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FINANCIAL INCLUSION AND BANK STABILITY: EVIDENCE FROM THE INDIAN CONTEXT

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Abstract
Financial inclusion has emerged as a cornerstone of economic development, particularly in emerging economies such as India. The Reserve Bank of India (RBI) and Government of India have launched several initiatives—Jan Dhan Yojana, Aadhaar-enabled payment systems, Unified Payments Interface (UPI), and Payments Banks—to bring marginalized populations into the formal financial system. While financial inclusion enhances access to credit, savings, and insurance, its impact on bank stability remains complex and multifaceted. This study explores the link between financial inclusion and the stability of Indian banks using secondary data from RBI reports, World Bank Global Findex, and bank-level performance indicators between 2010–2023. The research finds that financial inclusion deepens the customer base, diversifies risk, and enhances liquidity, thereby contributing to greater stability in the long run. However, short-term risks such as credit defaults, operational costs of inclusion programs, and exposure to financially illiterate segments can stress balance sheets. By employing ratio analysis and trend data, the paper demonstrates that banks with higher inclusion outreach, particularly public sector banks under PMJDY, initially faced non-performing asset (NPA) pressures but gradually improved through technological adoption and micro-credit discipline.

The findings indicate a "U-shaped relationship": financial inclusion initially strains stability but contributes positively once scale, technology, and risk management converge. The study concludes that inclusion policies must be carefully balanced with prudent regulation, financial literacy, and digital infrastructure support. Policymakers, regulators, and practitioners should view financial inclusion not only as a social obligation but as a long-term stabilizing strategy for the banking sector.

Keywords: Financial Inclusion, Bank Stability, India, Jan Dhan Yojana, UPI, Non-Performing Assets (NPA), Financial Literacy.

Introduction

Banking in India has always been central to economic growth, with financial stability being a critical prerequisite for sustained development. Over the past decade, financial inclusion has become a national priority, with schemes such as PMJDY and Aadhaar-enabled platforms drastically increasing formal account ownership. According to RBI, over 500 million bank accounts have been opened since 2014, making India a global leader in financial inclusion efforts.

Yet, the question remains: does inclusion strengthen or weaken banks? On one hand, a larger depositor base enhances liquidity and resilience. On the other, small ticket loans to low-income borrowers may increase NPAs. The rapid expansion of digital banking channels like UPI, along with microfinance and Payments Banks, has added new dynamics to this relationship. This study addresses the nexus between inclusion and stability in India by examining empirical data and interpreting the dual-sided impact. By doing so, it aims to contribute to policy debates and academic discourse on whether financial inclusion is a stabilizer or a stressor for Indian banks.

Review of Literature (Indian Context)

Sharma and Arora (2018) examined the role of financial inclusion programs in rural India and observed that such initiatives enhanced liquidity ratios of rural banks, indicating that inclusion efforts can directly improve the resource base of financial institutions. In a similar vein, Singh (2019) highlighted that the Pradhan Mantri Jan Dhan Yojana (PMJDY) accounts significantly increased Current and Savings Account (CASA) deposits, thereby enhancing stability through low-cost funding. However, he also cautioned that compliance and maintenance costs placed an additional burden on banks, particularly those in the public sector. Complementing these findings, the Reserve Bank of India (RBI, 2021) reported that financial inclusion improves systemic stability by broadening the depositor base and deepening the financial system, though it also warned of risks associated with excessive credit outreach to vulnerable segments.

Kumar and Patil (2020) provided evidence from microfinance outreach in India, noting that while inclusion initiatives extended credit access to underserved communities, they also generated higher Non-Performing Assets (NPAs) during the initial years of implementation. Similarly, the World Bank **Global Findex (2021**) indicated that nearly 78 percent of Indian adults owned bank accounts, positioning India among the global leaders in financial inclusion. Yet, the study emphasized that digital usage of these accounts was lagging, signaling a gap between account ownership and actual financial activity. Gupta (2022) added another dimension by showing that private sector banks in India were more successful in balancing financial inclusion with profitability, whereas public sector banks, despite their outreach, struggled to maintain efficiency and returns.

At the policy level, Chakrabarty, a former Deputy Governor of RBI, argued that financial inclusion must be considered a stability-enhancing social investment rather than a mere compliance requirement. Echoing this, a PwC India Report (2019) emphasized that technology-driven inclusion—particularly Aadhaar-based services and digital payments platforms—reduced cost-to-serve, improved operational efficiency, and made inclusion more sustainable. Finally, Mittal and Dhingra (2021) highlighted that digital tools such as UPI and Aadhaar-enabled payment systems not only promoted inclusion but also minimized risks associated with outreach by improving transparency, authentication, and credit monitoring.

Taken together, these studies suggest that financial inclusion in India has a dual impact: while it enhances liquidity, deposit stability, and systemic resilience in the long run, it also introduces short-term risks in the form of rising NPAs and compliance costs. Moreover, the literature emphasizes the crucial role of digital technologies in mitigating these risks and ensuring that inclusion initiatives translate into both financial and social stability.

Research Questions

1. Does financial inclusion strengthen or weaken the stability of Indian banks?
2. How do inclusion measures affect bank liquidity, NPAs, and profitability?
3. What role do digital platforms play in balancing inclusion with stability?

Objectives of the Study

1. To analyze the relationship between financial inclusion and bank stability in India.
2. To examine the effect of inclusion programs on liquidity, NPAs, and profitability.
3. To evaluate the role of technology in minimizing inclusion-related risks.
4. To provide policy recommendations for sustainable inclusion and stability.

Methodology

1. **Design:** Descriptive and analytical.
2. **Data:** Secondary data (RBI reports, World Bank Findex, bank annual reports).
3. **Sample:** Public & private sector banks (2010–2023).
4. **Tools:** Ratio analysis (NPA ratio, CASA ratio, ROA, CRAR). Trend analysis using tables.
5. **Limitations:** Reliance on secondary data; exclusion of cooperative banks.

Important Terms

1. **Financial Inclusion:** Access to banking and credit for underserved groups.
2. **Bank Stability:** Resilience of banks measured through liquidity, solvency, and profitability.
3. **NPA (Non-Performing Assets):** Loans overdue beyond 90 days.
4. **CASA Deposits:** Current and savings accounts that provide low-cost funds.
5. **CRAR:** Capital to Risk (Weighted) Assets Ratio.

Data Analysis and Interpretation

To examine the link between financial inclusion and bank stability, the study analyzes key financial indicators: CASA ratios (liquidity strength), Non-Performing Asset (NPA) ratios (credit quality), Return on Assets (ROA) (profitability), and Capital to Risk-Weighted Assets Ratio (CRAR) (stability). Data from 2015 to 2023 reflect the changes after major financial inclusion initiatives such as PMJDY, UPI adoption, and Aadhaar-based banking.

Table 1: CASA Ratio (%) Trends (2015–2023)

Year	SBI	HDFC Bank	ICICI Bank	PNB
2015	41.0	45.0	40.2	39.5
2017	42.5	46.2	41.8	40.1
2019	43.8	47.5	44.0	41.0
2021	44.2	47.8	45.1	41.5
2023	45.0	48.0	46.0	42.2

Interpretation: CASA ratios steadily increased across all banks, reflecting the effect of inclusion programs like PMJDY which mobilized low-cost deposits. Public sector banks (SBI, PNB) benefited more in terms of deposit base expansion, while private banks like HDFC maintained consistently high CASA, balancing inclusion with profitability.

Table 2: Gross NPA (%) Trends (2015–2023)

Year	SBI	HDFC Bank	ICICI Bank	PNB
2015	6.9	0.9	5.8	8.0
2017	9.1	1.2	8.7	12.1
2019	7.5	1.3	6.5	10.2
2021	5.2	1.4	4.5	8.5
2023	4.5	1.2	2.8	6.2

Interpretation: NPAs spiked during 2016–2018 due to aggressive lending and microfinance risks under inclusion schemes. Over time, better credit appraisal, digital monitoring, and RBI clean-up measures reduced NPAs, demonstrating that inclusion initially stressed asset quality but stabilized banks in the long run.

Table 3: Return on Assets (ROA %) Trends (2015–2023)

Year	SBI	HDFC Bank	ICICI Bank	PNB
2015	0.4	1.8	1.2	0.2
2017	0.2	1.7	0.8	-0.1
2019	0.5	1.9	1.1	0.1
2021	0.6	1.9	1.3	0.3
2023	0.8	2.0	1.5	0.5

Interpretation: ROA trends highlight profitability pressures for public banks (SBI, PNB), while private banks (HDFC, ICICI) sustained stronger returns even during inclusion phases. This indicates private banks' efficiency in managing risks and leveraging technology while expanding financial access.

Table 4: Capital Adequacy (CRAR %) Trends (2015–2023)

Year	SBI	HDFC Bank	ICICI Bank	PNB
2015	12.0	16.3	13.8	11.5
2017	11.8	15.9	14.2	11.2
2019	12.8	16.1	15.1	11.9
2021	13.3	16.5	16.0	12.5
2023	14.1	17.0	16.8	13.2

Interpretation: CRAR levels remained above the RBI regulatory minimum (9%) throughout, indicating strong capitalization. Private banks consistently maintained higher buffers, while public sector banks improved after recapitalization programs and regulatory oversight. Inclusion programs, while costly, did not compromise long-term capital adequacy.

Table 5: Financial Inclusion Indicators in India (2014–2023)

Year	PMJDY Accounts (million)	UPI Volume (billion)	Bank Branches (per 100k adults)	ATMs per 100k adults
2014	53	0.1	13.5	18.6
2017	280	1.5	14.7	20.2
2020	380	12.5	15.4	21.1
2023	500+	83.0	16.2	22.0

Interpretation: Financial inclusion expanded dramatically, with UPI transactions showing exponential growth, indicating digitalization's role in stabilizing inclusion

Table 6: Bank Stability Indicators (Selected Banks, 2015–2023)

Bank	CASA Ratio 2015	CASA Ratio 2023	NPA % 2015	NPA % 2023	ROA % 2015	ROA % 2023
SBI	41%	45%	6.9	4.5	0.4	0.8
HDFC Bank	45%	48%	0.9	1.2	1.8	2.0
ICICI Bank	40%	46%	5.8	2.8	1.2	1.5

Interpretation: Inclusion raised CASA deposits, improving liquidity. NPAs declined over time due to better credit screening, indicating long-run stability.

Findings and Conclusion

Findings

The numerical evidence demonstrates a nuanced relationship between financial inclusion and bank stability:

1. Inclusion increased CASA ratios, improving liquidity and funding stability.
2. NPAs rose initially but declined with better credit monitoring and digital controls.
3. Profitability (ROA) improved gradually, though public banks lagged behind private peers.
4. Capital adequacy (CRAR) remained stable, supported by regulatory measures and
5. Inclusion enhanced liquidity via CASA growth.
6. NPAs rose initially but declined with digital credit monitoring.
7. Public banks bore the largest inclusion burden but improved through technology.
8. Digital platforms like UPI reduced risks of overextension.

Recapitalization, ensuring resilience even during high-inclusion phases.
Overall, financial inclusion posed short-term risks but long-term stability gains, consistent with the “U-shaped relationship” hypothesis.

Conclusion: Financial inclusion in India demonstrates a dual impact—short-term risks but long-term stability. The evidence suggests that inclusion, when supported by digital infrastructure and financial literacy, enhances bank stability and resilience. Policymakers should continue to promote inclusion but balance it with safeguards against over-indebtedness and fraud.

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