ROLE OF FINANCIAL INSTITUTIONS ON - INCLUSIVE GROWTH

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ABSTRACT: Financial markets in India have acquired greater depth and liquidity over the years. Steady reforms since 1991 have led to greater integration of India’s economy with the world economy. Consequently, the global economic crisis has impacted India’s growth as well. Banks and financial institutions, acting as intermediaries and channelizing the savings into productive assets, have a very important role to play in reversing this slowdown. The study of “role of financial institutions on inclusive growth”, focuses on an issue having a great significance not only for a country like ours but the entire world. Inclusive growth as the literal meaning of the two words refers to both the pace and the pattern of the economic growth. Inclusive growth allows people to “contribute to and benefit from economic growth”. Growth is inclusive when it creates economic opportunities along with ensuring equal access to them. The concept “inclusion” should be seen as a process of including the excluded sectors for eg., The rural and the under privileged population of India, in the development process of the economic growth.

Banking is a key driver for inclusive growth. However, apart from the supply side factors, demand side factors, such as lower income and asset holdings also have a significant bearing on inclusive growth. Owing to difficulties in accessing formal sources of credit, poor individuals and small and macro enterprise usually rely on their personal savings or internal sources to invest in health, education, housing, and entrepreneurial activities to make use of growth opportunities. In this paper we will review the role being played by the “Banking and financial institutions of India” in explicitly creating productive economic opportunities for the poor and the vulnerable sections of the society. Thus, aiding Inclusive growth.

KEY WORDS: Inclusive Growth, Financial Institutions, India, Poverty

Introduction: Amartya Sen (2000) convincingly argued that poverty is not merely insufficient income, but rather the absence of wide range of capabilities, including security and ability to participate in economic and political systems. Today the term ‘bottom of the pyramid’ refers to the global poor who mostly live in the developing countries. These large numbers of poor are required to be provided with much needed financial assistance in order to sail them out of their conditions of poverty. Financial inclusion is an important element in tackling poverty and ensuring social justice. Getting basic banking right is the first essential step towards financial inclusion. Therefore policy support and the financial reforms by the government is needed in channeling the financial resources towards the economic upliftment of poor people in India. This paper is an attempt to comprehend the significant role played by the financial institutions on inclusive growth in the
context of a developing country like India wherein a large population is deprived of the financial services which are very much essential for overall economic growth of a country. Financial inclusion is intended to connect people to banks with consequential benefits. Ensuring that the financial system plays its due role in promoting inclusive growth is one of the biggest challenges faced by the emerging economies.

**Reasons for financial inclusion:**
There are a variety of reasons for Financial Inclusion. In remote, hilly and sparsely populated areas with poor infrastructure, physical access itself acts as a deterrent. From the demand side, lack of awareness, low incomes/assets, social exclusion, illiteracy act as barriers. From the supply side, distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes are common reasons for exclusion. All these result in higher transaction cost apart from procedural hassles. On the other hand, the ease of availability of informal credit sources makes these popular even if costlier. The 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. Thus the above barriers should be overcome and reaching out to the people lying at the bottom of the pyramid has become the priority. So the financial sector is one that has the most important role to play in unleashing this potential and thereby comes the role of Financial Inclusion.

**Financial inclusion and inclusive growth in India:**
From an annual average growth rate of 3.5 per cent during 1950 to 1980, the growth rate of the Indian economy accelerated to around 6.0 per cent in the 1980s and 1990s. In the span of four years (2003-04 to 2006-07), the Indian economy grew by 8.8 per cent. In 2005-06 and 2006-07, the Indian economy grew at a higher rate of 9.4 and 9.6 per cent, respectively. Reflecting the high economic growth and a moderation in population growth rate, the per capita income of the country also increased substantially in the recent years. Despite the impressive numbers, growth has failed to be sufficiently inclusive, particularly after the mid-1990s. The percentage of India’s population below the poverty line has declined from 36 per cent in 1993-94 to 26 per cent in 1999-2000. While India has witnessed unprecedented economic growth in recent past, its development has been lopsided with the country trailing on essential social and environmental parameters of development. The approach paper to the Eleventh Plan indicated that the absolute number of poor is estimated to be approximately 300 million in 2004-05. Accordingly, the 11th Five Year Plan has adopted “faster and more Inclusive growth” as the key development paradigm.

The importance of this study lies in the fact that India being a socialist, democratic republic, it is imperative on the policies of the government to ensure equitable growth of all sections of the economy. With only 34% of population engaged in formal banking, India has, 135 million financially excluded households, the second highest number after China. Further, the real rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. However, the economic liberalization policies have always tempted the financial institutions to look for more and more greener pastures of business ignoring the weaker sections of the society. In India, the financially excluded sections comprise largely rural masses comprising marginal farmers, landless labourers, self-employed and unorganized sector enterprises, urban slum dwellers, migrants ethnic minorities and socially
excluded groups, senior citizens and women. Some of the features of financial exclusion in India are captured in the following table.

**Table-1. Financial inclusion and development indicator:**

<table>
<thead>
<tr>
<th>Country</th>
<th>Composite Index of Financial Inclusion (per cent of population with access to financial services)</th>
<th>Poverty (per cent of population below poverty line)</th>
<th>Unemployment during 2000-04 (per cent)</th>
<th>Gini Index</th>
</tr>
</thead>
<tbody>
<tr>
<td>India</td>
<td>48</td>
<td>28.6 (1999-00)</td>
<td>4.3</td>
<td>32.5 (1999-00)</td>
</tr>
<tr>
<td>Brazil</td>
<td>43</td>
<td>22.0 (1998)</td>
<td>9.7</td>
<td>58.0 (2003)</td>
</tr>
<tr>
<td>China</td>
<td>42</td>
<td>4.6 (1998)</td>
<td>4.0</td>
<td>44.7 (2001)</td>
</tr>
<tr>
<td>Indonesia</td>
<td>40</td>
<td>27.1 (1999)</td>
<td>9.9</td>
<td>34.3 (2002)</td>
</tr>
<tr>
<td>Korean Republic</td>
<td>63</td>
<td>.</td>
<td>3.5</td>
<td>31.6 (1998)</td>
</tr>
<tr>
<td>Malaysia</td>
<td>60</td>
<td>15.5 (1989)</td>
<td>3.5</td>
<td>49.2 (1997)</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>59</td>
<td>25.0 (1995-96)</td>
<td>9.0</td>
<td>33.2 (1999-00)</td>
</tr>
<tr>
<td>Thailand</td>
<td>59</td>
<td>13.1 (1992)</td>
<td>1.5</td>
<td>42.0 (2002)</td>
</tr>
</tbody>
</table>


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 (Mohan, 2006).

It is essential for any economy to aim at inclusive growth involving each and every citizen in the economic development progression. It is in this context that financial inclusion should be aimed at inclusive growth in the Indian context.

**Issues and challenges:**

In the Indian context, Committee on Financial Inclusion in India (Chairman: Dr. C. Rangarajan, 2008) defines it as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost. Our country India currently faces several issues and challenges in the area of Financial Inclusion for Inclusive growth. Some of them are discussed below;

1. Insufficient Banking Services: Even though after often emphasized policy intervention by the government and the concerted efforts of Reserve Bank of India and the public sector banks there
has been a significant increase in the number of bank offices in the rural areas; but it is not in tune with the large population living in the rural areas. For a population of 70% only 45% of bank offices provide the financial services.

2. Bank Branches are required to be increased as it has a direct impact on the progress of financial inclusion. It is clearly established that as the bank branches increase number of bank accounts also increase significantly.

3. Poverty levels are having direct relationship with the progress of financial inclusion. We all know that when the poverty levels decrease financial inclusion increases. As such, there should be multi fold strategic approach in such poverty dominated areas for financial inclusion.

4. SC/ST population: In the areas of Scheduled Castes/Scheduled Tribes population the progress of Financial Inclusion is slow which indicates that the efforts for Financial Inclusion has to be increased significantly in such areas in order to bring in social and economic equity in the society.

5. Overcoming Bankers’ Aversion for Financial Inclusion Even though no banker openly expresses his aversion for the financial inclusion process, overtly it can be noticed that they are averse to it in view of the cost aspects involved in opening of no frill accounts.

Suggestions to facilitate financial inclusions:

a. **Ensure Banks to Grant Credit Facilities**: As already RBI has taken the initiative in granting small credit facilities in form of Over Drafts, GCC/KCC, etc, they can ensure banks to grant such small credit facilities and the credit amount can be increased based on successful repayment of credit obtained.

b. **More use of Mobile banking to reduce opportunity cost in rural areas**: Banks will have to reach out through a variety of devices such as weekly banking, mobile banking, satellite offices, rural ATMs. Since mobiles has penetrated to greater extent they can be used for sending information regarding attractive schemes, account balances, loan and interest payable, etc. to bank account holders and even receipt of salaries, pensions and payments for utilities, information regarding loans, insurance and MF products.

c. **More use of Business Facilitator & Correspondent Models**: Since, many bank branches are suffering from staff shortages; they should make use of more people of NGO or even Village heads and other retired teachers & officials as business facilitators or even business correspondents for surveying and account opening. Also they can also use local community based organizations and post offices for availing the knowledge about the customers in order to reduce the credit risk and transaction cost.

d. **Inspection of Infrastructure of bank branches**: The dissatisfaction with bank services in rural areas particularly about the floor space, delay in service and information available in the bank branches should be rectified. RBI can directly or indirectly carry out inspection in
certain rural branches to make sure they provide the basic infrastructure facilities and information required by the customer. Since if this is not ensured and if people are not happy with banking service, it will be a setback to financial inclusion project.

e. **Directing government benefits through service area Banks:** Any government or social security payments or payments under all the government schemes should be strictly routed through the service area bank account. This will make people in rural areas to compulsorily have an account in their service area branch to avail the government benefits.

f. **Educating the youths:** This is another major step for educating people on banking operations and services in the country. This can be done in two stages. In the first stage, RBI can have tie up with some of major educational institutions in India and conducting training and workshops on RBI & its operations, banking operations and services, rural credit and government schemes, etc. This first step is to create more of financial literacy among students on all aspects. In the second stage, RBI can ask the educational institution to adopt any of nearby village in their area and involve the trained college students in creating some camps and educating those people on banking operations, various services, up gradations in banking technology, etc. As a part of the camp, even survey on details of households, their financial literacy level and credit facilities availed and counseling required, etc can be collected by the students. Further as a reward, RBI can offer certificates to students involved in such financial awareness campaign after successful completion of stage two. This linkage if properly framed and utilized can be a win-win situation for both student and society.

**Conclusion:**

Importance of financial inclusion arises from the problem of financial exclusion of nearly 3 billion people from the formal financial services across the world. With only 34% of population engaged in formal banking, India has, 135 million financially excluded households, the second highest number after China.

Further, the real rate of financial inclusion in India is also very low and about 40% of the bank account holders use their accounts not even once a month. Financial Inclusion has far reaching consequences, which can help many people come out of abject poverty conditions. Financial inclusion provides formal identity, access to payments system & deposit insurance.

In order to involve a comprehensive measure of financial inclusion in the Indian context, we consider Priority Sector Lending as a significant measure of financial inclusion and its deepening. We are of the opinion that, mere opening of bank account would not be a true indicator of financial inclusion, but availment of financial services, more importantly; the much needed credit for the excluded sections of the society would definitely depict the measure of financial inclusion. Further, this measure would meet the requirements of the definition for measurement of Financial Inclusion provided by United Nations, wherein it is said that the indicator should measure the “Access to credit, insurance, savings and payment services”.

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The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty. There is a need for coordinated action between the banks, the Government and others to facilitate access to bank accounts amongst the financially excluded.

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