Banking as we see on the turn of decade

Rajkiran Rai G.*

Next year, India will mark half-a-century of Bank Nationalization, one of the most defining events of Indian banking. It marked a seismic shift in not just ownership of banking assets, but also the very purpose of banking in India. It heralded an era of democratizing finance by expanding reach across length and breadth of country. India witnessed an eclectic mix of policy ventures for last mile delivery of banking & financial services. However, the decades of 1990s and 2000s witnessed a resumption of faith in market forces for achieving the policy objectives. Accordingly, there was a manifest shift in operating procedures, with regulatory thrust changing from 'allocation' of credit to 'enabling' the flow of credit to productive sectors of economy. Policy increasingly turned ownership neutral as the regulator, Reserve Bank of India, defined similar goalpost of priority lending for both public sector and private sector banks. The decade of 2010s witnessed convergence of public policy and firm economics as banks pursued financial inclusion fervently.

The Indian financial ecosystem today is rich with variety, both in terms of scale and scope. It has grown varied, yet more inclusive. It has become tech-driven, yet remains human centric. It has become younger and gender diverse. Industry has turned competitive with entry of new and distinct kind of players. It has transformed from being the privilege of urban few to become a universal right of all citizens in our country. Customer service standards have also risen across the board with efforts to deepen access and awareness of banking & finance. Access to financing has never been so easier; people now bank at a place, time and medium of their choosing. It's reflective of the progress made in banking penetration, advances in information technology, evolution of credit information companies, analytics, and deepening digital footprints of consumers. It has made risk underwriting holistic yet economical for lenders.

However, when we speak of banking affairs today, the dominant narrative is of elevated stressed assets, provisioning cover and weak capital adequacy. There is increased divergence in efficiency ratios, viz. Return on Assets, Return on Equity, Net Interest Margin and Cost to Income Ratio, etc., at the banks in public sector and private sector. There is popular anger about rising instances of fraud at banks. Likewise, governance standards in making large ticket loans have also come under scrutiny. We hear about public sector banks (PSB) being too many, and arguments for having fewer and stronger banks. With more than half of PSBs under regulatory care (Prompt Corrective Action), indeed, there are questions galore about role and relevance of state ownership.

Indian Banking at the Onset of Decade 2010s

The narrative today is a stark contrast to the state of affairs at the turn of decade 2000s. Indian banks were praised effusively for prudence. The PSBs, in particular, emerged as a force stabilizer, providing cheaper liquidity when it was scarce and costly, as also increasing the credit flow to productive sectors of economy. With a little nudge from the Government,

*Managing Director & CEO, Union Bank of India.

Infrastructure sector received solid backing from the PSBs. Infrastructure share in loan outstanding of Scheduled Commercial Banks thus nearly doubled within a decade. Economic growth rebounded and India started flirting with the idea of double digits growth. The PSBs were hailed as vehicle of prosperity and Nation builders in immediate aftermath of Global Financial Crisis 2008-09.

This happy state of affairs didn't last long however, as post crisis exuberance came back to haunt Corporate-focused banks. With inflation zooming in double digits, Reserve Bank turned into inflation fighting mode, raising policy rates 13 times in succession. Externally, there was brewing nervousness in financial markets over Euro zone sovereign debt crisis and its implications for common currency union. India's fragile macro-fundamentals with inflation high and twin deficits at unsustainable level meant its currency came under speculative attack in early 2010s. Corporates, who had borrowed heavily, both at home and overseas, were in a difficult tangle as their incomes were falling while interest cost were rising. Exchange rate gyrations only aggravated their pain.

This deterioration in debt servicing ability of corporates started reflecting in asset quality of banks. In the early years, bankers and borrowers both seemed sanguine that economic rebound will cure much of the stress, and there's nothing structural to worry about. Gradually, however, it became clear that India was caught in debt crisis, aptly named as 'twin balance-sheet syndrome', which, left to itself, will take years to deleverage. It would mean prolonged growth slowdown with consequences in terms of lost opportunities for a young and aspirational India.

How we all came here?

Bad debt, it was found, was understated by banks due to their misplaced hope in economic recovery as also systemic constraints in dealing with powerful deviants. Consequently, the stressed assets continued to pile on bank balance-sheets, disguised as restructured assets. Banks were caught in a vicious circle of low capital, low profitability, and therefore, limited ability to provide if they were to recognize stressed assets as NPAs. Deferment seemed to be wise option than recognition. However, doing so was becoming increasingly costly with realization prospects dimming further. Economy was feeling the effects of leveraged corporates, slowing credit, and thus, private investments turned stagnant. Banking sector stress was gradually acquiring a systemic scale with several private sector banks, which were also corporate focused, showing stress build-up in their books.

With change in political helmsmanship, meanwhile, there came a change in approach towards dealing with the problem. There have been three manifest shifts under the new regime. First is about building legal capacity to deal with failures. It was important to solve the crisis of exits, by enabling closure of firms which had lost the economic race. Failure to do so meant capital remained locked in unproductive assets with creditors haplessly seeing their assets deteriorate and labour caught in non-remunerative jobs. The erstwhile system seemed to work well for the connected and deep pocketed promoters at the expenses of creditors and Nation at large.

It needed a holistic approach to bankruptcy to complete the market mechanism which has gained prominence in public policy since early 1990s. Insolvency & Bankruptcy Code (IBC) with its attendant infrastructure in National Company Law Tribunals (NCLTs), Insolvency Resolution Professionals (IRPs), etc., are the essential building blocks of creating a sound credit culture.

Second is about building capacity of banks to absorb losses, in eventuality, and build provisions in the interim, to expedite resolutions. As Basel 3 transitions were also underway, earnings driven capability building was inadequate. There was need for external infusion of capital, preferably by distributed ownership through markets, if not, from promoters. Markets and investors however were

suspicious of extent of stress problem in bank books, and accordingly they bid down banks' valuations to historical lows. To make any meaningful head-start in the fight against NPAs, Government infusing capital in the PSBs was an imperative. Government, however, has to balance the competing claims of fiscal rectitude vis-à-vis capital imperative of banks it owns. Besides, it would have been waste of opportunity if capitalization was not packaged with reforms in the very working of banks, so that there is no recurrence of current issues. Accordingly, there came Project Indradhanush, followed by the EASE Reforms, which are aimed at addressing both capacity and capability issues at the PSBs.

With legal ecosystem and player capacity rebuilt, the Third shift came in terms of the changed regulatory attitude towards banks. Government empowered the Reserve Bank to issue directives to banks on resolution of stressed assets. Accordingly, the regulator tightened noose around Top 40 defaulters, which cumulatively accounted for nearly half of the stressed assets of banking industry, directing banks to initiate resolution proceedings under newly enacted IBC. The IBC has well defined mechanism of time-bound resolution, failing which, enterprise would be forced towards liquidation. It reset the bank-borrower power symmetry and brought deviant borrowers back on negotiating tables. More importantly, it ushered a culture of responsible lending by articulating costs to both parties if they fail to honor their terms while banking. Encouraged by the response, the Reserve Bank finally wound –up all its regulatory forbearance and unveiled a sector agnostic asset qualification and resolution framework, which promises to usher a sound credit culture, going forward.

Where do we go from here?

The economic transformation of India, supported by demographics, urbanization and industrialization will provide holistic opportunities for the banking sector – be it retail, corporate or rural banking. India is a fast growing economy. Newcomers can grow without making it a zero-sum game for incumbents. Business opportunities notwithstanding, there will be considerable heterogeneity in terms of relative contribution to bottom-line. A focused pursuit of business will differentiate winners from laggards.

With new entrants like payments banks and small finance banks enhancing competition for low cost CASA resources, loans will increasingly become bigger driver for bank profitability. McKinsey estimates that loan share in revenue pool of banking sector could rise by 11 percentage points to 58% by 2022 from 47% presently while resources share could come down to 22% by 2022 from 30% presently. It is estimated that Retail and Small & Medium Enterprises (SME) together will be largest contributor in revenue pool of Indian banks by year 2022. Within corporate, mid-sized corporate will bring significant revenue opportunities for banks which have better bargaining power and more cross-sell opportunities. Indian banks have to seize this dynamic while outlining priorities from next three to five years' perspective.

For a banker gazing the crystal ball today, s/he would like to know answer of three questions: a) who all are/will be my customers at the turn of decade b) what do they need/wish for, and c) How do I bring value to him/her.

Prospecting customers, there are three categories to look at: a) digitally ignorant/illiterate, which prefer the conventional way of doing things, b) digitally literate, which do surfing on web for entertainment and social connectivity but are conservative when it comes to transacting money, and c) digital savvy, which leverage connectivity for everything from entertainment to social sharing to shopping, etc. India is a youthful country with average age about 28 years. About half of the population falls in the age group below 25 years. They make the future pool of customers for banking industry. They are/would be digital savvy. They like to experience banking

digitally to the extent of never visiting a brick & mortar branch ever. Of the remaining half, however, the need and expectations of banking will be varied.

Banks have broadened the scope of delivery channels to ATMs, internet banking, mobile banking and call centre apart from traditional interfaces such as branches. They have rolled out technology to the advantage of the customers. With mobile being already ubiquitous, internet usage will deepen faster and so will be usage of banking services. Digital channels already account for greater share of customer induced transactions than brick & mortar branches.

Going forward, customers looking for bank product would likely visit an online market platform, and choose the best offering from number of banks listed there than visiting a particular bank and choose among number of products offered there. We are already witnessing this phenomenon in retail products like home loan, car loan, personal loan, etc. Similar thing could happen with SME products. It will further squeeze down pricing and asset driven margins of banks. For winner banks, competitive advantage is more likely to come through expenditure optimization than product pricing. Banks, therefore, need to re-think their operating expenditure mix; rationalize investment in favor of digital interfaces as against brick-mortar structure as hitherto.

Next phase is about enhancing digitization and leveraging data for business efficiencies. Banks need scaling up portfolio of digital offerings and workflow management, both credit and operational aspects. They should also look at co-opting fin-techs in making a holistic offering for customers. It should help them withstand the competitive pressure from growing tribe of unconventional players.

Banks also need to re-think their workforce strategy by hiring specialist manpower directly and ushering a performance centric culture with right mix of incentives & rewards. The conventional approach of hiring generalists and grooming internally for variety of purposes slows down banks' adaptability and responsiveness to fast changing times. Encouragingly, there is good supply of specialized resources turning out of academic campuses, which banks can tap for their purposes.

Indian banks have been a messenger of hope for larger masses, democratizing finance and empowering poor & underprivileged to shape their destiny. Now there is at least one member in every Indian household, who is having a bank account. We have a lot of ground to cover in deepening the financial habits and servicing of newly bankable class, however. Besides, there is another aspect of inclusiveness in financing of millions of micro & small enterprises. Promoting entrepreneurship at the bottom of pyramid through timely and adequate finance could be biggest enabler in jobs creation. It's still a work in progress.

With demonetization and goods & services tax, the process of formalization has expedited. We are becoming a data-rich society. It is time we build on to these gains. Banks have massive customer base; this wealth of information on customers could be harnessed through data analytics. For example, our banks may shift from conventional balance-sheet / cash-flows analysis based lending framework to transaction based appraisal and now to alternative information footprints with data pooled from ones' social media imprints, mobility data, utility service behaviors, etc. Likewise, by leveraging technology, banks may bring down cost of credit, making more enterprises economically viable. Banking & financial industry could be more responsive in grievance redressal, building mutually beneficial relations with customers.

Union Bank: Becoming a preferred bank for New India

Union Bank has been navigating a challenging business milieu, while building strengths in our chosen areas. The Bank has the distinction of rising five notches in ranking of nationalized banks by

assets to become fifth largest nationalized bank as against 10th ranked couple of decades ago. The Bank achieved another landmark last year by crossing ₹ 7 lakh crore business mix; our growth has been capital light as reflected from 1.7% decline in risk weighted assets as against 4% growth in advances. It reflects that we are also growing qualitatively better. We aspire to break into Top 3, in domestic business, by year 2020; however, our primary goal is to grow profitably by enhancing efficiency of current business as well as extending presence in new revenue lines. Accordingly, last year, the Bank made decisive shift in strengthening the balance-sheet, increased the provisioning cover significantly while being compliant of capital adequacy norms.

Taking our horizon little farther; we are building our people's capabilities, in terms of knowledge, skills and technological support to serve customers with responsibility. There are interventions in making our processes efficient and people accountable. Take for example, credit underwriting. If it is done diligently, the chances of default are low. However, in our system, processing used to be dispersed across branches, and proposals escalate through layers like region/ zones/corporate offices. It is a time-consuming exercise, with quality subject to capabilities across different layers. Branches, in particular, have little time to attend to details, with diligence. Our most day-time is consumed in managing routine transactions. As a result, new business as well as asset quality often gets compromised. This needed to be changed through centralisation, to ensure speed of service, and quality through specialisation.

The Bank has centralised 50% of credit processing already, which cuts through size and sectoral exposure be it retail, agriculture, MSME or corporate business. We undertook special efforts in strengthening capacity of current processing centres, deploying skilled manpower and equipping with right kind of tech support, while also setting-up new centres across country. Agri processing centre, namely Union Sammridhi Kendras is a pioneering initiative for improving quality of underwriting in agriculture sector. Taken together, our aim is to scale-up credit centralization to 80% by next year.

Centralisation works in both ways, by making branches free for monitoring and mobilizing new business also improve quality of processing & enhanced due diligence. For effective monitoring & collections, the Bank has developed in-house model for early warning signals (EWS) to detect stress even earlier than accounts turn due. The EWS builds on 28 parameters, both internal and external, and gives us head-start in managing asset quality. The EWS is mapped with recovery teams constituted at all Regional Offices, which act upon stress signal, devising and implementing the corrective actions.

As an organization, we are committed to providing holistic environment for growth and well-being of our employees. The Bank is investing in mentoring youngsters with right kind of soft skills and customer service attitude. Union Bank has accordingly re-imagined its approach to institutional learning. The learning management system called Moodle (Modular Object Oriented Dynamic Learning Environment) leverages digital infrastructure to provide customized and progressive learning solutions for all employees. Over 100 plus e-learning modules have been developed. Employees have to pursue the relevant modules to keep abreast of developments in their field as also equip themselves for future roles. The learning progress is being mapped to their annual performance appraisal. It would complement the conventional campus based learning to make more informed and skilled workforce.

The Bank has been vibrant with initiatives in Digital Banking. Digital channels account for 76% of transactions, one of the highest in Indian banking. Every month, the Bank is coming with new products with unique features. Our focus is to speedily scale-up usage of the digital channels, like U-Mobile, Internet Banking, PoS and ATMs, etc. as these are big cost-

savers for the Bank and add convenience to customers resulting in higher satisfaction level. Internally, the Bank is leveraging digital for business analytics, performance monitoring and stress management. Going forward, the Bank aims to create a Digital Bank of its own, independent of the conventional bank, catering to the needs & expectations of digital savvy customers, while the parent organization continues servicing all types of clientless, especially digital illiterates and digitally literate who prefer to use conventional ways of banking.

To conclude,

There are positive vibes gathering force across the country as we approach the turn of the decade. Business performance has started gaining momentum. Investment activity is joining force with consumption which, in a favorable external milieu, could propel India on double digits growth trajectory in coming decade. It's important that we have the right mechanisms and structure in place so that we do not repeat the mistakes made earlier. We cannot be too conservative given challenges as well as too aggressive in light of opportunities. Union Bank is building right structures to benefit from India story. Also, the Bank is entering its centenary year this year and we are confident of becoming a preferred bank for New India.

☯

[1]Mastering the New Realities of India's Banking Sector; June, 2017; McKinsey.