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Small Finance Banks: A Paradigm Shift in Microfinance Fostering Financial Inclusion in India

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Abstract:
India is the lower middle-income fast-growing economies of world having a vision to become a USD 5 trillion economy by 2025 with a sustainable and equitable growth. Financial Inclusion is an important driver of this journey accelerating the economic development of the nation by bringing the unbanked and underbanked population within the framework of financial services. In recent times, it is been perceived as a tool to alleviate poverty, foster equitable distribution of wealth and human development. Hence, this necessitates a more meaningful and responsible financial inclusion approach which empowers the missing loop-poor, adult and women to contribute towards an inclusive economic growth. In the wake of attaining universal financial inclusion, Government of India (GoI) is consistently taking new initiatives to make financial services accessible to the last mile financially deprived population. To foster the roots of financial inclusion to unbanked people, small micro and medium business, low income households and unorganized sectors, GOI introduced new banking model–Small Finance Bank. It's a niche bank established with the objective of serving the financially excluded weaker section and vulnerable ones with the most suitable technology driven cost-effective model served by formalised financial institutions in a timely, transparent and secured manner. This paper delineates the emergence of Small Finance Bank and its performance.

Keywords: *Financial Inclusion, Small Finance Bank, Underserved and Unbanked Population, Microfinance.*

INTRODUCTION

Financial Inclusion means rendering the affordable bouquet of banking services to the large segment of population who have been hitherto deprived of such benefits. It endeavors to pull the financially excluded ones under the umbrella of organized financial system. It's aligned with UN sustainable goal and been focused aggressively across globe to pull the respective economies from the vicious circle of poverty by making weaker and vulnerable section financially strong and resilient by providing them various financial services like saving account, credit facility, insurance products, payment and remittance services at low cost.

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Countries across globe are taking varying measures to promote and increase financial inclusion, yet 1.7 billion people in world are unbanked as per The Global Findex Data 2017. A dynamic political and financial environment warrants a more meaningful and responsible financial inclusion for an inclusive economic growth which can be achieved when all segments of the society i.e. rich, poor, men, women, young, adult are integrated in the financial system (Julia & Sarah, 2019). Well-structured and developed financial system connects people with financial services like savings, credit, insurance etc. and thus, provides them with a cushion against economic shock.

FINANCIAL INCLUSION IN INDIA

Indian financial system is comprised of well-integrated network of banks. They are driving engine of financial inclusion providing a vast array of financial product and services in a timely and adequate manner under one umbrella. Banks, the epitome of financial services acts as a saving mobiliser and credit allocator accelerating the economic activities and boosting the economic growth of the economy. In India, a technology leveraged bank led model has been adopted for financial inclusion (FI). Hence, to spur the growth in financial inclusion, it's prerequisite to bring the financially excluded and unbanked population under the banking purview (Chakraborty, 2013). The Indian banking system is dominated by scheduled commercial banks i.e. Public Sector Banks, Private sector banks, Foreign banks, Regional rural banks, State cooperative banks and Urban cooperative banks.

The light of FI got ignited in India after independence when 14 major banks were nationalized in 1969 followed in row by 6 more in 1980 with the aim to reach the rural areas. It was further augmented with the establishment of Regional Rural Bank, Urban Cooperative Bank, Local Area Bank whose central focus was rural and semi urban population (Iqbal & Sami, 2017). The scenario was far more improved with the proliferation of non-banking finance companies (NBFCs) and Micro Finance Institutions serving the credit requirement of small individuals. Microfinance in India emerged in 1980 to reach the unbanked and underserved households in economically backward areas which couldn't be directly reached by banks owing to high transaction cost and risk. It operates through two channel – Micro Finance Institutions and Self-Help Group (SHG)-Bank Linkage Programme which is the largest microfinance programme in the world. As on 31st Mar 2018, there are 8.7 million SHGs out of which 5.02 million SHGs have outstanding bank loans of Rs 75598 crore to the banks. Similarly, micro finance institution is serving over 30 million clients having an outstanding loan of Rs 1,00,600 crore INR in FY 2014-16.

Financial inclusion has been further cemented with different models like Banking Correspondent, Kisan Credit Card , Know Your Customer, Direct Benefit Transfer, Mahatma Gandhi National Rural Employment Guarantee Act, Pradhan Mantri Jan Dhan Yojna (PMJDY), Jan Dhan – Mobile-Aadhar Trinity (JAM) and Technological Innovations like Mobile Banking, ATM, Debit-Credit Card, Unified Interface Payment, E-Wallet - the major contributor been the PMJDY. This is the world's largest FI drive under which 336.6 million new bank accounts were added leading to a total of such accounts to 536 million by the end of March 2018.

REVIEW OF LITERATURE

The growing importance of financial inclusion has garnered attention from researchers, policy makers, authors all over the world. An extensive research is been carried out in this context as it's been looked upon as a tool to alleviate poverty fostering higher economic development through income equality.

Quando & Alberto (2017) found that FI has a positive relationship with household income which is

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stronger for a low-income household in contrast to high and middle level income households.

Laura, Esther & Mercy (2019) studied that lower the gender gap, greater is the economic and social development. Financial Literacy among women should be increased and the banks to converge efforts towards this gender group to help achieve inclusive economic growth.

Sunildro (2013) brought the issues and challenges of rural credit in India which is a source of sustainable livelihood of rural population who constitutes 70% of the total population RBI is consistently adopting measures to correct the structural deformities of Regional Rural Banks and Co-operatives-the major source of rural credit. The micro credit facilitated through bank linkage self-help group model empowered women in rural areas.

Chakrabarty (2013) emphasized the importance of financial inclusion in economic development of the country through mobilizing saving into productive channels leading to generation of income and employment. He laid impetus on need of banks to come up with innovative products and delivery models tailor made as per the needs of the financially deprived lot in rural and semi urban area. To bring inclusive growth, banks to work on scalable, convenient, flexible, sustainable, technology driven cost effective model.

Pallavi (2014) noted that though rural credit across all geographical regions in the country gained momentum in the 2nd half of 2005 however at the same time marginalization of small urban borrowers increased. Hence there was a need to strengthen custom-made platforms to reach out to such borrowers.

Raghuram (2016) holds that lack of information, incentives and high transaction cost are the major impediment in bringing the rural population under the financial inclusion umbrella. Focus to be laid on easing payment and remittance system rather than expanding credit only. Mere lending credit will not generate financial inclusion. Skill needs to be developed to utilize the credit to generate income.

Siddiqui (2018) highlighted the different initiatives that GOI and RBI has adopted to increase the graph of financial inclusion of India, however, demand factors of FI remains the less focused area. More emphasis to be put on reducing transaction cost, expanding mobile technology and imparting financial literacy to help people effectively use “No frill account”.

Kittu & Chittawadagi (2018) pointed that the inclusive growth is incomplete as a large part of the rural population is deprived of formal banking activities owing to the concentration of only one third of the bank branches in rural area. The poor needs to be provided value for money and can be served profitably with quick decision-making power coupled with hassle-free paperwork. As the retail bank customers are dealt with different skill sets and risk, the need of “differentiated licensing” equipped with holistic approach of educating and spreading awareness about banking activities emerged.

Barik (2019) through his paper analyzed the path traversed by financial inclusion till date in India through various initiatives like PMJDY, MUDRA, UPI etc. Financial inclusion empowers people and provides social protection. The true meaning of financial inclusion is achieved when the bank accounts opened are looked upon as resource for economic development and effectively used for savings and accessing credit. The usage can be accelerated through financial literacy, low transaction cost, improving digital infrastructure and generating formal employment.

Ravikumar (2019) pitched the evolution of SFB and found that within a short period of time, SFB have shown satisfactory performance and penetration. To maintain sustainability, SFB will have to focus on lowering operational cost though digitization.

Kishore (2015) said that Small Finance Bank is the result of credit need of people at the bottom of the pyramid. Transition of credit driven MFI into diversified financial institution (SFB) faces different challenges in the form of compliance with prudential norm like CRR, SLR; change management and

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cutthroat competition from competitors. Nevertheless, of the challenges, it appears to be a good initiative and in relation to the country size, the number could be increased over time as suggested by author for nationwide immersion of financial inclusion

Jayadev, Himanshu & Pawan (2017) holds that SFB to operate pan-India under the lens of RBI will lend it credibility and relieve it from geographical risk which plagued the success of RRB and LAB. Further technology driven model enables ease of operation and help in fraud detection, process management etc. Building deposit (liability side) is the major challenge of SFB coupled with statutory compliance.

Khan (2018) observed that the major advantages which an SFB enjoys is the local knowledge owing to its confinement to a sector and product diversification. The model can address its challenges like deposit mobilization cost, comply with statutory requirements, high operation cost etc. through designing customized products and services, enhancing digital platform for usage.

EVOLUTION OF SMALL FINANCE BANK

India is predominantly an agricultural country and around 65%-70% of the population lives in rural parts. As India adopted a bank led model to drive FI, a mandate has been issued to the banks to open at least 25% of their branches in unbanked rural areas to reach the deep-rooted rural population (Dr Deepali, 2014). Hence during the first phase of financial inclusion plan (FIP) from April 2010 to Mar 2013, there was a spurt in the banking outlets (includes branches, BCs and other modes) in villages from 67,694 to nearly 2,68,000 outlets in Mar 2010. About 7,400 rural branches have been opened during this period and around 4,90,000 unbanked villages with a population less than 2000 were identified for opening a bank outlet. Notwithstanding the above developments, the rural bank (rural + semi urban) branches per 1,00,000 population as on Jun 2015 was 7.8 i.e. less than half of urban bank (urban + metropolitan) branches per 1,00,000 population (18.7) reflecting the existence of regional disparity. Though there was a spike in the rural bank branches, yet around 44% of the rural households relied on non-institutional credit agencies for loan in 2012 as per All India Debt and Investment Survey 2012.

In order to further penetrate deep into the economy to attract the unbanked and financially deprived population which were not timely, adequately and profitably served by the existing formal institutions led the RBI Nachiket Mor Committee to come up with differentiated banking license model. RBI on Sept 16, 2015 gave in-principle approval to shortlisted 10 organizations to commence operations as “Small Finance Banks”

Small banks in the form of Regional Rural Bank, Urban Cooperative Bank and Local Area Bank already exists in the Indian Banking System, but failed to achieve a satisfactory level of local economic development owing to certain limitation like geographical concentration risk, political influence, high cost of fund, high NPA etc. Moreover, In Jan 2010, around 9.2 million borrowers in Andhra Pradesh defaulted on MFI loans. This crisis of 2010 was an eye opener for the government which brought MFI under the regulatory framework. The step was taken to oversight the larger interest rates charged and coercive recovery practices adopted by MFI. Hence, the need arose to have a formal innovative institution which could serve the locally deprived population of financial services swiftly and cost effectively ensuring customer’s protection.

The underlying motive of setting up of this differentiated bank is to broaden and deepen financial inclusion by (a) acting as a savings vehicle and (b) supply of credit through low cost technology lashed operations. Shipra, Leora, Dorothe (2012) holds that savings leads to wealth creation and thus, outweighs credit- risk management tool.

10 SFB were granted license out of which 8 entities were already functioning as MFI. AU was a NBFC and Capital was a LAB. The new SFB which emerged are: Capital Small Finance Bank, Equitas Small Finance Bank, Suryoday Small Finance Bank,

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Utkarsh Small Finance Bank, Ujjivan Small Finance Bank, ESAF Small Finance Bank, AU Small Finance Bank, Fincare Small Finance Bank, North East Small Finance Bank and Jana Small Finance Bank. The word “small” is added with the bank name to signify the genre of customer it deals (Rajan, 2016).

In the row has been added Shivalik Mercantile Co-operative Bank Limited, the first UCB which has been granted in principle approval for SFB on Jan 06, 2020.

THE BROAD FEATURES OF SMALL FINANCE BANKS

SFB to comply with all RBI prudential norms of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). The minimum paid up equity capital of Rs 200 crore and Minimum Capital Adequacy to be maintained as 15% of risk weighted assets. 40% of paid up equity capital to be contributed by promoter for a lock in period of 5 years. At least 25% of the bank branches to be opened in unbanked rural centers (population up to 9,999 as per the latest census).75% of the adjusted bank net credit to be allocated to priority sector in the proportion of 40% in standard priority sector and 35% in any other priority sectors. Half of the loan size to be less than 25 lakhs.

Regulations for SFB have been designed by RBI with the underlying motive of serving the small customers. So far, these sectors have been successfully catered by MFI’s whose strong pulse of the local requirement will render a concrete platform for operation to MFI turned SFB. The diversified nature of the country warrants innovative models to accelerate the FI drive which in turn will fuel the economic growth. (Rajesh, 2019).

Since 2015, SFB’s have started their operation in a phased manner. Effective Mar 2018, there are 10 SFB fully functioning with a total count of 3998 branches. The branches of SFB have spread across all regions (Figure:1) and population group (Figure:2) with lowest concentration in North Eastern Region (4%) and the highest in Southern Region (32%). Around 58% branches have been opened in rural areas (rural and semi urban combined) and 42% in urban areas (urban and metropolitan combined).

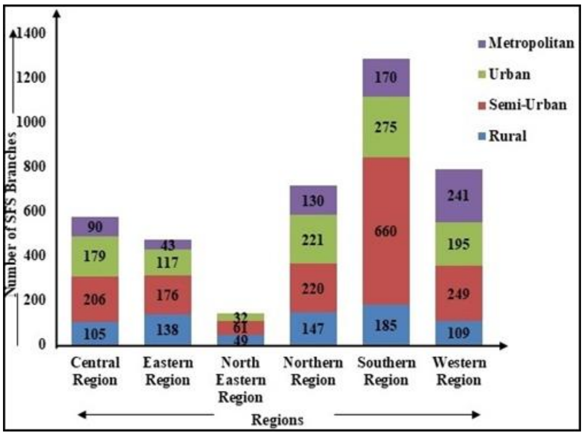
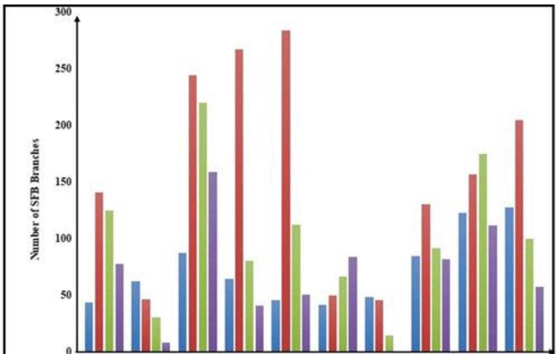


Figure 1: Region Wise Distribution of SFB Branches

Source - Branch Banking Statistics. Reserve Bank of India



	AU	Capital	Equitas	ESAF	Fincare	Jana	North East	Suryoda y	Ujjivan	Utkarsh
Rural	44	63	88	65	46	42	49	85	123	128
Semi-urban	141	47	244	267	284	50	46	131	157	205
Urban	125	31	220	81	113	67	15	92	175	100
Metropolitan	78	9	159	41	51	84		82	112	58

Figure 2: Bank-wise and Population Group-wise Number of Functioning Offices

Source-Branch Banking Statistics. Reserve Bank of India

The deposits and credit of the banks has also depicted year-on-year growth. There is a spurt in both deposit and credit in 2019 (Figure 3).The number of deposit accounts increased from 1476994 in 2018 to 7643000 in 2019. Credit accounts also had an increase from 7731119 in 2018 to 12184696 in 2019.

SFB’s are contributing to priority sector as per the defined guidelines i.e. 75% of Adjusted Bank Net Credit focusing majorly on Agriculture sector and

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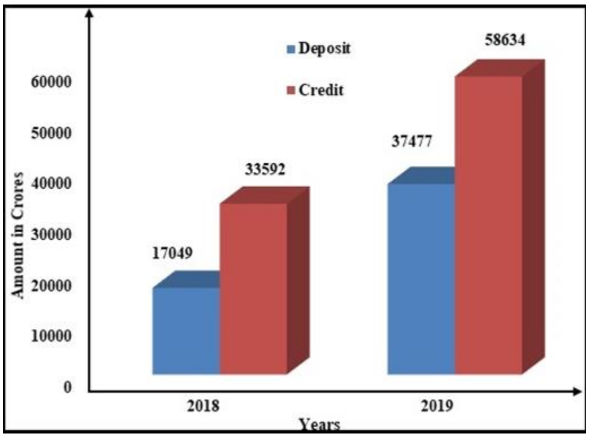
MSME with little impact on education and housing sector. It is reflected in figure 4 & 5.

Figure 3: Deposit and Credit Amounts of SFB for FY 2018 and 2019



Source-Basic Statistical Return. Reserve Bank of India

OPPORTUNITY TO BE UNLOCKED

Around 1.7 billion people across globe are unbanked. In 2014 the number was 2 billion. This unbanked population doesn't hold account either at financial institution or through mobile money provider. India with 190 million unbanked population takes the second seat after China (Global Findex Report, 2017). Fifty-six percent of all unbanked adults are women. The share of its inactive accounts is 48% which is highest in the world (Table 1). This shows that though the first stage of financial inclusion i.e. opening of accounts has reached a satisfactory level, however, it's effective utilization for saving and accessing credit will lead to a more inclusive growth (Barik, 2019)

Figure 4: Loans to Priority Sector 2018

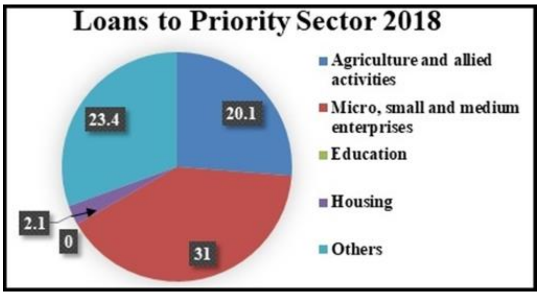
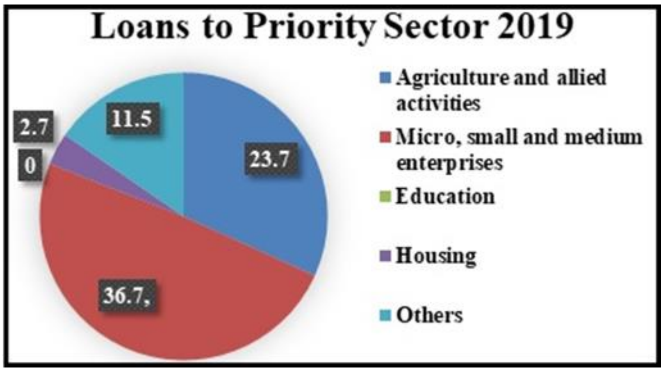


Figure 5: Loans to Priority Sector 2019



Source: Operations and Performance of IV Commercial Banks. Reserve Bank of India

Table 1: The financial inclusion representation of India (Source: Global Findex Database, 2017)

Financial Inclusion Summary			
Category	*2011*	*2014*	*2017*
Account in Financial Institution			
Male (% age 15+)	44	62	83
Female (% age 15+)	26	43	77
Older Adults (% ages 25+)	38	57	83
Saving at Financial Institution			
Male (% age 15+)	16	18	22
Female (% age 15+)	7	10	17
Older Adults (% ages 25+)	13	16	22
Credit from Financial Institution			
Male (% age 15+)	9	8	8
Female (% age 15+)	7	5	5
Older Adults (% ages 25+)	9	7	7
Credit from Non Financial Institution			
Male (% age 15+)	22	35	35
Female (% age 15+)	18	30	30

Financial institution apart from extending credit should also educate and skill people to channelize that credit in productive manner to generate income (Rajan, 2016).

Here lies the plethora of opportunity to be unleashed by the financial institutions in the journey ahead. Creation of SFB by RBI seems to be a positive measure in the right direction with its objective of reaching the economically backward in far flung areas to help deepen and broaden the financial inclusion.

Conclusion

Small Finance Bank is an innovative technology driven model of the GOI and RBI established with an aim to solidify the financial inclusive environment of the country by bringing the underserved and unbanked population under the ambit of financial institutions. The bank is still in its nascent stage and adopting every strategy to come up the success curve. In order to leverage the technology to reach last mile, the banks along with financial literacy should drive digital literacy programs too which would lend a mileage to SFB by bringing the non-tech savvy population under their umbrella. Further, the banks can penetrate deep into the education pocket with customized crafted models for women to economically uplift them. Around 70% of women led SME have inadequate or no access to financial services as per International Finance Corporation estimate (Julia & Sarah, 2019) SFB's by extending their support to women-controlled SME can help them empower to be financially independent and contribute towards the economic development of the country.

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