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## *A Case Study on Bandhan: The Newest Entrant in the Competitive Banking Sector in India*

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*Abstract: On 2<sup>nd</sup> April, 2014 Reserve Bank of India's High Level Action Committee granted an "in principle" approval to Bandhan to set up a bank. Bandhan was the only Micro Finance Institution amongst the 25 business giants like Bajaj Finance, Aditya Birla Nuvo, L&T Finance and India Post in the foray for setting up a bank. The parameters assessed by the central bank for granting new licenses included the analysis of the entities financial statements, 10 years track record of running the business, proposed business model for the bank, demonstrated capabilities for running a bank, culture of compliance and integrity and the plan for expanding inclusion. Bandhan which had already established a name for itself in the micro finance sector fitted well in RBI's criterion of financial inclusion. This case study carries out a SWOT Analysis and focuses on the strategies being adopted by Bandhan in its transition from a Micro finance institution to a bank. With a network of 2022 branches and a borrower base of 6.3 million, Bandhan's biggest strength lies in its ability to reach out and maintain an emotional connect with the bottom of pyramid section of the society which even the current commercial banks are finding difficult to achieve. However, it has to face competition from well-established and technologically advanced older banks. The biggest challenge for Bandhan lies in maintaining a balance between its development and profitability objective.*

*Key Words: Micro Finance Institution, Banking, Bandhan, New License, Transition Strategy.*

### I. INTRODUCTION

The CMD's office on the 8<sup>th</sup> floor of a building in sector V Salt Lake City, Kolkata was abuzz with visitors, reporters, congratulatory notes and bouquets of flowers. The occasion: Reserve Bank of India on 2<sup>nd</sup> April, 2014 granted an "in principle" approval to Bandhan to set up a bank. RBI's High Level Action Committee headed by the former RBI governor Bimal Jalan granted license to Bandhan and IDFC from amongst 25 applicants including business giants like Bajaj Finance, Aditya Birla Nuvo, L&T Finance, India Post and ADAG's Reliance capital to name a few. Bandhan was the only Micro Finance Institution which was in the foray for setting up a bank.

RBI had granted licenses after a decade: Kotak Mahindra bank and Yes bank were the last to get license in the year 2003-04. Prior to that 10 entities had been issued licenses in the year 1993. According to RBI Governor, Raghuram Rajan, "The point we want to make is the banking license in this country is a measure of trust and you have to deserve that trust. And we want to ensure that people who can build that trust get the opportunity to start a bank." (Economic Times, 2014).

The parameters assessed by the central bank for granting new licenses included the analysis of the entities financial statements, 10 years track record of running the business, proposed business model for the bank, demonstrated capabilities for running a bank, culture of compliance and integrity (should not have been under the scanner of any regulator) and the plan for expanding inclusion. Bandhan, which had already established a name for itself in the micro finance sector fitted well in RBI's criterion of financial inclusion. "This is a recognition for Bandhan's hard work in the field of financial inclusion," said Chandra

Shekhar Ghosh, Founder and Chairman of Bandhan, the country's largest microfinance company by loans. "It is also a recognition of the microfinance sector as a whole." (Economic Times, 2014)

#### A. About Chandrashekhar Ghosh

A shutterbug and a voracious reader, Chandra Shekhar Ghosh was born in Agartala in a family of Hindu refugees from Bangladesh. Despite the poverty, Ghosh's father struggled to give him a good education. After obtaining his MSc in statistics from Dhaka University, Ghosh joined BRAC: An international development agency based in Bangladesh. It was during this time that Ghosh witnessed the problems being faced by the poorest of poor. He came back to India in 1997 and starting working with an NGO. He soon realized that the NGOs were not willing to scale up and therefore Ghosh left his job.

In 2001, Ghosh set up a NGO called Bandhan (which meant togetherness) in Konnagar, West Bengal It was registered under the West Bengal Societies Registration Act. Bandhan's mission was: *"To reduce socio-economic poverty substantially and create employment by targeting low-income households across the country through providing cost-effective sustainable financial and non-financial services emphasizing on social securities"*. (Bandhan Website). It sought to achieve its objective by giving small loans to the poor in order to raise their incomes. Based on the model of "Individual lending through group formation", it provided credit facilities mostly to women for their social upliftment and economic emancipation. Credit was given only for income generating activities like vegetable vending, sewing etc and not for non-productive activities. "Bandhan believes that women, on any given day, make better money managers. Increased income in the hands of women is productively utilized towards children's education, bettering the family's living conditions, and building savings for the future, especially their children's future." (Bandhan Website).

To run the society, he borrowed Rs 1.75 lakhs from a local moneylender @ 7.5% per month and Rs 75000 from his sister and brother-in law. A major investment came in 2002 when SIDBI lent an amount of Rs 20 lakhs and another 5.4 lakhs for capacity building. With this, Ghosh started another branch at Bagnan providing loans of Rs 1000 @15% to the destitute women of West Bengal. That led to an increase in the average income from 300 to 2000 per month. Acknowledging Ghosh's commitment and spirit, in 2007 Ashoka – the organization promoting social entrepreneurship awarded Ghosh with an Ashoka fellowship. Ghosh used the monthly fellowship amount received to set up a school for children in the age group of 8 to 14 years of whom 70% were girls. The expenses of the school including all learning aids were borne by the society. On completing class III students were shifted to the nearby government school. Ghosh's efforts were recognized internationally too and in December 2007, Bandhan was ranked 1<sup>st</sup> in India and 2<sup>nd</sup> in the world by Forbes under its first ever list of world's top 50 MFIs. In fact, Bandhan superseded Grameen Bank which ranked 17<sup>th</sup> in the listing.

However, Ghosh realized that it was becoming increasingly difficult to continuously obtain funds from the banks as they were reluctant to lend. The ideal solution therefore was to convert the MFI into a NBFC. In this regard, in 2006 Bandhan acquired Ganga Niryat Pvt Ltd (GNPL-an NBFC) and started operating as an NBFC MFI, bringing itself under the ambit of RBI supervision and also under the Companies Act, 1956. In 2007 GNPL was renamed Bandhan Financial Services Pvt Ltd (BFSPL) and in 2009 entire functioning of Konnagar was transferred to BFSPL. Around the same time MFIs came under the scanner on account of the recovery tactics followed by them. The recovery mechanisms had led to suicides by borrowers in Andhra Pradesh. Bandhan was insulated from the scanner as it did not have any exposure in Andhra Pradesh. Moreover, being a NBFC MFI, it did not fall under the supervision of Andhra Pradesh MFIs (Regulation of Money lending) Act, 2010. Post SKS Microfinance fiasco, things got under control and banks regained confidence in MFIs. With 30% of the populations living Below Poverty Line (BPL) and 80% of the BPL living in rural areas, MFIs stood to gain favorably in reaching out to the unbanked areas especially Bandhan with its wide reach and ability to relate and develop trust with the unbanked masses.

With a vision to extend financial services to at least 1cr poor households by 2020, Bandhan operated in 22 states and Union Territories facilitated by a branch strength of 2022 (70% in rural areas) as of February 2015. It had a borrower base of 6.3

million (all women) and its loan book stood at 8908 crores as of February, 2014. With 2/3 branches and 3/4 loan portfolio concentrated in West Bengal, Assam and Bihar, it boasted of 100% recovery rate and a zero portfolio risk. Bandhan's lending activities were carried out through Bandhan Financial Services Pvt. Ltd, which was registered as a NBFC with RBI. There was a well-defined 4 tier organization structure and the roles were clear cut which smoothened the process of disbursement and collection of the loans. It also facilitated in being accessible to the borrowers and maintain a continuous connect with them.

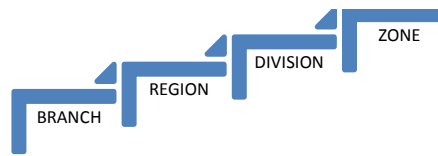


Fig-1: 4 Tier Organization Structure

The branch was lowest in the hierarchy and also served as the focal point of interaction and disbursement of loans to the borrowers. A branch was headed by a branch manager and formed the base of the credit officers and field staff. 6-7 branches combined to form a region (headed by a regional manager) and 5-6 regions in turn formed a division which was under the Divisional Manager. The Divisional manager was the highest field position. 8-9 divisions formed a Zone which was headed by a Deputy General Manager. For granting of loans, the credit officer assessed the demand around his branch and explained the products and functioning of BFSPL to the potential borrowers. That was followed by selection of members and formation of the group. Post group formations, members to be given loans were selected. To be eligible for loan, members should have attended at least two meetings of the group. The borrowers were generally women with monthly family income of less than Rs 3500 in rural areas, less than 5000 in small towns and less than 7000 in bigger cities. Those who owned less than 50 decimal of land or capital of equivalent value were also eligible for the loan. Loan forms were filled at 2 levels-Household- to assess the assets of the borrower and to make the family aware that a member had applied for a loan. At the second level being the group level, the form was filled so as to obtain the group's approval. This was followed by the branch manager's visit to the borrower's house after which the loan was disbursed. Moreover, loans were given according to the need and potential and not according to what was asked for by the borrower. To ensure transparency, the borrower was issued a passbook containing details regarding the amount of loan, interest, installments to be paid etc. If the borrower had any query, he could call on the helpline number given at the back of the passbook. Besides this, Bandhan's non-profit entity was also engaged in development activities like education, health, employment, insurance etc. The development activities were funded through 5% of the surplus generated from the micro-finance activities. These led to a holistic development of the poverty stricken customers (both socially and financially) and strengthened the bond with the customers.

The activities included:

1. Pension- The New Pension System- Swavalamban was offered by Bandhan to its borrowers in association with IRDA.
2. Insurance- Bandhan provided an insurance cover to its borrowers and their spouse in a corporate partnership with LIC.
3. Remittance Services- Bandhan provided remittance services in a tie up with Western Union Money Transfer services.

All that was based on the fundamental philosophy of CREATE which permeated throughout the NBFC, from the highest rung to the lowest.

Table I

Bandhan's values based on CREATE

Values	Organizational Focus
C: Cost Effectiveness and Simplicity	Towards financial sustainability and replicability
R: Respect for all	Towards Customer Service and satisfaction

E: Exemplary Governance	Towards Customer Service and satisfaction and organizational ethics
A: Accountability, professionalism and discipline	Towards organization ethics and competency building
T: Transparency and Integrity	Towards organization ethics
E: Effective Team work and commitment	Towards internal competency building and hence financial results

Source: (Datta, Singh, Nilakantan, Chakrabarti and Das, 2013)

Keeping in view the social and demographic profile of Bandhan's clientele, it became imperative to deal with them in a manner which would adhere to the CREATE philosophy. BFSPL ensured that the credit officers visited the customers every week no matter how difficult it was. Officers were not given any incentives for generating clientele or for collection of payments. These officers visited the customers on bicycles and not motorbikes. This ensured that they remained focused on a limited area and a connect was established between BFSPL and the customers.

Bandhan's profound experience in the priority sector (through financial inclusion) and its exposure to handling financial products could have been one of the reasons for the grant of the Banking License. "Bandhan's strength lies in reaching borrowers at their doorstep. It is also reasonably successful in places where commercial banks operate," said BP Kanungo, RBI's regional director in Kolkata. "It's USP is small loans, doorstep services and procedural simplicity. It may continue to follow its USP." (Ray and Rajshekhar, 2014).

Vijay Mahajan, a microfinance veteran, differed. "Once you have a banking license, you can't just say I will lend only to the poor," says Mahajan, chairman of Basix. "It's like a power utility—it can't supply electricity to just one segment of the people and not to the others. Similarly, once you become a bank, you have to observe all those public good requirements." (Ray and Rajshekhar, 2014). Besides, Bandhan would have to keep a balance between profitability and development objective on its conversion in to a bank.

## II. STRENGTHS

All said and done, Bandhan had developed a business model that was sustainable and commercially viable. It had also demonstrated its ability to reach out and maintain an emotional connect with the bottom of pyramid section of the society which even the current commercial banks found difficult to achieve. Though there were 3 main commercial banks operating in the Eastern part of the country- UCO Bank, United Bank of India and Allahabad Bank: they focused on serving different strata of society and their reach to the rural masses was almost negligible. On the other hand, Bandhan fitted well in the RBI's policy of priority sector lending norms. "We are catering to the not so easy unbanked segment. In fact, for existing banks or other companies to reach out to this populace is going to stand as a challenge." (Mukherjee, 2013). That would have also posed a big challenge for the new banks in the making like IDFC who had no exposure in dealing with the customers at the grass root level. For Bandhan, an existing readymade rural customer base of 6.3 mill would have reduced the time and effort involved in searching for new customers for the banking products. These customers would be served by the existing employees of the MFI. Since most of the employees were from rural backgrounds and understood the socio economic requirements of the customers, they would have continued to be associated with the current customers. That brought down the cost of hiring new employees and searching for customers. The new recruits from the cities would have focused on serving the customers in the urban areas as their probability of moving to the villages was remote. Bandhan had recruited nearly 90 people at the mid-level, who would be posted at its new branches. The new recruits had been inducted in departments such as risk management, operations, business development, planning, IT, internal audit, treasury and human resources. The top management would have comprised of 10-15 members with at least 15 years of experience in the banking industry. To ensure professionalism in every aspect, Bandhan hired the services of Aon Hewitt, a Human Resource Consultancy firm. It would support Bandhan to design compensation strategies for the employees.

According to Ghosh “Today 60% of Bandhan’s customers do not have bank accounts and the 40% with accounts do not use them regularly.(Ray and Rajshekhar, 2014). The license would have enabled Bandhan to offer services like savings, deposits, loans, insurance and remittances to the current customers who otherwise didn’t have access to banking facilities. Moreover, unlike urban customers, the rural populace kept the deposit in one bank only. They did not shift banks frequently. Garnering deposits from existing customers would have enabled Bandhan to reduce its dependence on banks for funds thereby bringing down the cost of funds. It would be in a position to raise deposits at 6-7% against 13% it paid to the banks. NBFCs had to borrow funds from banks or sell bonds to raise funds, which forced them to charge more from the borrowers (22% for loans up to Rs 15000).

Talking of the financial stability and robustness of Bandhan, it had a sound net worth of Rs 1500 crores Vis a Vis Rs 500 crores required of a new bank. Moreover, its Capital adequacy ratio of around 21% (as on March 2014) was much more than the required rate of 12% as prescribed by RBI. In March 2014, it had raised 100 crores by issuing non-convertible debentures (NCD) to a Geneva based investor. NCD’s facilitated in better management of funds as they were payable only on maturity. Prior to that, in August 2011, Rs 135 crores were raised by issuing equity to International Finance Corporation (IFC). This was IFCs biggest exposure in the Indian Micro Finance sector. IFC had also invested Rs 160 crores through subordinated debt at 14.5% per annum. There were talks of fresh equity commitment from the World Bank and Singapore's sovereign wealth fund, GIC, for Rs 1,700 crore. These would have been used to develop the banks’ infrastructure, investment in human capital and technology. IFC currently held 10.93% stake in Bandhan, SIDBI 10.2%, Ghosh 1.8% and remaining was held by 2 trusts. It also got itself graded yearly by rating agencies like CRISIL, CARE and ICRA. In 2012, CARE rated Bandhan Financial Services with a grade of MFI1 which was the highest rating on an 8 point scale.

### III. CHALLENGES

While Bandhan Financial Services Pvt Ltd. seemed to be on track in its transformation in to a bank, it was not bereft of challenges. Considering the diversity of its customer base, it had to provide different types of financial products, services and dealt with customers from different socio-economic set ups with differing expectations. It would have taken time to develop the kind of loyalty and trust of the potential customers as it had of the existing ones. This in turn would have required Bandhan to appoint a new set of employees and trainers who had an expertise in banking operations. Previously, DGMs and GMs acted as trainers. They were able to understand the problems of the clients, as many had worked as Credit Officers and with time had risen to the ranks of Divisional Managers. “Many of them being successful fighters of poverty in their personal life, have a built-in economizing outlook, which seems to have imparted a strong value system to the organization by recruiting employees from the same socio-economic strata and similar outlook.” (Datta,Singh,Nilakantan,Chakrabarti and Das, 2013).This feature seemed to have enabled Bandhan to go an extra mile as compared to the newer entrants in the banking domain. For that “the non-banking micro-lending firm planned to train around 1,500 employees every month under the guidance of 30 trainers at its 8 centres, The company had three training centres in West Bengal and one each in Assam, Agartala, Bihar, Delhi and Maharashtra. (Parmar, 2014).Training was given to new employees and there was also an annual training programme for all the employees.

However, with the transformation in process, a training attuned to banking services for the existing employees was the need of the hour. Besides training, Bandhan needed to handle the expectations of its existing employees in terms of higher remuneration and also the insecurities that they might have faced on account of the recruitment of new and more qualified employees. Besides, there could also have been a possibility of the competitors wooing the current staff by offering lucrative monetary benefits.

Keeping a balance between the expectations of the tech savvy affluent urban customers and the rural masses was a big challenge for Bandhan. Explaining legal and formal procedures like the KYC norms etc could have made the existing customers

uncomfortable and insecure. Loan sanctioning process could be delayed as compared to the process followed by an MFI on account of increased formalities, which could have added to the insecurities of the rural customers.

Also, unlike its past practices, once converted in to a bank, Bandhan would not have been able to issue loans without collateral. To protect interests of depositors, Bandhan would have to lend against collateral. It could also not keep lending rates high on account of competition which could have brought margins under pressure. In February 2015 the amount of loan disbursed by Bandhan was Rs 1572 crores and the loans outstanding were Rs 8908 crores- would it be able to do that as a bank was yet to be seen.

Besides handling different customer groups, on the regulatory front, Bandhan had to comply and fulfill the statutory requirements in terms of NPA provisioning, capital requirements and Reserve Ratios. The RBI had stipulated a CRR of 4% and an SLR of 23%. It would have entailed Rs 246cr as CRR and Rs 1420 as SLR to be maintained by Bandhan which would have added to its operating costs. Developing a branch network and overhauling of the existing branches would have also involved huge investments. To ensure the smooth transition, Bandhan was in talks with a number of consultancy firms like KPMG, BCG, McKinsey and Ernst & Young for the restructuring of its branches. According to Ghosh, “the consultancy firms have a huge experience in these matters. So it is necessary to seek outside help for smooth transition” (Financial Express, 2014).

The restructuring also involved technological and structural changes. Though Bandhan used the desired software for carrying on its micro finance activities, it would be required to move to the Core Banking System (CBS) which needed an all India infrastructure set up, connecting branches in rural areas with the ones in urban areas and enrolling experienced staff to handle it. Moreover, it also had to address the problems of poor internet connectivity and shortage of electricity in many rural branches. To address those issues it tied-up with FIS, a US-based company, as technology partner for the launch of the proposed Bandhan Bank. The seven-year technology outsourcing arrangement would provide services like core banking, channel solutions, trade finance, debit card management and transaction switching. FIS will also be responsible for delivery and management of the entire information technology infrastructure, including all disaster recovery capabilities and the inter-branch network.

FIS was the world’s largest provider of banking and payments technology solutions and a global leader in consulting and outsourcing solutions. With a long history deeply rooted in the financial services sector, FIS served more than 14,000 institutions in over 110 countries.

Though those consulting agencies would have facilitated Bandhan in its overhauling, they could also increase the cost of operations initially, for which Bandhan had to be geared for.

#### IV. OPPORTUNITIES

Bandhan’s presence in the rural areas provided it with a lot of opportunities. It served the unbanked eastern part of the country where the visibility of commercial banks was negligible. For instance in Dhanua village SBI opened its branch in 2013 but Bandhan had been there since 7 years. According to Ghosh, “Initially, we will lend only to retail customers. We are not going for corporate banking, where there are already many players. We don’t want to jump into a crowded sector. On the other hand, few banks take care of the needs for the poor and the unbanked population. This gives us immense opportunity for growth.” (Acharya, 2015)

The loyalty and trust that its existing customers showed would have reduced the effort to hunt for customers from scratch. Since Bandhan understood the needs of the rural masses it would have been in a better position to provide products and services more suitable to their requirements. Moreover in the past, rural populace had often been duped by collective investment schemes. An institution like BFS could have ensured that the savings were utilized effectively. In fact those savings could have been used to offer loans to MFIs, thereby fulfilling its dual objective of profitability and development of the economically weaker sections of the society.

Bandhan also had the advantage of recruiting the best of the best. . It received close to 27,000 applications for the 15 posts that were advertised. Nearly 15-20% of the applicants were from Indian Institutes of Technology (IITs) and Indian Institutes of Management (IIMs) backgrounds.

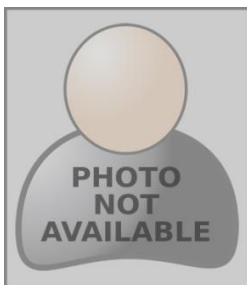
## V. CONCLUSION

While everything looked to be going the positive way, according to Ghosh, “Migrating a portfolio of Rs 8,000 crore, a borrower base of 6.2 million customers and 14,000 staff would not be easy.” (Acharya,2015). It had to devise strategies that would have helped it faces the challenges, serve people in a cost effective manner and be sustainable at the same time. Whether it would be able to meet its dual objective of development and profitability or not- only time would tell.

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