

Dr. Mahesh Abale

Research Guide, Director,

S. P. Mandali's Prin. N. G. Naralkar Institute of
Career Development & Research, Affiliated to
Savitri Bai Phule Pune University

Rasika Dighde

Research Scholar,

Suryadatta Institute of Management and Mass
Communication Pune, Affiliated to Savitri Bai Phule Pune
University

Abstract

Financial Inclusion is providing the financial services at affordable cost to vulnerable and unbanked section of the society in comparison to financial exclusion where those services are not available due to less affordability and lack of reach to this under privileged section of society. This paper explores the role of Small Finance Banks in promoting financial inclusion, emphasizing their unique characteristics and strategies. It also emphasizes how Small Banks contribute to economic growth and development by increasing the participation of individuals in the formal financial sector through financial inclusion.

KeyWords: Financial Inclusion, Small Finance Bank, Banking Services, Reserve Bank of India, Local Area Banks

Introduction

Financial inclusion essentially means providing equitable and affordable access to financial services for all, irrespective of their background. It aims to integrate disadvantaged and vulnerable sections of society into the economic mainstream, enabling them to benefit from financial services while simultaneously expanding the customer base of financial institutions. This, in turn, boosts the country's GDP by enhancing future earnings and sustaining a continuous cycle of growth. Moreover, financial inclusion strengthens GDP growth by stabilizing the financial system, encouraging savings among rural populations, and bringing marginalized individuals into the formal banking network.. [1] Chakrabarty described financial inclusion as "the process of guaranteeing access to suitable financial products and services for all sections of society, including vulnerable groups such as weaker sections and low-income households, at an affordable cost, delivered fairly, transparently, and through mainstream institutional channels." [2] Since the fiscal year 2005–06, the Reserve Bank of India (RBI) has placed increasing emphasis on financial inclusion in its annual policies. The RBI defines financial inclusion as a structured initiative to extend access to suitable financial products and services to all sections of society, particularly vulnerable groups such as weaker sections and low-income households. The objective is to provide this access in an affordable, fair, and transparent manner through mainstream institutional channels. [3] Financial inclusion involves providing affordable access to financial services and credit to disadvantaged groups and low-income individuals whenever they are in need. [4] Financial inclusion implies the provision of accessible, diverse, and affordable financial services, covering not just banking but also insurance and stock market investments..[5] The journey toward financial inclusion commenced in July 1969 with the nationalization of 14 commercial banks, followed by another six in 1980. To strengthen banking services in rural areas, Regional Rural Banks were established in 1975. Later, in April 2010, with the liberalization of the banking sector, significant reforms were introduced, including the issuance of both universal and specialized banking licenses. These initiatives were designed to expand the accessibility of financial services to rural populations. [6] Since 1975, the Government of India (GOI) and the Reserve Bank of India (RBI) have played a pivotal role in promoting financial inclusion by introducing a range of innovative financial services. These include Kisan Credit Cards (KCCs), the Banking Correspondent–Banking Facilitator Model, the Self-Help Group (SHG)–Bank Linkage Programme, Direct Benefit Transfer (DBT), USSD-based Mobile Banking, and the establishment of Regional Rural Banks. Furthermore, schemes such as Rashtriya Mahila Kosh and Rashtriya Swasthya Bima Yojana have also been launched to strengthen financial inclusion initiatives. [7] To guarantee the success of financial inclusion in India, it is important to note that due to organizational limitations and widespread financial illiteracy, these institutions have not been able to fully reach the entire population, particularly rural women and small-scale customers.

The Small Finance Bank (SFB), introduced by the RBI, is a recent initiative aimed at bringing unbanked and underbanked individuals into the formal banking system..[9] Acknowledging the vital role Small Finance Banks can play in enhancing financial access for micro and small enterprises, expanding banking services to underserved regions, and supporting the agricultural sector, the Reserve Bank of India (RBI) decided to permit the creation of new private "Small Finance Banks." [10]

Within this framework, the Reserve Bank of India granted licenses to private sector Small Finance Banks (SFBs). The primary aim of establishing these banks was to advance financial inclusion by efficiently mobilizing deposits

and extending credit to micro, small, and unorganized enterprises at minimal processing costs (RBI, 2014). [11] In order to advance this goal, the Government of India has launched various initiatives to drive financial inclusion, such as the Pradhan Mantri Jan Dhan Yojana (PMJDY), the MUDRA Programme, and the establishment of Microfinance Institutions. Furthermore, in September 2013, the Reserve Bank of India (RBI) constituted a committee headed by Dr. Nachiket Mor to reinforce and expand financial inclusion initiatives..[12] The Comprehensive Financial Services for Small Businesses and Low-Income Households report, widely referred to as the Nachiket Mor Committee Report, proposed two key banking models for India: the horizontally differentiated banking system (HDBS) and the vertically differentiated banking system (VDBS). Both models focus on the core elements of payments, deposits, and credit, aiming to address the diverse needs of micro enterprises and low-income households..[13] Small Finance Banks serve a crucial role in meeting the financial needs of underserved sections of society, such as small business units, marginal and small farmers, micro and small enterprises, and workers in the unorganized sector. These groups, often excluded from adequate financial access, are typically overlooked by Scheduled Commercial Banks and Non-Banking Financial Institutions..[14] Small Finance Banks are essential in fulfilling the financial needs of underserved sections of society, including small business units, marginal and small farmers, micro and small enterprises, and those in the unorganized sector. These groups, which often face inadequate access to financial services, are commonly neglected by Scheduled Commercial Banks and Non-Banking Financial Institutions. [15] A Small Finance Bank (SFB) is a specialized financial institution focused on advancing financial inclusion by offering technology-driven products and services tailored to meet the needs of marginalized individuals and enterprises.. [6] The Committee recommended the establishment of different types of Small Finance Banks as recognized banking institutions. Following these suggestions, the Reserve Bank of India (RBI) released guidelines in 2014, inviting applications from interested entities to set up Small Finance Banks. Subsequently, on September 16, 2015, the RBI granted “in-principle” approval to eleven institutions, including Microfinance Institutions (MFIs), Non-Banking Financial Companies (NBFCs), and Local Area Banks (LABs), to establish Small Finance Banks. The core objective of these banks was to serve the interests of economically disadvantaged sections of society. They were entrusted with key banking responsibilities such as mobilizing deposits and extending credit to underserved groups, including small business units, marginal and small farmers, micro and small industries, and unorganized retail businesses..[12] The primary purpose of establishing Small Finance Banks was to provide financial support to low-income individuals. As of March 16, 2019, India had several operational Small Finance Banks, including AU Small Finance Bank, Capital Small Finance Bank, Fincare Small Finance Bank, Equitas, ESAF, Suryoday, Ujjivan, Utkarsh, North East Small Finance Bank, and Jana Small Finance Bank. These institutions were created with the goal of meeting the financial needs of people from economically weaker sections of society..[16] The primary objective of setting up these banks is to promote financial inclusion among disadvantaged sections of the population that remain underserved by traditional banking institutions. These groups include small businesses, marginal and small farmers, micro and small enterprises, and those engaged in the unorganized sector. While operating on a smaller scale, Small Finance Banks perform functions similar to commercial banks, with a focused mandate to cater specifically to the needs of the low-income segment. [17] The main source of revenue for a Small Finance Bank comes from extending loans to its target customers. As per requirements, an SFB must ensure that at least fifty percent of its loan portfolio consists of loans and advances of ₹25 lakhs or below. [18] These institutions have been serving unserved and underserved communities across different parts of the country. Granting them a banking license transforms the concept of "Banking for the Unbanked" into a full-fledged financial institution, thereby strengthening their operations. This marks a significant milestone in the journey toward achieving comprehensive financial inclusion..[19]

Materials and Methods

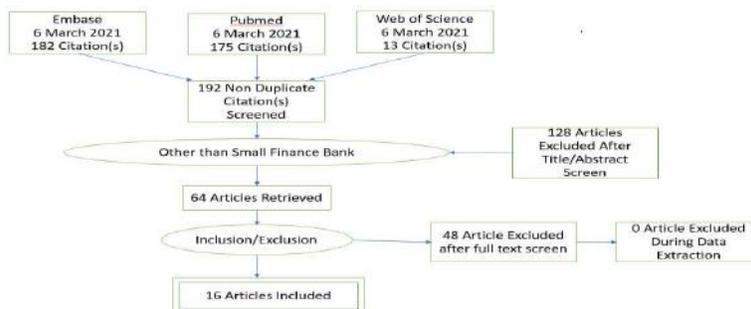


Fig. 1. Flowchart showing the search strategy and inclusion of studies from the peer reviewed data bases.

Table 1: Key Findings: The Role of Small Finance Banks in Promoting Financial Inclusion in India.

Research Type/Name	Study Population and Duration (Abstract what paper is about)	Type of intervention	Outcomes assessed/ Findings	Reference
Assessment of Functions: Small Finance Banks and Their Impact on Financial Inclusion in India.	This article highlights the pursuit of an efficient financial system, under which the Government of India has launched several initiatives, ranging from the Jan Dhan Yojana to granting licenses for local banks to operate as Small Finance Banks in the country.	Review	Small Finance Banks provide the government with an opportunity to extend its outreach, enhance credibility, and effectively implement policies in sectors and regions that remain underserved. The current priorities of the Indian economy are built on four pillars of financial services: awareness, affordability, accessibility, and accountability. By addressing these areas, Small Finance Banks play a vital role in fostering a financially inclusive and resilient economy in India, thereby reinforcing the strong link between financial inclusion and economic growth.	[8]
The Contribution of Small Finance Banks in India towards Financial Inclusion.	This article explores the development and achievements of Small Finance Banks over the years.	Review	Small Finance Banks significantly contribute to promoting financial inclusion in India by situating more than 95% of their branches in rural and semi-urban regions. They provide services to people from diverse economic backgrounds, including low-income groups.	[16]
Small Finance Bank in India: An Initial Analysis of Their Development	This paper highlights the growth of Small Finance Banks (SFBs) in India, focusing on their expansion in branch networks, geographic coverage, and overall scale of operations.	Preliminary Study	With the establishment and growth of Equitas SFB and Capital SFB—pioneering Small Finance Banks that evolved from a Microfinance Institution (MFI) and a Local Area Bank (LAB), respectively—the Southern and Northern regions initially experienced a stronger geographic presence. However, as more SFBs expand into different parts of the country, the distribution is expected to become more balanced by the end of 2020–21. Additionally, this period is projected to witness a greater concentration of branches in semi-urban and rural areas.	[12]
Small Financial Institutions and the Inclusive Development of our Economy	This article examines the significant role played by Small Finance Banks in advancing financial inclusion in India.	Review	Achieving a sustainable balance between long-term viability and the objectives of financial inclusion is essential for the success of specialized banks. The need for a holistic approach to address financial exclusion is increasingly evident. In this regard, banks play a vital role in raising awareness about financial products, offering financial literacy and guidance, supporting money management and debt counseling, fostering a culture of savings, and ensuring access to affordable credit.	[6]
The Emergence and Growth of Small Finance Banks in India: Boosting Financial Inclusion	This research paper analyzes the growth of Small Finance Banks (SFBs) in India and their role in enhancing access to financial services. The study employs a descriptive and analytical approach, utilizing data from multiple sources.	Review	As per the guidelines, Small Finance Banks (SFBs) are required to allocate 75% of their lending to priority sectors. Notably, more than 80% of the loans disbursed by the ten operational SFBs have been directed toward these sectors, with the primary emphasis on Small and Medium-sized Businesses (SMBs), followed by agriculture. This clearly highlights the pivotal role of SFBs in driving financial inclusion. During the fiscal year 2019–20, SFBs reported improved asset quality, leading to significant progress in provisioning and contingency buffers, along with an increase in their Capital to Risk-Weighted Assets Ratio (CRAR). To further strengthen their outreach, the	[18]

			Reserve Bank of India (RBI) introduced multiple measures to enhance the accessibility of these specialized banks. Additionally, the workforce size within these institutions stands as an important indicator of their contribution to economic development and employment generation.	
Leveraging India's Small Finance Bank (SFB) for the Attainment of Financial Inclusion	This study explores various dimensions of financial exclusion, with a particular focus on the critical role of Small Finance Banks in supporting the government's initiatives to enhance financial accessibility. It highlights the importance and relevance of Small Finance Banks in achieving financial inclusion in India, while also addressing the transformative challenges faced by Microfinance Institutions (MFIs) during their transition into Small Finance Banks.	Review	To tap into the vast potential of the rural market, Small Finance Banks must design appropriate products, formulate robust strategies, and build a reliable distribution network to effectively reach prospective customers. Moreover, adopting affordable mobile technology solutions tailored to the requirements of underserved areas is essential.	[19]
Small Finance Banks: An Innovative Categorization of Unique Banking Institutions	The institutions permitted to set up new banks have demonstrated a strong record of success as Microfinance Institutions (MFIs). However, their transition into Small Finance Banks brings notable challenges, especially in managing diverse asset and liability products. At the same time, these challenges open avenues for growth and expansion. This study offers a detailed analysis of the distinct features of the banks established under the Reserve Bank of India's initiative.	Review	Although Small Finance Banks (SFBs) face competition from established universal banks, they also hold the potential to emerge as strong challengers by attracting rural deposits and addressing priority sector obligations more effectively. Many Microfinance Institutions (MFIs) that transitioned into SFBs already possess wide outreach and can restructure their operations to capitalize on the opportunities offered by this new banking model.	[10]
Penetration and Hurdles Encountered by Small Finance Banks in India	This article delves into the growth and expansion of Small Finance Banks across India and examines the challenges they face during this journey.	Review		[15]
Performance of Small Finance Banks: A Preliminary Analysis*	The paper provides an initial evaluation of SFB performance for early policy inputs.	Preliminary Study	The empirical findings indicate that micro-level factors such as efficiency, leverage, liquidity, and banking operations significantly affect the profitability of SFBs in their early years of operation. This may be attributed to the fact that SFBs are established with the primary objective of serving specific underprivileged segments of the population, rather than functioning solely as profit-oriented intermediaries.	[11]

Small Financing Banks – Obstacles and Possibilities	Considering the evolving economic landscape, this article discusses the objectives, challenges, and future prospects of Small Finance Institutions.	Review	Small Finance Banks are poised to play a transformative role in the Indian banking system. They are expected to boost competitiveness and inclusivity in financial services for both borrowers and depositors, while also helping reduce overall banking costs for the wider population. Additionally, the Reserve Bank of India has allowed Small Finance Banks to open accounts through digital signatures and electronic verification, removing the requirement for physical signatures. This advancement simplifies customer onboarding, particularly in remote areas where setting up physical branches may not be practical.	[17]
Evaluating the Credit Risk of Small Finance Banks in India.	By extending their reach and serving a large section of the population, these banks are set to play a vital role in driving the nation's economic growth..	Review	Small-finance banks should strive to improve their current ratio since it will assist them in satisfying their short-term obligations. ii. Customers should invest in banks that offer greater interest yields and are able to refund deposits when necessary. iii. The loan portfolios of small finance institutions should be managed with care. This assists in maintaining a healthy asset turnover ratio. iv. The banks should reduce their operational expenditures if operational expenses comprise a significant portion of total expenses. v. The banks' operational expenditures should facilitate optimal development and upkeep.	[14]
Promoting Financial Inclusion in India: The Role of Small Finance Banks	This paper presents an analysis of the evolution of financial inclusion in India from 1956 to 2016, along with an in-depth review of the rise of new Small Finance Institutions.	Review	The author notes that regardless of their approach, Small Finance Institutions must focus on making borrowing easier, as finance often tends to exploit people. He laughed at the notion of finance being viewed as beneficial. Looking ahead, greater competition in rural banking is expected, compelling existing institutions to adapt to the changing landscape.	[1]

Discussion

However, considering the vast size of the country, having only 10 such banks may be insufficient. To advance financial inclusion nationwide in a meaningful way, a larger number of these banks will be required. The Reserve Bank of India has also expressed its intention to authorize more such banks in the future, depending on the performance of the initial set. These banks are expected to play a significant role in enhancing financial literacy. Furthermore, analyzing financial inclusion across different parameters can provide a more comprehensive understanding of its progress in the country.

Conclusion

Financial literacy plays a vital role in achieving financial inclusion. With the support of Small Finance Banks, the government can organize workshops to educate people on financial matters. The establishment of Small Finance Banks itself reflects the government's strong commitment to this goal and marks a significant step toward its realization. These banks have been authorized to serve underprivileged and marginalized communities, fostering greater competition and inclusivity in banking services for both borrowers and depositors, thereby making banking more accessible to the public.

Additionally, the RBI has allowed Small Finance Banks to open accounts using digital signatures and electronic verification, eliminating the need for physical signatures. This has simplified customer onboarding, particularly in remote areas where establishing physical branches may not be feasible. Hence, financial inclusion is closely linked to economic growth.

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