Profitability Performance and Capital Competence of Selected Small Finance Banks in India

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Abstract

Over 2.5 billion people worldwide are thought to lack access to financial services, with 33 per cent of them living in India. The enormous demand for financial services remains unquenchable despite the expansion of banking in India. These new inventions of small finance banks in India offering various financial and non-financial services to the unbanked people in India in recent times. This paper aims to study about the profitability and capital competence of selected small banks in India during the study period 2016-2017 to 2022-2023. The findings of this paper can help the stakeholders, policymakers, investors, bank management and future researchers to understand the profitability performance of small financial banks.

Keywords: Small Banks, Profitability, Capital Adequacy:

Introduction

Small Finance Banks (SFBs) are specialized financial institutions with a focus on offering essential banking and financial services to underserved and unbanked populations, particularly in rural and semi-urban areas. These banks are an essential part of the government's initiatives to advance financial inclusion and provide banking services across the nation. There is significance in taking into the account that access to bank credit and services through the establishment of small banks in unbanked and under-banked regions in India, where it is difficult to provide banking services to the underserved and unserved segments of the population. The growth and development of the economy are heavily dependent on sound financial institutions. The banking industry has provided India's economy with significant assistance for a number of years. The expansion of the Indian banking industry is crucial for the country's economy, particularly because financial inclusion and retail activities. A bank is a business entity that provides its clients with financial services. The Reserve Bank of India (RBI) is in charge of overseeing all facets of the

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financial sector in our nation. One of the most significant changes to the financial services sector over the last few years is denoted small financing banks in the country. Small finance banks received licenses in 2016 with the intention of expanding access to financial services by concentrating on fundamental business activities including deposit acceptance and lending to rural, small, and marginal entrepreneurs as well as farmers through low-cost and high-tech operations. Small finance banks are capable of performing fundamental banking tasks like accepting all deposit kinds and providing advances to unbanked areas. Small financing banks must follow all of the same guidelines that apply to commercial banks, including the need to have a CRR and an SLR. With 50 per cent of their loan portfolio made up of loans and advances of up to Rs. 25 lakhs, small finance banks are expected to lend 75 per cent of their money to priority sectors. SFBs offer everyone a low-cost banking platform in villages as commercial banks find it difficult to operate branches there as well. Through SFBs, offer lower interest rates on lending while paying higher interest rates on savings. Small companies and low-income people will benefit from this. Without its soul, which is profit, the company would be dead. For accounting purposes, the profit is the sum of all revenues minus all costs over a given time period. Brighan claims that while profitability is a result of profit, “financial management profit is the test of efficiency and a measure of control, to the owners a measure of the worth of their investment, to the creditors the margin of safety, to the government a measure of taxable capacity and a basis for legislative action and the country profit is an index of economic progress national income generated and the rise in the standard of living”.

Reviews of Earlier Studies

Due to their concentrated effort to meet the financial requirements of underserved and unbanked parts of the population, small financing banks have become well-known in the Indian banking industry over the last decade. In order to determine how effective they are at achieving the objectives of making profitability and capital competence, it is critical to evaluate their profitable performance. Review of pertinent literature on the assessment of the profitability performance of small finance institutions is provided in this section.

A report by **Prantik Ray (2016)** titled “Small Banking in India - Issues and Challenges” discusses the need for financial inclusion, as well as concerns, obstacles, and RBI recommendations for small finance banks. The case study of the conversion of Ujjivan Financial Service Limited to a small financial bank is covered in this essay, along with suggestions for the future of financial institutions in India. He came to the conclusion in this study that tiny financial institutions have a lot of promise for financial inclusion, but their profitable performance has not been adequate.

Jayadev M, Himanushu Singh and Pawan Kumar (2016) in their study titled "Problems for Small Financial Banks" The study's primary goal was to identify the difficulties that India's small financial institutions have encountered. According to the study's findings, small financial institutions are most likely to transform the Indian banking industry. The difficulties they confront include adhering to statutory and mandatory requirements for the cash reserve ratio as well as giving up on cost-effective banking options.

The primary goal of **Pinal Barot (2017)** in his study, "Financial Inclusion in India" is to comprehend the significance, scope, potential, and problems of financial inclusion in India as well as its current state in the Indian economy. Only a small portion of the population uses financial services in our nation, and the poor and underprivileged are more likely to be financially illiterate, which makes the process of financial inclusion more difficult. Hence, the Small finance banks are rendering services to the rural areas and making significant profits over the periods.

Goyal AM (2013) provided an explanation of the strength and profitability of Indian government banks. He also discussed the capital competence of the banks and how well the institutions function. With the aid of the capital structure, he mostly used multivariate analysis to examine the link between different elements such as earning per share, return on equity, and return on assets.

Statement of the Problem

Small financing banks are those that offer services to an underserved group of the general public which Scheduled Commercial does not serve financial institutions other than banks, for example, small businesses, small and small-scale industries, marginal farmers, and unorganized industries. These modest financial Banks offer fundamental services such as deposits and Deposits are accepted. These modest financial Banks are crucial to the Indian economy because most of the people have virtually little income. As they offer services to the underserved and unserved segments of society, these banks have greater room for expansion. The Centre and RBI are working harder than ever to promote financial inclusion. The Indian government is investing a sizable number of money in monetary inclusion programmes like JAM (Jan Dhan, Adhaar, and Mobile Banking) in order to bring every citizen of our nation into the formal banking system. To launch Payment Banks/Small Finance Banks, the RBI has granted Differentiated Banking Licenses to a variety of microfinance organizations and nonbanking financial entities. From this point of view; the researchers felt that it is foremost imperative and necessary to learn and analyze about the capital and profitability performance of the small finance banks in India in order to understand and compare about their performance in general. Further, several studies reveals and highlights the financial inclusions, performance and consumer perceptions about the small finance banks in last decade and but unfortunately there were no study found that the profitability and capital competence of these small finance banks in modern times. Hence, to fill the gap between the previous literature and to bring the data driven expressive analyses; the researchers tries to identify and analyze the profitability performance of the selected small finance banks in India is considered one of the right attempt. Keeping this background the present paper tries to narrate the profitability performance and the capital competence of the selected small finance banks in India.

Research Objectives

- To study about the small finance banks in India
- To analyze the profitability of the selected Small Finance Banks in India
- To evaluate and compare the capital adequacy of selected Small Finance Banks in India

Hypothesis taken for the Study

Ho: *There is no significant difference between the Operating and Net profits of selected Small Finance Banks in India.*

H1: *There is significant difference between the Operating and Net profits of selected Small Finance Banks in India.*

Research Methodology

Design: The profitability performance of India's small financing institutions is investigated in this study using a descriptive research design and ratio analysis. The systematic collecting and analysis of data is made possible by descriptive research, which enables the description and understanding of a phenomenon’s features.

Sample Size: Out of ten small finance banks; a sample of five small finance banks has been selected for analyzing purposes. The sample banks represent the diverse of regions across India. Further, the selection of these banks were based on the criteria such as size of the operation, size of the geographical representations and availability of reliable financial data from the concerned banks and these banks were selected based on the convenient sampling method for the present study.

Source of Data: Necessary data has been collected from the various sources such as websites, annual reports of the concerned banks, articles and other publications. The period of data collected for the present study starts from the year 2016-2017 to 2022-2023 covers around seven years.

Techniques Adopted for Analyses: Profitability ratios were employed to examine and compare the profitable position of the selected small finance banks. Furthermore, the kruskal-Wallis H test was adapted to analysis the variance between the samples. The test statistic for the Kruskal Wallis test (mostly denoted as H) is defined as follows:

$$H = \frac{12}{N(N+1)} \sum \frac{T_i^2}{N_i} - 3(N+1)$$

Where T_i = rank sum for the ith sample i = 1, 2,…,k

In Kruskal-Wallis test, the H value will not have any impact for any two groups in which the data values have same ranks. Either increasing the largest value or decreasing the smallest value will have zero effect on H. Hence, the extreme outliers (higher and lower side) will not impact this test.

Limitations of the Study

- ✓ The study's scope is limited to examine only the operating and net profits and not covers other dimensions of profitability analysis.
- ✓ The present context of the study is not to be covered whole type of firms and banks.

Results and Discussions

Profitability Performance of the Small Finance Banks

***Operating Profit Ratio*:** The relationship between operating profit and net sales is represented as a percentage by the operating profit ratio. Net profit, or profit before depreciation and taxes, is used to compute operational profit by deducting all non-operating expenses and revenues. A ratio that is consistently high shows that a business is running successfully and effectively.

***Net Profit Ratio*:** This ratio shows how much of the revenue remains for the owners after all operating costs have been paid. The profitability will be better the higher the ratio. The gross profit ratio and net profit ratio may be taken into consideration simultaneously to get a better understanding of profitability. If over the past five years, gross profit has increased but net profit has decreased, it means that administrative costs are gradually increasing.

Testing of Hypothesis:

Ho: *There is no significant difference between the Operating and Net profits of selected Small Finance Banks in India.*

Table – 1
Kruskal- Wallis Test for Operating Profits Ratios of selected Small Finance Banks

Year	Equitas	R1	ESAF	R2	Ujjivan	R3	Suryoday	R4	Fincare	R5
2016-2017	28.74	1	38.7	7	29.24	3	42.61	15	47.29	26
2017-2018	29.21	2	38.95	8	31.68	5	41.65	13	48.95	32
2018-2019	30.25	4	40.65	11	34.29	6	39.87	9	47.12	25
2019-2020	42.64	16	44.81	20	41.76	14	42.75	17	49.85	31
2020-2021	43.8	19	45.12	21	41.5	12	46.98	24	51.64	33
2021-2022	46.78	23	45.87	22	43.67	18	48.19	28	54.63	34
2022-2023	40.15	10	48.64	29	47.89	27	49.73	30	55.2	35
Ranks Total		**75**		**118**		**85**		**136**		**216**
SD	7.71526		3.82534		6.88564		3.72608		3.2863	
Mean	37.36		43.24		38.57		44.54		50.66	
CV	59.525		14.633		47.412		13.884		10.801	
CAGR	3%		3%		4%		2%		3%	

Sources: Computed based on the Secondary Data

Here;

$$H = \frac{12}{35(36)} \left[\frac{(75)^2}{7} + \frac{(118)^2}{7} + \frac{(85)^2}{7} + \frac{(136)^2}{7} + \frac{(216)^2}{7} \right] - 3(36)$$

H = (0.00952380952 X 13132)-3(36)

H = 17.09

It is observed from the above table; the operating profit ratio of Equitas small bank has around 28.7 per cent during the year 2016-2017 and which was increased 42 per cent and 46 per cent during the years 2019-2020 and 2021-2022. The mean operating profit ratio of the Equitas denotes 37.36 per cent with the variation of 59 per cent during the study period. The compound annual growth rates accounted nearly 3 per cent during the study period for the Equitas small banks. Further, the mean operating profit ratio of ESAF, Ujjivan, Suryoday and Fincare are depicted around 43.24, 38.57, 44.54 and 50.66 per cent respectively during the study period.

Further it is observed from the above table; the 'H' value of Kruskal- Wallis Variance test denotes 17.09 which was greater than the table value of 9.002. Hence the ***null hypothesis*** "*There is no significant difference between the Operating profits of selected Small Finance Banks in India"* is rejected and the *alternative hypothesis* there is significance of difference between the operating profits of selected small finance banks are accepted. It can be concluded based on the data that the operating profits of the selected small finance banks are differed during the study period.

Table – 2
Kruskal- Wallis Variance Test for Net Profits Ratios of selected Small Finance Banks

Year	Equitas	R1	ESAF	R2	Ujjivan	R3	Suryoday	R4	Fincare	R5
2016-2017	22.65	2	32.64	8	22.38	1	35.47	18	36.41	27
2017-2018	23.33	3	33.12	9	24.55	4	33.66	12	35.78	21
2018-2019	25.64	6	35.75	20	25.47	5	31.29	7	36.3	26
2019-2020	33.54	10	36.66	28	33.56	11	34.56	14	37.02	29
2020-2021	35.49	19	37.89	33	34.25	13	37.85	32	34.65	15
2021-2022	36.25	25	37.75	31	36.19	24	36.13	23	35.9	22
2022-2023	34.78	16	38.21	34	37.52	30	37.75	31	34.88	17
Ranks Total		**81**		**163**		**88**		**137**		**157**
SD	*6.07866*		*2.29495*		*6.21417*		*2.32803*		*0.8439*	
Mean	*30.24*		*36.01*		*30.56*		*35.24*		*35.84*	
CV	*36.95*		*5.267*		*38.616*		*5.42*		*0.712*	
CAGR	*2%*		*2%*		*1%*		*3%*		*1%*	

Sources: Computed based on the Secondary Data

Here;

$$H = \frac{12}{35(36)} \left[\frac{(81)^2}{7} + \frac{(163)^2}{7} + \frac{(88)^2}{7} + \frac{(137)^2}{7} + \frac{(157)^2}{7} \right] - 3(36)$$

H = (0.00952380952 X 14041.71)-3(36)

H = 25.72

It is inferred from the table no.2; the net profit ratio of the Equitas small banks has shown in the upward trend during the study period. The ESAF and Suryoday small banks indicate some positive net profit trends during the same period of the study. Further, the mean net profit ratio of Equitas depicted 30.24 per cent with the variation of 36.95 per cent. The standard deviation of Equitas and Ujjivan banks are high with compared to other selected banks during the study period. The compound annual growth rate of suryadoy banks were about 3 per cent during the study period and which was better growth as compared to the other banks in this category during the same period of time. Furthermore, the mean net profit ratio of ESAF denotes 36.01 per cent, Ujjivan 30.56, Suryoday 35.24 and Fincare 35.84 per cent during the study period.

It also observed from the table no. 2; the 'H' value of Kruskal- Wallis Variance test denotes 25.72 which was greater than the table value of 9.002. Hence the ***null hypothesis*** "*There is no significant difference between the Net profits of selected Small Finance Banks in*

India" is rejected and the *alternative hypothesis* there is significance of difference between the net profits of selected small finance banks are accepted. It can be concluded based on the data that the net profits of the selected small finance banks were differed during the study period.

Capital Adequacy Ratio of the Small Finance Banks

How well a bank is able to meet its obligations is indicated by the capital adequacy ratio, or CAR. The ratio, also referred to as the capital-to-risk-weighted assets ratio (CRAR), is used by regulators to assess a bank's risk of failure by comparing capital to risk-weighted assets. Capital Adequacy Ratio is measured as (Tier I + Tier II + Tier III (Capital funds)) /Risk weighted assets. To protect depositors and improve the effectiveness and stability of financial systems around the world, this ratio is used.

Table – 3
Capital Adequacy Ratio of selected Small Finance Banks

Year	Equitas	ESAF	Ujjivan	Suryoday	Fincare
2016-2017	20.19	19.12	23.61	29.64	21.23
2017-2018	19.24	15.64	22.41	29.57	24.65
2018-2019	19.61	19.85	26.32	35.03	28.81
2019-2020	24.01	22.63	30.32	37.64	18.94
2020-2021	20.68	20.64	35.24	34.65	17.63
2021-2022	21.94	19.52	24.8	22.36	22.04
2022-2023	21.53	22.36	23.26	24.12	22.26
Avg.	**21.0286**	**19.9657**	**26.5657**	**30.43**	**22.2229**
Rank	**4**	**5**	**2**	**1**	**3**

Sources: Computed based on the Secondary Data

It is inferred from the above table; the highest average Capital Adequacy ratio was secured by the Suryoday bank (30.43) followed by the Ujjivan small finance banks(26.56) and this results indicates that the suryoday bank was not much utilized capital resources as compared to the other similar banks during the study period.

Table – 4
Equity to Total Assets Ratio of selected Small Finance Banks

Year	Equitas	ESAF	Ujjivan	Suryoday	Fincare
2016-2017	0.64	0.54	4.46	0.74	14.32
2017-2018	0.69	0.63	3.67	1.1	11.2
2018-2019	0.72	0.66	5.45	1.61	10.65
2019-2020	1.34	0.74	7.89	2.17	9.35
2020-2021	1.91	0.85	9.86	3.24	14.65
2021-2022	1.85	0.99	10.87	3.85	17.21
2022-2023	2.91	0.78	7.58	2.75	13.87

Avg.	**1.43714**	**0.74143**	**7.11143**	**2.20857**	**13.0357**
Rank	**4**	**5**	**2**	**3**	**1**

Sources: Computed based on the Secondary Data

It is identified that the average equity to total asset ratio of Fincare is 13.03 which is good sign in the banking perspective and which is indicates that the fincare is holding less leveraged or owned by the debt or other instruments. The average E/TA ratio of Ujjivan is 7.58 per cent and ESAF is 0.78. The lesser ratio is cause for concern for ESAF, Equitas and Suryoday small banks during the study period. It is concluded that the ESAF, Equitas and Suryoday banks are must to improve their E/TA ratios in future period of times in order to sustain their business.

Table – 5
Calculations of Group Ranking

Ratios	**Equitas**	**ESAF**	**Ujjivan**	**Suryoday**	**Fincare**
CAR	4	5	2	1	3
E/TA	4	5	2	3	1
Avg.	4	5	2	2	2
Rank	**2**	**3**	**1**	**1**	**1**

Sources: Computed based on the Secondary Data

It is found from the above table; the group rank of Fincare, suryoday and Ujjivan secured no.1 position followed by the Equitas and ESAF. Further to identify the variance between the small banks the Anova has been performed and the results are depicted below.

Table – 6
ANOVA

Particulars	**SS**	**df**	**MS**	**F**	**P-Value**	**F Crit**
CAR						
Between Groups	1064.89	4	359.361	9.852	11.025	3.870
Within Groups	568.985	15	38.598			
Total	**1633.88**	**19**				
E/TA						
Between Groups	663.24	4	162.325	22.617	9.627	3.870
Within Groups	74.685	15	4.263			
Total	**737.925**	**19**				

Sources: Computed based on the Secondary Data

It is found from the above result that there is a significant difference between the results of the CAR of selected small finance banks during the study period at 5 per cent significant level. The p-value shows 11.025 which is greater than the table value of 3.870. Further, there is also significant difference between the results of E/TA. The p-value shows 9.627 which is greater than the table value. All these observation indicates that there is significant difference of CAR and E/TA of selected Small Finance Banks in India during the study period.

Conclusion

The measurement of financial performance of any institution / industry is cosmic mission and includes numerous calculations to perform this specific task. The present paper is plentiful attempt to cover the profitability and capital adequacy of selected small finance banks in India is one of the desirable attempts by the researchers in the present context of the study. The researchers believe that this paper may help the future researcher to study about small finance banks in various dimensions.

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