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Micro Finance Activities Offered by Small Finance Banks in India

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***Abstract*: This Project gives an exposure of the micro-finance activities being offered by small banks in India whereindetailed study has been provided for registration, performance and features of small banks as well as the micro finance industry in India. Title of the study is "*Micro-finance activities offered by small banks in India*". In this report, the study of small finance banks has been done which is a recent innovation in the Indian banking structure. These banks are expected to penetrate financial arena by providing basic banking and credit services with a differentiated banking model to the larger population. In doing this, the new SFBs are facing numerous challenges in developing a new, distinguished business model which include structuring of low-cost liability portfolio, technology management, and maintaining the regulatory compliances.**

All Small Finance Banks offer basic lending and deposit activities, like loans and deposits. However, what makes these activities stand out is that SFBs are required to focus their activities more towards the priority sector, which includes facilitating funds to poor people for housing, providing loans for agriculture and allied activities, funding to micro and small industries, and weaker sections of the society.

The Objectives of this study were, to understand the concept of micro finance activities offered by the small finance banks along with the vision of micro finance in India, which concerns the below questions:

- **What is the essence of differentiation as compared to regional rural banks or local area banks with the introduction of small finance banks and recognition of source of business opportunity by potential small finance banks?**
- **How are such new banks leveraging technology?**
- **How are such new banks building a liability portfolio and providing a wide range of liability products?**
- **What are their capital management strategies?**
- **What strategies do these banks visualize to face the challenges of a competitive banking landscape?**

The Research Method used in this project is the collection of Wikipedia information, study of economic journals, study of banking regulations, reports of Reserve Bank of India, top of mind views of senior executives of new small finance banks and other informative write ups.

This report has some limitations and the main operations related to micro finance adopted by the small banks are not recognized. The norms are changing with time. This study is done in the present scenario without foreseeing future developments.

The Findings of the study are based on the results obtained through the interpretation of analysis of the top management views and journals referred to in this study. From the study, it is clear that the new small finance banks are expected to redefine the banking sector in the country with a greater number of players competing in the rural financial services landscape.

Based on above Findings and Suggestions, the Conclusion is that the instant challenges for such banks are building the liability product portfolio, meeting the mandatory statutory norms of *cash reserve ratio*, developing improved digital connectivity with the large scale rural customer base, and designing cost effective banking solutions. Such new banks are yet to come out with an innovative banking business model to develop a path for differentiated banking.

***Keywords*: microfinance, small banks, India, investment, growth.**

1. Introduction

The microfinance area has acquired most extreme significance in encouraging comprehensive evolution by extending loans to borrowers who are stuck at the least edge of the monetary pyramid. With the development of this area, low-pay families have acquired such countless freedoms by getting easy admittance to advances. This area has had the option to stretch around 6.4 crore remarkable live borrowers to give credit to these borrowers who were not even mindful of customary monetary administrations prior.

Microfinancing' was presented in India during the 1980s as an answer for neediness and to engage ladies. Notwithstanding its solid potential, the microfinance area faces difficulties identified with openness in country India. Microfinance is a kind of banking administration gave to the individuals who experience issues in getting to formal monetary administrations. The main source of the disappointment of formal financial foundations in India while loaning to the rustic poor is the shortfall of evidence of perceived work or security that can be offered by poor people while applying for credits.

In India, the main drive to present microfinance was the Independently Employed Ladies' Relationship in Gujarat, which set up SEWA Bank in 1974. From that point forward, this bank has been offering monetary types of assistance to people who wish to develop their own organizations in country regions. There is a need to give microfinance offices to take into account India's huge rustic populace. The primary targets of microfinance in India ought to advance financial improvement at the grassroots level through a local area based methodology,

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enabling ladies and expanding the family pay.

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There is a need to give microfinance offices to oblige India's enormous country populace. The fundamental targets of microfinance in India ought to advance financial improvement at the grassroots level through a local area based methodology, engaging ladies and expanding the family pay. As with executing any extraordinary drive, running a microfinance program in provincial India accompanies a few difficulties:

By and by, the complete credit arrangement of this area sums to INR131 trillion and the advance disbursal has developed its volume by 20%. Such development has driven thus of swift progressing governing changes, significant use of payments through UPI, improvements in little money banks and different drives by the public authority and administrative specialists.

Little money banks have a place with the specialty banks in India. Banks having the permit of little money bank ordinarily deliver essential financial administrations of acknowledgment of stores and loaning. The point of these banks is to offer monetary types of assistance to segments of the economy which are not being served by some other banks, like private company units, little and peripheral ranchers, miniature and little businesses and the elements working in a chaotic area.

One of the greatest credit that goes to microfinance is that it urged business venture to battle neediness. Numerous parts of present day culture follow their underlying foundations back through history and microfinance is no exemption. Systems for giving advances to penniless populaces have existed in different structures in Asia for millennia. In Europe, Franciscan priests framed the Mounts of Devotion in the fifteenth century to reintegrate the most unfortunate populaces into local area life. As the main mutualist monetary establishment, it essentially served working populaces by giving them admittance to credit.

The Grameen framework turned conventional depending on its head. It offered little credits to helpless populaces, with no monetary ensures needed in kind. At long last, the program focused on ladies, who had been generally barred from the monetary framework.

In 1983, the program got the situation with a financial foundation. Grameen Bank was in this way conceived and would before long record shocking development. Before long an undeniable microfinance industry arose in agricultural nations. The mid-21st century denoted the global ascent of microcredit.

While the first microcredit culmination occurred in Washington in 1997, the G8 illustrated the standards of microfinance in 2004, following the shapes of another financial area. The UN named 2005 the Worldwide Year of Microcredit», and Muhammad Yunus won the Nobel Harmony Prize in 2006.

2. Objectives of the Study

The study's main goals are as follows:

- To gain a better understanding of the origins and notion of online banking.
- To investigate the significance, functions, benefits, and drawbacks of online banking.
- To describe the various types of online banking and to examine the rules and regulations governing online banking as set forth by the RBI.
- To draw attention to the security issues that exist in online banking, as well as how to mitigate these issues using security control tools.
- To use primary data to investigate the trend in online banking.
- To assess the current state of e-banking in terms of ATMs, Internet banking, mobile banking, credit card-debit card, fund transfer, and other e-banking services.
- By evaluating the issues that customers face, the effect of ATMs, Internet banking, mobile banking, and credit cards on customer satisfaction will be investigated.

3. Methods

Data Collection:

Primary data: The research relies on both primary and secondary data.

Primary data was obtained from the people of UTTARPARA for the purpose of the case study through phone calls, social media, and direct interviews.

Secondary Data: Secondary data was gathered from a variety of articles and websites, including www.wikipedia.com, www.google.co.in, and many others. To analyze and present the data, we used simple images, tables, and graphs.

Apart from that, I completed the project by following my supervisor's instructions.

MX Sampling Methodology: The primary data was obtained through a poll with a pre-tasted organized QUESTIONNAIRE on a random sample of 114 people from UTTARPARA, including college students, business people, service holders, working mothers, and individuals in the 20-60 age range. 100 of the 114 respondents use online banking, and the information gathered from them is used to analyze the Net-Banking trend.

Limitation of the Study:

The following are the study's principal limitations: The study uses a small sampl size of 114 respondents for primary data analysis. As a result, I am unable to make proper inferences about the respondents based on this sample size. I did not analyze the data using contemporary statistics methods. Due to a lack of time, I was unable to conduct a thorough investigation. I was unable to retrieve data from the UTTARPARA website. This research is based on the happiness of the majority of respondents. How their satisfaction may fluctuate with the passage of time, fashion, and need, among other factors.

Synopsis of the microfinance industry of the nation:

Microfinance rose to fame as a global movement in the early 1980s with an aim to facilitate loan availability to low-income households having controlled access to conventional banking. The uncertainty of governing landscape, over indebtedness of borrowers and absence of an institutional framework have become some of the considerable matters for the global microfinance industry. However, recently, the microfinance industry has been transformed significantly with the formation of self-regulatory organisations (SROs), formulation of structured guidelines, digital interventions and implementation of a redefined customer servicing approach resulting into a substantial enhancement in the loan portfolio and, consequently, the quantum of borrowers.

Currently, the microfinance industry across the globe approximates to INR 8.90 trillion having the loan disbursed amount rising at an average annual rate of 11.5% over the past 5 years. The industry has created a favourable impact in the lives of 139.9 million borrowers worldwide, 80% of whom are women and 65%, from a rural background.

South Asia has emerged to be among the principal markets in the global microfinance industry. It was providing credit facilities to the highest number of borrowers in 2018, i.e. 85.6 million borrowers which has been growing at a rate of 13.8%, which is much larger as compared to that of other locations. A considerable percentage of these borrowers belongs from India. In FY19, the loan portfolio of the country's microfinance industry has increased by 40% YoY, having an outstanding loan portfolio worth INR 1.785 trillion and 64.1 million unique live borrowers. Such growth could take place due to a landscape of varied microfinance providers as well as diverse micro lending models.

Two surveys were conducted in September–October 2019 by the professionals, intended to recognize the problems and issues faced by the microfinance industry and identify the prospects of the industry. One survey was directed to micro lenders including microfinance institutions (MFIs), non-banking financial companies (NBFCs), banks and non-governmental organisations (NGOs) in which more than 80 responses were received from senior executives (including CEOs, CFOs and managing directors) from 20 organisations (banks, MFIs, NBFCs and NGOs).

The second survey was conducted to recognize customer attitudes towards the microfinance industry. Around 200 people responded on the survey from several small-scale businesses in the transportation, logistics, agriculture, textile and other sectors.

Microfinance providers in the domestic lending landscape

Micro lending in India has been enabled by various players like banks, SFBs, MFIs, NBFCs and not-for-profit MFIs. MFIs cover a major share of the loan portfolio, for almost an amount of INR 681 billion which covers 38% of the total industry portfolio. It submits the preference of maximum borrowers to get loans from MFIs.

Among the players in the microfinance backdrop, banks have witnessed constant growth, with easy availability of funds, higher loan ticket size as well as lower percentage of crime. However, though MFIs hold the largest share of the loan portfolio, they are still struggling to enhance their growth which has been badly affected due to insufficient funds and high customer acquisition resulting in servicing costs taking place from operations in remote locations. Consequently, the rates offered by the MFIs may range from 24% for larger NBFC-MFIs to 35–45% for smaller MFIs, leading to an operational challenge of unaffordability for end customers and large NPAs for microfinance providers.

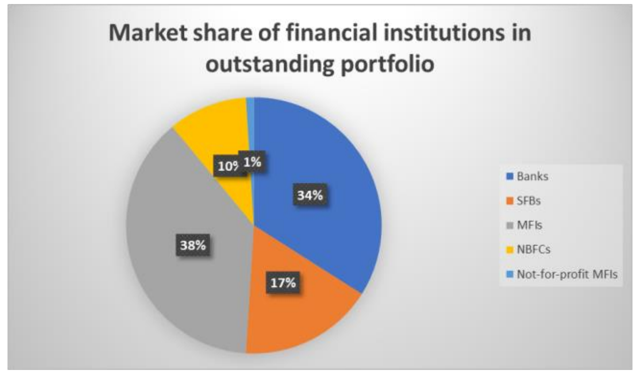

Fig. 1. Market share of financial institutions in outstanding portfolio

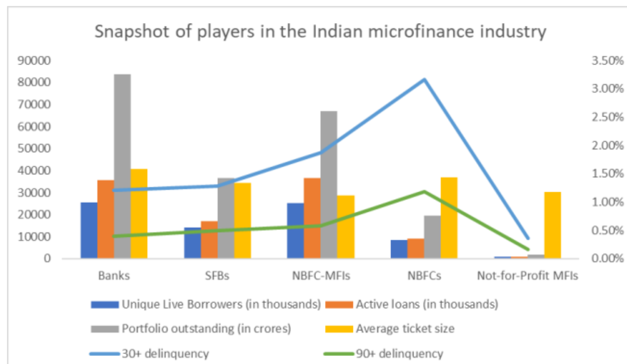

Fig. 2. Players in the Indian microfinance industry

Along with banks as well as MFIs, an important evolving player in the current microfinance landscape are Small Finance Banks, providing high-ticket loans having an edge over NBFCs and MFIs. In FY19, the average ticket size distributed per client by NBFC and MFIs was INR 25,850, while that distributed by SFBs was INR 30,780. SFBs are not controlled by MFI guidelines, which lets them to offer higher ticket size loans. With an increase in the market share of SFBs from the current 17%, they are expected to penetrate further and provide competitive products to borrowers.

The existence of numerous players having unique strengths and weaknesses has led to a need for a more collective approach for higher growth. Considering that, a circular was issued by RBI covering the aspects for co-origination of loans by banks and NBFCs/MFIs in September 2018, emphasizing to execute a joint arrangement between banks and NBFC/MFIs for credit and risk sharing. Co-lending can moderate the risk of lending for NBFCs, with a major share of the credit risk borne by the participating bank. It is also expected that the bank will also be benefitted from the extensive network of the NBFC/MFIs responsible for the sourcing and servicing of loans under this arrangement.

On-tap licensing for SFBs:

In September 2019, the RBI released draft norms for 'on-tap' licensing for the formation of SFBs according to which an application for an SFB license can be made by existing NBFCs, MFIs, payment banks and urban co-operative banksif they meet certain conditions and have a minimum paid-up capital of INR 2 billion.

Popular models of microfinance disbursement:

Most of the microfinance players in the domestic market extend loans through either of the wo models which are the joint Liability Group (JLG) and Self-help Group (SHG) model.

SHG model vs. JLG model:

The decision as to which disbursement model is to be chosen is determined entirely by the feasibility of the model and organizational plan of the institution. With limited funding access, JLG model is preferred by the NBFC-MFIs for being more scalable – faster turnaround, lower NPAs (<1% compared to 7–8% for SHGs), and joint liability which minimizes default risks, thus making it commercially viable to service the growing customer base. In totality, the JLGs have increased by 46% in FY19 as compared to FY18, having SFBs and commercial banks promoting JLGs through MoUs with NABARD. In future also, the SHG share is expected to decline compared to that of JLGs as NBFC-MFIs are transitioning to adopt the JLG model. It has been obvious from the historical trend of SHG contribution to the total MFI portfolio in selective states.

NABARD entered into 7 MoUs with State Bank of India during FY19 to support banks in capacity building, training and skill development for financing and fostering new JLGs through Joint Liability Groups Promoting Institutions (JLGPIs).

Prospects for growth of microfinance in the country:

Although multiple players are present in the microfinance landscape and mature models of micro lending are there, having a substantial portion of its population in the low-income band, still the country signifies a huge opportunity for the microfinance sector. In spite of enhanced access to government schemes and established financial institutions to microcredit for nearly 67% of the Indian population residing in rural areas, the substantial geographic attention of MFIs within a few districts of the country (34% of the districts having microfinance presence contribute 80% of the portfolio) indicates the potential for achieving higher microfinance penetration.

In addition to that, a substantial percentage of the Indian population still doesn't have access to credit from the formal sector and hence they borrow from informal channels like moneylenders or relatives which indicates that there is a wide scope of micro lending in achieving financial inclusion as well as overall industry growth.

But to realize this growth opportunity, it is important for the sector to recognize as well as evaluate the evolving needs within the sector and address the same through applicable initiatives for optimized growth.

Microcredit should perform in such a way that the borrower's journey gets transformed from that of a job seeker to a job creator. With the progress in the sector to improved norms and investment flows, there comes a necessity to leverage funds so that a sustainable and profitable ecosystem can be created for borrowers. The craftsman needs to be provided with an access to supplies to develop handicrafts along with an access to offline and digital platforms to sell products.

Future prospects for microfinance in the country

With the rise of varied requirements of the microfinance ecosystem, sustainable growth of the industry has become dependent on transformation initiatives centered around effectively improving the stakeholders' experience as well as managing overall operational efficiency.

Affordable borrowing for everyone: Hassle free access to microcredit:

In order to retain and service microfinance customers, availability of credit is of utmost importance. To boost more borrowing among customers and revive the slackening Indian economy, RBI has enhanced the lending limit for low-income borrowers and eligible income limit for rural and urban/semi-urban areas as follows:

Table 1

	Current (INR)	**Previous (INR)**
Lending Limit:		
Low-Income borrowers	1.25 Lakh	1 Lakh
Eligible Income Limit:		
Rural areas	1.25 Lakh	1 Lakh
Urban/Semi-urban areas	2 Lakh	1.60 Lakh

Such enhancement in lending limits, along with new investment channels and changing business models, will support complete growth of the microfinance sector.

New investment channels: Commercial banks have mostly been involved in funding micro lenders for debt and equity. Hence, partnerships must be developed by the sector with private donors which include foundations, NGOs, development agencies, venture capital and social impact investing through corporate social responsibility (CSR) funds, global trust funds and other financial sources. In FY18, INR 17.17 billion of the CSR funds of NSE-listed companies were remained unspent. The microfinance industry can enter into partnerships with private corporations also for routing unused CSR funds for enabling the industry. The funds can be channeled well through regulated platforms for these partnerships. The microfinance players can also view long-term benefits by leveraging funds from the retail bond market. Financial training institutes and kiosks for women's development can be created to support the microfinance industry using these funds. An investment corpus can be created for micro lenders to access by creation of funds in line with India Microfinance Equity Fund (IMEF). Micro lenders can effortlessly access the funds and boost the beginning of an entrepreneurial mindset and culture and upskilling of existing labour, thus contributing to the country's overall economic growth. Further, alternative investments can develop robust network effects to channel more private/public investors in the micro lending industry, there by delivering required incentive for growth.

Micro lenders could try new-generation fundraising options such as social impact bonds (SIBs), to access low-cost funds. Institutions having access to low-cost funds may channel these funds to micro-borrowers through well-regulated intermediaries, like the Prayaas initiative by SIDBI.

New business models: Considering the necessity to preserve capital for reducing dependence on external funding, new business models for smaller MFIs are being emerged. Such smaller MFIs, while lending on their own books, are aggressively assessing business correspondent (BC) models to source on behalf of larger banks and NBFCs, which would reduce the risks of raising capital for them. These institutions generate fee-based revenue by sourcing of loans for larger banks. In return, they waive interest-based revenue that could have been produced by sourcing their own loan, which have its own risk of over borrowing and NPAs. Micro lenders should assess their ability to bear risks and necessity of funds and cleverly choose the business model that would help in ensuring sustainability.

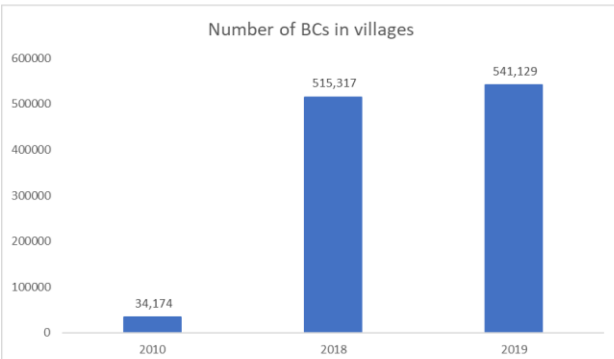

Fig. 3. Number of BCs in villages

Reaching the doorstep of every unbanked customer:

Financial services can be defined to have reached in true sense by developing awareness on microcredit disbursement, access to income generation and facility to benefit from government schemes. As microcredit disbursement grows, it endeavors to reach the underserved segment not only through direct access to credit but also through access to innovative products that would improve the unbanked population's standard of living. The National Strategy for Financial Inclusion (NSFI) for 2019-24 has been drafted by the RBI to ensure safe and transparent access to financial services for all the citizens. This is expected to accelerate financial inclusion and acknowledge the problems of low literacy rates, lack of awareness, high interest rates and poor access to technology infrastructure.

Customer-focused product and service offerings: Financial inclusion is not limited to just individuals with access to bank accounts. It is their ability to access a wide range of appropriate financial products and services that are associated with the changing dynamics of the target market. Microfinance players should deliver organized financial products focusing on individual needs like crop insurance and equipment leasing facilities with repayment terms provided to specific agricultural growth and output cycles.

Micro insurance, for example, is expected to cover a mass of risks, including natural risk and calamities, credit risk, market risk and health risks. Likewise, customized health financing products can include micro health insurance, access to subsidized medical products, and awareness of service providers' network.

The evolution of customer-centric products and services should be enabled by strong customer profiling based on lifestyles, personalities, occupations and behaviours for higher adoption. The subsequent access to diversified products can enable borrowers to enlarge their income capabilities and prevent the risks of over-borrowing.

Last-mile access: Many government schemes, private and trust fund initiatives have been promoted to provide and measure the access of financial services to deprived individuals. In September 2018, the Ministry of Finance, Government of India, launched the Financial Inclusion Index to measure access to, usage and quality of financial services. Further, Jan Dhan Darshak, a mobile app, has been launched by the Department of Financial Services (DFS) to assist people find relevant financial services in their locality. In order to provide last-mile services in unpenetrated locations, microfinance players can look to leverage government initiatives and develop new partnerships to drive financial inclusion efforts.

Furthermore, BCs can play a crucial role in facilitating access of financial services to customers as well as enablement through self-regulatory organizations. They can assist in restructuring their functioning by providing standard operational guidelines. Also, interoperability of agents among microfinance players and leveraging the pre-existing distribution infrastructure through corporate partnerships with FMCGs, logistics and manufacturing companies can also assist in enlarging the customer reach. A two-tier 'Train the Trainers' programme was designed and rolled out in March 2019, as part of the RBI's initiative to build the capacity and skills of BCs for effectively providing financial services at the grass-root level. The programme on financial literacy will sensitize the counsellors of Financial Literacy Centres (FLCs) and rural banks' branch managers, so that they may provide basic financial literacy at the ground level.

4. Conclusion and Road ahead

India is planning to reach anINR366 trillion economy by 2025 where the microfinance industry will play a principal role in uplifting the lives of millions of low-income households and will let them contribute to India's economic growth. Since the microfinance industry holds the current set of challenges, it is important for the industry to create strong governance and regulatory practices. The way forward of the industry will depend on capability of players to venture into new partnerships, develop new products, create new investment channels and leverage technology to meet the demands of consumers.

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