

# A Study on Credit Risk Analysis of Small Finance Banks in India

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## Abstract

The small finance banks in India play a prominent role as these banks provide services to the financially unincorporated population. These banks provide basic services to the small-scale farmers and micro and small-scale industries. These banks will help in boosting the economy of the country as they provide services to major population of the country.

**Keywords:** small finance banks, credit risk analysis, equity, Ratios,

## 1. Introduction

Credit risk analysis is a form of analysis which is performed to understand the creditworthiness of the firm. Small finance banks are the banks which provide services to certain uncovered segment of the society that are not served by Scheduled Commercial banks and Non-Banking Financial Institutions, such as small business units, small and marginal farmers, small scale industries and unorganized sectors. These small finance banks provide basic services like deposits and acceptance of deposits. These small finance banks play a major role in Indian economy as the majority of population have very minimal income.

These banks have larger scope in terms of growth as they provide services to the unserved and underserved sections of the society. This type of activities are helpful to Unorganized activities to Organized one. It is important to understand the creditworthiness and functionality of these banks for the understanding of financial inclusion and capital formation also. This helps the depositors to understand the risk and gains in depositing in these banks. Apart from this it also helps the investors to choose a right bank for investment. Evaluating of in these small banks as stakeholders will help the banks to increase capital, deposits and lending process, which eventually helps in expansion of the banks and their services with the support of financial tools. As such, this paper makes an

attempt to evaluate the credit risk analysis of Small Finance Banks in India.

## 2. Objectives of Study

- i. To study the credit risk management of listed small finance banks at Indian Stock exchange.
- ii. This study also makes an attempt to understand the functionality of the small finance banks using different financial tools
- iii. This study findings are evaluated and derived by understanding different aspects of bank functions like expenses, assets management, debt management and loan portfolio.

## 3. Limitations of the Study

- i. The study is limited to the small finance banks listed on National Stock Exchange Ltd., in India only.
- ii. Is not to be covered whole type of firms and banks.
- iii. The research data used for the study is sourced from published information.

## 4. Research methodologies

The study was done using secondary data from a published information. The published information contains the annual financial reports of the data.

### 4.1. Research design of the study

This paper makes an attempt to evaluate credit risk involved with the small finance banks in India using descriptive research design, which

deals with collection of quantifiable information to be used for statistical analysis.

**4.2. Research Method**

Data was collected from the annual financial reports of the selected companies and Ratios were computed to have a favorable comparative analysis of the same.

**4.3. Study period**

For the purpose of the study, previous five financial years (i.e., 2016-17 to 2020-21) data was considered. The study is empirical and analytical in nature with a focus on assessing the credit risk of selected small finance banks.

**5. Tools Applied for study**

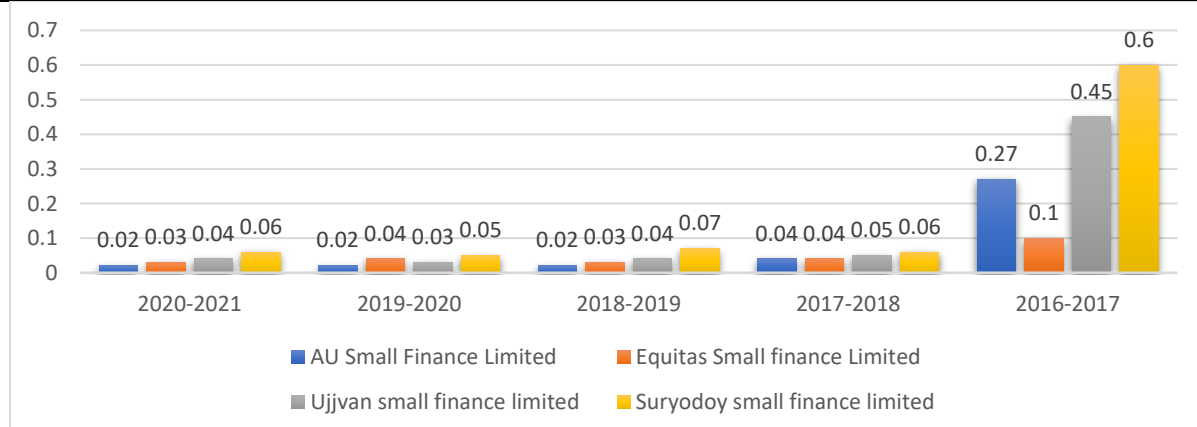
For betterment to evaluate the credit risk analysis of selected small finance banks in India, the following financial tools were applied to analysis.

- a) Current Ratio
- b) Quick Ratio
- c) Total debt to owner’s funds Ration
- d) Net interest / total funds Ratio
- e) Financial coverage Ratio
- f) Return on net worth (in Percental)
- g) Loans Turnover
- h) Interest expended to interest earned Ratio

**Data Analysis and Interpretation**

**Table No. 1 Current Ratio**

	AU small Finance Limited	Equitas Small Finance Limited	Ujjvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	0.02	0.03	0.04	0.06
2019-2020	0.02	0.04	0.03	0.05
2018-2019	0.02	0.03	0.04	0.07
2017-2018	0.04	0.04	0.05	0.06
2016-2017	0.27	0.10	0.45	0.60



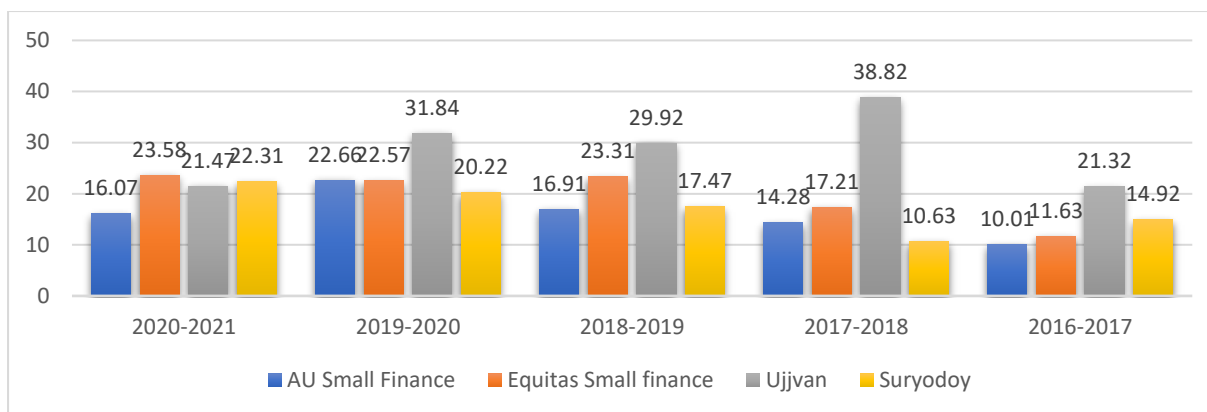
**Inferences:** From the last five years Suryodoy Small Finance limited has recorded high current Ratio. From 2017-18 to 2020-21 AU small Finance limited has recorded the least

current Ratio. In the year 2016-17, Equitas small finance limited has recorded the least current Ratio.

**Table No. 2 Quick Ratio**

	AU small Finance Limited	Equitas Small Finance Limited	Ujjvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	16.07	23.58	21.47	22.31
2019-2020	22.66	22.57	31.84	20.22
2018-2019	16.91	23.31	29.92	17.47
2017-2018	14.28	17.21	38.82	10.63
2016-2017	10.01	11.63	21.32	14.92

Source: Annual Report



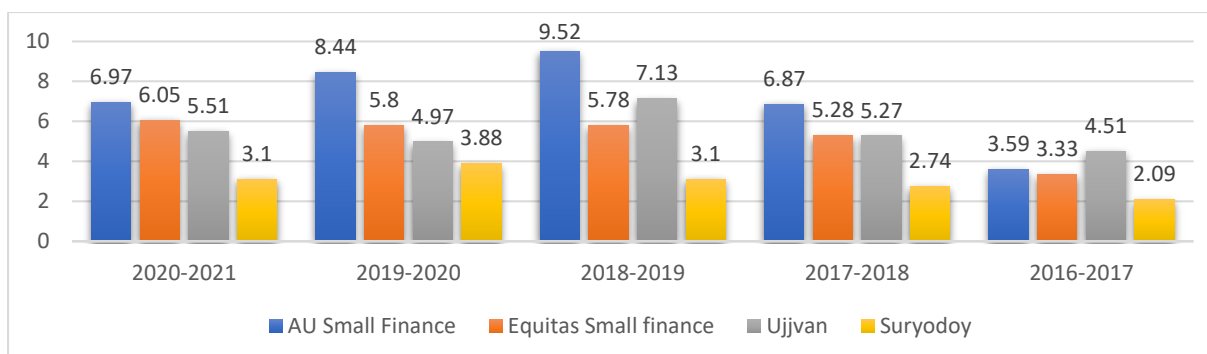
**Inferences:** Except in the 2020-21, Ujvan small finance limited had the highest quick Ratio compared to the others. In 2020-21, Equitas small finance had highest Ratio. In the

year 2016-17, 2018-19 and 2020-21, Au small finance limited had low quick Ratio. In the year 2019-18 and 2017-16, Suryodoy small finance limited had the lowest quick Ratio.

**Table No. 3 Total debt to owner's funds Ratio**

	AU small Finance Limited	Equitas Small Finance Limited	Ujvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	6.97	6.05	5.51	3.10
2019-2020	8.44	5.80	4.97	3.88
2018-2019	9.52	5.78	7.13	3.10
2017-2018	6.87	5.28	5.27	2.74
2016-2017	3.59	3.33	4.51	2.09

Source : Annual Report



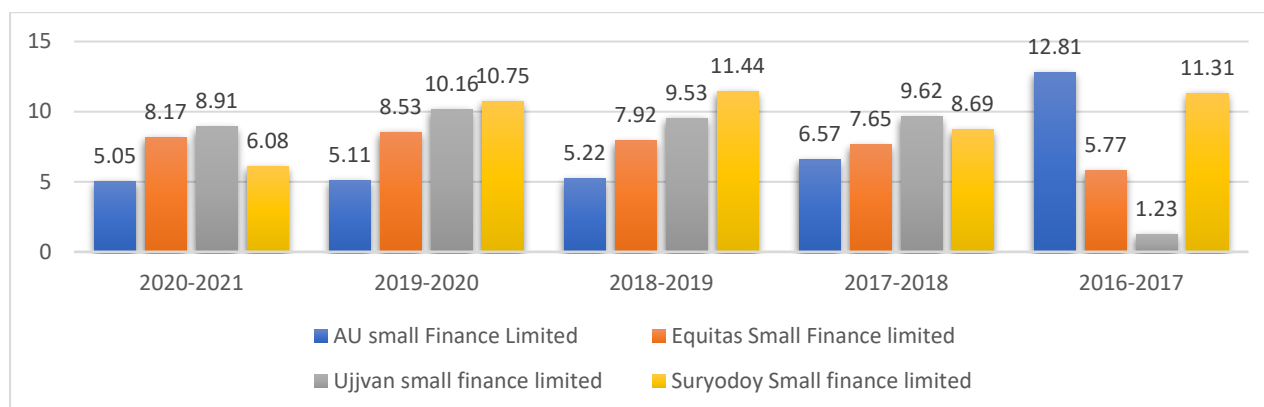
**Inferences:** In the years 20120-21, 2019-20, 2019-18, 2018-17, Au small Finance had highest total debt to owner's funds Ratio. In

2016-17, Ujvan had highest Ratio. In past 5 years, Suryodoy recorded low total debt to owner's funds Ratio.

**Table No. 4 Net Interest / Total Funds Ratio**

	AU small Finance Limited	Equitas Small Finance Limited	Ujvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	5.05	8.17	8.91	6.08
2019-2020	5.11	8.53	10.16	10.75
2018-2019	5.22	7.92	9.53	11.44
2017-2018	6.57	7.65	9.62	8.69
2016-2017	12.81	5.77	1.23	11.31

Source: Annual Report



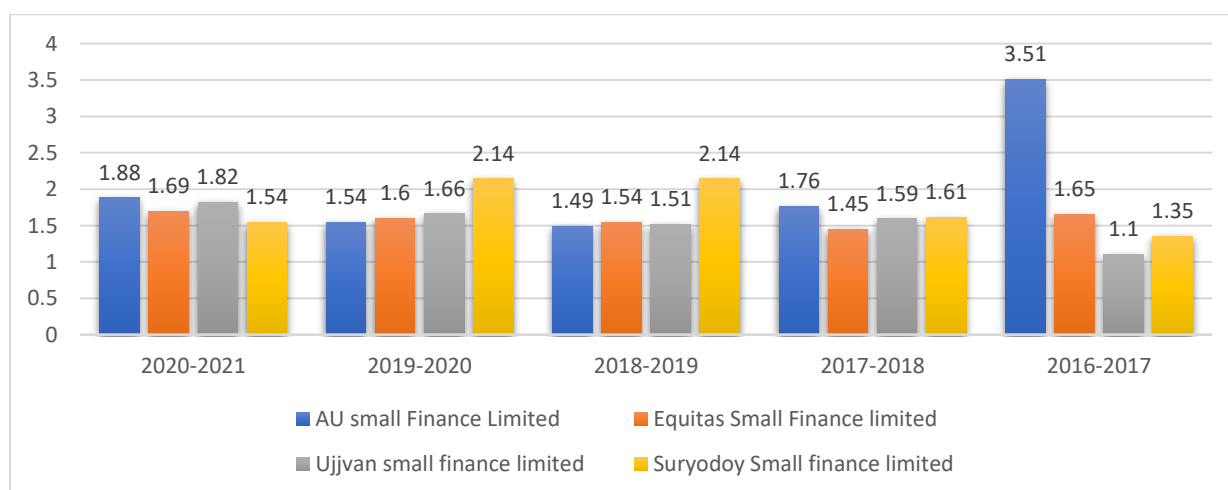
**Inferences:** Except in the year 2016-17, AU small finance had lowest net interest/total funds Ratio. Only in the year 2016-17, AU small finance recorded the highest Ratio. Wherein 2020-21 Ujjvan small finance

recorded highest. In 2019-20 and 2018-19 Suryodoy small finance limited has recorded highest. in the year 2017-18, Ujjvan small finance limited recorded the highest.

Table No. 5 Financial coverage Ratio

	AU small Finance Limited	Equitas Small Finance Limited	Ujjvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	1.88	1.69	1.82	1.54
2019-2020	1.54	1.60	1.66	2.14
2018-2019	1.49	1.54	1.51	2.14
2017-2018	1.76	1.45	1.59	1.61
2016-2017	3.51	1.65	1.10	1.35

Source: Annual Report



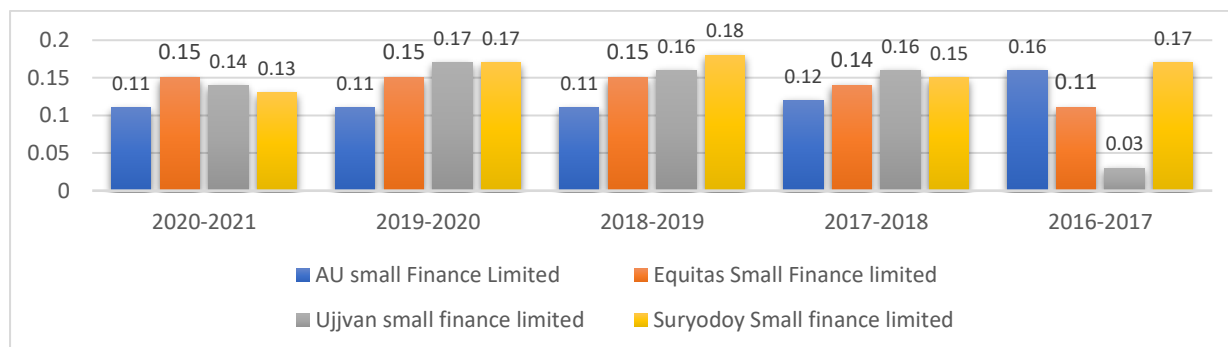
**Inferences:** AU small finance limited had the highest financial coverage Ratio in the years 2020-21, 2017-28, 2016-17 and recorded the lowest in the years 2019-20, 2018-19 compared to others. Suryodoy small finance had highest in years 2019-20, 2018-19 and

lowest in 2020-2021 has compared to others. In 2017-18, Equitas small finance limited recorded low financial coverage Ratio. In the year 2016-17, Ujjvan small finance had lowest Ratio.

**Table No. 6 Total asset to Turnover Ratio**

	AU small Finance Limited	Equitas Small Finance Limited	Ujivan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	0.11	0.15	0.14	0.13
2019-2020	0.11	0.15	0.17	0.17
2018-2019	0.11	0.15	0.16	0.18
2017-2018	0.12	0.14	0.16	0.15
2016-2017	0.16	0.11	0.03	0.17

Source: Annual Report



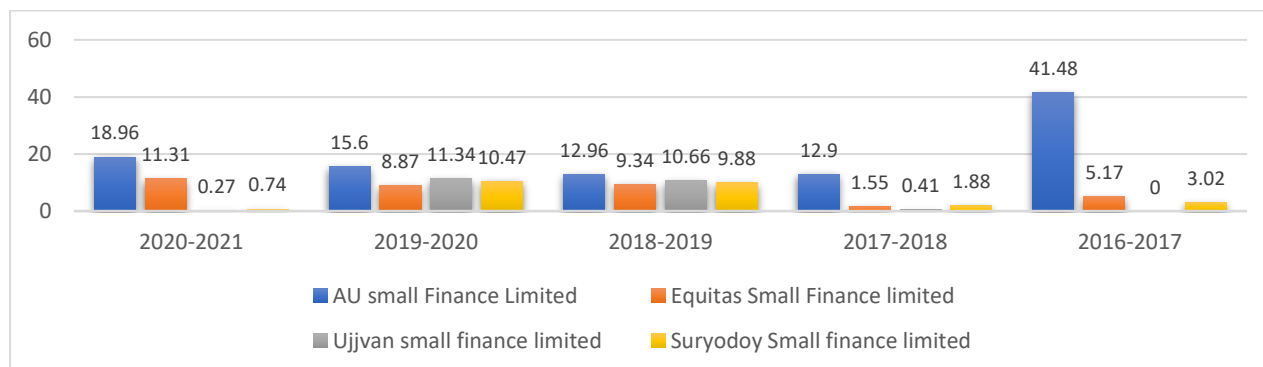
**Inferences:** In the past four years AU small finance limited had the lowest Total Asset to Turnover Ratio compared to the others. In the year 2016-17, Ujivan small finance had the lowest. In the years 2020-21, 2020-19 and

2017-18, Ujvan small finance had the highest Ratio. In the years 2019-20, 2018-19 and 2016-17, Suryodoy small finance had the highest Ratio.

**Table No. 7 Return on net worth (in Percentage)**

	AU small Finance Limited		Equitas Small Finance Limited	Ujivan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	18.96		11.31	0.27	0.74
2019-2020	15.60		8.87	11.34	10.47
2018-2019	12.96		9.34	10.66	9.88
2017-2018	12.90		1.55	0.41	1.88
2016-2017	41.48		5.17	-	3.02

Source : Annual Report



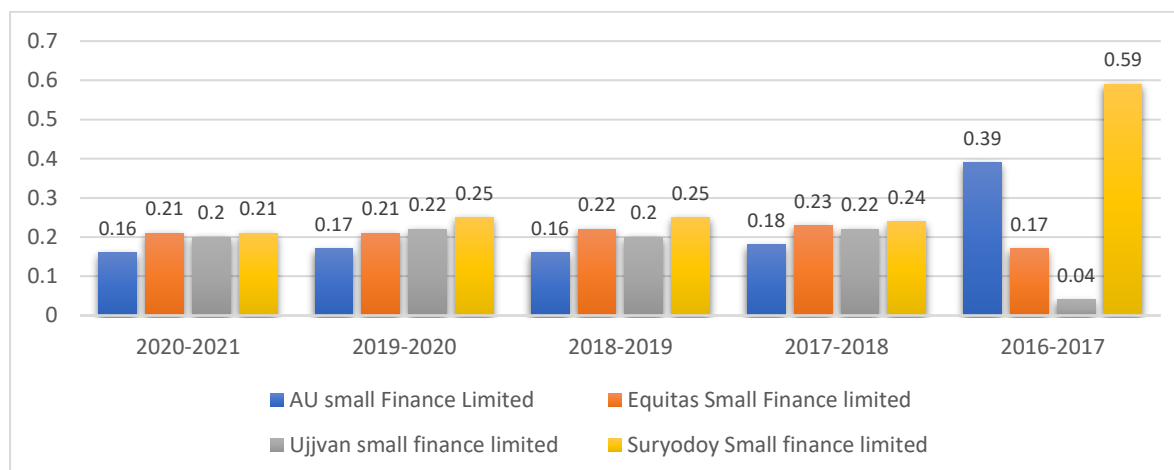
**Inferences:** In the past 5 years, AU small finance limited has recorded the highest return on net worth Ratio compared to the others. In the year 2020-21 and 2017-18 Ujvan had

lowest Ratio; in the year 2019-20 and 2018-19 Equitas small finance limited had the lowest. In the year 2016-17, Suryodoy Bank had the lowest

**Table No. 8 Loans turnover**

	AU small Finance Limited	Equitas Small Finance Limited	Ujjvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	0.16	0.21	0.20	0.21
2019-2020	0.17	0.21	0.22	0.25
2018-2019	0.16	0.22	0.20	0.25
2017-2018	0.18	0.23	0.22	0.24
2016-2017	0.39	0.17	0.04	0.59

Source: Annual Report



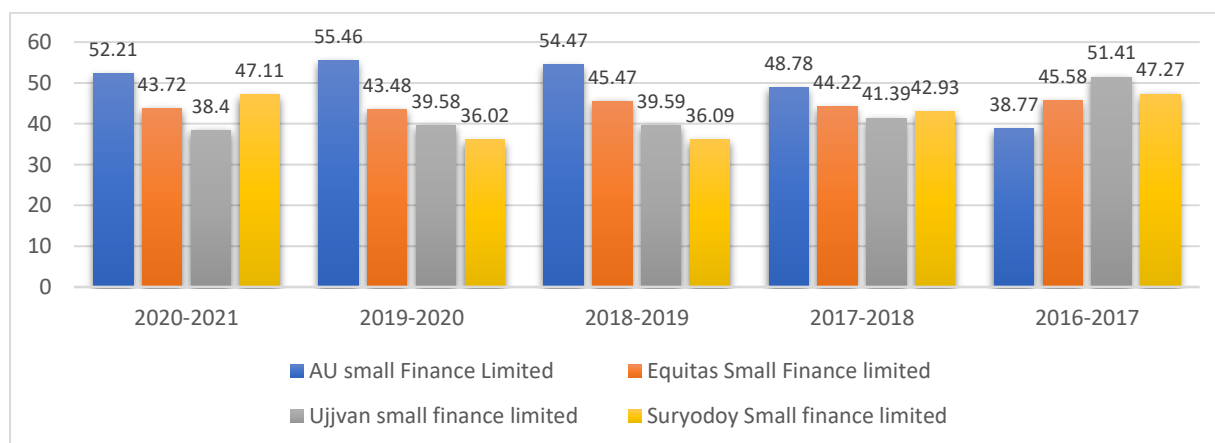
**Inferences:** From the past four year Au small Finance had lowest loans turnover Ratio. In the year 2016-17, Ujjvan had lowest Ratio. In the years 2020-21, Ujjvan small finance, Equitas small finance and Suryodoy had

recorded the almost equal Ratio. In the years 2019-20, 2018-19, 2017-18, 2016-17, Suryodoy small finance limited recorded the highest loan Turnover Ratio.

**Table No. 9 Interest expended/ interest earned Ratio**

	AU small Finance Limited	Equitas Small Finance Limited	Ujjvan Small Finance Limited	Suryodoy Small Finance Limited
2020-2021	52.21	43.72	38.40	47.11
2019-2020	55.46	43.48	39.58	36.02
2018-2019	54.47	45.47	39.59	36.09
2017-2018	48.78	44.22	41.39	42.93
2016-2017	38.77	45.58	51.41	47.27

Source: Annual Report



Inferences: The above table depicts, from past 4 years AU small finance limited had recorded highest interest expended/ interest earned Ratio. In the year 2016-17, Ujjvan small finance recorded the highest. In the years 2012-20-21 and 2017-18 Ujjvan small finance recorded the lowest. In the years 2019-20 and 2018-19 Suryodoy has recorded the lowest. In the year 2016-17, AU small finance recorded the lowest.

## 6. Findings

### 6.1. Current Ratio

The study shows that the current Ratio of the above listed banks is less than 1. Which clearly indicates that these banks could face problem in meeting their short-term commitments and obligations. AU small finance bank has the least current Ratio from the past 4 previous years. The comparative study also shows that Suryodoy small finance bank is having the highest current Ratio which reflects that the bank is trying to increase the current Ratio and liquidity position also.

### 6.2. Quick Ratio

The study shows that Equitas small finance bank, Ujjvan small finance bank, Suryodoy small finance bank have high quick Ratio compared to AU small finance bank. Usually, a good quick Ratio is 1.33% for the small finance banks. Which eventually means that all of these banks have good quick Ratio to pay off their current liabilities and these banks have good immediate liquidity.

### Total Debt to Owners funds Ratio

The above data gives an understanding that compared to other listed small finance banks Suryodoy small finance bank has the lowest Total Debt to Owners funds Ratio for the past 5 consecutive years. This puts the bank under less risk category for the investors. From the past 4 financial years AU small finance bank has high Total Debt to Owners funds Ratio. This makes the investment in this bank riskier. Equitas small finance bank Ratio is increasing year by year compared to its previous financial years which is not good sign for the growth. Ujjvan small finance bank has inconsistency in maintaining the Ratio which indicated that the company is striving for better numbers. Well only total debt Ratio is not a good indicator to judge the investment. Most of the times the

financial organizations fund their operations through the mixture of debts and equity.

### 6.3. Net interest/total funds Ratio

The study gives a clear understanding that Equitas small finance bank, Ujjvan small finance bank, Suryodoy small finance bank have good Net interest/total funds Ratio compared to AU small finance bank. This also means that the banks are regulating the utilization of the funds efficiently. Suryodoy small finance bank recorded 6.08% for the FY 2021-20 which is less compared to its previous financial year percentage that is 10.75% for the year 2019-20. This could be due to pandemic crisis. Despite of pandemic Equitas and Ujjvan small finance banks tried to keep up good Ratios. The Net interest/total funds Ratio is very sensitive to change. The quality of loan portfolio is also as an effecting factor for the change in the Ratio.

### 6.4. Total assets to turnover Ratio

The study shows that for most of the listed small finance banks above the Ratio is constant or slightly variable than their previous year data. It shows that Suryodoy small finance bank has an increase in its Ratio from the past 5 financial years except financial year 2020-21. As per this report, it depicts that Ujjvan small finance bank's performance is appreciable except for the financial year 2020-21. AU small finance bank has constant Ratio and the lowest compared to other listed banks from past four financial years.

### 6.5. Return on net worth Ratio

The study gives an understanding that the AU small finance bank has high return on net worth compared to the above listed small finance banks for the past five financial years which indicates that the bank is coherent in utilizing shareholder's money. Equitas small finance bank shows good return on net worth Ratio.

Ujjvan and Suryodoy small finance banks show high sensitivity to variability in the percentage compared to their previous financial year data. This gives an understanding that these banks are less efficient in deploying equity resources.

Sometimes, return on net worth Ratio may mislead like during the time of buyback of

shares. It is important to analyse with asset turnover Ratio before concluding.

**6.6. Loans turnover Ratio:**

The study shows that Equitas small finance bank, Suryodoy small finance bank and Ujjvan small finance bank loans turnover Ratios are close to each other’s Ratio for the past 4 financial Ratios. And in case of Equitas small finance bank the Ratio is constant and at times slight increase from past 5 financial years. Ujjvan has recorded increase in Ratio from financial years 2016-17 to 2020-21 and the Ratio is stable from past 4 financial years. This gives an understanding that these banks are using effective collection methods and reserving debt payments which leads to increase in terms of interest earning cash flow. This increase in cash flow eventually helps in paying debts and repayments. AU small finance bank is recording least from previous four financial years. Importantly, the firm is

recording less compared 0.39% which was recorded in year 2016-17.

**7. Recommendations**

- i. The small finance banks should work to better their current Ratio as this can help them in meeting their short-term liabilities.
- ii. The customers should invest in banks that give higher interest yield and in the banks which can return back the deposits when needed.
- iii. The small finance banks should take care of their loan portfolio. This helps in maintain good asset turnover Ratio.
- iv. The banks should limit their operational expenses if the operational expenses are large part of the companies’ total expenses.
- v. The banks operational expenses should help the banks to bring in optimum growth and maintenance.

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