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INDIA SECURING ECONOMIC GROWTH WITH EQUITY -
STEPS TO UNIVERSAL FINANCIAL INCLUSION
INTRODUCTION

At the very outset let me express how happy I am to be with you this afternoon. I commend the organisers on their initiative in organising so topical a Symposium and extend warm congratulations to them. I also thank the Head of the School Mr. Tony Maken and Dr. Umesh for extending an invitation to me allowing me to share a few perspectives and insights with you. Thank you all.

It is now evident that EMEs as Australia and India can buttress the global economy. This has been clearly demonstrated by our experience of the recent global economic crisis. The Great Recession, for example, has been less deep than it would have been because of the growth contribution of EMEs, particularly China and India and Australia. And at the current juncture, when advanced economies are still experiencing a demand recession, it is the import demand from our EMEs which is helping them make the necessary adjustment. However, in order to maintain their growth momentum, we will need to address huge challenges and put in place both collective and individual country strategies. Significantly the most important way in which we can contribute to global economic prosperity is by doing more of what they we been doing so far- that is by maintaining our growth momentum. The second area where we can contribute to global prosperity is through ensuring that multilateral fora such as the G-20 forum remain meaningful and effective and Academic Collaboration like the present and People to People exchanges increase. India far remained relatively insulated from these developments and our impact analyses suggest that our exposure to troubled sub-prime assets and related derivatives is negligible in comparison to many other economies. Whereas this may be regarded as fortuitous, it is perhaps our nuanced approach to financial sector reform and development that has served us well; our approach has been marked by conscious gradualism with the implementation of coordinated and sequenced moves on several fronts predicated on the preparedness for change of the financial system in particular, and of the economy in general.

We have built in appropriate safeguards to ensure stability, taking due cognisance of prevailing governance standards, risk management systems and incentive frameworks in financial institutions in the country. Overall, these progressive but cautious policies have contributed to efficiency of the financial system while sustaining the growth momentum in an environment of macroeconomic and financial stability. The real challenge we face today is ensuring economic growth with equity and distributive justice we have pledged to move towards Universal Financial Inclusion by 2012.
• The overarching and cross-cutting nature of financial inclusion has made it one of the main pillars of the development agenda. Distress in the advanced economies has increased vulnerability of the poor and brought the needs for safety nets into even sharper focus.

• The global financial system must be sound, stable, prudent and combat money laundering and terrorism. It must, however, also serve the global population, seeking to reach those who until now have been unserved. Inclusive growth as a strategy for economic development aims at making products and services, including financial services, available to those who for various reasons stand excluded. The financial sector in the country has experienced revolutionary changes, but there exist a large number of people who have not been benefited by this. Financial exclusion, which is generally the outcome of poverty, ignorance and environmental factors, is also to a great extent related to supply side issues, i.e. lack of appropriate financial services for such people.

• The Reserve Bank has in its Policy Statement clarified that it will implement policies to encourage banks which provide extensive services, while disincentivising those which are not responsive to the banking needs of the community, including the underprivileged. Further, banks have been urged to review their existing practices to align them with the objective of financial inclusion. There are issues both from the supply side and the demand side which require macro level policy interventions and operational issues at the level of policy we have in the recent past initiated several measures to create an enabling environment to give a boost to financial inclusion. Operational issues require the commitment of all stakeholders and of implementing agencies at the grassroots level to ensure that policy initiatives are translated to concrete progress on the ground.

As per the estimates provided by G-20, more than two billion adults continue to lack access to financial services and the millions of micro, small- and medium-sized enterprises (MSMEs) face difficulties in accessing finance. Financial inclusion is fundamental for improving the livelihoods of the poor and in
supporting MSMEs, the engines of economic growth and job creation, to start, grow and thrive.

The G20 has developed an Action Plan for improving financial inclusion, which provides a set of six concrete and pragmatic action areas to advance financial inclusion for individuals, households and MSMEs and promote the application of the G20 Principles for Innovative Financial Inclusion. We have been playing a part in the G-20 and I am the India expert on the Financial Inclusion Expert Group which is co chaired by Australia and in fact Paul Flanagan of the Australian Treasury is the moving spirit behind it and he makes us work very hard indeed!. Together we have cobbled together the Principles for innovative Financial Inclusion which we hope will shape the initiative in days to come.

G20 Principles for Innovative Financial Inclusion

These principles formulated by the G 20 aim to help create an enabling policy and regulatory environment for innovative financial inclusion, which will critically determine the speed at which the financial services access gap will close for the more than two billion people currently excluded. They reflect the conditions conducive to spurring innovation for financial inclusion while protecting financial stability and consumers. They are not a rigid set of requirements but are designed to help guide policymakers in the decision making process with regard to their own country context. The principles are as under:

1. Leadership: Cultivate a broad-based government commitment to financial inclusion to help alleviate poverty.

2. Diversity: Implement policy approaches that promote competition and provide market-based incentives for delivery of sustainable financial access and usage of a broad range of affordable services (savings, credit, payments and transfers, insurance) as well as a diversity of service providers.
3. **Innovation:** Promote technological and institutional innovation as a means to expand financial system access and usage, including by addressing infrastructure weaknesses.

4. **Protection:** Encourage a comprehensive approach to consumer protection that recognizes the roles of government, providers and consumers.

5. **Empowerment:** Develop financial literacy and financial capability.

6. **Cooperation:** Create an institutional environment with clear lines of accountability and co-ordination within government; and also encourage partnerships and direct consultation across government, business and other stakeholders.

7. **Knowledge:** Utilize improved data to make evidence based policy, measure progress, and consider an incremental “test and learn” approach acceptable to both regulator and service provider.

8. **Proportionality:** Build a policy and regulatory framework that is proportionate with the risks and benefits involved in such innovative products and services and is based on an understanding of the gaps and barriers in existing regulation.

9. **Framework:** Consider the following in the regulatory framework, reflecting international standards, national circumstances and support for a competitive landscape: an appropriate, flexible, risk-based Anti-Money Laundering and Combating the Financing of Terrorism (AML/CFT) regime; conditions for the use of agents as a customer interface; a clear regulatory regime for electronically stored value; and market-based incentives to achieve the long-term goal of broad interoperability and interconnection.
India scape

The country has registered impressive growth in the last couple of years which could be attributed to the policy stance taken by the Government and the Reserve bank. The GDP growth rate which was 4.4 percent in 2001 was 7.4 per cent during 2009-10.

<table>
<thead>
<tr>
<th>GDP Growth Rate</th>
<th>1999-2000</th>
<th>2000-01</th>
<th>4.4</th>
</tr>
</thead>
<tbody>
<tr>
<td>1989-90</td>
<td>6.1</td>
<td>2001-02</td>
<td>5.8</td>
</tr>
<tr>
<td>1990-91</td>
<td>5.3</td>
<td>2002-03</td>
<td>3.8</td>
</tr>
<tr>
<td>1991-92</td>
<td>1.4</td>
<td>2003-04</td>
<td>8.5</td>
</tr>
<tr>
<td>1992-93</td>
<td>5.4</td>
<td>2004-05</td>
<td>7.5</td>
</tr>
<tr>
<td>1993-94</td>
<td>5.7</td>
<td>2005-06</td>
<td>9.5</td>
</tr>
<tr>
<td>1994-95</td>
<td>6.4</td>
<td>2006-07</td>
<td>9.7</td>
</tr>
<tr>
<td>1995-96</td>
<td>7.3</td>
<td>2007-08</td>
<td>9.2</td>
</tr>
<tr>
<td>1996-97</td>
<td>8.0</td>
<td>2008-09</td>
<td>6.7</td>
</tr>
<tr>
<td>1997-98</td>
<td>4.3</td>
<td>2009-10</td>
<td>7.4</td>
</tr>
<tr>
<td>1998-99</td>
<td>6.7</td>
<td></td>
<td></td>
</tr>
</tbody>
</table>
It could be seen that the growth rate has been consistently higher from the year 2003-04 when compared to the earlier years. This could possibly be attributed to the inclusive growth development strategy adopted by the Government since that period.

For a country which is growing at a steady clip of 9% economic growth has meaning only if the benefits of growth are equally shared. ‘Inclusive growth’ as a strategy of economic development received attention owing to a rising concern that the benefits of economic growth have not been equitably shared. Growth is inclusive when it creates economic opportunities along with ensuring equal access to them. Apart from addressing the issue of inequality, inclusive growth may also make poverty reduction efforts more effective by explicitly creating productive economic opportunities for the poor and vulnerable sections of the society. Inclusive growth by encompassing the hitherto excluded population brings in several other appurtenant benefits to the economy. The concept of “Inclusion” should be seen as a process of including the excluded as agents whose participation is essential in the very design of the development process, and not simply as welfare targets of development programmes.

Banking statistics in India

No. of Scheduled commercial banks- 170
Of which RRBs- 82

Total number of branches- 80547
No. of rural branches- 31667
No. of semi urban branches- 31667
No. of urban branches- 15733
No. of metropolitan branches- 14178
Dimensions of Access problems

I could of course go on and on but time is both fleeting and limited hence a small chart to present to you the general drift.

Standard indicators of financial inclusion, ranging from percentage of population having bank accounts, insurance protection and debit/credit cards to distribution of availability of banking business across states, across different sections of the society and between urban and rural centres, suggest the possible existence of enormous untapped growth potential, which has not been exploited, partly due to lack of access to finance at reasonable cost. 50% The current level of banking penetration, measured in terms of outstanding bank credit to GDP, is significantly below the levels reached in advanced economies and several EMEs.
## Indicators of Barriers in Accessing Banking Services

### Indicators of barrier in accessing banking services (select countries) as % to GDP per capita

<table>
<thead>
<tr>
<th>Country</th>
<th>Private credit to GDP [%] (2004)</th>
<th>GDP per capita (US $)</th>
<th>Savings Account {deposit services}</th>
<th>Loan Services (SME)</th>
<th>Cost of transfer funds internationally ($250)</th>
<th>Amt.of fee for using ATM card [% of $100]</th>
</tr>
</thead>
<tbody>
<tr>
<td>Australia</td>
<td>100%</td>
<td>20871</td>
<td>0%</td>
<td>0%</td>
<td>100%</td>
<td>1%</td>
</tr>
<tr>
<td>Bangladesh</td>
<td>37%</td>
<td>692</td>
<td>0.2%</td>
<td>0%</td>
<td>15%</td>
<td>2%</td>
</tr>
<tr>
<td>Brazil</td>
<td>31%</td>
<td>168</td>
<td>0%</td>
<td>0%</td>
<td>5%</td>
<td>1%</td>
</tr>
<tr>
<td>Denmark</td>
<td>15%</td>
<td>2615</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>India</td>
<td>37%</td>
<td>670</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Indonesia</td>
<td>4%</td>
<td>896</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Pakistan</td>
<td>4%</td>
<td>564</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Philippines</td>
<td>14%</td>
<td>1025</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Sri Lanka</td>
<td>2.5%</td>
<td>502</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Minimum</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Average</td>
<td>6.2%</td>
<td>142%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
<tr>
<td>Maximum</td>
<td>50.2%</td>
<td>683%</td>
<td>0%</td>
<td>0%</td>
<td>1%</td>
<td>1%</td>
</tr>
</tbody>
</table>

*Note: Indicators are based on various countries and reflect the percentage of GDP per capita for the year 2004.*
The potential of the financial system has not been harnessed fully due to the extent of financial exclusion prevailing today.

Geographic and Demographic Penetration

<table>
<thead>
<tr>
<th>Country</th>
<th>Geographic Penetration</th>
<th>Demographic Penetration</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>No of bank branches per 1000 sq km</td>
<td>No of ATMs per 1000 sq km</td>
</tr>
<tr>
<td>Korea</td>
<td>65.02</td>
<td>436.88</td>
</tr>
<tr>
<td>U.K</td>
<td>45.16</td>
<td>104.46</td>
</tr>
<tr>
<td>India</td>
<td>22.57</td>
<td>#</td>
</tr>
<tr>
<td>Indonesia</td>
<td>10.00</td>
<td>5.73</td>
</tr>
<tr>
<td>USA</td>
<td>9.81</td>
<td>38.43</td>
</tr>
<tr>
<td>Mexico</td>
<td>4.09</td>
<td>8.91</td>
</tr>
<tr>
<td>Brazil</td>
<td>3.05</td>
<td>3.72</td>
</tr>
<tr>
<td>China</td>
<td>1.83</td>
<td>5.25</td>
</tr>
<tr>
<td>Russia</td>
<td>0.19</td>
<td>0.53</td>
</tr>
</tbody>
</table>

The approach to financial inclusion in developing countries such as India differs from that of the developed countries. In the latter, the focus is on the relatively small share of population not having access to banks or the formal payments systems whereas in India, the focus is on the vast majority who are excluded.

Financial And Development Indicators

The broad approach towards financial inclusion followed in India in the 1970s and the 1980s was more oriented towards branch expansion and meeting the credit requirements of specific sectors/segments and there was relatively less emphasis
on individual/household level inclusion. The recent approach focuses on financial inclusion of individuals and households.

Extent of Exclusion

In India, despite widespread expansion of the banking sector, particularly after nationalization of major commercial banks in 1969 and 1980, a significant proportion of the households, especially in rural areas, are still outside the coverage of the formal banking system. These households have been dependent on the informal money lenders for their credit needs and had few avenues for keeping their savings. A visit to the bank branch often resulted in their losing their wage for the day.

The financially excluded sections largely comprise marginal farmers, landless labourers, oral lessees, self-employed and unorganized sector enterprises, urban slum dwellers, migrants, ethnic minorities and socially excluded groups, senior citizens and women.

Some of the figures for Financial Exclusion are very glaring - 45.9 million farmer households out of a total of 89.3 million households do not have access to credit either from the institutional or non-institutional sources (NSSO, 2008); one branch is catering to the banking needs of 16,000 population (June, 2007); only 17 credit accounts and 54 saving accounts are there per 100 persons with all the institutions (June 2007); only 13 per cent are availing loans from the banks in the income bracket of less than Rs.50,000; and 53 per cent people are still taking loans from the institutional and non-institutional sources only for emergency purposes. The Eleventh Five Year Plan for the country states that ‘The development of rural India is an imperative for inclusive and equitable growth and to unlock huge potential of the population that is presently trapped in poverty with its associated deprivations’ (GoI, 2007).
Challenges to inclusion

There are several challenges towards achieving financial inclusion in India. Some of these are as under:

i. India’s large size, its sheer geographic proportion and the population of the country itself make it difficult for any programme at a national level to reach out to everyone. This is one of the biggest stumbling blocks in providing access to affordable financial services to each and everyone in the country.

ii. Poor infrastructure in many parts of the country inhibits the development process.

iii. Availability of flexible financial products that cater to the needs of the masses.

Initiatives of central bank

The Reserve Bank has significantly scaled up its efforts aimed at increasing the level of penetration of bank financing in the economy, using appropriate regulation as well as moral suasion.

There are 6 lakh villages in the country and the proportion of rural residents who lack access to bank accounts remains at 40%, and this rises to over three-fifths of the population in the east and north-east of India while there are 33,000 rural branches hence the task of moving to universal financial inclusion is indeed formidable and clearly neither brick and mortar nor click and portal will meet the case hence financial innovation becomes a desideratum Banks have been encouraged to devise innovative solutions and leverage technology to extend penetrative outreach.

Strategies adopted for financial inclusion:

(i) Road map for provision of banking service in villages

Banks have been advised to draw up a roadmap to provide banking services through a banking outlet in every village having a population of over 2,000, by March 2011. Such banking services may not necessarily be extended through a brick and mortar branch but can be provided through any of the various forms of ICT-based models, including through Business Correspondents (BCs). 73000 villages with population of more than 2000 with no banking facilities as per the 2001 census have been allocated to various banks for providing banking services.

(ii) Simplified branch authorisation

To facilitate opening of bank branches in the villages and to address the issue of uneven spread of bank branches, since December 2009, domestic scheduled commercial banks have been permitted to freely open branches in Tier 3 to Tier 6 centres with population of less than 50,000 under general permission, subject to reporting. In the remote hilly regions of North Eastern States and Sikkim,
domestic scheduled commercial banks can now open branches in rural, semi urban and urban centres without the need to take permission from Reserve Bank in each case, subject to reporting.

(iii) Financial Inclusion Plan (FIP) of banks

With a view to increasing banking penetration and promoting financial inclusion, domestic commercial banks, both in the public and private sectors, were advised to take some specific actions. First, banks were required to put in place a Board-approved Financial Inclusion Plan (FIP) in order to roll them out over the next three years and submit the same to the Reserve Bank. Banks were advised to devise FIPs congruent with their business strategy and to make it an integral part of their corporate plans. The Reserve Bank has deliberately not imposed a uniform model so that each bank is able to build its own strategy in line with its business model and comparative competitive advantage. Second, banks were required to include criteria on financial inclusion in the performance evaluation of their field staff as work done in the rural areas did not earlier have the same weightage for promotions as work done in other segments which lead to direct profit accrual for the Bank.

(iv) Relaxed KYC norms

The Prevention of Money Laundering is an International Concern hence there is a great stringency attached to the Know your customer norms. The Know Your Customer (KYC) requirements for opening bank accounts have been relaxed since August 2005 and simplified for small value accounts accounts with suitable deposit and transaction caps, balances not exceeding Rs. 50,000/- and aggregate credits in the accounts not exceeding Rs. one lakh a year. Introduction by an account holder who has been subjected to full KYC drill would suffice for opening such accounts or the bank can take any evidence as to the identity and address of the customer to the satisfaction of the bank.

(v) No frills accounts

Reserve Bank of India, in November 2005 advised all scheduled commercial banks to make available a basic banking 'no-frills' account with 'nil' or very low
minimum balances that would make such accounts accessible to vast sections of the population. Banks have also been advised to provide small overdrafts in such accounts to incentivise the poor borrower to visit the bank branch.

(vi) General Credit Cards

In December 2005, banks were advised to consider introduction of a General Purpose Credit Card (GCC) facility up to Rs. 25,000/- at their rural and semi-urban branches. The credit facility is in the nature of revolving credit entitling the holder to withdraw up to the limit sanctioned. Based on assessment of household cash flows, the limits are sanctioned without insistence on security or purpose. Interest rate on the facility is completely deregulated.

(vii) Business Correspondents/ Business Facilitators

Since January 2006, the Reserve Bank has permitted banks to utilise the services of intermediaries in providing financial and banking services through the use of business facilitator and business correspondent (BC) models. The BC model allows banks to do ‘cash in - cash out’ transactions at a location much closer to the rural population, thus addressing the last mile problem.

With a view to ensuring the viability of the BC model, banks have been permitted to collect reasonable service charges from the customer, in a transparent manner under a Board-approved policy.

The banks may engage the following individuals/entities as BC.

i. Individuals like retired bank employees, retired teachers, retired government employees and ex-servicemen, individual owners of kirana / medical /Fair Price shops, individual Public Call Office (PCO) operators, agents of Small Savings schemes of Government of India/Insurance Companies, individuals who own Petrol Pumps, authorized functionaries of well run Self Help Groups (SHGs) which are linked to banks, any other individual including those operating Common Service Centres (CSCs);

ii. NGOs/ MFIs set up under Societies/ Trust Acts and Section 25 Companies
iii. Cooperative Societies registered under Mutually Aided Cooperative Societies Acts/ Cooperative Societies Acts of States/Multi State Cooperative Societies Act

iv. Post Offices; and

v. Companies registered under the Indian Companies Act, 1956 with large and widespread retail outlets, excluding Non Banking Financial Companies (NBFCs). This liberalisation has been allowed recently.

(viii) Focus on Smaller Banks

Given the strategic positioning of Regional Rural Banks (RRBs), the Reserve Bank has directed their sponsor banks to speedily, and fully, implement Core Banking Solution (CBS) in all RRBs and commit to firm timeline, by September 2011, by which all RRBs will become fully CBS-compliant this is expected to give a further fillip to financial inclusion efforts given the penetrative outreach of the RRBs in the rural areas. The RRBs have been requested to open 2000 branches by September 2011. As on June 30, 2010, RRBs have reported opening 153 new branches.

(ix) Scaling up IT

Banks had been urged in May 2007 to scale up IT initiatives for financial inclusion speedily while ensuring that solutions are highly secure, amenable to audit, and follow widely-accepted open standards to ensure eventual inter-operability among the different systems.

(x) Mobile Banking

Mobile banking has immense financial inclusion potential and Mobile banking guidelines for banks were issued in October 2008. Since December 2009, banks have been permitted to offer this service to their customers subject to a daily cap of Rs 50,000/- per customer for both funds transfer and transactions involving purchase of goods/services.

(xi) 100 percent financial inclusion drive
At the state level, the State Level Bankers Committee (SLBC) has been advised to identify one or more districts for 100% financial inclusion. Responsibility is given to the banks in the area for ensuring that all those who desire to have a bank account are provided with one by allocating the villages among the different banks. As on March 31, 2010, 432 districts have been identified by SLBCs for 100 per cent financial inclusion. Of these, 250 districts in 18 States and 5 Union Territories have reported having achieved 100% financial inclusion.

(xii) Financial inclusion Fund and Financial Inclusion technology Fund (FIF and FITF)

Based on the recommendations of the “Committee on Financial Inclusion” set up by the Government of India (GoI) under Dr. C. Rangarajan, two Funds, namely the “Financial Inclusion Fund (FIF)” for meeting the cost of developmental and promotional interventions for ensuring financial inclusion, and the “Financial Inclusion Technology Fund (FITF)”, to meet the cost of technology adoption has been set up at NABARD with an overall corpus of Rs. 500 crore each. The corpus is shared by GOI, RBI and NABARD in the ratio 40:40:20. In the union budget for the year 2010-11, the corpus of each of these funds has been enhanced by another Rs. 100 crore.

(xiii) Financial Literacy and Credit Counselling centres

Each SLBC convenor has been asked to set up a credit-counselling centre in one district as a pilot, and extend it to all other districts in due course. As on March 2010, banks have reported setting up 135 credit counselling centres in various States of the country. A model scheme on financial literacy and credit counselling centres (FLCCs) was formulated and communicated to all scheduled commercial banks and RRBs with the advice to set up the centres as distinct entities maintaining an arm’s length from the bank so that the FLCC’s services are available to even other banks’ customers in the district.

(xiv) SHG bank linkage programme

To give an impetus to microfinance, the same was categorized under priority sector lending and lending to SHGs was brought under the weaker sections of the
priority sector. Banks have been advised to provide adequate incentives to their branches for financing the SHGs. According to the data as on March 2009, there are more than 61 lakh deposit-linked Self Help Groups (SHGs) in the country with outstanding deposits aggregating Rs. 5550 crore out of which 42 lakh-odd SHGs are credit-linked, having an outstanding loan amount aggregating Rs. 22,700 crore, signifying financial inclusion of close to 10 crore members.

Conclusion
Further, there needs to be an expansion of the ambit of financial inclusion process by moving from pure banking services to non-banking services such as general health and insurance services. Yet another challenge lies in ensuring the equitable distribution of banking business across regions of the country.

Financial inclusion is a win-win proposition for the people, banks and the nation. The merits of financial sector reform need to be seen through the prism of what finance could do to harness the growth potential with stability, and financial inclusion represents a critical component of the policy process that intends to make the financial system serve the needs of the real economy.
If we move towards Universal Financial Inclusion as large democracies we contribute to a more equal and a more stable world.