Financial Inclusion in Rural Area

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1. Introduction

Financial inclusion is where individuals and businesses have access to useful and affordable financial products and services that meet their needs that are delivered in a responsible and sustainable way. Financial inclusion is defined as the availability and equality of opportunities to access financial services. The responsibility of meeting the credit needs in the rural areas of India was entrusted primarily with the cooperative banking sector until about the mid-1960s. As the technological developments in the agricultural sector started gathering momentum, it was expected that commercial banks would play an increasing role in the rural credit market through branch expansion and direct lending. One of the major objectives of the nationalization of Indian commercial banks was the improvement of the flow of formal institutional credit into rural households, especially to the poor, thus relieving them of the burden of usurious debt.

The term "financial inclusion" has gained importance since the early 2000s, a result of identifying financial exclusion and it is a direct correlation to poverty by defines the goal of financial inclusion as follows:

- Access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance.
- Sound and safe institutions governed by clear regulation and industry performance standards.
- Financial and institutional sustainability, to ensure continuity and certainty of investment.
- Competition to ensure choice and affordability for clients.

2. Financial Inclusion in India

In India, RBI has initiated several measures to achieve greater financial inclusion and some of the steps are:

- **Opening of no-frills accounts**: Basic banking no-frills account is with nil or very low minimum balance as well as charges that make such accounts accessible to vast sections of the population. Banks have been advised to provide small overdrafts in such accounts.

- **Relaxation on know-your-customer (KYC) norms**: KYC requirements for opening bank accounts were relaxed for small accounts by simplifying procedures by stipulating that introduction by an account holder who has been subjected to the full KYC would suffice for opening such accounts.

- **RBI permitted banks to engage business facilitators (BFs) and BCs as intermediaries for providing financial and banking services during January 2006.** The BC model allows banks to provide doorstep delivery of services, especially cash in-cash out transactions and the list of eligible individuals and entities that can be engaged as BCs is being widened from time to time.

- **Use of technology**: The banks have been advised to make effective use of Information and Communications Technology to provide doorstep banking services through the business correspondent’s model where the accounts can be operated by even illiterate customers by using biometrics, thus ensuring the security of transactions and enhancing confidence in the banking system.

- **Adoption of EBT**: Banks have been advised to implement EBT by leveraging ICT-based banking through business correspondents to transfer social benefits electronically to the bank account of the beneficiary and deliver government benefits to the doorstep of the beneficiary, thus reducing dependence on cash and lowering transaction costs.

- **Opening of branches in unbanked rural centres**: The opening of branches in rural areas so as to improve banking penetration and financial inclusion rapidly the need for the opening of more branches besides the business correspondents banks have been mandated with monetary policy statement to allocate at least 25% of the total number of branches to be opened during a year to unbanked rural centres.

3. Focus on Financial Inclusion of Indian Rural and Semi-Rural Areas for the following Needs

- **Creating a platform for saving of money**: The lower income category has been living under the constant shadow of financial duress mainly because of the absence of savings.

- **Providing formal credit avenues**: 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.

- **Flow in public subsidies and welfare programmes**: A considerable sum of money that is meant for the
poorest of poor does not actually reach them. Therefore, government is pushing for direct cash transfers to beneficiaries through their bank accounts rather than subsidizing products and making cash payments.

4. Reasons for Financial Inclusion in Rural Areas

- Rural communities are highly underserved. Traditionally, formal financial institutions have avoided or failed to offer sustainable services in rural areas e.g. rural or agricultural development banks. So informal or semi-formal financial institutions as well as alternative providers like traders or input suppliers have become major providers of financial services.
- People living in rural areas may need access to financial services to purchase agriculture inputs; obtain veterinary services, transport goods to markets, manage peak season incomes to cover expenses in low seasons, invest in education, shelter, health and deals with emergencies.
- Climate change is impacting rural areas most severely. Rural communities cannot cope 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 risky businesses.
- Little knowledge exists on the demand for specific financial services other than credit, like savings, payment services and remittance transfers, leasing or insurance, which makes it difficult for supply to meet demand.
- Levels of financial literacy are often low in rural areas.
- Policy options Support knowledge and innovation in rural finance support financial institutions to innovate and adopt delivery models that reduce transaction costs.

5. Financial Inclusion Awareness in Rural Areas

Promote a savings and insurance culture among rural populations through awareness campaigns, financial education trainings or experience/testimony-sharing among insured and uninsured people. Support savings mobilization by efficient regulation of deposit-taking financial intermediaries. Avoid pressuring informal or semi-formal institutions to become regulated large formal institutions. Informal institutions have unique advantages that can be leveraged by linking them to formal finance. Integrate financial components in interventions like entrepreneurship development or local economic development. Improve infrastructure to lower transaction costs (e.g. in communications, electricity, transportation).

6. Factors Determining Financial Inclusion in Rural Areas

The conceptual framework determining the factors that drives financial inclusion they are listed below:

- Demand side factors of financial inclusion
- Supply side factors of financial inclusion
- Innovative delivery channels for financial inclusion

7. Demand Side Factors of Financial Inclusion

1. Irregular income: Very low income and inconsistent flow of cash for the poor people are considered as a demand driven factors of financial inclusion Poor people from the most vulnerable groups in the society not only have low income but also they get an irregular income and various uncertainties in cash flows.
2. **Lack of trust:** The negative experiences or negative perception of financial institutions makes the rural people to get mistrust of banks and which in turn leads to self-exclusion from the formal financial institutions. Disparities in financial inclusion has caused due to the lack of trust among the rural people in the banking systems leading to the loss of customers.

3. **Literacy level:** Financial isolation of the rural people often results in lack of understanding, which in turn makes them to distance themselves from the formal financial institutions. Even though banks have some suitable financial products for the poor people, due to their lack of knowledge and literacy level makes them an incorrect understanding of the products and hence lower the level of financial inclusion is highly associated with lower the level of financial literacy.

4. **High cost:** Obstacles of financial inclusion from the demand driven factors are high transportation and opportunity cost for the rural people to bank with formal financial institutions. The barrier for the low income group household since they spends more time in travelling to the bank or spend high transaction cost for accessing financial services from the banks.

5. **Technology:** In order to improve the access to financial services for the households in rural areas and promote greater financial inclusion an appropriate framework and business environment should support a greater interaction between Information and Communication Technology and financial sector for addressing the challenges posed by mobile banking.

8. **Supply Side Factors of Financial Inclusion**

1. **Distance:** Distance continues to be a major issue since Business Correspondent provides doorstep financial services to the outreach areas and for opening a bank account to the rural people distance and travelling from the bank branch to the remote areas is considered as a greatest challenge for the financial institutions.

2. **Policy regulations:** Banks are required by regulators to conduct sufficient identity checks before opening accounts. These regulations sometimes result in lack of access of genuine customers. Poor regulatory frameworks that reduces the quantity and quality of financial products and services that are accessible by the poor. Banks need to follow certain which was advised by Reserve Bank of India.

3. **Inappropriate products:** Banks and other financial services play an important role from supply side by providing access to basic financial services to the poor and disadvantage social group. Access to financial products are constrained by certain factors like lack of awareness about the products, the financial products are not convenient, flexible and low quality. The main reason for the financial exclusion from the supply side is documentation procedures and unsuitable financial products.

4. **Risk:** The banks bears risk due to the improper identification of customers and they use retail agents for money laundering or channel funding to terrorists.

9. **Innovative Delivery Channels for Financial Inclusion**

1. **Business correspondent model:** The significant role of the model is to provide doorstep delivery of banking service for the people from underdeveloped sections in the society. Business Correspondent is the authorized agent to take transactions on behalf of the bank. BCs can bridge a gap between the service providers that is banks and service seekers. The RBI guidelines strictly instructed banks to ensure that BCs cannot charge any fees to the customer for the services on behalf of the bank.

2. **Self help group:** Self Help group is a group formed by 15-20 members for covering various development programmes. This group helps for alleviation of poverty and women empowerment. Self Help Group is a registered or unregistered group of micro entrepreneurs and Self-Help Group -Bank linkage model is said to be an innovative channel in which the banks can directly lend to SHGs.

3. **Microfinance institutions:** Microfinance Institutions has reduced many barriers and constraints of financial inclusion. Penetration of microfinance institution has taken some areas which were neglected by the banking sectors and they suggested policy incentives to encourage expansion to those neglected areas. Microfinance Institutions (MFIs) play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor.

10. **Essential Elements of Rural Credit**

   The essential elements which provide the rural credit are as follows:
   - Credit can neither be cheap and facile nor on easy terms without regard to its use, but it should be guarded, guided and productive.
   - Financial Literacy and Credit counseling of Farmers
   - Policy must focus on promoting recovery climate and in no case should vitiate the recovery climate
   - Credit institution should have tailor-made loan products to match the specific needs of target groups
   - Loans must be linked to credit-worthiness of the person rather than to the credit-worthiness of the person
   - Effective communication helps to deal with rural clientele and earn their confidence
   - What is the Impact of Financial Inclusion Efforts in rural areas?
   - Since countries have accelerated efforts toward financial inclusion, it has become apparent that they face similar hurdles which impede their progress. These include:
• Ensure financial access and services extend to hard-to-reach populations, including women and the rural poor.
• Increase citizens’ financial literacy and capability so they understand different financial services and products.
• Make sure everyone has valid identification documents, and a low-cost, accessible means for them to be authenticated.
• Devise useful and relevant financial products, tailored to consumer needs.
• Establish robust financial consumer protection frameworks, and adapt relevant regulatory and supervisory authorities, including by utilizing technology to improve supervision.
• Globally, a lack of IDs makes it hard to open a bank account, access capital and credit.

11. Conclusion

An inclusive financial system facilitates efficient allocation of productive resources and thus can potentially reduce the cost of capital. Extending the reach of financial services to the poor through new technologies and simplified branch regulations hold promise. Bringing financial services to rural clients is the biggest challenge in the quest for broad-based financial inclusion. Often the main barrier to financial inclusion in rural areas is the great distances that rural residents must travel to reach a bank branch.

Those that promote financial inclusion argue that financial services can be viewed as having significant positive externalities when more people and firms participate. One of its aims is to get the unbanked and under banked to have better access to financial services. The government has taken several steps to promote financial inclusion. The innovative delivery channel is said to be the drivers of financial inclusion developed by the government helps in supporting the rural people to get an access for the financial services in a timely manner. But the rural people should be cultivated about the financial services and products by the officials of the bank to sustain their access in the formal financial institution.