INNOVATION BOOSTING FINANCIAL INCLUSION: AN ANALYTICAL STUDY OF THE SCOPE AND RELEVANCE OF SMALL FINANCE BANKS

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ABSTRACT

Financial Inclusion is becoming the call of the day. It has evolved as a priority area for policymakers, regulators and development agencies even the World Bank Group considers it as a useful tool to reduce poverty and boost prosperity. In India to give a pump to the idea of financial inclusion RBI awarded 10 Small Finance Banks licenses which has even opened gate for large no. of banking job opportunities. This paper analyses the present relevance of SFBs, its importance in boosting financial inclusion, its supremacy over Payment Banks and LABs, its future prospects and upcoming challenges that SFBs may encounter, also in the paper suggestions have been put forward about how SFBs can be made more productive in the coming future.

INTRODUCTION

Financial inclusion means that businesses and individuals have access to useful and affordable financial products and services that meet their needs and these are delivered to them in a sustainable and responsible way and the first step toward broader Financial Inclusion is to have access to a transaction account. Even the World Bank Group has emphasized on the importance of financial inclusion in reducing poverty and augmenting economic prosperity. They even put forward an ambitious goal to attain Universal Financial Access (UFA) by 2020. In lieu of this goal RBI in various committees and discussion papers have highlighted the need to establish small financial banks (SFB) as coveted vehicles for stimulating financial inclusion in India as compared to other banking structures as proliferation of small finance banks is providing solution to one of the biggest lacunae of dominant public sector banks i.e., providing banking services to the unserved and underserved regions. The experiment with Small Banks was made in 1996 also by setting up of Local Area Banks but their geographical constraint proved a failure, hence the idea of SFB was evoked that serve PAN India. This Paper highlights the present relevance and further scope of SFB in boosting financial inclusion as well as financial intermediation.

Following the recommendations of Nachiket Mor Committee Guidelines for licensing of small finance banks were released on July 17, 2014 which led to around 67 applicants contending out of which RBI awarded licenses to ten of them on September 2015. Like differentiated banks they preferably serve niche interests and their basic objectives are to serve as a) saving vehicles and b) supply credit to small and marginal farmers, small business units, etc. Registered as public ltd. Company under The Indian Companies Act, 2013 and licensed under sec.22 of The Banking regulation Act, 1949 will be awarded the status of scheduled bank after their operations are commenced as per sec. 42 (6)(a) of RBI Act, 1934.

Objectives of the Study

- To study the relevance of small banks in the present scenario and especially with reference to the unbanked areas.
- To compare the benefits of SFBs with presently working financial institutions.
- To analyze the further scope of SFBs in catering the perspective of Financial Inclusion AND Financial Intermediation.
- To mention some moderate challenges SFB’s may face in future.
- To suggest some simple measures for promoting the proliferation of SFBs

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METHODOLOGY

The research is focused on innovation boosting financial inclusion (studying the relevance and scope of small finance banks). The nature of the topic is completely theoretical and elucidatory and based on empirical research. The research is based on secondary data collected from known and relevant sites of the Govt. of India, RBI, recognized newspapers and noted financial institutions.

However, the research is gripped with certain limitations as highlighting below:

Some of the articles in the acknowledged newspapers may be biased by personal opinion of the concerned writer.

The idea of scope and challenges has been formulated according to the opinions and advises forwarded by various known personalities who are already a part of the bigger financial circle and may have raised opinions based on their preference and convenience.

By and large, there is immense chances of many other scope relevance and even challenges been skipped from the study.

Despite all these limitations, sincere efforts have been made to analyze minutely the actual intensity and motive of the topic.

Present Relevance of SFB’s

Committee on Financial sector reforms (Government of India, 2009) headed by former RBI Governor Raghuram Rajan mentioned in their report “A Hundred small steps” that there is a requirement to make changes in the pattern of achieving financial inclusion. It emphasized that the focus should now shift from incumbent large public sector banks towards improving efficiency, innovation and value of money. Financiers those with low cost structures but prompt in making decisions should be encouraged to start banks, and thus, recommended the entry of private, well-governed, deposit-taking small finance banks. Banking costs are likely to come down due to Multiplication of these banks.

The threat of brewing competition from these differentiated banks have triggered awareness among occupant banks to consider the importance of liabilities and payments as separate commercial activity apart from being just considering it as source of liquidity and promoting transactions.

Financial sector considers tapping the untapped sections especially in rural areas as a new opportunity in which SFB’s are excelling with an exorbitant speed.

Making banking services more thrifty and accessible by increasing competition and inclusiveness for small depositors as well as for borrowers.

Encouraging financial intermediation and thus exerting robust influence on economic development by reducing poverty as more people come under the purview of banking services. They have opened gate for large number of banking job opportunities and the shift is from non-experienced less professional jobs to more skill based professional jobs. Not only this even at senior levels people are moving from their well set impregnate roles to new, startling and enlarging opportunities at SFBs.

<table>
<thead>
<tr>
<th>Relevance as compared to LAB’s and RRB’s</th>
<th>SFB</th>
<th>LAB &amp; RRB</th>
</tr>
</thead>
<tbody>
<tr>
<td>AREA</td>
<td>PAN-INDIA</td>
<td>Geographically Constrained</td>
</tr>
<tr>
<td>SUPERVISION</td>
<td>Direct supervision of the RBI</td>
<td>Under the supervision of the sponsor banks</td>
</tr>
<tr>
<td>CRR and SLR</td>
<td>Same like other commercial banks hence making people more comfortable</td>
<td>Different from other scheduled commercial banks</td>
</tr>
<tr>
<td>COMPETITION</td>
<td>No compulsion to compete with HDFCs of the world</td>
<td>Like traditional banks they had to suffer this baggage</td>
</tr>
</tbody>
</table>

Relevance as compared to Payment Banks

<table>
<thead>
<tr>
<th>Relevance as compared to Payment Banks</th>
<th>SFB</th>
<th>Payment Bank</th>
</tr>
</thead>
<tbody>
<tr>
<td>LOAN</td>
<td>Small Banks can lend and emphasis should be on Priority Sector Lending’s.</td>
<td>They are not allowed to lend.</td>
</tr>
<tr>
<td>AREA OF FOCUS</td>
<td>The area of focus remains the segment that is unserved. Reason: Most of them are micro finance institutions.</td>
<td>Reason: The area of focus is a wide gamut(both the top as well as the bottom end)</td>
</tr>
<tr>
<td>DEPOSITS ACCEPTED</td>
<td>They can accept all types of deposits(FD, RD, Saving and current)</td>
<td>They can accept restricted deposits up to one lakh (1,00,000) per person</td>
</tr>
</tbody>
</table>

Relevance regards Technology

A report from China about a financial service (a branch of Alibaba) is spellbinding that says that the most backward regions (like Tibet) 80% of the transactions are done through mobile whereas it is low for developed regions (like Shanghai) as they have multiple other channels of transaction. This is definitely a very good indicator for SFB’s operating especially in unserved and underserved regions.

SFB’s are also devising methods to make use of JAM (Jan Dhan Aadhar Mobile) Techniques which promotes DBT and definitely a very good indicator for SFB’s operating especially in unserved and underserved regions.

Demonetisation and SFBS

Demonetization enabled large amount of cash to flow through banking channels and hence making banks engulfed with funds which benefited the SFBs as initially they are dependent on bank borrowings. BENEFIT: Low cost of borrowing.

Large size Banks flooded with liquidity and experiencing falling interest rates give a boost to lending activities and this gave opportunity to SFBs to provide retail and small business loans. BENEFIT: Improved credit outflow.

Cash less transaction enables obtaining information about individual’s consumption behavior and history of financial transactions easier using this information SFBs can design innovative credit products for their customers suiting their needs. BENEFIT: Less paper work and more chances of introducing innovation.

SFB’s can learn a lot from the weaknesses of the govt. and private banks which were highlighted during demonetisation period. (For e.g. weak control system, lack of money in ATMs, etc.) BENEFIT: Design robust system to face such weaknesses.
Further Scope of SFBS

According to a report out of 592,927 villages in India (population 9,999 approx.) 268,454 (in records) villages have been covered under financial inclusion initiative. This clearly leaves 324,473 out of the ambit of formal financial outreach. NBFC-MFIs turned SFBS have clearly higher access to these areas as compared to other banks as MFIs is efficient in providing last-mile services and this characteristics is automatically transferred to MFI turned SFBS.

Key to attract savings is providing convenient services to the customers and SFBS can create touch points to prompt customers to save regularly.

They can boost Pigmy deposit on which big banks are hardly focusing. Pigmy deposits have immense potential to encapsulate surplus cash from households and miniature businesses. This deposit scheme suits the saving needs of poor like the wage earners, traders, housewives, etc. (as they have small and uneven cash flows) The depositor’s receive door to door service which reduce their travel expenses as well. Due to staff’s unwillingness the banks have not emphasizes on Pigmy deposit and hence the SFBS can play a dominant role in filling this gap.

By serving their immediate objective of reaching to huge number of micro and small enterprises and thus enlarging lending under MSE sector they can even render their contribution towards economic growth as this sector is a channel for any developing country to accelerate growth economically.

They can transform into full-fledged banks (after RBI’s approval) by fulfilling the condition of establishing 25% branches in unbanked regions. SFBS by opening branches and extending banking activities in these regions can thus promote financial inclusion.

They have opened gate for large number of banking job opportunities and the shift is from non-experienced less professional jobs to more skill based professional jobs. Not only this even at senior levels.

They can very well provide on role jobs and reduce the exploitation caused by off role jobs.

They can boost expansion of ATM’s even in the remotest areas.

Challenges Ahead

It’s really hectic and time consuming to deal with customers who are first time users of any financial service. It will take time to make them familiar with the present system.

Door to door service demands excess physical along with mental devotion by the staff and hence services should be provided in a way different from that of Universal Banks.

High dependency on customer’s deposit. Savings turned deposits will take time to magnify and that too is possible only if trust and convenience is constantly maintained.

High transformation cost and transformation itself will not be that easier as to mobilize retail savings is tremendously challenging.

Capturing the rural mass will not be that easy as it requires challenging the commercial banks that are highly trusted by them.

Significant burden to manage RBI Guidelines of 4% CAR, 5% CRR and 21.4% SLR as it will result in reduction of their earnings until and unless they improve their depositor base substantially.

To cope up with the guidelines of putting cap of 74% foreign ownership will be an uphill task as presently many MFIs turned SFBS have more than 75% equity and to bring it substantially below 74% will not be that easy especially when there is shortage of domestic equity resources.

To confine in niche markets can be suicidal as you are detached from the more progressing and rapidly developing mass markets.

According to a report by The Economic Times in FY 2017 the market share of SFBS was 22% which is still less seeing the immense potential it possess regarding boosting Financial Inclusion.

Market Share

| Source: the economic times |

Suggestions for Future

Awareness should be created to make people (especially of unserved areas) realize the importance of SFBS in their life. Subsidizing is not always the option to promote a cause and we can very well learn from China where cost is incurred on marketing things to create demand instead of subsidizing things. Awareness can hence be created by advertising and marketing more about the benefits of SFBS.

Like the present case only MFIs or LABs should not only transform into SFBS. A more innovative idea is to turn the present buildings of Post Offices into SFBS as it will help in enlarging the reach of SFBS knowing the fact that post offices are present in most diversified areas. This will reduce the transformation cost of SFBS which is highlighted above as a challenge. The same will also serve in generating more employment without incurring the cost of developing infrastructure.
Special outdoor duty jobs should be generated so that door to door service do not become a tedious and ignorant task in the years ahead as it became in the case of big public sector banks. Provisions should be made by RBI and even GOI to assure they do not remain confined to niche interests which may hamper their progress and should be made compatible with commercial banks. This requires lowering CRR, SLR etc. at least in the initial years of progress. These measures by the authorities will prevent ruining of the SFBs like it happened in case of LABs.

Efforts should be made to increase the share of SFBs from present 22% to at least 40% to assure measures are taken in the direction of Financial Inclusion.

**CONCLUSION**

Challenges are minimal but scope and relevance is immense. In order to make their presence in PAN India SFBs are spreading from their core headquarters to all over India to further promote Financial Inclusion. In the era where convenience and door to door services are must SFBs will prove fruitful not only in unserved areas but also elsewhere. They are not only developing but also competing the incumbent banks.

**References**


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