Financial Inclusion: Role of Indian Banks in Approaching the Rural Populations

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India has seen historic progress and growth in the past decade. While the growth story has been impressive, there are causes for concern on other dimensions. We have a long way to go in addressing concerns of absolute poverty. Low-income Indian households in the informal or subsistence economy often have to borrow from friends, family or usurious moneylenders. They have little awareness and practically no access to insurance products that could protect their financial resources in unexpected circumstances such as illness, property damage or death of the primary breadwinner. Unrestrained access to public goods and services is an essential condition of an open and efficient society. It is argued that as banking services are in the nature of a public good, it is essential that the availability of banking services to the entire population without discrimination is the prime objective of public policy. Expectations of poor people from the financial system is security and safety of deposits, low transaction costs, convenient operating time, minimum paper work, frequent deposits, and quick and easy access to credit and other products, including remittances suitable to their income and consumption. It is now well understood that commerce with the poor is more viable and profitable, provided there is ability to do business with them. The provision of uncomplicated, small, affordable products can help bring low-income families into the formal financial sector. Taking into account their seasonal inflow of income from agricultural operations, migration from one place to another, and seasonal and irregular work availability and income, the existing financial system needs to be designed to suit their requirements. Mainstream financial institutions such as banks have an important role to play in this effort, not as a social obligation, but as a pure business proposition.

Financial inclusion is 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. Financial inclusion has become one of the most critical aspects in the context of inclusive growth and development. The importance of an inclusive financial system is widely recognized in policy circles and has become a policy priority in many countries. Several countries across the globe now

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look at financial inclusion as the means to more comprehensive growth, wherein each citizen of the country is able to use earnings as a financial resource that can be put to work to improve future financial status and adding to the nation's progress. Initiatives for financial inclusion have come from financial regulators, governments and the banking industry. The banking sector has taken a lead role in promoting financial inclusion. Legislative measures have been initiated in some countries. For example, in the US, the Community Reinvestment Act (1997) requires banks to offer credit throughout their entire area of operation and prohibits them from targeting only the rich neighbourhoods. In France, the law on exclusion (1998) emphasizes an individual's right to have a bank account. The German Bankers' Association introduced a voluntary code in 1996 providing for a so-called "everyman" current banking account that facilitates basic banking transactions. In South Africa, a low-cost bank account, called Mzansi, was launched for financially excluded people in 2004 by the South African Banking Association. In the UK, a Financial Inclusion Task Force was constituted by the government in 2005 in order to monitor the development of the process. Several African countries have harnessed the unique aspects of mobile banking to drive financial inclusion. A G-20 (Group of Twenty) Financial Inclusion Experts Group has been launched. The Principles for Innovative Financial Inclusion serve as a guide for policy and regulatory approaches with the objectives of fostering safe and sound adoption of innovative, adequate, low-cost financial delivery models, helping provide conditions for fair competition and a framework of incentives for the various banking, insurance, and non-banking entities involved and delivery of the full range of affordable and quality financial services.

The process of financial inclusion is an attempt to bring within the ambit of the organized financial system the weaker and vulnerable sections of society. Financial inclusion can be defined as the delivery of credit and other financial service at an affordable cost to the vast sections of the disadvantaged and low income groups. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include, within its ambit, people with low incomes. Through graduated credit, attempts must be made to lift the poor so that they come out of poverty. Financial inclusion may, therefore, be defined as the process of enabling access to timely and adequate credit and other financial service by vulnerable groups, such as weaker sections and low income groups at affordable cost.

The target for National Rural Financial Inclusion Plan (NRFIP) is to provide access to comprehensive financial services to at least 50% (55.77 million) of the excluded rural cultivator and noncultivator households, across different States by 2012 through‟ rural/ semi urban branches of Commercial Banks and Regional Rural Banks.

Importance of Financial Inclusion in India

The policy makers have been focusing on financial inclusion of

Indian rural and semi-rural areas primarily for three most important pressing needs:

- **Creating a platform for inculcating the habit to save money** – The lower income category has been living under the constant shadow of financial duress mainly because of the absence of savings. The absence of savings makes them a vulnerable lot. Presence of banking services and products aims to provide a critical tool to inculcate the habit to save. Capital formation in the country is also expected to be boosted once financial inclusion measures materialize, as people move away from traditional modes of parking their savings in land, buildings, bullion, etc.
- **Providing formal credit avenues** – So far the unbanked population has been vulnerably dependent of informal channels of credit like family, friends and moneylenders. Availability of adequate and transparent credit from formal banking channels shall allow the entrepreneurial spirit of the masses to increase outputs and prosperity in the countryside. A classic example of what easy and affordable availability of credit can do for the poor is the micro-finance sector.
- **Plug gaps and leaks in public subsidies and welfare programmes** – A considerable sum of money that is meant for the poorest of poor does not actually reach them. While this money meanders through large system of government bureaucracy much of it is widely believed to leak and is unable to reach the intended parties. Government is therefore, pushing for direct cash transfers to beneficiaries through their bank accounts rather than subsidizing products and making cash payments. This laudable effort is expected to reduce government's subsidy bill (as it shall save that part of the subsidy that is leaked) and provide relief only to the real beneficiaries. All these efforts require an efficient and affordable banking system that can reach out to all. Therefore, there has been a push for financial inclusion.

The Extent of Financial Exclusion in Rural India

Based on the All Indian Debt Investment Survey 2002, 111.5 million households had no access to formal credit. It also showed that 17 million households were indebted to moneylenders. The Arjun Sengupta Report on financing enterprises in the unorganized sector has pointed out that only 2.4 million out of 58 million units in this sector (with investment of less than Rs 25000) have got credit from commercial banks. The AIDIS 2002 also showed that lower the asset class or income, higher the degree of exclusion. These findings are corroborated by Invest India Incomes and Savings Survey (2007). The survey showed that 32.8% of households had borrowed from institutional sources and 67.2 % had borrowed from non institutional sources. The survey also found that

70 per cent of earners in the annual income bracket of more than Rs.400,000 borrowed from institutional sources as compared with only 27.5 per cent in the case of earners in the income bracket of less than Rs.50,000. Of the underprivileged sections of the society-farmers, small vendors, agriculture or industrial laborers, people engaged in unorganized sector, unemployed people, women, children, old people and the physically challenged – only 40% of the people have a check in account, 20 per cent have taken life insurance products, 0.6 per cent have taken non-life insurance products, only 2 per cent have access to credit cards. Geographically, only 5.2 per cent of the country's villages have a bank branch. (Kochhar, 2009)

Despite the vast network of rural branches, only 27 per cent of the total farm households are indebted to formal sources; of them, one third also borrow from informal sources. There are parts of the country where more than 95 per cent of the farm households do not get any credit from institutional or non institutional sources. Apart from the fast that exclusion itself is large, it also varies widely across regions, social groups and assets holdings. The poorer the group, the greater is the exclusion. There is evidence that farm debt is increasing much faster than farm incomes and the larger issue of the overhanging debt stock, as distinct from credit flow, has not even been on the agenda except of a few State governments. (Planning Commission, 2006). According to NSSO data in the situation assessment survey on "Indebtedness of Farmer households"(2003), 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. Further, only 27% of total farm households are indebted to formal sources. (RBI, 2009)

Committee on Financial Inclusion (Chairman: Dr. C. Rangarajan)

To build a structure and roadmap for Financial Inclusion, the Government of India appointed a committee on Financial Inclusion under the chairmanship of Dr.C.Rangarajan, (then Deputy Governor of Reserve Bank of India) in 2008. The Rangarajan Committee suggested that the financial inclusion should include access to mainstream financial products such as bank accounts, credit, remittances and payment services, financial advisory services and insurance facilities. Making banking and payment services available to the entire population without discrimination is the main objective of Financial Inclusion. Thus, the main focus of financial inclusion in India is on promoting sustainable development and generating employment in rural areas for the rural population.

Process of Financial Inclusion in India

The process of financial inclusion in India broadly involves three phases. During the First Phase (1960-1990), the aim was on channeling credit to weaker sections of the society. Second Phase (1990-2005) was aimed at strengthening the financial institutions as part of financial sector reforms through Self-Help Group (SHG)- Bank linkage and issue of Kisan Credit Cards (KCCs) to farmers. During the Third Phase (2005 onwards), the 'Financial Inclusion' was explicitly made as a policy objective and thrust was on providing safe facility of savings deposits through 'No Frill' accounts. The Report Committee on Financial Inclusion headed by Dr. C. Rangarajan (2008) has observed that financial inclusion must be taken up in a mission mode and suggested a National Mission on Financial Inclusion (NMFI) comprising representation of all stakeholders for suggesting the overall policy changes required, and supporting stakeholders in the domain of public, private and NGO sectors in undertaking promotional initiatives.

RBI's Policy on 'Financial Inclusion':

- When bankers do not give the desired attention to certain areas, the regulators have to step in to remedy the situation. This is the reason why the Reserve Bank of India places a lot of emphasis on financial inclusion.
- With a view to enhancing the financial inclusion, as a proactive measure, the RBI in its Annual Policy Statement of the year 2005-2006, while recognizing the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, urged banks to review their existing practices to align them with the objective of financial inclusion.
- **No-Frills' Account** : In the Mid Term Review of the Policy (2005-06), RBI exhorted the banks, with a view to achieving greater financial inclusion, 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 give wide publicity to the facility of such 'no frills' account, so as to ensure greater financial inclusion.
- **'Simplification of 'Know Your Customer (KYC)' Norms :**
  Banks are required to provide a choice of a 'no frills account' where the minimum balance is nil or very small but having restrictions on number of withdrawals, etc., to facilitate easy access to bank accounts. 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 'KYC' procedure for opening accounts for those persons who intend to keep balances not exceeding rupees fifty thousand (Rs. 50,000/-) in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed rupees one lakh (Rs. 1,00,000/-) in a year has been simplified to enable those belonging to low income groups without documents of identity and proof of residence to open banks accounts. In such cases banks can take introduction from an account holder on whom full KYC procedure has been

completed and has had satisfactory transactions with the bank for at least six months. Photograph of the customer who proposes to open the account and his address need to be certified by the introducer.

- **Ensuring reasonableness of bank charges:** As the Reserve Bank has been receiving several representations from public about unreasonable service charges being levied by banks, the existing institutional mechanism in this regard is not adequate. Accordingly, and in order to ensure fair practices in banking services, the RBI has issued instructions to banks making it obligatory for them to display and continue to keep updated, in their offices/branches as also in their website, the details of various services charges in a format prescribed by it. The Reserve Bank has also decided to place details relating to service charges of individual banks for the most common services in its website

ICICI Bank Gears Up For Financial Inclusion With Rural Banking

India's second largest and leading private sector lender ICICI Bank has announced the launch of 101 gramin branches spread over six states as part of its financial inclusion plan that is targeted to providing banking services in unbanked Indian villages. These gramin branches were formally inaugurated in nineteen districts across the states of Gujarat, Maharashtra, Madhya Pradesh, Rajasthan, Andhra Pradesh and Tamil Nadu in small villages, which were so far devoid of any banking facility.

While talking at the seminar on financial inclusion which was organized to mark the inauguration of a gramin branch of ICICI Bank at village Khatwa,in Rajasthan, K.C Chakrabarty, deputy governor, Reserve Bank of India said, *"Financial Inclusion is the bedrock on which the edifice for an inclusive social and economic ecosystem can be built. While the task of bringing the 1.2 billion populations within the fold of banking is indeed daunting, it is as much an opportunity for the banks. I feel that 'brick and mortar' branches, as delivery point for banking services, would continue to play a critical role for at least next 20 years."*

These gramin branches of ICICI Bank will offer the entire core banking services such as savings bank account, fixed and recurring deposit, remittances, Kisan Credit Card (KCC), credit cards, tractors and Farm machinery loans.
ICICI Bank has undertaken a wide range of initiatives in the last few years as part of its financial inclusion drive guided by the RBI. ICICI Bank has a wide distribution network to service its rural and under banked customers. It will service its rural customers through a network of more than 400 rural branches and 5000 customer service points, which will together serve more than 10,000 villages across the India.

Role of cooperative banks in facilitating Financial Inclusion

Cooperative banks have very good network in rural a reas;

moreover mostly they have local staff. Therefore they are better placed to understand and solve the problem of rural poverty by strengthening the supply side of Financial Inclusion. They can effectively contribute to improvement in demand side also. However, for effective facilitation of Financial Inclusion there should be total commitment by their respective boards. National Bank for Agriculture and Rural Development (NABARD) should undertake intensive training and development programme for board members of cooperative banks. This will result into better commitment by the boards towards poverty reduction in respective areas. Training and Development programme should make them understand their important role in the cause of poverty reduction through professional approach to management. Training inputs should over a period of time, change the approach of board towards management of cooperative banks.

Cooperative banks can take a leaf from the approach of public sector banks. They should extensively do direct lending to farmers, agriculture labourers, instead of lending through primary agriculture cooperatives wherever PACs are defunct or inefficient. This will result into better end use of funds and improve monitoring of advance. Moreover inefficiencies of PACs will be avoided. They should also lend extensively to small business enterprises in rural areas. In addition to agriculture they also lend for retail trade, small business and small scale industries. Lending to medium and small enterprises will go long way in poverty reduction effort as it will create sustainable employment in the area.

Role of NABARD in Financial Inclusion

RBI liberalized its policy to giving entity to opening of Savings Bank accounts by Self Help Group (SHG) is approved. National Bank for Agriculture and Rural Development (NABARD) has designed, developed and has been facilitating SHG-Bank Linkage Programme in India since 1992 with various partner agencies like Banks, NGOs, Government Agencies/ Departments, etc. The SHG–Bank Linkage Programme and other Micro Finance initiatives by NABARD has contributed much towards financial inclusion process in India. The SHG-Bank Linkage Programme and Micro Finance Institutions (MFI)-Bank Linkage Programme have been accepted as effective tools to inclusive growth for extending various financial services to hitherto excluded categories of poor and rural households.

Role of RRBs in Financial Inclusion

As on 31March 2010, there are 82 RRBs having a network of 15, 938 branches all over the country for extending credit to rural masses. The RRBs have emerged as a strong intermediary for Financial Inclusion in rural areas by opening large numbers of "No Frills" accounts and financing under General Credit Card (GCC). Total number of business accounts (deposit plus loan accounts) with RRB stood at 1188.83 lakh, as on 31 March 2010 of which number of deposit accounts is 1002.16 lakh and number of loan accounts is 186.67 lakh. Number of No Frills account opened by RRBs as on 31 March 2010 is 200.09 lakh.

CONCLUSION

It is concluded that RBI and NABARD play a vital role for financial inclusion in India by opening the no frill accounts for rural population and now it has been made an integral part of the banking sector. Financial inclusion is the gateway for achieving inclusive growth in India. All the commercial banks in India including cooperative banks are actively involved in financial inclusion process through opening of new branches in rural and urban areas. For rural prosperity financial inclusion is a basic requirement in India.

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