



# FINANCIAL INCLUSION AND RURAL-URBAN DIVERGENCES IN INDIA

**Dr.S.Sivaprasad**

Academic Consultant, Department of Economics, S.V.University, Tirupati, AP.

**Abstract:** Inclusive growth empowers people belonging to vulnerable sections depend on financial inclusion, which is promoting inclusive growth and helps in reducing poverty by providing regular and reliable sources of finance. In this direction, the drive for financial inclusion has taken several measures to increase the access to and availing of formal financial services by un-banked households. The purpose of this study is to assess the nature and extent of financial inclusion and its effect on the socio-economic status of households focusing on inclusive growth. It has been analyzed with the theoretical background on financial access and economic growth and by evaluating the existing literature on financial inclusion in the country and outside. The results show that there is a disparity in nature and extent of financial inclusion. Facilitating access to and availing of formal financial services pave the way to positive changes in the socio-economic status of households which are correlated, leading to inclusive growth based on which the study proposes to make the financial system more inclusive and pro-poor.

**Keywords:** Financial Inclusion, Financial services, Banking, Inclusive Growth.

## 1. INTRODUCTION

The Rangarajan Committee, Government of India (2008), defines financial inclusion as ‘the process of ensuring access to financial services and timely, adequate credit where needed, to vulnerable groups such as weaker sections and low-income groups, at an affordable cost’. This is an effort of ‘mainstreaming the marginalized’ which plays a key role in the process of inclusive growth involving all the sections of the population and regions of the economy. Therefore, access to finance is a pre-condition for poverty eradication is an integral part of the growth process.

While the importance of financial inclusion has been widely accepted, the literature on financial inclusion lacks a comprehensive measure that can be used to indicate the extent of financial inclusion across economies Mandira Sarma and Jesim Pais. (2008). Individual indicators (such as number of bank accounts, number of bank branches and so on) that are generally used as measures of financial inclusion can provide only partial information on the level of financial inclusion in an economy. A comprehensive measure of financial inclusion should be able to incorporate information on several aspects (dimensions) of financial inclusion, preferably in one single number. Many people now propose financial inclusion index (FII), which incorporates information on two or more aspects of financial inclusion; is easy and simple to compute; is comparable across countries; has values between ‘0’ and ‘1’, zero indicating lowest financial inclusion and ‘1’ indicating complete financial inclusion.

Peter J. Morgan and Victor Pontines (2014) study suggests that the greater financial inclusion could be either positive or negative for financial stability. Namita Rajput and Shelly Oberoi have said that financial inclusion has been made an essential part of the banking sector policy in India. All the commercial banks including cooperative banks are vigorously involved in financial inclusion process through opening of new branches in rural and urban areas. This study has developed a composite index of financial inclusion for each state using wide range of indicators. The computed values of Crisil Inclusix Index reveal that till date the plight of the states in India is not commendable.

Gandhi M.M. (2013) has argued that financial inclusion should be a social responsibility for the banks in the short-run but will turn out to be a business opportunity in the long-term. Financial inclusion is no longer an option, but it is a compulsion. The entire world is looking at this experiment in India and it is important that banks rise up to this challenge and meet it successfully.

Traditionally, formal financial institutions (e.g. commercial banks, rural or agricultural development banks) have avoided or failed to offer sustainable services in rural areas. This exclusion restrains rural communities from unleashing their potential.

Transaction costs in rural areas, especially in remote areas, are high due to low population density, lack of infrastructure (communications, electricity, transport) and small average transaction amounts. This makes financial services expensive. Prohibitive transaction costs are discouraging people from depositing savings, thereby depriving households of an opportunity to build financial assets. Legal systems that do not ensure marketable property rights contribute to weak collateral and contract enforcement mechanisms that further limit access to finance. As a consequence, products such as long-term financing hardly reach rural areas. Levels of financial literacy are often low in

rural communities. This prevents households and businesses alike from building effective risk management strategies and, for example, understanding how insurance works and why premiums need to be paid regularly without a timeline for payouts. Thus, informal or semi-formal financial institutions, as well as alternative providers like traders or input suppliers, or delivery channels like mobile phone companies, have become major players in financial services provision.

However, these informal providers often have weak institutional and managerial capacity and offer only a narrow range of financial services, often without regulation. Moreover, operating in isolation from the financial system has let some of these providers charge steep and sometimes even usurious interest rates. Climate change is impacting the rural economy most severely. Rural communities cannot cope with and adapt to growing incidences of drought, flooding or storms without access to insurance or emergency loans to deal with these sudden shocks, or to long-term finance for venturing into less risk-exposed businesses.

## **2. REVIEW OF LITERATURE**

The nexus between a sound financial system, economic growth and development has been researched for a long time and numerous theoretical and empirical studies show a positive relationship (T.Beck, 2011).

The rural communities are highly underserved by financial services. According to Global Findex data (World Bank, 2011), 62 per cent of the world's adult population had an account at a formal financial institution or had access to mobile money services in 2014.

At the international level studies, the data shows a gap between women and men with 58 per cent and 65 per cent respectively. The geographic regions with the lowest level of financial inclusion are the Middle East and North Africa, and Sub-Saharan Africa (14 per cent and 34 per cent respectively). While the 2014 data does not allow for a distinction between access in rural and urban areas, earlier data from 2011 found a considerable difference with only 46 per cent of adults in rural areas having access in contrast to 58 per cent in urban areas.

Post Office Savings Banks are emerging as significant providers of deposit services in rural areas, for example in Kenya, South Africa and the United Republic of Tanzania (G. Nagarajan et. al, 2016).

Member-owned financial institutions such as Self-Help Groups (SHGs), Village Savings and Loan Associations (VSLAs), Savings and Credit Cooperatives (SACCOs), and Credit Unions are increasing in numbers. Cooperatives can use cross-subsidization, and federations of SACCOs offer economies of scale to members, as in the case of Mixtlan SACCO and UNISAP Federation in Mexico (M. Hirschland et al, 2008).

Burundi, credit unions have recorded more deposit and loan accounts than commercial banks (O.P. Ardic, et. al, 2013).

A number of microfinance institutions (MFIs) have increased their rural operations (e.g. ACLEDA Bank in Cambodia) (G. Nagarajan et.al, 2016), while market pressures have driven others to terminate their rural operations. While microfinance has increased the access to finance of poor rural households, it is facing challenges for providing financial services to small farmers (M.K. Sharma et al., 2012).

Major differences exist between high income and developing economies in insurance provision. In 2011, developing countries counted 0.5 insurance policies per adult while high income countries had 2.5 (Ardic et al., 2013).

These figures are far lower especially in rural areas of developing countries. At the same time, government-supported schemes and Mutual Based Associations are increasing outreach. In India, 37 million families have been enrolled in the National Health Insurance Programme (RSYB) (Rashtriya Swasthya Bima Yojana, 2015) and 20 million farmers in the government's crop insurance scheme. In the Philippines, 80 per cent of health insurance is offered by Mutual Based Associations.

In the literature of the World Bank (2005) on the modern development theory, it is stated that 'the progression of financial access, growth, and income dynamics of different generations are closely related.

## **3. NEED FOR THE STUDY**

An exploration of the supply and the demand side of financial inclusion reveals that internationally there is a wider perspective regarding the concept of financial inclusion. In India currently, financial inclusion is confined to providing minimum access to a savings bank account to all. It is, having minimum facilities of banking by the general public or citizens of the country. Along with this, there are two extreme possibilities of access to finance. First, with the group of customers who get access to all the formal financial services and second with the group which is financially excluded and denied access to the most basic financial products. This scenario of multiple possibilities indicates that financial inclusion is a multi-faceted concept with several dimensions relevant to the specific region's agenda.

#### **4. PRESENT SCENARIO OF FINANCIAL INCLUSION IN INDIA**

The national agencies like Reserve Bank of India and NABARD from time to time undertook studies on financial inclusion in India for purpose of increasing the income and living standards of the population.

##### **a. RBI and Un-even Growth in Financial Inclusion in India**

Financial Inclusion in India is rather interdependent than independent phenomena. Rural Financial Inclusion cannot be achieved only by increasing banking services in rural area. The demand for the banking services has to be increased simultaneously. However the rural India is deprived of both availing the financial services and the demand of the people to use it. It has been explained that people's demand will increase only when they have sufficient assets to buy those services.

In India, there has been a decrease in the GDP from Agriculture and continuous rise in the GDP of service. But most of the population in rural India are dependent on the agriculture for their livelihood. Hence, without a secure livelihood, it is difficult to rise the demand of the rural masses to use the financial services. The Socio-Economic Census (2011) reveals that almost three fourths of the rural households live with a monthly income of less than Rs 5000. More than half the rural households do not own land and more than half of them are casual labour.

Education is one of the important assets for any livelihood generation. In India, where universal literacy is still to be achieved even in urban India, the situation of rural India is still far behind the urban India. According to population Census 2011, urban India has the male and female literacy rate of 88.76 and 79.11 where rural India has the male and female literacy rate of 77.15 and 57.93. It reveals that rural population in India has less opportunity to understand and utilize the financial services in India.

Similarly, health services to rural India are poorer than the urban India. The Infant mortality rate, anaemic children, women and pregnant women, underweight prevalence in Children, awareness regarding various diseases reveals the skewed development of India in regards to rural and urban India. The uneven development between rural and urban area become more apparent when the infrastructure is observed. Rural India is far behind urban India in regards to roads, electrification, drinking water, sanitation, Government as well as Non- Governmental institutions etc.

All the aforesaid aspects cause to reduce the overall livelihood of rural population and people without any secure income find it difficult to include themselves in the financial formal systems in India. In other words any bottleneck to secure people's livelihood influences to increase the demand for financial services negatively. Along with the aforementioned uneven development of rural India in regards to income generation, banking services in India is also uneven.

As per RBI, there are only 7.8 bank branches per 100,000 in rural and semi urban area, whereas, 18.7 branches are there in urban and metropolitan. In India total rural bank branches are 82,794 among 1065 million populations, but in Urban India the bank branches are 43,910 among the total urban population of 235 million. It can be observed that in Urban India, people have access to more financial services as the number of bank branches is more in urban areas.

There are 189 million saving bank account in rural and semi-urban area where as in urban and metropolitan the total number of saving bank accounts is 139. If we compare the total number of population in Rural India, it can be noticed that the number of Saving Bank account in Rural and Semi Urban area are very low in number as compared to Urban and Metropolitan areas. Moreover if we see the share of deposits in the bank accounts, rural areas have around 10 per cent of the total savings in India. (Reserve Bank of India, 2015).

##### **b. NABARD and Financial Inclusion in India**

NABARD in its study wanted to understand rural financial inclusion in its entirety covering aspects like borrowings on one hand and livelihood related aspects on the other. The focus of the Study is on livelihoods in addition to financial aspects. It also involved assessment of financial knowledge, attitude and behaviour at the individual level.

**a. Land and Assets:** The Average land owned by agricultural households is 1.1 ha. Two states, i.e., Kerala and Tamil Nadu recorded the same average size, while 14 states such as Nagaland, Rajasthan, Haryana, Punjab have higher than all India average land size, 13 States such as Bihar, West Bengal, Odisha have lower than average land size. Average land possessed by agricultural households is 1.1 ha.

**b. Income level and sources:** the average monthly income for agricultural households is Rs. 8,931; 35 percent of which is received from cultivation, followed by wages (34 per cent), salaries (16 per cent), livestock (8 per cent) and non-farm sector (6 per cent). Other sources, including income from rent on building or land, income from interest earned on bank deposits, dividend or interest earned from investments accounted for 1 per cent share of total income. Transfer income (which includes remittances) received by the households have not been accounted for, while calculating the total income. Non-agricultural households reported average monthly income of Rs. 7,269 per month, of which, 54 per cent is from wages, 32 per cent from salaries, followed by non-farm sector activities accounting for 12 per cent of total income. Taking all households combined, the average monthly income stood at Rs. 8,059. Compared to all India estimates 20 States are having higher average monthly income.

- c. **Savings and Investment:** 88.1 per cent of the households reported having a bank account. 55 per cent of Agricultural households reported any savings during the last year and of these 53 per cent saved with institutions like banks, post offices and SHGs. Average savings per annum per saver households was reportedly Rs. 17,488, of which 95 per cent is with institutional agencies. Savings amount per saver AH reportedly ranged from Rs.12,941 for lower marginal farmers (0.01 to 0.40 ha land possessed) to Rs. 31,831 for saver AH with more than 2 ha of land.
- d. **Incidence of Indebtedness and Borrowings:** The Incidence of Indebtedness (IOI), measured as proportion of HH reporting outstanding debt on the date of the survey. 52.5 per cent AH and 42.8 per cent NAH were reportedly indebted at the time of survey. All India IOI taking all rural households together stands at 47.4per cent. Considering all loans taken by agricultural households, it was found that a majority of 44per cent loans were taken for agriculture purposes, followed by domestic needs (19per cent) and medical expenses (12 per cent). Of the remaining, 16per cent loans were taken for non-agricultural purposes, 11 per cent for housing and 4per cent for other purposes.
- e. **Insurance and Pension coverage:** About 26 per cent Agricultural households and 25per cent of non-agricultural households reported to have been covered under one or the other type of insurance. Among AH who reported to have taken any loan for agricultural purposes in the last one year from institutional agencies, 6.9 per cent reported being covered under crop insurance.
- f. **Individual level Financial Knowledge, Attitude & Behaviour:** On overall, only 9.4 per cent individuals from rural areas and over 13.2 per cent from semi-urban areas reported to have been exposed to any session on financial education or training. So, on the whole 40per cent respondents fared well on financial knowledge scale giving all correct responses to the questions asked. Assessment according to location revealed that 48per cent respondents from rural areas and 52 per cent from semi-urban areas were assessed to be having sound financial knowledge.

## 6. THE PHASES OF FINANCIAL INCLUSION REFORMS IN INDIA

Though Financial inclusion is not a new concept in the Indian landscape as its roots date back to the time of independence, when poverty reduction assumed centre stage in government policies. The medium to high growth era ruled for a long while in India but could not reach the bottom of the pyramid. Hence, financial inclusion was adopted as a policy objective and seen as the only means to embrace the masses in the process of achieving sustainable and equitable growth. Several national and international agencies conducted studies with a view to gauge the status of inclusive growth in India. According to the Asian Development Bank Institute, there were six contributors of financial inclusion –namely agent banking, diverse service providers, reforms in public banks, mobile banking, regulation for financial identity and consumer protection. Simultaneously, Nachiket Mor Committee was assigned the task of analysing deep into the area of financial inclusion and it came out with six elements of an inclusive system: universal access to transaction accounts, payment systems, investment products, insurance products, credit facilities and right to suitability (2014).

The financial system, particularly the banking sector, had undergone the process of continuous evolution from laying the foundation of commercial banks and cooperative ventures to offering the services of business correspondents and basic savings accounts (2014). Nationalisation of banks in two phases, i.e. 1969 and 1980, marked the inception of reforms in India. Several initiatives, namely priority sector lending, the introduction of regional rural banks (1975), Self Help Group–Bank linkage program (1989) and the service area approach (1989), were also undertaken. In the 1990s financial reforms aimed to turn India into a global market. The banking sector underwent a dramatic change in a bid to raise the level of competition through new entrants, diversifying the presence of accessible and efficient services, generating customer satisfaction and reinforcing the institutional framework (2014).

The Financial Inclusion Plan (FIP) was another measure, taken in 2010. The main objective for FIP 2013–16 was to envelope the unbanked villages within the reach of bank players, better transaction volumes, refine the existing BC model and organise financial literacy camps on a frequent basis. The banks were expected to adopt a humane approach and exploit technological synergies to the extent possible. In a bid to mark the footprints of MSMEs in Indian industry, encouragement was given to banks to channel a greater proportion of total credit for the sector, with a growth target at 20 per cent per annum (Chakrabarty 2011). Banks were allowed to offer customised products and consultation services, and appoint specialised staff for better understanding of customer needs (2014). In 2013, RBI started financial literacy programs to spread awareness about the operations of the financial system, financial products and service offerings and their benefits in one's life. It took great care in developing the study material for trainers and trainees, guidelines for conducting sessions and a diary for practice purposes (2013a). In 2014, Pradhan Mantri Jan Dhan Yojna (PMJDY) was initiated to offer no-frills accounts with attractive benefits, serving as a medium to transfer cooking gas subsidy, pension, insurance benefits, etc. (2014; Awasthi 2015; Srinivas and Kapur 2018).

## 7. CONCLUSION

India is the second most populous country with the dominance of agriculture and MSMEs in the economy. The current status suggests that account ownership rose from 35 per cent to 78 per cent of Indian adults during 2011–21. Financial inclusion both in rural and urban is an important means to enhance the pace of economic growth and lessen inequality and poverty, thereby leading to the holistic development of the economy. An in depth examination reveals that low earnings, gender gap, ignorance towards marginalised groups, low degree of financial literacy, remote locations and cultural barriers are some of the prominent reasons for financial exclusion. Here, the pandemic acted as a catalyst for the greater adoption of digital infrastructure. To achieve this, the financial system underwent a process of continuous evolution, including the nationalisation of banks, introduction of regional rural banks, entry of old and new private banks, offering no-frills account and identity proof, setting inclusion targets for banks and adopting a comprehensive financial inclusion strategy. However, the low usage of account and credit availability still remains a major concern for better financial inclusion all underprivileged population.

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