# FINANCIAL INCLUSION- A PREREQUISITE FOR SUSTAINABLE GROWTH

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**Abstract :** The purpose of financial inclusion is to provide equitable opportunities to every individual to avail the facility of formal financial channels for better life, better living and better income Governments around the world are increasingly viewing financial inclusion as essential to economic development. Several governments are also making financial inclusion an integral part of their national plans. India's government, for example, has just launched the 'Pradhan Mantri Jan Dhan Yojana', with the explicit aim of removing financial untouchability.

The micro and macro benefits of inclusion are potentially immense. Individuals can cope better with irregular income and unexpected spending needs, as well as avoiding usurious interest rates and sometimes unreasonable collateral demands in the informal sector. Inclusion may also help pull them out of poverty through being able to tap better education and health care. For micro-enterprises, financial inclusion can provide funds for setting up or expanding, or for improving risk-management. On a wider scale, it can help improve potential growth in an economy by mobilizing savings. It can also draw more firms into the formal sector, raising tax revenues and making workers eligible for better protection and benefits.

**Keywords:** Financial , Sustainable , Growth

## 1 INTRODUCTION

### What is Financial Inclusion?

Financial Inclusion is defined as the “process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, at an affordable cost in a fair and transparent manner by regulated, mainstream institutional players”.

### Objectives of the study

- To highlight the need of financial inclusion towards the economic growth of a nation.
- To analyze the initiatives of the Government of India for sustainable economic growth.
- To examine the challenges towards achieving the objectives of inclusive growth.

### Hypothesis

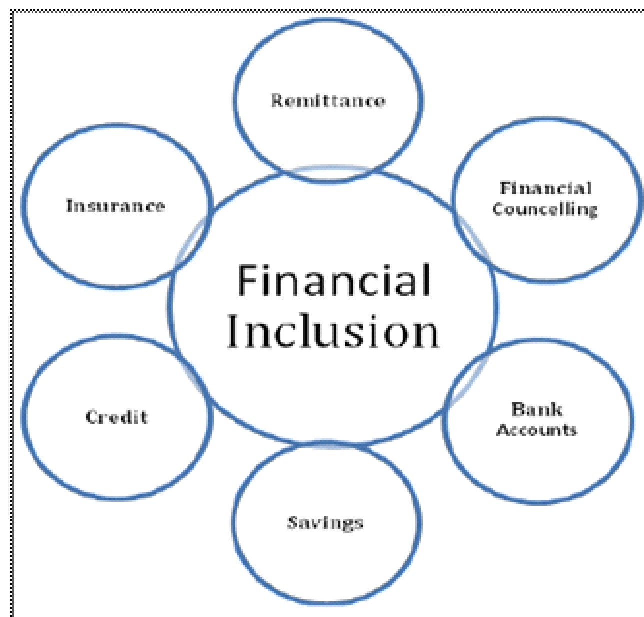
Financial inclusion can help individuals cope better with poverty, especially with the challenges of irregular income. It can eradicate poverty through improved education and health care and can boost economic growth by mobilizing savings.

**Methodology**

The paper is based on secondary data from reliable and authentic sources.

**Why Financial Inclusion?**

The purpose of financial inclusion is to provide equitable opportunities to every individual to avail the facility of formal financial channels for better life, better living and better income. The World Bank estimates that nearly 2.5bn adults globally (50% of the total adult population) is currently ‘unbanked’ or does not use formal financial services. The developed world (OECD countries) show a high proportion of the adult labour force included. This ratio drops significantly for emerging markets. Over two-thirds of the adult population in South Asia, SSA and MENA are still financially excluded. It is crucial to innovate and provide means to include the financially excluded by way of ensuring access to financial services, and timely and adequate credit.




Governments around the world are increasingly viewing financial inclusion as essential to economic development. Several governments are also making financial inclusion an integral part of their national plans. India’s government, for example, has just launched the ‘Pradhan Mantri Jan Dhan Yojana’, with the explicit aim of removing financial untouchability. The scheme has some ambitious targets, such as to provide a bank account to every household within 12 months. Every household opening an account would also be given personal accident insurance of INR 100,000 as well as life insurance of INR 30,000 (and an overdraft facility of INR 5,000 after a few months following a credit review). The scheme was launched on 28 August with 15 million new accounts being opened on a single day and targets 75 million new accounts by August 2015, though the Prime Minister is pushing for this to be completed by January 2015

**Financial Inclusion and Economic Development**

Banks need to mobilize resources from a wider customer base and extend credit to business activities which are not financed by banks till now. Financial inclusion will strengthen financial deepening and provide resources to the banks to expand credit delivery.

The financial system serves as a catalyst to economic development. The formal financial channels collect savings and idle funds and distribute such funds to entrepreneurs, businesses, households and government for investment projects and other purposes with a view of a return. This forms the basis for economic development in modern economic theory.

## Benefits of Financial Inclusion

### At the micro level

For individuals, formal financial institutions provide opportunities to better manage and increase savings. Individuals can also borrow to meet emergency cash needs, such as for hospital visits and funerals, lump-sum expenses such as weddings or funerals or to accumulate assets, such as a bicycle or a cart. Borrowers can also use a loan to fund education or health needs, such as school or medical fees. All these things can make people more productive and happier, boosting the economy as well as the standard of living. There are similar benefits for small entrepreneurs and firms. Loans from financial institutions allow them to overcome cash constraints to set up and pursue new businesses. These loans not only provide the funds for working capital needs but also for business expansion. Formal financial institutions also lower the reliance of individuals and firms on moneylenders and other sources of credit in the informal sector that often charge very high rates of interest and can have unreasonable collateral requirements.

### At the macro level

It helps mobilize savings that would otherwise be sitting idle and allows them to be invested in more productive areas, improving economic growth potential. At the same time, improvements in labour skills through better education and health care, as well as the set-up of new businesses raise economic productive potential. Lower interest rates charged in the formal sector also improve the sustainability of an individual or firm's financial condition.

A report looking at the full impact of financial inclusion on economic growth potential, estimates that a 10ppt increase in financial inclusion (measured as an account with a formal financial institution as defined in the Global Findex Survey) could raise income per worker by 1.3% on average, with increases in financial inclusion resulting in improvements in total factor productivity and capital per worker.

### Reducing inequality

Several experiments suggest that the impact on poverty reduction is significant but varies depending upon the type of instrument used (World Bank, 2014). Individuals have seen a significant improvement in consumption, savings and productive investment through access to basic accounts with financial institutions. Insurance also appears to have a positive impact on growth and poverty reduction through more productive investment in better seeds and more expensive tools, for example.

India's recently announced Jan Dhan Yojana promises to pay benefits directly into bank accounts. The government scheme will also provide overdraft facilities and debit cards to those who sign up. It is expected to help improve fiscal policy through lower leakage of benefits such as grain, fuel and fertilizer subsidies. This could reduce India's subsidy bill, which is now close to 2% of GDP. Reserve Bank of India (RBI) Governor Raghuram Rajan expects the "link between poor public service, patronage and corruption" to be broken through financial inclusion.

## Current Status of Financial Inclusion India

Financial inclusion has always been accorded high importance by the Reserve Bank and Government of India to aid the inclusive growth process for the economy, the history of financial inclusion in India is actually much older than the formal adoption of the objective. The nationalization of banks, Lead Bank Scheme, incorporation of Regional Rural Banks, Service Area Approach and formation of Self-Help Groups - all these were initiatives aimed at taking banking services to the masses. The brick and mortar infrastructure expanded; the number of bank branches multiplied ten-fold - from 8,000+ in 1969, when the first set of banks were nationalized, to 99,000+ today. The table below provides a glimpse of the manifold expansion of bank branches in India with their percentage

## BANK BRANCHES

| Year | Rural | Semi-Urban | Urban & metropolitan | Total | Rural share (%) |
|---|---|---|---|---|---|
| 1969 | 1,833 | 3,342 | 3,087 | 8,262 | 22 |
| 1970 | 3,063 | 3,718 | 3,350 | 10,131 | 30 |
| 1975 | 6,807 | 5,598 | 6,325 | 18,730 | 36 |
| 1980 | 15,105 | 8,122 | 9,192 | 32,419 | 47 |
| 1985 | 30,185 | 9,816 | 11,384 | 51,385 | 59 |
| 1990 | 34,791 | 11,324 | 13,637 | 59,752 | 58 |
| 1995 | 33,004 | 13,341 | 16,022 | 62,367 | 53 |
| 2000 | 32,734 | 14,407 | 18,271 | 65,412 | 50 |
| 2005 | 32,082 | 15,403 | 20,870 | 68,355 | 47 |
| 2010 | 32,554 | 21,053 | 34,834 | 88,441 | 37 |
| 2011 | 33,813 | 23,236 | 36,750 | 93,799 | 36 |
| 2012 | 35,653 | 25,542 | 38,698 | 99,884 | 36 |

Source: RBI

| S. No | Indicators of Financial Inclusion | India (%) | China (%) | Germany (%) | World (%) |
|---|---|---|---|---|---|
| 1 | Account at a formal financial institution (% age 15+) | 35 | 64 | 98 | 50 |
| 2 | Account at a formal financial institution, female (% age 15+) | 26 | 60 | 99 | 47 |
| 3 | Account at a formal financial institution, income, bottom 40% (% age 15+) | 27 | 47 | 98 | 41 |
| 4 | Account used to receive wages (% age 15+) | 8 | 19 | 46 | NA |
| 5 | Account used to receive government payments (% age 15+) | 4 | 7 | 62 | NA |
| 6 | Account used to receive remittances (% age 15+) | 2 | 9 | 17 | NA |
| 7 | Saved at a financial institution in the past year (% age 15+) | 12 | 32 | 56 | 22 |
| 8 | Saved using a savings club in the past year (% age 15+) | 3 | 2 | 4 | 5 |
| 9 | Loan from a financial institution in the past year (% age 15+) | 8 | 7 | 13 | 9 |
| 10 | Loan from family or friends in the past year (% age 15+) | 20 | 25 | 9 | 23 |
| 11 | Debit card (% age 15+) | 8 | 41 | 88 | NA |
| 12 | Credit card (% age 15+) | 2 | 8 | 36 | 15 |

Source: Demirguc-Kunt and Klapper, 2012,

It can be clearly observed from the above given data that there has been tremendous growth in the spread of banking network in the country since 1969. However despite this wide network of bank branches spread across the length and breadth of the country, the extent of financial exclusion in India is staggering. Out of the 600,000 habitations in the country, only about 36,000+ had a commercial bank branch. Just about 40 per cent of the population across the country has bank accounts. The proportion of people having any kind of life insurance cover is as low as 10 per cent and proportion having non-life insurance is abysmally low at 0.6 per cent. People having debit cards comprise only 8 per cent and those having credit cards only a marginal 2 per cent of the population

**Challenges to increasing financial inclusion**

While the reasons for lack of financial inclusion vary between countries and regions, a number of common themes emerge. Broadly there are five main barriers to financial inclusion –

**•Natural barriers**

A number of 'natural' barriers to financial inclusion often prevent poor people from accessing even the most basic formal financial services. Simply being too poor or the geographic distance to a bank can be a huge deterrent for a poor person. According to a study, globally 25% of 'unbanked' adults cited costs (this rises to 31% in SSA), 20% reported that the bank is too far away while 13% reported lack of trust in the bank. Transaction costs, both for banks and poor people, are another major barrier to financial inclusion.

**•Lack of financial infrastructure;**

Lack of financial infrastructure is the second major barrier to financial inclusion. Governments have a key role to play by facilitating banks' access to borrower information. This can be achieved either by passing laws and regulations that enable banks to share information or by directly setting up public credit registries. Public credit registries are databases established and managed by central banks that capture information on both individual and commercial borrowers and their credit status. Public registries can be important in the early stages of financial development, but they can reduce the attractiveness of private bureaus. Private credit bureaus refer to information-sharing arrangements maintained by private financial institutions.

**•Restrictive regulations**

Restrictive regulations are the third barrier to formal financial inclusion for the poor. The Global Findex data highlights that 18% of adults in the developing world cite 'lack of necessary documentation' as the reason for not having a formal account. Stringent KYC documentation requirements imposed by national regulators on banks in order to comply with guidelines around the prevention of money laundering and combating the financing of terrorism can block poor households from entering the financial system. According to a study, globally, each additional document required to open an account reduces the number of accounts by 153 per 1,000. More often than not, poor people do not have any form of formal identity documentation.

**•Governance failures**

Weak public-sector institutions that exemplify governance failure can be detrimental to financial inclusion. Improvements in public-sector governance can have a positive impact on the equitable use of and access to financial services. This applies both to banks' direct relationships with individuals and to any joint ventures they might make with correspondents, microfinance institutions or mobile providers.

**•Lack of suitable products.**

The final challenge to financial inclusion is creating attractive financial products. Financial products need to be tailored to meet the needs of the poor. Products need to be affordable, available within reasonable physical proximity and regulated to protect consumers. Banks may need to adopt a different approach towards the poorer segments of society. Although banks have some products that are suitable for addressing the needs of the poor, quite often the poor either have limited knowledge or an incorrect understanding of the products and are reluctant to use them.

**Conclusion**

Despite 67 years as an independent nation, India is still lagging behind in the process of providing financial services to the masses with nearly half the households remaining unbanked, and nearly ninety percent villages not having bank branches.

The government and Reserve Bank of India have been making concerted efforts since mid1950's and with renewed vigor since 2005 but success has been rather slow, due to lack of a strong network, and financial instruments not suited to rural residents. Moreover, lack of awareness and financial literacy among rural population are primarily responsible for low penetration of financial services

More incentives for the BCs, utilizing existing network for banking such as post offices, creating awareness for the use of banking technologies as well as mobile phones etc. will help in creating a big difference in the economy

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