CREDIT RISK MANAGEMENT PRACTICES OF ESAF BANK

Project Report

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By

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DECLARATION

I, **Nair Akshay Raju**, hereby declare that the Project Report entitled **"Credit Risk Management Practices of ESAF Bank"** has been prepared by me and submitted to the University of Calicut in partial fulfilment of requirements for the award of the Master of Business Administration, is a record of original work done by me under the supervision of **Dr. Suraj E S, Associate Professor**, of Naipunnya Business School, Pongam, Koratty East, Thrissur.

I also declare that this Project work has not been submitted by me fully or partly for the award of any Degree, Diploma, Title, or recognition before any authority.

Place: Koratty East, Thrissur **NAIR AKSHAY RAJU**

Date: YPAWMBA055

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INTRODUCTION

1.1 INTRODUCTION

Credit risk management is a crucial aspect of banking operations, as it directly impacts the profitability and sustainability of a bank. ESAF Bank, like any other banking institution, is exposed to various risks that can affect its financial performance. Effective credit risk management practices are essential to mitigate these risks and ensure the bank's stability.

The banking environment is characterized by numerous risks, including credit risk, market risk, operational risk, and liquidity risk. Among these, credit risk is a significant concern, as it arises from the possibility of borrowers defaulting on their loan obligations. The importance of credit risk management cannot be overstated, as it helps banks to identify, assess, and manage credit risk exposure.

The significance of this study lies in understanding how ESAF Bank navigates the complexities of credit risk, particularly in the backdrop of an increasingly competitive and regulated financial environment. By analyzing key performance indicators, such as the Capital Adequacy Ratio (CAR), Z-score, and Non-Performing Assets (NPAs), this project seeks to identify the strengths and weaknesses in ESAF Bank's credit risk management framework. Additionally, the study will compare ESAF Bank's practices with those of peer institutions, offering insights into industry best practices and potential areas for improvement.

Through a detailed examination of ESAF Bank's credit portfolio, risk assessment techniques, provisioning strategies, and recovery processes, this project will provide actionable recommendations to enhance the bank's credit risk management.

1.2 STATEMENT OF PROBLEM

ESAF Small Finance Bank faces challenges in managing credit risk effectively, crucial for its financial stability and growth. Despite a conservative lending approach, the bank's credit exposure and high-risk borrower proportion are rising. Declining Capital Adequacy Ratio (CAR) and Z-score indicate potential financial vulnerabilities. Fluctuations in Non-Performing Assets (NPAs) due to economic disruptions further stress the need for robust risk management strategies. The core issue is balancing aggressive lending with maintaining capital adequacy and effective risk management. This study seeks to identify gaps in ESAF Bank's current practices and propose strategies to enhance credit risk management, ensuring sustainable growth and resilience.

1.3 OBJECTIVES OF THE STUDY

1 Determine the total credit exposure for each year and analyze the trends in credit exposure for ESAF Bank.
2 To evaluate the effectiveness of ESAF Credit risk management Practices with its peer banks.
3 To evaluate ESAF Bank's financial performance in comparison to its peer banks.

1.4 SCOPE OF THE STUDY

This study delves into the credit risk management practices of ESAF Small Finance Bank, focusing on several key areas. It includes an analysis of ESAF Bank's credit portfolio across sectors like agriculture, trade, services, and personal loans, evaluating the composition of risk-weighted assets. The study also examines ESAF Bank's methodologies for assessing borrower creditworthiness, Furthermore, it investigates the Capital Adequacy Ratio (CAR) to assess ESAF Bank's financial stability and regulatory compliance. The management of Non-Performing Assets (NPAs) and strategies for provisioning and recovery will be analyzed, along with a comparative assessment against peer banks in the small finance sector. Additionally, the study explores how ESAF Bank integrates technology in its credit risk management framework and aims to provide actionable recommendations for enhancing these practices to ensure sustainable growth and resilience in a competitive banking environment.

1.5 RESEARCH METHODOLOGY

A researcher might outline their planned investigational strategy using a research approach. It is a logical, systematic approach to a problem. A methodology describes the steps a researcher will take to ensure that the study yields valid, reliable data that satisfies their aims and objectives. It contains information on the data they plan to collect, where to obtain it, how to collect it, and how to analyze it.

Research Design

- This research employs a analytical approach, comparative design.
- It uses secondary data to describe the financial performance of ESAF Bank and its peers across several key parameters. The study then compares ESAF's performance against industry benchmarks and analyzes trends over a three-year period (2020-2021 to 2022-2023).

Sources of Data

The research uses only secondary data sources. Financial statements that are accessible to the public, annual reports, and other pertinent financial publications are the sources of the data. The thorough historical and present financial data required for the research is provided by these sources.

Secondary Sources

- Financial Statements: Balance sheets, income statements, cash flow statements.
- Annual Reports: Detailed reports published by the companies.
- Other Publications: Relevant financial analysis reports, industry analysis reports.

Tools of Data Analysis

- Financial Ratios: Calculated based on data from financial statements, these ratios provide insights into key aspects like profitability, liquidity, solvency, and efficiency.
- Springate Z-score Model: A model used to assess the financial stability of banks, based on key financial indicators.
- CAMEL Model: A framework for assessing the overall financial health of banks, evaluating key aspects like capital adequacy, asset quality, management quality, earnings, and liquidity.

- Trend Analysis: Analyzing the historical data to identify patterns, changes, and trends in ESAF's financial performance and risk profile.
- Comparative Analysis: Comparing ESAF's performance against industry benchmarks to understand its relative strengths and weaknesses.

Period of the Study

The Study was Conducted for 2 Months From 1st April to 26th May 2024

1.6 LIMITATIONS OF THE STUDY

- The major limitation was the sensitive data of the risk management department were not given. So the lack of data restricted to conduct the analysis more depthly.
- Time constraint is another limitation faced during the study.

1.7 INDUSTRY PROFILE

Small Finance Banks Industry: An Overview Evolution of Small Finance Banks in India.

The RBI introduced rules for a new type of banks dubbed Small Finance Banks (SFBs) on November 27, 2014, committing to a paradigm shift in its financial inclusion mandate. Ten businesses were granted permission in principle by the RBI to become SFBs in 2015. To give the underbanked and unbanked segments of society access to basic banking and credit services, the RBI established these SFBs. By using high-tech, low-cost operations, the goal is to promote financial inclusion and provide credit services to marginal farmers, microenterprises, small businesses, and other unorganized entities.

SFBs are able to conduct all banking operations, such as lending and accepting deposits, just like commercial banks. According to RBI guidelines, preference will go to institutions that work with underserved populations in general, target the marginalized segments of small businesses, entities in the unorganized sector, low-income households, and farmers through credit and savings products, and concentrate on underserved regions of northeastern and eastern and central India.

Mandate for SFBs

- Provide sectors qualified for priority sector lending (PSL) with an extension of 75% of Adjusted Net Bank Credit (ANBC).
- Keep a minimum of 25% of their branches open and operating in unbanked rural areas without any limitations.
- Loans and advances totaling up to < 25 lakh should make up at least 50% of the loan portfolio.
- Maintain minimum Capital Adequacy Ratio (CAR) of 15% of its risk-weighted assets (RWA).
- Minimum Investment Requirement The minimum capital requirement under the new on-tap licensing guidelines was doubled by the RBI from ~ 100 crore to ~ 200 crore, with some exceptions. For example, the requirement is separately outlined for SFBs that are converted from NBFCs/MFIs or transited from primary (Urban) Co-Operative Banks.

Key Features of SFBs

- SFBs provide basic banking services and non-risk-sharing financial services, operating similarly to a universal commercial bank. As Authorized Dealers—Category II—these institutions are also able to provide foreign exchange services.
- SFBs provide a wide range of products and have the ability to cross-sell items to increase client loyalty and stickiness.
- NBFCs can increase deposits and reduce their cost of funds by converting to SFBs. These banks are able to offer competitive rates in the market and diversify their product offerings due to their cheap cost of funding.
- SFBs can deliver tailored product solutions to target consumer segments faster by utilizing technology more effectively.

Geographical diversification

Growing emphasis on portfolio diversification and geographic development into underserved areas and the hinterlands is likely to propel SFBs into additional locations, where growth is anticipated to be substantial.

Target audience

SFBs provide unique items to the low-income market niche. Small finance banks grow both vertically and horizontally, which allows them to have a decent mix of medium and low value customers, in contrast to NBFCs, which expand horizontally with a single emphasis product. Small financing banks can also cultivate devoted clientele by concentrating primarily on rural and microfinance borrowers, who have a low credit penetration and less player mobility.

Lower operational expenses

SFBs possess a profound comprehension of the requirements and possibilities of the underbanked, marginalized, and unbanked groups in society, having previously worked in the microfinance loan industry. They will be able to preserve economies of scale and operational efficiency with the help of this and strong technological systems.

Global Scenario

Small Finance Banks (SFBs) are financial institutions that provide banking services to underserved and unbanked populations, particularly in developing countries. While the concept of SFBs is most prominent in India, similar models exist globally under different names and structures, such as microfinance banks or community development banks.

Key Features Globally

- Focus on Financial Inclusion: SFBs target micro, small, and medium enterprises (MSMEs), low-income households, and individuals who lack access to traditional banking.

- Microfinance Roots: Many SFBs evolve from microfinance institutions (MFIs), expanding their services to include deposits, savings accounts, and small loans.
- Regulatory Framework: Varies significantly across countries. For instance, in Kenya, Equity Bank focuses on providing banking services to low-income customers, while in Bangladesh, Grameen Bank, the pioneer of microfinance, offers similar services.
- Technological Adoption: Leveraging mobile banking and fintech solutions to reach remote areas and reduce operational costs .

Challenges

- Regulatory Compliance: Meeting stringent regulatory requirements while maintaining low-cost operations.
- Financial Sustainability: Balancing social objectives with profitability.
- Technology Integration: Adopting advanced technologies to improve efficiency and reach.

India Scenario

In India, Small Finance Banks were established to further financial inclusion by providing basic banking services to underserved segments, including small farmers, micro-businesses, and informal sectors.

History and Evolution

- Inception: The Reserve Bank of India (RBI) granted licenses to 10 entities in 2015 to operate as Small Finance Banks.
- Objective: To enhance financial inclusion by providing credit and savings products to unserved and underserved sections.

Key Features

- Regulated by RBI: Must comply with banking regulations, maintain a minimum capital requirement, and adhere to priority sector lending norms.

- Services Offered: Include savings accounts, fixed deposits, recurring deposits, micro and small loans, insurance, and payment services.
- Target Customers: Focus on the lower end of the economic spectrum, including small farmers, small business owners, and low-income individuals.

Major Players

- AU Small Finance Bank
- Equitas Small Finance Bank
- Ujjivan Small Finance Bank
- Jana Small Finance Bank

Performance and Growth

- Growth: Significant growth in customer base and deposit mobilization since their inception.
- Technological Integration: Extensive use of digital platforms to extend their reach and improve service delivery.

Challenges

- High Operating Costs: Due to small ticket size loans and the need for extensive branch networks.
- Credit Risk: Higher default rates in the target customer segment.
- Competition: From both traditional banks and new-age fintech companies.

State Scenario

One of India's most industrialized and urbanized states, Maharashtra, is home to a sizable number of small finance banks. These banks are essential to improving financial inclusion in the state's rural and urban communities.

The economic landscape of Maharashtra consists of both large rural areas with agricultural operations and metropolitan centers like Mumbai and Pune. SFBs provide financial services to low-income people, small farmers, and micro, small, and medium-sized companies (MSMEs) in order to address the varied needs of these regions.

Major SFBs Operating in Maharashtra

1. AU Small Finance Bank
2. Equitas Small Finance Bank
3. Ujjivan Small Finance Bank
4. Jana Small Finance Bank
5. ESAF Small Finance Bank
6. Fincare Small Finance Bank
7. North East Small Finance Bank
8. Suryoday Small Finance Bank
9. Utkarsh Small Finance Bank
10. Capital Small Finance Bank

Key Features and Services

1. **Financial Inclusion**

- Rural Penetration: SFBs have extensive branch networks in rural and semi-urban areas, enhancing access to banking services.
- Credit Access: They provide microloans and small business loans, helping farmers and small entrepreneurs who often lack access to traditional bank credit.
- Savings Products: Offering savings accounts, fixed deposits, and recurring deposits to inculcate the habit of saving among the rural population.

2. **Technology Integration**

- Digital Banking: Many SFBs have adopted digital platforms to provide mobile banking, internet banking, and digital payment solutions, bridging the gap between urban and rural banking services.
- Agent Banking: Use of banking correspondents to reach remote areas where setting up physical branches is not feasible.

3. **Support to MSMEs**

- Micro Loans: Extending microcredit to small businesses, enabling them to expand and improve their operations.
- Tailored Products: Offering customized financial products to meet the specific needs of different customer segments.

Impact on Local Economy

1. **Economic Development**

- Job Creation: Establishment of branches and banking correspondents in rural areas creates employment opportunities.
- Business Growth: Improved access to credit facilitates the growth of small businesses, contributing to local economic development.
- Agricultural Support: Providing financial services to farmers helps in improving agricultural productivity and income levels.

Challenges

- Awareness and Trust: Building trust among the rural population and educating them about the benefits of formal banking.
- Infrastructure Issues: Dealing with infrastructural challenges such as inadequate internet connectivity and transportation facilities in remote areas.
- Regulatory Compliance: Navigating local regulatory requirements while ensuring compliance with national banking standards.

1.8 BANK PROFILE

ESAF SMALL FINANCE BANK

A small finance bank in India, ESAF Small Finance Bank (formerly called ESAF Microfinance) offers modest loans and banking services to underbanked people. March 2017 saw the establishment of this small financing bank. They are present in urban, semi-urban, rural, and unbanked rural areas, and their main goal is to broaden the banking horizon to include more unbanked and underbanked areas. They are a bank for everyone. When ESAF first became an NGO in 1992, it had a more expansive goal of transforming the impoverished and disenfranchised in a sustained and comprehensive way. ESAF's founder, Shri. K. Paul Thomas, saw his vision confirmed by the success of Grameen Bank in Bangladesh. With the establishment of ESAF Microfinance and Investments Pvt. Ltd. in 2008, he introduced Micro Enterprises Development (MED) services in 1995, emphasizing the role of finance in the overall economic development of the underprivileged and disenfranchised. One of the first organizations to create a formal, structured lending system at the village level was ESAF Microfinance and Investments Pvt. Ltd. This organization was able to instill confidence in the idea that "the poor of our country are trustworthy" while also bringing about financial sustainability. In the nation's remote, underbanked, and unbanked areas, ESAF may foster a culture of financial responsibility while simultaneously increasing worker participation rates as more women entered the workforce or began earning a living for their families.

Birth of ESAF Small Finance Bank

ESAF Small Finance Bank was established with a vision to provide financial inclusion and sustainable development, particularly in rural and semi-urban areas of India. Here is an overview of its origins and development:

Background and Origins

ESAF (Evangelical Social Action Forum):

- Foundation: ESAF was founded in 1992 by K. Paul Thomas as a non-governmental organization (NGO) aimed at addressing social and economic issues in India.

- Mission: Initially focused on microfinance and social development projects, the organization aimed to uplift marginalized communities by providing financial services, health care, education, and livelihood support.

Transition to Banking

- Microfinance Institution: In 1995, ESAF ventured into microfinance, providing small loans to underserved populations to encourage entrepreneurship and self-employment.
- RBI Licensing: In 2015, the Reserve Bank of India (RBI) granted an in-principle approval to ESAF to establish a Small Finance Bank, as part of a broader initiative to increase financial inclusion in India.
- Commencement: ESAF Small Finance Bank commenced operations on March 10, 2017.

Establishment and Growth

Core Focus:

- Target Demographic: ESAF Small Finance Bank focuses on serving the unbanked and underbanked segments of society, particularly in rural and semi-urban regions.
- Products and Services: The bank offers a range of financial products, including savings accounts, fixed deposits, loans, insurance, and payment services.

Branch Network

- Expansion: Since its inception, the bank has rapidly expanded its branch network across India, with a strong presence in Kerala, Tamil Nadu, and Maharashtra.

Innovative Approach

- Technology and Innovation: ESAF leverages technology to enhance its service delivery, including mobile banking and digital payment solutions, ensuring convenience and accessibility for its customers.
- Sustainability: The bank integrates sustainable practices into its operations, focusing on green initiatives and social responsibility projects.

Social Impact

- Financial Literacy: ESAF is committed to improving financial literacy among its customers, conducting various awareness programs and training sessions.
- Women Empowerment: A significant portion of ESAF's microfinance clients are women, emphasizing its role in promoting gender equality and economic empowerment.

Recent Developments

Growth and Performance:

- Financial Stability: ESAF Small Finance Bank has shown consistent growth in terms of assets, deposits, and loan disbursements since its establishment.
- Recognition: The bank has received various accolades for its contributions to financial inclusion and sustainable banking practices.

ESAF Small Finance Bank continues to play a crucial role in transforming the financial landscape for underserved communities in India, adhering to its founding principles of social action and economic empowerment.

Scheduled bank with NRE status

Scheduled Bank Status

Definition and Importance

Scheduled Bank: A scheduled bank is included in the Second Schedule of the Reserve Bank of India (RBI) Act, 1934. These banks comply with the criteria set by the RBI and are entitled to certain privileges, including access to facilities like the RBI's lending services and inclusion in the clearinghouse system.

ESAF's Achievement

Scheduled Status: On December 27, 2018, ESAF Small Finance Bank was included in the Second Schedule of the Reserve Bank of India Act, 1934. This recognition was a significant milestone in the bank's journey, marking its credibility and stability in the Indian banking sector.

NRE Account Facility

NRE Account

- Definition: A Non-Resident External (NRE) account is a bank account in India that allows Non-Resident Indians (NRIs) to deposit their foreign earnings. These accounts are fully repatriable, meaning both the principal and the interest earned can be transferred back to the NRI's country of residence without any restrictions.

ESAF's Offering:

- NRE Account Services: After achieving scheduled bank status, ESAF Small Finance Bank introduced NRE account facilities. This service enables NRIs to manage their income earned abroad and facilitates easy remittance to India.

Account Types: The bank offers various types of NRE accounts, including savings accounts and fixed deposits.

Benefits:

- Reparability: Funds in NRE accounts can be repatriated fully.
- Tax Exemption: Interest earned on NRE accounts is exempt from Indian income tax.
- Convenience: NRIs can easily manage their finances in India, including bill payments and investments, through these accounts.

Significance of These Milestones

Financial Inclusion and Growth

- Enhanced Services: The scheduled status and NRE account facility have enabled ESAF Small Finance Bank to expand its range of services, thereby catering to a broader customer base, including the Indian diaspora.
- Trust and Credibility: Being recognized as a scheduled bank enhances the trust and credibility of ESAF among customers and investors, affirming its compliance with the stringent regulatory standards set by the RBI.

- Global Reach: Offering NRE accounts helps the bank connect with NRIs globally, providing them with a reliable platform to manage their finances in India.

Highlights

ESAF Small Finance Bank has recently achieved several significant milestones and launched new initiatives that highlight its growth and commitment to customer empowerment.

1. IPO and Stock Market Debut:

- ESAF Small Finance Bank made a strong debut on the BSE and NSE on November 10, 2023. The shares were listed at a premium of nearly 20%, reflecting investor confidence in the bank's performance and potential. This event marked an important milestone for the bank, which started as a non-profit NGO before becoming a prominent financial institution.

2. Financial Performance:

- In the third quarter of FY24, ESAF Small Finance Bank reported a remarkable 200% increase in its net profit, reaching ₹112 crore. This growth underscores the bank's robust financial health and effective business strategies.

3. Growth Projections:

- The bank aims for a 25-30% growth in FY24, driven by a rebound in overall business activities and strong traction in both asset and liability products. This optimistic outlook is supported by significant increases in the bank's deposits and advances.

4. Brand Campaigns:

- ESAF launched a new brand campaign titled "The Power to Dream Bigger" in January 2024. This campaign, created by FCB Interface, aims to showcase how the bank empowers its customers across different segments. The initiative includes TV commercials, print, radio, and online platforms, emphasizing the bank's role in transforming customers' dreams into reality.

5. New Product Offerings:

- Alongside the brand campaign, ESAF also rolled out two specific product campaigns focusing on fixed deposits and gold loans. These products are designed to align with the bank's overarching goal of providing comprehensive financial support to its customers.

These highlights reflect ESAF Small Finance Bank's strategic growth, strong market presence, and dedication to customer-centric initiatives, positioning it as a significant player in the financial sector.

VISION

"To be India's leading social bank that offers equal opportunities for the whole society through universal access and financial deepening, thus promoting financial inclusion, livelihood and economic development as a whole."

MISSION

"To provide responsive banking services to the underserved and un-served households in India facilitated by customer-centric products, high quality service and innovative technology."

BRAND PROMISE

To deliver the Joy of Banking through personalized accessible, safer and responsive services.

KEY STRENGTHS

1. Strong Focus on Financial Inclusion

- Target Demographic: ESAF primarily targets underserved populations in rural and semi-urban areas, ensuring that banking services reach those who are traditionally excluded from the financial system.

- Microfinance Roots: Originating as a microfinance institution, ESAF has a deep understanding of the financial needs of low-income individuals, allowing it to design products and services that effectively cater to this demographic.

2. Extensive Selection of Goods and Services

- Diverse Offerings: ESAF provides a wide array of financial products, including savings accounts, fixed deposits, loans (microloans, business loans, housing loans), insurance, and payment services. This comprehensive range ensures that customers have access to all necessary financial tools.
- Tailored Solutions: The bank's products are tailored to meet the specific needs of its target customer base, promoting financial stability and growth within these communities.

3. Technological Innovation

- Digital Banking: ESAF leverages technology to enhance service delivery, including mobile banking and digital payment solutions. This focus on technology ensures that banking services are accessible, convenient, and secure for all customers.
- Innovation: The bank continuously innovates to introduce new products and services that address the evolving needs of its customers.

4. Sustainability and Social Responsibility

- Green Initiatives: ESAF integrates sustainable practices into its operations, focusing on environmental stewardship and community development projects.
- Social Impact: The bank's commitment to social responsibility is evident in its various initiatives aimed at improving financial literacy, promoting gender equality, and supporting livelihood development.

5. Strong Financial Performance

- Consistent Growth: ESAF has demonstrated robust financial growth, with significant increases in net profit, deposits, and loan disbursements. This financial stability underpins its ability to expand and enhance its services .

- Market Confidence: The successful listing of ESAF on the BSE and NSE reflects strong investor confidence and marks a significant milestone in its growth trajectory.

6. Customer-Centric Approach

- Customer Empowerment: ESAF’s brand campaigns, such as "The Power to Dream Bigger," highlight its commitment to empowering customers and helping them achieve their financial goals. The bank positions itself as a partner in its customers’ financial journeys, fostering long-term relationships based on trust and mutual benefit.
- Service Excellence: The bank prioritizes excellent customer service, ensuring that its clients receive personalized and efficient support.

7. Leadership and Vision

- Visionary Leadership: Under the guidance of K. Paul Thomas, MD and CEO, ESAF has maintained a clear vision focused on financial inclusion, sustainable development, and customer empowerment. The leadership’s commitment to these principles drives the bank’s strategic initiatives and operational success.

RISK MANAGEMENT DEPARTMENT IN ESAF SMALL FINANCE BANK

ESAF Small Finance Bank has put in place a structured Risk management architecture. In order to manage the Bank’s financial and non-financial risks in manner consistent with its risk appetite, a Risk Management structure has been constituted, within which the bank conducts its operations and business.

The risk management framework of the bank is built on the following fundamental principles:

1. Assessment of risks in business: identification and recognition of various risks relating to the origination and continuance of business are carried out by the respective business functions, to ensure that adequate processes are implemented

to identify, measure, monitor, report and mitigate the financial and non-financial risks.

2. Empowerment of the risk management function: risk managers have the requisite levels of expertise and independence and it is ensured that the function is empowered to take required decisions for managing risks. An escalation matrix is aligned down and reoffered to, when need arises.
3. Accountability: the framework ensures that the responsibilities of the business units in terms of the processes handled are clearly defined.

Risk management architecture in the bank: The bank has got three lines of risk management structure in place .

1. The business units themselves managing the risks emanating from various business activities of the bank, on the presumption that risk management is embedded in the business systems plan and activities.
2. The Risk Management Department identifying, measuring, monitoring, and managing the risk with active involvement and participation of all the business units and other controlling functions.
3. The internal audit functions cross verifying the risk management activities and results thereof through various systems of audits and inspections, pointing out deficiencies and shortfalls, if any, for rectification and management.

Risk Management Department is headed by the chief risk officer, who is independent of all business and other functions, and reporting directly to the Managing Director & CEO, with parallel reporting to the board of directors through the risk management committee of the board.

Risk Management Department has five divisions attached to it – Credit Risk, Market Risk, Operational Risk, Anti Money Laundering & Transaction Monitoring And Information Security Divisions for undertaking Risk Management functions. Heads of the Credit Risk, Market Risk, Operational Risk , Anti Money Laundering & Transaction Monitoring Divisions Report To The Chief Risk Officer (CEO) . The Chief Information Security Officer, who heads the information security division also reports to the chief risk officer.

Whole the board of directors is responsible for overall governance and oversight of core risk management activities, execution responsibility is entrusted to the Risk Management Committee Of The Board (RMCB) and further sub-delegated to the executive level Credit Risk Management Committee (CRMC) for managing Credit Risk, Operational Risk Management Committee (ORMC) For Managing Operational Risk And The Asset Liability Management Committee (ALCO) for managing Market Risk.

The RMCB approves and recommends to the board for its review and approval, the policies, strategies and associated frameworks for management of risk. The RMCB has been given responsibility by the board to supervise and evaluate the bank's risk management procedures and practices. It ensures appropriate risk organization structure with authority and responsibility clearly defined, adequate staffing and the independence of Risk Management function.

The RMCB is supported by the executive level Risk Management Committees, CRMC, ORMC, and ALCO in managing risks in their respective areas.

Credit Risk Management

Credit Risk is defined as the possibility of losses due to default by the borrowers and /or reduction in the value of the portfolio due to deterioration of credit quality of borrowers or counterparties.

Credit risk management is the direct responsibility of the Credit Risk Management Committee (CRMC) . The CRMC manages implementation of Credit Risk Management framework across the bank and provides recommendations to the RMCB and the board. It ensures implementation of credit risk policy and procedures as approved by RMCB and the Board across the bank recommends changes thereto, considering any changes in the regulatory instruction, business or economic condition. Additionally, it periodically assesses the quality of the loan portfolio, pinpoints trouble spots, and gives business units and directors instructions on how to fix the shortcomings.

The Credit Risk Division of Risk Management Department, which is supported by all the business units, is entrusted with the responsibilities of implementing process for Credit Risk Identification, Assessment, Measurement, Monitoring and Control. Credit Risk appetite statement are drawn up with inputs from the business units and the Credit Risk parameters and Credit Exposures or Concentration Limits set by the Bank's Board of Directors or RMCB and RBI. The division constructs credit risk identification systems monitors' quality of the bank's loan portfolio identifies problem credits and undertakes asset quality reviews with support from the business units the division captures early warning signals in the loan portfolio for identification of week exposures suggest ideal measures and monitors the action taken.

Market Risk Management

The Basel Committee on Banking Supervision defines Market Risk as the risk of losses in off- balance sheet positions , that arise from movement in market prices.

The major components of Market Risk include :

1. Interest rate risk: the potential loss due to movements in interest rates.
2. Liquidity risk: the potential loss due to the bank's inability to meet obligations as they fall due , or to fund increases in assets , without incurring unacceptable cost or losses.
3. Equity risk: the potential loss due to change in the stock price.
4. Foreign exchange risk: the potential loss due to change in value of the bank's assets and liabilities resulting from exchange rate fluctuations.
5. Commodity risk: The potential loss due to an adverse change in commodity prices.

Market risk management in the bank is overseen and undertaken by the Market Risk Division of the Risk Management Department. The division is responsible for the design and implementation of the Bank's Market Risk Management /ALM system. The Division offers an independent risk assessment and is separate from the business and trading units. This is essential to the ALCO's primary duty of managing and controlling market risks in compliance with the guidelines set forth by the Board and Risk Management Committee.

The Market Risk Division of the Risk Management Department is connected to the mid office of the bank's treasury function. The mid office creates and evaluates daily reports on the treasury's numerous operations for the bank. The Mid Office which is responsible for the critical functions of independent market risk monitoring, measurement, analysis, reports to the Bank's Chief Risk Officer through the Head of Market Risk Division.

The Market Risk Management/ALM function of the Bank is handled by The Asset Liability Management Committee (ALCO), the executive level committee, headed by the Managing director and CEO.

The major function of ALCO with respect to managing risks in the banking and investment books of the Bank includes:

- Design and implementation of effective market risk management and ALM framework in the bank.
- Review the new directives and regulatory limits for market risks, interest rate risk and liquidity risk monitoring and revisions to tolerance limits prescribed in the market risk management policy.
- Ensuring that business strategy of the bank is in line with bank's stated risk management objectives.
- Determining the structure, responsibilities and controls for managing Market risk and overseeing the liquidity positions.
- Ensuring the market risk and mid-office operations operate independently.

Operational risk management

The risk of loss arising from insufficient or malfunctioning internal processes, personnel, and systems, as well as from external events, is referred to as operational risk. Legal risk is covered by this definition, but reputational and strategic risk are not.
While Operational Risk Management is the responsibility of various functions and business units handling operational activities, it is overseen by the Operational Risk Management Committee (ORMC).

The principal objective of the ORMC is mitigation of operational risk within the institution by creation and maintenance of an explicit operational risk management process. It conducts detailed reviews of operational risk exposures across the bank and focuses on all operational risk issues.

The ORMC reviews the risk profile to retake into cognizance future changes and threats, and concurs on areas of highest priority and related mitigation strategy with the different departments and business units. The committee ensures adequate resources are being assigned to mitigate risk as needed, and communicate to business areas and staff, the importance of Operational Risk Management to ensure adequate participation and cooperation.

The Committee for Operational Risk Management doubles as the Business Continuity Management (BCM) Committee, overseeing the execution of the BCM policies and procedures throughout the bank.

Information security risk management

Information security governance is the system by which an organization directs and controls IT security. IT security governance is distinct from IT security risk management which relates to mitigation and management of risk and vulnerabilities that are centered in the IT infrastructure. Information security governance allocates the authority to make decisions and specifies the accountability framework and provides oversight to ensure that risks are adequately mitigated or managed. It ensures that security strategies that mange the flow and dissemination of information are aligned with business objectives and consistent with regulations.

The Information Security Governance Committee (ISGC) is in charge of overseeing information security governance for the bank. The ISGC is a management level committee headed by tee Managing Director & CEO. ISGC is the Central Representative Body of Senior Management from different functions to provide clear direction and support for information security risk management initiatives in the bank.

AML & Transactions Monitoring as Risk Management Activity

The increasing frequency of financial crimes and malpractices has made anti-money laundering activities one of the main areas of concentration for financial institutions. The regulatory controls and compliance requirements on place and the objective of ensuring that bank's customer base excludes persons attempting money laundering and other financial crimes , have placed prim importance on AML programme of the bank. In view of the increasing importance of this function, the Bank has attached its AML & Transaction Monitoring Division to Risk Management Department.

The AML & TM Division of the Risk Management Department functions with focus on the following aspects:

- Risk categorization of customers at the time of account opening, and transaction monitoring measures that commensurate with the risk categorization of the customers.
- Maintenance of a compliance culture across the organization ensuring that all employees starting from branch staff understand money laundering risks and all the consequences of breaches of the AML norms.
- Effective implementation of the KYC/AML policy of the Bank ensuring that the bank is not put to use for money laundering or terrorist financing activities.
- Development and maintenance of a comprehensive AML/Combating Financing of Terrorism (CFT) programme in line with the regulatory requirements covering systems and controls , training of staff and management oversight and ensure its effective implementation.
- Reporting on cash transactions above the limits specified, transaction involving receipts by nonprofit organizations and transactions involving the use of forged or counterfeit currency notes, to the Director, Financial intelligence unit – India.
- Monitoring of transactions with the intention of identifying and preventing frauds and malpractices, using fraud monitoring systems.

PRODUCTS/SERVICES PROFILE

1. Accounts
    - Savings accounts: We provide the best savings accounts possible to all types of clients. The end consumers' needs can best be met by the tailored options. It is now easier than ever to access your savings account with our user-friendly online banking tools.
    - Current account: For business customers across industries, we offer a wide range of Current Account products in a convenient, hassle free manner. Tailor made accounts for entrepreneurs, business men and individual customers are our specialty. Our catalogue of Current Accounts includes Basic, Classic, Premium and Diamond categories.
2. Deposits
    - Fixed: To earn the best interest rates, invest your money in the regular FD account of ESAF Small Finance Bank. You can invest your money with effortless ease, thanks to the well-established processes set for the same. From Regular FD and Tax savers FD account, you can choose the best one that fits your needs. With amazing interest rates and add on features, ESAF is the bank you can bank on. Come and experience the joy of banking and let your FD balance grow like never before.
    - Hrudaya: ESAF is a pioneer in offering its customers a unique social deposit product. As the name implies, Hrudaya Deposit supports social causes.

      Goal: ESAF Small Finance Bank has devised a creative way to offer our members reasonably priced financial services through Hrudaya Deposits.
      Highlights: An Opportunity to engage with the lowest strata of the society and can extend the engagement to other social classes. An opportunity for depositors to partake in the journey of serving the unbanked and under banked segments 3. Loans: We have created suitable lending options that satisfy our clients' needs. We understand that financial support is inevitable for holistic development of of the society. You will get performance reports on the funds on a regular basis. You possess the liberty to designate the

borrower group, your preferred location, and the intention behind mapping your deposit.

Basic Features

- Tenure: 1 year and above (Premature Facility available). Minimum deposit amount Rs.1 lakhs
- Extra features: Both Indian nationals and non-residents can use relationship banking. Can make online investments whenever it's convenient for you.
- Recurring: Recurring Deposits from ESAF allows you to build up your small savings. Small investments made at fixed intervals can be availed to meet your personal needs.

3. Loans:

We have created suitable lending options to satisfy our clients' needs. We are aware that monetary assistance is necessary for the society's overall development. With social upliftment as the prime focus area, our loan products are designed to cater to a multitude of customer segments. We provide a wide range of loans like micro housing loans & loans against property, business loans for entrepreneurs and 'Agri' loans to support farmers. Personal loans and micro financial loans are also provided by us to meet your needs.

4. Micro- Banking
    - Since launching our Micro Enterprises Development (MED) program in 1995, ESAF has established itself as a reputable name in microfinance.Since then, we have effectively spread the program across the nation, bringing social and economic prosperity to a number of underbanked and low-income societal groups. For those who are socially and economically disadvantaged, microbanking offers a comprehensive range of financial inclusion products and business development services. With group-based models, all financial services are delivered directly to your door via microbanking. When it comes to microbanking activities, they prioritize women, and over 1.20 million women are currently utilizing our services.Bank recently launched mobility banking in order to serve the

customers faster & better. Bank also provides all customers under the Micro Banking scheme, a PM Jan Dhan account with Debit cum ATM card.

5. Cards
    - Debit cards: ESAF has now offered its clients two different types of debit cards: a Platinum card with additional features and a Classic card with standard characteristics.

6. Payments
    - BBPS: We bring you the convenience of paying all your utility bills from one place. With Bharat Bill Payment System (BBPS) you can pay electricity bills, postpaid mobile/ landline/ broadband bills, DTH bills and many more. Use ESAF Internet Banking to pay bills easily and without difficulty.
    - UPI: The National Payments Corporation of India (NPCI) oversees the BHIM Unified Payment Interface (UPI), which is a payment platform. It enables money transfer between bank accounts or other payment systems via a Virtual ID made specifically for your bank account (NEFT/RTGS/IMPS). ESAF SFB is available on the BHIM UPI network. By connecting their ESAF bank account to the BHIM app, all ESAF clients can take advantage of the platform's benefits.

Features of UPI

- Instantaneous mobile money transfers available 365 days a year, 24 hours a day.
- Single mobile application for accessing different bank accounts.
- Single Click 2 Factor Authentication: This feature offers a smooth single click payment experience while adhering to regulatory rules.
- Virtual address of the customer for Pull & Push provides for incremental security with the customer not required to enter the details such as Card no, Account number; IFSC etc.
- Can be a solution to Cash on Delivery hassle, running to an ATM or rendering exact amount.
- Merchant Payment with Single Application or In-App Payments.

- Raising Complaint from Mobile App directly.

Customer Benefits

- 24X7 availability
- Access to different bank accounts through single app
- Virtual ID use is safer because there is no credential exchange.
- One click authentication
- Raise Complaint from Mobile App directly

Investments

- National Pension System (NPS)

SWOT Analysis of ESAF Small Finance Bank

Strengths

1. Strong Social Mission

- With a specific focus on underprivileged communities, ESAF Small Finance Bank has a distinct focus on financial inclusion and social impact. This goal draws in a devoted clientele that supports social concerns.

2. Wide Network and Reach

- With 614 ATMs and 753 banking locations spread throughout 23 states and 2 Union Territories, ESAF is well-represented in rural and semi-urban areas, improving accessibility for a greater number of people.

3. Diverse Product Portfolio

- In addition to savings and current accounts, fixed deposits, microbanking, loans, and digital banking options, the bank provides a wide range of financial goods and services. This variety improves customer retention by meeting a range of consumer wants.

4. Technological Integration

- ESAF has effectively integrated technology into its operations, offering internet banking, mobile banking, and other digital services, which improves operational efficiency and customer convenience

Weaknesses

1. Limited Brand Recognition

- In contrast to bigger national banks, there isn't as much awareness of the ESAF brand. This can make it difficult to draw in new clients, particularly in cities where there is fierce competition.

2. Dependency on Rural Markets

- The majority of ESAF's clientele is from semi-urban and rural regions. The bank's financial health and growth potential may be impacted by the economic volatility in these regions.

3. Resource Constraints

- As a small finance bank, ESAF may face constraints in resources such as capital and technological infrastructure compared to larger commercial banks. This can limit its capacity for expansion and innovation.

Opportunities

1. Expanding Digital Services

- With more people using digital banking services, ESAF has a chance to improve and promote its online and mobile banking offerings and draw in tech-savvy clients.

2. Regulatory Support

- An climate that is conducive to ESAF's service expansion and increased outreach to unbanked populations is created by government programs that support digital banking and financial inclusion.

3. Diversification of Services

- ESAF can lessen its reliance on rural areas and expand its customer base by introducing new products designed for urban and semi-urban markets.

Threats

1. Intense Competition

- There is fierce competition in the banking industry, especially in the small finance sector. Larger commercial banks with greater resources and networks as well as smaller financing institutions compete with ESAF.

2. Economic Fluctuations

- Economic volatility can have an impact on loan repayment rates and overall financial performance, particularly in rural areas where ESAF is heavily represented.

3. Regulatory Changes

- Modifications to banking laws and compliance standards may result in increased operational costs and have an impact on ESAF's business plan.

4. Cybersecurity Risks

- Cybersecurity risks affect ESAF as digital banking becomes more and more prevalent. Strong security protocols are essential to safeguarding client information and upholding confidence.

CHAPTER -II

REVIEW OF LITERATURE & THEORITICAL FRAMEWORK

2.1 LITERATURE REVIEW

Macaulay (1988) - On the implementation of best practices for credit risk management in US banks, more than 90% of those institutions have done so. Inadequate credit risk policies continue to be the primary cause of major issues facing the banking sector, which has led to a renewed focus on effective credit risk management in recent years. By keeping credit exposure within reasonable bounds, an efficient credit risk management program should aim to maximize a bank's risk-adjusted rate of return. Furthermore, banks must control both the risk associated with individual credit transactions and the credit risk across the board.

Donald et al. (1996) - Credit risk is the possibility that a counterparty or bank borrower won't fulfill its responsibilities under the terms of the agreement. By keeping credit risk exposure within reasonable bounds, credit risk management seeks to optimize a bank's risk-adjusted rate of return. Banks have to control both the risk associated with individual credits or transactions and the credit risk present in the entire portfolio. The correlations between credit risk and other hazards should be taken into account by banks. A thorough approach to risk management must include excellent credit risk management as a fundamental element, as it is vital to the long-term viability of any banking institution.

Ngugi (2001) - Suggests that the central bank of Kenya carried out a survey in September 2004 to ascertain the needs of the local banking sector with respect to risk management. The survey would give a status position on the degree to which risk management is practiced in the financial institutions operating in Kenya. According to the survey, banking organizations have a high degree of awareness regarding the significance of using systematic approaches for risk identification, analysis, and control or mitigation.

Cuthbertson and Nitzsche (2003) - Highlighted the significant transformation of risk management technology in the past decade. The advancements in information flow and international financial markets have given banks the ability to identify, assess, manage, and mitigate risks in ways that were previously unimaginable. The implementation of the Basel II Accord and the latest credit modeling software have played a crucial role in driving the development of appropriate credit risk modeling and capital adequacy requirements.

However, it is important to note that this accord cannot fully replace the need for a comprehensive business risk strategy.

Nelson and Schwedt (2006) - The banking industry has made significant advancements in managing credit risk. Previously, credit risk analysis focused mainly on individual loans, and banks held onto these loans until they matured. However, the approach has now evolved to include both loan reviews and portfolio analysis. Moreover, advancements in technology have allowed banks to move away from the traditional practice of holding loans on their books and instead adopt a more proactive strategy.

Hosna, Manzura, and Juanjuan (2009) - Investigated the influence of credit risk management on the profitability of commercial banks in Sweden. Their findings indicated that credit risk management has a considerable impact on profitability. Specifically, they observed a negative and significant correlation between non-performing loan ratio (NPLR) and profitability. Additionally, they found that capital adequacy ratio (CAR) positively contributes to profitability.

Tafri et al. (2009) - Examined the impact of financial risk in banks on their profitability in Malaysia. They found that credit risk has a significant impact on the financial indicators for conventional as well as Islamic banks. They found that interest rate risk has no significant impact on Islamic banks and has a weakly significant impact on conventional banks' return on equity. They also found that interest risk has a significant impact on the return on assets of banks and liquidity risk has a significant impact on both the financial indicators.

Kithinji (2010) - Found no association among profit, amount of credit, and level of non-performing loans. The author suggested that banks should focus on other factors along with credit and non-performing loans.

Ramadan et al. (2011) - Showed the impact of characteristics of internal and external factors of the bank on their profitability in Jordan. They found that characteristics such as low credit risk, good capitalization, high lending, and efficient cost management have a significant impact on the profitability of the bank. They suggested that banks should focus on these factors to enhance their profitability.

Kargi (2011) - Found that credit risk management of the banks has a significant impact on the bank's profitability in Nigeria. The author suggested that banks should focus on efficient credit policies that help in controlling credit risk and improving the banks' profitability.

Kaaya and Pastory (2013) - Conducted a study to examine how credit risk affects the financial performance of banks in Tanzania, specifically measured by return on asset. The study revealed that sound management practices and effective corporate governance play a crucial role in minimizing credit risk. By utilizing a regression model, the researchers discovered a negative correlation between credit risk and the performance of banks.

Ganesan (2013) - Discovered that the agriculture sector is the State Bank of India's primary worry when it comes to non-performing assets (NPAs), regardless of the size of the loans, the trend of inconsistencies, or government interference in terms of loan issuing regulations. According to the research, these and other natural disasters make it difficult for banks to recover loans from this particular sector, which accounts for the high proportion of non-performing assets.

Rani (2015) - In her investigations on the effects of non-performing assets (NPAs) on the financial standing of banks in the public and private sectors. She performed a regression analysis with the aim of determining the impact of non-performing assets (NPAs). The results showed that all eight sample banks taken into consideration for this research had their null hypothesis rejected.

Elbadry (2016) - Employed a range of independent and dependent variables in his article, including leverage ratios, provisions, and capital adequacy ratios. The article's findings show that while capital adequacy, provision, leverage, and asset utilization ratio have a favorable impact on operation risk, they have a negative impact on liquidity concerns for banks in Saudi Arabia.

Abel (2016) - Discovered that size, asset composition, credit risk, liquidity risk management, and expense management all had an impact on the banking industry's profitability in Zimbabwe. It was also discovered that raising the caliber of assets can increase banks' profits even further. The study demonstrates that bank managers significantly influence how profitable the various sectors are.

Ishaka & Ismail (2016) - Concluded in this paper that there is an indirect relationship between Return on Assets and both the Non-Performing Loan to Total Loan (NPLTL) and the Total Loan to Total Deposit (TLTD). The three listed commercial banks in Bursa, Malaysia, serve as the basis for the study.

Singh (2016) - Said that over the past ten years, non-performing assets (NPA) had tripled, raising serious concerns for Indian banks. According to the report, the non-standardized and inadequate recovery procedure is one of the main factors contributing to NPAs. Finally, the author suggests that the banks reorganize their loan programs and constantly monitor the borrowers. The author recommends that the RBI improve the current credit appraisal and grading criteria.

Sharma (2016) - Found the impact of NPA (gross and net) on the profitability of banks (ROA, ROI, and net interest margin) using regression analysis. It showed the result that there is a significant relationship between the variables. Thus, the impact is said to be existing between the profitability and the NPA of Indian Scheduled Bank.

Ghenimi et al. (2017) - Described credit risk management as "identifying, measuring, monitoring and controlling risk arising from the default," aiming for "reduction or elimination to avoid financial loss in lending."

Kohlscheen et al. (2018) and Hasan et al. (2020) - Highlighted bank profitability as an indicator of a bank's ability to earn profits, typically measured as the ratio of the bank's remaining profit after deducting taxes on its total capital or total assets. They utilized various measures of profitability including ROA (Return on Assets) and ROE (Return on Equity). ROA is defined as the ratio of net income to total assets, where a lower ROA suggests persistent lending and investment policies or high operating costs.

Akomeah et al. (2020) - Defined credit risk management as "the provision and management of the bank's credit limit," emphasizing it as "a combination of credit strategy and policy but also must maintain an appropriate credit risk scenario to protect and improve loan quality.

2.2 THEORETICAL FRAMEWORK

Risk

- Risk is exposure to uncertainty.
- Risk is a potential loss from a banking transaction
- Possibility of suffering from a loss , harm or danger

Risk is exposure to uncertainty: Risk is the result of future events or outcomes being inherently unpredictable. It recognizes that results can be influenced by uncontrollable events even with our best attempts to prepare and mitigate. This uncertainty may result from a number of things, including shifts in the economy, changes in the dynamics of the market, or unanticipated events .

Risk is a potential loss from a banking transaction: Risk in the context of finance is the chance that an investment or banking transaction may result in a financial loss. Lending money, buying stocks, or using sophisticated financial tools all include a risk that the expected gains won't materialize and cause financial difficulties.

Possibility of suffering from a loss , harm or danger: Risk doesn't just apply to financial situations; it also affects other areas of life. It includes the possibility of adverse consequences, which might range from injury to mental anguish. Extreme sports, medical operations, and even routine jobs like driving have inherent risks that might result in harm, damage, or other negative consequences for persons.

Credit Risk

Credit risk in most simple term is defined as the potential that a bank borrower or counter party will fail to meet its obligations in accordance with the agreed terms. There are many types of counterparty's obligations ranging from individuals to sovereign governments. Risk is inherent in all aspects of commercial operation. However, for banks and financial institution, credit risk is an essential factor that needs to be managed. Credit risk is the possibility that a borrower counter party will fail to meet its obligations in accordance with agreed terms. Credit risk, therefore, arises from the banks dealing with or lending to corporate, individuals and other banks or financial institutions. Credit risk is the largest element of risk in the books of banks and financial institutions.

Credit risk is the possibility of loss a bank might incur due to the following:

a) Default due to the inability or unwillingness (willful default) of a borrower or counterparty to meet commitments in relation to lending , trading , settlement or other financial transactions or,
b) Reduction in portfolio value arising from actual or perceived deterioration in credit quality of borrowers or counterparties.

- Default Risk: For banks and other financial institutions, default risk is the main worry. It includes the chance that one of the parties to a loan, trade, settlement, or other financial transaction may be unable to fulfill its half of the bargain. This failure may happen for several reasons:

a) Unable to Repay: If a borrower is in financial hardship and cannot afford to make their repayments, they may default. This may be the result of things like recessions, unforeseen costs, or inadequate money management.
b) Unwillingness to Repay (Willful Default): Although having the financial means to do so, debtors occasionally decide not to pay back their obligations. This could be the result of dishonest intents or strategic factors like trying to renegotiate conditions or take advantage of legal loopholes.
c) Counterparty Default: In addition to borrower default, counterparty default risk includes the possibility that counterparties will not perform as agreed upon in trading or settlement activities. This could happen as a result of operational issues, insolvency, or other circumstances that keep the counterparty from fulfilling its obligations.

- Credit Quality Deterioration: The possible decline in a bank's portfolio value as a result of real or perceived declines in counterparty or borrower credit quality is another facet of credit risk. There are several ways in which this decline may appear:

a) Credit Rating Downgrades: When a borrower's creditworthiness declines, rating agencies may downgrade their credit ratings, which can affect the value of the bank's bonds, loans, and other credit instruments. Reduced market demand for the borrower's debt securities or higher borrowing costs might arise from lower credit ratings, which signify an increased chance of default.
b) Market Perception of Risk: Shifts in market sentiment or views of the state of the economy can affect the value of credit instruments even in the absence of a real decline in credit quality. Investors may demand higher rates to offset their perceived heightened risk in response to negative news about a borrower's industry, regulatory changes, or geopolitical events. This will lower the value of the borrower's current credit exposures.
c) Credit Migration: The danger of borrowers moving from credit quality categories that are higher to ones that are lower is included in credit risk. This credit migration may happen more quickly in response to unanticipated circumstances like legal challenges, government acts, or natural disasters, or it may happen gradually as a result of changes in the borrower's financial situation.

Credit Risk Management

Credit Risk Management The goal of credit risk management is to maximize a bank’s risk adjusted rate of return by maintaining credit risk exposure within acceptable parameters. Bank need to manage the credit risk exposure inherent in the entire portfolio as well as the risk in individual credit or transactions. Bank should consider the relationship between credit risk and other risk. The effective management of credit risk is a critical component of a comprehensive approach to risk management and essential to the long-term success of any banking organization. Assessing credit risk an institution must consider three issues:

a) Default Probability
b) Credit Exposure
c) Recovery Rate

1. Default Probability : The possibility that a counterparty or borrower won't be able to fulfill its financial commitments in a given amount of time is known as the default probability. It measures the default risk connected to a certain borrower or counterparty and is a crucial component in determining credit risk.
   a) Measurement: A range of quantitative and qualitative techniques, including as statistical models, credit ratings, and expert opinion, can be used to evaluate the default probability. The probability of default is predicted by statistical models, like logistic regression or machine learning algorithms, by examining past data and pertinent financial metrics in relation to financial ratios, industry conditions, and macroeconomic indicators. The probability of default is also indicated by the credit ratings given by rating agencies; lower ratings correspond to a higher default risk.
   b) Factors: A number of factors, such as the borrower's financial stability and health, industry-specific risks, the state of the economy, and the terms of the credit arrangement, affect the likelihood of default. While financial difficulty, economic downturns, or unfavorable sector trends raise the possibility of default, stronger financial measures, reliable cash flows, and a good operational environment often suggest lower default probabilities.
   c) Use in Risk Management: A crucial component of credit risk assessment and management is default likelihood. Estimates of default likelihood are used by financial organizations to assess risk reserves, set lending terms, price credit products, and allocate capital. Institutions can evaluate the degree of risk associated with their credit exposures and implement appropriate risk management measures to minimize potential losses by calculating the likelihood of default.

2. Credit Exposure : Credit exposure is the possibility of suffering a monetary loss as a result of a counterparty's or borrower's default or non-performance. It gauges the quantity of money at risk and illustrates the size of possible losses in the case of default.

- Types of Credit Exposure: There are several ways in which credit exposure might manifest itself, such as:

a) Principal Exposure: The remaining principal on a loan, bond, or other credit instrument that has been given to the borrower.

b) Interest Exposure: The total amount of interest income that the lender anticipates earning during the duration of the loan arrangement.

c) Counterparty Exposure: The possible loss from dealing with a counterparty in derivatives, trading, or other financial transactions that involve both present and future responsibilities.

d) Off-Balance Sheet Exposure: Debt obligations, promises, or other contingent liabilities that, in the case of a negative event, could lead to credit losses.

e) Measurement and Management: In order to prevent future losses and maintain regulatory compliance, financial institutions measure and manage their credit risk. They use a range of risk management strategies, including credit limits, collateral restrictions, netting agreements, and credit derivatives, to spread credit risk over their portfolios and reduce exposure to specific counterparties or borrowers.

3. Recovery Rate : In the event of a borrower default or insolvency, the recovery rate is the percentage of the outstanding credit exposure that is retrieved by the lender or investor. The amount recovered from the sale or reorganization of collateral or other assets that the borrower pledged as security for payment of its debts is represented by this figure.

a) Calculation: The success of recovery attempts, the type of collateral, the legal and regulatory environment, and market conditions are some of the variables that affect recovery rate, which is commonly stated as a percentage of the overall credit exposure. It is computed as the actual recovery amount divided by the entire exposure, with any delays or recovery expenses taken into account .

b) Factors Affecting Recovery Rate: A number of factors affect the recovery rate, such as the effectiveness of legal and bankruptcy proceedings, the quality and liquidity of collateral, the seniority of the lender's claim in the case of insolvency, and the general state of the economy. Higher quality collateral and more robust legal safeguards typically lead to higher recovery rates; on the other hand, unfavorable market circumstances or inefficient operations may lower the likelihood of recovery.

c) Use in Credit Risk Management: Modeling credit risk, valuing portfolios, and allocating funds for credit losses all make use of recovery rate estimates. In order to determine the economic capital requirements and estimate potential loss given default (LGD), financial institutions include recovery rate assumptions in their risk assessments. Precise estimations of recovery rates are necessary to ascertain the sufficiency of risk reserves, set the appropriate price for credit products, and maximize capital allocation choices.

Principal of credit Risk management

The management of credit risk is essential to a sound credit management process, the basic principles a bank has to follow in its credit risk management are:

1. Background, Character and ability of the borrowers
2. Purpose of the facility
3. Term of facility
4. Safety and Security
5. Profitability
6. Source of repayment
7. Diversity of loan portfolio

1. Background, Character and ability of the borrowers : It is essential to evaluate the history, morality, and financial standing of borrowers. Analyzing their credit history, financial documents, track record as a business, managerial caliber, and honesty are all part of this. Determining the borrower's creditworthiness and reducing the default risk require an understanding of their capacity to repay debt commitments.
2. Purpose of the facility : It is crucial to assess the reason behind the credit facility request. Banks evaluate how well the planned use of the funds fits with the

borrower's risk tolerance, financial plan, and business goals. The risk of default is reduced when the facility's goal advances the borrower's long-term sustainability and financial stability.

3. Term of facility : Another important factor to think about is the credit facility's tenure or duration. Banks determine the proper repayment duration by taking into account the borrower's risk profile, business cycle, and cash flow estimates. Refinancing and liquidity risks can be reduced by matching the facility's tenure to the borrower's ability to repay and amount of liquidity required.
4. Safety and Security : Credit risk management heavily relies on security agreements. In order to reduce the risk of failure and minimize potential losses in the case of borrower insolvency, banks need sufficient collateral or security. To evaluate credit risk and safeguard the bank's interests, security asset quality, value, and enforceability must be assessed.
5. Profitability : Banks must strike a balance between sound risk management measures and the pursuit of profit, even if profitability is a crucial factor. Evaluating the trade-off between risk and return makes sure that lending decisions are both financially feasible and in line with the bank's return goals and risk tolerance. In order to maintain profitability and efficiently manage credit risk, banks take into account variables including interest rates, fees, margins, and credit spreads.
6. Source of repayment : Assessing the borrower's ability to meet debt commitments requires evaluating the source of repayment. The cash flows or income streams that will be utilized to repay the credit facility are examined by banks for stability, dependability, and predictability. Repayment certainty is increased and dependence on a single revenue stream is decreased through source diversification.
7. Diversity of loan portfolio : Reducing concentration risk and improving portfolio resilience need a well-diversified loan portfolio. In order to lessen correlation and exposure to certain risks, banks evaluate the distribution of credit exposures across various businesses, geographical areas, and borrower categories. Banks can distribute risk more successfully and reduce the negative effects of unforeseen occurrences on the performance of their entire portfolio by implementing diversification.

Tools used in Credit Risk Management

The quality of the credit portfolio of banks depends to large extent on the quality of its borrower.

To judge the quality of a borrower the bank's takes into consideration the following:

a) Character: It refers to the willingness of the customers to pay.
b) Capacity: The customer's ability to meet credit obligations.
c) Capital: The customer's financial reserves d) Collateral: Adequate net worth to support for the loan
d) Conditions :(economic)Recent trends in borrower line of credit
e) Compliance :(law& regulations)

1. Character : Is a term that describes a borrower's standing, morality, and readiness to repay credit. It includes elements like integrity, dependability, and moral behavior in financial transactions. To determine a borrower's degree of dependability and commitment to paying back loans, banks look at their prior actions, credit history, payment history, and interactions with creditors. While negative features might raise questions about creditworthiness and increase the chance of default, positive traits imply a higher likelihood of prompt repayment.
2. Capacity : Based on their financial resources and ability to generate revenue, the borrower's capacity is a representation of their ability to repay loan commitments. In order to determine the borrower's capacity to repay both current and new debt, it assesses their cash flow, income stability, profitability, and debt service coverage ratio (DSCR). Banks use information from operating margins, financial ratios, and revenue forecasts, among other sources, to assess a borrower's ability to repay credit. A weak capacity raises questions about creditworthiness and repayment abilities, whereas a robust capacity suggests a decreased likelihood of default.
3. Capital : The term "capital" describes the borrower's equity, net worth, and financial reserves, which act as a safety net to withstand setbacks and sustain loan commitments. It evaluates the borrower's ability to weather unfavorable

circumstances or financial hardship in terms of strength, solvency, and liquidity. To ascertain a borrower's capacity to withstand losses and preserve financial stability, banks assess the borrower's capital sufficiency in relation to loan levels, leverage ratios, and industry benchmarks. While inadequate capitalization raises questions about credit risk and financial vulnerability, higher levels of capital suggest better financial resilience and lower the chance of default.

4. Conditions : Macroeconomic variables, market dynamics, and industry developments all fall under the category of economic conditions and can have an effect on a borrower's capacity to repay loan. Banks examine the possible impact on borrower creditworthiness and repayment ability by looking at a variety of parameters, including GDP growth, inflation rates, interest rate patterns, and industry-specific characteristics. Current patterns in borrower credit lines, company performance, consumer demand, and competitive dynamics offer important new perspectives on the state of the economy and risk factors that influence credit risk. Banks incorporate economic variables into their risk assessment procedures to foresee possible hazards, modify lending policies, and reduce vulnerability to unfavorable economic occurrences.
5. Compliance : Ensuring the legitimacy, validity, and enforceability of credit agreements and transactions requires strict adherence to laws and regulations. Banks evaluate whether the borrower complies with all relevant legal and regulatory obligations, such as financial regulations, licensing, permits, zoning laws, environmental restrictions, and laws protecting consumers. Borrowers who violate legal and regulatory standards run the danger of facing legal action, fines, penalties, and reputational harm, all of which can negatively affect their creditworthiness and capacity to maintain their financial stability. In order to confirm compliance and reduce the legal and regulatory risks connected to credit transactions, banks carry out due diligence.

Theoretical Background

Credit risk refers to the possibility that a borrower may fail to repay their debt in full or in part, as agreed upon. This risk is a constant presence for banks due to the nature of their operations. It is crucial for banks to actively manage credit risk and effectively utilize their available funds across various economic sectors. By doing so, they not only safeguard their own stability but also contribute to the stability of the entire banking system. Studies have shown that effective risk management has a significant impact on banks' profitability. Factors such as bad loans, credit risk, liquidity risk, and capital risk greatly influence the performance of banks. It is important for banks to allocate sufficient resources to enhance their credit management capabilities and strike a balance between lending resources, risk factors, and borrowing demands. The current study is grounded in various theories that explain the theoretical framework of banks' performance and the factors that determine it.

The Commercial Loan Theory

The real bills doctrine theory, also known as the commercial loans theory, is the oldest theory regarding the fundamental business activities of banks. According to this theory, banks should only provide self-liquidating short-term loans and commercial papers to their clients (Hosna & Manzura, 2009). The purpose of the theory is to provide guidance to banks and influence them in a logical and convincing manner regarding their lending processes and overall economic activities.

The principle of this theory heavily relies on the display of liquidity, which in turn impacts all economic activities. As a result, some banks, whose liquidity primarily comes from customer deposits, believe that short-term loans are the most suitable option. This is because customer deposits can be withdrawn at any time and have a short-term nature. However, this approach does not benefit banks that maintain substantial reserves and aim to support developing economies by providing medium- and long-term loans, such as those for industrial and real estate purposes. Consequently, this creates a gap in economic development that relies on long-term financing for various sectors.

Therefore, adhering to this theory is crucial in order to place bank credit within its intended short-term context. However, it is important to note that this theory does not take into account the relative stability of bank deposits. In reality, not all withdrawal requests, whether normal or unusual, occur simultaneously. The relative stability of deposits allows banks to utilize them for reasonable periods of time without facing a high risk of liquidity shortage.

Despite the shortcomings of this theory, many banks worldwide still apply its fundamental principle of short-term lending and employ banking screening and activity evaluation procedures. Consequently, researchers and banking experts emphasize the significance of understanding the current banking activities and practices by evaluating the historical context of banks, which is primarily linked to comprehending the commercial loans theory.

Shiftability Theory

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The Anticipated Income Theory

H.V. Prochanow introduced a theory in 1944 regarding the extension of term loans by commercial banks in the United States. In 1949, Prochanow conducted a thorough study on loans and bank assets, leading to the development of the "Anticipated Income Theory." This theory, as highlighted by Soyibo, et al. (2004), primarily emphasizes long-term loans and advances. Afriyie & Akotey (2011) concluded in their study that banks aim to repay borrowers through expected profits rather than by monetizing assets or transferring loans to other lenders, regardless of the borrower's character or business nature. The Anticipated Income Theory suggests that banks should lend based on expected income rather than the current values of assets. Notably, this theory envisions loans and banking facilities being repaid or transferred to liquidity through cash flows or expected profits from the borrower's business and projects (Kolapo, et al., 2012). While the Anticipated Income Theory was a response to the commercial loan theory, it did not challenge the shiftability theory or capacity theory. Instead, it drew attention to the types of loans most suitable for banks and banking professionals.

The Credit Risk Theory

The credit risk theory posits that there is a possibility that the lender may face delays or defaults in receiving the installments or interests owed by the borrower (Dimitrios P. Louzis, et al., 2012). This risk entails the lender being at risk of financial distress, which may prevent them from returning deposits to depositors or meeting other financial obligations due to the loss of capital and interest. Additionally, the lender may face significant losses if borrowers fail to repay their loans, leading to what is known as non-performing loans. Consequently, lenders often perform credit checks, require loan insurance such as mortgage insurance, and seek additional guarantees for loans secured by the borrower's assets, such as personal guarantees or third-party guarantees. As a result, the level of risk associated with borrowers directly impacts the cost of loans, including interest rates and fees.

The Liability Management Theory

This theory argues that traditional practices in debt and liquidity management at banks are insignificant because banks can easily obtain money through short-term debt instruments from the capital market to address any reserve deficits. However, this does not imply that banks solely focus on managing their liabilities and neglect their assets. On the contrary, the liability management theory emphasizes the importance of the bank's asset structure in ensuring liquidity. Nevertheless, this theory has evolved to acknowledge the role of liabilities in providing adequate liquidity to fulfill withdrawal demands and meet loan applications. It is crucial to note that loans alone do not generate income for the bank. If a bank fails to provide sufficient liquidity to meet the loan and banking needs of its depositors, it will inevitably struggle to retain these depositors in the long run.

Credit Risk Assessment Approaches

The prospective loan poses a credit risk to financial institutions, which is assessed through credit analysis to determine the likelihood of customer default. In optimizing credit decisions, three main approaches are utilized outside of microfinance: the Structural approach, statistical approach, and expert-judgement approach. The Structural approach involves modeling the underlying dynamics of interest rates and firm characteristics that could lead to default events, using stochastic processes to evaluate default probability. This approach is commonly used in portfolio credit risk models, but it requires complex mathematical and stochastic techniques that may be challenging to implement. Moreover, this approach is limited in its applicability to public firms as it necessitates specific information, such as borrower's stock prices, which may not be available for all borrowers. Therefore, microfinance institutions and banks offering consumer loans may not benefit from this approach. The empirical or statistical approach, on the other hand, involves the use of credit scoring models in internal rating systems of some banks. According to the Basel Committee's principle 3, banks should validate their internal credit risk assessment models, which can be used in various aspects of the credit risk assessment process. These models link borrower characteristics to repayment performance on previous loans to estimate the likelihood of borrower default based on historical data.

Relationship between Credit Risk Management and Financial Performance

Various studies have emphasized the effectiveness of credit scoring in the financial sector. The credit scoring model streamlines the credit evaluation process, replacing manual loan decisions and addressing the high costs associated with gathering pertinent borrower information, thereby reducing administrative expenses. This proves to be highly advantageous as the narrow profit margins of microcredit make manual loan decisions increasingly unfeasible. Several scholars (Dellien, 2003; Kuhn and Olsen, 2008; Schreiner, 2003; Viganò, 1993) have highlighted these benefits. Additionally, different researchers (Berger et al., 2005; Fishelson-Holstine, 2004) have demonstrated that credit scoring not only boosts profits but also expands the client base, particularly among low-income individuals. Schreiner (2003, 2005) and Dellien (2003) have concluded that credit scoring enhances the scope, depth, and duration of outreach by reducing transaction costs, optimizing loan officers' time management, and thereby enhancing credit decisions and portfolio management. Simbaqueba et al. (2011) argue that due to the increasing demand for microcredit, it may not be feasible or cost-effective for microfinance institutions to train and retain a sufficient number of experienced credit evaluators, suggesting that credit scoring technology significantly enhances micro-lending. Moreover, the scoring model enables the adjustment of interest rates and fees based on risk (Kuhn and Olsen, 2008; Schreiner, 2003). Furthermore, the scoring approach identifies key risk factors, facilitating the development of more robust risk management systems and fostering a quantitative risk culture (Schreiner, 2005; Van Gool et al., 2011). Notably, by explicitly defining criteria, credit scoring diminishes the subjective element in loan decisions, reducing the potential for discrimination and bias by individual loan officers and minimizing human error in the credit evaluation process (Kuhn and Olsen, 2008; Schreiner, 2005). However, some critics argue that credit scoring has its limitations, such as overlooking qualitative aspects. Some scholars argue that various underlying components of credit risk management have an impact on performance, either in conjunction with other elements or independently. For example, research utilizing the CAMEL model has consistently found that the quality of earnings has a positive effect on the financial performance of financial institutions (Frederick, 2012). However, there is no unanimous agreement on the impact of other indicators such as Capital adequacy, Asset quality, and Management efficiency.

While Capital adequacy is believed to bolster performance by providing institutions with a strong capacity (Oludhe, 2011; Abiola, 2014; Iftikhar, 2016), some researchers have surprisingly discovered negative correlations between the two variables (Frederick, 2012). Nevertheless, a significant number of scholars have concluded that there are negative associations between credit risk management and financial performance. Some studies have used the Non-performing Loan ratio as an indicator, with findings supporting this negative relationship (Kargi, 2011; Epure & Lafuente, 2012). However, Abiola (2014) and Alshatti (2015) have unexpectedly found a positive relationship explained by the same indicator. This is attributed to the fact that despite high loan defaults, non-performing loans are increasing in proportion to profitability.

Additionally, researchers focusing on default rates, bad debt costs, cost per loan asset (Musyoki and Kadubo, 2012), Portfolio at Risk, Loan Loss Provision Ratio parameters (Otieno, Nyagol, and Onditi, 2016), less prudent lending (Berríos, 2013), among others, have all reached the consensus of negative relationships between credit risk management and financial performance. Despite the various perspectives on the relationship between credit risk management and financial performance, scholars unanimously advocate for the implementation of effective credit risk management practices in financial institutions to enhance performance levels. Kargi (2011), Fredrick (2012), and Poudel (2012) assert that credit risk management is crucial for optimizing the performance of financial institutions. Similarly, Berríos (2013) and Gatuhu (2011) posit that sound credit management is a prerequisite for the stability and profitability of financial institutions, as deteriorating credit quality often leads to poor financial performance.

A study conducted by Kaaya and Pastory (2013) revealed that the performance of banks can be improved through efficient credit risk management. Various strategies have been developed to minimize or completely mitigate the negative impacts of credit risk on bank performance. However, it is essential for banks to establish a robust framework for credit risk management in order to ensure their survival and profitability (Oke et al., 2012).

An effective credit risk management process enables credit managers to evaluate the potential of clients before extending credit to them (Gaitho, 2010). It also involves gathering reliable information from prospective borrowers (Derban et al., 2005) and promptly identifying any issues or conditions that require attention through the review of portfolio performance records. Gaitho (2010) emphasizes that credit risk management should encompass regular communication with borrowers, fostering an environment where the lending institution is perceived as a problem solver and trusted advisor. Additionally, developing a supportive culture towards borrowers is crucial for improving the long-term performance of the loan portfolio.

The firm's performance is significantly influenced by the success of credit risk management, as evidenced by various studies (Kargi, 2011; Abiola & Olausi, 2014; Musyokil & Kadubo, 2012). The primary objective of credit risk management is to optimize a bank's risk-adjusted rate of return by maintaining credit risk exposure within acceptable limits (Musyokil & Kadubo, 2012). Furthermore, it is widely acknowledged that effective risk management plays a crucial role in delivering superior returns to shareholders (Akkizidis and Khandelwal, 2007; Al-Tamimi and Al-Mazrooei, 2007).

The efficient management of credit risk is an integral component of the overall risk management framework and is essential for the long-term viability of banking institutions.

Variables

<u>Independent Variable</u>

Credit Risk Management

1. Net NPA
2. Gross NPA

1. **Net NPA**: After subtracting dubious and unpaid loans from the GNPA, the remaining amount is known as the net non-performing asset (NNPA). The bank sustained this loss.

   Net NPAs = Gross NPAs – Provisions

2. **Gross NPA**: The total amount of loan assets that have not been returned by borrowers within the allotted ninety days is known as gross non-performing assets, or GNPA.

   Gross NPAs = (Substandard + Doubtful + Loss) assets

<u>Dependent Variable</u>

Bank Performance

1. CAMEL MODEL

The CAMELS model is a comprehensive and internationally recognized system used by regulatory authorities to assess the health and stability of financial institutions, particularly banks. CAMELS stands for:

C - Capital Adequacy
A - Asset Quality
M - Management Quality
E - Earnings
L - Liquidity

A scale of 1 to 5 is used to rank each of these elements, with 5 being the worst (weakest) and 1 representing the best (strongest). Here's a quick rundown of every element:

Capital Adequacy

This measures a bank's capital relative to its risks. It ensures that the bank has enough capital to absorb potential losses and protect depositors. Key ratios include:

- Capital Adequacy Ratio (CAR)
- Tier 1 Capital Ratio

Asset Quality:

This assesses the quality of a bank's assets, primarily its loan portfolio, and its ability to manage credit risk. Key indicators include:

- Non-Performing Loans (NPL) Ratio
- Allowance for Loan Losses

Management Quality:

This evaluates the competence and effectiveness of a bank's management in ensuring the institution's soundness, compliance with regulations, and responsiveness to financial stress. Factors include:

- Governance Practices
- Strategic Planning and Implementation

Earnings:

This examines the bank's profitability and ability to generate income to support operations, grow, and provide returns to shareholders. Key metrics include:

- Return on Assets (ROA)
- Return on Equity (ROE)
- Net Interest Margin (NIM)

Liquidity:

This evaluates a bank's ability to meet its short-term obligations without incurring unacceptable losses. Key ratios include:

- Liquidity Coverage Ratio (LCR)

CAMELS Rating System:

The ratings for each component are aggregated to form a composite rating, also on a scale of 1 to 5:

1: Strong performance and risk management practices.

2: Satisfactory performance and risk management practices.

3: Performance and risk management practices that need improvement.

4: Deficient performance and risk management practices.

5: Critically deficient performance and high risk of failure.

CHAPTER -III

DATA ANALYSIS AND INTERPRETATION

3.1 Total Credit Exposure of ESAF Bank

YEAR	Total Credit Exposure (Rs. in Crore)
2020 -2021	8,369
2021-2022	12,057
2022- 2023	14,010

Table 3.1Total Credit Exposure between 20220 -2021 to 2022- 2023

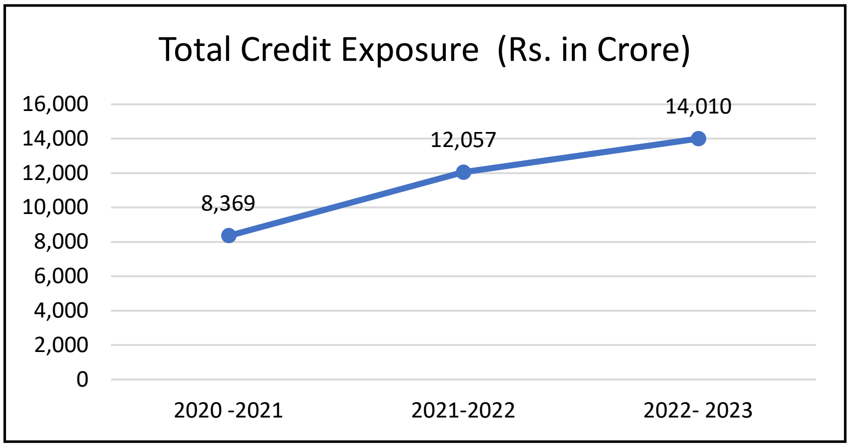

Figure 3.1 Total Credit Exposure between 20220 -2021 to 2022- 2023

INTERPREATION:

- The total credit exposure of ESAF Bank has been increasing steadily over the three-year period, with a compound annual growth rate (CAGR) of approximately 14%.
- The exposure increased by 44% from 8,369.14 crores in 2020-2021 to 12,057.28 crores in 2021-2022, indicating a significant expansion of the bank's lending activities during this period.
- The growth rate slowed down in the subsequent year, with an increase of 16% from 12,057.28 crores in 2021-2022 to 14,009.89 crores in 2022-2023. This could be due to various factors such as changes in the bank's lending strategy, regulatory requirements, or economic conditions.
- The increasing trend in total credit exposure suggests that ESAF Bank is taking on more risk, which could be beneficial if managed properly. However, it also increases the potential for losses if the borrower's default on their loans.

3.2 Credit Exposures by Risk Weights of ESAF Bank

Risk Weight	YEAR	Exposure (Rs. in Crore)	Risk Weighted Assets (Rs. in Crore)
Below 100% risk weight	2020 -2021	7,409.17	5,419.62
100% risk weight	2020 -2021	224.45	213.45
More than 100%	2020 -2021	735.52	133.37
Total	2020 -2021	8,369.14	5,766.44
Below 100% risk weight	2021-2022	10,003.58	7,186.21
100% risk weight	2021-2022	890.72	702.63
More than 100%	2021-2022	890.72	126.51
Total	2021-2022	12,057.28	8,015.35
Below 100% risk weight	2022 -2023	10,925.55	7,917.94
100% risk weight	2022 -2023	890.32	850.57
More than 100%	2022 -2023	2,194.02	166.7
Total	2022 -2023	14,009.89	8,935.21

Table 3.2 Credit Exposures by Risk Weights between 20220 -2021 to 2022- 2023

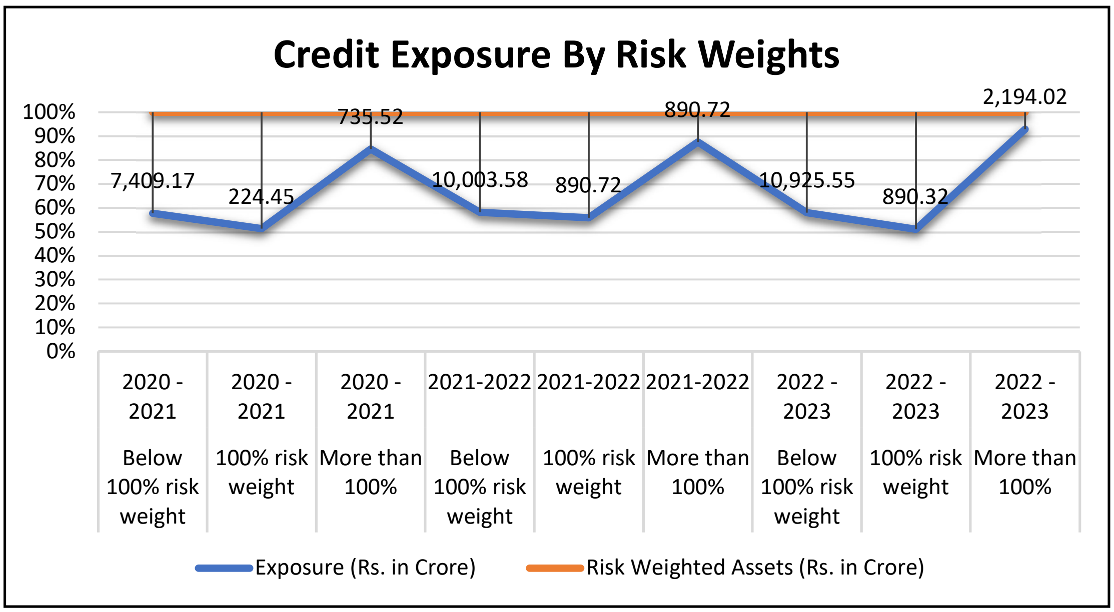

Figure 3.2 Credit Exposures by Risk Weights between 20220 -2021 to 2022- 2023

INTERPREATION:

- The majority of the credit exposure (around 70-80%) falls under the 'Below 100% risk weight' category, which is considered less risky. This suggests that ESAF Bank has a relatively conservative lending approach, with a focus on lower-risk borrowers.

- The '100% risk weight' category accounts for around 10-15% of the total exposure, indicating that the bank has a moderate level of exposure to borrowers with average credit quality.
- The 'More than 100% risk weight' category, which includes higher-risk borrowers, has been increasing over the three-year period. This could be a cause for concern, as higher-risk lending can lead to higher default rates and potential losses for the bank.
- The risk-weighted assets (RWAs) have also been increasing, which could indicate that the bank is taking on more risk or that the risk profile of its borrowers is deteriorating.

3.3 Capital Adequacy of ESAF Bank

Year	Capital (in crores)	Risk weighted assets (in crores)	Capital Adequacy Ratio (%)
2020 -2021	1,562.65	6488.9	24.23
2021-2022	1,632.17	8,757.82	18.64
2022 -2023	1,871.36	9,436.60	19.83

Table 3.3 Capital Adequacy between 20220 -2021 to 2022- 2023

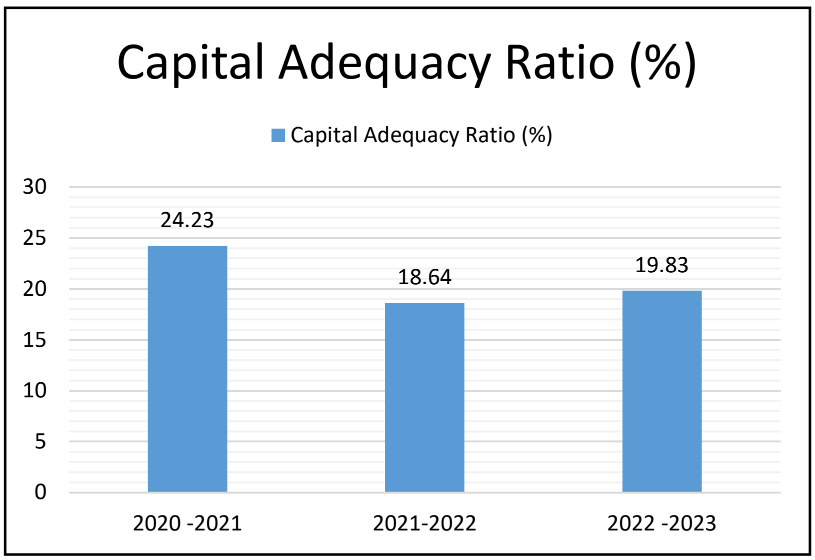

Figure 3.3 Capital Adequacy between 20220 -2021 to 2022- 2023

INTERPREATION:

- The capital adequacy ratio (CAR) has been decreasing over the three-year period, from 24.23% in 2020-2021 to 19.83% in 2022-2023.
- While the CAR is still above the regulatory minimum of 10.5%, the downward trend could indicate a potential weakening of the bank's capital position.
- A decreasing CAR could be due to various factors such as an increase in RWAs, a decrease in capital, or a combination of both.

- The bank should closely monitor its capital adequacy and take measures to maintain a sufficient capital buffer to support its lending activities and absorb potential losses.

3.4 Springate z score Model of ESAF Bank

Working capital/Total Assets (in crores)						
		2019	**2020**	**2021**	**2022**	**2023**
Working capital		5,293	7,462	9,975	12,950	14,658
Total Asset		7,058	9,470	12,339	17,708	20,224
Working capital/Total capital		75.0%	78.8%	80.8%	73.1%	72.5%
EBIT / Total assets (in crores)						
		2019	**2020**	**2021**	**2022**	**2023**
EBIT		902.8	1903.9	1054.0	547.3	3023.3
Total Asset		7,058	9,470	12,339	17,708	20,224
EBIT / Total assets		12.8%	20.1%	8.5%	3.1%	14.9%
Profit before tax / Current Liabilities (in crores)						
		2019	**2020**	**2021**	**2022**	**2023**
Profit Before Tax		1271	2562	1413	738	4060
Current Liabilities		6164	8385	10986	16295	18,508
Profit before tax / Current Liabilities		20.6%	30.6%	12.9%	4.5%	21.9%
Revenue / Total Assets (in crores)						
		2019	**2020**	**2021**	**2022**	**2023**
Revenue		1,032	1,413	1,641	1,940	2,854
Total Asset		7,058	9,470	12,339	17,708	20,224
Revenue / Total Assets		14.6%	14.9%	13.3%	11.0%	14.1%
SPRINGATE Z SCORE						
		2019	**2020**	**2021**	**2022**	**2023**
Final Score		1.360	1.690	1.233	0.922	1.407
Financial Stability		Strong	Strong	Strong	Strong	Strong

INTERPREATION:

- The Springate Z-Score model is used to assess the financial stability of a bank. The scores for ESAF Bank have been decreasing over the three-year period, from 1.690 in 2020 to 0.922 in 2022.
- While the scores still indicate a 'Strong' financial stability, the downward trend could be a warning sign. A score below 1.1 is considered 'Distress', so the bank should take measures to improve its financial stability.
- The decreasing Z-Score could be due to various factors such as an increase in non-performing assets, a decrease in profitability, or a deterioration in the bank's asset quality.
- The bank should closely monitor its financial stability and take corrective measures to improve its Z-Score and maintain a strong financial position.

In conclusion, the data suggests that ESAF Bank's lending activities and total credit exposure have been growing, but the bank's risk profile and financial stability have been showing signs of weakening. The bank should closely monitor its risk exposures, capital adequacy, and financial stability, and take measures to improve its overall risk management and financial position.

3.5 Gross NPA of ESAF and Peer Banks

BANKS	2020 -2021	2021-2022	2022-2023	Average	Rank
ESAF	6.7	7.8	2.5	5.67	5
AU	4.4	2.0	1.7	2.66	1
EQUITAS	3.7	4.2	2.8	3.58	2
UTTKARSH	3.8	6.1	3.2	4.36	3
UJJIVAN	7.1	7.1	2.6	5.60	4

Table 3.5 Gross NPA between 2020 -2021 to 2022- 2023

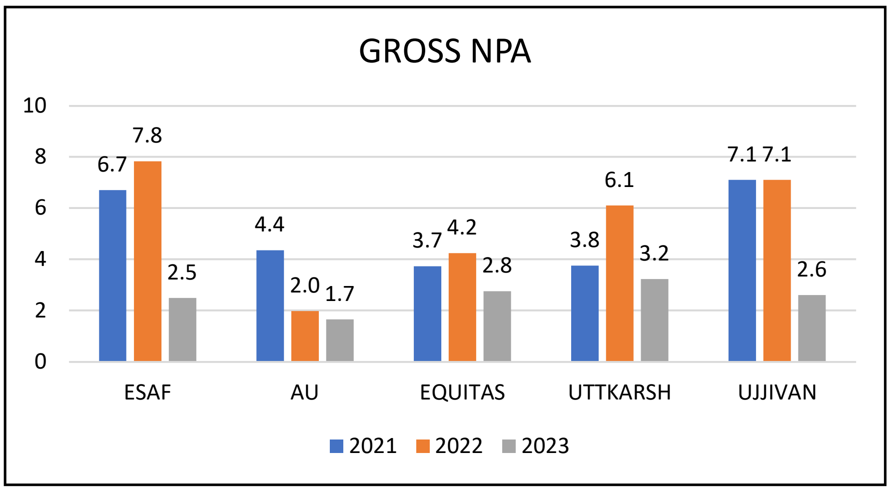

Figure 3.5 Gross NPA between 2020 -2021 to 2022- 2023

Interpretation:

1. ESAF: Gross NPA increased from 6.7% in 2020-2021 to 7.8% in 2021-2022, likely due to the pandemic's impact on borrowers' repayment capabilities. The sharp decrease to 2.5% in 2022-2023 indicates effective recovery measures and improved economic conditions.
2. AU: A consistent decrease from 4.4% to 1.7% suggests strong credit risk management and possibly a more resilient borrower base.
3. EQUITAS: While the increase to 4.2% in 2021-2022 might be attributed to economic disruptions, the subsequent decline to 2.8% shows recovery and better asset quality management.

4. UTTKARSH: The spike to 6.1% in 2021-2022 could be due to similar economic challenges, with the reduction to 3.2% reflecting recovery efforts.
5. UJJIVAN: Stable high NPAs around 7.1% initially indicate persistent challenges, with a significant drop to 2.6% highlighting improved recovery processes and economic recovery.

3.6 Net NPA of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	3.9	3.9	1.1	2.98	5
AU	2.2	0.5	0.42	1.04	1
EQUITAS	1.5	2.4	1.2	1.70	4
UTTKARSH	1.3	2.3	0.4	1.34	3
UJJIVAN	2.9	0.6	0.04	1.18	2

Table 3.6 Net NPA between 2020 -2021 to 2022- 2023

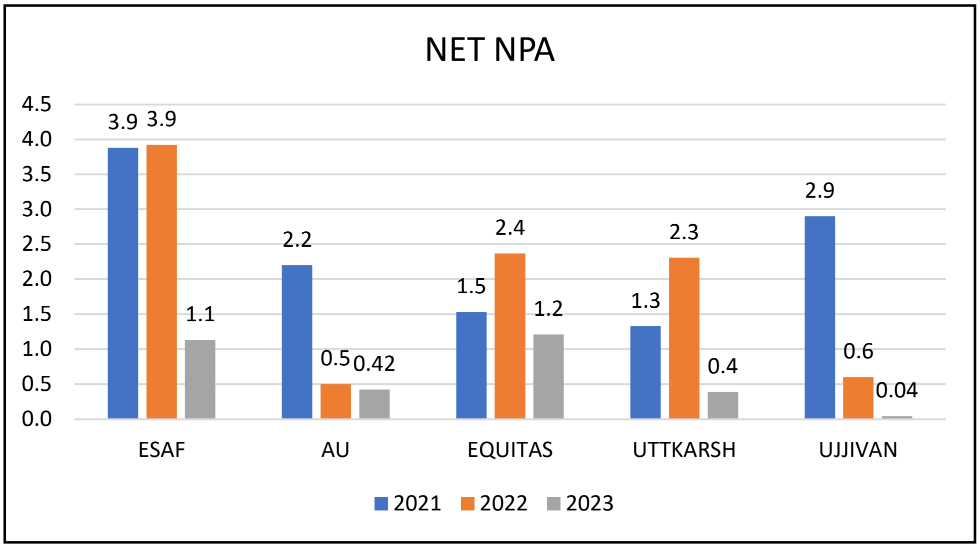

Figure 3.6 Net NPA between 2020 -2021 to 2022- 2023

Interpretation:

1. ESAF: The decline from 3.9% to 1.1% indicates better recovery of bad loans and improved asset quality.
2. AU: Consistently low Net NPA, decreasing to 0.42%, reflects excellent credit management and effective recovery of bad loans.
3. EQUITAS: The peak at 2.4% in 2021-2022 followed by a decrease to 1.2% indicates initial struggles but effective subsequent measures for bad loan recovery.
4. UTTKARSH: The initial increase to 2.3% before reducing to 0.4% suggests initial challenges followed by significant improvements in asset quality.
5. UJJIVAN: A drastic reduction to 0.04% from 2.9% shows highly effective recovery efforts and improved credit risk management.

3.7 Credit to Deposit ratio of ESAF and Peer Banks

BANKS/ YEAR		ESAF	AU	EQUITAS	UTTKARSH	UJJIVAN
Total Loan (in crores)	2020-2021	8,167.59	35,356.29	17,224.80	8,415.66	15,139.96
	2021-2022	11,637.00	46,788.79	19,731.91	10,630.72	17,487.65
	2022-2023	13,924.33	59,157.70	26,210.50	13,357.11	21,911.23
Total Deposits (in crores)	2020-2021	8,999.43	35,979	16,392	7,507.57	13,136
	2021-2022	10,708.97	52,585	18,951	10,074.18	18,292
	2022-2023	13,574.00	69,365	25,381	13,710.14	25,538
Percentage %	2020-2021	90.76	98.27	105.08	112.10	115.26
	2021-2022	108.67	88.98	104.12	105.52	95.60
	2022-2023	102.58	85.28	103.27	97.43	85.80

Table 3.7 Credit to Deposit Ratio between 2020 -2021 to 2022- 2023

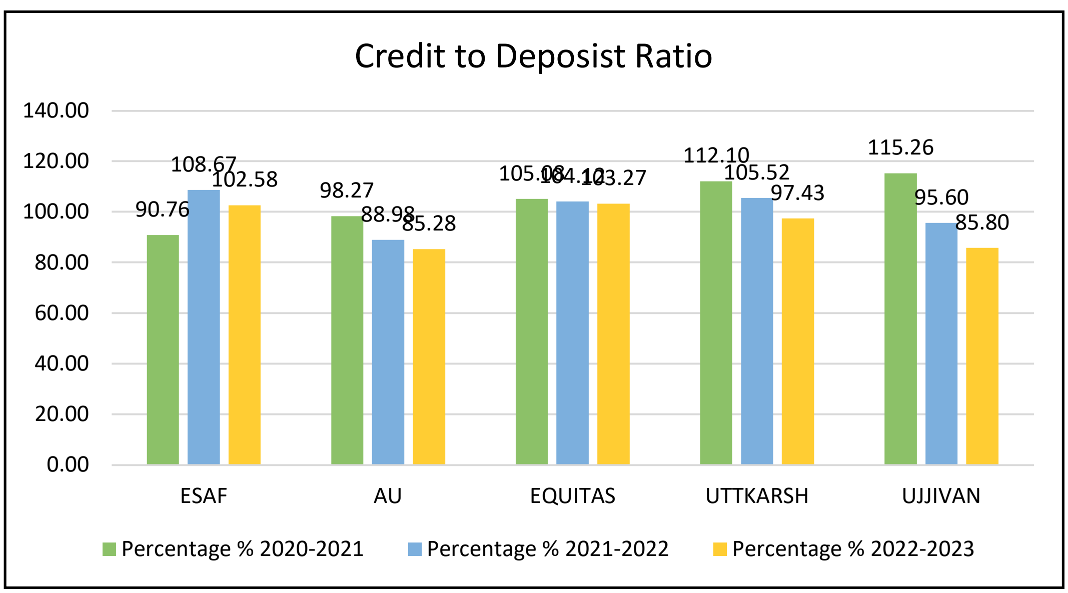

Figure 3.7 Credit to Deposit Ratio between 2020 -2021 to 2022- 2023

Interpretation:

1. **ESAF**: The ratio increased to 108.67% in 2021-2022, indicating aggressive lending relative to deposits. The slight decrease to 102.58% in 2022-2023 suggests a more balanced approach.
2. **AU**: The steady decline from 98.27% to 85.28% indicates a conservative approach towards lending or a substantial increase in deposits.
3. **EQUITAS**: Maintaining high ratios around 103% shows aggressive lending strategies.
4. **UTTKARSH**: The ratio's decrease from 112.10% to 97.43% suggests a shift towards more conservative lending or improved deposit mobilization.
5. **UJJIVAN**: The decrease from 115.26% to 85.80% indicates a significant increase in deposits or a more cautious lending approach.

3.8 Sector wise distribution of Gross Loans & Advances

BANK	YEAR	Industry Classification	Outstanding Total Advances (in crores)	% Share
ESAF	2020-2021	Agriculture and Allied Activities	3749	71%
		Industries Sector	447	8%
		Trade & Services	466	9%
		Personal Loans and other Retail	666	13%
		Total	5328	100%
	2021-2022	Agriculture and Allied Activities	5246	57%
		Industries Sector	850	9%
		Trade & Services	1602	17%
		Personal Loans and other Retail	1508	16%
		Total	9205	100%
	2022-2023	Agriculture and Allied Activities	7996	71%
		Industries Sector	683	6%
		Trade & Services	1861	16%
		Personal Loans and other Retail	794	7%
		Total	11334	100%
AU	2020-2021	Agriculture and allied activities	6738	27%
		Industries Sector	2831	11%
		Trade & Services	14537	58%
		Personal Loans and other Retail	832	3%
		Total	24939	100%
	2021-2022	Agriculture and allied activities	33292	100%
		Industries Sector	13388	40%
		Trade & Services	31028	93%
		Personal Loans and other Retail	3082	9%
		Total	33292	100%
	2022-2023	Agriculture and allied activities	8636	25%
		Industries Sector	4813	14%
		Trade & Services	2084	91%
		Personal Loans and other Retail	4096	12%

		Total	35058	100%
EQUITAS	2020-2021	Agriculture and allied activities	2784	27%
		Industries Sector	740	7%
		Trade & Services	4664	46%
		Personal Loans and other Retail	2070	20%
		Total	10257	100%
	2021-2022	Agriculture and allied activities	3286	24%
		Industries Sector	1144	8%
		Trade & Services	6732	50%
		Personal Loans and other Retail	2422	18%
		Total	13583	100%
	2022-2023	Agriculture and allied activities	4279	24%
		Industries Sector	1719	10%
		Trade & Services	8435	48%
		Personal Loans and other Retail	3071	18%
		Total	17503	100%
UTTKARSH	2020-2021	Agriculture and allied activities	4873	67%
		Industries Sector	181	2%
		Trade & Services	3416	47%
		Personal Loans and other Retail	385	5%
		Total	7250	100%
	2021-2022	Agriculture and allied activities	5756	65%
		Industries Sector	694	8%
		Trade & Services	4169	47%
		Personal Loans and other Retail	874	10%
		Total	8828	100%
	2022-2023	Agriculture and allied activities	6055	58%
		Industries Sector	518	5%
		Trade & Services	3369	32%
		Personal Loans and other Retail	4526	43%
		Total	10470	100%
UJJIVAN	2020-2021	Agriculture and allied activities	15855	19%
		Industries Sector	4675	6%

		Trade & Services	451	1%
		Personal Loans and other Retail	61748	75%
		Total	82728	100%
	2021-2022	Agriculture and allied activities	46481	34%
		Industries Sector	5206	4%
		Trade & Services	10888	8%
		Personal Loans and other Retail	74046	54%
		Total	136622	100%
	2022-2023	Agriculture and allied activities	48774	30%
		Industries Sector	6056	4%
		Trade & Services	7755	5%
		Personal Loans and other Retail	115375	71%
		Total	61813	100%

Table 3.8 Sector Wise distribution of Gross Loans & Advances between 2020 - 2021 to 2022- 2023

Interpretation:

1. **ESAF**: Predominant focus on Agriculture and Allied Activities, increasing from 57% to 71% in 2022-2023, shows a strategic emphasis on rural and agricultural lending. The rise in Trade & Services indicates diversification efforts.
2. **AU**: Major exposure to Trade & Services, with fluctuations in Agriculture and Allied Activities, suggests a focus on business and commercial lending.
3. **EQUITAS**: Balanced exposure across various sectors, with significant involvement in Trade & Services and Personal Loans, indicates diversified lending.
4. **UTTKARSH**: High focus on Agriculture and Allied Activities, shifting towards Personal Loans, shows a move to diversify lending portfolios.
5. **UJJIVAN**: Predominantly focused on Personal Loans, with increasing focus over the years, indicating a strategic emphasis on retail lending.

3.9 Provision Coverage Ratio of ESAF and Peer Banks

Bank	2020-2021	2021-2022	2022 -2023	Average	Rank
ESAF	52.77	59.38	56.67	56	4
AU	49.81	76.62	78.31	68	3
EQUITAS	58.59	42.73	56.90	53	5
UTTKARSH	65.49	63.62	88.29	72	2
UJJIVAN	60.34	92.20	98.41	84	1

Table 3.9 Provision coverage ratio between 2020 -2021 to 2022- 2023

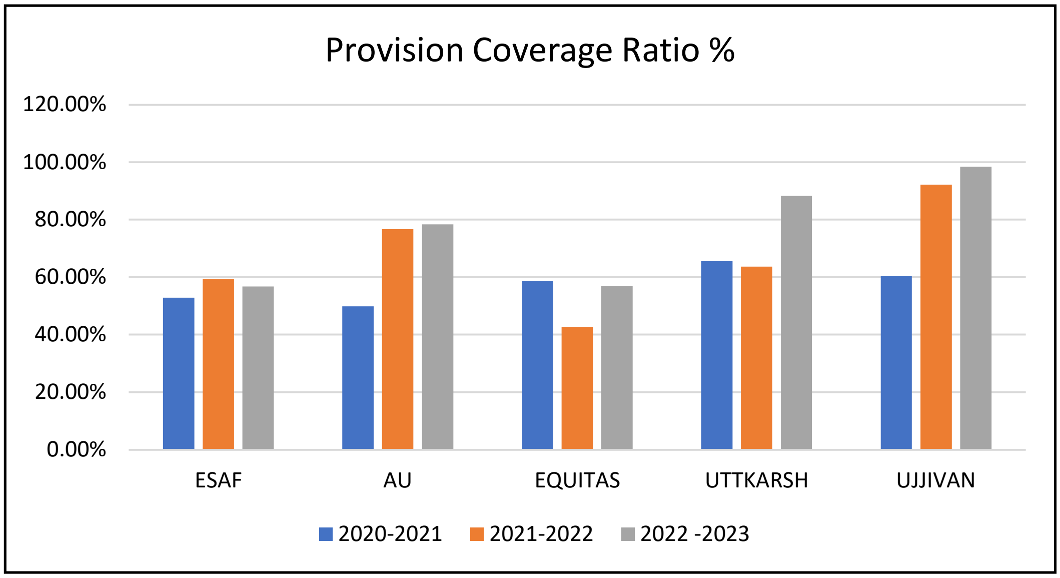

Figure 3.9 Provision coverage ratio between 2020 -2021 to 2022- 2023

Interpretation:

1. **ESAF**: Moderate increase from 52.77% to 56.67% suggests gradual improvements in provisioning for bad loans.
2. **AU**: Significant increase from 49.81% to 78.31% reflects robust provisioning, indicating strong risk management practices.
3. **EQUITAS**: Fluctuations with a slight increase indicate ongoing adjustments in provisioning strategies.

4. **UTTKARSH**: High increase to 88.29% shows strong provisioning efforts to cover potential losses.
5. **UJJIVAN**: Leading with the highest increase to 98.41%, indicating aggressive provisioning and strong risk management.

Conclusion

The data indicates that while all banks faced challenges during the pandemic, their recovery and risk management strategies varied significantly. AU and UJJIVAN stand out for their strong credit risk management and provisioning practices. ESAF, despite initial high NPAs, showed significant improvement, reflecting effective recovery strategies. The diverse sectoral focus and varying Credit to Deposit Ratios highlight different strategic priorities and risk appetites among the banks.

3.10 Return on Asset of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	0.9	0.4	1.6	0.96	4
AU	2.5	1.9	1.8	2.07	1
EQUITAS	1.7	1.1	1.8	1.53	2
UTTKARSH	1.0	0.4	2.4	1.27	3
UJJIVAN	0.04	-2.0	4.0	0.68	5

Table 3.10 Return on Asset between 2020 -2021 to 2022- 2023

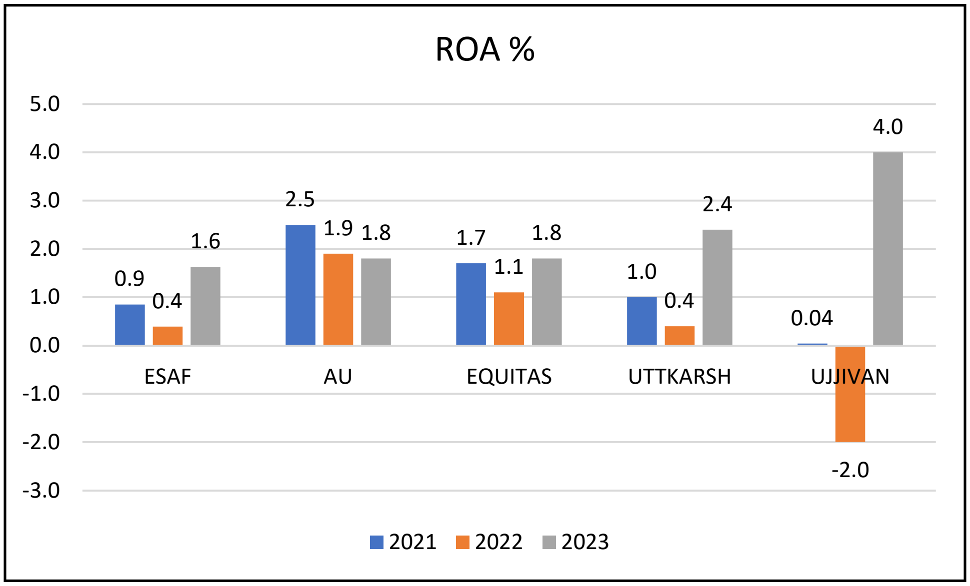

Figure 3.10 Return on Asset between 2020 -2021 to 2022- 2023

INTERPRETATION:

1. AU Small Finance Bank (AU) :
   - Highest Average ROA: With an average return on assets (ROA) of 2.07, AU leads the group, indicating strong asset utilization and profitability. Consistently high ROA in each year reflects efficient management and a robust financial strategy.
   - Slight Decline but Strong Performance: Although there is a slight decline from 2021 to 2023, AU maintains the highest ROA, showcasing its ability to generate profits from its assets effectively.
2. Equitas Small Finance Bank (Equitas) :

- Stable Performance: Equitas shows stable performance with an average ROA of 1.53. The ROA values indicate consistent profitability, with a slight improvement in 2023.
- Maintained Improvement: The steady improvement in ROA reflects effective asset management and operational efficiency.

3. Uttkarsh Small Finance Bank (Uttkarsh):
    - Significant Growth in 2023: Uttkarsh shows significant improvement in 2023, boosting its average ROA to 1.27. This indicates a turnaround in asset utilization and profitability.
    - Moderate Overall: While 2022 was a weaker year, the overall average indicates moderate success in leveraging assets for profit .
4. ESAF Small Finance Bank (ESAF):
    - Fluctuating Performance: ESAF's ROA fluctuates, with a significant increase in 2023. The average ROA of 0.96 suggests some challenges in asset profitability, but an upward trend in the latest year indicates potential improvement.
    - Need for Consistency: To improve its standing, ESAF needs to achieve more consistent performance across all years.
5. Ujjivan Small Finance Bank (Ujjivan):
    - Volatile Performance: Ujjivan has the lowest average ROA at 0.68, primarily due to a significant negative ROA in 2022. However, a strong recovery in 2023 shows potential for future improvement.
    - High Volatility: The high volatility in ROA indicates potential risk factors and operational challenges that need addressing to stabilize profitability.

3.11 Return on Equity of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	9	4	19	10.67	3.5
AU	22	16	15	17.67	1
EQUITAS	13	7	12	10.67	3.5
UTTKARSH	9	4	23	12.00	2
UJJIVAN	0	-15	33	6.00	5

Table 3.11 Return on Equity between 2020 -2021 to 2022- 2023

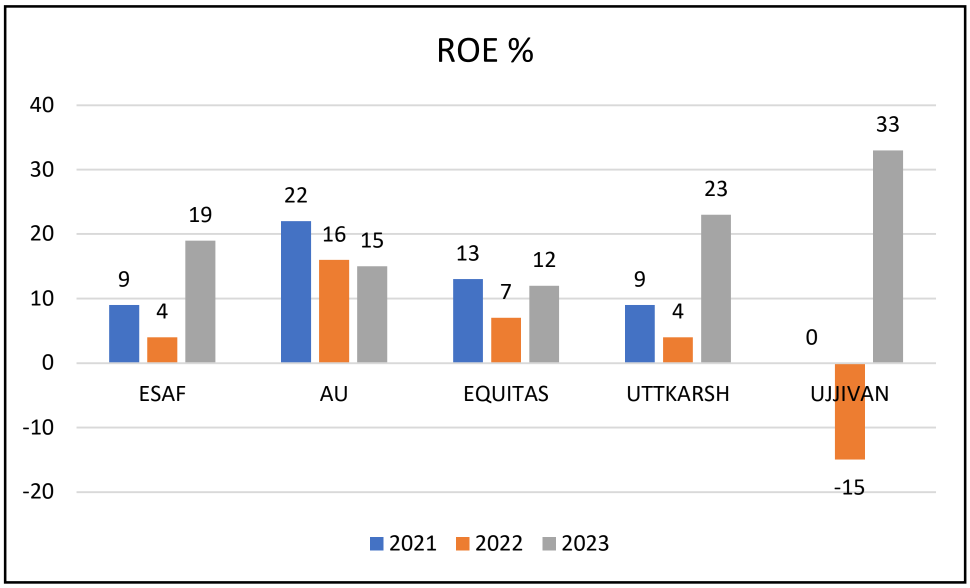

Table 3.11 Return on Equity between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

1. AU Small Finance Bank (AU):
    - Highest Average ROE: AU leads with an average return on equity (ROE) of 17.67. This indicates superior profitability and efficient use of equity to generate returns.
    - Consistent High Performance: AU's ROE values are consistently high, reflecting robust financial management and strong operational performance.
2. Uttkarsh Small Finance Bank (Uttkarsh):

- Significant Growth: Uttkarsh has the second-highest average ROE at 12.00, marked by a substantial increase in 2023. This suggests improved profitability and strategic management of equity.
- Variable Performance: While the ROE in 2021 and 2022 were moderate, the significant jump in 2023 indicates potential for sustained high returns.

3. ESAF Small Finance Bank (ESAF)
   - Improving Trend: ESAF shows an improving trend with an average ROE of 10.67. The significant improvement in 2023 highlights effective strategies to enhance profitability.
   - Moderate Consistency: Despite lower values in 2021 and 2022, the strong performance in 2023 boosts the overall average, reflecting potential for consistent high returns in the future.
4. Equitas Small Finance Bank (Equitas):
   - Stable Returns: Equitas, with an average ROE of 10.67, shows relatively stable returns over the period. This indicates steady profitability and effective equity utilization.
   - Consistent Performance: Equitas maintains a moderate yet consistent ROE, which suggests solid financial strategies and operational stability.
5. Ujjivan Small Finance Bank (Ujjivan) :
   - Volatile Performance: Ujjivan's average ROE is the lowest at 6.00, primarily due to a significant negative ROE in 2022. However, the high ROE in 2023 shows potential for recovery and strong returns.
   - High Variability: The wide fluctuations in ROE indicate operational and financial challenges, highlighting the need for stability and consistent performance.

3.12 Net Interest Margin of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	7.7	6.7	9.4	7.92	5
AU	5.3	5.7	6.1	5.70	4
EQUITAS	8.4	8.5	9.0	8.66	3
UTTKARSH	8.2	8.8	9.6	8.87	2
UJJIVAN	9.5	8.79	9.48	9.26	1

Table 3.12 Net Interest Margin between 2020 -2021 to 2022- 2023

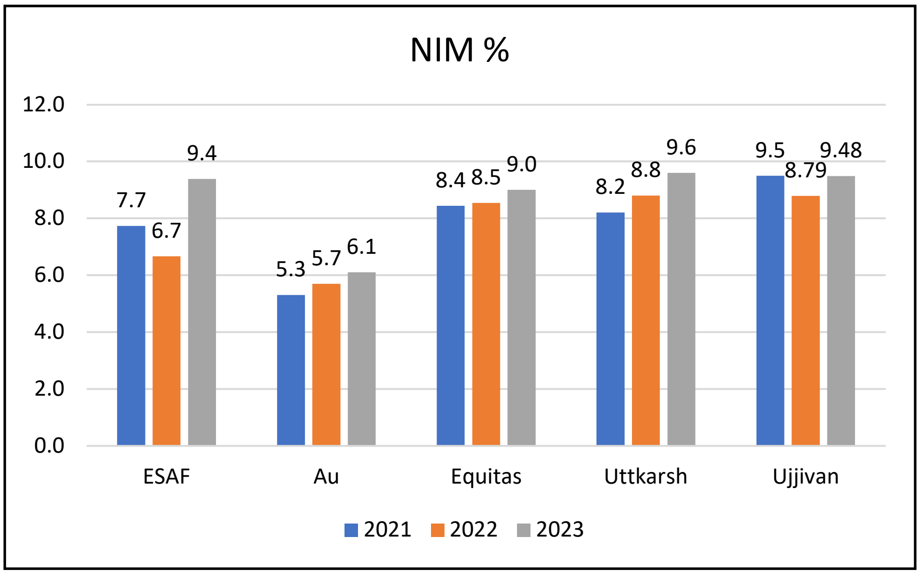

Figure 3.12 Net Interest Margin between 2020 -2021 to 2022- 2023

INTERPRETATION:

1. Ujjivan Small Finance Bank (Ujjivan):
    - Consistently High Margins: Ujjivan consistently achieves the highest net interest margins across all three years, with a peak in 2021 and stable high performance in subsequent years.
    - Average: With an average of 9.26, Ujjivan stands out as the top performer, indicating strong profitability and effective interest management.
2. Uttkarsh Small Finance Bank (Uttkarsh):

- Strong Performance: Uttkarsh shows strong net interest margins, leading in 2022 and 2023. The consistent increase each year signifies effective financial strategies.
- Average: The average of 8.87 places Uttkarsh second, reflecting its strong and improving financial health.

3. Equitas Small Finance Bank (Equitas):
    - Stable and High Margins: Equitas maintains high and stable net interest margins, with slight improvements each year.
    - Average: With an average of 8.66, Equitas ranks third, showcasing solid profitability and effective interest rate management.
4. ESAF Small Finance Bank (ESAF):
    - Fluctuating Performance: ESAF's net interest margins show some fluctuation, with a dip in 2022 but a strong recovery in 2023.
    - Average: The average of 7.92 places ESAF fourth, indicating a need for more consistency in maintaining high margins.
5. Au Small Finance Bank (Au):
    - Lowest Margins: Au consistently shows the lowest net interest margins among the banks listed. Despite a slight increase each year, its margins remain significantly lower.
    - Average: The average of 5.70 suggests that Au may need to reassess its interest rate strategies to improve profitability.

3.13 Net Profit Margin of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	6.4	2.8	10.6	6.61	3
AU	23.6	19.1	17.4	20.04	1
EQUITAS	12.0	8.1	13.8	11.31	2
UTTKARSH	2.5	1.0	5.2	2.91	5
UJJIVAN	0.3	-14.7	26.4	3.99	4

Table 3.13 Net Profit Margin between 2020 -2021 to 2022- 2023

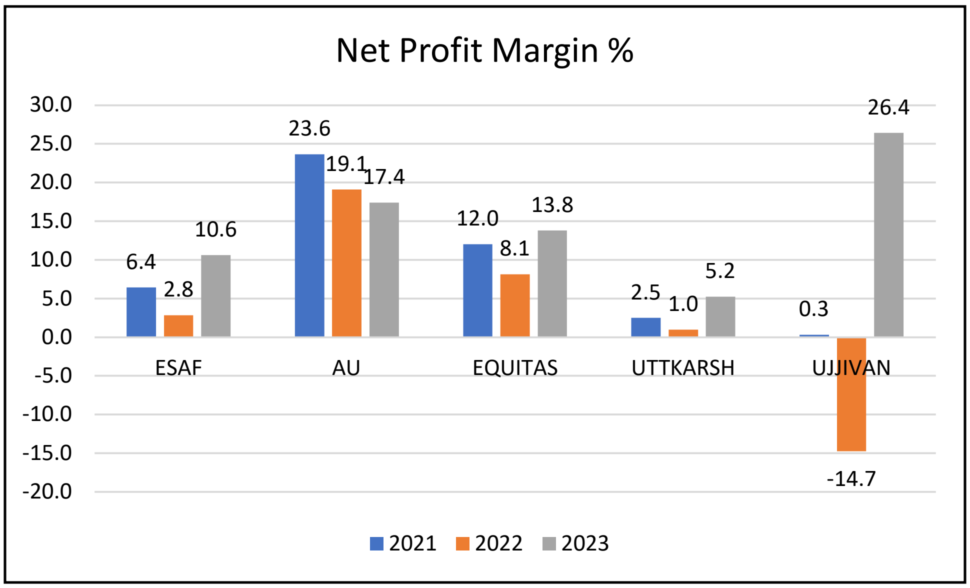

Figure 3.13 Net Profit Margin between 2020 -2021 to 2022- 2023

INTERPRETATION:

1. AU Small Finance Bank (AU):
   - Highest Average Net Profit Margin: AU leads with an average net profit margin of 20.04%, indicating excellent profitability and cost management. This high margin reflects strong financial health and effective operational efficiency.
   - Consistently High Performance: AU's net profit margins remain high across all three years, showcasing robust financial strategies and market positioning.

2. Equitas Small Finance Bank (Equitas):
    - Solid Performance: Equitas holds the second rank with an average net profit margin of 11.31%. The margins reflect consistent and solid profitability.
    - Improving Trend: Equitas shows an increasing trend in net profit margins from 2022 to 2023, indicating improving financial performance.
3. ESAF Small Finance Bank (ESAF):
    - Steady Improvement: ESAF has an average net profit margin of 6.61%. There is a noticeable improvement in 2023, which boosts its overall average.
    - Moderate Performance: While lower than AU and Equitas, ESAF's margins reflect moderate profitability with potential for further improvement.
4. Ujjivan Small Finance Bank (Ujjivan):
    - High Variability: Ujjivan has an average net profit margin of 3.99%. The significant negative margin in 2022 impacts its average, but a strong recovery in 2023 shows potential for high profitability.
    - Potential for Growth: Despite volatility, the high margin in 2023 indicates that Ujjivan can achieve substantial profitability if it stabilizes its operations.
5. Uttkarsh Small Finance Bank (Uttkarsh):
    - Lowest Average Net Profit Margin: Uttkarsh has the lowest average net profit margin of 2.91%, indicating challenges in achieving profitability.
    - Need for Improvement: The consistently low margins suggest a need for strategic adjustments to enhance profitability and operational efficiency.

3.14 Profit Growth of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	5.4	-45.27	202.33	54.15	5
AU	1070.68	1029.83	1327.93	1142.81	1
EQUITAS	284.22	180.73	473.59	312.85	2
UTTKARSH	11.82	-38.54	304.5	92.59	4
UJJIVAN	-91.7	-514.59	999.92	131.21	3

Table 3.14 Profit Growth between 2020 -2021 to 2022- 2023

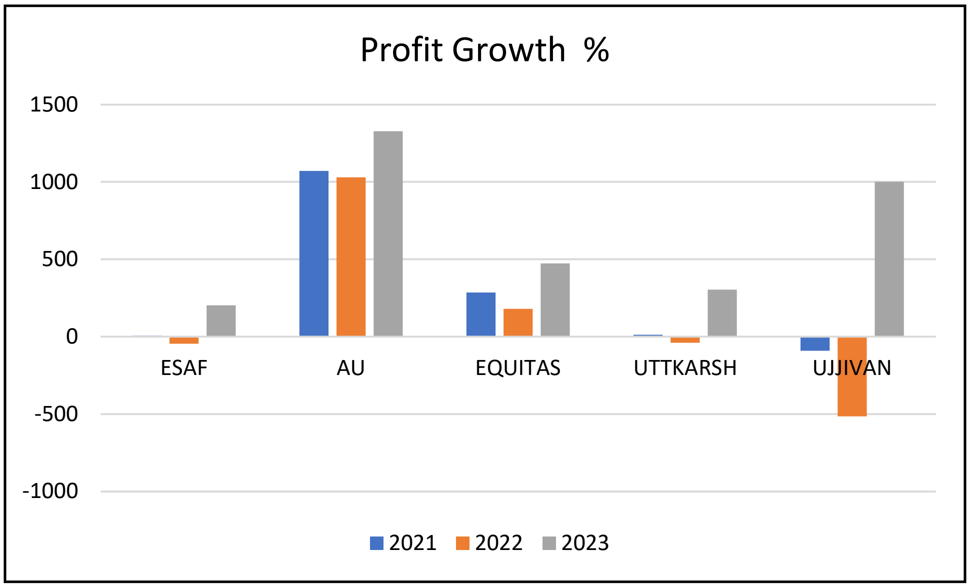

Figure 3.14 Profit Growth between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

1. AU Small Finance Bank (AU):
   - Highest Average Profit Growth: AU leads with an average profit growth of 1142.81, indicating excellent performance in increasing profitability over the three-year period.
   - Consistently Strong Performance: AU demonstrates consistent growth in profit across all three years, reflecting robust financial strategies and market positioning.
2. Equitas Small Finance Bank (Equitas):

- Solid Performance: Equitas secures the second rank with an average profit growth of 312.85, showcasing a solid and improving financial performance.
- Increasing Trend: Equitas shows an increasing trend in profit growth from 2021 to 2023, indicating improving financial health and profitability.

3. ESAF Small Finance Bank (ESAF):
   - Steady Improvement: ESAF exhibits an average profit growth of 54.15, showing a steady improvement in profitability, especially notable in 2023.
   - Moderate Performance: While lower than AU and Equitas, ESAF's profit growth reflects moderate performance with potential for further enhancement.
4. Ujjivan Small Finance Bank (Ujjivan):
   - High Variability: Ujjivan experiences significant variability in profit growth with an average of 131.21. The negative growth in 2021 and 2022 is offset by a substantial increase in 2023.
   - Potential for Growth: Despite volatility, the strong growth in 2023 suggests potential for Ujjivan to achieve significant profitability if it stabilizes its operations.
5. Uttkarsh Small Finance Bank (Uttkarsh):
   - Lowest Average Profit Growth: Uttkarsh ranks fifth with an average profit growth of 92.59, indicating challenges in achieving substantial profitability.
   - Need for Improvement: The consistently moderate profit growth suggests a need for strategic adjustments to enhance profitability and operational efficiency in Uttkarsh.

3.15 Working Capital of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	9975	12950	14658	12527.7	4
AU	37987	50161	65829	51325.7	1
EQUITAS	20063	21163	26468	22564.7	2
UTTKARSH	8989	11584	14897	11823.3	5
UJJIVAN	16604	18256	23395	19418.3	3

Table 3.15 Working Capital between 2020 -2021 to 2022- 2023

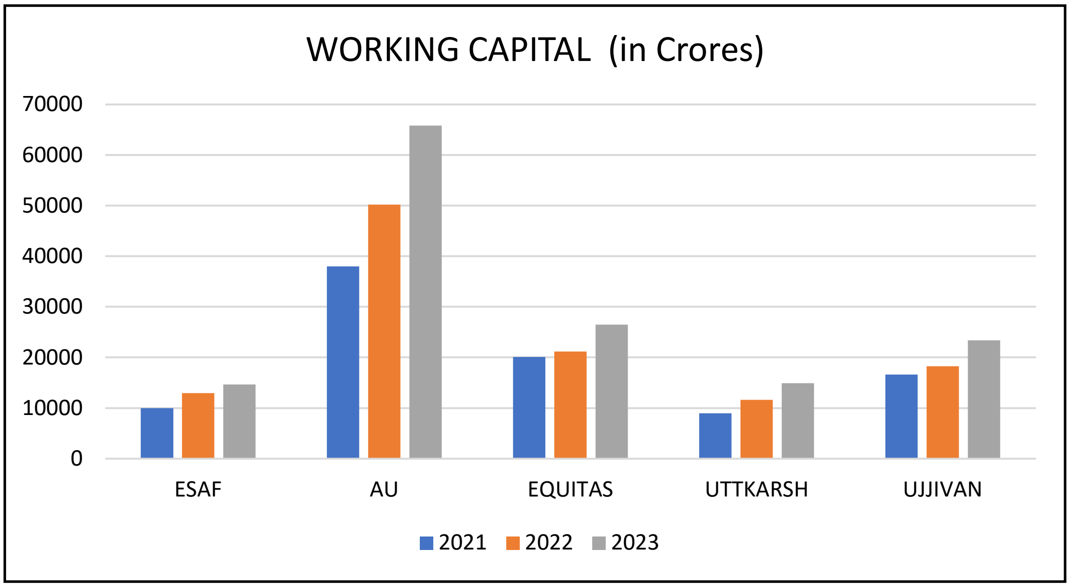

Figure 3.15 Working Capital between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

1. AU Small Finance Bank (AU):
   - Highest Working Capital: AU leads with an average working capital of 51,325.67, indicating a strong liquidity position. This high working capital allows AU to easily meet its short-term obligations and invest in growth opportunities.
   - Consistent Increase: The steady increase in working capital from 2021 to 2023 reflects robust growth and effective financial management.

2. Equitas Small Finance Bank (Equitas):
    - Strong Liquidity: Equitas holds the second rank with an average working capital of 22,564.67. This suggests a solid liquidity position, enabling the bank to cover its short-term liabilities comfortably.
    - Stable Growth: Equitas shows consistent growth in working capital over the three years, indicating effective management and operational efficiency.
3. Ujjivan Small Finance Bank (Ujjivan):
    - Moderate Liquidity: Ujjivan has an average working capital of 19,418.33, ranking third. This indicates a moderate liquidity position, sufficient to meet short-term obligations.
    - Steady Improvement: The increase in working capital from 2021 to 2023 reflects positive financial management and growth.
4. ESAF Small Finance Bank (ESAF):
    - Moderate Working Capital: ESAF's average working capital is 12,527.67, indicating a moderate liquidity position. While this is adequate, it is lower compared to the top three banks.
    - Positive Growth: ESAF shows a steady increase in working capital, suggesting improving financial health and better liquidity management.
5. Uttkarsh Small Finance Bank (Uttkarsh):
    - Lowest Working Capital: Uttkarsh has the lowest average working capital at 11,823.33, indicating the weakest liquidity position among the banks. This may constrain its ability to cover short-term liabilities and invest in growth.
    - Improving Trend: Despite being the lowest, Uttkarsh shows an increasing trend in working capital from 2021 to 2023, reflecting gradual improvement in liquidity management.

3.16 Earnings Before Interest & Tax of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	1054.0	547.3	3023.3	1541.53	5
AU	11706.8	11298.3	14279.3	12428.15	1
EQUITAS	3842.2	2807.3	5735.9	4128.49	2
UTTKARSH	1118.2	614.6	4045.0	1925.93	4
UJJIVAN	83.0	-4145.9	10999.2	2312.09	3

Table 3.16 Earnings Before Interest & Tax between 2020 -2021 to 2022- 2023

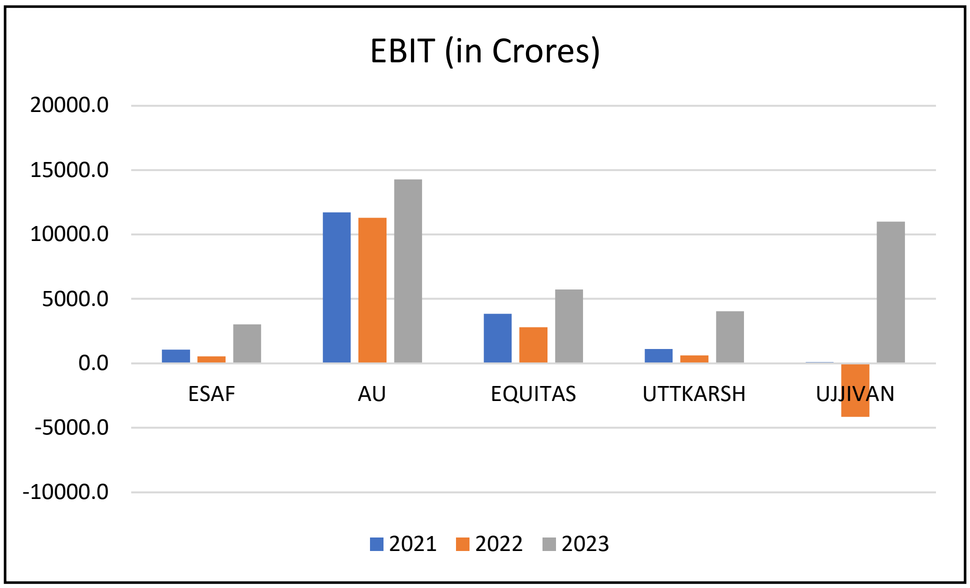

Figure 3.16 Earnings Before Interest & Tax between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

1. AU Small Finance Bank (AU):
    - Highest EBIT: AU leads significantly with an average EBIT of 12,428.15, indicating superior profitability and operational efficiency. This high EBIT suggests strong revenue generation and effective cost management.
    - Consistently High Performance: The consistently high EBIT across all three years reflects AU's robust business model and effective strategic execution.
2. Equitas Small Finance Bank (Equitas):

- Strong Performance: Equitas holds the second rank with an average EBIT of 4,128.49. The bank demonstrates strong profitability and efficient operations.
- Steady Growth: The increasing trend in EBIT from 2021 to 2023 indicates that Equitas is effectively scaling its operations and improving its financial performance.

3. Ujjivan Small Finance Bank (Ujjivan):
    - High Variability: Ujjivan ranks third with an average EBIT of 2,312.09. Despite a significant negative EBIT in 2022, a substantial recovery in 2023 boosts its average.
    - Potential for Stability: The high EBIT in 2023 shows that Ujjivan has the potential to achieve stable and significant profitability if it manages its operations effectively.
4. Uttkarsh Small Finance Bank (Uttkarsh):
    - Moderate Performance: Uttkarsh has an average EBIT of 1,925.93, indicating moderate profitability. The significant increase in EBIT in 2023 shows potential for improved performance.
    - Improving Trend: Despite lower EBIT in 2021 and 2022, the upward trend in 2023 suggests that Uttkarsh is on a path to improving its operational efficiency and profitability.
5. ESAF Small Finance Bank (ESAF):
    - Lowest EBIT: ESAF has the lowest average EBIT at 1,541.53, indicating the weakest profitability among the banks. This suggests that ESAF needs to enhance its revenue generation and cost management.
    - Positive Growth: The significant increase in EBIT in 2023 shows potential for improvement, but ESAF needs to maintain consistent performance to enhance its profitability

3.17 Retained Earnings of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average	Rank
ESAF	665.7	345.7	1909.5	973.6	1
AU	570.2	560.1	674.4	601.6	2
EQUITAS	243.6	384.2	280.7	302.9	3
UTTKARSH	100.1	58.2	404.3	187.5	5
UJJIVAN	8.3	-414.6	972.5	188.7	4

Table 3.17 Retained Earnings between 2020 -2021 to 2022- 2023

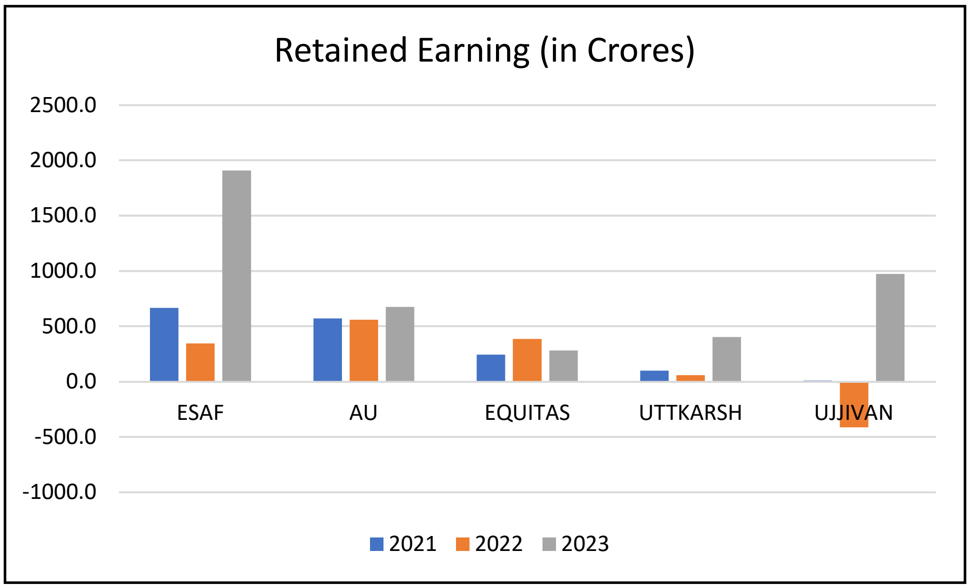

Figure 3.17 Retained Earnings between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

1. ESAF Small Finance Bank (ESAF)
    - Highest Retained Earnings: ESAF leads with an average retained earnings of 973.6, indicating strong profitability and a robust ability to retain earnings for reinvestment or to buffer against future losses.
    - Significant Growth in 2023: The substantial increase in retained earnings in 2023 suggests improved financial performance and effective profit retention strategies.
2. AU Small Finance Bank (AU):

- Strong and Stable Performance: AU ranks second with an average retained earnings of 601.6. The consistent values over the three years reflect stable profitability and a solid capacity to retain earnings.
- Consistency in Retention: The relatively stable retained earnings indicate effective financial management and steady growth.

3. Equitas Small Finance Bank (Equitas):
   - Moderate Retained Earnings: Equitas has an average retained earnings of 302.9, indicating moderate profitability. The increase in 2022 suggests potential for steady growth.
   - Improving Trend: The fluctuations in retained earnings show areas for improvement, but the overall trend is positive, indicating potential for stability.
4. Ujjivan Small Finance Bank (Ujjivan):
   - High Variability: Ujjivan ranks fourth with an average retained earnings of 188.7. The negative retained earnings in 2022 significantly impact its average, but the substantial positive value in 2023 shows a strong recovery.
   - Potential for Stability: The dramatic increase in 2023 suggests that Ujjivan has potential for stabilization and growth if it can manage earnings retention effectively.
5. Uttkarsh Small Finance Bank (Uttkarsh):
   - Lowest Retained Earnings: Uttkarsh has the lowest average retained earnings at 187.5, indicating weaker profitability and challenges in retaining earnings.
   - Improving Trend: Despite the low average, the increase in 2023 shows some improvement in financial performance, suggesting potential for better earnings retention with improved strategies.

3.18 Springate Z Score of ESAF and Peer Banks

BANKS	2020-2021	2021-2022	2022-2023	Average
ESAF	1.23	0.92	1.41	1.19
AU	1.51	1.30	1.29	1.37
EQUITAS	1.38	1.19	1.35	1.31
UTTKARSH	1.11	0.97	1.53	1.20
UJJIVAN	0.91	0.29	1.82	1.00

Table 3.18 Springate Z Score between 2020 -2021 to 2022- 2023

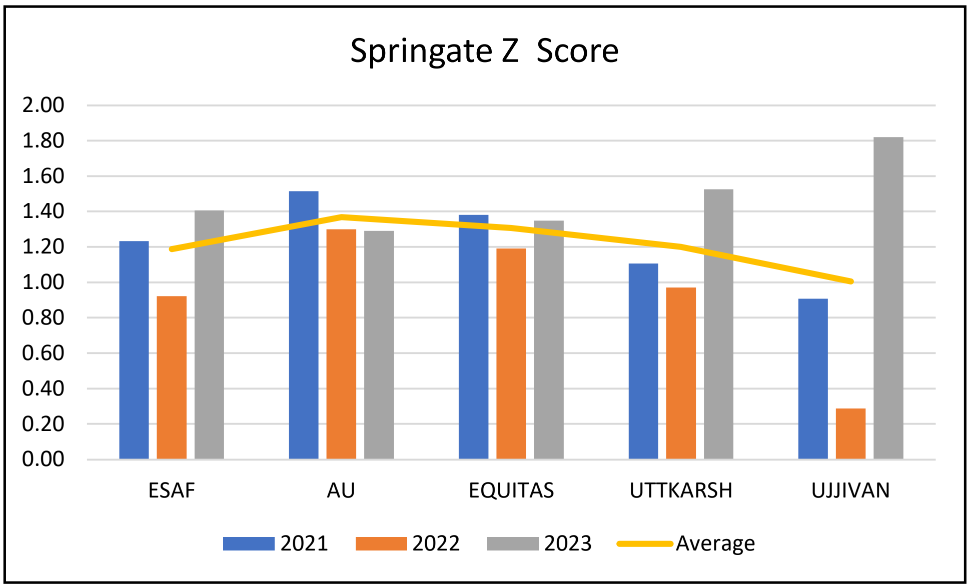

Figure 3.18 Springate Z Score between 2020 -2021 to 2022- 2023

INTERPRETATION:

1. ESAF Small Finance Bank (ESAF):
    - Significant Growth in 2023: ESAF's Z Score improved significantly to 1.41 in 2023 from 0.92 in 2022, indicating enhanced financial health and recovery.
    - Average Financial Health: The average Z Score of 1.19 over the three years suggests a moderate financial position, with a notable recovery in 2023 pointing towards effective management and improved financial strategies.

2. AU Small Finance Bank (AU):
    - Consistently Strong Performance: AU maintained a strong and stable Z Score across the three years, with values consistently above 1.29. This indicates robust financial health and effective management.
    - Stable Financial Position: The slight decrease from 1.51 in 2021 to 1.29 in 2023 still reflects strong financial stability, showcasing AU's consistent ability to manage its financial health effectively.
3. Equitas Small Finance Bank (Equitas):
    - Moderate but Stable Performance: Equitas had a moderate Z Score, averaging around 1.31 over the three years. This shows a steady financial position with room for improvement.
    - Positive Trend: The Z Score improved to 1.35 in 2023 after a slight dip to 1.19 in 2022, indicating a positive trend and potential for continued stability.
4. Uttkarsh Small Finance Bank (Uttkarsh):
    - Significant Improvement in 2023: Uttkarsh's Z Score increased substantially to 1.53 in 2023 from 0.97 in 2022, reflecting a strong recovery and improved financial health.
    - Upward Trend: Despite having a lower starting point in 2021 with a Z Score of 1.11, the upward trend over the three years suggests effective financial strategies and potential for continued improvement.
5. Ujjivan Small Finance Bank (Ujjivan):
    - High Variability but Strong Recovery: Ujjivan experienced the most significant fluctuations, with a very low Z Score of 0.29 in 2022 indicating high financial distress, followed by a dramatic recovery to 1.82 in 2023.
    - Potential for Stability: The substantial increase in 2023 demonstrates Ujjivan's potential for stabilization and strong financial health if it continues to manage its financials effectively.

CAMEL MODEL

3.19 C – Capital Adequacy of ESAF and Peer Banks

	BANKS		ESAF	AU	EQUITAS	UTKARSH	UJJIVAN
Banks Capital Adequacy Ratios	Capital Adequacy Ratios	2020-2021	24.3	23.4	24.1	21.8	26.4
		Rank	2	4	3	5	1
		2021-2022	18.6	21	25.1	21.5	19
		Rank	5	3	1	2	4
		2022-2023	19.8	23.6	23.8	20.6	25.8
		Rank	5	3	2	4	1
	Debt Equity Ratio	2020-2021	7.9	6.9	6.1	7.4	5.4
		Rank	1	3	4	2	5
		2021-2022	11.2	7.8	5.1	8.0	7.7
		Rank	1	3	5	2	4
		2022-2023	10.5	6.9	5.5	8.0	7.0
		Rank	1	4	5	2	3
	Total Advance to Total Asset Ratio	2020-2021	0.64	0.69	0.73	0.69	0.74
		Rank	5	3	2	4	1
		2021-2022	0.63	0.68	0.76	0.71	0.69
		Rank	5	4	1	2	3
		2022-2023	0.68	0.66	0.80	0.70	0.64
		Rank	3	4	1	2	5

Table 3.19 Capital Adequacy between 2020 -2021 to 2022- 2023

INTERPRETATION:

Capital Adequacy Ratios:

2020-2021

- Top Performer: Ujjivan (26.4%), indicating robust capital strength.
- Other Banks: ESAF (24.3%) and Equitas (24.1%) also exhibit strong capital adequacy, ranking 2nd and 3rd. AU (23.4%) and Utkarsh (21.8%) trail behind, with Utkarsh ranking last.

2021-2022

- Top Performer: Equitas (25.1%), showcasing significant capital strength.
- Other Banks: Utkarsh (21.5%) and AU (21%) follow, ranked 2nd and 3rd. Ujjivan (19%) and ESAF (18.6%) are lower, with ESAF ranking last.

2022 -2023

- Top Performer: Ujjivan (25.8%), maintaining top position, demonstrating consistent capital strength.
- Other Banks: Equitas (23.8%) and AU (23.6%) are close, ranked 2nd and 3rd. Utkarsh (20.6%) and ESAF (19.8%) are on the lower end, with ESAF again ranking last.

Debt-Equity Ratios:

2020-2021

- Top Performer: ESAF (7.9), indicating the highest leverage but potentially higher risk.
- Other Banks: Utkarsh (7.4) and AU (6.9) are moderate, while Equitas (6.1) and Ujjivan (5.4) have lower debt-equity ratios, suggesting more conservative leverage.

2021-2022

- Top Performer: ESAF (11.2), with a significantly high debt-equity ratio, indicating high leverage.
- Other Banks: Utkarsh (8) and AU (7.8) are moderate, whereas Ujjivan (7.7) and Equitas (5.1) are more conservative.

2022-2023

- Top Performer: ESAF (10.5), maintaining high leverage.
- Other Banks: Utkarsh (8) and AU (6.9) are moderate, while Ujjivan (7) and Equitas (5.5) have lower ratios, suggesting more conservative leverage.

<u>Total Advance to Total Asset Ratios:</u>

2020-2021

- Top Performer: Ujjivan (0.74), indicating efficient asset utilization.
- Other Banks: Equitas (0.73) and AU (0.69) are close, ranked 2nd and 3rd. Utkarsh (0.69) and ESAF (0.64) lag behind.

2021-2022

- Top Performer: Equitas (0.76), showing strong asset utilization.
- Other Banks: Utkarsh (0.71) and Ujjivan (0.69) follow, ranked 2nd and 3rd. AU (0.68) and ESAF (0.63) are lower, with ESAF ranking last.

2022-2023

- Top Performer: Equitas (0.80), demonstrating excellent asset utilization.
- Other Banks: Utkarsh (0.70) and AU (0.66) follow, ranked 2nd and 3rd. ESAF (0.68) and Ujjivan (0.64) are lower, with Ujjivan ranking last.

3.20 A - Asset Quality of ESAF and Peer Banks

	BANKS		ESAF	AU	EQUITAS	UTKARSH	UJJIVAN
Banks Asset Quality	Net NPA to Net Advance	2020-2021	3.88	2.18	1.52	1.30	2.90
		Rank	5	3	2	1	4
		2021-2022	3.92	0.50	2.37	2.30	0.60
		Rank	5	1	4	3	2
		2022-2023	1.13	0.42	1.14	0.40	0.04
		Rank	4	3	5	2	1
	Net NPA to Total Assets Ratio	2020-2021	2.57	1.46	1.08	0.9	2.08
		Rank	5	3	2	1	4
		2021-2022	2.57	0.39	1.78	1.57	4.22
		Rank	4	1	3	2	5
		2022-2023	0.78	0.27	0.89	0.26	2.71
		Rank	3	2	4	1	5
	Gross NPA to Gross advance Ratio	2020-2021	6.70	4.25	3.59	3.8	7.1
		Rank	4	3	1	2	5
		2021-2022	0.78	1.98	4.06	6.1	7.1
		Rank	1	2	3	4	5
		2022-2023	2.49	1.66	2.60	3.20	2.60
		Rank	2	1	3.5	5	3.5

Table 3.20 Asset Quality between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

<u>Net NPA to Net Advances:</u>

2020-2021

- Top Performer: Ujjivan (0.74), indicating efficient asset utilization.
- Other Banks: Equitas (0.73) and AU (0.69) are close, ranked 2nd and 3rd. Utkarsh (0.69) and ESAF (0.64) lag behind.

2021-2022

- Top Performer: Equitas (0.76), showing strong asset utilization.
- Other Banks: Utkarsh (0.71) and Ujjivan (0.69) follow, ranked 2nd and 3rd. AU (0.68) and ESAF (0.63) are lower, with ESAF ranking last.

2022-2023

- Top Performer: Equitas (0.80), demonstrating excellent asset utilization.
- Other Banks: Utkarsh (0.70) and AU (0.66) follow, ranked 2nd and 3rd. ESAF (0.68) and Ujjivan (0.64) are lower, with Ujjivan ranking last.

Net NPA to Total Assets Ratio:

2020-2021

- Top Performer: Utkarsh (0.9%), indicating excellent asset quality.
- Other Banks: Equitas (1.08%) and AU (1.46%) follow, ranked 2nd and 3rd. Ujjivan (2.08%) and ESAF (2.57%) have higher ratios, with ESAF ranked last.

2021-2022

- Top Performer: AU (0.39%), showing strong asset quality.
- Other Banks: Utkarsh (1.57%) and Equitas (1.78%) are moderate, ranked 2nd and 3rd. ESAF (2.57%) and Ujjivan (4.22%) have higher ratios, with Ujjivan ranked last.

2022-2023

- Top Performer: Utkarsh (0.26%), indicating improved asset quality.
- Other Banks: AU (0.27%) and ESAF (0.78%) are moderate, ranked 2nd and 3rd. Equitas (0.89%) and Ujjivan (2.71%) have higher ratios, with Ujjivan ranked last

3.21 M - Management Soundness of ESAF and Peer Banks

		BANKS	ESAF	AU	EQUITAS	UTKARSH	UJJIVAN
Banks Management Soundness	Total Advance to Total Deposit Ratio	**2020-2021**	0.94	0.98	1.05	1.12	0.74
		Rank	2	3	4	5	1
		2021-2022	0.91	0.89	1.04	1.06	0.74
		Rank	3	2	4	5	1
		2022-2023	0.95	0.85	1.03	1.02	0.66
		Rank	3	2	5	4	1
	Return on Net worth	**2020-2021**	7.77	18.66	11.31	8.19	0.27
		Rank	4	1	2	3	5
		2021-2022	3.90	15.04	6.62	3.88	-15.95
		Rank	3	1	2	4	5
		2022-2023	17.61	13.01	11.13	20.20	27.44
		Rank	3	4	5	2	1

Table 3.21 Management Soundness between 2020 -2021 to 2022- 2023

INTERPRETATION:

Total Advance to Total Deposit Ratio:

2020-2021

- Top Performer: Ujjivan (0.74), indicating a conservative approach to lending relative to deposits.
- Other Banks: ESAF (0.94) and AU (0.98) follow, ranked 2nd and 3rd. Equitas (1.05) and Utkarsh (1.12) have higher ratios, with Utkarsh ranked last, suggesting a more aggressive lending strategy.

2021-2022

- Top Performer: Ujjivan (0.74), maintaining a conservative lending approach.
- Other Banks: AU (0.89) and ESAF (0.91) are close, ranked 2nd and 3rd. Equitas (1.04) and Utkarsh (1.06) remain higher, with Utkarsh ranked last.

2022-2023

- Top Performer: Ujjivan (0.66), continuing its conservative approach.
- Other Banks: AU (0.85) and ESAF (0.95) are moderate, ranked 2nd and 3rd. Utkarsh (1.02) and Equitas (1.03) have higher ratios, with Equitas ranked last.

Return on Net Worth:

2020-2021

- Top Performer: AU (18.66%), indicating high profitability and efficient use of equity.
- Other Banks: Equitas (11.31%) and Utkarsh (8.19%) follow, ranked 2nd and 3rd. ESAF (7.77%) is moderate, while Ujjivan (0.27%) has the lowest return, indicating poor profitability.

2021-2022

- Top Performer: AU (15.04%), showing strong profitability.
- Other Banks: Equitas (6.62%) and ESAF (3.90%) follow, ranked 2nd and 3rd. Utkarsh (3.88%) is close, while Ujjivan (-15.95%) has a negative return, indicating significant losses.

2022-2023

- Top Performer: Ujjivan (27.44%), showing a significant turnaround in profitability.
- Other Banks: Utkarsh (20.20%) and ESAF (17.61%) are strong, ranked 2nd and 3rd. AU (13.01%) and Equitas (11.13%) have moderate returns, with Equitas ranked last.

3.22 E - Earnings and Profitability of ESAF and Peer Banks

		BANKS	ESAF	AU	EQUITAS	UTKARSH	UJJIVAN
Banks Earnings and Profitability	Return on Assets Ratio	**2020-2021**	85.1	60.48	34	92.27	3.93
		Rank	2	3	4	1	5
		2021-2022	31.06	45.6	104.27	40.49	-175.76
		Rank	4	2	1	3	5
		2022-2023	149.33	73.93	164.2	211.32	330.16
		Rank	4	5	3	2	1
	Net Income Margin Ratio	**2020-2021**	6.4	6.3	2.63	7.08	0.29
		Rank	2	3	4	1	5
		2021-2022	2.84	5.32	8.12	3.3	-14.75
		Rank	5	2	1	4	5
		2022-2023	10.58	8.13	13.79	16.13	26.41
		Rank	4	5	3	2	1

Table 3.22 Earnings and Profitability between 2020 -2021 to 2022- 2023

INTERPRETATION:

Return on Assets Ratio:

2020-2021

- Top Performer: Utkarsh (92.27), indicating excellent asset utilization.
- Other Banks: ESAF (85.1) and AU (60.48) follow, ranked 2nd and 3rd. Equitas (34) is moderate, while Ujjivan (3.93) is the lowest, indicating poor asset utilization.

2021-2022

- Top Performer: Equitas (104.27), showing significant improvement in asset utilization.

- Other Banks: AU (45.6) and Utkarsh (40.49) follow, ranked 2nd and 3rd. ESAF (31.06) is lower, while Ujjivan (-175.76) has a negative return, indicating substantial losses.

2022-2023

- Top Performer: Ujjivan (330.16), showing a remarkable turnaround and highest asset utilization.
- Other Banks: Utkarsh (211.32) and Equitas (164.2) are strong, ranked 2nd and 3rd. ESAF (149.33) and AU (73.93) are lower, with AU ranked last.

<u>Net Income Margin Ratio:</u>

2020-2021

- Top Performer: Utkarsh (7.08), indicating strong profitability margins.
- Other Banks: ESAF (6.4) and AU (6.3) are close, ranked 2nd and 3rd. Equitas (2.63) is lower, while Ujjivan (0.29) has the lowest margin.

2021-2022

- Top Performer: Equitas (8.12), showing strong profitability.
- Other Banks: AU (5.32) and Utkarsh (3.3) follow, ranked 2nd and 4th. ESAF (2.84) is lower, while Ujjivan (-14.75) has a negative margin, indicating losses.

2022-2023

- Top Performer: Ujjivan (26.41), showing significant improvement in profitability.
- Other Banks: Utkarsh (16.13) and Equitas (13.79) are strong, ranked 2nd and 3rd. ESAF (10.58) and AU (8.13) are lower, with AU ranked last.

3.23 L -Liquidity position of ESAF and Peer Banks

		BANKS	ESAF	AU	EQUITAS	UTKARSH	UJJIVAN
Banks Liquidity Position	Current ratio	2020-2021	0.17	0.11	0.16	0.11	0.15
		Rank	1	5	2	4	3
		2021-2022	0.09	0.10	0.09	0.14	0.10
		Rank	5	4	3	1	2
		2022-2023	0.04	0.12	0.04	0.15	0.08
		Rank	5	2	4	1	3
	Cash ratio	2020-2021	6.21	2.07	4.48	1.79	2.63
		Rank	1	4	2	5	3
		2021-2022	2.86	1.98	1.88	2.21	2.28
		Rank	1	4	5	3	2
		2022-2023	1.57	2.64	0.86	2.38	2.20
		Rank	4	1	5	2	3

Table 3.23 Liquidity Position between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

<u>Current Ratio:</u>

2020-2021

- Top Performer: ESAF (0.17), indicating the highest ability to cover short-term liabilities with current assets.
- Other Banks: Equitas (0.16) and Ujjivan (0.15) follow, ranked 2nd and 3rd. AU (0.11) and Utkarsh (0.11) have the lowest ratios, suggesting lower liquidity.

2021-2022

- Top Performer: Utkarsh (0.14), showing an improvement in liquidity.
- Other Banks: Ujjivan (0.10) and AU (0.10) follow, ranked 2nd and 4th. Equitas (0.09) and ESAF (0.09) are lower, with ESAF ranked last.

2022-2023

- Top Performer: Utkarsh (0.15), continuing to show strong liquidity.
- Other Banks: AU (0.12) and Ujjivan (0.08) follow, ranked 2nd and 3rd. Equitas (0.04) and ESAF (0.04) have the lowest ratios, indicating the weakest liquidity positions.

3.24 OVERALL TABLE OF CAMEL OF 2020-2021

Banks	C	A	M	E	L	Average	Rank
ESAF	2	4	4	2	1	2.6	2
AU	4	3	1	3	5	3.2	4
EQUITAS	3	1	2	4	2	2.4	1
UTKARSH	5	2	3	1	4	3	3
UJJIVAN	1	5	5	5	3	3.8	5

Table 3.24 Overall Table of Camel between 2020 -2021 to 2022- 2023

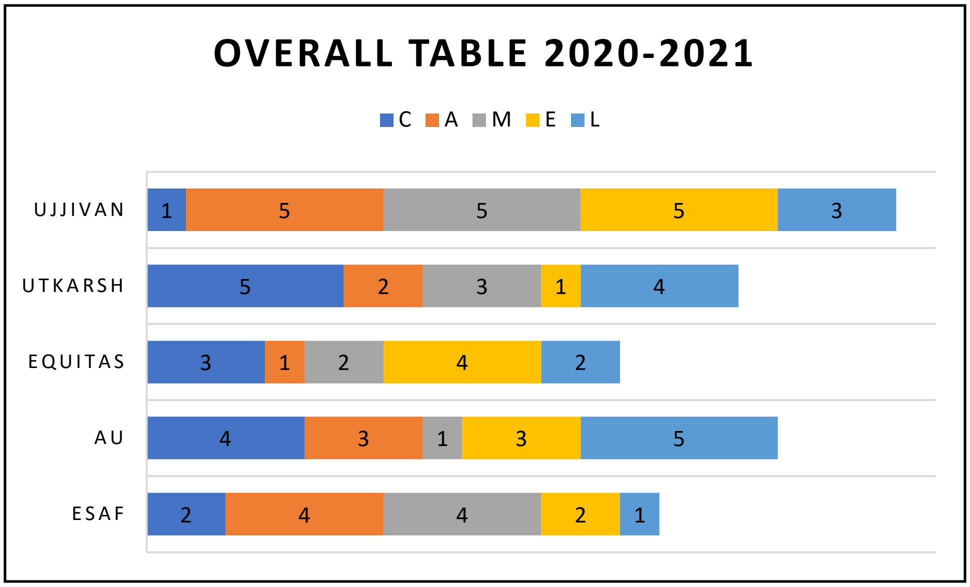

Figure 3.24 Overall Table of Camel between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

- Equitas is the top performer overall, with strong asset quality, reasonable management, and liquidity positions.
- ESAF follows closely, excelling in liquidity and earnings.
- Utkarsh has strong earnings and management but needs improvement in capital adequacy.
- AU shows strong management but struggles with liquidity and capital adequacy.
- Ujjivan has the best capital adequacy but falls short significantly in other areas, especially in asset quality, management, and earnings, placing it last .

3.25 OVERALL TBALE OF CAMEL OF 2021-2022

Banks	C	A	M	E	L	Average	Rank
ESAF	5	1	3	5	5	3.8	4
AU	3	2	1	2	4	2.4	2
EQUITAS	1	3	2	1	3	2	1
UTKARSH	2	4	4	4	1	3	3
UJJIVAN	4	5	5	5	2	4.2	5

Table 3.25 Overall Table of Camel between 2020 -2021 to 2022- 2023

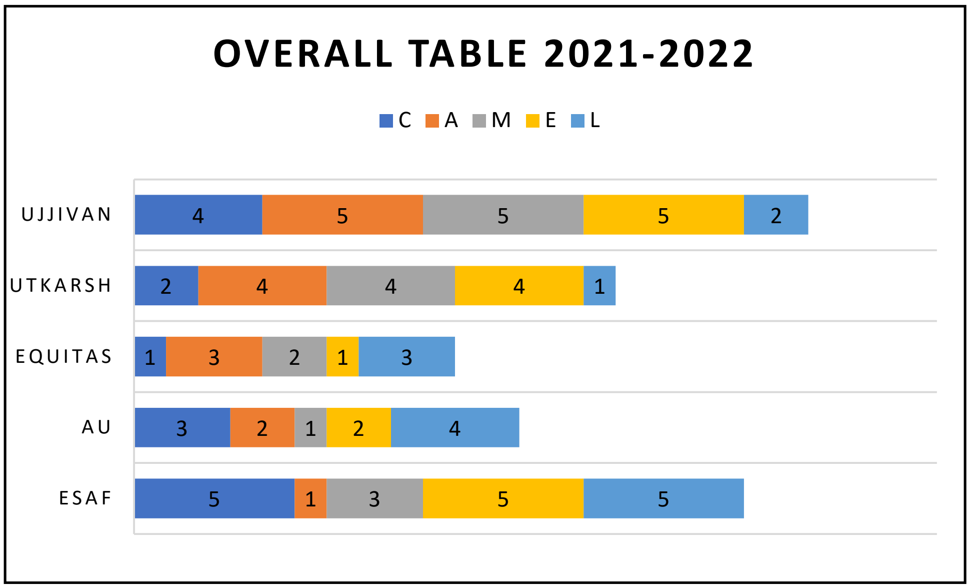

Figure 3.25 Overall Table of Camel between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

- Equitas is the top performer overall, with strong capital adequacy, management quality, and earnings. It needs some improvement in asset quality and liquidity.
- AU follows, excelling in management quality and showing good earnings and asset quality but requiring better liquidity and capital adequacy.
- Utkarsh has the best liquidity and good capital adequacy but needs improvement in asset quality, management quality, and earnings.

- ESAF excels in asset quality but struggles significantly in other areas, especially in capital adequacy, earnings, and liquidity.
- Ujjivan has the best capital adequacy but falls significantly short in asset quality, management quality, and earnings, placing it last overall.

3.26 OVERALL TBALE OF CAMEL OF 2022-2023

Bank	C	A	M	E	L	Average	Rank
ESAF	5	2	3	4	5	3.8	5
AU	3	1	4	5	2	3	3
EQUITAS	2	3.5	5	3	4	3.5	4
UTKARSH	4	5	2	2	1	2.8	2
UJJIVAN	1	3.5	1	1	3	1.9	1

Table 3.26 Overall Table of Camel between 2020 -2021 to 2022- 2023

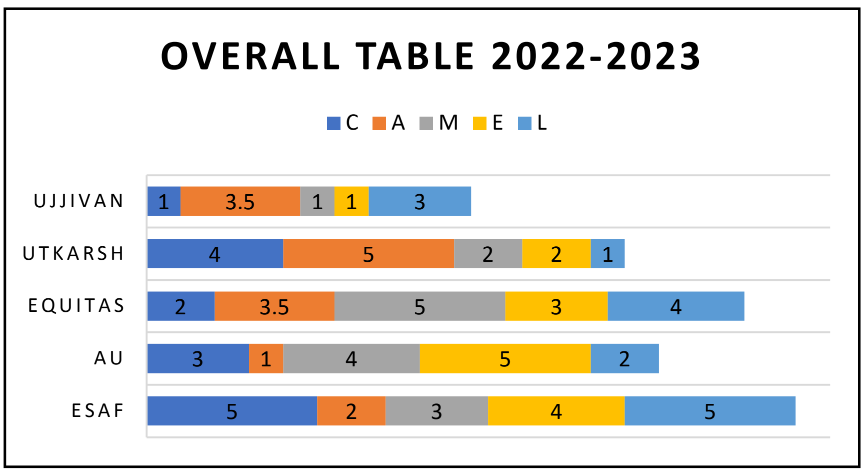

Table 3.26 Overall Table of Camel between 2020 -2021 to 2022- 2023

<u>INTERPRETATION:</u>

- Ujjivan is the top performer overall, with the best scores in capital adequacy, management quality, and earnings. It is slightly less strong in asset quality and liquidity.
- Utkarsh ranks second, excelling in liquidity and showing good management quality and earnings, but needing improvement in asset quality and capital adequacy.

- AU ranks third, with the best asset quality and good liquidity, but it needs significant improvement in management quality and earnings.
- Equitas ranks fourth, with a good capital adequacy score but needing improvement in management quality, asset quality, and liquidity.
- ESAF ranks last, with the poorest scores in capital adequacy and liquidity, and also needing improvement in earnings.

CHAPTER – IV

FINDINGS, RECOMMENDATIONS & SUMMARY

4.1 FINDINGS

1. ESAF Bank's credit exposure increased steadily over three years (CAGR: 14%). The growth rate slowed in the most recent year. The increasing trend suggests more risk, which could be beneficial if managed properly, but also increases potential losses.
2. Most credit exposure falls under 'Below 100% risk weight', indicating a conservative lending approach. The 'More than 100% risk weight' category, including higher-risk borrowers, has been increasing, potentially causing concern due to higher default rates and potential losses.
3. The capital adequacy ratio (CAR) has been decreasing, despite remaining above the regulatory minimum. The downward trend could signal weakening of the bank's capital position.
4. The Z-score, measuring financial stability, has been decreasing over three years, despite still indicating 'Strong' stability. The downward trend could be a warning sign, as a score below 1.1 indicates 'Distress'.
5. ESAF
    - Showed an increase in Gross NPA in 2021-2022 due to the pandemic, but the sharp decrease in 2022-2023 indicated effective recovery measures and improved economic conditions.
    - Credit to Deposit Ratio indicated aggressive lending, but a slight decrease in 2022-2023 suggested a more balanced approach.
    - A predominant focus on Agriculture and Allied Activities, increasing from 57% to 71% in 2022-2023, showed a strategic emphasis on rural and agricultural lending.
    - Moderate increases in Provision Coverage Ratio suggested ongoing improvements in provisioning strategies.
6. AU
    - Consistently low Net NPA, decreasing to 0.42%, reflected excellent credit management and effective recovery of bad loans.

- The steady decline in Credit to Deposit Ratio indicated a conservative approach towards lending or a substantial increase in deposits.
- Major exposure to Trade & Services, with fluctuations in Agriculture and Allied Activities, suggested a focus on business and commercial lending.
- Significant increase in Provision Coverage Ratio from 49.81% to 78.31% reflected robust provisioning, indicating strong risk management practices.

7. EQUITAS
    - Gross NPA increase in 2021-2022 might be attributed to economic disruptions, but the subsequent decline showed recovery and better asset quality management.
    - High Credit to Deposit Ratio indicated aggressive lending strategies.
    - Balanced exposure across various sectors, with significant involvement in Trade & Services and Personal Loans, indicated diversified lending.
    - Fluctuations in Provision Coverage Ratio with a slight increase indicated ongoing adjustments in provisioning strategies.
8. UTTKARSH
    - Gross NPA spike in 2021-2022 might be due to economic challenges, but the reduction indicated recovery efforts.
    - Credit to Deposit Ratio's decrease suggested a shift towards more conservative lending or improved deposit mobilization.
    - High focus on Agriculture and Allied Activities, shifting towards Personal Loans, showed a move to diversify lending portfolios.
    - High increase in Provision Coverage Ratio showed strong provisioning efforts to cover potential losses.
9. UJJIVAN
    - Stable high Gross NPAs indicated persistent challenges, but a significant drop highlighted improved recovery processes and economic recovery.
    - Drastic reduction in Net NPA showed highly effective recovery efforts and improved credit risk management.
    - Predominantly focused on Personal Loans, with increasing focus over the years, indicating a strategic emphasis on retail lending.

- Leading with the highest increase in Provision Coverage Ratio indicated aggressive provisioning and strong risk management.

10. Equitas consistently ranks as the top performer across the years, exhibiting strong capital adequacy, management quality, and earnings. It consistently shows improvement in asset utilization and profitability.
11. Ujjivan shows significant improvement in profitability and asset utilization in 2022-2023, placing it as the top performer in that period. However, it struggles with asset quality, management quality, and earnings overall.
12. AU maintains a strong position with robust financial health, efficient asset utilization, and high profitability, particularly in 2020-2021. However, it needs improvement in management quality and earnings.
13. Uttkarsh shows steady improvement in profitability and asset utilization throughout the period, particularly in 2022-2023. It needs improvement in capital adequacy and asset quality.
14. ESAF consistently struggles with capital adequacy and liquidity, needing improvement in earnings. It excels in asset quality but needs to improve its overall performance.

4.2 RECOMMENDATIONS

- Diversify Portfolio to reduce reliance on high-risk categories by diversifying loan portfolio.
- Regular Stress Testing to Conduct regular stress tests to identify vulnerabilities.
- Improve Stability to Focus on enhancing asset quality and operational efficiency.
- Early Warning Systems to integrate systems to detect financial stress indicators early.
- Maintain Recovery Efforts to Continue enhancing recovery strategies and monitoring loan performance.
- Robust Provisioning to Ensure adequate loan loss coverage through strong provisioning strategies.
- Diversify Lending to Expand into sectors beyond agriculture to balance the portfolio.
- Risk Assessment to Implement advanced risk models for agricultural lending.
- Balanced Approach to Monitor the ratio to support growth and liquidity.
- Deposit Mobilization to Enhance efforts to increase deposits
- Learn from Peers to Adopt strategies from top performers like Equitas and AU.
- Use Technology to Implement advanced credit risk management technologies.
- Strengthen Governance to enhance risk management governance and oversight.
- Continuous Training to regularly train staff on risk assessment techniques and regulations.
- Monitor KPIs to Develop key performance indicators for credit risk management.
- Develop digital lending platforms with fintech partners to reach underserved markets and streamline the lending process.
- Develop a decentralized ledger for borrower credit histories, improving the accuracy of credit risk assessments.
- Develop loan products specifically for renewable energy projects and eco-friendly businesses, diversifying the loan portfolio with a focus on sustainability.
- Develop a Borrower Score Card to analyze borrower ability to repay the amount.

4.3 SUMMARY

ESAF Bank's credit exposure grew at a compound annual growth rate (CAGR) of 14% over three years, although this growth has recently slowed. Most loans fall under the 'Below 100% risk weight' category, indicating conservative lending, but there is an increasing share of higher-risk borrowers, raising concerns about defaults. The Capital Adequacy Ratio (CAR) and Z-score, both measures of financial stability, have been declining, suggesting potential risks. Despite an increase in Gross Non-Performing Assets (NPAs) due to the pandemic, effective recovery measures significantly reduced NPAs in 2022-2023. The bank's Credit to Deposit Ratio shows aggressive lending, but recent trends suggest a shift towards balance. A strategic focus on Agriculture and Allied Activities increased this sector's portfolio share from 57% to 71%, with moderate improvements in provisioning strategies.

Compared to peers like AU, Equitas, Uttkarsh, and Ujjivan, ESAF Bank excels in asset quality but struggles with capital adequacy and liquidity. AU Bank maintains low Net NPAs and focuses on Trade & Services, while Equitas shows strong capital adequacy and diversified lending. Uttkarsh is improving profitability but needs better capital adequacy, and Ujjivan has improved recovery processes with a focus on Personal Loans.

To enhance credit risk management, ESAF Bank should diversify its loan portfolio, implement stricter risk assessment criteria, and strengthen its capital base. Regular stress tests, early warning systems, and robust recovery strategies are essential. Expanding lending beyond agriculture, boosting deposit mobilization, and adopting advanced technologies can further strengthen the bank. Learning from successful peers, continuous staff training, and developing innovative loan products and borrower assessment tools will support sustainable growth and financial stability.

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Appendix

ESAF
ESAF SMALL FINANCE BANK

Balance Sheet

As at 31 March 2023

Rs. In Thousands

	Schedule No.	As At 31 March 2023	As At 31 March 2022
CAPITAL AND LIABILITIES			
Capital	1	4,494,738	4,494,738
Employee Stock options Outstanding		58,752	48,058
Reserves and Surplus	2	12,596,545	9,573,214
Deposits	3	146,656,237	128,150,725
Borrowings	4	33,541,956	29,528,333
Other Liabilities and Provisions	5	4,888,329	5,280,573
Total		**202,236,557**	**177,075,641**
ASSETS			
Cash and Balances with Reserve Bank of India	6	7,395,480	13,006,682
Balances with Banks and Money at Call and Short Notice	7	275,009	2,112,364
Investments	8	48,885,274	40,702,983
Advances	9	139,243,307	116,370,048
Fixed Assets	10	1,879,269	1,594,747
Other Assets	11	4,558,218	3,288,817
Total		**202,236,557**	**177,075,641**
Contingent Liabilities	12	18,984	20,519
Bills for collection		-	-
Significant Accounting Policies and notes to accounts forming part of financial statements	17 & 18		

Schedules referred to above form an integral part of the Financial statements.

The Balance Sheet has been prepared in conformity with Form 'A' of the Third Schedule to the Banking Regulation Act, 1949.

ESAF
AF SMALL FINANCE BANK

3alance Sheet

s at 31 March 2022

₹ in Thousands

	Schedule No.	As on 31 March 2022	As on 31 March 2021
:APITAL AND LIABILITIES			
:apital	1	44,94,738	44,94,738
:mployee Stock Options Outstanding		48,058	-
?eserves and Surplus	2	95,73,214	90,25,896
)eposits	3	12,81,50,725	8,99,94,260
3orrowings	4	2,95,28,333	1,69,40,000
)ther Liabilities and Provisions	5	52,80,573	29,31,622
Total		**17,70,75,641**	**12,33,86,516**
ASSETS			
:ash and Balances with Reserve Bank of India	6	66,66,682	42,80,725
3alances with Banks and Money at Call and Short Notice	7	84,52,364	1,39,10,540
nvestments	8	4,07,02,983	1,93,20,690
\dvances	9	11,63,70,048	8,16,75,855
:ixed Assets	10	15,94,747	13,85,119
)ther Assets	11	32,88,817	28,13,587
Total		**17,70,75,641**	**12,33,86,516**
:ontingent Liabilities	12	20,519	15,042
3ills for collection		-	-
;ignificant Accounting Policies and notes to accounts forming part of inancial statements	17 & 18		

chedules referred to above form an integral part of the financial statements.

he Balance Sheet has been prepared in conformity with Form 'A' of the Third Schedule to the Banking Regulation Act, 1949

Balance Sheet

as at March 31, 2023

(₹ in '000)

Particulars	Schedule	As at March 31, 2023	As at March 31, 2022
CAPITAL & LIABILITIES			
Capital	1	6,667,450	3,149,000
Employees stock options outstanding		440,252	413,316
Reserves & Surplus	2	102,665,735	71,577,824
Deposits	3	693,649,864	525,846,206
Borrowings	4	62,986,521	59,907,786
Other Liabilities and Provisions	5	35,751,362	29,883,872
Total		**902,161,184**	**690,778,004**
ASSETS			
Cash and Balances with Reserve Bank of India	6	89,160,930	57,534,072
Balances with banks and Money at Call and Short Notice	7	5,090,793	1,751,078
Investments	8	200,720,099	153,065,043
Advances	9	584,215,441	460,952,564
Fixed Assets	10	7,401,394	6,225,713
Other Assets	11	15,572,527	11,249,534
Total		**902,161,184**	**690,778,004**
Contingent Liabilities	12	34,985,941	21,076,078
Bills for Collection		-	-
Significant accounting policies and notes to accounts forming part of financial statements	17 & 18		

The Schedules referred to above form an integral part of the Balance Sheet.
As per our attached Report of even date.

For Deloitte Haskins & Sells
Chartered Accountants
ICAI Firm Registration No.: 117365W

For and on behalf of the Board of Directors
AU Small Finance Bank Limited

BADLAAV
HUMSE HAI

Balance Sheet

as at March 31, 2022

(₹ in '000)

Particulars	Schedule	As at March 31, 2022	As at March 31, 2021
CAPITAL & LIABILITIES			
Capital	1	3,149,000	3,122,134
Employees stock options outstanding		413,316	1,031,171
Reserves & Surplus	2	71,577,824	58,598,853
Deposits	3	525,846,206	359,793,142
Borrowings	4	59,907,786	70,296,957
Other Liabilities and Provisions	5	29,883,872	23,070,802
Total		**690,778,004**	**515,913,059**
ASSETS			
Cash and Balances with Reserve Bank of India	6	24,684,072	15,693,478
Balances with banks and Money at Call and Short Notice	7	34,601,078	32,119,877
Investments	8	153,065,043	108,154,139
Advances	9	460,952,564	346,089,142
Fixed Assets	10	6,225,713	4,823,685
Other Assets	11	11,249,534	9,032,738
Total		**690,778,004**	**515,913,059**
Contingent Liabilities	12	21,076,078	12,208,441
Bills for Collection		-	-
Significant accounting policies and notes to accounts forming part of financial statements	17 & 18		

The Schedules referred to above form an integral part of the Balance Sheet.
As per our attached Report of even date.

For Deloitte Haskins & Sells
Chartered Accountants
ICAI Firm Registration No.: 117365W

For and on behalf of the Board of Directors
AU Small Finance Bank Limited

Balance Sheet
as on March 31, 2023

(₹ in 000's)

Particulars	Schedule	As on March 31, 2023	As on March 31, 2022
CAPITAL AND LIABILITIES			
Capital	1	21,547,066	19,283,142
Employees Stock Options and Purchase Outstanding	18(33)	512,205	421,958
Reserves and Surplus	2	20,031,799	8,321,239
Deposits	3	255,376,822	182,922,169
Borrowings	4	26,414,640	17,635,616
Other Liabilities and Provisions	5	9,286,243	7,537,714
TOTAL		**333,168,775**	**236,121,838**
ASSETS			
Cash and Balances with Reserve Bank of India	6	23,052,710	16,899,652
Balances with Banks and Money at Call and Short Notice	7	1,783,218	4,858,547
Investments	8	85,103,075	41,529,348
Advances	9	212,896,611	163,031,714
Fixed Assets	10	2,828,799	2,493,926
Other Assets	11	7,504,362	7,308,651
TOTAL		**333,168,775**	**236,121,838**
Contingent Liabilities	12	950,034	1,372,305
Bill for collection		-	-
Significant Accounting Policies	17		
Notes forming part of the financial statements	18		

The schedules referred to above form an integral part of the Balance sheet

The Balance Sheet has been prepared in conformity with Form A of the Third Schedule to the Banking Regulation Act, 1949.

As per our report of even date

For B K Ramadhyani & Co LLP	Mukund M Chitale & Co.	For and on behalf of Board of Directors of
Chartered Accountants	Chartered Accountants	Ujjivan Small Finance Bank Limited
FRN: 002878S/ S200021	FRN:106655W	

Balance Sheet
as at March 31, 2022

(₹ in 000's)

Particulars	Schedule	As at 31/03/2022	As at 31/03/2021
CAPITAL AND LIABILITIES			
Capital	1	19,283,142	19,283,142
Employees Stock Options and Purchase Outstanding	18(33)	421,958	437,235
Reserves and Surplus	2	8,321,239	12,467,143
Deposits	3	182,922,169	131,357,673
Borrowings	4	17,635,616	32,473,167
Other Liabilities and Provisions	5	7,460,518	7,786,180
TOTAL		**236,044,642**	**203,804,540**
ASSETS			
Cash and Balances with Reserve Bank of India	6	16,822,456	17,115,317
Balances with Banks and Money at Call and Short Notice	7	4,858,547	8,659,657
Investments	8	41,529,348	25,164,501
Advances	9	163,031,714	144,939,518
Fixed Assets	10	2,493,926	2,807,289
Other Assets	11	7,308,651	5,118,258
TOTAL		**236,044,642**	**203,804,540**
Contingent Liabilities	12	1,372,305	405,597
Bill for collection		-	-
Significant Accounting Policies	17		
Notes forming part of the financial statements	18		

The schedules referred to above form an integral part of the Balance sheet

The Balance Sheet has been prepared in conformity with Form A of the Third Schedule to the Banking Regulation Act, 1949.

As per our report of even date

For B K Ramadhyani & Co LLP	Mukund M Chitale & Co.	For and on behalf of Board of Directors of
Chartered Accountants	Chartered Accountants	Ujjivan Small Finance Bank Limited
FRN: 002878S/ S200021	FRN:106655W	

Balance Sheet

as at March 31, 2023

(All amounts in 000's of ₹, unless otherwise specified)

Particulars	Schedule	As at 31-Mar-23	As at 31-Mar-22
CAPITAL AND LIABILITIES			
Capital	1	1,11,05,582	1,25,20,277
Reserves and Surplus	2	4,04,73,895	2,99,41,409
Deposits	3	25,38,05,558	18,95,07,973
Borrowings	4	2,97,37,600	2,61,64,000
Other Liabilities and Provisions	5	1,44,58,651	1,13,42,556
TOTAL		**34,95,81,286**	**26,94,76,215**
ASSETS			
Cash and Balances With Reserve Bank of India	6	1,17,39,122	2,07,69,917
Balances With Banks and Money At Call and Short Notice	7	7,03,455	5,55,229
Investments	8	6,66,45,624	4,44,98,496
Advances	9	25,79,85,566	19,37,42,060
Fixed Assets	10	37,91,304	20,04,445
Other Assets	11	87,16,215	79,06,068
TOTAL		**34,95,81,286**	**26,94,76,215**
Contingent Liabilities	12	12,26,698	4,92,796
Bills For Collection		-	-

Balance Sheet

as at March 31, 2022

(All amounts in 000's of ₹, unless otherwise specified)

Particulars	Schedule	As at 31-Mar-22	As at 31-Mar-21
CAPITAL AND LIABILITIES			
Capital	1	1,25,20,277	1,13,92,783
Reserves and Surplus	2	2,99,41,409	2,25,70,628
Deposits	3	18,95,07,973	16,39,19,717
Borrowings	4	2,61,64,000	4,16,53,200
Other Liabilities and Provisions	5	1,13,85,335	75,48,419
TOTAL		**26,95,18,994**	**24,70,84,747**
ASSETS			
Cash and Balances With Reserve Bank of India	6	95,69,917	51,48,080
Balances With Banks and Money At Call and Short Notice	7	1,17,55,229	2,86,39,044
Investments	8	4,44,98,496	3,70,51,661
Advances	9	19,37,42,060	16,84,81,890
Fixed Assets	10	20,04,445	18,50,500
Other Assets	11	79,48,847	59,13,572
TOTAL		**26,95,18,994**	**24,70,84,747**
Contingent Liabilities	12	1,83,000	1,25,061
Summary of significant accounting policies	17		
Notes forming part of financial statements	18		

The accompanying notes are an integral part of the financial statements

As per our report of even date

For T R Chadha & Co LLP,
Chartered Accountants
Firm Registration No.: 006711N/N500028

For and on behalf of Board of Directors of Equitas Small Finance Bank Limited

Balance Sheet

as at March 31, 2022

(₹ in '000s)

	Schedule	As at 31 March 2022	As at 31 March 2021
CAPITAL AND LIABILITIES			
Capital	1	8,955,215	8,483,339
Reserves and Surplus	2	6,767,753	5,200,187
Deposits	3	100,741,826	75,075,681
Borrowings	4	25,719,349	26,078,252
Other Liabilities and Provisions	5	8,453,555	6,541,664
Total		**150,637,698**	**121,379,123**
ASSETS			
Cash and balances with Reserve Bank of India	6	5,338,972	2,749,383
Balances with banks and money at call and short notice	7	13,377,519	8,948,777
Investments	8	23,479,238	23,139,356
Advances	9	102,281,473	82,168,575
Fixed Assets	10	2,865,335	1,811,712
Other Assets	11	3,295,161	2,561,320
Total		**150,637,698**	**121,379,123**
Contingent Liabilities	12	**564,192**	**620,727**
Bills for Collection		-	-
Significant accounting policies	17		
Notes to the financial statements	18		

Schedules referred to above form an integral part of the Financial statements. The Balance Sheet has been prepared in conformity with Form 'A' of the Third Schedule to the Banking Regulation Act, 1949.

Balance Sheet

as at March 31, 2023

(₹ in '000s)

	Schedule	As at March 31, 2023	As at March 31, 2022
CAPITAL AND LIABILITIES			
Capital	1	8,959,047	8,955,215
Reserves and Surplus	2	11,044,159	6,767,753
Deposits	3	137,101,400	100,741,826
Borrowings	4	23,494,753	25,719,349
Other Liabilities and Provisions	5	10,576,056	8,453,555
Total		**191,175,415**	**150,637,698**
ASSETS			
Cash and balances with Reserve Bank of India	6	11,920,566	17,978,972
Balances with banks and money at call and short notice	7	13,243,064	737,519
Investments	8	28,594,222	23,479,238
Advances	9	130,687,655	102,281,473
Fixed Assets	10	3,033,239	2,865,335
Other Assets	11	3,696,669	3,295,161
Total		**191,175,415**	**150,637,698**
Contingent Liabilities	12	**3,416,049**	**564,192**
Bills for Collection		-	-
Significant accounting policies	17		
Notes to the financial statements	18		

Schedules referred to above form an integral part of the Financial statements. The Balance Sheet has been prepared in conformity with Form 'A' of the Third Schedule to the Banking Regulation Act, 1949.

As per our report of even date attached