Financial Inclusion is a process by which financial services are made accessible to all sections of the population. It is a conscious attempt to bring the un-banked people into banking. FI in the narrow sense may be achieved by offering any one of the financial services but a comprehensive FI would be to provide a set of services encompassing all the services. This part of the thesis reviews some of the significant studies done earlier. The review of earlier studies is essential, for new areas so far un-explored may be identified and studied in depth. FI is a widely discussed and researched topic. However, an all-out effort has been made to review the earlier studies on the topic. Most of the literary sources that inform this thesis are taken from various articles, books, committee reports, working papers, theses and dissertations as well as full- fledged publications on various aspects of FI.

International studies have also been accessed from websites on the Internet and reviewed to understand the status of the subject in developed and developing countries. Institutions and libraries visited to gather information include Institute of Rural Management Anand (IRMA-Gujarat); MS University (Baroda); Indian Institute of Banking and Finance (IIBF- Mumbai);
National Institute of Bank Management (NIBM – Pune); Bharathidasan University (Trichy - Tamil Nadu); Gandhigram Rural University (Dindigal - Tamil Nadu), Pondicherry University (Pondicherry) and various university libraries in Kerala.

The available literature has been classified into six areas, viz.

1. Finance, Economy and Inclusive Growth
2. Financial Exclusion
3. Financial Inclusion
4. Measurement of Financial Inclusion
5. Financial Inclusion and Informal Finance
6. Financial Inclusion through Micro Finance

2.1 Area of Study – Finance, Economy and Inclusive Growth.

Economic growth in a democratic country like India has to be inclusive in order to make it sustainable. If policies that bring about economic growth do not benefit the people in a wide and inclusive manner, they will not be sustainable. For achieving a sustainable growth, bringing in the benefits of growth to rural India is critical. It is only by delivering financial services to people in rural areas that they could be brought within the ambit of mainstream economic activity and the full potential of the country’s physical and human resources could be realised. That is why devising strategies for inclusive growth has become the guiding principle of public policy. For the first time in India, the term ‘Inclusive Growth’ has been used in the very title of the Approach paper of XIth Five Year Plan. The XIth Plan (2007-2012) is aimed at achieving a new vision of growth ‘Towards Faster and More Inclusive Growth.’
Literature has ample evidences for the existence of a strong link between a well-functioning financial system and inclusive growth. Since the time of classical thinkers like Adam Smith, Joseph Schumpeter etc: the role of finance in the development of the economy has been realised.

**Levine Ross (1997)** recognised that countries with larger banks and more active stock markets grow faster over subsequent decades even after controlling many other factors underlying economic growth. Industries and firms that rely heavily on external financing grow disproportionately faster in countries with well-developed banks and securities markets than in countries with poorly developed financial systems and the relationship between the initial level of financial development and growth is large.

**Moreno, L. A. (2007)** identified that a population that plays an active part in the economic process is much more likely to identify with the rest of the society contributing towards stability and to have a sense of ownership and belonging thereby. Belonging means having something to lose and this sense is fundamental to social cohesion.

**Beck et al. (2008)** insist that recently the debate expanded to include the notion of financial exclusion as a barrier to economic development and the need to build inclusive financial systems. Besides banking, insurance companies too would be required to target Bottom of the Pyramid (BoP) customers to achieve inclusive banking and in turn to achieve inclusive growth.

**Luce Edward (2008)** has remarked that a vast army of labourers is living in India, where the growth is not labour intensive which means a severe lack of job opportunities for the low and semi-skilled. The poor are not reaping the benefits of growth in the same way that they are in other rapidly growing economies like China and Vietnam. India finds itself higher on the [value-added] ladder than one
would perhaps expect it to be. It is just that most of its population is still standing at the bottom and India’s unusual development path is a serious problem.

Rangarajan, C. (2009) remarks that economic growth and social development are the two legs on which a nation must walk and FI is no longer an option but a compulsion. He asserts that one aspect of Inclusive Growth is FI. The process of FI is an attempt to bring within the ambit of the organised financial system, the weaker and vulnerable sections of society and Inclusive Growth cannot come without FI.

Chakraborty, K.C. (2009) comments that Inclusive Growth cannot come without FI and enabling people to get credit from small money lenders and the like is not FI but the access has to be through mainstream institutional players and only then such access will be fair, transparent and cost effective.

Sameer Kochaar (2009) affirms that economic growth can leave many people in persistent poverty, if they do not have the necessary capacity to participate in and benefit from the growth process. FI offers incremental and complementary solutions to tackle poverty to promote inclusive development and to address the Millennium Development Goals (MDGs).

Asha Jalan (2009) opines that Inclusive Growth aims to integrate the country’s poor in its growth trajectory, integrating the informal sector into the formal financial markets. The Self Help Group - Bank Linkage Program (SBLP), India’s large scale microfinance initiative is an important tool in this strategy of ‘Inclusive Growth’. This model of microfinance in India has the dual challenge of FI and poverty alleviation.

Mandira Sarma (2010) explains that an Inclusive financial system has several merits. It facilitates efficient allocation of productive resources and
thus can potentially reduce the cost of capital. In addition, access to appropriate financial services can significantly improve the day-to-day management of finance. An inclusive financial system can help in reducing the growth of informal sources of credit (such as money lenders) that are often found to be exploitative. An all inclusive financial system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services.

Nageswara Rao (2010) observes that the objective before present day economy is to ensure growth with distributive justice in tune with the democratic principles of the greatest happiness to the greatest number. Growth cannot be considered as an end itself until it translates into income generation and empowerment of the whole population irrespective of areas and sectors. Growth has to be an inclusive phenomenon and not confined to a few pockets of area and people which makes it exclusive.

Saroj Upadhyay (2010) states that access to financial services is an important tool for both economic growth and human development. Inclusion should be viewed as a process of including the excluded as agents of development instead of welfare targets. Inclusion should entail understanding the poor, their lives, their needs, their productivity and their vulnerability. If a poor person has to participate in economic growth, he should have the power to access a wide range of financial services such as savings, payments, remittances and insurance. The success of FI depends upon growth of credit which is to be matched by a corresponding growth in deposits.

Anuradha, P.S. and Ganesan, G. (2010) find that microfinance is one of the practical development strategies and approaches that have been discovered and implemented for sustainable development and used as a means to foster
Inclusive Growth in the Indian economy. The ultimate outcomes of Inclusive Growth are sustainable and equitable growth, social inclusion, empowerment and security.

Chandan Kumar and Srijith Misra (2011) find that finance has become an integral part of an economy. There is a two-way relationship between financial system development and real sector growth. Developed financial system drives real growth, while the growing economy’s demand leads to advancing the financial sector. Banking system/institutions has a vital role in facilitating the development of financial system.

Kaul, R.C. (2011) points out that the growth trend of Indian economy over the past few years has been quite good from all standards and indicates the beginning of a new phase of higher growth. The said progress does not seem to have resulted in commensurate growth in manufacturing employment leading to doubts about the inclusive nature of this growth.

### 2.2 Area of Study- Financial Exclusion

For promoting FI, the issue of exclusion of people who desire the use of financial services but are denied access to it needs to be addressed. Financial exclusion can be understood in terms of non-participation in the mainstream financial system with regard to accessing and using certain financial services. Like social ex-/inclusion, financial ex-/inclusion is perceived as a continuum with people experiencing more or less ex-/inclusion over time. Moreover, exclusion from financial services is not only a problem of a minority. It can affect everybody in society in some form or another and for various reasons. It is therefore not a homogenous group of people that experience exclusion over time. Many of the key aspects of social exclusion do apply to the exclusion from financial services. More specifically, financial exclusion is identified as a
multidimensional concept: people are excluded from a range of financial services that fulfill the financial needs of individuals and are necessary for participation in society. It also needs to be defined in relation to the needs of people which can vary from individual to individual.

**Leyshon, A. and Thrift, N. (1995)** have defined financial exclusion as referring to those processes that serve to prevent certain social groups and individuals from gaining access to the formal financial system. People living in rural areas and in locations that are remote from urban financial centres are more likely to be financially excluded. In a study ‘Geographies of Financial Exclusion: Financial Abandonment in Britain and the US’, they have identified that remote physical locations in which some poor individuals or households reside constitute barriers to the accessibility of financial services and products.

**Kempson, E. and Whyley, C. (1998)** recognised that in countries having well developed banking system, the excluded from the financial system are the persons who belong to low income groups, ethnic minorities, immigrants, the aged and so on. Being excluded, from employment or being unable to secure credit often leads to economic impoverishment.

**Namboodhiri, N.V. and Shiyani, R. L. (2001)** report that the formal financial sector is not effectively serving the rural population. These institutional agencies not only lacked the required mechanism to assess their credit needs but often overlooked their demand for credit on the ground that their needs are for non-productive purposes.

**Kofi Annan (2003)** remarks that the people living on low incomes cannot access mainstream financial products such as bank accounts, low cost credit, remittances and payment services, financial advisory services, insurance
facilities etc. He urges that the great challenge is to address the constraints that exclude people from full participation in the financial sector.

**RBI (2003)** reports that there is a distinct regional imbalance in the access to financial services, whereby the most heavily populated and poverty stricken regions of eastern, central and north-eastern India have a disproportionately lower level of financial access. While these states account for 54 per cent of the country’s population and 40.5 per cent of the total bank branches, they have only a 20 per cent share in outstanding bank credit and 29 per cent share of deposits.

**Clare Louise Chambers (2004)** identifies that if people are excluded from using financial products, then there is likelihood that these people may become socially excluded as well. Social exclusion is a shorthand term for what can happen, when people or areas suffer from a combination of linked problems such as unemployment, poor skills, low incomes, poor housing, high crime environments, bad health and family breakdown.

**Kempson, E. et al. (2004)** assert that the issues of financial exclusion have been of interest to scholars for some time now. Of the issues raised in academic debates, an important question is, whether economic development leads to all inclusive financial system. It has been observed that, even developed countries like US and UK have not succeeded to be all inclusive and certain segments of the population remain outside the formal financial systems.

**Basu Priya and Pradeep Srivastava (2005)** cite a combination of factors to understand why most Indians are unable to borrow from formal financial institutions. They argue that the banks are cautious of the repayment capacity of poor borrowers, their volatile income streams and incapability to provide
collateral. The clients also make bad - borrowers as they typically avail of loans for consumption smoothing rather than investment in business and when the loans are for entrepreneurial purposes the poor borrowers often lack the technical/business skills and market information to make their businesses viable. Further, the transaction costs of rural loans are significantly higher since the loan size is usually small, there is widespread illiteracy among poorer clients and they are spread over a large geographical area.

Clark et al. (2005) find that while the government seems to have been successful in promoting basic banking services, a bigger issue was that of dormant accounts and the limited use of automated banking. Many, were not able to take advantage of the benefits mainstream banking could offer, which is described in the literature as a case of ‘exclusion within inclusion’

Midgley, J. (2005) argue that while financial exclusion may be caused by one or a combination of factors, the experience of financial exclusion includes common factors which quite often are over-looked. These include social and economic prejudice or spaces of discriminatory ecologies which are aspects of religious faith or cultural differences, unemployment, single parenthood, class, social welfare, dependency, low-wage or level of household income, marital status, apprenticeship, non-homeowner or housing tenure, old age, impairment, immigrants and refugees, ethnicity or black and minority-ethnic (BME), minority neighborhoods and communities.

Andrew, L. et al. (2006) assert that individuals or households who based on past rejection and bad experience with banks or financial institutions pose the risk of voluntarily excluding themselves from financial services and products.

RBI (2006) reports that India in the last 15 years has witnessed unprecedented growth in financial services, unfolded by liberalisation and globalisation. But
alongside this positive development, there are evidences that the formal financial sector still excludes a large section of population. As on March 2006, the saving accounts per 100 adult populations were 63 and credit accounts were only 16 in India.

Chandrasekhar (2007) looks into the multiple levels of Financial Inclusion and Exclusion. At one extreme, there are customers who have wide range of financial products and services at their disposal, who are served well by the financial service providers. At the other extreme, there are people who are financially excluded, having no access to even the basic banking services. Another segment of population in between the two extremes exists having limited access to financial services.

Carbo et al. (2007) find that the denial of financial services and the conditions that lead to depriving an individual or a group from the benefits of these services is called Financial Exclusion. It can be of any type like access - exclusion, condition - exclusion, price - exclusion, marketing - exclusion or self - exclusion. It also depicts social deprivation or social standing. It can be due to many social and economic factors, viz: low household incomes, expensive source of credit, no savings and no insurance coverage. This takes us to the issue of ‘Financial Inclusion’.

Jefferis, K. (2007) affirms that Financial Exclusion or constrained access to finance has negative, interrelated, economic and social impacts. These consequences arise for a number of reasons. The lack of efficient financial service provision means that poor people are either forced to use inefficient provisions, often at high cost (high transaction cost, high interest rates or poor returns on savings). This in turn, tends to restrict the economic opportunities open to the poor (this is most obviously the case with credit, as almost all
entrepreneurship activities need capital). The poor are vulnerable to adverse events and financial loss (due to lack of insurance and secure savings products). The absence of savings products makes it difficult to build up capital. Poverty is entrenched, as the poor are faced with the high cost of accessing financial services and are denied entrepreneurship opportunities that might provide them with a chance to earn an income and economic growth is below potential as the level of investment is reduced.

**Mas Ignacio and Kabir Kumar (2008)** examine how banks can translate the potential of mobile phones into greater financial access for poor people. Although mobile phone operators have been able to use the mobile phone for mobile remittance and bill payment services in several countries, banks have had little success in using mobile phones as part of a growth or outreach strategy.

**Sameer Kochaar (2009)** remarks that to address the issue of Financial Exclusion in a holistic manner, it is essential to ensure that the following financial services are available to every individual. (i) A no-frill banking account for making and receiving payments, (ii) A savings product suited to the pattern of cash flow of a poor household, (iii) Money transfer facilities, (iv) Small loans and overdrafts for productive, personal and other purposes, (v) Micro insurance, and (vi) Micro-pensions.

**Mehrotra et al. (2009)** find that Prolonged and persistent deprivation of banking services to a large segment of the population leads to a decline in investment and has the potential to fuel social tensions causing social exclusion.

**Vani, K. Borooah (2010)** elucidates that social exclusion is the process by which certain groups are unable to fully participate in the life of their
communities. The things that people might be excluded from, include livelihood, secure and permanent employment, earnings, property, credit, land, housing, education, skills, cultural capital, the welfare state etc. The bases on which people are excluded, comprise age, caste, gender, disability, ethnic background, HIV status, migrant status, religion and sexual orientation. He adds that a denial of credit might lead to deprivation through an inability to pursue business opportunities.

Subha, Rao (2010) remarks that the statistics do not convey the true extent of Financial Exclusion. Even where bank accounts are claimed to have been opened, verification has shown that these accounts are dormant. Few conduct any banking transactions and even fewer receive any credit. Millions of people across the country are thereby denied the opportunity to harness their earning capacity and entrepreneurial talent and are condemned to marginalisation and poverty.

2.3 Area of Study - Financial Inclusion

Financial Inclusion can be perceived as a continuum. Opening a bank account though a positive step does not move someone from being excluded to ‘included’. In this context, Regan and Paxton (2003) note that the experience of Financial Inclusion is not just about access to products but also the quality of engagement with those products and the need for individuals to develop skills and confidence to make informed decisions.

Leeladhar (2005) states that there could be multiple levels of FI and FE. At one extreme, we have customers who are actively and persistently courted by the financial services industry and who have at their disposal a wide range of services and products. They are the ‘super included.’ At the other extreme, we have financially ‘excluded’, who are denied access to even the most basic of financial
products. In between are the ‘under included’, who use the banking services only for deposits and withdrawal of money. They have only restricted access and may not enjoy the flexibility of access offered to more affluent customers.

**Basu Priya (2006)** finds that rural households face several barriers when they attempt to borrow from banks. Firstly, banks demand collateral which poor people are unable to provide. Secondly, bank transactions tend to be time consuming and expensive. Bribes amounting to 20 per cent of the loan amount are not unheard of. On an average, bank loans take several weeks to be approved. Consequently, the share of informal sources of credit has jumped.

**Shetty (2006)** insists that FI rests on three pillars, viz: access to financial services, affordability of such services and actual utilisation of such services. FI can be achieved only if all the three pillars show affirmative results. Thus, the ABC of FI is Advice, Banking and Credit.

**Bluebook (2006)** states that the essence of FI is in trying to ensure that a range of appropriate financial services is available to every individual and enabling them to understand and access those services. FI does not require that everyone who is eligible uses each of these services but they should be able to choose them if they desired to use them.

**Usha Thorat (2006)** views that establishment of an account relationship can pave the way to the customer availing of a variety of savings products, loan products for consumption livelihood and housing. The account can be used for making small value remittances at low cost and making purchases on credit. The same bank account can also be used by the State Governments to provide social security services like health insurance and calamity insurance under various schemes for the disadvantaged. Thus the single gateway of banking account can be used for several purposes.
Devendraprasad Pandey (2007) finds that the subject of FI has come to the surface essentially as a consequence of the financial sector reform process of the 1990s, which neglected the rural credit structure and thus excluded the vast majority of rural artisans, farm community and micro enterprises from credit.

Anderloni et al. (2007) share the view that the ownership of a bank account is not enough to promote meaningful inclusion, for, an account may be inaccessible due to being overdrawn or may be only used for receipt of money, and may create a case of ‘exclusion within inclusion’.

World Bank (2008) reports that in the absence of inclusive formal financial system, poor individuals and small entrepreneurs have to rely on informal sources to invest in better opportunities because of its timely availability and easy accessibility but at a much greater interest burden. FI can help in removing this impediment. Achieving FI in a country like India, with large and diversified population with significant segments in rural and unorganised sectors requires a high level of penetration by the formal financial system.

Vijay Kelkar (2008) asserts that FI has to be viewed as a business strategy for growth. FI will result in reduced farmers’ indebtedness and better risk management for the farmers. By providing greater access to educational loans to all sections of society, improved FI will mean India becoming more equal opportunity nation, a pre condition for promoting inclusive growth; and enhanced FI will promote grass root innovations and entrepreneurship.

Suryanarayana, M.H. (2008) provides empirical evidence to show that the growth process between 1993-94 and 2004-05, has bypassed the majority and was not inclusive. At the national level, the inclusion coefficient is higher for the rural sector than for the urban. As regards the rural sector, inclusive coefficient is the lowest in rural Kerala; this is contrary to what one would
expect, given the progressive policies pursued in the state. Across states, the extent of inclusion of the deprived in the rural growth process is one of the highest (greater than 90 per cent) in the states of Bihar and Karnataka and the lowest in Kerala.

Mandira Sarma (2008) finds that the widely held view that NPAs are a result of providing credit to the low income groups, sometimes, in compliance with the directed lending programs such as ‘priority sector lending’ is not true. If lending to the poor and consequent default on their part is in fact the cause for ‘NPA’, then higher levels of ‘NPA’ should be associated with higher levels of Financial Inclusion. The results of the study show the opposite, indicating a higher level of ‘NPA’ associated with lower level of FI. It clearly shows that, the efforts to include more people into the financial system are not the significant cause for the ‘NPA’. Further, highly capitalised banking system, with a high ‘CAR,’ seems to be less inclusive. This is due to the fact that, a banking system having high ‘CAR’ tend to be more cautious in lending, negatively affecting FI.

Thyagarajan and Venkatesan (2008) in a recent study found that in some districts, at least more than 85 percent of the no - frills accounts are dormant, primarily due to distance from bank branches, low financial literacy, and poor marketing by banks.

Mas Ignacio and Kabir Kumar (2008) find that branchless banking has emerged as a promising new approach to accelerate Financial Inclusion. A branchless banking channel using mobile phones could be far more preferable to poor people than the available options: travelling to and queuing at distant branches or saving in cash or physical assets.
Drabu, H.A. (2009) finds that in India, policymakers have for years been going around in circles with regard to the issue of inclusion. Be it growth with redistribution or redistribution with growth, priority sector lending, micro financing and now FI, people in India have been addressing the same issue since the mid-1970s.

Bhave, C.B. (2009) observes that inclusion is not about deciding things for people, it is about giving people a choice, giving people the power to decide for themselves and FI is not something that is to be done in the future. It has to be done now.

Minakshi Ramji (2009) identifies that the pressure on banks to serve low income customers is growing in developing countries. More than 1 in 10 countries already require financial institutions to offer basic bank accounts. Banks typically view these accounts as unprofitable and they have had mixed results so far as a tool of FI. Since the RBI introduced its policy to encourage ‘no-frills’ accounts in 2005, Indian public and private banks have opened 15.8 million accounts.

Sameer Kochaar (2009) finds that FI to promote growth, has to move from “opening an account” in the bank, to regular savings and finally to a relationship which enables the borrower to access loans on a regular basis.

Usha Thorat (2010) endorses the above view and observes that people in India believe that FI primarily implies access to a bank account backed by deposit insurance, access to affordable credit and the payment system.

Pranab Mukherjee (2010) exhorts that new financial sector initiatives in India – be it in the form of prompt and innovative policy responses from the Government and the Central bank, or be it in the form of implementation
efficiency and inventiveness from the varied players - need to explicitly prioritise both FI and financial education and literacy.

**Subha Rao (2010)** notes that an open and efficient society is always characterised by the unrestrained access to public goods and services. As banking services are in the nature of public goods, FI should be viewed as availability of banking and payment services to the entire population without discrimination of any type.

**Rajalakshmi et al. (2010)** illustrate that though a bank account is a pre requisite to be included, it is not sufficient. Besides, FI should provide access to credit, affordable insurance and remittance facilities, credit counseling and financial education. Having conducted a study, they observe that a measure of using financial services is the size of institutional debt outstanding for a household, rather than number of bank accounts. This study has reference to Rao (2007) who suggests that, the status of debt of households owed to institutional and non-institutional sources could be a barometer of FI.

**Chakraborthy, K.C. (2010)** finds that FI is sometimes treated as synonymous with rural poverty. Concerns of urban poverty also need to be factored in and the needs of various groups as rickshaw- pullers, construction workers, migrant workers etc, must be factored in and products and services crafted as per their needs by the banking system to address urban FI.

**Suniti Nagpurkar (2010)** conducted an empirical study in the city of Mumbai, among the urban poor, both migrants and non-migrants, to understand the banking exposure and banking outcomes among these sections of population. The study reports the difficulty in dealing with the bank staff and acknowledges that the banks on their part do not seem to be making an all out efforts to reach out to the urban poor.
Nageswara Rao (2010) states that the banking to the poor is not poor banking. FI is not always only social banking. There is lot of potential to get business from the people at the bottom. There is an urgent need for bottom-up approach in driving FI movement in the coming days.

2.4 Area of study - Measuring Financial Inclusion.

Measurement of FI implies, to evaluate the extent of accessibility, availability and usage of financial services like saving, credit, insurance, remittance facilities, among many other such services. The measurement aspect of FI has not extensively been covered by the literature. India, for instance, being a very well diversified economy and society, it is imperative to give adequate attention to measurement of FI by policy makers and researchers. An appropriate measure of FI has to be multi dimensional, since FI is a complex phenomenon having several dimensions. There are few scholars who have attempted to measure some aspects of FI.

Anjali Kumar (2005) finds that in recent years, there has been growing effort and interest in measuring FI but as yet, we have no globally consistent datasets that can give us a clear sense of how this proportion has changed over the past decade. However, evidence from countries like Brazil, South Africa, India, and Kenya strongly suggests that there has been an upward trend.

Beck et al. (2007) has attempted to measure the financial sector outreach and its determinants by using cross-country data. This study has used individual indicators separately to assess the extent of FI. Some of the indicators used in this study are number of bank accounts (per 1000 people), number of bank branches (per million people), number of ATMs (per million people), amount of bank credit and amount of bank deposits. These indicators, if used
individually, will provide only partial information on the inclusiveness of the financial system.

Hanohan Patrick (2007) estimated the fraction of the adult population using formal financial intermediaries, using the information on number of banking and MFI accounts for more than 160 countries and then correlated with inequality (Gini Coefficient) and poverty.

Mandira Sarma (2008) has developed a three dimensional Index of FI (IFI), incorporating information on three dimensions of FI, viz. accessibility, availability and usage of banking services. ‘IFI’ captures information on banking penetration, availability of services and usage of banking systems, in a single number lying between 0 and 1. Higher value of ‘IFI’ implies higher levels of FI. ‘0’ denotes complete FE and ‘1’ indicates complete FI. Using data on all three dimensions for 55 countries and using data on only two dimensions (availability and usage), for 100 countries, two sets of Index of FI (IFI) are computed. The study finds that, India’s position is 50th among 100 countries, with a low IFI value (0.170), and among 55 countries, India ranks 31st with an IFI value of 0.155. The author observes that, in India, in spite of low density of bank branches, the usage of the banking system in terms of volume of credit and deposit is moderately high. Sharma also states that in most of the studies with regard to FI, sectoral indicators have been used to assess the extent of FI/FE. Such indicators include the number of bank accounts (per 1000 adult persons), number of bank branches (per million people), number of ATMs (per million people), amount of bank credit and amount of bank deposits etc. Such indicators while used individually can lead to misleading understanding of the extent of FI in an economy.
World Bank (2008) provides a composite measure of access to financial services, the percentage of adult population that has an account with a financial intermediary for 51 countries.

Mehrotra et al. (2009) also built up an index for FI using aggregate indicators like number of rural offices, number of rural deposit accounts, volume of rural deposit and credit from banking data for sixteen major states of India.

World Bank (2009) in “Banking the Poor” analysed the association between access to banking services as measured by the number of bank accounts per thousand adults in each country and several other factors like transactions offered at banks or required by banks and regulations adopted by country authorities that may affect banking access for 45 countries.

Beck et al. (2009) have discussed about the availability of plentiful amount of data on many aspects of the financial system, but systematic indicators of inclusiveness of financial sector are lacking.

Vijay Mahajan and Suman Laskar (2009) have made an attempt to design a new model of measuring financial access. They observe, the limitation of the surveys being conducted in India, to measure the total number of citizens, who come under some sort of FI. They report that, the All India Debt and Investment Survey (AIDIS), being conducted by National Sample Survey Organisation (NSSO), is not comprehensive, which talks of credit and repayment only once in ten years. They propose, a once in two years, large scale national sample survey, to measure financial access, called “Indian Index of Financial Literacy, Inclusion, and Transactions” (IND - FLINT). They consider, three major parameters for its design i.e.; Financial Literacy, Financial Inclusion, and Financial Transaction. Financial literacy identifies the level of awareness of various financial services and products, offered by
various service providers. Financial inclusion gauges, the proximity to financial service outlets, likelihood of being able to fulfill conditions for use (such as address proof for bank accounts and age proof in case of insurance), suitability of products, transaction cost etc. Financial transaction, takes stock of level of user-ships, in terms of actual volumes, frequency, and number of products/services, repeat purchase and long usage. They claim that, a tool like ‘IND-FLINT’ would be of use, to the policy makers, media and consumer groups, to create a pressure on the system, to act towards increased FI and inclusive growth.

Most of the studies discussed above, used the financial depth measures (how much finance) rather than actual outreach or access measures (how many users). These studies cover availability and accessibility elements to a large extent and usage to a certain extent. They mainly use aggregate banking data, which provides information only for service provided by banks or other service providers. This set of information can be termed as supply side information, which is partial in nature. It has its own shortcomings; it does not distinguish between business and individual accounts, or between individual having multi - accounts, or on the adequacy and timeliness of loan amount, or information about informal service.

Chandan Kumar and Srijith Misra (2010) attempted to fill the above gap by analysing both supply and demand side information and providing a comprehensive picture of FI in India. They tried to measure and understand FI by looking at supply of (banking outreach indicators such as number of deposit and credit accounts, number of bank branches, average deposit and credit amount per account and credit utilised) and demand for (indicators of household level access such as the proportion of households having saving,
credit and insurance facilities) financial services. Using the household level data, it also analyses the role of informal sector vis-à-vis formal sector, particularly, with regard to credit. Separate composite FI Indices (FIIs) using both the data sets are calculated for the year 2002 - 03 (as the most recent household level data available is for 2002 - 03) for all the States/Union Territories of India and used as complementary to each other to get a comprehensive picture. While comparing the economic development of the state (in terms of per capita income) vis-à-vis the outreach of the banking services, it is observed that states like Goa, Delhi, Chandigarh, Pondicherry, Maharashtra, Kerala and Karnataka have performed better in both the parameters. This reflects a larger spread of services among people in the states which are better developed.

In outreach of financial services from banks, one observes wide disparity between rural and urban areas with the latter performing better in almost all the cases. Compared to other states, Pondicherry is performing better in rural areas but not in urban areas, whereas Kerala performs better in urban and poorly in rural areas. The relatively higher financial access in urban compared to rural areas is found in the states of Kerala, Goa, Punjab, Himachal Pradesh, Andaman, Tamil Nadu, Delhi and Maharashtra. The study provides completely different and very interesting story. The supply side analysis shows 0.674 deposit accounts per person. Surprisingly, demand side analysis also confirms the same with more than 55 per cent of households have saving facility that means either Kerala has fairly equally distributed services, or it has some other formal institutions other than banks for saving, like post - offices, co - operatives, MFIs, SHGs or some other formal sources. In case of credit accounts, demand side shows higher penetration than supply side, which also indicates the presence of other formal sources than the banks and RRBs. It seems more appealing when
analyse the rural sector of Kerala, where the supply side show poor performance and it stands at bottom in ranking for number of deposit and credit account and availability of bank branches, whereas demand side shows it as one of the top performer. This might be possible due to the presence of other formal sources thereby reducing its dependence on informal sources of credit. More interestingly, Kerala also has high demand of financial services from informal sources. The presence of informal sector in providing financial services is significant, especially in rural areas. The state-wise examination reveals that almost all the major states of India showed high dependence on informal sources for credit.

Nageswara Rao (2010) argues that a number of measures initiated by the Central Government and RBI, with regard to FI, are still to be implemented by various banks. He tries to find out the understanding of the ground level operating functionaries about FI, and suggests a suitable structure to implement FI, after conducting a study, with limited samples of 26 officials from different banks across the country. The study finds that, majority of the bankers are clear in the concept of FI, but, the banks should conduct awareness camps about FI and the staff should be made more aware of FI.

Satya, R. and Rupayan Pal (2010) made an attempt to construct an index for FI considering six attributes of FI: (a) demographic penetration, defined as the number of bank branches per 10 lakh people, (b) geographic penetration, defined as the number of bank branches per 1000 square - kilometer land area, (c) number of deposit accounts per 1000 people, (d) number of credit accounts per 1000 people, (e) deposits - income ratio, and (f) credit - income ratio They used data on these attributes for 24 states corresponding to the year 1991, 2001 and 2007. Comparing the computed financial index for 1991 and 2001, they find that the levels of FI in India have declined from the year 1991 to 2001.
The same is true also in most of the states. However, in India as well as in each of its states, the levels of FI have increased during 2001-2007.

**Chattopadhay (2011)** has developed the financial inclusion index for the major states in India and for all the districts in West Bengal.

**Karmakar, et al (2011)** has constructed the financial inclusion for rural areas of the major twenty states in India. They have considered number of rural outlets, number of accounts per outlet, per outlet deposit amount, per outlet credit amount and per account deposit amount as indicator of financial inclusion.

In order to assess the performance of the public sector banks, the Finance Minister of India has introduced Financial Inclusion Index, based on two criteria, namely, the number of additional branches covered and the number of new no frill account opened (**Government of India, 2011**)

**Ramapal and Rupaynalp (2012)** in their study find that increase of the proportion of households using formal financial services in a state need not necessarily reduce the inequality in FI across income groups or foster FI among the poor households in that state.

### 2.5 Area of study - Financial Inclusion and Informal Finance

In the literature, there is an increasing recognition of the role and strength of informal finance in meeting the credit requirements of small borrowers. The overwhelming view is that the informal sector responds remarkably well to the short term credit requirements of lower income people, and it allows them to access services not available from the formal institutions. Informal sector works in an environment, which is suited to the low income people. Both financier and borrower know each other by face and cultural
affinity creates the feeling of confidence in each other. Easy availability of money from the moneylenders often persuades people to borrow even for wasteful expenditures. As it is a costly borrowing and many of the borrowers do not have regular income to pay back, often the repayment obligation multiplies beyond their capacity, which leads to suicides, fleeing from houses or, ends up in clashes and physical fights. In general, there are many prejudices about money lenders and they are sometimes considered as ‘anti-social’ institutions. The main prejudices are, that: - (i) informal lenders exploit the clientele, (ii) informal credit is used in an unproductive way, and (iii) informal finance is not regulated and it may undermine monetary policy.

The literature suggests that, in developing economies, both formal and informal financiers continue to do business and over time, the role of informal financiers get reduced with the spread of more formal institutions. Once the poor have been provided access to adequate credit under the microfinance schemes, the monopoly of money lenders would be weakened. Ideally, the strategy to reduce the dependence on money lenders is to develop Micro Finance Institutions (MFIs) and SHGs and reviving the rural co-operative credit structure. In the long-run, the strategy of FI advocated by the RBI and implemented by the banks will be helpful in bringing down the role of moneylenders.

Bouman and Hospes (1994) argue that from the economic perspective, the services of informal lenders may not be efficient, as they usually charge prohibitive rate of interest. Hence, they cannot make efficient reallocation of resources throughout the economy and contribute to economic growth as in the case of formal finance.

Schrader, H. (1994) observes that in some of the areas of the state of Kerala, individual financiers from the neighboring state (Tamil Nadu) provide loans to
people belonging to lower strata of the society consisting of labourers, petty traders and unemployed at an interest rate of Rs.10 per Rs.100 for a month (120 per cent a year).

**Joshi, N.C. (1998)** comments that banking sector reforms have created grave problems in the rural credit. No serious attempts have been made by rural credit agencies in mobilising rural deposits and they failed to cater to the real needs of the rural people, especially the middle and poor class. So even now, the ordinary people are outside the orbit of the organised institutions and they are in the clutches of moneylenders.

**Pramod, K.M. (2004)** examines why the rural poor cannot access formal institutional credit and finds that it runs in terms of the asymmetry of information between the borrowers and urban based banks regarding the purpose of and the use of loan and the borrower’s intentions regarding the willingness to repay. This justifies the role of private informal money lenders who live in proximity to the borrowers and possess knowledge about their traits.

A survey conducted by the **Government of Kerala (2005)** revealed that the total number of registered money lenders in Kerala is estimated at around 5,700 and the number of unregistered firms is around 6,000, thus taking their total number to 12,000, which is quite high as compared to the number of branches of formal financial institutions. It indicates wider accessibility to the customers and the consequent high penetration rate. Population covered per money lender is estimated at 5,590 as against 9,431 per branch of commercial banks.

**Basu Priya (2005)** states that according to the NSSO’s Situation Assessment Survey (SAS) 2003, the share of institutional agencies in loans outstanding of
farm households in India, was only 57.7 per cent. On the other hand, informal agencies provided 42.3 per cent of the outstanding loans of farm households in 2003, as against 30.6 per cent in 1991-92. The share of money lenders in total dues of rural households has increased from 17.5 per cent in 1991 to 25.7 per cent in 2003 (NSSO 1998 and 2005). A Rural Finance Access Survey (RFAS) 2003, conducted by the World Bank (WB) and National Council of Applied Economic Research (NCAER), revealed that 79 per cent of the rural households had no access to credit from formal sources. It is in this context that RBI has taken measures for FI and constituted a technical group for review of legislations on money lending (RBI, 2006).

**Jeromi, P.D. (2007)** opines that despite the strong presence of formal financial institutions like commercial banks and co-operatives, in Kerala money lenders (informally known as ‘blade companies’) form an important segment of the financial sector of the state. He acknowledges that the total number of registered money lenders in Kerala is quite high as compared to the number of branches of formal financial institutions.

**Lathika, K.K. (2008)** finds that Kudumbashree units in Kerala pool the small savings of members in such a way that they resemble an ‘informal bank’, to cater to the member’s consumption contingent and occasion needs. These informal banks – SHGs - have emerged as a source to protect the small agriculturists, agricultural labourers and artisans from the clutches of money lenders.

**Financial Express (2008)** reports that in India, over 50 per cent of the labourers surveyed, indicated saving cash at home while simultaneously borrowing at high rates of interest from moneylenders.

**Isern Jennifer and Louis de Koker (2009)** find that in lesser developed economies, financial services are often provided informally through money
lenders, informal money transfer operators, unregistered community finance organisations and others. Low-income people often prefer to use informal financial services because of convenient locations, familiarity with the institutions and their services and often fewer restrictions (such as ID requirements).

Rajalakshmi Kamat et al. (2010) observe that even from the first All India Rural Credit Survey in 1954, it has been documented that the credit needs of the financially excluded households are met by the informal, non-institutional sources rather than formal institutions.

Shibi, Sebastian and Usha, Nandhini. (2010) state that India is one of the largest markets for microfinance. Presently the demand for micro credit loans in India is estimated at about Rs.600 billion, four- fifths of which is met by informal finance or moneylenders.

2.6 Area of study- Financial Inclusion through Micro Finance

The literature on microfinance provides, mixed results, with researchers reaching differing conclusions. The new microfinance literature highlights the gender by emphasising the role of women in the microfinance revolution. The term microfinance was formally employed in academic literature in the 1980s (Marguerite, S. Robinson 2001). Microfinance in India has emerged as a powerful tool for FI (NABARD, 2006). India has been experimenting with microfinance strategy in the form of SHGs as a part of formal credit delivery system since 1960s, giving lot of freedom to NGOs to set up SHGs on various models (Das et al. 2008).

Puhazhendi and Badatya (2000) report that SHG members experience an increase in self worth, communication skills and desire to protest social evils
as well as a decline in violence in their household, greater opportunities in
terms of access to more and better jobs in the future.

**Sneh Lata Tandon (2001)** observes that SHGs have emerged as a popular
method of working with people in the recent years. This movement stems
from the people’s desire to meet their needs and determine their own
destinies, through the principle of “by the people, for the people and of the
people.”

**Jaya, S. Anand (2002)** observes that SHGs can bring about drastic changes in
the lives of the poor. Delivering credit alone may not produce the desired
impact. A wider range of other supporting measures are critical to make the
impact strong and sustainable.

**Linda Mayoux (2002)** finds that women’s empowerment will also require the
participation of men in the process of change. In many organisations it will
require changes in organisational culture and structure. Unless these changes
are made, microfinance will fail to realise its full potential as part of a holistic
agenda for women’s empowerment.

**Abdullah, M.A. (2003)** reports that empowering women by adequately
facilitating them with better access to credit, advocating them to form a
networking, disseminating the knowledge of various schemes available,
enhances the potential and personality of women outside the household and
check the social issues of population growth, infanticide, dowry, family
planning, marriage age, widow remarriage, and freedom to utilise
opportunities.

**Gariyali and Vettivel (2004)** observe that micro credit became means for
women’s empowerment aimed at reducing poverty, promoting self
employment and development-based activities. Daring women, some credit and a sense of hope has in fact put the country’s rural poor in a self-reliant mode. From being perilously close to penury, women now laugh their ways to banks and feel secure.

Radha, G. Friedman (2005) finds that India is home to an extraordinary number of heterogeneous MFIs the greatest aggregation of which are in the southern states which can perhaps be attributed to the long history of Christian social welfare efforts in the region. The author argues that microfinance programs are not necessarily empowering for women clients, because: a) they increase women’s burden within the household; (b) the women do not control the loans but are instead forced to give them to a male in the household and are still held responsible for them; (c) their workloads increase in order to repay the debt; and/or (d) there is increased pressure on them from within the families, within the sangam (group), and from microfinance institution staff.

Manivel, A. (2005) states that women are no longer confined to three K’s, namely, Kitchen, Kid and Knitting, rather, they have come to assume the role of entrepreneurs in various non-traditional areas.

Singh, B. K. (2006) holds that by providing credit and savings facilities to women, it is expected that women will be economically independent through increase in income level and control over the use of income; women will get experience of the outside world and get access to outside markets; women’s contribution to household income and family welfare will be appreciated, and women’s participation in household decisions will increase, especially on how money will be spent.

Malcolm Harper (2006) articulates that “India has varied, fast-growing standard Grameen groups and it has SHGs and then joint liability groups
(JLGs) and it has a massive branch banking network offering individual accounts to people who need and are ready for them. But people used to say—and I also used to say—that Indians should learn from elsewhere. And I’m hearing lots of people from elsewhere saying now that they can learn from India, which is great.”

**Devendra Prasad Pandey (2007)** finds that Indian model of microfinance offers greater promise and potential to address poverty as it is focused on building social capital through providing access to financial services through linking with the mainstream.

**Amudha Rani (2007)** reports that giving loans to poor women through SHGs is a beginning in their journey for economic emancipation and empowerment. The micro-credit, especially to women is a notion that mixes ‘ethics’ with ‘economics’ and is a socially conscious program.

**Abraham Punnoose (2007)** finds that the empowerment of women covers both individual and collective transformation. Empowerment through SHG would lead to benefits not only to the individual woman but also to the family and community as a whole, through collective action for development. It is not just for meeting their economic needs but to create more holistic social development.

**Swain and Nayak (2008)** find that the failure of the formal credit institutions in meeting the credit needs of the rural poor has been the major reason for the innovation in the micro financing. In order to improve the standard of living of the poor and the downtrodden, the concept of micro-finance has been initiated. Different organs of the society with appropriate mechanisms can look towards the SHGs as a tool for improving the quality of life in rural India.
Patra, S. (2008) states that the biggest challenge to any civilised society is the economic deprivation of the poor. The most potential tool against human deprivation is building of human capital among the deprived. Self realisation and self-initiatives are the two weapons to wash poverty out of the map. Microcredit or micro finance has been widely recognised as a key strategy for poverty alleviation and economic empowerment.

Duraisami, A. (2008) finds that the concept of SHG was the essence of Gandhian Sarvodaya, which aims at “Gram Swaraj,” which means ‘of the people, by the people and for the people’. It is the essence of the Co-operative Movement under the broad principle, “all for all”. Large size of co-operatives, their heterogeneous member’s characteristics, high political influence, intervention by the Government on their autonomy, and many other factors had not yielded the desired results, and thus paved the way for the concept of Self Help Group, as a viable alternative for sustained rural development.

Edward Luce (2008) insists that perhaps microfinance has an unusually important role to play in India that it would not in a country that has large industries demanding low-skilled labour. Critics of microfinance have suggested that micro-lending is not a powerful tool in increasing the speed of economic development. However, taking a loan out to invest in improving the agricultural productivity, starting a small shop or investing in the children’s education, so that they might take part in the knowledge economy is the best of a bad set of options for the Indian poor.

Prusty, R.R. (2008) finds that despite more than five decades of interventions to raise the status of women since Independence, women in rural areas continue to be overwhelmed by social and economic bosses. Rural women throughout India, irrespective of caste and religion, continue to have a
subordinate status both within home and outside. He opines that the extent of awareness and access to credit, higher levels of education and training are the prime determinants of women’s status and role in the process of development.

**Pati and Lyngdoh (2008)** observe that Microfinance alone cannot contribute fully towards women empowerment. Economic empowerment is not the only measure that leads to women empowerment. Microfinance intervention measures should be webbed with other developmental schemes and the focus should be on personality development and not economic aspects alone. The male folk should be made a part of the mix.

**Lathika, K.K. (2008)** finds that very often, the assistance aimed at the poor fail to hit the target due to the absence of proper identification machinery. Kudumbashree efforts have proved to be a welcome measure to suit the purpose. The small savings of members are pooled in such a way that they resemble an ‘informal bank’, to cater to the member’s consumption contingent and occasion needs. These informal banks – SHGs - have emerged as a source to protect the small agriculturists, agricultural labourers and artisans from the clutches of money lenders.

**Vijay Mahajan (2008)** one of the pioneers of micro finance in India and the founder of Basix, India’s best known MFI endorses, after an impact assessment study carried out at Basix, 6 years after its inception that the impact of micro credit is limited. The majority of micro credit loans are taken for consumption. Only a minority is taken for business.

**Dhar, S.N. (2009)** emphasises that the speed with which the microfinance movement took off in India in the early nineties and the short span in which it gained maturity is unparalleled. Most of the microfinance programs operate on
the principle of ‘Borrower knows the best’ and shifts the focus from individual to group approach as Self Help groups (SHGs).

Venkateshmurthy and Dinesh (2010) observe that SHGs, a means of reaching rural women with savings and credit services have taken off dramatically in India. Their benefits are social as well as economic. SHGs encourage women to become active in village affairs or take action against domestic violence, the dowry system or the lack of schools. The SHGs foster an entrepreneurial culture where each member realises that she needs the support of the group to achieve her objectives. The SHGs provide a firm base for dialogue and co-operation in programmes with other agencies/organisations. SHGs help women to improve their socio-economic status which leads to economic empowerment.

Panigrahi, S. (2010) attempts to analyse the progress of SHG - Bank Linkage Program (SBLP) of NABARD in rural India. The author observes that in India, SBLP have come a long way since 1992, passing through the stages of pilot (1992-95), mainstreaming (1995-98), Expansion phase (1998 onwards) and has emerged as the biggest microfinance programs in terms of outreaching linking 61.21 lakh groups by March 31, 2009; enabling an estimated 8.60 crores poor people to gain access to formal banking system.

Subrahmanyan, N. (2010) analysing the data, on the number of SHG linked with banks, bank loan disbursed and refinance provided by NABARD to primary lending institutions which provided credit to SHGs, for the years 2003 - 2007 finds that, significant development has been taken place in southern states such as, Andhra Pradesh, Karnataka, Kerala, Tamil Nadu and the Union Territory of Pondicherry, which are referred to as ‘SHG-developed states’. 
Raghuwanshi, D.B. (2010) reports that with regard to various components of microfinance related services, demand for savings service is higher than demand for credit services. Quoting World Bank reports, he states that the Indian microfinance activity currently reaches only 4 per cent of the poor which shows that despite the rapid growth in the past few years, the supply of credit is below the demand.

Rasure, K.A. (2011) inscribes that in the last three decades, Micro Finance has mushroomed from Grammeen’s tiny non-profit experiment in Bangladesh to a global industry. Many enthusiasts believe that MF is an important tool in the efforts to end world poverty. Whether they are right is still open to question.

2.7 Conclusion

For achieving long term sustainability of economic growth, bringing in the benefits of growth to all sections of the population is critical. This is possible only by way of FI. FI is a conscious attempt to bring the un-banked people into banking and financial services are made accessible to all sections of the population. The rural poor are denied satisfactory services by the formal financial sector in our country. Most of the time, the poorest of the poor is deprived of credit due to absence of adequate and suitable collaterals. Besides, the poor need credit in small doses frequently and that should be made available when it is needed the most. Hence, the access to credit by the rural poor is very much limited. The informal sector responds remarkably well to the short term credit requirements of lower income people. Informal sector works in an environment which is suited to the low income people. The strategy to reduce the dependence on money lenders is to develop Micro Finance Institutions (MFIs) and SHGs and reviving the rural co-operative
credit structure. Microfinance through SHGs is a novel way of reaching the rural people. In this attempt, Co-operative institutions have a vital role to play. They are regarded as ideal agencies for carrying out the message of microfinance in the rural areas, because of their vast number and maximum outreach.

Research Gap

Despite the growing recognition of the incidence of the financial exclusion of the sizeable population in developed and developing countries, the subject matter of FI has not attracted attention of the researchers to the extent it deserves, particularly in Kerala. The Indian literature on FI mainly comprises a detailed sketch of the proactive measures of the RBI for FI supplemented by a number of writings on the policies on rural finances and credit performance including the nature of farmer’s indebtedness in the social banking framework. Majority of the available literature on FI is confined to the way in which Micro Finance and MFIs function in various states of India. A few studies attempt to measure the FI at the macro level using country specific Financial Inclusion Index (FII), resulting in a dearth of studies at micro level. Most of the studies on FI are based on secondary data, which give only a macro picture. It does not bring into limelight, various aspects of FI, such as the nature of Awareness, Availability, Access, Affordability and Appropriation of financial products and services at micro level, for a proper assessment and understanding of FI/FE among the poor. Such insights can only be gained from a primary survey incorporating state specificities. Also, it is seen that only a limited number of studies have been undertaken in the State of Kerala with regard to FI, especially the role of co-operatives in FI. The present Study on the Role of District Co-operative Banks in the Financial Inclusion in Kerala is an attempt in this direction.
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Chapter 2


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Review of Literature


