Advances in Economics and Business Management (AEBM)
p-ISSN: 2394-1545; e-ISSN: 2394-1553; Volume 3, Issue 6; July-September, 2016, pp. 626-632
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http://www.krishisanskriti.org/Publication.html

Universal Financial Inclusion- Evolving Landscape, Issues and Challenges

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Abstract—*Financial inclusion had been a buzzword for the policymakers and governments for a long time. The Finance Minister laid out a definite set of targets to provide for financial accounts to every household. This aspiring target highlighted the importance of achieving it within a stipulated timeframe. The concurrent policy measures undertaken by the government and RBI have provided a push for financial inclusion in the country. However, there remain some key fissures and concerns that should be considered for achieving sustained comprehensive financial inclusion, specifically of the low income population. Despite tremendous growth of banking sector in India both horizontally and vertically, a large section of Indian population continues to remain unbanked even after attaining 69 years of our Independence. To address the issue of financial exclusion and long drawn financial sufferings, Prime Minister Narendra Modi announced a new scheme in his Independence Day speech on 15th Aug 2014, and called it as the National Mission on Financial Inclusion (NMFI) for weaker section and low income groups. While launching the Pradhan Mantri Jan Dhan Yojana on 28th Aug 2014, the Prime Minister commended the Banks, in particular, for having managed to open record 1.5 crores new accounts on the inaugural day itself. This effort will certainly go a long way in promoting economic growth and reducing poverty, while mitigating systematic risk and maintaining financial stability. The present paper endeavors to study the recent trends in financial inclusion in India with special reference to Pradhan Mantri Jan Dhan Yojana (PMJDY), highlighting its key areas and suggests strategies to ensure maximum financial inclusion for the underprivileged and unbanked areas.*

Keywords: *Pradhan Mantri Jan Dhan Yojana, Financial Inclusion, RBI Initiatives, Financial stability, Sustainable economic growth.*

1. INTRODUCTION

The Indian economy is facing massive transformation, with numerous policy initiatives. Positive business sentiments, improved consumer confidence and more controlled inflation are likely to escalate the economic growth. Increased spending on infrastructure, swift implementation of projects and continuance of reforms are expected to promote further growth of the economy. These factors propose that India's banking sector is also poised for robust growth as the fast growing business scenario would turn towards banking system for all their financial needs.

Even, the advancements in technology have brought the mobile and internet banking services to the front. The banking sector is promoting emphasis on improved services to their clients and also upgrading their technological infrastructure, in order to escalate the customer's overall experience as well as give banks a competitive edge over its peers.

2. GROWTH OF BANKING SECTOR IN INDIA

In order to understand present position of banking sector in India and its past progress, it will be appropriate to look at its development in a longer historical outlook. The past four decades and particularly the last two decades witnessed cataclysmic change in the face of commercial banking all over the world. Post nationalization, Indian Economy witnessed an increase in banking network from 8262 branches in 1969 to 60,220 branches in 1991, out of which there were 35206 and 11,344 branches were operating in Rural and semi urban areas respectively (Source: RBI (1998): Banking Statistics, 1992-95)

Post liberalization in 1991, there had been a significant growth in the banking sector, in the year 2014-15 alone, the growth in infrastructure posted in the banking network is significant. There had been 11315 new branches having collected Rs.94,351 billion as deposits and the access to liquidity was provided for by introduction of 189279 ATMs thus an important share had been there of the services sector predominantly banking and financial services in the GDP of the economy.

As indicated in Table 1 below, the number of bank branches and ATM's increased significantly for the period ending December 2014

Table 1: Branches and ATMs of Scheduled Commercial Banks as of end December, 2014

Bank type	Number of branches	On-site ATMs	Off-site ATMs	Total ATMs
Nationalised banks	33,627	38,606	22,265	60,871

State Bank of India	13,661	28,926	22,827	51,753
Old private sector banks	4,511	4,761	4,624	9,385
New private sector banks	1,685	12,546	26,839	39,385
Foreign banks	242	295	854	1,149
TOTAL	**53,726**	**85,134**	**77,409**	**1,62,543**

Source- https://en.wikipedia.org/wiki/Banking_in_India accessed May 4, 2016

It can be clearly evident from the above data that, there has been tremendous growth in the spread of banking network in the country since 1969 after nationalisation. However despite this wide network of bank branches spread across the country, the extent of financial exclusion in India is staggering.

3. A BRIEF CONTEXT OF FINANCIAL INCLUSION IN INDIA

Post-independence, almost all developed nations enthusiastically implemented finance policies, which focused predominantly on the provision of low cost credit to the rural population, through state monitored institutions. Indian policies on rural finance have reflected the worldwide outline since the 1950s with the execution of various forms of subsidised credit arrangements, including the grand Integrated Rural Development Programme (IRDP). The basis of outspreading subsidised credit is the model in developmental economics which proclaims that access to capital can lead to increased income and reduced poverty. The acute assumption of that model is that all households have an assignment to invest in and it is only the lack of collateral that halts banks from lending to the poor. It was precisely this justification that promotes innovation of collateral substitutes like joint liability which formed the basis for the microcredit revolution worldwide, predominantly in South Asia.

However, it is well known that economic needs of the 'excluded' segments of the economy go beyond access to credit. Improved access to various formal financial services includes safe instruments for savings, easy-to-understand insurance instruments, pension and transfer facilities, among others. These can enable building of an asset base which can provide future access to credit and risk management.

The main demand-side barriers to the provision of financial services to the poor are

1. The lack of awareness
2. Limited financial literacy
3. Limited access.
4. Complicated processes

Most products offered by banks are unsuitable for the poor and are usually attached with terms and conditions which prove to be cumbrous, further lowering the demand for these services. At the same time, inadequate financial literacy can result in people making wrong choices, and getting exposed to financial risks.

From the supply side, the main hindrance to the provision of formal financial services is transaction cost. As per the data**,** substantial numbers of bank accounts are under-operated, which depletes their cost effectiveness in regards to creation and maintenance of such accounts from the banks point of view.

From the banker's asset outlook, the insufficiency of collateral makes lending to small borrowers costly for banks and other financial institutions. Smaller coupon sizes add to the transaction costs. Furthermore, insufficient physical and lack of legal infrastructure make it difficult to extend and enforce contracts.

Unbanked India presents a significantly large opportunity that is still at a nascent stage of being tapped by the banking industry. Recent regulatory mediations have required banks to penetrate deeper in rural markets with ultra-small branches in villages with population as low as 2000. With substantial investments going into rural markets, developing a sustainable business model has therefore become a key imperative.

Various challenges inherent in rural finance have led to inadequate access to financial services for the unbanked population. Some of these are as below

***Inadequate credit information*:** Credit information for rural customers is usually constrained as the penetration of credit bureaus is not strong and the borrowers possess limited documentation in terms of proof of income.

***Limited collateral security*:** Assets ownership is limited and generally restricted to farm land with lack of clear title and documentation. Resultantly, this sector becomes a high risk segment for banks to finance.

High operational costs and complexity: Operational costs are higher on account of low ticket sizes, low population density and higher cost of due diligence. In addition, the rural economy is largely a cash economy, which leads to increased complexity and risk of operations.

Diverse profile: The sheer diversity of the Indian rural landscape poses significant challenges as the customer profile and banking needs vary across regions.

Lack of Effective Governance: There are evidences which show that there is an absence of effective governance in regards to repayment and many a time, such assets (loans) are even exempted from repayments or are restructured due to various political reasons.

Lack of control over Non Performing Assets: Due to the negligence of various parties to the effect, there occurs the

situation, where disproportionate credit is allowed by unethical means thus escalating the NPA of the banks.

4. REVIEW OF LITERATURE

In Portfolios of the Poor, *Collins et al. (2009)* tries to do this through the use of 'financial diaries'. The authors interviewed poor households in Bangladesh, India, and South Africa twice a month for a year, asking a series of questions which were then constructed into 'financial diaries' to understand how the poor spent their money. The poor in developing countries like India face three main issues or a *'triple whammy' — low incomes, lack of appropriate financial tools, and unpredictable outcomes*. It is these challenges which financial inclusion initiatives must address. This research found three main areas where poor households would frequently find the need to generate resources through financial tools. The financial portfolios of poor households are as diverse as those of their richest peers, with an average of 10 financial instruments per household (Collins et al., 2009). However, the diversity of financial instruments offered in India today by commercial finance companies as well as the government is limited in scope and scale, particularly to the poorer sections of society. According to a report of the Institute for Financial Management and Research (IFMR) (Kapoor et al., 2011), more than 90% of the population surveyed held bank accounts. Previous research indicates that though the access to credit and savings instruments can serve as insurance mechanisms along with societal arrangements of reciprocity, these are expensive in comparison to access to insurance instruments (Ravi, 2006). Limited understanding of health insurance results in a significantly lower claims to coverage ratio for the low income segment (Ravi & Rai, 2011).

5. FINANCIAL INCLUSION: THE NEED OF PRESENT TIMES

Most of the poor from both urban and rural background, lack access to basic financial services and address their need for financial products through various informal sources which are both high on cost and comparatively unsecured. Financial inclusion provides to reduce those risks, and offer safer options to them, but over the years, the policies implemented by the government to increase the presence of banks in remote rural areas have still not been able to cover the majority of the population. The individuals who have been provided with no-frills bank accounts failed to use these accounts to saving. Most of the strategies of the government in promoting financial inclusion have been based on the accessibility of bank accounts in order to facilitate credit to the poor. The provision of access to credit is one of the important constituent but not the only means through which the poor can be made to participate in the economy affairs through financial services.

I. **Rural population needs large sum of capital**: The economically weaker section needs to generate large sums of money to purchase agricultural paraphernalia or invest in numerous ways of human capital such as healthcare, school fees and ceremonial expenditures. However, there are various restraints on the ability to generate such large sums. Hence, they want those financial instruments that meet these needs by saving into a lump sum amount. Funding for daily expenditure is often unattended by the financial institutions, unlike the provision of lump sum of money. Therefore, the financial services, such as savings bank accounts, can be instrumental in cash flow management for households. Secure and accessible savings accounts can help them in consumption smoothing to a great extent.

II. **Contingencies arising out from unavoidable financial crisis:** Contingencies regarding those situations in which under-privileged find unable to provide for unavoidable crises like adverse weather conditions and health exigencies. These adverse situations forcibly set the marginal into poverty by forcing them to resort to borrowing from informal sources or to dispose of their assets. Exposure to high risk can also de-incentivise and demotivate them from investing into higher productivity.

The conventional banking model has clearly not worked in rural India due to its high cost structures and ineffectiveness in adapting to the requirements of rural customer. Making the best of the rural opportunity, the banks would be required to focus on the following few things:

- Developing simple products with minimal additional features and options.
- The product terms need to be communicated clearly and in a transparent manner.
- A gold loan is a good example of a highly simple and effective product to meet the credit needs of the rural customers.
- The product should require limited documentation
- It should provide the security of collateral like gold
- The present age banking should adopt Low cost innovative delivery models

Several new alternative channels are emerging as against the conventional bank branch model.

Business Correspondent (BC) channel has a strong potential to deliver technology enabled low cost solutions. However, the BC channel is only a means of delivering service and the banks would still need to work on product and market development to make the BC model sustainable and effective. Several instances are there of BCs opening a large number of accounts which continue to stay inactive and ultimately become dormant. Banks need to work on developing a comprehensive product including credit that can help BCs involve the customer for their financing needs.

Another low cost delivery model is *supply chain linked financing*. Several commodities and agricultural produce have a strong well developed value chain, wherein the linkage of the farmer to the end buyer can be tapped to create a financing opportunity.

6. Pradhan Mantri Jan–Dhan Yojana (PMJDY)

Financial inclusion had been a key objective of the government of India. Specific set of targets to provide for bank accounts to every household have been set up. Taking the ambition further, the Prime Minister announced the Prada Mantra Jan–Dan Yojana (PMJDY) with an objective of opening no-frills bank accounts. On the inauguration day itself, 1.5 crore bank accounts were opened. Within three months, the figure multiplied to 7.5 crore across India (http://www.pmjdy.gov.in/). Presently, the figure have touched the level of 21.61 crore accounts with the deposit mobilization of Rs. 36759.30 crores (2016)

Table 2: Pradhan Mantri Jan-Dhan Yojana (Accounts Opened as on 20.04.2016)

Bank Name	RURAL	URBAN	TOTAL	NO OF RUPAY CARDS	AADHAAR SEEDED	BALANCE IN ACCOUNTS	% OF ZERO-BALANCE-ACCOUNTS
Public Sector Bank	9.50	7.49	16.99	14.37	8.13	28876.72	26.79
Regional Rural Bank	3.29	0.54	3.83	2.66	1.19	6480.21	22.65
Private Banks	0.49	0.31	0.80	0.75	0.30	1402.37	39.31
Total	**13.27**	**8.34**	**21.61**	**17.78**	**9.62**	**36759.30**	**26.52**

Source- http://www.pmjdy.gov.in/ assessed 30- 04-2016

Financial inclusion in India focused on delivering credit through microfinance channels, state-owned banks and through state-promoted self-help groups. The PMJDY has complemented these efforts by forcefully accelerating the previous efforts of the Reserve Bank of India (RBI) of promoting financial inclusion through facilitating opening of bank accounts.

6. KEY FEATURES OF PRADHAN MANTRI JAN–DHAN YOJANA (PMJDY)

1. The PMJDY provides basic zero-balance bank accounts with accident insurance cover of 1 lakh
2. Overdraft facility of Rs 5,000 available for account holders.
3. The scheme would also facilitate the use of mobile banking among the poor through the National Unified USSD Platform (NUUP). The NUUP would allow customers to access banking services using a single number across all banks, irrespective of the telecom provider or mobile handset being used (National Payments Corporation of India, 2014).

PMJDY received strong support from both from public sector and private sector commercial banks. Resultantly, the provision of insurance and transfer facilities along with the overdraft facilities under PMJDY indicates a clear focus on expanding the portfolio of financial instruments available to all households in the economy.

7. MOR COMMITTEE

At a later stage in September 2013, Reserve Bank of India renewed its financial inclusion mandate with the formation of the Mor Committee on Comprehensive Financial Services for Small Businesses and Low Income Households. The recommendations of the committee included provision of bank accounts to all citizens, setting up state finance regulatory commissions and creation of a new entity in the financial system - payment banks.

8. ADVANCING FINANCIAL INCLUSION IN INDIA BEYOND THE JAN-DHAN YOJANA- THE WAY FORWARD

In November 2014, RBI has issued two new full bank licenses, released final rules for setting up small banks and payment banks. Small banks will provide both deposits and loans, but geared towards un-served and under-served segments such as small businesses and marginal farmers. Payment banks will offer a limited set of products, mainly demand deposits and remittances and transfers, and they will not be offering lending services.

With most financial inclusion policies in India solely focused on the provision of bank accounts and credit to the poor, there is a need to include more financial services in the portfolio of national financial inclusion strategies to account for the needs of this segment. We highlight some of these below and emphasize that they be ranked.

a. Innovation in savings instruments

Product design is analytically important when it comes to developing savings instruments for low-income households. The instruments must be designed according to the needs of the specific market segment. Extending products relating to the mainstream financial sector to the financially excluded segment can be risky. Thus, innovative products and services should be offered by the banking institutions, and they should not consider one product for all policy. This can be achieved through encouraging innovation and ensuring competition amongst the banking service providers in India.

Evidences of Financial Inclusion across economies

Internationally, the success of Bank Rakyat Indonesia (BRI) in providing commercially viable financial services – loans and savings, along with other financial products to the low-income households – has several lessons for India. BRI built a customer base of over 30 million depositors through tailoring their products and services offered to the needs of the clients. The management practices at the BRI have also been innovative such that each bank unit (branch) functions as an independent entity with its own targets and employee reward policies. This made the BRI a long term profitable bank.

Thailand’s largest state owned bank- Bank of Agriculture and Agricultural Cooperatives (BAAC) -followed BRI’s model and and there are evidences of bank reforms in China in tune with BRI model.

Another savings product is SEED (Save, Earn, and Enjoy Deposits) account, implemented by the Green Bank of Caraga in the Philippines (Ashraf et al., 2006). The SEED account provides individuals with a commitment which restricts their savings. The individual sets a goal, either a date or amount he/she wants to save, and is subsequently unable to withdraw money from the account until that goal is reached.

b. Indigenous institutions of financial inclusion

Research has shown that Chit Funds are widespread in India and have the appeal of a “bottom-up” approach to financial inclusion, aimed at providing low-income households the means through which they can meet their financial needs. In most parts of India, very large groups of people participate in different forms of informal regular savings-credit arrangements with each other quite similar to chit fund scheme which serves as an accessible option of insurance during financial crisis

c. Insurance instruments

Insurance is a critical component for financial inclusion of the unbanked, under-privileged and /or vulnerable segments of the population. As discussed earlier, the main needs for the poor are to have safety nets in order to provide for any unexpected circumstances, to hold lump sum money, and to provide day-to-day expenses. Besides tapping into savings, these needs can only be met through well-designed and easy-to-understand insurance products, including health, life, property, crop and myriads of other insurance instruments meant to mitigate different forms of shocks.

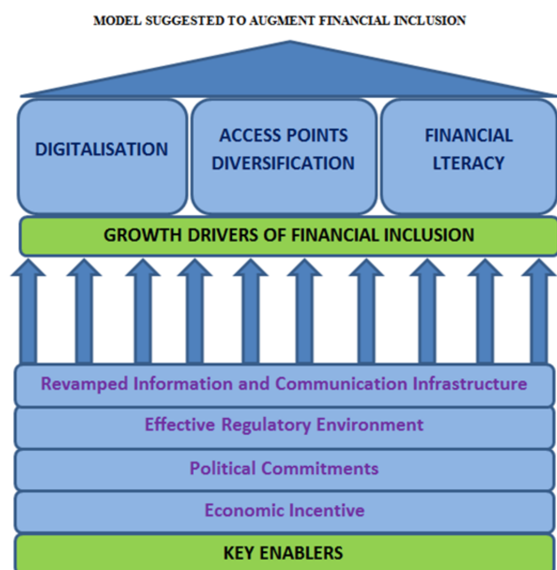
The new PMJDY provides some forms of insurance but is limited to accident and life. Launched in 2008, Rashtriya Swasthya Bima Yojana (RSBY) aims to provide health insurance coverage to all below poverty line (BPL) families in India. Till date more than 37 million BPL families have been enrolled in this health insurance scheme but it remains to be seen whether it is an effective tool to protect poor households from health shocks.

d. Technology

Technology had been the key factor in dropping the problem of access to banking services, and with schemes such as the PMJDY, providing access should not be among the major challenges. The technological options are prominently available, and with India’s booming telecom sector, the option of using mobile payments as a means for financial inclusion is feasible. According to the latest data released by the Telecom Regulatory Authority of India, the total number of mobile subscribers in India is around 900 million. Therefore, telecom companies have emerged as a viable tool to achieve financial inclusion. In Kenya, M-Pesa is one example of how mobile technology is used to complete banking transactions. The core idea of businesses such as M-Pesa rests solely on the facilitation of financial transactions via mobile phones. Under this system, customers can transfer money directly between accounts as well as between other customers as well, as long as both parties have M-Pesa (Kapoor et al., 2007).

9. CONCLUSION AND MODEL SUGGESTED

MODEL SUGGESTED TO AUGMENT FINANCIAL INCLUSION



Expanding access to financial services seems to hold promise as a means for including the poor, reducing poverty, and spurring economic development (Karlan & Murdoch, 2010). With the announcement of the new payment bank guidelines suggested by the RBI, there is anticipation that financial inclusion is a clearer and important mandate in the country. These measures emphasize the provision of bank accounts, which is an essential factor, but only a limited one towards achieving financial inclusion in India. Allowing and encouraging innovation in savings instruments for the poor by the formal financial sector is thus critical to achieving our goals of financial inclusion.

To complement such innovation, indigenous financial institutions must find a place within the financial inclusion policies of the government. Our policies must involve these and facilitate further healthy growth of such indigenous institutions. We must also actively seek to understand these institutions to shape a regulatory policy rather than shun all out of ignorance. Government policies must recognize this and build on the strengths of indigenous financial institutions. Thus for similar reasons, post offices must also be brought within the fold of national financial inclusion strategy due to their extensive network and greater accessibility.

Raising awareness and imparting financial literacy are also critical to the utilization of financial instruments and for better financial decision-making. Educating people about financial risks can prevent them from investing in doubtful schemes. Such schemes are particularly rampant amongst the poor and vulnerable sections of the Indian society, as recent scams have highlighted. Regulation should also ensure customer protection and transparency through requirements of clear and standardized reporting by the sellers of financial instruments.

Technology must be leveraged to bring down the operating costs of these financial instruments which are more expensive for small investments in comparison to large ticket instruments of the mainstream financial sector. Innovation in the financial sector- through greater autonomy and competition must be encouraged. Institutions should have the autonomy to experiment with management practices as well as financial products which can help offer sustainable solutions to the financial needs of all segments of the Indian economy.

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