



## India's retail banking poised for growth

Modi government is striving to bring more Indians into the formal economy and is looking to consolidate debt burdened public banks



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Manjula Shelar, a housewife from a small farming village in the Thane district of the state of Maharashtra in India, is well into her fifties but has never had a bank account.

"I get by with cash," she says. "Why do I need a bank account?"

There were 233 million adult Indians without bank accounts as of 2015, according to a report by advisory PwC. .

But unlike Manjula, more and more Indians are joining the banking system, and rising incomes and aspirations are helping to drive borrowing.

India's retail banking sector is poised for growth, analysts say.

"Retail banking as an industry is still growing at a very fast pace," says Rajiv Mehta, the assistant vice president of equity research at IIFL Investment Managers. "Retail loans across banks have been growing at a very healthy rate of 15 per cent to 20 per cent per annum. That has largely been driven by mortgages, and apart from mortgages we have also seen car loans, personal loans, credit cards growing quite fast. The disposable income levels are rising, aspirations are rising and consumption is going up. There's still a long way to go before we reach a point of saturation."

To tap this opportunity, Indian private bank IDFC and Shriram Union Finance this month announced plans to explore a merger to create what would be one of the country's largest retail banks.

In the current climate, consumer banking is looking more appealing than corporate lending, analysts say.

Mr Mehta explains that IDFC, which was traditionally an infrastructure lender and branched into retail banking in 2015, "has been struggling to acquire a large set of customers to sell their retail products ...so the thought process of the merger is to acquire the customers of Shriram".

India has a large number of banks, with 21 state run banks alone – a figure that the government wants to halve through consolidation. And new entrants have come into the market. There were 21 private banks in India at the end of the financial year of 2016, according to figures from the Indian Banks' Association. The 2016 Indian financial year started in April 2015 and ended in March 2016.

Uday Kotak, the managing director of Kotak Mahindra Bank, has warned that the structure of the banking sector is precarious "while we have relaxed entry norms in many areas of financial services".

"The banking industry's current structure is not sustainable," he says in his company's annual report. "The system's inability to recognise the inconvenient truth that banking is an economic and commercial activity with high leverage, and that years of 'kicking the can down the road' in high risk areas, mixing of social objectives and weak governance have all contributed to bringing this industry to a weak position."

He concludes that there is going to be "significant consolidation taking place in the financial services industry in the next few years", which will take place either through closures or mergers.

"The last two years has seen an expansion in the number of private sector banking institutions with the Reserve Bank of India giving differentiated licenses to small banks and payment banks," says Ausang Shukla, the managing director of Ambit Corporate Finance, an investment bank in Mumbai. "There has also been a significant increase in new licenses for non-banking financial companies and housing finance companies, focused mainly on the retail segments. A key driver for this has been to encourage greater penetration of financial services and enhancing financial inclusion, in light of the severe under-penetration of banking in India."

He also sees consolidation ahead, but explains that this is not to say that there are no enormous opportunities for retail banks in India.

India's government is striving to bring more Indians into the formal economy, with moves such as demonetisation in November, when Indian prime minister Narendra Modi banned the two highest value banknotes, when many Indians had to open bank accounts to deposit their old notes. Mr Modi after coming to power in 2014 unveiled an ambitious financial inclusion program, which aims for every Indian household to have a bank account. Local media reports state that 3 million bank accounts had been opened within just a few weeks of demonetisation coming into effect. All this is a fillip for the retail banking sector, including new entrants, according to Mr Shukla.

"The pick-up of use in technology has also been a growth driver for the retail segment, as lenders look to use digital platforms to reach out to new customers as well as enhance traditional credit scoring mechanisms with new digital data sources and analytics," he says.

As public sector banks in particular struggle under a huge burden of bad debts, largely because of defaults on projects related to corporate lending, this is a major factor that many analysts expect to trigger mergers.

Tie-ups by banks make sense as "institutions aim to broaden product capabilities and geographic presence in the private sector and due to asset quality in the public sector", Mr Shukla explains.

Babu Sivaprakasam, a partner at Economic Laws Practice, a law firm in Mumbai, says the number of banks per 100,000 people in India is the lowest of the major emerging economies among Bric countries.

"Considering that advanced economies have better banking presence and India is under-banked vis-à-vis its peer countries and with marked financial inclusion goals, there is actually a need for more banks and branch presence," he says.

"A growing economy with huge demands entails larger retail-lending prospects. The rising corporate NPA (non-performing asset) levels, alternate options for corporates to raise funds through bonds, external commercial borrowings, mutual funds, insurance companies. will drive banks to focus more on retail lending - especially with its low NPA levels it is alluring."

NPAs in the Indian banking system are estimated to have reached between 13 and 15 lakh crore, greater than the GDPs of countries such as Ireland and Greece, according to estimates by consultancy Oliver Wyman published in a report last year.

The retail banking sector has in fact been the key growth driver for the banking sector in India and have grown at an average annual rate of 16 per cent over the 2012 to 2016 period compared to a rate of 12 per cent for the total banking sector over the same period, according to Ambit Corporate Finance.

"The sector, particularly the mortgages segment, has seen significant focus from banks that have been looking to reduce exposure to the corporate lending sector, which has been

struggling due to lack of new investments by the corporate and legacy on-performing assets," says Mr Shukla.

There have been calls for mergers of state run banks and State Bank of India in April merged its associated banks. Several other public sector lenders have reportedly submitted consolidation plans to the finance ministry.

"Consolidation will probably happen in the public bank space," says Mr Mehta. "These government-owned banks have been struggling over the last three to four years because of a slowdown in the economy and the large creation of stressed assets. So some of these banks which are smaller in size or mid-scale banks are looking out for options to get themselves merged or acquired by the larger ones, and that's what even our government has been driving, for acquisitions or takeovers to happen, because that is how you can support a weaker bank in such kinds of crisis."

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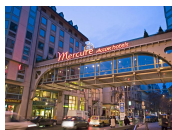
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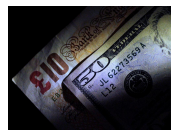
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