The catalytic role of finance in influencing the trajectories of economic growth and development is a well-documented phenomenon in economic literature. By facilitating the raising and pooling of funds and by providing instruments of risk mitigation, it allows riskier investments to be undertaken and moreover assists in allocating resources to their most productive uses. Finance is also found to play a vital role in addressing the issues of poverty reduction and the mitigation of income inequalities. Provision of timely and adequate finance acts as an insurance against income shocks thus enabling the poor to appropriately address the income smoothing needs. Microfinance in particular has been directly linked with a possible reduction in child labor, increasing education, organizing women and harnessing their potential.

And yet the distribution of finance is found to be extremely skewed. There is increasing evidence to prove that finance is accessible to only a privileged few viz. the large enterprises and wealthier individuals. Provision of finance through formal channels warrants – collateral, credit history and connections and quite often the poor lack all three, thus adversely affecting their access to financial services. It is in this context, that financial inclusion becomes important and has thus been a focus of public policy many developing economies. In India, as well the thrust on financial inclusion has been growing over the past decade or so. Financial Inclusion has been defined as ‘Financial inclusion refers to universal access to a wide range of financial services at a reasonable cost. These include not only banking products but also other financial
services such as insurance and equity products’ (Planning Commission, 2009).

If the proportion of adults with bank accounts is taken as one of the metrics of financial inclusion, Figure 1 shows that India ranks much below the global average as well as its closest competitor China. It becomes further important to ask the question regarding ‘who are the people that are financially excluded?’ In general, certain sections of the population viz. poor, rural population, women and the lesser educated are financially excluded. For each of these specific demographic profiles as well, India is found rank well below the global average.

**Issues of Access and Usage:**

Access and usage refer to two critical aspects with regards to financial inclusion. While the former comprises the supply side of financial inclusion, the latter related to the demand side aspects. In general, the barriers to financial inclusion on the supply and the demand are quite different. On the supply side, the main barrier is the prevalence of high transactions costs due to smaller volumes and even greater information asymmetry. The poor usually require frequent loans of smaller denominations thus significantly enhancing the transactions cost of making each loan. There are also other supply-side issues viz. credit rationing that arises owing to the interest rate regulations and frequent government interference that distorts the risk-return signals.

On the demand side, the issues are several. The fixed costs associated with the financial products offered by the formal sector (such a processing fees for loans and minimum balances for deposit accounts) are high. Poor often require financial products for certain specific purposes such as marriages, funerals or festivals that are often not available with the formal system. The presence of other non-pecuniary barriers (e.g. high literacy requirements) and the stigma associated with frequent rejections of loan proposals are a few other deterrents.

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**Figure 1: Percentage of Adults with Bank Accounts; Source: World Bank FINDEX, 2014**

<table>
<thead>
<tr>
<th></th>
<th>Global Average</th>
<th>India</th>
<th>OECD Countries</th>
<th>China</th>
</tr>
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<tbody>
<tr>
<td></td>
<td>62%</td>
<td>53%</td>
<td>91%</td>
<td>79%</td>
</tr>
</tbody>
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It is important to understand that while access is a necessary condition, it is not sufficient by itself to guarantee usage of the financial products provided by the financial sector.

**Financial Inclusion in India:**

In India, there have been a plethora of initiatives that have been put in place over the years to increase the levels of financial inclusion. Over the past decade, the focus has been on leveraging technology for enhancing the levels of financial inclusion. Here, there have been a wide range of initiatives ranging from Aadhar-linkage, Business Correspondent model, mobile banking and establishment of payment banks.

Even a cursory glance at the above reveals that most of these initiatives have been primarily aimed at addressing the supply side. And even, there the distribution of the spread of these initiatives has been far from uniform across the Indian states. In general, the southern region ranks much above the national average across all major parameters of Fi – viz. Bank Branch penetration, Deposit Penetration and Credit Penetration (CRISIL, 2013). Even though, the accounts have been opened their utilization and low usage continues to be a pressing concern.

Moreover, what stands out is the persistence of informal financial sector. Although, initially it was
believed that mere existence of the formal sector would lead to an automatic demise of the informal sector- that has not happened. Moreover, it is also not an issue of market fragmentation alone, wherein the formal and informal sectors cater to completely different clientele. Rather it is an issue of duality where the two thrive side by side. Thus formal and informal sectors are found to share the same clientele, women continue saving with chit funds long after they've opened deposit accounts with banks and despite qualifying for bank loans, borrowers prefer borrowing from money lenders. According to the AIDIS (2013), about 44% of the rural and 20% of the urban credit continues to fall under the purview of informal sector.

**Prevalence of the Informal Sector**

In this regard, it becomes important to understand what factors contribute to this persistence of the informal channels. Broadly, it is the decentralized approach to financing and leveraging the power of the ground level social networks that significantly lowers the transactions costs for the informal lenders. Due to the pre-existing long-term relationship, the lenders quite often have an insight into the clients' loyalty, character and private habits and thus reduces their reliance on proxies of the same (viz. occupational and financial histories).

Thus essentially there exists a trade-off between the formal and informal channels. Although, the formal channels possess financial muscle, they are constrained in terms of the local networks and social ties, thus aggravating the magnitude of agency risks. For informal channels, the propositions are exactly reversed. Hence, it becomes important to understand about how one can arrive at an amalgamation of the two forces. In this context, it is important to assess the demand side of FI and understand the precise nature of the social, cultural and economic factors that give rise to demand for informal credit sources. It is also important to understand the nature of relationship between the informal systems of finance and social systems. Our proposed project on FI precisely plans to delve into the same.