The big dream of small finance banks and the challenges ahead

Top bankers and executives from small finance banks and microfinance institutions gathered at the *Mint* South India Banking Conclave to discuss challenges their respective sectors face. *Mint* features two panel discussions which took place at the event held on 2 June in Bengaluru

(From left) Disha Microfin chief executive officer Rajeev Yadav; Microfinance Institutions Network CEO Ratna Vishwanathan; Ujjivan Small Finance Bank MD and CEO Samit Ghosh; Mint*'s consulting editor Tamal Bandyopadhyay, Equitas Small Finance Bank Ltd MD and CEO P.N. Vasudevan; IBM senior partner and vice-president, country lead (BFSI), global business services, Gayathri Parthasarathy at a panel discussion during the* Mint*'s Annual South India Banking Conclave.*

PHOTOGRAPHS BY HEMANT MISHRA/MINT

The impact of note ban and the preparations for GST

BY A STAFF WRITER
feedback@livemint.com

BENGALURU

At *Mint's* Annual South India Banking Conclave on 2 June, executives from small finance banks and microfinance institutions came together to discuss the challenges and opportunities faced by the sector. Small finance banks offer basic banking services, accepting deposits and lending to unserved and underserved sections including small business units, small and marginal farmers, micro and small industries, and entities in the unorganized sector. Ujjivan Small Finance Bank Ltd managing director (MD) and chief executive officer (CEO) Samit Ghosh; Equitas Small Finance Bank Ltd MD and CEO P.N. Vasudevan; Microfinance Institutions Network CEO Ratna Vishwanathan; Disha Microfin Pvt. Ltd chief executive Rajeev Yadav; and Gayathri Parthasarathy, senior partner and vice-president, global business services, financial services sector at the India unit of International Business Machines Corp., took part in a discussion on *The big dream of small finance banks* moderated by Tamal Bandyopadhyay, consulting editor at *Mint*. Edited excerpts:

Even though you are a small finance bank, you are subjected to higher capital requirements. Are you fine with the regulations?

Ghosh: Small finance banks (SFBs) are specialized institutions, we have the objective of financial inclusion. We have already got a set of norms which we have to comply with like 75% priority sector lending, etc. As we progress as a bank, there are a different set of challenges which we are going to face. It is very important to have a constant dialogue with the regulator. As an example, we all are going to become members of the state-level bankers committee—it assigns various targets for regular commercial banks. Our portfolio is already 100% priority sector loans (PSLs); to that extent things have to be modified. Loans on our book should automatically be classified as PSLs.

Is there any other example in your mind, Vasudevan?

Vasudevan: SFBs are small... Many people believe that the word small is a reflection of the word bank and not the word finance. Many people call us Equitas Small Bank. It is reflected in the guidelines you see, Rs100 crore capital we need and commercial banks need Rs100 crore....We have (to meet) 75% PSL, it is very onerous.

For people like us, there is no problem. Second part is 50% of portfolio is less than Rs25 lakh, these are the two defining characteristics of an SFB. We have no problems with it. The question is should I aspire to be a small bank or be a big bank?

Suppose you have capital of more than Rs500 crore, can you be given the flexibility of a universal bank? We all have invested heavily in technology. We are also filing periodical returns, the only difference is that we are in Basel II (banking norms, less onerous than Basel III).

Rajeev, both Ujjivan and Equitas are up and running; they are also listed. What are the challenges in setting up a small finance bank?

Yadav: We got a final licence in mid-May and we will be commencing (operations) in early July. Challenges are many... IT (information technology) takes a little longer, that bit is a short-term challenge. It is not easy to hire in cities other than the established ones.

I think right now we are learning from the experience of others. Meeting regulatory compliance in the short term will be a big transition step. Asset mix will change to more secured funds. All these aspects become a challenge; on a stand-alone basis it is workable.

What are the concerns you have in terms of challenges?

Parthasarathy: Moving to the next era, it is more to do with not customer segments, but customer experiences. It is more to bring customers on board. There is a lot of trust that needs to be built. Security will be a very important area which needs to be focused on, which will come from many other threats as expansion continues.

All of you suffered from demonetization, we saw the (loan) collection rate drop to low levels. The goods and services tax (GST) is knocking at the doors. How will it impact your small and medium enterprise business?

Vasudevan: Traditionally, we operate at an NPA (non-performing asset) ratio of 1% and annual provisioning is at 6 or 7%...NPAs shot up to the 5-7% level post-demonetization. Microfinance cannot operate at this level and we cannot call this the new normal.

Nobody can predict at what level NPAs will remain... In two quarters you make 100% provision, in our case. Amount of NPAs is almost equal to one year's profit in our case. If I have to make one-year profit provision in two quarters' time frame, it will severely impact my financials.

The reality is not as bad as it is being projected. What is being done to alleviate the pain? On GST, is there any industry-wide action you are taking so that small finance banks are not faced with inconvenience?

Vishwanathan: We did an enormous amount of work, challenges were several... when it came, it was tough dealing with it. Geographies that are displaying this behaviour are not traditionally drought-hit. Those geographies are paying 100%. There are not much changes in some geographies—we have Vidarbha region in Maharashtra. There are some issues in western Uttar Pradesh, drought-affected northern Karnataka. There is no rational explanation for this.

Being a bank, the market determines the interest rate. As a microfinance institution, it was capped at 10%. Your process is not equipped to handle this. If you are going for six-hour meeting, and if there is some issue, everything goes for a toss. Typical quality of your assets also hurt ability to lend. All in this context, could you throw some light?

Ghosh: This year you will see a lot of credit provisioning from microfinance institutions since RBI's temporary respite has gone now. As far as GST is concerned, a lot will depend how the government executes it.

Will you like to continue what you do or challenge universal banks?

Ghosh: We may seek a universal bank licence for different reasons. As a small finance bank, we have a fairly tough capital requirement, which a universal bank doesn't have. From that perspective, we would like to become a universal bank.

Vasudevan: In terms of universal bank aspiration, from day one, we have set up our bank from that perspective. Even though Basel III is not applicable to us, we voluntarily strive to comply with it. My business model may not change if given a universal licence.

This year will see higher credit provisioning by microfinance institutions, says Samit Ghosh

How to solve bad loan problems

BY A STAFF WRITER
feedback@livemint.com

BENGALURU

(From left) Canara Bank executive director P.V. Bharathi, Lakshmi Vilas Bank managing director and CEO Parthasarathi Mukherjee and State Bank of India MD Rajnish Kumar at Mint*'s Annual South India Banking Conclave.*

The theme of the Mint Annual South Banking Conclave this year was *Bad Loan Resolution: The Road Ahead*. The session moderated by *Mint*'s consulting editor Tamal Bandopadhyay saw some big names like State Bank of India managing director Rajnish Kumar, Lakshmi Vilas Bank MD and chief executive Parthasarathi Mukherjee, and Canara Bank executive director P.V. Bharathi discuss the challenges of bad loan resolution in the banking system. Edited excerpts:

Partho, you were with a large, new private bank and now you are with a relatively small, old private bank. We are not talking about bank-specific problems but tell us what your reading is of the trend and how do we get out of this?

Mukherjee: Our ability to read is just about as good as our ability to misread. What happened was that we read at a particular point of time and at that time, things were rather good, it was needed. Here in Bangalore city, while coming from the airport to this venue, my God, it's terrible. This country badly needs infrastructure. The banking system, at that point of time, stepped in and developed infrastructure. That was needed, everyone read it right. Where things went wrong subsequently was that various projections went wrong. Some of it was on account of policy perhaps, and various other things, and perhaps we made mistakes too but I would say that we didn't really misread the situation at that point of time.

The other question is this: should the Reserve Bank of India have been more aggressive with this AQR (asset quality review)—that you recognize bad loans and also clean them up? It has happened chronologically. First, you have recognized and now you are being forced to clean up. Bharathi is this bank-specific?

Bharathi: As public sector banks (PSBs), we have our social responsibility, we have a responsibility towards the economic development of the country. We have been asked to play a role in economic development. Initially, we were conservative, we had just five to seven years of term loans or at the maximum 15 years, depending upon the sector. Then the country decided that we have to go for linkage, we have to see that the roads are developed, that power is developed and that we have the required infrastructure to build that. Then, the PSBs were called in and given the responsibility to contribute towards this. Now when we go for this, these are actually 30-year loans which were done with due appraisal at that particular time, presuming that everything was in place but when the unit was ready, the PPA (power purchase agreement) was not available. At one point of time, we said there is shortage of power, now we say we are withdrawing the PPA or we contracted at different rates. The earlier rate was, say Rs5, now we say we are only going to give Rs2. So these sort of things were actually there at that point of time.

A project is envisaged or is looked into going by the circumstances at that point of time and what we expect the future to be.

As a banker, our interest would be to recover the money as much as possible. We would not straightaway jump into the question of recovery or recalling of a loan. Our first preference would be to recover the maximum amount today. So, probably, had the AQR not come into the picture at this point of time, these loans which we have contracted, being long-term loans, we might've thought not this year, maybe the next year we'll do good. So, we might've prolonged it for a long time. So what the AQR has done is that it has actually identified that the environment has changed so we may not get the cash flows which we had anticipated. And therefore, it is time to call it a bad loan. It has become a stressed loan. Now that there is a stressed loan you have to provide for it. And when we have to provide for it, on the one hand, we are talking about this development and on the other hand, we are quickly moving towards international compliances, that is Basel. So all the banks are now gearing up to reach the Basel norms where we have the challenge of maintaining the higher capital level. So all this is a challenge. Ultimately we are going to go down and zero in on capital because whatever the provisions, all the methods which have been suggested by the government are really good and we can go on. But everywhere it is the question of the postponement of my realization. I am not going to get the cash flow which I had envisaged. So when I don't have the cash flow, there are the obvious challenges of profitability and making provisions.

Kumar: We have spoken about the external environment and about the other things but definitely one error in my view which we committed was allowing the corporates to overleverage. That is where we should have been more careful and going ahead also, we should be very careful about overleveraging corporates. Everybody thought there is growth tomorrow, so everybody was in the mode of becoming Dhirubhai Ambani. Banks that are flush with excess liquidity looked for top-line flow without pricing risk adequately in the competitive mode. This was something that was at least avoidable but we could not avoid it because everything is clearer in hindsight but going forward, we must learn that lesson which has come at quite a heavy price.