FINANCIAL INCLUSION AND INCLUSIVE GROWTH THROUGH MICROFINANCE IN INDIA - AN EVALUATION

ABSTRACT
OF THE
THESIS
SUBMITTED FOR THE AWARD OF THE DEGREE OF
Doctor of Philosophy
IN
ECONOMICS
BY
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UNDER THE SUPERVISION OF
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ALIGARH-202002 (INDIA)
2014
ABSTRACT

Financial sector policies in India have long been driven by the objective of increasing financial inclusion, but the goal of universal inclusion is still a distant dream. The network of cooperative banks to provide credit to agriculture, the nationalization of banks in 1969, the creation of an elaborate framework of priority sector lending with mandated targets were all elements of a state-led approach to meet the credit needs of large sections of the Indian population who had no access to institutional finance. The strategy for expanding the reach of the financial system relied primarily on expanding branching, setting up special purpose government sponsored institutions (such as regional rural banks (RRBs) and cooperatives) and setting targets for credit to broad categories of the excluded. Its success has been mixed, and has been showing diminishing returns.

Poverty in India is one of the persisting problems since long time. Governments have been working hard to eradicate poverty from the country. A variety of socio-economic and welfare strategic programmes like Integrated Rural Development Programme (IRDP), District Rural Development Agency (DRDA), and Self-Employment Schemes etc.; have been launched to address the problem of poverty. These programmes have succeeded in providing desired result in some extent. Thus, it has been realised that unequal growth and financial exclusion are major causes for this menace. This in turned paved away to the concept of microfinance and financial inclusion that has been emerging in India since late 1980s. This evolution has been providing to be result-oriented and effective (Teki and Misra).

Poverty is multifaceted phenomenon, described as a situation where people are deprived of basic means such as income generating activities, adequate food, clothing, housing, health care, sanitary facilities, access to formal credit, opportunity for education etc. Causes of poverty vary from country to country. Presently about one and half billion people live on less than $1.5 a day, a majority being from third world countries. India itself (1999-2000) accounts for 260.3 million poor people (UNDP, 2004). India’s 34.7 per cent population income is below poverty line ($1.5 a day). As per national assessment, 28.6 per cent population is living below poverty line (UNDP).
Inclusive growth is crucial for long term economic development of the country, the economic growth that equitably would facilitate sustainable economic development. Within the portfolio of inclusive growth, financial inclusion is more important as financial services are integral part of the growth and development of society and economy as a whole. Financial exclusion, which is defined as a process by which specific segments of the population or a group of individuals is denied/deprived the access to basic formal financial system and financial services. Financial exclusion has gained importance during early 1990s in Europe where the geographers found that some definite pockets and regions of a particular country were behind the others in utilising financial services. It was also found that these areas/regions were poorer compared to regions which utilised more of financial services. Financial exclusion may not mean a social exclusion in India as it does in the developed countries, but it is a biggest issue that can be addressed. The large presence of informal credit could avoid social exclusion but the legal validity of such financial services pose an obstacle for creating a modern globalising economy. Financial exclusion reduces the growth and development of society as well as economy.

Financial inclusion has been defined as the “provision of affordable financial services” (RBI, 2006a) to those who have been left unattended or under-attended by formal agencies of the financial system. These financial services include “payments and remittance facilities, savings, loans and insurance services”. Microfinance has been looked upon as an important means of financial inclusion in India (RBI, 2006b). Indian concept of microfinance encourages access of SHGs to banks both as means of savings and providers of loan services.

The Reserve Bank of India (RBI) has emphasised access to banking services for all sections of the society as a large group of population has been excluded from the coverage of the formal banking sector. Census data revealed that in 2001, the proportion of rural households availing banking facilities was 30.1 per cent, while for urban households; it was around 49.5 per cent. The extent of exclusion was higher for specific population groups and regions. The NSSO (59th Round, 2003) data revealed that 45.9 million farmer households in the country and 51.4 per cent of the total of 89.3 million households do not access credit, either from institutional and non-institutional sources. Further, despite the vast network of bank branches, only 27 per cent of total households were indebted to formal sources (of which one-third also
borrow from informal sources). Farm households not accessing credit from formal sources, as a proportion to total farm households, was very high at 95.91 per cent, 81.26 per cent and 77.59 per cent in the north-eastern, eastern and central regions respectively (NSSO, 2003)\(^5\).

Indian financial sector observed two major changes in the beginning of 1990s relating to financial inclusion. Firstly, implementation of market-oriented financial sector reforms. Secondly, introduction of Self-help Group-Bank Linkage Programme. These shift influence the financial inclusion in an opposite direction. Because the focus in the period of reforms was on enhancing the efficiency and profitability of banking system and not to provide facilities to the poor. Many of the regulation that were applied on banking system during the policy of social banking were relaxed in order to allow a market based operation of the banking system. Exclusion of the poor of availing institutional borrowing, apart from undermining economic growth, could engender social tensions. Empirical evidence shows that inclusive financial system significantly raises growth, alleviate poverty and expand economic opportunity (K.B Rangappa)\(^6\).

In the beginning of 1990s NABARD felt the need for an alternative delivery mechanism to full fill the requirements of the poor and vulnerable section of society. As a result, it has launched Self-help Groups -Bank Linkage Programme in February 1992. In India as also in other countries, SHGs have been recognised by policy makers as an effective medium for accomplishing the distributive objectives of monetary policy (Shankaran, 2005)\(^7\). SHGs are small informal association created for the purpose of enabling members to reap economic benefit out of mutual help, solidarity and joint responsibility. These small homogeneous groups involved in savings and credit activities are capable of taking care of the risks through peer monitoring. SHGs considered being an agent to bridge the gap between banks and the weaker sections and unbanked people. The programme empowered the weaker section to approach the banking institutions for financial services. Banking institution also considered this programme as an effective conduit to cover the poor.

The purpose of the study is to explore the relative effectiveness of microfinance as a source of financial inclusion and inclusive growth for the vulnerable section of the society such as poor, women, senior citizen, and ethnic minorities. There are two basic models such as profit and NGOs model, which may or
may not charge interest on the loan in order to cover the cost of lending. Microfinance is unique in that, it addresses the issue of inequality, gender equity, health and, of course, financial inclusion of vulnerable section of the society.

Successive Indian governments have sought to achieve financial inclusion through two very prominent financial institutions viz, scheduled commercial banks (SCBs) and the rural co-operatives. The social responsibility fixed on these institutions notwithstanding, inclusion of the target section into their financial services has been very tardy and far from satisfactory. This has been due to a number of supply constraints, both from the supply and the demand side.

In the light of the above, in this study entitled “Financial Inclusion and Inclusive Growth through Microfinance in India-An Evaluation”, an attempt has been made to establish the link between the microfinance, financial inclusion and inclusive growth and their impact on the overall development of the country in general and poor section of the society in particular. There are following objectives of the study:

1. To explain the role and importance of microfinance in financial inclusion and inclusive growth.
2. To examine the role of banking system in extending banking services for financial inclusion.
3. To examine the trend and pattern of SHGs-bank linkage programme in India.
5. To suggest some policy implications on the design and modification of the SHGs-bank linkage programme.

As the microfinance sector in India is still in infancy, the sources of statistics related to the sector are also scattered. The study is based on secondary data collected from various sources such as Status of Microfinance in India (NABARD), Sa-Dhan (Bharat Microfinance Report), Handbook of Statistics on Indian Economy (RBI), Banking and Statistical Report of Commercial Banks (RBI), Economic Survey of India (Planning Commission, Government of India), Report on Currency and Finance (RBI), Mix Market, Microfinance Gateway, Ministry of Rural Development (GOI), Microfinance India- State of The Sector Report published by Access
Development Services, Various issues of State of the Microcredit Summit Campaign Report and many other publications by individual researchers and agencies.

The methodology used for the assessment of Self-Help Groups-bank linkage is based on different statistical tools. In order to study the growth rate in the variables, percentage growth rates, simple average and percentage have been calculated. The compound annual growth rate (CAGR) is used to calculate the growth over the period of time. In addition, averages, standard deviation, coefficient of variation and Pearson Correlation matrix have also been used to analyse different variables to get meaningful results.

Since inclusive financial system is judged from several dimensions, we use the multidimensional approach to construct the index of financial inclusion (IFI). The approach is based on the method suggested by Sarma (2008)⁸. UNDP has also used similar type of approach for computation for different type of indices such as HDI, HPI and GDI etc. Index of Financial Inclusion is computed by first calculating a dimension index for each dimensions of financial inclusion. The most commonly used indicator is availability of banking services (D1), banking penetration (D2), and usage (D3). Under banking penetration, we use number of bank accounts as a proportion of the total population as an indicator of this dimension. However, we use both deposit account or credit account or loan account as the indicators of banking penetration. Under availability of banking services, we use the number of bank branches per 1000 adult population and also number of branches per square km to measure the availability dimension. For usage (dimension), we consider two basic services of the banking system- outstanding credit and deposit. Accordingly, the volumes of outstanding deposit and credit as proportion of the state domestic product (GSDP) have been used to measure this dimension.

The dimension of index for ith dimension, di, is computed by the help of following formula.

\[ D_i = \frac{A_i - m_i}{M_i - m_i} \]  

(1)

Where

\( A_i \) = Actual value of dimension i.

\( m_i \) = minimum value of dimension i.
\( M_i = \text{maximum value of dimension } i. \)

Formula (1) ensures that \(0 \leq d_i \leq 1\). Higher the value of \(d_i\), higher the state’s achievement in dimension \(i\). If \(n\) dimension of financial inclusion are considered, then a state \(i\) will be represented by a point \(D_i = (D_1, D_2, \ldots, D_n)\) on the \(n\)-dimension Cartesian space.

In the \(n\)-dimension space, the point \(0 = (0,0,\ldots,0)\) represents the point indicating the worst situation while the point \(1 = (1,1,\ldots,1)\) represents the highest achievement in all dimensions. The index of financial inclusion, \(IFI_i\), for the \(i\)-th state, then this is measured by the normalized inverse Euclidean distance of the point \(D_i\) from the ideal point \(1 = (1,1,\ldots,1)\). The formula becomes,

\[
IFI_i = 1 - \sqrt[3]{((1-D_1)^2 + (1-D_2)^2 + (1-D_3)^2)}
\]

Using data on all three dimensions for 21 states for the year 2012-13, IFI values have been computed. Depending on the value of IFI, states are categorised into three categories, viz…

- \(0.67 < IFI < 1\) - high financial inclusion
- \(0.6 < IFI < 0.67\) - medium financial inclusion
- \(0 < IFI < 0.6\) - low financial inclusion

The proposed IFI takes values between 0 and 1, zero indicating lowest financial inclusion (i.e. complete financial exclusion) and 1 indicating complete financial inclusion.

Adequate, appropriate and comparable data for large number of years and for different states of the country is the essence of robust IFI. Owing to lack of appropriate data, we are unable to incorporate many aspects of an inclusive financial system in our present index, such as affordability, timeliness and quality of financial services.

For the analysis of agency-wise/state-wise/region-wise SHGs-bank linkage programme following three parameters have been used:

a. SHGs saving linked with commercial banks, cooperative banks and regional rural banks.
b. SHGs loan disbursed with commercial banks, cooperative banks and regional rural banks.

c. SHGs loan outstanding with commercial banks, cooperative banks and regional rural banks.

The study has following limitations:

i. The study mainly deals with the Self-Help Groups model of micro-financing in the country.

ii. The study is limited for the period 1992-93 to 2012-13, after the emergence of pilot project in the country.

iii. For computing financial inclusion index across the states, data have been collected only from scheduled commercial banks issued by RBI in the report, Basic Statistical Returns on Commercial Banks Report (BSR).

iv. The data on specific variable of Self-Help Groups-bank linkage was not available in the year 2006-07 and 2007-08 in north-eastern region of the country.

The present study has been divided into seven chapters which have been organized as follows:

Chapter first introduces the main theme of the study. It includes review of the relevant literature related to microfinance and financial inclusion, objectives of the study, database and methodology, scope and importance of the study and limitations of the study. It is an introductory chapter.

In chapter second, general description of microfinance has been discussed in detail. It throws light on the definition of microfinance, objectives and characteristics of microfinance, approaches and evolution of microfinance, rationale and growth of microfinance in the world and its role in poverty alleviation and rural development.

Chapter third gives emphasis on microfinance in India. In this chapter, emphasis has been given on the formal financial sector in India and its indicator, factors behind the failure of formal financial sector in serving the poor, evolution of microfinance in India, need for microfinance, microfinance and sustainable livelihoods, microfinance delivery models, prospects of microfinance, inclusive growth meaning and challenges, focus on women empowerment and gender dimension in economic development.
Chapter four mainly deals with the financial inclusion in India. In this chapter focus has been given to the definition of financial inclusion, a global perspective on financial inclusion, bank nationalisation phase and nationalisation and impetus to financial inclusion, extent of financial exclusion in India, north-eastern states and financial inclusion, financial inclusion through postal saving banks, barriers to financial inclusion, reasons for financial exclusion and its consequences, parameters of financial inclusion, role of banking sector in financial inclusion and measurement of index of financial inclusion across state in India by using three parameters, that is, penetration, availability and usage.

In chapter five state-wise assessment of Self-Help Groups -bank linkage programme has been discussed. In this chapter emphasis has also been given to the origin, evolution and characteristics of SHGs-bank linkage and its growth pattern in the country. Three parameters such as savings, loan disbursed and loan outstanding under commercial banks, cooperative banks and regional rural banks of SHGs-banking have been analysed. For state-wise/agency-wise analysis of SHGs-bank linkage programme, the above three parameters have been selected.

Chapter six deals with region-wise assessment of Self-Help Groups -bank linkage programme. Focus is also given on the outreach of SHGs-bank linkage programme in different regions of the country. Three parameters of SHGs-banking have been analysed such as savings, loan disbursed and loan outstanding under commercial banks, cooperative banks and regional rural banks.

Chapter seven of the thesis provides summary and conclusion of the study and some specific suggestions regarding financial inclusion and inclusive growth through microfinance in India.

The major findings of the study may be summarized as follows:

1. The analysis of the geographic spread of microfinance revealed that microfinance penetration in the country was non-uniform, with state specific contextual factors have been playing a major role in driving microfinance growth. A comparison of the spread of microfinance services with that of banking services reveals four distinct regional categories. While the southern and western regions are characterized by widespread availability of both kinds of services, the central region had low availability of both kinds of services.
The eastern and north-eastern regions showed high availability of microfinance but not banking services, while the northern region show high availability of banking but not microfinance services.

2. Financial exclusion is very acute in almost all major states except few and if we compare it on the rural-urban basis the exclusion gap is very large in scale. Around 73 per cent of farm households do not have access to formal credit sources. Exclusion is most acute in central, eastern and north-eastern regions-having a concentration of 64 per cent of all financially excluded farmer households (from formal sources) in the country (415.61 lakh households out of 659.54 lakh households). The extent of financial exclusion in different social groups are also very critical and only 36 per cent of ST farmer households are indebted (SCs and OBCs 51 per cent) mostly to informal sources.

3. Number of SHGs has increased over the period of time. SHGs-Bank Linkage Programme outreach spreading in new areas like eastern regions and especially in backward states like Uttar Pradesh and Bihar but their share is still marginal.

4. States like Kerala, Karnataka, Punjab, Maharashtra and Tamilnadu are in high financial inclusion range and these states have performed in a better way to the path of financial inclusion. On the other hand most of the states are in low financial inclusion range, however, north eastern-states have further very low value in financial inclusion index in comparison with other states and the region has high degree of financial exclusion.

5. SHGs-bank linkage programme has been concentrated mainly in southern states like Andhra Pradesh, Tamilnadu, Karnataka, and Kerala. Microfinance growth since inception in India has been skewed in favour of southern region. SHGs linked in the region consistently account for more than 50 per cent of the total SHGs linked in the country followed by the eastern region and Maharashtra with 22.09 per cent in the year ended March 2012.

6. Agency-wise analysis of SHGs-bank linkage programme reveals that the share of commercial bank in the amount of saving, loan disbursed and loan outstanding is very high in comparison to cooperative banks and regional rural banks.
7. State-wise analysis of SHGs-bank linkage programme shows that states like Andhra Pradesh, Karnataka, Tamil Nadu/Pondicherry, Maharashtra and West Bengal have greater bank linkage to SHGs in all the three parameters that is saving, loan disbursed and loan outstanding. These states have better coordination of banks linkage with commercial banks than cooperative banks and regional rural banks.

8. Southern region has exceptionally very high degree of SHGs-bank linkage with commercial banks, cooperative banks and regional rural banks in all the parameters such as saving of SHGs, loan disbursed and loan outstanding.

9. Microfinance has been playing very significant role in empowering women and reducing poverty from vulnerable sections of society.

Suggestions:

1. For financial inclusion and inclusive growth of backward regions of the country more bank branches should be opened.

2. Process of opening of account must be easier so that vulnerable section of the society can easily open their account in banks.

3. Promote the minimum balance or no frill account in both in public as well as in private sector banks.

4. Government should utilise the vast network of post office for financial inclusion of backward regions and rural people.

5. Government and NGOs should play a larger role in promoting SHGs-bank linkage programme in back ward states like UP, Bihar, MP and Chhattisgarh etc where SHGs-bank linkage share is exceptionally very low.

6. For better SHGs-bank linkage in resource poor states banking sector should play an important role to increase the share of the backward states by opening of new branches and linking it with SHGs.

7. As the role of SHGs is very important in women empowerment and poverty alleviation the government and non-governmental organisations should play prominent role for welfare of the society.
Future direction of research may be as follows:

1. First, as financial inclusion is not an end in itself but a means to promote more inclusive growth, research on how financial inclusion can effectively promote more inclusive growth is necessary. The potential role of technological improvements leading to transaction cost reduction; and improving the processes involved in accessing financial products, would be of particular interest.

2. Second, research on political economy factors that promote or hinder microfinance development could be useful to indicate, under what circumstances microfinance can flourish in a region. The findings could be useful for microfinance practitioners as well as policy makers. The uneven spread of microfinance in India, among states, provides a good opportunity for such research. In particular, research on how the state’s role with regard to microfinance can be consistent with its political and economic objectives would be important.

3. Third, experimentation and research on designing group microfinance programs that encourage better utilization of loans and specifically target graduation to individual financial services needs to be undertaken.

4. There is a need for the development of more effective management information systems to promote the further consolidation of sustainable financial service delivery through well performing SHGs.

5. For reducing apparent regional imbalances in linkage banking more emphasis should be put in future strategies on widening the outreach of the programme in the central and eastern regions of the country. To increase the effectiveness such outreach strategies may have to include different delivery models.

6. SHGs role in development could be further enhanced through an increased involvement in development programmes in the area.
References:


5. NSSO (2003), *All India Debt and Investment Surveys (AIDIS)*, Mumbai

