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10. Financial Inclusion & Institutional Difference Hypothesis- Perspective from India

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Abstract:

Institutions are essential to improving financial inclusion because they offer the necessary framework and platform to safeguard the interests of the socially disadvantaged. Therefore, the institution's financial inclusion initiative will be impacted by any functioning deficiencies. The Institutional Difference Hypothesis states that there are functional differences between the institutions in developed and emerging countries. This chapter examines the differences between the institutions of developing and developed nations, as well as the obstacles and approaches that India might take to broaden financial inclusion. India's current growth narrative. It is proposed that raising awareness, promoting microlending, and establishing a strong regulatory framework would assist India in removing its obstacles and bringing everyone under the purview of financial services.

Keywords:

Institutional Difference Hypothesis, Financial Inclusion, Micro lending.

10.1 Introduction:

Definition and Meaning of Institutional Difference Hypothesis:

The institutional difference hypothesis (IDH) postulates that there exists functional deficiencies in the institutions in the emerging nations and these difference impact the financial, economic and social output. The difference in how institutions operate in developed countries and how it operates in developing countries have an effect on a company's corporate social performance (CSP) and financial performance. This is due to the possibility that companies in emerging nations prioritises capital profits over socially responsible initiatives. IDH may have an effect on financial inclusion, as in India. Government-owned banks are responsible for disbursing riskier loans, such as farm loans; private banks that are not supported by the government refrain from making such loans. However, with India's central bank RBI (Reserve Bank of India) making priority lending mandatory, private banks have started giving rural loans. But literature suggest many reasons, how IDH can impact financial inclusion.

10.2 Institutional Differences and Financial Inclusion:

Institutional disparities determine the pricing and accessibility of financial services across different income levels and demographic groups, thus they have a considerable impact on financial inclusion. Following are the ways how institutions play a role in financial inclusion.

1. Institutional Quality and Access to Financial Services:

Robust institutional frameworks play a significant role in enhancing financial accessibility by providing individuals and businesses with reasonably priced financial products and services.

On the other hand, asymmetric impacts are more common in low-income nations and poorer institutions result in higher obstacles for marginalised communities.

2. Asymmetric effect on vulnerable group:

Higher institutional quality can mitigate gender disparities in financial access, as effective policies promote gender-sensitive financial products and services. On the other hand, in regions with poor governance and inadequate institutional support, marginalized demographics face heightened challenges, limiting their participation in the financial sector and economic activities.

3. The Role of Mobile Money:

Financial inclusion is greatly advanced by the integration of mobile money, especially in developing countries. Adoption and regulation of mobile financial services can be facilitated by strong institutional frameworks and infrastructure. However, a poor institutional and infrastructure foundation might pose a significant obstacle to the widespread adoption of mobile money services. Although in case of India this may seem to be different than other merging countries as India can take advantage of the robust telecom infrastructure and internet facilities at less cost.

4. Regulatory framework and Policy Implementation:

Government policies cannot be properly implemented in a nation with a strong institutional structure; on the other hand, policy makers can carry out policy implementation more successfully in such a nation. Since it aids in reaching the populace that truly deserves it. On the other hand, poor governance may lead to insufficient consumer protection and measurement as well as a decline in confidence in financial systems.

5. Reduction of corruption and Economic Development:

In the recent decade's Indian banks have suffered huge NPA losses due to corruption and fraud. The system has failed to check and control the corruption. Corruption and frauds can come as a strong barrier in promoting financial inclusion. It also creates hindrance in economic development and financial inclusion has a positive association with economic development and stability. Thus institutional quality plays a crucial role in controlling corruption and promoting economic development. Hence countries should put a high priority on establishing strong regulatory frameworks, battling corruption, and fostering openness in order to increase financial inclusion through institutional improvements. The implementation of efficient consumer protection measures, the promotion of different financial institutions, and the use of technology to create creative financial solutions are all necessary steps.

10.3 How Institutions in Emerging Nations Differs from Developed Nations:

India being a vast and diverse country differs from any of the developed countries. India being most populated country varies in size, structure, market composition, socio-cultural environment and various strata of population.

1. Reach of the Financial System:

A country of the size of India will always have a disproportionately small financial system. Furthermore, India's demographic distribution is lopsided, with a rural population that makes up around 63% of the total. These people lack trust and information, which hinders their ability to achieve financial inclusion. The various financial products and service are beyond their reach.

2. Dominance of Banking Sector:

India is majorly a bank based financial system, unlike developed economy which offers a mix of bank-based and capital market driven financing options.

The lack of education among the people in urban slums and women also restricts them to take benefit of financial products and there is over dependence on traditional banking products.

3. Regulatory Framework and Governance:

The regulatory environment in India is less sophisticated than in many developed countries. However, it is on track of improving governance framework. In the last decade India has stabilized core banking system.

There is lot of adoption on digitalization, lot of focus on rural banking & priority sector. Priority lending has been made compulsory for all the private banks. India follows more of European Standard norms and India is on track to implement BCBS, BASEL III norms.

However, addressing corruption issues still remains a huge challenge for the Indian Central bank. In the last few years the Non-Priority sector lending have resulted into more NPAs than priority sector lending.

4. Innovation and Technological Adoption:

In the field of technology & innovation India has achieved a significant landmark with a huge growth in FinTech, India is on the verge of shaping the entire Fin Tech Landscape for the world.

With the strong base of telecom infrastructure, the penetration is easier. However, the usage of mobile money, UPI based system is majorly concentrated in the urban areas.

5. Economic Situation and Growth Path:

The financial institutions in India function in an emerging market environment that is marked by increased volatility, ongoing economic transformations, and structural reforms. On the other hand, the financial systems of industrialised economies are typically more stable and predictable, which allows for longer-term growth that is more sustainable. Financial institutions in India use different risk profiles and investment strategies as a result of this variance.

6. Challenges with Capacity and Human Resources:

Governance problems and a lack of human resources may limit the ability and effectiveness of financial institutions in India. It is generally advantageous for developed nations to have well-trained employees who possess knowledge of financial management and regulatory compliance since those workers help create more efficient operational frameworks. India's challenge remains in developing institutional capability to strengthen its financial and economic system.

10.4 Challenges and Strategies That India Can Adopt to Increase Financial Inclusion:

1. Diversifying the financial products and Micro lending:

India needs to concentrate on creating specialized financial solutions for underprivileged populations and small enterprises, among other marginalized groups.

The provision of microloans, microfinance, and low-cost savings accounts should be prioritised. The central bank and government should formulate strategies in a way that makes microlending profitable for banks.

2. Creating Awareness and increasing financial literacy:

It is imperative that the government and other relevant entities strive to enhance financial literacy and awareness. Given that the inhabitants in rural areas mostly rely on moneylenders, there should be greater emphasis placed there. They avoid the main financial system due to a lack of knowledge, a lack of trust, and a lack of confidence. An comprehensive awareness drive must be put out, rural banks must have local language preferences. Banks need to implement a program like Hindustan Unilever's Project Shakti, which teaches an empowered village woman to sell HUL's products.

3. Leveraging Technology:

The financial inclusion initiatives can be greatly accelerated by the widespread usage of digital technologies. India can lower transaction costs and improve the provision of financial services by utilising fintech innovations including digital payment platforms, mobile banking, and blockchain technology. It will be essential to develop digital infrastructure in rural areas in order to guarantee that all sections of society have access to these technological developments.

Financial service providers can gain a deeper understanding of their customers' requirements and behaviours by utilising data analytics. This can help in forecasting hazards unique to certain locations and demographics and customizing financial solutions. Effective outreach initiatives to engage underprivileged groups can be guided by insights derived from data.

4. Regulatory Frameworks supporting microfinance institutions:

Microlending is essential for expanding into rural India and including women under financial inclusion. Policy makers should create a regulatory environment that supports the entry of diverse financial institutions.

Policymakers must create a regulatory framework that balances innovation with consumer protection, in order to build trust and reliability in the financial system.

Simplifying licensing procedures for fintech companies and microfinance institutions can enhance the delivery of financial services.

5. Encouraging Collaborations and agent-based networks:

Expanding agent-based banking is essential to reaching rural and underserved populations. By establishing a network of local agents who can facilitate transactions and offer basic financial services, banking can become more accessible in areas lacking formal banking infrastructure. Various collaborations can be made between government bodies, financial institutions, non-governmental organisations and technology providers to enhance the reach. Proper Implementation of these strategic measures can create a financial system that is more inclusive and will enable marginalized segments of the society to have access to proper banking system.

10.5 Indian Story So Far:

In India the term financial literacy was coined in 1969 (Gwalani and Parkhi,2013) However it gained momentum after 2005 as then Poverty, financial illiteracy , complex banking procedure, traditional and socio cultural behaviours was a major reason behind low banking penetration.

In India, the financial inclusion approach has been implemented gradually. The first action made towards this goal was the nationalization of banks, which was followed by institutional financing. As a result of the government's strengthening of financial delivery through cooperatives, nationalization of banks, and the introduction of numerous creative initiatives for fostering self-employment and rural development.

The second phase of the 1990s saw a shift in regulatory standards and a number of measures aimed at bolstering the financial sector. The introduction of Self Help Groups (SHG), bank connections, and Kisan Credit Cards were the highlights. The goal was to give everyone access to credit. And it ended up being quite successful, particularly for women. The present phase, which began in 2005, is clearly the result of a policy choice that placed more of a focus on coverage and extension. The RBI and the Indian government are taking a lot of steps to strengthen the situation. Post 2014 there has been constant push for financial inclusion, A zero balance account under Pradhan Mantri Jan Dhan Yojana (PMJDY), a financial inclusion campaign was launched in, 2014.(As of September 2024, around 192.1 million accounts have been opened under PMJDY.)

Similar to PMJDY there are other schemes which have been taken up by the government and RBI

1. **Pradhan Mantri Jan Dhan Yojana (PMJDY)-** Under this scheme someone who does not currently have a savings account to start one without having to meet any minimum balance requirements. They can also open a modest account if they self-certify that they do not possess any of the legally required documentation.

2. **Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY)-** The PMJJBY is available to people in the age group of 18 to 50 years having a bank account who give their consent to join / enable auto-debit. Aadhar is the primary KYC for the bank account.
3. **Pradhan Mantri Suraksha Bima Yojana (PMSBY)-** Under this scheme those with bank accounts who are between the ages of 18 and 70 who agree to join the program and allow auto-debit by May 31 at the latest for the coverage period of June 1 through May 31 on an annual renewal basis are eligible to participate. The primary KYC for the bank account would be Aadhaar. Under the policy, there is ₹2 lakh risk coverage for accidental death and full disability and ₹1 lakh risk coverage for partial impairment.
4. **Atal Pension Yojana, and Jeevan Suraksha Bandhan Yojana-**This scheme an universal social security system for the poor, the under-privileged and the workers in the unorganised sector.

5. **Pradhan Mantri Mudra Yojana**-. Under this scheme loans are given under three categories without any collateral to first generation entrepreneurs. Loan of up to ₹50,000 is provided under the sub-scheme "Shishu," between ₹50,000 and ₹5.0 Lakhs under the sub-scheme "Kishore," and between ₹5.0 Lakhs and ₹10.0 Lakhs under the sub-scheme "Tarun".

Due to the above steps the financial inclusion Index in India is continuously rising, as can be seen in the below chart

Chart1: Financial Index in India:

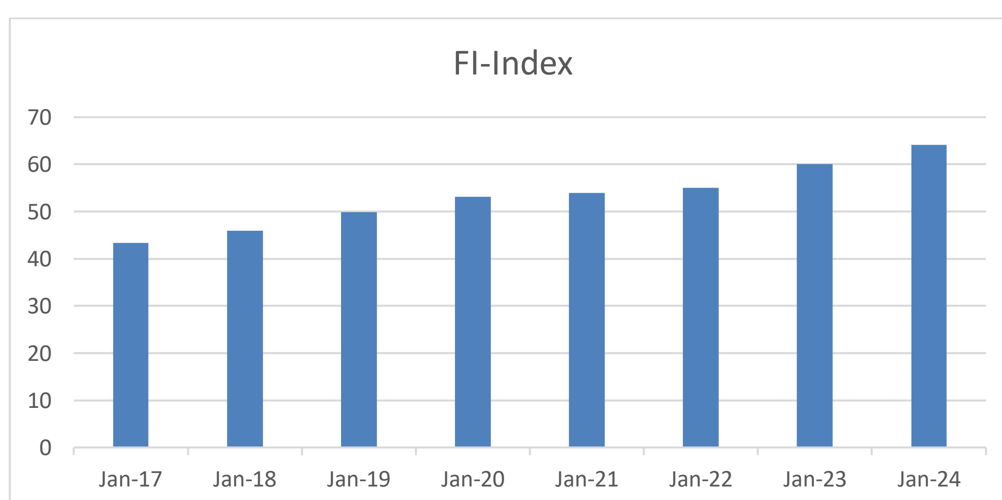

Figure 10.1: Financial Index in India

Source: RBI

10.6 Conclusion:

In India, financial inclusion is still difficult since a sizable portion of the population does not have access to basic banking services. The regulatory and governance aspects of institutions are becoming better, India has access to technology and innovation potential to revolutionise India's financial inclusion program. The true difficulty, though, is raising awareness and educating the rural population that depends on moneylenders. The banks need to keep up their priority lending program and grow their deposit base. The government, central bank, and all stakeholders need to find out ways to make microlending feasible, motivate financial institutions to engage in it, and close these gaps by launching programs to reach marginalised communities.

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