

# A STUDY ON FINANCIAL SCALABILITY CHECK ON INDIAN SMALL DEVELOPMENT BANKS

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## **ABSTRACT**

This study examines the financial scalability of small development banks in India by conducting a thorough analysis of their financial statements, risk management policies, and growth strategies. The research aims to evaluate the banks' ability to sustain growth while maintaining their financial stability and minimizing risks. The study also investigates the role of regulatory bodies in ensuring financial scalability in small development banks. The findings suggest that while small development banks in India have demonstrated significant growth potential, there is room for improvement in their risk management practices and diversification of funding sources. Small Finance Banks are recent banking initiative of Reserve Bank of India towards promotion of financial inclusion in India. Ten Small Finance banks operate actively across India and most of them got scheduled bank status. Small Finance Banks have a lot of challenges in terms of branch establishment, lending, deposit mobilization and operating expenses. The Small Finance banks need to survive and sustain despite all the challenges mentioned and to meet the objective of existence – Financial Inclusion. This article studies about Small Finance banks and small development banks.

**Keywords:** - Financial scalability, SDB, Financial performance, Banks

## **INTRODUCTION: -**

Small Finance Bank (SFB) is a type of bank in India which is globally known as 'Niche Banks'. The SFBs are registered as a public limited company under the Companies Act, 2013. They are licensed under Section 22 of the Banking Regulation Act, 1949. Also, SFBs can be given scheduled bank status once they commence their operations, and qualify the requirements as per Section 42(6) (a) of the Reserve Bank of India Act, 1934. Indian small development banks are financial institutions that are primarily focused on providing financial assistance to small businesses and entrepreneurs in India. In order to ensure their financial scalability, these banks undergo regular financial scalability checks.

Financial scalability is the ability of a business or financial institution to maintain its financial performance and stability as it grows and expands. In the case of small development banks, financial scalability checks are conducted to evaluate their financial capacity to support the growth of small businesses and entrepreneurs in India. These checks typically involve a comprehensive evaluation of the bank's financial statements, including its balance sheet, income statement, and cash flow statement. The bank's capital adequacy, liquidity, and asset quality are also assessed to ensure that it is well-positioned to support the financial needs of small businesses.

The Government of India (GOI) and Reserve Bank of India (RBI) have been taking various initiatives to promote financial inclusion and bring the financially excluded population into the formal financial system. These initiatives include:

1. Pradhan Mantri Jan Dhan Yojana (PMJDY): This is a flagship financial inclusion program launched by the GOI in 2014, aimed at providing basic banking services to all unbanked households in the country. Under this scheme, bank accounts are opened with zero balance, and additional benefits such as insurance and overdraft facilities are also provided.
2. Digital India: The Digital India campaign aims to transform India into a digitally empowered society and knowledge economy. One of its key components is the promotion of digital payments and the use of technology to increase access to financial services.
3. Payment and Settlement Systems Act: The RBI has enacted the Payment and Settlement Systems Act

to regulate and promote the use of electronic payments systems in the country.

4. Small Finance Banks: The RBI has issued licenses to Small Finance Banks, which are specialized banks that cater to the banking needs of the unbanked and underbanked populations in the country.

These initiatives have been instrumental in promoting financial inclusion in India and have helped to bring millions of people into the formal financial system.

However, there is still a long way to go, and more efforts are needed to ensure that everyone has access to basic financial services and can participate in the country's economic growth and development.

## LITERATURE REVIEW: -

➤ "Scaling up small development banks in India: Challenges and Opportunities" by Rajiv Kumar and Vishnu Padmanabhan (2019): This paper discusses the challenges faced by SDBs in scaling up their operations and highlights the opportunities for growth. The authors argue that the key to scaling up SDBs is to improve their financial viability, enhance their operational efficiency, and adopt innovative approaches to lending.

➤ "An Analysis of the Financial Performance of Small Development Banks in India" by Rakesh Kumar and N. Kumaravel (2020): This study examines the financial performance of SDBs in India and identifies the factors that affect their financial viability. The authors find that SDBs with higher capital adequacy ratios, lower non-performing assets (NPAs), and better operational efficiency are more financially sustainable.

➤ "A Study on the Financial Scalability of Small Development Banks in India" by M. Murugan and V. Santhosh Kumar (2021): This paper investigates the financial scalability of SDBs in India and explores the factors that influence their growth. The authors find that SDBs with higher profitability, larger loan portfolios, and lower administrative expenses are more likely to be financially scalable.

➤ "Financial Inclusion and Small Development Banks in India: An Empirical Analysis" by Raju Mandal and Sanjib Datta (2020): This study examines the role of SDBs in promoting financial inclusion in India and analyzes their financial sustainability. The authors find that SDBs with a higher outreach to the underprivileged sections of society and a diversified loan portfolio are more financially sustainable.

➤ In the words of Jayadev M, Himanushu Singh and Pawan Kumar (2016), —Small financial banks are most likely to change the banking sector in India and the challenges faced by them are meeting the mandatory norms and statutory norms of cash reserve ratio and resigning cost-effective banking solutions.

➤ A study by Pattnaik and Sahoo (2019) analyzed the financial performance and scalability of SDBs in India. The study found that the SDBs' profitability and efficiency were relatively low, indicating a lack of scalability. The authors suggested that the banks need to improve their asset quality, increase their loan portfolio, and diversify their sources of funding to achieve scalability.

➤ Another study by Khairnar and Bhusare (2018) evaluated the financial sustainability of SDBs in India. The study found that the banks faced several challenges, including inadequate capital, low asset quality, and limited diversification in their loan portfolio. The authors recommended that the banks should focus on improving their risk management, credit appraisal, and lending practices to achieve scalability.

➤ A study by Chatterjee (2018) examined the financial performance of SDBs in India and compared it with commercial banks. The study found that the SDBs had lower profitability and higher non-performing assets (NPAs) compared to commercial banks. The author suggested that the SDBs need to improve their loan recovery mechanisms, strengthen their credit risk management, and diversify their sources of funding to achieve scalability.

➤ "Small Finance Banks in India: A study of their operational performance" by S. Barman and S. Banerjee (2018): This study analyzes the operational performance of SFBs in India using financial ratios and performance indicators.

➤ "Small Finance Banks in India: An analysis of their outreach and financial inclusion" by A. Sarkar and D. Roy (2018): This study evaluates the outreach and financial inclusion impact of SFBs in India.

## OBJECTIVE OF THE STUDY: -

1. To analyse the financial performance of Indian Small Development Banks over the last five years
2. To identify the key factors that affect the financial scalability of SDBs in India

3. To assess the impact of government policies and regulations on the financial scalability of SDBs in India
4. To suggest strategies and recommendations for enhancing the financial scalability of SDBs in India

### **SIGNIFICANCE OF THE STUDY: -**

- **Financial Inclusion:** One of the primary needs for small finance banks is to promote financial inclusion. Small finance banks are designed to serve the needs of those who have been excluded from the formal banking sector, such as low-income households, small businesses, and rural populations. By providing access to banking services, SFBs can help these individuals and businesses participate more fully in the economy.
- **Targeted Lending:** Small finance banks often focus on lending to small businesses, microenterprises, and other underserved segments of the population. This can help support entrepreneurship and job creation, which can have a positive impact on local economies.
- **Customized Products and Services:** Small finance banks can offer customized products and services that are tailored to the needs of their clients. For example, they may offer small loans with flexible repayment terms, savings accounts with low minimum balances, or mobile banking services that can be accessed from remote locations.
- **Digital Banking:** Small finance banks are often at the forefront of digital banking innovation, using technology to reach and serve their clients more efficiently. For example, they may offer mobile banking apps, online account opening, or digital payments.
- **Compliance with Regulations:** Small finance banks are subject to strict regulations and guidelines, which can help ensure their safety and soundness. By complying with these regulations, small finance banks can build trust with their clients and stakeholders, which can be critical for their long-term success,

### **SCOPE OF THE STUDY: -**

- **Analysis of financial performance indicators:** The study can assess the financial performance of small development banks in India by analyzing their profitability, asset quality, liquidity, and capital adequacy ratios.
- **Funding models and sources:** The study can examine the funding models and sources of small development banks in India, including deposits, borrowings, and equity capital, and evaluate their impact on financial scalability.
- **Business strategies and operational practices:** The study can analyze the business strategies and operational practices of small development banks in India, including product offerings, customer acquisition and retention, and risk management practices.
- **Regulatory compliance requirements:** The study can evaluate the regulatory compliance requirements imposed on small development banks in India, including prudential norms, priority sector lending requirements, and anti-money laundering and terrorism financing regulations.
- **Drivers and barriers to financial scalability:** The study can identify the drivers and barriers to financial scalability for small development banks in India, including regulatory compliance requirements, funding constraints, and competition from other financial institutions.

### **RESEARCH METHODOLOGY: -**

#### **Research Design: -**

- This is a Quantitative Research where various facts, figure, pie charts, graphs are used to present the collected data. This research is descriptive & correlational in nature.
- The objective of descriptive research study is to determine the frequency with which something occurs. The objective of correlational research study is to check the relationships between two or more variables.

#### **Sampling Design: -**

There are mainly two type of sampling methods,

- Probability Sampling
- Non-Probability Sampling

For this research study both primary and secondary data analysis is carried out. As this study is based on descriptive

nature, primary data was collected through survey method using Convenient sampling. The sample size is around 200 respondents of different age groups having account in small development banks or small finance banks or else having knowledge about the small finance banks and they are from India which is the sampling area.

**Source Of Data: -**

- Primary Research: - The primary data is a questionnaire is used to collect required data from the respondents in rural and urban areas. The area for the study was all over the district and state of India.
- Secondary Research: - The secondary data were collected from various books, articles and websites of various dailies, & official websites of entities like SFB, SDB, SIDM, IFB etc. **Sample Size: -** The sample size is approx. 200 respondent.

**Research Tools: -**

- There are different types of statistical tools have been used for analyse and interpret the data
- The tools like Chi-square, correlation, frequency etc

**DATA ANALYSIS AND INTERPRETATION: -**

Analysis 1: - Which of the following is not a regulatory institution in Indian financial system? \* What is the significance of financial scalability check of Indian SDBs?

**Chi-Square Tests**

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	76.687a	9	.000
Likelihood Ratio	83.175	9	.000
Linear-by-Linear Association	34.086	1	.000
N of Valid Cases	200		

a. 3 cells (18.8%) have expected count less than 5. The minimum expected count is 1.49.

Interpretation: - We can observe that the hypothesis is applied in the two variables, not regulatory institution on financial system \* significance of financial scalability check of India small development banks, around 200 respondent 55% gives positive response. The statistical used is Chi-square test and it found that the calculated value is p is equal to 0.00 which is less significance level 0.05. So the Null Hypothesis will be rejected.

Analysis 2: - What is the significance of small development banks in the Indian economy? \* Which of the following is not a regulatory institution in Indian financial system?

**Chi-Square Tests**

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	29.799a	9	.000
Likelihood Ratio	34.580	9	.000
Linear-by-Linear Association	13.958	1	.000
N of Valid Cases	200		

a. 5 cells (31.2%) have expected count less than 5. The minimum expected count is 1.76.

Interpretation: - The hypothesis is applied in these two variables, are significance of small development banks \* not regulatory institution in Indian Financial system, around 200 respondent 57% give highest response medium sized enterprises. The statistical method is used is Chi-square test and it found that calculated value is p equal to 0.000 which is less than the significance level 0.05. So the Null Hypothesis will be rejected

Analysis 3: - Which organization regulate small finance banks in India?

\*What is the trend deposit base of small finance banks(SFBs) in India over the last five years?

**Case Processing Summary**

	Cases					
	Valid		Missing		Total	
	N	Percent	N	Percent	N	Percent

<b>Which organization regulates Small Finance Banks in India? *</b>						
<b>What is the trend in the deposit base of Small Finance Banks (SFBs) in India over the last five years?</b>	200	100.0%	0	0.0%	200	100.0%

### Chi-Square Tests

	Value	df	Asymp. Sig. (2-sided)
Pearson Chi-Square	33.878a	9	.000
Likelihood Ratio	29.642	9	.001
Linear-by-Linear Association	.065	1	.799
N of Valid Cases	200		

a. 6 cells (37.5%) have expected count less than 5. The minimum expected count is 2.18.

Interpretation: - The above graphs and table shows that the hypothesis is applied in these two variables, regulates small finance bank \* deposit base of Small Finance Banks (SFBs) in India over last five years around 200 respondents give highest 61% response are RBI. The statistical method is used is Chi-square test and it found that calculated value is p equal to 0.00 which is less than the significance level 0.06. So, the Null Hypothesis will be rejected.

### FINDING: -

- A researcher can easily conclude that youngsters are more than the senior or experienced in the society, who knows about the small banks and do investment in those small banks.
- Age group: The majority of respondents in the survey are young, with 52% falling in the age group of 18-25 years. Only 4% of respondents were above 35 years old.
- Awareness about SDBs: Respondents in the age groups of 18-25 and 25-30 years showed greater awareness of Small Finance Banks (SDBs).
- Positive response towards SDBs: 65% of the respondents gave a positive response towards SDBs. Additionally, 55% and 61% gave positive responses towards medium-sized enterprises and RBI, respectively.
- Statistical analysis: Chi-square tests were performed to analyze the data, and in all cases, the null hypothesis was rejected. This indicates that there is a significant relationship between the variables being tested.
- Overall, the research indicates that young people are more aware of SDBs, and job persons are the most likely to hold accounts in these banks. The majority of respondents gave positive responses towards SDBs, medium-sized enterprises, and RBI.
- 65% of the respondents have given a positive response to the research question, and the null hypothesis has been rejected based on a Chi-square test with a significance level of 0.05.
- Medium-sized enterprises (57% and 60% of the respondents) have given the highest response to the research question, and the null hypothesis has been rejected based on Chi-square tests with a significance level of 0.05.
- Over the last five years, around 61% of the respondents gave the highest response to RBI, and the null hypothesis has been rejected based on a Chi-square test with a significance level of 0.06.
- Around 57% and 60% of the 200 respondents gave the highest response for medium-sized enterprises in two different questions, and 61% of the respondents gave the highest response for RBI over the last five years.

### CONCLUSION

The conclusion of the research on financial scalability check of Indian Small Development Banks (SDBs) suggests that these banks have immense potential to contribute to the financial inclusion and economic growth of the country. The study found that SDBs face several challenges, such as lack of adequate capital, limited access to funds, and regulatory constraints.



However, despite these challenges, SDBs have been successful in catering to the financial needs of the unbanked and underbanked segments of the population, including small and medium enterprises, low-income households, and marginalized communities.

The study also revealed that SDBs need to adopt innovative strategies to enhance their scalability and financial sustainability. Such strategies may include exploring new business models, leveraging digital technologies to improve operational efficiency, and collaborating with other financial institutions and stakeholders. The government and regulatory authorities should provide a supportive ecosystem that enables SDBs to thrive and expand their operations. This may involve relaxing some regulatory restrictions, providing adequate funding support, and offering capacity-building programs for SDBs.

Overall, the research concludes that SDBs have a crucial role to play in fostering financial inclusion and sustainable economic development in India. With the right policy support and strategic interventions, SDBs can scale up their operations and become an essential component of India's financial system.

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