

Self Help Groups (SHGs) and Financial Inclusion Dimensions: An Analytical Study of Indian States

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Introduction

Financial inclusion is emerging as a new model of economic growth that plays a major role in eliminating poverty from the country. Financial inclusion is a priority for the country in terms of economic growth and it enables a reduction of the gap between the rich and the poor. In the current scenario financial institutions are the robust pillars of progress, economic growth and development of the economy.

Financial inclusion is defined as the process of ensuring access of financial services timely and adequately, and credits where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost (C. Rangarajan Committee, 2008). The different financial services include access to savings, loans, insurance, payments and remittance facilities offered by the formal financial system. This aspect of financial inclusion is of vital importance in providing economic security to individuals and families (Kelkar, 2014). From this, we can know that inclusive financial sector development makes two complementary contributions to poverty alleviation – (i) it drives economic growth faster which indirectly reduces poverty and inequality, and (ii) by creating appropriate, affordable, financial services for poor people, it can improve their welfare and living standards.

In India, many people are not considered for fair treatment either by the social institutions or by the financial institutions. The concept of financial inclusion can be traced back to the year 1904 when the co-operative movement took root in India. It gained momentum in 1969 when 14 major

commercial banks of the country were nationalized and the lead bank scheme was introduced shortly thereafter. Financial sector inclusion is a very important component of inclusive growth because poverty, deprivation and other socio-economic problems can arise due to financial exclusion. The existing literature on measuring financial inclusion has not been too comprehensive and the present research makes an effort towards the construction of a new financial inclusion index of Indian states for a more inclusive policy on Financial Inclusion.

Objectives

In the light of these above motivations and background, the specific objectives of the present study are: (i) to explore the current status of microfinance in India (ii) to understand the present status of India's financial inclusion by applying the financial inclusion index (FII).

Methodology

With the rising interest in financial inclusion among policymakers, a multiplicity of financial inclusion indicators has been developed. This study is also constructing a Financial Inclusion Index (FII). To construct an index, this study first calculates a dimension index for every dimension of financial inclusion. Steps are explained below.

Formula 1:

$$d_i = w_i * \frac{A_i - m_i}{M_i - m_i}$$

Where, w_i = weight attached to the dimension i, $0 \leq w_i \leq 1$

A_i = Actual value of dimension i, m_i = Minimum value of dimension i, M_i = Maximum value of dimension i, and d_i = Dimensions of financial inclusion i. Formula (1) confirms that $0 \leq w_i \leq 1$ and here, n dimensions of financial inclusion are represented by a point $X = (1, 2, 3 \dots)$. The point $0 = (0, 0, 0 \dots 0)$ represents the point indicating the worst situation and point $W = (1, 2, 3 \dots)$ represents an ideal situation. Here, both the worst point 0 and the ideal point W are the important factors to calculate an index for countries and states which indicate the position of financial inclusion. If the distance is

larger between X and 0, then it represents higher financial inclusion and similarly if the distance is lower between X and 0, then it represents lower financial inclusion.

Formula 2:

$$X_1 = \frac{\sqrt{d_1^2 + d_2^2 + d_3^2 + \dots + d_n^2}}{\sqrt{w_1^2 + w_2^2 + w_3^2 + \dots + w_n^2}}$$

Formula 3:

$$X_2 = 1 - \frac{\sqrt{(w_1 - d_1)^2 + (w_2 - d_2)^2 + (w_3 - d_3)^2 + \dots + (w_n - d_n)^2}}{\sqrt{w_1^2 + w_2^2 + w_3^2 + \dots + w_n^2}}$$

Formula 4:

$$FII = \frac{1}{2} (X_1 + X_2)$$

In the formula (2) for financial inclusion index (FII), X_1 indicates average of the Euclidian distance between X and 0. Higher value of X_1 implies more financial inclusion. In Formula (3), for FII, X_2 indicates inverse Euclidian distance between X and W and similarly, higher value of X_2 corresponds to be higher financial inclusion. The formula (4) is the simple average of X_1 and X_2 . Depending on the value of FII, states are divided into three categories such as:

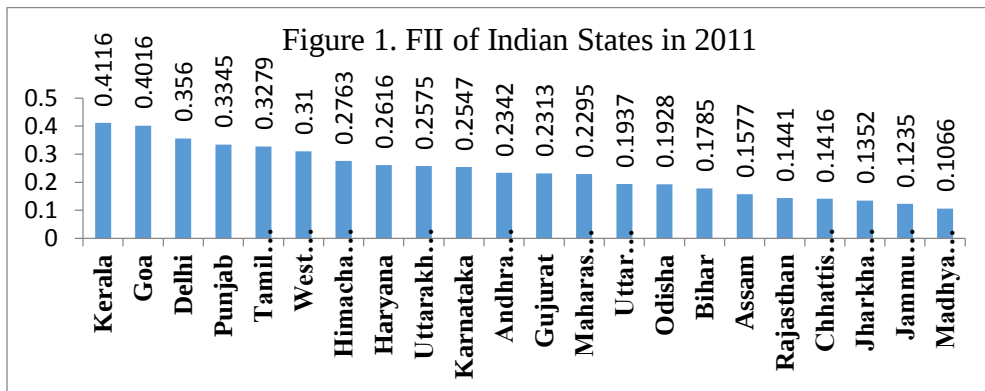
- i. $0.5 < FII \leq 1$ indicates high financial inclusion
- ii. $0.3 < FII < 0.5$ indicates medium financial inclusion
- iii. $0 \leq FII < 0.3$ indicates low financial inclusion

This study is primarily based on secondary data on banking penetration, availability of the banking services and usage of the banking system. Here, various variables such as Bank branches, ATMs, Deposits and Credits are taken from RBI. All dimension data are taken from Census of India (2011), RBI, and IMF. The Index of financial inclusion presented in formula 4 considers three basic dimensions of an inclusive financial system such as: banking penetration, availability of the banking services and usage of the banking system. These dimensions are largely motivated by availability of

relevant and consistent data for Indian states to compute comparable FII. Here, year 2011 is taken as the base for data representing indicators of financial inclusion for the computation of Financial Inclusion for 22 major Indian States. For absolute measure of Financial Inclusion of India, the study period spans from 2006 to 2014.

Results and Discussion

The FII is a composite index of all three dimensions (Banking penetration, Availability of the banking services and Usage of the banking system) and emphasizes uniform development of the states across these three dimensions. It suggests a direction for policymakers to improve the performance. The purpose of this analysis is to find out the dimensions across which a particular state is doing well or is underperforming.



Source: Author's Calculation

Table 1 and Fig.1 show the state-wise FII in 2011. From the data given in the table, it is quite evident that Kerala (0.4116) has secured first rank in FII followed by Goa (0.4016), Delhi (0.356), Punjab (0.33), Tamil Nadu (0.3279) and West Bengal (0.31). These states are categorized under the medium financial inclusion ($0.3 < \text{FII} < 0.5$). There is no state under the high financial inclusion. Madhya Pradesh (0.1066) has secured the last rank in FII among all other states in India. A state with low financial inclusion requires an increase in banking penetration, more availability of banking services and above all usages of the banking system. Even medium financial inclusion performing states essentially means that there is lot to be done to improve the position.

Table 1. Financial Inclusion Index (FII) of Indian States

State	FII	FII Rank	% of HH using BF* (2011)	Category
Kerala	0.41	1	74.2	<i>Medium Financial Inclusion</i> ($0.3 < \text{FII} < 0.5$)
Goa	0.40	2	86.8	
Delhi	0.35	3	77.7	
Punjab	0.33	4	65.2	
Tamil Nadu	0.32	5	52.5	
West Bengal	0.31	6	48.8	
Himachal Pradesh	0.27	7	89.1	<i>Low Financial Inclusion</i> ($0 \leq \text{FII} < 0.3$)
Haryana	0.26	8	68.1	
Uttarakhand	0.25	9	80.7	
Karnataka	0.25	10	61.1	
Andhra Pradesh	0.23	11	53.1	
Gujarat	0.23	12	57.9	
Maharashtra	0.22	13	68.9	
Uttar Pradesh	0.19	14	72.0	
Odisha	0.19	15	45.0	
Bihar	0.17	16	44.4	
Assam	0.15	17	44.1	
Rajasthan	0.14	18	68.0	
Chhattisgarh	0.14	19	48.8	
Jharkhand	0.13	20	54.0	
Jammu & Kashmir	0.12	21	70.0	
Madhya Pradesh	0.10	22	46.6	

Notes: % of households (HH) using banking facilities (BF)

From Table 1, percentage of household using banking services is the highest in Himachal Pradesh (89.1) followed by Goa (86.8), Uttarakhand (80.7), Delhi (77.7) and Kerala (74.2). The percentage of households using banking services is very low in Assam (44.1) in comparison to other states. Moreover, there is need of a comprehensive financial inclusion plan for India as a whole along with region specific inclusion plans. Till now financial

inclusion has not yielded the desired results but no doubt it is playing a significant role and is working on the positive side.

Conclusion

The paper examined the financial inclusion by applying the Financial Inclusion Index (FII) for Indian states. The FII was computed for 22 states of India, using data for indicators of three dimensions such as banking penetration, availability of banking services and usage of the banking system. On the basis of the range of index, states were grouped into three categories, namely, high financial inclusion, medium financial inclusion and low financial inclusion. Kerala ranked at the top of FII followed by Goa, Delhi, Punjab, Tamil Nadu etc. and Madhya Pradesh came at the bottom. Out of 22 states, there was no state under the high financial inclusion category. Kerala, Goa, Delhi, Punjab, Tamil Nadu and West Bengal come under the medium financial inclusion category and all other states are under the low financial inclusion category, indicating the need for further development on financial inclusion measures. More opening of no-frill bank accounts is not the purpose or the end of financial inclusion while formal financial institutions must gain the trust and goodwill of the poor (Sharma and Kukerja, 2013).

The SHGs-Bank linkage programme has been promoting microfinance facilities to ensure financial inclusion. It facilitates extending financial services to unbanked disadvantaged section of society. It is also found in the analysis that the number of SHGs positively endorses financial inclusion. The policies of financial inclusion may not be yielding the expected results but the measures adopted by the governments must be speeded up in every state, particularly to those regions where FII is low.

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