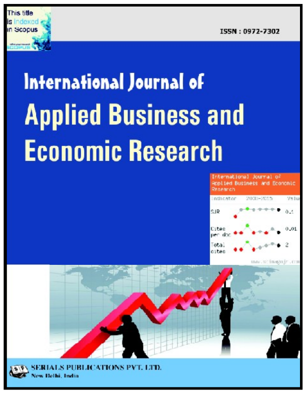


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# Financial Exclusion in and around Bengaluru—An Exploratory Study

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***Abstract:*** *Objectives:* The nature of financial exclusion will throw light into many aspects of the underprivileged and deprived lot of emerging market and developing economies. The reasons for financial exclusion will help the authorities to devise strategies and schemes to bring them to the mainstream economy. *Methods/Statistical Analysis:* A primary study is conducted across 461 households in the 6 rural villages close to Bengaluru and the urban poor residing in Bengaluru to understand the demographic profile, educational qualifications, average income, average working age, banking habits and the purpose of loans availed. *Findings:* Access to formal sectors of the financial system is limited due to factors like literacy levels and age of the borrower. People in the age group of 25 and 34 borrow the maximum followed by people in the age group of 35 and 44. Households prefer informal sector to the formal ones. *Conclusion/Improvements:* Making the financially excluded people aware of financial products available in the market will lead to their increased participation in the economic progress of the country. Special drives and programs to be conducted to inculcate saving habits accelerating the pace of economic development. Providing increased access to financially excluded people with appropriate financial products, savings products and combating psychological barriers are some of the ways in which the marginalized lot can be brought into the mainstream.

***Keywords***: Financial Exclusion, Growth

***JEL Classifications***: G00, G20, G21, I30

## 1. INTRODUCTION

The Indian economy has grown leaps and bounds over the decades. From a GDP of 2.3% in 1951-52 to 8.9% in 2010-11 to 7.6% in 2015-16, India has come a long way. The world is recognizing India as not an agriculture based economy, but as a major service provider in various services. From a mere 9.8% in 1951-52 to 30.6% in 2013-14, the growth in savings rate is tremendous. India's incredible journey in becoming self-reliant and a major centre of disseminating knowledge would not have been impossible if not for the various schemes undertaken by successive governments over the years.

The success story is not a rosy walkthrough. There are some sections benefitting by the progress, while some sections are yet to feel the benefit. These segments of the economy have not tasted the success of India's transformation. In spite of all the progress made, about 60% of Indian population does not have bank accounts and less than 10% are covered with life insurance policies—all these pointing out to the fact that a majority of India's population is still an under-privileged lot. The centre has therefore envisaged some policies to provide access to the formal financial services and bring them into the financial fold (financial inclusion) at an affordable cost to these vast sections of marginalized and relegated sections of society.

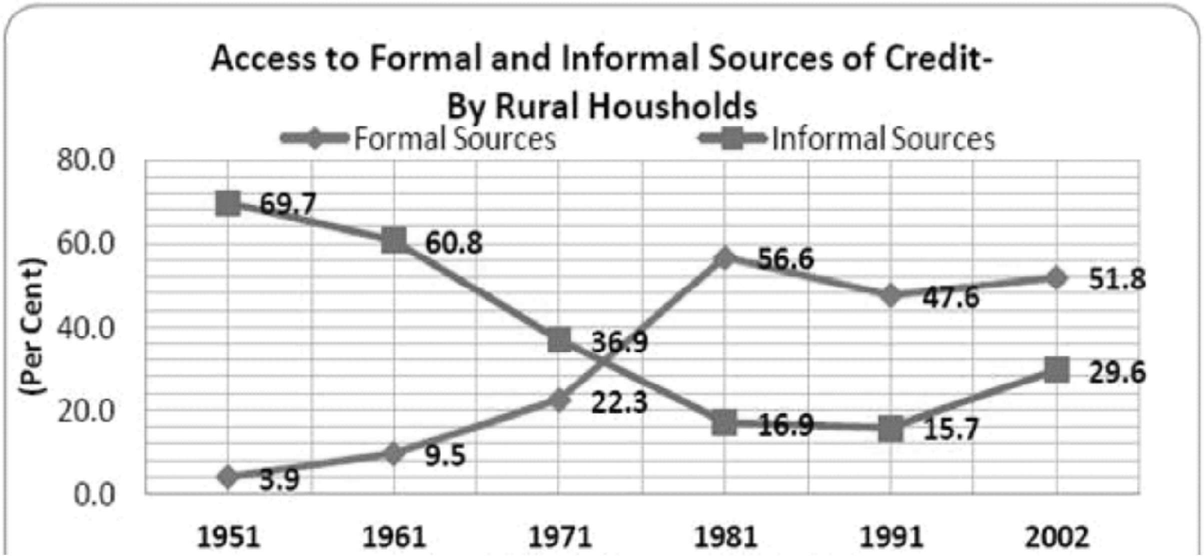
Of late, financial inclusion has increasingly come to the forefront of public domain. After the 2008 financial crisis and the global meltdown, there is a great thrust to include financially deprived sections of the society into the mainstream and policymakers all over the world are exploring ways to ensure greater inclusion of the financially excluded segments of society. World over, about 38% of the adult population have limited access to formal financial services. The official channels have a huge potential in bringing in these people into the official system. Loans advanced by the financial system to such people will help them alleviate their poverty, accelerate consumption and make them more reliable to absorb unforeseen shocks such as health-related issues, increased investment in durable goods, home improvements[1].

According to a report of the high powered committee of RBI in 2014 on financial inclusion in emerging market economies, 50% of Indian adults of had accounts with banks compared to 70% of various other BRICS economies. The same report also mentions that while 10% or more of the adult population borrowed from a financial institution, Indian adults borrowing was just 6%.

Financial inclusion is access to the formal financial sector of the marginalized and deprived sections of society. Representatives and officials of the financial system all over the world are exploring ways and means to ensure greater inclusion of these financially excluded segments of society. There has been renewed global impetus to financial inclusion, particularly following the global financial crisis in 2008. It is believed that financial inclusion could be welfare-enhancing and, as a result, there is greater political support for the entire process.

The 11th Five Year Plan (2007-12) has documented that significant segments of the Indian population have been excluded from the growth over the previous decade. The extent of financial exclusion is astonishing and shocking. India has 600,000 villages of which a meagre 30,000 villages have a commercial bank branch. More than 50% of India's population does not have any bank account and more than half of the total farmer households does not seek credit from either institutional or non-institutional sources of any kind. They approach the informal sector for their financial needs, like the village landlords, zamindars and pawn brokers who lend loans at high rates of interest.

By comparing the peer emerging market economies, India does not have a favourable position. A study by RBI says that in 2014, over 50 per cent of Indian adults held an account with a financial institution, while the percentage was 70 per cent in other BRICS economies. The percentages were still higher in the US and UK. Another interesting finding of the study is that only 6 per cent of Indian population had borrowed from a formal financial institution in the previous 12 months compared with 10 per cent or more in other BRICS economies (Chart 2.1).




*Source:* RBI Working Paper: 05/2013

**Chart 1: Access to Formal and Informal Sources**

A glance at the chart above explains the growth in formal and informal sources of credit by rural households. While the formal sources grew from 3.9% in 1951 to 56.6% in 1981 and has been constant in the later years, being 51.8% in 2002, the informal sources saw a decline from 69.7% in 1951 to 15.7% in 1991 and later to 29.6% in 2002. These data indicate that the formal sources have steadily increased and informal sources gradually declined.

The trend of bank nationalization started with the Imperial Bank of India being taken over by the government and rechristened as the State Bank of India in 1955. A little later, this was followed by the nationalization of 14 major commercial banks in 1969 and 6 other banks in 1980. These were the first few initiatives taken by the government to reach out to the poor and needy and bring the under privileged into the mainstream by providing credit in an organized manner. Unfortunately, to the dismay of the government, none of these measures had a great impact. An RBI report of 2009 mentions that the Lead Bank Scheme promoted by nationalized banks was a big failure as large sections of the rural population and the urban poor did not have access to banking facilities. Loans to agriculture sector are way below the targets set and public sector banks failed to achieve their targets. The recent Jan Dhan Yojana scheme launched recently with much fanfare by public sector banks has been lauded for its success rate. But regrettably, of the 17 crore new Jan Dhan accounts opened, almost 50% are non-operational. How then can this scheme be considered successful? There is a need to understand why these schemes are not yielding desired results.

## 2. WHO IS FINANCIALLY EXCLUDED?

Vulnerable groups that are particularly likely to be financially excluded include:

- Migrants and refugees
- Ethnic minorities
- Victims of domestic violence

### 2.1. Causes of Financial Exclusion

- Low disposable incomes and low access to retail financial services: such groups are not commercially viable for mainstream retail financial providers and hence they do not show any interest in such groups.
- Low levels of awareness of the need to plan and provide for the future
- Low levels of financial literacy
- Increased levels of job insecurity
- Structural changes[2] in labour markets brings in greater flexibility accompanied by high levels of youth unemployment. The current market conditions are such that there is a high need to be skilled to meet specific job requirements.

### 2.2. Consequences of Financial Exclusion

Not having access to key financial products like to a bank account, consumer credit, savings or insurance have serious implications in the present age. There are a lot of transactions which are automatically routed through bank accounts. Not having access to a bank account and banking facilities will make money management more complex and time-consuming, costlier and less secure. Being without a bank account means that people lack a secure place to keep their money until they are ready to spend it. The consequences impact on three main areas of citizens' lives:

- Handling cash and cheques
- Paying bills;
- Access to short-term credit facilities and other financial products

## 3. LITERATURE REVIEW

Many researches have been conducted to understand the term 'financial exclusion' and on the importance of bringing the underprivileged and downtrodden sections of the society into the mainstream. Many of such studies are done by researchers of other nations. There are not many studies done by Indian researchers. The present study is a step in this direction to understand the nuances of financial exclusion and its significance in a nation's progress.

Financial exclusion is defined in the context of the larger issue of social inclusion (or exclusion) in a society. It is described[3] as those processes that serve to prevent certain social groups and individuals from gaining access to the financial system. It is the "processes that prevent poor and disadvantaged social groups from gaining access to the financial system". The inability to access necessary financial services in an appropriate form is financial exclusion[4]. The lack of access to certain segments of society to appropriate, low-cost, fair, and safe financial products and services from mainstream providers is the meaning[5, 6] of financial exclusion. It is the process of provision of affordable financial services, (viz. access to payments and remittance facilities, savings, loans and insurance services) while those not availing these services provided by the formal financial system are financially excluded are the views of.

All the above studies and definitions emphasize that financial exclusion is the manifestation of a much broader issue of social exclusion of certain societal groups such as the poor and the disadvantaged. Financial exclusion is a process that fails to ensure the ease of access, availability and usage of the formal financial system to the needy and deprived sections of the society. Though people had negative views about financial institutions and did not welcome overdraft facilities or identity and credit cheques, the majority of the people opine that they should have a bank account. Overcoming mistrust and aversion towards financial service providers may be one of the biggest challenges to those wishing to promote financial inclusion[7]. The behavior[8] of low income people (unemployed or employed on a temporary basis) in 2006 across France, Spain and Italy points out that that a large proportion of such people do have access to credit though not necessarily from a bank.

An Indian study[9] views financial exclusion as a barrier towards accomplishing the goal of financial inclusion. It is 'a confluence of multiple barriers: lack of access, lack of physical and social infrastructure, lack of understanding and knowledge, lack of technology, lack of support, lack of confidence, among others'. The key to achieve 'financially inclusive growth' is possible by breaking these barriers.

## 4. DATA

The work is an attempt to understand the extent of financial exclusion where a large set of population is deprived of the financial services essential for the overall economic and inclusive growth of India. This study will throw light on the seriousness of financial exclusion.

The study is a primary survey in which opinions were sought from 500 households. The survey was conducted to understand the various characteristics of financial inclusion in the rural and urban households of Bengaluru and in 6 villages close to Bengaluru. The study was conducted over a period of 5 weeks. The participants to the survey included both rural and urban households. However, the survey elicited responses to all the queries only from 461 households.

The following data summarizes the survey report.

**Table 1**
**Characteristics of Rural and Urban Households and Financial Inclusion**

| *Characteristics of households* | *Number* | *%* | *Characteristics of households* | *Number* | *%* |
|---|---|---|---|---|---|
| Total number of households | 461 | 100 | | | |
| **Rural households** | 284 | 62 | **Urban households** | 177 | 38 |
| Borrowing households | 275 | 97 | Borrowing households | 169 | 95 |
| Formal financial institutions | 37 | 13 | Formal financial institutions | 18 | 11 |
| Informal arrangements | 238 | 87 | Informal arrangements | 151 | 89 |
| **Average Income (Rs.)** | | | **Average Income (Rs.)** | | |
| Average monthly income per member per day | 128 | | Average monthly income per member per day | 325 | |

*contd. table 1*

| *Characteristics of households* | *Number* | *%* | *Characteristics of households* | *Number* | *%* |
|---|---|---|---|---|---|
| Average number of members | 6.2 | | Average number of members | 5.6 | |
| Average number of working members | 2.28 | | Average number of working members | 2.23 | |
| Average working age (years) | 237 | | Average working age (years) | 177 | |
| 15 to 24 | 19 | | 15 to 24 | 31 | |
| 25 to 34 | 96 | | 25 to 34 | 67 | |
| 35 to 44 | 63 | | 35 to 44 | 49 | |
| 45 to 54 | 49 | | 45 to 54 | 24 | |
| 55 to 64 | 10 | | 55 to 64 | 6 | |
| **Education of households heads** | | | | | |
| Male heads | 237 | | Male heads | 148 | |
| Class X and below | 206 | 81 | Class X and below | 96 | 65 |
| Class X to XII | 54 | 15 | Class X to XII | 37 | 25 |
| University level | 23 | 3 | Discontinued from University | 15 | 10 |
| **Female heads** | 47 | | **Female heads** | 29 | |
| Class X and below | 39 | 83 | Class X and below | 21 | 72 |
| Class X to XII | 5 | 11 | Class X to XII | 6 | 21 |
| University level | 3 | 6 | Discontinued from University | 2 | 7 |
| **Banking habits Men** | **237** | | **Banking habits Men** | **148** | |
| Has a bank account | 219 | 92 | Has a bank account | 141 | 95 |
| Not banked at all | 18 | 8 | Not banked at all | 7 | 5 |
| **Banking habits Women** | 47 | | **Banking habits Women** | 29 | |
| Has a bank account | 18 | 38 | Has a bank account | 16 | 55 |
| Not banked at all | 29 | 62 | Not banked at all | 13 | 45 |
| Purpose of loan | 275 | | Purpose of loan | 169 | |
| Personal loans | 52 | 19 | Personal loans | 21 | 12 |
| Household loans | 39 | 14 | Household loans | 26 | 15 |
| Social loans | 178 | 65 | Social loans | 114 | 67 |
| Housing loans | 6 | 2 | Housing loans | 8 | 5 |

*Source:* Data collected and compiled by author (primary data)

## 5. EMPIRICAL RESULTS

The survey was conducted covering 62% of the rural households and the balance 38% of the urban households. One of the most important results of the survey was that 97% of the rural and 95% of urban households have taken loans. The respondents were asked whether any member of the household had borrowed from a bank (public sector / private sector / regional rural / cooperative bank) or had approached an informal financial mechanism, like the money lenders / pawn brokers / etc. The summary of the results indicate that 87% and 89% of the total borrowings were financed by the informal sources, while the formal sources accounted for only 13% and 11% of the loans advanced.

The study also collected information about the demographic profile, like the average income levels, number of members in the household, number of working members, average age of the working members and education levels. There is a large disparity between the average income levels of the rural and urban households. While the rural working member earns Rs. 128 per day, his urban counterpart earns Rs. 325. The average number of working individuals in the rural household is 2.28 and it is 2.09 in the urban household.

Of the households surveyed, 47 of the rural and 29 of the urban had female heads. It was found that education qualification wise, both, in the rural and urban households, many of the respondents had not studied beyond class X. In the rural survey, 87% and 83% of the males and females had education less than class X, while the percentages were slightly better in the urban scenario, the percentages were 65% males and 72% females had education less than class X.

## 6. FINDINGS

The study throws light on the demographic profile of the borrowers. One important finding that stands out from the survey is that many households still rely on the informal mechanism for loans. Factors like education, presence of the household—rural or urban, average income levels and number of working people are some important factors which have a bearing on financial exclusion.

Access to formal sectors of the financial system is limited due to factors like literacy levels and age of the borrower. It can be seen from the survey that people in the age group of 25 and 34 borrow the maximum followed by people in the age group of 35 and 44—the prime working years of an average Indian where the financial requirements are the maximum to a person. One probable reason as to why these households prefer informal sector to the formal ones is the delay and red tape of the formal sector wherein one has apply for a loan and the loan is sanctioned after a minimum of 2-3 weeks. This may be a long waiting period for the borrower and he therefore prefers to go the informal route where the money is given immediately.

One way to increase the households in the mainstream is by increasing the literacy levels of such people whereby they are equipped to assess better the pros and cons of borrowing from a formal and an informal sector. Secondly, if banks and financial institutions can gauge the requirements of a borrower in the shortest possible time and sanction loans, the problem of such borrowers falling into a debt trap with high rates of interest charged by the informal sector can be eliminated.

- 88 percent of rural households have bank accounts while 12 percent of rural households have never banked
- 97 percent of urban households have bank accounts and 3 percent of urban households have never banked and therefore do not have a bank account.
- Men have better access to finance both in rural and urban areas; only 38 percent of rural and 55 percent of urban women have bank accounts

The primary reason of loans taken by these people is to meet the societal needs, like attending a wedding and family functions and spending on festivals. Two thirds of the loans in both the categories of households are taken for this purpose. Banks and other financial institutions in the formal sector do not advance loans for these unproductive purposes and hence these people look upon informal sources to meet their requirements paying higher rates of interest. Another distinct result of the study is that very small amount is spent on housing needs.

- Social loans account for 65 percent and 67 percent in rural and urban household category.
- A meagre 2 percent of the rural household and 5 percent of the urban household loans are availed towards housing purposes

## 7. CONCLUSION

This paper analyzed the extent of financial exclusion in 461 households in and around Bengaluru. Factors like household income and educational, age, number of members in each household, banking habits, purposes of availing loans were considered to understand the extent of financial inclusion and exclusion. One glaring outcome of the survey is understanding the purposes for which loans are availed by this section of the society. Majority of the loans are availed to meet the societal pressures which are generally not productive in nature. Not many take loans for productive purposes.

Making such people aware of financial products available in the market will lead to their increased participation in the economic progress of the country. These programs also inculcate saving habits accelerating the pace of economic development.

Providing increased access to financially excluded people with appropriate financial products, savings products and combating psychological barriers are some of the ways in which the marginalized lot can be brought into the mainstream.

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