

## ROLE OF FINANCIAL INCLUSION IN INDIAN ECONOMY: A CONCEPTUAL FRAMEWORK

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### ABSTRACT

Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way. Financial Inclusion is an important priority of the Government. The main objective of Financial Inclusion is to extend financial services to the large hitherto un-served population of the country to unlock its growth potential. In addition, it strives towards a more inclusive growth by making financing available to the poor in particular. Access to a transaction account is a first step toward broader financial inclusion since it allows people to store money, and send and receive payments. Financial prominence of people plays a pivotal role in accessing available financial services. It is impossible for poor people to access financial services even when these services are made for lower income level group. Moreover in India, a lot of hidden bank charges which has been demotivated poor persons in availing these services. It enables to reduce the gap between rich and poor population. Financial inclusion is important priority of the country in terms of economic growth and advancement of society.

***Keywords:** Financial inclusion, Government, Transaction, Economic growth and Society.*

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### INTRODUCTION

Financial inclusion may be defined 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 (The Committee on Financial Inclusion, Chairman: Dr. C. Rangarajan). Financial Inclusion, broadly defined, refers to universal access to a wide range of

financial services at a reasonable cost. These include not only banking products but also other financial services such as insurance and equity products (The Committee on Financial Sector Reforms, Chairman: Dr.Raghuram G. Rajan). The essence of financial inclusion is to ensure delivery of financial services which include - bank accounts for savings and transactional purposes, low cost credit for productive, personal and other purposes, financial advisory services, insurance facilities (life and non-life) etc. Financial access facilitates day-to-day living, and helps families and businesses plan for everything from long-term goals to unexpected emergencies. As accountholders, people are more likely to use other financial services, such as credit and insurance, to start and expand businesses, invest in education or health, manage risk, and weather financial shocks, which can improve the overall quality of their lives. Financial inclusion means that individuals and businesses have access to useful and affordable financial products and services that meet their needs – transactions, payments, savings, credit and insurance – delivered in a responsible and sustainable way.

### **Why Financial Inclusion?**

Financial inclusion broadens the resource base of the financial system by developing a culture of savings among large segment of rural population and plays its own role in the process of economic development. Further, by bringing low income groups within the perimeter of formal banking sector; financial inclusion protects their financial wealth and other resources in exigent circumstances. Financial inclusion also mitigates the exploitation of vulnerable sections by the usurious money lenders by facilitating easy access to formal credit.

### **FINANCIAL INCLUSION IN INDIA**

In the Indian context, the term ‘financial inclusion’ was used for the first time in April 2005 in the Annual Policy Statement presented by [Y.Venugopal Reddy](#), the then Governor, [Reserve Bank of India](#). Later on, this concept gained ground and came to be widely used in India and abroad. While recognizing the concerns in regard to the banking practices that tend to exclude rather than attract vast sections of population, banks were urged to review their existing practices to align them with the objective of financial inclusion. The Report of the Internal Group to Examine Issues relating to Rural Credit and Microfinance (Khan Committee) in July 2005 drew

strength from this announcement by Governor [Y. Venugopal Reddy](#) in the Annual Policy Statement for 2005-06 wherein he had expressed deep concern on the exclusion of vast sections of the population from the formal financial system. In the Khan Committee Report, the RBI exhorted the banks with a view to achieving greater financial inclusion to make available a basic "no-frills" banking account. The recommendations of the Khan Committee were incorporated into the mid-term review of the policy (2005–06). Financial inclusion again featured later in 2005 when it was used by K.C. Chakraborty, the chairman of Indian Bank. [Mangalam, Puducherry](#) became the first village in India where all households were provided banking facilities. Norms were relaxed for people intending to open accounts with annual deposits of less than Rs. 50,000. General credit cards (GCCs) were issued to the poor and the disadvantaged with a view to help them access easy credit. In January 2006, the Reserve Bank permitted commercial banks to make use of the services of non-governmental organizations (NGOs/SHGs), micro-finance institutions, and other civil society organizations as intermediaries for providing financial and banking services. These intermediaries could be used as business facilitators or business correspondents by commercial banks. The bank asked the commercial banks in different regions to start a 100% financial inclusion campaign on a pilot basis. As a result of the campaign, states or union territories like [Puducherry](#), [Himachal Pradesh](#) and [Kerala](#) announced 100% financial inclusion in all their districts. Reserve Bank of India's vision for 2020 is to open nearly 600 million new customers' accounts and service them through a variety of channels by leveraging on IT. However, illiteracy and the low income savings and lack of bank branches in rural areas continue to be a roadblock to financial inclusion in many states and there is inadequate legal and financial structure.

The government of India recently announced "Pradhan Mantri Jan Dhan Yojna," a national financial inclusion mission which aims to provide bank accounts to at least 75 million people by January 26, 2015. To achieve this milestone, it's important for both service providers and policy makers to have readily available information outlining gaps in access and interactive tools that help better understand the context at the district level. MIX designed the FINclusion Lab India FI workbook to support these actors as they craft strategies to achieve these goals.

Several Startups are working towards increasing Financial Inclusion in India by organizing various large unorganized sectors where payments primarily happen in Cash, instead of a bank transaction.

Recently, the government of India came up with a policy under the name "rupee exchange" to exchange higher notes with the intent of: clamping down on tax defaulters, track down corrupt officers (by rendering valueless heavy cash stashed away secretly) and generally restoring sanity to the economic system. First off it is alarming that despite the fact that India's CRSISIL index is in excess of 40% and it is reputed to be heavy on technology, over 85% of its financial transactions are cash based. While income and inequality gaps will widen anyway, it is recommended that India embraces - proposed - as a matter of policy financial inclusion.



#### Why is financial inclusion needed in India? (A Graphical Representation)

Countries that have achieved the most progress toward financial inclusion have put in place an enabling regulatory and policy environment, and have encouraged competition allowing banks and non-banks to innovate and expand access to financial services. However, creating this innovative and competitive space has to be accompanied by appropriate consumer protection measures and regulations to ensure responsible provision of financial services. Digital financial technology, or “fintech,” and particularly the global spread of mobile phones, has facilitated expanding access to financial services to hard-to-reach populations and small businesses at low cost and risk: Digital IDs make it easier than ever before to open an account. Digitization of cash-payments is introducing more people to transaction accounts. Mobile-based financial

services bring convenient access even to remote areas. Greater availability of customer data allows providers to design digital financial products that better fit the needs of unbanked individuals. As countries have accelerated efforts toward financial inclusion, it has become apparent that they face similar hurdles which impede their progress. These include:

1. Ensure financial access and services extend to hard-to-reach populations, including women and the rural poor
2. Increase citizens' financial literacy and capability so they understand different financial services and products
3. Make sure everyone has valid identification documents, and a low-cost, accessible means for them to be authenticated
4. Devise useful and relevant financial products, tailored to consumer needs
5. Establish robust financial consumer protection frameworks, and adapt relevant regulatory and supervisory authorities, including by utilizing technology to improve supervision (so-called "reg tech")
6. Globally, a lack of IDs makes it hard to open a bank account, access capital and credit.

## **IMPORTANCE OF FINANCIAL INCLUSION**

The policy makers have been focusing on financial inclusion of Indian rural and semi-rural areas primarily for three most important pressing needs:

- Creating a platform for inculcating the habit to save money – The lower income category has been living under the constant shadow of financial duress mainly because of the absence of savings. The absence of savings makes them a vulnerable lot. Presence of banking services and products aims to provide a critical tool to inculcate the habit to save. Capital formation in the country is also expected to be boosted once financial inclusion measures materialize, as people move away from traditional modes of parking their savings in land, buildings, bullion, etc.
- Providing formal credit avenues – So far the unbanked population has been vulnerably dependent of informal channels of credit like family, friends and moneylenders. Availability

of adequate and transparent credit from formal banking channels shall allow the entrepreneurial spirit of the masses to increase outputs and prosperity in the countryside. A classic example of what easy and affordable availability of credit can do for the poor is the micro-finance sector.

- Plug gaps and leaks in public subsidies and welfare programs – A considerable sum of money that is meant for the poorest of poor does not actually reach them. While this money meanders through large system of government bureaucracy much of it is widely believed to leak and is unable to reach the intended parties. Government is therefore, pushing for direct cash transfers to beneficiaries through their bank accounts rather than subsidizing products and making cash payments. This laudable effort is expected to reduce government's subsidy bill (as it shall save that part of the subsidy that is leaked) and provide relief only to the real beneficiaries. All these efforts require an efficient and affordable banking system that can reach out to all. Therefore, there has been a push for financial inclusion.

### **ROLE OF RBI IN PROMOTING FINANCIAL INCLUSION**

RBI set up the Khan Commission in 2004 to look into financial inclusion and the recommendations of the commission were incorporated into the mid-term review of the policy (2005–06) and urged banks to review their existing practices to align them with the objective of financial inclusion. RBI also exhorted the banks and stressed the need to make available a basic banking 'no frills' account either with 'NIL' or very minimum balances as well as charges that would make such accounts accessible to vast sections of the population. Of the many schemes and programs pushed forward by RBI the following need special mention.

- Initiation of no-frills account – These accounts provide basic facilities of deposit and withdrawal to accountholders makes banking affordable by cutting down on extra frills that are no use for the lower section of the society. These accounts are expected to provide a low-cost mode to access bank accounts. RBI also eased KYC (Know Your customer) norms for opening of such accounts.
- Banking service reaches homes through business correspondents – The banking systems have started to adopt the business correspondent mechanism to facilitate banking services in those

areas where banks are unable to open brick and mortar branches for cost considerations. Business Correspondents provide affordability and easy accessibility to this unbanked population. Armed with suitable technology, the business correspondents help in taking the banks to the doorsteps of rural households.

- EBT – Electronic Benefits Transfer – To plug the leakages that are present in transfer of payments through the various levels of bureaucracy, government has begun the procedure of transferring payment directly to accounts of the beneficiaries. This “human-less” transfer of payment is expected to provide better benefits and relief to the beneficiaries while reducing government’s cost of transfer and monitoring. Once the benefits starts to accrue to the masses, those who remain unbanked shall start looking to enter the formal financial sector.

## CONCLUSION

Around 2 billion people don’t use formal financial services and more than 50% of adults in the poorest households are unbanked. Financial inclusion is a key enabler to reducing poverty and boosting prosperity. WBG President Kim has called for Universal Financial Access (UFA) by 2020. Access to a transaction account is a first step toward broader financial inclusion since it allows people to store money, and send and receive payments. A transaction account can also serve as a gateway to other financial services, which is why ensuring that people worldwide can have access to a transaction account is the focus of the World Bank Group’s Universal Financial Access 2020 initiative. An estimated 2 billion adults worldwide don’t have a basic account. Globally, 59% of adults without an account cite a lack of enough money as a key reason, which implies that financial services aren’t yet affordable or designed to fit low income users. Other barriers to account-opening include distance from a financial service provider, lack of necessary documentation papers, lack of trust in financial service providers, and religion. More than 200 million formal and informal micro, small and medium-sized enterprises (MSMEs) in emerging economies lack adequate financing to thrive and grow. MSMEs cite a lack of collateral and credit history, and business informality as main reasons for not having an account. Some groups are more financially excluded than others: Women, rural poor, and other remote or hard-to-reach populations, as well as informal micro and small firms are most affected. For example, the gender gap in developing countries is estimated at 9 percentage points: 59% of men reported

having an account in 2014, while only 50% of women did. The forcibly displaced populations present one of the most pressing financial inclusion challenges as almost 80% in adults in Fragile and Conflict-Affected States are outside the formal financial system.

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