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Profile of Small Finance Banks

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Small Finance Banks are a relatively new concept in India which was part of the plan of having differentiated banks in the system which would be niche in nature. These banks came into existence post 2016 with the objectives of providing a savings vehicle for the unserved sections as well as supplying credit to small business, marginal farmers, MSEs etc. 25% of their branches had to be in unbanked areas and the minimum capital required was Rs 200 crore. The capital adequacy ratio to be maintained was 15% with 7.5% being Tier 1. Further, 75% of ANBC had to be to the priority sector. Within this limit 40% had to follow the normal PSL guidelines while the balance could be to any sector within the scope of PSL. There was an additional condition that 50% of loans should be of a ticket size of less than Rs 25 lakhs.

The purpose here is to present a profile of these banks and juxtapose the same with the banking system. Data on 10 SFBs have been presented below which has been taken from the RBI's recent Report on Trend and Progress in Banking. The total size of balance sheet was Rs 1.33 lkh crore. Their share in the overall banking system was very insignificant at 0.7%. On account of a low base they were able to grow their asset book by 58% in FY20 as against 8.5% for the banking system (PSBs, private, foreign and SFBs). The table below provides information on the main heads in the balance sheets of these banks.

Table 1: Select variables in Consolidated balance sheet and P & L of SFBs (March 2020) Rs crore

Balance Sheet	
Capital	5,151
Reserves	11,047
Deposits	82,488
Term deposits	69,823
Investments	24,203
Loans	90,576
P & L	
Income	19,219
Interest	16,948
Other income	2,271
Operating expenses	17,251
Provisions	2,171
Net profit	1,968

SFBs had around 60% of their deposits in the less than 1-year bucket and 37.5% in the 1-3 years bucket. The comparable figures for PSBs were 40.4% and 22.8% respectively. Hence, their reliance has been more on shorter term maturities. On the assets side, loans with less than 1-year maturity were 38.1% of total and the 1-3 years bucket had a higher share of 42.4%. These numbers were 25.2% and 40.3% respectively for PSBs.

A similar picture was seen in investments where the share of up to 3 years was 85.3% compared with 35.2% for PSBs. The SFBs hence have a shorter duration of deposits and loans given that they are focused on the priority sector which includes agriculture and MSEs where the tenures of credit tend to be shorter.

Some of the main operating ratios are presented in the table below.

Table 2: Select ratios of banks (%)

	PSBs	Private Banks	Foreign banks	SFBs
Cost of deposits	4.96	5.26	3.65	***8.20***
Cost of funds	4.92	5.41	3.73	***8.66***
Return on advances	8.16	10.10	8.45	***19.87***
Return on assets	-0.23	0.51	1.55	***1.70***
Return on equity	-4.16	3.30	8.76	***15.0***

The table shows that SFBs do have a higher cost structure which also translates to higher returns on business. They have been paying higher interest rates on deposits to garner funds which in turn gets translated on the lending side too. This can be seen in the returns on advances which is around 20% and is higher than the other banks by 8-11%. Consequently, for these banks the return on assets as well as equity are the highest among various categories of banks. The net interest margin defined as NII by total average assets of FY19 and FY20 was highest for SFBs at 8.34% in FY20 as against 2.37% for PSBs, 3.42% for private banks and 3.26% for foreign banks.

Prudential indicators

The SFBs have also done well so far in terms of maintaining the prudential standards in banking as the table below shows. They have the highest capital adequacy ratio and lowest NPA ratio. As they have been in existence for the shortest period of time, these ratios need to be maintained going ahead.

Table 3: Prudential indicators

	PSBs	Private Banks	Foreign banks	SFBs
Capital adequacy ratio	12.9	16.5	17.7	***20.2***
Gross NPA ratio	10.3	5.5	2.3	***1.9***

Concluding remarks

Small finance banks have been fairly successful so far in terms of furthering the cause of financial inclusion. Their model is different as can be seen by the operating ratios where their cost of funds is high which is passed on the borrowers. This has also resulted in favourable profit ratios so far. Their performance is in contrast to Payments Banks which also have a high-cost model and have not yet turned profitable. There were 6 of them with a balance sheet size of Rs 8425 crore as of March 2020. They made losses of Rs 833 crore this year, which though an improvement from 2018-19 when they were Rs 937 crore, would have a long gestation period to become profitable. The limited operational space of these banks, coupled with high initial costs in setting up of the infrastructure, implied that the initial years would be invested in expanding their customer base and they will take time to break even.

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