

FA1111, Banking Operations & Risk Management, Dec 2023

BBA banking and fintech 5th Sem 2021-24 batch

Roll Number:

Date:

Case Study: 30 marks

Background:

SBL or Small Business Loans, a non-banking finance company was started by a group of professionals in 2018. These professionals had been part of the formal banking system and had seen how difficult it was for MSME who had limited documentation to borrow loans from the physical sector.

With the backing of few investors, Sameer who is the founder CEO, started operations in 15 locations and focused on giving loans to individual MSME borrowers. He built his core team from his previous colleagues and soon had the business rolling.

Given that the formal underwriting processes are not available, an underwriting model that was the brain child of Sameer that he had learnt this from his years of lending experience, was passed on to the loan officers.

Loan officers were specially trained to understand each borrower business model, cash flows and debt requirements. Basis a detailed analysis, they were then able to calculate the loan amount and pricing to be charged.

Collections from the MSME business also meant repayment dates were not standard and were linked to the business model of each borrower... however collection was often a delight as borrowers would come to pay the monthly instalment and bring along a box of cookies from their bakery or flowers or such small token of appreciation. This kept the staff motivated and they felt that they were adding positivity to their borrower's lives.

Also, the customer delight and customer connect ensure strong word of mouth marketing resulting in significant volumes coming in from the referral channel... low acquisition costs meant SBL was very profitable.

However, lengthy sanctions and collections were time consuming activities, and in the early phase as the company built up a portfolio of 800 Crore from the 15 locations in the first two years, the staff was working almost 12 hours per day, 6 days a week to make this happen.

Productivity promises from the new system

On the positive side, the company's long-awaited new enterprise IT was nearly ready to go live, and it promised to greatly reduce the staff's workload, for example, using AI to automate tasks like calculating pricing and loan amounts for customers.

On the contrary, each new software always comes up with adoption challenges and training requirements. Also, the company knew that software would need 4-6 months to stabilize and during these 4-6 months, the loan officers would be having to work extra, calculate the pricing and loan amounts using the software as well as calculate the same manually. Finally take a decision basis both outputs till they were fully trained and till such time all the bugs in the new software had been removed.

Market scenario

Given the early success of the company, competitors were circling, and Sameer needed to stay on the offensive. He couldn't let bigger banks lure away the previously underserved customers that SBL had brought into the financial system or let new "fintech" start-ups with digital-only banking services disintermediate his business.

The company was however in a dilemma on the growth strategy to be adopted

"If we grow too fast, we'll break from the strain."

"If we stop growing, we'll be eaten for lunch by our competitors"

He posed this question to his leadership team, CHRO Tanya, CFO Akshay and CTO Mridul.

Tanya, the CHRO, let out an audible scoff. She felt that aggressive growth had already stretched SBL too thin and that believing IT would lighten the burden on employees was optimistic. "When was the last time a new technology created less work for anyone?" she asked sarcastically. Any faster growth may result in employee burn out and significant HR challenges.

Akshay put together the financial projections and stated that if they do not grow fast, they will be marginalized and will not meet the growth target submitted to the investors.

Mridul, while disagreeing with Tanya, stated that he wished Akshay had given him higher budgets and Tanya would help him more with training and validation. He however confirmed that it may take 4-6 months to stabilize the new system as per the results from the first set of pilots.

Other challenges

The other question that Sameer had, while the loan officers have been trained and handheld personally by him initially during the start-up stage, as they now expand, his ability to train and mentor new loan officers will be limited. In the long run, as they expand, new loan officers, may not be trained well enough and may make mistakes. That may result in higher losses. Hence a system driven decision model implementation is very important to ensure growth with quality portfolio.

However, system driven model, however good they are, suffer from type B errors* resulting in lower sanction rates and hence moving away from humane lending models to models similar to formal banking systems.

*Type B errors-> rejecting good customers due to training bias or external impact on borrowers (divorce, death, health) that humans are able to assess and approve, while systems would reject these loans.

“So human beings may make more bad loans while machines may reject more good loans”

Sameer agreed with Akshay and stated that they would need to grow from 15 to at least 40 branches in the next one year if not 60 as promised to the investors. Also, this is the only way to keep competitors from catching up and making sure that early success is fully capitalized.

Please share your thoughts and views on **What should Sameer do?**

1. Is the promise of new technology realistic or over optimistic? (CO2)
2. The human beings are as capable of making bad loan decisions as the computers with AI/ ML models are, does it mean that human beings can be replaced by machines? (CO2 & CO4)
3. Should SBL open new branches immediately or set up the new system before opening new branches? (CO5)
4. Should SBL follow the decision making by loan officers or should they start relying completely on the new system? What checks and balances can be built up in either approach? (CO2,CO3 & CO6)
5. What changes in the human resource policies can SBL implement in this growth journey?
6. What operating changes or decisions that SBL can take to make sure that they meet the growth target while keep credit quality and customer connect intact? (CO2,CO5)

Remember, there are no right or wrong answers for this case study... the evaluation will be done basis your logical explanations.