What banks need to survive 2021

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Uncertainty and unpredictability were the watchwords for 2020. Business and consumer behaviour trends witnessed an everlasting evolution in 2020 and the velocity of change continues to increase. The Covid-19 pandemic and the economic impact has unveiled the deficiencies of many banks and the fallout is likely to continue into 2021, with several leading banks and the banking regulator confirming that there will be a discernible surge in NPAs as we go deeper into 2021.

In addition to the financial fallout, the global banking industry has reshaped on a number of dimensions, stifling growth in some traditional product areas and prompting a new wave of innovation. This has accelerated digitization in almost every sphere of banking and capital markets. While losses can be expected in every loan category, they may be most acute within credit cards, commercial real estate, and small business loans. Sectoral deployment of bank credit has witnessed a downward trend in some crucial industries and sectors, though the turnaround and optimism should be just as swift, especially with some end in sight for the Pandemic.

But credit where it is due, it was no easy feat to go fully virtual and execute an untested operating model in a matter of weeks. Though digital access was a primary focus in 2020, banks were still expected to provide personal service in a physically distanced world. Customers were served, employees were productive, and regulators were reassured. Although banks effectively deployed technology and demonstrated unprecedented agility and resilience, they will have to give dedicated attention to customers' financial well-being in the months ahead.

The demand for corporate and project loans will steadily pick up pace as we reach the end of 2021, not only due to the constant need to ramp up infrastructure in India but also due to Government initiatives aimed specifically at revival of ailing businesses as also to give a fillip to the MSME sector. We have already seen indications of this during the early days of the Pandemic and this trend can be expected to continue in the coming months. To focus on working capital and risk management in terms of both data and analytics, banks would need to step up, streamline their decision processes that allow for swift responses to changing situations.

Some of the concerns for banks surrounding lending and risk management can be alleviated by adopting strategies aimed at deeper yet swifter appraisals, cutting down on small business lending and high loan-to-value mortgages, renew their now-outdated risk monitoring models and ensure strict adherence to commercial parameters such as those on financial covenants prescribed by RBI from time to time. Another approach would be to reduce branch costs by being smarter about their footprint and technology as well as shifting to paperless and cashless branches to increase efficiency and optimize deployment of their own capital.

With the pile of bad-debts on an all-time high, Indian courts will be plagued with cases involving billions of dollars in distressed assets, loan moratorium cases and bankruptcy cases. The decisions would clarify what roles banks would play in helping companies devastated by the pandemic. Courts have recently issued orders favourable for borrowers, including barring lenders from selling pledged assets and stopping banks from marking accounts as bad loans. Based on the economic policy, central bank, lenders and the federal government have urged the top court to not grant more relief to borrowers.

As banks look for innovative ways to continue to meet the needs of their customers but also increase their non-interest income, additional risks on the credit side will evolve as 2021 unfolds. Unfortunately, banks will also need to focus further on compression of interest margin given the economic condition. To evaluate creditworthiness accurately in the context of this crisis, banks would need to go beyond analysing sectors or subsectors and focus on assessing individual borrowers. Business models can be very different from one company to another within the same subsector and will therefore be either more or less suited to survival and a faster recovery in the current environment. With government-guaranteed loans mounting quickly, processes should be simplified and banks should review their overall risk appetite and portfolio thresholds. Thus, the management of banks requires a lot of skill since multiple types of risks including liquidity risk, operational risk, market risk and credit risk needs to be mitigated. Some of these risks can be avoided whereas for the others the best that banks can do is to minimize their damage.

For 2021, the performance of the financial sector would remain under pressure on account of lack of credit uptake, risk aversion, lower fee income and covid-related provisioning. With the overhang of stressed assets continuing, banks will continue to focus on improving their collection efficiency and it will not be until the end of 2021 that a turnaround of any significance can be expected. Banks would need to confront ongoing challenges from the pandemic and boost their resilience – whether it is capital, technology, or talent, thus preparing a more comprehensive crisis management.

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