State-run banks must be privatised | Nandan Nilekani

By Nandan Nilekani

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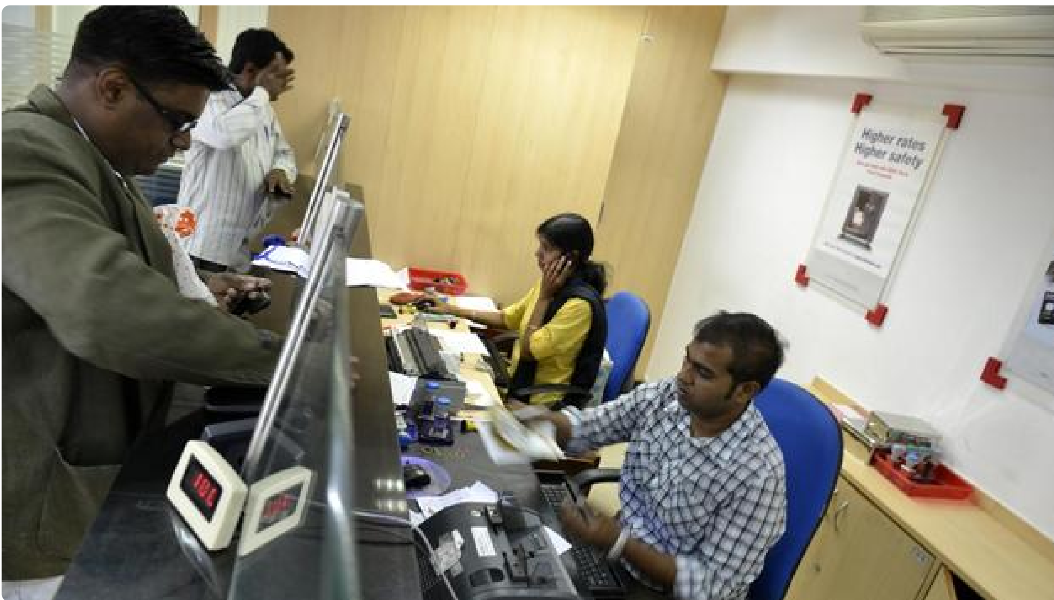
Cricket

Technological disruption has made it even more critical for State-owned banks to shape up. The failure of audit controls in the Nirav Modi case or NPAs also demonstrates how not just transactional banking, but even audit that needs a technological reimagining



By divesting from public sector banks, and yet devising a way to keep the upside of their future growth, the exchequer can still capture the value that is inexorably being eroded from these banks(Hemant Mishra/Mint)

From 1947 to 1955, 361 private banks in India had failed, leaving depositors in the lurch. On the midnight of July 19, 1969, 14 of the largest commercial banks in India, which accounts for 85% of all deposits, were nationalised. In the almost five decades since, we've managed to stabilise and expand access to banking to the people. India now has more than one billion bank accounts.

The argument for this drastic step was the delivery of credit. The private banks would only lend to a select few large industries and businessmen. In 1967, the lending to

agriculture as a percentage of total lending was 2.2%, and shrinking. Through nationalisation, the government could direct credit towards the priority sector: agriculture, small industries, traders and entrepreneurs.

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But if you have read the news lately, you would think the public sector banks (PSBs) don't know how to distribute credit. From 2015, the Reserve Bank of India (RBI) has changed the way banks report their non-performing assets. This uncovered a mountain of bad debt, triggering the introduction of the new Bankruptcy Code in 2016. The recent announcements by RBI have brought a larger section of loan accounts into the new approach, which focuses on the viability of borrowers. The apex bank has shown uncommon courage in pushing forth to remove the scourge of crony capitalism once and for all. This increases the pressure on PSBs to provision more losses, and on the government to provide more capital. The Nirav Modi case has only brought more systemic problems under the spotlight.

Most importantly, along with all the challenges of NPAs, systems, human resources and governance, PSBs now also face a rapidly evolving existential threat. Technology is a double-edged sword for finance. On the one hand, it has greatly expanded access. Many of the 300 million Jan Dhan accounts opened since 2014 have been enabled by Aadhaar electronic Know Your Customer (eKYC). On the other hand, technology is inverting the banking business model from low-volumes of high-value transactions at high cost to high-volumes of low value transactions at low cost. This is primarily driven by the rapidly plummeting costs of

transactions brought on by the India Stack based on the Jan Dhan, Aadhaar, Mobile (JAM) trinity. The dramatic move towards a less-cash economy powered by the Unified Payment Interface (UPI) will further change the competitive dynamics of the banking sector.

The failure of audit controls in the Nirav Modi case or NPAs also demonstrates how not just transactional banking, but even audit that needs a technological reimagining. It is possible to create a digital audit powered by artificial intelligence (AI), which is real-time and preventive instead of post facto and reactive.

But the rapid digitisation also means bankers, public or private, have to engage in a cyber arms race they are not trained for with fraudsters and hackers.

The opportunities and threats of rapid technological change thus make it even more difficult for PSBs to cope.

And yet, despite nationalisation, India is still credit starved. Our appetite for credit will only grow as GDP does. Moreover, low transaction costs using digital, means it is feasible to serve customers that couldn’t be served before. Credit in the economy will only deepen.

A recent Morgan Stanley report estimated the sector will grow from $370 billion to $1.8 trillion by 2027. The same report estimates that in 2017, PSBs will have a market share of less than 10%. PSBs will be left dealing with their legacy issues, stranded assets and technology challenges, while private banks and NBFCs respond nimbly, capturing most of that deep credit growth.

Given that financial inclusion and lending to the unserved is now possible with technology, the arguments for a State-owned thrust further wither away. The market knows these truths and today, HDFC Bank alone has a market capitalisation higher than the top 22 government-owned banks combined. The share of new loans issued by PSBs have dropped from 49% in 2014 to just 28% in 2017.

The argument for privatisation, then, is simple. It is already creeping up on us, whether we like it or not. Technological disruption has made it even more critical. By divesting from PSBs, and yet devising a way to keep the upside of their future growth, the exchequer can still capture the value that is inexorably being eroded from these banks. Privatisation is no longer a question of if, but when.

Nandan Nilekani is former chairman of the Unique Identification Authority of India and is currently chairman of Infosys Ltd