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# Turmoil in the banking landscape: Year of reckoning for PSU Banks

BY SALONI SHUKLA & ASHWIN MANIKANDAN, ET BUREAU | UPDATED: JAN 01, 2020, 09.05 PM IST

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For more than two decades, public sector banks managed to stave off competition due to inherent trust people had in them due to government backing. As the next generation comes in with different attitude, are they equipped to serve them? They need to reinvent to survive, say Saloni Shukla & Ashwin Manikandan

For half a century since bank nationalisation, public sector banks dominated the credit flow to the economy with more than four fifths of the share. In 2019, the golden jubilee year, private lenders accounted for Rs 69 of the every Rs 100 loan. The tables are turning.

As the economy adjusts to the new reality like technology-driven financial services, a robust bankruptcy law, vanishing 'phone banking' and plethora of competition from unknown quarters, the Goliaths of Indian finance face the formidable task of remaining relevant — and surviving momentous change.

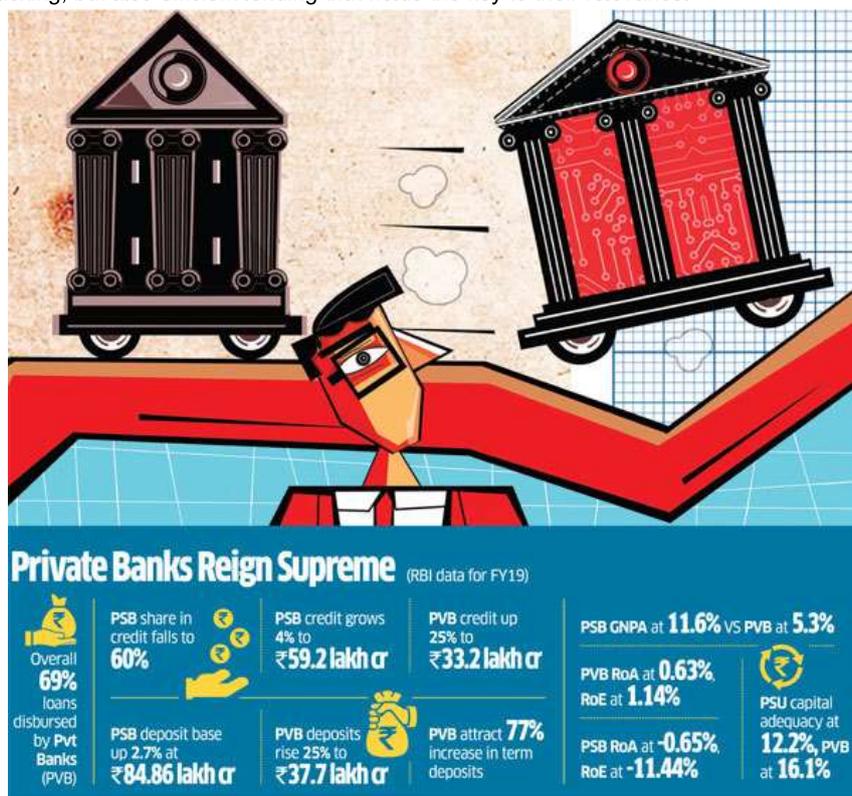
It's not just the availability of capital that provides strength to give out loans, but the skills and attitude to face the digital world, where customer convenience trumps everything else, that would determine their survival. It would not be just deposits that flow because of the comfort of government backing, but also efficient lending that holds the key to their relevance.

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The collapse of lending, lack of vision and risk aversion combine to present a muddy picture of state-run banks akin to other state-backed businesses, such as BSNL, Air India and BHEL, which failed to keep pace with advancements only to turn a pale shadow of their pasts.

"Unless government-owned banks put their house in order, they would see a much faster decline in the coming years and I highly doubt they will be able to face the onslaught of competition from new-age banks," said Kuntal Sur, partner, financial services, PwC.

Data shows that government-owned banks' share of total credit outstanding fell to 60% at the end of March 2019 from 75% in 2012.

State-run banks disbursed Rs 59.2 lakh crore at the end of March 2019, up 4% or Rs 57 lakh crore, from a year earlier, shows RBI data. By contrast, private sector peers loaned Rs 33.2 lakh crore in 2019, up nearly a fifth from Rs 26.6 lakh crore a year ago.

### CHANGING SCENARIO

Public sector banks remained the first port of call for anyone who sought banking services as they evoked trust and faith among people. The state-owned majority stakes in these banks led to the belief that every penny in those banks is safe.

Furthermore, private sector banking services gained notoriety where hidden charges were slicing away customers' funds without them even realising. There was a belief that state-run banks did not indulge in such practices.

But as the younger generation gets prominence and technology helps improve services, the millennial customer doesn't bother about whether a bank is state-owned or private.

"Public sector banks have to realise there is a new generation of consumers that expect a certain standard of service that perhaps these competitors are providing — be it in terms of the digital experience or technology or branch banking services," said K Cherian Varghese, former MD, Union Bank of India.

That even the seniors are moving into the digital age reflects the surge in electronic payments. Of the total small-ticket retail transactions worth Rs 10.32 lakh crore in March 2019, the share of online deals has risen to 61%, up almost three times from 24% in March 2016.

In the payment space, digital wallets and non-bank UPI players had a share of 14.7% in March 2019, up from 1.6% in the same period in 2016. Also, the key function of payments is being facilitated by the likes of Paytm and PhonePe reducing the reliance on bank platforms.

### TALENT TO COMPETE

The biggest differentiator has been the lack of specialised manpower at state-owned banks. The government recently announced its intent to fill middle-management positions at state-run banks and offer them a longer tenure. Nearly 70% of mid-management staff at PSU banks are over 50 years of age, suggesting their retirement isn't too far away.

"While the PSBs have all the necessary infrastructure in place such as the core banking systems and Internet banking solutions, it is the workforce that needs to be reoriented and retrained," said Varghese. "The attitude needs to change, there is a need for a ground-level training exercise conducted by the government to bring the PSB staff and bankers in tune with the market best practices."

State-owned banks are also constrained due to compensation they offer and senior PSU executives time and again have demanded they be allowed to hire a portion of their recruits the way private sector banks do, so that the best talent pools are also available to them.

"PSU banks need to change their people strategy, put more feet on the street, redeploy its current manpower, train them for specialised functions, initiate lateral hires for specific functions and every bank depending upon their strength needs to bring in a board-approved, market-linked compensation," said Sur.

### LEGACY DRAG

State-run banks, because of their ownership structure, were functioning more like a ward of the government rather than like businesses that are supposed to make profits. These lenders became tools for the governments to carry out their welfare agenda.

Also, cronyism led to many decisions being influenced and led to unviable projects getting funded. The last two decades saw an enormous surge in funding private infrastructure projects that led to a huge pile up of bad loans.

Data showed that PSU banks had a gross NPA ratio of 11.6% at the end of March 2019 and contributed nearly Rs 7.39 lakh crore to the total bad loan pile of Rs 9.36 lakh crore. Private banks on the other hand had a GNPA ratio of 5.3% with Rs 1.83 lakh crore as bad loans in value terms.

As state-run lenders got hobbled by bad loans, private banks stepped on the gas to secure more deposits. State-owned banks' total deposit base was at Rs 84.86 lakh crore at the end of March 2019, up from Rs 82.62 lakh crore a year ago. Private banks' deposits rose 25% to Rs 37.7 lakh crore.

But public sector banks believe that weakening metrics are just temporary and that they could roar back.

"The RBI data on total loans take into consideration both retail and corporate, and if the latter grows we will be back to our market share of more than 70%," said Mrutyunjay Mahapatra, chief executive of [Syndicate Bank](#). "There also has been a lot of cherry-picking in the consumer, LAP, MSME sector ... which is why you see this divergence. But, as the problems ease, the size and reach will help us to ride the growth."

Meanwhile, private lenders are turning more efficient than their state-owned peers. The spreads for PSU banks were at 2.8% for 2019 and 2.5% for 2018, while private banks had a spread of 3.6% in both 2019 and 2018, RBI data showed. Their cost of funds and cost of deposits were almost identical.

### **BABY STEPS**

PSU banks are also facing fierce competition from not only private peers but also from small finance banks, fintechs, non-bank lenders and micro-finance institutions. And the competition is only getting fiercer.

Small finance banks showed impressive growth with their total loans growing to Rs 59,491 crore versus Rs 34,879 crore, a growth of more than 70% in a year.

Banks which own the customers and have their deposits saw their control in the overall transactional pie gradually reducing to 81% from 92.7% three years ago.

As PSU banks realise that they could not do it on their own, they are looking to partner with these nimble firms in their catch-up act.

"Well, obviously we see competition from a host of entities that are trying to get a piece of PSUs' original hometurf, especially in rural and semiurban areas," says Mahapatra of Syndicate Bank. "Going forward, we see use of technology and collaboration as small finance banks, MFIs, non-banks are good at this, we see huge opportunities in coorigination."

But these banks also face sudden distractions. Last year was significant in the sense that the government moved to consolidate many banks that would make them bigger, but not necessarily more efficient and competitive.

The government decided to merge 10 state-run banks into four, including Oriental Bank of Commerce and United Bank of India with Punjab National Bank; [Andhra Bank](#) and Corporation Bank with Union Bank of India, opening up a new opportunity.

"Merger has given them a chance to redefine them," says PwC's Sur. "Today, all of them are copycats of each other; better and bigger banks will bring in more capital, talented workforce and the power of the combined entity."

While the process could slow them down as not all of them are on the same technology platform, there's hope of revival.

"With mergers playing out in 2020, the professionalisation of state-run banks will accelerate," said Mahapatra. "For the rank and file, it will be business as usual, it will be time consuming for the top management. But you will see staterun banks bearing the benefits of this merger in the times to come."

This year would also see two private sector banks, [ICICI Bank](#) and Axis Bank, which were dragged down by bad loans, make up for the lost time.

Mergers and government's investment of nearly Rs 3 lakh crore as capital in the past few years have ensured that they don't sink. But the field has gotten a lot more competitive that would force staterun banks to come up with new ways to survive.

"India is in the classic Darwinian mode of what I call survival of the fittest," said [Uday Kotak](#), founder of [Kotak Mahindra Bank](#).

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