

# FINANCIAL INCLUSION - ISSUES AND CONCERNS

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## 1. Introduction

India has a long history of development of banking system. After independence, the major focus of the Government and the Reserve Bank of India had been to develop a sound banking system which could support planned economic development through mobilization of resources/deposits and channel them into productive sectors. Accordingly, the Government is decided to use the banking system as an important agent to change the core policies that were formulated since independence. The planning strategy recognized the critical role of the availability of credit and financial services to the public at large in the holistic development of the country. In recognition of this role, the authorities modified the policy framework from time to time and whereby it ensured that the needs of financial services in various segments of the society were met adequately. The recent developments in banking technology have transformed banking from the traditional brick and mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines, credit/debit cards, internet banking, online money transfers, etc. However, the access to such technology is restricted only to certain segments of the society. Indeed, allowing, such increasingly sophisticated customer segmentation technology or more accurate targeting of sections of the market has led to restricted access to financial services for some groups. With an increased range of personal finance options for segments of high and upper middle income population and significantly large section of the population who lack access to even the most basic banking services, the gap widens and leads to financial exclusion. These large section of people, particularly, those living on low incomes, cannot access mainstream financial products such as bank accounts, credit, remittances and payments services, financial advisory services, insurances facilities, etc.

The subject matter of financial inclusion contributed to a consensus that merely having a bank account may not be a good indicator of financial inclusion. Further, indebtedness as quantified in the National Sample Survey Organization 59<sup>th</sup> Round (2003) may not also be a reflective indicator. If genuine claimants for credit and financial services were denied for the same, then that is a case of exclusion. As this aspect would raise the issue of creditworthiness or bankability, it is also necessary to dwell upon what could be done to make the claimants of institutional credit bankable on creditworthy. This would require reengineering of existing financial products or delivery systems and making them more in tune with the expectations and absorptive capacity of the intended customers.

## **2. Evolution of financial inclusion in India**

Prior to 1990, several initiatives were undertaken for enhancing the use of the banking system for sustainable and equitable growth. These included nationalization of private sector banks, introduction of priority sector lending norms, the lead bank scheme, branch licensing norms with focus on rural/semi-urban branches, interest rate ceilings for credit to the weaker sections and creation of specialized financial institutions to cater to the requirement of the agriculture and the rural sectors having the bulk of poor population. The different phases of financial inclusion measures at various points of time could be described as under.

### **2.1. Credit channeling (First Phase: 1960-1990)**

The term credit channeling was introduced in India in late 1960s. In the first phase, the focus was on channeling of credit to the neglected sectors of the economy. Special emphasis was laid on weaker sections of the society. Although the term 'financial inclusion' was not in vogue in India then, both the Government of India and the Reserve Bank have been concerned about the non-availability of banking facilities to the under-privileged and weaker sections of the society. Accordingly, several initiatives have been taken over time such as nationalization of banks, prescription of priority sector targets, lending to weaker sections at concessional rates and initiation of the lead bank scheme. These initiatives were undertaken at different point of time to expand the outreach of banking facilities and thereby increase the flow of credit to the rural areas. During this period, 19 banks were nationalized to improve the rural and agricultural credit. Henceforth, the nationalized banks have started mobilizing deposits on a massive scale and lending funds for all productive activities.

## 2.2 Strengthening financial system (Second Phase: 1990 - 2004)

In the second phase spanning the early 1990s to March 2005, the focus was mainly on strengthening the financial institutions as part of financial sector reforms. However, once the financial health of the banking system was restored, focused attention was again paid towards promotion of financial inclusion. Financial inclusion in this phase was encouraged mainly by the introduction of SHG-Bank linkage programme in the early 1990s and Kisan Credit Cards for providing credit to farmers. The Indian financial system essentially catered to the needs of planned in a mixed-economy framework, where the Government sector had a predominant role in economic activity. With the onset of economic reforms in the beginning of the 1990s, a strong and resilient financial sector was considered necessary for accelerating the growth momentum in the country and also for expanding the coverage of financial services in a sustainable manner. Accordingly, the financial sector reform process had placed more emphasis on creating a strong, vibrant and competitive banking system. An important step to bring financially excluded people within the fold of formal financial sector was the promotion of micro-finance in India. The SHG-Bank linkage programme was launched by NABARD in 1992, with policy support from the Reserve Bank of India, to facilitate collective decision making by the poor and provide 'door step' banking. Banks, as wholesalers of credit, were to provide the resources, while the NGOs were to act as agencies to organize the poor, build their capacities and facilitate the process of empowering them.

## 2.3. Financial inclusion (Third Phase: 2005 onwards)

In the third phase, beginning in April 2005, 'financial inclusion' was explicitly made as a major policy objective and thrust was on providing safe facility to savings deposits through 'no frills' accounts. The recent approach focused on financial inclusion on the individual and household levels. The important difference in the recent focus on financial inclusion is the adoption of market oriented approach that recognizes the importance of business consideration of banks and other financial institutions for the long-term sustainability of the process. The Annual Policy Statement for the year 2005-06 of the Reserve Bank of India observed that although there had been expansion, greater competition and diversification of ownership of banks leading to both enhanced efficiency and systemic resilience, there were legitimate concerns with regard to the banking practices that tended to exclude vast sections of population, in particular pensioners, self-employed and those employed in the unorganized sector.

### 3. Financial inclusion initiatives

The information technology and introduction of electronic payment system offers financial products and services, financial literacy, education and experience in several parts of the country to reach the masses through the use of kiosks, mobile vans, etc. The development of communication and computer technology and the availability of the internet have made e-banking possible to a common man whereby one can do most banking transactions from a remote location with ease.

**Internet banking/online banking/net banking:** The system allows individuals to perform banking activities such as account transfers, balance inquiries, bill payments, stop payment requests, etc. through the internet. As an integral part of the e-business, the e-banking has been growing rapidly. It is believed that the e-banking will help banks to cut costs, increase revenue and become more convenient for customers. The banks have adopted a business strategy of e-banking to target business customers for not only loans but other fee based services. Small banks were motivated to develop e-banking for potential future cost savings and gaining a competitive edge.

**Mobile banking:** Mobile banking is not a new channel but a modified version of online banking that fits on a two-inch screen through the mobile phone. Mobiles provides a unique opportunity for the financial services institutions to reach customers much better than internet banking service that necessitates a computer and internet connection. The internet connections are said to be in the region of a few million and active users could be much less. Therefore, given the wide availability of the mobiles and mobile network, the adoption of mobile banking will be more effective. Mobile banking is currently commonly used for basic banking like balance enquiry and account activities. This is achieved through the introduction of interbank mobile payment service, powered by National Payments Corporation of India. An IMP is a mobile based, bank led payment mechanism, which is a safe, secure, round-the-clock, convenient payment mechanism for Indians for domestic transactions.

**Tele-banking:** The system provides provision of certain banking services such as account balance inquiry, funds transfer, information about products and services, information about status of cheque issued or deposited, deposit interest rates, information about TM and branch locations and payment of bills through telephone.

**ATM:** An Automated Teller Machine is a computerized device that provides the clients of a financial institution with access to financial transaction in a public space without the need for a cashier or a human clerk. The main facilities provided under ATM are round-the-clock cash withdrawals, cash and cheque deposits, balance enquiry & statement of account, a mini statement comprising last few transactions.

**Biometric ATMs:** The importance of biometrics has grown tremendously with an increasing demand of security in accordance of unique identification of individuals by the biological phenomena of human body. The rapidly increasing applications, the scope of biometrics is also increasing, be it identification via face, voice, retina or iris. Finger printing, however, has the advantage of being a familiar concept world wide. ATMs with biometric devices are the latest solution in the ongoing effort to offer banking services to the rural masses. Establishing the identity of a rural depositor through biometrics makes it possible for illiterate or barely literate people.

**Mobile ATM:** Mobile ATMs are designed for providing ATM facility to the rural poor as well as to other customers. The van (Mobile ATM) move to the pre-determined places and it is also accessible to biometric card holders. Opening of accounts also can be undertaken during the visits to the rural areas. This can be used at weekly markets effectively. Mobile ATMs are useful at sporting events, trade fairs, social gatherings, etc.

**Smart cards:** A smart card is any pocket-sized card with embedded integrated circuits. Smart cards can provide identification, authentication, data storage and application processing. Smart cards come in different flavors with differing operating systems, memory capacities and processing power.

**Post offices:** Post offices have a physical presence in every nook and corner of the country. So the Department of Post, with its presence and skilled employees, can become the agent of change to bring about financial inclusion. The existing Indian Post Offices are strategically perfect source available to promote inclusive financial growth. The post offices are the only way to include the excluded masses into the banking stream is to reach them at their place of residence or work i.e. by providing doorstep banking through cost effective technology driven model.

#### 4. Conclusion

People, poor and rich, need reliable finance so that their ideas can be brought together with assets to generate long-run sustainable growth. The two key ingredients to a well-functioning market economy are: competition and access, competition so that performance keeps improving and access so that everyone has a chance to participate and nobody's talents are wasted. In the coming year of micro credit, the government will focus on access to finance, for after all, people, poor and rich, need reliable financing so that their ideas can be brought together with assets to generate long-run sustainable growth.

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