# Financial Inclusion - A Profitable Inclusion

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**Abstract - Financial inclusion has emerged as an important development goal at national and international level. Financial inclusion officially started in India in 2005, with a pilot project in Mangalam in Puducherry. It became the first village to achieve 100% financial inclusion. Financial inclusion is a structured strategy to extract a growth which is coupled with equivalent opportunities, constituting of economic, social, institutional and political dimensions. But it is still a stubborn challenge in size and scope, although, is of great deal in terms of social and business opportunities.**

**This research article is an attempt to comprehend how financial inclusion is profitable in India wherein problems like financial and digital illiteracy rule. With the introduction of right reforms and revolutionary approach (financial and digital literacy, appropriate financial services) by Reserve Bank of India and Government of India, the goal of achieving 100% financial inclusions is not far and have ensured to some extent the inclusive and efficient financial markets that have the potential to improve lives, deliver social security nets, reduce transaction costs, spur economic benefits and innovatively earn profits.**

***Keywords: Digital literacy, Financial literacy, Financial inclusion, economically profitable, inclusive growth, socially profitable.***

## I. INTRODUCTION

The approach to financial inclusion, which seems to be an anti-thesis of Narasimhan reforms, drifted its emphasis from priority sector lending to specific sectors (agriculture and small scale industries) towards unbanked individuals with a mix of developmental initiatives along with regulatory relaxations. Financial inclusion is a new wine in old bottle. Nicholson Report (1895) can be traced as the earliest effort of financial inclusion that emphasized on the need of Land Banks, and the process to save borrowers from covetous money lenders.

The process gathered momentum by setting up of cooperative societies in 1904, finding of All India Rural Credit Survey in 1950s, setting up of State Bank of India in 1955, lead bank scheme in 1969, Nationalisation of Banks in 1969 and 1980, Priority Sector Lending requirements for banks, establishment of Regional Rural Banks (RRBs) in 1975, National Bank for Agriculture and Rural Development (NABARD) in 1982, service area approach in 1989, banking sector reforms in 1991, Self help group-bank linkage programme in 1992, Rashtriya Mahila Kosh in 1993, rural infrastructure development fund in 1995, local area banks in 1996, kisan credit cards in 1998, opening no frill accounts in 2005, relaxation of know your customer norms in 2005, microfinance and microcredit facility, overdraft facilities in saving accounts, general credit cards, financial literacy programs and centres, involving information communication and technology based Business correspondents/Business facilitators in 2006 and 2009, immediate payment service in 2010, Swabhimaan in 2011, Rupay Cards in 2012, three year financial inclusion plan in 2010-2013 and 2013-2016, Direct Benefit Transfer in 2013, Pradhan Mantri Jan Dhan Yojana in 2014 and Atal Bima Yojana in 2015.

Analysing the issue and importance of inclusive financial system, Reserve Bank of India set up Khan Committee in 2004 to inquest planned and structured financial inclusion and recommend low cost safe delivery channels and policies for better accessibility to unbanked population without any discrimination. The recommendations of Khan Committee were incorporated in the mid-term review of the policy 2005-06. It urged banks to promote and achieve the targets of financial inclusion through no-frill accounts. Thus, financial inclusion officially started in 2005, with a pilot project in Mangalam village in UT Puducherry, by Dr. K. C. Chakraborthy. Mangalam village became the first village in India to achieve 100% financial inclusion.

Rangarajan Committee set up in 2008 recommended opening of 250 accounts in each branch every year in order to achieve the target of financial inclusion. It also recommended appointment of micro financial institutions and non government organisations as business correspondents as per Reserve Bank of India norms. The committee highlighted inability to provide collateral security, poor credit absorption capacity, weak community network as the main reasons for low level of financial inclusion in India.

Nachiket Mor Committee or Committee on Comprehensive financial services for small businesses and low income households which was set up in 2013 recommended providing a universal bank account to all

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above 18 years of age, to link aadhar cards with the bank accounts, adjust fifty percent of the priority sector lending with adjustments for sectors and regions based on difficulty in lending.

Deepak Mohanty Committee was set up in 2015 to work out a monitorable medium term action plan for financial inclusion in terms of payments, deposits, credits and insurance. Committee worked to look into measures to spread financial services to unbanked people, to review existing policies covering customer protection and financial literacy, to study cross country experiences in financial inclusion to identify key learning in technology delivery models, policies and practices.

## II. LITERATURE REVIEW

**Financial intermediation theory**: Financial intermediation refers to the process where banks act as intermediaries between saver/depositors and investors/borrowers and serves to reduce the channelizing costs and asymmetric information. The theory explains why banks act as agents and how because of market imperfections borrowers and savers are not able to interact directly. According to Diamond and Dybvig (1983), banks analyse that depositors are risk averters and they all don't demand money at the same time, so by keeping a small amount with the bank they lend out the money to the borrowers. Since banks facilitate both the customers, they charge higher rate of interest on loans as compensation for bearing risk on surplus lent funds and pay interest on deposits. If the role of delegated monitoring is done efficiently, then banks will run smoothly and their financial performance will improve over time.

**Mohanty (2015)** in the report of the "Committee on Medium-term Path on Financial Inclusion", committee which reviewed the existing policies and programs of financial inclusion, studied cross country experiences to retain key lessons and suggested medium-term plan with much focused on financial inclusion services, gaps in usage of accounts for deposits and credits, inclusion of women, small and marginal farmers, small and medium enterprises through possible Government-to-person payments, strengthening of financial literacy centres, problem of stability, to cut high technology costs and improve all delivery channels so that by 2021, around 90 percent of the underserved section of the society becomes part of the formal financial system.

**Kumar (2013)** intended to find out the current status of financial inclusion in India and determinants of financial inclusion. The study explored 29 major states and union territories for period 1995 to 2008 using Kendall's index of rank concordance, panel fixed effects and dynamic panel generalized methods of moments to seek convergence of states in targeting financial inclusion and determinants of financial inclusion. It was concluded from the study that branch network has strong positive association with financial inclusion. Number of banks and branches, number of employees, socio-economic and environmental surroundings, banking habit of people was few major determinants of financial inclusion. Demand side constraints exist in system as penetration indicators are not able to catch up the rate of population growth. This study provided a ground for policy makers to check the unachieved target of financial inclusion.

**Chattopadhyay (2011)** performed the study for the period 2006 to 2010 encompassing 23 states to evaluate the level of financial inclusion in India and particularly in West Bengal. Index of financial inclusion revealed that there had been great adoption of the financial inclusion programme but only two states i.e. Maharashtra and Karnataka had high index of financial inclusion values. Study highlighted that the trench between the urban and rural households had widened as there had been constraints both on the supply side and the demand side. Study also revealed that one third of the population of West Bengal thought that they did not have adequate income to open an account, and rural households depended upon the moneylenders for money. Majority of the people of the chosen three districts of West Bengal had financial literacy and were aware of the banking facilities.

**Rajan (2007)** elucidated the opportunities and challenges faced in the adoption of the financial inclusion programme. Due to low financial literacy, lack of banking habits among people, lack of financial services in remote areas, low income and many other factors, the status of financial inclusion had been low in India. So, Indian Bank initiated the drive to promote financial inclusion using Rural Financial Inclusion Model in Mangalam village of Puducherry and Urban Financial Inclusion Model in Dharavi, Mumbai as pilot projects in 2005. Paper highlighted the process undertaken, issues faced and raised, responses and reactions of general public and challenges faced by officials, volunteers and SHGs in accomplishing the project. It was found that officials had successfully completed the mission in 2006 achieving cent percent inclusion in both the projects. Author recommended banks to shift focus on financial literacy programmes, technology adoption, no-frill accounts, and various consumer friendly schemes and services.

## III. RATIONALE AND OBJECTIVE OF THE STUDY

Financial inclusion has emerged as an important development goal at national and international level. The G-20 has urged for global action both to advance financial inclusion and to boost financial stability at the global and national levels. It becomes requisite to comprehend how financial inclusion is profitable in all spheres of economy, how financial inclusion brings social and economical change.

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## IV. METHODOLOGY

The present research article is descriptive in nature and has been instituted using analytical analysis. The analytical analysis will be undertaken by reviewing existing literature, available financial intermediation theories and related empirical works, research publications, Reserve Bank of India reports and working papers and various efforts taken by government to promote financial inclusion. After analyzing the available literature, concrete observations will be framed.

## V. FINANCIAL INCLUSION

Financial inclusion is a structured strategy to extract a growth which is coupled with equivalent opportunities, constituting of economic, social, institutional and political dimensions. Rangarajan Committee (2008) defined financial inclusion as "the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."

Financial inclusion seeks to ensure that vulnerable groups such as weaker sections and low income groups, excluded population, marginalised majority have timely access to easy and adequate credit and can effectively use the appropriate full range of quality financial services and products ranging from savings, payments and transfers to credit and insurances, at reasonable cost and in a fair, efficient and transparent manner without compromising on acceptable levels of safety and soundness by responsible, formal, sustainable and regulated mainstream institutional players.

Diverse meanings and definitions of financial inclusion float in literature, but in general, it can be explained as: demand side financial inclusion and supply side financial inclusion. Demand side explains financial literacy and availing of financial services by the clients and supply side explains availability of bank branches and ATMs and accessibility deposit and credit accounts at a reasonable rate of interest by formal financial institutions.

Financial inclusion needs to concentrate on:

- An approach to provide access to diversified financial services at a reasonable affordable rates and not just credit or deposits alone.
- Meet the needs of marginal farmers, migrant population, small firms, and vulnerable sections of the society.
- Deprived segments of population on the basis of incomes, gender, remoteness, etc.

Financial inclusion is delivery of timely adequate financial products and services at reasonable rates. Though it seems simple in understanding, it is equally difficult in implementing as there are hurdles like financial illiteracy, complicated procedures to use financial products, orthodox traditional values, poverty and unemployment among others.

## VI. FINANCIAL INCLUSION AS SOCIALLY PROFITABLE INCLUSION

The blueprint to enhance financial inclusion is twofold: strengthen financial potentials through training and education but also help a efficient interaction between cash transfers beneficiaries and the financial system, and foster the supply of high quality financial services in rural areas, by different financial suppliers. No frill accounts, over draft facility, micro-financing financial literacy programmes of financial inclusion are the crucial factors for the bottoms of the pyramid.

Financial inclusion, an enabling factor which drives sustainable, equitable inclusive growth, eradicates poverty, dilutes regional disparities and supports rural and agricultural development, is quality of infrastructure. Disciplined inclusive sustainable growth with the help of financial inclusion can positively contribute to poverty reduction and employment generation by creation of productive, equal access of opportunities to poor, women and vulnerable groups.

Accelerating agricultural and rural development through priority sector lending and financing has the capability to revitalize the rural economy and hence is a pivotal component to enhance inclusive growth. Accepting yield improved technology, high priced commodities, mechanization, off farm goods and services, growth and employment opportunities, upgrading rural infrastructure, revamped health facilities, and regulated markets, render value addition.

Financial inclusion bestows legal identity to a being as birth certificates, ration cards, aadhar cards or any proof of identity in general are required for opening an account. Legal identity has the potential to empower women and emancipate them not indulging in economic activities.

Rendering access to finance accelerates thrift and habit of saving among low income earners, builds a confidence because of social security nets, direct benefit transfer schemes, etc. Central and state government direct benefit transfers are routed through aadhaar linked accounts. Through judicious use of financial resources, exploitation of economies of scale, removing market imperfections, vicious circle of poverty can be beaten.

If one tries to look into financial inclusion closely, one can see that it manifests macro-economic and indirect benefits. It is clear from the literature that financial inclusion is positively associated with growth and employment. Broader access to deposits has broader opportunities for poor to uplift from its current state. Financial inclusion can improvise the efficacy in execution of government payment of social safety net transfers i.e. government-to-


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person payments, which plays an crucial role in welfare of the unprivileged people.

Financial innovations and technology upgradation can immensely lower the costs of transactions and increased penetration. With the evolution of profits of financial inclusion, private sector has attracted and it is actively participating in penetrating financial inclusion, otherwise it had become the responsibility of government and public sector banks to target the unprivileged and vulnerable population.

## VII. FINANCIAL INCLUSION AS ECONOMICALLY PROFITABLE INCLUSION

"The major players for delivering formal credit are (i) Commercial and Regional Rural Banks (ii) Co-operative Banks, both urban and rural and (iii) Non Banking Financial Institutions. By and large, at end March 2015, Scheduled commercial banks dominated credit supply with nearly 71% of total credit outflow, followed by non banking financial institutions with about 12% *(Report of the committee on Medium term Path on Financial Inclusion, December 2015, Chaired by Deepak Mohanty)*." Commercial banks are important agents of banking system to bring a desirable change in different strata of the society.

Banks serve as the backbone of the financial sector that accumulate savings from surplus economic units in the form of deposits and provide it to deficit economic units in the form of advances, with the aim to generate income to back up their operational costs since the sole aim of the commercial banks is to earn profit. Liberalization, privatization and globalization have remarkably transformed the business activities of banks for better opportunities to generate profits and bank stability. Banks have commendably progressed and contributed in different areas, particularly in financial literacy, project financing, entrepreneurial assistance, technological adoption and upgradation, rural banking, ATMs and eased transactions. Banks create larger scope of financial inclusion for all levels of people of the economy by providing a platform which facilitates related financial intermediation by diversifying their activities.

Financial inclusion is likely to influence profitability and stability of banks by changing the level of lending opportunities. Financial inclusion is an important ingredient to increase the efficiency of banks. By reaching out to more and more unbanked population and areas and informal sector through financial outreach-geographical and demographical, banks may curtail distance, drop default rates, build strong relations with a wide range of customers and gather sufficient retail deposits. Retail deposits provide a diversified, stable, steady, secure cheaper long term funding base in comparison to wholesale funding which is extremely unstable and often costly. Small clients provide big opportunities to mobilize stable deposits. Low income savers tend to preserve a stable behaviour through business cycles. Hence during crisis, low income customers' deposits act as a source of funds when other finances melt away.

Greater diversification in funding strategy related with financial inclusion in mobilising deposits may lower risks and funding costs of banks and boost bank stability. Also according to portfolio theory, diversified banks can decrease earning volatility and adverse earning risk taking incentives through cross subsidisation.

Financial inclusion renders not only macro-economic benefits but also micro-economic benefits as it has the ability not only to influence deposits and credits but also insurances, payments via post offices, mobiles and internet. Small and marginal businesses' access to credit has positive impacts on their ability to widen their efficiency. Whereas households try to smoothen their consumption patterns and builds capital stocks. Insurances and savings help and builds confidence in common man to mitigate risks and shocks.

## VIII. MEASURES OF FINANCIAL INCLUSION

**Financial literacy**: "A combination of awareness, knowledge, skill, attitude and behavior necessary to make sound financial decisions and ultimately achieve individual financial wellbeing" (OECD). Human contact becomes necessary with illiteracy. Financial literacy has three vital components i.e. individual finance management, operational knowledge and knowledge about the products and services and financial literacy should lead to empowerment, poverty eradication, consumer awareness, and socio-economic development. A financially literate society can make best use of the financial resources. Financial literacy is essential for consumer protectionism. Transparent financial system coupled with easy norms and regulations can only eradicate information asymmetry between financial agents and clients.

Financial freedom is a choice, a choice that that comes with financial education. Financially empowered India is not only a vision but also a mission. Financial knowledge will change financial behavior, financial behavior will change financial attitude and financial attitude will change financial literacy.

**Digital revolution:** Digital literacy should be intrinsic part of the financial system since it has the capability to curtail intermediaries, save time, can be learnt faster, cut down cost of transactions, eased safe operations and transactions, facilitate upgraded technology updates, deliver comparable schemes, services and products, among others. Mobile banking, internet banking, net banking, etc. are most convenient, easy to own and great way to reach across.

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Financial literacy and digital literacy are hand in glove marketing strategies to catalyse financial inclusion. Before social inclusion, digital inclusion is the need of the hour. Bringing down the cost of transactions and facilitating services without physically visiting the banks is a win-win situation for both financial agents and customers.

**Aadhaar card linkage:** A centralized authentication system is anyhow better than a distributed system where banks kept the records of its own customers. All 27 public sector banks have made eKYC procedure common use. After the introduction of Aadhaar, the total number accounts opened and the total number of transactions done is 3.8 million and 6.3 millions respectively (Source: UIDAI, December 31, 2014. *https://uidai.gov.in/*). "Aaadhar is the backbone of financial inclusion initiatives that will not just strengthen financial deepening further but will create a universal robust platform for leakage proof direct transfer of government subsidies to the individuals at a much reduced cost, resulting in huge saving." Mr. Prashant P. Singh, Assistant Director General, UIDAI Regional Office, Mumbai, Government of India. Meaningful financial inclusion with the help of Aadhaar is certainly the key to inclusive economic development of the unprivileged and excluded section of the society, benefiting the development of the nation. UID will render safe, better and effective delivery of services and governance at a reduced cost. It has the potential to strengthen equity. Now schemes like swabhimaan and swamlamban will be more effective in functioning and encourage informal/unorganized sector to lead a dignified life.

**Jan dhan yojana:** The big bang launch of Pradhan Mantri Jan Dhan Yojana, accompanied by the innovation of zero balance accounts and insurance policy is a step in the right direction. "Dr. A. M. Pedgaonkar, Chief Advisor - Banking Technology, Indian Banks' Association, broadly spoke on the initiatives the government has taken to bring in money into the zero balance accounts. He said that the main focus should be in inculcating the trust factor amongst the customers. The government has launched the schemes with multiple benefits such as Rs. 30,000 insurance for social security, Rs. 5000 overdraft after 6 months and accident insurance up to Rs. 1,00,000. RuPay debit card has been issued to the customers so that they can withdraw money wherever they go. Evolution of the handheld devices has only made it easier to carry out transactions in remote areas." An agent needs to run a low-cost operation which opens "small" savings accounts, provides deposit and withdrawal services and offers products like micro insurance and Atal Pension Yojana.

## IX. CONCLUSION

With the introduction of right reforms and revolutionary approach by Reserve Bank of India and Government of India, the goal of achieving hundred percent financial inclusions is not far. Also with the help of financial and digital literacy, financial services and products will indeed be penetrated to every citizen of the country in near future. It has been found that policy makers and researchers are involved in framing rigorous policies and rules that can ensure and have ensured to some extent, the inclusive and efficient financial markets that have the potential to improve lives, deliver social security nets, reduce transaction costs, spur economic benefits, and innovatively earn profits. It has been also found that financial inclusion and financial literacy should go hand in hand to have sustainable inclusive growth. Empowered consumers will make best choices for personal well-being and thus in turn will lead to welfare of the entire nation. Research article supports that financial inclusion is certainly a profitable inclusion if practiced cautiously. Plethora of talks and actions has taken place in this direction but still it seems it is a long way to go.

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