUSIVE GROWTH PROCESS

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ABSTRACT

Indian economy has the central objective of ‘Growth with Equity’ right from the inception of planning process. Government has been taking various measures to achieve the same from many years and Financial Inclusion is prioritised among them. The phrase of Financial Inclusion objects at providing the financial services at affordable cost to those who are excluded from the formal finance system. This can be achieved if the basic banking services are made accessible to all. Perhaps, this is very vital also for sustaining long term equitable development. The three major aspects of financial inclusion are: (i) Accessing to financial market.(ii)Accessing to credit market. (iii) Learn financial matters. In recent years, there has been growing emphasis by the Government and the Reserve Bank on providing formal financial services to the hitherto unbanked/under banked areas. A multi-pronged strategy has been adopted to enhance the outreach of banking services across all sections of society. In order to achieve the objective of universal financial inclusion, banks have been directed to use a combination of strategies, which include:(a) Provision of basic banking products (b) Introduction of Business correspondent/Business Facilitator (BF) model(c) Relaxation of existing regulatory guidelines in the form of lenient Know Your Customer (KYC) norms(d) Enhanced use of technology and (e) Setting up financial literacy and credit counseling centres in districts to achieve greater outreach.

The current study aims at an empirical evaluation of financial inclusion growth in the Indian banking system and also looks insight to understand the growth process of Indian banks by integrating and inclusion of the same. The study evidences that there has been a better growth of rural banking and services so far and much more is anticipated with a countable quantum of problems.

KEYWORDS: Financial Inclusion (FI), Know Your Customer (KYC), No Frills Accounts, Rural Banking, Economic Growth.
1. INTRODUCTION

The term ‘Financial Inclusion’ literally means inclusion of all sections of society towards the financial services and products. The various finance products and services are banks, insurance, investments, personal finance etc. Of all, banking system is very important as most of the finance transactions will be done through banks only. In developing economies like India, the banks, as mobilisers of savings and allocators of credit for production and investment, have a very critical role. As a financial intermediary, the banks contribute to the economic growth of the country by identifying the entrepreneurs with the best chances of successfully initiating new commercial activities and allocating credit to them. At a minimum, all retail commercial banks also provide remittance facilities and other payment related products. Thus, inherently, the banking sector possesses a tremendous potential to act as an agent of change and ensure redistribution of wealth in the society. Having a bank account is a major objective of financial inclusion. But the angle in which Indian Economy intercepts the Financial Inclusion is different. In India, Financial inclusion is a new concept. More than 70% of our population lives in the rural areas. Financial inclusion is a necessity for a country where a large chunk of the world’s poor resides. Access to finance by the poor and vulnerable groups is a prerequisite for poverty reduction and social cohesion. Financial inclusion is a process to bring the weaker and vulnerable sections of society within the purview of the organized financial system. It creates conditions for accessing timely and adequate credit and other financial services by vulnerable groups, such as weaker sections & low income groups at affordable cost.

According to Former UN Secretary-General Kofi Annan, “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.” This paper discusses about the need and growth process of financial inclusion in the Indian banking sector right from its identity to the recent stages of development and initiations made by RBI and Government together.

2. OBJECTIVES OF STUDY

The current study has the following objectives to discuss:

✓ To understand the concept of Financial Inclusion and structuralise the outcomes.

✓ To study the various steps taken by RBI and Government of India in developing the Financial Inclusion in Banking sector.

✓ Also, to examine the growth of financial services in India through Financial inclusion implemented in the Indian banking system.
3. RESEARCH METHODOLOGY

The main gamut of discussion has been taken from various secondary sources like books, periodicals, journals and RBI press note circulars. Some of the websites were also referred for arriving at the reliable conclusion for the given objectives.

4. FINANCIAL INCLUSION-A PARADIGM OF GROWTH

The term financial inclusion refers to delivery of financial services at an affordable cost in a fair and transparent terms and conditions to vast sections of disadvantages, weaker and low income groups including household enterprise, small medium enterprise and traders. It not only enhances overall financial intensity of agriculture but also help in increasing rural nonfarm activities which lead to development of rural economy and improve economic condition of people. Financial inclusion includes micro credit, branchless banking, no-frills bank accounts, saving products, pension for old age, microfinance, self help group, entrepreneurial credit etc.

The Government of India’s Committee on Financial Inclusion in India’ begins its report by defining financial inclusion as “The process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost” (Rangarajan Committee 2008). It has been also defined as “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.” (Dr. K.C. Chakraborty, 2009). It should be a noteworthy here that Financial Inclusion and Financial Literacy as twin pillars where Financial Inclusion acts on the supply side i.e. for creating access and financial literacy acts from the demand side i.e. creating a demand for the financial products and services.

Let us understand how Financial Inclusion leads to economic growth. Financial Inclusion has the ability to generate positive externalities: it leads to increase in savings, investment and thereby, spur the processes of economic growth. It also provides a platform for inculcating the habit of saving money, especially amongst the lower income category that has been living under financial illiteracy. Presence of banking services and products aims to provide a critical tool to inculcate the savings habit. It also creates avenues of formal credit to the unbanked population who are otherwise dependent on informal channels of credit like family, friends and moneylenders. Availability of timely, adequate and transparent credit from formal banking channels will allow the entrepreneurial spirit of the masses to increase outputs and prosperity in the countryside. As we all know, Financial Inclusion has now been viewed as a remedy to plug gaps and leaks in distribution of government benefits and subsidies through direct benefit transfers to beneficiaries’ bank accounts rather than through subsidizing products and making cash payments. Thus, on the whole, Financial Inclusion has the potential to bring in the unbanked masses into the formal banking system, channelize their savings, stroke their entrepreneurial ambitions by making available credit and thus giving an uplift for the Economy.
5. FINANCIAL INCLUSION DEVELOPMENT IN INDIA SO FAR

Reserve bank of India and government plays an important role in promoting financial inclusion for economic growth to increase the banking penetration in the country. The various developments taken by both so far in the Indian economy are bulleted below:

- Creation of State Bank of India in 1955
- Nationalisation of commercial banks in 1969 and 1980
- Initiating the Lead Bank Scheme in 1970, was a big step to expand financial inclusion.
- Priority sector lending norms, branch licensing norms with focus on rural and semi urban branches.
- National Bank for Agriculture and Rural Development (NABARD) was set up in 1982 mainly to provide refinance to the banks extending credit to agriculture.
- Establishment of regional rural banks in 1975 are also the major steps for same aim which encourage branch expansion in rural area.
- Self help groups linkage programmed in 1992 by NABARD, which facilitates and provides door step banking.
- Simplifications of Know your customer (KYC) norms are another milestone.
- In 1998 Kisan credit card has been launched and on the suggestion of NABARD in 2005 General credit card has been launched which facility up to Rs. 25000/-.

In January 2006 NGOs, SHGs, AND Micro Finance Institutions are permitted by RBI. Now MFIs currently cover 8.3 million borrowers. MFIs, Self-help groups (SHGs) also meet the financial service requirements of the poorer segments. Thus the whole process of development can be summarised below:

<table>
<thead>
<tr>
<th>Period</th>
<th>Development</th>
</tr>
</thead>
<tbody>
<tr>
<td>1950-70</td>
<td>Consolidation of the banking sector and facilitation of industry and trade.</td>
</tr>
<tr>
<td>1970-90</td>
<td>Focus on channeling of credit to neglected sectors and weaker sections.</td>
</tr>
<tr>
<td>1990-2005</td>
<td>Focus on strengthening the financial institutions as part of financial sector reforms.</td>
</tr>
<tr>
<td>2005 onwards</td>
<td>Financial inclusion was explicitly made as a policy objective.</td>
</tr>
</tbody>
</table>
6. INITIATIONS TAKEN BY RBI, GOVERNMENT OF INDIA FOR THE GROWTH OF FINANCIAL INCLUSION

Some of the following important initiations are taken by RBI since it has identified the importance of Financial Inclusion.

- No Frill Accounts
- Simple KYC Norms
- Other Rural Intermediaries
- Usage of Regional Language
- Easier Credit Facilities
- Use of Technological services
- Co-operative Movement
- Setting up of State Bank of India
- Nationalization of banks
- Lead Bank Scheme
- RRBs
- Service Area Approach
- Self Help Groups

Among all, three important measures such as No Frills accounts, KYC norms and Use of technological services have a dominant role in promoting the Financial Inclusion.

6.1 KYC (KNOW YOUR CUSTOMER)

KYC is an acronym for “Know Your Customer”, a term used for customer identification process. It is a kind of framework for banks which enables them to know/understand the customers & their financial dealings to be able to serve them better. The objective of the KYC guidelines is to prevent banks being used, intentionally or unintentionally by criminal elements for money laundering.

Four key elements of KYC policies are

- Customer Acceptance Policy
- Customer Identification Procedures
Therefore banks are advised to follow certain customer identification procedure for opening of accounts & monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority.

6.2 NO FRILLS ACCOUNT

The annual policy statement of April 2005 recognized that the banking practices that tend to exclude rather than attract vast sections of population. With a view to achieving greater financial inclusion, all banks were asked to make available a basic banking ‘no frill’ account either with ‘nil’ or very low minimum balances as well as charges that would make such accounts accessible to vast sections of population. The nature and number of transaction in such accounts could be restricted, but made known to the customer in advance in a transparent manner. All banks were urged to give a wide publicity to the facility of such ‘no frill’ account so as to ensure great financial inclusion. The KYC procedure for opening of accounts has been simplified for those who intend to keep balances not exceeding Rs.50000/- in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed R. 100000/- in a year.

<table>
<thead>
<tr>
<th>Category</th>
<th>March 31, 2006</th>
<th>March 31, 2007</th>
<th>March 31, 2008</th>
<th>March 31, 2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Banks</td>
<td>332878</td>
<td>5865419</td>
<td>13909935</td>
<td>29859178</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>156388</td>
<td>860997</td>
<td>1845869</td>
<td>3124101</td>
</tr>
</tbody>
</table>

Source: RBI reports, 2009

The figures in Table 1 indicate the significantly major contribution of 89% by Public Sector Banks in order to open ‘no frill’ accounts to contribute towards financial inclusion followed by Private sector banks up to almost 11% total contribution till 2009. Also figures show an increasing trend in the growth of ‘no frill’ account from 2006-2009 in Indian Banking Sector, which is a good sign for financial inclusion in India. In the progress of ‘no frill’ accounts also it is very evident from above data that the public sector banks are far more ahead in reaching to the needy and marketing the accounts.

6.3 TECHONOLOGICAL SERVICES

However financial inclusion objectives would not be fully met if the banks do not increase the banking outreach to the remote corners of the country. This has to be done with affordable infrastructure & low operational costs with the use of appropriate technology. This would enable banks to lower the transaction costs. A few banks have already initiated certain pilot projects in different remote parts of the country utilizing smart cards/mobile technology to extend banking services similar to those dispensed from branches. Banks are, therefore, urged to scale up their...
financial inclusion efforts by utilizing appropriate technology. Care may be taken to ensure that the solutions developed are:

- Highly secure
- Amenable to audit
- Follow widely accepted open standards to allow inter-operability among the different systems adopted by different banks

The mobile revolution has created a sort of new world order. It has the potential to change the way banks do business. While banks are embracing the mobile channel & continuing to support the old standby of online banking, they are not integrating the technologies used to build e-banking solutions. Also as more people conduct their banking on mobile devices, these devices also will become the growing focus of hackers & fraudsters. Banks can work on two areas within the mobile channel. They are Fraud prevention & Marketing to customers. In fact, world over mobile banking already is playing a role in reducing fraud in a variety of ways – ranging from simple transaction & security alerts to mobile authentication for bank transfers.

With the rapidly growing mobile penetration in the country, mobile banking has the potential to become a mass banking channel, with very minimum investment required by banks. However, more security issues need to be addressed before banking can be conducted more freely via this channel.

7. RBI’S FOSTER POLICY INITIATIVES FOR ROBUST DEVELOPMENT OF FINANCIAL INCLUSION

The following policy development initiations were taken by RBI for a quick and fast development of Financial Inclusion.

(A) REACHING TO ALL

(I) EXPANSION OF BRANCHES IN ALL AREAS ESPECIALLY RURAL CENTRES

Branch authorisation has been relaxed to the extent that banks do not require prior permission to open branches in centres with population less than 1 lakh, which is subject to reporting. To further step up the opening of branches in rural areas, banks have been mandated to open at least 25 per cent of their new branches in unbanked rural centres. This is expected to facilitate the branch expansion in unbanked rural centres.

(II) AGENT BANKING - BUSINESS CORRESPONDENT/ BUSINESS FACILITATOR MODEL

In January 2006, the Reserve Bank permitted banks to utilise the services of intermediaries in providing banking services through the use of business facilitators and business correspondents.
The BC model allows banks to do ‘cash in - cash out’ transactions at a location much closer to the rural population, thus addressing the last mile problem.

(B) ACCESSING TO MANY

(I) RELAXATION OF KYC NORMS

- Know Your Customer (KYC) requirements have been simplified to such an extent that small accounts can be opened with self certification in the presence of bank officials.

- RBI has allowed ‘Aadhaar’ to be used as one of the eligible documents for meeting the KYC requirement for opening a bank account.

(II) ROADMAP FOR BANKING SERVICES IN UNBANKED VILLAGES

- In the first phase, banks were advised to draw up a roadmap for providing banking services in every village having a population of over 2,000 by March 2010. Banks have successfully met this target and have covered 74398 unbanked villages.

- In the second phase, Roadmap has been prepared for covering remaining unbanked villages i.e. with population less than 2000 in a time bound manner. About 4,90,000 unbanked villages with less than 2000 population across the country have been identified and allotted to various banks. The idea behind allocating villages to banks was to ensure availability of at least one banking outlet in each village.

(C) INITIATION OF NEW PRODUCTS AND SERVICES

In order to ensure that all the financial needs of the customers are met, the banks are advised by RBI to offer four basic products, viz.

- A savings cum overdraft account
- A pure savings account, ideally a recurring or variable recurring deposit
- A remittance product to facilitate EBT and other remittances, and
- Entrepreneurial credit products like a General Purpose Credit Card (GCC) or a Kisan Credit Card (KCC)

(D) FLEXIBILITY IN TRANSACTIONS

The recent introduction of direct benefit transfer, leveraging the Aadhaar platform, will help facilitate delivery of social welfare benefits by direct credit to the bank accounts of beneficiaries. The government, in future, has plans to route all social security payments through the banking network, using the Aadhaar based platform as a unique identifier of beneficiaries. In order to
ensure smooth roll out of the Government’s Direct Benefit Transfer (DBT) initiative, banks have been advised to:

- Open accounts of all eligible individuals in camp mode with the support of local Government authorities.
- Seed the existing and new accounts with Aadhaar numbers.
- Put in place an effective mechanism to monitor and review the progress in implementation of DBT.

8. HURDLES IN FINANCIAL INCLUSION

Many issues add to the financial inclusion woes in India. The first & foremost is access to banking services. The reason that most Indians lack access is because there are only around 85,000-90,000 bank branches in our country, which are mostly crowded in urban & semi-urban areas, leaving the rural areas largely un-serviced. And even if we increased access to banks in the rural areas, a multitude of problems continue to hamper financial inclusion.

Firstly is the bank account opening requirements. Regulations mandate extensive KYC documentation. This is often unfeasible for many in the rural areas to provide, leading them to money-lenders for credit and financial assistance.

Secondly, due to interest rate regulations with the intra-banking sector, banks can’t charge more than 12 to 13 percent interest rate, whereas money-lenders can charge even 40 to 50 percent. The cap on interest rate makes it unprofitable for banks to lend in the rural sector.

Thirdly, the agent for banking known as the business correspondent model, has not quite penetrated the rural sector. These untapped customers want quick, instant bank accounts, simplicity of product & flexibility of repayment. To solve these issues, we need literacy & financial education which was unfortunately missing in rural areas.

The last & most formidable challenge is the Indian geography, which is so vast. One institution cannot serve the needs of the poor. Banks, technology companies like Visa, & organizations with a large network such as a mobile company or the Indian post office need to collaborate to solve these issues.

9. RECENT PROJECTS UNDERTAKEN FOR FINANCIAL INCLUSION

Millions of people have lack of proper proof as driving license, Pan card, credit cards etc. so that they face difficulties to access public services like bank account, ATM facility, loan facilities etc. The project ADHAR (The brand name of UID) serve the KYC guidelines for the people who have lack of Identity. Thus, UID(Unique Identification Number) could act as a tool to drive financial inclusion for the rural and poor people. The various other projects for indulging the financial inclusion are as follows:
SWALABANA: A co-contributory pension scheme launched on September 26, 2010 for workers of unorganized sector. Under this scheme the worker of unorganized sector who contribute a sum of Rs. 1000 to Rs. 12000 per year in their pension account during financial year 2010-2011, the central government will contribute a sum of Rs. 1000 per annum. Swavalamban scheme totaling to 40 lakhs subscribers by March 2014.

SWABHIMAN: The central government has launched in a way to achieve financial inclusion programme Swabhiman on February 10, 2011 in which five crore household of 73000 villages would be provided access to banking services in unbanked area by opening 50,000,000 crore no frills account till March 2012.

PFRDA (Pension Fund Regulatory & Development Authority’s) Government has set a regulatory body for the pension sector on August 23, 2003. PFRDA’s effort are an important milestone in the development of the sustainable & efficient voluntary defined contributor based pension system of India. PFRDA also works for financial literacy and awareness campaigns as a part of its strategy to protect the interest of subscribers under Swavalamban scheme.

10. CONCLUSION

Financial inclusion envisages low-cost banking services to the financially excluded population & regions of the country. At the same time it has proved to be a cost effective business proposition for banks. This is possible by harnessing low cost technology, & provision of technical, financial & policy support from Government of India, RBI & NABARD.

The Banking sector, as the most important financial intermediary for mobilization of savings leading to investments towards growth, would thus, play the most crucial role in attaining the economic objectives of the country. Economic growth can be attained only by making banking more inclusive through expanding the coverage of banking services by reaching the vast unbanked & under-banked population of the country. Thus, inclusive banking is not an end in itself but also a means to achieve balanced, sustainable & inclusive growth. India’s fastest growing economies have become possible through financial inclusion.

Although various initiatives were introduced in India from last two decade but Financial inclusion remain distant dreams. A committee called by central government for financial inclusion has given its report that to access financial services including credit to be raised to 50% by 2012 and 100% by 2015. Thus, financial inclusion have enough scope for economic growth, raising living standard of people, equality etc. On the basis of above initiatives and projects we can conclude that a day will come when all Indians have their bank accounts and everybody will take part in financial inclusion.
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