CHAPTER I

INTRODUCTION

India has witnessed impressive growth acceleration since the 1991 economic reform, however, in an uneven form. Growth should reach every section of society—especially the vulnerable, the underprivileged and the marginalized. The growth acceleration has resulted in growing inequalities in income and wealth. The Eleventh Five Year Plan (2007–12) stipulates inclusive growth as a key objective. Assuming a moral responsibility to promote social equality, it is vital for any economy to aim at inclusive economic growth.

Economic growth and development depend heavily on real factors such as modernization of agriculture, innovation in industrial sectors, incorporation of emergent technologies in the service sector, high quality infrastructure facilities, expansion of internal trade, and organized foreign trade, monetary factors also play a significant role. The financial sector plays a pivotal role in creating robust inclusive growth. If the real factors are the machinery of growth, monetary factors are the grease that ensures it runs smoothly. The economies of all market-oriented nations depend on the efficient operation of complex and delicately balanced systems of money and credit. Banks form an indispensable element in these systems. Unlike hoarding of currency, banks facilitate savings and investment, contributing to wealth creation. India’s financial sector is predominantly bank-centric; thus, banking is a key driver for inclusive growth.

Indira (2011) Director, Centre for Development Alternatives, defines inclusive growth as the growth process that reduces poverty faster, that is broad-

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1. Director, Centre for Development Alternatives, India (2011) - Consultation on conceptualizing inclusive growth
based and labour intensive, reduces inequalities across regions and across different socio economic groups, opens up opportunities for the excluded and marginalized not only as beneficiaries but also as partners in the growth process. There are multiple definitions for the concept of inclusive growth. Some of the common features are: Growth is inclusive when it takes place in the sectors in which the poor work (e.g., agriculture), occurs in places where the poor live (e.g., relatively backward areas), uses the factors of production that the poor possess (e.g., unskilled labour) and reduces the prices of consumption items that the poor consume (e.g., food, fuel and clothing).

One of the key among the many strategies available for promoting inclusive growth is the development of an inclusive financial system. Governments, donors, and international financial institutions across the globe have increasingly recognized that access to financial services can play a pivotal role in poverty alleviation and in decreasing the vulnerability of poor people.

An inclusive financial system otherwise known as Financial Inclusion is defined by The Rangarajan Committee (2008) as "the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."

United Nations has defined financial inclusion as “A financial sector that provides access for credit for all bankable people and firms and saving and payment services to everyone. Inclusive finance does not require that everyone is eligible to use each of the services but they should be able to choose them if desired”

Since never part of the Millennium Development Goals (MDGs) set in 2000, financial inclusion as an issue has moved up the agenda of emerging and developing countries, including at the G20 in 2011. The Alliance for Financial

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2 Report of committee on Financial Inclusion”(2008) headed by Dr. C. Rangarajan, Chairman Economic Advisory Council to Prime Minister
Inclusion which led to 35 emerging and developing countries’ central banks, committing themselves to financial inclusion in 2012.

The Indian 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. Indian Government took efforts to study the causes of financial exclusion and designing strategies to ensure financial inclusion of the poor and disadvantaged. The reasons may vary from country to country and hence the strategy could also vary but all out efforts are being made as financial inclusion can truly lift the financial condition and standards of life of the poor and the disadvantaged.

Financial Inclusion is both a crucial link and a substantial first step towards achieving inclusive growth. The liberalized, increasingly global, market driven economy of India today, has failed to facilitate inclusive growth. In recognition of this, the government and the World Bank estimate that 2.7 billion people, over half the population of the developing world, live on less than US$2 a day. In the UK over one million adults are believed to be without a bank account or other basic financial services. Reserve Bank of India data shows that as many as 139 districts of India suffer from massive financial exclusion, with the adult population per branch in these districts being above 20,000 and only 3 percent with borrowings from banks. On the assumption that each adult has only one bank account (which does not hold good in practice, so that actual coverage is likely to be worse) on an all India basis, 59 percent of the adult population in the country has bank accounts. 41 percent of the population is, therefore, unbanked. In rural areas financial inclusion coverage is 39 percent against 60 percent in urban areas. The unbanked population is higher in the poorer regions of the country, and is the worst in the North-Eastern and Eastern regions.

Credit markets have much more exclusion, as the number of loan accounts constituted only 14 per cent of adult population. 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 perspective as well. Out of 203 million households in the country, 147 million are in rural areas and 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. As per NSS\(^4\) 9th round data, only 37 percent of the urban self-employed have access to credit.

It is not implied that financial inclusion alone has led to the development but is an important factor. The policymakers have set up their task force committees to understand how financial inclusion can be achieved including advanced economies like United Kingdom. India also set up a committee under the chairmanship of Dr. C.Rangarajan to suggest measures to increase financial inclusion (hence called the Rangarajan Committee on Financial Inclusion).

The financial services include savings, loans, insurance, credit and payments etc. The financial system has to provide its function of transferring resources from surplus to deficit and surplus units are those with low incomes, poor background etc. By providing these services, the aim is to help them come out of poverty. So far, the focus has only been on delivering credit (it is called as microfinance but is microcredit) and has been quite successful. Similar success has to be seen in other aspects of finance as well.

Vijay Kelkar(2010)\(^5\), the Chairman of Finance Commission stated that “financial inclusion is a quasi public good. Increasingly, in developing countries


access to finance is positioned as a public good, which is as important and basic as access to safe water or primary education. The pertinent question to ask here is whether 'Financial Inclusion' can be construed a public good? A good is considered a 'public good' if it meets the conditions of non-rivalness in consumption and non-excludability. The degree of 'publicness' in 'financial inclusion' maybe different from the standpoint of a typical public good like 'defense', but there is little doubt that financial inclusion meets the above two criteria to a large measure and to that extent is a "quasi public good". There are a number of positive externalities of financial inclusion. One of the important effects is one is able to reap the advantages of network externality of financial inclusion as the value of the entire national financial system increases. Yet another reason why financial inclusion is a quasi public good is that the consequent fuller participation by all in the financial system makes monetary policy more effective and thus enhances the prospects of non-inflationary growth.”

According to Supravat Bagli (2012)\textsuperscript{6} the externality of asymmetric information between the financial institutions and the disadvantaged section of the population may be the main cause of this exclusion. Besides, the geographical distance from bank, diffidence, financial illiteracy, gender-inequality, paucity of income and collateral assets, lack of proof of identity of the disadvantaged people are the plausible causes of financial exclusion. On the other hand shortage of staff, high transaction cost, economic viability of the extension of branch etc. are the common problems of the financial institutions in extending financial services to the disadvantaged section. So, there is a vast scope of achieving total financial inclusion in a country if it adopts necessary steps to reduce the information gap. Against this backdrop, India has taken several steps towards financial inclusion.

The common measures of financial inclusion are the number of bank account per adult, geographic branch penetration, demographic branch penetration, 

\textsuperscript{6} Supravat Bagli Papita Dutta (2012), A study of financial inclusion in India, Radix International Educational and Research Consortium, Volume 1, Issue 8 Economic and Political Weekly 35(19), 1637-1648.

For that Mandira Sarma (2008)\(^7\) in his work found out index of financial inclusion for 54 countries. Index of financial inclusion (IFI) is a measure of inclusiveness of the financial sector of a country/region. It has been constructed as a multidimensional index that captures information on various aspects of financial inclusion such as banking penetration, availability of banking services and usage of the banking system. The IFI incorporates information on these dimensions in one single number lying between 0 and 1, where 0 denotes complete financial exclusion and 1 indicates complete financial inclusion. In that Index India got 29\(^{th}\) rank, the IFI score is only 0.166. The scores in penetration, availability, usage dimensions were 0.164, 0.075, 0.269 respectively. Among these dimensions, India score is very less in availability dimension. Taking everything to in consideration, this study plans to compute financial inclusion index for various states.

Considering the almost similar indicators, Chattopadhyay (2008)\(^8\) has developed the financial inclusion index for the major states in India and for all the districts in West Bengal.

Karmakar (2011)\(^9\), also have constructed the financial inclusion for rural areas of the major twenty states in India. They have considered number of rural outlets, number of accounts per outlet, per outlet deposit amount, per outlet credit amount and per account deposit amount as indicator of financial inclusion.


All these attempts to measure financial inclusion were done for one year. So there is no possibility to compare and find whether there is any improvement in financial inclusion after many initiatives taken by government to promote financial inclusion.

The current study will provide Index for continuous eleven years, to understand the trend in financial inclusion Index for Indian states and districts of TamilNadu. In addition, it also tries to find out whether there is any change in financial inclusion after many policies and schemes implemented by Indian government are. This is the objective of this study.

In India, in an attempt to improve access to financial services or financial inclusion, the Reserve Bank of India (RBI) promulgated a drive for financial inclusion, where banks took the lead in providing all ‘unbanked’ households in a district, with savings accounts.

The Centre for Micro Finance\(^{10}\) conducted a study to assess the implementation of the financial inclusion drive and usage of banking services by households in Gulbarga district in Karnataka, one of the locations claimed to have achieved 100% financial inclusion. That study considered having a bank account as an indicator of financial inclusion.

Mere opening an account is not financial inclusion. Most of the earlier studies had revealed that Lone parents, unemployed or those in receipt of benefits, sick or disabled, Lone pensioners, particularly widows, households headed by students or part-time workers, Geographical remoteness or high density of low-income households are the indicators of higher levels of financial exclusion. Making all these sections of people to open a bank account is very simple. Even government can provide a bank account in nationalised banks using Aadhaar card as a proof. Unbanked is not an issue, under banked is an issue. How to make under

banked customers active? This is the question now before the government, banks, policy makers and researchers. Opening a bank account is the namesake financial inclusion. Most of the ‘no frill’ accounts opened under the financial inclusion policy are inactive without any transaction. Effective financial inclusion is possible only when government and banks provide the financial products, which will cater to the needs of the bottom of the pyramid people with simple procedures at an affordable cost.

The FDIC\(^\text{11}\) defines the unbanked as “those without an account at a bank or other financial institution and are considered to be outside the mainstream for one reason or another.” Another term is “the under banked” – “people or businesses that have poor access to mainstream financial services normally offered by retail banks. The under banked can be characterized by a strong reliance on non-traditional forms of finance and micro-finance often associated with disadvantaged and the poor, such as check cashers, loan sharks and pawnbrokers.” The under banked are distinct groups from the unbanked, who are characterized by having no banking facilities at all.

This study considers people without bank account as unbanked, and people with bank account but don’t have transactions for last two years were considered as under banked.

1.1 Need for Financial Inclusion

Why is financial inclusion necessary for economic growth?

An inclusive financial system empowers vulnerable people, motivates lagging sectors, and promotes equality in income distribution. Besides these desirable consequences of an inclusive financial system, it is anathema to the main handicap to India’s growth: corruption. For example, if the Indian government were to introduce a policy that any transactions above 1000 rupees should be done

\(^{11}\) FDIC(2012), National Survey of Unbanked and Underbanked Households
through banks, then tax evasion and corruption would be significantly reduced. For every such transaction, there would be transparency as where it comes from, where it goes and why it goes. However, for this to happen, an inclusive financial system is necessary. When there is transparency tax evasion will be abridged. It will help to increase the national income.

Poor people save, borrow, and make payments throughout their lives. However, to use these services to their full potential they need well-suited products delivered responsibly. To provide financial products it requires attention to human and institutional issues, such as quality of access, affordability of products, provider sustainability, and outreach to the most excluded populations.

Financial inclusion helps to come out from poverty. Many doubt the efficacy of opening bank accounts. The first question arises in every one’s mind is that there are so many policies by government to alleviate poverty but it do not create immense differences, then how providing access to financial services can bring drastic changes in poverty. The subsidies provided by Government on food, education and health tries to alleviate poverty not from the root level. There is a popular saying, for a poor do not give fish, give him a net, let him catch the fish. Most of the poverty alleviation programs provide fish to poor and not the net. Access to finance will provide the net to them. Access to finance provides opportunities for income earning, through creating employment opportunities on a large scale by providing loans to new small-scale entrepreneurs.

Dream of inclusive growth and poverty alleviation will not be complete until millions of micro-entrepreneurs are created across the country. For every person who wants to be an entrepreneur the first challenge in front of him or her is finance. Financial access will attract international investors to our country and that will result in increasing employment and business opportunities. Inclusive growth will act as a source of empowerment and allow people to participate more effectively in the economic and social process. Financial inclusion is significant to attain sustainable growth. For these entrepreneurs, broad access to financial services would smoothen project financing, positively influence growth and alleviate poverty
alleviation. A strong financial system encourages expansion in the market and competition for existing firms also.

Provision of financial services to poor people need not only be for increasing income, empowering women, or starting small businesses – it may simply aim to help them “manage better what little money” they already have.

1.2. Statement of the Problem and Need for the Study:

Inclusive growth is essential to achieve rapid growth and sustainable development. The access to financial services by poors would lead to their consumption smoothing and investments in health, education and income generating activities, thus expanding growth opportunities for them. Inclusive growth if targeted systematically may lead to financial stability, asset building and economic mobility and empowerment of the low income group people. Even after years of implementing financial inclusion policies still many households were excluded from banking industry and forced to remain in the grip of informal lenders.

In the international context many studies have focussed on the problems of financial inclusion. Economists and development scholars have ventured into the area and have researched into different issues pertaining to financial exclusion so as to implement suitable policies and adequate measures. But no economic analysis about under banking has been attempted so far. The study reports tell us that there is intense exclusion prevails between developed, developing and underdeveloped states. Not only among states of India, even among districts of states also there is drastic difference in financial inclusion.

Adequate statistics are not available about financial inclusion. This marginalized section of the society who lives ‘hand to mouth’ has not been able to connect to the booming growth of Indian economy and have no savings; if any, very low savings, consuming all they earn. Hence it is imperative to investigate about their socio-economic conditions, ability/inability to participate in financial markets, accessibility/inaccessibility to banks. The study is expected to throw light on these
issues and help policy makers and officials to implement or amend required policies and measures. It is an attempt to understand the nature of financial exclusion in India and TamilNadu based on an empirical study that takes into consideration the analyses at the grass root level at Villupuram district at TamilNadu

Considering the differences of financial exclusion among regions, it was considered that it will be appropriate to take up a study in a district which has least financial inclusion, probing the role and prospect of qualitative variables in the financial inclusion of the people with the following basic questions.

1.3 Research Issues

- Banks work with the support of deposits from the public and government subsidies. If it is accepts deposits from the public and provides some services to them then it is a business unit. AS it receives government subsidy is its responsibility is to provide services to the whole population. Financial inclusion should happen from consumer side. Government compels banks to make every individual inclusive in the financial stream. So it is necessary to study why financial inclusion can not happen on its own or not.

- Having found that financial inclusion is a prior policy, government gave lot of subsidies to all banks to take up financial inclusion projects. Banks too took many measures to enhance financial inclusion. It is necessary to find whether these policies brought any improvement in financial inclusion after implementing.

- Measuring financial inclusion is a major concern in front of the researcher. Number of bank accounts or amount of credit and deposits, cannot be an accurate measurement. Therefore, there is a need to find out variables, which will explain financial inclusion.
• It is ideal to find out the differences in financial inclusion among states of India and districts of any states so that it will be possible to have proper state specific, district specific financial inclusion policies. Financial inclusion tools should change according to the region needs. It cannot be same to the person in Chennai and another person in a village. So it is necessary to find suitable financial inclusion methods

• People get to in the financial stream because banks voluntarily approach them. How far their bank accounts are active after that is a big question. Now unbanked is not the big issue; under banking is the biggest issue.

• Many research works have been done in finding out factors responsible for financial exclusion using which many policies have been implemented. Still there is fear for some people even to enter into the bank. It is necessary to address this issue.

• Government recently announced that Government subsidies would reach the beneficiaries through bank. How many people are aware of it and if the subsidy is provided through bank will that money be used for that purpose. These are the issues which need to be addressed.

1.4 Research Questions

1. How is the financial inclusion measured?

2. What factors influence the financial inclusion?

3. Why the financial inclusion can not happen on its own? And why should the banks take an additional responsibility of including people in to the financial stream?
4. Where does India position in financial inclusion?

5. Are there any differences in financial inclusion among Indian States?

6. Is there any need for change in region level financial inclusion policies?

7. What is the awareness level of DST among people? Will the subsidies provided be utilized for the said purpose?

8. There are ‘n’ numbers of projects implemented. Is there any enhancement in financial inclusion after all this projects. This is the biggest question before everyone who is working for the cause of financial inclusion.

1.5 Objectives of the Present Study

The primary objective of this present study is to analyse the status of financial inclusion in India. The study attempts to measure and compare the financial inclusion index for the various states of India. Measuring the financial inclusion of Indian states enables to know the status and the position that the particular state occupies in the country. It attempts to sheds light on the growth trend of financial inclusion and also the responsibility of the governments to follow appropriate policies to protect the most excluded state.

The financially excluded are heterogeneous group. Different states find themselves excluded for different reasons. They can be personal or structural. The financial exclusion may be of different in nature, differing from one country to another country, from one state to another state and one district to another district. In order to know the differences in financial inclusion among districts this study attempts to measure and compare the financial inclusion index for the various districts of TamilNadu. Policy implication therefore can be context specific and
may be area specific and district specific even though some characteristics or broad perspective may be alike.

The present study is aimed at portraying a role of socio-economic variables and banking variables, particularly in selected village in Villupuram district as it got the least rank in financial inclusion. The study attempts to identify the factors and its probability of influencing the level of financial inclusion. An analysis of the social and economic conditions of a particular village enables to found out the effect of qualitative variables function in financial inclusion.

One of the facts that most studies revealed about financial inclusion is mere opening a bank account is not enough to be included in to the financial stream. Its usage is more important. But most of the accounts opened under zero balance were inactive. So this study tries to investigate the factors responsible for under banking in the study area

1.6 Scope of the Study

Without the necessary skills and financial capability, households can be locked in a cycle of poverty and exclusion or suffer because of inappropriate product choice, high cost credit, or for some, illegal money lending. Financial exclusion leads to inequality in growth of individuals, causes insecurity to income and saving, creates threat without insurance, hammer business, shrinks GDP growth rate and at last it hits national economic growth

So far, many researchers worked in this area, but they all focused on macro level that too for the current year. Therefore, a macro level study done about the financial inclusion for Indian states, among the Indian states, TamilNadu was selected for further study. Among the districts of TamilNadu, Villupuram district scored last rank according to this study. So Villupuram district was selected for primary study. Therefore, this study will help to know the basic practical issues relating to financial inclusion in Villupuram district. This study will focus on the factors affecting, and the factors boosting the financial inclusion. Also it will study
the difference among active account holders, inactive account holders and the unbanked...

1.7 Scheme of the Study

The study consists of six chapters. The first chapter ‘Introduction’ illustrates the financial inclusion in world and India. It also consist of statement of the problem, need for the study and the scope of the study.

Second chapter attempts to give a macro picture of financial inclusion in the world and India. Emphasis is given to understand the Phases of bank evolution in India and financial inclusion. And also discussed about different types of financial exclusion and discuss where all financial inclusion is needed and also discussed about the various steps taken by the government for promoting financial inclusion.

The theoretical view points, the review of literature and earlier studies related to the topics are presented in the following chapter.

The methodology of the study is primary survey through structured questionnaire and a detailed discussion including sample description is presented in chapter four. It discusses the process of selecting the sample respondents, development of the research tool, major variables used and limitations of the study.

Chapter five presents a detailed analysis of financial inclusion in India and TamilNadu. The results of various quantitative techniques applied to analyze the data, test the hypotheses and study the objectives are enumerated.

The sixth chapter deals with findings and conclusion. Few suggestions are put forth based on the research and the findings of the study.