

Hybrid models to help grow NBFCs' rural book

Low operating expenses will also boost growth

ADVAIT RAO PALEPU
Mumbai, 17 March

Rural-focused non-banking financial companies (NBFCs) have expanded their branch and sales networks significantly over the last two years. Having built innovative and low-cost business models, driven by a technology platform and low operating expenses, analysts said the room for growth was wide open.

Table-I illustrates the growth of the branch networks of a few NBFCs, especially in tier-III (plus) towns and villages, over the last three years. For example, Shriram Transport Finance Company (SFTC) has increased the number of its rural centres by 8.9 per cent to 930 at the end of December 2017. Bajaj Finance (BFL) increased its urban outlet network by 40.3 per cent to 529 branches at the end of December 2017. It added 191 branches in rural locations between March 2016 and December 2017.

Karthik Srinivasan, senior vice-president of rating agency Icria, said, "NBFCs are expanding beyond tier-I cities and the spreads they get in those regions are higher as they use a combination of both physical presence in terms of setting up branches and technology to reach out to borrowers."

Krishnan Sitaraman, senior director at CRISIL, said the operational architecture to actually build such a business depended on its nature.

NBFCs are not opening high-cost branches. They are

NBFC BRANCH NETWORK

		FY16	FY17	FY18	Growth %	Branch additions
Tata Capital Finance	Branches	299	305	NA	2.0	6
Shriram Transport Finance	Branches	853	918	1121	22.1	268
	Rural centres	803	854	930	8.9	127
Bajaj Finance	Urban	262	377	529	40.3	267
	Rural	397	538	588	9.3	191
	DSA	24,800	39,600	53,500	35.1	28,700
Mahindra Finance	Branches	1,167	1,182	1,178	-0.3	11
	DSA	286,007	319,409	330,000	3.3	43,993
Mannapuram	Branches	35	48	100	108.3	65
Cholamandalam	Branches	534	703	858	22.0	324
L&T Financial Services	Branches	700	NA	1,089	55.6	389

Source: Company sources, financial reports and presentations. NA: Not available. FY18 is as of December 2017. Growth: December 2017 (less) March 2016 except for Tata Capital. DSA: Direct/distribution sales agents

opening small branches even in metro cities, which has led to the underwriting process becoming more template-based. NBFCs use a 'hub and spoke' model for regional credit offices, so to that extent the incremental costs for new branches are definitely lower than what they were a couple of years back, said Srinivasan.

The information for SFTC and BFL in table II notes their respective rural assets under management due to the paucity of comparable information, while for the five other NBFCs their respective rural disbursement data has been produced. NBFCs first identify a 'hub', a regional branch well connected to nearby villages, which is a relatively large office with the requisite staff that is responsible for seeking customers, selling products and maintaining the firm's (loan) collection efficiencies.

NBFCs also set up small kiosks, or a small office in a specific place, which are connected to the main branch, or they may contact direct selling agents (DSAs) who are

licensed to sell NBFCs' products to customers in a specific region. Srinivasan said NBFCs need to see a decent amount of volumes being transacted at a particular location or a mini-branch, and only then do they scale up. "Till that time these companies use the hub and spoke model or have a set-up with minimal infrastructure and people to keep the operating expenditure down," he said. "One needs to look at the yields in the business very closely while devising the operating model. In terms of a profitability tree, if you subtract the borrowing cost, the operating expense ratio and the credit cost from the yields, that is what will indicate the profitability; which needs to be positive if the business model has to be sustainable," said Sitaraman.

In the past, most lenders (NBFCs or otherwise) had a physical, face-to-face model (direct model), but now the hub and spoke model offers better control to NBFCs over their credit and operational risk control, according to ana-

lysts. Other than the hub and spoke and DSA models, NBFCs are also focused on pushing their sales and services through a mobile application-based model (direct model).

Operational changes of traditional banks

"Public sector banks (PSBs) have branches across the country but given the current dynamics, most of the focus of branch managers seems to be on deposit mobilisation in rural areas, while credit focus does not seem to be high. What we see is that some PSBs and private banks are engaging with NBFCs for portfolio buyouts; so here the NBFCs originate the loan and services it, while the bank(s) purchases the portfolio," said Sitaraman.

Through this relationship the asset-side strengths of an NBFC, like their adaptability, local knowledge and innovation towards better customer targeting, are complemented by the liability-side strengths of a bank, Sitaraman told *Business Standard*. For NBFCs there is a lot of potential given the underpenetrated rural market.