FIBAC 2024

BANKING FOR A VIKSIT BHARAT

September 2024



Executive Summary (1/3)

India is taking strides towards becoming a developed nation by the 100th year of independence. The agenda is ambitious – $30 Tn GDP by 2047. Experience with other economies show that the financial services sector will have to grow 20 times for achieving 10X growth in GDP.

India, being a predominantly bank-led economy, will require the banking sector to play an anchor role while the other financial asset classes continue to grow much faster. This will require $4 Tn of capital base in banks, 1/3rd of which will have to be fresh capital deployment. The banking sector will need to be stable, resilient and achieve sustainable profitability to enable this ambition. Extreme volatilities of the past cycles will set us back on this journey.

India's banking system is in a strong position today – characterized by high profitability, robust capital adequacy, and low levels of non-performing assets (NPA). This provides an ideal launchpad for the Viksit Bharat mission. On this path, the industry needs to work on five structural themes.

Deposits | Household behaviors are changing and becoming financialized. Savings are shifting from physical to financial assets – borrowings are shifting from informal sources to formal channels.

Within financial savings, we see a move from bank deposits to pension savings and capital market instruments. Retail lending (household borrowings) continues to expand. As a result, households are becoming net borrowers from the banking industry, driving pressure on margins and liquidity. However, financial assets and borrowings are significantly under-penetrated compared to several other large economies. There is massive headroom for growth.

Banks will need to reimagine the value proposition of deposits to drive sustainable growth. Innovation of legacy, fixed-rate deposit products is critical. Marketing and customer awareness is required to emphasize the benefits of bank deposits vs other asset classes and the inherent associated risks. New operating models are required – digitally assisted, low cost for low-income pyramid; advisory-led for affluent segments.

India has been trying to deepen the secondary debt market over the past few decades. There is still work required on this front. Banks will continue to play a primary role in funding large capex, infra, and borrowing across sectors. Some structural support can be given to banks to create new deposit pools by reducing the regulatory cost of carry. These pools can enable targeted lending towards specific economic priorities or focused growth sectors.

Asset Quality | Retail lending growth has been the crown jewel of the banking industry over the past two decades – stable profitability (low retail NPAs) while driving financial inclusion through formalized affordable lending for many households.

The shape of this growth is very different though. Unsecured lending has grown much faster. The unsecured to secured loan mix is 30:70 in India (vs. 10:90 for many large economies).

Executive Summary (2/3)

India has a large adult population outside the formal workforce (~90%), and hence largely outside the ambit of formal financing channels. India has quickly gone from being a data-poor to a data-rich country. Lenders will have to re-imagine the operating model and underwriting capabilities to serve this segment. India will need to chart its own course on driving retail and MSME lending penetration.

While overall NTC borrowing in retail lending has performed as well as near-prime and prime segments, there are select pockets where credit quality has deteriorated significantly – small ticket loans with borrowers aged less than 35 yrs have shown excessive leverage build-up.

Lenders have predominantly focused on predictive credit models in retail lending. With the incidences of early delinquencies (proxy for frauds) rising – primarily in younger age groups and for unsecured loans, fraud control needs to change from reactive, high-touch, and judgmental action.

Conventional behavior on default sequencing is being challenged. 1 out of every 4 defaulting customers with multiple loans is shown to default on a secured loan, even while being regular on an unsecured loan. This proportion is even higher for higher age groups. Secured lenders will need to calibrate collection efforts and credit costs in select segments.

The formalization and credit expansion of MSMEs is progressing at a massive scale. Reforms have increased the richness of MSME data footprint. 'Guarantee schemes' have pushed many MSMEs towards formal financing. Banks are unable to sustain lending relationships profitably. Lenders have an opportunity to leverage advanced analytics and reimagine MSME lending. If done well, it can become the profit driver for the next decade.

Productivity | India Stack has been a game-changer. This unique DPI[1] has laid the foundation for a strong and resilient financial infrastructure and accelerated the pace of digitization. This is already evident with payments and is now extending into product sales.

Over the past decade, costs have risen faster than income. This has been driven by a rapid increase in technology spends and is expected to continue rising faster. Globally, Banks have the highest spend on technology but are often not viewed as the most innovative. Indian banks are under-indexed in terms of IT investment, especially on transformative 'change-the-bank' programs.

Employee productivity gains have lagged cost increase. Private sector and Public sector banks have experienced different structures of employee cost vs employee headcount. Incremental productivity will not materially change the cost trajectory. Banks will need to boldly reimagine their operating model and break the 'sticky' legacy cost structure.

Digital Maturity | Leading Indian banks are in the league of the global best on digital maturity (Ranked amongst the Top 5). BCG's

1. DPI – Digital Public Infrastructure

Executive Summary (3/3)

proprietary benchmarking methodology[1] shows that on average, both Private and Public sector banks score better than global peers. The score reflects the quality of the customer experience provided by each bank on multiple parameters – product journeys, payment ease, marketing & personalization, money insights, etc.

Many banks need to invest in digital capabilities and bridge the gap with market leaders. India Stack has enabled the entire industry to be at par or better than the global best on payments and transaction efficiency. On several other dimensions, banks will need to monetize the digital opportunity – e.g., product fulfillment journeys, and money insights.

Future capabilities | The Indian banking system, under a watchful and proactive regulator, has made significant strides in building future-ready competencies. It's time to embrace the next wave of opportunities and build capabilities to thrive for the next two decades.

Resilience: Resiliency is not just an exercise for Technology, Risk, or Compliance but for the entire Business. It is not about the pursuit of adding 9s to the service levels of tech systems alone. Resilience is about the end-to-end view of a customer service or process. Knowing which services to be prioritized for resilience planning will help optimize cost. In a highly connected world, resiliency also needs to be planned beyond traditional boundaries covering partners, ecosystem players, and tech vendors.

AI & GenAI: Across FIs, there is an appreciation of the transformative power of AI/ GenAI. However, they are facing the 'GenAI paradox' – unable to scale up beyond POCs. It is deceptively easy to launch pilots with initial promising results. It is immensely hard to move and implement at scale. It will require activation of 'mission-mode' COEs[2] to address tech, talent, and regulatory challenges.

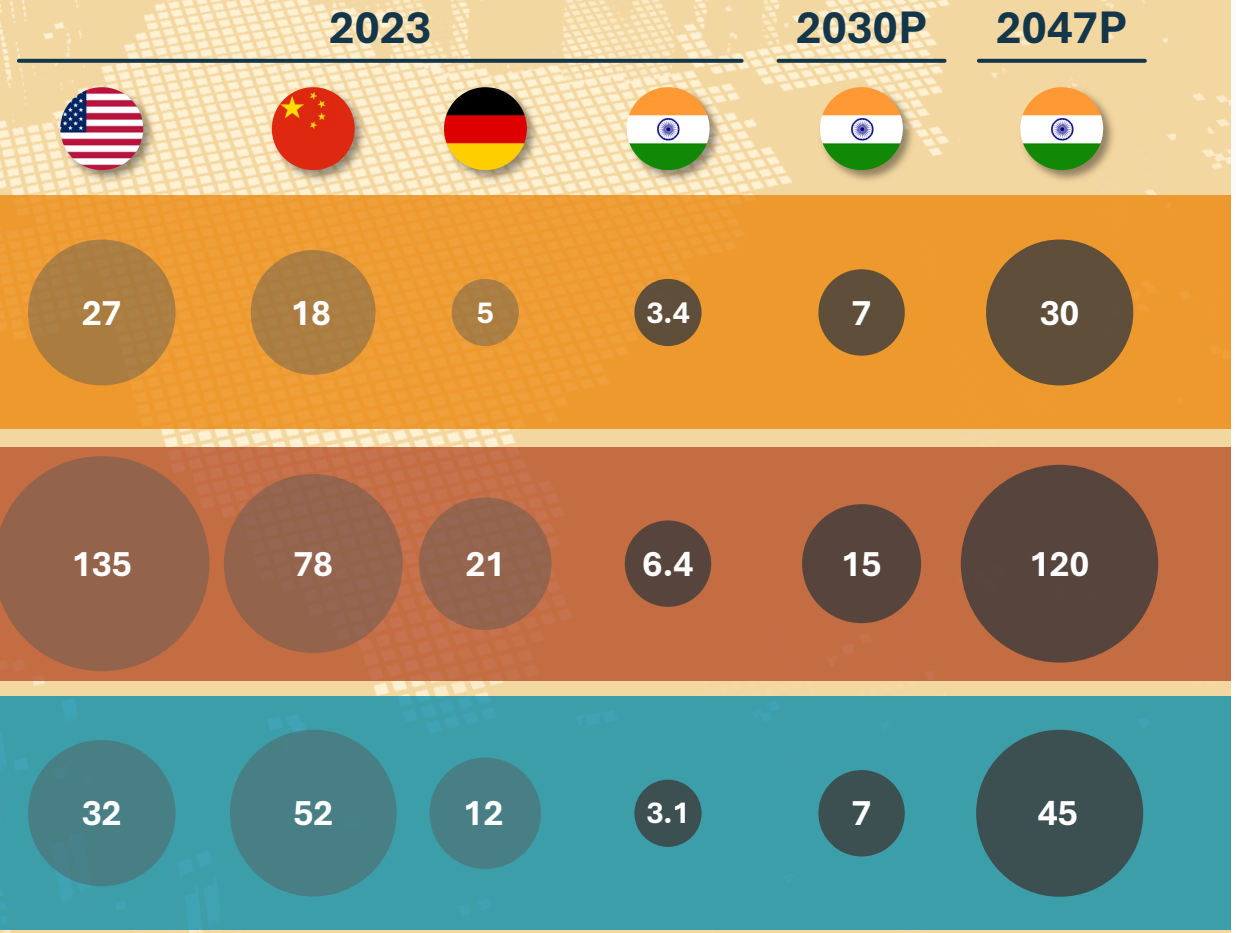
Climate Risk: 2 out of 3 banks consider climate-related risks as a material threat to their business. Climate change poses a dual-edged sword for Indian banks. There is a significant risk if timely action is neglected, with 53% of bank credit currently allocated to climate-vulnerable sectors, and, missing out on a $2.5 Tn financing opportunity. 60% of climate finance will assist the transition of small businesses. Banks need to change their operating model to cater to this opportunity.

Cyber Risk: India is the 2nd most targeted country in APAC on cybercrimes – with an expected negative impact of ₹1.6 Tn over the last two decades[3]. There is a need to create a centralized, real-time network for banks to coordinate and mitigate cyber-attacks while building specialized talent to patch systemic vulnerabilities.

Conclusion | While India's banking sector has made significant strides, achieving the Viksit Bharat mission will require sustained momentum. Regulatory and government action will further play a critical role in accelerating these efforts. The banking sector's success is instrumental in making India a developed nation.

1. BCG's Proprietary Mobile banking benchmarking methodology (InQbate) 2. Center of Excellence 3. Check Point report

Viksit Bharat: Stable, resilient Financial sector a pre-condition to 2047 mission

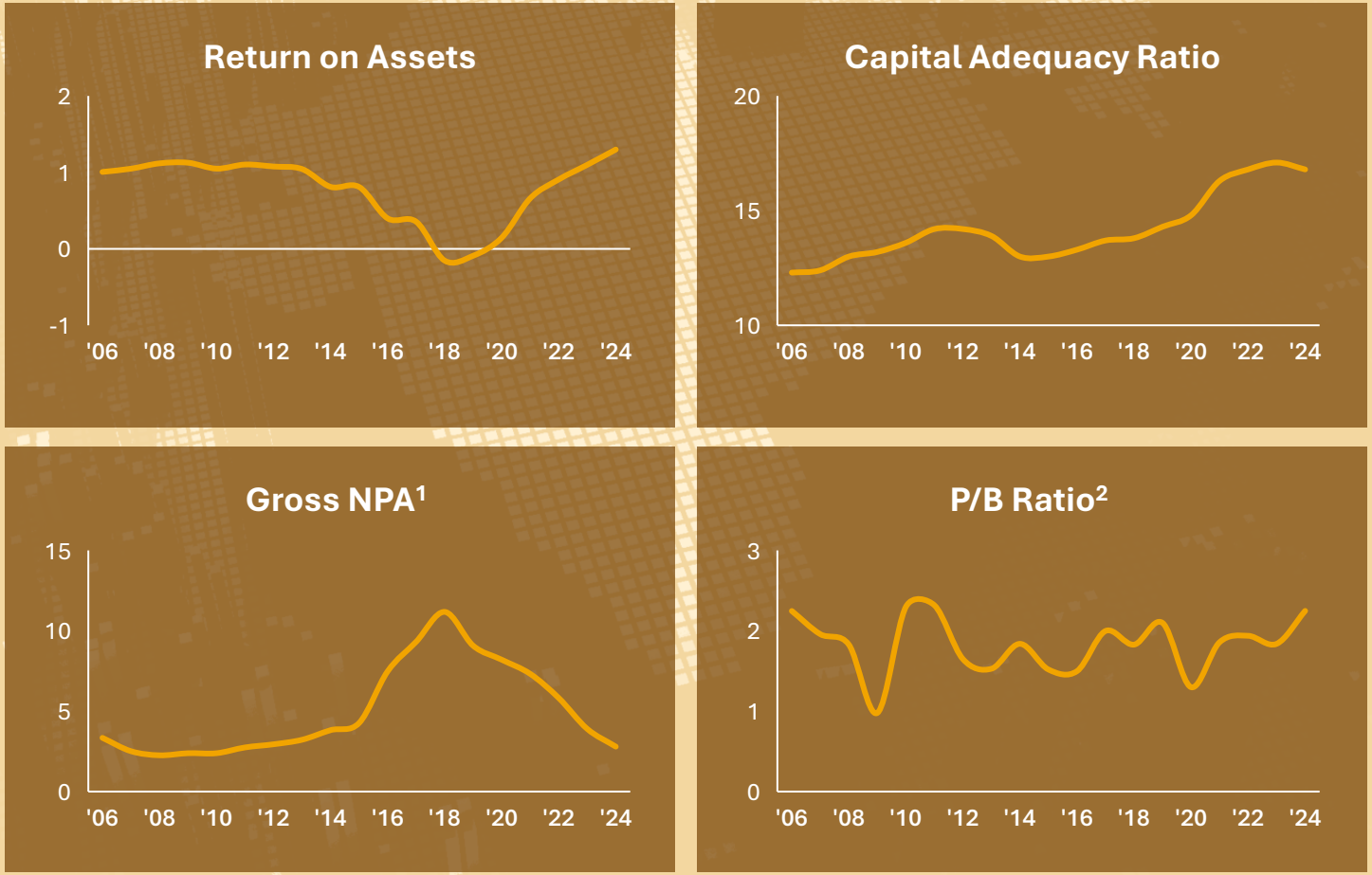


1. 2023 numbers for US, China, and Germany basis 2022 Financial Stability Board report
Sources: RBI; Financial Stability Board; World Bank; Federal Reserve; Bundesbank; BCG analysis.

India is taking strides towards becoming a developed nation by 2047 – the 100th year of independence. This calls for **consistent, sustainable economic growth** with a systemic capacity for resilience. The financial sector and assets will have to scale up much more rapidly to achieve this aspiration. For GDP to grow to 10x, **financial assets need to become 20x.**

This will require a vibrant and profitable financial services sector that can attract high-quality capital. India's banking industry will need to add **$4 Trillion in capital** in the next 2 decades; which will in turn create the multiplier effect for the economy to reach $30 Tn GDP by 2047.

Indian Banking sector's current strength an ideal launchpad for Viksit Bharat vision



1. Gross non-performing assets as % of total advances 2. Price to book value ratio of top 20 Indian Public sector and Private sector banks by assets
Sources: RBI; Capitaline.

India's financial system is currently the world's envy – **profitability, capital adequacy, and NPA levels are the best in over a decade** in addition to strong shareholder returns.

There is no better time than now to **reimagine and rebuild capabilities** that can support India's journey to Viksit Bharat. Delay or inconsistent action will be detrimental to 2047 vision.

India's financial sector will need to **future-proof its business model** to thrive and become more resilient, steering clear of extreme volatilities of the past cycles. An ambitious agenda needs to be set in place for the next two decades.

On the path to Viksit Bharat, Banks need to work on five structural themes



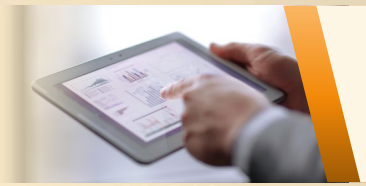
1 Deposits

Households are turning net borrowers from the banking industry, driving higher pressure on margins and liquidity.



2 Asset Quality

Indian banking charting own course on retail and MSME credit. Leverage build-up and potential fraud behaviors are increasing rapidly in select segments.



3 Productivity

Over the past decade, costs have risen faster than income. Productivity gains have lagged cost increases. Tech and compliance costs are expected to continue rising.



4 Digital Maturity

Select Indian banks are in the league of the global best. Overall, banks need to capitalize on the opportunity presented by India's world-class DPI[1].



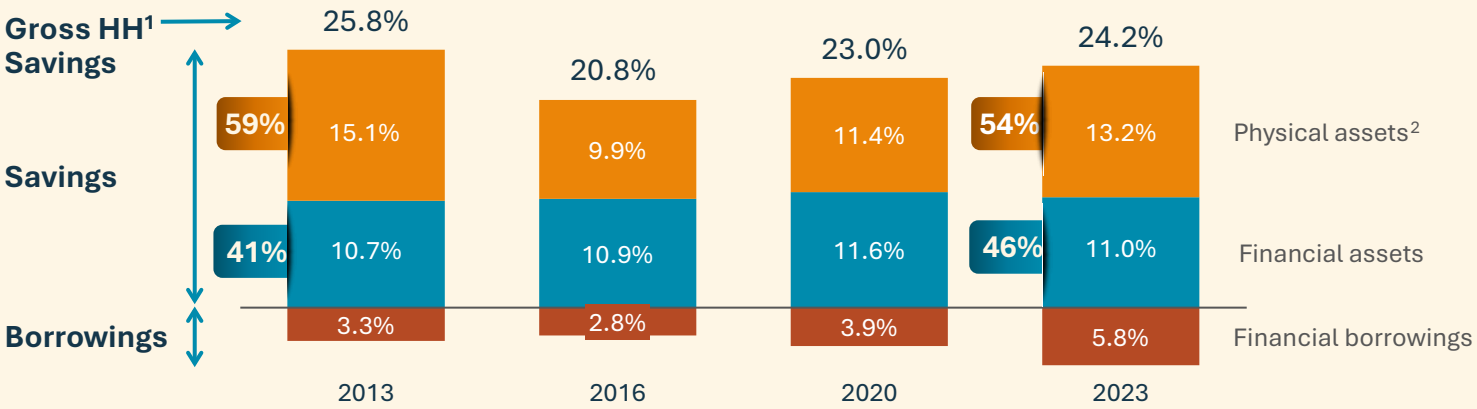
5 Future Ready Capabilities

Banks need to fully embrace future capabilities such as Operation & Tech Resilience, ESG, AI & GenAI.

1. DPI – Digital Public Infrastructure

Household savings becoming financialized, yet under-penetration remains

Household Savings & Borrowings: Flows as % of GDP



Household Savings & Borrowings: Stock as % of GDP

Data as of 2023	India	USA	UK
HH Financial assets/ GDP	**103%**	441%	217%
HH Financial borrowings/ GDP	**38%**	76%	83%

India's path towards becoming the 3rd largest economy depends on **channeling household savings** into productive assets and use. There is a **shift of these savings into the financial system** (vs real-estate, precious metals) and households are **becoming part of mainstream banking.**

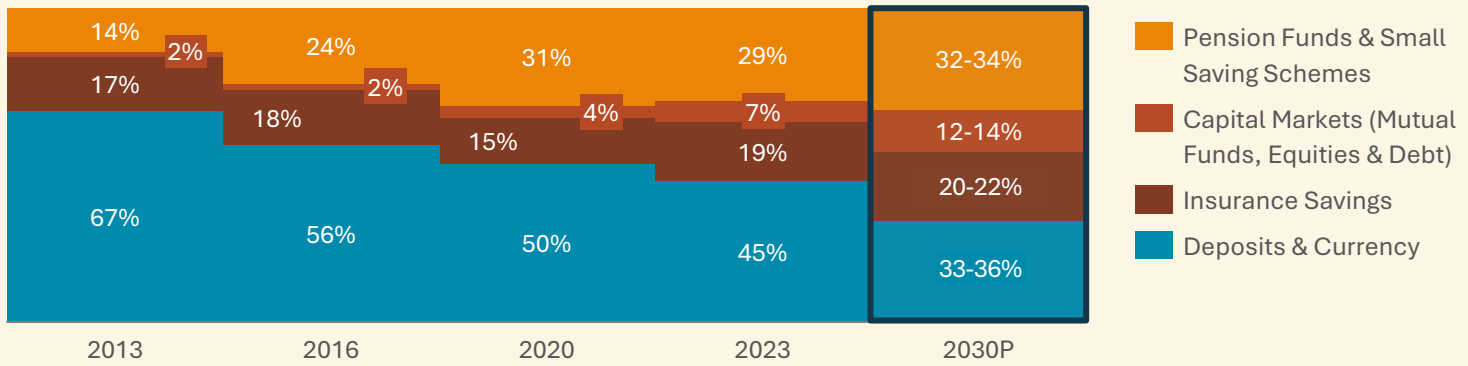
One of the starkest changes to have happened is the **doubling of formalized borrowings for households**[3] – largely due to the success of retail bureaus in the past two decades.

Despite these tectonic shifts, financial **assets and borrowings continue to be significantly under-penetrated** compared to other large economies.

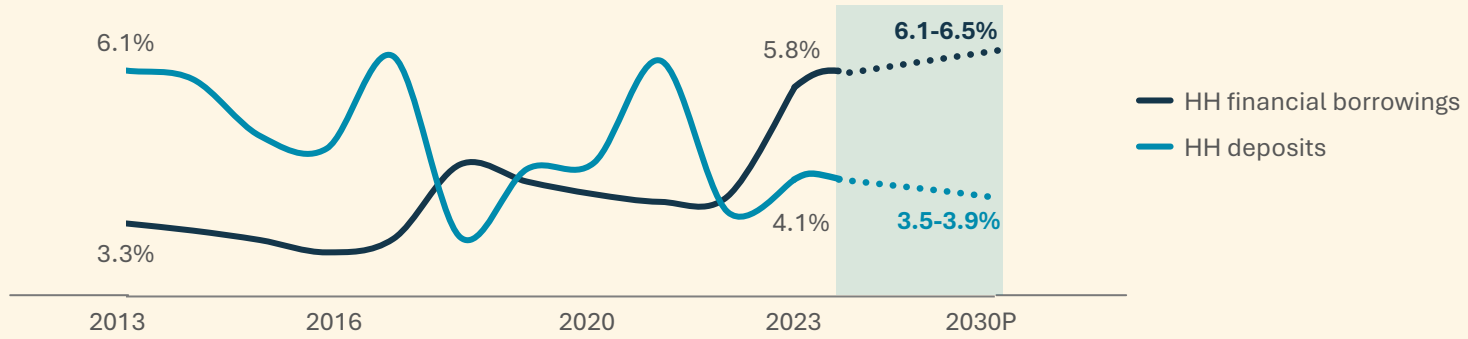
1. HH – Household 2. Physical assets include savings in gold and silver ornaments 3. Retail loans doubled in 5 years; growing 7% faster than overall credit
Sources: RBI; MoSPI; IMF.

Households have turned net borrowers from banks

Household Financial Savings: Annual allocation across asset classes



Household Savings (Deposits) & Borrowings: Annual flows as a % of GDP



1. 10-year weighted average (SA+TD Individual) returns in the last 10 years is ~5.1% annually while average inflation has been 5.2% annually for the same period

Sources: MoSPI; RBI; NSE; AMFI; NPS Trust; Tracxn; BCG analysis.

The "simple" household saver who for decades had put up with **negative real returns** from bank deposits[1] has tasted blood. Bank deposit share of financial savings has reduced from 2/3rd to less than half – and could soon shrink to a third of gross savings.

These savings are being funneled into **pension & savings schemes** (as India becomes older) and **capital markets** (for long-term wealth creation) resulting in a **deposit shortage** for banks in the traditional customer base.

India's unique digital public infra and fintech have made investments extremely convenient & frictionless – **5x rise in demat accounts** in 10 years, **3x rise in SIPs** in 5 years, **3x rise in NPS accounts** in 5 years & 3 WealthTech Unicorns.

For **Banks**

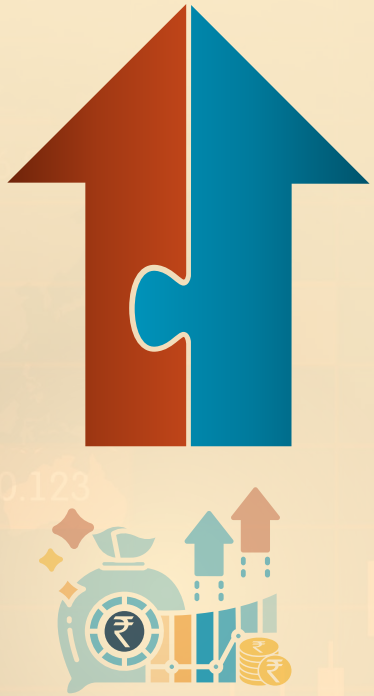
Significant re-imagination of value proposition

Enhance offerings: **Innovative Products**
Create innovative **deposit offerings** (e.g., market linked, G-sec based, flexible deposits) to help retain a large pool of household deposits in search of higher returns.

Enhance marketing: **Customer education**
Undertake information campaigns on the safety & stability of bank deposits vs capital markets (Incorrectly equated as "risk-free asset class" in today's environment).

Expand coverage: **Bottom of the pyramid**
As India's per capita income rises, a large base of the population will get added to formalized channels – a **low-cost, digitally assisted model** is required to serve this segment.

Expand Segments: **Serve the upper pyramid**
Reinvent the advisory model to holistically serve the HNI, and Wealth segments. Banks will need to curate bespoke offerings (e.g., estate planning, and alternate investments).



Implications

For **Economy**

Need structural interventions

Deepening of Alternate Credit Assets
HH **savings** need to be channeled **into debt securities** – creating a viable option for institutions.

Debt asset penetration is significantly lower in India (Bonds as % of GDP[1] - 16% vs US: 44%, UK: 92%).

Specialized credit vehicles (like REITs/InVITs) are required to provide long-term debt funding beyond banking. (REITs in India at 13.7% vs 98.9% in the US)[2].

Private credit is becoming prevalent in mature financial systems (3%+ of GDP in North America).

In the interim, savings mobilization will need to continue being bank-led.

Structural change to create new deposit pools
Regulatory support is required to create new deposit pools that are attractive to customers. Certain **long-term deposits** (e.g., Green, Infra) can be **made exempt from regulatory carry costs** (e.g., CRR, SLR, PSL) and provide higher customer rates. This can solve the structural issue of mobilizing funds to priority sectors.

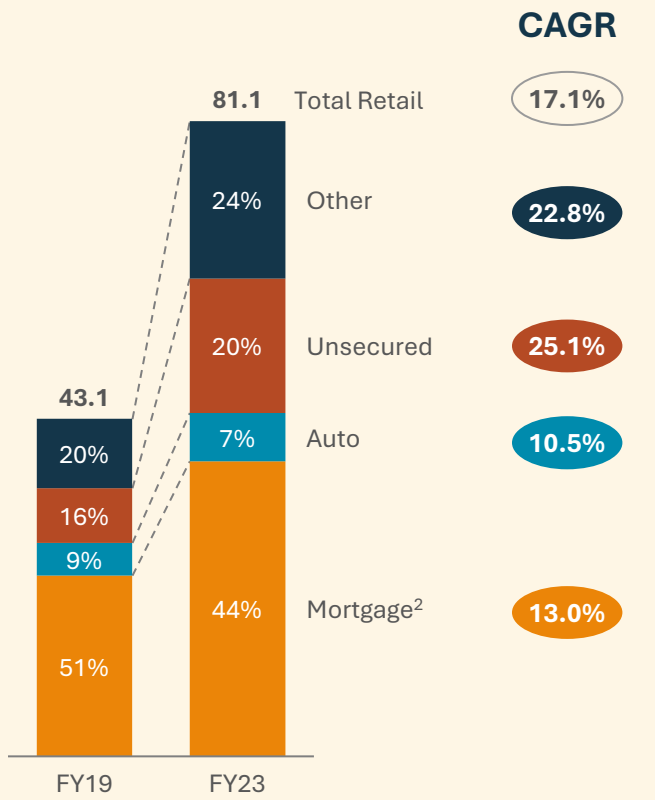
1. Outstanding value of bonds issued by financial and non-financial corporations (Government excluded) 2. Of listed real estate
Sources: SEBI; USA-Federal Reserve; IMF; IBEF; Oxford Economics.

Credit insights Partner: **TransUnion CIBIL**

Retail lending: Indian banking's crown jewel

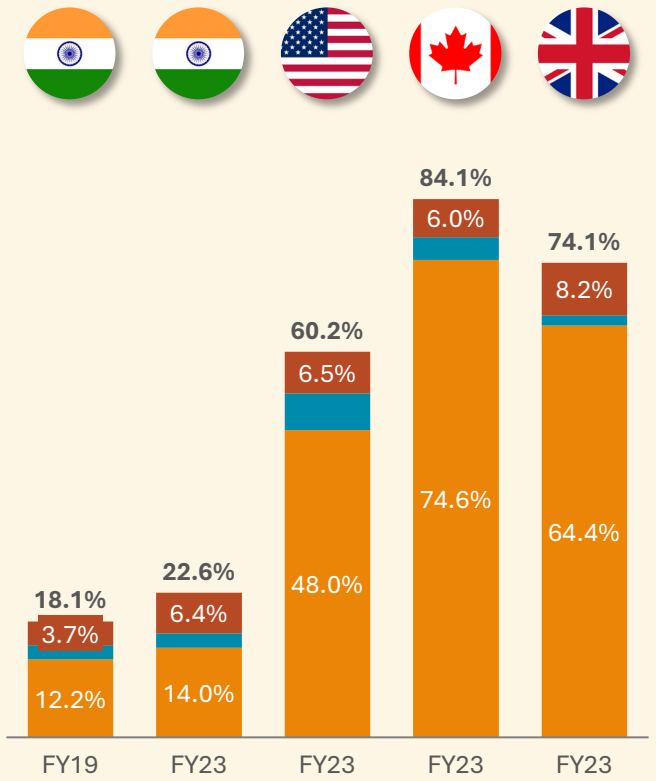
India: Retail lending[1] profile

(in ₹ Tn)



Global: Distribution of lending

(as a % of GDP)



1. Agri and Kisan Credit card excluded 2. Includes housing loans and LAP 3. Unsecured loans include Personal loans, Credit card, Consumer durable, Unsecured lines of credit; Secured – Auto & Mortgage loans

Sources: TransUnion CIBIL; US Federal Reserve; Bank of Canada; Bank of England; FIBAC 2023 Benchmarking report; BCG analysis.

Retail lending growth has been a huge success for the banking industry over the last 15 years – formalizing affordable lending for a large number of borrowers, maintaining low NPA levels aiding stable profitability for banks.

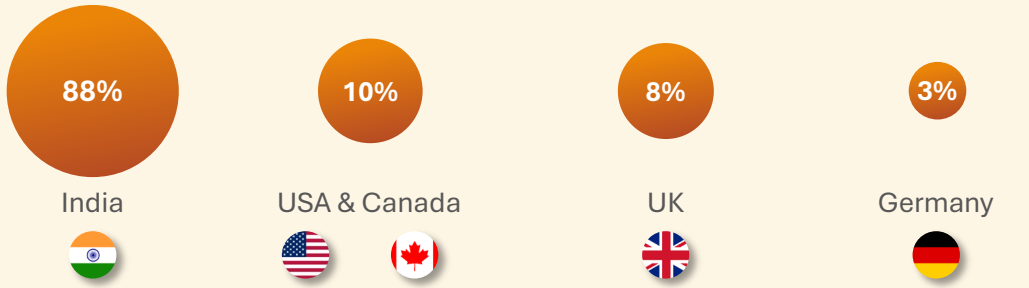
However, the shape of the credit **growth is starkly different from the rest of the world.** The mix of unsecured to secured lending[3] in India (30:70 vs 10:90 for the US, 7:93 for Canada, and 10:90 for the UK) has reached significantly high proportions and is still the fastest growing segment of retail credit.

India needs to chart its own course for retail growth. Large, un-penetrated base of customers will start their formal credit journey in the next two decades – banks will need to be ready to serve them.

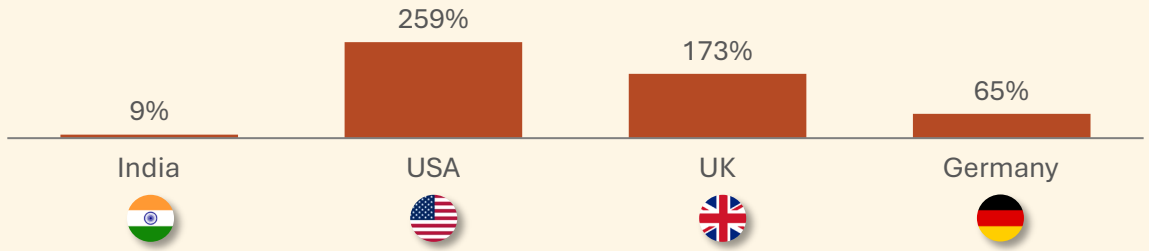
Credit insights Partner: **TransUnion CIBIL**

Need to craft India's unique small credit journey

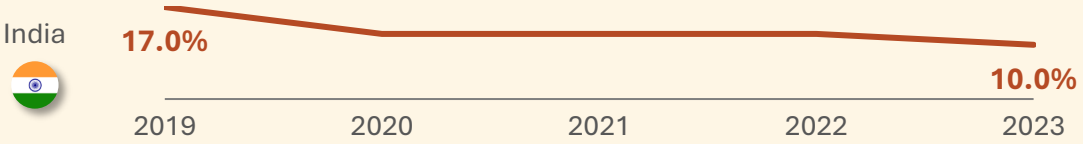
Informal employment
Proportion of informal force to total (2023)



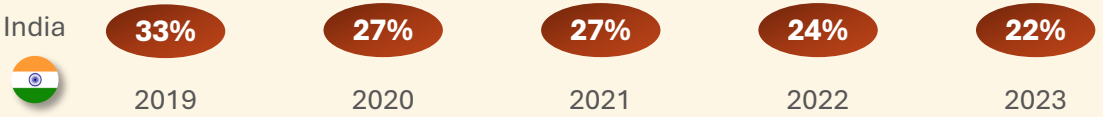
Unsecured lending penetration[1]
Retail loans as % of working population (2023)



Share of NTC borrower (%)
For all unsecured loans origination[2]



NTC loan approval (%)
Of all unsecured loans requests[2]



1. On count taken – Considering Personal loans & Credit cards 2. Considered Personal loans, Credit card & Consumer durable loans
Note: UK and Germany taken basis Taxation on Informal Economy in EU report (2022)
Sources: TransUnion CIBIL; ILO; RBI; BCG analysis.

India has a large, informal workforce with 50%+ labor dependent on agri & allied activities. **Formal credit penetration is still low.** As India becomes developed, per capita incomes will rise and push large number of this workforce to formal banking for the 1st time.

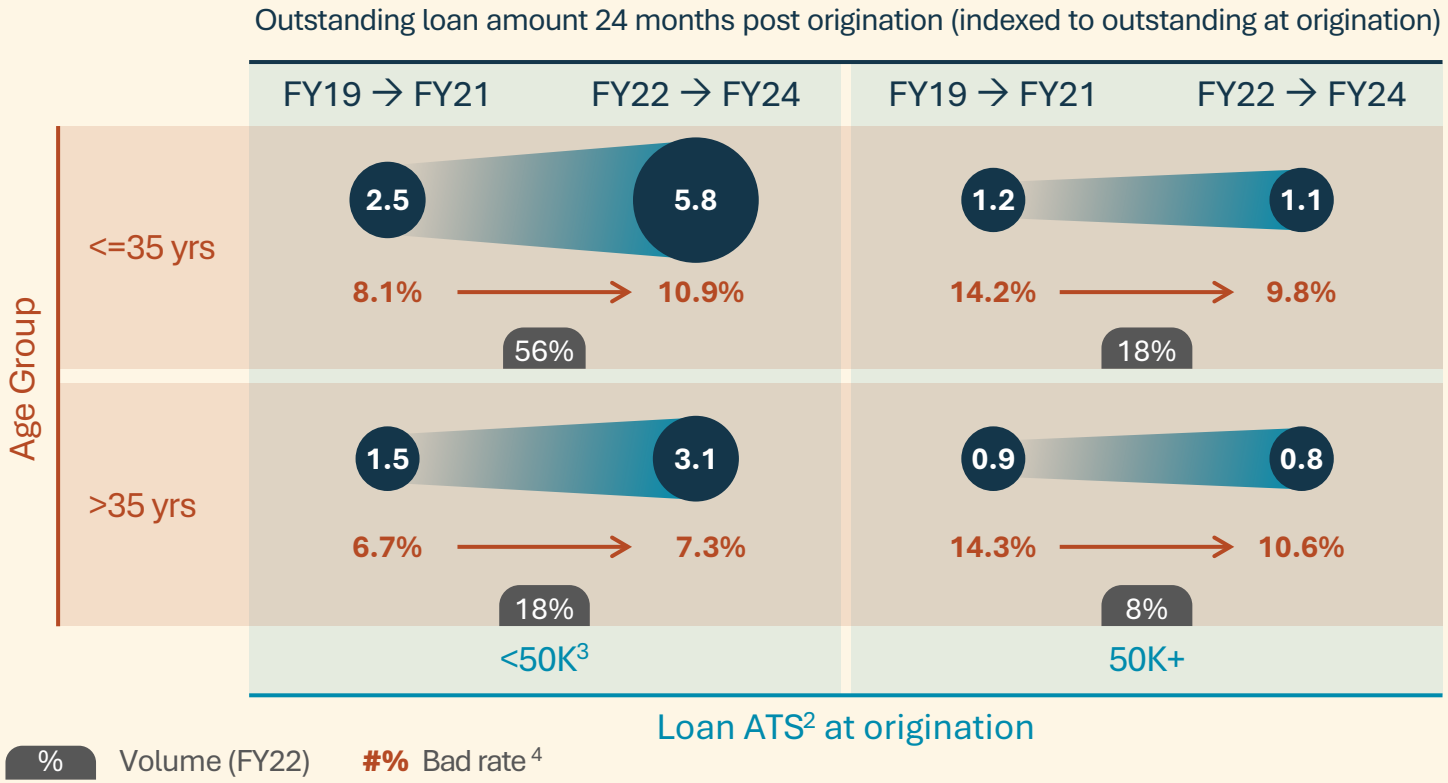
This segment has large, unmet need and will undertake a different credit path. Secured credit will not be their starting point. Mortgages have their own challenges in the real economy (e.g., clean title, charge creation).

Unsecured lending penetration needs to rise substantially (from 9% currently) for financialization of the lower-income pyramid. However, NTC lending is showing signs of a slowdown (low share with declining approval rates). **The economy will require a large share of small-ticket, NTC lending to proliferate.**

Credit insights Partner: **TransUnion CIBIL**

Leverage build-up in pockets among NTC customers, higher defaults observed

Amongst new-to-credit (NTC) borrowers, leverage build up[1] is prominent in younger age groups with small-ticket loans



1. The numbers in bubbles represent the outstanding loan amount 24 months post origination (indexed to outstanding at the time of origination) 2. ATS – Average ticket size 3. <50K loans account for 28% by value 4. Bad rate on volume – Ever 90+DPD within 24 months
Note: Analysis done for Consumption loans & Two-wheeler loans. Consumption loans include Personal loans, Credit cards, Consumer durables loans
Sources: TransUnion CIBIL; BCG analysis.

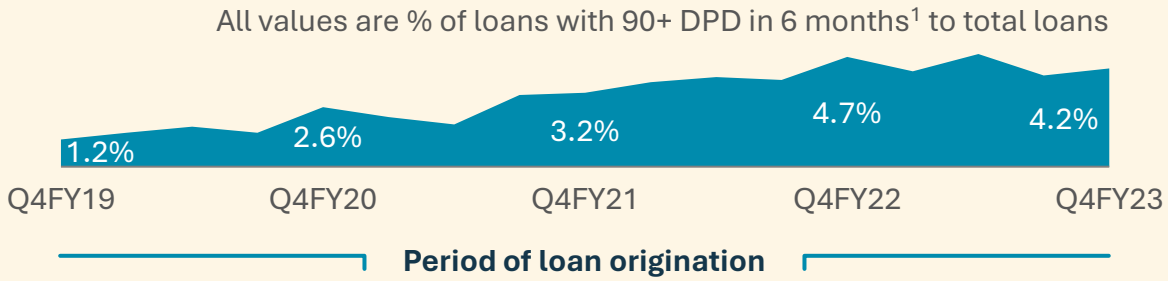
Sequential credit build-up is happening with customers that were outside the formal lending network. The leverage build-up starts with **small ticket sizes, short tenors, and rapid upgrades** to larger ticket sizes.

Overall NTC portfolio delinquencies are comparable with prime segment. However, there are **select pockets where credit quality has deteriorated.** Small tickets loans and borrowers less than 35 yrs have shown significant leverage build-up relative to the rest of the industry.

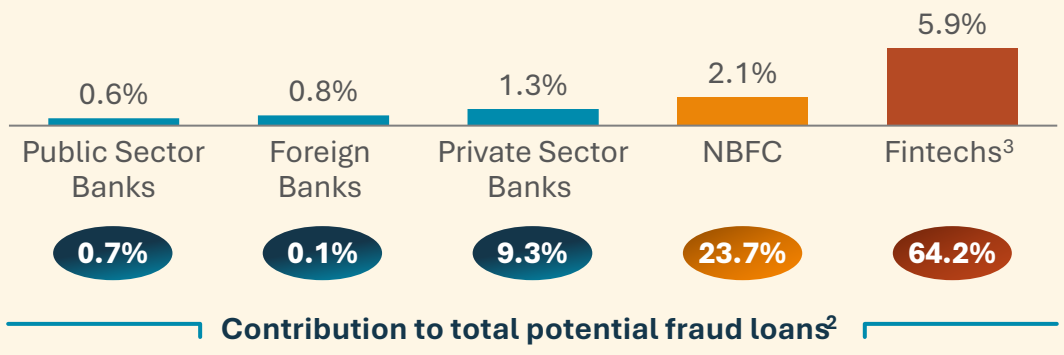
Credit Insights Partner: **TransUnion CIBIL**

Spike in early delinquency suggest a need for higher focus on application fraud control

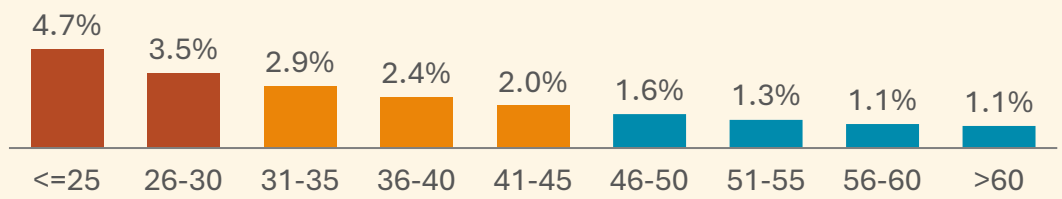
Early delinquency volumes over time *(Proxy for fraud)*



Early delinquency volumes by lender[4] *(Proxy for fraud)*



Early delinquency volumes by age[4] *(Proxy for fraud)*



1. Early Delinquency: 90+ DPD in 6 months is taken to determine applications with potential fraudulent behavior 2. Others (SFBs, Co-operative banks etc.): 2% of frauds 3. Non-bank digital lenders offering diverse financial solutions. E.g., Navi, Capital Float 4. Average data taken from period Q1FY19 to Q4FY23
Note: Analysis done for Personal loans, Credit card, Consumer durable & Two-wheeler loans.
Sources: TransUnion CIBIL; BCG analysis.

The retail credit penetration has predominantly focused on predictive credit risk models. While fraud control units exist, the **analytical rigor of typical lenders is usually reserved for credit risk.**

Thus, fraud control efforts are limited to **high-touch, judgmental, or rule-based investigations.** At times, it is reactive and involves post-disbursement hindsight.

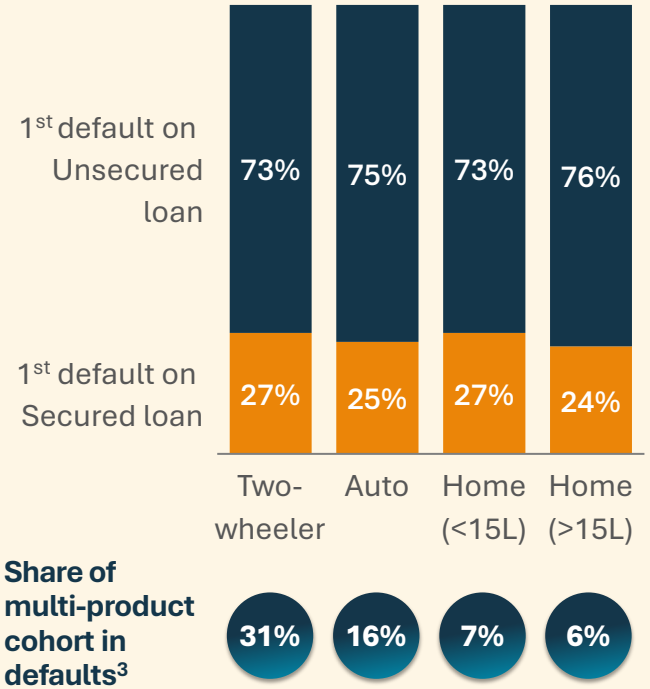
Limited sophistication in fraud risk management has seen a rising trend of delinquencies which may have an element of application fraud. Moreover, by most indications, loan applications with traits of potential fraudulent behavior may have **loss levels** that are more likely to be **underestimated** than overestimated.

Credit Insights Partner: **TransUnion CIBIL**

Secured asset lenders need to calibrate default expectations

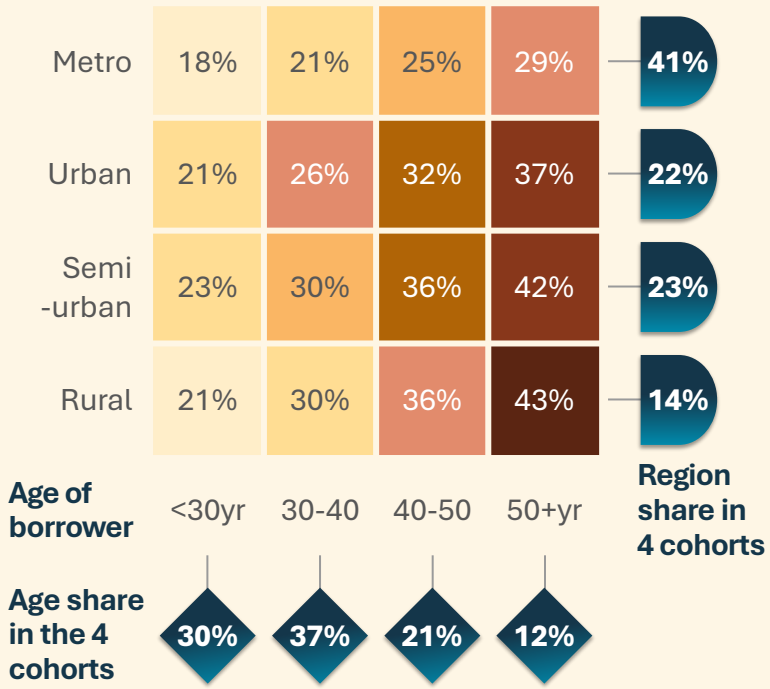
1 in 4 defaulting borrowers[1] with multi loans, default first on secured loan

% customers[1] defaulting first on unsecured[2] vs secured loan



Behavior more pronounced in higher age groups and non-metro geographies

% customers defaulting first on secured loan (On the 4 multi-product cohorts[4] considered)



Conventional belief on default sequencing is being challenged as leverage build-up increases and the customer base becomes more diverse. Secured lenders will need to **calibrate collections efforts** and eventually **credit costs** in select segments.

Of the customers who have defaulted and have both secured and unsecured loans, **1 out of every 4 customers is shown to default on a secured loan, even while being regular on unsecured loans.** This proportion is much higher in older age groups.

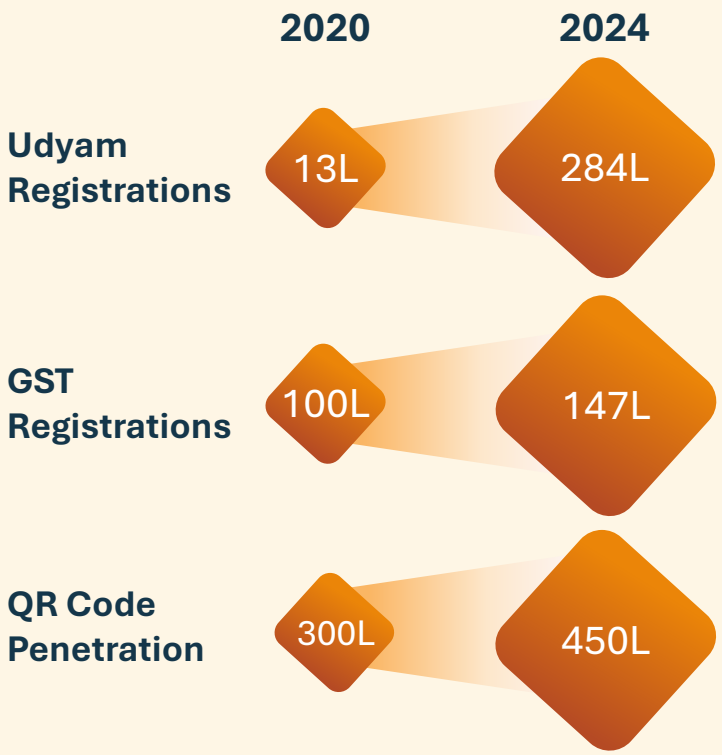
This trend is playing out across lender categories and there does not seem to be significant difference in customer behavior between NBFCs and banks.

1. Among customers having both secured and unsecured loans and have defaulted at least on one loan 2. Unsecured loans includePersonal loans, Credit cards & Consumer durables loans 3. Among customers with multiple product holdings at the time of default 4. These four cohorts are the ones mentioned in the left chart
Sources: TransUnion CIBIL; BCG analysis.

Credit Insights Partner: **TransUnion CIBIL**

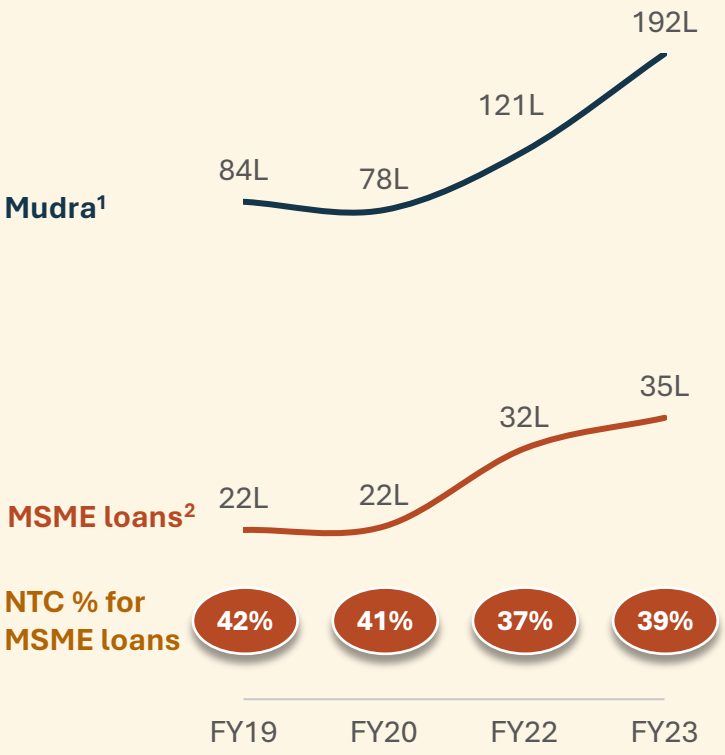
Formalization of MSMEs and credit expansion progressing at a massive scale

MSME formalization: Ecosystem data footprint on the rise



MSME lending: Annual originations expanding rapidly

(# of loans)



1. Tarun & Kishore Mudra origination loans with ticket size of > 50K 2. Some banks may have included Mudra in MSME loans, distinction not available
Note: FY21 is removed on the right chart due to COVID impact; Origination does not include renewals
Sources: TransUnion CIBIL; Udyam Registration; GST Council; RBI; BCG analysis.

MSMEs will be the critical workhorse to India's 2047 Mission and Aatma-Nirbhar journey. They are expected to contribute **50% of GDP** by 2030, employ **~150 Mn** and account for **60% of India's exports.**

Access to formal financing remains a challenge. Several reforms have increased the **richness of the MSME data** footprint (Udyam, QR codes, UPI payments, GST, etc.). **Guarantee schemes** (CGTMSE, CGFMU, etc.) have facilitated a large number of MSMEs to move towards formal financing.

Public sector banks are leading the way in NTC additions (50%+ of NTC loans), while Private sector banks issued 20% of the NTC loans over the last 5 yrs.

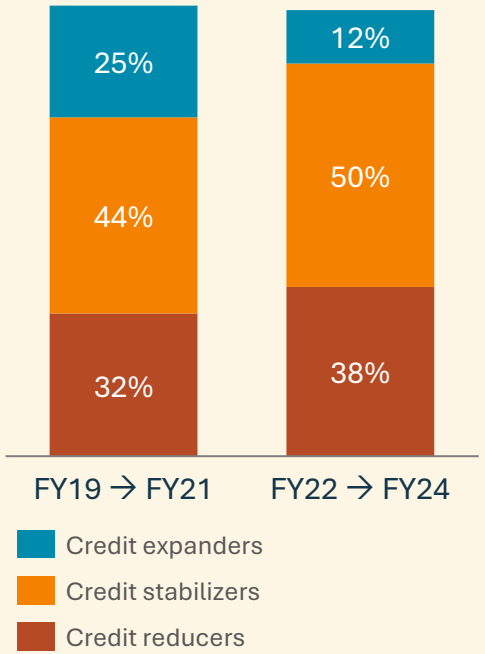
Lenders have an opportunity. If done well, MSME can be a very **profitable segment.**

Credit Insights Partner: **TransUnion CIBIL**

MSME NTC lending is complex; underwriting standards need to be strengthened substantially

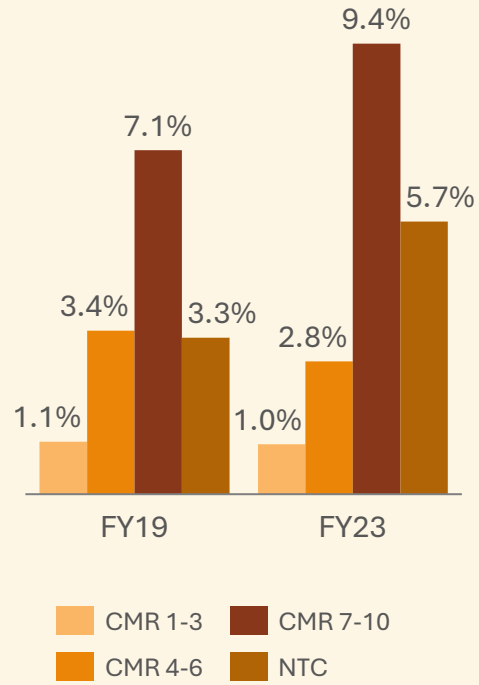
NTC accounts with credit expansion declining

Distribution of a/c status 24 months post origination



Bad rates for NTC MSME customers has increased

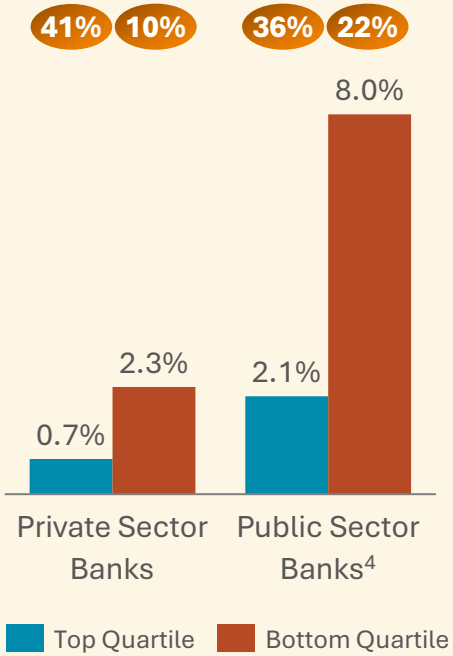
Bad rate[1] over time



Wide variation in NTC portfolio across banks[2]

Bad rate[1] (FY23)

Volume share in originations[3]



1. Bad rate: Ever 90+DPD within 12 months on volume 2. Top quartile and bottom quartile banks are taken basis bad rate; Average of 4 years is used to determine banks falling in these categories 3. Of originations within respective lender segment (Private and Public sector banks) 4. Delinquent portfolio adjustment done on very small ticket loans Note: Origination does not include renewals

Sources: TransUnion CIBIL; BCG analysis.

MSME lending continues to be challenging. It requires lot more effort and advanced underwriting capabilities. The stark difference in NPA levels among lenders is attributable to these capabilities.

Despite the increasing formalization and data footprint, banks are **unable to sustain lending relationships** profitably. Opportunity for lenders to use data (bank statements, tax, payment gateway data, etc.) to completely reimagine MSME lending.

Lenders that have got this right are performing significantly better than their private or public sector peers.



Implications on Retail & MSME lending

1. Need **massive expansion of small ticket loans** to rapidly increase credit penetration.

2. Lenders need to **embrace the full power of data** with advanced AI and ML models to be able to expand credit in a sustainable manner.

3. As digital lending increases, **fraud detection capabilities need** to evolve – it needs to be more pro-active driven by patterns analytics, and unified through common industry protocols/ utilities.

4. Collections function across lenders need to be transformed – fraud analytics, sharper risk segmentation, and collections personalization are required to **optimize the 'Cost and Loss' equation.**

India's digital public infra has unleashed rapid digitization in banking services

India Stack: Digital Revolution

Application Layer (OCEN)
- **17+** lenders
- **10+** loan agents
- **6+** Tech service providers

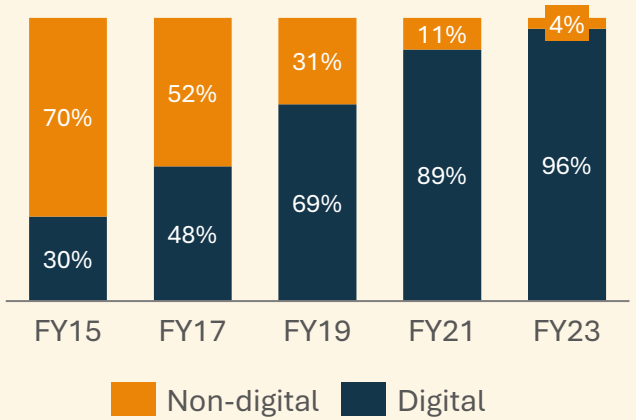
Data Layer (Account Aggregator)
103Mn+ customer data pulls done in 3 years

Payments Layer (UPI)
131Bn+ transactions *(80% of all digital payments)*

Identity Layer (Aadhaar)
- **1.3Bn+** Aadhar cards (95% adoption in 10 years)
- **500Mn+** Jan Dhan a/cs

Transactions have shifted to digital

Split of financial transactions[1] (by Volume)



Digitization of sales underway

28% Savings accounts opened digitally

40% Personal loans disbursed digitally

14% Other loans disbursed digitally

1. Financial transactions do not include cash transactions at branches; Digital transactions include UPI, Mobile Banking, Int ernet Banking, NACH, and POS; Non-digital transactions include Cheques and ATM

Sources: RBI; India Stack website; Govt. press release; FIBAC data; BCG analysis.

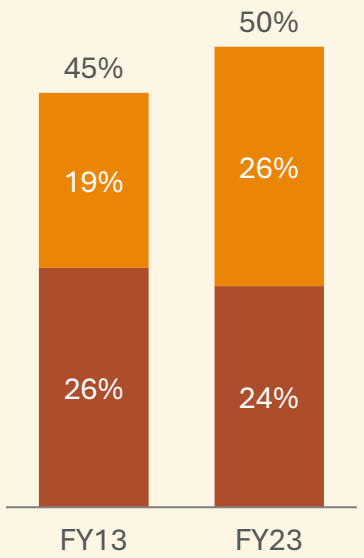
India Stack has been a game-changer. This unique framework has laid the foundation for a strong and resilient infrastructure, which has significantly **accelerated the pace of digitization within the banking sector.** This is evident with payments and is now extending into product sales.

The Digital Public Infrastructure has set the stage for Indian financial institutions to lead the way in global innovation across various sectors, from payments and lending to digital identity and financial inclusion. This has made operations efficient for banks and convenient for customers.

Costs rising faster than income

Cost Income Ratio

Industry Value

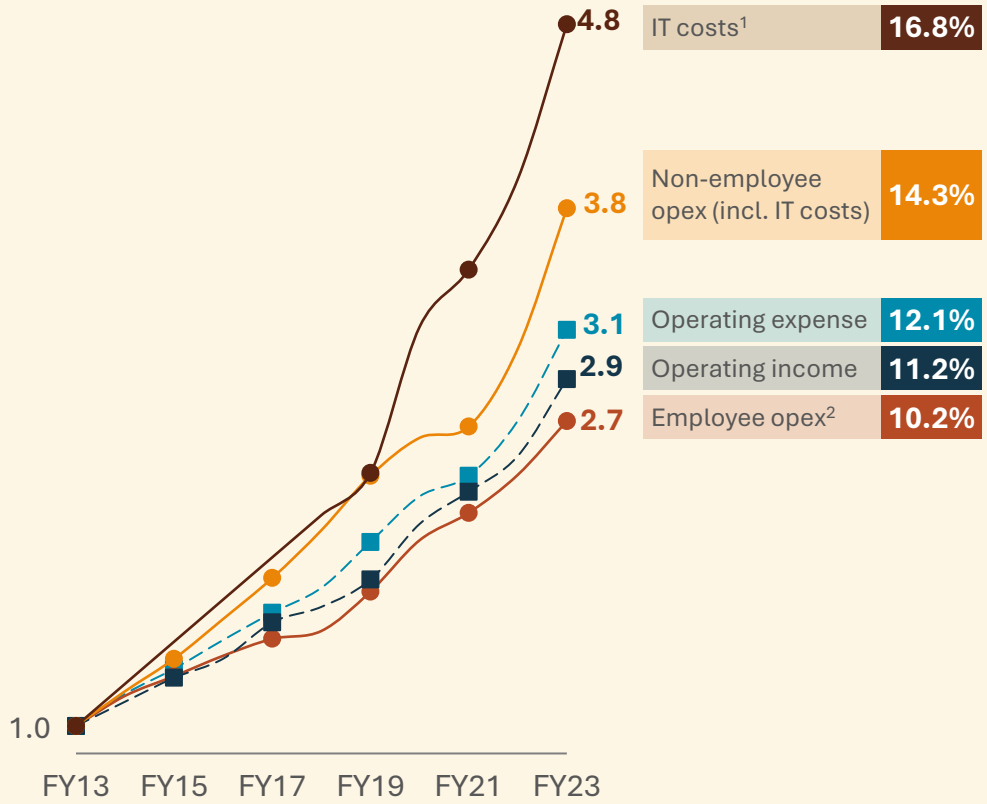


Non-employee costs

Employee costs

Operating income vs Operating expense

Indexed to 2013



	CAGR
IT costs[1]	16.8%
Non-employee opex (incl. IT costs)	14.3%
Operating expense	12.1%
Operating income	11.2%
Employee opex[2]	10.2%

Over the past decade, the banking industry's **cost-to-income ratio** has consistently **increased** despite technology investments and digital revolution. However, the productivity gains are yet to be seen.

Non-employee costs have continued to grow faster than operating income; **Tech spend are rising even faster.**

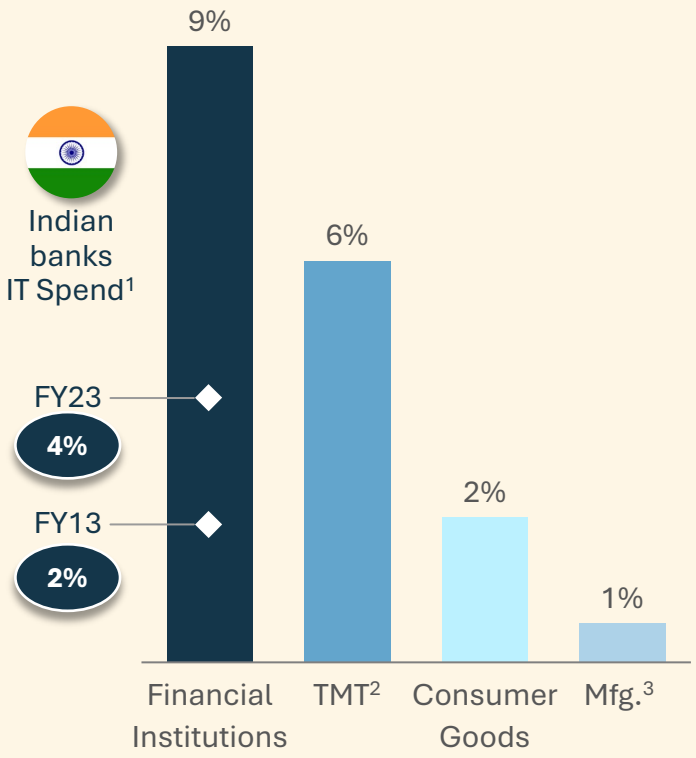
Regulatory action will become more complex (data privacy, resilience, etc.); **New frontiers** will emerge (e.g., GenAI) that will require accelerated investments. Banks need to structurally **unlock productivity.**

1. IT costs calculated based on data from 14 major banks 2. Employee costs include pension, arrears, etc.
Sources: RBI DBIE; Oxford Economics; FIBAC data; BCG analysis.

Banks largest spenders on tech, but not the most innovative

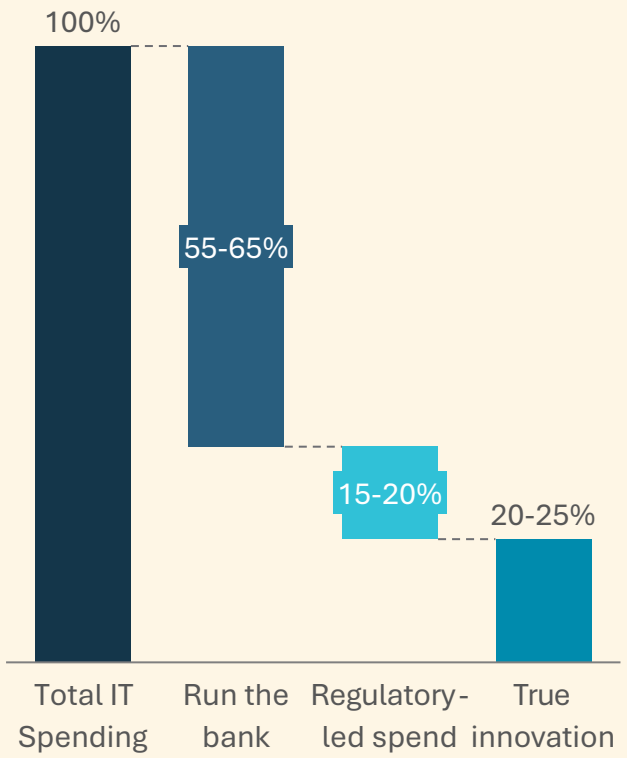
Global: IT spend by industry

IT spend as a % of industry revenue (FY23)



Spend on Run vs Change programs

Breakdown of FI IT spend



Technology is at the core of banks' operating models. Consequently, the share of income that **banks spend on IT is higher than the share spent in most other industries** – a gap that is still increasing.

In India, this spend is under-indexed. While investments have ramped up in the last few years, **Indian FIs are investing less than half of the global standard.**

Currently, a large part of this spend is towards "run the bank" programs vs "change the bank" transformations. **By investing in innovation, Indian banks will be able to bridge the gap** with global peers.

1. IT costs are calculated based on data from 14 major banks 2. Tech Media Telecom 3. Manufacturing
Sources: Future of Finance (2024); FIBAC data; BCG analysis.

Employee productivity has not improved significantly across the industry

Headcount & Cost/ employee increase for banks

		Employee base *Indexed to FY13 base of Private Banks*	10 yr CAGR	Cost/ employee *Indexed to FY13 base of Private Banks*	10 yr CAGR	Productivity[1]	10 yr CAGR
Public Sector Banks	FY13	2.7	-0.2%	1.2	8.9%	3.4	-0.1%
	FY23	2.7		2.9		3.3	
Private Sector Banks	FY13	1.0	10.1%	1.0	3.8%	5.2	1.1%
	FY23	2.6		1.5		5.9	

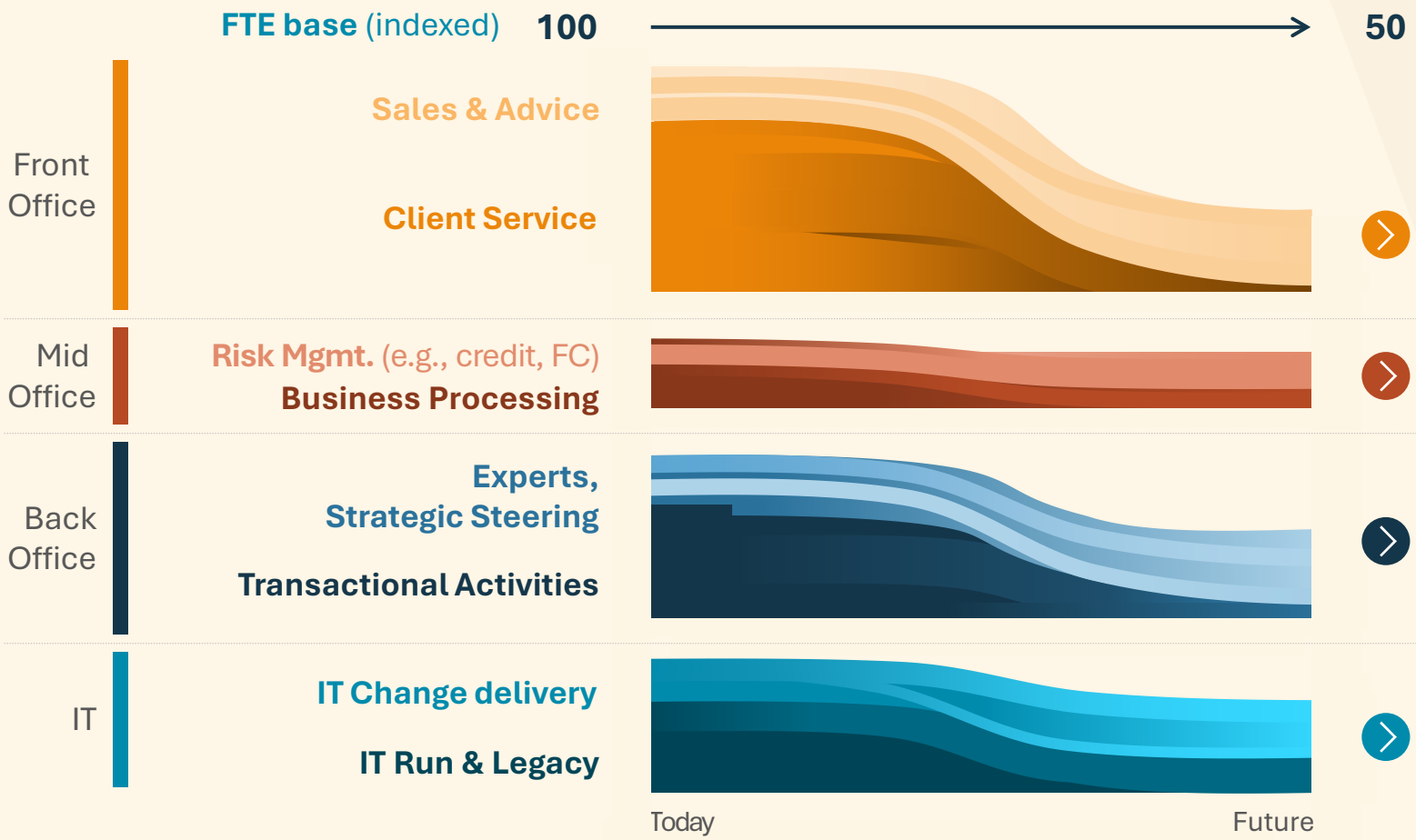
1. Productivity is defined as the ratio of operating income per employee to cost per employee
Sources: RBI DBIE; BCG analysis.

Indian banks have seen very **limited employee productivity gains** over the last decade. However, the tale of public sector banks and private sector banks could not be more diverse.

Public sector banks have seen employee **costs more than double** while headcount has remained the same. Middle management has become bulkier, clerical staff has shrunk. This will have serious implications for future growth capacity.

Private sector banks have done well to maintain cost increases below inflation. However, the **headcount has increased rapidly** to sustain growth. A significantly large number of employees are maintained off-roll. Productivity gains have been hard to realize on the P&L.

Banks need to take a bold vision on productivity, leveraging the full power of digital and AI/GenAI



Adopting a mobile-first approach with fully digitized processes and full online self-service capabilities.

Leveraging data, automation, and AI/ GenAI to improve focus on the management of risks.

Standardization and centralization of transactional activities and **leveraging automation** including **GenAI and self-service.**

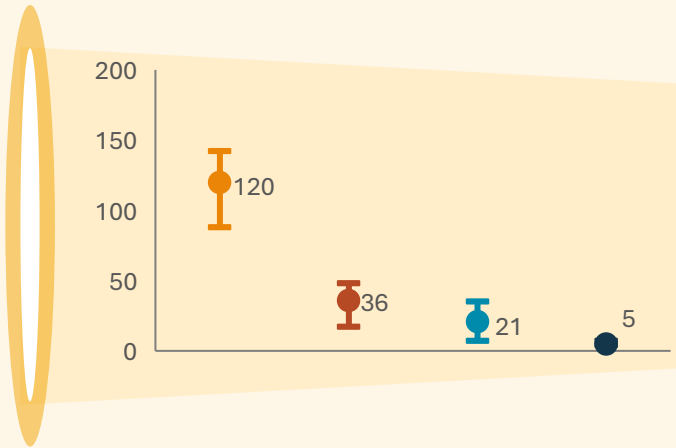
Rethinking change delivery with a platform-based **operating model** and **leveraging partnerships.**

Source: BCG analysis.

Digital Growth Acceleration | Banks need to continue investing to drive digital funnel growth

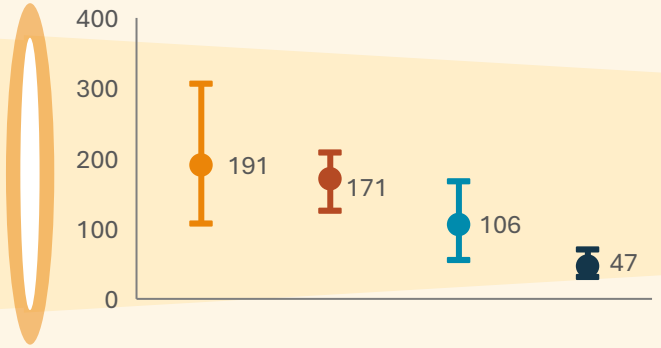
Driving web traffic

Normalized Traffic score[1]



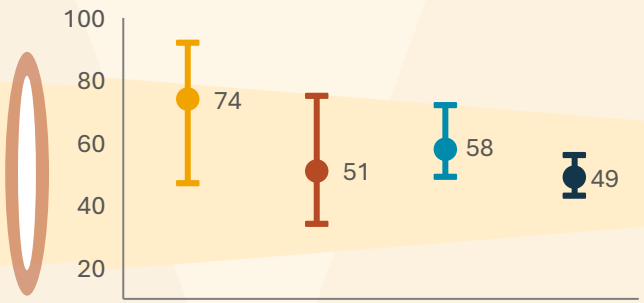
Driving App Downloads

Normalized app downloads[2]



Driving Engagement

Engagement Index[3]



Private New Private Old PSU Large PSU Medium

- Website traffic is a key channel for acquiring new-to-bank customers and driving growth.
- Banks need to drive significantly higher traffic, not just organically, but also by deploying higher paid digital marketing spends.

- High penetration of app users helps in monetization & reducing the cost to serve.
- Banks can use targeted digital interventions (e.g., app activations, paid campaigns, influencer marketing) and physical interventions (e.g., RM incentives, branch push) to drive downloads.

- Top Indian banks have developed extensive in-app digital capabilities (like self-service & deep product feature coverage) to increase stickiness and experience.
- Global peers drive 2-3x higher app usage by value-added services & personalized experiences.

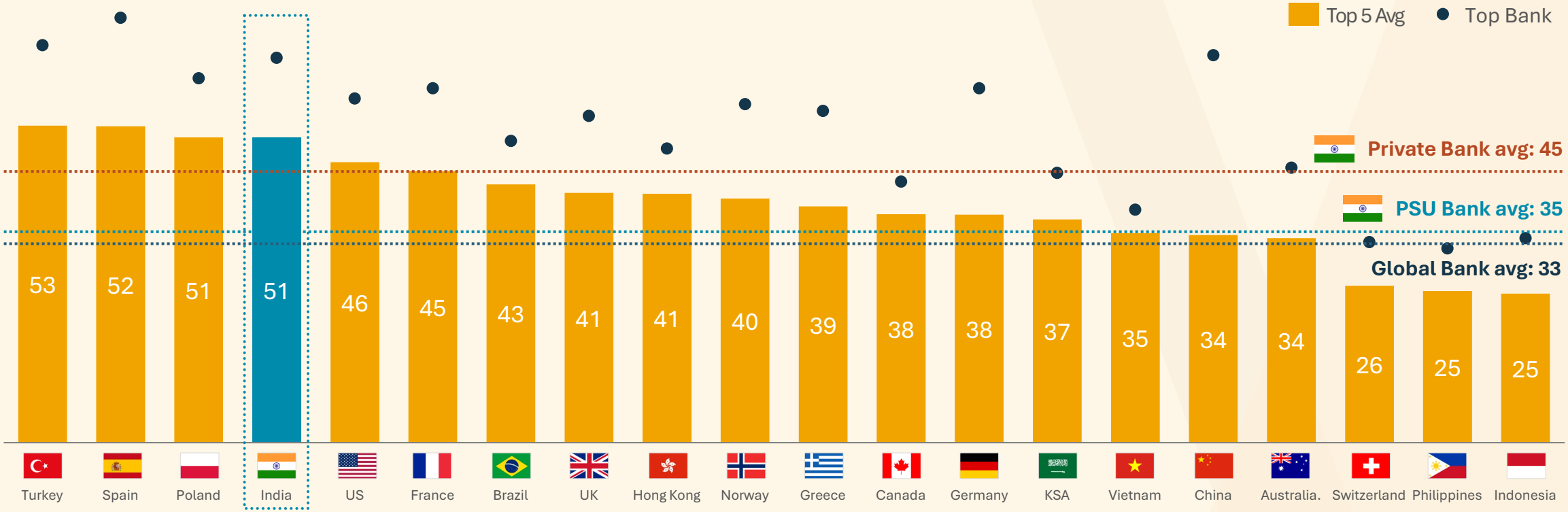
1. Traffic data normalized by the amount of savings account deposits for all the banks 2. Last 10 years' downloads divided by SA deposits 3. Indexed from 1-100 basis MAU & Cumulative downloads

Sources: Similar Web; Data.ai; Annual Bank reports; BCG analysis.

Digital 360^{0} | Top Indian banks are competitive with global best; Wide variation among banks in India

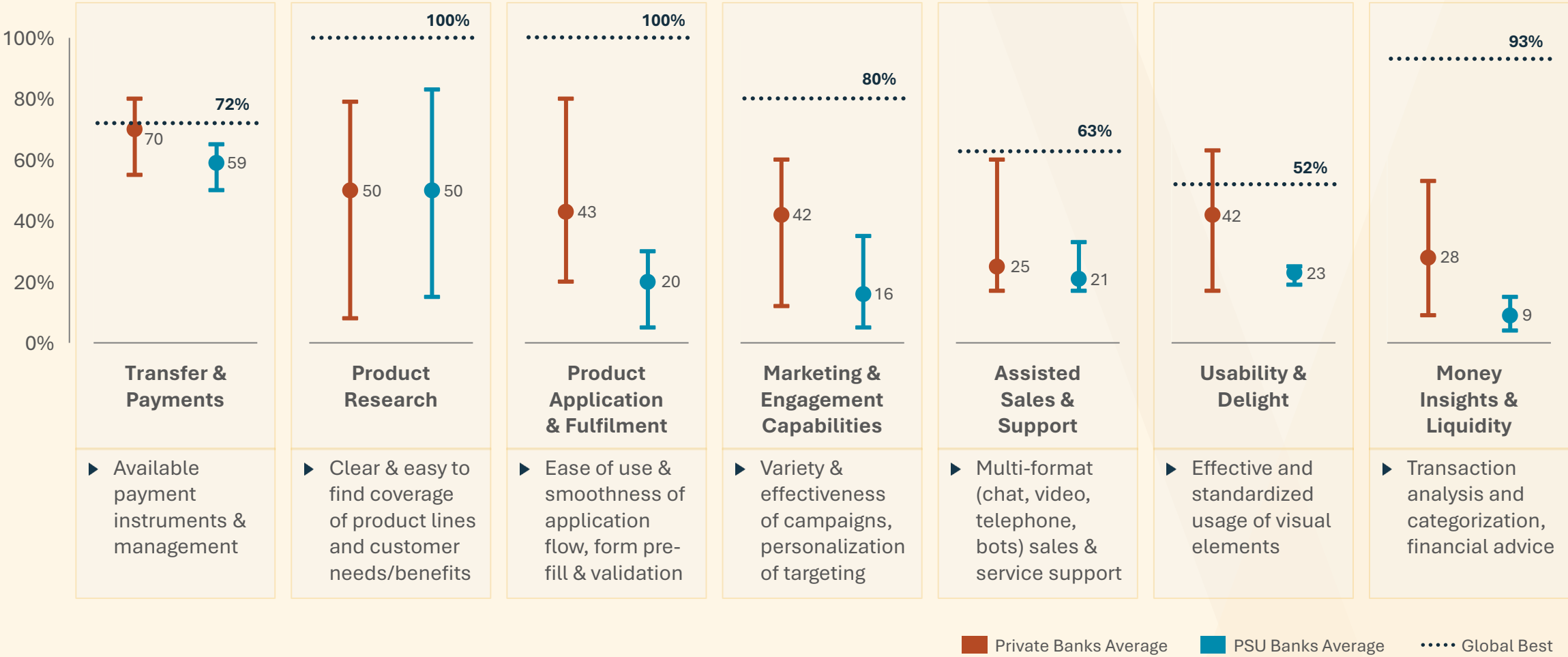
Mobile banking app maturity score (max 100)– BCG's proprietary benchmarking scores for global banks

BCG's proprietary Digital 360 mobile app diagnostic is a comprehensive framework, benchmarked across 350 banks in 50+ markets globally. It evaluates mobile banking apps across 11 key dimensions, generating a "Mobile Score" that reflects the quality of the customer experience provided by each bank



Source: BCG Digital 360º Diagnostic, >355 mobile banking applications in >50 markets assessed (as of Aug 2024); not all markets shown.

Digital 360° | While Indian Private banks perform better than PSUs, significant room for improvement when compared to leading global banks



Source: BCG Digital Sales & Engagement diagnostic, as of July 2024.

Money insights & liquidity

Current state: Basic transaction statement, with limited filters; leading banks have incorporated AA integration

Target state: 360 view of finances (within and outside the bank); auto-categorization of transactions with spending insights & budgeting

Usability & delight

Current state: Low consistency in graphics, color palette, iconography; dependence on external agencies

Target state: In-house team of UI/UX specialists; consistent visual grammar; capability to run AB/MVT to identify optimal UX

Assisted sales & support

Current state: Primary dependence on contact center; sub-optimal support integration in the purchase journey

Target state: Advanced drop-off management, with remote fulfilment capabilities; in-journey access to multi-channel support

Transfer & payments

Current state: Indian banks have the best transfer & payment capabilities globally, enabled by a strong & dependable India Stack – with unique features like international payments, non-card ATM withdrawals, 3rd party billing (utilities, mobile, credit card, etc.)



Marketing & Engagement capabilities

Current state: Generic/ non-personalized in-app campaigns, with minimal to no segmentation/ targeting

Target state: Advanced data analytics & MarTech capabilities to enable segment-of-1 personalization; "Next Best Action" for sales & service

Product research

Current state: In-app search capabilities; text-based product description; basic product FAQs

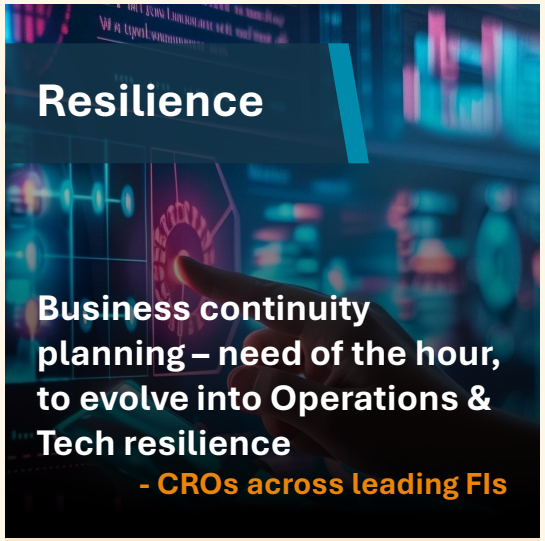
Target state: Advanced, intuitive tools for product comparison; extensive usage of in-app videos; contextual tool tips on product pages

Product application & fulfilment

Current state: Limited coverage of native product journeys (primarily pre-approved offers); visitors typically redirected to the website

Target state: Wide in-app product coverage, with fully native STP journeys; Instant virtual card issuance; pre-filled form fields

Time to embrace next set of capabilities for Indian banking sector



- Digitally mature banks are more susceptible to downtimes and increased regulatory action.
- Resilience requires taking a holistic view of the system and customer-level service level commitment.



- A lot of investments have started going into GenAI, globally – Banks have moved from PoCs to scaling up.
- AI & GenAI are projected to generate $1B+ in value, 65%+ productivity unlock, and increased profitability levels for banks.



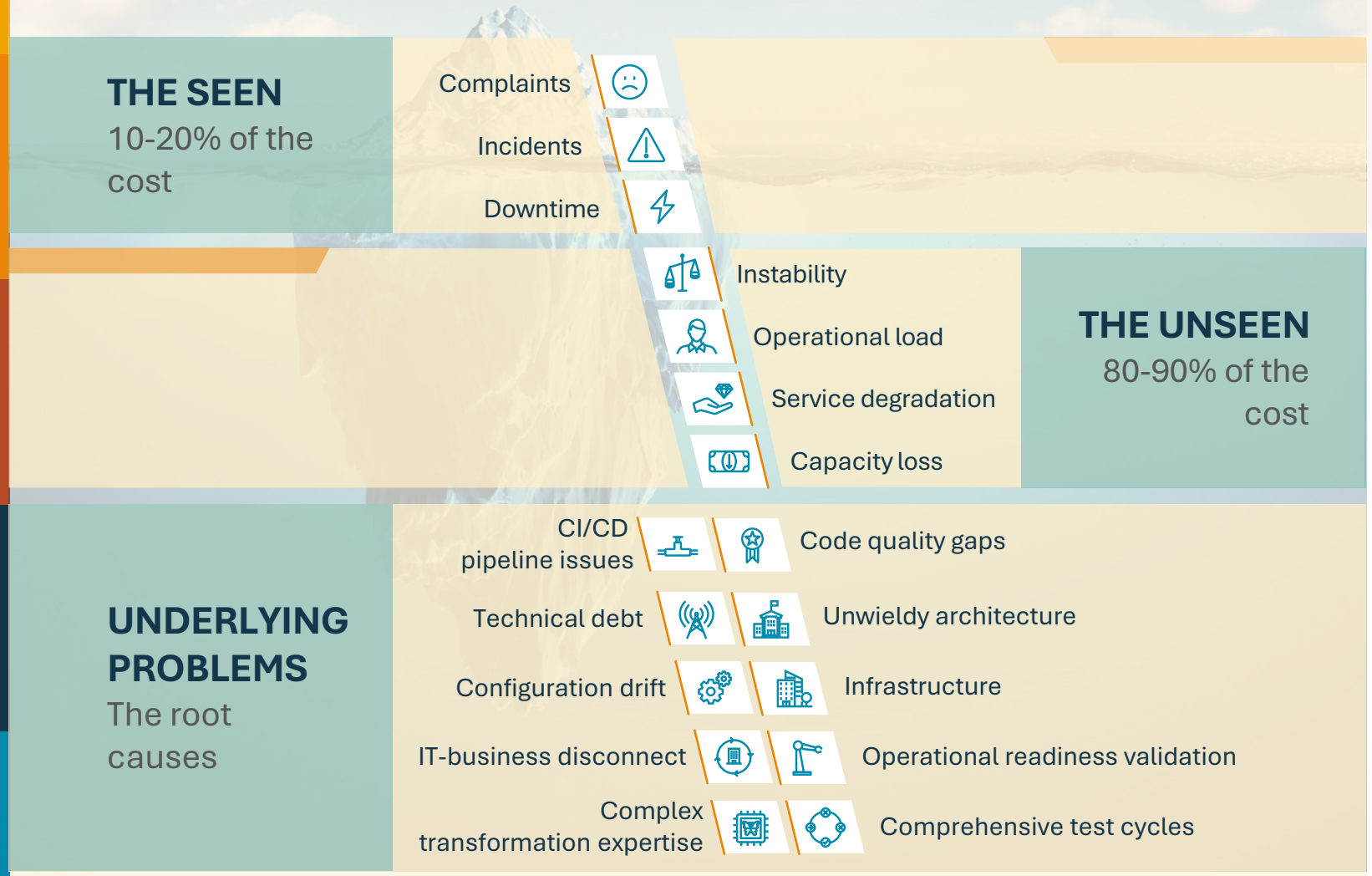
- Globally, 140+ banks committing to net zero pathway with a commitment on Scope 3 reductions also.
- Multiple draft regulations and guidelines released in the past few years; compliance is expected to rise significantly.



- The majority of cybersecurity breaches stemmed from organizational or human failure; a new paradigm comes into play with GenAI.
- Centralized, real-time network required for banks to coordinate, mitigate cyber-attacks & patch vulnerabilities.

Sources: RBI; Check Point Report; BCG GenAI in FI Benchmarking survey; CRO interviews; BCG analysis.

Resilience is far more than just incident management...



Source: BCG analysis.

Resiliency isn't just a tech term – it's a business imperative. This is not just an exercise for Technology, Risk, or Compliance but for the entire Business.

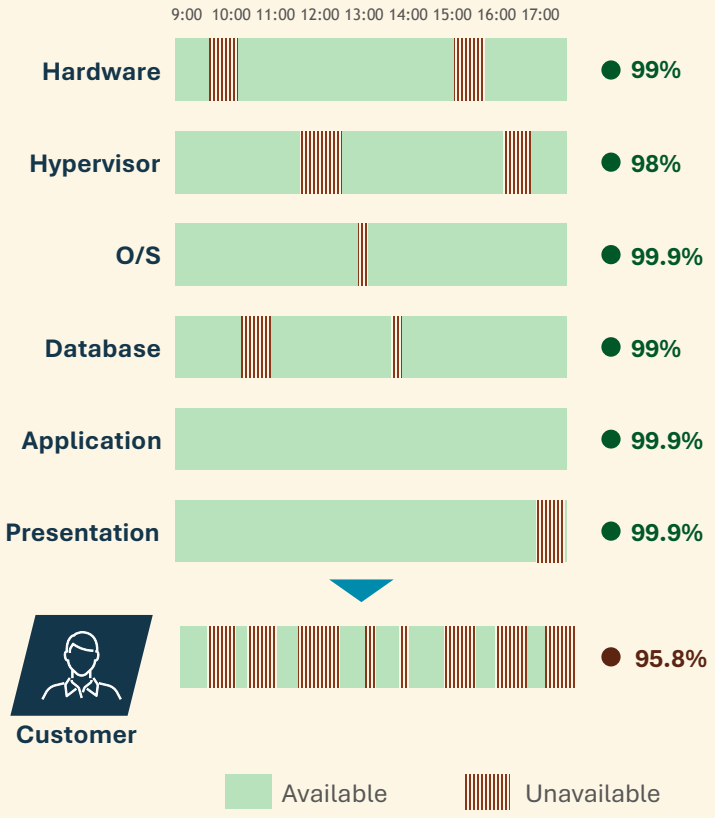
FIs need to define it from the customer's perspective – go from front-to-back to locate pressure points in the system. Understanding the crucial moments and planning for them is critical. High assurance in customer service creates differentiation and competitive advantage, better-managed business, and higher assurance of returns and reputation.

Focus on specific systems/ components gives a **false sense of operational uptime.** However, Important Business Services (IBS) persuades financial institutions to define services as the customer sees it – otherwise the **downtime can be much worse in the customer's experience.**

...and more than individual component availability – a service is as strong as its weakest link

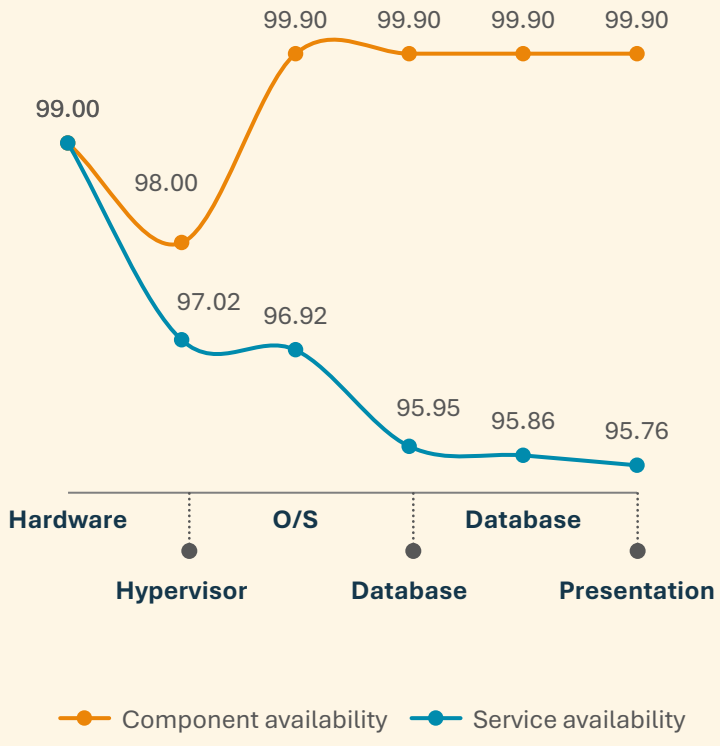
FIs focus on component-level 9s; while customers view service-levels

Availability (%)



One unreliable component can undermine overall service availability

Availability (%)



Source: BCG analysis.

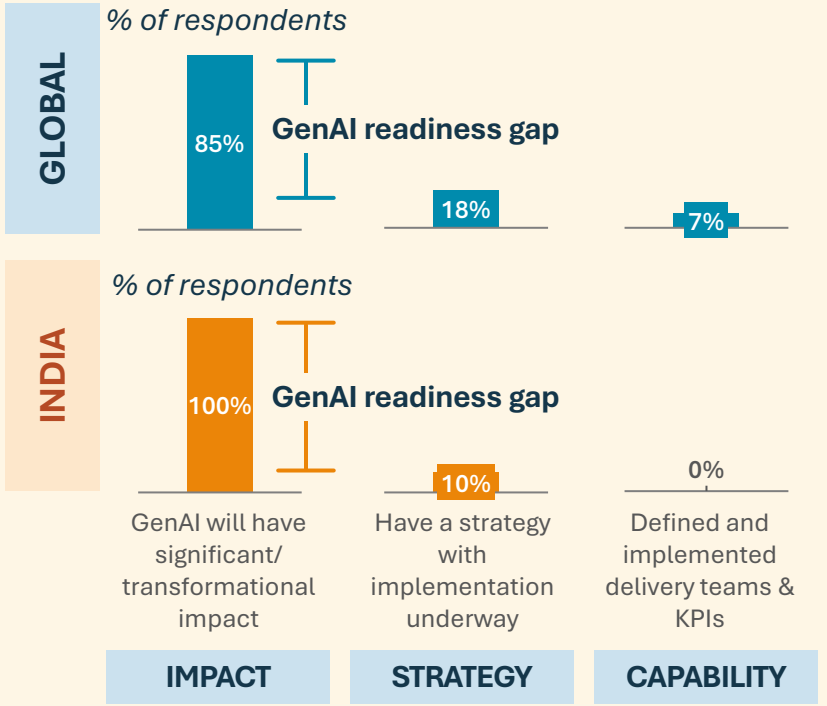
Resilience is not about the pursuit of adding 9s to the service levels of tech systems alone. All customer experience paths are not the same in terms of criticality. For e.g., transferring money is a critical functionality but a smart statement is not in the same league. Knowing which services need to be prioritized for resilience planning will help optimize cost.

In a highly connected world, resiliency also needs to be planned **beyond the traditional boundaries – covering partners, ecosystem players, and tech vendors** who have a direct impact on business outcomes.

Better understanding and mapping of process, people and technology interdependencies, not just reduce disruptions but also improve overall business processes.

FIs are facing the "GenAI Paradox" and are struggling to scale up beyond the initial Proof of Concept

Indian FIs expect GenAI to be transformative; the readiness gap is significantly high



Multiple challenges in scaling up the GenAI potential

- **80%** Struggle with **tech integration**
- **70%** Struggle with **talent**
- **50%** Struggle with impact **measurement**
- **50%** Struggle with **regulations**

The GenAI Paradox It is deceptively **easy to launch GenAI pilots** with initial powerful results. At the same time, it is immensely **hard to move towards @Scale**, converting the GenAI potential into real value.

Source: BCG GenAI in FI Benchmarking survey.

Proponents of AI and GenAI believe that it can **unlock human productivity** in a manner that computers and the internet did in the 20th century.

However, banks have yet to fully embrace its potential. AI and GenAI needs to move center stage – as core business and operating model decisions. The **readiness gap** is large – and wider than global banking peers despite the digital innovations & infra built.

GenAI projects need **to move beyond PoCs** – requiring sponsorship from business and IT, considering it as integrated capabilities, and activating "mission-mode" to build out CoE with requisite talent.

10-point agenda to strengthen the Banking sector in driving towards Viksit Bharat

Agenda for Banks

1. Need innovative products (e.g., market-linked FDs) & customer awareness for existing products (e.g., low risk) – for sustainable deposit growth.
2. Leverage data and advanced analytics for credit and fraud models – to drive faster credit penetration.
3. Reimagine operating model to dramatically lower 'sticky' cost structure – target 40% Cost to Income ratio amidst rising technology & compliance costs.

Agenda for Government

4. Promote consolidation of smaller segments of the industry – to unlock value and build capabilities to manage new-age risks, models.
5. Promote digitization of land records, the digital process to create mortgages – to prepare the ground for disruption in secured credit.
6. Create enabling regulation (e.g., Bureau access & mandatory reporting) for alternate debt classes (e.g., CP, Private credit) – to deepen debt markets.

Agenda for Regulators

7. Lead the way in use of advanced analytics in banking – to enhance efficacy and efficiency of supervision.
8. Promote world-class utilities like NPCI, Credit Bureau, etc. – for Climate, Cyber, and Fraud risks.
9. Enable seamless flow of capital to the banking sector – to attract $1.5 Tn fresh capital over the next 2 decades.
10. Allow banks some flexibility to tap into new businesses – to align to national priorities.

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Profile
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Central Bank
Digital Currency
Name
Account No.
Rajiv Kumar
12345678
View All Accounts
Check Balance
Total Spends
₹47,505
PoS Spends
₹22,111
E-Com Spends
₹16,542
Other Spends
₹8,852
View Account info
Transaction Chart
Contact
Abcdigitalbanking@email.com
AI Assist
Chat