*GenNext Banking : Issues and Perspectives**

K.C.Chakrabarty

Introduction

At the outset, let me thank the Indian Merchant's Chamber for inviting me to chair this session on GenNext Banking of the Fourth International Banking and Finance Conference 2009. I congratulate the organisers on having chosen such topical and germane topics as "Banking – Crisis and Beyond", and "Credit Instruments- Beyond Vanilla Lending" for the earlier sessions. I particularly congratulate the organisers for selecting the topic "GenNext Banking" for this session, which is both timely and contextual, and merits serious deliberation.

2. As you all may be aware, India is in the midst of a demographic transition. The demographic transition that India is going through will result in addition of millions of youth, who are potentially a bankable population and present a unique opportunity for banking system to expand their customer base. It has been estimated that the population in the 15-24 age group grew from around 175 million in 1995 to 190 million in 2000 and 210 million in 2005, increasing by an average of 3.1 million a year between 1995 and 2000 and 5 million between 2000 and 2005. In 2020, the average Indian will be only 29 years old, compared with 37 in China and the US, 45 in West Europe and 48 in Japan.

3. In addition to the demographic transition, other drivers of GenNext Banking are inadequate penetration, GDP growth and availability of information and communication technology. The issue is how the banking system will gear up and tune itself with this new generation across the length and breadth of the country. As India is poised to be a global power in the 21st century, GenNext banks will be a catalytic

* Address by Dr. K.C.Chakrabarty, Deputy Governor, Reserve Bank of India at the Panel Discussion on GenNext Banking at the 4th International Finance and Banking Conference organised by the Indian Merchant's Chamber on November 25, 2009 in Mumbai. The Assistance provided by Dr. Deba Prasad Rath and Mr. Tarun K Singh in preparation of the address is gratefully acknowledged.

agent in making India a global power. The GenNext society / economy will essentially be a knowledge society / economy and the challenge is to see how we can facilitate banking in a knowledge economy. There are also going to be challenges of dealing with knowledge workers.

4. In the above perspective, I organise the rest of my presentation under the following sections. First, in Section 1, I propose to cover the macro setting for GenNext banking by way of discussing the demographic composition of India's population and the nexus between low dependency ratio and saving. Section 2 provides a projection of Housing and Education Loan requirement in the economy in the next few years. Section 3 discusses how banks need to emerge GenNext with suitable new schemes and reorientation of their banking activities. It also contains discussion on how to facilitate banking in the context of knowledge economy/society. Section 4 concludes highlighting certain implications and challenges arising from GenNext banking which need further deliberation.

Section 1: Demographic Composition of India's Population

5. According to the Technical Group on Population Projections constituted by the National Commission on Population, May 2006, annual population growth is expected to gradually decelerate from 1.6 per cent in the five years ending in 2006 to 0.9 per cent in the five years ending in 2026. India's population, which is estimated to have gone up from the Census 2001 figure of 1,029 million to 1,112 million in 2006, is projected to increase to 1,400 million by 2026 (Table 1).

Table 1 : India : Population projections (in millions)

Year	2001	2006	2011	2016	2021	2026
Total	1,029	1,112	1,193	1,269	1,340	1,400
Below 15 years	364	357	347	340	337	327
15-64 years	613	699	780	851	908	957
Above 65 years	49	56	66	78	95	116

Note : Figures for 2001 are as per Census of India 2001. These figures will not tally with the total since 'age not stated' is excluded.

Source : Economic Survey 2006-07 based on Population Projections for India and States 2001-2026 – Census of India 2001: Report of the Technical Group on Population Projections constituted by the National Commission on Population, May 2006.

6. The age structure of a population affects a nation's key socioeconomic issues. The proportion of population in the working age group of 15-64 years will increase steadily from 62.9 per cent in 2006 to 68.4 per cent in 2026. This demographic transition actually to yield a demographic dividend would depend a lot on ensuring proper healthcare and other human resource development such as education, *etc.* as also their employability into the productive workforce of the economy.

Penetration levels suggest healthy potential and target market still expanding

8. Despite the aggressive growth in most financial segments over the past decade, there is still the under-penetration of most financial products/services. Even though Indian banking credit has enjoyed a significant growth during the period 2003-08, credit penetration remains well below regional benchmarks, which is suggestive of healthy growth potential in the medium-term. Indian financial sector offers structural growth opportunities and an

expanding target market. In India, it is the household sector which generates largest savings in relation to the private corporate and public sectors, in that order. A significant proportion of household financial savings is routed through the banking system. As of 2008-09, while the household deposits accounted for around 54 per cent of the gross financial assets, bank credit accounted for around 94 per cent of household financial liabilities.

9. While the credit growth during the high growth phase has encompassed all sectors – both retail and industrial - and incremental lending has been much diversified compared to in the mid and late 1990s, the retail credit as a proportion of GDP has remained quite low (Table 2).

10. With the low existing penetration levels and the fact that more than 30 per cent of Indians who are below 15 years of age will enter in the age group of 15-64 years over the next 5 to 10 years, the structural opportunity for banks is evident. The younger generation is far more open to consumer loans, financial products like insurance, mutual funds and wealth management and thereby offers a much bigger revenue base for financial-service providers.

11. Although significant financial deepening has been taking place in Indian economy over the years as seen from the deposit-GDP ratio, bank assets-GDP ratio and credit-GDP ratio, the low levels of penetration in India can provide a medium-term

Table 2. Outstanding Credit of Scheduled Commercial Banks as on 31 March

(Amount in Rupees Crore)

Year	Particulars	No. Accounts	Credit Limit	Amount of Outstanding	Ratio to GDP(%)
2008	Loans for Purchase of Consumer Durables	992246	8704	7147	0.1654
	Loans for Housing	5214331	291825	248435	5.7496
	Loans for Education	1065432	22616	16509	0.3821
	Total Bank Credit	106990180	3284091	2417007	55.9377
2007	Loans for Purchase of Consumer Durables	1807970	13174	9622	0.2546
	Loans for Housing	5009913	269745	228923	6.0572
	Loans for Education	843311	17455	12089	0.3199
	Total Bank Credit	94442027	2773409	1947100	51.5190
2006	Loans for Purchase of Consumer Durables	1464004	9228	6715	0.2046
	Loans for Housing	4521531	209235	182167	5.5498
	Loans for Education	646435	12213	8544	0.2603
	Total Bank Credit	85435381	2118527	1513842	46.1202
2005	Loans for Purchase of Consumer Durables	1510200	8057	6349	0.2206
	Loans for Housing	3666450	145034	126797	4.4062
	Loans for Education	463723	7985	5645	0.1962
	Total Bank Credit	77150794	1646266	1152468	40.0481
2004	Loans for Purchase of Consumer Durables	1354353	5548	4203	0.1656
	Loans for Housing	3035026	96692	85346	3.3625
	Loans for Education	460730	5771	4193	0.1652
	Total Bank Credit	66390290	1176959	880312	34.6829

structural growth driver for banks. A noteworthy feature discernible in the Indian context is that the rise in indicators of financial deepening takes place along with a noticeable rise in the domestic savings rate. This has to be seen in the backdrop of financial sector reforms, rise in total factor productivity and investment boom which has led to acceleration in the growth performance.

Low dependency ratio and saving nexus

12. In recent years, a virtuous cycle of growth, saving and investment has been in operation (Table 3) and is likely to continue in the near to longer term being contributed by demographic dividends and decline in dependency ratio. These factors will facilitate both rise in saving and capital formation and are expected to further reinforce the virtuous cycle of growth in future. The existing studies on India suggest a near one-for-one relationship between the dependency ratio and national savings. According to recent studies (Goldman Sachs 2007), 1 percentage point decrease in the dependency ratio adds 0.8 per cent to the national saving ratio. Rodrik and Subramanian (2004) used estimation results by Mulheisen (1997) on India's consumption behaviour, which shows a one-to-one relationship between the dependency and saving ratios. Accordingly in India, a fall in dependency ratio from 37.1 per cent in 2006 to 34.6 in 2011 and 31.7 per cent in 2026 will result in rise in saving from the present level of 37.7 per cent in 2007-08.

Section 2: A Projection of Housing and Education Loan Requirement

13. The vast business potential for banking can be ascertained from a brief empirical exercise and a projection on the housing loan in India. The housing loan is an important component of the loans and advances portfolio of the SCBs (Table 2). As at end-March 2009, the housing loans constituted 44 per cent of the retail loan portfolio of SCBs and 9 per cent of the total loans and advances of SCBs. The growth rate of housing loans, which witnessed very high growth during 2004-05 and 2005-06, has however been witnessing a deceleration since then.

Table 3: Trend of Saving and Investment and GDP growth

(Per cent to GDP)

	1970s	1980s	1991-92 to 1996-97	1997-98 to 2002-03	2003-04 to 2006-07	2007-08
1. Gross Domestic Savings	**17.2**	**19.0**	**22.7**	**24.1**	**32.7**	**37.7**
Household Sector	11.4	13.5	16.8	20.8	23.8	24.3
Private Corporate Sector	1.5	1.7	3.7	4.0	6.6	8.8
Public Sector	4.2	3.7	2.2	-0.7	2.3	4.5
2. GDCF#	**17.3**	**20.8**	**23.9**	**24.5**	**32.9**	**39.1**
Household Sector	6.9	6.8	6.8	10.5	12.7	12.6
Private Corporate Sector	2.6	4.5	7.7	6.6	11.7	15.9
Public Sector	8.6	10.6	87	6.9	7.1	9.1
3. Real GDP (Growth rate)	**2.9**	**5.6**	**5.7**	**5.2**	**8.7**	**9.0**

#: adjusted with errors and omissions.

14. A statistical analysis of the data on GDP, housing loan and educational loan for the period March 2004 to March 2009 suggests that a 1 per cent increase in GDP growth is associated with 3 per cent increase in housing loan and 5 per cent increase in education loan. Assuming a real GDP growth rate of 6.25 per cent in 2009-10 and 8 per cent each in 2010-11 and 2011-12, and 9 per cent each during 2012-13 to 2014-2015, the housing loan is expected to grow at 20.3 per cent in 2009-10, 25.0 per cent each in 2010-11 and 2011-12 and at 28.1 per cent during the period 2012-13 to 2014-15. The education loan is expected to grow at a rate of 32.3 per cent in 2009-10 and at 39.8 per cent each in 2010-11 and 2011-12 and 44.8 per cent during the period 2012-13 to 2014-15.

15. It may be mentioned here that these estimates are indicative and based on historical data. In reality as the country moves towards the high growth trajectory, given the strong income effect and complex interplay of factors affecting the demand for housing, the demand for housing loans may grow manifold. According to some estimates, presently there is a shortage of about 19.4 million housing units in India. In addition, the Indian population is projected to grow at a rate of 1.6 per cent per annum while GDP is expected to grow at a rate of 8-9 per cent per annum. As a result, the per capita income is expected to quadruple by 2020. The Indian middle class is also expected to expand by more than 10 times from its current size of 50 million to 583 million people in next 18 years. Given this rise in per capita income, swelling middle class and rapid urbanisation, it is estimated that additional 45 million housing units would be required by the year 2012. These estimates suggest that the housing loan to GDP ratio would grow sharply in the coming years.

16. Size of housing financial systems as a share of GDP in a cross-country perspective [Warnock, Veronica Cacdac and Francis E. Warnock (2008)] suggest that the emerging market economies generally have a smaller housing financial system averaging to 10 per cent of GDP with the largest being between 20 – 30 per cent of GDP and developed countries accounting for around 55 per cent of GDP. During 2001-05, mortgage debt (housing finance) to GDP ratio for India was lower at 4.9 per cent than other developed countries USA (67.4 per cent), the UK (66.6 per cent), Japan (35.7 per cent), France (24.1 per cent) and Korea (20.8 per cent), and Asian emerging economies like China (10.0 per cent), Malaysia (28.3 per cent), the Philippines (6.8 per cent), Taiwan (26.0 per cent) and Thailand (15.5 per cent).

17. An educated young population gives a head start in today's knowledge economy. In India, they form the backbone of the country's booming services sector. According to a NASSCOM study, the number of students enrolled for tertiary education in India is close to 10 million. While banks are now regularly extending education loan for courses in India and some banks are also contemplating extending education loans for courses aboard, this is indicative of the growth potential of education loans in India.

Section 3: GenNext Banking

Life Cycle wise products and services available under one roof

18. The Indian banks have identified the growth potential of the GenNext and are

already providing schemes especially keeping in mind the requirements and preferences of the younger generation. As mentioned in the earlier section, the banking sector can help in reaping the 'population dividend' by providing life cycle wise products and services under one roof. Let me elaborate on this. The GenNext banks would be offering products and services right from birth till death. The relationship would start with birth when a savings account could be opened. I recall PNB's scheme where soon after birth when devotees visited Golden Temple, an account was opened for the newly born. Then as the child grows, appropriate products and services would be offered at the right time. During infancy, small health and life insurance services could be offered. Other features could include recurring deposit and fund transfer from parents to kids account. As the child reaches educational stage, educational loans, debit card and two-wheeler/scooter loans could be offered. After education, as the youth enters job, products like housing loans, credit cards, *etc.* could be offered. Equity and mutual fund products also could be offered. Once he gets a job, savings, demat and e-broking accounts could all be offered. At later stages, the composition of investments in equity oriented schemes would shift in favour of debt oriented as the age advances. For entrepreneurs, loans and insurance could be offered for entrepreneurial ventures. For people in different professions, offering products suited to their profession would present a challenge and an opportunity. If a loan is given, then non-life insurance like that for house, education and car loans could be made available. At the stage of marriage, marriage loans could be offered. Once he becomes old, loans for refurbishment of house *etc.* would be offered and this cycle continues till funeral insurance products. Thus, the essential idea is that a relationship once built at birth carries on till death and all the products and services are made available under one roof. Every person will have a customised web-page where they can simply select and avail of the various products and services required by them.

19. The GenNext banking would thus not just be to attract the youth but to attract them at infancy itself so that in future the bank can become the preferred source for other requirements of the growing customer. The saving accounts for youngsters are intended to inculcate habits of thrift. They will have to be educated and financial education initiatives would be important. The banks would have to envisage the changing environment by gauging the dreams and aspirations of the youth brigade and launch/ provide services accordingly.

20. The banks are also providing facilities like internet banking, tele-banking *etc.* recognising that the younger generation is much more tech-savvy and believe in saving time and energy by using technology. Banks are also opening exclusive branches for GenNext, which cater to all the aspects of banking for the young population. But, in my opinion, for GenNext banking to be a success, staff at all branches would have to be youth-oriented, otherwise it is naturally not possible to reach the vast majority of our youth. To sum up, the various dimensions of GenNext banking which will have a profound impact are information requirement, number, volume, diversity, density and delivery model among others.

Knowledge Economy and Reorientation in Indian Banking

21. It is now commonplace to say that the 21st Century will be the "Knowledge Century" and we are transiting from product-based to knowledge-based economy. The knowledge economy - an economy in which wealth is based upon the ownership of knowledge and the ability to use that knowledge to create or improve goods and services – presents significant challenges. All the more so due to the demographic transition underway now in our country, since knowledge resources such as know-how and expertise are as critical as other economic resources in this economy. India will probably have the world's largest set of young people. Even as other countries begin to age, India will remain a country of young people, potentially to our great advantage.

22. The transformation of banking caused by the rapid development of information and communication technologies has provided banking entities with new ways of bringing their products to the customers. The banks would now have to increasingly deal with knowledge workers *i.e.* one who works primarily with information and uses knowledge in the work place. Traditional banking has thus changed into electronic banking, and therefore the standard form of contact – personal contact – is taking a back seat to new, faster, more conformable, and cheaper means of communication.

23. The introduction of electronic banking services also creates new tasks to be faced, such as the optimisation of distribution channels and the security of data transfer. The customer will not purchase a service that fails to meet his requirements or a service that does not guarantee the required privacy and security. That is why banks are trying to devote enough attention to all aspects of the modernisation of traditional banking.

24. Basic electronic banking includes services provided through self-service zones, Internet Banking, E-mail Banking and Phone Banking, *etc.* A new product is the electronic purse, sometimes called a "multipurpose payment card", which is a payment instrument for making non-cash payments. The e-shop represents a specific form of electronic banking. Electronic commerce comes in three basic forms: the e-shop, e-store, and e-exchange.

25. India's banking industry must strengthen itself significantly if it has to support the modern and vibrant economy which India aspires to be. Focusing on enriching human capital will help the banking sector competitive. The banking sector needs to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management and the overall organisational performance ethics. The last, *i.e.*, strengthening human capital will be the single biggest challenge. Old private sector banks also need to fundamentally strengthen skill levels. However, even more imperative is their need to examine their participation in the Indian banking sector and their ability to remain independent in the light of the discontinuities in the sector.

26. In the field of the knowledge economy, the re-orientation in banking is required at two levels. The first is the field of banking management, the continuous improvement

of which relates mainly to expanding the use of information technologies and knowledge systems. This will involve, above all, support for financial system management, internal quality management systems in banks, interactive payment systems, and management information systems.

27. The field of banking management is closely connected with the second field – banking products along with the services and operations directly related with them. On one hand, there are products directly connected with progressive information technologies – electronic banking and electronic commerce. A second group comprises products and services which in terms of formation and quality of provision are directly related to the quality, reliability and speed of information technologies. One of the most important components of the knowledge economy is the people who use the information and communication technologies.

Section 4: Issues and Challenges

28. The expansion of banking services for the millions of new customers would imply that there would be tremendous growth in the volume of such services. While this presents tremendous business opportunities for the banking sector, it also raises new issues and challenges for the players, regulators and policy makers.

29. As the banking sector takes initiatives to cater to the evolving needs of the economy, we need to deliberate on the following issues:

i) What are the appropriate systems and structure to generate information for future generation banks? Let us not do GenNext banking without information.

ii) Will the existing players be able to meet the required volume, number, density and diversity of services? If not, would new players, such as MFIs, NBFCs, Corporates, telecom companies and foreign players be authorised to perform these services?

iii) What should be the delivery structure for the entire financial system for seamless delivery of all products under one roof? Should the model be based on universal banking, subsidiary or collaborative route?

iv) What should be the delivery model at grass root level? Should it be by way of direct or indirect approach? Given the dimensions of business involved, a multichannel delivery system utilising a combination of branches, smart cards and mobile services appears to be the most appropriate model.

v) What are the policy changes necessary to meet these challenges and to facilitate growth and transition?

vi) What should be regulatory framework for meeting these challenges? Does it not require a 180° change? Since there are a large number and variety of financial products involved, what appropriate regulatory framework needs to be in place for effective regulation? The question that may need to be examined would be the appropriateness of single versus multiple regulators. Whether the existing regulatory co-ordination mechanism, as followed through

HLCCFM, continue in the same form? Is there a need to separate regulation from supervision?

vii) What should be the business model in terms of pricing, marketing, product development? Transparency in pricing is the key in the context of the huge volumes involved and banks may need to examine the level of their margins. Treating customers fairly will be a crucial issue for GenNext banking as the customers will be more educated and aware of their rights.

viii) What should be the approach to Risk Management Framework? In view of the large volume, products and customers involved and the exponential growth taking place in banking services, how risk management will evolve to mitigate the emerging risks?

ix) What are the institutions and supporting requirements and challenges in the technology, communication and network connectivity which will enable seamless services in a secured and cost-effective environment?

x) HR issues will assume prominence as the banks may have to assess the skill requirements for providing such services and accordingly create the workforce.

30. To sum up, I have attempted to outline the scope for increasing the banking industry's operations and competitiveness through information and communication technologies in the context of demographic trends of India and the knowledge economy that we are embarking upon. I hope that this conference will further deliberate on these issues and come out with the appropriate framework to be developed through which all players will work together to establish the system to cater to the requirements of the future. It is important that all the banking products be made available under one roof and provided in a seamless manner; otherwise, we would lose this opportunity. I am sure that 21st century will be our century and the banking sector will rise to these challenges and more. I wish the deliberations a success.

Select Reference

1. Goldman Sachs (2007), India's Rising Growth Potential, January 2007.

2. Government of India (2007), Economic Survey 2006-07.

3. Mühleisen, Martin (1997), Improving India's Saving Performance, IMF Working Paper No. 97/4, International Monetary Fund, January.

4. Rodrik, Dani and Arvind *Subramanian (2004*), Why India Can Grow at 7 Percent a Year or More: Projections and Reflections, IMF Working Papers 04/118, International Monetary Fund.

5. Warnock, Veronica Cacdac and Francis E. Warnock (2008), *Markets and housing finance,* Journal of Housing Economics.