Inclusive Growth – The Role of Banks in Developing Economies

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Inclusive growth is essential for the overall economic development of a country and is critical for achieving equity. It not only supports the advancement of the development process but also helps sustain the growth momentum. Inclusive growth means ensuring that everyone benefits from economic progress, regardless of their economic status, gender, disability, or religion. It is a concept that seeks to guarantee fair development for all participants in the economy by providing opportunities to every section of society. According to the World Bank, growth is considered inclusive when it is sustainable in the long term.

Inclusive growth relies on financial inclusion, which provides essential financial services to all individuals, especially those from disadvantaged or low-income backgrounds. This access allows people to participate fully in the economy and benefit from its growth, reducing inequality and promoting economic progress. In countries like India, financial exclusion has hindered inclusive growth, but promoting financial inclusion can lead to broader economic development and social equity.

Financial Inclusion act as a lever to Inclusive Growth

The mobilization and circulation of finance are fundamental to the development of an economy. In developing countries like India, financial inclusion plays a crucial role in achieving inclusive growth. Many people in India, nearly half of the population, have limited access to financial products and services from formal financial institutions, which highlights the critical issue of financial inclusion. Despite 77 years of independence, a significant portion of India's population remains excluded from basic banking services. This lack of access has led to financial instability and poverty among lower-income groups. However, in recent years, both the Government and the Reserve Bank of India have prioritized financial inclusion as a tool for fostering inclusive growth.

The **United Nations** identifies the goals of financial inclusion as –

- Access at a reasonable cost for all households to a full range of financial services, including savings or deposit services, payment and transfer services, credit and insurance;

- Sound and safe institutions governed by clear regulation and industry performance standards;
- Financial and institutional sustainability, to ensure continuity and certainty of investment; and,
- Competition to ensure choice and affordability for clients.

In collaboration with the National Bank for Agriculture and Rural Development (NABARD), the United Nations is working to enhance financial inclusion among the poor by developing suitable financial products, raising awareness of available financial services, and improving financial literacy, especially among women.

In the context of a developing economy, there is a clear link between 'Financial Inclusion' and 'Inclusive Growth.' Financial inclusion is, therefore, a prerequisite for achieving inclusive growth, and efforts are being made from various angles to integrate the previously excluded sections of society into formal financial services. Financial inclusion has become a key factor in promoting inclusive growth and development, with efforts dating back to 1969, when 14 commercial banks were nationalized to encourage social banking with a focus on rural areas. Despite several measures taken since then, significant progress remained elusive, as only 40 percent of the population was included in financial services before the launch of the "PRADHAN MANTRI JAN DHAN YOJONA" by the present Prime Minister. This situation raises the question of whether nationalized banks, with their extensive resources and networks, are better suited for financial inclusion, or whether co-operative banks, despite their limited resources, offer more value due to their local presence and cultural alignment with the communities they serve. In essence, the debate is whether fewer, larger banks or many smaller banks are more effective in promoting financial inclusion.

Scope of Inclusive Growth by Banking Sector

There is a wide variety of recognized institutions offering financial and allied services in the country. Though the structure and mode of functioning of those financial institutions are somehow different from each other, they are having a target of expanding their respective business network by increasing their respective client base leading to the achievement of a higher rate of growth in financial inclusion. Indian financial system is leading by the banking sector.

Indian Financial System - Share by Asset Size

Segment	Share of Financial Assets
Banks	72.9 %
Insurance Companies	10.5 %
Non-banking Financial Institutions	6.2 %
Mutual Funds	4.9 %
Provident and Pension Funds	5.5 %
Total	100

Source: Reserve Bank of India

Indian banking organism is lead by government owned public sector banks of which account about 60% of assets of commercial bank. The role of private sector banks has grown over the past 25 years, notwithstanding the recent failure of a number of them, and they typically have healthier balance sheets with lower NPL levels. Despite being in the finest financial shape, foreign banks only account up about 7% of the assets in the commercial banking sector. Outside of the commercial banking system, there exist smaller banks that cater to the demands of more specialised borrower groups. These include small finance banks, local area banks, and rural cooperative banks.

Different forms of banking institutions offering financial services in India is summarised through the Table given below:

Banking Structure in India as on March 31, 2024	
Commercial Banks	Public Sector Banks (12)
	Private Sector Banks (21)
	Foreign Banks (45)
	Regional Rural Banks (43)
	Local Area Banks (2)
Co-operative Banks	Urban Cooperative Banks (1,500)
	Rural Cooperatives (386)

Source: Reserve Bank of India

Data published by the Reserve Bank of India reveal that the Co-operative banks, Commercial banks, and other formal financial sector programme in rural areas failed to eradicate informal credit avenues, as not less than 33 per cent of rural households continue to rely on informal sources of credit still now. Our failure to achieve a cent percent financial inclusion with the help of the existing banking and other financial institutions has obviously raised a question, what more can be done in achieving our desired target. Co-operative banks can play a more proactive role than scheduled commercial banks in achieving financial inclusion.

One of the key institutions in achieving inclusive growth is the banking sector, which acts as a bridge between savers and borrowers and is crucial in determining economic outcomes. This paper aims to investigate the role of banks in promoting inclusive growth by concentrating on the following areas:

- Financial Inclusion as an essential Component of Inclusive growth
- Financial inclusion and its force on economic development.
- The role of banks in providing access to credit for small and medium enterprises (SMEs).
- Challenges and opportunities in extending banking services to marginalised populations.
- Policy recommendations for strengthening banks' role in inclusive growth.

Whether Financial Inclusion is an essential tool ?

Growth is said to be inclusive when it creates economic opportunities along with ensuring equal access to the people of a country irrespective of their socio-economic conditions. The Inclusive growth approach is having its focus on productive employment rather than on direct income redistribution as a means of increasing the level of income of the excluded groups which is not possible to achieve in the short run. Income distribution schemes can merely help people to derive benefit from economic growth in the short run, but Inclusive growth provides the opportunity for the people to "contribute to and benefit from economic growth". A nation can grow economically and inclusively only if its excluded population can turn out to be financially independent.

The inclusive growth by encompassing the excluded population can bring in not only the socio-economic welfare to the people but also several other benefits to the economy as a whole. The concept "Inclusive" should be viewed as a process of including the excluded section whose participation is essential in the initiation of the development process. Thus, financial inclusion is no longer a policy choice today but a policy compulsion. Financial inclusion is a strategy of inclusive growth, but inclusive growth itself is a subset of a larger set of Inclusive development.

The main reasons for financial exclusion from the demand side are lack of awareness due to illiteracy and poverty due to low income; while on the other hand, distance from branch, branch timings, cumbersome documentation and procedures, unsuitable products, language, staff attitudes, etc. are identified from the supply side. Due to all these procedural hassles, people feel it convenient to procure loans from informal credit sources, even at a higher rate of interest. Thus financial inclusion does not mean merely opening of saving bank account but signifies creation of awareness about the financial products, education and advice on money management and offering debt counselling etc. by banks. A customer with proper financial awareness can choose the appropriate financial product(s) to fulfil his individual needs which will lead to the overall growth of the country through proper utilisation of financial services. Hence, there is a need for financial inclusion to build uniform economic development and ushering in greater economic and social equity.

Financial Inclusion - a key Driver to Inclusive Growth

The availability and accessibility of financial services to all people, particularly those in low-income and excluded groups, is referred to as financial inclusion. A sizable section of the populace in many emerging nations is still shut out of official financial institutions, which restricts their capacity to engage in economic activity. By offering underprivileged groups a variety of services including savings accounts, microloans, and insurance, banks play a critical part in resolving this issue.

- ✓ Poverty Reduction
- ✓ Entrepreneurship and Job Creation
- ✓ Economic Empowerment of Women

Banks can promote financial inclusion through:

- **Branchless Banking and Mobile Banking,** allow banks to extend their services to distant areas where traditional branches are not feasible. It is important in developing economies with extensive rural populations.
- **Microfinance Services,** as a microfinance institutions to offer small loans to individuals and businesses where there is limited access to traditional banking services.
- **Financial Literacy Programs,** helping to overcome the barriers of financial illiteracy that prevent individuals from accessing financial services, play a key role in educating the mass about the financial products.

Access to Credit and its Impact on SMEs

Small and medium-sized businesses (SMEs) are frequently viewed as the foundation of growing economies as they foster innovation, create jobs, and reduce poverty. For SMEs, obtaining finance continues to be a major obstacle, particularly in nations with undeveloped or unreachable conventional banking institutions. Banks play a critical role in giving SMEs the funding they need to grow.

Due to the following factors, SMEs frequently have trouble acquiring financing:

- Many SMEs are unable to receive traditional credit because they lack the assets necessary to **secure loans**.
- A lot of small company owners don't have official **credit histories**, which might make it harder for them to get loans from official banks.

In response to these issues, banks have adopted a number of creative tactics, such as:

- By using alternative **credit scoring models** that use non-traditional data, banks may evaluate SMEs' creditworthiness without depending just on official credit histories.
- **Collaborations with microfinance organizations** allow banks to connect with underserved SMEs that might not be eligible for traditional loans.
- More and more banks are **creating loan products** especially for SMEs, such microloans with adjustable periods and reduced interest rates.

Challenges in Promoting Inclusive Growth through Banks

Even though banks may contribute to inclusive growth, many developing economies still faces several significant challenges. These obstacles can limit the effectiveness of the banking sector in fostering economic equality and reducing poverty. Some of the key challenges include:

- The spread of financial services, especially in rural regions, can be hampered in many developing nations by the **absence of basic infrastructure**, such as dependable internet connectivity or power.
- Excessively **stringent banking laws** may hinder banks' capacity to innovate and offer inclusive financial solutions in some emerging nations. Banks may be deterred from giving credit to high-risk groups by
- Limited **financial literacy and a lack of trust** in formal financial institutions can deter both individuals and businesses from utilizing banking services, especially in areas where informal financial systems dominate.
- Banks often view lending to low-income individuals and SMEs **as risky and unprofitable**, which can lead to fewer financial products available to these groups, particularly in regions where banks prioritize financial gain over social responsibility.
- Banks may limit their outreach to higher-income areas due to **high operational costs** associated with providing banking services to rural or low-income communities, potentially leading to unsustainable market growth.

- Traditional banking products often **don't cater to the unique needs** of underserved groups, such as low-income individuals, rural dwellers, and SMEs, limiting their engagement with formal banking systems.
- **Cultural norms and stigmas** in certain communities can discourage individuals from accessing banking services, leading to traditional systems like community-based savings groups or informal lending circles.

Policy Recommendations for Enhancing the Role of Banks in Inclusive Growth

To strengthen the role of banks in promoting inclusive growth, following policy recommendations are suggested to facilitate broader access to financial services for underserved populations.

- Governments, in partnership with banks, should take proactive steps to design and implement **extensive financial literacy initiatives**. By raising awareness and building financial capabilities, people will be better equipped to navigate the financial system and make informed decisions, which will encourage greater engagement with formal banking services.
- Banks need to be **encouraged to innovate** by **developing financial products** tailored to the unique needs of marginalized communities and low-income individuals. These products would help bridge the gap for underserved populations who may not fit the typical banking profile but still require access to financial services for personal or business growth.
- Governments and regulatory authorities should work to create a conducive environment for the growth of **digital banking services**, including mobile banking. By fostering policies that encourage investment in mobile banking infrastructure, governments can ensure that financial services are accessible in remote or underserved areas and integrating digital payment systems into the financial ecosystem can enhance the reach of banking services.
- Governments should focus on creating a more **adaptable regulatory framework** that would reduce barriers for banks and customers, making financial products more accessible and fostering economic participation in previously excluded areas.

Summary and Conclusion

While in developed countries, the formal financial sector comprising mainly the banking system serves most of the population. A large segment of the society has little access to financial services, either formal or semi formal. As a result, many people have to necessarily depend either on their own sources or informal sources of finance, which are generally at high cost. Overall growth of the country is not possible without providing basic financial services to the rural mass constituting a large portion of the total population. In spite of the existence of a variety of financial institutions, we have failed to achieve the target of extending basic financial services to the entire population.

In reality it is found that, though a good number of accounts are opened with the banks, most of the account holders hardly pay their second visit to the bank premises. Because, all such accounts are mostly opened under some campaign programme undertaken by the Government or other agencies and customers are rather pushed into the banks under a craze, even against their voluntary willingness. In the absence of a structured monitoring mechanism, such customers are found to be reluctant in enjoying financial services offered by the formal financial institutions. Continuation of regular financial transactions through these accounts by proper monitoring should be our motto to reach the mission of 'Financial Inclusion' in the true sense of the term, instead of an inflated statistical data to conceal the reality.

Bringing financial services to rural clients is the biggest challenge in the quest for broad-based financial inclusion and banks can play this role in the progress of financial inclusion. Banking institution can mobilize self-help and motivate people to make better use of their self help potential thus offering an economic future for rural youths. By doing so, banks can contribute to building more resilient, sustainable, and equitable economies in the developing world.

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