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THE ROLE OF SMALL FINANCE BANK IN INDIAN ECONOMY WITH THE SPECIAL REFERENCE TO AU BANK

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ABSTRACT

As we know banking sector plays an important role for the development of Indian economy. A bank is a financial institution which provides deposits and credits facilities to their customers. Over the past few years banking industry has gone through many changes. The most important change is to introduce Small Finance Bank. It was introduced in Sept 2015. RBI Granted licenses to 10 Small Finance banks. SFBs are those banks who focus to provide the basic banking facility of acceptance of deposits and provide loan facility to customers, small business units, small and marginal farmers, micro and small industries and unorganized sectors. Small Finance banks are solving the basic financial problems and providing 75% of their loans to priority sector comprising of agriculture, small enterprise and low income group. The small finance banks provide financial services like mutual funds, insurance products, pension products etc. but with the prior approval of Reserve Bank of India. The research design is descriptive research design. The secondary data was mainly collected from different web sites of small finance banks. This paper analysis the role of small finance bank in Indian economy also analyses the AU bank. This study tries to measure the challenges faced by Small finance bank.

***KEYWORDS**: Banking Sector, Small Finance Bank, Indian Economy and AU Bank.*

Introduction

As we know banking sector plays an important role for the development of Indian economy. A bank is a financial institution which provides deposits and credits facilities to their customers. Reserve Bank of India is the governing body of banking industry in our country. Over the past few years our banking industry has many changes in which recent change is emergence the concept of Small Finance Banks. In December 2013, Committee on Comprehensive Financial Services for Small Businesses and Low Income households, led by Nachiket Mor, was formed. This committee, in its recommendations, gave the idea of differentiated bank licensing to fill the gap in providing financial services to low income households and small businesses. In September, 2015 RBI provided license to 11 Payment Banks and 10 Small Finance Banks in India. Capital Finance Bank is the first bank that started as a small finance bank in the country. These banks should not be added to the list of Public Sector banks. Initially 10 institutions got license to operate their functions in the group of small finance bank they are:

- Ujjivan Small Finance Bank
- Jana Small Finance Bank
- Equitas Small Finance Bank
- AU Small Finance Bank
- Capital Small Finance Bank
- Fincare Small Finance Bank
- ESAF Small Finance Bank
- North East Small Finance Bank
- Suryoday Small Finance Bank
- Utkarsh Small Finance Bank

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Small Finance Banks shall perform basic banking function like: acceptance of all type of deposits and lending loans to unbanked areas of our country. Small Finance Banks have to follow all the norms and regulations application to commercial banks like: maintenance of Cash Reserve Ratio and Statutory Liquidity Ratio. Small Finance Banks are required to give 75% of their loan to priority sector and 50% of its loan portfolio constitutes loans and advances of maximum up to Rs. 25 lakhs. The minimum paid up equity capital is 100 crores. The promoter's stakes should be 40% minimum that must be brought down to 26% in 12 Years.

The maximum loan size and invest limit to any individual or a group cannot be more than 10 percent and 15 percent of capital funds of these banks. After establishing satisfactory track record a small finance banks will be eligible to convert itself into universal bank but policies and parameters will be decided by Reserve Bank of India. This opportunity is not available to payment banks. Resident individuals/professionals with 10 years of experience in banking and finance can apply for SFB also Companies and Societies owned and controlled by residents are eligible as promoters to set up SFBs. Non-Banking Finance Companies and Micro Finance Institutions owned and controlled by residents are also allowed to opt for the conversion into SFB.

The basic objective for the setting up of SFBs are provide credit facilities to small business units, small farmers, micro and small industries and unorganized sectors and reform to improve financial inclusion in the country. SFBs cannot perform non-banking financial services and not allowed to lend to big industries. SFBs are providing services where commercial banks are not available or not offering services. SFBs focus to open branches in rural areas and unbanked population. It also provide loans to priority sector and motivate people to save their excess funds. This makes them ideal bank for achieving the objectives of financial inclusion. SFBs can provide financial services like mutual funds, insurance and pension products but with the prior approval of RBI.

Objectives

- The main objective of the study is to analyses the role of Small Finance Bank in Indian Economy.
- To study the challenges faced by Small Finance Bank.
- To find out the ways to improve financial problems of unbanked sectors.
- To analyses the performance of AU Small Finance banks.

Research Methodology

The main objective is to know role of Small Finance Banks in Indian Economy also to find out the challenges faced by Small Finance Banks. The research design is descriptive research design. The secondary data was mainly collected from different web sites of SFBs, articles and journals. Hypothesis tested for the research is $H0$ = There is no contribution of Small Finance Banks in Indian Economy. $H1 \neq 0$: There is contribution of Small Finance Banks in Indian Economy.

Review of Literature

- Abijith S and Raghavendra N,(2018), **"An Empirical Study on Selected Small Finance Bank in Mysuru with reference to Micro, Small and Medium Enterprises"**, presented the introduction, functions, challenges and role of Small Finance Banks and also presented the awareness level of customers.
- Jeeban Jyotin Mohanty (2018) "**Leveraging small financial banks (SFB) in achieving Financial Inclusion in India"** focused the need and importance of small financial banks. In his study he analysed that Small financial bank has huge potential in unbanked and underserved areas and has a major role in development of Micro Small and Medium Enterprises sector.
- Viswan M G (2017) **"A study on the awareness and perception about small financial bank with special reference to ESAF small financial bank**" focused the awareness level of rural people about small financial banks and operation of small financial banks in Kerala. Primary and secondary data were collected. The findings of the study were to find the weak areas for the economic developments
- Pinal Barot (2017) **"Financial Inclusion in India"** presented the financial inclusion's importance, its opportunities and challenges in India also focused on the problems of financial inclusion in underprivileged areas.

- Jayadev M, Himanushu Singh and Pawan Kumar (2016) **"Small Financial Bank: Challenges"** analysed the challenges which has been faced by Small Financial Banks in India. He presented that because of mandatory norms and statutory norms of CRR, SFBs are facing many challenges.
- Prantik Ray (2016) "**Small Banking in India – Issues and Challenges"** focused the need for financial inclusion, issue, challenges, RBI Guidelines for small finance banks also presented the case study of Ujjivan financial service limited. In the study he also presented that small financial bank has great potential for financial inclusion but the performance of these institution has not been satisfactory.

Impact of Small Finance Bank on Indian Economy

The financial and economic conditions of India are superior then other country in the world. Credit, market and liquidity risk studies suggest that Indian banks are generally flexible and have withstood the global changes well. Banks are expected to play an important role in Indian economy. Indian banking industry has recently witnessed the roll out of innovative banking models like payment banks and small finance banks. The basic objective for the setting up of SFBs are provide credit facilities to small business units, small farmers, micro and small industries and unorganized sectors and also to improve financial inclusion in the country.

Small Finance Banks are providing financial services at low transaction cost. It is very difficult for commercial banks to open branches in every village so by mobile phones SFBs provide low cost platform for banking services to every citizen. SFBs provide higher interest rate on deposits and giving credit at lower rates. This will benefit the lower income group and small business. For customers, the real attraction will be convenience of carrying out banking transaction very easily. SFBs also provide benefit to government by reducing black money from financial system. It will encourage people for use of E-money. These banks are providing financial literacy to rural citizens specially women. SFBs will reduce dependency on cash so cashless economy will be opted.

According to RBI estimates 90% of small businesses do not have access to financial institutions. Commercial banks mainly funds large and medium industries or give loans for home, education or vehicle purposes. But it is very difficult small enterprises to get working capital funding. Small financial banks can solve these kinds of problems. RBI expects them to be high technology and low cost operators, which also bring new innovations in the banking industry. But SFBs affected commercial banks because of shift of savings accounts money also reduces regular fee income like- cash transfer, cheques withdrawals, fee for making demand drafts or ATM transactions.

SFBs will have to invest 75% of their deposits in government sector and it can reduce statutory liquidity ratio. The new banks are going to trust on new technology and this will go down their costs, make their services efficient and stop fraud chances. SFBs will not affect industrial and corporate sector but it will affect the retail business of existing banks. New banks will target the group of low income of rural areas. So there is a competition between rural banks and SFBs.

Role of AU Small Finance Bank "Growing the Right Way"

AU was founded by Mr. Sanjay Agarwal (managing director and CEO of AU Small Finance Bank) as a private limited company. AU began its journey in 1996 as AU financiers and under RBI guidelines, worked for over two decade as retail focused customer- centric, systematically important asset financing non banking financial company. It became Small finance Bank in 19 April, 2017. In the two years since AU became a bank they added nearly a million new customers and offering to 27 products and focus on solutions across key verticals of financing deposits, insurance, transaction banking, mutual funds, business banking and digital banking.

The first step of AU is to empower people is to create jobs and livelihood also focus to convert customer satisfaction to customer delight. The basic objective of AU stands for inclusiveness, progress for all, simplicity, action and urgency. These objectives are pillars on which AU SFB would be serving their customers. AU is serving low and middle income individuals, micro and small enterprises that have limited access to banking and finance channels. AU is playing a significant role in Indian Economy. AU SFB ranked 479 in the list of Fortune India 500 companies with annual revenue of 2,155.25 crores. AU SFB is listed on NSE and BSE with market capitalization of Rs. 17,000 Crores. On its first day of trading, the stock of this bank rose 51%. Due to its history as a vehicles finance company, as of march 2018 almost all the loans made by AU SFB were secured. So AU bank has grown its deposits by having very lower cost.

As on December 31, 2018, AU SFB's distribution network includes 396 branches, 84 asset centers, 49 business correspondents, 15 offices and 485 ATM spread contiguously across 11 states and one union territory of the country. We analyzed that he number of customer increased from 2.8 lakh to 15.23 lakh in March 2019. The customers deposit also increased to 19,422 crore in March, 2019. The Net worth increased from 1,988 crore to 3,163 crore in March, 2019. Interest income of AU bank also increased from 784 crore to 1,342 crore in March, 2019. EPS of AU Bank also increased from 11.2 to 13.2 in March, 2019. By this way we can say that AU Small finance Bank is playing an important role in Indian Economy and Indian Banking Sector.

Challenges Faced by Small Finance Bank

As we know that Small Finance Banks are playing a significant role for improve the financial inclusion. These banks have many advantages like promote the lending to small borrowers, help to understand the needs of unbanked areas. SFBs have low operational expenses. Apart of these benefits Small finance banks are facing some challenges in terms of building the required capacity, infrastructure to service to different clients and also to train its existing manpower. Because of the local nature of business, Small Finance Banks have higher risks, so care has been taken to license only experienced players in the field. It is observed that the banks that have done well in the past were those promoted by financial institutions. These successful banks had adequate experience in the financial services field, financial resources, a sound business model, and were well equipped in every way to run a bank.

A minimum Capital Adequacy Ratio of 15 per cent is to be maintained by the banks on a continuous basis. This Capital Adequacy Ratio requirement is higher than the 9 per cent requirement for scheduled commercial banks as well as 13 per cent for the new Universal Bank licenses. This clearly indicates that a Small Finance Bank is perceived riskier as compared to the Universal Bank due to its local nature of business. SFBs are also facing the lack of awareness along with inadequate funding. SFBs are geographically concentrated. So they have to face systemic risk like weather, crop prices and regional economic performance as compared to other banks. This could lead to governance problems. These banks have to pay higher rate to their depositors. It might create the need to make riskier loans and it might be raising nonperforming assets.

The initial challenge for the SFBs banks will be to adjust their promoter's contribution and foreign shareholding to follow with the RBI guidelines. Many of the institutions have foreign shareholding as high as 90 per cent, and so they will need to dilute this to 49 per cent. The next challenge would be to offer multiple banking products. It would be a high cost affair for developing a technologically sound system for low cost products. It requires large capital to build automated teller machine (ATM), automated banking machine (ABM) or automated branch network and this will make the delivery of banking services costly. The institutional transformation will also require the induction of new and diversified talent from the banking sector as well as training the existing staff to accustom them to this new system of delivering services.

Findings and Suggestion

SFBs are functioning as business correspondent of other banks. SFBs can perform almost all the function that a bank performs but on a small level. Small Finance bank does not concentrate more on advertisement. Small Financial Bank's plays a significant role in generation of sustainable challenges in rural and semi-urban areas. From the study it was found that most of customers are not aware of financial inclusion and small finance banks. Around 500 million people do not have access to even a basic bank account. The main function of Small Finance Banks is to provide financial services at a lower cost by innovative and ingeniously high technology.

SFBs can be a part of the payment and settlement system as a direct member or a sub member of a sponsor bank. These banks have very low cost structure so they can easily achieve profitability. Small Finance banks are allowed to create differentiated brands and leverage to create long term client relationship. It will also reduce the possibility of political interference. SFBs are providing the large range of product and it gives poor people the tools they need to manage the fluctuation in their income and expenses better, protect themselves against the risk. Small Finance Banks will require the efficient change management processes. SFBs will also need to approach their technological requirements comparatively traditional banks.

Conclusions

Small Finance Bank will mark biggest revolution after the nationalization of banks in the Indian banking Industry. It will make banking more competitive and more inclusive for both borrowers and depositors. It will make banking more affordable to the common citizens. So we can say "The new era of consumers has finally started". Small Finance Banks aims to provide basic banking and financial services to unbanked and disadvantaged section of the population. They should focused on establishing more bank branches in rural areas. Because of Small Finance Banks now the people in rural areas can easily avail the basic facilities such as loans, deposits and online banking. Small Finance Bank plays a crucial role to provide assistance for under and unserved faction in order to enhance their socio-economic environment. Small Finance Bank will be having a vital role in economic development and will provide a huge support to the Indian banking sectors.

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