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# FINANCIAL INCLUSION IN INDIA: A REVIEW OF POLICIES, PROGRESS AND CHALLENGES

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## ABSTRACT

Financial inclusion is increasingly being recognized as an important element of India's development strategy due to the fact that access to appropriate and affordable financial services can facilitate not only household security but also savings, productive investment, and a reduced dependence on informal sources of finance. Despite the India banking system expansion post nationalisation and growth of rural banking institutions many low-income households, small farmers, informal workers, women, and those living in remote areas were excluded from the formal financial system for a long time.

The review paper analyzes the evolution of financial inclusion in India, major policy initiatives, progress made and outstanding issues as per the literature and policy documents published till 2015. It includes the major initiatives of financial inclusion which were taken up in India like expansion of rural branches; priority sector lending; Regional Rural Banks; Self-Help Group-Bank Linkage Programme; no-frills accounts; Business Correspondent model; Financial Inclusion Plans; financial literacy programmes; technology-enabled banking; Direct Benefit Transfer; Pradhan Mantri Jan Dhan Yojana and others. The literature suggests that these measures significantly increased the geographical and institutional scope of formal finance. By March 2015, there was substantial increase in Banking Outlets in villages. Moreover, Basic Savings Bank Deposit Accounts (BSBDA) registered rapid growth. Despite improvements in financial access, the literature points out a continued gap in financial inclusion effective. The efforts to enhance the financial inclusion faced several limitations, including dormant accounts, lack of adequate formal credit, regional imbalance, low financial literacy, poor state of the infrastructure, irregular functioning of Business Correspondents, gender inequalities, and continued dependency on informal finance. The review suggests that we need to move from just opening accounts to ensuring that accounts are used frequently, providing appropriate financial products, affordable credit, financial capability, consumer protection and commercially sustainable last mile delivery mechanisms for achieving sustainable financial inclusion.

**Key words: Financial Inclusion, Banking Sector, Financial Literacy, Financial Access.**

## 1. Introduction

Financial inclusion can broadly be defined as a process through which individuals and businesses, mostly belonging to the under privileged group, must gain access to useful, affordable, and appropriate formal financial services. In Indian policy terms, the Committee on Financial Inclusion refers to Financial Inclusion as ensuring access to financial services with timely and adequate credit by vulnerable groups in particular the weaker sections and low-income groups at an affordable cost (Government of India, 2008). This definition highlights that having a bank account is not enough – but it must be affordable, adequate, accessible, and used effectively.

Financial inclusion is significant because finance and socioeconomic development are closely linked to each other. Many low-income families who can't afford the services of banks and credit unions are now borrowing money from moneylenders, relatives, traders, etc. Such arrangements may have a higher cost of borrowing, lower transparency and less consumer protection. When households have greater access to formal finance, they can safely save money, deal with shocks to their economy, gain access to productive credit, receive government payments, and take part in the economy more effectively. Evidence from India's experience of social banking shows that rural bank branch expansion led to decline in rural poverty and rise in non-agricultural output (Burgess and Pande 2005). International evidence similarly indicates that comprehensive access to financial services can have important implications for economic opportunity and development (Beck et al., 2007).

For a long time, India has been trying to democratise access to finance through policies. In the mid-2000s, financial inclusion was elevated as a major policy objective. According to Thorat (2007), the Reserve Bank of India (RBI) promoted no-frills accounts, encouraged banks to adopt the Business Correspondent (BC) model and increasingly used technology to overcome the cost and geographical constraints of traditional branch banking.

The Rangarajan Committee gave important conceptual and policy foundation for identification of financial exclusion as a barrier in inclusive growth and a coordinated national level approach to deal with it (Government of India, 2008). The inclusion strategy subsequently included Financial Inclusion Plans, simplified know-your-customer requirements, Basic Savings Bank Deposit Accounts, financial literacy campaigns, electronic benefit transfers and branchless banking, among others. The connection between financial inclusion and development has been of growing academic interest, which has led to attempts to measure inclusion using accessibility, availability and usage indicators (Sarma, 2008).

The major development was the launch of the Pradhan Mantri Jan Dhan Yojana (PMJDY) in August 2014. The goal of the programme was to ensure access to basic banking accounts and related financial services to households that were previously excluded. As per RBI, PMJDY accounts opens reached 165.7 million as on June 2015 (Reserve Bank of India [RBI], 2015).

In this context, the paper reviews the important literature published till 2015 on financial inclusion in India. It focuses on three inter-related issues. As such, the review differentiates between expansion in financial infrastructure and the deeper goal of continuing and productive participation.

## 2. Review of Literature

According to Burgess and Pande (2005) rural banking development in India has effects on people's development. Analysing India's social banking experiment, the authors discover that mandates requiring banks to spread into previously unbanked geographies increase rural branch penetration in less financially developed states. Expansion of rural branches was associated with lower rural poverty and rise in non-agricultural output. The research proposed that spatial banking expansion could enable social economic rewards besides mere institutional proliferation.

Basu (2006) studied access to finance of India's rural poor and highlighted the continuing importance of informal finance even after decades of formal banking expansion. Formal institutions need to strengthen their ability to meet the demands of poor households and small borrowers, the study highlights. The continuing exclusion of institutions from formal financial markets has been due to procedural difficulties, transaction costs, inadequate products and limited institutional outreach. The study suggested merely increasing the number of formal institutions would not be enough unless the suitability and accessibility of financial services is improved.

According to Beck et al. (2007), there are important differences in access to and use of banking services across countries. The differentiation between access and usage was a significant contribution to measuring Financial Inclusion as done by their work. According to the study, branches, ATMs, deposits and loans are potential measures of banking outreach which could help in future works on financial-inclusion.

In 2007, Thorat discussed India's experience of financial inclusion. He highlighted that in addition to the branch network, technological and institutional innovation need to happen for financial inclusion. In a statement, she said that a simplified bank account, the BC model, financial literacy, microfinance and technology-based delivery are some of the important mechanisms for reaching out to the unbanked. The analysis found that conventional branch banking cost structure creates constraints in reaching thinly populated and low-income areas.

The Committee on Financial Inclusion led by C. Rangarajan (Government of India, 2008) was a watershed in India's financial inclusion policy. The group thought of financial inclusion as access to cheap savings, credit, insurance, payment, and remittance services and mentions of vulnerable groups' specific needs. The strategy suggested a mission-oriented methodology, better institutional coordination, a strengthening of rural financial institutions, an advancement in financial literacy, and an increased use of technology.

Sarma developed an Index of Financial Inclusion (IFI) that would surpass the limits of a single indicator always being used like the number of a bank account, number of bank branches (2008). The financial service accessibility, availability and usage were measured by the index. The significance of the study lay in the fact that financial inclusion was not to be understood merely through the number of accounts. As a result, several studies of inter- and intra-state dissimilarities in financial inclusion followed.

According to Subbarao (2009), financing inclusion entails both challenges and opportunities and a supportive environment for technological innovation must be developed. The analysis added weight to the argument that banking policy alone cannot resolve financial exclusion as it is related to other developmental inequalities.

The report on financial inclusion by Kuri and Laha (2011a) examines selected districts in West Bengal. A awareness of banking services b literacy c diversification of the rural non-farm economy d household assets are important factors facilitating inclusion according to their analysis The research suggested that due to economic security, households move into formal financial systems. This means that awareness and accessibility also play an important role.

Kuri and Laha (2011b) have argued that an inclusive financial system could expand people's aspirations by improving their ability to participate in economic activities. The advantages of financial-sector development were not uniformly distributed across all states, according to their findings.

According to Demirgüç-Kunt and Klapper (2012), the Global Findex database provides internationally comparable evidence on formal account ownership, saving, borrowing and payment behaviour. The database showed there were major gaps in formal financial participation by income group, gender and country. According to the findings, experts believe it is essential for India to not only ensure access to financial institutions but also usage.

Chakrabarty (2012) made the case that indicators measuring access, availability, and usage should be the basis for assessing inclusion, rather than simply extending bank branches. He highlighted that delivery models needed to be appropriate to local socioeconomic and institutional circumstances in different jurisdictions.

Kumar (2013) through panel-data techniques, the study found that expansion of branch network had a clear positive impact on financial inclusion. Banking penetration was influenced by employment, industrial structure and the socio-economic environment. Significantly, the evidence points toward the persistence of regional gaps. There are little or no signs of voluntary disappearance due to market forces.

Chakravarty and Pal (2013) created an axiomatic measure of financial inclusion, and examined the impact of banking policies in Indian states. not a repeating sentence from an encounter The authors found geographical penetration and credit availability to be key dimensions requiring policy action.

Ghosh (2013) critically assessed the impact of microfinance on inclusion. The study refers to the experience of countries, particularly that of India including the Andhra Pradesh microfinance crisis, which warns against thinking microfinance is a universal panacea for financial exclusion. Ghosh noted that too much commercialisation of microfinance could create problems for vulnerable borrowers and that regulation, adequate subsidies, and broader institutional strategies were essential.

Paramasivan and Ganeshkumar (2013) analyses financial inclusion in India, underlining its significance for inclusive growth. It was contended that low-income households typically incur substantial costs and face great difficulties in accessing mainstream banking services. Their review stated the need of building alternative delivery mechanisms to inculcate banking habits of the rural people and provide of financial services at low cost.

The district-level measure of financial inclusion in India created by CRISIL (2013) is called CRISIL Inclusix The index which is focused on branch penetration, deposit penetration, and credit penetration became useful in assessing regional disparities more systematically. The national averages hide lots of variation by state and district and they reinforce the importance of geographically disaggregated measurement.

Reserve Bank of India started early efforts adopting Financial Inclusion Plan approach is a new development. The RBI (2012) said that rather than a peripheral social goal, including it in regular strategic and business planning of banks should be attempted.

The consequence of such reasoning is a large range of greening policy measures which meet various objectives. Most developed countries were a party to the OECD–Support for Greening Economies Initiative (2016). The perceived committee's emphasis on universal access, appropriate credit, payment services, savings, risk management and consumer protection. The approach showed that financial inclusion must be achieved with a complete ecosystem, not just banking products.

The RBI Annual Report 2013–14 shows efforts continuing to be made towards formal banking through branches, BCs, BSBD Accounts, credit products and use of technology. The emerged evidence points towards branchless delivery becoming an important factor for geographical reach' (RBI, 2014b). Nonetheless, the difficulty was to translate physical availability to sustained customer sales.

The PMJDY initiative, launched by the Government of India in the month of August of 2014, was a gamechanger in terms of scale and visibility of financial inclusion. According to Government of India (2014), the programme aims to provide basic banking accounts to households previously not availing banking services and a platform for provision of overdraft, insurance, remittances and government transfer. The push was very much about universal household-level banking access rather than incremental extension based mainly on traditional bank branches.

CRISIL through its second Inclusix report further documented the spacial dimensions of financial inclusion (2014). India's financial inclusion results showed geographical disparities under its district-oriented approach. Because areas with inadequate infrastructure and hind levels of economic development could not necessarily be served through a single model; evidence pointed to the need for differentiated strategies.

The World Bank (2014) contextualised financially inclusion in the broad framework of financial development and argued that financial systems must be assessed not just on their depth but also on their accessibility, efficiency and stability. This perspective mattered for India as rapid banking-sector growth did not automatically transform into an equitable access for rural citizens, women, lower-income households, and informal enterprises.

The Global Findex database was introduced by Demirgüç-Kunt et al. (2015) to provide up-to-date evidence. Their work indicates substantial international improvements in account ownership while showing much room for improvement related to gender, income and development. Their analysis also examines account usage, savings behaviour, borrowing and repayment behaviour, highlighting how ownership of an account is only one aspect of inclusion.

Ultimately, as per RBI (2015) the financial inclusion architecture of India has grown significantly. Between March 2010 and March 2015, total banking outlets in villages increased from 67,694 to 553,713. The number of basic savings bank deposit accounts more than tripled from around 735 million to 398.1 million. The RBI also noted that as many as 165.7 million

PMJDY accounts were opened by June 2015. These were impressive figures that showed good progress in access. However, they also raised the policy question of whether newly created accounts were being used actively and productively.

Combined, these 24 contributions reveal a development in the financial inclusion literature. Historically, the focus of studies was mainly physical banking outreach or an enhanced rural branch expansion. It is only later studies that focused on a multidimensional measure, financial literacy, technology, and usage of accounts, consumer protection, microfinance, and an all-encompassing financial service. The literature, thus, suggests that financial inclusion should be understood as a continuum starting from access to regular usage, which should lead to improvements in financial well-being.

### 3. Discussion

The literature reveals that India's journey of financial inclusion has been passed through distinct phases but interlinked. Earlier, the strategy was quite extensive in terms of institutional expansion. Nationalised banks, Regional Rural Banks, cooperative institutions, priority sector lending, and rural branches. As per Burgess and Pande (2005), meaningful development impact is the result of the introduction of a bank branching strategy in bank-branch deficient areas. Yet, due to its high cost, branch opening could not alone guarantee universal access to India's scattered geographic population.

Hence, the second phase increasingly turned to simplified accounts, BCs, microfinance, Self-Help Groups, financial literacy, and technology. These initiatives understood that physical distance from a bank branch was only one form of exclusion. Research by Sarma (2008), Kuri and Laha (2011a), Kumar (2013), and Chakravarty and Pal (2013) indicates that availability of banking facilities, socio-economic development, literacy, employment opportunities, credit availability, and awareness together determine financial inclusion.

The banking touchpoints expanded at a rapid pace. Most of this expansion was powered by branchless channels, in particular, the BCs. The RBI recorded an increase in the amount of Basic Saving Bank Deposit Accounts from 73.5 million to 398.1 million. The potential of regulation, technology, institutional innovation and government programmes is demonstrated.

Nonetheless, numerical expansion should not be interpreted as total inclusion. The literature often makes a distinction between access and usage. A person may have a bank account but still save, borrow and transact mostly through informal means. Dormant or low balance accounts therefore are a critical challenge. Savings accounts may be available, but this does not mean that access to formal credit and insurance, pensions, or remittances is adequate.

Once again, regional and socioeconomic disparities emerge. Various studies (Kuri and Laha, 2011b; Kumar, 2013; Chakravarty and Pal, 2013; CRISIL, 2013) show large variation at the state and district level. Limited literacy, inferior physical infrastructure, little awareness, erratic income, documentation hassles and weak confidence in formal institutions can reduce effective participation even where banking outlets are available.

The year 2014 witnessed a large-scale account-based inclusion which was possible due to the PMJDY (Pradhan Mantri Jan Dhan Yojana). So, up to the year 2015, the literature pointed to the fact that the central problem for India had moved from access to finance to use of finance and from targets to sustainable use of finance.

### 4. Conclusion

As the reviewed literature in the paper shows, the country's approach has been that of mix of institutional expansion, regulatory intervention, technological innovation, alternative delivery channels, financial literacy, microfinance and largescale government programmes. Rural branch expansion, priority sector lending, Regional Rural Banks, Self-Help Groups, no-frills accounts, the Business Correspondent model, Financial Inclusion Plans, Direct Benefit Transfer and PMJDY have all uniquely contributed to the outreach of formal finance.

By 2015, a significant progress was made. PMJDY has incorporated many more households into the formal banking structure (RBI, 2015). Also, the RBI's evidence shows that village banking outlets and Basic Savings Bank Deposit Account have grown rapidly. The developments marked a significant shift from largely branch-based operations towards a hybrid of physical and tech-enabled financial delivery.

But the literature demonstrates that financial inclusion cannot be assessed simply by looking at account, branch or BC outlet numbers. True inclusion means being accessible and affordable, using often enough and with adequate credit and the right products, capacity-building, trust and protection as well as proof of better home finances. Inequalities in terms of region, sex, income as well as rural and urban were still significant. The fact that people relied on informal loans and rarely used formal banking services indicated that access does not always lead to participation.

The Review thus concludes that India's experience as regards financial inclusion till 2015 has been one of considerable progress in expanding the architecture of access but incomplete or lack of progress in depth and quality of inclusion. The next stage of the policy should therefore transform mere access to basic banking into sustained financial involvement. It is important to assess financial inclusion by whether formal financial products bring economic opportunities, resilience, security and finally encompassing well-being. This will draw a line on whether people are in or out of the system.

### 5. Suggestions

Basic accounts should be linked with savings, affordable credit, remittances, insurance, pensions, government benefit payments, etc., on the basis of customer needs.

Financial literacy initiatives need to be enhanced, especially in rural areas, and among low-income households, women, small farmers, informal workers, and first-time customers. Financial literacy is not just about how to open an account. It's also about how to save, responsibly borrow, use electronic services, make sense of charges, and seek grievance redressal.

The BC model should be made more sustainable through adequate remuneration, training, and technology support liquidity management, supervision and customer protection mechanisms. Last-mile banking can be very useful in places where setting up branches is not commercially viable.

Policies should reflect regional diversities. Areas of the district and state level that continuously show low levels of inclusion should get more institutional and infrastructural attention than nay uniform national target.

Access to formal credit should also be given a higher weightage. Owning a savings account, without access to affordable, productive credit, may lead the household to informal lending. Lastly, Monitoring systems should be developed by the policymakers with a multipronged approach like access, use, affordability, quality, credit availability, customer satisfaction, and financial literacy. Making financial inclusion more than just a number would turn it from an ambitious goal into a tool for real change.

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