Inclusive Growth: Role of Financial Sector*

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Prof. Ashok Kolaskar, Vice Chancellor, KIIT University, Dr. Achyuta Samanta, Founder, KIIT University & Kalinga Institute of Social Sciences (KISS), Dr. Karmarkar, MD, NABARD, distinguished guests, ladies and gentlemen. It is a pleasure and privilege to be here at the National Finance Conclave – 2010 being organised by School of Management, KIIT University, Bhubaneswar. KIIT University under the leadership of Dr. Samanta is a living example to the society of the way of practicing social inclusion through spread of education. I take this opportunity to congratulate the University for the pioneering role it plays in spreading quality education and also for organising this Conclave. The theme of the Conclave, which is 'Inclusive Growth: Role of the Financial Sector', focuses on an issue having a great significance not only for a country like ours but the entire world. Since the term 'inclusive growth' is used very widely and loosely, I wish to spend some time in discussing this in a little detail.

2. 'Inclusive growth', as the literal meaning of the two words, refers to both the pace and the pattern of the economic growth. The literature on the subject draws a fine distinction between direct income redistribution or shared growth and inclusive growth. The inclusive growth approach takes a longer term perspective as the focus is on productive employment rather than on direct income redistribution, as a means of increasing incomes for excluded groups. Inclusive growth is, therefore, supposed to be inherently sustainable as distinct from income distribution schemes which can in the short -run reduce the disparities between the

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poorest and the rest, which may have arisen on account of policies intended to jumpstart growth. While income distribution schemes can allow people to benefit from economic growth in the short-run, inclusive growth allows people to 'contribute to and benefit from economic growth'.

3. 'Inclusive growth' as a strategy of economic development received attention owing to a rising concern that the benefits of economic growth have not been equitably shared. Growth is inclusive when it creates economic opportunities along with ensuring equal access to them. Apart from addressing the issue of inequality, inclusive growth may also make the poverty reduction efforts more effective by explicitly creating productive economic opportunities for the poor and vulnerable sections of the society. Inclusive growth, by encompassing the hitherto excluded population, can bring in several other benefits as well to the economy. The concept 'Inclusion' should be seen as a process of including the excluded as agents whose participation is essential in the very design of the development process, and not simply as welfare targets of development programmes (Planning Commission, 2007).

4. Though the Indian economy, achieved a high growth momentum during 2003-04 to 2007-08, it could not bring down unemployment and poverty to tolerable levels. Further, a vast majority of the population remained outside the ambit of basic health and education facilities during this high growth phase. In recent decades, economic and social inequalities have increased alongside high growth rates which have exacerbated regional inequalities. Over 25 per cent of Indians continue to live in abject poverty. As a result, inclusive growth has become a national policy objective of the Union Government. The 11th 5-year plan (2007 – 2012) envisions inclusive growth as a key objective. The Plan document notes that the economic growth has failed to be sufficiently inclusive, particularly after the mid-1990s. It has identified agriculture, infrastructure, health care and education as critical areas for achieving higher inclusive growth. Thus, the Eleventh Plan Document tries to restructure the policies in order to make the growth faster, broad-based and inclusive by reducing the fragmentation of the society. Huge investments in agriculture, education and health, and rural infrastructure were the key elements of the inclusive growth strategy as envisaged. Broadly, the policies aim at increasing the income and employment opportunities on the one hand and, on the other, it tries to finance programmes which are capable of making the growth more inclusive.

Inclusive Growth: Role of Financial Sector

5. There are supply-side and demand-side factors driving inclusive growth. Banks and other financial services players largely are expected to mitigate the supply-side processes that prevent poor and disadvantaged social groups from gaining access to the financial system. Access to financial products is constrained by several factors which include: lack of awareness about the financial products, unaffordable products, high transaction costs, and products which are not convenient, inflexible, not customised and of low quality. Financial inclusion promotes thrift

and develops the culture of saving and also enables efficient payment mechanism, strengthening the resource base of the financial institution which benefits the economy as resources become available for efficient payment mechanism and allocation. The empirical evidence shows that countries with large proportion of population excluded from the formal financial system also show higher poverty ratios and higher inequality. If we are talking of financial stability, economic stability and inclusive growth with stability, it is not possible without achieving financial inclusion. Thus, financial inclusion is no longer a policy choice but is a policy compulsion today. And banking is a key driver for inclusive growth. However, we must bear in mind that apart from the supply-side factors, demand-side factors, such as lower income and /or asset holdings also have a significant bearing on inclusive growth. Owing to difficulties in accessing formal sources of credit, poor individuals and small and micro enterprises usually rely on their personal savings or internal sources to invest in health, education, housing, and entrepreneurial activities to make use of growth opportunities.

What is different this time?

6. The role of the financial sector in the financial inclusion efforts in India date back to early 1960s when the focus was on channelling of credit to the neglected sectors of the economy and weaker sections of the population. Starting with 1990s, the focus shifted to strengthening financial institutions as part of financial sector reforms. The merits of financial sector reform need to be seen through the prism of what finance could do to harness the growth potential with stability, and financial inclusion represents a critical component of the policy process that intends to make the financial system serve the needs of the real economy. The 1990s also saw introduction of self-help groups (SHGs) – bank linkage programme and launch of Kisan Credit Cards (KCCs) in the country. The present phase of pursuing financial inclusion as a declared policy objective started in 2005. So, if financial inclusion efforts have been going on for that long, and clearly we have not succeeded, what is different this time and why are we talking so confidently about achieving universal financial inclusion now. It is because of the following reasons:

- the focus on inclusive growth, which has become the mantra of the times;
- the Information and Communication Technology (ICT) required by the formal financial sector for penetrating widespread unbanked areas in a cost-effective way is now available;
- the realisation that the 'Poor is Bankable'. FMCG companies, telecom companies and other retailers are all concentrating on the untapped rural markets for growth. Formal financial sector players also have realised that vast untapped excluded areas have growth opportunities not only for low-cost deposits/funds but also for other products such as micro-credit, micro-insurance, and micro-pension *etc.*

7. I wish to devote the remaining part of my address, on the objectives, bottlenecks and strategies in achieving financial inclusion in India. I would give you a glimpse

of the present phase of financial inclusion efforts including some misunderstood definitions and the initiatives being taken by the Reserve Bank of India. I would end my speech with a sneak peek at some of the targets that banks in India have set for themselves in next three years or so.

Definition: Financial Inclusion

8. A lot of confusion prevails amongst a lot of people about what constitutes financial inclusion. So, let me define it for you. Financial inclusion is the process of ensuring access to appropriate financial products and services needed by vulnerable groups such as weaker-sections and low-income groups at an affordable cost in a fair and transparent manner by mainstream institutional players. The Governor of the Reserve Bank has announced that we need to achieve financial inclusion through the mainstream financial institutions whether by mobile or card. We have reposed our faith in mainstream financial institutions to achieve financial inclusion. But, he has also made it clear that we cannot wait indefinitely for banks to come forward and exploit this opportunity of financial inclusion; otherwise we may have to look for other models of furthering financial inclusion. But, for the time being these issues have been resolved.

Objectives

9. What are the objectives of our financial inclusion efforts? It is to take banking services to everybody to meet their entire savings, credit and remittance needs initially, and needs for all other financial products and services subsequently. It is initially focused on villages with population above 2000 but the banks need to plan to cover villages with population below 2000 in an integrated manner over a period of next 3 to 5 years. The objective is also to provide banking services to entire population residing in urban and metro centers.

Bottlenecks

10. The bottlenecks and difficulties in achieving complete financial inclusion in our country are fairly well-known. The major obstacles are:

(i) The gigantic nature of the task, keeping in view the number of financially excluded people.

- In India, almost half the country is unbanked.
- Of the 6 lakh villages in India, only approximately 50,000 have bank branches.
- India has the highest number of households (145 million) excluded from banking.
- Only 10 per cent of the population has any kind of life insurance and 9.6 per cent of the population has non-life insurance coverage.

I may hasten to add that this is not an India-specific problem but a global one indeed.

- 2.5 billion adults, just over half of world's adult population, do not use formal financial services to save or borrow.
- 2.2 billion of these unserved adults live in Africa, Asia, Latin America, and the Middle East.

- Of the 1.2 billion adults who use formal financial services in Africa, Asia, and the Middle East, at least two-thirds, a little more than 800 million, live on less than $5 per day.

(Source: 'Half the World is Unbanked', 2009, Financial Access Initiative)

However, some of the critical indicators for access to finance in India along with benchmark indicators for selected high-income OECD member countries (Table 1) reveal that while there have been improvements during 2001-08 but it is still very adverse as compared to OECD economies.

(ii) Non-availability of appropriate banking technology till a few years ago. Lack of proper physical infrastructure, digital connectivity, *etc.* in some parts of the country. If financial inclusion is to take place, it can only be through Information and Communication Technology (ICT) based models.

(iii) Lack of proper Business Models. Banks still perceive this as a burden and an imposition and not as a viable Business Model.

(iv) Lack of cost-effective scalable Delivery Models. There is no facilitating and effective Delivery Model especially when problems are encountered. Business Correspondent (BC)-based Delivery Model is still in the evolutionary stage.

(v) The costs of administering low-value transactions and of financial intermediation are perceived to be on the higher side.

(vi) Planned, strategic and concerted efforts were lacking. It requires massive efforts from all stakeholders.

Strategy

11. What has been our broad strategy for achieving planned, sustained and structured financial inclusion? It is through a planned approach to the entire gamut of issues whose detailed steps are enumerated below:

(i) We have advised banks to formulate a board-approved Financial Inclusion Plan (FIP) for the next three years. We have not imposed a uniform model so that each bank is able to build its own strategy in line with its Business Model and comparative competitive advantage.

Table 1: Getting Finance Indicators for India, 2001-08

Indicator	2001	2002	2003	2004	2005	2006	2007	2008	Bench mark (OECD)
Branches per 1,00,000 people	6.42	6.33	6.25	6.26	6.33	6.37	6.35	6.6	10-69
ATMs per 1,00,000 people					1.63	1.93	2.4	3.28	47-167
Deposit accounts per 1000 people	416.77	421	418.7	426.1	432.1	443.1	459.5	467.4	976-1671
Loan accounts per 1000 people	50.99	53.9	55.84	61.88	71.42	78.0	83.59	89.03	248-513
Branches per 1000 km^2	22.18	22.3	22.41	22.57	22.99	23.5	24.13	25.49	1-159
ATMs per 1000 km^2					5.93	7.11	9.11	12.68	1-437

(Source: *Getting Finance in South Asia 2010, Kiatchai Sophastienphong*, Anoma Kulathunga, The World Bank)
Note: The Benchmark Indicator ranges are for selected high-income OECD member countries (Australia, Canada, France, Germany, Italy, Japan, the republic of Korea, New Zealand and the United States)

(ii) FIPs must be integrated with the normal Business Plans of the banks. We have freed interest rates and have also allowed banks to charge their customers for other transactions. We believe that banking to the poor is a viable business opportunity but a cost-benefit analysis needs to be done by the banks to make financial inclusion congruent with their Business Models. Banks must view financial inclusion as a viable Business Model.

(iii) Banks must view financial inclusion as a huge business opportunity and perfect their Delivery Models. BC-based delivery model has been made more flexible and inclusive.

(iv) For effective implementation of the financial inclusion strategies, banks must fix technology aspects first including completion of Core Banking Solution (CBS) in all their branches and those of sponsored Regional Rural Banks (RRBs), and seamless integration of front-end devices with the back-end systems. Without this, it would not be possible to scale up the activities.

(v) There is a need to increase the bouquet of products currently being offered. During discussions on their FIPs, banks have been advised to provide a minimum of four products to the account holder, *viz;*

a. A savings-cum-overdraft account.

b. A pure savings account, ideally a recurring or variable recurring deposit.

c. A remittance product to facilitate EBT and other remittances, and

d. Entrepreneurial credit products like a General Purpose Credit Card (GCC) or a Kisan Credit Card (KCC).

Apart from these minimum basic products, banks can offer any other product like insurance, mutual funds, *etc.* to the account holders.

(vi) On the issue of coverage, we have clarified that for a village to be considered covered by banking services, either a bank branch has to be present or a BC has to be visiting/ present in that village. There must be a bifurcation between villages with more than 2000 population and those with less than 2000 population. The plan needs to cover in an integrated manner both categories of villages. The name of the BC/branch covering a particular village needs to be indicated on the bank's website.

(vii) Special focus on financial inclusion at Urban and Metro centers through a functional approach.

(viii) Involve all the stakeholders in the process. Governments, both Central and State, Non-Government Organisations (NGOs), technology vendors, Industry Associations, Insurance and Mutual Fund companies and society at large.

(ix) The Reserve Bank's efforts have been to remove all regulatory bottlenecks for facilitating greater financial inclusion. Pricing has also been made free.

Myths about Financial Inclusion

12. Let me now come to a couple of myths surrounding financial inclusion and the first

of which is that Banks are not willing to do greater Financial Inclusion. In reality, the truth is that without appropriate technology, they could not have done it even when willing. It is not their willingness but the lack of ability to deliver which is coming in the way. The second myth is that the cost of achieving financial inclusion is too high. In reality, costs can easily be borne by banks. Overall cost of Financial Inclusion will not be more than ₹3000/4000 crore per year. The Central and State Governments can obviously provide a helping hand. Thus, the basic problem is not the cost or willingness, but the absence of Business Model and ICT based Delivery Model.

What do the FIPs indicate?

13. In the end, I only wish to say that the above steps initiated for creating a framework of sustainable financial inclusion are conceptually very sound. However, the real test is in successful execution and implementation. Just to give you a sense of the numbers being compiled from the FIPs submitted by the banks to understand the enormity of the task in next two and a half years.

- Close to 2,00,000 BCs/CSPs (customer service points) to be deployed.
- Over 4,000 rural brick-and-mortar branches to be opened in unbanked villages.
- Over 10 crore no-frills accounts to be opened.
- Over 3 crore KCCs and about 70 lakh GCCs to be issued.

The banks will really have to gear up for implementation of these plans. The numbers look good and if we can successfully execute the plans, India can present a role model to the world.

Conclusion

14. In conclusion, I would like to reiterate that the current policy objective of inclusive growth with stability is not possible without achieving universal financial inclusion. Thus, financial inclusion is no longer a policy choice today but a policy compulsion. And as agents entrusted with the task of achieving financial inclusion, the role of the mainstream financial sector in achieving inclusive growth becomes central. I am sanguine that with the concerted efforts of all the stakeholders, our planned, sustained and structured financial inclusion efforts would bear fruit and we can take the country not only towards an even higher growth rate but a growth which is inclusive and all encompassing. I am quite sure the students and faculty of KIIT will play a pioneering role in innovating and establishing an appropriate Business Delivery Model through the involvement of all stakeholders to make financial inclusion a reality. This Conclave will definitely throw up some innovative ideas in this direction. I am pleased to inaugurate this Conclave and wish it all success!

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