
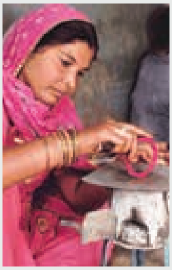

DIFFERENTIATED BY MISSION
SMALL FINANCE BANKS IN INDIA

R BHASKARAN







ASFBI

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Differentiated By Mission

Small Finance Banks
In India

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Abbreviations

ATM	Automated Teller Machine
AUM	Asset Under Management
BC	Business Correspondent
BCBS	Basel Committee on Banking Supervision
CAGR	Compound Annual Growth Rate
BIS	Bank for International Settlement
CASA	Currant Account Savings Account
CEO	Chief Executive Officer
CRAR	Capital to Risk weighted Asset Ratio
CRR	Cash Reserve Ratio
DAY-NRLM	Deendayal Antyodaya Yojana- NRLM
DCCB	District Central Cooperative Bank
EBR	External Bench Marked lending Rate
EMI	Equated Monthly Installments
EWI	Equal Weekly Installments
FII	Foreign Institutional Investors
FPI	Foreign Portfolio Investment
G/D SIB	Globally/Domestically Systemically Important Bank
GoI	Government of India
GRC	Governance, Risk Management and Compliance

GST	Goods and Services Tax
HQLA	High Quality Liquid Assets
IE	Interest Expense
II	Interest Income
IPO	Initial Public offer
IRAC Norms	Income Recognition and Asset Classification Norms
IRDP	Integrated Rural Development Programme
JLG	Joint Liability Group
LAB	Local Area Bank
LTV	Loan to Value Ratio
MCLR	Marginal cost based lending rate
MSME/SME	Micro Small and Medium Enterprises
NABARD	National Bank for Agriculture and Rural Development
NBFC-MFI	Non Banking Finance Company- Micro Finance Institution
NFSR	Net Stable Funding Ratio
NIBM	National Institute of Bank Management
NIM	Net Interest Margin
G/NNPA	Gross/ Net Non Performing Assets
NIM	Net Interest Margin
NPM	Net Profit Margin
NRI	Non Resident Indian
OE	Operating Expense
OI	Operating Income
PMJDY	Pradhan Mantri Jan-Dhan Yojana
PACS	Primary Agricultural Credit Society

PCARDB	Primary Cooperative Agriculture and Rural Development Bank
POS	Point of Sale
PROV	Provisioning
PSL	Priority Sector Lending
PSU Banks	Public Sector (commercial) Banks
RBI	Reserve Bank of India
ROE	Return on Equity
RRB	Regional Rural Bank
RWA	Risk Weighted Assets
SB Accounts	Savings Bank Accounts
SCB	Scheduled Commercial Bank
SCADRB	State Cooperative Agriculture and Rural Development Banks
SEEUY	Self Employment for Educated Unemployed youth
SEPUP	Self Employment Program for Urban Poor
SFB	Small Finance Bank
SHG	Self Help Groups
SIDBI	Small Industries Development Bank of India
SLR	Statutory Liquidity Ratio
UCB	Urban Cooperative Bank
USP	Unique Selling Proposition

Foreword

India has boasted of an impressive financial institutional infrastructure for long. While the numbers keep changing, in 2015, we had 150 domestic commercial banks comprising 19 Public Sector Banks, 20 Private Sector Banks, 44 Foreign Banks, 4 Local Area Banks, 56 Regional Rural Banks and over 2,700 Cooperative Banks operating in the country. The Government owns Seventy five percent of these banks. Added to this, since 1976, banks have had a statutory obligation for lending under the priority sector to ensure that credit is directed towards agriculture, SMEs and the weaker sections of the population. Sadly and ironically, despite all this, about 40 per cent of the adults did not have formal bank accounts. Although efforts towards building an inclusive financial system can be traced to 1969, when the first lot of bank nationalization was done; and later supplemented by creation of RRBs in 1975, introduction of priority sector lending in 1974, creating a new category of Local Area Banks in 1996, branch expansion, service area approach, opening of no frills accounts, among others; the supply side remained suspicious, skeptical, and often sclerotic in dealing with small borrowers.

In 2009, when the Raghuram Rajan Committee on Financial Sector Reforms, among others, recommended the "establishment of private, well governed, deposit taking Small Finance Banks", the idea was while on the one hand welcome and refreshing, on the other there was some feeling of "déjà vu", having witnessed the fate of Local Area Banks before. The idea of a small finance bank was refreshing because it acknowledged that the private sector, hitherto not a part of the scheme of things, could play an important role in advancing financial inclusion in the country. Since the recommendations did not flesh out the structure and the covenants of these banks in great detail, they didn't look too different from the earlier Local Area Banks, because of which, the viability of the idea looked doubtful.

Another trajectory to the idea of a SFB category was that perhaps this could be a chance for MFIs to "graduate" to a more recognized formal financial institutional entity. I was on the Board of Sa-dhan, and it's Committee on Policy for a few years; and the major discussion, particularly since 2005 was the clamor for a MFI Act, which, among others, would allow them to collect savings. Given that the MFIs were on the wrong side of the political discourse, and looked at suspiciously, their legitimacy continued to be in doubt, and despite fervent efforts, a Microfinance Bill was not in sight soon. For large MFIs to become SFBs could be an ideal situation. There were several examples in other countries, where MFIs were small Finance Banks. Given our long standing engagement, association and advocacy on microfinance issues, ACCESS didn't lose the opportunity, and for the first time perhaps, a session on Small Finance Banks was slotted in the Inclusive Finance India Summit in 2009 to elicit views on the feasibility of the idea of small finance banks.

Fortuitously, it was only a few years later that Dr. Raghuram Rajan took over as the Governor of the Reserve Banks of India. By this time, post the Andhra Pradesh imbroglio, MFIs had come to become fully regulated based on Malegam Committee recommendations, and were once again on the path of rapid growth, and had gained their due legitimacy as an effective channel to deliver financial services to low income households. This also coincided with a renewed commitment of the government for pushing the financial inclusion agenda, as despite efforts, large part of the country's population remained outside the ambit of formal finance. "Swabhimaan" of the UPA Govt. gave way to the more ambitious "Prime Minister's Jan Dhan Yojana" of the NDA Government. However, the emphasis of these programmes was largely large-bank led, public sector dominated, mandate driven and branch expansion focused, and mostly reduced to a numbers game, not necessarily resulting in meaningful financial inclusion.

In September 2013, the RBI set up the "Committee on Comprehensive Financial Services for Small Businesses and Low Income

Households" which made its ambitious recommendations in January 2014. While it recommended the provision of a bank account for all Indians above the age of 18 by January 2016, one major recommendation was the setting up of two types of differentiated banks viz. Payment Banks and Small Finance Banks. To set up these banks, things started to roll out fast within the RBI. At this stage, ACCESS, I recall, played an important role in influencing the guidelines issued by the RBI. As a part of its mandate under the Poorest States Inclusive Growth Programme (in partnership with SIDBI), ACCESS organized a series of round tables and consultative meetings on the SFB guidelines, and a major breakthrough was to get the "small area of operation" changed to pan India operations. Without this amendment, neither would the idea be viable, nor would large eligible MFIs be interested, given that most of them had large pan India presence. It was clearly established that it was not the banks that would be small but the finance. These banks would have a large presence but would purvey "Small finance" to small borrowers. Seventy-two applications were received, but only 10 were granted licenses. Of these ten, eight were erstwhile MFIs. This was a big moment for the MFI sector in India, with a new roadmap for growth and evolution.

The last 5 years has seen all the ten SFBs start their operations. In some manner, for the last four years, ACCESS has played an important role in helping sort out their niggling problems, as also important issues, through well-structured SFB CEOs Round Tables with the RBI, represented by Deputy Governor Vishwanathan himself along with his team, engaging in a transparent candid interactions to sort, solve and smoothen issues. ACCESS has also helped to structure similar meets of the SFB CEOs with the MSME Ministry. Committed to the idea of Small Finance Banks, ACCESS annually has one important session on Small Finance Banks as a part of the Inclusive Finance India Summit, as well as a well-researched chapter in the annual Inclusive Finance India Report.

Bhaskaran has painstakingly documented the idea of Small Finance Banks, how these new institutions differ from other similar institutional types of the past like RRBs and LABs, what are the key current constraints and challenged these newly created institutions are grappling with, their current operations, their growth and their future plans and strategies. He has helped in bringing this important book to highlight the need and significance of this new category of banks in lucid detail.

ACCESS firmly believes that the Small Finance Bank is the most appropriate institutional type to advance financial inclusion in the country in a true and tangible manner; through this important report, it seeks to highlight their need and significance within the overarching architecture of financial inclusion. With a requirement of 75% under priority sector lending, with a cap on maximum loan size, requirement for opening at least 25% of their branches in rural / unbanked areas, with high C-D ratio, with high quality technology in play, with a majority of the clients being women, and coming from low income households, and importantly, servicing them profitably, these banks are well poised to make a big difference. All this needs to be highlighted, specifically among policy makers. Even though these banks have had a short run so far, they are on track on all parameters, clearly demonstrating their alignment with their mandate.

Three successful SFB IPOs, overwhelmingly oversubscribed, also reflect that the SFB model is well accepted in the public view as a sustainable model. Its gladdening that the Reserve Bank, acknowledging this, among others, have now opened up SFB licenses on tap, are encouraging large Urban Cooperative Banks to transform into SFBs and are agreed to even Payment Banks to convert into SFBs. Potentially, it may encourage several of the big MFIs to also consider applying to become SFBs in the near future. Just ten is a small number for a model that broadly has demonstrated its viability. Maybe, in the next five years, there should be hundred small finance banks. Else, the idea could be lost, and this small clutch of SFBs, and their big contribution to the financial inclusion agenda could go unnoticed, like what happened with the Local Area Banks. ACCESS in its small ways, would continue to push to highlight the need for Small Finance Banks.

I take this opportunity to, at the outset, thank Dr. Bhaskaran for agreeing to take on this important challenge of documenting the story of these fledgling institutions, even though, getting all the relevant and current data was a big challenge. He has honestly captured all aspects of the journey of the Small Finance Banks so well. I also take the opportunity of thanking all the ten SFB CEOs and their teams in cooperating with relevant information and data, as also for helping Bhaskaran put together the CEO Speak Chapter. All ten SFBs have also made some financial contributions in bringing together this book. And without the alacrity with which we were supported by Uma Shankar Paliwal, the newly appointed CEO & Secretary of the Association of SFBs, in coordinating with all the members, the task would have been far more arduous.

I hope the SFBs will find this ACCESS effort of some value in their own efforts to share their journey and their challenges. I hope the policy makers will see a glimpse of the potential of SFBs in contributing to the financial inclusion scheme of things for the country. I hope the regulator will find enough rationale for providing an even playing field for this category of banks. I hope this book will play a useful role in upping the ante on the advocacy efforts.

Thank You Dr. Raghuram Rajan, for conceiving the idea of the "Small Finance Bank" realizing that "the poor need efficiency, innovation, and value for money which can come from motivated financiers who have low cost structure and thus see poor as profitable, but who also have the capacity to make decisions quickly, and with minimum paperwork." And therefore, he recommended, "that entry to private, well-governed, deposit-taking small finance banks be allowed".

Best wishes

Vipin Sharma
CEO
ACCESS Development Services

The Beginning

Background

An efficient Banking and Finance system and pursuit of financial inclusion are important to achieve a balanced (even and all encompassing) economic growth and development in a country. Currently, Indian Financial System consists of a variety of financial institutions with large number of branches and access points[1] spread across geographies, supported by an efficient payment and settlement system, catering to different segments of business/ population, offering various banking products as also specialised services and products customised to niche markets/segments. Yet, as observed by RBI departments in their 'Banking Structure in India -The Way Forward[2]' financial inclusion in India, as of 2013, was very low. The committee observed that 'on account of the efforts in promoting no-frill accounts, 175 million new accounts were opened between 2011 and 2014 because of which the penetration of financial services went up from 35% to 53%. Yet more than 1/3 rd of adult population was still excluded'[3]. The committee had discussed many options for the banking sector including Small Finance Banks which came into being about 5 years back.

The objectives of financial inclusion are (i) reaching financial products such as deposits, credit, insurance, mutual fund etc to every eligible person in the country (ii) make available transaction banking in every part of the country and (iii) spreading financial literacy among the target populace to facilitate informed financial decisions.

1. Payment System Infrastructure: India 2020 Millions, Number of Credit Cards-57.29, ATMs-0.23, Number of Debit Cards-845.41, Micro ATMs-0.3, Prepaid Payment Instruments-1900.81, POS Terminals-5.04, Wallets-1755.36, Bharat QR-2.11
2. Department of Banking Operations and Development (DBOD) & and Department of Economic and Policy Research (DEPR)-August 2013
3. Internal committee of RBI DBOD and other department

It should be said that 'no frill account' was not the only effort in this direction. PMJDY is a massive programme that was taken up in the year 2014 under which a large number of basic savings accounts were opened. PMJDY had credit component and it offered an Overdraft facility of ₹ 15000 to those so included. It included insurance as well. As per RBI data 2011 and 2020[4], including what is mentioned above, 526 million bank accounts have been opened, which has led to a strong growth in the number of new accounts, primarily from those excluded.

Credit is an important aspect of financial inclusion efforts. That credit can induce economic activity and growth has been well recognised and therefore, many development initiatives and efforts have been taken, over the past few decades by the Government of India and Reserve Bank of India to augment rural development and achieve poverty alleviation by mandating flow of credit to people engaged in agriculture, small business, small industries and weaker section collectively known as priority sector. 'Priority Sector Advances' is an unique idea/mandate that was introduced in the year 1974 initially with a mandate that 33.33% (currently 40%) share of total advances of a bank should be for Priority sector as defined, to ensure flow of credit to Agriculture, SME and weaker section.

Another initiative in this direction was the Nationalisation of Banks (1969). Among other things, Nationalisation aimed at (a) making available banking facilities in rural and sub-urban areas and (b) ensuring more credit flow to sectors, like agriculture, small industries and traders. Post Nationalisation, it is now an accepted policy that banks in India, be it Public Sector or Private Sector, will be involved in the developmental efforts of the country. This can be inferred from the fact that over the last 4 to 5 decades, they have been involved in the implementation of many government-initiated, subsidy-linked credit schemes like Integrated Rural Development Program (IRDP), Self Employment for Educated Unemployed Youth (SEEUY), and Self Employment Program for Urban Poor (SEPUP) and programs focused on certain segments of population, like farmers, tribals, minorities etc. The main objective of these programmes was extending developmental credit.

4. Based on the number of BSBD Accounts indicated (in Table IV.6) by RBI in its Annual report 2020.

Though not specifically mentioned, these programmes also aimed at increasing the banking outreach to the poor/marginalised and unreached. Almost all these programs are currently operational under DAY-NRLM which works mainly through Self Help Groups (SHGs). It is no longer credit and subsidy linked. It is a matter of record that in implementing IRDP and other programmes a very large number of SB accounts were opened, in the past, by the banks, only to languish as the programmes did not meet with the anticipated success, because credit inclusion of the poor and vulnerable population is not a one-shot affair, but requires long term financial support and sustaining of relationship.

Financial inclusion is not possible in the absence of banking network and/or appropriate banking technology. There are nearly 6.5 lakh villages in India, of which some 2.4 lakh villages have population levels of less than 1000. To reach these villages a good network of bank branches were needed. Banking technology and digital banking are post 90's phenomen. As such, in the early years, say from 1969 onwards, banks rapidly increased their branches. Also Regional Rural Banks and Local Area Banks were established to give focused attention to small borrowers. There were a large number of rural cooperative banks and nearly one lack primary agricultural societies. Also, institutions like NABARD and SIDBI were established to ensure resource support to banks and to give undivided attention to development of agriculture and small industries.

That the above initiatives have not been sufficient, is the view expressed by the high level committee (Chairman Dr. Raghuram Rajan) constituted by GOI on financial sector reforms. In its report titled 'A Hundred Small Steps[5]'(2008-9) the committee observed that there is a need for a paradigm shift in the strategies for financial inclusion because *'the poor need efficiency, innovation, and value for money'*. The committee indicated that the 'large-bank-led, public-sector dominated, mandate-ridden, branch-expansion-focussed strategy' being pursued needs to be changed and that financial inclusion for poor should come from *'motivated financiers'* with low cost structure; ability to take quick decisions and use minimum paperwork i.e. simple processes and procedures. Though it

5. A Hundred Small Steps Report of the Committee on Financial Sector Reforms: Government of India Planning Commission New Delhi-2009

did not comment about the high rates of lending by microfinanciers, it did say that these motivated financiers should, *'like micro finance' 'see poor as profitable'*. In this background, the committee recommended the establishment of private, well-governed, deposit-taking Small Finance Banks confining operations to a 'small geography'.

Another committee of RBI headed by Dr Nachiket Mor which looked into differentiated banks suggested Horizontally Differentiated Banking System (HDBS) and Vertically Differentiated Banking System (VDBS) based on the functional building blocks of payments, deposits and credit. Small Finance Banks would fall in the Vertically Differentiated Banks. 'Differentiated banks are (will be) distinct from universal banks as they (will) function in a niche segment'[6] and differentiation could be in terms of capital requirement, scope of activities or area of operations. They may offer a limited range of services / products or function under a set of differentiated or unique regulatory dispensations. The differentiated bank concept is not entirely new. In a sense, the UCBs, DCCBs, RRBs and LABs could be considered as differentiated banks as they do not handle all banking products and operate in localized areas'.[7]

Why Differentiated Banks?

There are a large number of conventional banks in India, with more than 0.14 million branches and nearly a million banking outlets (banking correspondents and others)[8]. In addition, these banks have, in the recent years, introduced ATM, POS, e-wallets, on-line banking and mobile banking to facilitate transactions, more particularly encourage cashless transactions. In a way, all these gave a boost to financial inclusion efforts. At the same time it should be noted, that though conventional commercial banks are well diversified, multi-product, multi -geography and multi-access points organisations, they do not have a reasonable exposure to people who are economically vulnerable. Banking with

6. R Gandhi, Deputy Governor, RBI, in a speech 2015

7. Differentiated Banks: Design Challenges: Sri V Narayanan Memorial Lecture" delivered by Shri R. Gandhi, Deputy Governor at Sastra University, Campus Kumbakonam on April 18, 2015)

8. There were 541, 129 rural BCs and 447, 170, urban BCs as of March 19. *(Source: Trends & Progress of Banking Report, RBI)J*

vulnerable population means ability to handle a large number of small deposit accounts, loan accounts and manage large number of small and that too cash transactions. The small loans need close supervision and weekly transactions which is people-intensive. Also, the extent of excluded population is large. Possibly this was not appropriate to the business and HR strategies of bigger commercial banks though they had the required funds. All these aspects/issues made a compelling case to try the option of differentiated banks exclusively focused on small and vulnerable people in the hope that this would help in unlocking potential of diverse opportunities and facilitate economic growth.

Small Finance Banks

a. A Differentiated Bank or a Small Finance Bank is a niche and specialised bank. It will focus on financing large number of small ticket and possibly unsecured credit for a given purpose or in a given geography. For this the bank should have low cost structure, be efficient in delivery, have close supervision of borrowers and have appropriate sk management systems. Obviously this is not possible for a large conventional commercial bank. The advantages of such niche/differentiated bank could be

b. Lower transaction cost on account of being nearer to the customer and financing large number of such customers. In this method, though individual transactions could be for small amounts, overall value of transactions and structured working will help in containing transaction cost.

c. Extending credit to almost all eligible people and businesses in a given area who find it difficult to reach the banks and face difficulties in complying with the norms of a commercial loan.

d. Unique and customised credit products for meeting fund or cash flow gaps in SME, typically in the form of asset and cash flow based lending.

e. Focused development of an identified area.

f. Customised and efficient Risk management systems.

g. Reduced intermediation cost, better price discovery and improved allocative efficiency.

There may not be any disadvantages. Yet these banks could face some issues such as:

- These banks, as they will focus on particular population, area or activity, could be fraught with concentration risk[9]. In view of this, a downturn in a particular business, season or region could jeopardize the operations and impact the financial strength of a bank.
- These banks will need customised and sharper asset-liability management policy and systems. ALM should be capable of managing sudden mismatches that could happen due to local situations. Till their customers become comfortable and familiar with digital banking, these banks will have to manage higher volume of cash transactions.
- Conventional and universal banks have a lager balance sheet and well diversified book which allows inherent cross subsidisation of risk, which enables them to manage loss in one or two segments because others could be in profit. This may not be the case with niche/differentiated banks. A single event (say demonetisation or intervention in recovery by some local political forces [10]) can impact cash flows and revenue. The localized operations, financing a niche area or area restrictions could pose a higher risk on niche banks.
- Niche banks cannot be viable on interest income alone. They must have fee and other income to ensure their viability. They must explore earning fee income through distributing insurance, mutual funds and offering more payment options.

From the above, it emerges that a Small Finance Bank cannot be designed like RRB or LAB. It should be able to replicate the success of NBFC-MFIs which operate in many states and yet focus on small borrowal accounts. In this background if they are allowed to accept deposits they can increase the credit flow.

9. Sri V Narayanan Memorial Lecture by Mr R Gandhi, Deputy Governor of the Reserve Bank of India, at Sastra University, Kumbakonam, 18 April 2015.
10. Such interventions happen in many states at the time of election

Small Finance Banks are niche commercial banks[11] focused on 'small borrowal accounts' but not confined to a geographical limit like Local Area Bank and Regional Rural Banks or the size of business like the community banks of USA. The word 'small' is indicative of the size of the loan that they will issue and not the balance sheet of the bank. The licensing authority has indicated that the main objective of establishing/licensing these banks is *'to give a fillip to financial inclusion efforts by the banking sector'*. It is clear that these banks will give access to savings, credit and transaction facilities (banking) to their customers and that their credit function will be focused on small business units, small and marginal farmers, micro and small industries, unorganised sector entities etc i.e. sections of the economy not being served by other banks. These are private commercial banks yet differentiated from universal banks on account of certain limitations in the credit function and as they operate in a niche segment of population namely 'financially excluded'.

In theory, differentiation could be anchored to capital conditions[12] and/or business activity and/or area of operation of banks or all of these. It is however evident, that if the operational area is limited, it will automatically bring in certain limitations on the business, persons served and products offered. Experience has shown that banks operating in a limited area face viability issues.

The idea of differentiated banks is not entirely new. Two types of rural cooperative banks namely Primary Agricultural Credit Society (PACS), District Central Cooperative Bank (DCCB) Scheduled Commercial Bank (SCB) and Primary Cooperative Agriculture and Rural Development Bank (PCARDB), State Cooperative Agriculture and Rural Development Bank SCADRB were established long back for meeting short term and long term credit needs of the farmers. Urban Cooperative Banks[13] were also started almost at the same time. These

11. Any bank adopting company form of organisation is commercial banks. The other form of organisation is cooperative society – those banks are called cooperative banks.
12. As practiced in Indonesia or to the activity as is the case in Australia, Singapore and Hong Kong
13. The term Urban Co-operative Banks (UCBs), though not formally defined, refers to primary cooperative banks located in urban and semi-urban areas. These banks, till 1996, were allowed to lend money only for non-agricultural purposes. This distinction does not hold today. These banks were traditionally centred around communities, localities work place groups. They essentially lent to small borrowers and businesses. Today, their scope of operations has widened considerably: https://www.rbi.org.in/history/Brief_Fun_UrbanCoopBanks.html

are different from commercial banks in terms of ownership, form of organisation, capital, targeted customers, banking products handled and area of operation. More importantly they cannot access capital from the market and their ability to raise capital from members is limited. The regulatory treatment of cooperative banks differs from country to country. It is however evident that as regulatory norms keep becoming stricter the cooperative banks are losing their share of market and many of these banks find the norms very difficult to comply though the norms are somewhat softer than thoseof commercial banks. Regional Rural Banks and Local Area banks are also differentiated banks in terms of capital, targeted customers, permitted business mix and area of operation. Capital of RRBs is contributed by GoI, State Government and sponsored banks.

Box 1.1: RRBs and LABs

Regional Rural Banks

Indian Banking system has been, since the beginning, functioning in a multi-agency set up. In this background, for giving focused attention for rural development Regional Rural Banks (RRBs) were established as 'State sponsored, region based and rural oriented commercial banks'. The idea was to set up professionally managed/regulated banks with a rural feel and familiarity with local needs as an additional channel for credit dispensation to farmers/agriculturists, rural industries, socio-economically weaker sections of population for agriculture, trade, commerce, industry and other productive purposes/activities. These banks were expected to mobilise local resources and with the support of sponsor banks, NABARD, SIDBI etc., play a significant role in developing agriculture and rural economy. The mandate for the PSU and other commercial banks for Priority sector were not changed on account of RRBs. As such it was expected that RRBs will supplement the efforts of SCBs and cover the needy not covered by SCBs despite larger resources with them and large branch network.

RRBs have been mandated to provide sufficient banking and credit facility for agriculture, small business (now known as MSME) and other rural activities. For the first few decades of existence and till recently, the area of operation of RRBs was limited to not more than three districts. Within this, they were allowed to open branches in the urban areas as well. Being scheduled commercial banks the regulatory norms for them were on par with Commercial banks. As such they were subject to CRR, SLR, NPA, Exposure norms etc. RRBs were established with a capital of ₹ 5 Crore. Currently they are required to maintain a minimum Capital to Risk-weighted

Assets Ratio (CRAR) of 9% on an ongoing basis. RBI has also mandated that RRBs should achieve Priority Sector lending to the extent of 75% of their outstanding advances[14] Actually RRBs were regarded as ideal institutions for achieving financial inclusion in rural areas- though the term financial inclusion came into use much later.

In all 196 RRBs were established. Barring one RRB which was sponsored by UP State Cooperative Bank, all other RRBs were sponsored by commercial banks. RRBs were joint ventures between the Sponsor bank, Government of India and State Government.

In today's terminology these are differentiated banks as (a) their focus was on banking and rural development in a limited area of two or three districts, (b) they did not offer all banking products.

As RRBs faced many challenges and had financial constraints, around 1990 the first recap plan was implemented. The regular scheme for recapitalisation of RRBs was started in 2010-11 and was extended up to 2019-20 in a phased manner with a financial support of ₹29 Billion with 50% Government's share of ₹14.5 Billion. Out of ₹14.5 Billion of GOI a sum of ₹ 13.95 Billion has been released to RRBs, up to 2019-20. Further, RRBs have also undergone a consolidation process since 2010 as a result of which there are only 53 RRBs as of March 2019. It is expected that there will be further consolidation bringing down their number to 35 @ one RRB per State or Union Territory. If this should happen RRBs will be niche banks with operational limit of a State.

Looking back, it is evident that "Regional Rural Banks (RRBs) were created with a hope that 'combining the good features of cooperatives and commercial banks will result in regionally oriented institutions extending direct credit to the under-privileged sections of the rural population'[15].

Also right from the beginning it was clear that financial viability of RRBs will always be under strain. This was, however, not a concern as Financial Stability related norms and NPA norms were not applicable those days. In view of this, it was only after financial sector reforms (1991) were introduced that the poor commercial viability and the inability of RRBs to comply with regulatory norms emerged as critical factors in their role in the emerging economic scenario. RRBs were stressed and could not deliver the expected objectives. Studies have shown that the financial health of RRBs was impaired mainly due to narrow business mix and lack of scope for expansion/diversification. They were also constrained by sub-optimal managerial capacities, and ill-informed board. Moreover, as in the case of PSU banks, government intervention in the recovery process resulted in higher credit risk with RRBs.

14. RBI/FIDD/2016-17/34 Master Direction FIDD.CO.Plan.2/04.09.01/2016-17 dated July 7, 2016
15. RBI ibid

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RRBs were stressed and could not deliver the expected objectives. Studies have shown that the financial health of RRBs was impaired mainly due to narrow business mix and lack of scope for expansion/diversification. They were also constrained by sub-optimal managerial capacities, and ill-informed board. Moreover, as in the case of PSU banks, government intervention in the recovery process resulted in higher credit risk with RRBs.

With the onset of financial sector reforms, a number of changes were brought about in the policy framework relating to RRBs to impart operational freedom and improve their financial health which was weak. Improving viability was attempted through recapitalisation, restructuring and amalgamation of RRBs along with the application of prudential regulatory framework. The Advisory Committee on Flow of Credit to Agriculture and Related Activities (Vyas-Committee 2004) had recommended a two-phase restructuring namely (i) merger between RRBs of the same sponsor bank in the same State; and (ii) merger of RRBs sponsored by different banks in the same State. After amalgamation, RRBs would become bigger in size with a larger area of operation, which would enable them to function in a competitive environment more effectively benefitting by the economies of scale and reduction in transaction cost. **This observation is important in the SFB perspective and points out that size and area of operation are important aspects, among other things, for the viability of banks.**

RRBs are a kind of small sized PSU banks. Over the years they have lost the advantage of small size as HR policies have been made on par with sponsor banks. RRBs were managed by officials deputed from the sponsor banks. The board members were drawn from the officials of sponsor bank, state government and NABARD and one or two public representatives.

These boards/banks followed the directions given by the sponsor banks and NABARD. CEO's were also from the sponsor banks, which deputed officials of appropriate rank depending up on the business volumes of the RRB.

Thus, despite amalgamations and mergers the financial constraints continue. NABARD, in its statistical book on RRB, observes that 'during 2018-19, 39 RRBs earned profit of ₹ 17.59 Billion while 14 RRBs incurred losses of ₹.24.11 Billion and RRBs as a group incurred a net loss of ₹ 6.52 Billion. It is noteworthy that as of March 19, four RRBs had total assets less than ₹ 10 Billion, 25 RRBs had total assets between ₹10 and ₹100 Billion and only 24 RRBs had business in excess of ₹100 Billion.

Needless to add, that before consolidation, most RRBs were of very small size. RRBs have been recapitalised a number of times by GOI, SG and Sponsor Banks for amounts aggregating to ₹ 29 Billion between 2011-2019[16].

Some lessons emerging from RRBs for SFBs are (i) limited area of operation is not viable for a commercial bank (ii) rates of interest on loans cannot be low for a small bank and (iii) Unsecured lending and government sponsored programmes possibly have higher credit risk.

Local Area Banks

LABs were announced by GOI in the annual budget speech of 1996 and established in the same year, with the objective of bridging the gaps in credit availability in the rural and semi-urban areas and provide efficient banking services in their area of operation. These banks could be promoted by individuals, corporate entities and societies and were allowed to start operations with a minimum capital of ₹ 5 Crore[17]. The area of operation of an LAB was restricted to a maximum of three geographically contiguous districts. LABs were required to finance agriculture and allied activities, SSI, agro-industrial activities, trading activities and non-farm sector. Their lending to priority sector was to be at least 40% of the net bank credit and lending to weaker section was to be at least 25% of their priority sector lending (10% of net bank credit). Over the years LABs have been subject to evolving prudential norms, accounting policies and other policies as laid down by RBI. CRAR has been kept at 8% of risk weighted assets. These banks are subject to income recognition, asset classification and provisioning norms on par with commercial banks. LABs had the objective of bridging the gaps in credit availability in the rural and semi-urban areas and providing efficient banking services in their area of operation.

16. The scheme for recapitalisation of RRBs was started in 2010-11 and was extended up to 2019-20 in a phased manner with a financial support of ₹ 2,900 crore with 50% Government's share of ₹ 1,450 crore. Out of ₹ 1,450 crore, an amount of ₹ 1,395.64 crore has been released to RRBs, up to 2019-20.
17. The promoter's equity stake was not to exceed 40% of the capital. This would carry a lock in period of three year from the date of licensing of the bank which could be extended to 5 year.

Initially 6 LABs were licensed. Of these only four LABs were functioning as of 2017[18] when one of them namely Capital Local Area Bank Ltd with its head office at Phagwara (Punjab) became a Small Finance Bank. Currently there are 3 LABs with less than ₹.5 Billion total assets. None of them have been scheduled despite long years of existence. Clearly, as observed in "A Hundred Small Steps" there were/are no regulatory or other efforts to make the LAB concept viable.

SFBs' are private banks but somewhat closer to RRBs and LABs in design except that RRBs and LABs had lower capital stipulations, limited area of operation (three contiguous districts) and limited products. RRBs have been facing a number of viability issues and have been recapitalised, merged and have become nearly one RRB per state. More importantly RRBs, despite being much smaller in size have been following 'PSU bank pricing' of loans which is not viable, from the bank's perspective for lending to small borrowal accounts. Like PSU banks, RRBs are also subject to instructions from GOI. Generally PSU banks and RRBs are more involved in implementing government sponsored programs than other banks. It is however, a fact that PSU banks seem more preferred by depositors than other banks including RRBs. Probably government ownership is a factor that weighs with the depositors.

Similar to PSU banks, RRBs also have high NPAs, though their NPAs are more from small loans, whereas it is from high value and corporate loans with PSU banks. It is not intended here to discuss these banks in detail but the above analysis is important to point out that if SFBs were to offer loans at low Rate of Interest and if their area of operation is limited to few districts their viability/profitability could be affected.

18. The promoter's equity stake was not to exceed 40% of the capital. This would carry a lock in period of three yea₹ from the date of licensing of the bank which could be extended to 5 yea₹.

Table 1.1: Comparison of Small Finance Banks with other specialised or niche banks

	Urban Cooperative Banks (UCBs)	Regional Rural Banks (RRB's)	Local Area Banks (LABs)	District Central Cooperative Banks [19]	Small Finance Banks
Established	Around 1900	1976	1996	Around 1900	2016
Ownership	Members-Cooperative – under State cooperative or Multi State Cooperative Act.	Chartered Company owned by sponsor bank, GOI and SG	Private individuals	Cooperative-Under State Cooperative Act Membership of societies and individuals	Company share holders
Number of banks (of which scheduled)	1544 (54)	56 (56)	3	363	10(10)
Target Customers	Members	Public	Public	Individuals and Primary	Public
Business	Deposits, small and medium size loans and transactions	Deposits, small and medium size loans and transactions	Deposits, small and medium size loans and transactions	Deposits, small and medium	
Area of operation	Normally few districts. Some in many states	Restricted to a few districts of a state	Restricted to one or two districts	Generally one district but could be more districts on account of bifurcation of districts	Branches in any number of states
Regulatory reserve ratios	CRR/SLR same for all banks				

19. DCCB is a federation of societies and have some individual members as well. It extends to primary societies which have farmers/artisans/weavers as members

	Urban Cooperative Banks (UCBs)	Regional Rural Banks (RRB's)	Local Area Banks (LABs)	District Central Cooperative Banks	Small Finance Banks
Regulatory reserve ratios	CRR/SLR same for all banks				
Capital Adequacy Ratio	9%	9%	8%	9%	15%
IRAC Norms	Same norms to all banks.				
Advances to priority sector specified by the regulator	40% (to be raised to 75%)	75%	40%,	No specific mandate. Refinance conditions make them lend more for rural and small loans	75%
Market share in total assets of the banking sector March 2019	3.37%	3.13%	Negligible	3.17%	0.47%
Supervision	RBI	NABARD	RBI	NABARD	RBI
Board	Elected	Appointed	Elected	Elected/ Appointed	Elected

Small Finance Banks and LABs are both in private sector except that LABs are non scheduled banks and operate in a very limited area. In fact when the guidelines for SFBs' were placed for public comments by RBI, it had contained the stipulation of small area of operation, say three or more contiguous districts. But this condition was removed based on suggestions received. As such SFBs' have been allowed to open branches in as many states as they desire. Many of the licensed NBFCs were also, at the time of application operating in many States and this could be a reason for not stipulating contiguous districts. Also unlike LABs which are the only non-scheduled commercial banks in India, SFBs', given their higher capital stipulation, have started as scheduled banks. The only similarity of SFB, RRB is that majority of their loans will be 'small loans' (small borrowal accounts).

Size is very important. The 'Review Group on the Working of the Local Area Bank Scheme[20]' constituted by RBI observed that 'In examining the working of the existing LABs, we cannot refrain from drawing attention to certain fundamental issues relating to the very concept of a LAB. We are strongly of the view that whether it is rural banking or any other segment of the financial sector, *size*, whether in terms of capital base or totality of operations as reflected in the balance sheets, is of critical importance. *It is size which inspires and retains the confidence of depositors and borrowers alike. It is size of capital which enables a financial entity to cope with unexpected adverse trends in its business and overcome threats to its survival from any panic reaction on the part of its investors. LABs in our view fail to pass this critical test'*. In this background the fact that Small Finance Banks have no size limitation is a welcome feature.

At this juncture it will be appropriate to see the arguments/ views of the report of the committee on financial sector reforms 'A Hundred Small Steps' and the views of internal committee of RBI on small banks. The committee observed that small banks in India namely RRB and LAB have not been much of a success because of (a) poor governance structures, (b) excessive government and political support as well as interference, and (c) unwillingness/inability of the regulator to undertake prompt corrective action. In this background

20. https://www.rbi.org.in/scripts/PublicationReportDetails.aspx?ID=294

it suggested allowing entry to (i) well-governed and (ii) deposit-taking private (commercial) Small Finance Banks. The word "small" indicating the size of 'loans' extended and not the size of the 'bank'. The committee felt that as these banks will be operating in a (iii) limited area there exist the possibility of higher risk from being geographically focused. Therefore it recommended that these banks be subject to (iv) higher capital adequacy norms, (v) a strict prohibition of related party transactions, and (vi) lower exposure limits/norms. The committee expressed a hope that SFBs would bring local knowledge to bear on the products that are needed locally, and be able to take quicker decisions. The committee hoped that this would offer an entry point into the banking system for entities which can eventually grow into large banks.

Essentially the committee felt that these banks should have a 'local feel' which was the basis of the Cooperative Banks, Local Area Banks and Regional Rural Banks. Literature shows that historical evidence is not in favour of Small Finance Banks. It is therefore hoped that 'technological solutions can bring down the costs of small banks substantially, as also increase their transparency'[21]. At the same time it is important to note that the committee observed that 'failure of one or more SFB will not have systemic consequences for the financial sector, until they become big'. Viewed in this perspective and that the Small Finance Banks with no geographical limitations like RRB or LAB have recorded impressive growth rates in the last four years, it may be expected some of them will soon become bigger banks.

The committee also observed that these banks should be closely monitored and that regulation and supervision cannot be in lieu of governance and management. Moreover supervision cannot be concurrent and close monitoring by regulator is impossible. Therefore the board and management of the banks should realise the fiduciary responsibility on account of the access given to public deposit. This should not be misused. It is in this connection the committee said that these banks should be "well governed".

21. A Hundred Small Steps. Planning Commission of India, 2007.

Almost all the points made by the committee were also made by the internal committee of RBI. The points/advantages listed in the internal report are:

a. Small banks will not be able to take large exposures as they will be, initially constrained by small capital and as their focus is small loans. A larger share of their lending will be to the small borrowers.

b. SFBs will have simple structures and help increase banking outreach to unbanked areas. These banks should be able to extend basic banking services in interior places and serve people of small means who require basic banking services.

c. Internationally it is seen that community banks in the US, which are locally owned and grounded in their communities, are able to provide services that are personalized and tailor made to meet local preference and needs. Community banks thus epitomize the notion of relationship banking. Likewise small banks will develop appropriate core competencies through relationship banking in financing agriculture, SMEs, industries, in a particular geographical area, and will be able to serve the credit needs of the area efficiently.

The committee felt that failure of SFBs, if any, will not have much contagion impact and resolution would be easier.

With the current approach to regulation being 'one size fits all' for a given segment or banking group Small Finance Banks may find the cost of compliance heavy on them. This is in contrast to the past when regulation was not focused on systemic importance and being 'big' or 'small' had no implication for the viability of the bank. In the past, small banks were viable because the regulations were neither focused on systemic importance nor global in nature. As such there were instances of banks performing very well despite geographical limitations and small size. But today regulation has become very rigorous and with every passing day some new regulation gets added. Moreover regulation covers almost all aspects of banking leaving very little scope to the Board of Directors for framing any policy. Another issue that may impact credit risk is the frequent announcement of generalised waivers[22] which will impact the

22. In the year 2017-18 10 states have announced farm loan waivers of ₹ 184800 Crore. Business Standard. Bloomberg has observed that government has incurred ₹ 3.15 Lakh Crore in recapitalising PSU banks.

repayment culture. It is apparent that waivers and recapitalisation have been institutionalised. In this background the probable issues are

a. Small banks by design face risks and are potentially vulnerable due to sector and geographical concentrations. They are vulnerable to shocks from the local economy. It is for this reason and as suggested by various committees, a higher capital adequacy norm has been prescribed which will cushion failure risk.

b. Small banks do not have many diversification possibilities as they cannot finance big-ticket investments, including infrastructure.

c. They will, till they become big, lack economies of scale and scope.

d. At the same time, on account of relationship banking, closeness to the customers and transactions moving to digital mode, small banks could have a comparative advantage.

Taking into account the above and the expectations that Small Finance Banks can play an important role in the supply of credit to micro and small enterprises, agriculture and banking services in unbanked and under-banked regions in the country, it was announced in the Union Budget of 2014-2015 that RBI *will create a framework for licensing small banks and other differentiated banks*. Later, RBI issued draft guidelines for allowing Small Finance Banks in the private sector. Also RBI issued final guidelines with one change that the SFB will not have any restriction in the area of operation.

RBI had received 72 applications of which it approved 10. Institutions which were granted license were:

Table 1.2: Details of Institutions that were Granted SFB Licences

Previous Institution	Small Finance Bank	H Q	Tagline	Date of	
				Starting	Scheduling
Au Financiers India Ltd		Jaipur Rajasthan	Chalo Aaghe Badhe	19/04/17	19/11/17
Capital Local Area Bank		Jalandhar Punjab	Viswas se Vikas tak	27/04/16	16/02/17
Equitas Micro Finance India Pvt Ltd,		Chennai Tamil Nadu	Its Fun Banking	12/09/16	16/02/17
ESAF Microfinance and Investments Pvt. Ltd		Thrissur Kerala	Joy of Banking	10/03/17	27/12/17
Disha Microfinance		Bengaluru Karnataka	A new Era in Smart Banking Begins	21/07/17	06/06/19

Previous Institution	Small Finance Bank	H Q	Tagline	Date of	
				Starting	Scheduling
Rashtriya Gramin Vikas Nidhi (North East) Microfinance Limited		Guwahati Assam	Likho Apni Kahani	28/03/18	01/08/19
Janalakshmi Financial Services		Bengaluru Karnataka	Viswas se Vikas tak	27/04/16	16/02/17
Suryoday Microfinance Private Limited		Navi Mumbai Maharashtra	A bank of Smiles	23/01/17	21/09/17
Ujjivan Financial Services Ltd		Bengaluru Karnataka	We believe in your belief	23/01/17	21/09/17
Utkarsh Microfinance Ltd.		Varanasi Uttar Pradesh	Aapki Ummeed ka Khata	01/02/17	07/09/17

The SFBs have been licensed for carrying out the following activities:

a. Offer (Undertake) basic banking services such as deposits and lending and remittances to un-served and underserved sections of population such as small business units, small and marginal farmers, micro and small industries and unorganised sector entities.

b. Distribute mutual fund units, insurance products, pension products, etc. On a non risk sharing basis and with the prior approval of the RBI. SFB should not commit its own fund in these activities.

c. Be an Authorised Dealer (Category II) in foreign exchange business for its clients' requirements.

d. As SFB it can set up branches anywhere in India (no geographical restrictions) and wherever it operates it should be responsive to local needs. It is not allowed to set up subsidiaries to undertake non-banking financial services activities.

The following are the licensing/regulatory conditions:

a. The minimum paid-up equity capital for Small Finance Banks shall be ₹ 1 Billion

b. All SFBs should maintain a minimum capital adequacy ratio of 15% of its Risk Weighted Assets (RWA- Basel ? Standardised approach) and Tier I capital of 7.5% on a continuous basis. This could be reviewed and increased from time to time. Tier II capital should be limited to a maximum of 100% of total Tier I capital.

c. Initially, promoter's shareholding should be a minimum 40% of initial paid-up equity capital of the bank. This shall be reduced in stages to 26% in 12 years from the date of commencement of business of the bank. There are certain specific provisions about FII/FPI/NRI investments in equity.

d. A SFB should list its shares within three years of reaching a networth of ₹ 5 Billion. It is however free to list earlier, subject to rules of market regulator.

e. A single shareholder's voting rights in Small Finance Banks like that of Private Sector Banks, are capped at 10%. This limit can be raised to 26% in a phased manner by the RBI.

f. Any subscription or acquisition of 5% or more of paid-up share capital in a SFB will require prior approval of RBI.

g. Small Finance Banks are subject to all prudential norms and regulations of RBI as applicable to existing commercial banks including stipulated maintenance of CRR and SLR.

h. SFB should extend 75% of its Adjusted Net Bank Credit (ANBC) under Priority Sector Lending (PSL). As per existing norms to commercial banks 40% of its ANBC is mandated under PSL, the balance 35% where the Small Finance banks have competitive advantage. Further, in order to ensure that the bank extends loans primarily to small borrowers, at least 50% of banks loan portfolio should be of loans and advances of up to ₹ 25 lakhs.

i. Exposure limit (loans and investments) to a single and group obligator would be restricted to 10% and 15% of bank's capital funds, respectively.

j. SFB cannot have any exposure to its promoters, and major shareholders i.e. those who hold 10% or more of the paid up equity capital. The other financial and non-financial services activities of the promoters, if any, should be kept distinctly ring-fenced and not commingled with the banking business.

k. SFBs are precluded from creating floating charge on their assets.

l. 25% of the branches of SFB should be, within a stipulated time, in rural areas.

m. A Small Finance Bank cannot be a Business Correspondent (BC) for another bank,but can have its own BC network.

Table 1.3: Year of Starting SFB operations

SN	Year	SFBs which commenced operations
1	2016 -17	Capital, Equitas, Suryoday, Utkarsh, Ujjivan & ESAF
2	2017-18	AU, Fincare, North East and Jana

The banking and financial sector has been undergoing many changes and facing new regulations over the past decade or so. Even as Small Finance Banks and payment banks set shop the sector is witnessing merger and consolidation of Public Sector Banks. One recalls the arrival of new Private Sector Banks in 1990s. It is but natural to ask if it will be a repeat of new Private Sector Banks where nearly 10 banks were established but on account of problems and mergers only 5 remain today.

In this background the following analysis of the performance of SFB is about (i) their role and market share, (ii) comparative performance among the Small Finance Banks and (iii) their contribution to financial inclusion. It will be interesting to study if the regulation is really proportional and if the banks are really differentiated other than the size which will be obviously small when they start the journey.

The Journey

"The journey[1] of a NBFC- MFI that issues small loans to group members is like travelling on a smooth road towards a dead end as growth has certain limits and it cannot give all financial products to its clients. On the other hand "the journey of a Small Finance Bank is like travelling on a small road towards a highway[2]" said a CEO, highlighting the difference between a NBFC and a SFB. A SFB will have more funds and be able to offer more products to its clients than a NBFC and as it reaches the highway (as it gains size) it will be able to offer almost all financial products to its clients which they very much deserve. Another point proudly made by all the CEO's whom we met for understanding SFBs closely, is that they give the same, if not better treatment, to their clients who are at the bottom of the pyramid than a HNI or large deposit customer gets from bigger private commercial banks. There is no doubt that their financial inclusion effort is leading to their clients enjoying multiple financial products and that too almost at their door steps. Meanwhile these banks have grown more than three times in the last few years and reached total assets of around ₹ 1300 Billion.

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1. Observations in this chapter are based on data inhttps://dbie.rbi.org.in/DBIE/dbie.rbi?site=publications#!4 as of March 19 and quarterly statistics as on March20. In addition data on SFB from Report on Trends and Progress of banking in the chapter on 'operations of commercial banks', RRB data from NABARD website, UCB data from chapter on 'operations of cooperative banking have also been used. As regards comparing inter SFB performance data from annual/financial reports (2018, 2019 and 2020 have been used. As such there will be minor differences in the data and ratios of SFBs. These will not however impact the conclusions.
2. Developed from a statement made by Shri Baskar Babu CEO Suryoday SFB during discussions.

What clearly emerges is that, in the initial years these banks have performed very well in financial inclusion. Not surprising. Because eight out of the ten SFB's, before they became a bank, were involved heavily in small loans (microfinance) as NBFC- MFIs'. Among the other two, one was a NBFC with more than 20 years' standing, focused on SME lending and the other was a Local Area Bank with two decades of existence. The NBFC-MFIs' had majority of their loans in microfinance (JLG type lending) and majority of their funds came from banks as lending by banks to MFIs' is reckoned as priority sector. As such, when they became banks, their accounts (existing) got added to financial inclusion and in almost all these accounts SFBs have, since opened savings accounts. They have mobilised other deposits as well. As of March 2020[3] SFBs had a share of 0.45% in deposits and 0.91% in the loans and advances of the commercial banking system. SFBs have grown aggressively during the year 2019-20 and recorded a growth of 66.7% in deposits and 57.6% in advances as against an overall growth rate of 9.5% in deposits and 6.4% in advances in the banking system. Together, these SFBs have business volumes similar to 15[4] Private Commercial Banks and two PSU banks, all of which have less than 1% share in the banking sector.

Business Volumes and Business Mix

SFBs are around since four years now. During this period, they have been able to reach a deposit base of ₹ 729 Billion. They have also increased (Table 2.1) the loan outstanding from ₹ 168 Billion in the year 2017 to ₹ 905 Billion as of March 20. In fact, during their first four years, business has grown more than four times and deposits have grown 14 times. It is seen that loans and advances account for about 68% (2020) of the total assets which is the highest among bank groups.

3. Quarterly statistics on deposits and credits of commercial banks. RBI
4. Estimated based on March 19 banking data (RBI) and subsequent mergers etc

Table 2.1: Small Finance Banks - Business Mix & Volume[5]

₹ Billion

	2017	2018	2019	2020
Number of banks	6	10	10	10
Capital & Reserves	56	97	117	150
Deposits	50	265	557	729
Borrowings	159	309	278	368
Other Liabilities	12	29	37	80
Cash & bank balances	9	22	36	51
Investments	84	179	219	329
Loans and Advances	168	469	699	905
Fixed and other Assets	16	30	35	42
Total Assets	277	700	989	1327

Table 2.1A: In % terms to total assets

	2017	2018	2019	2020
Number of banks	6	10	10	10
Capital & Reserves	20.3	13.9	11.8	11.3
Deposits	18.1	37.9	56.3	54.9
Borrowings	57.4	44.1	28.1	27.7
Other Liabilities	4.3	6.2	3.7	6.0
Cash & bank balances	3.2	3.1	3.6	3.8
Investments	30.3	25.6	22.1	24.8
Loans and Advances	60.6	67.0	70.7	68.2
Fixed and other Assets	5.8	4.3	3.5	3.2

The growth in business recorded by these banks is more than what is recorded by the banking system. The higher growth in deposit has to be juxtaposed with about 2 times growth in borrowings and reduction in the share of borrowing with SFBs. It is however seen that all Small Finance Banks do not have same growth or same volume of business.

5. From the annual report of the banks. RBI quarterly data indicates Deposits of ₹ 625 Billion and advances of ₹ 949 Billion.

Bank-wise business volumes and mix as on March 2020 (Table 2.2) was as under.

Table 2.2: Summary balance sheet of SFBs as on March 2020

₹ Billion

	AU	Capital	Equitas	ESAF	Suryoday	Fincare	Ujjivan	Utkarsh	NE	Jana	Total
Capital & Reserves	44	4	27	11	11	9	19	10	4	10	150
Deposits	262	44	108	70	28	47	12	52	9	97	729
Borrowings	103	4	51	12	13	14	108	27	7	29	368
Other Liabilities	13	1	6	2	2	2	44	5	1	6	80
Cash & Bank	10	2	4	3	1	11	12	2	1	5	51
Investment & Deposits	130	16	45	23	16	10	25	26	5	32	329
Advances	270	33	137	65	35	48	140	63	13	100	906
Other Assets	11	2	7	3	2	2	6	3	1	6	41
Total Assets	421	53	193	95	54	71	184	94	21	141	1327
Share in total SFB	32	4	15	7	4	5	14	7	2	11	

The average asset size of Small Finance Bank as of March 20 was ₹132.7 Billion. These banks have recorded a growth of 34% over the previous year. Evidently these banks are growing aggressively and will continue to grow fast over the next few years and as predicted by the committee on financial sector reforms (A Hundred Small Steps) some of these banks will, eventually become big. That their operations are not limited to a contiguous area and these banks are technologically almost similar to bigger commercial banks will help them speed up their growth. As such, size or operational area may not be a limiting factor for SFBs to play an important role in financial inclusion. Big PSU and Private Banks have already shown that financial inclusion can be pursued on a viable basis though its share in total business with them may not be as high that of SFBs.

Currently the size of these banks varies, and some of them are comparatively big. It is seen that, as of March'20, four SFBs, all of whom that have more than ₹ 100 Billion in assets, accounted (Table 3) for more than 70% of business in SFB sector.

Table 2.3: Market share analysis of Small Finance Banks

Size of Business	March 2019		March 2020	
	No of banks	Market Share (%)	No of banks	Market Share (%)
Less than ₹ 50 Billion	4	14.21	1	1.56
₹ 50-75 Billion	2	13.44	3	13.41
₹ 75-100 Billion	1	9.55	2	14.22
Above ₹ 100 Billion	3	62.80	4	70.81

At the same time the share of SFBs in the overall banking (Table 2.4) market may not be more than 1% as of March '20 (0.56% as of March '19).

While comparing performance of SFB with other banks data as of 31/3/19 is used except deposit and credit data as of March 20. SFB data is available as of 31/3/20 (0.56% as of March '19).

Table 2.4. SFB Comparison with other Banks

Item	PSU Banks	Private Banks	SFB	RRB	UCB
Capital & Reserves	43.81	40.29	1.01	2.55	3.76
Deposits	61.44	27.29	0.40	3.15	3.51
Borrowing	42.91	43.68	1.57	3.32	0.30
Investments	57.44	25.92	0.37	4.78	3.34
Loans & Advances	57.58	32.33	0.68	2.62	2.94
Total Assets	57.19	29.28	0.56	3.13	3.37

Small Finance Banks have, over the past 4 years recorded very good growth in business. As these banks have begun their journey with higher amount of capital and strong CAR they can grow aggressively in the early years of their business.

Branch Network

Financial inclusion has been attempted in our country since a long time now, but could not be achieved as the branch banking model is not, in the absence of outreach tools and digital banking, fully capable of increasing banking outreach. In fact, the pace of financial inclusion has remarkably increased with the arrival of banking technology and technology-driven new access points. Yet branches are important for achieving financial inclusion as they give recognition and also customer comfort. Small Finance Banks are allowed to open branches anywhere in India and have also been advised by RBI to have at least 25% of their branches in rural areas, that too in hitherto unbanked centres.

SFBs had about 4452 branches (Table 2.5) as of March '20 and accounted for nearly 3% of the total branches in the country. It is noteworthy that branches in tier 5 and 6 were 33.4% of the total branches of which the SFBs accounted for less than 0.5%

Table 2.5: Distribution of bank branches in India March 2020[6]

Bank	Tier 1	Tier 2	Tier 3	Tier 4	Tier 5	Tier 6	Total	Share in total Branches %
PSU	38890 (42)	6565 (7)	10221 (11)	8099 (9)	10214 (11)	18731 (20)	92,720	60
PVT	17419 (49)	3388 (9)	4983 (14)	2651 (7)	2491 (7)	4745 (13)	35,677	23
RRB	2086 (9)	704 (3)	1724 (8)	2395 (11)	4503 (20)	10852 (49)	22,264	14
SFB	1932 (43)	593 (13)	746 (17)	356 (8)	332 (7)	493 (11)	4,452	3

Note: Figures in bracket indicate % of branches to total branches of the group

6. From the annual report of the banks. RBI quarterly data indicates Deposits of ₹ 625 Billion and advances of ₹ 949 Billion.

During the year 2019-20 SFBs have added 30% more branches. It is observed that only 18% of the branches were in rural areas as against 33% rural branches for the system as a whole. 43 % branches of SFBs were in Urban and Metro areas.

It is worth mentioning that RRBs have nearly 70% of their branches in rural areas and 22% in Semi Urban areas. The progress of opening of SFB branches has been fast. It is seen in (Chart 2.1) that the number of rural branches are around 18% from the beginning.

Box 2.1: Importance of Branches in Achieving Financial Inclusion

The % of rural banks with the SFBs is about 18%. RBI while licensing these banks had indicated that the banks should have at least 25% branches in rural areas and that too in unbanked centres with a population of less than 10000. On the role and importance of branches, the SFBs said:

i. Customers come to know about a bank through the branches and get a feel and comfort by visiting the branches. Branches are important to give a feeling of safety and security to the customer and building a brand image of the bank.

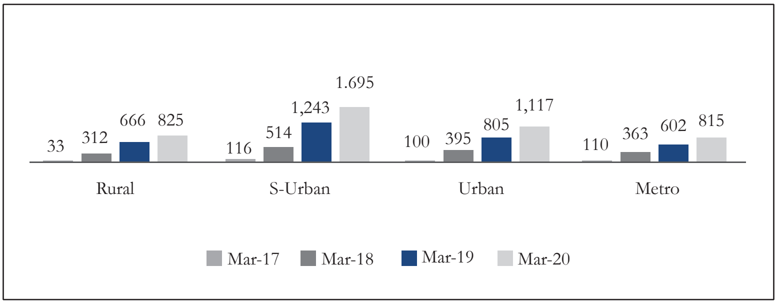
ii. Except transactions taking place at group meetings, an attempt is being made to encourage most other transactions in on-line or in ATM /Micro ATM and POS. As such, customers come to the branch seeking support for their other needs and to understand the products. Branches play a critical role in business development.

iii. Majority of SFB customers, particularly group loan borrowers are still on cash mode and therefore branch/banking outlet is important for them.

iv. Digital banking such as mobile banking and internet banking are not as entrenched in rural areas as they are in urban areas. Even in urban areas small value deposit or credit transactions may not take place in digital mode. Therefore in rural areas branches/banking outlets or BC offices will continue to be important. At the same time, digital banking is gaining acceptance among SFB's customers due to the recent lockdowns and other disturbances. Possibly, the role and importance of branches will change once digital transactions take root in the villages and urban slums.

v. Branches in small places will have viability issue. An unbanked centre need to be redefined as technology helps in reaching places without branches.

Chart 2.1: Population group wise number of branches of SFBs 2017 - 2020



In addition to the branch network SFBs' have installed 1926 ATMs, mostly on site and were also giving banking access to their customers through micro ATMs. Branches and other access points play a critical role in their strategy to attract customers. Though technologically all transactions can be done on-line, branches are important for recognition, customer confidence and also for building bank image or brand. As customers move transactions to ATMs, POS devices, internet and other modes, branches will focus on customer acquisition, borrower on boarding and increasing product penetration to each customer. One of the important mechanisms for SFBs in providing banking services to their customers in villages and slums is Micro ATMs. Going forward SFBs will have to focus on increased use of POS devices.

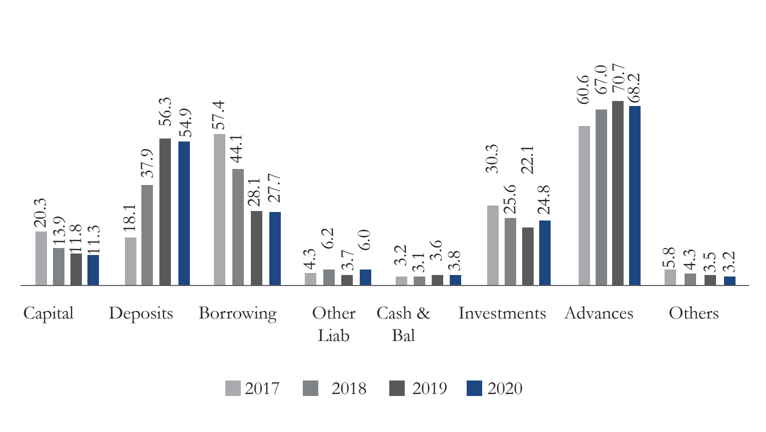
Box 2.2: Micro ATMs: Aadhaar-Enabled POS devices

- Reach of ATMs in rural areas is very less. The number of off-site ATMs of banks in rural areas is very small in comparison to urban areas. The number of ATMs wand Branches in rural areas is almost the same.
- Use of Micro ATMs banking solutions, through specifically enabled Point of Sales (POS) devices are aimed at enhancing cardless and PINless banking. It is possible to do basic banking transactions like cash deposit, cash withdrawal and balance inquiry through Micro ATM. These M-ATMs allow customers to perform basic financial transactions using their Aadhaar number and their biometrics (fingerprints or iris) for identity verification. This will be very useful in villages.
- All payments done by Micro ATMs are authenticated by UIDAI via biometric process and authorized by banks.
- POS devices can be easily carried on-person, hence, help banks/BCs extend basic banking services to the doorsteps of the customers. These POS can be used in group meetings of SFBs. MFI's can use banks POS for their customers.
- No service charges are payable by customers for the transactions done through such micro ATMs.
- Unlike an ATM, the cash-in / cash-out functions of the micro ATMs are performed by the banker/ BC, thus cutting down the cost of the device and the cost of servicing the customer.

Business Mix

It is seen that the overall business mix of the SFBs is (chart 2.2) similar to that of other commercial banks but with certain noticeable differences (as of March 2020) in terms of higher capital outlay (capital to total asset at 11.3%), higher share of loans (68.2% of total assets) and that the credit portfolio is made up of more number of small borrowal accounts. The share of borrowing (27.73%) in total assets was also higher than other banks. It is noteworthy that the share of deposits in total business has gone up from 38% in 2018 to about 55% in 2020. Investments are seen at 24.8% in 2020 and include deposits made in the interbank market.

Chart 2.2: Business Mix of SFBs for years 2017-2020



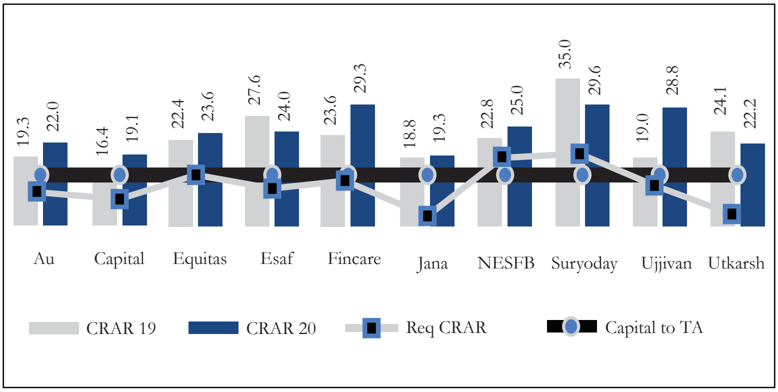
Higher Capital and Capital Adequacy Ratio

Against the minimum entry capital requirement of ₹1 Billion stipulated by RBI, these banks had capital ranging from ₹ 2 Billion in the case of Capital SFB, ₹ 3 Billion NESFB and Fincare SFB to ₹ 23 Billion in the case of AUSFB as of March '17. The Capital Adequacy ratio maintained by the Small Finance Banks, from the beginning has been higher than mandated by the regulator (which at 15% is much higher than what is in force in force for universal banks). CRAR of these banks as of March 20, ranged from 19.1% (Capital) to 29.6% (Suryoday) and the Capital to Total Assets Ratio varied from 7% to 20%.

One of the licensing conditions is that within a few years of reaching ₹ 5 Billion networth, these banks must issue shares in the market. They are however, in case they want; allowed to go to market earlier. Till now, only three banks have made public issue of shares. Two of the banks which had holding companies and had issued shares in the name of the holding company had requested for reverse-merger proposals which was refused by RBI[7]. Among the rest, as of March '20 only two banks had less than ₹ 5 Billion networth/capital and reserves. Given this, most of the banks will, shortly, make their IPOs. This will help

7. https://www.livemint.com/industry/banking/minimum-capital-requirement-to-set-up-small-finance-bank-set-at-rs-200-cr-1568387843368.html

Chart 2.3: Capital and Capital Adequacy



them grow fast. Though, as banks grow, some of the excess capital will come down, it is expected that, in the immediate future, the Capital to Total Asset Ratio of Small Finance Banks will remain higher than other commercial banks.

Investments include balances and deposits of SFBs with the banking system which are possibly higher due to higher level of cash transactions at SFBs as majority of their loans are under the Weekly/ Monthly Equated Instalments and collection is mostly in cash. As these loans warrant close collection methodology and involve cash in group meetings, cash balances will tend to be higher with SFBs. Though banks are encouraging their borrowers and clients to move more transactions to digital, it will take time for majority of the transactions to move on line. As such Small Finance Banks will have higher liquidity requirements than other banks.

Initially borrowings as percentage to total assets were high as deposit growth was rather small in the beginning. However the proportion of borrowing to total assets has declined steadily from 57% as of March 2017 to 27% as of March 2020, though, during this period, the amount of borrowing has almost doubled (Table 2.1).

Deposits

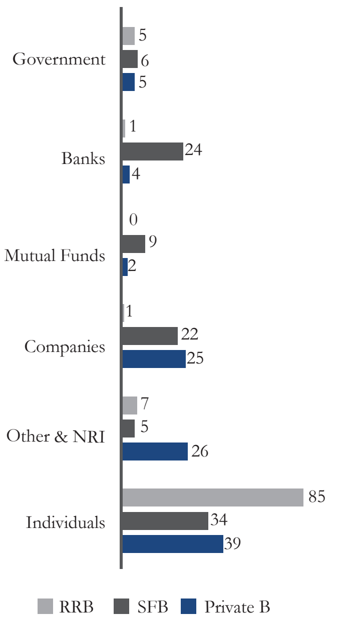
Deposits of SFBs' (as % to their total assets) and share of SFBs' in the deposit market (less than 0.5%) were low. They had mobilised deposits aggregating to ₹ 625 Billion as on March '20 which was 0.45% of the total deposits of the banking system which was ₹ 137 Trillion (March 2020)[8]. Over the last few years deposits with SFBs have increased and they have mobilised more of term deposits. It is observed that the Small Finance Banks have been offering a higher Rate of Interest on the deposit than what is offered by other commercial banks and cooperative banks. It is reported that "The highest FD card rate offered by some Small Finance Banks are around 200-300 bps more than the highest FD card rates offered by most PSUs and large Private Sector Banks[9]". In the recent months, the difference in the rates is declining. It is also seen that, generally share of CASA in the total deposits with these banks is low.

SFBs offer Savings, Current, Term Deposits and Recurring Deposits. Some of these banks have packaged savings deposits attractively for salary earners, senior citizens, minors, saving plus account etc., by varying /offering certain number of free transactions, varieties of debit cards like gold, platinum etc and variations in the required average monthly balance. Similarly product differentiation efforts are seen in current accounts as well. Between current and savings the number of current accounts with SFBs is lower.

As regards term deposits there are not many innovations or customisation except offering slightly higher rates than that offered by other commercial banks. Most banks offer recurring deposits which is linked to EMI and therefore convenient for group members. Some banks offer tax saving deposits as well. SFBs have issued 15.2 million debit cards as on March '20 (8.86 Million 2019). Debit card, though a common feature with bank deposits, is an important addition from the perspective of SFBs' customers who, previously had no access to debit cards. This will be a very good instrument in reducing cash

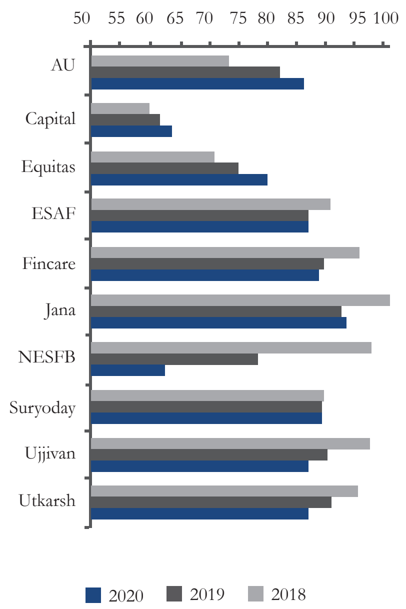
8. RBI Quarterly statistics
9. https://www.cnbctv18.com/personal-finance/small-finance-banks-offer-higher-rates-on-fixed-deposits-but-should-you-invest-6101531.htm

Chart 2.4: Source of deposits- 2019[10]



Source: RBI Data

Chart 2.5: Term deposits to total deposits (%) SFBs[11]



Source: SFB Annual Reports

transactions with them. It is likely that the number of deposit accounts will be similar or very near the number of debit cards, though some of the accounts (joint accounts) could have add-on cards. Apparently, all the group loan borrowers have, by now, access to debit card which is a remarkable achievement under financial inclusion.

To attract more deposits these banks offer a higher Rate of Interest on savings account and have also mobilised more of term deposits (Chart 2.5). Term deposits are useful in making available funds for their growth and also help in reducing cost of funds as these deposits replace high cost borrowings. Borrowings of SFBs are on a steady decline.

10. RBI data
11. SFB annual reports
12. SFB annual reports

As indicated earlier % of CASA to total deposits is low. However it is felt that the number of savings accounts will go up as every new borrower of SFB will open a SB account with the bank. The recent increase in the amount of deposit insurance to ₹ 5 lakh may also result in the inflow of deposits. Yet balances may not be high as the depositors/borrowers come from rural/poor background. It is also expected that as more SMEs are financed, number of current accounts and balances in current accounts will also improve. For attracting current accounts and high value deposits, these banks will have to seek business people and offer appropriate facilities. This calls for strategic marketing and may not be easy and therefore these banks will continue to depend more on term deposits. It is also seen that currently majority of term deposits are of less than three years maturity because SFBs access term deposits of shorter duration to suit their liquidity needs and at the same time control cost of deposits. The low level of CASA and accessing more term deposits and that too from other banks and companies will tend to increase the cost of deposits with these banks.

The source of deposits of SFBs makes an interesting reading. In the case of RRBs it is seen that more than 85% of the deposits are made by individuals (Chart 2.4) whereas it is only 34% in case of SFBs and 39% in the case of private banks. SFBs had, during 2019 raised deposits from banks (24%) and companies (22%) including companies that raise deposit from public. Among individuals, the % of women depositors (Chart 2.6) is high with the Small Finance Bank. This is possibly because of a higher quotient of microfinance customers with these banks where majority are women borrowers. Generally the average deposits are higher in the case of male depositors (Chart 2.7) except with PSU banks where the balances are more or less even. The average balance of women depositors is low because most of them are microfinance borrowers under group lending.

In the year 2019 more than half of the deposits of SFBs came from banks and companies. It is however seen that short term deposits (Table 2.6) particularly deposits up to 6 months account for 22% or so of the total term deposits of the SFB as against 4% in the case of RRBs. RRBs have access to funds from sponsor banks. Noticeably deposits above 3 years are rather less with the SFBs. This could be due to the ALM strategies of the companies and banks which place the deposits.

Chart 2.6: Ownership of deposit accounts-2019

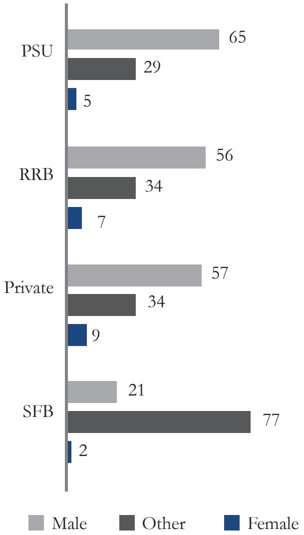
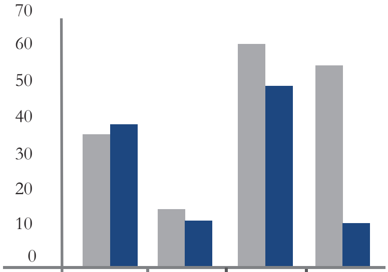


Chart 2.7: Average Deposit Balances-Gender wise-2019



	PSU	RRB	Private	SFB
Male	37335	16791	62520	56997
Female	39991	13457	51081	12447

Table 2.6: Maturity pattern of Term deposits (%) 2019

Time Bucket	Less than 91 days	< 91 days &> than 6 months	< 6 months &>than 1 year	< 1 year &> 3 years	< 3 years &>5 years	5 years & above
PSU	4.80	2.32	7.58	60.65	7.94	16.71
RRB	1.73	2.11	13.63	56.05	12.01	14.46
SFB	11.24	11.31	9.31	63.15	4.03	0.97

The names Local Area Bank, Regional Rural Bank or Urban Cooperative Bank are easy to understand and are not subject to interpretation. Similarly, though there are new and old generation private banks it is not mentioned specifically in the name of the bank. In this sense, the name Small Finance Bank could create some apprehension in the minds of depositors. In the early stages these banks were also apprehensive if the name Small Finance Bank would will hinder flow of deposit. It is now clear that these banks have good acceptance from the public. The growth of deposits with these banks in the last four years shows that the title 'Small Finance Bank' is not a constraint. But it must be said that banks have to often explain to their customers that the word Small Finance is to highlight their lending focus.

Box 2.3: Is the name "Small Finance Bank" a constraint?

Observations from SFB:

a. 'We know that the name Small Finance indicates that we will finance more of small borrowal accounts. But the name does not clarify'. Therefore these banks had, initially faced some difficulty in explaining this to potential customers. 'Also this does not limit the size of the bank'. However, currently (four years since they were started) banks have no issue with the name. Deposits have grown many times. Obviously banks need more deposits.

b. Initially it was a constraint. But the banks informed all their field staff that the name indicates the objective i.e. extending small loans and asked them to tell this to the people (customers) they meet. Now there is a good acceptance with the people with whom the banks work.

c. It is still not clear as to why the name is Small Finance Bank. What is not clear now is that as we grow and try to diversify into somewhat bigger customers whether we will be able to offer services on par with other commercial banks?

Borrowings

Borrowing is an important source of funds for the Small Finance Banks. As of March 2020 borrowings of SFB's were about 27% of the total assets. In comparison RRBs had 11% borrowing (2019) mostly in the form of refinance from NABARD/SIDBI etc. Private Sector Banks had 14% of their funds from borrowing. SFBs will continue to have a higher borrowing quotient for some more years till their share of deposits reach a level similar to other banks. Also, RBI has said[13] that SFBs are exempted from the regulatory ceiling on inter-bank borrowings till the existing borrowings (at the time of commencement of the bank) mature or up to three years from the

13. RBI/2016-17/81 DBR.NBD.No.26/16.13.218/2016-17.October 6, 2016.

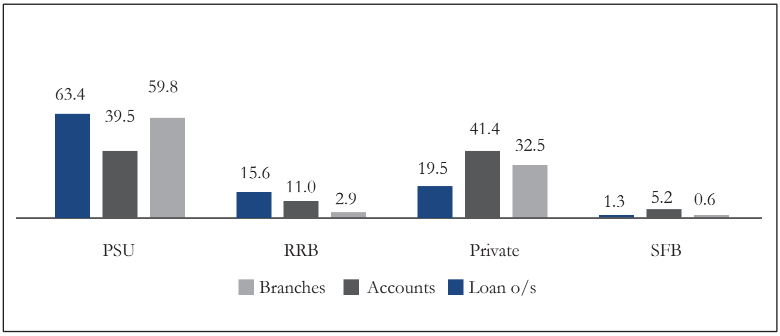
beginning of operations, whichever is earlier. Afterwards, SFBs will be subject to norms applicable for Scheduled Commercial Banks (Normally on a fortnightly average basis, borrowing outstanding should not exceed 100% of capital funds (i.e., sum of Tier I and Tier II capital) of latest audited balance sheet). However, borrowing made after the commencement of operations will be subject to inter-bank borrowing limits. SFBs will have to keep borrowing options open as they have to grow and meet the demand for loans.

Loans and Advances

SFBs issue loans to individuals of groups and a variety of other loans. 'Loans and advances' is the single largest item on the asset side of their balance sheet with the percentage of loans to total assets hovering around 70%. Given the higher Priority Sector mandate and the higher cost of funds which makes investments rather unviable, these banks will continue to have a higher exposure in credit and that too in small finance.

Total loans and advances of the banking system was ₹ 104.4 Trillion as of March 2020. With an outstanding amount of ₹ 949 Billion the share of SFBs was about 0.90% (0.68% of the amount and 5.2% in terms of number of accounts in the year 2019). Majority of the loans of SFB and RRB are of small size.

Chart 2.8: Loans & Advances of SFBs - 2017-2020



The loans and advances with SFBs was ₹ 698 Billion as of March 19. In this term loans were 90% and CC and OD were 10%. It is observed that (Table 2.7) nearly 98% of the loans were for amounts less than ₹ 5 lakh and the outstanding there constituted 54% of the amount of total loans.

While comparing performance of SFB with other banks data as of March 2019 is used except deposit and credit data as of March 20. SFB data is available as of March 2020.

Table 2.7: Loan limit wise Accounts & Amount Outstanding

In terms of % to total loans of the bank

March 2019	PSU Banks		Private Banks		Small Fin Banks	
Range	A	B	A	B	A	B
Up to ₹ 5 Lakh	85.96	15.27	90.77	13.53	98.16	54.00
5 lakh to 50 lakh	13.36	21.04	8.54	24.55	1.81	31.78
50 lakh to 100 Crore	0.68	25.13	0.68	39.17	0.03	14.05
Above 100 Crore	0.01	38.55	0.01	22.743	0.00	0.17
Data: RBI data Base. A= Number of Accounts. B= Amount Outstanding						

Most of the loans of SFB, as of March 2019 were of ₹ 5 lakh or less. Most importantly it is seen that the average loan (Table 2.8) size with SFBs (2019) was ₹ 65945. The purpose wise classification shows that these banks had issued loans for almost all purposes. That these loans were small in size is indeed a good addition to financial inclusion.

Table 2.8: Average Loan Size - March 2019

In ₹

Purpose	PSU	Private	SFB
Agriculture	1,76,703	1,24,582	43,624
Industry	14,951,997	33,00,943	62,053
Transport Operators	17,50,000	9,28,450	1,35,700
Professionals	22,19,738	11,67,590	59,429
Personal Loans	7,19,137	2,41,800	1,09,172
Trade	16,56,399	6,48,622	96,465
Finance	1,72,28,159	4,34,84,380	57,227
Others	11,25,267	7,30,336	1,44,604
All Loans Average	8,78,601	4,71,855	65,945

Table 2.9: Purpose-wise Credit Details - Comparison of SFBs and RRBs[14]

In terms of % to total loans of the bank

Purpose	RRB		SFBs	
	No: of A/Cs	Amt O/S	No: of A/Cs	Amt O/S
Agriculture	18.8	13.71	3.6	0.88
Industry	7.0	0.28	14.8	0.16
Trans Operators	2.0	0.57	5.3	2.30
Professionals	6.8	0.71	18.1	1.07
Personal	2.3	1.72	0.0	0.03
Trade	12.0	1.67	7.5	1.05
Finance	12.6	1.02	73.1*	0.84
Others	14.4	6.38	19.3	2.90

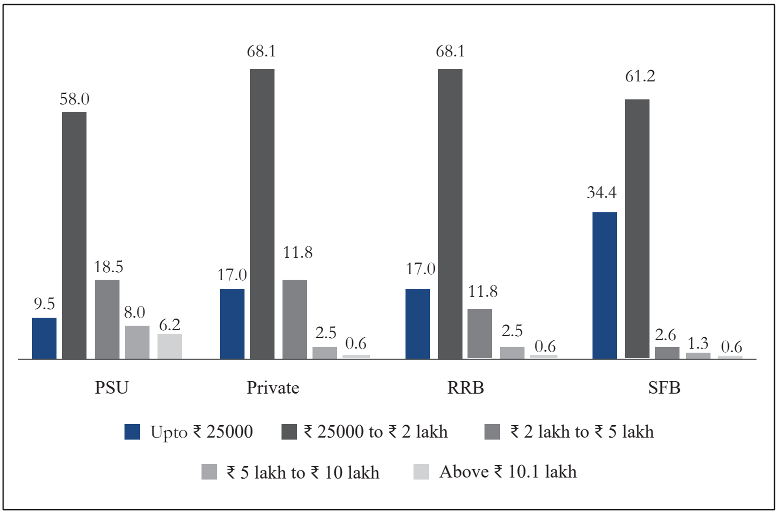
* Apparently SFBs classification of loans to finance purpose seem different than commercial banks. Because such a large number of its borrower may not be involved in financing activities. This data need corrections.

It must be added here that loans of SFB are small value/size loans and therefore the size and conduct of business by the borrowers will be different from that of larger loans of bigger commercial banks despite the purpose being same. These borrowers may not have any reserve strength or funds to meet with business cycle or other adversities. Given this the SFBs have sanctioned them term loans and collect repayment in the form of Equal Weakly Installments (EWI). It is seen that personal loans (aka retail loans) are much higher with commercial banks and RRBs and home loans and vehicle loans are very popular. SFBs have forayed into these areas only recently.

Analysis of data shows that nearly 95% of the loans of SFBs (chart 2.9) are in the size class of less than ₹ 2 lakh. Amount outstanding in this size of loans was about 35%. In comparison, RRBs have 85% loans in this bracket but have 50% exposure (Chart 2.10) in terms of loans outstanding. In case of PSU banks the number of accounts was 67% but outstanding was less than 10%. But given the size of these banks it is important to point out that PSU banks are playing a very important role in extending these loans and that they are very important in achieving financial inclusion.

14. Table No.3.5 – Population Group and Bank group-wise classification of outstanding credit of scheduled commercial banks according to occupation.

Chart 2.9: Number of loan accounts to total loan accounts (%) as per loan size



The total loans outstanding in this segment (i.e. less than ₹ 25000) is ₹ 521 Billion; of this the share of SFB 9.2% (i.e. ₹ 48 Billion). In the next slab the total credit outstanding is ₹ 7.9 Trillion of which the share of SFB is 2.4 % (i.e. ₹ 193 Billion).

Chart 2.10: Amount wise loan outstanding to total outstanding as per loan size (%)

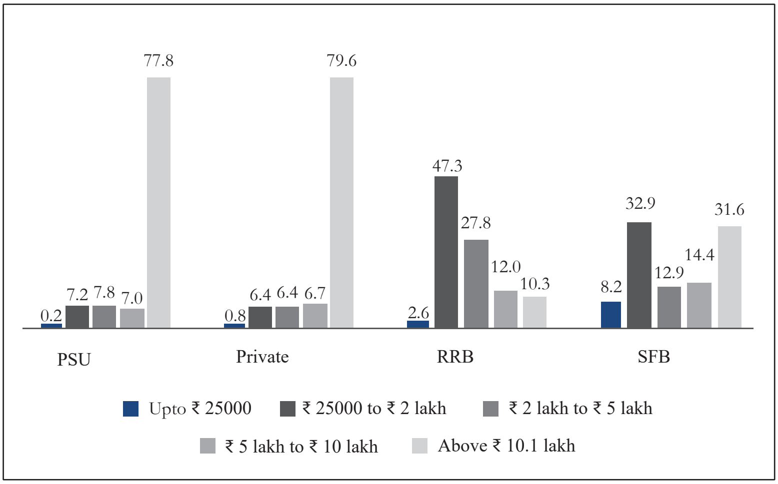
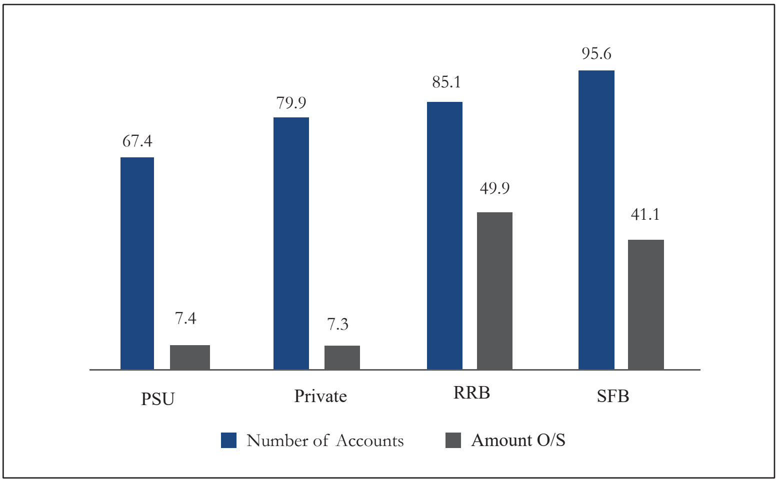
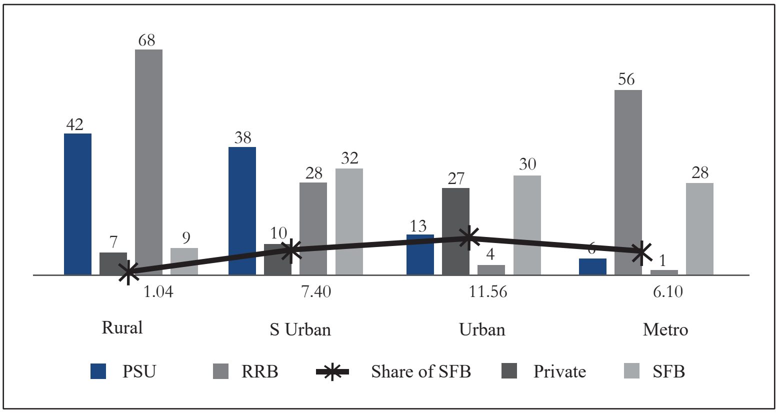


Chart 2.11: % of small loans in banks



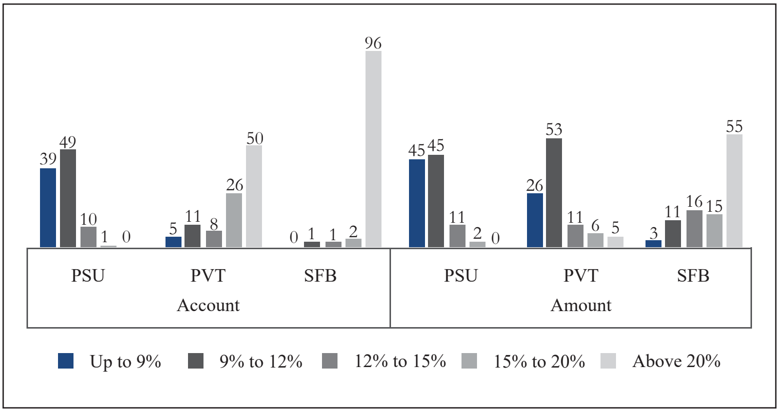
SFBs arrive at the lending rates based on RBI guidelines on MCLR. In this it is observed that (a) their cost of funds and (b) their cost of operations are higher than other commercial banks. It is observed that Small Finance Banks charge a higher rate of interest on loans than what is charged by other commercial banks. Within this, JLG loans are charged much higher rates than other loans. This could be on account of majority of them being NBFC-MFI earlier and had the benefit of the recommendation of Malegam committee, which had said that

Chart 2.12: % of small loans to total Loans



MFI's could price their loans at 24% (8% spread). The Committee had possibly, looked at the rate of interest only from the perspective of lender and not the client. It must be added despite such high rates the profit margin is not high. This could be because of high cost of operations. As these banks grow in size the cost of operation as a% of assets come down it could lead to some reduction in the rate of interest. For housing loans and some other secured loans banks arrive at the ROI based on EBR. In comparison interest rates of RRBs kind of reflect PSU bank's rates. It should be noticed that rates above 14% for small loans is rather rare in the case of PSU banks. A scrutiny of rates of interest displayed/announced in the websites of the SFBs show that highest interest rates range could be around 24%.

Chart 2.13: Interest rate wise Number of accounts & loan outstanding

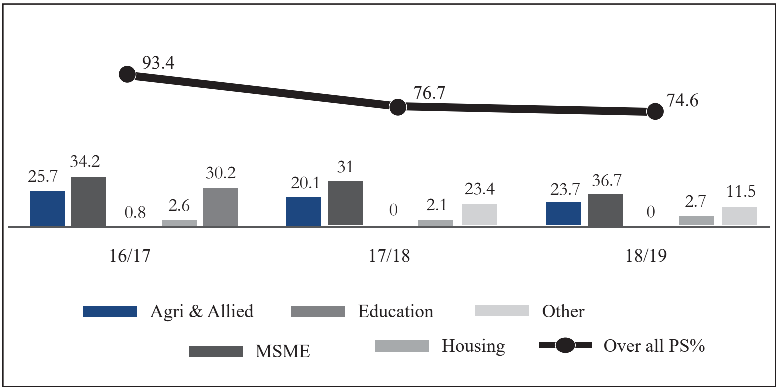


Priority Sector

One of the licensing conditions of SFB is that they should have 75% coverage of Priority Sector. Of this 40%[15] should be as per norms applicable to commercial banks and remaining in any one or more of these sectors and micro finance. In this regard it is observed that as these banks are focused on small loans there has been no difficulty in achieving the priority sector norms (Chart. 2.14).

15. As per RBI circular dated 04.09.20 SFB PS target is - 75 % of ANBC. Further it should be 18% of ANBC for Agriculture, 7.5% of ANBC for micro enterprises and 12% of ANBC for weaker section

Chart 2.14: Priority Sector Lending Break-up for SFBs



Loan Products

SFBs lend to small business, farmers and others. A study of various credit products announced in their websites show that banks have put in efforts to develop many products which are suited to the target groups. Variations are seen in terms of the name of the loan, purpose, customisation etc. Barring group loans (JLG on group basis or individual basis) most of the loans are secured by some form of collateral. Loans, other than group loans for a given purpose without collateral attracted 1%-2% more interest than secured loans.

a. **Agriculture:** These loans are issued to farmers and agricultural labourers. Unlike loans issued by PSU banks and RRB where the purpose such as crop loan or investment in agricultural equipment etc is the basis for loans SFBs issue loans to agriculturists with no particular emphasis on purpose or end use. Also unlike bigger commercial banks these banks do not adopt specific eligibility conditions for agricultural labourers and therefore able to issue loans to them. These banks offer (i) Agricultural Cash Credit, (ii) Individual Loan, (iii) Kisan Credit Card, (iv) Loan for land purchase and (v) tractor loans. Barring KCC most of these loans are term loans. Possibly, though they bear similar name like other commercial banks loan amounts will be much smaller.

b. **Business Loans:** These loans include (i) loans for business entities, (ii) business loans for individuals, (iii) enterprise development loan, and (iv) loans to commission agents (arthiyas). Variations are seen in terms of (a) secured business loans, (b) small business loans and (c) construction equipment loan

c. **Auto/Vehicle Loans:** Under this heading banks issue (i) Car Loan, (ii) Commercial Vehicle loan, (iii) Pre-owned vehicle loan, (iv) Two Wheeler loan, (v) Used Car Finance and (vi) Other Vehicle Loans

d. **Group Loans:** Varieties in this type of loans are (i) Agricultural Group Loan, (ii) Joint Liability Group Loan, (iii) Micro Credit Loan, (iv) Micro Finance and (v) Micro Housing Loan

e. **Home Loans:** This includes (i) Affordable Housing Loan, (ii) Dream Home Loan, (iii) Home Construction Loan, (iv) Home Loan/Finance, (v) Take over Home Loans, (vi) Home plus Loan, (vii) Home Purchase Loan and (viii)Home top up loan

f. **Loan against Property:** This loan is issued against mortgage of property for purposes such as business, personal use which could be any of the purposes mentioned above.

g. **MSME Loans:** For working capital or investment purposes for micro and small industries and enterprises.

h. **NBFC Finance:** Terms loans to MFI and NBFC- MFI for on-lending to groups and individuals. These loans are seen in MFI turned SFBs

i. **Overdrafts:** Secured and Unsecured overdraft (against security or clean) for personal or business purposes

j. **Consumer Loans:** For purchase of electronic goods and other items for personal needs.

k. **Other loans:** Fisheries Loan, Genset Loan, Gold Loan, Loan Against rent receivable, Piggery Loan, Income Generation Loan, Skill Development Loan, OD for cash flow management, Toilet Loan etc.

Group loans are more or less fixed and same amount of loan is given to all members of a given stage of group. These are generally given to members of women groups. These banks offer, one after another, up to 5 or 6 loans (known as loan cycles) for each group member.

Box 2.4: Unique Loans

Some of the unique loans offered by SFBs are

- Toilet Loan
- OD for small businessmen to tide over their cash flow problems
- Loan for agricultural labourers for carrying our agriculture activities
- School fees loan
- Loan against rent receivables
- Clean Energy Product Loan

Though, generally the ROI on loans are high, it is noteworthy that the above loans which are socially oriented are issued at lower interest rates.

In retail loans and other loans banks use LTV or margin for arriving at the loan amount. In addition to interest borrowers have to pay charges for processing, document verification etc., which could be up to 2% of the loan amount. As indicated earlier, interest is charged on MCLR or FBR basis. MCLR of the banks (Sept 20) ascertained from their websites and collated (end Sept 20) are provided in table 2.10.

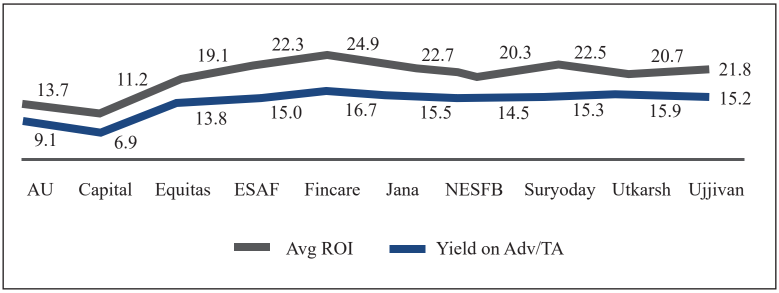
Table 2.10: MCLR[16]

Period	Minimum	Maximum
Overnight	8.10	14.27
1 month	7.55	14.20
3 Month	7.75	14.25
6 Month	8.50	14.45
1 Year	9.35	14.55
2 Year and above	9.35	14.65

As per extant regulations all floating rate loans should be priced on the basis of Marginal cost Based Lending Rate (MCLR). Further floating rate loans for home loans, auto loans and loans extended to SME should be based on External Benchmark Mark Rate (EBR). EBR is quoted on the basis of reverse repo rate or one year T Bill or G Sec rate. Small Finance Banks will find lending rates based on EBR could be unviable or difficult to manage. Banks arrive at risk premium for each purpose based on margin (LTV), amount of loan etc. Generally non-group loans are priced 4% to 7% lower interest rates than group loans. Credit rating and/or credit scores of the proponents are obtained from recognised institutions.

16. Ascertained from the websites of SFBs

Chart 2.15: Rate of Interest on Loans and Advances



Investments

Given the cost of funds with SFBs, investments are unviable. It must be added here that SLR investments in G Sec could be yielding negative returns as the cost of funds of SFB is higher vis-a-vis G Sec yields. Due to this and the higher Priority sector mandate the business mix of the banks is tilted towards more advances.

Business Performance

It is seen that the SFBs have increased their business from ₹ 700 Billion as of March 18 to ₹ 1327 Billion as of March 20. Details of balance sheet are given in annexure 1. The summary of total assets is given below.

It is also seen that banks have recorded very good increase in deposits and advances. Over the last three years the borrowings have declined and deposits are increasing.

Chart 2.16: Break-up of Balance Sheet (%) of SFBs - 2018-2020

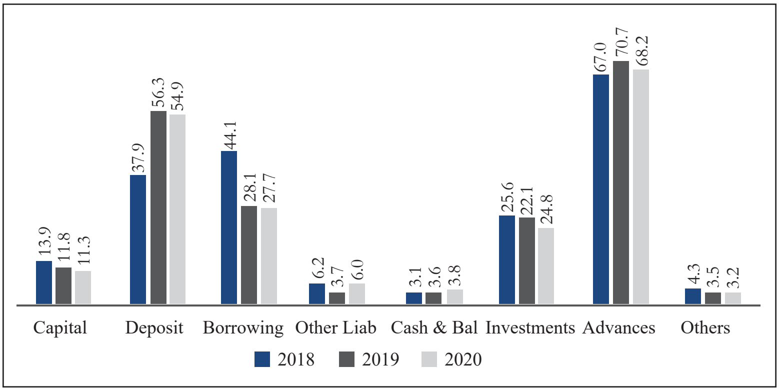


Table 2.11: Summarised Balance sheet of SFBs 2020

	AU	Capital	Equitas	ESAF	Suryoday	Fincare
Total Assets 2020	421	53	193	95	54	71
Total Assets 2019	326	43	158	71	38	42
Total Assets 2018	188	34	133	47	22	23
	Ujjivan	**Utkarsh**	**NE**	**Jana**	**Total**	
Total Assets 2020	184	94	21	141	1327	
Total Assets 2019	137	62	18	94	989	
Total Assets 2018	95	45	16	97	700	

Two small finance banks as of March 19 and one bank as of March 18 had incurred losses. This had impacted overall profitability of the sector. Generally profit is seen in the range of 1% to 2.5% of average total assets.

Table 2.12: Consolidated Profit and Loss details of small finance banks

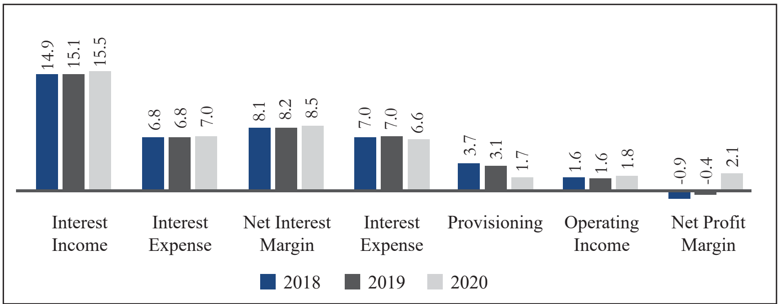
₹ Billion

Income	2018	2019	2020
Interest on Advances	71	103	149
Interest on Investments	7	10	15
Other Interest	6	5	6
Other Income	10	14	22
Total Income	94	132	192
Profit			24

Expenses	2018	2019	2020
Interest on deposits	9	28	54
Interest on Borrowing	34	29	25
Operational Exp	47	57	71
Provisions etc	27	25	17
Total Expenses	117	139	167
Loss	-23	-7	

The Net Interest Margin (NIM) recorded by these banks is seen around 8%. Operational expenses were around 7%. Provisioning was higher in the year 2017-18 due to the impact of demonetisation. ROE ranged from 9.84% to 21.18%.

Chart 2.17: Income, Expenditure and Profitability Ratios



Financial Inclusion

The main objective of allowing Small Fiancée banks is giving focused attention to financial Inclusion. It has been seen above that all the 10 banks have indeed, amply fulfilled this objective in the last three to four years of their existence. It is also seen that majority of their credit is for small loans and they have indeed opened nearly 1.5 million deposit accounts.

In fact these banks have done more than this because they have issued debit cards to their customers, offered insurance and mutual fund products and also enabled transactions closer to their home by providing ATM, POS and Micro ATMs. Essentially they have enabled financial inclusion with a higher degree of product penetration. Some of the banks have been stuied and presented in the next chapter are some case studies on SFBs their performance in financial inclusion.

Financial Inclusion Performance

The ten Small Finance Banks are doing well in terms of financial inclusion. Their business and growth strategies are different but products appear similar. More importantly they have performed well in financial inclusion by extending banking and finance services to more than 15 million people (as evidenced by the number of debit cards issued as of March 20) hitherto unreached at the same time complying with all regulatory norms. Interestingly most of them are getting ready to make public issue of shares in the market. An analysis of the financials of the banks show that:

a. The Banks are showing good growth in deposits. Generally CASA is low in the sector and most of the deposits are term and bulk deposits (from institutions). Cost of deposits with SFBs is high. This is because most of these banks have low share of CASA and a higher volume of term deposits and majority of term deposits come from others (i.e. not individuals). SFBs offer a higher rate on deposits because they are aware that those rates are still lower than what they pay on their borrowings. Deposit growth is good and this has resulted in a decline in borrowings and cost of borrowings.

b. All the banks have a high credit deposit ratio. Nearly 70% of their assets are in loans and advances. Within this the term loan quotient and small loan quotient is high. These banks are venturing into retail credit, cash credit and overdrafts. Here also the size of loans is smaller. Among the banks, NBFC turned SFBs continue to have a high quotient of micro loans and therefore their secured advances are comparatively less. It is observed that loans other than micro credit are mostly secured.

c. Cost of Funds and operational costs are high. One of the reasons for higher cost of operations is the need to closely and intensely supervise the small accounts and the need to monitor weekly repayments. This is staff intensive. As a result the rate of interest changed by Small Finance Banks on loans and advances are higher than other banks and therefore NIM, Return on Assets, and Return on Equity are higher than other banks. The high cost of funds with the banks makes return on investments (cost adjusted) negative. All SFBs have reported profit for the year 2019-20. Currently PSU banks and RRBs are showing net loss for the respective sector. The profit % of SFB is higher than other Private Banks. These banks also show good profit per employee.

d. The capital adequacy stipulated by RBI is 15% but is maintained above 20% by most SFBs.

e. Currently 4 banks account for 72% of the business. Number of branches, however are evenly spread among banks. Barring Capital SFB and NESFB rest of the banks operate in more than 12 States with Ujjivan operating in largest number (24) of States

f. Banks have different strategy in business. This reflects in the growth of business. It can be seen (Table 3.1) that though the average growth rate in major items are similar among the banks the growth rates vary.

Most of these banks continue to be strong in the area they were operating before they became banks and are diversifying in to other areas in a calibrated manner. It is seen, from description of the products given in the websites that these banks prefer secured lending except in the case of group lending where the collection methods are unique. They continue some of the microfinance processes in the bank as well. It is apparent that these banks have issued a large number of small loans. But financial inclusion is not only about credit inclusion. It is about making clients avail the facilities to make deposits, avail credit, use insurance, make transactions and use other banking services.

These banks have done well in financial inclusion in terms of opening various types of deposit accounts, extending credit and enabling transactions in POS, mobile banking etc. A case study based analysis follows.

Table 3.1: Growth rates of SFBs 2019-2020

	AU	Capital	Equitas	ESAF	Suryoday	Fincare
Capital & Reserves	38	63	22	21	21	36
Deposits	35	21	20	63	79	128
Borrowings	20	17	29	-29	13	7
Investment & Deposits	61	21	40	13	78	-5
Advances	18	27	19	44	30	74
Total Assets	29	23	23	34	41	71

	Ujjivan	Utkarsh	NE	Jana	All Banks
Capital & Reserves	7	32	4	55	28
Deposits	-83	38	233	130	31
Borrowings	159	87	-32	-29	32
Investment & Deposits	16	114	117	103	50
Advances	33	35	-3	60	30
Total Assets	34	51	17	50	29

Eight out of ten SFBs were NBFC MFI's before they became SFB. One was a NBFC loan company and one was a Small Finance Bank. Among the NBFC-MFI Equitas, prior to becoming one SFB had done some small diversification into other than group loan.All others had focused on group loans and that too in JLG model of lending. AU SFB had more of small business loans and loans for vehicles, SME etc. Capital SFB was Capital LAB and its business was typically like a commercial banks. It did not have much exposure to group loans or micro finance. It had a good exposure to agriculture credit. It is three or four years since all of them became SFBs. How does their profile look? Does it show they are differentiated by mission towards financial inclusion?

Prima facie these banks have performed well in the area of financial inclusion. Currently all these banks offer multiple products to their customers.

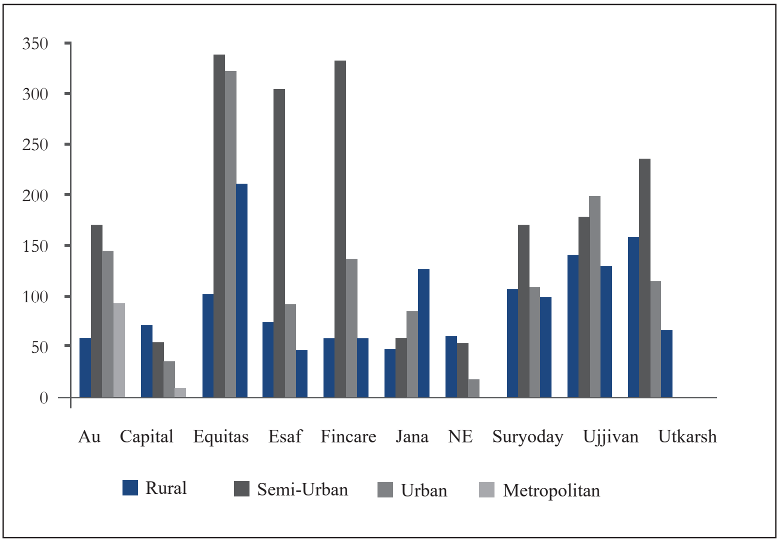
Increasing Banking Outreach

One of the contributions of these banks to their customers is creating more access points and allowing them banking transaction by opening branches, ATMs, POS and issuing Debit Cards. These banks had 768 branches in rural areas and majority of them in hitherto unbanked areas.

Table 3.2: SFB Branches and ATMs- March 20[1]

	States	Branches	ATM	Debit Cards million
AU	12	406	314	1.26
Capital	5	150	151	0.13
Equitas	17	854	322	0.68
ESAF	16	454	222	3.11
Fincare	15	512	108	2.77
Jana	22	278	131	1.37
NESFB	7	116		0.16
Suryoday	12	428	26	0.05
Ujjivan	24	568	475	5.32
Utkarsh	17	507	177	0.41
Total	14.7	4273	1926	15.77

Chart 3.1: Population Group-wise Branches of SFBs – March 20



1. Branches data from annual reports and ATM/POS and debit cards from RBI source

Increase banking and finance products: After becoming banks all of them have started offering a variety of deposits; every bank has tried to customize deposits to their client needs, variety of loan products and also make available insurance, mutual funds and other products. All the banks were approached and asked for data to enquire about their contribution to financial inclusion. These are presented in the form of very brief case studies. The objective of this is to validate financial inclusion, number of products offered and current penetration levels. Most of the information for this analysis has been provided by the banks and some information has been obtained from their websites and annual reports.

Financial Inclusion – The SFB Way[2]

Equitas Small Finance Bank

Equitas SFB had 11.74 lakh deposit account holders (Savings Bank Accounts 5.39 lakh, C A/C 1.12 lakh, Term Deposit retail 5.23 Lakh) as on March 20. Nearly 50% of its deposits by value were bulk deposits. It has introduced an Recurring Deposit (RD) product for its group (MFI) loan customers where, on a fortnightly basis RD instalments are collected at the group meeting which is convenient for the customer as there is no need to visit the branch for making deposits. Moreover they have cash when they remit the EMI and therefore it is easy to pay RD instalments. About 65% of its micro finance borrowers (as against 20 lakh micro loan borrowers) are now saving small amounts of about ₹ 200 to ₹ 300 per month.

Particulars	No. of Ac.	Amt Cr	% to total Borrowers	% to total Amt	Av Loan Size
Micro Finance	21,33,933	3,616.16	86.33	23.53	16,945
Small Business Loans	2,19,063	6,279.44	8.86	40.86	2,86,630
Vehicle Finance	1,13,567	3,759.97	4.59	24.47	3,31,082
Micro & Small Enterprises	986	669.41	0.04	4.36	67,84,990
Corporates	61	818.12	0.00	5.32	
Others	4,302	223.85	0.17	1.46	5,18,243
Total	24,71,912	15,366.95	100.0	100.0	62,162

2. Information from the bank and annual report 19-20

That 86% of the accounts account and 23.5% of the amount outstanding was in group loans and the average loan size in group loans was ₹ 16,945 indicates that the bank's focus continues to be small loans. The average loan amount in its credit portfolio was around ₹ 63,000/. The bank has reported that under CSR it has covered 5.95 lakh customers. It had 6 broad heads of credit products aimed at small business, microloans, vehicle finance, MSE, crop loans and others. In each area it offered a few variants.

Financial inclusion is more than having deposit accounts and credit. In this regard it is observed that the bank has issued about 6.69 Lakh Debit cards covering all its savings account and current account customers. These cards can be used in ATM and POS devices in shops as also for transacting at monthly meetings. Cash is still predominant but slowly coming down. Currently about 30% of transactions are done through other than branch channels. Only 5% of transactions happen at the branch location. The bank had (March 20) 854 banking outlets, 322 ATMs and worked with 242 BCs. It had 1.7 lakh mobile banking users, and sold 31.42 lakh insurance policies. The bank has also issued nearly 2 lakh Fast Tag cards.

North East Small Finance Bank

NESFB with 209 branches continues to be more focused on micro credit despite passage of three years as banking. It has not yet made any significant diversification into other purposes of loans. Its position as of March '20 was:

Sl. No	Name of the Product	No. of Borrowers	Loan Out-standing ₹	Acc (%)	Amt (%)	Average Loan Size ₹
1	Micro Finance	5,48,076	1,276.77	98.49	93.94	23,296
2	Micro Business Loan	7,781	60.41	1.40	4.44	77,642
3	Enterprise Development Loan	314	5.54	0.06	0.41	1,76,541
4	Skill Development Loan	1	0.01	0.00	0.00	12,000
5	Agri and allied	8	0.03	0.00	0.00	36,875
6	MFI	3	6.34	0.00	0.47	
7	Loan against rent receivable	2	0.09	0.00	0.01	4,72,500
8	Loan/OD against FD	301	9.95	0.05	0.73	3,30,794
		5,56,486	1,359.53	100.00	100.00	24,424

Nearly 98 % of accounts and 94% of outstanding are in group loans and small loans. The average loan size was approximately 24,500. Indeed small finance. Analysis of Deposits show that savings accounts were more in number. The average amount in these accounts was about 12,000.

Deposits March 20

SN	Name of the Product	No of accounts	Deposit Amt Cr	Average Amount ₹
1	Current A/C	2,039	13.04	63,967.71
2	Savings A/C	2,72,733	320.93	11,737.09
3	Fixed Deposits	61,848	538.90	87,134.15
4	Recurring Deposits	12,525	10.14	8,102.95
5	Daily Deposit Scheme	5,297	7.93	14,973.02

Bank has indicated that all its micro credit borrowers are covered by credit shield insurance. It has extended debit card and internet banking facility to all its savings bank customers. Possibly it has group loan borrowers where it does not have a nearby branch and therefore the savings accounts are less than the number of group borrowers.

Fincare Small Finance Bank

The Bank's customer breakup is as under:

Deposits March 20

As on March'20	In Lakh
No. of Savings Accounts	21.8
Number of Current Accounts	0.03
Number of RD Accounts	0.47
Retail Term Deposit Accounts	0.75
No. of Loan Accounts	24.0
No. of Customers who took Insurance in FY20	13.6
Debit Cards issued	21.8
Active debit card users	15.4
Active internet banking users	0.57
Active mobile banking users	1.4

From the data it appears that not all the loan accounts have savings accounts. This issue is also seen in all the SFBs. Currently the number of loan accounts are more than the number of SB accounts. More than half the customers have three products from the bank. Debit cards to Group loan borrowers who have opened savings account will be able to transact at shops which have POS and nearby ATMs.

The credit data (March 20) is given below:

Name of the Product	Number of borrowers	Loan outstanding ₹ Crore	% of Borrowers	% share in total portfolio	Average Loan Size
Micro loans	20,00,000	4,285	99.89	81.04	21,425
Loan against Property	10,970	533	0.01	10.08	4,83,135.8
Loan against Gold	16,000	184		3.48	1,15,000
Affordable Housing	250	20		0.38	8,00,000
MFI Loans		255		4.82	
Two wheeler loan	2,300	10	0.11	0.20	43,478
	20,02,300	5,287	100.00	100.00	25,131

Here again it is seen that small loans dominate both in terms of number of accounts and loan outstanding. The average loan size was less than 23500 as of March. The number of products that are available to the customers and which they enjoy shows good financial inclusion performance.

Capital Small Finance Bank

Unlike banks above all of which were NBFC-MFI before they became SFB Capital SFB was a Local Area Bank. A unique feature noticed in this bank is that its average rate of interest in loans is less than that charged by SFBs which have originated from NBFC-MFI or NBFC.

Information on Capital SFB's on three main products namely deposit loans and insurance are given below. It must be added that all the deposit customers have been issued debit cards.

Deposits March 20

Particulars (March 20)	%
Clients having only Deposit Accounts	72.12
Clients having only Loan Accounts	2.67
Clients having any two products	21.01
Clients having any three products	4.09
Clients having any four products	0.10
Total	100.00

The proportion of customers who enjoy two products is a good indicator of financial inclusion. The Credit/Loan Particulars of Capital SFB were:

Credit Data March 2020

Sl No.	Name of the Product	No: of borrowers	Amount O/S (Cr)
1	Working Capital Limits	3,653	597
2	Business Term Loans	3 951	582
3	Kisan Credit Card	10,698	1,200
4	Agriculture Term Loans	2,662	61
5	Mortgages	7,048	624
6	Auto, Consumer & Gold Loans	4 ,466	159
7	Other Retail Loans	7,527	103
	Grand Total	40,005	3,326

Credit Data March 2020

Sl No.	Name of the Product	% of Accounts	% of Accounts	Average loan size
1	Working Capital Limits	9.13	17.95	16,34,273
2	Business Term Loans	9.88	17.50	14,73,045
3	Kisan Credit Card	26.74	36.08	1,12,170
4	Agriculture Term Loans	6.65	1.83	2,29,151
5	Mortgages	17.62	18.76	8,85,358
6	Auto, Consumer & Gold Loans	11.16	4.78	3,56,023
7	Other Retail Loans	18.82	3.10	1,36,841
	Grand Total	100.00	100.00	8,31,396

The average loan size of this SFB is higher than the four banks mentioned above. It is arounds 8. 5 lakh. Agriculture loans of Capital SFB are mainly focused on farmers. Capital SFB does not have exposure to JLG type group lending.

Suryoday Small Finance Bank

Suryoday had (March '20) about 14 lakh customers. It has, during the year served 3.75 lakh customers, who have done banking for the first time. It has introduced Recurring Deposits with group members and it is finding encouraging response. Nearly 28% of its branches are in Unbanked rural centres. Its loan products were as under:

	Name of the Product	No of borrowers	Amt. Crore ₹	% of Borrowers	% of Amt.	Average Loan Size ₹
1	JLG	13,86,882	2,799	99.12	76.43	20,182
2	Commercial Vehicles	506	372	0.04	10.16	73,51,779
3	Home Loans	1,518	181	0.11	4.94	11,92,358
4	Loan Against Property	913	106	0.07	2.89	11,61,008
5	MSME	3,079	60	0.22	1.64	1,94,869
6	T-Nagar	6,270	43	0.45	1.17	68,581
7	FIG	17	101	0.00	2.76	
	Total	13,99,185	3,662	100.00	100.00	26,172

Group loans dominate and the average loan size is about 26,000. Suryoday has helped the borrowers manage the lockdown-induced cash flow problems by appropriate liquidity support in the form of small over drafts.

AU Small Finance Bank

Product Penetration Details

Banking Product	Customers served	Product Penetration
Savings Account	12,31,167	39%
ATM Card	12,27,937	39%
Motor Insurance	6,59,005	21%
Loans	6,18,450	20%
Internet banking	1,99,950	6%
Current Account	78,368	3%
Health Insurance	75,022	2%
Life Insurance	53,198	2%
Total	17,20,964	

AU Bank does not have group loans and its average outstanding is higher than SFBs which were previously NBFC-MFIs. It has high exposure to vehicle loans and small business loans. Its coverage of items/purposes is higher than other SFB.

Loan Product Details

Name of the Product	No of Borrowers	Amount O/S Mar 20 (in Cr.) ₹	% of Ac	% of Ac	Average Loan size ₹
Wheels Loan	4,68,027	12,946	76.08	47.83	2,76,608
Secured Business Loan	1,02,211	11,287	16.61	41.70	11,04,284
Agri Loans	2,039	1,213	0.33	4.48	59,48,995
OD Against FD	8,296	797	1.35	2.94	9,60,704
Home Loan	5,236	567	0.85	2.09	10,82,888
Personal Loan	4,378	181	0.71	0.67	4,13,431
Gold Loan	33,99	55	0.55	0.20	1,61,812
Consumer Durable Loan	21,600	20	3.51	0.07	9,259
	6,15,186	27,066	100.00	100.00	4,39,964

Almost all loans, barring loans extended to other MFIs' by some of the banks are less than 25 lakh.

It must be added here that all the 10 SFB have fully met the 75% priority sector target given by RBI. Most NBFC MFI turned SFBs have achieved the purpose wise target mostly within micro finance and other loans group loans. Equitas has a larger performance in vehicle loans whereas Capital SFB and AU SFB (more SME loans) have achieved in the form of other than group loans.

The objective of the above information/cases is to highlight the differentiated mission of the Small Finance Banks. All their erstwhile customers, when these banks were NBFCs have now access to savings account, debit card which allows operations in ATM and POS, and insurance. Some of the customers are using net banking. All these are points in favour of financial inclusion. Debit card helps in avoiding travel to bank for cash transaction and in a way saves a bit of expenditure for the customers. Prima facie analysis of data show that not all group members seem to have opened savings account as they might have previously (when they accessed loans from NBFCs) banked with other banks. It will therefore take some time for all the borrowers to have a savings account with the banks. One of the important indicators of financial inclusion is average size of loan which ranges from ₹ 14973 to ₹ 831393 for the above banks. It is indeed noteworthy that persons who are included are allowed modern banking facilities enabled by banking technology. Banks are diversifying into new loans and some of these loans flow to existing customers. While some banks have been fast off the block and achieved good progress, others are catching up. Despite having been a bank before it became a SFB, Capital Bank is making progress at a modest pace. NESFB and Jana SFB have taken more time to commence operations and hence their current state of business is lower than others. AU SFB and Equitas SFB seem to have the most diversified loan portfolio, not just in terms of products introduced, but also the variety in credit portfolio other than microfinance loans.

Yet the banks will be facing some challenges in terms of growth, Regulation, Technology, HR and diversification of loan portfolio.

CEO Speak

The CEOs speak is a special effort to bring out the intrigue, challenge and excitement in creating new banks. Managing a bank is not easy as there are multiple stakeholders and multiple regulators. Because banks deal with money their customers (public) trust them and deposit their hard earned money them. In order that depositors are protected banks are regulated. There are certain norms, certain expectations and certain asks' from regulators, central and state governments from the banks all of which will impact the bank. There could be interventions in rate of interest being charged and rates paid on deposits. There could be interventions restricting collateral securities. Collections have never been easy,as interventions in collection in the form of waivers are not unheard of. Actually, today every aspect of banking is so finely defined that, what is not defined is not banking, and one who does not fulfill eligibility norms and conditions cannot be a client of a bank. Clearly deviations from norms, regulations and definitions are not encouraged. Clearly compliance is the key word in bank management.

One of the expectations from the bank is 'Financial inclusion'. It needs a lot of efforts and within that credit inclusion is more complex due to the need to produce documentary proof for existence, address and business and the need for each loan to be viable in terms of cash flows and repayment ability.

How do you bring these aspects in a book? Tables, graphs and data make a good report not a book. No one but CEOs can bring out the real perspectives on various issues.

What follows is CEOspeak[1] which is about 12 questions/issues. For each question and sub-questions some background information has also been given. CEOs of all the Small Finance Banks have given their responses/views- some long- some crisp and almost all of them containing some message make it intriguing and interesting. Responses contain practical views/tips about managing Small Finance Banks, issues, strategies and above all leadership styles. There are many suggestions as well. No one question has been answered identically by all banks/CEOs. Every CEO speak and every bank is unique. Answers will help the reader to gauge the bank's DNA; understand all aspects of banking on a particular issue; see ten different ways simultaneously to look at an issue and gain insights on ten different ways to learn about an issue. The answers are arranged bank-wise (alphabetical order).

Regulation

Basel III is on. Given the pandemic related slowdown and economic issues it will not be much time before Basel IV will be talked about. As it is regulatory guidelines on various aspects of banking and finance run into hundreds of pages and are getting difficult to comprehend and comply. Compliance has become an involved, costly, time consuming routine. Given that here are banking groups and within a group no two banks are identical, many experts, governments and banking associations are insisting on proportional if not appropriate regulation. The underlying point is that though each bank belongs to a particular sector within banking (PSU, Private, Small Finance, Cooperative etc) within a sector there could be different foci (small finance, agricultural finance etc), different geographies, different sizes, different business mix and indeed different set of customers (small borrowers, companies, SME, start ups). Given this uniform regulation could hurt some of the banks and also some of the customers. The point that capital regulation

1. Indian Institute of Banking & Finance (IIBF) had in the years 2009 to 2013 brought out four of its quarterly journals as special editions containing CEO-speak wherein CEOs of big commercial banks had answered 12 questions on banking. Everyone who read these four CEO speaks found them very informative and enjoyable. Evidently though perspectives varied from bank to bank overall readers got comprehensive views of the sector and bank management. Also though all the banks were finding regulations tough and wanted to change the 'one size fit all' approach none of them were willing to make their feelings explicit. Readers learnt a lot about banking from these issues for there were appreciations from retired senior bankers as well.

could result in reduced credit flow and could impact economic growth has also been made. The debate is on.

Currently almost all regulations apply to all banks but there exist small differentiations in the norms applicable for different groups of banks. It seems that regulatory norms for banking groups other than commercial banks namely RRBs, Cooperative Banks, Small Financial Banks etc are arrived at plus (+) or minus (-) what is applicable to commercial banks. Also within a banking group norms are similar across banks i.e. regulation tends to be "one size fits all" for a group of banks say Small Finance Bank, Cooperative Banks etc.

Indian banking regulation has seen three distinct phases namely (i) Era of financial repression[2] (period before mid 90's) financial reforms (mid 90's till Global Financial Crisis (GFC) and post GFC globalisation of regulation (2010 till date). Today Indian banking regulation is a mix of high reserves (CRR and SLR) that is typical of financial repression coupled with CRAR, LCR, and NFSR etc., which are tools of financial stability oriented regulation. *Also the country is pursuing financial stability and financial inclusion- two important, compelling but not complementary objectives.*

The main instrument of regulation for ensuring financial stability is capital adequacy. In addition there are a number of other norms that banks have to comply with. On account of regulation, over the last two decades the banking sector has witnessed (i) increase in capital, (ii) decrease in leverage, (iii) decrease in ROA and ROE and greater focus on Governance. It is observed that as more regulation happens, NIM and NPM of banks are on the decline. The cost of compliance has increased with every dose of regulation.

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2. Financial repression occurs when governments implement policies to channel to themselves funds that in a deregulated market environment would go elsewhere. Policies include directed lending to the government by captive domestic audiences (such as pension funds or domestic banks), explicit or implicit caps on interest rates, regulation of cross-border capital movements, and (generally) a tighter connection between government and banks, either explicitly through public ownership of some of the banks or through heavy "moral suasion." Financial repression is also sometimes associated with relatively high reserve requirements (or liquidity requirements), securities transaction taxes, prohibition of gold purchases, or the placement of significant amounts of government debt that is nonmarketable. In the current policy discussion, financial repression issues come under the broad umbrella of "macro-prudential regulation," which refers to government efforts to ensure the health of an entire financial system.:https://www.imf.org/external/pubs/ft/fandd/2011/06/reinhart.htm

Some of the important regulatory norms/issues applicable to SFB are (a) Capital Adequacy Ratio, (b)Income Recognition and Asset Classification Norms (IRAC)- more popularly known as NPA- norms and Provision Coverage Ratio, (c) Priority Sector Norms, (d) Liquidity Coverage Ratio (LCR), (e) Exposure Norms, (f) Accounting Standards, (g) Marginal Cost of Fund Based Lending Rate (MCLR) and External Benchmark Rate (EBR), (h) Deposit Insurance and (i) Disclosures. In addition regulator has given guidelines on LTV, Margins, and Collaterals etc. Further it is noticed that though SFBs are covered by Basel II norms they have to publish disclosures on CRAR as per Basel III norms. It is important to add that there are specific guidelines on stage wise dilution of promoter shareholding and the time to go to market for public issue of shares. Some of the banks face some issue in complying with these conditions as market may not be favourable when it has to be accessed.

In this background CEOs were asked (i) **what's your view on proportional regulation? (ii) Are the current regulations appropriate to your bank? (iii) What changes in regulations will be appropriate to your bank given the importance of financial inclusion mission and the financial stability compulsions?**

Responses

Evidently though called Small Finance Banks there is not much difference in regulation between Commercial Banks and SFBs. On the contrary the norms are generally tough on SFBs. However SFBs feel that such norms at the time of establishment and growth could be extremely useful and as they grow, it is hoped that the norms could be changed or revisited. However there are some specific suggestions in the case of NPA norms, PS norms and certain other aspects.

Currently NPA norms are the same for a two to three year EWI/ EMI based loan account for small amounts at higher rate of interest where the borrowers liability is unlimited (i.e. to the extent of loan outstanding) and big loan accounts of companies with large cash flows at prime rates where the company management/promoter has limited liability. The smaller sized loan accounts which are issued to the vulnerable segment of the society are more prone to cash flow variability due to events such as demonetisation and Covid and even delayed rainfall than bigger corporate accounts. It is also well established that their consumption needs too are high. In view of this there is a definite need to have differential NPA norms for smaller accounts. Also while banks should conform to NPA norms they could be given flexibility to nurse the accounts as most of the small loans are without any collateral. Another issue is that SFBs cannot, unlike, commercial banks invest in PSL Certificates to comply with the higher PS norms. PS norms will hopefully be reviewed, as the banks need some diversification if they have to compete with Commercial Banks for deposit and growth. The norm that 50% of loans should be less than 25 lakh deserves reconsideration. Also SFBs will seek larger loans as a process of diversification.

Currently all Small Finance Banks have higher capital adequacy than mandated and strategically this will help them grow fast in the coming years. As such CRAR is not a pressing issue with the banks.

Another interesting point is about KYC and documents to be submitted for credit. It is suggested that 'for borrowers of very small businesses who can borrow up to say ₹ 10 lakh or so, there should be a different set of rules related to documentary evidences required for KYC, proving PSL status, end use verification etc'

Clearly these and other points mentioned by the CEO's are worth considering. But as of now all banks comply with all regulatory norms. As one of the CEO's indicated 'SFBs knew the norms when they were licensed' as such to expect immediate change is not practical.

AU SFB

Revision of NPA recognition of MSME Borrowers

The NPA classification guidelines were made in the mid-1990s when lending to MSME customers was very low. NPA classification was based on "past due" for "four quarters" in 1993 which evolved to "180 days overdue" by March 2003 and "90 days overdue" in March 2004. Evidently the extant classification & guidelines were developed to recognize NPAs in the borrowing by large corporates which are well organized. Further, it is noteworthy that loans to individual consumers have traditionally been provided mostly to salaried borrowers where income is assured. Upgrade of loans classified as NPAs is permitted only once arrears of interest and principal are paid by the borrowers.

We finance MSMEs. These are usually carried on at subsistence levels and have little ability to take care of any temporary shocks due to illness of owners, natural calamity, or any other reason. When these businesses go through a cash flow stress, the first casualty is the instalments payable to a bank. Customers often factor in that delayed instalments, with penal interest/cost would still cost

them only about 18% interest or in local language only 1.5% interest per month (dedh rupay senkada – as they say), which is cheaper than what they would have to pay for borrowing from informal sources of credit.
It is noteworthy that these businesses are often able to turnaround from temporary shocks or capitalize on opportunities due to temporary shocks. Only when the shock is more permanent – such as terminal illness or death of proprietor, or the shutdown of the business, that these businesses really default. It becomes a challenge for the Bank to strike the right balance between understanding the situation of the borrower and managing the overall NPAs, where the focus of all banks is to minimize their NPA borrowers.

In line with the differentiated guidelines for Small Finance Banks, it is suggested that NPA norms for Priority Sector MSME Borrowers with exposures <= 25 Lakh could be reviewed and aligned to the challenges faced by these businesses as per the below submission:

i. Distinguish between delay and default in the case of small businesses. Delays are normally resolved by the borrowers over a period of time.

ii. Distinguish between Term Loan facilities where monthly repayments of Interest and Principal is to be made and those where the borrower has availed Cash Credit or Overdraft facilities. In case of Term Loan facilities where Equated Monthly Instalments are payable by the borrowers through the tenure of the facility, the period of overdue before an account becomes an NPA could be longer.

iii. The stipulation that all overdues should be cleared before an NPA account becomes a standard is onerous for MSME borrowers. MSME borrowers could be allowed to be upgraded to Standard once overdues are <=3 EMIs by treating such delays as "Temporary Deficiencies" as defined in the "Master Circular - Prudential norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances".

Like we recognize the NPAs in a differentiated manner for Agriculture Lending, similarly the MSME sector also needs to be treated in a manner compatible with the requirements of this sector.

PPF Account Opening & Tax Payment Collection

SFBs are not allowed to open Individuals PPF Accounts and collect tax payments on behalf of the government. It is difficult for customers in rural and semi urban areas to maintain multiple accounts to get these services and could lead to loss of business opportunities. In view of this, SFBs could be permitted to open PPF accounts & collect tax payments.

This will lead to Operational convenience to customers, one-stop banking solutions and support to Government to create holistic eco system and encourage cashless banking in deeper geographies.

Prevention of Money laundering (Maintenance of Records) Rules, 2005

- Rule 2 (1) D: list of Officially Valid Document (OVD) for address doesn't cover Registered / unregistered / notarized Rent Agreement, which is the only document available with person who transferred / migrated from his hometown to other town due to service or business requirement.
- Rule 2 (1) D: have list of simplified deemed Officially Valid Documents however, condition being that customers need to submit Officially Valid Documents within three months from the date of account opening otherwise it is instructed bank to freeze the transaction in those accounts.

As these rules come in the way of opening accounts, SFBs may be permitted to accept alternative documents for address identification to enhance banking habits specifically for migrant population specifically in rural and semi urban areas. Ll

Limited AD-1 license for Scheduled SFBs basis their Networth or certain other criteria (within regulatory risk framework)

SFBs which have AD-2 License are unable to offer full-fledged banking forex services. This leads to avoidable delays and latency in providing services, results in additional cost to customers and eventually leading to customer dissatisfaction limiting their ability to open accounts.

SFBs may be allowed AD1 license based on certain criteria which lead to operational convenience and cost effectiveness to customers, avoid loss of business opportunity for banks and result in deeper reach at competitive cost.

Allow fully-hedged foreign currency borrowing (FCB)

AD-1 Category banks are permitted to borrow from international / multilateral financial institutions. However as Small Finance Banks are under AD-II category they are not allowed to borrow from international market. If SFBs are allowed to borrow foreign currency on fully-hedged basis (without any interest / currency risk), it will give alternate long term and cost-effective fund-raising avenue for SFBs, the benefit of which can be passed on to the to customers

Allow buy-out of portfolio (through assignment / securitization) from other entities as in normal business course

SFBs are currently not allowed to buy portfolio (through assignment / securitization) from other Banks/NBFCs. SFBs may be allowed to participate in securitization / assignment market as portfolio buyer as a business opportunity for both buyer and seller. This will create a more competitive environment within banking system, ensure liquidity support to NBFCs/ HFCs / MFIs and could result in a higher PSL portfolio which will lead credit flow to rural and semi urban sectors.

Allow specified user to share Credit bureau information(Credit Information Companies (Regulation) Act, 2005)

As per prevailing regulation, one specified user cannot share credit bureau information with other specified user even if they are fintech firms and banks. However, as both are registered with Credit bureau as specified user hence, information sharing between two specified users with customer consent should be permitted. It will lead to operational convenience, cost effectiveness and ultimate benefit to customer of this cost, robust information and risk management.

The above suggestions are made so that we are able to achieve the purpose for which the licenses were given. This will help realize the mission and vision of Financial Inclusion in India.

Capital SFB

There is merit to both the approaches. As far as generalized approach i.e 'one size fits all' approach for compliance for the whole banking sector treats all alike and puts the supervisory review on similar and comparable grounds. Such an approach makes the industry comparison, performance evaluation, industry benchmarking relatively easy and comparable. However, there is huge diversity within the industry that setting similar guidelines for one and all is not desirable as it can defy to serve the very purpose of setting the guidelines.

We, a Small Finance Bank, serving our niche market have our own strengths and weaknesses to combat and cater to the opportunities and threat. Our business model, product line, customer base, corporate structure, vision and mission, business strategy and management puts us in a different league which is unique and specific, so making generalized guidelines may not be the perfect approach. We are a compliance-friendly bank and strive to deliver on the basic premise for which we are in existence i,e financial inclusion. Our business model is based on providing affordable world class banking services under single rook in every nook and corner of our area of operations, specially to the under privileged and unbanked areas.

Financial stability is of utmost importance to every economy, rather the regulation should not over do its cause by cornering certain unique institutions like ours by over compliance and regulation. The size, complexity, product line, customer base, organization structure should be the guiding force for setting proper regulation. The regulation and performance evaluation should be commensurate with the above mentioned traits as the regulation should be to help and guide in building stronger, vibrant and sustainable banking sector, comprising of multi-variant entities with highly diverse structures. The cost involved, availability of resources, sophistication required and benefits from the regulation should be commensurate. All in all, 'one size fits all' may not be the right antidote for an organization like ours. Customized regulation will serve better than generalized guidelines.

Equitas SFB

Currently the RBI's regulatory framework for banks is based on the type of bank i.e. Universal Bank, Small Finance Bank, Cooperative Bank etc. Here the regulation distinguishes basically based on the capital adequacy, type of activities permitted to be entered into, etc.

However the customers serviced by these banks are very different. The regulation does not take into account the profile of the borrowers of these banks. Hence the regulations tend to be common across the banks when it comes to customers. *The regulation should ideally be also differentiated from a customer profile perspective*. For example, borrowers of very small type, say very small informal businesses who can borrow up to say ₹ 10 lakh or so, should be having a different set of rules related to documentary evidences required for proving PSL status, end use verification etc. If the regulation is customised more towards the objectives that SFBs are required to achieve (in terms of type of customers, size of loans and sectors of focus) it would enable these banks to operate better, expand faster and become significant players in financial inclusion.

ESAF SFB

Effective corporate Governance is critical to the proper functioning of the banking sector and the economy as a whole. Performance of banks is crucial to the economy as they intermediate funds between the depositors and borrowers and channelize the funds to activities that support enterprise and thereby help to steer the economy forward. The soundness of banks and their safety are very important to financial stability. Hence, the manner in which they conduct the business is central to the economic health of the country. Governance weaknesses at banks, therefore, can result in the transmission of problems across the banking sector and the economy as a whole.

The primary objective of corporate governance should be safeguarding the interest of the stake-holders in conformity with public interest on a sustainable basis. This clearly states that the interest of the depositors takes precedence over the interest of the shareholders.

It is in this backdrop the regulator looks at the Corporate governance structure, framework and its implementation in a Bank. The BCBS has also recommended that the implementation of this principle should be commensurate with the size, complexity, structure, economic significance, risk profile and business model of the Bank and the group to which it belongs. This means making reasonable adjustments as and where appropriate for Banks with the lower risk profile, and at the same time being alert to the high risks that may accompany more complex and publicly listed institutions.

SFBs as the name suggests, are differentiated banks aimed at deepening financial inclusion by taking banking to the unbanked and under banked areas. The main aim of their formation is to provide credit to the small and marginal farmers, micro and small industries and other unorganized entities, and thereby reaching out to the poorest sections of the society. With this aim, they are mandated to provide 75% of their loan portfolio to priority sector schemes and ensure that not less than 50% of the loan book is made up of loans up to 25 Lakhs.
SFBs normally deal with plain vanilla products, which are of low-risk nature and do not deal in complex and exotic products like derivatives. The profile of their customers is also of low-risk nature, which is different from many other Banks.

Such being the case, we are of the view that there is a need to have a differentiated approach in the corporate governance framework and structure of these SFBs, without in anyway diluting the control framework.

Fincare SFB

Proportional regulation is a good thought; however it would have lot of challenges in implementation. While there are various sectors within banking (PSU, Private, Small Finance, Co-operative, RRBs) , within these sectors there are banks of various sizes banks and one can argue that a 5000 Cr balance sheet bank cannot be compared with a bank of 50000 Cr Balance sheet.Hence, in case proportional regulation is to be implemented, it should have same basic regulations for all and some key important parameters may be added for larger banks within each of these sectors. Larger banks should also have stricter monitoring.

On compliance, though its cost is increasing over period of time, looking at banking sector issues in the recent past, it is good to have stricter monitoring. However the flexibility is to be created to ease the monitoring for banks which are performing well on defined parameters and has strong governance standards. You have mentioned that, "The objective of Regulation is financial stability

coupled with financial inclusion- two contradicting objectives". We however feel that both can be achieved with right mind set. Banks lose money not because they try to meet financial inclusion objective, it happens for the lack of right credit decisions, lack of honesty/sincerity to the job and personal agendas.
I think of 1 mission and deliver it with financial stability and we believe, we have right set of People with right culture; Products which can cater to economically weaker segment of society and help achieve financial inclusion objective, right Processes, right Technology tools and of-course a desire to excel.

Jana SFB

The RBI's operating guidelines for Small Finance Banks do not differentiate the operations from that of the Universal Banks except higher standards in some aspects like Capital and Priority Sector. There is no ease / differentiated policy for SFB's who have to essentially lend 75% of the loans and advances book to Priority Sector. Given the retail nature of the business, NPA norms cannot be "one size fits all" across the banking system as customer profile and cash flow patterns differ. For SFB's there should be differentiated parameters which should take into account the SFB's customer base while framing regulations.

North East SFB

We agree that SFBs have been set up with the objective of financial inclusion and financial stability. To achieve the first, the second objective needs to be more focused. And that is a cost intensive affair.

From the prospective of a stable bank, the basic requirements for SFBs itself are very stringent. The norms and the associated challenges are given below:

i. **CAR:** As compared to Universal Bank requirement of CAR is 9%, SFB requirement of 15% ends up blocking capital at the cost of providing capital stability as we cater more to informal sector. At the same time equity dilution norms for reducing promoters' stake within five years of operations creates additional pressure. In case we do consider BaselIII, requirements of capital conservations buffer and counter cyclical buffer, the additional capital to be kept aside is a cost intensive affair.

ii. **IRAC:** IRAC norms are primarily from the prospective of a universal Bank. An SFB which is catering to informal economy and is following physical door to door collection model of business will always find it challenging to meet IRAC norms. We believe IRAC for SFBs need to be relaxed and tailor made from the prospective of both the two above mentioned objectives.

It is observed that during crisis situations like floods, draughts, law and order situation or in case of events like Covid pandemic, the small borrower's livelihood activities come to a halt and they are unable to service the loan liabilities. In such times, as a prudent measure the loan liabilities should be deferred, but IRAC being very strict, does not consider deferment differently as against restructuring, seen in large quantum loans catering to traditional borrowing segments of a Universal Bank. This leads to a situation where ground reality and actual borrower dynamics for SFB and IRAC norms Commercial Banks are not in sync at all.

The cost of IRAC norms, NPA identification within 90 days and PCR owing to unsecured nature of micro advances tends to portray SFB as a "risky venture" as against traditional Universal Bank. This needs to be corrected.

iii. **PSL, LCR, exposure norms and Accounting Standards:** are more or less in line with basic operational matter. We believe these are basic benchmarks and can be complied without much hassles.

iv. **MCLR:** MCLR needs to be replaced with EBLR as we are looking at offering longer tenure credit products. At the same time this benchmark of EBLR should be ideally arrived at within SFB universe only.

v. **Deposit Insurance:** The amount needs to go up to provide comfort to the customers but at the same time the cost of DICGC for SFB needs to come down substantially. (this amount has been revised to 5 lakh recently)

vi. **Disclosure Norms:** This is fine with the SFBs as compared to the Universal Banks.

What the above points show is that the cost of achieving or complying to the second objective namely "financial stability" is high. With the added pressure of ROA and ROE, the broad objective of financial inclusion could get diluted in the quest of returns/profitability. In essence, the first objective "financial inclusion" does get defeated marginally.

Suryoday SFB

Small Finance Banks (SFBs), despite being new entrants to the banking sector, are committed to maintain good governance and protecting customer interest. We are investing heavily in technology platforms/solutions so that there is strict compliance with end to end monitoring.

Regulatory framework applicable to SFBs is quite onerous; Priority Sector Lending (PSL) target of 75% and Capital Adequacy Ratio (CAR) at 15% needs to be reviewed. Probably, the time has come to have a hard look at the regulatory framework set up for SFBs as their business model is now well established.

IRAC and NPA norms for SFBs are the same as those for Commercial Banks. It is quite demanding for the SFBs to comply with these stiff norms while serving the unorganised and vulnerable segment of the Indian economy.

The scarce capital which could pump growth is getting immobilised into regulatory pool which doesn't offer much return to the newcomers in the banking industry. This is a significant task for the promoters who have established these institutions on the strength of their limited resources.

Ujjivan SFB

We are of the opinion that existing financial regulations are broadly in line with our mission of financial inclusion to the un-served and underserved segments of the society. Indian Banks have withstood the turmoil in financial services and systems, over the last two decades, because of the stringent Capital Regulations of low leverage with high capital adequacy, which helped them manage the turmoil by and large, by protecting the interests of all the stakeholders. Banking is under transformation from traditional banking to digital banking which is fluid in nature. Therefore regulations related to that of the Digital, Fintech and related environment, considering Cyber Security, can be with specific focus on the collective Cyber Security measures through CSITE mechanism for the Industry as a whole.

SFB's core customers are of Micro banking clients, comprising of individual tiny micro entrepreneurs who have not been provided adequate weightage in the MSME model. Actually, the required push for this segment of the customers is through SFBs and MFIs. Our customers are not visible through the larger framework of the MSME, So due attention may be given to this segment through the collaboration between SFBs and NBFC to cater to the needs of customers who are underserved and un-served. Existing Financial Compliances are aligning with the goals and scope of the genesis of SFBs.

Utkarsh SFB

USFBL has been able to report very healthy financial performance (reflected in profitability ratios as well as in asset quality parameters) while meeting the objective of financial inclusion and serving the underserved and unserved segments of the population and geographies. The Bank fares very healthy on all parameters mentioned above including Capital Adequacy Ratio, IRAC- more importantly NPA- norms and PCR, Priority Sector Norms, LCR, Exposure Norms, Accounting Standards, MCLR, Deposit Insurance and Disclosures. The Bank has prepared itself for meeting all the regulatory norms, compliance requirements while simultaneously achieving good profitability and asset quality. Since the idea behind promoting SFBs was to introduce a differentiated set of banks for furthering the objective of financial inclusion of Government of India and RBI, it also came with differentiated regulations in some aspects. However, this has also created Regulatory Arbitrage for Universal Banks to some extent.

Two of these are:-

i. Higher PSL targets of 75% for SFBs vis-à-vis 40% for Universal Banks and more importantly SFBs are not allowed to purchase PSLC to meet overall shortfall. Although, given USFBL's deep presence in rural and semi urban areas and its focus on lending to underserved and unserved sections and financial inclusion, USFBL has been able to meet PSL norms comfortably.

   Also, presently, as per the Operating guidelines for Small Finance Banks dated October 6, 2016, SFBs are permitted to participate in securitization market only as originators and providers of associated credit enhancements and liquidity supports. Further, as per the RBI Master Direction –PSL for Small Finance Banks dated July 29, 2019, SFBs are allowed to invest in the securitized assets representing loans to various categories of Priority Sector, except 'others' category only with the specific purpose of meeting the sub-targets of PSL. Policy changes, with reference to allowing SFBs to invest in securitization transaction will be supportive in SFBs efforts to maintain a risk diversified loan book. RBI has issued draft norms and in this regard clarity and final norms are awaited.

ii. Higher CRAR of 15% as against 11.5% (9%+2.5% CCB) for Universal Banks: Although, SFBs have been exempted to set aside capital for their Market and Operational Risk, which results into around 2-2.5% of lower capital burden, the 15% requirement is still at a higher side. This makes the requirement actually at par with NBFCs wherein prescribing such a higher capital looks more logical. In my opinion, gradually, the CRAR requirement for SFBs should be toned down, which shall result into unlocking their capital for better usage.

   The Reserve Bank of India has also prescribed separate norms on other parameters like lower flexibility for large ticket lending and tighter exposure norms etc. which are more suited to the vintage for Small Finance Bank however are stringent compared to these norms for Universal Banks. We expect some of these regulations to get aligned with Universal Banks as Small Finance Banks achieve longer track record. Also, the Regulator has prescribed a road map for conversion of a SFB into a Universal Bank.

As far as relaxing other norms is concerned, RBI has already taken some very positive welcome steps by granting general permission to open new branches.

There are many regulatory norms, guidelines and circulars (there are more than 50 master circulars each of them giving references of circulars issued over the last three or four decades). There are certain areas where guidelines of past and present all co exist. To be frank however capable a board of a bank is they can hardly deviate from these regulations. Therefore the first thing the board has to do is to comply and then they can decide on strategies, what business (purposes for which loans can be issued) to pursue, what rate of interest on deposits, how many branches to open and etc.

Risk Events and Risk Management

In the economic history of recent years, from the perspective of SFBs', two events stand out, 'Demonetisation' which impacted cash flow for few months and 'Corona virus related lock down' which is still on over 9 months after it started. Demonetisation did not stop the world moving but affected business cash flows, and ability to spend and repay loans. Corona induced locked down has impacted almost everything. Countries and cities have gone into lock downs, travel has been stopped and many businesses had to stop. Costs have remained but income has dried out. Unemployment rate has, albeit temporarily increased by leaps and bounds. It has not impacted the ability to spend or do transactions but has completely crippled economic life, social life, movements and business activities. At the same time new methods of doing business are emerging.

The impact of these two events on lenders has been rather adverse because (i) business of borrowers suffered resulting in stoppage of repayments during the period with snowballing effect on subsequent period as no business could be transacted during the period of stress, (ii) demonetisation increased deposits and liquidity with banks but not with all of them. Cooperative Banks and small banks, in fact observed a reduction in deposit during demonetisation time as they were not allowed to accept old notes. As a result liquidity with these banks suffered. Both these events have shown that in such cases there will be (i) Credit risk (poor recovery) and (ii) liquidity risk with the banks beyond what has been possibly factored in arriving at current risk management guidelines.

Corona impact has been more substantial than demonetisation. As of now it is not known how long it will last! Evidently –post corona-credit risk could be more prolonged as it will take some time for businesses to recover and recoup the losses. In respect of small and micro loans the credit risk could be more pronounced as borrowers may not be able to recoup the losses. As indicated earlier unlike corporate borrowers who are protected by limited liability clause small borrowers are fully liable for the dues.

In both these events the regulatory reaction was rather typical. (i) offer moratorium for the period of impact (ii) Postpone NPA norms for the period and (iii) offer liquidity support. All this will have cost implications for both borrowers and banks.

How do these aspects impact your bank? What is the impact of Corona related slow-down in terms of cost, liquidity profitability? Did digitalisation help in collections? Do you expect any impact on asset quality? Going forward, how will you prepare your bank to manage such events? These are the questions to which CEOs respond below.

Capital SFB

Heightened uncertainty is the new normal. Banking, being the backbone of every economy, has to stand tall amidst all the gloom and doom and take pragmatic steps to safeguard its asset quality, keep ample liquidity and keep providing growth capital in the form of loans and advances to various sectors of the economy. Every bank is adjusting itself to this new normal by improving on digitization, by offering innovative products to cater to diverse needs of its customer base and keeping adequate liquidity in uncertain times.

The bank has so far stood tall and managed the challenges put forth by Covid in a very strong and positive fashion. The profitability, asset quality, strong recovery mechanism, helped better recoveries, falling cost of deposits, funding liquidity costs and ample liquidity are encouraging signs. It is tough to say about profitability but so far through the earlier targeted profit has fallen, ; we are still able to maintain growth over the last year. Digitization can help to improve the mode of collection but not the intention of the client. Going forward, calibrated business strategy, sound asset quality, digitization, product line innovation, ample liquidity, cost rationalization are going to play important roles and we are very confident of facing this challenge head on and coming out stronger from this challenge.

Equitas SFB

From time to time, there are developments in the economy and society that impact all institutions and financial institutions in particular. While in the recent past few years there have been such developments, even in the distant past, natural calamities, macro policy changes, global crises and political developments have had their effect; and the institutions have been able to grow and become better after weathering the difficult periods. We, as a bank, believe that financial institutions should be able to weather out crises and thrive during periods of good growth in the economy. The ability to manage crisis and cope with the extra risks will determine the character of the institution in the long run.
In the current context, the effects of COVID are still not fully accounted for. With the moratorium stretching upto August, the effect of the moratorium on asset quality would be known only towards the current calendar year end. For banks in general and our bank in particular liquidity is generally not an issue and the LCR ratios of all banks are very comfortable. The concern is clearly what might happen to asset quality which would be known only in the next 2-3 quarters once the exercise of restructuring of accounts (as advised by RBI) has been completed. Being a Small Finance Bank, our customer base is largely in essential service activities and generating daily/weekly cashflows and they are expected to maintain good repayment track record.

ESAF SFB

Demonetisation

i. While in the short term, demonetization resulted in an increase of deposits in banks, in the longer term it has helped the economy to become more formal. This has resulted in the structured development of the Small and Medium Industry sector. Although we saw a short term slowdown in the growth, the sector has become more regulated now and has more avenues for long term growth. Various government support schemes are also helping to boost the capacity of these businesses. Targeted work on linkages is helping on the demand side.

ii. The demonetization happened in November 2016. The profile of the customers had changed post-conversion into a Small Finance Bank, thereby increasing the portion of non-cash-based transactions. But, during the demonetization period, even the micro-credit customers, who earlier operated mainly in the cash economy, had moved to the digital mode.

Demonetization helped to move disbursement and collections to digital platforms and accelerate digital adoption, among them, to a large extent. It also resulted in an increased deposit base.

What is the impact of Corona related slowdown in terms of cost, liquidity profitability?

The easing of lockdown restrictions has coincided with a huge surge in Covid19 cases. Therefore, the future course of pandemic is unpredictable. Without knowing how long the pandemic will last, one cannot talk about its impact as it is still ongoing, unprecedented and unpredictable. However, we shall analyse and estimate the possible impact based on a few assumptions:

i. There was not much impact up to the last quarter (ended 31st March 2020) as those were the early days of Covid-19. Presently, the situation is very fluid due to its ongoing nature. In the two months of this quarter, the collections have been negligible while credit portfolio has grown by 4.38%. Of this, approximately 3% was due to interest application. During the same period, deposits grew by 2.71%.

ii. Micro loans make up the majority of the bank's portfolio. Although they have seen short term cash crunches, these loans have always seen quick recovery in repayments. The two main reasons for this are the resilience of the entrepreneurs and the low-cost assets owned by these micro-enterprises.

iii. Markets may be highly volatile for some time with rapid liquidity shifts and unexpected demand drops, thereby making the pricing of banking products more challenging. These, along with a general decrease in business activity, could create fluctuation in profits for some time.

iv. Asset Liability Management would be a challenge. There would be liquidity easing continuously to make the credit available to different sectors for the revival of the economy. The bank is creating alternate product lines in alignment with the government schemes and Priority Sectors.

Did digitalisation help in collections?

i. More than 90% of the Bank's portfolio is in the Micro-banking space as on 31st March. Micro-banking works on a high touch model, and most of the repayments and collections used to happen physically. Digitization has helped us move these repayments to digital platforms and made collections easier to a great extent.

ii. A lot of our customers have opted out of the second moratorium, and we were able to gain significant traction in our collections. These indicators signal a positive trend. A better assessment of collection and collection methods can be made after 31st August 2020, when the repayment moratorium gets over.

iii. The impact of digitalisation on collections has definitely seen an upward trend.

Do you expect any impact on asset quality?

The reality is that COVID has its impact across all sectors. The short term may see some temporary lapses in repayment, but there are many efforts from the authorities to stabilize the economy. It is very heartening to see that businesses are adapting rapidly to changing consumer patterns and are coming up with innovative ways to stay afloat. Right now, the businesses are on unusual mode, and we have to learn to deal with the changing conditions. I am optimistic that the active involvement of all the stakeholders will help stabilize the market and retain asset quality in the long run.

Going forward how will you prepare your bank to manage such events?

It is difficult to fully prepare for something as unpredictable as a pandemic, as the circumstances and situations are unlikely to repeat themselves. However, the lessons learned during the Covid19 pandemic would help the Bank to manage such disasters in a better manner if it is repeated in the future. However, this pandemic has intensified the need to focus on the following aspects as part of the crisis management plan:"

i. Diversify the Bank's business to different sectors, products and geographies to diversify the risk in future scenarios.

ii. Intensify the focus on digital channels by the Bank and use of digital channels by the customers. It is important to educate the customers on how to use it. Maximise online transactions and streamline the processes digitally. Create a process for online opening of deposit accounts, sanctioning loans, digital documentation and online collections.

iii. Identify staffing arrangements, alternate planning and cross-skilling and also take measures to protect the health of the staff. Identify the most critical functions and the manpower involved in each function, and work on worse scenarios like extreme absenteeism.

iv. Ascertain the steps and measures needed to maintain the Bank's business at branches, digital channels and administrative offices.

v. Develop a plan for the continuity of leadership in the event of the absence of key decision makers and executives.

vi. Prioritize customer and vendor relationships that are needed to be maintained at even the most stressed conditions and pinpoint those functions, the suspension of which could cause considerable difficulties to the customers and the public at large.

vii. Minimise physical business meetings and employee engagement programmes at different levels and instead conduct these meetings using digital audio-video facilities.

viii. Maintain sufficient liquidity and have contingency funding plans in place. Consider financial implications of income flow (both interest and others), cost increase, non-performing assets and provisions.

ix. Ensure adequate availability of cash and prompt replenishment of ATMs at all times.

x. Extensively test and put in place a structure for communication, in case of meeting urgencies for instant and accurate communication with all stakeholders including staff, BC, customers and other vendors.

xi. Maintain high standards of sanitization / safety and ensuring minimum social distancing norms.

xii. Identify and plan on an ongoing basis, availability of critical devises, spares or infrastructure, the shortage of which could impact the normal functioning of the Bank, for example, replacement parts for IT infrastructure, handheld devices, laptops or other electronic components.

xiii. Devise and strengthen cyber security protection due to the possibility of rising cyber-attacks aimed at exploiting any crisis.

xiv. Put in place norms and IT infrastructure for activities like Work from Home.

xv. Put processes in place to manage IT resources and applications under extreme stress situations, including the Data Centre and the Disaster Recovery Site.

xvi. Provide backup arrangements for Call Centre operations from alternate locations etc.

Fincare SFB

COVID 19 is completely uncharted territory for the world. Earlier crises either started by impacting supply side or demand side. The Covid crisis impacts channel too. It disturbs the high touch-doorstep servicing JLG model of centre meetings and group disbursals. Prolonged lockdowns and restricted field movements along with scare of spread of epidemic disrupted the usual work flow.

Offering moratorium to customers has helped client to smoothen her cashflow, while maintaining her credit history. This has also helped financial institutions to manage their loan book quality during the intervening period of chaos and disruption.

The good part is that now more than 70% clients with stable cashflow have opted out of the moratorium. It is testament to their credit discipline and financial literacy. This makes this model the most resilient.

Having said that, in the rural side, currently the direct impact on the business seems lower than urban portfolios. Our 95% of our portfolio is rural. We are broadly seeing resumption and continuation of economic activity in rural India. On the back of successful rabi crop and good MSP price by government, the agriculture-based economy seems to have responded in a stable manner. Agri-allied businesses- mainly milk, which is a perishable commodity has been relatively unscathed in terms of its cold chain movement and logistics. The cooperative milk movement and federations supported the farmers by continuing to procure at the same price point. Since agri and milk production got sustained, petty trade located in villages also did reasonably well. Obviously, consumptions have reduced and supply to trade is impacted a bit. *If there is any high impact, it is on rural labour and artisans which depended on urban construction or industrial employment due to lockdown. Similarly, services such as tailoring, and embroidery did see major dip on demand due to lower consumption.* With the onset of South West monsoon and expected near-normal rainfall, we expect credit demand to pick up in sectoral fashion in the current quarter. Collection efficiency is gradually picking up. We expect normalcy in disbursals in second half of the year. *However, we expect an increase in credit cost and GNPA. Meanwhile, we will have to maintain higher provisions purely from a safety and balance sheet management perspective.*

During lockdown, we were in contact with most of our customer base through phone. We trained our field officers about digital payments like Google Pay, PayTm, UPI etc. The loan officers in turn trained JLG customers. It resulted in fulfilling the customers' options by which they wanted to pay. However, the digital repayments did not make any significant share of total transactions.

In the current crisis, we have overhauled our business processes to account for the need of the times. Social distancing and safety of the client and staff is paramount. We have made the model, more doorstep oriented even for loan disbursals, which doesn't necessitate the client to take any risk in terms of travelling to town branches in groups.

Jana SFB

Slowdown will impact NPA though temporarily, due to lower income in view of the lockdown. After the lockdown is completely lifted, we expect the collections to be at 99%. The client base is resilient and understands the need to keep good credit scores and has, over the years, developed a long lasting relationship with the lenders.

Liquidity was a temporary issue in March 2020. It was a mix of market related events and impact of COVID-19. We don't have or foresee any liquidity issues. Profitability will be impacted in H1 due to lower disbursal which will be partially offset by lower costs. While H2 will be higher in disbursal, provisioning costs will lower the profits. It will be a profitable year though the profits will be lower than anticipated.

Digitalization did help in collections significantly. The Bank launched UPI QR code option for collection in April 2020 and post launch, digital payments (UPI / NACH) have accounted for 5%-10% of all the payments collected.

Moratorium was what differentiated the impact of demonetisation and COVID. It was timely and well communicated. Though the problem of COVID persisted longer than anticipated, the Bank is better prepared, having understood the nature of the problem.

North East SFB

The success of MFIs (Genesis of many SFBs) can be attributed to its close connect with its customers by providing services at their doorsteps. The lock down disrupted this connection and has created the challenges for SFBs as followings:

i. Cash flow rotation challenge owing to disruptions in field operations.

ii. Moratorium and actual restart of livelihood generation activities: The income from such activities is being used up for household expenses or consumption during lock down.

iii. The extended time line of moratorium has created an environment for possible deterioration of credit discipline.

iv. The loans disbursed during the Covid lock down period are being diverted from income generation to household expenses / personal consumption in some cases.

What the above points show is the short term effects of the short term measures. The above points can have mid and long term ramifications for the Banks as :

i. Moraratorium period provides short term relief but at the same time accrued interest on loan, cost of insurance, credit discipline challenges and high possibility of consumption of advances cause a bigger challenge for SFBs.

ii. Çash economy is the back bone of the informal economy. Financial inclusion and the banking services linkage itself are challenging in many customer segments and geographical terrains. Thus, technological aspects like digitalisation provide limited scope for Banking channels of collections of loan instalments. Also, technological advancement is a cost intensive aspect as well.

iii. The essence of our Business model of fixed collection of loan from the customers' door step cannot overnight change the behaviour of customers to form a habit of saving deposits and instalments deduction from Savings Accounts. The transition is gradual and till that time the channel for physical collection has to exist parallelly.

As a Bank, we have to slowly move into transformation of business model and field activities as a sudden change is impractical considering the customer segment that we deal with and the infrastructure in the region. At the same time, we also need to consider the cost of such a transformation, time to prepare, upgrade and prepare the employees who are the face of the bank and more importantly to make customers see the benefits of adopting technology, maintaining credit discipline and returning back to normal as was in pre-Covid era.

Suryoday SFB

For all organisations the Covid pandemic has been a black swan event but with every such event, there are always new opportunities that emerge.

In demonetisation we witnessed all MFIs and SFBs moving to cashless disbursement and overall we saw digital repayments become more popular. In the case of Covid-19, there is an acceleration of digital initiatives. For example, before Covid-19, customers were not keen to adopt digital repayment modes but post this pandemic we see increasing adoption of digital repayments on a daily basis. We are setting up overdraft facilities for them to fulfil their working capital needs. We have taken initiatives to conduct virtual meetings with customers on account of the formidable challenges of free movement at the field level.

In our view it's a 360 degree change driven by digital infrastructure – the high touch business model is evolving into an efficient, need based, quick delivery model, which has the potential to spread its wings far and wide into the hinterland of this country.

Ujjivan SFB

With on-going COVID-19 pandemic, we are in an unchartered territory and the entire world is going through a tough phase. The moratorium being offered during this period may have some adverse impact on the customer behaviour which may in turn, result into delays in collections. We expect some impact on our portfolio quality on account of moratorium which, in turn, may have a negative impact on our overall profitability. *On the cost front, we are working towards digitizing the existing processes, enhancing the span of control of our existing supervisory layer, renegotiating costs with the existing business partners, reducing our term deposit rates etc. Though we kept sufficient liquidity in hand as part of our preparedness to handle the COVID pandemic, it is a drag on our P&L by way of negative carry on the surplus liquidity.* We are focussing on digitisation of our collection process with help of tie-ups with Business Partners for providing solutions for cashless repayments.

Our preparedness to manage such events: We will continue with our focus to deliver high quality products and services with minimal manual intervention to our customers while keeping a close eye on the costs which covers people, processes, marketing spends, finance and prevention of revenue leakage. We will ensure that we keep sufficient liquidity buffer in the form of line of credit, refinance facilities, govt. securities to tide over the difficult times in future.

Utkarsh SFB

Events like Covid-19 and Demonetization are disrupting events in a significant way for a large number of businesses and individuals. Different events have different impacts, so for example, while Demonetization impacted MFIs / SFBs more, as these institutions were collecting the EMIs in "cash", Covid-19 is having more impact on metropolitan and urban locations and on certain industries, while so far, rural & semi-urban geographies and agriculture and other essential activities are less impacted.

Our liquidity position is comfortable as we decided to be more prudent on liquidity front and maintained higher liquidity buffers amid Corona virus uncertainty and to meet all funding requirement of our depositors in a timely manner. *While maintaining sufficient liquidity remains our top priority, maintaining large liquidity buffer impacts the bank's net interest margin on account of negative carry on investments.*

We are not expecting significant impact on our cost efficiency due to Covid-19 as a large part of impact on account of lower growth during this phase is expected to be compensated by the various cost control measures taken by the Bank.

While as of now, micro finance collections continue to happen largely through cash, we expect significant developments on digital collection in micro finance business on account of Covid-19 issues. A lot of times, lot of positive developments seeded in difficult times happen, for example, micro finance industry moved largely to cashless disbursements following demonetization event.

Events like demonetization and Covid-19 have an impact on business of some of our borrowers and their ability to service loans which in turn could impact our asset quality. However, as a rural focussed SFB, a large proportion of our borrowers are engaged in agriculture and allied activities which are not much impacted by Covid-19 and a large part of our borrowers are in rural and semi-urban locations. Both of these i.e. agriculture & allied activities and rural & semi-urban locations have been less impacted by Covod-19 and hence we expect relatively lesser impact on our asset quality vs. more metro / urban focussed entities.

The Events like Demonetization and Covid-19 are unpredictable events and to that extent, it is difficult to be fully prepared in advance to face situations like these. However, as a bank we are focussing on maintaining strong processes and systems, technology and digitization and strong financial position to come out strongly even from difficult events / times like Demonetization and Covid-19.

AU SFB

In our journey of the last 25 years, we have been through several seasons of growth, plenty, and challenges. Whether it was the financial crisis of 2008, oil crisis of 2014 or demonetisation of 2016; each adversity felt the most adverse during the time when we faced it. However, it is our reaction to the adversity, not adversity itself that determines how our story will progress. Since our inception, we had stayed focused on building the right character of our organization and have been driven by the guiding principles of prudence, sensibility, and honesty. This is what keeps us sailing through such testing times too.

In our journey of FOREVER, we have a profound realisation that a Bank matters beyond the Maths. We appreciate the value of a banking platform by being part of the essential service. This institution is more than risk and returns. It is the fulcrum of the economy. We are proud of our ability to manage excellent service delivery standards even during the COVID times. As the nation followed a lockdown, our 2000+ soldiers were out there, serving customers at 350+ branches and keeping their faith in our strong banking system.

We have always focussed on growing the right way to build a resilient institution that can withstand the test of time. As a young bank but an institution with 25 years of rich experience, we bring fresh approach to the table by leveraging the wisdom of the old and the energy of the young.

In these times, we are fortunate to have this banking platform. As bankers, we find an opportunity to build trust and make the world a better place again. I believe banking will evolve to build bridges for a sustainable world. We launched AU COVID Shield Deposit – a must-have emergency deposit product. We maintained complete virtual and remote support for our customers by ensuring zero downtime in Customer Care Number, Retail Internet & Mobile Banking, Corporate Internet Banking and ATMs. We swiftly shifted to online mode and conducted trainings across business through Microsoft Teams. We did virtual meetings effectively and used Sharepoint as document collaboration tool. For business support, we operated through remote outbound Call Centre solution for Collections, insurance and Digital Marketing.

As for the asseed impact of COVID-19 on Key Business Indicators (published details as on 31st March), let me share:

- Disbursements - Opportunity missed around ~5-6% (~₹ 20,000 Cr vs ₹ 18,634 Cr)
- Deposit Mobilization - March momentum impacted due to macro issues in banking sector and COVID-19;
- Deposit Base could have increased by 8-10% (₹ 28,000 Cr vs ₹ 26,164 Cr)
- Liquidity Position - Increased liquidity cushion by ₹ 1500-2000 Crore; additional cost Impact (PAT reduced) by ~₹ 15-20 Crore)
- Gross NPA - Would have been in 1.5% range
- Provisioning - COVID-19 provisioning of ₹ 138 Crore created in Q4 FY20 other than Standard Asset Provisioning and NPA Provisioning
- Impact on March Collection Efficiency - Short by ~10%
- Fee and cross-sell income throughout - Impacted by ₹ 7-8 Crore around loan processing and asset ops; ₹ 5-6 Crore from cross sell.

There is no challenge with respect to the liquidity. As a bank we have access to public deposit and are not dependent on institutional borrowing. Also, the regulator has taken ample measures to ensure adequate liquidity. With a stable deposit profile, the liquidity has sustainably increased from March. Most of our geographies are not severely impacted by the issue as we operate mostly in rural/semi-urban hinterlands. Majority of our customers are covered under the MSME stimulus announced by the government. Things have started improving June onwards and we expect an onward trajectory.

The experience of going through a global pandemic taught us important lessons. We will let our learning and experience guide us to contribute towards a more sustainable world. Like Mahatma Gandhi ji had said, "We may stumble and fall but shall rise again." We will rise again! The way India stood strong during the lockdown; I am sure the same sentiment will be displayed now towards combined efforts of social responsibility to bring the nation back to normalcy. Going forward with a strong-willed government, we look forward to accelerating reforms and policies, paving the way for sustainable growth of the economy. Even during the enormous challenges, we face today; I have great faith and hope about the future - because I believe in us, in the power of banking, in the power of people, to save the world.

Credit Access to Small Entities

Former Governor of Reserve Bank of India, Raghuram Rajan while delivering the Y B Chavan Memorial lecture (2016), had said "My sense is that Small Finance Banks will create easier access to finance to all small entities looking for finance". On another occasion he had stated that "Local financial institutions, with local control and staffed by knowledgeable local people, could be more effective at providing financial services to the excluded'. It is in this connection and to provide an alternative institutional avenue for inclusion that the RBI has created a new institution called the Small Finance Bank, where "small" refers to the kind of customer the bank deals with, not its size". Evidently RBI has great hopes on Small Finance Banks to deliver financial inclusion.

Do you agree that SFBs can make this happen? Are the extant guidelines conducive for the same? What are all the conditions needed to "create easier access to all small business/entities looking for finance"?

Equitas SFB

The SFBs have already created a niche market for themselves. They serve a distinctly different class of borrowers compared to the universal banks. The typical customers, aside from microfinance clients are - small micro enterprises (even unorganised) in the tier 2 ,tier 3 towns, first time commercial vehicle owners (drivers graduating into owners), new-to-banking customers who do not have adequate documentation of their business, agro-enterprises and the like. The only regulatory guidelines which can further help the SFBs in their financial inclusion mission are as mentioned earlier, viz. differentiated regulatory framework for very small and informal borrowers compared to other borrowers.

Some of the policies, that are not regulatory in nature might require a tweak to enable SFBs to accelerate the pace of inclusion initiatives in the credit side. How we define MSMEs for the purpose of Priority Sector, the entry norms for guarantee schemes such as CGTMSE, documentation required for small housing loans to be accepted as affordable housing loans under Priority Sector, etc., are examples where policy tweaks will help.

ESAF SFB

Dreams float in the changing times and situation and never get crystallized. While this is true to a large extent, at some point we need to look back and ponder over our action and its outcome. This hindsight compels us for course corrections. Honestly, our vision to be the leading social bank in the country is still in its infancy. We are satisfied with the progress we achieved, but are impatient to complete the remaining tasks. We are on a long voyage and I feel now we are in the mid-sea. To get into the shore, braving the turbulent waves will be daunting and we are prepared for that.

We as a bank are satisfied with our performance culture and compliance culture. At the same time, we are of the view that SFBs are a special lot and need more care and attention from all those who matter. SFBs are babies in the domain of banking. We have started taking baby steps, and special care is needed to convert these into long strides. We are optimistic and will continue to strive for an India we dream of.

Fincare SFB

As we celebrate, five years of the experiment of deeper financial inclusion by way of award of SFB licenses, it is widely evident that this model is well and truly on its way to achieve the stated vision of the regulator. The lending portfolio of 8 out of the 10 SFBs before conversion was microfinance. Post conversion, SFBs are diversifying from being a mono-line product entity to be a banker at the BOP segment. Their asset product suite is increasingly getting diversified and includes MSME loans, affordable housing loans, vehicle loans, gold loans and wholesale lending program. Their liability franchise is also nicely building and is fuelling further stability for the model. The MSME loans are mostly structured to provide loans to micro, small and medium enterprises against property, for working capital, business expansion, asset purchase etc.

Through such offerings, SFBs are ensuring financial inclusion for micro, small, medium enterprises. Also, the spread of the branch network of most of the SFBs in rural and semi-urban areas is substantial to provide organized banking and financial inclusion.

Jana SFB

Specialised banks for financial inclusion were a strategic step and SFB's will significantly contribute to furthering the objectives of serving the unserved and the underserved sections of the economy.

SFB's Banks can meet this objective given its character of direct connect with the customer and focus at the bottom end of the pyramid. To make this happen to the full extent, we need certain policies to give the effort a fillip. For example, SFB's are ideally positioned to lend to small MFI's and allow them to grow. However, lending by SFB's to MFI's is not regarded as PSL unlike for the Universal Banks.

North East SFB

SFB can definitely be the financial linkage of its citizens to the banking ecosystem. The objective, as detailed under point 1 is in letter and spirit the right one, as mainstream bank finds it challenging to cater to this niche segment of informal economy.

The principal challenges revolve around the small borrowers traditionally being weak in terms of credit papers to prove his/her credentials, business activities, the norms of profitability, the linkage to the formal economy benchmarks like IT return, GST and most importantly the matters of maintaining accounts / accounting entries in a proper form. All such things and many more basic credentials requirements make them ineligible to the credit models of traditional banks. The risk associated with such borrowers, the lack of traditional security collateral and the unsecured nature of the loans make it ideal for SFBs to occupy or in fact desire to occupy this gap in the banking ecosystem. But from the start, the operating guideline is stringent with limited leeway provided as compared to universal banks.

One of the classic issues is the competition, as against the traditional bank with lesser intensive guidelines. The lack of exclusivity pits a SFB with traditional bank at the same time. This, pertaining to loans and advances, mobilizations of savings and deposits, banking transaction services and branches / customer points to rural / semi urban places. Ultimately, all this makes customers, investors, regulators and the government look at SFB with the same set of eyes as it sees the traditional banks.

The exclusivity needed to create easier access to all small entities by helping with provision of replacing 'grandfather borrowings' with exclusive line of credit from RBI for 5 years at lowest possible cost. The cost of refinancing activity which should have been low for the first 5 years of operation and taxation related relied, could have helped immensely to cater to customers with competitive pricing of loans and slowly build up the SFB to meet the strictly extant guidelines. *The failure to do so shows only the stick part of the stick and carrot analogy.*

Suryoday SFB

There is no doubt the SFB model is the best in this country to drive and provide access to credit to informal business enterprises and MSMEs at the grass root level. The SFBs have the hunger for growth and readiness to work with granular credit portfolio, which is unparalleled in the banking industry. Having credit providers, whose core business model rests on priority sector lending, is a dream come true for the policy makers in India.

Most of the SFBs were microfinance entities previously and have an established relationship with the customers. The banking license helped us make it more meaningful by extending deposit products and helping the customers mobilise savings.

Strengthening the digital infrastructure and providing unbridled connectivity could lend a significant support to SFBs. At this juncture when digital transactions are picking up pace, this is a critical need to be met. This will make the service delivery more efficient and cost effective, benefitting millions of micro businesses at the grass root level.

Ujjivan SFB

SFBs can make this happen, this is very clear from the last three years of existence and operations of SFBs. All the SFBs succeeded in delivering the goals of Financial Inclusion, which is evident from the Balance sheets of SFBs. Better access to the small entities can come through low cost distribution models through Fintech and through partnering with NBFC. Access to credit for small entities is usually a push mechanism from the Public Sector Banks, whereas SFB's core customer segment is that of Individual tiny micro customers, who are being brought into Financial Inclusion through formal bank credit by the SFBs. The large private sector banks largely neglect this segment of customers.

The extant guidelines are conducive for now, even though there relaxations are being sought in certain areas of Financial Inclusion, Housing, MSME and PSL, from the Regulator.

Utkarsh SFB

Within three or four years of commencing banking operations, SFBs have performed well on expanding the banking services to the underserved and unserved customers supported by their deep-rooted presence, specifically in the rural and semi-urban locations and wider product offerings. While credit growth for the banking sector as a whole, moderated in FY2019-20 to around 6%, the credit growth for SFBs remained healthy at around 30% during FY2019-20. Total deposits of SFBs have also grown by more than 45% in FY2019-20, in our estimate, as against overall banking industry growth of 8% during the same period.

Utkarsh Small Finance Bank Limited (USFBL's) asset under management has increased by 40.5% in FY20 to ₹ 6,660 crore and deposits grew by 38% to ₹ 5, 235 crore. As of now we have a loan side client base of more than 25 lakh and deposit accounts of more than 5.5 lakh which shows strong financial inclusion impact of our Bank as a SFB.

We strongly believe that SFBs have been and will be able to meet RBI's expectation of penetrating financial services to unserved and underserved customers and geographies on the back of SFB's deep rooted presence and franchise. This is also supported by their ability to operate in rural and semi urban locations and meeting the financial needs of informal sector as well while maintaining cost efficiency and profitability metrics.

While SFBs have performed well on deposits mobilization, still their deposits franchise is not comparable with large and established banks and it is going to take few years before SFBs reach to that position. Refinancing Institutions like NABARD and SIDBI have provided long-tenure refinancing lines to SFBs which has supported SFBs in maintaining healthy growth in providing finance to small entities / borrowers.

Regulatory regime allowing / giving access to SFBs of more and more long term and stable funding sources, through allowing bond issuances by SFBs in the line of Housing or Infrastructure Bonds or other modes, could augur well for SFBs' ability in providing access to small entities / borrowers. Also, steps through which SFBs can raise funds from providers of long term capital i.e. Insurance Companies / Provident Funds / Mutual Funds could augur well for the sector.

Partial credit guarantee scheme, something on the lines of Emergency Credit Line Guarantee Scheme for all the small & micro businesses / individuals could also create easier access to Small entities looking for finance.

AU SFB

Small Finance Banks (SFBs) are consistent with our country's development agenda as their licensing guidelines stipulate 75% lending to Priority Sector, maintenance of 50% loan book below ₹ 25 Lac ticket size and to have over 25% branches in rural and unreached areas. RBI introduced on-tap licensing guidelines for SFBs during FY20, which is a testimony to the significant untapped opportunities in the informal/semi-formal sectors, and efficacy of this delivery mode.

In this regard SFBs have made a remarkable impact since coming into existence in 2017. They have swiftly gained reasonable scale by garnering a credit portfolio of over ₹ 94,919 crore and a deposit base of more than ₹ 62,507 crore as on 31st March 2020.

At AU Bank, we are endeavouring to be the change-makers pursuing a mission to re-imagine and simplify banking for all. Since inception, we have been working relentlessly as retail focused, customer centric, premier and trusted asset financer. In our NBFC avatar, loans are extended on a bottom up approach which concentrates on understanding the customer and its business. As several target enterprises do not have formal income documentation proofs, AU devised ways to assess them. This included evaluating their purchase bills, visiting the businesses & assessing their turnover, calculations through informal income sources, inclusion of guarantors in loan structure etc. Even after becoming a Bank, AU continues to provide loans through this approach.
We truly believe that for India to grow it is important for its hinterlands to prosper. Therefore, we align ourselves with the Government of India's novel Jan Dhan Yojana which represents India's National Mission for Financial Inclusion. As a Bank we provide the facility of opening of Jan Dhan Accounts and encourage our customers to enable Aadhaar seeding in our accounts.

We would like to suggest the following to further ease the access to all small entities looking for finance:

Revised definition of MSME industries: The MSME Act, 2006 should include other manufacturing as well as service industries which are not presently part of this act, to make it at par with current requirements of MSME sector.

Ascertaining the investment in Plant and Machinery for classification of an enterprise as Micro, Small and Medium for loans up to ₹ 25 Lakhs[3]:
Ministry of MSME on March 8, 2017, instructed banks to collect following documents for classification of their loans to Micro / Small / Medium Enterprise:

i. Copy of the invoice of the purchase of plant and machinery; or
ii. Gross block for investment in plant and machinery as shown in the audited accounts; or
iii. A certificate issued by a Chartered Accountant regarding purchase price of plant and machinery.

The challenge is that most of these MSMEs are from unorganized sector. Hence, they always face difficulty in submission of original invoice of Plant & Machinery; these entities are not mandatorily auditable entity, hence, non-availability of audited balance sheet. Further, all these entities are from semi urban and rural markets where the cost to obtain CA certificate is huge.

In view of the above we suggest classification of MSME loans up to ₹ 25 Lakhs on basis of Self-declaration / attestation by the borrower.

The status of Small Finance Bank differentiates us from others and has made us responsible for territories which are under-served and where exist un-exhausted potential and capacity. We are working towards building the Financial Ecosystem and are contributing our bit to the Financial Inclusion in the country.

Capital SFB

We are hundred percent confident and believe that SFBs are going to make this happen. The quality of local knowledge, zeal, enthusiasm and experience of the SFBs, the entrepreneurial skills and vision of the young organizations is going to make it happen. The understanding of the credit needs, business cycles, suitability of the product line for the niche market, management vision and culture of the organization, along with proper hand-holding and guidance from the regulatory authorities are going to be the pre-requisites for achieving the desired results.

3. Recently as a part of Pandemic related package MOF has announced that 'Micro units: MSMEs will now be called Micro units if they have investments upto ₹ 1 crore and turnover of less than ₹ 5 crore. The definition earlier was on investment criteria of up to ₹ 10 lakh for Service MSMEs earlier and ₹ 25 lakh or manufacturing. Small units: For an MSME to be defined as a Small unit, its investment limit has been raised from ₹ 5 crore to ₹ 10 crore with a turnover of less than 50 crore. This applies to all MSMEs including the Service enterprises which earlier came under investment of up to ₹ 2 crore.

Deposits

Deposits are the major source of funds for banks. The share of deposits (March 20) of SFBs in their total assets was about 55% and CASA was around 20%. As against this in the case of PSU banks the total deposits as % of total resources are around 85% and CASA around 28%. Private Banks have a lower deposit to total asset ratio but higher CASA. It is seen that despite the competition from new private sector banks for more than three decades PSU banks maintain an edge in deposits. Among the private banks bigger banks attract more deposits than the small ones.

It is seen that Small Finance Banks offer a higher rate of interest on savings and term deposits. Prima Facie it is seen that offering higher rate of interest has resulted in attracting term deposits and bulk deposits and not CASA. It seems higher rates offered by SFBs have not resulted in huge shift of deposits of individuals from other banks including Cooperative Banks to SFB. It is also seen that for the purpose of Government deposits SFBs do not have a level playing field.

What are the strengths and weaknesses of small finance banks in the area of deposits and what are the strategies for increasing the deposits and CASA? How to improve deposit growth with SFB? What should authorities do to encourage public to deposit more funds with SFB? Will the recent increase on Deposit insurance cover from ₹ 1 lakh to ₹ 5 lakh be of some use?

ESAF SFB

I can only speak about my Bank's deposit strategy. We were always clear that we wanted to build a retail liability portfolio and we have been executing this for the past three years. Currently, our Liability book exceeds our Asset book by a small margin. Further, our dependency on bulk deposits is almost nil with over 95 % of the liability book being retail deposits as on 31st March, 2020.

It's a fact that the 'New Generation Private banks' have built up their CASA book quite effectively. Currently, ESAF bank's CASA ratio stands at about 14% as on 31st March 2020, While it is true that higher rates of interest on term deposits are an attraction, our experience shows that it is not enough. We have followed a segmented strategy, picked the right customer segments and offered them services that are attractive besides high rates of interest. We have also utilised our branch network effectively in reaching out to new geographies and segments. Plans are on the anvil for broadening of the customer base and new customer acquisition. Sensitising training has been provided to staff for the systematic building of relationships with customers and meeting their requirements on time. We have expanded the retail portfolio by adding services like payments, transfers, direct banking channels and asset products. This is expected to result in the CASA book holding a higher share in the liability base of the Bank. We have been growing our liability book by 60-70 %, which is by no means a small growth. So I would say that banks with the right retail strategy have been successful in growing rapidly. As to moving more funds to SFBs as a class, one has to keep in mind that SFBs [or any Bank for that matter] also have to show a matching quality in asset growth. So this cannot be viewed in isolation.

The increase in DICGC cover for deposits is a good move for all banks and customers. I must also say that the SFBs as a class and ESAF Bank, in particular, have been doing a lot of work with the unserved and underserved segments of the population. This is also designed by the Regulator. Hence the expectation that deposits and business, in general, will move from PSU Banks to SFBs in large volumes may not be correct.

Fincare SFB

As most of the SFBs converted from being non-deposit taking NBFCs, deposit base is being built up from scratch as a new product offering. FY 2017-18 was the first year of operations for most of the SFBs. Hence, it is unfair to compare the CASA ratio or retail deposits ratios with PSU and Private Sector Banks which have been existing since decades. Given that, SFBs have been ramping up the deposit base quickly. In FY19, Total deposits of SFBs jumped 130%. We expect the share of granular deposits to increase over the medium-term. The strength of SFB in the area of deposits is higher rates of interest i.e. 300 to 500bps more than Private and PSU banks on Savings Accounts and Fixed deposits. The weakness is the comparatively weaker brand name as against the old PSUs and Private banks which have garnered trust among customers over the years.

3D (Digital, Door-step banking and Distribution) strategy is helping us improve our CASA book. We have been focussing on customer acquisition through online Savings accounts - Digital 101 Savings accounts to improve retail deposits. Even during the lockdown, we have added a lot of online customers who have brought in deposits. Further, the focus will be on funding these accounts to build CASA book. At the same time, we are emphasizing on leveraging existing customer relationships to cross sell CASA. We shall continue investing in on Digital product offerings, Digital Distribution channels and Door-step banking that are scalable and improve customer experience.

Jana SFB

Given that the SFB's serve the under privileged section of the population, Central and State Governments should be requested to keep CASA equivalent of the SFB loans in the State with SFB's. This will help them reduce costs to the borrower and incentivise SFB's to serve better. Such a concept should be extended to the entire SFB industry, given that their main objective is financial inclusion.

Recent changes in the DICGC insurance cover limit, have been helpful to build the trust factor with customers. Such regulations will help SFB's to market and source deposits.

North East SFB

Being new to the Banking market with no exclusivity in areas of operation, had to resort to providing better Rate of Interest than the competitors to mobilize the deposits. At the same time the general perception of the masses and the industry has pitted them as riskier than traditional Public and Private Sector Banks.

What authorities could have done is encourage SFB with more exclusive zone of operations like:

i. Ru Rural DBTs via SFB accounts only

ii. Government account with SFBs in rural areas

iii. Sensitising and increasing public awareness about SFB especially focusing on Government & RBI's intention of establishing SFBs as a vehicle for financial inclusion. We expected much more focused support from the RBI and Government in terms of endorsement and promotion of SFBs and not just limit to clarifying doubts raised by the general public on SFBs.

Concentration risk limit for five years as well as behavioural study for ALM stable and volatile nature of deposits to be relaxed for five years. *Govt. endorsement of SFBs for the region, like all State Govt. of North East for NESFB will be a welcome development.*

Suryoday SFB

SFBs have just started the journey as banking institutions so it would be premature to compare them with Public Sector Banks and Large Private Sector Banks. Suryoday has almost a 50% split between retail and bulk book, and we are seeing a near 100% growth year on year in the deposit book. The strategy of offering a slightly higher interest rate helped in generating visibility for SFBs.

This is critical motivating factor for the non-microfinance customers who already have relationship with existing Public/Private Sector Banks.

SFBs being new, the customer awareness is low. People are sometimes apprehensive of dealing with new players in the banking industry fearing for the safety of their money. *To address these concerns, the enhancement in the DICGC cover to ₹ 5 lakh has been a timely step which can go a long way in widening the resource pool for SFBs.* Considering the crucial role of financial inclusion played by SFBs, it will be fair for the Government to allow its various arms, including public sector enterprise, to have banking relationship with them. This will help establish trust for these newcomers in the market and also augment their cost effective pool of deposits by getting a large float.

Ujjivan SFB

The recent announcement of increase on DICGC cover on the deposits has helped in building the public confidence. *SFBs do expect from the authorities to release public notification stating the role of SFB's in achieving their mission toward financial inclusion.* For building up the granular core retail deposits, we are also working towards providing complete basket of services to our customers to fulfil their entire financial and banking requirements. With this approach, we will be able to build more granular and stable CASA, over time.

The CASA with the Public Sector Banks is of Institutional CASA and that of Private Sector Banks is of Medium and Corporate CASA in addition to middle class and affluent customers. But the CASA with SFBs is predominantly from the small customers. To make the transition easier, SFBs should be enabled for sourcing Government Accounts and Government Institutional CASA (Agency Business).

Utkarsh SFB

The key strength of SFBs is their focussed approach and strong customer-connect in deposits mobilization. In the initial years, SFBs have also been offering higher Rate of Interest to build strong deposits profile which is expected to normalize as they gain track record. SFBs have been able to offer attractive Rate of Interest, given their higher lending yields. SFB have also been focussing significantly on building retail deposits (both CASA and retail term deposits), however building a very large retail deposits base takes years and to that extent SFBs dependence on bulk deposits is higher v/s established Universal Banks. Also, SFBs have limited track record of 3-4 years, which is relatively short in banking perspective, and still in process of strengthening their physical and technological infrastructure in line with established commercial banks.

The addition of word “Small Finance Bank” with name of Bank also does not augur well when competing with established Universal Banks.

Increase in DICGC cover from ₹ 1 lakh to ₹ 5 lakh is certainly positive for the banking sector as a whole in terms of customer confidence. While the deposit ticket sizes had increased significantly over last several years DICGC cover had not changes and hence the increase is certainly a good decision by the Government / Regulators.

AU SFB

We are a scheduled commercial bank and a Fortune India 500 Company. *We started banking operation in April 2017. Within 3 years, we have established operations across 640+ Banking Touch points serving over 17 Lakh+ customers in 11 states of North, West and Central India with a talent base of 17,000+ employees. We have a net worth of more than ₹ 4300 Cr.+, robust deposit base of about ₹ 26,000 Cr.+ and a strong lending base of about ₹ 30,500 Cr.+*

On the deposit side, we are working on focussed and segmented strategy. We have categorized our geographical presence into two groups – *Urban and Core locations.* Each location has its own diversified market base, customer needs & unique way of delivering services. We have a clear market strategy in place and distinct customer segmentation in place where we work towards customised acquisition, engagement, servicing, and transaction strategy.

We propagate an important aspect of depositor’s safety that the money of each depositor in each Scheduled bank is insured up to ₹ 5 Lakh. *The recent increase of DICGC cover from 1 lakh to 5 lakhs has been very helpful indeed.*

Being a New Age, technology led bank, we have designed best in class deposit products offering industry best rate on saving account and value propositions in current accounts. In a short span of three years, we are standing strong on the payments side with - best in class corporate internet banking, being live on all digital payment modes and marquee debit card offerings. We are working on the Credit Card strategy to complete our bouquet of payment options. This year, we also launched one of our best in class offering ‘AU Royale’ - premier Contactless Debit Card targeting the Upper middle-income segment.

Our data suggests that our customer on the credit side resides in the hinterlands of the country but we get deposits from Metropolitan and Urban Areas. *Here, we observed that the tag of "Small" in Small Finance Bank is perceived as risky by such depositors and we have trouble in convincing them that we are fully functioning bank*. Small Finance Banks should be empowered to garner low-cost deposits, so that they can provide low-cost Financial Services. These low-cost deposits are the public money, and the public perceives Small as risky.

Key to building a Strong Deposit Franchise

To make Small Finance Banks fully functioning Banks and to give these institutions a level playing field it is extremely important that Small Finance Banks build a Deposit Franchise. The benefits of the same are: -

1. More Trust in the Brand
2. Access to funds
3. Host of products and services
4. Efficient Delivery
5. One-stop solution for all Financial Services
6. Inhibiting the Ponzi Schemes

We believe, to enable inclusion, the cycle first starts with credit and the ability to extend such credit depends on the deposit that we have. We therefore propose some points below which could be critical for the effective implementation of the Financial Inclusion principles: -

i. To revisit the **nomenclature of Small Finance Banks**– We do have specialized Banks in the country like Local Area Bank, Regional Rural Bank, Cooperative Bank, etc. which either convey the geographical presence of such Banks or the essence on which the institution is built.

ii. The customers of such Banks perceive them accordingly; however, the **"Small" in the Small Finance Bank shifts their perception towards risk.** Therefore, there is a need to revisit the title of Small Finance Banks. With the 75-50-25 condition, we are modeled in a way that we would do "Small Finance" but that should not make our depositors wonder whether we are a fully functioning Bank. This would help us to have a level playing field with other Private Sector Banks in the country.

To further Financial Inclusion and to consequently raise relevant deposit, if authorities were to publish guidelines about the Scheduled Commercial Bank status accorded to Small Finance Banks & given the fact that it is the same as has been given to other established Banks in the country, this would go a great way to help us garner requisite deposits from various government organizations and schemes to further the inclusion agenda.

Capital SFB

Every SFB, rather every bank has its own strengths and weaknesses. There cannot be generalized demarcation as to deposits as such. *However, we strongly believe, its' not the Rate of Interest, rather it is the association, business and transaction volume and quality of service which is going be the deciding factor in deposit mobilization and that too CASA mobilization.* The trust and consistency, clarity of charges, transparency, personalized touch are even more important ingredients for sustainable deposit mobilization rather than Rate of Interest which can bring highly sensitive deposits but not sustainable one. SERVICE plays a very important role to build the CASA book rather than interest based selling. The private players with whom SFBs are being compared here are pretty old in the market and actually bigger in size as well. Things are already changing and with more time, when the SFB age/market share will increase, trust of the people will be more strengthened and service will be more efficient in comparison with the other Private Banks, CASA will be comparable. The product kitty, be it AD1 business or Nodal Account business or Government Business or acceptability at Embassies etc., are different for SFBs vis-a-vis other Private Banks which also plays a role in differential CASA book. CASA ratio of Capital SFB stood at more than 37% as on March 31, 2020.

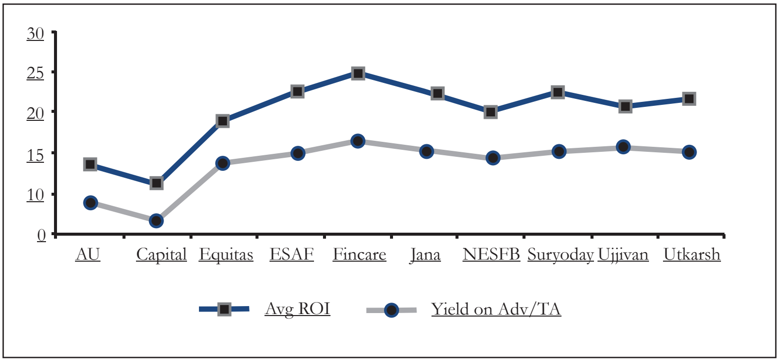
Equitas SFB

Depositors' motivation to choose a particular bank depends on many factors of which the name recall, perceived 'safety' status and convenience are critical besides the interest rates. And it takes a long time for any bank to build the above. Hence SFBs by nature would need to depend on bulk deposits for sometime as their brand builds up leading to retail deposit tractions. It is a long term play and would need to be gone through, to see the benefit of retail deposits and CASA deposits coming into full play for SFBs. SFBs are in for a sustained period of hard work on introduction of good products, backed up by good customer service, a reliable technology backbone and building of the brand as a bank as they scale up their deposit franchise. The public authorities should create a level playing field for all banks to market their products and services. *Some of the current instructions (formal and informal) that exclude SFBs from mobilising deposits of some public authorities or opening of accounts of beneficiaries of certain public schemes should be reviewed.* A pronouncement that SFBs are banks and deposits with these banks are insured to the same extent as with other banks might be in order. Also some guidance on validity and legitimacy of instruments such as bank drafts, banker's cheques, guarantees issued by SFBs and the need for their acceptance by public authorities will level the field.

Margins and Rate of Interest

The average Return on Advances of SFBs was 18.6%[4] as on 31/3/20. The return on advances as % of Total assets was 12.9%. It is seen that interest rate charged in most of the group loans are in excess of 24%. In addition SFBs charge processing fee for loans above ₹ 25000. Borrowers are Chart needs numbering. are also covered by life insurance policies for the period of loan.

Chart 4.1: ROI on loans by SFBs 2020



In view of this, the cost of small loans, should be easily above 24% for the borrowers of SFB. However as the loans are for smaller periods,the overall interest burden on such loans should be lower than similar loans but for longer periods than given by other banks. Historically the poor in India have been paying a higher rate of interest on their loans while the corporates and salaried class have been benefitted by a lower rate of interest on much higher loan outlays. SFBs have to follow MCLR and EBR for pricing of loans as per RBI guidelines. In this background do you think the higher interest rates offered by SFB will continue? Is this rate viable for the borrowers?

4. Data Source RBI

Fincare SFB

Offering microloans to customers incur higher customer acquisition and servicing costs arising due to operations in remotest geographies in comparison to Bigger Private and Public sector banks which are catering to customers in semi-urban, urban areas or metropolitan cities. With weekly/fortnightly/monthly collection meetings, the SFBs loan officers are frequently travelling from village to village often up to 40km from the home branch at the doorstep of customers and incurring amount of money on fuel and vehicle maintenance. Typically, Private Sector and PSU Bank would charge ₹100-₹200 for a door-step service. If this were to be adjusted in the interest that SFBs charge the effective interest rate would be significantly lower. In addition to high costs of operations, SFBs also manage higher risk in providing microloans to customers which are without collaterals. Hence, the cost of per transaction is high which leads to higher Rates of Interest. *Also the cost of funds for SFBs is higher than Private or PSU banks. However, we believe that with Cost of Funds/cost of borrowing coming down in last few years, rates will come down.*

Further we need to compare this with the SHG lending model carried out by PSU Banks, wherein the SHGs are expected to get 4 x credits for 1x deposit. Also, as the average loan outstanding versus disbursed value is 50%. The effective yield for the PSU Bank would be around 20.50% where there is no doorstep service. It should also be mentioned that in the case of private sector banks where the cost of fund is in 5-6% range also, the price of the MFI loans is in the 20-24% range.

Jana SFB

Smaller ticket loans and loan servicing which are people intensive will involve higher costs than normal loans. This very construct is the reason that the banking sector has been unable to achieve significant progress in financial inclusion. This construct needs to change in order to make the lending rates lower.

Lending costs will come down when collections process becomes digital. Introduction of Credit Insurance to help during eventualities like Covid / Demonetisation will be an additional key factor to reducing costs.

Finally, as formalisation increases, there will be reduction in pricing as credit appraisals will be more quantitative and less subjective.

Anyway the pricing is driven by many players across the nation and market is determining the price which is appropriate for a healthy industry.

North East SFB

Pricing of loan pertaining to customer of SFB primarily being high due to:

i. Higher cost of Funds – Deposit rates higher than competition.

ii. Higher operating cost because as a new bank it requires higher opex primarily owing to door to door collection model of the business.

iii. Inability to replace grandfathered borrowings with lower cost of borrowings as no exclusive line of credit facilities are available to SFBs to retire these high costs, debts other than savings/ term deposits mobilization.

iv. Refinancing cost is high as it includes the Risk premium for SFBs

For next 3-5 years (implying 5-7 years of SFB operations) we do see moderation of pricing of credit products. At the same time, we also feel the objective of financial inclusion, pricing of credit products and the costs incurred by the delivering institutions (SFB in this case), all are inversely proportional to each other. *The poor segment of the society due to "perceived risks", an adjective used because they are misfits to traditional credit model of the banks, tends to end up paying higher interest rate.* If there could be any exclusive guarantee fund under central Govt., for the loans and Advances which qualifies for SFB objective of financial inclusion and access to lines of credit at near about repo rate to retire old high cost debt as well as lower financing cost, it would make tremendous impact in lowering the price of credit products. *Another issue could be an exclusive ten-year tax holiday with emphasis of using the 23-30% of the PBT (which otherwise would have been paid as tax) as buffer to absorb the loss arising out of lower priced loans in the subsequent financial year, would be a welcome addition to enable SFB for offering low priced loans to the bottom of the pyramid customers.*

Suryoday SFB

Suryoday as a New Age bank has continuously been investing in technology platforms to match those of the existing vintage players and that should reduce our cost of processing the loans substantially, the benefit of which can, in turn, be passed to the customers. Across the SFBs the rates have gradually declined and in future we can see it decline further.

We should also keep in mind that for the rates to go down in a sustainable manner, the credit risk premium needs to go down. *The loss suffered by the banks results in increase in risk premium, thus raising the cost of credit for new borrowers.* Natural calamities impair the repayment capacity of the borrowers at the bottom of the pyramid; this has become regular phenomena thanks to the adverse impact of climate change across the globe. In addition, policy changes like demonetisation and GST implementation, and crisis like Covid 19 pandemic, adversely affect impact the earning potential of the enterprises, leading to large scale default.

The various loan waivers announced by Government from time to time vitiate the borrowing discipline among customers, raising fresh challenges for the banks every now and then.

Ujjivan SFB

We see cost of funds going down as the system becomes more efficient and SFBs are able to achieve further efficiencies in the overall cost of operations. SFBs will be transmitting the benefit by way of reduced lending rates to our customers. Considering the current economic scenario, the higher interest rates offered by the SFB will gradually come down. The other aspect is lower levels of CASA as discussed in the previous point. *Because the SFBs deal with small depositors, the average balances in CASA are way lower than that of Private Sector Banks. This keeps the cost of funds higher for SFBs, even though the trajectory is trending towards lower cost of funds.*

Utkarsh SFB

Higher interest rate by SFB to its borrowers is primarily on account of high cost of operations for serving these small ticket loans *and not primarily due to weaker credit profile (poor / rich) of the borrowers. In fact, SFBs / MFIs have been able to maintain very good asset quality while lending to bottom of the pyramid customers (micro finance lending).* The higher lending rates of SFBs are also on account of their relatively higher cost of funding compared with established Universal Banks and higher operational cost given these are still initial years of Banking Operations. As these costs are expected to reduce over next few years, the lending rates of SFBs are expected to decline too.

Also, the segments which are catered primarily by SFBs (unserved and underserved sections) do not get required funding from mainstream banks and were relying on informal sources of funding (private moneylenders etc.) where the Rate of Interest is enormously high.

US F BL's Gross and Net NPAs, lowest among the SFB banks, were 0.71% and 0.18% respectively as on March 31, 2020.

AU SFB

AU's growth story is from the hinterlands not urban cities. Early on AU banked on people's aspirations, skill sets and intentions to fuel their dreams. We consciously chose to serve the under-served regions lacking formal financial documents, where customers are often at the mercy of moneylenders. AU Bank's wide market penetration and deep understanding of the rural and semi-urban economies has enabled it to create a platform that facilitates inclusive growth.

The Rate of Interest on loans is determined by two factors - Cost of funds and risk-based matrix (which depends on the customer's profile). Over the years, we have funded micro/ small enterprises, which were otherwise unable to secure credit due to lack of formal income documents, credit history and banking services in remote areas. As a bank, we have not only extended the bouquet of banking products but enhanced the services to better serve the overall financial needs of the segment. Thus, we have developed a strong credit scoring model, enabling easy access to credit for income generation activities.

At NBFC platform too, Customer Focus was one of our key AU Dharmas' and we have always had a customer-centric outlook. However, being an NBFC we perceived our customer as a 'Borrower'. To be honest, the transformation of the 'Borrower' to a 'Customer' happened soon after we became a Bank. It has been the most satisfying revelation and we take pride in executing our enhanced understanding. And as we wore the new lenses, we sharpened our focus to convert customer satisfaction into customer delight. Also, as we develop banking relationship with the customer and our holistic understanding of the customer deepens, we become better equipped to offer better rate to the customer.

About the cost of funds, we make the following points.

Special window / Funds and preference from Govt and PSU treasuries for SFBs in term of CASA/deposits:

- Most of Govt dept and PSU treasuries keep their CASA / Deposit with Public / large Private Sector Banks. Currently cost of fund with SFB is very high at the same time RBI has mandated to provide 50% of funding for upto ₹ 25 Lakhs loans with PSL achievement of 75%. Therefore there is an urgent need for keeping some percentage of government funds with SFBs;
- Authorities may also consider creating some specific funds that could be placed with SFBs. This will lead to low cost access of deposit to provide competitive interest rates to MSME & Retail sector; enhancing the flow of Financial Services to unserved and under-served areas; enable SFBs to spread their reach and operations by leveraging their design.

Capital SFB

Every entity has its own charge structure based on multiplicity of factors, the cost of deposits and sources of deposits are one of the crucial factors apart from capital and other stable funding sources in determining the return on advances. Most of the SFBs are from non-banking sector, so their cost of deposit is also high which makes advances at higher rates too. *Going forward, once the other formal channels of deposit mobilization are adopted by the SFBs, their returns of advances shall come down drastically along with the reduction of their cost of deposit which shall be great for the small and vulnerable/weak borrowers.* The average return on advances for Capital SFB for FY 20 was around 11.57%.

Equitas SFB

Interest rates are arrived at by factoring cost of funds, cost of delivery of the loan, collection efficiency and the credit cost of that segment of borrowers. Currently the final spread or yield to the banks are not very dissimilar and the RoE of SFBs are not much different from some of the well run private banks who charge much lower rates of interest. This is because they service a completely different set of borrowers. *The cost of operation for a loan of ₹ 5 Cr is 10 times less than the cost to service a loan of ₹ 5 lakh.* The cost of delivery to customers will continue to be high as the average ticket size is much smaller than in case of other banks. *The cost of deposits with SFBs will continue to be higher in the medium term as it takes time to develop a good deposit base, where interest rate is not a significant differentiator. The risks of very small businesses and 'new to banking customers' are higher than others and the risk costs have to be absorbed.* A combination of these three factors contributes to the higher interest rates. Over time, all interest rates have trended low based on improved efficiencies of banks, automation and improved customer behaviours, etc. The example of Microfinance Sector, where the rates declined to around 18% to 20 % in some MFIs, from the RBI permitted cap of 27% over a eight year period, is worth noting in this regard.

ESAF SFB

In the long run, the interest rates (higher is a relative term) offered by SFBs will come down with the extent of usage of technology and innovation of new operational models. On the interest rate viability, I feel small loans should not be looked at, from an interest rate angle alone. From a financial calculation perspective, yes, but we don't use this matrix to evaluate such business in reality. That being the case, the interest on small loans, which is mostly given for similar purpose should be not be considered from that angle.

In short, it's not the Rate of Interest per se, which makes it viable or unviable but the purpose/utilization of the credit, the credit absorbing capacity, how the credit is used etc. will decide whether it is viable or non-viable for a small borrower. Even at zero interest rate, loans could be unviable for many persons. While I agree that benefits of interest rates should be extended to small borrowers, it's important to look at loan viability from real cause perspective than merely looking at it only from 'interest' perspective.

Priority Sector Lending

Commercial banks have a target of 40% of ANBC whereas the target is 75% for SFB. Initially micro bank portfolio is helping SFB to more than fulfil these norms. But as the bank grows, achieving PS norms needs to be strategized. The recent changes announced in MSME definitions[5] in terms of turnover and assets owned will help SFBs in financing them. At the same time for NBFC-MFI turned SFBs financing SME etc will call for concerted efforts.

Are these PS norms compatible to your business vision? Can SFB continue to achieve a major portion of PS through micro baking? Given the micro banking specialisation with SFB are these norms easy? Currently SFBs are not permitted to achieve the target through PSLC. At the same time they can market excess PS if any as PSLC. Is the income on account of sale of PS loans to other banks as participation certificates adequate compensation for a higher mandate of PS loans? In the past commercial banks found it difficult to achieve PS targets under Agriculture and this resulted in huge flow of funds to NABARD under RIDF. What are your constraints in achieving the purpose wise targets?

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5. Revision in MSME definition was announced in the Atmnirbhar Bharat package on 13/5/20. As per this the definition of Micro manufacturing and services units was increased to ₹ 1 Crore of investment and ₹ 5 Crore of turnover. The limit of small unit was increased to ₹ 10 Crore of investment and ₹ 50 Crore of turnover. Similarly, the limit of medium unit was increased to ₹ 20 Crore of investment and ₹ 100 Crore of turnover. GOI on 01/06/20 announced upward revision of the MSME Definition to ₹ 50 Crore of investment and ₹ 250 Crore of turnover. https://pib.gov.in/PressReleasePage.aspx?PRID=1628925

Jana SFB

The 75% Priority Sector requirement is absolutely in line with our Bank's vision. As an SFB, we have diversified into SME lending, Home loans and Deposits, but our core is still micro banking business. Given the micro banking specialization, the norms are achievable.

North East SFB

We believe the 75% PSL target of SFB is in line with the broad objective as loans are primarily catering to rural segment of customers and loans predominately are small ticket sized loans to agrarian, services and simplified industrial segments with a small portion of house building loans. Thus, PSL targets are in line with a vision of expanding NESFB and catering to the need of the segment. *SFB's only have to pay attention to the segmentation as per PSL norms as most of them were clubbed under Micro business segments.*

Suryoday SFB

Suryoday, like most other SFBs started with a majority microfinance portfolio which is its core strength and hence a target of 75% did not pose any challenge. However, as we move towards graduating these customers to retail loans, there may be a shift that some of the entities might need in future. The recent change in MSME classification could prove to be a useful intervention by the policymakers.

The non farm sector carries significant importance in Indian agriculture. It can play a vital role in doubling farmers' income in foreseeable future under Government's mission. *SFBs can play a key role in the non-farm sector by supporting dairy farming, poultry, sericulture, horticulture, etc., through attractive lending programs.* The semi urban and rural economy can immensely benefit from the growth thrust of SFBs with their ever expanding network of branches and appropriately crafted digital strategies.

Ujjivan SFB

Regulatory guidelines for SFBs mandate target of 75% of ANBC towards Priority Sector, as the primary objective for setting up of SFBs is Financial Inclusion by providing Banking facilities to Underserved and Unserved. RBI guidelines specify that " 'While 40 per cent of ANBC should be allocated to different sub-sectors under PSL as stipulated by RBI, the balance 35 per cent can be allocated to any one or more sub-sectors under the PSL, where the banks have competitive advantage' ".

Many of the SFBs have originated and transited from being Micro Finance Institutions, and the major portion of achievement of 75% of ANBC is through the Micro Banking segment. SFBs continue to operate in the Micro Banking Segment. *Since PSL targets are pegged at 75%, the scope of earning through sale of PSLC is lower when compared with the other scheduled commercial banks, where PSL target is at 40%.*

The challenge for the SFBs is the documentation for the micro customers, who may not be able to give documents as per bank norms. Most of them are daily wage/ low income earners and working in tiny jobs in unorganised sector, keeping a track of the documentation and record of the invoices like the traditional MSE segment customers is a difficult task.

Utkarsh SFB

As a Small Finance Bank, Utkarsh SFB focuses primarily on unserved and underserved segments of our country. Micro finance, financial inclusion and small ticket lending remain mainstay of our Bank. As a result, USFBL's priority sector compliant portfolio is always well in excess of the regulatory minimum requirement of 75%. While the PSL target for SFBs at 75% is significantly higher than that of 40% for Universal Banks, USFBL does not face any challenge in meeting PSL target on account its focus on financial inclusion and lending to underserved and unserved sections of the society. Despite such higher PSL target, USFBL has surplus PSL portfolio which is monetized through sale of PSLC certificate. PSLC lending rates are market driven rates and decided by market participants and depend on demand supply dynamics.

AU SFB

While Financial inclusion is defined as extending banking services to the unreached, at AU, it goes beyond. We understand their needs and partner in their success. Focus on Priority Sector lending sets us apart from other banks. It is our forte. Our reason to become a Small Finance Bank was simple - our business model is of Small Finance! Understanding the customer, adjusting our requirements, reaching the unreached are the important pillars of our Business and therefore our licensing conditions get fulfilled naturally and easily.

Lending to Priority Sector is our business model and is possibly one of the reasons why we got the revered Small Finance Bank License. Continuing our legacy, this year, AU Bank exceeded the requirements of our key licensing guidelines with ~85% loans to Priority Sector, ~60% of our loans less than 25 lakh and ~31% of our branches at rural locations. Yes, the priority sector norms are compatible to our business vision. We can continue to achieve a major portion of PS through funding income generating assets.

AU in its essence serves the segment which has a big unmet demand for financial services. We have around 61% of our branches in Semi-Urban, Rural and Unbanked Rural Areas. Through our distribution network we have always served customer profile such as Drivers, Small Transport Operators, Automobile Dealers, Kirana Shops, Hardware and Electrical Shops, Carpenter and Furniture works, Brick Making Units, Fabrication Units, Flour Mills, Educational Institutes and various other Small Manufacturers and Traders and they continue to be our target customer base even in our Bank avatar. In FY 19-20, 97% of the total number of loans disbursed were of amount less than ₹ 25 Lakhs.

Since we maintained average PSL of ~85% for FY 2019-20 against regulatory requirement of 75%, we had the availability of excess PSL portfolio over and above regulatory requirement with an option to capitalize through right mix of Securitization and PSLC. We issued PSL Certificates of ~₹ 5,710 Crore.

We got an opportunity to undertake a number of Financial Inclusion initiatives to the remotest corners of the country including patronizing and promoting key schemes of the Government of India, opening of several Basic Savings Bank Deposit Accounts, enabling Direct Benefit Transfer (DBT), organizing several financial literacy camps etc.

In this regard we would like to suggest that PSL guidelines for SFB should be at par with other scheduled (Universal) banks (other than 75% PSL targets): PSL classification in certain areas is distinct for SFBs; For example SFB is not allowed to classify on-lending to NBFC/HFCs/ MFIs as PSL for SFBs; Limiting opportunities to fund small NBFCs / HFCs / MFIs. Such conditions may be relooked. It will provide us a level-playing field to achieve PSL targets; More credit inflows to small NBFCs/MFIs / HFCs.

Capital SFB

As far as our bank is concerned, we do not face much of a challenge on this front. Majorly, SFBs have built their models in a way to maintain such high PS. As per the mandate for SFBs, the focus is more on the PS business where they do not have much option to enter into other high yield businesses if they want to enter. Being PSL at 75%, there is not much option left with the SFBs to sell off the PS loans to other banks. High PS can be an issue going forward; depending upon the impact in trail of Covid 19.

ESAF SFB

The prudential norms prescribed by RBI, for Priority Sector lending, for SFBs is a well-thought-out strategy, as SFBs normally operate in unbanked / underbanked territories. They enjoy the territorial advantage of dealing with such customers, in large numbers, who fall within the ambit of PSL norms. While it is incumbent on SFBs to allocate 40% to the PSL targets, to the sub-sectors, as per the RBI prescriptions, SFBs have the leverage of allocating the remaining 35 % to PSL sectors where they have a competitive advantage. Hence, meeting the regulatory PSL targets is not a challenge for SFBs.

As a major chunk of our lending constitutes Microloans, ESAF SFB is comfortably placed above the mandated targets. Further, it's in tandem with our long term corporate strategy and vision. The Participatory certificate is an opportunity for SFBs for monetising the surplus exposure in PSL. This is also a collateral benefit for the SFBs, for the concerted efforts put in by them to build up the PSL portfolio.

As our existing microloan customers are involved in various activities of Priority Sector, including those related to Agriculture and Allied sectors, through a proper grouping of customers, we will be able to meet our PSL sub-targets with ease. Mor Moreover, more than 50% of our Branches are in rural or semi-urban areas, where we will have opportunities to serve a new set of customers, who will also come into the ambit of PSL.

Fincare SFB

These norms are compatible to our business as our major lending is in to MFI loans. Most of the SFBs are lending their major portion to MFI loans and most of these are under PSL. Until SFBs continue lending to MFI loan segment it will be easier under the existing norms. The SFBs having surplus PSL above than the regulatory norm, are selling PSLC. In present scenario, there are no constraints to achieve PSL norms and we are well off in PSL achievement and there is no requirement to invest in RIDF NABARD for achieving the PSL purpose wise target. Further, we can design products in MSME which are also PSL as we move toward diversification.

Human Resources

Efficient and involved personnel are critical for the success of a bank. A perusal of few annual reports of SFBs in their websites indicate that there is a high churning of staff at critical positions in the banks while in the traditional micro banking area there is not much attrition? Similarly, perusal of data on staff in rural, semi-urban and metro branches of SFBs show[6] that staff in rural branches is less and a higher % of SFB's staff work in Urban and Metro areas. The cost of staff salary with SFB is much higher compared to PSU and Private Banks (Staff expenses[7]as % of total expenses was 16% in PSU, 11% in Private Banks and 22% in SFB).

How do you manage continuity in jobs? What are your HR constraints? Micro banking needs intense supervision which cannot be achieved without dedicated staff. Will digitalisation help in reducing staff cost?

North East SFB

The cost of human capital is challenging proposition as identifying talent at key positions is time and cost intensive proposition. To attract and retain such talents SFB has to offer upfront higher compensation and attractive long term benefits which leads to incurring front loaded cost for the bank.

At the same time, building local talent and growing middle management to handle top management norms faces challenges from RBI stipulations/ perspective of minimum exposure, experience and requirements for fit and proper criteria. *What is seen is that this issue created due to regulatory requirements lead to opportunistic employment scenarios and higher churning.* The traditional local talent at mid management is unable to fit in to Senior management role and a large quantum of cost gets escalated during the whole process. This needs to change as SFB needs intense resources which understand the regulatory, geographical and business market dynamics.

Digitalisation / Technology helps partially, but "man in loop" need of functionaries especially control functions with stiff requirement in terms of exposure and experience, leads to unavoidable staff costs. Regulatory relaxations in this regard would ease the SFB cause.

6. RBI dbie
7. Data source RBI

Suryoday SFB

It is too early to compare with established banks and arrive at conclusions. For us, it is critical to hire domain experts in banking as we establish ourselves and we treat it like an investment more than a cost or expense. Once on boarded, there are several initiatives that we take to retain our key personnel, including providing a non-hierarchical work environment and open communication, which are integral part of the culture. All these initiatives motivate the talented youngsters to contribute and grow exponentially with us.

Ujjivan SFB

SFBs are a new format of banking. There has been natural attrition in the critical roles, owing to retirement or, resignations for different reasons. Some churn is natural during the transition period. That said the SFBs are working towards creating an atmosphere, where it is easy for the new employee to adjust.

As per RBI regulations, SFBs are required to have at least 25% of branches in location that do not have a scheduled bank. Thereby 75% of the SFB branches are in urban, semi-urban and metro areas. The distribution of the staff in the branches follows the same. Rest of the staff is in the Head Office and Regional Offices, which are in the metros/urban cities. Thus the skew towards metros and urban locations.

The microfinance set up within the SFBs has a business model that entails a deep monthly touch point with customers. This necessitates a higher number of field workers. Moreover, the SFBs were formed in 2017. *There's been only 3 years of banking operation, which is in its infancy compared to the other banks. That has an impact on scale. In addition, automation and digitization are in process which will drive efficiency and productivity, leading to lower cost burden of staff salary. It is work in progress and will certainly help manage costs better in the future.*

Our hiring is driven by employee referral which is about 50-55% of new hires which is supported by a strong referral policy. This ensures good functional and culture fitment of the referred candidates. In addition to this we are an employee centric organization that offers great development opportunities and benefits. Employees are also encouraged to take on new roles and challenges.

SFBs are currently seeing a churn of people and often we incur costs hiring and training employees who leave. We are working on HR automation to build more sophisticated systems that create efficiencies.

SFBs are also spread geographically in semi-urban and rural areas that make availability of local talent difficult. Cultural assimilation is sometimes challenging since many employees come from Universal Bank set up. Many employees in Micro-banking take a little more time to up-skill on regulatory learning.

Utkarsh SFB

The overall attrition for Utkarsh is below the industry average when compared with SFBs due to high focus on employee voice and proactive measures to redress areas causing employee grievance. At Utkarsh, attrition at critical positions in the Bank is lower as compared to the attrition in the traditional micro-banking area. The reason for higher attrition in micro-banking is that a high proportion of micro-banking staff is hired as fresh graduates who at times find it difficult to align themselves with the job requirements especially in terms of working primarily in rural and semi-urban locations.

For Utkarsh, the %age of SFB staff working in rural and semi-urban locations is higher than that in urban and metro locations as most of the micro-banking branches and business portfolio of Utkarsh is from rural and semi-urban locations.

In order to maintain continuity of jobs, we consciously maintain bench strength of employees in entry level roles and encourage internal replacements for other roles. The key constraint faced in HR is finding quality talent with requisite skill set, especially at our rural and semi-urban centers.

The share of staff salary expenses as % of total expenses is higher at SFB on account of small ticket lending and borrowers largely being self-employed segment which require relatively larger workforce and more intense engagement with customers vs. corporate lending or lending to salaried individuals.

As of now, collections in micro finance lending are largely through cash collections at centre meetings. Digitalization of activities at field level specifically on the collection front will improve efficiency of our field staff significantly and reduce staff cost.

AU SFB

Since inception, we have stayed focused on building the right character of our organization and have been driven by the core guiding principles of AU Dharma.

Our people philosophy is anchored around three aspects – Build, Connect and Re-Imagine. These ethos are the cornerstones of our employee value proposition. It nurtures a culture of learning and growth; collaboration and building relationships to deliver excellence; and challenges the status-quo. Over the past several years, we have granted ESOPs to employees across levels; enabling wealth creation opportunities for them.

After becoming a Bank, the purpose of living our values and steering our passion further assumed a greater importance. I have come to believe that the banking platform tests all the capabilities of a professional. From building relationships to product development, from risk management to right governance, we are learning every day and they are our key assets in our journey.

Like any other bank, we also faced some challenges around attrition, especially at junior positions (there is no churning in the critical positions). To address the same, we have renewed our focus on people management and enhanced our focus on skill development. As we are growing and adding new people, we are swiftly integrating new team members with our timeless guiding principles of AU Dharma and 'sharpening the saw' by up-skilling and training our employees.

Over the years, we have been consistent with innovations at AU, to un-complicate our customers' lives and improve service quality. I believe in the power of technology to a great extent as it can help you find the solutions and distribute its' benefits at a very large scale in no time. Hence, technology will always be an enabler in the banking sector, and we will leverage it to enrich and strengthen our relationship with the customer. In fact, post Covid, digitisation is going to thrive, there is going to be better customer acceptance as learned during the aftermath of demonetisation as well.

Capital SFB

We have been in the banking industry for the past twenty years, first as Local Area Bank and then as the first Small Finance Bank of the country. We do not face any challenge as to attrition. The attrition rate for senior management for FY 20 is 0%. Rather, our strategy of local hiring has gone a long way in building a pool of leaders and family atmosphere where self-motivation and self-discipline is in our culture. We have one of the lowest attrition rates in the industry. SFBs are new generation banks, as far as, cost is concerned, with growing digitization and automation, it's bound to come down over time.

Equitas SFB

Since SFBs give a much smaller size of loan, they need to employ larger number of people. The productivity per staff for SFBs would be much lower than other banks since the loans volume per staff is small for SFBs. Hence this would be reflected in staff cost percentage also. It is part of the framework of such banks itself which are focussed on small value lending. Further the banks are still in their initial years and are making investments on new business verticals including liabilities. The investments are also significant in Human Resources, and the productivity of HR will increase over time. With higher productivity, the staff costs as a proportion will decline, but SFBS on account of the nature of customers that they target, will carry higher costs than the average Commercial Bank.

ESAF SFB

The salary structure in Public Sector Banks and most of the old Gen Private ector Banks are as per IBA standards. Staff in these Banks has a definite and gradual career progression without much extra or incremental cost in the staff expenses. Once in five years as per IBA revision, they get an increase in salary and perks. It is a gradual increase in staff expenses. Moreover, the number of people coming to these banks on lateral entry is very minimal. Whenever lateral entry happens in Banks, the remuneration bill shoots up. In these banks, people join to retire but in new-gen banks and a new type of banks like SFBs, they consider it as a stepping place to go for the next attractive place.

The market was open for all SFBs together in a period of 1-2 years. There was a dearth of good talents in the market and all the new entities were forced to offer very high packages in order to onboard good talents. Usually, the people coming on lateral entry gets a hike of minimum 20-30 % from their previous pay, and it accounts for a substantial amount in staff expenses. Being new outfits, incentives, performance pay and similar offerings are given by SFBs to retain and motivate employees. Productivity at the lower level is a big challenge as the staff is not used to pure banking and was mainly exposed to micro-banking, earlier.

Training is another aspect, which increases the cost of SFBs. The responsibility of giving multidimensional training for all staff, migrated from Micro banking remains as a huge staff expense.

Most of the workforce is in the millennial group, which does not believe in sticking on to a single job. For retaining them, the major challenge being faced by HR is in giving quick promotions and training. Here, employee engagement plays a significant role. An engaged employee gives better productivity. Still, cost is a factor for meaningful engagement programmes. Better Rewards and Recognition programmes also can bring in rich dividends, the millennials believe in more recognitions and admirations. So SFBs have to invest time and money for keeping them well engaged and also to retain them.

Another area the young talent will be interested in is to get continuous learning opportunities. Even though some of them may quit after receiving the best training, Bank can consider it as a social responsibility to contribute trained staff to the Banking sector.

Embracing technology is the only way to minimise staff strength. Definitely, in Micro-banking, digitalisation can bring sea changes in operating expenses.

Fincare SFB

The churn needs to be viewed in context of respective business line. E.G. in Rural Banking division where the business is primarily JLG lending in rural markets, customer engagement is ensured at more than 1 level viz. frontline staff as well as 2 levels in supervisory team. Also, the business is significantly tech-enabled, and transactions as well as account connect, as well as an independent servicing is done using a tab, reliance on any one individual is significantly lowered. As a result, the churn, which is primarily in the frontline staff, does not disturb the operations materially. Most SFBs have migrated from an NBFC-MFI and have acquired to a large extent, resilience and balance, when it comes to offering a seamless experience to the customer. The checks and balances in the form of a 2-level customer credit and audit structure is an added safety net and aids to the micro-supervision. At Fincare, Rural Banking is the largest division, comprising 53% of the total workforce as on Mar 31, 2020. The JLG portfolio comprises 80% of the Total Assets of the bank.

Regarding Staff Cost and Staff in Rural Areas

When it comes to the newer franchises viz. Mortgages and Liabilities, which are largely urban and peri-urban businesses, hiring, engaging and retaining the workforce is a clear priority. SFBs are a new entrant to these segments and the ability to build the right value proposition, set the right expectations and thus attract the right talent is a journey. Given that the employer brand takes time to establish, most SFBs, which migrated from a rural-only to a 'rurban' play, are taking numerous steps in order to establish themselves as an employer of choice. Having said that, the career opportunity with SFBs is one of a balanced of a challenging job, an accelerated career progression track and a high dose of pride in the business, along with salary and benefits having a reasonable mix of performance-linked pay. Since the manpower is an investment for the future, the trend on staff expenses as % of overall expenses is trending in the right direction. In addition to that, we are a door-step model and a direct model (not outsourced) – so staff costs become higher.

How do you manage continuity in jobs? What are your HR constraints?

As. Fincare SFB is a high-growth organization, the need for talent is ongoing and we continue to make investments in building a steady supply of right-fit candidates. As we have witnessed over the past few years, in the urban world, there is a higher propensity to relinquish the job at much quicker intervals in search of a better opportunity, than in semi-urban and rural markets. We monitor this churn very closely and work on mitigating potential impact on our customer value proposition. In our experience, there are geographical nuances as well with pockets with high degree of staff stability and others where output has lagged efforts. We welcome freshers with no market experience but the right intent and values to join us. The only limitation, or a focus area, if one may call, is that our urban presence is recent and we need to work hard in establishing the employer brand in this market. Once the first wave of growth is over and candidates in the market are able to see our people build a career, it would attract others, giving us a wider selection pool.

Will digitalisation help in reducing staff cost?

The one significant mitigant to any adverse impact of the churn is technology. Given that SFBs have only recently started their operations, the realization came early that technology is the passport to the future. By adopting modern, innovative technology solutions available in the market, SFB are agile and nimble institutions, representing the new breed of no-baggage, challenger banks, offering superior user experience and convenience to savvy customers. A toll free call centre, a Website chatbot, Internet and Mobile banking, and doorstep service to top that with, are strong enablers of this connect and continuity and we tick all these boxes. With the advent of online account opening, video-KYC, Aadhaar-enabled payment solutions, click-and-mortar (read digital-first) is the mantra. At Fincare SFB, we pride ourselves in having embraced these technology solutions early on and have emerged as a front runner in the category of digital banks in the country, both SFBs and private sector banks, put together. The payoff of the digital solutions are tremendous and not necessarily because it allows for lesser intake of manpower. The staff cost is a necessary cost and the bank does not necessarily believe in reducing that. However, the power to enable a productivity multiplier is immense and gives us tremendous confidence in the future of the bank. In the long run, by reducing reliance on a human being, and getting a favourable cost benefit is a promising development.

Jana SFB

One bank employee is required to cater to every 600 to 700 borrowers. *This SFB reality is not true for Public Sector Banks or Private Banks. Hence the staff costs are higher and will remain so.* These will start coming down as the MFI industry starts to digitalise especially Collections.

Small Borrowal Accounts and Credit Products

For financial inclusion to be achieved in real sense, small borrowers need loans for income smoothing as also for business and investments. These loans should be appropriate for their needs and specific to their cash flows. A bank should have it loan products appropriately designed to meet its customer needs. Moreover bank loan should be accompanied by other banking products. **Do you agree? Highlight some of your bank products (objectives and which of the borrower need it fulfils?) and how it meets with the aspiration of rural entrepreneurs?**

Suryoday SFB

One product we found to be most useful and suitable for microfinance borrowers is the Recurring Deposit because they were more comfortable with setting aside small amounts as savings on a regular basis.

Our T Nagar loan product provides access to credit to micro business enterprises at their door step, taking away their hardship of making rounds to the bank branches and submitting multiple documents for availing of a composite loan for investment as well as working capital.

Ujjivan SFB

Since our transformation into a bank, we have started a journey of encouraging banking habits and behaviour in 4.5 million underprivileged and underserved customers. We have done this with the help of various financial literacy programs, need-oriented products for customers, relevant high-tech delivery channels, customer engagement drives, and reliable customer protection policies. Ujjivan – true to its tagline – is indeed building “a better life” for the underserved sections of society. To adopt for changes in economy, the product philosophy of Ujjivan not only focuses on the underserved and marginal farmers living in villages but Ujjivan is taking into its fold the urban poor (lower income groups) who despite living in cities are living on the fringes of society. We have especially employed the strategy of catering to both the rural and urban underserved customer segments through need based product design.

Bank has designed products covering ancillary/ allied activities which support agriculture, Animal Husbandry and which align with investment requirements and income generated in such activities, for Rural segment which can be offered to Urban customers as well. Besides we have Business Loans and current accounts to cater the needs of Rural-entrepreneurs, who are primarily engaged in non-agricultural activities. We have recently launched Agri Secured product Kisan Pragati Card, one of the innovative banking products with an objective to enable farmers to meet their holistic credit requirement covering an array of agriculture and allied needs. Additionally to cater to the rural entrepreneurs Ujjivan has rolled out unique initiative like Kisan Pragati Club, which consist of 15-20 volunteer farmers to disseminate the principles of development through credit, inculcate better repayment ethics and promote customer's participation.

All these products and services are delivered by specially trained staff. In addition to handling loans, each of our field team members is equipped to offer complete banking solutions through products like saving accounts along with loans, term deposit at **attractive rates, micro-insurance schemes (for security of customer's family) through cutting edge technology using handheld devices with minimal paperwork.**

Utkarsh SFB

Most of our microfinance lending is towards income generating activities through Joint Liability Group (JLG) structure. Keeping in perspective, the need and aspiration of our micro finance borrowers about increasing the scale of their business, we have launched Individual Business Loan (IBL) product for our existing micro finance borrowers. Under this product we provide unsecured larger ticket loan to the customers who have good repayment track record with us. During FY19, USFBL also launched a "swacchata" loan product for construction / renovation of toilet by the borrower. This product is intended to improve the basic lifestyle and hygiene of our borrower. During FY20, we have also launched a 'two wheeler' loan product for our micro finance customers to make their transport convenient.

For our other retail assets (including MSME lending) customers also, the bank is in the process of launching various variants of working capital loan products and wheels loans.

AU SFB

As a NBFC, for over two decades Au Financiers provided funding for income generating assets to those who would otherwise find it difficult to get it. This way, we always partnered in their journey of sustainable growth. Right from the very start, we have been funding small borrowers and over the last 25 years we have observed that to truly create an inclusive environment the first step is to provide credit to such people. They use that credit to fund their small business, earn from those funds and meet their working capital needs. Besides, they save some funds in Banks, park some in investment instruments and use them for insurance and other services. To make them reach a point where they would be motivated to start Banking or make use of investment funds like SIPs or Insurance, it is needed that they generate sufficient income to take care of their daily expenses and still have some disposable income to deposit with Financial Institutions.

Since the inception of AU we have lived by the mantra of 'doing it now!' which has been instrumental in shaping of our vintage verticals. *We operate in markets where many do not have easy access to finance.* When we provide them funding, we actually become the enablers of their growth. Over the years we have been fulfilling this responsibility with a lot of passion. *We have a long and stable track record in lending small ticket, secured, retail loans primarily to un-banked and under-banked self-employed individuals for purchasing assets which will generate income.* Our retail asset segment includes our two key focus products - Vehicle Loans and Small Secured Business Loans to MSME. Let me share few customer case studies on how these products are fulfilling the needs of small borrowers.

Vehicle loan has been a key product since the beginning and is the most seasoned book in our portfolio. We offer one of the widest product ranges in the industry and extend credit to 2- to 22-wheeled vehicles for personal and commercial use.

Our customer Motilal Prajapati, along with his two younger brothers, used to do menial labor work as a means of livelihood. After many years of hard work, they could only open a small tea stall. They earned about ₹ 10,000 every month, which was still a meager income to support a family of 8 members including his wife & children, and the families of his younger brothers. So, he decided to start another income avenue and identified an opportunity. He could start transporting goods from factories to warehouses. However, he needed a vehicle for this and a loan to finance the vehicle. But who would finance a tea stall operator? For someone like him who lacked any paperwork and practically had nothing to give as collateral, AU Small Finance Bank turned to be the ideal support. He got the vehicle within 2 days and encouraged his younger brother to start driving it and become self-dependent. Both elder brothers could also save enough to get their youngest brother married and setup a tea-stall as a regular income source for him. Finally, the family income came up to ₹ 35,000 per month from ₹ 10,000 per month.

Secured business loans: MSME is our second most important product within the retail assets segment. Our loans primarily serve Micro, Small and Medium Enterprises (MSMEs) with annual turnover between 40 lakh and `10 crore. They usually have at least a few years of track record in such businesses and generate cashflows at high frequency and have limited or no formal documented income proofs (for example grocery/kirana stores, dairy/cattle rearing and hotel/ restaurants).

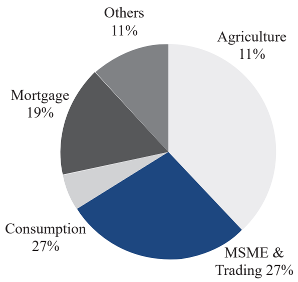
Our customer in Gujarat, Renuka Patel was earning ₹ 15000 per month as an employee in stitching factories. She started working at the age of 40. From being one of the workers in the stitching and embroidery factory of her husband's friend, she went on to become a supervisor in few years. With her hard work, within 6 years Hema was supervising work in 4 factories and even advised the owner on his business expansion. Eventually, considering her grip on the business, the owner offered to sell one of his factories to her and fuel her entrepreneur journey. Her husband and son were very supportive. She received funding from Au Financiers (now AU Small Finance Bank). Within first 6 months Renuka set up two business units, one for stitching & embroidery in Vastral, Ahmadabad and another in the nearby village of Mahijeda for making cloth bags. Her household income has gone up from ₹ 50,000 per month (including husband's salary) to over ₹ 1,20,000 per month. She is already employing more than 13 full-time women workers and 5-7 women who work from their homes in Vastral.

We have been consistently scaling up our customer centric efforts. Recognizing the need of our rural customers for consumer durables finance; the bank came up with a unique solution to meet their demands. The rural branches not only provided consumer finance loans but went one step ahead and acted as pick up center for the customers who could not get the goods delivered in their remote villages. Our customer is paramount to us and if the customer needs it, we will make it happen.

Capital SFB

We agree with your view that small businesses need loans to smooth income as also for business and investments. The understanding of the business cycles, customer needs, product innovation, and development of product as per the customer needs are the key. We continuously develop and create products and means to serve better our clients by understanding their needs. Our bouquet of products both on deposits and advances includes several customer driver initiatives where we have developed products to match the needs of our customer base.

Agriculture	MSME & TRADING	Mortgages
Kissan Credit Card	Working Capital Limits	Housing Loans
Agri Team Loans	Machinery Loans	Loans against Property
Commission agent Financing	Project Financing	OD agent Property
Avrage Ticket Size of INR 11.30 Lacs	Avrage Ticket Size of INR 16.2 Lacs	Avrage Ticket Size of INR 11.02 Lacs



Equitas SFB

Generally, all the borrowers of SFBs are micro entrepreneurs. They avail the loan and the same is used in their businesses. However the income generated from such *business may partly get deployed back in business while the remaining part may be taken out for family maintenance.* Most microfinance and tiny enterprise loans are rotated by the borrowers many times over during the period of the loan and that is how their livelihoods are supported. *The loan amount itself is a smaller proportion of overall annual turnover for many of these businesses.* It is natural for such borrowers to use some cashflows from business for purposes of a personal nature from time to time.

ESAF SFB

I completely agree with the statement that for financial inclusion to be achieved in the real sense, aspirations of small borrowers need to be addressed. 90% of India's workforce is in the informal sector and this segment lacks access to formal credit. We have been trying to bridge this gap, initially through microloans and now we have come up with several offering for this segment on the Retail Loans space. All our loans are designed with this segment in mind and therefore, we don't insist on documented income to appraise a loan application. Our Sales and Credit teams do income assessment of this segment of customers through personal discussions and arrive at loan eligibility.

We understand that credit to this segment will be the real driver of our economy since the aspiration levels of this segment are high.

We have the following products in the retail loan space:

- **Micro Housing Loan:** Micro housing loan is given to borrowers having no formal income. Income assessment is done by the Sales and Credit teams. We lend up to ₹ 20 lakhs under this product. This loan helps them to acquire one important element, out of the material Trinity of Roti-Kapda-Makaan
- **Loan against property:** Loan against property is given to customers who have no formal income documents to produce, but need working capital to start small businesses. The loan is sanctioned based on property value and income assessment. The maximum loan ticket size under this segment is ₹ 15 lakhs.
- **Three-Wheeler loans (Passenger and Cargo):** Three-wheeler loans are offered to first time users who wish to make a living by relying on three wheelers(Passenger/Cargo).
- **Light commercial vehicles:** Light commercial vehicle loan is also offered to first time users who wish to make a living by relying on light commercial vehicles.
- **Two-wheeler Loans:** Two-wheeler is the most desired mode of travel for this segment and our Two-wheeler loans help them address their aspirations.
- **Clean energy Loans:** We have loans for clean energy product like solar installations. This product not only helps in saving electricity but also impacts the planet positively.
- **Used Car loan:** Owning a Car is an aspiration for this segment. While they may not be able to afford a new Car, our used Car loan product helps them in securing a low end used car.

Fincare SFB

Financial inclusion is an all-encompassing objective. At one end there are borrowers. Their need is for income generating and special purpose loans which they can deploy and through their own skill and dint of hard labour, generate income producing assets. But a bank can go much deeper in terms of fulfilling felt and unfelt needs of financial services. The Bank is committed to providing the broad range of banking services to the unbanked and under banked customer segments for income augmentation or cashflow smoothing as also for business & investments.

- **Loan against Property (LAP):** It is a secured loan offering for Self Employed Professionals, Small Businessmen & Service Professionals such as Dairy/Tailoring/Hardware Shops, and Firms under Proprietorship structure (manufacturing/Service/Trading), Partnership Firms, Private Limited Companies and Salaried Individuals. The loan amount varies from ₹ 5.01 Lakhs to ₹ 50 Lakhs for a period of 84 months to 120 months. The bank additionally offers a Micro LAP product for ₹ 1.5 – ₹ 5 Lakhs amount for a period of 60 months. The end use for this product can include personal as well as professional use which may include but not limited to Working Capital/Business Expansion, Asset purchase (e.g. cows, machinery- etc.), Renovation/Extension of House/Office/Shop/Factory, Debt consolidation, Education or Marriage. The Bank captures the end use of all LAP cases in the Loan Appraisal & Recommendation Note and end use letter is obtained from the customer.
- **Loan against Gold (LAG):** It is a secured loan offering for individuals businesses and businessmen for personal or professional use. As a part of the product upto 75% of the value of the gold is provided ranging from ₹ 5 Thousand to ₹ 25 Lakhs.
- **Shakti Saving Accounts:** We open Savings Account called Shakti Savings account for all our MFI customers. This Savings Account comes with a Debit Card. This enables MFI customers to withdraw the disbursed loan amount anytime from ATMs/ any other facility as per their requirement. This process created customer delight by removing unnecessary hassles. The same account is linked with DBT as per customer's preferences.
- **DBT and AEPS:** Direct Benefit Transfer (DBT) and AEPS facility is enabled across banking outlets in order to provide a complete range of financial services specifically to rural customers. This is playing a key role in current situation when the Gov't is providing relief measures through DBT apart from other subsidies.

To meet the borrower's cash flows for shopkeepers / retailers, we have introduced daily and weekly cash flow products.

To meet the agriculture customer needs we offer loans focussed on dairy industry wherein the loan amount suits the purchase of cattle and repayments are fortnightly.

For our Group Loan customers, we have Individual business loans which are available after their first cycle and help them from tailoring to weaving to small tiffin and other businesses.

North East SFB

NESFB has loan offerings that cater to client needs:

i. **Micro Credit Loan/Income Generation Loan:** This loan is tailor made for the business need which caters the requirement of the niche portion of the society/bottom of the pyramid. This is typically a group loan.

ii. **Micro Business loan:** This loan caters the needs of the street Mudra Segment who are basically street vendors, road side sellers, pullers etc.

iii. **Entrepreneur Development loan:** This is the loan for the Micro enterprises for upliftment of their business.

Vision

Most of the CEO's of SFB are part of the promoting team. Their decision to convert NBFC/LAB to a small finance bank or promote a SFB should be part of their 'promoter's vision'. **As you look back over the last few years, are your vision/dreams getting realised? What is your wish list on policy changes or environment to realise your vison.**

Ujjivan SFB

Bank is successfully aligned to the goal of Financial Inclusion; we could enrol our underserved and unserved micro banking customers into the Savings Bank and Term deposit products, by introducing savings habit to them.

The additional support required are on the areas of

i. **Increase in the Loan amount qualified for PSL and the Annual household income for JLG (Joint Lending Group):** The loan component for Individual borrowers may be enhanced from ₹ 50,000/- to ₹ 1,00,000/- and the annual household income may be revised to ₹ 1,25,000/- and ₹ 2,00,000/- for rural and non-rural areas respectively.

ii. SFBs may be permitted for incentivizing customers for prompt repayment of loans under digital channels through cashless repayments. Under the current scenario of Stress in the economy owing to Covid 19 Pandemic, this will not only encourage our customers for prompt repayment but also helps in aligning with the Government`s initiative on digitalization.

Utkarsh SFB

The banking platform provides us huge opportunity in the form of penetrating the banking and financial services to the underserved and unserved sections and geographies of the country and at the same time offering our unique products and services to the customers across the country.

As a microfinance company, Utkarsh was primarily engaged in providing micro finance loans to bottom of the pyramid customers. After conversion to a Small Finance Bank, Utkarsh's product profile got expanded significantly and also includes liability products such as Saving account, Current account & Term deposits. The Bank has been able to offer these products to its existing as well as new customers.

Presently, as per the Operating guidelines for Small Finance Banks dated October 6, 2016, SFBs are permitted to participate in securitization market only as originators and providers of associated credit enhancements and liquidity supports. Further, as per the RBI Master Direction –PSL for Small Finance Banks dated July 29, 2019, SFBs are allowed to invest in the securitized assets representing loans to various categories of priority sector, except 'others' category only the specific purpose of meeting the sub targets of PSL. Allowing SFBs to invest in securitization transaction will be supportive in SFBs efforts to maintain a risk diversified loan book. RBI has issued draft norms in this regard; clarity and final norms are awaited.

AU SFB

We transformed ourselves into Bank in April 2017. With more than two decades of proven track record as NBFC in secured retail asset lending, it was a natural progression for us, yet we had made several underlying assumptions and had our own reasons to become a bank.

On the Banking platform, with every passing day, we see these underlying assumptions and reasons are coming true. We realise the magnetic pull of this powerful, deeply trusted, preferred and holistic platform and its' scalability. *It has got natural entry barriers and substantive regulatory environment.* It has perpetual existence and is synonymous with money. Now that we have completed three years as a Bank, I believe, that we have found the real purpose of our existence in financial services spectrum. By becoming a Bank, our longstanding efforts have got a meaningful direction and our path has become clearer as to where we must go. As a MD & CEO of a 25 years old institution but more importantly of a three-year young, fresh, and vibrant bank, I feel privileged to have got this opportunity.

As an organisation, we see both positive and negative sides of the current environment and events. However, we remain focused to see the positives in negative, maintain our integrity and grow the right way. Banking is gradually undergoing a structural shift wherein increasingly customers are preferring and transacting with private sector players and we will continue to be one of the major beneficiaries of that. It is now our job is to sustain this trust and build a franchise that lasts forever. In these times, we are fortunate to have this banking platform. As bankers we find an opportunity to build trust and make the world a better place again. I believe banking will evolve to build bridges for a sustainable world. We have always focussed on growing the right way to build a resilient institution that can withstand the test of time. Being a young bank with no legacy, we bring fresh approach to the table by leveraging the wisdom of old and energy of young.

In our journey of FOREVER, we had a profound realisation that a *Bank matters beyond the Maths.* We appreciated the value of a Banking platform by being part of the essential services. This institution is more than risk and returns. It is the fulcrum of the economy.

Capital SFB

The dreams are high and large. We are striving hard for them and taking strides in the right direction. We need the guidance and encouragement from the regulators to develop into stronger, resilient, bigger and sustainable organization by allowing our management and promoter team to keep putting their best to serve the society and achieve financial inclusion along with realizing their own dreams of making it large in the banking industry.

Equitas SFB

The play of SFBs has been good so far, leading to RBI making new licenses for SFBs on tap. The overall regulatory support has been pretty good for the SFBs. At this early stage of growth of SFBs, it is difficult to point to any policy change as critical for realising the dreams of SFBs. Regulator has been receptive, accommodative and incrementally refining guidelines in the light of growing experience of the SFB segment.

ESAF SFB

In retrospect, I am very happy and satisfied today as the founder of ESAF SFB. In 1992, when ESAF was launched, as an NGO, our dream was to transform communities through self-reliance. To achieve this dream, we started Micro-Enterprise Development programs in 1995. Microcredit was an integral part of the whole scheme. In order to attract more funds and serve more people, we moved to a regulated NBFC Structure in 2008. After serving the people as an NBFC-MFI, we realized the importance of holistic development through value-added services, other than monetary support. By giving mere financial support, we were not able to fulfil the aspirations of our customers. In several other geographies, I have seen the impact MFIs could create by becoming a bank. Hence, I started dreaming about ESAF becoming a bank and by sheer providence; I was able to fulfil my dream in 2017. Today, we have completed three years as a bank and I am happy to see that the businesses of our borrower groups are growing. Now, they don't need to go to other banks for other banking facilities. We are now able to meet all their financial requirements like savings, money transfer, insurance etc. SFBs in the present form need more comfort and pliability to execute the plan RBI has visualized. SFBs are small in size but larger in their efforts to cater to the sectors unattended by Commercial Banks. The role of SFBs cannot be bracketed with the role being played by big Banks. *SFBs need hand-holding and guidance, that should be viewed from the prism of small-credit complexities.* Likewise, tax sops shall be the right step, which could bracket them with new manufacturing concerns. SFBs play a key role in alleviating deficiency of capital for entities like small artisans, small traders, small farmers etc. By offering tax sops to SFBs the lending capabilities of SFBs can be augmented, and they will be able to offer more attractive rates than what is prevalent.

SFBs should be treated separately and should be recognized along with platforms available for poverty eradication and environment protection, with an adequate guarantee from Govt. and quasi Govt. organizations, which run programs. If that happens, we can dream of a country which is more inclusive and planet-friendly.

Fincare SFB

Our dream is to make a strong presence in country's banking ecosystem and keep aligning banks offering to the evolving needs of our existing and potential customers. With every decision we take at the bank, we are progressing toward realizing that dream. The bank received "Scheduled Commercial Bank Status" last year. We made significant progress on key business and operation metrics variables. Apart from offering microloans, our product offering has expanded to include 5 other distinct business vertical offering loan against property, institutional finance, loan against gold, 2 wheeler loans and affordable housing finance. The advances growth last FY was 74%. Secured assets currently accounts for more than 20% of total advances. Return metrics have been very strong with ROE at 18.4% and ROA at 2.64% after Covid provision. Our liability franchise grew by 125% in FY20 with a focus on building granular retail deposits which stands strong at 77%. We have opened Saving accounts for more than 1.5 lakh mass retail customers, ~2.5 lakh 101 Digital Savings accounts and more than 22 lakh Savings Account for MFI customers. Today, the bank has a strong network 712 banking outlets in 14 states and 2 UTs. We have remained committed to compliance, governance and transparency in our business activities. Fincare has established a very strong platform which is well positioned for the next stage of growth with strong foundations of scale, geographical reach, systems & processes and leadership.

From a policy perspective it is quite important that SFBs are recognized by the Govt and the regulator as distinct banks focused on Financial Inclusion.

Jana SFB

SFB is a successful idea and what needs to be worked upon, is the next phase of growth. The policy direction to look at SFBs in terms of reducing cost of deposits through Government / Institutional support can be of a big help.

North East SFB

Our Vision is based on the broad objective of financial inclusion and becoming the last mile connect for the under banked and unserved segment of the society. As we are about reach almost 3 years of operational existence we have covered some solid ground in achieving this objective. *We have been successful in establishing our branches at remote locations and principally 70% in rural places.* Thus the infrastructure and associated processes, technology, human capital and customer connect has been slowly established with NESFB brand at field level. We believe we are poised to capitalize on these pillars and will be able to achieve the broad objectives in coming time.

At the same time substantial work needs to be completed for the formation of NESFB foundation for social upliftment & client developmental activities. This will be our prime focus within next 3 years

Suryoday SFB

As a As an NBFC- MFI we could serve only the basic financial needs of the customers, but the banking license *has given us an opportunity to provide holistic banking to customers.* From the policy perspective it is important that the government forms committees within the purview of the regulators to effectively deal with black swan events.

Governance

Bank governance is a challenge because there are many regulations and guidelines issued by the regulators. The expectations from Governance are high. The Board of the SFBs should have a majority of independent Directors says RBI. It is seen that currently the number of directors of SFBs range from 7 to 10 of which independent directors were 5 to 8. There are a few nominee directors as well. A perusal of management information given in bank websites show that independent directors are ex-bankers and almost all have banking and finance experience. SFB Boards have constituted all essential committees.

Bank Governance is broadly concerned with making policies, strategies, business plans and about review, monitoring and control and compliance. It is recognised that policies are to a large extent be guided by regulatory guidelines and therefore board's role becomes more operational in nature in terms of planning strategies, business plans, products and geographies to be pursued. They have a very crucial role in supervision and control and ensuring compliance. A perusal of performance of the 10 SFBs in terms compliance (all of them are fully compliant from regulation perspective) financial performance, growth rates, product and geographies pursued would show that Governance is indeed different from bank to bank.

As SFBs' are private commercial banks all norms applicable to commercial banks are applicable to them as well. Governance has to be very effective to navigate the banks in difficult times.

In this background we asked the banks to rate their banks governance? Is it compliance oriented? Do you undertake professional pre-meeting briefing to directors on important issues as all of them may not be fully aware of banking nuances in depth?

Utkarsh SFB

We believe in following highest standard of Governance. Our Board comprises seven Directors of which four are independent, two are investor nominees and a Managing Director & CEO. The Chairman of the Board is independent and non-executive director.

Compliance is very critical control function of our Bank. The Bank has a full-fledged and separate team for compliance function. This Independent Compliance Function in Utkarsh SFB strives for best in class Compliance practices to be followed in the Bank. The Compliance Department of the Bank acts as a focal point for receipt and dissemination of all statutory, regulatory and internal guidelines and instructions in the matters of compliance among all Business departments / Operations units.

We also undertake professional pre-meeting briefing to concerned directors on all important issues.

Overall, we believe that Governance and Compliance have to be of the highest order irrespective of the size of the Bank and follow the same.

AU SFB

Governance functions play vital role in strategic decisions of the Bank. We have an independent Risk, Compliance and Audit Function with unfettered access to the Board. The Compliance function tracks all regulatory compliances and ensures timely implementation in the Bank. The Internal Audit provides independent assurance on the design & operating effectiveness of internal controls through a Risk based audit approach.

Often when companies prepare business continuity plans (BCP) or discuss force majeure, the general sense is that they might never have to enforce these plans as such situations will never arise. However, in a very short period of last four years as SFB we had to, on a few occasions/ situations (amidst the Corona virus scare) take action based on BCP. This is giving us a whole new perspective on risk management and helps us realise 'risk appetite' of our lending strategies in real terms.

Bank is a synonym of hope & trust. It gives *hope* to people that whenever they want to move ahead in life, they will be monetarily supported by the institution called Bank. People trust us with their hard-earned money, which they want to save for their future or business, for livelihood, for education, for family or for retirement. They trust us with their future and our bank is led by a Board of

Directors which is uncompromisingly committed to keep their trust intact and ensure sound corporate governance practices. Our Board comprises of majority of Independent Directors (6 independent directors) and the new additions in the last year took the strength of board to 9 members from 7 members in FY19 end. We do undertake professional pre-meeting briefing to directors on important issues and time and again we have received guidance and support from them.

We are listed at both the leading exchanges viz. NSE and BSE. We have consistently maintained a high external credit rating from all major rating agencies like CRISIL, ICRA and India Ratings.

A testimony to our robustness are awards at national platforms which includes Golden Peacock Award for Excellence in Risk Management – 2019; Golden Peacock Award for Excellence in Corporate Governance – 2019; ASSOCHAM SME Excellence Award 2018 (SFB category) and Best MSME Bank-2018 (SFB category); ET Now BFSI Award 2018 'Bank with more rural branches'.

Capital SFB

We are a professionally driven two-decade old banking entity with huge emphasis on following highest standards of corporate governance and compliance. The Bank has 13 Directors on Board, out of which 7 are independent directors and 2 directors are qualified under proviso to Section 10A(2)(a) of the Banking Regulation Act, 1949. Further, the Board of Directors of the Bank satisfies the compliance with Section 10A of Banking Regulation Act. We do undertake professional pre-meeting briefing to directors on important issues. Moreover, we keep our directors well versed and trained with latest developments in the industry so that they can provide professional and forward looking guidance.

Equitas SFB

Governance is the same for all banks irrespective of nature or size. Any bank which accepts public deposit has to be put through the same level of scrutiny and governance framework. Hence the SFBs' governance framework is no different from universal banks. And the directors on the boards of SFBs in my view are no less experienced or capable than directors on the boards of universal banks and hence there is really no difference in approach here. Our bank has apart from the Managing Director only one non-independent director. The remaining eight are independent directors with a record exemplary performance in their fields in public and private sector. The depth of banking knowledge with these directors and their efforts to keep themselves abreast of financial sector and banking developments have been significant.

ESAF SFB

Effective Corporate Governance is critical to the proper functioning of the banking sector and the economy as a whole. Performance of banks is crucial to the economy as they intermediate funds between the depositors and borrowers and channelize the funds to activities that support enterprise and thereby help to steer the economy forward. The soundness of banks and their safety are very important to financial stability. Hence, the manner in which they conduct the business is central to the economic health of the country. Governance weaknesses at banks, if any, can result in the transmission of problems across the banking sector and the economy as a whole.

The primary objective of corporate governance should be safeguarding the interest of the stake-holders in conformity with public interest on a sustainable basis. This clearly states that the interest of the depositors takes precedence over the interest of the shareholders.

It is in this backdrop the regulator looks at the Corporate governance structure, framework and its implementation in a Bank. The BCBS has also recommended that the implementation of this principle should be commensurate with the size, complexity, structure, economic significance, risk profile and business model of the Bank and the group to which it belongs. This means making reasonable adjustments as and where appropriate for Banks with the lower risk profile, and at the same time being alert to the high risks that may accompany more complex and publicly listed institutions.

As directed by RBI, the majority of the Directors are Independent Directors, who are qualified / experienced in the areas like Banking, Finance, Rural Banking, Agriculture, MSME, Accounting etc. which is a prerequisite for selecting Directors. The most important committees of the Board like Audit Committee, Risk Management Committee, Nomination and Remuneration Committee, IT Strategy Committee etc. are represented mainly by Independent Directors, who also chair those committees. In this way, the Bank ensures full compliance with the regulatory guidelines. All the issues are placed to the Board / Committees for detailed discussion and the guidance of the Board / Committee are taken on all important aspects of the Bank. Every Director has the freedom to express their views independently and decisions are taken in all the meetings in a collaborative manner.

Fincare SFB

As SFB I would rate our Bank's governance very high with our deeply involved independent Board. The Bank is committed to ensuring and implementing the highest standards of corporate governance principles and practices. The Bank determines the composition of the board of directors to cater to the interests of the company as well regulatory requirements. The Bank has optimal combination of executive directors, non-executive chairman, non-executive directors and independent directors to meet the needs of the Bank as well as in compliance with the provisions of the Companies Act, 2013, the Banking Regulation Act, 1949 and the directions issued by the RBI for small finance banks.

During the year, the Bank has strengthened its Management and Board Committee framework and documentation processes to ensure superior governance standards. The quality of the compliance documentation has improved tremendously. Monitoring and evidencing has been carried out vigorously. *We also implemented CERMO+, an online tool for monitoring and driving a compliance culture, across our all branches and BC outlets.*

The Board has constituted audit committee, IT strategy committee, customer service committee, risk management committee, credit approval committee, nomination & remuneration committee, corporate social responsibility committee and fraud monitoring committee to take informed decisions in the interest of the Bank and to establish best corporate governance practices. The Board meets regularly, and the agenda of the meeting is decided in advance. Professional pre-meeting briefing is done as required.

Jana SFB

We would rate our Bank's Board and Governance to be the best in class standards. This is based on the professional qualifications, experience of Board members and the manner in which the Board is conducted.

North East SFB

Governance is an important aspect and cannot be diluted at all. *At the same time, relaxation of extending of age requirements of independent directors as well as MD and CEO till 75 years could go a long way.* This is because SFB requires guidance role from the distinguished professional directors who meet fit and proper criteria as led down by RBI but constraint of age limit lowers the scope of attracting such key talents to the bank's board. We feel that having 25% of representation of promoters in board and remaining 75% members to be professionally experienced independent directors would help sharper shaping of SFB and better governance. This increase of age to 75 years and 25/75 composition of nominee/ independent member for board would pave way to better governance norms with the broad objectives in mind.

Suryoday SFB

The Board of Suryoday is quite diverse and the Directors hold substantial banking and financial service experience. Strong governance and transparency have been our key building blocks. The organisation has significant emphasis on compliance culture appropriate for a well run banking enterprise.

Ujjivan SFB

The composition of the Board of Directors of the Bank is governed by the relevant provisions of the Companies Act, 2013, the Rules made there under, the Banking Regulation Act, 1949, Securities and Exchange Board of India (Listing Obligations and Disclosure Requirements) Regulations, 2015 (Listing Regulations) and the Articles of Association of the Bank. Our Board has an optimum combination of executive and non-executive Directors. The Board presently comprises of 10 Directors and possess a diverse combination of professionalism, knowledge, expertise and experience as required in the banking business. We recognise and embrace the importance of a diverse Board in our success and are endowed with the appropriate balance of skills, experience and diversity of perspectives, thereby ensuring effective and strong corporate governance. The Board provides strategic direction, plans and priorities of the Bank, monitoring corporate performance against strategic business plans, overseeing our operating results on a quarterly basis to evaluate whether the business is being properly managed, overseeing our Corporate Governance framework and supervising the succession planning process for our Directors and Senior Management.

Bank's Management has easy access to the Board for any guidance that they may need. The Bank's Management also engages with the Board regularly and keeps them informed with a monthly update covering all aspects of the Bank including Business, Compliance, Risk, Finance etc. Bank's Management also reaches out and connects with the Board Members and keeps them informed with matters relating to Finance, Risk, Compliance etc prior to every Board Meetings.

Growth and Market Share

Based on an annualised growth of 33% in the assets under management (AUM) in the first 9 months of Financial Year 2019-20 recorded by SFBs, rating agency ICRA (as reported by ET) expects small finance banks (SFBs) to grow at a compounded annual growth rate of 25% to 30% thanks to diversified loan growth, deposit mobilisation, improving asset quality and better return on equity. Our analysis shows that the Banks have grown @ 42% in the year 18-19 and 37% in the year 19-20. Within this, the growth rates are not similar among banks as can be seen from the data below.

Table 4.1: Growth Rate of banks 2019-2020

Item	AU	Capital	Equitas	ESAF	Suryoday	Fincare	Ujjivan	Utkarsh	NE	Jana	Total
Capital & Reserves	38	63	22	21	21	36	7	32	4	55	28
Deposits	35	21	20	63	79	128	-83	38	233	130	31
Borrowings	20	17	29	-29	13	7	159	87	-32	-29	32
Other Liabilities	-11	-99	22	7	-6	6	1078	96	-38	13	-2
Cash & Bank	29	3	-5	23	-39	645	174	22	28	-56	38
Investment & Deposits	61	21	40	13	78	-5	16	114	117	103	50
Advances	18	27	19	44	30	74	33	35	-3	60	30
Other Assets	23	7	22	45	32	14	10	65	35	-6	19
Total Assets	29	23	23	34	41	71	34	51	17	50	29

In this background CEO's of banks highlight their performance in the last few years and also project where they will be in 2025.

AU SFB

FY 2019-20 marked the completion of 12 quarters, for us, as a Bank. Last year (19-20) was a year of great slowdown, where the economy seemed to be headed for the intensive care unit. Despite these headwinds, we did our work right and grew steadily. Our team's energy and execution orientation enabled us to win through a balanced approach. *We are growing in assets, growing in deposits while maintaining good asset quality, and managing risk.*

We clocked a growth of 16% in our new loan disbursements resulting in a strong 27% growth in our Assets Under Management to ₹ 30,893 crore. *Alongside this, despite a challenging environment in terms of slowing macro, outbreak of Covid-19 and transition to daily reporting of NPAs, we have maintained stable asset quality due to which our Gross and Net NPAs were 1.7% and 0.8% respectively.* This is due to strong collections and recoveries through the year. We scaled up our deposits franchise to over a million customer accounts and our total deposits rose 35% in FY 2019-20 closing at ₹ 26,164 crore. Return on Average Assets (ROAA) was 1.8% and Return on Average Equity (ROAE) was 17.9% for FY 2019-20. Like all Small Finance Banks conceived with the intent of driving financial inclusion, we have made our presence felt and have been growing in our market share steadily in the last four years of our existence.

I am happy that, currently, we are leading the SFB pack with a share of 42% in Deposits and 33% in Advances[8]. We are completely aligned with the Government of India & RBI's broader perspective of growth, inclusiveness, last mile access to credit, asset quality, easy & low-cost credit flow to MSME sector and understand our accountability as responsible banker.

Our vision for 2025 - *to be the world's most trusted retail bank and coveted employer that is admired as the epitome of financial inclusion and economic success, where ordinary people do extraordinary things to transform society at large, thereby guaranteeing Trust, Confidence and Customer Delight.*

Capital SFB

The Bank started as a Small Finance Bank on April 24, 2016 with 47 branches and have expended to 150 branches as on March 31, 2020 out of which 131 branches were in Punjab, 11 in Haryana, 4 in Delhi, 2 in Chandigarh and 2 in Rajasthan. During the last 4 years of journey, as on March 31, 2020, the loan book and deposit book of the Bank has grown at a CAGR of 34% and 23% respectively. Capital SFB is retail centric organization with more than 90% of retail deposit and an overall deposit ticket size of around ₹ 60k. The average ticket size for loan book is also around ₹ 11 lakh with 98-99% secured book. The Bank is in growing phase and is opening new branches in a consistent and

8. 42% in Deposits (26,164 Cr out of total deposit base of SFBs of 62,507 Cr) and 33% in Advances (30,893 Cr out of total advances of SFBs of 94,919 Cr) – Source RBI, data as on 31st March 2020

strategic manner. Bank is moving towards more of digitalization gradually and all the factors should eventually result in high revenue numbers.

In 2025, we foresee Capital SFB, one of the most dominant Banks in the entire North India with outreach in all parts of the Country.

Equitas SFB

As per annual report "With the build out phase behind us, we now see operating leverage playing out. We clocked a 31% growth in advances and 26% in deposits excluding CD, while our cost-to-income ratio improved by 390 basis points to 66.38% in FY20. Our Profit Before Tax (before provisions and write offs) grew 40%. Asset quality remained steady through the year, with Gross Non-Performing Assets (GNPA) at 2.72%."

ESAF SFB

Our growth rate till March 2020 was 47% CAGR on Advances (AUM) and 158% on Deposits. Our Market share as on March 2019 was 7.6% in deposits and 8.8% in Advances. We observe that our growth rate during the past was above the average rate of growth of SFBs[9].

AUM CAGR growth for ESAF SFB from Mar-17 till Mar-20 is 47%, for the same period the CAGR of deposits grew by 158%.

Year	AUM ₹ Crore	Deposits	AUM Growth	Growth Rate of deposits
Mar-17	2137	409		
Mar-18	4087	2523	91%	517%
Mar-19	4972	4317	22%	71%
Mar-20	6818	7028	37%	63%
CAGR	47%	158%		

The market share of ESAF SFB, among SFBs in advances is 7.6% and in deposits is 8.8% as on Mar-2019 (source RBI - Report on Trend and Progress of Banking in India- 2019)

9. Bank cannot make any predictions on future growth or market share as it is in the silent period in connection with its impending IPO.

Fincare SFB

Our advances grew by 74% and deposits grew by 125% in FY20. Our Deposits and Gross Advances are expected to grow at a CAGR of ~20-25% from FY20 – FY25.

Jana SFB

Currently we are amongst the top 4 players in the SFB space. By 2025 we will be a full suite bank i.e. all products catering to the lower and middle class in India across most States in India. We will be digitised to best in class globally and will be a preferred employer.

North East SFB

Our aim and aspiration are more in line with the broad objectives of SFB formation. Competition, market share and aggressive business growth among SFBs operating in different geographies / nationally makes it necessary to pursue our vision closely. We aspire to reach certain benchmarks by 2025 as mentioned below:

i. Balance sheet size of ₹ 10,000 Crore.

ii. Market share of 3% of advances and deposits in North East.

iii. Network of 350+ branches with 66% rural representations with first preference of unbanked areas.

iv. 20 lakh customer base for the bank

We are aspiring to build NESFB *as a one stop financial shop for rural economy which* will cater the savings, credit, investments and Insurance and become the last mile connect of such people with formal banking eco system.

Suryoday SFB

Our growth rate is in line with the market and our portfolio has grown at 25% year on year basis as at end of March 2020 and deposits grew by approx. 79%. *Our Bank has been gradually diversifying into the retail segment which accounts for approx. 20% of the book. As per our strategy we will increase this share gradually in systematic manner*. The SFB sector is at a nascent stage at present and each player has its own USP where it has clearly outperformed others. Every bank has its key focus areas to scale up. By 2025, we envisage ourselves as a Bank catering to multiple segments of the market while *offering customised products digitally*. We cherish the simplicity that we offer in our products and services to our customers as a significant value proposition. This is the core of Suryoday which puts the customers at ease.

Ujjivan SFB

We plan to be the best mass market bank by *providing the best in class products and services to 40 million customers over next 5-7 years.* This will be a 8-fold increase in our current customer base. We also plan to provide insurance and other value added products to all our customers. We aspire to become a large mass market bank creating significant impact in the area of financial inclusion, hence our strategy is to scale up and reach out to a larger customer base with well-designed suit of products and services, using modern digital channels, rather than vie for a market share.

Utkarsh SFB

Our Bank's Asset Under Management grew by 40.5% during FY20 to ₹ 6660 crore as on March 31, 2020. *USFBL's growth at 40% in AUM is higher than SFB industry average of close to 30% during FY20.* Our market share (estimate) in advances of SFB's is more than 7%. *USFBL's loan book could cross ₹ 30000 crore mark by 2025.* USFBL's deposits grew by 38% during FY20 to ₹ 5235 crore as on March 31, 2020.

Strategies

Strategies are important. Strategies will differ from bank to bank and time to time. Every SFB faces competition from many banks, financial institutions, NBFCs and Fin-techs. All of them can be partners in business as well. Strategy will decide where to compete and where to partner. Products or processes can be strategies as well. In this background it is interesting to know that each bank has certain specified focus and strategy. It is not expected that banks will share their strategies in detail. Yet a glimpse of their strategy will make interesting learning.

It is important to note that banks treat their customers as partners in progress which is indeed a good strategy. It can also be seen that some of the strategies are (i) offering higher interest rates on deposits, (ii) focusing on some geographies, (iii) digital push, (iv) offering as many verities on each purpose of loan as possible, (v) door step banking, (vi) employee engagement, (vii) strict compliance and (viii) pursuit of assets in areas of comfort like micro credit, SME etc.

What are the strategies of Small Finance Banks? Let's listen to the CEOs

AU SFB

We have always challenged the 'status quo' to simplify banking for our customers. That is why we could design a bank that is focused on paperless banking; that provides freedom to customers with 'no home branch' concept; that offers extended banking hours for customer convenience; and monthly interest pay out on Savings Accounts. It is our endeavour to carve a strong identity for ourselves in the banking space which stands for *'trust and customer-centeredness'* and sustains for ages to come.

We are building a Bank that our customers always wanted. By listening to their needs, paying attention to their wants & catching their imagination, we have been taking consistent steps and are continuously focusing on deepening our understanding of our customers. We restructured our product portfolio in line with our customers' perspective - Personal Banking & Commercial Banking. Further to give focused attention we have categorized our geographical presence into two groups – Urban and Core locations. Each location has its own diversified market base, customer needs & requires its own unique way of delivery. We are committed to playing on our strengths and delivering delight to our customers.

We believe that the customer needs to be profitable and we could make him profitable by creating a pool of revenue around him. We are aware that merely offering a single product at competitive and reasonable rate may not make him profitable but by offering multiple products, for instance, a current account, an insurance plan and a loan all at reasonable rates, we could create a pool of multiple revenue streams and work to achieve the customer level profitability. We are determined to comprehensively understand the customers and make revenue pools around them.

The key differentiating factor is the power of imagination coupled with the power of execution. The differentiation starts with getting our priorities right in today's world of imperfections. It all depends on how well one reads the environment and accordingly strategizes and aligns the necessary resources. There must be an absolute understanding of the market segment that one operates in. I think Retail is all about Detail. One needs gain precise understanding of its geographies and cater to its specific requirements; *understand their customers by graduating from KYC (know your customer) to UYC (understand your customer) & understand what inputs need to be in place to achieve the desired output. And of course, the most important differentiating factor is our passion and the patience in pursuit of our purpose.*

We believe that a right combination of Data, *Digital and Distribution* will allow us to deliver Delight to our Customers and help us differentiate between ordinary and extra-ordinary banking.

Capital SFB

Capital SFB is working on the motto of *"Vishwas se Vikas tak"*. Our Bank is built on trust and performance. The Bank has been nurturing its business model, product line, along with its vision and mission statement to provide world class banking services at affordable prices even to under banked and unbanked customer base for achieving financial inclusion in true sense. The Bank embraces challenges and carves out its strategies making optimal use of its inherent strengths to meet the challenges. The customer oriented approach with transparency and humane touch has been the hallmark of the bank. The business model built on continuous innovation and product development as per the customer requirements has been the key strategy of the Bank.

ESAF SFB

Our strategy revolves mainly around our *culture, ethos and values*. When you dissect that you find a customer-centric approach, guided by our core value *'servant leadership'*. We want to deliver our brand promise *'joy of banking'* across all our touch points. We want all our customers to experience joy, for which we have developed *responsive products and superior service*. We want every customer to feel the value proposition that we put forward. At the end of the day, we need to make our customers loyal to us. Loyal customers can act as ambassadors, and they can bring us more new customers. In addition to the products and service we deliver, customers can also be (indirectly) part of the social initiatives of the bank. The model that we pursue is difficult but not impossible to make it happen. I think we are on the right track in building a unique social organization.

Fincare SFB

We strive to become a banker of choice for customers in some of the segments we operate. We are working to achieve the same through our 3D strategy i.e. *Digital, Doorstep and Distribution.*

- **Digital:** Digital-first philosophy has been the core of the bank and driver of all business operations to make banking faster, simpler, and more secure for the customers. We promote cashless banking in true sense that more than 98% of asset and liability customers are on boarded through digital channels. The disbursals, account opening, KYC Validation, all are instant. More than 2 lakh customers have opened Digital 101 Savings Accounts completely online till May 2020. We are on leadership position in conversational WhatsApp Banking amongst all banks in India. We continue investing on digital product offerings that are scalable and improve customer experience. We are strengthening our automation and analytical capabilities to identify new segments and for cross-sell. We are building comprehensive digital stack for the next stage of growth to provide seamless experience to customers.

- **Doorstep Banking:** Our strong digital core enables transparent banking and instant account opening at time and place of choice. *Service requests of customers are being fulfilled at their doorsteps without any hassle and need of visiting the branch.* Providing more avenues of hassle-free service to customers will be our focus areas
- **Distribution:** We strive to transform our distribution network rapidly for range of asset and liability products through newly launched Connect Application and through various digital channels to penetrate deeper in existing markets and explore new markets. The Fincare Connect mobile application, which is available on Play store, is for lead generation. The enrolment of Connector partners (Freelancers, DSAs, brokers etc.) is done digitally end to end. The leads updation by Connector Partners and acknowledgement to customer is instant.

Jana SFB

Customer connect, *multi channel customer service*, door step banking, pricing of credit, deposits and services, pleasant banking experience and partnering borrowers in their time of need are our strategies to create a strong impression and attract customers towards us.

Suryoday SFB

The SFB's operate in a very large market and each has enough space to carve out a niche for itself without getting into a negative cycle of unhealthy competition. Our strategies are segment specific and it is *our endeavour to be a wealth partner for our customers. Our products are developed after analysing the customers' needs and we are committed to deliver a superior customer experience. We are collaborating with Fintechs and investing in tech solutions.*

Ujjivan SFB

Being a Small Finance Bank, we are focused on serving the mass market, especially those who are financially underserved and unserved. *Our focus is to introduce digital products to our customers through digital inclusion.* We wish to offer specialized mobile Banking, UID, and digitalize loan repayment. Under the current economic scenario, the socio-economic development of our country is improving the economic conditions of the people and also building aspirations of a better life. The new technological developments such as mobile on internet, UID, advent of payment platforms etc. are changing the banking behaviour of the customers and the penetration of these is also increasing at a fast pace. The largest portion of India's population is moving towards the middle of the income 'diamond' having come above the poverty line and continuously striving to attain better livelihoods and living standard. This creates a huge opportunity for specialized banks such as SFBs, though they have to compete with each-other, the incumbents such as existing banks and NBFC, and new entrants such as FinTechs.

Our strategy is to deep dive into the catchment areas of our branches by providing best in class products and services to the target customer segments. We carry out extensive customer segment mapping in our branch working areas, supplemented by market research carried out by reputed specialized agencies. We use this information to enrich and expand the basket of products and services, creating a range which is comprehensive and need based. *We have specialized business verticals taking care of Micro-Banking, Agri& Allied Banking, SME, Affordable Housing, Personal Loans, Vehicle Loans, Institutional Deposits and Lending, Digital Banking, Insurance and other 3rd Party.*

The focus of service quality and giving utmost priority to customer experience is a trait we have inherited from our parent; we have a dedicated service quality team with dedicated staff in every branch. In order to serve our customers, we have put in place modern channels- *Mobile Banking, Internet Banking, Phone Banking and SMS banking which function in multiple regional languages. We are also working on specialized Voice-Video-Vernacular mobile application for the microfinance customer segment.*

Our continuous focus on technology, digital and analytics helps us to serve our customers better and achieve efficiencies in operations. In fact, one of our competitive advantages is the program to acquire a large number of customers using digital platforms and serve them digitally.

In order to strengthen our relationship with the customer, we have come up with *Family Banking program* which entails understanding the varying needs of the family members of our customers and serving them with right products and services.

Our large network of branches in 24 states & UTs enables us to provide services to the customers end-to-end, in their native places to the place of their work which could be even in a different state. Similarly the range of products of varying ticket sizes helps the customers to find a suitable product as they grow their businesses and incomes.

Financial Inclusion activities undertaken by our bank help in development of banking behaviour amongst the customers who have had so far minimal or no banking experience. This program has been running since the inception of our parent organization and with time has become more modern and now uses digital platforms as well.

Utkarsh SFB

The Bank will continue to focus on financial inclusion, *serving underserved and unserved sections and rural and semi urban locations*. Focussed approach towards our customers, suitable product offerings, quality and ease of services through our physical infrastructure and digital offerings are our key strategies to attract more customers to our Bank. Also, the bank enjoys healthy customer connect and will strengthen that further. The Bank is also focussing on significant use of technology specifically in hinterlands of the country which relatively lacks technology access.

Through the Looking Glass

Small Finance Banks are growing steadily yet not all of them grow at the same rate. They are all making profit, again not all at the same rate. They are all not of the same size either and the business and product mix varies from bank to bank. Between March 18 and March 20 the SFB sector has grown by 89 % with growth of individual banks ranging from 33% to 128%. Seven of these banks have more than doubled their total assets in three years. The NBFC MFI turned SFBs (eight) continue to have a high quotient of group loans. It is also noticed that all these banks have extended a line of credit to other MFIs'. Branch expansion of SFBs is rapid and all of them have the latest in banking technology.

> A Small Finance Bank may choose to continue as a differentiated bank. If it aspires to transit into a Universal Bank, such transition will not be automatic, but would be subject to it applying to RBI for such conversion and fulfilling minimum paid-up capital / net worth requirement as applicable to Universal Banks; its satisfactory track record of performance as a small finance bank for a minimum period of five years and the outcome of RBI's due diligence exercise. On transition into a universal bank, it will be subjected to all the norms including NOFHC structure as applicable to universal banks.

Discussions with these banks reveal that they would all like to grow and become Universal Banks. They are all firm that even when they become big they will continue to have a higher quotient of small loans. They all have some concern about risk management and regulation. Currently their cost to income ratio is high due to initial investments on establishing systems and procedures, need to maintain many specialized staff/departments and cost of compliance.

It is expected that, as they grow the cost to income ratio will come down but will continue to be higher than that of bigger Commercial Banks and Universal Banks as long as the loan ticket size is small and the proportion of microfinance loans is high the credit portfolio.

Currently SFBs maintain more than the required level CRAR and also a higher Tier-I ratio. These banks offer a number of variants in deposits to suit their customers and have also started diversifying into other credits. Contrary to the initial apprehension that it may be tough to mobilise deposits, they have been able to mobilize good amount of deposits and the name 'Small Finance Bank' has not been a deterrent. Evidently their core competency is working with small borrowers, small and micro enterprises/businesses and economically vulnerable people. Indeed a *differentiated mission.* Are the present structure, regulation and systems sufficient for them to grow and continue playing an important role in financial inclusion? Let's peep into future.

Size is Critical

Small Finance Banks are Private Commercial Banks. Some of them have grown aggressively in the last three years and four of the SFBs account for nearly 3/4th of the current business volumes of all the SFBs. Regarding the term 'small finance bank' contrary to their initial apprehension it is now seen that there is good acceptance among people and name is not a constraint. These banks are aware that name is not about their size but the size of loan or means of people with whom they will work. It is now clear that these banks will grow and will not remain small in size for a long time. In this connection it is worth recalling here a statement made by the Review Group on the Working of the Local Area Bank Scheme (constituted by RBI) which had observed that '*whether it is rural banking or any other segment of the financial sector, size, whether in terms of capital base or totality of operations as reflected in the balance sheets, is of critical importance*. Size in terms of capital and balance sheet size is critical though bigger PSU banks have been able to manage huge NPAs and write offs [10]technical or otherwise and been able to comply with CRAR norms due to recapitalisation of nearly ₹ 3.15 lakh crore by Government of India.

10. Public sector banks have written off bad loans worth ₹ 1.94 lakh crore (March 19). Data compiled by Bloomberg Quint.: https://www.bloombergquint.com/economy-finance/public-sector-banks-write-off-a-fourth-of-their-bad-loans-in-fy19

That size is important can also be inferred from the fact that even as Small Finance Banks have been licensed, regulatory push seems to be in favour of big banks. The pursuit is for institutions which are 'too big to fail' which means that *big banks should not fail or should not be allowed to fail*. In view of this the regulatory norms and oversight are rather tight on all types of banks. Of course, in the case of smaller banks regulators are trying proportional regulation but yet they seem to nudge banks to consolidate. There is however no ideal size. As such Small Finance Banks will grow and will not remain small. Apparently there are no restrictions on the growth of Small Finance Banks. In the normal course, after 5 years of existence RBI will take a view and then approve if these banks can become Universal Banks in the private sector.

Will all the 10 SFBs become big Universal Banks? In this regard it is worth noting that both the high power committee on financial sector in their 'A 100 small steps' and the internal committee of RBI on 'Banking structure in India- the way forward' have pointed out possibly some of the SFBs may fail. This is not surprising because banking is like any other business and business losses can lead to discontinuance of business as evidenced by certain failures in the banking industry over a period of time. Such business losses could be on account of market forces, business cycle events and mistakes deliberate or otherwise. A quick look back will show that there have been, in the recent years many mergers in the private sector banks either due to growth aspirations of some banks or due to resolution efforts of RBI wherein weak or about to fail banks have been merged with bigger but not necessarily stronger banks; a case in point being merger of United Western Bank with IDBI bank. In fact among the new generation private sector banks that commenced their journey in 1993 less than half are around today. One of the somewhat mid size new gen private banks was in the news recently as it faced many difficulties including high NPA and inability to comply with stipulated CRAR[11]. In the case of new generation private banks it is also noticeable that banks

11. Yes Bank, a medium-sized private sector bank, first ran into trouble following the central's bank's asset quality reviews in 2017 and 2018, which led to sharp increases in its impaired loans ratio. It is reported that the bank under-reported Non-Performing Assets to the tune of ₹ 3,277 crore in 2018-19. Despite continued poor performance, the RBI did not place the bank under the Prompt Corrective Action framework and chose to move directly to a moratorium. https://www.deccanherald.com/business/business-news/explained-what-went-wrong-with-yes-bank-811559.html

promoted by financial institutions have a higher survival rate than those are promoted by others. This clearly brings to focus that size both in terms of capital and balance sheet is critical for banks survival and banks should have capacity to manage adverse situations. Having adequate capital and ability to raise capital or funds are important for banks. These aspects will be, going forward critical for SFBs. SFBs should therefore carefully and strategically plan their growth.

Box 5.1: Vision of SFB CEOs on Transitioning to Universal Bank

It is well recognized that SFBs cannot remain small in size for ever. Also as the financial inclusion objective is very large more number of Small Finance Banks may be established. In this background we discussed the growth strategies with the banks. Firstly they all pointed out that the word "Small Finance" in their name is not about size and they will definitely grow big. In fact, the current surpluses in CRAR maintained by them are strategic and will enable them high growth in the next few years. They were categorical that even when they become universal, their DNA will be of small finance. The % of small finance in the bank could come down but it will be still be substantial. Banks will take up other advances as well but even after growing big they may not be keen on loans and advances of size above ₹ 500 Million.

They point out that when they become big the regulatory norms of commercial banks will apply which means Priority Sector will be 40%. Therefore these banks hope to do PSLC for the remainder 35% and earn good fee. This can be a good source of fee income as long as these banks are able to achieve a higher PS ratio than stipulated. Of course small loans are their forte. They have noticed that big private banks start with corporate banking, and then move to retail banking and then to small loans. Small loans more a compliance than an objective of setting up the bank. On the contrary SFBs have started with small loans, will move to retail banking and may then move into corporate finance more out of need to have a well diversified portfolio. Even then corporate folio will be small. For these banks small finance is main business not a compliance issue.

Bank Size and Financial Inclusion

The recent initiative of consolidating the PSU banks is mainly focused on consolidation and reaching critical size. Currently 7 PSU banks account for about 92.5% of the total PSU banks business and the other 4 account for about 7.5%[12]. In the Private banking sphere

12. Author's estimate by projecting March 19 data

7 banks account for 86.1% of the business and the remaining 15 account for 13.9%. It is estimated that (based on data as of 2019 and factoring mergers completed in PSU space recently) some 11 big banks could be classified as systemically important (D-SIB) as against 3 banks as of 2018.

Table 5.1: Market share wise Break-up of Banks

Share in total Assets of the banking system %	PSU	Private
2% and more	7	4
1% to 2%	3	4
Less than 1%	2	14 + 10 SFB

In this background it is important to ask - Will size impact financial inclusion?

One of the objectives of licensing Small Financial Banks is giving a thrust to financial inclusion. As all these banks were, before becoming bank, extending small loans, small business loans and MSE loans they have not faced any difficulty in achieving the mandate of 75% of their advances under priority sector and that 50% of their loans should be of loan size less than ₹ 25 lakh. In fact small loans are more than 90% with these banks. As they grow they will continue to finance more of small loans though share of small loans in total loans will come down.

Chart 5.1: % Share of small loan accounts & amounts in the Bank's Portfolio 2019

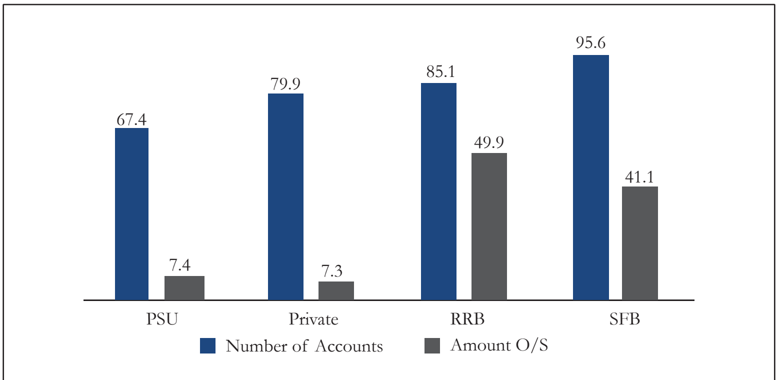
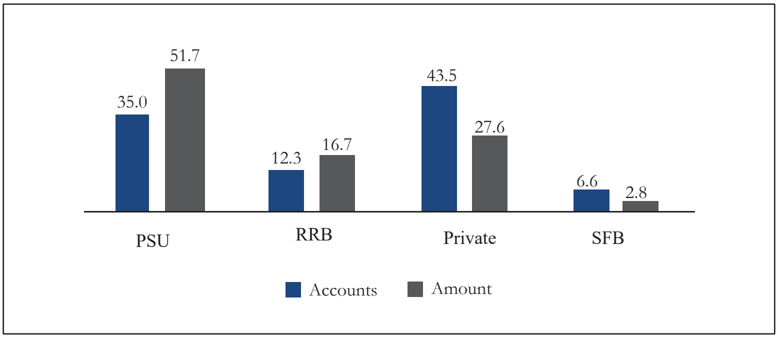


Chart 5.2: % Share of small borrowal accounts of banks in the banking system-2019



Financial inclusion is a national programme and all banks are implementing it. In fact PSU banks and Private Banks have financed a large number of small loan borrowers. Data as of March 19 shows that Private Banks had a larger share of small accounts than PSU banks whereas in the case of PSU banks their share in the amount of credit outstanding was higher, possibly due to higher agriculture loans. RRBs have, despite large number of branches and long years of existence only 12% share in number of small accounts. It should however be stated that the scope for inclusion is much larger. This can be inferred from RBI data[13] which shows that over the last decade 600.4 million SB (basic) Accounts have been opened against which only 6.4 million accounts have been extended over draft (OD) facility. This shows that while large number of deposit accounts has been opened credit inclusion is not of equal level but much lower. Thus there exist a huge potential and need for credit inclusion so that economic status of the target populace can be improved. To achieve these banks should have resources and be willing to extend credit customised to such people and businesses. These are all pointers to the fact that for *achieving financial inclusion size of the banks is critical*. Given that a large number of people are not yet credit included all banks big and small has a definite role. **As such even after becoming big, small finance banks can play a crucial role in financial inclusion.**

13. Table IV.6: Financial Inclusion Plan: A Progress Report (End-March 2020). RBI annual report 2020

Risk Management

The key words are "Risk Management". No one including the regulator say 'Don't take risk'. Everyone asks banks to 'Manage Risk'. From the angle of stability, regulator has given some boundaries such as exposure limits, LCR, LTVs, margins, spreads etc. This is because there can be no banking if there is no risk. When a bank accepts money (deposit or borrowing) from a large number of people and extends credit to a few or invests it takes risk. When a bank borrows short and lend long it takes risk. Risk is inherent in banking as they intermediate for funds and trade in markets where prices and rates vary not only due to demand and supply but also due to many known and unknown reasons. Technology has also brought in many new risks which are grouped under cyber risk.

Whatever is the size of a bank, risk management is important. Risk management is a set of policies, rules and processes that a bank uses to identify analyse and manage risks such as credit risk, operations risk, market risk, liquidity risk, cyber risk, systemic risk etc, which may impact the business performance. Of course one must not forget compliance risk which has come to centre stage these days and is concerned with non-compliance and/or not reporting compliance to norms, regulations and conditions which could lead to monetary penalties and other complications leading to, at times suspension of business activity. Risk has to be managed by managing business mix, implementing appropriate strategies and taking corrective action.

There is a general perception that regulation helps in risk management. This may be so, though the major emphasis or objective of regulation is financial stability and not the stability and/or profitability of bank. Objective of regulation is to ensure that banks have sufficient resilience and do not fail and therefore the financial system runs smoothly.

Small Finance Banks have a large number of small accounts including group loans which are not secured. The quality of these assets are known to be affected by events like introduction of GST, Demonetization and Covid related lockdown which are known to impact the turnover and cash flows of businesses and reduce the borrower's (individual or unit) ability to repay. Banks which are efficient in collection of dues during normal times may not be able to do so in the event of a downturn due to stress faced by the borrowers or socio-political reasons. It is also seen that in some of the government sponsored schemes wherein collaterals

Table 5.2: Provisioning for NPA[15]

(₹ Crore)

Year	AU	Capital	Equitas	ESAF	Fincare
17/18	71.41	37.74	189.91	32.43	40.32
18/19	131.22	63.20	110.52	101.29	40.07
19/20	214.18	37.74	158.30	61.90	48.46

Year	Jana	NE	Suryoday	Ujjivan	Utkarsh
17/18	1655		19.37	45.36	
18/19	1380	5.25	25.06	52.51	56.32
19/20	230	8.35	70.23	108.73	28.35

are not permitted there could be high defaults. For example in one of the banks, it is reported that MUDRA[14] loans caused huge losses. As such they have a higher probability of credit risk.

Generally banks which have just commenced operations, delay in repayment or default will be very low and as such provisioning in the first few years will be low. But in the case of some of the SFBs due to the loans which they had financed earlier and which continue in their books they have been facing stress in the last few years due to above mentioned reasons.

A view about the extent of credit risk can be had from the provisioning data (Table 5.2) of SFBs. **SFBs should therefore be aware that credit risk is the major risk faced by them and accordingly develop their business plan.**

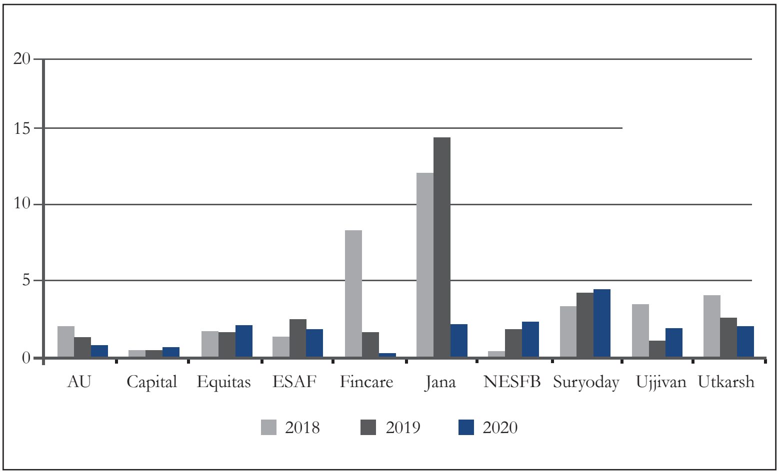
NPA Norms

On account of Covid related slow down, currently banks have been advised[16] that '90-day NPA norms' shall not apply on standard accounts and there will be a standstill on asset classification of such standard accounts during moratorium period' and that banks shall not charge penal interest rates on default, if any. It may be recalled that when GST was introduced (2018) there were some temporary relaxations in terms

14. https://www.financialexpress.com/industry/banking-finance/mudra-loan-bengaluru-based-small-finance-bank- -has-second-highest-npas-under-mudra-scheme/1652802/
15. From the financial statements of the bank given in their websites
16. RBI/2020-21/16 DOR.No.BP.BC/3/21.04.048/2020-21 August 6, 2020

of number of days of default before an account becomes NPA in the case of MSME accounts[17]. Given this, once things become normal banks will have to restructure existing loans while continuing to lend to the borrowers.

Chart 5.3: Provisioning as % of Total Assets



The borrowers of SFB are from the bottom of the pyramid and the loan product and repayments are appropriately structured. In this regard it is observed that, currently NPA norms are kind of 'One size fit all"[18] and uniform across banks, geographies and size of loans be it big or small. But microfinance/small loans have a development objective and are more prone to cashflow variability therefore there is a case to reconsider NPA norms. To illustrate this let us consider a grocery shop in a village and a big wholesaler in city. Currently both are subject to same NPA norms, despite apparent differences in the business volumes and cash flow pattern. Naturally the wholesaler, in most cases will have

17. RBI/2017-18/129: DBR.No.BP.BC.100/21.04.048/2017-18 dated February 07, 2018.
18. Today Banks are not allowed to deal in NPA by themselves and have little flexibility hence the small loans suffer and big borrowers (at least some of them) take great advantage. In company form of organisation the limited liability clause protects the promoters/directors whereas in small loans the borrowers business and personal assets are not spared. Managing Non-Performing Assets. Need to de-stress process. Author: Dr. R Bhaskaran. FIAKS Feb 2018.

a better ability to manage a downturn than the small grocery shop owner. This can also be seen in the case of milk chain. Both the dairy farmer and the dairy which processes and sells milk and milk products are subject to same NPA norms, if they borrow from the bank. If the grocery shop and dairy farmer suffer a setback they will need additional funding whereas the wholesaler and dairy may have deep pockets and may at best need short term funding. However, currently unless allowed by Regulator banks have no flexibility in NPA norms and cannot vary it even for genuine disturbance in the cash flow of the borrowers. This can be clearly seen from the fact that had RBI had to issue specific relaxations in the norms due the GST and Covid related issues. This situation must change.

NPA norms are indeed necessary and banks must follow transparent norms such that the books are 'true and fair'. At the same time uniform and inflexible norms across all types and sizes of customers are not appropriate. SFB Bank's board should be allowed to adopt norms suitable to their customer profile possibly within a range based on size and type of facility. One way forward could be for **the Regulator to specify a range based NPA norms and allow each bank to work within those norms with a proviso that NPA norms cannot be varied frequently. This will ensure that complicated risk events are better managed and that the banks are able to take commercial decision to finance or not finance a defaulting borrower without waiting for regulatory clearance. In case of small loans nursing of genuine loan accounts will be important as most of these loans are unsecured and therefore have little scope for recovery through legal processes.**

It must be added here that it is too early to predict how Covid will affect though it is clearly seen that in the last quarter of 19-20 and first quarter of 20-21 banks have witnessed decline in the growth rate of deposits and Credit and also small decline in the deposits.

Chart 5.4: Amount and Growth of Advances of SFBs

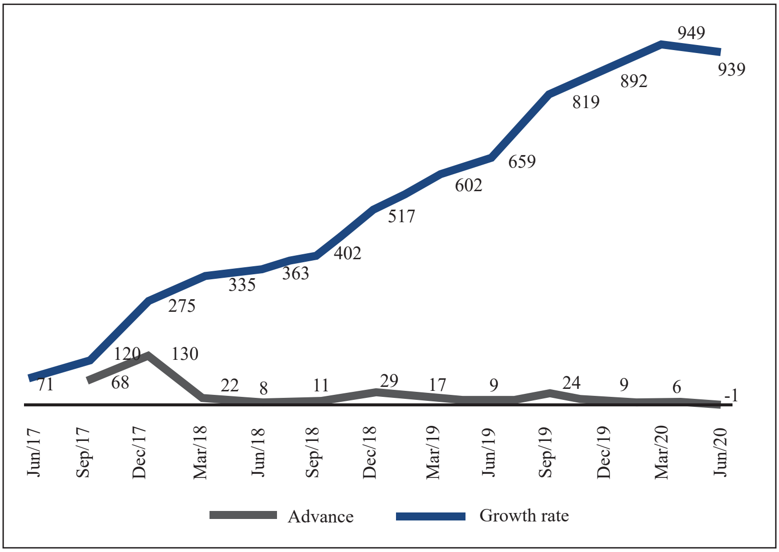
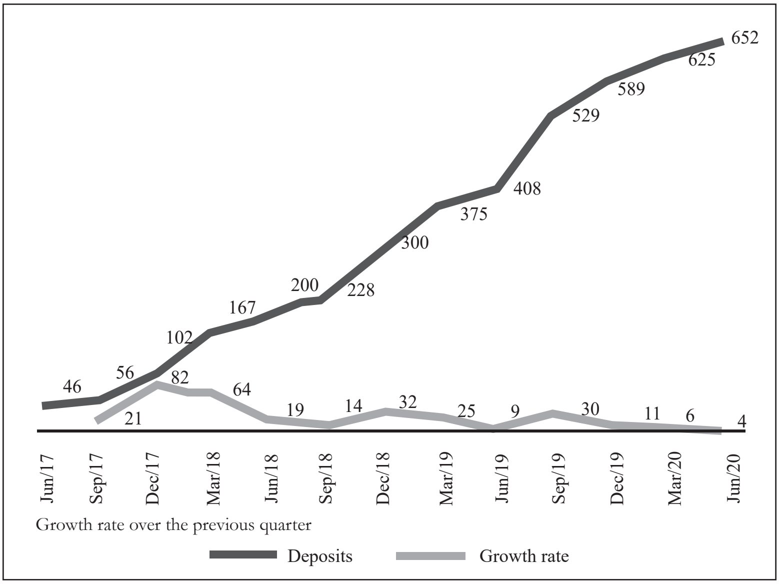


Chart 5.5: Amount and Growth of Deposits of SFBs



A scrutiny of various market reports, reports by financial firms, credit rating agencies and credit bureaus shows there is a possibility that corona related lock downs will have greater impact on the low and middle-income individuals and small businesses who are incidentally primary targets for the SFBs. It is observed that daily wage earners, self-employed individuals and businesses other than essential commodities have suffered substantial business slow down and losses during this period. Evidently this will reflect in SFB's collections. RBI has granted temporary relief to banks and borrowers in the form of term loan moratorium. This may be extended for further periods. However it may take a longer period for the business people to recover and there could some asset quality deterioration in the year 20-21 and thereafter.

SFBs may have faced some slowdown in disbursements in the first two quarters of 20-21, which has been spent in lock down. While the Economy has gradually opened up by September 2020 it is apprehended that even after the restrictions are lifted, consumption and growth could remain subdued. The slowdown will affect the group loans, and retail loans more importantly housing and vehicle loans. SFBs have shown good growth in deposits but it is likely that 20-21 may not see much growth.

SFBs have certain responsibilities towards depositors and need to keep a close eye on liquidity particularly at the time of events like Demonetization and Covid. Deposits have been growing and banks should strive to ensure that nothing untoward happens which will impact depositors faith or trust in the bank. This is particularly important because loans are about 70% of the total assets and microfinance loans (JLG loans) account for about 85% of the total loans. As such anything that will negatively impact the loan portfolio will impact liquidity. And the current climate has drawn attention to the high risks associated with priority sector lending. Given this, it **is worth creating a liquidity fund to help the banks in such events.** The SFB association which has been formed recently can play a role in creating such funds

One of the key differentiators of SFB from Universal Banks is the personalized customer service that SFBs are offering especially to the marginalized and excluded in the form of home/village visits not only for loan collections, but also for deposits or enabling transactions. This will be the USP of Small Finance Banks. Another key feature of SFB operations is the concept of monthly meetings wherein banks organize activities like free medical check-up etc. These are socially oriented yet offer business opportunities. These meetings help in collection and marketing as well. Of course, in the first two quarters of 2020-21 such personalized service and monthly meetings were impossible. Pandemic has impacted the way banking is done and on-line business is picking up. There will be change in the way people bank. Activities such as monthly meeting, bank officials going to customer's house to handle cash etc., may not be possible to the pre-Covid levels till vaccination for the disease is found and implemented though banks have in the recent months resumed these activities with sufficient precautions. SFBs will have to develop appropriate strategies to navigate the slowdown and maintain credit quality.

Regulation and Compliance

Over the past decade, more particularly post Global Financial Crisis regulatory norms have become global, more pronounced and more focused on risk management. Though it is said that Regulation is differentiated and proportional most norms, as indicated earlier are applied to all banks. It seems that the norms for small banks and other niche banks are arrived at by some (+) or (-) Universal Bank norms. Noticeably within a banking group the norms are kind of 'one size fit all' despite apparent variations in size, market share, geographical limitations if any and type of customers served etc., of individual banks. Also among the norms it is in capital adequacy where proportionality is evident and not so much in NPA, Exposure, LTV[19] and other norms. Capital Adequacy has an impact on the financial leverage of the banks and thereby on their size and growth. It does not impact the customers whereas other norms particularly NPA, Exposure, LTV, EBR etc., have impact on the customer's account.

In a BIS speech it has been mentioned that 'The objective of good regulation is and has always been to prevent economic bubbles from forming as far as this is possible and - if a crisis is unavoidable - to limit its impact on the general public and the economy'. On the

19. As a part of risk management risk weight guidelines by RBI.

other hand, an INSEAD Professor of Banking and Finance[20], in his white paper titled "Banking regulations after the global financial crisis, good intentions and unintended evil", says that these regulations may safeguard banks (banking systems) from future meltdowns but the economy could suffer because credit flow could be severely curtailed. It is also said that 'Anyone wanting to live in a completely risk-free world would have to accept much less dynamic economic growth[21]'. The extent of regulation is such that today banks could often find that they have money but cannot lend due to regulations. The dilemma is what is the correct/appropriate regulation? What constitutes a proportionate regulation? Which of the regulations are appropriate and which are disproportionate?

What is important from the perspective of SBFs is that regulation could slow down credit inclusion. Not surprisingly, the issue that the SFBs have raised in their meetings with the regulator[22] and being debated across the globe is proportional regulation. Currently regulation is somewhat proportional in the sense among banking groups there are certain differentiations but within a banking group the norms are 'one size fits all'. The real issue is not 'proportional regulation' but 'appropriate regulation' as there are definite expectations from the bank from the economic development and country's growth perspective which are part of financial inclusion objectives that regulation will be proportional and appropriate to the size and objectives.

The primary objective of regulation is financial stability. SFBs are subject to regulations on Capital Adequacy which is higher than other banks, IRAC norms including NPA, Exposure Norms and many more. Both GOI and Regulators also pursue the goal of financial inclusion. If these banks grow they will automatically move into Basel III framework and if they are efficient they will find Basel III easy to manage though they will be less systemically important. (based on RBI published

20. https://knowledge.insead.edu/node/629/pdf.
21. Speech by Dr Andreas Dombret, Member of the Executive Board of the Deutsche Bundesbank, at the 21st Colloquium of the Institute for Banking and Financial History (IBF) "Ways to a stable financial system", Frankfurt am Main, 23 November 2017
22. Annual Small Finance Banks CEO's Conference Organised by ACCESS ASSIST. Hosted by College of Agricultural Banking (CAB) April 12, 2019 and previous edition of the same conference

data (March 19) and factoring subsequent mergers etc it can be said that there are 18 banks (PSU 10, Pvt 8) which have a market share of more than 1%. The remaining 70 banks have less than 1% share in the market. Individually they are all less systemically important). Currently regulation is kind of similar for both systemically important and less systemically important banks.

Table 5.3: Various Regulatory Instruments[23]

SN	Objectives/ Issue	Instruments
1	Financial Stability/Risk Management	i. Minimum Capital Requirement also known as Capital to Risk Weighted Assets Ratio. Banks must have sufficient amount of capital which is a stipulated % of risk weighted assets. Weights for Credit, Market and Operation risk stipulated by regulator. ii. Globally Systemically Important Banks (GSIBs) and Domestically systemically important banks (DSIBs) could be asked to maintain additional capital based on assessment by regulator.
2	Financial Stability/ Credit Risk/ transparent reporting	i. Income Recognition and Asset Classification Norms particularly about NPA/NPL. Normally bank accounts are maintained on accrual basis. But under IRAC norms income is not recognised on accrual basis but on cash basis in the case of defaulted/ stressed assets. Also banks have to provision for anticipated loan/asset losses. ii. Counter Party Credit Exposure Norms beyond which banks will not take exposure on a given client. iii. Loan to Value Norms to be adopted by banks in their lending to certain sectors like real estate ensure reasonable valuation and that the borrower has some stake in the business. LTV is used for assessing risk
3	Financial Stability/ Avoid Misuse of Banking system	i. Anti Money Laundering and Countering Financial Terrorism Law and procedures ii. KYC rules and customer acceptance policy

23. Regulation and sustainability of Cooperative Bank. Cross country study. Dr. R. Bhaskaran. https://www.icba.coop/ master/document/images/image1869.pdf

SN	Objectives/ Issue	Instruments
4	Financial Stability/ Liquidity Risk	i. Liquidity Cover to be maintained at a given % known as LCR or Liquidity Cover to be ensured by HQLA ii. Banks to maintain Net Stable Funding in terms of highly liquid assets (NSFR) iii. CRR and SLR are the two traditional instruments used by regulators for liquidity management of banks. SLR also helps governments to get their bond issues subscribed. Unlike LCR CRR is lodged with the RBI and SLR is invested in Government Securities.
5	Interest Rates/ Reasonable rate for the customer	i. Base rate or Marginal Cost of Funding Rate or External Bench Mark Rates. Banks have to follow the criteria given to arrive at the lending rates which could vary based on risk perception
6	Ensuring Access to Credit	i. Priority Sector Norms
7	Bank Management	i. Corporate Governance Guidelines and Fit and Proper Criteria for Board Members and CEO
8	Credit Risk	i. Collateral Norms ii. Credit Rating Norms iii. Margin Norms These are norms to be followed by banks in their business. Further these are nature of guidelines but are concerned with maintaining the asset quality with banks. These aspects are important in calculating RWA for credit risk for arriving at Regulatory Capital.

A related issue is compliance. A clear understanding of risk management and compliance is important for the bank. If the bank's board, management team and risk managers know where compliance and risk management differ, and where it is similar it can contribute to robust risk management and compliance. Compliance covers both risk and non-risk aspects of banking. Non-compliance can trigger fines, penalties and a lot of follow up activities. At the same time risk management is not a matter of ticking off a checklist. It is about understanding risk and keeping it within limits by deciding what can be managed and what cannot be and not taking chances. Compliance is procedural whereas risk management is strategy and process. Take the case of credit. Compliance in credit is concerned with exposure limits, LTV; MCLR etc whereas credit risk management is about robust appraisal, collateral efficiency, close monitoring of accounts and taking timely action whenever there are signs of cash flow problems with the borrower.

Rural Branches

SFBs have been asked to have 25% of the branches in rural areas. As against this SFBs have about 18% of the branches in rural areas. Given that these are new banks this compares will with PSU banks that have, as of March 2019, 32.7% of their branches in rural areas while Private Banks have 21%. It is observed that SFBs use BC network and are also adopting the latest in banking technology. There are certain inherent distinctions in rural and urban banking because rural banking is less transaction oriented than urban banking. Rural banking is more cash oriented. The number of offsite ATMs in rural area is much lower and the adoption latest technology in rural areas is behind the metro and urban areas. As technological advancement in rural areas catch up with Urban and Metro centres SFBs may have to evaluate the need of rural branches and possibly have a viable mix of Branches and BCs

CRAR

Access Assist has organised a number of workshops for Small Finance Banks where the SFBs have dialogued with the regulators. One of the issues that appears in all such discussions is CRAR.

SFBs are subject 10 15% CRAR though rural cooperatives and RRBs have been stipulated a lower CRAR. For commercial banks CRAR has been, since Global Financial Crisis (GFC) gradually increased and is currently at per Basel III standards. RBI Governor in his speech at NIBM June 19 observed that *'As of March 2019, the capital to risk weighted assets ratio (CRAR) of scheduled commercial banks (SCBs) at 14.2% remains well above the regulatory requirement of 9.0%. However, if we take into account the capital conservation buffer (CCB), some banks, especially Public-Sector Banks (PSBs), are falling short of the required 10.875%. Overall,* *the Government's efforts to infuse capital into PSBs has significantly helped them achieve these targets'*. Recently PSU banks have been impacted by a higher level of NPA in corporate and other big loans. Yet PSU banks have not been subject to higher CRAR possibly because of Gov't ownership and frequent recapitalization. As of now there are certain apprehensions that Covid related economic impact will have definite adverse effect on asset quality and it will take some time for borrowal accounts and banks to come back to pre-Covid levels. In this regard a higher CRAR may help the banks. To ensure stability CRAR has an important role to play. But given the financial inclusion mandate of SFBs a higher CRAR will limit their ability to increase their inclusion outreach. Also there exists a feeling that regulator may feel comfortable, as the above quoted speech indicates, if the actual CRAR were to be more than what is stipulated. Therefore if the regulatory views and approach towards Capital is transparently shared it will help SFBs to plan their capital better rather than keep excess capital merely on the feeling that "just in case" or as a 'comfort' factor. It is a matter of record that banks could run into difficulties despite fulfilling CRAR norms as evidenced by some of the recent bank failures.

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Moratorium on Loans and Restructuring of Loans

RBI had announced in the month of March 2020 that banks can give a loan moratorium of three months to help their borrowers manage the lockdown effect on their business/life. Subsequently this was extended till end of August 2020. It is seen that a large number of borrowers of SFBs have opted for the moratorium(Table 5.4). It will be difficult for the borrowers who availed this facility to repay the loan within the original term. Therefore, RBI is currently working on a restructuring package which will be announced shortly.

It can be seen that SFBs have highest % of borrowers opting for moratorium (85%) and amount involved is 63%. SFBs will have to carefully rework the repayment as in their case entire EMI i.e. both principal and interest would have been subject to moratorium. The accounts which are under moratorium will may require restructuring while the borrowers may need fresh funding to continue their business or economic activity. These issues will require undivided attention of the SFBs in the financial year 21-22.

Governance

Governance, Risk Management and Compliance (GRC) is a much discussed topic. This will be very important for the SFBs. Banks manage risk by board's directions on 'what risk to take', 'how much risk to take' and 'how to protect'. The management of the bank executes these policies by taking appropriate business decisions. These actions are reviewed by the board. It should be clear that board review is post facto and not concurrent. At the same time board review is ahead of supervision. Board can take corrective steps ahead of any regulatory action which will always lag the risk event.

Apparently there is high expectation form the boards of SFBs. RBI lays great emphasis on Governance. Nowadays there is a strong belief that more the number of independent directors' better will be the governance. Possibly reflecting this sentiment, currently Boards of all SFBs have majority independent directors. This seems to be an initiative to ensure better governance or possibly more compliant governance. At the same time with so many regulations and guidelines covering almost all policy aspects it is clear that bank governance should be more concerned with business strategies, plans and control. It will be a challenging task for the independent directors to ensure good governance because they have

Table 5.4: Borrowers of banks availing moratorium on loans as of April 20[24]

Sector	Corporate		MSME		Individual		Others		Total	
	% of total customers	% of total outstanding	% of total customers	% of total outstanding	% of total customers	% of total outstanding	% of total customers	% of total outstanding	% of total customers	% of total outstanding
PSBs	29	58	74	82	80	80	49	64	67	68
PVBs	22	20	21	43	42	34	39	41	49	31
SFBs	79	44	91	52	91	73	65	12	85	63
UCBs	63	69	67	66	57	62	36	59	57	65
NBFCs	40	56	61	61	33	46	37	41	29	49
System	31	42	46	65	50	55	46	55	49	50

24. Table 5.4 A RBI Financial stability Report July 20

to avoid some of the recent happenings in the banking sector such as 'underreporting of NPA', violating 'exposure norms' by a large margin, 'misreporting lending figures', 'over-leveraged banks, besides failing to report 'negative cash flows' and 'adverse key financial ratios'. Small Finance Banks should keep these events in mind and also the impact of events like GST, demonetization and Covid lockdown like risk events while making strategies. Technological solutions can bring down the cost of compliance of small banks substantially and also increase transparency. It is true that initially, the failure of one or two small banks will not have systemic consequences, unlike the failure of a single large bank. But if more small finance banks were to be opened any sector specific risk could impact the market.

There are two models of Governance, the shareholder model and the stakeholder model. Banks have to adopt the stakeholder model because they accept deposits from a large number of people and also that their decisions have an impact on the society. In this regard it is well recognised that wherever shareholders/stakeholders are well dispersed and the management is in few hands there is a greater possibility of poor governance. If a bank should fail the impact on shareholders is limited to the shares held by them whereas the impact on depositors could be unlimited. It is for this reason the role played by the regulator on 'resolution' becomes important.

A scrutiny of recent cases[25] indicates that poor governance cannot be attributed to any particular type of organisation or ownership such as public limited company, cooperative etc. Only people in charge (Directors) of business at a point of time can ensure honest and good governance.

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25. The bond market has faced big default by IL&FS (Infrastructure Leasing and Financial Services Limited) in September 2018, problems in companies such as DHFL, India Bulls Housing Finance and Yes Bank.

    Rating agency ICRA had downgraded Yes Bank's ₹ 1,344-crore upper tier II bond programme to 'D', or default grade, from BB+, a day after the bank said it had been barred from making coupon payments on these bonds, due on June 29.

    Punjab and Maharashtra Cooperative Bank (PMC Bank) has been facing regulatory actions and investigation over alleged irregularities in certain loan accounts. Loans given to financially stressed real estate player Housing Development & Infrastructure (HDIL) are at the centre of the investigation.

Regulation alone cannot ensure good governance. Supervision is not in lieu of internal control and audit functions. The committees which had recommended SFBs have indicated that close supervision is necessary. In this background it may be necessary that in addition to the RBI it may be appropriate to have an industry association monitoring the banks supplementing the efforts of the regulator. If this is ensured, regulator can be far more selective in applying 'fit and proper' criteria. Very recently the Small Finance Banks have created an association of SFBs. It is hoped that this associations can undertake quasi-supervision and also develop common strategies or capital, capacity building etc. It can help in improving Governance.

Rate of Interest on Loans and Advances

Banks have to link their lending rates to MCLR and EBR[26]. Primary objective of these measures are transparency about the way interest rates are arrived. Another not so explicit objective is to keep the interest rates reasonable, particularly as the regulator has given up control over rates of interest charged on loans. To the bank management these instruments should definitely give a feel of risk when they pursue high rates of interest in comparison to prevailing market rates. Another aspect of these measures is that at times, as historically proven, Government and Regulators could use to these instruments to coerce the lenders,

26. Having gone through a massive NPA crisis, which has cost taxpayers close to ₹15 lakh crore, banks today are a lot more cautious about how they use precious capital. If the flow of credit has slowed sharply over the past few months, it is because there aren't too many credit-worthy borrowers; the sharp slowdown in the economy has left companies, especially smaller ones, in trouble. At a time like this, it is surprising the Reserve Bank of India should be forcing banks to price retail loans—home and auto—and loans to MSMEs over an external benchmark. This could be the repo, the three-month or six-month Treasury bill, or any other market benchmark interest rate published by Financial Benchmarks India Pvt Limited. The move is ill-timed, and not just because interest rates—both the risk-free yield and the repo—are at relatively low levels, but also because the rate of growth of deposits is slow. Borrowers find it hard to cope when rates go up, and when the economy starts looking up, interest rates are bound to rise. Also, banks have been reducing the interest rates on deposits, but most of the cuts have already taken place, with not too much room for more. Indeed, from here on, the fall in deposit rates would be just slightly more than the fall in the repo.https://www.financialexpress.com/opinion/forcing-banks-to-cut-lending-rates-is-a-really-bad-idea/1697579.

formally or otherwise, to bring down the rate of interest on loans.

Currently, Rate of Interest charged by Small Finance Banks and Private Banks are higher than those charged by PSU banks and RRBs. It is seen that the rate of interest charged by small finance on microfinance loans and other loans is higher than what is charged by other commercial banks. Is it viable for the borrowers? Prima Facie yes because it is a well documented point in favour of micro finance that 'availability credit is more important than rate of interest'. Apparently, on a cost plus basis the rates seem reasonable for lenders as amply stated by Malegam committee for NBFCs. It is also argued that the rural business/industries may have higher profitability and rates need not reflect market rates that apply for corporate lending. But the question still remains that given the economic strata from which the borrowers for SFBs emerge and their vulnerability, can they afford these rates? It is too early to conclude. It is said that borrowers are aware of the rates when they borrow. True but do they have alternative sources? Obviously not.

Despite high rates of interest profit as % of TA is only around 1.5% on account of higher cost of funds as evidenced by a high cost to income ratio. One must also factor the high initial costs incurred in establishing procedures, processes etc. Operational costs are more on account of the need to employ specialist staff and need to adopt latest technology. Currently per staff volume of business is also low. As the banks grow in size these costs will come down which will have positive impact on the profitability. Technology may not bring down the cost as the customer profile of SFB is typically cash oriented and it will take time to move them to on-line and non cash mode of transactions.

Route the SFBs Can Take in Future

"It is in this kind of banking atmosphere that Small Finance Banks will grow. As indicated earlier these banks are, currently using Micro ATMs for transactions at the customer's place. Mobile banking is also being used but not as much as Micro ATMs. Towards this end they could develop partnership with Fintechs in the area of customer due diligence, appraisal etc".

Banking is changing in terms of regulations, norms and more use of technology. Technology impacts both the front and back end operations of the banks. It is in this backdrop that Small Finance Banks will grow. SFBs are, currently using Micro ATMs for transactions at the customer's place. Mobile banking is also being used but not as much as Micro ATMs. It is evident that changes in regulation and technology will continue. These banks need to keep pace. Their growth strategy should be primarily based on using latest technology appropriate to deliver banking products and transactions to their major clientele, namely small loan borrowers. This will help contain the operations cost and manage the profit margins efficiently. Towards this end SFBs could develop partnership with Fintechs in the area of customer due diligence, appraisal etc.

It is evident that Small Finance banks have successfully navigated the demonetisation impact on their performance and finances. They have carefully strategized their growth and are moving ahead full speed with clear mandate and good performance. In view of their good performance, evidently more small finance banks will be established. Possibly some of the UCBs may be converted into Small Finance Banks making the space more competitive and challenging. If SFBs are nimble and make their customers use more of tech based access points than branches and offer more products to each customer, they have a clear and rewarding growth path ahead, given that their mandate is financial inclusion and scope for business is vast.

At the same time the current economic situation is a cause of concern. During the lockdown period the SFBs were not able to undertake home visits which they routinely make for loan collections, deposit mobilisation and also enabling transactions for the customers. The monthly meetings were also not held. In this background FinDev gateway observes that 'If historical experience is any guide, the Microfinance (Small Finance in the case of Small Finance Banks) sector will soon face deep distresses'. In the background of Corona virus health crisis and the depth of the economic fall-out throughout the world, it is expected that national and multilateral regulatory and financial institutions would come together and provide the full support to the sector 'and the needs of 140 million low income people it serves'. Majority of the Small Finance Banks are

Microfinance/Small Finance oriented and have more than 85% of their loans in the form of small loans. RBI data on loan moratorium announced in wake of economic stress on account of Covid 19 shows that Small Finance Banks have extended moratorium, as of 31/8/20 in the case of 82.47% of their loan accounts involving 68.18% of the amount outstanding. It is well known that, in India the lockdown instituted to protect the country against the Novel Corona Virus has worst affected the low and middle-income individuals, daily wage earners and self-employed individuals all of who are customers of small finance groups. Banks have extended Covid Relief to borrowers in the form of moratorium up to end of August. This will be followed by restructuring of the accounts. There could be situations where, in addition to the restructured accounts, borrowers may need new loans as well to manage their business. As such their borrowers will definitely need liquidity and financial support to move ahead. The full impact of these measures in terms of asset quality and reduced profitability will be felt by SFBs in the years 2020-21 and 2021-2022.

Currently (January 2021) economic activities have picked up, Covid vaccines have been approved and RBI has announced Resolution Framework for Covid-19-related Stress. RBI, in its Trends and Progress of Banking 2020 says that 'The immediate impact of lockdowns on the financial performance of Commercial Banks was mitigated through timely policy actions'. It further says that the risks to the banking sector, which includes Small Finance Banks, *remain tilted upwards*, much will depend on the pace and spread of the economic recovery, the green shoots of which will be is seen in the second half of 2020-21. In this regard Rating agency ICRA has observed that these banks have shown improvement in collection efficiency in July 2020. Also discussions with some banks and perusal of new items show that in the recent months the repayment levels have reached about 85% in most of these banks. This is indeed good performance. Yet, it points out to definite stress in the loan portfolio which could impact this year's financial performance. The Small Finance Banks will therefore have to carefully strategise and navigate the situation.

In this regard it is interesting to see some financial ratios of SFBs and other Private Banks which will kind of show the future path of the SFBs.

Table 5.5: Comparing SFB with other private sector Banks; Ratios

Ratios	SFB	L P B	O PB
Credit + Investment to Deposit	152.2	126.4	108.9
Deposit to Total Liabilities	59.9	68.8	81.5
CASA	18.2	44.2	30.0
Priority Sector to Total Advances	66.6	28.2	43.5
Term Loans to Total Advances	87.2	70.6	56.2
Secured Advances to Total Advances	44.1	75.9	90.9
Business per employee. ₹ Crore	222.0	1325.0	1538.0
Profit Per Employee. ₹ Crore	2.5	11.2	-3.7

Ratios	SFB	B P B	O PB
Interest Income to total Assets	14.2	8.1	8.5
Net Interest Margin	7.9	3.4	3.2
Other Income Margin	1.6	1.7	1.1
Operations Cost to Total Assets	6.0	2.2	2.5
Operating Profit to Total Assets	3.4	2.8	1.8
NPM- Return on Assets	1.7	1.1	0.2
Return on Equity	11.6	9.8	-1.2
Cost of Funds	7.7	5.5	5.9
Return on Advances	18.0	9.9	10.3
Source: RBI. Ratios 2019. LPB Large Private Banks. OPB Other Private Banks			

It is not intended to compare SFBs with the Private Banks. But as we peep into the future it is reasonable to assume that these banks will be private sector banks in genre. Their growth could be organic or inorganic like some of the new gen big private banks whose growth has been facilitated by mergers and consolidations with other banks.

It is also clear that per employee business with them will increase and deposit as % of total assets will increase. There will be some reduction in the cost of funds and possibly there will be some reduction in the yields on advances. Fee income will play a critical role in ensuring profitability of these banks. As these banks grow they have to be more aligned to the market in terms of interest rates and therefore their rates of interest on loans, net profit margin, return on assets etc will tend to reflect market.

Currently not all private banks for that matter not all PSU banks are in profit. As such SFBs will have to carefully chose their strategies and have good credit management. Evidently SFBs will open more branches for brand building and give a visual image of the bank and at the same time adopt latest banking technology. These have cost and business implications particularly if SFBs would like to become universal banks and also continue with high quotient of small bank accounts and loan accounts. In the absence of technology the cost of delivery will be high.

SFBs, have been, in the current year hit by a number of challenges such as microfinance crisis in Assam[27] the after-effects of floods in Maharashtra and Karnataka and Covid related lockdown and slow down. It seems that similar to demonetization and the A P Crisis, Covid could have lasting impact on microfinance and SFBs. As of now it is not clear as to when the pandemic will end and how long thereafter will the economy come back to normal. Given this SFBs will have to focus on business continuity plans. To remain competitive, SFBs will need to adapt. They have to "Go digital". SFBs have long been saying that they are digitally advanced and have many payment options; this is the time to prove it. Currently rural economy is still a cash economy. Also the technological advancement of urban areas has not yet reached all rural areas making digital banking bit constrained in rural areas. It is time to work closely with technology providers and rural customers to move more customers to digital banking.

Nandan Nilekeni Committee had observed that the number of digital payments per capita has raised 10 fold from 2.4 in March'14 to 22.4 in March'19. Total digital payment as of Jan 20 was ₹ 125.78 Trillion of the total ₹ 132.38 Trillion. In this context, the Committee has set the following targets to be achieved in 3 years: (i) ten-fold increase in per capita digital transactions (from 22.4 currently to 220), (ii) doubling the value of digital transactions as a % of GDP (from 769% currently to 1500%), and (iii) tripling the number of digital payment users (from estimated 10 crore currently to 30 crore).

27. The microfinance sector is again facing trouble, this time in Assam with stress in rural households and a spate of loan defaults raising the specter of a repayment crisis that hit Andhra Pradesh in 2010.https://economictimes.indiatimes.com/ markets/stocks /news/mfis-stare-at-repayment-crisis-in-rural-assam at

It is in this kind of banking atmosphere that small finance banks will grow. As indicated earlier these banks are, currently using Micro ATMs for transactions at the customer's place. Mobile banking is also being used but not as much as Micro ATMs. They are also striving towards making all their operations and transactions technology driven. As they grow use of digital banking will increase. Simultaneously new technologies and regulatory norms will also evolve. They need to keep pace. Their growth strategy should be primarily based on using latest technology appropriate to their main clientele to deliver banking products and transactions. This will help contain the operations cost and manage the profit margins efficiently. Towards this end they could develop partnership with Fintechs in the area of customer due diligence, appraisal etc.

Small finance banks are moving ahead full speed with clear mandate and good performance. In view of their good performance, evidently more small finance banks will be established. Possibly some the UCBs may be converted into small finance banks making the space more competitive and challenging. If SFBs are nimble and make their customers use more of tech based access points than branches and offer more products to each customer, they have a clear and rewarding growth path ahead, given that their mandate is financial inclusion and scope for business is vast.

Annexure

Table1: Balance sheet of SFBs in 2018-2020

₹ Billion

2020	AU	Capital	Equitas	ESAF	Suryoday	Fincare	Ujjivan	Utkarsh	NE	Jana	Total
Capital & Reserves	44	4	27	11	11	9	19	10	4	10	150
Deposits	262	44	108	70	28	47	12	52	9	97	729
Borrowings	103	4	51	12	13	14	108	27	7	29	368
Other Liabilities	13	1	6	2	2	2	44	5	1	6	80
Cash & Bank	10	2	4	3	1	11	12	2	1	5	51
Investment & Deposits	130	16	45	23	16	10	25	26	5	32	329
Advances	270	33	137	65	35	48	140	63	13	100	906
Other Assets	11	2	7	3	2	2	6	3	1	6	42
Total Assets	421	53	193	95	54	71	184	94	21	141	1327
2019											
Capital & Reserves	32	3	23	9	9	7	18	8	4	7	117
Deposits	194	37	90	43	16	20	74	38	3	42	557
Borrowings	86	4	40	17	11	13	42	14	11	41	278
Other Liabilities	14	45	5	1	2	2	4	2	1	5	82
Cash + Bank	8	2	4	2	1	1	4	2	1	11	37
Investment+ Deposits	81	14	32	21	9	11	22	12	2	16	219
Advances	228	26	116	45	27	28	106	47	14	62	699
Other Assets	9	1	6	2	1	2	6	2	1	6	36
Total Assets	326	43	158	71	38	42	137	62	18	94	989

Table 2: Balance sheet of SFBs 2018

₹ Billion

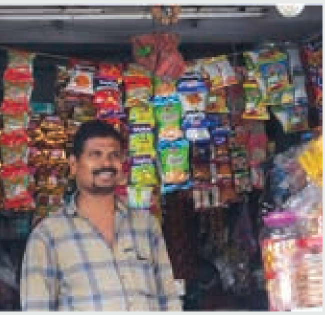
2020	AU	Capital	Equitas	ESAF	Suryoday	Fincare	Ujjivan	Utkarsh	NE	Jana	Total
2018											
Capital & Reserves	23	2	20	3	5	3	16	4	3	15	97
Deposits	79	29	56	25	7	7	38	22	1	1	266
Borrowings	76	2	52	17	7	11	39	18	11	77	309
Other Liabilities	10	1	5	2	2	1	2	1	1	6	30
Cash + Bank	5	2	4	4	1	1	2	2	1	2	24
Investment+ Deposits	43	11	47	10	4	5	15	10	4	29	179
Advances	133	19	77	32	16	16	73	31	11	60	468
Other Assets	7	10	5	1	1	1	4	2	1	6	39
Total Assets	188	34	133	47	22	23	95	45	16	97	700

Table 3: Financial performance of SFBs: Years 2018-2020. All percentages to total asset

Bank	Interest Income	Interest Expense	NIM	Operations Expenses	Provision	Other Income	OPM	NPM
								2018
AU	11.5	6.4	5.1	3.8	0.7	1.9	3.2	2.5
Capital	9.5	5.9	3.6	3.4	0.6	0.9	1.1	0.5
Equitas	15.1	6.6	8.5	6.7	2.0	1.6	3.4	1.4
ESAF	17.1	7.5	9.6	7.3	1.6	1.6	3.9	2.3
Fincare	19.0	8.0	11.0	7.6	0.0	2.6	6.0	6.0
NESFB	15.9	7.1	8.8	6.9	2.2	1.0	2.9	0.7
Suryoday	16.7	6.0	10.7	5.9	4.3	1.9	6.7	2.4
Ujjivan	16.8	6.7	10.2	8.2	1.8	2.0	4.0	2.2
Utkarsh	16.7	7.4	9.3	6.1	2.1	1.3	4.5	2.4
Jana	16.9	8.3	8.6	9.9	2.1	3.7	2.4	0.3
All SFBs	15.5	7.0	8.5	6.6	1.7	1.8	3.8	2.1
								2019
	15.5	7.0	8.5	6.6	1.7	1.8	3.8	2.1
AU	11.5	6.2	5.2	4.2	1.3	1.8	2.8	1.5
Capital	9.0	5.5	3.5	3.4	0.4	0.8	0.9	0.5
Equitas	14.6	6.7	7.9	6.9	1.5	1.9	2.9	1.4
ESAF	17.5	7.8	9.7	7.7	2.4	1.9	3.9	1.5
Fincare	18.8	7.1	11.7	9.2	1.5	2.2	4.7	3.2

Bank	Interest Income	Interest Expense	NIM	Operations Expenses	Provision	Other Income	OPM	NPM
NESFB	16.5	7.5	9.0	5.9	1.6	0.8	3.9	2.2
Suryoday	17.8	6.4	11.4	6.6	4.2	2.3	7.1	2.9
Ujjivan	15.8	6.2	9.5	8.6	0.9	1.8	2.7	1.7
Utkarsh	16.3	7.1	9.2	6.1	2.5	1.1	4.3	1.7
Jana	13.0	8.5	4.6	11.8	14.3	1.2	-6.0	-20.3
All SFBs	15.1	6.9	8.2	7.0	3.1	1.6	2.7	-0.4

Bank	Interest Income	Interest Expense	NIM	Operations Expenses	Provision	Other Income	OPM	NPM
								2020
AU	12.6	5.8	6.8	5.3	2.0	2.7	4.3	2.3
Capital	9.7	5.5	4.2	3.1	0.5	0.8	1.8	1.4
Equitas	15.8	6.0	9.8	7.8	1.7	2.1	4.1	2.4
ESAF	18.2	8.2	10.0	8.0	1.3	2.7	4.7	3.4
Fincare	17.6	6.5	11.1	9.8	8.3	2.0	3.3	-5.0
Jana	13.0	9.5	3.5	11.8	12.0	0.3	-8.0	-20.0
NESFB	12.6	6.3	6.3	3.4	0.2	1.0	3.9	3.7
Suryoday	17.2	6.5	10.7	7.0	3.2	2.0	5.7	2.5
Ujjivan	17.0	6.8	10.2	7.3	3.5	1.2	4.2	0.7
Utkarsh	15.6	7.0	8.6	6.5	3.9	1.2	3.3	-0.5
All SFBs	14.9	6.8	8.1	7.0	3.7	1.6	2.7	-0.9



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