Personal Finance

Nitin Chopra
Head, Consumer Banking (India)
ABN AMRO Bank N.V.

Nitin Chopra is the Senior Vice President and Head, Consumer Banking, ABN AMRO Bank N.V. (India). Nitin Chopra is responsible for all branch banking, consumer loans, credit cards and preferred banking businesses across the country. Earlier he was with Bank of America and ITC Classic.

There was a time not so long ago when the average middle-class Indian had to toil hard for a good number of years to acquire basic amenities like the refrigerator, a television, and a tape recorder. Owning an air-conditioner, a music system, a washing machine and a microwave oven would be a neighbors envy owner's pride kind of situation. While buying a house was a lifetime dream for almost all of the middle-class fraternity, buying the goodies on loan was a taboo for most Indians.

Fast forward to the 21st century, welcome to the Generation-next India… growing up in the thick of the information revolution, the connectivity boom, coalition politics, IT enabled everything, the rise of the service economy and where living off debt is a well-accepted norm of life. If recent statistics on consumer finance are any indication, the last few years have been trend setting. The conservative debt-averse middle-class Indian who lived a life-style within his frugal means, never to spread his feet beyond his sheet, seems to have given way to a new middle-class that is free from all inhibitions regarding conspicuous consumption. Unlike his earlier predecessor, the middle-class has donned a new outlook; he attaches no social-stigma in borrowing for his spending.

How did this paradigm shift happen? Several factors are responsible but all of them can be traced back to one word or rather two – Economic Liberalization. If one were to examine the factors one by one- The soft interest rate regime and low inflation have delivered a double booster dose to consumer spending, - they increased the cost of saving and reduced the cost of buying. There is a stated policy that the Government wants interest rates to be lowered and inflation to be kept in check.

The second key factor is the manner in which media has evolved in this country. Satellite TV and the Internet have brought the East and West much closer and today a consumer in India is quite aware of the latest trends in global markets and aspires to a similar lifestyle. Add to it the availability and choice of goods that a consumer has and you have most of the answers. All major MNC consumer goods brands now have a presence in India and some of them are even using India as a manufacturing hub for the Asian markets. Superior products, lower prices thanks to the competition, better services and most importantly backed by deep pockets to spend on advertising and sales promotion was enough to spark off consumer interest. Banks and Non-Bank Finance Companies made a beeline to capture this opportunity by enabling easy access to credit finance to customers across the socio-economic and geographical spectrum.

The National Council of Applied Economic Research reckons that the impact of consumer finance first began to be felt in 1999-00. In that year cheaper finance added to the growth in the demand for white goods- demand for financed white goods rose 23.9 per cent while the overall market grew just 18.9 per cent. In the rural markets the availability of cheap finance was an even bigger factor in growth. While rural demand for white goods grew 22.4 per cent in 1999-00, the growth of financed white goods rose a phenomenal 39.6 per cent.

The arrival of cheaper finance has completely changed buying patterns. At one level, Indians can now pay in installments for everything from automobiles to microwaves. What's more, it has enabled them to upgrade and buy costlier products. As a result of this, purchase patterns have changed significantly, and consumers are now buying higher quality goods. So sweeping and complex have been the changes in the spending volumes and pattern that the traditional classification of consumers based on income levels (lower, middle and high incomes) has lost some relevance. Incomes may still be low by international standards but the availability of cheaper consumer finance has turned large swathes of India into consumers.

While just 4.6 per cent of consumers bought what NCAER calls Category III goods like cars and colour TVs in 1985-86, by 1998-99, this rose to 10.1 per cent. Similarly, in the automobile sector, for instance, sales in the entry-level Category A class (the Maruti 800) were overtaken in 1999-00 by those in the more expensive Category B which includes slightly bigger cars like the Zen and the Santro. And last year, the fastest growth segment, albeit on a lower base, was the D segment which includes cars like the Skoda Octavia and the Toyota Corolla — sales in this category rose from 990 in 2001 to 5,600 in 2002.

There is a definite urge to splurge in the new emerging middle class. The 350- 400 odd million Indians' in the age group of 22 – 40 approach to life is very different from the 100 odd million Indian's in the age group of over 40 – 45 age group. One reason is because consumer financing means there may not be a big difference in the monthly instalments. For instance, an entry-level conventional fridge costs Rs 8,000 while a frost-free costs around Rs 14,500. However the monthly instalments on the cheaper model is around Rs 600. That's compared to Rs 900 for the more expensive fridge.

In fact, this huge potential saw the manufacturers and financiers getting together to make some very attractive offers to the consumer who was now only too willing to borrow and spend. In conjunction with the manufacturers, Banks and finance companies came up with various innovative products and services to lure the consumer- from 0% interest schemes, to 100% finance schemes to instantaneous loan approvals, all leading to a spurt in the Consumer Finance market in India.

The key asset or loan products offered under the consumer finance umbrella is broadly classified into two categories - namely 'Secured' and 'Unsecured' products and each of these categories have individual product lines within them.

The Secured Loans category includes products like Home Loans, Auto Loans, Loans against Securities, Two Wheeler finance etc.

On the Unsecured side we have products like Credit Cards, Personal Loans etc.

Banks like ours are offering customized financing solutions by offering schemes which have 'step up' and 'step down' repayment options (monthly installment increases or decreases each year) or repayments which are Front Ended (Higher Repayments at the beginning) or Back Ended (Higher Repayments towards the end). ABN AMRO Bank offers many innovative programs to prospective customers. Customers applying under the *Credit Card program*, Select *Club Membership Program*, having a satisfactory repayment history on a loan with any of the specified financiers are not required to submit any proof of income:

Innovations like these have really helped the consumer finance market to evolve at a fast clip and today the size of the consumer finance market is estimated at over Rs 70,000 crore, clocking an annual growth of over 30 percent.

With the growth in the consumer finance market, the role of risk management, measured in the form of containing delinquencies and losses in repayment of loans, has also increased. To measure and manage this risk requires an extremely skilled workforce and highly evolved credit delivery and monitoring processes. Banks in India have developed their own unique techniques to manage these risks and have been quite effective at that- banks use surrogates such as past repayment record of a previous loan, owning a credit card, etc to understand the financial credibility of an individual. Surrogate studies have helped mitigate losses to quite an extent.

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From a macro economic perspective, factors affecting the delinquencies and losses can be immense, but are also extremely product specific.

The mortgage portfolio performance will get affected by a sharp drop in real estate prices, drop in rental values for rented properties, changes in the tax laws removing exemptions for mortgage repayments. The Autoloans portfolio can get affected by the drop in re-sale values of cars, decrease in car prices, exchange rates – especially where the import components are high, taxes like sales tax, excise duty etc. Unsecured products like personal loans and credit cards can get affected by macro economic factors like employment rates, inflation, interest rates etc.

All of these are in some manner or the other associated with the business cycle. Any economic downturn or slowdown can have a telling effect on the loan portfolio.

Apart from these the financier also has to deal with operational risks like frauds, which get aggravated in our country due to the absence of adequate data on defaulters, sharing of this information among the banks, high levels of forgery in documents and slow and laborious law enforcement.

While Banks and NBFCs are doing their bit to ensure relatively low risk credit delivery, they could certainly do with some help by way of legislation to help in cases like foreclosures etc., in case of defaults. This would help lenders to keep their balance sheets in the black and play their due role in the overall growth of the Indian economy.