India's Century: Sustainable and inclusive growth

A FICCI-McKinsey multi-year forum

Banking Committee Report

India's Century vision for the Banking Sector

Short-medium term

From 14%
in 2021 to
40%+
Retail Credit to GDP ratio (by 2030)

From ~55%
currently to
100%
Financial Inclusivity (by 2030) (RBI FI-Index)

From <40%
in 2019 to
80%+
MSME Formal Credit Lending (by 2030)

40%
Green Assets share to Lending Portfolio (by 2030)

Long term

From ~5%
In 2019 to
0-1%
Commercial borrowing cost gap with peer economies (by 2047)

From ~56%
in 2020 to
100%+
Credit to GDP Ratio (by 2047)

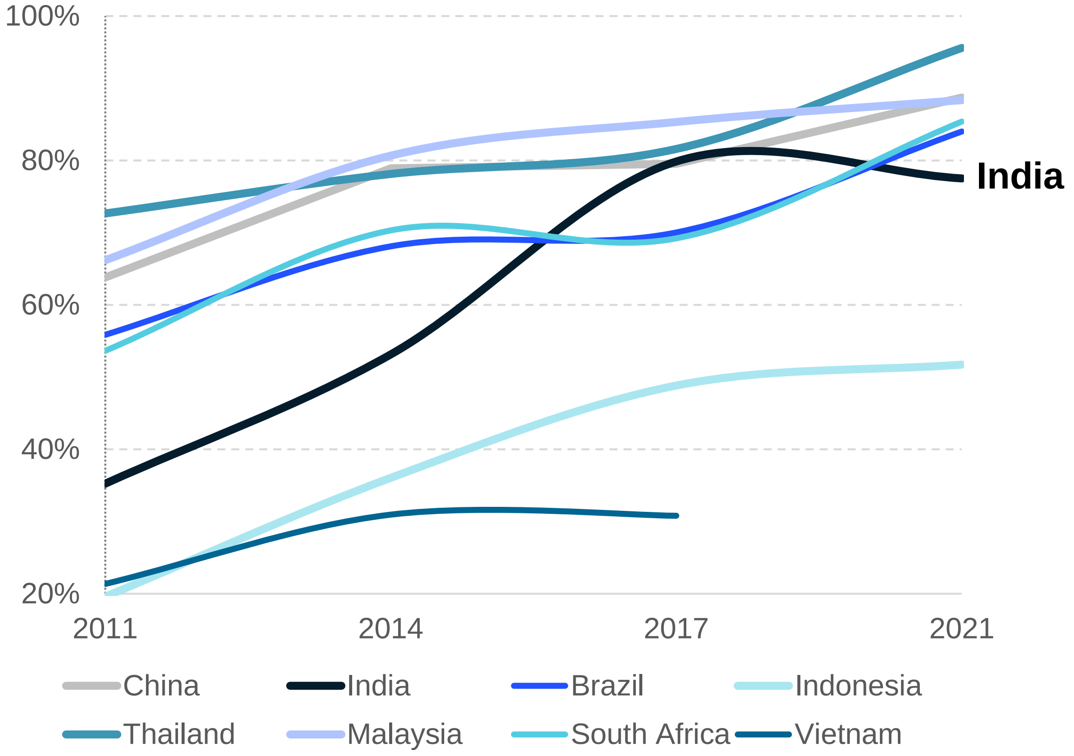
From 1
currently to
5+
Indian Banks in Global Top 50 list by Asset Size (by 2047)

From ~USD 200 Bn
in 2021 to
3.1-3.5 Tn
Banking contribution to GDP (by 2047)

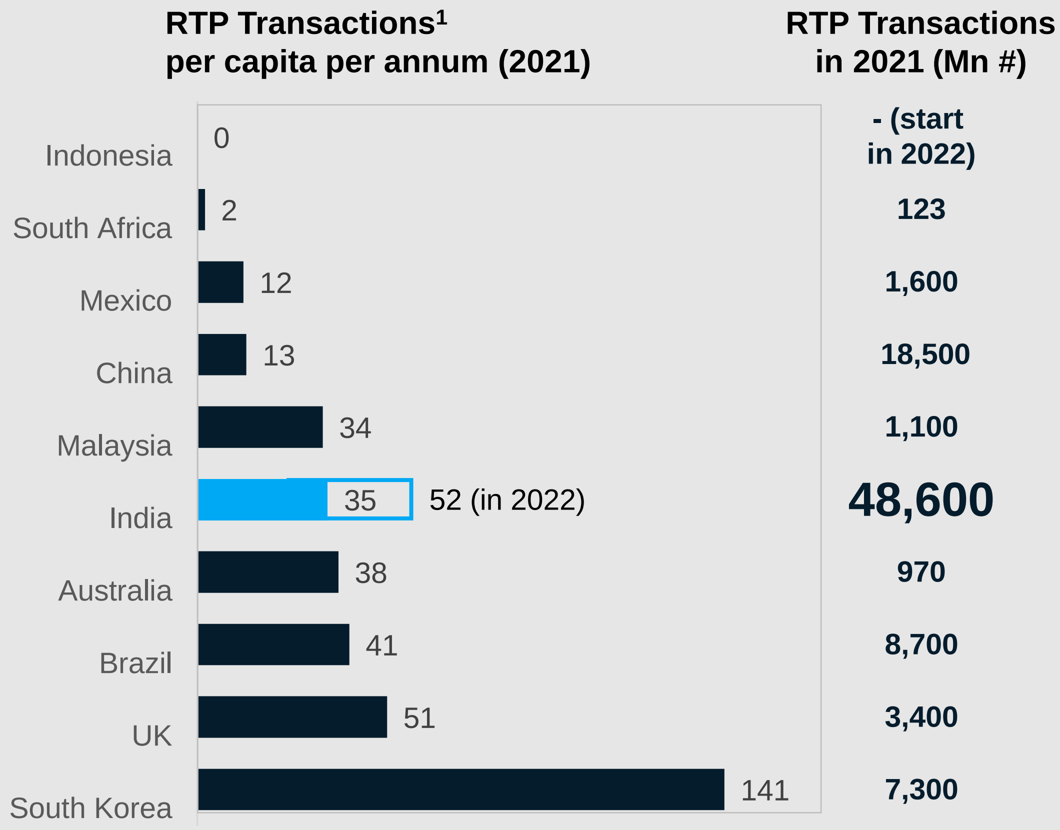
India has witnessed two major transformations – in banking inclusion, and digital payments

India's Account penetration has doubled in past 10 years from 35% in 2011 to 78% in 2021

% of Adults (15+) with Bank Accounts



RTP transactions (per capita p.a.) have grown from <5 (2016) to 35 (2021) to 52 (2022), surging ahead of peer economies



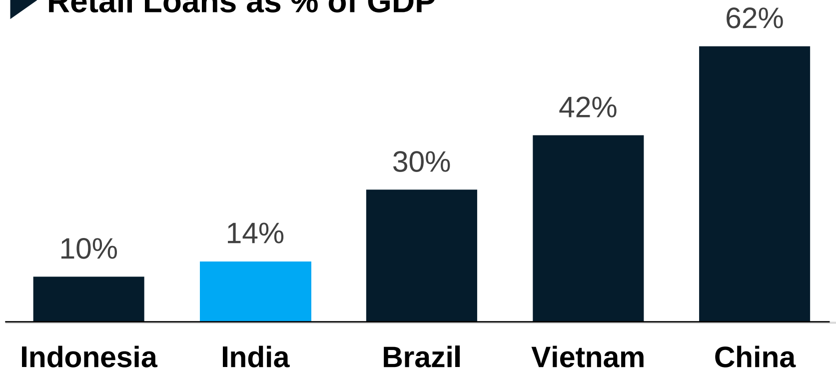
1. RTP – Including real-time banking payments, e-cash (wallet) payments, credit card, debit card

Source: Global Findex Database, ACI Worldwide, RBI

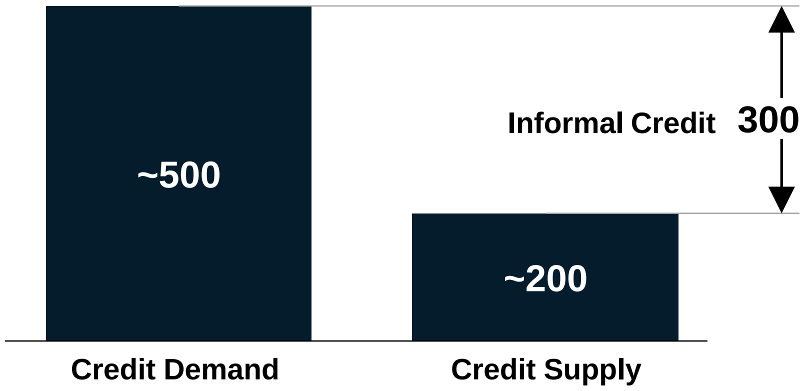
Credit penetration has lagged in terms of low access, higher cost…

Retail, MSME segments lag behind in terms of credit penetration

Retail Loans as % of GDP



Credit Gap in MSME Lending in India (USD Bn)



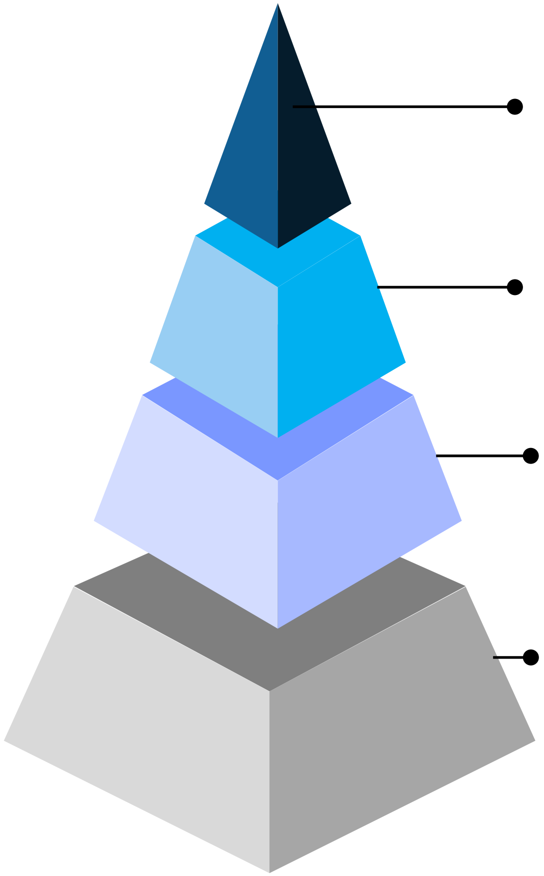
Formal banking is inhibited by high Interest Rates: 5% more than peer economies

Average nominal rates, 2019%		Drivers of differences in the cost of commercial loans in India v/s other emerging economies Percentage Points	
India	Other Emerging Economies[1]		
10.7	5.5	Fund and fee-based charges paid by borrowers	5.2
1.2		Crowding out effect of government borrowing	1.2
1.8	0.6	Credit risk provisions due to non-performing loans	1.2
2.7	1.4	Operating expenses	1.3
5.0	3.5	Cost of borrowing, and other residual effects	1.5

1. Simple average of China, South Korea, Thailand

Source: McKinsey analysis, UK Sinha MSME Report (2019), India's Turning Point, Aug 2020 – published by McKinsey Global Institute

…particularly within the MSME space



MSME Segments	# of enterprises	Current outstanding (INR L Cr)	Nature of customers
Large firms INR>=100Cr	~0.04 crores	6.9L	Fabricated metal Manufac-turer, Large Distributor, Pharma API company, Logistics company (Large fleet operator), Mega Store, Multi facility Hospital 
Mid-sized firms INR>=25Cr–<100Cr			
Small-sized firms INR >=5Cr–<25Cr	~0.24 crores	7.2L	Small scale industry, Retail Store, Local hospitals, IT company, Chemical Distributor, Garment Manufac-turer 
Micro enterprises <INR 5Cr	~5.6 crores	5.2L	Kirana Stores, Pharmacy Shop, Pan Shop, Printing Store, Auto Garage, Textile store 
	~7.2 crores	19.2L	

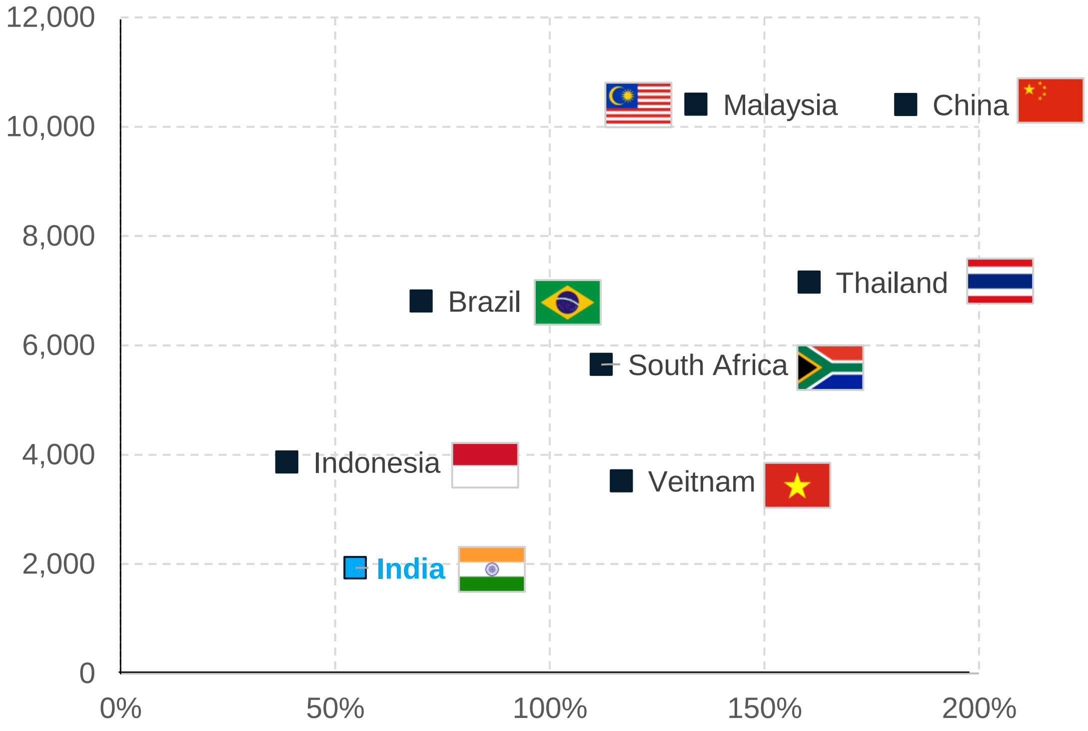
Typical challenges

- **Underwriting standards** heavily rely on **traditional financial information** (e.g. 3 year audited financial statements, ITR filings etc.) which are not uniformly available for all SMEs
- **Relatively lower adoption of transaction related data** (e.g. GST, e-way bills, bank statements, e-commerce/aggregator platform transactions) for underwriting, while this data is being leveraged for **marketing** / **sourcing**
- **Stringent collateral requirements** (e.g. land, properties peripheral to approved land not considered) and limited adoption of **non-traditional collaterals** (e.g., invoices)
- **Limited tailoring of propositions** to underlying needs and business cycles (e.g., flexible repayment cycles)

Opportunity to transform Credit is Now

Credit fuels the economic growth – countries with higher credit ratio witness a clear positive co-relation with GDP

GDP per Capita ($, Nominal, 2020)



Credit[1] to GDP Ratio (2020)

Need to capitalize on well-set digital infrastructure to expand Credit coverage

Growing formalization – GST rollout (e.g. MSME penetration increased from 4% to 25%+) , Aadhar based KYC, implementation of Udyam portal has led to increase in formalization of business sector

Data Explosion – Formal (e.g. GST payout data, online transaction, financial statements, credit bureau etc.) and in-formal data sources (e.g. telco, social media, e-commerce data, utility data) which is granular, current, verified and electronic accessible can be leveraged to transform underwriting and solution customization process

Data Democratization – adoption of consumer-consent driven inter-operable **Open data approach**, embodied by creation of IndiaStack, UPI, AA, OCEN, etc. has laid the roadmap for credit transformation

Govt. Credit Push for Retail – e.g. Kashi, KYC Setu, PMAY (affordable housing) and **MSME** – e.g. Priority lending status, 59-minute loans launched by SIDBI, interest subvention, ELCGS infusion, CGTMSE etc.

Emerging Ecosystems driven by banks partnering with Fintech, Bigtech platforms, to improve lending. For e.g. – Partnership b/w ICICI and Amazon (e.g., credit card, overdraft facility, FASTag); SBI Yono integrated app; ICICI partnership with Niyo to provide pre-paid payroll cards to MSME workers.

1. Domestic Credit to Private Sector

Source: Domestic credit to private sector (% of GDP), and GDP per capita (current US$) – 2020 data sourced from World Bank

Opportunity to capitalize on MSME credit schemes

	Name of scheme	Nature of financing provided by scheme	Scheme Performance	% share of funds disbursed to MSMEs
1	**CGTMSE** Credit Guarantee Fund Trust for Micro and Small Enterprises)	75% - 85% guarantee coverage for loans (upto INR 2 Cr) for micro, small enterprises	Credit Guarantee Amount FY21: ~INR 31,000 Cr FY22: ~INR 55,000 Cr	5% - 10%
2	**ECLGS** Emergency Credit Line Guarantee Scheme	100% guarantee coverage of top-up loans (upto INR 15 Cr[1]) for MSME, business enterprises	Loans Disbursed FY21: ~INR 1.9 lakh Cr FY22: ~INR 0.7 lakh Cr	15%-30%
3	**PMMY** Pradhan Mantri Mudra Yojana	Micro-finance (<INR 10 L) to micro, small enterprises Collateral free, with govt. guarantee	Loans Disbursed FY21: ~INR 3.2 lakh Cr FY22: ~INR 3.4 lakh Cr	50%-60%
4	**PMEGP** Prime Minister Employment Generation Programme	15% - 35% subsidy on loans (upto INR 20 / 50 L) for new individual / micro enterprises	Margin Money disbursed: FY21: ~INR 2,200 Cr FY22: ~INR 3,000 Cr Total lending amount is ~4 times of Margin Money	2%- 3%

Other Schemes – MSE-CDP (Micro & Small Enterprises Cluster Development), CLCSS (Credit linked Capital Subsidy Scheme), PM SVANidhi (Street Vendor's AtmaNirbhar Nidhi), SFURTI (Scheme of Fund for Regeneration of Traditional Industries)

1. 30% of outstanding credit (should be <INR 50 Cr for general eligibility). Further, higher limits exists for hospitality, aviation, healthcare and 26 other sectors identified by Kamath Committee on Resolution Framework
2. HDFC Bank, Axis Bank, Tata Motors Finance, Bajaj Finance)
3. MSME Pulse, June 2021 – published by TransUnion CIBIL and SIDBI

Source: Press Search for ECLGS (1, 2), Mudra website, CGTMSE Dashboard

Key observations

- **MSME Schemes remain under-utilized**
  ECLGS, Govt. flagship scheme, launched during COVID-19, has disbursed <60% of the sanctioned credit limit in past 2+ years
  Similarly, CGTMSE scheme has been able to meet ~5% of MSME lending, much below ~15% recommended by K.V. Kamath Committee.
- **Schemes adopted by select Few Private Banks only**
  In CGTMSE Scheme, top 4 Private Institutions[2] have alone doubled their combined share of loans to 30% in past 3 years, whereas combined share of remaining private players has remained b/w 5% to 10%.
- **Govt. MSME Schemes cover ~50% of total lending to MSME lending**
  Total loan origination in MSME by value was ~INR 10 lakh Crore in FY21[3]

Unlocking wider MSME credit access via ONDC + OCEN + AA + UPI

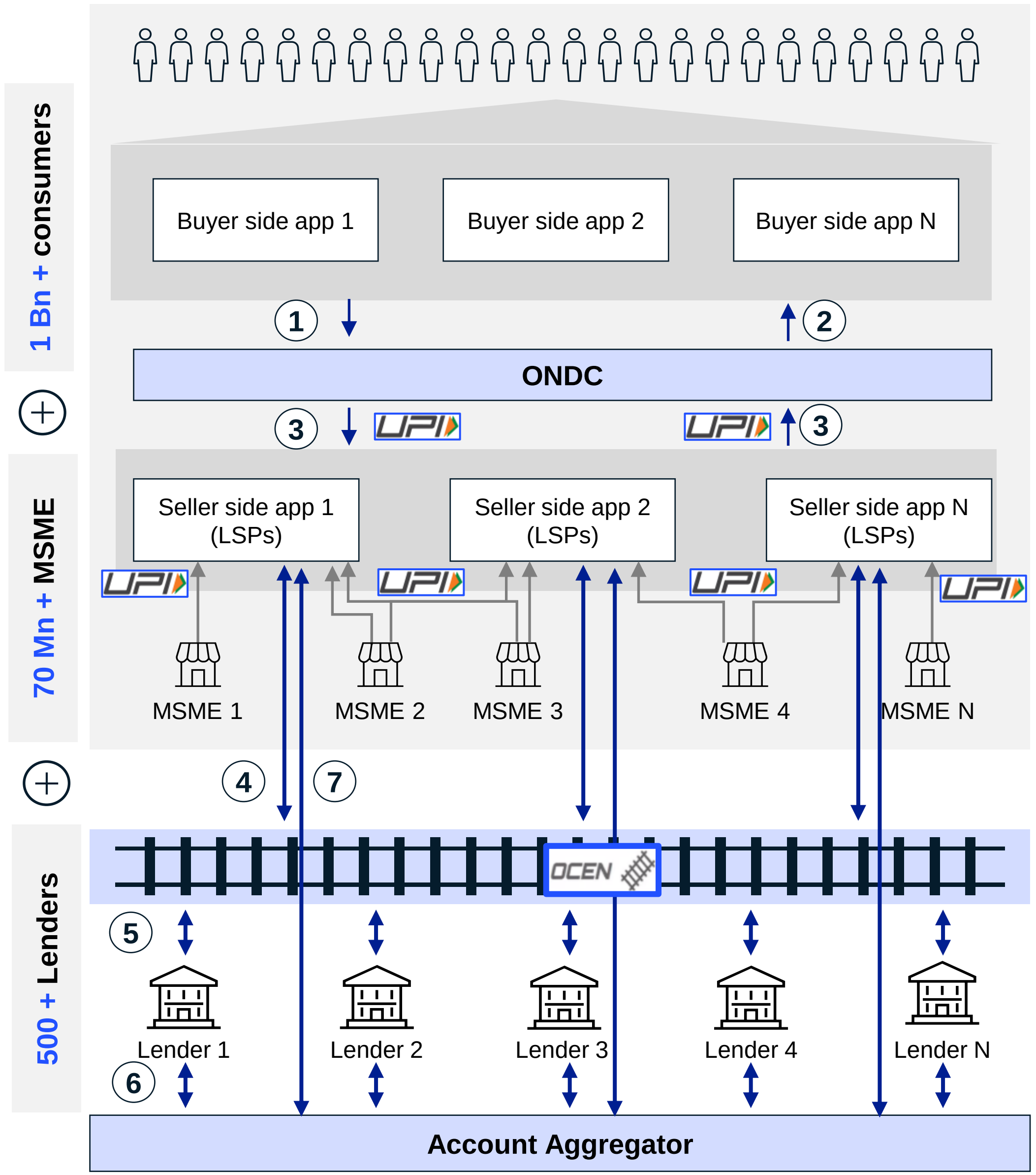


Exhibit 1

How ONDC, OCEN, Account Aggregator and UPI can come together in the context of MSME credit

1. Buyer **search is multi-cast** across all seller apps connected to ONDC gateway
2. Buyer gets the product information from all the sellers present in the ONDC network; **Selects desired seller and logistics vendor**
3. Buyer places **order from one seller** app and **subsequent communication and servicing via the seller app**
4. LSP **provides access to MSMEs / customers** seeking credit and initiates onboarding journey

   LSP **offers platform data signals** to Lender (inputs for EWS models, triggers)

   LSP **sends intimation of auto-debit** from customer's account
5. Lender **evaluates and communicates loan offer**
6. AA **provides consolidated financial information** from various FIs such as: bank statements, GST, ITR etc.
7. LSP **takes consent for financial data** from AA for loan monitoring

   AA **provides consolidated financial information** on pre-defined frequency e.g. banks statements, GST, ITR etc.
8. Borrower **repays loan using UPI**

Expected benefits for MSME credit

- ✓ **Widen access** to untapped MSMEs via multiple new seller apps
- ✓ **Seamless credit disbursal** to 'credit-seeking' customers
- ✓ **More choices** (for MSME) **–** ability to see offers from multiple lenders, better price discovery
- ✓ **Tailored products –** granular, lower-ticket products which better meet repayment/ working capital needs
- ✓ **More and standardized data** – Fluid access to buyer and seller platform data (in addition to data from AA)
- ✓ **Lower cost –** reduces cost to acquire and serve (assuming digital-first origination and servicing)

India has significant ground to cover in enabling Digital Credit Journeys

High Medium Low

	Process	India's Maturity Level		End-state Aspiration
1	**Digital Identifier**		Aadhar, Udyog AadharTAN, PAN, GSTN	Create **digital identifiers** through online identification process – either of customers or businesses – and linking it to downstream data
2	**Credit Rating**		Consumer Bureau, Commercial Bureau Public Credit Registry	Enable **dynamic and richer credit ratings** by aggregating users' financial (e.g. bank statements, tax statements) and non-financial data (e.g. utility payments, telecom bills, online marketplace)
3	**Fraud Detection** - Source of Fund Verification - Income Verification		e-KYC, KYC Setu	**Improve Digital KYC coverage** and conduct **comprehensive fraud assessment** via enriching fraud registries with non-financial data sources & analytics based scores
4	**Credit Underwriting**		AA, OCEN, Underwriting Models	Drive **context-specific lending** enabled by automated (& self-learning) underwriting models, consent-based data sharing
5	**Online Documentation**		e-Sign, Digilocker	**Enable digital documentation** fully via API led digital publication, document sharing, and consent-based access to specific data-sets
6	**Collateral Verification**		-	Drive digital security creation via creation of digital collateral, **tokenized** via blockchain based utilities to enable chain tracking and underwriting
7	**Loan Disbursement**		UPI, RTGS, IMPS, Kashi	Enable **speedy disbursement** enabled via digital payments infrastructure
8	**Loan Servicing**		e-NACH / e-Mandate	Provide early warning signals via advanced segment analytics (based on geography, industry etc.), dynamic credit ratings, automated payment tracking
9	**Loan Collection**		Collection models	Improve collections via advanced analytics-based utilities (micro-segmentation, strategy formulation), inter-operable collections protocols, pooled fraud registries

Enablers

Data Aggregation & Ingestion *(Digitization, Collation, Cleansing)*

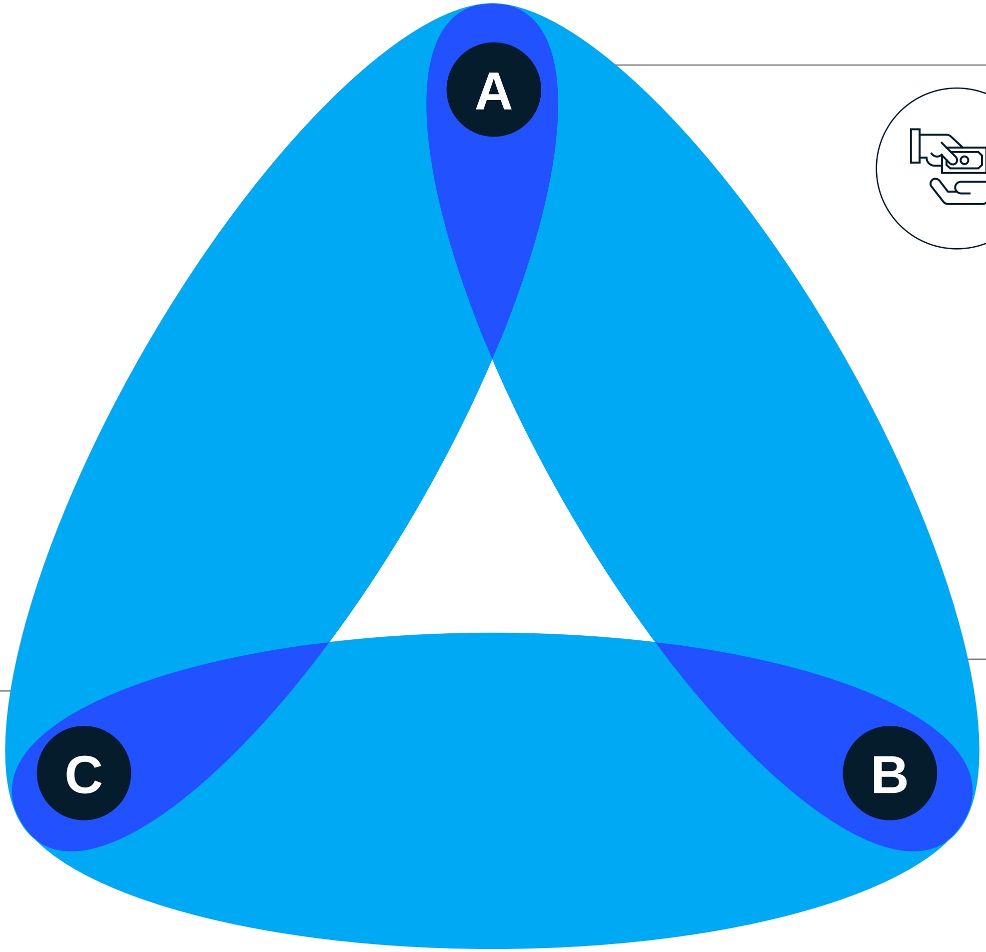
Customer Interface App. Omnichannel Presence

Data Standards & Protocols

Streamlined, Agile Regulatory Environment (governed by RBI)

Source: McKinsey analysis, Expert Interviews

Key Imperatives for Banking Sector



Enhance capabilities and infrastructure to reduce cost of intermediation

Establish utilities, frameworks, policies to expand markets

Enable ecosystems to broaden access

Banking Sector Unlocks (1 of 2)

Draft

Enhance capabilities and infrastructure to reduce cost of intermediation

1

- **Evolve Credit Bureaus:** Credit Bureau / Government Public Credit Registry to explore evolution into comprehensive consent driven **Information Bureau(s)** which enables stronger underwriting and monitoring
  - — capture and aggregate **consumers' banking information to create** early delinquency signals
  - — provide **(near) real-time data** vs. data with a time-lag, through **more real-time integrations** with industry participants to enable creation of **more dynamic and richer credit ratings & scores**
- **Expand AA framework:** RBI could expand Account Aggregator framework further to **include beyond-banking information,** including **Government services** (e.g. IT, GST, PF), **utilities** (e.g. electricity, telco, gas, water), other information (warehouse receipts, e-way bills, crop information etc.,) – **leveraging the consent-based architecture** (for information collection and dissemination). Towards this, RBI could allow all regulated entities (SEBI, IREDA etc.) to participate in the AA framework.

2

- **Enrich fraud registries:** Fraud utilities can leverage an expanded AA framework to enrich fraud registries with **additional non-financial data sources**[1] (e.g., bill payments, online purchase), thus enabling **creation of sharper fraud signals** (using behavioral patterns) **and more accurate, dynamic probabilistic fraud scores**

3

- **Strengthen Cybersecurity**: Create central agencies focused on financial cyber crime prevention, detection and legal enforcement as well as central **consent based databases across banks** to trace fraudsters

4

- **Share collections infrastructure**: Lenders to work with regulators to create **inter-operable collections protocols** enabling them to share collection capacity and drive **more efficient utilization of installed collections infrastructure** (esp. in underserved geographic locations)

5

- **Expedite NPA resolution**: Ministry of Finance can expedite NPA resolution further by implementing E-court management systems, e-bidding of bankrupt assets, expanding ambit of Pre-packaged resolutions (PRIRP) from being limited to MSMEs and including requisite pre-approvals for regulatory authorities across sectors as part of asset resolution

6

- **Create India CBDC[2] stack**: RBI to clearly **define standards** for institutions across **systems, protocols, core infrastructure**, and leverage **support from private entities** to build use cases, improve market penetration, drive innovation. CBDC would drive penetration across MSME segments and further **augment MSME lending** due to **better visibility of MSME cashflows to institutions**, real time cross-border remittances (with reduced transfer costs) and trade finance offerings via international collaboration

1. Covering non-sensitive information that can enrich fraud identification
2. CBDC - Central Bank Digital Currency

Banking Sector Unlocks (2 of 2)

Draft

Establish utilities, frameworks, policies to expand markets

7
- **Tokenize Collateral:** Banking Industry with regulatory support (from RBI), to incubate **'centralized, block-chain based, asset-specific' utilities to enable digital security creation as well as 'tokenize' and 'bring on-chain' various physical collateral** (e.g., homes, vehicles, gold) as well as **financial assets** (e.g., invoices, securities) to enable their digital verification, lien-marking, trading and securitization

8
- **Set-up Integrated Debt-Platform:** Financial Institutions to collaborate and **set-up an industry wide digital debt-platform** that enables lenders and suppliers of capital to **seamlessly plug-and-ingrate their balance sheets** and turn-on / turn-off funding supply

9
- **Launch a centralized awareness program:** Banking industry (potentially under Indian Banking Association)[1] to set up a centralized cross-industry awareness program focused on responsible lending practices, borrow and lender security against fraud / cyber-crimes, build-up of credit rating, lending risks etc.

10
- **Streamline and expand KYC:** Expand the ambit of digital and video KYC to all entities (beyond individual), rationalize focus on address proofs, improve coverage to non-individuals & smaller ticket size cases as well as accelerate CKYC registration of legacy accounts through targeted programs

Enable ecosystems to broaden access

11
- **Enable Ecosystems:** Financial and public institutions to work together to orchestrate **ecosystems around underserved segments** (e.g., MSME B2B commerce ecosystem, Rural agri. ecosystem) to expand reach and credit access. These ecosystems to be characterized by
  - Public-private partnership across a mix of financial services, sector specific stakeholders that jointly establish critical ecosystem infrastructure e.g., marketplaces, transaction platforms, data platforms to share and store non-financial data
  - Policies to drive mass-adoption of critical use-cases that enable at-scale digitization of transaction flows and underlying assets across the 4 key protocols ONDC, OCEN, AA and UPI
  - Seamless embedding and integration of tailored credit products in the ecosystem journeys

12
- **Facilitate Green Financing:** Create incentives to **increase access to credit for MSMEs in green value chains** (e.g. financing to MSMEs for green initiatives other than renewable energy to be included in PSL, harmonizing cost of green bonds issuance, tax breaks), backed up by well-defined regulatory framework (**national taxonomy of green assets** to create common, transparent standards & avoid green washing; sustainability disclosure & auditing standards) and **enabling market mechanisms** (e.g. green funds, carbon markets, green credits).

1. SEBI has mandated mutual funds to set apart 2 basis points of their net assets for investor awareness. Further, the mutual funds pool half of this mandated amount to Association of Mutual Funds in India (AMFI), which in turn undertake comprehensive media campaign for promoting mutual funds among investors.

Backup

Structurally higher lending cost – 500 bps higher than comparable peer economies

Drivers of differences in the cost of commercial loans in India v/s other emerging economies Percentage Points		Average nominal rates, 2019% India	Average nominal rates, 2019% Other Emerging Economies[1]	Potential levers to reduce cost of commercial loans
Fund and fee-based charges paid by borrowers	5.2	10.7	5.5	
Crowding out effect of government borrowing	1.2	1.2		Streamline public finances, market linking small-savings rates, rationalizing SLR requirement, focusing PSL obligations on key priorities
Credit risk provisions due to non-performing loans	1.2	1.8	0.6	Strengthening the Insolvency and Bankruptcy Code (refer next slide)
Operating expenses	1.3	2.7	1.4	Building operational efficiency through privatization, digitization, and automation, among others
Residual Expenses	1.5	5.0	3.5	

1. Simple average of China, South Korea, Thailand

Strengthening IBC framework

Challenges

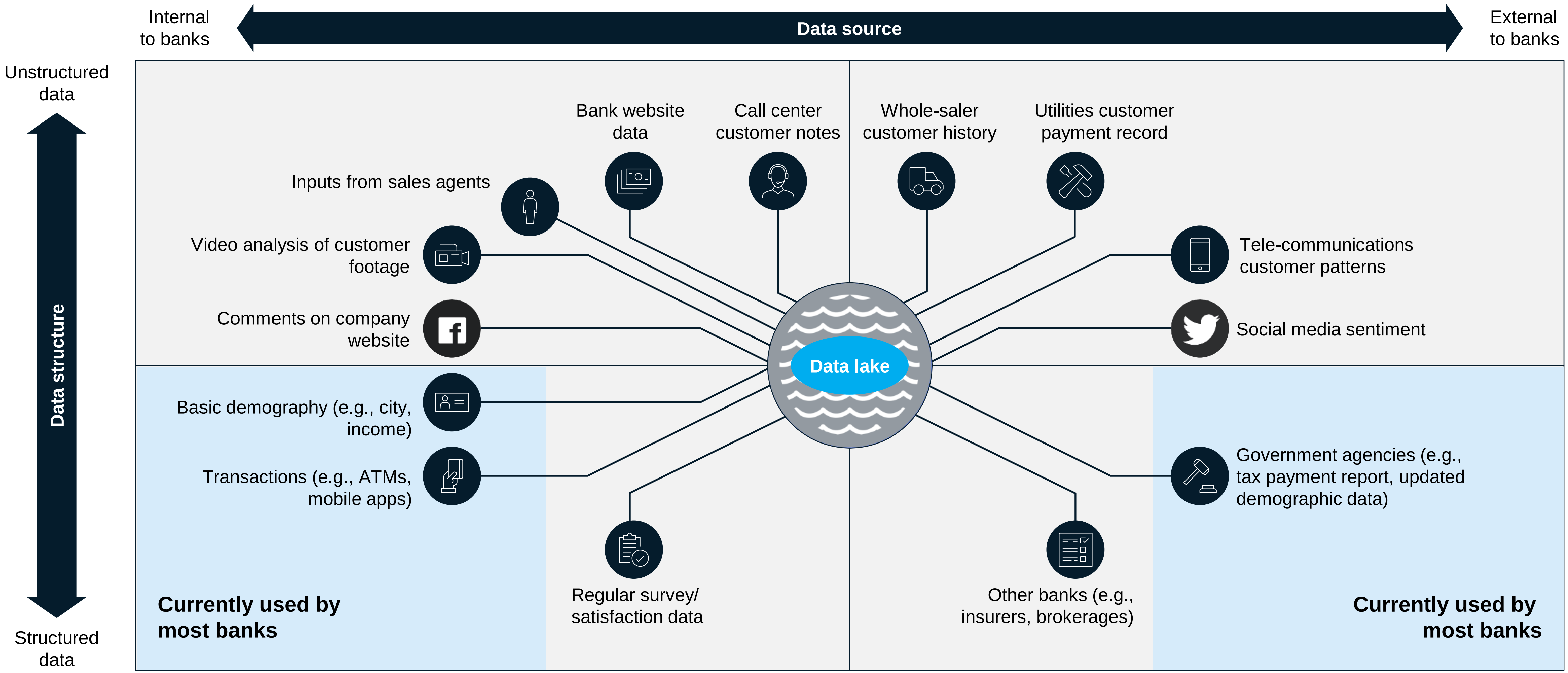
- **Slow resolution process** – 70%+ cases resolved in 270+ days after admission (as against mandated 90 days)
- **Withdrawals under Section 12A** – ~17% of cases liquidated – potentially adding avoidable burden of cases on the tribunals
- **High number of liquidation cases** – nearly half of ~3,200 cases have been liquidated

Unlocks

- **E-court management systems** could be implemented, and e-bidding of bankrupt assets could be allowed
- Creditors could be enabled to **invoke corporate and personal guarantees** provided by promoters as part of the IBC framework itself[1]
- A clear methodology and **mechanism (e.g., formula-based) for price discovery** could be set up, with the aim of removing ambiguity in decision-making and a enable speedy resolution process. The mechanism could be set by an independent IBBI-approved evaluator or defined by IBBI.
- Expand the ambit of **Pre-packaged resolutions (PRIRP)** from being limited to MSMEs, to help ease the case load on bankruptcy courts.
- "**Asset preservation agencies / asset operators**" could be incubated, with interim funding provided by the creditors, to operate the asset as soon as lender files for insolvency (even before the case is admitted to the NCLT), to prevent leakage in value of the assets.
- Strict conditions could be put in place for withdrawal of cases (**including timelines for withdrawal**), and timelines for filing cases after default.
- Disincentives and punitive damages could be established for **unnecessary delays and incorrect claims** by the CoC[2].
- The resolution plan could include **requisite approvals from regulatory authorities across sectors (e.g., TRAI, NHAI, etc.)** so that there are no additional approvals required post the successful resolution of the asset.

1. In line with the Supreme Court ruling as in the case of Essar
2. For example, in Spain, the government provided incentives/ penalties to discourage stakeholders from rejecting reasonable restructuring options. In Hong Kong, the Bankruptcy Act protects creditors against asset depletion and provides for three types of liquidation: members' voluntary liquidation, creditors' voluntary liquidation and compulsory liquidation.

Opportunity to tap into multitude of non-traditional data sources



Source: McKinsey Global Institute

Data tsunami underway in India: 10+ data sources have emerged

Traditional data source | New data source

Traditional data source				
Aadhaar- 940 mn+ registered numbers	**Registrar of companies- 1 mn+ registered companies**	**IT department – 35 mn+ tax payers (Form 26 AS)**	**Credit Bureaus - 200mn+ retail customers**	**Employees Provident Fund - ~50 mn active subscribers**
Customer information: Name, age, address, photograph Issued first card in 2010	Company details Balance sheet Profit and loss	Income tax paid Employment history Customer information	Credit history RBI defaulters list Employment details Customer information	Customer information Employment details PF contribution & status

Traditional data source	New data source	New data source	New data source
LPG gas connections - ~90 mn+ connections	**E-commerce- 40mn+ [1] registered users**	**Data aggregators- 250+ [2] financial institutions registered**	**Others - Utility bills, Insurance, car registration**
Customer information Number of connections LPG consumption history	Customer spends and payment history Supplier inventory and payment history	SMS scraping of bank account Transaction data, e.g., spends category	Utility bills Employee state insurance corporation Car registrations and customer information

1. FlipKart, Amazon, and Snapdeal have > 40mn registered users;
2. Perfios has signed up more than 250 financial institutions

Source: Company website; web search, interviews

Customer journey transformation scope

Journeys	Journey transformation programmes	
Help me **buy a home** Help me to **re-finance my home** Help me to **help my client buy a home**	1 **Mortgage lending & Intermediaries**	
Help me set up my **business banking** services	2 **Onboarding**	**Commercial**
Help me **borrow money for my business**	3 **Lending**	**Commercial**
Help me **open an account** for my everyday banking (Personal current accounts, Savings)	4 **Personal current account**	**Retail Customer Onboarding**
Help me **switch** my everyday banking to you	5 **Savings**	**Retail Customer Onboarding**
Help me to **buy what I need** or want	6 **Credit cards**	**Retail Customer Onboarding**
Help me **borrow money** (Credit Card, Loans)	7 **Loans**	**Retail Customer Onboarding**
Help my employees prepare for **Retirement**	8 **Corporate pensions**	
Help me **service** my Everyday Banking **Accounts** Help me when **something goes wrong** Help me **service** my **borrowing** products Help me change my **personal details and address** Help me get **power of attorney**	9 **Personal account servicing**	
Help me with my **Business Banking Services** Help me manage my **working capital**	10 **Commercial servicing**	

Customer Transformation journey impact…

80% of total Bank customers

90+% of total retail & commercial servicing transactions

65+% of total loans and advances

100% of corporate pensions clients

~40% of Bank's total FTE

Customer Journey Transformation scope covers…

All core brands

All channels (branch, digital, telephony)

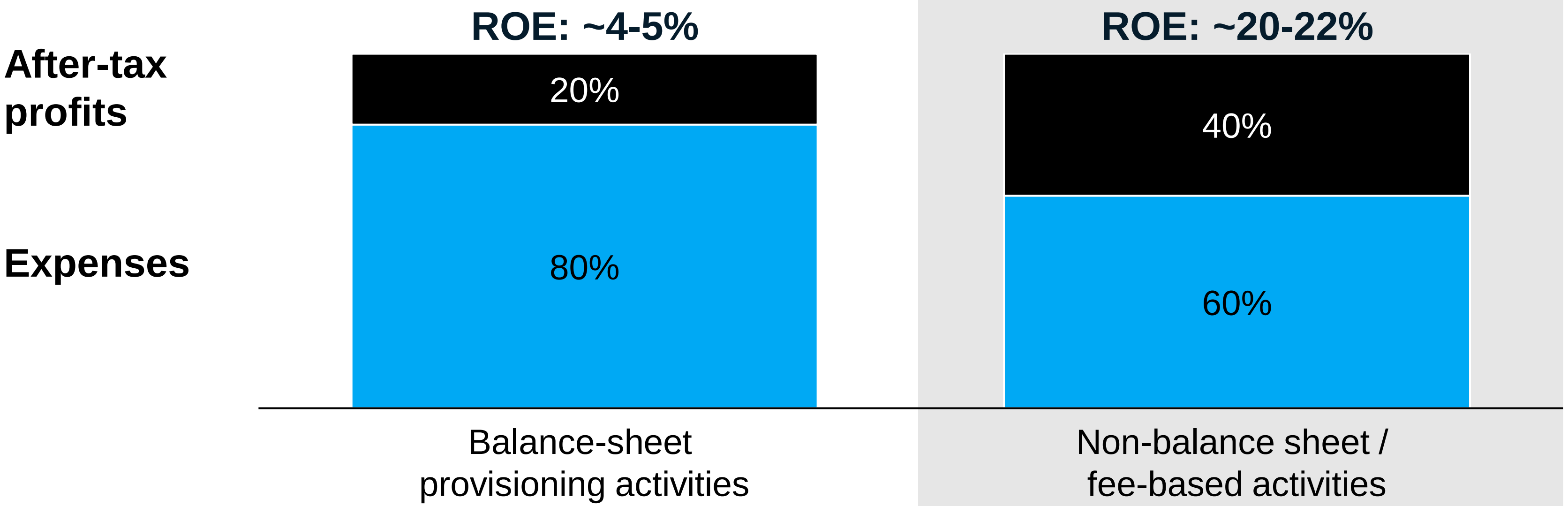
Source: McKinsey analysis

FinTechs have focused on the more 'profitable' non-balance sheet based revenue pools

Focus of FinTechs

Global banking revenues and profits by activity[2]

% share for 2018



Activities

	Balance-sheet provisioning activities	Non-balance sheet / fee-based activities
Activities	Loan booking and provisioning	Sales & origination
	Account provision (e.g., demand, term)	Services (e.g., transactions, payments, advice, investments)
	Product manufacturing	White-labelled products and solutions

~4X

higher ROE could be generated by FinTechs by focusing on origination/ sales activities vs balance sheet provisioning; also generate majority of industry's after tax profits

1. As of October 10, 2018: PEG ratio calculated as Share Price/Earnings per Share (EPS) divided by EPS Growth Rate
2. Exhibit 2: The future of bank Risk Management

Source: McKinsey Panorama — Global Banking Pools