



Report and Recommendation of the President to the Board of Directors

Project Number: 48278
October 2014

Proposed Loans and Technical Assistance Grant Axis Bank Limited and YES Bank Limited Strengthening Rural Financial Inclusion and Farmer Access to Markets Project (India)

This is an abbreviated version of the document approved by ADB's Board of Directors that excludes information that is subject to exceptions to disclosure set forth in ADB's Public Communications Policy 2011.

Asian Development Bank

CURRENCY EQUIVALENTS

(as of 30 September 2014)

Currency unit	–	Indian rupee/s (Re/Rs)
Re1.00	=	\$0.01621
\$1.00	=	Rs61.667

ABBREVIATIONS

ABL	–	Axis Bank Limited
ADB	–	Asian Development Bank
CAGR	–	compound annual growth rate
ESMS	–	environmental and social management system
GDP	–	gross domestic product
IFI	–	international financial institution
LIC	–	Life Insurance Corporation of India
NPA	–	nonperforming asset
PSL	–	priority sector lending
RBI	–	Reserve Bank of India
ROAA	–	return on average assets
ROAE	–	return on average equity
SHG	–	self-help group
SMEs	–	small and medium-sized enterprises
SUUTI	–	Special Undertaking of the Unit Trust of India
TA	–	technical assistance
TASF	–	Technical Assistance Special Fund
YBL	–	YES Bank Limited

NOTES

- (i) The fiscal year (FY) of the Government of India, Axis Bank Limited, and YES Bank Limited begins on 1 April and ends on 31 March. “FY” before a calendar year denotes the year in which the fiscal year ends, e.g., FY2014 ends on 31 March 2014.
- (ii) In this report, “\$” refers to US dollars.

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I. THE PROPOSAL

1. I submit for your approval the following report and recommendation on (i) a proposed loan of up to \$200,000,000 to Axis Bank Limited (ABL); (ii) a proposed loan of up to \$200,000,000 (or Indian rupee equivalent) to YES Bank Limited (YBL); and (iii) proposed capacity development technical assistance (TA) of up to \$2,000,000 to be financed on a grant basis by the Technical Assistance Special Fund (TASF - other sources) to ABL and YBL for the Strengthening Rural Financial Inclusion and Farmer Access to Markets Project in India.¹

II. THE FINANCIAL INTERMEDIARIES

A. Investment Identification and Description

1. The Rural Economy

2. Despite the impressive reduction in poverty, most Indians, especially in rural areas, cannot meet their basic needs. Economic and financial sector reforms that originated in the 1990s resulted in sustained economic growth with a gross domestic product (GDP) compound annual growth rate (CAGR) of 7.5% during 2000–2012, outperforming India's GDP CAGR of 4.5% during the preceding four decades by a wide margin. Strong economic performance coupled with slower population growth has resulted in a dramatic improvement in India's poverty headcount index, which fell from 66% in 1977 to 33% in 2009.² Despite this considerable improvement, recent research underscores that about 680 million Indians, or 56% of the population, continue to lack the income and safety nets required to meet their essential needs, most of whom are rural dwellers.³ Of particular concern is the lagging performance of agriculture, which is the primary source of rural employment and income.

3. The importance of agriculture to the economic and social fabric goes well beyond its contribution to GDP. Agriculture has not kept pace with recent growth in India's broader economy, as productivity has stagnated. Based on recent estimates, agricultural productivity per worker in India is 60% lower than that of construction and 75% lower than that of manufacturing. Despite significant improvement in recent decades, India's agricultural crop yields remain substantially below those of its Southeast and East Asian peers—ranging from 10% to 50% (with the exception of wheat). This has adversely impacted the agriculture sector's contribution to GDP, which has decreased considerably from 42% in 1961 to 17% in 2012. In spite of this decline, agriculture continues to play the predominant role in the rural economy, which comprises some 68% of India's population, providing 73% of rural employment (much of it undertaken by women) and generating 52% of rural household income.⁴ The importance of agriculture sector productivity is central to the development of the rural economy. Improving the productivity and performance of the agriculture sector is the most direct route to addressing rural poverty.

4. Structural issues and inefficiencies contribute to low agricultural productivity. While crop, food, and livestock production growth have exceeded population growth since 2009, low agriculture growth and productivity are general problems across crops and regions, although large interstate yield differences exist.⁵ Low agricultural productivity in India stems from a number of factors,

¹ The design and monitoring framework is in Appendix 1.

² Measured at \$2 per day purchasing power parity. World Bank. PovcalNet. <http://iresearch.worldbank.org/PovcalNet/index.htm?0> (accessed 29 April 2014).

³ McKinsey Global Institute. 2014. *From Poverty to Empowerment: India's Imperative for Jobs, Growth, and Effective Basic Services*. Mumbai (February).

⁴ Some 79% of rural women are involved in agricultural activity (2010). Asian Development Bank (ADB). 2013. *Country Program and Strategy: India, 2013–2015*. Manila (Gender Assessment).

⁵ Punjab's grain yield per hectare (2011–2012) exceeded that of Odisha and Rajasthan more than three times. Important factors explaining the difference are tractor intensity, the use of fertilizer, the availability of irrigated land, and, perhaps

including (i) slow progress on land reforms, (ii) inefficient state-controlled input supply and marketing, (iii) inadequate irrigation infrastructure resulting in high dependence on rainfall,⁶ (iv) limited research and slow adoption of modern agricultural practices and technologies, (v) weak integration of farmers into the value chains of agribusiness companies, and (vi) limited and costly access to financial services for farmers.

5. Agriculture production has been put under greater stress with the emergence of the middle class. India's solid GDP growth has improved personal income levels and facilitated the emergence of a growing middle class⁷—a trend that is expected to gain strength over the medium term. Growing income and the expansion of the urban population at a rate of 10 million persons per year has resulted in rising demand for quality food and beverage products, which is outpacing the growth of supply. The surge in food prices since 2007 underscores the increasing demand–supply gap and points to the tremendous need to improve India's agriculture productivity.

2. Rural Financial Inclusion and the Role of Private Sector Banking

6. Despite notable improvements, rural residents have inadequate access to finance. Since the 1990s, financial sector reforms in India have improved the operating environment for banks. In particular, the deregulation of interest rates and the entry of new private sector banks have intensified competition, improved sector performance, and enhanced service coverage. Largely as a result, private sector credit has grown significantly, up from 25% of GDP in 1990 to 51% in 2012. While the government runs sizeable subsidized lending programs to reach the unbanked, it has increasingly recognized the limited sustainability of such interventions and has acknowledged that a commercial business banking approach is needed. To ensure that banks place reasonable emphasis on serving the lower-income segments, the Reserve Bank of India (RBI) instituted priority sector lending (PSL) policies requiring banks to lend at least 40% of their net credit of the previous year to priority sectors. The PSL targets include, among others, agriculture (18%) and economically weaker sectors (10%). Notwithstanding such policies, banks have not met these PSL targets and improving rural financial inclusion has remained a challenge.

7. Low financial services depth in agriculture is a major impediment to investment. Agriculture generated more than 17%–19% of GDP during 2007–2012, yet the sector only received 11%–12% of institutional credit. Limited access to affordable funding is the key factor constraining investment by India's 120 million small farmers. Banking services typically provided to farmers are usually limited to basic payments and deposits and to a minimal extent, credit, as traditional lending processes require collateral documentation and financial statements that most farmers are unable to produce. Services customized to a farmer's cash flow, for instance, are still in their infancy. However, creative solutions such as cash flow-based lending are needed to address the interrelated challenge of limited financial inclusion and low agricultural productivity.

8. To address these intertwined challenges and to maximize development impact by reaching a large number of small farmers to whom the Asian Development Bank (ADB) cannot lend directly, ADB conducted a search of potential high-quality private banks with broad reach in rural areas, successful lending programs serving small farmers, and which were willing to partner with ADB to

even more so, the use of farm credit. Farm credit in Punjab exceeded that of Odisha by more than 10 times; and contributed to farmer access to improved inputs and management for maintaining soil fertility, seed quality and irrigation, as well as the application of adequate farming techniques and post-harvest management supported by capital, research, and land titling—all of which can have a critical impact on agricultural yields.

⁶ Nearly 70% of the net sown area is in rain-fed agriculture.

⁷ Some 20% of India's 240 million households can be characterized as high to upper-middle income (>\$7,400/annum), while 30% are lower-middle income (>\$3,300≤\$7,400/annum) and 50% are low-income. The upper-middle-income segment spends 20%–35% of their income on food and beverages, while the lower-middle-income segment spends up to 45% on this expenditure item. The average Indian household spends 31% on food and beverages.

deepen rural financial inclusion. Two commercial banks were identified—ABL, India's third largest private bank, and YBL, the fourth largest. Through dedicated inclusive business units, which target agriculture and financial inclusion, both banks have initiated the development of innovative commercial inclusive finance solutions for the rural unbanked, particularly women, and better integration of farmers in the agriculture value chain.

B. Axis Bank Limited

9. **Business overview and strategy.** Established in 1994, ABL is India's third largest private bank with total assets of Rs3,832 billion (\$63.96 billion, end of FY2014). Since FY2011, ABL has diversified its asset mix by expanding its retail franchise and strengthening its small and medium-sized enterprises (SMEs) lending, and has grown its distribution network to 2,402 branches in 29 states & 5 Union Territories. ABL's business strategy leverages on domestic growth opportunities. ABL regards agricultural lending and financial inclusion as an integral component of its rural strategy to further extend its reach in the rural market..

10. **Ownership.** ABL was founded by its state-owned promoters—Unit Trust of India, subsequently the administrator of the Special Undertaking of the Unit Trust of India (SUUTI); Life Insurance Corporation of India (LIC); General Insurance Corporation of India; and four other public sector insurance companies. ABL is listed on the national and Bombay stock exchanges. Following the March 2014 sale of share capital by SUUTI, state ownership fell to 29.2%, with LIC holding 13.5% and SUUTI 11.7% as of 30 June 2014. Ownership is well diversified, with 59.5% held by private institutional investors, and 8.0% by private non-institutional investors (corporates and/or individuals), each holding below 5% interest—the RBI significance threshold level.

11. **Management and governance.** Consistent with the listing requirements of the stock exchanges, RBI, and the Securities and Exchange Board of India regulations, as on 31st March, 2014 ABL is controlled by a 14-member board of directors, half of whom are independent. The board is well supported by a system of committees, including the committee of directors; and the audit, human resources and remuneration, risk management, customer service, and information technology strategy committees. ABL's senior management, responsible for day-to-day management of ABL, is led by Mrs. S. Sharma and consists of 20 other senior managers, all experienced professionals who head business lines, business support, and independent risk and control functions. ABL has a centralized decision-making model with policy and approvals provided by the head office in Mumbai, while its branches focus on customer relationships.

12. **Capital adequacy.** ABL has maintained sound capital adequacy over FY2011–FY2014, as capital growth has kept pace with the rise in risk-weighted assets. In line with RBI regulations, ABL began the phased transition to Basel III capital adequacy guidelines in April 2013. As a result of the change in treatment of Tier 2 capital in the computation of the capital charge, ABL's total capital ratio slightly declined from the previous year to 16.1% as of the end of FY2014, while the Tier 1 capital ratio increased to 12.6%.

13. **Loan portfolio and asset quality.** After loan portfolio growth of 19.2% in FY2012, its pace slowed moderately to 16.0% in FY2013 and to 16.8% in FY2014. Despite the macroeconomic slowdown, asset quality has remained stable with ABL pursuing new lending opportunities targeting highly rated companies. Contrastingly, and consistent with ABL's diversification strategy, the retail portfolio grew at a CAGR of almost 39.0% per annum during FY2011–FY2014. ABL's agricultural and SME portfolio growth has increased since FY2011, rising by 19.1% in FY2014.

13. **Funding.** The Bank is primarily funded through its stable deposit base. ABL has issued subordinated bonds and entered into bilateral placements overseas to raise short- to medium-term funds (1- to 3-year tenor). ABL has an annual funding plan to raise at least \$1 billion during FY2015–FY2017, which it plans to close through offshore issuances via medium-term notes, bilateral and

club loans, in addition to sourcing funds from entities such as international financial institutions (IFIs).

14. **Earnings performance.** ABL's net income grew at a CAGR of 22.4% over FY2011–FY2014, from Rs33.9 billion to Rs62.2 billion. Helped by the diversification in assets toward the higher-yielding retail portfolio and a deposit-dominated low-cost funding base, net interest income growth was healthy, rising by 20.6% in FY2013 and by 23.6% in FY2014. Fee income also increased, climbing by 16.8% in FY2013 before slowing to 8.4% in FY2014. ABL's profitability remained sound in 2014, with a return on average assets (ROAA) of 1.8% and a return on average equity (ROAE) of 18.2%.

C. YES Bank Limited

15. **Business overview and strategy.** Established in 2004, YBL is India's fourth largest private bank with total assets of Rs1,090 billion (\$17.7 billion) as of the end of FY2014. YBL's corporate, retail, SME, and inclusive business platforms offer comprehensive services through its network of 560 branches. Acting largely as a wholesale bank during its early years, YBL under its 2010–2015 strategy is diversifying its portfolio by emphasizing growth in its retail and inclusive and social business lines. YBL's Inclusive and Social Banking Division, through its YES Livelihood Enhancement Action Program, focuses on developing outreach to small farmers, using YBL's agribusiness corporate relationships, and low-income women self-help groups (SHGs) in villages, in partnership with its business correspondents acting as service intermediaries.⁸

16. **Ownership.** The founders, R. Kapoor and the family of the late A. Kapur, collectively own 22.2% of YBL's share capital. The remaining 77.8% of the shares are held by insurance companies (of which LIC holds the largest 7.4% interest), foreign institutional investors, and mutual funds, which own 60.6%, and individuals and trusts, which own 9.8%. YBL shares are listed on both the national and Bombay exchanges. Except for the founders and LIC, all shareholders are below the RBI significance threshold of 5.0%.

17. **Management and governance.** Daily management of YBL is undertaken by an experienced management team headed by R. Kapoor, a well-established businessman, who previously co-founded Rabobank's Indian corporate finance and investment banking subsidiary, Rabo India Finance Pvt. Ltd. YBL's 10-member board is composed of seven independent directors. The remaining directors include R. Kapoor, as both promoter and chief executive officer, and two nonexecutive, non-independent directors. Responsible for policy formulation, strategy, performance oversight, and compliance with applicable laws and regulations, the board is adequately supported by committees, including the audit, risk monitoring, capital raising, and information technology strategy committees.

18. **Capital adequacy.** YBL has demonstrated its ability to raise capital to support its asset growth, as evidenced by its initial public offering in FY2005 and its four subsequent market placements, as well as internal capital generation through retained earnings and perpetual debt instruments. Subsequent to its placement of \$500 million on 30 May 2014, YBL's Tier 1 capital ratio strengthened to 13.0%, while the total capital ratio rose to 18.0%—well above the RBI prudential limit. The May 2014 placement was five times oversubscribed, highlighting strong international and domestic confidence in YBL.

⁸ Business correspondents in India are organized as companies or nongovernment organizations with in-depth experience in forming and managing self-help groups. Business correspondents that are affiliated with microfinance companies have the additional benefit of skills in customer credit evaluation and management.

19. **Loan portfolio and asset quality.** From FY2011 to FY2014, YBL's loan portfolio grew at a CAGR of 17.4%. Although large companies continue to comprise the largest part of its loans, lending to this segment decreased in FY2014 in line with YBL's risk and income diversification strategy. Retail, which includes inclusive and social banking, experienced the highest loan growth, more than doubling in FY2014. YBL's inclusive and social lending activities involve lending to SHGs coordinated by selected business correspondents. Although from a low base, YBL's inclusive and social banking exposure tripled in FY2014 to Rs6.6 billion. YBL is also interested in developing its agribusiness portfolio, seeing significant growth potential in agribusiness, particularly value chain direct farmer lending. During FY2012–FY2014, YBL's agribusiness portfolio expanded at an average of 13.0% per annum to reach Rs63.2 billion as of the end of FY2014. YBL's asset quality is strong compared with its private bank peers. Asset quality of YBL's agriculture-related portfolio also remained solid, with a gross NPA ratio (RBI definition) of 0.03% as of the end of FY2014, down from 0.16% as of the end of FY2012.

20. **Funding.** In spite of high inflation during the past few years, YBL's deposits have grown briskly, rising by over 36.0% in FY2013 and by another 10.8% in FY2014. YBL's deposit mobilization has shifted from more volatile corporate deposits toward more diversified, albeit short-term, retail deposits as a key funding source. Current and savings accounts represented 22.0% of deposits as of the end of FY2014. To address YBL's need for longer and more stable funding, borrowings, particularly from IFIs, have become increasingly important—funding an annual average of \$924 million during FY2011–FY2014.

21. **Earnings performance.** YBL's earnings have been consistently strong, with net income increasing from Rs7.3 billion in FY2011 to Rs16.2 billion in FY2014 (CAGR of 30.5%). Income growth during FY2011–FY2014 has been supported by strong growth in net interest income (CAGR of 29.6%) and fee income (CAGR of 29.0%). YBL's profitability is strong, with ROAA exceeding 1.5% and return on equity exceeding 20.0% since FY2009. In FY2014, ROAA was 1.6% and return on equity was 25.0%.

D. Unique Features

22. The project would constitute ADB's first nonsovereign intervention in India that targets small farmers and low-income women through private banks.

III. THE PROPOSED ADB ASSISTANCE

A. The Assistance

23. The assistance includes two senior unsecured loans, one of up to \$200 million (or Indian rupee equivalent) with a 7-year tenor to YBL and a second of up to \$200 million with a 7-year tenor to ABL, and a capacity development TA grant of up to \$2 million to both ABL and YBL. In line with ADB policies, both banks will lend the Indian rupee equivalent amount of ADB's aggregate loan disbursements to eligible borrowers to finance working capital and investment loans targeting (i) small farm households, and (ii) rural women, organized in either savings and credit SHGs or joint liability groups. In line with ADB's cofinancing strategy, a portion of the risk on ADB's loans may be transferred to counterparties.⁹

B. Implementation Arrangements

24. Dedicated agriculture and inclusive business credit teams in ABL and YBL will select and monitor the subloans consistent with both banks' lending policies and performance-tracking

⁹ The terms of the risk transfer agreements, if any, will be subject to approval by ADB's Investment Committee.

systems. ABL and YBL will each provide (i) annual financial statements; (ii) quarterly compliance certificates for agreed covenants; (iii) semiannual progress updates on (a) their rural service outreach, (b) the use of subloans, (c) progress updates on relevant design and monitoring (DMF) indicators, and (d) progress updates on the TA implementation and impact; and (iv) annual environmental and social management system (ESMS) reports.

C. Value Added by ADB Assistance

25. The ADB assistance is expected to have the following value additions:

- (i) **Support of scalable lending models for priority sectors and inclusive agriculture growth.** The current level of commercial bank lending to agriculture remains inadequate and limited access to finance for the rural population limits their ability to undertake critical investments to improve yields and income. Although ABL and YBL have done some successful groundwork since 2010 in developing lending models for supporting small farms and rural women, the banks still remain below the RBI-instituted PSL targets. By channeling funds and providing TA to ABL and YBL for lending to small farmers and rural women, ADB's support will not only contribute appreciably towards both banks' efforts to meet PSL targets, but also signal to the market and catalyze more local bank finance to support the development of this important sector, helping to alleviate rural poverty.
- (ii) **Strengthening the banking sector by providing bank access to long-term funding.** Banks in India largely lend from short-term, less stable deposits because of difficulties in sourcing sufficient long-term financing, given the developing nature of the country's financial sector. Increasing competition for deposits and the Basel III mandated need for more stable funding sources requires banks to borrow from diversified sources to fill large funding gaps, including IFIs. ADB's loans will make a sizeable contribution to ABL and YBL's funding in support of rural financial inclusion.
- (iii) **Technical assistance.** ADB's TA will directly complement ADB's credit lines, supporting the buildup of both banks' inclusive business strategies via business correspondents and targeted lending products to small farmers, using innovative approaches for linking them to markets. ADB's TA will help improve the integrity of credit data at the farmer level, and enhance credit assessment and risk management at both banks, which will benefit farmers with improved access to credit. With ADB's assistance, the banks' business models can become scalable and replicable flagship initiatives to support inclusive and commercially viable approaches to funding farmers and women borrowers through SHGs.
- (iv) **Effective gender mainstreaming.** The assistance includes a comprehensive approach to improve YBL's ability to reach an additional 2.5 million rural, low-income women. This includes women's awareness of financial planning, savings, and borrowing for their farm and household needs as reflected in the gender action plan.

IV. DEVELOPMENT IMPACT AND STRATEGIC ALIGNMENT

A. Development Impact, Outcome, and Outputs

26. The expected impact is improved financial inclusion for small farmers and women SHGs, as measured by commercial banks reaching at least 14.4% of the RBI PSL target for agriculture by 2025 and an increase in the volume of bank loans to women SHGs.

27. The expected outcome of the intervention is that ABL and YBL will have established scalable financing models for sustainable outreach to small farmers and women SHGs. This will be reflected by growth in both banks' small farmer and women SHG portfolios and borrower numbers, while maintaining adequate asset quality. The provision of financial services to small farmers and women

SHGs and their integration into formal agribusiness supply chains will increase farmer income and employment.

28. The expected outputs of the investments are (i) ABL and YBL banking services to small farmers and women SHGs expanded, (ii) operating and risk management systems improved, (iii) women SHG financial literacy improved, and (iv) compliance with ADB's Safeguard Policy Statement (2009) ensured.

B. Alignment with ADB Strategy and Operations

29. Under the Midterm Review of Strategy 2020, ADB aims to strengthen the financial sector by promoting inclusive growth.¹⁰ Inclusive finance will be supported by the focus on rural areas where productivity is low and the potential for income generation is high. The assistance is also consistent with ADB's country partnership strategy, 2013–2017 for India,¹¹ which highlights the importance of inclusive growth through inclusive financial systems. ADB will assist both banks to expand their services to small farmers and low-income women, which is consistent with the government's efforts as emphasized in the Mor Report.¹² ADB's nonsovereign support will complement earlier and ongoing sovereign efforts in capital market and rural credit cooperative restructuring, as well as agribusiness infrastructure development.¹³

V. POLICY COMPLIANCE

A. Safeguards and Social Dimensions

30. The loans are classified as category FI for impacts on the environment and FI treated as C for involuntary resettlement, and indigenous peoples. No subloans classified environment category A may be financed under the loans. The potential environmental and social impacts of the loans and associated risks have been assessed, as well as the banks' commitment and capacity for environmental and social management. ABL and YBL will apply ADB's prohibited investment activities list, ensure that investments using ADB funds abide by applicable national laws and regulations, comply with ADB's Safeguard Policy Statement (2009), and establish and maintain an ESMS satisfactory to ADB before disbursement of the loans.¹⁴ ABL's and YBL's ESMS will include arrangements to comply with national labor laws and ADB's Social Protection Strategy.¹⁵

31. The project is classified as effective gender mainstreaming. Through its YES Livelihood Enhancement Action Program, YBL services 530,000 rural women, organized via SHGs across 16 states, including eight priority states identified by the National Bank for Agriculture and Rural Development. YBL has 35 accredited business correspondents that source and service the SHGs. Under YBL's current business strategy and ADB's assistance, YBL aims to increase the number of low-income women in rural areas that it services to 3 million. To operationalize that goal, YBL is strengthening its outreach to women SHGs via business correspondents, enhancing YBL field staff presence, and concentrating processing into dedicated regional hubs.

¹⁰ ADB. 2014. *Midterm Review of Strategy 2020: Meeting the Challenges of a Transforming Asia and Pacific*. Manila.

¹¹ ADB. 2013. *India: Country Partnership Strategy, 2013-2017*. Manila.

¹² Government of India, RBI. 2013. *Committee on Comprehensive Financial Services for Small Businesses and Low Income Households Report*. Mumbai.

¹³ ADB. 2006. *Report and Recommendation of the President to the Board of Directors: Proposed Program Loan and Technical Assistance Grant to India for Rural Cooperative Credit Restructuring and Development Program*. Manila; and ADB. 2011. *Report and Recommendation of the President to the Board of Directors: Proposed Multitranche Financing Facility to India for Agribusiness Infrastructure Development Investment Program*. Manila.

¹⁴ Summary Poverty Reduction and Social Strategy; and Financial Intermediary: Environmental and Social Management System Arrangement (accessible from the list of linked documents in Appendix 2).

¹⁵ ADB. 2001. *Social Protection Strategy*. Manila.

B. Anticorruption Policy

32. ABL and YBL were advised of ADB's policy of implementing best international practice relating to combating corruption, money laundering, and the financing of terrorism. ADB will ensure that the investment documentation includes appropriate provisions prohibiting corruption, money laundering, and the financing of terrorism, and remedies for ADB in the event of noncompliance.

C. Assurances

33. Consistent with the Agreement Establishing the Asian Development Bank (the Charter),¹⁶ the Government of India will be requested to confirm that it has no objection to the proposed assistance to ABL and YBL for the Strengthening Rural Financial Inclusion and Farmer Access to Markets Project. ADB will enter into suitable finance documentation, in form and substance satisfactory to ADB, following approval of the proposed assistance by the Board of Directors.

VI. RECOMMENDATION

34. I am satisfied that the proposed loans and technical assistance grant would comply with the Articles of Agreement of the Asian Development Bank (ADB) and recommend that the Board approve

- (i) a loan of up to \$200,000,000 to Axis Bank Limited;
- (ii) a loan of up to \$200,000,000 (or Indian rupee equivalent) to YES Bank Limited; and
- (iii) technical assistance of up to \$2,000,000 to Axis Bank Limited and YES Bank Limited

for the Strengthening Rural Financial Inclusion and Farmer Access to Markets Project in India, from ADB's ordinary capital resources and special funds resources, with such terms and conditions as are substantially in accordance with those set forth in this report, and as may be reported to the Board.

Takehiko Nakao
President

23 October 2014

¹⁶ ADB. 1966. *Agreement Establishing the Asian Development Bank*. Manila.

DESIGN AND MONITORING FRAMEWORK

Design Summary	Performance Targets and/or Indicators with Baselines	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
<p>Impact</p> <p>Improved financial inclusion for small farmers and SHGs in India</p>	<p>Commercial banks reach at least 14.4% of RBI priority sector lending target ratio for agriculture (2025) up from 11.7% (2011)^a</p> <p>Bank loans to SHGs increased from Rs394 billion (March 2012) to Rs600 billion (2025)^b</p>	<p>RBI statistics</p>	<p>Assumption Banks gradually adopt cash flow-based lending processes for the agriculture sector</p> <p>Risks Volatility of rainfall, calamities,</p>
<p>Outcome</p> <p>ABL and YBL have established scalable financing models for sustainable outreach to small farmers and women SHGs</p>	<p>ABL's small farmer loan portfolio increased</p> <p>ABL's women SHG loan portfolio increased</p> <p>YBL's small farmer loan portfolio increased</p> <p>YBL's women SHG loan portfolio increased</p> <p>ABL's women serviced through SHGs increased</p> <p>YBL's women serviced through SHGs increased</p> <p>YBL's small farmer borrowers increased</p> <p>ABL's small farmer borrowers increased</p>	<p>ABL and YBL audited financial statements</p> <p>YBL and ABL capacity development TA progress reports</p>	<p>Assumptions</p> <p>ABL and YBL are well supervised by their boards</p> <p>Asset quality maintained</p> <p>Risks</p> <p>Crop losses, wastage of crops</p>
<p>Outputs</p> <p>1. ABL and YBL banking services to small farmers and women SHGs expanded</p> <p>2. Operating and risk management systems improved</p> <p>3. Women SHG financial literacy improved</p>	<p>ABL disburses at least Rs67 billion in new loans to eligible borrowers under the ADB funded project (2014–2021)</p> <p>YBL disburses at least Rs53 billion in new loans to eligible borrowers under the ADB funded project (2014–2021)</p> <p>YBL's operating systems, and oversight of business correspondents (subcontracted by banks) and SHGs improved</p> <p>ABL's management, operating systems, and oversight of lending to SHGs improved</p> <p>Number of audits, ratings and certifications of YBL-affiliated business correspondents (subcontracted by banks) performed by independent firms by 2018</p> <p>number of women SHGs trained in financial literacy through audio and/or video messaging in local language by 2018</p>	<p>ABL and YBL semiannual progress reports</p>	<p>Assumption</p> <p>Banks carry out business as planned</p> <p>Risk</p> <p>Borrower loan default risk</p>

Design Summary	Performance Targets and/or Indicators with Baselines	Data Sources and/or Reporting Mechanisms	Assumptions and Risks
4. Compliance with ADB's Safeguard Policy Statement (2009) ensured	ESMS screening system to exclude projects with potential adverse environmental and social impacts		
Activities with Milestones 1. ADB executes loans each to YBL and ABL from December 2014. 2. ADB provides capacity development TA 3. ADB conducts monitoring and review missions.		Inputs ADB: Up to \$402 million, comprised of loans of up to \$200 million each for ABL and YBL; and up to \$2 million in capacity development TA.	

ABL = Axis Bank Limited, ADB = Asian Development Bank, ESMS = environmental and social management system, RBI = Reserve Bank of India, SHG = self-help group, TA = technical assistance, YBL = YES Bank Limited.

^a RBI statistics and N. Shabbir. 2013. Sectorwise Priority Sector Advances in India. *International Journal of Research in Social Sciences*. 3 (2), pp. 57–71.

^b H.R. Kahn. 2014. Rural Finance: Issues and Challenges. *NABARD and RBI Monthly Bulletins*. June 2014 p. 13. Sources: Axis Bank Limited, YES Bank Limited, and Asian Development Bank.

