Testing times for public sector banks' leadership

The banking industry has been passing through one of its most trying times since independence. The high ratio of non-performing assets (NPAs) and weak profitability have raised the risks to the sector's stability. The increasing share of weak, highly leveraged corporates in the banks' NPAs has raised the system's credit risk profile. Poor and lopsided credit growth, mostly in low-yielding retail loans, has added pressure on the margins, forcing many banks to resort to raising fees for numerous services and even reducing savings deposit rates.

There are many other serious challenges facing the leadership of public sector banks (PSBs). These emanate primarily from the regulatory, human resources and competitive landscape areas. First, the transition to the new Indian accounting standards has commenced. Consequently, in FY19, the provisioning and tier-I capital requirements of all banks are expected to go up significantly at a time when they are certainly not the darlings of the stock market.

Second, the rapid growth of digitization has disrupted the banking industry with a re-writing of the rules of competition. The incumbent banks are seeing their market shares being cannibalized by far nimbler fintech companies, non-banking financial corporations and new banks. In fact, PSBs lack the skill set necessary to take on the competition, while regulatory restraints hold back these banks from making lateral recruitments to bridge the talent gap. Also, digitization has made price and product comparisons so much easier that the power of choice has been transferred to the customer who is now increasingly transaction-driven rather than relationship-driven.

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Third, PSBs are grappling with the challenges posed by the "missing middle" wherein a significant number of retirements have been taking place since 2008 with an inadequate number of sufficiently experienced personnel available to fill up the vacancies. This has been caused by the sudden freeze on recruitment in the early 2000s when core banking and other tech initiatives were taken up by the banks amid the cacophonous clamour for "right sizing".

Fourth, the increasing sophistication of risk management methodology and regulatory oversight has significantly added to the cost of doing business and circumscribed the banks' ability to respond to business opportunities with alacrity. Last and most importantly, the government has recently cleared the proposals for merger of PSBs. This is bound to affect the enthusiasm of personnel in the banks which are about to lose their identities to take any long-term initiatives for improved performance.

The government had organized a couple of "Gyan Sangams" in 2015 and 2016 to brainstorm these various issues with the top leadership of PSBs. It came up with an "Indradhanush" of seven recommendations/action points:

i) Appointment of managing directors and chief executive officers with a non-executive chairman post in place of erstwhile chairman and managing directors (since implemented).

ii) The Banks Board Bureau to be formed and duly empowered to give impetus to the reforms direction. But no major decision has come from this body despite almost 18 months of existence. H.N. Sinor's resignation (and retraction) was probably a pointer to this.

iii) Capitalization of banks. Estimates range from Rs1.8 trillion to Rs3 trillion of fresh capital by 2019. The government's fiscal consolidation objectives stand seriously challenged.

iv) De-stressing of PSBs with faster resolution of stressed assets. The formation of the Insolvency and Bankruptcy Board of India and the introduction of the Insolvency and Bankruptcy Code are a

step in that direction. However, it is still too early for the results to show.

v) Empowerment of bank managements (read boards) in decision-making with the government assuring “no interference, only intervention” on its part. Ask any bank chief on this and a cynical smirk is an assured response.

vi) A framework of accountability for performance of banks’ top management around Indian Banks’ Association-drafted key performance indicators. All banks consistently fail to achieve a decent score.

vii) Governance norms in PSBs revolving around P.J. Nayak Committee recommendations, including reduction of government holdings in PSBs to below 50% and transfer thereof to a holding company. Also, the report calls for concomitant improvements in the quality of boards’ deliberations with induction of part-time, non-executive members having domain skills, strategic competence and independent thinking. Most of this is yet to see the light of day.

All banks recognize that their business is undergoing fundamental changes. There is a move away from balance sheet based activities to seeking incomes from investment-related, third-party products, transactions/payments solutions, asset management services, etc. Most banks have begun to leverage technology to focus on customer relationship management, work flow efficiency, risk management and so on.

As such, in the coming years, the stability and growth of PSBs will be determined by the strategic choices their boards make in tackling the emerging threats, and by how quickly they are able to cash in on new opportunities. The selection of an effective leadership having the requisite stamina, professional competence and people skills—not to mention making organizational learning and renewal an integral part of a bank’s DNA—will be key factors in achieving this. In the words of Bradley Leimer, former head of innovation at Santander Bank, in this age of advanced financial technology, banks have to decide between being capital-providing utilities or transforming into technology companies that provide banking services and products. There is hope only for the latter.

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