GAME OF THRONES

FULL OWNERSHIP OF INDIA UNIT, SPECTRUM IN THE BAG, A $3 BN ARSENAL — VODAFONE GUNS FOR GLORY  p54
DESERVING THE

Bandhan

NATURE OF BUSINESS
Gives micro loans

CONTRIBUTION TO THE ECONOMY
A sustainable financial inclusion model in a country where 60 per cent of the population is unbanked

PORTFOLIO
97 per cent loans given to small women entrepreneurs doing zari work, selling vegetables, tailoring etc

FINANCIAL PERFORMANCE
Revenue: ₹337.28 crore
Net profit: Not Available

STARTED IN
2001

NO. OF EMPLOYEES
13,010

TOTAL ASSETS
₹6,769 crore

BRANCH NETWORK
2,000 plus branches all over India, but major presence in eastern region

LOANS AND ADVANCES
₹9,199 crore

ASSET QUALITY
NPAs very low, 0.13% of net advances

IMPACT OF SLOWDOWN
None, business is growing

(Assets and loan figures for 2013/14, unaudited)
Source: BT Research

Marufa Laskar, 50, is a zari worker, with four children living in Dhamua village of West Bengal. She also sells readymade children's wear door to door. She is a typical example of the average borrower from Bandhan Financial Services, the Kolkata-headquartered microfinance institution (MFI), which has now been
How do the winners of the two new banking licences – microfinance lender Bandhan Financial Services and infra institution IDFC Ltd – measure up to the challenges of operating as full-fledged banks?

By ANAND ADHIKARI

Highly creditable: A credit officer from Bandhan collecting the weekly payment from a group of women in Dhamua village, West Bengal

granted a licence by the Reserve Bank of India to get into full-fledged banking. Laskar borrowed ₹25,000 from Bandhan six months ago, and every Friday a credit officer from Bandhan visits her village to collect her weekly installment repaying it. Laskar has never defaulted.

Bandhan, set up in April 2001, has been helping relatively poor people in areas of the country where banks hardly exist, with bulk of the loans ranging from a minimum of ₹1,000-₹50,000 invested in small businesses such as zari work, tailoring, fish and vegetable selling, running small provision stores and so forth. To turn into a bank it will now have to mobilise low-cost deposits, both savings accounts and current accounts, which will enable it to lower the interest rate on its loans as well. (Currently, Bandhan, like all other MFIs, borrows from banks.) "We are willing to accept even ₹100 as deposit. We will go doorsteps of people to garner deposits," says Chandra Shekhar Ghosh, Bandhan's soft spoken Founder-Chairman. (See interview on page 70.)

Bandhan is startlingly different from the other institution that has also been granted a banking licence – IDFC Ltd. In terms of client profile, management bandwidth and asset size, the two are in study in contrast. What they do have in common – apart from plush, glass-and-steel headquarters – is that IDFC too was created to satisfy another unmet need of growing India: encouraging private sector involvement in infrastructure development. IDFC was formed in 1997, following the recommendations of an expert group on commercialisation of infrastructure projects chaired by Rakesh Mohan, later RBI deputy governor. Why get into full-scale banking? "IDFC has a very significant footprint in the corporate landscape but we are able to provide only a very narrow class of products (only term loans) to that client base," Rajiv Lail, Executive Chairman, said at a conference call with analysts a year ago. "Converting into a bank opens up the opportunity to serve an existing client base with a range of new products that today go to banks and other institutions."

Why These Two
The choice of Bandhan and IDFC by the RBI as the first two to be granted bank licences among the 26 which had applied, has surprised many. Among those still waiting are biggies such as the Aditya Birla Group, the Reliance ADA Group, the Bajaj Group, the Shriram Group, L&T Finance, Indiabulls and LIC Housing. Why these two? "A question the regulator had been grappling with was how to avoid creating replicas of existing private sector banks," says a person who has been close to the process. In
the last two decades, the RBI has cautiously allowed a dozen new banks to emerge, but of the seven which have survived — and whose share of deposits and lending in the entire banking sector is around 15 per cent — most are indeed clones of the banks which already existed, offering the same services. Given their background, Bandhan and IDFC are expected to be different.

The RBI is also undecided about whether granting banking licences to big corporate houses is a desirable step. RBI Governor Raghuram Rajan had said, when earlier he was advisor to Prime Minister Manmohan Singh: “I think the old RBI policy of not allowing corporate banking licences was a good one. I still stand by that.” So too his predecessor D. Subbarao had sought changes in the RBI to give it the additional power of superseding the board of a bank if required, in order to protect the interests of depositors, before corporate houses were allowed into the sector. Besides, corporate houses are unlikely to set up banks any different from the existing ones. Some claim the Tata and Videocon groups withdrew their banking licence applications because they anticipated an unfavourable response.

In his 2010 Budget speech that first announced the intention to grant more banking licences, then finance minister — and now President — Pranab Mukherjee had clearly stated that this was being done to extend the geographical coverage of banks and improve access to banking services. Banking penetration is much higher in the south and west of the country than in the north and east — this lowered the chances of the entities from these parts which had applied, the Shriram Group or gold loan company Muthoot Finance, for instance, of getting licences. In contrast, only three banks have their headquarters in eastern India — United Bank of India, UCO Bank and Allahabad Bank, among which UBI is in all kinds of trouble for its reckless lending — which could well have worked in favour of Bandhan getting its licence. There are just 54 credit accounts per 1,000 population in eastern India, almost half the average of the rest of the country. In Laskar’s village Dhanuwa, for instance, the State Bank of India (SBI) opened its first branch last year, while Bandhan has been there for seven to eight years.

Besides, no established bank will, like Bandhan, loan sums as low as ₹1,000 — which is the amount Laskar first sought in the mid-2000s to invest in her zari work — nor will it do so without seeking collateral, as Bandhan does. “Financial inclusion doesn’t mean just opening a bank account, but also providing credit,” says Rajeev Arora, Director at Fino PayTech, which has the largest banking correspondent network in the country. For Laskar, the ₹1,000 loan, duly repaid, was followed by a loan of ₹5,000, then ₹8,000 and finally ₹25,000.

The choice of IDFC is more easily explained. It is clearly to help and support the government in meeting its target of getting investments totaling $1 trillion in the next five years. “IDFC as a pure independent financial institution with management bandwidth was a clear front runner. The two licences actually balance each other out: one is retail oriented, the other is a wholesale banking player,” says Abizer Diwanji, Banking and Financial Services Head, at consultancy firm EY, formerly Ernst & Young.

Trust Factor

Bandhan’s business model so far has revolved around lending only to groups of women, numbering 10 to 30, in unbanked areas. “This helps recovery if there is a default,” says Pratim Samaanta, Deputy General Manager, Bandhan. Money is given solely to support income generating assets like zari
work. This is not the same as lending to women’s self-help groups, which some banks also do—in the latter case, all the women have to be engaged in a single business activity. Bandhan’s success is mainly because of the trust it inspires. “All financial deals require trust on both sides,” says Ghosh, who worked with close to two dozen NGOs before starting Bandhan. “You also need discipline.”

Bandhan too initially began as an NGO, but converted to a non-banking finance company (NBFC) in January 2006. It has an asset base of ₹6,769 crore, with a presence in two dozen states including West Bengal, Tripura, Assam, Bihar, Jharkhand, Uttar Pradesh and Maharashtra. It was in 2009 that Ghosh felt the need to further scale up the business. “The issue was how to offer loans at a comparatively low interest rate to people,” Ghosh adds. Since Bandhan borrows from banks to lend to its customers, its rates cannot drop beyond a point. Borrowers like Laskar end up paying 22.90 per cent while bank customers in comparison pay 16-18 per cent on a personal loan. But once it turns into a bank, Bandhan will have its depositors’ funds too. “I will be able to offer a lower interest rate if I manage to raise low-cost current and savings accounts (CASA) at five to six per cent as a bank,” says Ghosh. 57.

For IDFC, there were two main reasons for converting into a bank. With its entire loan portfolio in the infrastructure sector, it was, given the downturn, facing challenges in raising assets. As a bank it will have a much lower capital adequacy requirement than as an NBFC—nine per cent against 12 per cent. “This will allow IDFC to undertake higher leverage or grow its assets to several times its equity, translating into higher returns in terms of return on equity,” says Suruchi Jain, equity analyst at Morningstar India.

Second, IDFC was already competing with banks—banks too fund infrastructure projects—but with the handicap that banks could charge lower interest. “Risk funding increases for an NBFC once it attains a certain size because of the wholesale nature of the borrowings,” says Lall. It was indeed the growing delays in the completion of infrastructure projects—due to the downturn, policy paralysis of the government, environmental concerns and land acquisition problems—that led IDFC to consider turning into a bank. “It was the next logical step as IDFC faced the consequences of concentrated portfolio in a single segment,” says Diwanji of EY. IDFC needed a banking platform too because it had diversified into the retail business like mutual fund and needed bank branches to sell these effectively.

Hurdles Ahead
The transition to a bank, however, is not going to be easy. Banks have mandatory obligations—there is priority-sector lending, there is the requirement of rural branches, there is statutory liquidity ratio (SLR) and

---

No place too remote for us to bring energy to you.

From the scattered islands of Andamans to the winding backwaters of Kerala, IndianOil moves life round-the-clock, day after day. With a nationwide network of 40,000 customer touch points delivering a wide range of petroleum products to suit each and every need—from transportation and aviation fuels to SERVO lubricants and Indane LPG, IndianOil is proud to be an integral part of everyday life in India.

IndianOil. In every part. In every heart.

Petroleum Refining and Marketing | Pipeline Transportation | R & D | Technology Solutions | Petrochemicals | Gas Sourcing & Marketing | Exploration & Production | Alternative Energy
NEW GARB
What IDFC and Bandhan need to do to turn into full fledged banks

**Bandhan Financial Services**

**IDFC Ltd**

**SLR REQUIREMENT**
Will have to set aside 23 per cent of its funds as standing liquidity ratio, invested in govt securities
Will have to do the same. Given its large balance sheet, keeping so much money idle will be tough

**PRIORITY SECTOR REQUIREMENT**
Already lending solely to the priority sector
Must disburse 40 per cent of its loans to priority sectors like agriculture

**DIVERSIFIED PRODUCT BASKET**
Already well diversified, but will need to expand its product basket
Loan portfolio heavily focused on infrastructure, will need to scale up loans to other sectors

**RISK MANAGEMENT**
Operates without collateral which is risky, may need to change
Operates with collateral, has good risk management system in place

**DEPOSIT FRANCHISE**
Already has over 2,000 branches
Has only four branches, will need to expand fast, a big challenge

**ADDITIONAL EXPERTISE REQUIRED**
Will need talent to handle treasury management, build more products for rural areas
Will need to build expertise in dealing with sectors other than infrastructure

**WILL COMPETE CLOSELY WITH**
Other MFIs due to lower cost of capital
Banks that have been doing infrastructure financing

**MANAGEMENT BANDWIDTH**
Will need to hire expertise
Possesses high-quality management staff already

**CAPITAL**
₹1,100 crore (RBI’s mandated minimum requirement is ₹500 crore)
Well capitalised at ₹1,516 crore

**HUMAN RESOURCE CHALLENGE**
Many employees are undergraduates, will need more qualified people
Majority of employees are well qualified, have worked for big institutions

cash reserve ratio (CRR) to be maintained which basically means leaving assets idle. Bandhan will have no problems with priority sector lending or rural branches for, as Ghosh points out, its entire portfolio is priority sector compliant while the RBI’s requirement is only 40 per cent. “We only need to meet the SLR and CRR requirements,” says Ghosh.

Opening more branches will certainly be a major task for IDFC, which currently has only four. It will also have to invest 23 per cent of its funds in government securities under the SLR requirement, which will be a whopping sum given its balance sheet size of ₹71,059 crore. Lall admits the next three years will be spent in achieving compliance, geographical expansion and experimentation. “We are not focused on balance sheet growth in the first three years,” Lall says. Profitability will be under pressure as capital goes into opening branches, buying technology and hiring people. Rating agency India Ratings expects IDFC’s profitability ratios, especially return on assets and return on equity, to drop sharply in view of the SLR, CRR and other regulatory requirements. (See New Garb).

Bandhan is banking on converting its 5.5 million borrowers into savings bank customers. In comparison, HDFC Bank has 18 million retail customers. But this is easier said than done. The trust factor may work for it in the east, but not beyond that. The challenge will be to diversify the lending from small and unsecured amounts to large amounts against collateral to protect the interest of depositors. Also, Bandhan has to follow strict lending norms; lending will get more complicated than its present one-page loan application form.

The duo has a year and a half’s time to set things in order. But a lot of additional responsibility has now descended on them.

@anandadhikari
Chandra Shekhar Ghosh gave up a steady job at BRAC, the well-known Bangladesh-based NGO, to start his own which later metamorphosed into Bandhan Financial Services. He started with just ₹2 lakh and two employees. No one around him believed he would succeed, but he was not deterred. “I relied solely on my own confidence,” he says. When established banks turned him away, he borrowed from moneylenders. Today, he occupies a swanky office in Kolkata’s Salt Lake area. He spoke to Anand Adhikari.

Edited excerpts:

How did you transform Bandhan from an NGO to a non-banking finance company? As an NGO, our only source of funds was donors’ money. In 2005/06, we converted ourselves into an NBFC. India is a big country and we also had big plans. I wanted to scale up my operations. Scaling up has two kinds of impact – first, the cost of operations comes down. Second, until I reach a large number of people, I make no impact on the community. So, these factors encouraged me to go for an NBFC model. We also needed more money to reach out to more people. Banks are also happier funding an entity if it is an NBFC. In fact, we were functioning as an NBFC even though we were an NGO.

When did you feel you wanted to turn into a bank, and why?
In 2009, I felt the need to scale up. The unbanked population in India is still 60 per cent. Banks also have limitations in giving loans to poor. The issue was how I can give loans at a comparatively low interest rate. Our borrowing rate (from banks) was high, so we were passing it on to the customers. If we get the opportunity to access low-cost deposits, our cost of funds would also come down and I could pass the benefit on to the customers.

Why don’t existing banks do this?
Existing banks have other skills. They are tapping customers at the top of the pyramid. It will take them time to come from the top of the pyramid (large corporate houses) to the bottom of the pyramid.
Your expertise lies in lending. How do you plan to build a deposit franchise which requires different skills and probably different markets?

We have 5.5 million borrowers as customers. We can easily convert them into deposit account holders. There is no bank which has 5.5 million customers from day one of commencing business. Secondly, we are working within a community which knows us. We are very transparent in our dealings. For example, we hold meetings with borrowers in villages every week. People trust us.

Bankers say rural markets are more of lending markets and large deposits can only be raised in urban areas.

If we want to develop India, we should break the mental blocks in the minds of people. I remember a villager coming to Apollo Hospital and settling a bill of ₹1 lakh in cash. People in villages also have money, but nobody has gone to them to tap it. It’s not like you set up a shop and expect customers to come to you. You have to go to them.

PSU banks are already present in rural areas, but people there prefer to deal in cash. People don’t use cheques or cards. How do you plan to break this mental block?

Of course, there is some fear in people’s minds because of the tax implications (of using cheques and cards). You have to educate them about the advantages of keeping money in a bank. The second part is doorstep banking. We are willing to accept even ₹100 as deposit. We will go to the doorstep of people to garner deposits. The staff should be customer-friendly and motivated to work for the benefit of the community.

Will your business model change to become a bank?

We will gradually expand the customer base from women to all types of people. We will do both doorstep as well as branch banking. A customer won’t come to your branch to deposit ₹50, when he has to spend another ₹30 on travelling. We can also continue door-to-door instalment collection on a weekly, fortnightly or monthly basis in a banking step up. Our model is a financially viable model. We have already proved it.

How will you fulfill banking regulations relating to collateral, priority sector, SLR, CRR etc?

We will not seek collateral for loans up to a certain amount. But we will ask for collateral after that as per banking rules. We will also do SME and other business loans. Today, our entire portfolio comes under priority-sector lending. We are fully compliant with the RBI’s priority sector lending. We only need to meet SLR and CRR requirements.

@anandadhikari