# With growing interest: a perspective on the Indian banking and NBFC industry post-pandemic

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The banking and non-banking financial company (NBFC) sector in India has witnessed significant market-driven and regulatory events in the last decade. Cumulatively, these have had a profound impact on the industry. Some of the noteworthy developments include the issuance of new bank licences for universal banks, introduction of a new category of banks (small finance banks and payments banks); insolvency processes and the resolution of a few large non-performing assets (NPA) situations; and consolidation of public sector banks (PSBs), etc. Before the onset of the COVID-19 pandemic, the sector was dealing with the contagion effects associated with the collapse of a few NBFCs and co-operative banks.

However, innovation and the continuous adoption of technology did not falter within the sector even through these tough times.

The evolution of the core banking system has transformed the banking sector's propositions, with anywhere banking and internet banking reducing the customers' need for visiting the branch. Digital payments not only helped in business-to-business (B2B) transactions but also pushed the adoption of e-commerce.

The global pandemic in 2020 did not spare the banking and NBFC sector. In this column we analyse the medium and long-term implications that have emerged by virtue of the experience. Three potential high-impact changes that could impact the banking and NBFC industry have been highlighted here:

## 1. Power of digital and analytics

The pandemic has motivated the industry to reconsider its operation model and client acquisition strategy. Digitisation and automation have taken centre stage. With an increased focus on the Micro, Small and Medium Enterprises (MSME) and retail segments, banks are discovering novel ways of delivering financial services products to their end customers. Newer digital lending products introduced by fintech players have been willingly embraced by customers, thereby creating disruption, especially around client acquisition and retail lending products. A seamless customer journey has emerged as the ultimate aspiration and, therefore, guiding principle for the industry. Introduction of digital lending products largely entails self-service applications supported by back-end processing of applications on risk-rating processes. Additionally, tools that aid risk-based pricing and lending decisions are expected to be

the next growth enablers for banks. Banks have realised the importance of data and are investing in technology infrastructure to leverage both structured and unstructured data and transform this into analytics and subsequently, actionable insights. Cloud technology and the use of artificial intelligence and machine learning tools to perform forward-looking analytics should help in effective client acquisition, better credit decisions, improved efficiency and optimised costs.

**2. Transformation of public sector banks**

The growth of PSBs has been majorly stunted by their high level of NPAs. The market capitalisation of all 12 PSBs is less than that of one of the leading private sector banks. The government expects the top six PSBs to realign their business and operating models and be self-reliant when it comes to their capital requirements for growth. Furthermore, the government's decision to privatise and divest PSBs would also contribute to building scale and efficiency in this segment. Select PSBs have already commenced on their transformative journey by adopting digital lending products, creating alliances and partnerships with fintech players and investing in technology for data analytics.

**3. Governance of NBFCs and conversion into banks**

The Reserve Bank of India recently issued discussion documents on the extent of ownership of banks as well as scale-based governance frameworks for NBFCs. While the industry provided feedback on both these documents, it is now eagerly awaiting the regulator's final decision and circular on the matters. It appears almost certain that larger NBFCs that have the potential to systemically influence the overall banking and financial services system may now enjoy less of a regulatory arbitrage and be subject to a governance framework akin to banks. With expected regulations around corporate houses being allowed to own a bank (albeit with restrictions), we can also expect significant consolidation in this segment resulting in a few large NBFCs either converting into a bank or merging with existing banks. The decision to convert into a bank though could also depend on the transition guidelines, especially those related to liquidity ratio. At the same time, it would be interesting to see if large NBFCs will leverage the government's privatisation of PSB programme to convert into banks.

Banking and NBFC sector is once again at an inflexion point, given the potential transformational, operational and stakeholder changes influenced by the above-mentioned drivers. There's a need for financial institutions to assess and evaluate their current business model and take a strategic call on their commercial and operational framework in anticipation of newer ways of doing business coupled with changes in market and competition landscape.