From MFI to Small Finance Banks: Transacting Business Differently
Diksha Singh, IFMR LEAD

The last one year has seen sweeping changes in the design and architecture of India’s banking system. In 2015, the Reserve Bank of India granted in-principle banking licenses to a new category of Financial Institutions, Small Finance Banks (SFBs). The primary objectives of setting up SFBs is to further financial inclusion by (i) provision of savings vehicles primarily to unserved and underserved sections of the population, and (ii) supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low cost operations.

2015: In-principle licenses granted
- RGVN
- Janalakshmi
- Disha
- Au Financiers
- Suryoday
- Ujjivan
- Capital
- Equitas
- Utkarsh
- ESAF

2016: Received final nod from RBI
- Suryoday
- ESAF
- Utkarsh
- Ujjivan
- Equitas
- Capital

2016: Commenced Operations
- Capital
- Equitas

The Small Finance Bank Game: Progress so Far

The 10 in-principle licensees comprise of eight large Microfinance Institutions, one Local Area Bank (Capital) and one Non-Banking Financial Company (Au Financiers). The licensees are now in the process of seeking final approval from the Reserve Bank of India, and as seen above, two institutions have commenced operations as well. These institutions have been shortlisted based on their significant regional outreach and have a proven track record of serving unbanked and underserved clients in these regions. However, they now face the challenge of establishing themselves in a differentiated segment and restructuring their businesses as per Reserve Bank of India’s operating guidelines for Small Finance Banks.

From Micro to Small Finance: Business Case

- **Diversified product offerings and client base:** Opportunity to diversify their product offerings and provide a holistic suite of financial products to clients comprising of savings and credit, as well as distribution of insurance, pension, mutual funds, payment/remittance facilities and access to ATMs; diversify their client portfolio from low ticket size collateral-free borrowers to higher ticket sizes.
- **Financial deepening:** Cater to unmet credit and savings requirements of the agricultural household segment and the micro and small enterprises segment, as well as aspirations of microfinance borrowers with proven credit histories who are eligible to graduate to higher ticket size loans. It is estimated that agricultural households and micro and small enterprises have unfulfilled credit requirements to the tune of INR 32 trillion, and unfulfilled savings needs to the tune of INR 25 trillion\(^1\). In terms of geographies, states of central and north-east India present significant opportunity for expansion as well.
- **Diversified funding base:** In the long-term, access to low-cost funding from mobilisation of savings can help SFBs to diversify their capital structure from debt and equity.

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\(^1\) Small Finance Banks – Is there an opportunity for MFIs/NBFCs? MicroSave (2015)
Critics of the differentiated licensing regime have pointed out that India’s past experience with cooperative banks and local area banks has been far from satisfactory. The experience of other countries suggests that the single most important factor that can determine the success of transforming MFIs is the successful mobilization of savings from the public, including from large numbers of low-income clients (IFC, 2006). As a host of new financial players enter the financial system and emerging players intensify the drive to expand their operations, the newly formed Small Finance Banks are likely to face stiff competition on the asset as well as liabilities side. While there is significant market potential for the SFBs to tap into, the key to a successful transformation will lie in how they manage the above challenges, and further strengthen their understanding of clients’ needs, in order to establish a niche for themselves in the new ecosystem.

2 Small Finance Banks: What can we learn from Indian experience? MicroSave; Fierce competition for India’s newly minted Small Finance Banks, CGAP Blog