Payment Services & Transaction Based Banking in Agriculture

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- HDFC Bank was incorporated in 1994,
- Promoted by the Housing Development Finance Corporation
- Balance sheet size of USD 55 bn and Net Profit of USD 0.78 bn for the 9 months ended Dec 31, 2011
- Distribution of 2201 branches, 7110 ATM’s across 1174 locations (limited overseas presence)
- India’s number one bank (by Market cap), In the top 5 overall
- Widest product range in the country covering wholesale banking, Retail Banking and Treasury Services
- Key strengths include Cash Management, Trade Finance and Consumer Banking
Achievements of Indian Agriculture
• Self sufficiency in agricultural produce
• Among the Largest producers of food grains, pulses, milk, F&V in the world
• Produced a recorded 240MM tones of food grain in 2011.
• Agriculture is approx 16% of GDP, employs 50% of the Population,
• Expected to grow 4 times its existing size of $577bn

Challenges facing Indian Agriculture
• Growing population (expected to touch 1400MM by 2025)
• Demand supply gap in food grains estimated at 54MM MT by 2025
• Increase in Under nourished persons from 210MM to 250 MM from 1990 to 2006
• Stagnating yields & after effects of the green revolution
• Fragmentation of family land (average farm size decreased from 1.9ha to 0.91
• Un-organised markets Under developed post harvest / food processing industry

Key Challenges in Agri Business for Banks (& Industry)
• Low Value transactions due to Fragmentation of Land
• Vast Geography
• High volume of cash in the system.
Agricultural Business initiated in 2007. The Three Pillars

• Retail Agri – (farmer Services)
  - 60,000 farmer relations
  - Book of $600MM growing at 60% year on year
  - 450 Relationship managers, do asset, liability, cross sell and collections.

• Commodity Finance & Warehouse Receipt (Post Harvest Services)
  - 3000 customers, primarily agro/food processors
  - Business is retail in nature average ticket is USD 0.20MM
  - 200 Relationship Managers ( & Warehouse Inspectors )

• Rural Initiative Group – (Supply chain Group)
  - 60,000 farmers linked to Corporates /Aggregators /Input dealers
  - Serviced through 350 BC’s
  - Average float equivalent to $7MM (Rs 35 Cr)
  - Loans worth $2MM (Rs 10 Cr) disbursed each month
HDFC Agriculture – Business Approach

- Offer full-package of services.
  - Cash-management
  - Personal Savings Bank – includes ATM / Mobile / Net banking / Bill-payment
  - Consumer loans
  - Business loans - working capital, warehouse-receipt, investment loans
  - Insurance services - cross-sell HDFC insurance subsidiary products

- Multiple delivery channels/Client Management
  - Direct through relationship managers (Retail Agri, Commodity Finance)
  - Indirect through Business Correspondents
  - Branch & ATM Expansion
Agriculture & The Cash Generation Challenge

High volume of Cash transaction is a major problem in development of agriculture

Causes of Cash economy in Agriculture

• Lack of access to banks / Service
• Tax related
• Traditional local markets, Un-organised supply chain & retailing – e.g

Farmer (e.g ground nut)
- 5 Acre of land
- Cash sales USD 5000 per season
- Savings in Gold jewelry

Indermediary
- More than 1 layer
- commission of 1-2%
- Off balance sheet
- Cash txn

Processor (Oil Miller)
- Cash Sales in local markets
- 25-30% on balance sheet
- Average balance sheet USD 2MM

Agriculture is 16% of the GDP /50% of the work force
- However only 25-30% of the payments come, through the banking system
- Leading to financial exclusion of a large part of the farming community
- Business viability for Banker & Industry affected
A typical supply chain in India can have up to 7 layers of intermediation between the Farmer and the Consumer.

Corporate Supply Chain – also Cash Dominated

A typical supply chain in India can have up to 7 layers of intermediation between the Farmer and the Consumer.

- Including Commission Agents & Input Dealers and agri processors is important to keep payments within the banking system.
- The bank needs to have the product offerings to suit each of them.

Where supply Chain breaks and payments Turn to cash
At the Agent / Processor stage.
Banks are compelled to reach the last mile due to directed lending by the RBI (Central Bank).

The key to viable lending at the last mile is to trap the cash flows through a Transaction and Payments systems.

Key challenges in Setting up Transaction & Payments systems in Agriculture:
- Converting cash into account balances for transactions.
- Operating customer Access points.

Contract farming is best suited to trapping cash flows:
- Convert payments for produce into bank account credits.
- Cash outflow can also be converted into non cash bank transaction by partnering Input company’s & equipment suppliers.
- Sugarcane & Dairy are the best available contract farming models.

Customer Access points provided through Business Correspondents:
- Key challenge is delivering cash to the outlets during the harvest season.
- Partnering with ATM cash vendor’s is a solution tried at HDFC Bank.
Farmers produce multiple crops and may be attached to one or more supply chains of the organised sector such as dairy / cane / seed production.

- Currently 60,000 farmers from 160 dairy units / 18 sugar mills in FY12 are operating on this model.
- Family savings averaging USD 150/- a/c.
- Dairy farmers receive USD 40-100 per mth / Sugarcane USD 5000 per season.
- Average Loan size is also USD 6000 for total cropping.

Contract farming – Payments System

- Drip irrigation mfg Co.
- HDFC Bank
- Farmer
- Sugar Mill
- Input supplier Co
- Working Capital credit
- Payments
- Output
- Reaching the Farmer

Family savings
Consumer loans
Contract farming has its limitations for commodity crops, here the Warehouse receipt can be effective in converting payments to account credits.

- Warehouse Receipt Loan market currently at the top end traders & processors
- Market is underdeveloped at USD 0.2bn as against crop production lending of USD 66bn
- Working with Agro processors to set up Terminal Markets at Factory gate is the way forward to approach it viably and partly overcome infrastructural issues.
• Model helps us reach the farmer through the Fertiliser Co’s Loyalty Program
• Key limitation is that cash flows still unorganised
• However, given the shortage of seeds & fertiliser through the loyalty program and Customers can start a savings habit
• The bank has piloted this at 25 dealer outlets adding around 75 customers a month
Key Success Factors

- Getting the basic Services right, account operations, Crop / investment loans, turnaround times

- Efficient BC services – provides door step service by a known face
  - Adequate BC remuneration while keeping the cost low
  - Cash management efficiency
  - Supervision, Accountability and prevention of frauds

- Successfully tackling intermediaries with vested interests

- Getting the right corporate partners is very important, Partners should benefit by more walk in’s (sales) / or quality sourcing

- Handling, the banks internal challenges, adequate incentive for the bank staff (working in difficult conditions)

- The initiative should result in higher productivity and cost saving for the bank
Agri supply chain poised for major development

- Consolidation in the Agri processing & growth in organised Retailing
- Existing process of sourcing Agricultural raw material will be challenged as the demand supply gap increases.
  - Corporates need to develop sustainable sources of Raw Material
  - Corporates will need to reach the last mile to develop suppliers (Farmers)
  - Corporates face the same challenge as banks to reach the last mile
- A good transaction & Payment System will facilitate more engagement of the organised sector in agriculture
In Conclusion

The flow funds through the banking system will result in
• Better business viability due to floats & commissions
• Better credit control, lower delinquency
• Savings from lower cash handling.

This in turn should lead to
• More inclusion of famers
• Better products
• Increased term lending for farm development / irrigation

Corporates / the organised sector benefits by
• Quality sourcing of raw material
• Savings from transaction efficiency & cash management
• Opportunity to develop sustainable supply bases

Thank you

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