

New Licence Policy will be Banking's 1991 Moment

Guest Column



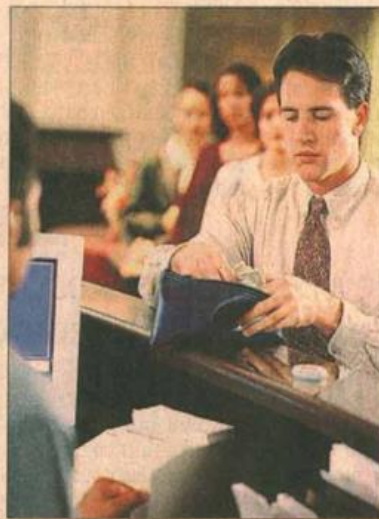
V VAIDYANATHAN

Chairman, Capital First

Banking had a "clubby" feeling to it — if you got in, you had a licence to take deposits, lend loans participate in interbank settlements. What added to the feeling was that joining the club was difficult, as only a couple of licences were issued every 10 years or so. Under the new bank guidelines announced by RBI on Monday, licences will be allowed on tap, subject to certain conditions. There is no doubt that this policy is to banking what the 1991 reforms were to India's destiny.

Picture this: By 2025, just a decade from now, India's GDP will be \$6.7 trillion if nominal GDP grows by 13% (8% growth plus 5% inflation). The population will be 1.5 billion, of which 40% will be urban, literacy will have risen to 80%. The market for passenger cars will be about seven million a year and 320 million people will travel by air every year. In short, in the next 10 years, India will add more to its GDP than it did in the last 68 years (source TOI research).

To finance such a burgeoning economy, the capital available with existing banks will be found to be very short, and capital will, in fact, be a bottleneck to growth. A 2014 Fitch report said that Indian banks will require more than \$200 billion in capital by 2019 to comply with Basel III requirements, while annual profits of Indian banks are not even a half of that. Clearly, the opening up of new banks will bring in greater capacity



in terms of capital availability.

It is not just the availability of capital. The existing 21-odd state-owned banks have the same shareholder, hence hire employees the same way and usually have the same governance. So they usually have the same products, same policies, and target the same customer. For example, they all have 20-year home loans, all at base rate, all monthly amortising, and target the same salaried customer at same income-installment ratios. So they should be seen as one large bank. In any case, all banks in India usually like the organised-salaried market. If you see it that way, there are not more than 40 SCBs in India for over a billion people.

Now extend this concept to financing the self-employed. Over 94% of India's working population is part of the unorganised sectors, which are often unlicensed, self-employed with unregistered economic activities such as kirana stores,

handicraft and handloom workers, rural traders, dental clinics, salons, painters, wedding planners, small retail shops, hawkers, paan shops, tea stalls and the like. This huge market is underserved, which in size, is perhaps in multiples of the corporate salaried market.

If we have to be able to address these markets, both in terms of credit as well as deposit needs, there is no way but to allow the entry of newer players, basically newer shareholders. They will have newer strategies, different credit evaluation techniques, target new segments, and will, therefore, open up the market like never before. In fact, the need to force banks to do priority lending will diminish, as the existing markets will get crowded and banks will look for newer pastures in the priority sector.

To understand how significant this moment is, consider this. After 1969, when the banking system was nationalised, India waited for 25 years before 4-5 licences were issued in 1994. Ten years later in 2004, two more licences were issued. In 2014, Bandhan and IDFC Bank were born. In 2015, the number went up to 19 (eight payments banks and 11 SFBs). In 2016, it's on tap, with professionals welcome to set up banks. No doubt this is the most significant and bold step towards revolutionising the banking industry and by extension even the Indian economy.

Some ask if the tailwind of a strong economy that was available for growth of the two banks of 2004 is available today. Yes, 2016 feels like 2006 all over again in the growth trajectory sense, and this time around, technology and a supportive digital ecosystem will be the additional sources of engine power for success of the new banks.

(The author is the Founder and Chairman Capital First. Views are personal.)