

# Small Finance Bank in India A Supportive Measure for Micro and Small Enterprises

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## Introduction

Small Finance Bank is a specialized segment of banking created by the Reserve Bank of India (RBI) with an aim to strengthen the Indian economy. Such banks intend to execute the concept of financial inclusion by mainly undertaking the basic banking activities to under-served and underprivileged sections of the country. Subsequently, the SFBs cater to the sections like small business units, micro and small enterprises, small and marginal farmers, and the unorganized sector. These banks also undertake the basic banking activities such as lending and accepting deposits just like other commercial banks. The RBI issued the guidelines of the Small Finance Bank in November 2014, just after the announcement of the Union Budget for 2014-15. Around 72 entities from across the segments applied for the license, while only 10 of them were provided the license of operations.

## Objectives

Small Finance Banks are set up to provide basic banking services to underprivileged and underserved sections of the population in India. These banks are allowed to lend money and accept deposits to the deserving masses. Following are the objectives of the SFBs in India: To strengthen the financial inclusion and promote small business units, small and marginal farmers, micro and small enterprises, and unorganized sectors through high technology low-cost operations. To give specific data of around 90% of small businesses that have no links with the formal financial institutions. To identify and expand access to financial services of sections that are neglected by the other private and public sector banks.

## Features of Small Finance Banks

Resident individuals having minimum 10 years of experience or more in banking and finance, companies and Societies will be eligible to act as promoters to set up small finance banks.

NBFCs (Non-Banking Financial Companies), MFIs (microfinance institutions), and LABs (Local Area Banks) can convert their operations into those of small finance banks.

Small finance banks require a prior approval for initial 3 years for branch expansion. They must have a 'local feel' and culture.

They must chiefly undertake basic banking services like lending advances and accepting deposits to the needy and deserving category. It is not permitted for the SFBs to establish subsidiaries to undertake non-banking financial functions.

A robust framework for risk management is needed and the banks are subject to all the prudential norms and RBI rules and guidelines such as maintaining the SLR and CRR.

The Small Bank might need to diversify its portfolio of loans. The maximum loan size and investment limit exposure to group borrowers individuals is restricted to 15% of capital funds

Loans and advances less than or equal to INR 25 lakhs, must constitute a minimum of 50% of the loan portfolio. This must be primarily aimed at the micro-enterprises only.

## RBI Guidelines for Small Finance Banks

Minimum paid-up equity capital must be INR 100 crore.

Every such small finance bank must carry the words "Small Finance Bank" in its name.

SFBs must obtain prior approval of the RBI to carry out financial operations like the distribution of mutual fund units, pension and insurance products, and so on.

These banks must have 25% of its branches set up in unbanked parts of the country.

Small Finance Banks must maintain a CRR (Cash Reserve Ratio) and SLR (Statutory Liquidity Ratio) SFBs in India are required to extend 75% of its ANBC (Adjusted Net Bank Credit) to the sectors that are eligible to be classified as priority sector lending by the RBI.

At least 50% of its loan portfolio should constitute loans and advances of up to INR 25 lakh

SFBs may transit to a universal bank, however, they need to fulfil the minimum paid up capital/ net worth requirements as per the universal banks

Such banks cannot act as a BC (Business Correspondent) for other banks. Although, they can have their own BC network. In July 2014, the Reserve Bank of India (RBI) made initial guidelines for small finance banks and asked for feedback from the public. In November 2014, the final rules for small finance banks were issued by RBI. Interested organizations had to apply by January 2015. In February 2015, RBI listed 72 groups that applied for a small finance bank license. An advisory committee led by Usha Thorat was set up to evaluate the applications. By September 2015, RBI gave temporary licenses to ten groups, mainly microfinance NBFCs, to become small finance banks within a year. Capital Small Finance Bank became the first to start, opening branches in April 2016. In April 2021, RBI approved Shivalik Mercantile Co-operative Bank to become India's first urban co-operative bank to transform into a Small Finance Bank.

### **Acts Applicable On Small Finance Banks**

The small finance bank shall be registered as a public limited company under the Companies Act, 2013.

The following acts apply to Small Finance Banks.

It will be licensed under section 22 of Banking Regulation Act, 1949

Foreign Exchange Management Act, 1999

Reserve Bank of India Act, 1934

Payment & Settlement Systems Act, 2007

Credit Information Companies (Regulation) Act, 2005

Deposit Insurance and Credit Guarantee Corporation Act, 1961

Regulatory Provisions Related To Small Finance Banks

Existing NBFCs, MFIs, and LABs can become small finance banks.

They can be promoted by individuals, corporates, trusts, or societies.

Established as public limited companies under the Companies Act, 2013.

Governed by RBI Act, 1934, Banking Regulation Act, 1949, and relevant laws.

No regional restrictions.

Aim to promote rural savings and provide credit for local economic activities.

75% of net credits in priority sector lending, 50% of loans in ₹25 lakh range.

Minimum paid up capital requirement of ₹200 crore.

Promoters need 10 years of banking and finance experience.

The initial promoter stake is 40%, reduced to 15% in 15 years from the date of commencement of business of the bank.

No joint ventures or foreign shareholding is allowed as per FDI rules.

Mandatory listing within three years at a net worth of ₹500 crore, voluntary below that.

### **Guidelines Of RBI Related To Operations Of Small Finance Banks**

Minimum Paid-up Equity Capital; INR 200 crore

Name Requirement: Must include the words "Small Finance Bank" in the name

RBI Approval for Financial Operations : Prior approval needed for activities like mutual fund distribution, pension, and insurance products.

Branches in Unbanked Areas :25% of branches must be in unbanked parts of the country

Reserve Requirements; Maintain CRR (Cash Reserve Ratio) and SLR (Statutory Liquidity Ratio)

Priority Sector Lending ;75% of Adjusted Net Bank Credit (ANBC) to eligible priority sectors

Loan Portfolio Composition :At least 50% of loan portfolio for loans and advances up to INR 25 lakh.

Transition to Universal Bank Allowed, :subject to meeting universal bank capital/net worth requirements.

Business Correspondent (BC) Role: Cannot act as BC for other banks, but can have its own BC network.

### **Scope of Activities of Small Finance Banks**

**Basic Banking Services:** Offering a range of basic banking services such as deposit acceptance, lending, and other financial transactions.

**Financial Inclusion:** Focusing on providing banking services to unserved and underserved sections of the population, including rural and semi-urban areas.

**Microfinance:** Providing credit and financial services to small and marginal farmers, micro and small industries, small business units, and other unorganized sector entities.

**Priority Sector Lending:** Extending a significant portion of their credit to priority sectors as defined by the Reserve Bank of India (RBI).

**Unbanked Regions:** Establishing a certain percentage of branches in unbanked parts of the country to promote financial access.

**Technology-driven Operations:** Leveraging high technology and low-cost operations to ensure efficient and accessible banking services.

**Mutual Fund Distribution:** With prior RBI approval, small finance banks can distribute mutual fund units.

**Pension and Insurance Products:** Subject to RBI approval, offering pension and insurance products to customers.

**Retail Banking:** Engaging in retail banking activities, including savings and current accounts, fixed deposits, remittances, and payment services.

**Non-Resident Indian (NRI) Services:** Providing banking services to Non-Resident Indians, subject to RBI regulations.

**Corporate Banking:** Offering banking services to small and medium-sized enterprises (SMEs) and other corporate entities.

**Housing Finance:** Extending credit for housing and real estate-related activities.

**Mobile and Digital Banking:** Emphasizing mobile and digital banking services to enhance customer convenience and accessibility.

**Financial Literacy and Education:** Conducting financial literacy programs to educate customers about banking and financial matters.

**Promotion of Self-Help Groups (SHGs):** Collaborating with self-help groups for micro-credit and other financial services.

**Community Development:** Participating in community development initiatives and contributing to the local economy.

### **List of Small Finance Banks In India**

1	Ujjivan Financial Services Pvt Ltd	1 February 2017	Ujjivan Small Finance Bank	Bangalore
2	Janalakshmi Financial Services Pvt Ltd	29 March 2018	Jana Small Finance Bank	Bangalore
3	Equitas Holdings Pvt Ltd	5 September 2016	Equitas Small Finance Bank	Chennai
4	Au Financiers India Ltd	19 April 2017	AU Small Finance Bank	Jaipur
5	Capital Local Area Bank Ltd	24 April 2016	Capital Small Finance Bank	Jalandhar
6	ESAF Microfinance	17 March 2017	ESAF Small Finance Bank	Thrissur
7	RGVN North East Microfinance Ltd	17 October 2017	North East Small Finance Bank	Guwahati
8	Suryoday Microfinance Pvt Ltd	23 January 2017	Suryoday Small Finance Bank	Navi Mumbai
9	Utkarsh Microfinance Pvt Ltd	23 January 2017	Utkarsh Small Finance Bank	Varanasi
10	Shivalik Mercantile Co-operative Bank Ltd	26 April 2021	Shivalik Small Finance Bank	Noida
11	Centrum Financial Services Limited and Bharat Pe	1 November, 2021	Unity Small Finance Bank	Delhi