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INNOVATIVE SOLUTIONS TOWARDS SUSTAINABLE DEVELOPMENT: FINANCIAL LITERACY SHOULD ACCOMPANY INCLUSION

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ABSTRACT
The world is changing –perhaps more dynamically than ever before in its history. This new age, lightning-speed leap in the pace of transformation has been enabled by a world which is integrally connected by four rapid forms of connectivity. These are environment, people, economy and ideas. Out of these economic integration is must for sustainable development. But in India the rural population -the other side of mankind- development in financial literacy followed by inclusion is minimal. Rural areas that are the principal target of the government's goal of financial inclusion have only 38% of bank branches and only 40% of the country's population has bank accounts. For India and other emerging economies, where more than half the population doesn't have a bank account, this paper has a message: 'You can't pull the nation forward with the single horse of financial inclusion; you must ride in tandem with financial literacy also'.

The study not only tells about the impact of financial literacy but also how consumers use savings, investment and debt management techniques in their personal finances,"

Key words –sustainable development, financial literacy, financial inclusion, saving, investment, rural, urban, risk averse

INTRODUCTION

It is a fact of life that education contributes to financial literacy. Financial literacy can broadly be defined as providing the familiarity with and understanding of financial market products, especially, rewards and risks, in order to make informed choices. Viewed from this standpoint, financial literacy primarily relates to personal financial literacy to enable individuals to take effective actions to improve overall well-being and avoid distress in the matter that are financial. Financial literacy then becomes very important and indispensable for better financial behavior and discipline. To be effective, financial literacy needs to inform and empower the individual and would need to cover a wide range of subjects on personal financial management including savings credit, investments , customer protection and so on. But such literacy can take different forms. while Indians know more about saving, Americans know more about investing. Internet-savvy Indians are 20% more financially than Americans. The survey of 2,500 individuals or families was conducted by financial website InvestmentYogi.com. Financial literacy was assessed by asking respondents to answer simple questions related to interest rates, savings and the growth of money.

The report cannot be extrapolated to the whole of India, particularly the rural areas that are the principal target of the government's goal of financial inclusion. Today, only 38% of bank branches are in rural areas and only 40% of the country's population has bank accounts. The banking system has been asked to first target all habitations having a population in excess of 2,000. According to finance minister Pranab Mukherjee, there are around 73,000 such areas. Banks will cover 20,000 villages this year (by March 31). The remaining 53,000 will be covered in 2011-2012. This will be through both bricks-and-mortar branches and banking correspondents (BCs). The latter are agents for the banks -- normally individuals, but the Reserve Bank of India (RBI) has recently allowed companies to be appointed as BCs also.

POSSIBLE MINEFIELD

Inclusion comes with potential dangers. Recent experiences in India in the microfinance arena show that poor people take loans that they have no capacity to service. Farmers have also taken loans that they have not been able to repay. Many have been driven to suicide because of debt problems. Unless financial literacy goes hand in hand with financial inclusion, there could be a minefield ahead. "The mortgage crisis [in the U.S.] proved that we did not have a handle on how poorly educated consumers taking the loans, and agents offering the loans, really were," That's in the U.S., where financial inclusion is not a major issue. For India and other emerging economies, where more than half the population doesn't have a bank account, there is a message: You can't pull the nation forward with the single horse of financial inclusion; you must ride in tandem with financial literacy also.

The saving versus investing aspect should have been logically deduced: According to *Businessweek*, the household savings rate in China is 38% and in India 34.7%. At the other end of the spectrum, it is 3.9% in the U.S. and 2.9% in Japan. It can be shored up like Indians use about 38% of monthly income to cover monthly expenses -- they save or invest 62% of their salary. The people are risk averse.The real takeaways from the survey are in the realm of financial behavior. Indians tend to be underinsured: Only two-thirds of the participants report any insurance, including medical and life. Most report having clear financial goals, with education as the most popular goal (true for all risk categories -- those comfortable with some financial risk, much risk or no risk at all). Most Indians are not comfortable with taking risks, however.

As could be expected, higher education is a good indicator of financial skills. Highly educated Indians take on more financial risk; find better returns on investments and better rates for insurance policies; have more financial goals in general and specifically more long-term goals; and hold more financial instruments. Participants report an average of 1.67 loans per household, for either personal use, home loans or car loans. Home loans are the most prevalent liability (and the soundest), and this applies for all categories of risk tolerance and education. "Looking at how each education group distributes loans shows that home loans are the most popular, with all categories having above 50% of loans in home loans," says the survey report. "Post-grads have the highest concentration of car loans with 26% and the graduates have the most personal loans as a share of all liabilities with 22%."

THE REAL INCLUSION

India requires a huge amount of financial inclusion. Therefore, one can also get the social objective achieved without compromising on the commercial aspects of doing the business. There is huge potential in rural and semi-urban markets. The savings rate in India is very high -- more than 34%. But in rural and semi-urban markets the savings are invested in gold, which is an illiquid asset, or in land, which again [does not offer] the right kind of return. Or in the best case situation, [their savings are] maybe in a fixed deposit with a co-operative bank. So, rural India is not exposed to many of the high-return financial products like equities or mutual funds or even insurance, which can take care of the risk part also. This is where a company like Tata Capital, which has a strong name and a strong distribution network, can play an important role in educating rural India, in terms of converting some of [their] non-productive or illiquid assets, or low-income assets into relatively higher-income assets, which will also give them better liquidity and better returns.

It is a long haul. This objective is not going to be achieved overnight. One needs to have a long-sustaining ability, which is what the BCs should be ready to do. Services of different non banking financial companies can be taken like Tata Capital and the Tata Group which can play an important role in financial inclusion by bringing rural India and semi-urban India into a network of these financial products.

GROWING INTEREST: BANKS ARE REACHING OUT TO RURAL INDIA

In the western Indian state of Maharashtra, in the Mann Desh region, lives 39-year-old Lakshmi Shellar. She spends a typical day in the field tending to her crops; she also rears buffaloes and sells their milk in the village door to door. A widow since the age of 17, Shellar got in touch with Mann Deshi Mahila Bank, a cooperative bank in rural Maharashtra, a few years ago, where she learned the basics about banking products. Now she runs a financial literacy school by night, attended by 20 women from her village. Women such as Shellar act as business facilitators to India's banks. Some work directly for the bank, others through banking correspondents (BCs) such as microfinance institutions and nongovernment organizations. Each facilitator is connected to hundreds of people. On behalf of the bank, they create awareness about savings and other products, identify potential borrowers, collect and verify loan applications, monitor borrowers' repayment and follow up for recovery.

Shellar's story is told whenever Duvvuri Subbarao, governor of the Reserve Bank of India (RBI), delivers speeches on financial inclusion across the country. Subbarao hopes more women like Shellar will help to promote banking deep within the country. It will be crucial for an organized financial system to find its roots in rural India.

A December 2009 RBI report, "Financial Inclusion: Challenges and Opportunities," points out that the country has 600,000 habitations -- clusters where the population is 100 or more -- but only 30,000 have a commercial bank branch. Less than half the population has a bank account, with the disparity greater in the northeast. Only about 10% of the people have life insurance, and less than 1% have other types of insurance. A full 37% of the population still lives below the poverty line.

It is here that Subbarao sees opportunity. As incomes grow and awareness increases, aspirations rise among the poor. Moreover, rural savings deposits tend to remain in customers' accounts. In the long run, this reduces a bank's dependence on bulk deposits, minimizing the risk posed by sudden large withdrawals. Subbarao stresses that some bankers will need to convert "what they see as a deadweight [social] obligation into an exciting opportunity, and move aggressively on financial inclusion."

NO-FRILLS ACCOUNTS

Indian banks, especially those in the public sector, have made substantial efforts to tap the country's rural population. But expanding through branches has been a costly -- and largely unsuccessful -- endeavor. Out of 50 public sector and private sector banks, 26 have therefore appointed BCs, through which eight million no-frills accounts have been opened as of March 31, 2009.

Using banking correspondents in such a way is gaining in popularity globally. A recent RBI directive added six more types of correspondents -- including shop owners and public call office operators -- to the existing categories of microfinance institutions and nongovernment organizations. In Brazil, several banks have adopted the correspondent banking model, acquiring more than 15 million accounts this way. In the networks of two of the largest players, half of account holders earn less than US$4 a day.

In India, few banks have been as active as State Bank of India (SBI), India's leading public sector bank, which has 2.5 million no-frills accounts. It has expanded through 24,000 direct agents, including thousands of nongovernment and microfinance organizations. "From 12,000 villages in 2008, we now have a presence in 50,000 villages," O.P. Bhatt, SBI chairman, told business publication *Business India* recently. The goal, he added, is to double that number by March.

Migratory labor is a target, as remittances through banks make it easier to send money home. Huge sums are remitted across India, predominantly from migrant labor, and more than 90% occurs through informal channels.

Banks have also added more sophisticated and diverse products. SBI, for instance, has a product where a customer deposits up to US$21 at any one time for one to five years. At the end of the term, the customer gets principal plus interest at a fixed deposit rate of 6% to 8%.

In the insurance space, SBI has Grameen Shakti, a dual-benefit life insurance product. For a five-year term with a Rs.26,000 benefit, the premium is about Rs. 300 a year. Upon the group member's death, the beneficiary receives the benefit. Upon maturity, the group member recovers half of the premiums paid over the five years. SBI also has launched Chota SIP (Systematic Investment Plan), an equity-based mutual fund plan with a minimum monthly investment of Rs. 100 over at least five years. Chota SIP funds are invested in bigger funds, including a blue-chip fund, a balanced fund and a growth fund with a small value component.

THE PRICE OF GROWTH

Despite banks' success with informal channels, reaching rural customers comes with a price tag. The main challenge, bankers point out, lies in financial education: helping the masses to understand these products, and the benefits of saving and investing. The faster users of banking services learn of the benefits, the shorter will be the bank's gestation period in recovering its investments.

In response, financial literacy centers are being set up across India. Members of SEWA Bank -- a cooperative bank established in 1974 by 4,000 self-employed women -- have held three-day financial education camps in the state of Orissa. Such centers provide individual counseling services on responsible borrowing and early savings. There are advantages to being connected to the financial sector, and there is a need for the people to understand that.

Technology is expected to be one enabler. SBI's Tiny Cards concept, initiated in 2006, is a big step forward. A microchip in a smart card stores a customer profile, including photograph, fingerprint and transaction details. Says Anup Banerji, deputy managing director of rural business and national banking at SBI: "This scheme has been rolled out in 19 states in India. In 2008-2009, the number of cards issued rose from 270,000 to more than 2 million. In that same period, the number of no-frills accounts has doubled to 2.5 million."

SBI's Tiny Cards are connected to the network through a mobile phone or point-of-sale machine. They are used along with handheld devices with fingerprint-scanning facilities, made available to women like Shellar. If used through the banking-correspondent route, nongovernment organizations such as Zero Mass Foundation and Little World, and technology providers such as Financial Information Network and Operations (FINO), bear the cost of the devices. They, in turn, recover costs by working with banks around predefined service agreements.

In the state of Andhra Pradesh, for instance, 350,000 people receive money from the government through such programs as the National Rural Employment Guarantee Scheme, social security and pensions. Of the

2% commission SBI receives from the government for distributing these funds, it passes on 1.5% to the correspondent or facilitator.

BRINGING LIFE TO ACCOUNTS

For a bank the size of SBI, acquiring new accounts is not the problem. The real issue, across the industry, is deriving revenues from these accounts. India is still a country with over a billion people where nearly half the nation is unbanked. There should be the inclusion of a small charge on the customers' end, to make the banking correspondents' route more viable. The challenge for the bulk of the poor is financial services, not affordability. Suzuki Motor Company in India, the manufacturer of Maruti cars, boasts of its service network throughout the length and breadth of the country. Similar pride should be taken by State Bank of India, the country's premier public sector bank, by expanding its reach throughout the country. Since the buzzword "financial inclusion" is sweeping the country, it is time the SBI took the initiative and established its presence in all rural areas.

The cost-benefit analysis of having presence in all areas will throw on a different light and may force banks not to venture into unbanked areas where they will not find any viability to run a branch. But in the years to come, India's rural population will also benefit through high incomes due to an increase in disposal incomes of the middle class. This will create demand for all products and have its impact on rural areas also.

But the real issue is in educating the masses about banking, the need for having an account, and creating interest among rural populations to opt for banking services. Like postal services, banks should increase their reach through deployment of men for a complete understanding of banking. Financial inclusion without proper education is of no avail.

Funds distributed through government schemes, for instance, are rolled out into 400,000 accounts in Andhra Pradesh, while the total number of no-frills accounts acquired has crossed 1.8 million in the state. There is little or no life in accounts acquired outside such schemes; the average balance in such accounts hovers around 50 cents. Meanwhile, costs to maintain the accounts continue to rise. BCs keep up servers that interact with point-of-sale machines. The BC servers interact with a server at the bank. This server, in turn, connects these accounts to the bank's core operations.

There are also operational issues -- like the facilitator's travel expense from branch to home and the security of funds while at residence -- that have yet to be resolved. Expenses mount as new accounts register, and there is already a mismatch between revenues earned and costs incurred in undertaking BC operations. Banks charge BCs interest for the temporary overdraft provided to them. This adds to operating costs. Further training of BC staff involves even more outlays. The commission paid by banks to the BCs is not adequate for a viable business model. A majority of BCs have reported losses, and some of them have even suspended their operations. This, in turn, affects the banks [since] it becomes difficult for banks to [find substitutes for them]. Financial inclusion, however, is not an end by itself. It is a means -- the end being social inclusion. Banks play the role of financial intermediation and, therefore, are an important catalyst in attaining inclusive growth.

The government has been active in this area. The National Bank for Agriculture and Rural Development (NABARD) launched two financial inclusion funds in 2007-2008 with about US$100 million each. These funds have equal investments by the government and the RBI, and an additional 20% by NABARD. The latter disburses these funds annually to Indian banks. One fund actively invests in developmental and promotional activities in backward regions and unbanked areas. The second promotes the use of technology in similar places. Yet bankers say greater support will be required to make the BC route a success.

The opportunity lies at the bottom of the pyramid: The only way to reduce costs is to increase volumes. As the country grows at 8%, job opportunities grow. As people start earning, their incomes will provide a growing source of bank deposits -- and banks that are ahead of the curve in establishing a presence in the hinterlands will likely have a first-mover advantage.

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