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Poor asset quality has caused a churn in banking system

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The banking sector in India has been in the midst of a churn over the last few years. (Reuters)

The banking sector in India has been in the midst of a churn over the last few years. Asset quality, especially of public sector banks (PSBs), has deteriorated drastically; a significant chunk of banks' high-rated corporate business has switched to more cost-effective sources of funds such as bonds; the banks have shifted their focus to the retail segment; and non-banking financial companies (NBFCs) have seen their balance sheet expand considerably on the back of credit expansion.

With digital banking becoming increasingly popular, especially in the urban areas and with the youth, banks are re-drawing their business models and expansion strategies. Even as they rationalise their branch network, the emphasis has been on providing customers innovative products through new-age digital channels. The Centre and the Reserve Bank of India (RBI) have taken bold steps to address some of the sectoral concerns, the most notable being the resolution of stressed assets through the Insolvency & Bankruptcy Code (I&BC), recapitalisation of PSBs and consolidation of state-run lenders. While the impact of these steps is a work in progress, bankers and industry experts see the future of banking in India intertwined with digitisation, innovation and human resource management.

Bankers see digitisation pushing the expansion of banking services in the next 5-6 years. Technology will play a very important role in making banking services faster, cheaper and more convenient. It will enable linkage of different databases, thereby facilitating seamless exchange of information. However, digitisation is unlikely to replace the existing banking channels in the near future. And efforts to change the face of banking are likely to be a combination of high-touch and digital initiatives. “In a country like India with 1.3 billion people, of whom 40% are still unbanked, digitisation can only be a facilitator. It cannot replace the existing channels,” says Sunil Srivastava, deputy MD, corporate accounts group, SBI. “Digitisation will also need connectivity and that includes affordability. When we look at India, availability is poor and affordability low. So we would not see digitisation running at the same speed in rural India as in Mumbai and Bengaluru”.

Bankers also stress the need to develop a robust risk management system before aggressively pursuing digitisation. “I think it won’t be prudent to move very aggressively in this direction without ensuring that certain safeguards are in place. KYC has to be very strong. We have to be sure who we are lending to. The Aadhaar linkage and its validity should be very strong as well,” says Shanker Iyer, former CFO, Bank of India.
On the future of banking in India, Iyer thinks lenders will prefer to go for businesses which are not very capital intensive and build on products with less capital consumption. Once the IND-AS and BASEL III norms become fully functional, capital would be rationed carefully by banks, he says. The I&BC

gives banks unprecedented power to initiate corporate insolvency against defaulters.

Bankers are hopeful that once some of the larger accounts are resolved, the IBC mechanism would evolve into a very powerful tool for lenders. “If we are able to recover or resolve a major portion of a large account, and once the recycling of funds happens, there won’t be any problem as far as banks’ credit growth is concerned,” Iyer says. However, collateral management in public sector banks would need to be strengthened, experts say. “We have realised that because the collateral management is not very efficient, judicial processes take longer and the banks end up in a prolonged judicial battle. We take pride in saying we believe in secured lending. But what is the point of the exercise if one cannot recover the security on time? ” says Ashvin Parekh, managing partner, APAS LLP.

Karan Kalra, head of financial services at Nishith Desai Associates, says the bankruptcy code is a comprehensive law as it consolidates the existing laws relating to insolvency into one legislation. “As a welcome step, the central government, the central banking institute and the central securities exchange regulator in India have added teeth to the code by ensuring that its implementation is smooth and efficient,” he adds. Another milestone for the Indian banking sector is the proposed consolidation of public-sector banks. Many of the public sector banks have huge resources, be it their branch network or their workforce. Often, these are not efficiently utilised, and there is a lot of overlap. “Consolidation can bring about rationalisation of resources. Banks can also improve their geographic coverage because of consolidation,” Parekh says. Consolidation would pave the way for emergence of specialised banks focused on niche services, changing the way credit is delivered in India.

There is also need for collaboration between banks and NBFCs, which have been gradually gaining market share, often at the cost of the former. “The future is more about the future of financial services because we are moving away from a bank-centric financial services structure. In the new structure, the bond market, NBFCs, HFCs, MFs, insurance companies play a very important role in credit delivery," says Rashesh Shah, chairman, Edelweiss Group . HR Khan, former deputy governor of RBI, says that banking globally, and particularly in India, would focus in the future on seven Ps — Products, Processes, Partnerships, People Management, Prudential Challenges, Positioning and Profitability. Developing the right products would be of paramount importance to the Indian banking sector. For example, India has more than 30 crore Jan Dhan accounts. More often than not, these zero-balance accounts are under-utilised, being primarily used for liability sourcing. So there is immense scope to develop products specifically for the account holders, which would not just further financial inclusion but also increase the scope of business for banks.

In terms of processes, banks would have to focus on reducing costs, enhancing customer convenience, and meeting customer expectations. The lenders would also have to develop a clear roadmap and a strategy to forge close-knit partnerships with NBFCs and FinTech companies. Another issue that banks, particularly PSBs, need to deal with pertains to their manpower . In state-run banks, the way recruitment happens, even at the top level, the way compensation is structured and even the quality of people recruited pose a challenge to their efficient functioning.

Further, banks would need to put in place a robust plan to meet prudential challenges, be it additional capital requirements to comply with Basel III, Ind-AS norms or enhanced KYC guidelines. Also, it would be important for banks to determine how they want to position themselves, whether as universal banks or as niche players. And finally, the banks would have to create channels for generating profit. They would not be able to sustain themselves if they have negative return on assets. "If we can overcome these challenges, then I think the future of banking in India is bright. We still have a lot of scope for expansion of banking services in India. We have a huge number of bottom-of-the-pyramid customers waiting to be serviced. As much as 80% of MSME requirements are yet to be met," Khan says.