Research

CRISIL

An S&P Global Company

Industry Chapter

For Capital Small Finance Bank

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Confidential Document

CERTIFIED TRUE COPY
For Capital Small Finance Bank Ltd.
Authorised Signatory

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1. Introduction

Capital Small Finance Bank , herein referred to as 'Client', has requested the services of CRISIL Research to work on the Industry Chapter for public issuance, as per the scope of work detailed below.

CRISIL is a leading, agile and innovative global analytics company driven by its mission of making markets function better.

We are India's foremost provider of ratings, data, research, analytics, and solutions. A strong track record of growth, culture of innovation and global footprint sets us apart. We have delivered independent opinions, actionable insights, and efficient solutions to over 100,000 customers. Our businesses operate from India, the United States (US), the United Kingdom (UK), Argentina, Poland, China, Hong Kong, Singapore, and the United Arab Emirates (UAE).

We are majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics, and data to the capital and commodity markets worldwide.

CRISIL Research is the largest, independent research house providing research and analysis on the Indian economy, industries, capital markets and companies. We serve more than 1,200 Indian and global clients. These include banks, exchanges, companies, mutual funds, insurance companies, wealth managers, brokers, private equity firms, investment banks, consultants, industry associations and educational institutions.

Our clients include:

- 90 per cent of India's banks
- 15 of the top 25 Indian companies (by market capitalisation)
- The entire Indian mutual fund and life insurance industry
- Three large private general insurance companies
- Top 5 global consulting firms

2. Scope of Work

1. **Indian Economy**
   - Economy growth comparison with developing and developed countries
   - GDP trend in India and growth outlook for next one years and long-term considering the impact of COVID
   - Growth Drivers *(with special emphasis on North India & State of Punjab)*
   - Commentary on latest RBI and government measures in relation to the pandemic
   - Savings pattern of Indians *(with special emphasis on North India & State of Punjab)*
     - Population and demographics in the above context
     - Household and financial savings trend, household savings as % of GDP, Trend in constituent of financial savings in India
   - Credit penetration in India with details on NBFC credit and Bank credit as well as retail credit penetration *(with special emphasis on North India & State of Punjab)*
   - Structural Reforms - Pradhan Mantri Jan Dhan Yojana, Housing for All, & Financial Inclusion including RBI measures, RBI impetus on SFB's.
   - Digitization – Volume and Value transaction and trend *(with special emphasis on North India & State of Punjab) - Company to check if data available from NPCI,RBI*
2. **Financial Inclusion**
   - Current Scenario - Market size and potential, including financial inclusion through MSME and agriculture and key developments
   - Rural / Urban contribution to GDP vs. credit penetration including NBFC credit, deposit penetration, – Based on data available from RBI and census *(with special emphasis on North India & State of Punjab)*
   - State-wise financial inclusion parameter - State wise GDP growth, penetration for credit, deposit branches and ATMs. *(with special emphasis on North India & State of Punjab))* (with competitive landscape in state of Punjab for credit, deposit, branches (PSB, Large private banks, small banks, NBFC). Also bank branch distribution in rural / semi urban & urban to show scope for small banks to gain market share especially from PSBs in deposits and lesser formal institutional presence (especially of large private banks / NBFCs) in semi urban / rural areas where CSFB has strong hold to depict competitive advantage against PSU's and informal channels)
   - Need for Priority Sector Lending and status of PSL lending state wise/sector wise *(with special emphasis on North India & State of Punjab)) – Overall value of loan products which come under PSL will be looked at, bureau data could be used*
   - Financial Inclusion – a reality/business opportunity for scalable business model model (both asset and liability side)
   - Steps taken by the government to boost financial inclusion
   - Digitalization and technology in financial inclusion
   -
3. **Indian Banking Industry**
   - Overview & structure of Indian Banking Industry
   - Evolution and key events including regulatory developments (in banking and impacting banking) since then (covering impact of recent key events like demonetization, GST, Covid-19, etc.)
   - Structural Developments in the Indian banking industry

- Indian retail and commercial banking, SFBs
- Statewise distribution of bank branches and split between PSU/ PVT/ SFB
- Types of products on assets and liability side – with deep dive on the products offered by SFBs vs Capital SFB.
- Systemic credit and deposit growth
    - Systemic credit in India over the past 5 years ending FY21 and factors explaining the growth in credit /Outlook for next 3 years *(with special emphasis on North India & State of Punjab)*
    - Deposits growth outlook for the next 3 years ending FY24 along with explanation of factors driving the same *(with special emphasis on North India & State of Punjab)*
    - *Can we show the Retail deposits and CASA across Private Sector banks*
    - Comparison of credit to GDP in India *(with special emphasis on North India & State of Punjab)*
    - Share of various player groups (public sector banks, private sector and foreign banks, NBFC/HFCs, and small finance banks) in credit *(with special emphasis on North India & State of Punjab)*
- Evolution and key events including regulatory developments (in banking and impacting banking) since then (covering impact of recent key events like demonetization, GST, COVID, etc. more elaborately)
- Performance of lending book including asset quality by type of lenders, secured vs unsecured, ticket size wise.
- Credit deposit trends
    - *with special emphasis on North India & State of Punjab*
    - within Punjab deep dive on the area where Capital Local Area Bank was operating (5 districts – Jalandhar, Hoshiarpur, Kapurthala, Ludhiana & Amritsar)
- Profitability of banks

4. Small Finance Banks

- Evolution and rationale behind giving licenses to SFBs – growth in credit and deposits
    - Key advantages & challenges for a LAB and/or NBFC upon conversion to SFB SFB, with commentary on the rationale for giving licenses to players like Au and Capital SFB.
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    - Distribution outlets for SFBs
    - Branch network of the SFBs (state wise & *with special emphasis on North India & State of Punjab)*, demography wise split of the branches (rural, urban etc.), full service/asset centres split
- Key guidelines- regulations governing SFBs
- Growth Drivers for SFB
- Comparison of different business models of SFB and Commercial bank (*full suite product offering, economic middle class vs BPL target segment)*
- Impact of various crisis on SFBs and smaller mid-sized private banks like CSB, CUB, KVB etc. (demon, Covid-19) comparison of Capital SFB vs. SFBs *(with special emphasis on asset quality, GNPA, write-offs, collection efficiency)*
- Peer Benchmarking of various SFBs in India and smaller mid-sized private banks like CSB, CUB, KVB (To be done based on publicly available data on a best effort basis)
    a) Liabilities:

- Size of deposits
- Breakup of deposits into retail, wholesale and CASA
- Deposits as a % of funding (deposits + borrowing)
- Growth rate of retail deposits
- Cost of deposits
- Cost of funds
- Roll over ratios of TD
- Interest rates offered on retail term deposits (SB & TD)
- Share of top 20/100 depositors to total deposits

b) Advances:
- Size of AUM
- Growth rate of AUM
- % of AUM from secured products (with additional reference to collaterised with immovable mortgages within the secured portfolio)
- Breakup of AUM into Micro finance, SME/ MSME, mortgages-HL & LAP, NBFC lending, retail lending.
- Percentage of AUM availed Mort 2, portfolio restructured under 1.0 & 2.0
- Break-up of AUM as per Average Ticket Size
-
- Share of top 20/100 borrowers to total advances
- Incremental market potential for key states

c) Financial & Other Parameters
- Financial Parameters
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- Total income & NII
- PPOP & PAT
- Other Parameters
- Credit to deposits ratio
- Yields, Cost of funds & Interest Spread
- OPEX as % to average total assets
- CIE ratio
- Opex per branch outlet
- RoE & RoA
- Capital Adequacy Ratio
- No of employees
- Return on AUM
- Cost to Income
- Advances to Balance sheet size to show growth headroom for CSFB (from existing liquidity on balance sheet)
- fee income to total assets
- CASA Ratio

d) Asset Quality
   - GNPAs & NNPAs
   - Write-offs
   - Collection Efficiency
   - Provisioning Coverage ratio with sub set of secured lending
   - Asset behaviour of the secured portfolio vs unsecured portfolio during the period of crises (demon and Covid 19)
   - overall credit cost including NPL provisioning, write offs. Also total credit cost to Advances
   - LTV
   -

e) Branch Distribution
   - Branch network of the SFBs (state wise & *with special emphasis on North India & State of Punjab)*, demography wise split of the branches (rural, urban etc.), full service/asset centres split
   - Geographic mix of AUM– preferably top 5 states
   - Operational Efficiency – Business per Branch, Advances per branch, Retail deposits per branch, Business per employee, Advances per employee, Retail Deposit per employee with growth rate

f) Digital Initiatives by SFBs
   - % of digital transactions to non-cash transactions\

g) Credit Rating

5. **MSME loans (secured) with focus from Rs 1 million to Rs 20 million ticket size – Bureau data required** (We can further bifurcate the ticket size range to be more relevant for our purpose. We can, if possible and preferable, to give sub segments say from 1mn to 5mn, 5mn to 10mn & 10mn+. Competitive scenario in small ticket MSME financing between PSBs, large private banks, small private banks and NBFCs

   - Brief overview of MSMEs in India, Current market size and assessment of growth in the past 3 years - based on credit bureau data (*with special emphasis on North India & State of Punjab)*
   - Credit Penetration - Organized vs Unorganized lenders - CRISIL will use its dated survey and MSME survey to show penetration of formal credit among small MSME borrowers
   - Present market size and Growth outlook for the next 3 years and growth drivers (*with special emphasis on North India & State of Punjab) – Growth outlook throughout the report will be provided on pan-India basis*
   - Regulatory and policy-level factors that are spurring the market
   - Share of NBFCs vs Banks key factors driving competitiveness of banks
   - Asset Quality

6. Comparative trend of the focused segment vs overall MSME/advances (covering GNPA, NNPA, write-offs, LGDs) – LGD data will be provided from RBI reports if available for various loan products
7. **Agriculture Loans with focus from Rs. 0.5 million to 2.5 million ticket size**

   - Brief overview Agriculture in India, Current market size and assessment of growth in the past 3 years - (*with special emphasis on North India & State of Punjab)*

- Credit Penetration - Organized vs Unorganized lenders
- Present market size and Growth outlook for the next 3 years and growth drivers *(with special emphasis on North India & State of Punjab)*
- Regulatory and policy-level factors that are spurring the market
- Asset Quality
  - Comparative trend of the focused segment vs overall agriculture/advances (covering GNPA, NNPA, write-offs, LGDs) *can look to work with the same to provide right output*
  - Asset quality trends in state of Punjab for targeted agriculture advances
  - Direct crop proceed to farmers possible benefit on asset quality

8. Mortgage Lending (HL & LAP) – with focus from Rs 0.5 million to Rs. 5 million ticket size – Bureau data required (income proof based)

- Brief overview of mortgage lending in India, Current market size and assessment of growth in the past 3 years - based on credit bureau data *(with special emphasis on North India & State of Punjab) Data pertaining to Punjab & North can be tried for*
- Credit Penetration - Organized vs Unorganized lenders
- Present market size and Growth outlook for the next 3 years and growth drivers *(with special emphasis on North India & State of Punjab)*
- Regulatory and policy-level factors that are spurring the market
- Share of NBFCs vs Banks key factors driving competitiveness of banks
- Asset Quality
  - Comparative trend of the focused segment vs overall Mortgage/advances (covering GNPA, NNPA, write-offs, LGDs)

9. Outlook and potential

- Growth drivers for banks & small finance banks
- Projected growth in assets under management of SFBs over the next 3 years (split of MFIs & Non MFIs)
- Growth in deposit base of SFBs and mix of retail and wholesale deposits and CASA deposits (region wise, branch demography wise)
- Projected growth in deposits over the next 3 years
- Asset Quality of SFBs split of MFI & non MFI business
- Present market size of deposits and advances of North India with special emphasis to state of Punjab
  - Share of Capital SFB in incremental deposit in various sub-segments of Punjab (Doaba, Malwa, Majha), 2016-2021 *(Industry report)*
- Market size of Economic Middle Class(INR 4-50 lac income group) with special reference to Punjab and North India and growth outlook for next 3 years. But this is our bread n butter need to figure out a way to figure it out.
- Historic data and expected LGD of collaterised/secured lending to economic middle class
- Expected Key growth drivers in post covid era – agri/MSME
- Profitability of SFBs

Important Mention: North India herein referred to the state of Punjab, Haryana, NCR and Rajasthan.

Note: In cases where credit bureau data is required for the analysis (such as industry-wide and state-wise trends and asset quality), given the nature of the process and the end-purpose where the data will be used, the client will procure the requisite data from credit bureaus and also make available the required reproduction rights to CRISIL Research.

We will not get any NBFC player group data region or state wise, except where data is sourced from bureau. Hence, it cannot be incorporated. Geography wise banking industry data which we get from RBI can be incorporated.

3. Proposed Engagement Team

CRISIL Research will constitute a dedicated team comprising analysts and sectoral experts to provide relevant inputs to the assignment. Summarized resumes of the proposed engagement team members are given below.

Ajay Srinivasan – Director, CRISIL Research

Ajay Srinivasan, Director, CRISIL Research, has 17 years of experience in industry research, financial analysis and forecasting. He leads a team of analysts tracking the Indian banking and financial services (BFSI) industry. CRISIL Research regularly publishes its views on business growth, asset quality, profitability, and the implications of key policy events such as monetary policy on the banking sector.

He has also contributed to various analytical pieces done by CRISIL in this space for industry journals such as FICCI Banking and Finance journal. Besides, Ajay has been invited as a speaker at industry forums like the ICC Banking Summit on areas of relevance such as investment outlook and implications for the banking sector, and financial inclusion.

Ajay has also worked closely with domestic and international clients in areas such as market assessment and opportunity identification. In addition to the BFSI sector, Ajay also looks at the automobiles, cement, telecom, media, information technology, cement and educational services sectors

Ajay joined CRISIL in 2003. He holds a Bachelor's degree in Commerce and Masters in Management from the Mumbai University. He has also passed all three levels of the CFA Program offered by the CFA Institute, USA.

Aniket Dani, Associate Director- CRISIL Research

Aniket Dani, Associate Director, CRISIL Research is an industry specialist with over 12 years of experience in analyzing the Banking and financial services sector and providing outlook on parameters like credit growth, deposit growth, profitability and asset quality. He has worked on various company specific assignments like evaluation of business and financial feasibility in setting up of a proposed Regional Development Bank, diagnostic study to evaluate application of a leading NBFC for a universal banking license.

In addition to these, he has also worked on various industry analysis assignments which include estimation of retail loan potential for 5 products in 15 upcoming Tier II and III cities and analysis of various loans products which are a focus area for NBFCs.

Aniket joined CRISIL in 2006 and holds a Master of Management Studies (MMS) degree from Mumbai University and has cleared all 3 levels of Chartered Financial Analyst (CFA) exam conducted by CFA Institute U.S.

The core team members described in the previous section will be supported by a Review Committee manned by Mr. Prasad Koparkar, Senior Director, CRISIL Research. As a reviewer his role will be to ensure that the conclusions of the core team are robust: backed by sufficient data and evidence, and a product of analytical rigour.

Prasad Koparkar, Senior Director- CRISIL Research

Prasad Koparkar, Senior Director, GIX. He heads the operations of Industry and Customised Research division at CRISIL. He has an overall experience of more than 20 years in credit ratings, equity research, fund advisory and information business. In his previous role as Head – Operations, CRISIL Risk and Infrastructure Solutions, he was responsible for overseeing a team of about 50 professionals responsible for execution of advisory assignments. Prior to this,

Prasad headed the Structured Finance and Rating Criteria & Product development team in CRISIL's rating business. He is a CA, ICWA, CFA (USA) and Global Association of Risk Professional (GARP), USA.

4. Client's task

The client shall appoint one of its senior level personnel who shall be the project coordinator for the Services (Services Coordinator). The client shall procure that the Services Coordinator shall be the single point of contact for CRISIL Research for all operational matters relating to the performance of the Services, including matters relating to provision of Client Materials and the following:

- Approving on behalf of the client any data collection template or questionnaire developed by CRISIL Research;
- Arranging meetings with relevant persons – whether those of the client or third parties;
- Participating at various meetings that CRISIL Research may from time to time request;

The client may by a reasonable prior written notice to CRISIL Research replace a Services Coordinator with another of its personnel. The client shall be responsible to ensure the replacement Services Coordinator is properly briefed and updated on the Services.

The instructions and approvals issued by the Services Coordinator shall be binding on the client. On CRISIL's request, the client will appoint/designate a team (Client Team) which will work under the supervision of the client's Services Coordinator. The client will ensure that the Client Team attends and effectively participates in the meetings requested for by CRISIL

Review and Acceptance of Deliverables:

Once CRISIL shares the draft Deliverables, the client shall have [1 week] ***(Review Period)*** to review them and provide its comments to CRISIL, provided that any such comments must be consistent with the agreed Scope of the Deliverables. The Review Period may only be extended by mutual written agreement of the parties. CRISIL shall consider the client's comments in good faith and take them into account in finalising the Deliverables, at all times using CRISIL's independent professional judgement.

Upon such finalisation, or if CRISIL has received no comments from the client during the Review Period, the client shall be considered to have accepted the Deliverables.

Unless otherwise agreed by CRISIL in writing, all correspondence between the parties will be in the English language.

Consent Letter

The consent letter for content reproduction for the IPO document will be issued by CRISIL Research. The consent letter will be issued subject to the following conditions:

1. Your providing information specific to the purpose of the issue, as the same has to be mentioned in the consent letter
2. Your ensuring that the Disclaimer of CRISIL is also reproduced along with the report

The consent letter is for issues to take place within the **purview of Indian jurisdiction and in accordance with the SEBI regulations**. Once the confirmation on the mandate is received, we will share the Draft Consent Letter with you.

5. Terms and Conditions

5.1 Document Framework, Definitions

1. From time to time Client and CRISIL or their respective affiliates may execute order form(s) (each an ***Order Form***) setting out the services agreed to be provided under the Order Form(s) (***Services***) incorporating the MTC. Each such Order Form and the MTC (together with the relevant annexure or schedules) will operate as an independent contract between the parties executing that Order Form and shall be called the ***Agreement***. References to "CRISIL" and "Client" in the MTC shall refer to the relevant parties executing the Order Form. Where the parties executing an Order Form have agreed to changes to the terms of the MTC as incorporated into the Order Form, the changes shall apply only to that Order Form (and not to any other Order Form). To the extent of a conflict between the MTC and the Order Form, the Order Form will prevail.

2. Definitions are given in clause 7.12.

5.2 Services, Use, Change Control Procedure and Timelines

1. CRISIL will provide the Services in accordance with the Agreement.

2. Client may use the Services for no purpose other than: (a) its own internal business purposes; and (b) any other purpose if specified in the Order Form.

3. For the avoidance of doubt, Client shall not (except, where CRISIL has consented in writing and Client has agreed to pay the applicable charges):

   a) Redistribute, resell, display, reproduce or publish any part of any Service;

   b) use any part of any Service to create any index (whether, single, composite or otherwise) or any derivative without the express prior written consent of CRISIL in each case;

   c) directly or indirectly permit any third party or users to do what it is not permitted to do under the Agreement; or

4. Where CRISIL consents to Client's use as stated in clause 2 and 3, additional conditions may apply as CRISIL may specify at the relevant time (including Client providing additional indemnity, documentation and display of appropriate disclaimers).

5. Change Control:

   a) Upon Client request for changes to Service Particulars applying to Packaged Services, CRISIL will within a commercially reasonable time notify Client of the feasibility of effecting those changes, the timeline for effecting those changes, and any revisions to the Fees. Upon Client confirming in writing its acceptance of how the changes will be effected to the Packaged Services, CRISIL will commence implementing the agreed changes.

   b) CRISIL may make changes to be made to Packaged Services as follows: For Service Particulars which are specific to the Client, CRISIL may make changes with the prior written consent of the Client which will not be unreasonably withheld or delayed. For Service Particulars which are not specific to the Client, CRISIL may make changes so long as they are generally applied to the Services.

   c) Notwithstanding anything to the contrary stated elsewhere in the Agreement, CRISIL reserves the right to modify any Service Particulars as follows: (a) in the case of Standard Services, CRISIL may make changes so long as those changes are generally applied to the relevant Standard Services; (b) in the case of all Services, where a change is required to comply with applicable laws, regulations, or orders of a government, statutory, regulatory, judicial or other authority.

6. Finalisation of the Report

   a) Subject to CRISIL receiving payment of the Charges as per the decided payment schedule , CRISIL will share with the Client a draft report (the "**Report**") for Client's inputs (as CRISIL may request), and verification of the factual content of the draft Report (and not for any other purpose).

   b) Within 7 calendar days of receiving the draft Report, Client will provide the inputs where requested and may notify CRISIL of any factual inaccuracy in the draft Report. CRISIL will consider the submissions made by the Client and, where it considers necessary in its professional judgement, revise the draft Report and finalise the Report.

   c) If CRISIL receives no communication from the Client under clause b), CRISIL shall be entitled to assume Client has no submissions to make and CRISIL may thereafter proceed to finalise the Report with the information/materials available with CRISIL. Thereafter, CRISIL shall not be obliged to consider any further submissions made by the Client or accede to requests for changes made by the Client to the finalised Report.

d) At any time before finalisation of the Report, CRISIL may at its sole discretion forthwith and without incurring liability, terminate the Agreement if:

   i. Client does not cooperate and/or provide or inordinately delays providing Client Material or performing its obligations as are necessary for CRISIL to perform the Services;

   ii. the Charges remain unpaid or overdue (including for reasons where a cheque issued by the Client has not been realised);

   iii. CRISIL is of the opinion that circumstances warrant the termination the Agreement.

5.3 Charges

1. Unless stated otherwise in the Order Form: (a) CRISIL will invoice Client in accordance with the agreed invoicing schedule as contained in the Order Form; (b) Client shall pay to CRISIL the Fees and Charges within 15 calendar days of Client's receipt of CRISIL invoice (***Due Date***). CRISIL may apply a service charge calculated at the rate of 1.5% per month for each day from the Due Date that Charges remain unpaid. Charges are not refundable.

2. In addition to Charges, Client will pay all statutory taxes and levies (except those on CRISIL's net income).If Client deducts tax at source, it shall comply with law with respect to such deduction and provide CRISIL with documentation in support of that in a timely manner.

3. The fees and any amounts payable under the Order Form are exclusive of all applicable taxes (including GST), levies, duties etc. Any such tax will be charged over and above the fees and amounts payable to CRISIL under the Order Form. The GST registration number ("GSTIN") provided by the Client will be used by CRISIL for filing of the GST returns.

4. With regards to the applicability of Goods and Services Tax, the Client's address as mentioned for the purposes of GST will be considered as the consumption location for the Services provided by CRISIL under the Order Form.

5. CRISIL shall not be liable for loss of credit arising on account of incomplete, erroneous or wrong details captured by the Client in the details and documents uploaded to the GSTN. Additionally the Client shall be responsible and liable for providing its correct GSTIN and CRISIL will not be responsible for verification of the Client's GSTIN. Where the Client fails to furnish its GSTIN, CRISIL will treat the Client as being unregistered for GSTIN.

6. Where CRISIL issues a credit note to the Client in relation to any invoice, the Client shall adjust and upload its Input Tax Credit on the GSTN on or before the end of the month in which the credit note is issued by CRISIL to the Client. If the Client fails to do so, and this results in additional liability for CRISIL, Client shall be liable to be reimburse CRISIL for any liability incurred by CRISIL (being the tax, interest and any penalties thereon).

5.4 Term and Termination

1. The Agreement shall commence on the Start Date mentioned in the Order Form and continue for one year unless terminated earlier in accordance with this clause 5.4 (Term).

2. A party may terminate the Agreement with immediate effect by written notice to the other if the other party: (i) has materially breached the Agreement and that breach is incapable of remedy or where the breach is capable of remedy the other party has not remedied it within 1 month of receiving a written notice of the breach; or (ii) re-organises, reconstructs or otherwise undergoes a change in constitution (otherwise than for the purpose of solvent amalgamation or reconstruction where the emerging company assumes the obligations of the party); or (iii) becomes bankrupt, insolvent and/or is unable to pay its debts as they fall due, enters liquidation, is wound up, compounds with its creditors or has an administrator, receiver or other such person appointed over all or any part of its assets or otherwise takes or suffers any similar action in any jurisdiction, or threatens or resolves to do any of the above in consequence of debt. CRISIL may terminate the Agreement on a written notice if CRISIL is unable to provide the Services under the Agreement due to change in any existing applicable law, regulations, government or statutory rules or guidelines.

3. CRISIL may terminate the Agreement for no cause by giving the Client a written notice of at least 1 months. If CRISIL so terminates, CRISIL will refund to Client the unused Fees paid by Client in advance subject to deductions on account of any unpaid dues that Client may owe CRISIL.

4. If at any time CRISIL determines that considering the available information or materials it is not possible to provide any part of the Services conforming to CRISIL's professional standards, CRISIL may at its discretion (but acting reasonably) terminate this Agreement to the extent it relates to such part of the Services. In such an event, as CRISIL's entire liability, CRISIL will (if applicable) refund to Client any Fees paid in advance for the affected part of the Services after deducting from it Fees as applicable until the effective date of termination.

5. A termination of this Agreement shall not limit a party's rights as shall have accrued up to the effective date of termination.

5.5 Confidentiality

1. Each receiving party will hold the Confidential Information of the disclosing party in confidence and except with the prior written consent of the disclosing party (or as permitted by the Agreement) not disclose it to any third party whose knowledge of such Confidential Information is not necessary for the party's performance of this Agreement (each a Permitted Recipient). Each receiving party will procure that each of its Permitted Recipients complies with these confidentiality obligations. These confidentiality obligations do not apply to information which is already in the public domain or comes into public domain through no fault of the receiving party. Confidential Information means all information except those excluded afore in this clause whether commercial, financial, legal or otherwise, which is made available to the receiving party or which otherwise comes to the attention of or into the possession of the receiving party, its representatives or persons acting under its control or direction in the course of performance of this Agreement.

2. The confidentiality obligations with respect to an item of Confidential Information will be throughout the Term and for a period of 2 years after termination of the Agreement.

5.6 Intellectual Property

6. As between the parties: (a) all intellectual property rights in the Services including all of its contents (but excluding Client Brands) belong exclusively to CRISIL; and (ii) Client Brands belong exclusively to Client.

7. Client will not use the name of any Service (or any part of it) as part of its corporate, business or trading name or style or create or attempt to register or otherwise assert any intellectual property right in any part of the Service or CRISIL Brand.

8. CRISIL may use Client's Brands in its marketing or presentation material targeted for IPO related clients or in CRISIL's marketing in social media, provided that except with the Client's prior written consent (which will not be unreasonably be withheld or delayed),.CRISIL may not use any Brands of the Client in any advertisements in any other mass media. CRISIL will comply with Client's standard branding guidelines (as notified by Client to CRISIL in writing) in the case of any such use.

5.7 Warranty and Disclaimers

1. Client warrants that

   a) Client's access, use and distribution (where permitted by CRISIL) of the Services shall be lawful and that Client has (or shall have) all necessary rights, permissions and licenses for use of the Services as permitted by this Agreement.

   b) the Client requirements are adequate and complete in all material respects;

   c) CRISIL may provide the Services relying on the Client requirements. CRISIL is not obliged to independently verify or validate any Client requirement (although CRISIL may at its discretion choose to do so).

   d) the Client Material is: (i) accurate, adequate and complete in all material respects; (ii) not false or misleading; and (iii) within the rights of the Client to share and use for the purpose of the Services;

   e) CRISIL may provide Services relying on and using the Client Material, as it deems appropriate;

   f) Client shall be responsible (and shall take all reasonable steps) to procure that the Users' access to the Report is subject to the condition that CRISIL is not responsible or liable to any User for the User's access and/or use of the Report;

   g) the Client shall not, whether directly or indirectly, portray the Report as a substitute or alternative to any other service of CRISIL;

2. CRISIL will use reasonable care and skill in preparing and providing the Services.

3. Client acknowledges that: (a) CRISIL does not guarantee the accuracy or completeness of the information on which the Services is based or the information contained in the Services; (b) preparation of the Services does not constitute an audit or rating of any of the entities whose names may feature in the Services; and (c) nothing in the Services constitutes recommendations or advice as to buy, sell or hold any instruments issued by the entities whose names may feature in the Services or as to entering (or not entering) into any transaction with any of them. EXCEPT AS MENTIONED IN CLAUSE 2, CRISIL MAKES NO REPRESENTATIONS OR WARRANTIES WITH REGARD TO THE SERVICES AND EXPRESSLY EXCLUDES ALL REPRESENTATIONS AND WARRANTIES OF WHATEVER KIND INCLUDING, WITHOUT LIMITATION, WARRANTY THAT THE SERVICES WILL BE ERROR-FREE, COMPLETE, OR FIT FOR PURPOSE.

5.8 Indemnity & Liability

1. Client agrees to indemnify CRISIL and hold harmless, its directors, officers and employees, against any costs, loss, damages, claims or expenses incurred or suffered by reason of provision of the Services, including, without limitation those that arise as a result of breach of Client's warranties set out above (but excluding those that arise as a result of CRISIL's breach of this Agreement).

2. Client assumes the entire risk as to Client's use of the Services and the decisions made based on the Services. CRISIL expressly disclaims all liability with respect to any such use or decisions. The Services are not intended to be investment advice or recommendations.

3. Neither party will be liable for indirect or consequential losses, exemplary or special damages, or loss of profits, loss of business or economic loss even if advised of the possibility of such losses or damages. The foregoing shall apply regardless of whether such liability is based in contract, tort, (including but not limited to negligence) and strict liability or any other theory of legal liability. Subject to indemnity obligations, neither party's aggregate liability will exceed an amount equivalent to the Fees paid by the Client under the Order Form in the latest twelve month period preceding the date of the claim. Neither party shall be liable for failure or delay in its performance of its obligations under the Agreement (other than in the case of Client, its obligation to pay Charges as are due), to the extent such delay or failure or delay is caused by a force majeure cause.

5.9 General

The Agreement contains the entire agreement of the parties as to its subject matter and supersedes all prior agreements and understandings written or oral in relation to the subject matter. Except as otherwise stated in the Agreement, any amendment to the Agreement shall only be effective if in writing and executed by a duly authorized representative of each party. Client may assign, transfer or novate any of its rights or obligations under the Agreement, provided Client obtains the prior written consent of CRISIL (which will not be unreasonably withheld). CRISIL may assign, transfer or novate any part of the Agreement to any of its affiliate or CRISIL's successors in business upon a written notice to the Client. For the avoidance of doubt, CRISIL may subcontract any part of its obligations, provided that CRISIL shall remain responsible for the performance those obligations by its subcontractors. Any assignment, novation or transfer in breach of this clause shall be null and void. The Agreement will be governed by and construed in accordance with the laws of India and the parties agree to submit to the exclusive jurisdiction of the courts of law in Mumbai, India and their appeal courts to settle any disputes that relate to the Agreement.

Nothing in the Services/ Report is to be construed as CRISIL providing or intending to provide any services in jurisdictions where CRISIL does not have the necessary permission and/or registration to carry out its business activities with respect to the Services or Report under this Agreement. Client will be responsible for ensuring compliances and consequences of non-compliances for use of the Services/Report or part thereof outside India.

5.10 Anti-Bribery & Corruption:

Each Party represents, warrants and undertakes that:

a) It has not and shall not offer, promise, give, encourage, solicit, receive or otherwise engage in acts of bribery or corruption in relation to this Agreement (including without limitation any facilitation payment), or to obtain or retain business or any advantage in business for any member of its group, and has and shall ensure to the fullest extent possible that its employees and agents and others under its direction or control and directly involved in providing Services under the Agreement do not do so. For the purposes of this clause it does not matter if the bribery or corruption is (i) direct or through a third party; (ii) of a public official or a private sector person; (iii) financial or in some other form; or (iv) relates to past, present, or future performance or non-performance of a function or activity whether in an official capacity or not, and it does not matter whether or not the person being bribed is to perform the function or activity to which the bribe relates, or is the person who is to benefit from the bribe. For the purposes of this clause, a "person" is any individual, partnership, company or any other legal entity, public or private.

b) Each Party shall, adhere to applicable anti-bribery and corruption laws.

c) Each Party shall, immediately upon becoming aware of them, give the other Party all details of any non-compliance with Clause (a) and Clause (b).

d) It is a condition of this Agreement that each Party fully complies with this Clause. If it does not do so, without prejudice to any other remedy available to a party, the non-breaching party shall have the right (but not the obligation) in its absolute discretion to terminate the whole of this Agreement, or that part of this Agreement to which the bribery or corruption relates. For the avoidance of doubt, any breach of this Clause shall be deemed to be incapable of remedy.

5.11 Economic and trade sanctions

As of the date of this Agreement, (a) neither you nor any of your subsidiaries, or any director or corporate officer of any of the foregoing entities, is the subject of any economic or trade sanctions or restrictive measures issued by the United Nations, United States or European Union ("Sanctions"), (b) you are not 50% or more owned or controlled, directly or indirectly, individually or collectively, by one or more persons or entities that is or are the subject of Sanctions, and (c) to the best of your knowledge, no entity 50% or more owned or controlled by a direct or indirect parent of you is the subject of Sanctions. For purposes of clause (c) in this section, "parent" is a person or entity owning or controlling, directly or indirectly, 50% or more of you. For so long as this Agreement is in effect, you will promptly notify CRISIL if any of these circumstances change. If CRISIL reasonably determines that it can no longer provide the services to you in accordance with applicable law, then CRISIL may terminate this Agreement, or any particular services, immediately upon written notice to you.

5.12 Definitions

Unless opposed to the context, the following terms have the meanings given to them when used in the Agreement: ***Brands*** means brands, logos, trade names, trademarks, brand features or other identifiers; ***Charges*** means Fees, out of pocket expenses and other amounts payable for the Services by the Client under an Order Form; ***Fees*** means the fees for the Services payable by the Client as set out in the Order Form (subject to revisions in accordance with the Agreement); ***Client Material*** means the information, material, documents, declarations and confirmations (including any Brands of the Client or the entity to which the Report relates or any other party) provided by the Client pursuant to this Agreement; ***MTC*** means this document titled "Master Terms and Conditions", together with any related annexure or schedule that the parties have agreed in writing; ***Order Form*** means an order form executed by the relevant parties incorporating or referencing the MTC, together with any related schedules and annexure; ***Packaged Services*** means Services in respect of which Service Particulars shall be as CRISIL generally provides to its clients from time to time except to the extent modified as stated in the Order Form; ***Service Particulars*** with respect to a Service means its format, delivery mode, delivery schedule, specifications, content and other relevant particulars; ***Services*** means the services subscribed to by the Client under the Order Form and may be Standard Services and/or Packaged Services; ***Standard Services*** means the Services in respect of which the Service Particulars shall be as CRISIL generally provides to its clients from time to time; ***Start Date*** means the start date of an Order Form; and ***Users*** means any third party who has access to the Report through Client whether directly or indirectly.

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Associate Director, Business Development
CRISIL Research
+91 9324296928
dinesh.agarwal@crisil.com

Research

CRISIL

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Please return to us the enclosed duplicate of this Letter duly signed by you in acceptance hereof.
We agree, accept and confirm:

For CRISIL Research, a division of CRISIL Ltd.	For Capital Small Finance Bank
CRISIL Limited	For CAPITAL SMALL FINANCE BANK LTD AUTHORISED SIGNATORY
Name: Vishal Ahuja	Name : Munish Jain
Designation: Director – Business Development	Designation: Chief Financial Officer & Chief Operating Officer
Company Stamp	
DATE :26th October 2021	DATE: October 26, 2021

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Profile

CRISIL Research

Who We Are

CRISIL Research is India's largest independent integrated research house. We provide data, insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues.

We are India's most credible provider of economy and industry research. Our industry research covers 76 sectors and sub-sectors and is known for its rich insights and perspectives. Our analysis is culmination of mining our proprietary databases and inputs from our large network of primary sources, including industry experts, industry associations and trade channels.

We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries.

We pioneered independent equity research in India, and today offer services across company valuation, commercial due diligence and competitive benchmarking.

Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

Who We Serve

We serve more than 1,000 Indian and global clients. These include banks, exchanges, companies, mutual funds, insurance companies, wealth managers, brokers, private equity firms, investment banks, consultants, industry associations and educational institutions.

Our clientele includes:

- 95% of India's banking industry by asset base
- 15 of the top 25 Indian companies by market capitalisation
- Entire Indian mutual fund industry
- Entire life insurance industry in India
- 6 of the world's leading consulting firms

How We Add Value

Our opinions and insights, delivered through an innovative web-based platform, help our clients take informed lending, investment and strategic decisions, thereby mitigating and managing risk.

Our fixed income valuations and indices provide greater transparency in the fixed income markets and empower investors with independent benchmarks to evaluate the performance of their investments.

Our independent equity and company research reports provide insights to investors on under-researched companies. Our reports have improved transparency levels and trading volumes for companies under coverage.

Our executive training service helps train and equip finance professionals to meet real-life business situations.

Our Capabilities
Making Markets Function Better

Economy and Industry Research

- Largest team of economy and industry research analysts in India
- Acknowledged premium, high quality research provider with track record spanning two decades
- 95% of India's commercial banking industry by asset base uses our industry research for credit decisions
- Coverage on 76 industries: We provide analysis and forecast on key industry parameters including demand, supply, prices, investments and profitability, along with insightful opinions on emerging trends and impact of key events
- Research on sectors and clusters dominated by small and medium enterprises covering analysis of relative attractiveness, growth prospects and financial performance
- Special coverage on key sectors like Agriculture, NBFC, SME & Railways providing opinion on the growth prospects, competitive scenario & attractiveness of these segments supported with analytical tools

Customised Research

- High-end customised research for many leading Indian and global corporates
- Focused sectors include Automotive, Energy, Metals, Cement, Infra & logistics, Real Estate and BFSI
- Tailored studies in market sizing, demand forecasting, competition benchmarking, project feasibility and entry strategy

Funds and Fixed Income Research

- Largest and most comprehensive database on India's debt market, covering more than 32,000 securities
- Largest provider of fixed income valuations in India, servicing ~ Rs. 107 trillion (USD 1,573 billion) of outstanding Indian debt securities
- Most widely accepted provider of fixed income and hybrid indices; we maintain over 100 standard indices and over 100 customised indices
- Mutual fund rankings, the industry standard for performance evaluation, coverage includes 79% of assets under management and Rs 12.8 trillion (USD 197 billion) by value
- Research partners to Employees' Provident Fund Organisation (EPFO) and National Pension System (NPS) Trust for monitoring performance of fund managers

Equity and Company Research

- Independent Equity Research, Due Diligence and Valuation services across sectors executed over 300 assignments
- Due Diligence, IPO Grading and Independent Equity Research for SME companies planning to list or already listed on SME platforms of stock exchanges

Executive Training

- Conducted 1500+ training programs on a wide spectrum of topics including credit, risk, retail finance, and treasury; trained more than 30,000 professionals till date
- Training programs offered in India, Sri Lanka and Bangladesh through an extensive network of well-qualified financial professionals & through customised E – Learning Modules

About CRISIL Limited

CRISIL is a global analytical company providing ratings, research, and risk and policy advisory services. We are India's leading ratings agency. We are also the foremost provider of high-end research to the world's largest banks and leading corporations.

CRISIL is majority owned by S&P Global Inc., a leading provider of transparent and independent ratings, benchmarks, analytics and data to the capital and commodity markets worldwide.

About CRISIL Research

CRISIL Research is India's largest independent integrated research house. We provide insights, opinion and analysis on the Indian economy, industry, capital markets and companies. We also conduct training programs to financial sector professionals on a wide array of technical issues. We are India's most credible provider of economy and industry research. Our industry research covers 86 sectors and is known for its rich insights and perspectives. Our analysis is supported by inputs from our network of more than 5,000 primary sources, including industry experts, industry associations and trade channels. We play a key role in India's fixed income markets. We are the largest provider of valuation of fixed income securities to the mutual fund, insurance and banking industries in the country. We are also the sole provider of debt and hybrid indices to India's mutual fund and life insurance industries. We pioneered independent equity research in India, and are today the country's largest independent equity research house. Our defining trait is the ability to convert information and data into expert judgements and forecasts with complete objectivity. We leverage our deep understanding of the macro-economy and our extensive sector coverage to provide unique insights on micro-macro and cross-sectoral linkages. Our talent pool comprises economists, sector experts, company analysts and information management specialists.

CRISIL Privacy

CRISIL respects your privacy. We may use your contact information, such as your name, address, and email id to fulfil your request and service your account and to provide you with additional information from CRISIL. For further information on CRISIL's privacy policy please visit www.crisil.com/privacy

Last updated: May 2018

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CERTIFIED TRUE COPY
For Capital Small Finance Bank Ltd.

Authorised Signatory

ADDENDUM NO. 2 TO THE AGREEMENT FOR SERVICES

This Addendum No. 2 ("Addendum") dated 11th July 2023 amends the Agreement for Services effective 16th August 2021 (Reference number: SS/BD/CSFB/DRHP/2021/CH1213) as may have been amended previously, ("Agreement"), executed between Capital Small Finance Bank

AND

CRISIL Limited, a company incorporated under the laws of India whose registered office is at CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400 076 ("**Supplier**")

"**Capital SFB**" and "**Supplier**" shall wherever the context permits be individually referred to as "**Party**" and collectively referred to as "**Parties**".

RECITALS:

A. The Parties have entered into the Agreement where the Supplier has agreed to an update to Services to Capital SFB- **Industry Update basis March 2023** numbers and according to the terms and conditions contained in the Agreement.

B Unless repugnant to the context, any capitalized term not otherwise defined herein shall have the meaning ascribed to it in the Agreement.

OPERATIVE CLAUSES:

1. Except as otherwise modified under this Addendum, all other terms and conditions of the Agreement shall remain unchanged for the term of the Agreement, including the term extended by this Addendum.

2. The Parties hereby agree that this Addendum shall be read in conjunction with the Agreement and all terms and conditions as mentioned in the Agreement shall apply *mutatis mutandis* to this Addendum.

3. The Recitals under this Addendum form an integral part of the Agreement and are binding on both the Parties.

IN WITNESS WHEREOF the Parties have executed this Addendum on and as of the date first mentioned above.

CERTIFIED TRUE COPY
For Capital Small Finance Bank Ltd.
Authorised Signatory

Capital Small Finance Bank For CAPITAL SMALL FINANCE BANK LTD	CRISIL Limited
Signature: AUTHORISED SIGNATORY	Signature:
Printed Name: Munish Jain	Printed Name: Dinesh Agarwal
Title: Chief Operating Officer & Chief Financial Officer.	Title: Director- Business Development, MI&A
Date: July 12, 2023	Date: July 11, 2023

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For Capital Small Finance Bank Ltd.
Authorised Signatory

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ADDENDUM NO. 2 TO THE AGREEMENT FOR SERVICES

This Addendum No. 2 ("Addendum") dated 27 December 2023 amends the Agreement for Services effective 18th August 2023 (Reference number: SS/BD/CAPITIALSFB/DRHP/2023/CHI201) as may have been amended previously, ("Agreement"), executed between Capital Small Finance Bank

AND

CRISIL Limited, a company incorporated under the laws of India whose registered office is at CRISIL House, Central Avenue, Hiranandani Business Park, Powai, Mumbai – 400 076 (**"Supplier"**)

"Capital Small Finance Bank" and **"Supplier"** shall wherever the context permits be individually referred to as **"Party"** and collectively referred to as **"Parties"**.

RECITALS:

The Parties have entered into the Agreement where the Supplier has agreed to an update to Services (Industry Report) to Capital Small Finance Bank according to the terms and conditions contained in the Agreement. The update would be as per the below mentioned details:

- One-time RHP update for updating September 2023 nos (this will include updating only macro's and peer benchmarking sections)

A. Unless repugnant to the context, any capitalized term not otherwise defined herein shall have the meaning ascribed to it in the Agreement.

OPERATIVE CLAUSES:

1. Except as otherwise modified under this Addendum, all other terms and conditions of the Agreement shall remain unchanged for the term of the Agreement, including the term extended by this Addendum.

2. The Parties hereby agree that this Addendum shall be read in conjunction with the Agreement and all terms and conditions as mentioned in the Agreement shall apply *mutatis mutandis* to this Addendum.

3. The Recitals under this Addendum form an integral part of the Agreement and are binding on both the Parties.

IN WITNESS WHEREOF, the Parties have executed this Addendum on and as of the date first mentioned above

CERTIFIED TRUE COPY
For Capital Small Finance Bank Ltd.
Authorised Signatory

Capital Small Finance Bank	CRISIL Limited
For CAPITAL SMALL FINANCE BANK LTD	
Signature: AUTHORISED SIGNATORY	Signature:
Printed Name: Munish Jain	Printed Name: Dinesh Agarwal
Title: Executive Director & Chief Financial Officer	Title: Director,Business Development, CRISIL MI&A
Date: January 02 2024	Date: 27th December 2023

Disclaimer

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January 15, 2024

Mr. Munish Jain,

Capital Small Finance Bank
MIDAS Corporate Park
3rd Floor, 37, G.T. Road
Jalandhar 144 001
Punjab, India]

Kind Attn.: Mr. Munish Jain, Executive Director & CFO

Dear Sir,

Re.:
Proposed initial public offering of equity shares of face value of Rs. 10 each (the "Offer") by Capital Small Finance Bank Limited (the "Company"/ "Bank")

We refer to your e-mail/ request dated 27 December 2023 regarding the content provided to you for your internal use by CRISIL Market Intelligence & Analytics (CRISIL MI&A) as part of your subscription to its Industry Research on the following industry:

- *CRISIL Market Intelligence & Analytics (CRISIL MI&A) – [Report on Small Finance Banks and various loan products] [released in Mumbai] in Dec 2023]*

As requested by you, we accord our no objection and give consent to your reproducing content (hereinafter referred to as 'Material') available to you as part of the above subscription in the the red herring prospectus ("**RHP**") and the prospectus ("**Prospectus**") to be filed with the Registrar of Companies, ("**RoC**"), SEBI and the Stock Exchanges, as applicable or any other document to be issued or filed in relation to the Offer, including any publicity or other materials, presentations or press releases prepared by the Company or its advisors, including any international supplement of the foregoing for distribution to investors outside India to be issued or filed and research reports prepared by the Company (collectively along with RHP and Prospectus, "Offer Documents") in relation to the Offer and any other corporate or investor presentations or press releases and research reports prepared by the Company/BRLMs appointed in connection with the Offer, as applicable, or any other document to be issued or filed in relation to the Offer in India, subject to the following:

- Your reproducing the Material on an 'as is where is basis' clearly mentioning the document source & date of release. Eg. - CRISIL MI&A on Report on Small Finance Banks and various loan products,Dec 2023[insert report details].
- Your ensuring that there is no misrepresentation/modification to our views/opinions and that the Material is not mentioned out of context or misguidingly.
- Your ensuring that the Material consisting of charts/graphs also contains the relevant texts explaining the charts / graphs.
- Your ensuring that the Disclaimer of CRISIL (given below) is also reproduced along with the Report, at the relevant place in the Issue Documents.

You agree and undertake not to misrepresent, make any changes to, obliterate or tamper with the Report or present any part thereof out of context or in violation of applicable laws and regulations, if any. Further, you acknowledge and agree that CRISIL does not accept responsibility for the Offer Documents or any part thereof except in respect of and to the extent of the Material reproduced or included in the Offer

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Documents subject to the below stated disclaimer. We confirm that information contained in the Materials have been obtained or derived from publicly available sources and interaction with industry participants, which we consider as reliable and after exercise of reasonable care and diligence by us.

Given below is the disclaimer to be used in the Issue Documents.

"CRISIL Market Intelligence & Analytics (CRISIL MI&A), a division of CRISIL Limited (CRISIL) has taken due care and caution in preparing this report (Report) based on the Information obtained by CRISIL from sources which it considers reliable (Data). This Report is not a recommendation to invest / disinvest in any entity covered in the Report and no part of this Report should be construed as an expert advice or investment advice or any form of investment banking within the meaning of any law or regulation. Without limiting the generality of the foregoing, nothing in the Report is to be construed as CRISIL providing or intending to provide any services in jurisdictions where CRISIL does not have the necessary permission and/or registration to carry out its business activities in this regard. Capital Small Finance Bank Limited will be responsible for ensuring compliances and consequences of non-compliances for use of the Report or part thereof outside India. CRISIL MI&A operates independently of, and does not have access to information obtained by CRISIL Ratings Limited, which may, in their regular operations, obtain information of a confidential nature. The views expressed in this Report are that of CRISIL MI&A and not of CRISIL Ratings Limited. No part of this Report may be published/reproduced in any form without CRISIL's prior written approval."

The Material may be shared by the Company, with the Book Running Lead Manager(s) (and advisers concerned in relation to the Offer (as listed in Annexure A of this Letter). We also consent to the inclusion of the Report and this letter as a part of "*Material Contracts and Documents for Inspection*" in connection with the Offer, which will be available to the public for physical inspection from the date of the Red Herring Prospectus until the Bid / Offer Closing Date and also will also be made available online on the Company website i.e. https://www.capitalbank.co.in/, and the link to where the Report would be accessible would also be included in the UDRHP, RHP and Prospectus and any such other form of access to the Report as may be required under applicable law or regulatory direction, request or order, and we have no objection with you sharing the Report with any regulatory or judicial authority as required by law or regulation in relation to the Offer or pursuant to a request / order passed by any authority.

We understand that this letter does not impose any obligation on the Company or the BRLMs to include in the Offer Documents all or any part of the Material

Further, we consent to the engagement letter [(Reference number: SS/BD/CAPITIALSFB/DRHP/2023CH1201) dated 18th August 2023 and Addendum 2 dated 2nd January 2024] executed between us and the Company being hosted on the website of the Bank, being made available to the public on such website and a link to the Report being disclosed in the Offer Documents.

We confirm that we are not and have not been engaged or interested in the formation or promotion or management of the Company and as per our records and information submitted by the Company, we confirm that the Company, its Promoter, Directors, Key Managerial Personnel and the BRLMs (defined below) as stated in Annexure A are not a related party (as defined under the Companies Act, 2013, as amended) of CRISIL Limited as on the date of this letter.

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We further confirm that we have, where required, obtained requisite consent or duly acknowledged the source(s), as may be required, by any governmental authority or other person, in relation to any information used by us in the Material.

We represent that our execution, delivery, and performance of this consent has been duly authorized by all necessary actions (corporate or otherwise).

This letter may be shared by the Company, with the book running lead managers ("BRLMs") and advisers appointed in relation to the Offer by the Company and the BRLMs. We also authorise you to deliver this letter of consent to SEBI, the Stock Exchanges and the RoC pursuant to Section 26 and Section 32 of the Companies Act 2013, and the rules thereunder, each as amended, or any other legal, governmental or regulatory authority as may be required, in relation to the Offer.

This letter does not impose any obligation on the Company or the BRLMs to include in any Offer Document all or any part of the information with respect to which consent for disclosure is being granted pursuant to this letter provided that the terms of this letter are complied with.

We agree to keep strictly confidential, the non- public information relating to the Issue until such time that: (A) such disclosure by us is approved by the Company; or (B) such disclosure is required by law or regulation; or (C) such information is already in public domain or comes into public domain through no fault of ours.

For CRISIL Limited

CRISIL Limited Mumbai

Rahul Prithiani
Senior Director, CRISIL MI&A

Annexure A:

Key Manegerial Personnel

Sarvjit Singh Samra
Munish Jain
Amit Sharma

Promoters

Sarvjit Singh Samra
Amarjit Singh Samra
Navneet Kaur Samra
Surinder Kaur Samra
Dinesh Gupta

Directors

Navin Kumar Maini
Sarvjit Singh Samra
Munish Jain
Srinath Srinivasan
Mahesh Parasuraman
Dinesh Gupta
Gurpreet Singh Chug
Sham Singh Bains
Nageswara Rao Yalamanchili
Balbir Singh
Rachna Dikshit
Kamaldeep Singh Sangha
Sukhen Pal Babuta

BRLM

Nuvama Wealth Management Limited
DAM Capital Advisors Limited
Equirus Capital Private Limited

Legal advisor

Cyril Amarchand Mangaldas
J. Sagar Associates

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Report on Small Finance Banks and various loan products

Capital Small Finance Bank

December 2023

Macroeconomic Scenario

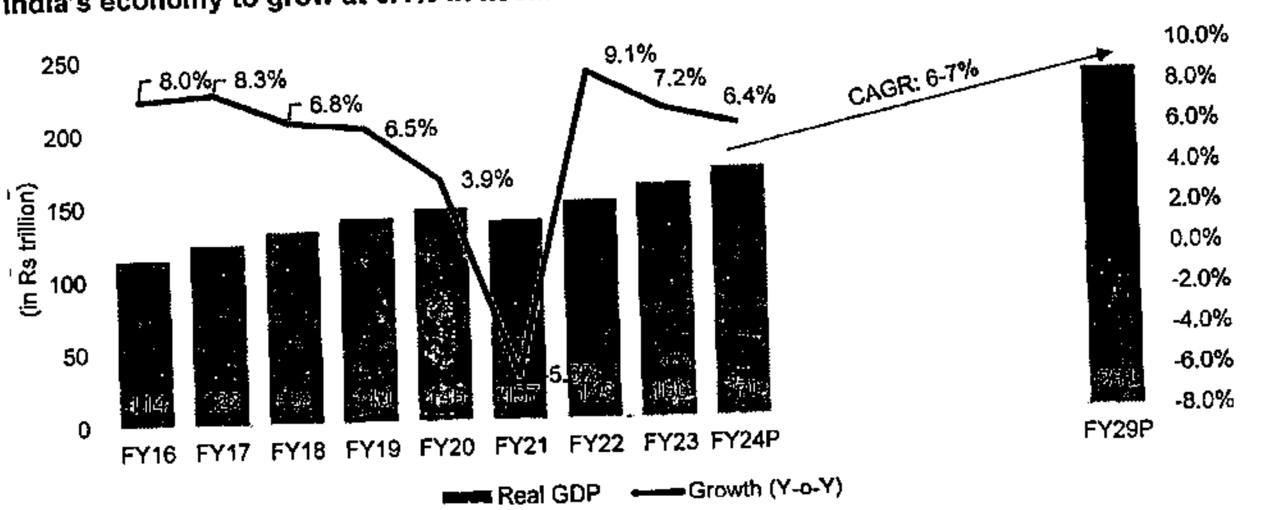
India to expected to remain the fastest growing economy in the world with GDP growth of 6.4 % in Fiscal 2024

The Indian economy was among the fastest-growing in the world prior to onset of the Covid-19 pandemic. In the years leading up to the global health crisis, the country's economic indicators posted gradual improvements. The twin deficits, namely current account and fiscal deficits, narrowed, while the growth-inflation mix showed a positive and sustainable trend. Despite geopolitical instability, India continues to maintain its position as one of the fastest-growing economies globally. This can be attributed to various factors such as demographic advantage, robust domestic demand, economic reforms, manufacturing and infrastructure development, technological advancements, and digital push.

In fact, the International Monetary Fund (IMF), in its October 2023 economic outlook update, revised its India economic growth forecast in real terms for the current fiscal to 6.3% from previous 6.1% estimate in July 2023, citing momentum from stronger-than-expected growth in the fourth quarter of fiscal 2023 as a result of stronger domestic investment. In contrast, global economic growth is projected to decelerate from an estimated 3.5% in 2022 to 3.0% in 2023 and 2.9% in 2024, according to the IMF. While the forecast for 2023 is slightly higher by 0.2% than the earlier estimate, it remains weaker than the historical average.

CRISIL MI&A expects growth outlook for Fiscal 2024 to be fettered with multiple risks including sluggish exports and lagged impact of rate hikes manifested fully into the economy. Nevertheless, India is expected to remain the fastest growing economy in the world with GDP growth of 6.4% projected in Fiscal 2024 as per CRISIL MI&A.

India's economy to grow at 6.4% in fiscal 2024

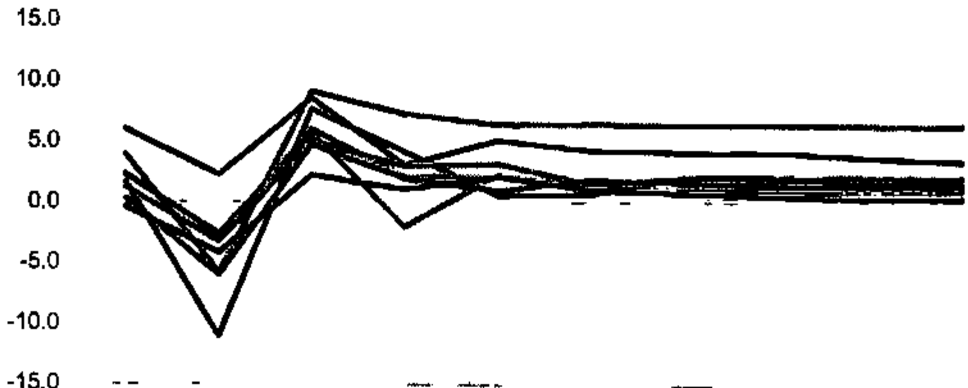


Note: P = Projected, E: Estimates; GDP growth till fiscal 2023 is actuals. GDP Projections for fiscals 2023- 2024 is projected based on CRISIL MI&A estimates and that for fiscals 2025-2029 based on IMF estimates.

Source: NSO, CRISIL MI&A, IMF (World Economic Outlook – October 2023 update)

Over the past three fiscals, Indian economy has outperformed its global counterparts by witnessing a faster growth. Going forward as well, IMF projects that Indian economy will remain strong and would continue to be one of the fastest growing economies.

India is one of the fastest-growing major economies (GDP growth, % year-on-year)



	2019	2020	2021	2022	2023P	2024P	2025P	2026P	2027P	2028P
India	3.9	-5.8	9.1	7.2	6.3	6.3	6.3	6.3	6.3	6.3
China	6.0	2.2	8.5	3.0	5.0	4.2	4.1	4.1	3.7	3.4
United Kingdom	1.6	-11.0	7.6	4.1	0.5	0.6	2.0	2.1	1.8	1.5
United States	2.3	-2.8	5.9	2.1	2.1	1.5	1.8	2.1	2.1	2.1
Brazil	1.2	-3.3	5.0	2.9	3.1	1.5	1.9	1.9	2.0	2.0
Russia	2.2	-2.7	5.6	-2.1	2.2	1.1	1.0	1.0	1.0	1.0
South Africa	0.3	-6.0	4.7	1.9	0.9	1.8	1.6	1.4	1.4	1.4
Japan	-0.4	-4.2	2.2	1.0	2.0	1.0	0.7	0.5	0.4	0.4

Note: All forecasts refer to IMF forecasts. GDP growth is based on constant prices, Data represented is for calendar years, P: Projected; Source: IMF (World Economic Outlook – October 2023 update), CRISIL MI&A

Indian economy to be a major part of world trade

Along with being one of the fastest growing economies in the world, India ranked fifth in the world in terms of nominal GDP for 2023 according to IMF forecasts (World Economic Outlook -October update). India overtook UK to become the fifth largest economy in the world in CY2022. In terms of purchasing power parity ("PPP"), India is the third largest economy in the world, only after China and the United States.

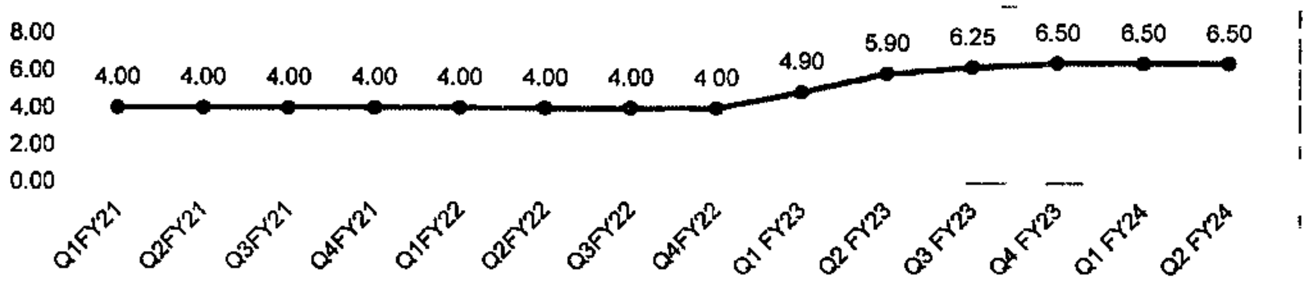
Financial conditions stabilize, broader economy to face elevated rates

The RBI's Monetary Policy Committee (MPC) is expected to be on an extended pause for the next few meetings, as it evaluates the inflation trajectory and growth momentum. The impact of past rate hikes on growth will be the most prominent in the current fiscal. As growth slows, CRISIL MI&A expects RBI to initiate rate cuts in the last quarter of fiscal 2024. While the pause on rate hikes has augured well for financial markets, elevated bank lending rates could tighten financial conditions for some segments of the economy which could ease down subsequently basis the direction of the economy. As the RBI noted in its October monetary policy, bank lending and deposit rates have not increased to the same extent as the repo rate in the current rate hike cycle. It has taken measures to speed up transmission of rate hikes, such as open market sales to reduce excess liquidity, and regulatory measures to temper credit growth (increasing risk weights for unsecured consumer credit and non-bank financial companies). Bank lending rates are already above average seen in the 5 years preceding the pandemic, and further rise in borrowing costs could moderate domestic demand.

Repo rate remains unchanged, with phase of aggressive rate hikes behind us

In fiscal 2023, the Reserve Bank of India (RBI) raised the repo rate by 90 basis points ("bps") in Q1, and since then, it has continued to increase every quarter. By Q2 of fiscal 2024, the repo rate reached 6.50 per cent, which signifies a substantial increase of 250 bps from Q1 of fiscal 2023. The initial rate hike occurred in May 2022, when the central bank's rate-setting panel unanimously raised the benchmark lending rate by 40 bps. However, the repo rate remains unchanged in Q2 of fiscal 2024 as compared to Q4 of fiscal 2023.

Repo rate in India (%)

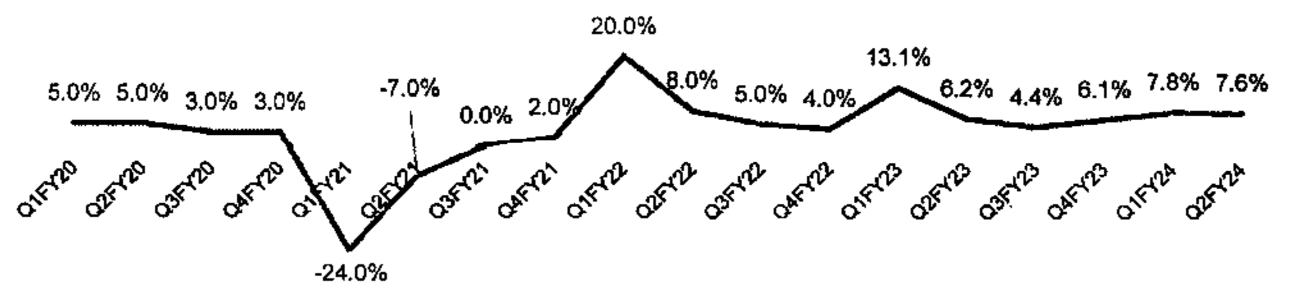


Source: RBI, CRISIL MI&A

MPC maintains status quo on monetary policy

The Monetary Policy Committee (MPC) of the Reserve Bank of India (RBI) kept its policy rates unchanged in the December meeting for the fifth consecutive time. It also maintained its stance of 'withdrawal of accommodation' to progressively align inflation to 4%, the mid-point of the RBI's target range. The central bank highlighted continued vigilance on inflation and global and financial risks. The bank also announced regulatory measures for lending in certain fast-growing consumer segments. The Central bank revised its GDP growth forecast for Fiscal 2024 by 50 basis points to 7.0% following a stronger than expected performance in the second quarter. RBI does not see significant comfort on inflation yet, with upside risks from food prices. Growth is expected to slow down from 7.6% in Q2FY24 to 6.5% in Q3FY24 and 6.0% in Q4FY24. In Fiscal 2025, growth is expected to stay resilient at 6.7% in the first quarter, 6.5% in second quarter and 6.4% in the third quarter according to RBI with risks evenly balanced.

Trend in real GDP year-on-year growth rate on quarterly basis



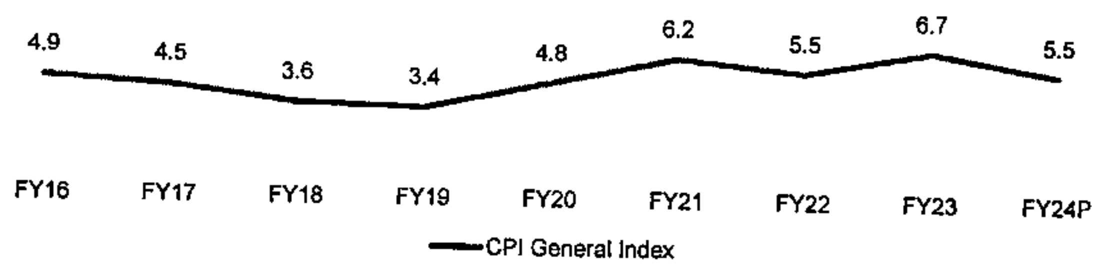
Source: CSO, RBI, CRISIL MI&A

Consumer Price Index ("CPI") inflation to average at 5.5% in Fiscal 2024

Inflation based on the consumer price index (CPI) rose to 5.6% in November from 4.9% in October on account of jump in the prices of vegetables, fruits, sugar and pulses that lifted food inflation to 8.7% in November from 6.6% in October. However, non-food CPI softened further. The recurring flare-ups in food prices are a remainder that as long as food prices reman high and volatile, they will inflect upon headline inflation and hence the monetary policy. The non-food CPI inflation remained supportive on account of a sharper fall in fuel inflation (on account of lower oil prices) and reduced retail price of LPG. Core inflation stood at 4.1% in November reflecting impact of lower input costs in general and softening domestic demand as compared with previous quarters. Core inflation which is the stickier part of inflation has been steadily softening since July and hence been a relief to monetary policy. Vegetables inflation jumped to 17.7% in November from 2.8% in October driven by a sharp rise in the prices of tomatoes and onions. CRISIL MI&A expects that RBI would closely monitor inflation as it remains above the MPC's long term target of 4.0%.

For Fiscal 2024, CRISIL MI&A expects CPI inflation to come down, averaging 5.5% on-year, within the RBI's target range of 4-6% and foresee the RBI holding interest rates steady for the remainder of this fiscal. A combination of three factors — impact of rising interest rates on domestic demand, a global demand slowdown leading to falling international commodity prices, and the base effect — should lead to lower inflation. While softening core inflation rules out a possibility of a rate hike, high food prices and 'higher for longer' stance of the western central banks will not permit an early rate cut.

Inflation to moderate to 5.5% in Fiscal 2024



Source: Note: P = Projected, CRISIL MI&A

Macroeconomic outlook for Fiscal 2024

Macro variables	FY23	FY24P	Rationale for outlook
GDP (y-o-y)	7.2%	6.4%	Slowing global growth is likely to weaken India's exports in Fiscal 2024. Domestic demand could also come under pressure as Reserve Bank of India (RBI) rate hikes are transmitted to consumers. Despite the lower forecast, India continuous to grow at highest rate in world.
Consumer price index (CPI) inflation (y-o-y)	6.7%	5.5%	Lower commodity prices, base effect, and cooling off domestic demand is likely to help in moderating inflation in Fiscal 2024.

10-year Government security yield (Fiscal end)	7.4%	7.0%	A moderate increase in gross market borrowings is budgeted for Fiscal 2024. This, coupled with lower inflation, is likely to moderate yields in Fiscal 2024.
CAD (Current account balance)/GDP (%)	-2.0%	-1.8%	Lower commodity prices, especially in energy space and support from healthy services exports is expected to lead to moderation of trade deficit in Fiscal 2024
Rs/$ (March average)	82.3	83.0	While a lower current account deficit (CAD) will support the rupee, challenging external financing conditions will continue to exert pressure in the next Fiscal. However, the overall impact on the rupee is expected to remain below the levels indicated by current forward premiums for the year.

Note: P – Projected; Source: Reserve Bank of India (RBI), National Statistics Office (NSO), CRISIL MI&A

Positive government measures to aid economic growth

Going forward, CRISIL MI&A expects India's gross domestic product (GDP) growth to decelerate to 6.4% in Fiscal 2024 from 7.2% in Fiscal 2023 due to a global slowdown, monetary policy impact and volatile geopolitical scenario. However, some optimism can be seen in form of moderating consumer inflation, capital and productivity increases aided by better physical and digital infrastructure. CRISIL MI&A expects this growth to be supported by the following factors:

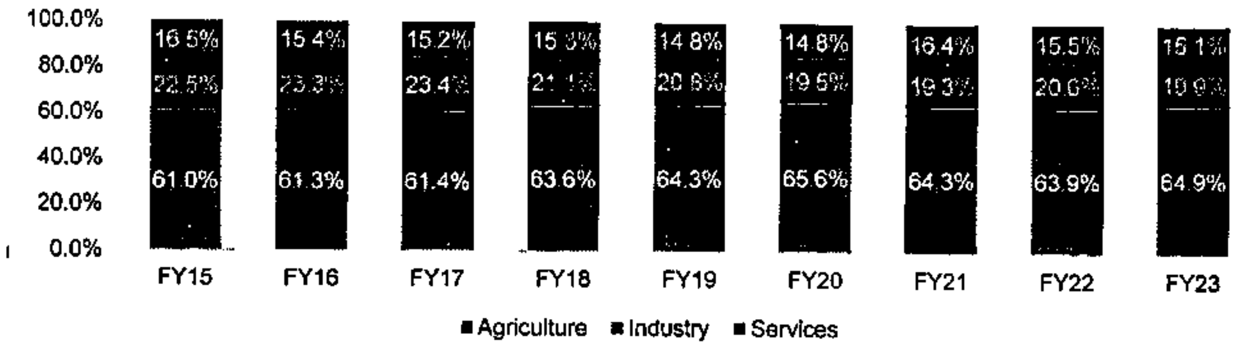
- The **Union Budget 2023-24** announced by Finance Minister highlighted that the government has set 7 priorities – Inclusive Development, Reaching the last mile, Infrastructure and Investments, Unleashing the Potential, Green Growth, Youth power and Financial Sector, which they called **'Saptarshi'**, which will strive to turn India into a developed country
- One key area of announcement was towards Support in technological advancement would promote financial inclusion, ensure better availability of customer data, enable faster and secure sharing of documents with financial institutions and increase rural penetration. This will in turn is expected lead to improving efficiency in terms of operating and credit cost for financial institutions.
- The increase in aggregate budgetary support for infrastructure by 17% to reach Rs. 12.5 trillion lays emphasis on the broad plan for infrastructure spending by the Government that is expected to give a push to economic growth. The railways capex has been increased by 15% over fiscal 2023 and capex for roads and highways was increased by 25% over fiscal 2023. These capex initiatives are expected to drive economic growth.
- Production linked incentive (PLI) scheme, which aims to incentivise local manufacturing by giving volume-linked incentives, has been launched by the government for six of India's top 10 export verticals, which is likely to propel incremental exports. In Fiscal 2024, PLI-driven exports will be the lone growth driver for India, helping improve the overall export growth to 2-4%.
- Government has launched two key initiatives to promote financial inclusion, Pradhan Mantri Jan Dhan Yojna (" PMJDY") and Pradhan Mantri Jeevan Jyoti Bima Yojna ("PMJJBY"), under PMJDY it aims to ensure a bank account in every household to avail all financial services. Under PMJJBY, one year life insurance is offered with a life cover of Rs. 0.2 million at a premium of Rs. 330 per annum per member, which can be renewed every year.

- Focus on investments rather than consumption push enhancing the productive capacity of the economy. Policy pushes and new age opportunities to lead capex growth in Fiscal 2024.
- Policies aimed towards greater formalisation of the economy, which are bound to lead to an acceleration in per capita income growth.

Contribution of various sectors to India's GDP

As compared to various developed economies, which witnessed a good contribution from manufacturing and industry first and subsequently in services, the Indian transformation story has been different. A notable feature of Indian economy has been the services sector's rising contribution to the overall output of the economy. Over fiscals 2018 to 2020, the service sector has grown at a rate of approximately 7%, thereby increasing the contribution of services sector to 65.6% in fiscal 2020 in terms of Gross Value Added (GVA) at constant prices. In Fiscal 2023, overall GVA expanded by approximately 7.0%.

Share of sector in GVA at constant prices



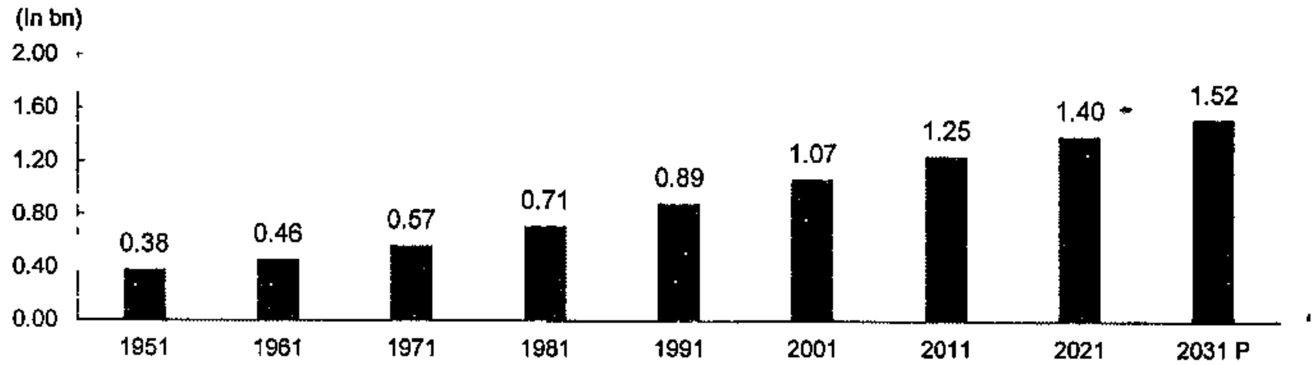
Source: RBI; CRISIL MI&A

Key growth drivers

India has the world's largest population

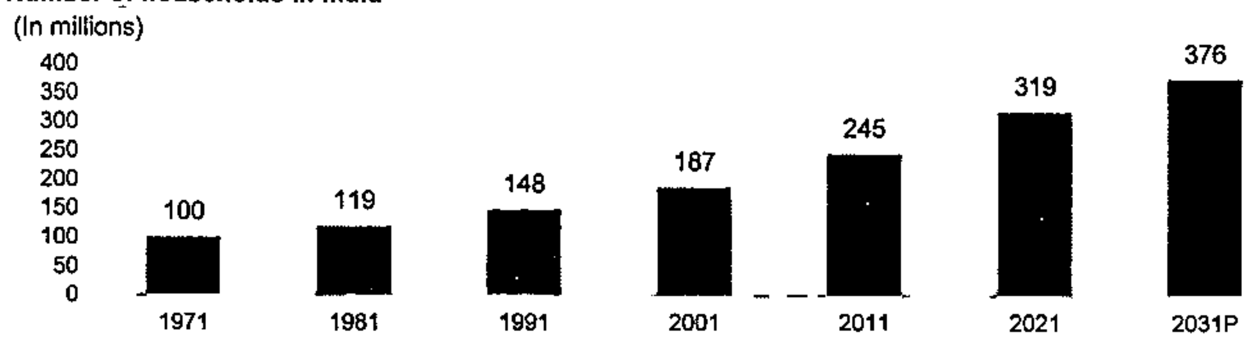
As per Census 2011, India's population was ~1.25 billion, and comprised nearly 245 million households. The population, which grew at nearly 1.5% CAGR between 2001 and 2011, is expected to increase at 1.1% CAGR between 2011 and 2021, to 1.4 billion. The population is expected to reach 1.5 billion by 2031, and number of households are expected to reach ~376 million over the same period.

India's population growth trajectory



Note: P: Projected, Source: United Nations Department of Economic and Social affairs[1], CRISIL MI&A

Number of households in India

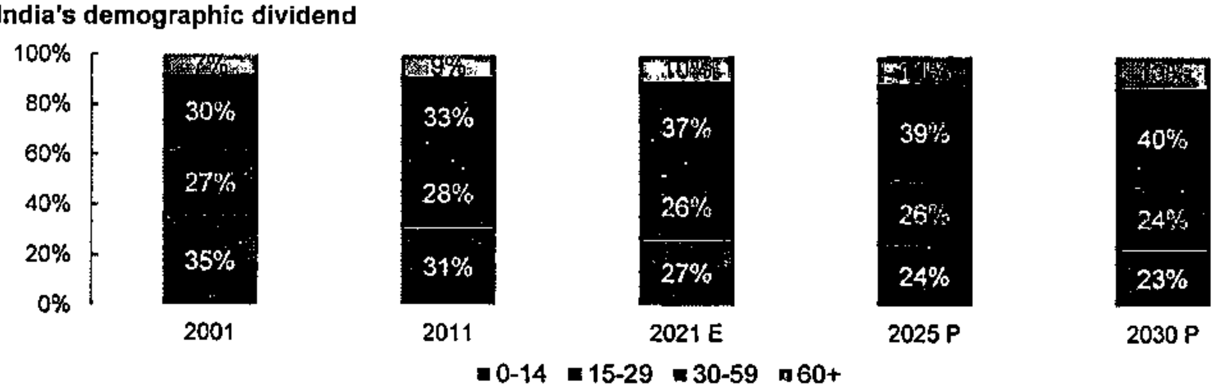


Note: P: Projected, Source: Census India, CRISIL MI&A

Favourable demographics

As of calendar year 2022, India has one of the largest young populations in the world, with a median age of 28 years. CRISIL MI&A estimates that approximately 90% of Indians are still below the age of 60 in calendar year 2021 and that 63% of them are between 15 and 59 years. In comparison, in calendar year 2020, the United States (US), China and Brazil had 77%, 83% and 86%, respectively, of their population below the age of 60.

India's demographic dividend



Note: E: Estimated, P: Projected, Source: United Nations Department of Economic and Social affairs[2], CRISIL MI&A

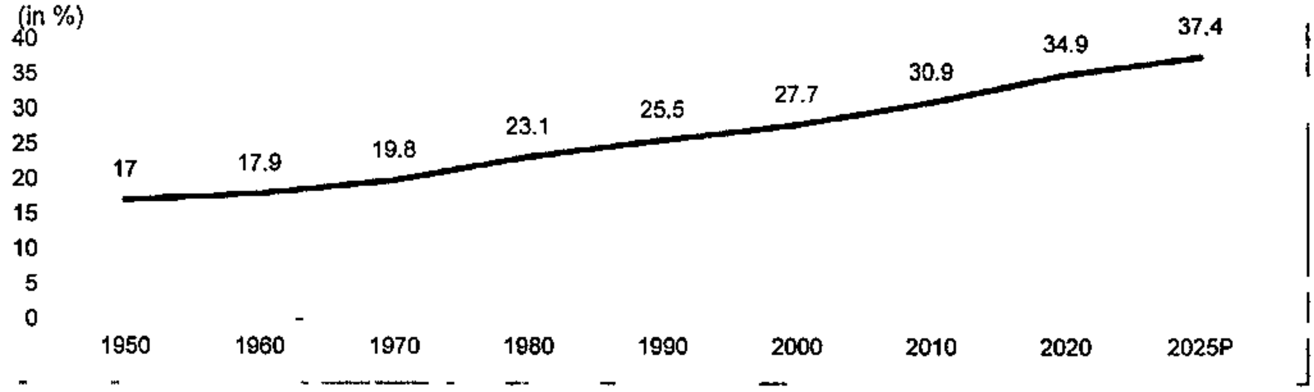
[1] https://population.un.org/wpp/

[2] https://population.un.org/wpp/

Urbanisation

Urbanisation is one of India's most important economic growth drivers. It is expected to drive substantial investments in infrastructure development, which in turn is expected to create jobs, develop modern consumer services and increase the ability to mobilise savings. India's urban population has been rising consistently over the decades. In 1950, it was 17% of total population. As per the 2018 revision of World Urbanization prospects, it was estimated at 34.9% for India. This is expected to reach 37.4% by 2025.

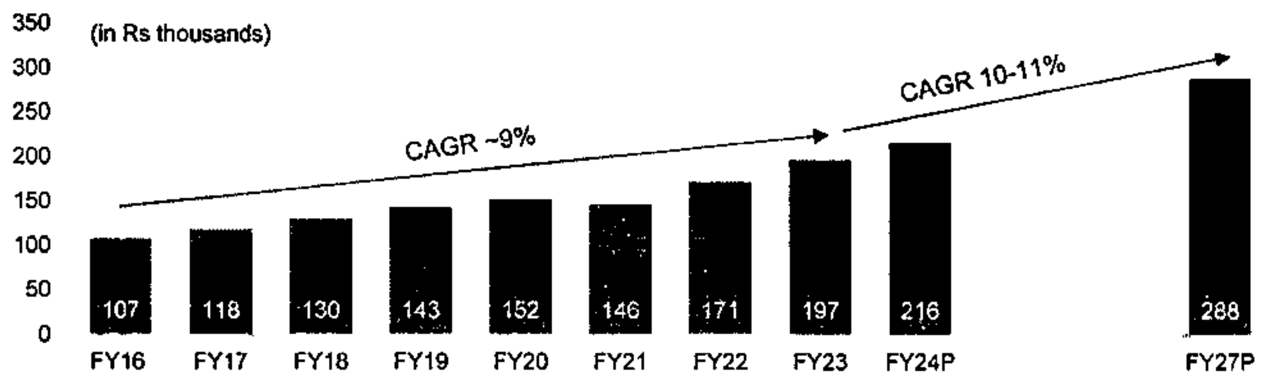
Urban population as a percentage of total population (%)



Note: P – Projected, Source: Census 2011, World Urbanization Prospects: The 2018 Revision (UN)[3]

Trend in Nominal GDP per capita (at current prices)

As per IMF's estimates, India's nominal GDP per capita (at current prices) is projected to increase at a CAGR of 10-11% from FY2023 to FY2027.



Notes: P- Projected, FY23 estimates based on second advanced estimates by Ministry of Statistics and Program Implementation FY24 – FY27 Projections based on IMF – World Economic Outlook (October 2023 update)
Source: MOSPI, IMF, CRISIL MI&A

Rising Middle India population to help sustain growth

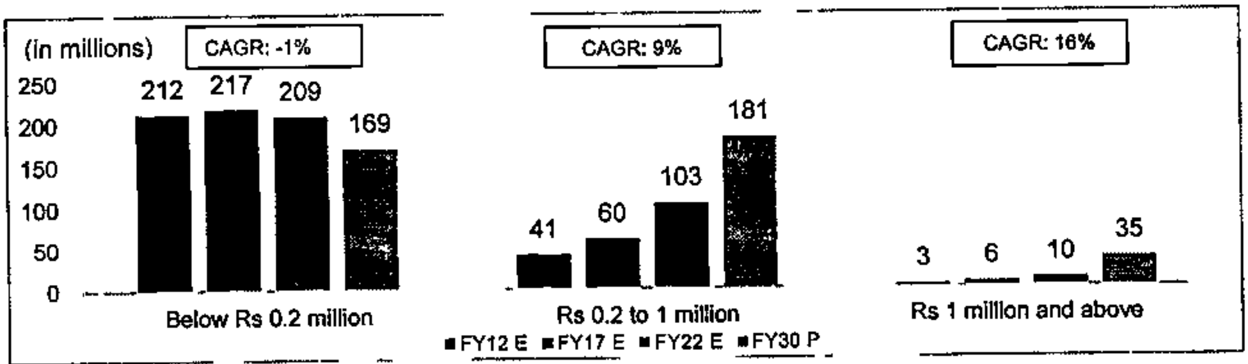
Proportion of Middle India (defined as households with annual income of between Rs. 0.2 to 1 million) has been on a rise over the last decade and is expected to grow further with continuous increase in the GDP and household

[3] *https://population.un.org/wup/*

incomes. To illustrate, CRISIL MI&A estimates that there were 41 million households in India in this category as of Fiscal 2012, and by Fiscal 2030, they are projected to increase to 181 million households translating into a CAGR of 9% over this time period. This growth in the number of middle-income households is expected to lead to enhanced opportunities for retail and MSME financiers as well as consumer goods marketers. A large number of these households, which have entered the Middle-Income bracket in the last few years, are likely to be from semi-urban and rural areas. The rise in incomes in these areas is also evident when one observes the trend in share of deposits coming into banks.

Consistent improvement in the literacy levels, increasing access to information and awareness, increase in the availability of basic necessities such as electricity, cooking gas, toilets and improvement in road infrastructure has led to an increase in aspirations of Middle India, which is likely to translate into increased opportunities for financial service providers. In fact, some of these trends are already visible. Smart phone ownership, internet users and the proportion of users accessing social media is increasing at a breakneck speed. Smaller cities and towns (with population less than 1 million) account for a significant portion of sales of e-retailers.

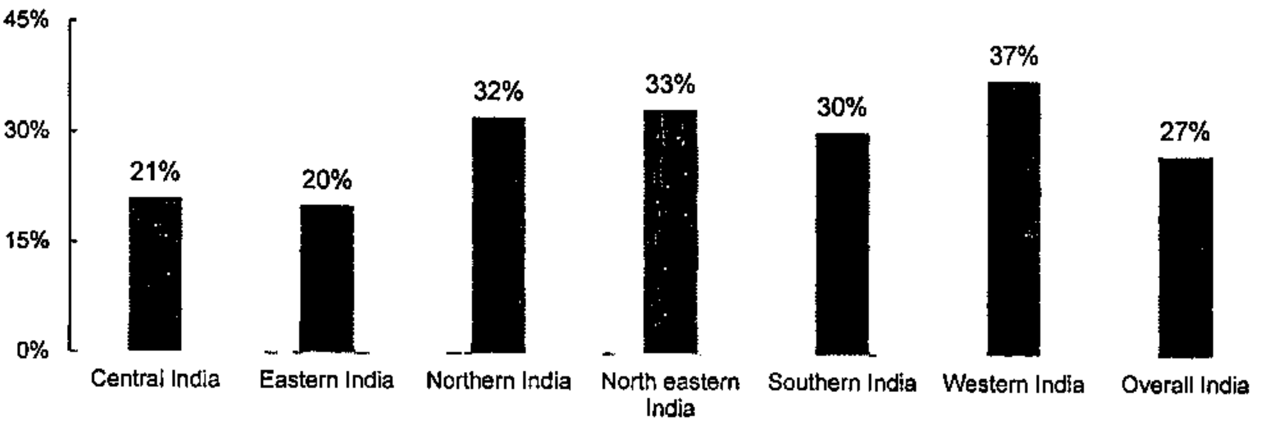
Middle India households to witness high growth over Fiscal 2012 to Fiscal 2030



Note: E: Estimated, P: Projected; Source: CRISIL MI&A

With increasing financial literacy, mobile penetration, awareness and the Prime Minister's Jan Dhan Yojana bank accounts (scheme aimed at bringing the unbanked under the formal banking system), there has been a rise in the participation of individuals from non-metro cities in banking. With more people attached to the formal banking sector, the demand for financial products in smaller cities has seen a major increase in recent years. Going forward, CRISIL MI&A expects financial penetration to increase on account of increasing financial literacy.

Financial Literacy across India (2019)

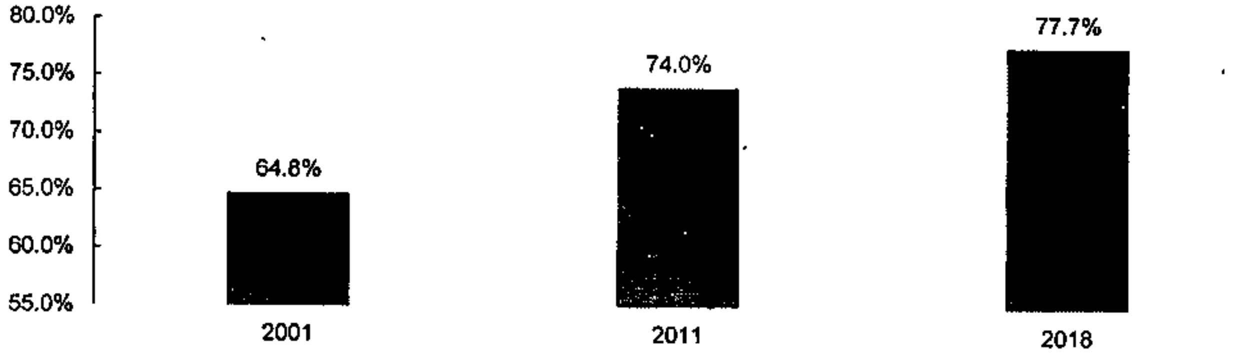


Source: National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019 Report, National Centre for Financial Education

Financial penetration to rise with increase in awareness of financial products

Overall literacy in India is at 77.7% as per the results of recent NSSO survey conducted in 2018 which is still below the world literacy rate of 86.5%. However, according to the National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019, only 27% of Indian population is financially literate indicating huge gap and potential for financial services industry. The survey defines financial literacy as combination of awareness, knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing. India's financial inclusion has improved significantly over calendar years 2014 to 2021 as adult population with bank accounts increased from 53% to 78% (Source: Global Findex Database) due to the Indian government's efforts to promote financial inclusion and the proliferation of supporting institutions.

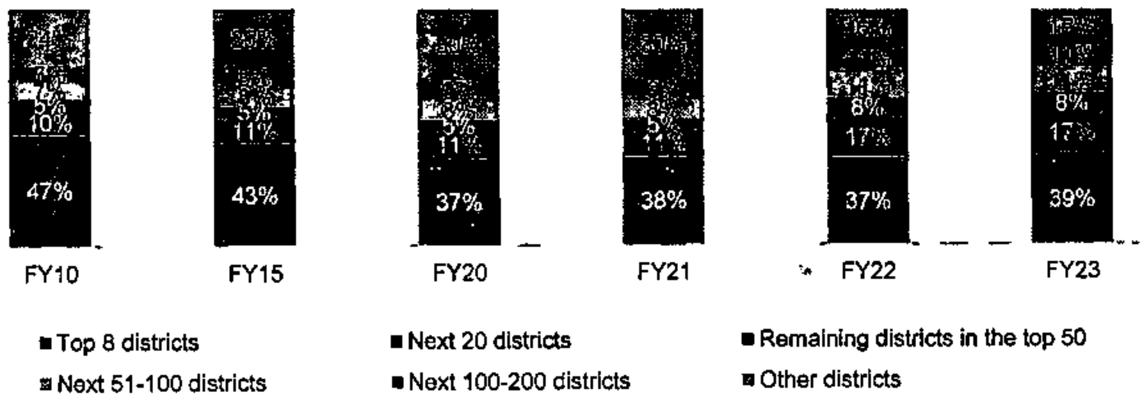
Overall literacy rate on a rise in India



Source: Census 2011, NSO Survey on household social consumption (2017-18), CRISIL MI&A

With increasing financial literacy, mobile penetration, awareness and the Prime Minister's Jan Dhan Yojana bank accounts (scheme aimed at bringing the unbanked under the formal banking system), there has been a rise in the participation of individuals from non-metro cities in banking. With more people attached to the formal banking sector, the demand for financial products in smaller cities has seen a major uptick in recent years. Going forward, CRISIL expects financial penetration to increase on account of increasing financial literacy.

Share of top 8 cities in banking deposits exhibits a reducing trend indicating increasing financial penetration



Note: 1) Classification of districts is done based on population as per Census 2011;
2) Mumbai Metropolitan Region (MMR), National Capital Region (NCR), Bengaluru and Kanpur have each been considered as a district.
3) MMR includes Thane and Mumbai, NCR includes Delhi, Gurugram, Geutem Buddha Nagar, Ghaziabad and Faridabad, Bengaluru includes Bangalore Urban and Bangalore Rural, Kanpur includes Kanpur Nagar and Kanpur Dehat
Source: RBI, CRISIL MI&A

The two key initiatives launched by the Government to promote financial inclusion are the Pradhan Mantri Jan Dhan Yojana (**PMJDY**) and Pradhan Mantri Jeevan Jyoti Bima Yojana (**PMJJBY**). Under the PMJDY, the Government's aim is to ensure that every household in India has a bank account which they can access from anywhere and avail uof all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJJBY is a one-year life insurance scheme that offers a life cover of Rs. 0.2 million at a premium of Rs. 330 per annum per member, which can be renewed every year. The Government has also launched the Pradhan Mantri Suraksha Bima Yojana (PMSBY), an accident insurance policy that offers an accidental death and full disability cover of Rs. 0.2 million at a premium of Rs. 12 annually. As per the Government, more than 100 million people have registered for these two social security schemes.

PMJDY launched in August 2014, is aimed at ensuring that every household in India has a bank account, which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJDY focuses on household coverage compared to the earlier schemes that focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India.

Account Aggregators framework to build a financial data ecosystem in India

On 2nd September 2021, RBI launched the Account Aggregators scheme, which is a framework to allow financial data more accessible by creating intermediaries called account aggregators. These intermediaries will collect and share financial information to various entities. It is a big step towards creating a financial ecosystem where it will save transaction cost and ensure a person's credit worthiness.

PLI scheme to boost manufacturing in the long run

The Government has budgeted ~Rs.2 trillion to give incentives to the locally manufacturing units to 13 key sectors. The key sectors to get benefit from the scheme include automobiles, pharma, telecom, electronics, food, textile, steel, and energy. By incentivising production subject to achieving the desired scale, the scheme aims to spawn a handful of globally competitive large scale manufacturing units in the identified sectors. Furthermore, the Government also hopes to reduce India's dependence on raw material imports from China. The scheme is expected to provide a boost to India's exports and economic growth over the medium-term and create more employment opportunities as many of these sectors are labour intensive in nature. Along with the PLI, entering into free trade agreements with key importing countries will also be critical.

The rate of incentives offered under PLI are measured as a percentage of incremental sales over 5–7-year period varies between 4-6% for mobile phones and white goods, 5-20% for pharma active ingredients and 8-18% for auto and auto components. CRISIL MI&A expects the PLI scheme to lead a potential overall capex of Rs. 2.5-3 trillion over the scheme period.

Digitisation aided by technology to play pivotal role in growth of economy

Technology is expected to play an important role by progressively reducing the cost of reaching out to smaller markets. India has seen a tremendous rise in fintech adoption in the past few years and has the highest fintech adoption rate globally of 87% which is significantly higher than the global average rate of 64% *(Source: InvestIndia)*. Among many initiatives by the government, the Unified Payments Interface (UPI) is playing a pivotal role towards financial inclusion. It provides a single-click digital interface across all system for smartphones linked to bank accounts and facilitates easy transactions using a simple authentication method. The volume of digital transactions has also seen a surge in the past few years, driven by increased adoption of UPI. Apart from financial services industry, digitisation in other industries like retail will also play an important role in growth of economy.

UPI usage data statistics

As of month, end	No of banks live on UPI	Volume of transactions (million)	Value of transactions (Rs. billion)	YoY growth (on value basis) in transactions (%)
March 2018	91	178	242	764%
March 2019	142	800	1,335	452%
March 2020	148	1,247	2,065	55%
March 2021	216	2,731	5,048	210%
March 2022	314	5,406	9,606	90%
March 2023	399	8,652	14,104	47%
April 2023	414	8,863	14,070	43%
May 2023	445	9,415	14,891	43%
June 2023	458	9,335	14,755	45%
July 2023	473	9,965	15,336	44%
August 2023	484	10,586	15,765	47%
September 2023	492	10,556	15,791	41%
October 2023	505	11,409	17,158	42%
November 2023	516	11,235	17,397	46%

December 2023	NA	12,020	18,229	42%

Note: NA: Not Available; Source: National Payments Corporation of India (NPCI), CRISIL MI&A

Over the years, India has witnessed a strong push from government to improve the digital payments infrastructure in the country. On August 2, 2021, a digital payment instrument, namely e-RUPI, was launched. This instrument is developed over the existing UPI platform by National Payments Corporation of India (NPCI), in collaboration with Department of Financial Services, Ministry of Health and Family Welfare and the National Health Authority. e-RUPI is a cashless and contactless instrument for digital payment. It is a QR code or SMS string-based e-voucher, which is delivered to the mobile of the beneficiaries. The users of this seamless one-time payment mechanism will be able to redeem the voucher without a card, digital payments app or internet banking access, at the merchants accepting e-RUPI. e-RUPI would be shared with the beneficiaries for a specific purpose or activity by organizations or Government via SMS or QR code.

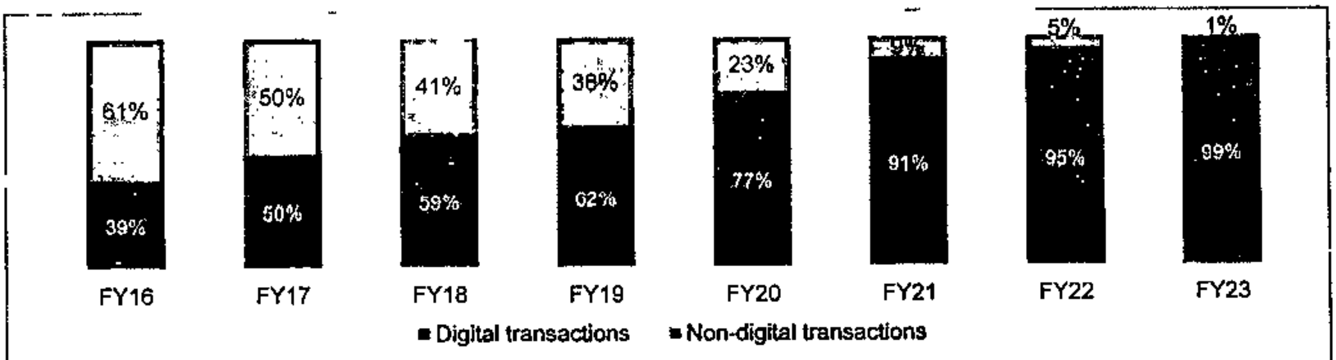
Increasing share of digital channels in domestic monetary transactions

The share of different channels in domestic money transfer has changed significantly over the past five years. Banks, for example, are witnessing a change in customer behaviour with fewer customers visiting bank branches for transactions. This change in behaviour was led by demonetisation when cash transactions slowed down, many new accounts were opened, and digital banking witnessed a surge in use and continued its growth trajectory. The preference has also shifted from cost factors to convenience and ease of performing transactions, which helps in saving time spent in queues, not disturbing the daily working hours and avoiding any potential monetary loss. Post-COVID-19, with consumers preferring to transact digitally rather than engage in physical exchange of any paper or face-to-face contact, digital transactions have received another shot in the arm.

Digital payments have witnessed substantial growth

Total digital payments in India have witnessed significant growth over the past few years. Between Fiscal 2018 and 2023, the volume of digital payments transactions has increased from 13.9 billion to 113.9 billion respectively, causing its share in overall payment transactions to increase from 59% in Fiscal 2018 to 99% in Fiscal 2023. During the same period, value of digital transactions has increased from Rs. 1,371 trillion in Fiscal 2018 to Rs. 2,087 trillion in Fiscal 2023.

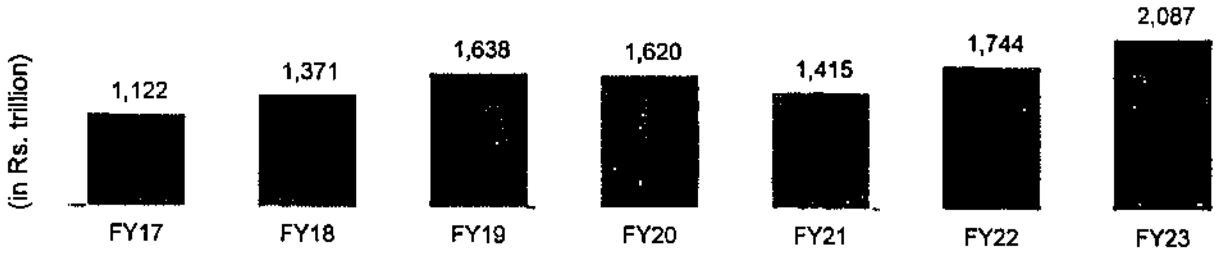
Trend in volume of digital payments



Note: Digital Payments includes RTGS payments, Credit transfers (AePS, APBS, ECS Cr, IMPS, NACH, NEFT, UPI), Debit Transfers (BHIM, ECS Dr, NACH Dr, NETC), Card Payments (Debit and Credit Cards) and Prepaid Payments Instruments

Source: RBI, CRISIL MI&A

Trend in value of digital payments



Note: Digital Payments includes RTGS payments, Credit transfers (AePS, APBS, ECS Cr, IMPS, NACH, NEFT, UPI), Debit Transfers (BHIM, ECS Dr, NACH Dr, NETC), Card Payments (Debit and Credit Cards) and Prepaid Payments Instruments
Source: RBI, CRISIL MI&A

Key structural reforms: Long-term positives for the Indian economy

Financial inclusion

According to the World Bank's Global Findex Database 2021, the global average of adult population with an account (with a bank, financial institution, or mobile money providers) was ~76% in 2021. India's financial inclusion has improved significantly between 2014 and 2021, with the adult population with bank accounts rising from 53% (as per Global Findex Database 2014) to 78% in 2021 with concerted efforts by the government to promote financial inclusion and the proliferation of supporting institutions. That said the rise in the number of bank accounts has not translated into a corresponding increase in the number of transactions and fruitful usage of those accounts.

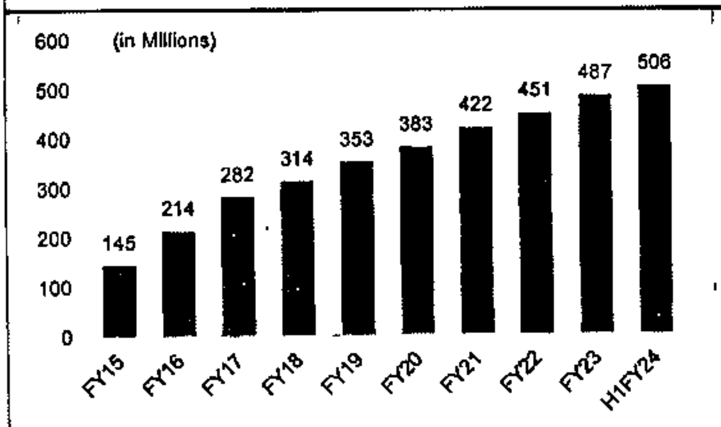
As per the Global Findex Database 2021, ~50% of the world's unbanked adults are in India, Bangladesh, China, Egypt, Indonesia, Nigeria and Pakistan. Of the world's total unbanked adults (~1.4 billion), 54% of the unbanked, 740 million are from just these seven countries. India (17% or 230 million) and China (9% or 130 million), despite having high rates of account ownership, have the highest share of unbanked adults in the world because of their huge population.

The two key initiatives launched by the government to promote financial inclusion are the Pradhan Mantri Jan Dhan Yojana (PMJDY) and Pradhan Mantri Jeevan Jyoti Bima Yojana (PMJJBY). Under the PMJDY, the government's aim is to ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJJBY is a one-year life insurance scheme that offers a life cover of Rs. 0.2 million at a premium of Rs. 330 per annum per member, which can be renewed every year. The government has also launched the Pradhan Mantri Suraksha Bima Yojana (PMSBY), which is an accident insurance policy and offers an accidental death and full disability cover of Rs. 0.2 million at a premium of Rs. 12 annually. As per the Government of India, more than 100 million people have registered for these two social security schemes.

Pradhan Mantri Jan Dhan Yojana (PMJDY) launched in August 2014, is aimed at ensuring ensure that every household in India has a bank account which they can access from anywhere and avail of all financial services such as savings and deposit accounts, remittances, credit and insurance affordably. PMJDY focuses on household coverage compared with the earlier schemes that focused on coverage of villages. It aims to extend banking facilities to all within a reasonable distance in each sub-service area (consisting of 1,000-1,500 households) across India.

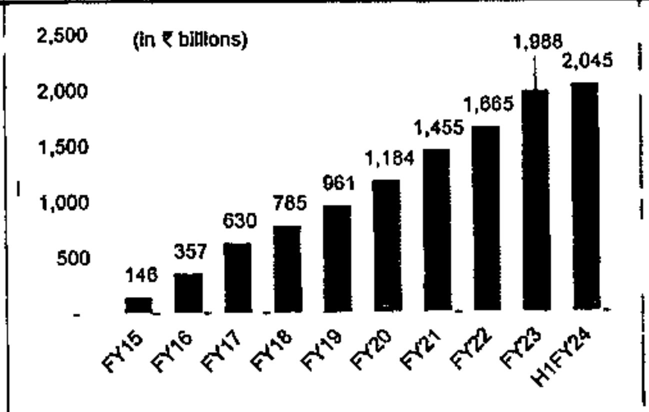
As of September 30, 2023, 506 million PMJDY accounts had been opened, of which, 67% were in rural and semi-urban areas, with total deposits of ₹ 2,045 billion.

Number of PMJDY accounts



Note: As at the end of each Fiscal and as of September 2023 for H1FY24; Source: PMJY; CRISIL MI&A

Total balance in PMJDY accounts



Note: As at the end of each Fiscal and as of September 2023 for H1FY24; Source: PMJY; CRISIL MI&A

GST implementation

Introduced on July 1, 2017, the GST is an indirect tax regime that subsumed multiple cascading taxes levied by the central and state governments. Its implementation has spawned structural changes in the supply chain and logistics network in the country. The crux of the GST mechanism is input tax credit, which ensures more players in the supply chain come under the tax ambit. As supply from only registered taxpayers will get input tax credit, businesses and stakeholders will insist on registration of their suppliers and traders, leading to an increase in the share of organised participants. The GST regime has been stabilising fast and is expected to bring more transparency and increase in formalisation, eventually leading to higher economic growth.

PLI scheme to boost manufacturing in the long run

The government has budgeted ~Rs 2 trillion to give incentives to the local manufacturing units in 13 key sectors. The key sectors likely to get benefit from the scheme include automobiles, pharma, telecom, electronics, food, textile, steel and energy. By incentivising production subject to achieving the desired scale, the scheme aims to spawn a handful of globally competitive large scale manufacturing units in the identified sectors. Furthermore, the government also hopes to reduce India's dependence on raw material imports from China. The scheme is expected to provide a boost to economic growth over the medium-term and create more employment opportunities as many of these sectors are labour intensive in nature.

Broad Sector	Segment	Budgeted (Rs. Bn) *	
Automobiles	Advance Chemistry Cell (ACC) Battery	181	751
	Automobiles & auto components	570	
Electronics	Mobile manufacturing and specified electronic Components	409	521
	Electronic/technology products	50	

Broad Sector	Segment	Budgeted (Rs. Bn) *	
	White goods (ACs & LED)	62	
Pharma and medical equipment	Critical key starting materials/drug intermediaries and active pharmaceutical ingredients	69	253
	Manufacturing of medical devices.	34	
	Pharmaceuticals drugs	150	
Telecom	Telecom & networking products	122	122
Food	Food products	109	109
Textile	Textile products: MMF segment and technical textiles	107	107
Steel	Speciality steel	63	63
Energy	High efficiency solar PV modules	45	45
Total			1,972

Approved financial outlay over a five-year period, Source: Government websites; CRISIL MI&A

Thrust on affordable housing

The residential real estate segment saw two policy changes – Real Estate (Regulation and Development) Act (RERA) and Goods and Services Tax (GST) – which had a direct impact on the sector's demand-supply dynamics. Consequently, new launches dropped sharply, with developers focussing on completing ongoing projects. The sector had been battling weak demand for the past couple of years, and one of the key reasons was unaffordability, as developers focussed on the middle and premium income-category projects. However, government initiatives have prompted developers to explore affordable housing as a new area. Going ahead, about half of the incremental supply being added in urban stock is expected to be via affordable housing. Additionally, the formalisation of the industry is likely to bring in more transparency, leading to an increase in consumer demand.

In a major relief to real estate sector, the government has extended the timelines of RERA projects by six months for projects expiring on or after March 25, 2020. Further, in affordable housing, it has extended the deadline to March 31, 2022, for first time homebuyers to avail additional Rs 150,000 interest deduction on home loans. PMAY U and G have been focused to provide affordable housing for lower income group and Economic weaker section households which is nothing but affordable housing in country. The government remains focused on the PMAY U and G, and as of January 2024, construction of close to 33.2 million homes across urban and rural regions have been completed.

PMAY Gramin (Rural)

Under the PMAY-Gramin (PMAY-G), as many as ~25.3 million houses were completed as of January 3, 2024. The government has set up a target of constructing 29.5 million houses by fiscal 2024 under the scheme. CRISIL MI&A believes budgetary allocation for the scheme is insufficient. As a result, it will have to rely heavily on extra budgetary resources raised through NABARD bonds. Till January 3, 2024, around 29.4 million houses were sanctioned under PMAY Gramin.

PMAY G status (as of January 3, 2024)

	Target (MoRD)	Sanctioned	Completed	Funds Released (Rs. trillion)
PMAY G	29,500,000	29,446,513	25,301,519	3.22

Note: MoRD: Ministry of Rural Development, Source: PMAY-G, CRISIL MI&A

PMAY Urban

On 10th August 2022, the Union Cabinet approved the proposal of Ministry of Housing and Urban Affairs (MoHUA) for continuation of Pradhan Mantri Awas Yojana- Urban (PMAY-U) up to 31st December 2024, wherein financial assistance is to be provided for completion of all 122.69 lakh houses sanctioned till 31st March 2022. As on July 10, 2023, the Government had sanctioned over Rs. 2.0 trillion towards this scheme. However, the central assistance released is about Rs 1.55 trillion, which amounts to approximately 78% of the required assistance. Like the PMAY-G, the PMAY-U also relies heavily on extra budgetary resources raised through Housing and Urban Development Corporation Ltd bonds. The flow of funds from the central government is crucial for the scheme's success.

PMAY U status (as of January 1, 2024)

	Target	*Sanctioned (million)*	*Houses Grounded (million)*	*Completed (million)*	*Funds Released (Rs. Trillion)*
PMAY U	Housing for All	11.86	11.35	7.90	1.55

Source: MOHUA, CRISIL MI&A

IBC a key long-term structural positive

The Insolvency and Bankruptcy Code (IBC) is a reform that will structurally strengthen the identification and resolution of insolvency in India. The IBC enhances the credit enforcement structure and provides certainty around the timeframes for insolvency resolution. It attempts to simplify legal processes, preserve value for creditors and provide them with greater certainty of outcome. With this reform, the RBI has sent a strong signal to borrowers to adhere to credit discipline and also encourage banks to break resolution deadlocks by introducing definite timelines. IBC will enhance investors' confidence when investing in India. Internationally, recovery rates have improved significantly after the implementation of bankruptcy reforms, as can be seen in the following table:

Country	Year of bankruptcy reform	Pre-reforms		Five years post-reforms	
		Recovery rate (%)	*Time (years)*	*Recovery rate (%)*	*Time (years)*
Brazil	2005	0.2	10.0	17.0	4.0
Russia	2009	28.2	3.8	42.8	2.0
China	2007	31.5	2.4	36.1	1.7
India	**2016**	**26.0**	**4.3**	**43***	**1.6***

*Note: * As of 2019*

Source: World Bank, CRISIL MI&A

Household savings to increase

India's savings touched a 15 year low in fiscal 2020 with gross domestic savings witnessing a decline to 27.1%, post which in the next two fiscals the savings have witnessed a growth and touched ~29% during fiscal 2022. Despite the slow-down, with rise in India's savings rate it remains favourable as compared with most emerging market peers with 29% in fiscal 2022, greater than the world average of 28%. Amongst Indian regions, West and North have the highest per capita deposit of Rs. 0.24 million and Rs. 0.20 million respectively.

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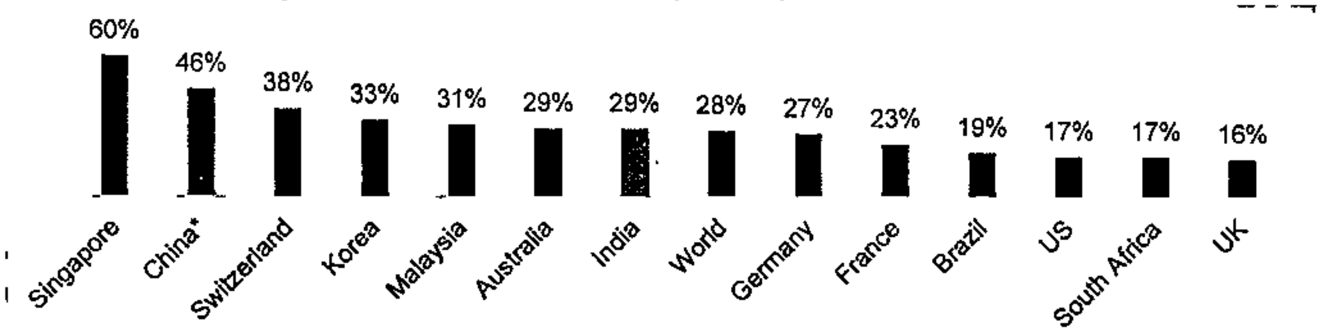
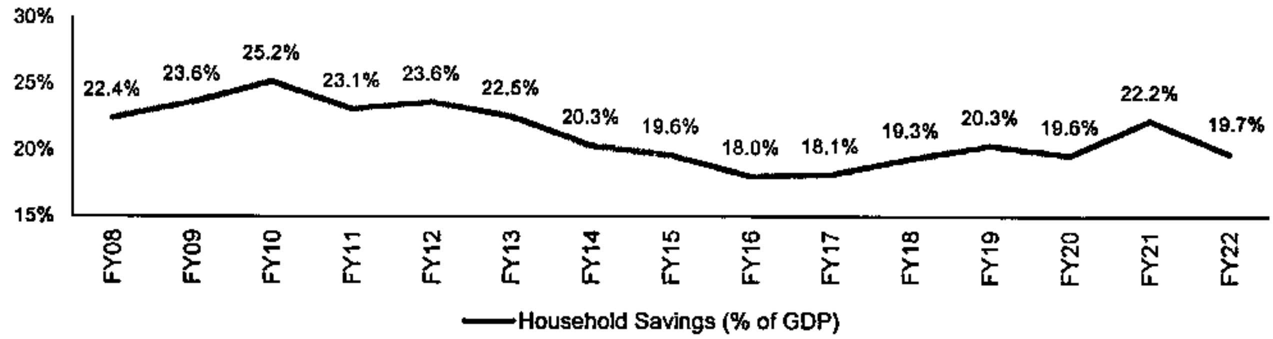
Gross Domestic Savings rate: India vs other countries (CY 2022)



Note: Gross Domestic Saving consists of savings of household sector, private corporate sector and public sector; (*) Data as of CY2020;
Source: World Bank, Handbook of Statistics on Indian Economy 2020-21, RBI, MOSPI, CRISIL MI&A

India is also in a sweet spot to harness the economic dividend from demographic change. A larger working-age population is expected to lead to increased labour force participation, driving economic growth and productivity. Further, individuals in this group tend to also accumulate savings at a higher rate, facilitating further investment-led growth and development.

Household savings as a percentage of GDP has increased to 22.2% in fiscal 2021, declined in fiscal 2022



Note: E: Estimated, Source: Ministry of Statistics and Programme Implementation (MOSPI), RBI, CRISIL MI&A

Gross domestic savings trend

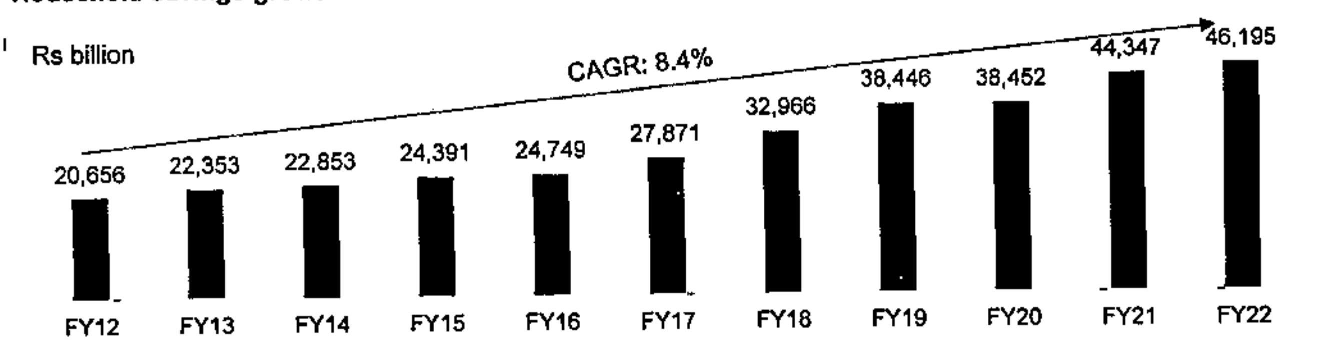
Parameters (Rs billion)	Mar-14	Mar-15	Mar-16	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22
GDS	36,082	40,200	42,823	48,251	54,807	60,003	59,959	55,924	54,266
Household sector savings (net financial savings, savings in physical assets and in the form of gold and silver ornaments)	22,853	24,391	24,749	27,871	32,966	38,446	39,291	43,906	46,195
Household sector savings as proportion of GDS (%)	63%	61%	58%	58%	60%	64%	66%	79%	85%
Gross financial savings	11,908	12,572	14,962	16,147	20,564	22,636	23,991	31,089	25,979
Financial liabilities	3,587	3,768	3,854	4,686	7,507	7,712	7,866	8,052	8,071
Savings in physical assets	14,164	15,131	13,176	15,946	19,442	23,094	22,735	20,484	27,690

Savings in physical assets as a proportion of GDS (%)	39%	38%	31%	33%	35%	38%	38%	37%	51%
Savings in the form of gold and silver ornaments	368	456	465	465	467	427	431	384	597

Note: The data is for financial year ending March 31; Physical assets are those held in physical form, such as real estate, etc.
Source: MOSPI, National Accounts National Accounts Statistics, CRISIL MI&A

CRISIL MI&A expects India to be a savings economy, although households' savings in physical assets has declined to 61% in fiscal 2022 from 69% in fiscal 2012, it constitutes a substantial share in overall savings. On the other hand, the share of net financial savings has witnessed an uptrend to 39% in fiscal 2022 from 31% in fiscal 2012. In the long-term, with increase in financial literacy, CRISIL MI&A expects the share of financial assets as a proportion of net household savings to increase over the next five years, thereby boosting investments in assets such as bank deposits, insurance and mutual funds.

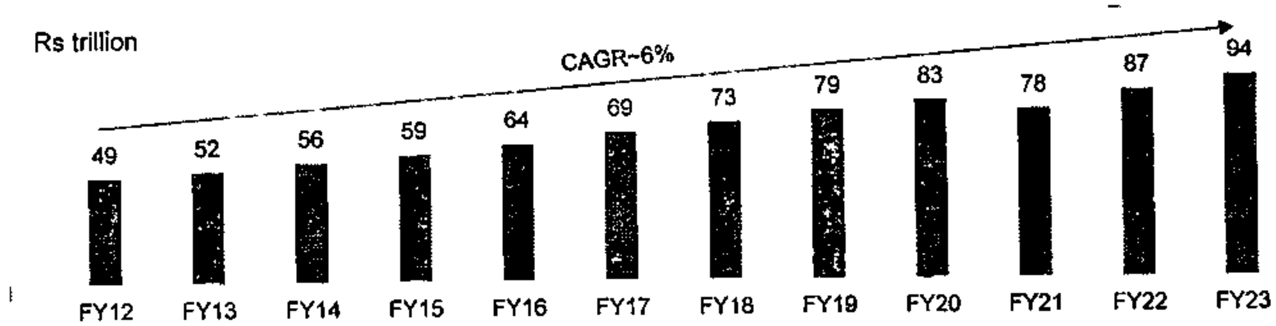
Household savings growth



Note: The data is for financial year ending March 31, 2022; Source: MOSPI, CRISIL MI&A

CRISIL MI&A expects India to continue being a high savings economy. CRISIL MI&A is also sanguine on savings rate increasing in the medium-term, as households become more focused post the pandemic-induced uncertainty on creating a nest egg for the future.

Private final consumption expenditure (PFCE) has grown ~6% over fiscal 2012-23

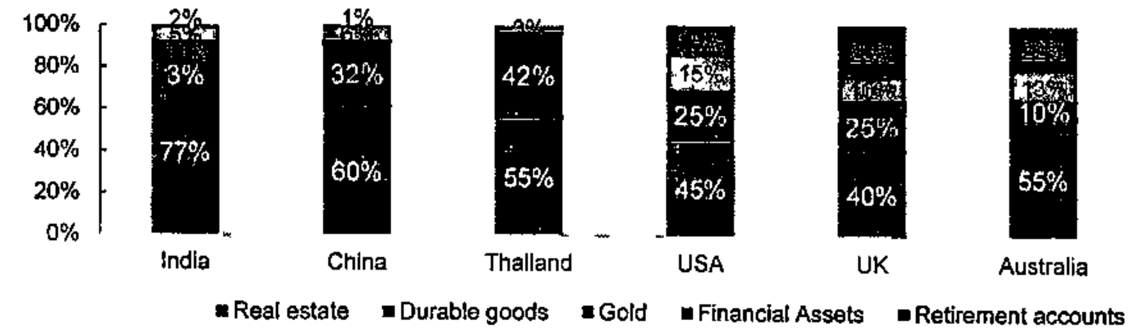


Note: Private final consumption expenditure is at constant prices (at 2011-2012 prices); Source: RBI, CRISIL MI&A

Physical assets still account for majority of the savings

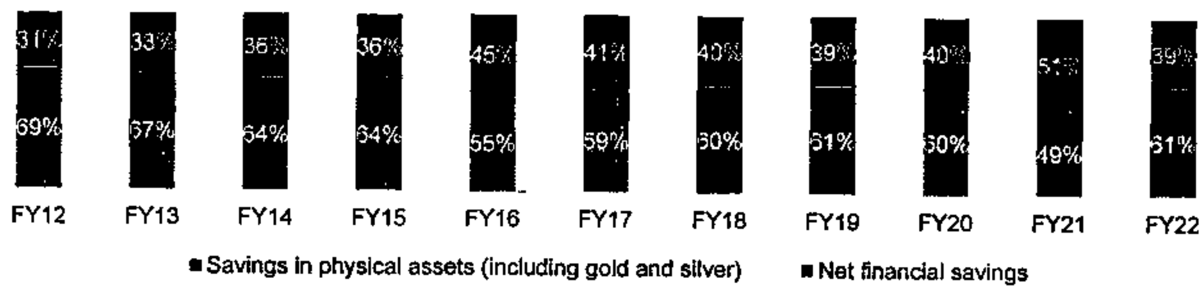
Unlike most other countries, where financial savings account for a significant proportion of savings, physical assets in the form or real estate, gold and silver still account for most household savings in India.

Trend of savings in India and other economies



Source: Report of the Household Finance Committee[4]:July 2017, RBI, CRISIL MI&A

Trend of household savings in India



Note: The data is for financial year ending March 31, 2022; Source: Handbook of Statistics on Indian Economy, RBI, MOSPI, CRISIL MI&A

Digitisation: Catalyst for the next growth cycle

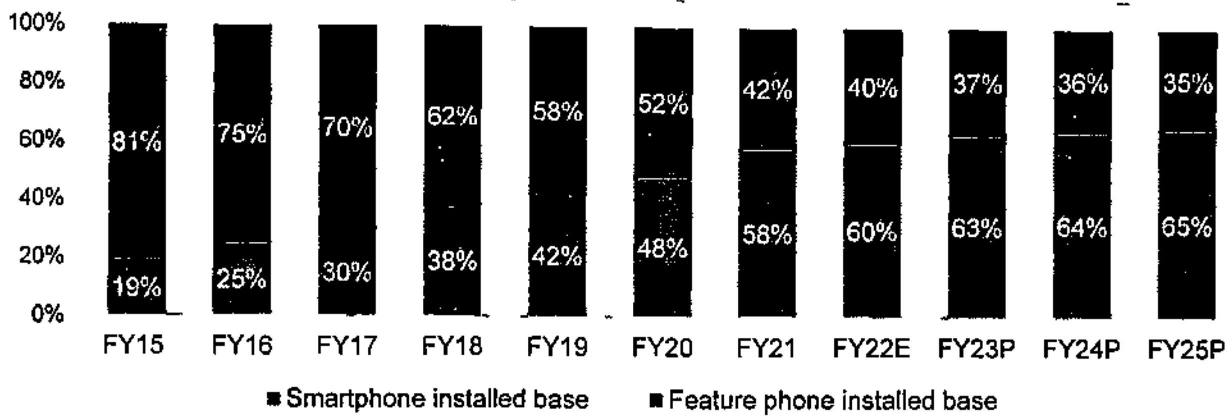
Technology is expected to play a pivotal role in taking the financial sector to the next level of growth, by helping surmount the challenges stemming from India's vast geography, which makes physical footprints in smaller locations commercially unviable. Technology is conducive for India, considering its demographic structure where the median age is less than 30 years. The young population is tech savvy and at ease with using it to conduct the entire gamut of financial transactions. With increasing smartphone penetration and faster data speeds, consumers are now encouraging digitisation as they find it more convenient. Digitisation will help improve efficiency and optimise cost. Players with better mobile and digital platforms will draw more customers and emerge as winners in the long term.

In August 2020, RBI has announced a new licence for NUE (new umbrella entity) for retail payments. These NUEs will innovate and compete with NPCI in setting up and managing new payment systems in the retail space.

Mobile and internet penetration: Higher mobile penetration, improved connectivity and faster and cheaper data speed, supported by Aadhaar and bank account penetration have led India to shift from being a cash-dominated economy to a digital one.

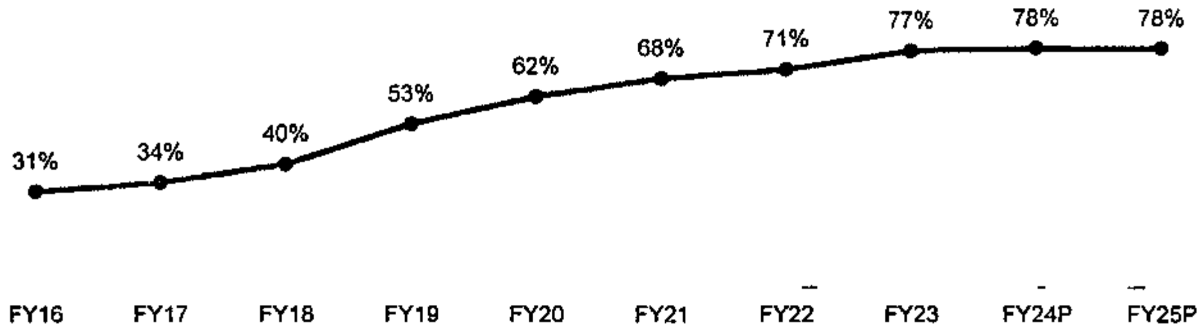
[4] *https://rbidocs.rbi.org.in/rdocs/PublicationReport/Pdfs/HFCRA28D0415E2144A009112DD314ECF5C07.PDF*

Data-savvy and younger users to drive adoption of smartphones



Note: P: Projected, E: estimated if actual data is not available, Source: CRISIL MI&A

Data subscribers as a proportion of wireless subscribers to increase significantly through FY25



Note: P: Projected, Source: TRAI, CRISIL MI&A

Rise in 4G penetration and smartphone usage

The digital revolution has paved the way for digital payments. India had 1,144 million wireless subscribers as of June 30, 2023, and the number is growing at a steady pace every year. The reach of mobile network, internet and electricity is also expanding the digital payments footprint to remote areas. This is likely to increase the number of digital payment transactions. However, in semi urban and rural areas, internet, 4G and smartphone penetration is still lower compared to urban areas

All-India mobile and data subscriber base

	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY24P	FY25P
Wireless subscribers (million)	1170	1183	1162	1157	1181	1142	1144	1170	1189
Data subscribers (million)	401	473	615	720	799	814	883	917	933
Data subscribers as a proportion of wireless subscribers	34%	40%	53%	62%	68%	71%	77%	78%	78%
4G data subscribers (million)	131	287	478	645	719	734	786	746	713

4G data subscribers proportion	33%	61%	78%	90%	90%	90%	89%	81%	76%

Note: P: Projected
Source: TRAI, CRISIL MI&A

Wireless data consumption in India has grown ~12 times in the past five fiscals at a CAGR of ~65%. The proportion of data subscribers is hence expected to rise to ~78% in fiscal 2025 from ~62% at fiscal 2020. India's 4G data rates are among the lowest in the world. So, a combination of affordable handsets, growing consumer preference for data on the go and affordable data tariffs are set to accelerate the adoption of wireless internet in India, leading to a 4G data subscriber proportion at ~90% in fiscal 2023.

Across India, Uttar Pradesh and Maharashtra are the largest two access areas in terms of subscriber base. Punjab stands at 15th across the country out of 22 service areas indicating further scope of penetration in this region for digital services and subscriptions. The lower adoption indicates that going ahead, larger proportion of the population can be served using digital services.

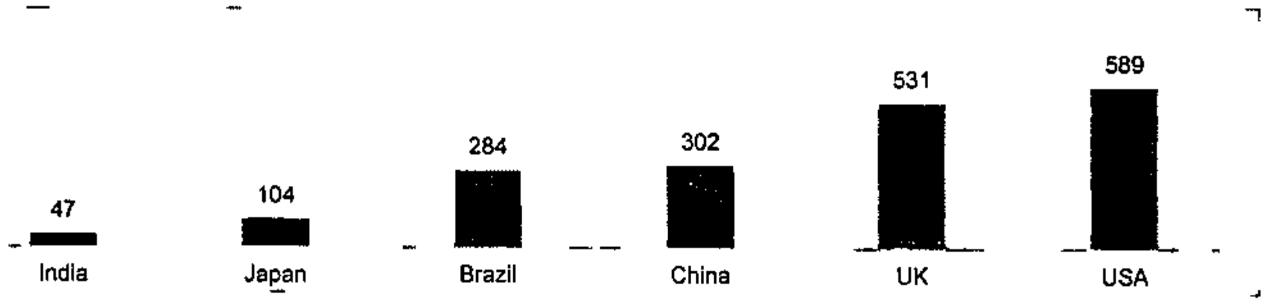
All-India access subscriber base (Wireless + Wireline) as of June 2023

Service Area	June-23 (million)
Andhra Pradesh	85.59
Assam	25.49
Bihar	93.20
Delhi	58.63
Gujarat	67.51
Haryana	26.98
Himachal Pradesh	8.94
Jammu and Kashmir	12.59
Karnataka	68.93
Kerala	43.68
Madhya Pradesh	78.56
Maharashtra	93.51
Mumbai	37.26
North East	12.52
Odisha	33.83
Punjab	36.56
Rajasthan	64.65
Tamil Nadu	79.48
Uttar Pradesh E	100.97
Uttar Pradesh W	63.18
Kolkata	24.88
West Bengal	56.97

Source: TRAI, CRISIL MI&A

Digital payments and per capita transactions in India are among the lowest compared with similar countries. The government has taken multiple initiatives to give a boost to digitalisation in the country. This includes biometric identification of all Indian citizens through the Aadhaar programme, financial inclusion through the 'Jan Dhan Yojana', launch of Aadhaar-enabled payment systems, and push to online tax filings. UPI, which is based on the immediate payment service or IMPS platform, allows a user to transfer money from one bank account to another bank account instantly, and is seen as the next big leap in digital payments. Recent initiatives aimed at addressing the structural issues around lending requirement including GST filings, government launched UPI 2.0.

Average number of non-cash payments transactions per capita, per annum (CY 2021)



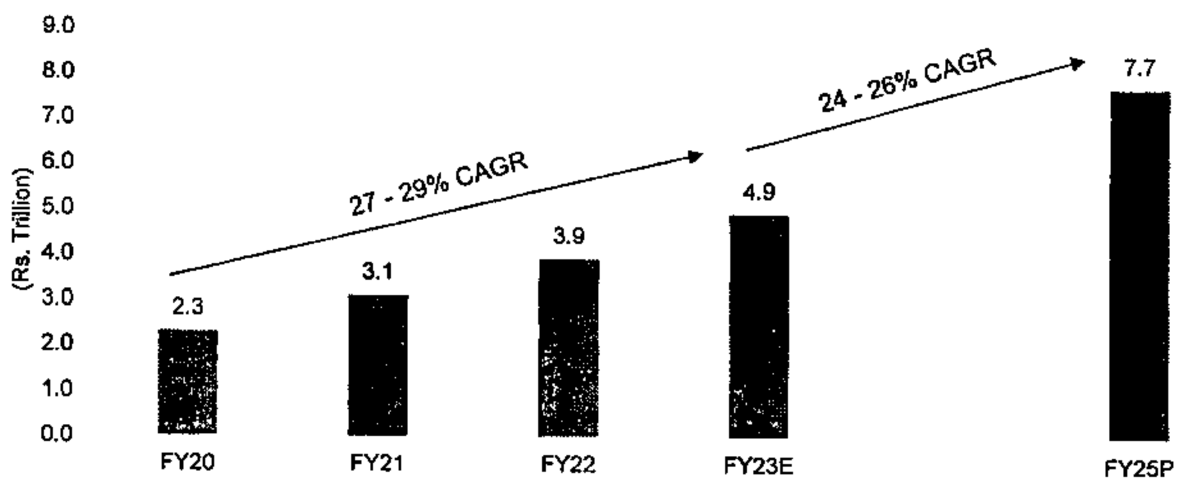
Source: Bank of International Settlements, CRISIL MI&A

Consumers are increasingly finding transacting through mobile convenient. CRISIL MI&A expects the share of mobile banking and prepaid payment instruments to increase dramatically over the coming years. In addition, CRISIL MI&A expects improved data connectivity, low digital payment penetration and proactive government measures to drive digitalisation in the country, transforming it into a cashless economy.

Continuous rise in retail spending on goods

E-retail spending on goods and services in India has grown at a 3-year CAGR of 27-29 % between fiscal 2020 and fiscal 2023. In fiscal 2021, retail consumption saw a hit due to the implementation of nationwide lockdown. However, retail spending gradually recovered in fiscal 2022 and fiscal 2023, on account of low base, full year of store operations and waning impact of the pandemic. In the long run, retail spending is expected to reach Rs. 7.2-7.7 trillion by fiscal 2025, contributing to the digital payment growth in the country.

E-retail spending to grow at ~24-26% CAGR between fiscal 2023 and fiscal 2025.



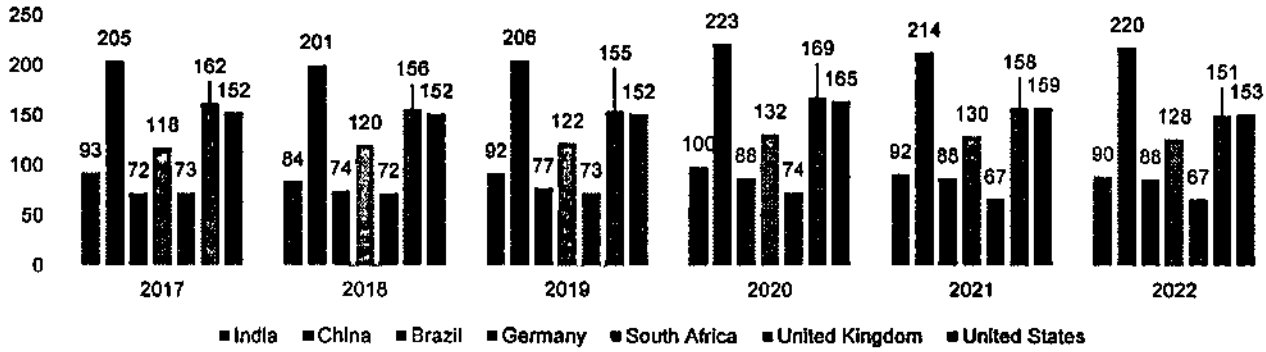
Source: CRISIL MI&A Estimates

Financial inclusion

Current scenario and key developments

The significance of financial inclusion has deepened, particularly in the post-pandemic era, as vulnerable households and businesses strive to navigate the crises and achieve recovery .In terms of the credit to GDP ratio, India has a low credit penetration compared with other developing countries, such as China indicating that the potential that can be tapped. Similarly, in terms of credit to households as a proportion of GDP as well, India lags other markets, with retail credit hovering at around 26% of GDP as of Fiscal 2023.

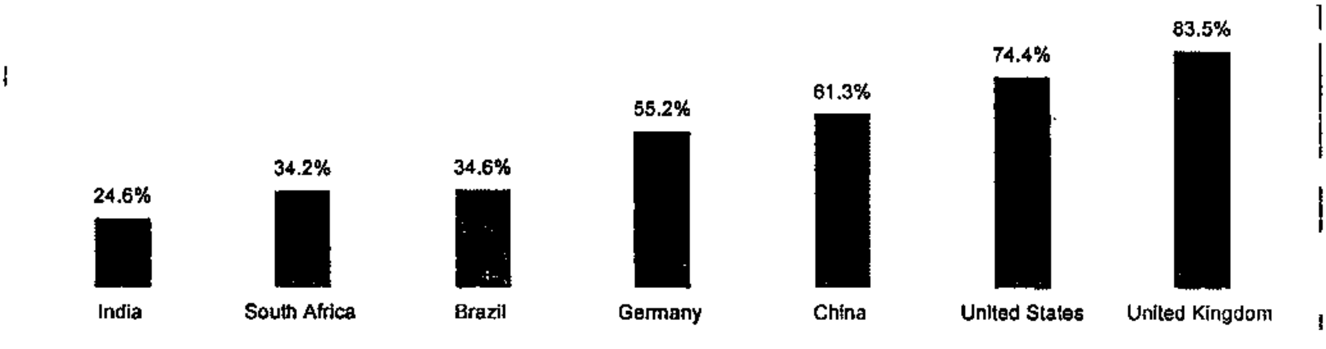
Credit to GDP ratio (%) (CY2022)



Note: Data is represented for calendar years for all countries except India. For India, numbers are for fiscal year

Source: Bank of International Settlements[5], CRISIL MI&A

Retail Credit to GDP ratio (CY2022)



Note: For India, Retail Credit to GDP ratio as of FY23, Source: Bank of International Settlements, CRISIL MI&A

Financial Inclusion on a fast path in India

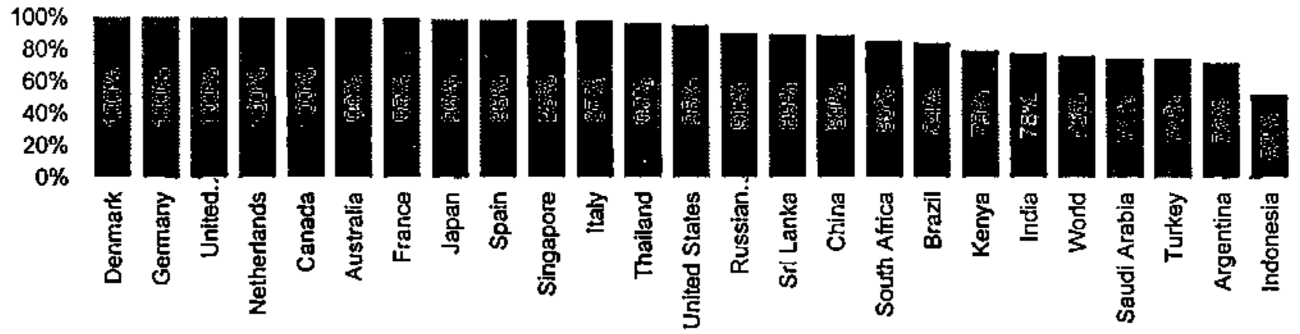
Overall literacy in India is at 77.7% as per the results of recent NSSO survey conducted from July 2017 to June 2018 which is still below the world literacy rate of 86.5%. However, according to the National Financial Literacy and Inclusion Survey (NCFE-FLIS) 2019, only 27% of Indian population is financially literate indicating huge gap and potential for financial services industry. The survey defines financial literacy as combination of awareness,

[5] *https://www.bis.org/statistics/c_gaps.htm?m=6_380_670*

knowledge, skill, attitude and behaviour necessary to make sound financial decisions and ultimately achieve individual financial wellbeing.

According to the World Bank's Global Findex Database 2021, the global average of adult population with an account opened with a bank, financial institution, or mobile money provider, was approximately 76% in calendar year 2021. India's financial inclusion has improved significantly over calendar years 2014 to 2021 as adult population with bank accounts increased from 53% to 78% (Source: Global Findex Database) due to the Indian government's concentrated efforts to promote financial inclusion and the proliferation of supporting institutions.

Adult population with a bank account (%): India vis-à-vis other countries

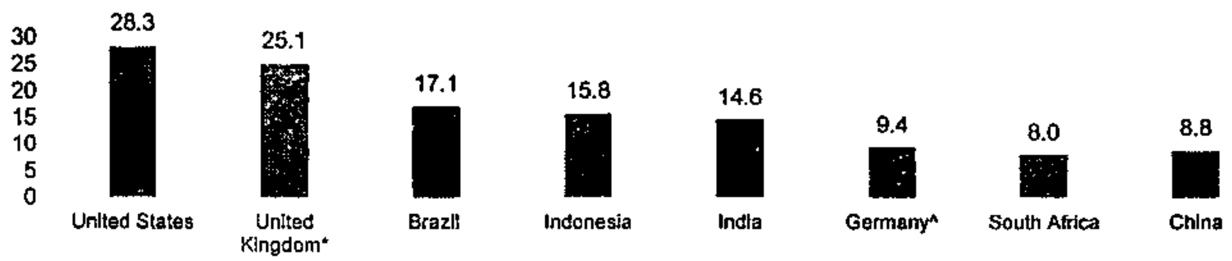


Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Account penetration is for the population within the age group of 15+, Source: World Bank - The Global Findex Database 2021, CRISIL MI&A

The low levels of adults with bank accounts in comparison with various countries can be further explained by the large number of rural households in the country, which account for nearly two-thirds of the total households in the country. The shift in households towards urban regions is taking place albeit at a very slow pace.

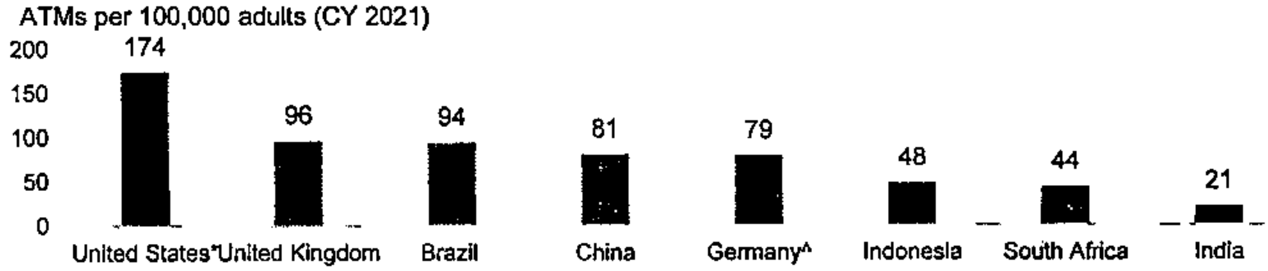
India is one of the countries with lower commercial bank branches and ATM penetration indicating huge room for financial inclusion and banking services penetration. As of calendar year 2020, India has 14.7 branches and 22 ATMs for one lakh adults according to World Bank data which is relatively lower than other developing and developed countries.

Commercial bank branch penetration across the world



Note: (*) UK data is as of 2013 calendar year, (^) Germany data is as of 2020 calendar year; Source: World Bank, RBI, CRISIL MI&A

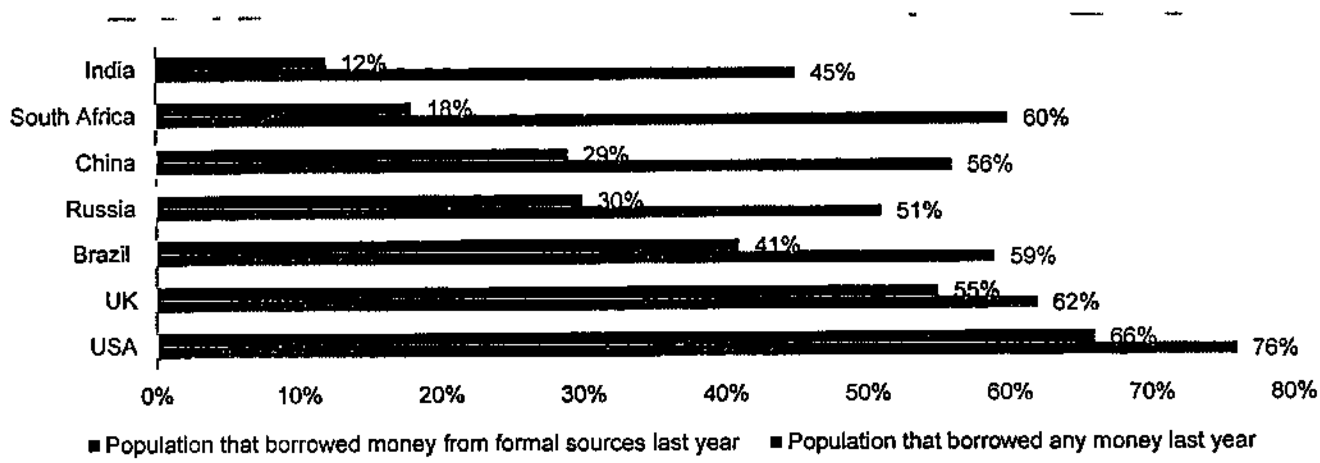
ATM penetration across the world



Note: (*) – US data is as of 2009 calendar year, (^)-Germany data as of 2020 calendar year.
Source: World Bank, RBI, CRISIL MI&A

According to the World Bank's Global Findex Database 2021, only 12% of the Indian population borrowed money through a formal channel like financial institutions which is very low compared to other developed and developing countries. The population that borrowed money through formal channel was 8% as of 2017 (Source: World Bank-The Global Findex Database 2017).

Only 12% of India's population borrowed money from formal sources (CY2021)



Note: 1. Global Findex data for India excludes northeast states, remote islands and selected districts. 2. Data is for the population within the age group of 15+, 3. Money borrowed from formal sources includes money borrowed from Banks, NBFCs and usage of credit card
Source: World Bank - The Global Findex Database 2021, CRISIL MI&A

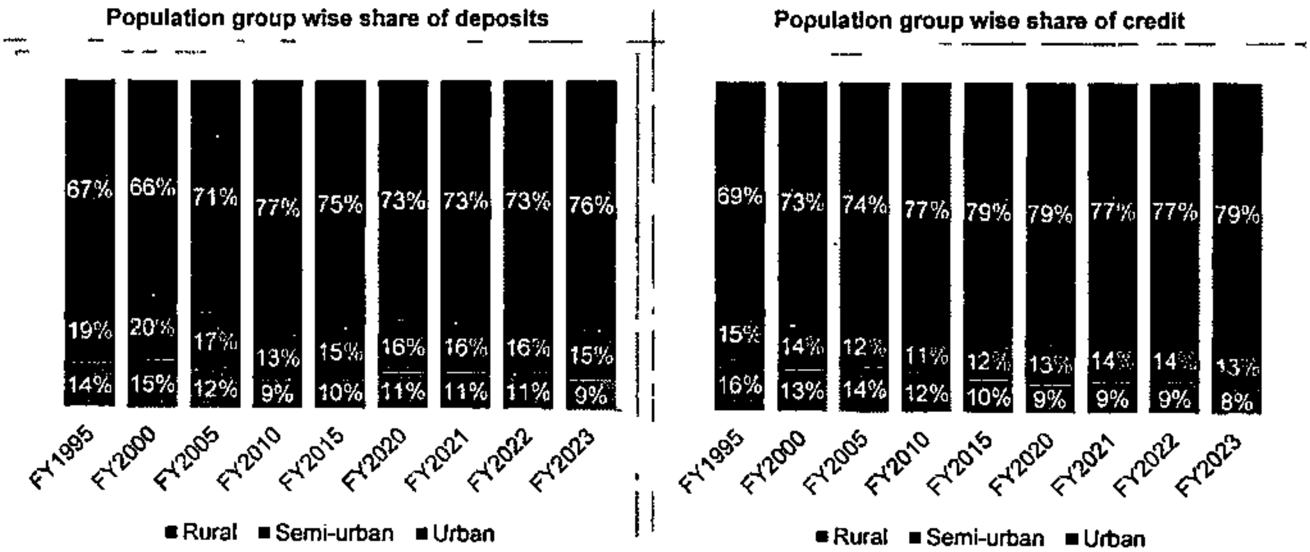
To tackle financial exclusion, the Indian government introduced the PMJDY, a scheme that facilitates opening bank accounts by the unbanked. However, the effective use of these new accounts, increase in the number of transactions in these accounts and availability of credit remain key challenges, which need to be effectively addressed as borrowings from the formal sources still remains low.

Rural India accounts for about half of GDP, but only about 8% of total credit and 9% of total deposits

According to Census 2011, there are about 640,000 villages in India, which are inhabited by about 893 million people, comprising about 65% of the country's population as of CY2021. About 47% of India's GDP comes from rural areas. The share of total credit outstanding is about 8% in rural areas and 92% in urban areas as of March 31, 2023. The massive divergence in the rural areas' share of India's GDP and banking credit services compared with urban areas is an indicator of the extremely low penetration of banks in rural areas.

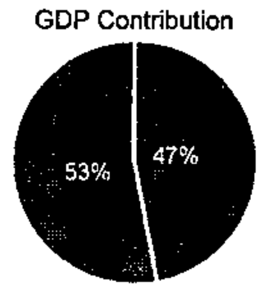
The charts below show the percentage of GDP contribution and credit outstanding in rural and urban areas:

Low share of banking credit and deposit indicates lower penetration in rural areas



Source: RBI, CRISIL MI&A

Rural vs urban split of GDP



Source: CSO; RBI; CRISIL MI&A estimates (for GDP contribution as per 2017)

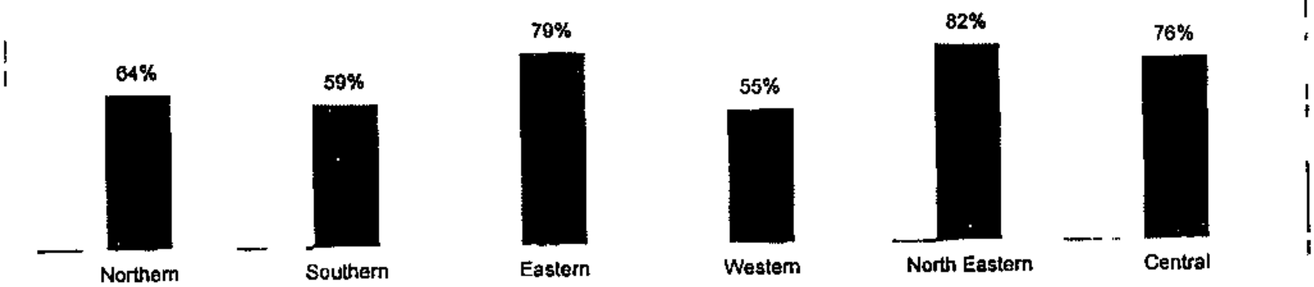
Although the majority of Indian households are located in the rural region, the banking infrastructure in these regions is relatively inferior and, thus, there is a gap in the supply and demand of financial services in the backward regions of the country, which is a pocket of opportunity for the financial services sector.

Financial exclusion is widely prevalent in countries, such as India, due to poverty and low income, financial illiteracy, high transaction costs, and lack of infrastructure (primarily information technology). Consequently, a significant proportion of the population still lacks access to formal banking facilities. According to NABARD All India Rural Financial Inclusion Survey 2016-17, 40% loans were reported as taken from non-institutional investors or informal channels like relative and friends, money lenders and local landlords.

With a high proportion of population in the rural areas across the country, the financial institutions have less competition for banking services here compared with urban areas. Also, since the level of financial inclusion is lower, it presents a significant opportunity for these entities to penetrate these regions.

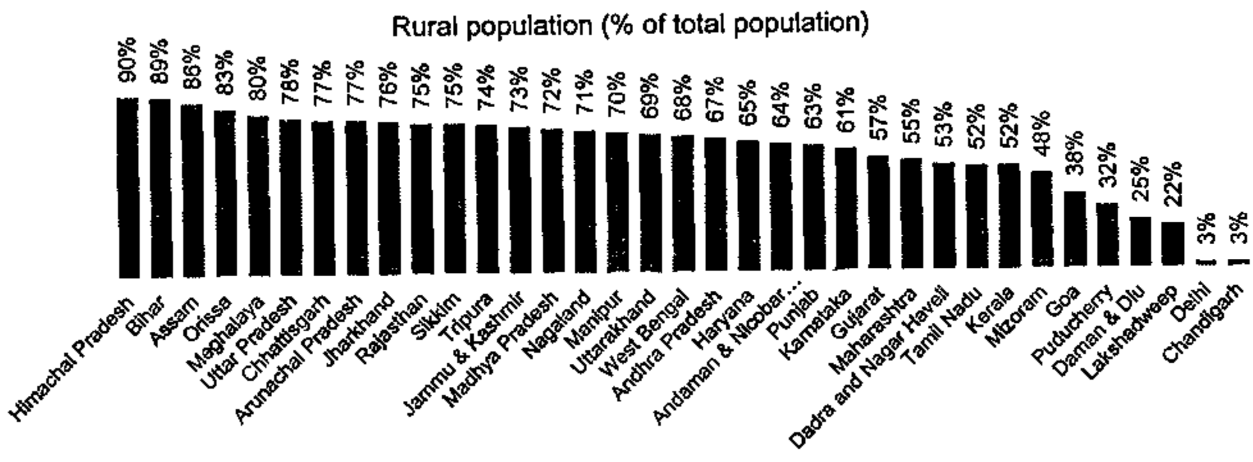
The structural changes, combined with a positive macro environment, will improve rural business prospects, provide business opportunities for the banking and financial services sector and drive the long-term growth of the economy. Further, abundance of natural resources in the northern part of the country could also drive related industries and in turn aid in economic growth of the region. Punjab and Haryana have high agricultural yield in comparison to other states and offers bright growth prospects to agro-processing and agro-residual industries. Thus, the northern region is likely to grow with aid from the financial institutions to support agriculture and industrial sector.

Region-wise share of rural population as a % of total population (CY 2011)



Source: Census 2011, CRISIL MI&A

State-wise share of rural population (CY 2011)



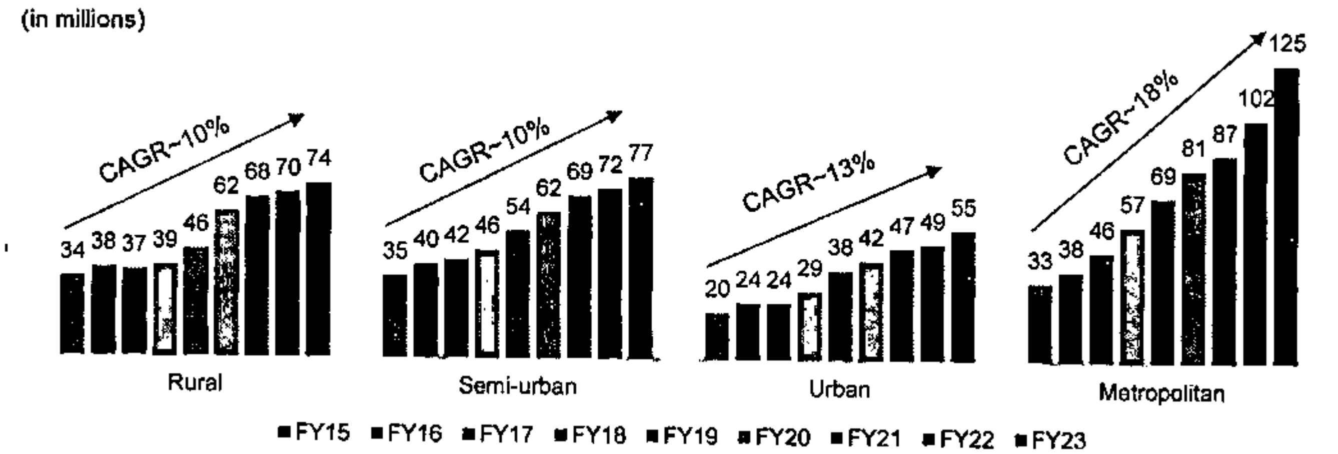
Note: Sequence of states are arranged in descending order of the proportion of rural population; Source: Census 2011, CRISIL MI&A

The number of bank credit accounts in rural areas grew at a CAGR of 10% between the end of Fiscal 2015 and the end of Fiscal 2023 and the number of bank deposit accounts grew at a CAGR of 3% between the end of Fiscal 2015 and the end of Fiscal 2023. However, with Small Finance Banks increasing their reach and expanding into rural areas[6] and increasing financial awareness, faster growth in rural areas can be expected in the future given the huge untapped potential. Between the end of Fiscal 2015 and the end of Fiscal 2023, the number of credit accounts in

[6] *The share of Small Finance Banks in terms of branches have increased from 1% in fiscal 2018 to 2% in fiscal 2023*

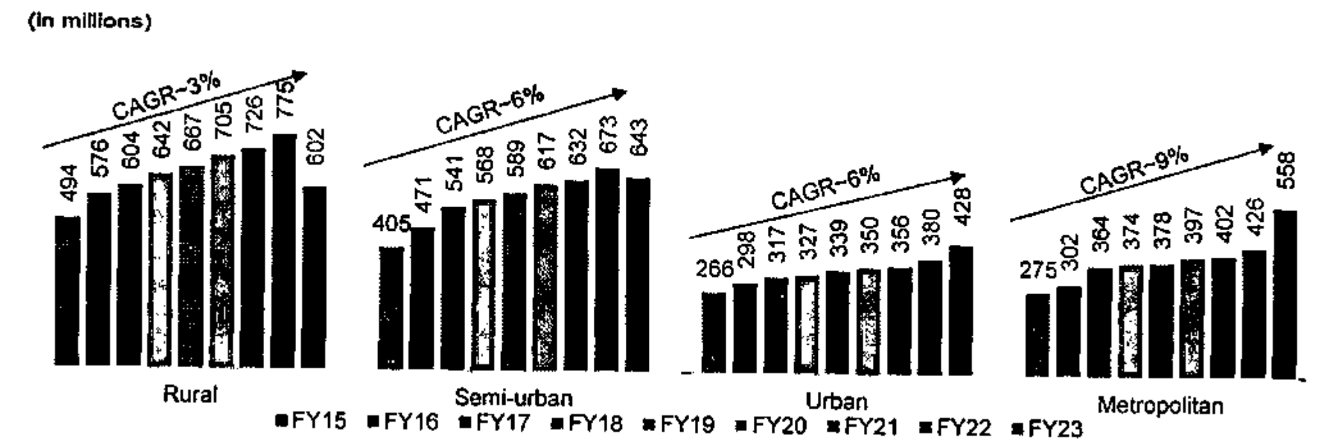
semi-urban areas grew at a CAGR of 10% and between the end of Fiscal 2015 and the end of Fiscal 2023, the number of deposit accounts grew at a CAGR of 6%. Between the end of Fiscal 2015 and Fiscal 2023, the number of credit accounts in urban areas grew at a CAGR of 13% and between the end of Fiscal 2015 and the end of Fiscal 2023, the number of deposit accounts grew at a CAGR of 6%.

Bank credit accounts in rural, semi-urban and urban areas



Note: Data represents only bank credit accounts; Source: RBI; CRISIL MI&A

Bank deposit accounts in rural, semi-urban and urban areas



Note: Data represents only bank deposit accounts; Source: RBI; CRISIL MI&A

Large variation in credit availability across states and districts

There is a wide variation across states and within various districts in the same state as well in terms of credit, which indicates latent opportunity for providing banking services to unserved or underserved customers. Uttar Pradesh and Bihar are the most populous states in India, accounting for 17% and 9% respectively of overall population in India, as compared to other states like Assam, Jharkhand and Odisha with share of ~3% each. Based on bank credit accounts in rural areas, Himachal Pradesh, Odisha, Jharkhand and Bihar have more than 45% of the credit accounts in rural areas compared to Maharashtra, Delhi, Kerala where the share of accounts in rural areas is below 10%.

In value terms, bigger states like Maharashtra, Delhi, Gujarat and Kerala have less than 10% of credit outstanding in rural areas compared to Meghalaya, Himachal Pradesh and Jammu & Kashmir with more than 30% of rural credit outstanding. Maharashtra and Delhi, among the states with high share in overall credit, have more than 70% of total credit outstanding concentrated in the top five districts as of FY22.

State-wise rural credit accounts in banks and top five districts concentration (FY23)

State	No. of districts	% Share in overall population in India	Share in overall credit (FY23)	Credit to Deposit ratio (FY23)	Concentration of credit in top 5 districts#	% Of credit in rural areas (FY23)	Concentration of credit accounts in top 5 districts*	% Credit accounts in rural areas#
Maharashtra	36	9%	23%	85%	90%	2%	77%	7%
NCT of Delhi	11	1%	11%	93%	100%	0%	100%	0%
Tamil Nadu	38	6%	9%	109%	62%	11%	44%	27%
Karnataka	31	5%	7%	69%	75%	11%	50%	28%
Gujarat	33	5%	6%	81%	72%	8%	49%	18%
Telangana	33	3%	5%	112%	79%	9%	48%	22%
Uttar Pradesh	75	17%	5%	49%	38%	21%	23%	37%
Andhra Pradesh	26	4%	5%	149%	64%	18%	49%	29%
West Bengal	23	8%	4%	51%	73%	14%	47%	45%
Kerala	14	3%	4%	68%	66%	4%	52%	4%
Rajasthan	33	6%	3%	87%	53%	16%	40%	30%
Madhya Pradesh	52	6%	3%	75%	54%	13%	33%	25%
Haryana	22	2%	3%	65%	62%	10%	44%	19%
Punjab	23	2%	2%	56%	61%	19%	46%	28%
Bihar	38	9%	2%	47%	46%	27%	36%	48%
Odisha	30	3%	2%	47%	61%	21%	47%	51%
Chhattisgarh	28	2%	1%	76%	73%	10%	52%	22%
Assam	34	3%	1%	54%	50%	23%	37%	43%
Jharkhand	24	3%	1%	36%	68%	19%	53%	49%
Chandigarh	1	0%	1%	78%	100%	0%	100%	1%
Jammu & Kashmir	20	1%	1%	57%	60%	34%	50%	50%
Uttarakhand	13	1%	1%	38%	89%	21%	82%	32%
Himachal Pradesh	12	1%	0%	34%	74%	59%	68%	69%
Goa	2	0%	0%	26%	100%	18%	100%	31%
Puducherry	4	0%	0%	69%	100%	12%	100%	15%
Tripura	8	0%	0%	43%	87%	33%	83%	37%
Meghalaya	12	0%	0%	38%	93%	38%	88%	44%
Manipur	16	0%	0%	76%	83%	30%	82%	28%
Nagaland	12	0%	0%	50%	84%	21%	81%	27%
Arunachal Pradesh	25	0%	0%	28%	72%	29%	65%	33%

Note: Arranged in descending order of share in overall credit outstanding of banks, (*) As of FY21, (#)As of FY22; Source: RBI, CRISIL MI&A

Similarly in terms of bank deposits, Odisha, Jharkhand, Assam, Himachal Pradesh, Sikkim and Meghalaya have more than 50% of the deposit accounts in rural areas compared to Maharashtra, Delhi and Kerala where the share of accounts in rural areas is below 20%. In value terms, Maharashtra, Delhi, Kerala, Karnataka, Tamil Nadu and Haryana have less than 10% of deposits in rural areas compared to Sikkim, Tripura, Meghalaya, Arunachal Pradesh, Himachal Pradesh and Jammu & Kashmir with more than 25% of rural deposits. Maharashtra and Karnataka, among the bigger states have more than 75% of total deposits concentrated in the top five districts as of FY22.

State-wise rural deposit accounts in banks and top five districts concentration (FY23)

State	No. of districts	% Share in overall population	% Share in overall deposits (FY23)	Concentration of deposits in top 5 districts *	% Of deposits in rural areas*	Concentration of deposit accounts in top 5 districts*	% Deposit accounts in rural areas*
Maharashtra	36	9%	21%	85%	3%	52%	18%
NCT of Delhi	1	1%	9%	100%	1%	61%	2%
Uttar Pradesh	75	17%	8%	41%	19%	16%	46%
Karnataka	31	5%	8%	80%	7%	46%	29%
Tamil Nadu	38	6%	6%	63%	8%	33%	24%
West Bengal	24	8%	6%	70%	17%	43%	48%
Gujarat	33	5%	5%	62%	11%	43%	26%
Kerala	14	3%	4%	63%	3%	53%	4%
Telangana	35	NA	4%	84%	6%	49%	25%
Haryana	22	2%	4%	68%	9%	41%	25%
Rajasthan	33	6%	3%	55%	15%	34%	37%
Madhya Pradesh	52	6%	3%	53%	11%	24%	32%
Punjab	23	2%	3%	57%	21%	47%	32%
Bihar	38	9%	3%	49%	22%	30%	50%
Odisha	30	3%	2%	59%	23%	36%	57%
Andhra Pradesh	20	7%	2%	63%	16%	50%	28%
Jharkhand	24	3%	2%	69%	18%	42%	52%
Chhattisgarh	28	2%	1%	65%	17%	38%	44%
Assam	33	3%	1%	60%	21%	32%	54%
Uttarakhand	13	1%	1%	85%	23%	75%	44%
Jammu & Kashmir	22	1%	1%	69%	28%	50%	51%
Himachal Pradesh	12	1%	1%	74%	59%	67%	75%
Goa	2	0%	1%	100%	24%	100%	34%
Chandigarh	1	0%	1%	100%	1%	100%	3%
Tripura	8	0%	0%	91%	28%	81%	48%
Meghalaya	12	0%	0%	92%	25%	82%	56%
Puducherry	4	0%	0%	100%	6%	100%	17%
Arunachal Pradesh	18	0%	0%	75%	27%	62%	44%
Nagaland	9	0%	0%	95%	11%	87%	26%
Manipur	15	0%	0%	89%	25%	74%	40%
Dadra & Nagar Haveli & Daman & Diu	3	0%	0%	100%	5%	100%	15%
Mizoram	11	0%	0%	89%	12%	79%	34%
Sikkim	4	0%	0%	100%	30%	100%	52%

Ladakh	2	NA	0%	100%	23%	100%	34%
Andaman & Nicobar Islands	3	0%	0%	100%	24%	100%	37%
Lakshadweep	1	0%	0%	100%	29%	100%	41%

*Note: Population as of FY21 according to CRISIL estimates, *Fiscal 2022 data, States are arranged in descending order of share in overall deposits of banks*

Source: RBI, CRISIL MI&A

Maharashtra and Tamil Nadu have registered highest credit account penetration in FY22

States like Andhra Pradesh, Karnataka and Uttar Pradesh have huge headroom for growth given the credit penetration and economic growth. Similarly, In the West, states like Maharashtra and Gujarat have showcased good growth in terms of GDP and Gujarat has a relatively lower credit penetration, which provides a huge potential to be addressed.

GDP growth has been varied across states with Tripura growing at the fastest rate of 8.9% CAGR, followed by Bihar, Gujarat and Andhra Pradesh. Uttar Pradesh, Bihar, Madhya Pradesh, Jharkhand, and Chhattisgarh have the lowest credit account penetration among all other states in the country. Uttar Pradesh and Bihar are the most populous states in India, accounting for 17% and 9% respectively of overall population in India, but their share in overall credit outstanding is only 5% and 2% respectively which shows large variation in credit. In terms of the northern states, the state of Punjab has the least share in overall credit outstanding with ~2% share indicating huge opportunity. These presents an opportunity in terms of financial institutions to penetrate these regions and tap the markets that have high potential for future growth.

State-wise GDP and GDP growth (FY 2022)

States	GSDP - Constant Prices FY22 In Rs. Billion	Y-o-Y growth	CAGR (FY17-FY22)	Credit Account Penetration as on FY22	Deposit Account Penetration as on FY22	Branch Penetration as on FY22	ATM Penetration as on FY22	CRISIL Inclusix Score (FY2016)
Tamil Nadu	13,984	7.85%	6.17%	14%	184%	144	337	77.2
Karnataka	12,522	9.47%	5.86%	10%	183%	151	259	82.1
Uttar Pradesh	11,687	7.26%	2.93%	2%	127%	77	100	44.1
Andhra Pradesh	7,469	11.43%	6.69%	6%	156%	122	191	78.4
Rajasthan	7,330	11.04%	4.20%	4%	135%	103	140	50.9
Telangana	6,856	11.22%	6.18%	15%	203%	158	318	72.8
Madhya Pradesh	6,217	10.12%	5.72%	4%	142%	90	132	48.7
Haryana	5,888	9.80%	5.21%	11%	202%	177	235	67.7
Kerala	5,509	7.10%	2.57%	10%	211%	175	278	90.9
Odisha	4,276	10.11%	4.86%	4%	149%	112	163	63
Punjab	4,162	5.12%	3.36%	10%	215%	212	239	70.9
Assam	2,738	9.13%	6.27%	4%	141%	84	120	47.9
Himachal Pradesh	1,244	8.35%	3.84%	5%	189%	213	268	72.3
Jammu & Kashmir	1,239	6.16%	NA	8%	157%	126	182	47.8
Tripura	469	12.16%	8.95%	7%	141%	140	129	66.2
Meghalaya	254	8.89%	3.14%	9%	96%	111	129	34.6

Note:

1. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state

2. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state
3. Branch penetration is calculated as Number of bank branches per million people
4. ATM penetration is calculated as Number of ATMs per million people
5. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered
6. CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and microfinance institutions) on four dimensions (branch, credit, deposit and insurance).
Source: RBI, MOSPI, CRISIL MI&A

State-wise GDP and GDP growth (FY 2021)

States	GSDP - Constant Prices FY21 In Rs. Billion	Y-o-Y growth	CAGR (FY16-FY21)	Credit Account Penetration as on FY22	Deposit Account Penetration as on FY22	Branch Penetration as on FY22	ATM Penetration as on FY22	CRISIL Inclusix Score (FY2016)
Maharashtra	18,893	-7.57%	2.69%	43%	176%	106	213	62.7
Gujarat	12,443	-1.95%	6.82%	9%	157%	128	186	62.4
West Bengal	7,927	1.06%	5.40%	4%	160%	91	123	53.7
Delhi	5,647	-3.86%	3.49%	26%	292%	192	400	86.1
Bihar	4,199	2.50%	7.21%	1%	123%	62	73	38.5
Chhattisgarh	2,455	-1.77%	5.19%	4%	145%	98	134	45.7
Jharkhand	2,271	-4.75%	5.36%	3%	145%	90	106	48.2
Uttarakhand	1,759	-6.55%	2.87%	9%	284%	289	378	69.0

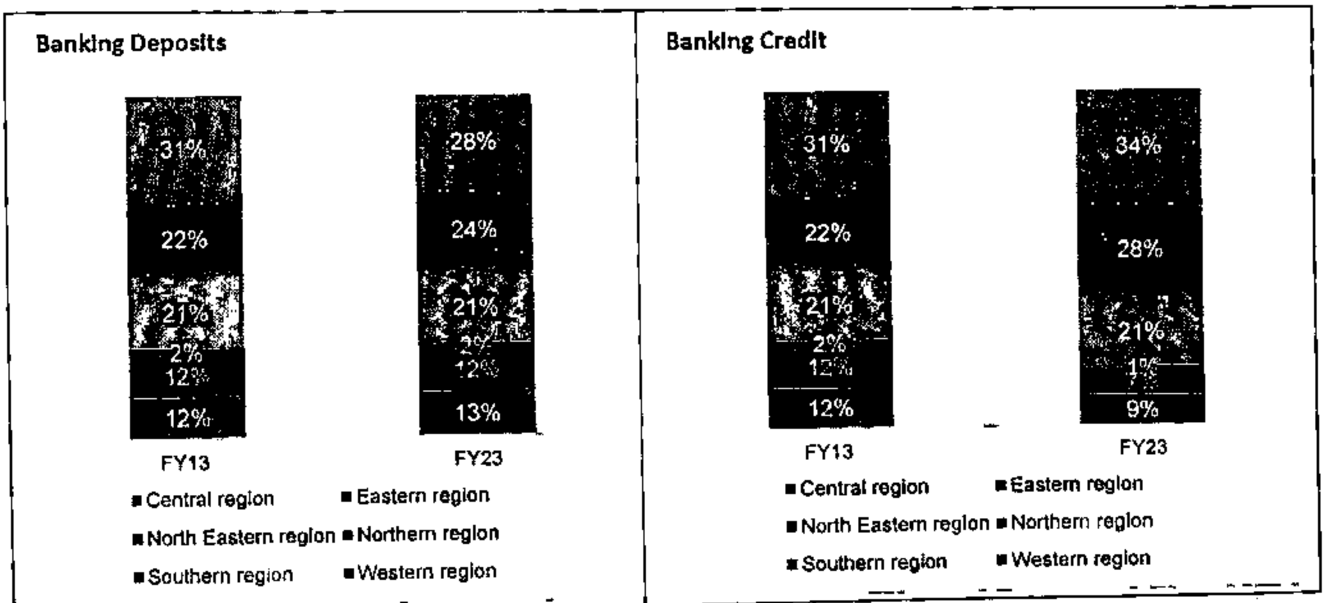
Note: 1. Credit account penetration is calculated as total number of retail bank credit accounts/population of the state, 2. Deposit account penetration is calculated as total number of bank deposit accounts/ population of the state, 3. Branch penetration is calculated as Number of bank branches per million people, 4. ATM penetration is calculated as Number of ATMs per million people, 5. For Credit and Deposit account penetration, this does not represent unique borrowers or depositors, total number of accounts have been considered, 6. CRISIL Inclusix, India's first financial inclusion index, was launched in 2013 with the objective of creating a dependable yardstick that would become a policy input to further the cause of inclusion. CRISIL Inclusix weighs three service providers (banks, insurers and microfinance institutions) on four dimensions (branch, credit, deposit and insurance).
Source: RBI, MOSPI, CRISIL MI&A

Region-wise asymmetry: Central and eastern regions have a lower share in total bank credit and deposits

Bank credit and deposits are predominantly concentrated in the southern and western regions, whereas they have been especially low in the north-eastern and eastern regions. Deposit penetration in the southern region has increased over fiscal 2013 and fiscal 2023 by 2%. West, South and North have over 80% share in total bank credit in fiscal 2023. Amongst these three regions, North has the lowest share in bank credit which provides an opportunity for growth for the financial institutions.

Moreover, the deposit penetration in the northern region has maintained its share at 21% of the overall banking deposits as of Fiscal 2023 which is comparatively lower than Southern (24%) and Western (28%) regions. Accordingly, there is huge scope for further penetration in the northern, eastern, north-eastern and central region across both credit and deposits.

Region-wise share of total banking deposits and credit

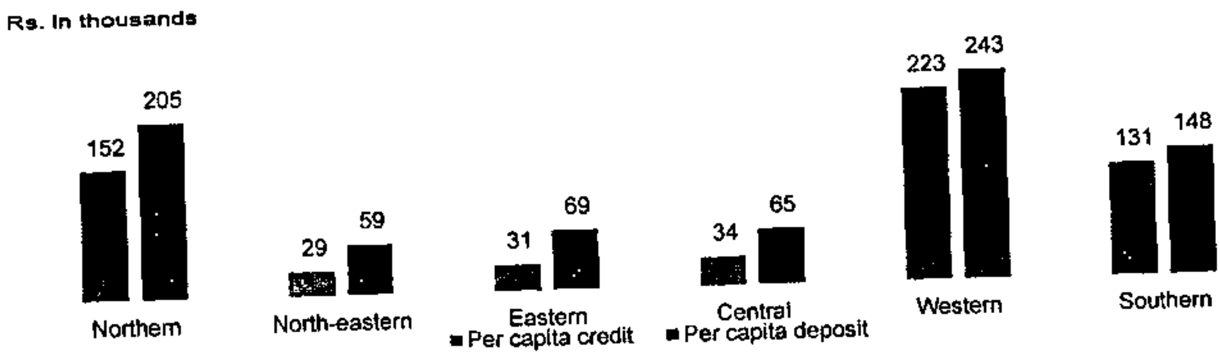


Note: The percentages are as of the end of the fiscal year indicated.

Source: RBI; CRISIL MI&A

Bank credit per capita in the north-east is the lowest and is nearly four times lower than in the south and and nearly eight times than in the west. Low per-capita credit as well as deposits in eastern and north-eastern regions compared with other regions implies low penetration of banks in these areas. This provides an opportunity for all lending and deposit accepting institutions to expand in these regions and expand their reach in specific areas around them. In terms of deposits, the southern region is moderately penetrated compared with the northern and western regions, leaving a lot of headroom for growth for the players to capitalise on.

Region-wise per capita* banking credit and deposits as of the end of FY23 of scheduled commercial banks



*Note: Population as of FY22 according to CRISIL estimates, *Region-wise per capita banking credit is calculated as Banking credit divided by population, *Region-wise per capita banking deposit is calculated as Banking deposit divided by population*
States are divided into regions according to RBI nomenclature as follows:
Northern: Punjab, Haryana, Jammu and Kashmir, Delhi, Chandigarh, Ladakh, Rajasthan
North-eastern: Arunachal Pradesh, Assam, Meghalaya, Manipur, Mizoram, Nagaland, Tripura
Eastern: Odisha, Bihar, Jharkhand, West Bengal, Andaman & Nicobar Island, Sikkim
Central: Madhya Pradesh, Chhattisgarh, Uttar Pradesh, Uttarakhand
Western: Maharashtra, Gujarat, Goa, Dadra and Nagar Haveli, Daman and Diu
Southern: Andhra Pradesh, Karnataka, Kerala, Tamil Nadu, Lakshadweep, Puducherry, Telangana
Andhra Pradesh and Telangana are considered as one state
Source: RBI; Census India, CRISIL MI&A

In terms of branches, the share of SFBs in total branches is lowest in the Central region followed by Eastern region and then Northern region. These areas are still largely dominated by public sector banks. This provides considerable opportunity to SFBs to gain further share through their specialised offerings and expanding their services to the underbanked.

Region-wise, state-wise bank group wise distribution of branches across branches

		Share across branches (Mar-23)			
Region	State	PSBs	Private Banks	RRBs	SFBs
Northern	CHANDIGARH	63%	33%	0%	3%
	HARYANA	53%	31%	13%	4%
	HIMACHAL PRADESH	70%	14%	15%	1%
	JAMMU & KASHMIR	25%	57%	18%	0%
	LADAKH	42%	56%	2%	0%
	NCT OF DELHI	57%	39%	0%	4%
	PUNJAB	62%	28%	7%	4%
	RAJASTHAN	52%	23%	19%	6%
	Northern Region Total	**65%**	**29%**	**12%**	**4%**
Southern	ANDHRA PRADESH	59%	22%	17%	1%
	KARNATAKA	52%	28%	16%	4%
	KERALA	49%	37%	9%	5%
	LAKSHADWEEP	100%	0%	0%	0%
	PUDUCHERRY	53%	24%	17%	6%
	TAMIL NADU	52%	36%	5%	6%
	TELANGANA	55%	28%	16%	2%
	Southern Region Total	**53%**	**30%**	**12%**	**4%**
Western	DADRA AND NAGAR HAVELI AND DAMAN AND DIU	58%	42%	0%	0%
	GOA	68%	30%	0%	2%
	GUJARAT	57%	30%	8%	5%
	MAHARASHTRA	55%	33%	5%	6%
	Western Region Total	**56%**	**32%**	**6%**	**6%**
Eastern	ANDAMAN & NICOBAR ISLANDS	84%	16%	0%	0%
	BIHAR	53%	16%	27%	4%
	JHARKHAND	66%	16%	13%	4%
	ODISHA	57%	20%	18%	5%
	SIKKIM	62%	34%	0%	5%
	WEST BENGAL	57%	32%	10%	2%
	Eastern Region Total	**57%**	**23%**	**17%**	**4%**
Central	CHHATTISGARH	49%	25%	20%	6%
	MADHYA PRADESH	56%	21%	17%	6%
	UTTAR PRADESH	60%	15%	23%	2%
	UTTARAKHAND	65%	20%	13%	2%
	Central Region Total	**58%**	**18%**	**21%**	**3%**
North Eastern	ARUNACHAL PRADESH	62%	18%	17%	3%
	ASSAM	50%	28%	15%	6%

	MANIPUR	67%	20%	11%	2%
	MEGHALAYA	53%	18%	24%	4%
	MIZORAM	36%	17%	46%	2%
	NAGALAND	66%	26%	6%	2%
	TRIPURA	43%	29%	24%	4%
	North Eastern Region Total	**51%**	**26%**	**18%**	**5%**
Grand total		**57%**	**56%**	**27%**	**14%**

Note: Private banks include private sector banks, foreign banks, local area banks and payment banks; Source: RBI; CRISIL MI&A

Similarly in terms of credit and deposits, the share of SFBs across various regions is in the range of 0-5% and hence significant improvement in their share is possible by providing targeted services by being attached with the population at ground level.

Region-wise, state-wise bank Player group wise distribution of deposits

Share across Deposits (Mar-23)				
Region	**State**	**PSBs**	**Private Banks**	**SFBs**
Northern	CHANDIGARH	58%	41%	2%
	HARYANA	44%	55%	1%
	HIMACHAL PRADESH	86%	13%	1%
	JAMMU & KASHMIR	25%	75%	0%
	LADAKH	26%	74%	0%
	NCT OF DELHI	52%	47%	1%
	PUNJAB	70%	27%	2%
	RAJASTHAN	69%	27%	4%
	Northern Region Total	**56%**	**42%**	**2%**
Southern	ANDHRA PRADESH	77%	23%	0%
	KARNATAKA	52%	47%	1%
	KERALA	52%	46%	2%
	LAKSHADWEEP	100%	0%	0%
	PUDUCHERRY	74%	25%	2%
	TAMIL NADU	55%	44%	1%
	TELANGANA	56%	43%	0%
	Southern Region Total	**56%**	**43%**	**1%**
Western	DADRA AND NAGAR HAVELI & DAMAN AND DIU	73%	27%	0%
	GOA	74%	26%	0%
	GUJARAT	63%	36%	1%
	MAHARASHTRA	51%	49%	1%
	Western Region Total	**54%**	**46%**	**1%**
Eastern	ANDAMAN & NICOBAR ISLANDS	87%	13%	0%
	BIHAR	83%	16%	0%
	JHARKHAND	85%	15%	0%
	ODISHA	78%	22%	0%
	SIKKIM	66%	34%	0%
	WEST BENGAL	69%	31%	0%

	Eastern Region Total	**76%**	**24%**	**0%**
Central	CHHATTISGARH	74%	25%	1%
	MADHYA PRADESH	79%	19%	1%
	UTTAR PRADESH	77%	23%	1%
	UTTARAKHAND	82%	17%	0%
	Central Region Total	**77%**	**22%**	**1%**
North Eastern	ARUNACHAL PRADESH	88%	12%	0%
	ASSAM	78%	21%	1%
	MANIPUR	78%	22%	0%
	MEGHALAYA	75%	25%	1%
	MIZORAM	78%	21%	0%
	NAGALAND	76%	24%	0%
	TRIPURA	85%	14%	1%
	North Eastern Region Total	**79%**	**20%**	**1%**
Grand total		**61%**	**38%**	**1%**

Note: FY23 deposits data unavailable for Regional Rural Banks (RRB)

Source: RBI; CRISIL MI&A

Region-wise, state-wise bank group wise distribution of branches across credit

		Share across Credit (Mar-23)			
Region	**State**	**PSBs**	**Private Banks**	**RRBs**	**SFBs**
Northern	CHANDIGARH	70%	29%	0%	1%
	HARYANA	42%	53%	3%	2%
	HIMACHAL PRADESH	76%	15%	7%	2%
	JAMMU & KASHMIR	23%	72%	4%	0%
	LADAKH	43%	56%	1%	0%
	NCT OF DELHI	59%	41%	0%	0%
	PUNJAB	54%	40%	3%	3%
	RAJASTHAN	54%	34%	7%	5%
	Northern Region Total	**54%**	**42%**	**2%**	**2%**
Southern	ANDHRA PRADESH	73%	19%	8%	0%
	KARNATAKA	55%	39%	4%	1%
	KERALA	56%	39%	5%	1%
	LAKSHADWEEP	100%	0%	0%	0%
	PUDUCHERRY	56%	34%	6%	4%
	TAMIL NADU	54%	43%	2%	2%
	TELANGANA	60%	36%	5%	0%
	Southern Region Total	**58%**	**36%**	**4%**	**1%**
Western	DADRA AND NAGAR HAVELI & DAMAN AND DIU	47%	53%	0%	0%
	GOA	67%	33%	0%	0%
	GUJARAT	48%	48%	2%	2%
	MAHARASHTRA	46%	53%	0%	1%
	Western Region Total	**46%**	**52%**	**1%**	**1%**

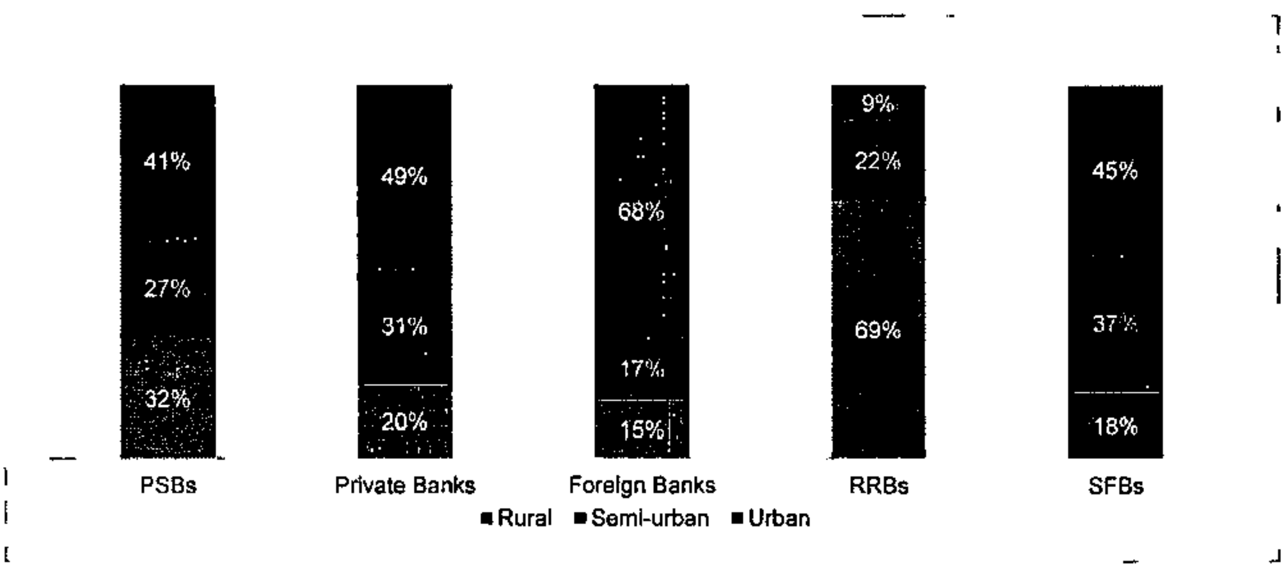
Eastern	ANDAMAN & NICOBAR ISLANDS	94%	6%	0%	0%
	BIHAR	64%	22%	11%	3%
	JHARKHAND	69%	25%	5%	2%
	ODISHA	67%	26%	6%	2%
	SIKKIM	82%	17%	0%	1%
	WEST BENGAL	58%	38%	3%	1%
	Eastern Region Total	**62%**	**31%**	**5%**	**2%**
Central	CHHATTISGARH	67%	27%	4%	2%
	MADHYA PRADESH	62%	29%	5%	4%
	UTTAR PRADESH	61%	28%	10%	1%
	UTTARAKHAND	67%	28%	4%	1%
	Central Region Total	**62%**	**28%**	**7%**	**2%**
North Eastern	ARUNACHAL PRADESH	87%	7%	5%	0%
	ASSAM	67%	26%	6%	2%
	MANIPUR	81%	15%	3%	0%
	MEGHALAYA	74%	16%	9%	1%
	MIZORAM	49%	8%	42%	0%
	NAGALAND	89%	10%	1%	0%
	TRIPURA	54%	20%	23%	3%
	North Eastern Region Total	**68%**	**22%**	**8%**	**2%**
Grand total		**54%**	**41%**	**3%**	**1%**

Note: PSBs- Public Sector Banks, SFBs – Small Finance Banks, Source: RBI; CRISIL MI&A

A large potential exists for SFBs to wrestle share from other player groups especially the public sector banks in the rural and semi urban region where there exists scope for deepening the levels of financial inclusion of the population. Especially the entities with strong background and experience will be able to garner higher share in these regions as can be seen from the experience in last few years, where share in branches of PSBs has fallen as against SFBs increasing their share from 1% in FY18 to 2% in FY23 (rural) and from 1% in FY18 to 6% in FY23 (semi urban). These entities can focus on both the asset and liability side where currently the PSBs dominate.

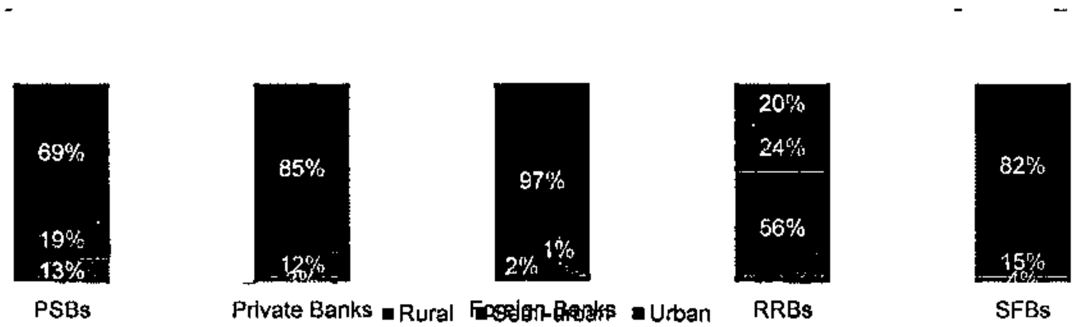
Further, SFBs have a considerable share of their overall share of branches, deposits and credit in the semi-urban region as compared with private banks, foreign banks, and public sector banks. Slowly, we expect that the SFBs will incrementally expand share in the rural region considering their experience in the semi-urban areas and lower competition in the rural region from other player categories. This in turn can work to their benefit on account of being specialised with certain products and having deeper on the ground connection in these regions.

Population group wise share of branches across various player groups (Mar-23)



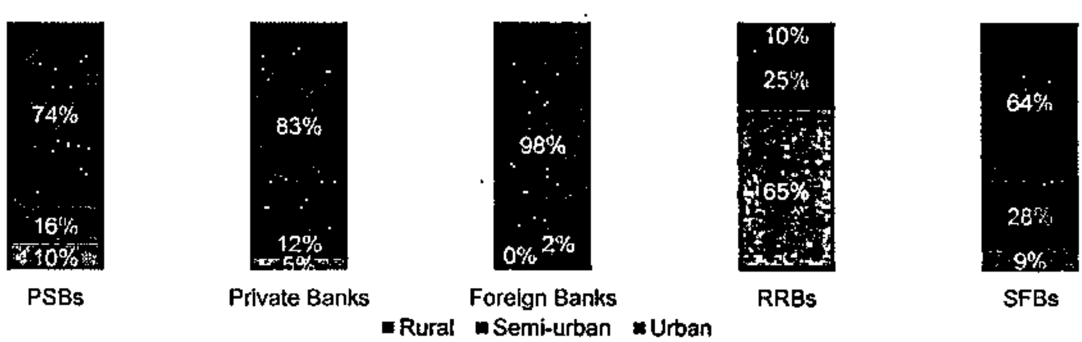
Source: RBI; CRISIL MI&A

Population group wise share of deposits across various player groups (Mar-23)



Source: RBI; CRISIL MI&A

Population group wise share of credit across various player groups (Mar-23)



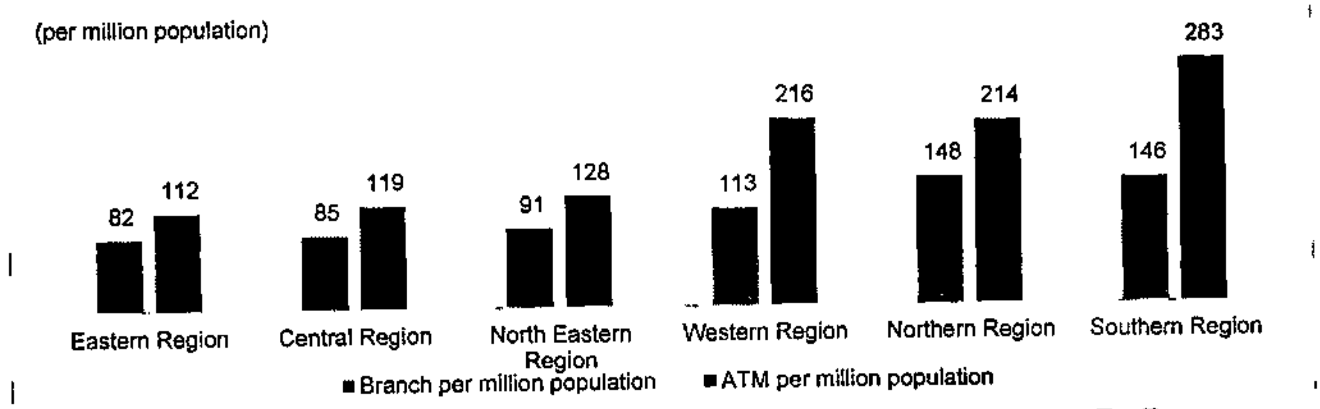
Source: RBI; CRISIL MI&A

The number of branches and ATM facilities in the eastern regions, where credit penetration and deposit-base are low is also below those of the southern and western regions, which CRISIL MI&A believes is largely due to lower focus from the bigger banks.

Despite existing branch and ATM network, there remains scope for further penetration and huge opportunity in terms of expanding the financial inclusion parameters.

The number of branches and ATM facilities in the eastern regions, where credit penetration and deposit-base are low is also below those of the southern and western regions, which CRISIL MI&A believes is largely due to lower focus from the bigger banks.

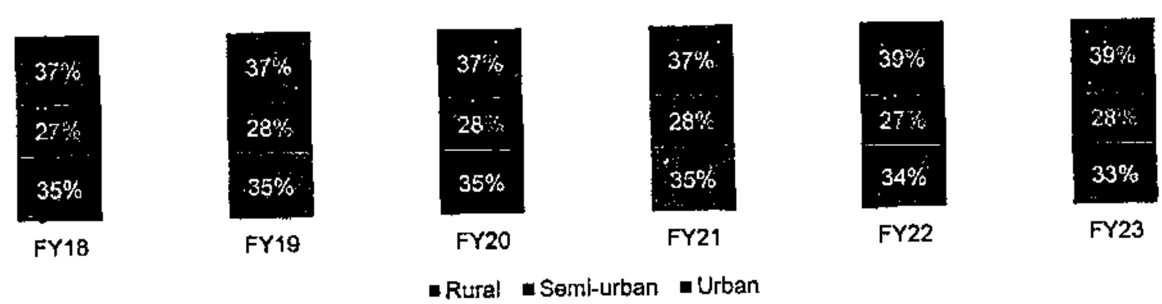
Region-wise presence of bank ATM and branches (as of March 31, 2023)



*Note: *Population is as per the census data of 2011, Source: RBI; Census India; CRISIL MI&A*

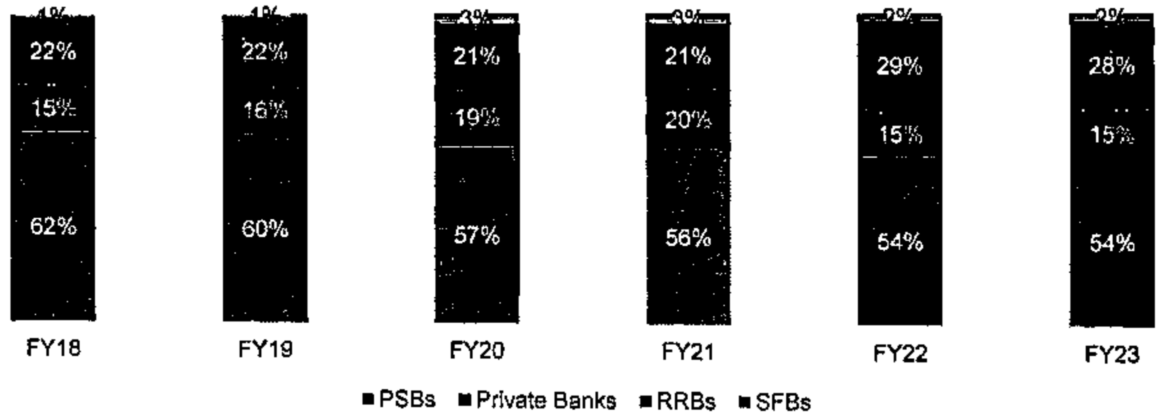
The number of branches in the urban region has the highest share with 39% in fiscal 2023, followed by rural region and semi urban region with 33% and 28% share respectively. The branches in rural and region are further distributed into player groups where Public Sector Banks have the highest share of 54% and SFBs have a current low share of 2%. However, given the strong hold and experience of these entities in dealing with customers across these regions, the share of SFBs will go up as against the public and private sector banks and thus presents a large opportunity for SFBs to penetrate these regions deeply at the expense of others.

Bank branch distribution in rural, semi-urban and urban areas



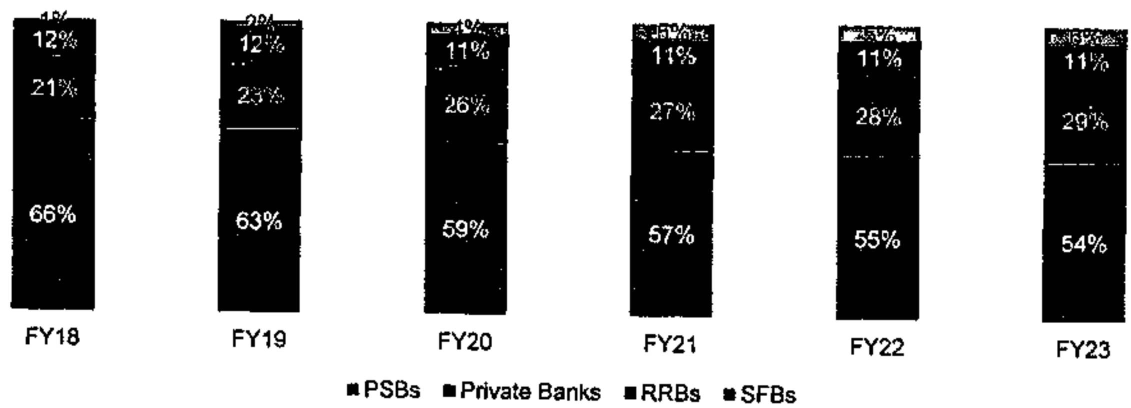
Source: RBI; CRISIL MI&A

Trend in distribution of rural branches amongst player groups



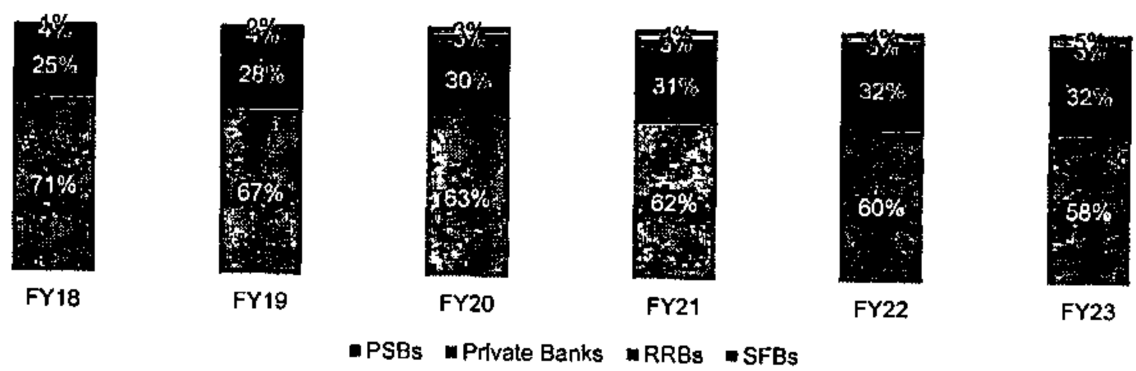
Source: RBI; CRISIL MI&A

Trend in distribution of semi-urban branches amongst player groups



Source: RBI; CRISIL MI&A

Trend in distribution of urban branches amongst player groups



Source: RBI; CRISIL MI&A

Competitive landscape in the northern region in terms of credit and deposits

In the northern region, the NCT of Delhi is the largest in terms of deposits with ~Rs 16.5 trillion worth of deposits on Mar-23 followed by the states of Haryana, Rajasthan, and Punjab. The northern region accounts for 21% of deposits as on Mar-23 and 28% of incremental deposits as on Mar-23 over the aggregate deposits as on Mar-22.

Higher share of northern region in the increase in deposits over last fiscal

	Actual Deposits (Rs billion)						Incremental deposits (Rs billion)				
State/Region	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
NCT Of Delhi	11,457	11,901	12,177	13,988	14,899	16,589	444	276	1,811	911	1,690
Haryana	3,674	4,099	4,758	5,571	6,140	6,818	426	658	814	569	678
Rajasthan	3,368	3,786	4,276	4,788	5,306	5,523	418	490	512	518	217
Punjab	3,505	3,795	4,129	4,670	5,101	5,479	290	334	541	431	378
Jammu & Kashmir	1,045	1,181	1,280	1,433	1,532	1,563	137	99	153	99	31
Himachal Pradesh	858	955	1,045	1,131	1,237	1,286	98	90	86	106	49
Chandigarh	623	686	727	824	897	999	63	42	97	73	102
Ladakh	-	-	50	62	75	82	-	50	12	13	7
Northern Region	**24,529**	**26,404**	**28,441**	**32,467**	**35,188**	**38,339**	**1,876**	**2,037**	**4,026**	**2,721**	**3,151**
Pan India	1,14,793	1,25,687	1,37,501	1,54,400	1,70,088	181,452	10,794	11,915	16,898	16,688	11,364

Source: RBI; CRISIL MI&A

In terms of CASA deposits, the northern region accounts for 20% of the CASA deposits in the country and 31% of incremental deposits in the country in fiscal 2023. Punjab accounts for 15% of CASA deposits in the northern region and 3% across pan India.

Trend and share of northern region in CASA deposits in comparison to pan India

	CASA Deposits (Rs billion)						Incremental CASA deposits (Rs billion)				
State/Region	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
NCT Of Delhi	3,488	3,752	4,127	4,884	5,389	5,616	265	375	757	504	227
Haryana	1,817	1,972	2,179	2,578	2,869	2,966	155	208	399	291	96
Rajasthan	1,672	1,856	1,997	2,370	2,727	2,723	184	141	373	357	(4)
Punjab	1,494	1,596	1,689	2,005	2,283	2,373	103	92	316	278	91
Jammu & Kashmir	541	603	659	758	801	792	62	56	99	44	(9)
Himachal Pradesh	347	378	403	453	518	529	30	25	50	65	11
Chandigarh	229	239	256	322	384	412	10	18	65	62	27
Ladakh	-	-	31	40	49	54	-	31	9	9	5
Northern Region	9,586	10,395	11,340	13,410	15,020	15,464	809	945	2,069	1,610	445
Pan India	48,393	53,033	57,840	68,032	76,790	78,245	4,639	4,807	10,192	8,759	1,455

Source: RBI; CRISIL MI&A

In terms of credit, the northern region accounts for 20% of overall credit of SCBs and 15% in the Incremental credit of SCBs as on Mar-23 over Mar-22.

Northern region accounts for 22% of the overall credit of SCBs as on Mar-23

	Actual credit (Rs billion)						Incremental credit (Rs billion)				
State/Region	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
NCT Of Delhi	10,700	12,870	13,486	13,086	13,875	14,963	2,170	616	-401	789	1,088
Rajasthan	2,544	3,071	3,345	3,688	4,177	4,851	528	274	343	489	674
Haryana	2,183	2,473	2,715	2,893	3,355	4,111	290	241	178	462	756
Punjab	2,214	2,286	2,342	2,540	2,758	3,008	72	56	198	218	250
Chandigarh	674	730	780	769	801	756	56	51	-11	32	(45)
Jammu & Kashmir	448	537	587	693	790	905	89	50	106	97	115
Himachal Pradesh	265	294	313	351	396	453	29	19	38	45	57
Ladakh	-	-	18	22	27	33	-	18	4	5	6
Northern Region	19,028	22,262	23,587	24,041	26,180	29,079	3,234	1,325	454	2,139	2,899
Pan India	86,826	98,184	1,04,496	1,10,353	1,22,293	141,980	11,358	6,312	5,857	11,940	19,687

Source: RBI; CRISIL MI&A

In retail credit, northern region accounts for 16% of the retail credit across India and 20% of the incremental retail credit across India as of Mar-23. Punjab accounts for 11% of the retail credit in the northern region as against 15% CASA deposits indicating further growth potential for retail credit in the state relative to deposits.

Northern region accounts for 16% of the retail credit of SCBs as on Mar-23

	Retail credit (Rs billion)						Incremental retail credit (Rs billion)				
State/Region	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
NCT Of Delhi	786	865	1,013	1,061	1,214	1,629	79	148	48	153	568
Rajasthan	627	771	906	1,027	1,228	1,618	144	135	121	201	591
Haryana	476	577	681	779	918	1,362	101	104	98	139	583
Punjab	386	456	528	597	705	896	70	72	70	108	299
Jammu & Kashmir	182	240	274	334	394	485	57	34	60	60	151
Chandigarh	90	106	124	138	162	191	15	19	14	24	53
Himachal Pradesh	90	104	116	136	159	206	14	12	20	23	70
Ladakh	0	0	10	13	17	23	0	10	3	4	10
Northern Region	2,638	3,119	3,652	4,085	4,797	6,411	481	533	433	712	2,326
Pan India	18,307	21,000	24,878	28,229	32,891	40,001	2,693	3,878	3,351	4,662	11,772

Source: RBI; CRISIL MI&A

- In the northern region, PSBs, private banks, SFBs, and foreign banks have their highest proportion of their credit and deposits in the urban population group followed by semi-urban with low proportion in rural population group in terms of both credit and deposits. However, the RRBs have a higher proportion of their credit and deposits in the rural region.

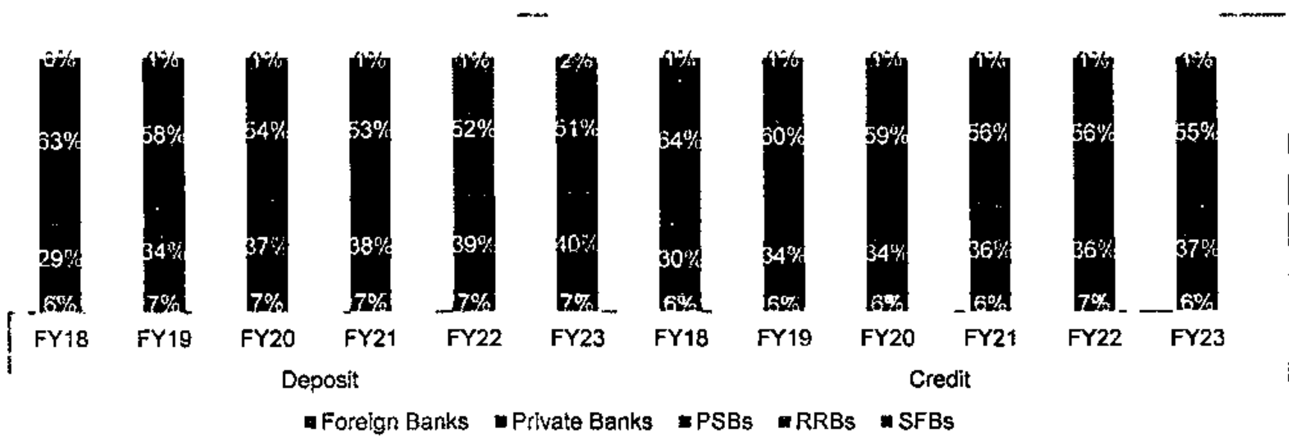
For deposits, within the rural population group of the northern region, share of PSBs is the highest at 66% as on Mar-23 but has decreased constantly from 72% as on Mar-18. This is due to the increasing presence of Private Banks and SFBs in the rural population group. In terms of credit too, we have seen a similar trend with share of PSBs decreasing to 53% on Mar-23 from 66% as on Mar-18. During the same time period (FY18-FY23), SFBs have increased their share marginally and increased their systemic relevance, albeit a low base.

Trend in deposits and credit in the northern region across population groups and lender type

Population Group	Lender Type	Aggregate Deposits in Northern region (Rs billion)						Credit of SCBs in Northern region (Rs billion)					
		Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Urban	Foreign Banks	1,226	1,363	1,625	1,762	1,901	1,984	930	1,022	1,241	1,235	1,394	1,503
	Private Banks	5,675	7,053	7,972	9,479	10,453	12,108	4,685	6,241	6,578	7,112	7,617	8,536
	PSBs	12,192	11,885	11,829	13,353	14,149	15,484	10,008	11,165	11,609	11,081	12,021	12,915
	RRBs	92	95	105	117	132	142	33	38	43	50	59	71
	SFBs	57	126	186	263	388	519	79	129	161	203	261	339
Semi-urban	Foreign Banks	-	7	5	5	6	14	-	54	2	3	6	13
	Private Banks	576	706	788	969	1,111	1,288	517	633	696	832	976	1,291
	PSBs	2,211	2,353	2,676	2,897	3,071	3,262	1,127	1,162	1,229	1,260	1,375	1,560
	RRBs	117	130	145	159	171	186	81	89	96	109	122	138
	SFBs	19	30	39	54	69	85	33	54	75	97	121	143
Rural	Foreign Banks	2	3	2	1	1	1	1	1	1	3	3	1
	Private Banks	335	422	511	612	703	808	277	343	432	512	572	717
	PSBs	1,697	1,854	2,130	2,305	2,467	2,687	1,006	1,048	1,114	1,193	1,254	1,307
	RRBs	319	364	409	468	512	568	245	274	294	333	375	423
	SFBs	11	14	18	23	28	32	5	9	15	18	23	28
All	Foreign Banks	1,228	1,372	1,631	1,769	1,908	2,000	931	1,077	1,245	1,241	1,403	1,517
	Private Banks	6,586	8,181	9,271	11,059	12,266	14,205	5,478	7,217	7,706	8,456	9,166	10,544
	PSBs	16,100	16,092	16,636	18,555	19,687	21,432	12,141	13,375	13,952	13,534	14,650	15,783
	RRBs	528	589	659	743	814	896	360	402	433	492	555	631
	SFBs	87	170	243	340	485	636	118	192	251	318	404	510

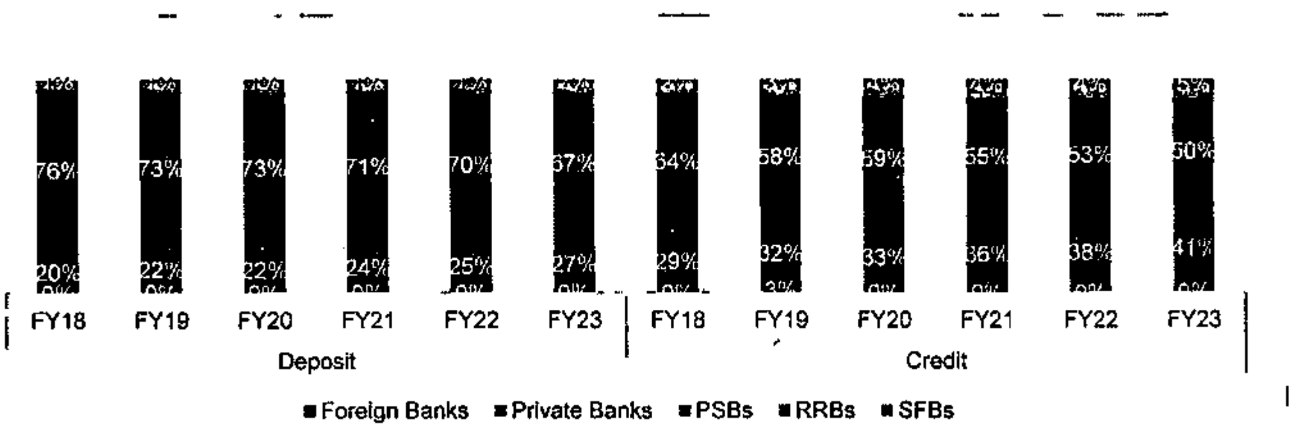
Source: RBI; CRISIL MI&A

Trend in distribution of urban deposits and credit across player groups in the northern region



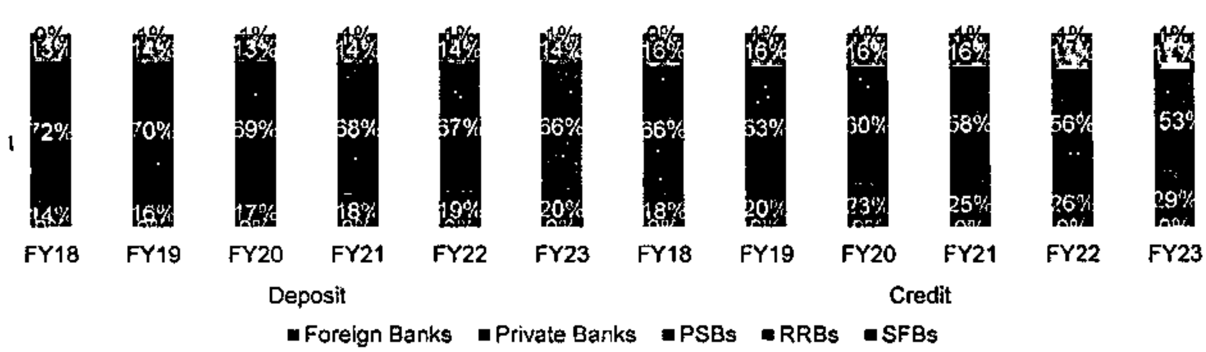
Source: RBI; CRISIL MI&A

Trend in distribution of semi-urban deposits and credit across player groups in the northern region



Source: RBI; CRISIL MI&A

Trend in distribution of rural deposits and credit across player groups in the northern region

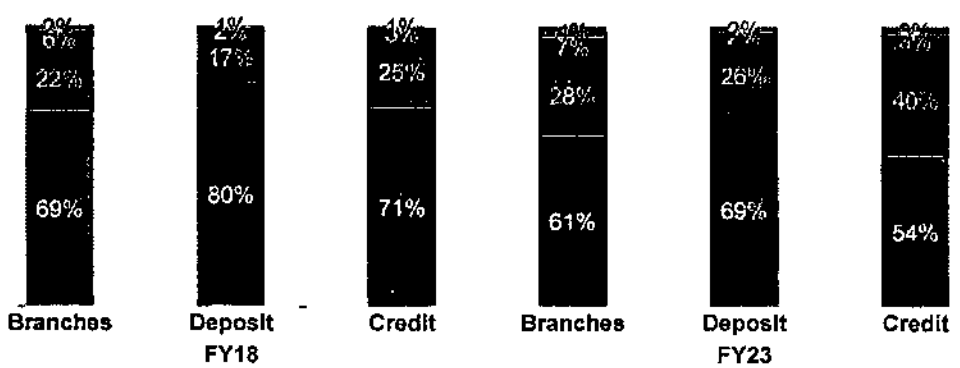


Source: RBI; CRISIL MI&A

Competitive landscape in the state of Punjab in terms of credit, deposits, and branches

Share of public sector banks in Punjab has been seen dwindling as against that of private banks and SFBs. SFBs have a stronger position especially in the rural and semi urban region within the state on account of being present at ground level, understanding the needs of customers and on account of improving financial inclusion in the region. SFBs have increased their market share to 4% in Mar-23 from 2% as on Mar-18. Similarly, their share in deposits and credit has also doubled in the same period. However, their share is still lower than the other player groups and thus there remains a scope of further expansion despite the better performance in prior years. Capital SFB's share of deposits in Punjab is 1.20% of the total deposits of commercial banks in the state which constituted 1.51% of incremental deposits of commercial banks in the state of Punjab from Fiscal 2021 to Fiscal 2023.

Share of SFBs growing in branches, credit and deposit in the state of Punjab



	Branches	Deposit FY18	Credit	Branches	Deposit FY23	Credit
■ SFBs	2%	1%	1%	4%	2%	3%
■ RRBs	6%	2%	3%	7%	2%	3%
■ Private Banks	22%	17%	25%	28%	26%	40%
■ PSBs	69%	80%	71%	61%	69%	54%

■ PSBs ■ Private Banks ■ RRBs ■ SFBs

Source: RBI; CRISIL MI&A

Within Punjab, the districts of Amritsar, Hoshiarpur, Jalandhar, Kapurthala and Ludhiana account for 43% of the overall branches, 53% of the deposits and 48% of the scheduled banks' credit as of March 2023. Their share has been almost stable in the last 4 years in terms of the branches, deposits, and credit within the state of Punjab.

District-wise branches, deposits and credit in the state of Punjab (Mar-23)

Districts	Number of Reporting Offices	Deposit (Rs crore)	Credit (Rs crore)
Amritsar	541	52,498	25,246
Barnala	123	6,124	4,091
Bathinda	316	18,689	16,106
Faridkot	128	7,774	5,287
Fatehgarh Sahib	156	9,354	7,060
Fazilka	166	7,893	7,882
Ferozpur	169	9,940	8,353
Gurdaspur	290	22,281	9,069
Hoshiarpur	378	37,728	9,762
Jalandhar	735	85,101	25,759
Kapurthala	268	27,199	7,103

Ludhiana	872	93,582	75,958
Malerkotla	67	5,326	2,258
Mansa	126	4,824	5,037
Moga	215	13,699	6,680
Muktsar	173	7,495	7,073
Pathankot	137	11,985	4,183
Patiala	427	40,068	24,163
Rupnagar	155	12,582	4,429
Sahibzada Ajit Singh Nagar	435	48,907	26,791
Sangrur	243	13,740	9,537
Shahid Bhagat Singh Nagar	170	14,840	3,261
Tarn Taran	161	8,647	5,637
Punjab Total	**6,451**	**560,275**	**300,724**

Source: RBI; CRISIL MI&A

Trend of district-wise deposits in the state of Punjab

District	Overall Deposits in Punjab (Rs billion)						Incremental Deposits in Punjab (Rs billion)				
	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Amritsar	336	364	391	434	476	525	28	28	42	42	49
Barnala	40	43	46	53	57	61	3	3	7	4	5
Bathinda	118	128	138	158	174	187	11	9	20	16	13
Faridkot	47	53	58	66	74	78	5	5	8	8	4
Fatehgarh Sahib	58	63	69	78	86	94	5	6	9	8	8
Fazilka	45	49	56	66	72	79	5	7	10	6	7
Ferozpur	58	64	68	82	89	99	6	5	13	7	11
Gurdaspur	139	152	168	186	203	223	13	16	18	17	20
Hoshiarpur	248	270	292	335	353	377	22	22	43	18	24
Jalandhar	586	622	669	738	786	851	36	47	69	48	65
Kapurthala	180	193	210	234	254	272	14	17	24	20	18
Ludhiana	572	614	674	763	841	936	42	60	88	78	94
Mansa	29	32	36	41	45	48	3	4	5	4	3
Moga	86	92	98	114	123	137	6	6	15	9	14
Muktsar	45	49	53	61	69	75	4	4	9	8	6
Pathankot	71	79	87	101	109	120	9	7	14	8	11
Patiala	260	281	301	345	372	401	20	20	44	27	29
Rupnagar	76	84	93	106	115	126	8	9	13	9	11
Sahibzada Ajit Singh Nagar	239	268	306	351	414	489	29	38	45	63	75
Sangrur	119	128	138	157	126	137	9	10	19	-31	12
Shahid Bhagat Singh Nagar	102	110	116	133	140	148	8	6	16	7	8
Tarn Taran	51	56	61	70	77	86	5	5	9	7	10
Punjab Total	**3,505**	**3,795**	**4,129**	**4,670**	**5,102**	**5,603**	**290**	**334**	**541**	**432**	**501**

Source: RBI; CRISIL MI&A

Trend in breakup of deposits type across districts in Punjab

Districts	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23

	Current	Savings	Term	Current	Savings	Term	Current	Savings	Term	Current	Savings	Term	Current	Savings	Term
Amritsar	5%	36%	59%	4%	35%	60%	5%	38%	58%	5%	39%	56%	5%	37%	58%
Barnala	4%	44%	53%	4%	43%	54%	4%	46%	50%	3%	48%	48%	4%	46%	50%
Bathinda	4%	36%	60%	4%	35%	61%	4%	37%	59%	5%	40%	55%	4%	37%	59%
Faridkot	4%	40%	56%	3%	39%	58%	3%	42%	55%	3%	44%	53%	4%	42%	55%
Fatehgarh Sahib	7%	39%	54%	6%	38%	57%	8%	40%	52%	7%	43%	49%	7%	42%	51%
Fazilka	5%	47%	47%	5%	45%	50%	6%	47%	47%	6%	49%	45%	5%	47%	48%
Ferozpur	4%	43%	52%	4%	42%	54%	4%	45%	51%	4%	47%	50%	7%	44%	50%
Gurdaspur	3%	46%	51%	3%	44%	53%	3%	47%	50%	3%	48%	49%	3%	47%	50%
Hoshiarpur	3%	41%	57%	3%	40%	57%	3%	41%	56%	3%	43%	54%	2%	41%	57%
Jalandhar	4%	32%	65%	4%	31%	65%	4%	32%	64%	4%	34%	62%	4%	34%	63%
Kapurthala	3%	36%	61%	3%	36%	61%	3%	38%	60%	2%	40%	57%	3%	40%	58%
Ludhiana	8%	37%	55%	7%	36%	58%	7%	37%	55%	8%	38%	54%	8%	37%	56%
Mansa	4%	44%	52%	6%	42%	52%	5%	46%	49%	5%	48%	47%	4%	46%	50%
Moga	3%	42%	55%	3%	41%	56%	3%	44%	53%	3%	46%	51%	3%	45%	52%
Muktsar	4%	45%	50%	4%	44%	52%	5%	46%	49%	5%	49%	47%	4%	46%	49%
Pathankot	4%	39%	57%	4%	38%	58%	4%	39%	57%	4%	40%	56%	4%	38%	58%
Patiala	3%	34%	62%	4%	33%	64%	3%	35%	62%	3%	37%	60%	3%	35%	62%
Rupnagar	2%	44%	54%	4%	43%	53%	3%	43%	54%	2%	44%	53%	2%	44%	54%
Sahibzada Ajit Singh Nagar	4%	37%	58%	5%	35%	60%	5%	36%	58%	5%	40%	55%	6%	39%	55%
Sangrur	4%	40%	57%	4%	39%	57%	4%	42%	55%	3%	42%	55%	3%	39%	58%
Shahid Bhagat Singh Nagar	2%	38%	60%	2%	39%	59%	2%	40%	58%	2%	42%	57%	2%	41%	57%
Tarn Taran	4%	54%	42%	4%	53%	44%	4%	55%	41%	3%	57%	40%	4%	56%	41%
Punjab Total	4%	38%	58%	4%	37%	59%	4%	38%	57%	4%	40%	55%	4%	39%	57%

Source: RBI; CRISIL MI&A

Trend of district-wise credit in the state of Punjab

District	Overall Credit in Punjab (Rs billion)						Incremental Credit in Punjab (Rs billion)				
	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Amritsar	165	177	175	195	223	252	12	-2	20	28	29
Barnala	30	30	31	33	37	41	1	1	2	4	4
Bathinda	99	102	110	125	138	161	2	9	15	13	23
Faridkot	40	42	42	45	49	53	2	0	3	4	4
Fatehgarh Sahib	39	42	43	48	58	71	3	1	6	10	13
Fazilka	66	64	64	68	73	79	-2	1	4	5	6
Ferozpur	66	67	68	73	78	84	1	1	5	5	6
Gurdaspur	73	76	76	79	84	91	3	0	3	5	7

Hoshiarpur	71	84	78	79	87	98	13	-6	1	8	11
Jalandhar	177	189	200	212	230	258	12	10	12	18	28
Kapurthala	50	51	53	57	59	71	1	2	5	2	12
Ludhiana	628	622	618	658	729	760	-6	-4	40	71	31
Mansa	38	39	36	45	43	50	1	-3	9	-2	7
Moga	51	51	52	54	60	67	0	1	2	6	7
Muktsar	56	56	56	58	64	71	-0	1	2	6	7
Pathankot	27	30	30	35	37	42	3	0	5	2	5
Patiala	151	160	166	189	222	242	9	6	23	33	20
Rupnagar	28	31	33	35	39	44	3	1	3	4	5
Sahibzada Ajit Singh Nagar	206	220	255	282	263	268	13	35	27	-19	5
Sangrur	85	85	87	92	84	95	0	1	5	-8	11
Shahid Bhagat Singh Nagar	26	26	27	29	29	33	0	0	3	0	4
Tarn Taran	41	42	44	47	51	56	1	1	3	4	5
Punjab Total	2,214	2,286	2,342	2,540	2,758	3,007	72	56	198	218	249

Source: RBI; CRISIL MI&A

Key steps taken by the government to boost financial inclusion

To improve financial inclusion, especially in rural areas, the government is focusing on improving the overall rural infrastructure for penetration of financial services as well as empowering the development of parallel supporting institutions. This has provided an opportunity for NBFCs and other financial institutions to cater to the unserved population or act as a channel between the larger financial institutions and other service providers to better serve the underserved customers. Further, SFBs and RRBs have increased their share of branches in rural areas as compared to PSBs and Private Banks. The share of branches of SFBs has increased from 1% in fiscal 2018 to 2% in fiscal 2023 and the share of branches of RRBs has increased from 22% to 28% during the same period.

Considerable progress has been made over the past 5-7 years to bring unbanked individuals into the formal banking system. The RBI and the government have taken several measures, such as:

Small Finance Banks (SFBs)

As of July 2021, the RBI had awarded SFB licenses to 12 institutions, which aim to service the underserved customers through savings instruments, and supplying credit to small business units, small and marginal farmers, micro and small industries, and other unorganised sector/lending through informal channels. SFBs are also required to dedicate 75% of their Adjusted Net Bank Credit (ANBC) towards priority sector. Shivalik Mercantile Co-operative Bank (SMCB) had received an in-principal approval from RBI on Jan 6, 2020, and has commenced operations as a small finance bank with effect from 26th April 2021. It became the first urban co-operative bank (UCB) in India to transition to an SFB under the voluntary transition scheme. For the SFBs, nearly 19% of their deposits arise from the rural and semi-urban areas, whereas the credit view shows a geographic skew with 39% of the advances in rural and semi-urban areas as of March 2022. This has led to increasing credit penetration in the rural areas, thereby ensuring financial inclusion. Recently, in June 2021, RBI gave in-principal approval to Centrum Financial Services to set up a small finance bank paving a way for the take-over of Punjab & Maharashtra Co-Operative (PMC) Bank Limited.

Resilient Innovations Private Limited (BharatPe) will be an equal partner. The SFB will be guided by the directions and timelines of the RBI on the amalgamation of PMC Bank Ltd.

Microfinance Institutions

Microfinance institutions (MFIs) and non-banking financial companies (NBFCs) are generally present in areas where commercial banks are not able to service customers. MFIs provide door to door service and strong engagement with borrowers, which makes their networks strong and help them open branches in underserved areas. The operating costs is relatively higher for MFIs given the expansive coverage required for financial inclusion in rural parts. Currently, MFIs charge a higher rate of interest to the customers, as most of their loan portfolio is unsecured or given to slightly risky customers. NBFCs rely on strong tailor-made products by continually introducing customised and flexible offerings for the underserved or untapped market after learning about the needs of the locals. MFIs have a significant role to play in furthering financial inclusion. As of March 31, 2022, 35% of microfinance is held by 98 NBFC-MFIs with a total gross loan portfolio of Rs 1,004 billion. Key NBFC-MFI players in the industry are CreditAccess Grameen, Satin Creditcare Network, Spandana Sphoorty Financial, Asirvad Microfinance, Muthoot Microfin, Arohan Financial, Annapurna Finance and Fusion Microfinance.

A total of 211 entities present in this space with the business of NBFC-MFIs (including SFBs) has grown sharply in recent years to reach Rs 2,931 billion as of the end of Q1FY23. This portfolio size is including that of other NBFCs, not-for-profit MFIs and banks (excluding SHG).

According to the Microfinance Institutions Network (MFIN), NBFC-MFI had a borrower base of 39 million clients as of March 31, 2023. NBFC-MFIs had an average loan ticket size of Rs 42,000 and a total employee base of 1,61,010, providing door-step credit to low-income customers.

Going forward, NBFC-MFIs can tap huge growth opportunities by capturing market share from unorganised financiers and drawing newer customers into their fold, while increasing penetration with existing customers and entering new geographies.

Payment banks

Another step taken towards financial inclusion was the RBI granting in-principle approval on August 19, 2015 to 11 players to launch payment banks. The decision came after the recommendations from Nachiket Mor Committee to set up a specialized bank ("Payments Bank") to cater to the low income groups. After the licences were granted to 11 players, three players withdrew their application. Of the remaining eight, seven institutions – India Post Payments Bank Ltd, Airtel Payments Bank Ltd, PayTM Payments Bank Ltd, Fino Payments Bank, Aditya Birla Idea Payments Bank Ltd and Jio Payments Bank and NSDL Payments Bank had commenced operations. In 2019, Aditya Birla Payments Bank Ltd shut down its operations due to mounting losses.

The objective of a payments bank is to widen the spread of payment services and deposit products to small businesses, low-income households, migrant labor workers and other unorganized entities by enabling high volume low value transactions in deposits and payments/remittance services in a secured technology-driven environment.

Payment banks can accept deposits, subject to a cap of Rs. 100,000 per customer, and provide payment and remittance services through channels, such as the internet, branches, business correspondents (BCs) and mobile banking. However, these banks cannot offer credit facilities directly, but can choose to act as a BC of another bank for credit and other services.

Along with maintaining a cash reserve ratio (CRR) with the RBI, payment banks are required to invest a minimum of 75% of their demand deposit balance in government securities eligible under the statutory liquidity ratio (SLR), with maturity of up to one year, and hold a maximum 25% in current and fixed deposits with Scheduled Commercial Banks (SCBs).

Business Correspondents (BCs)

In one of its foremost measures, the RBI introduced the BC model of banking outreach in January 2006, aimed at leveraging information and communication technology to widen access to the banking system. BCs are retail agents engaged by banks to offer banking services at locations other than a bank branch/ATM. They are authorised to perform a variety of activities including collection of small-value deposits, disbursal of small-value credit, recovery of principal, collection of interest, sale of micro insurance, mutual fund products, pension products, other third-party products, and receipt and delivery of small value remittances/other payment instruments. In July 2014, the RBI allowed NBFC-MFIs to work with banks as BCs. As of March 2020, 600 million basic savings bank deposit accounts (BSBDA) were opened through BCs.

Aadhaar

Adoption of Aadhaar and Aadhaar authentication in the Indian financial system is expected to transform the financial landscape. To increase financial inclusion, the Unique Identification Authority of India partnered with the RBI, National Payments Corporation of India (NPCI), Indian Banks Association (IBA) and banks to develop:

- Aadhaar Payments Bridge (APB) – The system was launched in 2011 to enable a smooth transfer of all government welfare scheme payments to a beneficiary's Aadhaar Enabled Bank Account (AEBA)
- Aadhaar enabled payment system (AEPS) – A system that leverages Aadhaar online authentication and enables AEBAs to be operated in anytime-anywhere banking mode by the marginalised and financially excluded via micro-ATMs

According to the Ministry of Electronics and IT, Aadhaar-generated unique identity covered over 99% of total estimated adult population of India, as of December 2020. An Aadhaar number will be used to verify the identity of a person receiving a subsidy or a service. Disbursements will take place through a centralised electronic benefit transfer system using the unique Aadhaar beneficiary numbers.

The Aadhaar (Targeted Delivery of Financial and Other Subsidies, Benefits and Services) Bill, 2016, came into effect on March 25, 2016, to strengthen the role of the Aadhaar card. The Bill aims at providing targeted delivery of subsidies and services to individuals residing in India by assigning them a unique Aadhaar numbers. To reduce the cost of consumer on-boarding and transactions, the government launched IndiaStack. IndiaStack is a set of APIs that allows government businesses, start-ups and developers to utilise a unique digital infrastructure to solve problems, such as presence-less finance, paperless and cashless service delivery.

Also, Aadhaar-enabled micropayments have many features, including elimination of the need for individual KYC requirements by banks for no-frills or basic accounts, and reductions in the direct and indirect KYC cost of financial institutions on account of the UIDAI's 'know your residence' standards being sufficient for authentication.

Aadhaar-enabled payments with clear authentication and verification process allow financial institutions to network with village-based BCs. Thus, customers will be able to withdraw money and make deposits at the local BC. UIDAI's authentication will help banks verify residents both in person and remotely. The electronic transfer, backed by UIDAI's authentication, will help residents transact electronically, reducing the cost of transactions. Also, it has helped reduce the KYC approval turnaround time from the previous 10-15 days, when the customer had to submit various documents for identity and address proof, to almost-instant KYC approval.

As per the Supreme Court's Judgment of September 2018, the Aadhaar Act was held constitutional, however, it was also held that Aadhaar cannot be made mandatory for availing banking services and body corporates/persons were restrained from using Aadhaar details pursuant to a contract only. It further held that the use of the Aadhaar must be backed by a legislation. Accordingly, the amendment in the legislation was brought about in February 2019, whereby banks were allowed to use Aadhaar for KYC but with customer consent. This enabled banks to open instant bank accounts using eKYC based on Aadhaar authentication through the OTP mode. The change in the RBI's KYC guidelines is in line with the changes made by the government to the Prevention of Money-laundering Rules (PMLA) in February 2019 and the Aadhaar and Other Laws (Amendment) Ordinance, 2019 (passed in Lok Sabha in July 2019). The Department of Revenue, vide its circular issued in May 2019, had also notified that all regulated entities may approach their respective regulators to seek Aadhaar authentication facilities. However, fintech companies are still not allowed to use biometrics or OTP-based eKYC and are only permitted to use offline Aadhaar verification. Furthermore, maximum lending through OTP-based e-KYC is Rs 60,000.

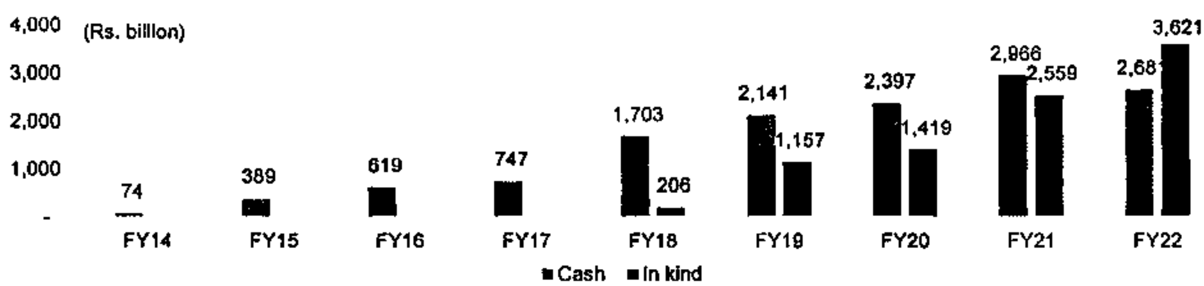
Digital India

An umbrella programme to transform India into a knowledge economy has supported the financial inclusion initiative. Some of the initiatives under this programme include development of digital infrastructure, delivery of government services digitally and improvement in digital literacy, especially in rural India.

Some of the initiatives include:

- **Direct-benefit transfer:** As of end of fiscal 2014, only 28 schemes were covered under the direct-benefit transfer (DBT), where the payment is directly done into the bank account of the beneficiary. This has grown to 318 schemes as of the end of fiscal 2022. Benefit transfer in form of cash through the DBT mechanism has increased from . has resulted in fewer slippages, and faster and easier remittance to the intended. This, in turn, is expected to give rise to the usability of agent network for other related transactions, when the money is already in the bank accounts of customers. CRISIL MI&A expects the availability of funds in the bank accounts of the beneficiaries will support growth in digital transactions.

Amount transferred to beneficiaries through DBT



Note: DBT also includes in-kind transfers which includes transfer of goods and services at very low price or for free to the beneficiaries of various such Government schemes, Source: DBT website; CRISIL MI&A

- **Common service centres 2.0:** This is a service delivery-oriented entrepreneurship model, with a large variety of services made available for citizens. Under Digital India, at least one common service centre (CSC) was envisaged for each of the 250,000-gram panchayats, including the 100,000 operational CSCs launched in the initial version of the programme. The objectives of the programme include:
    - Non-discriminatory access to e-services for rural citizens
    - Expanding the self-sustaining CSC network to the gram panchayat level
    - Empowering District e-Governance Societies (DeGSs) under the district administration for implementation
    - Creating and strengthening the institutional framework for rollout and project management, thereby supporting the state and district administrative machinery
    - Enabling and consolidating online services under a single technology platform
    - Providing a centralised technological platform for delivery of services, transparently to citizens
    - Increasing the sustainability of village-level entrepreneurs (VLEs) by sharing maximum commission earned through delivery of e-services and encouraging women to join as VLEs

  The services to be provided at the CSCs include agriculture services, education and training services, rural banking and insurance services, entertainment services, utility services, healthcare services, and other commercial services.

- **Bharat-Net:** This project aims to provide 100 Mbps broadband connectivity to almost all the 0.25-million-gram panchayats in the country. Under the first phase of the project, 100,000-gram panchayats were to be connected by laying underground optical fibre cable (OFC). Under Phase-II, targeted to be completed by March 2019, connectivity will be provided to the remaining 0.15-million-gram panchayats, using an optimal mix of underground fibre, fibre over power lines, radio and satellite media. As per Bharat Broadband Network Limited (BBNL), ~0.14-million-gram panchayats have been linked with this.

  Moreover, under the 'Digital India program', the government also proposed to provide free-high speed Wi-Fi in 2,500 cities and towns, at an estimated investment of Rs 70 billion. Under the plan, the government aims to set up 50,000-60,000 Wi-Fi hotspots across the country.

CRISIL MI&A expects, on completion, these projects will help catalyse the growth of digital services to the rural masses, and especially to the lower category of the population. This strengthening of digital infrastructure will help various sectors including healthcare, education, skills training, etc. It would provide the private enterprises with an opportunity to expand their services in these remote underserved areas.

Priority sector lending aimed at facilitating financial inclusion

The definition of 'priority sector' was formalised in 1972, based on a report submitted by the Informal Study Group on Statistics, relating to advances to priority sectors, constituted by the RBI in May 1971. The requirement for PSL as a proportion of Adjusted NBC was set at 33.3% for SCBs in 1979 and raised to the current 40% in 1985. Currently, all banks including foreign banks need to comply with this 40% requirement.

Targets and sub-targets for banks were further classified under the priority sector and revised at intervals. As per the latest regulations, unveiled in 2015, medium enterprises, social infrastructure and renewable energy are part of the priority sector, in addition to the existing categories. Also, non-achievement of priority sector targets has been assessed on a quarterly average basis at the end of the respective year, from fiscal 2017 onwards, instead of annually.

As per the RBI, these sub-divisions include:

- **Agriculture:** For all SCBs, 18% of the ANBC or the credit equivalent amount of off-balance sheet exposure (CEOBE), whichever is higher, is to be extended for agriculture. Within the 18% target for agriculture, a target of 10% of ANBC or CEOBE, whichever is higher, has been prescribed for small and marginal farmers. Also, the sub-target of 10% of ANBC or the CEOBE, whichever is higher, is applicable for foreign banks with 20 branches or more, for lending to small and marginal farmers.
- **Social infrastructure:** A maximum bank loan of Rs 100 million will be extended per borrower to build social infrastructure, including schools, healthcare, drinking water, and sanitation facilities, as well as construction/ refurbishment of household toilets and household-level water improvements in tier II to VI centres. Bank credit to MFIs, extended for on-lending to individuals and to members of self-help groups (SHGs)/ joint lending groups for water and sanitation facilities, will be eligible for categorisation as the priority sector under 'social infrastructure'.
- **Renewable energy**: Bank loans up to Rs.300 million will be given to borrowers for solar-based power generators, biomass-based power generators, windmills, micro-hydel plants, and for non-conventional energy-based public utilities (street lighting systems), and remote village electrification. For individual households, the loan limit is Rs 1 million per borrower.
- **Microcredit:** As much as 7.5% of ANBC or the CEOBE for all SCBs should be given in the form of microcredit. Further, the sub-target of 7.5% of ANBC or CEOBE, whichever is higher, for banks' lending to microenterprises will also be applicable to foreign banks with 20 branches and above from fiscal 2019.

  The RBI has also removed the currently applicable loan limits of Rs 50 million and Rs 100 million per borrower to micro/small and medium enterprises (services), respectively, for classification under the priority sector. Accordingly, all bank loans to MSMEs, engaged in the provision or rendering of services as defined in terms of investment in equipment under the MSMED Act, 2006, will qualify under the priority sector without any credit cap.

- **Advances to weaker sections:** 12% of ANBC or the CEOBE, whichever is higher, must to be extended to weaker sections. Foreign banks with 20 branches or more had to achieve the weaker sections target within five years, between April 1, 2013 and March 31, 2018, as per the action plan submitted by them and approved by the RBI.
- **Education loans:** These include loans and advances granted to individuals only for educational purposes, including vocational courses, of up to Rs 2 million. These loans and advances will be considered eligible for the priority sector.

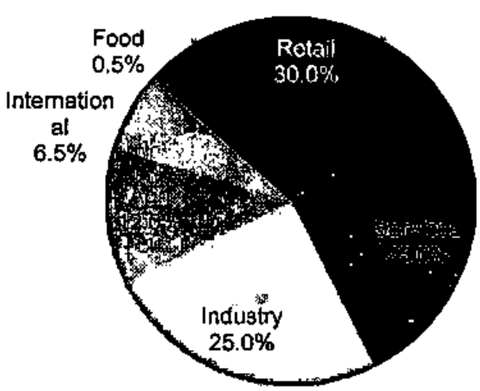
- **Housing:** The government has tried to bring greater convergence of PSL guidelines for housing loans with the Affordable Housing Scheme and boost low-cost housing for economically weaker sections and lower income groups. Thus, it decided to revise the housing loan limits for PSL eligibility from the existing Rs 2.8 million to Rs 3.5 million in metropolitan centres (with a population of 1 million and above), and from the existing Rs 2 million to Rs 2.5 million in other centres, provided the overall cost of the dwelling unit in the metropolitan centre and at other centres does not exceed Rs 4.5 million and Rs 3 million, respectively. For foreign banks with less than 20 branches, no specific sub-targets for sectors are laid out. For these banks, up to 32% can be in the form of lending to exports and not less than 8% can be to any other priority sector.

In September 2020, RBI new guidelines for PSL, wherein higher weights would be assigned to districts having a relatively lower credit penetration. From FY22, a weight of 125% would be assigned to incremental priority sector credit in identified districts where credit flow is lower and per capita PSL is lower than Rs 6,000. A lower weight of 90% will be assigned to incremental PSL in identified districts where credit flow is relatively higher and per capita PSL is more than Rs 25,000. Other districts will continue to have the existing weightage of 100%. This will incentivise credit flow to credit deficient geographies.

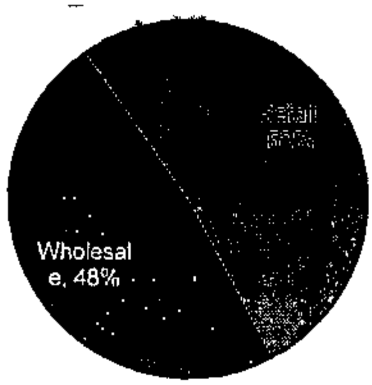
With high focus on retail loans, NBFCs and NBFC-MFIs driving financial inclusion

While banks are the primary institutions for banking in India, retail loan portfolio forms only 30% of the overall banking credit. Other focus areas for banks are wholesale lending to large corporates, credit to services sector and agriculture sector. Lower presence of banks in the retail space has created an opportunity for NBFCs and NBFC-MFIs to penetrate the segment which has also led to greater financial inclusion as NBFCs, and NBFC-MFIs also cater to riskier customer profiles with lower income. Compared to that of banks, NBFC credit to retail segment forms more than 52% of its portfolio and NBFC-MFI exclusively into retail indicating larger focus on retail customers.

Retail credit forms 30% of banking credit as of fiscal 2023 as compared to which...



...retail credit in NBFCs loan portfolio accounts for 52% share as of fiscal 2023



Source: RBI, CRISIL MI&A estimates

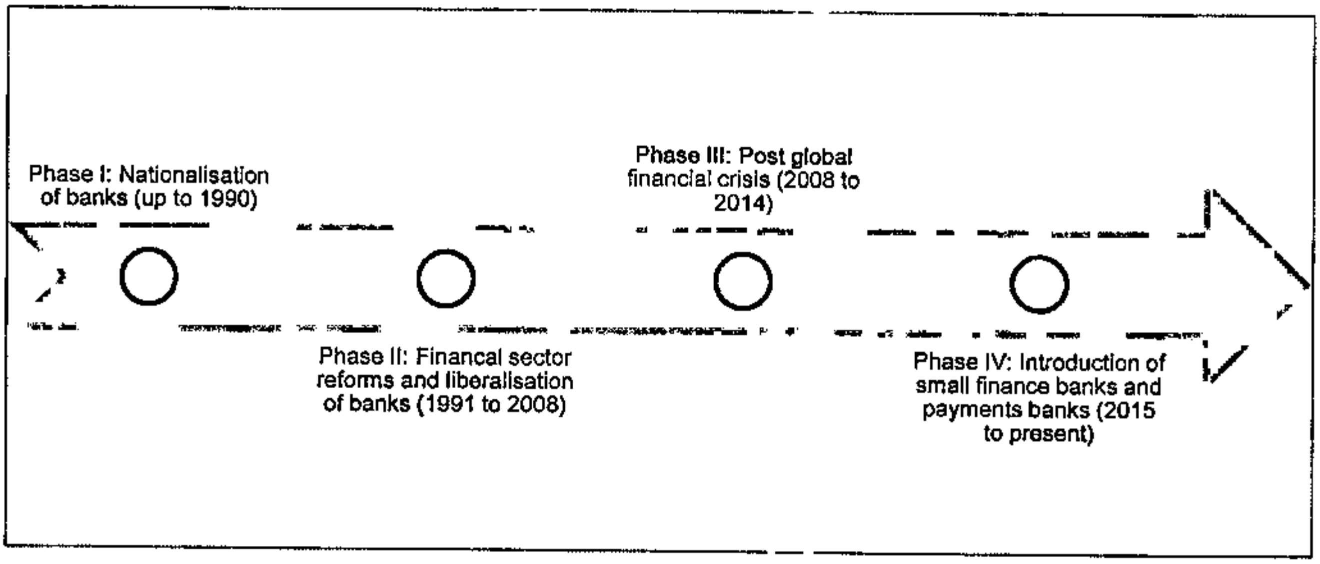
Thus, these entities, in addition to existing larger financial institutions, with help of adoption of the right fit and scalable business model across the asset and liability side can potentially penetrate the gap in financial inclusion and establish a robust and growing business. This is despite the efforts from all the corners to enhance the level of financial inclusion in the country and various schemes and measures implemented for higher financial inclusion. These entities can take benefit from the thrust on this area and can rapidly scale up.

Indian banking Industry

Evolution of the Indian Banking Industry

The banking industry plays a crucial role in mobilising savings and stimulating the economic development of a nation. The banking structure in India has multiple layers to cater to the varied and specific requirements of customers. The existing banking structure in the country has evolved over several decades and has been serving the credit and banking services needs of the economy. The evolution of the Indian banking industry can be divided into four phases following independence. Nationalisation of banks in the first phase was one of the biggest structural reforms the industry has seen. In the second phase, the Indian economy was liberalised in 1991 to make it more market- and service-oriented. This move markedly improved the performance and strength of the banking structure. At present, the Indian commercial banking system is very well-developed and comparable with most of the advanced and emerging economies in the world.

Development of Indian banking industry



Source: CRISIL MI&A

Structural developments in the Indian banking industry and changes related to universal banking licence:

First phase: Nationalisation of banks (up to 1990)	Second phase: Financial sector reforms and liberalisation of banks (1991 to 2008)	Third phase: Post global financial crisis (2008 to 2015)	Fourth phase: Introduction of SFBs and payments banks (2015 onwards)
• Nationalisation of 20 banks in two phases (1969 and 1980)	• 12 new private banks opened between 1991 and 2008	• Two new private banks opened during the period.	• in-principle approval granted to 11 payment banks & 12 SFBs
Key developments: ***Following a series of mergers and amalgamations, the number of commercial banks in the country decreased from 640 in 1947 to 85 in 1969** ***State Bank of India Act, 1955** ***State Bank of India (Subsidiary Banks) Act, 1959** ***Bank nationalisation: Banking Companies (Acquisition and Transfer of Undertakings) Ordinance 1969: Government acquired 14 commercial banks with deposits over Rs 500 million** **1980: The government nationalised six banks with deposits over Rs 2,000 million**	**Key developments:** **January 1993:** **The RBI released guidelines for licencing of new banks** in the private sector. **Ten new** banks were formed on the basis of these guidelines **January 2001:** **The RBI revised the guidelines for new bank licences. Later, two new banks** — Kotak Mahindra Bank and YES Bank — were formed	**Key developments:** **August 2010:** The RBI released a discussion paper on the entry of new banks into the private sector **August 2011:** The RBI released draft guidelines for licensing of new banks in the private sector **February 2013:** The RBI released final guidelines for licencing of new banks **September 2013:** A committee was formed, headed by Bimal Jalan, to screen the applications **April 2014:** The RBI granted in-principle approval to IDFC and Bandhan Financial Services to set up banks	**Key developments:** **August 2015:** In-principle approval to 11 applicants to set up payment banks **September 2015:** In-principle approval to 10 applicants to set up SFBs **August 2016:** Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector **October 2016:** Guidelines for SFBs and payment banks **December 2019:** Guidelines for 'on tap' Licensing of Small Finance Banks in the Private Sector

Source: RBI, CRISIL MI&A

Phase 1: Nationalisation of banks

Following a spate of mergers and amalgamations, the number of commercial banks in the country decreased from 640 in 1947 to 85 in 1969. The first phase of the Indian banking industry's evolution is the most prominent one as it laid down the foundation of the Indian banking industry. It began with the State Bank of India Act (1955), through which the RBI acquired a controlling interest in Imperial Bank of India, and it became State Bank of India. However, the government later acquired the RBI's stake in the State Bank of India to avoid any conflict of interest. In a move to smoothen the functioning of the banking industry, the government passed the State Bank of India (Subsidiary Banks) Act in 1959, which made eight state banks associates of the SBI.

The biggest reform during the first phase came with the nationalisation of banks, which occurred in two stages. First, in July 1969, the Government of India acquired 14 large commercial banks with the basic objective of ensuring credit flow to priority sectors of the economy. Second, in April 1980, six more banks, with cumulative deposits of over Rs 2,000 million, were nationalised. This move increased banking penetration in the country considerably.

Phase 2: Financial sector reforms and liberalisation of banks (1991 to 2008)

The period beginning from the early 1990s witnessed the transformation of the banking sector as a result of the financial sector reforms that were introduced as a part of structural reforms initiated in 1991. The reform process in the financial sector was undertaken with the prime objective of creating a strong and resilient banking system. The progress achieved in the areas of strengthening the regulatory and supervisory norms ushered in greater accountability and market discipline among the participants.

Since 1991, the size of the Indian economy in terms of GDP at market prices has increased several times. Consequent to the recommendations of the Narasimham Committee I in 1991, guidelines were released in 1993 with a minimum capital requirement of Rs 1,000 million for new banks. Under the 1993 guidelines, 10 new private sector banks received their licence. In the aftermath of the recommendations of the Second Report of the Narasimham Committee on Banking Sector Reforms, a new set of guidelines were issued in 2001 with the capital requirement of banks set at Rs 3,000 million. Under the 2001 guidelines, two new private sector banks were licenced.

With competition increasing in the immediate aftermath of liberalisation, credit and deposits continued to grow at a healthy 19% and 18% CAGR, respectively, between the ends of fiscal 1991 and 2008. Several players in the private sector acquired critical mass during the phase and the share of private sector increased to 21% by the end of fiscal 2008.

Phase 3: Post global financial crisis (2008 to 2015)

The third phase of the banking evolution started with the global financial crisis. The crisis hit the global banking industry severely and many big global banks collapsed. Foreign banks operating in India significantly withdrew from the credit market in several jurisdictions, and more so where they had branch presence. Growth in lending by foreign banks dropped to 4% and -1% during fiscals 2009 and 2010. The crisis also impacted the growth of the Indian banking industry. However, compared with advanced economies, India faced the global financial crisis of 2007-09 from a position of strength, with the limited openness of the Indian financial system working in its favour. To further strengthen the Indian banking system, multiple measures like Basel III introduction and revised regulatory framework for NBFCs were undertaken by the RBI after the crisis. On December 30, 2011, the RBI released the draft guidelines for Indian banks under Basel III. Final guidelines on Basel III Capital Regulations were implemented in India with effect from April 1, 2013, in a phased manner until March 31, 2019.

Phase 4: Introduction of small finance banks and payments banks (2015 to present)

The fourth phase of the banking evolution started with RBI granting Small Finance Bank (SFB) licenses to ten players and payment bank licenses to eleven entities in 2015. A total of seventy-two players had applied for SFB license and 10 were granted the same by RBI. Eight out of these ten entitles granted SFB license were microfinance institutions. The exceptions were Capital Local Area Bank Limited (Now Capital Small Finance Bank), which operated in five districts of Punjab, and Au Financiers (Now AU Small Finance Bank) which was a non-banking financial corporation. SFBs emerged to fulfill the requirement of providing fundamental banking services, such as accepting deposits and offering loans, to segments that were unserved or underserved. The key incentive for Micro Finance Institutions (MFI) for converting into SFBs was the access they gain to deposits and to offer a wider range of loan products to customers. The objectives of setting up of small finance banks were to further financial inclusion by provision of savings vehicles, and supply of credit to small business units; small and marginal farmers; micro and small industries; and other unorganised sector entities, through high technology-low-cost operations. The objectives of setting up of payments banks were to further financial inclusion by providing small savings accounts and payments/remittance services to migrant labour workforce, low-income households, small businessess, other unorganised sector entities and other users. In October 2016, RBI came out with operating guidelines for Small Finance Banks and Payments Banks.

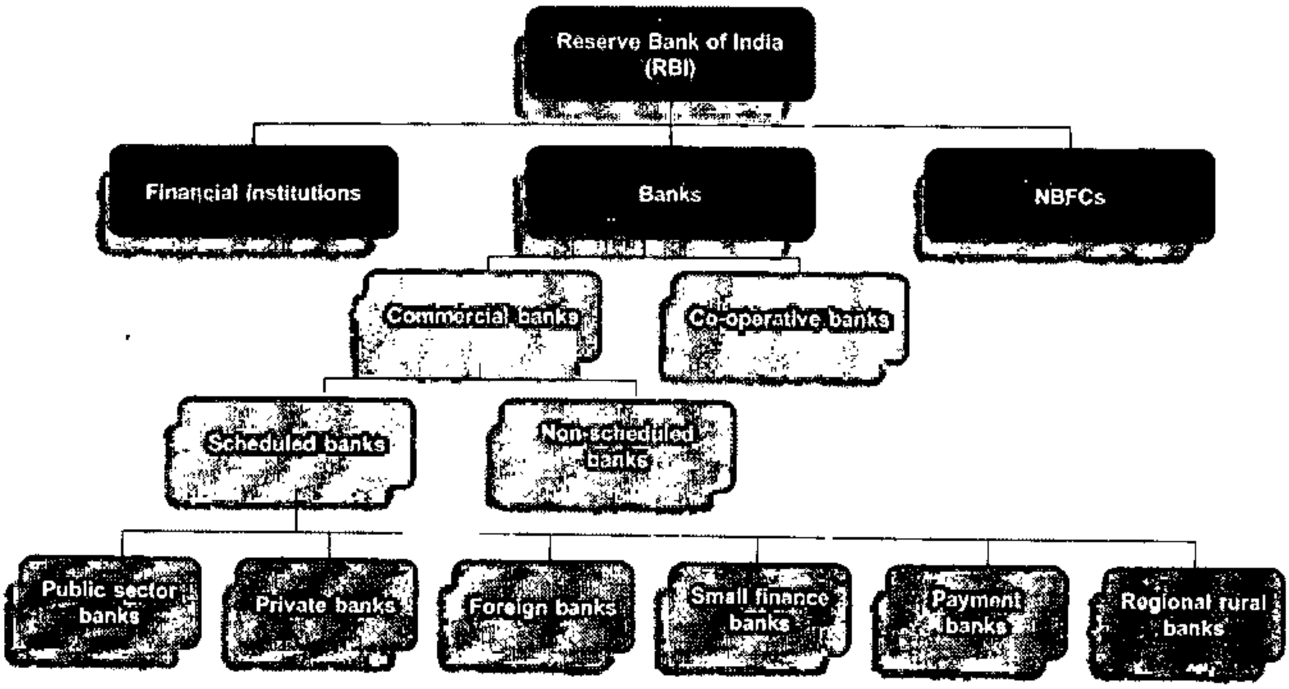
In 2016, RBI also notified on guidelines for 'on tap' licensing of Universal Banks in the Private Sector with an objective to increase competition and bring newer ideas into the banking system. Similarly, in December 2019, RBI notified on guidelines for 'on-tap' licensing of Small Finance Banks in the Private Sector with a similar objective to encourage competition.

In June 2020, the RBI had constituted a five-member IWG (internal working group) headed by Shri Prasanna Kumar Mohanty to examine existing licensing and regulatory guidelines relating to ownership and control, corporate structure and other related issues. In November 2020, the report of the IWG was released. Major recommendations of the group include allowing the large corporate/industrial houses as promoters of banks after necessary amendments to the Banking Regulations Act, 1949, considering well run large Non-banking Financial Companies (NBFCs, with an asset size of Rs 500 billion and above, including those which are owned by a corporate house) for conversion into banks, and relaxing the eligibility criteria for Payments Banks intending to convert to a Small Finance Bank from a track record of 5 years of experience as Payments Bank to 3 years. Other recommendations revolved around corporate structure of Non-operative Financial Holding Company (NOFHC), listing requirements for banks, harmonisation of licensing guidelines, promoter shareholding, initial capital, pledging of shares and ADR/GDR issued by banks.

Banking industry overview

The Indian banking system currently consists of 12 public sector banks, down from 26 owing to the merger of some public sector units to make them more relevant, 21 private sector banks, 42 foreign banks, 43 regional rural banks, 12 SFBs, 6 payment banks, 2,550 cooperative banks. All the banks fall under the purview of the RBI.

Structure of Indian banking system



Note: All India Financial Institutions includes NABARD, SIDBI, EXIM Bank

Source: RBI, CRISIL MI&A

Key regulations and developments in the banking sector

Changes in interest rate regime

Effective October 25, 2011, the RBI deregulated the deposit rate on savings bank accounts. It also changed the base rate calculation methods to reflect the marginal cost of funds. All floating rate rupee loans sanctioned and credit limits renewed from April 1, 2016 were priced with reference to a bank's marginal cost of funds-based lending rate (MCLR,) which is the internal benchmark for such purposes. The RBI issued a circular on September 4, 2019 making it mandatory for banks to link all floating rate personal or retail loans and floating rate loans to housing, auto and MSME borrowers to an external benchmark with effect from October 1, 2019. Subsequent to the introduction of this system, monetary policy transmission improved and it was decided that all new floating rate loans extended to MSME from April 1, 2020 would be linked to external benchmarks. Effective monetary transmission needs to happen on both sides, to avoid asset liability mismatch, hence banks would like to look at possibilities of linking their liabilities with external benchmark. Banks are free to choose one of the several benchmarks indicated in the circular. Banks are also free to choose their spread over the benchmark rate, subject to the condition that the credit risk premium may undergo a change only when a borrower's credit assessment undergoes a substantial change, as agreed upon in the loan contract.

With the advent of various digital systems and to address various integration issues, there have been efforts to bring industry-wide standards. With respect to loan pricing, banks are being nudged to link the price of all their loans and deposits to an external observable benchmark, but no such regulation applies at present.

Developments related to the licencing of Universal banks in the private sector

The share of public sector banks in the total assets of banks declined from over 90% in the early 1990s to ~74% in March-end 2011 and further to 56% as on Mar-21 with private banks gaining share. Another drive for providing licences to a limited number of new banks had begun following the announcement in the Union Budget 2011 and as indicated in the RBI's Policy Statement of April 2010.

Further, in February 2013, fresh guidelines for licencing of new banks were issued. The guidelines, *inter alia*, permitted business/industrial houses to promote banks, conversion of NBFCs into banks and setting up of new banks in the private sector by entities in the public sector through a Non-Operative Financial Holding Company (NOHFC) structure. The minimum capital requirement for setting up a bank was Rs 5 billion. In 2014, the RBI granted in-principle approval to IDFC and Bandhan Financial Services to set up banks, both of which commenced operations in fiscal 2016.

Consolidation of public sector banks

The government has been consolidating public sector banks (PSBs) to create banks with stronger balance sheets, rationalize capital structure of the banks, improve efficiency of the banks, diversify risk and improve ability to finance larger projects. The aim is enhancing value for stakeholders over a period of time. In 2017, five associated banks (State Bank of Bikaner & Jaipur, State Bank of Mysore, State Bank of Travancore, State Bank of Patiala and State Bank of Hyderabad) and Bharatiya Mahila Bank became a part of SBI. In fiscal 2019, Dena Bank and Vijaya Bank was merged with Bank of Baroda. LIC also acquired a controlling 51% stake in the stressed IDBI Bank

In August 2019, the government further announced its plan to merge 10 state-owned banks into four to strengthen a sector which is struggling with bad loan clean-up and create banks with stronger balance sheet to boost credit growth. The banks which were impacted due to this exercise are as follows:

- Oriental Bank of Commerce and United Bank are merged into Punjab National Bank, making it the second largest nationalised bank in terms of business and branch network
- Canara Bank and Syndicate Bank merged into a single entity, making it the fourth largest PSB after Bank of Baroda
- Andhra Bank and Corporation Bank were merged into the Union Bank of India, creating the fifth-largest lender of the country
- Indian Bank and Allahabad Bank were merged into a single unit, making it the seventh largest PSB

These merged entities became effective from April 1, 2020 onwards and are expected to reap benefits from economies of scale and synergy with respect to current and saving accounts, network of branches and employees. This exercise is also expected to bring down operational cost significantly and increase banks' ability to absorb shocks.

Licencing of SFBs and Payments Banks

In September 2013, Committee on Comprehensive Financial Services for Small Businesses and Low-Income Households, headed by Nachiket Mor, was formed by the RBI. In January 2014, the Nachiket Mor Committee submitted various recommendations, among which it recommended the formation of two new categories of bank called Payments Bank and Small Finance Banks. In November 2014, RBI released the final guidelines for Payment Banks and Small Finance Banks. In 2015, RBI gave "in-principle" licences to eleven entities to launch Payments Banks and awarded Small Finance Bank licences to 10 players. In 2020 and 2021, RBI gave "in-principle" approval to two more small finance banks, making the total count of SFBs in the country at 12.

On-tap Universal banks' licensing in the private sector

After the successful experience of licensing two universal banks in 2014 and granting final approvals for SFBs and payment banks, in August 2016, the RBI released the framework for granting 'on-tap' licences to universal banks in the private sector. Under this facility, the RBI accepts applications and grants banking licence throughout the year. The policy allows aspirants to apply for a universal bank licence at any time, subject to the fulfilment of the set conditions.

Some of the key eligibility features are:

- Minimum 10 years of successful track record of existing NBFCs (that are resident-owned and controlled) / promoter / promoting entity / promoter group / entities / group in private sector (that are resident-owned and controlled). Non-financial business of such entity / group should not account for 40% or more in cases where the total asset of the entity / group adds to more than Rs 50 billion.
- Initial minimum paid-up voting equity capital of Rs 5 billion. Minimum net worth of Rs 5 billion at all times (also applicable to NBFCs converting into banks).
- Aggregate foreign investment limit not more than 74%.
- After getting the licence, as per the guidelines, the entity shall get its shares listed on the stock exchanges within six years of the commencement of business by the bank. The bank shall open at least 25% of its branches in unbanked rural centres (population up to 9,999 as per the latest census). The bank shall comply with the priority sector lending targets and sub-targets as applicable to the existing domestic scheduled commercial banks.

As per the RBI's guidelines, the licensing window will be open on-tap, and the applications in the prescribed form along with requisite information could be submitted to the RBI at any point of time. The applications will be referred to a Standing External Advisory Committee (SEAC) to be set up by the Central bank. The committee will submit its recommendations to the RBI for consideration. The Internal Screening Committee (ISC), consisting of the governor and the deputy governors, will examine all the applications and submit its recommendations to the Committee of the Central Board of the RBI for a final decision to issue in-principle approval. The validity of the in-principle approval issued by the RBI will be 18 months from the date of granting in-principle approval and would thereafter lapse automatically.

On-tap Small Finance Banks' licensing in the private sector

RBI, in December 2019, released the final Guidelines for 'on-tap' licensing of small finance banks in the private sector and opened the window for applicants to approach the regulator at any point in time for on-tap licensing of SFBs. Below are some of the key eligibility features:

- Existing Non-Banking Finance Companies (NBFCs), Micro Finance Institutions (MFIs), and Local Area Banks (LABs) in the private sector, that are controlled by residents and having successful track record of running their businesses for at least a period of five years will be eligible to apply for SFB licence.
- Additionally, existing Payments Banks (PBs) which are controlled by residents and have completed five years of operations will also be eligible to apply for SFB licence.
- The minimum paid-up voting equity capital for small finance banks shall be Rs 2 billion. In case of an existing NBFC/MFI/LAB/PB, the entity shall have a minimum net worth of Rs 2 billion, or it shall infuse additional paid-up voting equity capital to achieve net worth of Rs 2 billion within eighteen months from the date of in-principal approval or as on the date of commencement of operations, whichever is earlier. For cooperative banks, the entity shall have a minimum net worth of Rs 1 billion, which should be increased to Rs 2 billion within five years from the date of commencement of operations.
- Listing of the small finance bank will be mandatory within three years after it reaches the net worth of ₹5 billion for the first time.

The SFB will be required to maintain a minimum capital adequacy ratio of 15 per cent of its risk weighted assets (RWA) on a continuous basis, subject to any higher percentage as may be prescribed by RBI from time to time. Tier I capital should be at least 7.5 per cent of RWAs. Tier II capital should be limited to a maximum of 100 per cent of total Tier I capital. Basel II norms will be generally applicable to the small finance banks, unless stipulated otherwise.

As per the RBI's guidelines, the licensing window will be open on-tap, and the applications in the prescribed form along with requisite information could be submitted to the RBI at any point of time. The applications will be referred to a Standing External Advisory Committee (SEAC) to be set up by the central bank. The committee will submit its recommendations to the RBI for consideration. The Internal Screening Committee (ISC), consisting of the governor and the deputy governors, will examine all the applications and submit its recommendations to the Committee of the Central Board of the RBI for a final decision to issue in-principle approval. The validity of the in-principle approval issued by the RBI will be 18 months from the date of granting in-principle approval and would thereafter lapse automatically.

Recently, in June 2021, RBI gave in-principle approval to Centrum Financial Services to set up a small finance bank paving a way for the take-over of Punjab & Maharashtra Co-Operative (PMC) Bank Limited. Resilient Innovations Private Limited (BharatPe) will be an equal partner. The SFB will be guided by the directions and timelines of the RBI on the amalgamation of PMC Bank Ltd. Shivalik Bank has already started operations at the beginning of this fiscal after receiving approval to do so as an SFB.

Regulatory development timeline for banking sector

November 1974: Official notification on priority sector lending norms

- In November 1974, banks were advised to raise the share of these sectors in their aggregate advances to the level of 33.33% by March 1979

April 1992: Prudential norms and introduction of Basel I in the Indian banking system

- Prudential norms relating to income recognition, asset classification, provisioning and capital adequacy (Basel I) were introduced in a phased manner

January 1993: Reduction in SLR

- A phased reduction in SLR was undertaken from January 1993. SLR was progressively brought down from the peak rate of 38.5% in February 1992 to the then statutory minimum of 25% by October 1997

April 1993: Phased reduction in CRR

- CRR was progressively reduced effective April 1993 from the peak level of 15% to 4.5% by June 2003

April 1993: Rationalisation of lending interest rates

- Rationalisation of lending interest rates was undertaken from April 1993, initially by simplifying the interest rate stipulations and the number of slabs, and later by deregulation of interest rates. Deposit interest rates, other than those on savings deposits and FCNR(B), were fully deregulated

April 1997: Phasing out maximum permissible bank finance

- The maximum permissible bank finance (MPBF) was phased out from April 1997

March 2000: Change CAR norms for banks

- In order to strengthen the capital base of banks, the capital to risk-weighted assets ratio for banks was raised to 9% from 8%, from the year ended March 31, 2000

January 2001: Revised guidelines on new bank licences

- The RBI revised the guidelines for new bank licences. Two new banks — Kotak Mahindra Bank and YES Bank — were formed

2001-2004: FDI limit in foreign banks

- With a view to liberalising foreign investment in the banking sector, the government announced an increase in the foreign direct investment (FDI) limit in private sector banks under the automatic route to 49% in 2001 and further to 74% in March 2004, including investment by FIIs, subject to guidelines issued by the RBI

February 2005: Policy framework for governance in private sector banks

- A comprehensive policy framework for governance in private sector banks was put in place in February 2005 to ensure (i) ultimate ownership and control was well diversified; (ii) important shareholders were 'fit and proper'; (iii) directors and CEO were 'fit and proper' and observed sound corporate governance principles; (iv) private sector banks maintained minimum capital for optimal operations and for systemic stability; and (v) policy and processes were transparent and fair

February 2005: Guidelines on Basel II issued by the RBI

- In February 2005, the RBI issued the first draft guidelines on Basel II. Initially, the Basel II implementation target was set for March 2007 but was postponed later. The RBI had implemented Basel II standardised approach (for credit and market risks) and basic indicator approach in internationally active banks by March 2008 and other scheduled commercial banks by March 2009

July 2005: Guidelines to banks on purchase / sale of non-performing assets

- To increase the options available to banks for resolving their non-performing assets (NPAs) and to develop a healthy secondary market for NPAs, where securitisation companies and reconstruction companies are not involved, the RBI issued guidelines to banks on purchase / sale of NPAs

November 2005: No-frills account

- Banks were advised to introduce a facility of 'no-frills' account with nil or low minimum balances in November 2005

January 2006: Permission to use services of BCs

- In January 2006, banks were permitted to use the services of non-governmental organisations (NGOs/ SHGs), MFIs other civil society organisations as intermediaries in providing financial and banking services through the use of business facilitator and BC models

July 2007: Revision in credit exposure norms for banks

- Revision in exposure norms for banks

July 2010: Introduction of base rate mechanism for lending by banks

- The base rate system was introduced with the aim of enhancing transparency in the lending rates of banks and enabling better assessment of transmission of monetary policy. With effect from July 1, 2010, all categories of domestic rupee loans were priced only with reference to the base rate and this system was applied to all new loans and to old loans that came up for renewal

2010-2011: Deregulation of savings rate

- Effective October 25, 2011, the RBI deregulated the deposit rate on savings bank accounts

April 2012: Revisions to the guidelines on securitisation transactions

- Guidelines on the minimum lock-in period and minimum retention criteria for securitised loans originated and purchased by banks and NBFCs. These guidelines also cover prudential treatment of transfer of assets through direct assignment of cash flows and the underlying securities, if any

May 2012: Final guidelines on Basel III implementation

- Guidelines on implementation of Basel III capital regulations in India

July 2014: Revised Basel III norms

- Revised guidelines on Basel III capital regulations implemented in India with effect from April 1, 2013, in a phased manner till March 31, 2019

April 2014: New universal banking licence to IDFC and Bandhan

- In 2014, the RBI granted in-principle approval to IDFC and Bandhan Financial Services to set up banks, both of which started operations in fiscal 2016

April 2015: Revision in priority sector guidelines

- Medium enterprises, social infrastructure and renewable energy to form part of the priority sector. The distinction between direct and indirect agricultural priority lending has been dispensed. The priority sector non-achievement would be assessed on a quarterly average basis at the end of the respective year from fiscal 2017 onwards, instead of annual basis as at present

August 2015: Introduction of payment banks

- In-principle approval for setting up payments banks were granted to 11 applicants on August 19, 2015

September 2015: Introduction of SFBs

- On September 16, 2015, in-principle approvals were granted to 10 applicants for setting up SFBs

May 2016: Promulgation of the Insolvency and Bankruptcy Code

- A watershed event that has allowed the valuation of age-impaired assets to be put in persepective. While the transfer of such assets to various asset reconstruction companies was not effective owing to valuation issues, IBC, through its auction mechanism, allows such assets to have executable bids

August 2016: Guidelines for 'on tap' Licensing of Universal Banks in the Private Sector

- Focusing towards increasing the level of competition and bringing new ideas in the system, the RBI decided to grant on-tap universal banking licences to the applicants that satisfy the eligibility criteria

October 2016: Introduction of marginal cost of funds-based lending rate

- This new methodology replaces the base rate system introduced in July 2010. All rupee loans sanctioned and credit limits renewed w.e.f. April 1, 2016 are being priced with reference to the MCLR

October 2016: Guidelines for SFBs and payment banks

- Considering payments banks and SFBs' differentiated nature of business and their focus on financial inclusion, separate operating guidelines for these banks were issued in October 2016. The guidelines elaborate the areas of prudential regulations, risk management, ownership and control regulations, corporate governance, and banking operations to be

November 2016: Withdrawal of legal tender character of existing Rs 500 and Rs 1,000 bank notes

- Withdrawal of currency notes with denominations of Rs 500 and Rs 1,000 from circulation with actions to be taken by citizens and procedure for exchange of the notes and the provision for such facility along with further reporting mechanism for the banks were notified

December 2016: Final guidelines on large exposure framework

- Towards aligning the exposure norms for Indian banks with the Basel Committee of Banking Supervision standards and to further diversify the banks' lending base, on December 1, 2016, the RBI issued final guidelines on LEF, effective April 1, 2019. The exposure limits will consider a bank's exposure to all its counterparties and groups of connected counterparties

December 2018: Guidelines on loan system for delivery of bank credit

- To enhance credit discipline among larger borrowers, the guidelines on the loan system for delivery of bank credit were finalised wherein the minimum level of loan component, effective date of loan, share of woirking capital of loan, amount and tenor of loan, repayment/rollover/renewal of loan component and risk weights related guidelines were issued

June 2019 Revised prudential framework on stressed assets

- In addition to building an incentive for early adoption of a resolution plan, its applicability was also extended to SFBs, NBFC -SI, deposit-taking NBFCs and All India Term Financial Institutions

December 2019: Guidelines for 'on tap' Licensing of Small Finance Banks in the Private Sector

- After a review of the performance of the existing small finance banks and to encourage competition, the Reserve Bank, after gaining experience in dealing with these banks, has considered 'on tap' licensing of these banks. Under this facility, the RBI accepts applications and grants small finance banking licence throughout the year.

September 2020: Banking Regulation (Ammendment) Bill, 2020

- Lok Sabha passed banking Regualtion Ammendment Bill, 2020 to bring urban and multi-state co-operative banks under the supervision of the RBI.
- The bill allows RBI to initiate a scheme for reconstruction of a bank without placing it under moratorium. Also, if the RBI imposes moratorium on a bank, the lender can not grant any loans or make investments in any credit instruments during the moratorium tenure.
- The co-operative banks will be allowed to issue equity, preference, or special shares on face value or at a premium to its members, or to any other person residing within their area of operations. The banks may also issue unsecured debentures or bonds or similar securities with maturity of ten or more years to such persons. Such issues can be made only after prior approval from RBI.

Source: RBI, company reports, CRISIL MI&A

Systemic credit to grow at 10-12% CAGR between Fiscal 2023-2025

Overall systemic non-retail credit grew ~9% in Fiscal 2019, mainly driven by public sector undertakings and energy sector (oil and gas and power generation and distribution). The corporate credit of banks grew just ~3% on-year as of March 2019, as demand dropped sharply, and alternate capital market channels opened up. The financial sector, which was already reeling under the NBFC liquidity crisis, saw financial institutions turn cautious towards corporate lending and shift their focus towards the retail segment. While this shift has caused retail credit to drive overall credit growth, it witnessed a slowdown in growth from 18.3% in Fiscal 2018 to 15.4% in Fiscal 2019 on account of a slump in consumption. The slowdown in economic activity, coupled with heightened risk aversion among lenders, further tightened the overall credit growth to ~6.6% in Fiscal 2020. Retail credit grew by 16.3% in Fiscal 2020.

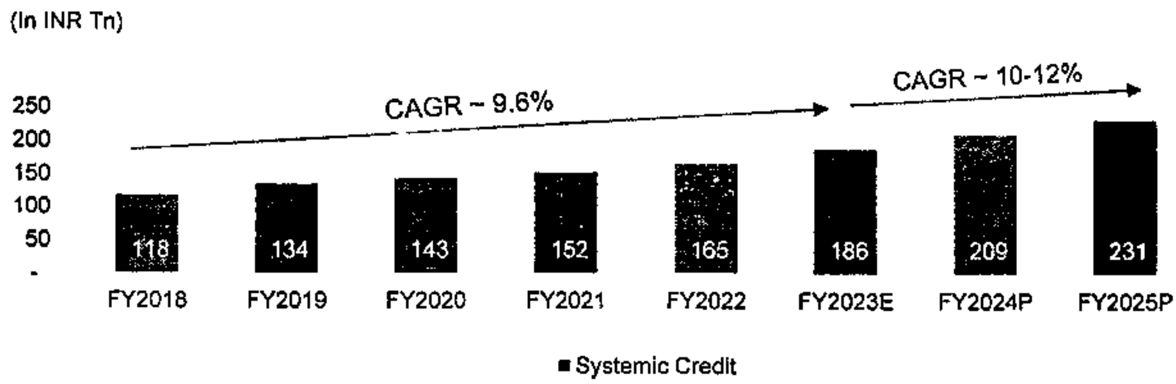
During pandemic

Overall systemic credit growth took a hit in first half of Fiscal 2021 on account of a significant slowdown in retail credit and intensifying COVID-19 pandemic which triggered a national lockdown. The COVID-19 pandemic came as a jolt for an already slowing economy with a decadal low growth in GDP, low private consumption, cautious lending by financial institutions, poor capital expenditure (capex), and in turn, weakening credit growth. However, with a slew of government and regulatory measures announced, Indian economy started to revive in the second half of the Fiscal. In Fiscal 2021, credit grew by ~6.4% supported by disbursements to MSMEs under the Emergency Credit Line Guarantee Scheme (ECLGS) and an uptick in economic activity post the COVID-19 lockdown.

Post pandemic

In Fiscal 2022, the systemic credit growth picked up steam despite the second wave of COVID-19 hurting economic growth in the first quarter of the Fiscal. The systemic credit grew at 8.6% from the previous year to reach ~INR 165 trillion. The growth was mainly driven by the budgetary push towards investments, pick-up in private investment, and business activity also slowly humming back to pre-COVID-19 levels. CRISIL MI&A projects systemic credit to grow at 10-12% CAGR between Fiscals 2023 and 2025 on back of pent-up retail demand from sectors like housing and auto in Fiscal 2023. Credit demand also grew due to strong credit demand from NBFCs and trade segment.

Systemic growth is estimated to have grown at 13% year on year in fiscal year 2023



Note: E: Estimated; P: Projected; Systemic credit includes domestic banking credit, NBFC credit, commercial papers, external borrowings, corporate bonds excluding those issued by Banks and NBFC
Source: RBI, Company Reports, CRISIL MI&A

Bank credit to move marginally faster than systemic credit

Over the past decade, banking credit growth lagged systemic credit growth for several years as NBFCs grew at a much faster pace. However, the NBFCs suffered a blow after IL&FS defaulted in September 2018. NBFCs, lacking the advantage of size, rating, and/or strong parentage, found themselves in the midst of a liquidity crisis and faced challenges in raising funds. Initially, post the IL&FS crisis, banks were expected to fill the space left out by NBFCs. However, with slower economic growth and muted private capex, banking credit growth remained low at ~6.8% in Fiscal 2020.

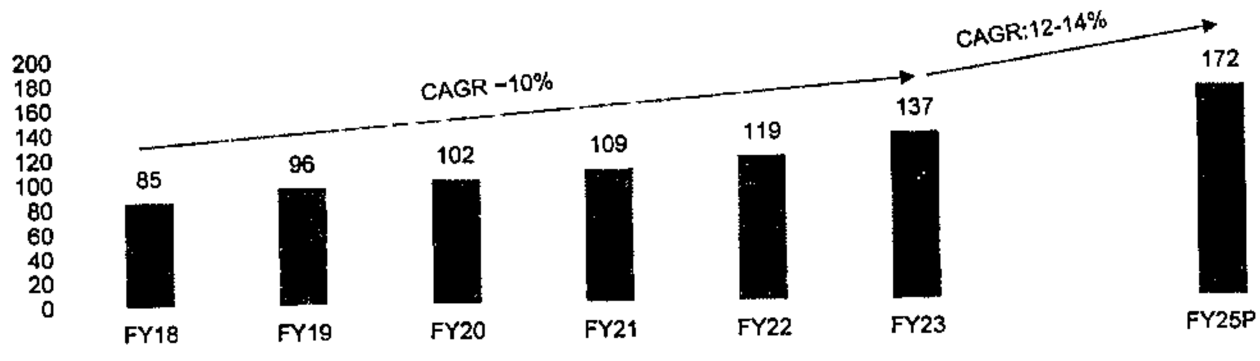
In the fourth quarter of Fiscal 2020 and the first quarter of Fiscal 2021, with the outbreak COVID-19 pandemic, challenges had intensified for both banks and NBFCs. NBFCs were hit harder in terms of demand, and they also turned cautious as they lend to borrowers with relatively weaker credit profile. In the second half of Fiscal 2021, the Indian economy showed signs of improvement, the effect of which was seen in the credit growth.

At the end of Fiscal 2021, the banking credit grew by ~5% on year while NBFCs witnessed a growth of 7.3% during the same period. In Fiscal 2022, the second wave of the COVID-19 pandemic led to weak demand for credit in the first quarter of the year. However, the pace of credit has now recovered, with overall credit growing by 8.4% and retail credit increasing by 11.6% year-on-year as of March 2022. Further, high frequency indicators point out that economic activity and consumer spending is returning to pre-COVID-19 levels. With the effect of COVID-19 waning, vaccination coverage progressively improving, the situation and growth has improved further.

Due to COVID-19 pandemic, demand for credit reduced drastically on account of economic activity coming down to standstill due to lockdown led sharp fall in disbursements. However, there has been a pickup in disbursements since the second half of Fiscal 2022, a trend that continued in Fiscal 2023. The bank credit demand was broad based in Fiscal 2023 growing at 15% year on year. There was strong retail credit demand from segments like personal loans, consumer durables, credit card, vehicle loans etc.

Going forward, credit to the overall retail segment is expected to lead the growth of the banking sector, supported by healthy growth in housing, consumer durable, gold and other personal loans segments. CRISIL MI&A expects bank credit to grow at 12-14% CAGR between Fiscal 2023 and Fiscal 2025.

Bank credit to clock a CAGR of 12-14% through Fiscal 2023 to Fiscal 2025



Note: P: Projected, Source: RBI, CRISIL MI&A

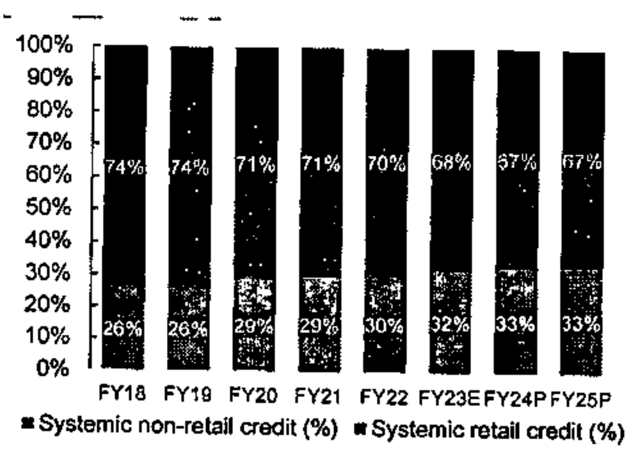
The Reserve Bank of India on August 10, 2023, announced that Scheduled Banks would have to maintain an incremental cash reserve ratio (ICRR) of 10% on the increase in their net demand and time liabilities (NDTL) garnered between May 19, 2023, and July 28, 2023. The central bank has announced the ICRR with an aim to manage high surplus liquidity in the system, following the return of Rs. 2000 notes into the banking system. This move is likely to have some impact on liquidity and credit growth in the short term, but the long-term expectations of banking credit remains intact and strong.

Private Banks and SFBs to continue to increase their share in banking credit

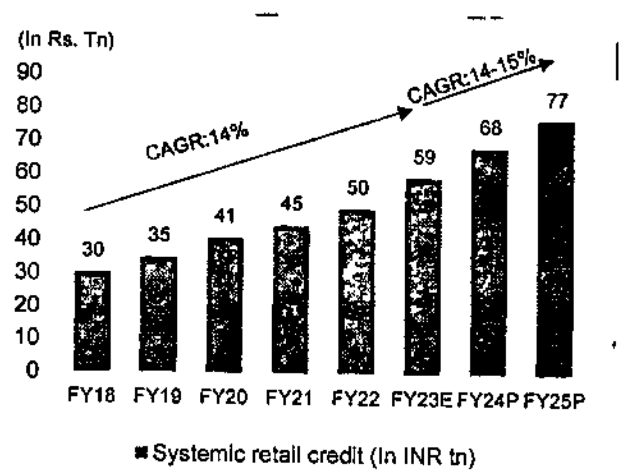
Source: RBI, CRISIL MI&A

While systemic credit in India grew at a tepid rate of 10% CAGR annually between Fiscals 2018 and 2023, systemic retail credit grew at a much faster rate of 14% CAGR during the same period. Retail credit growth in Fiscal 2020 was around ~16.3% which came down to ~9.2% in Fiscal 2021. However, post-pandemic, retail credit growth revived back to reach ~11.6% in Fiscal 2022 due to increase in demand from segments like personal loans, consumer durables, credit card, vehicle loans, etc. CRISIL MI&A thus expects retail credit growth to continue in the long term with banks and NBFCs' continued focus on the segment.

Retail segment is estimated to account for 32% of overall systemic credit as of March 31, 2023



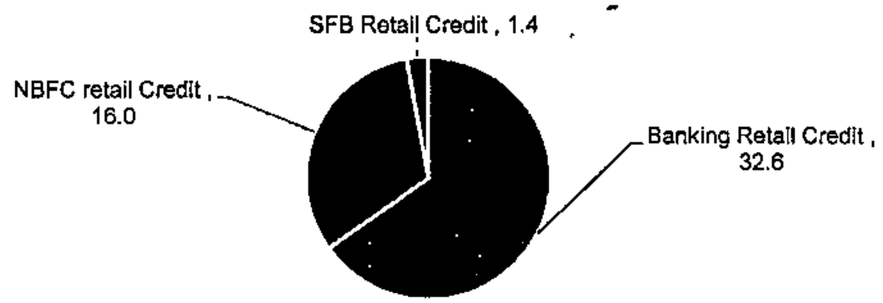
Retail credit growth to continue a strong footing in Fiscals 2024 & 2025



Source: RBI, CRISIL MI&A

Banks command a majority share in retail credit

(in Rs trillion)



Note: Banks include data for private banks, public banks, RRBs and other cooperative banks; NBFCs include HFCs
Source: RBI, CRISIL MI&A

Within retail credit, banks continue to retain significant market share. In the near term, banks will continue to benefit in the current environment of rising concerns and panic due to wider access to deposits. In the past, non-banks have consistently gained market share, with segments such as housing finance, microfinance, auto loans and education loans propelling growth. Non-banks have been able to compete with banks mainly on account of their strong origination skills, extensive reach, better customer service, faster processing, fewer documentation requirements, customised product offerings, local knowledge, and differentiated credit appraisal methodology. However, post the IL&FS crisis, NBFCs are struggling to grow, which presents a strong opportunity for private banks and SFBs to grow their market share.

Given their access to deposits and relatively lower funding costs combined with deep understanding of micro-markets, SFBs do have an edge over most NBFCs. SFBs can also offer a wide suite of products to their target customers.

NBFC credit to witness slightly better growth than Systemic credit

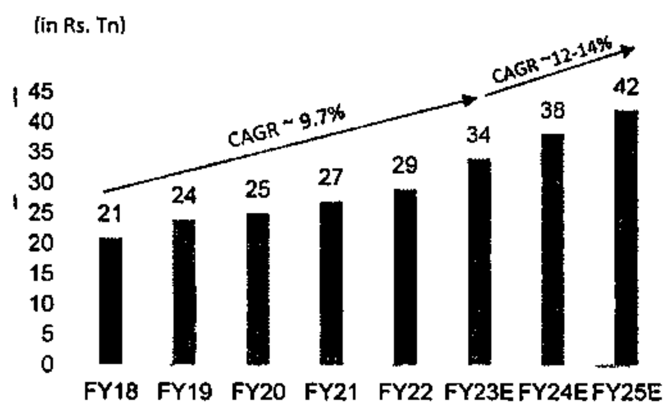
In the fourth quarter of Fiscal 2020 and the first quarter of Fiscal 2021, with the outbreak COVID-19 pandemic, challenges had intensified for both banks and NBFCs. NBFCs were hit harder in terms of demand, and they also turned cautious as they lend to borrowers with relatively weaker credit profile. Due to COVID-19 pandemic, demand for credit reduced drastically on account of economic activity coming down to standstill due to lockdown led sharp fall in disbursements. Few NBFCs also experienced credit rating downgrades and/or negative outlook changes during fiscal 2021. In the second half of Fiscal 2021, the Indian economy showed signs of improvement, the effect of which was seen in the credit growth.

In Fiscal 2022, the second wave of the COVID-19 pandemic led to weak demand for credit in the first quarter of the year. However, the pace of credit recovered, with overall credit growing by 9% and retail credit increasing by 11.3% year-on-year as of March 2022. With the effect of COVID-19 waning, vaccination coverage progressively improving, the situation and growth improved further.

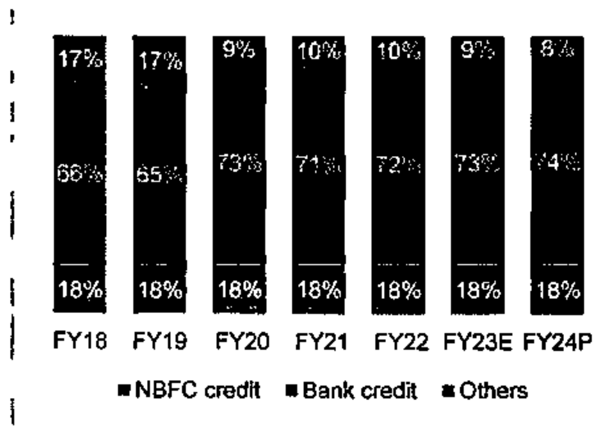
In Fiscal 2023, pace of credit further improved and is at par with pre-COVID level. Overall credit grew by estimated 13.3% and systemic retail credit grew by 19.2%. Banking credit has grown at 15% in Fiscal 2023 as compared to 16% for NBFCs. CRISIL MI&A projects NBFC credit to grow at 12%-14% between Fiscal 2023 and Fiscal 2025. The credit growth is expected to be driven by the retail vertical, including housing, auto, and microfinance segments. Rapid revival in the economy is expected to drive consumer demand in Fiscal 2024, leading to healthy growth NBFCs.

Moreover, organic consolidation is underway with larger NBFCs gaining share. In addition, growth of the non-banking industry is expected to be driven mainly by NBFCs with strong parentage who have funding advantage over other NBFCs.

NBFC credit to grow at CAGR 12-14% between Fiscals 2023 and 2025



Share of NBFCs credit in overall systemic credit remained 18% in Fiscal 2023



Source: RBI, CRISIL MI&A

NBFCs have shown remarkable resilience and gained importance in the financial sector ecosystem, growing from less than ₹ 2 trillion assets under management ("AUM") at the turn of the century to ₹ 34 trillion at the end of Fiscal 2023. CRISIL MI&A expects NBFC credit to grow at 12-14% CAGR between Fiscal 2023 and Fiscal 2025. Their share in the overall credit pie has increased from 12% in Fiscal 2008 to 18% in Fiscal 2023 and projected to be remained stable in fiscal 2024. CRISIL MI&A believes that NBFCs are expected to remain a force to reckon within the Indian credit landscape, given their inherent strength of providing last-mile funding and catering to customer segments that are not catered by Banks.

Credit penetration in India

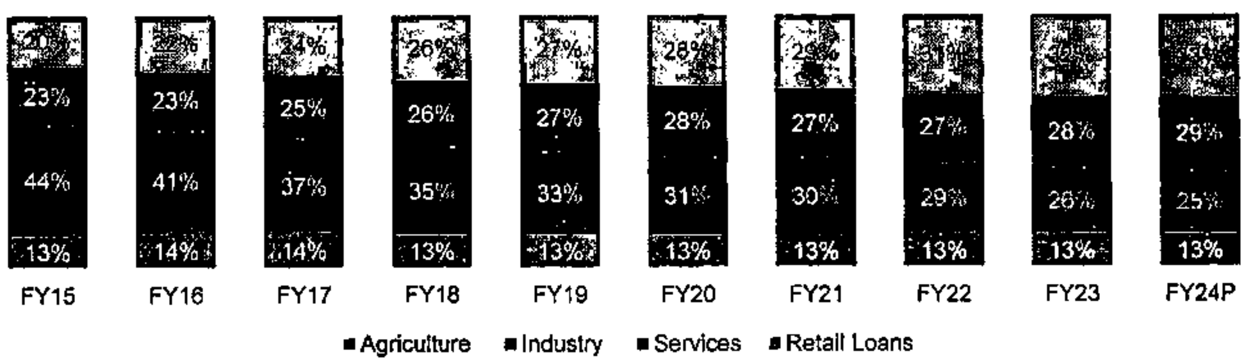
Retail and agricultural sector to drive credit growth in fiscal 2023

The share of retail segment in overall credit reached 32% in fiscal 2023, followed by services segment at 28%, industry segment at 26% and agriculture segment at 13%. Industrial credit accounted for nearly one fourth of the overall banking credit mix in fiscal 2023. The demand has been lower in the past three fiscal years, owing to subdued capital expenditure, low commodity prices and low asset quality. This has led to gradual reduction of share of industry credit in the overall banking sector's credit. In contrast, credit towards the retail and services segments has risen rapidly over the past five fiscal years, driven by strong consumer demand, lower NPA and better margins.

Retail Loans segment grew in fiscal 2023 driven by demand in housing segment and pent-up demand in vehicle loans segment. Going forward, CRISIL MI&A expects personal loans and services segment to drive credit growth in fiscal 2024. The segments are expected to show strong growth in fiscal 2024 on back of credit demand from housing loans, consumer durables and other retail loan segment.

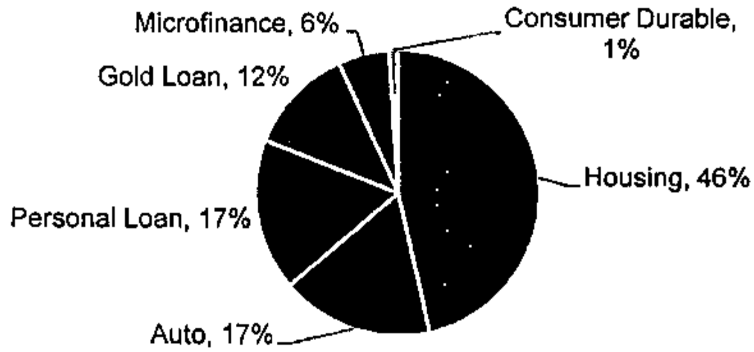
India's economic landscape is deeply rooted in agriculture. Despite this, the credit flow into the agricultural segment remains limited and inadequately explored, indicating a substantial potential for growth and development. However, it's crucial to acknowledge that agriculture is a somewhat precarious sector, demanding a profound understanding of its intricacies. Entities like Capital Small Finance Bank distinguish themselves – their ability to comprehend the complexities of the agricultural sector enables them to cater to its unique financial needs and mitigate risks effectively.

Retail loan share reached 32% as of March 31, 2023



Note: P: Projected
Source: RBI; CRISIL MI&A

Retail credit mix as of March 31, 2023

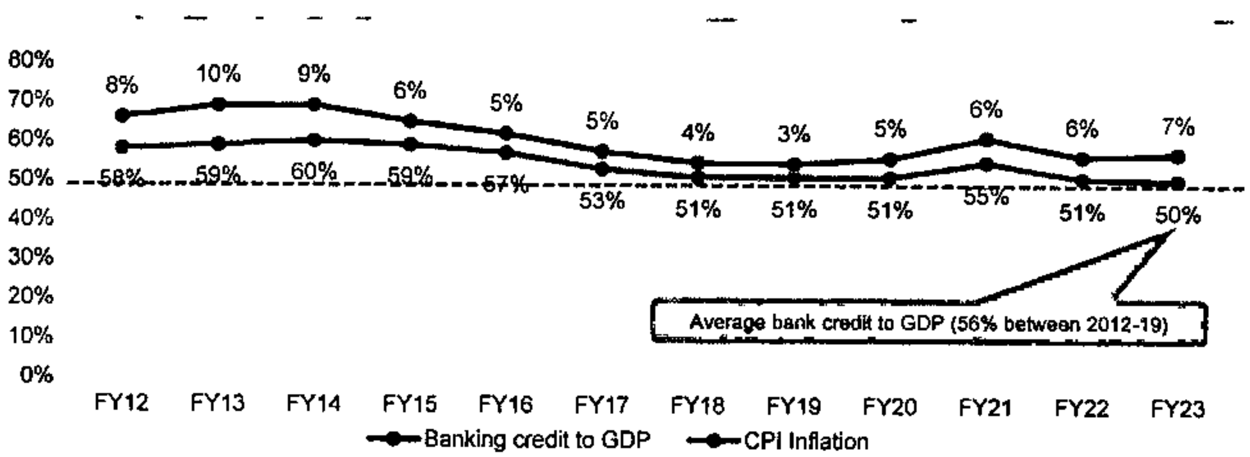


Source: RBI; CRISIL MI&A

Credit to GDP gap has remained largely stable till fiscal 2022

Credit to GDP ratio has remained broadly stable till fiscal 2022 in the wake of the global economic slowdown and the intensifying pandemic.

Trend in banking credit to GDP and CPI Inflation



Note: E: Estimated
Source: RBI, CRISIL MI&A

Total credit-to-GDP ratio to pick up in the long-term on the back of structural reforms

Fast-paced economic growth, improving digitisation initiatives, increasing banking penetration, and government's implementation of structural reforms such as IBC, augur well for the India's credit to GDP ratio in the long term.

In terms of the states within India, the proportion of state bank credit to GDP is quite skewed in terms of some states accounting for significant chunk of bank credit. In terms of the credit penetration, western and southern region account for 146% and 86% ratio in terms of bank credit to GDP. For other regions, there is significant opportunity in terms of capitalising the businesses as well as retail customers as against the contribution to GDP. Within the Northern region, Punjab is at 68%, Rajasthan at 62%, Haryana at 68% and Himachal Pradesh at 34% in terms of bank credit to GDP.

State-wise bank credit to GDP ratio as of fiscal 2023

Region	State	Bank Credit to state GDP ratio^
Northern	Haryana	68%
	Himachal Pradesh	34%
	Punjab	68%
	Rajasthan	62%
	Chandigarh*	271%
	Delhi*	240%
	Northern Region Total	**113%**
Southern	Andhra Pradesh	77%
	Karnataka	73%
	Kerala	83%
	Tamil Nadu	94%
	Telangana	102%
	Southern Region Total	**86%**
Western	Goa	48%
	Gujarat*	58%
	Maharashtra*	206%
	Western Region Total	**146%**
Eastern	Bihar*	46%
	Jharkhand*	42%
	Odisha	46%
	Sikkim	28%
	West Bengal*	62%
	Eastern Region Total	**52%**
Central	Chhattisgarh*	61%
	Madhya Pradesh	60%
	Uttar Pradesh	57%
	Uttarakhand*	37%
	Central Region Total	**57%**
North Eastern	Arunachal Pradesh*	37%
	Assam	45%
	Manipur*	50%
	Meghalaya	41%
	Mizoram*	28%
	Nagaland*	42%
	Tripura	27%
	North Eastern Region Total	**42%**

*Note: * State GDP at current prices used in denominator pertains to FY21 or FY22, whichever is available as per RBI data; GSDP at constant prices (2011-12) used for calculations; Final total arrived at by addition of all states mentioned in the table*

^Bank credit based on fiscal 2023 whereas state GDP values based on latest available data from RBI

Source: RBI, CRISIL MI&A

Bank deposits to grow at 11-12% in Fiscal 2024

In Fiscal 2018, deposit growth rate fell to its lowest in over 55 years to ~7%, as the effect of demonetisation subsided, and households moved their savings from deposits to other lucrative instruments such as shares and debentures. However, in Fiscal 2019, deposit growth picked up and clocked 11%, in the wake of capital market volatility and higher deposit rates offered by the banks. In addition, inclusion of more people under the formal financial services channel improved deposit mobilisation as players continued to expand in the underbanked areas. Banking deposit growth was higher in semi-urban areas as compared to urban and rural areas, which witnessed similar growth.

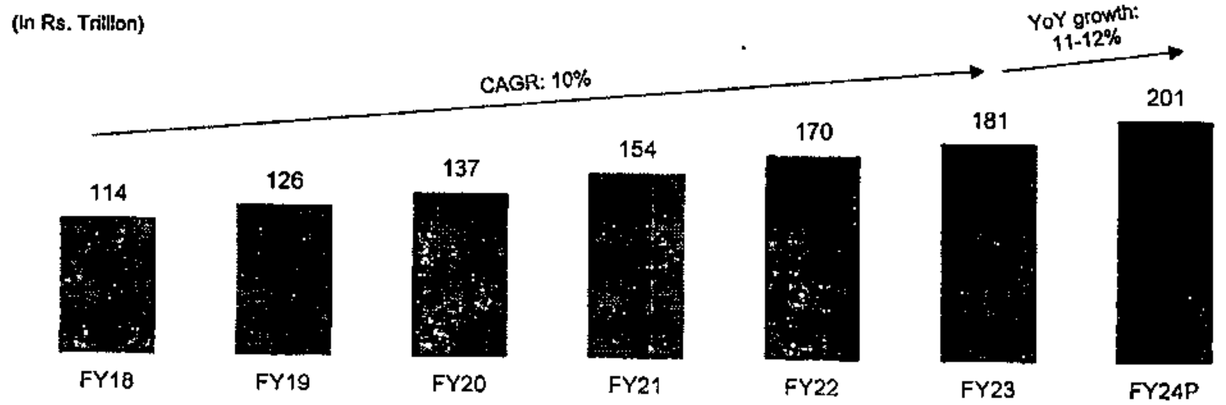
In Fiscal 2020, with slowdown in the economy, deposits grew at a moderate ~9%. The banking sector witnessed movement of deposits from private sector banks to public sector banks as one of the private sector banks gross NPAs spiralled. Towards the end of Fiscal 2020, Yes Bank was put under moratorium for 30 days, wherein withdrawal of deposits was restricted before a management change was effected by the regulator and the central Government. Earlier, in 2019, the RBI had imposed operational restrictions and restrictions on withdrawals from Punjab and Maharashtra Co-operative Bank Limited after finding financial irregularities. Fiscal 2020 also saw deposit rates coming down with lending linked to an external benchmark and interest rate cycle on a downward scenario, resulting in banks reducing deposit rates to preserve their spread.

With the outbreak of COVID-19 in the last quarter of Fiscal 2021, conserving money became a priority and households reduced their private consumption, leading to a 11% deposit growth in Fiscal 2021.

The weighted average domestic term deposit rate declined 80 bps from 6.07% as of April 30, 2020 to 5.28% as of March 31, 2021. (Source: CRISIL MI&A). With the RBI maintaining its accommodative stance with policy rates unchanged for the entire Fiscal 2022, the weighted average term deposit rate declined a further 25 bps to 5.03% as of March 31, 2022. RBI hiked the policy rates by 40 bps in May 2022, 50 bps in each of June 2022, August 2022 and September 2022, 35 bps in December 2022 and 25 bps in February 2023 taking the repo rate to 6.50% as of February 2023. With this, the weighted average term deposit rate moved upwards to 5.90% as of January 31, 2023. Further, the incremental credit to deposit ratio rose to more than 100% during the second quarter of Fiscal 2023 and deposit growth continued to lag credit growth.

CRISIL MI&A expects deposits rate to inch up with increase in competition and to support the credit growth. However, the increase in Fiscal 2024 might be at a slower pace on account of new taxation rule that will come into effect from April 1, 2023, which will take away tax advantage from most debt mutual funds and will give edge to bank fixed deposits. Hence, the deposits are expected to grow by 11-12% in Fiscal 2024.

Bank deposits to grow faster on-year in fiscal 2024 than previous year



Source: RBI, CRISIL MI&A

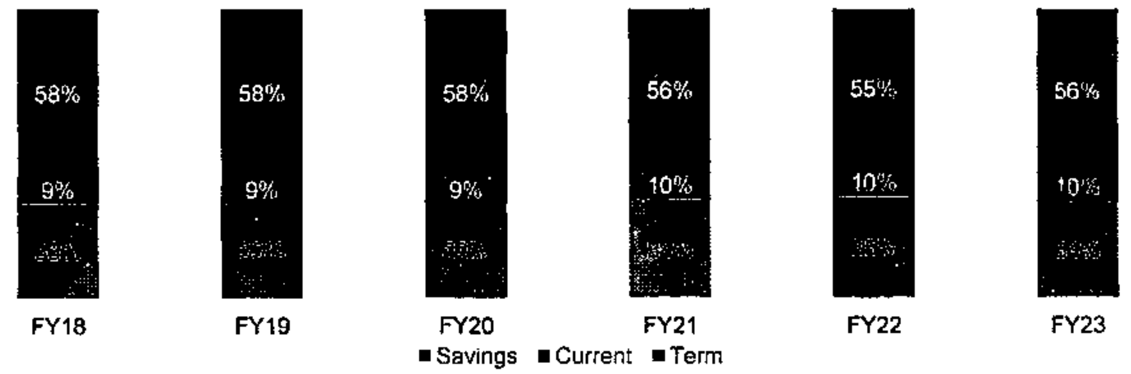
Among the banks, public sector banks have the highest share in deposits. However, over the last few years, private sector banks have witnessed an increase in their share from 25% in Fiscal 2018 to 34% in Fiscal 2023. The new-age private sector banks and Small Finance Banks are offering higher interest rates on deposits compared to traditional private sector banks in order to create differentiation in the industry, attract more customers, and enhance the granularity and stickiness in their customer base. Currently, the share of newer banks in the system, i.e. Small

Finance Banks and Payments banks, is less than 1%. Nonetheless, with increase in scale and operations, and deeper penetration in unbanked and under-banked areas as well as increase in number of customers entering the formal banking system, the share of these segments is also expected to increase going forward.

Private Banks continue to improve their share in banking deposits

Source: RBI, CRISIL MI&A

Share of current and savings deposits increased between fiscals 2018 and 2023



Note: Data includes data for banking deposits of public sector banks, private sector banks, regional rural banks, foreign banks and small finance banks
Source: RBI, CRISIL MI&A

State-wise deposits and share of various deposits (as on March 31, 2023)

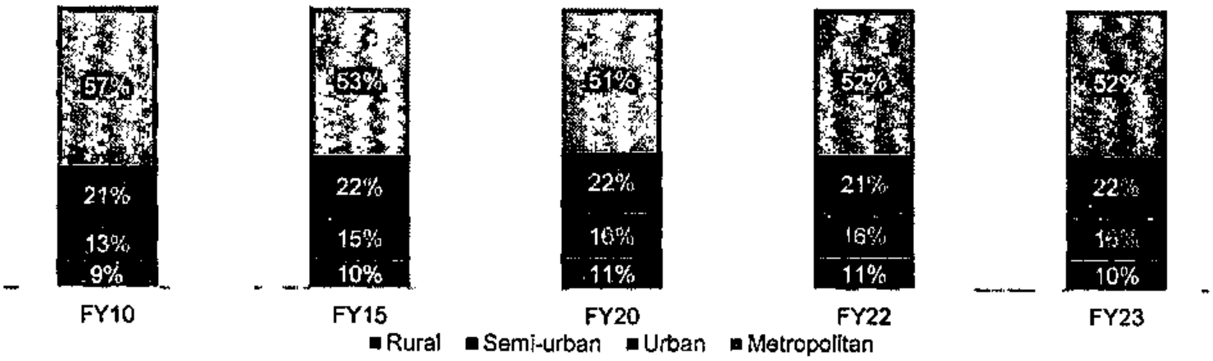
State/Union Territory	Total Deposits (Rs. bn)	Current Deposits	Saving Deposits	Term Deposits
Maharashtra	39,023	15%	20%	64%
NCT of Delhi	16,589	12%	22%	66%
Uttar Pradesh	14,310	7%	47%	46%
Karnataka	14,334	12%	31%	57%

Tamil Nadu	11,915	11%	34%	55%
West Bengal	10,270	8%	34%	58%
Gujarat	10,071	10%	34%	56%
Kerala	7,021	5%	31%	63%
Telangana	6,719	12%	34%	54%
Haryana	6,818	10%	33%	57%
Rajasthan	5,523	8%	42%	51%
Madhya Pradesh	5,195	7%	42%	52%
Punjab	5,479	5%	39%	57%
Bihar	4,371	6%	59%	35%
Odisha	4,400	6%	38%	56%
Andhra Pradesh	3,812	7%	43%	49%
Jharkhand	2,945	6%	42%	52%
Chhattisgarh	2,021	8%	47%	45%
Assam	1,949	8%	52%	40%
Uttarakhand	1,933	5%	41%	54%
Jammu & Kashmir	1,563	9%	42%	49%
Himachal Pradesh	1,286	4%	38%	59%
Goa	1,020	5%	28%	67%
Chandigarh	999	6%	35%	59%
Tripura	261	8%	48%	45%
Meghalaya	277	11%	47%	42%
Puducherry	256	6%	37%	56%
Arunachal Pradesh	232	21%	47%	32%
Nagaland	151	19%	52%	29%
Manipur	144	16%	64%	20%
Dadra And Nagar Haveli & Daman And Diu	142	12%	45%	44%
Mizoram	95	9%	54%	37%
Sikkim	136	7%	35%	58%
Ladakh	82	17%	48%	35%
Andaman & Nicobar Islands	71	9%	54%	37%
Lakshadweep	14	14%	74%	12%
Total	181,425	10%	33%	57%

Note: Data includes data for banking deposits of public sector banks, private sector banks, regional rural banks, foreign banks and small finance banks, Source: RBI, CRISIL MI&A

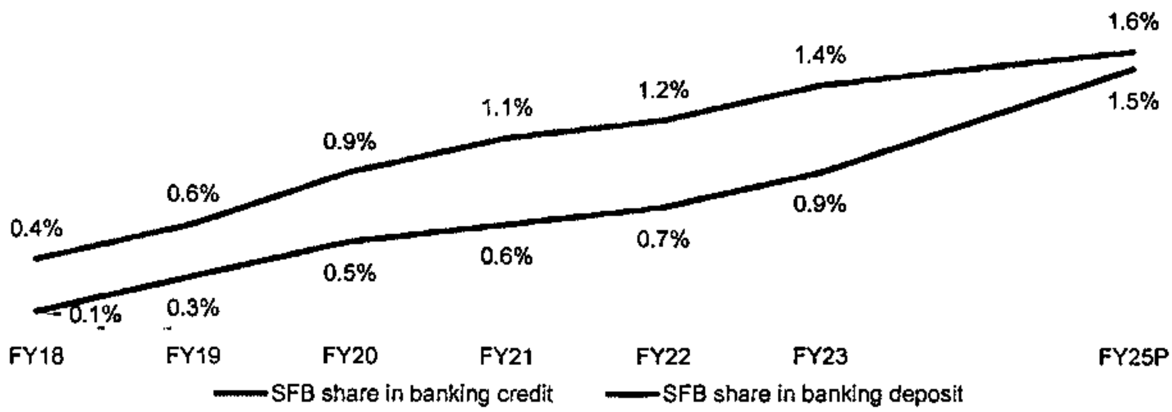
With increasing financial penetration and access to financial services in the rural and semi-urban areas, the share of deposits in these areas have also increase over the last ten years. While the share of metropolitan areas in the deposit's distribution has reduced over the years, share of urban areas has remained stable and semi-urban areas have seen the highest increase in share of deposits.

Share of bank deposits in rural and semi-urban areas has increased over the last decade



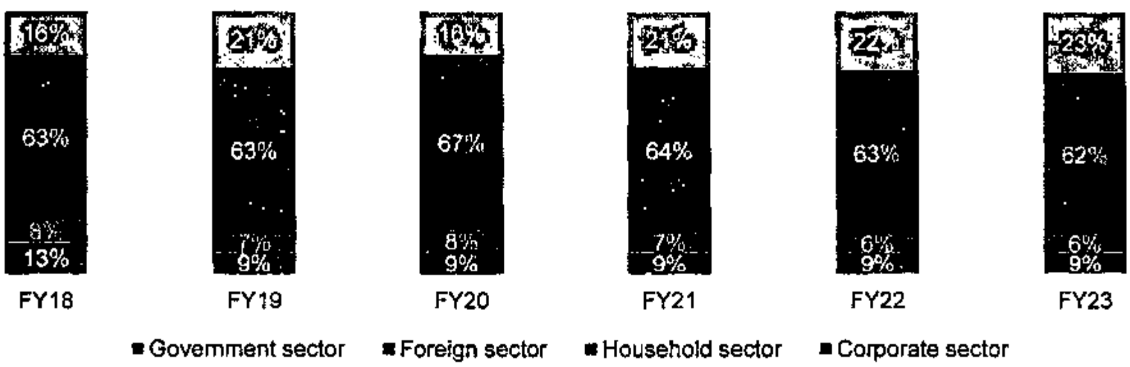
Note: As at the end of each Fiscal
Source: RBI, CRISIL MI&A

SFBs share in overall banking credit and deposit to grow



Note: As at the end of each Fiscal. P: Projected
Source: RBI, CRISIL MI&A

Sector-wise deposit with the SCBs



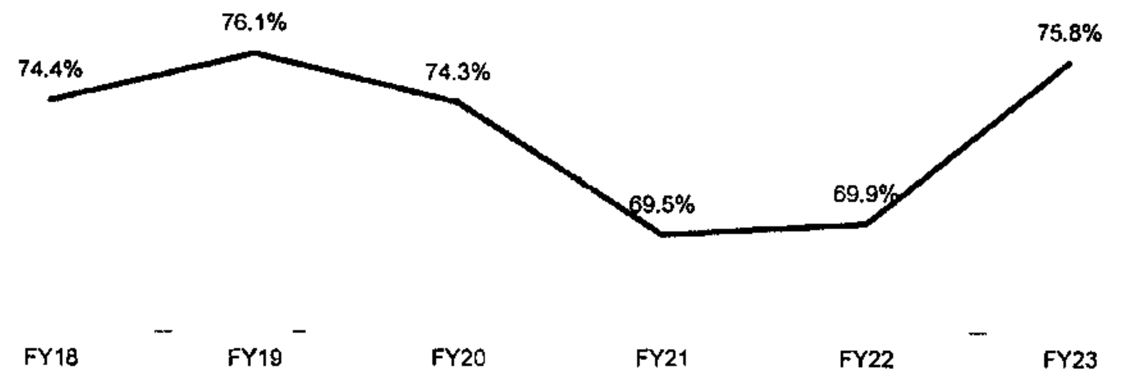
Note: 1) Government sector includes deposits made by central and state governments, quasi-government bodies, local authorities and public sector corporations; 2) Corporate sector includes deposits made by both financial and non-financial companies; 3) Household sector includes

deposits made by individuals, proprietary and partnership concerns, trusts, educational and religious institutions; 4) Foreign sector includes deposits made by non-residents, foreign consulates, trade missions and other services, as at the end of each Fiscal.
Source: RBI, CRISIL MI&A

The household sector continues to dominate overall share in deposits in SCBs. The share of the household sector increased from 63% in Fiscal 2018 to 67% in Fiscal 2020 and came down to 62% in Fiscal 2023. The share of the foreign sector in total deposits with SCBs decreased from 8% in Fiscal 2018 to 6% in Fiscal 2023. The corporate sector witnessed an increase in the share of total deposits from 16% in Fiscal 2018 to 23% in Fiscal 2023, while the government sector saw its share reduce to 9% in Fiscal 2023 from 13% in Fiscal 2018.

The credit-to-deposit ratio for banks has seen substantial uptick to reach 76.1% in Fiscal 2019 post the lows of demonetisation back in Fiscal 2017. It moderated in Fiscal 2020 and further lowered to 69.9% in Fiscal 2022 because of the pandemic-led slowdown in the economy. However, the ratio seems to rise back to pre-covid level at 75.8% in fiscal 2023.

Credit-to-deposit ratio



Note: As at the end of each Fiscal.

Source: RBI, CRISIL MI&A

GNPA of SFBs at ~3.0% as compared to ~4.0% for all banks in fiscal 2023

The pandemic resulted in one of the worst economic declines in decades. Airlines, hospitality, travel, gems and jewelry, auto dealers, and real estate were hit the hardest, given the discretionary nature of these sectors. Both collections and disbursements were impacted significantly in the first half of Fiscal 2021. However, with measures taken by the government and the RBI assisting in containing the deterioration in asset quality, overall GNPA ended Fiscal 2021 at 7.4%.

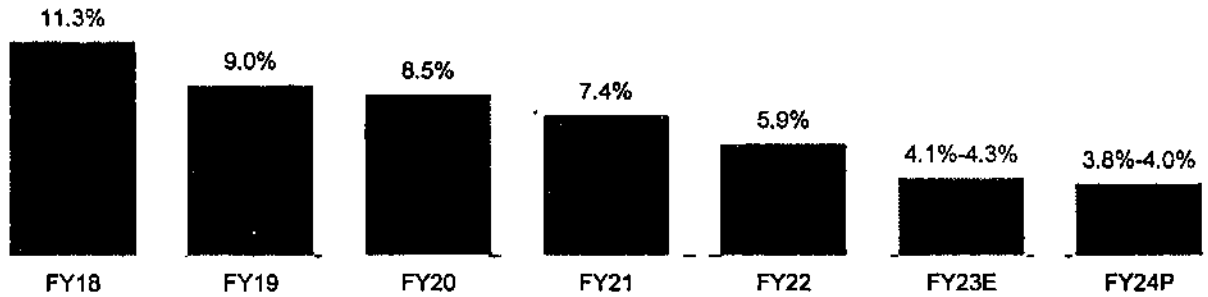
About 0.9% of the total credit outstanding was restructured by the RBI as of March 2021 under the one-time restructuring framework 1.0, which was significantly lower than earlier estimates. In the case of public banks, the majority of the restructurings come from the corporate sector. In the case of large and mid-size private sector banks, the proportion of retail assets in total restructuring (invoked + implemented) was relatively high.

On May 5, 2021, the RBI announced the restructuring framework 2.0 to protect individuals and MSMEs from the adverse impact of the second wave. The resolution facility was applicable for accounts classified as 'Standard' as at March 31, 2021, wherein individuals and MSMEs having an aggregate loan exposure of up to ₹250 million who have not availed restructuring under any of the earlier restructuring frameworks and who were classified as 'Standard' as on March 31, 2021 were allowed to restructure their loans. Restructuring under the proposed framework was able to be invoked up to September 30, 2021 and had to be finalised and implemented within 90 days after invocation of the resolution process (with the last date to implement the restructuring for banks being December 31, 2021). This framework saw better response from corporate borrowers. CRISIL MI&A estimates the overall restructuring (1.0 and 2.0) at ~1.4% of the loans outstanding as of March 2023. However, the stress on account of slippages from this portfolio remains to be monitored.

GNPA of both private and public banks improved in Fiscal 2022 on account of reduction in fresh slippages and improvement in upgrades and recoveries. GNPA of scheduled commercial banks stood at a six-year low of ~5.9% as of March 2022. CRISIL MI&A estimates the GNPA of scheduled commercial banks to have declined further in Fiscal 2023 on account of lower slippages, higher recoveries and expectation of recoveries via the NCLT and National Asset Reconstruction Company Ltd (NARCL) route.

Amongst different bank groups, PSBs have the highest NPA of 5.2% as opposed to 2.9% of SFBs as of March 2023. Going forward, CRISIL MI&A expects GNPA of banks to improve to 3.8%-4.0% in Fiscal 2024 due to robust collections, upgrades for large corporate accounts and lower slippages

GNPAs of banks to improve to 3.8-4.0% in Fiscal 2024



Note: As at the end of each Fiscal. E: Estimated, P – Projected
Source: RBI, Company Reports, CRISIL MI&A

Trend in bank group wise GNPAs for scheduled commercial banks

	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Public Sector Banks	11.7%	14.6%	11.6%	10.8%	9.5%	7.6%	5.2%
Private Sector Banks	4.1%	4.7%	5.3%	5.1%	4.8%	3.7%	2.2%
Foreign Banks	4.0%	3.8%	3.0%	2.3%	2.4%	2.8%	1.9%
Small Finance Banks	NA	2.2%	1.6%	1.9%	4.1%	3.9%	2.9%

Note: GNPA Data for Small Finance excludes data for North-east SFB and Unity Small Finance Bank
Source: RBI (Financial Stability Report – June 2023), RBI, Company Reports, CRISIL MI&A

Trend in sector wise GNPAs for scheduled commercial banks

	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23
Agriculture	5.4%	7.0%	8.5%	10.1%	9.8%	9.4%	7.7%
Industry	17.7%	22.8%	17.5%	14.1%	11.3%	8.4%	5.2%
Services	6.0%	6.0%	5.7%	7.2%	7.5%	5.8%	3.9%
Retail	2.0%	2.0%	1.8%	2.0%	2.1%	1.8%	1.4%

Source: RBI (Financial Stability Report – June 2022), RBI, Company Reports, CRISIL MI&A

Profitability to improve in Fiscal 2024

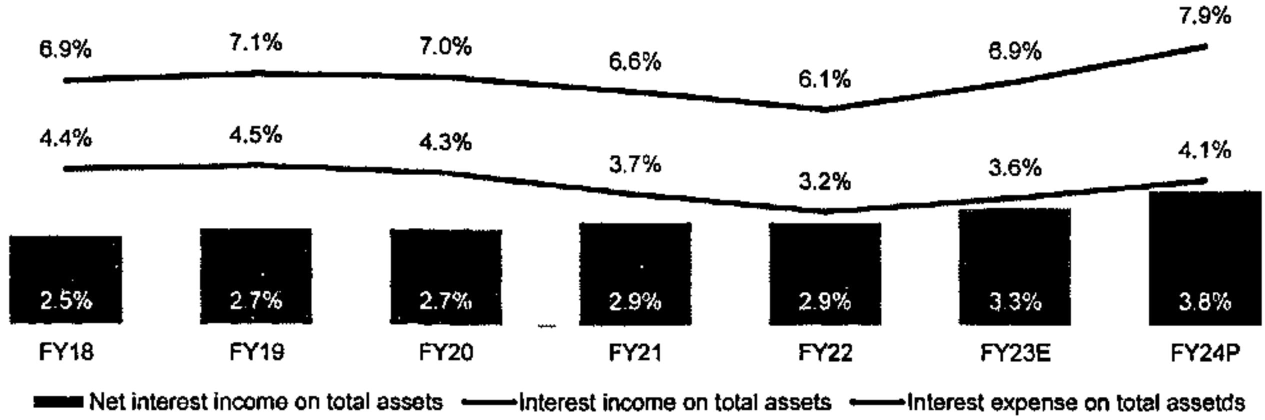
The Reserve Bank of India cut the repo rate by ~225 bps (including 40 bps cut in Fiscal 2021) since March 2019. Since the RBI perceived that banks tend to transmit interest rates more rapidly in a rising rate scenario than in reducing interest rate regime, the RBI introduced new guidelines on external benchmark linking rates (EBLR; linked to repo rate), mandating banks to link all new personal or retail floating rate loans, and micro, small and medium enterprises floating rate loans to the external benchmark effective October 1, 2019.

As a result, interest earned as a percentage of total assets declined ~40 basis points (bps) to 6.6% in Fiscal 2021 with lowering of the repo rate. However, with interest expended as a % of total assets reducing ~60 bps, Net Interest Income rose ~20 bps. The apex bank-maintained status quo on the repo rate at 4% in Fiscal 2022 and, hence, interest expended as a percentage of total assets declined further to 3.2%.

In Fiscal 2023, to tackle inflation RBI started increasing policy repo rate rating by 40 bps in May 2022 and 50 bps in June, August and September 2022, 35 bps in December 2022 and 25 bps in February 2023, taking policy repo rate to 6.50%. With faster increase in repo rates the yield on loans are expected rise quicker as compared to historical trend due to implementation of new guidelines on EBLR linking of loans and cost of deposits to rise at a slower pace since banks will be benefitted by lower cost of funds during Fiscals 2023 and 2022.

During Fiscal 2023, CRISIL MI&A estimates interest earned as a percentage of total assets to have risen by ~80 bps and interest expended as a percentage of total assets to have risen by ~40%, resulting in an improvement in Net Interest Income to total assets at 3.3%.

Operating profitability of banks to improve in Fiscal 2024



Note: E – Estimated, P – Projected, Ratios are on total average assets
Source: Company reports, CRISIL MI&A

Small finance banking industry

In order to promote financial inclusion, the Indian banking industry has seen several changes in recent years. NBFCs, such as Bandhan and IDFC received permission to set up universal banks. Also, a few microfinance companies, local area banks and NBFCs have received permission to set up small finance banks (SFBs). The RBI awarded SFB licences to 10 players in keeping with the government's focus on financial inclusion and inclusive banking. Of the 11 SFBs, eight were MFI players; one was a local area bank; one was a co-operative bank and the other an NBFC. Of these, Capital SFB commenced operations as India's first small finance bank in 2016. Capital SFB was the largest local area bank before converting into an SFB.

In June 2021, RBI granted in-principal approval to Centrum Financial Services to set up a small finance bank paving a way for the take-over of Punjab & Maharashtra Co-Operative (PMC) Bank Limited.

SFBs are allowed to take deposits, which provide them with the edge of having lower cost of funds as compared with NBFCs. MFIs turned into SFBs are now diversifying their advances mix and focusing on other retail and corporate lending business.

Evolution of SFBs

Despite various measures taken by the government to boost financial penetration in India, a significant percentage of the country's population is still without basic access to financial services.

In 2013, the RBI constituted a committee to further their goal of financial inclusion. The committee recommended differential licencing in the form of payment banks which was chaired by Dr Nachiket Mor and small finance banks which was chaired by Mrs. Usha Thorat.

On November 27, 2014, the RBI released guidelines for a new class of banking entity called small finance banks that would cater to the diverse needs of low-income groups. On September 16, 2015, the RBI awarded small finance bank licences to 10 players on account of the government's focus on financial inclusion and inclusive banking.

The objective of SFBs is to extend banking services to the underserved and unserved population of India through savings instruments, and supplying credit to small business units, small and marginal farmers, micro and small industries, and other unorganised sector/lending through informal channels. These players are technologically driven right from the start not only to reduce the cost of operation but also to ensure faster reach to the untapped market.

According to the World Bank's Global Findex Database 2021, India's financial inclusion level has improved significantly with the adult population with bank accounts rising from 53% (year 2014) to 78% (year 2021) because of government initiatives, institutional support and use of mobile phones as a medium for distributing financial services. The opportunity presented in front of small finance banks is indeed huge and requires them to be more innovative in terms of introducing customised and flexible offerings to the untapped market.

8 out of the 10 entities given in-principal approval were microfinance institutions, with the exception of Capital SFB and AU SFB. They were given approval on account of lending in contiguous districts, mobilizing rural savings and making them available for local investments and were aimed at furthering financial inclusion.

Regulations governing SFBs

Key features of the RBI regulations for small finance banks

Parameter	Key guidelines
Scope of activities	• Basic banking activities of acceptance of deposits and lending to underserved sections of the society • Simple financial services, such as distribution of mutual funds, insurance products with prior approval from the RBI • Prior approval required from RBI for branch expansion of SFBs in the initial five years; In March 2020, RBI liberalised the prior approval requirement and granted permission to all existing SFBs to open banking outlets subject to the Unbanked Rural Centre. It has further exempted all existing SFBs from seeking approval of the RBI for undertaking non-risk-sharing simple financial service activities, which do not require commitment of own fund, after three years of commencement of business by the SFB • An SFB cannot be a business correspondent (BC) for another bank. They can have their own BC network • An SFB can apply to have an Authorised Dealer Category-I license after completion of at least two years of operations as Authorised Dealer Category -II.
Prudential norms	• Requirement of maintaining CRR and SLR as applicable to existing commercial banks • 75% of their adjusted net bank credit should be given to sectors eligible under priority sector lending as per the RBI, 40% as per PSL prescriptions and remaining 35% under the PSL where the SFB has competitive advantage • Minimum 50% of their loan book to constitute loans of ticket size up to Rs 2.5 million, which can be relaxed by the RBI
Capital requirement	• Minimum paid up capital - Rs 2 billion • Minimum Tier 1 capital: 7.5% of risk weighted assets (RWA); minimum capital adequacy ratio of 15% of RWA
Shareholding	• For a holding company structure, initial shareholding by promoter in the bank should be brought down to 40% within a period of five years. Minimum paid-up capital with promoter should be at least 40%, which should be bought down to 30% within 10 years and to a maximum of 15% within 15 years of commencement of operations • In case of SFBs which are transited from urban cooperative banks (UCBs), the promoters shall always hold a minimum of 26% of paid-up voting equity capital during the first five years from the commencement of the bank's business. The promoter's holding in this case may be brought down to 15% over a period of 15 years • Mandatory listing requirement of SFBs within three years of reaching Rs 5 billion net worth • Foreign direct investment (FDI) as per the FDI policy for private sector banks amended from time to time
Branch requirement	• Required to have 25% of their branches in the rural unbanked region (population <10,000) within one year of commencement of operations • SFBs are given three years to align their existing branches with this requirement, but 25% of all new branches opened in a year should be in URCs.

Source: RBI, CRISIL MI&A

On December 5, 2019, the RBI released guidelines for on-tap licencing of SFBs which will allow the applicant to approach the regulator. The RBI looks to prefer applicants who are willing to set up the bank in underserved or unserved clusters such as in the north-east, east and central regions in the initial stages and will prefer promoters who have a diversified shareholding and a timeframe for listing the bank. The central bank would also be open to liberation of scope of activities for SFBs after a stabilisation period of five years and a review of the SFBs by the central bank. The minimum paid-up capital of Rs 2,000 million is required for the on-tap licence of SFBs, except for those that are converted from UCBs. The listing of the bank will be mandatory within three years after the SFB reaches the net worth of Rs 5,000 million for the first time.

As per the RBI, tier-wise classification based on population and population group-wise classification is given below.

Details of tier-wise classification of centres based on population

Classification of centres (tier-wise)	Population (as per 2011 census)
Tier 1	100,000 and above
Tier 2	50,000 to 99,999
Tier 3	20,000 to 49,999
Tier 4	10,000 to 19,999
Tier 5	5,000 to 9,999
Tier 6	Less than 5,000

Source: RBI, CRISIL MI&A

Population-group-wise classification of centres	Population (as per 2011 census)
Rural centre	up to 9,999
Semi-urban centre	From 10,000 to 99,999
Urban centre	From 1,00,000 to 999,999
Metropolitan centre	1,000,000 and above

Source: RBI, CRISIL MI&A

Regulatory distinction between NBFCs, Banks and SFBs

	NBFC - ND – SI	NBFC – D	Banks^ (Basel - III)	SFBs
Minimum net-owned funds	Rs. 20 million	Rs. 20 million	N. A	Rs. 2,000 million
Capital adequacy	15.0%	15.0%	9.0%	15.0%
Tier – I Capital #	10.0%	10.0%	7.0%	7.50%
Cash Reserve Ratio (CRR)	N. A	N. A	4.5%	4.5%
Statutory liquidity ratio (SLR)	N. A	15.0%	18.0%	18.0%

Notes: # Currently 10% for infrastructure finance companies and proposed to be increased to 10% for all NBFCs except gold loan NBFCs which will have to maintain 12%; ^Under phase-wise implementation of Basel-III by March 2019; numbers exclude capital conservation buffer of 2.5%

Source: RBI, CRISIL MI&A

Comparison of different business models

	Scheduled commercial banks	SFBs
Targeted lending to sectors	• 40% of their adjusted net bank credit (ANBC) or equivalent off-balance sheet exposure (whichever is higher) for priority sector lending o 18% of ANBC to agriculture o 7.5% of ANBC to micro-enterprises o 10% of ANBC to weaker sections	• 75% of their ANBC for priority sector lending o 18% of ANBC to agriculture o 7.5% of ANBC to micro-enterprises o 10% of ANBC to weaker sections • At least 50% of loan portfolio should constitute loans and advances of up to Rs. 2.5 million
Capital adequacy framework	• Minimum Tier-I capital: 7% • Minimum capital adequacy ratio: 9%	• Minimum Tier-I capital: 7.5%(Tier-II capital cannot be more than 100% of Tier-I capital) • Minimum capital adequacy ratio: 15%
NIM	• No margin cap	• No margin cap
CRR / SLR	• Maintenance of CRR/SLR ratio mandatory • CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021, 4.5% beginning May 21, 2022. • SLR – 18%	• Maintenance of CRR/SLR ratio mandatory • CRR – 3%, 3.5% begin. March 27, 2021, 4% beginning May 22, 2021, 4.5% beginning May 21, 2022. • SLR – 18%
Leverage ratio	• Minimum leverage ratio of 4%	• Minimum leverage ratio of 4%
LCR (liquidity coverage ratio)/ NSFR (net stable funding ratio)	• Mandatory requirement to maintain liquidity coverage ratio of 100% from April 1, 2021	• Minimum liquidity coverage ratio of 100% by April 1, 2021
Deposits	• Primarily rely on deposits, CASA and term deposits, for funding requirements	• Primarily rely on deposits, CASA and term deposits, for funding requirements • Deposit ramp-up will take time
Bank loans / market funding	• Access to broader array of market borrowings	• Access to bank loans and broader array of market borrowings
Products offered	• Full spectrum of banking, savings, investment and insurance products	• Can offer savings and investment products apart from credit products / loans • Can act as corporate agent to offer insurance products • Cannot act as business correspondent to other banks
Target Segment	• Corporate as well as retail segment of customers	• Retail segment with higher focus on Below Poverty Line Segment and Economic Middle Class

Source: RBI, CRISIL MI&A

Key advantages and challenges for a Local Area Bank, NBFC, Urban Co-operative Bank upon conversion to SFB

The RBI awarded in-principle SFB licences to 10 players (including eight MFIs) in September 2015. All the applicants have received final approval from the RBI to start operations. In January 2021, one more entity - Shivalik SFB, received license from RBI to carry on banking business as a Small Finance Bank, thus becoming the first Urban Co-operative Bank to transition to a Small Finance Bank (Scheduled Bank) and began its operations in April 2021.

CRISIL MI&A expects that in the next few years these SFBs will focus on gradually growing their banking business and complying with tougher regulations. On the other hand, transformation into SFBs has provided access to stable and granular public deposits in the long run, which will bring down their cost of funds. The cost of funds for SFBs has been constantly decreasing and at 7.3% in fiscal 2021 from 8.2% from fiscal 2020.

For non-NBFC entities like a local area bank or an urban co-operative bank, the scheduled bank license to run as an SFB act as a booster in terms of enhancing their reach in the geographies where they already are present to further bank the unbanked and provide extended services beyond their initial scope of activities. Additionally, it will help with better governance while adhering to RBI norms. Enhanced ability to raise funding from diverse sources and being competitive in their cost structure further can improve prospects for these entities.

Players like AU SFB and Capital SFB are the only two that are not NBFC-MFIs to receive an SFB license. For AU, it started as an NBFC and was engaged in business of commercial and personal vehicle loans, Micro, Small and Medium Enterprise (MSME) loans and SME loans serving primarily low and middle income, under-served and unreached customer segment.

Similarly, Capital SFB, was only Local Area Bank permitted to operate in 5 districts of Punjab. However, these were given SFB licenses on account of their lending primary in the rural and semi-urban regions as well as furthering financial inclusion by means of bringing high number of people into the banking fold. Their asset side book comprised majorly of small ticket retail loans aimed at enhancing the reach of credit to the micro, small and medium industries sector. Capital SFB's share of deposits in Punjab is 1.20% of the total deposits of commercial banks in the state which constituted 1.51% of incremental deposits of commercial banks in the state of Punjab from Fiscal 2021 to Fiscal 2023.

A few of the advantages and challenges that an entity would face upon transition to SFB in the initial phase are as follows:

Advantages

Sizeable market opportunity

- The market is under-penetrated compared with the opportunity size of the overall banking sector. The sheer size of the market and suitable business model brings an opportunity for SFBs to not only cater to the unbanked and rural population, but also service the low income group in urban areas by bringing in modern banking facilities at low cost

Widen product offerings and enhance customer stickiness

- Can offer a wide range of already existing products and also cross-sell products while enhaning customer stickiness and loyalty by brining in modern state of art service offerings to enhance financial inclusion. Over a period of time, the stronger, larger and better-run SFBs would also benefit from the trust that a scheduled banking licence provides over the existing structure

Raise funds at substantially lower rates

- Converting to SFB would help Local Area Banks and NBFCs to raise deposits and not only bring down their cost of funds substantially but also diversify their resources profile. This will also help them to lend at more reasonable rates to customers.

Lower operational expenses and removal of geographical barriers

- SFBs with their strong associations to a particular region will help them understand the needs and market potential, and thus help them serve better. This coupled with robust technology systems will help them have highly cost-effective operations and allow the local area banks to achieve exponential growth by removal of geographical barriers

Challenges

Geographical concentration

- LABs, NBFCs and MFIs are initially geographically concentrated and thus are highly vulnerable to systemic risk as compared to large private or public sector banks, but have an opportunity to expand without these barriers in place. However, as per regulatory requirements, SFBs are required to open 25% of the branches in unbanked geographies, which pose some operational challenges.

Adhering to stringent regulations

- Players need to adhere to reserve requirements with the RBI such as maintaining CRR and SLR. In addition, they also have to adhere to PSL guidelines and maintain promotor holding which can result into enhanced governance costs
- Most players who have won licences have large foreign shareholders. They have to raise a high amount of domestic equity to reach minimum domestic holding requirement to comply with the regulations

Building a liability profile

- Raising retail liabilities will be a challenge as it depends on factors such as customer mindset given the low-ticket size liability, customer base and ability to gain customer trust. However, some entities already having experience on the liability side and banking systems and processes are expected to do better on this front

Asset diversification

- Venturing into newer products will require new skillsets and underwriting processes. New entitles may face asset quality issues in the newer products due to limited experience of the product. Competing with universal banks for talent may also result in heightened costs for these SFBs

Going Digital increasing the thrust area for financiers

The financial services sector is evolving with several spheres witnessing digital disruptions. Customers are also seeing enhanced experience as lenders offer personalised products and services using analytics. In order to expand their reach quickly, SFBs and NBFCs are moving beyond branches and using alternative electronic delivery channels. Such deeper digital penetration has widened financial inclusion net. The emergence of Covid-19 has led financiers to accelerate their digital adoption in order to retain their market.

Asset side: SFBs and NBFCs have mobile/tab-based applications to automate loan processing at the field which allows sales staff to do a real time assessment of customer's credit worthiness by performing an accurate financial analysis through access to bureau information. This has led to an improvement in productivity. Cashless disbursements have also seen a rise in the industry, however, on the collection front majority of the portfolio is still cash collection which remains a challenge and impacts operating expenses.

Of the various processes in the customer value chain on loan products, CRISIL MI&A is of the view that digitisation and usage of technology has had the biggest impact on customer acquisition and on-boarding followed by credit assessment to some extent. In the other processes – documentation, loan disbursements and collections and monitoring –, the extent of digitisation is comparatively lower. Although lenders during Covid-19 pandemic has increased their focus on adoption of technology in the loan disbursements and collections as well. However, even in these spheres, technology is indeed progressively being tapped by institutions by digital monitoring of portfolio through dashboards and analytics.

Lending value chain

Traditional retail lending value chain	Technology enabled lending value chain
Sourcing & on-boarding	
• Paper based KYC procedures involving manual data entry prone to have low quality data and data entry errors	• Tab-based paperless **on-boarding using AADHAR based e-KYC** • Cross sell products using internal as well as external data
Credit assessment	
• Manual assessment done through personal discussion, site-visits and excel based calculation with income proofs as inputs • Risk evaluation and credit scoring of collateral	• Real time assessment of customer's credit worthiness and **auto-approve loans using algorithms** by analysing financial, bureau and alternative data
Documentation	
• Loan structuring documents are made for customer and documents is stored physically	• Paperless on-boarding enables **storage of data in electronic formats**
Disbursement	
• Disbursement is made directly into account, but it takes more time	• Instant loan amount disbursed post loan approval • **Cashless disbursements on rise** in the industry
Collection & monitoring	
• No automatic triggering of mails to notify customer about repayment • Manual tracking of early warning signals	• Predicting defaults and **identifying customers with high/low risk** through various probability of default models • Various monitoring applications allows executives to post daily transactions of the repayments and ensure transparency

Source: CRISIL MI&A

Impact of technology on various retail loan products:

	Micro-finance	Agriculture Loans	MSME loans	LAP	Housing Loans	Auto Loans
Sourcing and on-boarding	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Credit assessment	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Documentation	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Disbursement	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]
Collection and monitoring	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]	[redacted]

Source: CRISIL MI&A

Low [redacted] Medium [redacted] High [redacted]

Liability side: Digitisation allows SFBs to lower their operational cost by removing their repetitive and time-consuming processes i.e., during account opening through increased front-end support. The players in the industry are now using mobile/TAB based paperless on-boarding rather than the conventional means, which has led to a significant reduction in TAT to a maximum of 1 hours from 1-2 days when using traditional means. In order to reduce the operational expenses, small kiosks are being set up by players to support both deposits and withdrawals. SFBs also offers an online savings account, which can be opened in a few minutes anytime and anywhere with access benefits available to digital / self-service customers.

In January 2020, Video-KYC was permitted by RBI for opening a savings or a Fixed deposit (FD) account. Amidst COVID, this feature has come as a boon as SFBs have put in place technology to allow customers to self-on-board with no physical contact or branch visit.

After an account is opened, customers mostly use mobile application to use and operate their account. For any issues or queries, they mostly use interact with the customer service executive using a chat application through mobile or through call. Many players in the industry also use chat-bots to address generic queries raised by the customers.

Impact of technology on liability side

	Savings account
Sourcing and on-boarding	[redacted]
Documentation	[redacted]
Post account opening customer experience	[redacted]

Source: CRISIL MI&A

Low [redacted] Medium [redacted] High [redacted]

Digital Transactions: Digital Transactions have increased exponentially in India due to introduction of different modes of alternate payment system including Bharat Interface for Money-Unified Payments Interface (BHIM-UPI) and Immediate Payment Service (IMPS). Digital Transactions have shown record growth over the last few years supported by the continuous effort of the government and banking institutions. The main aim of promoting easy and convenient digital transactability include ease of living, ease of access and growth in businesses. The main benefits of digital transactions in the economy are as follows:

- **Instant payment service:** Money can be easily and instantly transferred from bank accounts to the beneficiary accounts using UPI or IMPS. UPI has also enabled users to transfer money from multiple bank accounts through a single mobile app.
- **Security:** Digital Transactions provide a safe and secure method of payment due to multiple levels of authentication required for a digital transaction to be completed.
- **Enhanced Transparency:** Digital Infrastructure like UPI provides a system of digital payment where social security benefits can be provided directly to the beneficiary's account ensuring no leakage of funds.
- **Ease of use:** Digital Transactions can help people living in rural areas who face difficulty in travelling and accessing a bank outlet. The usability of digital payments will help government's aim to increase financial inclusion and henceforth expand the formal banking network.
- **Digital Data to be used in credit decisions:** Digital Payments host a good number of data points which can help lenders make decisions on credit worthiness of a person or a business using digital transaction histories.

Capital SFB has the third highest volume of mobile banking transactions among SFBs from January 2023 to June 2023

Capital SFB recorded the third highest volume of mobile banking transactions from January 2023 to July 2023. AU SFB and Ujjivan SFB recorded the first and the second highest number of mobile banking transactions during the same time.

Digital Transactions of SFBs from January 2023 to June 2023

	Digital Transactions (January 2023 – June 2023)			
	Mobile Banking		Internet Banking	
	Volume of transactions (In Thousands)	Value of transactions (In Millions)	Volume of transactions (In Thousands)	Value of transactions (In Millions)
AU SFB	149,901	977	5,086	770
Capital SFB	4,990	38	71	14
Equitas SFB	1,846	82	700	60
ESAF SFB	1,068	26	497	18
Fincare SFB	1,536	28	408	30
Jana SFB	763	24	165	11
North East SFB	25	0.3	201	19

Shivalik SFB	109	8	86	19
Suryoday SFB	2,321	32	100	10
Ujjivan SFB	138,975	247	433	122
Unity SFB	7	0.1	-	-
Utkarsh SFB	529	15	90	12

Note: Companies are arranged in order of alphabetical order. Source: RBI, CRISIL MI&A

Mobile Banking trend of SFBs from January 2023 to June 2023: Number of active customers (in thousands)

No of active customers (in thousands)	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
Ujjivan SFB	980	987	1,019	1,101	1,130	1,234
AU SFB	256	258	269	276	276	280
Fincare SFB	194	195	218	223	217	223
Jana SFB	180	170	188	188	190	194
Equitas SFB	81	79	78	78	77	76
ESAF SFB	37	38	39	33	41	41
Suryoday SFB	41	58	56	54	53	40
Utkarsh SFB	21	21	22	23	24	24
Capital SFB	20	19	19	20	20	20
Shivalik SFB	3	3	3	4	4	4
Unity SFB	0	0	0	0	1	2
North-East SFB	1	1	1	1	1	2

Note: Companies are arranged in order of decreasing number of active customers as of July 2023. Source: RBI, CRISIL MI&A

Internet Banking trend of SFBs from January 2023 to June 2023: Number of active customers (in thousands)

No of active customers (in thousands)	Jan-23	Feb-23	Mar-23	Apr-23	May-23	Jun-23
Equitas SFB	103	105	105	101	98	94
AU SFB	43	43	49	47	47	48
Ujjivan SFB	11	10	11	12	11	11
Suryoday SFB	9	9	9	9	9	7
Fincare SFB	7	7	8	8	7	7
Utkarsh SFB	3	5	5	6	6	6
Jana SFB	11	22	20	6	6	6
ESAF SFB	4	4	4	2	4	4
North East SFB	3	3	3	3	1	2
Shivalik SFB	1	1	1	2	1	1
Capital SFB	1	1	1	1	1	1

Note: Companies are arranged in order of decreasing number of active customers as of July 2023. Source: RBI, CRISIL MI&A

Distribution outlets for SFBs

In order to preserve the advantages of the MFI/NBFC structure of SFBs and with a view to further financial inclusion, MFI turned SFBs have been increasingly expanding their presence by opening new branches or converting existing MFI branches into banking outlets, where it intends to conduct banking business of accepting deposits, allowing encashment of cheques/withdrawals besides carrying out the current lending activities. The format of branches that the SFBs have are as follows:

- **Liability branches** – these branches mostly accept deposits by opening savings, current or fixed/term deposit accounts. They also offer facility of withdrawal and encashment of cheque.
- **Asset branches** – These branches of SFBs only carry out lending activities i.e., making advances to the customer. Application and documents for all the assets sold are then entered into the system for processing and approval from the regional asset centre, after which disbursement is made to the customer.
- **Asset centre** – These are generally loan processing centre where all the documents for credit evaluation of the individual and collateral is sent for due diligence. Once the asset centre approves the loan after profiling and due diligence, the amount is disbursed to the customer. In case, a loan application is rejected, the asset branch may seek additional documents for re-processing.
- **Fully fledged banking branch** – These banking outlets provide both liability and asset services. Each branch is assigned a liability target for new account opening (CASA) and asset target (advances) across different product portfolio. The branch staff works together to meet the branch target while achieving their individual targets in this process.

Capital efficiency for SFBs

Financial institutions like local area banks, co-operative banks, MFIs, etc., generally have a lower capital expenditure than that of traditional commercial banks because of their low-cost infrastructure. But upon conversion into SFBs, they have to be cognisant of the cost associated with the transformation from a specialised local institution to a diversified financial institution. This involves incremental cost of upgrade in infrastructure, core banking services and new product development etc. On an average, setting up of a new branch generally costs Rs. 60-70 lakhs whereas conversion of an existing outlet to a commercial banking outlet generally takes Rs. 35-40 lakhs. For a new branch, the breakeven period is generally 28-36 months while that of a converted branch is 15-20 months depending on the quantum of operational expense and revenue, as per our assessment. Thus, speaking of processes and systems and understanding of functioning of branch dynamics for retail as well as liability side functioning, the localised banks are better placed in comparison to the MFIs.

Impact of various crisis on financial institutions

Impact of government enactments such as demonetisation

The banking sector enjoyed double-digit deposit growth of approximately 13% between fiscals 2013 and 2015, due to competitive deposit rates. However, the growth slowed to approximately 7% in fiscal 2016 as RBI cut repo rate, nudging banks to reduce deposit and lending rates. In fiscal 2017, deposits grew approximately 10% as households deposited their savings in banks after demonetisation in the second half of the fiscal. As a result, the deposit-to-household-savings ratio also rose significantly in the fiscal to nearly 39% from 26% in the previous fiscal. In fiscal 2018, the growth rate fell to its lowest in over 55 years to approximately 6%, with the effect of demonetisation subsiding, and households moving their savings from deposits to other lucrative instruments, such as shares and debentures.

Impact of Kosi, Orissa and Kerala floods

The massive Kosi River floods of August 2008 caused unprecedented loss of lives and livelihoods, infrastructure in Bihar. The local economy was disrupted, and massive damage was caused in terms of village and household level. At a household level, the losses were in terms of lives, livestock, agriculture operations and employment opportunities. People reported huge income losses which had an adverse impact on the MFI industry in Bihar.

In August 2018, Kerala witnessed the worst floods in 100 years. Localised institutions like local area banks, MFIs, etc., which operate at the ground level and focus on lending to small and marginal borrowers in rural and remote areas, were hit hard. They saw an increase in credit slippage in the ravaged state. Reviving their operations was also a challenge. According to MFIN report, as of June 2018 Kerala had 303 NBFC-MFI branches. In May 2019, Odisha witnessed the worst cyclone in 20 years. This also resulted in a near-term spike in PAR portfolio of these entities.

Impact of cyclone Amphan

Cyclone Amphan which made a landfall in May 2020 near the India-Bangladesh border and was responsible for economic losses to the tune of USD 14 billion as per the 'State of the Global Climate 2020' report released by UN. The extreme weather combined with the pandemic dealt a double blow for millions of people in 2020.

Around 2.4 million were displaced in India, mostly in West Bengal and Odisha on account of the cyclone. It is expected that entities focussed on the affected region are bound to face several credit losses on account of the cyclone and the economic losses resulting from the same.

NBFCs' liquidity crisis following the IL&FS default

In the first half of fiscal 2019, NBFCs grew a robust 17% on-year. However, default by Infrastructure Leasing and Financial Services Limited (IL&FS) in mid-September 2018 created panic, affecting investor confidence in NBFCs. This subsequently spiked market rates for NBFCs and slowed down their commercial paper (CP) and bond issuances. Investors' risk perception towards players with asset-liability mismatch and high exposure to developer financing increased significantly. NBFCs that have been relying heavily on short-term CP instruments to grow their book found it difficult to grow at the same pace and witnessed a sharp slowdown in the second half of fiscal 2019. In February 2019, Reliance Home finance defaulted on its loan payments to Punjab & Sind Bank. Later, in June 2019, DHFL, one of the leading housing finance company also failed to repay its obligations due to lack of liquidity and inability to raise funds.

The liquidity squeeze, which continues even now, has affected the wholesale and loan against property (LAP) segments the most, as they have longer tenured loans which resulted in asset-liability mismatch. Financiers with shorter term loans and ability to pass on interest rates (such as microfinance, consumer durable, gold loan segments) are not seeing much of an impact.

CRISIL MI&A expects non-banks to lose market share to well capitalised banks and SFBs amid the ongoing crisis of confidence and liquidity crunch. NBFCs are heavily reliant on banks for funding which has led to a rise in cost of funds. However, for SFBs, access to deposits will lower cost of funds. This advantage will help them compete with NBFCs on pricing in the underpenetrated region and gain market share.

Impact of Yes Bank crisis and COVID-19

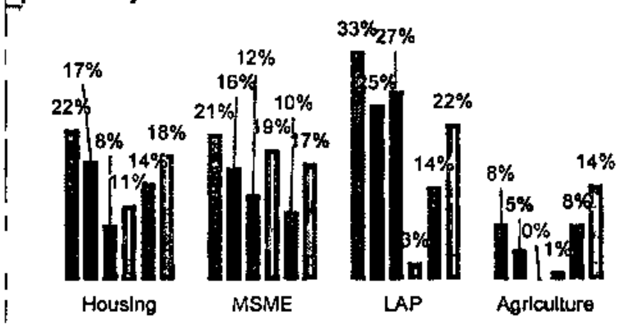
The financial position of Yes Bank had declined since 2018; largely due to inability of the bank to raise capital to address loan losses and resultant downgrades, triggering invocation of bond covenants by investors. The bank had also experience serious corporate governance Issues which had led to its decline. After careful considerations of these developments, On March 5, 2020, RBI imposed a 30-day moratorium on Yes Bank, capping deposit withdrawals at Rs 50,000 owing to deterioration in financial position of the bank. It also superseded the bank's board. The moratorium was lifted on March 18. In the wake of the crisis, many shifted their deposits to public sector banks (PSBs) and larger established private banks. SFBs, which have a liability franchise, are newer entities in the sector. They may find it difficult to gain customer confidence and should focus more on building a strong reputation if they have to maintain stable deposits. However, higher interest rates offered by SFBs will be an attraction. In addition, the amended Deposit Insurance Credit Guarantee Corporation (DICGC) rules are a big positive for SFBs. The new rules increased the deposit insurance to up to Rs 5 lakh (principal and interest) from Rs 1 lakh earlier. Thus, those who have parked money in SFBs can rest assured that their deposit amount is insured to a five times higher extent. Even as the financial sector was still grappling with the Yes Bank fiasco, the Novel Coronavirus (Covid-19) pandemic delivered another blow to the sector with the nation-wide lockdown to arrest the spread of the virus impacting the normal operations of businesses.

In Fiscal 2021, loan disbursements slowed owing to the outbreak of the Covid-19 pandemic, which impacted the low and middle income group. However, there was a faster-than-envisaged revival in the second half of fiscal 2021 on the back of the RBI, the Centre and state governments providing impetus to the economy. The overall economy bounced back in Fiscal 2022 and Fiscal 2023 with gross bank credit growing by 11% and 16% in Fiscal 2022 and Fiscal 2023 respectively. CRISIL MI&A expects lenders with stronger deposit base, varied funding avenues, deeper distribution network, superior underwriting skills, higher capability to offer customised products, and ability to keep asset quality under check will continue to drive growth and stay ahead of the pack.

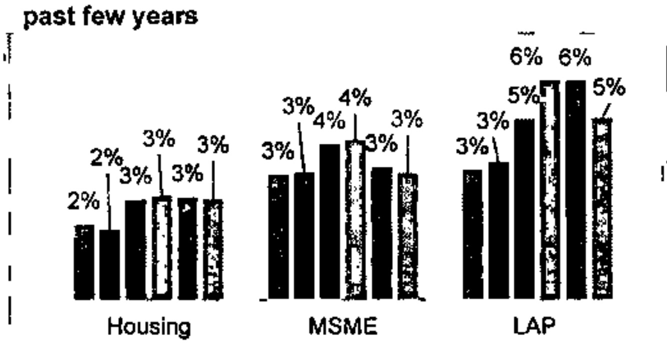
Indian economy has remained resilient over various events

The Indian economy has remained resilient over the years despite various events such as Demonetisation (November 2016), GST implementation (July 2017), IL&FS crisis (September 2019) and Covid-19 pandemic (March 2020). The below chart shows the trend of credit growth and its asset quality across asset classes.

Credit Growth in various asset classes over the past few years



Asset Quality across various asset classes over the past few years



Note . Housing and MSME loans data as per CRIF Highmark, Microfinance loans data as per MFIN, Auto loans data as per CRISIL MI&A estimates Source : MFIN, CRIF Highmark, CRISIL MI&A	Note : Housing and MSME data as per CRIF Highmark, Microfinance loans data as per MFIN, Auto loans data as per CRISIL MI&A estimates, PAR>90 for Microfinance Source : MFIN, CRIF Highmark, CRISIL MI&A

During Fiscal 2023, in spite of increasing inflation, volatile macro-economic factors and rising supply chain costs, credit grew at a growth rate of 16%. A large part of this growth was spurred by the retail segment, primarily owing to home loans and vehicle loans and supported by recovery in service segment with pent up demand in NBFCs and trade segment.

Housing Loans: For the last few fiscals, housing loans segment grew on back of increasing demand from tier II and tier III cities, rising disposable incomes and government initiatives such as PMAY, interest rate subvention schemes and fiscal incentives.

MSME loans: MSME loans segment grew at a comfortable pace since the last few fiscals on account of improving economic conditions, ease of lender to lend, data availability and lower credit penetration.

LAP loans: Loan against property is availed by mortgaging properties (residential or commercial) with the lender. LAP is a secured loan which provides collateral to the financier in the form of property. The LAP portfolio witnessed higher growth in the last few fiscals than non-LAP as lenders preferred mortgage-based lending over cash flow based lending.

Agricultural Loans: Agricultural loans have grown over the years on account of increased government focus and need for affordable credit to be provided to farmers in an industry where credit penetration is low, and dependence is on informal lending. Agri-financing has also grown on account of farmers investing in modern agricultural practices, purchasing quality inputs, and focussing on increasing farm productivity. Growth in agri-ancillary activities have also aided growth in agri-financing.

Impact analysis of various events on credit, deposits and GNPA across player groups

Across various player groups, the important events have had a specific impact resulting in them gaining or losing share and slowing down or accelerating their deposits and credit franchise. Within player groups, SFBs have been able to differentiate themselves from other banks by offering personalised service to customers, understanding of the micro-market and strong connect with local stakeholders. Further, SFB also cater to markets that are in the rural and semi-urban regions and this has prompted them to increase their focus on digital initiatives in order to keep operating expenses under check. The SFBs that have already transitioned and made requisite investments in people, process and technology are expected to reap more benefits and grow faster than their peers.

Capital SFBs performance across the major disruptive events has been strong and resilient and it has fared better or at par in comparison to other player groups during these events. In terms of the overall deposits, Capital SFB has beaten the growth in PSBs and Private sector Banks as well as all the banks combined, in all the years across all the 4 major events.

In terms of the overall credit growth too, Capital SFB has grown the fastest when compared to overall banking industry, the PSBs and private sector banks across each year and each event. Also, Capital SFB had the highest average growth in overall deposit and credit as compared to overall banks, public sector banks and private banks from Fiscal 2019-2023.

Trend in growth of overall deposits of bank groups in comparison to Capital SFB

Parameter	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Avg (FY19-FY23)
Overall Banks	11.2%	6.8%	9.4%	9.5%	12.3%	10.1%	10.2%	10.3%
Public Sector Banks	9.1%	3.2%	6%	8.2%	10.4%	8.0%	8.1%	8.1%
Private Banks	19.6%	17.4%	15.4%	10.4%	16.6%	14.5%	14.7%	14.3%
Small Finance Banks	NM	NM	119.8%	67.2%	40.1%	37.9%	33.2%	59.6%
Capital SFB	31.1%	19.9%	28.7%	21.3%	17.4%	15.8%	8.5%	18.3%

Note: NM: Not Meaningful; Source: RBI, Company Reports, CRISIL MI&A

Trend in growth of overall credit of bank groups in comparison to Capital SFB

Parameter	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Avg (FY19-FY23)
Overall Banks	5.4%	9.5%	13.1%	6.4%	5.6%	10.7%	15.9%	10.3%
Public Sector Banks	1.8%	4.7%	9.2%	4.2%	3.6%	7.4%	14.6%	7.8%
Private Banks	17.1%	20.9%	20.2%	9.3%	9.1%	15.3%	18.7%	14.5%
Small Finance Banks	NM	NM	74.5%	61.1%	19.6%	26.1%	33.7%	43.0%
Capital SFB	19.2%	35.3%	40.8%	27.5%	13.1%	24.4%	17.1%	24.6%

Note: NM: Not Meaningful; Source: RBI, Company Reports, CRISIL MI&A

Comparison of performance of Capital SFB as against various player groups retail profile during major events

Capital SFB has shown superior performance against each of the player groups across the 4 events mentioned above and has shown resilience to tide over the adverse impact of these major events. In terms of CASA deposits, Capital SFB has shown the maximum growth amongst and against all the player groups post demonetisation. It has fared better than the public and private sector banks post implementation of GST, during and post the IL&FS crisis when the liquidity was low in the system as well as post covid, which saw far reaching impacts across the financial system globally.

Growth in CASA deposits across player groups during and post major events

Parameter	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Avg (FY19-FY23)
Public Sector Banks	24.5%	6.1%	5.2%	7.6%	14.9%	9.5%	3.9%	8.2%
Private Banks	31.1%	18.7%	18.7%	10.1%	24.4%	18.6%	9.8%	16.3%
Small Finance Banks	NM	NM	73.9%	38.8%	107.1%	89.1%	25.8%	66.9%
Capital SFB	47.3%	21.3%	23.5%	14.7%	29.6%	21.8%	7.8%	19.5%

Note: NM: Not Meaningful; Source: RBI, Company Reports, CRISIL MI&A

Growth in retail credit across player groups during and post major events

Parameter	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Avg (FY19-FY23)
Public Sector Banks	15.1%	14.3%	8.6%	13.8%	14.2%	13.8%	19.1%	13.9%
Private Banks	22.5%	33.2%	26.9%	24.2%	12.9%	20.4%	21.8%	21.2%
Small Finance Banks	NM	NM	37.2%	503.2%	115.5%	98.6%	19.0%	154.7%

Note: NM: Not Meaningful; Source, RBI, Company Reports, CRISIL MI&A

Strong asset quality performance of Capital SFB across years and events

The asset quality of Capital SFB is superior to all the player groups across the time period across all the major events denoting better approval mechanism and strength of the asset franchise of Capital SFB. Capital SFB had the lowest average GNPA as compared to public sector banks and private banks from Fiscal 2019 to Fiscal 2023.

Trend in GNPA across player groups across various events

	Mar-17	Mar-18	Mar-19	Mar-20	Mar-21	Mar-22	Mar-23	Avg (FY19-FY23)
Public Sector Banks	11.7%	14.6%	11.6%	10.8%	9.5%	7.6%	5.2%	8.9%
Private Sector Banks	4.1%	4.7%	5.3%	5.1%	4.8%	3.7%	2.2%	4.2%
Small Finance Banks	NM	2.2%	1.6%	1.9%	4.1%	3.9%	2.9%	2.8%
Capital SFB	1.0%	1.1%	1.3%	1.8%	2.1%	2.5%	2.8%	2.1%

Source: RBI (Financial Stability Report – June 2023), RBI, Company Reports, CRISIL MI&A

Growth drivers for Small finance banks

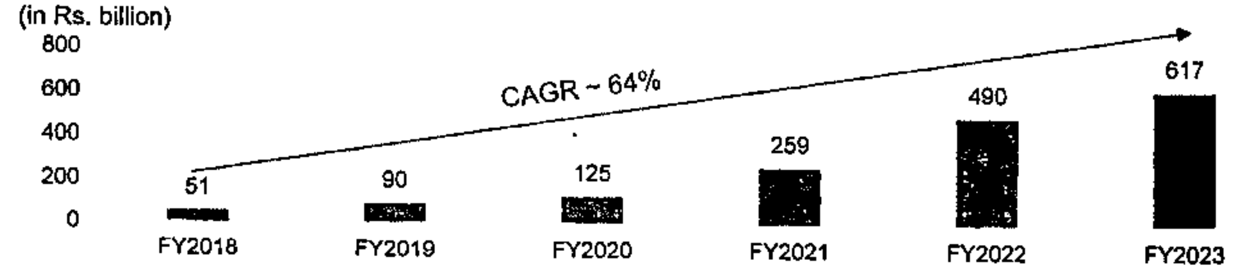
Customized products aided by technology and information availability

Greater use of technology is enabling lenders to provide customised products, that too at much lower turnaround time. Multiple data points are available for lenders that is facilitating quick decision making. In fact, they can take lending decisions within minutes using data-driven automated models. These models would help in supply of credit to small business units and the unorganised sector at low cost. Technology also helps these players expand their reach to under penetrated population in remote areas at a lower operating cost.

Availability of funds at cheaper rates

CASA and other retail deposits are a cheap source of funds for SFBs, which help them expand their product portfolio. They can provide lower rates in the market to compete with NBFCs. With SFBs expanding in the underserved regions further, their deposit base is expected to further widen. The CASA deposits for SFBs have grown at 64% CAGR from Fiscal 2018 to Fiscal 2023.This will give them an advantage over NBFCs and help expand their asset book.

CASA Deposits for SFBs has reached ₹ 617 billion as of March 31, 2023



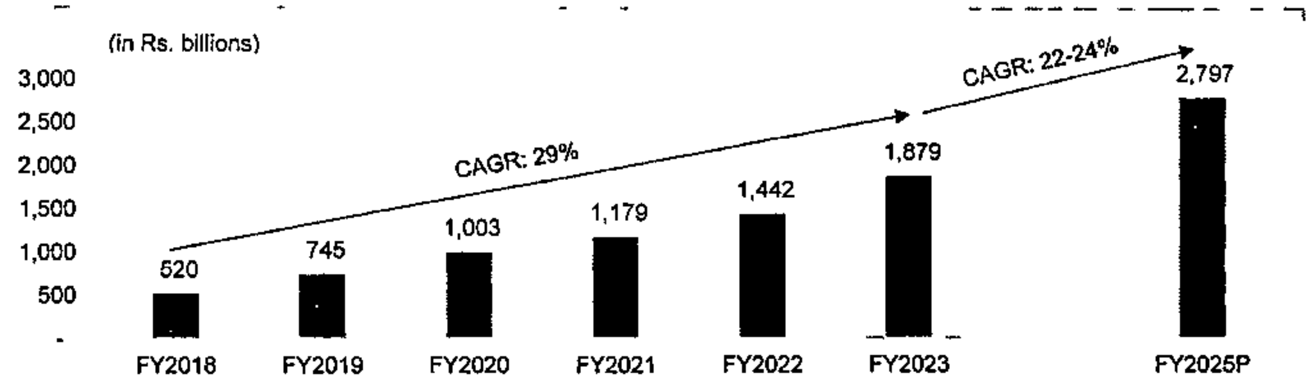
Source: RBI, CRISIL MI&A

Large Target audience

SFBs' target audience is the low-income segment, who can be wooed with a sachet level product suite. Unlike NBFCs, which expand horizontally with a special focus product, SFBs has a chance to expand vertically and horizontally. This will enable them to have a good mix of medium and low-value customers. Also, rural and microfinance borrowers have low credit penetration and migrate less from one player to another. This will enable SFBs to build longer and loyal customer relationships.

Industry growth and outlook

Huge opportunity to support growth over next three years (AUM)



Note: P: Projected, the amounts are as of the end of the Fiscal indicated
Source: Company reports, CRISIL MI&A

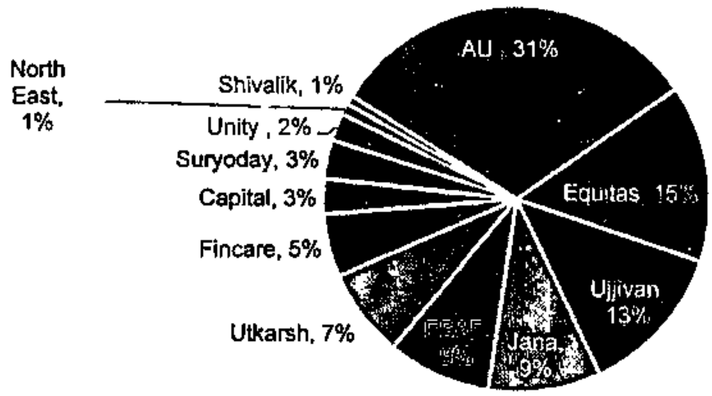
Small finance banks' AUM clocked 29% CAGR during Fiscals 2018-2023. The top three players accounted for ~59% of the aggregate AUM as of Fiscal 2023, up from 55% as of Fiscal 2017. These three players logged a 28% CAGR during Fiscals 2018-2023. The top six players account for ~85% of the market share as of Fiscal 2023. In Fiscal 2021 and 2022, new loan origination remained low as SFBs turned cautious and selective in disbursals due to the pandemic. However, as economy revived and business operations normalised, SFB's AUM witnessed strong growth post pandemic. CRISIL MI&A expects the sector's loan portfolio to see a strong ~22-24% CAGR from Fiscal 2023 to Fiscal 2025 as most of the SFBs have completed the transition phase and likely to get benefit from the operating leverage. Growth in SFB AUM will be driven by following factors:

Huge market opportunity in the rural segment – Despite its larger contribution to GDP of 47%, the rural segment's share in credit remains fairly low at ~8-9% of the overall credit outstanding as of Fiscal 2023. This provides a huge market opportunity for SFBs and other players present in the segment

- **Presence of informal credit channels** – In remote areas, informal credit channels have a major presence. In other words, there is a huge section of unbanked population. SFBs have an opportunity to tap this market
- **Geographic diversification** – With increased focus on diversifying their portfolio and expanding their reach, SFBs are expected to log higher growth as they tap newer geographies
- **Loan recovery and control on aging NPAs** – SFBs are experienced in collection and monitoring of default risk. This will help them keep asset quality under check
- **Ability to manage local stakeholders** –SFBs have the ability to manage local stakeholders and maintain operational efficiency

- **Access to low-cost funds & huge cross sell opportunity–** SFBs' cost of funds is low substantially as they are allowed to raise CASA deposits. This will also help them lend at more reasonable rates to its customers, hence enhancing their cross-sell opportunity in terms of asset products, insurance etc.

Top six players accounted for 85% of industry AUM as of Fiscal 2023

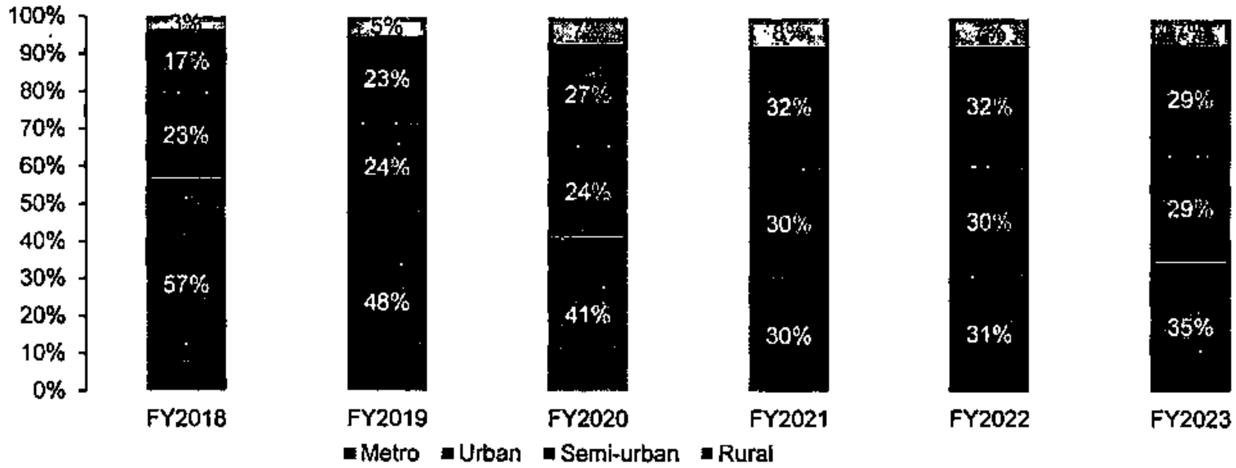


Note: AUM for Jana SFB, North East SFB and Shivalik SFB are estimated based on net advances
Source: Company reports; CRISIL MI&A

Advances across regions for SFBs as of March 31, 2023.

Note: As at the end of each Fiscal.
Source: RBI, CRISIL MI&A

Share of urban and semi-urban regions in total advances continue to increase for SFBs



Note: As at the end of each Fiscal. Rural: Population less than 10,000, Semi urban: 10,000 <=Population <0.1 million, Urban: 0.1 million <=Population <1 million, Metropolitan: Population 1 million and above
Source: RBI, CRISIL MI&A

State wise Tamil Nadu contributes to the largest share of loan portfolio for SFBs at 14.3%, followed by Maharshtra and Rajasthan as at end of Fiscal 2023. Also Uttar Pradesh state has seen the highest growth in the loan portfolio for SFBs from Fiscal 2018 to Fiscal 2023 with CAGR of 64% among the top 10 states as of Fiscal 2023.

Top 10 states contribute approximately 81% of the SFB loan portfolio as of March 31st, 2023

Top 10 States	Share as at end of FY2023	FY18-23 CAGR growth
Tamil Nadu	14.3%	24%
Maharashtra	14.2%	46%
Rajasthan	13.8%	28%
Madhya Pradesh	7.9%	57%
Gujarat	6.9%	45%
Karnataka	6.2%	61%
Punjab	5.2%	32%
Uttar Pradesh	4.9%	64%
Bihar	3.9%	61%
Haryana	3.8%	59%

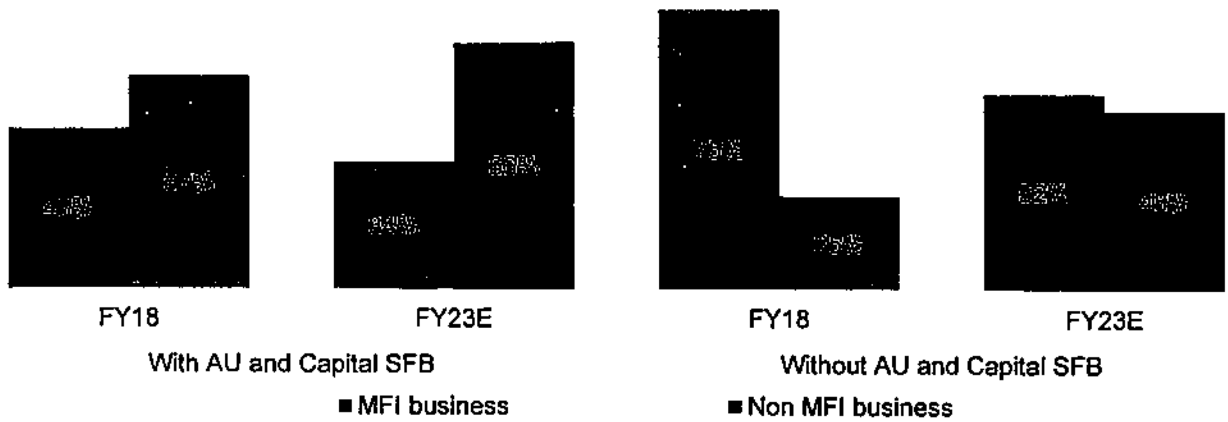
Source: RBI, CRISIL MI&A

SFBs continue to diversify their portfolio

Eight of the 10 firms that got SFBs licence in the initial phase were MFIs and for most of them microfinance is the central product. The microfinance segment accounted for 34% (including Capital and AU SFB) of the overall business of SFBs in Fiscal 2023.

In fact, SFBs have shifted their focus from microfinance to other products. But their core customer base is unlikely to have changed much because of the regulatory norms. After the conversion of NBFC-MFIs to SFBs, the focus is now on diversifying the product portfolio. As a result, the share of their MFI portfolio in total advances reduced to 34% as of Fiscal 2023 from 90-95% as of Fiscal 2016. Going forward, SFBs will have to focus on small-ticket size lending to financially under-served and un-served segments (loans below Rs. 2.5 million will have to form at least 50% of their loan book). CRISIL MI&A expects MFIs that converted to SFBs to further diversify and focus on allied segment loans, such as MSME loans, affordable housing finance, gold loans, CV/non-CV loans and two-wheeler loans, which will reduce the dominance of microfinance in their overall loan portfolio. SFBs with a diversified portfolio will have advantage in terms of a larger target audience, better assessment of borrower's credit risk, higher profitability, better asset quality and lower cost of funds.

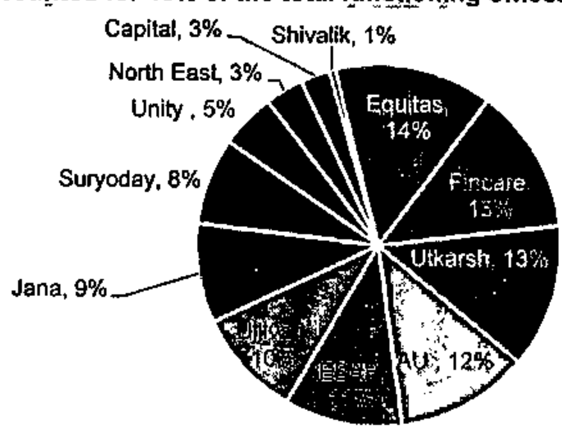
Advances mix for small finance banks



Notes: As at the end of each Fiscal. E: Estimated, 1) Capital and AU SFB are excluded as they mostly deal with non-MFI business, 3) AUM data includes data for all 12 SFBs for Fiscal 2023.

Source: Company reports, CRISIL MI&A

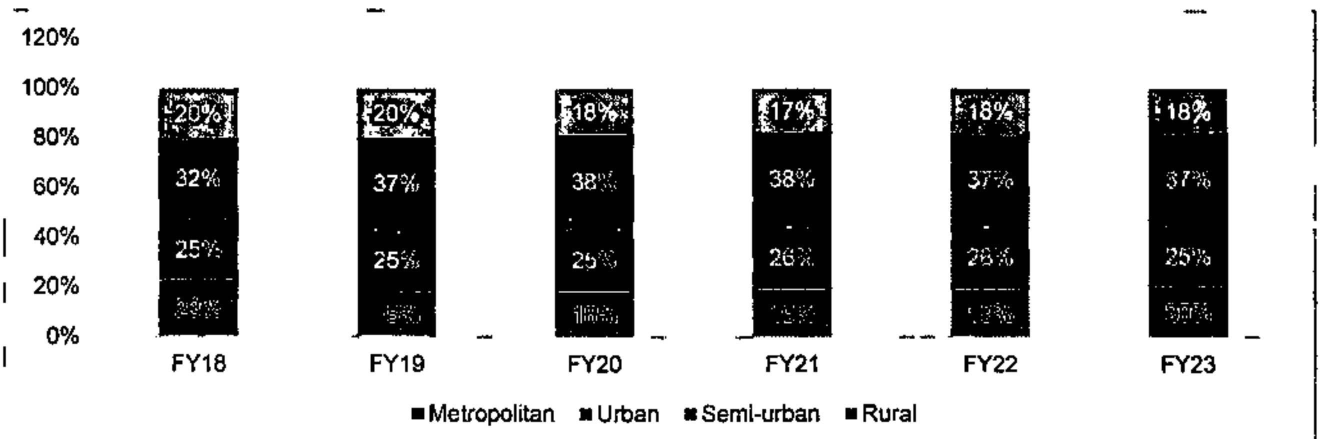
Top three players accounted for 40% of the total functioning offices as of March 31, 2023



Source: RBI; CRISIL MI&A

The top three players accounted for 40% of the total number of functioning offices as of March 2023. Expansion of functioning offices has also helped SFBs in diversification of loan portfolios and overcome geographic concentration.

Share of semi-urban branches at 37% as of March 31, 2023



Note: As at the end of each Fiscal. Rural: Population less than 10,000, Semi urban: 10,000 <=Population <0.1 million, Urban: 0.1 million <=Population <1 million, Metropolitan: Population 1 million and above

Source: RBI, CRISIL MI&A

SFBs have branches spread across the country with top 10 states accounting for 4,989 branches which is ~75% of total SFB branches. The northern region has 1,196 branches which account for 18% of total SFB branches in the country as of Fiscal 2023. Within the northern region, the state of Rajasthan and Punjab have 525 and 271 branches respectively, being the highest and second highest in the northern region and being the third and eleventh highest across India.

Branch network of SFBs (March 2023)

Region	State	Branches
Central Region	Chhattisgarh	172
	Madhya Pradesh	432
	Uttarakhand	36
	Uttar Pradesh	427
	Total Central Region	**1,067**
Eastern Region	Bihar	348
	Jharkhand	139
	Odisha	288
	Sikkim	8
	West Bengal	179
	Total Eastern Region	**962**
North Eastern Region	Arunachal Pradesh	5
	Assam	202
	Manipur	6
	Meghalaya	15
	Mizoram	4
	Nagaland	3
	Tripura	22
	Total North Eastern Region	**257**

Northern Region	Chandigarh	16
	Haryana	217
	Himachal Pradesh	22
	Jammu & Kashmir	3
	NCT of Delhi	142
	Punjab	271
	Rajasthan	525
	Total Northern Region	**1,196**
Southern Region	Andhra Pradesh	114
	Karnataka	463
	Kerala	343
	Puducherry	17
	Tamil Nadu	821
	Telangana	97
	Total Southern Region	**1,855**
Western Region	Goa	13
	Gujarat	452
	Maharashtra	890
	Total Western Region	**1,355**
	Total	**6,692**

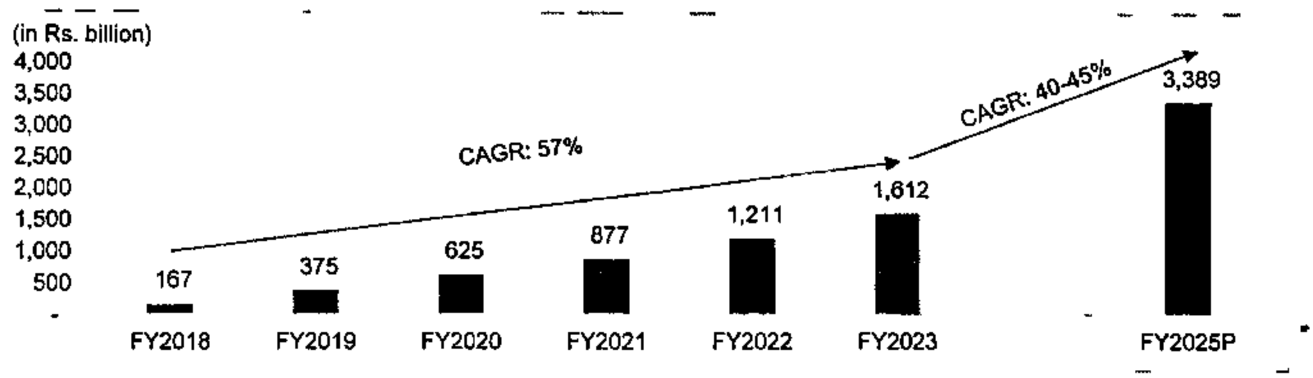
Source: RBI, CRISIL MI&A

SFB deposits to grow faster than private and public-sector banks

SFBs have a significant growth potential as most of them were functioning as NBFCs/MFIs previously. Immediately after commencement of their operation, all SFBs focussed on increasing their deposit base. Their overall deposit base doubled to around Rs. 375 billion as of Fiscal 2019. It further increased at ~48% CAGR to reach Rs. 1,612 billion in Fiscal 2023. Further, proportion of CASA deposits has short up from nearly ~20% as of Fiscal 2020 to ~38% as of Fiscal 2023. The increase could be attributed to the higher interest rates they offer and increase in their branch network.

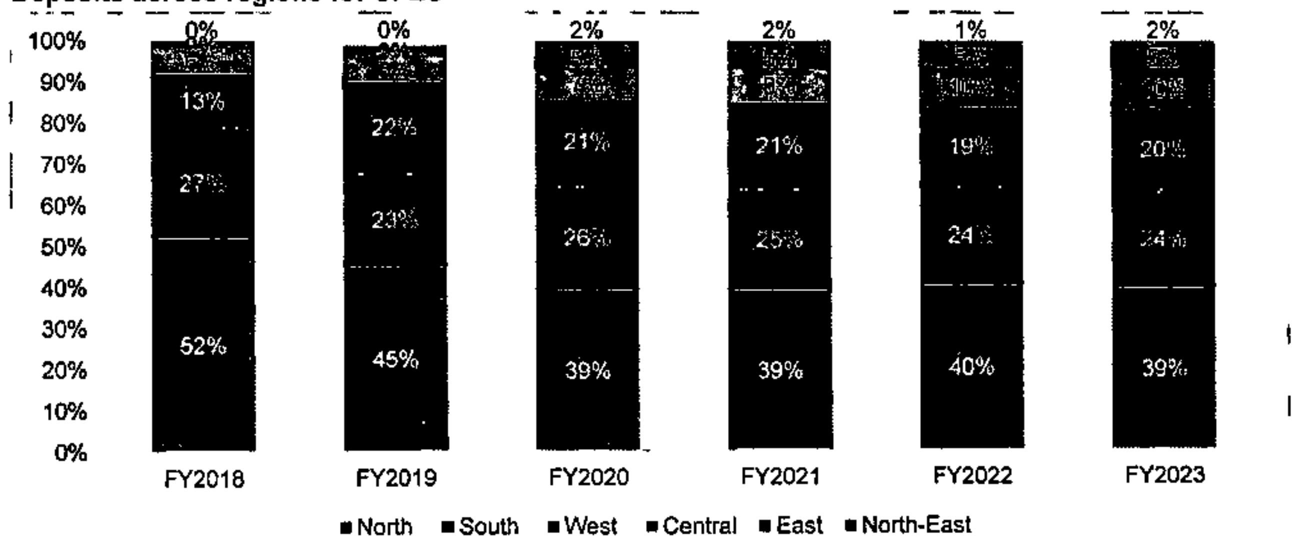
Going forward, CRISIL MI&A expects SFBs' deposit to grow at 40-45% CAGR over Fiscals 2023-2025 as players focus on popularising convenient banking habits to cover the last mile and widen financial inclusion by deepening their penetration in untapped geographies..

SFB deposits to grow robustly



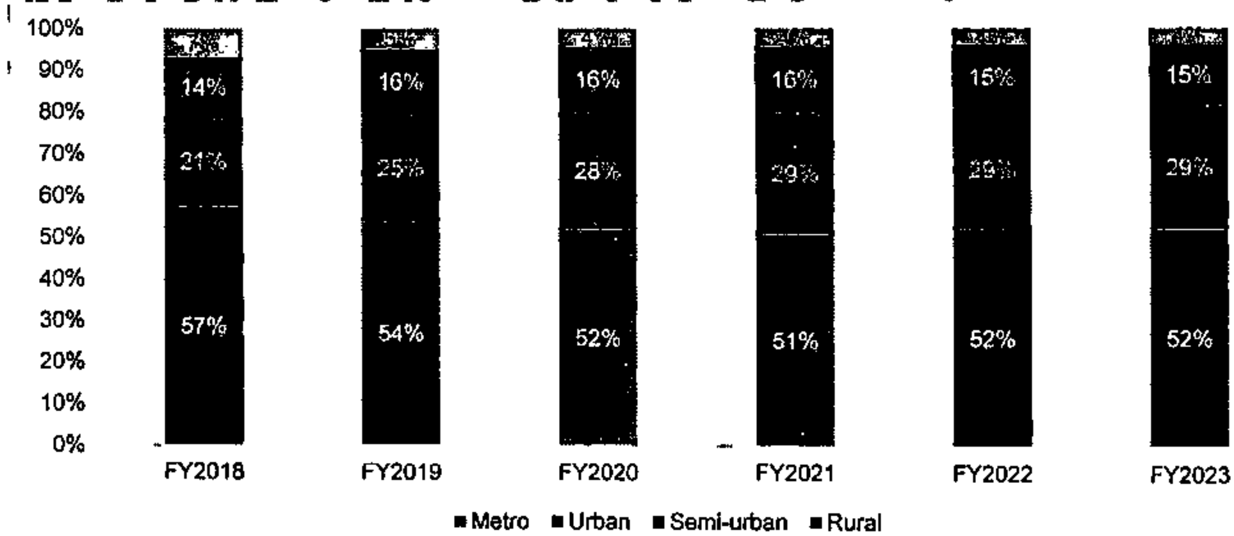
Note: Amounts are as at the end of Fiscal year indicated; P: Projected.
Source: Company reports, CRISIL MI&A

Deposits across regions for SFBs



Note: As at the end of each Fiscal.
Source: RBI, CRISIL MI&A

Around 80% deposits is from metropolitan and urban regions for SFBs



Note: As at the end of each Fiscal. Rural: Population less than 10,000, Semi urban: 10,000 <=Population <0.1 million, Urban: 0.1 million <=Population <1 million, Metropolitan: Population 1 million and above
Source: RBI, CRISIL MI&A

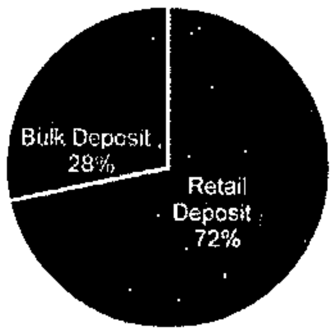
The northern states comprising of Rajasthan, Punjab, Haryana, NCT of Delhi, Chandigarh, and J&K together account for 39% of the overall deposits with SFBs amounting to ~Rs 636.25 billion. Within these, Rajasthan accounts for 15%, Punjab for 8%, NCT of Delhi and Haryana for 9% and 5% respectively of the deposits across the country.

Top 10 states contribute approximately 85% of the deposits as of Fiscal 2023

Top 10 states	Deposits (in Rs. Billion)	Share at the end of FY23
Rajasthan	243.68	15%
Maharashtra	229.83	14%
NCT of Delhi	149.87	9%
Kerala	135.44	8%
Tamil Nadu	132.51	8%
Punjab	127.03	8%
Karnataka	92.53	6%
Haryana	88.48	5%
Gujarat	86.45	5%
Uttar Pradesh	77.64	5%

Source: RBI, CRISIL Research

Share of retail deposit in total deposit as on March 31, 2023



Note: Retail deposit include CASA and Retail term deposits; Data excludes data for Jana SFB; Retail deposit estimated for North East SFB, Shivalik SFB and Unity SFB as of Fiscal 2023.
Source: Company reports, CRISIL MI&A

Share of Current, Saving and Term deposit in total deposit as on March 31, 2023

States	Current	Saving	Term
Chhattisgarh	5%	45%	50%
Madhya Pradesh	7%	37%	56%
Uttarakhand	2%	35%	63%
Uttar Pradesh	7%	34%	60%
Central Region	**6%**	**36%**	**58%**
Bihar	4%	40%	56%
Jharkhand	3%	31%	65%
Odisha	3%	27%	70%
Sikkim	2%	23%	75%
West Bengal	4%	27%	68%
Eastern Region	**4%**	**30%**	**66%**
Arunachal Pradesh	29%	37%	34%
Assam	5%	49%	45%
Manipur	22%	48%	31%
Meghalaya	3%	28%	69%
Mizoram	0%	11%	89%
Nagaland	16%	66%	18%
Tripura	6%	32%	63%
North Eastern Region	**6%**	**45%**	**50%**
Chandigarh	3%	33%	65%
Haryana	4%	38%	58%
Himachal Pradesh	1%	24%	75%
Jammu & Kashmir	3%	32%	65%
NCT Of Delhi	5%	27%	69%
Punjab	3%	35%	62%
Rajasthan	6%	44%	50%
Northern Region	**4%**	**37%**	**59%**
Andhra Pradesh	3%	58%	39%

Karnataka	4%	32%	63%
Kerala	1%	20%	79%
Puducherry	2%	40%	57%
Tamil Nadu	3%	39%	58%
Telangana	4%	42%	54%
Southern Region	**3%**	**31%**	**66%**
Goa	2%	21%	77%
Gujarat	5%	38%	57%
Maharashtra	5%	28%	66%
Western Region	**5%**	**31%**	**64%**
All-India	**4%**	**34%**	**62%**

Source: RBI, CRISIL MI&A

CASA Ratio for small finance banks

Note: As at the end of each Fiscal.

Source: RBI, Company Reports, CRISIL MI&A

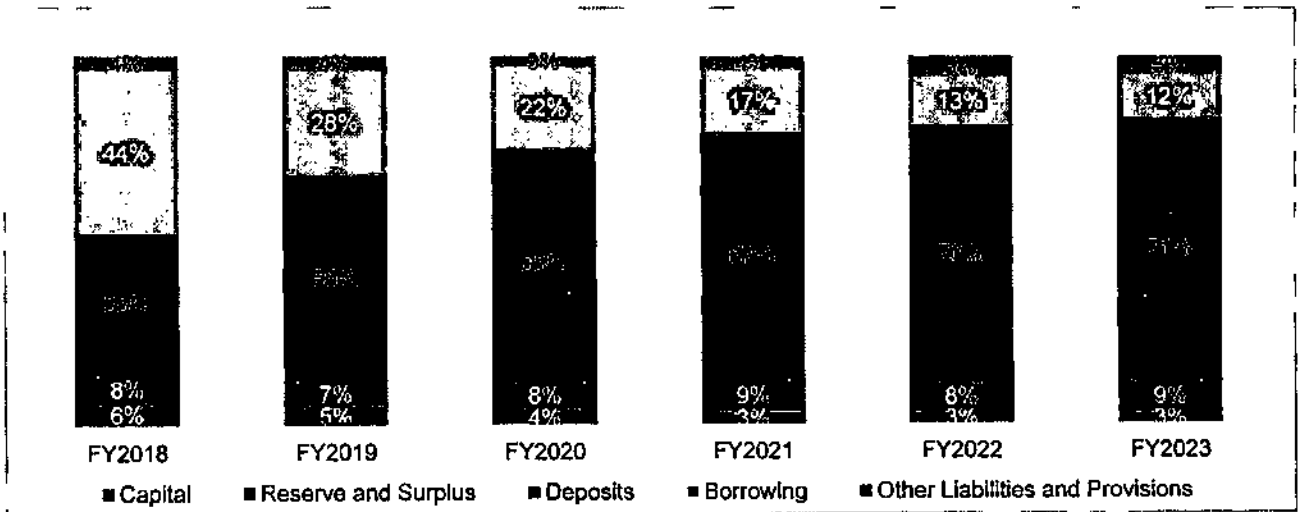
Over the next couple of years, CRISIL MI&A expects established SFBs to focus on gradually building their banking business and complying with tougher regulatory norms. In addition, transformation into SFBs will provide access to stable and granular public deposits over the long run, which will bring down their cost of funds. SFBs which are well positioned in terms of retail and granular deposits will have an advantage of lower cost and hence higher profitability over its peers. The share of SFBs in deposits as well as credit has seen a steady rise over the years and is expected to reach 1.5% and 1.6% respectively by Fiscal 2025 from the current 0.9% and 1.4% in deposits and credits in Fiscal 2023.

Transformation in Resource profile of SFBs

The resource profile of SFBs has completely transformed in the last two to three years owing to a decrease in share of borrowings from 44% as of Fiscal 2018 to 12% as of Fiscal 2023 and a rise share of deposits from 38% to 71% during the same period. Their asset-liability management (ALM) profile remains comfortable owing to conservative liquidity policy, mobilisation of deposits and shorter tenure loans.

Their liquidity profile is also supported by regulatory requirements such as higher requirement of minimum net owned funds ensuring capital adequacy and mandatory maintenance of CRR/SLR ratio, which provides access to call money market and provide better cushion than other NBFCs.

Rapid ramp-up in deposits for SFBs



Note: As at the end of each Fiscal. The percentages are as at the end of Fiscal year indicated; Borrowing mix includes data for all 12 SFBs, Source: Company reports, CRISIL MI&A

Profitability for SFBs has increased in Fiscal 2023

In Fiscal 2020, the return on assets (RoA) of SFBs increased by 20-30 bps. However, outbreak of COVID-19 followed by the nationwide lockdown in the month of March 2020, caused a rise in credit costs for SFBs who made special COVID-19 provisioning, in addition to standard provisioning as of Fiscal 2020.

In Fiscal 2022, the industry RoA declined sharply to 0.7% from 1.48% in Fiscal 2021 and 1.91% in Fiscal 2020 largely due to increased provisioning made by many players in the industry, considering the likely impact of COVID-19 on asset quality. Players who had adequate capital went for front loading of credit costs in Fiscal 2021 itself, while players who have lower margins and higher operating costs spread out the increased provisioning over the course of Fiscal 2021 and Fiscal 2022.

In fiscal 2023, to tackle inflation, RBI started increasing policy repo rating by 40 bps in May 2022, 50 bps in June, August and September 2022, and an additional 25 bps increase in February 2023. With faster increase in repo rates, yield on loans rose quickly. Moreover, interest income for SFBs increased at a faster pace than interest expenses which resulted in improvement of net interest margins. At the end of FY 2023, the net interest income ratio is estimated to have reached 7.5% from 6.8% in FY 2022. Improvement in profitability is estimated to increase return on assets of SFBs to 2.1% at the end of FY 2023 from 0.7% in FY 2022.

Going forward, increasing interest income coupled with reduction in Opex and credit cost because of improved collection efficiency is expected to augment profitability for small finance banks.

Profitability of SFBs is estimated to have inccreased in FY23 on account of lower credit costs

RoA tree (SFB)	FY19	FY20	FY21	FY22	FY23
Interest income	14.1%	14.5%	12.9%	11.8%	12.5%
Interest expense	6.6%	6.7%	6.0%	5.0%	5.1%
Net interest income	7.5%	7.8%	6.9%	6.8%	7.5%
Opex	6.1%	5.8%	4.9%	5.3%	5.5%

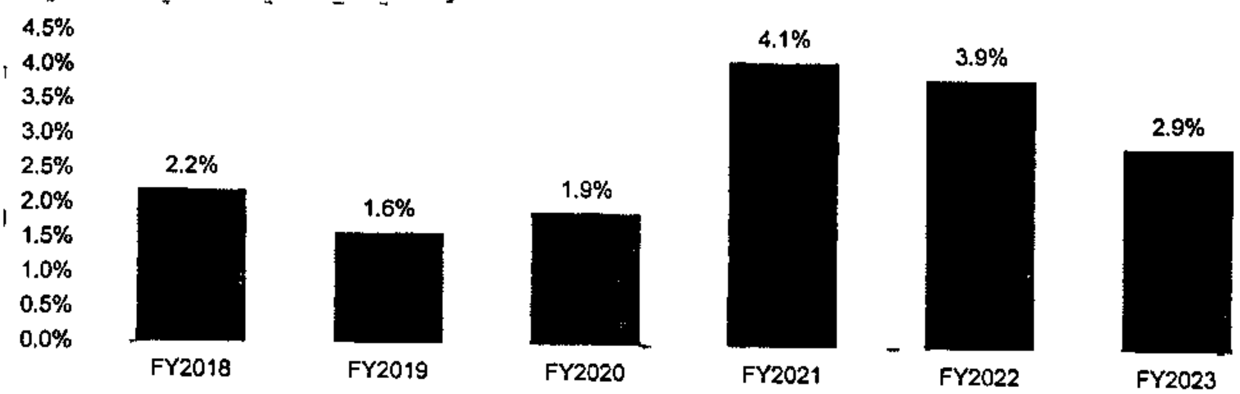
Other income	2.0%	1.7%	2.1%	1.6%	1.6%
Credit cost	0.9%	1.3%	2.2%	2.3%	1.0%
RoA	1.6%	1.9%	1.5%	0.7%	2.1%

Note: E: Estimated, Numbers are based on Ind-AS, Data excludes Jana, North East SFB, Shivalik SFB and Unity SFB.
Source: CRISIL MI&A

Asset quality for SFBs improved in Fiscal 2023 after pandemic related stress

GNPA of SFBs improved to 1.6% as of Fiscal 2019 from 2.2% as of Fiscal 2018 which was majorly impacted by demonetization and residual asset quality issues. This could be attributed to diversification of product mix into relatively less risky assets, write-off of legacy loans and reduction in microfinance loans due to better collection mechanism and deep understanding of their local geographies and customers. In Fiscal 2021, SFBs faced severe asset quality issues on account of COVID-19. Despite government measures, the lockdown impacted borrower income. While banks offered moratorium period to borrowers, SFBs' asset quality deteriorated due to difficulties faced by their borrowers, the impact of which can be witnessed in FY 2022. In FY 2022, the GNPAs improved marginally to 3.9%. In FY 2023, the asset quality of SFBs improved on account of lower slippages, writing offs and improved collection efficiencies. GNPA for SFBs is estimated at 2.9% at the end of FY 2023.

GNPA trend of overall SFB Industry



Note: GNPA Data excludes data for North-east SFB and Unity Small Finance Bank,
Source: Company Reports, CRISIL MI&A

Market Intelligence
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Loan against property (ticket size between Rs 0.5 to 5 mn)

Loan against property (LAP)

A LAP is availed by mortgaging a property (residential or commercial) with the lender. LAP is a secured loan, as it provides collateral to the financier in the form of the property. Its interest rate is lower than personal or business loans. The end-use of the loan amount is not closely monitored. It could be used for either business or personal purposes. It can be availed by both salaried and self-employed individuals. For all these reasons, LAP has become popular among borrowers in recent years.

Evolving landscape of the LAP market

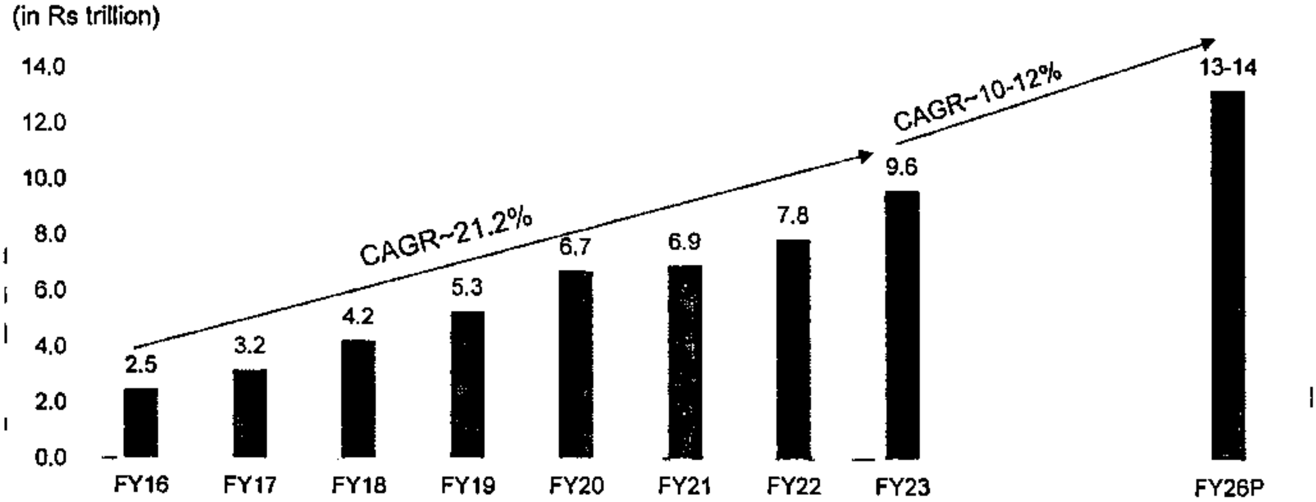
Key factors that contributed to high LAP growth are:

- **Greater transparency in the system:** Demonetisation, GST, and the government's strong push for digitisation have led to higher transparency in the system. This will keep pushing up loan amount eligibility of borrowers. Formalisation will also help many new borrowers come under the ambit of formal lending channels
- **Rising penetration of formal channels:** Increase in penetration and availability of formal lending channels outside the top 10 cities will eat into the market share of moneylenders
- **Higher comfort for lenders:** Lenders are comfortable disbursing LAP loans, as they offer favourable risk-return characteristics, compared with MSMEs and unsecured loans. They also offer higher recovery in case of default (supported by the Securitisation and Reconstruction of Financial Assets and Enforcement of Securities Interest Act, 2002) and better asset quality, which is only partly offset by lower yields.

Overall LAP portfolio to grow at 10-12% CAGR between fiscal 2023-2026

LAP (banks and non-banks) clocked a CAGR (compounded annual growth rate) of ~21.2% between fiscals 2016 and 2023, driven by rising penetration of formal channels and higher comfort for the lenders to lend. The growth slowed to ~3% in fiscal 2021 in the wake of the liquidity crisis and increasing asset quality concerns due to the pandemic. Overall LAP segment has bounced back in fiscal 2022 after growing at 14% year-on-year. At the end of Fiscal 2023, the overall LAP grew by 22.3% year-on-year on account of improved economic conditions and normalization of business activities. Going forward, CRISIL MI&A expects overall LAP portfolio to grow at 10-12% CAGR over fiscals 2023-26 aided by increasing lender focus and penetration of such loans, enhanced availability of data increasing lender comfort while underwriting such loans, enhanced use of technology, newer players entering the segment, and continued government support.

Overall LAP advances are expected to grow over FY23-26 at a CAGR of 10-12%

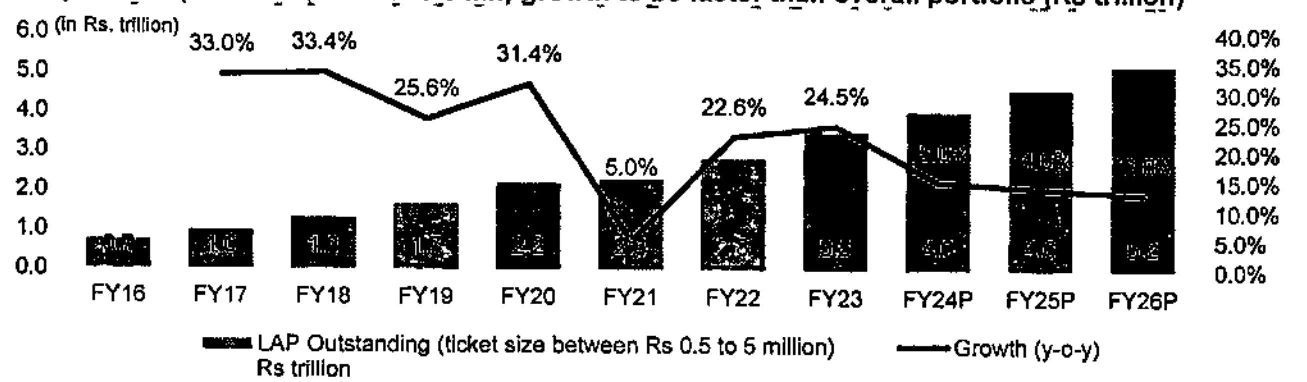


Note: P: Projected
Source: CRIF Highmark, CRISIL MI&A

Lower ticket size LAP (ticket size between Rs 0.5 to 5 million) portfolio has witnessed a growth of 24.7% between fiscal 2016 and fiscal 2023. The growth in this segment is attributed to increasing financial penetration and increase in number of players in the targeted market. The low-ticket LAP market grew by only 5% year on year in fiscal 2021 on account of the pandemic. However, the growth rate rebounded to 23% in fiscal 2022 due to income levels of salaried customers remaining intact and home loan rates hovering around historical lows. In Fiscal 2023, year-on-year growth rate increased to 24.5% on account of strong credit demand. The share of LAP portfolio with ticket size of Rs 0.5 to 5 mn in overall market increased from 30% in fiscal 2016 to around 37% in fiscal 2023.

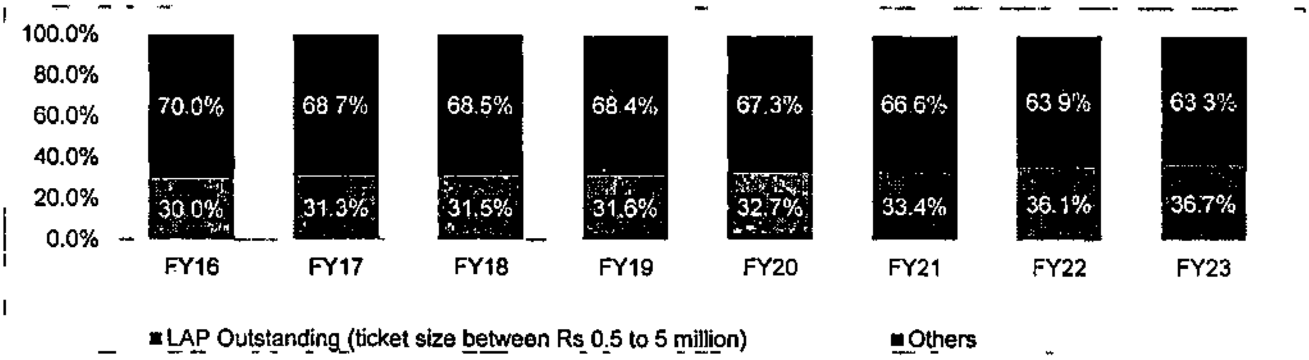
CRISIL MI&A expects low ticket sized LAP credit to grow at a faster rate as has been seen in the past as well, leading to a CAGR of 14-16% between fiscal 2023 and fiscal 2026.

LAP portfolio (ticket size Rs 0.5 to 5 mn) growth to be faster than overall portfolio (Rs trillion)



Note: P- Projected
Source: CRIF Highmark, CRISIL MI&A

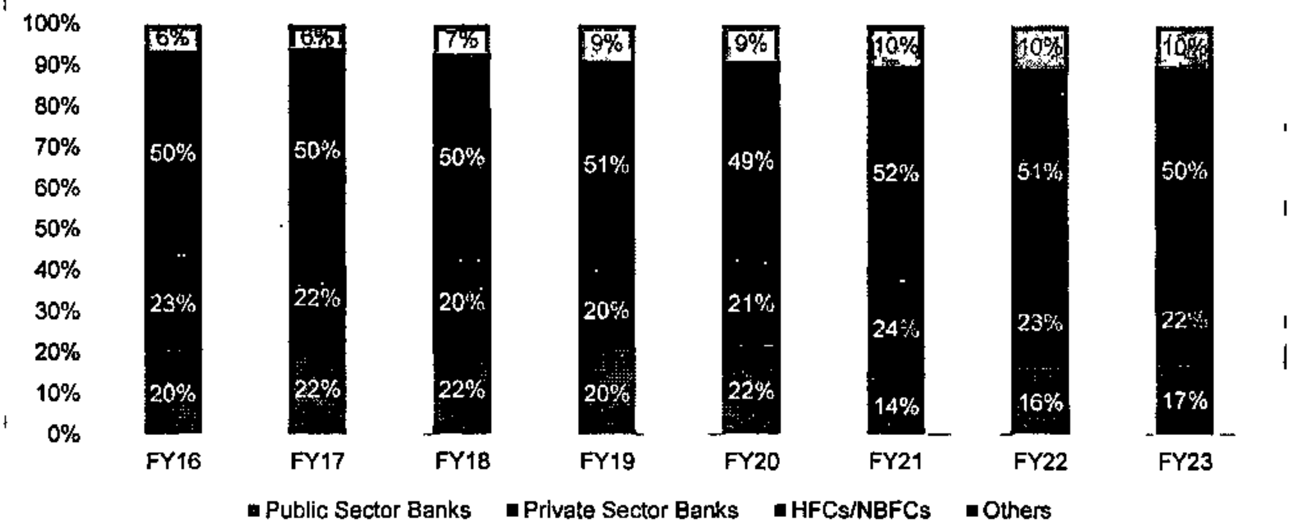
Share of LAP portfolio with ticket size between Rs 0.5 to 5 million in overall LAP portfolio



Source: CRIF Highmark, CRISIL MI&A

Competitive scenario

Trend in market share of various lenders in portfolio outstanding of ticket size Rs. 0.5 – 5.0 million



Note: Others include Foreign Banks, SFBs, and Others
Source: CRIF Highmark, CRISIL MI&A

Private Banks and housing finance companies (HFCs) registered strong growth in the LAP market due to their aggressive market strategies, branch network, and the advantage gained by their low cost of funds. Private Banks have grown at CAGR of 24.0% between fiscals 2016-23, whereas HFCs have grown at a CAGR of 24.3% during the same time. Compared with non-banking finance companies (NBFCs), private banks and SFBs have a relatively high deposit base and credit rating. NBFCs have also lost their LAP share due to efforts to contain asset quality deterioration and yield pressure. Against the backdrop of high delinquency seen by certain NBFCs over the past 2-3 years and liquidity issues, we expect NBFCs growth to slow down further over the next three years. Growth for even HFCs is expected to slow down over the next 3 years due to some liquidity issues. However, private banks and well capitalised PSU banks as well as SFBs will partly be able to capture the slowdown in NBFCs and HFCs and grow at a faster pace during the same period.

Self-employed customers' accounts for a large part of LAP borrower base

Self-employed people account for almost 80-85% of LAP disbursements; of these, approximately 70-75% are self-employed non-professionals (SENP) and the rest self-employed professionals (SEP). The salaried class accounts for the remaining approximately 15%, primarily obtaining LAP to meet personal expenses related to marriage, education, healthcare and repayment of previous loans.

SEPs comprise doctors, chartered accountants and architects, who mainly need funds for expansion of their clinics and offices. SENPs, on the other hand, comprise small manufacturers and traders, who avail of LAP as a term loan to meet capacity expansion, debt repayment, business diversification or working capital needs.

While NBFCs/HFCs target riskier self-employed customers, banks focus more on salaried individuals and self-employed individuals with good credit profiles. For borrowers, who have taken several personal and business loans earlier at higher interest rates, LAPs offer an attractive option, helping them foreclose old loans and take a single loan (LAP) at comparatively lower interest rates.

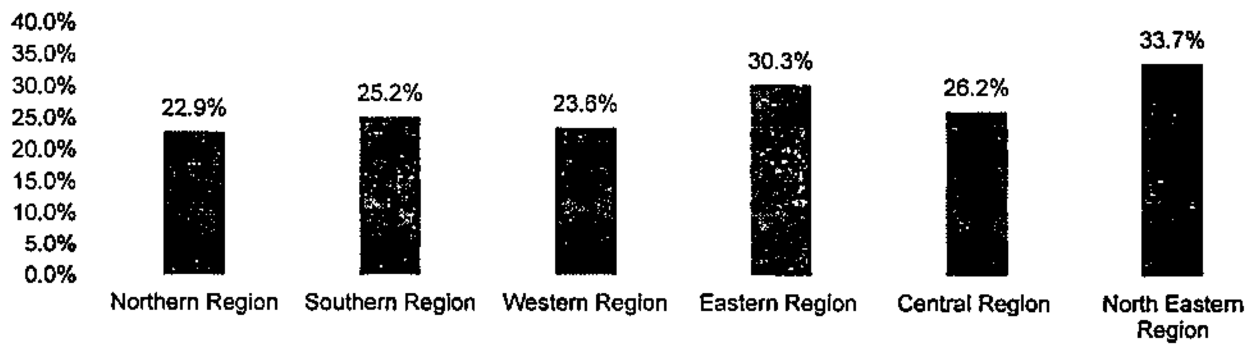
Region-wise loans outstanding (between ticket size of Rs 0.5 to 5 million)

The Southern and Western regions account for 39% and 25% respectively of the outstanding LAP between Rs 0.5 to 5 million with balance being accounted for by Northern region (18%), Central region (13%), Eastern region (5%) and North Eastern region (1%) as of fiscal 2023. Thus, there remains adequate opportunity across player groups to penetrate further in the more populous central and northern regions and expand the share in overall loans outstanding between Rs 0.5 to 5 million.

Within the Northern region, Punjab accounts for 3.7% share in pan India and 20.0% share within the northern region with Rajasthan accounting for 39.8% share, Delhi for 17.3% share and Haryana with 19.3% share within the northern region as of fiscal 2023.

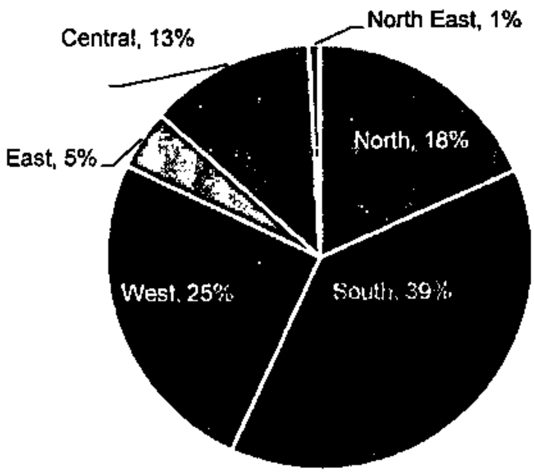
LAP outstanding grew the fastest in the North Eastern Region growing by 33.7% CAGR over Mar-16 to Mar-23 as against the overall growth of 24.7% during the corresponding period. The loans outstanding for Northern region grew by 22.9% CAGR during this period.

Growth in LAP outstanding (Rs 0.5 to 5 million) LAP segment (Mar-16 to Mar-23 CAGR)



Source: CRIF Highmark, CRISIL MI&A

Northern Region accounts for ~18% of the overall LAP portfolio with ticket size between Rs 0.5 and 5 million



Source: CRIF Highmark, CRISIL MI&A

Based on the LAP outstanding between Rs 0.5 to 5 million, the top 10 states/UTs account for ~81% of the loans in this segment as of March 2023. Maharashtra tops the list with the highest share of 15%, followed by Tamil Nadu (12%), Gujarat (10%), Karnataka (10%) and Rajasthan (7%) as of fiscal 2023. Among top 10 states, Andhra Pradesh has seen highest increase of ~34% CAGR between Mar-16 and Mar-23 followed by Telangana (34%) and Rajasthan (29%).

Punjab stands at 11th in terms of share across pan-India and saw an increase of 23% CAGR in between Mar-16 to Mar-23 with GNPA of 4.05% as on Mar-23.

Top 10 states/UTs account for close to 81% of outstanding LAP between Rs 0.5 to 5 million as of fiscal 2023

Region	State	Portfolio Outstanding Mar-16(Rs billion)	Portfolio Outstanding Mar-23(Rs billion)	Growth CAGR (FY16-23)	GNPA FY23	Share in region (Mar-23)	Share in India (Mar-23)	Share of LAP outstanding with ticket size between Rs 0.5 to 5 million in overall LAP outstanding (Mar-23)
Northern	CHANDIGARH	4	8	10%	2.53%	1%	0%	19%
	HARYANA	32	124	21%	3.09%	19%	4%	32%
	HIMACHAL PRADESH	1	10	34%	8.70%	1%	0%	48%
	JAMMU & KASHMIR	1	5	23%	3.64%	1%	0%	49%
	DELHI	39	112	16%	3.20%	17%	3%	16%
	PUNJAB	30	129	23%	4.05%	20%	4%	46%
	RAJASTHAN	44	256	29%	2.58%	40%	7%	47%
	Northern Region Total	**162**	**644**	**23%**	**4.12%**	**100%**	**18%**	**32%**
Southern	ANDHRA PRADESH	24	189	34%	2.76%	14%	5%	53%

	KARNATAKA	72	340	25%	5.88%	25%	10%	34%
	KERALA	37	158	23%	10.87%	12%	5%	50%
	LAKSHADWEEP	0	0	13%	15.60%	0%	0%	80%
	PONDICHERRY	2	7	19%	3.89%	1%	0%	46%
	TAMIL NADU	113	411	20%	3.91%	30%	12%	43%
	TELANGANA	33	250	34%	1.12%	18%	7%	41%
	Southern Region Total	**281**	**1,355**	**25%**	**4.54%**	**100%**	**39%**	**42%**
Western	DAMAN AND DIU	0	0	17%	6.44%	0%	0%	23%
	DADRA AND NAGAR HAVELI	0	1	18%	2.67%	0%	0%	35%
	GOA	2	7	21%	4.14%	1%	0%	34%
	GUJARAT	86	346	22%	2.54%	39%	10%	39%
	MAHARASHTRA	112	527	25%	4.55%	60%	15%	27%
	Western Region Total	**200**	**882**	**24%**	**3.76%**	**100%**	**25%**	**31%**
Eastern	ANDAMAN & NICOBAR ISLANDS	0	0	23%	0.58%	0%	0%	48%
	BIHAR	5	36	32%	3.06%	22%	1%	52%
	JHARKHAND	3	15	27%	4.01%	9%	0%	47%
	ODISHA	5	32	31%	3.21%	20%	1%	45%
	SIKKIM	0	1	31%	2.16%	1%	0%	24%
	WEST BENGAL	12	78	30%	7.34%	48%	2%	29%
	Eastern Region Total	**25**	**162**	**30%**	**5.22%**	**100%**	**5%**	**36%**
Central	CHHATTISGARH	9	40	23%	3.56%	9%	1%	37%
	MADHYA PRADESH	25	148	29%	2.93%	34%	4%	48%
	UTTAR PRADESH	44	218	26%	3.85%	50%	6%	45%
	UTTARAKHAND	8	34	24%	2.85%	8%	1%	44%
	Central Region Total	**87**	**441**	**26%**	**3.43%**	**100%**	**13%**	**45%**
North Eastern	ARUNACHAL PRADESH	0	1	36%	5.35%	2%	0%	39%
	ASSAM	4	22	30%	3.33%	74%	1%	52%
	MANIPUR	0	2	52%	4.86%	6%	0%	64%
	MEGHALAYA	0	1	42%	1.68%	3%	0%	35%
	MIZORAM	0	1	86%	5.00%	4%	0%	48%
	NAGALAND	0	1	37%	2.56%	2%	0%	34%
	TRIPURA	0	3	64%	2.48%	10%	0%	59%
	North Eastern Region Total	**4**	**30**	**34%**	**3.37%**	**100%**	**1%**	**51%**
	Grand total	**749**	**3,514**	**24.71%**	**3.98%**	**100%**	**100%**	**37%**

Source: CRIF Highmark, CRISIL MI&A

Share of HFCs/NBFCs is higher in the northern region in comparison to all India share in LAP with ticket size in between Rs 0.5 to 5 million. Within the northern region, the state of Punjab has a relatively higher share of private sector banks (28%) against all India level of 22%. The share of HFCs and NBFCs is 43%, public sector banks at 22% and others at 6% as of fiscal 2023.

State-wise market share of player groups in LAP with ticket size between Rs 0.5 to Rs 5 million in fiscal 2023

Region	State	Share of PSBs	Share of Private sector banks	Share of HFCs/NBFCs	Share of Others

Northern	Chandigarh	22.8%	27.8%	44.1%	5.2%
	Haryana	17.0%	30.0%	49.0%	4.0%
	Himachal Pradesh	48.7%	7.1%	16.6%	27.6%
	Jammu & Kashmir	21.2%	62.6%	11.8%	4.5%
	Delhi	8.3%	23.3%	63.8%	4.5%
	Punjab	22.3%	28.1%	43.1%	6.5%
	Rajasthan	21.0%	17.9%	54.1%	7.0%
	Northern Region Total	**18.7%**	**23.5%**	**51.6%**	**6.1%**
Southern	Andhra Pradesh	20.3%	12.7%	52.4%	14.7%
	Karnataka	15.1%	18.9%	45.5%	20.5%
	Kerala	18.5%	26.7%	29.6%	25.2%
	Lakshadweep	60.8%	8.5%	27.8%	2.9%
	Pondicherry	18.2%	15.7%	58.4%	7.6%
	Tamil Nadu	14.1%	17.9%	61.7%	6.3%
	Telangana	12.8%	19.2%	63.1%	4.9%
	Southern Region Total	**15.5%**	**18.7%**	**52.8%**	**13.0%**
Western	Daman And Diu	23.7%	29.0%	40.6%	6.6%
	Dadra And Nagar Haveli	25.4%	30.3%	43.3%	0.9%
	Goa	43.4%	22.0%	17.3%	17.3%
	Gujarat	12.3%	34.4%	45.1%	8.2%
	Maharashtra	12.3%	25.3%	48.8%	13.7%
	Western Region Total	**12.5%**	**28.9%**	**47.1%**	**11.5%**
Eastern	Andaman & Nicobar Islands	76.7%	11.5%	11.2%	0.5%
	Bihar	38.1%	20.6%	32.4%	8.8%
	Jharkhand	29.3%	29.5%	35.8%	5.4%
	Odisha	33.2%	33.2%	27.8%	5.8%
	Sikkim	76.8%	14.6%	8.5%	0.1%
	West Bengal	23.0%	24.6%	46.6%	5.8%
	Eastern Region Total	**29.4%**	**25.8%**	**38.4%**	**6.4%**
Central	Chhattisgarh	28.6%	25.6%	40.8%	5.0%
	Madhya Pradesh	16.2%	15.3%	62.4%	6.0%
	Uttar Pradesh	27.1%	17.1%	51.4%	4.4%
	Uttarakhand	29.7%	15.1%	49.9%	5.3%
	Central Region Total	**23.8%**	**17.1%**	**54.0%**	**5.1%**
North Eastern	Arunachal Pradesh	83.0%	8.1%	8.0%	1.0%
	Assam	25.0%	42.0%	30.7%	2.4%
	Manipur	52.4%	42.8%	4.4%	0.4%
	Meghalaya	47.3%	7.6%	10.7%	34.4%
	Mizoram	22.6%	3.4%	0.4%	73.6%
	Nagaland	62.9%	7.3%	3.5%	26.3%
	Tripura	24.0%	45.3%	11.3%	19.4%
	North Eastern Region Total	**28.7%**	**38.3%**	**24.5%**	**8.4%**
	Grand Total	**17.1%**	**22.4%**	**50.4%**	**10.0%**

Source: CRIF Highmark, CRISIL MI&A

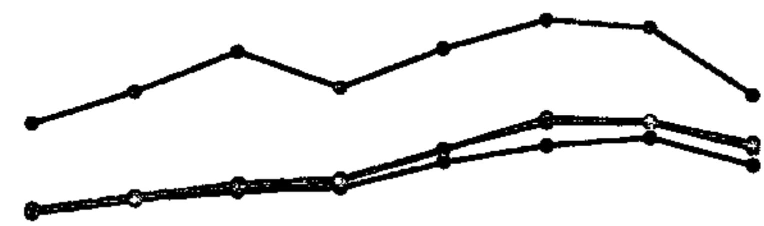
Asset Quality

In the past, intense competition in the LAP segment led to aggressive lending by non-banks. They sourced major proportion of the book through balance transfer, whereby additional top-up loans were given leading to higher loan-to-value (LTV) ratios and thus higher risks in the LAP book.

Over the past few years, asset quality for LAP loans has been deteriorating across the broad due to portfolio seasoning, slower growth and the impact of liquidity crisis and LAP portfolio with ticket size between Rs 0.5 million and Rs 5 million is no exception. Moreover, due to COVID-19, income of the borrowers was impacted severely in fiscal 2021, which led to rise in GNPA numbers whose effect can be witnessed in fiscal 2022. However, the systemic GNPA ratio for portfolio in the Rs 0.5 million to Rs 5 million band is lower at 4.0% as compared to other smaller ticket size and larger ticket size loans. Overall, secured loans portfolio had a GNPA of 4.6% as of March 2023.

In the long run, however, better availability of borrower data with GST implementation will help lenders assess borrower's profile (in terms of business sales and cash flow) and control NPAs.

Asset quality of various lender types in overall LAP portfolio



	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
LAP with ticket size below Rs 0.5 million	5.4%	6.6%	8.1%	6.8%	8.2%	9.2%	9.0%	6.5%
LAP with ticket size between Rs 0.5 million and 5 million	2.2%	2.7%	3.0%	3.1%	4.1%	4.7%	5.0%	4.0%
LAP with ticket size greater than Rs 5 million	2.2%	2.6%	3.1%	3.4%	4.5%	5.7%	5.6%	4.8%
Overall LAP portfolio	2.3%	2.8%	3.3%	3.5%	4.6%	5.5%	5.5%	4.6%

Source: CRIF Highmark, CRISIL MI&A

Private banks including SFBs have been lending selectively during the pandemic and have kept their asset quality under control in this segment with GNPA levels of 1.7% as against the Industry numbers of 4.6% as of March-23. PSBs have not been able to maintain their asset quality at lower levels in this segment and have seen a continuous deterioration in the asset quality over the last 5 years, Despite lending to the risky segment, HFCs, due to their expertise in the product have been effective in maintaining their asset quality and going forward, private banks and SFBs are expected to replicate this behaviour and on account of the lower cost of funds, can aggressively target selected profiles at better rates and thus maintain asset quality on the books.

Selective lending from private banks have helped them maintain their asset quality for portfolio of ticket size Rs 0.5 million to Rs. 5 million

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
PSBs	4.4%	4.3%	4.5%	4.6%	6.2%	5.5%	6.9%	4.7%
Private Sector Banks	1.0%	1.3%	1.8%	2.0%	1.6%	2.6%	2.1%	1.7%
HFCs/NBFCs	1.4%	1.7%	2.0%	1.9%	2.8%	3.4%	3.6%	3.0%
Others	6.4%	10.2%	8.8%	9.3%	11.8%	15.7%	15.2%	13.0%

Source: CRIF Highmark, CRISIL MI&A

Profitability in LAP segment

In fiscal 2022, interest rates were at a historic low, which decreased the yield on advances and kept profitability under pressure. Companies in LAP segment operate with yield in the range of 15-18%, on an average. With average cost of funds being in the range of 10-11%, net interest margins (NIMs) for this segment are in the range of 5-7%. CRISIL MI&A estimates the profitability in this segment to have increased in Fiscal 2023 owing to improving credit costs and increase in interest yields. Going forward, in Fiscal 2024, borrowing costs are expected to stabilize and overall profitability of MSMEs loans is still expected to be sustained, on account of higher interest income.

Key risks and monitorable include the impact of pandemic on asset quality, the liquidity amongst the affordable HFCs, governance across the smaller institutions and collection efficiency across loan sizes as well as the corporate loan books of the players involved in retail LAP. Selective lending, continuous monitoring of asset quality and tackling frauds in this category of loans is imperative in this segment which is comparatively well dealt by the banks on account of investment in technology.

MSME Finance

Brief overview of MSMEs in India

The National Sample Survey (NSS) 73rd round dated June 2016 estimated that there are around 63.5 million MSMEs in India. Since then, the number of MSMEs is estimated to have increased further to around 70 million as of fiscal 2022. MSMEs complement large corporates as suppliers or directly cater to end users. The MSME sector contributes to India's socio-economic development by providing huge employment opportunities in rural and backward areas, reducing regional imbalances, and assuring equitable distribution of national wealth and income. The segment currently contributes to 30% of the GDP, over 40% of exports and creates employment for about 110 million people in the country, thus supporting economic development and growth.

Existing and revised definitions of MSMEs

Old MSME classification			
Criteria: Investment in plant and machinery or equipment			
Classification	Micro	Small	Medium
Manufacturing enterprises	Investment < Rs. 2.5 million	Investment < Rs. 50 million	Investment < Rs. 100 million
Services enterprises	Investment < Rs. 1 million	Investment < Rs. 20 million	Investment < Rs. 50 million
Revised MSME classification			
Composite Criteria: Investment and annual turnover			
Classification	Micro	Small	Medium
Manufacturing and Services enterprises	Investment < Rs. 10 million and Turnover < Rs. 50 million	Investment < Rs. 100 million and Turnover < Rs. 500 million	Investment < Rs. 500 million and Turnover < Rs. 2.5 billion

Source: Ministry of MSME, CRISIL MI&A

Financial institutions also use internal business classifications to define MSMEs, based on their turnover. Most banks and non-banks follow this practice.

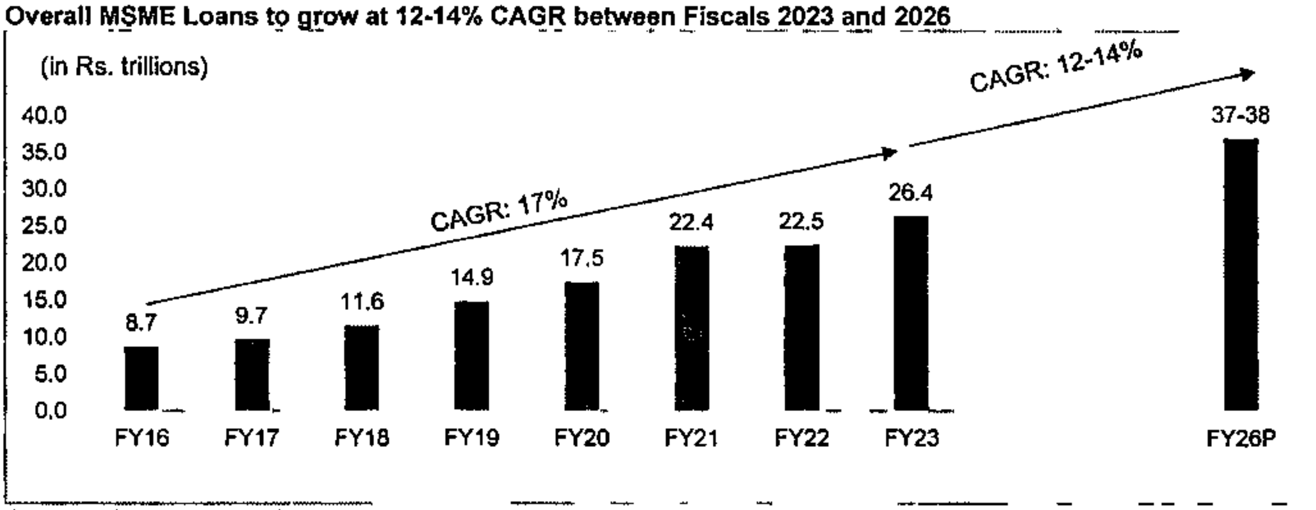
MSME loans to grow at 12-14% CAGR over fiscals 2023 and 2026

MSME loans grew at a fast pace, registering a CAGR of 17% over Fiscals 2016 and 2023. Over the years, more data availability and Government initiatives like GST has led to lenders' increasing focus, especially the NBFCs, on the underserved segment of MSME customers as lending to this segment has become easier compared to the past. More and more lenders/fin-techs/banks reach out to this underserved pool on account of the higher availability of data around these entities. However, in Fiscals 2019 and 2020, the growth was relatively muted due to the NBFC liquidity crisis as well as a cautious stance being taken when lending to MSMEs due to slower economic growth. Due to liquidity constraints for NBFCs, the growth slowed in Fiscal 2020.

Covid-19 pandemic led a heavy impact on the MSME industry in fiscal 2021 which was also seen in fiscal 2022 leading to slower growth. However, ECLGS schemes aimed to reduce the impact of the pandemic on the MSME sector. In fiscal 2023, the MSMEs rebounded owing to pick up in economic activity and fading impact of Covid-19, leading to strong to normalization of economic activities and increased revenue growth for SMEs. At end of Fiscal 2023, the overall MSME loan outstanding stood at ₹26.4 trillion growing at 17% on year.

Going forward, CRISIL MI&A expects the overall MSME portfolio to grow at 12-14% CAGR over Fiscals 2023 and 2026, aided by increasing penetration of such loans, enhanced availability of data making it easier to underwrite such loans, enhanced use of technology, newer players entering the segment and continued government support.

Overall MSME Loans to grow at 12-14% CAGR between Fiscals 2023 and 2026

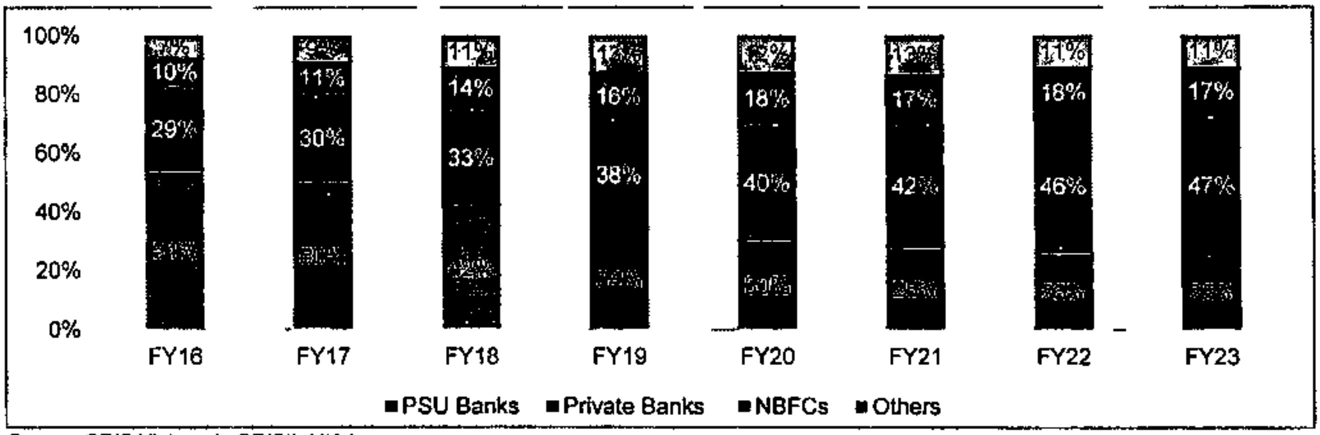


Source: CRIF Highmark, CRISIL MI&A

Private Sector banks, SFBs and NBFCs outpace PSUs' MSME lending over FY16-FY23

Though Public sector banks accounted for the highest share of lending to this segment (~54% in FY16), private sector banks, SFBs and NBFCs increased their market share over fiscals 2016-2023, owing to their aggressive approach, higher risk-taking ability, and better leveraging of their underwriting capabilities. However, despite slowing down post the IL&FS default NBFCs have been able to wrestle share from public sector banks. Private banks too in addition to SFBs have gained share consistently on account of availability of funds at better rates, and targeted focus towards this segment.

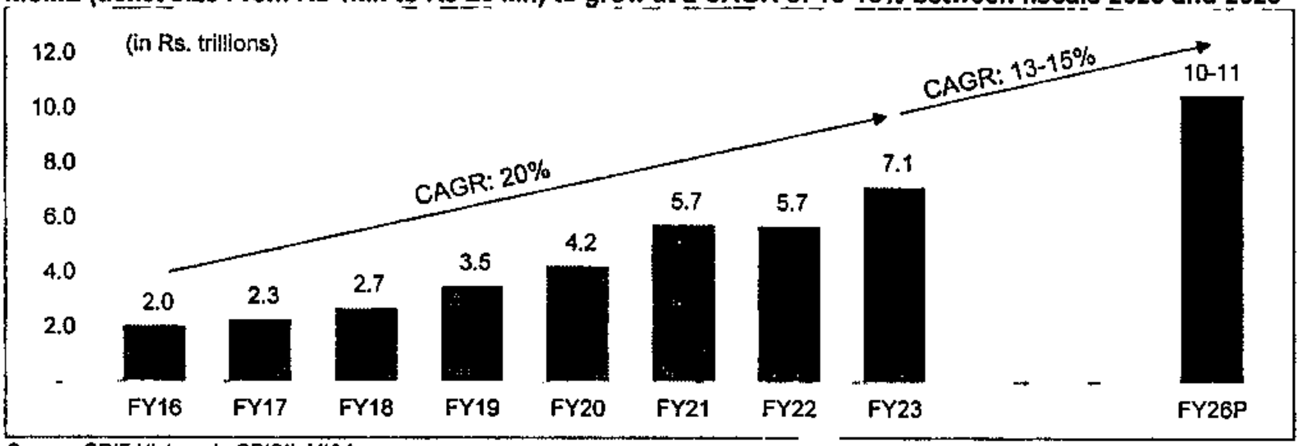
Private Banks along with NBFCs account for highest share in overall MSME credit



Source: CRIF Highmark, CRISIL MI&A

Low ticket MSME loans are expected to grow at a faster pace than overall MSME loans in the build up to recovery post the pandemic and higher requirement from this segment. MSME loans (ticket size from Rs 1 Mn to Rs 20 Mn) grew at a fast pace, registering a CAGR of 20% over Fiscals 2016 and 2023. The low ticket MSME loans (between Rs 1 Mn to Rs 20 Mn) is expected to grow at 13-15% CAGR in the next three years between fiscals 2023 and 2026.

MSME (ticket size From Rs 1Mn to Rs 20 Mn) to grow at a CAGR of 13-15% between fiscals 2023 and 2026

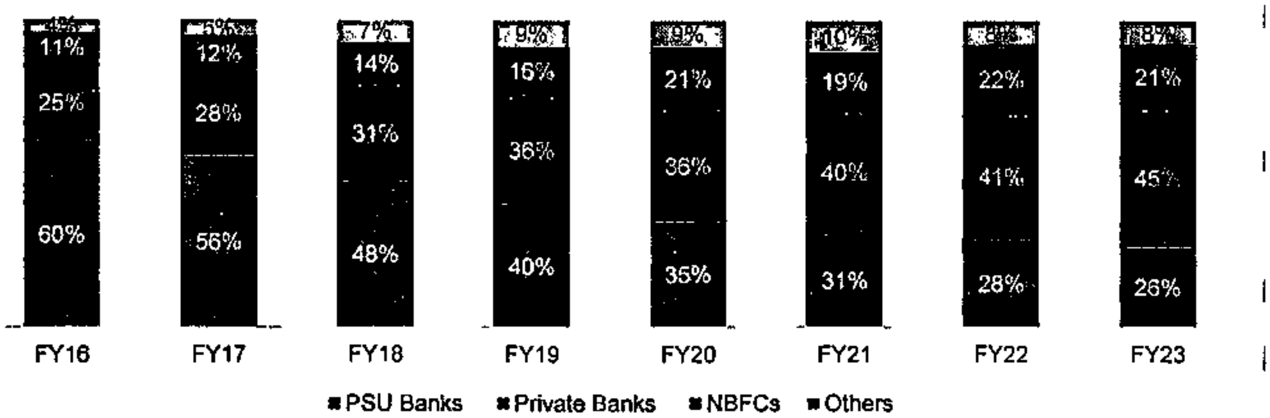


Source: CRIF Highmark, CRISIL MI&A

Private Banks, SFBs and NBFCs increasing their presence in the low ticket MSME (ticket size up from Rs.1 Mn to Rs. 20 Mn) segment

With higher focus on this segment, private sector banks, along with SFBs and NBFCs have managed to carve out a strong presence in business loans due to their focus on serving the needs of the customer segment, faster turnaround time, customer service provided and expansion in geographic reach. Over the years, the MSME portfolio of these entities (ticket size from Rs 1 million to 20 million) have grown at a faster rate than the overall MSME portfolio at a systemic level. Private banks including SFBs have improved their share from 25% as on Mar-16 to 45% as on Mar-23. Similarly, NBFCs have grown expanded their share from 11% to 21% during the same period. They have wrestled share from PSU banks which had only 26% share as on Mar-23 as against 60% in Mar-16.

Private Banks along with SFBs account for highest share in low ticket MSME credit (ticket size Rs.1 Mn to Rs. 20 Mn)



Source: CRIF Highmark, CRISIL MI&A

Growth drivers

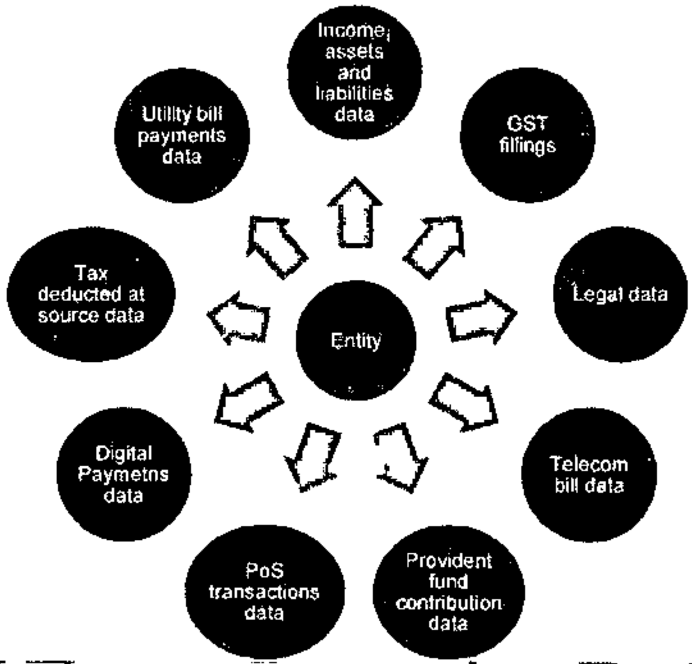
Low credit penetration for MSMEs

Less than 15% of approximately 70 million odd MSMEs have access to formal credit in any manner as of March 2022. High risk perception and the prohibitive cost of delivering services physically have constrained traditional institutions' ability to provide credit to underserved or unserved MSMEs historically. They are either self-financed or take credit from the unorganised sector. This untapped market offers huge growth potential for financial institutions.

Increased data availability and transparency

With increased digital initiatives by the MSMEs, the shift towards their formalisation and digitisation has created a plethora of data points for lenders that would help improve the efficacy of credit assessment and gradually enable provision of credit to hitherto underserved customer segments. For example, the quantum of retail digital payments has catapulted from Rs 140 trillion in fiscal 2017 to Rs 606 trillion in fiscal 2023. Within UPI, the quantum of person-to-merchant payments has zoomed from Rs 6.2 trillion in fiscal 2021 to Rs 30.7 trillion in fiscal 2023. This increase has created a digital footprint of customers, which can be potentially used for credit decision making, along with other relevant parameters such as customer demographics, business details, credit score, and personal situation of the borrower.

Multiple data points can be used for credit assessment



Source: CRISIL MI&A

Reduction in risk premiums due to Information asymmetry

In the absence of reliable information about small businesses, it becomes difficult for lenders to assess the creditworthiness of the borrower. Hence, lenders often charge a hefty premium from these customers, leading to higher interest rates – typically 10-16% for secured loans and in the range of 16-30% for unsecured loans. By leveraging technology and using a combination of traditional data (bureau data, financial statements, credit score), non-traditional data (payments, telecom, provident fund contribution and psychometric data), and Government data (Aadhaar, GST), lenders would be able to gain greater insight into their customers' data, thereby increasing the accuracy of customer assessments. This would reduce the level of asymmetry in information and could lower the credit risk premium over a period.

Increasing competition with entry of new players and partnerships between them

More players in consumer-facing businesses with a repository of data (such as e-commerce companies and payment service providers) have entered the lending business, thus intensifying competition. For example, In June 2018, Amazon India launched a platform for lenders and sellers, wherein sellers can choose loan offers from various lenders at competitive rates. In August 2021, Meta (earlier known as Facebook) partnered with Indifi Technologies to provide loans to small businesses that advertise on its platform. Incumbent traditional lenders are increasingly leveraging the network of their partners and/or digital ecosystem to cross-sell products to existing customers, tap customers of other lenders, and also cater to new-to-credit customers. This will expand the market for MSME loans.

Reduction in TAT and increased use of technology

With the availability of multiple data points and technological advancement, TAT for lending to MSMEs has been continuously declining. This too will drive the demand for MSME loans.

Government initiatives

Relaxation in the threshold under SARFAESI Act from Rs 5 million to Rs 2 million for NBFCs

In the Union Budget 2021-22, presented by the Finance Minister, for NBFCs with a minimum asset size of Rs 1 billion, the minimum loan size eligible for debt recovery under the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act (SARFAESI) Act, 2002 was proposed to be reduced from the existing level of Rs 5 million to Rs 2 million. The objective of this move is to improve credit discipline while continuing to protect the interest of small borrowers. This relaxation is expected to facilitate recovery from stressed books, help the NBFCs to improve their ability to recover smaller loans and strengthen their overall financial health. More importantly, it acts as a deterrent to default and enhances the enforceability of collateral for players focused on the medium ticket size LAP segment with loans of Rs 2-5 million.

Inclusion of retail and wholesale trade under MSME category

In July 2021, the Ministry of Micro, Small and Medium enterprises decided to include Retail and Wholesale trade as MSMEs for the purpose of Priority Sector Lending and they would be allowed to be registered on UDYAM Registration Portal. The move is structurally positive from long-term perspective, as it will enable entities operating in the segment to register on Government's UDYAM portal, participate in government tenders and also avail financing options/ benefits available to the category. This move will also aid in the formalisation of India's retail trade and enable financial support to small and mid-sized retail businesses. By widening the scope of MSME to cover wholesale as well as retail trade, this move also creates an additional opportunity for MSME lenders to increase their penetration and business.

Credit Guarantee Fund Scheme extended to cover NBFCs

One of the major reasons why MSMEs are credit-starved is the insistence by banks or financial institutions for the provision of collateral against loans. Collaterals are not easily available with such enterprises, leading to a high-risk perception and higher interest rates for these MSMEs. In order to address this issue, the government launched the Credit Guarantee Fund Scheme under the aegis of the Credit Guarantee Fund Trust for Micro and Small Enterprises (CGTMSE) in order to make collateral-free credit available to micro and small enterprises.

In January 2017, the scheme was extended to cover systemically important NBFCs as well. Key eligibility criteria for this scheme are:

1) NBFCs should be registered with RBI and meet specified prudential norms.

2) the NBFC should have made a profit for the three preceding fiscals at the time of enrolment.

3) the NBFC should be lending to micro and small enterprises with minimum 5 years of lending experience, minimum Rs 100 crore of MSE loan portfolio, NPA level below 5% for MSE portfolio and average recovery ratio of 90% for preceding three fiscals at the time of enrolment and

4) it should have long-term credit rating of at least BBB. The overall limit under the scheme has also been enhanced to Rs 20 million.

Guarantees approved under CGTMSE

Year	Number of guarantees approved	Amount of guarantees approved (Rs billion)
FY19	435,520	302
FY20	846,650	459
FY21	835,592	369
FY22	717,020	561
FY23	1,165,786	1,048

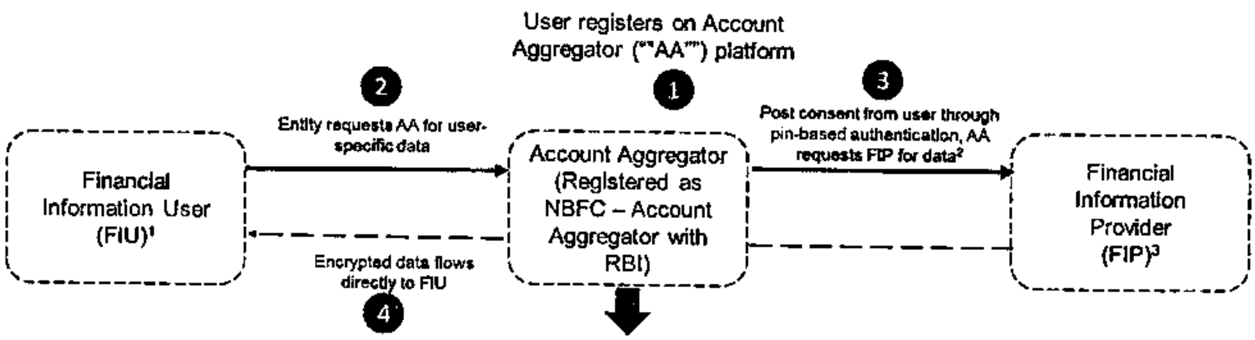
Source: CGTMSE, CRISIL MI&A

Government initiatives addressing structural issues in the MSME market

The government has unveiled a number of initiatives aimed at addressing some of the structural issues plaguing small business lending segment. These include granting licenses to account aggregators, the Pradhan Mantri Mudra Yojana (PMMY), unveiling Trades Receivables Discounting System (TReDS) platforms and the implementation of GST.

Licensing account aggregators

The RBI launched the account aggregator system on September 2, 2021, which has the potential to transform the MSME finance space once there is widespread adoption amongst the lending community. Four account aggregators also announced the launch of their apps on the same day which include OneMoney, FinVu, CAMSFinServ and NADL (NESL Asset Data Limited). Account aggregators are essentially non-banking financial companies, licensed by RBI, that act as an intermediary to collect and consolidate data from all Financial Information Providers (FIP) that hold users' personal financial data like banks and share that with Financial Information Users (FIU) like lending agencies or wealth management companies that provide financial services.These account aggregators would provide granular insights to lenders into customers' financial assets and their borrowing history centrally, based on customer consent. Inclusion of additional data such as electricity bill payments and mobile recharges/bill payment data under the purview of account aggregators would further enhance its utility.



1. FIU is any registered entity[4] which requires access to user data; once registered as an FIU, the entity will have access to data of all users registered on AAs (basis their consent); the consent will be valid for a period of time as permitted by the user
2. The user has complete control over his/her available FIP data which can be shared with FIU; for example, a user who has three bank accounts can decide to share data from only one bank account
3. The current details that can be sourced through AA portal/app are bank accounts, deposits, mutual funds, insurance policies and pension funds

Note: [4] Registered with any one of the regulators – SEBI, RBI, IRDAI, PFRDA

Source: CRISIL MI&A

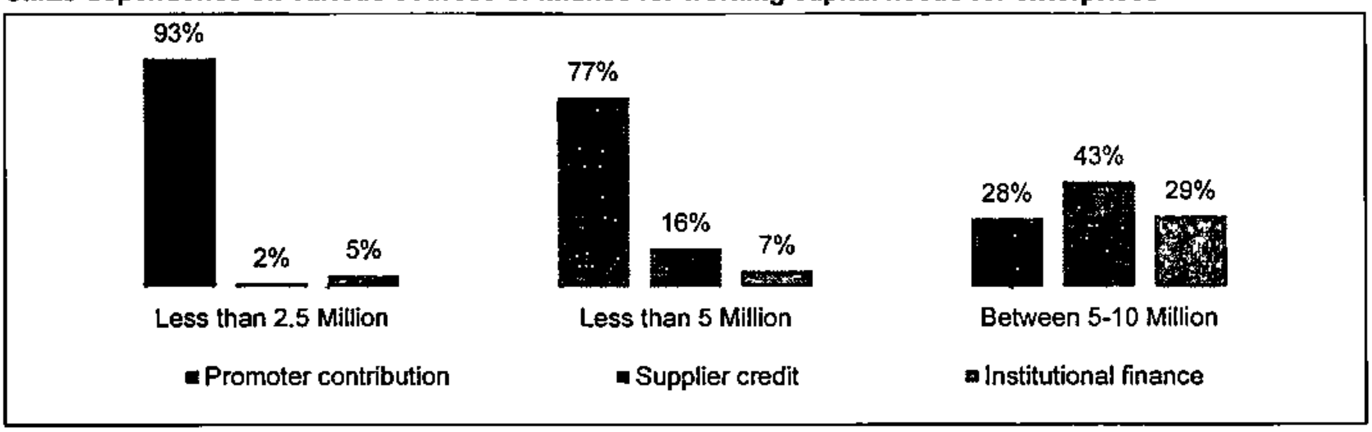
Some of the other government and regulatory initiatives are detailed below:

- UDYAM registration: Paperless and online registration process for MSMEs with an aim to promote ease of doing business.
- Stand-up India: It facilitates bank loans between ₹ 1 million and ₹ 10 million to at least one scheduled caste or scheduled tribe borrower and at least one-woman borrower per bank branch for setting up a greenfield enterprise.
- Make in India: Launched with an intention to make India a global manufacturing hub, which in turn will provide employment to numerous youths in the country
- Mudra loans: To fulfil funding requirement of MSMEs who were earlier left out by financial institutions; credit guarantee support also offered to financiers.
- 59-minute loan: Online marketplace that provides in-principle approval to MSME loans up to ₹ 10 million in 59 minutes.
- Unified Payments Interface 2.0 (UPI 2.0): Real-time system for seamless money transfer from account
- Trade Receivables Discounting System (TReDS): Institutional mechanism to facilitate financing of trade receivables of MSMEs from corporates and other buyers through multiple financiers.
- Factoring to support more participation from NBFCs: In an amendment to Factoring Regulation Act, 2011, the Lok Sabha passed the Factoring Regulation (Amendment) Bill in July 2021.

Institutional finance remains out of bounds for micro enterprises

An analysis of 12,000 SMEs rated by CRISIL between January 2010 and September 2015 indicates poor access to institutional finance. The survey indicates that Smaller enterprises are much more starved of access to institutional finance. SMEs with turnover less than 2.5 million neither have much support from suppliers nor from Institutional finance whereas SMEs with slightly higher (Between 2.5 Million to 5 Million) have relatively better supplier credit but still they have to self-finance majorly.

SMEs dependence on various sources of finance for working capital needs for enterprises



Source: CRISIL Ratings, CRISIL MI&A

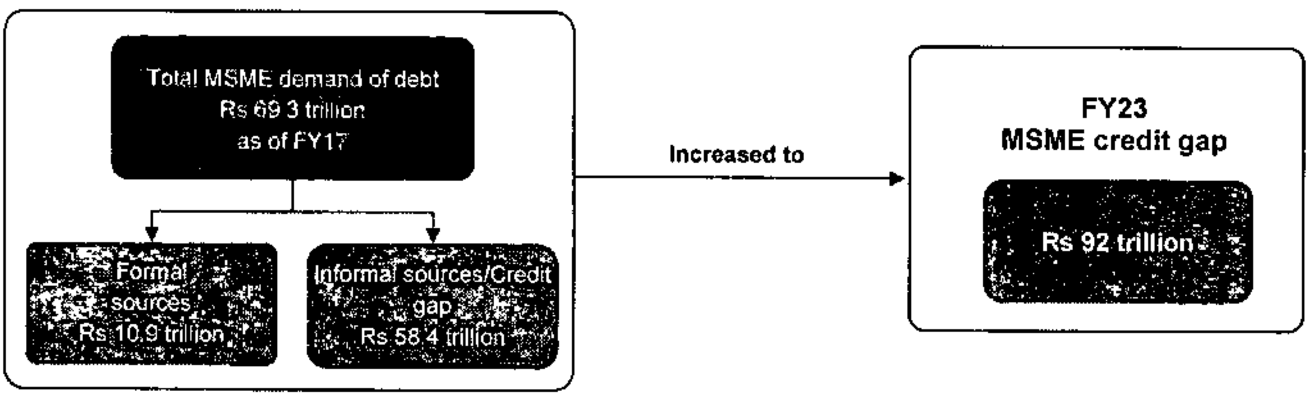
MSME Credit gap estimated at Rs 92 trillion as of Fiscal 2023

High risk perception and prohibitive cost of delivering services physically have constrained formal lending to MSMEs. The emerging self-employed individual and micros, small and medium enterprise segment is largely unaddressed by lending institutions in India. An IFC report titled Financing India's MSMEs (November 2018) estimated the MSME credit demand at Rs 69.3 trillion in fiscal 2017, of which only ~16% of demand was met through formal financing[7] and consequently, the MSME credit gap *(defined as the gap between the demand for funds amongst MSMEs and the supply from formal financiers)* was estimated at Rs 58.4 trillion. This gap was met through informal sources including moneylenders, chit funds and personal sources from friends and relatives. The interest rate for these sources generally ranges between 30-60% per annum.

The credit gap is estimated to have further widened over the last 4 years due to slower economic growth in fiscal 2020, followed by the COVID-19 pandemic in fiscal 2021. In fiscal 2021, the nationwide lockdown to contain the spread of the COVID-19 pandemic disrupted economic activity, hurt demand, impacted working capital needs and supply chain along with future investments and expansions. Domestic supplies and supplies from imports also suffered, affecting both, their availability and cost. Contractual and wage labour were also hit due to lower demand and layoffs. MSMEs and businesses in the sectors such as hotels, tourism, logistics, construction, textiles and gems and jewellery suffered the most during the first half of the fiscal. Businesses in the retail sector, especially those catering to daily usage goods and everyday cash and carry businesses such as grocery shops, fruits and vegetables sellers, etc., however, fared relatively better as their availability close to the residences of customers' increased the demand for their services.

Furthermore, government schemes post the COVID-19 pandemic such as the ECLGS scheme provided relief only to MSME units with existing loans from a formal financial institution. As of Fiscal 2023, the MSME credit demand is estimated to be around ₹ 117 trillion, of which 21% of demand met through formal financing. Assuming an increase of around 9% annually[2] in the demand for credit and the availability of credit from formal sources, CRISIL MI&A estimates the credit gap to have increased to ₹ 92 trillion as of Fiscal 2023.

MSME credit demand largely met by informal sources



Source: IFC report on Financing India's MSMEs dated November 2018[8], CRISIL MI&A

[7] *Formal sources include Public sector banks, Private sector banks, Foreign banks, Regional rural banks (RRBs), Urban Cooperative Banks (UCBs), NBFCs, and government institutions including SIDBI and State Finance Corporations (SFCs).*

[8] *https://www.ifc.org/wps/wcm/connect/dcf9d09d-68ed-4e54-b9b7-614c143735fb/Financing+India%E2%80%99s+MSMEs+Estimation+of+Debt+Requirement+of+MSMEs+in+India.pdf?MOD=AJPERES&CVID=my3Cmzl*

Even while the credit gap has increased, new MSME units continue to be set up across India. Between Fiscals 2016 and Fiscal 2022, 18.3 million units were set up, according to the Indian government registration data of MSMEs. Thus, though a myriad of small businesses is set up every day in the country, access to credit remains a challenge. However, the industry has witnessed an increase in access to formal credit to MSME, which could be attributed to the increase in the number of registered MSMEs to 130,93,698 In Fiscal 2023 from 4,95,013 in Fiscal 2016. According to Udhyam Registration Publication, Maharashtra, Tamil Nadu and Gujarat cumulatively accounts for 36% of overall MSME registration as of June 2023. Further, under the micro category, the maximum number of registrations were from Maharashtra followed by Tamil Nadu, Uttar Pradesh, Rajasthan and Gujarat. Under small and medium category, maximum registrations were from Maharashtra followed by Gujarat and Tamil Nadu.

Year-wise and MSME category-wise registration of MSMEs

Year/ Category	FY16	FY17	FY18	FY19	FY20	FY21*	FY22^	FY23$
Micro	4,21,516	21,47,908	13,44,612	18,70,932	22,48,730	35,95,577	49,75,082	126,17,959
Small	70,866	2,16,558	1,66,259	2,41,187	3,02,299	4,00,525	1,72,432	4,35,885
Medium	2,631	8,592	6,584	9,426	11,229	35,541	11,294	39,854
Total	**4,95,013**	**23,73,058**	**15,17,455**	**21,21,545**	**25,62,258**	**40,31,643**	**51,58,808**	**130,93,698**

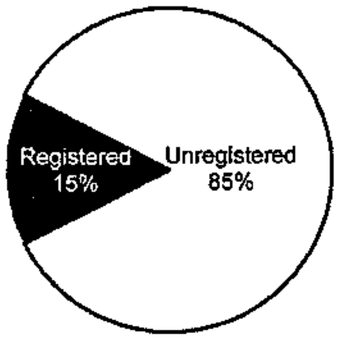
*Note: * Based on UAN and UDYAM registrations, ^Based on UDYAM registrations, $ Based on Udyam registrations as on December 2022 as stated in the MSME Annual Report 2022-23; Source: Development Commissioner Ministry of Micro, Small & Medium Enterprises (DCMSME), CRISIL MI&A*

State-wise category-wise registration of MSMEs

State	Cumulative MSME Registration *	Share in overall MSME registration	Growth in MSME Registration (March 2022-June 2023)
Maharashtra	3,057,608.00	18%	88%
Tamil Nadu	1,737,814.00	10%	103%
Gujarat	1,272,221.00	8%	96%
Uttar Pradesh	1,511,846.00	9%	139%
Rajasthan	1,262,078.00	7%	100%
Karnataka	968,158.00	6%	107%
Madhya Pradesh	789,572.00	5%	120%
Bihar	693,733.00	4%	123%
Punjab	630,391.00	4%	123%
Haryana	578,670.00	3%	105%

Note: (*) Based on Cumulative MSME registration as of June 2023 (https://dashboard.msme.gov.in/Udyam_Statewise.aspx), MSME Registration for FY22 based on Udyam Registration Publication: Registration of Micro, Small and Medium Enterprises (MSMEs) in India 2020-22; Source: Development Commissioner Ministry of Micro, Small & Medium Enterprises (DCMSME), CRISIL MI&A

Only 15% of MSMEs are registered



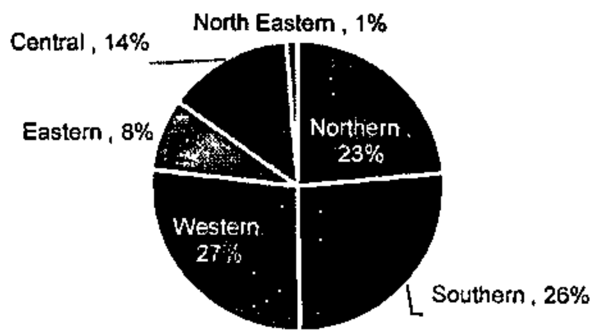
Note: Registered MSMEs includes entities that file business information with District Industry Centres (DCs) of the State / Union Territory
Source: IFC, CRISIL MI&A

Region/ State wise analysis (outstanding loans with ticket size between Rs 1 Mn to 20 Mn)

Region-wise split of MSME segment

Eastern region is underpenetrated and accounts for a meagre 8% share, whereas southern and western regions account for approximately 53% of outstanding loans in the MSME segment as of fiscal 2023. This is mostly due to organised nature of MSMEs present in these regions. North region accounts for 23% of outstanding loans in MSME segment which is lower than that of the Western and Southern region indicating scope for further penetration from organised lenders.

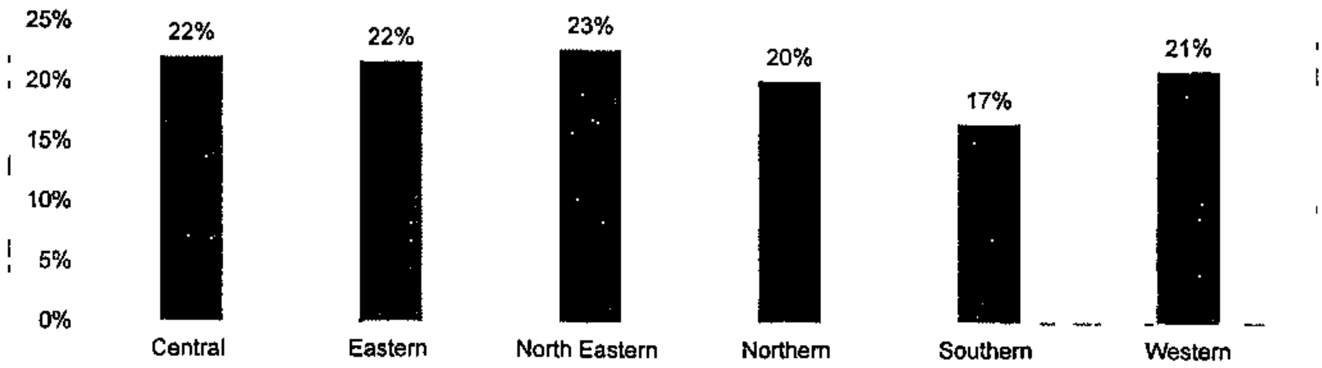
Northern Region accounts for ~23% of the outstanding loans with ticket size between Rs 1 million and 20 million as on Mar-23



Source: CRIF Highmark, CRISIL MI&A

MSME loans between ticket size of Rs 1 million to Rs 20 million have grown fastest in the north eastern region (23%) followed by the central (22%), eastern (22%), and western (21%) region in the country from fiscal 2016 to fiscal 2023.

Growth in loans outstanding (Rs 1 million to 20 million) MSME segment (Mar-16 to Mar-23 CAGR)



Source: CRIF Highmark, CRISIL MI&A

As on Mar-23, top 10 states account for 75% of the MSME loan outstanding market (ticket size between Rs 1 Mn to 20 Mn).

About 75% of the loan portfolio is concentrated in top 10 states with Maharashtra (16%), Gujarat (11%) and Tamil Nadu (8%) recording the highest share as of March 2023. Share within northern region is highest for Rajasthan, followed by Delhi, Haryana, and Punjab with 30%, 25%, 21% and 18% share respectively within the northern states. Across India, these states have a share of 7%, 6%, 5% and 4% respectively in fiscal 2023. In terms of the GNPA, northern region (2.07%) has the lowest GNPA in comparison to all India level of 2.80%.

Growth and share of MSME loans outstanding by region and state (ticket size between Rs 1 million to 20 million)

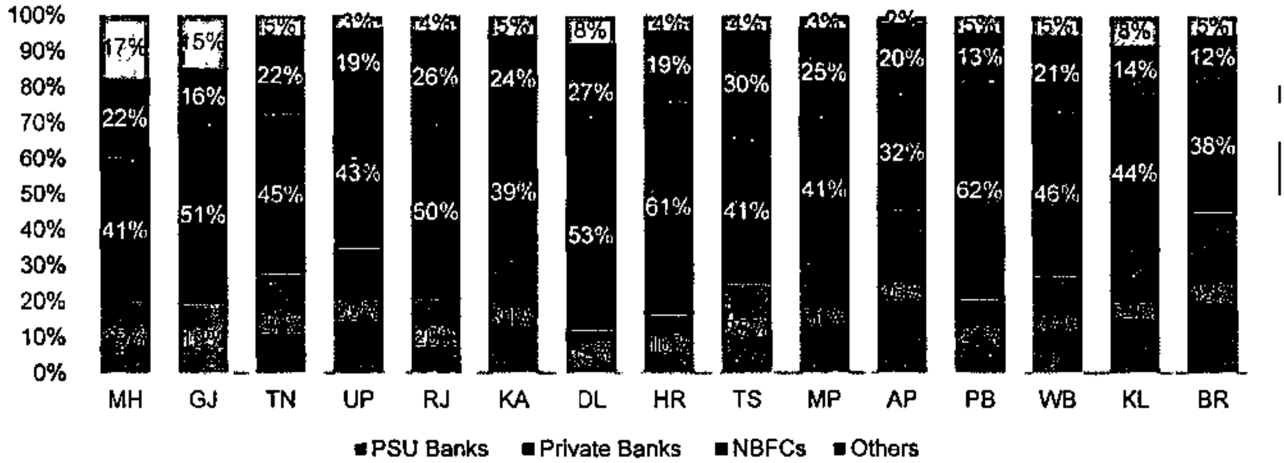
Region	State	Mar-16 (Rs billion)	Mar-23 (Rs billion)	Growth (CAGR) FY16-FY23	GNPA (Mar-23)	Share in region (Mar-23)	Share in India (Mar-23)	Share of loans with ticket size between Rs 1 million to 20 million in overall MSME outstanding (Mar-23)
Central	Chhattisgarh	28	105	21%	2.49%	11%	1%	25%
	Madhya Pradesh	79	322	22%	2.49%	32%	5%	35%
	Uttarakhand	16	65	22%	2.31%	7%	1%	31%
	Uttar Pradesh	123	501	22%	2.92%	50%	7%	33%
	Central Region Total	**246**	**993**	**22%**	**2.69%**	**100%**	**14%**	**33%**
Eastern	Andaman & Nicobar Islands	1	3	16%	1.45%	0%	0%	36%
	Bihar	27	118	24%	3.41%	21%	2%	34%
	Jharkhand	17	70	22%	3.42%	12%	1%	30%
	Odisha	28	117	23%	2.95%	20%	2%	28%
	Sikkim	0	2	20%	1.26%	0%	0%	21%
	West Bengal	72	265	20%	3.68%	46%	4%	22%
	Eastern Region Total	**145**	**575**	**22%**	**3.43%**	**100%**	**8%**	**26%**

Northern	Chandigarh	11	27	13%	1.88%	2%	0%	23%
	Delhi	135	419	18%	2.13%	25%	6%	20%
	Himachal Pradesh	13	39	17%	2.48%	2%	1%	30%
	Haryana	89	358	22%	1.91%	21%	5%	29%
	Jammu & Kashmir	16	34	11%	3.70%	2%	0%	29%
	Punjab	88	294	19%	2.37%	18%	4%	36%
	Rajasthan	109	498	24%	1.81%	30%	7%	36%
	Ladakh	0	0	18%	0.00%	0%	0%	43%
	Northern Region Total	**462**	**1,669**	**20%**	**2.07%**	**100%**	**23%**	**29%**
North Eastern	Arunachal Pradesh	1	4	26%	3.09%	5%	0%	31%
	Assam	16	66	23%	1.97%	74%	1%	28%
	Meghalaya	1	2	23%	2.07%	3%	0%	26%
	Manipur	1	5	25%	3.06%	6%	0%	36%
	Mizoram	1	2	21%	3.89%	3%	0%	38%
	Nagaland	1	3	22%	3.30%	4%	0%	32%
	Tripura	2	6	19%	2.24%	7%	0%	36%
	North Eastern Region Total	**21**	**90**	**23%**	**2.21%**	**100%**	**1%**	**29%**
Southern	Andhra Pradesh	84	298	20%	2.63%	16%	4%	32%
	Karnataka	154	448	16%	2.79%	24%	6%	25%
	Kerala	83	189	12%	4.65%	10%	3%	28%
	Pondicherry	5	11	11%	6.01%	1%	0%	31%
	Tamil Nadu	232	605	15%	4.34%	32%	8%	27%
	Telangana	81	323	22%	2.61%	17%	5%	25%
	Southern Region Total	**639**	**1,874**	**17%**	**3.44%**	**100%**	**26%**	**27%**
Western	Daman and Diu	1	2	7%	1.44%	0%	0%	15%
	Dadra and Nagar Haveli	1	2	10%	2.60%	0%	0%	15%
	Goa	8	17	11%	2.83%	1%	0%	23%
	Gujarat	182	781	23%	1.80%	41%	11%	29%
	Maharashtra	311	1,118	20%	3.32%	58%	16%	22%
	Western Region Total	**504**	**1,920**	**21%**	**2.69%**	**100%**	**27%**	**24%**
	Grand total	**2,017**	**7,120**	**20%**	**2.80%**	**-**	**100%**	**27%**

Source: CRIF Highmark, CRISIL MI&A

Within the player groups, PSBs and private banks dominate the market share across major states followed by NBFCs and others. PSBs have a share of 21%, private banks 62% and NBFCs have a share of 13% in the state of Punjab in MSME loans between ticket size of Rs 1 to 20 million as of fiscal 2023. A similar distribution is observed across other states in the northern region as well.

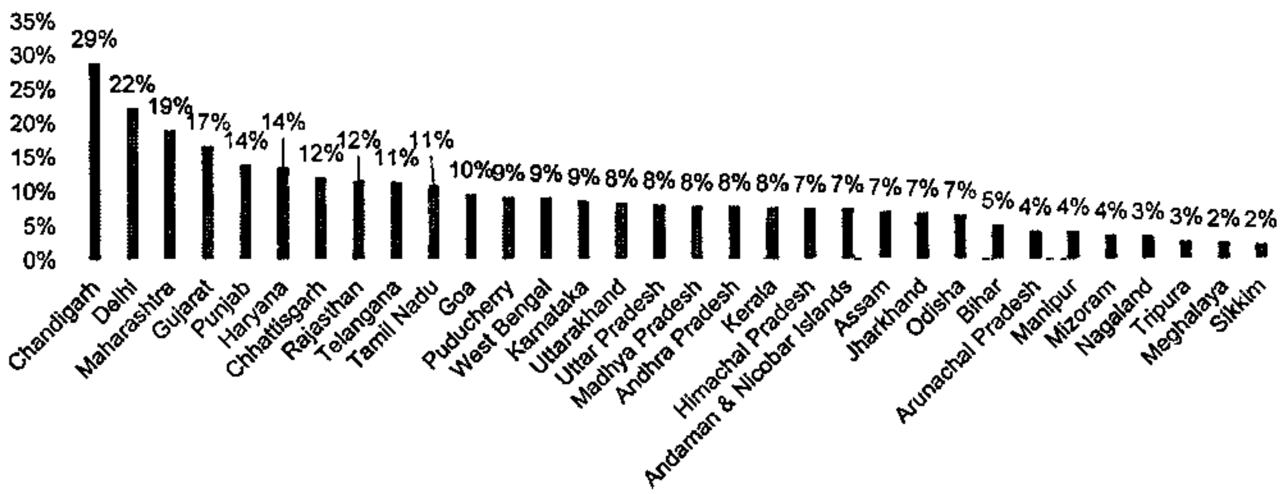
State-wise player group-wise MSME outstanding distribution (as of March 2023 – Rs 1 Mn to Rs 20 Mn)



Note: MH: Maharashtra, GJ: Gujarat, TN: Tamil Nadu, UP: Uttar Pradesh, RJ: Rajasthan, KA: Karnataka, DL: Delhi, HR: Haryana, TS: Telangana, MP: Madhya Pradesh, AP: Andhra Pradesh, PB: Punjab, WB: West Bengal, KL: Kerala, BR: Bihar; Source: CRIF Highmark, CRISIL MI&A

Credit penetration for MSME loans is low in most of the states across the country as compared to the all-India average as it is skewed by some well penetrated states and union territories like Delhi, Chandigarh, and Maharashtra etc. The northern states of Punjab and Rajasthan have lower credit penetration of 14% and 12% respectively in comparison to all-India credit penetration level of 16% indicating significant scope of improvement.

State-wise MSME Credit penetration (March 2023)



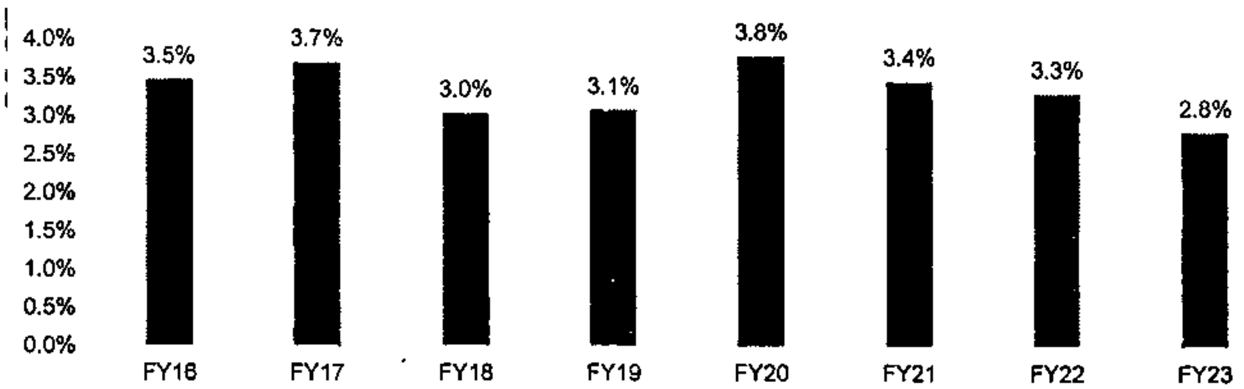
Note: MSME penetration = MSME outstanding/GSDP; For Andhra Pradesh, Bihar, Delhi, Haryana, Himachal Pradesh, Haryana, Jharkhand, Karnataka, Kerala, Madhya Pradesh, Meghalaya, Odisha, Punjab, Rajasthan, Sikkim, Tamil Nadu, Telangana, Tripura, Uttar Pradesh and Uttarakhand GSDP is as of end of March 2022; For Arunachal Pradesh, Assam, Chandigarh, Chhattisgarh, Goa, Gujarat, Maharashtra, Manipur, Mizoram, Nagaland and West Bengal GSDP is at of end of March 2021
Source: CRIF Highmark, CRISIL MI&A

Segment profitability and asset quality (ticket size between Rs 1 Mn to Rs 20 Mn)

Asset quality improved by 50 bps in fiscal 2023

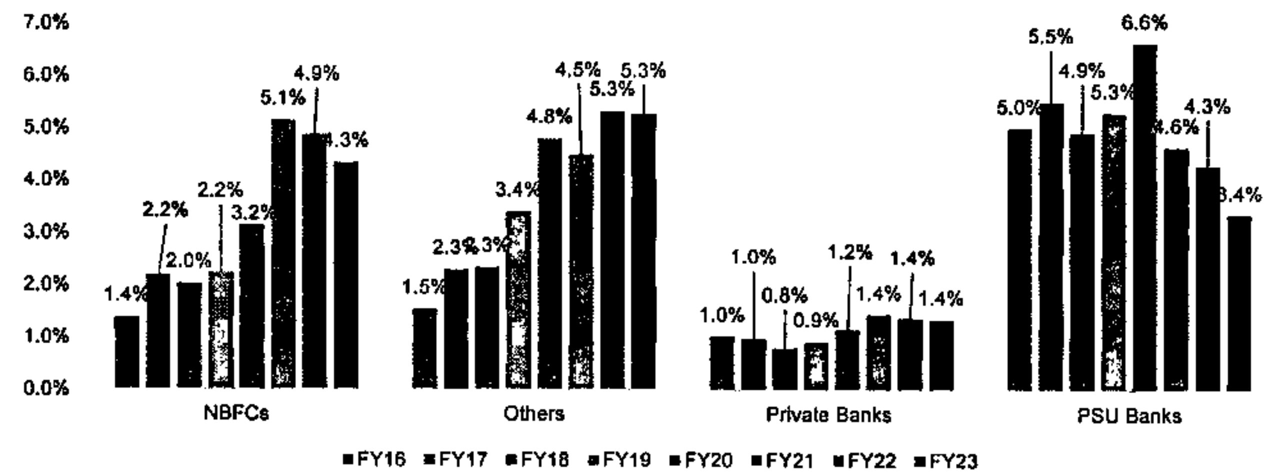
Asset quality in MSME loans between ticket size Rs 1 Mn to Rs. 20 Mn improved by 50 bps in Fiscal 2023 due to continued improvement in economic activity, better collection efficiency and strong credit growth. As of March 2023, the GNPA ratio for overall MSME loans stands at 3.2%.

GNPA trend in MSME loans between ticket size Rs 1 Mn to Rs 20 Mn



Source: CRIF Highmark, CRISIL MI&A

Player group wise GNPA trend

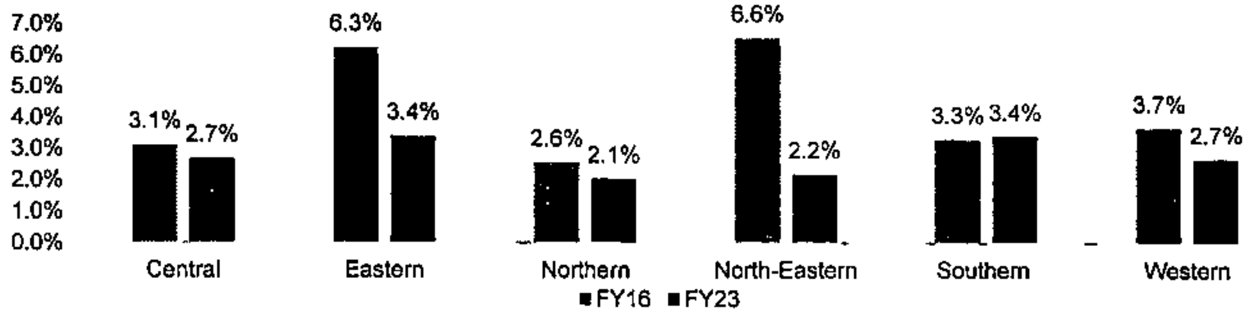


Source: CRIF Highmark, CRISIL MI&A

Northern region has lowest GNPA levels whereas Southern region has highest GNPA levels as of fiscal 2023

Northern region has lowest GNPA level as compared to other regions as of fiscal 2016 as well as fiscal 2023. In northern region, Punjab and Haryana sit at the top of the NITI Aayog Sustainable Development Goals (SDG) India Index 2021 and thus get higher focus from across players for maintaining cleaner books and lower GNPA.

Region wise GNPA



Source: CRIF Highmark, CRISIL MI&A

Profitability of MSME loans to improve due to lower credit cost

CRISIL MI&A estimates the profitability in this segment to have increased in Fiscal 2023 owing to better credit costs and increase in interest yields. Going forward, in Fiscal 2024, borrowing costs are expected to stabilise or marginally move upwards, and overall profitability of MSMEs loans is still expected to be sustained, on account of higher interest income. Further, improvement in collections is expected to lead to aid profitability for the segment.

By leveraging technology, financial service providers would be able to reduce the cost of customer acquisition, credit assessment and documentation, and provide credit to customers cost-effectively. With increasing data availability and improvement in the efficacy of the credit assessment process of MSME lenders (Banks and NBFCs), CRISIL MI&A expects that ability of the financier to keep credit cost & Opex under control will remain a key monitorable.

Housing loans (ticket size – Rs. 0.5 to 5 million)

Housing is regarded as the engine of economic growth and can give a big push to the economy through its forward and backward linkages with more than 250 anciallry industries. The sector has strong inter-industry linkages and investments in housing can have multiplier effects on generation of income and employment in the country. Recognising the importance of housing as a basic human need, the government has announced multiple schemes to conitnue their focus on housing in the country.

Indian household investment in Real estate

In country like India, it is one of the largest Investment for majority of people in their lifetime and holds significant importance. With the large population, having decent housing is a dream many spend their lives fulfilling for. As per household finance committee report issued by the RBI in 2017, the average Indian household holds 77% of its total asset in real estate which includes residential buildings, buildings used for farm and non-farm activities, constructions such as recreational facilities, and rural and urban land.

As per 2011 census, India has 330.84 million houses of which only 130 million houses were good habitable condition

As per 2011 census, India has 330.84 million houses of which 244.64 million houses were used for residence purpose or residence-cum-other use purpose. Further, 130.12 million house amongst the occupied ones were classfiied as 'good habitable condition', followed by 101.44 million (41%) as 'liveable habitable condition' and remaining as "dilapidated habitable condition'.

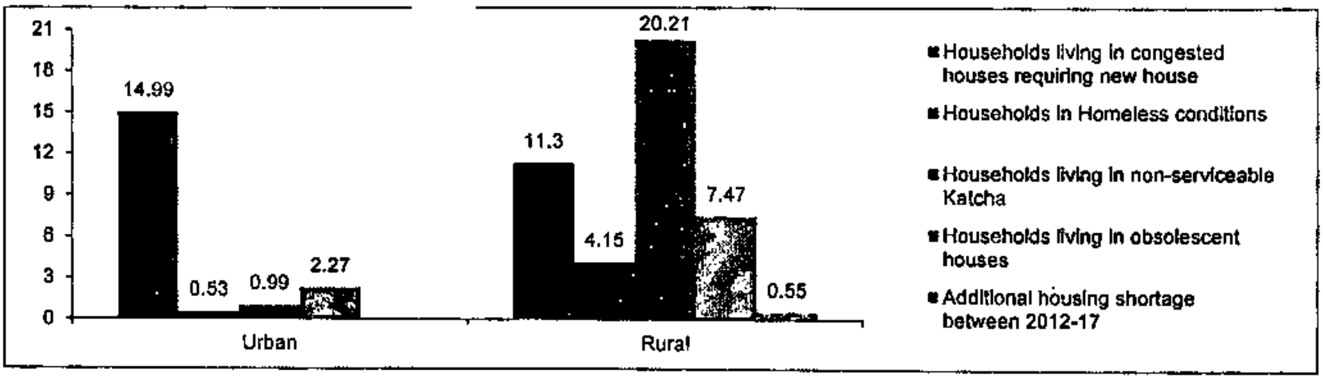
Housing shortage in India (in million)

Area	Total Number of Census Homes	Occupied Census House	Distribution of Occupied Census Houses			
			Residence	Residence cum other use	Total of Residence and Residence cum other use	All other Non-Residential Use
Rural	220.70	207.12	159.93	6.23	166.16	40.96
Urban	110.14	99.04	76.13	2.35	78.48	20.56
Total	330.84	306.16	236.06	8.58	244.64	61.52

**Other use – Shop, Office, School, College, Hotel, lodge, guest house, hospital dispensary, Factory, workshop, work shed, place of worship, etc; Source: Census 2011, Ministry of Housing and Urban Poverty Alleviation National Buildings Organisation; Planning Commission, CRISIL MI&A*

Despite the constant focus on the housing segment, housing in India is far from adequate. The shortage of housing in India has been a perpetual problem, deterring the economic growth of the country. The shortage of overall house is much higher at 62.5 million (as per twelfth five-year plan 2012-17) due to changing social and demographic pattern in India such as nuclearization of families and rapid growth of urbanisation. The below graph clearly states that Urban housing shortage arising more from congestion and rural housing shortage due to non-serviceable and kutcha house (low quality house) followed by congested houses.

Housing shortage split between urban-rural (2012) - million



Source: 2012 Estimates, Ministry of Rural development, Planning commission, CRISIL MI&A

In its Twelfth Five Year Plan (2012-2017), the Government accorded this issue utmost importance and focused on increasing the amount of housing units available both in the urban as well as the rural sector. As per the estimates of the Twelfth Five Year Plan, the shortage of housing in the urban segment of the society stood at 18.78 million. The economically weaker section (EWS) accounts for ~56% of the shortage. Lower Income Group (LIG) approximately accounts for ~39% of housing shortage in urban regions.

Urban Housing shortage split among Socio-Economic Group (2012) – million

Category	*Urban Housing Shortage*	*(in %)*
EWS	10.55	56.2%
LIG	7.41	39.5%
MIG & HIG	0.82	4.3%
Total	**18.78**	**100%**

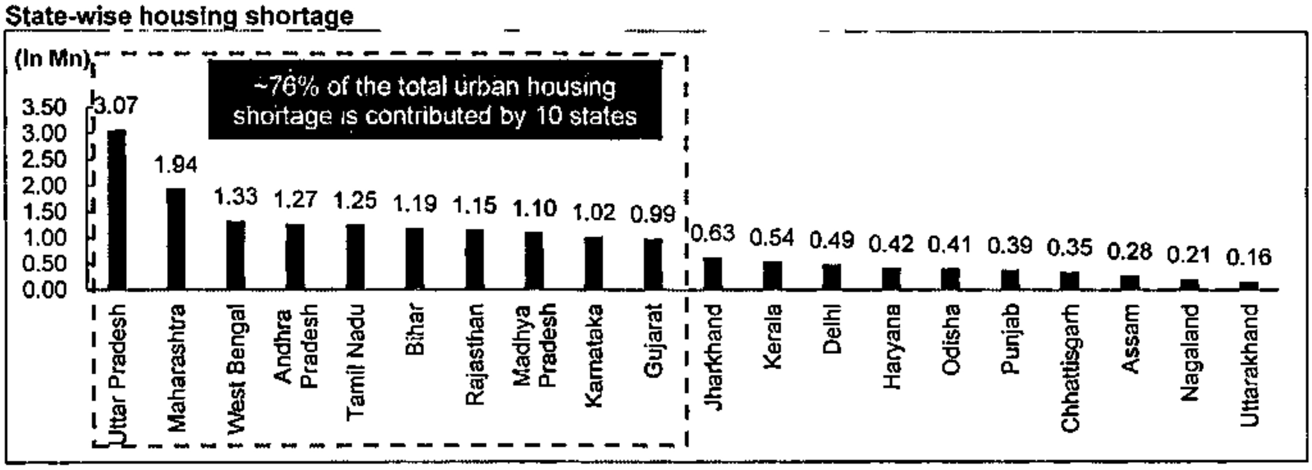
Note: 2012 Estimates; Source: Ministry of Rural development, Ministry of Housing and Urban Poverty Alleviation National Buildings Organisation; Planning Commission, CRISIL MI&A

The erstwhile Planning Commission and Ministry of Rural Development, Government of India, has taken official initiative to assess the quantum of housing shortage in rural India. As per the estimates of the Twelfth Five Year Plan, the shortage of housing in the rural segment of society stood at 43.13 million.

76% of total urban housing shortage is contributed by top 10 states (2012)

As per the estimates of the Twelfth Five Year Plan, 10 states accounted for ~76% of the urban housing shortage. Uttar Pradesh has a housing shortage of over 3 million, followed by Maharashtra (1.94 million), West Bengal (1.33 million), Andhra Pradesh (1.27 million) and Tamil Nadu (1.25 million).

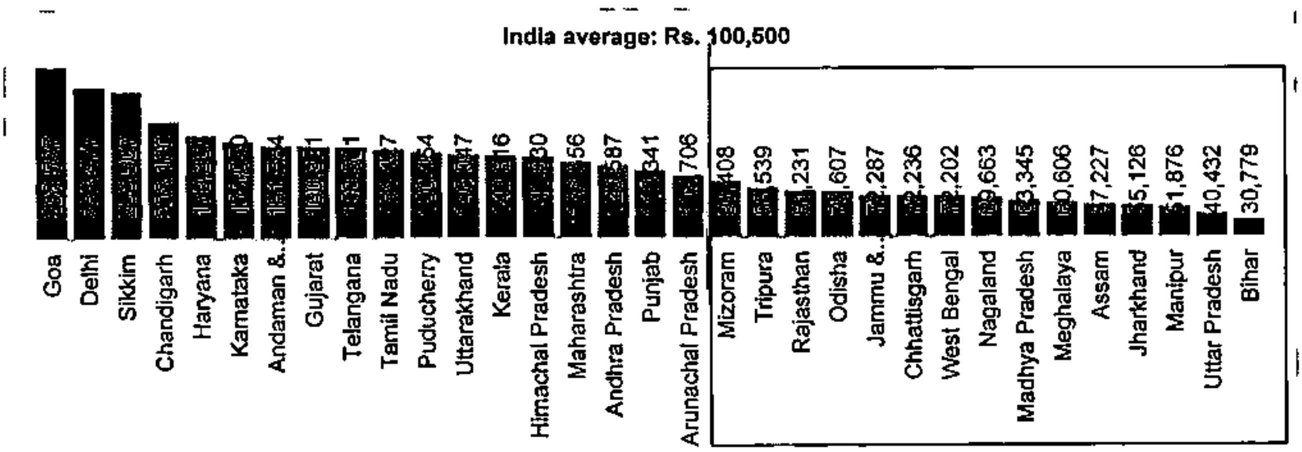
State-wise housing shortage



Source: Report of the Technical Urban Group on Urban Housing Shortage (TG-12), CRISIL MI&A

Amongst the top states with high shortage of homes, some states such as Uttar Pradesh, Bihar, West Bengal, Rajasthan & Madhya Pradesh have a lower per capita income, as compared to the national average. This shows that there is significant headroom for growth in terms of increasing per capita income and reducing the housing shortage in the country.

45% of the India's state have lower per capita income than national average (fiscal 2023)

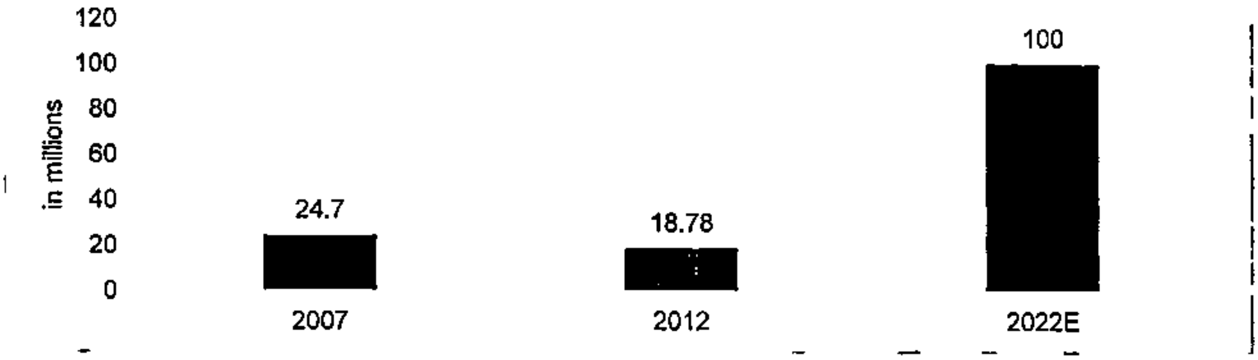


Source: RBI CRISIL MI&A

Estimated shortage and requirement of ~100 million houses in 2022

The housing shortage in India has only increased since the estimates at the time of the Twelfth Five-year plan. As per the report of RBI-appointed Committee on the Development of housing finance securitisation market (September 2019), the housing shortage in India is estimated to increase to 100 million units by 2022. Majority of the household shortage is for Lower income group (LIG) and Economic weaker section (EWS) with a small proportion of shortage (5-7%) of the shortage coming from middle income group or above. Total incremental housing loans demand, if this entire shortage is to be addressed, is estimated to be in the region of Rs 50 trillion to Rs 60 trillion, as per the Committee report. In comparison, the overall housing loans outstanding (excluding PMAY loans) as of March 2023 is around Rs 31.1 trillion. This indicates the immense latent potential of the market, in case, a concrete action is taken for addressing the shortage of houses in the country.

Housing Shortage in India

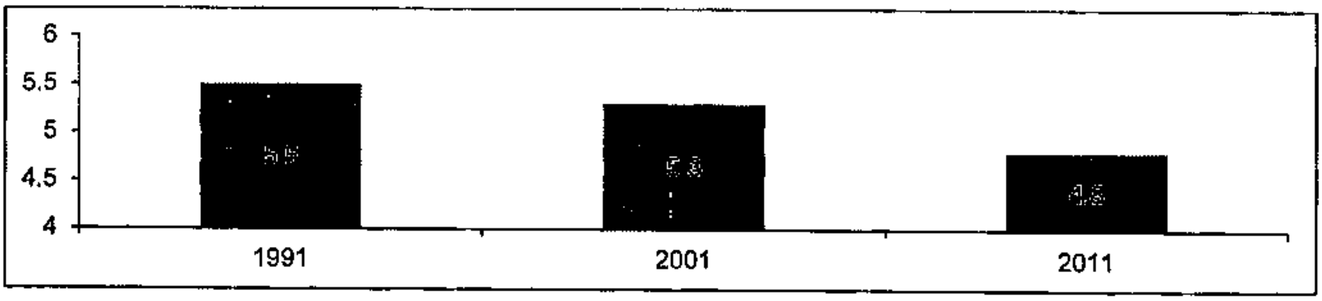


Note: E: Estimated; Source: RBI, Planning Commission, CRISIL MI&A

Household sizes and number of dwelling rooms (accommodation occupied by one household)

With increased urbanisation, India is also moving towards higher nuclearization leading to smaller family sizes. This is also reflected in the steady reduction in average household size from 5.5 members per household as of 1991 to 4.8 members as per Census 2011. Based on the trends in respect of urbanisation over the past decade, the average household size is likely to have further reduced to 4.4-4.5 members by 2021.

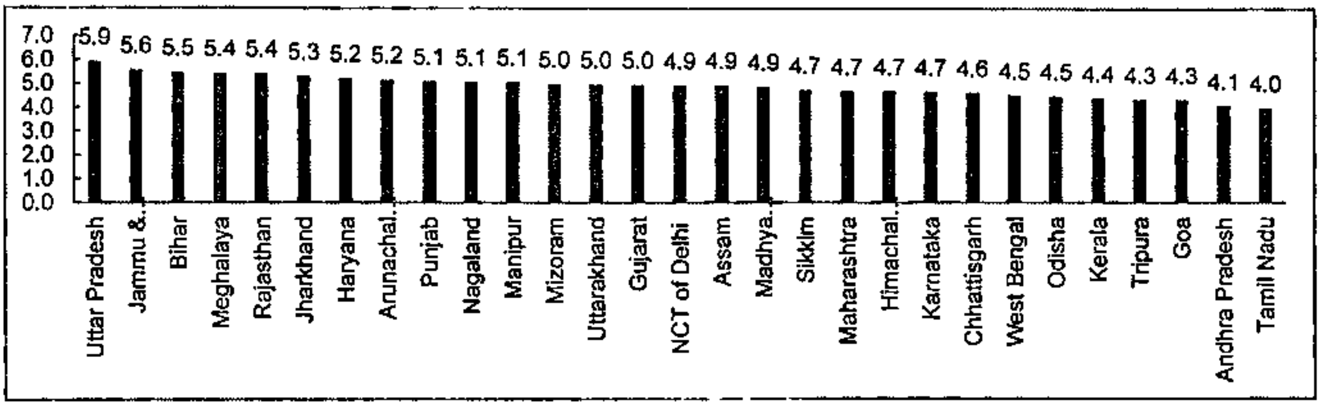
Average household size – members per household



Source: Census 2011, CRISIL MI&A

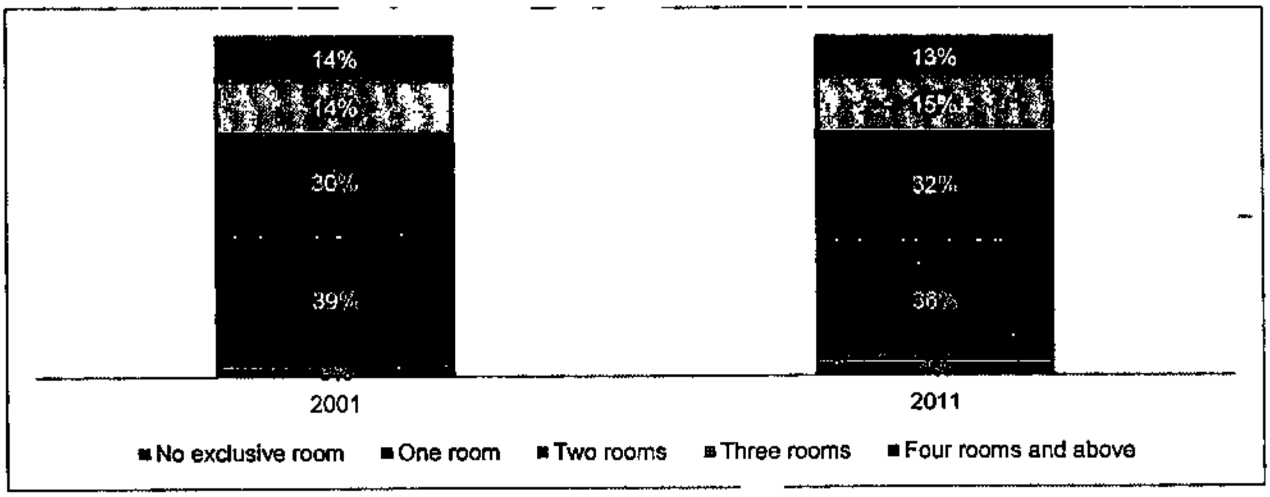
Furthermore, according to the Census 2011, majority of the Indian households live in a one-room or two-room house. According to the NSSO Survey on Housing Conditions conducted in 2012, the average floor area of a dwelling unit was 40.03 sq. m in rural India and 39.20 sq. m in urban India during 2012. The average household size in India was 4.5. It was 4.8 in rural India and 4.2 in urban India. The states of Uttar Pradesh and Jammu and Kashmir had the highest average household size of 5.9 and 5.6 respectively, whereas in the states of Andhra Pradesh and Tamil Nadu, the average household size was 4.1 and 4.0 respectively.

State-wise average household size



Source: NSSO (National Sample Survey Organisation), CRISIL MI&A

Indian households – number of dwelling rooms



Source: Census 2011, CRISIL MI&A

In Karnataka, the number of households that have no exclusive room is the highest and amounts to 13% of total households. In Kerala, the percentage of households that have four room and above is the highest and amounts to 34% of total households.

State-wise number of dwelling rooms

States	No exclusive room	One room	Two rooms	Three rooms	Four rooms and above
Jammu & Kashmir	4%	22%	28%	22%	25%
Himachal Pradesh	1%	20%	29%	17%	33%
Punjab	1%	23%	31%	22%	23%
Uttarakhand	1%	26%	33%	16%	24%
Haryana	2%	25%	32%	20%	22%
NCT of Delhi #	1%	32%	30%	20%	17%
Rajasthan	3%	35%	31%	14%	17%

Uttar Pradesh	4%	33%	31%	15%	18%
Bihar	3%	45%	30%	11%	12%
Sikkim	2%	22%	32%	22%	23%
Arunachal Pradesh	4%	30%	36%	19%	11%
Nagaland	2%	23%	35%	24%	17%
Manipur	2%	14%	31%	31%	22%
Mizoram	3%	19%	43%	22%	14%
Tripura	4%	71%	20%	4%	2%
Meghalaya	2%	22%	34%	22%	21%
Assam	3%	33%	30%	18%	16%
West Bengal	4%	52%	29%	9%	7%
Jharkhand	3%	27%	39%	16%	16%
Odisha	2%	37%	38%	14%	9%
Chhattisgarh	2%	35%	35%	16%	13%
Madhya Pradesh	3%	40%	33%	14%	12%
Gujarat	3%	42%	35%	13%	7%
Maharashtra	4%	42%	32%	13%	8%
Andhra Pradesh	3%	41%	35%	13%	8%
Karnataka	13%	33%	29%	14%	11%
Goa	3%	19%	25%	25%	28%
Kerala	1%	7%	25%	32%	34%
Tamil Nadu	8%	40%	31%	14%	8%

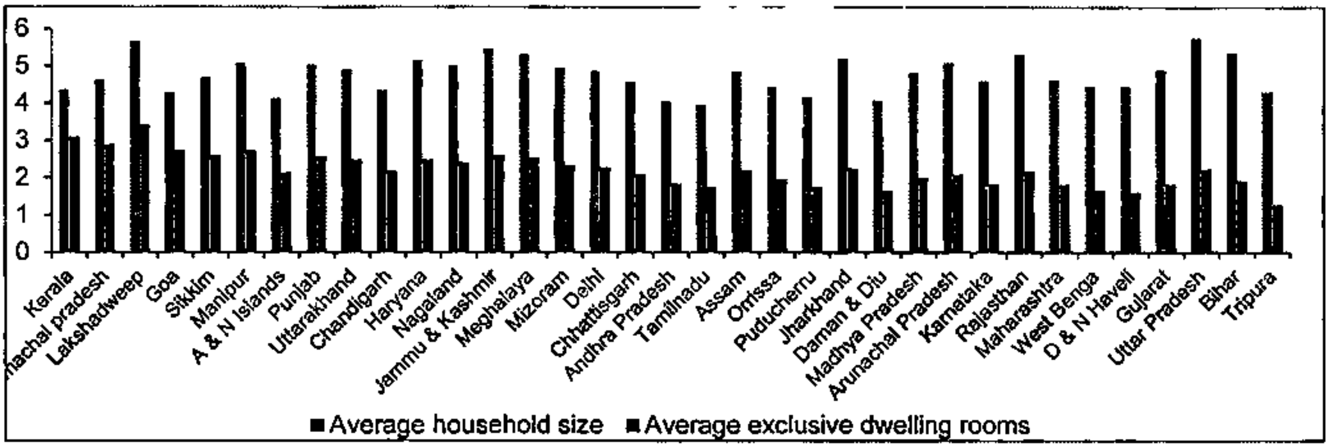
Note: # - NCT of Delhi includes Delhi, Noida, Gurgaon, Faridabad and Ghaziabad

Source: Census 2011, CRISIL MI&A

State-wise congestion

If we consider two people for one exclusive room then only 9 states have surplus dwelling rooms which is Punjab, Uttarakhand, Manipur, Lakshadweep, Sikkim, Andaman and Nicobar island, Himachal Pradesh, Goa and Kerala.

Household size vs dwelling rooms



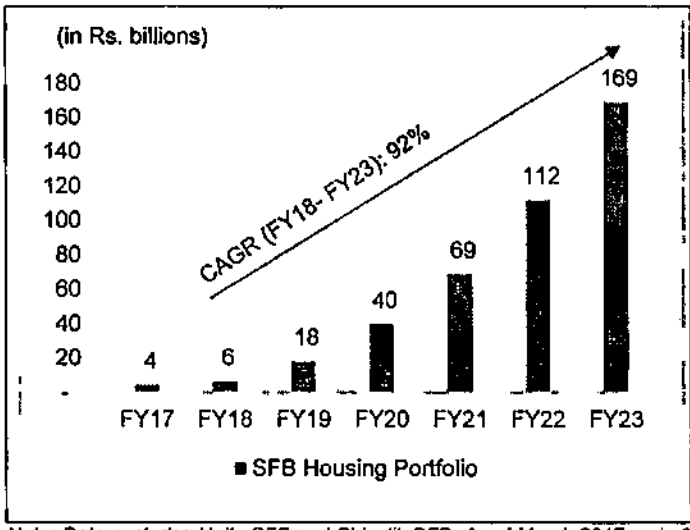
Note: The states are arranged in descending order of congestion.
Source: Census 2011, CRISIL MI&A

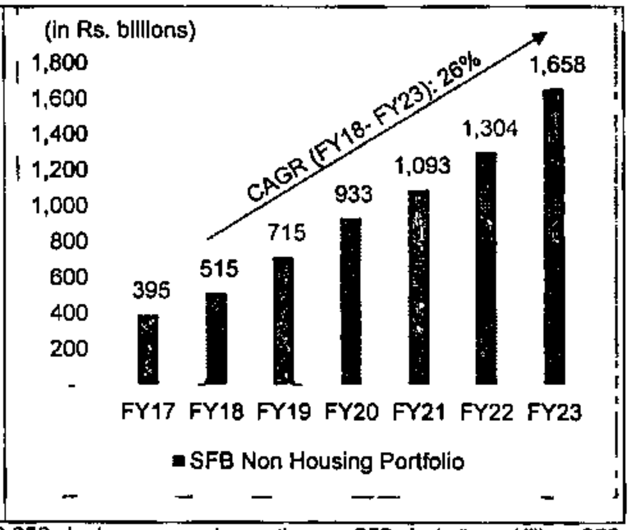
Housing Market Growth and Opportunities for SFBs

On October 7, 2015 RBI granted in-principle approval to 10 companies to set up small finance banks in India. These small finance banks were formed to provide banking service to unbanked and underbanked areas in the country. These SFBs had an extensive branch network already set up to provide loans such as microfinance, auto loans, MSME loans in rural and semi urban areas. As the 10 companies got the in-principle approval from RBI, they capitalised on their existing competencies in terms of customer base and local presence and started building a more comprehensive basket of relevant loan products to provide to their customers. Some of the SFB's had prior experience of managing a housing loan portfolio while others stared disbursing housing loans. All of the 10 SFBs granted licence foryared into housing product in order to cater to their existing customer base and also to increase the share of secured advances in their overall portfolio as housing loans are inherently secured loans.

Housing Loans portfolio for SFB's increased at a CAGR of 92% from Fiscal 2018 to Fiscal 2023. The growth rate for housing loan portfolio was higher than growth rate of non-housing loan portfolio. This has caused the share of housing loans in overall portfolio to rise from 1% in Fiscal 2017 to 9% in Fiscal 2023.

Trend of Housing Loan Portfolio of SFBs	Trend of Non-Housing Loan Portfolio of SFBs

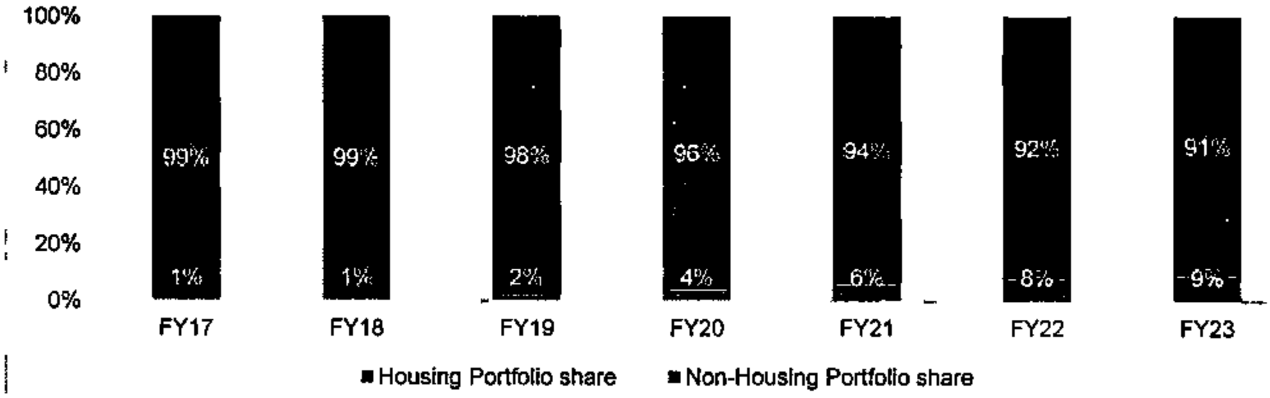




Note: Data excludes Unity SFB and Shivalik SFB. As of March 2017, only 6 SFBs had commenced operations as SFBs including – Ujjivan SFB, Equitas SFB, ESAF SFB, Utkarsh SFB, Suryoday SFB and Capital SFB. However for comparison purposes rest of the players loan portfolio data is also shown as SFB loan portfolio for all years.

Source: Company Reports, CRISIL MI&A

Trend of housing vs non housing loan share



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Source: Company Reports, CRISIL MI&A

CRISIl MI&A expects SFBs to increase their presence in the housing loan segment as its is a secured asset and it helps an SFB secure long term funding for business use. Some of the SFBs have introduced home loans under Pradhan Mantri Awas Yojana to its customers. SFBs will face stiff competition from HFCs and NBFCs in this segment which also caters to low and middle income families with a similar ticket size product. Yield on a housing loan is lower when compared to other products like microfinance, however SFBs have advantage in terms of lower cost of funds when compared to an NBFC/HFC. SFBs with their varied loan portfolio can also provide a range of different products to the same customer giving them an advantage over NBFCs and HFCs which cannot provide that many products.

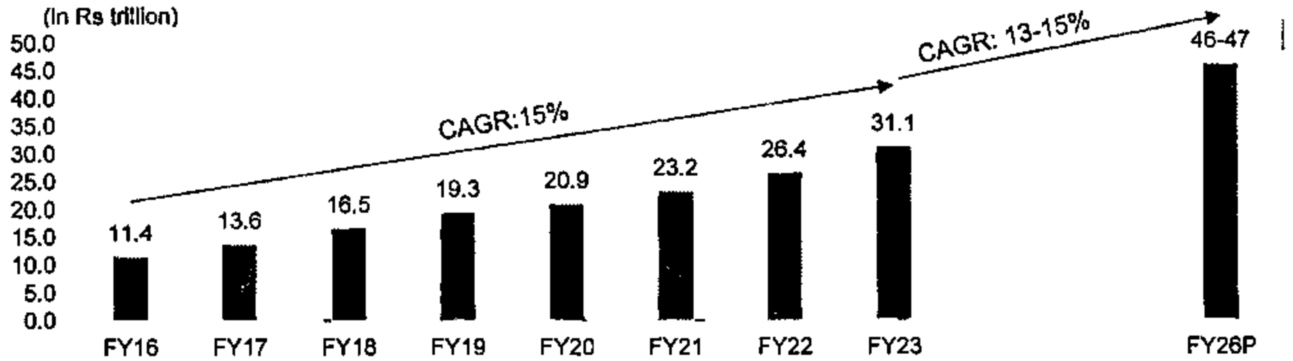
Indian housing finance market

The Indian housing finance market clocked a healthy ~15% CAGR (growth in loans outstanding) over fiscals 2016-2023 on account of a rise in disposable income, healthy demand and a greater number of players entering the segment. Indian Housing Finance market witnessed low disbursements in the first quarter of Fiscal 2021 on account of pandemic, however the overall market grew by 14% in Fiscal 2022 due to improved affordability, pent-up demand and historically low interest rates. In Fiscal 2023, despite the aggressive rate hikes by RBI, the credit growth for Indian Housing Finance market stood at 18% year on year on account of pent-up housing demand and focus on increase in housing penetration in Tier I and Tier II cities.

Rise in disposable income: India's per capita income grew at a 10% CAGR between fiscal 2012 and 2020. In fiscal 2021, the per capita income declined marginally due to COVID-19 pandemic impacting the economy but saw an increase of 7.4% in fiscal 2022. This continuous increase in per capita income, will aid housing finance demand in the country. As per IMF's estimates, India's nominal GDP per capita (at current prices) is projected to increase at a CAGR of 10-11% between fiscals 2023 and 2027 which will lead to demand for homes.

Healthy demand emanating from smaller markets: Faster growth in smaller districts and relatively muted demand for high ticket housing in metros have led to increased share of smaller districts (tier-II and below cities) in housing loans over the last couple of years.

Home loan segment to witness 13-15% growth in credit outstanding from fiscal 2023 to fiscal 2026



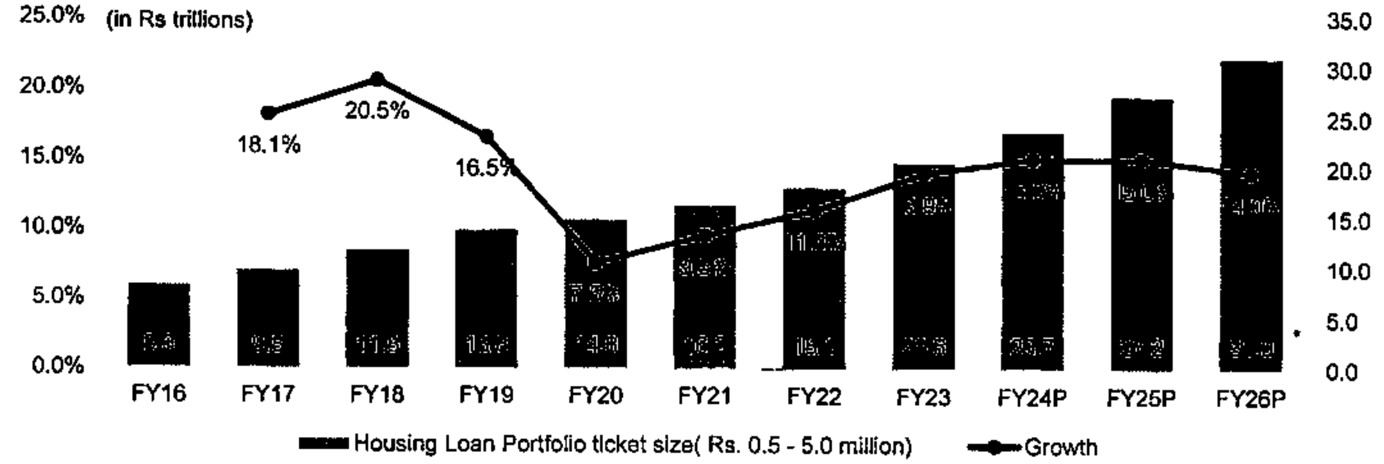
Note: P: Projected, Data includes only Housing loan excluding PMAY for Fiscal 2023;
Source: CRIF Highmark, CRISIL MI&A

In the last five years, growth in the housing finance market was spurred by the medium ticket size segment of Rs 2.5-10 million (4 year CAGR ~ 18% from fiscal 2019-2023), which witnessed increased housing project launches. As compared to ticket size of Rs 2.5-10 million, ticket size <Rs. 2.5 million saw a CAGR of 6% whereas ticket size > Rs 10 million witnessed a CAGR of 17% from fiscal 2019-2023.

Housing finance (loans with ticket size between Rs 0.5 to 5 million) sector witnessing encouraging trends; to grow by 14-16% up to fiscal 2026

Housing loans (0.5 to 5 million) logged a CAGR of ~14% during fiscals 2016-2023. This was largely because of the government's increased focus on the housing loans (up to Rs. 5.0 mn) segment. In fiscal 2020, however, the growth slowed down considerably to below 10% on year due to liquidity constraints in NBFCs and HFCs and the onslaught of the pandemic in the last quarter. The growth further remained at ~9.5% on year in fiscal 2021 due to economic slowdown on account of the pandemic. However, the loan segment bounced back in fiscal 2022 by growing at 11.3% due to income levels of salaried customers remaining largely intact and home loan rates hovering around historical lows. Housing loan portfolio of ticket size (Rs. 0.5 – 5.0 million) grew by 13.9% in Fiscal 2023 due to pent up demand in housing as affordability, though deteriorating, continues to be favourable. CRISIL MI&A forecasts housing credit market for ticket size Rs 0.5 to 5 million to grow at 14-16% between fiscal 2023 and 2026 on account of increase in capital values and incremental construction under PMAY. The outstanding portfolio of housing loans of ticket size Rs 0.5 to 5 million constitutes 66% of the overall housing market as of fiscal 2023, hence CRISIL expects this ticket size segment to support growth of overall housing segment.

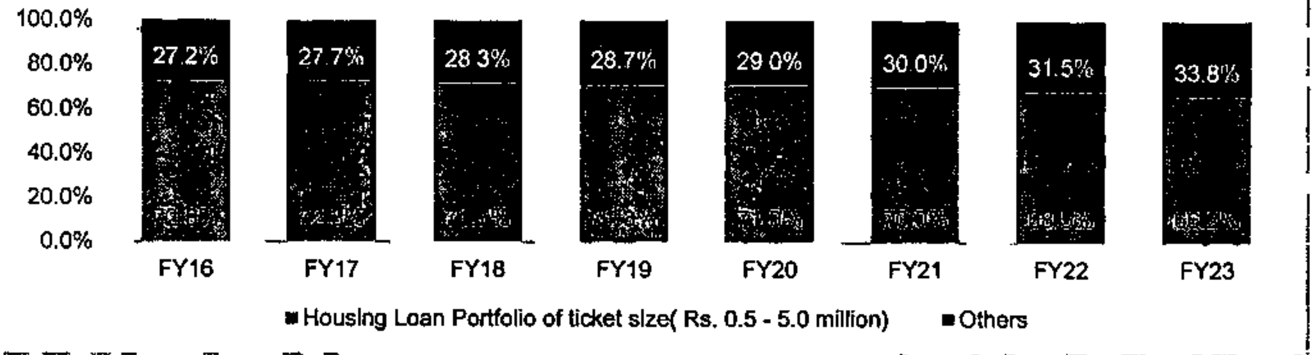
Housing loan portfolio of ticket size Rs 0.5 to 5 mn to grow at 14-16% CAGR between fiscals 2023-26



Note: P: Projected, Data includes only Housing loan excluding PMAY for Fiscal 2023;
Source: CRIF Highmark, CRISIL MI&A

Housing loans outstanding having ticket size in the range of Rs 0.5 to 5 million have seen their share in the overall housing loans outstanding decrease in last 7 years having reduced from 72.8% as on Mar-16 to 66.2% as on Mar-23. This high share is largely on account of the emphasis from the regulators and schemes available to both the developers and the customers falling in this ticket size range. We expect this category to maintain its majority share in the overall home loans outstanding in the medium term on account of larger focus from entities like SFBs and HFCs which are expected to improve their market share amongst the player groups.

Trend in share of housing loans – loans between ticket size Rs 0.5 to 5 million vs others

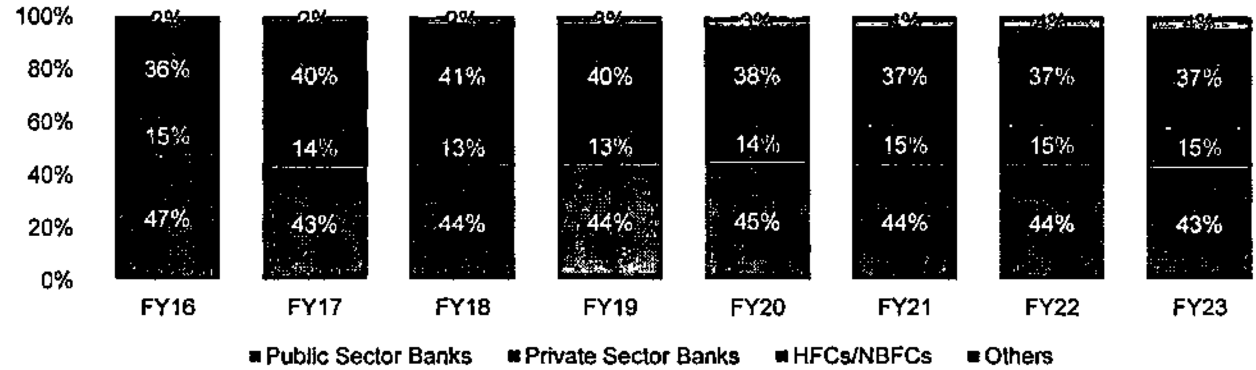


Note: Others include portfolio outstanding for ticket size <0.5 million and portfolio outstanding for ticket size > 5 million, Data includes only Housing loan excluding PMAY for Fiscal 2023
Source: CRIF Highmark, CRISIL MI&A

Banks to gain market share in housing finance (Rs. 0.5 to 5 mn)

Public sector banks have the highest share amongst various player groups, followed by HFCs and NBFCs in portfolio outstanding of housing loans of ticket size Rs 0.5- 5 million. In fiscal 2023, share of HFCs and NBFCs is 37% while public sector banks have a share of 43%. CRISIL MI&A expect banks especially private banks and SFBs to grow at a faster pace vis-à-vis HFCs in housing loans (Rs 0.5 to 5 mn), given their advantage in terms of cost of funds and base of deposit accounts. Despite HFCs focus on housing loans (Rs 0.5 to 5 mn), as they attempt to ward off competition from banks and protect profitability, the liquidity crisis coupled with sluggish economic activity post Covid-19 has plagued their share. CRISIL MI&A expects the SFBs to grow at a faster pace as compared to other banks and HFCs over the next two to three years.

Banks to continue to hold majority foothold in this segment



Note: Others include Foreign Banks, SFBs, and Others, Data includes only Housing loan excluding PMAY for Fiscal 2023
Source: CRIF Highmark, CRISIL MI&A.

Key factors contributing to high competitiveness of SFBs in housing loans (Rs. 0.5 to 5 mn) will be:

- **Clear understanding of target market:** Given the target borrower's profile, players need to have a clear and deeper understanding of micro markets and develop a strong local network. The strong network helps players to source business from niche customer category by having references from their existing customers. It is observed that successful players in the segment generally focus on a few geographies where they have a good understanding and scale up gradually to manage costs and asset quality better.

- **Collection Efficiency:** Given that players in the segment typically cater to the lower income customer segment, many of whom may not be financially literate, a strong focus and understanding of SFBs on collections and monitoring risk of default at customer level will help them to keep asset quality under check.
- Access to public deposits for the SFBs gives it a pricing advantage due to lower cost of funds as compared to HFCs

Region-wise loans outstanding (Rs 0.5 to 5 mn)

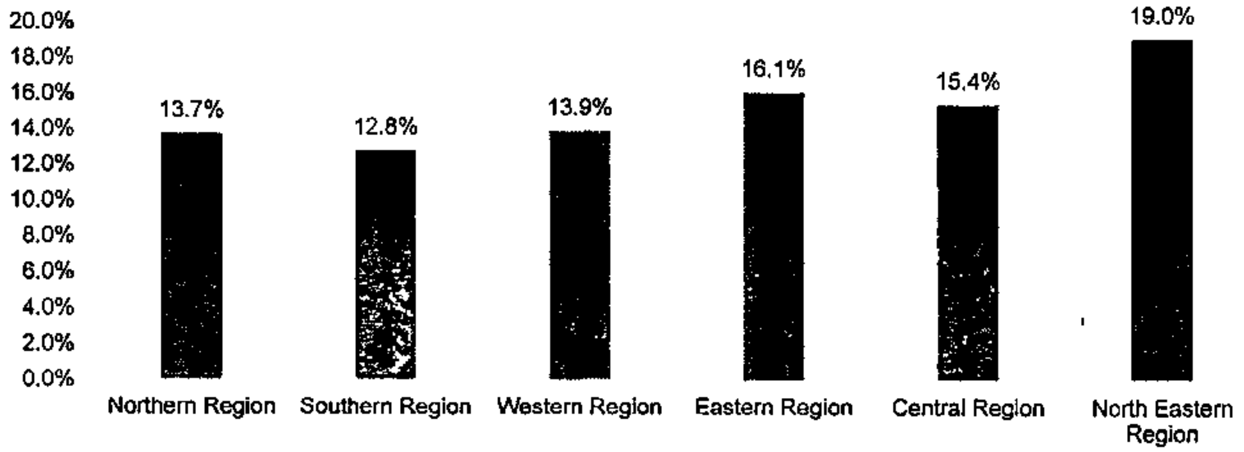
There are wide variations in the size and growth of the housing finance market within various states in the same region, which indicate latent opportunity for offering loans to unserved or underserved customers for all player groups.

The Southern and Western regions account for 35% and 30% respectively of the outstanding loans between Rs 0.5 to 5 million with balance being accounted for by Northern region (14%), Central region (13%), Eastern region (7%) and North Eastern region (1%). Thus, there remains adequate opportunity across player groups to penetrate further in the more populous central and northern regions and expand the share in overall loans outstanding between Rs 0.5 to 5 million.

Within the Northern region, Punjab accounts for 2.0% share in pan India and 14.6% share within the northern region with Rajasthan accounting for 33.4% share, Delhi for 25.3% share and Haryana with 16.9% share within the northern region.

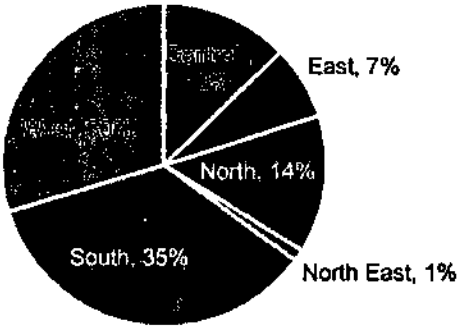
The loans outstanding grew the fastest in the North Eastern Region growing by 19.0% CAGR over Mar-16 to Mar-23 as against the overall growth of 13.8% during the corresponding period. The loans outstanding for Northern region grew by 13.7% CAGR during this period.

Growth in loans outstanding (Rs 0.5 to 5 mn) housing segment (Mar-16 to Mar-23 CAGR)



Note: Data includes only Housing loan excluding PMAY for Fiscal 2023, Source: CRIF Highmark, CRISIL MI&A

Northern Region accounts for ~14% of the outstanding loans with ticket size between Rs 0.5 and 5 million in fiscal 2023



Note: Data includes only Housing loan excluding PMAY for Fiscal 2023, Source: CRIF Highmark, CRISIL MI&A

Based on the home loans outstanding between Rs 0.5 to 5 million, the top 10 states/UTs account for ~79% of the loans in this segment as of March 2023. Maharashtra tops the list with the highest share of 20%, followed by Gujarat (9%), Tamil Nadu (9%), Karnataka (8%) and Telangana (7%). Among top 10 states, Andhra Pradesh has seen highest increase of 18.1% CAGR between Mar-16 and Mar-23 followed by Rajasthan (18.0%) and Gujarat (17.6%).

Punjab stands at 14th in terms of share across pan-India and saw an increase of 14.2% CAGR in between Mar-16 to Mar-23 with GNPA of 4.45% as on Mar-23. Thus, in terms of opportunities, all the regions have high potential for growth having seen moderate growth in the past and having low to moderate share apart from the western region that is more evolved in terms of the housing finance. Thus, right levers can push the growth to higher levels and selective targeting can help the players penetrate these states in an opportune manner.

Top 10 states/UTs account for ~ 79% of outstanding housing loans between Rs 0.5 to 5 million as of FY 2023

Region	State	Mar-16 (Rs billion)	Mar-23 (Rs billion)	Growth (CAGR) FY16-23	GNPA (Mar-23)	Share in region (Mar-23)	Share in India (Mar-23)	Share of loans with ticket size between Rs 0.5 to 5 million in overall home loans outstanding (Mar-23)	Population Density (2011)
Northern	CHANDIGARH	24	58	13%	3.26%	2.0%	0.3%	59%	9,258
	HARYANA	225	480	11%	3.51%	16.9%	2.3%	50%	573
	HIMACHAL PRADESH	34	113	19%	4.74%	4.0%	0.5%	81%	123
	JAMMU & KASHMIR	17	106	29%	1.16%	3.7%	0.5%	86%	124
	NCT OF DELHI	390	717	9%	4.84%	25.3%	3.5%	47%	11,320
	PUNJAB	164	415	14%	4.45%	14.6%	2.0%	77%	551
	RAJASTHAN	297	948	18%	1.53%	33.4%	4.6%	77%	200
	Northern Region Total	**1,153**	**2,837**	**14%**	**3.28%**	**100.0%**	**13.8%**	**62%**	**-**
Southern	ANDHRA PRADESH	338	1,080	18%	1.20%	14.9%	5.2%	76%	308
	KARNATAKA	918	1,747	10%	2.11%	24.2%	8.5%	54%	319
	KERALA	374	996	15%	2.47%	13.8%	4.8%	77%	860
	LAKSHADWEEP	0	1	18%	0.00%	0.0%	0.0%	84%	2,149

	PUDUCHERRY	15	31	11%	2.15%	0.4%	0.2%	76%	2,547
	TAMIL NADU	946	1,919	11%	2.33%	26.5%	9.3%	71%	555
	TELANGANA	526	1,459	16%	0.86%	20.2%	7.1%	61%	NA
	Southern Region Total	**3,117**	**7233**	**13%**	**1.83%**	**100.0%**	**35.1%**	**65%**	**-**
Western	DD and DN	5	10	11%	1.22%	0.2%	0.1%	88%	NA
	GOA	37	71	10%	2.00%	1.2%	0.3%	70%	394
	GUJARAT	621	1,935	18%	2.10%	31.6%	9.4%	77%	308
	MAHARASHTRA	1,803	4,110	12%	2.92%	67.1%	20.0%	58%	365
	Western Region Total	**2,466**	**6,126**	**14%**	**2.65%**	**100.0%**	**29.8%**	**63%**	**-**
Eastern	ANDAMAN & NICOBAR ISLANDS	4	8	13%	0.38%	0.5%	0.0%	75%	46
	BIHAR	80	304	21%	2.07%	20.0%	1.5%	78%	1,106
	JHARKHAND	60	151	14%	2.35%	9.9%	0.7%	78%	414
	ODISHA	95	251	15%	2.06%	16.6%	1.2%	76%	270
	SIKKIM	10	25	14%	1.73%	1.6%	0.1%	86%	86
	WEST BENGAL	286	777	15%	2.86%	51.2%	3.8%	75%	1,028
	Eastern Region Total	**535**	**1,516**	**16%**	**2.49%**	**100.0%**	**7.4%**	**76%**	**-**
Central	CHHATTISGARH	90	242	15%	1.98%	9.2%	1.2%	78%	189
	MADHYA PRADESH	250	740	17%	2.21%	28.3%	3.6%	76%	236
	UTTAR PRADESH	540	1,381	14%	3.27%	52.7%	6.7%	74%	829
	UTTARAKHAND	83	256	18%	2.13%	9.8%	1.2%	81%	189
	Central Region Total	**963**	**2,619**	**15%**	**2.74%**	**100.0%**	**12.7%**	**76%**	**-**
North Eastern	ARUNACHAL PRADESH	2	6	22%	1.61%	2.4%	0.0%	65%	17
	ASSAM	54	167	17%	1.66%	66.1%	0.8%	85%	398
	MANIPUR	4	18	22%	1.01%	6.9%	0.1%	86%	115
	MEGHALAYA	5	12	14%	2.01%	4.8%	0.1%	77%	132
	MIZORAM	3	20	30%	1.91%	7.8%	0.1%	86%	52
	NAGALAND	2	4	13%	2.18%	1.6%	0.0%	75%	119
	TRIPURA	5	26	27%	1.22%	10.2%	0.1%	85%	350
	North Eastern Region Total	**75**	**253**	**19%**	**1.61%**	**100.0%**	**1.2%**	**84%**	**-**
Grand total		**8,309**	**20,584**	**14%**	**2.43%**	**100.0%**	**100.0%**	**66%**	**-**

Note: Population density is as provided by RBI taken from Census data – calculated as population per sq. km., Data includes only Housing loan excluding PMAY for Fiscal 2023

Source: CRIF Highmark, CRISIL MI&A

Share of HFCs/NBFCs is higher in the northern region in comparison to all India share in housing loans with ticket size in between Rs 0.5 to 5 million due to higher presence of HFCs in the northern region of the country focussed on affordable home loans catering to this ticket size segment. They are expected to remain competitive in this region but with better liquidity and availability of funds at lower cost, the competition from banks is expected to be fierce for the other entities in this region. With SFBs further diversifying their portfolio and establishing tie-ups with other entities, they are expected to remain competitive too. Within the northern region, the state of Punjab has a higher share of public sector banks (50%), followed by HFCs/NBFCs (37%). The share of private sector banks and others is low at 10% and 3% respectively.

State-wise market share of player groups in housing loans with ticket size between Rs 0.5 to Rs 5 million (FY23)

Region	State	Share Of PSBs	Share Of Private Sector Banks	Share Of HFCs/NBFCs	Share Of Others
Northern	Chandigarh	55%	9%	34%	2%
	Haryana	42%	13%	42%	3%
	Himachal Pradesh	68%	3%	11%	17%
	Jammu & Kashmir	19%	72%	6%	3%
	Delhi	29%	15%	55%	1%
	Punjab	50%	10%	37%	3%
	Rajasthan	42%	11%	41%	5%
	Northern Region Total	**40%**	**14%**	**42%**	**4%**
Southern	Andhra Pradesh	60%	7%	30%	3%
	Karnataka	44%	14%	38%	4%
	Kerala	58%	16%	22%	5%
	Lakshadweep	76%	8%	15%	1%
	Pondicherry	53%	9%	36%	2%
	Tamil Nadu	41%	13%	44%	1%
	Telangana	40%	11%	45%	4%
	Southern Region Total	**47%**	**12%**	**38%**	**3%**
Western	Dadra And Nagar Haveli	34%	38%	27%	0%
	Daman And Diu	37%	18%	43%	2%
	Goa	72%	8%	15%	5%
	Gujarat	30%	33%	32%	5%
	Maharashtra	34%	20%	39%	7%
	Western Region Total	**33%**	**24%**	**37%**	**6%**
Eastern	Andaman & Nicobar Islands	89%	3%	8%	0%
	Bihar	68%	7%	23%	2%
	Jharkhand	63%	8%	27%	3%
	Odisha	65%	10%	24%	2%
	Sikkim	54%	3%	43%	0%
	West Bengal	64%	9%	25%	2%
	Eastern Region Total	**65%**	**9%**	**25%**	**2%**
Central	Chhattisgarh	55%	10%	28%	7%
	Madhya Pradesh	42%	13%	42%	3%
	Uttar Pradesh	40%	10%	46%	3%
	Uttarakhand	36%	6%	48%	10%
	Central Region Total	**42%**	**11%**	**43%**	**4%**
North Eastern	Arunachal Pradesh	88%	2%	8%	1%
	Assam	71%	6%	20%	2%
	Manipur	87%	6%	6%	1%
	Meghalaya	72%	3%	11%	13%
	Mizoram	51%	0%	0%	48%
	Nagaland	91%	3%	6%	0%

	Tripura	63%	4%	11%	21%
	North Eastern Region Total	71%	5%	16%	8%
	Grand Total	43%	15%	37%	4%

Note: Others include Foreign Banks, SFBs, and Others, Data includes only Housing loan excluding PMAY for Fiscal 2023.

Source: CRIF Highmark, CRISIL MI&A

Long-term growth drivers for overall housing finance

Higher transparency in the sector, increasing affordability and urbanisation, and government incentives will push up the housing finance market in longer term.

Government Initiatives

- **PMAY-U:** The scheme aims to fill the supply-demand gap in the housing sector. On supply side, the scheme offers incentives for beneficiary-led housing, public private partnerships (PPP) in building homes for economicaly weaker sections (EWS) and low income group (LIG) by offering incentives such as allowing higher floor space index and announcing grants and subsidies for slum redevelopment. On the demand side, the PMAY provides credit-linked subsidies to stimulate demand
- **PMAY-G:** The scheme is for the rural population who don't have their own houses. It provides financial assistance and interest rate subsidy
- **Special financing window:** This window is expected to help revive stalled housing projects which require a last-mile funding to reach completion
- **Relaxation of ECB guidelines:** The relaxed external commercial borrowing (ECB) guidelines will enable easier access to overseas funds and stimulate the sector
- **Tax incentives:** Provides various tax benefits to home loan borrowers
- **RERA:** The law was introduced in order to make the sector transparent
- **GST:** The GST rate for affordable housing projects was cut
- **EPF corpous withdrawal:** Permission to withdraw 90% of employees provident fund (EPF) corpus enables prospective home buyers to make the down payment and pay their home loan EMIs
- **Smart Cities Mission**

Regulator initiatives

- Risk weight rationalisation on housing loans to improve sentiment for the real estate sector
- **Regulatory authority of HFCs to shift from NHB to RBI:** The Budget 2020 proposed a change in regulatory oversight and supervision of HFCs from the NHB to the Reserve Bank of India (RBI). This shift will lead to more streamlined regulations and better risk management framework for HFCs.
- **SARFAESI Act:** Bringing HFCs under the ambit of the SARFAESI Act has helped them accelerate recoveries
- **NHB refinance:** The NHB refinancing schemes help HFCs lower their borrowing costs
- **PSL guidelines revised:** The RBI increased the threshold limit for home loans to be classified as PSL in order to promote PMAY

Other factors

- **Low mortgage penetration**
- **Rising urbanisation and nuclearisation:** Decreasing average household size and rising level of urban population create more housing demand.
- **Rising income levels:** Rising income levels help improve the affordability of houses
- **Rising independent housing demand:** Increase in share of independent houses helps housing finance market grow in the long term

Source: CRISIL MI&A

Government Initiatives

The government's scheme to provide housing for all and various steps taken to implement it are expected to boost sales of affordable and low-cost housing units. This will, consequently, increase the demand for loans. Under the Housing for All mission, the government has introduced credit-linked subsidy scheme (CLSS) as a demand-side intervention in order to expand institutional credit flow and meet the urban demand.

Affordable housing: PMAY for rural and urban regions

Under the PMAY-Gramin (PMAY-G), as many as 23.3 million houses were completed as of July 27, 2023 (Phase I + Phase II). CRISIL MI&A believes budgetary allocation for the scheme is insufficient. As a result, it will have to rely heavily on extra budgetary resources raised through NABARD bonds.

PMAY G status (as of July 27, 2023)

	Target	Sanctioned	Completed	Funds Transferred (Rs. Billion)
PMAY G (Phase I + II)	29,500,000	29,276,244	23,298,231	3,079
Phase I	9,857,330	9,855,502	9,562,943	1,167
Phase II	19,642,670	19,420,742	13,735,288	1,912

Source: PMAY-G, CRISIL MI&A

PMAY Urban

Under the PMAY-U, 11.9 million have been sanctioned as of July 27, 2023, and 7.5 million have been constructed. As on July 27, 2023, the Government has sanctioned ₹ 2.0 trillion towards this scheme. However, the central assistance released is about ₹ 1.4 trillion, which amounts to 74% of the required assistance. Like the PMAY-G, the PMAY-U also relies heavily on extra budgetary resources raised through Housing and Urban Development Corporation Ltd bonds. The flow of funds from the central government is crucial for the scheme's success.

PMAY U status (as of July 27, 2023)

	Target	*Sanctioned (million)*	*Houses Grounded (million)*	*Completed (million)*	*Funds Released (Rs. Billion)*
PMAY U	Housing for All	11.9	11.2	7.5	1,479

Source: MOHUA, CRISIL MI&A

Interest subvention scheme to boost loan disbursements

Under the Housing for All scheme, in order to expand institutional credit flow to the urban population, the government introduced the Credit Linked Subsidy Scheme (CLSS) as a demand-side intervention. In May 2020, the government extended the CLSS component till March 2021. This move will help in supporting the loan disbursements over the coming fiscal. On 10th August 2022, the Union Cabinet approved the proposal to continue PMAY-U scheme till 31st December 2024. CLSS is a vertical with which the PMAY-U scheme is being implemented.

The CLSS will be provided on home loans for eligible urban population to acquire and construct houses. For loans of up to Rs 0.6 million for EWS and LIG beneficiaries, the interest subsidy has been fixed at 6.5% for eligible borrowers buying a home of up to 60 sq. meter carpet area. In February 2017, the CLSS was extended to include MIG households with incomes in the range of Rs 0.6-1.8 million per annum.

Category	Annual household Income (Rs)	Loan amount (Rs)	Interest subsidy (%)	Size of the proposed house (carpet area, sq m)

EWS & LIG	Up to 0.6 million	0.6 million	6.50	60
MIG 1	0.6-1.2 million	0.9 million	4.00	160
MIG 2	1.2-1.8 million	1.2 million	3.00	200

Source: CRISIL MI&A

Last mile affordable housing funding package and relaxation of ECB guidelines

In September 2019, the government announced Rs 100 billion special window to provide last-mile funding for the completion of ongoing housing projects that are non-NPA, non-NCLT and are net worth positive in the affordable and middle-income categories. The government will contribute about Rs 100 billion and outside investors such as Life Insurance Corporation of India, private capital, sovereign wealth funds and development finance institutions will contribute roughly the same amount. The objective of this move is to focus on the construction of unfinished units. This move is expected to benefit roughly 0.35 million projects in the country. The government also announced that the external commercial borrowing (ECB) guidelines will be relaxed to facilitate financing of home buyers. This will be carried out in consultation with the RBI to help identify eligible beneficiaries under the PMAY. The relaxation will be in addition to the existing ECB norms for affordable housing.

Tax incentives

The government has traditionally used tax regulations to promote the housing sector. Tax sops for the housing sector have been instrumental in driving growth in the housing and housing finance sectors.

Some of the tax benefits announced in Union Budget 2021 are:

- Additional tax benefits for buyers (Rs. 1,50,000 under section 80EEA) and developers (80-IBA) of affordable houses (up to ticket size of Rs. 4.5 million) extended till March 2022. This is expected to drive demand for affordable housing, especially in high inventory markets. The extension under Section 80-IBA will continue to provide profit linked tax exemption to developers.

Other tax benefits include:

- As per Section 24 (B) of the Income Tax Act, 1961, annual interest payments of up to Rs 200,000 (Rs 300,000 for senior citizens) on housing loans can be claimed as a deduction from taxable income
- As per Section 80 C (read with Section 80 CCE) of the Income Tax Act, 1961, principal repayments of up to Rs 150,000 on a home loan are allowed as a deduction from gross total income
- As per Section 80 EE, an additional deduction in respect of interest of Rs 50,000 per annum has been provided exclusively for first-time home buyers, given the property value is up to Rs 5 million and the loan is up to Rs 3.5 million

Real Estate (Regulation and Development) Act

The year 2017 stands out for policy initiatives in the real estate sector. One such initiative was the implementation of the Real Estate (Regulation and Development) Act (RERA), which had a direct impact on the supply-demand dynamics in the sector. The RERA is expected to improve transparency, timely delivery, and organised operations over time. The Act does not permit developers to launch new projects before registering them with the real estate authority. This is a major shift from the practices followed earlier by developers, wherein they managed to sell part of the project through soft/pre-launch activities. The RERA puts an end to fund diversion across projects as it mandates 70% of the funds collected from customers for a specific project should be maintained in a separate escrow account and used only for the same project. Besides, developers have to disclose project-related information, such as project plan, layout, government approvals, carpet area of units, construction status and delivery schedule.

However, more than three years after it came into force, the implementation of the RERA – which was aimed at bringing some discipline into the real estate sector and protecting consumers against unscrupulous builders – remains tardy. Only a few states such as Maharashtra have seen significant project registrations. The RERA regulation passed by several states diverges from the Centre's model RERA in key aspects such as definition of ongoing project. With consumers facing the brunt of delays in projects, a strong and effective RERA law, and stringent implementation are critical to boost the consumer confidence.

State-wise number of registered projects (2020)

Region	State	No. of registered projects
Northern	Chandigarh	NA
	Haryana	740
	Himachal Pradesh	56
	Jammu & Kashmir	NA
	Nct Of Delhi	22
	Punjab	891
	Rajasthan	1,243
Southern	Andhra Pradesh	960
	Karnataka	3,446
	Kerala	NA
	Lakshadweep	NA
	Puducherry	NA
	Tamil Nadu	1,635
	Telangana	1,902
Western	DD And DN	97
	Goa	NA
	Gujarat	6,903
	Maharashtra	25,604
Eastern	Andaman & Nicobar Islands	1
	Bihar	894
	Jharkhand	NA
	Odisha	374
	Sikkim	NA
	West Bengal	938
Central	Chhattisgarh	1,142
	Madhya Pradesh	2,663
	Uttar Pradesh	2,818
	Uttarakhand	279
North Eastern	Arunachal Pradesh	NA
	Assam	NA
	Manipur	NA
	Meghalaya	NA
	Mizoram	NA
	Nagaland	NA
	Tripura	NA

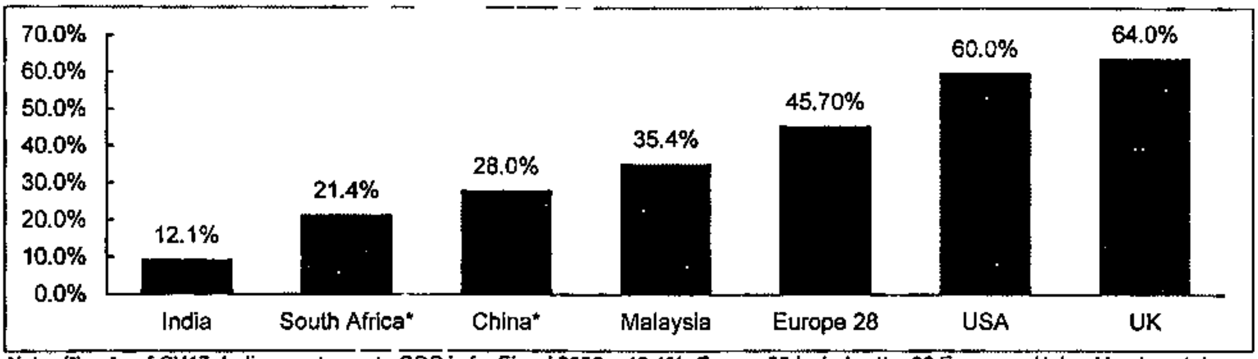
Source: Gujarat Real Estate Regulatory Authority – Annual Report 2020, CRISIL MI&A

Other factors

Mortgage-to-GDP ratio in India lower than other countries

India has very low penetration in terms of housing finance as compared to its rising peers which shows the higher potential for Indian housing finance companies to expand. Housing finance market continue to face supply constraints from Banks and NBFCs, particularly for lower income group as they are perceived as risky due to informal sector.

Mortgage-to-GDP ratio in India (FY23) compared with other countries (CY18)



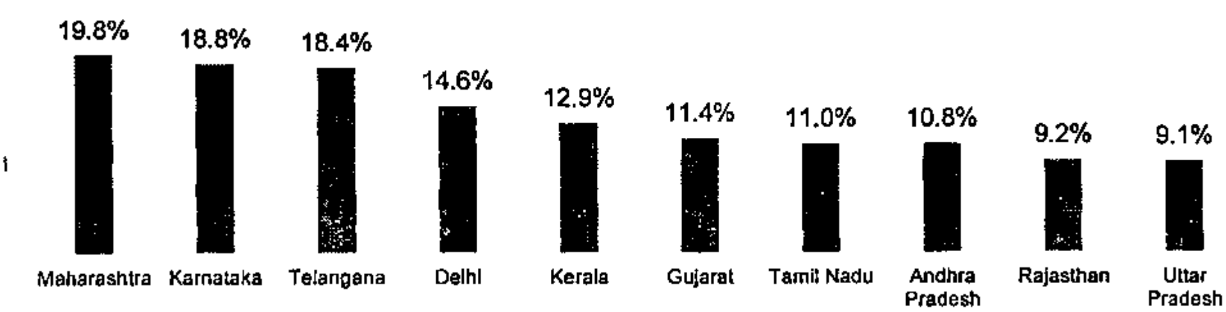
Note: (*) – As of CY17, Indian mortgage to GDP is for Fiscal 2023 – 12.1%; Europe 28 includes the 28 European Union Member states as of December 2018; Source: HOFINET, European Mortgage Federation, NHB, CRISIL MI&A

Within India, the mortgage to GDP levels of some states like Punjab, Bihar, Rajasthan Delhi etc. is lower as compared to all India levels and hence there is significant scope of mortgage lending to increase across these regions.

State wise mortgage penetration in India

The mortgage-to-GDP ratio varies widely for the top 10 states based on home loan market size, ranging between ~9% and ~20%. Maharashtra had the highest housing loan penetration with ~19.8% of GDP followed by Karnataka and Telangana at second and third position respectively. Uttar Pradesh has the lowest mortage penetration amongst the top 10 states at end of fiscal 2023.

Housing Loan Penetration in top 10 states by Housing Loan Outstanding as of Fiscal 2023



Note: Housing loans penetration is computed as Housing loan outstanding over GSDP at current prices; Source: CRIF Highmark, CRISIL MI&A, NSO, MOSPI, GOI, RBI, Indian Brand Equity Foundation, State Budgets 23-24

Below table indicates the housing loan penetration for top 10 states by housing loan outstanding and clearly indicates an increasing trend across all the geographies (except Tamil Nadu which has remained stable). Amongst the top states, Karnataka and Telangana has witnessed the sharpest rise in housing loan penetration.

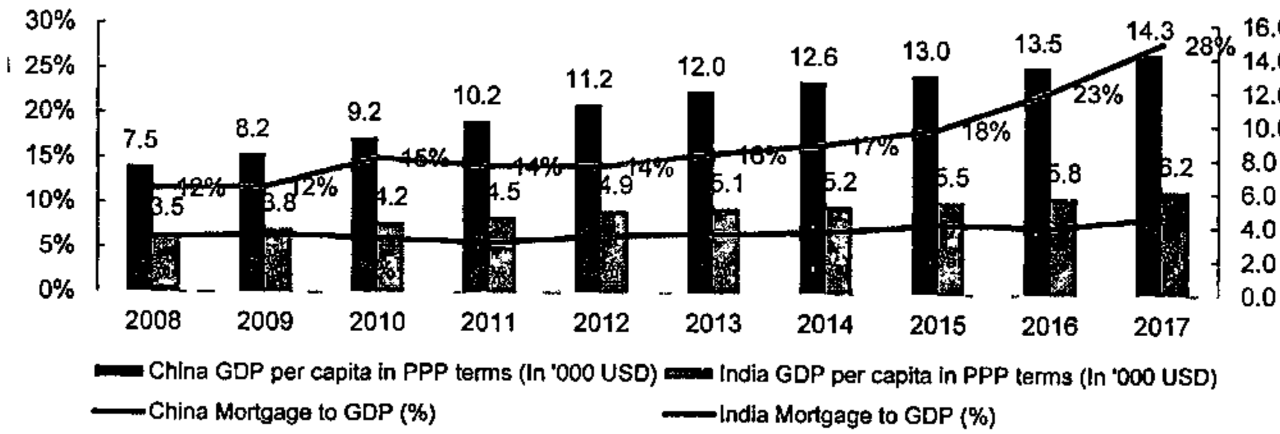
States	Housing Loan Penetration (FY19)	Housing Loan Penetration (FY23)
Maharashtra	16.8%	19.8%

Karnataka	13.7%	18.8%
Telangana	13.9%	18.4%
Delhi	13.4%	14.6%
Kerala	10.8%	12.9%
Gujarat	9.7%	11.4%
Tamil Nadu	11.0%	11.0%
Andhra Pradesh	8.8%	10.8%
Rajasthan	7.3%	9.2%
Uttar Pradesh	7.1%	9.1%

Note: Housing loans penetration is computed as Housing loan outstanding over GSDP at current prices; Source: CRIF Highmark, CRISIL MI&A, NSO, MOSPI, GOI, RBI, Indian Brand Equity Foundation, State Budgets 23-24

Rise in per capita income to drive the growth of mortgage penetration in India

The mortgage penetration in China is correlated to the GDP per capita of the country and the GDP-to-mortgage ratio of China has grown from 12% in 2008 to 26% in 2017. The per capita income of the country has increased from USD 7,900 in 2008 to USD 15,300 in 2017. India has gone through a similar trajectory with mortgage penetration in the country increasing from 6% in 2008 to 9% in 2017 which is correlated to the increase in per capita income of the country from USD 3,900 in 2008 to USD 6,500 in 2017.

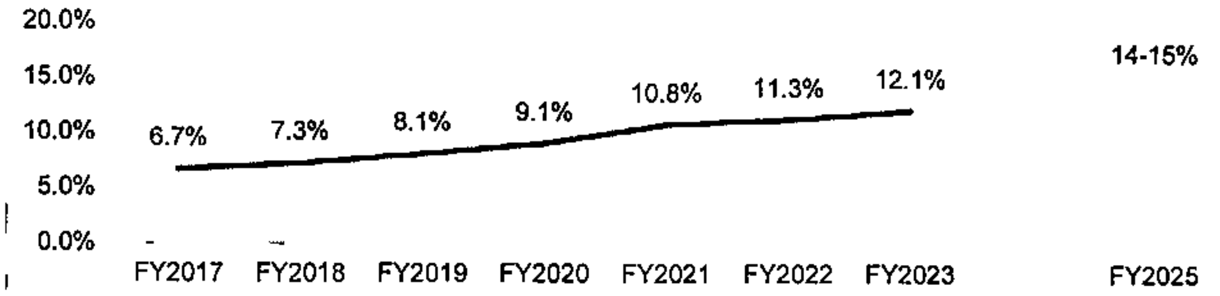


Source – HOFINET, Peoples Bank of China, World Bank, CRISIL MI&A

Mortgage-to-GDP ratio in India to grow to 14-15% by fiscal 2025

In fiscal 2023, India's mortgage-to-GDP ratio stood at 12.1%. Though low compared with other developing countries, it has significantly improved from 6.5% in fiscal 2009. The factors that contributed to the improvement are rising incomes, improving affordability, growing urbanisation and nuclearization of families, emergence of tier-II and tier-III cities, ease of financing, tax incentives, and widening reach of financiers. Given the expected steady growth from fiscal 2023, CRISIL MI&A projects the ratio at 14-15% by fiscal 2025.

Trend in mortgage-to-GDP ratio in India

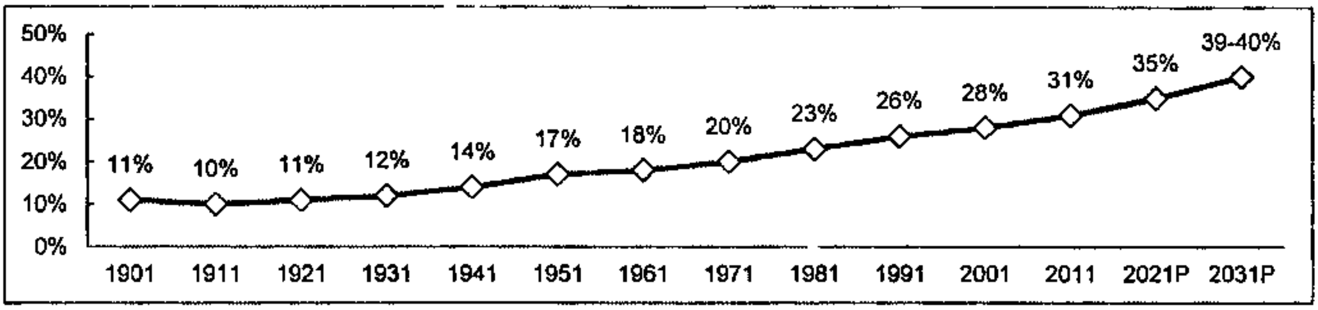


Note: P – Projected, Data for mortgage to GDP for India includes both Housing loans outstanding over constant GDP for India; Source – NHB, World Bank, CRISIL MI&A Estimates

Urbanisation crossed 35% by 2021

The share of urban population in relation to the total population has been consistently rising over the years. People from rural areas move to cities for better job opportunities, education, better life, etc. Entire families or only a few people (generally earning member or students) may migrate, while a part of the family continues to hold on to the native house. The urban population was 377 million in 2011, marking a CAGR of 2.8%; rural population was 833 million, up at a CAGR of 1.16%. Urbanisation levels rose from 28% in 2001 to about 31% in 2011. It is expected to have reached about 35% in 2021. This percentage is expected to increase further in the years to come, thereby translating into higher demand for housing and related amenities in the urban areas.

Urban population as a percentage of total population



Note: P: projected

Source: Census 2011, World Urbanisation Prospects: The 2011 Revision (UN), CRISIL MI&A

Rise in number of nuclear families leads to formation of new houses

Nuclearisation refers to formation of multiple single families out of one large joint family. Each family lives in a separate house, while the ancestral house may be retained or partitioned to buy new houses. Nuclearisation in urban areas is primarily driven by changing lifestyle of people, individualism, changing social/cultural attitudes, and increased mobility of labour in search of better employment opportunities. These trends are expected to continue in future.

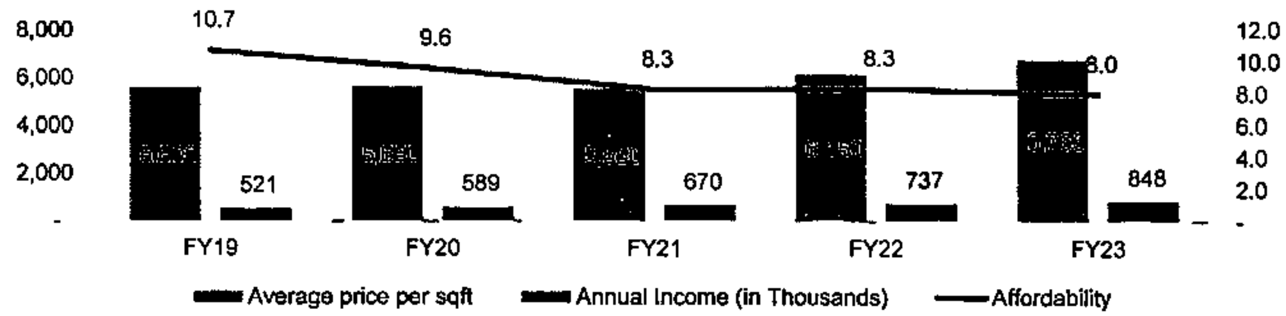
Infrastructure development to boost demand for Real Estate

Real estate market is impacted by infrastructure growth. Development of new infrastructure such as roads, bridges, airports, smart cities etc., opens up new areas for development and increases the value of existing properties. It also attracts businesses and population growth to an area, which boosts the local economy and supports the real estate market.

Higher affordability

CRISIL forecasts that the per capita income will gradually improve with a pick-up in GDP growth and sustained low inflation. This will be an enabler for domestic consumption leading to rise in demand for housing. Further, increase in household savings over the last decade coupled with availability of underwrite and provide credit to the vulnerable or informal segment owing to advancement in technology has also led to higher demand for housing.

Real estate prices relatively higher though affordability has only improved historically



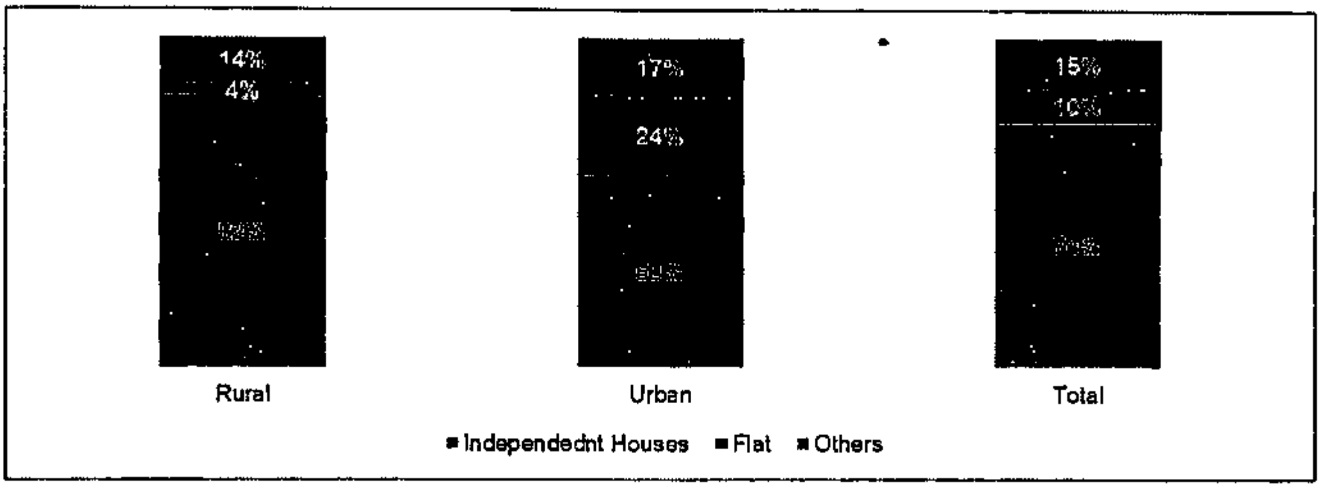
Note: The charts indicate the price per sqft based on top 10 markets -Delhi NCR, Mumbai, Pune, Ahmedabad, Chennai, Kolkata, Bangalore, Chandigarh, Hyderabad, and Kochi, at a Pan India level, the overall prices could be way lower than estimates, Affordability is computed as average price per sqft / annual income; Source: CRISIL MI&A

Changing floor space requirement

Floor space requirement is dependent on the family size as well as affordability determined by income levels. With increasing nuclearization, the per capita floor space area required reduces as the family size shrinks. As income rises, people shift to bigger houses, thus increasing demand. For lower income groups, floor space required is marginally higher in rural areas than in urban areas. This may be attributed to lower prices in rural areas.

Rising demand for independent houses

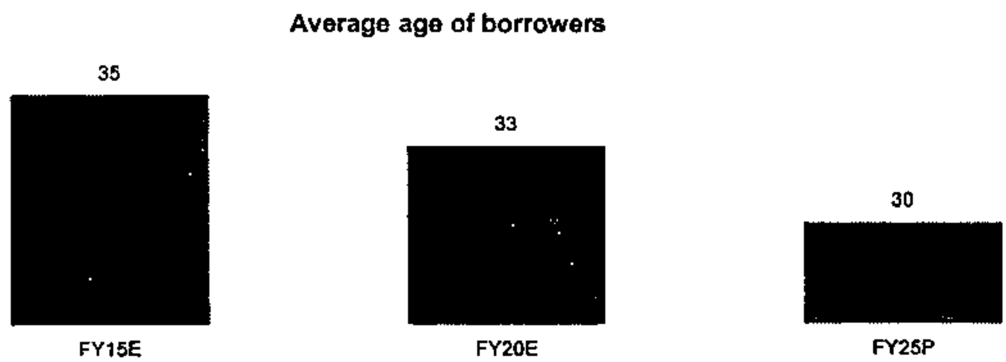
Indians traditionally prefer to live in independent houses. However, the increase in population density, especially in urban areas, has increased the demand for flats. As per Census Data it has been very clear that Indians do prefer independent housing. This will continue to drive the demand for such homes, which are often self-constructed, especially in the smaller cities.



Source: Census 2001, CRISIL MI&A

Declining age of home loan borrowers

Average age of borrowers has been declining over the years and was estimated at 33 years in fiscal 2020. We expect this figure to decline further with growth in salaries and people's strengthening preference for accumulating assets, both for investment purpose and tax benefits.



Note: E – Estimated, P – Projected, the numbers for FY15 and FY20 are estimated.
Source: CRISIL MI&A

Risk and Challenges for affordable housing segment

- Funding disadvantage for lower rated HFCs
- Credit score availability in India is still at a nascent stage which makes it difficult for the lenders to judge the ability of borrowers to repay who are availing loans in affordable housing segment

Profitability in Affordable Housing Segment

The housing segment showed signs of a recovery in the second half of fiscal 2021, supported by various initiatives by the Central and state governments to revive economic activities. NIM Increased from 5.6% in fiscal 2021 to 6.0% in fiscal 2023, similar pattern was observed in cost of borrowings which reduced from 8.9% to 7.7% in same period, with improved net interest margins and lower cost of borrowing the return on assets improved to 4.0% during fiscal 2023. RoE also improved from 11.1% to 13.1% between fiscal 2021 and 2023.

Profitability Metrics for Affordable Housing Players

Parameter	2020-21	2021-22	2022-23
NIMs	5.6%	5.7%	6.0%
Yield on Advances	12.9%	13.4%	13.6%
Cost of borrowings	8.9%	7.3%	7.7%
Opex	3.2%	3.3%	3.6%
Credit Cost	1.0%	0.4%	0.3%
RoE	11.1%	12.4%	13.1%
RoA	3.4%	3.9%	4.0%

Note: The above table is computed based on data of Aadhar Housing Finance Limited, AAVAS Financiers Limited, Aptus Value Housing Finance India Limited, Home First Finance Company India, India Shelter Finance Corporation, Vastu Housing Finance Corporation Limited; Source: Company reports, CRISIL M&A Estimates.

Asset quality has remained stable, although high, for major players in fiscal 2023

As demand for home loans largely comes from first-time buyers, who stay in property purchase, asset quality in this segment has remained healthy historically. However, due to the seasoning of portfolios delinquency rates have moved up. Moreover, due to their presence in a few geographies, smaller HFCs (loans up to Rs. 5 mn) are more susceptible to local events and developments that impact the repayment behaviour compared with their larger counterparts. Banks usually lend to less vulnerable segment as well which has protected them on the downside. Small Finance Banks also have a competitive advantage in terms of higher liquidity as well as retail deposits compared to HFCs/NBFCs. In fiscal 2020 and 2021, overall GNPA increased due to economic slowdown, which has impacted low-income groups more on account of the pandemic. The impact of lockdown resulted in steep rise of NPA's in the end of the first quarter of fiscal 2022. GNPAs of housing loan portfolios increased in fiscal 2022 on account of stress witnessed by MIG and LIG borrowers and transition of NBFCs/HFCs to new NPA recognition norms based on RBI's circular (Prudential Norms on Income Recognition, Asset Classification and Provisioning pertaining to Advances). In Fiscal 2023, overall GNPA was high yet stable at 2.5%.

However, in the long term, the affordable housing customers are expected to return to comfortable earnings and savings leading to low GNPA in comparison to the GNPA in across all ticket sizes. We believe the ability to manage credit costs by appropriately leveraging information availability through technology and data analytics as well as being in touch with the customers on the ground will be a key differentiator among financiers operating in the housing finance (loans up to Rs. 5 mn) segment.

CRISIL MI&A expects GNPAs for the housing loan portfolio to improve in fiscal 2024 due to stable credit cost and healthy credit growth during the fiscal.

Trend of GNPA in housing finance across various ticket size groups

	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
Loans with ticket size less than Rs 0.5 million	5.4%	6.8%	7.1%	7.6%	9.3%	8.8%	9.0%	10.0%
Loans with ticket size between Rs 0.5 million and Rs 5 million	1.1%	1.4%	1.7%	1.6%	2.3%	2.4%	2.5%	2.4%
Loans with ticket size greater than Rs 5 million	0.9%	1.3%	1.8%	1.6%	2.4%	2.7%	2.3%	2.3%
Overall Housing Finance	1.3%	1.6%	1.9%	1.8%	2.5%	2.6%	2.6%	2.5%

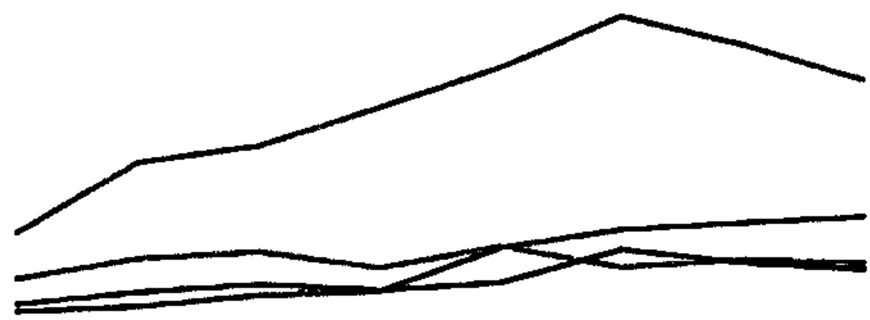
Note: Data includes only Housing loan excluding PMAY for Fiscal 2023
Source: CRIF Highmark, CRISIL MI&A

GNPA are higher for others category comprising of Foreign Bank and Others and has seen a sharp increase over the last 6 years. In this ticket range, Private Sector Banks have the best asset quality on account of selective lending to this category of customers and having seen a considerable improvement in fiscal 2022 and fiscal 2023. HFC/NBFCs have GNPA of 2.9% as of Mar-23. Private sector banks including SFBs are one of the better performers in this category in terms of the asset quality.

Most of the SFBs involved in lending housing loans are in the affordable segment. SFBs have extensive knowledge of the borrower profile in the Tier 3 and Tier 4 cities and also provide a varied range of customer offerings. Most of the SFBs have transitioned from a microfinance led portfolio to a retail portfolio with various lending products including housing. SFBs have been able to play on their already extensive branch network, strong rural ground presence, technology led operations and low ticket size offerings. SFBs like private banks have asset quality in the range of 1-2%, lower than other players in the housing loan segment. In the longer term, CRISIL MI&A expects the housing segment to bounce back sharply on account of the following:

- Favourable government and regulatory support to promote housing loans industry
- Recovery in economic activity over the medium term
- Increased supply of affordable homes
- Rising demand for affordable homes as consumers increasingly work out of Tier 2/3/4 cities
- Work from home scenario pushing purchase decision for houses
- Ease of access to finance and rise in finance penetration

Player group wise GNPA in housing finance with ticket size between Rs 0.5 to 5 million



	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23
PSBs	1.5%	1.9%	2.1%	1.7%	2.3%	1.8%	2.0%	1.9%
Private Sector Banks	0.9%	1.2%	1.4%	1.2%	1.4%	2.2%	1.9%	1.7%
HFCs/NBFCs	0.7%	0.8%	1.1%	1.2%	2.2%	2.6%	2.8%	2.9%
Others	2.5%	4.2%	4.5%	5.4%	6.3%	7.5%	6.9%	6.1%

Note: Others include foreign banks, Data includes only Housing loan excluding PMAY for Fiscal 2023
Source: CRIF Highmark, CRISIL MI&A

The proportion of amounts written off as against the total sanctioned amount in overall home loans have stayed in the range of 0.1% to 0.4%, except Foreign Banks which saw a write off of 1.6% as of Mar-23. As against this, for loans with ticket size between Rs 0.5 to 5 million, these have been similar. We expect the write-off to be in similar range going ahead with marginal improvement seen in the next few years on account of advancement in technology and appraisal processes.

Regulatory framework

Risk weight rationalization of Housing Loan for real estate sector by RBI

Until October 2020, risk weightage was assigned on the basis of ticket size and loan to value (LTV) ratio. However, for all new housing loans sanctioned up to March 31, 2022, risk weights will be assigned only on the basis of LTV. While these risk weights will be applicable to all ticket sizes. Housing loans above Rs 7.5 million will benefit the most as risk weights for these loans will reduce from 50% to 35%.

Existing risk weight allocation

Outstanding loan	LTV ratio	Risk weight
<Rs 3.0 million	<80%	35%
	80-90%	50%
Rs 3.0-7. 5 million	<80%	35%
>Rs 7. 5 million	<75%	50%

Source: RBI, CRISIL MI&A

Revised risk weight allocation

LTV ratio	Risk weight
<80%	35%
80-90%	50%

Source: RBI, CRISIL MI&A

Change in PSL eligibility

The RBI has increased (notification released in June 2018) eligibility for PSL in housing loans with a view to converge PSL guidelines with the PMAY. The eligibility has been increased to Rs 3.5 million from Rs 2.8 million for metropolitan centres and to Rs 2.5 million from Rs 2 million for other centres. Overall cost of dwelling unit has been capped at Rs 4.5 million in metropolitan centres and at Rs 3 million in other centres.

Due to the reduction in risk weights for various home loan categories, banks have been able to lend more money with the existing capital, resulting in increased supply and greater competition among lenders. This has eventually resulted in lower lending rates for home loans. The lower provisioning requirement has also made more funds available, ultimately enabling a reduction in home loan rates.

SARFAESI Act

The SARFAESI Act sanctions three provisions to recover Non-Performing Assets

Securatisation	Asset Reconstruction	Security Interest Enforcement
• Refers to the process of drawing and converting of loans and other financial assets into marketable securities worth selling to investors	• Referes to the conversion of NPA into performing assets and must be done in accordance with the SARFAESI Act	• Under this, FIs are entitled to issue notices to the defaulting loan takers as well as guarantors, asking them to clear the sum of arrears within 60 days

Source: CRISIL MI&A

The objective of SARFAESI Act was to ensure efficient or rapid recovery of non-performing assets of banks and other financial institutions. It allows banks and other FIs to auction properties when the borrower fails to repay loans. Various amendments were made to the Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI) in 2015 and 2016 to strengthen the process and include a wider set of lenders. Access to the SARFAESI Act means financial institutions do not have to seek recourse through the tedious and time-consuming conventional legal route. This allows them to lend more freely and permits them to increase their exposure to the low-cost housing informal sector customers, who are mostly situated in small towns where legal action is costly and time-consuming. Further, the SARFAESI Act functions as a deterrent to defaulters.

Recent Changes in the Housing Finance Segment

Co lending model

Co-lending arrangement between Bank and NBFC / HFCs is to extend credit by joint contribution of funds at the facility level by both the lenders and sharing of risks and rewards. The revised Co-lending Model (CLM) put in place by RBI vide notification RBI/2020-21/63 dated 05 November 2020, with intension to improve the flow of credit to the unserved and underserved sector of the economy and make available funds to the ultimate beneficiary at an affordable cost, considering the lower cost of funds from banks and greater reach of the NBFCs / HFCs.

Under co-lending model banks are permitted to co-lend with all registered NBFCs (including HFCs) based on a prior agreement. The co-lending banks will take their share of the individual loans on a back-to-back basis in their books. However, NBFCs shall be required to retain a minimum of 20 per cent share of the individual loans on their books. Additionally, banks can claim priority sector status in respect of their share of credit while engaging in the CLM adhering to the specified conditions.

Recent co-lending agreements for HFCs

1. Axis Bank and Shriram Housing Finance announced a co-lending agreement to provide affordable housing loans to borrowers in rural and semi-urban areas.
2. Yes bank enters into co-lending agreement with Aadhar Housing Finance (2023)
3. India bulls Housing Finance Limited agreement with Yes Bank (July 2021)
4. IIFL Home Finance agreement with Punjab National Bank (September 2021) for offering home loans.
5. State Bank of India agreement with five housing finance companies i.e., PNB Housing Finance, IIFL Home Finance, Shriram Housing Finance, Edelweiss Housing Finance and Capri Global Housing Finance

The co-lending model has not seen a vast spread testing period and hence certain business nuances continue to exist like impact on asset quality of bank books and profitability for lenders in addition to the challenges stated earlier.

Shift in housing landscape post-merger of HDFC Bank and HDFC

The merger of HDFC Bank and HDFC in first half of fiscal 2024 is set to change the dynamics of the retail housing finance market. In fact, growth of HFCs between fiscals 2019 and 2021 was supported by high growth of HDFC due to its wide geographic reach and market penetration. At end-fiscal 2023 of the Rs 31.1 trillion housing finance market, the share of banks was ~60-63%, with the balance with HFCs/NBFCs.

Post-merger of the HDFC twins, the mortgage book of HDFC Bank will increase to an estimated 33% of the total book post-merger. Hence, following the merger of the two entities, the market share of banks vis-à-vis NBFC/HFC is expected to shift to 80:20 from 66:34, with banks having majority market share. Some of the key players after HDFC are LIC Housing Finance, Indiabulls Housing Finance, PNB Housing Finance and CanFin Homes. Further, in terms of HFCs/NBFCs, SFBs, other large players with favourable funding profile, strong parentage and capability to invest and expand into newer geographies are likely to gain market share from smaller players. Small Finance Banks with retail deposits and hence lower cost of funds as compared to HFCs/NBFCs will help gain market share in the housing loan segment. Further, this would also open up finding limits for Banks to lend to smaller HFCs to lend to the end customer.

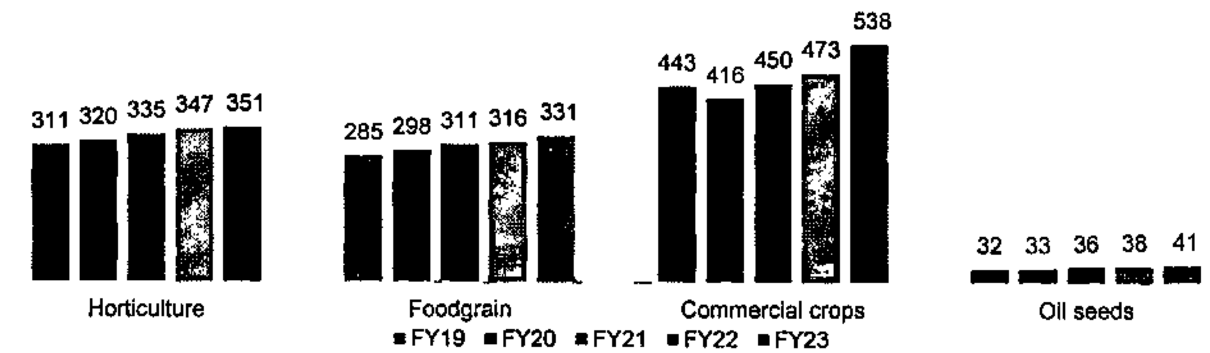
Agriculture loans

Brief overview of agriculture in India

India is the largest producer of pulses, milk and jute and ranks as the second largest producer of rice, wheat, sugarcane, cotton, fruit, vegetables, tea, farmed fish and sheep & goat meat. India is blessed with large arable land with 15 agro-climatic zones as defined by ICAR, having almost all types of weather conditions, soil types and capable of growing a variety of crops. While agricultures share in India's economy is just at 15.1% (Fiscal 2023[9] – GVA at constant price). Agriculture is the primary source of livelihood for about 58% of India's population. India's food grain production continues to grow which has made us net exporter of food grain. In fiscal 2023, agriculture ministry estimated that food grain production was 330.53 million tonnes which is higher by ~16% than last year on the back of better output of rice, maize and pulses along with good rain. As per the first estimate of fiscal 2023, horticulture crop production for the year is 350.87 million tonnes as compared to 347.18 million tonnes in fiscal 2022.

The Indian food processing industry is having huge growth potential and at the same time is increasing its contribution to world food trade every year. According to Ministry of Commerce and Industry, during fiscal 2022, exports of agricultural products (including marine and plantation products) have crossed USD 50 billion which is the highest level ever achieved for agricultural exports. During the current financial year (April 2022 - January 2023), exports of agricultural products have amounted to USD 43.37 billion registering a growth of 6.04% over same period last year.

Agriculture production in India (million tonnes)



*Note: Horticulture includes Fruits, Vegetables, Aromatics and Medicinal, Honey, Plantation crops and spices; Food grain includes Rice, Wheat, Bajra, Maize, Ragi, Small millets, Barley, Cereals, Tur, Gram, Urad, Moong, Lentil and Other Kharif and Rabi pulses; Commercial crops include Sugarcane, cotton, Jute and Mesta; Oil seeds includes Groundnut, Castorseed, Sesamum, Nigerseed, Soyabean, Sunflower, Rapeseed and Mustard, Linseed and Safflower; * Fiscal 2023 numbers are based on 3rd advance estimates for Food grain, commercial crops and oil seeds and 1st advance estimates for Horticulture crops*
Source: Ministry of Agriculture and Farmers Welfare

State-wise agriculture production (million tonnes - Fiscal 2022)

States	Horticulture	Food grains	Commercial Crops	Oil seeds	Total
Uttar Pradesh	41.6	56.1	177.4	1.2	276.3
Maharashtra	30.7	17.1	117.7	5.9	171.4
Karnataka	20.7	13.8	63.1	1.2	98.8
Madhya Pradesh	34.5	39.0	6.8	7.9	88.2
West Bengal	33.4	20.5	9.9	1.2	65.0

[9] *As per Second Advanced Estimates 2022-23*

Bihar	22.9	16.2	12.9	1.1	53.1
Andhra Pradesh	28.8	11.3	5.4	5.6	51.1
Tamil Nadu	20.8	12.0	15.8	1.0	49.6
Punjab	8.2	28.2	7.8	0.1	44.3
Rajasthan	4.7	21.0	2.8	8.4	36.9
Haryana	6.8	16.3	10.1	1.4	34.6
Telangana	4.8	15.1	8.9	0.7	29.5

Note: Data for 2021-22 are based on fourth advance estimates; Oilseeds data comprises total for nine oilseeds out of eleven in all; Commercial crops include Sugarcane, cotton, Jute and Mesta

Source: RBI, Ministry of Agriculture and Farmers Welfare, Government of India, CRISIL MI&A

Northern States contributes major of overall crop production in India. Uttar Pradesh, Punjab, Haryana and Rajasthan contribute more than 40% of overall food grain production in India. Alone Punjab state accounts for 9.7% of food grain production in India. Uttar Pradesh is largest producer of agriculture products; it alone contributes around 25% of overall country's agriculture production.

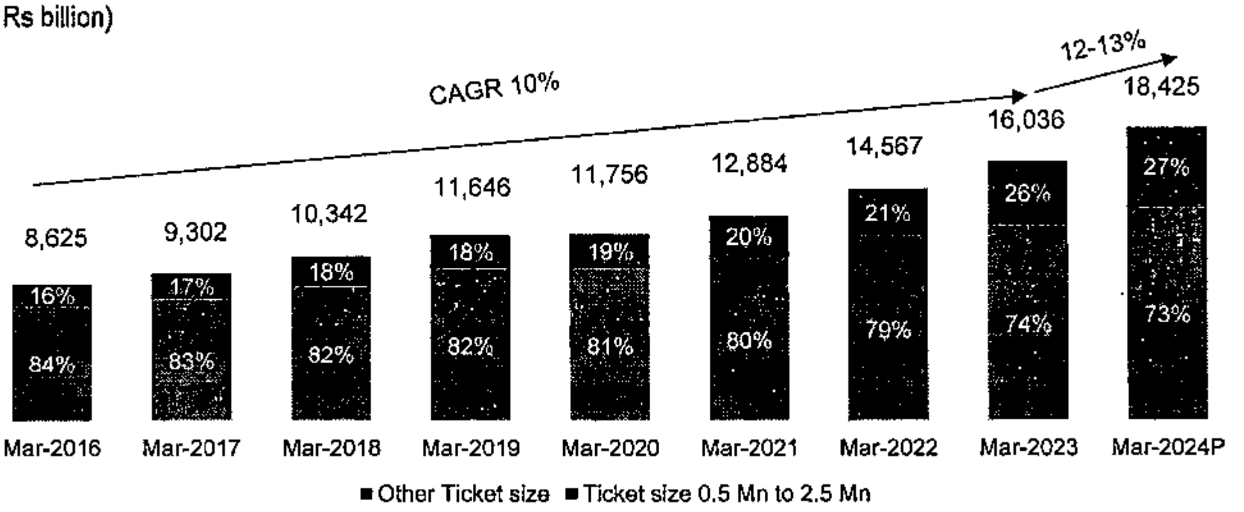
Agri-credit to grow at a healthy pace of 12-13% in fiscal 2024

Notwithstanding the impact of the pandemic, agriculture, and allied sectors (on the back of normal monsoon) supported the robust revival of Credit to agriculture in FY21. Agriculture credit has grown by ~11% for fiscal 2021 and by 13% in fiscal 2022. CRISIL MI&A estimates agriculture-credit to have grown at 10.5-11% in fiscal 2023 due to higher food-grain production. CRISIL MI&A expects agriculture-credit to grow at a healthy pace of 12-13% in fiscal 2024 due to increment in agriculture target and expected credit growth in agri-ancillary activities like food processing, setting up agri-clinics and agri-business centres.

Growth of credit in food processing (15% share in agriculture credit), warehouse receipts (2% share in agriculture-credit) and farm mechanization (4% share in agriculture credit) and inclusion of animal husbandry and fisheries under KCC to support credit growth. With considerable liquidity in the system and improving credit quality in the segment, and with expectation of better monsoon, lending to this segment is expected to increase with more and more small and marginal farmers having better access to credit via grass root organisations and direct reach of these entities. Thus, the lower ticket size segment is expected to grow faster.

Growth of agriculture credit over the years

(in Rs billion)



Note: P: Projected

Source: RBI, CRISIL MI&A

The agricultural sector in India receives its primary credit infusion from commercial banks, cooperative banks, small finance banks, and regional rural banks, which collectively drive the financial support into this sector. These entities play a pivotal role in contrast to the comparatively minor role that other lending organizations play in contributing credit. The significant contribution of these banking institutions highlights their central importance in sustaining the agricultural industry. Through the collaborative efforts of Rural Financial Institutions, the operational launch of Small Finance Banks, the backing of NABARD through the Long Term Rural Credit Fund (LTRCF) to RRBs and Rural Cooperative Banks, as well as NABARD's Area Development Scheme, the credit influx into the agricultural sector has consistently surpassed set targets for the last four consecutive years, which demonstrates the effectiveness of these initiatives in enhancing the flow of credit within the agricultural domain.

Over the past few years, Agricultural credit has witnessed a CAGR of 10% from Rs. 8,625 billion in fiscal 2016 to Rs. 16,036 billion in fiscal 2023. Most of the disbursed credit consists of smaller amounts. As of March 2023, the proportion of smaller ticket size credit constitutes 74%, whereas credit amounts ranging from Rs. 0.5 million to 2.5 million hold a share of 26%.

Regulations impacting agriculture loans

Government has taken various initiatives to double the farm income in recent years which has boosted the agriculture and agriculture finance industry.

1. Permitting private wholesale market and allowing direct purchase from farmers will reduce farmer's dependency on APMC Mandis this in would turn to boost agriculture sentiment.
2. Direct crop proceeds to farmers will help to mitigate the exploitation of farmers at Mandi which in would turn better income in hands of farmers.
3. Rs. 40 billion was allocated towards implementing Pradhan Mantri Krishi Sinchayee Yojana in order to provide irrigation facilities to each farmer and improve water use efficiency to achieve the motto of "Per drop more crop".
4. Under Union budgetary allocation 2021-22, Government has allocated Rs.650 billion for Pradhan Mantri Kisan Samman Nidhi Yojana under which farmers get direct transfer benefit in their respective accounts.
5. In July 2021 and August 2021, Punjab and Tamil Nadu has announced farmers loan waiver of Rs 17.1 billion and Rs. 121.1 billion of crop loans respectively. This will create additional space for fresh lending in respective states.
6. In June 2021, Government has released funds for farm mechanisation such as establishment of custom hiring centres, farm machinery bank and high-tech hubs in different states.
7. In November 2020, government has inaugurated Mega food park in Punjab which is spread over a 55 acre of land.
8. NABARD has set-up a subsidiary to provide credit guarantee for loans related to agriculture and rural development.

9. Support provided by MSP across various products

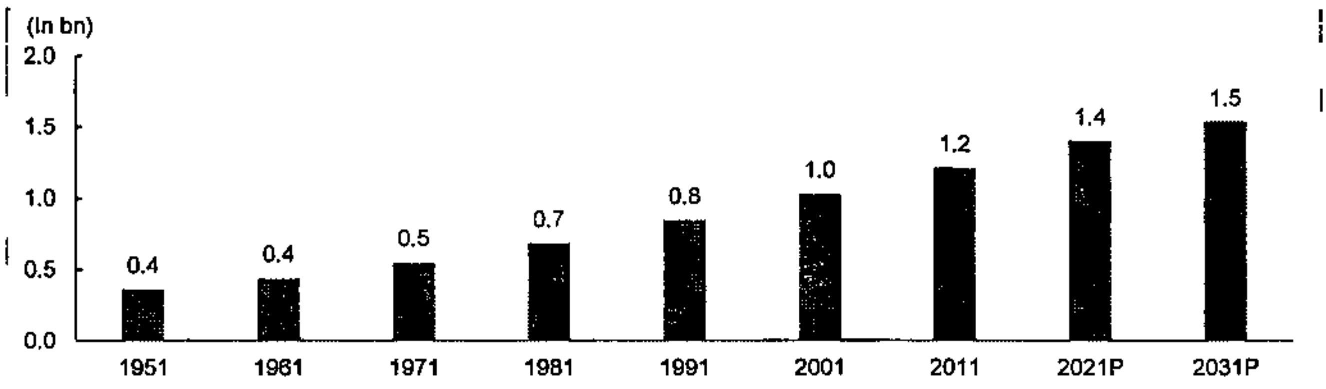
10. As per the Farm Services Act, 2020, a farmer may enter into a Farming Agreement for the sale of any farming produce before the actual production takes place. This helps farmers in better crop planning, risk mitigation and reduced dependence on middlemen.

Growth drivers for agriculture loans

India has the world's largest population

As per Census 2011, India's population was ~1.2 billion, and comprised nearly 245 million households. The population, which grew nearly 18% between 2001 and 2011, is expected to increase about 11% between 2011 and 2021, to 1.4 billion. The population is expected to reach 1.5 billion by the end of 2031 and number of households are expected to reach ~376 million by the same date. India accounts for 18% of world's population with increase population, the need for various agricultural products has increased significantly. The farmers have adopted various technologies, methods and diversified to various food needs like dairy, fisheries and livestock. The adoption of new methods and technologies will continue to increase demand for agriculture finance in country.

India's population growth trajectory



Note: P: Projected
Source: United Nations Department of Economic and Social affairs, CRISIL MI&A

Increasing per capita GDP

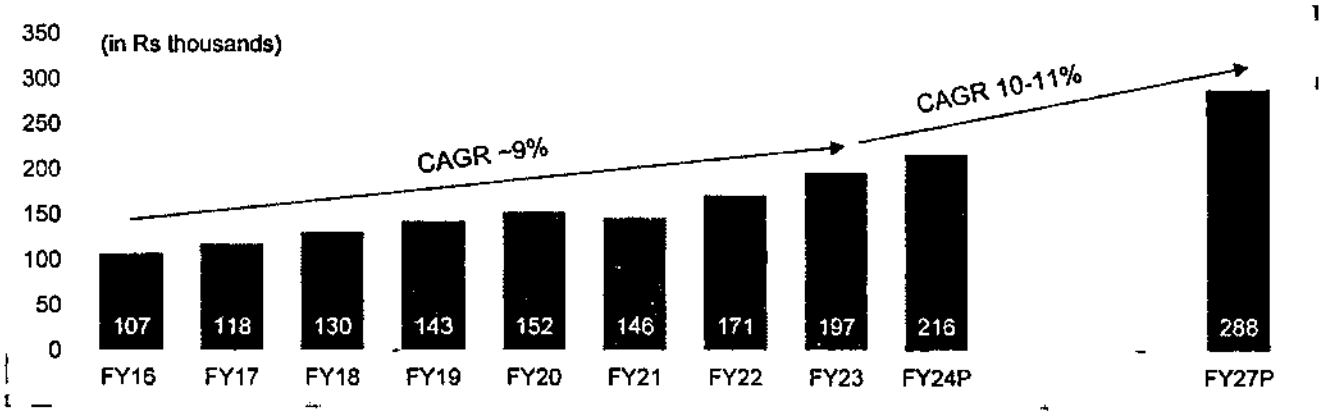
In Fiscal 2023, India's per capita income expanded by 6.0%. As per IMF estimates, India's per capita income (at constant prices) is expected to grow at 5% compound annual growth rate (CAGR) from Fiscal 2023 to Fiscal 2026.

	Level in FY2023^ (₹ '000)		Growth at constant prices (%)										
Per capita income	Current prices	Constant prices	FY14	FY15	FY16	FY17	FY18	FY19	FY20	FY21	FY22	FY23	FY26P
	172	98	4.6	6.2	6.7	6.8	5.7	5.8	2.9	-7.6	7.6	6.0	5.3*

Note – P: Projected, (^) Per Capita NNI as per second advanced estimates of national income, 2022-23; (*) – 3-year CAGR growth (FY2023-FY2026), as per IMF estimates of April 2023
Source – Ministry of Statistics and Program Implementation (MOSPI), International Monetary Fund (IMF), CRISIL MI&A

Trend in Nominal GDP per capita (at current prices)

As per IMF's estimates, India's nominal GDP per capita (at current prices) is projected to increase at a CAGR of 10-11% from FY2023 to FY2027.



Notes: P- Projected. FY23 estimates based on second advanced estimates by Ministry of Statistics and Program Implementation FY24 – FY27 Projections based on IMF – World Economic Outlook (April 2023); Source: MOSPI, IMF, CRISIL MI&A

The rise in disposable income of consumers is driving agriculture market in both terms of producer and consumer. This has pushed farmers to invest more in agriculture infrastructure such as quality seeds, equipment's, fertilizers, irrigation facilities, warehousing, cold storage, etc. the need to improve agriculture infrastructure will push the agriculture finance in country.

Government support to improve agriculture sector

Government of India has taken various steps directly and indirectly to boost agriculture sector in India. Some of the steps as announced in the Union Budget (2023-24) are as follows:

1. Government had fixed target disbursement of ₹18 lakh crore as the target for 2022-23. For the current financial year, the Government announced an 11% hike in agriculture credit to ₹20 lakh crore with focus on animal husbandry, dairy and fisheries.
2. The government has also announced a new sub-scheme of Pradhan Mantri Matsya Sampada Yojana with a targeted investment of Rs. 6,000 crores to improve supply chain and help micro and small enterprises to expand the target market.
3. For promoting financial inclusivity and to cover small and marginal farmers in the formal credit system, RBI has raised the limit for collateral free agriculture loans.
4. Government in the union budget had also proposed an Agriculture Accelerator Fund to encourage agri-tech start-ups.
5. Government has also allocated Rs. 2,200 crores under Aatmanirbhar Horticulture Plant Programme to support high value horticultural crops.
6. The Government has also started the development of Agriculture Investment Portal names "KrishiNivesh" in December 2022 and it is developed as an integrated and centralized one stop portal for all Agri-investors and help them with various government schemes.

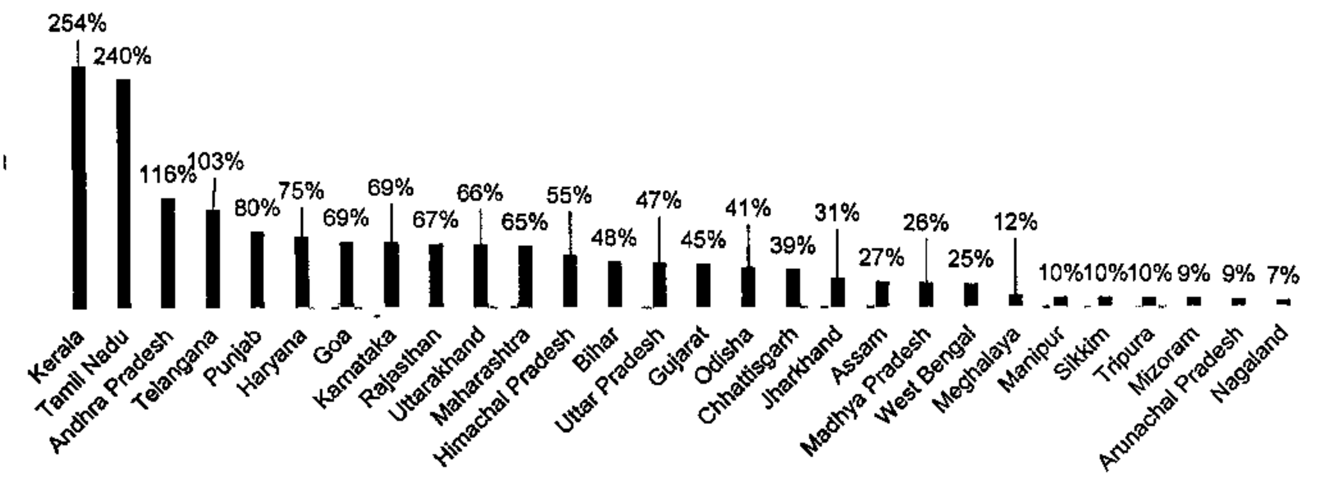
Contract farming

The Government of India has permitted contract farming which has created a positive impact on agriculture sector. This will increase private sector investment in the sector also it will enhance stable income in the hands of farmer which would in turn give financial institution comfort to provide enhanced loan volume and better Interest rates to farmers.

Agriculture loan penetration

In terms of agriculture loan penetration, agriculture loans are highly concentrated towards top six states which has agriculture penetration more than pan India average. India has merely ~36% of agriculture penetration as of Fiscal 2023 which indicates huge growth potential for agriculture finance. Tamil Nadu and Kerala states has highest agriculture loan penetration in country which has credit outstanding close to the overall agriculture GSVA of respective states.

State-wise Agriculture Loan penetration in India (Fiscal 2023)



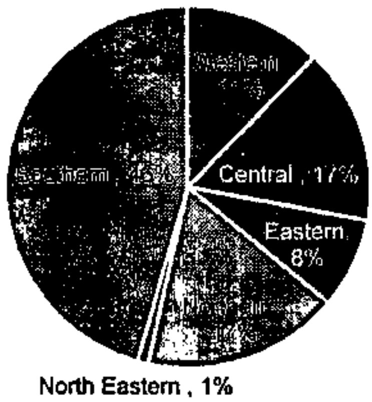
Note: We have not considered Delhi, Chandigarh, Puducherry as they are outliers; Agriculture penetration = Agriculture Credit Outstanding as of fiscal 2023 / Latest available agriculture GSVA of states; Source: RBI, CRISIL MI&A

Region/ State wise analysis (Overall)

Region-wise split of agriculture loans segment

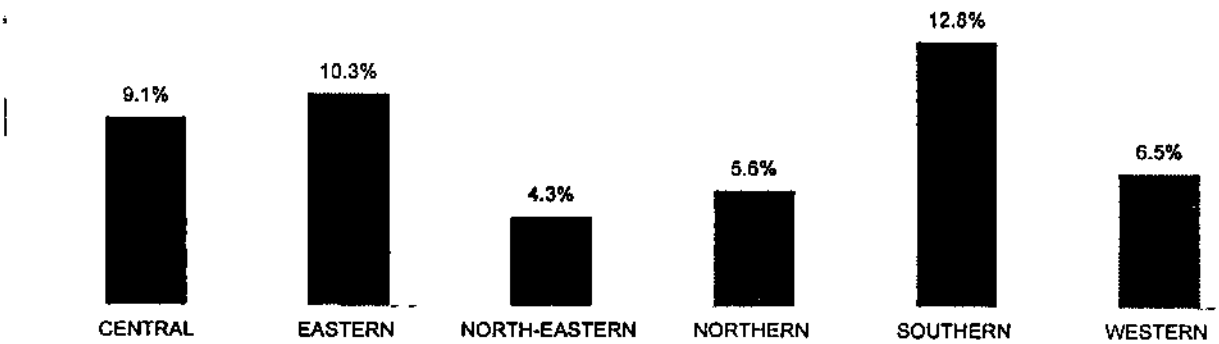
Eastern region is underpenetrated and accounts for a meagre 8% share, whereas southern region account for approximately 46% of outstanding loans in the agriculture segment. North region alone accounts for 17% of outstanding loans in agriculture segment.

Northern Region accounts for ~17% of the outstanding loans as of March 2023



Source: RBI, CRISIL MI&A

Growth in loans outstanding (Overall) agriculture segment (Mar-18 to Mar-23 CAGR)



Source: RBI, CRISIL MI&A

States like Punjab, Uttar Pradesh, Haryana, and Rajasthan accounts for 22% of overall agriculture credit (Overall agriculture Loans) as of fiscal 2023

In terms of agriculture produce, Punjab, Uttar Pradesh, Haryana, and Rajasthan accounts for 35% of India's total agriculture produce, however, these states contribute only 22% in terms of agriculture credit. This indicates the higher scope of credit penetration in this region which is currently not proportionate to the produce. Uttar Pradesh which contributes about 24% of overall agriculture production in India, has an agriculture credit share of only about 8%.

State-wise agriculture credit (Overall)

Region	State	FY17 (Rs billion)	FY23 (Rs billion)	Growth CAGR (FY17-23)	Share in Region FY-23	Share in India - FY23
Central	Chhattisgarh	104	164	8%	6%	1%
	Madhya Pradesh	497	933	11%	37%	6%
	Uttarakhand	77	89	2%	3%	1%
	Uttar Pradesh	886	1,361	7%	53%	8%
	Central Region Total	1,564	2,546	9%	100%	17%
Eastern	Andamans & Nicobars	1	2	16%	0%	0%
	Bihar	232	433	11%	35%	3%
	Jharkhand	53	105	12%	8%	1%
	Odisha	119	282	15%	23%	2%

	Sikkim	1	3	20%	0%	0%
	West Bengal	257	411	8%	33%	3%
	Eastern Region Total	663	1,237	10%	100%	8%
Northern	Chandigarh	21	15	-5%	1%	0%
	Delhi	202	459	15%	16%	3%
	Himachal Pradesh	51	67	5%	2%	0%
	Haryana	372	526	6%	18%	3%
	Jammu & Kashmir	50	92	11%	3%	1%
	Punjab	617	671	1%	23%	4%
	Rajasthan	621	1,033	9%	36%	6%
	Northern Region Total	1,935	2,866	6%	100%	17%
North Eastern	Arunachal Pradesh	2	3	7%	2%	0%
	Assam	87	117	5%	78%	1%
	Manipur	4	6	7%	4%	0%
	Meghalaya	6	5	-5%	3%	0%
	Mizoram	1	2	10%	1%	0%
	Nagaland	3	3	2%	2%	0%
	Tripura	14	14	0%	9%	0%
	North Eastern Region Total	116	149	4%	100%	1%
Southern	Andhra Pradesh	777	1,797	15%	24%	11%
	Karnataka	764	1,202	8%	16%	7%
	Kerala	445	898	12%	12%	6%
	Lakshadweep	-	0	NA	0%	0%
	Puducherry	17	39	15%	1%	0%
	Tamil Nadu	1,162	2,692	15%	36%	17%
	Telangana	398	902	15%	12%	6%
	Southern Region Total	3,563	7,530	13%	100%	46%
Western	Dadra & Nagar Haveli and Daman & Diu	1	2	13%	0%	0%
	Goa	7	14	13%	1%	0%
	Gujarat	457	729	8%	37%	4%
	Maharashtra	997	1,233	4%	62%	8%
	Western Region Total	1,462	1,979	7%	100%	11%
	Grand total	9,302	16,306	10%	NA	100%

Source: RBI, CRISIL MI&A

Segment asset quality

Decline in agriculture NPA and improvement in asset quality in fiscal 2023

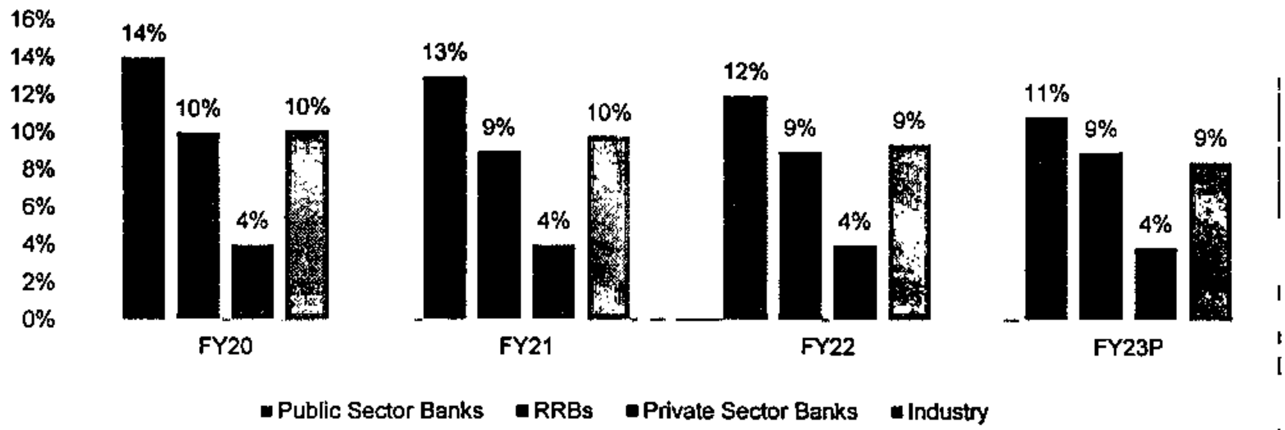
Overall, NPAs have declined in FY21, since the moratorium that ended in Aug 30. Repayments have started and most of the recoveries have been done. Overall Agri-NPA has declined in FY22 to 9.4% levels from 9.8% levels in FY21 owing to initiatives like One Time Settlement of loans by State Bank of India. Further, increase in profits has supported farmers to repay loans on time.

GNPA is estimated to be ~4% for private sector banks and ~12% for PSBs in fiscal 2022 after having increased in the past 3 years. Private sector banks on account of selective lending have been able to keep it lower in comparison to the PSBs. Even the RRBs are facing a similar issue in terms of the asset quality for these loans and its GNPA levels are ~9% as of fiscal 2022.

CRISIL MI&A estimates Agri-NPA levels to have declined in FY23 to 8.5-8.7% levels owing to improvement in collection efficiency and schemes like "One Time Settlement" of loans by State Bank of India. Banks like SBI have increased their share in Agri-gold loans which is expected to lower Agri-NPA.

For the ease of farmers, government has brought in E-procurement of crops in which farmers can receive crop proceeds directly in their account. The e-procurement requires farmers to register their mobile numbers, crop details, acreage and time of harvest through online or through the E-seva centres. This will help farmers to reduce the cost of sale by avoiding exploitation at the hands of middlemen and procurement agencies. This in turn will help to reduce the NPA levels in agriculture segment.

Player group wise Agri-NPA trends



Note: For NPA computation banks considered are SBI, PNB, BOI, BOB, Canara Bank, HDFC, Axis Bank, Kotak Mahindra Bank, Yes Bank, ICICI Bank.; P: Projected
Source: RBI, CRISIL MI&A

Region-wise risk and opportunity comparison for agriculture lending

Northern states have traditionally seen better yields which is expected to continue and on account of the same, are expected to fare better in terms of opportunity going ahead. They see a higher per hectare profitability on account of the same. Presence of lower proportion of small and marginal farmers in the region, higher penetration of horticulture crops across some states in the northern region are some of the major reasons which are expected to drive lending in the region and make this an opportune region in terms of lending going ahead.

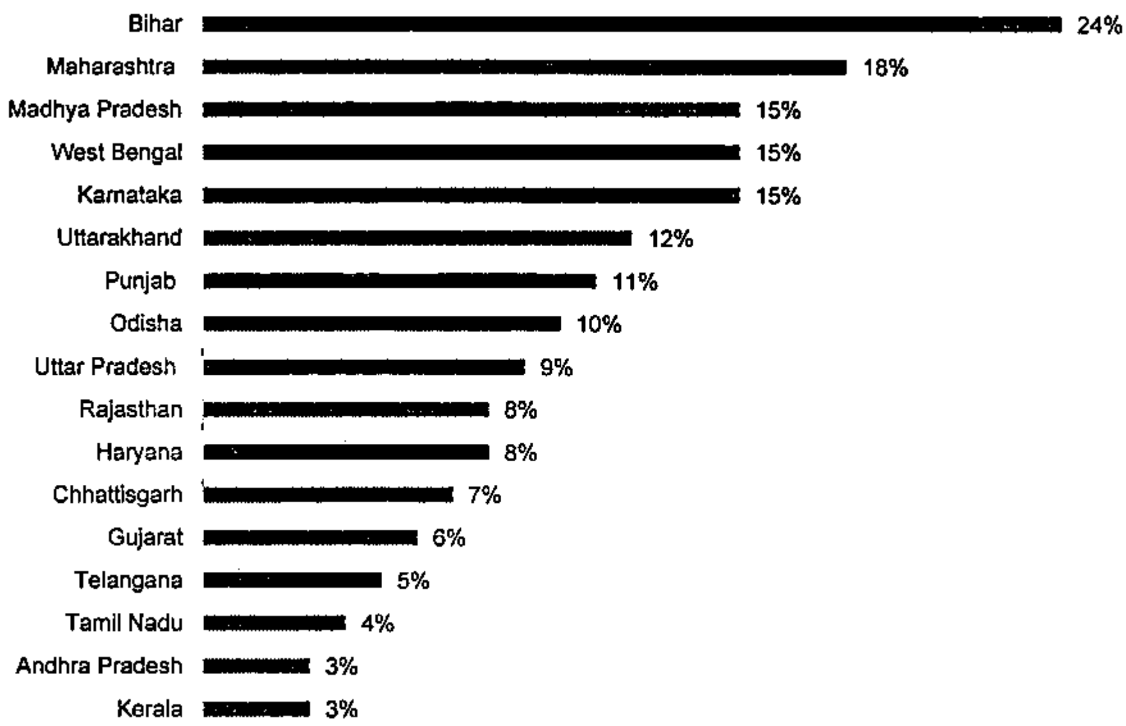
Southern states provide a healthy balance of opportunity and risk despite low cropping and irrigation intensity, owing to low non-performing asset (NPA) levels (barring Karnataka, all have NPA levels <5-6%) and high credit penetration. Also, there is a shift towards mechanisation and allied activities, which will require higher disbursals.

High NPAs in Bihar (24%), Odisha (10%), West Bengal (15%) is expected to impact the credit offtake and hence make them unattractive. While in the western region, Maharashtra seems least lucrative (NPA levels 18%) from a lending perspective, Gujarat (NPA levels 6%) stands out amongst the most lucrative.

Farmers with higher income levels tend to exhibit lower chances of becoming NPAs, in contrast to those with lower or moderate incomes. This connection underscores the significance of understanding the relationship between agricultural earnings and loan repayment behaviour. Top three Indian states in terms of average monthly income per agricultural household (during the agricultural year July 2018 June 2019) are Meghalaya (Rs. 29,348), Punjab (Rs.

26,701) and Haryana (Rs. 22,841) whereas the bottom three states are West Bengal (Rs. 6,762), Odisha (Rs. 5,112) and Jharkhand (Rs. 4,895)

State-wise GNPA levels (Fiscal 2021)



Source: RBI, CRISIL MI&A

With banks being the largest and most trusted segment amongst the farmers, dominance of RRBs and local area banks in the rural region across some areas, the acquaintance on being present on the ground in some regions and through the grass roots organisations in others, banks are estimated to remain a dominant segment in this sector. Additionally, the transmission of various government schemes through banks will further keep the relationship with farmers constant and hence will dominate non-banks in this segment.

Peer benchmarking

In this section, we have compared Capital SFB with established SFBs in India based on the latest available data for half year ended fiscal 2024. Capital SFB already had its presence across the retail liability and asset side on account of operating as a local area bank before converting to a small finance bank. As a result of the same, its retail franchise and reach had already been established across the current and savings deposits as well as retail term deposits placing it in good stead as against other small finance banks. For Capital SFB, the base is already present and further improvements on top of the same is helping it grow faster.

In terms of the retail lending operations as well, Capital SFB is well diversified with product knowledge and experience across various asset classes. In comparison, SFBs which are primarily focused on MFI lending, could find it more difficult to penetrate into other products as the knowledge has to be built from scratch and the entire operational cost has to be borne to be set up from base across asset classes. Thus, for Capital SFB the products, systems and processes are already in place since it had been operating as a local area bank and is in a good position to scale up its operations across different geographies. The below analysis is done on the reported numbers for half year ended fiscal 2024.

Capital SFB has the lowest cost of funds amongst comparable SFB players

Capital SFB's cost of funds at 5.79% was the lowest amongst comparable SFBs as of half year ended fiscal 2024. AU SFB had the second lowest cost of funds at 6.36% as of half year ended fiscal 2024.

SFBs players as of end of H1 Fiscal 2024

Rs million	Net Advances (H1FY24)	Net Advances CAGR (FY20-H1FY24)	Deposit (H1FY24)	Banking outlets*** (H1FY24)	Number of employees (H1FY24)	Capital adequacy ratio (CAR)	Cost of funds (%)$
AU SFB	641,685	28.07%	757,429	1,042	28,500	22.43%	6.36%
Equitas SFB	287,679	23.54%	308,395	956	21,862	21.33%	7.16%
Ujjivan SFB	243,250	16.99%	291,393	700	21,040	25.19%	6.96%
Jana SFB	210,090	23.77%	189,370	754*	18,184*	17.50%	7.48%
ESAF SFB	149,018	26.49%	174,163	700	5,505	20.57%	6.97%
Utkarsh SFB	140,804	25.94%	139,646	871	16,364	24.82%	7.68%
Fincare SFB	104,695	24.84%	94,532	1,231*	14,804*	20.73%	7.82%
Suryoday SFB	67,210	20.18%	63,884	635	6,989	30.23%	6.85%
Capital SFB	**57,842**	**17.31%**	**70,003**	**173**	**1,838**	**20.72%**	**5.79%**

*Note: (1) Players are arranged in descending order of Net Advances as of half year ended Fiscal 2024, (2) ***: Banking outlets including bank branches, ultra-small branches and asset centres as reported by the players, (3) $: Cost of funds is calculated as interest expense divided by total borrowings (borrowing + deposits), (4) *: Data as of Fiscal 2023*

Source: Company reports, CRISIL MI&A

Deposit details of SFBs and other players as of H1 fiscal 2024

SFBs	Proportion of deposit to total loan book (%)	Proportion of deposit in total borrowing (%)	Retail deposits (% of deposits)	CASA (% of deposits)	Retail TD (% of deposits)	Bulk TD (% of deposits)
AU SFB	118.04%	93.41%	65.64%	33.89%	31.75%	33.05%
Equitas SFB	107.20%	92.55%	74.09%	33.56%	40.53%	25.91%
Ujjivan SFB	119.79%	88.64%	64.58%	24.06%	40.52%	34.09%
Jana SFB	90.14%	78.09%	70.22%*	20.21%*	50.01%*	29.67%*
ESAF SFB	116.87%	87.70%	88.91%	18.04%	70.87%	11.09%
Utkarsh SFB	99.18%	88.01%	66.00%	20.00%	46.00%	34.00%
Fincare SFB	90.29%	73.92%	76.60%	24.70%	51.90%	23.40%
Suryoday SFB	95.05%	72.04%	77.59%	15.72%	61.88%	22.42%
Capital SFB	**121.02%**	**92.44%**	**93.59%**	**37.76%**	**55.83%**	**6.41%**

Note: 1) Retail deposits include CASA and retail term deposits. Bulk deposits include institutional deposits. 2) CASA ratio is calculated based on overall deposits 3) (*) Data as of Fiscal 2023

Source: Company reports, CRISIL MI&A

Capital SFB has the highest proportion of retail deposits to total deposits amongst comparable SFBs

At the end of half year ended fiscal 2024, Capital SFB had the highest proportion of retail deposits at 93.59% depicting the strength of the company's retail franchise and its ability to raise deposits while offering the lowest rates on savings bank deposits and retail term deposits amongst comparable SFBs. Capital SFB is followed by ESAF SFB (88.91%) and Suryoday SFB (77.59%).

Capital SFB has the highest proportion of CASA deposit to total deposits amongst comparable SFBs

At the end of half year ended fiscal 2024, Capital SFB had the highest proportion of CASA deposits amongst comparable SFBs at 37.76%, followed by Fincare SFB (24.70%) and Ujjivan SFB (24.06%).

Capital SFB had the third highest proportion of deposit in overall borrowing amongst comparable SFBs despite offering lowest interest rates

In terms of proportion of deposit in overall borrowings, Capital SFB had the third highest proportion of deposits in overall borrowing at 92.44% as of half year ended fiscal 2024. AU SFB and Equitas SFB had the highest and second highest proportion of deposit in overall borrowing at 93.41% and 92.55% respectively as of half year ended fiscal 2024. Capital SFB is the lowest interest paying SFB where-in its rate of interest for retail term deposits inches up to only 7.60% whereas others offer a higher rate across some of the tenors in retail deposits. Capital SFB offers saving bank deposit rate of 3.50% irrespective of the amount of saving deposit as compared to other banks which have different saving bank deposit rates for various buckets.

Capital SFB had the highest proportion of deposit to total loan book amongst comparable SFBs

At the end of half year ended fiscal 2024, Capital SFB had the highest proportion of deposit to total loan book ratio at 121.02% followed by Ujjivan SFB (119.79%) and AU SFB (118.04%). Capital SFB has the highest proportion of deposit to total loan book ratio despite offering lowest interest rate as compared to other comparable SFBs.

Capital SFB has the most granular deposit base as compared to other comparable SFBs

At end of half year ended fiscal 2024, Capital SFB had most granular deposit base with concentration of top 20 depositors accounting to 6.68% of overall deposits. It is followed by ESAF SFB at 9.90%. This shows that Capital SFB has the lowest concentration risk in terms of deposits.

Capital SFB has lowest cost of deposit amongst comparable SFBs

At end of half year ended fiscal 2024, Capital SFB had lowest cost of deposit (4.94%) followed by AU SFB (5.48%) and Ujjivan SFB (6.00%).

Deposit details of SFBs as of H1 fiscal 2024

	Cost of deposits$	Highest rate of interest on TD**	Highest Interest rate offered on standard savings account***	Concentration of top 20 accounts in total deposits
AU SFB	5.48%*	8.00%	7.25%	14.47%*
Equitas SFB	6.03%	8.50%	7.80%	16.21%*
Ujjivan SFB	6.00%*	8.25%	7.50%	18.29%*
Jana SFB	6.71%*	8.50%	7.55%	14.58%*
ESAF SFB	6.10%*	8.25%	7.50%	9.90%
Utkarsh SFB	6.60%*	8.50%	7.50%	18.00%
Fincare SFB	6.48%*	8.61%	7.50%	18.97%*
Suryoday SFB	6.09%*	8.65%	7.75%	24.30%*
Capital SFB	**4.94*%**	**7.60%**	**3.50%**	**6.68%**

*Note: **Highest rate of interest on TD is considered as the maximum rate of interest offered by the player across all tenor of TDs, *** Highest Interest Rate for Savings Account at the end of December 2023, ($) Cost of deposits is calculated by interest paid on deposits divided by average deposits; (*) Data as of Fiscal 2023*
Source: Company reports, CRISIL MI&A

Capital SFB has highest proportion of secured lending amongst comparable SFBs.

99.85% of Capital SFBs AUM is secured as of half year ended fiscal 2024 which is the highest amongst comparable SFBs. AU SFB had the next highest secured AUM (%) at 91.00% as of half year ended fiscal 2024. Capital SFB, whose majority portfolio is secured is also closely comparable with SFBs like AU SFB whose major focus is also towards Small Business Loans. Other SFBs are still shifting away from microfinance book by diversifying into newer product segments.

Lending details of SFBs as of H1 fiscal 2024

(%)	Secured AUM	NBFC lending	Concentration of top 20 accounts in total Advances	Collection efficiency
AU SFB	91.00%	3.92%	2.32%*	106.00%**
Equitas SFB	79.99%*	3.34%	3.87%*	100.00%**
Ujjivan SFB	27.00%	4.91%(1)	3.73%*	99.00%
Jana SFB	54.70%*	7.77%*	6.23%*	90.00%*
ESAF SFB	24.65%*	4.67%(2)	3.44%*	95.00%**
Utkarsh SFB	34.00%	11.23%(3)	4.90%*	100.00%**
Fincare SFB	44.29%*	1.77%(4)*	2.13%*	97.00%**

Suryoday SFB	39.00%*	10.82%[(5)]	9.66%*	102.00%*
Capital SFB	**99.85%**	**8.42%[(6)]$**	**5.38%**	**99.00%***

*Note: Collection efficiency is as reported by each player, collection efficiency is typically calculated as a percentage of the total collections (after adjustments with respect to collections due towards arrear demands and amount collected in advance) to the total amount due for collection for the month, *Data as of fiscal 2023, $ Data as of June 2023, ** Data as of fiscal 2022.*

(1) *Loans to Financial Institutions Group*
(2) *Loans to Financial Institutions and MSME loans*
(3) *Loans termed as Wholesale Lending*
(4) *Loans termed as Institutional Finance loan*
(5) *Loans to Financial Intermediary Groups*
(6) *Loans to Large Corporates*

Source: Company reports, CRISIL MI&A

Capital SFB had the highest liquidity on its balance sheet amongst comparable SFBs

Capital SFB had the highest proportion of cash and bank balances as a % of total assets on its balance sheet as of half year ended Fiscal 2024 indicating that it has low dependency on external funds or borrowing to cater to its short to medium term assets side needs and can deploy the excess liquidity for growth in its loan book.,

Liquidity details of SFBs

(%)	Liquidity – cash and bank balance to total assets As of Fiscal 2023	Liquidity – cash and bank balance to total assets As of H1 Fiscal 2024
AU SFB	10.45%	6.52%
Equitas SFB	3.56%	3.30%
Ujjivan SFB	7.45%	5.83%
Jana SFB	8.14%	3.60%
ESAF SFB	3.79%	5.12%
Utkarsh SFB	13.16%	8.33%
Fincare SFB	6.19%	5.58%
Suryoday SFB	8.45%	6.69%
Capital SFB	**11.02%**	**10.16%**

Note: Liquidity is calculated as cash and bank balances divided by total assets

Source: Company reports, CRISIL MI&A

Profitability of SFB players

Capital SFB had the lowest Opex (as % of average assets) amongst comparable SFBs

Capital SFB had lowest operating cost of 2.95% (as a % of average assets) followed by AU SFB (4.39%), Ujjivan SFB (5.78%) and Jana SFB (5.83%) as of half year ended fiscal 2024.

Profitability of SFB players for half year ended fiscal 2024

Players	Yield on advances* (%)	Cost of funds (%)**	Advances to Total Assets (%)	Gross Spread (%)	NIMs (%)	Opex (% of average assets)	Opex (% of average advances)	Cost to income (%)
AU SFB	13.30%	6.36%	66.86%	6.93%	5.36%	4.39%	6.66%	63.11%
Equitas SFB	17.35%	7.16%	71.69%	10.19%	8.04%	6.49%	8.94%	65.49%
Ujjivan SFB	20.55%	6.96%	62.89%	13.59%	8.98%	5.78%	9.13%	52.51%
Jana SFB	19.23%	7.48%	74.75%	11.75%	7.35%	5.83%	8.08%	58.48%
ESAF SFB	23.24%	6.97%	66.62%	16.27%	11.10%	7.17%	10.60%	56.40%
Utkarsh SFB	19.56%	7.68%	71.63%	11.87%	8.91%	6.21%	8.87%	56.73%
Fincare SFB	22.71%	7.82%	70.85%	14.89%	9.20%	8.03%	11.41%	70.53%

Suryoday SFB	20.08%	6.85%	61.91%	13.24%	8.61%	6.51%	10.59%	61.46%
Capital SFB	10.88%	5.79%	68.94%	5.09%	4.17%	2.95%	4.45%	62.35%

*Note: ** Cost of funds is calculated on total borrowings (borrowing + deposits), Gross Spread is calculated as difference in yields and cost of funds, * Yield on advances calculated as interest on loans divided by average of net advances, Yield on advances, cost of funds, gross spread, NIMs, Opex (% of average assets) and Opex (% of average advances) are annualized numbers.*

Source: Company reports, CRISIL MI&A

Capital SFB has been growing consistently for the past two fiscals amongst comparable SFBs

Capital SFB is the only SFB amongst comparable SFBs to show an increasing trend in Profit After Tax for both Fiscal 2022 and Fiscal 2023. Capital SFB is also the only SFB amongst comparable SFBs to witness a growth in RoA and RoE for Fiscal 2022 whereas all other peers' RoA had decreased in Fiscal 2022. Capital SFB has grown consistently over the past two fiscals as against other peers which showed degrowth in RoA and RoE in Fiscal 2022 before expanding by a considerable margin in Fiscal 2023 depicting its consistent outperformance against comparable SFBs.

Capital SFB had the sixth highest Return on Equity (RoE) as of half year ended fiscal 2024 amongst comparable SFBs

In terms of RoE, Fincare SFB had the highest return on equity as of H1 FY2024 at 30.86% followed by Ujjivan SFB (29.38%) and ESAF SFB (29.29%). Capital Small Finance Bank had the sixth highest RoE at 16.45% as of half year ended fiscal 2024. In terms of Return on Assets, Ujjivan SFB had the highest RoA at 3.62% followed by Fincare Small Finance Bank (3.21%) and ESAF Small Finance Bank (2.54%) as of half year ended fiscal 2024. Capital Small Finance Bank had an RoA of 1.33% as of half year ended fiscal 2024.

Capital SFB also had the third highest average RoE from Fiscal 2021 to H1 Fiscal 2024 at 13.91%. AU SFB had the highest average RoE at 17.08% during the same time interval. Capital SFB is the only SFB which has shown a growth in RoA in Fiscal 2022 and Fiscal 2023 amongst comparable SFBs.

Trend of Profit After Tax of SFB players

Players	Profit After Tax (in Rs. million)					
	FY21	FY22	FY23	H1FY24	% Change in FY22	% Change in FY23
AU SFB	11,707	11,300	14,279	7,887	-3.47%	26.37%
Equitas SFB	3,842	2,807	5,736	3,893	-26.94%	104.32%
Ujjivan SFB	83	(4,146)	10,999	6,518	-5094.94%	365.31%
Jana SFB	843	54	2,560	2,132	-93.59%	4635.12%
ESAF SFB	1,054	547	3,023	2,701	-48.07%	452.40%
Utkarsh SFB	1,118	615	4,045	2,219	-45.04%	558.14%
Fincare SFB	1,131	89	1,036	2,189	-92.16%	1068.43%
Suryoday SFB	119	(930)	777	979	-884.40%	183.52%
Capital SFB	408	626	936	544	53.43%	49.59%

Source: Company reports, CRISIL MI&A

Trend of RoA of SFB players

Players	RoA							
	FY21	FY22	FY23	H1FY24	Avg (FY21-H1FY24)	Change in FY22	Change in FY23	Change in H1FY24
AU SFB	2.50%	1.87%	1.79%	1.69%	1.96%	-0.62%	-0.08%	-0.10%

Equitas SFB	1.75%	1.09%	1.85%	2.07%	1.69%	-0.66%	0.77%	0.22%
Ujjivan SFB	0.04%	-1.89%	3.86%	3.62%	1.41%	-1.93%	5.75%	-0.24%
Jana SFB	0.51%	0.03%	1.12%	1.59%	0.81%	-0.48%	1.09%	0.47%
ESAF SFB	0.97%	0.36%	1.59%	2.54%	1.37%	-0.60%	1.23%	0.95%
Utkarsh SFB	1.04%	0.45%	2.37%	2.29%	1.54%	-0.59%	1.91%	-0.08%
Fincare SFB	1.50%	0.09%	0.89%	3.21%	1.42%	-1.41%	0.79%	2.32%
Suryoday SFB	0.20%	-1.25%	0.86%	1.89%	0.43%	-1.45%	2.11%	1.03%
Capital SFB	**0.70%**	**0.93%**	**1.24%**	**1.33%**	**1.05%**	**0.23%**	**0.31%**	**0.09%**

Note: RoA (%) numbers are annualized as of half year ended Fiscal 2024. Change in FY22 calculated as RoA in Fiscal 2022 minus RoA in Fiscal 2021, Change in FY23 calculated as RoA in Fiscal 2023 minus RoA in Fiscal 2022, Change in H1FY24 calculated as RoA in H1 Fiscal 2024 minus RoA in Fiscal 2023

Source: Company reports, CRISIL MI&A

Trend of RoE of SFB players

Players	RoE							
	FY21	FY22	FY23	H1FY24	Avg (FY21-H1FY24)	Change in FY22	Change in FY23	Change in H1FY24
AU SFB	22.31%	16.56%	15.52%	13.93%	17.08%	-5.74%	-1.05%	-1.59%
Equitas SFB	12.52%	7.35%	12.20%	14.64%	11.68%	-5.17%	4.85%	2.44%
Ujjivan SFB	0.26%	-13.97%	31.80%	29.38%	11.87%	-14.23%	45.77%	-2.42%
Jana SFB	7.77%	0.46%	17.08%	19.53%	11.21%	-7.30%	16.61%	2.45%
ESAF SFB	8.65%	3.97%	19.41%	29.29%	15.33%	-4.68%	15.44%	9.88%
Utkarsh SFB	9.37%	4.18%	22.64%	18.94%	13.78%	-5.19%	18.46%	-3.70%
Fincare SFB	11.78%	0.80%	8.31%	30.86%	12.94%	-10.98%	7.51%	22.55%
Suryoday SFB	0.89%	-6.00%	5.03%	11.98%	2.98%	-6.89%	11.03%	6.95%
Capital SFB	**9.56%**	**13.00%**	**16.62%**	**16.45%**	**13.91%**	**3.44%**	**3.62%**	**-0.17%**

Note: RoE (%) numbers are annualized as of half year ended Fiscal 2024. Change in FY22 calculated as RoE in Fiscal 2022 minus RoE in Fiscal 2021, Change in FY23 calculated as RoE in Fiscal 2023 minus RoE in Fiscal 2022, Change in H1FY24 calculated as RoA in H1 Fiscal 2024 minus RoA in Fiscal 2023

Source: Company reports, CRISIL MI&A

Capital SFB has the lowest credit cost (as % of average assets) amongst comparable SFBs from Fiscal 2021 to H1 Fiscal 2024

Capital SFB had the lowest credit cost of 0.08% (as a % of average assets) and 0.12% (as a % of average advances) respectively as of half year ended fiscal 2024. Capital SFB also has the lowest credit cost (as % of average assets) amongst comparable SFBs from Fiscal 2021 to H1 Fiscal 2024 at 0.28% followed by AU SFB (0.65%) and Equitas SFB (1.40%).

Profitability of SFB players for half year ended fiscal 2024

Players	Total income (In Rs million)	PPOP (In Rs. Million)	Credit Cost / Provisioning ** (In Rs. Million)	Credit cost to average advances (%)
AU SFB	57,300	11,937	1,473	0.48%
Equitas SFB	29,657	6,423	1,233	0.90%
Ujjivan SFB	30,439	9,413	730	0.64%
Jana SFB	22,156	5,561	3,429^	3.54%
ESAF SFB	20,141	5,903	2,283	3.17%
Utkarsh SFB	16,739	4,589	1,599	2.36%
Fincare SFB	13,604	3,523	640	1.34%

Suryoday SFB	8,361	2,114	803	2.52%
Capital SFB	**4,152**	**754**	**33**	**0.12%**

Note: Credit costs to average advances is calculated as Provisions on average advances,(**) Provisions (other than tax) and contingencies, (^) Total provisions and contingencies, Credit cost to average advances (%) numbers are annualized as of half year ended Fiscal 2024

Source: Company reports, CRISIL MI&A

Profitability of SFB players for fiscal 2023

Players	Total income (In Rs million)	PPOP (In Rs. Million)	Credit Cost / Provisioning ** (In Rs. Million)	Fee income to Total asset	Credit cost to average advances (%)
AU SFB	92,399	20,195	1,548	1.09%	0.30%
Equitas SFB	48,315	11,760	4,072	0.09%	1.80%
Ujjivan SFB	47,542	14,849	178	1.08%	0.09%
Jana SFB	36,999	10,004	7,444^	1.20%	4.84%
ESAF SFB	31,416	8,937	4,877	0.99%	3.82%
Utkarsh SFB	28,043	8,383	3,025	0.45%	2.60%
Fincare SFB	19,708	4,431	3,131	1.10%	3.98%
Suryoday SFB	12,811	3,374	2,366	0.95%	4.40%
Capital SFB	**7,255**	**1,487**	**246**	**0.59%**	**0.49%**

Note: Credit costs to average advances is calculated as Provisions on average advances,(**) Provisions (other than tax) and contingencies, (^) Total provisions and contingencies.

Source: Company reports, CRISIL MI&A

Trend of Credit Cost (as % of average assets) of SFB players

Players	Fiscal 2021	Fiscal 2022	Fiscal 2023	H1 Fiscal 2024	Average (FY21-H1FY24)
AU SFB	1.49%	0.60%	0.19%	0.32%	0.65%
Equitas SFB	1.71%	1.91%	1.32%	0.66%	1.40%
Ujjivan SFB	4.12%	5.40%	0.06%	0.41%	2.50%
Jana SFB	2.21%	2.90%	3.25%	2.55%	2.73%
ESAF SFB	2.85%	2.78%	2.57%	2.14%	2.59%
Utkarsh SFB	2.66%	3.04%	1.77%	1.65%	2.28%
Fincare SFB	3.34%	4.47%	2.68%	0.94%	2.86%
Suryoday SFB	2.80%	5.26%	2.62%	1.55%	3.06%
Capital SFB	**0.30%**	**0.42%**	**0.32%**	**0.08%**	**0.28%**

Source: Company reports, CRISIL MI&A

Capital SFB had third highest liquidity coverage ratio amongst comparable SFBs

Capital SFB has maintained third highest liquidity coverage ratio of 246.13% as of H1 Fiscal 2024. Jana SFB had the highest liquidity of 510.45%. Capital SFB also had the third lowest slippage ratio amongst comparable SFBs as of fiscal 2023. AU SFB had the lowest slippage ratio (2.03%) followed by Ujjivan SFB (2.05%) as of Fiscal 2023.

Non-performing asset of SFB players for half year ended fiscal 2024

Players	Provision Coverage Ratio (%)	Liquidity Coverage Ratio (%)	Capital Adequacy Ratio (%)	Slippage ratio***	Restructured book as % of advances^
AU SFB	73.00%	125.00%	22.43%	2.03%	0.80%
Equitas SFB	57.72%	182.17%	21.33%	5.61%	1.00%*
Ujjivan SFB	96.28%**	185.67%	25.19%	2.05%	0.55%
Jana SFB	34.00%*	510.45%*	17.50%	10.08%	34.01%*
ESAF SFB	70.50%	151.06%^^	20.57%	6.18%	0.20%
Utkarsh SFB	94.60%	211.70%	24.82%	5.09%	0.22%*

Fincare SFB	52.03%**	246.84%^^	20.73%	8.48%	0.94%*
Suryoday SFB	50.50%	141.00%	30.23%	10.63%	10.70%$
Capital SFB	**50.96%****	**246.13%**	**20.72%**	**3.33%**	**1.72%**

*Note: ** Provision coverage ratio is calculated as (GNPA-NNPA)/ GNPA; $ Data is as of March 2022; * Data is as of March 2023; ^ Restructured book as % of advances calculated as restructured book divided by advances, *** Slippage ratio calculated as of Fiscal 2023; ^^ Data is as of June 2023; NA – Not Available,*

Source: Company reports, CRISIL MI&A

Capital SFB had the second lowest average GNPA amongst comparable SFBs from Fiscal 2021 to H1 Fiscal 2024

Capital SFB had the second lowest average GNPA at 2.52% amongst comparable SFBs from Fiscal 2021 to H1 Fiscal 2024 after AU SFB (2.45%). Capital SFB had the fourth lowest average NNPA at 1.30% from Fiscal 2021 to H1 Fiscal 2024 after Ujjivan SFB (0.92%), AU SFB (0.93%) and Utkarsh SFB (1.05%). However, AU SFB and Ujjivan SFB have higher write offs as a % of loan book as compared to Capital SFB. Capital SFB also had consistent asset quality in the range of 2%-3% from Fiscal 2021 to H1 Fiscal 2024 as compared to other peers which showed higher variability.

Trend of asset quality of SFB players

Players	GNPA					NNPA				
	FY21	FY22	FY23	H1FY24	Avg (FY21-H1FY24)	FY21	FY22	FY23	H1FY24	Avg (FY21-H1FY24)
AU SFB	4.25%	1.98%	1.66%	1.91%	2.45%	2.18%	0.50%	0.42%	0.60%	0.93%
Equitas SFB	3.73%	4.24%	2.76%	2.27%	3.25%	1.58%	2.47%	1.21%	0.97%	1.56%
Ujjivan SFB	7.07%	7.34%	2.88%	2.35%	4.91%	2.93%	0.61%	0.04%	0.09%	0.92%
Jana SFB	7.24%	5.71%	3.94%	NA	5.63%	5.33%	3.95%	2.64%	NA	3.97%
ESAF SFB	6.70%	7.83%	2.49%	2.64%	4.92%	3.88%	3.92%	1.13%	1.19%	2.53%
Utkarsh SFB	3.75%	6.10%	3.23%	2.81%	3.97%	1.33%	2.31%	0.39%	0.16%	1.05%
Fincare SFB	6.42%	7.79%	3.25%	1.59%	4.76%	2.80%	3.55%	1.30%	0.77%	2.11%
Suryoday SFB	9.41%	11.80%	3.13%	2.90%	6.81%	4.73%	5.97%	1.55%	1.46%	3.43%
Capital SFB	**2.08%**	**2.50%**	**2.77%**	**2.73%**	**2.52%**	**1.13%**	**1.36%**	**1.36%**	**1.36%**	**1.30%**

Note: NA: Not Available; Source: Company reports, CRISIL MI&A

Players	Write-offs as a % of loan book		
	FY21	FY22	FY23
AU SFB	0.33%	0.41%	0.33%
Equitas SFB	1.45%	1.86%	0.60%
Ujjivan SFB	0.51%	4.84%	2.27%
Jana SFB	2.00%	4.50%	3.60%
ESAF SFB	0.00%	0.64%	3.57%
Utkarsh SFB	0.44%	2.17%	2.93%
Fincare SFB	0.64%	5.25%	6.34%
Suryoday SFB	2.43%	4.88%	4.57%
Capital SFB	**0.001%**	**0.002%**	**0.002%**

Note: Write offs calculated as write offs divided by net advances. Source: Company reports, CRISIL MI&A

Capital SFB has the second highest retail deposits per branch and second highest CASA deposits per branch amongst comparable SFBs

Capital SFB has Rs. 366.78 million of retail deposit per branch which is the second highest amongst comparable SFB players behind only AU SFB which has retail deposits per branch of Rs. 477.13 million as of half year ended

Fiscal 2024. In terms of CASA deposits per branch, Capital SFB has Rs. 152.80 million of CASA deposit per branch which is the second highest amongst peers. AU SFB had the highest CASA deposit per branch at Rs. 246.31 million as of half year ended Fiscal 2024.

Capital SFB had the third highest outstanding net advances per branch at Rs. 334.35 million after AU SFB (Rs. 615.82 million) and Ujjivan SFB (Rs. 347.50 million).

Per branch comparison (H1 FY24)

(Rs Million)	Banking outlets (***) (H1 FY24)	Revenue per branch	Outstanding net advances per branch	Retail deposit per branch	CASA deposits per branch	Opex per branch	Total business per branch$
AU SFB	1,042	54.99	615.82	477.13	246.31	19.60	1,350.98
Equitas SFB	956	31.02	300.92	238.99	108.25	12.75	649.25
Ujjivan SFB	700	43.48	347.50	268.83	100.17	14.87	795.90
Jana SFB	754*	29.38^	278.63^	152.11*	43.78*	10.39^	455.37*
ESAF SFB	700	28.77	212.88	221.21	44.89	10.91	498.66
Utkarsh SFB	871	19.22	161.66	105.82	32.07	6.91	331.30
Fincare SFB	1,292	10.53	81.03	56.05	18.07	4.23	168.81
Suryoday SFB	635	13.17	105.84	78.06	15.81	5.31	209.60
Capital SFB	**173**	**24.00**	**334.35**	**366.78**	**152.80**	**7.22**	**743.71**

Note: (***) Banking outlets including bank branches, ultra-small branches and asset centres as reported by the players, ($) For calculating total business per branch, gross advances + total deposits have been used, (*) Data as of Fiscal 2023, (^) Ratio computed using number of branches data as of Fiscal 2023

Source: Company reports, CRISIL MI&A

Capital SFB has the highest retail deposit and total business per employee as well as outstanding net advances per employee amongst comparable SFBs

Capital SFB has retail deposits worth Rs. 34.52 million per employee which is the highest amongst comparable SFBs as of half year ended Fiscal 2024. It is also highest in terms of total business per employee with Rs. 70.00 million. Capital SFB is second highest in terms of income per employee with Rs. 2.26 million revenue per employee behind only ESAF SFB which has Rs. 3.66 million revenue per employee. Capital SFB is also the highest in terms of outstanding net advances per employee with Rs. 31.47 million advances per employee as of half year ended fiscal 2024.

Per employee comparison (H1 FY24)

(Rs Million)	No. of employees	Income per employee	Outstanding net advances per employee	Retail deposit per employee	Total business per employee $
AU SFB	28,500	2.01	22.52	17.44	49.39
Equitas SFB	21,862	1.36	13.16	10.45	28.39
Ujjivan SFB	21,040	1.45	11.56	8.94	26.48
Jana SFB	18,184*	1.22^	11.55^	6.31*	20.04*
ESAF SFB	5,505	3.66	27.07	28.13	63.41
Utkarsh SFB	16,364	1.02	8.60	5.63	17.63
Fincare SFB	14,804*	0.92^	7.07^	4.89^	14.73^
Suryoday SFB	6,989	1.20	9.62	7.09	19.04
Capital SFB	**1,838**	**2.26**	**31.47**	**34.52**	**70.00**

Note: ($) For calculating total business per branch, gross advances + total deposits have been used, (*) Data as of Fiscal 2023, (^) Ratio computed using number of employees data as of Fiscal 2023

Source: Company reports, CRISIL MI&A

Product mix

Capital SFB has the most diversified portfolio amongst comparable SFBs, with book size in multiple asset classes as of half year ended fiscal 2024. Most of the SFBs are pure MFI turned SFB, and hence still have a huge concentration in MFI products whereas Capital SFB has about 19.66% of portfolio concentration towards MSME whereas agriculture accounts for 38.65% of portfolio and 26.06% of portfolio accounts for Mortgages.

Product mix of SFBs (as of H1-fiscal 2024)

	Micro Finance	Vehicle/Auto Loans	Mortgage loans	MSME Finance	Large & mid-corporate loans	Gold loans	Agriculture	Others
AU SFB	-	31.89%	7.79%	28.61%	22.76%	-	-	8.95%
Equitas SFB	18.82%	24.90%	11.47%	40.31%	3.34%	-	-	1.16%
Ujjivan SFB	72.07%	-	15.19%	5.43%	-	-	-	7.32%
ESAF SFB	73.45%	-	-	4.67%**	-	-	4.85%	17.03%
Utkarsh SFB	62.40%	4.98%	3.96%	13.28%	11.23%	-	-	4.16%
Fincare SFB	54.00%	-	14.00%	19.00%	-	10.00%	-	3.00%
Suryoday SFB	59.33%	7.87%	10.89%	9.39%				12.53%
Capital SFB*	-	-	**26.06%**	**19.66%^**	-	-	**38.65%**	**15.63%**

Note: 1) (*) Data as of Fiscal 2023, 2) (**) MSME loans and loans to financial institutions, (^) MSME and Trading.
Source: Company reports, CRISIL MI&A

Geography Mix of SFBs

Capital SFB is focused more in rural and semi-urban areas amongst comparable SFBs

Capital SFB has highest branch concentration towards Rural and Semi-urban areas amongst comparable SFBs as of H1 Fiscal 2024 depicting that Capital SFB has well defined niche catering to middle income group segment with special emphasis on rural and semi-urban areas. Also, Capital SFB has very minimal presence/no presence in Metropolitan areas.

Region-wise functioning offices (H1 FY24)

	Rural	Semi-urban	Urban	Metropolitan
AU SFB	12.08%	32.70%	25.16%	30.06%
Equitas SFB	9.13%	34.15%	33.64%	23.08%
Ujjivan SFB	23.17%	27.17%	29.24%	20.41%
Jana SFB	20.92%	13.24%	30.88%	34.97%
ESAF SFB	11.06%	58.44%	19.57%	10.92%
Utkarsh SFB	26.66%	35.18%	20.91%	17.26%
Fincare SFB	12.84%	56.31%	20.64%	10.21%
Suryoday SFB	25.35%	36.46%	20.66%	17.53%
Capital SFB	**40.68%**	**33.90%**	**19.21%**	**6.21%**

Source: RBI, CRISIL MI&A

Comparison of Capital SFB with private banks in India

Capital SFB has the highest retail deposit (%) as compared with leading private sector banks

Capital SFB had 93.59% retail deposits (as % of total deposits) as of half year ended Fiscal 2024, which is the highest as compared to leading private sector banks for whom data is available.

Capital SFB has CASA ratio comparable with leading private sector banks

Capital SFB, despite being an SFB has CASA ratio which is similar to some of the leading private sector banks like HDFC Bank, Axis Bank, ICICI Bank. Capital SFB also had similar interest rate offered on retail TD as compared to other private banks.

Private Players comparison

(Rs Million)	Total Deposits-H1FY24	Growth in deposits (FY20-H1FY24)	CASA (%)	Retail Deposit (%)	Interest rate offered on Savings Account***	Highest Interest rate offered on retail TD**
HDFC Bank	21,728,578	20.01%	38.00%	83.00%	3.00%	7.20%
ICICI Bank	10,900,080	10.40%	48.41%	NA	3.00%	7.10%
Axis Bank	9,555,564	12.85%	44.00%	80.00%	3.00%	7.10%
Kotak Mahindra Bank	4,009,630	13.13%	48.30%	NA	3.50%	7.25%
Indusind Bank	3,597,865	17.92%	39.34%	43.72%	3.50%^	7.50%
IDBI Bank	2,494,810	2.24%	51.49%	87.56%	3.00%	7.00%
Federal Bank	2,328,684	12.90%	31.17%	NA	3.45%	7.50%
Jammu & Kashmir Bank	1,265,897	7.65%	50.61%	NA	2.90%	7.10%
IDFC First Bank	1,712,359	36.44%	46.41%	77%	3.00%^	7.75%
Bandhan Bank	1,120,779	21.26%	38.54%	74.04%	3.00%^	7.85%
RBL Bank	897,804	13.40%	35.74%	NA	4.25%^	8.00%
Karur Vysya Bank	830,685	10.23%	32.26%	NA	2.25%^^^	7.50%
City Union Bank	527,140	7.57%	29.57%	NA	3.00%^	7.00%
DCB Bank	454,960	12.24%	25.04%	NA	1.75%^	8.00%
CSB Bank	254,384	14.59%	29.28%	NA	2.10%^	7.75%
Nainital Bank	78,091	0.48%	NA	NA	2.85%	7.10%
Capital SFB	**70,003**	**13.84%**	**37.76%**	**93.59%**	**3.50%**	**7.60%**

***Highest rate of interest on TD is considered for all time periods, *** Interest Rate for Savings Account with balance up to Rs. 50 lakhs as of December 2023, ^ Interest Rate for Savings Account with balance up to Rs. 1 lakh as of December 2023, ^^ Interest Rate for Savings Account with balance up to Rs. 2 lakh as of December 2023, ^^^ Interest Rate for Savings Account with balance up to Rs. 5 lakh as of December 2023.*
Source: Company reports, CRISIL MI&A

Capital SFB has GNPA(%) comparable with leading private sector banks despite being smaller in size

Capital SFB's GNPA (2.73%) is the tenth lowest as compared with leading private sector banks despite being smaller in size. CSB Bank has the lowest GNPA at 1.27% as of half year ended fiscal 2024.

Capital SFB has the fifth lowest Average GNPA from Fiscal 2021 to H1 Fiscal 2024 as compared with leading private sector banks

HDFC Bank had the lowest average GNPA from Fiscal 2021 to H1 Fiscal 2024 at 1.24%, followed by CSB Bank (1.76%), IndusInd Bank (2.21%), Kotak Mahindra Bank (2.29%) and Capital SFB (2.52%) among leading private sector banks.

In comparison with private banks, Capital SFB had one of the lowest write-off as a % of loan book

Capital SFB had one of the lowest write-off as a % of loan book at 0.002% as compared with leading private sector banks.

GNPA of Private banks

	GNPA (%)- H1FY24	Avg GNPA (FY21-FY23)	Write-offs as a % of loan book^
Axis Bank	1.73%	2.57%	0.74%
Bandhan Bank	7.32%	6.37%	2.64%
City Union Bank	4.66%	4.71%	1.20%
CSB Bank	1.27%	1.76%	0.00%
DCB Bank	3.36%	3.75%	0.47%
Federal Bank	2.26%	2.71%	0.21%
HDFC Bank	1.34%	1.24%	0.67%
ICICI Bank	2.48%	3.46%	4.43%
IDBI Bank	4.90%	13.20%	13.49%
IDFC First Bank	2.11%	3.12%	1.74%
IndusInd Bank	1.93%	2.21%	1.30%
Jammu & Kashmir Bank	3.50%	4.01%	0.84%
Karur Vysya Bank	1.73%	4.47%	2.87%
Kotak Mahindra Bank	1.72%	2.29%	0.22%
Nainital Bank	8.91%	11.69%	0.07%
RBL Bank	3.12%	3.81%	2.48%
Capital SFB	**2.73%**	**2.52%**	**0.002%**

Note: ^ Write-offs as a % of loan book as of Fiscal 2023.
Source: Company reports, CRISIL MI&A.

In comparison with leading private banks, Capital SFB had the fourth highest Return on Equity

As of H1 fiscal 2024, ICICI Bank had the highest Return on Equity (19.11%) followed by Axis Bank (17.75%) and Karur Vyasa Bank (16.61%). Capital SFB has the fourth highest return on equity (16.45%) despite its smaller size as compared with leading private banks.

Capital SFB has fourth highest RoE among leading Private banks as of half year ended fiscal 2024

	Return on Equity (%) – FY23	Return on Equity (%) – H1FY24
Axis Bank	7.96%	17.75%
Bandhan Bank	11.87%	14.29%
City Union Bank	13.35%	13.24%
CSB Bank	18.70%	15.90%

DCB Bank	10.81%	10.87%
Federal Bank	14.94%	15.18%
HDFC Bank	16.96%	16.30%
ICICI Bank	17.18%	19.11%
IDBI Bank	8.38%	11.06%
IDFC First Bank	10.43%	11.36%
Induslnd Bank	14.44%	15.29%
Jammu & Kashmir Bank	13.27%	13.74%
Karur Vysya Bank	13.67%	16.61%
Kotak Mahindra Bank	14.02%	15.32%
Nainital Bank	6.67%	11.87%
RBL Bank	6.74%	8.41%
Capital SFB	16.62%	16.45%

Note: Return on Equity calculated on standalone numbers and annualized as of H1 Fiscal 2024.
Source: Company reports, CRISIL MI&A.

As per the CRISIL MI&A analysis, it seems that the SFBs already having experience with the products across asset and liability side are better off in comparison to others on account of accumulated knowledge, systems and can going ahead focus on expansion with removal of geographical barriers. Additionally, a lot of these banks have increasingly invested in digital initiatives like digital only savings accounts and fixed deposits on DIY models with digital KYC, virtual RMs, phygital model for asset side products, etc. These products or suites became more relevant in the pandemic helping the SFBs reduce physical touch points. Usage of analytics for cross sell, appraisal, penetration of various products etc. are some additional digital initiatives finding use amongst these banks and have significantly helped them bring down costs and enhance the offering to their customers.

The presence of digital ID and the proliferation of mobile phones in addition to the foray of world class payment systems in the country have been utilised extensively by the SFBs either through in-house development or with tie-ups with third party fintechs etc. Many of these banks have digital transactions to the tune of more than ~50% of their overall transactions and are further seeing them rise.

List of formulae

Parameters	Formula
RoA	Profit after tax / average of total assets on book
RoE	Profit after tax / average net worth
NIM	(Interest income – interest paid) / average of total assets on book
Cost to income	Operating expenses / (net interest income + other Income)
Cost of funds	Interest paid / (average of deposits and borrowings)
Non-interest income	(Total income – interest income)/ average of total assets on book
PPOP	Total Income – Interest Expense – Operating expense
Credit cost	Provisions / average of total assets on book
Credit to Deposit Ratio	Advances / Deposit
Fee income to Total asset	Fee Income / Average total assets
Slippage Ratio	Additions to Gross NPAs during the year / advances of previous year (at beginning of the year)

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