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Financial inclusion is a must and will add value to India's sustainable growth

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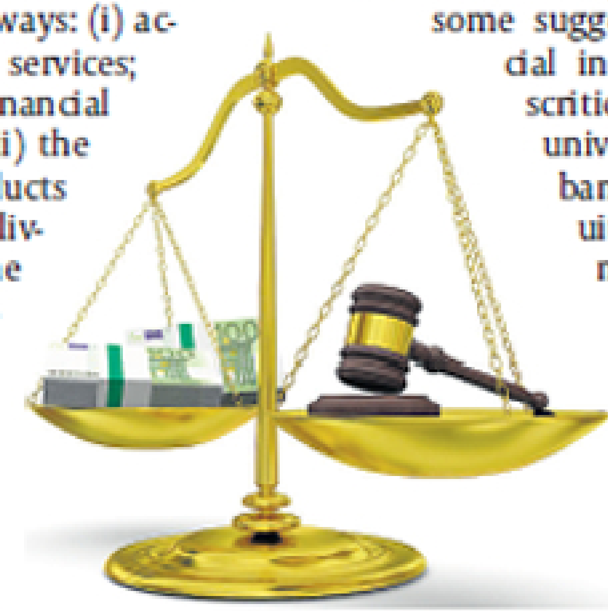
The World Bank Global Financial Inclusion Database indicates that 2.5 billion adults globally, about half the total adult population, have no access to financial services delivered by regulated financial institutions. While account penetration is nearly universal in high-income economies, with 89 per cent of adults reporting that they have an account at a formal financial institution, it is only 41 per cent in developing economies. Those in developing economies have to depend on informal mechanisms for loans, savings and to protect themselves against risks such as uneven cash flows, seasonal incomes and unplanned needs.

The absence of financial inclusion also contributes to slower economic growth and persistent income inequality. Allowing broad access to financial services, without price or non-price barriers to their use and offered in a responsible manner, have been shown to benefit poor people and other disadvantaged groups. Economies with deeper financial intermediation tend to grow faster and reduce income inequality.

Measuring inclusion

The global partnership for financial inclusion (GPFI) developed a comprehensive and holistic set of financial inclusion indicators with the aim of deepening the understanding of the financial inclusion landscape which was endorsed at the G20 meeting in Russia in September 2013.

Financial inclusion is measured in three ways: (i) access to financial services; (ii) usage of financial services; and (iii) the quality of products and service delivery. In India, the number of people with access to the products and services offered by the banking system is limited.



According to the World Bank Findex Survey (2012), 35 per cent of Indian adults had access to a formal bank account, 2 per cent of adults used an account to receive money from a family member living in another area and 4 per cent used an account to receive payment from the government.

There is need for a further push to ensure that people at the bottom of the pyramid join the formal financial system and thus add value to India's sustainable growth.

The RBI panel headed by Nachiket Mor recently came up with some suggestions on financial inclusion. It coverscritical areas such as universal electronic bank account, ubiquitous access to payment services and deposit products at reasonable charges, sufficient access to affordable formal credit and universal access to a range of deposit and investment products, and insurance and risk management products at reasonable charges.

It also suggests that a special category of banks, called payments banks, be set up to widen the spread of payment services and deposit products to small businesses and low-income households.

Such banks will have a minimum entry capital requirement of ₹50 crore, one-tenth of what a full-service bank requires, since they will have a near-zero risk of default. Payments banks will be required to comply with all RBI guidelines relevant for commercial banks. Existing banks should be permitted to create a payments bank as a subsidiary.

The danger

Financial inclusion can be successful only by imparting financial literacy among the unbanked and giving confidence to them to use basic banking services. Banks should approach financial inclusion as a viable and sustainable business model. Banks should leverage on technology developments such as mobile banking. The efforts to drive financial inclusion can be counterproductive unless handled well. Without healthy competition and effective regulation, credit is often overextended to people not qualified to receive it. And promoting credit without regard to cost actually exacerbates financial and economic instability.

The subprime mortgage crisis in the US that caused the global financial crisis had its origins in the forced drive for inclusion. It led government-backed agencies to lend to customers with limited ability to repay.

The dangers of aggressive credit expansion in the name of financial inclusion should serve as a cautionary tale for policymakers. Easing access to credit without addressing real economy constraints is unlikely to either boost growth or help fight poverty. Financial inclusion can be a worthy goal only if it helps reduce poverty levels sustainably.

The writer is the group CEO of Doha Bank