Chapter – I

Introduction

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INTRODUCTION

“One should view the financial intermediaries from an evolutionary perspective. They perform a crucial economic function in all times and in all places. However, the form they have, changes with time and place. May be once they were giants, dinosaurs so to say, in the US. Nowadays, they are no longer that powerful, but they did not lose their key function, their economic niche. Instead, they evolved into much smaller and less visible types of business, just like the dinosaurs evolved into the much smaller omnipresent birds”.

- Bert Scholtens and Dick van Wensveen (2003)

Though this statement is for USA banking system, it holds good to all banking systems.

1.1 Introduction

Financial inclusion is believed to be the game changer to achieve inclusive growth by including hitherto excluded poor people into the formal financial sector. It is an attempt towards social justice which intends to bring marginalized people into the mainstream economy. It is both, an opportunity and a challenge to financial system. Development experience evidences a strong correlation between financial access and economic growth. In the process of development they are supplementary to each other. Financial exclusion traps poor people in the vicious circle of poverty. People who face difficulties in accessing and using financial services experience real hurdle not only in terms of the monetary costs but also the social and psychological costs (Elaine Kempson and Sharon Collard, 2012). Financial empowerment leads to economic and social empowerment. (Kempson and Whitley, 1999). A well developed financial system is essential for faster and broad-based economic growth. It is highly important for economic development and wellbeing of people. Financial Inclusion is an umbrella term that captures a number of different types of products and services. It is a multi-dimensional, complex process that includes effective measures for financial participation, financial capability and financial wellbeing. Access to finance especially by the poor and marginalized people is a prerequisite for creating employment opportunities, economic growth, poverty reduction and social cohesion. It breaks the chain of poverty (Arunachalam P and Kartikeyan, 2013). Financial services can reduce the vulnerability of the poor and strengthen them to face financial
emergencies. Financial access provides an opportunity to save, get credit and to make productive investments (DFID, 2004).

Literal translation, from Gitanjali, a poem “Disgraced” of Rabindranath Tagore (1861-1914) a Bengali Nobel Laureate in Literature, rightly depicts the importance of inclusion of down trodden people.

“Those whom you push down will chain you down
Those whom you leave behind will pull you behind
The more you envelope them under darkness of ignorance
The more distant will your own welfare be!”

In the development process, social and economic exclusion of majority of people of the society has resulted in poverty, low agricultural growth, income and social inequalities, unemployment, less employment opportunities, regional disparities, gender inequalities etc. Prof Amartya Sen has rightly pointed out “extremely asymmetric development of the global economy”. The same caution holds good for India also. The biggest challenge India is facing today is to ensure inclusive growth. Financial inclusion is the means to achieve inclusive growth and sustainable development.

Currently, India has the second highest number of financially excluded households in the world next only to China. RBI in its report ‘Trends and Progress in Banking” 2012, considered that universal financial inclusion both as national commitment and policy priority. RBI is carrying out financial inclusion efforts through banking system in co-ordination with the Government. Because of its inherent advantages, wide network of banking institutions is used to reach the target of financial inclusion. Dr. D. Subba Rao mentions “Financial inclusion is a win-win opportunity for all the stake holders, the poor, the banks, the regulator and the Government. Because of improving awareness levels, aspirations of the poor are on the rise, banks will not be forgiven if they do not rise up to meet these aspirations. It is for the banks to convert what they see as a dead-weight obligation into an exciting

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1 Quoted by Dr. Atiur Rahman, Governor, Bangladesh Bank in Joesph Mubiru Memorial Lecture organized by the central bank of Uganda, on 20 November, 2009. “ Financial Inclusion as tool for Combating Poverty”
opportunity and move on aggressively on financial inclusion that banking on the poor can actually be a rich banking proposition².

After Nationalization, opening of branches in rural and backward areas and preference lending to priority sectors and weaker sections got momentum. To reduce inequality among sectors and imbalance in regional development, service area approach was adopted and Lead Bank Scheme was introduced in 1969. RBI decided to put into service Lead Bank Scheme through Nationalized banks. The present research intends to study growth of financial inclusion and throw light on the role of lead bank in realizing financial inclusion and evaluates the efficacy of financial inclusion.

1.2 Major Concepts of the current study

Financial Exclusion, Inclusive Growth, Financial Inclusion and Lead Bank are the four major basic concepts of the present study. Clear understandings of these terms provide necessary insight to carry the study further.

1.2.1 Financial Exclusion:

Financial exclusion is nothing but exclusion of people from affordable credit, savings, insurance, productive assets and financial counseling, which led to deprivation of benefits of these services. The financially excluded section largely comprises marginal farmers, landless laborers, small unorganized sector enterprises, slum dwellers, migrants, weaker sections, socially excluded groups, senior citizens and women (Dr. Chitta Ranjan Mishra, 2012).

Related to the meaning, Leyshon and Thrift (1993) defined financial exclusion as “those processes that serve to prevent certain social groups and individuals from gaining access to the formal financial system”. This definition implies the deprivation of banking access to poor and weaker sections. Kempson and Whiley (1999) identified five major forms of financial exclusion as access exclusion, product exclusion, condition exclusion, price exclusion, self-exclusion which are also the reasons for exclusion.

² Dr. D. Subbarao. Ex Governor, RBI, remarks at the Bankers’ Club in Kolkata on December 9, 2009.
The causes for Financial exclusion can be attributed to both demand and supply factors. Demand side factors are low income and irregular cash flow, low literacy rate that too low financial literacy, gender, age, fear and hesitation to approach formal institutions, penalties, and conditions attached to financial product, cumbersome procedures and documents required, collateral requirements, language problem, unsuitable products, unaffordable prices of financial products nature of occupation, lack of required information, poor financial habits and so on. Supply side factors are geographic remoteness, distance of formal financial institutions, unavailability of diversified products and services, poor infrastructure, inadequate number of financial institutions to existing number of population, high information barriers and low awareness, psychological and cultural barriers, poor functioning and financial history of some financial institutions, improper identity proof, poor credit record and low credit worthiness of creditors, high transaction costs, unable to market the financial products, lack of customized products and easy availability of informal credit and so on (Thorat, 2007; World Bank, 2008; Dr. K.C. Chakrabarty, 2011).

Financial exclusion trapped poor in a vicious circle of poverty. Financially excluded people cannot actively participate in mainstream economic activities. Financial exclusion may lead to loss of opportunities to thrift and borrow, reduced consumption, unemployment, increase in crime rate, turn down in investment, low productivity, difficulties in gaining access to formal credit or receiving credit from informal sources at very expensive rates, decline in social and economic status, reducing growth prospects, hindrances in money payment and transfers, loss to bank business, inaccessibility to pension and insurance and so on. The excluded people have to rely on personal savings or local sources to meet the expenses of health, education, unexpected events and entrepreneurial needs. Financial exclusion eventually leads to other societal problems like increase in social and gender inequalities, concerns of health, lack of education, low productivity, and low agricultural development and so on (Vaas, 2007). These consequences necessitate inclusive growth.

1.2.2 Inclusive Growth:

‘Inclusive growth’ as an approach of economic development gained significance because growth cannot be completed by excluding major portion of deprived population. Growth becomes inclusive with creation of economic
opportunities and ensuring access to them. Inclusive growth model is inherently sustainable as it is different from other poverty reduction and income distribution measures which have short term impact. Inclusive growth is “a process of including the excluded as agents whose participation is essential in the very design of the development process and not simply as welfare targets of development programmes” (Planning Commission of India). Inclusive growth, with interchangeable terms like ‘broad based growth’, ‘shared growth’, ‘pro poor growth’ is nothing but the including of all sections of people and diverse areas of economy in the growth process and help them to reap the benefits of growth. This is crucial for achieving the equity objective in growth. The challenges of achieving more inclusive growth are committed with social, political and financial inclusion. Late Prof. C. K. Prahlad in his epic book, “Fortune at the Bottom of the Pyramid” wrote, “What is needed is a better approach to help the poor, an approach that involves partnering with them to innovate and achieve sustainable win–win scenarios where the poor are actively engaged and at the same time, the companies providing products and services to them are profitable”.

The prime objectives of inclusive growth are reduction of poverty and inequalities existing in the economy. It uplifts the living standards of the deprived section of people. It is the holistic approach of growth with human face. Inclusive growth is significant as it is essentially sustainable development process on the foundations of equity and justice. Growth should evenly be shared by all. Maximizing economic opportunities, ensuring economic well-being and ensuring equal opportunities are the three pillars of inclusive growth (Ifzal Ali, 2007). The Eleventh Five Year Plan (2007-12) has specifically underlined the need for inclusive growth. The 12th Five Year Plan in India is focusing on “Faster, Sustainable and more Inclusive Growth” for the overall development of the Nation. Commission on Growth and Development (2008) make a note that “inclusiveness, a concept that encompasses equity, equality of opportunity and protection in market and employment transitions as an essential ingredient of any successful growth strategy”. Financial inclusion, promoting agriculture, revamping labour regulations, infrastructure development, bringing up the lagging states and regions, empowering poor by proactive policies are significant steps in achieving Inclusive growth. Financial inclusion is the major step to accomplish inclusive growth.
1.2.3 Financial Inclusion:

“Financial Inclusion denotes delivery of financial services at an affordable cost to the vast section of disadvantaged and low income groups” (Rangarajan C, 2008). It is an attempt of ensuring access to financial services at an affordable cost and providing timely and adequate credit to needy people. Financial development propels economic development either through supply pushing or demand pulling ways. Financial Inclusion opens up opportunities for the marginalized poor to break vicious circle of poverty (Dr. Atiur Rahman). Financial Inclusion begins with access to banking services in the absence of price and non-price barriers. The access to bank products and services including basic savings bank account, customized savings products, remittance, payment, insurance, healthcare, mortgage, financial advice, entrepreneurial credit, and social security payments and so on.


The main objectives of financial inclusion are achieving balanced inclusive growth through participatory development, raising standard of living of common people by helping them to overcome poverty, enhancing employment opportunities, providing secured savings, productive utilization of idle savings, providing subsidiary financial services like remittance, financial counseling, insurance and other needy services are the important objectives of financial inclusion. Sustainable development, creating wider market for the financial products, effective implementation of government programmes are the other objectives of the mission.

Financial inclusion is based on both demand and supply aspects. From the demand side good financial decision making on the part of the people needs financial ability or capability and financial motivation. Financial ability depends on economic
condition of the people; financial motivation depends on financial literacy or understanding of financial concepts. Increase in employment opportunities and income, financial literacy, customized and flexible financial products and services, affordable price, convenient timings, helps to overcome demand side constraints of financial inclusion (Manohar V. Serr, Dr A.H. Sequeira, Dr V. Basil Hans). The supply side is nothing but providing banking services at an affordable cost to hitherto excluded sections of people. Appropriate technology, proper and efficient delivery model, determination and involvement of financial and institutional system, co-ordination and collaboration among financial institutions, efficient technical service providers, involvement of Business Correspondents (BC), effective administration, customized products are the rudiments to attend the supply side constraints and accomplishment of financial inclusion.

Financial inclusion has high significance in context of achieving inclusive growth. It is a step to inclusive and participatory development. It boosts self confidence of excluded section of society. Equitable growth, reduction of poverty, increase in national income, easy and safe financial transactions, social security transfers, and secured savings with formal financial institutions, protection from risks and shocks, financial security are the benefits of financial inclusion. Financial inclusion benefits all the stake holders. Common people are benefitted with the access and use of bank products and services. For ‘Banks’ financial inclusion, may be a social responsibility in the short-run but that boosts business opportunities in the long-run. It widens the customer base and enhances resource for efficient intermediation and allocations, helping them to improve their asset-liability management. For the ‘Regulator’ of the financial sector, when transactions are carried through formal financial institutions, monitoring will become easy and transparency can be maintained. For ‘Government’, financial inclusion drive would help crucially to achieve inclusive growth and participatory development.

Providing financial literacy, ensuring enough income, developing customized financial products, overcoming identification problem, introducing customer centric approach to financial institutions, reducing the transaction cost, adopting viable delivery mechanism and appropriate technology, developing the supporting infrastructure in unbanked areas are the challenges faced by financial inclusion.
Branch penetration, deposit penetration, and credit penetration are the main three indicators of financial inclusion. According to CRISIL\textsuperscript{3} Inclusix, whose methodology is similar to other global indices, such as UNDP's Human Development Index, “measures financial inclusion on the three critical indicators of basic banking services - branch penetration, deposit penetration, and credit penetration”. In the present study same three indicators are used to explain access and use of bank services. The subject matter chosen for the study intended to observe the role of lead bank in achieving financial inclusion needs to understand the concept of Lead Bank Scheme.

1.2.4 Lead Bank Scheme (LBS):

Lead bank as consortium leader coordinates the activities of banks, government offices and other stakeholders both at state level and district level. Lead bank scheme operates with different fora at state, district and block level. Before nationalization of commercial banks, banking access to common people was less. “The average population served by a commercial bank office in India was as high as 73,000 as against 4,000 in United Kingdom and 7,000 in USA. In the rural areas, it was found that only one per cent of the total number of villages (5,64,000) were served by commercial banks as at the end of June 1967. Further, there was an uneven spread of bank offices and banking business between States and population groups” (Report of the High Level Committee to review the Lead Bank Scheme). The above situation necessitated to make commercial banks to join the force. Based on the recommendations of the Study Group chaired by Prof. D. R. Gadgil\textsuperscript{4} and the Committee headed by Shri F. K. F. Nariman\textsuperscript{5}, in Dec 1969, Lead Bank Scheme came into existence with “area approach” to achieve targeted and focused banking, by Reserve Bank of India. Lead bank is operating in all districts in the country including metropolitan areas. At present 1 private and 25 public sector banks are operating in 671 districts of the country (RBI data, as on June 30, 2014) under Lead bank scheme.

\textsuperscript{3} CRISIL is a global investigative research oriented company providing ratings, and policy advisory services. Inclusix is a financial inclusion index measures the progress of financial inclusion, down to the district-level.

\textsuperscript{4} Study Group on the organizational framework for implementation of the social objectives.

\textsuperscript{5} Committee of Bankers on Branch Expansion Programme of public sector banks.
Lead Bank is acting as a medium of communication and coordination among concerned State Governments, banks and other financial institutions. It has the objectives of expansion of bank branches, boosting the mobilization of deposits, priority sectors lending, augmenting financial inclusion measures, providing financial and credit counseling, provision of ‘credit plus’ services, skill development, access to physical and digital infrastructure for better connectivity.

Regarding structure and implementation of Lead Bank Scheme, it is operating at state, district and block levels. Under Lead Bank Scheme various fora have been created at the state level, district level and the block level to work efficiently. State Level Bankers' Committee (SLBC) and State Level Co-ordination Committee (SLCC) at state level, District Consultative Committee (DCC), District Level Review Committee (DLRC) and Standing Committee of the DCC at district level, Block Level Bankers' Committee (BLBC) at block level are operating to execute the functions of Lead bank. These fora help to streamline the system to discuss the problems to find out solutions and as also to monitor the progress in execution of the credit plans. This network also helps to reach the goal of achieving targeted and focused banking with co-ordination of all stakeholders.

1.3 Significance of Current Study

Achieving inclusive growth is the policy priority and a challenge to GOI and RBI. Both the institutions make coordinated efforts to meet this challenge through financial inclusion. RBI has adopted bank led financial inclusion model to attend the issue. In this direction RBI introduced LBS by considering area approach, allotted each district of the country to a leading bank of the area. This has the objective of taking each and every district on the development path by reducing imbalances among regions and sectors. Lead Bank as the leader bank of the district makes co-ordinate efforts to achieve the target set by RBI.

The research work is about the role of Lead Bank in achieving financial inclusion. Efforts undertaken by RBI and GOI at national level and initiatives taken at state level and district level under Lead Bank Scheme is elaborately studied to highlight the better reach and use of financial services under financial inclusion. On the other hand from beneficiaries side the study try to associate relationship between improvement in social, economic and general conditions with financial inclusion.
1.4 Scope of the Study

As banking comes under public services, it must reach every one without any discrimination. To achieve universal financial inclusion the support and participation of all stakeholders like policymakers, regulators, governments, IT solution providers, media and the public at large is needed. The financial inclusion initiatives at national, state and district level is included in the study. The present study considers Mysore district for the case study, it attempts to highlight the expansion that has taken place in banking sector under financial inclusion period under Lead Bank scheme. The study also includes the beneficiaries' point of view as it tries to find out the causes for financial exclusion. It tests the efficacy of financial inclusion through the changes occurred in awareness level, economic, social and general condition of BSBD account holders.

1.5 Methodology

Financial inclusion is an attempt to include all the sections of the society into formal banking system. For the study, the data was collected from both secondary and primary sources. The study tries to identify the role of Lead Bank in financial inclusion. With the help of secondary sources of information, growth of financial inclusion is studied by using three major financial inclusion parameters of banking i.e. branch expansion, deposit mobilization and credit penetration. To prove the role of Lead Bank comparative study has been conducted at National, State and District levels.

Primary study consists two parts, the supply side i.e., Bank side and the demand side i.e., BSBD account holders side. Research design is both descriptive and analytical in nature. From the bank side, primary data was collected from Regional offices of major commercial banks to identify role of Lead Bank of the Mysore district and constraints faced by banks in implementing financial inclusion measures. In the study, specific target group is BSBD account holders. The study area consists of Mysore district which has seven taluks. Stratified random Sampling method was adopted to collect primary data from account holders. Among the seven taluks of the district, four taluks, Mysore, K R Nagara, Hunsur and Heggadadevana Kote were selected for the purpose of study. In each taluk, five villages and in each village 20 respondents were randomly selected to gather relevant information.
The target population is the population of the whole district. The study population includes selected BSBD account holders. Four hundred BSBD account holders were considered as sample respondents. To examine the impact of financial inclusion on BSBD account holders, primary data was collected by using structured questionnaire. It is further supplemented with interviews with key informants and focus group discussions.

For the purpose of satisfying the research objectives the collected data was analyzed through tabular presentation method where frequencies and percentages were worked out wherever required. Statistical analysis was carried out through SPSS for windows (Version 16.0) and mini tab. To find out the impact of financial inclusion on Branch Expansion, Deposit Mobilization and Credit penetration compound growth rate is calculated for two periods i.e., pre financial inclusion period and for financial inclusion period. t test was conducted to test to find out any significant difference between two periods regarding branch expansion, deposit mobilization and credit penetration. Regarding rural penetration of banking and to check the role of Lead bank at district level ANOVA test was conducted. To study the impact of financial inclusion on BSBD account holders about changes in awareness level about banking products and to assess the changes in economic, social and general condition of account holders’ chi-square statistical method has been adopted.

1.6 Statement of the Research Problem

Financial exclusion is one of the reasons for poverty, unemployment, vulnerability. To achieve inclusive growth financial inclusion is the useful tool deliberate to include hitherto excluded into the mainstream economy. In India multi model approach was taken up to accomplish financial inclusion. Among them bank led financial inclusion model is prominent one. To overcome regional imbalance and prioritize lending, Service Area Approach was adopted. In this direction Lead Bank scheme was implemented. Lead bank acts as the leader of banking system guides, directs, and monitors the banking institutions both at state and district level. Lead Banks play coordinating role which encompasses all formal and informal financial institutions to provide banking services to common people. The banking institutions under the motivation and guidance of Lead Bank, implementing financial inclusion measures effectively to reach the hitherto unreached people.
A few researchable issues that emerge in this context are:

a) What is the extension and efficacy of financial inclusion through banking system at national, state and district level?

b) What are the diversified measures undertaken by RBI and GOI to enhance financial reach?

c) What is the role of Lead Bank to promote financial inclusion both at state and district level?

d) What is the impact of financial inclusion on BSBD account holders?

1.7 Objectives of the Study

1. To make comparative study of financial inclusion at national, state and district level.

2. To assert the role of Lead bank in financial inclusion.

3. To identify the constraints faced by banks in financial inclusion.

4. To examine socio-economic background of BSBD account holders.

5. To assess the changes in awareness level about banking products, economic, social and general condition of BSBD account holders after financial inclusion.

1.8 Hypotheses

1. Financial Inclusion brings positive change in branch expansion, Deposit mobilization and Credit penetration at National level.

2. Financial inclusion enhances banking reach in rural areas.

3. Lead Bank plays significant role in financial inclusion through banking penetration.

4. There is significant difference in the level of awareness among the BSBD account holders about widely used bank products after financial inclusion.

5. There is significant difference in the level of awareness among the BSBD account holders about less used bank products after financial inclusion.

6. There is positive impact of financial inclusion on economic, general and social conditions of the people.
1.9 Navigating the Thesis

The thesis consists of six chapters. They are arranged in sequential order.

**Chapter I** deals with introduction, major concepts of the current study, significance of the study, scope, methodology, statement of research problem, objectives, and hypotheses of the study.

**Chapter II** presents theoretical base in support of this work and an extensive literature review to identify the research gap.

**Chapter III** provides a bird’s eye view of the attempts of financial inclusion at International level and detailed study at National level.

**Chapter IV** analyzes and evaluates the role of lead bank both at state and district level through related variables like branch expansion of banks, deposit mobilization, credit distribution and priority sector lending.

**Chapter V** is based on primary data collected from field work. The primary data collected from regional offices of major commercial banks operating in the district and sample BSBD account holders has been analyzed by using proper methodology.

**Chapter VI** presents research findings related to the study, which helps to make policy suggestions for overall financial inclusion.