Chapter – II

*Historical and Theoretical Perspectives of Financial Inclusion*
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HISTORICAL AND THEORETICAL PERSPECTIVES
OF FINANCIAL INCLUSION

2.1 Historical Genesis of Financial Exclusion

Well known is the fact that exclusion, in particular, of certain groups of people like the tribes from the main stream of social framework, surfaces on account of divergent causes and, as such development literature is blessed with nomenclatures like social exclusion, economic exclusion, financial exclusion and the like. All these forms of exclusion, no matter howsoever they distinguish themselves from each other, boil down to the single feeling that the excluded social groups are not taken along with the mainstream, or the excluded are, by themselves, inclined not to be a part of the mainstream society. Beneath all analytical concerns of any type of exclusion, one can identify a number of underlying factors, which are rooted in the fundamental nature, and working of the society or the economy in which the exclusion persists. Moreover, all types of exclusion are intertwined with each other. Very often, one can hardly find the beginning and the end of this intertwining process. For instance, social exclusion can pave the way for economic exclusion and vice versa. Both of these can engender financial exclusion, and at a later stage, one may find financial exclusion as exacerbating the seeds of social and economic exclusion. How this vicious circle can be broken with deliberate inclusionary techniques and instruments like access to finance, credit, and empowerment of social groups like the tribes is an issue that deserves to be probed. At the outset it must be mentioned that exclusion has become popular and a much disheartening thing today though it has been there all times throughout the history of humankind.
2.2 Current Indian Scenario

Nationalization of banks in India marked a paradigm shift in the focus of banking as it was intended to shift the focus from class banking to mass banking. The rationale for creating Regional Rural Banks was also to take the banking services to poor people. The branches of commercial banks and the RRBs have increased from 8,321 in the year 1969 to 68,282 branches as at the end of March 2005. The average population per branch office has decreased from 64,000 to 16,000 during the same period. The new Branch Authorization Policy of Reserve Bank encourages banks to open branches in these under banked states and the under banked areas in other states. The new policy also places a lot of emphasis on the efforts made by the Bank to achieve, inter alia, Financial Inclusion and other policy objectives. But the study of Distribution of Commercial Bank Branches-Region/State/Union Territory shows that, there are certain under-banked states such as Bihar, Orissa, Rajasthan, Uttar Pradesh, Chattisgarh, Jharkhand, West Bengal and a large number of North-Eastern states such as Assam, Manipur and Nagaland, where the average population per branch office continues to be quite high compared to the national average of 16,000 people per bank branch.

Some of the major financial inclusion initiatives introduced by Government of India and Reserve Bank of India since 1969 are listed in Table 2.1. PMJDY is one of the financial Inclusion initiatives
Table 2.1: Financial Inclusion initiatives by Government of India and Reserve Bank of India

<table>
<thead>
<tr>
<th>Year</th>
<th>Milestones in Financial Inclusion in India</th>
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<tbody>
<tr>
<td>1969</td>
<td>Nationalization of Banks</td>
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<tr>
<td>1975</td>
<td>Establishment of Regional Rural Banks(RRBs)</td>
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<tr>
<td>1982</td>
<td>Establishment of NABARD</td>
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<tr>
<td>1992</td>
<td>Launching of Self Help Group(SHG) Bank Linkage Programme</td>
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<tr>
<td>1998</td>
<td>NABARD sets goals for linkage One million Self Help Group by 2008</td>
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<tr>
<td>2000</td>
<td>Establishment of SIDBI for micro credit</td>
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<tr>
<td>2005</td>
<td>Committee on Financial Inclusion</td>
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<tr>
<td>2007</td>
<td>Proposed bill on Micro Finance regulation introduced in Parliament</td>
</tr>
<tr>
<td>2011</td>
<td>Swabhimaan Campaign</td>
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<tr>
<td>2015</td>
<td>PMJDY</td>
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The previous plan Swabhimaan focused on coverage of villages while the PMJDY focuses on coverage of households. The focus of this scheme is to cover rural as well as urban areas which are betterment from the previous plan which targeted only villages above 2,000 population. The number of accounts opened under PMJDY as on 23rd August 2017 is 29.58 crores and the number of Rupay cards issued is 22.73 crores. The balance in the beneficiary accounts is INR 65,89,999 lakhs. The government aims to achieve a comprehensive financial inclusion by August 14, 2018.

2.3 Theoretical Framework

Since ancient times the issues of equality and justice have preoccupied thinkers, politicians and religions worldwide, reducing inequality and increasing degrees of inclusiveness can lead to a process of strong and sustained growth. In developing countries, revising the policy approach to inequality, ensuring a greater participation of workers of all occupations in overall productivity growth and more
social protection for the poor is well recognized not only for alleviating poverty, but also for strengthening the dynamics of domestic markets. UNCTAD survey report says that a comprehensive income policy, linking wage and productivity growth, including legal minimum wages and a tight social safety net for poorer families would favour investment dynamics and monetary stability in the country. These principles are considered fundamental in governance of a country and these principles should be applied in making laws to establish a just society in country. (BAN Ki-Moon, UNCTAD, 2012). India is a welfare state and its twin objectives are growth and social justice as mentioned in the directive policy. The fulfillment of these objectives leads to inclusive growth which calls for reducing inequalities by ensuring equal participation of all in the growth process. Financial Inclusion can be instrumental for poverty alleviation, inclusive growth and social inclusion of the underprivileged sections of the society. Financial Inclusion has received increased attention in view of the international initiatives towards inclusive growth of the emerging economies. Financial Inclusion is viewed as a device for the new vision of inclusive growth (Chakrabarty, 2009 and Mehrotra, 2009). Inclusive growth may be viewed as a target and Financial Inclusion as a tool for achieving it. In cross-country regressions, Beck, Demirguc-Kunt, and Levine stated that financial development alleviates poverty and reduces income inequality (Beck, Demirgüç and Levine, 2004). Development of financial sector is crucial for inclusive growth (Ianchovichina and Lundstrom, 2009). It will reinforce financial development which will contribute towards inclusive and economic growth of the country (Mohan, 2006). Their results indicate that financial development exerts a disproportionately positive influence on the poor and alleviates poverty both by boosting growth and by reducing income inequality.
A Theoretical framework is proposed to illustrate how financial exclusion is emerged and aggravated in the process of financial and economic development. Globally, current financial exclusion has stemmed from the evolvement of a fragile financial foundation built on the sole objective of making exorbitant profit through the adoption of new cost saving technical devices Automated Teller Machines (ATMs), Mobile Banking, and Internet Banking by the banking institutions. This is obviously different from the phenomenon of “exclusion” that occurred in India in days immediately succeeding the attainment of independence and the advent of Planning Process in 50s and early 60s, when the lack of branch expansion was supposed to be the hurdle. In response to this state of affairs, in 1969 the historic decision of nationalizing commercial banks was taken, and consequent upon that the policy of branch expansion got a fillip, resulting in the spread of banks to the hitherto “unbanked” places in India (Bera, 2009). Of course, one can hardly deny the truth that in countries like India where fundamental bottlenecks are associated with society and polity, the germination, and perpetuation of financial exclusion are imminent. Hence, as far as the financial exclusion is concerned, these fundamental factors deserve to be thoroughly looked into.

2.4 Free Market Model

This model, technically labeled as the “Shareholder Wealth Maximization Model”, hereafter abbreviated as SWMM, explains the process of financial exclusion at the macro level. This model rests on the principle of projecting “Market” as the sole panacea for all illness of an economy.
2.5 Financial Intermediation and Growth theory

It tells us that investment is instrumental for economic growth and financial intermediaries play the crucial role of allocation of capital. Generally relation between financial sector and growth is studied theoretically by several authors (Harrison et al. 1999). Therefore, Financial Inclusion which provides access to financial services to all can be an essential tool to ensure that some sections of society are not deprived and capital is allocated to all sections of society.

2.6 Adoption Approach

With an introduction of TAM model, we discuss its several extensions. Technology Acceptance Model (TAM) is primarily intended to foretell users’ acceptance of Information Technology and usage in an organizational perspective. By focusing on the attitude explanations of intention to use a specific technology or service, TAM model deals with perceptions as opposed to real usage, suggests while a new technology is presented to the potential adopter, two attitude-affecting factors, Perceived usefulness and perceived ease of use, influence their decision about how and when they will use it. Theory of Reasoned Action (TRA) is an extension of TAM. The main point of this theory is that human behaviour originates from their intentions and behavioural intention (BI) is a kind of cognitive activity which consists of two facets, namely attitude and subjective norm. To sum up, according to TRA both attitude and subjective norm component of individual behaviour is determined by salient belief. The Theory of Planned Behaviour (TPB) recognizing the situations where people might not have complete control over their behaviour, an extension of TRA and is known as the theory of planned behaviour (TPB). However, TPB also
proposed unequivocal formulations of the determinants of the behavioral attitude and subjective norm of the TRA-model. TPB has been applied and proven successful in predicting and explaining several types of behaviour. However, in case of ICT systems or services adoption, the model consists of five concepts. As in the TRA-model, it includes behavioral attitudes, subjective norm, intention to use and actual use. In addition to the behavioral attitude and subjective norm element as in TRA, the model includes behavioral control component which is directly Financial Inclusion through Mobile Banking: In TPB, behavioral control encompasses two elements. The first one is "facilitating conditions" reflecting the resources needed, such as time, financial resources etc., to use a particular system. The second component is self-efficacy; which is described as "an individual's self-confidence in his/her ability to perform a behaviour". When compared to TAM, found TPB-model explain more of the variance in intention to use than the TAM-model did and therefore they conclude that TPB model with a behavioral control element has more explanatory power than TAM-model and thus must be considered while analyzing factors of technology adoption. However, Critics argued that both TPB and TRA have not specified any determinants of behavioral attitudes, subjective norm and, also to some extent, behavioural control.

2.7 Decomposed theory of planned behaviour

The decomposed TPB model is an alternative version of TPB, uses constructs from the innovation literature (e.g., relative advantage, compatibility) and assumes that people's intention to adopt technology is driven by attitude, subjective norms and perceived behavioral control. In addition, this model explains the behavioral control
and subjective norm component from a specific dimension, thereby NurAlamSiddik et al. (2017) provides a more accurate way to understand and investigate person's behavioral intention to adopt or use a particular technology. Both the decomposed TPB and TAM have some similar advantages, such as both models identify definite salient beliefs which may influence technology adoption and usage. However, TPB is considered better than TAM in understanding technology adoption and usage in that it integrates additional factors which are not present in TAM.

2.8 The Theory of Asymmetric Information

One reason for financial exclusion is the lack of correct information about the potential borrower and lender. At a time when information technology rules the world of financial operation, financial exclusion, arising out of information asymmetry assumes significance. The information happens to be asymmetric or imperfect when one party to a product has more information than the other. When these conditions persist, many problems surface, which may adversely affect economic exchanges of financial products and in its culmination it can lead to the denial of financial products to some groups of people. In addition, sometimes it is likely that the potential borrower may misinform the lender, the banks, about their credit worthiness, which ultimately raises the loan default rate, paving the way for an escalation of financial crisis, making the financial institutions to be more vigilant in lending. This extra vigilance will finally end up with the exclusion of more people, who would otherwise be included, from the purview of financial network. It is observed that institutional arrangements in the form of banks find it difficult to break the barrier of information asymmetry especially in rural areas, which ultimately tempt the buyers to seek
financial products from informal sources. Informal sellers of financial products like moneylenders, on the other hand, are quick in addressing the problem of information barrier. Hence, the low or zero information cost coupled with low transaction cost of the financial products being offered by the informal sellers of financial products makes the lending operation cost-effective. Thus, perfect or near to perfect information is the key to the successful and sustainable operation of a financial system. This is because many of the credit contracts that happen in the financial sector are of forward looking in nature.

2.9 Financial Inclusion and Economic Growth

According to this theory, financial development enables conditions for economic growth through both a supply (financial development fuels growth) and demand (growth increases the demand for financial products) channel (Dabla-Norris, Ji, Townsend, & Unsal, 2015). Furthermore a well-developed financial system enlarges access to funds, whereby economic agents have access to their own funds and do not have to knock at the door of informal sources such as money lenders at high cost. An important attribute of finance also involves the extent to which individuals and firms can have access to financial services such as credit, deposit, payment, insurance and other finance-related services. It is well documented that the lack of financial services restricts the range and scope of entrepreneurial activities of households and firms, especially the small and medium-sized ones. During 1900s, there was the view that if much credit is granted to the public to start new business, it will generate more income leading to economic growth and consequently reduce income inequality if the economic wealth is distributed equally (Adnan, 2011).
Theoretical framework based on the nature of this work, the study of Financial Inclusion at rural dwellers in Nigeria is anchored on two theories: modern development theory and sustainability theory. Modern development theory was developed by Burr, HS in the year 1958 and it is a conglomeration or a collective vision of theories about how desirable change in society is best achieved. The theory was based on modernization theory which is used to analyze the way in which modernization processes in a society can take place. The theory looked at which aspect of the economy can forester development and which one that constitutes obstacles for economic growth. This is because the idea of Financial Inclusion in rural dwellers is the developmental assistance targeted at those particular aspects that can lead to modernization of tradition or backward societies. The earliest principles of development theory can be derived from the idea of progress which stated that people can develop and change their society themselves. This is an indication that this counting is meant to be developed by us not by any other foreigner. Sustainability theory as developed by Felix Ekardt 1986 describes sustainability as a form of economy and society that is lasting and can be lived on a global scale. The society-changing potential of the claim: More justice between generations, more global justice – at the same time faces the problem of getting out of sight. Sustainability is just not the general claim to take social, economic, and environmental policy serious and to strike a sound balance between these aspects. Sustainability theory tries to explain the potential for long-term maintenance of well-being, which has ecological, economic, political and cultural dimensions will be in the long run. Sustainability requires the reconciliation of environmental, social equity and economic demands to achieve its aim especially in the rural areas.
2.10 Financial Inclusion and Economic Growth: Theoretical Outlook

The earlier theories of economic development/growth recognized labour, capital, institutions, etc., as the factors for economic growth, while the importance of finance for economic growth has been frequently ignored by earlier economists due to existence of Modigliani–Miller theorem and efficient market hypothesis. Both the theories assumed that the market is perfect and there are no frictions, that is, the capital market is perfect. The assumption implies that the investors buy and sell the securities freely in perfect capital market situation without any transaction cost. The assumption that firms and individual investors can borrow and lend at the same rate is not applicable in real world. However, the early theories of economic development also believed in the need for a developed and extensive financial system that could tap savings and thereby channelize the funds for generating a wide spectrum of business activities. Very little work is available on nexus between finance and economic growth. But modern theories of development strongly advocate that financial development is a must because it creates enabling conditions for economic growth through either a ‘supply-leading’ (financial development spurs growth) or a ‘demand-following’.

Schumpeter (1912) contended that well-functioning banks spur technological innovation by identifying and funding potential entrepreneurs. Economists like Joan Robinson (1952) opined that ‘where enterprise leads, finance follows’, thereby taking a position that economic development creates demand for particular types of financial arrangements and the financial system responds automatically to these demands. Levine (1997) and Burgess and Pande (2003) argued that Financial Inclusion plays a crucial role in ushering in industrialization. Empirically, in the Indian context, Carbo,
Gardener and Molyneux (2005) have shown how financial intermediaries have played a leading role in influencing its economic performance. The financial sector, among other things, not only led to promoting aggregate investment and output but also in attaining finance-led industrialization. Studies by Burgess and Pande (2003) and Burgess et al. (2004) have shown that rural branch expansion in India was associated with non-agricultural growth and has helped in reducing rural poverty significantly. This has been termed by some as supply-leading strategy.