CHAPTER ONE

INTRODUCTION

1.1. Background of the Study

There is a general consensus among the economists that financial development spurs economic growth and this has been theoretically articulated and empirically supported in studies across the world (Bencivenga and Smith, 1991; Benhabib and Spiegal, 2000; Levine, 1997). In the Indian context too financial development has been seen as a key to growth (Bhattacharya and Sivasubramanian 2003; ISED, 2006; Sahoo and Patra, 2006). According to Mohan (2006), a developed financial system broadens access to funds, empowers the poor and low-income people both socially and economically by lifting the financial condition and standards of life and integrates them into the economy of their country in a better way. In this regard, the Approach Paper to the 11th Five Year Plan (GOI, 2006) has also asserted that access to financial resources enables the poor to exploit investment opportunities, reduces their vulnerability to shocks and promotes economic growth.

In recent years, there has been a considerable widening and deepening of the Indian financial system, of which banking is a significant component. But there are concerns that banks have not been able to reach and bring vast segment of population, especially the underprivileged sections of the society, into the fold of basic banking services. Such excluded groups include small and marginal farmers, women, unorganized sector workers including artisans, the self-employed and pensioners (Dev, 2006). Such a high level of financial exclusion of the underprivileged section of the society, especially
low-income households, mainly located in rural areas, has remained a major concern as it involves various social and economic costs. People who save by informal means rarely have the benefit of the interest rate and moreover, these saving channels are much less secured than formal saving facilities. Likewise, lack of formal credit leads to dependency on non-formal providers like money lenders. In the rural areas, the increasing dependence on money lenders may force farmers to sell off their land or even lead to other socially undesirable practices such as bonded labour (Chakravarty, 2006). Hence, in a country like India, the need for financial inclusion i.e. the delivery of basic banking services to all sections of society at an affordable rate has been felt urgent for both social and economic reasons (RBI, 2006).

Nationalization of commercial banks in 1969 which aimed at extending the reach of organized banking services to rural as well as neglected sections of the society, marked a paradigm shift in banking sector i.e. from class banking to mass banking. The same rationale led to the creation of the Regional Rural Banks (RRBs). The rapid development which followed since 1969 till 1991 included increased number of bank branches, decreased average population per bank offices (APPBO) and increment in deposits, advances, lending to the priority sectors, etc. The significance of the informal sector also declined with the spread of the banking system to rural areas (Goyal, 2008).

The entry of banking system into the operational dynamics of the economy of Assam was relatively late. Though belated, the state also felt the positive impact of the new thrust in development banking, especially after the nationalization of banks along with the rest of India. From 74 odd offices in 1969, the bank network increased manifolds to
1236 in 1991 and so was the boost in terms of the deposits, advances, and credit deposit (CD) ratio (Goyal, 2008).

Thus, after nationalization the banks gradually directed their focus from the elitist class to the vast multitude of India’s poor. But soon it became visible that this proclaimed concern for the poor was diluted by political populism which caused tremendous harm to the banking system, particularly in the eighties. The banks lost incentives to make profits and improve the financial health as nationalization destroyed competition and stifled innovations in banking. This resulted in the sub-optimal use of credit, low levels of investment and growth, decline in productivity, and erosion of profitability of the banking sector in general, which necessitated the government to introduce reforms in the financial sector to upgrade the operating standards, health, and financial soundness of banks to internationally accepted levels (Kumar et al, 2005).

Although the post-reform period (after 1991) brought significant improvement in all the areas relating to financial viability, profitability and competitiveness, the objective of nationalization of banks which was ‘reaching the unreached’ took a backseat as banks opted for the preferred customer route in their pursuit of profit (Raju, 2006). This preferred notion of class banking and mounting bad debts crumpled the model of mass banking. The share of priority sectors in total bank credit came down to 31 per cent in 2001 from 43 per cent in 1990, before again rising to 35 per cent in 2006. According to AIDIS, the share of money lenders had increased to 29.6 per cent in 2002 from 15.7 per cent in 1991, while that of non-institutional sources overall rose to 43 per cent from 36 per cent. The APPBO also surged to 15000 in 2005 from 13700 in 1991.
The problem of financial exclusion in the economy of Assam, if not the worst, is as severe as anywhere in the country. According to RBI (2006), the APPBO of 21000 in the state was markedly higher than the all-India figure of 16000 and was particularly high in rural areas. The ratio of bank accounts (current and savings) of SCBs per 100 adult population in the state was 39, which is distinctly lower than the national figure of 59. The same ratio for rural and urban areas in the state shows that although the ratio is lower than the national figure in rural areas, it is higher for urban areas. The district level ratio of deposits accounts per 100 population reveals that within the state there are large divergences among the districts; from 13.6 (Dhubri) to 56.4 (Kamrup). The Credit Deposit (CD) ratio in the state was 34 per cent as compared to the national average of 66 per cent in 2005. According to Census (2001), in Assam, only 20.5 per cent households have access to banking services in 2001 as against all-India figure of 35.5 per cent. Assam was among the few states which recorded significant rural-urban disparities in availing banking services with the percentage of the urban households (53.3%) having a bank account being more than double that of rural households (15%) (Bhavani and Bhanumurthy, 2012). According to NSSO 59th Round Survey (2003), in Assam only 18 per cent farmers are indebted to both formal and informal sources. The percentage of indebted farmer households by source of loan showed that only 15 per cent indebted farmer households obtain loans from formal sources and 88 per cent from informal sources in the state as against all-India figures of 56 and 64 respectively. In the state around 63 per cent of outstanding loans of farmer’s are from informal sources as against the national figure of 42 per cent (Goyal, 2008). According to RBI (2006), in the NER, including Assam, the level of financial inclusion is not related to the poor
alone and gauged by any measure, financial penetration and financial inclusion is very low.

Thus, the reforms in the financial sector increased disparity particularly in the rural-urban divide regarding the development of the banking institutions across the country. While the share of both deposits and credit in metropolitan areas is now higher than it was in 1969, lending to agriculture, artisans and village industries, and other small-scale industries as a proportion of total bank credit has declined significantly (Chakravarty, 2006). It was also found that banks were unable to include the vast segment of population, especially the underprivileged sections into the fold of basic banking services (Leeladhar, 2005). However, according to Chakravarty (2006), the main problem was the lack of access to banking services i.e. financial exclusion rather than declining relative share in credit only. This was a pan Indian phenomenon with Assam being no exception. And it is under these circumstances that the concept of financial inclusion was introduced in Indian banking system by the Reserve Bank so that banking sector could play its proper role in the overall growth of the country.

Financial inclusion assumes a significant role in the development of rural economy of Assam as it can significantly contribute in improving the living conditions of the poor farmers, rural non-farm enterprises and other vulnerable groups, who form the major part of the population of the state. It has the ability to uplift the financial condition and standard of life of the poor and the disadvantaged by integrating them into the economy of their country in a better way. Considering the magnitude of ‘super exclusion’ in many parts of the country, while RBI’s early initiatives with regard to financial inclusion had focused on ‘bare inclusion’ by ensuring a bare minimum access to a
saving bank account without frills to all, it has been observed that financial inclusion proper involves a lot more (Arunachalam, 2008; Dev, 2006). As the requirements for financial services of various regions, social groups, communities, etc. are different, the nature of financial inclusion is likely to be different for each of them. Again, as the rural parts of the country have received little attention from the financial service providers, the growth of this region has been disappointing. In this context, an investigation into financial inclusion among the rural households of the state assumes added importance as it would provide more insights into the overall status of financial inclusion/exclusion at household level and give direction to feasible strategies to enhance the outreach of formal financial services in Assam in general and rural areas in particular.

1.2 Significance of the Study

Financial access/inclusion is considered crucial for individuals/households to manage their incomes, to exploit opportunities and thereby, improving their economic positions. Given the fact that most of the banking parameters show dismal condition of Assam, it is important to examine the extent and nature of financial inclusion/exclusion in the state. However, as in the recent times the focus of policy makers is to use the intermediaries for promoting financial inclusion, especially in rural areas, the question whether various new forms of financial service providers or institutions have helped in promoting/enhancing financial inclusion also becomes pertinent. The present study seeks to address to these important issues. While a few studies on some of the aspects of the financial inclusion have been done recently, no concrete study on the multiple dimensions of financial inclusion/exclusion in the state in general and in the rural areas
in particular is available. The proposed study is induced by the necessity to fill-in this gap to some extent. Based on the analysis of rural household survey, in combination with an evaluation of the role of financial institutions, the study examines different forms of financial service providers, both formal and informal. Moreover, the proposed study has important policy implications as well. It has made some recommendations for policy advisors and financial service providers on how to scale-up access to finance for Assam’s rural poor in a commercially sustainable manner.

1.3 Objectives and Research Questions

1.3.1 Objectives

The study has been taken up six basic objectives. They are as follows:

a) To examine the present status and pattern of financial exclusion in the state.

b) To investigate the supply-side and demand-side constraints of financial inclusion in the state in general and in the rural areas in particular.

c) To investigate the nature of demand for financial services in rural areas of the state.

d) To estimate the cost of financial exclusion of the households in rural areas.

e) To investigate the effectiveness of new forms of non-conventional banking partners in enhancing financial inclusion in rural areas of the state.

f) To review the existing policy and institutional initiatives towards financial inclusion and suggests changes and modification if required.
1.3.2 Research Questions

In addition to the above objectives, the following research questions will be specifically pursued in the course of the proposed study:

a) To what extent the various new forms of financial service providers or institutions have been helping in promoting/enhancing financial inclusion?

b) Does any mismatch between the supply of institutional products and services and the demand pattern of households exist and if yes, to what extent it has contributed towards the financial exclusion of the rural households of Assam?

1.4 Data Source and Methodology

1.4.1 Data Source

The present study has been based on both primary and secondary sources of data. Data pertaining to different aspects of financial inclusion/exclusion of the state have been collected from the Reserve Bank of India (RBI), State Level Bankers’ Committee (SLBC), Census of India, NABARD, All India Debt and Investment Survey (AIIDS), the various rounds of NSSO Surveys, various published sources of Government of Assam such as Directorate of Economics and Statistics, Planning and Development Department, and also from some of the published sources of Government of India like the Planning Commission, the Ministry of Finance, and various independent studies and reports, etc. These secondary sources of data provided a broader picture of the spatial and temporal variations in the financial inclusion/exclusion in Assam. It also gave some indication on the success and failure of various initiatives undertaken to promote financial inclusion. In short, analysis of these data provided a broad picture of the status and extent of financial inclusion/exclusion in the state. However, this was not
sufficient to represent the households’ preferences, choices and responses with regard to various financial services, demand and supply mismatches, etc., without considering which, the true picture of financial inclusion can’t be comprehended. To capture these dimensions, a field survey and a case study have been conducted to collect primary data.

1.4.2 Sample Design for Primary Data Collection

Primary data has been collected with the help of the technique of multistage sampling. In the first stage two districts were selected purposively from the plain districts of Assam depending upon the status of financial inclusion. The two selected districts, namely Nalbari and Hailakandi though fall in the plains areas, belong to two different valley regions namely, Brahmaputra and Barak Valley region respectively of the state. In the rural financial inclusion index value calculated for all districts of Assam, Nalbari and Hailakandi both occupy second position, one from the top and another from bottom respectively in the state. In the second stage, two development blocks were selected purposively from each of the districts in such a way that one was relatively financially included and other was relatively financially excluded. This choice in relation to financially included and excluded block was made after taking into account the block index value calculated on the basis of various banking parameters. In the third stage, two villages were selected purposively from each development block, taking into account both the financially included and excluded areas. Here, the presence and absence of a bank branch in the village has been taken as the criteria for financially included and excluded village. Finally, 10 percent of the households (subject to maximum 40), have been selected at random from each village. This way, a sample of
267 rural households from 8 villages has been gathered at random as ultimate sample units for detailed observation. A case study has also been conducted on one of the recent initiatives to measure its performance in ground reality and its success/failure in promoting financial inclusion in Assam.

1.4.3 Analytical Methodology

As banking system is a significant component of financial system and as most of the definitions describe financial inclusion in terms of banking services, in the present study contextualization of financial inclusion in Assam has been done mainly with respect to banking inclusion. However, with the limited secondary material available, it also looks into the extent and various dimensions of financial inclusion at the household level in Assam in general and rural Assam, in particular. The status of financial inclusion in Assam has been measured primarily in comparison to all-India figures. The data on the various indicators/dimensions of financial (banking) inclusion have been collected from secondary sources as mentioned in 1.4.1 and the trend on each indicators/dimensions has been analyzed to find out the status of financial inclusion in Assam in general and rural Assam in particular over time. Moreover, the district level data on the various indicators/dimensions of financial inclusion have also been collected to investigate the present status of financial inclusion/exclusion in Assam.

Further, to investigate the variations in the extent of financial inclusion across the districts only deposits (savings) and credit services from banks\(^1\) have been taken. On

\(^1\) Other formal institutions data has not been taken primarily because of two reasons. First these statistics are not easily available and second, even if data are available, they do not cover
the other hand, for a more rigorous analysis, financial inclusion across the sample households has been calculated on the basis of three services, savings, credit and insurance availed from both, formal and semi-formal sources.

The examination and analysis of the spatio-temporal variations in the financial inclusion/exclusion across Assam has been done primarily on the basis of the three important dimensions – availability, accessibility and usage of financial inclusion and its various indicators. An Index of Financial Inclusion (IFI) has been developed to measure the extent of financial inclusion across districts using all three dimensions and seven banking indicators. The dimensions and indicators of financial inclusion have been discussed in detail in Section 5.3 of Chapter 5.

As financial inclusion is the recent phenomena in India, very limited work has been done in the field of measuring financial inclusion. The literature on financial inclusion lacks a comprehensive index that can be used to measure its extent across economies. However, most of the studies are taking references from the index developed by Sarma (2008) to measure the extent of financial inclusion. The index is a multidimensional one. Although the methodology used is too some extent similar to that used by UNDP, it applied the Euclidean distance method to calculate the index value of financial inclusion.

various dimension which banking statistics cover. Hence, clubbing data of all formal institutions will limit the number of indicators/dimensions in developing index of financial inclusion.
In this model, Index of Financial Inclusion (IFI) for the \( i^{th} \) country or state, is measured by the normalized inverse Euclidean distance of the point \( D_i \) from the ideal point \( I = (1,1,1,...,1) \).

\[
IFI_i = 1 - \frac{\sqrt{(1 - d_1)^2 + (1 - d_2)^2 + ... + (1 - d_n)^2}}{\sqrt{n}} \quad --- (1.1)
\]

where, \( n \) is the number of dimensions and \( d \) is the dimensional index which is computed by the following formula

\[
d_i = \frac{(A_i - m_i)}{(M_i - m_i)} \quad --- (1.2)
\]

where

- \( A_i = \) Actual value of dimension \( i \)
- \( m_i = \) minimum value of dimension \( i \)
- \( M_i = \) maximum value of dimension \( i \)

and \( 0 \leq d_i \leq 1 \). Higher the value of \( d_i \), higher the economy’s achievement in dimension \( i \).

In formula (1.1), the numerator of the second component, i.e., Euclidean distance of the point \( D_i \) from the ideal point \( I \), is normalized by square root of \( n \) and subtracted from 1 to give the inverse normalize distance. The normalization is done in order to make the value lie between 0 and 1 and the inverse distance is considered so that higher value of the IFI corresponds to higher financial inclusion.

The index developed by Sarma (2008) has its own merits and limitations. In the present study a similar index has been constructed with some modification. Here, more indicators have been used in each dimension, which make the proposed index more
‘inclusive’. In the present analysis, there are three stages of calculation, viz. indicator index, dimension index and financial inclusion index, whereas Sarma (2008) has used two stages, dimension index and financial inclusion index. Further, the methodology used in calculating dimension index is also different, as the methodology used by Sarma for calculating the same is used here for calculating indicator index. In the present study, both the dimension index and financial inclusion index is based on a measure of the distance from the ideal, Euclidean distance formula to make it more comprehensive.

The examination and analysis of the extent and variations of total as well as rural financial inclusion across districts of Assam has been done on the basis of various dimensions/indicators data collected from secondary sources with reference period of 2011. On the basis of this analysis (more particularly index value of rural financial inclusion), districts for the field works have been selected. The analytical details of index of financial inclusion have been discussed in details in Chapter Five.

The preliminary explanation of the variations in the extent of financial inclusion/exclusion across the sample households has been done along with the relevant socio-economic factors for which descriptive statistics have been used. However, to measure the depth of financial inclusion/exclusion, two methods have been developed – score method and index method. The financial inclusion score (FIS) and financial inclusion index (FII) for individual household have been developed on the basis of savings, credit and insurance services availed (taking into account both formal and semi formal sources). A household which has access to any of the three financial services, viz. savings, credit and insurance from either formal or semi-formal sources or both is
considered as financially included and those who do not have access from either formal or semi-formal sources as financially excluded. The household is assigned financial inclusion score on the basis of use of the financial products and services by sources. The methodology used to develop FIS and FII is discussed in details in Chapter Seven. In addition, economic status index (ESI) has also been prepared by taking into account various goods and services possessed by the households to find out the relation between the economic status of the households and their access to financial services.

The preliminary explanation of the variations in the extent and depth of financial inclusion/exclusion across the sample households has further been substantiated for more intensive analysis of the primary data for which suitable econometric modeling have been used. In order to investigate the factors affecting the extent of financial inclusion, non-linear regression models, censored tobit regression and ordered logistic regression have been used.

1.5 Limitations of the Study

The investigation into financial inclusion can comprehensively be done only after looking into both demand and supply side of it. A major limitation of this study is that, here, primarily demand side of financial inclusion has been looked into. Besides, the study deals mainly with two services, i.e., savings and credit, and to some extent insurance, while several other equally important services like payment and remittance facilities, mutual fund, money advice, etc. which are integral components of financial inclusion have not been dealt with. The study covers districts only from the plain areas, while a more comprehensive one including both plains and hills areas could have given a more precise picture of the extent of financial inclusion among rural households in
Assam. Moreover, the dynamics of the process of financial inclusion can be meaningfully looked into only if all the households in a given village are included in the field study.

1.6 Structure of the Dissertation

The thesis is comprised of eight chapters. This introductory chapter is followed by Chapter Two, which covers theoretical issues and empirical debates related to financial inclusion/exclusion. Chapter Three looks into the initiatives undertaken to promote financial inclusion and examines the role of various forms of non-conventional banking partners in this context. Chapter Four, though contextualizes financial inclusion primarily in the banking profile of Assam, it also looks into the various dimensions of financial inclusion/exclusion at the household level with the help of available secondary data. It also examines the recent initiatives and its effectiveness in promoting financial inclusion in Assam. Chapter Five analyzes the extent of financial inclusion in Assam with the help of index of financial inclusion developed in the study. A brief background of the field study areas, the sample and a preliminary analysis of field level inputs have been sketched in Chapter Six to capture the detailed information regarding demand-side aspects of financial inclusion/exclusion and provides insight into demand and supply mismatches, households’ preferences, choices and responses with regard to financial inclusion/exclusion. Chapter Seven deals primarily with the extent, depth and determinants of financial inclusion with the help of an intensive analysis of the inputs from field investigation using different indices developed and econometric tools. The concluding chapter presents a recapitulation of the principal findings, abstractions of broad inferences emerging from the study and a discussion of its policy implications.