CHAPTER-2

REVIEW OF LITERATURE

The literature review provides an overview of the key concepts, theoretical and empirical perspectives that are important to the thesis. A review of the available literature is predictable in order to locate the progress made in the concerned area and to identify the gaps to be filled in by the researcher. The main theoretical background of the Economic Growth theory, and Economic inequalities, human capital importance of inclusive growth policies provide a solid starting point for understanding importance for the new path of economic growth polices to sustain the nations. The empirical reviews present demand side and supply side reviews of the studies of the financial inclusive growth and activities with regard to Indian perceptive in the context of financial inclusion.

A large number of studies have been made so far on financial inclusive growth with fruitful findings and policy imperatives. Though some of the studies are comprehensive, yet some gaps still persist. Many challenges on the problems of access to finance, credit, resources for unbanked population have not been adequately examined and duly focused. While the findings, analytical framework and policy proposals developed by the scholars are of worthy note, the present study is a diagnostic attempt of finding out the position, pattern, and prospects of financial inclusive growth. Against this background an attempt is made in the present chapter to present a brief resume of the literature available at both International and National levels relating to what strategies are affected to include the unbanked population.

After more than sixty years after planned development in India, the rural transects are still facing impoverishment, a consequence of failure of trickle down of development efforts at the grass roots. Inspite of planner’s motivation to achieve development with equality popularly known as ‘inclusive growth’, the country has been facing wide regional disparities both between urban and rural and between regions. Poverty, a case and consequence of underdevelopment is a continuing issue to be tackled with. Rural indebtedness has been an agenda of discussion right from the time of independence. Safer easy and affordable credit and other financial services to the poor and vulnerable groups, disadvantaged areas and lagging sectors is recognised as a pre-condition for accelerating growth and reducing income disparities and
poverty. Access to the functioning of better financial system by creating equal opportunities enables economically and socially excluded people to integrate better into the economy and actively contribute to development and protects themselves against economics shocks (RBI, 2009)

A. THEORETICAL BACKGROUND REVIEWS

2.1 The Importance of Economic Growth

Arthur Blakemore and Berthold Herrendorf (2009) Concluded in their report that Economic growth is critically important for individual well-being. Specifically, even small differences in growth rates over long horizons lead to large differences in living standard. Economists have learned a great deal about growth and development and a consensus is forming.

Robert E. Lucas (1995), He was the Nobel Prize winner in 1995 in Economics from the University of Chicago for his work in business cycles, not growth, famously said before the Cambridge faculty in 1986: How do economies grow over time?

“Is there some action a government like India’s could take that would lead the Indian economy to grow...If so, what action exactly? If not, what is it about the ‘nature of India’ that makes it so? The consequences for human welfare involved in questions like these are simply staggering: Once one starts to think about them, it is hard to think about anything else.”

Therefore, the fundamental measure of economic activity used by economists to measure growth is real gross domestic product (GDP). GDP captures the total output of an economy. Equivalently, it can be regarded as the total income earned in that economy. Real GDP, as opposed to nominal GDP, cancels out the effects of inflation over time.

Kirkpatrick, (2000) Emphasized that Finance is an essential part for the human development. Financial development is considered to be an integral factor in the economic growth of a country. So far, many studies have noted that a well-functioning financial system that mobilizes savings, allocates resources, and

facilitates risk management contributes to economic growth by supporting capital accumulation, improving investment efficiency, and promoting technological innovation (Kirkpatrick, 2000).

### 2.1.2 Economic Growth Theories:

**World Bank (2008)** Economic Growth Theories of development advocate that financial development creates enabling conditions for growth through either a ‘supply-leading’ (financial development spurs growth) or a ‘demand-following’ (growth generates demand for financial products) channel. Earlier theories of development hypothesised that a rise in inequality was inevitable in the early stages of development. The earlier literature, they did not focused on the need to develop an extensive financial system that could tap savings and then channel the funds so generated to a wide spectrum of activities. The modern development theory perceives the lack of access to finance as a critical factor responsible for persistent income inequality as well as slower growth. A large body of empirical literature suggests that developing the financial sector and improving access to finance may accelerate economic growth along with a reduction in income inequality and poverty. Without an inclusive financial system, poor individuals and small enterprises have to rely on their own limited savings and earnings to invest in their education and entrepreneurship to take advantage of growth opportunities (World Bank, 2008).

Hicks (1969) debated in his article if the natural experiment to examine whether access to finance is a critical component for fueling economic growth and productivity. The question of whether finance creates growth based on the Robinson argument (e.g., Hicks (1969)).

Robinson (1952) argued that with date, at least as far as Schumpeter (1912). In general, researchers find it difficult to study the direction of causality between financial development and economic growth because finance and growth are endogenously determined and rest in equilibrium. Further, what the precise channels

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are through which any finance-to-growth effect operates remain unclear (Alexander W. Butler, Jess Cornaggia) 66.

2.1.3 The Finance and Growth Nexus

Jose Manuel Gonzalez-Paaramo (2005) Concluded in his speech that there is strong evidence that access to finance is conducive to economic growth. This is a long-standing view in economics. The channels through which finance fastens growth include:

- The pooling of savings from disparate depositors, preventing production processes from being limited to inefficient scales;
- The allocation of resources through the selection of the most promising investment projects, allowing capital to flow to where it can be used most profitably; and
- The management of risk through aggregation and the transfer of risks to those more willing and able to bear them.

Dr. William F. Miller of Stanford University (2008) has outlined a new world business paradigm that began to emerge in the 1980s and 1990s (BACEI, 2008) 67. This new paradigm is characterized by global sourcing and distributing, extensive direct foreign investment, and the development of technology and industry clusters.

Hasan Torun-Cumhur (2007) 68 emphasized the growth as the increase in GDP per hour of labour per unit time. He carefully measured the fraction of this growth that was actually attributable to increases in capital, such as investments in machinery and related equipment, since the theory of the day was that capital accumulation was the primary determinant of growth. And also he argued that the capital accumulation accounted for less than a quarter of the measured growth. Solow’s insight was in attributing the remainder of the growth, the majority share, to "technical change.” In this empirical study placed the role of innovation in economic growth squarely on centre stage, where it has remained for the past

half century. The magnitude of the residual calculated in this empirical study placed the role of innovation in economic growth squarely on centre stage, where it has remained for the past half century. Since Solow’s contributions, the relationship between innovation and growth has been modeled in increasingly sophisticated ways.

2.1.4 Equitable growth

UN MDGs report debated the central role economic growth can potentially play in human development, poverty reduction, and the achievement of the Millennium Development Goals (MDGs). Equitable Growth is becoming widely understood amongst the development community that special efforts must be made to ensure that poorer sections of society are able to participate in economic growth. For instance, with low inequality a country with a growth rate of 2% per head and 40% of its population living in poverty, can halve poverty in ten years, but a country with high inequality would take nearly 60 years or more to achieve the same reduction (wikipedia, 2011)\textsuperscript{69}.

2.1.5 Inequality and Economic Growth

Kaldor Nicoals (1955)\textsuperscript{70} reported that in the initial days inequality theories incorrectly stated that inequality had a positive effect on economic development, later it was determined that the marginal tendency to save was to increase with wealth and inequality increases savings and capital accumulation. Therefore, the analysis based on comparing yearly equality figures to yearly growth rates was flawed and misleading because it takes several years for the effects of equality changes to manifest in economic growth changes (Berg & Ostry, 2012)\textsuperscript{71}.

Galor and Zeira(1993)\textsuperscript{72} he demonstrates that inequality in the presence of credit market imperfections has a long lasting detrimental effect on human capital formation and economic development, In contrast to the representative agent approach that dominated the field of macroeconomics for several decades, Galor and Zeira analyzed the role of heterogeneity in the determination of macroeconomic

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\textsuperscript{70} Kaldor, Nicoals, 1955, Alternative Theories of Distribution,” Review of Economic Studies, 23(2), 83-100


activity. They advanced the novel viewpoint that heterogeneity, and thus income
distribution, plays an important role in the determination of aggregate economic
activity and economic growth. Their research demonstrated that under plausible
conditions (i.e., credit market imperfections and fixed costs in the acquisition of
human capital); income distribution has a long lasting effect on investment in human
capital, aggregate income, and economic development (Galor O., 2009).

the relationship between income distribution and economic development has been
subjected to dramatic transformation in the past century. While the Classical
economists advanced the hypothesis that inequality is beneficial for economic
development, the neoclassical paradigm, which subsequently dominated the field of
macroeconomics, dismissed the Classical hypothesis and advanced the viewpoint that
the study of income distribution has no significance in the understanding of the
growth process.

Persson and Tabellini (1994), argues that inequality is harmful for
economic development because inequality generates a pressure to adopt redistributive
policies that have an adverse effect on investment and economic growth, this research
advanced the hypothesis that inequality, in the presence of credit market
imperfections, may be detrimental for human capital formation and economic
development.

that Innovation is a much effective driver of growth than capital. In the old economy,
where large amounts of capital were needed to construct an emergent factory
economy, and before the emergence of the kinds of sophisticated global capital
markets, of today, neoclassic lists’ overriding focus on capital accumulation may have
made some sense.

73 Oded Galor, Inequality and Economic Development: An Overview, Brown
University, 2009, pp. 2-12
74 Francisco Rodríguez C. Inequality, Economic Growth and Economic Performance A
Background Note for the World Development Report 2000
75 Persson, T. and Tabellini, G., 1994, Is Inequality Harmful for Growth? American Economic
Review, 84, 600-21.
76 Robert D. Atkinson and David b. Audretsch, Economic Doctrines and Policy Differences:
Has the Washington Policy Debate Been Asking the Wrong Questions?, 2008
Robert D. Atkinson (2011)\(^{77}\) tried to convince arguments that today’s economy, trying to stimulate the supply of an item that the economy has plenty of – investment capital – does not make much sense. The problem in the new economy is not a lack of investment capital but a lack of good investment opportunities. Supply-side tax cuts on individuals do not make much difference in the availability of capital; and even if they did, the supply of capital is not the key factor driving economic growth in today’s knowledge based economy.

Robert D. Atkinson, (2008)\(^{78}\) emphasized in his article that Global major economies have been transformed by the forces of technology, globalization, and entrepreneurship and that the doctrines guiding economic policy makers have not kept pace. Robert Atkinson explores innovation economics is a new economic framework for the 21st century to build a framework for poverty alleviation. In the global billion poor can be the engine of the next round of global trade and prosperity.

Prof. C.K.Prahalad (2004)\(^{79}\) strongly argued that “Serving the Bottom of the Pyramid (BOP) consumers will demand innovations in technology, products and services, and business strategies”. More importantly, it will require large firms to work collaboratively with civil society organizations and local governments. Market development at the BOP will also create millions of new entrepreneurs at the grass roots level from women working as distributors and entrepreneurs to village-level micro enterprises. These micro enterprises will be an integral part of the market-based ecosystem. It will require organizational and governance innovations as well as prosperity. It can be a source of innovations. When the poor are converted into consumers, they will go for more than access to product and service, the poor themselves are willing to experiment, learn, and change. The interconnectedness of the approach to economic development and social transformation is visualized. Serving the BOP consumers improved domestic macroeconomic conditions bode well for domestic revenue outlook.

Developing the innovation system requires that:

i. Structures are reformed and organisational, operational and regional fragmentation will be reduced

\(^{77}\) Robert D. Atkinson The Chain of Logic to Get to a Robust National Innovation and Competitiveness Policy, published by The Information Technology & Innovation Foundation, 2011
ii. the co-ordination and steering of policy actions will be strengthened at government level

iii. the prioritisation and selection of subject matters and contents will be undertaken

iv. the quality of research will be improved multi-lateral cooperation will be enhanced and the division of labour between public R&D institutes and enterprises clarified

v. the position of the SME sector within the innovation system will be strengthened

vi. a long-term infrastructure policy will be created and the wide use of public data enhanced the means for monitoring policies will be improved

Recent OECD study indicated that distribution of resources among certain segment of the population failed and redistribution schemes cannot be the only response to rising poverty rates in certain segments of the population. Therefore, the study concluded that the inclusive growth approach takes a longer term perspective as the focus is on productive employment rather than on direct income redistribution, as a means of increasing incomes for excluded groups. In the short run, governments could use income distribution schemes to attenuate negative impacts on the poor of policies intended to jump start growth, but transfer schemes cannot be an answer in the long run and can be problematic also in the short run. The emerging need is to identified innovation and economic framework for financial inclusive growth.

2.2 Inclusive Growth Policy Pullers

According to the World Bank (2008) report that access to financial service implies an absence of obstacles to the use of these services, even though there were some difficult obstacles is price or non price barriers to finances. The majority of the developing countries had failed to make this distinction can complicate efforts to defined and measure access. Financial market imperfections, such as information asymmetries and transaction costs, are likely to be especially binding on the talented poor and on micro- and small enterprises that lack collateral, credit histories, and connections. Without inclusive financial systems, these individuals and enterprises with promising opportunities are limited to their own savings.

ADB (2011) report said that “ In the 20th century, particularly ADB adopted inclusive economic growth as one of its three critical strategic agendas in Strategy

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2020”, ADB bank strategy is supporting for inclusive growth in the region through financing, policy advice and knowledge solutions, and technical assistance and capacity building, with particular on building infrastructure, providing basic public services such as water and sanitation and education, developing the financial sector and fostering financial inclusion, and enhancing food security.

Asian Development Bank (2011) emphasized the report that the concept of inclusive growth is economic growth that aims at high and sustained growth while ensuring that all members of the society benefit from growth in a high, efficient, and sustained growth to productive jobs and economic opportunity with equality of life. There are three policy pillars supported by good governance and institutions are identified as requirements for a strategy anchored on inclusive growth. The importance of three policy pillars expansion of economic opportunity, social inclusion to promote equal access to opportunities, and social safety nets supported by good governance and strong institutions, can promote inclusive growth where all members of the society can benefit from and contribute to the growth process.

2.3 Global Economic Disparities in the Current Earn

Sunil Chaudhary (2009) in his book indicated that the “Globalization Trade may shift economic inequality from a global to a domestic scale. When rich countries trade with poor countries, the low-skilled workers in the rich countries may see reduced wages as a result of the competition, while low-skilled workers in the poor countries may see increased wages”. And also he attributes that to increased trade with poor countries and the fragmentation of the means of production, resulting in low skilled jobs becoming more tradable. However, finally he concluded that the effect of trade on inequality is minor when compared to other causes, such as technological innovation, to promote inclusive growth shared by other experts.

Wikipedia Encyclopedia (2011) article said that “Economic inequality (wealth and income differences) comprises all disparities in the distribution of economic assets and income. The term typically refers to inequality among individuals and groups within a society, but can also refer to inequality among countries”. Therefore, the issue of economic inequality are related to the equality

distribution of resources and equity of outcome and opportunity. The main issue is whether economic inequality is a positive or negative phenomenon, both on utilitarian and moral grounds. However, finally they concluded that negative social phenomena such as shorter life expectancy, higher disease rates, homicide, infant mortality, obesity, teenage pregnancies, emotional depression, and prison population correlate with higher socioeconomic inequality.

According to World Economic Forum (2011) Disparities and Economic inequality have existed in a wide range of societies and historical periods; its nature, cause, and importance are open to broad debate. Therefore, the country’s economic structure or system (for example, capitalism, or socialism), ongoing or past wars, and differences in individuals' abilities to create wealth are all involved in the creation of economic inequality. The world is in no position to face major, new shocks. The financial crisis has reduced global economic resilience, while increasing geopolitical tension and heightened social concerns suggest that both governments and societies are less able than ever to cope with global challenges to enhance understanding of how a comprehensive set of global risks are evolving, how their interaction impacts a variety of stakeholders, and what trade-offs are involved in managing them. Issues of economic disparity and equity at both the national and the international levels are becoming increasingly important, see the Figure: 7 politically, there are signs of resurgent nationalism and populism as well as social fragmentation. There is also a growing divergence of opinion between countries on how to promote sustainable, inclusive growth.
Simon Kuznets (1963) argued that levels of economic inequality are in large part the result of stages of development. Kuznets saw a curve-like relationship between level of income and inequality, now known as Kuznets curve. According to Kuznets, countries acquire more capital through various possible redistribution mechanisms such as social programs and more developed countries move back to lower levels of inequality. However, Kuznets demonstrated the relationship using cross-sectional data. Kuznets’ curve indicated that income inequality will eventually decrease given time, when distribution of resources is done equally for the low income communities. This does not necessarily disprove Kuznets’ theory.
2.4 Globally Financial Excluded

The Economist (2012)\textsuperscript{86} report indicated that the financial exclusion is a global issue. In that report the World Bank estimates that, in some countries, fewer than 10 per cent of people have access to financial services of any kind. But even in developed countries, the harsh realities of exclusion are just as real. The global emerging challenges in access to finance, access to resources and use of financial services remains a big constraint. Two thirds of the adult population in developing countries or 2.7 billion people lack access to basic formal financial services, such as savings or checking accounts.

According to World Bank (2010)\textsuperscript{87} report empirical results indicated that in the largest share of the unbanked live in Sub-Saharan Africa (12% banked) and South Asia (24% banked). East Asia, Middle East and North Africa, Latin America and Eastern Europe and Central Asia are also low-access regions with less than 50% of their population banked. Among the unbanked a large proportion lives on less than $5 dollars a day”. Finally the report concluded that financial inclusion needs to leverage all financial services providers, for example microfinance industry as well as from recent innovations to deliver financial service outside of conventional bank branches. However, falling the financial services gap will require significant commitment from a wide variety of bank and non-bank financial institutions, including commercial banks, credit unions, savings banks, microfinance institutions, postal banks, and mobile banking operators.

2.5 Past Efforts at Financial Inclusion in India

Even before the emergence of financial inclusion the history of regulating rural financial situation in India dates back to colonial period as a part of the Jargon in the finance and banking arena. The Indian polity had shown tremendous foresight in formulating polices for the same, right from the mid 1950s to the mid 1980. The institutionalization of systems for financial inclusion in India started with the establishment of credit cooperatives following the enactment of Cooperative Societies Act in 1904. After independence, these efforts were intensified following the

\textsuperscript{86} The Economist, Banking for billions Increasing access to financial services, published by BARCLAYS, London, 2012

recommendations of All India Rural Credit Survey committee of 1954. The expansion of the traditional commercial banks to rural areas commenced with the nationalisation of Imperial Bank of India and its conversion to Stage Bank of India in 1955, the review undertaken by the All India Rural Credit Review Committee found that the cooperatives had not reached up to the expectations in mobilizing deposits and dispensing credit at the national level.

The Committee, therefore, felt that the efforts of the cooperatives had to be supplement and recommended the adoption of a multi-agency approach to provide credit to rural and semi-urban areas with a role for commercial Banks. The nationalisation of 14 major commercial banks in 1969 and another six commercial banks in 1980 were steps that facilitated rapid expansion of the banking system to hitherto unbanked areas. With the nationalisation of major banks, special responsibility of stepping up advance for the entire priority sector was given to them. In 1970 the Lead Bank Scheme introduced commercial banks as lead banks to coordinate the efforts of financial institutions meeting the credit needs of the economy (K.G Karmakar, 2011).

The cooperative forms of organizations were introduced in India by Cooperative Societies Act in 1904 which was modified in 1912 to overcome the deficiencies of the former, establishing a three tier system at village, district, and provincial level. Though this was an earnest step in institutionalizing rural financial scene, failure of cooperatives to finance agriculture and other allied activities was identified by Malcom Darling’s Report (1935) and the Statutory report of RBI (1937).

Leeladhar, (2005) observed that despite making significant improvements in all 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.

However, in 2003, the RBI policy of financial inclusion to provide access to financial services to the poor can be earmarked as another bold initiative in serving the rural transects targeting inclusive growth. Committee on financial inclusion in

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2008 (Rangarajan committee) observed that financial inclusion to hitherto excluded segments of the population is critical to sustain and accelerate growth momentum. For achievement of the same, the committee has put forward multi-pronged strategies including establishment of National mission on financial inclusion, revitalizing the RRBs and Cooperatives, introducing MFI model (SHG-bank linkage) and Business Facilitator and Business Correspondents Model.

K. A. Shreenivasan, P. Vaijayanthi, Kaundinya Narsimha (2013) have discussed in their conference paper that depriving access to credit claims is a key barrier that denies the poor, the right to take advantage of investment opportunities. These barriers, which are more binding on the poor, lead to higher inequalities in income with higher credit constraints (Galor, Oded and Zeira, 1993) Banerjee and Newman, (1993)⁹⁰.

Aghion and Bolton, (1997)⁹¹ is empirical analysis results suggest that “improved access to finance is not only pro-growth but also pro-poor, reducing income inequality and poverty”. International studies (World Bank Policy Research Working Paper 3338 2004; Clarke, Colin and Heng-fu, 2006)⁹² ⁹³ observed that “the income of the poorest quintile grows faster than the average per capita GDP in countries with better developed financial intermediaries”. Studies on international practice also confirm the influence of financial intermediaries on economic growth measured by GDP per capita and productivity per capita in terms of private credit (Levine, Loayza, Beck, and Thorsten, 2000)⁹⁴. Hence small firms and the poor disproportionately benefit these groups. For poor households, though credit is the high priority, financial service is needed by the small firms and the poor households depend on these intermediaries for good savings, payment services and insurance (.World Bank Policy Research Report, 2008)⁹⁵.

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2.5.1 The Diversity of the Financially Excluded and Underserved Groups

FATF (2011)\(^{96}\) report emphasized that disadvantaged and other vulnerable groups such as SC, ST and Women, including low income households, handicapped, individuals in rural communities and undocumented migrants, in both developed and developing jurisdictions, are more likely to be excluded from the formal, regulated financial sector, because of other barriers such as problems in meeting the documentary and other requirements, non-awareness, wrong perceptions, limited knowledge, high cost, etc. Underserved clients represent a very heterogeneous category with very different risk profiles in different jurisdictions. As a consequence, they cannot be classified as low risk clients on the sole basis that they are financially excluded.

2.6 Present Scenario of Financial Exclusion in India

Dr Debesh Roy’s (2012)\(^{97}\) research report emphasized that out of 600,000 habitations in the country; only about 5 percent have a commercial bank branch. Also only about 57 percent of the population across the country has bank account (savings), and this ratio is much lower in the North-Eastern states. Further, 13 percent of the population has debit cards and 2 percent has credit cards. India has a significantly low level of financial penetration compared with OECD countries. However, in India access to finance, access to credit is worse off when compared with China, Malaysia, and Thailand. However, in terms of financial access through ATMs for rural population, India fares poorly compared to select Asian peer group countries (RBI, 2010).

Shri Harun R Khan (2012)\(^{98}\) indicated that the Habitations in the country which have a commercial bank branch is: 30,000(out of 600,000)

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\(^{96}\) FATF, Anti-money laundering and terrorist financing measures and Financial Inclusion, published by The Financial Action Task Force (FATF), report, 2011, France

\(^{97}\) Dr Debesh Roy, Financial Inclusion in India Emerging Profitable Models, published by BANCON, Mumbai, 2012, P.129.

\(^{98}\) Shri Harun R Khan, Issues and Challenges in Financial Inclusion: Policies, Partnerships, Processes & Products India at the symposium on “Financial inclusion in Indian Economy” organized by the Indian Institute of Public Administration, Bhubaneswar on June 30, 2012)
Table: 2.1 Financial Inclusion: Snapshot

<table>
<thead>
<tr>
<th>S.No</th>
<th>Particulars</th>
<th>Percentage</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Bank Accounts(savings)</td>
<td>57%</td>
</tr>
<tr>
<td>2</td>
<td>Life Insurance</td>
<td>10%</td>
</tr>
<tr>
<td>3</td>
<td>Non-life insurance</td>
<td>0.6%</td>
</tr>
<tr>
<td>4</td>
<td>Debit Cards</td>
<td>13%</td>
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<tr>
<td>5</td>
<td>Credit Cards</td>
<td>2%</td>
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The above table provides a set of summary statistics relating to the penetration of various categories of financial products. First, the relatively low penetration of bank branches must be highlighted - only 30,000 out of 6,00,000 habitations have a banking presence. As is well understood, the goal of having a physical banking facility in every habitation is unrealistic, which is why the inclusion strategy is largely based on the use of Information and communication technology (ICT) to expand banking access virtually through the mechanism of a Business Correspondent (BC), who carries a handheld device networked to the bank's systems. This is an enormous technological discontinuity enabled by the spread and efficiency of the mobile telephone network and, clearly, the inclusion strategy must take full advantage of this resource.

There are several barriers which exclude a considerable mass of the population, the lower strata in specific, from using the services of the banks and other intermediaries. A World Bank study (Beck, Aslý and Maria ,2007a) concluded that these barriers to access of banking services vary significantly across countries and were inversely correlated with the actual use of financial services. Barriers including locations (head office, branch, and other offices of the banks), minimum balance requirement to open and maintain an account, fees for payments, documentation formalities, and processing times are found to vary considerably among banks and between countries. Barriers, like minimum balance requirement to open an account, maintenance fee, documentation rituals to open account, period to process loan
applications and charges for using ATMs, are confirmed to have a significant inverse correlation with per capita GDP and private credit to GDP.

In India, the lowered level of access to financial services can be attributed to both demands - side and supply side barriers. Supply side constrictions include deprived banking infrastructure, low resource base of credit supply institutions, security based loaning processes, prolonged and unwieldy formalities, and poor financial literacy. The demand side impediments to extension of coverage of institutional credit include factors like “inadequate human capital, skewed distribution of land including lack of proper land reforms, presence of large section of landless laborers, poor state of physical infrastructure (road, bridges, irrigation structures, market yards, cold storages), underdeveloped social capital (gram Panchayat, local administration, commodity cooperatives, etc), low productivity leading to low level of profitability, poor linkages, poor risk mitigation mechanism, etc.” (Government of India, Report of the Committee on Financial Inclusion, 2008).

2.6.1 Vulnerable Groups in India

According to Chandrima Chatterjee Gunjan Sheoran (2011)99 research report analysis results showed that there are multiple socio-economic disadvantages that members of particular groups experience which limits their access to health and healthcare in India. Therefore, the task of identifying the vulnerable groups is not an easy one. In addition there are multiple and complex factors of vulnerability with different layers and more often than once it cannot be analysed in isolation. They found in their research the prominent factors on the basis of which individuals or members of groups are discriminated in India, i.e., structural factors, age, disability, mobility, stigma, and discrimination that act as barriers to health and healthcare. However, the vulnerable groups that face discrimination include Women, Scheduled Castes (SC), Scheduled Tribes (ST), Children, Aged, Disabled, Poor migrants, People living with HIV/AIDS and Sexual Minorities. Sometimes each group faces multiple barriers due to their multiple identities. For example, in a patriarchal society, disabled women face double discrimination of being a women and being disabled.

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99 Chandrima Chatterjee Gunjan Sheoran Vulnerable Groups in India published by The Centre for Enquiry into Health and Allied Themes (CEHAT), Mumbai, 2007, p.p.5-6
2.6.2 Vulnerable Groups Facing Structural Discrimination

According to a NSS report the majority of social group facing structural discrimination physically, technically and virtually even today of the society in India are Women & men of Scheduled Tribes. The structural norms are attached to the different relationships between the subordinate and the dominant group in every society. A group’s status may for example, be determined on the basis of gender, ethnic origin, skin colour, etc. The norms act as structural barriers giving rise to various forms of inequality. Access to resources, access to finance, health, education, and technology for the subordinate groups is reduced due to the structural barriers. The figure 2.5 explains the structural discrimination faced by the groups and their human right violations.

Figure: 2.5 Structural Discrimination Faced by Groups


According to NSSO Survey 59th Round: Extent of Exclusion –

(a) General :

- The majority of farmer households 51.4 per cent are financially excluded from both formal and informal sources.
- The total farmer households, only 27 per cent access formal sources of credit, but one third of this group also borrow from non-formal sources.
- Overall 73 per cent of farmer households have no access to formal sources of credit.
(b) Region-wise:

- Exclusion is most acute in Central, Eastern and North-Eastern regions have a concentration of 64 per cent of all financially excluded farmer households in the country.
- Overall indebtedness to formal sources of finance alone is only 19.66 per cent in these three regions.

(c) Occupational Groups:

- Marginal farmer households constitute 66% of total farm households. Only 45 per cent of these households are indebted to either formal or non formal sources of finance.
- Only 20 per cent of indebted marginal farmer households have access to formal sources of credit.
- The majority 80 per cent of the non-cultivator households not access credit from any source.

(d) Social Groups:

- The majority 36 of ST Farmer households are indebted (SCs and Other Backward Classes - OBC - 51%) mostly to informal sources.
- Analysis of the data provided by RBI thru’ its Basic Statistical Returns reveal that critical exclusion (in terms of credit) is manifest in 256 districts, spread across 17 States and 1 UT, with a credit gap of 95 per cent and above. This is in respect of commercial banks and RRBs.

2.7 Nature, Causes and Consequences of Financial Exclusion

Nature and Causes:

Sinclair (2001)\(^\text{100}\) indicated that the nature and forms of exclusion and the factors responsible for it are varied and, thus, no single factor could explain the phenomenon. So the principal barriers in the expansion of financial services are often identified as physical access, high charges, and penalties, conditions attached to

products which make them inappropriate or complicated and perceptions of financial service institutions which are thought to be unwelcoming to low income people. Kempson et al. (2000)\textsuperscript{101} analysed in their report the range of physical and geographical barriers to financial inclusion factors that can contribute to financial exclusion for different products and individuals under certain circumstances. There are a number of ‘dimensions’ or ‘forms’ of financial exclusion that have been identified. The critical dimensions of financial exclusion include: (i) access exclusion- restriction of access through the process of risk management (by financial services providers); (ii) condition exclusion - conditions attached to financial products which make them inappropriate for the needs of some segments of population; (iii) price exclusion- some people can only gain access to financial products at prices they cannot afford; (iv) marketing exclusion - some people are effectively excluded by targeted marketing and sales; and (v) self-exclusion - people decide not to opt for a financial product because of the fear of refusal to access by the service providers. However, in many countries, many non-poor individuals, micro, small and medium entrepreneurs also have difficulty in accessing financial services. The most conspicuous dimension is that many of the low-income segments of the population do not have access to even the very basic financial services. Even amongst those who have access to finance, most are underserved in terms of quality and quantity of products and services. Significant proportion of low-income households is dependent on unsustainable, subsidy-dependent and poorly performing institutions (Chart-VII.2) (Kempson and Whyley, 1999; Kempson et al., 2000; Connolly and Hajaj, 2001).

United Nations (2006b)\(^{102}\) report emphasized that exclusion may also have resulted from a variety of structural factors such as unavailability of products suiting their requirements, stringent documentation and collateral requirements and increased competition in financial services. There has also been particular emphasis on socio-cultural factors that matter for an individual to access financial services.

Ashvin Parekh, D. S. Rawat (2011)\(^{103}\) in their report analysed the global situation the following table depicts a comparison of the state of financial exclusion among some regions/countries across the world. It considers FI as ownership and ignores the levels of activity in savings accounts. The state of exclusion will surely

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http://www.uncdf.org/sites/default/files/Download/bluebook_0.pdf

\(^{103}\) Ashvin Parekh, D. S. Financial inclusion for equitable growth published by ASSOCHAM and Ernst & Young, Mumbia, 2011, p.p:2-34
become worse if the real rate of inclusion, which measures usage frequency, is also taken into account.

Table: 2.2 Global Snapshots of Financially Excluded Households (2005)

<table>
<thead>
<tr>
<th>S.No</th>
<th>Country/Region</th>
<th>No. of households (million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>China</td>
<td>263</td>
</tr>
<tr>
<td>2</td>
<td>Africa</td>
<td>230</td>
</tr>
<tr>
<td>3</td>
<td>Rest of Asia</td>
<td>132</td>
</tr>
<tr>
<td>4</td>
<td>India</td>
<td>135</td>
</tr>
<tr>
<td>5</td>
<td>Indonesia</td>
<td>30</td>
</tr>
<tr>
<td>6</td>
<td>Latin America (Ex-Brazil)</td>
<td>28</td>
</tr>
<tr>
<td>7</td>
<td>Middle East</td>
<td>20</td>
</tr>
<tr>
<td>8</td>
<td>Central and Eastern Europe</td>
<td>19</td>
</tr>
<tr>
<td>9</td>
<td>Western Europe</td>
<td>18</td>
</tr>
<tr>
<td>10</td>
<td>USA</td>
<td>17</td>
</tr>
<tr>
<td>11</td>
<td>Brazil</td>
<td>14</td>
</tr>
<tr>
<td>12</td>
<td>Commonwealth of Independent States</td>
<td>14</td>
</tr>
</tbody>
</table>

Source: BCG Report

2.8 Factors Affecting Access to Financial Services

According to RBI (2008)\(^{104}\) report there are a number of factors affecting access to financial services which have been identified in many countries. These are:

1) **Gender issues:** Access to credit is often limited for women who do not have, or cannot hold title to assets such as land and property or must seek male guarantees to borrow.

2) **Age factor:** Financial service providers usually target the middle of the economically active population, often overlooking the design of appropriate products for older or younger potential customers.

3) **Legal identity:** Lack of legal identities like identity cards, birth certificates or written records often exclude women, ethnic minorities, economic and political refugees, and migrant workers from accessing financial services.

4) **Limited literacy:** Limited literacy, particularly financial literacy, *i.e.*, basic mathematics, business finance skills as well as lack of understanding often constrains demand for financial services.

5) **Place of living:** Although effective distance is as much about transportation infrastructure as physical distance, factors like density of population, rural and remote areas, mobility of the population (i.e., highly mobile people with no fixed or formal address), insurgency in a location, etc., also affect access to financial services.

6) **Psychological and cultural barriers:** The feeling that banks are not interested to look into their cause has led to self-exclusion for many of the low income groups. However, cultural and religious barriers to banking have also been observed in some of the countries.

7) **Social security payments:** In those countries where the social security payment system is not linked to the banking system, banking exclusion has been higher.

8) **Bank charges:** In most of the countries, transaction is free as long as the account has sufficient funds to cover the cost of transactions made. However, there are a range of other charges that have a disproportionate effect on people with low income.

9) **Terms and conditions:** Terms and conditions attached to products such as minimum balance requirements and conditions relating to the use of accounts often dissuade people from using such products/services.

10) **Level of income:** Financial status of people is always important in gaining access to financial services. Extremely poor people find it difficult to access financial services even when the services are tailored for them. Perception barriers and income discrimination among potential members in group-lending programmes may exclude the poorer members of the community.

11) **Type of occupation:** Many banks have not developed the capacity to evaluate loan applications of small borrowers and unorganised enterprises and hence tend to deny such loan requests.

12) **Attractiveness of the product:** Both the financial services/products (savings accounts, credit products, payment services and insurance) and how their availability is marketed are crucial in financial inclusion.
The Financial Action Task Force (FATF), (2011) report summarized the main obstacles to financial inclusion can be summarized as follows:

A. Supply side

1) **Outreach:** low density areas and low income populations are not attractive for the provision of financial services and are not financially sustainable under traditional banking business strategies and corresponding regulatory requirements

2) **Regulation:** frameworks are not always adapted to local contexts

3) **Business strategies:** mostly with high fixed costs

4) **Providers:** limited number and types of financial service providers

5) **Services:** non-adapted products and services for low income populations and the informal economy

B. Demand side

- Irregular income
- Frequent micro-transactions
- Lack of trust in formal banking institutions
- Literacy level, lack of awareness and/or knowledge/understanding of financial products
- Cultural obstacles (e.g., gender and cultural values).

2.9 Building Inclusive Financial Sectors

According to United Nations(2006) said that many developing countries need to design appropriate strategies for increasing access to financial services by all segments of the population. Those countries must also turn their strategies into effective policy measures and implementation plans. Therefore, the multiple stakeholders must work together to design these strategies and determine the best ways to organize their implementation. However, an effort entails the co-operation of the range of governments, financial institutions, civil society organizations,
development partners, and the private sector. And also it requires all stakeholders to ensure that adequate attention is focused on financial inclusion over the long term.

According to the Asia Multi-Stakeholder Dialogue (2005)\textsuperscript{107} agreed that there is a large unmet demand for financial services by the poor and micro- and small entrepreneurs. The most underserved groups (example SC, ST, OBC and women in India) include those living in remote or sparsely population locations, minorities and those lacking legal status, as well as mobile groups. Additionally Besides, economically inactive individuals, or beginners in using financial services have a latent demand for services that is not articulated. Therefore, some workers in certain sectors, such as crop farming, are often not served because the long production cycle of their economic activity does not align with loan repayment schedules required by lenders. Hence, the Emerging entrepreneurs who need larger loans to scale up their microenterprises to small enterprises are usually not served by MFIs and also encounter problems with larger financial institutions because of a lack of collateral.

2.9.1 Consequences of Financial Exclusion

Dr. Reena Agrawal\textsuperscript{108} indicated that Financial exclusion is a serious concern among SC,ST,OBC and women households as well as small businesses, mainly located in semi-urban and rural areas. The main Consequences of financial exclusion being financially excluded the absence of access to bank accounts and other saving opportunities result in lack of savings, low investments and lack of financial planning, then it becomes difficult in gaining access to credit getting credit from informal sources at exorbitant rates results in increased unemployment due to lack of self – employment opportunities as well as higher incidence of crime etc. Therefore, small business may suffer due to loss of access to middle class, and higher-income consumers, higher cash handling costs, delays in remittances of money, lots of reliance on private money lenders for small credits. He concluded that financial exclusion not only widens the ‘Rich-Poor divide ’, it also leads to ‘Social Exclusion’.

\textsuperscript{107} The Asia Multi-Stakeholder Dialogue, Building Inclusive Financial Sectors for Development: A Regional Multi-Stakeholder Dialogue During the Asian Development Bank’s ”Microfinance Week” 2005

\textsuperscript{108} Dr. Reena Agrawal, 100 \% Financial Inclusion : A Challenging Task Ahead present at Conference on Global Competition & Competitiveness of Indian Corporate, IIM. Lucknow, 2011,p.p.276-279
According RBI (2008)\textsuperscript{109} it is emphasized that the Financial Exclusion is broadly defined as the lack of access by certain segments of the society (SC, ST, OBC, and women) to suitable, low-cost, fair, and safe financial products and services from mainstream providers”. Thus the essence of financial inclusion is to ensure that a range of appropriate financial services is available at affordable price to every individual and access those services. In reality, the Reserve Bank of India found that the main reasons for financial exclusion, from the demand side are lack of awareness, low income, poverty and illiteracy; and from the supply side it is the distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes, etc. The RBI found that due to all these procedural hassles people feel it easier to take money from informal credit sources, in spite of, high cost of credit. It results in compromised standard of living and higher costs. Informal credit increased exposure to unethical and unregulated providers and vulnerability to uninsured risks. The RBI concluded that financial inclusion does not mean merely opening of saving bank account but signifies creation of awareness about the financial products, education, and advice on money management, offering debt counseling, etc. by banks. Every society should ensure easy access to public goods. Therefore, banking service being a public good should also be aimed at providing service to the entire population.

2.9.2 Barriers to Financial Inclusion

Collins (2009)\textsuperscript{110} studied more than 250 financial diaries of low income individuals in Bangladesh, India, and South Africa. Their findings show that each household uses at least four types of informal financial instruments (such as interest free loans and informal savings clubs) in a year, with the average being just under ten. This suggests that low income individuals do need access to financial services, and the existence of barriers that prevent their use of formal sector services. There are many complex factors that prevent rapid progress towards the goal of financial inclusion. In the UK, the Financial Inclusion task force (which monitors access to basic banking services) has differentiated between supply and demand side factors of financial exclusion, in its action plan for 2008-2011. The supply side factors include


non-availability of suitable products, physical barriers, and non-eligibility on account of documentation issues. On the demand side, financial literacy and financial capability are regarded as important factors by the task force. While financial literacy refers to the basic understanding of financial concepts, financial capability refers to the ability and motivation to plan financials, seek out information and advice, and apply these to personal circumstances.

**Figure: 2.7 Barriers to Financial Inclusion**

![Barriers to Financial Inclusion]

Source: Researcher’s Design

### 2.10 Concept of Financial Inclusion

*Mandira Sarma, Jesim Pais (2008)*\(^{111}\) report analyzed the history that in India the concept of financial inclusion was started in the years of 1904 as Cooperative movement, and then it gained momentum in 1969 when 14 major commercial banks of the country were nationalized and lead bank scheme was introduced shortly thereafter. From the that year the majority of bank branches were opened in large numbers across the country and even in the areas which were hitherto being neglected. However, there is a severe gap in financial access which needs special attention. So many studies have proved that lack of inclusion or rather exclusion from the banking system results in a loss of 1 per cent to the GDP. Thus, the RBI concluded that the financial inclusion is not just a socio-political imperative but also an economic one and realized the gravity of the problem. Finally the Reserve Bank of India made the Mid Term Review of Monetary Policy (2005-06), urged the banks to make financial inclusion as one of their prime objectives.

2.10.1 Defining Financial Inclusion

United Nations, (2006)¹¹² in the report defined “financial inclusion as the timely delivery of financial services to disadvantaged sections of society”. But this definition encompasses concept’s primary dimension. Firstly, financial inclusion refers to a customer have access to a range of formal financial services, from simple credit and savings services to the more complex such as insurance and pensions. Secondly, financial inclusion implies that customers have access to more than one financial services provider, which ensures a variety of competitive options. Flowing from this definition, financial exclusion would mean the inability of the disadvantaged to access financial services. A range of obstacles could lead to financial exclusion; barriers include geography (limiting physical access), regulations (lack of formal identification proof or of appropriate products for poor households), psychology (fear of financial institution’s staff, structures, complicated financial products, etc.), information (lack of knowledge regarding products and procedures), and low financial acumen (low income and poor financial discipline), among others.

Claessens (2006)¹¹³ said that access to finance can be defined as “availability of a supply of reasonable quality financial services at reasonable costs, where reasonable quality and reasonable cost have to be defined relative to some objective standard, with costs reflecting all pecuniary and non pecuniary costs”. It can also be defined as the “absence of price and non-price barriers” (Demirguc-Kunt and Levine 2008)¹¹⁴. Leyshon and Thrift (1995) define financial exclusion processes as those which serve to prevent certain social groups and individuals from gaining access to the formal financial system.

According to World Bank (2008)¹¹⁵ Access to finance eases the external financing constraint that prevents firms’ expansion. Low access also leads to increased income inequalities, poverty, and low growth rates. Thus access to finance and an inclusive financial system which caters for all groups of people has been advocated as a means to reduce inequalities and poverty in developing countries.

Demirguc-Kunt (2010) observed that, “Without inclusive financial systems, poor individuals, and small enterprises need to rely on their personal wealth or internal resources to invest in their education, become entrepreneurs, or take advantage of promising growth opportunities”

RBI Report (2008) indicated several definitions of financial inclusion/exclusion have evolved in the below table. There are main operational definitions of financial exclusion generally focus on ownership or access to particular financial products and services.

Meadows et al., (2004) argued that the focus narrows down mainly to the products and services provided by the mainstream financial service providers. But just providing the services for poor is different and need to design particular products or services at the affordable cost-effective products.

Bridgeman (1999) positively expand the definition such financial products may include money transmission, home insurance, short and long-term credit and savings. Furthermore, the operational definitions have also evolved from the underlying public policy concerns that many people.

H.M. Treasury (2004) concluded that particularly those living on low income, cannot access mainstream financial products such as bank accounts and low cost loans, which, in turn, imposes real costs on them - often the most vulnerable people in urban and rural India.

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120 H.M. Treasury, (2004), —Promoting Financial Inclusion , HMSO, St Clements House, 2-16 Colegate, Norwich, December
Table 2.3: Definitional Aspects of Financial Inclusion/Exclusion

<table>
<thead>
<tr>
<th>Institution</th>
<th>Author Definition</th>
<th>Indicators</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>ADB(2000)</strong></td>
<td>Provision of a broad range of financial services such as deposits, loans, payment services, money transfers and insurance to poor and low-income households and their micro-enterprises.</td>
<td>Deposits, loans, payment services, money transfer and insurance.</td>
</tr>
<tr>
<td><strong>Stephen P. Sinclair(2001)</strong></td>
<td>Financial exclusion means the inability to access necessary financial services in an appropriate form. Exclusion can come about as a result of problems with access, conditions, prices, marketing, or self-exclusion in response to negative experiences or perceptions.</td>
<td>Basic banking services for money transmission, credit, insurance, debt and debt assistance, long-term savings and financial literacy</td>
</tr>
<tr>
<td><strong>Chant Link and Associates, Australia(2004)</strong></td>
<td>Financial exclusion is lack of access by certain consumers to appropriate low cost, fair, and safe financial products and services from mainstream providers. Financial exclusion becomes a concern in the community when it applies to lower income consumers and/or those in financial hardship</td>
<td>Deposit accounts, direct investments, home loans, credit cards, personal loans, building insurance and home insurance.</td>
</tr>
<tr>
<td><strong>Treasury Committee, House of Commons UK(2004)</strong></td>
<td>Ability of individuals to access appropriate financial products and services</td>
<td>Affordable credit and savings for all and access to financial advice.</td>
</tr>
<tr>
<td><strong>Scottish Government (2005)</strong></td>
<td>Access for individuals to appropriate financial products and services. This includes have the capacity, skills, knowledge and understanding to make the best use of those products and services. Financial exclusion by contrast, is the converse of this.</td>
<td>Access to products and services, and/or capacity, skills, knowledge and understanding</td>
</tr>
<tr>
<td>Source</td>
<td>Definition</td>
<td>Access to financial services and timely and adequate credit.</td>
</tr>
<tr>
<td>--------------------------------------------------------------------------------------------</td>
<td>----------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------------</td>
<td>-------------------------------------------------------------------------------------------------------------------------------</td>
</tr>
<tr>
<td><strong>United Nations (2006b)</strong></td>
<td>A financial sector that provides ‘access’ to credit for all ‘bankable’ people and firms, to insurance for all insurable people and firms and to savings and payments services for everyone. Inclusive finance does not require that everyone who is eligible use each of the services, but they should be able to choose to use them if desired.</td>
<td></td>
</tr>
<tr>
<td><strong>Report of the Committee on Financial Inclusion in India</strong></td>
<td>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</td>
<td></td>
</tr>
<tr>
<td><strong>Chairman:</strong> C. Rangarajan, 2008</td>
<td></td>
<td></td>
</tr>
<tr>
<td><strong>World Bank (2008)</strong></td>
<td>Broad access to financial services implies an absence of price and non-price barriers in the use of financial services; it is difficult to define and measure because access has many dimensions.</td>
<td>Access to financial services such as deposit, credit, payments, insurance.</td>
</tr>
</tbody>
</table>

Source: RBI report, 2010
2.11 Initiatives for Financial Inclusion in India

RBI (2008)\(^{121}\) report explained the long history of sound banking system developed by RBI after Independence, which could support planned economic development through mobilisation of resources/deposits and channel them into productive sectors. Hence, in order to overcome the exclusion RBI want to expand the credit and financial services to the wider sections of the population and a wide network of financial institutions has been established over the years. The organised financial system comprising commercial banks, regional rural banks (RRBs), urban co-operative banks (UCBs), primary agricultural credit societies (PACS), and post offices caters to the needs of financial services of the people. Besides, MFIs, self-help groups (SHGs) also meet the financial service requirements of the poorer segments. Furthermore, development of the institutional framework in recent years has focused on new strategies of expanding financial services involving credit dispensation using multiple channels such as civil society organisations (CSOs), non-government organisations (NGOs), post offices, farmers’ clubs, and panchayats as business facilitators/correspondents. Specific financial instruments/products were also developed in order to promote financial inclusion.

However, the RBI had taken various initiatives that could broadly be categorised into three phases. The first phase was started in the late year of 1960s through the 1980s. In this year the main focus was on gateway of credit to the neglected sectors of the economy. So the RBI was emphasized on weaker sections of the society. In the year of 1990 second phase was started through March 2005. The RBI had been focused mainly on strengthening the financial institutions as part of financial sector reforms. In this phase financial inclusion was encouraged mainly by introducing SHG-bank linkage programme and Kisan Credit Cards (KCCs) for providing credit to farmers. The final phase was begin in April 2005. In this phase ‘financial inclusion’ was explicitly made as a major policy objective and thrust was on providing safe facility of savings deposits through ‘no frills’ accounts.

2.11.1 Financial Inclusion in India – Key Elements

**Leeladhar(2006)** stated that financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. Therefore, unrestrained access to public goods and services is the *sine qua non* of an open and efficient society. Moreover, the banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy.

**Mohan(2006)** financial exclusion signifies lack of access by certain segments of the society to appropriate, low-cost, fair and safe financial products and services from mainstream providers. Financial exclusion is thus a key policy concern, because the options for operating a household budget, or a micro/small enterprise, without mainstream financial services can often be expensive. This process becomes self-reinforcing and can often be an important factor in social exclusion, especially for communities with limited access to financial products, particularly in rural areas.

**Thorat(2006)** Financial inclusion means the provision of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded.

**Reddy(2007)** The process of financial inclusion consists of seeking each household and offering their inclusion in the banking system.

**Dr. C. Rangarajan, (2008)** stated that 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 to achieve financial inclusion.

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122 V. Leeladhar Taking Banking Services to the Common Man : Financial Inclusion, published by the Reserve Bank of India, bulletin, January 2006
125 RBI, Financial Inclusion and measurement, Published by RBI, 2007
2.11.1 Self-Help Group – Bank Linkage Programme

RBI (2008)\textsuperscript{127} report there are three different strategies that have emerged under the linkage programme:

- **Model I**: This involves lending by banks directly to SHGs without intervention/facilitation by any NGO.
- **Model II**: This envisages lending by banks directly to SHGs with facilitation by NGOs and other agencies.
- **Model III**: This involves lending, with an NGO acting as a facilitator and financing agency. Model II accounted for around 74 per cent of the total linkage at end-March 2007, while Strategies I and III accounted for around 20 per cent and 6 per cent, respectively.

Ashvin Parekh, D. S. Rawat (2011)\textsuperscript{128} report on “Beyond the maze: Financial inclusion for equitable growth” analysed the main key initiatives taken by RBI for financial inclusion in the recent years. These are:

1) **Priority Sector Lending**: RBI has stipulated that a portion of the credit is extended to the priority sector.

2) **No frills Accounts**: In November 2005, RBI asked banks to offer a basic banking ‘no-frills’ account with a low or zero minimum balance and minimum charges for people in low income groups.

3) **Easier credit facility**: RBI directed banks to extend a General Purpose Credit Card (GCC) facility of up to INR25,000. However, the scheme was not very effective since the total number of GCCs issued by banks, as on end-March 2009, was only 0.15 million.

4) **Simpler KYC Norms**: Know your customer (KYC) norms, which were considered to be a big obstacle in offering banking services to people in far-flung areas, were relaxed for accounts with a balance not exceeding INR50,000, and credits the ret not exceeding INR100,000 in a year.


\textsuperscript{128} Ashvin Parekh, D. S. Rawat, Financial inclusion for equitable growth published by ASSOCHAM and Ernst & Young, Mumbia, 2011, p.p:2-34
5) **Use of Information Technology**: The use of biometric smart cards to open bank accounts is geared to take banking services to customers’ doorsteps. In October 2008, RBI issued guidelines relating to issues such as technology, security standards and customer protection pertaining to the use of mobile hand-held electronic devices for banking transactions.

6) **EBT Through Banks**: RBI has encouraged state governments to promote usage of EBT by banks, to transfer funds to people under their various schemes. 100% financial inclusion drive: RBI launched a drive to achieve 100% FI in one district in each state. The scheme was later extended to other areas/districts.

7) **Business Correspondent Model**: Appreciating the challenges involved in operating in far-flung areas, RBI permitted banks to employ local non-government entities/individuals to act as business correspondents (BCs) for banks in 2006. The BC model is aimed at providing customers with easy access to banking services in such areas. BCs can include NGOs, microfinance institutions, retired bank employees, ex-servicemen, retired government employees and teachers and kirana/medical/fair price shop owners, Section 25 companies, individual Public Call Office (PCO) operators, the agents of small savings schemes and insurance companies, petrol pump owners and self-help groups (SHG) linked to banks. Banks can also collect a reasonable service charge in a transparent manner to ensure the viability of the BC model.

8) **Liberalization of rules governing the expansion of bank branches and ATMs**: In October 2009, RBI allowed domestic scheduled commercial banks (other than RRBs) to open branches in towns and villages with a population of less than 50,000. Furthermore, RBI will ensure that at least one-third of such branch expansion takes place in underbanked districts. The regulator has also totally freed the location of ATMs from prior authorization.

9) **Expansion of banks in the north-east**: RBI has offered to fund capital and running costs for five years in identified unbanked areas in the north-east, provided adequate security arrangements are made by the concerned state government. For example, in Meghalaya, RBI has allotted eight centers to three public sector banks through a bidding process.

10) **Project financial literacy**: Since financial literacy is a pre-requisite for FI, RBI has initiated “Project Financial Literacy,” with the objective of disseminating information relating to general banking concepts to various target groups.
11) **Financial literacy and credit counseling centers**: The convenor banks of each of the State Level Bankers’ Committees has been asked to set up a financial literacy-cum-counseling center in any one district on a pilot basis, and extend the facility to other districts in due course. These centers are expected to provide free financial education to people in rural and urban areas on various financial products and services, while maintaining an arm’s length relationship with the parent bank. Till now, 154 credit-counseling centers have been set up in various states in the country.

12) **Financial curriculum in schools and colleges**: RBI has collaborated with various state governments to include financial literacy in the school syllabus. It has already launched a pilot in Karnataka, which can be adopted across the country.

**2.12 Issues and Challenges in ICT Based Financial Inclusion**

*a. Use of technology*

For the success of the ICT-based strategies, resolving technology related issues is the key. One of the major constraints of the ICT based BC model has been the technical problems associated with the model. It has been reported that devices, such as, hand held machines, smart cards, POS terminals and utilities which are crucial to the functioning of the model are not properly functioning in many areas of the country. Limited number of technology service providers to cover the unbanked villages of all banks as well as limited service centres for servicing devices has resulted in banking operations coming to a halt in many villages. Given the literacy level of the rural population, availability of trained manpower in the villages to ensure that transactions are carried out in a user friendly manner in the local language and that the customers smoothly transit from assisted model to self-service model in using technology, wherever feasible (e.g. use of ATMs/mobile/internet banking). This could lead to erosion of confidence on the ICT-based BC model. Technical glitches, therefore, need to be addressed quickly. Banks also have to ensure that the turnaround time between account opening and account operationalization has to be minimised so as to gain confidence of the customers in such strategies.

*b. Security concerns*
Given the increasing reliance on technology to deliver banking services to customers, it is essential that adequate attention is paid to security, especially IT security. Security related issues resulting in frauds have the potential to undermine public confidence in the use of electronic payment products. Further, they could also lead to reputation risks. While preventing fraud through robust security measures, one should not lose sight of the fact that the ease and efficiency in operations for the customers is not unduly eroded. Cumbersome security procedures would deter customers from using the product and carrying out electronic transactions. Accordingly, a proper balance should be struck between such apparently conflicting objectives. The Reserve Bank has been taking several measures to strengthen the security for electronic transactions to prevent their misuse. For instance Second Factor Authentication has been made mandatory for all Card Not Present (CNP) transactions (e.g. requirement of PIN in addition to CVV while putting through the transactions). Similar measures are going to be implemented for Card Present (CP) transactions (e.g. use of chip and PIN or Aadhar cards) over a defined time period. SMS alerts now made mandatory for all card related transactions is another added security feature. Encryption of transactions for value above 5,000/- has also been mandated for all mobile based transactions as a better security protocol.

c. Infrastructural limitations

Power supply and network connectivity are issues in most parts of the country, especially, so in the rural/remote areas. While banking transactions are enabled on a real-time basis in urban centres, it often takes more time to complete a transaction in remote areas due to poor internet connectivity and frequent power failures. To overcome this in the North Eastern states, the Reserve Bank had launched the Satellite Connectivity Scheme in 2009 to provide 100% subsidy to bank branches in the North-East Region (NER) subject to a maximum of `12,000/- per month or the actual expenditure incurred by the bank, whichever is less, subject to the condition that the branches would offer services of electronic funds transfer free of charge to their customers. The total 1756 branches in the North-East region, 762 branches (43.4 per cent) had taken satellite connectivity after the launch of the scheme. The scheme has since been extended by another year and Sikkim has also been brought under the ambit of the Scheme.
**d. Multiplicity of strategies**

Multiple technologies and delivery strategies could be used based on the geographical peculiarities, infrastructure availabilities, etc. Too many disparate technologies, however, may prove counter-productive as there will be several challenges like integration with CBS, support issues and people at the operating level (i.e. at the level of BFs and BCs) may not fully apprehend all the products and technologies. So it may be a better idea to narrow down to a few stable and scalable technologies and delivery channels and build the financial inclusion products around them with inter-operability being the key theme.

**2.13 Overcoming barriers to financial inclusion**

Sarma and Pais,(2008)\(^{129}\) study indicated how to overcome barriers to financial inclusion in India. So Financial inclusion is the process that will ensures the ease of access to finance, market and resources must keep in availability and usage of the formal financial system for all members of an economy. Financial inclusion has three dimensions: accessibility, availability, and usage. Therefore, the empirical findings strengthen the argument that financial exclusion is important as a policy objective to overcome financial exclusion.

K.G. Karmakar, G.D. Banerjee and N.P. Mohapatra(2011)\(^{130}\) in their book on “Towards Financial Inclusion in India” discussed in the depth way that there are Structural Challenges: these are:

1. **For Bank:**

   - **Branch expansion:** Constraints for banks to open branches in remote and difficult terrain areas
   - **Human Resources:** Closed mindset of the staff at the branches; obligation and not service; finding willing employees to work in these remote areas

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Cost: high cost of covering the large numbers (cost of enrolment); relative high maintenance costs for such accounts

Operations: small ticket size for each transaction not profitable for the bank; affordability of the product or service; communication and involvement of locally acceptable personnel; large-scale coverage including difficult geographic terrain and areas with lack of electricity and normal telecommunication facilities

Offering a simple loan product which is not based on or linked to the purpose of the loan, the collateral or assets held or income earned by the household but is purely based on cash flow and credit record of the household to all low-income households and unrecognized enterprises

Processing capacity constraints at branches: Alternate processing capacities like Central Processing Centres required

Technology strategy varies with role played

2. For BC/BFs:

- BCs find viability doubtful; small ticket deposits/loans/transactions will yield small commission; fixed cost may not be covered
- Not willing to security deposit
- Capacity to invest in POS/other equipments; BCs prefer the banks to pay
- Cash handling (large volumes, for example, government benefit payments)
- Finding locals for setting up customer service points (CSP) who are trustworthy and capable; issue of activity level of CSP scaling up and BCs not willing to increase costs
- Enrolment process: time consuming, require identifying persons correctly with similar names and similar village
- Capacity problems in personalization of cards, delivery of cards, custody of undelivered cards; BCs need assured volume of accounts/cards
- Connectivity problems experienced in few cases; offline transactions cannot be uploaded in specific time
Banks staff at operating level not confident and apprehensive about the new BC channel
BCs cum technology vendor is an ideal combination
Prospective BCs are sitting on the fence and watching others

3. Social Challenges:

- Rural populace have inhibition to approach the ban branches
- Inhibitions due to illiteracy and lower economic status
- Lack of active customer education campaign

4. Regulator Challenges:

- Customer identification/authentication
- Customer confidentiality/privacy
- KYC/AML issues
- Outsourcing and bank’s responsibility for their agents
- Interoperability and open standards
- Imaging standards and adherence to payments system regulations
- Restricted eligibility criteria for BCs permitted by the RBI
- Distance criteria
- Restrictions on engaging sub-agent

2.14 Chapter Summary

Today, there are numerous players in the field of financial inclusion; some weak, some strong, and some with strong parentage, some without a backgrounds. However, all of them offer different technologies but for the same ultimate objective. The literature review given clear concepts of innovation economics and economic growth theory and tried as much as possible to structure them accordingly.

Empirical evidence clearly indicated that economic growth follows financial inclusion. Though the procedures and rituals for enabling landless laborers and farmers enter into the realm of inclusion were implemented by the Scheduled Commercial Banks, majority of the people surveyed had not utilized these benefits. Educating the farmers regarding the availability of these vital entry benefits free of cost needs to be undertaken. Augmented manpower for marketing of loan/saving
products, amplified technical assistance such that they are available in the interiors of villages (for example through mobile units) might help to assuage the problem of geographical access. And also with optimization of advanced technology use for cost-effective financial products for social groups. So that they can afford to use and people will have safe savings along with access to allied products and services such as insurance cover, entrepreneurial loans, payment and settlement facility, etc.

The literature review gave a brief account of empirical studies in different aspects to cover the financial inclusion for the benefits to the new growth path to alleviation of poverty. The review studies explained the concepts of inclusive growth, pillars of inclusive growth stating that the issue of financial exclusion causes of exclusion, types of exclusion as a symbol of financial deepening and a sign financial development. The researcher reviewed the very important studies to find the gap in the study.
References


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