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FINANCIAL INCLUSION- AN OVERVIEW

Uma Gowri. M. [*]

B.Kavitha [**]

Abstract

Bank nationalization in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. The banking industry has shown tremendous growth in volume and complexity during the last few decades. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to include vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services.

The period 1969 to 1991 saw a huge increase in the branch outreach in India as reflected in the average population covered by a bank branch fell from 64,000 to 13,711 numbers. In 1991 along with reforms for liberalizing and opening up of the economy, financial sector reform aimed at deregulation, increased competition and strengthening of the banking sector through recapitalization and adoption of prudential measures.

The rationale for creating Regional Rural Banks was also to take the banking services to poor people. Estimates reveal that 24 per cent of the total population that constitutes 245 million adults in rural India does not have a bank account and 60 million out of 245 million may not

[*] **Ph.D (Agricultural Economics), Research Associate, Tamil Nadu Agricultural University, Coimbatore, Tamil Nadu, India**

[**] **Ph.D (Agricultural Economics), Assistant Professor, PGP College of Agricultural Sciences, Namakkal, Tamil Nadu, India**

need banking services because they are below the poverty line. About 185 million potentially bankable people do not use formal banking services because of reasons like poor access or usage. In India, as per the Census of 2001, the ratio of deposit accounts (data available as on March 31, 2005) to the total adult population was only 59 per cent. Efforts are being made to study the causes of financial exclusion and designing strategies to ensure financial inclusion of the poor and disadvantaged.

Introduction

Focus in India

The Indian economy is growing at a steady rate of 8.5 per cent to 9.0 per cent in the last five years or so. Most of the growth is from industry and services sector. Agriculture is growing at a little over two per cent. The potential for growth in the primary and small and medium enterprise sector is enormous. Limited access to affordable financial services such as savings, loan, remittance and insurance services by the vast majority of the population in the rural areas and unorganized sector is believed to be acting as a constraint to the growth impetus in these sectors. Access to affordable financial services, such as credit and insurance enlarges livelihood opportunities and empowers the poor to take care of their lives. These empowerment aids will create social and political stability.

The Indian banking industry today is quite robust and strong to be able to take on the challenges of achieving greater financial inclusion. To enhance the financial inclusion, the Reserve Bank of India in its Annual Policy Statement for the year 2005-06, emphasized and urged that banks should review their existing practices to align the inclusion of vast section of population with the objective of financial inclusion.

As per the Mid Term Review Policy (2005-06), RBI exhorted the banks, with a view to achieve greater financial inclusion and to make available a basic banking 'no frills' account either with nil or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population. The nature and number of transactions in such accounts would be restricted and made known to customers in advance in a transparent manner. All banks are urged to extend wide publicity to the facility of such no frills account so as to ensure greater financial inclusion.

Further, in order to ensure that persons belonging to low income group both in urban and rural areas do not face difficulty in opening the bank accounts due to the procedural hassles, the know your customers procedure for opening accounts has been simplified for those persons who intend to keep balances not exceeding rupees fifty thousand in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed rupees one lakhs in a year.

Role of Government

State Governments are playing a pro-active role in facilitating financial inclusion that includes issuing of official identity documents for opening accounts, creating awareness through nongovernmental organizations or self help groups and involving district and block level functionaries in the entire process, Meeting cost of cards and other devices for pilot projects, undertaking financial literacy drives are some of the ways in which the State and district administration have involved themselves. India Post is also looking to diversify its activities and leverage on its huge network of post offices, the postman's intimate knowledge of the local population and the enormous trust reposed in him. Banks are entering into agreements with India Post for using post offices as agents for branchless banking.

All these activities of the government and Reserve Bank of India are mainly aiming to avoid financial exclusion for social and economic empowerment.

Fig 1.1 Components of Financial Inclusion

COMPONENTS OF FINANCIAL INCLUSION

(Source: UN Department of Economic and Social Affairs (DESA) and the UN Capital Development Fund (UNCDF), 2006)

Need for Financial Inclusion

Households with low income often lack access to bank account and have to spend time and money for multiple visits to avail the banking services, be it opening a savings bank account or availing a loan. These families find it more difficult to save money and to plan for the future. Generally, the unbanked public is largely cut off from the banking products/services. It is the endeavour of the bank to provide the basic banking facility of savings bank account to all the unbanked.

Importance of Financial Inclusion

"Financial inclusion is the process of ensuring access to timely and adequate credit and financial services by vulnerable groups at an affordable cost". "Banks have core-banking solutions, that don't mean that it will reach out to everyone, banks are computerized, and that doesn't mean that they reach out to everyone, hence banking sector should integrate itself with efforts of various governmental and non-governmental initiatives to achieve this goal of inclusion of low income groups." ***(P. Chidambaram, Honourable Finance Minister, 2007).***

Access to finance by the poor and vulnerable groups is a pre requisite for poverty reduction and social cohesion. In fact, providing access to finance is a form of economic empowerment of the vulnerable groups. Apart from these benefits, financial inclusion imparting formal identity, provides access to the payments system and to savings safety net like deposit insurance.

A vast segment of India's population exists on the margins of India's financial systems, per-capita savings of this class may not be very high and their number and their amount of savings are of a considerable amount. If their entry in the formal financial sector is made easier, those savings can be channelized for the formal economy. The savings cum risk products are needed to meet their primary requirement and it can be structured for them, once they are part of the formal banking system.

National Mission on Financial Inclusion

The Committee feels that the task of financial inclusion must be taken up in a mission mode as a financial inclusion plan at the national level. A National Mission on Financial Inclusion (NaMFI) comprising representatives from all stakeholders may be constituted to aim at achieving universal financial inclusion within a specific time frame. The Mission should be responsible for suggesting the overall policy changes required for achieving the desired level of financial inclusion, and for supporting a range of stakeholders – in the domain of public, private and NGO sectors – in undertaking promotional initiatives.

A National Rural Financial Inclusion Plan (NRFIP) may be launched with a clear target to provide access to comprehensive financial services, including credit, to atleast 50% of financially excluded households, say 55.77 million by 2012 through rural/semi-urban branches of Commercial Banks and Regional Rural Banks. The remaining households, with such shifts as may occur in the rural/urban population, have to be covered by 2015. Semi-urban and rural branches of commercial banks and RRBs may set for themselves a minimum target of covering 250 new cultivator and non-cultivator households per branch per annum, with an emphasis on financing marginal farmers and poor non-cultivator households.

Development and Technology Funds

There is a cost involved in this massive exercise of extending financial services to hitherto excluded segments of population. Such costs may come down over a period of time with the resultant business expansion. However, in the initial stages some funding support is required for promotional and developmental initiatives that will lead to better credit absorption capacity among the poor and vulnerable sections and for application of technology for facilitating the mandated levels of inclusion. The Committee has, therefore, proposed the constitution of two funds with NABARD –the Financial Inclusion Promotion & Development Fund and the Financial Inclusion Technology Fund with an initial corpus of Rs. 500 crore each to be contributed in equal proportion by GoI / RBI / NABARD. This recommendation has already been accepted by GoI.

No Frills Accounts

Possessing a bank account is a minimum requirement for any citizen so that banking channels are kept open to him. The bank has so far opened 1, 41,826 no-frills accounts, with average balance of Rs: 430/- per account and Rs: 5/- for opening of account. A pilot scheme for achieving 100% financial inclusion by providing no-frills accounts has been implemented in Srikakulam district in Andhra Pradesh and Ganjam district in Orissa, where we happen to be the lead bank, in collaboration with other banks. This was a gigantic task and required a lot of coordination amongst banks, educating the customers, making due identification, etc. The task, however, was successfully completed by March 2007. It is proposed to extend the scheme to all other districts in the State of Andhra Pradesh.

General Purpose Credit Cards

Access to minimum credit is increasingly being seen as a "right" of the customer, rather than a "facility" sanctioned by banks after so much of scrutiny. The bank has initiated steps to cover households to meet the credit needs for economic activities under the existing schemes and also to initiate steps for sanction of "General Purpose Credit cards” to the eligible and needy. This is expected to materialize at the earliest.

Kisan Credit Card Scheme:

The Kisan credit card scheme was first introduced in India by Andhra Bank in 1998. The scheme aims to facilitate access to short-term credit to farmers and to simplify the credit mechanism, so that farmers can receive credit on time. The different commercial banks, Regional Rural Banks (RRBs) and cooperative banks issue the Kisan credit card. By September 2002, 271.81 lakh Kisan credit cards had been issued (See Table 1), which is considered a significant achievement. Rural financial institutions are not well integrated with agriculture support systems like R&D, Extension, supply chain and processing, and their credit policy is too crop centric. So non-crops and other high value activities are not taken care of. Only traditional crops have credit access; most banks give out only 15% or less of their total portfolio to the agri-sector as against the mandatory 18%.It was expected that with the introduction of the Kisan credit card, the farmers’ condition will improve and they will be less dependent on moneylenders, but in reality farmers now are more dependent on moneylenders because of the lack of proper implementation of the policies laid down for the benefit of farmers and bureaucratic hurdles in getting credit from banks.

Role of RRBs

RRBs, post-merger, represent a powerful instrument for financial inclusion. Their outreach vis-à-vis other scheduled commercial banks particularly in regions and across population groups facing the brunt of financial exclusion is impressive. RRBs account for 37% of total rural offices of all scheduled commercial banks and 91% of their workforce is posted in rural and semi-urban areas. They account for 31% of deposit accounts and 37% of loan accounts in rural areas. RRB's have a large presence in regions marked by financial exclusion of a high order. They account for 34% of all branches in North-Eastern, 30% in Eastern and 32% in Central regions. Out of the total 22.38 lakhs SHGs credit linked by the banking industry as on 31stMarch 2006, 33% of the linkages were by RRBs which is quite impressive to say the least. Significantly the more backward the region the greater is the share of RRBs which is amply demonstrated by their 56% share in the North-Eastern, 48% in Central and 40% in Eastern region. RRBs are, thus, the best suited vehicles to widen and deepen the process of financial inclusion. However, there has to be a firm reinforcement of the rural orientation of these institutions with a specific mandate on financial inclusion. With this end in view, the Committee has recommended that the process of merger of RRBs should not proceed beyond the level of sponsor bank in each State. The Committee has also recommended the recapitalization of RRBs with negative Net Worth and widening of their network to cover all unbanked villages in the districts where they are operating, either by opening a branch or through the BF/BC model in a time bound manner. Their area of operation may also be extended to cover the 87 districts, presently not covered by them.

Key Performance Indicators

5.08 Reforms introduced in RRBs by GoI in consultation with RBI and NABARD have yielded positive results in respect of key performance indicators, as indicated under:

Table 1 Key Performance Indicators

Key Performance Indicators : RRBs

Amount Rs. crore

Sr. No	Indicator	31.03.2004	31.03.2005	31.03.2006
1	No. of RRBs	196	196	133
2	No. of districts covered	518	523	525
3	No. of branches	14446	14484	14494
4	No. of staff	69249	68912	68629
5	Owned funds	5438	6181	6647
6	Deposits	56350	62143	71329
7	Borrowings	4595	5524	7303
8	Investments	36135	36761	41182
9	Loans outstanding	26114	32870	39713
10	Credit-deposit (CD) ratio	46%	53%	56%
11	Loans issued	15579	21082	25427
12	No. of RRBs having accumulated losses	90	83	58
13	Accumulated losses	2725	2715	2637
14	No. of RRBs in profit	163	166	111
15	Net NPA (%)	8.55%	4.84%	3.99%
16	Recovery (%) (as on 30 June)	73%	78%	80%
17	Per branch productivity	5.71	6.56	7.66
18	Per staff productivity	1.19	1.38	1.62

The following trends can be highlighted:

• 111 RRBs out of total 133 registered profit in the year 2005-06.

• CD Ratio has been increasing from 46% on 31 March 2004 to 53% on 31 March 2005 and further to 56% on 31 March 2006.

• Recovery percentage has been improving from 73% during 2003-04 to 80% during 2005-06.

• Consequently, net NPAs have declined from 8.55% on 31 March 2004 to 3.99% on 31 March 2006.

• Loans disbursement registered an impressive 35% annual growth in 2004-05 and 21% in 2005-06.

• Per branch productivity has increased from Rs. 5.71 crore on 31 March 2004 to Rs. 7.66 crore on 31 March 2006.

• Per staff productivity has increased from Rs.1.19 crore on 31 March 2004 to Rs.1.62 crore on 31 March 2006.

• There has been a decline in the total number of staff.

Performance under "Doubling of Agriculture Credit": RRBs

More importantly, the performance of RRBs under GoI's initiative on doubling of agriculture credit in three years (from base year 2003-04) and greater coverage of small and marginal farmers have been impressive. They disbursed agriculture loans of the order of Rs. 12,404 crore during 2004-05 registering a phenomenal annual growth of 64% against the targeted 30%. During 2005-06, agriculture credit flow stood at Rs. 15,223 crore with a growth of 23%. Thus, RRBs have achieved the target of doubling of agriculture credit in 2 years. RRBs financed 18.58 lakhs new farmers in 2004-05 and another 17.03 lakhs new farmers in 2005-06.

Table 2: Spatial Distribution of Banking Services

(Per cent)

	Offices			Deposits			Credit		
	1969	1996	2005	1969	1996	2005	1969	1996	2005
1	2	3	4	5	6	7	8	9	10
Rural	22.2	51.2	45.7	6.4	14.4	12.2	3.3	11.4	9.5
Semi-urban	40.4	21.3	22.3	21.8	19.5	16.9	13.1	13.1	11.3
Urban	19.2	15.2	17.6	26.5	22.4	21.5	21.8	17.7	16.4
Metropolitan	18.2	12.3	14.4	45.3	43.7	49.4	61.8	57.8	62.7
Total	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Source: Reserve Bank of India

SHG – Bank Linkage Scheme

The SHG - Bank Linkage Programme can be regarded as the most potent initiative since Independence for delivering financial services to the poor in a sustainable manner. The programme has been growing rapidly and the number of SHGs financed increased to 29.25 lakhs on 31 March 2007. The spread of the SHG - Bank Linkage Programme in different regions has been uneven with Southern States accounting for the major chunk of credit linkage. Many States with high incidence of poverty have shown poor performance under the programme. NABARD has identified 13 States with large population of the poor, but exhibiting low performance in implementation of the programme. The ongoing efforts of NABARD to upscale the programme in the identified States need to be given a fresh impetus. The Committee has recommended that NABARD may open dedicated project offices in these 13 States for up scaling the SHG - Bank Linkage Programme. The State Govts. and NABARD may set aside specific funds out of the budgetary support and the Micro Finance Development and Equity Fund (MFDEF) respectively for the purpose of promoting SHGs in regions with high levels of exclusion. For the North-Eastern Region, there is a need to evolve SHG models suited to the local context of such areas. NGOs have played commendable role in promoting SHGs and linking them with banks. NGOs, being local initiators with their low resources, are finding it difficult to expand in other areas and regions. There is, therefore, a need to evolve an incentive package which should motivate these NGOs to diversify into other backward areas.

The SHG - Bank Linkage Programme is now more than 15 years old. There are a large number of SHGs in the country which are well established in their savings and credit operations. The members of such groups want to expand and diversify their activities with a view to attain economies of scale. Many of the groups are organizing themselves into federations and other higher level structures. To achieve this effectively, resource centres can play a vital role.

Federations of SHGs at village and taluk levels have certain advantages. Federations, if they emerge voluntarily from amongst SHGs, can be encouraged. However, the Committee feels that they cannot be entrusted with the financial intermediation function.

Extending SHG – Bank Linkage Scheme to Urban Areas

There are no clear estimates of the number of people in urban areas with no access to organized financial services. This may be attributed, in part at least, to the migratory nature of the urban poor, comprising mostly of migrants from the rural areas. Even money lenders often shy away from lending to urban poor. The Committee has recommended amendment to NABARD Act to enable it to provide micro finance services to the urban poor.

Joint Liability Groups

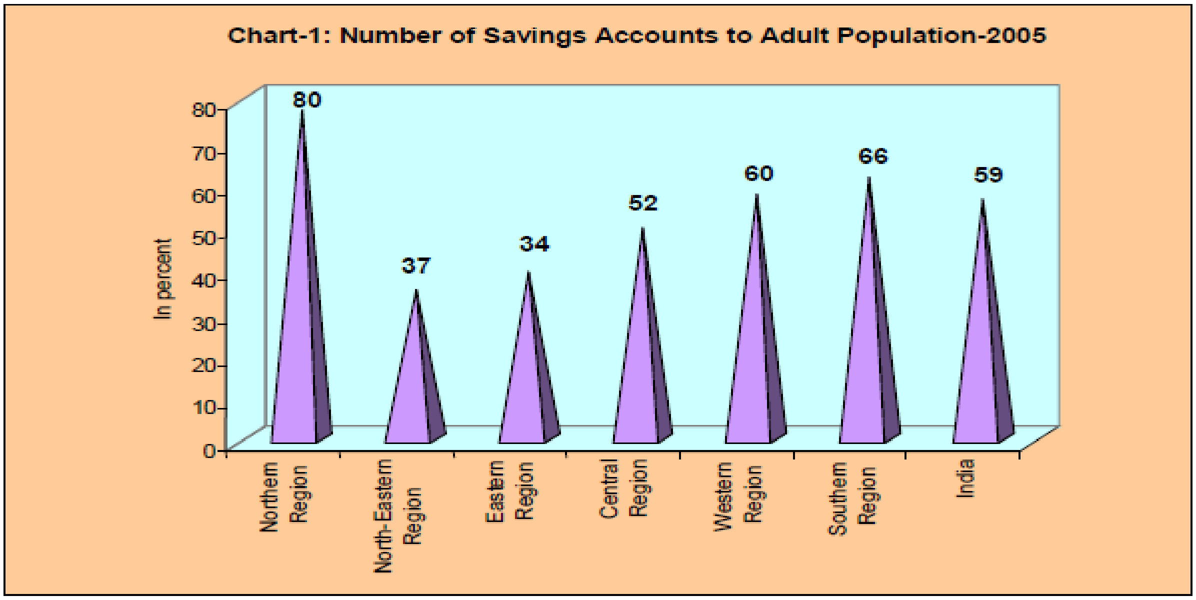
SHG-bank linkage has emerged as an effective credit delivery channel to the poor clients. However, there are segments within the poor such as share croppers/oral lessees/tenant farmers, whose loan requirements are much larger but who have no collaterals to fit into the traditional financing approaches of the banking system. To service such clients, Joint Liability Groups (JLGs), an up gradation of SHG model, could be an effective way. NABARD had piloted a project for formation and linking of JLGs during 2004-05 in 8 States of the country through 13 RRBs. Based on the encouraging response from the project, a scheme for financing JLGs of tenant farmers and oral lessees has also been evolved. The Committee has recommended that adoption of the JLGs concept could be another effective method for purveying credit to mid-segment clients such as small farmers, marginal farmers, tenant farmers, etc. and thereby reduce their dependence on informal sources of credit.

Micro Finance Institutions - NBFCs

Micro Finance Institutions (MFIs) could play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. Many of them operate in a limited geographical area, have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations providing a level of comfort to their clientele. The Committee has, therefore, recommended that greater legitimacy, accountability and transparency will not only enable MFIs to source adequate debt and equity funds, but also eventually enable them to take and use savings as a low cost source for on-lending. There is a need to recognize a separate category of Micro finance – Non Banking Finance Companies (MF–NBFCs), without any relaxation on start-up capital and subject to the regulatory prescriptions applicable for NBFCs. Such MF-NBFCs could provide thrift, credit, micro-insurance, remittances and other financial services up to a specified amount to the poor in rural, semi-urban and urban areas. Such MF-NBFCs may also be recognized as Business Correspondents of banks for providing only savings and remittance services and also act as micro insurance agents. The Micro Financial Sector (Development and Regulation) Bill, 2007 has been introduced in Parliament in March 2007. The Committee feels that the Bill, when enacted, would help in promoting orderly growth of microfinance sector in India. The Committee feels that MFIs registered under Section 25 of Companies Act, 1956 can be brought under the purview of this Bill while cooperative societies can be taken out of the purview of the proposed Bill.

NSSO Survey Results

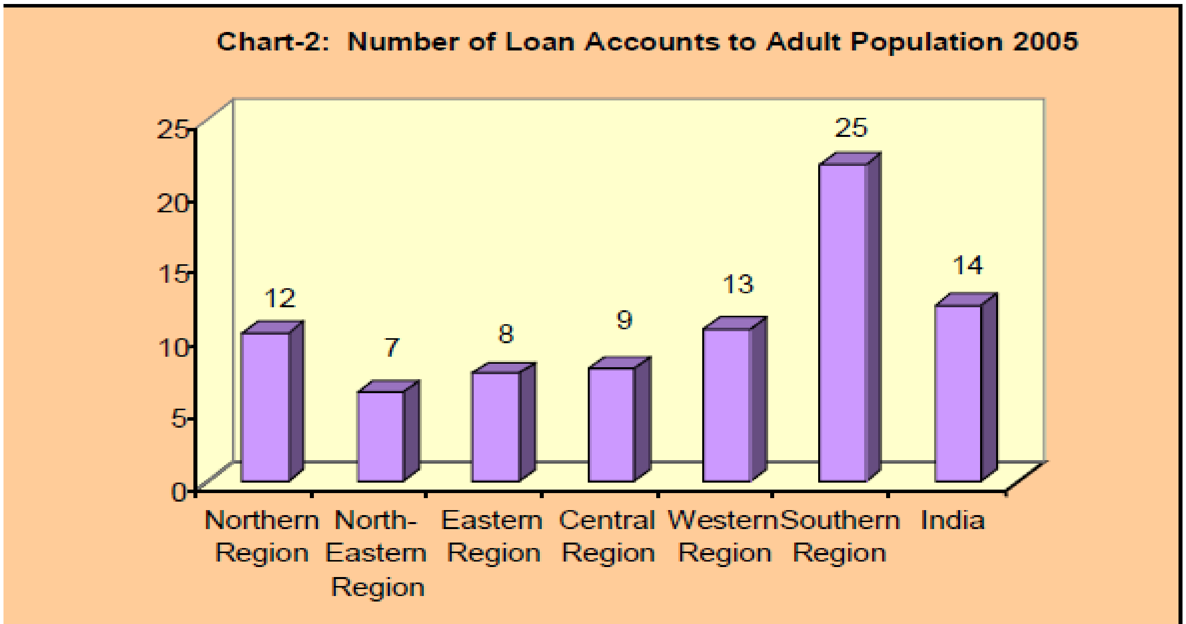
The Committee debated the various dimensions of inclusion and concluded that while aspects such as savings, remittance facilities, insurance, etc. were important, nevertheless exclusion was particularly germane from the standpoint of access to credit by vulnerable groups.



The Committee accordingly scanned the data put out by the NSSO in the situation assessment survey on "Indebtedness of Farmer Households" (2003). The Committee noted that the definition of indebtedness as adopted in the survey referred to farmer households having outstanding loans from institutional or non-institutional sources[4] in cash or kind having a value of Rs.300 or more at the time of transaction. As per NSSO data, 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households do not access credit, either from institutional or non-institutional sources. Only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). In other words, 73% of farm households do not have access to formal credit sources. For purposes of this analysis, "financially excluded" households will be defined as those not having any debt to formal credit sources. The various aspects of such exclusion among specific regions and population groups are indicated below.

The extent of exclusion from credit markets is much more, as number of loan accounts constituted only 14 per cent of adult population (Chart-2). In rural areas, the coverage is 9.5 per cent against 14 per cent in urban areas. Regional differences are significant with the credit coverage at 25 per cent for the Southern Region and as low as 7, 8 and 9 per cent respectively in

North Eastern, Eastern and Central Regions. The extent of exclusion from credit markets can be observed from a different view point. Out of 203 million households in the country, 147 million are in rural areas – 89 million are farmer households. 51.4 per cent of farm households have no access to formal or informal sources of credit while 73 per cent have no access to formal sources of credit.



Similar data are not available for non farm and urban households. Looking at the different sources of credit, it is observed that the share of non institutional sources reduced from 70.8% in 1971 to 42.9% in 2002. However after 1991, the share of non institutional sources has increased; specifically, the share of moneylenders in the debt of rural households increased from 17.5 % in 1991 to 29.6% in 2002. In urban areas the share of non institutional sources has come down significantly from 40% in 1981 to around 25 % in 2002.

Level of Non-indebtedness: Across Regions

The farm household's not accessing credit from formal sources as a proportion to total farm households is especially high at 95.91%, 81.26% and 77.59% in the North Eastern, Eastern and Central Regions respectively. In terms of absolute numbers these regions taken together account for 64% of farm households not accessing credit from formal sources as detailed below:

The Southern Region, on the other end, exhibits relatively better levels of access to formal / non-formal sources (72.7%) mainly on account of spread of banking habits and a more robust infrastructure.

Table 3 Level of Non-indebtedness across Region

No. of Farmer Households (HH) in Lakh

Region	Total HHs	Indeb-ted HHs	% to total HHs	Non indeb-ted HHs	% to total HHs	Indeb-ted to formal sources	% to total HHs	Exclu-ded by formal sources	% to total HHs
Northern	109.46	56.26	51.40	53.2	48.60	27.423	25.05	82.04	74.95
North Eastern	**35.40**	**7.04**	**19.90**	**28.36**	**80.10**	**1.448**	**4.09**	**33.95**	**95.91**
Eastern	**210.61**	**84.22**	**40.00**	**126.39**	**60.00**	**39.467**	**18.74**	**171.14**	**81.26**
Central	**271.33**	**113.04**	**41.60**	**158.29**	**58.40**	**60.814**	**22.41**	**210.52**	**77.59**
Western	103.66	55.74	53.70	47.92	46.30	45.586	43.98	58.07	56.02
Southern	161.56	117.45	72.70	44.11	27.30	69.072	42.75	92.49	57.25
Group of UTs	1.48	0.49	33.10	0.99	66.90	0.15	10.14	1.33	89.86
All India	**893.50**	**434.24**	**48.60**	**459.26**	**51.40**	**243.96**	**27.30**	**649.54**	**72.70**
NE, C & E Regions *	**517.34**	**204.30**	**39.49**	**313.04**	**60.51**	**101.73**	**19.66**	**415.61**	**80.34**
Share to All-India (%)	**57.90**	**47.05**		**68.16**		**41.70**		**63.99**	

* NE = North-Eastern Region, C = Central Region, E = Eastern Region.

Level of Non-indebtedness: Across States

The proportion of non-indebted farmer households was most pronounced in Jammu & Kashmir (68.2%) and Himachal Pradesh (66.6%) in the Northern Region, all States in the North-Eastern Region (61.2% to 95.9%) except Tripura, in Bihar (67%) and Jharkhand (79.1%) in Eastern Region, and Chatisgarh (59.8%), UttarPradesh (59.7%) and Uttaranchal (92.8%) in the Central Region, as per details given below

Table 4 Level of Non-indebtedness: Across States

State / Region	Non-indebted farmer HHs @		State / Region	Non-indebted farmer HHs @	
	Lakh	%		Lakh	%
Northern	**53.21**	**48.7**	West Bengal	34.53	49.9
Haryana	9.11	46.9	**Central**	**158.29**	**58.4**
Himachal Pradesh	6.03	66.6	Chhatisgarh	16.50	59.8
Jammu & Kashmir	6.43	68.2	Madhya Pradesh	31.09	49.2
Punjab	6.38	34.6	Uttar Pradesh	102.38	59.7
Rajasthan	25.26	47.6	Uttaranchal	8.32	92.8
North Eastern	**28.36**	**80.4**	**Western**	**47.92**	**46.3**
Arunachal Pradesh	1.15	94.1	Gujarat	18.20	48.1
Assam	20.51	81.9	Maharashtra	29.72	45.2
Manipur	1.61	75.2	**Southern**	**44.11**	**27.3**
Meghalaya	2.44	95.9	Andhra Pradesh	10.84	18.0
Mizoram	0.60	76.4	Karnataka	15.52	38.4
Nagaland	0.51	63.5	Kerala	7.82	35.6
Tripura	1.19	50.8	Tamil Nadu	9.93	25.5
Sikkim	0.36	61.2			
Eastern	**126.39**	**60.0**	**Group of UTs**	**0.99**	**66.9**
Bihar	47.42	67.0			
Jharkhand	22.34	79.1	**All India**	**459.26**	**51.4**
Orissa	22.09	52.2	@ refers to non-indebtedness to both formal / non-formal sources		

Level of Indebtedness to Institutional Sources

Derived data indicate that only 27.3% of the total farm households were indebted to institutional sources as detailed below:

Table 5 Level of Indebtedness to Institutional Sources

Region	Total no. of HHs (lakh)	Incidence of indebtedness to both formal and non formal sources		Indebtedness to institutional sources	
		Lakh HHs	(% to total HHs)	Lakh HHs	(% to total HHs)
Northern	109.46	56.26	51.39	27.42	25.05
North Eastern	35.40	7.04	19.88	1.45	4.09
Eastern	210.61	84.22	40.01	39.47	18.74
Central	271.33	113.04	41.66	60.81	22.41
Western	103.66	55.74	53.77	45.59	43.98
Southern	161.56	117.45	72.70	69.07	42.75
Group of UTs	1.48	0.49	33.10	0.150	10.14
All India	**893.50**	**434.24**	**48.60**	**243.96**	**27.30**

Level of Non-indebtedness: Across Marginal / Small Farmer Households

It can be seen from the table below that 87% of all non-indebted farm households belong to the marginal (70.6%) and small (17.1%) farmer categories. The NSSO estimates of the year 2003 show that only around 45% of marginal famer households (viz., up to 1 ha.) had access to both institutional and non-institutional credit. There are no data to show the position of finance extended exclusively to marginal farmers by institutional sources. A major portion of the credit from financial institutions for weaker sections has supported small farmers. However, marginal farmers who account for 66% of all farm holdings remain by and large excluded from the formal financial system and by rough approximation, only around 20% of these households access credit from formal banking sources.

Table 6 Level of Non-indebtedness: Across Marginal / Small Farmer Households

Category of farmer HH	Size class of land owned (Ha)	Total farmer HHs (no. lakh)	Non-indebted farmer HHs (no. lakh)	Incidence of exclusion by both formal and non formal sources (%)	Proportion of non-indebted HHs. (%)
Marginal	<1.00	589.06	324.04	55.0	70.6
Small	1.01 – 2.00	160.60	78.68	49.0	17.1
Semi-medium	2.01 – 4.00	93.50	39.10	41.8	8.5
Medium	4.01 – 10.00	42.58	14.84	34.9	3.2
Large	10.00 +	7.76	2.60	33.6	0.6
All sizes		**893.50**	**459.26**	**51.4**	**100.0**

Demand side causes and solutions for Financial Inclusion

The Committee's report has so far concentrated on supply side issues of financial inclusion and what can be done to enhance supply of financial services, through increased outreach by existing institutions, enhancing their incentives to serve the excluded and adding new distribution channels. The Committee is of the view, however, that financial exclusion is also caused by demand side issues – the fact that nearly 22% of the population is below the poverty line, and could not fully participate in the mainstream economy. Unless some steps are taken on the demand side, or in the "real sectors", mere supply side solutions from the financial sector will not work.

Resource Endowment Issues

It is widely recognized in economic literature that there are at least five different types of capital – physical (roads, buildings, plant and machinery, infrastructure), natural (land, water, forests, livestock, weather), human (nutrition, health, education, skills, competencies), social (kinship groups, associations, trust, norms, institutions) and financial. One of the causes as well as consequences of poverty and backwardness is inadequate access to all these forms of capital. Thus to look at financial inclusion in an isolated way is problematic. Merely pumping a backward region with financial capital is not going to be enough in the absence of improvements on the side of human, social and physical capital. The people in the first place have to be healthy and educated to be productive, so that they can use finance effectively. There has to be a substantial degree of trust and functioning institutions, in other words social capital, for economic transactions to take place in an atmosphere of confidence. Finally, there has to be adequate access to physical capital in terms of roads, bridges, canals, warehouses and market yards, in addition to electric power and telecommunication, for financial capital to be useful. In the absence of all this, merely insisting on financial inclusion will not work. This explains why the credit deposit ratio in some of the eastern States, remains low over several decades. Let us examine the adequacy of various other forms of capital.

Inadequate Human Capital

Health and education are both essential pre-requisites for financial inclusion. Moreover, access to these services is enabled by access to financial services. Important health indices like life expectancy at birth, infant and under-five mortality levels show that a lot remains to be done. On the education front also, quality of education imparted in the mainstream system of education, poor attainment level of children and high dropout rates at all levels need to be tackled urgently. The educationally excluded groups mainly belong to socially disadvantaged groups like the STs, SCs, OBCs and girls from poor households. In such a situation, financial inclusion has to be preceded by effective investments by the government to ensure near universal access to primary health and education.

Inadequate Access to Natural Capital

Land is the most important form of natural capital, followed by water. In most of the districts and states where financial inclusion is low, a vast majority of the rural population is either landless or have less than 1 hectare of land. In rain fed areas land ownership is higher, but the percentage that is irrigated is small. For example in Jharkhand, less than 10% of the cultivable land is irrigated. In Vidarbha, the extent of irrigation is only 7% of the gross cropped area. For small farmers the access to land and water resources is a key precondition for using credit. It is in this context that programmes for enhancing access to land and water become relevant. For tribal communities, access to natural capital in terms of forest lands is severely restricted and this adversely affects their livelihoods and the ability to use credit.

Underdeveloped Social Capital

There is a general correlation between financial exclusion and under-developed institutions. Gram Panchayats, commodity cooperatives, local administration and even local markets in the financially excluded regions are not well developed. Making these work is again both a pre-condition for financial inclusion, and will be assisted by it.

Productivity Issues

Low Productivity

The Committee noted that most of the regions which have low degree of financial exclusion, also exhibit a low level of agricultural productivity. While the Committee was not able to commission any detailed studies on this topic, a cursory review of data indicates a high degree of correlation between low financial inclusion and low agricultural productivity. The Committee is aware of the aphorism that “correlation is not causation”. That is why instead of saying that pumping more creditwill enhances agricultural productivity in such regions, it is felt that there is a need for “real sector” interventions to enhance agricultural productivity which would then generate demand for additional finance.

No local value addition

One of the primary uses of finance is when value is added locally to primary produce. Regions such as Western Maharashtra and Western Uttar Pradesh have become prosperous by not only growing sugar cane but by adding value to it by local processing and marketing. This may be at the traditional level of “gur” or intermediate level of khandsari units, or modern sugar mills. The value chain can be further enhanced by producing by-products from molasses, such as alcohol and co-generated power.

Work in progress

The Finance Minister in his budget for 2007-08 has announced the setting up of two funds for FI; the first called Financial Inclusion Fund for developmental and promotional interventions and the other called Financial Inclusion Technology Fund to meet cost of technology adoption of about $ 125 million each. The scope of these funds is being worked out. Setting up of financial literacy centres and credit counseling on a pilot basis, launching a national financial literacy campaign, forging linkages with informal sources with suitable safeguards through appropriate legislation, evolving industry wide standards for IT solutions, facilitating low cost remittance products are some of the initiatives currently under way for furthering FI.

Conclusion

The financial system in India has grown rapidly in the last three decades and more. The functional and geographical coverage of the system is truly impressive. Nevertheless, data do show that there is exclusion and that poorer sections of the society have not been able to access adequately financial services from the organized financial system. There is an imperative need to modify the credit and financial services delivery system to achieve greater inclusion. The implementation of the recommendations made in this Report could go a long way to modify particularly the credit delivery system of the banks and other related institutions to meet the credit requirements of marginal and sub-marginal farmers in the rural areas in a fuller measure. However, creating an appropriate credit delivery system is only a necessary condition. This needs to be supplemented by efforts to improve the productivity of small and marginal farmers and other entrepreneurs so that the credit made available can be productively employed. While banks and other financial institutions can also take some efforts on their own to improve the absorptive capacity of the clients, it is equally important for Government at various levels to initiate actions to enhance the earnings capacity of the poorer sections of the society. The two together can bring about the desired change of greater inclusion quickly.

The economy is presently in a phase of rapidly rising incomes, rural and urban, arising from an expansion of extant economic activities as well as the creation of new activities. Corporate profitability has exhibited sustainable trends and consumer incomes are increasing rapidly, riding on the growth momentum. All of these developments suggest that the demand for financial services, both for savings as well as production purposes, will be greater than has been the case in the past, and there will be many new entrants in need of financial services who have not hitherto been served. At present our financial depth is much lower than that of other Asian countries, though it has picked up in the recent past. While there is evidence of an increase in financial deepening, particularly during the present decade, the increase in the breadth and coverage of formal finance has been less than adequate. Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present stage of development of our country.

There has been a burst of entrepreneurship across the country, spanning rural, semi-urban and urban areas. This has to be nurtured and financed. It is only through growth of enterprises across all sizes that competition will be fostered. A small entrepreneur today will be a big entrepreneur tomorrow, and might well become a multinational enterprise eventually if given the comfort of financial support. But we also have to understand that there will be failures as well as successes. Banks will therefore have to tone up their risk assessment and risk management capacities, and provide for these failures as part of their risk management. Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth. The Parliament passed the Credit Information Bureau Act last year and the guidelines for its implementation will be released shortly. This should enable, over time, the availability of credit histories of both individuals and small businesses, which will help significantly in reducing transactions and information costs for banks. It will also help in spreading the credit culture among borrowers. It should help banks greatly in assessing and managing risk at low cost.

As poverty levels decline and households have greater levels of discretionary incomes, they will be first time financial savers. They will, therefore, need to have easy access to formal financial systems to get into the banking habit. Banks will need to innovate and devise newer methods of including such customers into their fold. The importance of 'no-frills' account and expanding the range of identity documents that is acceptable to open an account without sacrificing objectivity of the process in this milieu can never be over-emphasized. Banks will need to go to their customers, rather than the other way around. The micro-credit and the Self Help Group movements are in their infancy but are gathering force. More innovation in the form of business facilitators and correspondents will be needed for banks to increase their outreach for banks to ensure financial inclusion. New entrants to the banking system need households at their doorstep. To conclude, I wish to stress that with increasing liberalization and higher economic growth, the role of banking sector is poised to increase in the financing pattern of economic activities within the country. To meet the growing credit demand, the banks need to mobilize resources from a wider deposit base and extend credit to activities hitherto not financed by banks. The trend of increasing commercialization of agriculture and rural activities should generate greener pastures, and banks should examine the benefits of increasing penetration therein. Financial inclusion will strengthen financial deepening and provide resources to the banks to expand credit delivery. Thus, financial inclusion will lead to financial development in our country which will help to accelerate economic growth.

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