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FINANCIAL INCLUSION –CONCEPTUAL STUDY ON THE FUNCTIONS OF SMALL FINANCE BANKS

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ABSTRACT

In India, extending the banking services to the underserved and unserved sections of the society has been posing a challenge. Therefore, the concept of Small Finance Bank was concocted to address such challenge and recommended by the NachiketMor committee on financial inclusion. In tune with the Central Budget 2014-15, RBI has started licensing small banks and other differentiated banks in anticipation that they would cater to the credit needs of small businesses, unorganized sector, low income households, farmers and migrant work force. This study, in a nutshell, attempts to analyze the various parameters in the operations of the Small Finance Banks.

Keywords: Small Finance Bank, Indian Economy financial inclusion, low income, migrant work force

Introduction

An effort to find out the efficacy of small banks in India was made in pursuance of an announcement made by Shri P.Chidambaram, Hon'ble Finance Minister in the Union Budget on 22nd July, 1996. Accordingly, it was conceived that setting up of new private local area banks (Local Area Banks) primarily in rural and semi-urban areas with jurisdiction over two or three contiguous districts would be low cost structures and they would enable mobilisation of rural savings by local institutions, which would be made available for providing competitive and efficient financial intermediation in the same local areas.It is seen that the concept of LABs did not gather momentum, as contemplated, as even over about 2½ decades only three LABs are functioning now. The reasons for such fall out may be smallness in size, converged ownership, concentration risks, locational disadvantage, problems in retaining competent management and professional staff. The growth of LABs is highly negligible. Probably to overcome some or all of the problems, with LABs, a slightly upgraded model was developed as "Small Finance Banks"

As per the release by RBI in February, 2015, 72 entities had applied for Small Finance Bank licenses. RBI, on 17thSeptember 2015, announced that it had granted provisional licenses to ten entities, which should convert into small finance banks within a year. Out of these ten entities, eight were then existing NBFCs, in the microfinance fields. Effectively, there are only two additional entities, in this new concept. Capital Finance Bank was the first one that started as a small finance bank.

Concept of Small Finance Bank

The SFBs are to be registered as public limited companies under the Companies Act, 2013. As in the case of a normal bank, the SFBs will be licensed under Section 22 of the Banking Regulation Act, 1949 and governed by the provisions of the Banking Regulation Act, 1949; Reserve Bank of India Act, 1934; Foreign Exchange Management Act, 1999; Payment and Settlement Systems Act, 2007; Credit Information Companies (Regulation) Act, 2005; Deposit Insurance and Credit Guarantee Corporation Act, 1961; other relevant Statutes and the Directives, Prudential Regulations and other Guidelines/ Instructions issued by Reserve Bank of India (RBI) and other regulators from time to time. Also, the SFBs will become scheduled banks, once they commence their operations. SFBs can also become Authorised Dealers (Category II) in foreign exchange business for their clients' need. Small Finance Banks have to follow all the norms and regulations applicable to commercial banks like maintenance of Cash Reserve Ratio, Statutory Liquidity Ratio. Small Finance Banks are required to give 75% of their Adjusted Net Bank Credit to priority sector and 50% of its loan portfolio should be loans and advances below Rs. 25 lakhs. The minimum paid up equity capital is Rs.100 crores. The promoter's stakes should be 40% minimum that must be brought down to 26% in 12 years. The maximum loan size and invest limit to any individual or a group cannot be more than 10 percent and 15 percent of capital funds of these banks. After establishing satisfactory track record a small finance banks will be eligible to convert itself into universal bank but policies and parameters will be decided by Reserve Bank of India.

Need for the Study

As per the Central Budget 2014-15, while on the one hand, the Central Government is for consolidation of many Public Sector Banks into a very few Public Sector banks to strengthen the operational efficacy and increase the global competitiveness of Indian Banks, on the other hand it has taken a diagonally opposite decision of licensing small banks and other differentiated banks.

Small Finance Bank, listed as Scheduled Bank under the Reserve Bank of India Act, 1934, is all the more a normal bank with core functions like accepting deposits, lending, etc., however, with various additional conditions right from their formation (like minimum capital requirement Rs.100 crores) till their day to day performance like focusing more (75%) on priority sector lending, curb on issue of credit cards. While the object of formation of Small Finance Banks is noble and though the idea of forming Small Finance Bank is hatched from the Budget of the Central Government, it is skeptical as to whether their performances and achievements are satisfactory and sufficient, in the real sense of the term; however, their progress is far better than that of the LABs. In the banking system, the ratios relating to the core business of banking i.e.

deposits and advances of small finance banks are negligibly just in the range of 1% with 4486 branches, as of 31st March, 2020, representing just 3.02% of the branches of all scheduled commercial banks.

Scope of study

Probably to overcome some or all of the problems, with LABs, a slightly upgraded model was developed as "Small Finance Banks" The Small Finance Banks may be considered as an extension of the LABs, except, *inter alia*, the former's freedom to open branches, throughout India. In 2014, RBI has permitted LABs to be converted into Small Finance Banks subject to them meeting the prescribed eligibility criteria. But, the LABs did not opt to utilise this opportunity.

It is pertinent to point out, at this point, that the concept of small banks as differentiated banks is not altogether new as UCBs (Urban Co Operative Banks), PACs (Primary Agricultural Credit Societies), RRBs (Regional Rural Banks) and LABs (Local Area Banks) are already functioning and they may be deemed as differentiated banks. Further, the existing banks, themselves, with their sizeable rural presence are carrying out, besides the core banking services, the functions, expected of Small Finance Banks to a great extent. Nidhi companies, lending 100% against securities – jewellery, house property documents, life insurance policies, etc., also play a similar role, though they cannot be equated with banks.

Objectives

- To analyze the efficacy of the performance of Small Finance Banks.
- To know about the special features of small finance banks with respect to their banking network, interest rates on deposits, interest rates on loans and advances, priority sector lending,
- To understand about the importance of Small finance Banks by doing comparative study of Small Finance Banks with nationalised and private banks.

Research Methodology

The main objective is to know about the contribution by Small Financé Banks in Indian Economy and also to find out their performance, in comparison with some other category of banks. The nature of research design is a descriptive one. The sources of secondary data are website of RBI, web sites of SFBs, articles and journals.

Sample size:

State of Tamilnadu hosts the maximum number (716) of branches of all Small Finance Banks, representing 16.60% of share in total network of branches. Further, there are two Small Finance Banks with headquarters at Chennai, Tamilnadu. Of which, Equitas Small Finance Bank, has been chosen for the study and the other Small Finance Bank i.e. ESAF Small Finance Bank is not considered for the study since its Corporate Office is in Trissur, Kerala. In accomplishing the study, comparison has been made with the performance anationalised bank and a private sector bank, both of which are head-quartered in the same State of Tamilnadu.

Sample Unit

Tiruchirappalli District, in the central part of Tamilnadu, has been taken up to study about the branch net-work of SFBs. It may safely be presumed that this pattern will mostly repeat in all other places, where the branches or SFBs are scattered.

Limitation of the Study

The analysis in this study is limited in view of the difficulties, apprehended in collection of primary data due to the onslaught of the COVID -19 epidemic and the data collected are from the reliable sources like various pages of the websites of Reserve Bank of India, respective banks and individual experience of some customers of the banks. Such details have been collated to coin various tables. Apple to apple comparison of certain items of study is not possible, in all cases. In certain cases, details/ corresponding data relating to RRBs/ LABs/ Foreign Banks are not available. However, it is firmly opined that those details will hardly distort this study and resultant observations/ conclusions/ suggestions.

Review of Literature

- Abijith S and Raghavendra N,(2018), **"An Empirical Study on Selected Small Finance Bank in Mysuru with reference to Micro, Small and Medium Enterprises"**, presented the introduction, functions, challenges and role of Small Finance Banks and also presented the awareness level of customers.
- JeebanJyotin Mohanty (2018) "**Leveraging small financial banks (SFB) in achieving Financial Inclusion in India"** focused the need and importance of small financial banks. In his study, he analysed that Small financial bank has huge potential in unbanked and underserved areas and has a major role in development of Micro Small and Medium Enterprises sector.
- Viswan M G (2017) **"A study on the awareness and perception about small financial bank with special reference to ESAF small financial bank**" focused the awareness level of rural people about small financial banks and operation of small financial banks in Kerala. Primary and secondary data were collected. The findings of the study were to find the weak areas for the economic developments.

DATA ANALYSIS AND INTERPRETATIONS

Table 1.Population Group wise comparison of Functioning offices of Small Finance Banks with all SCBs

Quarter ending	Rural	Rural/ All SCBs	Semi-urban	Semi-urban/ All SCBs	Urban	Urban/ All SCBs	Metro-politan	Metro-politan/ All SCBs	Total	Total/ All SCBs
30-09-2020	840	1.60%	1799	4.1%	1218	3.97%	919	2.91%	4776	3.02%
31-03-2020	826	1.57%	1701	3.9%	1132	3.80%	827	2.63%	4486	2.87%
31-03-2019	678	1.31%	1264	3.0%	839	2.92%	632	2.08%	3413	2.24%

Source: websites of SFBs

The above table reveals that the branch expansion of LABs over tenure of 2½ decades is not perceptible, the total functioning offices of SFBs' strength as of 30-09-2020 is just 3.02% of all Scheduled Commercial Banks.

Chart I – Population Group wise comparison of Functioning offices of Small Finance Banks with all SCBs (in percentage)

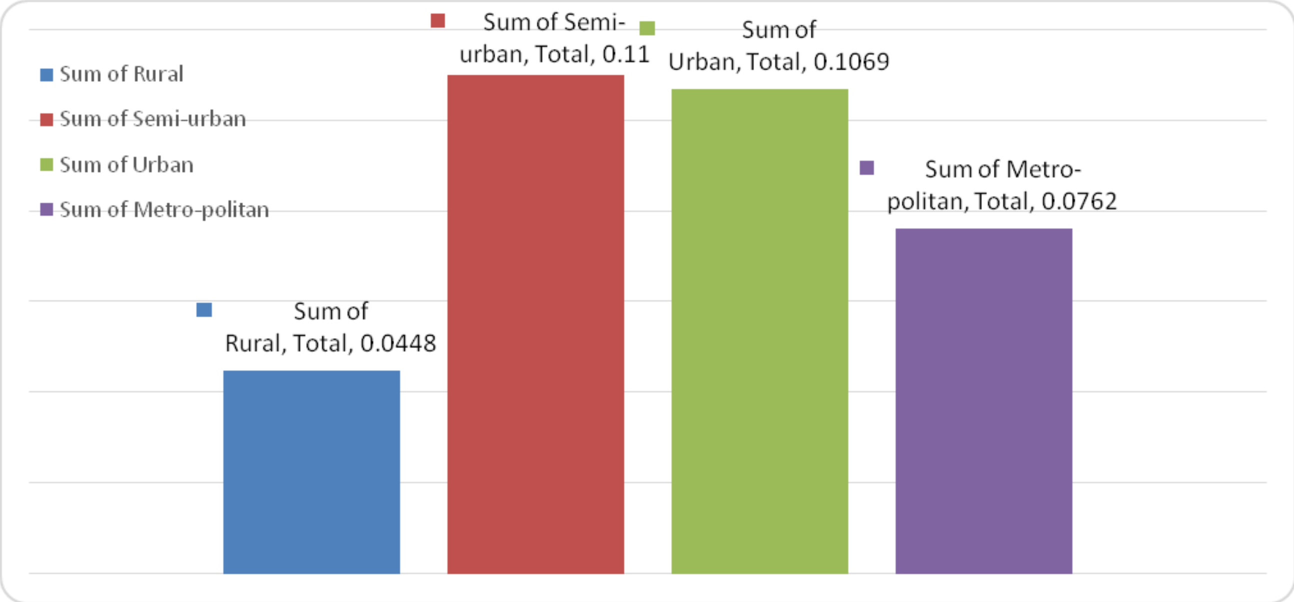

Table 2: POPULATION GROUP-WISE NUMBER OF FUNCTIONING OFFICES OF SMALL FINANCE BANKS

Quarter ending	Rural/ Total	Semi-urban/ Total	Urban/ Total	Metropolitan/ Total
30-09-2020	17.59%	37.67%	25.50%	19.24%
30-06-2020	18.25%	37.99%	25.24%	18.52%
31-03-2020	18.41%	37.92%	25.23%	18.44%
31-03-2019	19.87%	37.03%	24.58%	18.52%

Source: Websites of SFBs

Note: Functioning offices, besides branches include Head Office, Zonal Office, Regional Office, Area Office, Service Branch

From the above table,it is observed that the operation of SFBs in rural areas is less than the operations in Semi-Urban, Urban and Metropolitan area.

Table 3:Distribution of the Branches of Equitas Small FinanceBanks in Tiruchirappalli.

SL. NO.	BRANCH	DATE OF OPENING	PHYSICAL LOCATION	DISTANCE APART
1	THILLAI NAGAR	19-Dec-16	THILLAI NAGAR	1 km
2	TRICHY	31-Dec-19	THILLAI NAGAR	1 km
3	SRIRANGAM	28-Nov-16	SRIRANGAM	2 kms
4	SRIRANGAM	22-Mar-19	TIRUVANAIKOIL	2 kms
5	KATTUR	31-Oct-16	TANJORE MAIN ROAD	2 kms
6	ARIYAMANGALAM	22-Mar-19	TANJORE MAIN ROAD	2 kms
7	CANTONMENT	22-Mar-19	CANTONMENT	5 kms
8	K K NAGAR TRICHY	22-Mar-19	K K NAGAR	5 kms
9	WORIYUR	22-Mar-19	WORIYUR	5 kms
10	TRICHY II	31-Dec-19	BIKSHANDARKOIL	5 kms

Source: Website of Equitas Banks

It may be observed from the above Table that in Tiruchirappalli, in all the mentioned places, there is at least one bank branch; in some locations, one branch of another SFB itself is there and in some rare cases in the very same complex. This, probably, may be taken as the representative of the distribution of branches of SFBs. Though there are many unbanked areas in many Tehsils/ blocks in Tiruchirappalli District, the inclination of the bank managements is to concentrate in the cluster areas only, probably in view of the inherent commercial character of SFBs to maximise profit.

Table 4: Total Number of EQUITAS SFBBranches in Tamil Nadu

Population Group	No. of branches	Percentage to total no. of branches
Rural	88	10.07%
Urban	287	32.84%
Semi-urban	298	34.10%
Metropolitan	201	23.00%
	874	100.00%

Source: Website of Equitas SFB

From the above table, it is observed that out of 874 Branches of Equitas SFBs in Tamil Nadu it operates 88 branches alone in rural Areas - a meager 10.07%. The overall rural presence is less than 25%.

Table 5: Total Number of Branches of Equitas Small Finance Bank in Trichirappalli District

Population Group	No. of branches	% to total number of branches in the district
Rural	3	15.00%
Semi-urban	8	40.00%
Urban	9	45.00%
		100.00%

From the above tables, it may be inferred that the SFBs are commercial institutions and as such are no exclusion to the concept of business i.e.maximising profit, rather than earning profit reasonably. Even though they are termed as "Small Finance", they, actually, are "big interest" – both on the Deposits and Loans and Advances fronts and also concentration in respect of rural presence is hardly satisfactory.

Table 6: Comparative study about the interest rates offered by SCBs and SFB

	IOB	Equitas	KVB
Fixed Deposit	3.40% to 5.25%	3.60% to 7.00%	3.50% to 6.00%
RD	5.75% to 6.80%	7.00% to 8.00%	3.50% to 6.00%
Savings Accounts	3.05%	3.50% to 7.25%	2.75% to 3.50%

Source: Supervisory returns submitted by banks to RBI

The above table reveals that the additional interests on different tenors of term deposits with Equitas SFB and those with IOB or KVB is varying in the range of 0.20% to 1.50%.

Interest on normal savings bank accounts in SFBs was about 3.50% p.a. more or less at par with that of the other banks, which is in the range of 2.75% p.a. to 3.50 % p.a. for other categories of banks. However, in respect of some special savings account, where the daily balances cross some minimum amount say, Rs.1.00 lakhs, the interest offered by SFBs vary from 7.00% p.a. to more than 7.25% p.a. This higher interest rate is higher than the highest interest offered by the nationalised/ private sector banks for Term Deposit >1 Year; the average of the rates of interest (the range being 5.56% to 6.02%) on such term deposits as at the end of each of the 53 Fridays commencing from 03-01-2020 to 01-01-2021.

High Cost of Funds

Cost of funds of Small Finance Banks has also been high. Percentage of current and savings accounts (CASA) in their deposit base is lower.It means that even the higher interest on savings bank deposits (up to 7.25%) failed to attract more quantum into their kitty. If more funds are acquired through CASA, it may be a red alert to the risk of jeopardising liquidity.

(Note: Cost of funds is annualised figures and asset-weighted averages. SCBs include PSBs,PVBs and FBs only)

Table 7: Tenor – wise MCLR effective from 1st January 2021

Tenor	EQUITAS	KVB	IOB
Overnight	12.65%	7.90%	6.85%
1 Month	12.30%	8.05%	6.85%
3 Month	12.45%	8.20%	7.40%
6 Month	12.70%	8.55%	7.40%
1 Year	12.90%	9.65%	7.45%

Above table reveals that MCLR of Equitas Small Finance Bank is the highest, more than that of a private bank, which itself is higher compared to a nationalized bank's MCLR. This will be that pattern of MCLR for all SFBs.

Chart IITenor – wise MCLR effective from 1st January 2021

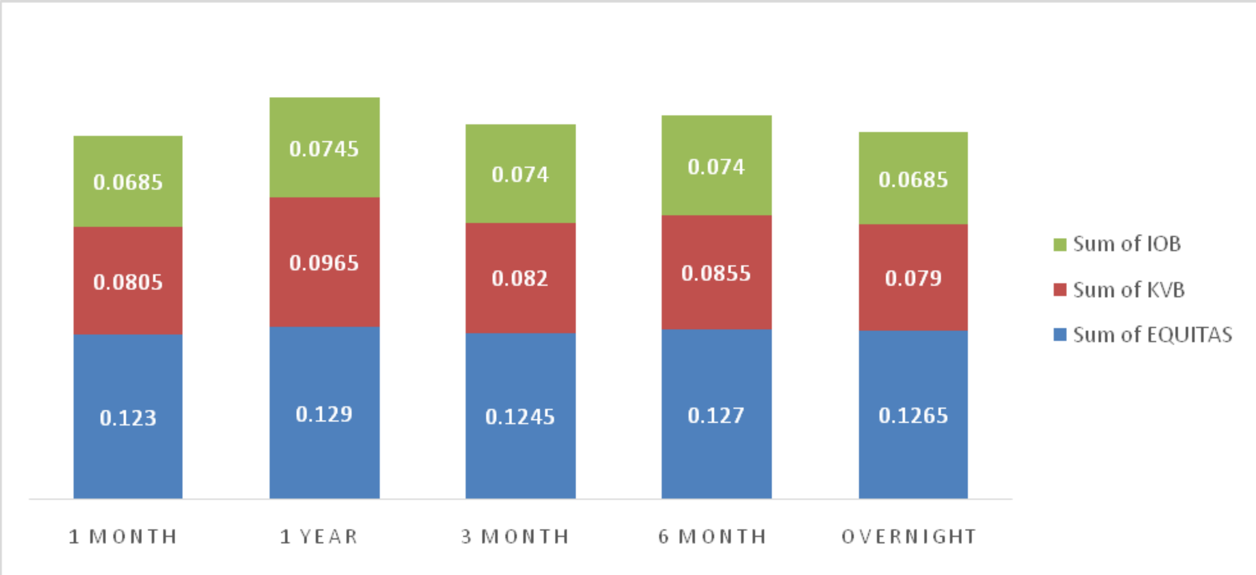

Table 8:Comparison of interest on loans charged by SCBs and SFB

	IOB	Equitas	KVB
Home Loan	7.45% * Floating		7.45% to 9.55%
Loan Against Property Rates	9.75% to 10.25%	14.00% - 24.00%*	9.25% to 12.50%
Personal Loan	11.50% to 15.25%		12.00% to 19.00%
Vehicle Loans	7.55% to 10.05%	11.00% to 30.00%	8.50% to 17%
Business Loan	14.90% to 15.25%	18.00%	The applicable Rate of Interest (ROI) is linked to the Credit Score / Rating and is the combination of EBR-R, Credit Risk Premium and Business Strategy Premium
Gold Loan	7.05% to 9.75%	11.00% to 16.00%	
Micro Finance	..	23.00% to 24.00%	The applicable Rate of Interest (ROI) is linked to the Credit Score / Rating and is the combination of EBR-R, Credit Risk Premium and Business Strategy Premium

From the above table, it is observed that while the additional interest rate on deposits, offered by SFBs over the interest rate on deposits accepted by nationalised/ private sector banks is about 1.50%, the SFBs do not load the corresponding hike but a heavier margin to their interest rates on loans, advanced, though, as per the preamble by RBI, the purpose of formation of SFBs is to cater to the financial needs of small business units, small and marginal farmers, micro and small industries and other unorganised sector entities. Another observation is that some NBFCs charge just 12% p.a. on jewel loans, despite their cost towards heavy advertisement budget, SFBs, which do not do aggressive advertising, charges higher rates. While the customers of nationalised and private sector banks are crying over the comparatively reasonable cost of borrowal, the captioned load of higher interest on loans and advances of Small Finance Banks casts a heavier burden.

Though the interest on loans are comparatively higher than those in the same segment of banking, the only solace is that such rates are very much less than the exorbitant ones, fleeced from the borrowers by indigenous moneylenders.

Table 9: CHARGES LEVIED FOR VARIOUS SERVICES by SCBKS AND SFB

	IOB	Equitas	KVB
Pre-closure charges	0.00% to 2.00%	3.00% to 5.00%	1.00%
Processing charges for loans	0.00% to 0.71%	1% to 2%	0.20% to 0.70%
Documentation charges for loans	1500 to Rs.3000	Rs.1150	
Cheque bounce charges	Rs. 500	Rs.500	Rs.600 to Rs.7500

From the above table, it is observed that the SFBs charges higher pre closure charges, higher processing fees than SCBs. However, Equitas Small Finance Bank charges lesser for documentation charges.

Table 10: DETAILS OF PRIORITY SECTOR LENDING AS ON 31-03-2020:

	Total PSL out-standing (Rs. in crores)	Per cent of ANBC/ CEOBE	PSB/ Total	PvSB/ Total	SFB/All SCBs
Total Priority Sector Advances of all SCBs	37,99,648	88.22%	60.91%	33.50%	1.20%
of which					
Total Agriculture	15,30,935	26.94%	63.45%	32.92%	0.91%
Small and marginal farmers	7,75,040	25.27%	66.24%	29.60%	1.68%
Non-corporate Individual Farmers	10,95,677	29.31%	64.97%	31.52%	1.38%
Micro Enterprises	6,82,479	29.53%	58.05%	37.16%	2.23%
Weaker Sections	10,78,466	58.59%	63.41%	31.54%	2.81%

The above table reveals that the percentage of total priority sector advances of Small Finance Banks to that of all Scheduled Commercial Banks is 1.20%, though the total priority sector advances to ANBC/ CEOBE is 88.22%. It is worth noting here that the above percentage 1.20% is so miniscule, even though the prudential norms require that at least 75% of their total lending should be to priority sectors as against 40% for other categories of Scheduled Commercial Banks.

Table 11: No. of Branches, Establishment Costs and Staff Strength

	No. of branches	Staff Strength	No. of staff/ branch	Establish-ment Costs (Rs. in crores)	Establish-ment Costs / branch (Rs. in crores)	Establish-ment Costs / staff (Rs. in lakhs)
Public Sector Banks	92768	790687	8.52	115044	1.24	14.55
Private Sector Banks	35680	554685	15.55	47357	1.33	8.54
Small Finance Banks	4486	95215	21.22	3811	0.85	4.00

The above table infers that in respect of the Small Finance Banks, the staff strength per branch is about 21, the establishment cost per branch is Rs.0.85 crores and establishment cost per staff is Rs.4.00 lakhs.

CONCLUSION:

The contents in the foregoing paragraphs make one think as to whether a special announcement in the budget is to be made for creation of SFBs at all; instead, formal instructions (followed by meticulous monitoring) to the existing banks to concentrate more on those sectors which the creation of SFBs is to serve and achieve, would have served the purpose. In view of meager presence and miniscule participation in the banking system, it is suggested that the concerned authorities may ponder over a proposal to merge such SFBs, with the nationalised banks, head-quartered in the respective areas of the registered offices or in the State, where the presence of branches of SFBs is predominant. This suggestion is founded on the following premises:

1. smallness in branch distribution (about 3.02% of all SCBs), lower density in respect of presence of branches throughout India
2. higher rates of interest on advances to even the down trodden sections of the society, whose financial needs they are supposed to address and which is the primary purpose of their formation
3. almost stagnancy in respect of additional players entering into this field
4. responsibility to be shouldered by RBI in monitoring the SFBs, occupying a comparatively minute presence in the entire banking field
5. other supporting factors like the following are additional considerations
    - low per employee business (Rs.1.82 crores),
    - high per branch staff strength (21.22 staff and 6.18% of all Scheduled Commercial Banks)),
    - low per staff salary (Rs.4.00 lakhs p.a.)

On the contrary, if *status quo* is maintained, another suggestion is made that the authorities may consider incentivising such of those SFBs, who volunteer to focus all or major chunk of their operations for the benefit of unserved and underserved societies, somewhat similar to subsidies for capital investment/

backward area/ electricity charges offered for starting industries or by entrepreneurs categorised as Scheduled Caste or Scheduled Tribe or women and ensuring effective supervision so that the incentives are passed on to the loan customers, offering a level playing fields.

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