ISED
Policy Brief
The latest development issues for policy makers from the ISED Small Enterprise Observatory

an ISED Small Enterprise Observatory Policy Briefing
Issue: 2 | March | 2023

Financial Inclusion in India-Seventeen years on

Key messages & recommendations

Key Message 1: Enhancing the tempo of financial inclusion requires boosting of market linkages of MSMEs.	**Recommendation 1:** Comprehensive studies on linkages need to take place at sub-sector/ industry level (eg. Policy Briefs). Findings need to support the policy and implementation of existing lending schemes.
Key Message 2: Informed decision making mechanism for State Level Bankers' Committees (SLBCs), on lines of recommendations of the Usha Thorat Committee and the K. C. Charabarty Committee.	**Recommendation 2:** SLBCs need to be elevated into a think-tank role by including subject experts.
Key Message 3: Meticulous national efforts on bringing down the rigidities relating to credit flow need to be initiated.	**Recommendation 3:** 'Ease of Lending' need to be introduced as a new tool for comparing the performance of the financial sector, within the framework of 'Co operative Federalism', by NITI Aayog.
Key Message 4: Financial Inclusion is a supply-side concept; the need of the hour is building up a demand-side conceptual approach.	**Recommendation 4:** 'Responsible Finance' agenda need to be brought into focus. Comprehensive studies need to be initiated by the RBI.
Key Message 5: Given the ever increasing competitive environment in the corporate sector, the market opportunities of Banks are greater with the SME constituency.	**Recommendation 5:** Beyond simple arithmetic, MSME portfolio management needs to be scientifically structured by banks, using the expertise of knowledge brokers.

ISED-SEO
ISED PUBLICATiONS
www.isedpublications.org
http://isedonline.blogspot.in/
https://www.facebook.com/india.sme
info@isedonline.org , seo@isedonline.org

Financial Inclusion in India- Seventeen years on

In any economy, institutionalizing finance and deepening credit delivery have both a social purposes as also a business case. The social purpose is that it contributes to strengthening and broad basing the formal economy. Financial institutions with a social agenda, or a "double bottom line approach", might be interested to promote 'formalization' to efficiently enhance their social impact. It is also possible that such interventions could enhance their business objectives. Generally speaking, there is also a strong business case for the financial institutions: the larger the number of individual accounts, the greater is the first- order and second- order conditions of credit delivery . But quality of accounts is still a grey area, where lot more needs to be done.

Concept and Rationale

'Financial inclusion' implies deepening of banking services and credit, by covering the hitherto unbanked sectors of society. It implies delivery of banking services like availability of basic savings bank account, access to need based credit, remittances facility, insurance and pension to the excluded sections i.e. economically weaker sections, at an affordable cost. Financial Inclusion is a national priority of the Government as it is an enabler for inclusive growth. Financial Inclusion is important as it provides an avenue to the poor for bringing their life-savings into the formal financial system.

Financial inclusion is a key component of the global development agenda today. Ensuring that people worldwide can have access to a 'transaction account' continues to be an area of focus for the World Bank Group (WBG). Its Universal Financial Access 2020 initiative was followed by the United Nations (SDG Goals), and G 20(High Level Principles for Digital Financial Inclusion).

In India, Financial inclusion has been defined as "the process of ensuring access to financial services, timely and adequate credit for vulnerable groups such as weaker sections and low-income groups at an affordable cost". (Committee on Financial Inclusion - Chairman: Dr C Rangarajan, RBI, 2008). The Committee on Medium-Term Path to Financial Inclusion (Chairman: Shri Deepak Mohanty, RBI, 2015) has set the vision for financial inclusion as, "convenient access to a basket of basic formal financial products and services that should include savings, remittance, credit, government-supported insurance and pension products to small and marginal farmers and low-income households at reasonable cost, with adequate protection progressively supplemented by social cash transfers, besides increasing the access of small and marginal enterprises to formal finance with a greater reliance on technology to cut costs and improve service delivery, ..."

Origin and Early Initiatives

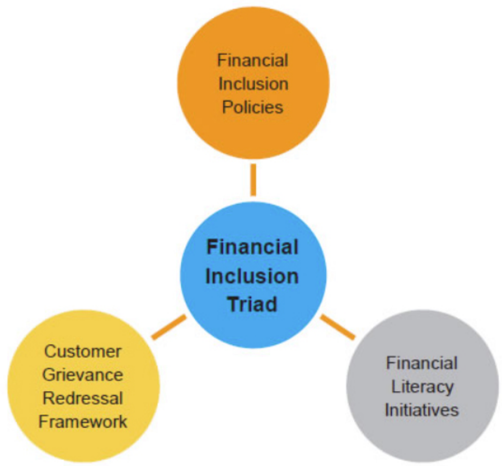
The Microfinance movement has a long and distinguished history in India. Introduced for the first time by the SEWA Bank, in Gujarat in 1974,it has since become instrumental in extending financial services to many who remained excluded from the economic mainstream. India's microfinance sector has served 6.6 crore borrowers as of March 31, 2023, with an outstanding loan amount of INR 3,48,339 crore across all states. While Micro finance implied an addition to the financial architecture of the country, 'financial inclusion' marked a major directional change in credit delivery system.

While inclusive banking began, in spirit, with the Nationalization of banks in 1969 and 1980 in India, the real thrust on FI came in 2005 when the Reserve Bank of India highlighted its significance in its Annual Policy Statement of 2005-06. Indian Bank, one of the major public sector banks India, launched its Financial Inclusion Pilot Project in 2006. This initiative aimed to provide banking and financial services to unbanked and underbanked rural areas in the country. Indian Bank, like other banks in India, participated in various government-led financial inclusion programs to expand banking services and promote financial literacy among marginalized and rural populations. These efforts were part of the broader goal of enhancing financial inclusion and economic development in India.

The RBI has taken various initiatives to achieve higher financial inclusion just like facilitating no-frills accounts and general credit cards for little deposits and credit. By facilitating inclusive participation, microfinance can accelerate the pace of poverty reduction—a target christened in the UN's 2030 Sustainable Development Goals (SDGs). In fact, financial inclusion can assist in meeting 7 of the 17 SDGs.

Scope

'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. Being able to have access to a transaction account is a first step toward a broader financial inclusion strategy. Since a transaction account allows people to store



money, and send and receive payments, it serves as a gateway to other financial services.

'Financial inclusion', as a comprehensive strategy of savings mobilization and credit delivery, has several benefits, including poverty reduction, economic growth, and increased financial stability. When people have access to financial services, they are better able to save for the future, invest in education and healthcare, and start or expand businesses. Governments, financial institutions, non-profits, and international organizations often work together to promote financial inclusion through various initiatives and policies. These efforts aim to bridge the gap between the financially excluded and the formal financial system, ultimately contributing to the economic well-being of individuals and communities.

India's Policy Thrust

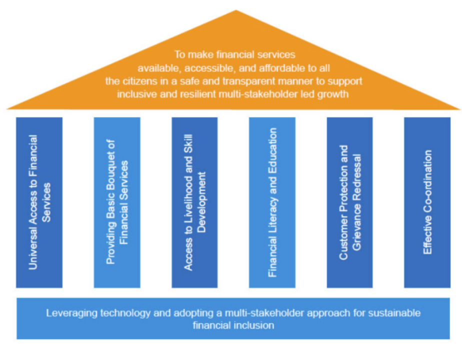
The National Strategy for Financial Inclusion 2019-2024(NSFI), by the Reserve Bank of India, sets forth the vision and key objectives of the financial inclusion policies in India to help expand and sustain the financial inclusion process at the national level through a broad convergence of action involving all the stakeholders in the financial sector. The strategy aims to provide access to formal financial services in an affordable manner, broadening & deepening financial inclusion and promoting financial literacy & consumer protection. RBI has identified six strategic objectives of a national strategy for financial inclusion: (i) universal access to financial services, (ii) providing basic bouquet of financial services, (iii) access to livelihood and skill development, (iv) financial literacy and education, (v) customer protection and grievance redressal, and (vi) effective coordination. According to RBI, the NSFI and National Strategy for Financial Education 2020-2025 (NSFE) provide a roadmap for a coordinated approach towards financial inclusion, financial literacy, and consumer protection.

The key facets of financial inclusion include:

1. Access to Banking Services: This includes access to basic banking services such as savings accounts, checking accounts, and payment services like debit cards. Many people in underserved communities do not have access to traditional banks.
2. Credit and Loans: Access to credit is essential for individuals and small businesses to invest, grow, and cope with financial emergencies. Microloans, small business loans, and personal loans are examples of credit services that should be accessible.
3. Insurance Services: Insurance products, such as life insurance, health insurance, and crop insurance, can protect individuals and businesses from unexpected financial shocks. Financial inclusion aims to make these services more accessible.
4. Savings and Investment Opportunities: Encouraging people to save and invest in their future through access to savings accounts, pension plans, and investment options that suit the financial capacity and goals of individuals.
5. Digital Financial Services: In many cases, technology plays a significant role in expanding financial inclusion. Mobile banking, digital payment platforms, and fintech services can reach people in remote areas where traditional brick-and-mortar banks may not be present.
6. Financial Education and Literacy: Alongside access to financial services, it's important to educate individuals about financial management, budgeting, and the responsible use of credit.

Public Schemes

Under the National Strategy of Financial Inclusion in India, several steps have been undertaken to take forward the agenda of financial inclusion. These include: (i) Pradhan Mantri Jan Dhan Yojana (PMJDY), under which 34 crore accounts have been opened with deposits amounting to Rs 89,257 crore (as of January 2019), (ii) schemes such as the Pradhan Mantri Suraksha BimaYojana to provide accident death or disability cover and Atal Pension Yojana to provide pension cover to subscribing bank account holders. Further, it noted that the bank-led model of financial inclusion adopted by the RBI through issuance of



Source: Reserve Bank of India

differentiated banking licenses (small finance banks and payments banks) and the launch of Indian Post Payments Bank in September 2018 has helped bridge the gap in last mile connectivity.

MSMEs contribute nearly 31% to India's GDP, 45% to exports and provide employment opportunities to more than 11.1 crore skilled and semi-skilled people. There are approximately 6.33 crore MSMEs in the country. A number of initiatives have been undertaken for facilitating credit off take in this sector. A special capacity building programme named 'National Mission for Capacity Building of Bankers for financing MSME Sector' (NAMCABS) was put in place to familiarise bankers with the entire gamut of credit related issues of the MSME sector. A Certified Credit Counsellors (CCC) scheme was launched for creating a structured mechanism to assist the entrepreneurs in preparing financial plans and project reports in a professional manner, thus facilitating the banks to make informed credit decisions. Web portals like the 'UdyamiMitra' and 'psbloanin59minutes' have also been launched to provide easy access to credit. Trade Receivables Discounting System (TReDS) platforms have been set up to address the problem of delayed payments to MSMEs. Pradhan Mantri Mudra Yojana (PMMY), a scheme to finance small business enterprises has been launched in April 2015 whereby lending institutions would finance to micro entrepreneurs up to ₹10 lakhs. Interest subvention scheme has been launched for MSMEs to reduce cost of borrowing.

ISED Initiatives on Financial Inclusion

Inspired by the findings of the Dr. C. Rangarajan Committee Report, a pioneering initiative of the ISED Small Enterprise Observatory came in the form of a National Conference: "Financial Inclusion & Beyond-Issues and Opportunities for India", held at Cochin on November 5, 2006. Marked by the wide participation of all leading institutions and experts in the subject area, the event was organized jointly with the Reserve Bank of India, International Labor Organization and the Indian Bank.

Latest Global Developments

'Financial inclusion' implies universal access, at a reasonable cost, to a wide range of financial services, provided by a variety of sound and sustainable institutions. Inclusive finance strives to enhance access to financial services for both individuals and MSMEs.

Digital financial services offer a real hope to help the world get back on track to achieve the Sustainable Development Goals (SDGs) by 2030. Through its work under the G20 2023 FIAP, the Global Partnership for Financial Inclusion (GPFI) will continue its quest to rapidly advance the financial inclusion of vulnerable and less-served groups, with a renewed focus on promoting effective access and usage of financial services by individuals and MSMEs.

The European Commission created the European Union Initiative for Financial Inclusion (EUIFI), in partnership with four leading European finance institutions (EFIs), namely: the European Investment Bank (EIB); the European Bank for Reconstruction and Development (EBRD); KfW; and Agencefrançaise de développement (AFD). The EUIFI main aim is to extend financing to MSMEs, including support to innovative start-ups, in the Neighbourhood SouthEN. Through facilitating access to finance and providing MSMEs with the right tools, the EUIFI aims to increase their competitiveness, which in turn creates much needed jobs and powers economic growth.

Germany's bank-based financial system provides a high level of financial inclusion, measured by bank outreach and use of financial services. However, the most vulnerable individuals and small enterprises in Germany tend to be excluded or credit constrained.

In India, the introduction of Financial Inclusion Index in the year 2021 marks a major leap forward in measuring the degree, and comparative static and spatial distinctions of financial inclusion. This comprehensive index incorporates details of banking, investments, insurance, postal, as well as the pension sector, in consultation with government and respective sectoral regulators. It comprises of three broad parameters – access (35 per cent), usage (45 per cent), and quality (20 per cent), each consisting of various dimensions, which are themselves calculated based on many indicators. The index is responsive to ease of access, availability and usage of services, and quality of services. A unique feature of the index is the quality parameter which captures the quality aspect of financial inclusion as reflected by financial literacy, consumer protection and inequalities and deficiencies in services. Financial inclusion refers to the efforts to provide access of financial tools and products to various segments of the society.

The FI-Index of the RBI has been constructed without any 'base year' and it reflects cumulative efforts of all stakeholders over the years towards financial inclusion. The annual FI-Index for the period ending March 2021 was 53.9 as against 43.4 for the period ending March 2017.The Index increased across all metrics in March 2022 and reached 56.4. It was 53.9 in March of the previous year. The FI-Index will be published annually in July every year.

Critical Gaps

Some critical gaps remain an impediment for financial inclusion in India. These include: (i) inadequate infrastructure (in parts of rural hinterland, far flung areas in Himalayan and north-eastern region), (ii) poor tele and internet connectivity in rural hinterland, (iii) socio-cultural barriers, and (iv) lack of market players in payment product space.

Looking for the Larger Picture?

This Policy Brief emerged from the research and deliberations connected with the India MSME Communication Programme,(IMCP), under the aegis of the ISED Small Enterprise Observatory. Launched in 1997, IMCP is a unique programme using knowledge as a trigger of MSME development. The Programme has two components: 1) India MSME Report series, a state of the art annual review; and 2)India MSME 'Darshan', a pan-India development outreach programme.

Way Forward

The Financial Inclusion (FI) Index of the Reserve Bank of India (RBI) stood at 60.1 per cent for the financial year ending in March 2023, as compared to 56.4 per cent in March 2022, due to improvements in Usage and Quality dimensions.

The RBI launched the pilot project of CBDC, popularly known as 'Digital Rupee' on December 1, 2022, for the retail segment. At present, 13 banks are participating in the pilot for the retail segment

The main objective of financial inclusion public policy is making accessible the banking and payment facilities to a wide range of populations without any discrimination. It escalates the resource base of the financial sector by inculcating a habit of savings among the majority of the population in the rural areas.

Pradhan Mantri Jan DhanYojana (PMJDY), today, is one of the biggest financial inclusion initiatives in the world. According to the Ministry of Finance, Government of India, 55.5 per cent bank accounts have been opened by women, and 67 per cent have been opened in rural/semi-urban areas.

Of the financially excluded population that has opened bank accounts in the country, less than 30 percent are operational. Financial inclusion initiatives focus on providing economic security to individuals and families of the under privileged communities. Very often, these communities have no access to banks and financial services in the form of savings accounts, term deposits, loans, and insurance and remittance facilities.

References

- P.M. Mathew(2006) Financial Inclusion in India: Questions Seeking Answers, **The Hindu Daily**, October 9.
- ISED (2022): **India Micro Small & Medium Enterprise Report 2022** (Cochin, ISED).
- ISED (2022): **India Micro Small & Medium Enterprises in the States Report 2022** (Cochin, ISED).
- ISED (2006): **Financial Inclusion & MSME Development in India(Proceedings of the ISED-Reserve Bank of India National Conference on 'Financial Inclusion & Beyond: Issues and Opportunities for India)** (Cochin. ISED).
- P.M.Mathew, Malcolm Harper & P.P.Pillai (2010): **Micro Privatisation India: Some Issues** (Cochin, ISED).
- Reserve Bank of India (2020) : **National Strategy for Financial Inclusion (NSFI): 2019-2024** (Mumbai, RBI).
- The World Bank (2021): **Global Findex Database, 2021** (Washington, The World Bank).

About 'ISED Policy Brief' Series

The purpose of ISED Policy Brief Series is to provide a concise summary of an issue that includes the policy options to solve a problem and recommendations on the best option. Its most common audience is the decision-maker, in government, business or finance. Written for organization leaders, policymakers, and others who are responsible for creating and influencing policy, the target audience also includes academics, the press, and the broader public.