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# FINANCIAL INCLUSION IN INDIA: AN ANALYSIS

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**ABSTRACT**

More than 150 million poor people have access to collateral-free loans .However; there are still large sections of the world population that are excluded from the financial services market. In India half of the poor are financially excluded from the country's main stream of the banking sector. Still in India 22 percent of the people are living below the poverty line. Their monthly income is less than $1 per day and they are living in most un-liveable conditions. In India, growth with equity has been the central objective right from the inception of the planning process. The eleventh Five year plan (2007-12) re-emphasized the need for a more inclusive growth in order to ensure that the per capita income growth is broad- based. More and more Indian companies are trying to enter in the list of fortune 500 and one of our Indian entrepreneurs appears in the list of the top five richest persons of the world. The paper discuss about tackling this disparity between people by ways of financial inclusion through micro finance models and it also analyses how that leads to the economic development of a country.

**Keywords**: Financial Inclusion, SHGs, MFIs, Index of Financial (IFI), Micro Finance, Poverty Alleviation,

## INTRODUCTION

The causality between economic growth, financial deepening and financial inclusion has been well recognized in India's development strategy, particularly since the reforms of the early 1990s.However an accelerated effort through targeted interventions has been a more recent story. The eleventh five year plan (2007-12) of the Government of India has further emphasized the initiatives of financial inclusion with its greater focus on "inclusive growth". The farming ,micro, small and medium enterprises have immense potential to play a critical role in achieving the objective of faster and more inclusive growth as these sectors contribute to output and employment generation in a significant way with capacity to expand regionally diversified production and generating widely dispersed off farm employment.

Access to finance, especially by the poor and vulnerable groups is a prerequisite for employment, economic growth, poverty reduction and social cohesion. Further, access to finance will empower the vulnerable groups by giving them an opportunity to have a bank account, to save and invest, to insure their homes or to partake of credit, thereby facilitating them to break the chain of poverty.

The banking industry in India has recognized this imperative and has undergone certain fundamental changes over the last two decades. Reforms since the early nineties in the banking sector have facilitated increasing competition, the development of new generation private sector banks as well as technological breakthrough in diverse financial products, services and delivery channels. With the recent developments in technology, both delivery channels and access to financial services have transformed banking from the traditional brick-and-mortar infrastructure like staffed branches to a system supplemented by other channels like automated teller machines (ATM), credit / debit cards, internet banking, online money transfer, etc.

The moot point, however, is that access to such technology is restricted only to certain segments of the society. Indeed, some trends, such as increasingly sophisticated customer segmentation technology - allowing, for example, more accurate targeting of sections of the market - have led to restricted access to financial services for some groups. There is a growing divide, with an increased range of personal finance options for a segment of high and upper middle

income population and a significantly large section of the population who lack access to even the most basic banking services. This is termed "financial exclusion". These people, particularly, those 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.

In its landmark research work titled "Building Inclusive Financial Sectors for Development"1 (2006), more popularly known as the Blue Book, the United Nations (UN) had raised the basic question: "why are so many bankable people unbanked?"An inclusive financial sector, the Blue Book says, would provide access to credit for all "bankable" people and firms, to insurance for all insurable people and firms and to savings and payments services for everyone.

"Financial inclusion, thus, has become an issue of worldwide concern, relevant equally in economies of the under-developed, developing and developed nations. Building an inclusive financial sector has gained growing global recognition bringing to the fore the need for development strategies that touch all lives, instead of a select few."

## OBJECTIVES OF THE STUDY

- To review the present status of the financial inclusion in India in particular and the world general.
- To highlight the measures taken by the Government of India and RBI for promoting financial Inclusion.
- To highlight how the micro finance models are useful to increase Financial Inclusion.

## METHODOLOGY OF THE STUDY

Secondary research was conducted to review the present status of financial inclusion in India. Research methodology explains and chooses the best (in terms of quality and economy) way of doing it. The information and data for the research can be collected through primary as well as secondary sources i.e. published articles, journals, news papers, reports, books and websites." Various graphs and tables have been used. Data has been collected from the websites of the Reserve Bank of India and also taken from various committee reports submitted to Government of India on Financial Inclusion.

## FINANCIAL INCLUSION: AN OVERVIEW

More recently, the term financial inclusion has gained argument among professionals. "Financial Inclusion" focuses attention on the need to bring previously excluded people under the umbrella of financial institutions. There is no universally accepted definition of financial inclusion. Financial Inclusion is generally defined in terms of exclusion from the financial system. The working or operational definitions of financial exclusion generally focus on ownership or access to particular financial products and services .Furthermore, the definitions have witnessed as shift in emphasis from the earlier ones, which defined financial inclusion and exclusion largely in terms of physical access, to a wider definition covering access to and use and understanding of products and services.
Rangarajan's committee on financial inclusion defines it as:

"***Financial inclusion may be defined as the process of access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost.***"

The financial services include the entire gamut - savings, loans, insurance, credit, payments etc. The financial system has to provide its function of transferring resources from surplus to deficit units but both deficit and surplus units are those with low incomes, poor background etc. By providing these services, the aim is to help them come out of poverty. So far, the focus has only been on delivering credit (it is called as microfinance but is microcredit) and has been quite successful.

The access to finance could be divided into four segments:

1. The proportion of the population that uses a bank or bank like institution
2. Population which uses services from non-bank "other formal" financial institutions, but does not use bank services
3. The population which only uses services from information financial service providers
4. Percentage of population transacting regularly through formal financial instruments and,
5. The population which uses no financial services.

Since measuring inclusion is perceived to be difficult, financial inclusion has generally been defined in terms of exclusion from the financial system. It focuses on ownership or access to particular financial products and services. Specific indicators such as number of bank accounts, number of bank branches that are generally used as measures of financial inclusion can provide only partial information on the level of financial inclusion in an economy.

In India, the financially excluded sections comprise largely marginal farmers, landless labourers, oral lessees, self employed and unorganized sectors enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women. 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.

**NSSO Survey Results**

The Committee debated the various dimensions of inclusion and concluded that while aspects such as savings, remittance facilities, insurance, etc. were important, nevertheless exclusion was particularly germane from the standpoint of access to credit by vulnerable groups. The Committee accordingly scanned the data put out by the NSSO in the situation assessment survey on "Indebtedness of Farmer Households" (2003). The Committee noted that the definition of indebtedness as adopted in the survey referred to farmer households having outstanding loans from institutional or non-institutional sources4 in cash or kind having a value of Rs.300 or more at the time of transaction.

As per NSSO data, 45.9 million farmer households in the country (51.4%), out of a total of 89.3 million households does not access credit, either from institutional or non-institutional sources. Only 27% of total farm households are indebted to formal sources (of which one-third also borrow from informal sources). In other words, 73% of farm households do not have access to formal credit sources. For purposes of this analysis, "financially excluded" households will be defined as those not having any debt to formal credit sources. The various aspects of such exclusion among specific regions and population groups are indicated below.

## RATIONALE FOR FINANCIAL INCLUSION

Finance has come a long way since the time when it wasn't recognized as a factor for growth and development. It is now attributed as the brain of an economic system and most economies strive to make their financial systems more efficient. It also keeps policymakers on their toes as any problem in this sector could freeze the entire economy and even lead to a contagion.

The earlier research focused on how finance helps an economy. Now, research shows that financial inclusion is as important. The new avenue for research in finance is - making financial inclusion workable. Patrick Honohan (of Trinity College, Dublin) in his research developed an index to measure access to finance in 160 countries. If the index is put on a world map it can be clearly seen that those economies having higher indices are usually those, which we term as developed/advanced economies. It is not implied that financial inclusion alone has led to the development but is an important factor. The policymakers have set up their task force/committees to understand how financial inclusion can be

achieved including advanced economies like United Kingdom. India also set up a committee under the chairmanship of Mr. C.Rangarajan to suggest measures to increase financial inclusion (hence called the Rangarajan Committee on Financial Inclusion). The World Bank had organized a conference in March 2007 and has released a report titled "Finance for All" in November 2007.

The first question that comes to mind is why can't financial inclusion happen on its own? Why do we need to make a policy to increase the same? Like any other product or service, why can't it find a market of its own? The reasons are:

a) **Financial Exclusion:** It has been found that financial services are used only by a section of the population. There is demand for these services but it has not been provided. The excluded regions are rural, poor regions and also those living in harsh climatic conditions where it is difficult to provide these financial services. The excluded population then hasto relies on informal sector (moneylenders etc) for availing finance that is usually at exorbitant rates. These leads to a vicious cycle. First, high cost of finance implies that first poor person has to earn much more than someone who has access to lower cost finance. Second, the major portion of the earnings is paid to the moneylender and the person can never come out of the poverty.

b) **High cost:** It has also been seen that poor living in urban areas don't utilize the financial services as they find financial services are costly and thus are unaffordable. Hence, even if financial services are available, the high costs deter the poor from accessing them. For example, to open a checking account in Cameroon, the minimum deposit requirement is over 700 dollars, an amount higher than the average GDP per capita of that country, while no minimum amounts are required in South Africa or Swaziland. Annual fees to maintain a checking account exceed 25 percent of GDP per capita in Sierra Leone, while there are no such fees in the Philippines. In Bangladesh, Pakistan, Philippines, to get a small business loan processed requires more than a month, while the wait is only a day in Denmark. The fees for transferring 250 dollars internationally are 50 dollars in the Dominican Republic, but only 30 cents in Belgium.

c) **Non-price barriers:** Access to formal financial services also requires documents of proof regarding a persons' identity, income etc. The poor people do not have these documents and thus are excluded from these services. They may also subscribe to the services initially but may not use them as actively as others because of high distance between the bank and residence, poor infrastructure etc.

d) **Behavioral aspects:** Research in behavioral economics has shown that many people are not comfortable using formal financial services. The reasons are difficulty in understanding language, various documents and conditions that come with financial services etc.

## WHO ARE THE EXCLUDED AND WHY?

Many people across the globe are excluded from mainstream banking. These range from people with low income to people with low information and accessibility to people with no social security or insurance cover. The main reasons behind exclusion are:

a) **Lack of information:** Lack of information about the role and function of banks, banking services and products, interest rates, etc. stop people from including themselves in mainstream banking.

b) **Insufficient documentation:** Many people (even in metropolis and urban areas) are unable to show their self identification documents during the opening of a bank account or during taking a loan.
c) **Lack of awareness:** Many people are unaware of the banking terms and conditions laid down from time to time.
d) **High transaction charges:** Various commercial banks across the globe levy transaction charges on credit or debit transactions, on over usage of banking services, on cheque book issuance etc.
e) **Lack of access:** Accessibility is a problem from all those people who live in geopolitically isolated regions. Moreover, as most of the commercial banks are located in the vicinity of cities, people in rural areas (mainly in developing countries) have a geographical barrier in accessing banks.
f) **Illiteracy:** Because of illiteracy, a substantial number of people are unable to take recourse to banking services.

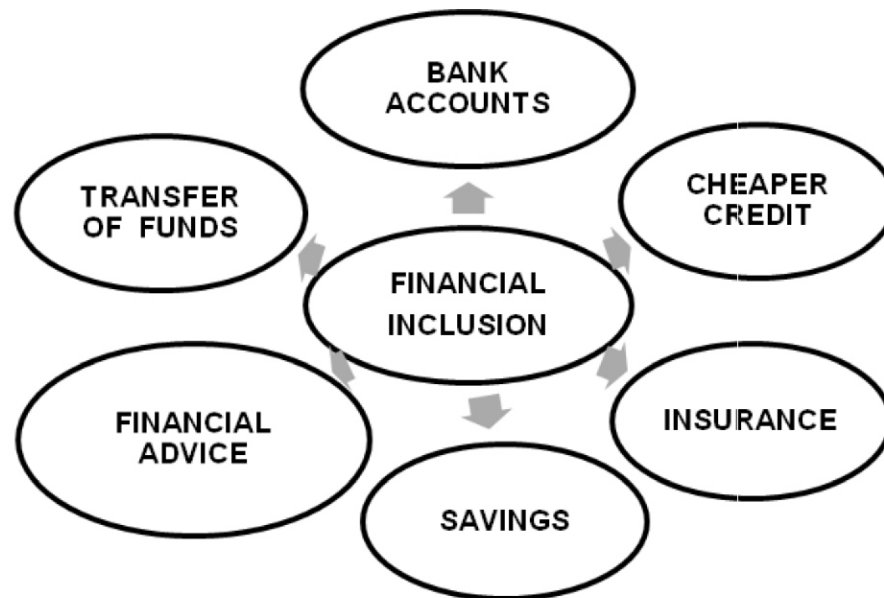


*Figure 1 : An overview of Financial Inclusion Services*

## WHY INCLUSIVE GROWTH?

Why inclusive growth now considered essential even to sustain the growth momentum. The rationale behind the inclusive growth is as under:

1. The poor chunk of India's population is based in rural areas.
2. From supply side management, growth in agriculture is necessary in order to keep manufacturing prices under check provide food security and keep inflation under control.
3. Higher growth in agriculture and rural areas coupled with demographic dividend (i.e. . growing proportion of population in the working age group of 15-65 ) will lead to rise in the savings level for financing the increasing level of investments necessary to sustain the overall growth momentum;
4. The limitations on increasing production and productivity in agriculture are driving migration to urban areas leading to population pressure in urban areas and increase in urban poor;
5. In India, the growth process is knowledge based and services led, the requirement of skilled labor is quite substantial in comparison to the present availability.

6. It is the unorganized non-farm sector that is increasingly absorbing most of the labor force. This sector has huge potential for growth once there is sufficient investment in infrastructure ensuring linkage to markets and easier access to assets and skills. Entrepreneurial development has to be encouraged by having an enabling competitive environment and easy availability of finance for newer projects and enterprises.
   **In Professor C.K.Prahalad's words:**
   "***If we stop thinking of the poor as victims or as a burden, and start recognizing then as resilient and creative entrepreneurs and value conscious consumers, a whole opportunity will open up.***"

Thus there are several factors to be considered for inclusive growth. Uppermost among these is the need for raising the allocative efficiency of investment and resources use across different sectors of economy-this can be met by addressing two basic supply-side issues-

1. Effective credit delivery system to facilitate productive investment in employment impacting sectors especially, agriculture, micro, small and medium enterprises and
2. Large scale investment in infrastructural facilities like irrigation, roads, railways, communication, ports, power , rural/urban reconstruction and in social infrastructure such as health care education and sanitation.

## FACTORS AFFECTING ACCESS TO FINANCIAL SERVICES

**Gender Issues**

Access to credit is often limited for women who do not have, or cannot hold title to assets such as land and property or must seek male guarantees to borrow.

**Age Factor**

Financial service providers usually target the middle of the economically active population, often overlooking the design of appropriate products for older or younger potential customers.

**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.

**Limited literacy**

Limited literacy, particularly financial literacy, i.e., basic mathematics, business finance skills as well as lack of understanding often constraints demand for financial services.

**Place of living**

Although effective distance is as much about transportation infrastructure as physical distance, factors like density of population, rural and remote areas, mobility of the population (i.e., highly mobile people with no fixed or formal address), insurgency in a location, etc., also affect access to financial services.

**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 country's Social security payments

**Bank charges**

In most of the countries, transaction is free as long as the account has sufficient funds to cover the cost of transactions made. However, there are a range of other charges that have a disproportionate effect on people with low income.

**Terms and Conditions**

Terms and conditions attached to products such as minimum balance requirements and conditions relating to the use of accounts often dissuade people from using such products/services.

**Level of Income**

Financial status of people is always important in gaining access to financial services. Extremely poor people find it difficult to access financial services even when the services are tailored for them. Perception barriers and income discrimination among potential members in group-lending programmes may exclude the poorer members of the community.

**Type of occupation**

Many banks have not developed the capacity to evaluate loan applications of small borrowers and unorganized enterprises and hence tend to deny such loan requests.

**Attractiveness of the Product**

Both the financial services/products (savings accounts, credit products, payment services and insurance) and how their availability is marketed are crucial in financial inclusion.

According to Report on Currency and Finance 2006-08 the critical dimensions of Financial exclusion include access exclusion, condition exclusion (conditions attached to financial products), price exclusion and self exclusion because of the fear of refusal to access by the service providers. The financial exclusion process becomes self-reinforcing and can often be an important factor in social exclusion, especially for communities with limited access to financial products, particularly in rural areas.

One of the successes in the last few years is supposed to have been the Mahatma Gandhi National Rural employment Guarantee Scheme. It has increased financial inclusion because it is mandated into the scheme that payments are made through the job cards, through bank accounts. Prior to this scheme of 'No frills accounts', as directed by the RBI, paved the way for Financial Inclusion. It is mandatory for state agencies to make the payments under various social security schemes through bank account.

## MAJOR MILESTONES IN FINANCIAL INCLUSION IN INDIA

1969 Nationalization of Banks
1971 Establishment of priority Sector Lending Banks
1975 Establishment of Regional Rural Banks
1982 Establishment of NABARD
1992 Launching of the Self Help Groups bank Linkage Programme
1998 NABARD sets a goal for linkage one million SHGs by 2008
2000 Establishment of SIDBI foundation for Micro Credit
2005 One million SHF linkage target achieved three years ahead of date 2006 Committee on Financial Inclusion
2007 Proposed Bill on Micro Finance Regulation introduced in parliament

2008 Committee submitted its final report on Financial Inclusion to Union Finance Minister in January

**Table 1: Status of financial Inclusion in India**

| Category of farmer house | Size class of land hold | Total farmer households (lakhs) | Non – indebted farmer households | Incidence of Exclusion | Proportion of non-indebted households in percentage |
|---|---|---|---|---|---|
| **Marginal** | Less than 1 | 589.06 | 324.04 | 55.0 | 70.6 |
| **Small** | 1.01-2.0 | 160.60 | 78.68 | 49.0 | 17.1 |
| **Semi-Medium** | 2.01-4.0 | 93.50 | 39.10 | 41.8 | 8.5 |
| **Medium** | 4.01-10 | 42.58 | 14.84 | 34.9 | 3.2 |
| **Large** | 10.0+ | 7.76 | 2.60 | 33.6 | 0.6 |
| **All sizes** | | 893.50 | 459.26 | 51.4 | 100 |

## COSTS AND CONSEQUENCES OF FINANCIAL EXCLUSION

Broadly, the issue of cost of financial exclusion may be conceived from two angles, which are intertwined. First, the exclusion may have cost for individuals entities in terms of loss of opportunities to grow in the absence of access to finance or credit. Second, from the societal or the national perspective, exclusion may lead to aggregate loss of output or welfare and the country may not realize its growth potential. The more tangible outcomes of financial exclusion include cost and security issues in managing cash flow and payments, compromised standard of living resulting from lack of access to short-term credit, higher costs associated with using informal credit, increased exposure to unethical, predatory and unregulated providers, vulnerability to uninsured risks, and long-term or extended dependence on welfare as opposed to savings (Chant Link and Associates, 2004).

Access to a bank account, credit and insurance are now widely regarded as essential supports for personal financial management and for undertaking transactions in modern societies (Speak and Graham, 1999). According to the Treasury Committee, UK (2006), financial exclusion can impose significant costs on individuals, families and society as a whole. These include (i) barriers to employment as employers may require wages to be paid into a bank account; (ii) opportunities to save and borrow can be difficult to access; (iii) owning or obtaining assets can be difficult; (iv) difficulty in smoothening income to cope with shocks; and (v) exclusion from mainstream society.

In terms of cost to the individuals, financial exclusion leads to higher charges for basic financial transactions like money transfer and expensive credit, besides all round impediments in basic/minimum transactions involved in earning livelihood. and day to day living. It could also lead to denial of access to better products or services that may require a bank account. It exposes the individual to the inherent risk in holding and storing money - operating solely on a cash

basis increases vulnerability to loss or theft. Individuals/families could get sucked into a cycle of poverty and exclusion and turn to high cost credit from moneylenders, resulting in greater financial strain and unmanageable debt. At the wider level of the society and the nation, financial exclusion leads to social exclusion, poverty as well as all the other associated economic and social problems. Thus, financial exclusion is often a symptom as well as a cause of poverty. Financial exclusion is not evenly distributed throughout society; it is concentrated among the most disadvantaged groups and communities and, as a result, contributes to a much wider problem of social exclusion.

Another cost of financial exclusion is the loss of business opportunity for banks, particularly in the medium-term. Banks often avoid extending their services to lower income groups because of initial cost of expanding the coverage which may sometimes exceed the revenue generated from such operations.

Two other factors have often been cited as the consequences of financial exclusion. First, it complicates day-to-day cash flow management being financially excluded means households, and micro and small enterprises deal entirely in cash and are susceptible to irregular cash flows. Second, lack of financial planning and security in the absence of access to bank accounts and other saving opportunities for people in the unorganized sector limits their options to make provisions for their old age.

## INITIATIVES FOR FINANCIAL INCLUSION IN INDIA

India has a long history of banking development. After Independence, the major focus of the Government and the Reserve Bank was to develop a sound banking system which could support planned economic development through mobilization of resources/deposits and channel them into productive sectors. Accordingly, the Government's desire to use the banking system as an important agent of change was at the core of most policies that were formulated after Independence. The planning strategy recognized the critical role of the availability of credit and financial services to the public at large in the holistic development of the country with the benefits of economic growth being distributed in a democratic manner. In recognition of this role, the authorities modified the policy framework from time to time to ensure that the financial services needs of various segments of the society were met satisfactorily.

In order to expand the credit and financial services to the wider sections of the population, a wide network of financial institutions has been established over the years. The organized financial system comprising commercial banks, regional rural banks (RRBs), urban co-operative banks (UCBs), primary agricultural credit societies (PACS) and post offices caters to the needs of financial services of the people. Besides, MFIs, self-help groups (SHGs) also meet the financial service requirements of the poorer segments. Furthermore, development of the institutional framework in recent years has focused on new models of expanding financial services involving credit dispensation using multiple channels such as civil society organizations (CSOs), nongovernment organizations (NGOs), post offices, farmers' clubs, and panchayats as business facilitators/correspondents. Specific financial instruments/products were also developed in order to promote financial inclusion.

### Progress till 1990

Before 1990, several initiatives were undertaken for enhancing the use of the banking system for sustainable and equitable growth. These included nationalization of private sector banks, introduction of priority sector lending norms, the Lead Bank Scheme, branch licensing norms with focus on rural/semi-urban branches, interest rate ceilings for credit to the weaker sections and creation of specialized financial institutions to cater to the requirement of the agriculture and the rural sectors having bulk of the poor population. The announcement of the policy of social control over banks was made in December 1967 with a view to securing a better alignment of the banking system with the needs of economic policy. The National Credit Council was set up in February 1968 mainly to assess periodically the demand for bank

credit from various sectors of the economy and to determine the priorities for grant of loans and advances. Social control of banking policy was soon followed by the nationalization of major Indian banks in 1969. The immediate tasks set for the nationalized banks were mobilization of deposits on a massive scale and lending of funds for all productive activities. A special emphasis was laid on providing credit facilities to the weaker sections of the economy.

The National Bank for Agriculture and Rural Development (NABARD) was set up in 1982 mainly to provide refinance to the banks extending credit to agriculture. RRBs, which were set up in 1975 to cater, inter alia, to the credit requirements of the rural poor, shave recently been restructured.

## SOME INITIATIVES STARTED BY COMMERCIAL BANKS TOWARDS FINANCIAL INCLUSION

INDIAN BANK: The bank has established an exclusive microstate branch in Chennai for financial inclusion of lower income people who are also migrants form villages settled in different parts of the city by bringing large number of under privileged persons into the banking fold through the concept of SHGs. In the case of SHGs, a line of credit is provided to them giving flexibility, with simplified accounting procedures. The bank proposes to open one more such specialized branch in Chennai and in 10 other metros and urban across the country.

**UNION BANK OF INDIA-**Village Knowledge Centers: Keeping in view the urgent requirement to educate the rural inhabitants and farmers in particular, for updating them with the latest technological developments, a pioneering effort has been initiated by Union bank of India by establishing Village Knowledge Centers (VKCs) at strategic rural locations. So far, the bank has established 198 KVCs all over the country.

**Pilot Project in Andhra Pradesh:** Andhra Pradesh Government has embarked on a pilot project with six banks. Viz SBI, SBH, Andhra Bank, Union Bank, UTI Bank and AP Grameena Vikas bank, to make payments of social security pensions and AP Rural Employment.

To further promote the SHG-bank linkage programme in the country, banks were advised in 1998 that SHGs that were engaged in promoting the saving habits among their members would be eligible to open savings bank accounts and that such SHGs need not necessarily have availed of credit facilities from banks before opening savings bank accounts. Subsequent to the Monetary and Credit Policy announcement for the year 1999-2000, banks were advised that interest rates applicable to loans given by them to micro credit organizations or by the micro credit organizations to SHGs/member beneficiaries would be left to their discretion. Subsequently, banks were advised that they should provide adequate incentives to their branches for financing the SHGs and that the group dynamics of working of the SHGs may be left to themselves.

The objective of bringing financially excluded people within the fold of the banking sector received renewed emphasis in 2005-06 as the term 'financial inclusion' was explicitly used for the first time in the Annual Policy Statement for 2005-06. It observed that there were legitimate concerns in regard to the banking practices that tended to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in the unorganized sector. It also indicated that the Reserve Bank would (i) implement policies to encourage banks which provide extensive services, while disincentivising those which were not responsive to the banking needs of the community, including the underprivileged; (ii) the nature, scope and cost of services would be monitored to assess whether there was any denial, implicit or explicit, of basic banking services to the common person; and (iii) banks urged to review their existing practices to align them with the objective of financial inclusion.

The process of financial inclusion received further impetus in November 2005, when banks were advised to make available a basic banking 'no frills' account with low or nil minimum balances as well as charges to expand the outreach of

such accounts to vast sections of the population. The low cost or free of cost account is internationally considered to be helpful in expanding the access of banking services, particularly to the low income groups. Similar types of accounts, though with different names, have also been extended by banks in various other countries with a view to making financial services accessible to the common man either at the behest of banks themselves or the respective Governments.

In order to ensure that persons belonging to low income groups, both in urban and rural areas do not encounter difficulties in opening bank accounts, the know your customer (KYC) procedure for opening accounts was simplified for those accounts with balances not exceeding Rs.50,000 and credit limits not exceeding Rs.100,000 in a year. The simplified procedure allowed introduction by a customer on whom the full KYC drill had already been done.

Besides the KCCs, which were introduced in 1998, banks were advised in 2005 to consider introduction of a General Credit Card (GCC) facility up to Rs.25,000 at their rural and semi-urban branches. Under GCC, based on the assessment of household cash flows, the limits are sanctioned without insistence on security or purpose. The credit facility is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned. Based on assessment of household cash flows, the limits are sanctioned. Interest rate on the facility is completely deregulated. Fifty per cent of GCC loans are treated as priority sector lending.

The SLBC identifies one or more districts for 100 per cent financial inclusion.3 The responsibility is given to the banks in the area for ensuring that all those who want to have a bank account are provided with one by allocating the villages to the different banks. In April 2008, SLBCs reported achieving 100 per cent financial inclusion in 134 districts in 18 States and 6 Union Territories (UTs) of the country. The Reserve Bank is undertaking an evaluation of the progress made in these districts by independent external agencies to draw lessons for further action in this regard.

In January 2006, the Reserve Bank, permitted banks to utilize the services of NGOs/ SHGs, MFIs (other than NBFCs) and other civil society organizations as intermediaries for providing financial and banking services through the use of business facilitator (BF) and business correspondent (BC) models. In April 2008, banks were permitted to engage retired bank employees, ex-servicemen and government employees as BCs, subject to appropriate due diligence. The BC model allows banks to do 'cash in - cash out' transactions at a location much closer to the rural population, thus, addressing the last mile problem. Banks are also entering into agreements with Indian Postal authorities for using the enormous network of post offices as BCs, thereby increasing their outreach. In order to provide social security to vulnerable groups, in some cases banks have provided, in association with insurance companies, innovative insurance products at affordable cost, covering life disability and health cover. SHGs and MFIs are also being used extensively for financial inclusion on the credit side.

## SELF-HELP GROUP - BANK LINKAGE PROGRAMME

An SHG is a group of about 15 to 20 people from a homogenous class who join together to address common issues. They involve voluntary thrift activities on a regular basis, and use of the pooled resource to make interest bearing loans to the members of the group. In the course of this process, they imbibe the essentials of financial intermediation and also the basics of account keeping. The members also learn to handle resources of size, much beyond their individual capacities. They begin to appreciate the fact that the resources are limited and have a cost. Once the group is stabilized, and shows mature financial behavior, which generally takes up to six months, it is considered for linking to banks. Banks are encouraged to provide loans to SHGs in certain multiples of the accumulated savings of the SHGs. Loans are given without any collateral and at interest rates as decided by banks. Banks find it comfortable to lend money to the groups as the members have already achieved some financial discipline through their thrift and internal lending activities. The groups decide the terms and conditions of loan to their own members. The peer pressure in the group ensures timely repayment and becomes social collateral for the bank loans Generally, the SHGs need self-help promoting institutions

(SHPIs) to promote and nurture them. These SHPIs include various NGOs, banks, farmers' clubs, government agencies, self-employed individuals and federations of SHGs. However, some SHGs have also been formed without any assistance from such SHPIs. There are three different models that have emerged under the linkage programme:

- **Model I:** This involves lending by banks directly to SHGs without intervention/facilitation by any NGO.
- **Model II:** This envisages lending by banks directly to SHGs with facilitation by NGOs and other agencies.
- **Model III:** This involves lending, with an NGO acting as a facilitator and financing agency.

Model II accounted for around 74 per cent of the total linkage at end-March 2007, while Models I and III accounted for around 20 per cent and 6 per cent, respectively.

## GRAMEEN BANK IN BANGLADESH

The Grameen Bank (GB) was launched as a project in a village of Bangladesh in 1976 to assist the poor families by providing credit to help them overcome poverty. In 1983, it was transformed into a formal bank under a special law passed for its creation. It is owned by the poor borrowers of the bank who are mostly women. GB has reversed conventional banking practice by obviating the need for collateral. It has created a banking system based on mutual trust, accountability, participation and creativity. GB provides credit to the poorest of the poor in rural Bangladesh, without any collateral.

As GB was initiated as a challenge to the conventional banking, it rejected the basic methodology of the conventional banking and created its own methodology. The most distinctive feature of Grameen credit is that it is not based on any collateral, or legally enforceable contracts. It is based on 'trust' and not on legal procedures and system. It offers credit for creating self-employment, income-generating activities and housing for the poor, as opposed to consumption. It provides service at the doorstep of the poor based on the principle that the people should not go to the bank, bank should go to the people. In order to obtain loans, a borrower must join a group of borrowers. Although each borrower must belong to a five member group, the group is not required to give any guarantee for a loan to its member. The repayment responsibility solely rests on the individual borrower, while the group and the centre/branch oversee that everyone behaves in a responsible way and none gets into repayment problem. There is no form of joint liability, i.e., group members are not responsible to pay on behalf of a defaulting member. Loans can be received in a continuous sequence. New loan becomes available to a borrower if her previous loan is repaid. All loans are to be paid back in installments (weekly or bi-weekly). Savings, namely personal savings account, special savings account, Grameen Pension Savings and credit-life insurance savings fund. After operating group lending for 25 years, the GB switched to individual lending recognizing that with repeated loan cycles and greater credit exposure, homogeneity of the group would weaken as loan requirements vary with variation in the levels of upliftment attained. Thus, the more flexible Grameen II is more appropriate for reaching the poor because its products can be conveniently used for everyday money management as well as for microenterprises. GB II dispensed with the general loans, seasonal loans, family loans, and more than a dozen other types of loans. It also gave up the group fund; the branch-wise and zone-wise loan ceiling; fixed size weekly installment; the rule to borrow for one whole year, even when the borrower needed the loan only for three months.

The Government of Bangladesh has fixed interest rate for government-run microcredit programmes at 11 per cent at flat rate, which amounts to about 22 per cent on a declining basis. The interest rate charged by the Grameen Bank is lower than that fixed by the Government of Bangladesh. There are four interest rates for loans from Grameen Bank: 20 per cent (declining basis) for income generating loans, 8 per cent for housing loans, 5 per cent for student loans, and 0

per cent (interest-free) loans for struggling members (beggars). All interests are simple interest, calculated on declining balance method. This implies an annual interest rate of 10 per cent for income-generating loan which is less than that (11 per cent) fixed by the Government of Bangladesh. GB offers attractive rates for deposits ranging from 8.5 per cent to 12 per cent. As of March, 2008, it had 7.46 million borrowers, 97 per cent of whom were women. With 2,504 branches, GB provides services in 81,574 villages, covering more than 97 per cent of the total villages in Bangladesh.

## CONCLUSION

Access to financial services such as savings, insurance and remittances are extremely important for poverty alleviation and development. In order to achieve the goal of total financial inclusion, policymakers, banks, MFIs, NGOs and regulators have to work together. In addition to cooperating with other stakeholders, policymakers who believe that microfinance can help them to speed up financial education programs that allow their citizens to realize the economic potential of microfinance. Basic financial literacy programs can help achieve better results in poverty alleviation.

### Problems and Challenges

1. Since independence, the Government had been dependent on its machinery first and then, after nationalization, on banks to reach the poor. But government machinery suffered all the demerits of bureaucracy and corruption and hence, failed miserably.
2. Banks also could not succeed in reaching the poor society because of many reasons. First, most of the Indians Banks were in government hands till the late nineties their employees were looking for a "salary", not for achieving the 'national target'.
3. Second, banks have to follow certain rules which sometimes create bottlenecks in their targets of reaching the poor. For example, no bank will give a cheque book of ATM facility to a poor man unless he has a minimum of Rs. 1000 in his account; which means if a poor man opens a bank account, he stills remains in the "stone age".
4. Financial literacy is very low in India. Forget about BPL people, even the educated urban population is financially illiterate. Many college going students still cannot write cheques and a major part of white collar working class people need consultants to fill simple income tax returns.
5. Due to financial illiteracy, most of the people do not maintain proper records or books of accounts. This leads proper records or books of accounts. This leads to removing of these people from the financial services of the banks.

***To sum up, banks need to redesign their business strategies to incorporate specific plans to promote financial inclusion of low income groups treating it both a business opportunity as well as a corporate social responsibility.***

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