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Financial Inclusion of Rural Markets: Understanding the Current Indian Framework

Financial Inclusion of Rural Markets: Understanding the Current Indian Framework

by

Pranaya K. Swain*and Baldeep Singh**

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Abstract:

History bears the testimony to the relationship between development of financial markets and economic growth, thus leading to the reduction of poverty on a

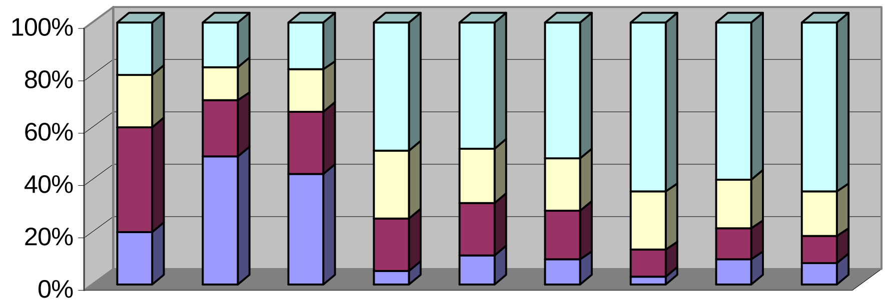
1. Introduction

An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. In addition, access to appropriate financial services can significantly improve the day-to-day management of finances. It can also help reducing the growth of informal sources of credit (such as moneylenders) which are often found to be exploitative. Thus, an all-inclusive financial system enhances efficiency and welfare by providing avenues for secure and safe saving practices and by facilitating a whole range of efficient financial services (Sarma, 2008). The importance of an inclusive financial system is widely recognized in the policy circle in recent years and financial inclusion is seen as a policy priority in many countries (Kempson et. al. 2004). The Government of India has also expressed its precise concern on the issue of overall inclusion in the development process through its various initiatives such as the Rural Employment Guarantee Scheme, the Bharat Nirman programme, the Sarva Shiksha Abhiyan, among others.

A committee on financial inclusion (FI hereafter) with Dr. C. Rangarajan

2. Role of financial markets

In many economies around the world, there is enough evidence of the relationship between the development of financial markets and economic growth, and hence the reduction of poverty. Financial democracy[1] gets expanded through financial markets development. It becomes crucial because, first, the lack of it prevents people from gaining access to the resources that would enable them to make the most of their abilities and thus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required for ensuring overall sustainable overall growth in the country.

The approach to FI in developing countries such as India is thus somewhat different from the developed countries. In the latter, the focus is on the relatively small share of population not having access to banks or the formal payments system whereas in India, we are looking at the majority who are excluded.

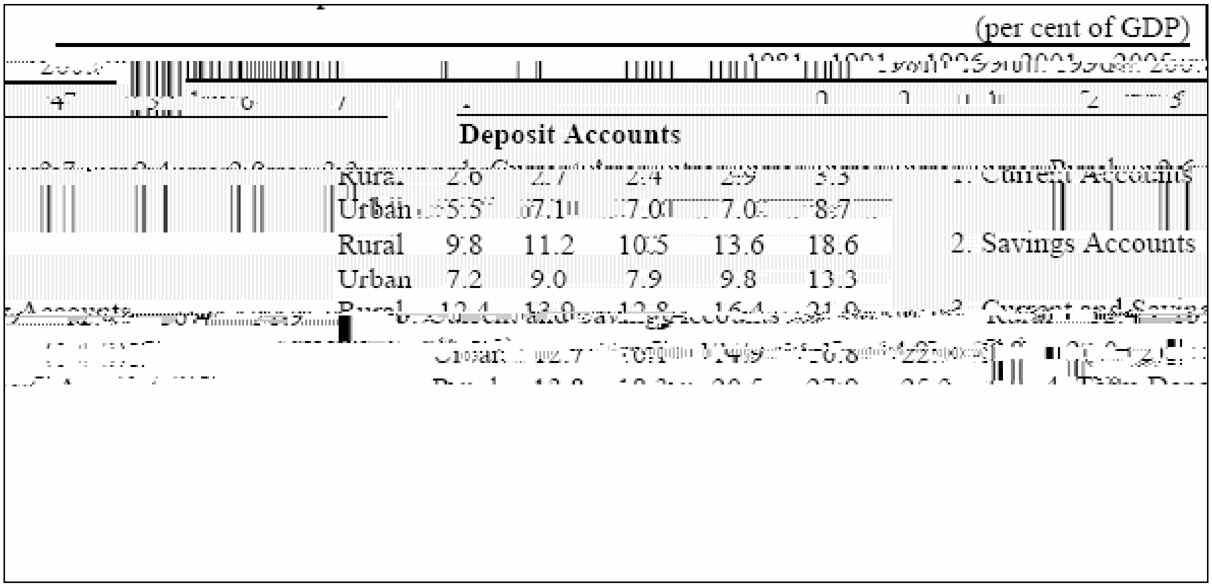
FI can be thought of in two ways. One is exclusion from the payments system –i.e. not having access to a bank account. The second type of exclusion is from formal credit markets, requiring the excluded to approach informal and exploitative markets. After nationalization of major banks in India in 1969, there was a significant expansion of branch network to unbanked areas and stepping up of lending to agriculture, small industry and business. More recently, the focus is on establishing the basic right of every person to have access to affordable basic banking services.

The total number of saving accounts, considered to be a better indicator of banking penetration than other deposit accounts, as per cent of number of households, was 137 in rural areas and 244 in the urban areas on the eve of reforms in 1991.

(Per cent of Number of Households)

			1981	1991	1996	2001	2004	2005
8	1	2		3	4	5	6	7
	Deposit Accounts							
4.6	Current Accounts	Rural		3.6	5.5	4.7	4.9	4.4
18.3		Urban		15.0	23.4	24.1	19.2	17.5
131.5	Savings Accounts	Rural		59.6	137.0	129.8	123.3	126.8
[illegible]		Urban	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	Current and Saving Accounts	Rural	63.2	142.6	134.5	128.2	131.1	136.1
[illegible]		Urban	[illegible]	[illegible]	[illegible]	[illegible]	224.0	231.4
[illegible]	Term Deposits Accounts	Rural	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
[illegible]		Urban	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
Total Deposits Accounts		Rural	86.1	184.4	180.0	180.1	179.4	181.8
		Urban	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]	[illegible]
	Credit Accounts	Rural	10.0	16.0	[illegible]	[illegible]	[illegible]	[illegible]
2		Urban	15.1	29.9	27.1	28.4	42.5	50.[illegible]

By 2005, despite the reforms, the differential continues to be similar. In the case of credit accounts, the situation have deteriorated for rural households while showing significant improvement in the urban areas (as shown in the table above, Census 2001), corroborating the very significant increase in retail credit.



(per cent of GDP)

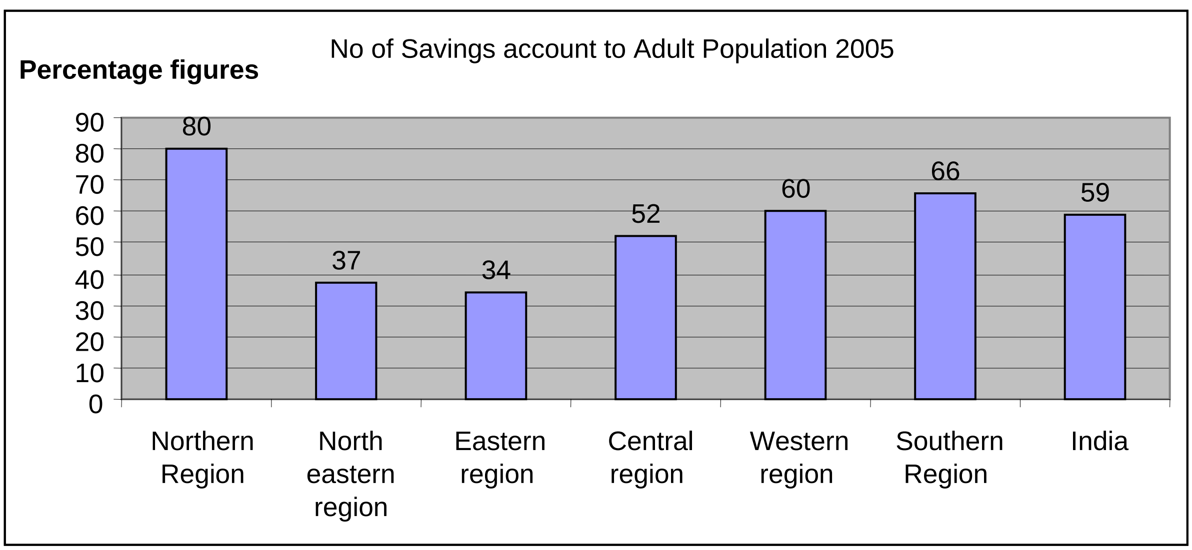
Deposit Accounts

1. Current Accounts	Rural	2.6	2.7	2.4	2.9	3.3
	Urban	5.5	7.1	7.0	7.0	8.7
2. Savings Accounts	Rural	9.8	11.2	10.5	13.6	18.6
	Urban	7.2	9.0	7.9	9.8	13.3

The table above shows the number of deposits and credit accounts in Scheduled Commercial Banks (as a percent of GDP). Total deposits, as per cent of GDP, increased from 32.2 in 1991 to 47.1 in 2005 in rural areas and from 37.3 to 61.2 in urban areas. Similarly, credit extended, as per cent of GDP, increased from 17.3 to 22.3 in rural and from 24.8 to 45.0 in urban areas (RBI, 2007)

3.2 Measures of Financial Inclusion

One common measure of FI is the percentage of adult population having bank accounts (shown in chart below). Going by the available data on the number of savings bank accounts and assuming that one person has only one account, (which assumption may not be correct as many persons could have more than one bank account) we find that on an all India basis 59 per cent of adult population in the country have bank accounts – in other words 41 per cent of the population is unbanked. In rural areas the coverage is 39 per cent against 60 per cent in urban areas. The unbanked population is higher in the North Eastern and Eastern regions (RBI, 2007).



The extent of exclusion from credit markets is much more, as number of loan accounts constituted only 14 per cent of adult population (shown in chart below). In rural areas, the coverage is 9.5 per cent

The task of policy-makers in designing an appropriate package of measures becomes more challenging and other banks are in the verge of completeion of 100% financial inclusion in Cuddalore district.

Financial inclusion project is also implemented in Kollam, the lead district of the bank in Kerala involving all other banks operating in the district. Now all the households in the District have been brought under the banking ambit. Besides, UTP, Cuddalore and Kollam districts, the Bank is also taken up implementation of 100% financial inclusion project in other 11 lead districts across the country. The Bank has also initiated the process in other districts where it has no lead bank responsibilities. Two sponsored regional rural banks of the Bank have opened “No frills” SB accounts and issued overdraft and general credit with an outlay of 605.10 lacs.

5. Recent initiatives by Reserve Bank of India

The period 1969 to 1991 saw a huge increase in the branch outreach in India as the average population covered by a bank branch fell from 64,000 to 13,711. In 1991 along with reforms for liberalizing and opening the economy, financial sector reform aimed at deregulation, increased competition and strengthening the banking sector through recapitalization and adoption of prudential measures. The Indian banking industry today is qu

7. Huge increase in “no-frills” accounts

other livelihoods and could be several times the deposits made by the SHG. Most of the SHGs have been linked to public sector banks in view of the latter's dominant presence in the rural areas.

The private sector banks have a

In rural areas customers cannot be expected to come to branches in view of opportunity cost and time and hence banks will have to reach out through a variety of devices such as weekly banking, mobile banking, satellite offices, rural ATMs and use of Post offices. In urban and even in rural areas where mobile phones have penetrated, banks could use mobile technology for facilitating banking transactions. Mobile phones can be used to transfer funds real time from and to bank accounts and could make remittances and payments at very low cost. Once the data base and track record is established, a multitude of financial services can be offered including savings, remittance, transaction banking such as receipt of salaries, pensions and payments for utilities, loan including home loans, insurance and MF products. Here the branches can render more business and variety of products to existing clientele as also source new customers within the area of operation.

Financial inclusion offers a huge potential for business in terms of resources and assets and banks therefore need to take aggressive steps to use

RBI is setting up an Advisory Group on IT solutions for financial inclusion and it is hoped that collaborative effort between banks governments and post offices will be facilitated by the deliberations of this Group.

11. Role of Government

State Governments can play a pro-active role in facilitating FI. Issuing official identity documents for opening accounts , creating awareness and involving district and block level functionaries in the entire process, meeting cost of cards and other devices for pilots, undertaking financial literacy drives are some of the ways in which the State and district administration have involved themselves (Thorat, 2007).

India Post is also looking to diversify its activities and leverage on its huge network of post offices, the postman's intimate knowledge of the local population and the enormous trust reposed in him. Banks are entering into agreements with India Post for using post offices as agents for branchless banking.

11.1 Work in progress

The Finance Minister in his budget for 2007-08 has announced the setting up of two funds for FI; the first called Financial Inclusion Fund for developmental and promotional interventions and the other called Financial Inclusion Technology Fund to meet cost of technology adoption of about $ 125 million each. The scope of these funds is being worked out. Setting up of financial literacy centres and credit counseling on a pilot basis, launching a national financial literacy campaign, forging linkages with informal sources with suitable safeguards through appropriate legislation, evolving industry wide standards for IT solutions, facilitating low cost remittance products are some of the initiatives currently under way for furthering FI.

Moreover, the loan waivers given to farmers in the 2008 budget will also go a long way in enabling financial inclusion to Indian farmers[4].

Two recommendations of the Committee on Financial Inclusion proposed to be accepted viz (i) to advise commercial banks, including RRBs, to add at least 250 rural household accounts every year at each of their rural and semi-urban branches; and (ii) to allow individuals such as retired bank officers, ex-servicemen etc to be appointed as business facilitator or business correspondent or credit counselor; banks to be encouraged to embrace concept of Total Financial Inclusion; Government to request all scheduled commercial banks to follow the example set by some public sector banks and meet the entire credit requirements of SHG members, namely, income generation activities, social needs like housing, education, marriage etc., and debt swapping.

(i) Fund of Rs.5,000 crore to be created in NA7e3(sem)8.cnr7e3of -1.15 TT90.0397 036t

Differential Rate of Interest (DRI) scheme: Borrower's eligibility criteria for loan under the DRI scheme to the weaker sections of the community engaged in gainful occupations enhanced**.**

11.2 Scheme of Debt Waiver and Debt Relief for farmers:

Scheme to cover all loans disbursed by scheduled commercial banks, regional rural banks and cooperative credit institutions up to March 31, 2007 and overdue as on December 31, 2007 are covered under the scheme;

Complete waiver of all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008 for marginal farmers and small farmers;

one time settlement (OTS) scheme in respect of other farmers for all loans that were overdue on December 31, 2007 and which remained unpaid until February 29, 2008; Rebate of 25 per cent against payment of the balance of 75 per cent under OTS;

Agricultural loans restructured and rescheduled by banks in 2004 and 2006 through special packages also eligible, either for a waiver or an OTS on the same pattern;

products providing basic features required by financially excluded customers are available. Accessibility problems can arise in a number of ways. For example, basic bank accounts were created to increase access to appropriate banking products in the UK. But these accounts were inaccessible for many financially excluded customers.

12.2 Demand problems:

Even when financial products do meet the needs of excluded customers, they may be unaware that these products exist, or of the benefits they can bring, and therefore be unwilling to invest the time and effort needed to take them up. Often, lack of demand results from people believing that they will not be served by financial services providers. This belief can be based on prior experience of having been turned down, or on hearsay or prejudice. In many cases it is reinforced by social or cultural preferences or alternatives, such as Christmas hamper saving schemes in US. Finally, lack of demand for financial products may rise because people do not have the financial capability to make well-informed decisions. In these circumstances, many opt out altogether, and operate primarily in cash.

13. Challenges for Financial Inclusion

While there has been real progress, there remains a lot to be done, and key challenges to be met, if the governmenT0.03(a)-0.7(nd ed)]ϕrnm

- Replicating the success of DTI's pilots to date in the nationwide rollout of projects to tackle illegal lending

- Promoting the role of banks and other financial services providers in supporting people out of financial distress,

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To conclude, therefore, we wish to stress that with increasing liberalization and higher economic growth, the role of banking sector is poised to increase in the financing pattern of economic activities within the country. To meet the growing credit demand, the banks need to mobilize resources from a

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