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Role of Financial Inclusion in Restraining Entrepreneurial Breakdown In India

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Abstract : Financial inclusion is a new strategy of development in the emerging third world countries, emerged from the grassroots, the so called "informal economy". Small and marginalised, enterprises are often clandestine, unregistered, and operated by the individuals as family based economic activities that do not generate taxes. Thus, the fate of millions of potential entrepreneurs is trapped in a vicious circle of exclusion, and they are unable to reap the fruits of globalisation due to inadequacy of access to formal financial institutions. The provision of basic financial services to this unbanked, low-income population, living at the subsistence level, can have a truly transformative impact on their productivity and the ability to create wealth for themselves. The relevance of such studies grows manifold in a liberalised scenario where opportunities for upward mobility through start-ups and small businesses have grown enormously due to micro-franchising and outsourcing. This research article seeks to explore how financial inclusion can bring fruition to this enormous opportunity.Both quantitative as well as qualitative techniques of research has been applied to analyse, test and get indications on research findings. Use of SPSS 19 software has been used for data analysis and data interpretations. Access to financial services, especially credit and insurance, enlarges the livelihood opportunities and empowers the poor to take charge of their lives. This research is expected to highlight how financial inclusion can help to limit the entrepreneurial failure by creating an entrepreneurial environment that fosters the emergence of new ventures in an interconnected set of elements, comprising risk takers, information brokers, resource providers, and expands markets and enabling technologies that act together to form a virtuous cycle of wealth creation. This contribution to economic development is even greater when the enterprises, that are not formally registered, are included. This research seeks to explore the possibility of the establishment of linkages between the formal and the informal economy through the sound tools of financial inclusion so that leakages and wastages of the informal economy can be plugged in and the nascent entrepreneurs, who particularly suffer from liquidity constraints, in these economies, can sustain their productive initiatives.

Key Terms: Financial Inclusion, Entrepreneurship, Transitional Economies, Informal Economy.

INTRODUCTION

Entrepreneurship lies at the core of the process of economic development. A country could be rich in natural resources, yet poor in terms of living

standards until its people are willing and able to exploit its natural wealth. This is the reason why nations, regions and communities that actively promote entrepreneurship development demonstrate much higher levels of development than the nations, regions and communities whose institutions, policies and cultures hinder entrepreneurship [1]. The failure of entrepreneurship in the transitional economies, like India, is perhaps the most potent limiting factor in the economic development. Angus Madison‟s monumental work, „The World Economy: A Millennial Perspective, documented very well that, except for a small minority of hardly 2% of the population, the entire world was poor before 1500 A.D. Prosperity is a recent phenomenon which slowly began in 1500A.D and gathered momentum since 1820. The spread of prosperity was noticeable in countries which could produce complements of business capital and introduce institutional changes in favour of property rights. Prosperity has spread to countries and regions which could provide a favourable entrepreneurial eco-system to create micro enterprises which grew to reap the benefits of scale and scope economies. The neo-classical view that countries with larger banking networks and healthier financial institutions grow faster over the subsequent decades was empirically tested and found true. Similarly, the idea that finance led economic growth can be safely ignored was completely rejected. Economic development, achieved largely through productivity growth, is very important to developing economies.

The early local experiments with financial liberalisation and formation of a sound financial infrastructure generated a burst of rural entrepreneurialism that ignited the entrepreneurial motivation and resulted in the "Chinese Miracle". Many of the China‟s corporate luminaries came from the rank of unemployed, street-entrepreneurs, household producers of early 1980s and the low paid workers of MNCs of early 1990s. The Chairman and CEO of "Lenovo", that bought the personal computer division of IBM in 2004, started his post-cultural-revolution journey as a sales agent of IBM. The person who owns "New Hope", the largest animal feed firm in China, started his career by raising chicken in his balcony. The person who owns the Chinese MNC, TCL, that acquired "Thomson", French electronic company, spent much of the 1980s producing magnetic tapes in the backyard of an agricultural machinery storehouse. The owner of „Wahaba‟ group, which is the biggest competitor of „Coca-Cola‟ in China, was selling cheap ice-creams on the streets in the mid-1980s. The list goes on. The common factors in every „rags to riches‟ story are the steps taken for the financial liberalisation in the country that enhanced the entrepreneurial motivation of these visionary people of China. Luck and chances are less important than the motivational capacities crafted by the strong infrastructural base, particularly in the financial sector. A transition economy is an economy which is eventually making efforts to change from a centrally-planned economy to a free-market economy. In these economies, the issue of entrepreneurship and

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enterprise finance is extremely important for the three basic reasons– (Wikipedia)

(i) First, it affects the core of the transition process, that is, creation of the private sector.

(ii) Second, there is still on-going debate whether it is finance or the entrepreneurial activity that matters for the start-ups and sustainability of the existing firms.

(iii) Third, the way it affects the private sector creation determines the policies needed to promote the transition.

The financial markets in most of the transition countries like India are at their infancy. Financing enterprise start-ups and restructuring is a crucial and challenging issue. Several studies of the established market economies suggest that entrepreneurs are liquidity constrained. Insufficient funds prevent the start as an entrepreneur or generate a start at a sub-optimal asset level. In the context of asymmetric information, the latter generates lower growth rates and shorter survival rates. Most of these emerging market economies are characterised by a polarised industrial system of a few large enterprises owned by the government, MNCs or a handful of rich local entrepreneurs, mostly in the informal sector. The informal sector is the part of the economy which is characterised by entrepreneurs operating without licences or titled property rights and doing family-based businesses that do not generate taxes. Small and marginalised enterprises are often clandestine, unregistered and operated by the individuals who hold assets without property rights or representations which the financers cannot use as assets in the market. As rights to use these assets are not properly documented, these assets cannot lead a parallel economic life alongside their physical existence.Thus, the fate of millions of potential entrepreneurs is trapped in a vicious circle of exclusion and they are unable to reap the fruits of globalisation, due to the inadequacy of access to the formal financial institutions.

Creation of business capital, in every segment of the society, requires the existence of a well-oiled and efficient basic financial infrastructure. Failure in one area leads to cascades of failures in other areas, thereby, jeopardising the process of transformation of savings and wealth into business capital. Deficit in financial infrastructure increases the cost of establishing and doing business, which ultimately transforms the potential entrepreneurs into job seekers. The total unmet need for credit by all the formal and informal micro and marginalised enterprises in the emerging market today is in the range of $2.1-2.5 trillion [2]. In fact, of the estimated 365-445 million micro and small enterprises in the developing world, approximately 70% do not have access to formal financial institutions. However, the significant contribution of the micro and small enterprises in these transitional economies is evident from the fact that formal micro and small enterprises represent approximately 45% of employment and approximately 33%of GDP [3].This contribution to GDP could be far greater if the potential enterprises of the informal sector could also be included. The

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transitional emerging market economies are teeming with street entrepreneurs, vendors and hawkers, using their skills, frugal innovations, goodwill and physical assets to provide a wide variety of goods and services which are capable of capturing the interest of the consumers and, hence, find a place in the market. "One cannot walk through a Middle Eastern market, hike up to a Latin American village, or climb up to into a taxicab in Moscow without someone trying to make a deal with you". Thus, it is not unnatural to believe that this enterprising energy, if provided with appropriate financial assistance and means to flourish, has the potential to become the most important driver of economic development. OECD findings suggest that start-up rates are positively associated with economic growth [4].

In 1990s, a new strategy for the emerging market economies arose that is referred to as „Financial Inclusion‟. It can be defined as the process of ensuring access to easy and timely financial services and adequate credit, needed by the vulnerable group such as low income groups, at an affordable cost [5].

THE INDIAN SCENARIO

India‟s failure to create entrepreneurs in large numbers, particularly in the manufacturing sector, is rooted in the formation and evolution of India‟s development paradigm in the post-independence period. Indian policy makers understood the critical importance of capital in the modernisation and development of the Indian economy. Thus, India‟s investment package in the 1950s was heavily biased towards creation of physical capital by giving top priority to heavy industry. Heavy industry is capital intensive and requires highly skilled workforce in small numbers. Accordingly, higher education received top priority in India‟s education policy. The scarce material and human resources were devoted to the creation of centres of excellence like IITs and IIMs to the relative neglect of universal school education and vocational training centres. This kind of massive step-up in public investment in capital- intensive technology in relation to limited resources led to multiple pockets of scarcity of industrial inputs. In order to enforce the government‟s ambitious plan of self-sufficiency in machinery, government had to scale down investments in strengthening the financial infrastructure and the human augmenting services. The poor coverage and quality of infrastructure in physical and financial services kept India undercapitalised in respect of credit needs and human capital without which entrepreneurial motivation cannot be generated.

Entrepreneurial motivation is present in a big way in India. The entrepreneurial spirit and pulse are palpable when we find the street vendors, „Chai-walas‟, doing enormous business selling „tit-bits‟ with tea across the villages in our countries. However, at the same time, we find that entrepreneurial capacities are severely constrained due to the absence of institutional mechanism of transforming unproductive wealth into capital. Thus, new product creation and innovation or expanding business by complementariness‟ is lacking.

Capitalism should be such that it can be harnessed towards creating structures of equal opportunities. That mediation is fundamentally done by the government and our government has to do it adequately. When we have 70% of Indians living in an environment that does foster wealth creation, when a giant democratic country like ours has a large majority of voter base in rural India, and when rural India offers the values which businesses crave for, there has to be a great future for "Inclusive Capitalism" which could be possible only through micro-entrepreneurship. The government has to lead the way through policies of financial inclusion that triggers creative and inclusive capitalism. With the changes in economic policies since 1991, India has started realising accelerated growth, but this would be unsustainable if it fails to include the large proportion of disenfranchised population into the growth process. In the absence of a strong financial infrastructure, the toiling of petty producers stands little chance of surviving the social Darwinism of the markets. A study conducted in Brazil for UNDP and SEBRAE identified few significant policies like reduction in administrative costs associated with the opening of formal micro-enterprises, simplified access to social security, easy access to non-expensive and plentiful credit, training and technical assistance can cultivate entrepreneurship and jointly stimulate a gradual reduction of the vast informal sector.

RATIONALE AND SCOPE OF RESEARCH

Financial inclusion in India has been an important tool to reduce the risk, poverty and vulnerability of the common people, which has helped in the development of micro-entrepreneurship through micro-finance, in the country. However, RBI data shows that as many as 139 districts of India suffer from massive financial exclusion. On an all-India basis, only 59% of adult population in the country has bank accounts and 41% of this population is, thus, unbanked. In rural areas, the coverage is 39% against 60% in the urban areas. The unbanked population is higher in the poorer regions of the country and is the worst in the north-eastern states of India.

Financial exclusion is experienced by both developing and developed countries alike, only the degree varies. As the western economies gradually recover from recession, it is seen as a jobless recovery and it is being debated whether the traditional capitalist model, that we are used to, can bring back sustainable and holistic growth. The western capitalist system, born during the industrial revolution, has raised standards of living across the western hemisphere by accelerating innovation and giving customers greater choice. But, this same brand of capitalism has proved itself to be excess prone and inefficient. Development has been found to be slow or non-existent for many of the world‟s poorest regions where, even today, more than 2.8 billion people live on less than US $2 per day. Capitalism, as we know, requires plenty of resources, financial, technological and natural to feed its hunger for growth. But this resource-driven model is not at all sustainable as the financial and natural resources are in, increasingly, limited supply. In its pursuit of short-term goals, an

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obsession with the bottom line, the broader concerns of the stakeholders are often found to be sacrificed, to the narrower interests of the shareholders. In order to address these negatives, a new iteration of capitalism is required, one that builds on the strength of this earlier model, is holistic and offers inclusiveness and sustainability as well. This new brand of capitalism takes a longer-term view and includes socio-economic as well as environmental sustainability for business and consumers alike. To remain sustainable, capitalism must employ the frugal and inclusive principle like "more for less for more" [6], which means it must deliver more value using less money and resources for more citizens. The development trajectory of free market capitalism in India is poised to follow a different route because it also suffers from something that the western nations were not accustomed to until recently, i.e., scarcity.

This pervasive scarcity of financial, technological and natural resources requires innovative Indian financial corporations and entrepreneurs to develop such products and services that deliver more value at less cost for more people. Micro-credit has the capacity to do so. According to a recent study of Global Entrepreneurship Monitor 2002, 107 million in India alone are trying to establish 85 millions of businesses. Unfortunately, very few start-ups have the potential to make an impact on jobs and growth and a negligible section benefit from venture capital, while a vast majority relies on informal funding.

The employment of the sound tools of financial inclusion acts as enabler in getting the property rights well defined, properly documented and supported by enforcement, and thus millions of dollars of assets could lead a parallel life in the form of capital and produce billions of dollars of additional value, thereby, augmenting direct and indirect employment in the organised sector. This is not to romanticise the potential of informal sector in the transitional economies like India but to understand the process of transforming the informal into formal sector through the comprehensive instruments of financial inclusion. With GDP growing around 8.5-9% p.a., the Indian economy is on the right track of rapid economic development [7]. This growth is expected to be sustainable only if growth in the rural manufacturing sector also accelerates. Micro credit enables the marginalised entrepreneurs to obtain and leverage capital to put their ideas to work for themselves and helps in spurring up the investment rate and eventually the manufacturing units in the country. The financial and market knowledge, acquired through microfinance initiatives, empowers the potential entrepreneurs with skills that make them more competent in product validation and choice, which naturally minimizes the "Infant Entrepreneur Mortality Syndrome". This can have tremendous multiplier impact on the GDP of the transitional economies like India and initiate a gradual reduction of the vast informal sector by inducing some micro-entrepreneurs to formalise their businesses or else set up co-operatives through financial inclusion. This has been attempted, to be

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analysed, through the application of the basic Keynesian multiplier model [8] as follows:

(i)……………………Y = 1/(1-b).(a + I)

Here, Y= GDP (Gross Domestic Product) of the country,

b = marginal propensity to consume (m.p.c),

a = autonomous consumption

I =Autonomous Investment of the economy.

As we can logically see that the whole value of "Y" will automatically increase if "I" (i.e. the investment in the economy also increases, due to a spur in entrepreneurship development in the country.) This increase in "Y"(i.e. the GDP/National Income) will pull up the per capita level in the economy and this would be-

- Most spent on consumption goods and rest be saved
- The extra spending allows the businesses to grow more which in turn allows more per capita income and further increase in (m.p.c) consumer spending, enhancing the multiplier impact of income generation and growth.

The table given below shows that the regional differences in the percentage share in all India GDP are largely explained by the extent of financial services (percentage share of credits and deposits).

Distribution Of Financial Services in India – Regional Distribution

Region	Share in all India GDP (%)	Share in all India Credit (%)	Share in all India Deposit (%)	Share in all India Branches (%)
Northern	18	21.5	22.9	16.1
North Eastern	3	1.5	1.6	2.5
Eastern	14	9.2	12.9	17.7
Central	17	8.9	13.6	20.3
Western	22	32.2	26.4	15.6
Southern	28	26.6	22.6	27.4
Total	100	100	100	100

Source: Access to Rural Finance in India.The Evidence. Basu.P. World Bank, 2005.(Author has quoted RBI, Basic Statistical Returns,2002, RBI, Handbook of Statistics,2003, Census 2001.)

India's lesser developed and low income regions like north eastern region has availability of the financial services which is least (just 1.5% of all India credit, 1.6% of all India deposit and 2.5 % in all India branches) and its corresponding contribution to all India GDP(Gross Domestic Product) is just 3%, whereas, southern region whose share of financial services is relatively better (26.6% of all India credit, 22.6% share of all India deposits and 27.4% share in all India branches) contribute 28% to all India GDP. In fact this table suggests a two way relationship between financial inclusion and economic growth, showing both reinforcing each-other. The table shows that

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Western region of India, which has also, traditionally, been the business hub of the country, indicates a more developed financial institutional network with second highest contribution to overall GDP of the country.

Data Analysis

On the basis of the research insights in the literature review, the following hypothesis can be developed in the context of the study of the impact of Financial inclusion on the GDP of the region. Correlation and Regression analysis has been done on the given data in the table above, using SPSS. 19, to prove the hypothesis given below:

H0 : GDP of a region is independent of the extent of financial inclusion in the region.

HA: GDP of a region is dependent on the extent of financial inclusion in the region.

Table (1) in the **Appendix A**. Indicates that the correlation of GDP with the variables of Financial inclusion, namely, all India percentage share of credit, all India percentage share of deposits and all India share of branches of the formal financial institutions, is not only significant at 0.01 % but is extremely high, too. Table (2) and Table (3) in **Appendix .C** strengthens the assertion that financial deepening (indicated by All India percentage share of branches) facilitates the growth of GDP in the concerned region. Even, the figure-1. in **Appendix. B** indicates the strong positive relationship between GDP of a region and the extent of financial inclusion in that region. As our empirical analysis confirms that financial deepening can indeed help in spurring up economic and productive activities, which is reflected in higher levels of GDP in the concerned region, therefore we reject the null hypothesis.

The Evidence Review

"The inclusive capitalism" will remain a distant dream unless India strengthens her financial infrastructure and re-focuses her developments priorities. The commercial success of India"s wireless industry is impressive and can be potentially harnessed for the financial liberalisation and to bring about an information and social revolution in which connectivity is the key enabler, as it connects the constrained and deprived peoples" access to assets and markets. A mission named "*Aadhar*" (unique identification card „for each Indian") has been launched, by the Prime Minister"s Office, to ensure, to some extent, the capability of India and its population to tackle some tougher challenges related to corruption, security, financial environment and the prevalent entrepreneurial ecosystem. What started off as an identification project has morphed into India"s biggest Financial Inclusion tool. The strengthening of financial infrastructure in India would create a positive entrepreneurial ecosystem that can extract "boom from the busts". Narayan Murthy, founder of a world class company called "Infosys" has proved „to the world", that the democratisation of

wealth can spur high-growth sustainable companies and the value-based business leadership can create goodwill for business, even in our country. The next best known example is "*Fabindia*", a handloom and handicrafts products manufacturing chain, which produces its products from the thousands of rural weavers and craftsmen all over India. These organisations have managed to involve the poor and petty producers in the value chain and made them stakeholders. Another exemplary model of financial inclusion in India is, "*Dharavi*", a bustling industrial-slum in Mumbai, which has demonstrated that financial inclusion is a potentially viable business proposition. Ironically, even though it is situated right in the heart of Mumbai‟s financial district, *Dharavi* did not have a single commercial bank branch till the year *2007*, notwithstanding its celebrated entrepreneurial spirit and export performance. In just three years‟ time, this bank branch recorded business excess of Rs. 440 million. It is exporting goods worth $600-$700 million, on yearly basis. Inspired and enthused by this success, there are nine ATMs in *Dharavi,* now, all being very actively used. The widespread notion that certain segments are not commercially viable has not deterred these organisations and places from designing innovative business and training models to make the masses financially employable. We are starting to see the emergence of such profit-making and scalable business models that promise to be the social enterprises of tomorrow. "Reaping the democratic dividend is not automatic" [9]. It would require coordinated efforts to develop necessary enabling infrastructure in order to capture new avenues of growth and higher capital productivity of the small and petty entrepreneurs so that the credit made available can be channelized to productive activities, improves the absorptive capacity of the clients and helps in achieving greater inclusion to limit the nascent entrepreneurial failure.

Conclusion

The diagnosis of the impact of financial inclusion on entrepreneurship failure, in the emerging economies, is scarce and offers a fertile area of research. An effort such as this faces a number of data-driven limitations. The problem of credit, particularly, in these countries, is significant. The challenges to closing the credit gap are also phenomenal. Presence of informal economy represents wastage and significant leakages from the circular flow of income, in the economy. Formal and legal entrepreneur statuses are often necessary steps to plug these leakages. India‟s entrepreneurship development is at an important crossroad today, signalling strong potential for faster growth. The proposition that financial inclusion speeds up investment in the concerned region and results in enterprise growth, remains hypothetical due to data constraints and the issues of time-lag. The correlation and regression analysis, in this study, done with the help IBM SPSS 19, clearly indicate an extremely positive

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relationship between GDP of the region and the financial deepening (indicated by All India percentage share of bank branches). Table: (3) shows the **R2** to be 98.9%, which is significantly high and describes that higher financial inclusion facilitates higher growth of GDP of the concerned region. The value of „F‟ and „t‟ also indicate the same, as given in Table(3) and Table(4) of the **Appendix C**. However, the handicap of data hampers the validity of the analysis and flow of useful information as the micro and small enterprises are characterised by several forward and backward linkages. India‟s achievement of a broad based economic growth hinges on a successful entrepreneurship development programme in the country. Financial inclusion can make this happen by „cultivating entrepreneurship‟. The resultant entrepreneurship revolution, through financial inclusion, has the ability to reinforce greater financial inclusion, by increasing the employment opportunities and enterprise income of the country, and could prove to be a „win-win‟ proposition for all the stakeholders in the value chain.

APPENDIX: A.

Table(1): Correlation Matrix, obtained from SPSS.19, demonstrates a strong correlation between GDP and the variables of Financial Inclusion (% of Credit in All India Credit, % of Deposits in All India Deposit and % of Branches in All IndiaBranches

		GDP	CREDIT	DEPOSIT	BRANCHES
GDP	Pearson Correlation	1	.994**	.995**	.995**
	Sig.(2-tailed)		.000	.000	.000
	N	7	7	7	7
CREDIT	Pearson Correlation	.994**	1	.994**	.981**
	Sig.(2-tailed)	.000		.000	.000
	N	7	7	7	7
DEPOSIT	Pearson Correlation	.995**	.994**	1	.980**
	Sig.(2-tailed)	.000	.000		.000
	N	7	7	7	7
BRANCHES	PearsonCorrelation	.995	.981	.980	1
	Sig.(2-tailed)	.000	.000	.000	
			7	7	7

**. Correlation is significant at 0.01 level (2-tailed).

APPENDIX : C

Table :(2)

R	R Square	Adjusted R Square	Std. Error of the Estimate
.993	.989	.987	3.701

The independent variable is Branches.

Table: (3)

ANOVA

	Sum of Squares	df	Mean Square	F	Sig.
Regression	6188.363	1	6188.363	451.743	.000
Residual	68.494	5	13.699		

The independent variable is Branches.

Table 4:

Coefficients

	Unstandardized Coefficients		Standardized Coefficients	t	Sig.
	B	Std. Error	Beta		
Branches	.991	.047	.993	21.254	.000
(Constant)	.582	1.930		.302	.775

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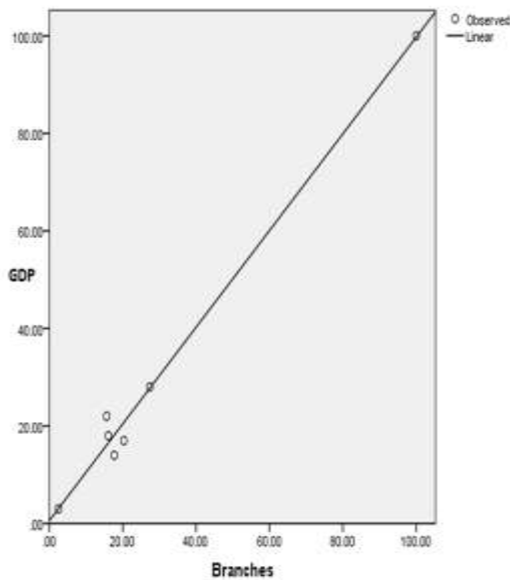
APPENDIX : B

FIGURE-1: Showing a strong positive relationship between GDP and Financial Deepening



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