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Original Article

The Role of Urban Cooperative Banks in Financial Inclusion and Economic Development: An Empirical Analysis of the Indian Context

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Abstract: *India's banking system is a layered, complex structure, where Urban Cooperative Banks (UCBs) hold a distinctive and vital position. Unlike traditional commercial banks focused on profit, UCBs are founded on cooperative principles emphasizing mutual support and democratic governance, making them naturally aligned with the goal of financial inclusion. This study delves into the diverse roles UCBs play in advancing financial inclusion and driving economic growth in India, with a specific focus on the years 2021 to 2025. Drawing on secondary data from sources like the Reserve Bank of India (RBI), the Press Information Bureau (PIB), and scholarly journals, the research examines the sector's growth, financial stability, and inclusion indicators. The findings reveal a robust performance by UCBs, marked by better asset quality-evidenced by a decline in the Gross Non-Performing Assets (GNPA) ratio to 6.2% by FY25. Additionally, the sector saw healthy credit growth of 6.7% and deposit growth of 5.2%, outperforming previous years. UCBs have also made notable contributions to the national Financial Inclusion Index (FI-Index), which reached 67.0 in March 2025. By extending affordable loans to Micro, Small, and Medium Enterprises (MSMEs) and the informal sector, UCBs act as important drivers of local economic progress. Nonetheless, challenges persist, including governance complexities, technological shortcomings, and rising competition from Small Finance Banks (SFBs). The paper concludes with policy recommendations aimed at reinforcing regulatory frameworks and enhancing technological capabilities to ensure UCBs remain pivotal in India's economic journey toward becoming a $5 trillion economy.*

Keywords: *Urban Cooperative Banks, Financial Inclusion, Economic Development, India, RBI, MSMEs, FI-Index.*

I. INTRODUCTION

Financial inclusion has shifted from a policy goal to a cornerstone of India’s economic strategy. At its essence, financial inclusion means making appropriate financial products and services accessible to every segment of society-especially vulnerable and low-income groups-affordably and transparently through mainstream institutions. Given India’s vast and diverse population, achieving universal inclusion is a monumental challenge that requires cooperation among various financial entities such as public and private banks, Regional Rural Banks (RRBs), and Cooperative Banks. Among these, Urban Cooperative Banks (UCBs) stand out because of their community-based roots, localized focus, and commitment to serving the “common man.”

UCBs, or Primary Cooperative Banks, are registered under State Cooperative Societies Acts or the Multi-State Cooperative Societies Act. Their uniqueness lies in their cooperative ethos-truly “of the people, by the people, for the people.” Unlike commercial banks driven by shareholder profits, UCBs prioritize service to their members. This member-first approach helps them overcome information gaps that often deter larger banks from lending to small entrepreneurs, artisans, and low-income urban households.

The origins of UCBs in India trace back to the late 19th century, inspired by successful cooperative movements in Britain and Germany. The establishment of Anyonya Sahakari Mandali in Baroda in 1889 marked the beginning of urban cooperative credit in India. Since then, the sector has evolved through numerous regulatory and economic changes and is now a crucial part of the urban financial landscape, offering a spectrum of services tailored to local businesses-from savings accounts to specialized credit products.

The connection between UCBs and economic development is deep. By pooling local savings and recycling them as credit within the community, UCBs create a virtuous cycle of investment and growth. They are key financiers of the informal sector and MSMEs, which form the backbone of India’s economy by contributing significantly to GDP and employment. Moreover, UCBs play an essential role in implementing government financial inclusion initiatives like the Pradhan Mantri Jan

Dhan Yojana (PMJDY), Pradhan Mantri Suraksha Bima Yojana (PMSBY), and Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY).

However, the sector faces notable challenges. The dual regulatory control by State Governments (for incorporation, management, and audit) and the RBI (for banking functions) has created overlaps and governance difficulties. Recently, the RBI has taken steps to streamline oversight, including introducing a four-tier regulatory framework and the Prompt Corrective Action (PCA) framework, aiming to bolster the financial resilience of UCBs while preserving their cooperative spirit.

This paper aims to thoroughly analyze UCBs' role in financial inclusion and economic development in contemporary India. Using secondary data and empirical evidence, this study addresses the following key questions:

1. How has the UCB sector performed in growth and financial stability during the post-pandemic period (2021-2025)?
2. To what extent have UCBs contributed to national financial inclusion goals as reflected by the FI-Index and other metrics?
3. What impact does UCB lending have on local economic development, especially for MSMEs and the informal sector?
4. What major challenges confront the UCB sector, and how can policy interventions effectively address them?

II. LITERATURE REVIEW

The role of Urban Cooperative Banks within India's financial system has been widely studied and debated. This section reviews their historical development, key regulatory milestones, and recent empirical research focusing on their contribution to financial inclusion and economic growth, with an emphasis on studies from 2023 to 2025.

A) Historical Evolution of UCBs in India

The cooperative movement in India was initiated to shield small borrowers from exploitative moneylenders. The first urban cooperative credit society, Anyonya Sahakari Mandali, was founded in Baroda in 1889. This success prompted the Cooperative Credit Societies Act of 1904, providing legal backing for cooperative formation. While initially focusing on rural credit, urban cooperative banking grew notably in Maharashtra, Gujarat, and Karnataka.

Post-independence, the sector expanded considerably. The RBI gained regulatory authority over UCBs through the 1949 Banking Regulation Act (applied to cooperative societies from 1966), ushering in a dual-control system shared with State Governments. Various committees have reviewed UCB performance and regulations over the years, such as the Madhava Das Committee (1978) promoting expansion into unbanked urban areas, the Marathe Committee (1992) recommending more liberal licensing, and the Madhava Rao Committee (1999) calling for stricter entry norms and prudential standards amid governance concerns.

B) Regulatory Milestones and the 2024 PCA Framework

In recent years, the regulatory framework has evolved significantly. The 2020 Banking Regulation (Amendment) Act empowered the RBI with greater control over UCBs, including superseding boards and initiating resolution for failing banks-addressing the dual-control challenge and aligning UCB regulation closer to commercial banks.

In July 2024, the RBI introduced an updated Prompt Corrective Action (PCA) framework effective April 2025. This framework identifies financially weak UCBs early and triggers corrective measures, based on indicators like Capital to Risk-weighted Assets Ratio (CRAR), Net Non-Performing Assets (NNPA), and Return on Assets (ROA). This ensures stronger financial health and depositors' protection.

A four-tier regulatory structure based on deposit size was also introduced:

- Tier 1: Deposits up to ₹100 crore
- Tier 2: ₹100 crore to ₹1,000 crore
- Tier 3: ₹1,000 crore to ₹10,000 crore
- Tier 4: Above ₹10,000 crore

This tiered system applies proportional regulation, easing smaller UCBs' compliance burdens while imposing stricter norms on larger banks.

C) Recent Empirical Studies (2023–2025)

Contemporary research emphasizes digital transformation and governance challenges. Agarwala (2023) highlights UCBs' potential as intermediaries enhancing access to banking and credit for low-income urban households and small businesses, while noting disparities due to capital constraints and governance issues.

Gautam (2024) finds that UCBs with sound governance and technology adoption deliver better transaction costs and reliable financial products, boosting inclusion indicators. Yet, structural weaknesses remain, particularly in managing non-performing assets and complying with dual regulatory systems.

Prasuna (2024) investigates financial inclusion intensity, showing UCBs as critical contact points for clients often excluded from commercial banks due to small transaction sizes or irregular payments.

Apte and Nerlekar (2024) discuss digitalization's uneven impact, with larger UCBs successfully integrating digital payments, while smaller banks struggle with compliance costs and regulatory pressures.

Kumar and Chauhan (2025) conclude that UCBs complement India's broader financial inclusion efforts, especially post-2015, by expanding formal saving tools and reducing dependence on informal credit sources in urban and semi-urban areas.

III. METHODOLOGY

This research paper employs a descriptive and analytical research design to explore the role of Urban Cooperative Banks (UCBs) in financial inclusion and economic development in India. The study is primarily based on secondary data, which is analyzed to identify trends, patterns, and relationships within the UCB sector.

A) Data Sources

Data were sourced from:

- Reserve Bank of India (RBI) reports and statistical tables (2021-2025)
- Press Information Bureau (PIB) releases from the Ministry of Finance and Cooperation
- NABARD reports on cooperative banking
- Academic journals such as Economic and Political Weekly, Journal of Cooperative Management
- RBI's Financial Inclusion Index (FI-Index) data, covering Access, Usage, and Quality sub-indices

B) Study Period

The study focuses on the period from 2021 to 2025. This period is particularly significant as it covers the post-pandemic recovery phase, during which the Indian banking sector underwent significant technological and regulatory transformations. The inclusion of data up to March 2025 allows for a contemporary analysis of the UCB sector's performance and its contribution to the national financial inclusion goals.

C) Analytical Framework

The data analysis employs:

- Trend Analysis to track growth in UCB numbers, deposits, and credit
- Ratio Analysis using Credit-Deposit (CD) ratio, Gross and Net Non-Performing Assets (GNPA/NNPA) ratios to gauge financial health
- Comparative Analysis contrasting UCBs with Scheduled Commercial Banks (SCBs) and Small Finance Banks (SFBs) where relevant
- Descriptive Statistics to summarize data with means, growth rates, and percentages clearly

IV. RESULTS AND ANALYSIS

A) Structural Overview

The UCB sector has consolidated and undergone regulatory refinement, with total UCBs declining from 1,926 in 2004 to 1,457 by March 2025. This reduction stems from RBI-driven mergers and license cancellations for non-viable banks.

Table 1: Number of Urban Cooperative Banks in India (2021-2025)

Year (As of March)	Scheduled UCBs	Non-Scheduled UCBs	Total UCBs
2021	53	1,481	1,534
2022	52	1,459	1,511
2023	51	1,438	1,489
2024	49	1,418	1,467
2025	24	1,433	1,457

Source: *Compiled from RBI Annual Reports and PIB releases.*

The steep drop in Scheduled UCBs in 2025 highlights RBI's stringent scheduling standards and sector consolidation. Despite fewer banks, the sector's reach and impact have grown, with stronger institutions emerging.

B) Financial Performance: Deposits and Credit Growth

Post-pandemic, UCBs showed steady gains in deposits and credit. Deposits grew to 5.2% in FY25 from 4.1% the year before, totaling ₹5.84 lakh crore.

Table 2: Deposit and Credit Growth of UCBs (2021-2025)

Year (FY)	Deposit Growth (%)	Credit Growth (%)	Credit-Deposit (CD) Ratio (%)
2021	3.8	4.2	61.5
2022	4.0	4.5	61.8
2023	4.2	5.0	62.1
2024	4.1	5.2	62.4
2025	5.2	6.7	63.3

Source: *Compiled from RBI Trends and Progress of Banking in India Reports.*

Credit growth reaching 6.7% in FY25 underscores UCBs' pivotal role in economic recovery. The rising Credit-Deposit ratio to 63.3% shows improved efficiency in channeling deposits into productive lending.

C) Asset Quality: Non-Performing Assets Trends

UCBs have significantly improved asset quality, with GNPA ratios steadily falling from double digits.

Table 3: Asset Quality Metrics of UCBs (2021-2025)

Year (As of March)	Gross NPA (GNPA) Ratio (%)	Net NPA (NNPA) Ratio (%)	Provision Coverage Ratio (PCR) (%)
2021	11.3	5.8	52.4
2022	10.5	5.2	55.6
2023	8.7	4.1	60.2
2024	7.5	3.2	64.8
2025	6.2	2.5	68.5

Source: *Compiled from RBI Reports and News Analysis.*

The drop to 6.2% GNPA by March 2025 reflects better credit appraisal and recovery, supported by RBI's proactive supervision. A higher Provision Coverage Ratio (68.5%) means UCBs are better equipped to absorb losses, enhancing stability.

D) Contribution to Financial Inclusion

a. Financial Inclusion Index (FI-Index)

The RBI's FI-Index, measuring inclusion on a 0-100 scale based on Access (35%), Usage (45%), and Quality (20%), has steadily improved.

Table 4: Financial Inclusion Index (FI-Index) Trends (2021-2025)

Year (As of March)	FI-Index Value	Annual Growth (%)
2021	53.9	-
2022	56.4	4.6
2023	60.1	6.6
2024	64.2	6.8
2025	67.0	4.4

Source: *RBI Press Releases and PIB.*

This upward trend signifies growing financial inclusion momentum, with UCBs playing a crucial role-especially in expanding access and usage among urban and semi-urban populations by offering basic banking to the unbanked and underbanked.

V. DISCUSSION

The data paints a compelling picture of UCBs as resilient, transformative agents in India's financial and economic fabric. This discussion explores their local strengths, technological advances, and the governance and regulatory hurdles ahead.

A) The "Local" Advantage: Relationship Banking and Community Trust

UCBs' success in inclusion and development is rooted in their close community ties. Unlike large commercial banks relying on standardized credit models and centralized decisions, UCBs emphasize relationship banking and social collateral. This personalized approach helps overcome information gaps that typically bar small borrowers from formal credit.

Situated in urban and semi-urban centers, UCBs deeply understand local economies, small business needs, and borrower creditworthiness. This proximity allows tailored credit products and flexible repayment plans aligned with MSMEs' cash flows. The cooperative framework also fosters ownership and trust among members, encouraging savings and timely loan repayments.

B) Technological Transformation: Bridging the Digital Divide

Between 2021 and 2025, the Urban Cooperative Bank (UCB) sector in India has undergone a remarkable technological transformation. This shift has been largely driven by regulatory mandates from the Reserve Bank of India (RBI) and mounting competition from digital-first banks. Many UCBs have embraced modern banking technologies such as Core Banking Solutions (CBS), mobile banking applications, and digital payment platforms. This technological advancement has played a pivotal role in accelerating financial inclusion by enabling UCBs to offer contemporary, accessible, and cost-effective banking services to their members.

Beyond enhancing customer convenience, technology adoption has significantly boosted operational efficiency within UCBs. Automated credit appraisal systems have streamlined loan evaluations, while real-time monitoring of loan accounts has strengthened risk management and contributed to better asset quality. Moreover, UCBs' integration with the Unified Payments Interface (UPI) and other digital payment ecosystems has empowered their members to engage more actively in India's formal digital economy. This integration has positively influenced key financial inclusion metrics, especially the "Usage" and "Quality" components of the national Financial Inclusion Index (FI-Index), reflecting both higher transaction volumes and improved service standards.

VI. CONCLUSION AND RECOMMENDATIONS

Since their inception in the late 19th century, Urban Cooperative Banks have evolved into a cornerstone of India's financial framework. Today, they are indispensable players in the country's quest for inclusive growth, providing crucial banking services that promote financial inclusion and stimulate economic development at the grassroots level. This research has examined the contemporary performance and impact of UCBs, highlighting their resilience amid challenges, their significant contributions toward national financial inclusion objectives, and the obstacles they continue to face.

A) Summary of Findings

- **Resilient Performance:** Despite the ongoing pressures of the post-pandemic economic environment and tighter regulatory scrutiny, UCBs have demonstrated steady and robust growth. Deposits grew by 5.2% in FY25, while credit expansion reached 6.7% during the same period, signaling increased trust and activity within the sector.
- **Improved Asset Quality:** There has been a marked improvement in the financial health of UCBs, with the Gross Non-Performing Assets (GNPA) ratio dropping to a commendable 6.2% by March 2025. This reflects enhanced credit evaluation and recovery processes.
- **Contribution to Financial Inclusion:** UCBs have played a vital role in elevating the national Financial Inclusion Index (FI-Index), which climbed to 67.0 in 2025. Their extensive outreach in urban and semi-urban areas has been instrumental in bringing banking services to underserved populations.
- **Economic Development Impact:** The credit extended by UCBs to Micro, Small, and Medium Enterprises (MSMEs) and informal sector businesses has spurred local economic growth, fostering entrepreneurship and employment generation.
- **Technological and Regulatory Challenges:** While significant progress has been made in adopting new technologies, a digital divide persists, particularly among smaller UCBs that face resource constraints. Additionally, governance and regulatory complexities continue to pose challenges.

B) Policy Recommendations

- **Accelerate Consolidation:** The RBI should persist in encouraging the consolidation of weaker UCBs through mergers and acquisitions by stronger institutions to build a more resilient and efficient sector.
- **Technological Support for Smaller UCBs:** Recognizing the resource limitations of smaller UCBs, the government and RBI should offer targeted financial aid and technical assistance to help them adopt and maintain modern banking technologies.
- **Governance Reforms:** There is an urgent need for comprehensive governance reforms within the UCB sector to improve transparency, accountability, and operational efficiency.
- **Capital Infusion and Resource Mobilization:** UCBs should be motivated and supported to explore innovative avenues for capital raising, including partnerships, equity instruments, and other financial mechanisms.
- **Capacity Building and Training:** Regular, structured training programs must be implemented for UCB staff and management to enhance their skills in areas such as risk management, technology use, and customer service, ensuring the sector's sustainability and growth.

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