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Sustainable Finance Track

Runner-up

Bandhan (A): Advancing Financial Inclusion in India
&
Bandhan (B): Sustainable Banking in India

Inspection Copy

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Bandhan (A): Advancing Financial Inclusion in India
Bandhan (B): Sustainable Banking in India

ABSTRACT

Established in 2001 by Chandra Shekhar Ghosh to address the dual objective of poverty alleviation and empowerment of women, Bandhan was the largest microfinance institution (MFI) in India and the largest non-deposit taking MFI in the world. By 2013, it had grown to 2,016 branches across 22 states and union territories within India. With over 5 million borrowers and total outstanding loans of INR 57 billion (~US$1 billion), it had zero non-performing loans.

Case A sets up the need for and significance of financial inclusion, and the role of microfinance in the Indian context. It highlights Bandhan's operational model and the various elements that explain its unique stature in the microfinance space. This case is poised at a junction when Ghosh is looking back with humility at Bandhan's extraordinary achievements and contemplating plans to extend Bandhan's reach by foraying into payment banking.

Case B is set at a time when Bandhan was about to embark on an organizational transformation that would convert it into a mainstream bank. In July 2013, supported by a Geneva-based investor, Bandhan had applied for a banking license to expand its operations by leveraging its network. And in May 2014, the Reserve Bank of India (RBI) had granted the license to Bandhan, making it the first MFI in the country to win a bank license, and also the youngest entity to be allowed to enter the banking space in India.

Ghosh had ambitious growth plans focused on the rural sector. Bandhan seemed to have built the right capabilities to be successful as an MFI. The cases allow for a rich discussion about the new capabilities that Bandhan would require as it shifted from being a pure MFI to a banking entity and how it should go about acquiring those capabilities. Was it preparing well to deal with the challenge of entering, surviving and growing in the banking industry while continuing to serve and grow in the MFI space? Could Bandhan develop a unique and innovative model to help it straddle both worlds?

With this license, Bandhan had been offered an opportunity to re-create the entire banking edifice in India. Participants have the opportunity to analyze the key issues in the cases and attempt to answer the question playing on everyone's mind – how would Bandhan deliver on the goals of financial inclusion and sustainable banking?

BANDHAN (A): ADVANCING FINANCIAL INCLUSION IN INDIA

It was March 2013 and the Bandhan team had gathered as usual for the annual board meeting at the Kolkata head office. There was excitement in the room as the group congratulated one another on the latest feather in Bandhan's cap, the Skoch[1] Financial Inclusion Award 2013. The fact that Bandhan had received the prestigious award for the third year in a row was no surprise to the energized team members. Since its inception in 2001, the organization had received a number of awards and accolades in recognition of its efforts for women's empowerment and poverty alleviation.[i]

As Chandra Shekhar Ghosh, chairman and managing director of Bandhan Financial Services (Bandhan), waited for the elation to settle down, he thought how he would frame his opening remarks to start the meeting. Ghosh had set up Bandhan in 2001 to address the dual objective of poverty alleviation and empowering women, and in 13 years it had grown to become one of the largest and most profitable microfinance institutions in India.[ii] Besides microfinance, Bandhan also worked on the overall development of its marginalized customer base through its activities in education, health, employability and livelihood generation.

Although Bandhan had a proven track record in the rural areas in which it operated, Ghosh was deeply motivated to maximize financial inclusion at the grassroots level with a much larger and deeper impact. He was confident that it was now time to take Bandhan to the next level. Given its commitment to serve the hitherto unbanked, was banking the next step in Bandhan's progression? Ghosh strongly believed that if he could be successful in sustainably running a microfinance enterprise with social intentions, he would succeed in a banking venture too.

Yet he knew that the management team was going to be taken aback by this bold idea. Paramount in their minds was the question: How should Bandhan sustain its current growth momentum? There was bound to be resistance to Ghosh's audacious decision. Did Bandhan really need to become a bank to advance its objectives of financial inclusion?

EVOLUTION OF THE MICROFINANCE INDUSTRY IN INDIA

According to the World Bank, as of 2012, about 50% of adults around the world did not have an account with a formal financial institution. These 2.5 billion "unbanked" faced barriers such as cost, distance, and the need for documentation to access basic financial services.[iii] This growing recognition had led to increased interest in financial inclusion and the role it played in reducing poverty and supporting sustainable development.[iv]

Financial Inclusion in India

In India, the banking sector had made great strides since the country gained independence in 1947. Commercial bank credit as a percentage of gross domestic product (GDP) had grown from 5.8% in 1951 to 56.5% by 2012. The population per bank branch had come down from 64,000 in 1969 to 12,300 in 2012. The industry had witnessed a major boom in transactions through ATMs and internet and mobile banking in the previous decade.

While this meant heavy competition for profitable segments of the market, the remote and poorer areas that offered fewer rewards continued to be unserved. Although India had 27 state-run banks and 22 private sector banks for a country of 1.2 billion people, nearly half of

[1] Skoch Financial Inclusion Awards are given to recognize best practices from the banking and financial services sector and are bestowed on organizations from across urban and rural India that promote inclusive growth and poverty alleviation. http://www.bandhanmf.com/awards.aspx accessed March 1, 2016.

the households in India were unbanked. Only 35% of India's adults had bank accounts. With little or no access to formal sources of credit, the unbanked population relied on more easily accessible, but very expensive, village moneylenders.

India had made attempts to address this gap in several ways. The nationalization of banks, priority sector lending stipulations, the lead bank scheme, the establishment of regional rural banks, the launch of self-help groups (SHGs), business correspondents, and bank linkage programs were all part of the RBI's initiative to provide financial access to the unbanked masses (*refer to* ***Exhibit 1***). Yet, progress had been slow. This was mainly attributed to poverty, illiteracy and lack of regular income of the unbanked as well as banks' limited reach, high transaction costs and unsuitable product portfolios. Also, since the normal banking model was found to be wanting in terms of scalability, convenience, reliability, flexibility and continuity, banks hesitated to open in rural areas.[v]

Microfinance in India

In response to this failure of the banking model and the inability of formal institutions to provide rural credit, microfinance had emerged in India. Microcredit was the most common product offering of MFIs. These loans were typically in the range of INR 5,000 to INR 20,000. The MFIs were either not-for-profit companies like non-governmental organizations (NGOs) or for-profit companies, which were regulated by the government as "non-banking financial companies" (NBFCs).

One popular model among for-profit MFIs was the joint-liability group model popularized by the Grameen Bank in Bangladesh. Loans were extended to and recovered from each member of the group, but the group took collective responsibility for the loans. SKS Microfinance and many others used this model (*refer to* ***Exhibit 2***).

By 2012, MFIs, both for-profit and non-profit entities, reached 31.4 million customers with a total outstanding loan portfolio of INR 208 billion (US$3.8 billion). The SHG-Bank Linkage Program reached 98.1 million customers with a total outstanding loan portfolio of INR 306 billion.[vi]

Microfinance Challenges

Microfinance quickly made forays into the financially excluded rural communities across India, particularly in the southern state of Andhra Pradesh (AP). Some of the prominent MFIs in AP grew at a phenomenal pace. Soon, however, some of these MFIs were criticized for having moved their focus more toward growing the loan portfolio and reducing operating costs, rather than reaching out to the really needy and educating borrowers.

As a result, in 2010, these MFIs came under state government scrutiny after allegations that their strong-arm recovery tactics had led to a spate of borrower suicides. With strict new guidelines in force after the local government introduced new regulations, micro lenders were obliged to significantly drop their lending rates. This was a period of crisis for the sector. But subsequently, in July 2012, the RBI intervened with sweeping reforms and the Micro Financial Sector Development and Regulation Bill, 2012 was passed and MFIs were brought within the ambit of the central bank.

With the objective of promoting financial inclusion, the then finance minister Pranab Mukherjee announced in his budget speech for 2010/11 that companies and business houses would be allowed to set up new banks. In February 2013, the RBI went on to release the final licensing guidelines for new banks. The deadline for filing applications was July 1, 2013.

BANDHAN FINANCIAL SERVICES

Early History

Chandra Shekhar Ghosh set up Bandhan in 2001 as an MFI to address "the dual objective of poverty alleviation and women empowerment." Currently chairman and managing director of Bandhan and a senior Ashoka Fellow, he came from humble beginnings and served in his father's sweet shop while growing up. After earning a master's degree in statistics from Dhaka University, he went on to work with BRAC, a non-governmental development organization, in Bangladesh. Around this time, his father died and, since the income from the sweet shop was insufficient to support the needs of a family of eight, he took a job with an NGO in Kolkata. "When one is desperate for work, getting a job in an NGO is an easy option," said Ghosh wryly. During this period, he worked for nearly 20 NGOs in the West Bengal region, where he saw from close up the exploitation of the poor by moneylenders who charged exorbitant interest rates for loans.

Recalling some of his early experiences, he said:

"I saw this man on a bike giving INR 500 to a vegetable vendor in the morning, collecting INR 5 as interest, and then coming back again in the evening to collect the INR 500. I pointed out to the vendor that he was paying 1% a day for this loan of INR 500, which amounted to 700% per annum. But, surprisingly, his rationale was different. For him, it was about paying INR 5 – equivalent to the price of two cups of tea – for the convenience of someone coming to his place for the transaction, and providing a loan without the need for a guarantor, security, signature or paper work. This made me realize that people are willing to pay more if whatever they need is provided to them – on time, at their place and in a very simple way."

He realized that while most NGOs focused on education, health or environmental issues, the real issues of the poor were subsistence related – generating sufficient income to provide three meals a day for the family. Deciding he wanted to make a difference, Ghosh worked with nearly 10 NGOs in the state and developed them in an attempt to provide microcredit to 100,000 families each, but without much success.

In 2001, distressed by the state of affairs, he quit his job and created a small lending outfit with INR 0.2 million in capital and two employees, despite concerns from his family about the loss of a regular income. He registered as an NGO by the name of Bandhan Konnagar and started operations in West Bengal. At first he borrowed from friends to have funds to lend. But he finally got his big break when the state-run Small Industries Development Bank of India (SIDBI) put up capital of INR 2 million, which allowed him to expand his loan portfolio. In 2006 Bandhan acquired Ganga Niryat Private Limited – an NBFC registered in 1995 – and subsequently started operations as Bandhan Financial Services Private Limited (BFSPL), incorporated under the Companies Act, 1956. This transformation from NGO to company took place over three years and required major restructuring within the organization.

Based on the philosophy that assisting women has multiplier effects in transforming society, Bandhan targeted its programs at disadvantaged women. The lending model it followed was "individual lending through group formation," whereby loans were disbursed at the branch office and repayment of installments took place at the weekly group meetings of borrowers.

The International Finance Corporation (IFC), the World Bank's investment arm, invested around INR 1.35 billion in 2011, amounting to a stake of about 11% in Bandhan. The only other institutional investor in Bandhan was SIDBI, with a 10% stake. Over time, Bandhan became India's largest microfinancier, focusing on the northeast and then expanding across the country. The microfinance activities were carried out by the NBFC, Bandhan Financial

Services Pvt. Ltd. By 2013, of the 1,816 branches across 19 states and union territories, 70% were in rural and semi-urban areas. Bandhan had about 12,070 employees to serve a customer base of 4.7 million in the microfinance fold, nearly all of them women, with an average loan size of INR 10,000. It had a cumulative loan disbursement of INR 241 billion and total loans outstanding of INR 43 billion, with a repayment rate of 99.78%. A total of 34 banks and financial institutions were funding Bandhan[vii] (*refer to **Exhibits 3**, **4** and **5***).

Bandhan also had a development wing called Bandhan Konnagar, which operated as an NGO and catered to 440,000 households across six states with interventions in the field of education, health, employment, and the like.

Organization and Processes

A branch office was the core of Bandhan's operations. Each branch served as a residence-cum-office for the field staff. It was managed by a branch manager along with 5 credit officers and catered to 125 groups comprising 3,000 borrowers. A region, comprising six or seven branches, was managed by a regional manager, who in turn reported to the divisional manager, in charge of seven or eight regions. Around five or six divisions constituted a circle office headed by a deputy general manager, who was based in head office, but spent considerable time in the field. The four circle offices were in Mumbai, Delhi, Patna and Guwahati while the head office operated out of Kolkata (*refer to **Exhibit 6***).

The credit officer at a branch was responsible for interacting with people within the branch area and familiarizing them with Bandhan, its financial products and how they could benefit from these products. After some initial discussions, people were selected to officially form a group. The group nominated a set of five borrowers for the first loan. One loan form was completed at the household level for each borrower to determine the assets, and another one was filled in at the group level to obtain the other group members' approval. The branch manager then visited each applicant's house and issued a passbook containing information about the loan amount, interest, instalments, etc. Over time, this cycle was repeated for other members of the group.

Operational Model

Ghosh became aware of two important factors early in his experience of providing credit to the poor – one was their need for regular cash flow and the other was their need for regular service. He explained:

"In microfinance, the ticket sizes are small and the transaction cost is high. The mainstream banking channel is focused on the balance sheet – how many deposits have you collected and not how many new clients have you acquired. The ground reality is that 60% to 70% of the poor do not have access to a banking service in order to start a new business, or to scale or diversify. So, our job is to reach them. However, to ensure the sustainability of my customer, I need to be sustainable too. Therefore, I have to think of ways to minimize cost."

Simplicity and cost reduction became the overarching objectives as Bandhan went about building the organization. Each branch was a one-room office with very basic furniture like plastic chairs and a table. As a conscious decision, instead of a motor cycle, the staff were given a bicycle to make visits. Although this limited the geographical area that the officer could cover, it ensured stronger and deeper relations with the client. Instead of hiring full-time accountants, the credit officers served as the accountant on job rotation. Ghosh reasoned:

"It is just half an hour's work. We even simplified the account books with basic headings such as disbursement, collection, salary, expenditure listed on top of the book. The cash

book had 30 rows, one row per day, where the daily transactions were recorded. Any non-accounting person could also easily understand and do this kind of work."

As the needs of the organization grew, Bandhan began computerizing its systems. By 2011 each branch was equipped with a computer. The branch staff entered their data using MFSol software and it was then sent to head office either online or offline using data cards. At head office, branch level data was reconciled to generate reports.

Recruiting and Building Capacity

Bandhan made a conscious decision to hire staff for its branches from the local community. The local connection was valued more than education or experience. As Ghosh elaborated:

"So many people are unemployed. That is a big opportunity for us. If I decided to hire educated or "high profile" people, the cost of hiring them would be high, and secondly, they would not be willing to go to the village to work with poor people. So I chose people based on two aspects – one was that they were from a poor family background, understood poverty and felt strongly about it, and the second was that they were rural people. After that, we sent them to the Training Centre where we changed their mindset to the way we do things, and then sent them into the field. In the field, too, we assigned people to provide support and handholding to new members. This was a continuous process, not one time."

Although these recruits had studied up to grade XII at least, Bandhan provided further training. The provision of residential facilities to the staff at the branches also had benefits. Ghosh explained:

"If the staff live together, bonding develops among them and there are several learning opportunities. Every day, they spend four hours sitting and living in the same premises, sharing their problems and discussing their work. These four hours are like an informal training session, and multiplied into 25 days of the month, we end up with nearly 100 hours of free training sessions."

In the initial five to six years of operations, Bandhan's administrative staff who handled operations also conducted training. Later, a separate training department was created with training officers for different areas. Over the years, Bandhan had set up eight training centers and developed 41 trainers to provide training across the organization.

Although Bandhan's client profile was largely women, there were fewer female staff than male. Cultural factors such as marriage, family and children were some of the reasons that women took up fewer opportunities in the Bandhan field offices.

Monitoring and Supervision

Customers were given passbooks with Bandhan's helpline number printed on the back. Any issues or complaints received on the number were dealt with at the headquarters. Serious issues were escalated to an ombudsman committee of senior, non-operational employees. Customers also had the option of dropping anonymous chits into a suggestion/complaint box available in all branches.

Bandhan set up a system of quarterly internal audits to monitor and supervise the branches. Every quarter, the internal audit team visited the branch and also lived there. Along with formal paperwork and field work, there was informal discussion too. Commenting on the benefits of this system, Ghosh said:

"Some credit officers may not be very open in discussing problems with their branch manager, as he is the boss. But when the outsider comes as part of the audit team, they are more willing to share their problems with him."

Incentives, Retention and Culture

Bandhan's culture, which reflected humility and simplicity, permeated throughout the organization. All staff, including those at head office, were encouraged to spend time in the field. However, in a major departure from the strategy of other microfinance players, Bandhan did not give its staff any cash incentives. Explaining his rationale, Ghosh said, "One big cause of the Andhra Pradesh crisis was the incentives that were dependent on disbursement and collection, which led to unhealthy and coercive practices by the field staff." Bandhan relied only on promotions as a means of incentivizing employees.

Yet, the culture and policies had resulted in high staff retention. As Ghosh reasoned:

"If they love it, they cannot leave. They see their career path and realize the kind of opportunities that they get from Bandhan. They realize that even if they decide to leave, they are not going to get a job easily. In fact, the people we selected at first were those who had no alternative but to take up the job. Also, during the years that they spent with us, they saw how an organization can be built and how they had built themselves. Even the senior management consists of people who have grown from the bottom ranks and are now running the organization."

Ghosh also tried to meet with all employees regularly. He made a point of meeting all the staff every two years through yearly picnics, which provided an informal forum for interaction. "With close to 14,000 employees, we had 40 yearly picnics. I attended 20 picnics one year and 20 the next," said Ghosh. Once a week, he also visited the training center at Kolkata where he had the opportunity to interact with around 100 people at a time.

Commenting on the policy of encouraging newcomers without work experience, Piyali Bhattacharjee, assistant general manager for R&D, explained:

"Very few corporates encourage "freshers." But Bandhan hired me straight from college and I am still here today. Another reason that the staff stay with Bandhan is the accessibility of Mr Ghosh. Also, the fact that he is very strict as far as respect is concerned and will never compromise on bad behavior. At the end of the day, it is not always about the salary component. We, as employees, also need love and respect. So we are like one big happy family."

Bandhan had also set down some clear ground rules for conduct that established its value system. Ghosh elaborated:

"I set three ground rules for all my employees. First, don't touch the money, meaning don't use office money for personal use. Second, don't touch the women. This is a big challenge as all of our customers are women, while the majority of the staff are men. Even a staff member marrying someone in the same locality where he works is not allowed as it does not look good from the community's perspective. Third, don't be rude or misbehave with the customers. Anyone, at any level in the organization, will have their employment terminated if they breach any of these ground rules."

A Time for Transformation

With more than a decade of experience in working as an MFI, Ghosh realized that there were gaps in the market that could only be fulfilled by a bank, for example taking deposits from those with a surplus and investing these funds with those who had a deficit and needed money for their business. However, as an NBFC, Bandhan could not take deposits. In its present operations as a microfinancier, Bandhan had to borrow from other financial institutions to issue loans, which meant its interest rates were as high as 22% annually.

Looking around at the pensive faces in the conference room, Ghosh explained in his characteristically calm manner, “Banks can give loans at a lower rate, as their cost of money is lower than that of MFIs. Once we become a bank and access public deposits, our cost of money will also come down and we will certainly pass on the benefit to our borrowers. In fact, this is why we want to become a bank.” He leaned back in his chair as he gauged the reactions. He had put forward the case for moving to banking. However, it remained to be seen if the organization was truly ready for this transformation.

Exhibit 1
Financial Inclusion Reforms in India

Year	Reforms Undertaken
1969	• Nationalization of 14 major banks to use them as instruments to advance rural banking. • Lead bank scheme introduced towards the end of year, whereby individual banks (in both public sector and private sector) took on a lead role for the districts allotted to them.
1971	Establishment of Priority Sector Lending Banks to ensure provision of loans to identified sectors such as agriculture and small scale industries.
1975	Establishment of Regional Rural Banks in several states with equity participation from commercial banks and central/state governments.
1982	Set-up of National Bank for Agricultural and Rural Development (NABARD) as an apex development bank with greater latitude to explore options without branches by leveraging self-help groups and microfinance entities.
1992	Launch of the Self Help Groups (SHGs) Bank Linkage Programme.
1998	NABARD sets a goal for linkage of one million SHGs by 2008.
2005	Banks directed to offer basic banking “no frills accounts” with low or zero balances and minimum charges on transactions.
2006	Banks permitted to use the services of certain entities as Business Correspondents (BCs) and Business Facilitators (BFs) to provide financial and banking services.
2007	Proposed Bill on Micro Finance Regulation introduced in parliament.
2010	Banks advised to draw up a 3-year Financial Inclusion Plan (2010–2013) with self-set targets for rural brick-and-mortar branches opened.

Source: Compiled by the author, http://www.rbi.org.in/scripts/BS_SpeechesView.aspx?Id=871, http://indianresearchjournals.com/pdf/IJMFSMR/2012/June/5.pdf

Exhibit 2

Data on Individual Non-Banking Financial Companies and Microfinance Institutions

S. No.	NBFC-MFI	Year	Gross loan portfolio (GLP) (INR billion)	Clients	Loan amount disbursed annually (INR billion)	Loans disbursed annually	Branches	Employees
1	Bandhan	FY 12-13	44.21	4,433,885	57.79	4,092,588	1,803	11,450
		FY 11-12	37.30	3,617,641	62.55	4,191,525	1,553	9,548
2	SKS	FY 12-13	23.59	4,308,301	33.20	2,995,639	1,261	10,809
		FY 11-12	16.69	4,256,719	27.37	2,730,310	1,461	16,194
3	Spandana	FY 12-13	22.23	2,284,729	15.80	1,129,357	1,144	4,616
		FY 11-12	27.04	3,444,474	15.09	1,241,551	1,674	8,328
4	Janalakshmi	FY 12-13	9.53	695,974	11.26	631,662	95	2,005
		FY 11-12	3.49	300,847	4.22	277,140	66	1,004
5	Share	FY 12-13	19.65	2,128,478	12.21	826,293	841	3,696
		FY 11-12	21.10	2,161,119	15.66	1,109,272	914	4,352
6	Ujjivan	FY 12-13	11.26	10,06,52	15.41	968,521	301	3,656
		FY 11-12	7.03	819,400	10.83	896,360	299	3,449
7	Equitas	FY 12-13	11.35	1,344,310	11.49	916,898	286	2,370
		FY 11-12	7.24	1,193,247	6.63	583,384	265	2,211
8	Satin	FY 12-13	5.80	487,639	6.26	401,113	161	1,437
		FY 11-12	3.20	306,317	3.88	254,032	144	1,058
9	Asmitha	FY 12-13	11.12	983,167	6.45	416,895	460	2,161
		FY 11-12	12.41	1,123,480	8.80	612,339	529	2,646
10	Panchratna (Muthoot)	FY 12-13	3.27	405,697	5.37	421,225	148	1,317
		FY 11-12	1.79	202,695	2.36	213,779	79	704

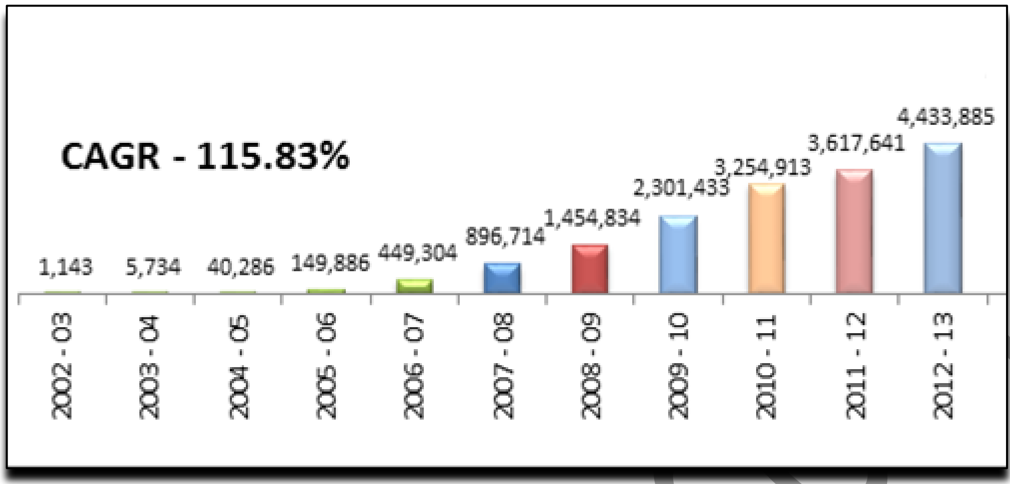
Source: Micrometer, Issue 10, data as on June 30, 2014; http://mfinindia.org/wp-content/uploads/2013/02/Micrometer-Issue-10_Q1-FY-14-15_6th-Aug-2014_for-dissemination.pdf

Exhibit 3
Bandhan as of 2013

Particulars	Total
States & union territory	19
Districts covered	209
Branches	1,816
Staff	12,070
Borrowers	4,713,754
Cumulative loan disbursement (INR in billion)	241
Loans outstanding (INR in billion)	43
On time repayment rate	99.78%

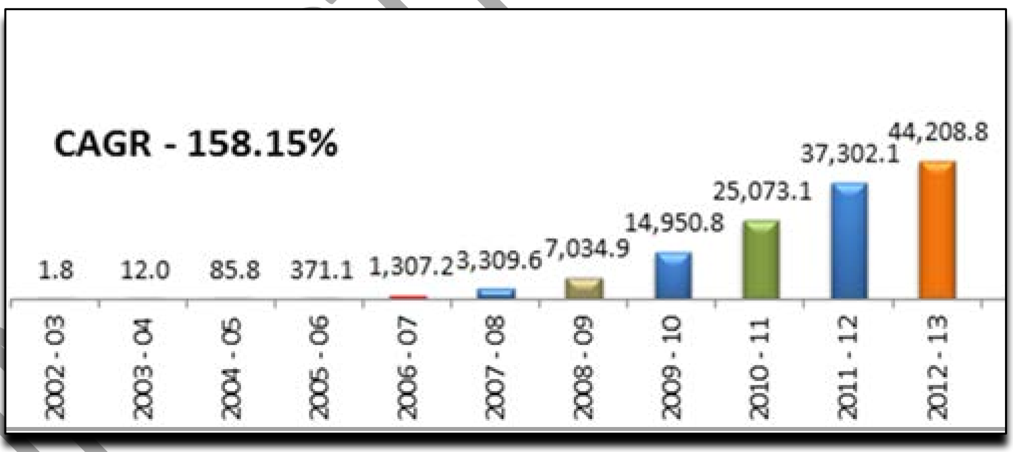
Source: Company information

Exhibit 4
Growth in Borrowers



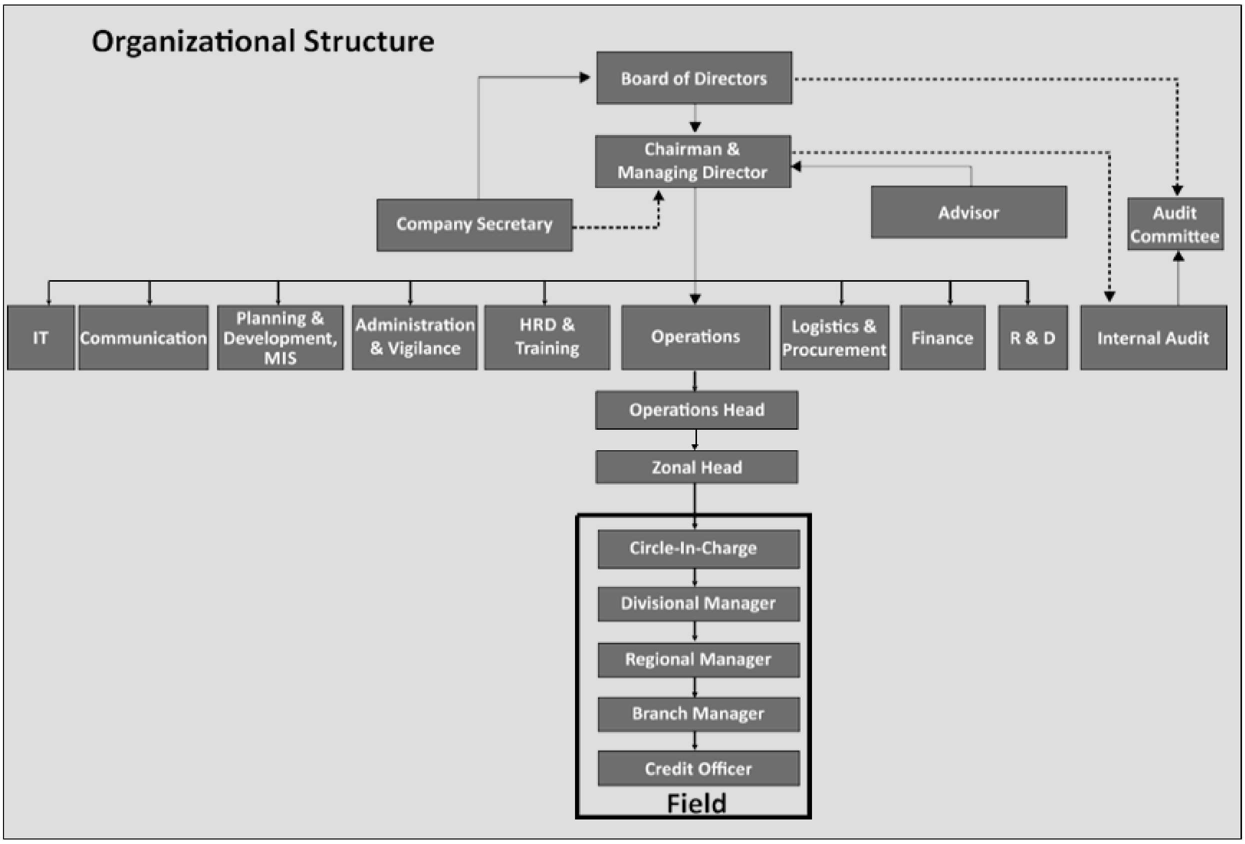
Source: Company information

Exhibit 5
Loan Book over the Years (INR million)



Source: Company information

Exhibit 6
Bandhan Organization Chart



Source: Company information

BANDHAN (B): SUSTAINABLE BANKING IN INDIA

By the end of 2013, Bandhan Financial Services (Bandhan) had established itself as the largest microfinance institution (MFI) in India and the largest non-deposit taking MFI in the world.[viii] Yet, even within India, Bandhan had only scratched the surface. More opportunities lay ahead, but sustaining the growth demanded new sources of capital at a reasonable cost. In July 2013, supported by a Geneva-based investor, Bandhan applied for a banking license and in May 2014, RBI[ix] granted the license, making Bandhan the first MFI in the country to win a bank license. Bandhan was set for an organizational transformation that would convert it from an MFI into a mainstream bank.

According to the in-principle approval given by the RBI, Bandhan had to be ready for the final license by October 2015. To aid it in this journey, Bandhan had appointed consultancy firm Deloitte. A team of 30 senior people at Bandhan had also been identified to work closely with Deloitte to facilitate the transition.[x]

It was now September 2014 and Bandhan was five months into the transformation process. In the conference room at the head office in Kolkata, the team from Deloitte had just concluded a detailed presentation on the organizational changes that had to be implemented. During the meeting, articulating the ambitious growth plans, Chandra Shekhar Ghosh, chairman and managing director of Bandhan, had said:

"Right from day one of starting operations as a bank, we will open 600 bank branches in 26 states and start with at least 10 million savings accounts."

Yet, with just 12 months to prove themselves, Ghosh was pensive as he mulled over what he had just said. Bandhan seemed to have built the right capabilities to be successful as an MFI. What new capabilities would be required as it shifted from being a pure MFI to a banking entity? How should it go about acquiring those capabilities? Was it preparing well to deal with the challenge of entering, surviving and growing in the banking industry, while continuing to serve and grow in the MFI space? Could Bandhan develop a unique and innovative model to help it straddle both worlds?

With this license, Bandhan had been offered an opportunity to re-create the entire banking edifice in India. How could it manage to change strategy without disrupting the organization?

ON THE ROAD TO BANKING: CHALLENGES AND OPPORTUNITIES

After reviewing 25 applicants, including large corporates such as ADAG Group, Aditya Birla Group and Bajaj Group, the RBI had granted in-principle approval for banking licenses only to infrastructure financing firm IDFC and Bandhan. These were the first bank licenses the RBI had issued after a gap of 11 years.

The RBI had assessed the quantitative and qualitative aspects of the applicants, including their financial statements, 10-year track record of running businesses, proposed business model for the bank and demonstrated capabilities for running a bank, plan for expanding inclusion, and culture of compliance and integrity. According to RBI governor Raghuram Rajan, the mandate for these new banks was to penetrate poverty-hit rural areas to promote lending and saving among farmers, small businesses and others whom traditional banks had been reluctant to serve. Bandhan's bank license was an important signal for the success of India's microfinance sector.

"Since we will now be able to take deposits directly from people our cost of funds will reduce and this in turn will help reduce the lending rate to the customer and thereby increase his or her income," explained Ghosh.[xi]

Intending to start banking operations by the next financial year (2015-16), Ghosh felt that there was adequate capital to start Bandhan Bank. The capital adequacy ratio was about 21%. It had raised INR 2.6 billion through a mix of non-convertible debentures and soft loans, taking the capital to INR 11 billion. It was not looking for a tie-up or partnership. Under the license conditions, one in four branches had to be in towns with fewer than 10,000 people. However, Bandhan planned to go further, setting up nearly 80% of its branches in rural areas. At the same time, a few "signature" branches in cities were planned to raise Bandhan's profile.

Bandhan also intended to continue to cater to a rural and unbanked customer base from its existing branch network. Its current customers would be the bank's first customers. The plan was to open nearly 600 bank branches in 26 states and start with at least 10 million savings accounts to serve its existing customer base. "If we get two family members from our client base opening accounts, we'll automatically have one crore [10 million] accounts," explained Ghosh. While Ghosh felt that raising deposits would not be a problem, keeping up with the statutory requirements might prove challenging. According to the RBI guidelines, all banks had to put 4% of their deposits with the RBI with zero interest, and another 23% in government securities at around 8% interest. In its new role, Bandhan would also have to learn treasury operations and risk management.

Bandhan already enjoyed a top credit grading and a near zero default rate because under its current system an entire local community pledged to keep watch over one of its members who was borrowing. However, as it grew further, the risk for Bandhan was that most of its borrowers would be unsecured – they had no assets to pledge against their debt. Another challenge for Bandhan was that its activities were more concentrated in West Bengal. As it grew rapidly across the country, it might have to deal with a diverse socio-economic, demographic and linguistic environment.

Bandhan had appointed consultancy firm Deloitte to advise it on converting from a microfinance institution to a bank. IFC, which held close to an 11% equity stake in Bandhan, planned to share knowledge on best practices for transforming into a bank followed by MFIs in which IFC was a stakeholder in Mexico and Cambodia.

Ronendra Chowdhury, general manager of operations, explained Bandhan's plans for acquiring banking operations knowledge:

"*We have about 13,000 staff at different levels with strong microfinance experience. Yet, no banking experience. We realized that we need experienced banking staff. So we have already begun the process of hiring professionals for senior positions in retail banking, treasury and risk management. This way, they get time to settle within our operational structure while we learn banking procedures from them.*"

Along with hiring new people, Bandhan planned for some of its existing employees to start banking operations within the 18-month period given by RBI. "To absorb the existing workforce into the bank, Bandhan is also conducting a staff assessment of employees to assess what position they can fit. For instance, to check if one could work as a teller at the bank or if another is capable of working as a branch head," explained Maneeta Rathore, assistant general manager for communications.

As Bandhan became a bank, Ghosh felt that some staff would require training to deal with more sophisticated financial products. Three-fifths of the present employees had studied up to grade XII in school. "Having a degree has never been the most important qualification for a job with us," Ghosh explained. With eight training centers in the country, Bandhan already focused a lot on training, with around 1,500 people trained every month at these centers. However, from operational training, the focus would now have to move toward banking.[xii]

Bandhan also realized that the real issues with merging existing and new staff would be more cultural than capability-related. Although current employees could be brought up to speed with training on finance and banking, inculcating the Bandhan "way of life" in the newcomers would be a bigger challenge.

As Bandhan grappled with its own transformation internally, financial inclusion experts in the outside world were also left wondering: What kind of bank will Bandhan be?[xiii] According to a senior RBI official, "Inside the RBI, this is being seen as an experiment. The RBI wants more local/niche banks. In that sense, there is a lot riding on how Bandhan fares."[xiv] There were concerns about meeting statutory requirements too. "Running a bank requires stricter adherence to the letter and spirit of the regulations, and the RBI watches much more closely," explained Vijay Mahajan, chairman of Basix.[xv] Further, with increasing professionalization at Bandhan, some experts felt that people issues were bound to crop up. "Bandhan has always been very centralized, a one-man show. If bankers come and join him, he will have a job keeping the new and old guard happy," said an industry expert.[xvi]

Articulating what he saw as Bandhan's main challenge, Partha Pratim Samanta, deputy general manager of operations, said:

"Our main challenge is going to be that the existing customers (poor) are going to think that Bandhan has now become a bank and will not be with us. On the other hand, the potential customers (rich) are going to be thinking that Bandhan is for the poor people and not for us."

Tamal Bandyopadhyay, advisor at Bandhan, added:

"Bandhan Bank, in some sense, is a unique creature globally. One part of Bandhan Bank will continue to do what it is doing in rural India which is basically credit related – a bank for Bharat. Of course, it will collect rural folks' savings too, which are often gobbled up by the so-called shadow banks. In metros, Bandhan will operate like any other bank – a bank for India. Here, the special focus will be mobilization of deposits which can finance the loans for individuals, SMEs and MSMEs in rural India.[2] Bandhan's job is going to be about reassuring both sets of customers successfully."

THE WAY FORWARD

For its present set-up, everything at Bandhan seemed to be a perfect fit. But as its segment shifted from the predominantly rural poor – who valued very low interest, convenience and other financial support – to the rest of India, Bandhan might begin to see itself being driven more and more by the changes to its environment. When the pressure to adjust to this new context increased, Bandhan might feel additional strain on its strategy and structure. Could Bandhan quickly reorganize itself without disturbing or losing all the good things that were already in place? How should Bandhan adjust to the new reality without compromising on its core values and strengths?

[2] SMEs = small and medium enterprises; MSMEs = micro, small and medium enterprises. MSMEs are defined as manufacturing enterprises whose investment in plant and machinery does not exceed INR 10 crores and service enterprises whose investment in equipment does not exceed INR 5 crores (Source: https://www.rbi.org.in/commonman/English/scripts/FAQs.aspx?Id=966).

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[xiv] ibid.

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