CHAPTER III

INCLUSIVE GROWTH THROUGH FINANCIAL INCLUSION

3.1 Introduction

The linkage between financial development and economic growth has been globally recognized. Financial development does not necessarily imply financial inclusion. It has been observed that even ‘well-developed’ financial systems have not succeeded to be ‘all-inclusive’ and certain segments of the population remain outside the formal financial systems. This chapter provides a detailed discussion on the financial inclusion process adopted by the Government of India from the 11th Five Year Plan period.

3.2 Financial Exclusion

Financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society to which they belong. The disadvantaged section of the population comprises of marginal farmers, daily wage earners, landless labourers, unorganized sector employees, urban slum dwellers, minority communities, SCs/STs, socially excluded groups and women. In India, affordable access to basic financial services has been denied to a majority of the population in the Eastern, North Eastern and Central Indian states besides several districts in other parts of the country.

Financial exclusion has been predominant in rural areas primarily due to poor infrastructure resulting in lesser access. This, along with financial illiteracy, burdensome documentation and procedures insisted by formal sources of credit, lack of customized financial products, leads to exclusion. Lack of credit history and absence of documentary proof of identity or address of the prospective
borrowers become obstacles for formal sources of credit to provide access to financial services. Consequently, this segment of the population goes to informal sources of credit for his / her financial needs even though it is costlier.

**EXHIBIT 3.1**

**FEATURES OF FINANCIAL EXCLUSION IN INDIA**

Source: Compiled by authors

Financial exclusion is often the symptom as well as the cause of poverty. Hence, inclusion becomes a major pre-requisite to poverty alleviation. Financial Inclusion facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. Financial Inclusion improves the day-to-day management of finances, reduces the growth of informal sources of credit (such as moneylenders) which are often found to be exploitative. It enhances efficiency and welfare of poor people by providing avenues for secure and safe saving practices and facilitates a whole range of efficient financial services.

Financial Exclusion is disbarring of the disadvantaged and the poor from access to financial services. Financial exclusion is the inability, difficulty or reluctance to access appropriate, so-called mainstream, financial services. Financial exclusion is a serious issue and a current policy concern because it creates financial problems such as exclusion from affordable loans, leaves people
who need to borrow money with no option but to use high-interest credit, lack of insurance and savings makes families vulnerable to financial crises following unexpected events such as burglary or flooding. A lack of savings can lead to poverty in old age; many employers will only pay wages into a bank account, not having a bank account with a direct debit facility excludes people from this method of paying bill. Financial exclusion reinforces social exclusion. It is not just an individual problem, a whole community can suffer from under-investment in financial services. Conversely, financial inclusion significantly contributes to elimination of poverty.

3.3 Adoption of Financial Inclusion

In India, last fifteen years has witnessed growth in financial services unfolded by Liberalization and Globalization of financial services due to adoption of information technology and unlocking of the regularity frame work. But, alongside this positive development, there are evidences that formal financial sector still excludes a large section of population. So, financial inclusion represents reliable access to affordable savings, loans, remittances and insurance services. It primarily implies access to a bank account backed by deposits insurance, access to affordable credit and the payments system. Financial exclusion is better to understand the meaning of financial exclusion and its implications so as to have the better understanding about the concept of financial inclusion or inclusive growth and its importance.

The Indian economy is heading towards a new direction-aiming at achieving two digit annual growth rates, a sustainable, equitable and inclusive growth, taking into account the needs of all sections of the society. The Financial Inclusion (FI), the current buzzword, is considered as one of the key factors for the inclusive growth and ultimately ensuring sustainable overall growth. In the first-ever Index of Financial Inclusion to find out the extent of reach of banking
services among 100 countries, India has been ranked 50. Only 34 per cent of India's population has access to banking services. The India-Urban Poverty Report 2009 states that the urban population in India is increasing at a faster rate than its total population. At present 28 per cent of the population is urban (286 million) and by 2030, India will have 41 per cent of its population living in cities and towns. Due to increasing urbanization, there is an increase in the number of urban poor. The latest National Sample Survey Organisation survey reports that there are over 80 million poor people living in the cities and towns of India and they lack access to the most basic banking services. Low-income groups do not have access to the formal banking systems, as they usually do not have the documents needed to open a bank account. As a result, they depend on the informal sector for their savings and loan requirements. Thus, financial inclusion is considered to be critical for achieving inclusive growth, which is required for ensuring overall sustainable growth. Recognizing the importance of inclusive growth in India, efforts are being taken to make the financial system more inclusive.

The Report Committee on Financial Inclusion headed by C. Rangarajan (2008) has observed that financial inclusion must be taken up in mission mode and suggested a National Mission on Financial inclusion (NMFI) comprising representation of all stakeholders for suggesting the overall policy changes required and supporting stakeholders in the domain of public, private and NGO sectors in undertaking promotional initiatives. The present chapter deals with the various issues relating to financial inclusion and measures taken by the Government of India to improve financial inclusion.

The importance of an inclusive financial system is widely recognized in the policy circle in recent years and financial inclusion is seen as a policy priority in many countries. India adopted faster and more inclusive growth strategy in its 11th (2007-2008) Five Year Plan. The Government of India’s ‘Committee on
Financial Inclusion’ has the process of ensuring access to financial services and timely and adequate credit needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost (Rangarajan Committee 2008).

Financial inclusion currently in use is the delivery of financial services at an affordable cost to the vast section of disadvantaged and low-income groups. The economy should recognize exclusion as a logical, indeed, inevitable outcome and to design appropriate mechanism for addressing each of the factors that make for it. Financial Inclusion rests on three pillars — accesses to financial services, affordability of such make for it. Financial inclusion can be achieved only if all the three pillars show affirmative results. Thus the ABC of Financial Inclusions includes Advice, Banking and Credit. It must also be focused that for developing countries like India, generally the process of financial inclusion starts with opening of savings bank accounts. The process, at a later stage, must also incorporate credit facilities and other financial services such as insurance. Thus, promotion of financial inclusion would require holistic and coherent approach on the part of the banking industry as also the regulator RBI (Reserve Bank of India) and GOI (Government of India).

3.4 Definition of Financial Inclusion

The Committee on Financial Inclusion defines financial inclusion as "a comprehensive and holistic 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”. The committee suggested that the financial inclusion should include access to mainstream financial products such as bank accounts, credit, remittances and payment services, financial advisory services and insurance facilities. Financial inclusion is delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. Financial inclusion means extending the banking habits
among the less privileged, both in urban and rural areas. Making banking and payment services available to the entire population without any discrimination is the main objective of Financial Inclusion. Thus, the main focus of financial inclusion in India is on promoting sustainable development and generating employment in rural areas for the rural population.

3.5 Need for Financial Inclusion

There are a number of factors affecting access to financial services by weaker section of society in India. The people living in remote and hilly areas suffer from poor infrastructure. The lack of awareness, low incomes and assets, social exclusion, illiteracy are the barriers from demand side. The distance from bank branch, branch timings, cumbersome banking procedure and requirements of documents for opening bank accounts, unsuitable banking products/schemes, language, high transaction costs and attitudes of bank officials are the barriers from supply side. Therefore, the weaker sections approach informal financial sector as it is easily available even though it is costly. The most important reason for the financial exclusion in the case of migrants and slum dwellers is the requirement of independent documentary proof identity and address. One of the main reasons for a large percentage of the country's population remaining outside the formal financial system is the lack of adequate financial literacy among the masses. Therefore, financial literacy assumes greater importance to enhance the ability of the masses to effectively use the available financial resources to improve their well being. Hence, there is a need for financial inclusion to build uniform economic development, both spatially and temporally and ushering in greater economic and social equity.

3.6 Financial Literacy

Financial literacy is the ability to understand finance. More specifically, it refers to an individual’s ability to make informed judgments and effective decisions about the use and management of their money. In India, “Project
Financial Literacy” is one of the RBI’s financial education initiatives. The objective of the project is to disseminate information regarding the central bank and general banking concepts to various target groups, including, school and college going children, women, rural and urban poor, defense personnel and senior citizens.

As financial markets now offer complex choices to consumers, literacy is essential for consumers to make informed choices. The objectives of the Financial literacy programme is to spread awareness and build skills of poor women on clarity of financial concepts, making better financial decisions, accessing financial products and services, building assets, overcoming vulnerability, and planning towards economic security. Bank’s experience with the Business Correspondents reveals that there is good awareness on the need for financial literacy among the Self-Help Groups and these SHGs have been utilized as an effective tool for spreading financial literacy.

3.7 The Process of Financial Inclusion in India

The process of financial inclusion in India can broadly be classified into three phases.

**EXHIBIT 3.2**

**THE PROCESS OF FINANCIAL INCLUSION IN INDIA**

- **Phase I (1960-1990)**
  - Focus on channeling of credit to weaker section

- **Phase II (1990-2005)**
  - Encourage in SHG bank linkage programme
  - Providing kisan credit cards (KCC) to farmers

- **Phase III 2005 onwards**
  - Safe facilities of saving
During the First Phase (1960-1990), the focus was on channeling of credit to the neglected sectors of the economy. Special emphasis was also laid on weaker sections of the society. The Second Phase (1990-2005) focused mainly on strengthening the financial institutions as part of financial sector reforms. Financial inclusion in this phase was encouraged mainly by the introduction of Self-Help Group (SHG) bank linkage programme in the early 1990s and Kisan Credit Cards (KCCs) for providing credit to farmers. The SHG bank linkage programme was launched by the National Bank for Agriculture and Rural Development (NABARD) in 1992, with policy support from the Reserve Bank of India, to facilitate collective decision making by the poor and provide 'door step' banking. During the Third Phase (2005 onwards), the 'financial inclusion' was explicitly made as policy objective and the thrust was on providing safe facility of saving deposits through 'no frills' accounts. The scope of financial inclusion can be expanded in two years.

1. Through state-driven intervention by way of statutory enactments.

2. Through voluntary effort by the banking community itself for evolving various strategies to bring within the ambit of the banking sector the large strata of society.

The three components of financial inclusion in India are:

1. Knowledge of Access to Financial Services

2. Affordable Services

3. Actual Utilization
3.8 Measures by RBI and GOI towards Financial Inclusion

Historically, the Reserve Bank of India (RBI) and the Government of India (GOI) have been making efforts to increase banking penetration in the country. Some of these measures include the creation of the State Bank of India in 1955; nationalization of commercial banks in 1969 and 1980; initiating the Lead Bank Scheme in 1970; establishing Regional Rural Banks (RRBs) in 1975; introducing a Self-Help Group (SHG) Bank Linkage Programme in 1992 and formulating the Kisan Credit Card Scheme in 2001. Following is the brief outline of the efforts pursued by the Reserve Bank of India to further financial inclusion. RBI's approach to financial inclusion aims at 'connecting people' with the banking system and not just opening accounts. This includes meeting the small credit needs of the people, giving them access to the payments system and providing remittance facilities. This has led to some notable developments.
1. **No Frills Accounts:** In November 2005, RBI asked banks to offer a basic banking 'no-frills' accounts with low or zero minimum balances and minimum charges to expand the outreach of such account to the low income groups. The nature and number of transactions in such accounts could be restricted, but made known to the customer in advance in a transparent manner. All banks were also advised to give wide publicity to such a 'no-frills' account including on their web sites indicating the facilities and charges in a transparent manner. Banks are required to make available all printed forms to be used by retail customers in the concerned regional language. Significant progress has been made in this regard, and till now, banks have opened more than 15 million no-frills accounts in the country.

   As announced in the Annual Policy Statement for the year 2008-09, and in order to give further impetus to financial inclusion, banks were advised in May 2008 to classify overdrafts upto Rs. 25000 (per account) granted against 'no-frills' accounts in rural and semi-urban areas as indirect finance to the agriculture sector under priority sector with immediate effect.

2. **Overdraft facilities in No-frill Accounts:** RRBs have been specifically advised to allow limited overdraft facilities in 'no-frills' accounts without any collateral or linkage to any purpose. The idea is that provision of such overdraft facility provides a ready source of funding to the account holder who is thereby induced to open such accounts.

3. **One-Time Settlement:** A simplified mechanism for one-time settlement of loans with principal amount upto Rs. 25000 which have become doubtful and loss assets as on September 30, 2005 was suggested for adoption. Banks have been specifically advised that borrowers with loans settled under the one time settlement scheme will be eligible to re-access the formal financial system for fresh credit.
4. **General Purpose Credit Card:** With a view to providing credit care like facilities in the rural areas, with limited Point-Of-Sale (POS) and limited ATM facilities, the Reserve Bank of India advised all scheduled commercial banks, including RRBs, in December 2005 to introduce a General Credit Card (GCC) facility without insistence on collateral or purpose, with a revolving credit limit up to Rs. 25000 based on the assessment of income and cash flow of the household to enable hassle free access to credit to rural and semi-urban households. The Reserve Bank of India also advised banks to classify fifty per cent of the credit outstanding under loans for general purposes under General Credit Cards (GCC), as indirect finance to agriculture under priority sector. The Reserve Bank further advised banks in May 2008 to classify 100 per cent of the credit outstanding under GCC as indirect finance to agriculture sector under the priority sector with immediate effect.

5. **Simpler KYC Norms:** In August 2004, banks were advised to ensure that customers belonging to poor sections of the society are not kept away from banking system, on account of difficulties in meeting the KYC requirements for opening bank account. The KYC procedure for opening accounts was simplified further for persons who intend to keep balances not exceeding Rs. 50000 in all their accounts taken together and the total credit in all the accounts taken together is not expected to exceed Rs. 1 lakh in a year. The customer is allowed to exceed the threshold limit only after the full compliance with the KYC norms. Based on feedback received on the extant KYC/AML/ CFT regime, relevant guidelines were revised on February 18, 2008. These guidelines include among others (i) in case of close relatives who find it difficult to furnish documents relating to place of residence while opening accounts, banks can obtain an identity document and a utility bill of the relative with whom the prospective customer is living, along with a declaration from the relative that the said person (prospective customer)
wanting to open an account is a relative and is staying with him/her. Banks can also use any supplementary evidence such as a letter received through post for further verification of the address; (ii) banks have been advised to keep in mind the spirit of the instructions and avoid undue hardships to individuals who are otherwise classified as low risk customers; (iii) banks should review the risk categorization of customers at a periodicity of not less than once in six months.

6. **100 per cent Financial Inclusion Drive:** The Reserve Bank launched a financial inclusion drive targeting one district in each state for 100 per cent financial inclusion. In the light of the experience gained, coverage has been extended to other areas/districts. An external evaluation of the quality of 100 per cent financial inclusion reported by banks was carried out by the RBI. On that basis, in January 2009, RBI advised banks to (i) ensure provision of banking services nearer to the location of the no-frills account holders through a variety of channels; (II) provide GCC/small overdrafts along with no-frills accounts to encourage the account holders to actively operate the accounts; (iii) conduct awareness drives of the facilities offered to the no-frills accounts holders; (iv) review the extent of coverage in districts declared as 100 per cent financially included; and (v) efficiently leverage on the available technology enabled financial inclusion solutions.

7. **Electronic Benefit Transfer (EBT) through Banks:** To encourage banks to adopt Information and Communication Technology (ICT) solutions for enhancing their outreach, the RBI formulated a scheme to quicken the pace of adoption of the smart card-based Electronic Benefit Transfer (EBT) mechanism by banks and rolled out the EBT system in the States that are ready to adopt the scheme. As per the scheme, the RBI would reimburse the banks a part of the cost scheme. As per the scheme, the RBI would reimburse
the banks a part of the cost opening accounts with bio-metric access/smart cards at the rate of Rs. 50 per account through which payment of social security benefits, National Rural Employment Guarantee Act (NREGA) payments and payments under other Government benefit programmes would be routed to persons belonging to Below Poverty Line (BPL) families. The scheme was implemented in Andhra Pradesh and 6 districts of Haryana. So far, seven banks have been paid Rs. 1.8 crore for smart cards issued by banks in Andhra Pradesh during July-December 2008. The process is at different stages of implementation in other States such as Karnataka and Uttrakhand and the scheme of partial reimbursement by the Reserve Bank of India has been extended by one year upto June 30, 2010. Banks are advised to work in co-ordination with the respective government departments at the Central and State level to ensure that all State benefits are delivered to individuals only through bank accounts within a specific timeframe.

8. **Business Correspondent Model:** Possibly the most important initiative of the Reserve Bank of India has been the Business Correspondent (BC) model. The BC model ensures a closer relationship between poor people and the organized financial system. Recognizing this, in 2006, the RBI permitted banks to use the services of non-government organizations, micro-finance institutions, retired bank employees, ex-servicemen, retired government employees, section 25 companies, and other civil society organisations as Business Correspondents in providing financial and banking services. The BC model allows banks to do 'cash-in-out' transactions at a location much closer to the rural habitation, thus addressing the last mile problem. Banks are also entering into agreements with India Post for using the vast network of post offices as business correspondents, thereby increasing their outreach and leveraging on the postman's intimate knowledge of the local population. Even as the BC model has taken off, it needs to be fine tuned and
monitored appropriately to improve its efficacy, including by better training BCs. Recently, the RBI has further enlarged the scope of the BC model by permitting banks to appoint individual kirana/medical/fair price shop owners, individual Public Call Office (PCO) operators, agents of Small Savings schemes and insurance companies, individuals who own petrol pumps, retired teachers and self-help groups linked to banks as BCs. While appointing such individuals as BCs, the Reserve Bank advised banks to ensure that these individuals are permanent residents of the area in which they propose to operate as BCs and also institute additional safeguards as may be considered appropriate to minimize agency risk.

With a view to ensuring adequate supervision over the operations and activities of the BCs, the Reserve Bank of India advised banks that every BC should be attached to and be under the oversight of a specific bank branch to be designated as the base branch. The distance between the place of business of a BC and the base branch, ordinarily, should not exceed 15 kms. (further extended to 30 kms from April 2009) in rural, semi-urban and urban areas. In metropolitan centers, the distance could be upto 5 kms. However, in case a need is felt to relax the distance criterion, the matter can be referred to the District Consultative Committee (DCC) of the district concerned for approval.

With a view to ensuring the viability of the BC model, banks have also been permitted to collect reasonable service charges from the customer in a transparent manner. Going forward, the Reserve Bank of India will endeavour to give complete flexibility to banks to appoint BCs with only a negative list of entities that would not be eligible.

9. **Bank Branch and ATM Expansion Liberalized:** The Reserve Bank of India has totally freed the location of ATMs from prior authorization. Further, in October 2009, the RBI took another big step by freeing branch
opening in towns and villages with a population below 49,999. After examining the recommendations of the Working Group constituted to review the extant Branch Authorization Policy, the RBI has permitted domestic scheduled commercial banks (other than Regional Rural Banks) to open branches in Tier 3 to Tier 6 centers (with population upto 49,999 as per census 2001) without having the need to take permission from RBI circular is available at its website www.rbi.org.in. Domestic scheduled commercial banks (other than RRBs) are asked to ensure that at least one-third of such branch expansion happens in the under banked districts of under banked states. This will be one of the criteria in the Reserve Bank's consideration to open branches in major city (Tier 1 and Tier 2) centers.

10. **Expansion of Banks in the North-East:** To improve banking penetration in the North-East, the Reserve Bank asked the State Governments and the banks to identify centers where there is a need for setting up either full fledged branches or those offering forex facilities, handling government business or for meeting currency requirements. The RBI has also offered to fund the capital and running costs for five years, provided the State Government concerned is willing to make available the premises and put in place appropriate security arrangements. Meghalaya has been the first of the state, and eight centers have been allotted to three public sector banks, by following a bidding process. The Reserve Bank is working with other states in the north-east to institute similar arrangements.

11. **Project Financial Literacy:** Financial literacy is a stepping-stone toward financial inclusion. Moreover, as financial markets are becoming increasingly complex with serious problems of information asymmetry, the need for financial literacy has become even more acute. Recognizing this, the Reserve Bank of India has undertaken a project titled “Project Financial Literacy” to
disseminate information regarding the central bank and general banking concepts to various target groups, including, school and college going children, women, rural and urban poor, defense personnel and senior citizens. The information would be disseminated to the target audience with the help of, among others, banks, local government machinery, schools/colleges by using pamphlets, brochures, films, as also, the Reserve Bank's website. The Reserve Bank has also created a link on its website 'For the Common Person' to give the ease of access to information, in Hindi, English and 11 regional languages (Assamese, Bengali, Gujarati, Kannada, Malayalam, Marathi, Oriya, Punjab, Tamil, Telugu and Urdu). A 'Financial Education' site link on the Reserve Bank's website was launched on November 14, 2007, mainly aimed at teaching basics of banking, finance and central banking to children in different age groups. The economic books format has been used to explain the complexities of banking, finance and central banking in a simple and interesting way for children.

12. Financial Literacy and Credit Counseling: In May 2007, convenor banks of the SLBCs/UTLBCs were advised to set up, on a pilot basis, a Financial Literacy and Credit Counseling Centre (FLCC) in any one district in the State/Union Territory coming under their jurisdiction. The objectives of the FLCCs are to provide free financial literacy/education and credit counseling, educating people in rural and urban areas with regard to various financial products and services available, providing face-to-face financial counseling services, and formulating debt restricting plans for borrowers in distress and recommending the same to formal financial institutions for consideration. FLCCs should not, however, act as investment advice centers. In rural areas, the centers could concentrate on financial literacy and counseling for farming communities and those engaged in allied activities while the centers in metro/urban areas could focus on individuals with overdue in
credit cards, personal loans, housing loans, etc., among others. So far, banks have reported setting up or proposing to set up 123 credit counseling centers in various states of the country.

13. Establishment of FIF and FITF: In order to meet the costs of technology adoptions, developmental and promotional interventions for ensuring financial inclusion, the Union Finance Minister, in his Budget Speech for 2007-08 announced the constitution of the Financial Inclusion Fund (FIF) with an overall corpus of Rs. 500 crore each at NABARD. The FIF/FITF would be in operation until financial inclusion to the extent of 100 per cent of rural families in all districts is achieved, over a period of five years from the date of commencement of the Fund for such enhanced period as may be decided by the Government.

The FIF would be used for activities such as funding support for capacity building inputs to BCs/BFs; providing promotional support to institutions such as resource centers, farmers’ service centers and RSETIs; providing funding support for promotion, nurturing and credit linking of SHGs; funding support for setting up of Rural Credit Bureaus and credit rating of rural customers; and supporting pilot projects for development of innovative products, processes and prototypes for financial inclusion. The FITF would be used for purposes such as providing financial support to technological solutions aimed at providing affordable financial services to the disadvantaged sections of the society; creating a common technology infrastructure with comprehensive credit information; providing viability gap/pilot project funding for unproven but potential technological interventions; and conduct of studies, consultancies, research, evaluation studies relating to technological interventions for financial inclusion.
14. **Other measures:** The Reserve Bank of India has also been periodically issuing guidelines on public grievance redressal mechanism in banks, including constitution of Customer Service Centers for ensuring improvements in quality of service rendered. In the Reserve Bank, the Customer Service Department has recently been constituted to, inter alia, serve as the interface between customers and banks. Moreover, the Government of India has also expressed its explicit concern of the issue of overall inclusion in the development process through its various initiatives such as the Rural Employment Guarantee Scheme, the Bharat Nirman programme, the Sarva Shiksha Abhiyan, and the like. A Committee on Financial Inclusion, with Dr. C. Rangarajan as Chairman, has also been constituted by the Government of India in June 2006, to recommend a strategy to achieve higher financial inclusion in the country.

3.9 **Financial Inclusion and Economic Development**

Financial inclusion is an essential pre-condition to building uniform economic development, both spatially and temporally, and ushering in greater economic and social equity. There are several government and non-government programmes aimed at reducing poverty and bringing greater equity in the country. But few have proved to be inherently productive and sustainable. Financial inclusion can transform them into productive and self-sustainable projects. The micro-credit programme launched through numerous Non-Government Organizations has found fancy with the banking industry and can prove to be an excellent tool to bring in greater equity through financial inclusion.

No-frills account when promoted extensively ploughs back the returns from these projects into bank coffers, thus encouraging the savings habit and ensuring that banks act as a repository of savings and sources of credit. This will make banking enter into the daily routine of a common man. Besides nurturing the habit
of saving among the masses, it will remove the apprehensions and fear from their mind towards the financial products and services. This will encourage un/under-banked consumers to enter into or make better use of the financial mainstream. It will also persuade people to take credit for setting up new ventures. In a way provision of easy credit will encourage the first generation entrepreneurs to initiate new venture; aggravate the capital formation in the society; create new employment opportunities and thus will help in escalating the economic development of the country. This also will automatically lower the increasing crime rates in the society.

3.10 The Model for Financial Inclusion

Deepening the financial system and widening its reach is crucial for both accelerating growth and for equitable distribution, given the present state of development of our country. After analyzing in depth the underpinning reasons of financial exclusion in India and going through the success stories of UK and USA, and interacting with NGOs mainly operating in different states of central India, it becomes obvious that we have to continue with our tireless endeavor to combat monsters like illiteracy, poverty, ignorance, cultural and psychological hurdles and simultaneously design innovative, lucrative and low cost banking products and services to lure the public to join the mainstream. Need was felt to reorient the attitudes of the operating staff to make them appreciate the benefits of extending the reach to wider sections of the society. The model discussed below will be instrumental in bringing hundred percent financial inclusion in our country.

Stage I : Create Awareness and Financial Literacy

Intensive awareness, education and promotion drive to create an in-depth impact on the masses.
• Government should promote introduction of basic banking – relevance, services, merits as a topic in secondary and higher secondary classes in all education institutions.

• Government sponsored publicity campaigns through all media–radio; television; newspapers; e-choupal; village panchayat; movies; local stage shows etc.

• Banks should design and organize aggressive education cum promotion campaigns in unbanked parts of urban, semi – urban and rural areas to enhance financial literacy and awareness, as well as to remove the doubts and apprehensions that the masses have towards the banking sector.

• Banks should involve the knowledgeable and well-informed local inhabitants in such activities. This will help the banks to consolidate and ensure prompt and extensive response from the populace.

• Banks should gather support from the NGOs, retired bank personnel, academic institutions, to reach the desired numbers within a limited span of time.

Once the fallacy is removed from the minds of the general public, they automatically will join the mainstream. The all round awareness and education simulation will drive them to open savings and current accounts. This will mark the beginning of basic banking in the true sense.

**Stage II: Basic Banking**

The banks need to adopt a considerate approach towards this new clientele, to remove their qualms and disbeliefs. It is necessary that the basic banking should be comprehensive in scope and have attractive USPs that can lure people at large:
• All banks should allow no frill accounts i.e. savings accounts which can be opened with a nominal amount of Rs.5/- or even with zero balance. They should allow 6-7 withdrawals in the accounting period and should not restrict the number of deposits.

• The RBI along with banks should toil hard to reduce the amount of paperwork in relation to the opening of an account as well as in getting small credits. This would reduce the complexity and also speed up the processing at banks.

• Banks should make sure that local people are positioned in the front offices, so that the general public does not have to endure with language problem and does not have to suffer perceived / actual racial discrimination.

• It is all the more necessary for the banks that besides offering the conventional products and services, they should set up teams who can understand the needs and requirements of the common man and design innovative products and services having greater suitability and desirability. Also banks should work as one-stop-store and offer diversified products in banking and insurance.

• Despite the risk, financing of first time entrepreneurs is a must for financial inclusion and growth. Banks should arrange and provide technical advice for these entrepreneurs. They will have to tone up their risk assessment and risk management capacities, and provide for these facilities.

• Banks should give free financial counsel to low-income households and small entrepreneurs.

• The pricing of the product should also be done keeping in mind the pockets of the potential clientele. The cost burden should proportionately be shifted to high potential sectors, who can afford a little upswing in their banking cost.
Stage III: Innovative Strategies

Basic banking itself needs to be supported by innovative strategies, in order to improve the reach and reduce the operating cost of the banks.

• Infrastructure sharing amongst banks and other organizations will help in lowering the operating cost and thus the cost benefit can be transferred to customers.

• Bank should open small extension counters at organization providing public utility services such as local schools, primary health care centres, village mandies, farmers’ associations, cold storages and warehouses, railway stations, bus stops etc.

• This should simultaneously be supplemented by mobile banks. Wherever it is not economical to set up a branch, credit camps / loan ‘melas’ must be organized on weekly basis, to disburse small loans on easy terms.

• Greater use of technology should be made by the banks to improve their reach, speed of processing, as well as to cut down the operating cost.

Last but not the least, the Government of India should initiate a ‘civil rights law’ prohibiting discrimination by banks against low and moderate income neighborhoods. This will create a pressure on banks to play an important role in bringing financial inclusion in the country. This model will result in: improved financial literacy; make banking enter into the daily routine of the masses; broaden the deposit base; wider disbursement of credits, larger number of transactions. Jointly it will lead to formalized and systematic banking; faster economic growth; new employment opportunities in the society and financial as well as social inclusion.

3.11 Measures Taken for Financial Inclusion in India

Several steps have been taken by the Reserve Bank of India and the Government to bring the financially excluded people to the fold of the formal banking services. With a view to bring the financial inclusion, in the Mid Term
Review of the Policy (2005-06), the RBI advised all banks in November 2005 to make available basic banking 'no-frills' accounts either with 'nil' or very low minimum balances as well as charges that would make such accounts accessible to vast sections of the population. The nature and number of transactions in such accounts could be restricted, but made known to a customer in advance in a transparent manner. All banks were also advised to give wide publicity to the facility of such 'no-frills' account, including on their web sites, indicating the facilities and charges in a transparent manner. In the 'no-frill' account, an account holder besides being allowed to have low or nil balance is also entitled to have ATM facility and can operate five to ten free transactions per month. These accounts can also be used for the disbursement of existing subsidies and cash transfers to the poor under different Government programmes such as NREGS. A nationwide Electronic Financial Inclusion System (NEFIS) shall also be created by linking the 'no-frill' accounts to enable the electronic transfer of funds to these accounts.

In addition, the banks in India are advised by the RBI to make available all printed material used by retail customers in the concerned regional language.

The RBI has also introduced a simplified mechanism for One-Time Settlement (OTS) of overdue loans upto Rs. 25,000 and advised the banks that borrowers with loans settled under the OTS Scheme will be eligible to reaccess the formal financial system for fresh credit.

In order to ensure that persons belonging to low income group both in urban and rural areas do not face difficulty in opening the bank accounts due to the procedural hassles, the RBI has also eased the 'Know Your Customer' (KYC) norms to keep the procedural hassles involved in opening a bank account to the minimum. This is to enable those belonging to low-income groups to open bank accounts without documents of identity and proof of residence. In such cases, banks can take the individual's introduction from an existing account holder on
whom the full KYC procedure has been completed and has had satisfactory transactions with the bank for at least six months. The photograph and address of the prospective account holder need to be certified by the person who introduces him/her. These simplified KYC norms are applicable for those who intend to keep balances not exceeding Rs. 50,000 in all their accounts taken together. The total credit in all the accounts taken together should not exceed Rs. 1,00,000 in a year.

Further, in order to extend hassle-free credit to bank customers in rural areas, the RBI has simplified the guidelines on General Credit Card (GCC) Schemes to enable customers' access credit on simplified terms and conditions, without insistence on security, purpose or end-use or credit. With a view to providing hassle-free credit to customers, banks were allowed to issue General Credit Cards akin to Kisan Credit Cards (KCC). Similarly, Swarojgar Credit Cards (SCC) is another facility offered by the banks for financial inclusion exclusively for unorganized poor people in rural and urban areas. Farmers' clubs are being developed with the help of banks for technology transfer and knowledge dissemination to the poor people in rural areas.

In January 2006, banks were permitted to utilize the services of Non-Governmental Organisations (NGOs) and Self-Help Groups (SHGs), Microfinance Institutions (MFIs) and other civil society organisations as intermediaries in providing financial and other banking services through the use of Business Facilitator (BF) and Business Correspondent (BC) models. The BC model allows banks to do' cash in-cash out' transactions at the location of the BC and non-banking areas.

The RBI also considers that IT-enabled services can meet the challenges which need to be addressed for increasing the scope and coverage of financial inclusion such as lack of adequate infrastructure, higher transaction costs and low volumes of transactions. RBI, along with IDRBT, is working on the use of
multi-application smart card systems which can operate as bank accounts as also store of electronic cash, as a data repository for essential information relating to the cardholder, containing security features such as biometric identification which can also be used as an entitlement identifier or as a social security card.

Towards achieving financial literacy, the RBI has undertaken a project titled 'Project Financial Literacy'. The objective of the project is to disseminate information regarding the central bank and general banking concepts to various target children, women, rural and urban poor, defense personnel and senior citizens. A multilingual website in 13 Indian languages on all matters concerning banking and the common person has been launched by the RBI on June 18, 2007. A model scheme on Financial Literacy and Credit Counseling (FLCC) centers was formulated and communicated to all scheduled commercial banks entities maintaining an arm's length from the bank so that the FLCC’s services are available to even other banks’ customers in the district.

The Report of Committee on Financial Sector Reforms headed by Prof. Raghuram Rajan (2008) put forward a road map for further intensifying the on-going financial inclusion process in India among other things. It suggested that a significant investment in financial literacy is required if the poor are to make effective use of various initiatives to foster financial inclusion.

Keeping in view the enormity of the task involved, the Committee on Financial Inclusion recommended the setting up of mission mode National Rural Financial Inclusion Plan (NRFIP) with a target of providing access to comprehensive financial services to at least 50 per cent (55.77 million) of the excluded rural households by 2012 and the remaining by 2015.

3.12 Progress of Financial Inclusion in India

The 100 per cent of financial inclusion drive is progressing all over the country. The State Level Bankers Committee (SLBC) has been advised to identity one
or more districts for 100 per cent financial inclusion. So far, the SLBC has identified 431 districts for 100 per cent financial inclusion. As on 31st March 2009, 204 districts in 18 States and 5 Union Territories have reported having achieved the target.

The success of the financial inclusion can be measured by the actual quantity and quality of usage of the newly opened ‘No Frill’ accounts.

TABLE 3.1
NUMBER OF NO FRILL ACCOUNTS OF SCHEDULED COMMERCIAL BANKS (As at 31 March)

<table>
<thead>
<tr>
<th>Bank Group</th>
<th>2006</th>
<th>2007</th>
<th>2008</th>
<th>2009</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Group</td>
<td>3,32,878</td>
<td>58,65,419</td>
<td>1,39,09,935</td>
<td>2,98,59,178</td>
</tr>
<tr>
<td>Private Sector Group</td>
<td>1,56,388</td>
<td>8,60,997</td>
<td>18,45,869</td>
<td>31,24,101</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>231</td>
<td>5,919</td>
<td>33,115</td>
<td>41,482</td>
</tr>
<tr>
<td>Total</td>
<td>4,89,497</td>
<td>67,32,335</td>
<td>1,57,88,919</td>
<td>3,30,24,761</td>
</tr>
</tbody>
</table>

Source: is www.rbi.org.in/financialeducation/home.aspx

The number of 'no-frill' accounts increased from 4,89,497 on 31st March 2006 to 3,30,24761 on 31st March 2009. It is observed that majority of 'no-frills' accounts notably, the public sector banks account for the majority of these 'no-frills as at end March 2009 compared to private sector banks. Regrettably, the statistics do not indicate how many of these accounts were opened in urban areas and there is a strong feeling among a large section of the population that banks in urban areas are reluctant to open 'no-frills' accounts for the urban poor. A sample study carried out by the Banking Coded and Standards Board of India in Mumbai revealed the poor awareness about 'no-frills' accounts and relaxed KYC norms amongst the bank staff itself, a general unwillingness by the not simplified and did not contain any information about the required documents under simplified KYC norms and in none of the branches the staff were in a position to offer any guidance in case the prospective customer was not in a position to produce required documents.
in proof of identity and address. As a result, the weaker sections of India hesitate to take part in financial inclusion and help to increase economic growth of the country. Hence, among the less privileged people, awareness should be created about the savings and the use of No Frill accounts.

The other benchmarks employed to assess the degree of reach of financial services to the population of the country are spatial distribution of banking services, number of deposit and credit accounts as well as percentage of deposits and credit accounts to GDP in rural and urban areas and quantum of deposits accounts (current and savings) held as a ratio to the adult population. The number of banks' offices is increasing in Metropolitan areas as compared to rural areas. The share of deposits and credit in rural and semi-urban areas is on the declining trend when compared to metropolitan areas. The share of credit is lower than that of deposits in all regions except the metropolitan, implying that resources get intermediated into metropolitan areas.

### TABLE 3.2

**POPULATION GROUP-WISE DISTRIBUTION OF DEPOSITS AND CREDIT OF COMMERCIAL BANKS (per cent)**

<table>
<thead>
<tr>
<th>Area</th>
<th>Offices</th>
<th>Deposits</th>
<th>Credit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>22.2</td>
<td>45.7</td>
<td>39.7</td>
</tr>
<tr>
<td>Semi-urban</td>
<td>40.4</td>
<td>22.3</td>
<td>23.7</td>
</tr>
<tr>
<td>Urban</td>
<td>19.2</td>
<td>17.6</td>
<td>19.4</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>18.2</td>
<td>14.4</td>
<td>17.2</td>
</tr>
<tr>
<td>Total</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
</tbody>
</table>

Source: is www.rbi.org.in/financialeducation/home.aspx

One of the indicators for measuring banking access is the population per branch. Since the nationalization of banks in 1969, branch network of SCBs
expanded rapidly. As a result, the population per branch declined significantly between 1969 and 1991. The population per branch in the rural segment increased after 1991. However, the population per branch continued to decline in the urban areas.

**TABLE 3.3**

**POPULATION PER BANK BRANCH OF COMMERCIAL BANKS**

<table>
<thead>
<tr>
<th>End March</th>
<th>Rural</th>
<th>Urban</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>82</td>
<td>33</td>
<td>63</td>
</tr>
<tr>
<td>1981</td>
<td>20</td>
<td>17</td>
<td>19</td>
</tr>
<tr>
<td>1991</td>
<td>14</td>
<td>16</td>
<td>14</td>
</tr>
<tr>
<td>2001</td>
<td>16</td>
<td>15</td>
<td>16</td>
</tr>
<tr>
<td>2005</td>
<td>17</td>
<td>14</td>
<td>16</td>
</tr>
<tr>
<td>2007</td>
<td>17</td>
<td>13</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: www.rbi.org.in/financialeducation/home.aspx

One of the factors responsible for increase in population per branch in rural areas between 1991 and 2007 was the reclassification of 953 rural centers, classified as rural, as per 1991 census, which moved to higher population centers on account of increase in population.

**TABLE 3.4**

**POPULATION GROUP-WISE NUMBER OF DEPOSIT ACCOUNTS OF COMMERCIAL BANKS ACCORDING TO TYPE**
(As on 31st March 2008) (No. of Accounts in thousands)

<table>
<thead>
<tr>
<th>Area</th>
<th>Current</th>
<th>Saving</th>
<th>Term</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No</td>
<td>Per cent</td>
<td>No</td>
<td>Per cent</td>
</tr>
<tr>
<td>Rural</td>
<td>29,45</td>
<td>13.5</td>
<td>1330,08</td>
<td>31.0</td>
</tr>
<tr>
<td>Semi-urban</td>
<td>46,24</td>
<td>21.3</td>
<td>1132,32</td>
<td>26.4</td>
</tr>
<tr>
<td>Urban</td>
<td>59,09</td>
<td>27.2</td>
<td>905,85</td>
<td>21.1</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>82,58</td>
<td>38.0</td>
<td>923,10</td>
<td>21.5</td>
</tr>
<tr>
<td>All-India</td>
<td>217,36</td>
<td>100</td>
<td>4291,35</td>
<td>100</td>
</tr>
</tbody>
</table>
In terms of banking penetration, the number of current deposit accounts of scheduled commercial banks is significantly lower in the rural and semi-urban areas as compared with the urban areas. However, the number of savings accounts is high in rural and semi-urban areas when compared to urban and metropolitan areas. In the case of term deposits, the metropolitan area accounts for majority of accounts population.

**TABLE 3.5**

**REGION-WISE COMMERCIAL BANK BRANCHES IN INDIA**

*(As on June 30)*

<table>
<thead>
<tr>
<th>Region</th>
<th>2008</th>
<th>2009</th>
<th>Average population per bank branch (in'000)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No.</td>
<td>Per cent</td>
<td>No.</td>
</tr>
<tr>
<td>Northern</td>
<td>13,175</td>
<td>17.13</td>
<td>13,800</td>
</tr>
<tr>
<td>North-East</td>
<td>2,051</td>
<td>2.67</td>
<td>2,133</td>
</tr>
<tr>
<td>Eastern</td>
<td>13,017</td>
<td>16.93</td>
<td>13,406</td>
</tr>
<tr>
<td>Central</td>
<td>15,328</td>
<td>19.93</td>
<td>16,027</td>
</tr>
<tr>
<td>Western</td>
<td>11,839</td>
<td>15.40</td>
<td>12,440</td>
</tr>
<tr>
<td>Southern</td>
<td>21,481</td>
<td>27.94</td>
<td>22,563</td>
</tr>
<tr>
<td>All-India</td>
<td>76,891</td>
<td>100</td>
<td>80,369</td>
</tr>
</tbody>
</table>

In terms of regional dis-aggregation, at the end June 2009, the average population per bank office is high in North eastern region, followed by Eastern and Central regions. The population per bank branch is the lowest in Northern and Southern regions. Three regions, North-Eastern, East and Central have higher population per office than the all India average as compared to other regions in
India. Majority of commercial bank branches is in Southern region followed by Central and Northern regions.

**TABLE 3.6**

**REGION-WISE NUMBER OF SAVINGS ACCOUNTS OF SCHEDULED COMMERCIAL BANKS (Per 100 persons)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Total</td>
<td>Rural</td>
<td>Urban</td>
<td>Total</td>
<td>Rural</td>
<td>Urban</td>
</tr>
<tr>
<td>Northern</td>
<td>40.0</td>
<td>41.5</td>
<td>30.1</td>
<td>29.9</td>
<td>62.6</td>
<td>64.1</td>
</tr>
<tr>
<td>North-East</td>
<td>17.8</td>
<td>21.2</td>
<td>16.1</td>
<td>18.9</td>
<td>28.4</td>
<td>33.6</td>
</tr>
<tr>
<td>Eastern</td>
<td>21.8</td>
<td>23.3</td>
<td>17.7</td>
<td>18.4</td>
<td>40.0</td>
<td>44.4</td>
</tr>
<tr>
<td>Central</td>
<td>23.8</td>
<td>27.4</td>
<td>21.0</td>
<td>23.7</td>
<td>34.7</td>
<td>40.2</td>
</tr>
<tr>
<td>Western</td>
<td>35.5</td>
<td>37.5</td>
<td>24.7</td>
<td>26.4</td>
<td>53.8</td>
<td>53.6</td>
</tr>
<tr>
<td>Southern</td>
<td>37.0</td>
<td>43.8</td>
<td>34.6</td>
<td>38.7</td>
<td>42.7</td>
<td>53.8</td>
</tr>
<tr>
<td>All-India</td>
<td>29.9</td>
<td>33.0</td>
<td>24.5</td>
<td>26.2</td>
<td>45.6</td>
<td>50.8</td>
</tr>
</tbody>
</table>

Source: is www.rbi.org.in/financialeducation/home.aspx

The region-wise pattern indicates that savings accounts per 100 persons have increased considerably in all the regions between 1991 and 2007. This pattern was also observed in both the rural and urban areas. Compared to an all-India average of 33.0 savings accounts per 100 persons in 2007, almost all of the states in the eastern and north-eastern regions and several pockets in the central region had figures lower than this average. In the rural areas, northern and southern region dominate as the number of savings accounts per 100 persons is more than the all-India average resulting in a substantial improvement in savings account penetration. The improvement in the savings account could be observed both in urban and rural areas as the all-India average savings accounts per 100 persons increased from 24.5 in 1991 to 26.2 in 2007 in rural areas and from 45.6 in 1991 to 50.8 in urban areas. This
reflects a rise in the income levels and the various initiatives taken by the Reserve Bank of India such as urging banks to open 'no frill' accounts with nil or low minimum balances. Similarly, the region-wise pattern of number of credit accounts per 100 persons has increased considerably in all the regions between 1991 and 2007 barring North-Eastern, Eastern and Central regions in which the number of credit accounts per 100 persons has declined between 1991 and 2007. This pattern was also observed in urban areas and not in rural areas.

### TABLE 3.7
REGION-WISE NUMBER OF CREDIT ACCOUNTS OF SCHEDULED COMMERCIAL BANKS (per 100 persons)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Northern</td>
<td>6.4</td>
<td>7.1</td>
<td>6.6</td>
<td>5.6</td>
<td>5.9</td>
<td>10.0</td>
</tr>
<tr>
<td>North-East</td>
<td>4.4</td>
<td>4.3</td>
<td>4.4</td>
<td>4.1</td>
<td>4.4</td>
<td>5.5</td>
</tr>
<tr>
<td>Eastern</td>
<td>6.6</td>
<td>4.8</td>
<td>7.2</td>
<td>4.5</td>
<td>4.3</td>
<td>6.2</td>
</tr>
<tr>
<td>Central</td>
<td>5.5</td>
<td>4.8</td>
<td>5.8</td>
<td>4.3</td>
<td>4.4</td>
<td>5.0</td>
</tr>
<tr>
<td>Western</td>
<td>5.7</td>
<td>10.5</td>
<td>6.2</td>
<td>4.8</td>
<td>4.8</td>
<td>18.9</td>
</tr>
<tr>
<td>Southern</td>
<td>11.8</td>
<td>16.8</td>
<td>13.6</td>
<td>14.4</td>
<td>7.6</td>
<td>21.6</td>
</tr>
<tr>
<td>All-India</td>
<td>7.3</td>
<td>8.3</td>
<td>7.9</td>
<td>6.5</td>
<td>5.5</td>
<td>13.1</td>
</tr>
</tbody>
</table>

Source: is www.rbi.org.in/financialeducation/home.aspx

The number of credit accounts per 100 persons in all the states in the Northern, North-Eastern, Eastern and Central regions is less than the all-India average of 8.3 in 2007 whereas it is more than in Western and Southern regions.

In the rural areas, only Southern region is above the all-India average, while in the urban areas, Southern and Western regions dominate as the number of credit accounts per 100 persons is more than the all-India average.

### 3.13 Financial Inclusion and Inclusive Growth
The Eleventh Five Year Plan (2007-12) envisions inclusive growth as its key objective. It defines inclusive growth to be 'a growth process which yields broad-based benefits and ensures equality of opportunity for all'. The inclusive growth implies an equitable allocation of resources with benefits accruing to every section of the society. It is aimed at poverty reduction, human development, health and provides opportunity to work and be creative. Achieving inclusive growth in India is the biggest challenge as it is very difficult to bring 600 million people living in rural India into the mainstream. One of the best ways to achieve inclusive growth is through financial inclusion. There are supply side and demand side factors driving inclusive growth. Banks largely are expected to mitigate the supply side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. Apart from the supply side factors, demand side factors, such as lower income and/or asset holdings also have a significant bearing on financial inclusion. Owing to difficulties in accessing formal sources of credit, poor individuals and small and macro enterprises usually rely on their personal savings or internal sources to invest in health, education, housing and entrepreneurial activities to make use of growth opportunities. Access to financial products is constrained by several factors which include lack of awareness about the financial products, high transaction costs and products which are not convenient, inflexible, not customized and of low quality. Financial inclusion promotes thrift and develops culture of saving and also enables efficient payment mechanism strengthening the resource base of the financial institution which benefits the economy as resources become available for efficient payment mechanism and allocation.

3.14 Issues and Challenges

As far as the financial inclusion in India is concerned, there are three issues involved. Basically, there is a difference between the rural poor and the urban poor as far as proof of identity and address are concerned. In a village, almost everyone knows about everyone, whereas in the urban areas, one may not know
who one's neighbor is, let alone be convinced of the identity and address of the urban poor. It implies that if the instructions to banks are easy to apply in rural areas, they are not necessarily so in urban areas which brings us to the second issue.

All along, banks have been made to focus on the KYC requirements and the risks involved in non-compliance thereto as a result of which the importance of being equitable and non-discriminatory in the rendering of banking services has been relegated to the background. If there is no risk involved for the bank or the banking system in maintaining no-frills accounts, why can't we permit the opening of no-frills accounts on the basis of a simple self-declaration form regarding identity and address with photograph. For instance, the post offices in India accept savings of the poor or rich for that matter, on the basis of a simple account opening form without insisting upon documentary evidence.

The third issue is that the KYC formalities are only used as a convenient tool to block access to banking services to the urban poor. The real problem lies elsewhere. It is not the fear of risk involved but the fear of additional work involved. It lies in the unwillingness on the part of banks in urban areas to provide such services as it means more footfalls, more record-keeping, more work in general. This is just not acceptable. Firstly, there has to be a top down approach in each bank to bring about an attitudinal change in this regard. Secondly, there has to be greater publicity and awareness among this section of the urban population about the availability of banking services. Hence, both the banks and the regulator need to have a rethink on the above three issues, if they are at all serious about providing access to banking services to the urban poor.

With the strong emphasis of the Government in the Budget 2009-10 and in the 100 day agenda on amelioration of the urban poor, the banks have a twofold challenge before them. (i) One is to meet the existing micro credit needs of the urban poor for meeting consumption needs and reduce their dependence on informal and costly
sources of credit and (ii) To move from micro credit to micro enterprises or the self-employed or casual workers such as cobblers, rickshaw driver, carpenters, hand-cart vendors, hawkers, plumbers, mechanics, etc. These are the ones who also keep the life cycle of a metropolis ticking. Effective from 30th April 2007, the RBI has enlarged the base of the priority sector lending so as to include micro-credit and direct and indirect finance to micro and small manufacturing and service enterprises including small business, retail trade, professional and self-employed persons.

3.15 Financial System and Innovations in the Globalized Era

Financial markets are an important component of financial system in an economy. Financial system aims at establishing a regular, smooth, efficient and cost effective link between savers and investors. Thus, it helps encouraging both savings and investment. Financial systems facilitate expansion of financial markets over space and time and promote efficient allocation of financial resources for socially desirable and economically productive purposes. They influence both the quality and the pace of economic development. After the economic liberalization, the entire financial sector has undergone a change and now we are witnessing the emergence of new financial products and services almost every day. Thus, the present scenario is characterized by financial innovation and financial creativity. Hence, it is imperative that one should understand the various causes for financial innovation.

3.16 Factors Influencing Financial Innovation

Financial intermediaries have to perform the task of financial innovation to meet the dynamically changing needs of the economy and to help the investors cope with an increasingly volatile and uncertain market place. There is a terrible necessity for the financial intermediaries to go for innovation due to the following factors.

a. Low Profitability
The profitability of the major financial intermediary, namely the banks, has been very much affected in recent times. There is a decline in the profitability of traditional banking products. So, they have been compelled to seek out new products which may fetch high returns.

b. Cut-Throat Competition

The entry of many financial intermediaries in the financial sector market has led to intensive competition among themselves. This severe competition has paved the way for the entry of varied nature of innovative financial products so as to meet the varied requirements of the investors.

c. Economic Liberalization

Reform of the financial sector constitutes the most important component so advanced that even the world's issuers can be linked with the investors in the global financial markets without any difficulty by means of offering so many options and opportunities. Hence, innovative products are brought into the domestic market in recent times.

d. Customer Service

Now-a-days the customers' expectations are very great. They want newer products at lower cost or at lower credit risk to replace the existing ones. To meet this increased customer sophistication, the financial intermediaries are constantly undertaking research in order to invent a new product which may suit the requirement of the investing public. Innovations thus help them in soliciting new business.

e. Global Impact

Many of the providers and users of capital have changed their roles all over the world. Financial intermediaries have come out of their traditional approach and they are ready to assume more credit risks. As a consequence, many
innovations have taken place in the global financial sector which has its own impact on the domestic sector also.
f. Investor Awareness

With a growing awareness amongst the investing public, there has been a distinct shift from investing the savings in physical assets like Gold, Silver and Land etc., to financial assets like shares, Debentures and Mutual Funds etc. Again, within the financial assets, they go from "risk free" bank deposits to risky investments in shares. To meet the growing awareness of the public innovation has become the need of the hour.

3.17 Globalization and Liberalization in the Financial Sector

The process of globalization has paved the way for the entry of innovative and sophisticated financial products into our country. Since the Government is very keen in removing all obstacles that stand in the way of inflow of foreign capital, the potentialities for the introduction of innovative international financial products in India are very great. Moreover, India is likely to enter the full convertibility era soon. Hence, there is every possibility of introduction of more and more innovative and sophisticated financial services in our country. The Government of India has initiated many steps to reform the financial services industry. The Government has already switched over to free pricing of issues form pricing issues by the controller of capital issues. The interest rates have been deregulated. The private sector has been permitted to participate in banking and mutual funds and the public sector undertakings are being privatized. The Securities and Exchange Board of India has liberalized many stringent conditions so as to boost the capital and money markets. In this changed context, the financial service industry in India has to play a very positive and dynamic role in the years to come by offering many innovative products to suit to the varied requirements of the millions of prospective investors spread throughout the country.
3.18 Conclusion

It is hoped that this discussion of financial inclusion for rural and urban poor will not remain only a discussion and that this will get transmitted into an action plan by all concerned. Opening a bank account may not be a big deal for most of us. But for a large part of the population living on low incomes, getting one was rather difficult. Financial inclusion as a part of inclusive growth plays a major role in driving away poverty from India. A day will come when all the Indians will have bank account and everybody will take part in financial inclusion.

The growing need for innovation has assumed immense importance in recent times. This process is being referred to as Financial Engineering. Financial Engineering is the lifeblood of any financial ability. "Financial Engineering is the design, the development and the implementation of innovative financial instruments and processes and the formulation of creative solutions to problems in finance". Realizing all these factors, the Government of India has initiated many steps to reform the financial services industry. The private sector has been permitted to participate in banking and mutual funds and the public sector undertakings are being privatized. In this changed context the financial service industry in India has to play a very positive and dynamic role in the years to come, offering many innovative products to suit the varied requirements of the millions of prospective investors spread throughout the country.
References


5. Vighneswara Swamy and Vijayalakshmi, "Role of Financial Inclusion for Inclusive Growth in India-Issues & Challenges".