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Financial Inclusion - Issues in Measurement and Analysis

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A B S T R A C T

Financial inclusion is delivery of banking services of an affordable cost to the vast sections of disadvantaged and low income groups. As banking services are in the nature of public good, it is essential that availability of banking and payment services to the entire population without discrimination is the prime objective of the public policy. The banking industry has shown tremendous growth in volume and complexity during the last few decades. Despite making significant improvements in all the areas relating to financial viability, profitability and competitiveness, there are concerns that banks have not been able to include vast segment of the population, especially the underprivileged sections of the society, into the fold of basic banking services. Internationally efforts are being made to study the causes of financial exclusion and designing strategies to ensure financial inclusion of the poor and disadvantaged. The reasons may vary from country to country and hence the strategy could also vary but all out efforts are being made as financial inclusion can truly lift the financial condition and standards of life of the poor and the disadvantaged.

Introduction

In India, the focus of the financial inclusion at present is confined to ensuring a bare minimum access to a savings bank account without frills, to all. Internationally, the financial exclusion has been viewed in a much wider perspective. Having a current account or savings account on its own, is not regarded as an accurate indicator of financial inclusion. There could be multiple levels of financial inclusion and exclusion. At one extreme, it is possible to identify the super-included, ie, those customers who are actively and persistently courted by the financial services industry, and who have at their disposal a wide range of financial services and products. We may have the financially excluded, who are denied access to even the most basic of financial products. In between are those who use the banking services only for deposits and withdrawals of money. But these persons may have only restricted access to the financial system, and may not enjoy the flexibility of access offered to more affluent customers.

Consequences of financial exclusion will vary depending on the nature and extent of services denied. It may lead to increased travel requirements, general decline in investment, difficulties in gaining access to credit or getting credit from informal sources at exorbitant rates, and increased unemployment etc. the small business may suffer due to loss of access to middle class and higher -income consumers, higher cash handling costs, delays in remittances of money.

An interesting feature which emerges from the international practice is that the more developed the society is, the greater the thrust on empowerment of the common person and low income groups. It may be worthwhile to have a look at the international experience in tackling the problem of financial exclusion so that we can learn from the international experience.

Financial Inclusion is considered to be the core objective of many developing nations since from last decade as many research findings correlate the direct link between the financial exclusion and the poverty prevailing in developing nations. According to World Bank report “Financial inclusion, or broad access to financial services, is defined as an absence of price or non-price barriers in the use of financial services.” The term Financial Inclusion needs to be interpreted in a relative dimension. Depending on the stage of development, the degree of Financial Inclusion differs among countries. It’s been surprising fact that India ranks second in the world in terms of financially excluded households after china .For the inclusive growth process of economy the central bank has also provided high importance to the financial inclusion.

Normally the weaker sections of the society are completely ignored by the formal financial institutions in the race of making hunks of profits or the complexities involved in providing finance to the weaker section. Financial inclusion or inclusive financing is the delivery of financial services, at affordable costs, to sections of disadvantaged and low income segments of society. There have been many formidable challenges in financial inclusion area such as bringing the gap between the sections of society that are financially excluded within the ambit of the formal financial system, providing financial literacy and strengthening credit delivery mechanisms so as to improvised the financial economic growth. Thus the term Financial Inclusion can 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.

Objectives of the study

The main objectives of the study are to identify the issues in measurement and analysis of financial inclusion.

Database and methodology

The present study is based on secondary data which is obtained from available published sources.Research methodology is partly descriptive, partly exploratory.

Financial Inclusion – Measurement and Analysis

Financial inclusion or inclusive financing is the delivery of financial services at affordable costs to sections of disadvantaged and low-income segments of society, in contrast to financial exclusion where those services are not available or affordable. An estimated 2.5 billion working-age adults globally have no access to the types of formal financial services delivered by regulated financial institutions. For example in Sub-Saharan Africa only 24% of adults have a bank account even though Africa's formal financial sector has grown in recent years. It is argued that as banking services are in the nature of public good; the availability of banking and payment services to the entire population without discrimination is the prime objective of financial inclusion public policy. The importance of financial inclusion, based on the principle of equity and inclusive growth, has been engaging the attention of policy makers internationally. Achieving universal financial inclusion is, indeed, a global objective and has multiple dimensions. While each jurisdiction will, perhaps, evolve its own delivery model, we need to acquire from each other and implement what is suitable in each constituency.

Approaches to Financial Inclusion - International Initiatives

The origins of the current approach to financial inclusion can be traced to the United Nations initiatives which broadly described the main goals of inclusive finance as access to a range of financial services including savings, credit, insurance, remittance and other banking / payment services to all *'bankable'* households and enterprises at a reasonable cost. The Report of the Centre for Global Development (CGD) Task Force on Access to Financial Services (October, 2009has laid down the broad policy principles for expanding financial access, including institutional mechanisms, with particular emphasis on the need for ensuring data collection, monitoring and evaluation. The G20 Toronto Summit (June, 2010) had outlined the "Principles for Innovative Financial Inclusion", which serves as a guide for policy and regulatory approaches aimed at fostering safe and sound adoption of innovative, adequate, low-cost financial delivery models, helping provide conditions for fair competition and a framework of incentives for the various bank, insurance, and non-bank actors involved in the delivery of a full range of affordable and quality financial services.

The global financial crisis has brought the need for financial inclusion into greater focus worldwide as it is believed that widespread incidence of financial exclusion was one of the factors that precipitated the financial crisis. While spread of financial inclusion is recognized through formal financial institutions such as banks, credit unions, post offices or microfinance institutions, the approach of keeping some/ all of these entities as a part of the core or as support players, varies from country to country. Besides, it is important to note that the defining principles of financial inclusion, coverage, role and responsibilities of institutions and measurement / monitoring requirements have been evolving over the years.

Approaches to Financial Inclusion - National Initiatives

Several countries across the globe now look at financial inclusion as the means for a more comprehensive growth, wherein, each citizen of the country is able to use his/her earnings as a financial resource that they can put to work to improve their future financial status and simultaneously contribute to the nation's progress.. Initiatives for financial inclusion have come from the financial regulators, the governments and the banking industry. While the banking sector has taken several steps to promote financial inclusion, legislative measures have also been initiated in some countries. For example, in the United States, the Community Reinvestment Act (1977) requires banks to offer credit throughout their area of operation and prohibits them from targeting only the rich neighborhood. The German Bankers' Association introduced a voluntary code in 1996 providing for an 'everyman' current banking account that facilitates basic banking transactions. In South Africa, a low cost bank account called 'Mzansi' was launched for financially excluded people in 2004 by the South African Banking Association. In the United Kingdom, a 'Financial Inclusion Task Force' was constituted by the government in 2005 in order to monitor the development of financial inclusion.

The history of financial inclusion in India is actually much older than the formal adoption of the objective. The nationalization of banks, Lead Bank Scheme, incorporation of Regional Rural Banks, Service Area Approach and formation of Self-Help Groups - all these were initiatives aimed at taking banking services to the masses. The brick and mortar infrastructure expanded; the number of bank branches multiplied ten-fold - from 8,000+ in 1969, when the first set of banks were nationalized, to 99,000+ today. Despite this wide network of bank branches spread across the length and breadth of the country, banking has still not reached a large section of the population. The extent of financial exclusion is staggering. Out of the 600,000 habitations in the country, only about 36,000+ had a commercial bank branch. Just about 40 per cent of the population across the country has bank accounts. The proportion of people having any kind of life insurance cover is as low as 10 per cent and proportion having non-life insurance is abysmally low at 0.6 per cent. People having debit cards comprise only 13 per cent and those having credit cards only a marginal 2 per cent of the population.

The National Sample Survey data (2002-03) revealed that nearly 51 per cent of farmer households in the country did not seek credit from either institutional or non-institutional sources of any kind. A number of rural households are still not covered by banks. They are deprived of basic banking services like a savings account or minimal credit facilities. The proportion of rural residents who lack access to bank accounts is nearly 40 per cent, and the figure rises to over three-fifths in the eastern and north-eastern regions of India. Accordingly, our primary objective is to take banking to all excluded sections of the society, rural and urban.

A more focused and structured approach towards financial inclusion has been followed since the year 2005 when Reserve Bank of India decided to implement policies to promote financial inclusion and urged the banking system to focus on this goal. Our focus has, specifically, been on providing banking services to all the 600 thousand villages and meeting their financial needs through basic financial products like savings, credit and remittance. The objectives of financial inclusion, in the wider context of the agenda for inclusive growth, have been pursued through a multi-agency approach. In 2006, the Government of India constituted a Committee on Financial Inclusion which made a wide range of recommendations on the strategies for building an inclusive financial sector and gave a national rural financial inclusion plan. Government of India has set up the Financial Stability and Development Council (FSDC), which is mandated, *inter alia*, to focus on Financial Inclusion and Financial Literacy issues. In order to further strengthen the ongoing financial inclusion agenda in India, a high level Financial Inclusion Advisory Committee has been constituted by RBI. The Committee would pave the way for developing a viable and sustainable banking services delivery model focusing on accessible and affordable financial services, developing products and processes for rural and urban consumers presently outside the banking network and for suggesting appropriate regulatory framework to ensure that financial inclusion and financial stability move in tandem. Financial sector regulators including RBI are fully committed to the Financial Inclusion Mission. I will cover this in more detail in a subsequent section.

The fact that financial inclusion concepts have different meanings in different parlance has often led to difficulty in using a standard yardstick for benchmarking its policy parameters. The associated difficulties are that the targeted variables used for financial inclusion may differ from one country or organization to another because of different institutional set up. Inherent weaknesses in the linkages between the financial inclusion database and welfare parameters of the society add to the complexity. Moreover, there are no agreed composite measures of financial inclusion which could facilitate comparisons across time and geography. Therefore, in order to ensure consistency and accuracy in measurement of financial inclusion parameters, it is essential that the parameters concerned are objectively defined in the first stage of the measurement process. As a way forward, we need to assess financial behavior and understand where the challenges and opportunities lie for the future. To do that, we need high-quality, multi-dimensional, comparable financial inclusion data based on internationally standardized terms and concepts. As such, the measurement needs also include analytics for correct interpretation of data and establishment of international benchmarks.

Various dimensions of data on Financial Inclusion

There are several structural dimensions in the process of building up data on financial inclusion. These include:

Measurement of the progress in financial inclusion initiatives by way of building up suitable indictors. Such indicators must contain data on access to (supply of) and usage of (demand for) financial services as well as their coverage and penetration. Measuring availability and actual use of deposit accounts, payment services, credit for poor households (micro-credit schemes), micro-level insurance products ought to be part of the framework.

The second aspect relates to understanding constraints or barriers for financial inclusion and development of indicators for assessing the same.

Another important dimension is the collection of transactional data on amount of credit extended, deposits placed, remittances made, etc. This is important in order to gauge the effectiveness of the financial inclusion initiatives. Merely opening of accounts without ensuring transactions undermines the beneficial impact of the financial inclusion measures.

Finally, diverse data are required to be pooled and benchmarked at international level. In this respect, one needs to take a stock of current status of data relevant for building up globally applicable indicators.

Basic data covering both the quantitative and qualitative aspects can be obtained through self-reporting templates by the formal financial intermediaries or by means of household surveys. There is also a need for international benchmarking of financial inclusion indicators as practices followed across the developed and developing economies can vary considerably. It is necessary to develop standard statistics on a comparable and consistent scale in order to set benchmarks and best practices for structuring plans for financial inclusion.

International Databases on Financial Inclusion Indicators

Financial Inclusion is fast emerging as a candidate for being a core driver of sustainable long-term economic growth and is, therefore, attracting the attention of central bankers and various global developmental and financial institutions. It is, however, emerging that a lot of ground remains to be covered in understanding the reach of the financial sector, and particularly, the degree to which vulnerable groups such as the poor, women, and youths are excluded from formal financial systems. Availability of systematic indicators of the use of different financial services needs to be improved in most economies and consequently, at the global level. It is heartening to note that multilateral organizations such as the World Bank and the International Monetary Fund (IMF) are paying attention to the development of relevant database, besides focusing on the issue of financial inclusion through policy prescriptions and guidelines. The World Bank database, known as the Global Financial Inclusion database (Global index), provides survey based data as part of the annual Gallup World Poll. The survey conducted in 2011 covered at least 1,000 adults each in 148 economies using randomly selected, nationally representative samples. The focus of the Global Index Database encompasses a set of indicators that measure how adults save, borrow, make payments, and manage risk, stressing thereby on how a well-functioning financial system serves the vital purpose of offering savings, credit, payment, and risk management products to people with a wide range of needs. Inclusive financial systems allowing broad access to financial services, without price or non-price barriers to their use, are especially likely to benefit poor people and other disadvantaged groups. Without inclusive financial systems, poor people must rely on their own limited savings to invest in their education or for entrepreneurial activities, while small enterprises would need to rely on their limited earnings to take advantage of promising growth opportunities. This can contribute to persistent income inequality and slower economic growth. index reports data in terms of the proportion of people (of age 15+) for a number of parameters such as (a) who have saved money with financial institutions or other sources, (b) taken loan from financial institutions or other sources, (c) paid for health / agriculture insurance and (d) used cheques / electronic payment / mobile payment systems for financial transactions. The World Bank has released a research study on the database in April 2012.

Table.1 Financial Inclusion Plan- Summary progress of all banks including RRBs

Sl No	Particulars	Year ended March 2010	Year ended March 2011	Year ended March 2012	Year ended March 2013
1	Banking Outlets in Villages - Branches	33378	34811	37471	40837
2	Banking Outlets in Villages - BCs	34174	80802	141136	221341
3	Banking Outlets in Villages - Other Modes	142	595	3146	6276
4	Banking Outlets in Villages - Total	67694	116208	181753	268454
5	Urban Locations covered through BCs	447	3771	5891	27143
6	Basic Savings Bank Deposit A/c - branches (No. In millions)	60.19	73.13	81.20	100.80
7	Basic Savings Bank Deposit A/c - branches (Amount □. In billions)	44.33	57.89	109.87	164.69
8	Basic Savings Bank Deposit A/c - BCs (No. in millions)	13.27	31.63	57.30	81.27
9	Basic Savings Bank Deposit A/c - BCs (Amount □. in billions)	10.69	18.23	10.54	18.22
10	OD facility availed in BSBDA's (No. In millions)	0.18	0.61	2.71	3.95
11	OD facility availed in BSBDA's (Amount □. in billions)	0.10	0.26	1.08	1.55
12	KCCs - (No. in millions)	24.31	27.11	30.24	33.79

Source: Annual Report of RBI.

A snapshot of the data on some indicators for select countries is given in. The study reveals that:

50 per cent of adult population worldwide report owning an account with a formal financial institution, but actual operation and use of these accounts for transactions varies widely across regions and economies. And when one starts probing the numbers granularly, the actual spread of financial inclusion indicators across countries would turn out to be wider.

Financially excluded populace is predominant in developing countries, where only 41 per cent adults have a formal account, with only 37 per cent of women having formal account against 46 per cent of men; the gender gap widens further because of varying degrees of income inequalities observed among the developing countries.

The cross country comparison would reveal that bank account penetration, measured as a per cent of adult population, varies widely across the countries. In high-income economies, account based financial inclusiveness is much higher with 89 per cent adults having accounts with formal financial entities. For India, account penetration is reported to be 35 per cent (43.7 per cent for men and 26.5 per cent for women) while China scored better at 63.8 per cent (67.6 per cent for men and 60 per cent for women). South Korea reported high account penetration at 93 per cent, universality of education, and particularly, the spread of financial literacy.

However, such aggregative nature of data masks many critical performance related information for understanding the depth and granularity at sub-national level. Another specialty of the database (FINDEX) used in the World Bank study is that it is a survey based reporting system which may have small sample biases and such constraints are natural for household surveys, particularly, when they involve people in the lower rung of the financial inclusion pyramid.

Further, the initiatives are technology driven so as to make the financial services deliverable in a cost effective manner, tailor made by the market participants to best suit their requirements. RBI has encouraged the ICT model which would enable banks to overcome the barriers of geography and ensure efficient financial inclusion. The ICT based delivery model adopted should be technology-neutral to facilitate easy up-scaling and customization, as per individual requirements. Against this background, the major initiatives taken by RBI include the following:-

Encouraged the SHG-Bank Linkage Model, one of the largest micro finance models in the world, under which 4.79 million SHGs have been credit linked, covering 97 million poor households (till March 2012).

Mandated Commercial Banks including Regional Rural Banks to migrate to the Core Banking Platform.

Substantially liberalised the BC based service delivery model in phases.

Permitted domestic scheduled commercial banks to freely open branches in Tier 2 to Tier 6 centres.

Mandated banks to open at least 25% of all new branches in unbanked rural centres.

Substantially relaxed the Know Your Customer (KYC) documentation requirements for opening bank accounts for small customers.

Encouraged Electronic Benefit Transfer for routing social security payments through the banking channel.

Pricing for banks totally freed; Interest rates on advances totally deregulated.

Separate programme for Urban Financial Inclusion initiated.

Conclusion

It is becoming increasingly apparent that addressing financial exclusion will require a holistic approach on the part of the banks in creating awareness about financial products, education, and advice on money management, debt counseling, savings and affordable credit. The banks would have to evolve specific strategies to expand the outreach of their services im order to promote financial inclusion. One of the ways in which this can be achieved in a cost effective manner is through forgoing linkages with microfinance institutions and local communities.

On the measurement challenges, first, it needs to be reckoned that financial inclusion concepts, policies, delivery models and implementation processes are still evolving. It is, therefore, essential that the policy for achieving total financial inclusion also keeps changing to adapt to the needs of the environment. This poses challenges for measurement of various financial inclusion initiatives as also their aggregation across activities, institutions, regions and so on. Statistical analysis of performance of financial inclusion initiatives and development of benchmarking standards can be quite complex. Second, while existing initiatives in measuring financial inclusion are commendable, there is a need for greater focus on the micro and distributional dimensions. Third, we should explore the need to change the focus of present information systems of banking business from traditional accounting model to customer centric business model. This would call for expanding the scope of the currently used measures of financial inclusion.

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