‘IPO funds will help us in setting up the bank’

THE C-Suite Chat

SAMIT GHOSH

Bengalaru-based microfinance company Ujjivan will transform itself into a Small Finance Bank (SFB) in the next calendar year, becoming one of the first ten banks in this category. **Samit Ghosh**, the 62-year-old founder and managing director of Ujjivan, is a first generation entrepreneur and an experienced banker with over 30 years at Citibank, Standard Chartered and HDFC Bank. In an interview with **Manju AB**, Ghosh talks about the challenges of transforming the lender from a microfinance institution to an SFB.

In the next calendar year, Ujjivan will become an SFB into which all the assets of the MFI will be transferred. Ujjivan will remain just a holding company and the SFB needs to be listed in three years from the start of its operations. So why are you listing Ujjivan now? In three years' time you will have two listed entities...

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Yes, under the current regulations, this will be the case as the SFB will have to listed in three years. We are exploring the possibility of a reverse merger. If there is a reverse merger with the holding company and the subsidiary, then there will be just one listed entity. Discussions are on with the regulator on these operational issues. Considering the size and the nature of business, we may ask for extending date of listing for the SFB. The SFB will start off as a wholly owned subsidiary, and later, if RBI permits, it will merge into Ujjivan. When the SFB is formed, all its shares will be allotted to Ujjivan.

Why was listing of Ujjivan important? Will the funds be ploughed back to build the bank?

Our foreign shareholding was close to 90%. We need to bring it down to 49%. With the pre-IPO, it came down to 77% and post IPO, it will be around 44%. IPO was the only route available to bring down the large foreign shareholding. We could not have gone for a private placement, a route some of other players who have got the SFB licence are taking. We will raise about Rs 600 crore to Rs 800 crore. Yes, it will help us in setting up the bank.

In the red herring prospectus, the company says that the RBI guidelines on the SFBs are uncertain. What needs to be clarified?

The draft guidelines are exactly the same as the existing guidelines for commercial banks. RBI is in discussion with us on how to revise those guidelines to suit the needs of the SFBs and their customers. Take for instance the branch network — practically difficult to convert MFI branches to bank branches overnight. We intend convert about 40% of our existing branches into bank branches and over a period of three years all our 470 branches will be converted. We expect RBI to consider these in the final guidelines. RBI has made it very clear to us that priority sector lending requirements of 75%, capital adequacy of 15% the CRR and SLR are not negotiable; it is mandatory as we transform to a bank. We are mostly engaging with the regulator on the operation side.

When the SFB is set up, 20% of the profits have to be transferred to a special reserve fund. You say that this may restrict your ability to pay dividends. Will it also restrict the 20% to 25% of the returns that you are giving your equity investors?

This will also be a standard requirement. We are already making profits. That is not going to be a challenge. We should be able to handle that. We are not in a start-up situation. We will pay dividends and also pay our investors returns. No major concern here.

Almost your entire book is unsecured and group lending on a peer guarantee model. How do you plan to change the nature of the loans to individual loans and with collateral?

We are gradually changing the profile of our customers to deposit making customers. So, all our customers – about 2.6 million – will be our savings bank customers. We will work out schemes to mobilise term and savings deposit from our customers. We will not be able to convert entire customer base with securities as these are poor people from the urban and the semi-urban areas. That is something that RBI will have to take a look at both in terms of regulations and the quantum of security needed. The whole philosophy of microfinance is that these people are poor and they do not have security to provide, making the MFI model a successful one in these areas. Our contention is that this is a different set of customers who do not have adequate securities to cough up so there should be another set of rules while dealing with customers of this category. What percentage of assets should be unsecured and secured needs to be closely studied, and for the small finance banks, these ratios need to revisited.

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There have been negative cash flows from operations in the past. What is the reason for this?

This is primarily due to the fact that we have been funding a significant portion of our financing activities through external borrowings. It is the part and parcel of the business operations. A negative cash flow in any other business would be truly negative but for an MFI. We are constantly borrowing for on-lending. We are not creating any fixed assets with the money we borrow. They are all rolling capital. Unlike the banks, we are sitting only on one side of the balance-sheet that is the assets side. We do not have any liabilities or deposits like commercial banks who have inflows as savings and deposits. We deploy short-term funds for creation of long-term assets. Constantly, our growth is funded by borrowings.

How much of funds do you raise annually? Do you also raise money from the money market?

Book size is close to Rs 5,000 crore and our borrowing is close to Rs 4,000 crore. This net borrowing during the financial year is Rs 3,700 crore. About 70% of our borrowing is from public sector and private sector banks. Financial institutions like Sidbi, Nabard and Mudra account for 10% of our funding requirements. About 16% of our funding comes from NCDs (non-convertible debentures) into which the mutual funds have invested. We are building our brand in the money market which will help Ujjivan as a bank. Our first commercial paper had a tenure of three months and then we had a roll on of the same CP. It was a Rs 50 at coupon rate 9.75%. This financial year also we will raise about Rs 500 crore of commercial paper at much lower rates. So next year as a bank we are well set to launch the certificate of deposits.

Banks are saddled with such huge NPAs. How come your NPAs are low and recovery nearly 100%? Any strong arm tactics used to recover money?

No strong arm tactics at all. We are very sensitive in terms of our collection strategy. Even in the group lending model, we do not enforce the group guarantees. We only tell them to take care of the first three installments. Strong arm tactics will lead to the crisis we have seen in Andhra Pradesh. We engage with our customers very closely and understand the stress situations and take care of this.