

Riding India’s Digital Super-cycle

India’s spirited pursuit of public digital platforms is pushing banks towards much bolder digital transformation. Handsome rewards for those who embrace it; rapid decline for those who won’t.

Saurabh Tripathi (BCG)

FIBAC, Nov 22, Mumbai

Riding India's Digital Super Cycle

India's spirited embrace of digital public goods is pushing banks towards bolder digital transformation. New business models like embedded finance can turbocharge profitability (30% growth; 50% cost). But, unless banks adopt new capabilities, they stand to lose customer relationships (>85% unhappy with banks' digital journeys). SME would be the next space where customers will gravitate towards BigTech / Fintech. Like UPI has shown, it will happen faster than it seems at first.

Unlike the first phase of tech adoption, this time much bolder investments (~USD 5 bn p.a.) are needed & should be accompanied with much more difficult talent induction and cultural changes as Banks try to become "tech product companies". Banks have to deal with rising transaction loads due to UPI and account aggregators (6x in next 5 years) in the meanwhile and high branch density (1.5x China) to start with.

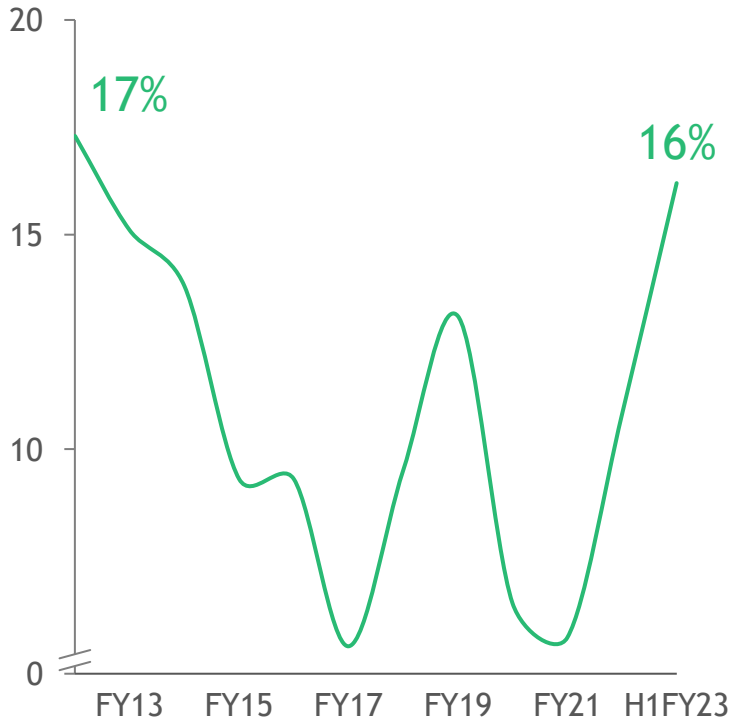
Many banks can not accomplish this transformation with their resources and ability to attract talent. Even the ones who do, need support from Government and RBI.

Banks need help from Government in the form of upgrade of public digital infra (e.g., Singpass of SG for KYC), tax incentives for digital innovation, digitization of secured credit with asset tokenization (blockchain) to realize high productivity (~40 C:I ratio).

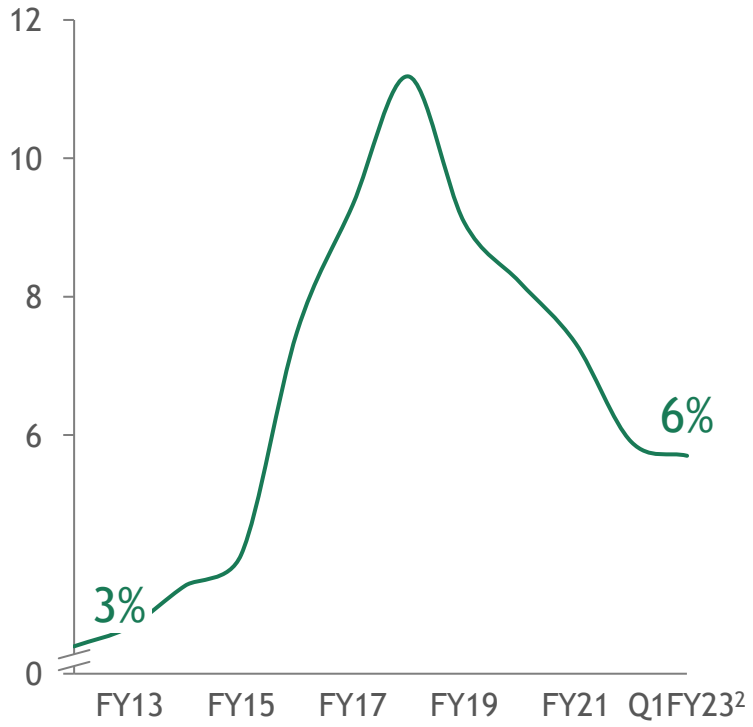
RBI needs to acknowledge new model of bank investments in the agile framework. More importantly, given its enormity, a number of banks can not realistically accomplish digital transformation and industry needs consolidation to manage systemic risks in the medium term.

Indian banks entering a phase of higher growth and strengthening balance sheets

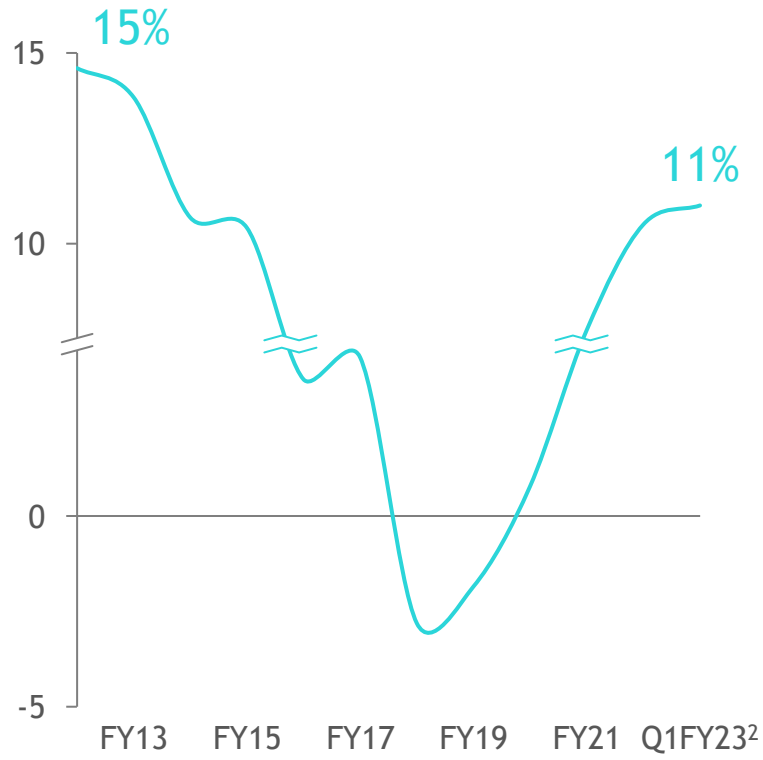
Credit Growth[1] (%)



GNPAs (%)



ROE (%)



1. Credit growth as per RBI's commercial banks at glance statement 2. Q1FY23 figures are based on 35 scheduled commercial banks in India as disclosed in their financial results
Source: RBI, Financial Results, Investor Presentation, BCG analysis

National scale public digital goods are a defining element of India's pursuit of rapid economic and social progress



National Agri stack

- Land records, advisory, marketplace
- 1.5[1] X+ income for 50M+ farmers



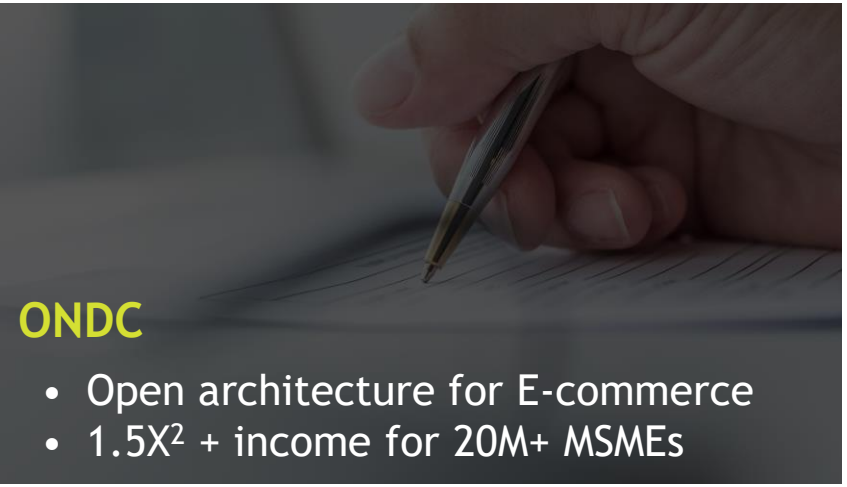
Logistics - Gati Shakti

- Increased infra efficiency
- 5-15% savings in logistics cost



National Health stack

- Rapid payout to healthcare industry
- 30% increase in health insurance cover



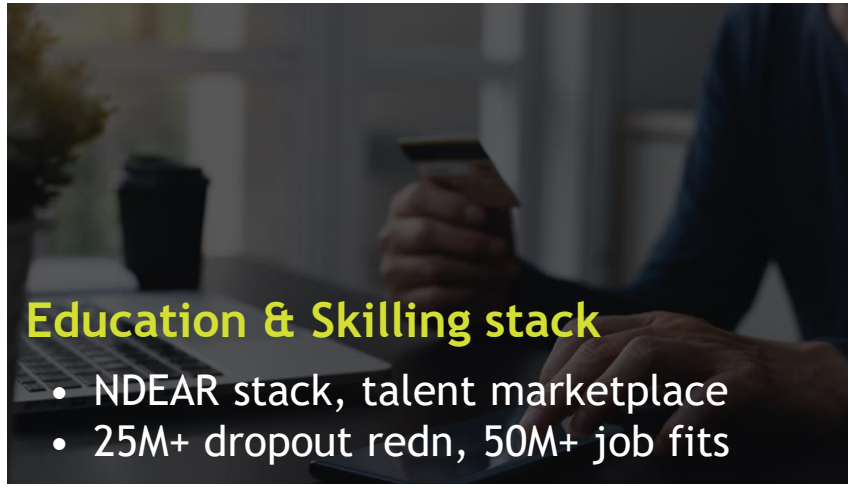
ONDC

- Open architecture for E-commerce
- 1.5X[2] + income for 20M+ MSMEs



GeM

- B2G digital procurement marketplace
- 56% sourcing from SMEs, Digi lending



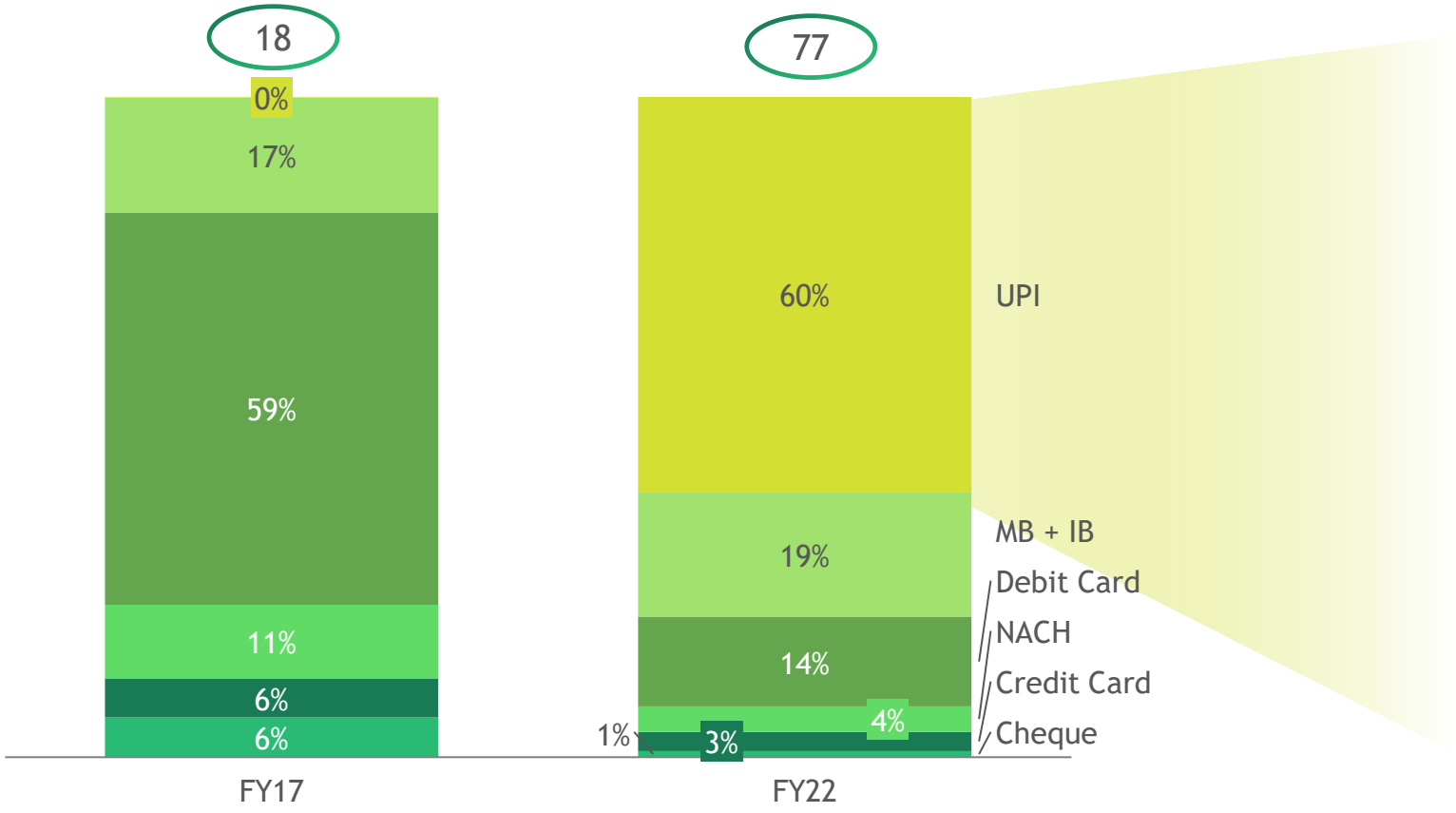
Education & Skilling stack

- NDEAR stack, talent marketplace
- 25M+ dropout redn, 50M+ job fits

1. Include benefits relating to price improvement, productivity improvement and credit cost savings 2. Includes benefits related to credit cost savings, price improvement & sales
Source: The potential of open digital ecosystems – BCG, Omidyar Report, Digital India, GeM dataset, BCG analysis

Customer rapidly gravitated to Bigtech for UPI

No. of transactions (in Bn)



Market share %

PhonePe 47%

G Pay 33%

Paytm 15%

Notes: 1. Financial Transactions do not include cash transactions at branches; 3.Internet transactions include RTGS, ECS, NEFT and IMPS financial transactions · ATM and Mobile transactions included are financial transactions only; 4. CAGR is calculated from FY20 to FY22 5. Total may not sum to 100 because of differences due to rounding off 6. Ticket Size calculated basis Value/Volume; Branches include Administrative Offices; NM: Not Meaningful
Source: RBI data, National Payments Corporation of India (NPCI) statistics, BCG analysis

Public digital platforms will spur growth in lending with lower processing and acquisition costs

~30% lending book growth expected

Beneficiaries		Impact (INR lakh crores)	% existing lending
Agri (Agri stack)	• Farmers • Suppliers	5	40%
MSMEs (ONDC, GEM, Heath stack)	• SMEs (both B2C & B2B) • Health care prof. • Online buyers	12	35%
Infra (Gati Shakti)	• Infra companies • Logistics players	3	15%

50%+ Productivity Enhancement

Cost of acquisition and processing	From	To
Agri loan	2.5%	1.5%
MSME loan	2%	1%
Personal loan	3.5%	1.5%

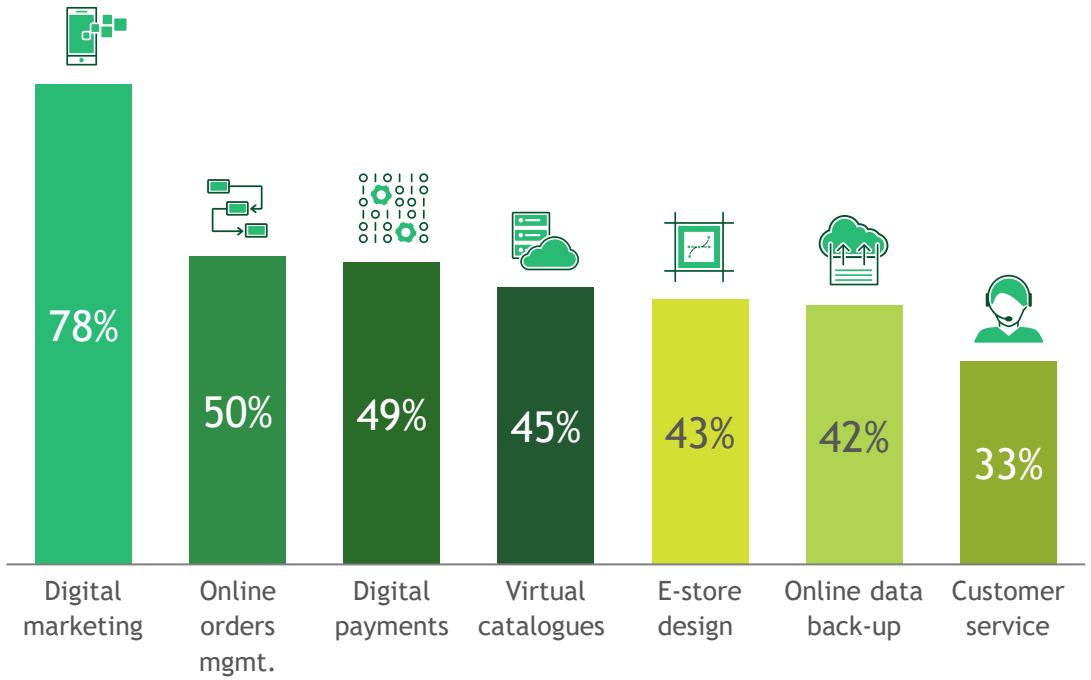
Source: BCG Analysis

Indian SMEs looking for digital sales will gravitate towards platforms with integrated preposition

60%+

SMEs expect that their online sales will further increase in the future

SMEs struggle with various aspects of online sales (% SMEs)



~50%

SMEs are open to banks to help them navigate their challenges for a fee

Source: BCG India MSME Survey 2022 — 1000+ MSMEs

Globally massive growth in embedded finance for SMEs expected; digital platforms to disrupt upto half of SME banking rev pool in 5 yrs

% value added services from digital platform utilized by SMEs

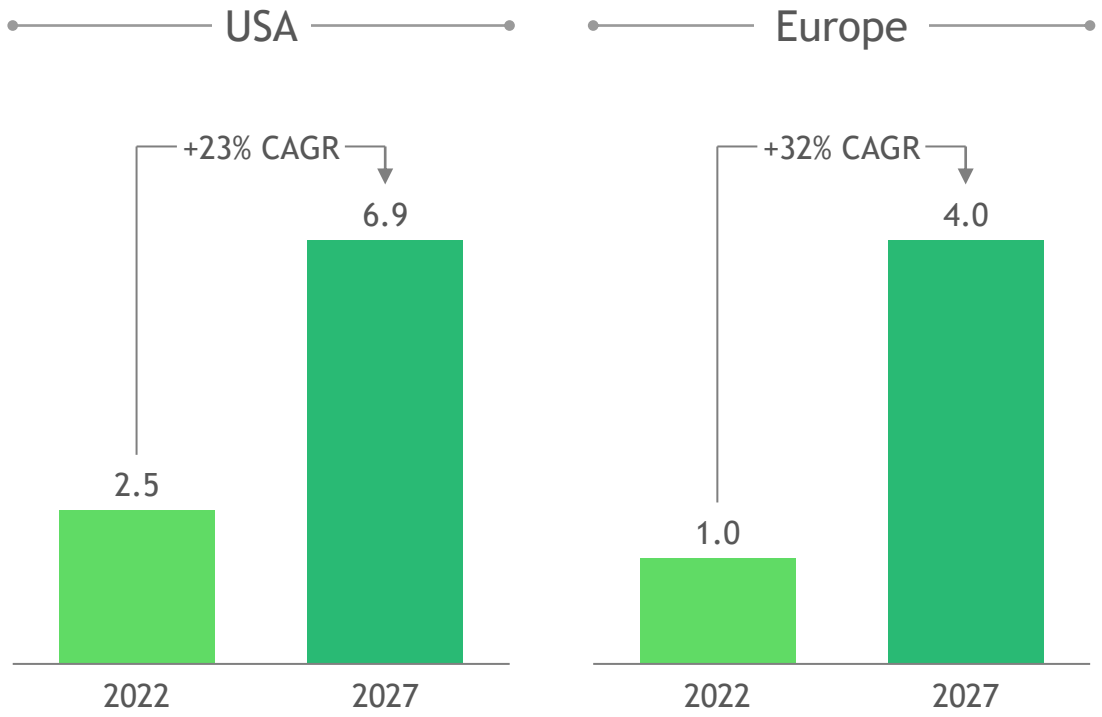
Payment processing	Digital mkt. services	Inventory mngt.	Accounting
34% » 74%	31% » 72%	31% » 69%	31% » 74%

Payroll mngt.	Customer loyalty mngt.	Labor mngt.	Fraud protection services
25% » 66%	24% » 69%	22% » 64%	20% » 67%

xx% Current use of services on platforms/marketplace (% respondents)

xx% Future consideration on platforms (% respondents)

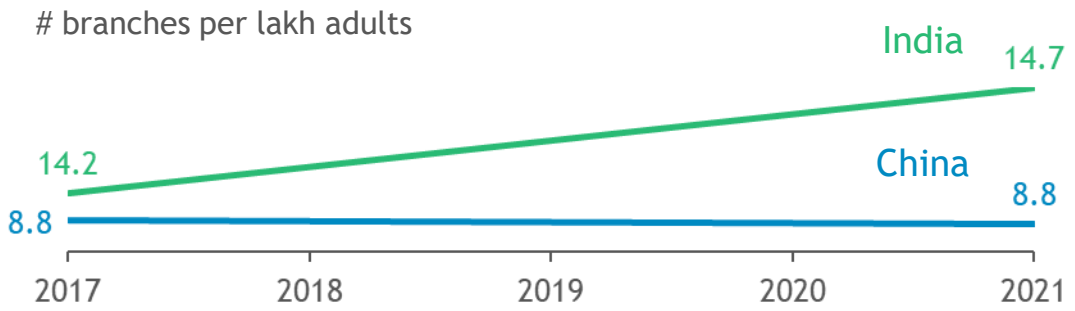
Estimated embedded finance revenue potential for 2022 to 2027 ($ bn)



Source: BCG Adyen report – How platforms are revolutionizing SME banking, BCG survey of 2000+ MSMEs in US, Europe, Australia, Canada

Indian banks start with daunting challenges

5000+ branches opened in India in last 3 years; current ratio significantly higher than China



Transaction load to explode

5X Increase in UPI volumes in next 5 years

20% Additional UPI transaction equivalent load due to Account Aggregator

Customers not satisfied with current bank journeys

<15% Customers and MSMEs satisfied with existing journey and demands expected to increase rapidly

Risk & Compliance Cost to Increase

- Cyber security
- Digital frauds
- Data security & privacy
- Regulatory reporting

Source: Worldbank; BCG Consumer survey 2022 – 2000+ consumers; BCG Analysis

Under Account Aggregator framework, SME are expecting tech enabled value added services from banks in return for sharing data

~40%

SMEs are willing to share data

MSMEs expectation if they agree to provide data(% MSMEs)

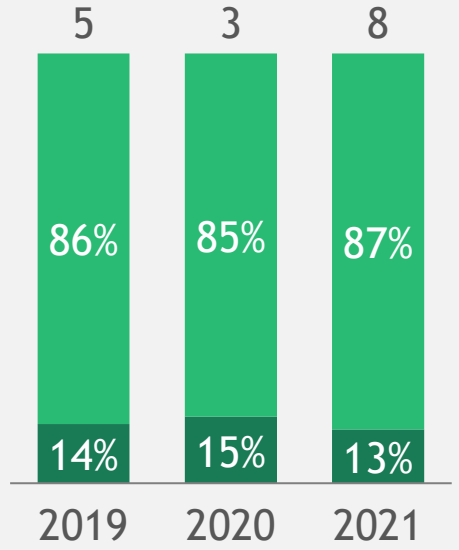


Source: BCG India MSME Survey 2022 — 1000+ MSMEs

In sharp contrast to global trends, FinTech funding in India is skewed towards those competing with, rather than those enabling the banks

Annual Equity funding raised from 2019-2021 ($B)

India



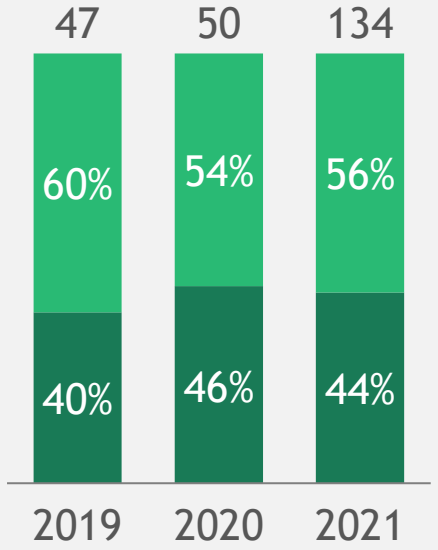
Disruptor

FinTechs who compete with banks for wallet share

Enabler

FinTechs who provide services to banks to improve their offering

Global

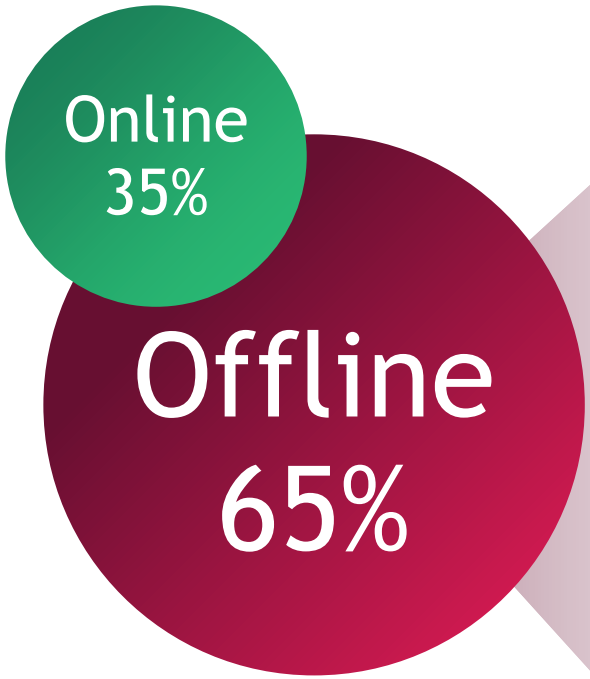


Implication

- Less digital savvy banking industry is less attractive for FinTech to partner as enabler
- Banks stand to gain during FinTech winter (more enabling b2b to get funding over b2c)

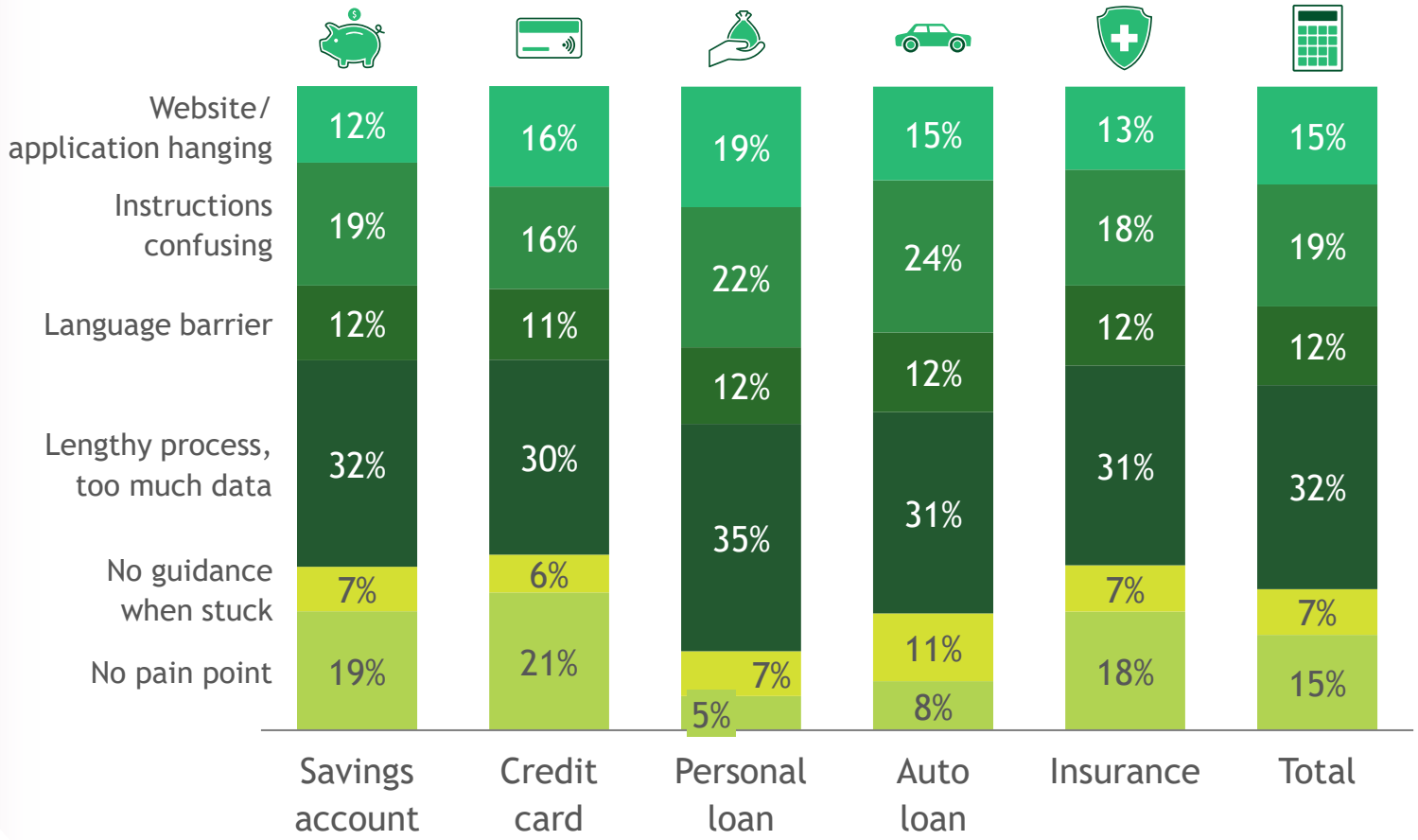
Note: Funding excludes Ant Financial, Du Xiaoman Financial, and JD digit funding rounds Companies with an informed HQ location. M&A and IPO funding has not been considered.
Source: BCG FinTech Control Tower

Poor experience with banks digital journeys, leads to 65% customers preferring offline product purchase



Preference for buying new banking products (% consumers)

Experience of customers who attempted digital journeys (%)

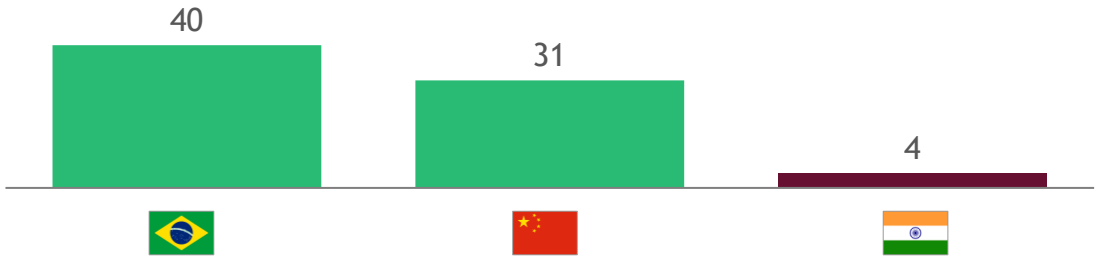


Source: BCG Consumer survey 2022 – 2000+ consumers

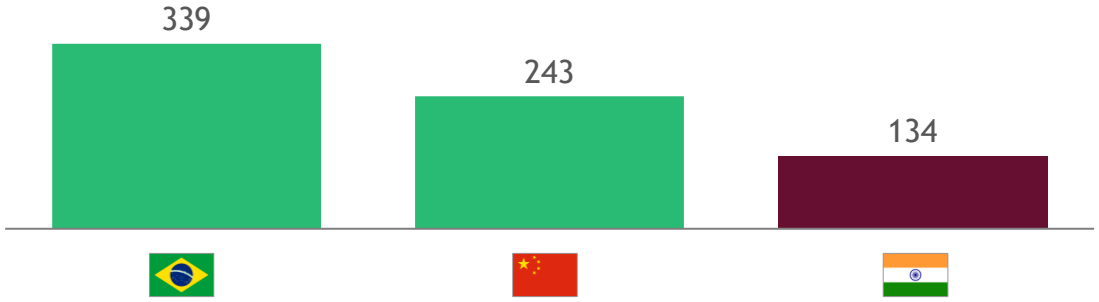
Success of UPI is only a start, Indian banks to witness massive growth in transaction loads given current under penetration

India still lags major comparable economies on digital penetration

Digital Payments to Cash in Circulation[1] (value)

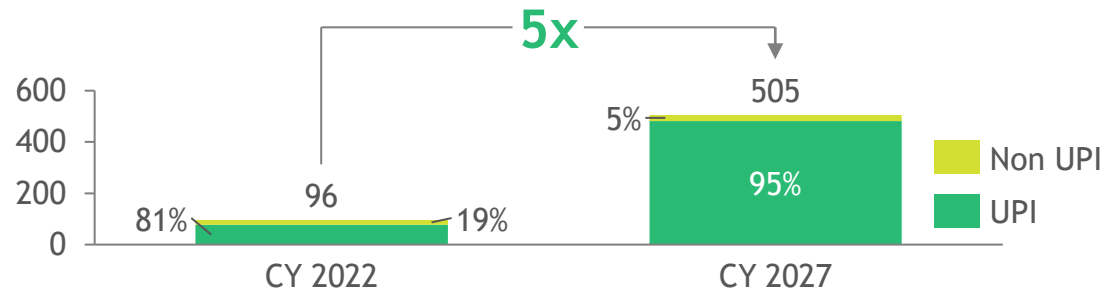


Digital Payments per Banked Person[1] (volume)

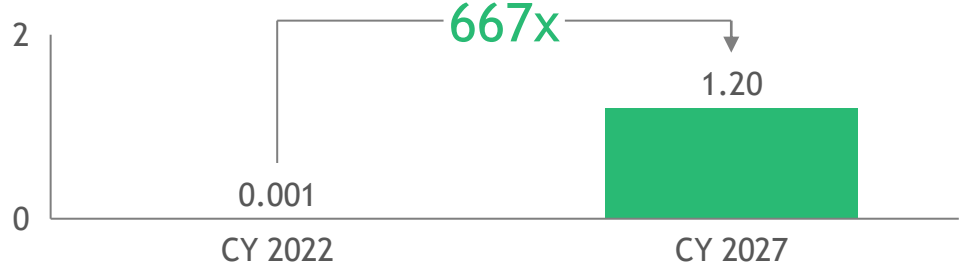


Transaction load to grow significantly on account of UPI and account aggregator

Digital Payments Volumes (Bn)



Pulls from Account Aggregator (Bn)



1. Banked population defined as people of above 15 years of age having accounts with Financial Institutions
Sources: World Bank Global Findex Database; FIBAC Trends and Benchmarks 2022; BCG global payments model 2022; BCG analysis

A cycle to avoid: Many institutions struggle with ROI on digital transformation due to vicious cycle of lower investment

Talent Constraints
- Customer journeys not designed by professional designers

Low BU Ownership
- Product portfolio not rationalized
- Legacy process not challenged



Budget Constraints
- Underlying technology platform cannot be changed

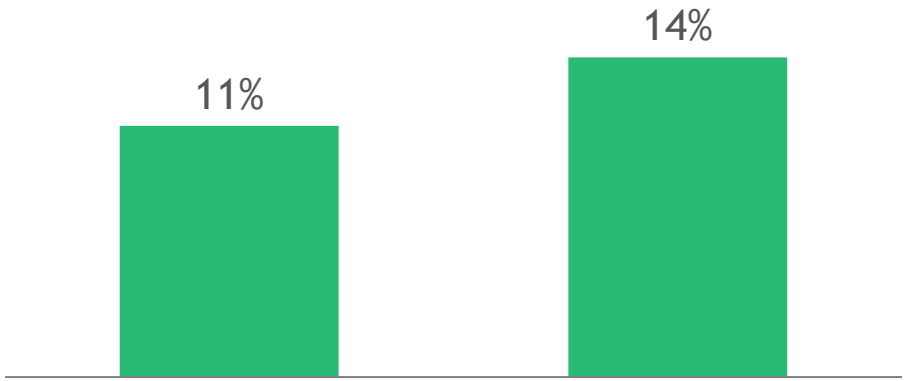
New journeys have not 'landed'
- High 'drop off' rate
- Majority customers have to take physical leg

New journeys not cool enough for significant customer traffic
- Revenue upscale not gained

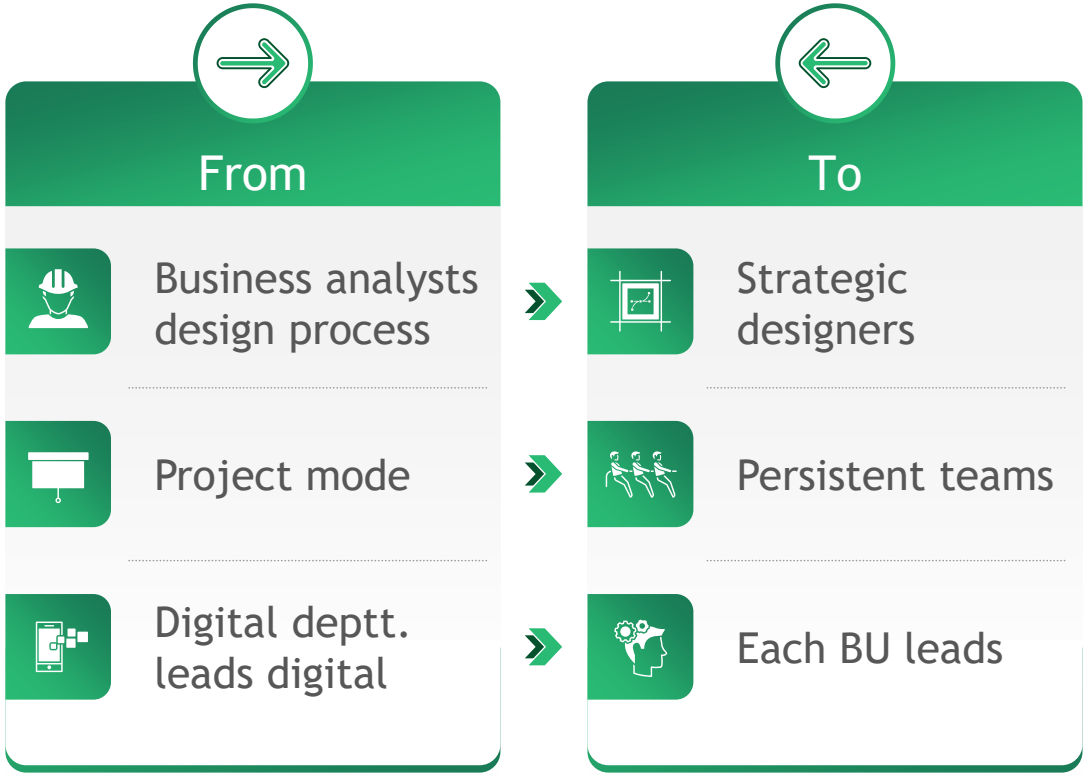
Old physical journeys have to be maintained
- Cost not out

Successful digital transformations require bolder financial investment and deeper organizational interventions

% of revenue spent on digital transformations

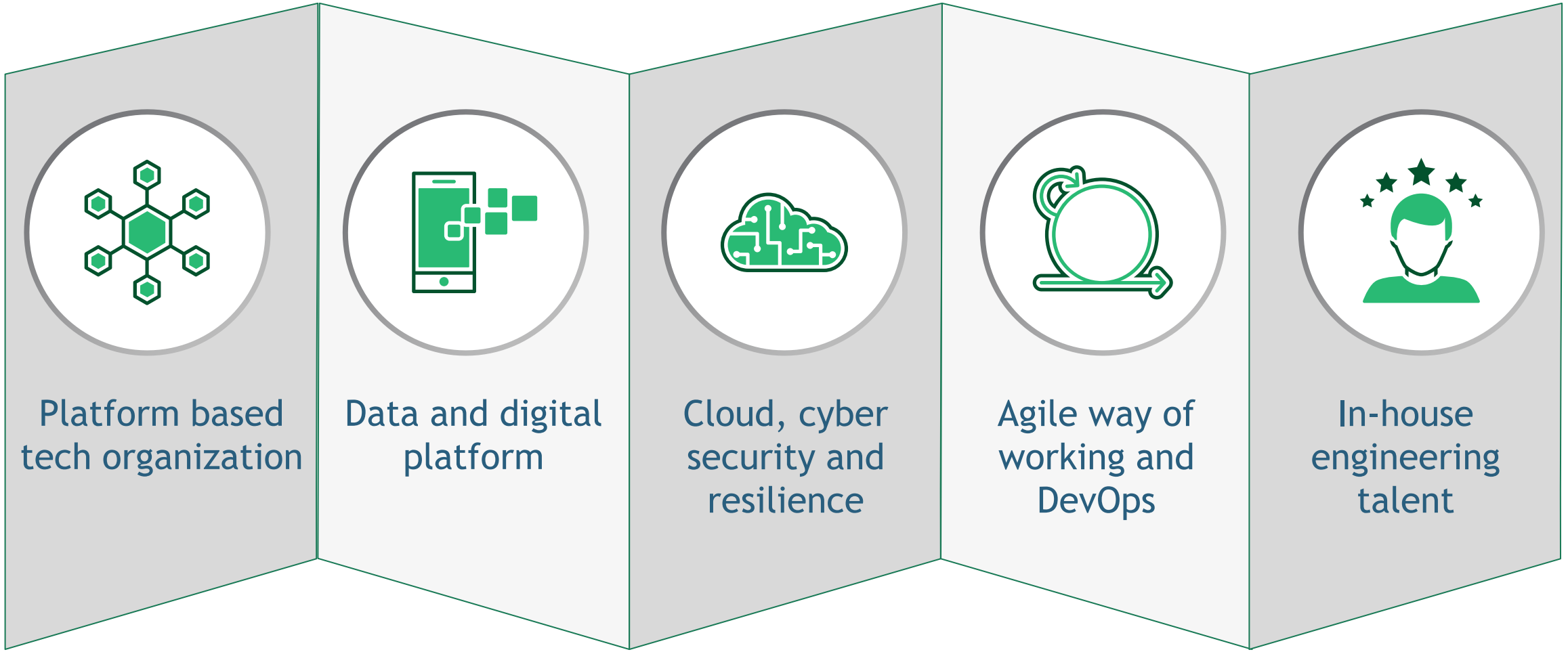


Deeper organizational interventions



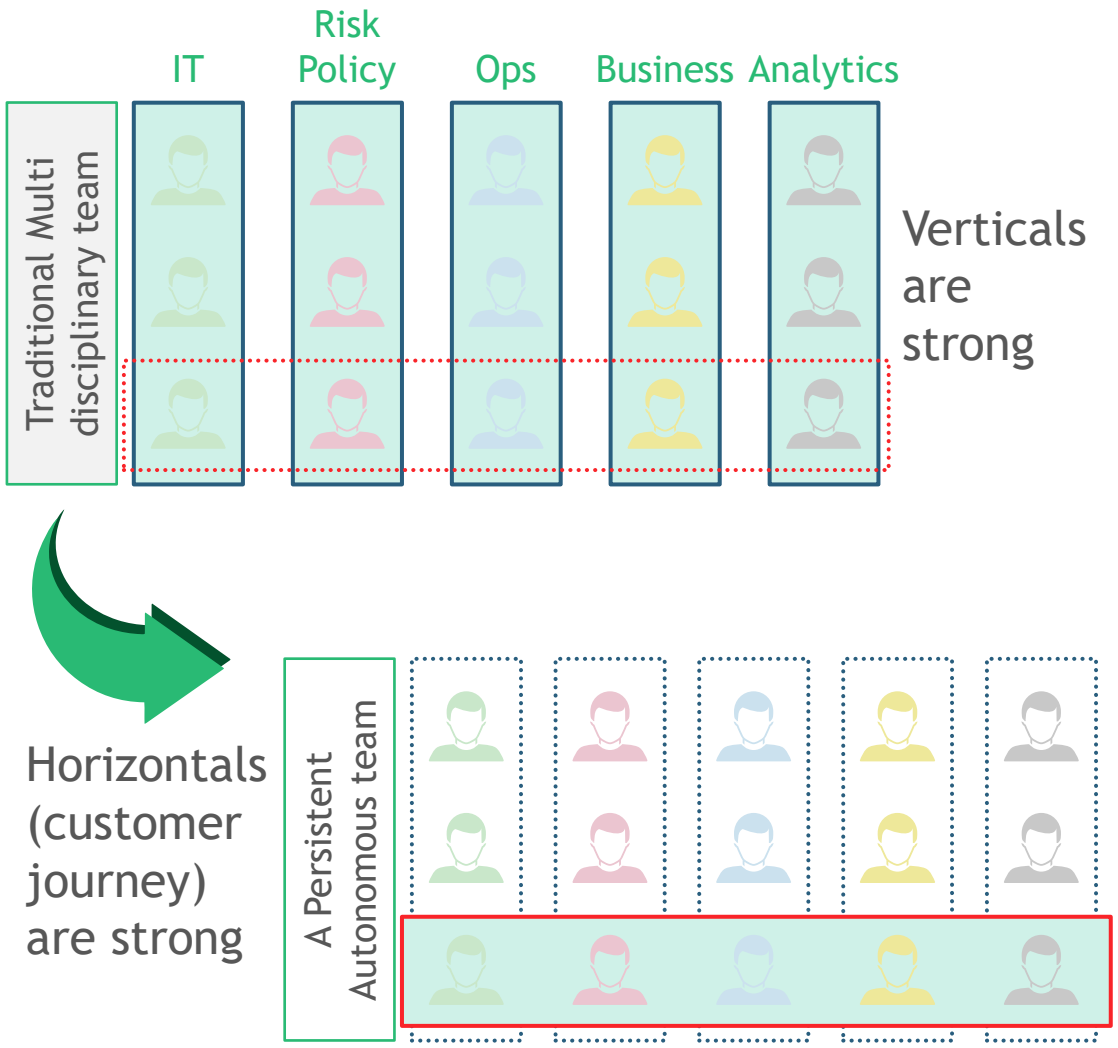
Source: BCG Global Digital Transformation Survey, 2021

Banks need cloud first tech architecture with in-house engineering and new agile ways of working

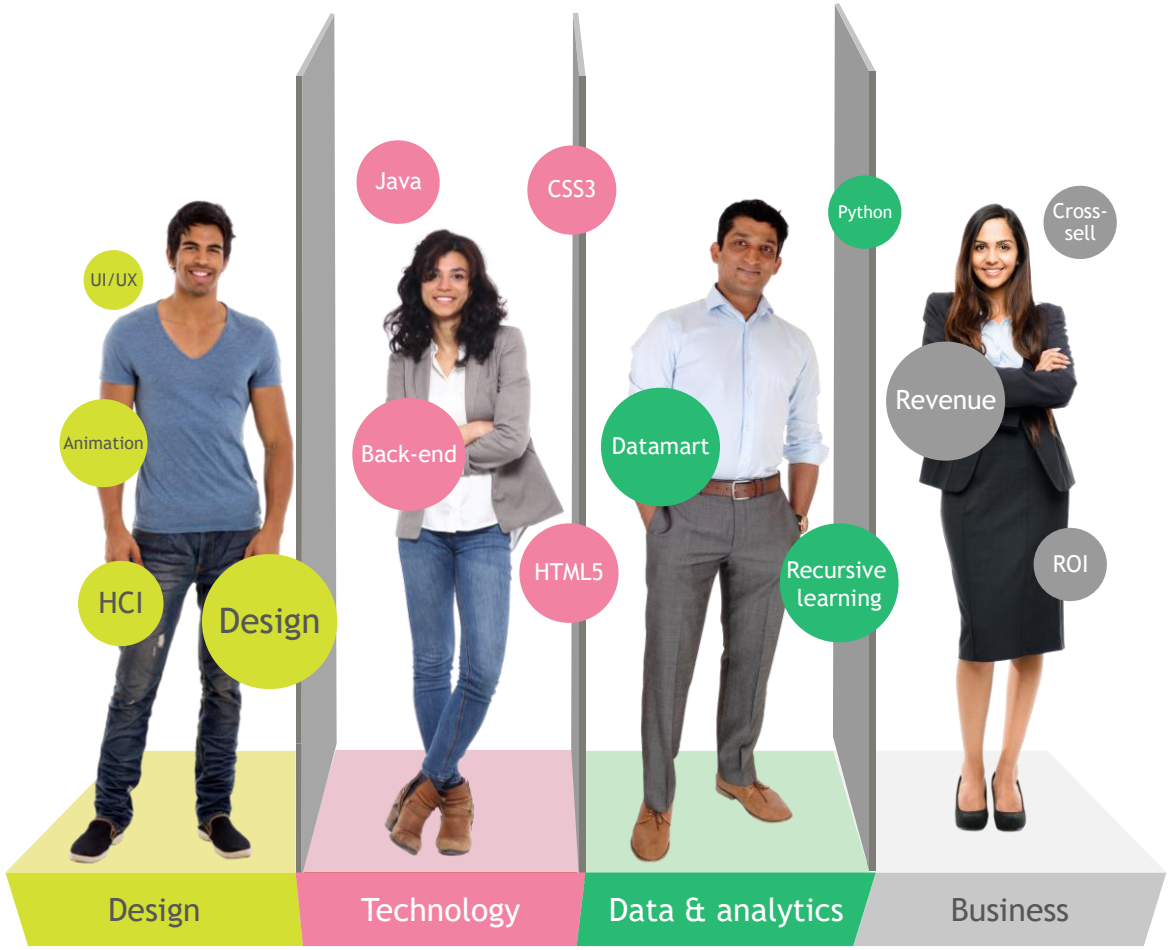


Source: BCG analysis

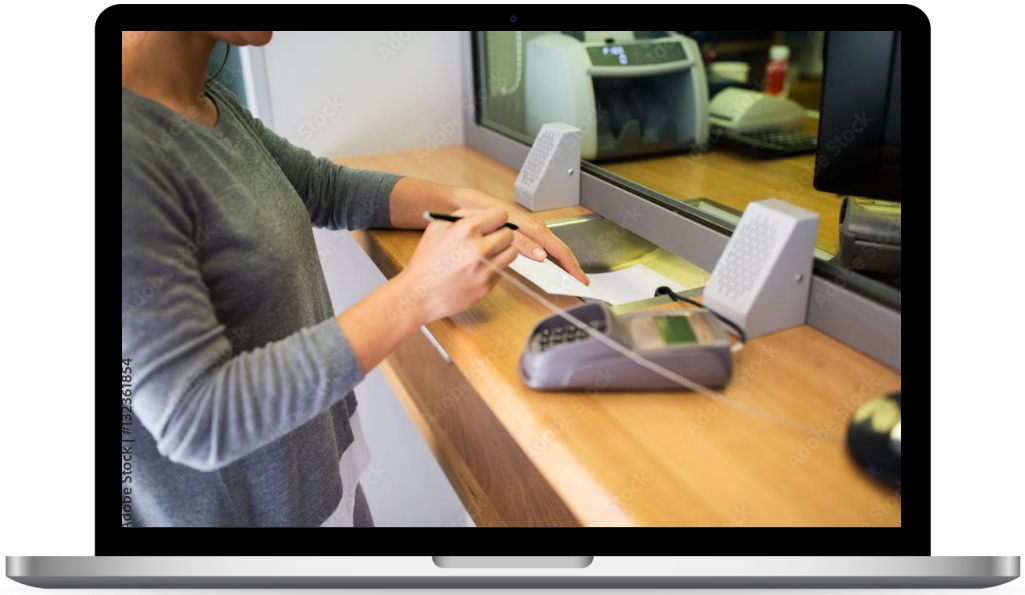
Persistent multi disciplinary autonomous teams to become a norm; Diverse talent to be onboarded; Design yet to get due recognition



Onboarding of diverse talent at scale required



With 5G quality, video banking can reduce branch need

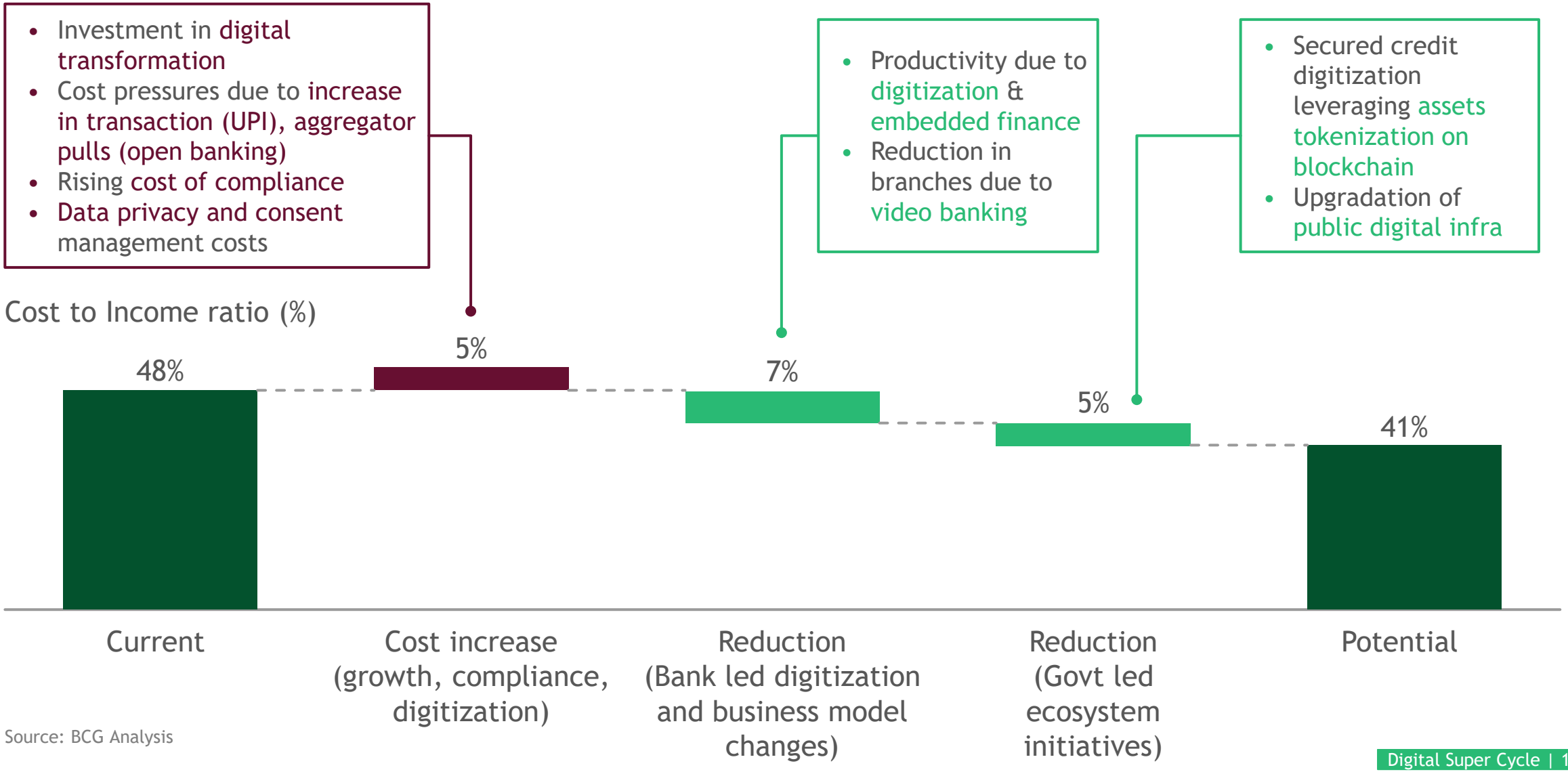


Example: mBank

(Video, Voice, Chat, online document sharing and co-browsing)



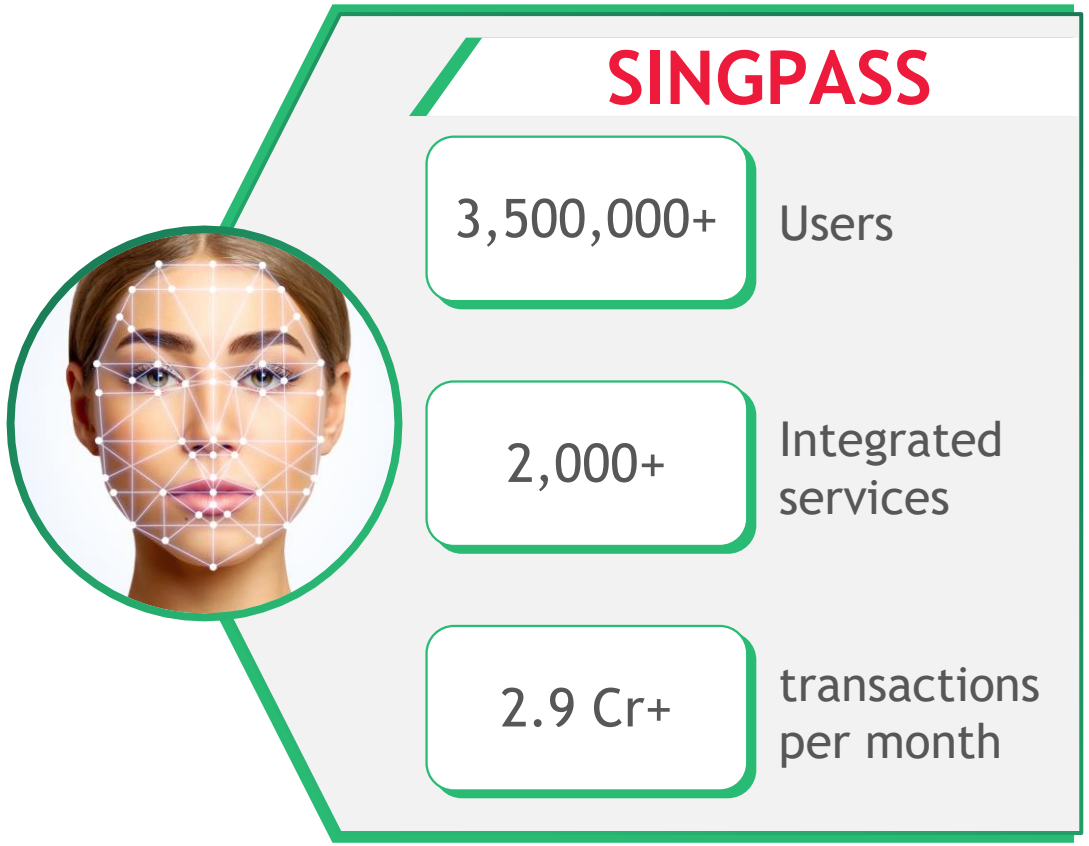
With bolder digital transformations, banks can keep pace with evolving digital ecosystem, and achieve productivity excellence



Source: BCG Analysis

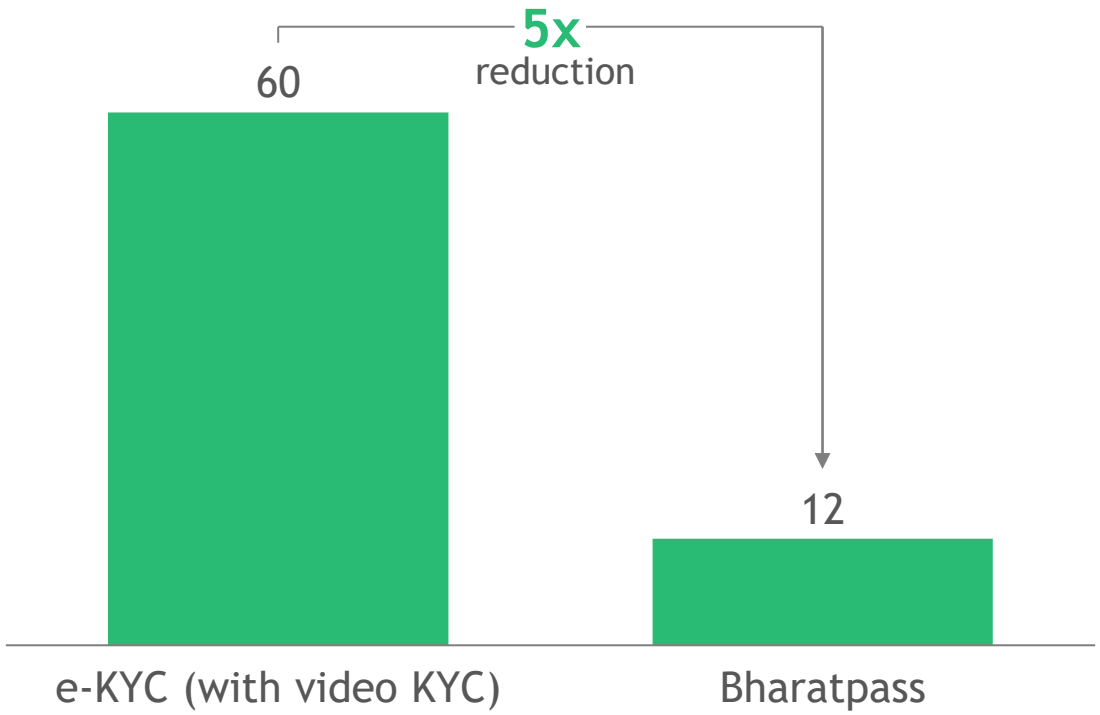
Aadhar has to be upgraded to allow facial recognition based identity verification along lines of Singpass in Singapore

Facial recognition based digital identity system (e.g., Singapore)



Public infrastructure like "Bharatpass" can dramatically reduce KYC cost

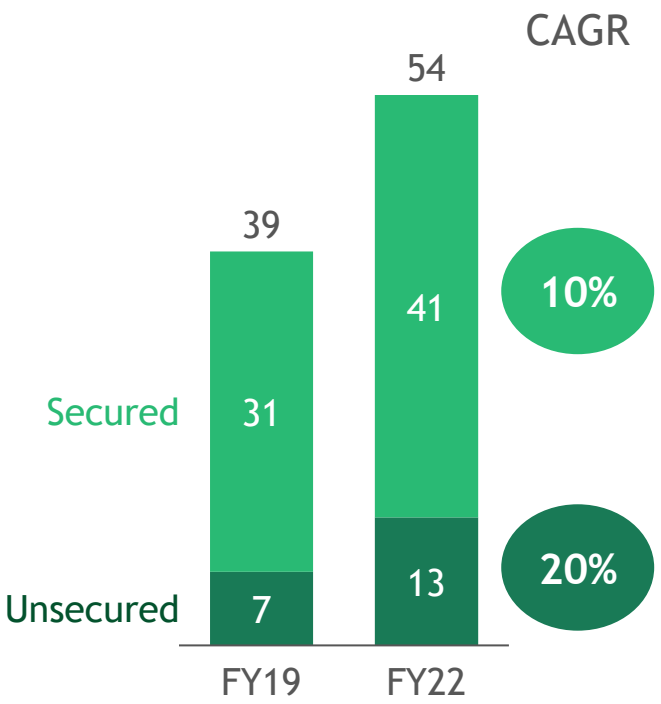
Effective all in KYC cost per customer (in Rs)



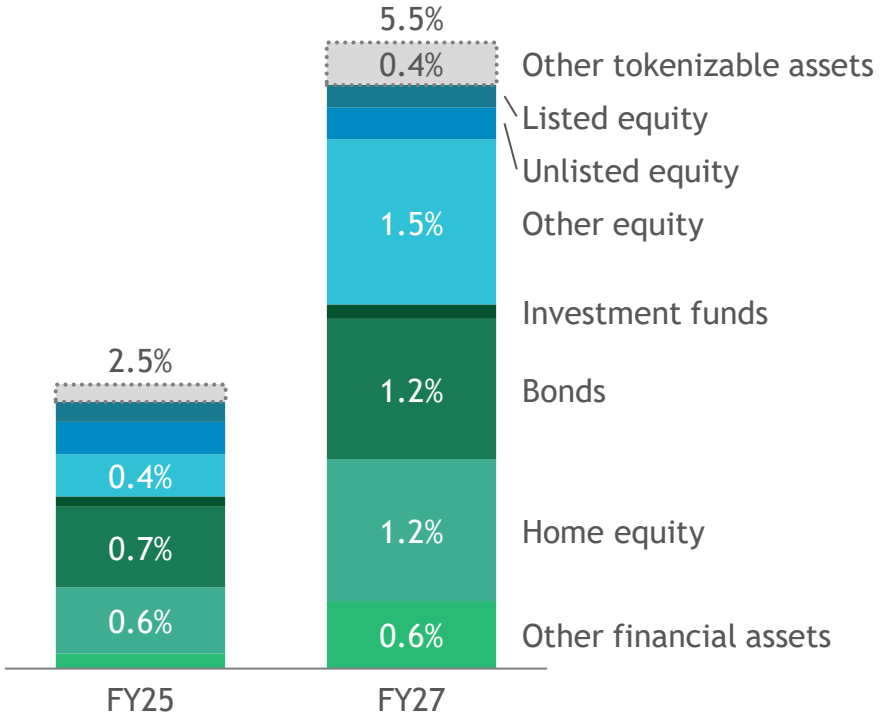
Source: Singpass website; cost estimates basis BCG analysis and expert interviews

India should embrace tokenization of real assets on blockchain to digitize secured lending in the same way as unsecured is today

Secured lending growing at half the pace of unsecured lending



Digital tokens of real assets to reach 5% of global GDP by 2027



Digital tokens to transform secured lending

2X

Growth in secured credit portfolio

60%

Reduction in COA

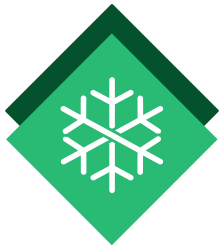
Note: Secured credit includes Auto, Gold, Commercial Vehicles, Commercial Equipment's, Property, Housing and Two-Wheeler; Unsecured credit includes Business, Consumer Credit Cards, MFI and Personal Loans
Source: CIBIL, FIBAC Trends and Benchmarks 2022; Relevance of on-chain asset tokenization in Crypto-Winter - BCG report; BCG Analysis

Banks should be supported by tax incentives for investments in innovation like other industries

India provides various benefits to few industries (including R&D)



Pharma



Cold Chain



IFSC

Globally research and development allowances are industry agnostic and allow to banks also

Non-Exhaustive

Tax Credits		Upto 20% of expense allowed as tax credit
		13% of expense allowed as tax credit
		5% to 30% of expense allowed as tax credit[1]
Lower Rates		64% lower tax rate on income from IP[2]
Higher Dedn		2.5x deduction of R&D spends

1. 30% below EUR 100 Mn and 5% portion exceeding EUR 100Mn 2. from 25.8% to 9%
Source BCG Analysis

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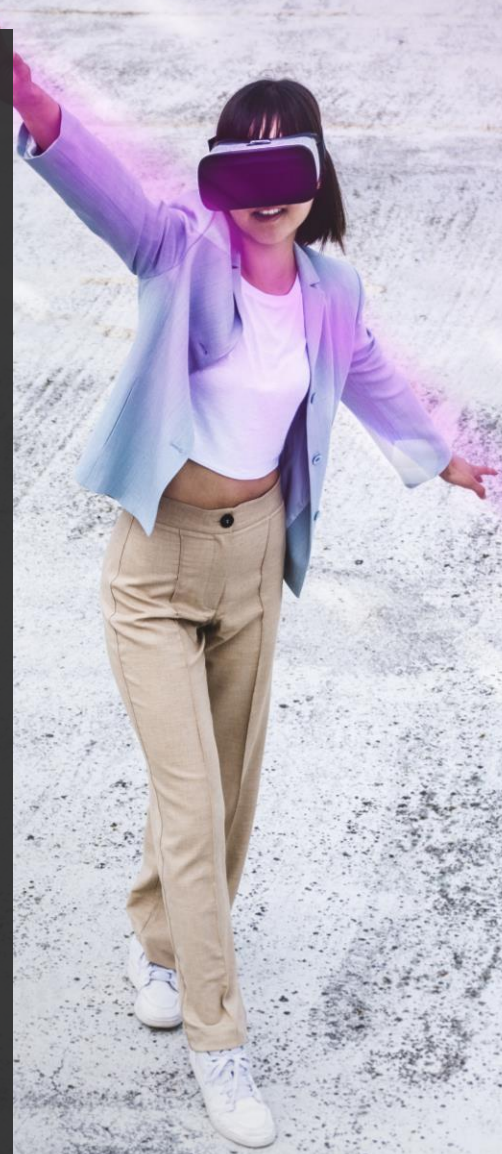
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