



# WINNING IN **UNCERTAIN TIMES**

November 2023



# Executive Summary (1/3)

Navigating through a period of heightened economic uncertainty characterized by escalating geopolitical risks and unprecedented macroeconomic volatility, **Indian banks have emerged as a global beacon of stability and growth.**

This performance comes against a backdrop of inflationary spirals in developed economies, a drastic reconfiguration of global supply chains, and a fast-approaching data consumption era where data consumed from now till 2025 is expected to match all data consumed in the 21<sup>st</sup> century. As interest rates surge to historic highs and many industries face funding slowdown, plummeting valuations, and mass layoffs, **Indian financial institutions continue to demonstrate remarkable resilience with record profitability, robust credit growth, and a quality book** signaling a phase of strategic expansion and balance sheet strengthening.

Indian banks' success amidst such challenging global conditions poses critical questions about the sustainability of this growth and the strategic imperatives required to maintain this trajectory. The sector stands at a pivotal moment, tasked with identifying & implementing practices that can sustain its profitability and shield it from the after-effects of global market turbulence. In this context, the report posits **five key imperatives**, which, if adopted, could underpin the **continued success of Indian banks** in complex and unpredictable times.

Central to these imperatives is the focus on **Economic Profit (EP) as an alternative for guiding financial strategies.** EP offers a comprehensive view of profitability which connects more directly to shareholder value than other commonly used metrics.

Our research indicates that EP, along with conventional metrics such as ROA, is a better indicator in predicting a bank's Price to Book (P/B) ratio. **Banks with higher EP have significantly higher P/B compared to those with lower EP at similar ROA levels.** However, EP levels vary widely among banks – while some consistently achieve high EP, **over 50% have faced negative EP for more than half of the past decade.** Therefore, a strategic shift towards prioritizing EP across banking operations is essential for smarter, more prudent capital allocation.

**1 Future of distribution:** In the evolving banking landscape, shaped by open banking and digital public infrastructure, the distribution medium has changed significantly over the years. However, for a diverse nation like India, with pronounced digital divides, the relevance of physical branches in fostering customer trust remains crucial.

Hence, banks must focus on three key areas: **transforming branches into advisory-led centers rather than product pushers; strategically aligning services with the most effective channels tailored to specific customer segments; and adopting a 'phygital' approach.**

# Executive Summary (2/3)

This hybrid model, balancing digital capabilities with physical interaction, not only optimizes the cost-income ratio but also extends the reach of banks.

By leveraging open architecture-based tech platforms, banks can provide inclusive and personalized banking through FinTechs, BCs and DSAs.

**2 Digital public infrastructure:** India's financial inclusion is on the brink of a significant change with the Account Aggregator (AA) framework, potentially having an impact similar to that of UPI.

**With consents increasing 12-fold in the past year and expected to reach 15-20 million daily by 2027,** AA is reshaping the landscape of lending and wealth management by democratizing access to authenticated data in a structured manner. For banks and NBFCs, the challenge will lie in harnessing this data for meaningful insights, within the consent framework.

Institutions which will **adopt AA early** to create quick digital journeys and tailored financial solutions are **set to gain disproportionately,** potentially reshaping the competitive landscape.

**3 Gen AI adoption:** Generative AI (GenAI) isn't just another fleeting technology trend; it's a **transformative force at a scale**

**never seen since the launch of the world wide web** and is set to fundamentally change banking.

It can work in tandem with traditional AI to deliver a dual-pronged approach that combines analytical depth with creativity and has the **potential to improve process efficiency, reinvent banking functions and spawn entirely new business models.**

As banks navigate margin compression and rising cost-income challenges, adopting GenAI becomes crucial. However, most banks currently focus on a few use cases while missing its broader potential.

Banks need to adopt a more **holistic view and consider key archetypes of using GenAI** to fully leverage its capabilities. This shift requires equipping teams with the **skills to use GenAI effectively** and responsibly, ensuring it enhances customer service while guaranteeing **robust risk governance.**

**4 Risk management maturity:** With the digital banking boom and the availability of **aggregated financial data from multiple sources, banks are dealing with a lot more customer data than before.** This increase in data brings new challenges, especially in terms of cyber & data security risks.

Since Covid-19, Indian banks have become more cautious, **reflected in a 5-10% decrease in loan approval rates across various products**



# Executive Summary (3/3)

**and segments. Simultaneously, there's a rise in customer level leverage, indicating changing credit dynamics.** Banks must now urgently update their risk models, integrating new data and evolving beyond traditional metrics.

Another big issue is climate change, which banks need to start considering in their risk models. According to our survey, **only 10% of banks adopting an integrated risk management strategy, highlighting the need for establishing dedicated Risk Centers of Excellence.** These centers are pivotal for enhanced risk management and informed strategic decisions in navigating emerging risks.

**5 Climate strategy:** Today, climate change poses a dual-edged sword for Indian bank: **a vast \$2.5 trillion opportunity** in green financing, or a significant risk if timely action is neglected, **especially as 53% of bank credit is currently allocated to climate vulnerable sectors.**

This dichotomy demands a two-pronged approach: modifying current operating models to include climate risk and incentivizing eco-friendly financing, while simultaneously preparing for future green banking initiatives. Drawing lessons from international peers, Indian **banks can pursue innovative climate finance strategies** to scale climate financing. Given that 60%+ of climate finance will assist the transition of small businesses, Indian banks must design inventive

products and develop ecosystems incentivizing integrated blended finance solutions to truly move India towards a low-carbon economy.

**India's banking sector** has been instrumental in **elevating the country's GDP from \$250 Bn in the 1990s to \$3.7 Bn in 2023.** As the sector aims to support India's grand vision of a \$30 trillion economy by 2047, **an estimated capital infusion of \$2-2.5 trillion is required over the next two decades.**

To realize this, the banking sector along with regulatory support must **sustain current levels of returns** amidst uncertainty and continue to be economically viable. Consolidation of financial institutions and the creation of new lending entities to **build multiple large banks** will be instrumental in fostering a sustained era of growth and economic value creation.

# Inescapable trends influencing the world



## GEOPOLITICS

**90%**

increase in  
Geopolitical Risk  
Index<sup>1</sup> from avg. levels  
between 1985–2019



## INFLATION

**40 yrs.**

since inflation in  
western economies  
last exceeded  
inflation in India



## DATA AND ANALYTICS

**400+ ZB**

data to be consumed  
from 2023 to 2025, same  
as data consumed till  
date in 21<sup>st</sup> century



## DEMOGRAPHICS

**1 in 6**

people in the world  
will be 60 years and  
older by 2030



## SUSTAINABILITY

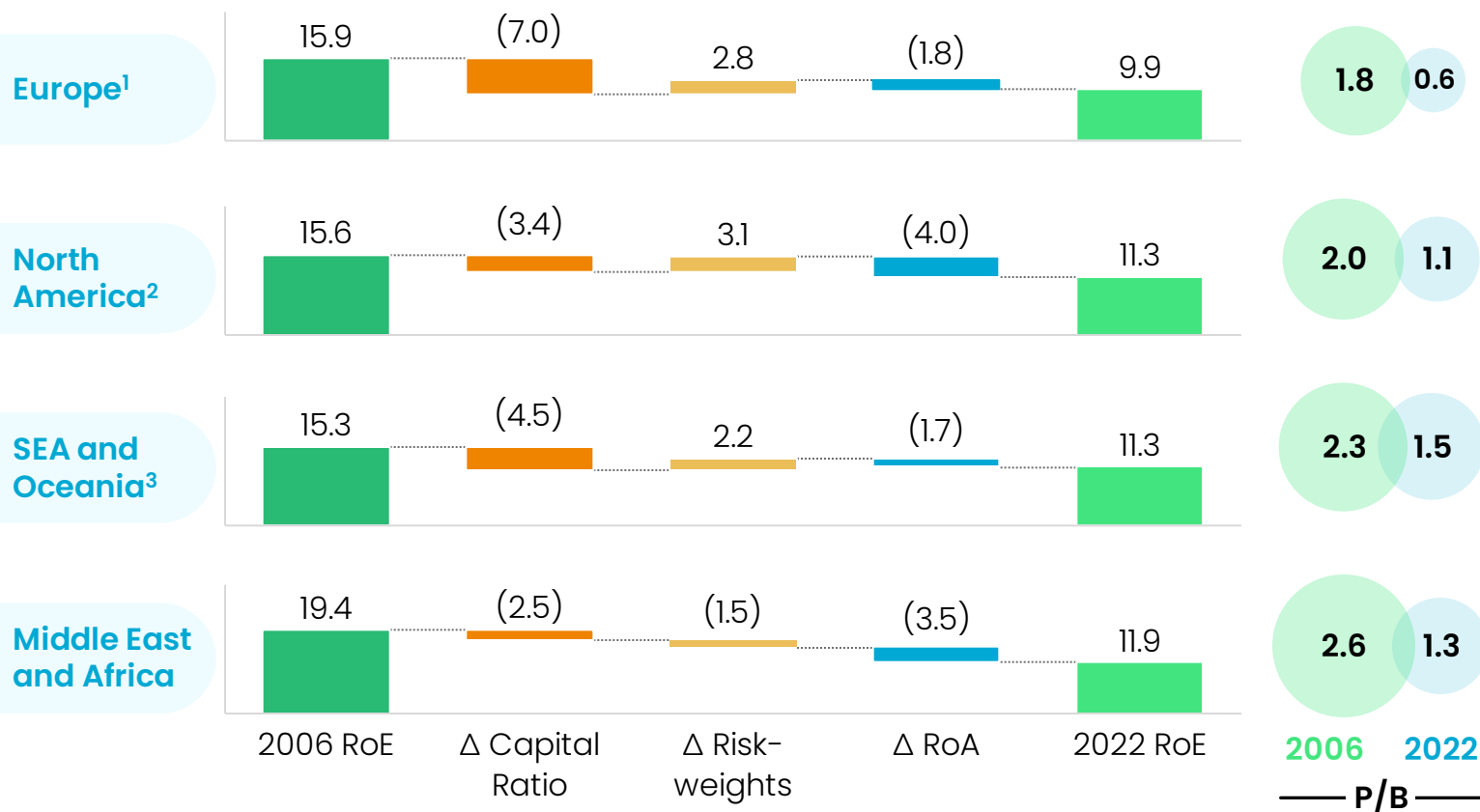
**2.8 °C**

global warming by  
the year 2100 at  
current trajectory

1. Latest value of GPR index as of Nov'23 is 189.52, and average levels between 1985–2019 is indexed at 100  
Note: Western economies includes USA, UK, Germany, Italy, Belgium, Netherlands; ZB = 1 trillion gigabytes  
Source: Caldara, Dario and Matteo Iacoviello (2022); World Bank; Statista; WHO; UNEP Emissions Gap Report 2022

# Banking returns have dropped significantly since global financial crisis, driven by regulatory action

## RoE comparison over two decades across regions



Globally, RoE has gone down by  
**460 bps**



**82%**  
of drop in RoE due to increased regulatory capital stipulations

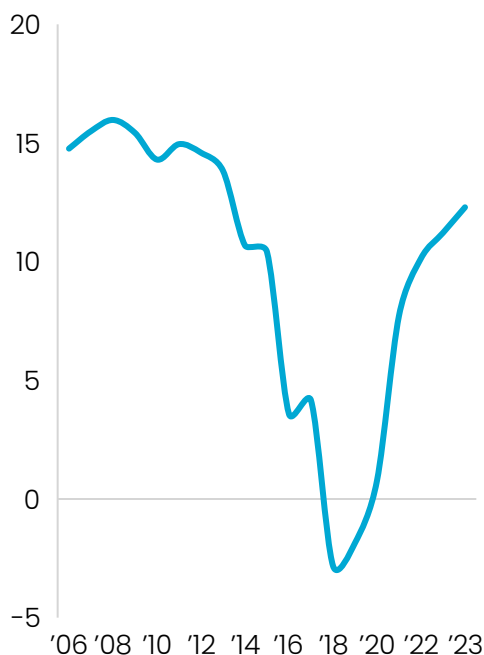


Globally, P/B has gone down by  
**66%**

1. Europe – European Union, UK and Nordics 2. North America – USA and Canada 3. SEA and Oceania – South Asia, Southeast Asia, India and Australia  
Note: Values derived from equity and market cap of largest listed banks (80% of asset share in the region); Capital ratio computed as total equity/total risk-weighted assets  
Source: BCG Analysis

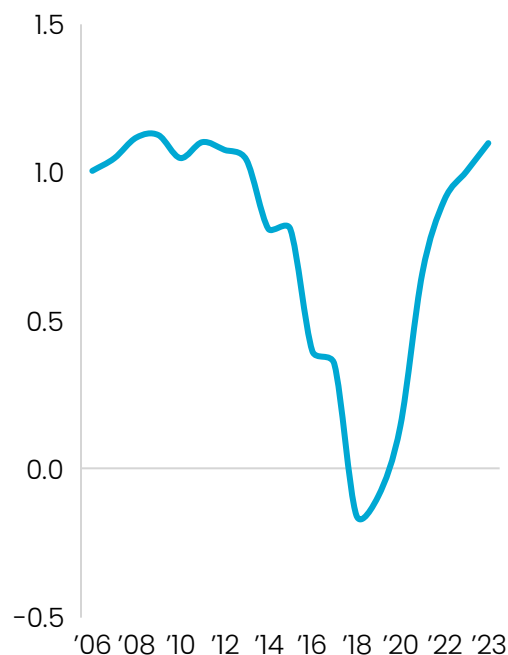
# Indian banking a **North Star** amidst uncertainty across markets

**RoE (in %)**



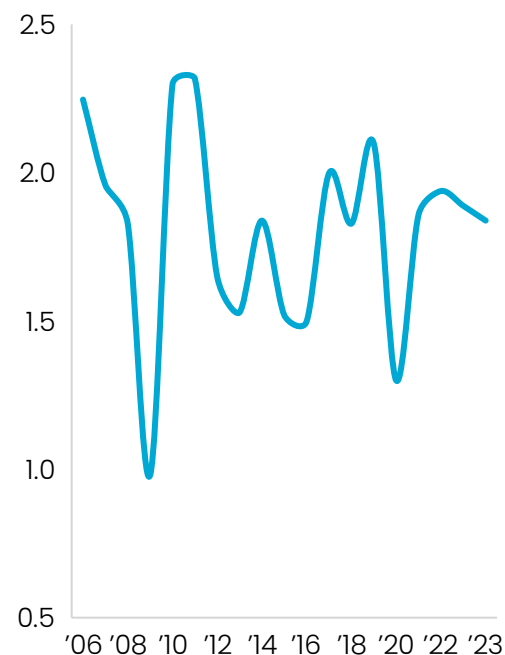
RoE down by **250bps** against **460bps** globally

**RoA (in %)**



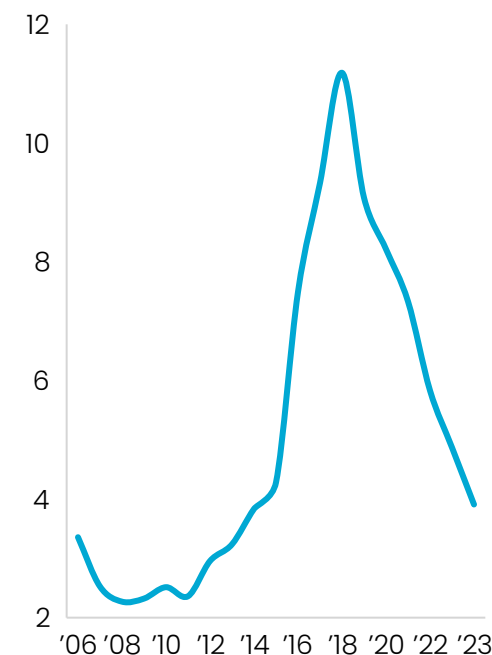
RoA up by **10bps** against **10bps** decline globally

**P/B<sup>1</sup> ratio**



P/B down by **18%** as against **66%** globally

**GNPA<sup>2</sup> (in %)**

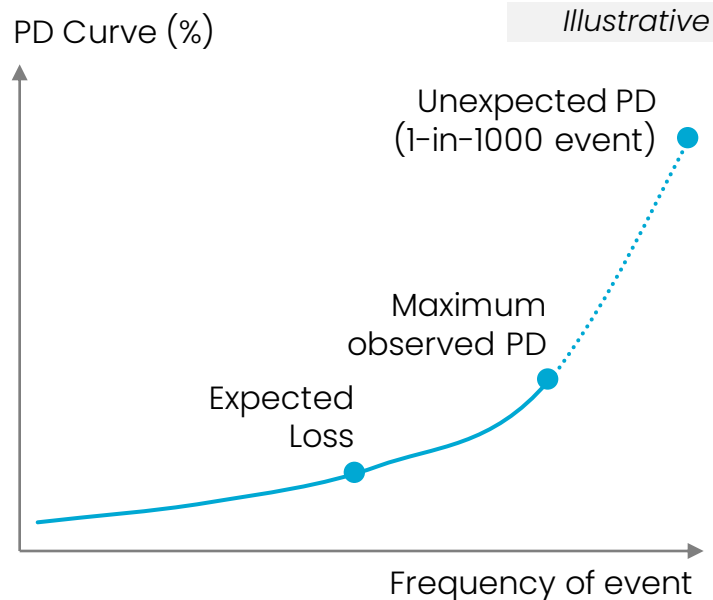


Credit costs<sup>3</sup> at decadal low at **60 bps**

1. Price to book value ratio of top 20 Indian PSU and Private banks by assets 2. Gross non-performing assets as % of total advances 3. Loan provisions as % of average total assets  
Note: RoE, RoA, GNPA and credit costs are calculated for Indian scheduled commercial banks  
Source: RBI; Capitaline

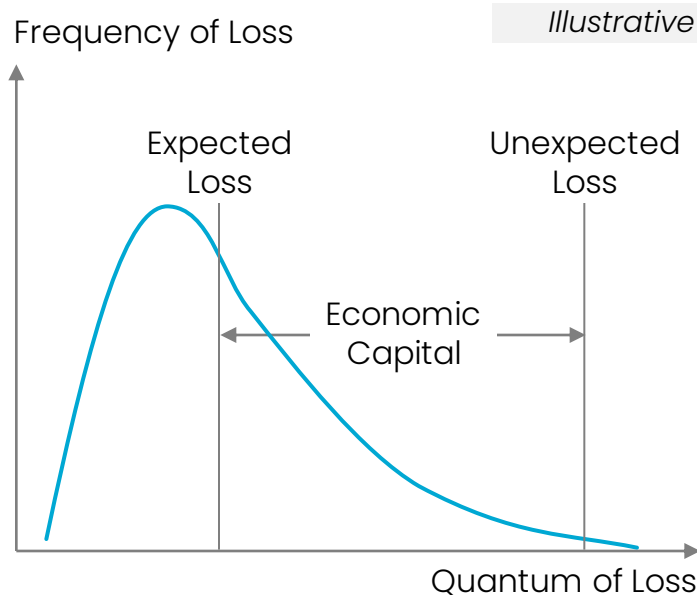
# Economic profit: A measure of economic value addition for banks

## Unexpected PD (1-in-1000 loss event)



Unexpected PD modelled as extreme loss scenario over a long-term period

## Economic Capital (Solvency buffer)



Economic Capital is Tier 1 Capital required to absorb unexpected loss level (1-in-1000 event) basis historical portfolio performance

## Economic Profit vs. Traditional return metrics

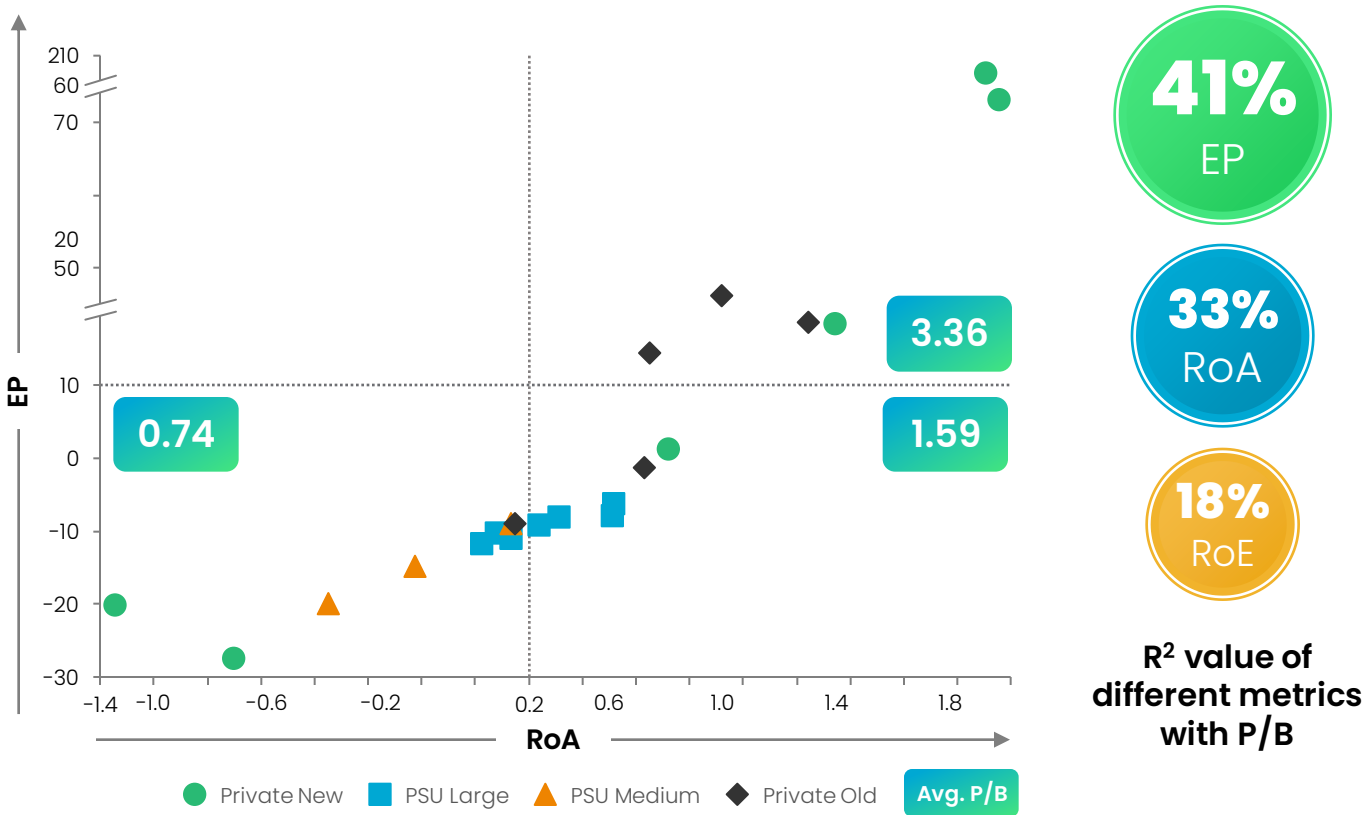
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- Economic Profit is return on Economic Capital over and above the cost of equity
- Traditional metrics (RoA, RoE) account for the costs of only expected or observed losses






# EP is the best predictor of valuations; critical for strategic planning

## EP vs. RoA of top 20 Indian banks over the last 3 years

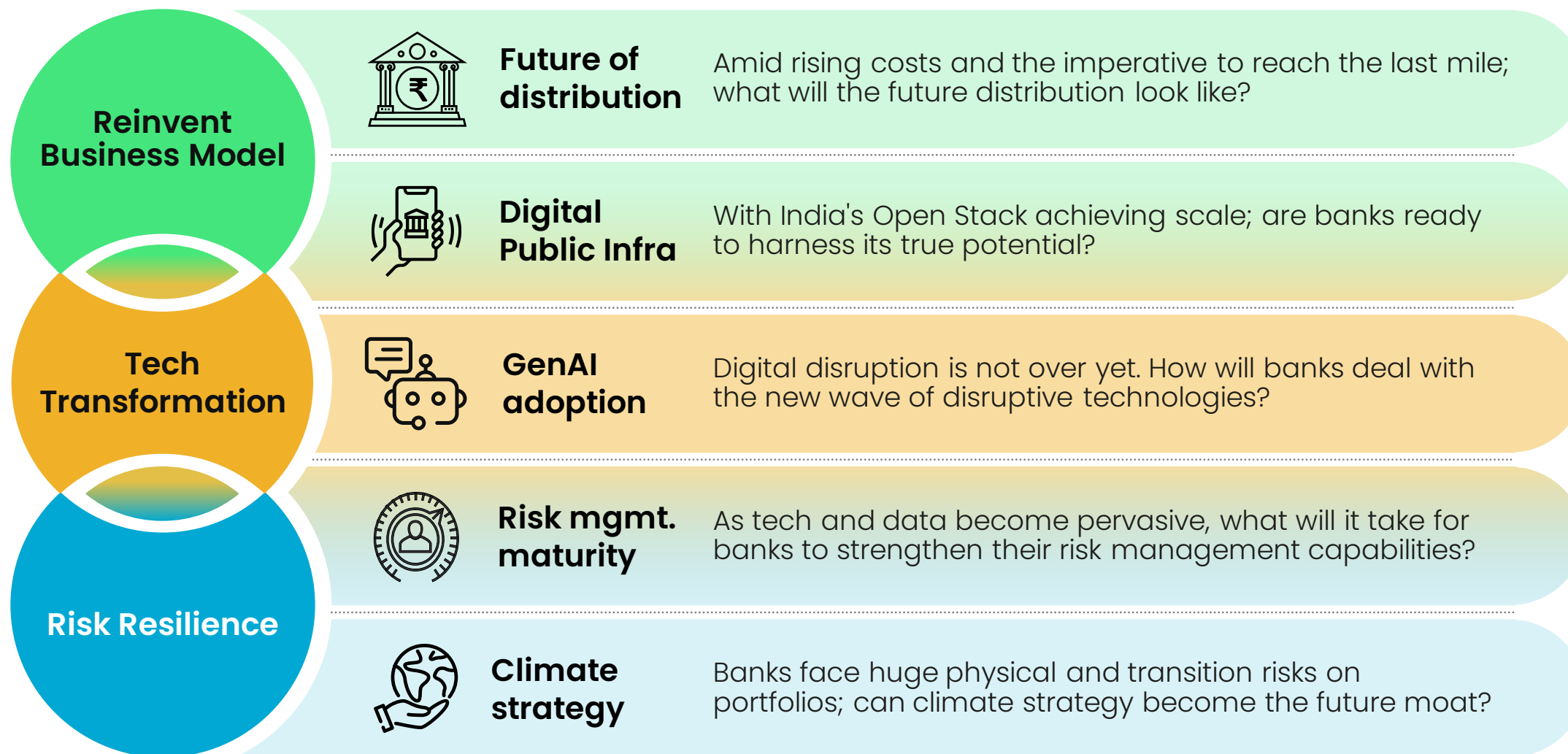


## Implications for banks

-  Measure and track Economic Capital and Economic Profit
-  Use EP for capital allocation across business units, products
-  Incorporate EC and EP as a measure of business unit's performance

Note: RoA and EP are based on weighted average of last 3 years data; P/B represents the average P/B of the banks in particular quadrant  
Source: RBI; Capitaline; Bloomberg; BCG Analysis

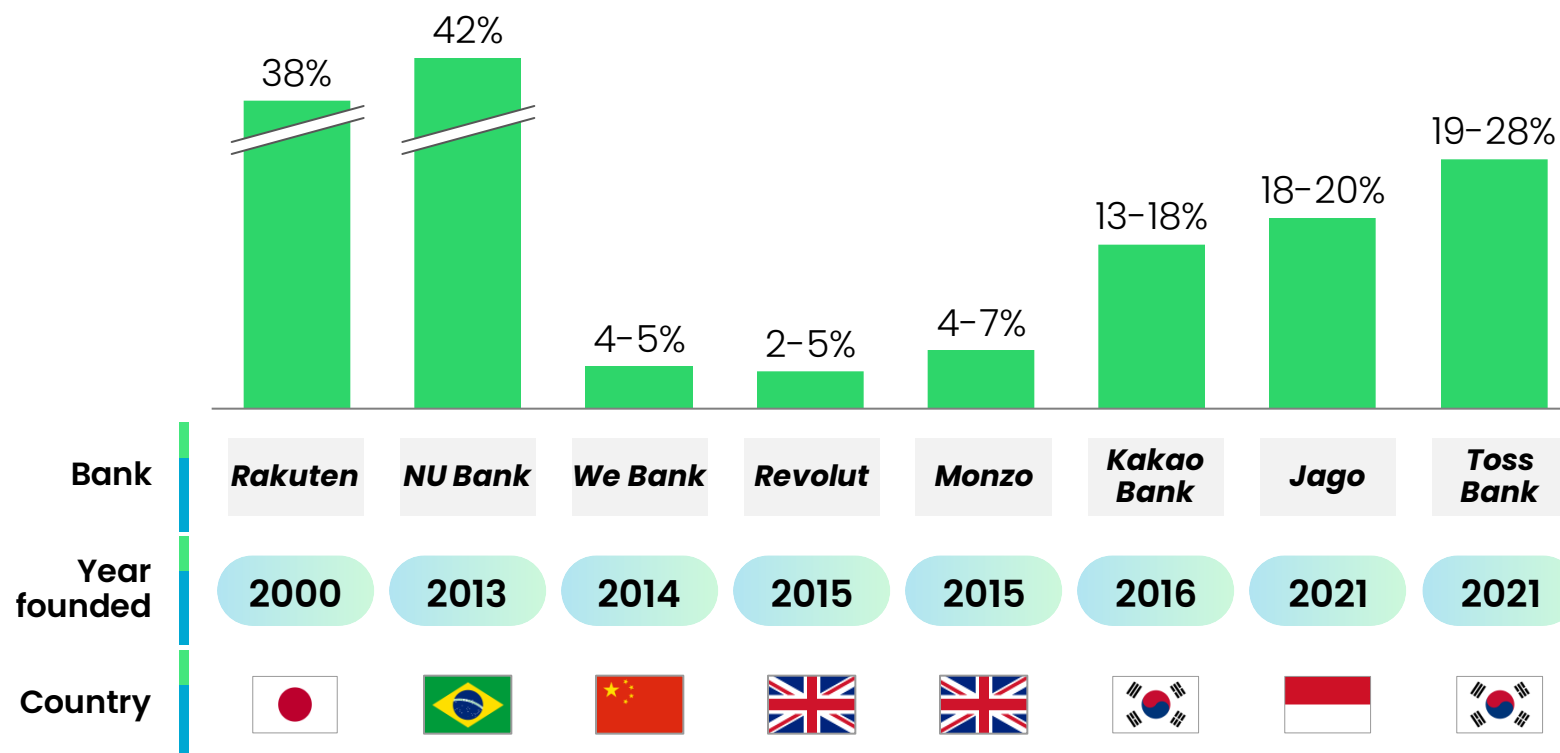
# Five imperatives for banks to **win in uncertain times**



# Primacy of human touch is critical

## Digital only approach not successful globally; digital banks saw lower deposit base compared to traditional banks

Avg. deposits size<sup>1</sup> with digital banks<sup>2</sup> as % of avg deposit size with incumbent banks<sup>3</sup>



## Physical touchpoint a key imperative for customer trust



Physical assistance critical to **educate and engage** customers



**Elderly and Non-tech savvy customers** still rely on branches for daily banking

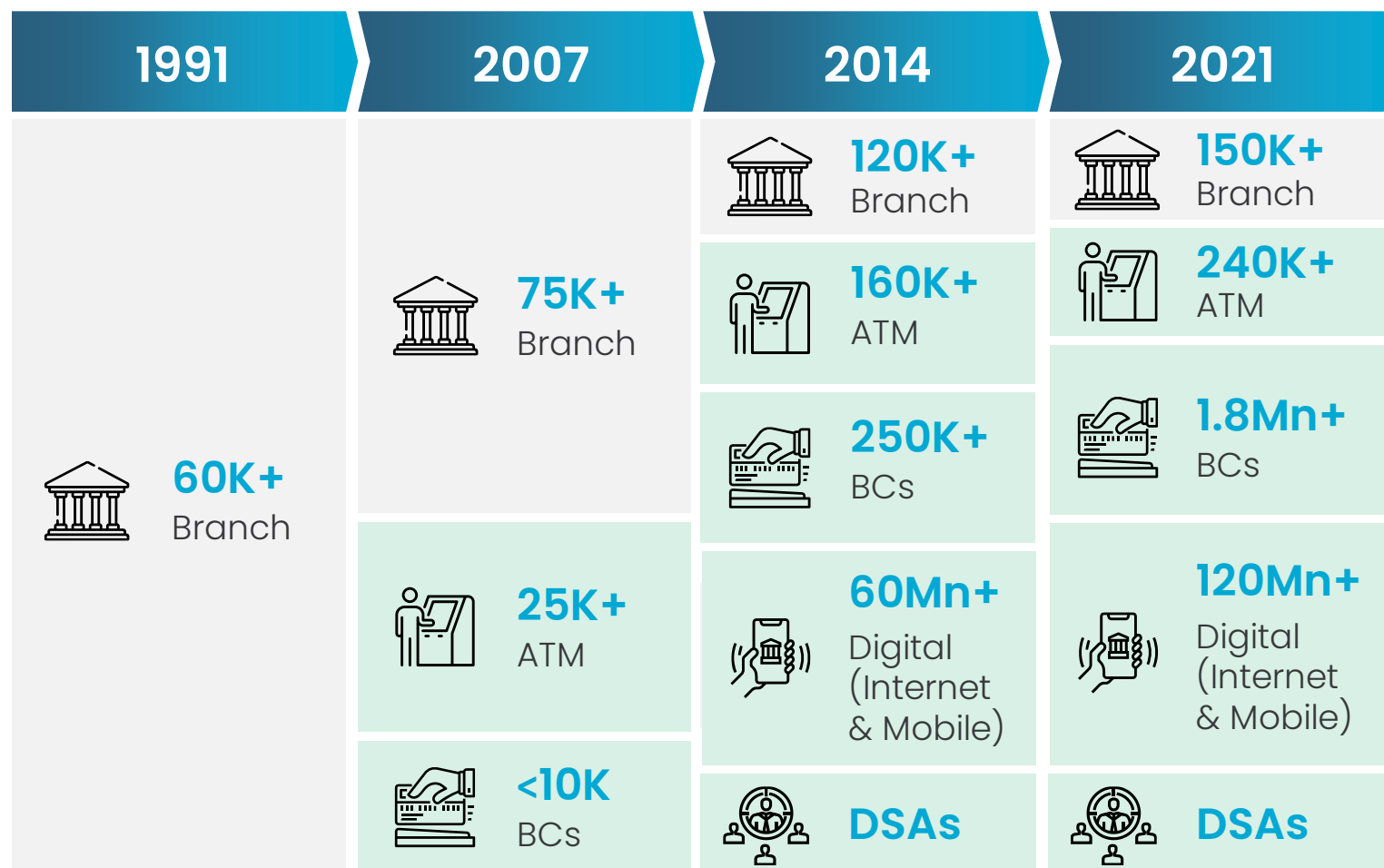


Physical touchpoints a **bridge to unbanked** areas

1. Avg. deposit per customer = (Total balance of retail CASA + TD)/Total number of customers 2. Digital only banks have no physical branch presence 3. Incumbent banks are one or average of the largest banks in the market  
Source: Company reports; BCG Analysis

# What will be the **future of banking** in India?

## Non-branch physical channels or digital embedded finance



Branch



ATM



Business Correspondents



Digital (Internet & Mobile)



DSAs



Embedded Finance

Fintech

**Zerodha**

**Policy Bazaar**

Big Tech

**Google Pay**

**Paytm**

**Phone-Pe**

Eco system

**Amazon**

**Flipkart**

**Jumbootail**



# India's unique digital infrastructure to enable ubiquitous banking

## Augmented digital banking to act as a force multiplier



### Consent based open architecture

- Aadhaar, AA, eSign, OCEN as enablers



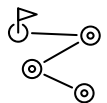
### Seamlessly embedded across channels

- Frictionless, STP customer experience



### Full suite of banking solutions

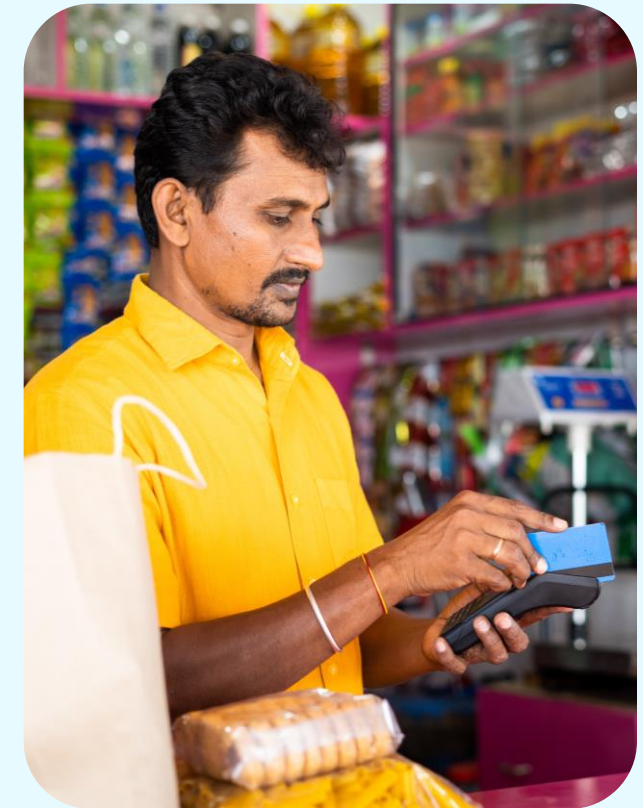
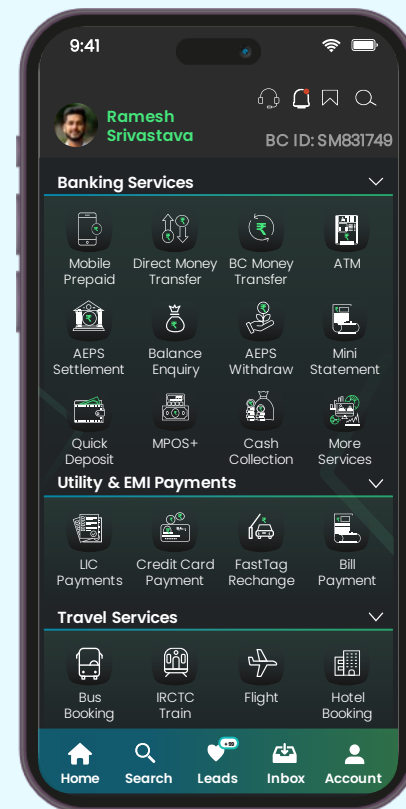
- Available digitally in a paperless manner



### Each touchpoint "working for me"

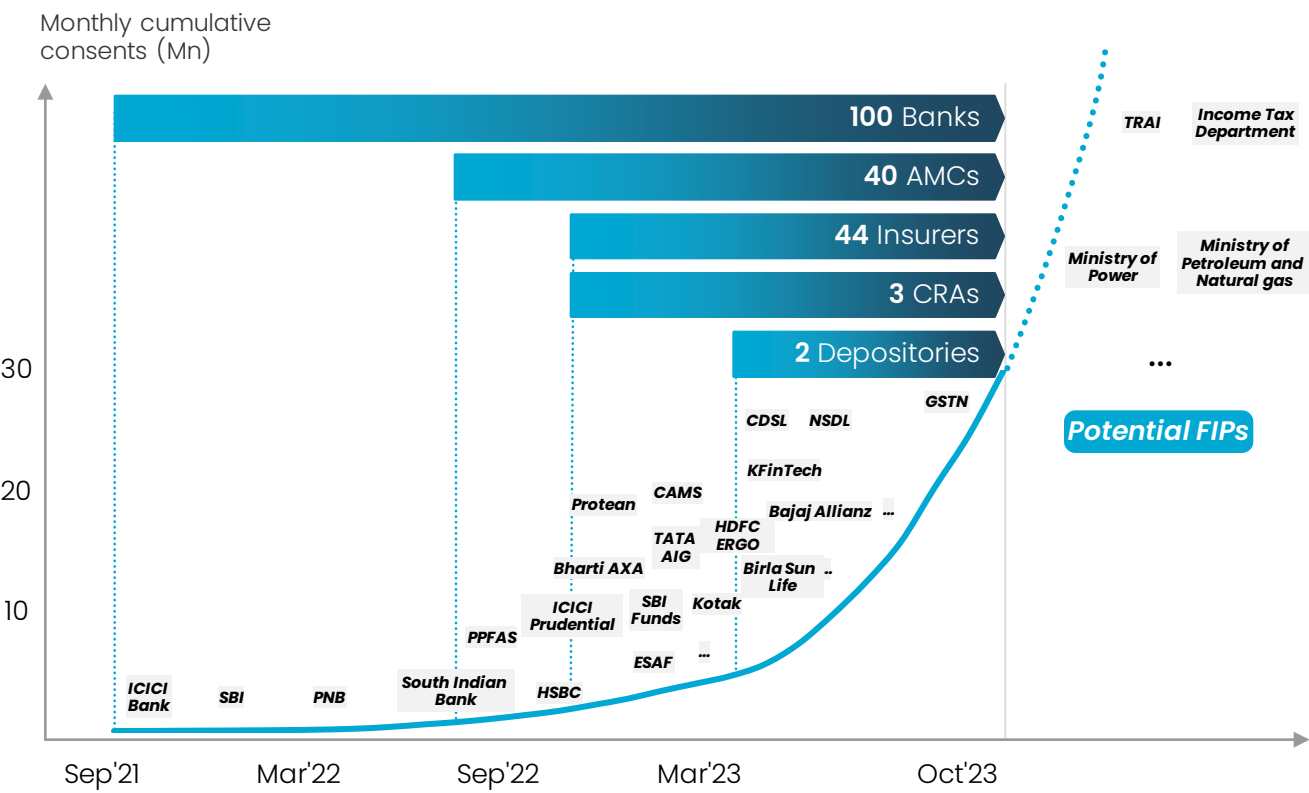
- AI/GenAI led tailored experience

## Enabling all small merchants as BCs<sup>1</sup> to create last mile digital services platform



# AA at an inflection point: Robust customer profiling enabled

## Adoption growing exponentially as different types of FIPs get onboarded



### Raj Sharma

32 years old, self employed professional, looking for unsecured loan for his business

#### Traditional underwriting

##### Banking

- Repayment behavior
- Enquiry profile
- Savings volatility

#### New data sources from AA

##### Insurance

- Financial discipline
- Policy profile
- Persistency ratio

##### Investment

- SIP consistency
- Asset class diversification



Eligibility



Limit

- Deposits
- Balances

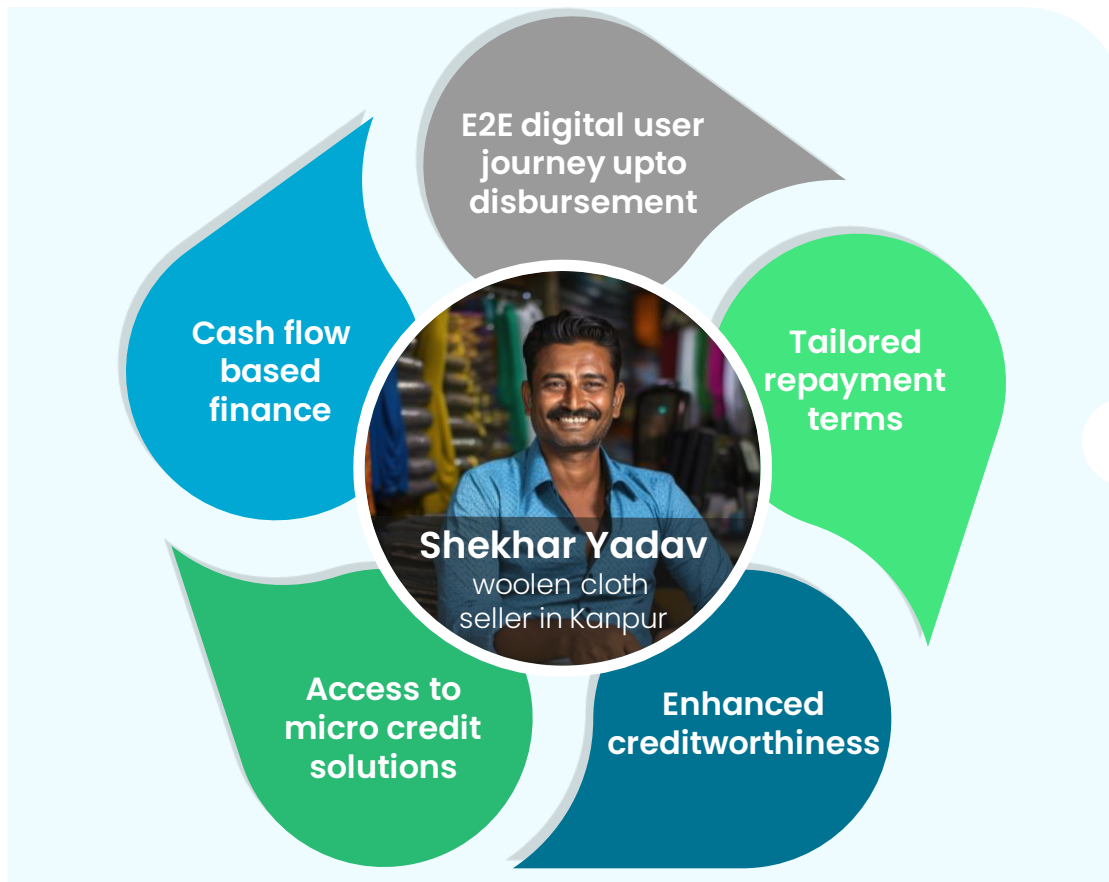
- Sum assured
- Surrender value

- Portfolio value

1. Includes entities live on AA and those under evaluation/testing  
Source: Sahamati

# Are banks **ready to embrace** the opportunity?

## Future of credit: proliferated by Open Stack



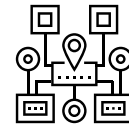
## Banks need to reimagine multiple functions



Robust **consent management** and governance  
e.g. Collection, purpose limitation, revocation



Minimize TAT, **no human intervention**  
e.g. quant models for eligibility, limit, pricing, collateral



**Platform based approach**, across channels  
e.g. embedded finance, own digital channels, contact center



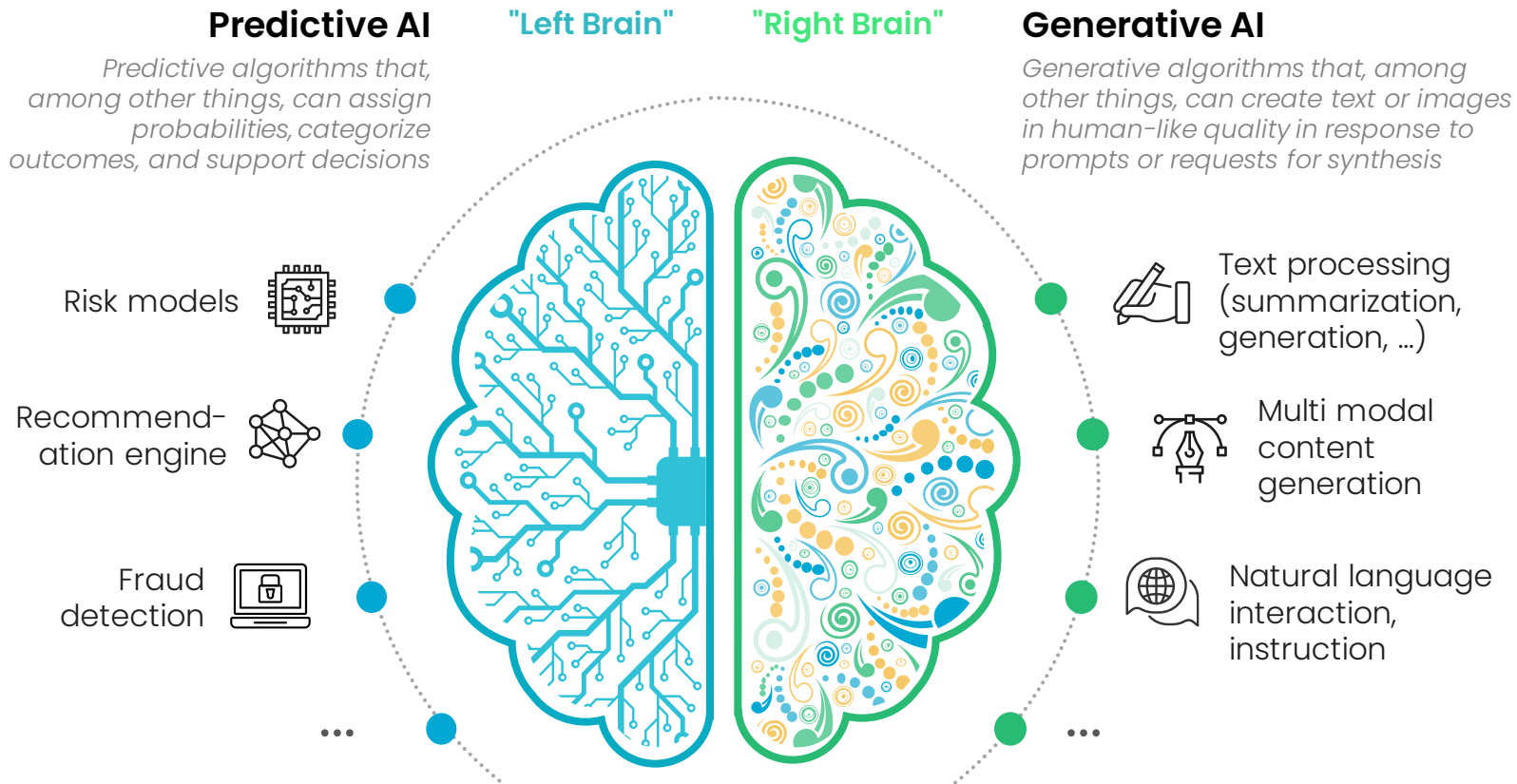
Design innovative, **miniaturized products**  
e.g. intra-day lending, ultra-micro loans, daily repayment



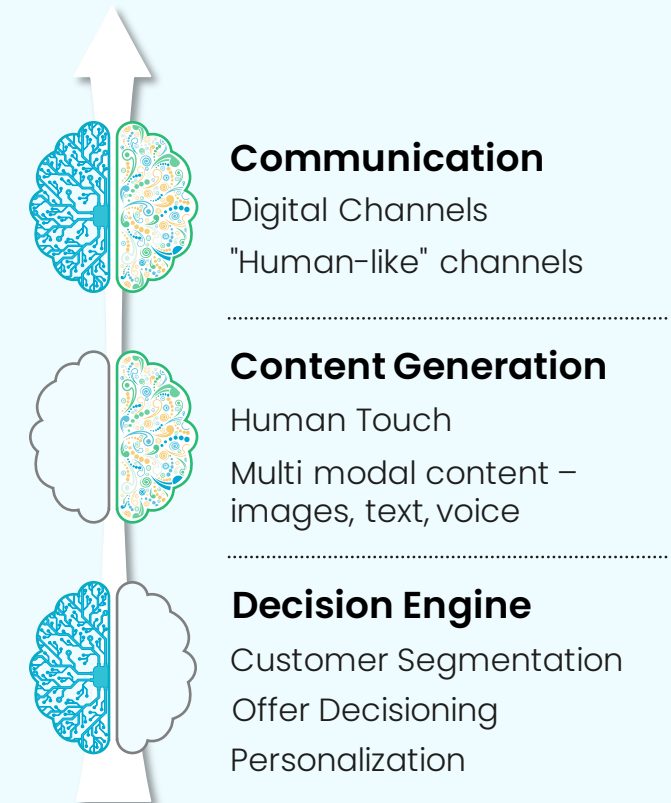
Drive **customer awareness** and adoption  
e.g. remote assistance, agent-on-call, digital nudges

# Two to Tango: "Predictive AI" and "Generative AI"

## Predictive AI and Gen AI will complement each other



## Personalization reimaged: @Scale and Segment-of-1



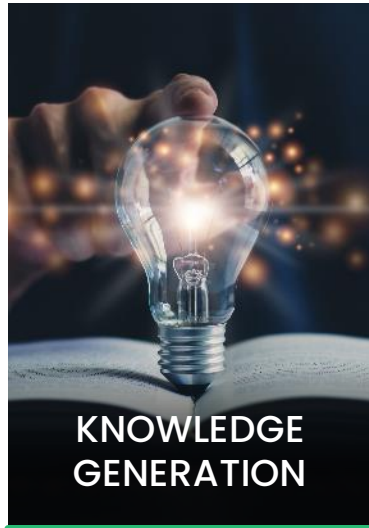


# Need to think of **GenAI archetypes** and not just use cases



- Chat enabled end-user interface—voice / text

- e.g., chat bots for customer service



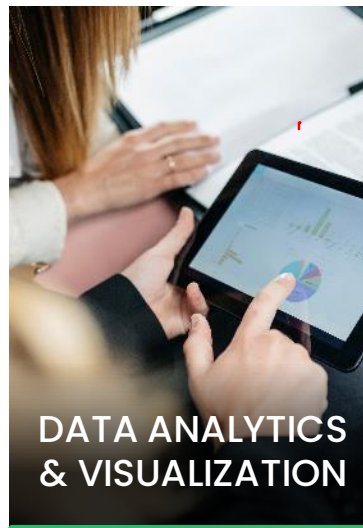
- Generate long-form content, documents, creative output

- e.g., sales & marketing content



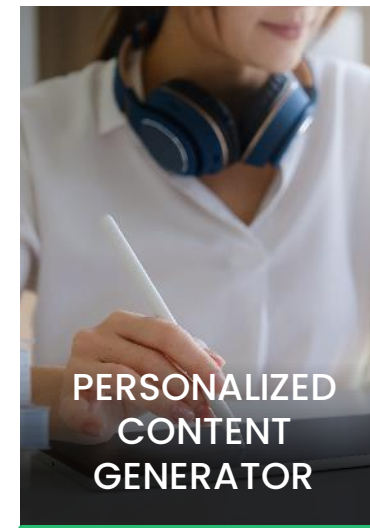
- Parametrize unstructured data

- e.g., sales calls, changes in law



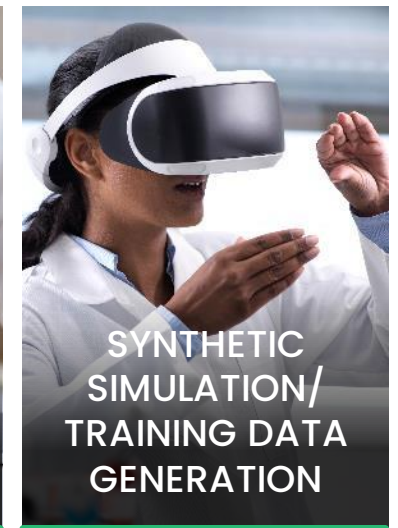
- Visualize large volumes of structured and unstructured data

- e.g., identifying macro trends



- Generate personalized and contextual text, images, audio, video

- e.g., customized sales pitch for customer

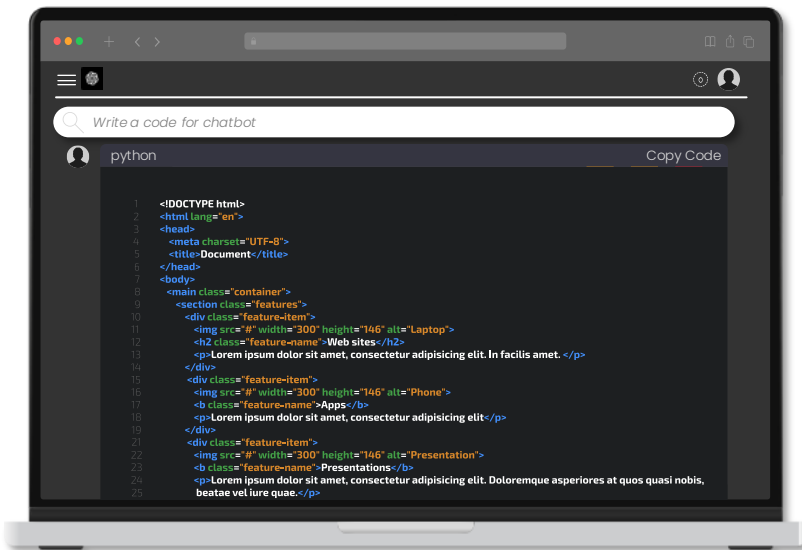


- Generate synthetic data for test cases

- e.g., simulation for fraud or risk modelling

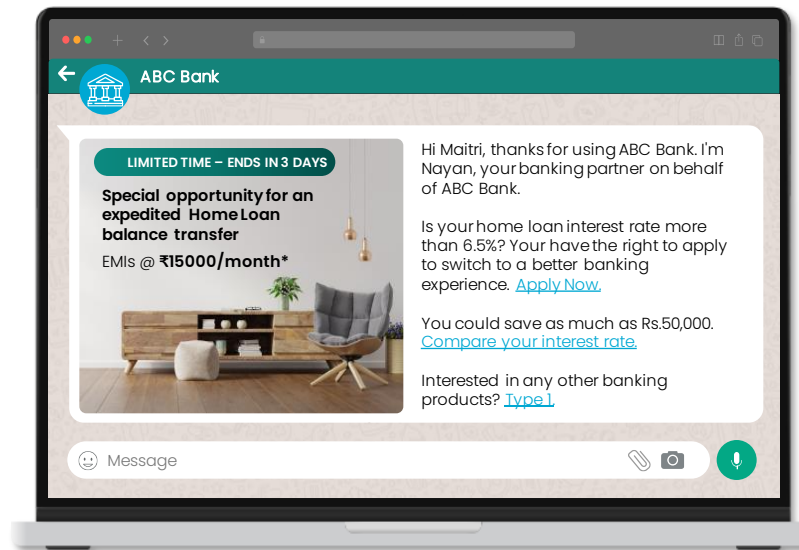
# GenAI can unlock **unparalleled efficiency** while creating new **business models**

## Process efficiency



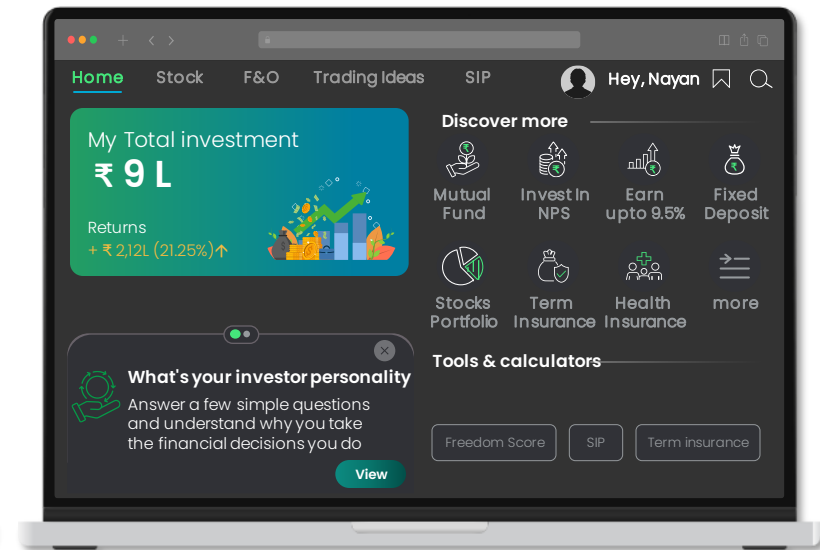
- Writing, debugging, updating codes leveraging GenAI
- Enable co-pilot assistants to human developers, testers

## Function reinvention



- Personalized content creation for targeted marketing
- Unblocking constraints of time and human content generation

## New frontiers



- Wealth management for mass segment customers
- Enabling cost-effective models for traditional RMs

# Integrating Gen AI will require **upskilling of talent** and robust **risk governance** agenda

## Identify and upskill talent 'fit for purpose'

### Build AI

Tech specialists to build and monitor AI models



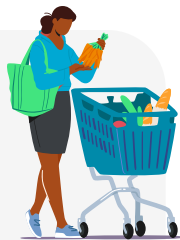
### Use AI

Practitioner using outputs from AI models and interpreting results



### Shape AI

Functional experts for operationalizing AI to deliver business outcome



### Govern AI

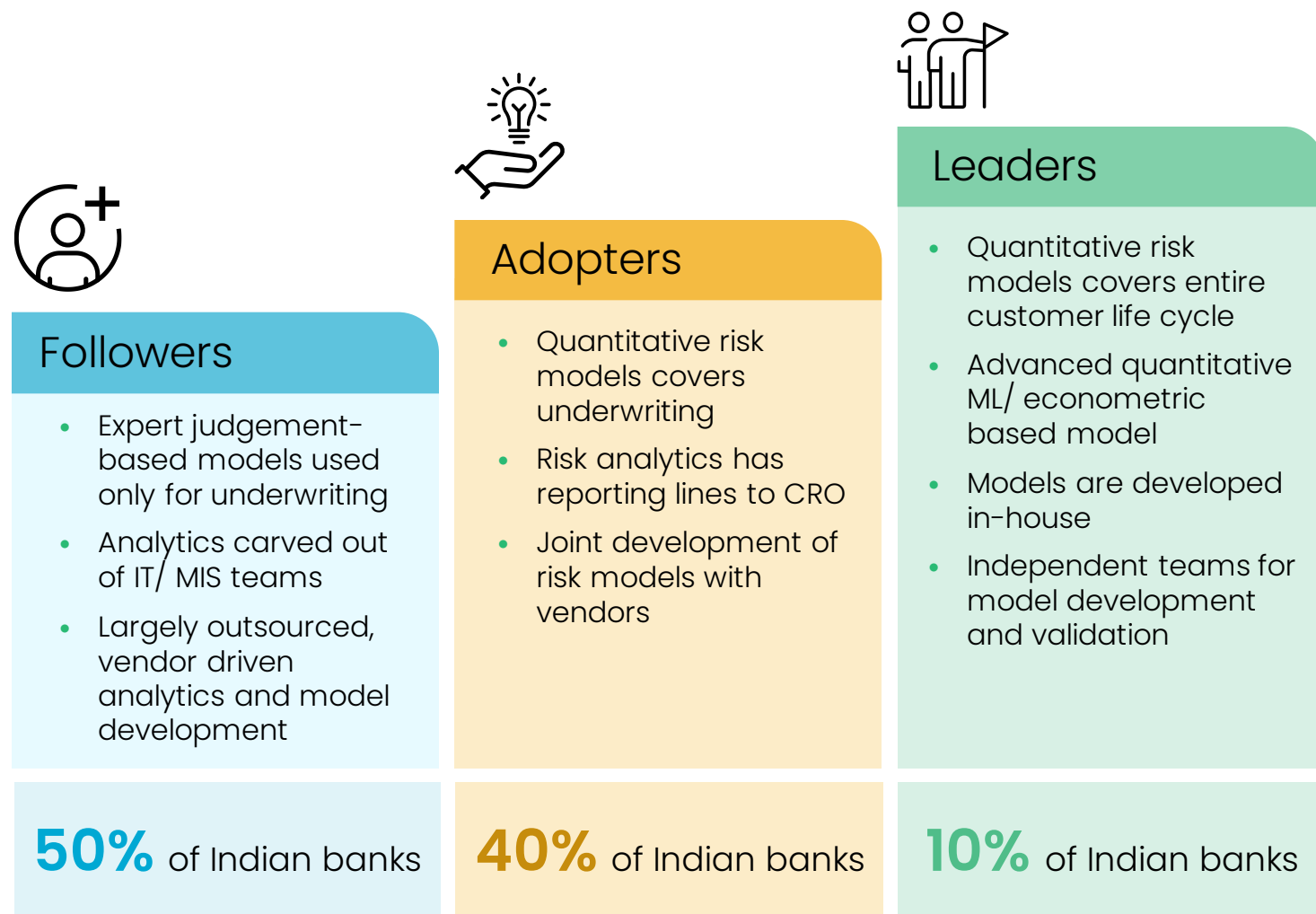
Governance specialists to monitor AI outputs to ensure tech is safe and ethical







## Newer forms of risks will need to be managed



# Amidst data and tech disruption, Indian banks are still **behind the curve on risk maturity**



## Banks need to strengthen risk management capabilities

-  Standalone "Risk CoE" with ability to develop advanced AI/ML/econometric models
-  Embedding model output into decision making for pricing, portfolio and capital allocation
-  On-the-tap ability for stress testing to handle uncertainty (e.g., climate risk)
-  Ability to absorb evolving data sources (e.g., AA, geospatial) & new techniques (e.g., Gen AI)



# Conservative bias reflecting a sharp fall in approval rates for perceived high-risk customers

## Approval Rates by Score<sup>1</sup>

	Retail Secured			Retail Business			Retail Unsecured		
	FY20	FY23	Delta	FY20	FY23	Delta	FY20	FY23	Delta
New to Credit	51%	41%	-10%	30%	22%	-8%	28%	22%	-6%
Subprime	26%	20%	-6%	17%	12%	-5%	12%	9%	-3%
Near Prime	48%	43%	-5%	27%	21%	-6%	26%	21%	-5%
Prime & Above	50%	49%	-1%	27%	25%	-2%	37%	32%	-5%



Scope to **increase approval rate sustainably** in non-prime segment by enhancing models' usage and leveraging alternate data



**Optimize digital customer journeys** with synchronized fraud and credit modules to increase credit through-put

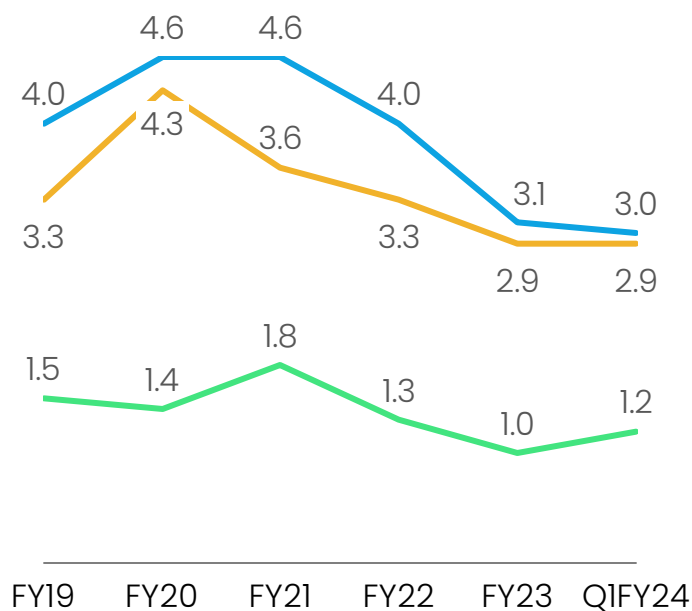
1. CIBIL Score: Subprime = 300–680; Near prime = 681–730; Prime & Above = 731–900;

Note: Retail Business includes BIL, LAP & CV/CE; Retail Secured includes Home loans, Auto loans, Gold loans and Two-wheeler loans; Retail Unsecured includes Personal loans, Credit cards, Consumer loans, MFI and others

Source: TransUnion CIBIL; BCG analysis

# Portfolio quality better than pre-Covid levels but the increase in consumer leverage requires close monitoring

## 1-year lagged delinquencies<sup>1</sup> (%)

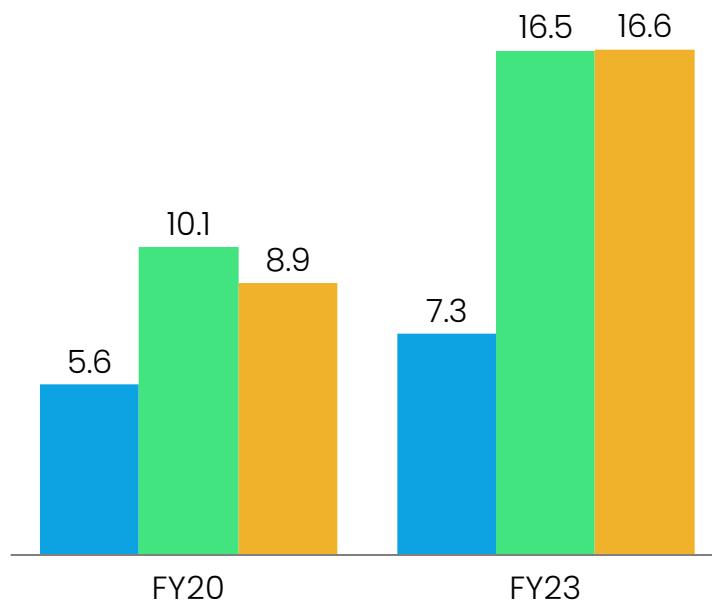


■ Retail Business

■ Retail Secured

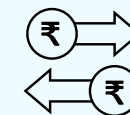
■ Retail Unsecured

## 3+ loans opened in last 6 months at origination (%)



## Redefine risk model design

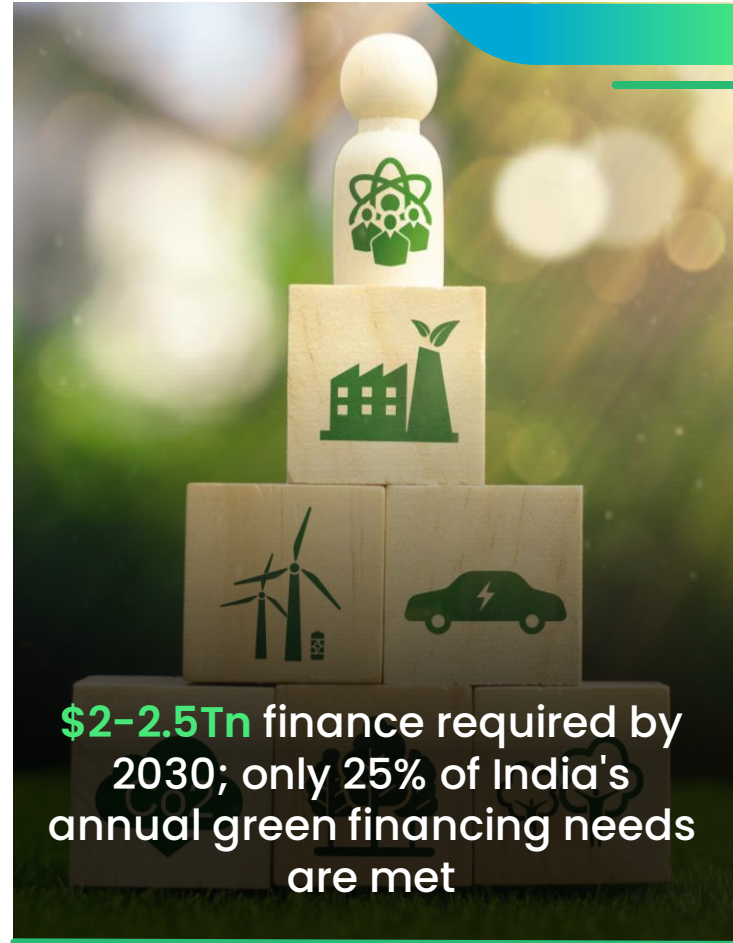
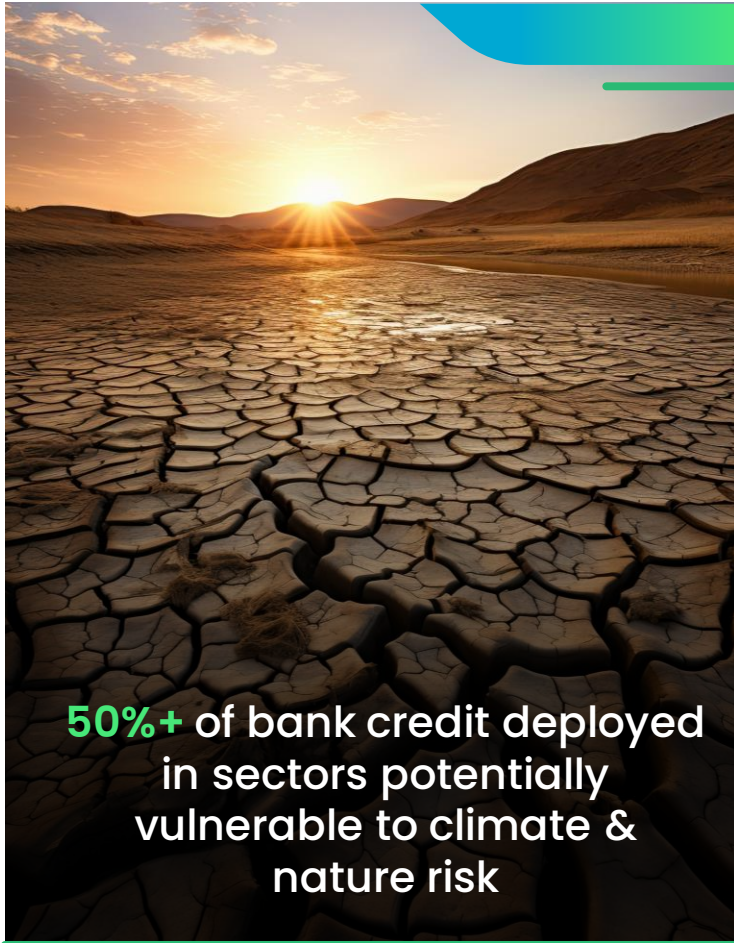
Conventional **probability of default models** to be **supplemented with** credit bust-out<sup>2</sup> models i.e. leverage build-up and bust



Looking beyond conventional FOIR<sup>3</sup> approach and focus on **borrower debt capacity models** and embedding macro-sensitivity in retail debt servicing capability

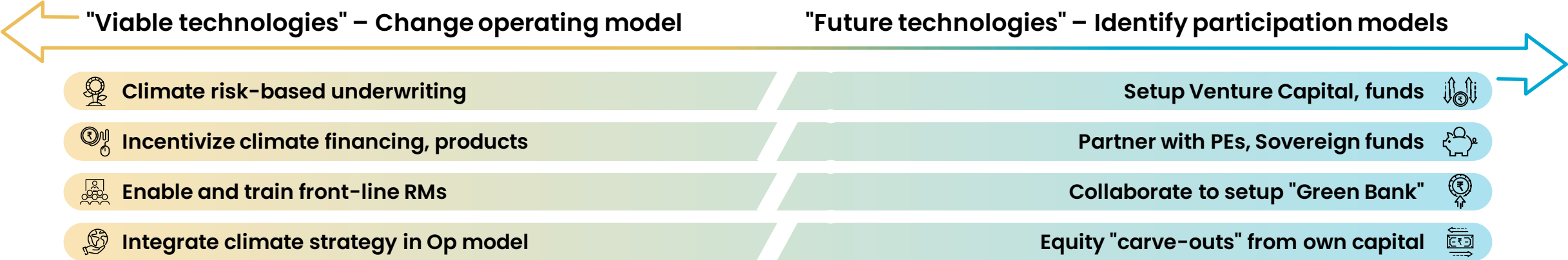
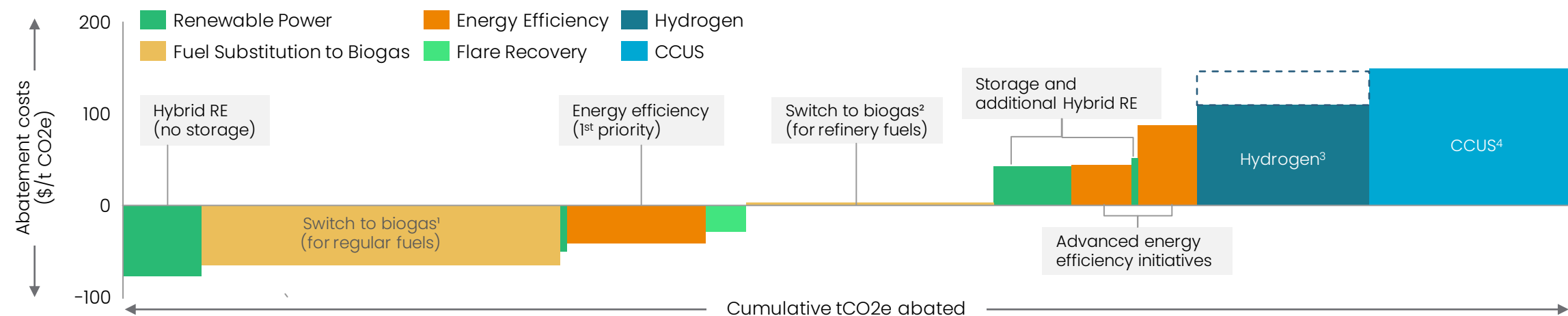
1. Data for PSBs, Pvt Banks, NBFC/HFC & Fintechs 2. Credit bust-out: Borrowers accessing too much credit within a short period of time 3. FOIR: Fixed Obligation to Income Ratio  
 Note: Retail Business includes BIL, LAP & CV/CE; Retail Secured includes Home loans, Auto loans, Gold loans and Two-wheeler loans; Retail Unsecured includes Personal loans, Credit cards, Consumer loans, MFI and others; Data for 3+ loans opened in last 6 months at origination excludes new-to-credit borrowers  
 Source: TransUnion CIBIL; BCG analysis

Climate change presents a **huge opportunity to act & win** but also poses a **big risk to lag & fail**



# Banks need to adapt to a "two speed world" for climate financing

## Marginal Abatement Cost Curve (MACC) for Indian Oil & Gas industry



1. For fuels with an established market 2. For fuels with limited market (refinery fuels) 3. Cost range (~\$100-180/tCO<sub>2</sub>e) depending on RES power prices 4. ~\$150/tCO<sub>2</sub>e depending on EOR profit sharing agreement  
Note: Assuming cost of Natural Gas at \$10/MMBTU (last 10 years average for landed LNG in India)  
Source: BCG Analysis

# Indian banks need to **explore innovative solutions** to scale climate financing

## Indian banks face several challenges to scale climate finance



### Limited understanding of tech

- Climate tech is complex and fast evolving



### Lack of climate data

- Data not captured consistently & correctly



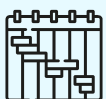
### Disaggregated demand

- Small size making green projects unviable



### Inbuilt uncertainty in climate finance

- Lack of risk maturity to price climate risk



### Long gestation period

- Climate tech needs long time to become viable

## Globally, banks taking lead in climate finance innovations

### **BNP Paribas**

*Value added services*

Set up a **carbon platform** to assist offsetting GHG emissions via sequestration projects with developers

### **Natwest**

*OEM tie-ups*

OEM tie-ups to offer EV charging bundles; provides customers access to **discounted EV charge points**

### **ABN AMRO**

*Innovative product*

Tie-up to **combine sustainability & financial data** to map emissions & advise for investments required

### **Societe Generale**

*SME advisory*

Provide expertise support & advisory; partnered with energy project facilitators to **advise SMEs & Mid Caps**

### **Natixis**

*Redesign ops.*

**Green & Sustainable Hub innovation center**, cascading through BUs by 100+ "green captains"



# 60%+ of climate finance will be required to transition small businesses in the supply chain



## Meet Sharman,

A small-scale linen supplier to leading hotel chain

**Sharman aged 42**, owns an SME unit manufacturing linens in Vapi, Gujarat. The unit sells >50% of the output to a leading global hospitality chain

As part of its sustainable tourism commitment, the hospitality chain **announced Net Zero targets**; forcing its entire supply chain to become green.

This means that Sharman must also transition its operations to reduce emissions and invest in energy efficient measures at the manufacturing facility. Failing to certify the operations green would result in significant loss of business.

**This transition will require increased investment and expertise. Sharman is wondering how can his banker help him?**

## Banks need multiple capabilities to serve SMEs manage climate transition



### Design Innovative products

- Blended finance (e.g., MDBs, Govts.)
- Innovative technologies (e.g., biogas machinery)
- ....



### Ecosystem offerings

- VAS (e.g., green certification)
- Partner tie ups (e.g., efficient lighting OEMs)
- ....



### Advisory solutions

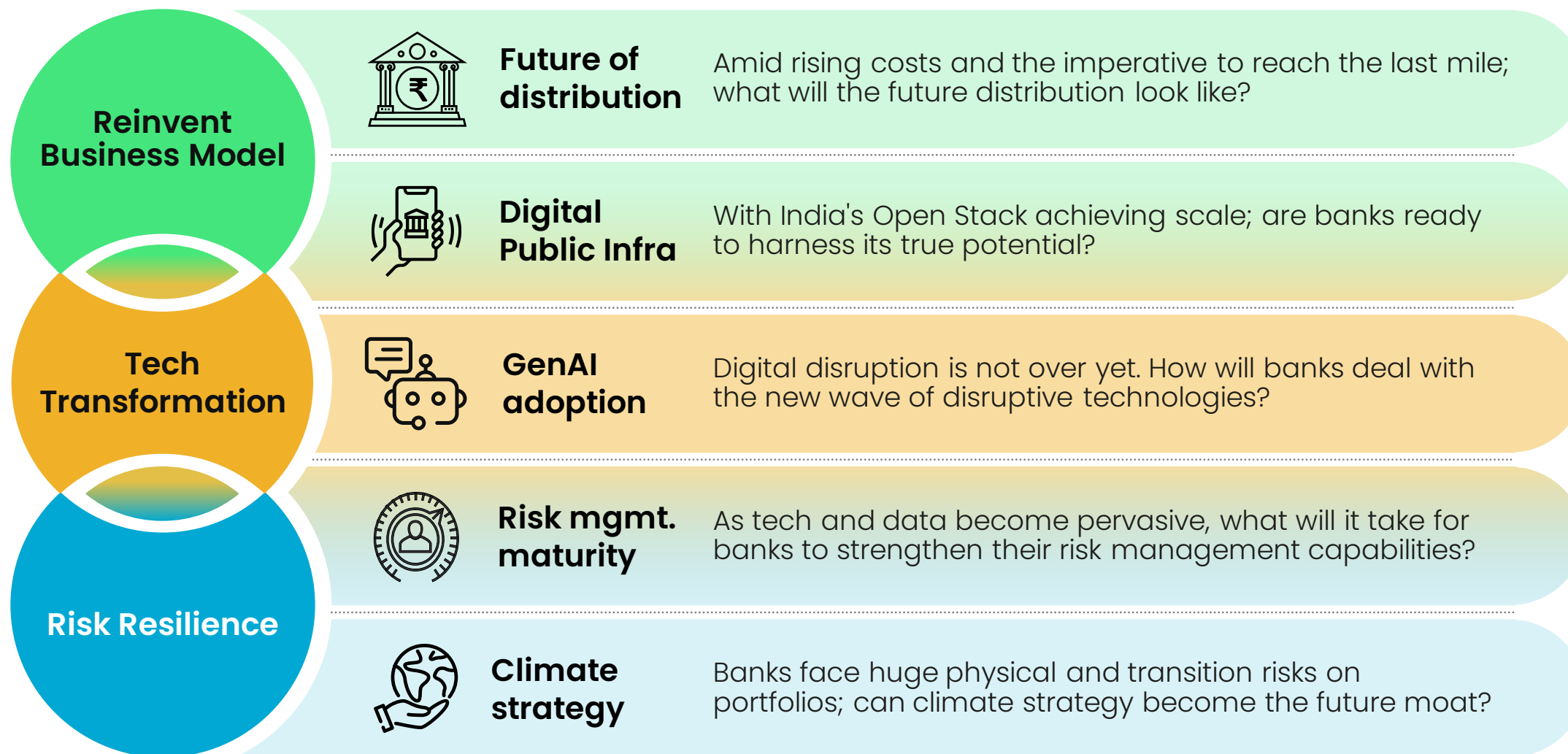
- Specialized climate transition RM team
- Sector pathways advisory
- ....



### Redesign operations

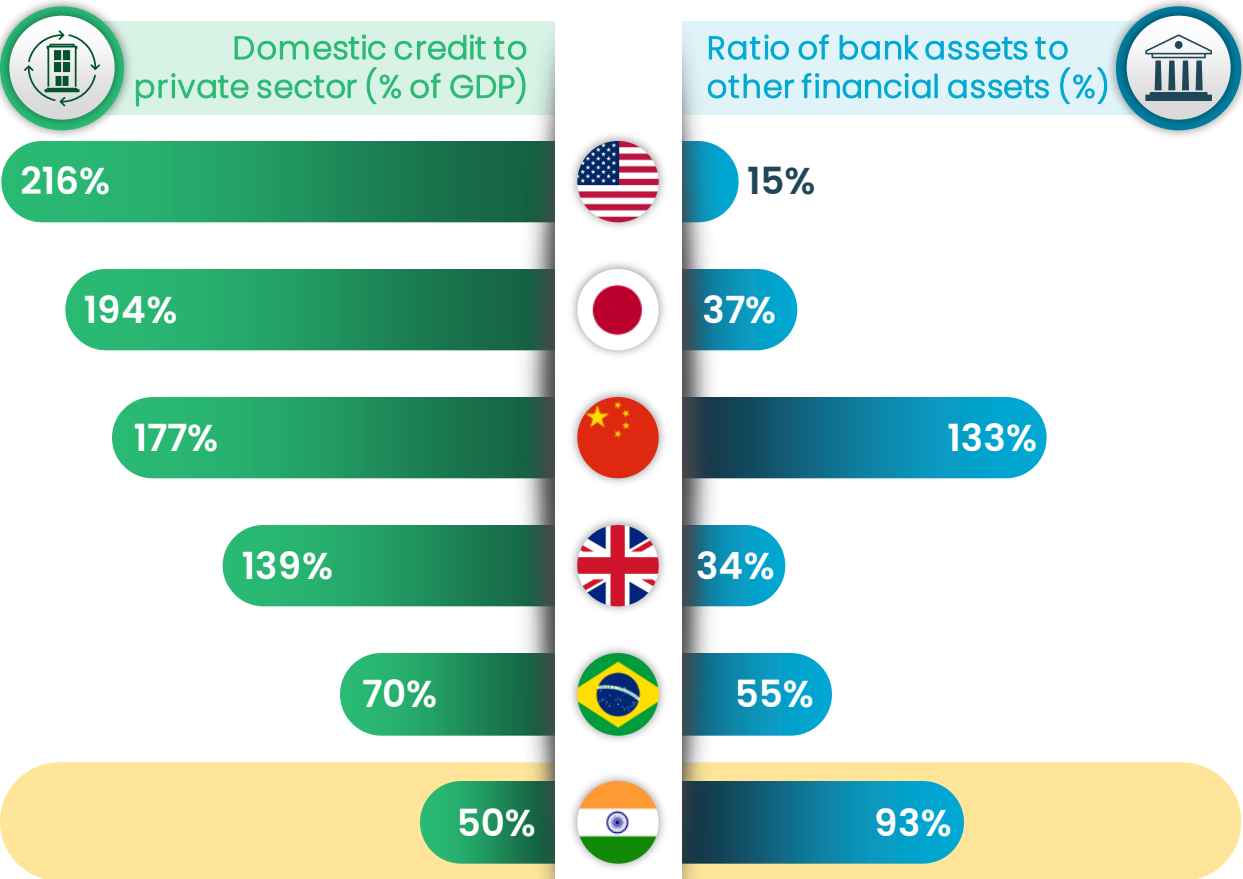
- Climate training for front-line RMs
- Physical and transition risk pricing in u/w
- ....

## Recap | Five imperatives for banks to **win in uncertain times**



# Banks will play a pivotal role in **bolstering credit growth** as India aims for a **\$30Tn economy** in 2047

Significant credit under-penetration in India, banks to play a major role in boosting credit growth



For banks to contribute to \$30Tn dream, industry and regulator should ensure:



Banks maintain healthy levels of returns on capital



Creation of multiple large banks through consolidation and up-tiering big NBFCs



Credit penetration grows persistently across retail, MSME, and corporate



An enabling regulatory environment, allowing for sustainable profitable growth

Note: Private sector includes household and non-financial corporations; Other financial assets include bonds, mutual funds, insurance and pension fund  
Source: IMF 2022; World Bank 2022; NITI Aayog Draft Vision; BCG analysis

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A dramatic photograph of an offshore oil rig structure, possibly a platform or jacket, partially obscured by a massive, turbulent wave crashing against it. The water is a deep blue, and the spray is white and frothy. The sky is a dark, deep blue. The overall mood is one of power and resilience. A large, stylized white logo is centered over the image.

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