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Leveraging Small Finance Banks in Achieving Financial Inclusion in India

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Abstract

With the yielding of licenses to 11 payments banks and 10 small banks in September, 2015 the Indian banking sector has seen a key evolution in reaching out to a different clientele and model of delivery which was not previously covered by the scheduled commercial banks. The objective of the change is to improve financial inclusion in the country. This paper discusses the essential of financial inclusion of a great priority sector in India that is left unbanked or informally-banked. It discusses the RBI policy to advance financial inclusion and the recent licensing of Small Finance Banks in order to achieve so. Small finance banks start with great assure of catering to rural and urban poor and the unbanked segment of population but they also expression huge challenges in terms of building the required capacity, infrastructure to service a wide variety of clients and also to train its existing manpower to reorient themselves for offering a more full-fledged service than a typical MFI. The paper attempts to study the guidelines through which the RBI has licensed these banks, the backdrop of this new experiment and the issues and concerns shared by a wide body of stakeholders. The paper would also like to know the impact of small finance banks on financial inclusion.

Key Words: *Small finance bank, financial inclusion, economic status, social status.*

Introduction

The concept of Small finance Bank (SFB) is the new step taken by RBI to bring unbanked and under-banked community under the territory of banking sector. Hence RBI issued the principal approval to ten institutions to start SFB in the nation. As Micro Finance Institutions (MFIs) have been practicing among rural people for long time, they are in a position to understand the credit needs of rural and under-served population. So, out of ten entities, eight are from microfinance sector which shows the importance of microfinance institutions to contribute to low income group in rural India. These banks are new and innovative in the formal banking sector. Under this context, an analysis is required to recognize their role in financial inclusion.

In case of small banks, deposits and loans are provided by small banks for small areas. Farmers, micro, small and medium entrepreneurs and other unorganized sectoral people benefit from small banks. Chances are rendered for micro finance institutions and non banking financial companies to start small finance banks. License should be granted for such micro finance institutions and non banking financial companies to start small banks which will serve for a quarter of rural branching and a half of loan facilities to micro, small and medium entrepreneurs. Not all are applicable for the license of small banks. License for small banks cannot be applicable to cooperative banks. But, non residence Indian can have access for licenses for small banks. From the point of view subsidiaries, small banks cannot have their subsidiaries.

Under the payment banking, current account savings account cardholders, net banking cardholders, debit card holders and prepaid card holders are only permitted to payment banking. Investment in government securities is allowed but fixed deposits or loans are not admitted. Concern of payment bank focuses on the poor people, migrants, and the unorganized. Payment banking can be used to pay and remit money for these poor people, migrants and the unorganized. Payments and remittance to the poor, migrant and the unorganized can also be possible via post. But, while payments and remittances are made by post commission has to be paid. Payments and remittance involves the commission by which for these poor, migrant and the unorganized may suffer.

Review of Literature

Acharya (2017), in her article pointed out that the Reserve Bank of India (RBI) is instrumental in promoting the idea of Small Finance Banks to provide banking services to unbanked region. It is compulsory as per RBI norms that these banks have to operate at least 25% of its branches in unbanked areas to give financial assistance to rural poor. Banks can expand their banking outlets and make sure the services to deprived community in unbanked areas.

According to Bandyopadhyay (2017), 75% of Small Finance Bank loans have to be disbursed to priority sectors of the society. Demonetization movement affected MFI-turned-Small Finance Banks as it increased the amount of Non Performing Assets. Cash is the foundation for their business form and small customers from informal sectors cannot easily accept cash-less business model. By adopting better technology system and experienced employees, SFBs can accomplish the RBI's goal to provide financial assistance to unbanked population.

Ninan (2017), mention that out of ten SFBs, eight are from microfinance institutions and this is a clear evidence of the contributions of MFIs to financial inclusion process. SFBs can serve better the un-served rural population by issuing small amount of credits to meet their different life cycle requirements.

Ray (2017), in his paper point out that Small Finance Bank is an innovative development in the Indian banking industry to extend financial aids among rural and semi-urban poor. They adopt differential model of delivery apart from scheduled commercial banks to reach out to the needy. Small Finance banks have to develop adequate infrastructures and trained manpower in order to fulfill their assigned tasks.

Ravi Singh et al (2016), articulate that the financial inclusion is the main purpose of granting license to start small finance banks to existing Non-banking finance companies and local area bank. These banks have to focus on lending low-value customers at the bottom level of the society. The banks are permitted to collect deposits and perform other banking activities.

Morbia (2016) says that the Small Finance Banks are allowed to carry out the basic banking services such as accepting deposits and lending money, mainly to low-income groups. Since working as banks, the interest rates can be reduced, so the low-value customers and small enterprises can enjoy the benefits of low cost credits. Institutions, transforming into Small Finance Banks are in a position to understand the financial needs of rural poor. By providing bank loans, these banks help rural population to come out of poverty.

Statement of the Problem

Commercial banks and other financial entities are not effectively serving the rural population especially un-served and under-served rural population, because of lack of understanding the credit requirements of rural people. They are mainly interested in providing finance to large and medium corporate and urban customers. In our nation, majority of the people belong to low and middle income group. In rural India, formal banking facilities are still a scant product. Micro and small enterprises and small customers especially from rural and semi urban areas are partly served by private financial institutions and local money lenders. The concept of Small Finance Bank is an innovative step taken by policy makers to serve the un-served and under-served rural population. Small Finance Banks have better knowledge of the financial needs of rural community because, most of these banks were working as MFIs and their employees have better knowledge regarding the credit needs of rural customers. In this situation, the present study tries to analyze the role of Small Finance Banks in promoting financial inclusion. In this process it is needed to examine the outcome of small finance banks on financial inclusion.

Objectives of the Study

1. To understand the concept of small finance banks and financial inclusion.
2. To examine the effect of small finance banks on financial inclusion.

Research Methodology

The study is based on secondary data. To study the role of Small Finance Banks in promoting financial inclusion, secondary data is collected from various journals, publications and websites.

Importance of Small Finance Banks

Small banks can play vital role in giving loans in small scale. Reserve Bank of India prefers to have small banks that can serve for poor people. Small banks can spread their banking activities to the rural masses. Reserve Bank of India also gives preference to take banking to the rural poor people. Reason for the preference of Rural Bank of India is that rural poor people have no access for full coverage of banking services. By having small banks, India wishes to develop a network of small and focused lenders. These small banks specifically target the low-income segment in the country.

These types of small banks are similar to US community banks. These small banks undertake their banking operation as commercial banks but in a limited scale. These small banks can give loans to low-income segment. These small banks are an opportunity for low-income segments but not to big borrowers. Therefore, these small banks are good news for the Indian poor. Reserve Bank of India announced 8 out of 10 Microfinance Institutions (MFIs) as small finance banks in-principle. These are Au Financiers (India) Ltd, Capital Local Area Bank Ltd, Disha Microfin Pvt. Ltd, Equitas Holdings Pvt. Ltd, ESAF Microfinance and Investments Pvt. Ltd, Janalakshmi Financial Services Pvt. Ltd, RGVN (North East) Microfinance Ltd, Suryoday Micro Finance Pvt. Ltd, Ujjivan Financial Services Pvt. Ltd and Utkarsh Micro Finance Pvt. Ltd. Eight out of these 10 entities are micro-finance institutions (MFIs), one is a local area bank and one is a non-banking financial company.

Announcement of MFIs as small finance banks helps MFIs and poor people to a greater extent. MFI are well-familiar with the degree of banking with the poor borrowers. MFIs were so far not allowed to accept deposits and engaged in extending credit. Now, by getting access to banking, MFIs can value public deposits, which will significantly lower their cost of borrowing and enable them bring down their rate of interest on loans lower.

Small finance banks offer a variety of financial products and services to poor people in India who do not have access to formal banking system. The institution's mission is to "provide full range of financial services to the economically active poor to build better lives". To fulfill the specific needs of its customers, the bank offers various types of individual and group loans.

Small finance banks and its impact on financial inclusion

The move of giving licenses to payment banks and small financial banks will be the major step towards pushing financial inclusion in the country. The main target for payment banks and small finance banks will be small businesses and low-income household by providing them financial services at low transaction cost. It is uneconomical for banks to open branches in every village, but with mobile phones which have wider penetration can provide low-cost platform for taking banking services to every citizen. It will include people who mainly transact in cash to take their first step into banking system and also accelerate India's journey as a cashless economy.

Cost of banking will come down due to competition from payment banks and small banks. Currently, private banks like ICICI, HDFC, Axis, etc. are making huge profits by collecting funds at lower costs from savings accounts & current accounts (CASA deposits account for 40% of bank deposits) and lending it to small borrowers at higher rates. But payment banks and small finance banks get big chunk from this by providing higher interest rate on deposits and giving credit (small finance banks only) at lower rates. This will increase competition and lower-income group and small businesses will be benefitted the most.

For customers, the real attraction will not be higher interest rates, but the convenience of carrying out banking transactions at fingertips. Also, as payment banks will mainly have government as a borrower, there is very less chances of defaults. Government is also get benefitted as a borrower, as payment banks will expand access to cheap funds. As payment banks can only invest in short-term government bonds, government can borrow more at cheap rates.

We can also eliminate black money from large part of financial system by reducing cash transaction and encouraging people for use of e-money. This is achievable within 5-10 years with investment in financial literacy and educating rural citizens, especially women.

Payment bank will reduce dependency on cash and will increase m-commerce, as mobile wallets will be used as payment option. It will also transform our subsidy and social welfare schemes. With the troika of Aadhaar card, Jan Dhan Yojana and payment banks will enable government to provide direct subsidy.

Today, there is a large unmet need for those at the bottom of the pyramid not just to have a bank account but also to get loan to run their small businesses and get out of poverty. Various models of rural and cooperative banks have failed to deliver these. But organizations that are selected for small financial banks have successfully done this job of giving small and know their borrowers' needs. So they have high chance of success.

Small financial banks will extend formal financial access to small enterprises that are currently dependent on high-cost unorganized sector lending. According to RBI estimates 80 percent of small enterprises do not have access to formal financial institutions. So it will be a huge step towards full financial inclusion.

Findings

- While small banks have the potential for financial inclusion, performance of these banks in India (Local Area Banks and Urban Co-operative Banks) has not been satisfactory. So if small banks are to be preferred, the issues relating to their size, numbers, capital requirements, exposure norms, regulatory prescriptions and corporate governance need to be suitably addressed.
- Further, in a dynamic economy, banks would either grow or fail. So, the number of small institutions at the root level will likely shrink over a period of time even as the population needing basic financial services increases. These demands for a regular licensing of institutions to provide a steady supply of financial services to the priority sector.

Suggestions

- Government of India and RBI decided to start Small Finance Banks as the part of financial inclusion to ensure better banking services to every section of the society. To achieve this objective, SFBs have to follow low-cost operations system based on the latest technological tools.
- Two main challenges of SFBs are talented work force and advanced technology. The existing staff needs to be properly trained to sell new products of SFBs and take deposits. In order to reach un-served and under-served rural areas, SFBs can adopt low-cost, mobile based technologies.
- SFBs offer financial support to small business units and micro and small industries. In the mean time, adequate training can provide to these units as well as the interested rural people to develop entrepreneurship skills so that they can manage their business more effectively and efficiently.
- Majority of SFBs' customers are from the rural areas. So financial literacy is another concern faced by these entities. Financial education and counseling help the rural people to invest money productively in their ventures.
- They will become aware of the benefits of good credit records and timely settlement of credit. These small-valued population need to be educated about e-money and cashless business model to reduce the use of cash as India is moving towards digital economy.

Conclusion

Small Finance Bank is the appropriate step taken by the Government of India and RBI to bring the isolated un-banked and the under-banked community under the domain of formal banking system. Most of these entities were working as MFIs for a long period of time; they are in a better position to understand the credit needs of rural poor. Therefore authorities can efficiently execute microcredit programmes through Small Finance Banks. In our country, more than half of the population belongs to low-to-middle income group and are residents in rural area. The economic development of the nation is possible only through uplifting this particular category. Financial inclusion is also necessary for the development of the nation. To understand the impact of small finance banks on financial inclusion, it is evident that the Small Finance Bank has substantially enhanced the banking services to the rural population to improve economically as well as socially. Micro credit is the major tool to assist the un-served and underserved community for enhancing their economic and social life. So it can be restated that, Small Finance Banks have important role to improve the economic as well as social status of rural population.

RBI prefers small banks and payment banks for taking the concept of financial inclusion of India. Payments banks will modernize financial services. Both Small Banks and Payment Banks have few similarities.

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