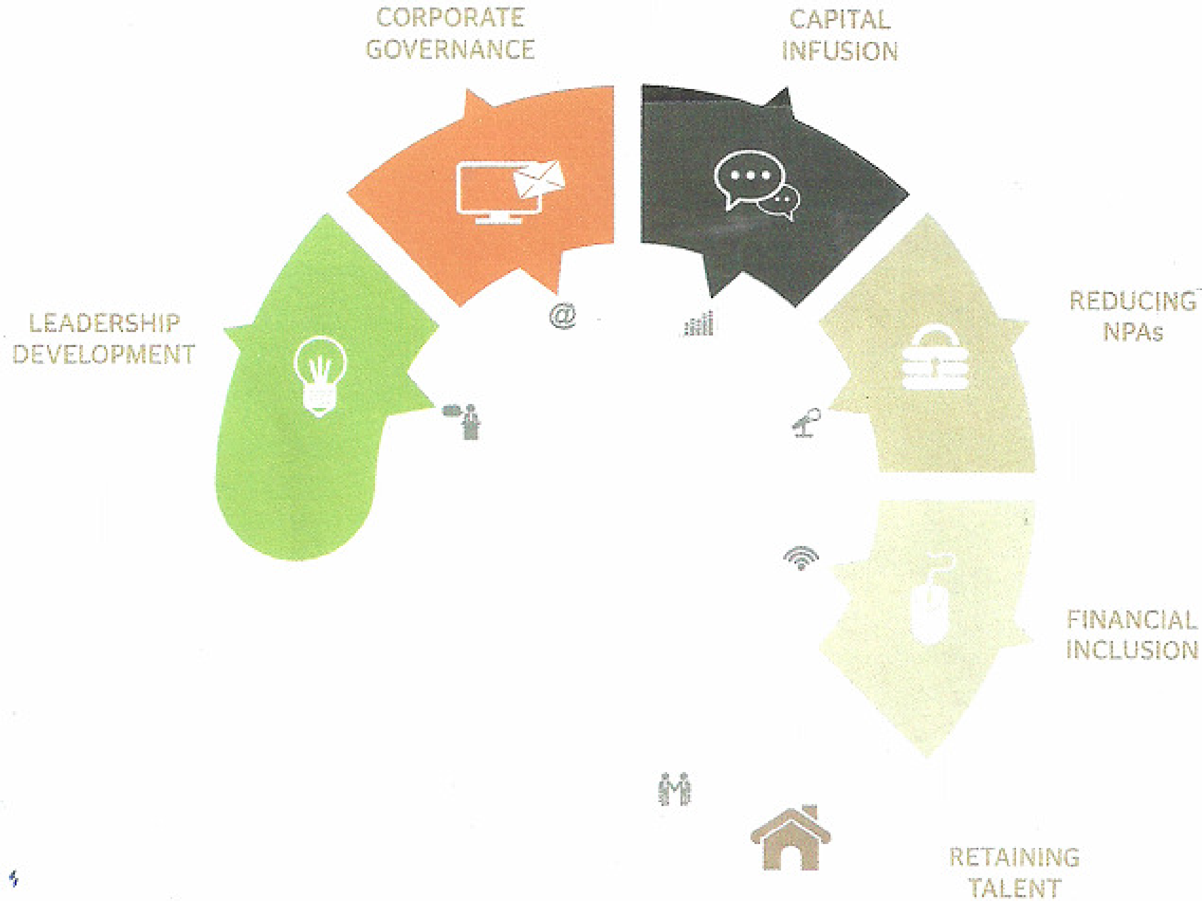

BANKING ON INDIA

THE WAY FORWARD

The dynamics of public sector banks (PSBs) are rapidly changing, bringing with them challenges that they will have to deal with for a smooth, bankable road ahead.

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The Indian banking sector has recorded phenomenal growth since fourteen banks were nationalised in 1969. It can be said to the credit of the banking system that the objectives of nationalisation such as social welfare, control on private monopolies, expansion of banks, reduction in regional imbalances, etc, have largely been accomplished.

The trigger for the evolution of Indian banking can be attributed to the process of financial sector reforms pursuant to the recommendations made by the Narasimham Committee in 1991. The reforms were initiated as part of structured reforms to impart efficiency and dynamism to the financial sector.

PSBs are finding it harder than their private-sector competitors to maintain their interest income as they battle higher slippages and rising levels of non-performing assets (NPAs). At the same time PSBs' relatively weaker service levels and lack of innovative products are affecting their non-interest income growth.

Post core banking, banks now have to move towards developing new capabilities and processes in areas like customer relationship management, risk management, regulatory and business reporting, etc, to optimise operations and establish competitive differentiation. PSBs' biggest challenges lie in the area of human resource development. Some major reforms are overdue post the Khandelwal Committee.

The leadership hurdle

The Ministry of Finance, Government of India, had appointed me to study and report HR issues in PSBs; the committee was popularly known as the Khandelwal committee. The report released in 2010, examined in detail various challenges faced by PSBs today. The first is the challenge of leadership development.

In the last five years, a significant number of senior and top managers have retired from the industry. PSBs are growing at an unstoppable speed, they are geographically dispersed, and today, only banking-related services cannot help them survive. The need of the hour is talented leaders who are innovative and can manage large organisations and uncertainties from external environment.

The Khandelwal committee pointed out weaknesses in developing leaders in existing processes, such as imperfect appraisals, nebulous training, skewed exposures, etc. We discovered that the method used by most banks in developing senior and top management involves ad-hoc and sporadic exposure to various management development programmes in India and abroad. Multiple exposures to similar programmes do not necessarily add value.

There is an absence of a well-knit and comprehensive strategy to develop people who can take up strategic positions at the top. The quick-promotion system adopted currently to get over the problem of finding successors to retiring senior managers without proper leadership grooming is far from adequate in meeting the new challenges.

The biggest risk to a company and its shareholders is weak leadership that may not be able to give robust returns. PSBs now require tech-savvy, execution-savvy and bold decision-makers who are strongly focused on people. As per a McKinsey study, PSBs need to groom 10,000 leaders over the next five years, in various leadership capacities. This proposed report is yet to find favour with the government.

Retaining talent

PSBs have lesser attrition as compared to other industries, though retaining talent is still a challenge. Specialised personnel such as chartered accountants, MBAs, technology experts, etc, as also credit, international operations and treasury operations specialists are easily snapped up by private and foreign banks.

New proposed banks in the horizon will no doubt require seasoned and trained officers and branch managers. It is likely that many general bankers will seek opportunities in these new banks. The main attraction for these bankers would be higher compensation and reward based on merit. The Khandelwal Committee recommended various ways of retaining talent. The standardised wage system in the entire banking sector is a major hurdle in the process. The committee recommended that each bank should work out their own wage system based on its performance and capacity to pay. Most importantly, the incentive system should be linked to performance so as to help retain staff.

NPAs a concern

Earlier this month, credit rating agency Moody's said its outlook on the Indian banking system for the next 12 to 18 months remains negative. This is because asset

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quality is set to weaken due to uncertainty in the macro-economic environment. Moody's had downgraded its credit rating last November.

The challenges for government-owned banks are many. Besides rising NPAs, appetite for credit has remained weak due to high interest rates. These banks have also seen an erosion of low-cost deposits, which include money deposited in current and savings accounts. This means banks have had to shell out more for deposits.

Corporate governance

The advisory group under the chairmanship of Late Dr R H Patil set up by the Reserve Bank of India (RBI) suggested that the process of induction of directors into a bank's board ought to be streamlined. Another major problem affecting banks has been the representation given to the various interest groups on the boards.

The main objective of these representations was to give voice to various sections of the society at the board level. Hence, major reform is needed in the area of constitution of the boards of the banks. The chairmen, executive directors and non-executive directors on the boards of PSBs (including State Bank of India and its subsidiaries) need to be appointed on the advice of an expert body set up on the lines of the UPSC, with similar status and independence.

Such a body may be set up jointly by the RBI and the Ministry of Finance. There is also no need to have directors who represent narrow sectional and economic interests. All the objectives that the banks are supposed to achieve should become an integral part of the corporate mission statements of these institutions.

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Need for capital

Though PSBs are well capitalised as of now, they could face huge challenges in meeting the capital requirements to meet the growing needs of the economy.

In view of the ambitious target of 8% GDP growth, advances of the banks are expected to record a growth of 20-22% per annum. In order to meet this level of credit growth and realise the 12th plan target of infrastructure financing of $1 trillion, it is expected that banks will have to mobilise total additional capital of ₹5 lakh crore by 2018, with the implementation of the Basel III guidelines. Of this, common equity should be ₹1.75 lakh crore.

PSBs face a peculiar problem—given the current government policy of no stake dilution below 51%, capital for PSBs will have to come from the government's budgets, the bank's own retained earnings and public issues. But the availability of capital through budgets sets a limit on the extent of expansion of credit by these banks. With credit growth between 20-22% per annum, if PSBs are to retain their market share, there will be need for continuous injection of capital into these banks.

Banks have made significant progress in the context of financial inclusion as is evident from the following statistics from 01.04.2010 to 31.12.2012.

- 5,694 new rural branches opened.
- 1,43,540 unbanked villages provided banking services.
- 98 million no-frill accounts opened.
- 59 million accounts opened through the business correspondent model.
- 7.5 million Kisan Credit Cards issued.
- 1.7 million general credit cards issued.

Source: Financial Literacy and Financial Inclusion—Indian Way presentation by Dr K C Chakrabarty, Deputy Governor, Reserve Bank of India at the Fourth OECD/RBI/INFE Asian Roundtable on March 6, 2013.

Financial inclusion

Although it is now 44 years since nationalisation and there has been rapid expansion of banking facilities, especially in rural areas, only 50% of Indians have access to formal banking services and products.

In this context, financial inclusion has assumed significant priority for the banking industry. The Government of India and RBI have realised that inclusive growth cannot be achieved without financial inclusion. It is the considered view of all the experts and policy practitioners that a sustainable model of development is feasible only through inclusive growth. Similarly, it is also acknowledged by all that India cannot achieve inclusive growth with the current level of financial exclusion reflected by the fact that 50% of the population does not have a basic bank account.

The above statistics reveal that banks have taken keen interest in pushing forward the agenda of financial inclusion. However, as a country, we still have a long way to go to ensure a bank account for every citizen, since there are still nearly four lakh villages where banking services are yet to be provided.

Future forecast

Although PSBs have come a long way on their journey of transformation and are now quite par with many of their private-sector competitors, the main challenge before them today is to manage costs, move onto the next wave of technology using big data for CRM, customer lifetime value, channel management, risk management and carrying out enterprise-wide performance management.

The government will have to improve the process of corporate governance building, leadership bench-strength and introducing a culture of autonomy. Some of these intangible factors will drive the tangible outcomes. F