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Global agenda of financial inclusion: Where does India stand?

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Introduction

Financial inclusion may 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 (The Committee on Financial Inclusion, 2008). India's journey of financial inclusion began even before its independence with the establishment of the Imperial Bank of India in 1920. Section 2(b) of the Act that led to the establishment of the bank clearly stated, *"that within five years from the commencement of this Act, the Bank shall establish and maintain not less than one hundred new branches, of which at least one-fourth shall be established at such places as the Governor General in Council may direct"* (IMPERIAL BANK OF INDIA ACT, 1920). This commitment is further confirmed by similar conditions put on the State Bank of India when it was nationalized in 1955 in independent India and took it forward by the nationalization of banks in 1969 and 1980. By the mid-1980s, however, there was a realization that despite the massive expansion of the branch network of public sector banks, disadvantaged groups still did not have access to credit as they lacked collateral and had low repayment capacity (RBI, 2018). The MYRADA experiment with self-help affinity groups in the mid-1980s and NABARD and RBI support later to the experiment, addition of the SHG-Bank Linkage model of access to formal credit become easier in the early 1990s. This spread rapidly in some parts of India, opening the door of banks to disadvantaged women (Fernandez, 2007).

The latest episode of India's financial inclusion journey is the introduction of the flagship programme Pradhan Mantri Jan-Dhan Yojana (PMJDY) in 2014. Though there has been a phenomenal increase in the share of adults having a bank account by 30 per cent after the introduction of PMJDY, several challenges including the duplication and dormancy of accounts along with a disproportionate increase in the number of borrowers raise the question of the appropriateness of PMJDY to achieve universal financial inclusion in India (Sinha and Azad, 2018). The objective of providing access to formal banking through PMJDY was also to facilitate Direct Benefit Transfers (DBTs) like welfare pensions, scholarships, MNREGA wages etc. Going by the definition of financial inclusion, financial access does not imply the availability/affordability of financial services for the weaker and marginalized. In this context, this study analyses the trends in *financial access and financial use* in India from a comparative perspective.

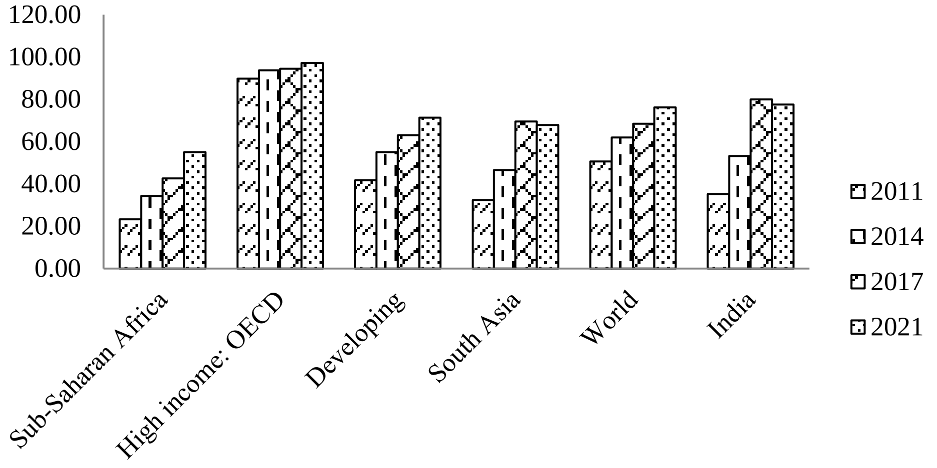
This paper uses the Global Findex database 2021 to analyze performance in access and usage dimensions of financial inclusion by comparing with other country groups. The World Bank publishes Global Findex data, which provides information on the incidence of various financial services and the intensity of their use by adults in 148 economies around the globe. The various indicators used in the database are collected through interviews with more than 1,50,000 randomly picked individuals (adults) from the 148 economies. The first report of this triennial survey came out in 2011, next in 2014 followed by 2017, and the latest in 2021.

Access

Account ownership can be considered a proxy for the access component of financial inclusion. It can be placed at the very base since it is the gateway to the formal banking system and the first point of contact to the same. The Global Findex 2021 defines account ownership as the ownership of an individual or jointly owned account at a regulated institution, such as a bank, credit union, microfinance institution, post office, or mobile money service provider[1] (Figure-1).

[1] Global Findex Report, 2021.

Figure 1: Percentage of Adults owning a bank account



Source: Global Findex database, 2021.

There has been a gradual increase in account ownership in the last decade. As per the latest Global Findex database 2021, about 76 percentage of global adults[2] own bank accounts (Figure 1). Nonetheless, the cross-country variations are significant. While the advanced OECD countries have achieved close to 100 per cent account ownership, in Sub-Saharan Africa (SSA), more than 60 per cent of the adult population still does not have a bank account. In India, account ownership has grown from 35 per cent in 2011 to 77 per cent in 2021, the highest among the developing countries. India's account ownership marked a historical growth rate of 26 percentage points between 2014 and 2017, which can be attributed to the world's largest financial inclusion drive Pradhan Mantri Jan Dhan Yojana. During the same period, world account ownership has grown by 6.57 percentage points while that of developing economies by 7.27 percentage points. The growth rate of developing economies was led by India. The growth rate of the developing economies, excluding India is just three percentage points.

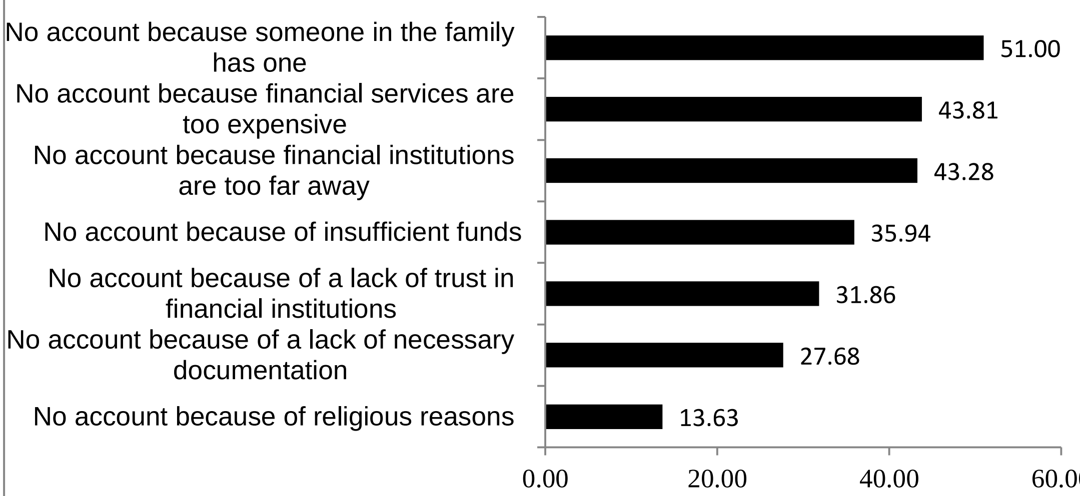
Another stylized fact is that account ownership has marginally fallen by three percentage points from 80 percentage to 77 percentage during 2017-2021 in India. Most importantly, India is the only comparator country with an absolute decline in ownership of formal bank accounts. All other groups under consideration show an increase in adult account ownership from 2017 to 2021. Another significant trend crucial for policy is that India has the largest share of inactive accounts, with 35 per cent of the adult population who reported having an account owned an inactive account. This trend corresponds to the finding in the previous

[2] More than 15 years of age.

studies, which argued that PMJDY contributed to dormant bank accounts (Sinha and Azad, 2018). Among the reasons for not using, 49 per cent of them reported that distance to the financial institution was the reason, while 46 per cent reported that they did not need an account (Figure-2).

Despite the impressive rise in account ownership, India is home to the largest number of people without a formal bank account (17%). Among the non- account holders, multiple factors that contribute to their status of unbanked. In the Indian case, individuals prefer not to hold an account because someone in the family has one is the most significant reason reported by the respondents. This can be considered a byproduct of PMJDY, and it is noteworthy that it leads to voluntary exclusion. That is the adults prefer themselves to be not a part of the formal financial system rather than due to supply bottlenecks. Affordability is the second most significant reason for exclusion from formal banking services, followed by distance to the banks. These two factors are quite disturbing since affordability is one of the most important components of financial inclusion, but still it acts as the prime hindrance for involuntary exclusion. Also, even after a century after the enactment of the Imperial Bank Act which stressed on the directed branch expansion followed by a series of other policies for the same, distance acts as the second most important cause of involuntary exclusion from the formal banking services in India (Figure-2).

Figure 2: Reasons for not having a Financial Institution Account in India



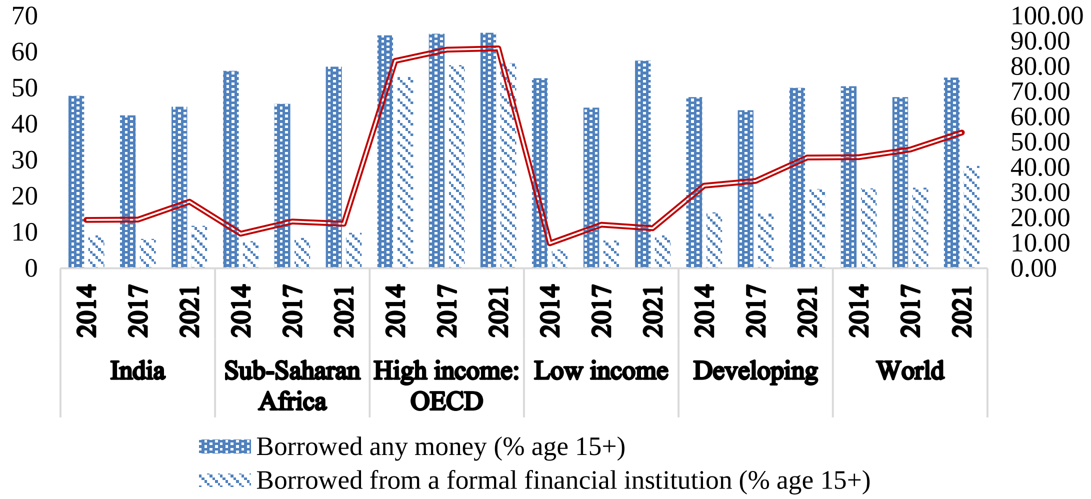
Source: Global Findex database, 2021.

In the era of digitalization, technology can be leveraged to bring the under-banked Indian population under the net of formal banking. The problem of proximity and affordability can be mitigated by popularizing mobile-based banking, and we have some successful models from Sub-Saharan Africa to adopt. There is a growing literature which underscored the importance of digital financial inclusion and fintech in fostering financial inclusion (Ghosh, 2019). Though India has a very high rate of mobile phone diffusion and digital financial inclusion compared to many other countries, India's achievement is not impressive. In the case of India, while 65.6 percentage of people own a mobile phone, only 12 percentage use a mobile phone to make some financial transactions (World Bank, 2021).

Use

The second main pillar of financial inclusion is the use of financial services from formal institutions. Formal financial institutions provide a wide range of financial services which ranges from deposits, loans, payment function, investment, etc. Among them, one of the important development functions that formal financial institution such as banks carry out is lending loans to their customers. So the usage dimension of financial inclusion is aptly captured by the borrowings. People can borrow from formal sources and informal sources. But formal sources are more desirable to the system since they can protect the marginalized and vulnerable sections from usurious interest and exploitation from informal sources such as money lenders, traders or landlords (Figure-3).

Figure 3: Total Borrowings and Borrowings from Formal Sources (in %)



Source: Global Findex database, 2021.

It could be observed from Figure 2 that a minimum of 45 percentage of households borrow money across country groups. But the differences in the proportion of people borrowing from formal sources are glaring across countries. High-income OECD countries have the highest share of institutional credit in total borrowings, while the share becomes very minimal in the case of SSA, low-income economies and the same for India. In India, the percentage of households borrowing money decreased from 47 percentage in 2014 to 42 percentage in 2017 and increased marginally to 44.7 percentage in 2021. There is an increase in borrowing in general, and holds the same for institutional borrowings in 2021. This increased indebtedness could be partly attributed to the COVID-19-induced income and livelihood crisis, where millions have lost their jobs across the world and resulting in an unprecedented rise in unemployment, especially for those employed in the informal sector (ILO-OECD, 2021). Significant variations exist in the proportion of people borrowed from the formal source. Though dependence on formal sources increased marginally from 2017 to 2021, India still has a very large dependence on informal sources as only 11.78 per cent borrowed from formal sources compared to the 28.3 per cent global average.

Among the people who borrowed, the share of people borrowed from formal sources in India is just 26 per cent compared to 53 per cent of the world average and 43 per cent for developing countries. On the contrary, in the high-income OECD countries, 87 per cent of those borrowed have been borrowed by formal financial institutions. While India made significant strides in improving access, almost comparable to OECD countries and way above the developing countries, in terms of formal financial access, The economy hardly showed any significant improvement in borrowing from formal sources after implementing PMJDY in 2014. This clearly shows that India's remarkable success in the financial inclusion journey has only been confined to improving access.

Conclusion

This paper analyzed the performance of India's financial inclusion in terms of financial access and use of financial services for the last 10 years in a comparative perspective using the World Bank Global Findex database. India has shown phenomenal progress in improving financial access measured in terms of percentage of adults having bank account. The highest increase in access to banking from 2014 to 2017 could be attributed to India's flagship financial inclusion program, PMJDY. In 2021, financial access in India is significantly higher than the developing country average and almost comparable to OECD countries. However, notwithstanding enormous progress in access, India is still home to the most significant proportion of the unbanked population in the world. Two factors stand out as primary reasons for not owning a bank account; distance to the banks and lack of affordability. The distance factor remains a significant barrier. Since India has much potential for harnessing the rapid diffusion of mobile phones enabling digital financial inclusion. India has one of the lowest proportions of people using mobile phones for banking.

This paper also shows that improvements in access did not culminate in improved use of formal financial services. India's proportion of people borrowing from formal sources compares poorly with other developing countries. Though there have been some improvements after 2017, only 26 per cent of borrowed depended on formal sources. This trend shows that India needs to focus on measures to improve the use component of financial inclusion, without which India's financial inclusion agenda remains half-completed. In the future, India should draw lessons from the successful experiments of technological innovations to deliver services unbanked at an affordable cost.

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