CASE
STUDY

Rural outreach

When HDFC Bank made its foray into the hinterland, there was a compelling vision that powered its goals—one that embraced a holistic, customer-focussed approach as opposed to a product-oriented one. The rural populace had for long been an underserved lot with respect to financial services, and the environment was strewn with challenges. However, the Bank navigated with relative ease by clearly distinguishing between financial access and financial inclusion, and optimally leveraging its technological expertise. Its sustainable livelihood initiatives have now reached over 28,000 villages across 27 states and its flagship Parivartan programme has impacted 7.8 crore people—a clear pointer to the Bank's seminal role in redrawing India's financial landscape.

On October 26, 2020, Aditya Puri, Founding Managing Director of HDFC Bank, stepped down from executive responsibilities at India's largest private sector bank (by assets). His exit marked the end of the longest tenure of anyone at the helm of a bank in India. Under his leadership, in the 26 years since its inception, HDFC Bank's market capitalisation increased to over ₹6 lakh crore, making it the largest bank in India by market cap. Interestingly, HDFC Bank's market cap is larger than the combined market value of 22 listed public sector banks put together[1]. In contrast, the State Bank of India, India's largest bank, whose total assets are two-and-a-half times that of HDFC Bank, had a market cap of ₹1,90,000 crore in September 2020.

During this quarter century, the Bank handsomely rewarded its investors—over 23 times more than the Sensex. Between July 1996 and June 2020, an investment of ₹ 1,00,000 in HDFC Bank grew to roughly ₹ 3,26,00,000—indicating a 326x growth in 25 years. During the same period, the same investment in Sensex companies registered only a modest growth of 14x. Through its prudent bottom-line focus, the Bank compensated its shareholders with a return on capital employed (ROCE) that ranged between 15 and 21 per cent, perhaps the best in the Indian banking industry.

HDFC Bank followed a different strategy; from around 2008, it did not have a separate PSL Department. Instead, in every single business—corporate, retail, SME, or the emerging corporate's group—the Bank identified businesses, segments, and customers that would fall within the priority sector categories.

In its formative decade, HDFC Bank had benchmarked itself against several niche and mainstream banking institutions across the globe—State Street Corporation (US)[2] for its transactions expertise; Bank Mandiri (Indonesia)[3] for small-ticket loans; and the Hang Seng Bank (Hong Kong)[4] for its good returns. Wells Fargo was the benchmark for product penetration, cross-selling, and virtualised banking. Several analysts observed that HDFC Bank mirrors Wells Fargo in many respects. The San Francisco-based company was the third largest bank in the US with a market cap of $273 billion in March 2020. In 2015, it was rated the most valuable bank in the world in terms of market capitalisation, far ahead of the Industrial and Commercial Bank of China, and its American competitors J.P. Morgan Chase and Citigroup. The Bank's secret to success was its focus on core units like consumer lending, banking services, and mortgage origination rather than reliance on subprime loans[5], complex derivatives[6], or risky trades funded by borrowed money[7]. Just like its role model, HDFC Bank was stable during the global slowdown of 2008, was a consistent performer, and a hot favourite among investors. In 2015, HDFC Bank had a better return on assets (ROA)—at 1.72 per cent—than Hang Seng Bank, the bank it had set as a benchmark[8].

However, an aspect of the Bank's vision and its strategic implementation that was not inspired by an international bank but by its understanding of and sensitivity to India's specific requirements was its rural and priority sector lending strategy.

Financial inclusion, not just financial access

Due to the social and legal mandate in India, 40 per cent of a domestic bank's loan book is focussed on priority sector lending (PSL). This goes back to the year 1978, when Reserve Bank of India (RBI) directed all banks to contribute 33.33 per cent of net bank credit to priority sector areas. Later, this was expanded to 40 per cent for domestic banks and 32 per cent for foreign banks. The philosophy of mandatory PSL in India aimed at ensuring that banks' profitability concerns would not deprive employment generating sectors, such as agriculture, small-scale enterprises, and even export-oriented units from getting sufficient funding when compared to medium and large enterprises. Almost all banks had a PSL Department to achieve annual targets that need to be reported to RBI and other regulatory authorities.

However, HDFC Bank followed a different strategy; from around 2008, it did not have a separate PSL Department. Instead, in every single business—corporate, retail, SME, or the emerging corporate's group—the Bank identified businesses, segments, and customers that would fall within the priority sector categories. Paresh Sukthankar, former Deputy Managing Director, says, "We have figured our approach as the only sustainable way of doing PSL. Otherwise, you have a focussed department, where you go and find out one more opportunity to lend, do it, and that is the end of it. Then you are looking for next year's opportunities. The purpose behind the target is lost." Also, right from the beginning, HDFC Bank distinguished between financial access and financial inclusion. Puri often

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emphasised, "You give a poor woman a consumption loan. Before, she was a poor woman with no loan. Now (after the loan) she is a poor woman with loan[9]". While financial access meant opening bank accounts for the rural populace, financial inclusion for the Bank meant economic empowerment leading to a life of self-respect and dignity.

Sustainable Livelihood Initiative

The Bank launched Sustainable Livelihood Initiative (SLI) in 2009 to provide livelihood finance to unbanked and underbanked segments of the population. Over the last decade, increasing levels of literacy, access to information and communication technology, and several government programmes at the state and central levels have marginally increased the levels of disposable income among the rural and semi-urban masses, thereby improving the demand for basic facilities and products. With a little support, vocational training, and financial assistance, a lot could be done to make rural youth (constituting one-third of India's population) economically self-sufficient.

SLI attempted to do just that. Like many other banks, it also lent to microfinance institutions (MFIs). But it also lent to self-help groups (SHGs) and joint liability groups (JLGs). Apart from the actual lending activity, SLI contributed to financing the formation of these groups and training. An integrated approach of offering training, enhancing occupation skills, providing credit counselling, financial literacy, and facilitating sales efforts and market linkages was implemented. HDFC Bank believed that a combination of these could make the rural population economically independent and bring them into the banking fold. The programme focussed on disadvantaged sections in semi-urban and rural India, especially women and youth—helping them find jobs locally, enhance their income, and prevent migration. Various tailormade skill and competency-building programmes that promoted entrepreneurial activities and upskilling for agricultural and allied practices were taken up based on the specific needs of the community.

According to the 2011 Census, only 58.7 per cent households utilised formal banking services. According to CRISIL[10], 37.8 per cent in the southern region and 71.4 percent in the eastern region had no access to formal banking facilities. For many decades, financial inclusion initiatives were aimed at opening bank accounts, especially in rural areas. In fact, public sector banks received a mandate to open accounts in the unbanked and underbanked regions; and thousands of such accounts were opened. But there were hardly any transactions. The high-powered Nachiket Mor Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households, set up by RBI, found that 60 per cent of the rural and urban population in India did not have a functional bank account[11]. The reason was that along with the account opening, it was essential that the rural customers had a sustainable banking need. Most often, loans were not taken for income-generating activities, but for spending on requirements such as children's marriage. Eventually, due to lack of sustained sources of income, these were written off, thereby making banking in rural areas a loss-making endeavour. The Government's flagship financial inclusion programme announced by Prime Minister Narendra Modi in 2014—Pradhan Mantri Jan Dhan Yojana (PMJDY)—attempted to address this challenge. Within five years of its announcement, over ₹ 36.1 crore bank accounts were opened and over ₹ 1.05 lakh crore were deposited under the scheme, with 53 per cent of the beneficiaries being women.

Initiated five years before the PMJDY, SLI encouraged the habit of savings through financial

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literacy. This took the form of cultivating the habit of saving money—received either as pension, or even other sources of income—through a recurring deposit. Such a corpus created by the customer could then be available for any sudden consumption need, such as an illness in the family, education, or marriage. On the other hand, borrowing from the Bank would be for income-generating activities. This balanced approach would be sustainable for rural customers and the Bank. By March 31, 2020, 1.29 crore people had participated in HDFC Bank's Financial Literacy Programme through the 16.9 lakh financial literacy camps conducted in over 22,000 villages across the country.

The SLI approach aimed at creating a virtuous cycle and breaking the vicious cycle of poverty. Under the guidance of the Bank's employees, women from the community formed Self Help Groups (SHGs) or Joint Liability Groups (JLGs). They were given training on occupational skills, financial literacy, credit counselling, livelihood finance, and market linkages. By 2019, over 3,05,364 SHGs and 9,66,546 JLGs currently existed under SLI.

SLI was thus an integrated approach that helped the individual who was borrowing, because the Bank was helping to improve his or her ability to repay by supporting his or her earning capacity. This, in turn, also had a positive impact on his or her ability to service the loan, and therefore on the Bank's asset quality. As on March 31, 2020, the Bank had Gross NPAs at 1.26 per cent. In contrast, the Gross NPAs of the 53 scheduled commercial banks stood at 8.5 per cent in March 2020. Thus the Bank aimed at implementing a win-win approach of contributing to rural society through a well-integrated strategy within the regular course of banking.

Through SLI, rural women availed themselves of credit and utilised it for occupations like tailoring, designing jewellery, starting grocery shops, and grazing goats. They also sought to take advantage of services such as credit counselling, occupation skills enhancement, and connecting with markets. More than 7,00,000 women were reached through the capacity building programmes, which aimed at upskilling beneficiaries in various trades. SLI used the collective power of women's groups

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to even make an impact in village communities by implementing health and sanitation programmes; nearly 100 per cent of SLI customers were women.

The SLI also linked rural people with mainstream banking facilities and substantively eliminated the role of middlemen and money lenders who charged usurious rates of interest on small-ticket loans to ill-informed rural folk. About 10 per cent of the Bank's employee strength[12] was consistently involved in this project. Each location had a dedicated manager who had 8 to 10 field officers providing services within a radius of 25 km. Potential customers were selected through a well-structured engagement programme. The Bank also planned a conscious spread of its presence in semi-urban and rural areas. By 2020, 52 per cent of its 5,416 outlets (5.6+ crore customers) were in semi-urban and rural areas, up from 34 per cent in 2010. In 2012 alone, 88 per cent of the branches were opened in unbanked markets. An interesting example of the rural spread was that it set up rural branches from Kargil, bordering Pakistan, to the Andaman & Nicobar Islands, near Indonesia's Aceh province. By March 31, 2020, the Bank's credit to agriculture and allied activities stood at ₹146,516.75 crore, and that to the semi-urban MSME segment stood at ₹159,107.93 crore.

Challenges galore

Despite the Bank's excitement to contribute to this space in meaningful ways, the journey to the hinterland was not an easy one. Compared to urban areas and metros, rural markets posed unique challenges. For decades, there was a well-networked presence of PSBs (public sector banks), RRBs (regional rural banks), and Cooperative Banks that had an existential mandate to assist the rural public. Added to these were Non-Banking Financial Corporations (NBFCs) that provided niche services. Unlike their city counterparts, rural folk needed small-ticket loans and most often had no collaterals to offer. The average ticket size of loans was between ₹ 10,000 and ₹ 25,000. Besides these, loans were primarily for agricultural purposes with sole dependence on uncertain monsoons. A large chunk of transactions in these areas was outside formal banking channels, with the predominant presence of cash-based exchange. Most importantly, the Bank needed to develop a cadre of local employees that balanced the two—building relationships with the native population and adhering to its high professional, ethical, and process-oriented standards.

To overcome some of these challenges, the Bank worked hard to perfect its rural model. For these markets, it transitioned from a product-centric to a customer-centric approach using its IT expertise. Through two, three, or five-member branches, the Bank lent directly to farmers. Attempting the same level of efficiency and turnaround time as in urban areas, and backed with a data warehouse, even the two men branches provided all banking products to a cluster of villages through Business Correspondents. By March 2020, it had a network of 4,800 Business Correspondents primarily catering to the rural and semi-urban markets.

The Bank introduced several products focussed on niche rural requirements, such as loans for buying two-wheelers, light commercial vehicles, and tractors, all of which were connected to the rural agro-based focus. The 'loans against securities' portfolio—that focussed on shares, debts, and mutual funds in urban areas—included National Savings Certificates[13] and Kisan Vikas Patras[14] in rural areas. It also gave loans against jewellery and property, besides personal loans; and was the first to give a debit card linked to a crop loan account. In addition to dairy and cattle loans, customers gained access to all products, including digital offerings like

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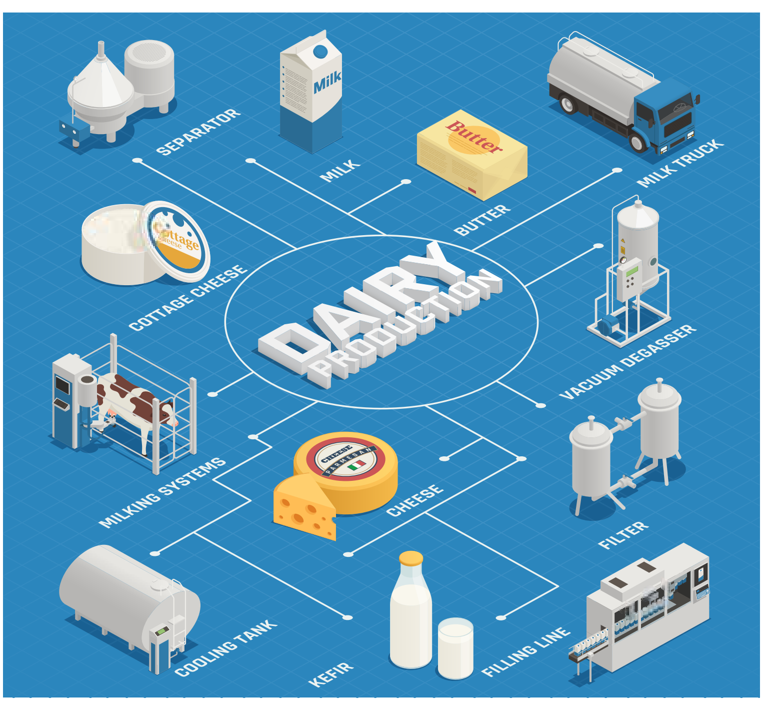
10-second personal loans, Kisan Credit Card, Bill Pay, and Missed Call Mobile Recharge. It offered last-mile access through mobile applications such as BHIM, UPI, USSD, Scan and Pay, and RuPay-enabled micro-ATMs. In June 2020, the Bank further reworked its business strategy for the farm sector by adding 1,00,000 village level entrepreneurs (VLEs) to push products such as gold loan, personal loan, and loan against property[15]. More importantly, it connected all these efforts and developed a sense of identity for a private bank in rural India, through investments in brand building. It even followed the telecom industry approach of 'painting walls and holding meals[16]' .

Innovative initiatives for dairy and agri sectors

An innovative programme named 'Milk-To-Money', with a unique dairy industry-specific model, was implemented by the Bank in Gujarat and Rajasthan in 2013. At select milk societies in Gujarat, an imported machine from Australia measured the weight and fat content of the milk deposited by the farmer. This information automatically flowed to the milk society office, which authorised the Bank for payment. The amount credited to the farmer's account could be withdrawn from the micro-ATM attached to the society. The programme started with 37 machines, with a target to scale up to 250 within a year. In Rajasthan, over 42,000 dairy farmers affiliated to the Rajasthan Cooperative Dairy Federation and the National Dairy Development Board were covered under this programme. By 2020, the Bank digitised payments at over 1,200 milk co-operatives across 21 states, benefitting more than 4.5 lakh dairy farmers. The dairy societies routed the payments to the farmers through bank accounts. Zero balance accounts were opened for dairy farmers along with access to Rupay debit cards, cheques, and pass books[17]. This not only gave them access to most of the Bank's products but also brought them into the banking mainstream. The programme also procedurally eliminated the involvement of middlemen, who could play a role in the dilution of milk quality, and thereby helped dairy farmers increase productivity and get the real worth of their output.



A similar programme in North India, launched in collaboration with PunjGrain, reduced the payment time to farmers from two weeks to two days. Through its banker visits in far-flung rural areas, lakhs of farmers benefitted from crop financing. Puri had observed, "Most banks in these geographies are present only on the liabilities (deposits) side. We are one of the few players in organised finance who, besides priority sector advances, are also there on the assets (loan) side[18]".

With over 50 per cent of its branches in semi-urban and rural areas, and despite higher operating costs of covering a dispersed rural population and lower revenue per branch, the

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rural and semi-urban sector, which accounted for at least half of India's output, got 48 per cent of the Bank's total loans as of September-end, 2019.[19] To bring more underbanked sections into formal financial channels, it opened nearly 25 lakh accounts under PMJDY and enrolled 33.4 lakh customers in social security schemes since its inception. A conducive entrepreneurial environment created by the government of the day, and the increasing disposable income and demand for personal and commercial financial assistance, played a key role in achieving some of these numbers[20].

Key learnings

Though not an easy terrain, the Bank's rural foray has been a win-win strategy on four counts:

- It helped to achieve PSL targets, even without having a discrete department.
- Given the commitment and rural value systems, delinquencies were lower than those faced by the Bank in metro cities.
- It was able to empower, both financially and socially, a few crore people—not through charity, but through a nuanced social entrepreneurship approach. This was complemented by its CSR investments, which stood at ₹ 535 crore in 2019-2020. The company's flagship Parivartan programme impacted 7.8 crore people by 2020. Its holistic rural development programmes reached nearly 1,300 villages across 17 states.
- As the fixed costs came down with an increase in scale over a decade, the Bank worked towards making its rural foray profitable instead of a tick-box item. Puri had always maintained that for PSL to be effective, it was not necessary to compromise banking sector efficiency and profitability. In targeting the right sectors and activities that mitigate credit risk and enhance productivity, PSL could be an avenue for sustainable financial intermediation while furthering the cause of inclusive growth and equality[21]. With Puri at the helm of affairs for 26 long years, the Bank attempted to maintain this balance.

In 2008, when I first interacted with Puri to understand his vision for the Bank, he had said, "'We have decided that we will make 1 crore families self-sufficient. If every major company would aim at making 1 crore families self-sufficient, there would be no poverty. I think that is a major goal of this organisation. It may be by 2020, but through this initiative (SLI), we would have really altered lives."

With such a powerful vision, backed by a robust strategy and committed leadership, the Bank did achieve its target. By 2020, SLI reached over 1 crore households in 28,000+ villages across 400+ districts in 27 states. Directly or indirectly, SLI impacted nearly 5 crore individuals pan-India to rise above the poverty line[22], making it one of the largest such programmes in the world. This, I believe, is HDFC Bank's singularly important contribution under the leadership of Aditya Puri, to the nation, and its people. IM

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3 Headquartered at Jakarta, Bank Mandiri is the largest bank in Indonesia in terms of assets, loans, and deposits.
4 Founded in 1933 and headquartered in Central Hong Kong, it is a part of the HSBC Group.
5 These are loans that are granted to borrowers who do not have a good credit rating and have higher chances of defaulting. These loans have a higher interest rate due to increased risk associated with such borrowers.
6 In finance, a derivative is a contract that derives its value from the performance of an underlying entity. This underlying entity can be a share, currency, physical asset, etc. A complex derivative is one whose pay-offs (returns) are more complicated to calculate when compared to simple derivative products.
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