Financial Inclusion through and Digitalisation of Financial Services:
Assessment and Prospects¹

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Financial Inclusion through and Digitalisation of Financial Services: Assessment and Prospects

Introduction
The world has made considerable progress in financial inclusion and access to financial services have grown significantly. However, there are challenges in bridging the remaining gap mainly on account of last mile connectivity. Besides, the challenge is to make the financial inclusion sustainable by converting access to financial services into meaningful usage of the same. Globally, there is a growing realisation that digital technology can play an effective role in plugging the remaining gaps.

2. What is Financial Inclusion?
Let us have a look at the two important definitions of financial inclusion to understand the objective, scope and approach to financial inclusion in Indian context.
As per the Committee on Financial Inclusion (Chairman: Dr. C. Rangarajan), financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed, by vulnerable groups such as weaker sections and low income groups at an affordable cost.

As the country progressed on the path of financial inclusion the approach to financial inclusion got further refined which is reflected in the definition given by Dr. Raghuram G Rajan, former Governor RBI in his speech on “The Changing Paradigm for Financial Inclusion” on July 18, 2016. According to Dr. Rajan, Financial inclusion is about (a) the broadening of financial services to those people and enterprises who do not have access to financial services sector; (b) the deepening of financial services for those who have minimal financial services; and (c) greater financial literacy and consumer protection so that those who are offered financial products can make appropriate choices.

3. Present Status of Financial Inclusion in India
3.1 Access to financial services
As per the Global Findex Database 2017, the following are key insights on access to financial services in India

- Share of adults with a bank account - more than doubled since 2011 to 80%
- Enabling account ownership among unbanked adults through biometric identification cards was one of the important factors for the increase in the level of inclusion.
- Account ownership : trends in financial inclusion between 2014 and 2017
  - In the poorest 40 percent of households, it rose by more than 30 percentage points among women as well as among adults.
  - In the wealthiest 60 percent of households - it increased by about 20 percentage points among men and among adults.
The launch of PMJDY in 2014 benefited the traditionally excluded groups and helped ensure inclusive growth in account ownership. The status of financial inclusion through

**Chart 1: Access to Financial Services through PMJDY**

![Chart 1](source)

(Source: PMJDY Portal, accessed on February 22, 2020)

**3.2. Roadmap for Provision of Banking Services**

The provision of banking services through banking outlets have increased manifold in the recent years. Table 1 indicates the growth in number of banking outlets (including business correspondents) in villages from 67,694 in March 2010 to 5,97,155 as at the end of March 2019. The business correspondents (BCs) have played an important role in the provision of banking service in villages. The number of such BCs have increased significantly. As on March 2019, BCs were providing banking facilities to 5,41,129 villages. In urban areas, BCs were providing banking facilities to 4,47,170 locations as on March 2019.

**Table 1: Banking outlet data**

<table>
<thead>
<tr>
<th>Banking outlet data</th>
<th>March 2010</th>
<th>March 2018</th>
<th>March 2019</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banking Outlets in Villages – Branches</td>
<td>33,378</td>
<td>50,805</td>
<td>52,489</td>
</tr>
<tr>
<td>Banking Outlets in Villages &gt;2000-BCs</td>
<td>8,390</td>
<td>1,00,802</td>
<td>1,30,687</td>
</tr>
<tr>
<td>Banking Outlets in Villages &lt;2000-BCs</td>
<td>25,784</td>
<td>4,14,515</td>
<td>4,10,442</td>
</tr>
<tr>
<td>Total Banking Outlets in Villages – BCs</td>
<td>34,174</td>
<td>5,15,317</td>
<td>5,41,129</td>
</tr>
<tr>
<td>Banking Outlets in Villages – Other BCs</td>
<td>142</td>
<td>3,425</td>
<td>3,537</td>
</tr>
<tr>
<td>Banking Outlets in Villages – Total</td>
<td>67,694</td>
<td>5,69,547</td>
<td>5,97,155</td>
</tr>
</tbody>
</table>

(Source: Annual Report, RBI, 2019)

It may be observed from the above that India has made considerable progress in financial inclusion both in terms of reach of the banking service points as well as the number of persons having access to the financial services. However, the challenge remains on account of lower
usage of financial services by people who have been provided access to the financial services. In this regard, FinTechs enabled digital financial services can play an effective role.

4. Digital Financial Services

4.1 Digital Financial Services – Definition
Digital financial services (DFS) can be defined as financial operations using digital technology, including electronic money, mobile financial services, online financial services, i-teller and branchless banking, whether through bank or non-bank institutions. DFS can encompass various monetary transactions such as depositing, withdrawing, sending and receiving money, as well as other financial products and services including payment, credit, saving, pensions and insurance. DFS can also include non-transactional services, such as viewing personal financial information through digital devices (G20/OECD INFE, 2017).

4.2 Expansion of Digital Financial Services in India
The Reserve Bank has over the years encouraged greater use of electronic payments so as to achieve a “less-cash” society. In recent years, a focussed effort has been made by the RBI to develop a state of the art national payments infrastructure and technology platforms, be it Immediate Payments Service (IMPS), Unified Payments Interface (UPI), Bharat Interface for Money (BHIM), Bharat Bill Pay System (BBPS), or Aadhaar-enabled Payment System (AePS). This has changed the retail payments scenario of the country.

The preference of mode of transaction during 2016-19 indicates a dramatic shift from the conventional paper based transaction and there too use of (Unified Payment Interface) UPI is remarkably high as shown in the Table 2 below and the Chart 2 & Chart 3.

<table>
<thead>
<tr>
<th>Item</th>
<th>Volume (million)</th>
<th>Value (₹ billion)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Retail Payments</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Total Paper Clearing</td>
<td>1,206.7</td>
<td>1,170.6</td>
</tr>
<tr>
<td>Total Retail Electronic Clearing</td>
<td>4,222.9</td>
<td>6,382.3</td>
</tr>
<tr>
<td>1. ECS DR</td>
<td>8.8</td>
<td>1.5</td>
</tr>
<tr>
<td>2. ECS CR</td>
<td>10.1</td>
<td>6.1</td>
</tr>
<tr>
<td>3. NEFT</td>
<td>1,622.1</td>
<td>1,946.4</td>
</tr>
<tr>
<td>4. IMPS</td>
<td>506.7</td>
<td>1,009.8</td>
</tr>
<tr>
<td>5 UPI</td>
<td>17.9</td>
<td>915.2</td>
</tr>
<tr>
<td>6. NACH</td>
<td>2,057.3</td>
<td>2,503.3</td>
</tr>
<tr>
<td>Total Card Payments</td>
<td>5,450.1</td>
<td>8,207.6</td>
</tr>
<tr>
<td>Total Retail Payments</td>
<td>10,879.7</td>
<td>15,760.5</td>
</tr>
<tr>
<td>Grand Total</td>
<td>10,991.2</td>
<td>15,888.4</td>
</tr>
</tbody>
</table>

Source: Annual Report of RBI
It may be observed from chart 2 that the electronic clearing expanded rapidly during 2016-19 while paper clearing witnessed declining volumes. The value of transactions through electronic clearing also doubled during the period (Chart 3). Chart 4 presents component-wise growth of electronic payments.

**Chart 4 : Electronic Payments (Volume in Mn)**

(Source: RBI Annual Report)

The use of UPI witnessed a geometrical expansion during the period 2016-19 from 17.9 million to 5353.4 million (approx. 300 times) in India.

5. **Issues and Challenges**

The National Strategy on Financial Inclusion has highlighted some issues and challenges in furthering financial inclusion in India. The issues and challenges are mentioned below:
Inadequate Infrastructure: In rural, remote and hilly areas, and Left Wing Extremism (LWE) affected areas, limited physical infrastructure and limited transport facility pose challenges in financial inclusion efforts.

Poor connectivity: The provision of financial services through information and communication technology based models is one of the effective ways of achieving financial inclusion. However, in rural, remote and hilly areas and LWE affected areas, limited tele and internet connectivity affect provision of digital financial services and operations of business correspondents.

Convenience and Relevance: The on-boarding procedures act as a deterrent, particularly when the financial literacy levels are low or when the products are not easy to understand. It can also happen if the products do not meet the requirements of the customers, e.g. micro entrepreneurs whose cash flows are uncertain.

Socio-Cultural Barriers: There are certain value system and beliefs in some sections of the population which result in lack of favourable attitude towards formal financial services. In some sections of the society women have limited freedom and choice to access financial services because of cultural barriers.

Product Usage: As per the estimates given in World Findex Database 2017, while the gap in access to financial services in India has shrunk to 20%, almost half of account owners had an account that remained inactive in the preceding year. The usage of financial services need to be increased with enhanced adoption of digital financial services. The convergence of financial inclusion efforts with the skill development and livelihood programmes and efforts to increase financial literacy would also help in increase in usage.

Payment Infrastructure: There is also a need to promote innovation & competition in respect of payment products and infrastructure to accelerate digital financial inclusion.

6. Conclusion
We have seen from the data presented in the preceding paragraphs that during the recent years the technology has evolved rapidly and the domain of digital financial services has seen expansion. There are non-bank entities (mainly FinTechs) operating in this domain and collaborating as well as competing with banks. These non-bank entities are operating either as technology service providers to banks or directly providing retail electronic payment services. The RBI has provided appropriate enabling regulatory framework to encourage enhanced participation of non-bank entities in the payments domain.

As per the estimates given in World Findex Database 2017, while the gap in access to financial services in India has shrunk to 20%, almost half of account owners had an account that remained inactive in the preceding year. The challenge presents an opportunity to the digital
financial services provider to expand the account access and enhance usage. The proliferation of digital financial services in India has helped FinTechs play an important role in financial inclusion. We shall cover the role played by non-bank entities in the next pre-read material covering the role of FinTechs in financial inclusion.
Electronic Payments (Notes to Chart 4)

NACH: “National Automated Clearing House (NACH)” is a service which includes both Debit and Credit. It facilitates interbank high volume, low value debit/credit transactions, which are repetitive in nature, electronically using the NPCI service.

UPI: Unified Payments Interface (UPI) is an instant payment system developed by the National Payments Corporation of India (NPCI), an RBI regulated entity. UPI is built over the IMPS infrastructure and allows you to instantly transfer money between any two parties’ bank accounts.

IMPS: IMPS provides real time fund transfer which offers an instant, 24X7, interbank electronic fund transfer service that could be accessed on multiple channels like Mobile, Internet, ATM, SMS, Branch and USSD(*99#). IMPS is allows instant transfer of funds within banks across India which is not only safe but also economical. This facility is provided by NPCI through its existing NFS switch.

NEFT: National Electronic Funds Transfer (NEFT) is a nation-wide centralised payment system owned and operated by the Reserve Bank of India (RBI). NEFT offers the following advantages for funds transfer or receipt:

- Round the clock availability on all days of the year
- Near-real-time funds transfer to the beneficiary account and settlement in a secure manner
- Pan-India coverage through large network of branches of all types of banks
- Positive confirmation to the remitter by SMS / e-mail on credit to beneficiary account
- Penal interest provision for delay in credit or return of transactions
- No levy of charges by RBI from banks
- No charges to savings bank account customers for online NEFT transactions
- Besides funds transfer, NEFT system can be used for a variety of transactions including payment of credit card dues to the card issuing banks, payment of loan EMI, inward foreign exchange remittances, etc.
- Available for one-way funds transfers from India to Nepal

ECS: ECS is an electronic mode of payment / receipt for transactions that are repetitive and periodic in nature. ECS is used by institutions for making bulk payment of amounts towards distribution of dividend, interest, salary, pension, etc., or for bulk collection of amounts towards telephone / electricity / water dues, cess / tax collections, loan instalment repayments, periodic investments in mutual funds, insurance premium etc. Essentially, ECS facilitates bulk transfer of monies from one bank account to many bank accounts or vice versa.
References:

2. OECD, G20/OECD INFE Policy Guidance Digitalisation and Financial Literacy, 2018
5. PMJDY portal