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Role of SFBs in Financial Inclusion: A Critical Review

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ABSTRACT:

Financial inclusion (FI) has been the focus of the policies of the Reserve Bank of India since 2005-06. Along with various initiatives of the Government of India, the RBI approved the setting up of Small Finance Banks (SFB) in the year 2015. SFBs are niche banks set up to undertake basic banking activities for the unserved and underserved sections of the population.SFBs are those banks that focus to provide the basic banking facility of acceptance of deposits and provide loan facility to small business units, small and marginal farmers, micro and small industries and unorganized sectors. Small Finance banks are solving the basic financial problems and providing 75% of their loans to priority sector comprising of agriculture, small enterprise and low income group.

Keywords: Financial Inclusion, SFBs, RBI, Low Income Group

Introduction:

Financial inclusion may be defined as the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost (The Committee on Financial Inclusion, Chairman: Dr. C. Rangarajan). Financial inclusion plays a vital role in inclusive growth of the country. The growth of the country's economy is reliant on the growth of rural sector. The availability of quality financial services in rural areas will spur the growth of rural households by providing them with livelihoods. The process of financial inclusion is not new. It began with nationalization of banks and continuing with the initiatives of the government for formation of Regional Rural Banks (RRB), Local Area Banks (LAB), Co-operative Banks; other steps like providing microfinance, micro-credit. The decision to float small finance banks (SFB) is another step to augment the concept of financial inclusion.

During the past few years the banking industry has gone through many changes in which recent change is emergence of Small Finance Banks. In December 2013, Committee on comprehensive financial services for small businesses and low income households, led by NachiketMor, was formed. This committee, in its recommendations, gave the idea of differentiated bank licensing to fill the gap in providing financial services to low income households and small businesses. In September, 2015 RBI provided license to 11 Payment Banks and 10 Small Finance Banks in India. Capital Finance Bank is the first bank that started as a small finance bank in the country.

The basic objective for the setting up of SFBs are to provide credit facilities to small business units, small farmers, micro and small industries and unorganized sectors and reform to improve financial inclusion in the country. SFBs cannot perform non-banking financial services and not allowed to lend to big industries. SFBs are providing services where commercial banks are not available or not offering services. SFBs focus to open branches in rural areas and unbanked population. It also provides loans to priority sector and motivates people to save their excess funds. This makes them ideal bank for achieving the objectives of financial inclusion. SFBs can provide financial services like mutual funds, insurance and pension products but with the prior approval of RBI.

Review of Literature

Patel and Fulwari (2021) trace the progress of SFBs in India in terms of the number of branches, regional spread and volume of business. They found that since the establishment of SFBs, over the period of five years, there has been considerable expansion of SFB branches with a wider regional spread and substantial increase in their volume of business. The preliminary examination of SFBs suggested that they are progressing in the right direction as envisaged in the objectives behind setting them up.

Amulya (2019) has studied the progress of SFBs in achieving financial inclusion and tracing if their performance is commercially feasible when compared with other banks. The performance of SFBs has been measured in five dimensions, namely, range of products which includes deposits and advances of SFBs, deposits as a medium to raise funds, profitability ratios like ROA, NIM, ROE, geographical spread and customer base. The study inferred that despite regulatory compulsions in terms of the size of loans and priority sector lending, SFBs had performed well. They suggest continuous inspection of data over a longer period for a greater understanding of the feasibility of the SFBs.

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.

Kangayan and Dhevan (2020) have examined the sustainability of SFBs in India by analyzing their growth in business and their financial performance. The study conducts correlation analysis of cost of funds and net interest margins of select SFBs to gauge its impact on the profitability of SFBs. They found that profitability of SFBs was not affected by the cost of funds.

Ravikumar, Murugan, and Suhashini (2020) have studied the penetration and performance of SFBs using parameters such as number of branches, advances, deposits, presence in States, net nonperforming assets (NNPA), and capital adequacy ratios (CAR) until March 2019. The study inferred that SFBs has penetrated well across the country with a steady growth in deposits and advances. The ratios like NNPA and CAR reflected sound financial positions over the period of study. They have also examined the challenges faced by SFBs in the form of loan restrictions, cost of banking products, limited area of operation, etc.

Bhaskar Arora, Saurab Sharma, Manvinder Singh Pahwa and Shailesh Yadav (2018), they conducted a Study on Role of Small Finance Banks for Achieving Financial Inclusion in India, and found that the current requirement of Indian economy is 4A‟s (awareness, affordable, accessible and accountable) financial services and Small banks can assist to build a sturdy and financially inclusive economy in India. There is a positive correlation between financial inclusion and economic growth.

P Dhanya and P B Bhanudevi (2019), An Empirical Study on the Threats and Challenges to Small Finance Banks with Special Reference to Coimbatore City- conducted the study through SWOT analysis to observe the evolution, and progressiveness, but failed to include the relevance to Coimbatore City, also not thrown any finding on financial progress of Small Finance Banks so as to suggest the solution to more robust.

Khan Firdaus MassaratRashid(2019), Banking for the Poor: A GLM Study on Small Finance Banks In India" Author conducted Generalized Linear Model a repeated regression on the Deposit and Credit progress of Small Finance Banks in India, so as to verify if there is significant difference between deposit and credit activity and difference in time periods. The GLM study reveals and concludes that there is significant difference between deposit and credit activity and difference in time periods.

Objective

- To study the emergence and licensing requirements of SFBs in India
- To review the development of SFBs in India
- To review the contribution of SFBs in financial inclusion in India

Research Methodology

This paper is a conceptual paper. This study is primarily based upon secondary data. Data have been collected from various sources, viz., journals, published papers, news articles, RBI Data, annual reports of SFBs.

Financial Inclusion in India

Financial inclusion is a method of offering banking and financial services to individuals. It aims to include everybody in society by giving them basic financial services regardless of their income or savings. It focuses on providing financial solutions to the economically underprivileged. The term is broadly used to describe the provision of savings and loan services to the poor in an inexpensive and easy-to-use form. It aims to ensure that the poor and marginalised make the best use of their money and attain financial education. With advances in financial technology and digital transactions, more and more startups are now making financial inclusion simpler to achieve. Financial inclusion is the process of ensuring access to financial products and services needed by vulnerable groups at an affordable cost in a transparent manner by institutional players.

PMJDY: Around 192.1 million accounts have been opened under the Pradhan Mantri Jan Dhan Yojana (PMJDY). These zero-balance bank accounts have been accompanied by 165.1 million debit cards, a life insurance cover of Rs 30,000 and an accidental insurance cover of Rs 1 lakh. Other than PMJDY, there are several other financial inclusion schemes in India — Jeevan Suraksha Bandhan Yojana, Pradhan Mantri Vaya Vandana Yojana, Pradhan Mantri Mudra Yojana, Stand Up India scheme, Venture Capital Fund for Scheduled Castes under the social-sector initiatives, Pradhan Mantri Suraksha Bima Yojana (PMSBY), Atal Pension Yojana (APY), Varishtha Pension Bima Yojana (VPBY), Credit Enhancement Guarantee Scheme (CEGS) for scheduled castes, and Sukanya Samriddhi Yojana.

Financial inclusion strengthens the availability of economic resources and builds the concept of savings among the poor. Financial inclusion is a major step towards inclusive growth. It helps in the overall economic development of the underprivileged population. In India, effective financial inclusion is needed for the uplift of the poor and disadvantaged people by providing them with the modified financial products and services.

Objectives of Financial Inclusion

- Financial inclusion intends to help people secure financial services and products at economical prices such as deposits, fund transfer services, loans, insurance, payment services, etc.
- It aims to establish proper financial institutions to cater to the needs of the poor people. These institutions should have clear-cut regulations and should maintain high standards that are existent in the financial industry.
- Financial inclusion aims to build and maintain financial sustainability so that the less fortunate people have a certainty of funds which they struggle to have.
- Financial inclusion also intends to have numerous institutions that offer affordable financial assistance so that there is sufficient competition so that clients have a lot of options to choose from. There are traditional banking options in the market. However, the number of institutions that offer inexpensive financial products and services is very minimal.
- Financial inclusion intends to increase awareness about the benefits of financial services among the economically underprivileged sections of the society.
- The process of financial inclusion works towards creating financial products that are suitable for the less fortunate people of the society.
- Financial inclusion intends to improve financial literacy and financial awareness in the nation.
- Financial inclusion aims to bring in digital financial solutions for the economically underprivileged people of the nation.
- It also intends to bring in mobile banking or financial services in order to reach the poorest people living in extremely remote areas of the country.
- It aims to provide tailor-made and custom-made financial solutions to poor people as per their individual financial conditions, household needs, preferences, and income levels.
- There are many governmental agencies and non-governmental organisations that are dedicated to bringing in financial inclusion. These agencies are focussed on improving the access to receiving government-approved documents. Many poor people are unable to open bank accounts or apply for a loan as they do not have any identity proof. There are so many people who live in rural areas or tribal villages who do not have knowledge about documents such as PAN, Aadhaar, Driver's License, or Electoral ID. Hence, they cannot avail many of the services offered by governmental or private institutions. Due to lack of these documents, they are unable to avail any form of subsidies offered by the government that they are actually entitled to.

Emergence of SFBs

NitiAyog (erstwhile Planning Commission) set up a committee under the Chairmanship of Dr. Raghuram Rajan for Financial Sector Reforms, Committee in its Report popularly known as "A Hundred Small Steps" (2009), in which committee proposed setting up of Small Finance Banks to further financial inclusion, by means of deepening the financial services to small and marginal farmers, low income households, migrant labourers, small business, and other un-organised entities. SIDBI has submitted Draft Recommendations on licensing Small Finance Banks on 14th August 2014(www.sidbi.in). RBI has come out with guidelines to issue license to Small Finance Banks in Private Sector (RBI Press Release, 2014). Accordingly, 10 Small Finance Banks have been granted in-principle license by RBI. (RBI Press Release, 2015) among those ten, eight are Micro Finance Institutions who have had good track record. The 10 institutions that got license to operate their functions in the group of small finance bank are:

1. Ujjivan Small Finance Bank
2. Jana Small Finance Bank
3. Equitas Small Finance Bank
4. AU Small Finance Bank
5. Capital Small Finance Bank
6. Fincare Small Finance Bank
7. ESAF Small Finance Bank
8. North East Small Finance Bank
9. Suryoday Small Finance Bank
10. Utkarsh Small Finance Bank

Licensing Requirements of SFBs

Already existing NBFCs, LABs and MFI owned by residents can apply for a license. The promoter shall hold an experience of a minimum of 10 yrs. in the banking sector. Paid-up equity capital must have the least value of 100 crore. The SFBs must be licensed under the Banking Regulations Act Sec 22(1). These banks too must be supervised by the RBI Act 1934 and Companies Act 2013 as a public company. Once operational and working with complete significance these banks must attain scheduled bank status as per RBI Act 1934 Sec 42(6)(a). These banks too must live by all prudential norms as per the RBI norms for CRR and SLR. The promoter shall be giving a minimum of 40% of the total paid-up equity in the initial phase of 5yrs. One of the net value reaches 500cr listing of the banks will be done mandatorily. Extend 75% of ANBC to the sectors classified as PSL. At least 50% of its loan portfolio should constitute of loan and advances upto 25 lakhs.

Small finance banks must be enrolled as a public limited company under the Companies Act, 2013 and will be authorized under Section 22 of the Banking Regulation Act, 1949. Also, it is administered by the terms of the Banking Regulation Act, 1949 & Reserve Bank of India Act, 1934. Along with another important statute and the Directives/Regulations including other Guidelines/Instructions allotted by RBI and other regulators from time to time.

Conclusion

Small Finance Banks aim to provide basic banking and financial services to unbanked and disadvantaged section of the population. SFBs play a crucial role to provide assistance for low income and unserved population in order to enhance their socio-economic environment. Small Finance Banks are much refined form, comparing earlier special purpose financial vehicles like RRBs, LABs or co-operative movement. SFBs will be having a vital role in economic development and will provide a huge support to the financial inclusion initiatives.

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