Banking: Stepping into the next decade

Rajnish Kumar*

Banking in the new millennium has seen transformational changes and the next decade is all set to accelerate the trend. Globalization of banking which started a few decades back will accelerate to the new levels in the coming decade. Like all major sectors, the growth of the banking industry will be determined by the 5 important mega trends, transcending borders:

- Changing Demographics
- New age workforce
- Digitalization of services
- Unified and global marketplace; &
- Regulatory Landscape

As banks step into the new decade, they need to evolve – both in their product portfolio and business models. They will need to serve a new set of customers – the unbanked in the emerging and developing economies and the underserved in the developed worlds, and the hugely and digitally literate new age customers across the globe actively aided by path breaking technology. Further, the regulatory landscape emerging in the aftermath of 2008 financial crisis and constantly adjusting to the new age demands will decide the direction that Banks will take in the next five to ten years.

In the coming decade, banks will increasingly focus on profitability rather than revenues. On one hand, they will introduce new products more aligned to emerging client needs, on the other they will deconstruct the existing ones to make them tailor made to customer needs. Partnership with other financial players, like fintech companies and outsourcing less profitable businesses, like the back-office functions that no longer provide competitive advantage will be common phenomena. The role of bank branches will shift from being delivery channels to being facilitators of financial services and banking no longer will be confined to the existing "brick and mortar" model.

Indian Banking – The Next Decade

In India, the growth story somehow has taken a slightly different trajectory. With a mix of population from the digital age and a huge unbanked population, the growth has been uneven, but rapid. The change has been more rapid during the last 10 years, triggered by the global factors like technological enhancements, changing customer needs, Regulatory interventions etc. Some of the key changes are:

- wide adoption of digital banking channels like online and mobile banking.
- faster and convenient payment options for both wholesale and retail payments.
- rapid increase in retail loans (Housing, Auto, Student, Credit cards etc.).
- increased competition from private sector banks, NBFCs and new players like FinTechs.
- increased regulations that called for improvement in risk management practices of the Banks.

In the light of above transformational changes that

*Chairman, State Bank of India.

occurred in such a short time frame, visualizing banking landscape 10 years from now, is not easy. However, one thing is certain, the banking 10 years hence, will definitely not be the same as what we see today.

Looking at current trends as well as the changes that occurred in the advanced countries, I believe the transformation would be seen both in the technology as well as the products and also the way they are delivered.

Changes for the Next Decade: Technological Changes

Massive Investments in Digital Transformation

As customers become more digital, more demanding and more tech-savvy, existing bank infrastructure will be unable to support new modes of engagement and digital expectations. Banks are expected to re-define their digital roadmap and overcome the silos created by various channels, such as mobile, data analytics, cloud etc. into a consolidated digital plan. They are supposed to ensure a consistent experience across all channels while directing customers to their channels of choice. Banks will have to implement customer-centric technology and operational platforms to support a co-ordinated channel strategy. Cultivating a customer-first culture throughout the banking industry will be a priority. This is going to be a playing field where the winner shall be decided based upon path breaking innovation, flexibility to adapt and successful implementation of ideas.

In response to increasing competitive pressures and people's rising expectations, financial institutions around the world will have to invest aggressively in digital transformation projects. Experiences with non-banking industries such as retail and communications will shape consumers' expectations from banks and credit unions.

Blockchain and artificial intelligence (AI) will continue to disrupt the financial services industry. AI development will focus on cognitive use in the sales, marketing, investments, wealth management and compliance sectors of the financial services industry. This is a critical step in moving from advanced robotic technologies like machine learning and predictive analytics to real growth in cognitive computing.

With the entire banking industry shifting to digital channels, digital-only players will pose more and more challenges to the historical dominance of traditional banks and credit unions. According to Capgemini's Top 10 Technology Trends in Retail Banking, this new breed of banking providers has defied the conventional model with highly innovative products and services with mass appeal to today's digitally-savvy consumer. These challenger banks will fuel increased competition in the industry, forcing traditional financial institutions to improve their digital offerings and extend their reach to fend off these disruptors.

Moreover, adoption of the cloud in banking will increase, but with enhanced focus on security and regulatory compliance. We can expect to see enterprise-wide middle- and back-office applications start to move into the cloud. Banks and credit unions will feel the push to create more cloud-enabled business models in next couple of years which will drive consumer applications to the cloud even more.

In the future, banks will have to deliver intelligence by using data to learn more about customer behaviour and preferences and then use AI-powered processing to produce real-time insights that offer customers the services they want just as they need them. We're moving from the age of mobile banking to the age of digital voice-enabled banking, where (with consumer consent) banks can use AI-based, digital voice-enabled devices to execute processes, like information about balances, payments and loan processing—instantly, 24/7. To be as responsive as customers expect will mean pushing processing from the center to the edge of the network. While still mastering the journey to cloud, banks will also need to master the journey to the edge and think

about how analytics and processing can be done on phones, wearable devices and static contact points like ATMs to ensure that customers get the 'in the moment' experience that will truly delight them.

As all of this plays out, there will be successes and failures. But, by planning ahead and spending time peering into the future, banks can avoid the type of rapid reversal of fortunes suffered by Nokia, Blockbuster, Blackberry, MySpace and Kodak and have a true technology vision.

Changes in the Product and Delivery

Securitization of Retail Loans

Indian economy is growing at a healthy clip of 7% plus and is expected to grow at same or better rate for next few years. The burden of supporting growth will still be on the banking system, mostly PSBs, as other sources like capital markets, debt markets are still not deep enough. While, it is a fact that currently PSBs and some of the large private sector banks are grappling with asset quality issues, the recent resolution of a few large loans through Insolvency & Bankruptcy Code (IBC) framework, offers a glimmer of hope that soon banks will be out of this and start growing. While, so far, Government has been infusing additional capital in PSBs as needed, this cannot be taken for granted and hitting the path of positive earnings only, will be the long-term solution for PSBs.

This situation may force the Banks to increasingly look for securitization of loans or 'originate to sell'. In developed economies like US and UK, securitization of mortgage loans and other retail loans by pooling loans and issuing securities for various investors is quite common. This will enable the banks to earn fee income from servicing rights, without needing a significant amount of capital with an added benefit of retaining the customer relationship. However, this will require development of eco system like title insurance companies, which insure title to the property, agencies that guarantee the repayment of loan and also investment bankers who pool the loans and securitize. Development of suitable accounting norms and uniform under-writing standards will be the pre-requisites.

Trading of Corporate Loans

There is an established model for trading in Shared National Credit loans in US, which are loans syndicated by banks for large corporates with strong cashflows (not project finance). The lead bank, based on the term sheet agreed with the borrower, prepares information memorandum, underwrites the loan and provides the required finance to the corporate subject to the corporate meeting certain due diligence standards. It then scouts for interesting banks for participation and assigns the loan in their favour, while choosing to keep the loan administration with itself for fee. These banks can then either retain the loan in their books or in turn sell them to other interested banks in secondary market. So, loans can be bought and sold for meeting the liquidity and managing the earnings.

In the light of large exposure norms going to be effective soon, Indian Banks under the auspices of RBI, can create suitable mechanism for trading of corporate loans on the above lines. This will help the large banks who sell the loans, in unlocking their capital, while offering a chance to smaller banks, who do not have the expertise to underwrite large loans, to participate in such loans for diversification of their portfolio. However, the pre-requisites would be development of

- regulations around minimum under-writing standards that are expected for the loans;
- standard loan documentation;
- Periodic scrutiny of the loans by RBI at one place i.e., lead bank and disseminating the information among the participating banks, i.e. common asset classification among the banks.

Partnership with FinTechs

FinTechs with their innovative technology based and convenient offerings, have the potential to nibble into the traditional customer base of banks whether in payments or small loans. While banks are heavily regulated, Regulations on FinTechs are almost non-existent. Banks can't afford to ignore their potential and face the difficult choice of either competing against them which will call for large investments in technology and skilled man power or collaborate with them for mutual benefit. Similarly, there is a huge threat from entities like FANG (Facebook, Amazon, Netflix and Google), which are increasingly blurring the line between pure technology companies and banks. So, eventually Bank account may be reduced to a mere holding unit for parking surplus funds for safety and liquidity needs, while other needs of the customer are serviced by different FinTechs in payments, wealth management, securities trading etc. Only a few large banks may afford to provide all the services required by the customer.

Data Privacy, Cyber Security Risks

One major challenge, which all the organizations will be facing, is securing their data and information assets. Data security has become one of the highest concerns for any financial institution today. With the increase in digitalization and ease of banking services, the instances of ransomware attacks and other cybercrimes are expected to increase exponentially. A secure Information Security & Cybersecurity Policy and a Framework to protect the organization's information asset is a priority for organizations. The increased concerns around data privacy and cyber security risks will warrant huge investments by banks in strengthening their IT systems, fine tuning the way data is collected, shared etc. Already, regulations are catching up in this area and punitive monetary penalties cannot be ruled out in case of breaches.

Human Capital

Banks will continue to be attractive places to work for the new generation of employees. However, meeting the high standards of credit delivery, digital banking and otherwise also, will require a highly motivated, trained and professional workforce. To achieve this, it will be necessary to transform employee propositions. A proper "succession plan" will be needed, for mentoring and nurturing of future leaders. It won't be the pay-package anymore, but compelling HR policies that will help secure and retain talent.

New Avenues of Credit Growth: At present banks' exposure to innovation and R&D is through the VC route. Whatever direct exposure exists, is very small. However, increasingly the demand for capital to directly finance innovation will rise, most of which will be from the proprietors and partnerships firms. Banks also have to gear up quickly, lest they lose this space to other sources of funding like peer-to-peer funding or the crowd funding.

As the income generation gathers pace, retail banking will be one of the most important segment from where banks will generate substantial revenue. The opportunities for banks will come on both sides of the balance sheet. The factors that augur well for robust retail banking business include a sizable young population with 47% in unmarried category. The average house-hold size in India is 4.8 persons per house-hold. With nearly 95% marriage rates in India by age 35, the number of house-holds will rise dramatically from the current level of 24.8 crore.

This will fuel demand for financial products of various kinds and can be promoted using the aid of technology. On the liability side, banks will have to provide innovative life cycle based savings products, bank accounts for minors, girl child etc. On the advances side, banks will be lending for consumer durables, housing (given the thrust for low cost housing and smart cities), education loans etc.

Consolidation in Banking Industry

At the broad industry level, consolidation in banking industry is imminent. Large banks reap certain advantages in terms of efficiency, risk diversification

and capacity to finance large projects. The efficiency gains resulting from lower cost of services and higher quality of services are too attractive to ignore. It is also felt that a larger bank may be less risky than a smaller bank as the larger bank will have a more diversified portfolio resulting in less volatility in its earnings. Consequently, a large bank may command higher credit rating than a smaller bank.

Conclusion:

In a nut shell, I summarise below, the current and future states of future Indian banking

Current state		Future State
1. Asset Growth	→	Value Creation
2. Transactions	→	Relationships
3. Products	→	Customers
4. Advertising	→	Targeted Marketing
5. Brick and Mortar	→	Targeted Delivery
6. Disaggregated Risk	→	Integrated ERM
7. Human Resources	→	Talent Management
8. People Intensive	→	Digital Intensive

The trajectory of Indian banking in the next decade will be shaped by the forces of balance sheet restructuring to tide over the stress asset problem. In doing so, the banks' lending will get directed to those sectors which have high priorities in terms of increasing the share of manufacturing in overall GDP to 23% and also generate substantial employment opportunity. The importance of corporate lending will reduce not as a sector, but, in terms of the share in overall bank lending books. Financial dis-intermediation due to RBI guidelines and IBC will also alter the composition of banks' balance sheet.

The role of technology is going to increase undoubtedly. The Report of Artificial Intelligence Task Force has identified Fintech and retail and customer relationship as important areas where India can use the technology for meeting its development goals. At the same time laws on privacy, ownership of digital data, and its storage and cyber security will also get priority and attain desired clarity.

Lastly, the famous quote that says, 'banking is important, banks are not'; it is not clear whether global banking and banking in India will reach this state in the next decade. Interestingly, the role of brick and mortar banks has not diminished and very few brick and mortar banks have become totally virtual.