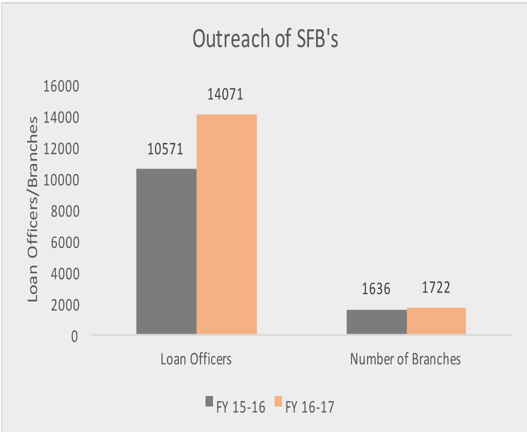
Small Finance Banks: New Hope for the Unbanked?

Key Highlights of Small Finance Banks

With an agenda to further the financial inclusion objectives of the government, the Reserve Bank of India, in 2014, announced the guidelines for a new banking entity, the Small Finance Bank (SFB), further issuing 10 in-principal licenses to existing financial entities amongst which were non-banking financial companies, microfinance institutions and local area banks. With an initial capital requirement of 100 Cr and promoter contribution at 40% to be brought down to 26% in 12 years, these institutions were expected to see financial inclusion as their core business. More than the size of the institution, the nature of the portfolio was seen as important. SFBs were meant to serve local areas and meet credit and remittance needs of small businesses, the unorganized sector, low-income households, farmers and the migrant workforce. With priority sector norms at 75% of adjusted net bank credit (ANBC) to be extended to the weaker sections of the society, an SFB was seen as an opportunity to sell different types of products to the same person.

- Five of the NBFC-MFIs which were provided the SFB in principle license in FY 15-16 converted into SFBs during FY 16-17. At the end of FY 16-17, the five SFBs, (ESAF, Equitas, Suryoday, Ujjivan and Utkarsh) with a branch network of 1,722 and 1.04 Cr loan accounts had a loan outstanding of INR 14,447 Cr, a 10.8% increase from FY 15-16.
- The cumulative loan amount disbursed for these 5 SFB's increased by 32.41% from INR 11,356 Cr in FY 15-16 to INR 15,037 Cr in FY 16-17. During FY 16-17, on an average they disbursed INR 23,516 per account.
- RGVN and Disha Microfin Ltd started their operations in FY-17-18 and Janalakshmi Financial Services which has got its final nod to commence operations plans to start in FY 18-19.



Source: Financial Reports 2016-17|SFB's

Ujjivan Financial Services	• As of 2017, about 85 per cent of its portfolio is in microfinance with a focus on small individual loan, MSME and housing portfolio. • Offering an interest rate of 4% on savings it has, 65 full-fledged brick and mortar branches in eight states and two Union Territories. [1]
Utkarsh Microfinance	• The overall reach is in 110 districts of ten states with over 12 lakh active client base. • The current portfolio outstanding is over INR 1,700 crore and currently targeting micro enterprise loans (MEL) and affordable housing loans (AHL). Savings deposit interest rate is at flat 6%.
Suryoday	• Started with 4 branches, it is maintaining a stable microfinance book and ensuring other products grow as a percentage of the total portfolio. • It provides loan against property, housing loans and MSME loans lending at a ticket size of INR 1.5 lakhs to 5 lakhs
ESAF	• Plan to start with 85 branches and expand to 500 by 2020, it will have 20% of its portfolio for micro, small and medium enterprise (MSME) borrowers, 10% towards housing and agriculture and the remaining 70% towards microfinance borrowers in two years.[2] • Offering an interest rate of 6%- 7% on savings, it will target to grow its liabilities through the large NRI population in Kerala
Disha Microfin Ltd	• Now known as Fincare Small Finance Bank, the bank raised over INR 225 Cr of deposits from its about 1000-odd depositors during the start of its operations in May 2017 • Started with 25 branches and plans to have 500 branches by 2018 it will consolidate a strong SME and self-employed base of customers.[3]
Janalakshmi Financial Services	• Has raised INR 1030 Cr and will start operations in 2018. It plans to have 300 store fronts for its SFB operations • It will continue to provide microloans for home improvement and education and introduce innovative financial products for their customer base to interact with the cashless economy.[4]

[1] http://www.thehindubusinessline.com/money-and-banking/ujjivan-small-finance-bank-receives-scheduled-bank-status-from-rbi/article9836399.ece
[2] http://www.livemint.com/Industry/b1KxpKPjdXIFBdJnv8QgsM/Esaf-Microfinance-to-launch-small-finance-bank-operations-on.html
[3] http://www.thehindubusinessline.com/money-and-banking/fincare-small-finance-bank-starts-operations-with-25-branches/article9840351.ece

RGVN	• Having raised INR 115 Cr and operating in most of the North-Eastern States, it plans to have 164 branch offices focusing on serving the unbanked, rural and SME units in its area of operations.[5]
Equitas	• Commenced its operations with 3 branches and plans to add in the remaining 409 branches by FY 18. • Offering a savings interest rate of 6-7.50%, its focus is to provide microfinance, commercial vehicle finance, MSME and affordable housing loans.

Challenges and Opportunities for Small Finance Banks

CHALLENGES

1 Since 8 of the 10 SFB's were NBFC-MFI's, the biggest challenge ahead of them is to raise deposits as against merely giving out loans. While most of them have been following the strategy of raising interest rates to build on their base of depositors, superior service delivery and garnering trust will pose challenges in fulfilling the same.

2. MFI/NBFC employees are experineced in microlending operations with limited exposure to raising deposit, sell and push products such as liabilities, insurance and pensions. This leads to challenges of attracting, training and hiring personnel from the banking industry. This may lead to increased expectation and market competition leading to challenges in manpower management

3. Demonetization and the encouragement towards a cahsless economy has resulted in a sudden surge in NPA for the SFB's, where cash was the main-stay of their previous NBFC-MFI business model.

4. Maintaining a higher Capital Adequacy ratio of 15% and Cash reserve Ratio of 4% and Statutory Liquidity Ratio of 22% has been a significant burden to manage until the SFB's develop a significant depositor base.

5. Rolling out branches has not been easy, and has seen a high cost to income ratio for most SFB's during the transition.

6. Compliance with RBI norms- internal audit, cyber security and overall compliance has been a management challenge.

OPPORTUNITIES

1. With a shortage of 30 million affordable homes in India and not more than 5% of enterprises being bank funded, there lies a huge untapped potential, with the market not limited to MFI only, but SME and housing segment.

2. From bank liabilities, SFBs may initially rely on bulk deposits to fund assets and then eventually move to retail deposits, however since the cost of bulk deposits and regulatory requiement is margi- dilutive, sticky asset pricing can help in offseting margin pressure.

3. SFB's are coming up with innovative ideas to convince customers that they are better placed versus unorganized establishments in delivering on service and trust eg: Janalakshmi offers pre paid loan cards and Equitas offered piggy banks to its customers which can be transferred upon the commencement of bank operations.

4. Technology is an enabler of consistent and seamless service delievery. Investing in analytics to design new products has huge opportunity; and profitability can be sustained if the bank can meet other financial needs of its customers, beyond loans. The SFB's are incurring one time capex of building IT infrastructure which may hurt profitablity in a medium term but will help SFB's to diversify their portfolio.

Way Forward for Small Finance Banks

- **Focusing on Rural Market:** A small finance bank with a regional stronghold will be attractive from the investors' standpoint, however business cannibalization will not be easy and there is a large growth potential for the SFBs to grow in the rural and underserved markets. While most SFB's are retaining their customer base, new products with higher ticket size would be served.
- **Mobilizing Deposits:** Though the SFB's have been well capitalized in the initial months of their operations, their focus in the next financial year has been to raise deposit, through different products, foreign investors and commercial paper.
- **Invest in Human Capital and Technology:** SFBs plan to invest significantly to equip their field staff with the skills to mobilize savings, build trust and brand image. They are also investing heavily in IT infrastructure to boost their banking experience.

[4] http://www.moneycontrol.com/news/business/companies/janalakshmi-financial-services-raises-rs-1030-cr-ahead-of-small-finance-bank-launch-2384463.html
[5] https://economictimes.indiatimes.com/industry/banking/finance/banking/north-easts-first-small-finance-bank-to-start-operations-from-june/articleshow/58430284.cms