

The \$5tn goal: Importance of the banking sector

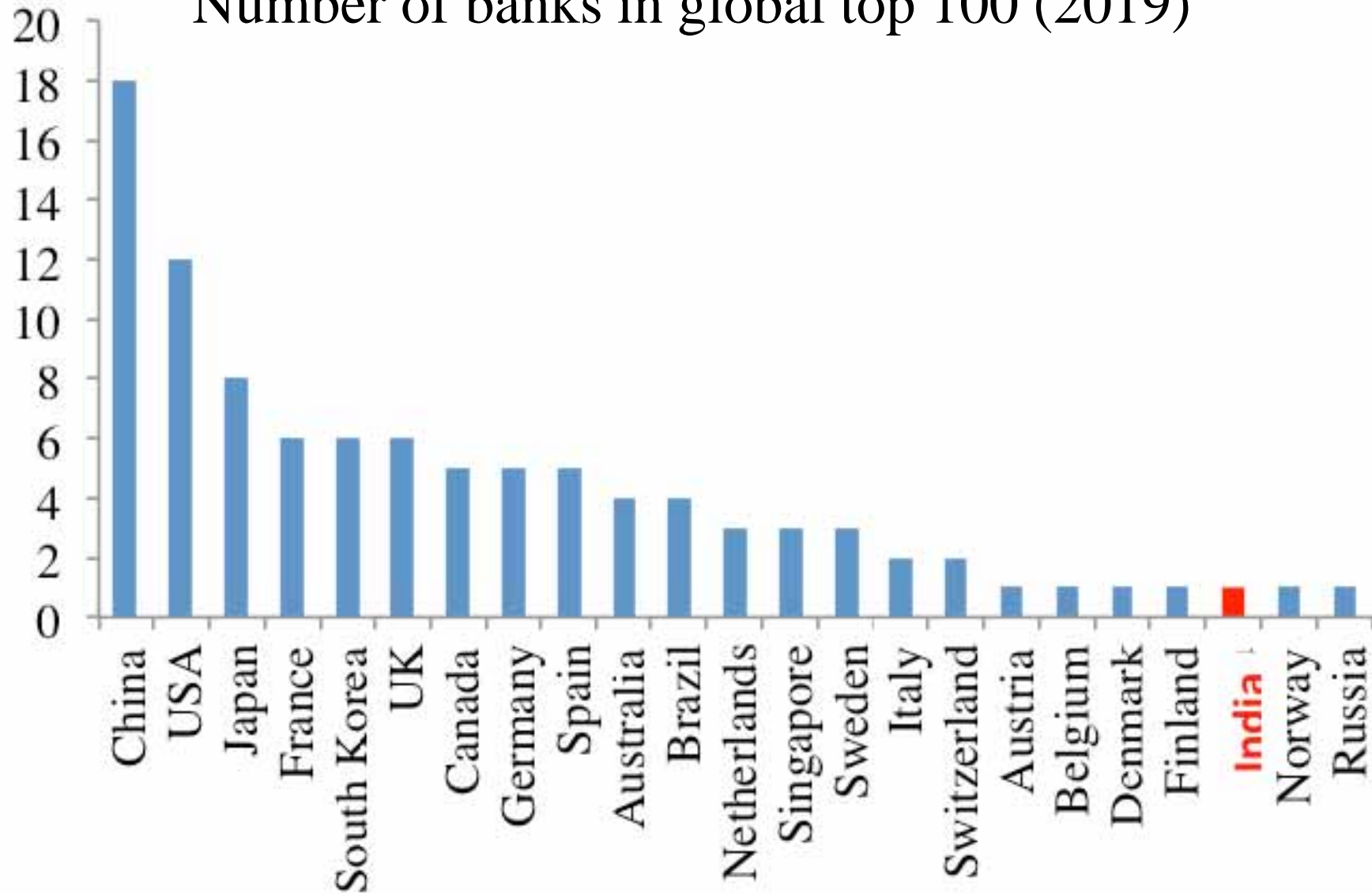
**Dr. K V Subramanian
Chief Economic Adviser
Government of India**

The Banking Sector and the Economy

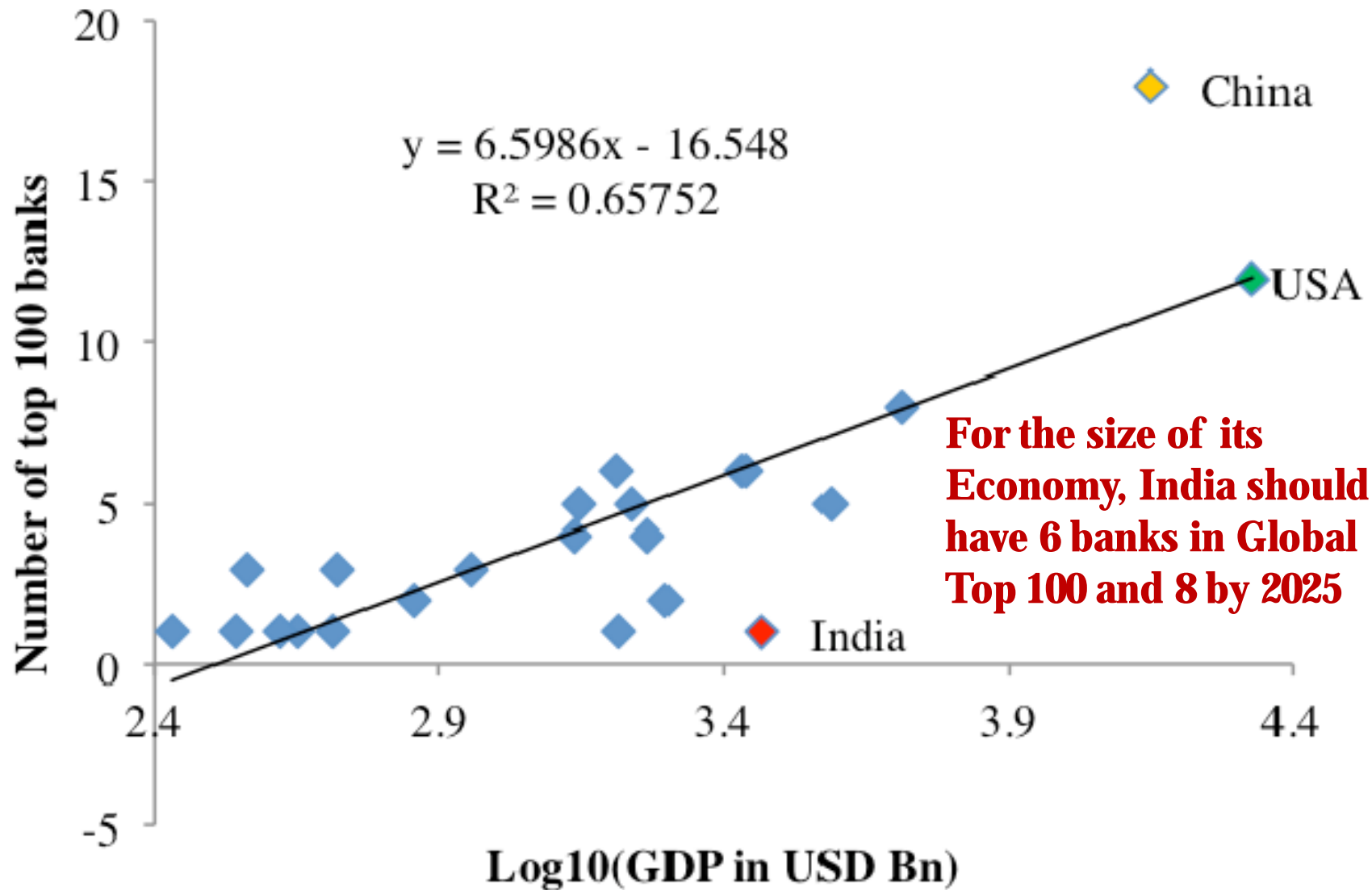
- ❑ In the last 50 years, the top-five economies have always been ably supported by their banks
- ❑ The support of the U.S. Banking system in making the US an economic superpower is well documented.
- ❑ In the 80s, during its heydays, Japan had 15 of the top 25 largest banks.
- ❑ Top four largest banks globally are all Chinese. As of 2019, 18 of the top 100 largest banks globally are Chinese banks.
- ❑ Yet, 50 years after bank nationalisation, the 5th largest economy in the world has one bank in top 100 - a lowly 55th ranked SBI

Sub-scale of India's Banking Sector

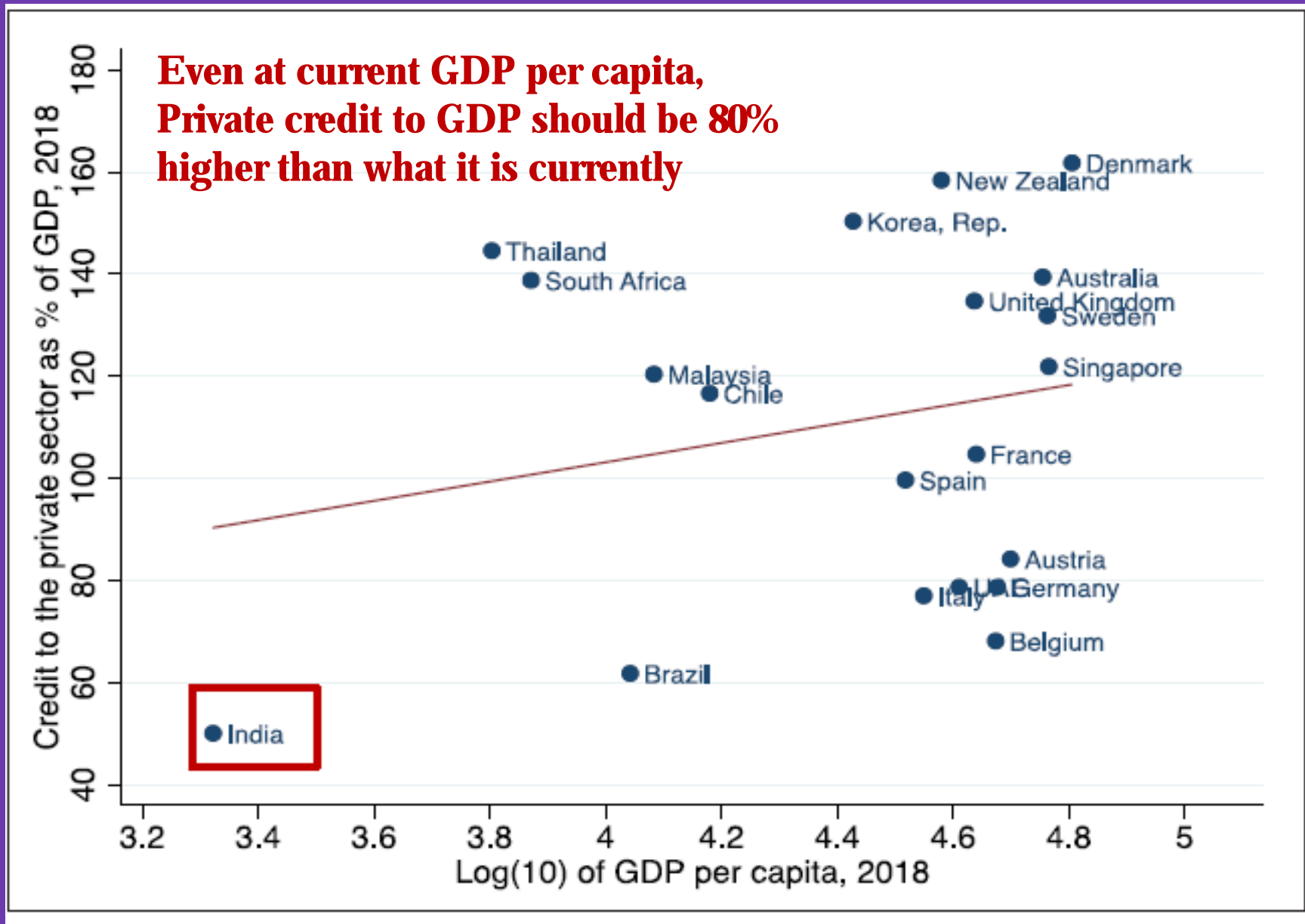
Number of banks in global top 100 (2019)



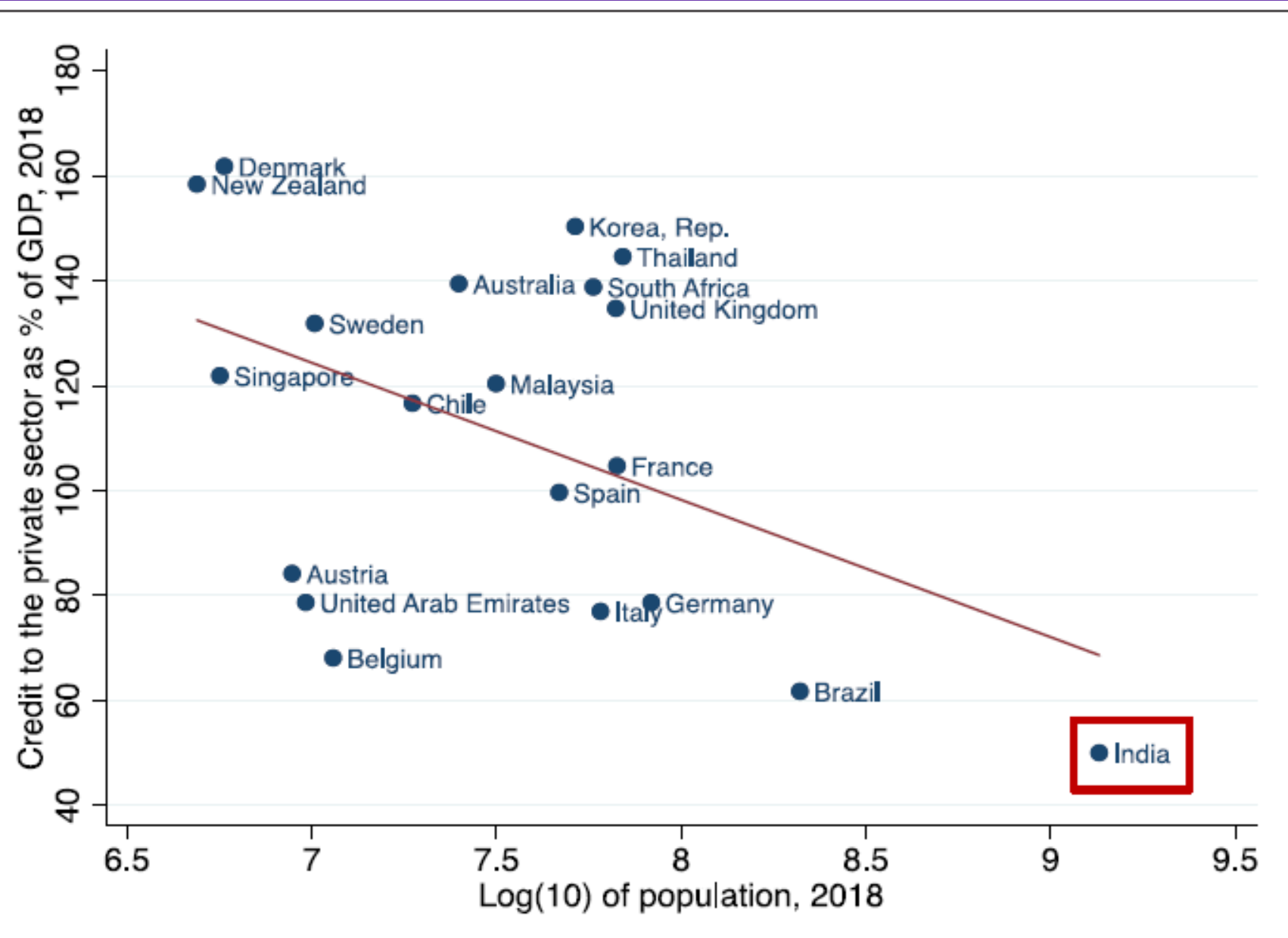
Sub-scale of India's Banking Sector



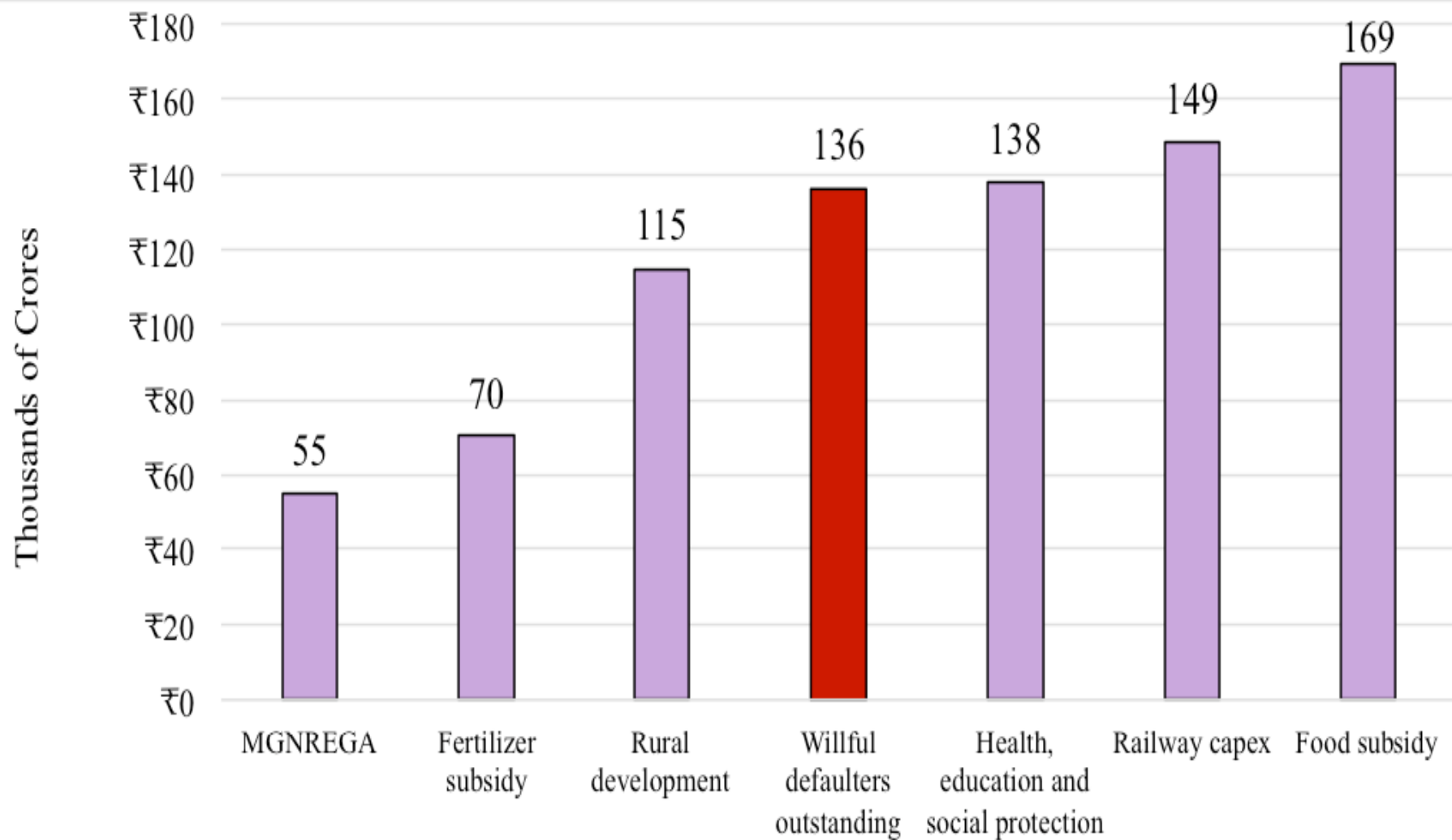
Sub-scale of India's Banking Sector



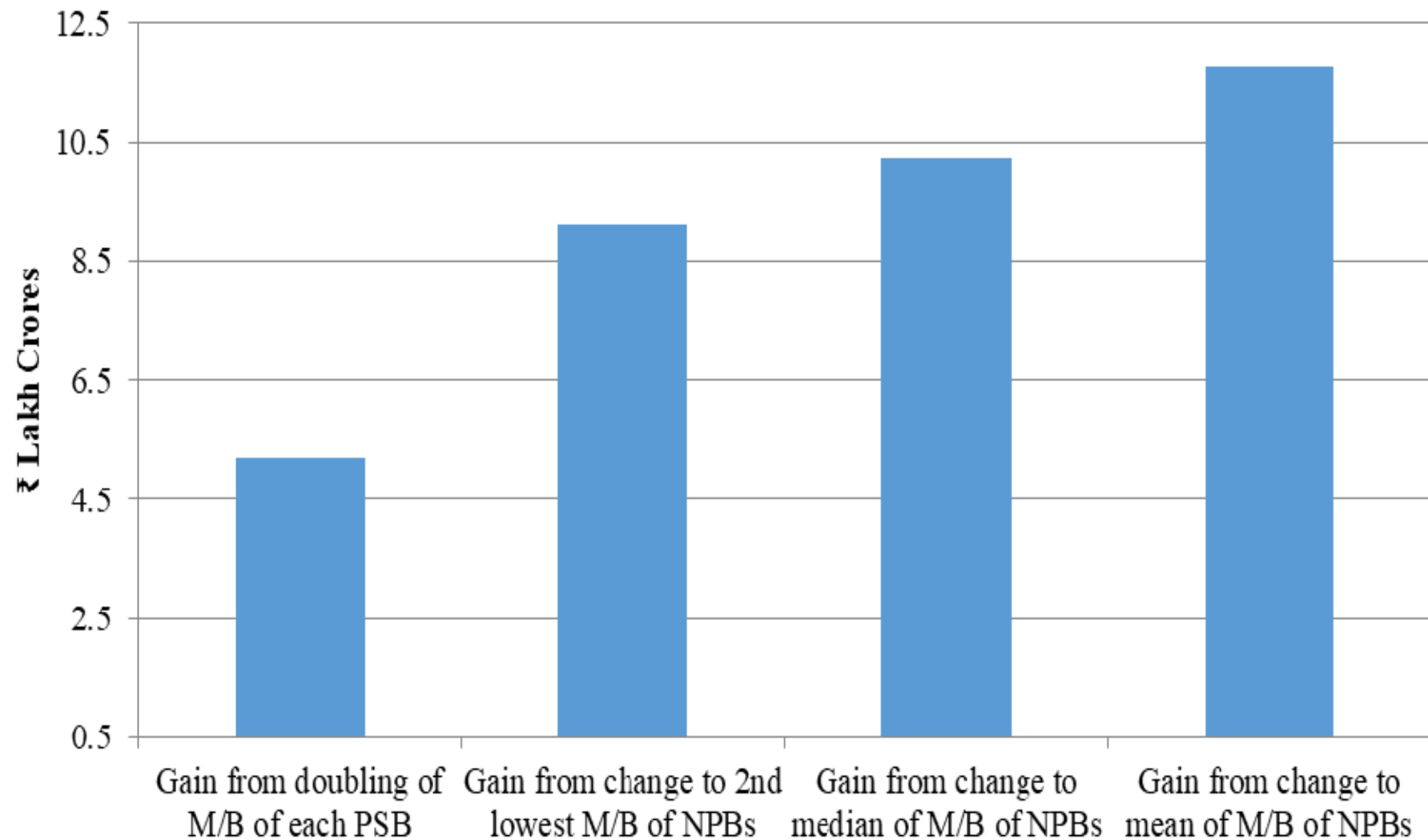
Sub-scale of India's Banking Sector



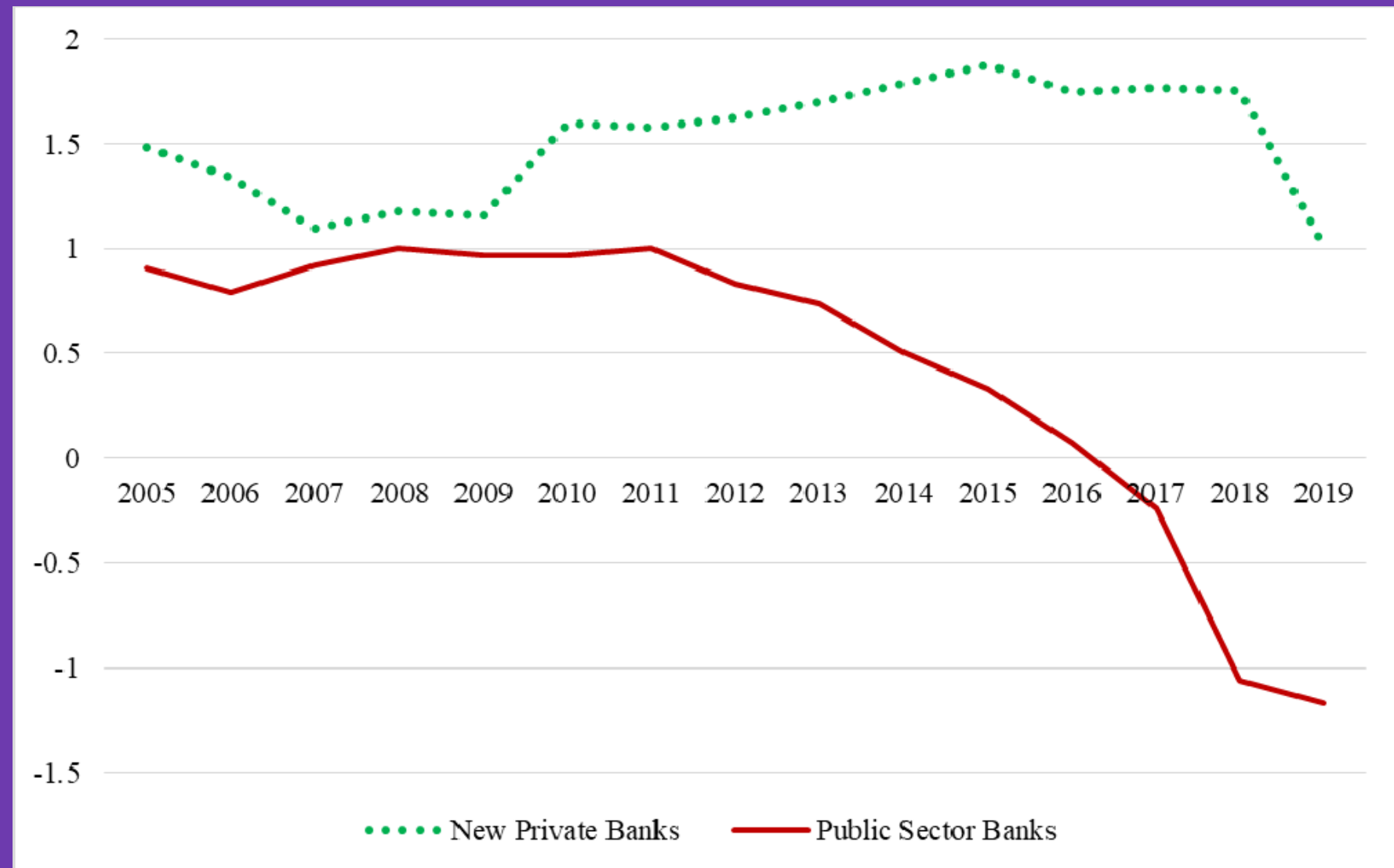
Wealth erosion by willful defaulters



Potential gains to the taxpayer from enhanced efficiency in PSBs



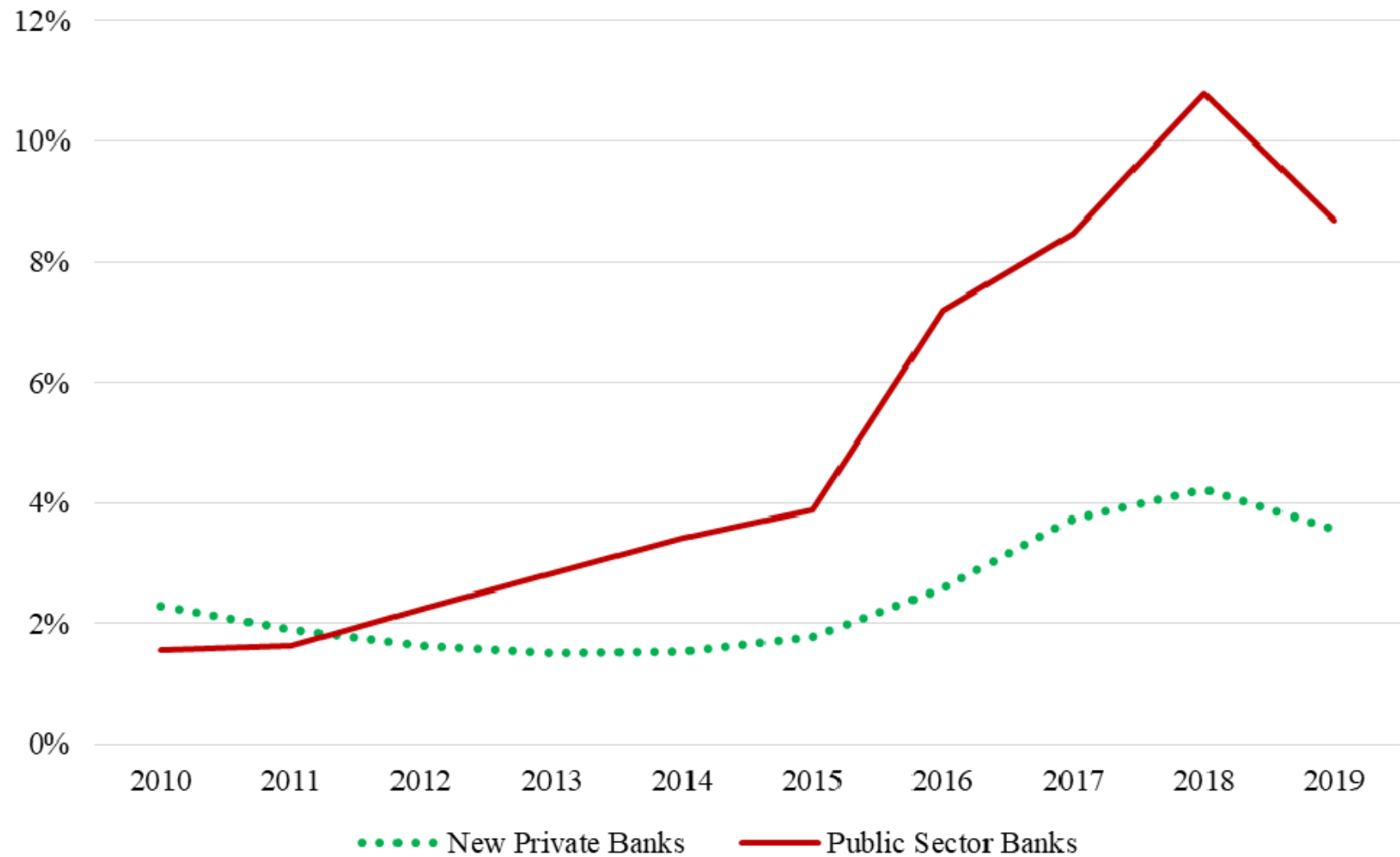
Return on Assets



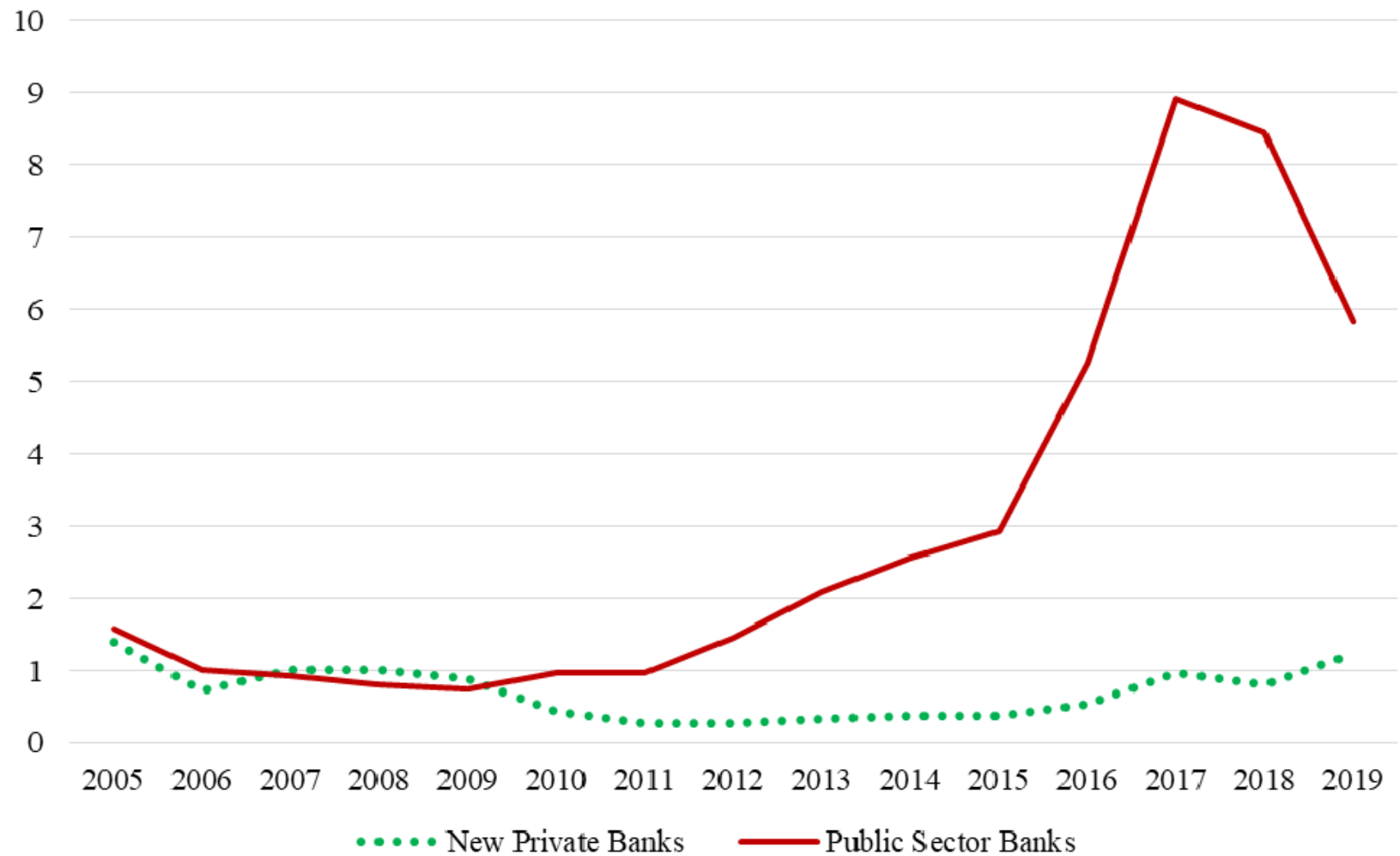
Return on equity



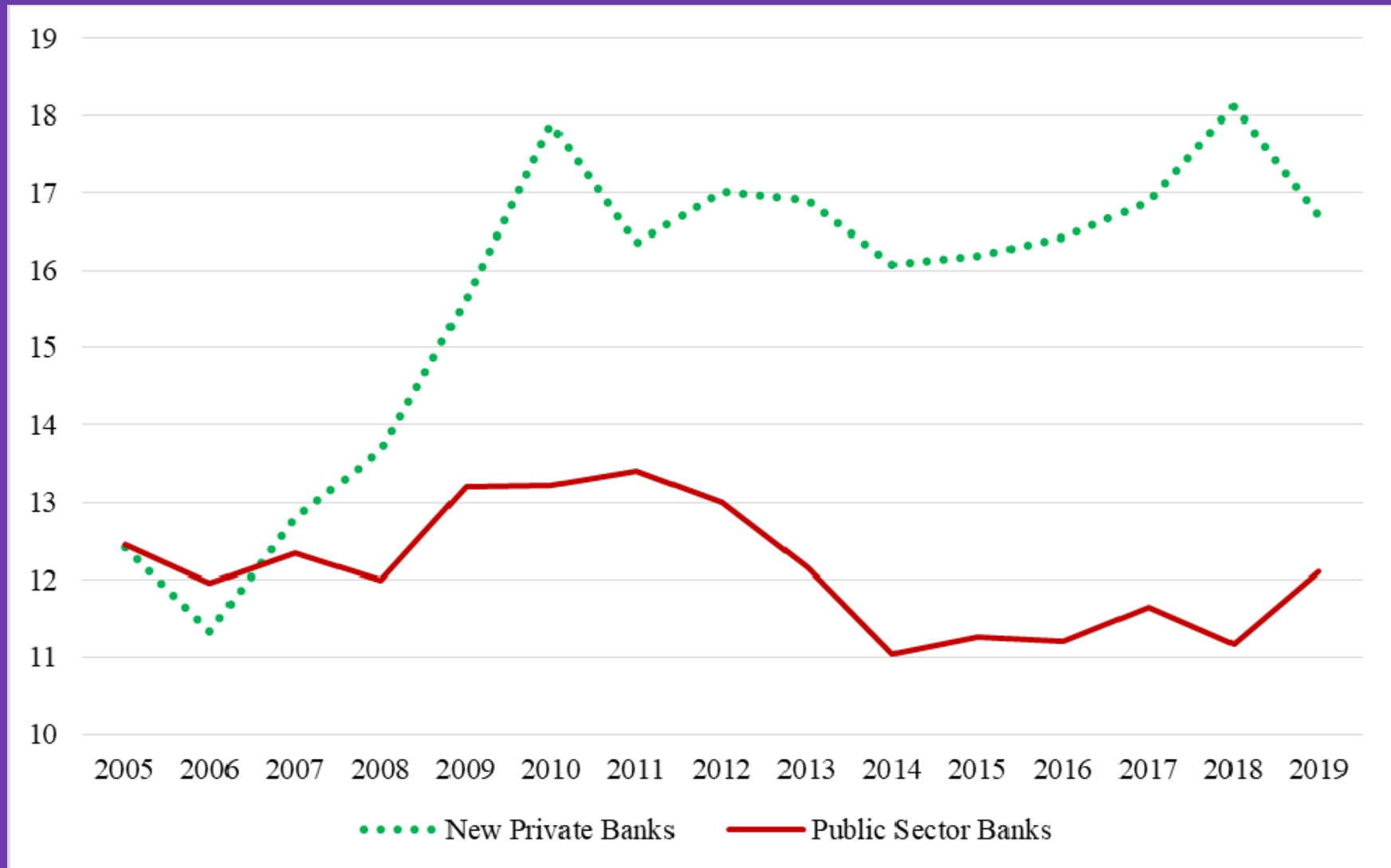
Gross NPA to Advances



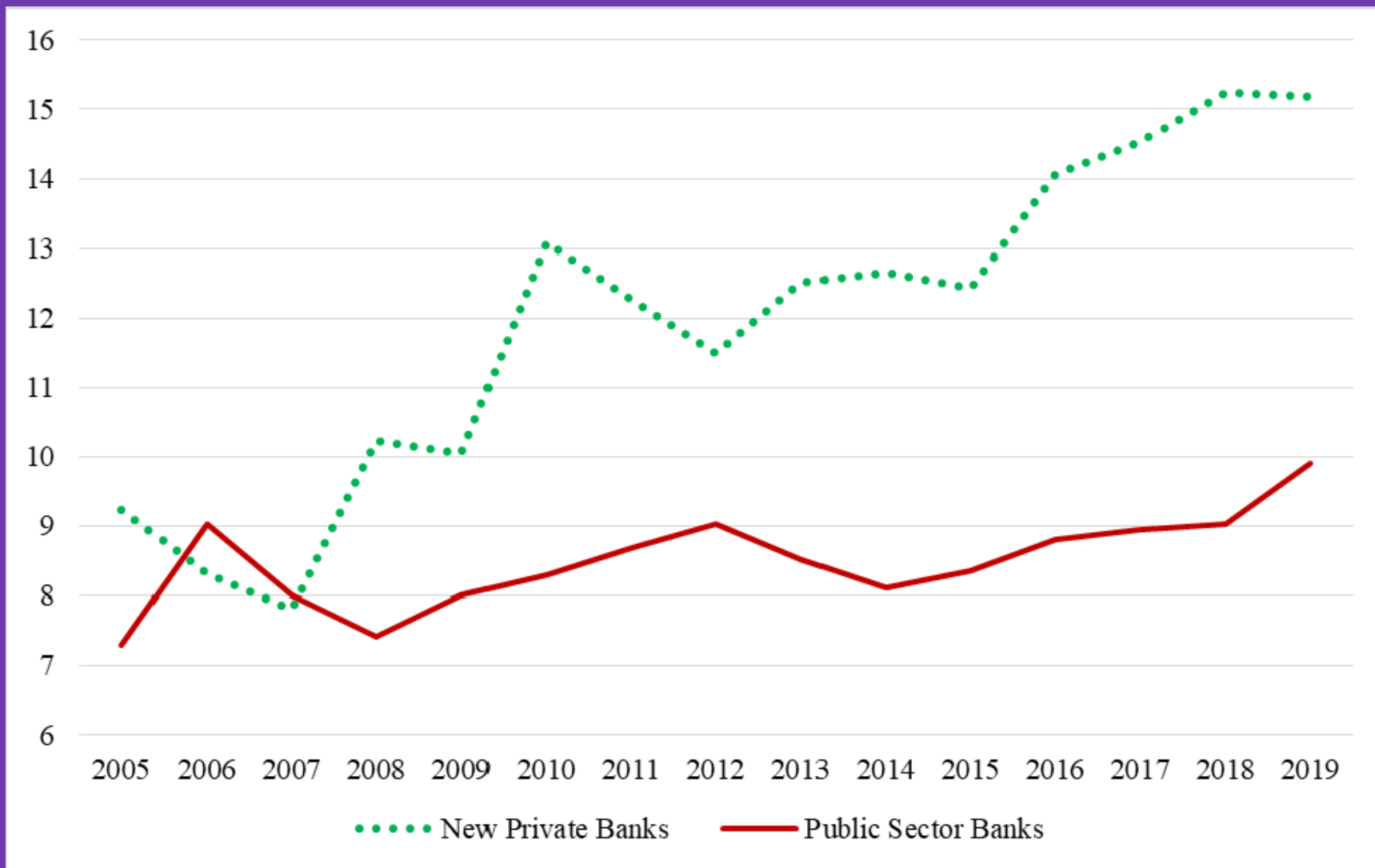
Net NPA to Advances



Total Capital Adequacy Ratio



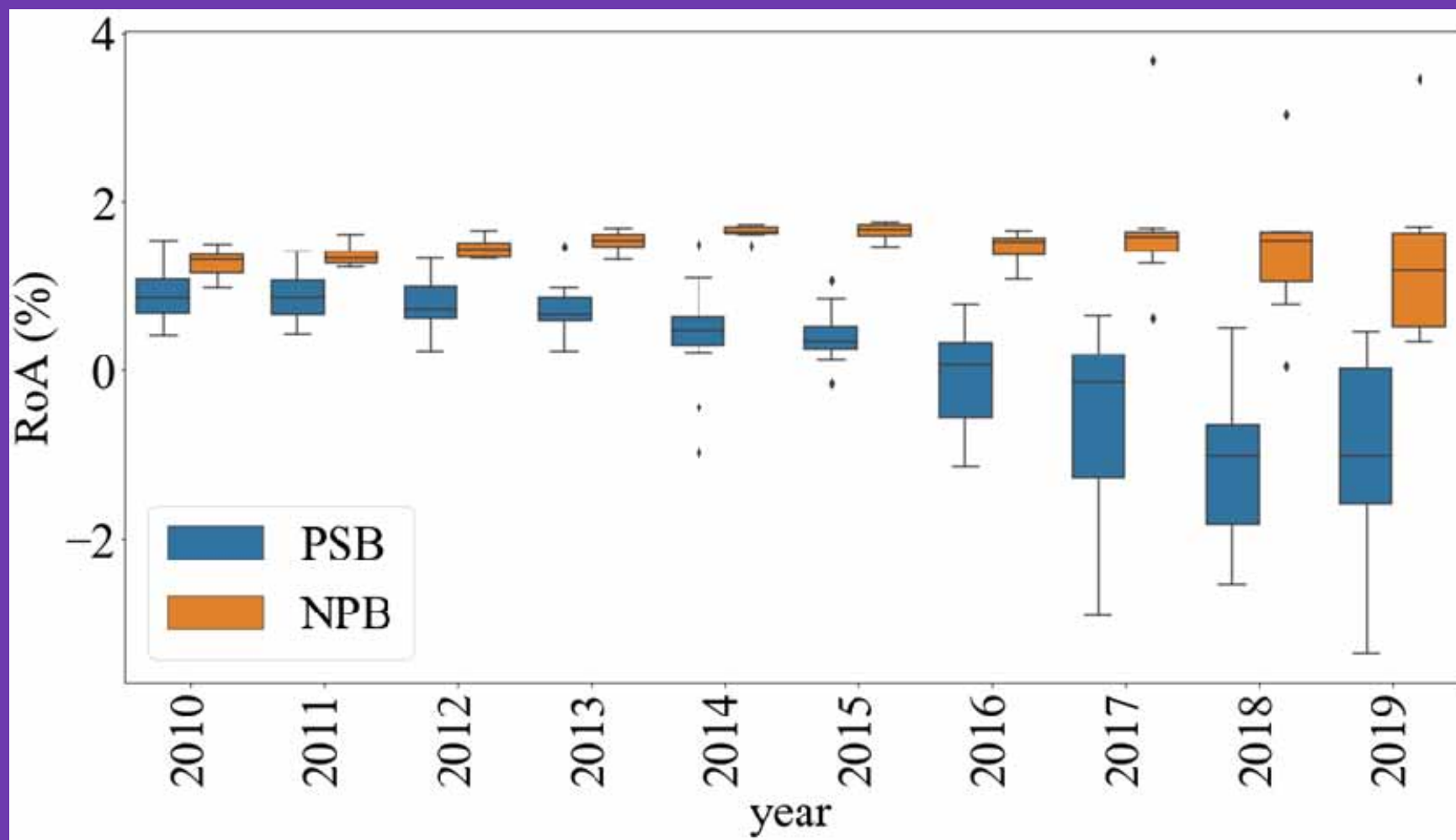
Tier-1 Capital Adequacy Ratio



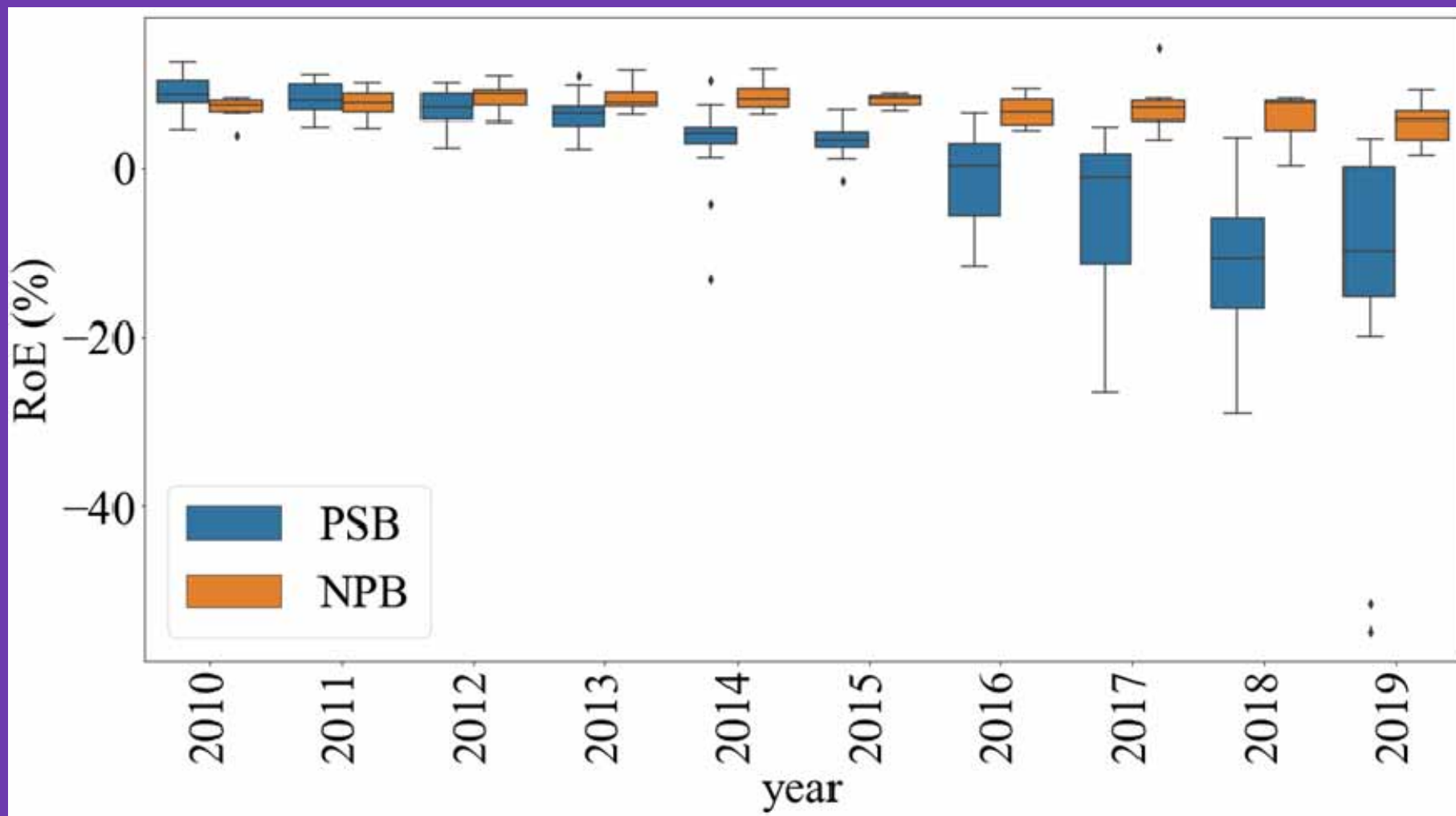
A key statistical principle for correct inference

- Note carefully why a comparison between the average performance of PSBs and average performance in NPBs is an appropriate, apples-to-apples comparison.
- In any economic activity, heterogeneity is inevitable
- Wide variation within PSBs in their performance
- Similarly, some variation in NPBs performance too
- But, incorrect to “pick one NPB to say NPBs no better!”
- Comparing performance of average PSB with either best or worst performing NPB is incorrect
 - ❖ Mixes up two statistical measures – averages and outliers
 - ❖ Leads to an apples-to-oranges comparison

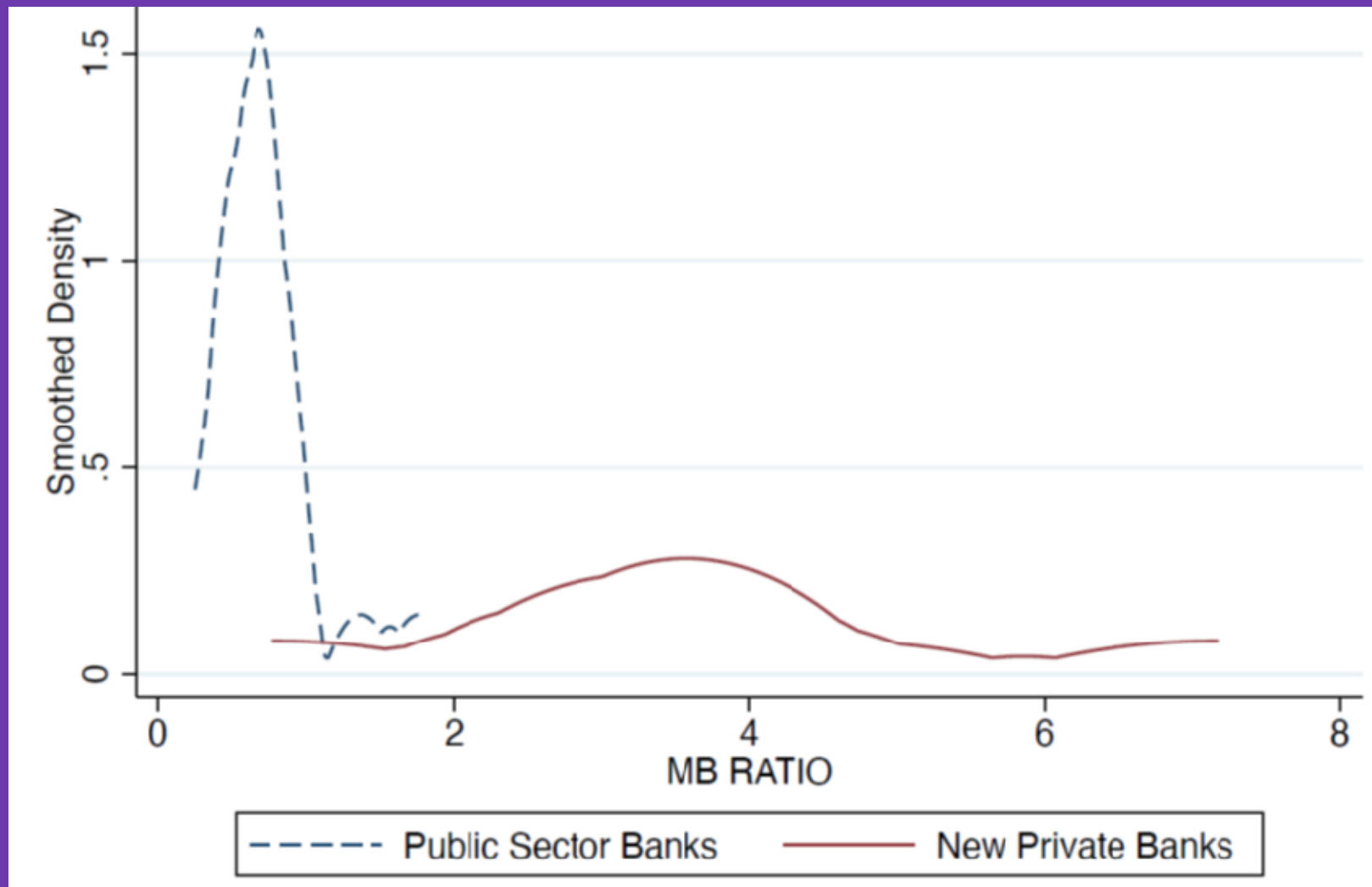
Comparison accounting for heterogeneity: Return on Assets



Comparison accounting for heterogeneity : Return on Equity



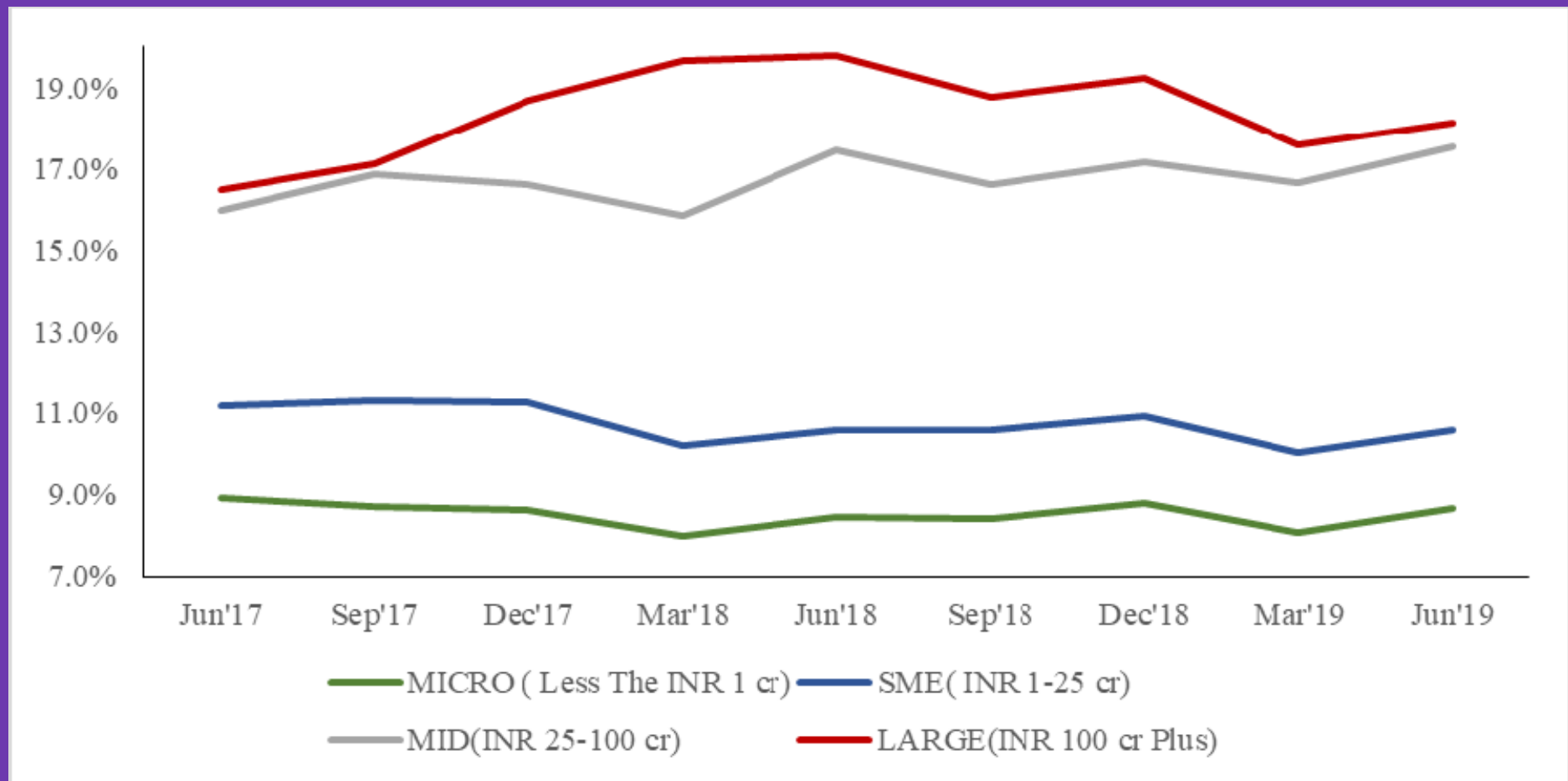
Distribution of Market-to-book ratios



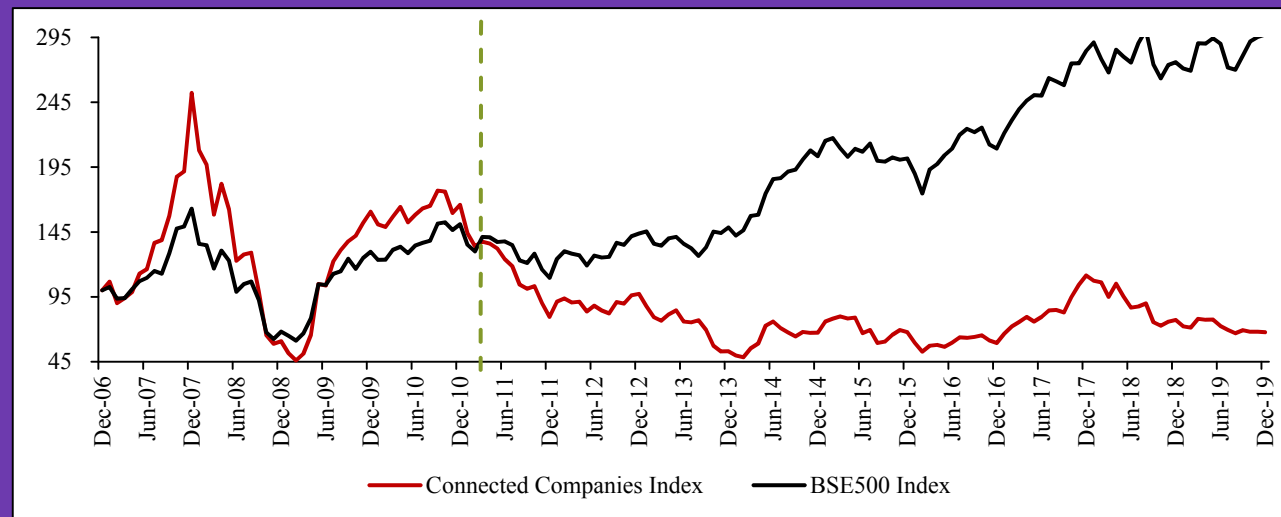
PSBs need radical transformation

- ❑ Estimate of return on equity in 2019 highlights that every rupee of taxpayer money invested in PSBs as equity by the Government loses 23 paise.
- ❑ The market-to-book ratio, which indicates the quality of a bank's governance, is 0.5 as of 2019 while that of the average private sector bank is >3.
- ❑ To enable PSBs to become efficient and thereby catalyse the banking sector and stimulate economic growth, structural solutions are necessary.

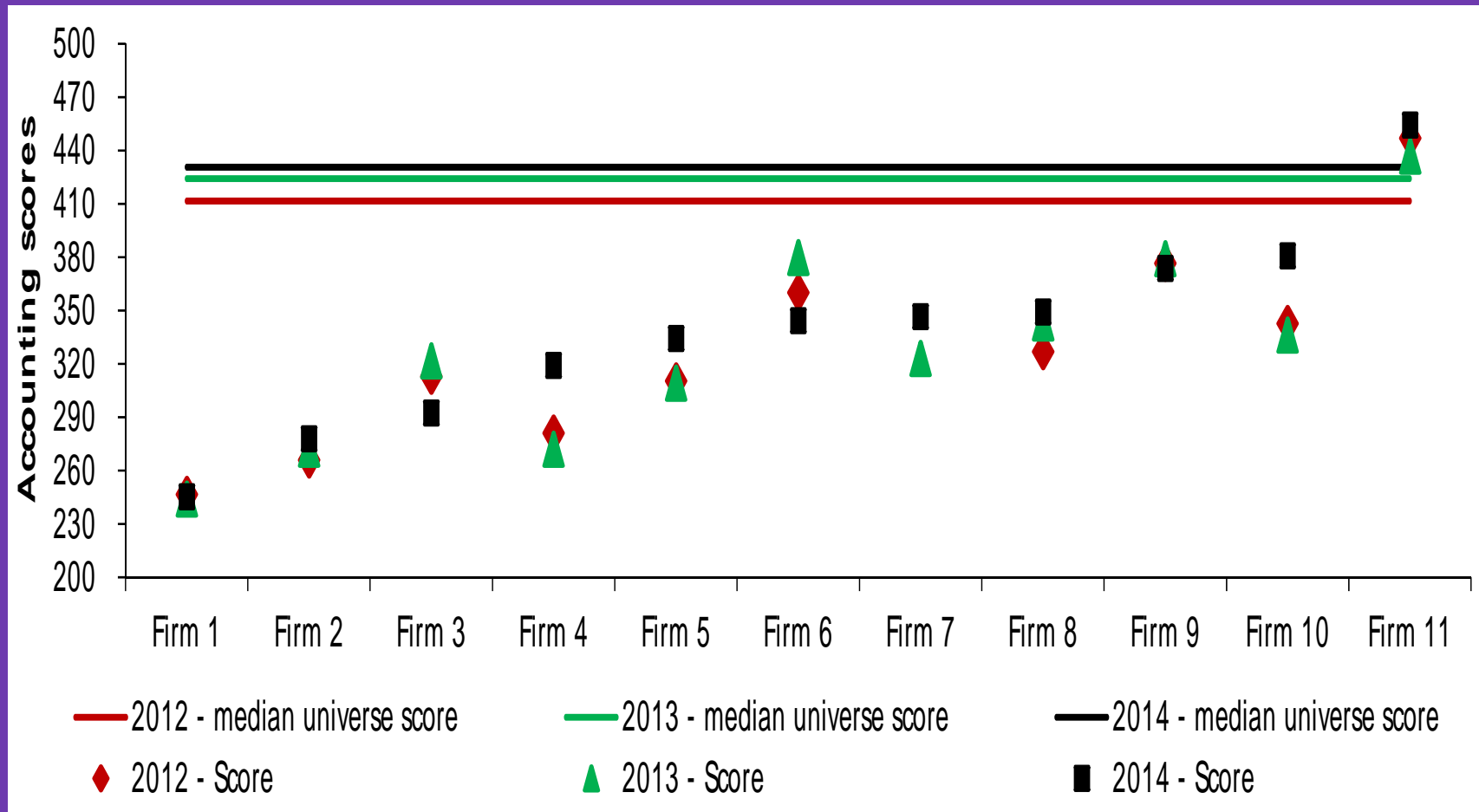
Non-Performing Asset (NPA) Rate by Size of the Loan



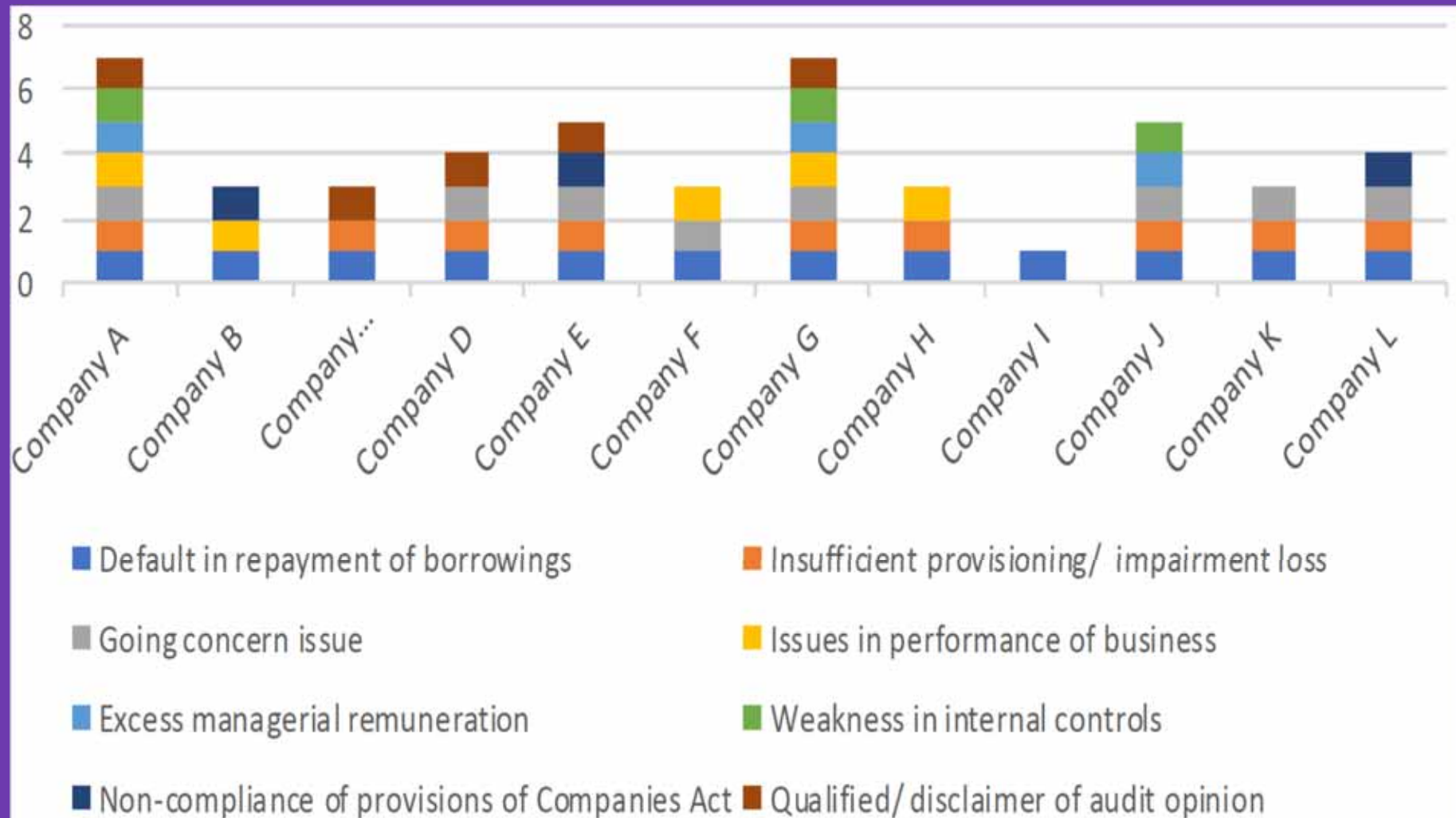
Pro-crony policies undermine trust



Leading Indicators using quality of financial statement disclosures by large defaulters

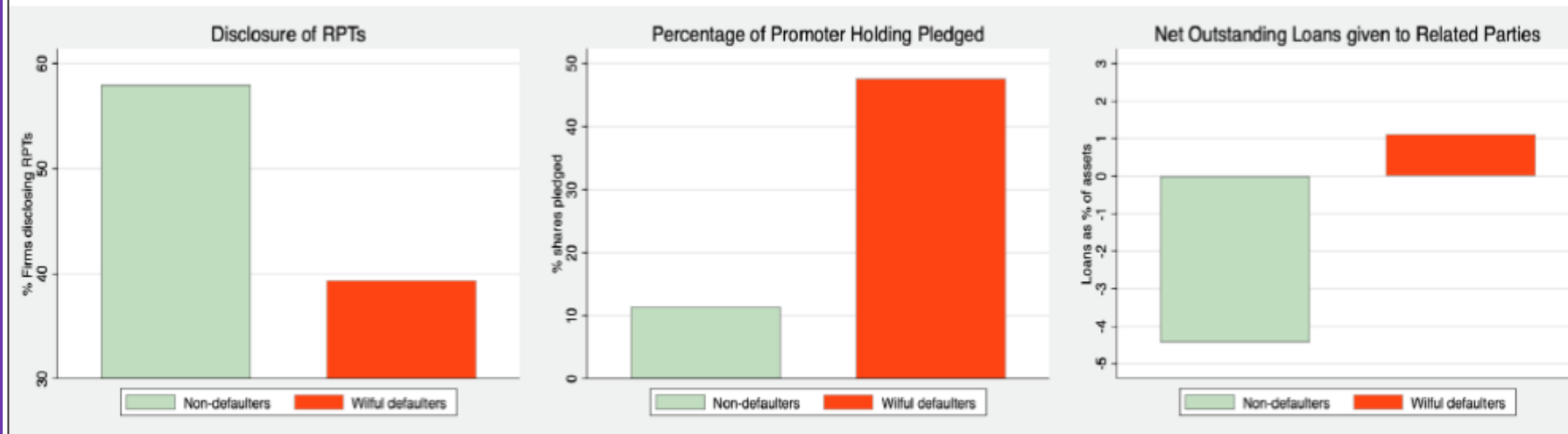


Leading Indicators using quality of financial statement disclosures by large defaulters

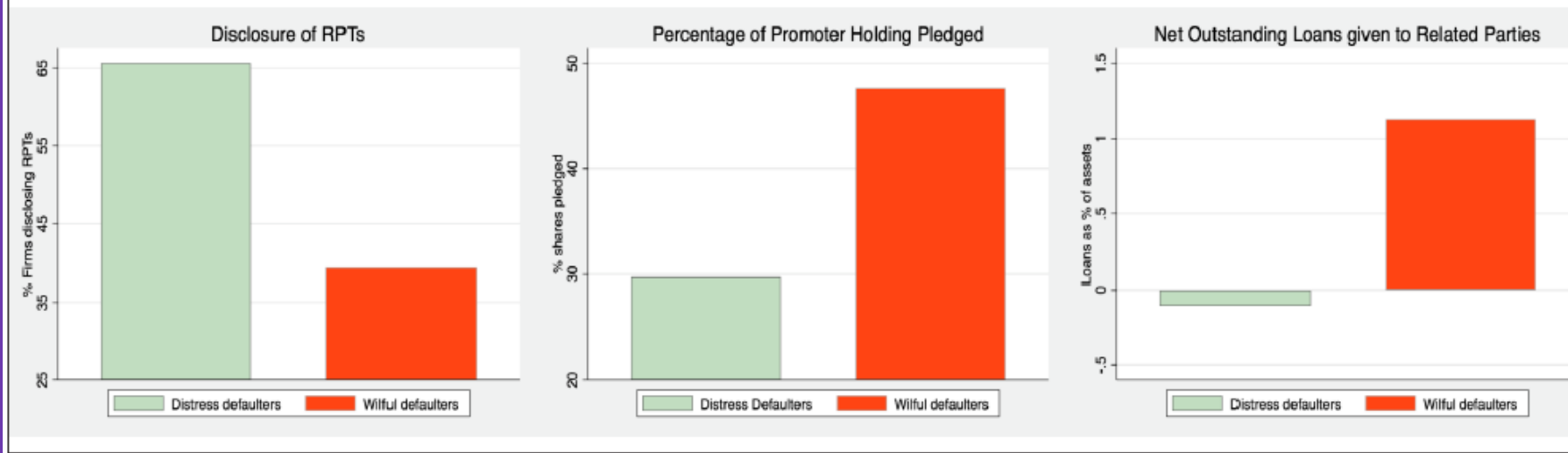


Leading Indicators: Related party transactions and Share Pledging by wilful defaulters

Panel A: Comparing Wilful Defaulters and Non-Defaulters

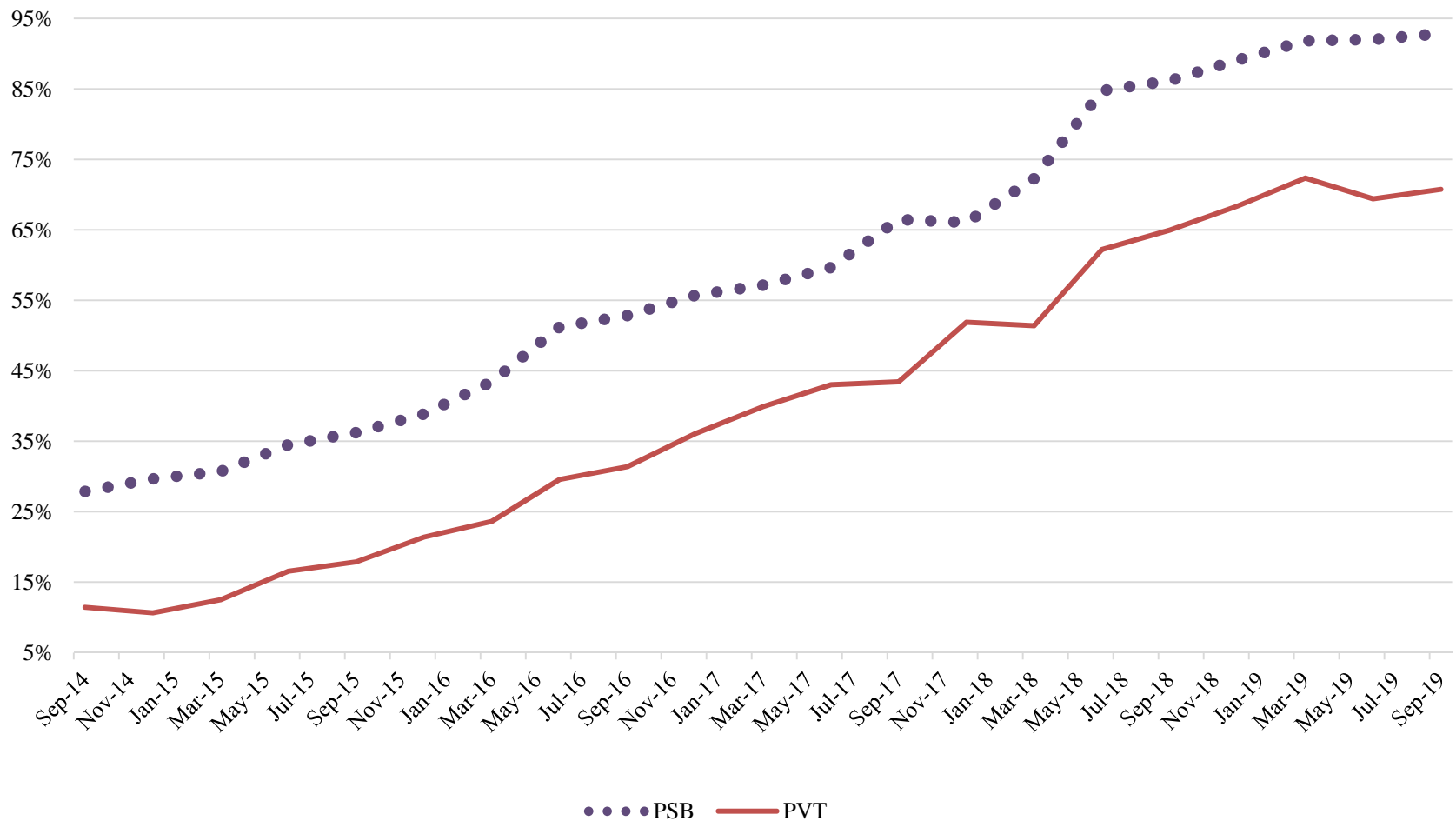


Panel B: Comparing Wilful Defaulters and Distress Defaulters

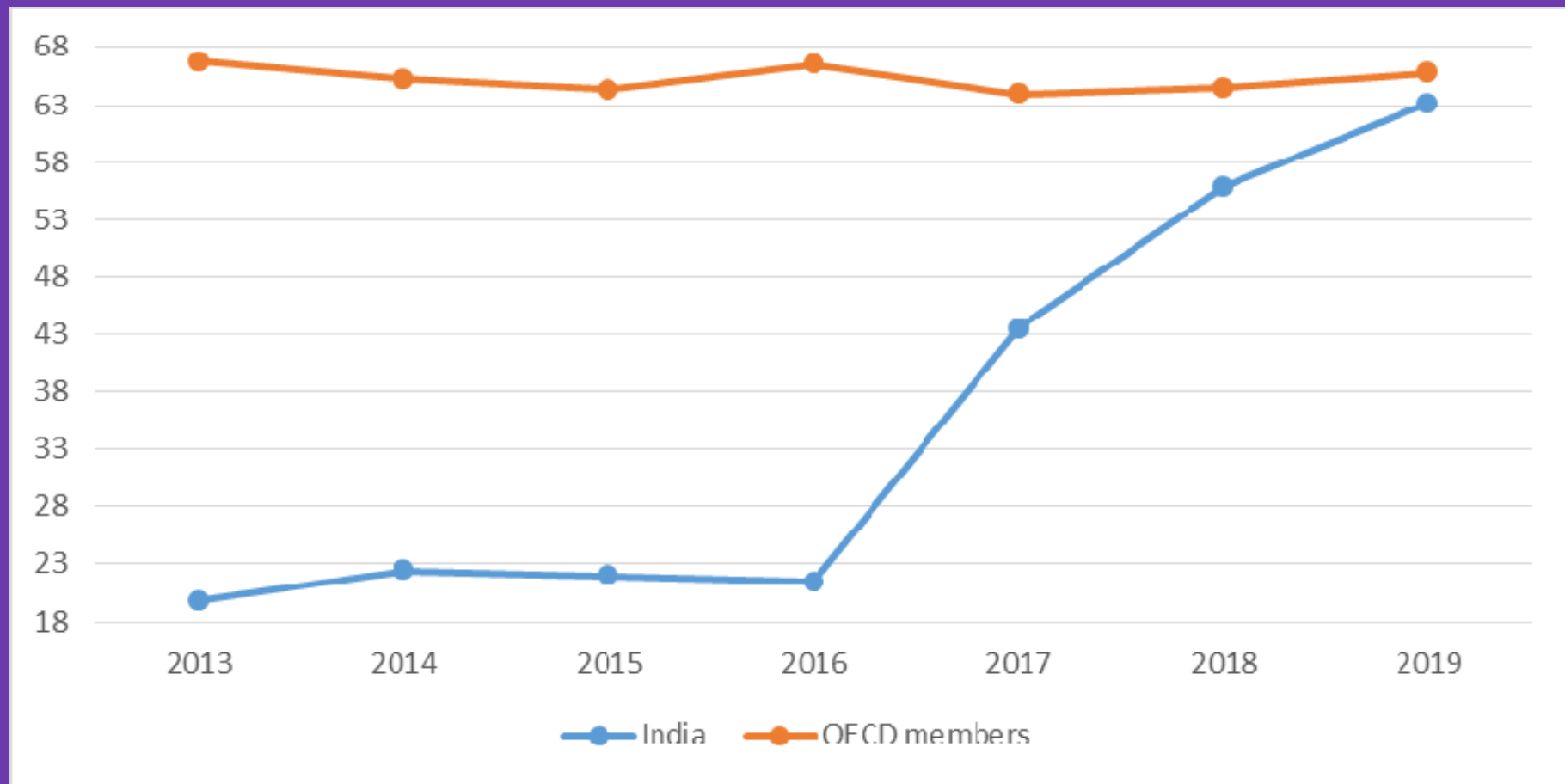


Leading Indicators: Information with other banks

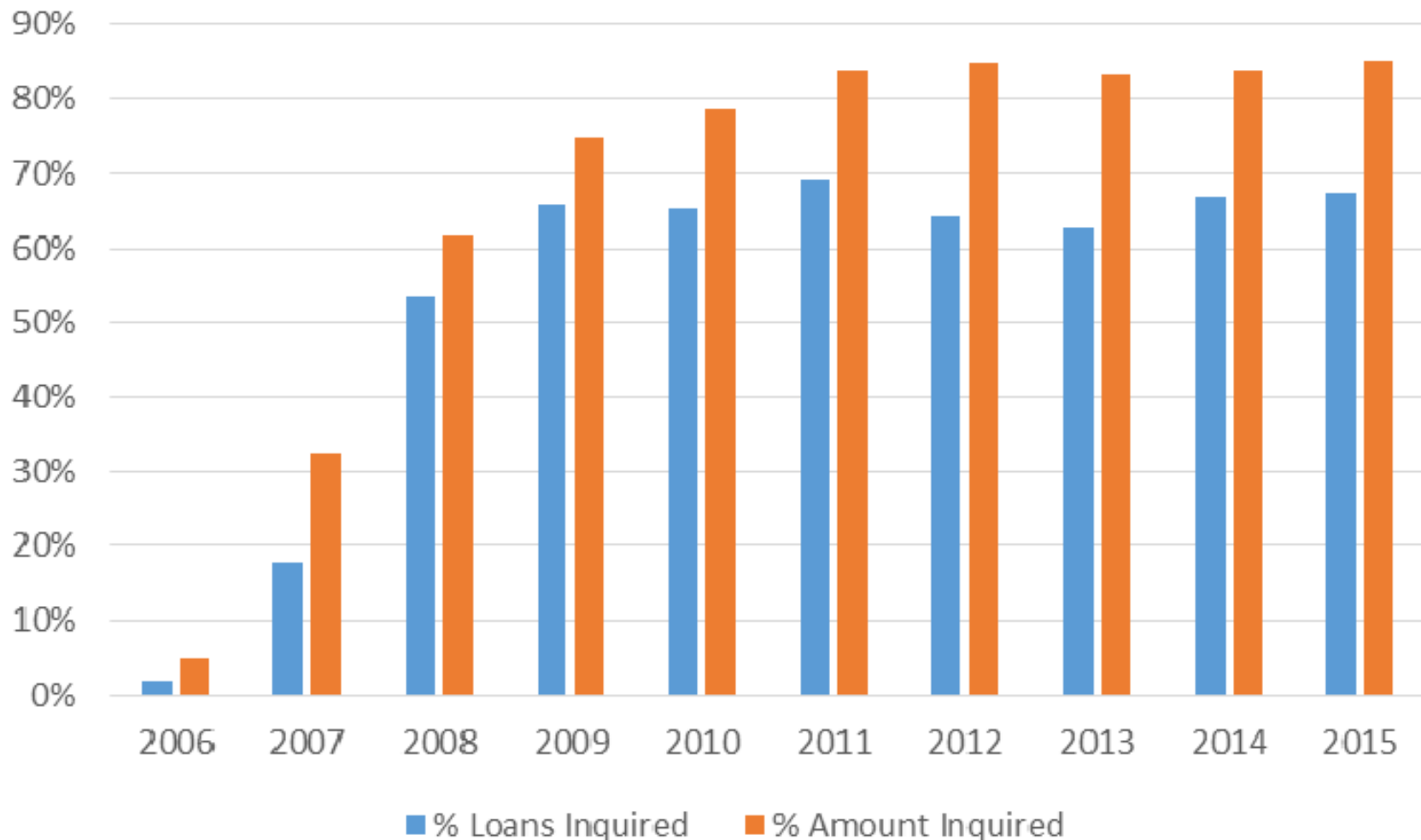
Proportion of Lenders Tagging an already tagged NPA (by Another Bank) as NPA in their books



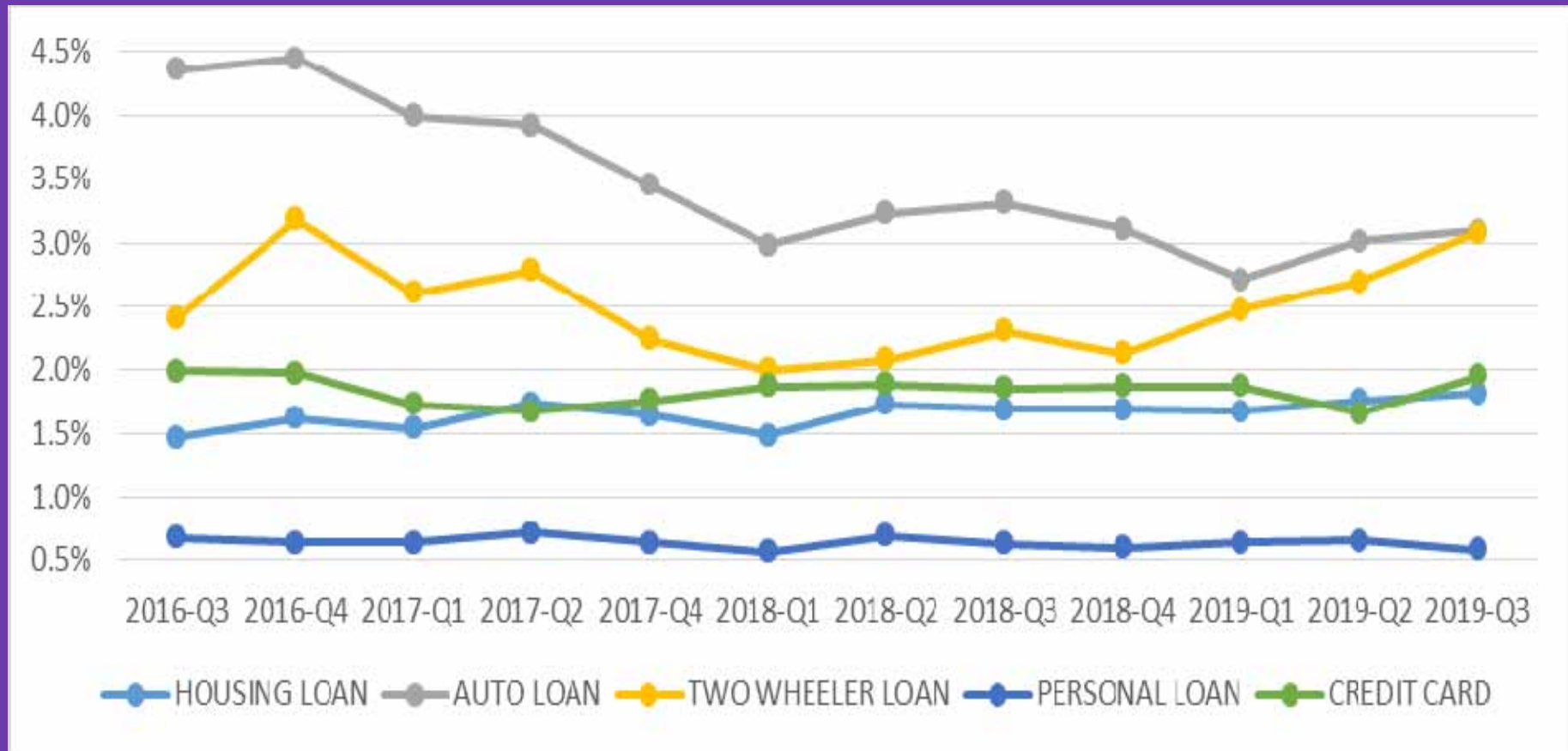
Learning from use of data and analytics in Retail loans: Credit bureau coverage



Learning from Retail loans: Use of Credit Bureau Data in NPBs



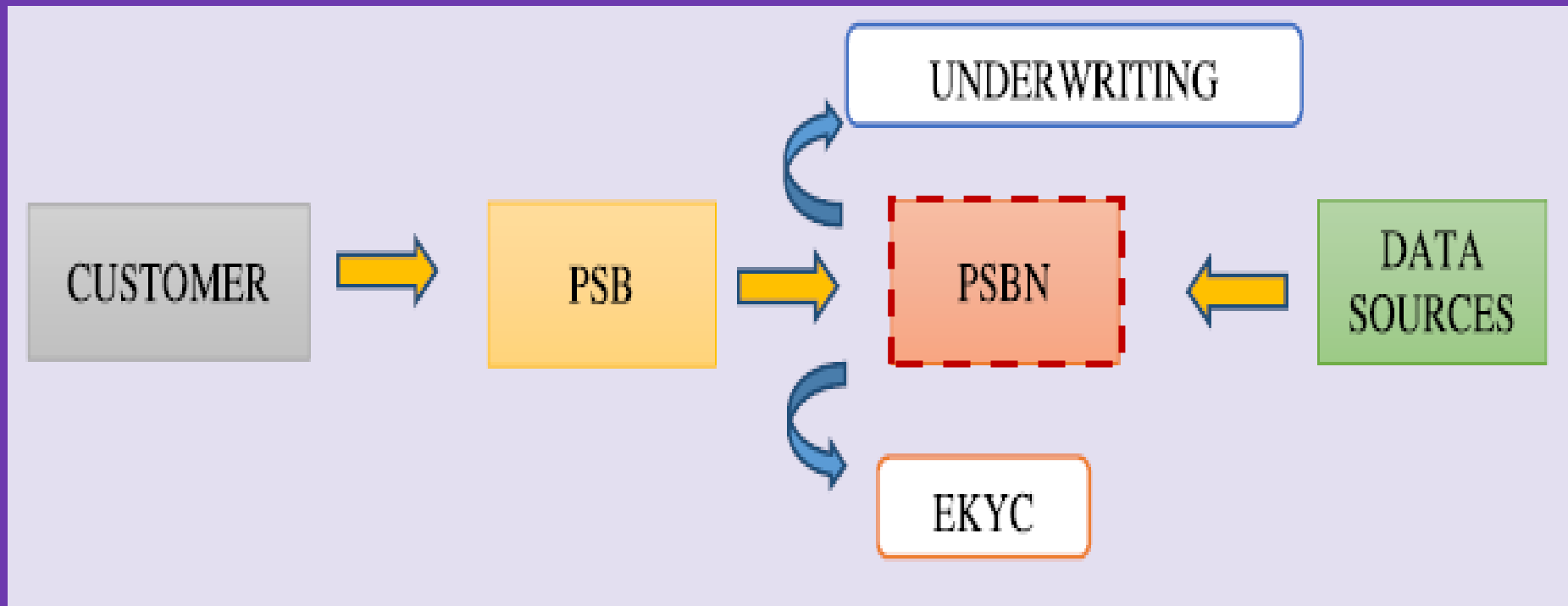
Learning from use of data and analytics in Retail loans: NPAs since 2016



Solutions

- Several suggestions in Narasimham Committee (1991, 1997), Rajan Committee (2007) and P J Nayak Committee (2014)
- Employee ownership via ESOPs
 - ❖ To benefit from data & analytics, HR is key
 - ❖ Employee ownership via ESOPs to provide incentives for being at the cutting edge of banking
 - ❖ Heavy investments in generating high-quality data
 - ❖ Enable PSBs to hire the best from the IITs to build data analytics platforms; set them on a fast track
 - ❖ Extremely intensive training of current personnel to use data, analytics, AI, Machine Learning
- Large shareholders, especially activist investors

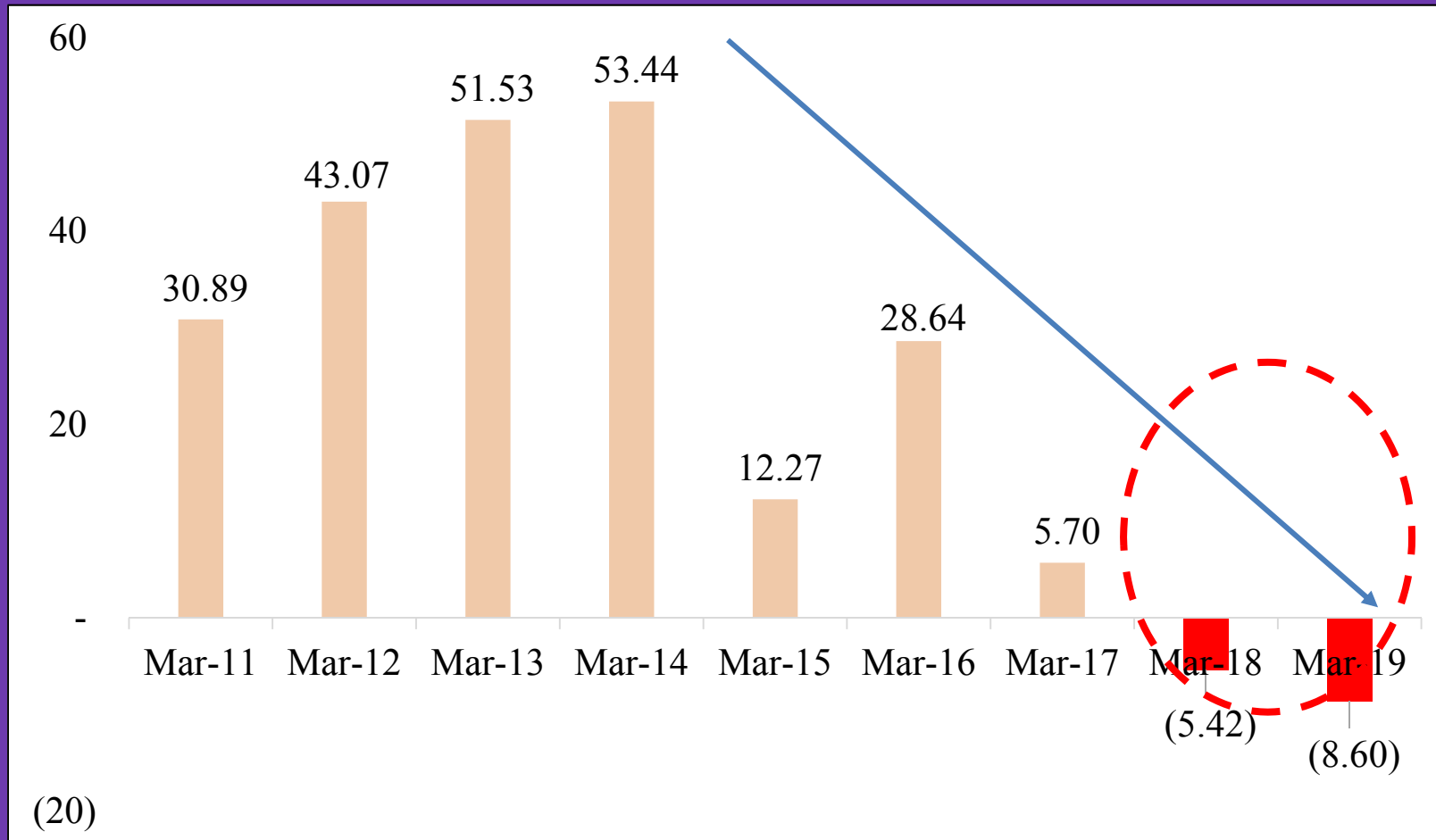
Suggested Architecture and Solution Flow for FinTech in PSBs



Thank You

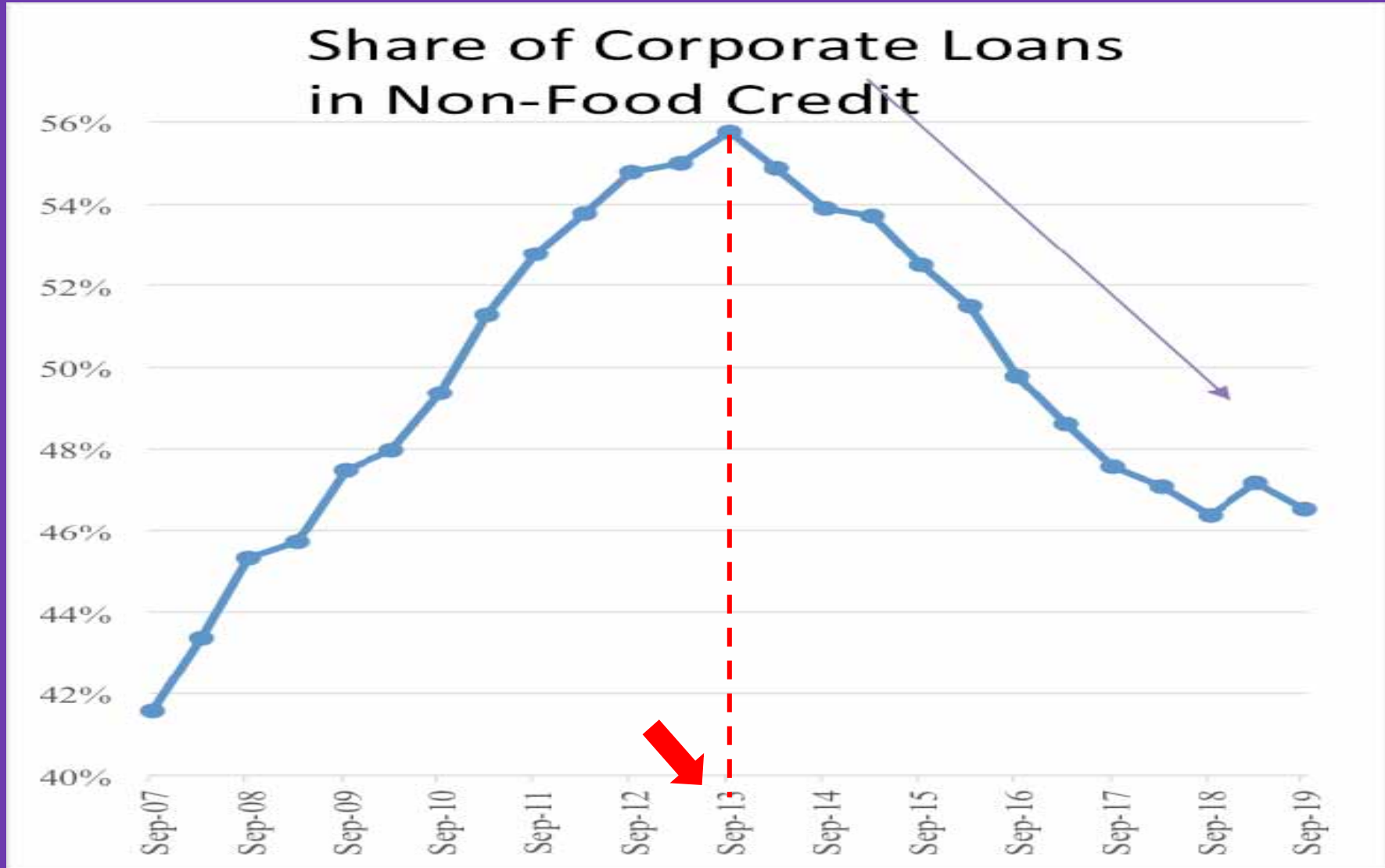
Financial Fragility in the NBFC Sector

Health Score (HFC Sector)



The Survey proposes an EWS (Early Warning Score) to highlight potential fragilities in NBFCs.

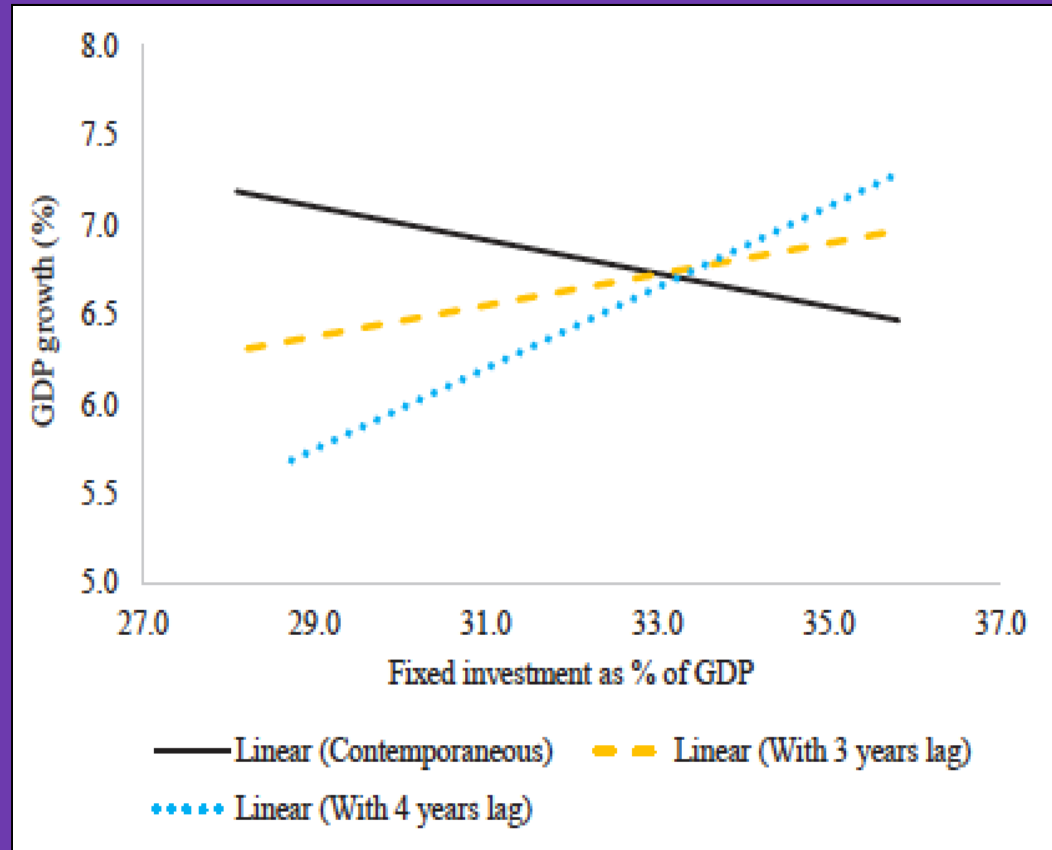
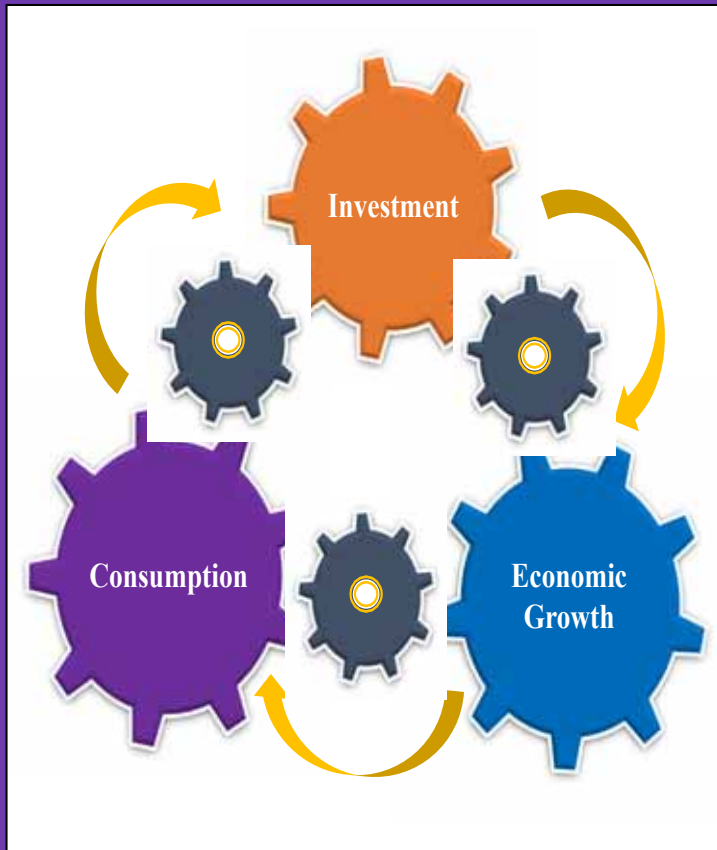
Boom & bust in Corporate Credit



Investment affected by Declining Credit

Firm Year	Credit Expansion (Increase in debt/assets ratio)	Investment (Growth in Fixed Assets)	Relationship
2011	2006-10	2011-15	Not Significant
2012	2007-11	2012-16	Not Significant
2013	2008-12	2013-17	Significant and Negative
2014	2009-13	2014-18	Not Significant
2015	2010-14	2015-19	Not Significant

Lagged effect of declining investment on growth



The growth decline since 2017 is partly due to a 4 year lag effect of decline in investment