



# Riding India's Digital Super-cycle

India's spirited pursuit of public digital platforms is pushing banks towards much bolder digital transformation. Handsome rewards for those who embrace it; rapid decline for those who won't

# Riding India's Digital Super Cycle

India's spirited embrace of digital public goods is pushing banks towards bolder digital transformation. New business models like **embedded finance can turbocharge profitability (30% growth; 50% cost)**. But, unless banks adopt new capabilities, they stand to lose customer relationships (>85% unhappy with banks' digital journeys). **SME would be the next space** where customers will gravitate towards BigTech / Fintech. Like UPI has shown, **it will happen faster** than it seems at first.

Unlike the first phase of tech adoption, this time much **bolder investments (~USD 5 bn p.a.)** are needed & should be accompanied with much more **difficult talent induction** and cultural changes as Banks try to become "tech product companies". Banks have to deal with rising **transaction loads due to UPI and account aggregators** (6x in next 5 years) in the meanwhile and high branch density (1.5x China) to start with.

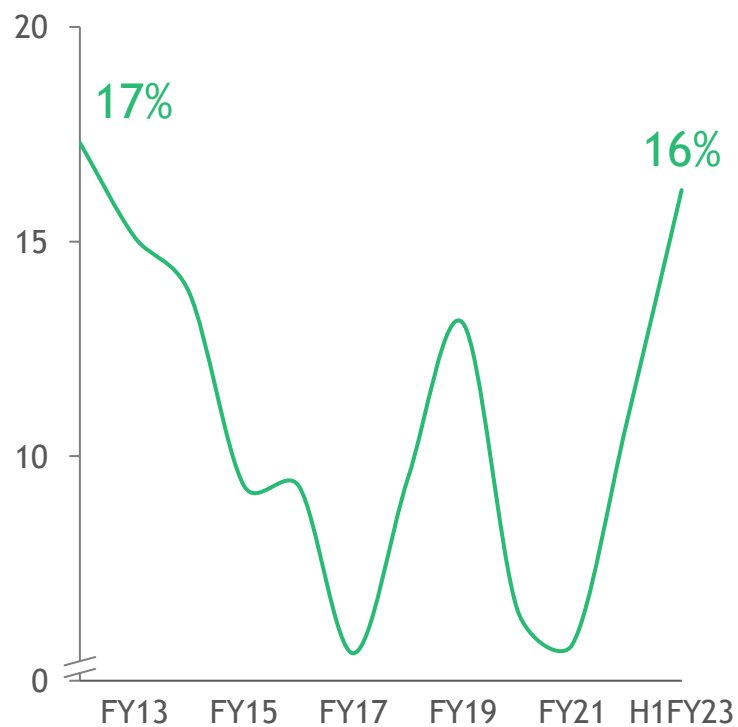
**Many banks can not** accomplish this transformation with their resources and ability to attract talent. Even the ones who do, need support from Government and RBI.

Banks need help from Government in the form of upgrade of **public digital infra** (e.g., Singpass of SG for KYC), **tax incentives** for digital innovation, digitization of secured credit with **asset tokenization (blockchain)** to realize **high productivity (~40 C:I ratio)**.

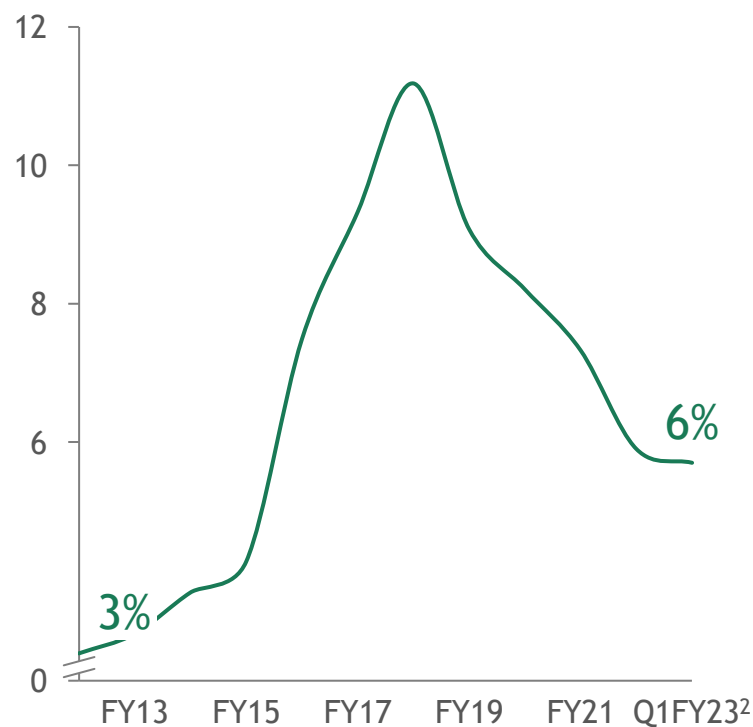
RBI needs to acknowledge new model of bank investments in the **agile framework**. More importantly, given its enormity, a number of banks can not realistically accomplish digital transformation and industry needs **consolidation to manage systemic risks** in the medium term.

# Indian banks entering a phase of higher growth and strengthening balance sheets

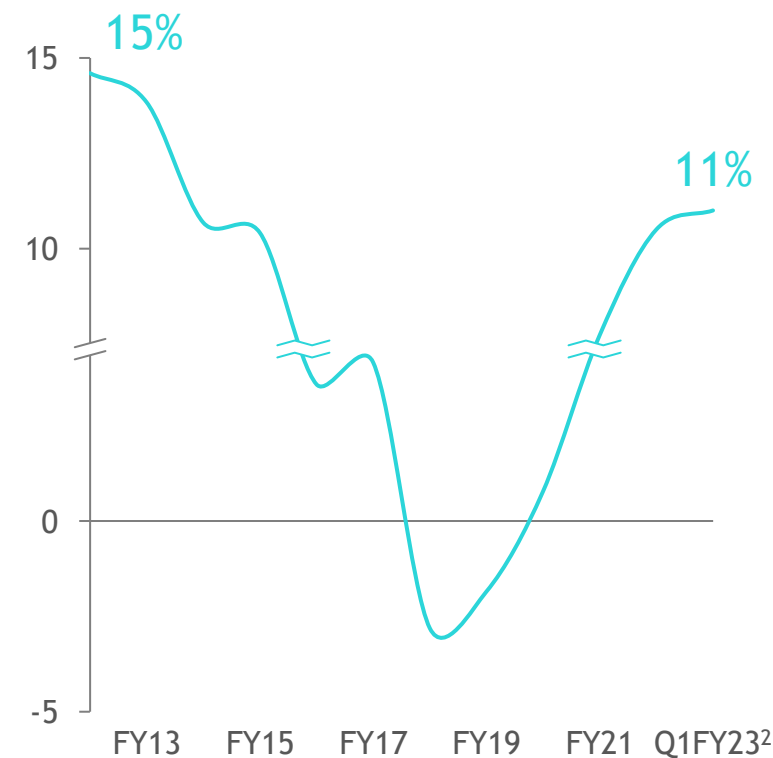
## Credit Growth<sup>1</sup> (%)



## GNPAs (%)



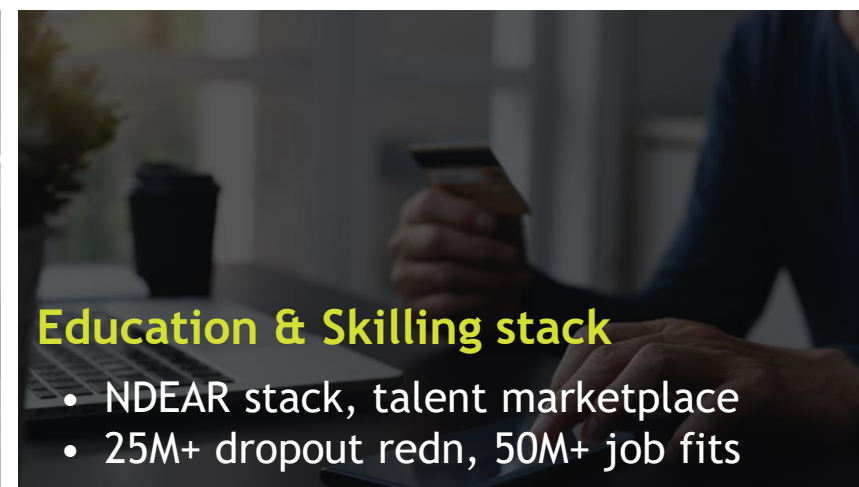
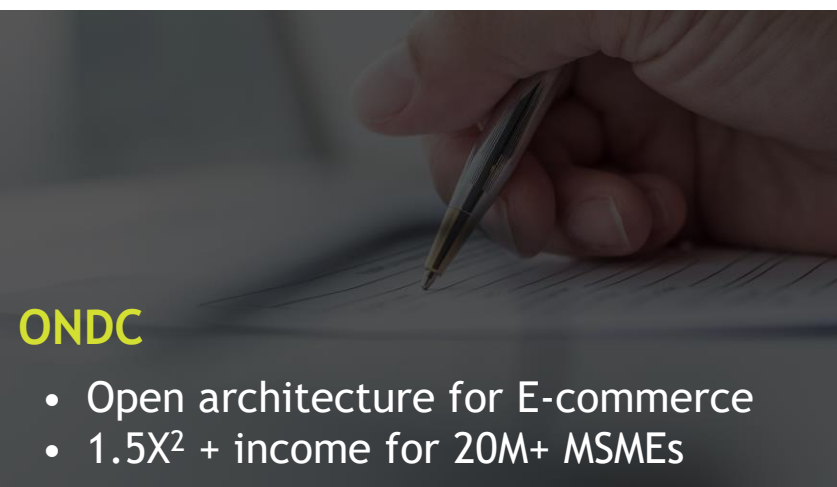
## ROE (%)



1. Credit growth as per RBI's commercial banks at glance statement 2. Q1FY23 figures are based on 35 scheduled commercial banks in India as disclosed in their financial results  
Source: RBI, Financial Results, Investor Presentation, BCG analysis

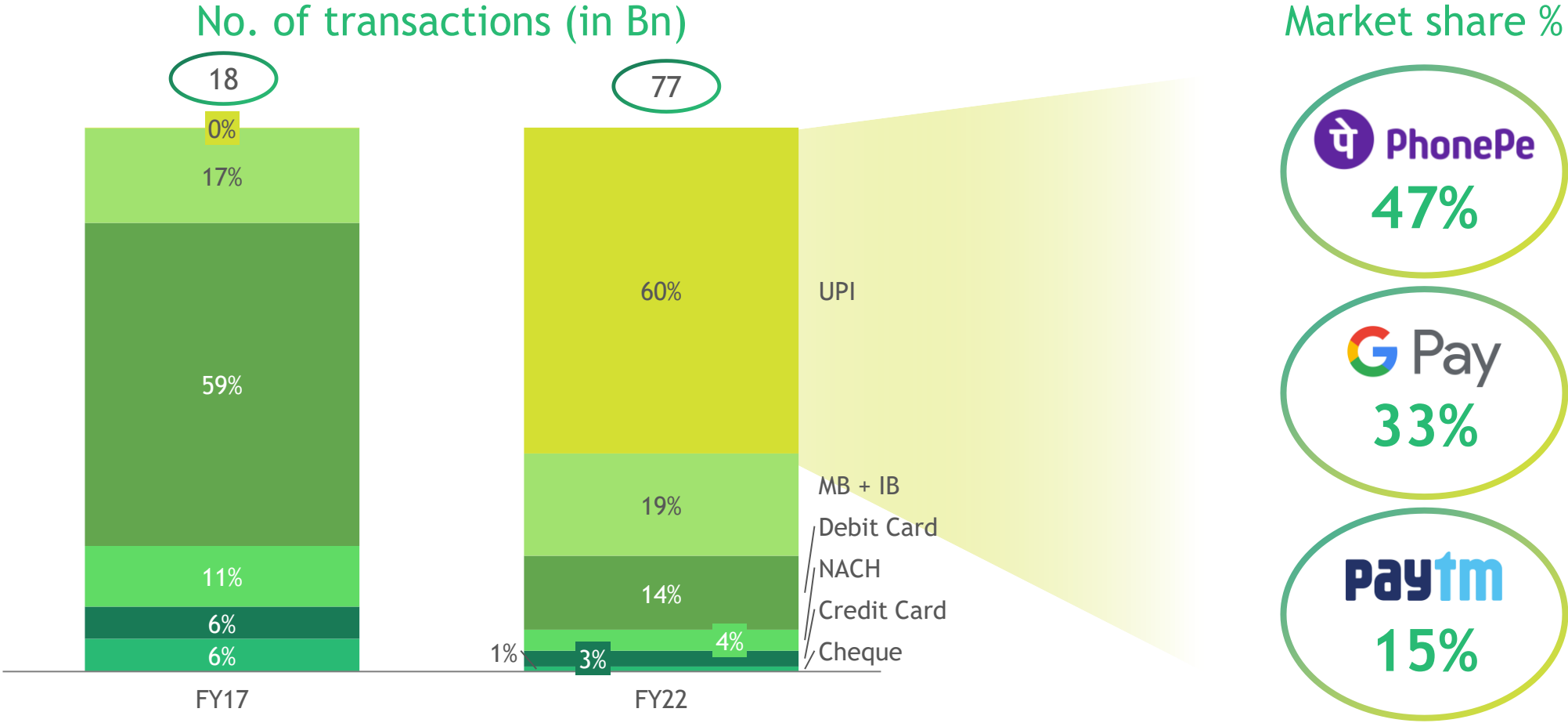


# National scale public digital goods are a defining element of India's pursuit of rapid economic and social progress



1. Include benefits relating to price improvement, productivity improvement and credit cost savings 2. Includes benefits related to credit cost savings, price improvement & sales  
Source: The potential of open digital ecosystems - BCG, Omidyar Report, Digital India, GeM dataset, BCG analysis

# Customer rapidly gravitated to Bigtech for UPI



Notes: 1. Financial Transactions do not include cash transactions at branches; 3. Internet transactions include RTGS, ECS, NEFT and IMPS financial transactions · ATM and Mobile transactions included are financial transactions only; 4. CAGR is calculated from FY20 to FY22 5. Total may not sum to 100 because of differences due to rounding off 6. Ticket Size calculated basis Value/Volume; Branches include Administrative Offices; NM: Not Meaningful  
Source: RBI data, National Payments Corporation of India (NPCI) statistics, BCG analysis

# Public digital platforms will spur growth in lending with lower processing and acquisition costs

~30% lending book growth expected

Beneficiaries		Impact (INR lakh crores)	% existing lending
Agri (Agri stack)	<ul style="list-style-type: none"><li>Farmers</li><li>Suppliers</li></ul>	5	40%
MSMEs (ONDC, GEM, Heath stack)	<ul style="list-style-type: none"><li>SMEs (both B2C &amp; B2B)</li><li>Health care prof.</li><li>Online buyers</li></ul>	12	35%
Infra (Gati Shakti)	<ul style="list-style-type: none"><li>Infra companies</li><li>Logistics players</li></ul>	3	15%



50%+ Productivity Enhancement

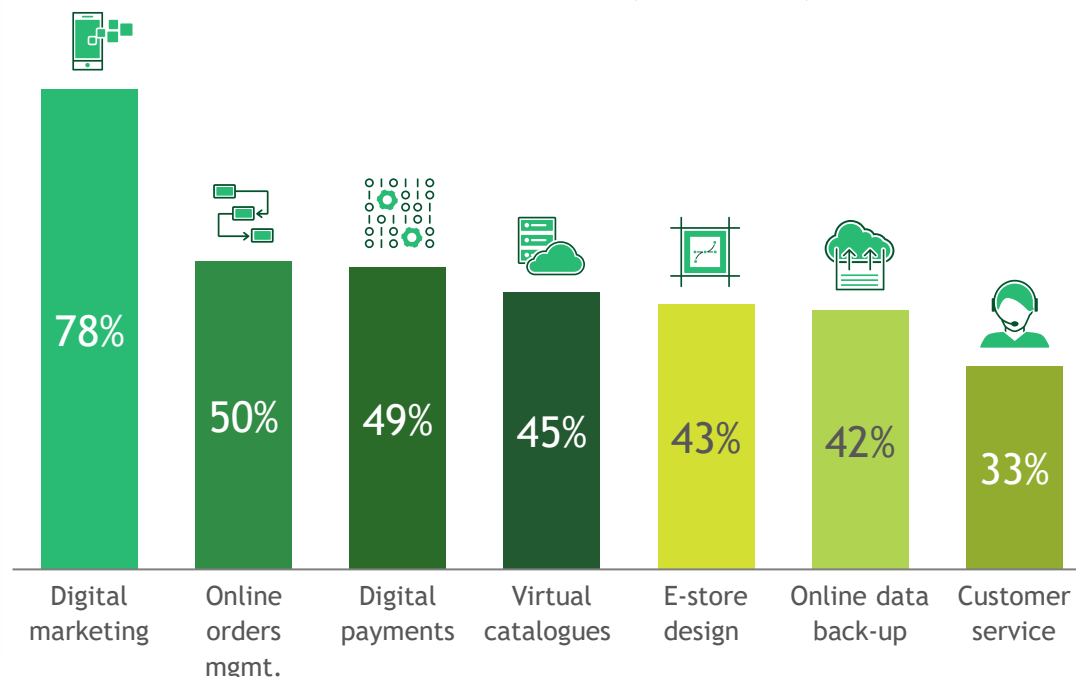
Cost of acquisition and processing		
	From	To
Agri loan	2.5%	1.5%
MSME loan	2%	1%
Personal loan	3.5%	1.5%

# Indian SMEs looking for digital sales will gravitate towards platforms with integrated preposition

60%+

SMEs expect that their online sales will further increase in the future

SMEs struggle with various aspects of online sales (% SMEs)

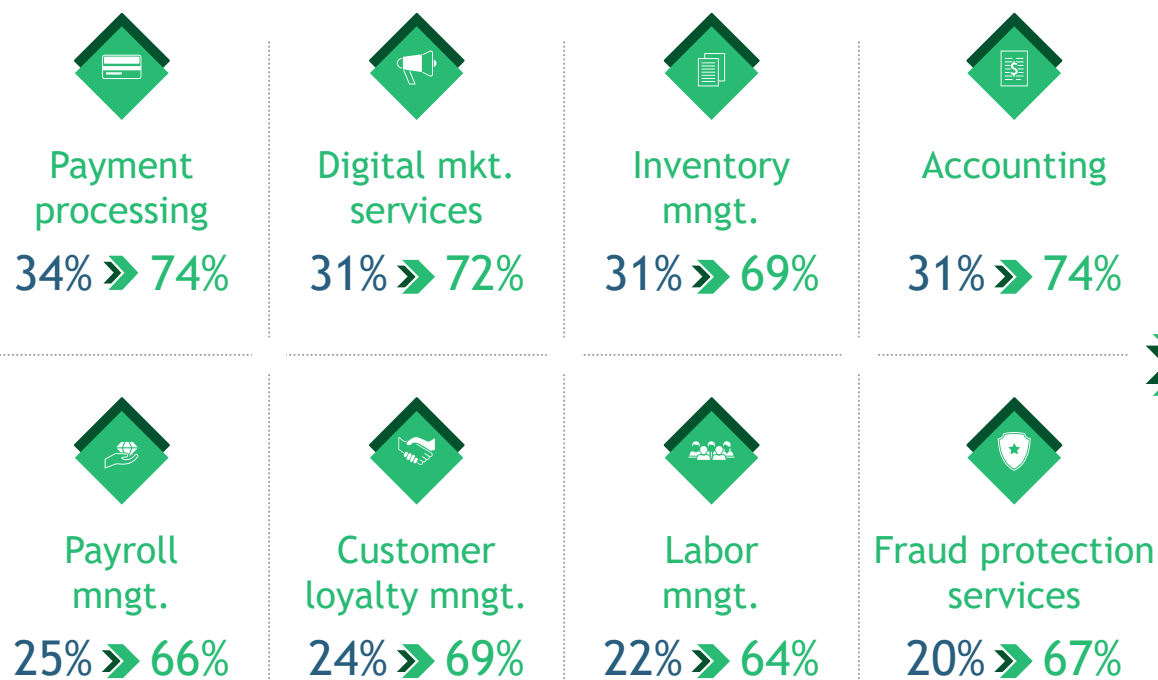


~50%

SMEs are open to banks to help them navigate their challenges for a fee

# Globally massive growth in embedded finance for SMEs expected; digital platforms to disrupt upto half of SME banking rev pool in 5 yrs

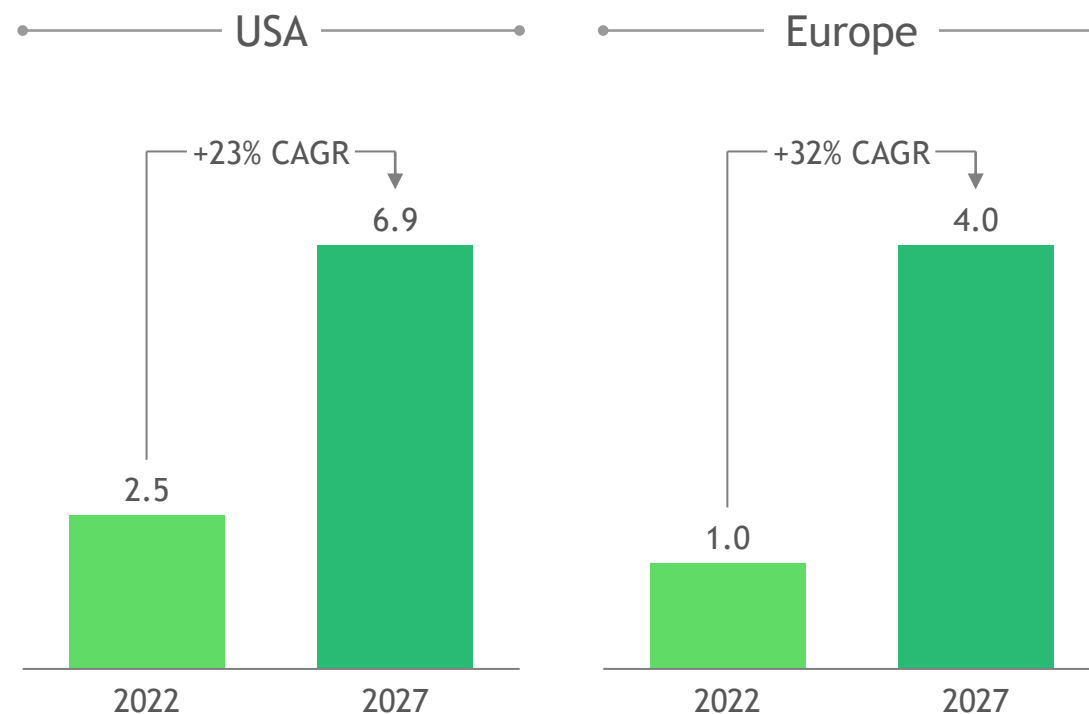
## % value added services from digital platform utilized by SMEs



xx% Current use of services on platforms/marketplace (% respondents)

xx% Future consideration on platforms (% respondents)

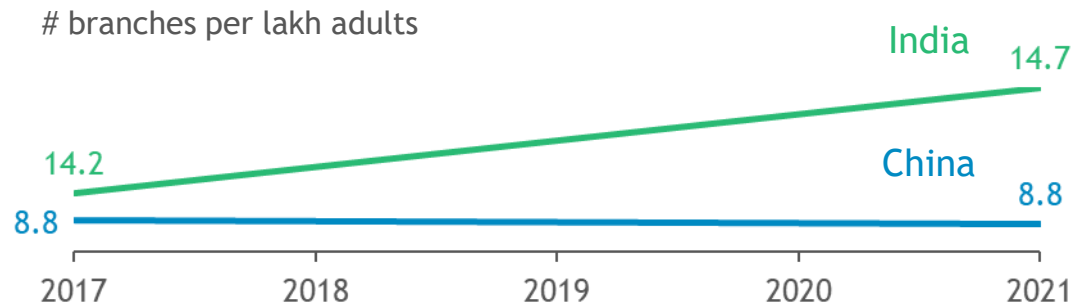
## Estimated embedded finance revenue potential for 2022 to 2027 (\$ bn)



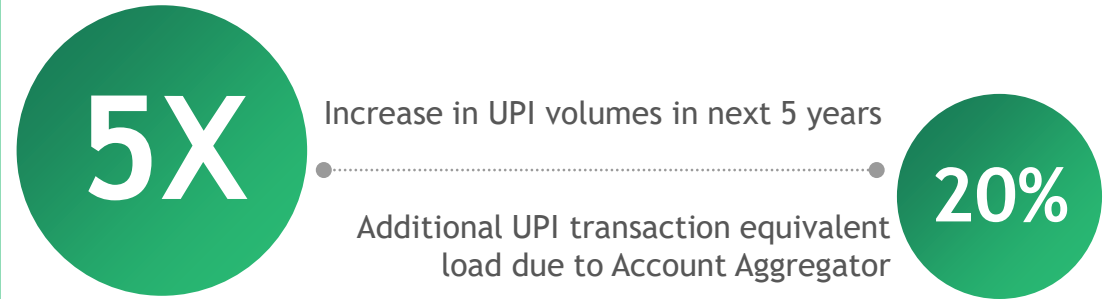


# Indian banks start with daunting challenges

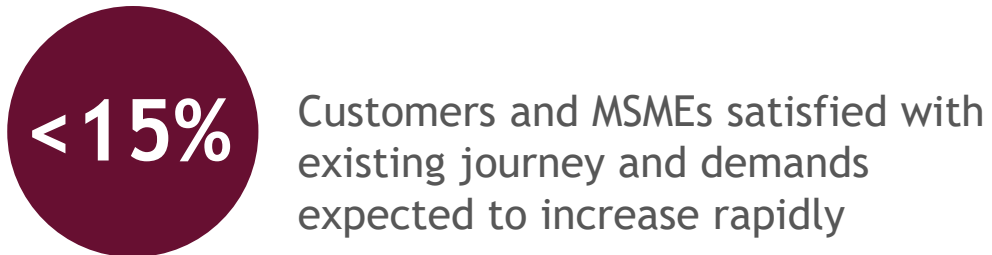
5000+ branches opened in India in last 3 years;  
current ratio significantly higher than China



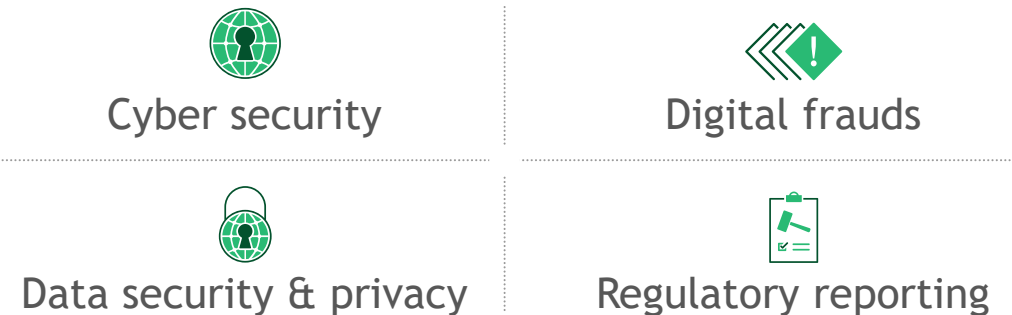
Transaction load to explode



Customers not satisfied with current bank journeys



Risk & Compliance Cost to Increase

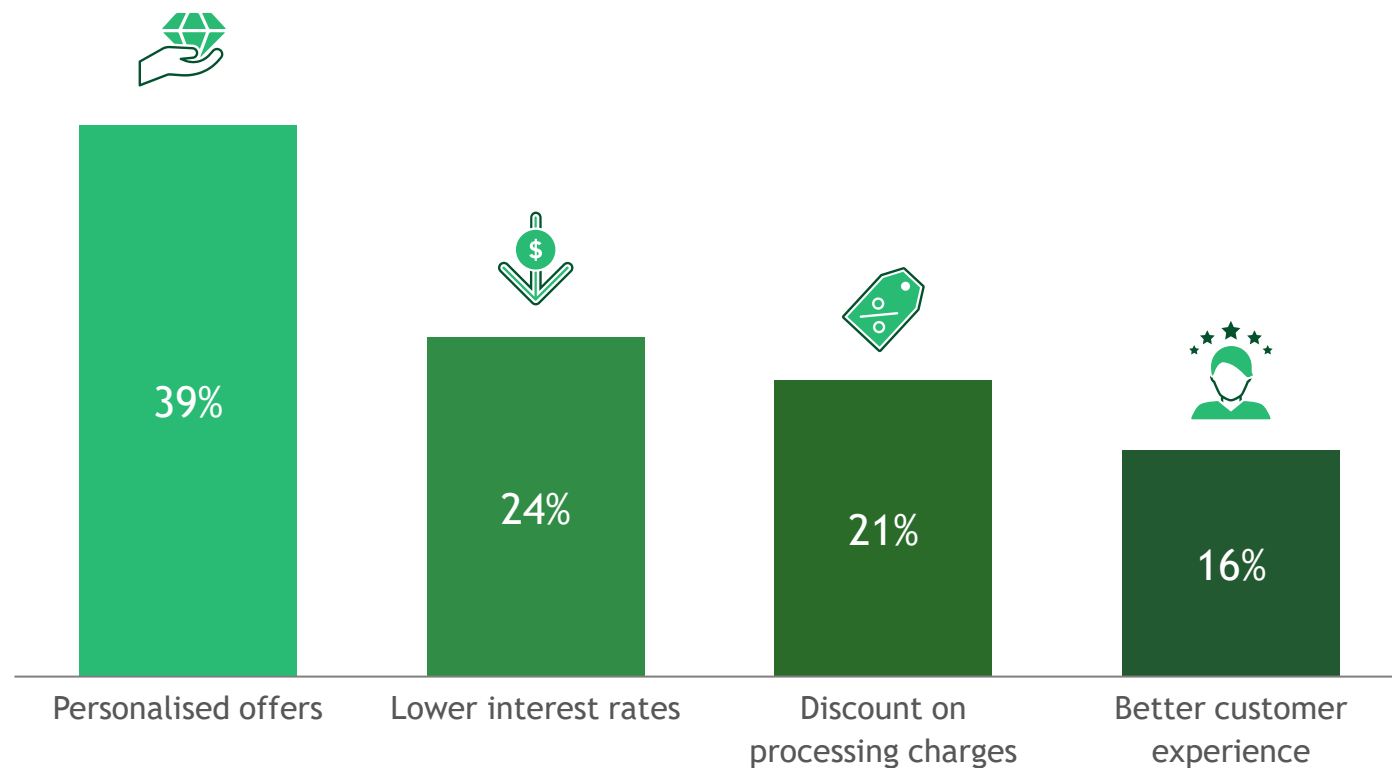


# Under Account Aggregator framework, SME are expecting tech enabled value added services from banks in return for sharing data

**~40%**

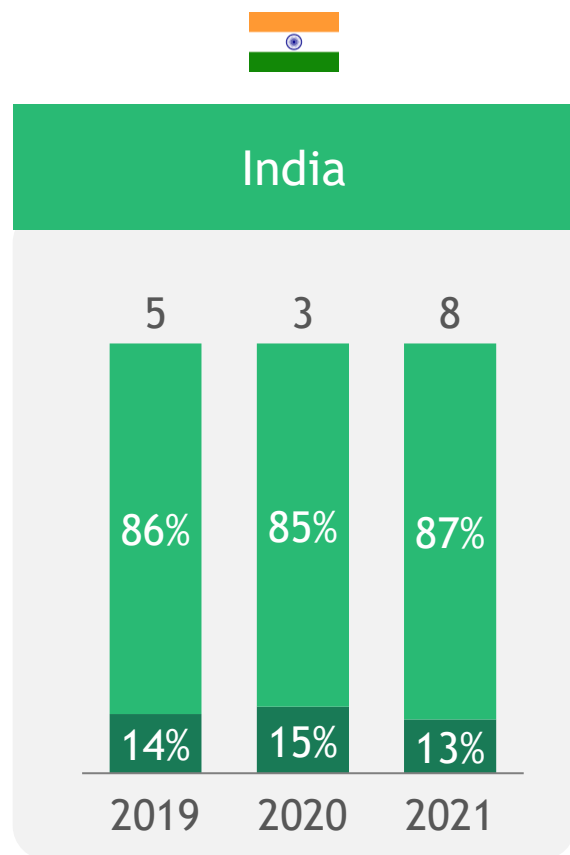
SMEs are willing to share data

MSMEs expectation if they agree to provide data(% MSMEs)



# In sharp contrast to global trends, FinTech funding in India is skewed towards those competing with, rather than those enabling the banks

Annual Equity funding raised from 2019-2021 (\$B)

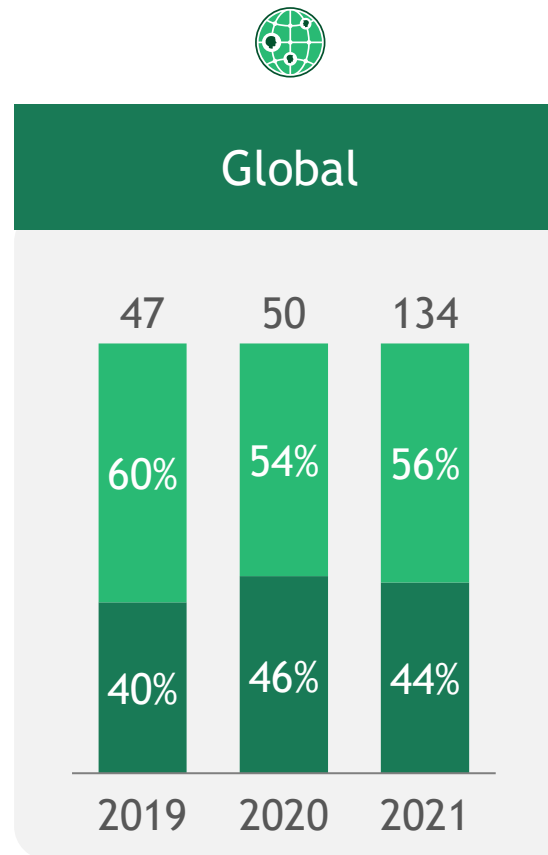


## Disruptor

FinTechs who compete with banks for wallet share

## Enabler

FinTechs who provide services to banks to improve their offering



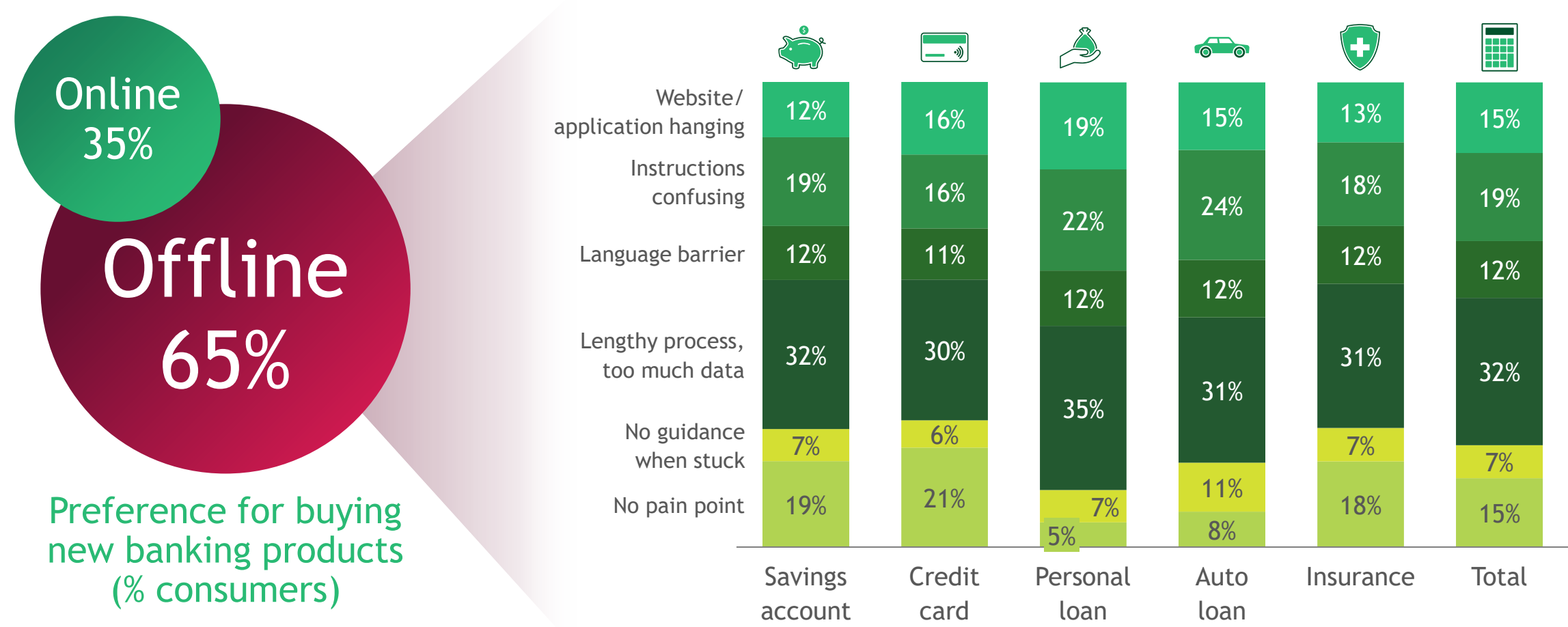
## Implication

- Less digital savvy banking industry is less attractive for FinTech to partner as enabler
- Banks stand to gain during FinTech winter (more enabling b2b to get funding over b2c)

Note: Funding excludes Ant Financial, Du Xiaoman Financial, and JD digit funding rounds Companies with an informed HQ location. M&A and IPO funding has not been considered.  
Source: BCG FinTech Control Tower

# Poor experience with banks digital journeys, leads to 65% customers preferring offline product purchase

Experience of customers who attempted digital journeys (%)



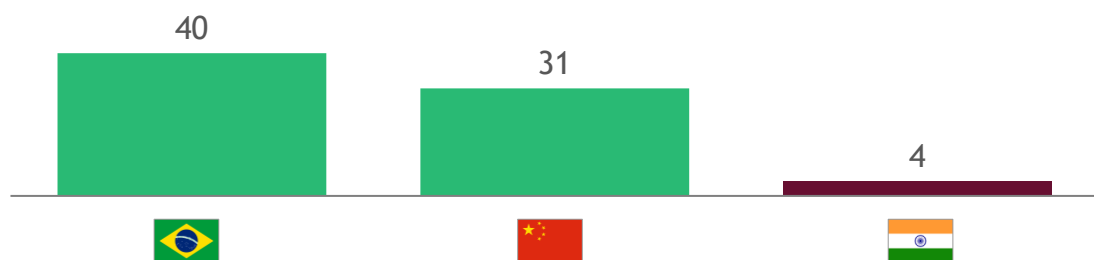
Source: BCG Consumer survey 2022 - 2000+ consumers



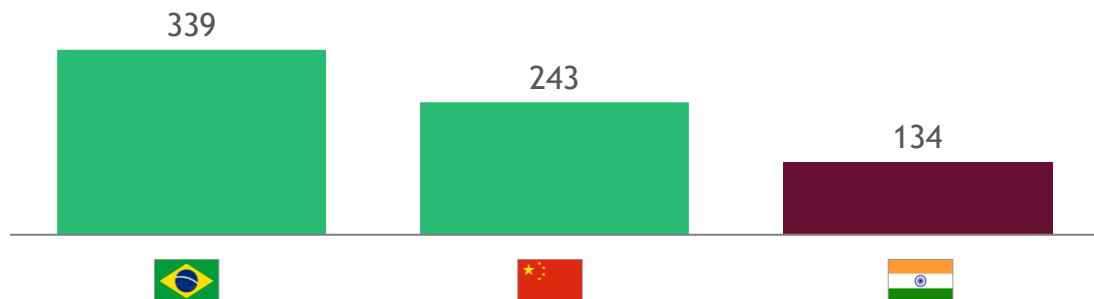
# Success of UPI is only a start, Indian banks to witness massive growth in transaction loads given current under penetration

India still lags major comparable economies on digital penetration

Digital Payments to Cash in Circulation<sup>1</sup> (value)

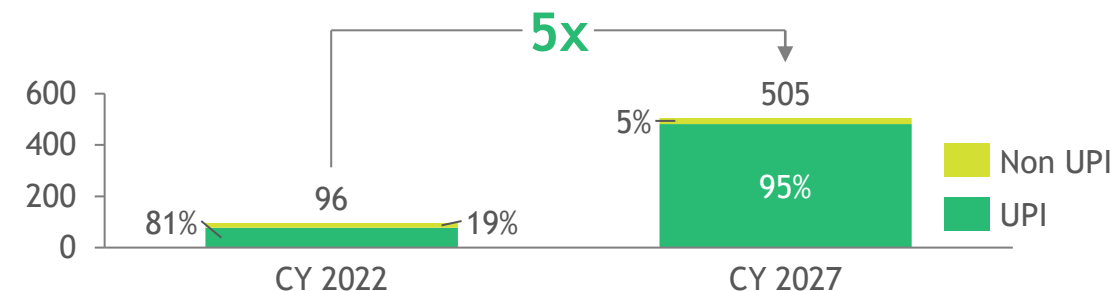


Digital Payments per Banked Person<sup>1</sup> (volume)

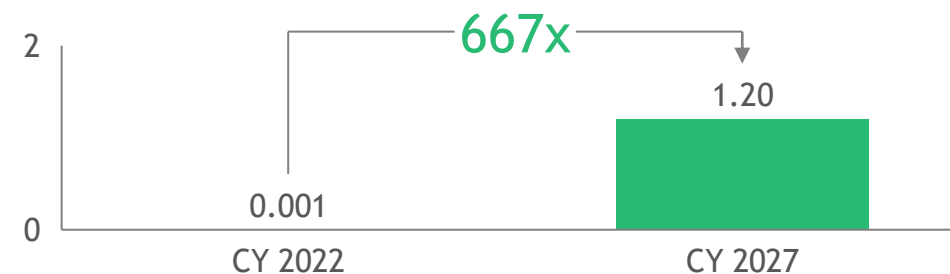


Transaction load to grow significantly on account of UPI and account aggregator

Digital Payments Volumes (Bn)



Pulls from Account Aggregator (Bn)



1. Banked population defined as people of above 15 years of age having accounts with Financial Institutions

Sources: World Bank Global Findex Database; FIBAC Trends and Benchmarks 2022; BCG global payments model 2022; BCG analysis

# A cycle to avoid: Many institutions struggle with ROI on digital transformation due to vicious cycle of lower investment

## Talent Constraints

- Customer journeys not designed by professional designers

## Budget Constraints

- Underlying technology platform cannot be changed

## New journeys not cool enough for significant customer traffic

- Revenue upscale not gained



## Low BU Ownership

- Product portfolio not rationalized
- Legacy process not challenged

## New journeys have not 'landed'

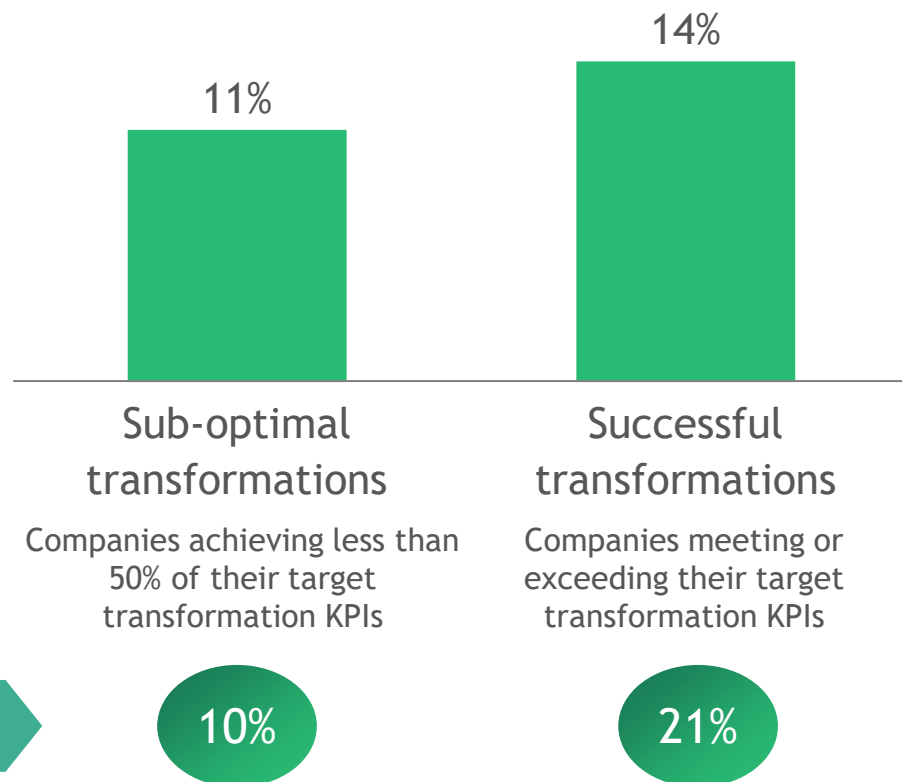
- High 'drop off' rate
- Majority customers have to take physical leg

## Old physical journeys have to be maintained

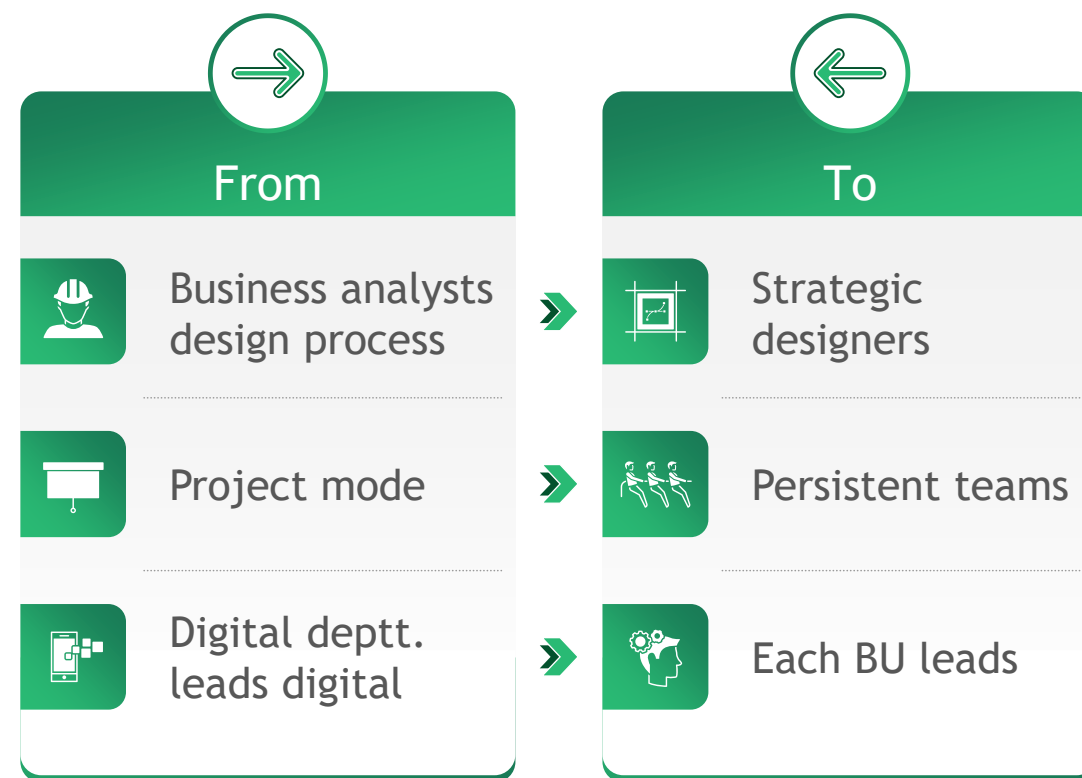
- Cost not out

# Successful digital transformations require bolder financial investment and deeper organizational interventions

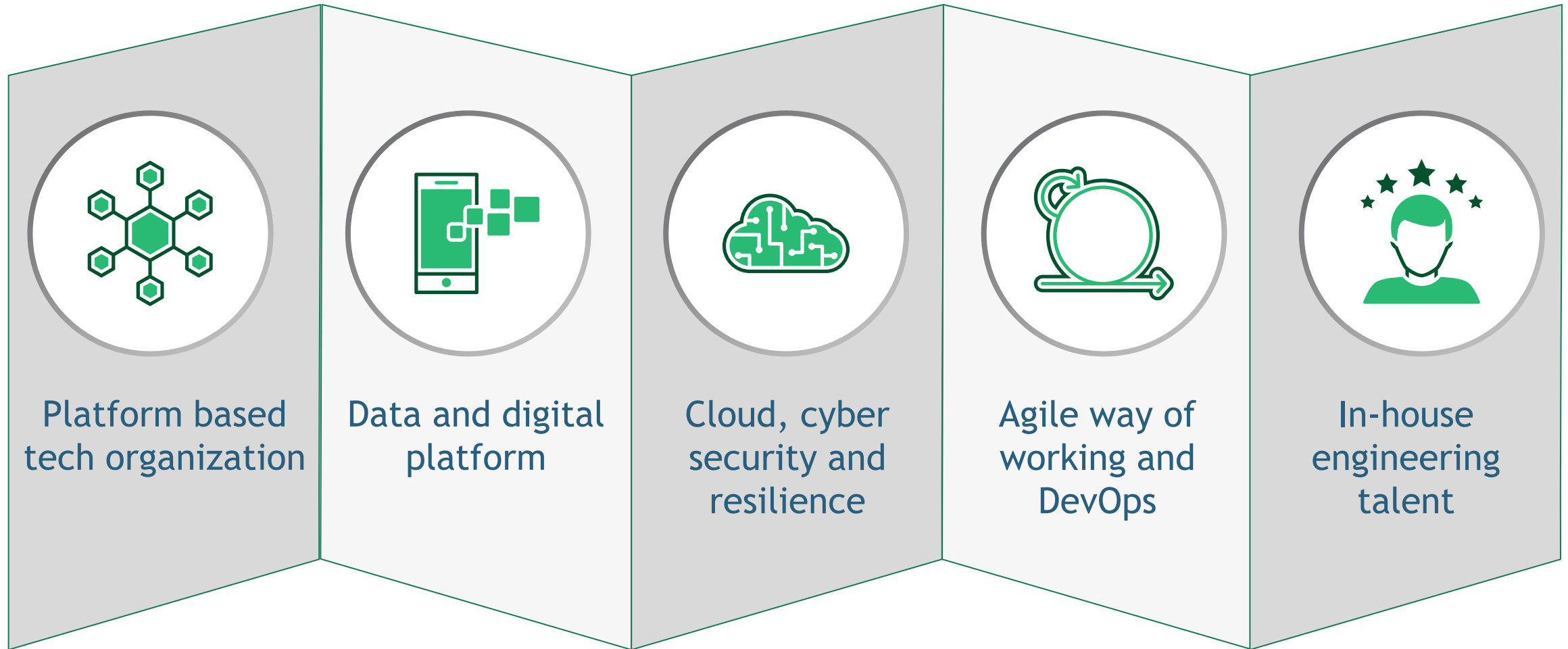
## % of revenue spent on digital transformations



## Deeper organizational interventions

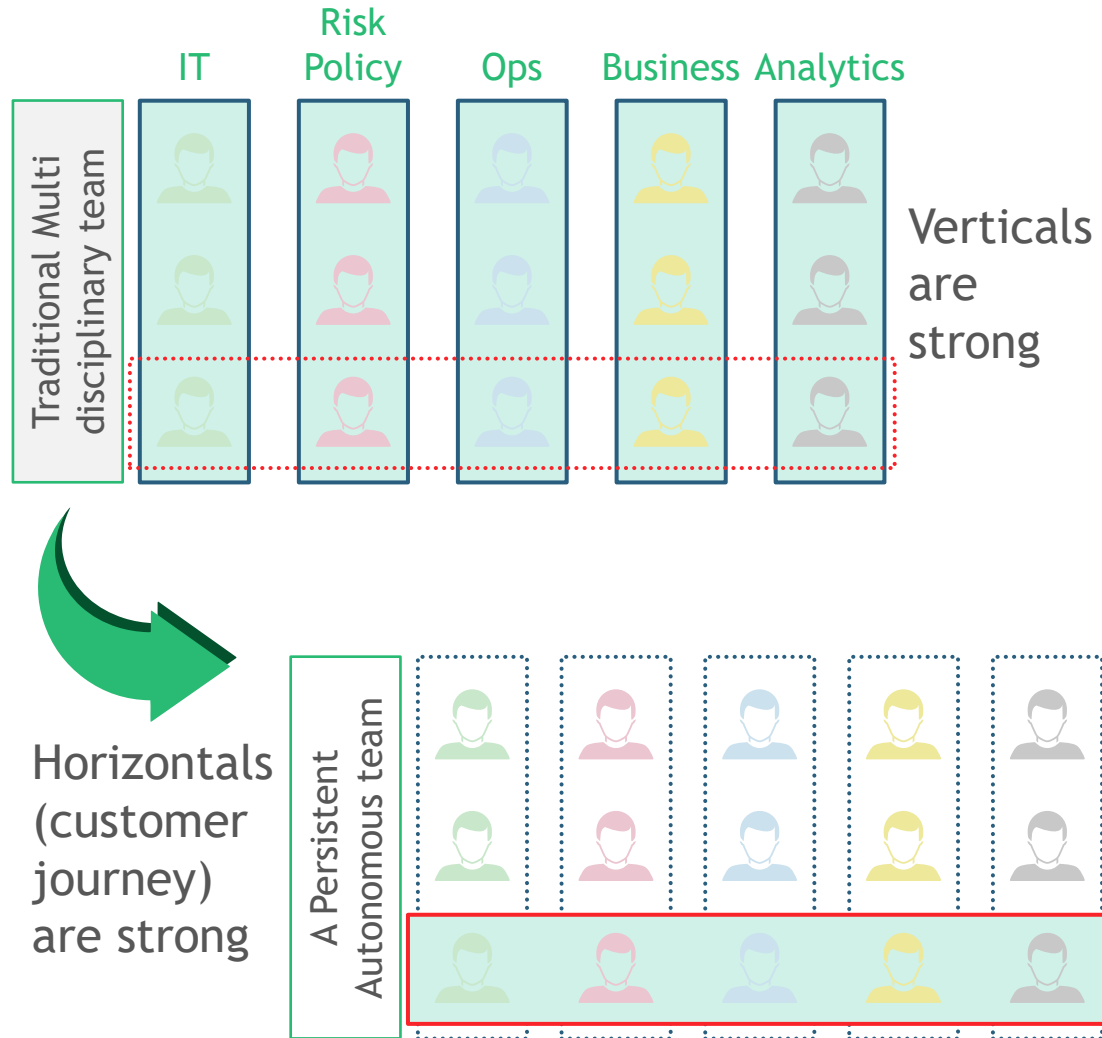


# Banks need cloud first tech architecture with in-house engineering and new agile ways of working

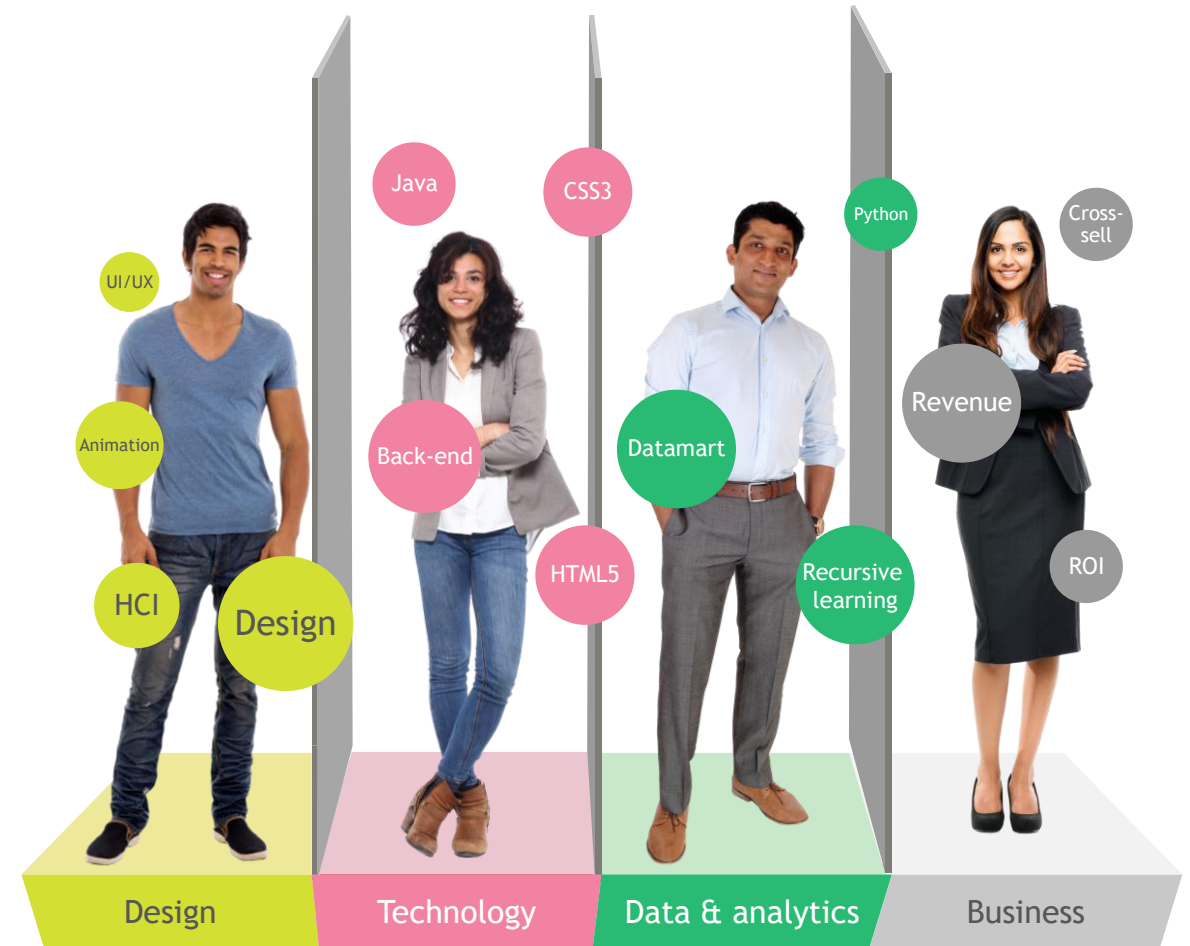




# Persistent multi disciplinary autonomous teams to become a norm; Diverse talent to be onboarded; Design yet to get due recognition



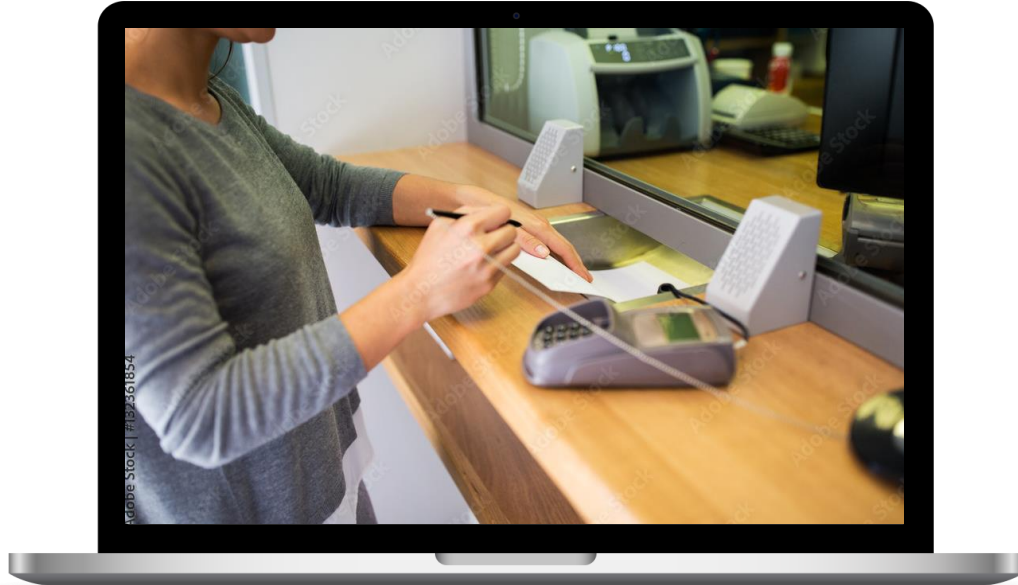
## Onboarding of diverse talent at scale required



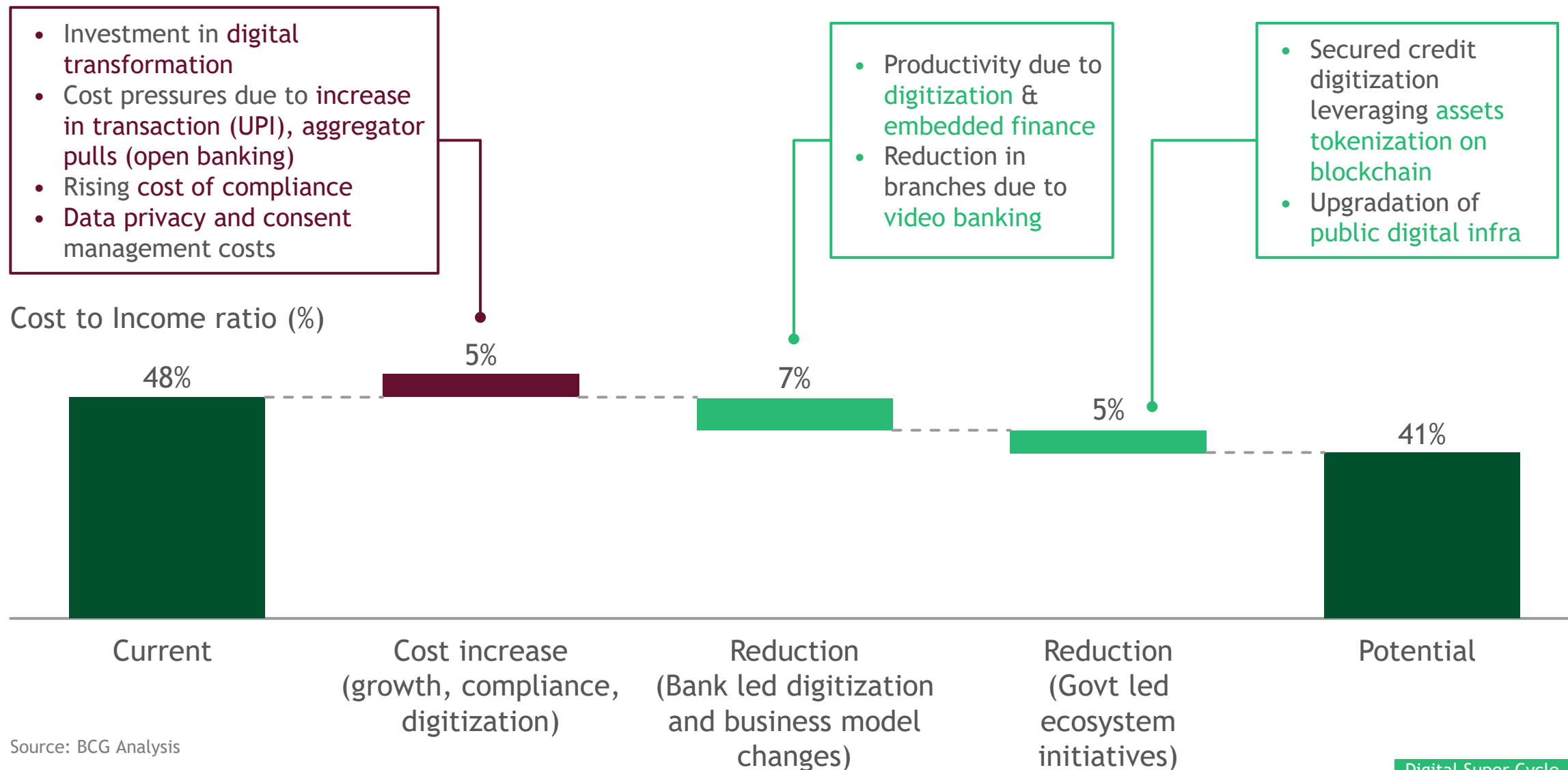
# With 5G quality, video banking can reduce branch need

## Example: mBank

(Video, Voice, Chat, online document sharing and co-browsing)

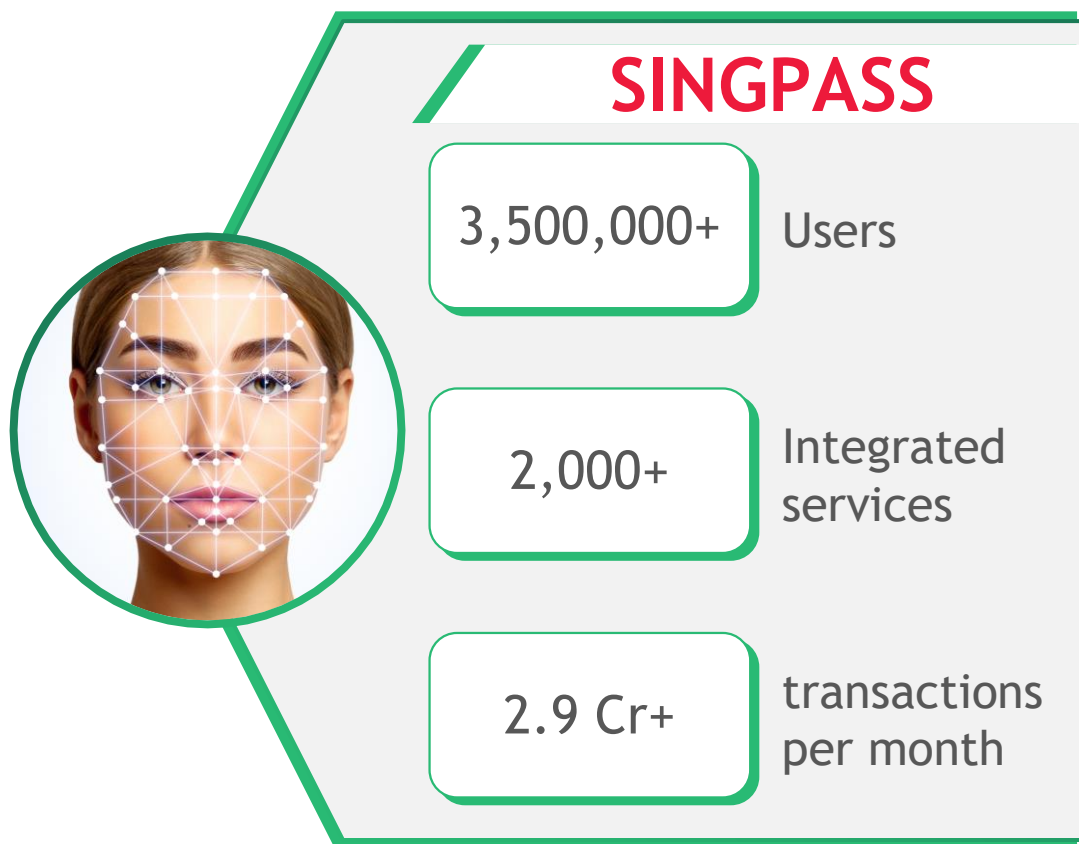


# With bolder digital transformations, banks can keep pace with evolving digital ecosystem, and achieve productivity excellence



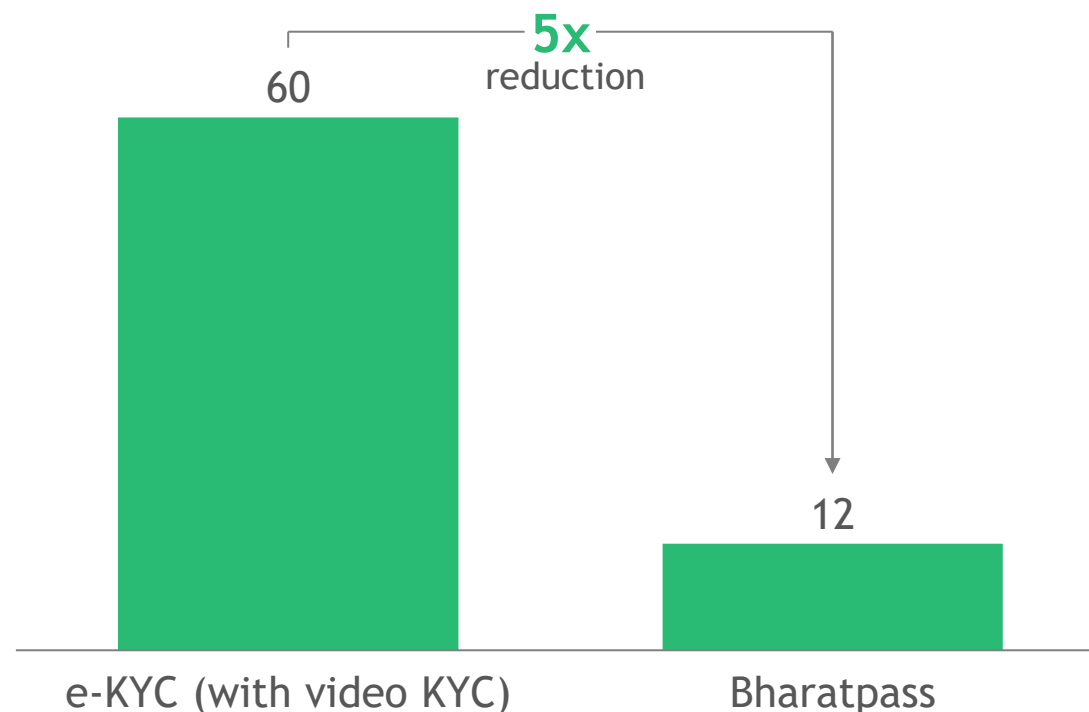
# Aadhar has to be upgraded to allow facial recognition based identity verification along lines of Singpass in Singapore

Facial recognition based digital identity system (e.g., Singapore)



Public infrastructure like "Bharatpass" can dramatically reduce KYC cost

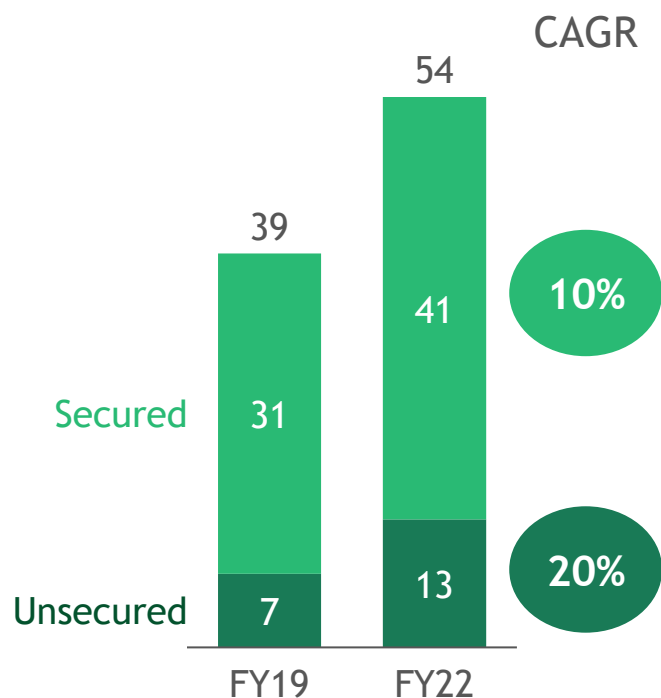
Effective all in KYC cost per customer (in Rs)



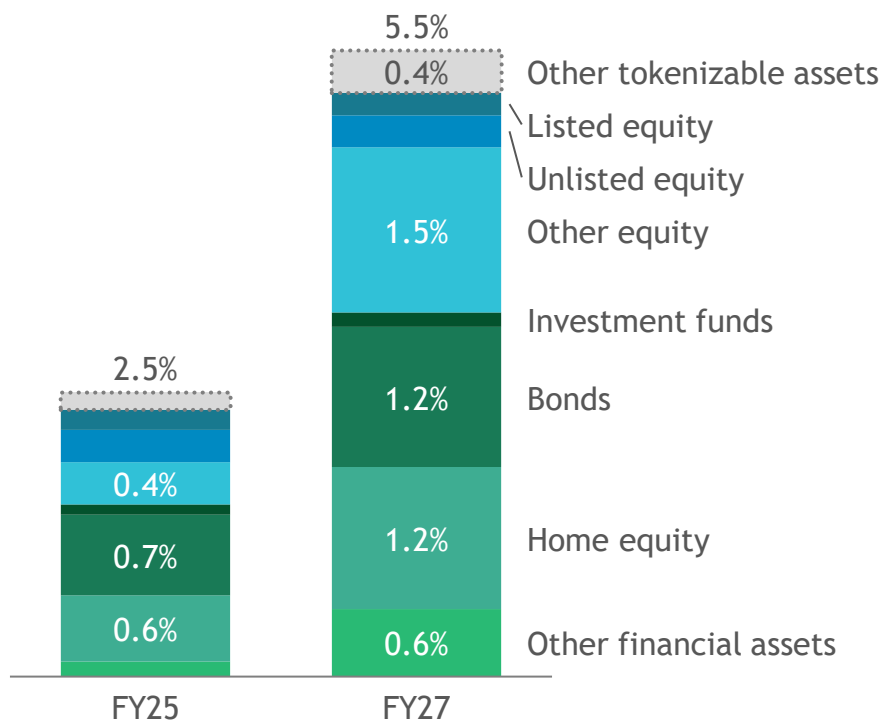


# India should embrace tokenization of real assets on blockchain to digitize secured lending in the same way as unsecured is today

Secured lending growing at half the pace of unsecured lending



Digital tokens of real assets to reach 5% of global GDP by 2027



Digital tokens to transform secured lending



Growth in secured credit portfolio



Reduction in COA

Note: Secured credit includes Auto, Gold, Commercial Vehicles, Commercial Equipment's, Property, Housing and Two-Wheeler; Unsecured credit includes Business, Consumer Credit Cards, MFI and Personal Loans

Source: CIBIL, FIBAC Trends and Benchmarks 2022; Relevance of on-chain asset tokenization in Crypto-Winter - BCG report; BCG Analysis

# Banks should be supported by tax incentives for investments in innovation like other industries

India provides various benefits to few industries (including R&D)



Pharma








Cold Chain



IFSC

Globally research and development allowances are industry agnostic and allow to banks also

Non-Exhaustive

Tax Credits		Upto 20% of expense allowed as tax credit
		13% of expense allowed as tax credit
		5% to 30% of expense allowed as tax credit <sup>1</sup>
Lower Rates		64% lower tax rate on income from IP <sup>2</sup>
Higher Dedn		2.5x deduction of R&D spends

1. 30% below EUR 100 Mn and 5% portion exceeding EUR 100Mn 2. from 25.8% to 9%  
Source BCG Analysis

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