INDUSTRY Overview

Small Finance Banks

March 2025

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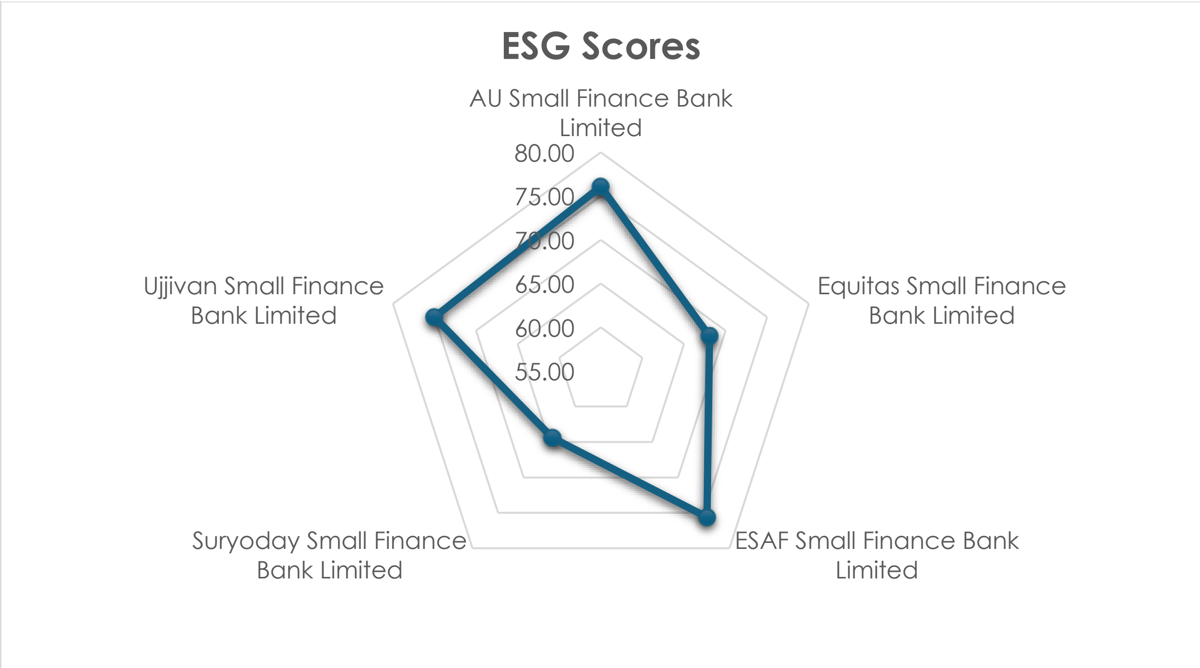
Executive Summary

The industry overview report offers a detailed ESG (Environmental, Social, and Governance) analysis of five leading Small Finance Banks (SFBs) in India: Suryoday Small Finance Bank Limited, Equitas Small Finance Bank Limited, AU Small Finance Bank, Ujjivan Small Finance Bank Limited, and ESAF Small Finance Bank. These banks, focused on promoting financial inclusion and serving underserved communities, have been assessed based on their ESG practices, with their ESG scores calculated using the ESGRisk.ai methodology.

AU Small Finance Bank and Ujjivan Small Finance Bank stand out with notably high ESG scores (76.09 and 75.02, respectively), reflecting their strong commitment to sustainability, governance practices, and social responsibility. The other three banks also lie between the range of 65.00 to 75.00.

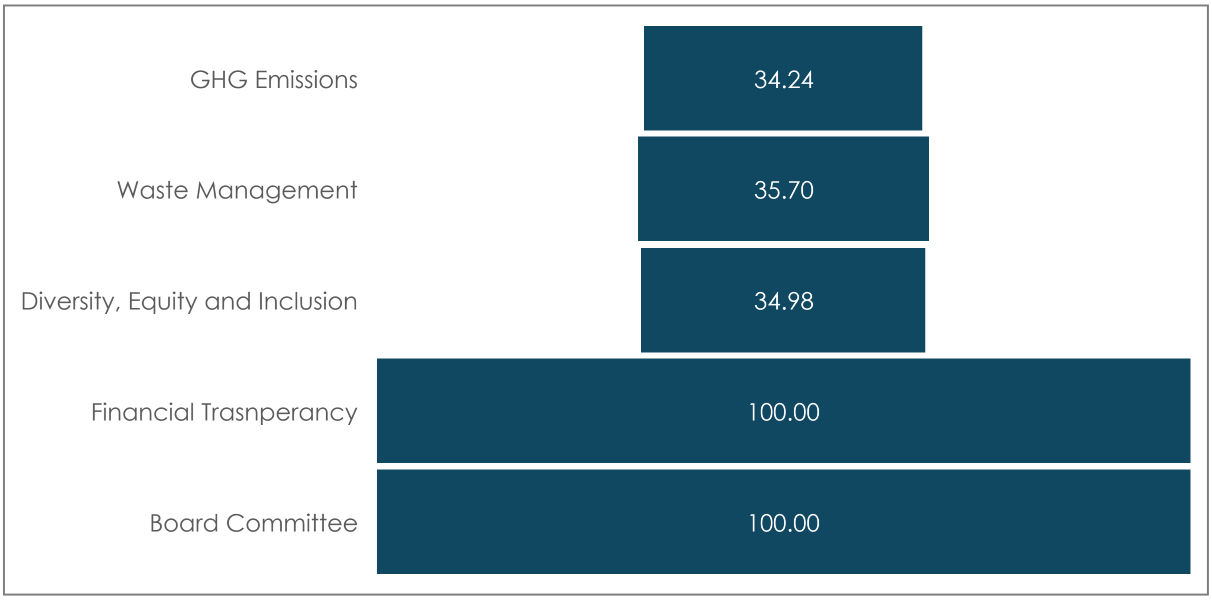
Figure 1: ESG Scores



While all five banks have taken steps towards environmental sustainability, there is a noticeable gap in managing greenhouse gas (GHG) emissions and developing environmentally responsible products and services. Banks could benefit from further attention in this area, especially in reducing their environmental footprint. Under the social umbrella, banks have demonstrated significant strengths in social initiatives, including offering green financing, supporting women entrepreneurs, and fostering community development. However, challenges in Diversity, Equity, and Inclusion (DEI) remain a common risk factor across the industry, which could affect their long-term sustainability. All banks exhibit moderate to strong governance practices, where the score of 100 is the median score for material key issues such as Board Committees and Financial Transparency.

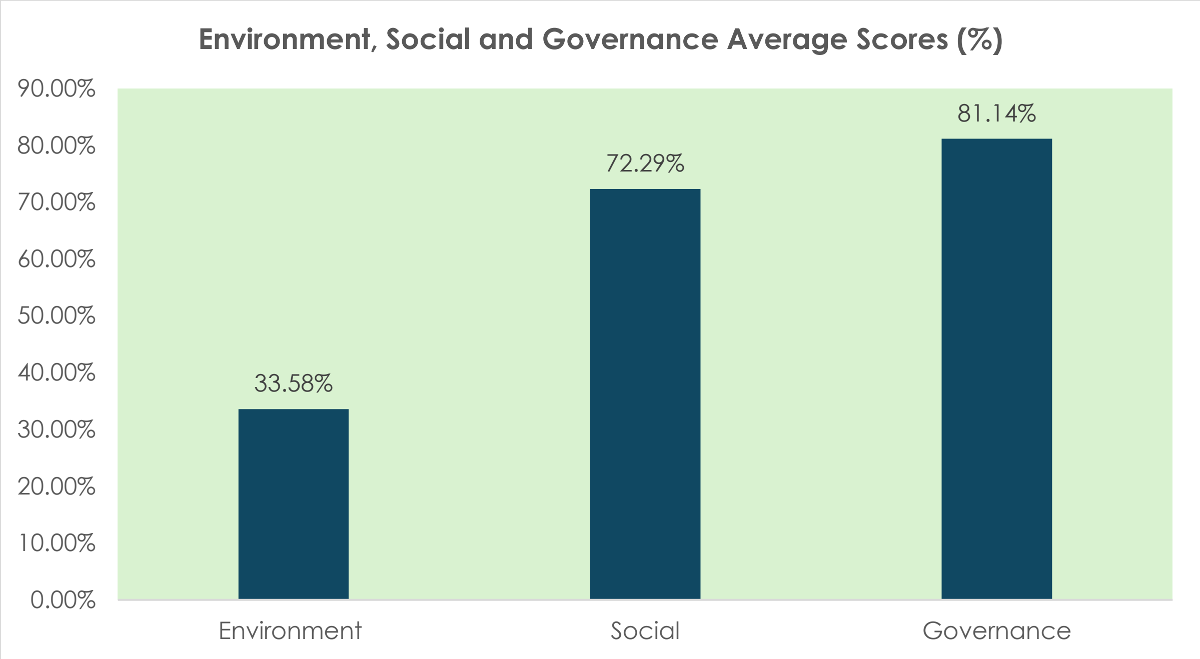
Figure 2 contains the average score in percentage for the above material key issues identified.

Figure 2: Material Key Issues - Average Scores (%)



Sector Overview

Figure 3: Environment, Social and Governance Average Scores (%)



Environment

The environmental opportunities facing Small Finance Banks (SFBs) in India primarily revolve around GHG emissions, energy efficiency, waste management, and environmentally responsible products and services. Banks are increasingly adopting sustainable practices to mitigate their environmental impact, but there is still considerable room for improvement.

Key Insights:

- Many banks have implemented energy-saving measures such as optimizing HVAC systems, adopting energy-efficient lighting, and using electronic processes to reduce paper waste. However, formal policies targeting GHG emissions reduction and the adoption of renewable energy are still in early stages for most.
- Waste management has been a priority, with initiatives like plastic waste reduction, e-waste disposal programs, and recycling efforts. Banks have made notable progress by integrating green initiatives like tree-planting drives and recycling a significant percentage of waste.
- Banks are also exploring green financing and supporting environmentally friendly alternatives, such as electric vehicles and sustainable products. However, they still need to improve their strategies around environmentally responsible products and services.

While the sector is moving in the right direction, there is a need for stronger commitment to GHG emissions reduction and more comprehensive strategies for sustainable products and services. Continuing efforts to integrate renewable energy and enhance waste management practices will be critical for improving the overall environmental sustainability of Small Finance Banks.

Social

The Social Pillar in Small Finance Banks (SFBs) focuses on issues such as community support, employee development, employment quality, data privacy, and employee safety. Banks are increasingly prioritizing these areas to drive social responsibility, enhance customer trust, and ensure workforce well-being.

Key Insights:

- Majority of the banks are deeply committed to community empowerment through CSR initiatives, funding programs that focus on education, healthcare, and rural entrepreneurship. Initiatives such as Equitas Gurukul Schools and ESAF's Urjabandhu program contribute significantly to social welfare.
- Employee development is another area of strength, with banks offering robust training programs and career development opportunities. These boast high employee training rates and focus on continuous learning and skill development.
- Data privacy and employee safety are well addressed across the sector, with several banks implementing strong information security systems and occupational health and safety measures.
- Diversity, Equity, and Inclusion (DEI) remains an area with room for improvement across most banks. Banks have undertaken certain professional development programs which are steps in the right direction, but the industry must further focus on fostering more inclusive workplaces.

While the sector is excelling in community engagement, employee training, and data security, there is an ongoing need for improvements in DEI, community impact, and employment quality to strengthen the social fabric of these institutions.

Governance

The Governance Pillar in Small Finance Banks (SFBs) focuses on business ethics, board independence, financial audits, and shareholder rights. These areas are essential for ensuring transparency, trust, and long-term sustainability in the banking sector.

Key Insights:

- All five banks show strong commitment to financial transparency and adhere to regulatory standards, with clear reporting practices and robust internal audit systems. They have made notable progress for their emphasis on board independence and audit controls, ensuring that their governance frameworks align with best practices.
- Board structure and gender diversity are areas of focus, with several banks, having made strides in ensuring balanced and diverse boards, including female representation. However, further efforts are needed across the sector to improve in this area, particularly at the executive compensation level.
- Shareholder rights and business conduct are areas where the banks are doing well, with regular audits and adherence to shareholder regulations. However, there is still room for improvement in areas such as bribery and corruption controls and executive compensation practices.

While governance practices are strong across the sector, further improvement is needed in business conduct and ESG oversight to strengthen the long-term sustainability and ethical practices of Small Finance Banks.

10 Key Initiatives Undertaken by SFBs

ESAF Small Finance Bank	**Urjabandhu Program**: Promotes renewable energy by supporting sustainable energy solutions in rural areas.
	Arogyamitra: Focuses on women's health, providing access to healthcare services and raising awareness.
Equitas Small Finance Bank	**Equitas Gurukul Schools**: Provides education to children from low-income families, contributing to social upliftment.
	Birds Nest Programme: Assists in relocating pavement dwellers and providing them with safer living conditions.
AU Small Finance Bank	**AU Ignite Program**: Supports youth skill development, equipping young individuals with practical skills for employment.
	Green Loan Portfolio: Offers loans to finance environmentally friendly initiatives such as CNG and LPG vehicles.
Ujjivan Small Finance Bank	**Parinaam Foundation Partnership**: Launched a savings initiative that helps underserved families open savings accounts and access banking services.
	Customer Satisfaction Programs: Conducts surveys like NPS and C-SAT to enhance customer engagement and improve satisfaction.
Suryoday Small Finance Bank	**Plastic Waste Reduction**: Focuses on reducing plastic waste in bank operations, encouraging sustainable alternatives like glass bottles.
	Employee Safety Initiatives: Implements regular mock drills and safety training programs to ensure the well-being of employees at all branches.

ESGRisk.ai Observations

In his inaugural address at the Board of Directors conference for Small Finance Banks (SFBs), J Swaminathan emphasized the critical role of good governance practices in ensuring long-term stability and fostering sustainable growth in the financial services sector. He outlined the need for SFBs to effectively balance their social objectives with profitability, driving the financial inclusion agenda while adopting responsible practices in Environmental, Social, and Governance (ESG) matters.

ESGRisk.ai reiterates the address of Mr. Swaminathan and highlights the below key observations:

- **Employee Retention and Succession Planning:** Swaminathan raised concerns about the high attrition rates within SFBs, particularly at frontline staff levels. This issue impacts social sustainability, as the loss of institutional knowledge can disrupt service delivery and increase training costs. From an ESG perspective, it's vital for SFBs to focus on employee retention strategies, particularly in fostering an inclusive workplace that promotes diversity and gender equality.
- **Financial Inclusion and Responsible Lending:** A cornerstone of Swaminathan's address was the need for SFBs to not only comply with regulatory targets such as priority sector lending but also to assess the social impact of their financial inclusion efforts. SFBs are making positive strides in extending services to underserved communities, particularly small farmers, small businesses, and rural populations. Furthermore, SFBs should strengthen their grievance redressal mechanisms to better handle customer complaints, promoting transparency in line with governance standards.
- **Governance Structures and Board Independence:** Swaminathan stressed the importance of a robust governance framework and the clear delineation of responsibilities between the Board and management. SFBs with strong governance practices, such as the establishment of independent audit committees and clear roles for Whole Time Directors (WTDs), show higher resilience in managing environmental, social, and governance risks. However, there is a need for some SFBs to focus on gender diversity at the board level, a critical social factor in fostering inclusive decision-making.

Addendum 1 - ESGRisk.ai ’s approach to ESG ratings

ESGRisk.ai’s ESG Rating model and report are designed to quantify ESG performance on a uniform scale across industries, based on industry-specific benchmarks and peer performance analysis. This approach helps investors and other stakeholders quickly understand and quantify an issuer’s ESG risk exposure and risk management framework. While all data used for ESG ratings provided by ESGRisk.ai is collected and analyzed from publicly available sources, ESGRisk.ai also provides subscribers an option to review data used for ESG Rating of their company and provide feedback to ESGRisk.ai for any corrections, if needed.

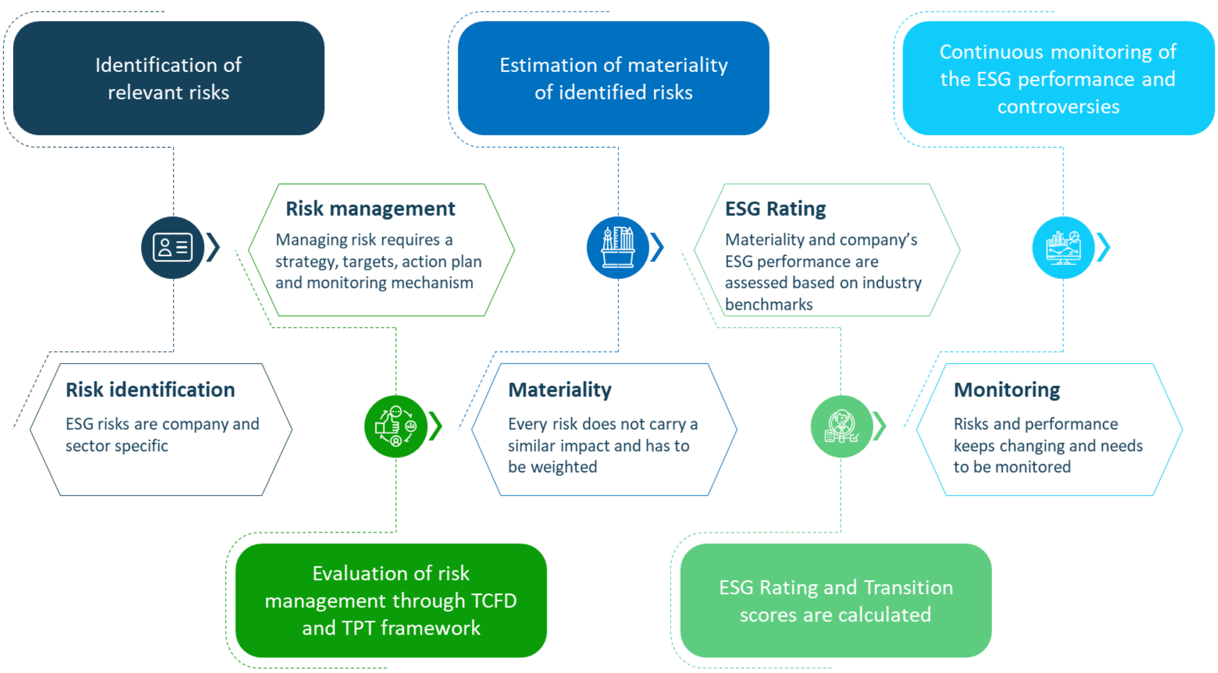
ESGRisk.ai’s ESG rating provides a summary of the company’s ESG strategy, programs/initiatives, results and controversies across 34 Key Issues, including GHG emissions, water efficiency, environmental management, ESG oversight, human rights, supply chain, Minority shareholders’ rights, among others. The ESG ratings are based on a wide range of 1108 indicators that have been selected and assigned weights based on their materiality and relevance to specific industries.

Indicators are weighted and scored based on the company’s key issue specific performance. Scores are aggregated using materiality and polarity to derive the ESG rating. This document details the approach to ESGRisk.ai ’s ESG ratings.

Addendum 2 - Summary of a comprehensive ESG rating assessment

ESGRisk.ai defines ESG Rating as an objective and comparative opinion on the ability of an entity to mitigate Environment, Social and Governance (ESG) risks on its business operations and financial performance over the long term. Essentially, it is a comprehensive and relative assessment of the risk management practices adopted by a business entity to guard against the adverse impact of environmental, social and governance factors. Therefore, an ESG Rating can be a reliable indicator of long term and sustainable shareholder value. The assessment also includes a benchmarking of the ESG practices of the entity with that of the listed peers in the specific industry.

Figure 4: ESGRisk.ai framework for ESG rating.

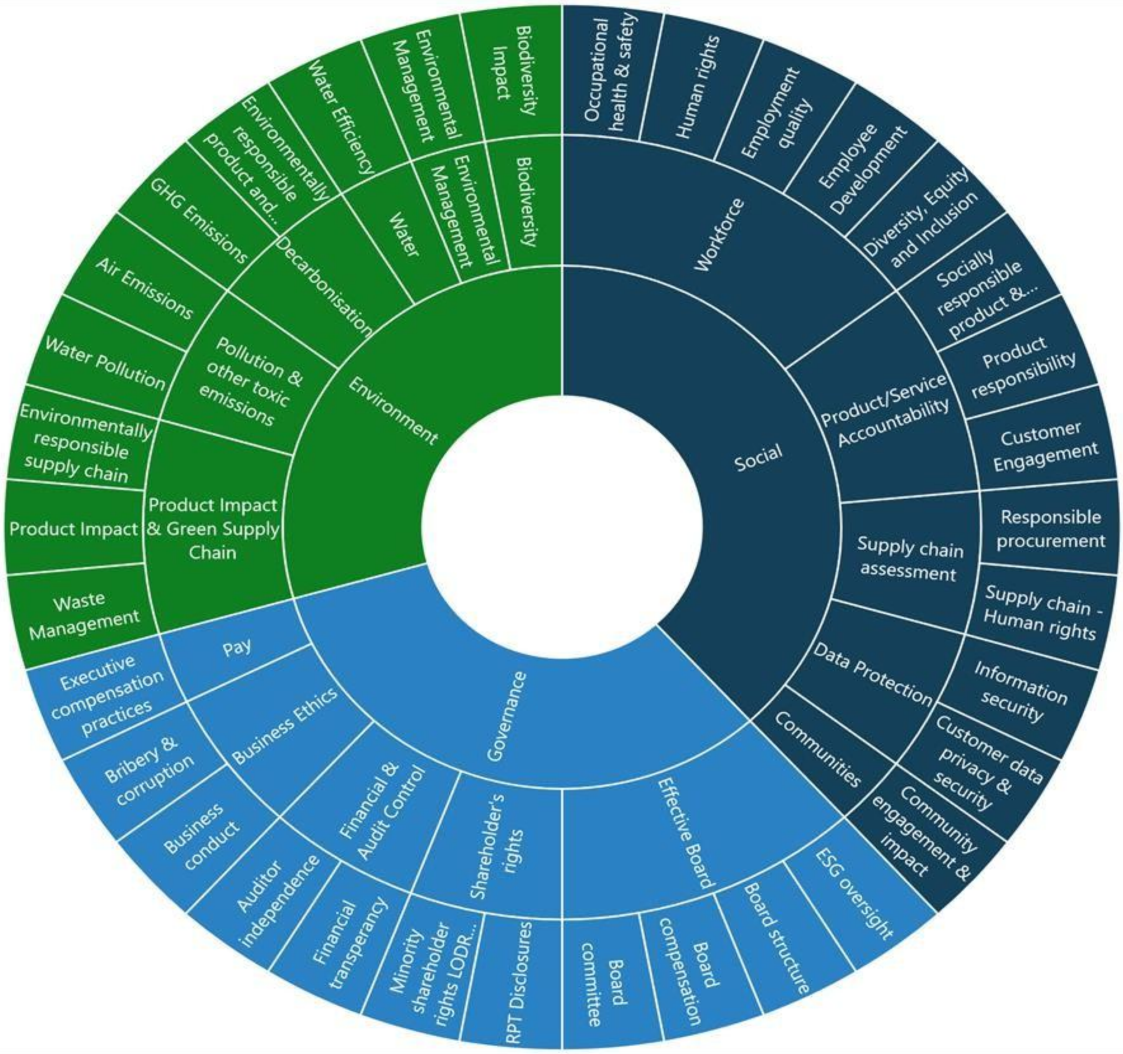


Understanding ESGRisk.ai's ESG data taxonomy

A comprehensive assessment for ESG rating requires identifying all material ESG risks and evaluating the company's risk management practices to proactively address these risks. Since every company has exposure to a wide variety of risks and each risk impacts a company to varying degrees, the evaluation of exposure and scoring of the risk management process must be structured in a hierarchy where individual data points pertaining to the risk exposure and management can be aggregated to evaluate the performance. ESGRisk.ai aggregates data in three levels, viz.: The Key Issue, Theme and

Category level, each of which is the next level of aggregation for hierarchical risk evaluation.

Figure 5: Visual representation of ESGRisk.ai's Data taxonomy.



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