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Fintech Challenges for Banking Industry

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Sr. No.	Examination / Other books	Medium	Name of the Book	Edition	Published By	Price (Rs.)
1	JAIIB / Diploma in Banking & Finance	English	Principles & Practices of Banking	5th Edition, 2021	M/s Macmillan India Ltd.	Rs. 830/-
2	JAIIB / Diploma in Banking & Finance	English	Accounting & Finance for Bankers	4th Edition, 2021	M/s Macmillan India Ltd.	Rs. 570/-
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MISSION

The mission of the Institute is to develop professionally qualified and competent bankers and finance professionals primarily through a process of education, training, examination, consultancy / counselling and continuing professional development programs.

ध्येय

संस्थान का ध्येय मूलत: शिक्षण, प्रशिक्षण, परीक्षा, परामर्शिता और निरंतर विशेषज्ञता को बढ़ाने वाले कार्यक्रमों के द्वारा सुयोग्य और सक्षम बैंकरों तथा वित्त विशेषज्ञों को विकसित करना है ।

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Mr. Biswa Ketan Das
Chief Executive Officer,
IIBF, Mumbai

"The enterprise that does not innovate ages and declines. And in a period of rapid change such as the present, the decline will be fast".

By: Peter Drucker

One of the finest management consultant, Mr. Peter Drucker had long back envisioned that innovation is the key to leverage the opportunities arising out of the dynamics of changing business environment. Indian banking Industry is globally known for its agility, robust regulatory framework and sound managerial control. Indian banking system had witnessed seamless transformation from brick and mortar structure to click and mortar operations. In the recent past, there has been a paradigm shift in the way banks function. One of the reasons for this shift is due to the emergence of Fintech companies and their disruptive business model. No doubt, Fintech presents a slew of exciting opportunities, but at the same time, one has to be aware of the challenges it brings to the financial ecosystem. Fintech is still at a relatively nascent stage in India but poised for a big leap forward.

With the EASE reforms focussing on customer centricity and the use of digital modes to satisfy the expectations of the customers the best way forward for the banks and Fintech companies is to collaborate with each other. The theme of this issue of Bank Quest is therefore on "Fintech challenges for banking Industry".

The Institute had organised its 95th Annual General Meeting (AGM) on 17th September, 2022. We are carrying the President's address by Shri. Dinesh Kumar Khara, Chairman, State Bank of India in this issue which provides a brief insight into the various activities undertaken by the Institute during 2021-22.

This issue also includes the Speech by Shri. L. V. Prabhakar, Vice-President, IIBF & Managing Director & CEO, Canara Bank during the AGM of the Institute. Shri. Prabhakar shared his valuable opinion on the current economic & banking landscape and suggested that going forward, the banking and financial services sector in India will have to address two key risks, namely, Technology Risk & People Risk.

The first article on the theme of this issue is penned by Mr. Nagamohan Gollangi, former, Chief Information & Security Officer (CISO), Bank of India on "Fintech Challenges for Banking Industry". The article discusses about different Fintech segments in India and addresses the major challenges affecting Fintech adoption in India.

The next article on the theme of this issue is authored by Mr. Pramod Kumar Ojha, SWO 'A', Punjab National Bank & Research Scholar, Mittal School of Business, Lovely Professional University, Jalandhar on "FinTech: Financial inclusion or Banking disruption". The author has suggested the way forward in the form of mnemonic

‘SECURE’ that incorporates Security, Education, Customer, Undertaking, Regulation and Evolution to make the incumbent financial Institutions more secure.

The third article of this issue is jointly written by Ms. Kajal Kiran, Research Scholar, IKG Punjab Technical University, Kapurthala & Head of the Department, JC DAV College, Dasuya, Dr. Mandeep Kaur, Assistant Professor, IKG Punjab Technical University, Kapurthala & Dr. Gunjan, Assistant Professor, Mehr Chand Mahajan DAV College for Women, Chandigarh on “FinTech: A Revolution in Financial Access and Financial Usage”. The authors have suggested that collaboration of Banks with FinTech companies can be a win - win situation.

The next article of this issue is written by Mr. Arun Misra, former Deputy General Manager, Bank of Baroda on “Why Banks Need to Embed Environmental, Social, and Governance (ESG) Factors into their strategy?” Mr. Misra has emphasised on embedding ESG factors into a bank’s culture and system. The author has shared his opinion on different avenues through which, banks can embed ESG into their own business strategies

This issue also features “Legal Decisions Affecting Bankers” by Mr. Prakhar Galaw, Deputy Manager, HDFC ERGO.

Apart from the above articles, we are also carrying a summary of the Macro Research Report on “A Report on Issues and Challenges in Financing MSME in Pune, Maharashtra” by Mr. Prasad Shrikant Barje, Director, State Bank Institute of Learning & Development & Dr. Elizabeth James, Assistant Professor, National Institute of Bank Management, Pune.

I am hopeful that this issue of Bank Quest will open new doors for welcoming innovative thoughts and together we all will scale new heights of enlightenment in the quest of acquiring, developing and nurturing knowledge.

Biswa Ketan Das

Shri. Dinesh Kumar Khara
President, IIBF and Chairman, State Bank of India

Dear Members,

It gives me great pleasure to place before you the highlights of the Institute's performance during the financial year 2021-22.

I would like to commence with a brief on "Economic Outlook", followed by a "Banking Update" and culminating in the "Performance of the Institute."

Economic Outlook

The global recovery from the COVID-19 pandemic is turning out to be muted with downside risks rising significantly from the escalation of geopolitical tensions. Global crude oil prices are ruling above US$ 110 per barrel and remain volatile. Further, the normalisation of monetary policy in major advanced economies is now expected to gain pace significantly.

In the Indian context, headline CPI inflation edged up, breaching the upper tolerance threshold of 6 percent. Core inflation i.e. CPI inflation excluding food and fuel remained elevated. As per the National Statistical Office (NSO), India's real Gross Domestic Product (GDP) growth is estimated at 8.7 per cent[1] for FY 2021-22, 1.5 per cent above the pre-pandemic (2019-20) level.

With respect to the outlook, the forecast of a normal southwest monsoon brightens the prospects for kharif production. The recovery in contact-intensive services is expected to be sustained, with the ebbing of the pandemic and the growing vaccination coverage. Investment activity should get an uplift from robust Government capex, improving capacity utilisation, stronger corporate balance sheets and congenial financial conditions. On the other hand, the worsening external environment, elevated commodity prices and persistent supply bottlenecks pose formidable challenges. On balance, the Indian economy appears capable of weathering the deterioration in geopolitical conditions.

Against this background, the Monetary Policy Committee (MPC) of Reserve Bank of India at its meeting held on June 8, 2022 decided to increase the policy repo rate by a further 50 basis points to 4.90 per cent with immediate effect. The MPC also decided to remain accommodative while focusing on withdrawal of accommodation to ensure that inflation remains within the target going forward, while supporting growth.

In terms of the fiscal policy, a significant fiscal space in FY 2022-23 has been planned to be utilised for capital assets generation, which is important for revival of investment led growth cycle and thus for creating more job opportunities.

Banking Update

On a year-on-year (y-o-y) basis, non-food bank credit registered a growth of 9.7 per cent in March 2022 as compared to 4.5 per cent a year ago. Credit to agriculture and allied activities continued to perform well, registering growth of 9.9 per cent in March 2022. Credit growth to industry picked up to 7.1 per cent in March 2022 while services sector accelerated to 8.9 per cent in March, mainly

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The address was delivered on the occasion of 95th Annual General Meeting (AGM), held on Aug 17,2022.

[1]Ministry of Statistics and Programme Implementation, Press Release, May 30, 2022: (https://pib.gov.in/PressReleasePage.aspx?PRID=1829784#:~:text=Real%20GDP%20or%20Gross%20Domestic,2022)

due to significant improvement in credit growth to NBFCs and robust credit offtake in 'trade' and 'transport operators'. Personal loans segment grew by 12.4 per cent in March 2022 from 10.7 per cent in March 2021.

Growth (y-o-y) in aggregate deposits moderated to 8.4 per cent[2] in March 2022 (11.3 per cent in March 2021) as both public sector and private sector banks recorded lower growth. Private Sector Banks continued to outpace Public Sector Banks (PSBs) in credit and deposit growth.

With a view to incentivise credit flow to the Micro, Small, and Medium Enterprise (MSME) borrowers, in February 2021, Scheduled Commercial Banks were allowed to deduct credit disbursed to new MSME borrowers from their Net Demand and Time Liabilities (NDTL) for calculation of the Cash Reserve Ratio (CRR). The Trade Receivables Discounting System (TReDS) facilitates the financing of trade receivables of MSMEs. To further enhance the ease of financing to MSMEs, the NACH mandate limit is increased from ₹1 crore to ₹3 crores for TReDS related settlements. Moreover, the Government of India has approved the extension of Interest Equalization Scheme for Pre and Post Shipment Rupee Export Credit ('Scheme') up to March 31, 2024 or till further review, whichever is earlier. This measure is specifically intended at incentivising the exports from the MSME segment especially.

In recent times, digital banking has emerged as the preferred banking service delivery channel in the country along with 'brick and mortar' banking outlets. In pursuance of announcements made in the Union Budget 2022-23, guidelines have been prepared for setting up of Digital Banking Units (DBUs). Scheduled Commercial Banks (other than RRBs, PBs and LABs) with past digital banking experience are now permitted to open DBUs in Tier 1 to Tier 6 centres, unless otherwise specifically restricted, without having the need to take permission from Reserve Bank of India in each case.

Moreover, EASE 5.0 'Common reforms agenda' of EASENext program has been launched on June 8, 2022 and would comprise of two major initiatives: EASE 5.0 (common PSB reforms agenda) and Bank specific strategic 3-year roadmap (based on individual bank's business priorities). Under EASE 5.0, PSBs will continue to invest in new-age capabilities and deepen the ongoing reforms to respond to evolving customer needs, changing competition and the technology environment. EASE 5.0 will focus on digital customer experience, and integrated & inclusive banking, with emphasis on supporting small businesses and agriculture. Simultaneously, all PSBs will also create a bank-specific 3-year strategic roadmap across diverse themes - business growth, profitability, risk, customer service, operations, and capability building.

The advancement in technology has brought mobile and internet banking services to the fore. India's digital lending stood at US$ 75 billion in FY18 and is estimated to reach US$ 1 trillion by FY23 driven by the manifold increase in digital disbursements. The FinTech market in India was valued at ₹1.9 trillion in 2019 and is expected to reach ₹6.2 trillion by 2025 across diversified fields like digital payments, digital

[2] RBI Annual Report: Economic Review 2021-22 (https://rbi.org.in/Scripts/AnnualReportMainDisplay.aspx)

lending, Peer to Peer (P2P) lending, crowd funding, block chain technology, distributed ledgers technology, big data, RegTech and SupTech, etc.

Performance of the Institute

The Institute has exhibited commendable resilience in conducting its academic endeavours, examinations and training programmes, while pandemic-led disruptions prevailed, albeit partially, for the major part of the year. The Institute has leveraged upon the digital infrastructure for pedagogical delivery and conducting the examinations seamlessly. Facilities such as AI-driven remote proctoring of examinations and training through web-based platforms have emerged as important tools in the Institute's overall repertoire.

Some of the major initiatives undertaken by the Institute during the year are provided below.

- The syllabi for the Institute's flagship courses, JAIIB and CAIIB, has been restructured to reflect the ever evolving and practical nature of the banking & finance and to enhance the cognitive value proposition to the banking fraternity at large. The Institute's coursewares for the examinations are also in the process of being updated accordingly.
- In parallel, the syllabi for the Institute's capacity building courses, offered in accordance with the directions from RBI in the specialised domains of Treasury, Credit, Risk Management and Accounting & Finance, have also been restructured in line with the industry expectations.
- The Institute has introduced two new Certificate courses in the domains of 'Strategic Management & Innovations in Banking' and 'Emerging Technologies'. These courses are specifically designed to equip the banking fraternity with the relevant knowledge-base in an increasingly technology-driven sector with evolving management priorities.
- With 'e-learning' fast becoming the preferred mode of learning especially for working professionals with continuous learning and development needs, the Institute has been proactive in assimilating e-learning in its pedagogical repertoire. The e-learning modules developed by the Institute have been accepted and recognised by the banking fraternity for their extensive content coverage and interactive user interface. These e-learning modules have been made available for individual members and non-members as well as institutional members like banks, at a nominal cost, duly customised for on-boarding of new inductees if required.
- The Institute has also been developing new e-learning modules on contemporary topics with even increased interactivity to ensure 360 degree learning of the participants.
- The Institute has launched the 'Professional Banker' qualification, a gold-standard qualification for the Banking Professional at mid and senior management level.

- The Institute has responded to the growing industry demand to quality and practicality-based training sessions for Banking & Finance professionals at all levels through its open and customised programmes, both in physical and online mode. The growing number of training programmes bears testimony of the delivery and content design by the experienced faculty members of the Institute.

- 178 Training Programs have been conducted by the Institute in FY 2021-'22, including both customised and open programs, with thrust on high value customised programs, e.g. Leadership Development Program in collaboration with XLRI, Jamshedpur and Advanced Program on Strategic Management in collaboration with JBIMS, Mumbai.

- Advanced Management Program (AMP) offered by the Institute has gained acceptance in the industry, as apparent from the increasing number of participation.

- The Institute, in association with Department of Economic Affairs, Government of India has conducted a high quality capacity building program in the areas of PPP and Infrastructure Development, for developing the skillsets of the Central and State Government officials.

- The Institute continued to leverage on its domestic and international collaborations. The FRR Certification, in association with the Global Association of Risk Professionals (GARP), has been introduced to augment the learning in risk management domain.

- The Institute has also collaborated with National Institute of Securities Markets (NISM), Mumbai and National Insurance Agency (NIA), Pune to design a unique programme, "Certified BFSI Professional".

The Annual HR Conference of the Institute was also organised virtually on August 27, 2021 with participants from regulatory bodies, academic institutions and bankers. During this conference, the Institute has sought for and received invaluable inputs and feedback from the HR officials of Banks and Financial Institutions on future requirements.

The 37th 'Sir Purshotamdas Thankurdas Memorial Lecture' was successfully organised by the Institute in virtual mode on November 10, 2021 and was delivered by Shri Supratim Bandyopadhyay, Chairperson, PFRDA.

As part of its Member Education series, the Institute has successfully hosted a Webinar on the contemporary topic of 'Central Bank Digital Currency' on March 23, 2022, with Shri Soumya Kanti Ghosh, Chief Economist, SBI and Shri Prasanna Lohar, Chief Innovation Officer, DCB Bank as distinguished speakers. Moreover, three Webinars on contemporary topics of strategic importance were organised by the Professional Development Centres of the Institute. The topics were:

➢ Pre-Packaged Insolvency Resolution Process (PPIRP) and IBC 2016

- Blockchain Technology –Application in Banking industries and e-Commerce Platforms
- Cyber Crimes in Banking

  All these conferences/webinars, duly followed by Panel Discussions, have been well-attended, and enthusiastically received by the banking fraternity.

Corporate Social Responsibilities

The Institute has taken voluntary Corporate Social Responsibility (CSR) initiatives, as a measure of good governance. The CSR Policy of the Institute intends to achieve the following objectives:

- Promotion of education including special education and employment enhancing vocational skills among different groups of society.
- Promoting equality among all the different sections of the society, including men, women, differently abled persons, economically and socially backward class of people in both urban and rural areas.

Protecting the Environment

The Institute pursues 'Green Initiative' of the Ministry of Corporate Affairs, Government of India by reducing use of paper and increasing the use of electronic mode in its activities. Besides ensuring that all the operations and exams are in the on-line mode, the Institute aims to completely eliminate the use of paper in the long run and to follow the policy of 'Go Green/conserve nature' in all its activities.

Looking Ahead

With post-pandemic shift towards digitalization, the Banking and Financial Services sector is poised for a radical change in product designing and service delivery, in line with the evolving customer expectations. The skillsets and knowledge-base of new-age bankers are also in a constant state of flux and the Institute has duly taken that factor into cognizance while designing its newer initiatives. Pedagogical shift towards technology-leveraged delivery has been the hallmark of the Institute last year. More specialised and customised training programmes will be developed by the Institute, keeping an eye on the requirement of various Banks. Going forward, the Institute is likely to increase its footprint to the entire BFSI sector. The Institute is also looking to revamp its Certificate programs to make them more conceptual, practical and relevant to the BFSI sector.

The Institute will continue to keep the interests of its members at the forefront and work towards enhancing their skill and knowledge base. I am sure that the Institute will replicate its robust performance in the ensuing financial year too.

Shri. L. V. Prabhakar
Vice-President, IIBF & Managing Director & CEO, Canara Bank

Ladies and gentlemen,

I welcome all the Governing Council members to this 95th Annual General Meeting of Indian Institute of Banking & Finance.

I also take this opportunity to welcome all the fellow members and associate members to this meeting.

It is my pleasure to be a part of this Annual General Meeting and I sincerely appreciate the contributions made by each one of you in the growth of the Institution.

After being one of the worst sufferers of the pandemic, the Banking and Financial sector has finally shown the signs of recovery. Easing of supply chain pressures and the recent ebbing of commodity prices are providing some breather from record high inflation. In India, supply conditions are improving, with the recent monsoon pick-up, strong momentum in manufacturing and a rebound in services. The onset of festival season should boost consumer demand, including rural, also as sowing activity picks up. Robust Central Government capital outlays are supporting investment activity. Inflation remaining at elevated levels, warrants appropriate policy responses to anchor expectations going forward.

Moving ahead, rural consumption is expected to benefit from the brightening agricultural prospects. The demand for customer contact-intensive services and the improvement in business and consumer sentiment should bolster discretionary spending and urban and rural consumption. Investment activity is expected to get support from the Government's capex push, improving bank credit and rising capacity utilisation. On the other hand, elevated risks emanating from protracted geopolitical tensions, the upsurge in global financial market volatility and tightening global financial conditions continue to weigh heavily on the outlook. Taking all these factors into consideration, the Reserve Bank of India has retained the real GDP growth projection for 2022-23 at 7.2 per cent.

The Indian Banking sector is undergoing a paradigm shift which will have far-reaching consequences. The emergence of differentiated Banks, growing role of NBFCs, surge in Neo-banks and Fintech companies will change the way the banking sector has been operating in India.

In recent times, digital banking has emerged as the preferred banking service delivery channel in the country along with 'brick and mortar' banking outlets. In pursuance of announcements made in the Union Budget 2022-23, guidelines have been prepared for setting up of Digital Banking Units (DBUs). Scheduled Commercial Banks (other than RRBs, PBs and LABs) with past digital banking experience are now permitted to open DBUs in Tier 1 to Tier 6 centres, unless otherwise specifically restricted, without having the need to take permission from the Reserve Bank of India in each case.

The address was delivered on the occasion of 95th Annual General Meeting (AGM), held on Aug 17,2022.

The advancement in technology has brought mobile and internet banking services to the fore. With post-pandemic shift towards digitalization, the Banking and Financial Services sector is poised for a radical change in product designing and service delivery, in line with the evolving customer expectations.

Going forward, the banking and financial services sector in India will have to address two key risks, namely-

- Technology Risk
- People Risk

With the introduction of a whole gamut of technology-based financial solutions by Banks and Financial Institutions, the industry has to effectively handle the growing concerns on the privacy and security of customer data, especially from a transactional point of view.

Moreover, there is a definite need to create a pool of banking and financial services professionals who have the adequate knowledge-base and skillsets to handle the evolving customer expectations in an ever-changing BFSI ecosystem.

In this context, the role of IIBF assumes paramount importance. With the experience of serving the Banking and Financial services industry in India for over nine decades as the industry's trusted knowledge partner, the Institute is well poised to leverage the current advancements in technology and provide the necessary support to the banking and financial services fraternity in their quest of attaining professional excellence through education and certification.

The skillsets and knowledge-base of new-age Bankers are in a constant state of flux and the Institute has duly taken that factor into cognizance while designing its newer initiatives. Pedagogical shift towards technology-leveraged delivery has been the hallmark of the Institute. More specialised and customised courses and training programmes will be developed by the Institute, keeping an eye on the requirement of various Banks. Going forward, the Institute is likely to increase its footprints to the entire BFSI sector.

The Institute will continue to keep the interests of its members at the forefront and work towards enhancing their skill and knowledge base. I am sure that the Institute will replicate its robust performance in the ensuing financial year too.

I, on behalf of the Governing Council, thank all of you for attending the AGM.

Fintech Challenges for Banking Industry

Nagamohan Gollangi*

Most of the technology disruptions across the globe so far, have happened in the service sector, be it Amazon, Uber, OLX, Wikipedia or Google, they have made easier the process of retail buying, availing taxi services, selling/buying of used goods, replacing Encyclopedia Britannica and providing searching tools for information. One consistent common characteristic one may find in all these disruptors is 'easing of process to obtain service', which is the key behind their stellar success.

On similar lines, by making easier the process of obtaining financial services by way of fast, efficient and customer-friendly means, Financial Technology (Fintech) firms have lately gained popularity and eventually started mushrooming across the globe. Thanks to Fintech, it is no longer about who is the biggest, but who is the fastest and the most responsive at effectively addressing the ever-changing consumer demands. The solutions offered by Fintech companies are no longer "one size fits all". Instead, they offer targeted – often niche – services that fill the gap of a particular financial need, sometimes at much lower costs than those offered by traditional financial providers.

Thus, becoming so popular in a short time, Fintech startups are significantly disrupting the financial industry. They have a number of advantages over traditional banking institutions that let them be more creative and offer customers services quicker and more affordable. People are speculating as to whether this spells the end of conventional financing. To quote Bill Gates, "Banking is necessary, banks are not." And that may be true. Digital financial technology is all about improving the lives of users and Fintech is disrupting financial industry.

Traditional financial institutions are at present not able to catch up with Fintechs on account of their slower adoption to change, legacy issues as well as regulatory limitations. Bourgeoning proliferation of Fintechs is now posing a serious challenge to traditional financial sector and hence, has ignited the urgent need for latter for faster change management.

In India, there are more than 2000 fintech companies right now and, according to 'The Economic Times', their market capital totals up to 31 billion US Dollars in 2021. More than two-thirds of Fintechs have been set up during the last five years itself.

There are currently about 200 Fintech 'Unicorns' worldwide, and about 10% of them are based in India (A Unicorn company is a start-up valued at a minimum of one billion US Dollars). Some of the popular examples are Acko, BharatPe, BillDesk, Coin DCX, Cred Avenue, Groww, MobiKwik, Oxyzo, Open, Paytm, PhonePe, Pine Labs, Policy Bazaar, Razorpay, and Zerodha.

Different Fintech segments in India

Peer-to-peer lending, real-time payments, quicker loan disbursement, investment advice, transparent

*Former Chief Information & Security Officer (CISO), Bank of India.

insurance advisory and distribution, and a number of other services that previously required human capital are now quickly integrating into the digital-native Fintech landscape. Now that lending to consumers and MSMEs is a priority, the Indian Fintech ecosystem has started covering these segments too. The sector also includes more conventional financial services like insurance, personal finance, and gold lending. Let's have a look at some of the popular Fintech segments in India.

PayTechs: Payment security, card networks, Application Programming Interface (API)/White label solutions, and payment gateways are all examples of PayTechs. Paytm, PhonePe, MobiKwik, and Google Pay are the leading competitors in this market.

LendTechs: Provide business and consumer-focused services, including corporate cards, fixed term finance, and trade finance, as well as Buy Now Pay Later (BNPL), personal loans, salary loans, gold loans, auto loans, education loans, and P2P lending. Among the Fintech services used in this market are collections management, credit bureau, alternative credit scoring, lending as a service, Loan Origination System (LOS), and Loan Management System (LMS). Leading lending platforms for both customers and businesses are emerging, including Google Pay, M-Swipe, and Razor Pay.

Digital banking: In this segment, technology is being leveraged through the establishment of digital subsidiaries of banks, retail neobanks, and Small and Medium Enterprise (SME) neobanks. Neobanks are essentially digital platforms for commercial banks. Conversational platforms, account aggregators, API providers and aggregators, banks with open APIs, Banking as a Service (BaaS), and core banking are examples of Fintech services used in digital banking. YONO of SBI, Khatabook, and Crazybee are a few of the major companies involved in digital banking.

InsurTechs: Provide services including employee insurance, digital insurance, electronic insurance, and insurance comparison platforms. By providing services like claims management, sales platforms, underwriting risk management, insurance infrastructure API, insurance product configurator, and policy admin system, fintech can be utilised in this market. One of the prominent market player in this niche is Policy Bazaar.

WealthTechs: Through discount brokers, robo advisors, mutual fund investment platforms, research platforms, and alternative investment platforms, WealthTechs offer wealth and expense management services. Examples of Fintech services applicable in this market include white label robo advisors, portfolio management suites, and CapTable management. In this market, two well-known companies are Zerodha and Smallcase.

RegTechs or Regulation Techs: AML, KYC, digital onboarding, fraud detection, Anti-Money Laundering (AML), and banking compliances and risk management solutions are just a few of the compliance and regulatory requirements that are met in the financial sector by using Fintech.

It is interesting to note that Payment and Lending segments contribute to more than three-fourths of Fintech business.

What are the major challenges affecting Fintech adoption in India?

While Fintech adoption in India has been unprecedented, it continues to face challenges such as the risk of data security and privacy leaks, platform downtimes, a lack of financial literacy and awareness in India, and disparities in adoption rates among MSMEs, which dominate the Indian economy.

Furthermore, the changing nature of the sector's regulations creates cost-related challenges for users and businesses. For Fintechs, regulations for investment exists whereas cryptocurrency, payment regulations, data security, infrastructure security, and consumer protection are still evolving.

As per the findings of the Working Group on Digital Lending (WGDL) constituted by RBI, there are approximately 1100 lending apps available for Indian android users across 80+ application stores and around 600 are illegal lending apps. These digital lending apps were discovered to charge high interest rates, use unethical and harsh recovery methods, and operate in an opaque manner.

Lack of timely enactment of regulatory controls may pose some serious consequences, like it happened in China. Let's have look at these.

Regulatory challenges – China's example

The extent of disruption 'unregulated' Fintechs may cause in an economy has been witnessed in China by the acts of two internet giants, Jack Ma's Alibaba and Tencent, the arch rivals in Fintech industry. These two, the then unregulated giant Fintechs of China, became bigger than any of the local banks and could dominate the whole banking sector in the country especially in the segments of retail banking and retail payment. The rise of the two companies has been both a blessing and a curse for China. In the meantime, another two Fintech biggies, Baidu and JD.com joined the wagon. While the investment and innovation they offer have helped the economy, the sway Fintechs held over China's people and economy was a concern for the Government.

In late 2020, the Chinese Government shocked financial markets when it suspended the most anticipated IPO of the year. i.e. Jack Ma's Ant Group. Following this, in early 2021, the Chinese Government issued a ban on banks selling deposit products via online platforms, fearing that the rapid expansion of the largely unregulated and uncontrolled Fintech sector could increase risks in the wider financial and social system.

As a result of this ban, the deposits of a few lakh customers were locked up and it resulted in unrest among the common bank customers fearing extension of ban to other institutions. Due to the scale of the challenges, there are signs that the Chinese Government will reverse its antagonistic policy towards Fintech companies in China, embracing and collaborating with them as opposed to vilifying them. Reforms intended to centralize control of fintech companies will have to be made long-term aim as opposed to short-term measures, and confrontation with said companies and business leaders will have to reduce if China hopes to reignite its economic growth and fortunes in the industries of the future.

RBI's regulation of August 10, 2022

The Reserve Bank of India (RBI) issued the first set of long-awaited regulatory framework for digital lending on August 10, 2022. The central bank has taken a position on key issues and provided clarity on topics such as direct loan disbursement to borrower account and borrowers' consent before increasing credit limit, among others.

The process of developing guidelines for the burgeoning sector had begun a long time ago. The initial work began in January 2022, after the RBI formed a Working Group on Digital Lending (WGDL).

The RBI has addressed malpractices committed by illegal Chinese apps in the digital lending rules, putting a stop to activities such as data scraping from consumer phones, obtaining explicit consent for data collected for lending, and upfront disclosure on all costs involved and a cooling-off period for borrowers to exit digital loans

The regulator has also barred automatic increase in credit limits.

The majority of participants see the new lending framework as a positive step, with digital lending Fintechs finally being recognised as an agent of banks/NBFCs and legally permitted to do business. On the other hand, the new framework is expected to increase regulatory pressure on Fintechs, which will have to collaborate with the existing lending infrastructure.

The guidelines, on the other hand, will result in the emergence of newer banking solutions, with Fintechs collaborating with banks and NBFCs for underwriting, loan disbursement, and collection.

As opposed to what happened in China, RBI has taken timely measures in Fintech regulation, neither too early nor too late. Had the regulator's action been too early in the nascent stage of Fintech evolution, it would have hampered innovation and if it had waited too long to initiate regulations, it would have hurt the Fintech firms as they would have already evolved to the extent where it would have been a painful path of return.

Having understood the present day scenario of Fintechs in India, let us try to answer the following questions.

Do Fintech startups pose a significant threat to traditional banks?

Fintech startups are unlikely to displace established banks for a number of reasons. First, consumers continue to put their faith in established banks rather than new businesses to responsibly manage their money. Banks have developed a solid foundation of customer loyalty over many years, whereas Fintech startups will need to be patient and gain customers' trust over time.

The significant exchange between banks and Fintech startups through collaboration is a crucial factor to take into account. Through mergers, the purchase of startup companies, and mentorship programs, banks acquire technology and insights. These partnerships help Fintech startups expand their customer base and market share. This collaboration over market competition will be beneficial for both banks and Fintech startups.

Is it worthwhile for banks to invest in fintech?

Certainly, there are expenses and difficulties to take into account when implementing and maintaining Fintech. Fintech, however, offers tremendous opportunity for banks to reduce operating expenses and increase efficiency, which will ultimately result in better services for their clients. Those who do not keep up with the growing demand for Fintech run the risk of being left behind by their rivals' technological advancements. The financial services sector will soon be impacted by fintech; it is up to the banks to decide how they will adapt to meet customer expectations.

Conclusion

Former Chairperson of State Bank of India (SBI), Smt. Arundhati Bhattacharya, having been at the helm for four years, shared her views in one of her recent interviews in this respect. According to her, the banks have a long history, a sizable clientele, a comprehensive understanding of who their clients are, and have amassed sizable portfolios over time, whether it be of deposits or credit, in addition to having a strong balance sheet. In contrast to Fintechs, the liability side of banks' balance sheets has a variety of sources. In that sense, the banking industry as a whole is stable, which is very difficult to say for smaller players like Fintech startups.

Because the banking system offers stability, customers will continue to use it. All things considered, the customer might receive either quicker service from Fintechs or a lower interest rate from banks. Fintech startups cannot charge lower interest rates due to the lack of more affordable funding, but they can deliver faster service.

Therefore, collaboration is the best solution in these circumstances. Collaboration between Fintech companies with innovative, good-quality ideas that improve the lives of customers and deal with their problems, something that banks have not yet done. If they collaborate, they will have the concepts and answers, and the banks will have the clients and their confidence. If both are combined, you find a win-win solution.

Many Fintech startups are eager to collaborate with banks because it provides them with stability. It allows them to enter an already established market. They simply enter the market with their solutions. As a result, a good collaboration between the two would be the best outcome.

If this occurs, the consumer would be the ultimate winner.

फिनटेक नवोन्मेष को सुगम बनाना: रिज़र्व बैंक का दृष्टिकोण

पिछले दशक में प्रौद्योगिकी के व्यापक प्रयोग के कारण, पारंपरिक वित्तीय क्षेत्र की संरचना और कामकाज के तरीके में मूलभूत परिवर्तन हुआ है। फिनटेक ने अपनी उत्पाद संरचना, बैक-एंड एनालिटिक्स, सेवाओं की आपूर्ति, आदि के तरीकों से, बैंकिंग, वित्तीय सेवाएँ और बीमा (बीएफएसआई) क्षेत्र में, बाधाएँ उत्पन्न की है। जैसा कि अपेक्षित है, इस तरह के नवोन्मेष पहले बाज़ार को परेशान करते हैं और जब एक बार अपनी रचनात्मक भूमिका स्थापित कर लेते हैं तो विनियामक और प्राधिकरण, नवोन्मेष को सतत पोषित करने और संबद्ध जोखिमों को कम करने के लिए इसे विनियमित करते हैं। नवोन्मेष भले ही अविनियमित होकर मुक्त विकास का दावा करते हैं परंतु, किसी क्षेत्र की सतत संवृद्धि के लिए नियमों, विनियमों/ विधियों की आवश्यकता होती है।

समष्टि (वित्तीय स्थिरता और साइबर सुरक्षा) और व्यष्टि (उपभोक्ता संरक्षण और वित्तीय समावेश) दोनों स्तरों पर फिनटेक क्षेत्रक के बढ़ते प्रभाव के कारण, फिनटेक स्पेस में विनियामक आदेश लाने के अलावा नवोन्मेष को सुविधाजनक बनाना जरुरी हो जाता है। इस तरह के नवोन्मेष को विनियमन के साथ संतुलित करना, रिज़र्व बैंक का सूक्ष्म दृष्टिकोण रहा है और यह बाज़ार के विकास के साथ-साथ सचेत रूप से विकसित हो रहा है।

इस क्षेत्र के नये घटनाक्रमों से निपटने के लिए, रिज़र्व बैंक ने नवोन्मेष सुगमकर्ता की प्राथमिक भूमिका के रूप में भी सचेत प्रयास किए हैं। रिज़र्व बैंक द्वारा फिनटेक के प्रत्यक्ष विनियमन के कुछ उदाहरण - गैर-बैंकिंग वित्तीय कंपनी - पीयर टू पीयर (एनबीएफसी-पी 2 पी) प्लेटफॉर्म, अकाउंट एग्रीगेटर्स, ट्रेड रिसीवेबल्स डिस्काउंटिंग सिस्टम (टीआरईडीएस) प्लेटफॉर्म आदि हैं। डिजिटल उधार पर कार्य-दल की नवीनतम रिपोर्ट (18 नवंबर 2021) डिजिटल स्पेस के लिए एक व्यापक विनियामक ढांचा निर्माण का एक और प्रयास है।

रिज़र्व बैंक ने अपने प्रयास, जैसे - विनियामक सैंडबॉक्स, रिज़र्व बैंक नवोन्मेष केंद्र की स्थापना, हैकाथॉन, आदि के माध्यम से गैर-पारंपरिक केंद्रीय बैंकिंग की भूमिका का निर्वहन भी किया है। अपनी पहल पर ध्यान केंद्रित करने और बदलते वित्तीय परिदृश्य में उभरती समस्याओं से निपटने के लिए रिज़र्व बैंक ने फिनटेक विभाग की स्थापना की है। फिनटेक क्षेत्र में, रचनात्मक नवाचार और नवोन्मेष की सुविधा से संबंधित सभी समस्याओं के लिए एकल संपर्क-बिंदु होने से निश्चित रूप से इस क्षेत्र में एकीकृत दृष्टिकोण अपनाना सरल होगा।

केंद्रीय बैंक, नवोन्मेष को प्रोत्साहित करते हुए, फिनटेक क्षेत्र में उभरते जोखिमों पर भी समानांतर रूप से ध्यान दे रहा है। प्रौद्योगिकी का अधिक उपयोग साइबर सुरक्षा से संबंधित चिंताएँ बढ़ाता है। इसके अलावा, बीएफएसआई सेगमेंट में दिग्गज तकनीकी कंपनियों की भागीदारी प्रणालीगत जोखिम भी लाती है। उपर्युक्त सभी का वित्तीय स्थिरता पर असर पड़ता है। रिज़र्व बैंक का कार्य, वित्तीय सेवा उद्योग में उपयोगी एप्लिकेशनों की बहुलता के बीच फिनटेक को प्रोत्साहन देते हुए, प्रौद्योगिकी और फ्रेमवर्क (ढांचे) के सावधानीपूर्वक चयन के माध्यम से, ऐसे जोखिमों को कम करना है।

उपर्युक्त मुद्दों से निपटने के लिए, रिज़र्व बैंक का दृष्टिकोण जोखिम प्रबंधन के किसी भी सिद्धांत से समझौता किए बिना, विनियमन और नवोन्मेष के बीच संतुलन स्थापित करना होगा।

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FinTech: Financial inclusion or Banking disruption

Pramod Kumar Ojha*

Abstract

In the present scenario, the landscape of financial system has seen a fundamental transformation. Financial innovation in the form of FinTech has increased the options of delivery channels as well as increased the population of bankable leading to financial inclusion to a great extent. However, it has also breached into the territory of traditional banking institutions resulting in the disruption of their normal working making the financial environment uncertain, raising new challenges for financial regulators and supervisors. This article also suggests way forward in the form of mnemonic 'SECURE' that incorporates points like Security, Education, Customer, Undertaking, Regulation and Evolution to make the incumbent financial institutions more secure.

Introduction

Financial technology, it is better known as FinTech, can be define as the new technology that seeks to improve and automate the delivery and use of financial services. It is a union of financial services and information technology. In simple terms, it can be explained as the industry that uses technology to make financial system and delivery of financial services more efficient. The relation of finance and technology is quite old, however, the word has gained relevance in past decade after the 2008 financial crisis.

It is working efficiently for the agenda of financial inclusion by providing financial services in cost effective, accessible, speedy, transparent to those who were neglected by banks due to constrains of resources and geography. Present demographic conditions of India with young and tech savvy population are providing prepared ground for FinTech to evolve. India is one of the fastest growing FinTech market in world with six thousand plus FinTech startups.

It has challenged the business model of conventional banking and has blurred the boundaries between conventional banking and other financial technology industries. It has raised the concern for the financial regulators and law enforcement. The rise of digitalization of financial system is also raising the concern for public fund and data. Financial fraud, cybercrime, issues related to data piracy and unregulated financial agent have also increased along with developments in FinTech landscape.

This article explains the historical background of FinTech followed by emergence of FinTech in India, relevance of FinTech for financial inclusion and the disruption caused by FinTech in conventional banking business model. This article is trying to establish a tradeoff between financial technology and banking with the suggestions as way forward.

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Historical Background

It seems like it is a recent term but the relation of finance and technology is as old as modern society. History of FinTech can be traced back to 17th century with the introduction of infrastructural changes all over globe witnessing financial globalization. Table1 is summarizing different eras of FinTech revolution that the world has witnessed so far.

Table 1: Evolution of FinTech

Date	1866-1967	1967-2008	2008 - current	
Era	FinTech 1.0	FinTech 2.0	FinTech 3.0	FinTech 3.5
Geography	Global/Developed	Global/Developed	Developed	Emerging/ Developing
Key elements	Infrastructure/ computerization	Traditional/ internet	Mobile/start-ups/new entrants	
Shift origin	Linkage	Digitalization	2008- financial crisis/smart phone	Last mover advantage
Remarks	Telegraph, railroad and steamship were utilized for cross border financial transactions	Shifting from analog to digital	Distrust of the traditional banking and emergence of new player	Globalization of digital banking
Examples	1866- Transatlantic cable 1918- Fedwire in USA 1950-Credit card	NASDAQ-digital stock exchange 1973 - SWIFT Bank Mainframe computers, e-commerce business model	2009- Bitcoin and boom in cryptocurrencies, smartphone, introduction of payment apps	Acceptance of FinTech by India and China

Source: Author's illustration based on Bester A, 2022

In the recent years, key enabling technologies that FinTech have adopted are Application Programming Interface (API) that is used for communication between two or more softwares, Cloud computing for increasing scale and flexibility, Biometric for human identification, Distributed Ledger Technology (DLT), that is a digital system to record transactions, Big data for information gathering and Artificial Intelligence (AI) & Machine Learning (ML) to perform complicated tasks without intervention of human.

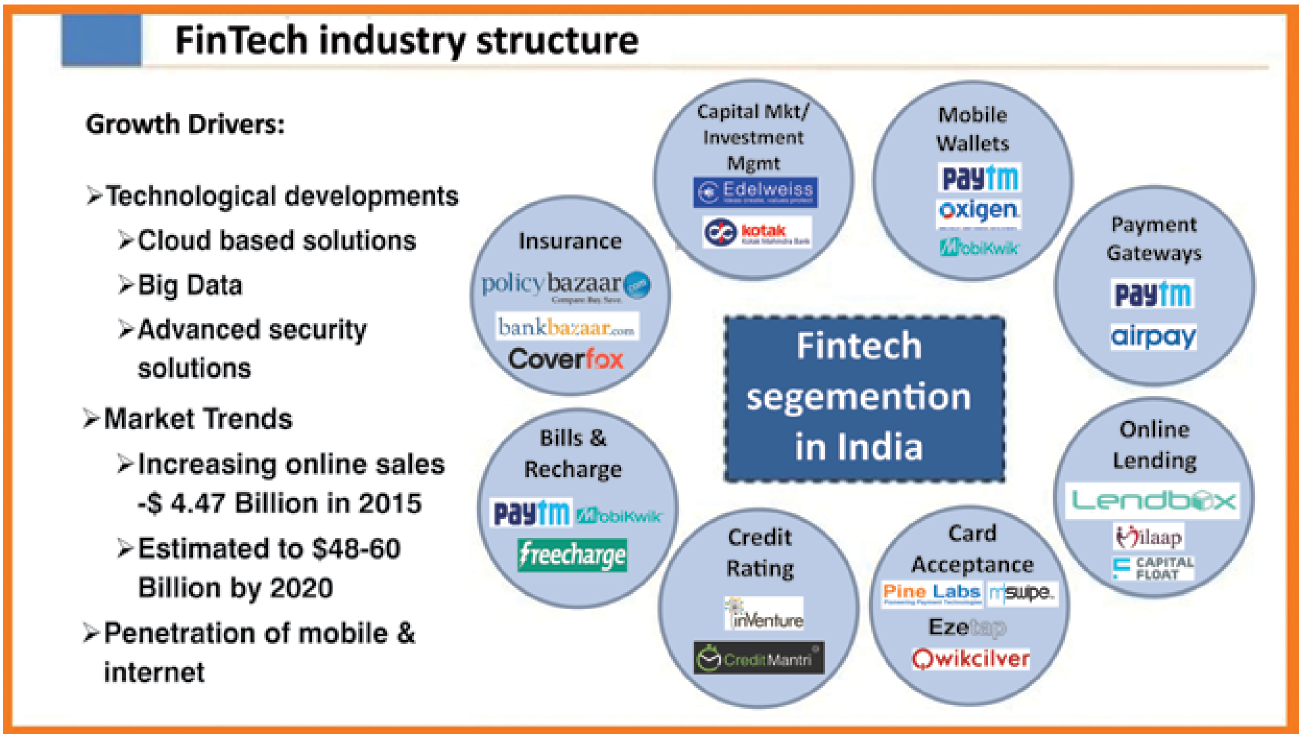
FinTech in India

The evolution of the FinTech in India is due to the mixed efforts of technological enabler, regulatory intervention and business opportunities including some unique characteristics in India. India has witnessed many growth drivers that has given favorable conditions for the growth of FinTech (a) massive internet and smartphone penetration (b) High volume of funds invested in the form of venture capital and institutional investor to drive innovation in this sector (c) Technological innovation in the form of machine learning and artificial intelligence (d) Favorable demographic of young and tech savvy population that has shown trust on FinTech (e) India stack (digital infrastructure) in form of Application Programme Interface(API) like Aadhar, UPI, Bharat Bill Payment GSTN (f) Massive financial inclusion initiative accelerated digital evolution.

India is the third largest FinTech ecosystem globally and has the highest FinTech adoption rate of 87 percent, significantly higher than the global average of 64 percent. India is among the fastest growing FinTech market with 6636 FinTech startups in India with expected market size of $150 bn in 2025 and has witnessed an investment of $8 bn in 2021 alone[1]. These companies are also operating as InsurTech and Wealth Techs. Twenty-three FinTechs have gained the status of unicorn registering the share of one fifth of total unicorns. FinTech like Zerodha, Zestmoney, Lendingkart, Policy Baazar, Money Tap, etc. are some of FinTech working in India.

Figure 1 shows the list of services that are carried by FinTech industries in India which includes insurance, stock market, sending and receiving money, paying bills, applying for personal loan online etc.

Figure 1: FinTech industry structure in India



Source : Shrivastava, 2021

FinTech has entered in every aspects of the banking territory which was earlier the sole area of banking and financial sector. The developing countries like India and China have witnessed a leap frogging in financial technology beyond brick-and-mortar banking and has reached to the people and area that were financially excluded.

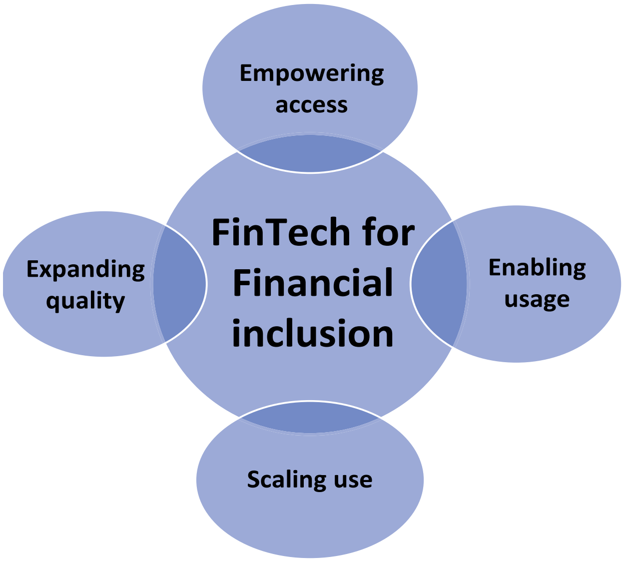
FinTech and Financial Inclusion

It has been claimed by many literatures that there is a positive and significant relation between FinTech and financial inclusion. There are many corners in the world where traditional banking has not been able to put its footprint due to resource and geographical

[1]Investment India, National Investment Promotions & Facilitation Agency.

constraints, preventing financial inclusion to be universally affordable. This is where FinTech can democratize access to financial products and world will move closer to achieve financial inclusion. FinTech has the ability to spread in all dimensions of financial inclusion, let it be access, usage and quality as it has lowered cost, increased speed and has improved accessibility through tailored financial services to the financially excluded people so far. Financial technology has helped the Government and financial companies to reach out to the financially and geographically excluded masses and educate them about the various financial products ensuring that their hard-earned money be invested as per their choice, (Kandpal & Mehrotra, 2019). In the report of Alliance for Financial Inclusion (AFI), it has been explained that framework for FinTech for financial inclusion works on four pillars which are represented in figure 2.

Figure 2: Framework for FinTech for financial inclusion



Source: Author's illustration based on AFI Special Report, 2018

The framework has incorporated Pillar 1 as empowering access through digital identification, e-KYC and simplified account opening. Pillar 2 represent enabling usage through digital payment infrastructure, Pillar 3 indicates scaling use of digital payment by Government for benefit transfers and at last Pillar 4 emphasizes improving the quality and range of digital services. In fact, it is FinTech that will financially include people rather than financial inclusion will acknowledge FinTech. We have seen how FinTech in form of JAM (Jan Dhan Aadhar and Mobile) trinity has proved to be a game changer in reaching out to people in need during pandemic period through KYC verified accounts. India has done quite good in access dimension of financial inclusion, however, its usage and quality dimensions still need improvement in which FinTech can be a game changer. The wider objective of FinTech is to serve the financial excluded segment of the society through its cost effective technologies, digital products and quick approval of credits to small and medium enterprises who were quite neglected by the traditional financial institutions due to cost and risk constraints. Unlike the traditional banking institutions, FinTech, since their initial stages have played a significant role in proliferation of financial inclusion through innovative business model including the products such as wallets, pay later solution, QR based payment, low-cost insurance, collateral free credits for lower income groups, who were earlier unserved or under served by financial institutions. FinTech is doing far beyond payment and microcredit products and are leveraging technologies to design, customize and distribute financial products that suits lower income groups fulfilling the agenda of financial inclusion. Encroachment of territory of financial institutions has created a kind of disruption in their working, leading to re-examination of their business model.

FinTech and Banking disruption

In last few years, financial technologies have developed rapidly as compared to technologies in other sectors. Financial technologies have become the backbone of present financial system and it even managed to establish as a separate segment as "FinTech" and have influenced the conduct of traditional way of financial service sector.

The traditional banking has seen major disruption in its operation in last couple of years starting with financial crisis of 2008 followed by advancement of in financial technology. In fact, it was the joint effort of IT professionals and sacked bank professional during 2008 financial crisis that gave rise to FinTech startups for resolving customer problems[2]. Financial crisis has resulted in loss of trust of customers on traditional banking and heavy regulatory and compliance requirements by financial institutions impacting their image and profit. This gave an opportunity to digital finance and user centric financial services to evolve.

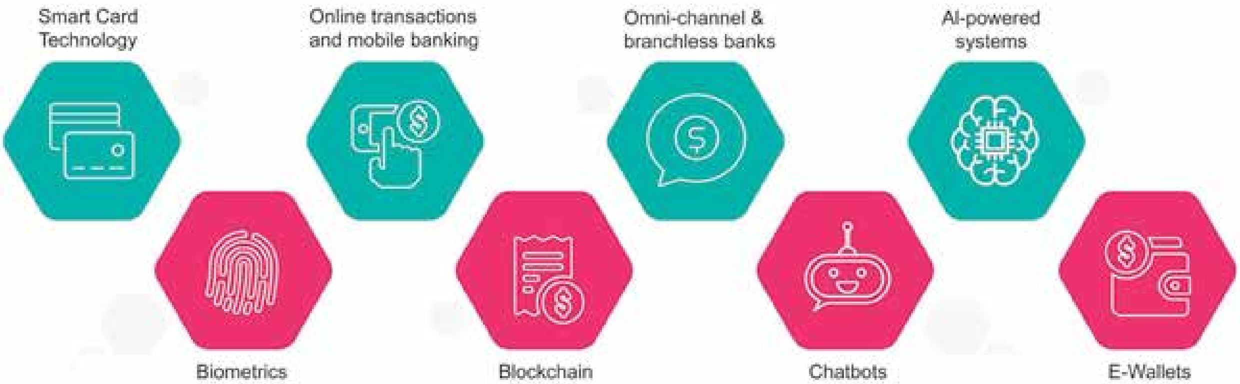
Disruption in banking is not new, financial institutions have faced many disruptions earlier like introduction of internet banking resulting in fewer visit of customers to bank, emergence of smart phone applications made banking transactions on move. This made ATMs, plastic cards and physical interactions with bank irrelevant. (Abdullah, 2017). In the current disruption, banking has fragmented into distribution business and credit provisioning.

It is inherent business model of traditional banking institutions and its major flaws that has given rise to FinTech. Delay in transaction process, working hours, effect of inflation on saving and inaccessibility due to geographic and legal boundaries that are impending banks to compete with FinTech. According to Abdullah (2017), overall banking revenue around 10-40 percent will be at risk by 2025 due to FinTech innovations outside banking institution. In today's digital financial ecosystem, it is not at all required to be bank to provide banking services. FinTech are carrying out savings, investments, credits, insurance etc. at cheaper rate which were earlier the sole responsibility of financial institutions. FinTech are providing better rate to their customers as they don't have to bear administrative cost & like traditional brick and mortar banks. According to PCW report, 70 percent of banks reported loss of market share and increased pressure on their margin due to competition given by FinTech firms (Abdullah, 2017). Traditional banking is also lagging behind due to core banking mechanism which are decades old and not able to keep up with the requirement of the modern consumers.

It is not true that banks have totally neglected digital financial innovations or customer centric approach to accommodate in its business model. Banks have incorporated e-wallets, mobile banking, smart chip technology, biometric sensors, online transactions, branchless banking (digital corner), customer service chatbots, artificial intelligence, machine learning, and block chain technology in its financial service, however, its rate of accepting digital technology is much slower than the FinTech firms. Figure 3 clearly explains the impact of FinTech on traditional banking business.

[2]The FinTech Magazine, 2022.

Fig 3: Impact of FinTech on Banking Industry



Source : Muzykya, 2022

If the traditional banking goes with same business model and same speed of digitalization, then future is more upsetting. Decentralize Finance (DeFi) is about to enter in financial market which may end the requirement of conventional banking. It encompasses wide range of services like decentralize exchange and credit application. It is loaded with the advantages like flexibility, transparency, removing borders, interoperability, speed and accessibility. It has also raised the challenges for financial regulators, policy makers and law enforcement agencies as Decentralize Finance will be unregulated and may also result in anonymous participation. It is also most likely that few FinTech will plunge to form their own banks. There are challenges to banking sector from FinTech companies but only if the banks remain traditional. Banks adopting FinTech innovations to remain relevant and future course of regulators will be a deciding factor.

Way Forward

The rapid transformational changes brought by FinTech in financial sector has created disruptions in functioning of traditional financial sector impacting its profit, image and security, however, the concern of overtaking of financial institution by FinTech is still a long distance. It is still not evident that FinTech has become biggest sign of danger for banks but the claim cannot be neglected in future and it depends on steps taken by banks in next couple of years to counter the FinTech. Till now, FinTechs are working only on a small niche, then what bank works on but future is unknown. Banks should not wait and watch rather it should take prompt action on the lacuna and issues which have provided space to FinTech to enter into their zone. To make the traditional financial institutions free from FinTech disruptions in future, it must work on the concept of 'SECURE' which include aspect like Security, Education, Customer, Undertaking, Regulation and Evolution for securing its future from FinTech.

Security

Security of customer's funds and their personal data has become one of the main concerns for the banks in the era of FinTech. Customers still prefer banks for the security reasons and the faith that has developed for banks in the decades. Banks should rely on its in-house application to provide its digital products rather than depending on third party.

Reserve Bank of India has directed banks to trim their relation with FinTech for third party products, especially for providing credits through digital apps. Security and privacy of customer should be prime focus of the financial industries as the cybercrime is at its peak and FinTech companies are one of their common targets. RBI is thinking of setting up of fraud registry to create data base of fraudulent websites and phones which will prevent fraudsters to repeat the crime once black listed. As per the Kaspersky, a cybersecurity firm, Asia pacific is going to witness an increase in cyber attack through Androids and iOs devices. The FinTech has become usurer of modern era through its loan app which provide hassle free loan without much documentations leading to debt trap with a processing fee of 15 to 25 percent, 182 to 325 percent of interest rate and recovery rate of 90 percent in case of default and their net profit reaching almost 25 percent. It has also been traced out by the security agencies that such apps are operating with proxies directors and call centers based in China, Pakistan, Bangladesh, Hong Kong etc. converting the extorted money to cryptocurrencies and transferring them out of India.

Expert, Education and Training

Traditional financial institutions in India are facing a huge crisis of appropriate skills to handle the present scenario of techno driven financial system. Most employees all over the world and in India lacks desired financial skills to succeed in the financial sector and recruitment of the right talent in financial industry is a big challenge in country like India. These are some of the loopholes, where FinTech has stood ahead of traditional banking system. In the present technological environment of financial system, we require digitally literate employees at front office who can understand customers' problems and digital experts at back office who can solve it swiftly. Banks are struggling for highly skilled staff against both FinTech and Bigtech. It was pointed in the 2020 report of United Kingdom Financial Service Skill Commission that there is need to develop skill like digital literacy among all workforce and more specialized expertise in the form of data analytics and software development skills from digital side. Creative thinking and coaching from behavior side will add further value. The future of banking will be less about traditional relationship management and more about customizing digital services and this is where FinTech seems ahead as of now. Financial institutions need to take proactive approach in identifying future skill requirement that can help them to cope up with rapid technological and societal changes. There is requirement of retaining and retraining of financial workforce to reskill and upskill them for future competition with the FinTech firms.

Customer and Communication

Customer is the axis around which the whole financial service revolves. Customers are now more service centric where they expect hassle free and cost-effective services at their fingertips. Customer base is the back bone of traditional financial services and banking sector are constantly looking for ways to provide best security to them. It is this customer base that FinTech aspire to snatch from banking industry. The way FinTech are providing financial services with the help of technologies, it is most likely that customers will be attracted towards them. It is the call of the hour that banks should take proactive steps to provide cost effective, swift and fraud less customer service using new technologies like chatbots to interact with customers. Artificial intelligence and machine learning should be used for fraud detection, smart chips, biometric, e-wallets etc. Banking industry should take a step forward for providing smart card, omnichannel banking and customization of services that makes customer service attractive and convenient. Communication with customers is vital part of customer service but over communication may lead to erosion of brand image and customer faith in the institution. Communication within institution is as important as communication with customer. It helps the staff to be updated with the recent developments in the financial environment. It also helps in dissemination of products and services as per the plan and target of authorities, however, unnecessary and frequent propagation of plan may lead to disinterest among staffs. Two-way communication should always be welcomed in the banking organization which helps the back office to design the products and services as per the customer choice taking the feedback from the front office.

Undertaking or Merger or Alliance

There are various conceptions that FinTechs are disrupting the business of financial institutions and have impact on their profit and image. Though the FinTech has entered in the business of financial sector which was earlier secured for banks but it will not be a cakewalk for FinTech. At present, both banks & FinTechs have their are advantages and disadvantages. FinTechs are armed with digital innovation and customized services, whereas, banking institutions are loaded with large customer base and vast experience. There future will depend on the steps they take against each other or with each other and may think for alliance or merger to see a combined effect. Alliance, merger or other form of cooperation can produce many benefits for both parties, it will enhance the brand reputation, expand the digital banking functions, lower capital expenditure, increase the reach of banking in younger generation and new geographies leading to more financial inclusion, lower the cost of business by reducing direct public dealing and diverting the human resource towards more productive works like NPA recovery and searching new avenues for credit supply.

Regulation

It has been observed that there is no single regulatory framework for FinTechs in India due to its overlapping and non-linear business model. It has also been observed that the regulatory initiatives that are intended for customer safety and suitability always face obstruction. Financial regulators are facing extreme challenges with the emergence of FinTechs due to their dynamic nature of services. As FinTechs have become an integral part of Indian financial system, so, it is the call of the time to reorient our regulatory requirements which ensure both swift digital innovation and security of customers' funds and data. Indian legislation and financial regulators have to do a lot of homework to bring FinTech under single, all-encompassing regulatory framework. With the increase in FinTech business, the boundaries between financial and non-financial firms are getting blurred and geographical boundaries in the era of FinTech are no longer a major constraint. We must realize that the regulation of complicated nature of FinTech business and traditional financial institution can be done in parity through use of technologies like Regulatory Technology (RegTech) and Supervisory Technology (Sup Tech) that can handle complex regulatory and supervisory requirement such as AML (Anti Money Laundering) and KYC (Know Your Customer). With the help of these technologies that uses data mining, artificial intelligence, machine learning, automation etc., this task may be accomplished.

Evolution and Innovation

Until recent time, the customer has to move to bank personally in need of financial services but today scenario has totally changed due to emergence of digital banking. Customer's expectation is changing exponentially in the evolving digital financial market where they have variety of options for financial services where innovations not only lead to success but also sustain the survival. Traditional financial institutions must plan to focus on digital product innovation to retain the customers which are migrating towards FinTech due to better service options. Innovations in banking sector is more than adopting new technology, it requires a paradigm shift in the institution's mindset and engagement across all level of business. In lack of such ambitious vision, banking may feel acute disruption from neo-banks and FinTechs. Innovation enables banks to meet changing expectations and leads to streamlining internal process and helps in maintaining market share. Innovation in banking industry should focus on customer centric services which are fast and efficient with flexibility and convenience. Banks should focus on changing its operational model to make it suitable for changing digital environment to deliver better products and services. Banks should learn to tap its brilliant talent pool as it is evident that it was collaboration of IT professionals and sacked bank professionals after 2008 financial crisis that gave rise to FinTech.

Conclusion

It is true that FinTech companies have entered in the secured zone of banking companies. Banking sector has experience of decades and even centuries. Banking sector have large customer base and time-tested regulations which FinTech still lacks. Banks should remember that it is loophole from their side that has given rise to their competitors, therefore, their approach in reading the pulse of the customers and accepting technologies should be more accommodating than their competitors. FinTech has played a major role in financial inclusion in the area where banks have constraints due to resources and regulations. The scenario has changed after 2008 financial crisis and has taken a paradigm shift after COVID-19. It is prerequisite of time to be more customer centric and tech savvy than to earning profit from traditional brick and mortar banking. It will be a wrong perception if we view FinTech and banking as two different entities. Banking sector has to invest in research and development and has to improve its human resource to handle the complexity of financial technologies like blockchain, artificial intelligence and machine learning. The banking industry has to think of new partnership model with these companies as it will be more profiteering for both as competition of a bank is not from FinTech firms but from other banks which are leveraging FinTech better.

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BANK QUEST THEMES

The themes for "Bank Quest" are identified as:

1. October - December, 2022: Growing importance of co-lending in Financial Intermediation
2. January - March, 2023: Increased footprints of Financial Planning and Wealth Management
3. April - June, 2023: Competence based Human Resources Management in Banks
4. July - September, 2023: Digital disruption - Challenges and Opportunities

FinTech: A Revolution in Financial Access and Financial Usage


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Dr. Mandeep Kaur**


Dr. Gunjan***

Introduction

Access to finance is the key enabler of financial inclusion. A number of policies have been made by governments and central banks to widen the access to finance. There was a time when traditional banks enjoyed monopoly to provide financial services. Later on privatisation and globalisation reforms put a challenge to the traditional banking system to meet stiff competition from new banks as the new entrants were rich in providing innovative products and services, backed by good customer response, wide spread bank branches and promotional services. As a result, customers were benefitted with better quality financial products and services at competitive prices. Still, Global Findex Report 2011 by World Bank brings out that only 51% adults around the world had an account at financial institution. However, the era of digitalisation, internet and mobile penetration, digitalisation of banks and FinTech companies have accelerated financial access across countries. Global Findex Report 2017 brings out that now 74% adults around the world have an account at financial institution.

The term "FinTech" in its expanded form refers to Financial Technology. This term was first coined in the year 1972 by a New York banker and has become a buzz word in 21st century. As per Financial Stability Board, FinTech can be defined as technology enabled financial innovations that could result in new business models, applications, processes or products with an associated material effect on financial markets and institutions and the provision of financial services. In fact, FinTechs are the startup companies created to disrupt well established financial system and the organisations which are not technology savvy (Gnanmote, 2018). FinTech firms focus on providing innovative products and services to create more value to end user. This is done via partnership of startups focused on technology and startups meant for providing specialised financial services. Beginning with niche area of business, then creating satisfaction to end user, these FinTechs gradually expand their coverage and market share. FinTech domain has gained huge market share by providing innovative, technology based, secured, affordable financial sevices characterised with mobility and faster pace. The global market share of FinTech is reported to be USD 112.5 billion in the year 2021 and it is expected to be 332.5 billion by the year 2028 exhibiting compound annual growth rate of 19.8% (Vantage Market Research, 2022).

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FinTech innovations

FinTechs are growing at fast pace with innovations in various categories like mobile payments, digital currency, peer to peer lending, robo advice and artificial intelligence etc. Table 1 reveals the major FinTech innovations.

Table1 : Fin Tech Innovations

Category	Innovations
Deposits, Lending and Capital raising	crowd funding, peer to peer lending, distributed ledger, digital currencies
Market Provisioning	smart contracts, e-aggregators, cloud computing
Payment and Clearing Settlement	mobile and web based payment, digital currencies, distributed ledger
Investment Management	robo advice, smart contracts, e-trading
Data Analytics and Risk Management	big data, artificial intelligence, robotics

Source: Report of the working group on Fin Tech and Digital Banking (RBI)

Impact of FinTech on banking sector

Last financial crisis in 2008 led to the beginning of FinTech disruptions in banking industry. This financial crisis led to the retrenchment of many professionals in finance. These professionals created FinTech startups by partnership with professionals in IT sector to solve people problems concerning finance. This crisis had also shattered the faith of people in banking industry and they were searching new avenues of savings and managing finance. It was quite realised that banking is necessary, banks are not (Bill Gates, 1994). FinTechs took the benefit of this opportunity. FinTechs have brought revolution in the banking functions by introducing innovative business models, products and services. Now, customer's outlook of financial access and usage has changed and they are using innovative products and services offered by FinTechs to avail banking services. FinTechs provide the facility of online lending and borrowing money to individuals and businesses. It has proved to be a win-win situation for all the participants whether it is lender, borrower or a facilitator. Peer to peer model of online lending by FinTechs connects lenders and borrowers and thereby generating revenue for FinTechs in the form of fees and charges without any investment. The advancement in mobile technology, internet penetration and innovative applications and products offered by FinTechs have moved the attention of customers toward online platforms for making payment. Many e-commerce companies have acquired reputed mobile wallet and online payment providers to win the faith of customers by providing them good experience of making payment. FinTech revolution in banking is the result of many flaws in traditional banking system like more regulations, huge operating cost, risk averting tendencies, less customer involvement, lack of innovation and technology etc.

FinTechs have the core competency to use superior technology, provide consumer friendly interface, more focus on business activities yielding higher return, more equity funding and the ability to attract best talent. These potentials were lacking in the traditional banking system. However, FinTechs have some bottlenecks in the form of absence of loyal customer base, limited access to soft information, no banking license, less expertise and experience to manage risk and lack of regulations.

FinTech in India

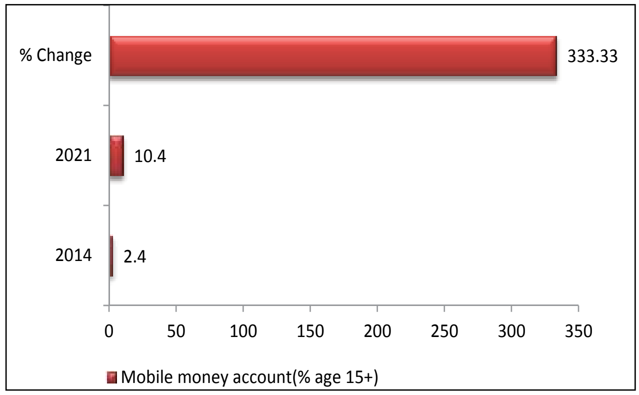
As per KPMG (2016) report, India is moving into a dynamic eco-system offering a platform to FinTech startups to grow into billion dollar unicorns. As per EY Global FinTech Adoption Index 2019, FinTech adoption rate is highest in India and China at 87% for both the countries. Backed by mobile wallets, Unified Payment Interface (UPI) and other FinTech innovations, Indian consumers have greeted the use of mobile payments in their daily transactions. Many FinTech companies are FinTech unicorns in performing banking and payment functions in India. Some of the examples are given in Fig 1.

Fig1: FinTech Unicorns in India

FinTech and Financial Inclusion in India

Internet and mobile revolution in India has provided a ground for FinTech to boost up financial inclusion in India. Internet and mobile penetration in India has proved to be the medium for FinTech for financial access. India has also witnessed increase in financial usage in terms of increase in mobile money accounts as well as increase in volume of mobile money transactions. Fig. 2 reveals that 2.4% people (% age 15+) in India report to have a mobile account in the year 2014 while it increased to 10.4% in the year 2021. There is overall 333.33% increase in mobile money accounts from 2014 to 2021 showing access to formal financial system through FinTech.

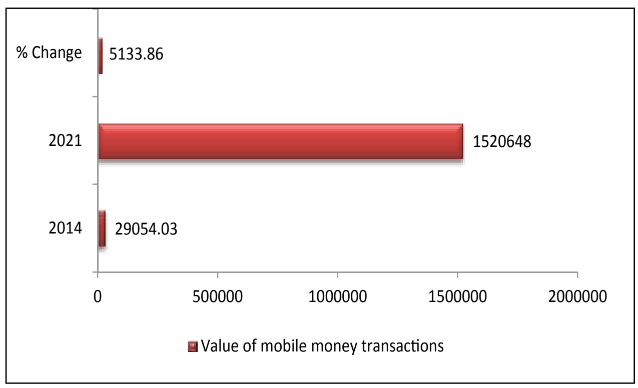
Fig 2: Mobile Money Accounts (% age 15+) in India



Source: World Bank Global Findex Report

Increase in number of mobile money accounts is supplemented with increase in value of mobile money transactions also. Figure 3 reveals that value of mobile money transactions increased from 29054.03 billion in 2014 to 1520648 billion in the year 2021 depicting 5133.86% increase in value of mobile transactions in India. Such a leap in percentage of value of mobile money transactions indicates the potential of FinTechs to boost financial usage.

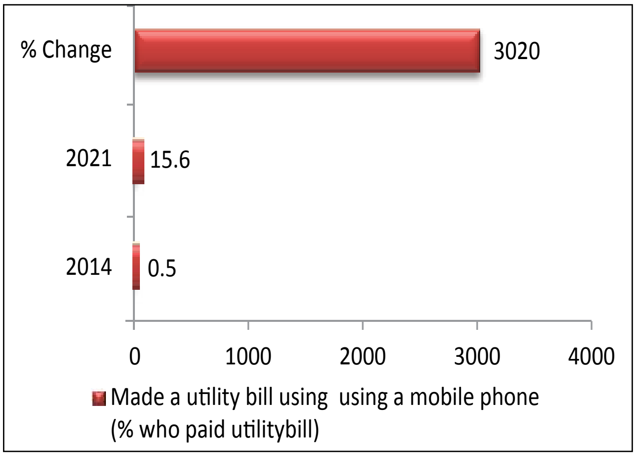
Fig 3: Value of Mobile Money Transactions in India



Source: World Bank Global Findex Report

Fig. 4 reveals the popularity of mobile phones in India to make utility payments. 0.5% people reported to use mobile phones to make utility payments in the year 2014 and this percentage increased to 15.6 in the year 2021.There has been overall increase of 3020% from 2014 to 2021. This shows that people in India find FinTech domain convenient, innovative and affordable characterised with mobility and faster pace to make bill payments.

Fig 4: Utility Bill Payments using Mobile phone in India



Source: World Bank Global Findex Report

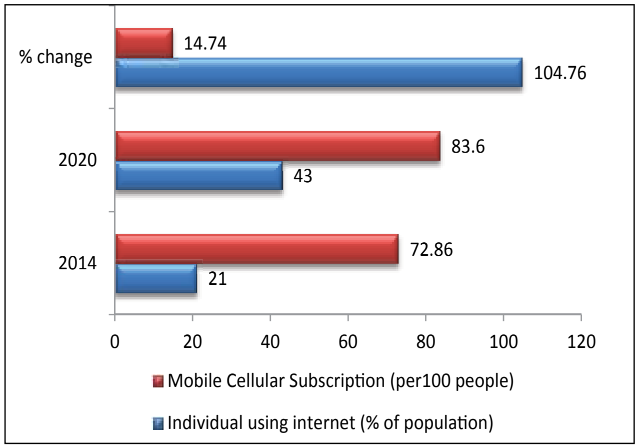
Enabling environment in India acting as pillars for FinTech to grow

The contribution of FinTech to broaden financial access and increase financial usage can-not be neglected. Various factors in India have helped FinTech to make their huge market share.

1. Internet and mobile penetration

India has witnessed sharp increase in percentage of people using internet and having mobile cellular subscription. Fig. 5 reveals that from the year 2014 to 2020, there has been 104.76% increase in internet users and 14.74% increase in mobile cellular subscribers in India. Mobile and internet have fulfilled the basic need of FinTech to provide apps which facilitate people to make or receive payments.

Fig. 5 Internet and Mobile penetration in India



Source: World Development Indicators Database

2. India's Aadhaar System, e-KYC and simplified account opening

Aadhaar card system in India, being operated by the Unique Identification Authority of India, has facilitated access to financial accounts, increased efficiency, lowered cost and enabled digitisation of government payments and services. Till October 2021, there are 1.31 billion aadhaar card holders in India. Further, e-KYC based on aadhaar cards help to establish the identity of prospective financial customer much easier. Till August 2018, over 22 billion identity authentications and over 6 billion e-KYC requests have been processed. Moreover, 289 million Basic Savings Bank Deposit Accounts (BSBDAs) have been opened till Dec 2021 under financial inclusion plans. These three pillars i.e. Aadhaar Card, e-KYC and Basic Savings Bank Deposit Accounts acted as basic infrastructure to FinTech to reach the masses.

3. Funding support to Startups

The Government of India has created a fund of ₹ 10,000 cr. to meet capital requirements as well as to catalyze private investments and thereby, boost the growth of the Indian startup ecosystem. Moreover, Department for Promotion of Industry and Internal Trade (DPIIT) has created Startup India Seed Fund Scheme (SISFS) with an outlay of ₹ 945.00 cr. which aims to provide financial assistance to startups. Many FinTech startups have flourished in India due to funding support from government.

Challenges to banking sector and a way ahead to meet challenges

FinTechs are growing at faster pace and making their remarkable place in all the sectors. People are opting for FinTech offered banking services to fulfill their banking needs. FinTechs are posing stiff competition to banking sector. Banking system has to innovate new business models to serve fast evolving and technology savvy customer base to survive in this cut throat competition.

➢ Banks should plan more investment to bring digital transformation in their operations to ensure fresh perspective to target customers and meet competition with FinTech.

➢ Innovation should become the culture of banking system and be practicsed on regular basis. Recruiting innovative minds can help banking system to cut down its operating and resource cost.

➢ Advanced customer relationship management tools can help banking sector to target customer demand area and customize their services as per the needs of the customers.

➢ Banks should have good forecasting team to predict the upcoming trends and ideas. Banks still are financially strong and have loyal customer base. Upcoming trends and disruptive ideas of FinTechs can be used by banks to innovate new business models.

➢ Banks should analyse their core strengths and weaknesses. They can plan for collaboration with FinTechs for such areas where banks identify their core weakness and cannot benefit by being alone. Areas with growth prospects and low customer value proposition should be identified and accordingly right FinTechs partner should be selected to cover up the service gap.

Collaboration of Banks with FinTech a win - win situation

Banks and FinTechs have their own core competencies. They can collaborate together to better serve the customer base and move the economy towards inclusive growth.

➢ Banks are in the possesion of financial information of their customers which FinTechs do not have. Collaboration with FinTechs will help the banks to use the technology of FinTechs to serve the customers and still be the sole authenticating authority. It will result in safe and secure customer transactions.

➢ Collaboration will result in higher return on investment in long run due to large scale economies which will be beneficial for banks, FinTechs as well as customers.

➢ Association with FinTechs will help the banks to offer a variety of services to its customers. It will help banks to attract new customers and face cut throat competition.

➢ Pooled investment by banks and FinTechs in technology, innovation and other projects will bring sharing of risk and more courage to serve the customers.

➢ Collaboration with FinTechs will mean constant acceptance of changes in the financial market and improving and upgrading the services accordingly which will ultimately meet the customers' expectations.

- Low operating cost and large number of transactions due to such collaboration will help the banks to provide more offers to customers thus adding new customers in its existing customer base.

In simple words, FinTech companies and Banks in collaborative way can provide innovative and improved financial services to people and bring win-win situation for all the players.

Conclusion

FinTechs have made their own space in all the sectors of the economy and banking is no exception to it. The Darwin theory "It is not the strongest of the species that survives, nor the most intelligent, but the one most responsive to change" is still true in today's age of cut throat competition. The banks, to face the competition from FinTechs, have to offer innovative and technology based services at less cost to its customers. Banks need to identify their core strengths and weaknesses. They have to work on their weaknesses and where they find no alternative to overcome such weakness on their own, they should collaborate with FinTechs. However, customer faith, trust, privacy norms and loyalty should be given top priority.

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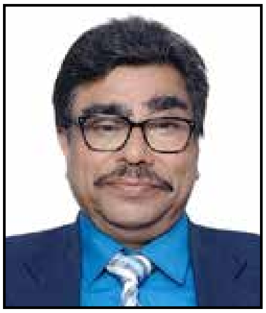

Why Banks need to embed Environmental, Social, and Governance (ESG) factors into their Strategy?

Arun Misra*

The ESG standards are increasingly critical to a bank's operations and reputation. We dive into their history, advantages and the ways to implement them.

Banks play a critical role in driving a country's economic progress and running the financial sector. The banking system promotes economic growth by channelling funds into investments and increasing resource allocative efficiency. Thus, an efficient Indian Banking System is a necessary prerequisite for the country's development. Serving as a hub for savers and investors, these institutions form the foundation of India's financial system.

The history of the Indian Banking System can be traced back to the early nineteenth century when State Bank of India, was the first bank to be established in 1806. Today, Reserve Bank of India (RBI), established in 1935, governs and controls the country's banking sector which includes commercial banks, cooperative banks and development banks.

Over the years, banking in India has undergone tremendous transformations. Starting with the economic reforms of 1991 which included liberalisation, privatisation, and globalisation, the size of India's economy in terms of GDP at market prices has increased by almost fifteen times. On the other hand, household financial savings have expanded by sixteen times and the gross domestic savings by almost seventeen times during the same period. The substantial diversification in the economy opened up an integration channel with the global economy. As the real economy was dynamic, the Indian banking system became flexible and competitive to cope with multiple objectives and demands made on it by various constituents.

From the perspective of financial inclusion, there was a pressing need to extend the reach of financial services to the excluded segments of society. In 2022, the banking structure of India has both the need and scope for further growth in size, shape, and strength when it comes to matching and following international banking norms as required.

As we are all aware, banking in India has moved from ledger based banking to computerization and now to digitalization. The financial crisis between mid-2007 and early-2009 fuelled the global banking scenario. Later on, the impact of COVID-19 pandemic severely impacted the world economy. Apart from the adverse effects on the economy from worldwide lockdowns, the pandemic imparted a lot of lessons which led to the formation of new ways of banking. As the world economy has started returning to robust growth, familiar risks are making their way back into the system along with new ones. These need to be dealt with systematically and sustainably.

The reality of climate change can no longer be denied. The significant systemic risks it poses to the global financial system has been routinely discussed by regulators and environmentalists over the years.

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COVID-19 has now confirmed that the threat of overlooking the planet and people's health is real and has drastic consequences on the future. There is no industry that can afford to separate themselves from this context in which it functions, be it environmental, social, or government regulations and requirements. Climate change is a big source of financial risks, one which Indian banks must prepare themselves for.

Environmental, Social, and Governance (ESG) refers to the three key factors that determine the long term and ethical impact of a business or investment. In 2013, Indian Companies Act made it mandatory for all the firms to disclose the amount they spent on corporate social responsibility from April, 2014. Similarly, new norms for ESG were introduced by the Securities Exchange Board of India (SEBI) in 2020 for the top listed firms by market capitalization. Even in the Indian mutual funds industry, ESG funds are gaining popularity and large corporations are adopting this concept to attract private equity. In short, ESG has become the trusted indicator for sustainability. When banks invest using these criterias, stakeholders view them as socially and environmentally conscious institutions-the kind they are.

COVID-19 not only upended the global value chain and economy, but also caused a fundamental shift in mindset of businesses and entities towards a people and planet centric approach. It has made the link between economic stability, environmental and social issues apparent, along with their combined impact on a company's bottom line. This is where the importance of the financial system comes in. As they serve as the backbone for businesses, banks need to step up and act responsibly by embedding ESG factors into their day-to-day operations and strategies.

In banking terms, the importance of ESG is due to its associated opportunities and risks for financial institutions. Not only do ESG considerations make sense for the environment, sustainable operations are closely linked with better economic performance. Moreover, it has become the measure of resilience and sustainability of an organisation. The factors are used to make strategic goals for the future, ensure operational executions and also, conveying sustainable business practices to stakeholders and customers.

Overall, there are several compelling reasons for embedding ESG standards and practices across all functions in the banking industry. Other than being essential for sustainable economic development, it proves useful for the organisation from the local bank branch to C-suite management. In order to achieve a holistic transformation of banks, ESG factors prove to be the most effective and efficient approach. A majority of the global banks have integrated these standards into their product designs, corporate strategies and risk management processes.

All in all, there are three trends which may help to position ESG standards as the indicator of good banking practices:

Climate Change: This can be restricted by increasing funding towards the de-carbonization of economic activity. It has the potential to open up new revenue streams for banks in the future.

Reputational: In such cases where banks and businesses do not measure up to their ESG pledges, they can be accused of greenwashing. Case in point: one of the major automobile manufacturer admitted to cheating emissions tests by fitting vehicles with a 'defect' device which altered engine performance to reduce emission levels when tested, all the while their engines were emitting almost 40 times the allowed limit for nitrogen oxide pollutants.

Regulation: Government policies will require financial institutes to measure and disclose ESG risks in their loan portfolio and banking activity.

There are several ways banks can embed ESG into their own business strategies. Ahead are the three categories they fit into:

I. Sustainable Finance

Sustainable Finance can be defined as furthering economic growth while reducing pressure on the environment. It also takes social and corporate governance aspects like inequality, human rights, management structures and executive remuneration into account. Moreover, it also focuses on environmental factors such as climate mitigation and adaptation, conservation of biodiversity and circular economy. In short, it refers to business and investment decisions which take ESG factors into consideration along with financial returns.

In the middle of the 2010, the global interest in sustainable finance had increased. This was partly in accordance with the Paris Climate Accords i.e. the Paris Agreement signed by 195 countries in 2015. All the countries including India have made a commitment to ensure economic growth is achieved in a climate-friendly manner and an overall reduction of greenhouse gas emissions.

Banks include ESG in their lending portfolio's sustainability strategy as a mainstream component to enhance it. By embedding ESG in their own business, banks can improve their lending portfolios and accommodate sustainable projects. A way this can happen is when banks prioritize loans and other lending instruments for companies with sustainability and ESG as a strategic commitment. Responsible lending in the banking industry sends a strong message to the businesses and corporates looking for capital access.

Green Loans, Social Bonds or Sustainability Linked Bonds are sustainable finance instruments which are tailor-made to help support ESG initiatives. Globally, the total green issuance surpassed $269.5 billion USD in 2020, $517.4 billion USD in 2021[1] and shows a growing trend in 2022 and beyond, according to Climate Bonds Market Intelligence. A total of 835 green bonds have been issued globally since the start of this year raising $245 billion, a number derived from the analysis by global law firm 'Linklaters'. The sustainable bond market is predicted to exceed the $1 trillion mark this year.

II. Operational Efficiency

Agility, resilience, productivity and eco-sustainability are redefining operational excellence. Business globalisation along with the worldwide pandemic intensified the operational requirements to maintain competitiveness and growth. Within the Indian banking system, digital system implementation will be a differentiating factor. It will improve operational efficiency and will promote excellence by improving operational agility and minimising resource consumption and waste.

Operational excellence journey must address sustainable waste reduction as part of a complete solution for corporate clients. Waste reduction in industrial economic and economic terms is essential for today's competitive environment. Initiatives like these are called lean management, operational excellence, sustainability strategy or other similar terms.

In the present scenario, it is difficult for banks to manage both efficiency and operational agility due to the disturbance in domestic and international operations. The use of digital platforms with fintech will make the journey comfortable and can be optimised by plugging in any value leaks through the operational cycle.

[1]Source: https://www.climatebonds.net/

Eco-sustainability requires commitments in order to improve operational efficiency which includes performance, asset reliability, and quality compliance. Visibility across all levels into Key Performance Indicators (KPIs) on an operational level, and insightful and interactive reports enable team collaboration and shared best-practices across different functions. This can be done with the help of advanced analytics, market learning, and artificial intelligence to help uncover hidden improvement opportunities and optimize operational conditions.

Global and local brands have started tackling ESG issues. This renewed focus on climate change and environment has given rise to new measures by big banks like J. P. Morgan, Wells Fargo, and Bank of America to enhance their commitments to ESG standards. One such example is J. P. Morgan. It set up a new Green Economic Specialized Industry Team to provide dedicated banking services and expertise to companies that produce eco-friendly products, services or focus on environmental conservation. Bank of America aims to deploy and mobilize $1 trillion through its Environmental Business Initiative by 2030 to smooth the transition to a low-carbon economy.

There are a number of ways banks can pursue operational efficiencies to align their ESG strategy; ultimately creating a cumulative effect through the sustainable ecosystem.

III. Responsible Investing

Also known as Sustainable Investing or ESG Investing, Responsible Investing is the strongest catalyst which drives the ESG ecosystem for large institutional investors. It is a way of investing in companies based on their commitment to ESG factors.

The increased awareness regarding climate change, corporate misconduct, and social inequality which has led ESG to become key factors in the reputation and success of businesses and corporations. This presents an opportunity for banks and financial institutes to drive growth and differentiate to meet the needs of clients.

In light of the three strategies stated above, investors need to be aware of the ESG framework in India. This can be broken down into three: Corporate Social Responsibility (CSR), Social Stock Exchange of India, and Business Responsibility and Sustainability Report (BRSR).

Under the Companies Act, 2013, certain profitable companies are required to spend a minimum of 2% of their three-year annual average net profit towards CSR initiatives in a financial year. The Government requires full disclosure by companies towards these spending in order to increase overall transparency in the future.

Social Stock Exchange (SSE) was an idea floated by Finance Minister, Nirmala Sitharaman in her 2019-20, Budget Speech. It serves private and non-profit sectors by providing them with greater capital and additional avenues to raise funds. The Securities and Exchange Board of India (SEBI) has said that SSE will be a separate segment of the existing stock exchanges. This novel concept gained momentum during the pandemic and spotlighted the need for social capitals for organisations working for social welfare. On the basis of recommendations proposed by working group and technical group constituted by the regulator, framework for SSE has been developed as per which a separate segment of the existing stock exchanges will be developed.

The Business Responsibility and Sustainability Report (BRSR) framework is the result of the Paris Agreement of 2015 and United Nations' Sustainable Development Goals (SDGs) for 2030. SEBI demands BRSR for the top 1000 listed entities in India. The framework merges the financial performance of a listed company with its ESG performance which helps regulators, investors, and stakeholders in assessing the business stability, growth, and sustainability. The BRSR report consists of three sections for disclosure:

General Disclosure: It specifies details of the listed entity, products, services, operations, employees, CSR details, and others.

Management & Process Disclosure: This helps entities demonstrate the structures, policies, and processes that are put in place towards regulatory compliance.

Principle-Wise Performance Disclosure: These govern the manner in which a business conducts itself with respect to environment and social matters. The collected information is categorised under essential determinants and leadership indicators.

Commercial banks faced many challenges like digitalization, new competitors, low interest rates, regulations, and others. This might make it appealing to restrain ESG issues with regards to large-scale transformation projects. But it is important to remember that a bank's wealth and asset management functions have the potential to enhance the long term sustainable performance of the portfolios.

Financial institutions and banks that align themselves to the needs of the nation while being conscious of the impact of its operations are more likely to generate long-term sustainable returns for all stakeholders. This is why embedding ESG factors into a bank's culture and system is the need of the hour.

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Legal Decision Affecting Bankers

Prakhar Galaw*

Appellant(s) : Bank of Baroda & ANR.

Vs.

Respondent(s) : M/S PARASAADILAL TURSIRAM SHEETGRAH PVT. LTD. & ORS.

Court : Supreme Court

Bench Strength : 2

Bench : B.R Gavai, J PAMIDIGHANTAM SRI NARASIMHA, J

Citation : CA NO. 5240/2022

Relevant Provision of Law

Section 17 of Securitisation and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002 (SARFAESI), hereinafter referred to as the Act.

Brief Facts of the Case

1. The Respondent company availed credit facility of ₹ 2,34,15,456/- from appellant bank. The directors of the company gave personal guarantee of the loan along with equitable mortgage of immovable property of the company.

2. The company defaulted in its repayment of loan amount, which led the bank to classify the loan account of the company as Non - Performing Assets (NPAs) as per RBI's NPA classification and prudential norms.

3. The appellant bank issued a demand notice under Section 13 (2) of the SARFAESI Act, 2002 demanding the defaulting company to regularize its account. The company did not regularize its loan account within 90 days as mandated under Section 13 (2) of the Act.

4. The appellant bank issued a notice under Section 13 (4) of the Act for taking symbolic possession of the mortgaged property. The bank took the physical possession of the mortgaged property on 30.08.2010.

5. The respondent company against the said action of taking physical possession was challenged in civil writ petition challenging the notices issued under Section 13 (2) and 13 (4) of the Act and sought a writ of mandamus restraining the Bank from taking any coercive action for the recovery of the amount.

6. The said writ petition was disposed with a direction to the company to pay the remaining loan amount in 4 equal instalments and if the Company fails to pay up the dues within the time prescribed, the bank would be at a liberty to exercise all its rights under the SARFAESI Act.

7. The respondent company failed to comply with the directions of the High Court. Meanwhile, the appellant bank issued a sale proclamation with respect to the mortgaged property of the respondent company, which culminated in favour

*Deputy Manager (Litigation & TP claims), HDFC ERGO.

of an auction purchaser. And a sale certificate was issued in his favour.

8. The said proceedings of the bank under Section 13 (4) was challenged by the respondent under Section 17 of the Act, which was dismissed by the Debt Recovery Tribunal (DRT), Lucknow as it was filed beyond the statutory period of 45 days from the date when bank took actions under Section 13 (4).

9. The said order of the DRT was challenged in a review petition before DRT on the ground that the Director of the company died prior to the actions taken by the bank to securitize the assets of the bank, due to which the Legal representatives of the company could not challenge the actions of the bank/notices under Section 13 through section 17 appeal within statutory time period of 45 days. The DRT allowed the application of the company in revision petition.

10. The said orders of DRT were challenged in Debt Recovery Appellate Tribunal (DRAT), which held that there has been no error apparent on the face of record. Thus, dismissed the order of DRT passed in revision and restored the original orders of the DRT.

11. That, against the order of the DRAT, the respondent company through its Directors filed a writ petition on the same ground raised in revision petition. The High Court admitted the petition and stayed the operation of orders passed by DRAT.

12. That, against the said order of the High Court passed in WP, the appellant bank had preferred a Civil Appeal in the Supreme Court.

Findings and Observations of Supreme Court

The Supreme Court held that the reason for providing a time limit of 45 days for filing an application under Section 17 can easily be inferred from the purpose and object of the enactment. In Transcore v. Union of India and Anr. This Court held that the SARFAESI Act is enacted for quick enforcement of the security. It is unfortunate that proceedings, where a property that has been brought to sale and third-party rights created under the provisions of the Act, have remained inconclusive even after a decade.

The Court observed that although the court stayed the operation of the orders of High Court, 5 years ago in the Special Leave Petition (SLP). However, no final orders were passed in the matter thereafter. Thus, the Court held that the orders passed by the High Court were not justifed and restored the orders of the DRT dismissing Section 17 appeal of the respondent company, also orders passed in revision petition and dismissed the orders of High Court and directed the Court to decide the matter within 3 months.

Summary of Macro Research Report (2020-21)

A Report on Issues and Challenges in Financing MSME in Pune, Maharashtra

By:

Shri. Prasad Shrikant Barje, Director, State Bank Institute of Learning & Development, Pune

&

Dr. Elizabeth James, Assistant Professor, National Institute of Bank Management, Pune.

"You can't connect the dots looking forward; You can only connect them looking backwards. So, you have to trust that the dots will somehow connect in your future. You have to trust in something-your gut, destiny, life, karma, whatever. This approach has never let me down, and it has made all the difference in my life"

- Steve Jobs

Micro, Small and Medium Enterprises (MSMEs) are growth drivers for our economy. They contribute through innovations, investments, growth and employment. Bank finance will continue to be crucial for MSME sector. Governments, banks, financial institutions, intermediaries have been trying to boost MSMEs growth. There are good numbers of schemes for MSMEs but still we are yet to achieve the expected results considering our potential. The study has identified the problems in financing MSMEs in Maharashtra with specific reference to Pune. Apparently, all the stakeholders have been contributing for MSMEs development but why expected growth in MSMEs is still not taking place? This question has not been previously studied in depth. We studied this question in detail. Through our study we found that over the years the appraisal methods have undergone revisions, but those were suitable for domestic scenario now the industry has to compete internationally, with existing appraisal methods the financial assistance available to MSMEs is not giving the expected support to compete with global counterparts. All stakeholders have been contributing for the forward and backward linkages but still there are lot of innovations that can be done to boost MSMEs growth and our real potential can be met.

The summary of various Chapters in this report are as follows:

Chapter 1 elucidates on the reasons for MSMEs commanding a focused attention for developmental initiatives. This segment is vulnerable to facing financial difficulties during its life cycle compared to large corporates. It is making a sizeable contribution to employment and exports, and its potential to contribute more is also recognized. Banks and other lending institutions are trying to adopt an appropriate system of timely and adequate credit delivery to borrowers in this segment.

Chapter 2 provides a snapshot of the role of MSME, in the Indian and global economy and their role and significance in Maharashtra and Pune. It goes on to quantify its contribution to important growth parameters for an economy viz. GDP (Gross Domestic Product), employment and exports both globally and in India. It is interesting to study Pune as an emerging destination for investment by MSMEs as there is a conducive environment for businesses to flourish. The largest number of MSMEs are in Konkan (including Mumbai) which accounts for 37% of the total MSMEs in Maharashtra. And Pune has the second largest share of MSME at 27%. Pune has topped in Maharashtra in terms of investment in

Special Economic Zones (SEZs). It states that world over definition of MSMEs is based on three main criterias viz. & number of employees, assets, and turnover or sales.

Chapter 3 gives a brief on the relevant recent past studies on issues and challenges in financing MSMEs. In the recent past many studies were published on the impact of COVID-19 on MSMEs in general and specific to sectors, issues and challenges in financing MSMEs taking into consideration, the challenges faced by both lenders and borrowers individually and collectively but with a limited scope.

Chapter 4 enumerates on the research methodology used for the study. This study meets its objectives through analysis of six research questions. The first research question was **"What is the lending scenario with regard to MSMEs by Financial Institutions in Maharashtra ?"** To analyze this question, information from SLBC (State Level Bankers Committee), Maharashtra website was taken and two hypothesis were developed and a regression analysis was conducted to arrive at the results. The two-hypothesis constructed were:

H1: More number of branches leads to a greater number of MSME accounts.

H2: More number of MSME accounts would lead to more credit.

The second research question was **"What are the issues and challenges faced by banks and financial institutions in financing MSMEs?"** To analyze this, questionnaire was designed to elicit responses through focus group discussion, interviews and using online google forms. Stratified convenient sampling technique was used. 500 responses were elicited from branches of Public Sector Banks (PSBs), Private Sector Banks (PVBs), Cooperative banks and NBFCs (Non-Banking Finance Companies) in Pune district, Aurangabad, Sangli, Nasik, Ahmednagar, Nagpur, Kolhapur and Satara.

The third research question was **"What are the issues and challenges faced by MSME borrowers in availing assistance from lending Institutions?"** To analyze this, questionnaire was designed to elicit responses from MSME borrowers through focus group discussion, interviews and using online google forms. Here, again stratified convenience sampling was used and responses were elicited from entrepreneurs who were categorized into micro, small and medium enterprises. Around 500 responses were recorded for analysis from borrowers in Pune district, Aurangabad, Sangli, Nasik, Ahmednagar, Nagpur, Kolhapur and Satara.

The fourth research question was **"What are the issues and challenges faced by the MSME borrowers from the perspective of consultants?"** To analyze this question, questionnaire was designed to elicit responses from Chartered Accountants (CA) and other Consultants who were helping MSMEs in preparing loan proposals and giving guidance for all other facets of their business. Here, again convenient sampling was used. 50 responses were recorded for the analysis from borrowers in Pune district, Aurangabad, Sangli, Nasik, Ahmednagar, Nagpur, Kolhapur and Satara.

The fifth research question was **"How are lending Institutions appraising the MSME loan proposals for sanctioning loan/refinance/restructuring?"** To find answers to this question, case method was used i.e. cases (loan proposals) were collected from branches of lending institutions from Pune and all, over Maharashtra pertaining to different businesses. The collected cases were of defence unit, energy unit, flour and food unit, machine manufacturers unit, intellect systems unit, dairy unit, specialized structural engineering unit, textiles unit, sugar manufacturing unit, ceramics unit, pharmaceuticals unit, educational institute, winery unit, beauty parlor unit, petrol pump unit, agro tourism unit, paint manufacturing unit and construction company. These cases are presented in a concise manner in the report followed by thorough analysis of major setbacks of the case and conclude with observations which have been converted to recommendations.

The sixth research question was **"Which are the prevailing global practices with regard to MSME financing?"** To analyze this question existing literature available on online platforms and information gathered through extensive discussions with the stakeholders has resulted in earmarking certain countries whose strategies/policies can be studied and replicated in India. Those countries are Bangladesh, Canada, European Union, and Hong Kong.

The seventh research question was **"By studying the issues and challenges faced by lenders to MSME and borrowers under MSME, can a credit delivery model be designed that can be replicated to other states?"** To design this model, the actual issues faced by borrowers and lenders were collected through this study.

Chapter 5 analyses total lending to MSME in Pune and in Maharashtra. Pune district had the highest registrations of micro enterprises, which are 3.9 per cent of the total registrations till December 2020. Since March 2016, achievements under the Annual credit plan for Pune was lowest for the year March 2020 at 85% and March 2021 at 73% respectively. The period of (01.04.2021 to 31.12.2021) was considered crucial as vaccination drive for COVID-19 was in full swing and the economy was on the recovery track but was severely devastated due to the second wave. During this period granular tails of amounts disbursed reveal that in "Micro" segment, Public Sector Banks (PSBs) have a market share of 54% as against 43% by Private Sector Banks (PVBs). In the "Small" category, PSBs have 38% as against 62% by PVBs and the gap widens towards Medium, where PSBs have a 26% share as against 74% of PVBs. Interestingly, as regards, Khadi & Village, PSBs have a 43% share as against 54% for PVBs - identical to the Micro category first mentioned in these paragraphs. In the "others" category (as given in the data provided by SLBC (State Level Bankers Committee), PSBs are totally dominant with 99%. Going further into the lending styles, PSBs credit disbursement portfolio ratios to Micro-Small-Medium are 49:34:17, PVBs ratio is 23:40:37 and, in the case of SFBs, it is 90:6:4. This underscores the lending style of PVBs in favor of small and medium category.

Granular details of accounts (number of borrowers - beneficiaries), PSBs have 39% of market share as against 46% of PVBs and 15% by SFBs. In Micro, PSBs have a 42% share as compared to 40% of PVBs. The share of PSBs in "small" reduces to 28% for PSBs against 71% for PVBs and further widens in Medium from 7% for PSBs to 93% for PVBs. The credit disbursement portfolio ratios (excluding Khadi and Others) to Micro-Small- Medium in respect of PSBs, is 80:9:1, and in respect of PVBs is 65:20:15, whereas in the case of SFBs it is 99:1:0. This further underscores the fact that the lending style of PSBs is comparatively more skewed towards Micro, whereas in the case of PVBs, it is more skewed towards Small and Medium.

Descriptive and inferential statistical analysis tool utilized on the data of MSME, disbursal of loans both district wise and bank wise (under Maharashtra) for the year 2020-21 shows that maximum amount of correlation is between: -

- Total branch and number of accounts (0.7793)
- Total branch and Total amount under MSME accounts (0.7836)
- Total number of account and Total amount under MSME accounts (0.9410)

Two hypothesis were developed and a regression analysis was conducted to arrive at the results. The two hypothesis constructed were:

H1: More number of branches leads to a greater number of MSME accounts.

H2: More number of MSME accounts would lead to more credit.

First model which was for testing for H1 showed that total number of branches is a significant factor which leads to increase in total number of accounts (p value < 0.05) thus rejecting null hypothesis.

Further test for heteroscedasticity (Het test) is done to satisfy the regression assumptions and to be able to trust the results, the residuals should have a constant variance. As the p-value is less than 0.05 the null hypothesis is ignored thus stating that there is presence of heteroscedasticity in the data.

Second model which is testing for H2 shows that Number of accounts under MSME sector is highly significant to determine the amount of credit under MSME sector. (p- value < 0.05), rejecting the null hypothesis.

Heteroscedasticity test for same interprets the presence of non-constant variance as p - value < 0.05

Chapter 6 analyses the responses collated from 500 accounts of MSME borrowers which was given by branch managers of banks/financial institutions and from MCCIA (Mahratta Chambers of Commerce, Industries and Agriculture) regarding the challenges faced while lending to MSME borrowers. The information was collected through survey with the help of questionnaires, focus group discussion and interviews. The information was broadly collected under three heads:

(a) Efforts taken by the branch in reaching out to MSMEs.

(b) Status of MSMEs (in terms of sector, volume, NPA, interest rate, type of loan) loans advanced.

(c) Areas where change/improvement is required.

A snapshot of findings is given as under:

1. It has been found that most of the banks are having minimum one dedicated MSME vertical and each zone is having minimum one SME city Centre (Centralized Processing Centre) where all MSME proposals above Rs.10 Lacs are processed.
2. Most of the respondents have cited lack of industry data, financial statements or record keeping, standard estimation of operating cycle, regular customer base regarding MSME business as the major challenges in financing MSME.
3. Average time taken to assess the proposal for loans to MSMEs is still around 2 weeks and 59-minutes appraisal is yet to be accomplished.
4. Lending Institutions increase risk premium by charging an effective interest rate of over 16% and also insisting on additional security if the MSMEs business is not generating positive EBITDA (Earnings Before Interest Tax Depreciation Amortization).
5. The NPA rates have spiked across the MSMEs segment.

Out of the responses received 50% have 35% to 45% accounts under SMA 0 (Special Mention Accounts), 60% have 16% to 25% accounts in SMA1 and 50% have 20% accounts in SMA 2 and the segments which contributed to it were highest from auto components business (30%) followed by agro-industries (25%) and micro units (20%).

6. 80% of the respondents have disbursed MUDRA loans up to 10 lakhs.
7. Risk mitigation has been largely done through collaterals followed by higher equity contributions and loan covenants.
8. Moveable assets as collateral are also gaining traction due to its acceptability by lending organizations.
9. Around 14% of MSME loan portfolio is under restructuring and the major cause is due to delay in payment from large corporates followed by muted demand for their products and services.
10. The lenders find it difficult to assess the net income of the MSME business as there is no proper segregation of business and personal assets, the payables and receivables are not recorded properly, there are no standard days for receivables and payables, there is difficulty in verifying the prices of raw materials.
11. Lenders are providing up to Rs.2 crore collateral free loans under the CGTMSE (Credit Guarantee Trust for Micro and Small Enterprises) scheme only on demand by the borrowers, who are aware of the scheme which shows the insensitivity of the stakeholder.
12. According to lenders, the challenges faced by the borrowers are that they find the annual guarantee fee for the CGTMSE Scheme high, their market knowledge is limited which affects the sale of their products and services, banks interest rate and charges are on the higher side, there is delay in the sanctioning of loans, restructuring and rehabilitation support is not adequately provided by the banks.

Suggestions

1. Generally, MSMEs are not comfortable in bringing more capital due to the fear that if they bring fresh capital, their cases will be taken up under scrutiny by Income Tax Authorities and they will have to face unnecessary enquiries from Income Tax Authorities. For arriving at the net income of the borrowers, along with capital, unsecured loans which are subordinated should be considered (of course with a condition that these loans will not be withdrawn during the tenor of the loan).
2. Main problems faced by MSME units are meeting the current ratios and TOL/TNW (Total outside Liability/Tangible Net Worth) and often they are forced to bring capital or unsecured loans for meeting promoters' equity. Due to this, MSMEs resort to borrowings in the form of unsecured loans from various NBFCs at the very high rate of interests. Majority of them give ECS instructions to the debit of their operating Cash Credit/Overdraft account for EMI repayments. Indirectly even these unsecured loans are also funded by working capital bankers only. Majority of MSMEs are of the view that they are not given need-based finance at an appropriate time. Delays in taking decisions for sanction/review of limits are the other problems faced by MSMEs. Steep increase in the cost of electricity charges, not getting refund of GST paid by them on

exports are major complaints given by MSMEs. Earlier banks were giving loans against export incentives receivables. Like that bank may grant loans against GST refund receivables (especially for Export oriented units where the refunds are delayed between 3 to 5 months) in the form of demand loans at soft interest rates with an understanding that the GST refunds received are used for liquidating these loans.

3. Basic parameters given for restructuring are not prepared based on the problems faced by MSMEs. For Example, Kamath Committee recommendations announced by RBI (Reserve Bank of India) in the year 2020 for restructuring are meant mainly for large scale industries but are not applicable for MSMEs. A separate set of guidelines need to be prepared for restructuring MSMEs.

4. Often smaller units are forced to give deposits for taking factory premises; electricity deposits etc., at present the maximum amount lent under the MUDRA scheme is Rs.10 lakhs. Hence, many MSMEs find it difficult to purchase machines, pay premises deposits, electricity deposit apart from ear marking funds for working capital. Hence, apart from Rs.10 lakhs ceiling on fund-based limits, certain portion of non-fund-based limit in the form of bank guarantees should be given. The electricity companies should be instructed to obtain bank guarantees instead of deposit amounts. In this way, MSMEs availing MUDRA loans will have more funds on hand. While paying premium on MUDRA loans, banks may pay premium on both funded and non-fund based limits so that the risk is covered by insurance.

Chapter 7 studies the survey responses collated from 500 MSME borrowers and 50 Consultants/ Intermediaries (who help MSME businesses in preparing credit proposals and suggesting best practices in business) with the help of questionnaires, focus group discussion and interviews.

The information was broadly collected under three heads:

(a) Business details of the borrower.

(b) Ease of availing finance from banks and other financial institutions.

(c) Challenges faced and expectations of the borrower from the lending institution.

The responses received were majorly from entrepreneurs classified as micro enterprises (55%), followed by small scale enterprises (37%) and medium enterprises (8%) out of which private limited company was 50%, sole proprietorship (30%) and partnership were (20%). The sector distribution of responses was (41%) from manufacturing business followed by (37%) from services and (22%) from both.

50 Consultants who participated in the study majorly were Chartered Accountants and Bankers who are delivering services as Consultants. The businesses covered in the study were retail sale of electronic products, manufacturing of various types of cables, electronic and electro-mechanical assemblies, electronic controllers, pharma and medical, marketing of pharma products, manufacturing of medical devices, biotech, ventilators, food and beverages, distilled water, food products, engineering precision components, orbital welding machines, plastic injection moulded products, plastic parts for automotive and white good industry, solar project works, etc.

A snapshot of findings is given as under:

1. The two major issues faced by the businesses were: running short of cash frequently and delayed payments from the customers followed

by low/declining margin, stiff competition and low marketing efforts.

2. Raw material cost was the major contributor to operating cost of the enterprises followed by labour and electricity and taxes. Other issues that were affecting their business were: shortage and retaining of manpower.

3. Most of the businesses got suppliers credit of around 30 days while the receivables period extended to customers was between 30 to 60 days and the cash conversion cycle was between 60 to 90 days.

4. 27% of the MSME businesses had long term contracts with their suppliers which extended to more than three years.

5. 80% of the businesses were registered on Udyam portal and the 20% who were not registered were due to lack of confidence in its benefits.

6. 46% of businesses did not have succession planning.

7. Most of the businesses (83%) are seeking credit facilities from the financial institution which is near to their business establishment. Few who are not availing credit facilities mentioned difficulties due to business hours of the lending institution which is not comfortable for the borrower.

8. The preferred source of funding is from banks compared to money lenders majorly due to low interest rates charged, various schemes available to meet the needs, legal and lenient recovery measures, less processing charges, huge amount can be availed as loan, safety and transparency in the process.

9. Most of the businesses are having maximum requirement of cash credit/working capital and overdraft facility followed by secured business loans and bills discounting facility. On a standalone basis, availing credit from a bank is not without hassles. The businesses require strong financials, there is an elaborate internal process for appraisal which is not clearly and timely put across to the borrowers, there is lack of coordination between the banks as same information is to be provided every time to all the banks, borrowers are called for discussion number of times.

Suggestions

1. There should be a relaxed yard stick on submission of collateral securities.

   Banks take collateral securities for mitigating lending risk, but the percentage of collateral cover should be reduced to say 40% of the loan value instead of 80 to 100% expected by the bankers. In order to ascertain the performance of units, banks should incorporate a condition in the sanction letter about mandatory submission of GSTR 1, 3B every month/quarter. Month wise monitoring of sales with the projected results should be undertaken. If the branches are under Concurrent Audit, the concurrent auditor should be instructed to compare the turnover in GSTR 1 and 3B with the actual credit summation and identify diversion of funds if any done by the borrowers. It will function as an early warning signal for identifying potential NPAs. Core Banking Solution (CBS) system used by the bank should give an exceptional reporting to the branch head if any ECS payments are made by the borrowers to any NBFCs. If any payments are made for real estate or stockbrokers, the same should be given in the form of exceptional reporting to identify diversion of funds.

2. Sufficient staff should be provided in the branch, and IT infrastructure should be bettered as there is too much downtime. Banks and financial institutions should understand the nature of business and capture the potential in the business rather than just looking at the documents. If the business prospects are good, it should lend to the MSMEs, even if a document is not available or the balance sheet shows some loss.

3. MSMEs need proper hand holding. Focus should be on helping MSMEs and not just a mechanical process of lending.

   Main reason for MSMEs restructuring is, it is rather forced on MSMEs i.e. When MSMEs are unable to pass on increased costs to customers, not getting orders for their products, production line or some of the basic machines becoming obsolete due to change in the technology.

Chapter 8 contains another important contribution made by this study. The issues that came into light for the MSME borrowers and the lending institutions after analyzing proposals collected from various lending institutes pertaining to different sectors are mentioned below.

A snapshot of the observations made regarding challenges faced by MSME borrowers are as under:

1. Entrepreneurs have experience of Production, Service and Management but not of financial literacy.

2. Entrepreneurs have Know Your Customer (KYC) documents, but they do not have documented plan for their business or service.

3. Micro enterprises have less capital and higher expectations. They would like to do the business with public money and, with minimum personal equity and are particular about financial security.

4. Entrepreneurs want facility of concurrent borrowings and prefer unsecured loans to formal credit products/schemes.

5. Entrepreneurs carry unknown pressure of tax payments.

6. MSMEs are faced with problems such as sub-optimal scale of operation, supply chain inefficiencies being so much engaged in their day-to-day operational issues that they don't have time and resources to acquire various techniques for improvement. They are burdened with problems due to technical obsolescence, increasing domestic and global competition, changes in manufacturing strategies, uncertain market conditions, fund shortage and non-use of special purpose vehicle.

7. Over dependence of entrepreneurs on their consultants for the compliance, project report preparation, preparation of loan proposals has led to masking the real picture of the existing business or the new initiative to the lender.

8. Credit Guarantee Trust for Micro & Small Enterprises (CGTMSE) Scheme is poorly utilized by the banks and the borrowers.

9. Green field entrepreneurs have first-hand information about the product and services, but they do not have the proper documentation for convincing the bank officials.

10. MSMEs are dependent on few big units for business.

11. Neither is the need of the borrower properly assessed by the lending institute nor is the business model understood.

12. The borrower does not have a financial plan hence stretched receivables adversely affected the cash flows of the business.

13. Promoters were not able to maintain key professionals in the business.

14. Restructuring was considered on the basis of revaluation of the security. Delay in restructuring of a viable unit caused tremendous loss to all the stakeholders.

15. Ground reality of the business of the borrower was not understood. Abrupt reduction of working capital limits leads to failure of the business.

16. Critical review of schemes initiated for MSME borrowers have not been conducted before their approval.

17. There is a lack of contingency plan for the borrowers. Only loan availability is assured but there has been lack of hand holding by the lending Institutes.

18. Assessment is done by banks without any proper provision for market risk.

19. Factoring services are utilised by a select group of enterprises because of stringent norms of factoring companies.

Observations made regarding challenges faced by lending Institutions

1. The borrower is ignorant regarding various acts.

2. Lack of provision of additional finance to the borrower has led to business failure.

3. Banks need certification from the Chartered Accountants at various stages. The purpose of certification is for compliance purpose which delays the disbursement.

4. There is lack of awareness among borrowers about CIBIL Reports.

5. Techno Economic Viability (TEV) guidelines are conveniently interpreted by various bank officials.

6. Sudden declarations about certain sectors in the economy spoil the efforts of all the stakeholders.

7. Relationship banking is crucial, but now such relationship with the borrower is viewed with suspicion by the investigating agencies when the loan account is under stress.

8. Certain Government departments insist on the bank guarantees in their prescribed form which are not permissible as per the Indian Banks' Association (IBA) or Reserve Bank of India (RBI) guidelines.

9. There is lack of expertise for the bank guarantee or letter of credit limit at branch level.

10. The practice of opinion reports of the banks is almost discontinued in the name of competition.

11. There is hardly any sharing of information amongst the consortium members.

12. Multiple banking arrangement is risky for banks and customers.

13. Banks are working with core banking solutions and have been facing serious issues regarding correctness of data entry in respect of basic parameters like

    - Activity code
    - Segment
    - Original value of investment in plant and machinery, equipment
    - Details of primary security and collateral security
    - Loan disbursement schedule
    - Loan repayment period
    - Contact details, email - id, address for communication

- Credit Guarantee Trust for Micro & Small Enterprises cover flag
- Amount of loan instalment

In the absence of the data integrity and periodical verification of correctness of the input, it is difficult for the bank to monitor the sector wise exposure norms. As a result, banks are maintaining the margin of safety and restrict finance in those sectors without understanding the business potential of that sector.

14. Committee approach to taking lending decisions is beneficial only to the banks as every committee tries to safeguard banks interest and in the process the borrower is clueless.

Chapter 9 This chapter focusses on International best practices on lending to MSMEs in the following countries.

Bangladesh - The new National SME Policy 2019 of Bangladesh guides SME financing and sets targets for financial institutions which will be monitored through a three tier - monitoring system (Head Office, Branch Office and Banks).

Canada - The Growth Driver Program run by the government-owned Business Development Bank of Canada (BDC) in Canada provides selected companies across all sectors with formal management training, peer-to-peer networking, and other tailored non-financial services. It is executed through a small team of experienced advisors collaborates with firms to assess their needs and identify solutions to their challenges, including planning a multiyear growth outlook and preparing a management plan-as well as providing targeted support for CEOs and leadership teams.

European Union - The European Union supports SMEs through various focused programmes. The most important initiatives that will support MSMEs during the period 2022-2027 will be Single Market Programme, Invest EU and Horizon Europe.

Hong Kong - It is quite interesting to study how this country has progressed by capitalising on digital technology.

Chapter 10 - gives final recommendations for the study.

A snapshot of recommendations is as under:

On loan procedure

Pursuant to the simplified system of lending to the MSMEs, banks and financial institutions have devised the loan application forms and check list. Generally, common application form as per the Indian Banks Association format is used for loans up to Rs.2 crore. It is expected that the terms and conditions regarding margin and security should be provided on the reverse of the application form itself. Similarly, there should be standard loan appraisal forms for new units, enhancement, renewal and review of loans prescribed by the banks and financial institutions. Banks have prescribed the time norms for disposal of MSME applications to ensure all loan applications from all categories of potential customers are disposed of expeditiously. Generally, these time norms are two weeks to four weeks from the date of receipt of the loan application. As per the feedback of the customers, some banks have reduced the time norms for processing by the credit officer in the range of six days to 22 days if all such applications are complete in all respects and accompanied by the required certificates, documents. As per RBI guidelines, it is mandatory to acknowledge all applications submitted by MSME borrowers through manual or online mode.

For transparency, it is expected that a running serial number is recorded on the application form and as well on the acknowledgement. It is conveniently followed on case-to-case basis. If the borrower insists for the acknowledgement, initially, it is avoided. In case of compulsion, it is with a disclaimer remark that application is incomplete.

On Margin

The normal margin requirement for the loan is in the range of 10% to 25%. Where subsidy/margin money assistance is available from the agency, then it should be considered while sanctioning the loans and, no additional margin should be insisted. In reality, it is demanded by the credit officers.

On CGTMSE Scheme

All loans to Medium and Small Enterprises up to Rs.2 crore which are otherwise eligible to be covered under have to be sanctioned collateral free due to guarantee cover of CGTMSE. This important provision is known to borrowers and bank officials. There are misconceptions about this scheme. Generally, it is perceived as costly scheme with lot of terms and conditions, so not suitable for the borrowers. Credit officers do get comfort from collateral by the borrower.

Expectation of Good track record of the borrower

Sanctioning authority needs good track record and financials for the credit decision. The criterion for determining the good track record and strong financials is unknown to the entrepreneurs. Their consultants/advisors should take due care to sustain this illiteracy level. Bankers' expectations for good track record are as under

- Satisfactory conduct of cash credit/working capital account.
- Loan instalments and interest have to be serviced regularly.
- Timely submission of stock statements, final accounts, review / renewal data.
- Continuous profit earning.
- Credit rating, Total outside liability to Tangible Net worth ratio, Debt Service coverage ratio at acceptable levels.

Borrowers should submit the stock statements in time. If they have genuine difficulty, borrowers should approach the bank and get the necessary permission for submission of stock statements at longer intervals. Generally, there is penalty for non-submission of stock statement in time. If the borrower fails to submit the stock statements, then the bank can appoint a chartered accountant for the stock audit. It adds cost to the borrowers. Due to ignorance, it is very difficult for the units to fulfil these expectations. Then, they make up their mind to avail unsecured loans from the private lenders at higher rates.

Working Capital assessment

The working capital requirements of the units shall be assessed on the basis of say, 25% to 37.5% of the projected turnover or on the basis of operating cycle or processing cycle of the unit. In this regard, the entrepreneur has to infuse minimum 7.5% own margin so that, effectively, the unit can get working capital limit of 30% of the projected turnover. Higher of the two limits can be sanctioned. The disbursement on the basis of actual level of operations can be possible.

Loan application form as a major source of information about the entrepreneur

Loan application contains more than 77 items of information about the entrepreneur and their business.

Loan Appraisal

The loan needs to be appraised according to the check list provided by the bank. All items need to be discussed with the borrowers and guarantors. This exercise is necessary for credit appraisal as per the banks' policy. Liberalised scheme needs to be put into practice wherein the quantum of loan is not linked to the security or collateral offered by the unit. It duly considers the genuine requirements of the unit for carrying on its activity with profit. The application and the appraisal forms should be different to avoid confusion in the minds of the borrower and the lender. Schemes for technically qualified entrepreneurs which provide financial assistance to entrepreneurs for setting up new viable industrial projects should be promoted by the bank.

Provision of Sustenance Money

There is provision by some banks to provide financial assistance to the entrepreneurs to maintain themselves during the gestation period of the first year of establishment. This money can be provided by clean term loan and the amount can be included in the pre-operative expenses of the project.

Restructuring or Rehabilitation of sick MSMEs

While identifying and implementing the restructuring package, the credit officer has to observe the unit's operations closely. There is provision of 'holding on operations' which allows MSMEs to draw funds from their working capital account to the extent of their deposits of sale proceeds during the period of holding operation. While restructuring of the loan account 'viability' criteria is important. Credit officer has to work out the operating and cash break even points. Promoters' sacrifice and additional infusion of funds is necessary. The existing prudential norms for restructured accounts make the standard account on restructuring as substandard account which attracts additional provision. The Non - Performing Assets, upon restructuring, would continue to have the same asset classification as prior to restructuring and slip into further lower asset classification categories as per extant asset classification norms with reference to the pre-restructuring repayment schedule. The rehabilitation package consists of restructuring of present dues to the bank and sanction of additional credit facilities as per the need. Such additional finance carries risk of lower asset classification, in case, it does not qualify for upgradation at the end of the specified period. The restructuring norms should be revised with improved relaxation in asset classification and provisioning for the deserving cases (businesses having potential to generate profits).

The standard accounts classified as Non - Performing Assets retained in the same category on restructuring should be upgraded only when all the outstanding credit facilities of the unit perform satisfactorily during the specified period. Loan restructuring is a process in which borrowers facing financial distress renegotiate and modify the terms of the loan with the lender to avoid default. It helps to maintain continuity in servicing the debt and gives borrowers a certain degree of flexibility to restore financial stability.

About Entrepreneurship

Financial planning for entrepreneurs is important to establish the financial goals of the unit. Banks are doing feasibility study without financial plan. Banks and entrepreneurs work on projected balance sheet for further 3 to 5 years. They assume that business will be successful. After commencement of actual production or service, entrepreneurs realise the success can be illusive. Creation of business plan along with financial plan is real feasibility study of what it takes to be successful.

Conversion of Deposits to other Financial Products

The factual position is that with the emergence of cross-selling now banks are trying to convert their deposits into other financial products to earn profit out of commission. Banks deposits are being converted to other financial products which is eroding away the deposit corpus leading to reduction in lendable resources of the banks. For instance, if a bank has deposits worth Rs.20,000 crores and if Rs.10,000 crores is converted into other financial products it reduces the deposit base which also helps banks to improve their Credit Deposit Ratio (CDR) without any loan disbursement.

This trend will restrict the lending capacity of the banks in due course of time and the victims will be MSMEs. MSMEs will at some point encounter difficulties repaying their monthly instalments due to investment in such products. The growth of deposits in banking system can boost the capacity to use these deposits for the production and services. The trust of the depositors in the prudence and viability of the local banking system and strong regulatory system to ensure safety of deposits is a must. At the same time, the banks should tap the opportunities to increase their deposits to increase their capacity to lend.

SHGs for MSMEs

Self-Help Groups (SHGs) are currently for individuals, and they are widely successful. This model can be replicated for MSMEs from unorganized sector to support their non - schematic financial needs. It will also ensure timely and adequate financial assistance to the entrepreneurs at reasonable rate.

No Recognition of achievements of officers serving MSMEs.

At present, there are no incentives, recognition or motivation for business achievement in MSMEs. Whereas there are incentives for cross selling. Banks should recognize the achievement by officers in MSMEs

Relationship banking is necessary

MSMEs are not comfortable with the present compartmentalization of their loan processing. They need handholding at several times. They need guidance and support. This requires trust and relationship. Single point contact is necessary for fulfilment of their banking requirements.

Special Purpose Vehicles (SPVs)

There is a need to provide facility of SPVs to make MSMEs competitive in the global market

Open term loan facility

This facility enables the customer to identify and purchase the machinery of choice as per the requirement. Within overall term loan limit customer can purchase machinery, equipments in suitable stage safety and restrict finance in those sectors without understanding the business potential of that sector.

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