A STUDY ON BUSINESS ACTIVITIES OF SMALL FINANCE BANKS IN INDIA AND THEIR ROLE IN FINANCIAL INCLUSION - A THEORETICAL STUDY

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Abstract

Banks are crucial to the financial sector's operation and the nation's economic growth. By directing money toward investments and improving resource allocation efficiency, the banking sector plays a significant role in fostering economic growth. The development of India is increasingly viewed as predicated on the existence of an effective banking system. The foundation of India's financial system is these institutions, which act as a gathering place for investors and savers. The Reserve Bank of India (RBI), which oversees the whole Indian financial industry, is the central bank that regulates the country's banking system. Small Finance Banks (SFBs) in India are financial institutions that primarily focus on providing financial services to small and marginal customers, including small business units, small and marginal farmers, micro and small industries, and unorganized sector entities. Small Finance Banks basically work as savings vehicles as well, as they are engaged in offering credit facilities to small business units, micro and small industries, small and marginal farmers and other unorganized sectors through their advanced technology & low-cost operations.

Keywords:- Reserve Bank of India, Financial Sector, Monetary Policy, Fiscal Policy, Small Finance Banks, Financial Institutions, Financial Literacy, Financial Inclusion.

Financial institutions are those institutions where financial transactions like deposits, loans etc. take place. Banks are institutions that accept deposits from the public and grant loans to the needy subject to conditions. They operate on the basis of the general guidelines and conditions set by the Reserve Bank of India. The Bank of Hindustan established in 1770 is India's first modern bank.

Even though banks basically perform the same functions, there exist differences in some operations. On the basis of

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operations, banks are classified into commercial banks, cooperative banks, development banks, and specialized banks. The growth of the banking sector since then can be divided into three phases. The first phase stretches from 1770 to the nationalization of banks in 1969. The second phase stretching from 1969 to 1990, witnessed a speedy development of banks. In the third phase, stretching from 1991 onwards, banks started rendering services, other than their basic functions.

In view of the announcement made in the budget 2014-15 regarding creation of a framework for licensing small banks, and to give a thrust to the supply of credit to micro and small enterprises, agriculture and banking services in unbanked and under-banked regions in the country, Reserve Bank decided to license new **"Small Finance Banks (SFBs)"** in the private sector. The scope of activities of a small finance bank would primarily be to undertake basic banking activities of acceptance of deposits and lending to un-served and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganized sector entities.

Scope and Significance of the Study

Small Finance Banks (SFBs) in India have a substantial scope to drive financial inclusion, support economic growth, and enhance the overall banking landscape by catering to the needs of the underserved and unbanked population. SFBs in India play a crucial role in promoting financial inclusion by providing banking services to underserved and unbanked sections of society. They focus not only on basic banking services but also meeting the dynamic banking and financial needs of the country by technological integration through digital banking and fintec collaboration. Moreover, their functions have large influence on country's economy by employment generation and rural development. Hence this study has wider scope and relevance.

Review of Literature

Girish Joshi, Bindya Kohli & Sandeep Nalawade (2021) has conducted a phenomenological study to investigate whether small finance banks (SFBs) in India are working towards financial inclusion. This study demonstrates that the existing body of knowledge on financial inclusion is insufficient to explain the ways in which the poor in India behave. Numerous themes of financial inclusion were identified by the study, including credit identification, timely payback, self-esteem, technology use, financial literacy, cross-referencing, and financial stability. While the overall results are encouraging, SFBs need to continue operating for a while longer in order to extrapolate the outcomes. To achieve financial inclusion and commercial improvement, microfinance businesses of a similar scale can benefit globally from the study's conclusions.

Khan Firdaus Masarrat Rashid (2019) studied the scope of Small Finance Banks as the vision of financial services for the poor. Data shows that the actions of extending credit and accepting deposits are different and are influenced by different things. Demonetization clearly had an impact on the banking industry in the first and second quarters of the 2017–18 fiscal years. Deposits have increased annually, although primarily from non-poor states; formerly, loan issuance appeared to have a non-poor slant. However, for the past two quarters, it appears to favor Low Income States and North Eastern States. Though it is early days to judge the performance of SFBs in the banking sector, there is a justifiable optimism emerging from the empirical analysis that financial inclusion is being implemented and bearing some fruit. The study revealed that SFBs have a very important role to play in financial inclusion imperative.

Statement of the Problem

About 60 per cent of India resides in rural and semi-urban areas. According to Micrometer (MFIN, 2018) report, low-income states (LIS) and north-eastern states (NES) collectively have a total of 85.7 million low-income households. These households have an unfulfilled credit demand of INR18.3 trillion and the potential to save INR21.4 trillion. In addition, there are about 11.8 million micro and small enterprises in LIS and NES that have a collective debt demand (for working capital and assets financing of around INR 21.8 trillion and savings potential of INR5.9 trillion. Here lies the importance of SFBs in implementing their business operations in financial inclusion.

Objectives

- To identify the business activities of Small Finance Banks in India.
- To study the role of Small Finance Banks in Financial Inclusion and Development.
- To examine the influence of SFBs in Indian financial sector.
- To find the scope of banking activities of SFBs in unserved, underserved and unorganized sections.

Research Methodology

Descriptive research is followed in the study. The data were collected from secondary sources. The study attempts to explain the service of SFBs systematically. This type of research makes an attempt to collect any information that can be expressed in quantifiable terms. It is used to observe and describe a research subject or problem without influencing or manipulating the variables in any way. Thus, such studies are usually correlation or observational. This type of research is conclusive in nature, rather than inquisitive. Publications and circulars of RBI have been contributed a lot in data collection.

Results and Discussion

Introduction

The Bank of Hindustan established in 1770 is India's first modern bank. The growth of the banking sector since then can be divided into three phases. The first phase stretches from 1770 to the nationalization of banks in 1969. In this phase, the presidency banks, Bank of Bengal, Bank of Bombay, and Bank of Madras were established by the British East India Company. The operation and the growth of banks were slow during this phase.

The second phase stretching from 1969 to 1990, witnessed a speedy development of banks. The view that banks should operate with the aim of social progress led to the nationalization of 14 banks in 1969 and six banks in 1980. In 1993, the nationalized bank, New Bank of India was merged with the Punjab National Bank. As a result, there are only 19 nationalized banks in India.

In the third phase, stretching from 1991 onwards, banks started rendering services, other than their basic functions. There were several banking reforms which helped in quick and time saving services, ease of procedure, etc. Introduction of Automated Teller Machines (ATM), credit card, phone banking, net banking, core banking, etc. are the results of the third phase of development.

The private banks which received license during this period introduced new and innovative functions at a much quicker pace. Such banks are known as new generation banks. Even though banks basically perform the same functions, there exist differences in some operations. On the basis of operations, banks are classified into commercial banks, cooperative banks, development banks, and specialized banks.

List of Nationalized Banks after amalgamation

1. Central Bank of India
2. Bank of India
3. Punjab National Bank
4. Bank of Baroda
5. Canara Bank
6. Union Bank of India
7. Indian Overseas Bank
8. Bank of Maharashtra
9. Indian Bank
10. Punjab and Sindh Bank
11. State Bank of India
12. UCO Bank

Emergence of Small Finance Banks (SFBs) in India

Given the declaration in the 2014–15 budgets about the establishment of a framework for small bank licensing and the promotion of credit availability to micro and small businesses, the agricultural sector, and banking services in under-banked and unbanked areas of the nation has been recognized. The nation's Reserve Bank made the decision to grant new private sector "Small Finance Banks (SFBs)" licenses. Ten applicants received in-principle approvals to establish SFBs after a due process, according to a press release dated September 16, 2015.

List of SFBs in India

1. Au Small Finance Bank Ltd.
2. Capital Small Finance Bank Ltd.
3. Fincare Small Finance Bank Ltd.
4. Equitas Small Finance Bank Ltd.
5. ESAF Small Finance Bank Ltd.
6. Suryoday Small Finance Bank Ltd.
7. Ujjivan Small Finance Bank Ltd.
8. Utkarsh Small Finance Bank Ltd.
9. North East Small Finance Bank Ltd.
10. Jana Small Finance Bank Ltd.
11. Shivalik Small Finance Bank Ltd.
12. Unity Small Finance Bank Ltd.

Objectives of a Small Finance Bank

The objective of setting up of small finance banks is to further financial inclusion by,

a) Provision of savings vehicle and primarily to unserved and underserved sections of the population and,

b) Supply of credit to small business units, small & marginal farmers; micro and small industries and other unorganized sector entities through high technology & low cost operations.

Guidelines for SFBs on Financial Inclusion and Development

Considering the differentiated nature of business and financial focus of the SFBs and taking into account the important role that SFBs can play in the supply of credit to micro and small enterprises, agriculture and banking services the need for a specific compendium of guidelines for SFBs on areas relating to Financial Inclusion and Development have been prepared. The provisions of these instructions shall apply to every Small Finance Bank licensed to operate in India by the Reserve Bank of India.

The categories under priority sector are as follows:

1. Agriculture
2. Micro, Small and Medium Enterprises (MSMEs)
3. Export Credit
4. Education
5. Housing
6. Social Infrastructure
7. Renewable Energy
8. Others

Small Finance Banks will have a target of 75 per cent for priority sector lending of their Adjusted Net Bank Credit (ANBC). While 40 per cent of ANBC should be allocated to different sub-sectors under PSL as mentioned below, the balance 35 per cent can be allocated to any one or more sub-sectors under the PSL, where the banks have competitive advantage. The computation of priority sector targets/sub-targets achievement will be based on the total ANBC as on the corresponding date of the preceding year.

Major share of Adjusted Net Bank Credit is targeted to the priority sector itself. Moreover, SFBs are concentrating on agriculture, small and marginal

Table 1

Various Service categories and their target share

Categories	Target
Total priority sector	75% of ANBC
Agriculture	18% of ANBC
Small and Marginal farmers	Within the 18 percent target for Agriculture, a target of 8 percent of ANBC is prescribed for Small and Marginal Farmers.
Micro enterprises	7.5% of ANBC
Advances to weaker sections	10% of ANBC

Source: rbi.org.in

Table 2

List of eligible activities under priority sector

1 Farm Credit	A. Loans to individual farmers [including Self Help Groups (SHGs) or Joint Liability Groups (JLGs), dairy, fishery, animal husbandry, poultry, beekeeping and sericulture.
2 Agriculture	i) Loans for construction of storage facilities (warehouses, market yards, godowns and silos). ii) Soil conservation and watershed development. 6 iii) Plant tissue culture and agri-biotechnology, seed production, production of bio-pesticides, bio-fertilizer, and vermi composting.
3 Ancillary activities	(i) Loans up to ₹5 crore to co-operative societies of farmers for disposing of the produce of members. (ii) Loans for setting up of Agriclinics and Agribusiness Centers. (iii) Loans for Food and Agro-processing up to an aggregate sanctioned limit of ₹100 crore per borrower from the banking system.

Source: rbi.co.in

farmers, micro enterprises and weaker sections of the society. Small Finance Banks will have a target of 75 per cent for priority sector lending of their Adjusted Net Bank Credit (ANBC). While 40 per cent of ANBC should be allocated to different sub-sectors under PSL as mentioned below, the balance 35 per cent can be allocated to any one or more sub-sectors under the PSL, where the banks have competitive advantage.

Description of Eligible Categories under Priority Sector

1. Agriculture: the lending to agriculture sector will be categorized as

(i) Farm Credit (which will include short-term crop loans and medium/long-term credit to farmers)

(ii) Agriculture Infrastructure and

(iii) Ancillary Activities. A list of eligible activities under the three sub-categories is indicated below:

Crop loans to farmers which will include traditional/nontraditional plantations and horticulture, and, loans for allied activities. Medium and long-term loans to farmers for agriculture and allied activities (e.g. purchase of agricultural implements and machinery, loans for irrigation and other developmental activities undertaken in the farm, and developmental loans for allied activities.) Loans to farmers for pre and post-harvest activities, viz., spraying, weeding, harvesting, sorting, grading and transporting of their own farm produce. Loans to Custom Service Units managed by individuals, institutions or organizations who maintain a fleet of tractors, bulldozers, well-boring equipment, threshers, combines, etc., and undertake farm work for farmers on contract basis.

2. Micro, Small and Medium Enterprises (MSMEs)

The Micro, Small and Medium Enterprises engaged in the manufacture or production of goods to any industry specified in the first schedule to the Industries (Development and Regulation) Act, 1951 and as notified by the Government from time to time. The Manufacturing Enterprises are defined in terms of investment in plant and machinery. The limits for investment in plant and machinery/equipment for manufacturing / service enterprise, as notified by Ministry of Micro, Small and Medium Enterprises, vide S.O.1642(E) dated September 9, 2006 are as under:-

3. Export Credit

Up to 2 per cent of ANBC shall be treated as priority sector. Export credit includes pre-shipment and post-shipment export credit (excluding off-balance sheet items) as defined in Master Circular on Rupee/Foreign Export Credit and Customer Service to Exporters issued by our Department of Banking Regulation.

4. Education

Loans to individuals for educational purposes including vocational courses upto ₹ 10 lakh irrespective of the sanctioned amount will be considered as eligible for priority sector.

5. Housing

i. Loans to individuals up to ₹ 28 lakh in metropolitan centers (with population of ten lakh and above) and loans up to ₹ 20 lakh in other

Table 3

Investment limits in Manufacturing Sector (MSMEs)

Manufacturing Sector Enterprises	Investment in plant and machinery
Micro enterprises	Does not exceed 25,00,000 rupees
Small Enterprises	More than 25,00,000 rupees but does not exceed 5,00,00,000 rupees
Medium Enterprises	More than 5,00,00,000 rupees but does not exceed 10,00,00,000 rupees

Source: rbi.co.in

Table 4

Investment limits in Service Sector (MSMEs)

Service Sector Enterprises	Investment in equipment
Micro Enterprises	Does not exceed ten lakh rupees
Small Enterprises	More than 10,00,000 rupees but does not exceed 2,00,00,000 rupees
Medium Enterprises	More than 2,00,00,000 rupees but does not exceed 5,00,00,000 rupees

Source: rbi.co.in

centers for purchase / construction of a dwelling unit per family provided the overall cost of the dwelling unit in the metropolitan centre and at other centers should not exceed ₹ 35 lakh and ₹ 25 lakh, respectively.

ii. Loans for repairs to damaged dwelling units of families up to ₹ 5 lakh in metropolitan centers and up to ₹ 2 lakh in other centers.

iii. Bank loans to any governmental agency for construction of dwelling units or for slum clearance and rehabilitation of slum dwellers subject to a ceiling of ₹ 10 lakh per dwelling unit.

6. Social Infrastructure

Bank loans up to a limit of 5 crore per borrower for building social infrastructure for activities namely schools, health care facilities, drinking water facilities, sanitation facilities, construction/ refurbishment of household toilets and household water quality improvements in Tier II to Tier VI centers.

7. Renewable Energy

Bank loans up to a limit of 15 crore to borrowers for purposes like solar based power generators, biomass based power generators, wind mills, micro-hydel plants and for nonconventional energy based public utilities viz. street lighting systems, and remote village electrification. For individual households, the loan limit will be 10 lakh per borrower.

Financial Inclusion Plans

As the Small Finance Banks have been set up to further financial inclusion and their client base would primarily be migrant labour workforce, low income households, small businesses, other unorganized sector entities etc. their internal target should be in line with their objectives. The bank's Board shall review the progress in this regards on regular basis and submit progress report on monthly basis in respect of the various parameters prescribed by RBI in the Financial Inclusion Plan (FIP) monitoring format. In this connection, the guidelines on FIP for Small Finance Banks are as under:

a. Small Finance Banks shall adopt the template of Financial Inclusion Plan provided by RBI to submit granular data up to district level across the four population groups, namely- Metropolitan, Urban, Semi Urban and Rural. The date of submission of the monthly progress shall be 15th of the succeeding month for data pertaining to the previous month.

b. Progress in respect of various parameters of FIP shall be monitored on a monthly basis and a review shall be conducted on an annual basis.

Major Findings

- The scope of activities of a small finance bank would primarily be to undertake basic banking activities of acceptance of deposits and lending to unserved and underserved sections including small business units, small and marginal farmers, micro and small industries and unorganized sector entities.
- They aim to reach rural and semi-urban areas where traditional banking services are limited.

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- SFBs accept deposits, offering savings, recurring, and fixed deposit accounts. They provide loans for various purposes, including microloans, agricultural loans, and small business loans. SFBs facilitate payment and remittance services, promoting ease of transactions.
- SFBs operate under the guidelines and regulations set by the RBI, ensuring a stable and secure banking environment. They must maintain a minimum paid-up equity capital of ₹ 200 crore (approx. $27 million).
- SFBs are increasingly leveraging technology to offer digital banking services, including mobile banking, internet banking, and digital payments. Collaborations with fintech companies enhance their service delivery and operational efficiency.
- By supporting small businesses and entrepreneurs, SFBs contribute to job creation and economic development. Access to credit and banking services in rural areas stimulates agricultural and non-agricultural activities, fostering rural development.
- SFBs are required to open at least 25 per cent of its branches in unbanked rural centers.
- Further, these banks are required to extend 75 per cent of its ANBC to priority sector.
- The computation of priority sector targets/sub-targets achievement will be based on the total ANBC as on the corresponding date of the preceding year.
- The outstanding deposits under RIDF and other funds with NABARD, NHB, SIDBI and MUDRA Ltd. in lieu of non-achievement of priority sector lending targets/sub-targets will form part of ANBC.
- Considering the differentiated nature of business and financial focus of the SFBs and taking into account the important role that SFBs can play in the supply of credit to micro and small enterprises, agriculture and banking services the need for a specific compendium of guidelines for SFBs on areas relating to Financial Inclusion and Development have been prepared.
- The provisions of the instructions shall apply to every Small Finance Bank licensed to operate in India by the Reserve Bank of India.
- The computation of priority sector targets/sub-targets achievement will be based on the total ANBC as on the corresponding date of the preceding year.
- Loans for setting up of Agriclinics and Agribusiness Centers can be considered as innovative schemes.
- With the increasing emphasis on financial inclusion and digital transformation, SFBs have significant growth opportunities.

Suggestions

- SFBs should strictly comply with the common guidelines for all categories of advances under the priority sector.

- To ensure continuous flow of credit to priority sector, the compliance of banks will be monitored on quarterly basis.
- Further, non-achievement of priority sector targets and sub-targets will be taken into account while granting regulatory clearances / approvals for various purposes.
- As the business activities of SFBs of India play a vital role in the financial inclusion in the economy, the Govt. needs to pay at most attention.
- Their success depends on their ability to navigate challenges, leverage technology, and innovate continuously.
- As SFBs face challenges such as competition from larger banks, maintaining asset quality, and managing operational costs, the management should be keen in their crucial decision areas.
- They are likely to diversify their product offerings to include insurance, mutual funds, and other financial products. Continuous innovation in financial products and services will be key to their growth and sustainability.

Conclusion

Small Finance Banks basically work as savings vehicles as they are engaged in offering credit facilities to small business units, micro and small industries, small and marginal farmers and other unorganized sectors through their advanced technology & low-cost operations. As the Small Finance Banks have been set up to further financial inclusion and their client base would primarily be migrant labour workforce, low income households, small businesses, other unorganized sector entities etc. their internal target should be in line with their objectives.

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