Ushus-Journal of Business Management
2023, Vol. 22, No. 1, *31-39*
ISSN 0975-3311 | https://doi.org/10.12725/ujbm.62.3

Issues and Challenges Faced by Small Finance Banks in Debt Collection with Special Reference to Rural Areas - A Conceptual Study

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Abstract

The Reserve Bank of India (RBI) created Small Finance Banks (SFBs) in 2015 to encourage financial inclusion and offer banking services to underserved populations. Small business units, micro- and small businesses, farmers, and low-income households are just a few examples of the unbanked and underbanked groups of the population that SFBs primarily target with basic banking services. SFBs are nevertheless vulnerable to non-performing assets (NPAs), which can arise for a number of causes, just like other banks. SFBs use a variety of strategies, such as effectiv credit appraisal and monitoring, quick recovery actions, loan restructuring, and legal action against defaulters, to manage and reduce their NPA levels. To maintain compliance with prudential norms and protect stability, the RBI supervises and conducts routine inspections of SFBs.

Keywords: Reserve Bank of India, Small Finance Banks, Financial Inclusion, Non-Performing Assets, Micro Finance

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Introduction

Small Finance Banks (SFBs) are a type of niche bank in India that was introduced by the Reserve Bank of India (RBI) in 2015 to promote financial inclusion and provide banking services to underserved and unbanked segments of the population such as small business units, micro and small industries, farmers, and low-income households. As per RBI guidelines, SFBs can only operate within a defined area of operation, which is usually limited to a few districts or a single state. They are required to primarily focus on providing basic banking services such as savings accounts, current accounts, term deposits, and credit facilities to the unbanked and underbanked segments of the population. However, like other banks, SFBs are also susceptible to Non-Performing Assets (NPAs), which are loans and advances that have stopped generating income for the bank due to non-payment of interest and principal for more than 90 days. NPAs can develop for a number of causes, including a slowing economy, failed businesses, fraud, and willful defaults. Depending on variables like their lending methods, borrower profiles, and economic situations in their area of operation, separate SFBs may have different NPA levels. SFBs employ a variety of tactics, including efficient credit evaluation and monitoring, prompt recovery actions, loan restructuring, and legal action against defaulters, to manage and lower their NPA levels. In order to ensure compliance with prudential standards and to safeguard the stability and soundness of the banking system, the RBI also oversees and performs periodic inspections of SFBs.

Review of Literature:

Dr. Bhagirathi Nayak (2020) made an attempt to investigate the factors that influence financial inclusion and how it is measured throughout the state of Odisha. The study took into account a number of variables, such as district-specific infrastructure, industry, educational institutions, and main crops. By using data up to the end of March 2019, the researcher conducted the study to estimate financial inclusion in Odisha. The study examined the state of financial inclusion in Odisha and its future prospects. In their research, the author talks about the impact of the Index of Financial Inclusions in relation to other elements including infrastructure, agriculture, fisheries, educational institutions, MSME, and main crops. The study discovered that the Index of Financial Inclusions had no appreciable effect on infrastructure, MSME, or Fisheries. Major crops and education were significantly impacted by the Index of Financial Institutions.

Kini & Patil, (2022), To address the difficulties in determining the nation's financial structure, microfinance developed. By examining the causes and motivators of microfinance in the five districts of the Northern Karnataka region, this study seeks to answer the question of whether microfinance and joint liability groups are feasible in India. The study discovered that SFBs' microfinance services were crucial in enhancing the socioeconomic standing of the majority of the population, particularly women. The study demonstrates that SFBs encounter difficulties in providing financial services to joint liability groups from the perspectives of accessibility, affordability, and operational issues. In order to achieve full financial inclusion, the report recommends a deliberate rollout of microfinance in rural areas through SFBs.

Nitin Kumar, (2021) An early evaluation of the performance of SFBs for early policy inputs is provided in the article Performance of Small Finance Banks - An Early Reflection. The analysis shows that elements like effectiveness, leverage, liquidity and the banking industry are statistically important drivers of these institutions' performance.

S D. V. (2018), India's MSME sector is renowned for producing jobs. As a result, the Indian government places increased emphasis on promoting and growing micro, small, and medium-sized businesses (MSMEs). Bank credit is a crucial component of this. Regrettably, need-based financing hurts these businesses. As a result, there are more sick units and non-performing assets (NPAs) in the MSME sector. The Government of India and the Reserve Bank of India have both undertaken numerous measures over the years to develop new policy guidelines and plans, enhance institutional frameworks, and update lending standards. Streamlining the lending process and requesting that banks use best practices. Yet the issue hasn't been fixed. As a result, MSMEs stop making their loan payments on time and become NPAs. To this purpose, it calls for an examination of the MSME sector's NPA portfolio and a review of loan recovery strategies, from which recommendations for improved NPA management in the industry can be proposed.

Joo & Durri(2015) Bankers all around the world used to concentrate on macro-finance, but more recently, their strategies have changed to emphasize microfinance because they believe that smaller is both attractive and effective. Researchers worry, meanwhile, that offering microfinance services will have a bad impact on these institutions' financial success. So, the authors made an attempt to examine the financial sustainability and viability of Jammu and Kashmir Grameen Bank, one of the state's top microfinance institutions. The study's findings show that the bank has expanded its reach in both breadth and depth and that both its interest rate spread and asset quality have improved during the reference period. In spite of low levels of non-performing assets, the bank is losing a sizable amount of money, according to the slippage analysis. In order to increase the financial viability and sustainability of these institutions, the study, therefore, suggests a policy of enforcing more control over asset quality, spread, and burden management.

Objectives

1. To know the role of SFB in the rural area
2. To understand the challenges and issues faced by SFB in debt collection.
3. To provide constructive suggestions to improve debt collection.

Leading Small Finance Banks in India

1. AU Small Finance Bank: With a total asset base of over Rs. 35,000 crores and a client base of over 2 million, AU Small Finance Bank is one of the top SFBs in India. The bank has more than 600 locations and operates in 13 states.
2. Equitas Small Finance Bank: With a total asset base of over Rs. 17,000 crores and a client base of more than 5 million, Equitas Small Finance Bank is another notable SFB in India. The bank has more than 850 locations and operates in 16 states.

3. Ujjivan Small Finance Bank: With a total asset base of over Rs. 16,000 crores and a client base of over 5 million, Ujjivan Small Finance Bank is one of the top SFBs in India. The bank has more than 550 locations and operates in 24 states.

4. Fincare Small Finance Bank: With a total asset base of over Rs. 8,000 crores and a client base of over 2 million, Fincare Small Finance Bank is a rapidly expanding SFB in India. The bank has more than 550 locations and operates in 8 states.

5. ESAF Small Finance Bank: Based in Kerala, ESAF Small Finance Bank is an SFB with a total asset base of more than 6,000 crores of rupees and a clientele of more than 2 million. The bank has approximately 400 locations and operates in 14 states.

Role of SFB in Rural Areas

1. Greater Financial Inclusion: By offering banking services to the unbanked and underbanked portions of the population, SFBs have significantly contributed to greater financial inclusion in rural areas. SFBs have been able to meet the financial demands of small business units, micro and small industries, farmers, low-income households, and other groups by concentrating on offering basic banking services to the rural population.

2. Credit Access: SFBs have also given rural borrowers who were previously shut out of the conventional banking system access to credit. SFBs have been able to use technology to lower the cost of credit delivery and to reach out to remote and underdeveloped areas, allowing them to provide loans to rural borrowers at competitive rates.

3. Job Creation: By opening branches and hiring local workers, SFBs have provided employment prospects in rural areas. In addition to giving locals a job, this has raised the financial knowledge and awareness of the rural populace.

4. Support for Rural Economy: By giving loans to farmers and small companies, SFBs have also helped the rural economy grow. This has made it possible for these companies to grow, hire more people, and support the general growth of the rural economy.

5. Financial Literacy: SFBs have been essential in raising rural borrowers' level of financial literacy. Rural borrowers have been made aware of the value of savings, credit, and other financial services by SFBs through the implementation of financial literacy programs and awareness campaigns.

Challenges and Issues Faced by SFB in Debt Collection:

1. Lack of Financial Awareness: The lack of financial literacy among the rural population is one of the major obstacles SFBs confront in recovering debt from rural areas. The lack of understanding of interest rates, repayment plans, and loan documents among many rural borrowers might result in late payments or defaults on payments.

2. Infrastructure Deficits: Lack of basic infrastructure, such as roads, electricity, and internet connectivity, can make it challenging for SFBs to interact with borrowers and monitor payments. Delays in debt collection and an increase in NPAs may result from this.

3. Seasonal Cash Flows: Many rural borrowers, like farmers who only make money during harvest, have cyclical cash flows. Because of this, SFBs may find it challenging to collect a debt during the off-season, which may cause payback delays.

.4. Inadequate Collateral: Many rural borrowers lack sufficient collateral to provide security for loans, which can make it challenging for SFBs to collect loans in the event of default. This can result in more NPAs and a general decline in the quality of the loan portfolio.

5. Cultural Aspects: Cultural aspects may also be important in rural debt collection. For instance, borrowers in some rural communities could put social commitments like weddings and religious ceremonies ahead of loan repayment. Delays in debt collection and an increase in NPAs may result from this.

Purpose of Establishment of Small Finance Banks

The establishment of small finance banks will have dual purposes:

i. providing savings vehicles to underserved segments of the population,

ii. providing credit to micro and small businesses, small and marginal farmers, other unorganized sector entities, and other business units through high technology, low-cost operations.

Small financing banks will not have any restrictions on where they can conduct business, but preference will be given to applicants who initially establish their institutions in a collection of underbanked States or districts, such as those in the North-East, East, and Central parts of the nation. These applicants won't face any obstacles when it comes time to eventually branch out to other areas. Small finance banks are anticipated to focus primarily on serving local needs. The first stabilization period of five years has passed, and after a review, the RBI may relax the previous clearance requirement for yearly branch development plans and the range of services offered by small financing banks. If there are any, the promoters' additional financial and non-financial services operations should be kept clearly separate from their banking operations. To set itself apart from other banks, the small finance bank must include the phrase "Little Finance Bank" in its name.

Technologies Used by SFB for Effective Debt Collection

1. Digital Lending Platforms: To enhance loan disbursement and monitoring, SFBs are using digital lending platforms. These platforms evaluate customer creditworthiness, expedite loan processing, and continuously track repayment behaviour using data analytics and machine learning. These platforms allow SFBs to lower their risk of defaults and NPAs.

2. Mobile Applications: To increase client involvement and make loan payback easier, SFBs are also utilizing mobile applications. These programs give borrowers access to information about their loan accounts, repayment plans, and payment options. SFBs can increase communication with borrowers and lower the frequency of late payments and defaults by deploying mobile applications.

3. SFBs are utilizing cloud computing to enhance analytics and data management. Cloud-based options allow SFBs to store and analyse data.

4. Artificial Intelligence and Machine Learning: To enhance their credit risk assessment and loan monitoring, SFBs are also utilizing artificial intelligence and machine learning. In order to lower the risk of defaults and NPAs, SFBs can use these technologies to identify possible defaulters, monitor repayment behaviour, and modify loan terms in real time.

5. Blockchain: To enhance loan disbursement and monitoring, SFBs are investigating the usage of blockchain technology. SFBs can use blockchain to build a tamper-proof digital ledger of all loan transactions, increasing transparency, lowering the risk of fraud, and encouraging better loan payback practices.

Capital Structure and NPA

A small finance bank's (SFB) capital structure performance is crucial because it affects the bank's capacity to meet regulatory obligations, absorbs losses, and foster future growth. An SFB needs a balanced capital structure to be successful over the long term because it makes it possible to manage risks, support expansion, and maintain regulatory compliance. Strong financial structures enable SFBs to withstand economic downturns and seize expansion opportunities. The capital structure of a bank directly affects how well it can absorb losses from NPAs. A bank's ability to endure non-performing loan losses without going bankrupt increases with capital. The capital structure of the bank may suffer if NPAs are significant. For addressing the risks related to NPAs, it is crucial to maintain a sound capital structure. Even in difficult circumstances, a bank with adequate capital is better able to manage the effects of non-performing loans on its balance sheet and can continue to provide loans and support economic growth.

Conclusion

The paper illustrates how Small Finance Banks (SFBs) help rural economies, promote financial literacy, increase loan availability, and create jobs. SFBs, however, experience difficulties in collecting debt due to cultural factors that affect repayment, infrastructure deficiencies, seasonal cash flows, insufficient collateral, and lack of financial literacy. These difficulties could cause debt collection delays and a rise in non-performing assets (NPAs). Overall, SFBs are essential in fostering financial inclusion in rural areas, but they must solve these issues to keep their loan portfolios viable.

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