Banking in the next decade: An Economist's Perspective

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I. Introduction

In the last decade, Indian Banking has changed a lot in several ways. The first and the major development in the Indian Banking has been the introduction of a new category of banks, namely the Payments Bank and Small Finance Bank. Simultaneously, RBI has also liberalised the policy to give out banking licenses "on tap". Second, the non-bank front has seen even more action, with a host of payment providers, mobile wallets and online lenders entering the fray. In March 2017, Amazon became one of the biggest international names to bring a payments product to India, in the form of Amazon Pay. Third, a crucial factor is the strong regulatory push that has been unleashed in favour of open and inclusive banking. The Indian Government has launched the JAM trinity – Jan Dhan Yojana, Aadhaar, and Mobile – to give a huge boost to financial inclusion, and the results are encouraging: Aadhaar registrations now number more than 1 billion, Jan Dhan accounts opened are more than 320 million new bank accounts in around four years, and smartphone usage is well on its way to reach 700 million by 2020.

On the back of demonetisation, a number of innovative digital products has been launched both by the banks and NBFCs, to cater the needs of the customers. The Government is also the driving force behind the creation of a revolutionary payments interface in the form of UPI (Unified Payments Interface), which promises to be a real game changer. These developments have piled a healthy competitive pressure on banking incumbents, who are fighting hard to differentiate themselves amidst a field of new rivals. Also, as more and more Indians, including those who were previously un-banked, have started using financial products and services, it is imperative that banks reimagine their offerings, and particularly their customer experience, to stay in the market. The ideal banking experience should be as seamless and intuitive as to be nearly invisible.

II. Banking in the Next Decade: An Economist's View

Against this backdrop, it is imperative to look forward into the next decade. We, accordingly propose to discuss the following changes that could shape banks in the next decade.

a) **Digital Banking:** The Government of India has launched the Digital India programme with an aim to transform the country into a digitally

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empowered and knowledge economy. While, the success of Digital India programme would largely depend upon the digital banking in the country. The next decade of banking can be easily dubbed as "decade of digital banking". The size of digital banking (digital banking can be defined as the sum of credit cards transaction at PoS + debit cards transaction at PoS + Pre-paid Instruments including m-wallets + mobile banking transactions), which was merely ₹0.5 trillion in Apr'15 rose to ₹ 1.7 trillion in Oct'16 (pre-demonetisation) and after that has exponentially increased to ₹ 2.8 trillion in May'18.

As per various estimates, the Digital India programme could boost GDP up to $1000 billion by 2025. It can play a key role in GDP growth, employment generation, labour productivity, businesses enhancement and revenue seepages for the Government. The World Bank report (2016) indicate that a 10% increase in mobile and broadband penetration increases the per capita GDP by 0.81% and 1.38% respectively in the developing countries. India is the 2nd largest telecom market in the world with more than 1 billion wireless subscribers and world's 3rd largest Internet market with almost 400 million broadband users. There is still a huge economic opportunity in India as the tele-density in rural India is only 45% where more than 65% of the population lives.

b) **Changing Regulatory Environment:** In the post crisis period, the market and regulatory environment has changed in many ways with the introduction of Basel III capital norms. The Indian regulator, RBI has rightly advised a tighter regulations for the Indian Banks. However, countries like India, where financial sector is still developing, the highly regulatory system that has been put in place post crisis period has also led to increase in compliance cost to the banks/ institutions. Some of the difficulties arising out of this regulated environment in India are: (1) Failure to exploit economies of scale; (2) Lack of legal clarity on responsibilities and powers of regulators, inter-regulatory disputes, regulator-regulated legal battles; (3) Turf conflicts; and (4) Inhibiting products and markets when they involve multiple regulators, etc. Going forward, the Banking system will have to navigate all such challenges.

c) **Regulatory Architecture:** In India, there should be proper segregation of regulatory space among various regulators: RBI regulates credit products, savings and remittances; SEBI regulates investment products; IRDA regulates insurance products; and PFRDA regulates pension products. In addition to these, plethora of Government Ministries and Agencies involved in policy making. Even the State Governments also claims a regulatory role in certain other cases.

Let me highlight some of the problems that our present regulatory architecture has:

- Due to multiple entities with little clarity on division of responsibilities, regulatory arbitrage is emerging in the financial system.
- It is quite difficult to create financial intermediaries that will offer plethora of financial services.
- Conflicts of interest has also emerged among certain regulators. For example, RBI is not only the banking regulator, but also the investment banker for the Government and the maker and reviewer of monetary policy.
- The present architecture also creates difficulties in co-ordination among various agencies. For example, in managing systemic risks, regulatory co-ordination at entire level of financial system is crucial. In India's financial system, unless the FSDC plays a vigorous role, the inter-agency synchronisation will remain quite weak.

d) **Uniform Financial Regulations:** If we make a comparison of India across BRICS countries and Asian economies in terms of pre-emptive ratios like CRR and SLR, India has the highest ratio of 23.5%. If we add to this to the Priority Sector Lending (PSL) commitments, India has the highest stipulated norms across all such countries. Further, adding the stipulated LCR ratios under Basel III, it legitimately raises the pertinent question of whether uniform global financial regulation is desirable and appropriate.

As a matter of fact, asymmetric policy responses across developed economies have now become more fashionable and shows that every country may have to adopt differentiated macro policies to suit its own interest rather than go for a blanket uniformity in policies (Ghosh, 2015).

e) **Banks vs. NBFC Regulations:** In India, both banks and NBFCs are doing similar types of business. So, it is pertinent that they should be equally regulated. The licensing and operating regulations of a bank are more rigorous than that of an NBFC. Moreover, a bank cannot operate any other business except banking, but an NBFC can operate such business. So, the presence of regulatory arbitrage has had some negative impact on financial stability. Going forward, there is a need to bring under a uniform regulatory architecture.

f) **Artificial Intelligence (AI)** including Big Data Analytics: Banking analytics is moving more towards analysing unstructured data and mapping it with structured data to get a holistic view of customers and build a real-time recommender system to predict their next moves. In the age of digital consumerism, financial institutions are taking a deep dive into incredibly rich big data. This can be utilized in many ways, for example: personalized offers made by banks. Personalization in the era of digital banking is the single most important thing to maximize their profitability. There has been a growing trend of commercial banks developing and using real-time recommender systems. For example, receiving a promotional SMS offering discount for buying movie tickets using the bank's credit card; receiving a message on your mobile saying your coffee time is coming up, or that one could use accumulated points on his/her credit card. In essence, to take advantage of and understand the next likely moves of customers, it is important that recommendations be sent to the right person at the right time.

However, perfecting these real-time recommendations is not easy and requires combined use of advanced statistical methods and machine learning algorithms. While distributed computing through Hadoop is becoming more mainstream for banks, it is the expertise in using some of the most advanced models, variational Bayes methods, alternating direction method of multipliers, parallel matrix factorization that will give banks an edge in effectively retaining existing customers and increasing revenue.

What seems to be the need of the hour is, merging several strands of information across systems such as data from customer relationship management, portfolio, loan, debit, credit card etc., and mapping them on a seamless 360-degree view of customers. Customer analytics is the most powerful device for banks. Research by McKinsey shows that banks with advanced capability of using customer analytics have a four to six percentage point lead in market share over banks who do not. The immediate areas where banks can leverage the value of big data analytics and maximize value are customer retention, market share growth, discovering potential affluent customers, selling the next best product pricing of products and increasing lead generation potential among others (Ghosh & Ghosh, 2015).

g) **Changing Banking Structure:** The present banking structure in India has been transmuted from several decades. There are several types of banks say universal banks, regional banks, cooperative banks, local area banks, payment banks and small finance banks etc., who are catering specific needs of the different customer segments. In the Union Budget 2015-16, Government has given the thrust to setup strong and efficient banks in India. So, we believe the present banking structure will change in the future to meet the changing needs of the economy. In this context, RBI has placed a discussion paper on "Banking Structure in India – The Way Forward" to address certain issues like enhancing completion, financing for higher growth, specialised services and financial inclusion etc., by changing the structure, if required. The indicative profiles of the new structure may be as under:

III. Conclusion & Way Forward

The future of the Indian Banking depends upon a number of factors say economic and regulatory environment, entry & exit of players, customers behaviour etc. With the entry of new players into the sector including NBFCs, who offers similar products, the banking business will become tough, which may push the banks to extend their business beyond financial services. They need to innovate, buy or collaborate to become a part of the consumer's day to day life. In other words, banks in future will leverage with the customer's preferences to become central in their financial and non-financial needs. This will combine the internal capabilities with external innovations to be a valuable aggregator, service provider and access facilitator. Instead of a rear-view mirror perspective, it will provide a consumer with a GPS view of their financial needs in the future.

In India, the e-commerce market is growing exponentially, which holds a potential to transform the banking business significantly. The customers who enjoy the convenience of online purchase from e-commerce say Flipkart, Amazon, etc., will expect their banks to improve their delivery channels to be more secure and user friendly. So, banks and FIs need to continuously embrace the changing

Indicative New Structure of the Indian Banking Sector

Type of Banks	Process
Tier 1: International Banks (3/4 big Banks)	• M&As of PSBs with significant global presence • Foreign Banks operating in India
Tier 2: National Banks (PSBs, Pvt Banks, FBs)	• Consolidation in the banking sector, by considering the synergies in between them. • Encourage strong Foreign Banks to operate through subsidiary mode of presence in India. • Differentiated bank licences in specialized areas like trade finance, infrastructure finance etc.
Tier 3: Regional Banks (RRBs, Cooperative Banks, SFBs)	• Strong regional banks through consolidation and promoted by national banks • Well managed cooperative banks into commercial banks
Tier 4: Digital Banks (Payment Banks)	• New licences to strong companies who have presence all over India • Move in the digital pathway

technology by innovating their delivery channels so as to remain intact in their business operations. Offers and opportunities need to be presented in real-time basis based on the preferences of the consumers need.

In this context, SBI has launched a digital platform namely YONO (You Only Need One) in 2018, to meet the growing needs of the Gen X & Y customers. This is India's first and fully digital service platform designed to facilitate banking as well as lifestyle needs of our customers through an all-encompassing B2C marketplace (SBI Annual Report 2017-18). Apart from banking services, the application is designed to offer other financial products including investments, insurance & credit cards and also lifestyle services like railways/flight ticket booking, movies, restaurants bill payment etc. Thus, banking will be invisible and seamless in providing need based support for e-commerce, communication and making life smoother and easier in overall.

In order to remain sustainable in the banking business, the banks need to innovate their products, services and delivery channels, rather than simply depending on core banking areas like accounts, deposits & credits. Competitors has been trying to eat a significant parts of the banking value chain with the potential of limiting banks to becoming nothing more than utilities.

In the future, the banks need to leverage their portfolio of solutions in a personalized way to cater to the needs of the individual consumers at any given moment. This will provide multiple options for the consumer to select from, some of which may be provided by their competitor organizations. These personalised solutions may also extend beyond just digital platforms, to include human interaction as appropriate to understand the problems and needs of the customer.

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