Small Banks For Big Financial inclusion deeds – A study

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ABSTRACT

Since 2005-06, the Reserve Bank of India's policies have prioritized expanding access to financial services. The Reserve Bank of India (RBI) gave its blessing to the establishment of Small Finance Banks (SFB) in 2015, one of several government initiatives that year. SFBs are specialized banks established to provide financial services to the unbanked and underbanked. This study looks at how SFBs in India have grown over time in terms of their branch count, geographic footprint, and total annual revenue. Over the last five years since SFB's inception, the company's branch locations, regional reach, and overall business volume have all seen significant growth. It was also discovered that towards the conclusion of the research period, there were more SFB branches established in peri-urban and rural regions.

Key words: Small finance banks, financial inclusion, banking

Introduction

Traditional definitions of poverty have focused on people's lack of access to financial resources, but more recent analyses of the issue have taken into account a more nuanced set of factors, seeing poverty through the lens of people's actual lived experiences. When considering poverty from a multi-dimensional perspective, it is not enough to consider financial hardship alone. To provide a more complete image of poverty, it includes issues like poor health or malnutrition, a lack of clean water or power, a low quality of job, and restricted access to education (Niall McCarthy, Forbes 2007). According to a Press Release from the United Nations Development Programme (UNDP), 271 million Indians were lifted out of poverty between 2006 and 2016 (UNDP, 2019). This may not have been feasible without the many initiatives taken by the nation, beginning with independence and culminating with the introduction of Small Finance Banks as a tool in the fight against poverty.

Small finance banks

The need in the country has increased for a plethora of financial services, including but not limited to savings, microcredit, insurance, pension, mutual fund, transfers, and so on. In its report titled "A Hundred Small Steps" (2009), the Committee on Financial Sector Reforms established by the Niti Ayog (formerly the Planning Commission) and chaired by Dr. Raghuram Rajan recommended the establishment of Small Finance Banks in order to "further inclusion" by expanding access to financial services for low-income households, migrant workers, small businesses, and farmers. On August 14, 2014, SIDBI (www.sidbi.in) released its Draft Recommendations for the regulation of Small Finance Banks. The Reserve Bank of India (RBI) has issued regulations for the licensing of private sector small finance banks. As a result, the Reserve Bank of India has granted 10 small finance banks a "in-principle" license. Eight of the 10 are reputable Micro Finance Institutions (RBI Press Release, 2015).

Literature Review

Biswa Swarup Misra (2007). Regional Rural Banks in India: Can We Learn Anything from Their History- The research used a logical method and empirical analysis to confirm the profitability of RRBs, investigate the variables that affect their efficiency, and reach the conclusion that failing RRBs are not unique to any one state or any one sponsor bank.

M.S.Sriram (2014), Local Area Banks in India-A Review, This research examines the current state of trusts and financial inclusion. Financial inclusion may be achieved via the use of local area banks. The study argues that regulations on the size and scope of local banks are warranted. It proposes a scaled-down version of conventional financial institutions.

Jayadev, Himanshu Singh and Pawan Kumar (2017), in his study “Round Table-Small Finance Banks: Challenges- small finance banks' adherence to regulations was compared to those of other financial inclusion vehicles, and the origins of both were examined. We interviewed top bank executives from small finance institutions to get their take on things, and they confirmed that their institutions had adapted a good business model.

Alok Misra and Ajay Tanka (2018), Inclusive Finance India Report-Chapter7-“Small Finance Banks and Payments Banks: Struggle for Differentiation and Business Model continues”- study analyses comparatively, the Small Finance banks and Payment Banks and studies the genesis challenges in future, bystudying the individual business profiles of the SFBs, splashes out what challenges industry would face.

Jeeban Jyoti Mohanty (2018), “Leveraging Small Financial Bank(SFB) in achieving Financial Inclusion in India”- used primary and secondary data from sources including micro save, the World Bank's Consultative Group to Assist the Poor, and other organizations to form a mixed-methods research. The study ends by advising the SFBs to develop adequate goods, a credible strategy, and a strong distribution channel, but also pointing out the failure of previous cooperative, local area banks to accomplish their goals.

Bhaskar Arora, Saurab Sharma, Manvinder Singh Pahwa and Shailesh Yadav (2018), Efficient, reasonable, accessible, and responsible financial services are what the Indian economy needs right now, and small banks can help to provide just that by making such services more widely available. Inclusion in the financial system is associated with a more prosperous economy.

Indira R and Paramasivaiah (2019), While this study confirms cooperative banks' importance to rural and urban economies and their rapid expansion, it also reveals some of their limitations. According to the research, the cooperative movement has been co-opted by a certain government agency.

RESEARCH PROBLEM

According to the data compiled by the Rangarajan Committee in 2014, a staggering 363,000,000 people worldwide live in poverty. MoSPI, Centre for Statistics Report, 2018, states that 21.90 percent of the country is living below the poverty line (Rural 25.70 percent, Urban 13.70 percent). SFBs are cutting-edge methods of rescuing the poor from poverty. disadvantaged groups through increasing access to financial services including banking, saving, credit, mutual funds, micro insurance, and transfers. SFB is a novel unique vehicle and developmental phase. From what we can see thus far, they are doing a great job, and their 17% market share in microfinance (Microfinance Pulse Report Oct'19*) is impressive. Possibly in response to the prior failings of LABs, RRBs in accomplishing the aim of financial inclusion, the Licensing policy of RBI, to SFBs is severe and watertight. SFBs are introduced into the open market where Commercial Banks face intense competition, with strict regulatory compliance criteria in place. This led us to the conclusion that the long-term viability of SFBs merits academic investigation.

Numerous studies and reports have shown that SFBs' high funding costs reduce profits and hinder their potential to expand. However, nobody checked the claim in a reasonable way. Therefore, it is crucial to confirm this discrepancy, if small finance banks' cost of funding impacts their Net Interest Margin and the scalability is constrained. Small Finance Banks' goal of wider inclusion is meaningless unless its feasibility can be tested.

AIM OF THE RESEARCH

To investigate the background and regulations governing small financing banks in India.To appreciate the development of India's small finance banks To determine whether their Net Interest Margin is affected by the cost of funding.

HYPOTHESIS

H0: The Net Interest Margin of SFBs is suffering as
a result of rising costs of funds.
H1: SFB's cost of funds has no effect on their NII.

RESEARCH METHODOLOGY AND SAMPLING

The study data is collected from RBI website

Coverage of study

There are probably some problems with this research. This research is subject to the same caveats that plague all statistical analyses. It is difficult to compare data from different small finance banks because there is no standard format for their Annual Information Report and the RBI Data does not maintain a separate database for SFBs; instead, all available information comes from the Basic Statistical Return. Due to the nature of SFBs as specialized financial vehicles, we are unable to apply the same standards of interpretation to them as we would to Scheduled Commercial Banks.

DATA ANALYSIS AND DISCUSSION

Research is using both quantitative and qualitative methods since Small Finance Banks are still a novel idea in India and a specialized tool. In order to grasp their growth, the momentum behind their inception, and the constancy of their financial performances, it is important to verify and test for correlating the financial data inter alia across and inside themselves.

Small Finance Banks for sustainable financial inclusion

The sustained development of India's small finance institutions during the year's first half of 2019. As can be seen in Table 1, there has been a net decline in bank borrowing at small finance banks as a result of an increase in deposits. The requirement on capital to be increased to 500 crore in 5 years causes a fictitious growth in capital. Historically, big financial institutions (MFIs) have been the primary source of borrowed money for the SFB. As a result, the high cost of their borrowing reduces their bottom line. Following their transition into full banking status, small finance institutions are required by regulation to repay all outstanding bank loans. Conversely, by entering the banking industry, they will be afforded the same rights as Scheduled Commercial Banks and will be able to accept deposits, offer third-party goods such as mutual funds and insurance, and contribute to retirement plans. Due to their new status as an SFB, they are now on same footing with Scheduled Commercial Banks in terms of accepting deposits from the general public.SFB is a replacement for the expensive and prohibitive borrowing done before they became small finance banks. In addition, the promoter's interest must be reduced to 40% upon SFB status, and then to 26% over a period of time. Over time, foreign ownership must be cut to 49% as well. To increase capital to Rs.100 core and then Rs.500 core within 5 years, the rules also require a staggered listing. The SFBs are proceeding in the expected direction, as a result. Total gross NPA is 2.

Performance or financials

Revenue Sources for Small Finance Institutions 1.Interest on Loans - Interest earned on their loan portfolio, which includes loans to SMEs, FMCGs, SMFMs, and low-income consumers. Investments in government-rated securities, bonds, and other rate instruments provide interest for small finance institutions. 3.Fee Income - Safekeeping, Bill of Exchange Acceptance, and Other Banking Services Charged by SFB Foreign Exchange (Forex) Transactions - Foreign Exchange Trading Fees Charged by Banks 5.Third-Party Commissions: Commissions made on the sale of corporate goods like as insurance, mutual funds, credit cards, etc., via Small Finance Banks.

Relevance of Cost of Funds to Net Interest Margin:

It has been pointed out in many review of literature that the SFB"s cost of funds is high and thus theirprofitability would be reduced, and need to hit it for improvement, so as to gain the investors attraction. Many are of the view, that, to reduce the cost of funds, SFBs can go for high cost deposits, market debts etc. Hence, we attempted to verify the empirical view on it, through correlation analysis between „Costs of Funds" of select SFBs, with their „Net Interest Margin"

Table 1. Correlation Analysis

Name of SFBs	x	y	zx	zy	Zx.zy
AU SFB	8.55	8.07	0.35	-0.08	0.03
UJJ SFB	9.89	11.43	0.6	0.29	0.01
SURYODAY SFB	11.01	-0.49	0.70	0.21	0.25
ESAF SFB	5.9	5.99	-0.6	-0.21	0.1

NORTHEAST SFB	6.6	2.29	-0.32	-0.86	0.30
EQUITAS SFB	5.22	16.22	-0.6	0.70	-0.35
		AVERAGE			0.05
		R^2	0.004		
Source: Annual Reports Computed and Combined with Other Data X = Typical Expense of Borrowing Money Y = Typical Return on Borrowing Money Standardized variables Zx and Zy, the R-correlation coefficient expressed as a Z-squared number, and the squared correlation coefficient, Rsquared, are used to calculate the percentage of variance in Y relative to X.					

Source: author's calculation

The Costs of Funds Net Interest Income Net Interest Margin Null hypothesis was created to investigate this a priori inverse connection. To investigate the nature of the connection between SFBs' "costs of funds" and their "Net Interest Margin," we gathered data from a random sample of 6 of the 10 SFBs in the sample. The results of the linear correlation analysis showed a value of R = 0.02 and a R squared value of 0.004, both very close to Zero. Therefore, we accept H1 as the alternative hypothesis and "reject" the Null Hypothesis. Costs of funds are assumed to have no impact on a small finance bank's interest income or net interest margin. Therefore, it may be concluded that the Cost of Funds is not seriously reducing profits.

CONCLUSION

When compared to prior special purpose financial institutions like RRBs, LABs, and the Cooperative movement, small finance banks are a considerably sophisticated form. The data shows that they have the skills and potential to do the job. Small Finance Banks are a long-term solution to reaching the underserved market since they are treated similarly to Scheduled Commercial Banks in terms of regulatory compliance. In general, the country's effort to promote Financial Inclusion and reduce poverty relies on the services provided by small finance banks.

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