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Financial Inclusion: Reasons for Financial Exclusion and Re-Engineering of Strategies to Address Such Issues in North East India

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Abstract

In India, 65% of the population live in rural areas where most of the places are still unbanked and financially excluded. Financial inclusion is burning topic now a days and over the years, it has earned significant importance in the social policies of the Government . Interestingly, India is poised to become the world's fourth-largest economy by 2025 with a GDP growth rate of 7 – 8 % a year. However, barely 34 % of its population is associated with formal banking channel. India has the second highest number – about 190 million – of financially excluded households in the world. In fact, low income, poor proximity to financial services outlets etc. are some of adverse factors that make it difficult for many to join the formal sector. Moreover, it is seen that those who are financially excluded have poor grasp of financial services offerings and also find formal channels cumbersome and time consuming.

Although Government of India has initiated a series of measures to overcome the problem of bringing the unbanked masses under the ambit of banking, success is yet to be seen. Research shows that many a times the financial excluded ones are brought under the banking net but owing to their fragile livelihood, they remain temporarily included and subsequently they are once again excluded. This is because a very few risk management and vulnerability reducing products are available to economically weaker sections which could create strong 'safety and security nets' for the poor and enable them to pursue diversified livelihoods.

Therefore, the paper focuses on finding reasons for financial exclusions and banking strategies to be revisited to access the unbanked and creating sustainable mechanisms to ensure that they continue to stay financially included.

Key works: Financial inclusion, Banking strategies.

Introduction:

According to Stephen P. Sinclair (2001): Financial Exclusion means the inability to access necessary financial services in an appropriate form. Exclusion can come about as a

result of problems with access, conditions, prices, marketing or self-exclusion in response to negative experiences or perceptions.

Reasons of Financial Exclusions: Root cause of financial exclusion can be attributed following factors. Firstly, the exceptional decline in financial retail outlets in poorer communities. Secondly, consequent to the physical problems of access among people living in poorer communities, especially by the low levels of vehicle ownership aggravated the situation. The concept of financial exclusion can also be further looked in other ways (S. Ramesh & Preeti Sahai, 2007): Insufficient access to financial services due to several reasons such as: Inefficient and inadequate sources of financial services in rural areas. There is no safe deposit, savings or insurance services. These financial services are generally offered by unprofessional money lenders who are permeated in the nook and corner of the villages. Low awareness and high level of barriers to avail information, especially for women in rural places. High cost of operating the business or servicing the poor people, huge client size but less volume of transactions added to the causes of exclusion by financial institutions, primarily because of low outreach. Some beleaguered financial institutions have poor functioning and financial history like financial cooperatives. The ineffectiveness of such financial cooperatives has limited their outreach figures largely. Therefore, absence of formal financial services found not only in rural areas, but also in urban areas

The cost of credit availed by the poor is very high and the conditions on which money is being lent is exploitative. Credit lent against the pledge of gold is very expensive than the effective interest rates, similarly, interest rate paid by hawkers and vendors are very high and generally the interest is charged on daily basis on these lending.

Absence of social security schemes like insurance products and pension plans are felt largely. The needs of life, assets, and health are substantially low.

One of the basic problems of Northeast India is the lack of adequate literacy and there is a connection between literacy rate and financial exclusion. Sufficient financial education is essential to include more number of people within the reach of financial inclusion or to minimize the degree of financial exclusion. With this level of literacy background, providing financial capability to the people is not just difficult, rather it is highly challenging task. The financial inclusion process has become more complex because of social exclusion issues. This has slowed down the extension of financial services to people and making them financially literate in a big way (S. Ramesh & Preeti Sahai, 2007).Self-Exclusion: This indicates that people on their own voluntarily believe that they are refused to avail financial services by the providers and hence feel there is absolutely no need of applying for financial services. The reason why people feel on their own that they will be rejected at application stage itself may be due to perceived differences in dealing with the service providers or due to their experiences. The risk perception attached to the financial products and services offered to the poor people, its cost of assessment and management of products, inadequate rural infrastructure such as road, electricity, internet etc. and finally the

vast geographical spread of rural areas are major causes of financial inclusion in India. The population that desires to access financial services has to have some level of income. Hence, the large population that fall below the poverty line is deprived of the financial services. As a result, the extent of financial exclusion tends to be higher due to lack of demand from this segment of population. The reason is simple, that poor may not have sufficient savings to place deposit in savings bank account or to avail credit in turn. Consequently low income results in slack demand for financial services, particularly savings and credit products (RBI, 2008).

India with its large geographic size, overwhelming population, and diverse culture has extreme disparities in income. About 35 % of the country's population resides in metro and urban cities, while the rest spread in several semi-urban and rural areas (NEDFi, Databank Quarterly, 2004). Interestingly, a large percentage of its population still remains illiterate but, at the same time, the country has a large reservoir of managerial and technologically advanced talents. All these pose a major challenge for the policy makers of India in bringing about equitable development and growth of all the regions as well as its people.

In spite of diversities, India is well positioned to become the world's fourth-largest economy by 2025 with a GDP growth rate of 7–8 % a year[1]. This rapid expansion is expected to continue as growth in the services and high technology manufacturing sectors accelerates. Though the economic growth rate looks satisfactory, but this growth rate cannot be considered as inclusive. This is due to the fact that the economic condition of the people in rural areas is worsening further. And one of the typical reasons for poverty is being '*financially excluded'*. Thus, financial inclusion of the masses, especially the economic weaker sections, is highly important for the society because the consequences of financial exclusion may be quite harmful.

In fact, India, with barely 34 % of its population engaged in formal banking, has the second highest number – about 190 million – of financially excluded households in the world (Sinha & Subramanian, 2007). GOI had been utilising the banking sector as a tool to provide services to low-income households or certain sectors of the economy viz. agriculture, livestock, rural trade and industry etc. In spite of this, financial exclusion – individuals' limited access to or use of formal financial services has emerged as a concern for policymakers in recent years in India as well as in other countries of the world. As most of the financial services are coordinated through banks, financial inclusion can be treated synonymous to banking inclusion. In other words, as banks are the gateway to the most basic forms of financial services, financial inclusion/exclusion is often used as analogous to banking inclusion/exclusion.

Objectives of the study: The main objective of the study is to identify the causes of financial exclusion and an endeavor is made to design additional strategies to overcome problems of financial exclusion in the North east region.

[1]McKinsey & Company's Report on 'India Banking 2010 – towards a high-performing sector', October, 2005.

Research Methodology: Secondary research was conducted to study the current scenario of financial inclusion in Northeast India based on the reported information of Reserve Bank of India, Banking institutions and research papers.

This paper first offers conceptual discussion on the much-debated topic 'financial exclusion' and then systematically offers an analysis of the existing policies pertaining to financial inclusion. The author also proposes additional strategies for banks, which seeks to overcome the limitations of existing strategies and also to penetrate deeply into unbanked areas.

Financial Inclusion/Exclusion: The basic objective of financial inclusion is to provide access to affordable banking services to a vast segment of hitherto unbanked people. This is deemed necessary for achieving inclusive growth because availability of easy and cost-effective banking services for savings, investments and credit enables the people to break the chain of poverty by using credit for various productive and consumption purposes.

In a broad sense, financial inclusion refers to delivery of financial system of an economy to its members (Chakravarty & Pal, 2010). The Government of India's '*Committee on Financial Inclusion in India*' defines financial inclusion 'as the process ensuring access to financial services and timely adequate credit where needed by vulnerable groups such as the weaker sections and low income groups at an affordable cost' (Rangarajan Committee, 2008).

Financial inclusion is often defined in terms of financial exclusion. The RBI Deputy Governor, Smt. Usha Thorat (2007), defined financial inclusion in terms of exclusion — exclusion from the payments system and exclusion from formal credit markets. Exclusion from the payments system is measured in terms of not having access to a bank account while exclusion from formal credit markets is measured in terms of number of loan accounts.

Financial Inclusion in Northeast India–Policy Perspective: In order to bring the unbanked people to the financial mainstream of our country, the GOI/ RBI had been designing innovative strategies. Most of these strategies were targeted towards the unprivileged people who are reluctant to join the formal banking sector owing to their meagre income and lack of education. For instance, the RBI, in its Annual Policy Statement for the year 2005-06, advised banks to simplify '*know your customer*' (KYC) procedure and also make available a basic banking 'no-frills' account with low or 'nil' minimum balance as well as charges. The motive is to expand the outreach of such accounts and cover that percentage of population who are yet to be banked.

Banks were also asked to utilise the services of NGOs/ SHGs, MFIs and other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitators/ business correspondent models and thereby, facilitate in the delivery of innovative products which also includes insurance policies at affordable cost and covering life disability and health. Use of Information and Communication Technology

(ICT) solutions by banks are also encouraged for enhancing their outreach with the help of their business correspondents. Above all, RBI emphasised on financial education and also made it mandatory for Banks to provide all the material related to opening accounts, disclosures etc. in the regional languages.

However, it spite of all these, a huge chunk of the Indian population is still remains unbanked.

Financial Inclusion in India–The Reality: In India, after more than 63 years of independence and nearly a dozen of five-year plans, a shocking 30-35% of the country's total population still lives below the poverty line (Arunachalam, 2008). What is disheartening to state is that poverty is now almost uniform in terms of the proportion of population in rural and urban areas and it is accompanied by low health and nutrition levels, high infant mortality and illiteracy. Even more disturbing is that, those less-privileged who are within these poor, are the poorest, and they live on an income of less than $0.50 per day. This segment of the population are confined not only to the rural area but also seen in urban areas and consists of farmers, small vendors, agricultural and industrial labourers, people engaged in unorganised sectors, unemployed, women, old as well as physically challenged people.

The Indian economy is growing at a fast pace and it is mainly due to contribution from the services sectors. However, the growth in agriculture is quite dismal, despite the fact that it is the source of sustenance to a majority of our people (Srivastava, 2008). The main reasons that can be attributed for poor growth of agriculture in the country are limited access to affordable financial services, such as savings, loan, remittance and insurance by the vast majority of the rural population. In other words, it can be said that farmers' low income, poor proximity to financial services outlets and lack of knowledge about financial products presently available are hindering the flow of funds to these areas from the organised sector. This eventually compels them to approach unorganised sectors – the indigenous bankers like *seths*, *sahukars* etc. and thereby they opt for costlier and exploitative sources of finance. Another striking fact about agricultural activities in our country is that Indian farmers are still using the traditional techniques of farming and are also dependent on monsoons. An agrarian debacle – a drought or a bad harvest – is enough to ruin the farmer and his family. In fact, many end their lives as they were unable to come out of the '*debt traps*'.

The plight of the industrial labourers, small vendors, and village artisans is almost similar to that of the farmers. Unfortunately, their meagre daily earnings are not enough to provide a square meal to their family members. This often forces them to borrow money from unorganised sector at a very high rate of interest. The consequence is that many are not in a position to repay such loans and eventually they end up selling their household assets.

Significantly, in India, low literacy level, lack of financial education and awareness, poor proximity to financial services outlets and presence of unorganised sector especially in rural

areas are believed to act as constraints to the growth impetus in these areas. Moreover, the rural population–in view of lack of proper education – has a poor grasp of financial services offerings and also find formal channels intimidating. All these factors are partially responsible for aggravating the problem of financial exclusion in India.

In spite of the best of efforts made by the Government and the banks to bring the economically weaker section – the farmers, village artisans and those having low income under the ambit of banking, total success is yet to be seen. Many of the unprivileged tend to remain temporality included but in the long-run, they are financially excluded once again. This is due to the fact that a few risk management and vulnerability reducing products are available to this category of population. Unfortunately in India, financial inclusion is more or less restricted merely to opening 'no-frill' savings accounts and/or providing credit for consumption/consumer spending. But the focus for financial inclusion should have been on something else. To be specific, it needs to focus more on enhancing the livelihood sustenance power of the poor and ensuring that they remain financially included in spite of their fragile livelihoods and the vicious cycle of poverty. It needs to devise and deliver financial products–innovate, hybrid and custom-made–that can help in risk and vulnerability management for the poor.

Re-engineering of strategies to overcome the problem of Financial Exclusion: Financial institution should come up with products that are able to mitigate livelihood-risk and essentially support and supplement the earnings of the economically vulnerable groups through effective-linkage of financial products with social security and income generating schemes. Moreover, there is a need of a multi-pronged strategy by banks to reach out to the poor for financial inclusion in view of the complexity involved as well as the huge quantum of the task to be completed (Srivastava, 2008). Thus, in the context of this, the strategies of banks and financial institutions should be formulated or moulded in the light of the following:

(a) **Linking Social Security Schemes with Financial Inclusion:** Poverty is directly connected to the lack of resources to generate an income that enhances an individual's standard of living .In a developing country like India, one of the main reasons for financial exclusion of the economic weaker section is that apart from their meagre income, they often lack a regular source of income. Thus, they are vulnerable to become financial excluded even if they are being included at one point of time. Therefore, it is warranted that in order to ensure that those who are financial included remains included, the government in collaboration with financial institutions should float various schemes under the Mahatma Gandhi National Rural Employment Guarantee Act and also similar other social security schemes. The existing schemes under NREGA aims at enhancing the livelihood security of people in rural areas by guaranteeing hundred days of wage-employment in a financial year to a rural household whose adult members volunteer to do unskilled manual work. These schemes tend to supplement the meagre income-base of the poor. This in turn

promotes regular small amount of savings on their part and guarantees to some extent that they remain financial included.

Moreover, the Government should have tie-ups with insurance companies and other micro-finance institutions and ensure that against a nominal amount of premium, the individuals from the economic weaker section are insured or they are able to save a small amount of their earnings in certain micro-finance schemes and earn a reasonable return. Thus, it is believed that by linking social security schemes with financial inclusion, the underprivileged lot can remain financially included.

(b) Innovation & Customization and Risk Management: Banks, in the wake of intense competition on the market, have focused on product innovation and their products are designed in the light of customers' ever-changing requirements. In fact, many banks have come forward to provide customized products and services to their clients. However, most of the products that banks have in their product-bouquet are aimed to meet the requirements of a class of people – those who are financially well off. Unfortunately, there are too few products meant for the excluded segment of the population. Their needs are varied and as such the need for savings by these groups requires special attention. To be specific, an average Indian requires finances to meet his life cycle needs, to create assets, to repay high cost of borrowings, to meet emergencies. It is quite astonishing that most of the products that banks have in their product-bouquet at present do not effectively meet these needs. Thus, in the light of these requirements of the excluded group, focus should be on product innovation especially catering to their needs. Moreover, these groups may not be having a regular source of income. Therefore, the products should be designed to reduce their livelihood-risk exposure. Thus, while designing products, it is desirable that a saving or a credit product is clubbed up with a micro-insurance product with life and health cover facilities. Marginal investments in such products would eventually ensure that they remain financially included and at the same time, they and their family members would be insured against risks to some extent.

(c) Financial Education: Financial services have failed to adequately reach poorer populations. One of the many reason why poor customers are ignored is the common perception that lending to the poor is too risky to be commercially viable. Moreover, banks and financial institutions perceived that targeting and serving the poor many not be a profitable business proposition. In view of this myth, banks and financial institutions have ignored the financial needs of this category of the population. This is one of the many reasons why a huge chunk of the country's population is denied access to banking services.

But in reality this is not so. Even the excluded segment, if effectively targeted with right type of banking and financial products, can turn out to be profitable venture for the banks. Moreover, the customer-base as well as income of a bank can be increased substantially when these targeted groups (the excluded population) volunteer to come forward and procure banking and financial products. This would be possible if customers

are '*financial literates*'. In view of this, opening of credit counselling centres by banks is deemed necessary. Although a few commercial banks have already taken such initiatives but the number is inadequate when compared with the large population of the country. The Counsellors in these Centres should assist people on a face-to-face basis and also through other communication channels. Apart from advising people on the availability of banking and financial products, they should also advise them on what could be the other diversified activities/ trades they can opt for and enhance their earnings. The objective, however, should be not only to increase the customer-base of the bank and bringing the masses under the banking net permanently but also at the same time the focus should be on '*creating entrepreneurs and not borrowers*', so that they remain financially included permanently.

(d) Local Tie-ups/Involvement: Financial services have failed to adequately reach poorer populations for a number of reasons, including–inadequate infrastructure, inhibiting regulatory and legal environments, and limited understanding and awareness of financial services by the poor. Moreover, successful financial inclusion requires the outreach of banks even in the remotest places of the country. Although banks and financial institutions have a role to play in nation building but these institutions cannot single-handedly guarantee inclusive growth in the country. This is because it would not be viable for banks and financial institutions to establish branches in every nook of the country. However, this problem can be overcome if various social-change entities are entangled in the process. These entities can play the role of catalyst in the process of facilitating financial inclusion and can be the extended arms of the banks and financial institutions. They include the NGOs, SHGs, MFIs and business correspondents/ business facilitators.

Local tie-up with the local Kirana Shops, Pharmacy Shops, Petrol Pumps and Village Panchayat can be additional effective strategies in the process of financial inclusion with relaxed KYC norms at least making initial relations with the potential customers to encourage door step banking.

Limitations/implications: This paper is theoretical in its nature and as such proposes a basis for a detailed empirical examination of the proposed strategy and its associated propositions.

Conclusion: As the process of financial inclusion can be greatly facilitated through the active involvement of banks, therefore, the need of the hour is formulation of conscious strategies for augmenting the financial initiatives by banks.

These strategies are to be designed in the light of the socio-economic complexities in India with focus on innovative products (capable of risk mitigation) and effective service delivery channels.

Recently Indian Postal bank has taken game-changing strategy called banking at the door steps though Postman and Gram Dhak Sevak to provide banking services at the doorsteps of

every house hold. However this unique strategy is still in the planning stage. If this is implemented properly then it will redefine the concept of financial inclusion in North east India.

Concurrently, efforts should be made by the banks and the Government to create awareness on the availability financial services as well as on the need and benefits of remaining financially included among the unbanked people.

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