This chapter provides the theoretical basis for the concept of Financial Exclusion. It will discuss the emergence of Financial Exclusion from debates about poverty and social exclusion more broadly. The concept of poverty forms the origin of this discussion. From a narrow understanding of poverty as a lack of material resources sufficient to guarantee one’s subsistence, to the much wider concept of social exclusion has developed. In the broadest sense this refers to exclusion as nonparticipation in society. Literature on Financial Exclusion has defined it in the context of a larger issue of Social Exclusion of certain groups of people from the mainstream of the society. Social exclusion is another facet of exclusion - which is about more than Financial Exclusion. FI may be all about money and finance, but it must be with the ultimate objective of abolishing the state of social exclusion. FI can truly lift the financial condition and standards of life of the poor and the disadvantaged.

3.1 The Concept of Poverty

Poverty is a contested concept: there is not a single, correct, scientific agreed definition (Alcock, 2006). In the theoretical tradition, poverty is understood in terms of distributional issues: the lack of resources at the disposal of an individual or household to ensure a suitable standard of
subsistence or living (Barnes, 2005). Rowntree (2000) defines an absolute measure of poverty. According to him, individuals or households are understood to be in poverty, if their total earnings are insufficient to obtain the minimum necessaries for the maintenance of mere physical efficiency. This definition of absolute poverty attempts to define minimum standards of living which everyone ought to have regardless of the country he or she lives in. This is also endorsed by the Copenhagen World Summit on Social Development (United Nations, 1995). Here, poverty is understood as a condition characterised by severe deprivation of basic human needs including food, safe drinking water, sanitation facilities, health, shelter, education and information. It depends not only on income but also on access to services.

Although the maintenance of physical efficiency is of relevance for much of the population in developing countries, it is less applicable as a concept to the population of developed societies, who generally enjoy greater standards of living than residents of developing nations, but may experience disadvantage in terms of social or cultural needs (Barnes, 2005). There are certain norms in each society under which people are expected to live and the needs of individuals vary according to location and circumstances. For example, what one regards as shelter or adequate diet greatly depends on the resources available, the climate or the kind of customs in society. Lister (2004) and Spicker (2007) challenge absolute definitions of poverty. They suggest that absolute elements of poverty such as the type of food and shelter needed to maintain physical efficiency are in fact subject to social norms and customs and as such can be interpreted in different ways in different places and by different people. Poverty is thus a relative concept which needs to be understood in the context of a given society rather than in fixed terms.
As early as 1776, Adam Smith commented: “By necessaries I understand, not only the commodities which are indispensably necessary for the support of life, but whatever the custom of the country renders it indecent for creditable people even of the lowest order to be without.” (Townsend, 1979). Townsend defines poverty as ‘relative deprivation’. “Individuals, families and groups in the population can be said to be in poverty when they lack the resources to obtain the types of diet, participate in the activities and have the living conditions and amenities which are customary or at least widely encouraged or approved in the societies to which they belong. Their resources are so seriously below those commanded by the average individual or family that they are in effect excluded from ordinary living patterns, customs and activities”.

Oppenheim and Harker (1996), note that low income causes lack of participation in key activities in social life not only in terms of physical needs but also in terms of taking part in social and cultural customs. Thus, both absolute and relative concepts focus on a wide range of dimensions of non-participation that go beyond physical needs and consider a range of processes that lead to exclusion other than material deprivation. The similarities between the two concepts seem to suggest that social exclusion in many ways is simply a new label for ‘deprivation’ or ‘poverty’.

3.2 The Concept of Social Exclusion

Financial exclusion is deeply interrelated with social exclusion: when social exclusion automatically leads to financial exclusion, financial exclusion is considered as belonging to a process that reinforces the risk of social exclusion. Social exclusion means being unable to access the things in life that most of the society takes for granted. People who are socially excluded are
more economically and socially vulnerable and hence they tend to have diminished life experiences. It describes a process by which certain groups are systematically disadvantaged because they are discriminated - on the basis of their ethnicity, race, religion, sexual orientation, gender, disability, HIV status etc.

Social exclusion is about more than income poverty. Social exclusion is the cumulative marginalisation from production, from consumption, from social networks (community, family and neighbours) and decision making. As social exclusion denies opportunities and rights to the disadvantaged, it is often the cause for poverty and conflict. Being excluded from service provision including financial services has become increasingly recognised to be one of the processes that lead to social exclusion. Social exclusion is about participation in the larger society.

In sociology, the term social exclusion is used to describe both a situation and a process. In industrial economics, the word exclusion is often used to describe the process. As a process, it focuses on how social and economic forces operate to accentuate or diminish the exclusion of individuals or groups from livelihood or rights which are the basic source of well being. Markets also play an important role in exclusion. In market economy, economic stratification - a process which distributes the benefits of economic growth by integrating some and marginalising others - is inherent.

The coining of social exclusion in the modern discourse about social exclusion is generally attributed to René Lenoir’s publication *Les Exclus* (1974), though an earlier reference to social exclusion was made in Jean Klanfer’s *L’Exclusion Sociale* (1965). Central to the notion of social exclusion as it originated in France is the Republican idea of social solidarity which
emphasises the role of the state to provide assistance to citizens (Beland, 2007). The Greek Philosopher, Aristotle and the Scottish political economist and philosopher, Adam Smith explored some of the concepts contained in social exclusion (Although, Lenoir coined the term, the idea is not new). Both of these thinkers linked exclusion to a lack of individual choice or freedom to make choices. In Aristotle’s view, an impoverished life is one without the freedom to undertake important activities of choice. Smith defined the freedom to live a non-impoverished life as “the ability to appear in public without shame,” is a good example of a capability deprivation which takes the form of social exclusion.

Amartya Sen (2000), has identified two categories of social exclusion: (1) **Active Social exclusion** - something promulgated by law or by pronouncement such as not allowing a group of people because of ethnicity or some other defining reason to participate in a political process (it is an elite form of exclusion), (2) **Passive Social exclusion** - Something that comes about through social processes such as poverty or isolation. Because of a sluggish economy or financial crisis he or she may not be able to afford it and therefore be excluded. Asian Development Bank (ADB) has set out six examples of both active and passive exclusions. (i) Poverty - passive, (ii) Exclusion from the labour market - active, (iii) Credit market exclusion - active, (iv) Gender related exclusion - active/passive, depending upon the country, (v) Health care - passive, (vi) Food market and poverty - active/passive.

Social exclusion draws attention to the failure by the state in including all social groups with significant consequences for the social cohesion and social solidarity of society as a whole. Later, its understanding shifted to emphasise the right of social citizenship. The concept of the right of
citizenship is based on three parts or elements of citizenship: Civil (equal rights to individual freedom and justice), Political (equal rights to participate in the exercise of political power) and Social (equal rights to a minimum standard of economic welfare and security, opportunity to make choices) (Lister, 2000). This concept is extended by Rogaly (1999), in terms of ‘economic citizenship’ or lack of access to paid and unpaid work which also encompasses access to financial services and financial literacy.

The concept of social exclusion is thus much more focused on processes and on looking for an explanation of exclusion not in the behaviour of the excluded themselves but in the wider processes that are at large in society. This led to an identification of multiple processes or dimensions of exclusion such as exclusion from the financial system - Financial Exclusion.

### 3.2.1 Dimensions of Social Exclusion

Social exclusion is a dynamic process and encompasses several dimensions. Social exclusion is a broader concept than poverty, encompassing not only low material means but the inability to participate effectively in economic, social, political, and cultural life and in some characterisation, alienation and distance from the mainstream society (Walker, A. 1997). Social exclusion is non-participation ‘in the normal activities of citizens’ (Burchardt, et al., 1999). This is based on the notion of participation in five types of activities: (i) **Consumption activity** – to be able to consume the minimum level of goods and services that are perceived as normal for society; (ii) **Savings activity** – includes assets such as home ownership, savings and private pension provision; (iii) **Production activity** – being engaged in economically or socially valued activity such as paid employment, caring responsibility and retirement; (iv) **Political activity** - being engaged in
collective activities that benefit the individual’s immediate or wider social and physical environment; and (v) **Social activity** – includes social interactions with family and friends.

Researchers look at the phenomenon of social exclusion in different ways. While some refer to social exclusion in terms of non-participation and examine the different kind of activities from which people are excluded, others concentrate on the different aspects of exclusion which lead to non-participation, for example; low income. In other words, while some concentrate on the outcomes of social exclusion, others refer to social exclusion in terms of processes. Exclusion is hence ‘both a process and a state which enshrines a lack of integration’ (Gloukoviezoff, 2007).

Social exclusion is a dynamic concept: people move in and out of social exclusion and are affected by different dimensions of the phenomenon over time. Despite its dynamic character, social exclusion on various dimensions can be a persistent experience for some. Therefore, one could argue that for the minority of people who experience exclusion over a long period of time, this can be a state or a way of living. Nevertheless, to say that social exclusion is static, denies people the possibility of change. An individual is socially excluded if (a) he or she is geographically resident in a society, but (b) for reasons beyond his or her control, he or she cannot participate in the normal activities of citizens in that society and he or she would like to participate (Burchardt, et al. 1999). This refers to people as being excluded only if, they do want to participate but are denied participation and so exclusion is beyond their control. Conversely, those who do not participate in the normal activities of citizens’ and do so voluntarily are not socially excluded. In this context, Levitas (2006), points out that: ‘whatever people say about not wanting to
participate in or not being interested in a particular activity low income restricts participation’.

Research demonstrates that most acts of nonparticipation are involuntary or cause distress to the individual in some ways or another. In this context, lack of disposable income or poverty is understood to be a major contributory factor to social exclusion. For example, poverty can reduce people’s capacity to partake in social life and reduce the number of social contacts they have.

The arguments presented in the literature suggest that choices are often restricted and thus acts of exclusion are not truly voluntary. In these cases, non-participation in an activity can be regarded as a case of social exclusion. Although there are some arguments in the literature for treating all acts of non-participation as ‘socially problematic’ and thus cases of social exclusion, since they violate social solidarity and can create inequality of opportunity, individuals are active agents in shaping their own trajectory.

The notion of individual choice and action is also central to contemporary theories of social exclusion. Socially excluded people are therefore not just passive citizens who are denied participation. What is important is that individuals are able to choose amongst a wide range of feasible options and make informed decisions. Here, what is missing is individuals’ inability to participate effectively in economic, social, political and cultural activities, due to their distance from the financial mainstream - i.e. Financial Exclusion.

3.3 The Concept of Financial Exclusion

The literature has identified FE as reflection of a broader problem of social exclusion. FE is a relatively new concept. The term FE was first coined
in 1993, by geographers who were concerned about limited physical access to banking services as a result of bank branch closures (Leyshon and Thrift, 1995). It was in 1999, that the term FE seems first to have been used in a broader sense to refer to people who have constrained access to mainstream financial services (Kempson and Whyley, 1999).

Three types of financial services are identified in the literature (Sinclair, 2001). (i) **Transmission services** - allowing receipt and transfer of money and cheques (banking services); (ii) **Protective services** – offer long-term and medium-term financial security and protection against fluctuations in income and expenditure (life assurance, private pension provisions, home contents insurance, savings and credit); and, (iii) **Promotional services** - facilitate autonomy and enable individuals to promote themselves (e.g. loans for starting up micro-enterprises). World Bank has identified four key areas of Financial Exclusion; – Transaction banking; – Savings; – Credit; – Insurance. The need for these services however, varies. Exclusion from each of the areas above has various implications both for individuals and for society as a whole.

FE is defined both as a state and a process. In the narrow sense, FE refers to the exclusion from certain financial products and services, while more broadly, it describes the processes which have the effect of shutting out the less well off from mainstream money services (Sinclair, 2001). On the individual level, FE creates difficulties with regard to day-to-day personal money management, longer and medium-term financial security and purchasing consumer goods (Kempson and Whyley, 1999). Banking exclusion is then more dynamic with households suspending or closing down accounts when circumstances change particularly in case of unemployment. There is ample evidence that FE is both a dynamic and multidimensional concept.
3.3.1 Dimensions of Financial Exclusion

3.3.1.1 Access Exclusion/Banking Exclusion.

The access to a bank account is seen as a universal need in most of the developed as well as developing nations. Access to a bank account facilitates – storing money safely until it needs to be withdrawn; availing of credit; converting cheques into cash; receiving payments of funds such as salaries, pensions or social assistance (electronically); paying for goods and services other than in cash; paying bills electronically; making remittances etc. Though, it is not enough to have access to a bank account to be qualified as financially included, the lack of access to banking has such bad effects that social inclusion will be effectively damaged due to the following factors:

1) It is the basic and generalised financial provision.
2) It is a key to access other financial services (credit/savings)
3) Lack of a bank account may give an opportunity to unfair provisions to grow and may consequently increase risk of poverty.
4) It becomes more difficult and expensive for people who can pay only in cash, with more risk of being stolen.

3.3.1.2 Savings Exclusion.

With regard to savings exclusion, some social problems have been identified in the literature. They are associated with lack of identification documents and lack of advantage brought by a deposit account due to costs, fees and/or complexity of the procedures. For various reasons, the people may not have deposits. These include:

1) Lack of money to save (due to low income/no job)
2) Lack of habit to save money in a bank.
3) Unwilling to deal with the banks due to negative past experience or prejudice.

Thus, lack of deposit is more often a consequence than a cause of social problems. As opposed to saving money informally or at home, having savings is considered to have an independent effect on individuals’ life chances and thus social inclusion. Having some savings give a sense of empowerment and control as well as a sense of security (Harvey, et al. 2007). FI strategy aims to improve individual’s wealth and financial well-being through building up savings and assets. Theorem of asset-based welfare argues that the ownership of assets constitutes an important part of individuals’ well-being and is a key element of poverty eradication. The evaluations of financial education projects in England and Wales and Scotland report that financial education had an impact on respondents’ financial knowledge and behaviour including a greater understanding of saving strategies, ability to budget and save ((Nicole Lederle, 2009). Improving people’s financial situation and their ability to save might achieve better outcomes in terms of savings inclusion.

3.3.1.3 Credit Exclusion

Credit is a major financial tool to enable access to goods or expenditures that oversize the monthly budgets. It may play a significant role to smooth consumption and to protect against income shocks. Lack of access or use of this financial provision may impact social inclusion in many ways (European Commission, 2008). The concern for the credit aspect of FE stems mainly from the apparent exclusion of low-income households from affordable sources of credit. Without access to mainstream credit or alternative (affordable) credit options, people may resort to borrow from lenders that operate at the lower end of the credit market or illegal moneylenders. Lack of
access to affordable credit options is identified as a contributory factor to debt problems. It is not only the costs of illegal credit that causes concern but also the lending practices of some of these lenders which lead clients into more debt thereby creating and perpetuating a cycle of borrowing and indebtedness. Consequently, low-income consumers seek access to an appropriate source of borrowing to prevent future financial difficulties.

In India, scores of demand side factors such as inadequate human capital, skewed distribution of land including lack of proper land reforms, presence of large section of landless labourers, poor state of physical infrastructure (road, bridges, irrigation structures, market yards, cold storages), underdeveloped social capital (Gram Panchayats, local administration, commodity co-operatives, etc), low productivity leading to low level of profitability, poor linkages, poor risk mitigation mechanism, etc., have adverse effects on the expansion of coverage of institutional credit (Rangarajan Committee, 2008).

3.3.1.4 Financial Service Exclusion

The need for financial services and the difficulty of some individuals with accessing financial products have been increasingly recognised in the literature as a concept in recent years. Alongside the dimensions of social exclusion that are widely acknowledged in social exclusion literature survey, includes service exclusion as one aspect of social exclusion. This refers to the non-use of financial services including insurance, because of their unavailability or costs. Lack of availability rather than lack of affordability is the main barrier to using financial services. This indicates that service exclusion is a phenomenon that impacts on the collective rather than the individual level with services being unavailable to some sections of society or in some areas. Service exclusion in this respect plays a central role in processes of social exclusion.
Supply of services does not imply access neither does access entail use of a service; hence service exclusion needs to be understood as a spectrum with unrestricted use of services at one end and non-use (total exclusion) at the other. Thus, service exclusion has consequences for individuals’ social and economic life. In the Indian context, both supply side and demand side barriers have both been recognised as responsible for low level of access to financial services. Supply side constraints like poor banking infrastructure, low resource base of credit purveying institutions, security based lending procedures, lengthy and cumbersome formalities, low level of financial literacy, etc., are still dominant in the sector. Nowadays some kinds of insurance are essential in the organisation of modern societies and some of them are therefore mandatory (for example: those for the use of motor vehicles, or to carry on some kind of jobs). However, there is no clear definition of which types of insurance are considered essential so that anyone who lacks them might be considered financially excluded

3.3.1.5 Information Exclusion

The process of spatial withdrawal of mainstream financial institutions is reflected by a process of information exclusion and isolation of areas where less affluent customers are concentrated. Those included in the financial system become more informed in financial terms and well-educated, which enable them to make informed financial decisions, while those left outside become more distanced from the financial sphere. This results in a clear divide in information provision for different types of customers (Kempson and Jones, 2000). As a consequence, financially excluded people find it even more difficult to become included in the financial system since they do not know what services are available or how to access them. They are fatally handicapped as they live in both financial and information exclusions.
Similar to geographic exclusion and social distancing, lack of information about financial products is likely to further increase psychological barriers and encourage the view of disadvantaged that certain financial services are not available to them (Kempson and Whitley, 1999). In addition, the population has become increasingly polarised with respect to accessing the electronic economy (Pahl, 1999). In this context, those on low incomes (credit poor) not in employment, in low-paid work or retired (work poor) and a lack of understanding of the new financial system (information poor) are least likely to participate in the cashless society (e.g. credit cards, internet and telephone banking). This is fuelled by lower levels of access to the internet among this group. Therefore, while these new developments particularly internet and telephone banking mean that money can be accessed without physical contact with the banking branch network, people living in areas most likely to be affected by geographic exclusion are least likely to take advantage of these changes.

In this context, new entrants such as mobile phone banking may offer alternative means of becoming engaged in the financial system. Although the role of financial institutions in distributing information is crucial in explaining information exclusion amongst some consumers, customers also play an active role in this process. Researchers emphasise that people need to be able to make effective use of financial products in terms of financial literacy and capability. FI and financial literacy are the two pillars. Financial literacy stimulates the demand side - making people aware of what they can and should demand. FI acts from the supply side - providing in the financial market what people demand.

Without being financially literate and capable, households can be locked in a cycle of poverty and exclusion or suffer as a result of inappropriate
product choice, high cost credit or for some illegal money lending (Hayton et al. 2007). In terms of financial literacy, this means that individuals and households need to have knowledge of sources of credit and an understanding of basic financial terminology. The well informed customers are the most valuable assets for the banks.

**3.3.1.6 Self Exclusion/Use Exclusion and Mistrust of Banks**

People with basic bank account may be reluctant to use their account because of the imposition of charges which can contribute to financial difficulties or because of mistrust of banks. Alongside the issues of access, other forms of exclusion can influence people’s perceptions about mainstream financial service providers. Living at a distance from branches may not directly prevent people from opening an account but the geographic distance of financial service providers can create a psychological barrier since people feel that financial services are not for them and that banks are reluctant to do business with them (Kempson and Whyley, 1999). These feelings of mistrust of mainstream financial institutions are widespread among people who are largely excluded from the financial system.

Mistrust of banks is one of the factors which explain why individuals might not want to access or use mainstream financial products. This puts exclusion from the financial system into a different light since it suggests that some consumers prefer not to be included for one reason or another. Feeling of mistrust may be based on actual individual experience or by the experience of friends, family or neighbours or negative media coverage of mainstream financial service provision. FI can be seen as a basic human right, for example: in France, it gives citizens the right to have a bank account. This may be the indicator of the degree of financialisation of social relations. A degree of
choice exists in deciding which type of transaction services people want to use (ranging from very basic services to more sophisticated banking products) and how they want to use available products (e.g. use of automated banking). This diversity with respect to accessing and using banking products is widely acknowledged in the literature (Speak and Graham, 2000).

Choice or personal preferences also play a role in explaining (non-) access to other types of financial services. Researchers note that some people choose to remain without these services like insurance because they feel they do not need it or have a greater readiness to assume risk. Although, consumer credit can be seen as an essential service to smooth consumption when income or expenditure change, research notes that some people are clearly averse to borrowing and make a free and unconstrained choice not to use credit or people prefer to use a particular source of credit while other sources may be available.

Research offers ample evidence on the barriers that financially excluded individuals experience and which prevent FI. The question remains, whether, those who freely decide not to engage with the financial system in some way or another, should be included in the definition of FE. In this case, people’s choice needs to be accepted as genuine and hence, not as an act of FE (Devlin, 2005). People may simply have no need for, say, a personal loan and cannot be considered as excluded from such a market if not using that product. However, it is not known, if people would be denied access should they approach a bank for credit or other financial services. In practical terms, however, FE is generally discussed in the context of imposed exclusion rather than ‘self’ exclusion’ by choice. Although, there is the possibility of voluntary financial exclusion, most people will in fact experience barriers to inclusion rather than making an unconstrained choice of self- exclusion.
3.3.2 Degrees of Financial Exclusion

FE is multi-faceted with different degrees of exclusion being identified. Larger numbers of households are marginally included having only one or two financial products in comparison to a minority of households that are without any mainstream financial products. With respect to low levels of utilisation of banking services, the term ‘under banked’ is also used as opposed to being ‘unbanked’ or without any kind of banking service across a wide range of financial products and services and levels of utilisation. People’s level of engagement with specific financial products as well as level of access varies.

3.3.3 Causes of Financial Exclusion

The Causes of FE can be broadly classified into two categories, viz. demand side barriers and the supply side barriers.

A. Demand Side Barriers

The people who have the requirement but still not demanding/availing the financial services/products can be due to the following reasons:

1. Low Income: A higher share of population below the poverty line results in lower demand for financial services as the poor may not have savings to place as deposit in savings banks. Hence the market lacks incentives in providing financial service/products.

Most of the people belonging to financially excluded group are having irregular/seasonal income. Hence opening of a bank account and operating it i.e. deposit and withdrawal in very small denominations with high frequency will increase the cost of transaction. They also anticipate that bank will refuse if they transact with so small amount. Likewise, as they have low earning they cannot maintain minimum balance
requirements of a normal saving bank account and various annual maintenance charges (AMC) levied by banks.

2. **Transaction Cost**: Vast number of rural population resides in small villages which are often located in remote areas devoid of financial services. Consequently, the overall transaction cost to the customer in terms of both time and money proves to be a major restraint for visiting financial institutions. The excluded section of the society find informal sector more reachable due to proximity and ease of transaction.

3. **Financial Services Being Very Complex In Nature**: Excluded sections of the society find dealing with organised financial sector burdensome.

4. **Easy Access to Alternative Credit**: For a good amount of low income people, the alternative credit provided by the money lenders and private banks are far more attractive and hassle free compared to getting a loan from a commercial bank. Some of the poor that do not have property find it impossible to get credit without the collateral. The uneducated poor would rather put their trust in moneylenders who provide easy non-collateral credit than on the well established commercial banks. There might also be cultural reasons for trusting a moneylender rather than a bank. Distance from bank branch, branch timings, cumbersome documentation/procedures, unsuitable products, language, staff attitude etc: are common reasons.

5. **Low Literacy Level**: The lack of financial awareness about the benefits of the banking and also illiteracy act as stumbling blocks to FI. Lack of financial awareness maybe the single most risk in FI as those who are newly included in the financial sector have to maintain within the formal financial sector.
6. **Legal Identity:** Lack of legal identities like identity cards, birth certificates or written records often exclude women, ethnic minorities, economic and political refugees and migrant workers from accessing financial services.

7. **Sophisticated Financial Terminologies:** Bankers often use complex financial terminologies which the masses are unable to comprehend and hence do not approach for financial services voluntarily.

8. **Terms and Conditions:** Terms and conditions attached to products such as minimum balance requirements and conditions relating to the use of accounts, as in the case of saving bank account often dissuade people from using such products/services. The terms and conditions and its framework is generally so tedious and detailed that understanding it is not possible for those who cannot write their name or are less literate and do not understand English or Hindi (in case of some regional rural areas).

9. **Psychological and Cultural Barriers:** The feeling that banks are not interested to look into their cause has led to self-exclusion for many of the low income groups. However, cultural and religious barriers to banking have also been observed in some of the countries.

10. **Disincentives for the Consumer:** The cost of maintaining an account (non-zero balance accounts) and procedural problems in accessing formal credit act as disincentives for consumers with weaker financial background. The bank would rather give smaller number of large credits to middle and upper class individuals and institutions due to the lower cost involved in banking with them. The banks and other financial service firms have fewer financial products which are attractive to the poor and the socially disadvantaged. All these act against the interest of a consumer from a poor background.
B. Supply Side Barriers

Some of the important causes of relatively low extension of institutional credit in the rural areas are risk perception, cost of its assessment and management, lack of rural infrastructure and vast geographical spread of the rural areas with more than half a million villages some sparsely populated.

1. Perception among Banks about Rural Population: Generally, there exists a perception among banks that large number of rural population is unbankable, as their capacity to save is limited. Therefore, they do not look favourably at small loans often required by marginalised section. Such loans are considered to be non-productive.

2. Miniscule Margin in Handling Small Transactions: As the majority of rural population resides in small villages that too in remote areas, banks find small transactions cost ineffective.

3. KYC Requirements: The ‘Know Your Customer’ (KYC) requirements of independent documentary proof of identity and address can be a very important barrier in having a bank account, especially for migrants and slum dwellers.

4. Unsuitable Products: One of the most important reasons for the majority of rural population not approaching the formal sector for financial services is the unsuitability of products and services being offered to them. For example, most of their credit needs are in the form of small lump sums and banks are reluctant to give small amounts of loan at frequent intervals. Consequently, they have to resort to borrowing money from moneylenders at exorbitant rates.

5. Staff Attitude: As public sector banks (PSBs) cater to more than 70 percent of banked population and about 90 per cent of rural banked
population, a majority of staffs in these PSBs remain insensitive to the needs of customers and shirk away from duty. The situation is even worse in rural branches where they behave with rural poor in a lofty manner.

6. **Poor Market Linkage:** It is often argued that we may have been growing second fastest in the world but still - 75 percent of our villages in rural areas have no electricity arrangement, so it can be imagined that how much penetration market would be having, especially, when it comes to providing financial services/products. Therefore, there is no institutional infrastructure available in the rural area. Poor market linkage or say, penetration of service providers also constitutes the major factors of FE.

7. **Lack of Interest from Commercial Banks:** There is a lot of criticism on the commercial banks because of their inherent tendency to think that poor people are not worthy of being banked on. Banks are in business to make profit and would like to only indulge in activities that give them profit. Due to high transaction costs on smaller transactions and the speculated high risk in lending credit to the lower strata of the society, they see banking with poor as unviable.

8. **Poor Credit Record:** Areas with poor credit record, bad past experience, socially unstable and poor recovery of previous loan/credit given are observed to be highly financially excluded, as banks blacklist such areas as the part of their risk management strategy.

### 3.3.4 Consequences of Financial Exclusion

FE is deeply interrelated with social exclusion. When social exclusion automatically leads to FE, FE is considered as belonging to a process that reinforces the risk of social exclusion. Hence, the consequences of FE on the individual and the society must not be underestimated. Those unable to access
finance for enterprise development or personal consumption have greater difficulties in integrating socially and economically. No access to financial services may bar people from accessing vital services and activities including employment as some companies pay their employee’s wages by electronic transfer only. Equally, financially excluded people can have difficulty in participating in mainstream social activities and events specific to their cultural reference group. FE also results in less ability to face financial shocks and unexpected expenses. People excluded from savings services are more vulnerable to theft as they are forced to keep their cash and savings at home. Moreover, people excluded from financial services such as cheques and transfers by the mainstream financial sector are likely to turn to institutions that offer these services at a much higher price. This is also true for access to credit as people who are refused credit from mainstream financial institutions are forced to turn to private intermediaries or informal moneylenders who charge more and offer less favourable conditions, further exacerbating their vulnerability and exclusion and putting them at risk of becoming over-indebted.

From the macro economic stand point, being without formal savings can be problematic in two respects. First, people who save by informal means are not benefited from the interest and tax advantage that people using formal savings methods enjoy. Second, informal saving channels are much less secure than formal saving facilities. The exclusionary procedures of the mainstream financial market by offering fewer financial products with limited features and in general less promotional material and information about the products they offer may persuade the affected customers to look outside the formal financial system to satisfy their financial - service needs. The linkage between lack of access to mainstream credit and the use of informal credit and illegal lenders is confirmed by Ellison et al (Ellison et al. 2006). They find that users of illegal
lenders seem to be those unable to access credit from formal sources because areas are not served by them, customers have defaulted on or reached the credit limit. This suggests a direct link between the use of illegal lenders and the lack of access to formal lenders.

3.4 Conclusion

The understanding of FE sums up several important aspects of the concept. FE is conceptualised in terms of difficulty in accessing and/or using financial products. It is also a relative concept which needs to be defined in relation to the society in which people live and refers to exclusion from the ‘mainstream market’ to which the majority of people have access. FE is not just about access but the appropriateness of available financial products and services. It implies that FE is not simply about offering people a range of financial products regardless of their appropriateness. For consumers, products need to be responsibly chosen and offered. It is not necessarily negative, when people are refused certain financial products such as credit, when these are not appropriate to their needs and circumstances. But, FE occurs when the quality of services provided is not guaranteed and non-appropriate services are made available to consumers. Ultimately, processes that lead to FE contribute to the broader dynamic processes of social exclusion, since people cannot ‘lead a normal life’ without financial products and services.
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