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Leveraging Small Finance Bank (SFB) In Achieving Financial Inclusion in India

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ABSTRACT: *Despite the growth which the banking sector has made especially in the last two decades, there are concerns that banks have not been able to include vast segments of the population, especially the disadvantage sections of the society, into the fold of basic banking services. Estimate and surveys of different study reports point out that exclusion levels of people in India is estimated to be around 40%. Realising that financial inclusion will remain a dream unless a paradigm change is introduced, the RBI, on September 16, 2015, had announced the name of 10 entities called as "Small Finance Banks" (SFB). SFBs have been designed to reach out to the remotest places and unbanked Micro and Small Enterprises in all parts of the country. This paper discusses the various aspects of financial exclusion and the role of SFB in expanding the access to finance agenda of the government. The study also delves into the need and importance of Small Finance Bank in achieving the financial inclusion in India and tries to understand the various transformational challenges of MFI into Small Finance Bank. The study has utilized secondary data sourced from reports, journals, articles available at RBI database, MFIN Micrometer, CGAP, MicroSave, World Bank and NITI Aayog, etc. Techniques of simple statistics have been applied for analysing the data and getting the results to derive a logical conclusion. The study found that there is huge potential in the rural market; SFB needs to develop suitable products, credible strategy and a strong distributional channel to attract the potential clients. In addition to it, there is a need for cost effective mobile based technology deployments that are better suited to reach underserved areas. The future of SFB will determine the path that microfinance sector will take.*

KEY WORDS: *Small Finance Bank, MFI, Financial Technology Financial Inclusion and Financial Exclusion.*

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I. Introduction

Despite the growth which the banking sector has made especially in the last two decades, there are concerns that banks have not been able to include vast segments of the population, especially the disadvantaged sections of the society, into the fold of basic banking services. Estimates and surveys from different study reports point out that exclusion levels of people in India is estimated to be around 40%[2]. In the whole gamut of "inclusive growth" process, financial inclusion constitutes an important founding pillar to reach out to "excluded" sections of the society and help in upliftment of the financial condition and standards of the disadvantaged. In India the critical barriers of exclusion have been - limited network presence of banks in the hinterland, lack of established systems of delivery mechanisms, absence of clear business model to ensure that small customers are brought to the portals of the bank with a view to convert them into long term customers of significance over time, low investments in technology, limited availability of technology solutions that can cost effectively meet the requirement of adding a large number of clients to the banking system and insufficient effort at creating financial literacy etc. However, setting up of the committee on financial inclusion, policy changes in the Banking Correspondent framework, use of technology, introduction of mobile based banking, roll out of a scheme for financial literacy and setting up of two financial inclusion funds helped improving marginally the levels of inclusion and benefiting the disadvantaged as a result.

The move by RBI on September 16, 2015 to set up differentiated banking structures is one of the most far reaching initiatives on financial inclusion in the country. Differentiated Banking structures are contemplated to meet credit and remittance needs of small businesses, unorganised sector, low income households, farmers and migrant work force. Out of the 10 selected applicants for SFBs, one is an NBFC (Au Financiers), one a Local Area Bank and the rest 8 are Micro Finance Institutions (MFIs). These institutions have been serving the underserved/unserved sections of the population in various geographies across the country. The granting of the

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[2] State of the Sector Report -2015

banking license will provide an impetus to "Banking the Unbanked" by transforming them into a full service financial institution. It's a defining step towards Universal Financial Inclusion.

II. Methodology Of The Study

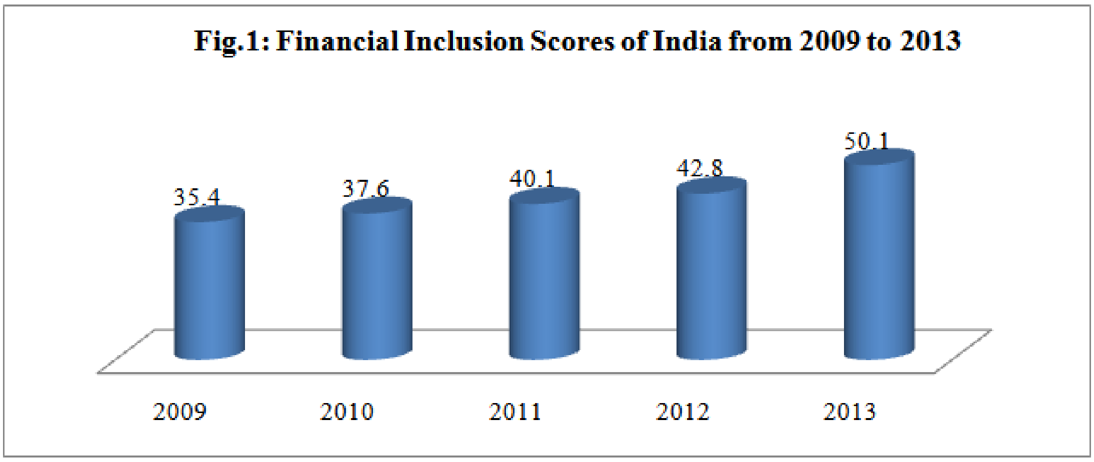
Financial Inclusion is an important priority of the Indian Government as there is increasing evidence which confirms the fact that appropriate financial services can help improve household welfare and further economies with deeper financial intermediation tend to grow faster and reduce income inequality. The last two years have witnessed profound changes in the institutional design and architecture of the Indian financial system. RBI in-principal banking licenses to SFB, was a step towards access to finance by the poor. The new breed of financial institutions are envisaged to develop into important and effective intermediaries / partners for reaching out to the MSME Sector, particularly in unbanked and underserved areas. Looking various aspects of financial exclusion and role of Small finance Bank, a study was required to understand the status of financial inclusion and exclusion in India and role of SFB in expanding financial inclusion in India. More than this the study had also focused on the transformational challenges of MFI into SFB. There are various explicit and implicit factors related to this. With this backdrop, the objectives of the study had been stated more precisely as follows.

i. To study the various reasons for financial exclusion in India and its consequences on rural and semi-urban population.
ii. To explore the need and importance of Small Finance Bank in achieving the financial inclusion in India.
iii. To understand the transformational Journey and key challenges of MFI into Small Finance Bank.

SOURCE OF DATA: The study is an attempt of exploratory research, based on the secondary data sourced from reports, journals, articles available at RBI, IMF, CGAP, MicroSave, World Bank and NITI Aayog, etc. Techniques of simple statistics have been applied for analysing the data and getting the results to derive a logical conclusion. The analysed data has been presented based on the objectives of the study in the form of tables and graphs, which are described, interpreted and conclusions drawn.

III. Concept Of Financial Inclusion And Exclusion

According to CGAP, "Financial Inclusion as means that households and businesses have access and can effectively use appropriate financial services. Such services must be provided responsibly and sustainably, in a well regulated environment". On the other hand, financial exclusion refers to a process whereby people encounter difficulties accessing and/or using financial services and products in the mainstream market that are appropriate to their needs and enable them to lead a normal social life in the society in which they belong.
According to the World Bank research (Global Findex 2014), there are more than 2 billion unbanked people in the world. The unbanked are those who do not have traditional bank accounts or access to banking services. Countries in Asia and Africa have some of the highest rates of unbanked populations. In Asia, the rates of unbanked as a percentage of the total population are 21% in China, 47% in India and 64% in Indonesia.



Source: CRISIL (2015), CRISIL Inclusix: An Index to measures India's Progress on Financial Inclusion, Vol

In Indian context, eastern, north-eastern and central regions lag behind in terms of banking penetration. While demographic penetration in terms of bank branch coverage, normalised by population, has increased one-and-a-half times during 2006-15, the north-eastern states as also states such as Bihar, Jharkhand, Uttar Pradesh, West Bengal and Madhya Pradesh are less penetrated in terms of the number of branches in relation to their population. As per CRISIL Inclusix report, the financial inclusion scores of India have improved from 2009 (35.4%) to 2013 (50.1%) (Fig-1). Figure-1 depicts the financial inclusion measured by CRISIL Inclusixis based on branch penetration, deposit penetration and credit penetration. According to the Financial Access Survey (FAS) database of the International Monetary Fund (IMF) suggest that there were 1542.26 deposit accounts with commercial banks per 1000 adults and outstanding deposits with commercial banks is 65.76% of the GDP (Table-1).The extent of financial exclusion in India is found to be higher than many developed and some of the major emerging economies (Nair and Tankha, 2014).

Table 1: Usage of and Access to Financial Services in India (2015)

Sl.No	Parameters	Value
1	Commercial bank branches per 1,000 square km	42.54
2	Branches of Commercial banks per 100,000 adults	13.55
3	ATMs per 100,000 adults	19.71
4	ATMs per 1,000 square km	61.88
5	Deposit accounts with Commercial banks per 1000 adults	1542.26
6	Loan accounts with Commercial banks per 1000 adults	154.49
7	Outstanding deposits with Commercial banks (% of GDP)	65.76
8	Outstanding loans from Commercial banks (% of GDP)	50.69

Source: International Monetary Fund (2015)

As per the financial inclusion plans (RBI, 2016-17), the progress and performance of banks are quite satisfactory. The number of banking outlets in villages went up from 67,694 in March 2010 to 598,093 in March 2017 after RBI permitted appointment of BCs and laid out a roadmap for spreading banking services in rural India through a mix of bank branches and BC outlets. In addition, the number of urban locations covered through BCs has also surged from 447 in March 2010 to 1, 02,865 in March 2017 (Table-2). The Basic Savings Bank Deposit Accounts (BSBDAs) have gone up from 73 million in March 2010 to 533 million as on March 31, 2017. Under the PMJDY alone, until September 30, 2017, 30.26 crore accounts have been opened with an approximate balance of Rs. 666.06 bn. The total number of transactions in BC-ICT accounts which were around 26.5 million during 2010-11 have increased to 1159 million as on March 31, 2017. There were 47.31 million small farm sector credit accounts and 13 million small non-farm sector credit accounts with an outstanding of Rs. 5130.7 billion and Rs. 2117 billion outstanding, respectively, as on March 31, 2017 (Table-2).

Table 2 : Financial inclusion Plan- Summary progress of all Banks including RRBs

Sl.No	Particulars	Year ended March 2010	Year ended March 2015	Year ended March 2016	Year ended March 2017
1	Banking Outlets in Villages – Branches	33,378	49,571	51,830	50860
2	Banking Outlets in Villages – Branchless Mode	34,316	504,142	534,477	547233
3	Banking Outlets in Villages –Total	67,694	553,713	586,307	598093
4	Urban Locations covered through BCs	447	96,847	102,552	102,865
5	BSBDA*-Through branches (No. in million)	60	210	238	254
6	BSBDA-Through branches (in billion)	44	365	474	691
7	BSBDA-Through BCs (No. in million)	13	188	231	280
8	BSBDA-Through BCs (INR in billion)	11	75	164	285
9	BSBDA-Total (No. in million)	73	398	469	533
10	BSBDA Total (INR in billion)	55	440	638	977
11	OD facility availed in BSBDAs (No. in million)	0.2	8	9	9
12	OD facility availed in BSBDAs (in billion)	0.1	20	29	17
13	KCCs -Total (No. in million)	24	43	47	46
14	KCCs -Total (INR in billion)	1240	4382	5131	5805
15	GCC-Total (No. in million)	1	9	11	13
16	GCC-Total (INR in billion)	35	1302	1493	624
17	ICT-A/Cs-BC-Total Transactions (No. in million)	26.5	477.0	826.8	332
18	ICT-A/Cs-BC-Total Transactions (in billion)	6.9	859.8	1686.9	965

Note: BSBDA- Basic Saving Bank Deposit Account, Source: RBI Annual Report 2016-17

3.1 REASONS FOR FINANCIAL EXCLUSION

The two important factors which have traditionally believed to have inhibited financial inclusion of the vast majority are the high transaction cost and the risk associated with financial outreach programs. Other challenges are around products or the lack of product diversity, service delivery, and communication and consumer protection. The way to access and use the financial services are also dependent on geographical, technical, cultural, educational or about guarantee and risk analysis criteria. This leads to a large range of access and use difficulties that are deeply related to market structure in a given area. Much of the exclusion appears to arise from a failure of the mainstream commercial providers to supply a range of products and services that are appropriate to the needs of all sections of society (European Commission, 2008).

The perfect financial inclusion may therefore be described by the capacity to access and use appropriate financial services proposed by mainstream providers. Meanwhile, there may be an adequate "second best choice" to get appropriate services proposed by alternative providers that comply with rules and regulations and do not exploit low income people. At least, an authenticated provider may give a sufficiently safe / positive image to enable excluded people to try once again financial services, which could then be the first step towards financial inclusion with mainstream financial providers. This calls for innovative approaches to bridge the gap between the excluded population segments and formal financial institutions. Technology is a potent tool which, if employed innovatively, can significantly reduce both the traditional inhibiting factors of financial inclusion. This also has been voiced by the Committee on Medium-term Path on Financial Inclusion set up by RBI. As per the committee report, although a quantum jump in banking access has taken place, a significant element of regional exclusion persists for various reasons that need to be addressed by stepping up the inclusion drive in the north-eastern, eastern and central states to achieve near-universal access. This may entail a change in the banks' traditional business model through greater reliance on mobile technology for 'last mile' service delivery, given the challenges of topography and security issues in some areas" (Report of the Committee on medium-term path on Financial inclusion, 2015).

3.2 IMPORTANCE OF FINANCIAL INCLUSION IN INDIA

In majority of the developing countries, access to finance (Khan, 2012) is now being perceived as a public good, which is as important and basic as access, say, to safe water or primary education. A question that arises is whether financial inclusion can be interpreted as a public good. A good is considered a public good if it meets the conditions of (a) 'non-rivalness' in consumption and (b) non-excludability. Financial inclusion meets these two criteria. One of the important effects of financial inclusion is that the entire national financial system benefits by greater inclusion, especially when promoted in the wider context of economic inclusion (Gandhi, 2013). The wide extent of financial exclusion in India is visible in the form of high population per bank branch and low proportion of the population having access to basic financial services like savings accounts, credit facilities, and credit and debit cards. State wise percentage of households, availing Banking Services in 2011 (Table 3), clearly show that there still remain a large number of households which do not avail banking services, resulting to financial exclusion.

Table 3: State wise Household (HH) availing banking services in 2011							
Sl.No	State/UT	Banking Services total no of HH (Excluding Institutional HH)	Banking Services HH availing banking Services (%)	Sl. No	State/UT	Banking Services total no of HH (Excluding Institutional HH)	Banking Services HH availing banking Services (%)
1	INDIA	246692667	58.7	19	Mizoram	221077	54.9
2	Andhra Pradesh#	21024534	53.1	20	Nagaland	399965	34.9
3	Arunachal Pradesh	261614	53	21	Odisha	9661085	45
4	Assam	6367295	44.1	22	Punjab	5409699	65.2
5	Bihar	18940629	44.4	23	Rajasthan	12581303	68
6	Chhattisgarh	5622850	48.8	24	Sikkim	128131	67.5
7	Goa	322813	86.8	25	Tamil Nadu	18493003	52.5
8	Gujarat	12181718	57.9	26	Tripura	842781	79.2
9	Haryana	4717954	68.1	27	Uttar Pradesh	32924266	72
10	Himachal Pradesh	1476581	89.1	28	Uttarakhand	1997068	80.7
11	Jammu & Kashmir	2015088	70	29	West Bengal	20067299	48.8
12	Jharkhand	6181607	54	30	A & N Islands	93376	89.3
13	Karnataka	13179911	61.1	31	Chandigarh	235061	80.1
14	Kerala	7716370	74.2	32	D & N Haveli	73063	56.7
15	Madhya Pradesh	14967597	46.6	33	Daman & Diu	60381	65.4
16	Maharashtra	23830580	68.9	34	Delhi	3340538	77.7
17	Manipur	507152	29.6	35	Lakshadweep	10703	85.3
18	Meghalaya	538299	37.5	36	Pondicherry	301276	64

Source: Census of India, 2011 (NITI Aayog: http://niti.gov.in/content/household-availing-banking-services-percent)

#: Data relates to undivided Andhra Pradesh; estimates for newly created State of Telangana are not available separately in the source documents

Table 4: Deposit, advances of schedule commercial banks in India as on March 2016						
Sl.No	Name of Banks	No of Banks	Deposit	In %	Advances & investment	In %
1	SBI and its Associates	6	21132.74	22.1	16113.02	21.4
2	Nationalized Banks	21	46676.85	48.6	35146.14	46.7
3	Foreign Banks	20	4449.78	4.6	3769.63	5.1
4	RRB	56	3055.23	3.2	2068.43	2.7
5	Private Sector Banks	20	20680.69	21.5	18129.21	24.1
	Total	**123**	**95995.29**	**100**	**75226.43**	**100**

Source: Basic Statistics Returns, RBI

Indian banks have played a major role in the mobilization of saving and have promoted economic development. There has also been a substantial increase in banking business over the years. Among the bank group, nationalized banks plays a critical role in holding substantial market share in deposit (48.6%) and contributed significantly by providing credit (46.7%) to agriculture and various poverty alleviation programme (Table-4).

Table 5: Distribution of Bank branches across India, as on March 30, 2016

Sl.No	Bank Group	Rural	Semi-urban	Urban	Metropolitan	Total	%
1	SBI and it's Associates	8099	6784	5030	4128	**24041**	17.83
2	Nationalized Banks	22223	17873	14159	13008	**67263**	49.88
3	Foreign Banks	8	12	55	251	**326**	0.24
4	RRBs	15039	4066	1329	283	**20717**	15.36
5	Private Sector Bank	4733	7239	5071	5468	**22511**	16.69
	Total	**50102**	**35974**	**25644**	**23138**	**134858**	**100**
	Percentage	37.15	26.68	19.02	17.16	100	

Source: Database of Indian Economy, RBI Data warehouse

3.3 SMALL BANKING STRUCTURE IN INDIA

In the context of improving financial inclusion, UCB, RRBs, LABs have huge potential and along with local financial markets, can offer services like savings, credit, remittances, insurance, etc. It suggested that RBI should relook into the strengthening these financial institutions for reaching the last mile.

Table 6: Existing Small banking structure

Sl. No	Particulars	Urban Cooperative Bank (UCB)	Regional Rural Bank (RRBs)	Local Area Banks (LABs)
1	Commencement	1889	1976	1996
2	Supervision	RBI	NABARD	RBI
3	Ownership	Cooperative structure, mostly dominated by community	Public sector bank (35%), State Govt (15%) & Govt of India (50%)	Private Individuals
4	Number of Banks	1574	56	3
5	Area of Operation	Higher concentration in a few districts	Restricted to a few districts of a state	Restricted to one or two districts
6	RegulatoryReserve Ratio	Applicable	Applicable	Applicable
7	Prudential norms of capital adequacy	Applicable	Applicable	Capital adequacy Ratio of 15%
8	Clientele	Mostly form semi-urban and urban Areas	Rural customers (Middle and lower income groups)	Middle and lower middle income groups
9	Credit	Productive Purposes	Agriculture Credit	Small Microenterprise
10	Challenges	High NPAs	High NPAs	Moderate NPAs

Source: Jaydev et al, 2017, Small Finance Bank: Challenges, IIMB Management Review, PP-313

At this juncture one more institution needs to be mentioned, i.e. microfinance institutions, although for a long time these have not been regulated by the RBI.

3.4 ROLE OF MICROFINANCE INSTITUTIONS IN FINANCIAL INCLUSION

With a view to meet the challenge of uneven spread leading to exclusion, the financial system witnessed the emergence of Micro Finance Intermediaries. Micro Finance Institutions (MFIs) play a significant role in facilitating inclusion, as they are uniquely positioned in reaching out to the rural poor. By virtue of their limited area of operation, they have a greater understanding of the issues specific to the rural poor, enjoy greater acceptability amongst the rural poor and have flexibility in operations, thus providing a level of comfort to their clientele. MFIs also played as catalysts in broadening the concept of micro finance, first from micro-credit into micro-finance, then into the concept of building entire financial systems that serve their poor and low income population, viz., financial systems that are inclusive. Micro Finance sector in India has registered impressive growth in the last few years. The micro finance sector has experienced exponential growth in the last ten years. It has benefited from widespread international recognition as a development tool, prompting multilateral lending agencies, bilateral donor agencies, developing and developed country governments, and non-government organizations to extend active support for the development of the sector. Donors and socially oriented investors, having recognized the potential for social and financial returns have directed increased funding towards micro finance.

Table 7: Transformation journey from MFI to SFB

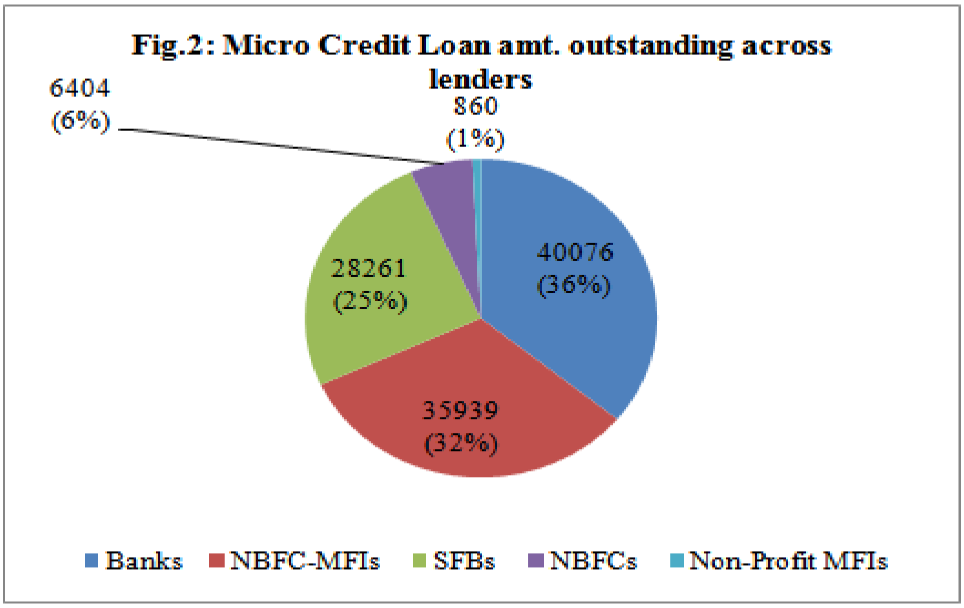
Year	Key milestone
1970 - 1979	• The term Micro Finance emerges on the scene- Prof. Muhammad Yunus (Bangladesh) started shaping the modern microfinance modern movement. • Roots of Micro Finance in India - SEWA Bank (Shri Mahila Sewa Sahakari Bank), Gujarat • SEWA Bank owned and managed by women to provide financial services to women in the unorganized sector.
1980 - 1989	• Micro Finance in India started evolving around the SHG concept- pre -dominantly a NGO driven intervention in the financial inclusion space supported by NABARD • NABARD advocates SHG model as an important tool for poverty alleviation. Other government agencies follow (1984). • Mysore Resettlement and Development Agency (MYRADA), one of the early innovators of the concept of self-help groups (SHG) (1989).
1990 - 1999	• SIDBI emerges on the scene- *The Market Maker (1990)* • NABARD started the SHG Bank Linkage Programme (SBLP), (1992). • Launch of SIDBI Foundation for Micro Credit (SFMC), (1999). • Sa-Dhan, the association of Community Development Institutions comes in to existence (1999).
2000-2010	• With the view to draw upon the international experience and bring in the *microfinance best practices* within the country, the "National Micro Finance Support Programme (NMFSP)" was launched by SIDBI in collaboration with DFID, UK (2000). • RBI includes MFI lending within the priority sector and recognizes it as a tool for financial inclusion (2004). • UN declares "*The international year of Micro Credit" (2005).* • The Grameen Bank and the founder, Prof. Muhammad Yunus, were jointly awarded the Nobel Peace Prize (2006). • Microfinance Institutions Network (MFIN), the association of NBFC-MFIs comes in to existence (2009). • Andhra crisis unfolds- sector slips in to abyss (2010).
2011 - 2017	• RBI grants approval for conversion of Bandhan Financial Services Pvt Ltd, the largest MFI in India at that time, in to a Universal Bank (2014). • RBI vide press release dated Nov. 26, 2013 issues guidelines for creation of Self Regulatory Organisations (SROs) for NBFC-MFIs (2014). • MFIN was formally recognized by RBI as a Self Regulatory Organsiation (SRO), (2014). • RBI accords SRO status to Sa-Dhan (2015). • PM launches Micro Units Development & Refinance Agency Ltd (MUDRA) as a wholly owned subsidiary of SIDBI to *fund the unfunded (2015).* • RBI accords in-principle approval to 10 entities to set-up **Small Finance Banks** (SFBs)- 9 out the 10 entities, including 8 MFIs, existing partners who have been nurtured and supported by SIDBI over the years (2015). • **SFBs start rolling out gradually in accordance with RBI guidelines (2016).**

3.5 CURRENT STATUS OF MICROFINANCE INDUSTRY AND SFB

Microfinance institutions, Non-Banking Finance Companies, and Local Area Banks are concentrated in rural areas and provide services where commercial banks are not available or unwilling to offer services. They follow relationship banking which makes their network and customer base really good and helps them reach the targets of opening rural branches and financial inclusion. The kind of loans they offer can also go a long way in meeting priority sector requirements. This makes them ideal vehicles for achieving the RBI's objectives of financial inclusion (Ray, 2016).

Table 8: Comparative advantage of SFB over MFI

MFI	SFB
► Can't provide micro savings, the most important of financial services to poor. ► Subject to micro regulation/expensive regulation on portfolio composition, client segments, available market, pricing, CRAR ► Dearth of suitable equity	► Allowed to services all possible target clientele needs – easier to achieve vision. ► Enhance client stickiness; reduce client drop outs, lower delinquency risks. ► Reduced regulatory risk- easier to move into new geography/customer segments. ► Wide equity choices. ► Attract better quality human resources.



As of Sep17, Banks are the largest provider of microcredit with a loan outstanding of Rs 40,076 Cr, accounting for 36% of total micro-credit lending. This includes both direct lending as well indirect lending through BC partnerships. NBFC-MFIs as a group are the second largest provider of the micro-credit with a loan amount outstanding of Rs35,939 Cr (excluding BC portfolio channeled through NBFC- MFIs), accounting for 32% to total industry portfolio (i.e. loan amount outstanding). SFBs have a total loan amount outstanding of INR 28,261 Cr with total share of 25%. NBFCs account for another 6% and Non-profit MFIs account for 1% of universe (MFIN, Micrometer). In the pie chart below, numbers represent loan amount outstanding in Rs Cr and share of each peer group in the universe as percentages. Compared with Q1 fy17-18, Banks portfolio has grown by 4%, NBFC-MFIs by 11% and NBFCs by 7%. There is de-growth in portfolio of SFBs by 1% and Non-profit MFIs by 6%.

As of Q2 FY 17-18, SFBs have 1.76 Cr loan accounts with a total loan amount outstanding of INR 28,261 Cr under micro-credit (Fig-3). Last quarter, SFBs disbursed 19.07 Lakh micro-credit loans amounting to INR 5,119 Cr. Compared with last quarter, loan amount disbursed came down by 15% (Fig-4). It may be noted that data captured here for SFBs is only for assets under micro-credit and does not include data on other credit products (MFIN Micrometer).

Fig 3: Loan accounts and outstanding of SFB

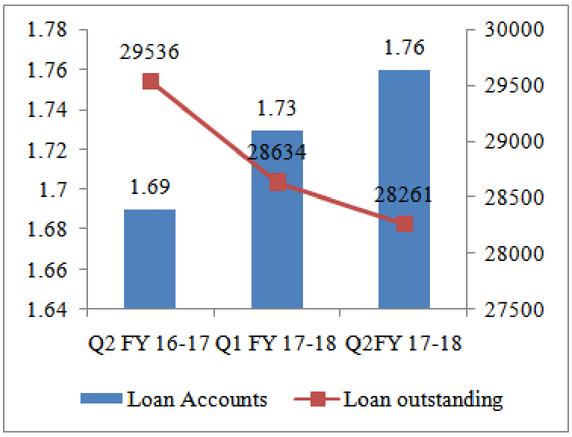
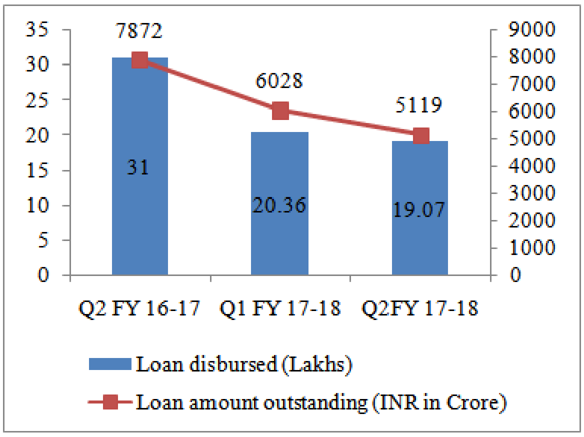


Fig 4: Loan disbursed and outstanding of SFB



IV. Small Finance Bank

The committee on Financial sector reforms (Chairman: Dr. Raghuram G Ranjan), 2009 had examined the relevance of small banks in the Indian context. The committee had opined that there was sufficient change in the environment to warrant experimentation with licensing of small banks. It recommended allowing more entry to private well-governed deposit taking small finance banks (SFBs) offsetting their higher risk from being geographically focused by requiring higher capital, a strict prohibition on related party transactions, and lower allowable concentration norms. In 2013, the RBI constituted a committee under the Chairmanship of Dr. Nachiket Mor, to further goal of financial inclusion in India. The committee recommended differential licensing in the form of two categories, (a) Payment Bank and (b) Small Finance Bank. On September 16, 2015, Reserve Bank of India, after evaluation of 72 applications, had announced the names of following 10 applicants (Table 7) which had been granted *'in-principle'* approval for setting up SFBs.

The *"in-principle"* approval is valid for 18 months during which time the applicants are required to comply with requirements in terms of RBI's Guidelines for SFBs and the conditions stipulated by RBI while granting the said approval. On being satisfied that the requisite conditions stipulated have been complied with, RBI would consider granting them a license for commencement of banking business under Section 22(1) of the Banking Regulation Act, 1949.

Table 9: Key Features of SFB as per the RBI Guidelines

Registration	○ The small bank shall be registered as a public limited company under the Companies Act, 2013
Capital Requirement	○ Minimum paid-up equity capital of INR 100 crore. ○ Minimum 51% domestic equity.
Promoter Contribution	○ 40% - to be brought down to 26% within 12 years of commencement of Banking business.
Scope of Activities	○ Allowed to undertake basic banking activities - acceptance of deposits, lending to unserved and underserved sections ○ No restriction in the area of operations ○ 75% credit to Priority Sector ○ Minimum 50% of the Loan Portfolio should constitute Loans & Advances upto INR 25 lakh.
Foreign Shareholding	○ The foreign shareholding in the small finance bank would as per the FDI policy for private sector banks as amended from time to time.
Prudential norms	○ Subject to all prudential norms and regulations of RBI as applicable to existing commercial banks including requirement of maintenance of Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR). ○ Required to extend 75 percent of its Adjusted Net Bank Credit (ANBC) to the sectors eligible for classification as priority sector lending (PSL) by RBI. ○ At least 50 percent of its loan portfolio should constitute loans and advances of upto INR 25 lakh

Table 10: Small Finance Bank - At a Glance

Sl No	Name of SFB	Previous Name	State	Previous legal Status	Commencement of Banking operations since	Area of Operation	GLP* (In Cr)
1	AU SFB	Au Financiers (India) Ltd	Rajasthan	NBFC	Apr-17	Rajasthan based having a presence in Northern & Western India	4900
2	Capital SFB	Capital Local Area Bank Ltd	Punjab	Local Area Bank	Apr-16	Punjab based expanding operations in Northern India	2600
3	Equitas SFB	Equitas Holdings Pvt Limited	Tamilnadu	NBFC-MFIs	Sep-16	Chennai based having a presence in Southern, Western and Central India	2320
4	ESAF SFB	ESAF Microfinance and Investments Private Ltd.	Kerala	NBFC-MFIs	Mar-17	Kerala based having presence in Southern India and some part of Western & Central India.	1022
5	Suryoday SFB	Suryoday Micro Finance Private Ltd.	Maharashtra	NBFC-MFIs	Jan-17	Mumbai based with presence in AP, Gujarat, Karnataka, Maharashtra, Odisha, Rajasthan & TN	638
6	Ujjivan SFV	Ujjivan Financial Services Private Ltd.	Karnataka	NBFC-MFIs	Feb-17	All India with strengths in Southern & Western India.	3513
7	Utkarsh SFB	Utkarsh Micro Finance Private Ltd	Uttar Pradesh	NBFC-MFIs	Jan-17	UP based with Regional focus on Northern India, with presence in Western and Central India.	811
8	Fincare SFB	Disha Microfin Private Ltd.	Gujarat	NBFC-MFIs	Jul-17	While Disha is Western India based / focussed, Fincare has strong presence in Southern India	166
9	Janalakshmi SFB	Janalakshmi Financial Services Private Limited	Karnataka	NBFC-MFIs	Yet to commence	Karnataka based with presence in 12 States [excluding Eastern India] with strengths in Southern and Western India	4533
10	North East SFB	RGVN (North East) Microfinance Limited	Assam	NBFC-MFIs	Yet to commence	Guwahati Based having presence mainly in the NE States of India	227

1.1 STEPS INVOLVED IN TRANSFORMATION

- **Domestic Capital:** Majority of the MFIs are having large foreign shareholdings in the range of 80-90% at present. SFBs are required to have 51% domestic capital. This requires dilution of the exiting shareholdings or rising of fresh equity. Most of the MFIs are adopting holding Company structure for transformation.
- **Branch Conversion:** SFB are required to identify the existing branches to be converted into full fledged commercial branches and also open new branches. The remaining branches of the MFI would be called Customer Service point or staff enabled BCs.
- **Satisfy unbanked/under banked Criterion:** SFBs will be required to open minimum 25% of new branches in unbanked/under banked areas.
- **Core Banking Solution:** MFIs need to upgrade their core banking software/upgradation of each function to meet SFB requirement. Build data warehouse software, BCP and DRM, etc.
- **Human Resources:** Identify the gaps in human resources, recruitment of staff suitable for functioning of SFB, skill up gradation of the existing staff to handle responsibilities and aligning them to functioning of SFB.
- **Treasury:** set up to handle fund management as well as forex operations.
- **Risk Management/Control systems** to be put in place.
- **Channel Development:** Partnering/Development channels for customer connect, viz. ATM network/mobile based transactions, etc.
- **Meeting CRR/SLR requirements:** To comply with SLR/CRR norms from day one. Arrange for additional funds or run down of the existing portfolio.
- **Regulatory approvals/implementation of regulatory software**

4.2 OPPORTUNITY FOR SMALL FINANCE BANK

Sl. No	Particulars		Description
1	Farmers	:	51.4 % of farmer households have no access to either formal or informal source of credit
2	Farm-related Business	:	Includes irrigation, Cold storage, post harvest support, farm technology, agri related research and development, etc.
3	MSME sector	:	78% of the total finance demand of almost INR 40 lakh Cr is met either from informal sources or personal savings
4	Social Infrastructure Initiatives	:	Includes education, health, and sanitation, Swachh Bharat Abhiyan, etc.

Source: Adhikari (2015), Small is fanciful, Business Today

4.3 KEY CHALLENGES

MFIs lack trusted brand for saving, will also been obstacles for SFBs in their quest to mobilize deposits. It will have to offer at least competitive interest rate on deposit to compensate this intrinsic drawback.

The recent in principle approval of RBI to setup payment banks will create another challenge. Incumbent payment banks belong to large conglomerates and thus have robust financial muscle. RBI's intended objective to allow such banks is to enhance financial inclusion in unbanked regions. SFB will face stiff competition from payment banks to mobiles deposits as their target segment will overlap (MicroSave).

V. Conclusion

The SFB are envisaged to develop into important and effective intermediaries/partners for reaching out the MSME sector, particularly in unbanked and underserved areas, wherein the performance of Cooperative and local area bank in India has not been satisfactory. There is huge potential in the rural market; SFB needs to develop suitable products, credible strategy and a strong distributional channel to attract the potential clients. In addition to it, there is a need for cost effective mobile based technology deployments that are better suited to reach underserved areas.

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