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Indian Banking Sector – Challenges and Opportunities

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ABSTRACT

The Financial sector, of which Banking sector is the largest player, plays a dominant role in building the economy of an individual as well as a nation. Banks have control over a large part of the supply of money in circulation. They are the main stimulus for the economic progress of a country. A strong banking and finance sector is, therefore, necessary for a country to emerge as a developed one. It is vital for growth, creation of jobs, generation of wealth, eradication of poverty, encouraging entrepreneurial activity and increasing the gross domestic product. Today banking is known as innovative banking. Information technology has given rise to new innovations in the product designing and their delivery in the banking and finance industries. Customer services and customer satisfaction are their prime work. One of the most significant areas where IT has had a positive impact is on substitutes for traditional funds movement services. With the advent of electronic banking, electronic funds transfer and other similar products, funds transfer within time frames which would have appeared impossible a few years ago has made it reality. With networking and internet connection new challenges are arising related to security privacy and confidentiality to transactions. Finally the banking sector will need to master a new business model by building management and customer services with a variety of products and controlled cost to stay in the long run and services. The paper attempts to present the emerging trends and its challenges that recently emerged in the banking sector. It will be useful to the academicians, banking and insurance personnel, financial advisors, professionals, students and researchers. Common readers will also find it informative and inculcating. Key words: Financial sector, Banking sector, E-Banking, Innovative banking, Information

Key words: Financial sector, Banking sector, E-Banking, Innovative banking, Information Technology, Electronic Fund Transfer.

1. INTRODUCTION

In this study, the author aims to consider the transformational sourcing of capital for strong banking system in the Indian economy. The paper examines the challenges faced by the Indian banking industry in the form of rural market penetration, management of risks and the role of the public and private banks, mergers, acquisition and consolidation of banks in India. A healthy banking system is essential for any economy striving to achieve good growth and yet remain stable in an increasingly global business environment.

The Indian banking system, with one of the largest banking networks in the world, has witnessed a series of reforms over the past few years like the deregulation of interest rates, dilution of the government stake in public sector banks (PSBs), and the increased participation of private sector banks. The growth of the retail financial services sector has been a key development on the market front. Indian banks (both public and private) have not only been keen to tap the domestic market but also to compete in the global market place. New foreign banks have been equally keen to gain a foothold in the Indian market. Banks must change the way they think about things; outsourcing is a

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great example of this. Traditionally, outsourcing was promoted as a way of reducing costs by transferring projects to an external service provider

2. LITERATURE REVIEW

Garg (1994) studied that Indian scheduled commercial banks have achieved remarkable progress in last two decades under study, particularly in branch expansion in rural areas, deposits mobilization and credit deployment to priority sector and small borrowers. Banking sector reforms is an integral part of the economic reform package. The reform involved the liberalization of interest rates, promotion of market-based system of credit allocation, enhancing competition, and efficiency of the regulatory and supervisory framework (Jegede et al. 2004). Financial reforms were designed to enable the banking industry develop the required resilience to support the economic development of a nation by proficiently performing its function of financial intermediation (Lemo, 2005).
Biresh (2011) examined the performance of banks in India in post transition period and concluded that the positive trend of the reform process is visible through the increase in technical efficiency over the years of the post transition period.

3. OBJECTIVES OF THE STUDY

1. To study the emerging trends of Indian banking sector
2. To study its Challenges & Opportunities.

PRESENT SCENARIO
COMMERCIAL BANKS AT A GLANCE

SL.NO	INDICATORS	2006	2007	2008	2009	2010	2011	2012	2013
1	Number of Commercial banks	222	182	173	170	167	167	173	155
	i)Scheduled Commercial Banks	218	178	169	166	163	163	169	151
2	Aggregated deposits of Schedules Commercial banks in India(Rs.Billion)	21090.49	26119.34	31969.4	38341.1	44928.26	52079.69	59090.82	67504.54
	i)Demand deposits	3646.4	4297.31	5243.1	5230.85	6456.1	6417.05	6253.3	6622.99
	ii)Time deposit	17444.09	21822.23	26726.3	33110.25	38472.16	45662.64	52837.52	60881.55
3	Bank credit of Scheduled Commercial Banks in India(Rs.Billion)	15070.77	19311.9	23619.13	27755.49	32447.88	39420.83	46118.52	52604.59
4	Credit –Deposit Ratio(per cent)	70.1	73.5	74.6	73.8	73.7	76.5	78.6	79.1
5	Investment –Deposit Ratio (%)	40	35.3	35.5	35.7	36.4	34.3	34.6	35.2
6	Cash –Deposit Ratio(%)	6.7	7.2	9.7	7.3	7.7	8.2	5.8	5.1

TABLE No 1

4. EMERGING TRENDS

1. Financial Reforms :- A reform is not a static word but indicates a journey of Banking sector. The major banking sector reforms known as Narasimham Committee-I (1991) report and the Narasimham Committee-II (1998) report in India helped to attain major changes in Indian banking sector. The reforms were aimed at to make the banking sector more competitive, versatile,

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efficient, productive to follow international started and to free from the directions and control of Government. Interest rates have been deregulated and new entrants allowed in the banking and the securities business. The Indian equity market has become world-class. New private banks have emerged that are more customer-oriented. These recommendations not only helped unleash the potential of banking in India, they are also recognised as a factor towards minimizing the impact of global financial crisis starting in 2007. Unlike the socialist-democratic era of the 1960s to 1980s, India is no longer insulated from the global economy and yet its banks survived the 2008 financial crisis relatively unscathed, a feat due in part to these Narasimham Committees.

FINANCIAL REFORMS: some measures

i. Reduction of SLR from 35.8% to 25%
ii) Reduction of CRR from 15% to 3-5% iii) Interest Rate Determination.
iii) Establishment of ARF: to get rid of bad debts.
iv) Removal of Dual control.
v) Banking Autonomy.
vi) Narrow banking.

2) Financial Crisis: Financial crisis, the second trend listed in the emerging trends of banking sector. The crisis has affected the real economy. Growth prospects of emerging economies have been affected by the financial crisis. Foreign Inflow has shown a subtraction of 61.4% in the FY 2008-09 from the last period. Even the deposit has been decreased by 1 % in the year 2008-09and cash-deposit ratio reverse a growth of 24.7%. Bank credits have been decline by 9.5% in the year 2008-09. Deposit have also affected with 7% decreased in the same year..Import Substitution resulted as the outcome of the reforms develop the belief that India need to rely on internal markets for development and not the international trade. The role of rural markets, their rising spending power and the consumption trends followed by the rural Indians are considered to be the driver of future growth of companies. And this trend of tapping rural markets is visible across all sectors now, be it FMCG, IT, Banking, education etc. For example, today, India is in better state than China because our GDP is less dependent on exports as compared to them, where maximum revenues come from exporting to the European and US markets. Thus, tapping the rural markets is most important for us to be a self sustaining economy.

3) Financial Convergence: Under financial convergence, universal banking stands a vital role whereby all financial services are made available to customers under one roof. For example, a bank, apart from its ordinary business of accepting deposits and lending money, may also offer investment banking, credit card services, or sell insurance policies. Commercial banks in India also market the mutual fund schemes. India Post sells a whole range of saving schemes, gold coins, etc. in addition to its postal services. The main advantage of Universal Banking is that it results in greater economic efficiency in the form of lower cost, higher output and better products. Many Committees and reports by Reserve Bank of India are in favour of Universal banking as it enables banks to exploit economies of scale and scope.

i). Management Performance:- The credit deposit ratio reflects the management performance of the banks. It can be seen after financial liberalization, most of the banks reported higher C-D ratio. Aggregate deposits of all Scheduled Commercial Banks (SCBs), as a percentage of GDP increased from 61% in FY07 to 67% in FY13, driven by increasing demand from retail customers. Credit to GDP increased from 45% in FY07 to 53% in FY13 indicating the improved lending of SCBs to various industries, which has enhanced trade and economic development. Deposits increased at a CAGR of 11.4% during FY09– Growth in deposits was primarily due to strong growthϒFY13 to reach USD 1, 360 billion in FY13. in current account savings account (CASA) (33% growth in

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FY13). CASA growth was strong for new private sector banks, due to their higher savings deposit rates. (IBS Report 2014)

ii). Expansion of Banking business: India‘s banking sector is currently valued at Rs. 81 trillion (US$ 1.31 trillion). It has the potential to become the fifth largest banking industry in the world by 2020 and the third largest by 2025, according to KPMG-CII report. ATMs in India have increased to 1, 45,858 in January 2014. Bank deposits have grown at a compound annual growth rate (CAGR) of 21.2 per cent over FY06–13. Total deposits in FY13 were US$ 1,274.3 billion. Total banking sector credit is anticipated to grow at a CAGR of 18.1 per cent (in terms of INR) to reach US$ 2.4 trillion by 2017. Total Earnings growth is 16% valued at 8614 bn (2012) when compared to 7416 bn for the year 2011. Net Profit has also contributed with a growth of 12.6% and valued at 912 bn in the year 2012.

4) Financial Engineering: Financial engineering,’ the next trend, is about the development and creative application of financial technology for solving financial problems, exploiting financial opportunities, and for otherwise adding value. Some of trends and examples are E-Banking, Internet Banking, Mobile &Sms Banking, ATM expansion, volumes of Debit & Credit Card, RTGS and NEFT.

i). Information Technology-Modern Banking Services: Under the regime of banking sector reforms, IT gave new dimensions to the Indian banking sector. IT has created transformation in banking structure, business process, work culture and human resource development. The new evolution in same field is E-Banking i.e. though Electronic channels, such as the telephone, the internet, the cell phone, etc. The concept and scope of E-banking is still evolving. It facilitates an effective payment and accounting system thereby enhancing the speed of delivery of banking services considerably.

ii). Mobile Banking: In recent years, the mobile banking has been reflecting a growing trend with the volume and value increasing by 108.5% (53.30 million in FY13 vis-à-vis 25.56 million in FY12) and 228.9% (USD1.1 billion in FY13 vis-à-vis USD0.2 billion in FY12), respectively. (IBS Report 2014) iii).

iii) Trends in Non-Cash Payments system: In 2013, credit, debit, and other electronic payments grew at a rate of 35 per cent from the previous year in terms of payment transactions. POS terminals shipment volumes in the country are anticipated to grow from 0.8 million units in 2013 to 1.1 million units by 2015 growing at a CAGR of 17.2 per cent. According to Niju V, Director, Automation & Electronics, Frost & Sullivan, “India is currently the 13th largest non-cash payment market in the world with a high potential to grow significantly as more merchants install POS terminals and accept card payments"(Frost & Sullivan).

5). Financial Inclusion: Financial inclusion is the process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low-income groups at an affordable cost. As per PMJDY Brouchure- Census 2011 estimated that out of 24.67 crore households in the country, 14.48 crore (58.7%) households had access to banking services. Of the 16.78 crore rural households, 9.14 crore (54.46%) were availing banking services. Of the 7.89 crore urban households, 5.34 crore (67.68%) households were availing banking services. Methodology The present study is descriptive in nature. The study is undertaken at a stretch of five (5) emerging trends of financial services in India. The paper examines the trends of 6 years from 2007- 2012 comprising of some analysis with limited coverage of years. The data used for the study is secondary in nature and has been collected from RBI (Reserve Bank of India)

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bulletin, annual reports of RBI and, Report on trend and progress of banking in India, various reputed journals, newspapers, white papers and websites of RBI & World Bank.

5. METHODOLOGY

This paper is the outcome of a secondary data on Indian Banking Sector with special reference to Indian context. To complete this, annual reports, various books, journals and periodicals have been consulted, several reports on this particular area have been considered, and internet searching has also been done.

6.ANALYSIS AND RESULTS

GROWTH OF BANKING INVESTMENT

% SHARE OF INVESTMENT	FY 2011	FY 2012
Central Government Securities	61.2	62.7
State Government Securities	16.2	16.8
Other Trustee Securities	0.3	0.2
Shares and Debentures of Joint Stock Co.	7.5	7.8
Other Investments	14.8	12.5
Total Volumes (Rs.in Bn)	3043.2	3776.8

Source: Basic Statistical Return-5, RBI

TABLE No 2

TRENDS OF IMPACT OF GLOBAL FINANCIAL CRISIS

Indicators	FY2007-08	FY 2008-2009	Source
Foreign Investment (Rs.in Bn)	$18.90	$7.3	S1
Credit –Deposit Ratio (%)	74.6	73.8	S2
Cash –Deposit Ratio (%)	9.7	7.3	S2
Deposit(Rs. In bn)	822	763	S2
Credit (Rs. In bn)	610	552	S2

TABLE No 3

S1. N.A. MUJUMDAR 2014:" GLOBAL FINANCIAL CRISIS AND HOW INDIA IS COPING WITH IT" S2.RBI REPORT.

iMOBILE BANKING

INDICATORS	2007	2008	2009	2010	2011	2012
Mobile users(per 100 pop)	202	29.5	44.1	62.4	73.1	69.9
Internet Users(per 100 pop)	3.95	4.38	5.12	7.5	10	12.6
Gross capital formation (%of GDP)	38	35.5	36.3	36.5	36.4	34.7
GDP growth (%)	9.8	3.9	8.5	10.3	6.6	4.7

Source :Basic Statistical Return-5, RBI.

TABLE No 4

MODERN BANKING

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YEAR	DEPOSIT RS.IN BN	GROWTH %	CREDIT RS. IN BN	GROWTH %
2007	665	35.99	495	40.63
2008	822	23.61	610	23.23
2009	763	7.18	552	9.51
2010	1030	34.99	742	34.42
2011	1182	14376	896	20.75
2012	1170	1.02	916	2.23

TABLE No 5

OUTSTANDING CREDIT

OUTSTANDING CREDIT OF SCBS FY 2012	
Occupations	% share
Personal loan	15.6
Agriculture	11.7
Other	3.9
Trade	9.8
Industry	40.4
Professional & Other services	7.6
Transport	2.5
Finance	8.5

Source: World Development Indicators

TABLE No 6

7. CHALLENGES AND OPPORTUNITIES

The Indian banking sector continues to face some structural challenges. We have a relatively large number of banks, some of which are sub-optimal in size and scale of operations. On the regulatory front, alignment with global developments in banking supervision is a focus area for both regulators and banks. The new international capital norms require a high level of sophistication in risk management, information systems, and technology which would pose a challenge for many participants in the Indian banking sector. The deep and often painful process of restructuring in the Indian economy and Indian industry has resulted in asset quality issues for the banking sector; while significant progress is being made in this area, a great deal of work towards resolution of these legacy issues still needs to be done. The Indian banking sector is thus at an exciting point in its evolution. The opportunities are immense – to enter new businesses and new markets, to develop new ways of working, to improve efficiency, and to deliver higher levels of customer service. The process of change and restructuring that must be undergone to capitalize on these opportunities poses a challenge for many banks.

The Indian banking sector is faced with multiple and concurrent challenges such as increased competition, rising customer expectations, and diminishing customer loyalty. The banking industry is also changing at a phenomenal speed. While at the one end, we have millions of savers and investors who still do not use a bank, another segment continues to bank with a physical branch and at the other end of the spectrum, the customers are becoming familiar with ATMs, e-banking, and cashless economy. This shows the immense potential for market expansion. The exponential growth for the industry comes from being able to handle as wide a range of this spectrum as

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possible. In this complex and fast changing environment, the only sustainable competitive advantage is to give the customer an optimum blend of technology and traditional service. As banks develop their strategies for giving customers access to their accounts through various advanced services like e banking, mobile banking and net banking, they should also regard this emerging platform as a potential catalyst for generating operational efficiencies and as a vehicle for new revenue sources. Banking industry‘s opportunities includes

- Agrowingeconomy
- Banking deregulation
- Increased client borrowing
- An increase in the number of banks
- Anincrease inthemoneysupply
- Low government-set credit rates and

Larger customer checking account balances. Developing countries like India, has a huge number of people who don‘t have access to banking services due to scattered and fragmented locations. But if we talk about those people who are availing banking services, their expectations are raising as the level of services are increasing due to the emergence of Information Technology and immense competition between the services and products provided by different banks. Since, foreign banks are playing in Indian market, the number of services of offered has increased and banks have laid emphasis on meeting the customer expectations. India's banking sector has made rapid strides in reforming and aligning itself to the new competitive business environment. The major challenges faced by banks today are as to how to cope with competitive forces and strengthen their balance sheet. Today, banks are groaning with burden of NPA‘s. It is rightly felt that these contaminated debts, if not recovered, will eat into the very vitals of thebanks.

INDIAN CONSUMER

The biggest opportunity for the Indian banking system today is the Indian consumer. Demographic shifts in terms of income levels and cultural shifts in terms of lifestyle aspirations are changing the profile of the Indian consumer. This is and will be a key driver of economic growth going forward. The Indian consumer now seeks to fulfil his lifestyle aspirations at a younger age with an optimal combination of equity and debt to finance consumption and asset creation. This is leading to a growing demand for competitive, sophisticated retail banking services. The consumer represents a market for a wide range of products and services – he needs a mortgage to finance his house; an auto loan for his car; a credit card for on-going purchases; a bank account; a long-term investment plan to finance his child‘s higher education; a pension plan for his retirement; a life insurance policy – the possibilities are endless. And, this consumer does not live just in India‘s top ten cities. He is present across cities, towns, and villages as improving communications increases awareness even in small Indian Banking Sector – Challenges and Opportunities www.iosrjournals.org 59 | Page towns and rural areas. Consumer goods companies are already tapping this potential – it is for the banks to make the most of the opportunity to deliver solutions to this market.

REVOLUTION OF INFORMATION TECHNOLOGY

Technology is the key to servicing all customer segments – offering convenience to the retail customer and operating efficiencies to corporate and government clients. The increasing sophistication, flexibility, and complexity of product and servicing offerings makes the effective use of technology critical for managing the risks associated with the business. Developing or acquiring the right technology, deploying it optimally, and then leveraging it to the maximum

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extent is essential to achieve and maintain high service and efficiency standards while remaining cost-effective and delivering sustainable returns to shareholders. Early adopters of technology acquire significant competitive advantage. Managing technology is, therefore, a key challenge for the Indian banking sector. Wide disparities exist between various banks as far as technology capabilities are concerned; the sector as a whole needs to make significant progress on this front. Banks may have to go for mobile banking services for a cluster of villages. Alternatively, technological institutions have to come out with low-cost, self-service solutions/ ATMs. The government and the RBI should actively support such research efforts. Here, it is worthwhile to mention that the adaptability of the Indian rural population to high-tech devices is one of the fastest in the world. A wider dissemination of information on technologies and products to the Indian banking industry by the research institutions could benefit the banking institutions. This cross-pollination of ideas would mutually enrich the banking and the technology development processes. The Indian banks are subject to tremendous pressures to perform otherwise their very survival would be at stake.

INDUSTRIAL DEVELOPMENT

The developments in Indian industry and government and the integration of India with the global markets also offer innumerable opportunities to the banking sector. Companies and governments are increasingly seeking high-quality banking services to improve their own operating efficiency. Companies seek to offer better customer service and maximize shareholder returns and governments seek to improve the quality of public services. The internationalization of India offers banks the opportunity to service cross-border needs of Indian companies and India-linked needs of multinationals.

KNOWLEDGE SOCIETY

Building knowledge-driven, learning organizations is important in the current scenario of rapidly evolving operating environments. Knowledge and assimilation of new ideas and trends are essential to keep the organization ahead on the curve. This is true for banking as it is for all other sectors. Banks must continuously seek to be aware of cutting edge practices in banking internationally and institutionalize this learning across the organization. This will prepare them for the future as Indian markets become more sophisticated and integrated into the global financial markets. Another critical area for the Indian banking sector is people. The ability to attract and retain talent is a key success factor for a people-oriented business like banking. Banks have to build organizations that are process driven yet innovative, stable yet flexible, and responsive to change.

INTENSE COMPETITION

The RBI and Government of India kept banking industry open for the participants of private sector banks and foreign banks. The foreign banks were also permitted to set up shop on India either as branches or as subsidiaries. Due to this lowered entry barriers many new players have entered the market such as private banks, foreign banks, nonbanking finance companies, etc. The foreign banks and new private sector banks have spearhead the hi-tech revolution. For survival and growth in highly competitive environment banks have to follow the prompt and efficient customer service, which calls for appropriate customer centric policies and customer friendly procedures.

EMPLOYEES' RETENTION

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The banking industry has transformed rapidly in the last ten years, shifting from transactional and customer service-oriented to an increasingly aggressive environment, where competition for revenue is on top priority. Long-time banking employees are becoming disenchanted with the industry and are often resistant to perform up to new expectations. The diminishing employee morale results in decreased revenue. Due to the intrinsically close ties between staff and clients, losing those employees completely can mean the loss of valuable customer relationships. There tail banking industry is concerned about employee retention from all levels: from tellers to executives to customer service representatives because competition is always moving in to hire them away.

FINANCIAL INCLUSION

Financial inclusion has become a necessity in today‘s business environment. Whatever is produced by business houses that have to be under the check from various perspectives like environmental concerns, corporate governance, social and ethical issues. Apart from it to bridge the gap between rich and poor, the poor people of the country should be given proper attention to improve their economic condition. In India, RBI has initiated several measures to achieve greater financial inclusion, such as facilitating no-frills accounts and GCCs for small deposits and credit.

RURAL MARKET

Banking in India is generally fairly mature in terms of supply, product range and reach, even though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. Consequently, we have seen some examples of inorganic growth strategy adopted by some nationalized and private sector banks to face upcoming challenges in banking industry of India. For example recently, ICICI Bank Ltd. merged the Bank of Rajasthan Ltd. in order to increase its reach in rural market and market share significantly. State Bank of India (SBI), the largest public sector bank in India has also adopted the same strategy to retain its position. It is in the process of acquiring its associates. Recently, SBI has merged State Bank of Indore in 2010.

HIGH TRANSACTION COSTS

A major concern before the banking industry is the high transaction cost of carrying non-performing assets in their books. The growth led to strains in the operational efficiency of banks and the accumulation of non-performing assets (NPA‘s) in their loan portfolios.

SOCIAL AND ETHICAL ASPECTS

There are some banks, which proactively undertake the responsibility to bear the social and ethical aspects of banking. This is a challenge for commercial banks to consider these aspects in their working. Apart from profit maximization, commercial banks are supposed to support those organizations, which have some social concerns.

TIMELY TECHNOLOGICAL UP GRADATION

Already electronic transfers, clearings, settlements have reduced translation times. To face competition it is necessary for banks to absorb the technology and upgrade their services. Global banking The impact of globalization becomes challenges for the domestic enterprises as they are bound to compete with global players. If we look at the Indian Banking Industry, then we find that

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there are 36 foreign banks operating in India, which becomes a major challenge for Nationalized and private sector banks.

8. SUGGESTIONS

As per the above discussion, we can say that the biggest challenge for banking industry is to serve the mass market of India. Companies have shifted their focus from product to customer. The better we understand our customers, the more successful we will be in meeting their needs. In order to mitigate above mentioned challenges Indian banks must cut their cost of their services. Another aspect to encounter the challenges is product differentiation. Apart from traditional banking services, Indian banks must adopt some product innovation so that they can compete in gamut of competition. Technology up gradation is an inevitable aspect to face challenges. The level of consumer awareness is significantly higher as compared to previous years. Now- days they need internet banking, mobile banking and ATM services. Expansion of branch size in order to increase market share is another tool to combat competitors. Therefore, Indian nationalized and private sector banks must spread their wings towards global markets as some of them have already done it. Indian banks are trustworthy brands in Indian market; therefore, these banks must utilize their brand equity as it is a valuable asset for them.

9. CONCLUSION

Over the years, it has been observed that clouds of trepidation and drops of growth are two important phenomena of market, which frequently changes in different sets of conditions. The pre and post liberalization era has witnessed various environmental changes which directly affects the aforesaid phenomena. It is evident that post liberalization era has spread new colors of growth in India, but simultaneously it has also posed some challenges. This article discusses the various challenges and opportunities like rural market, transparency, customer expectations, management of risks, and growth in banking sector, human factor, global banking, environmental concern, social, ethical issues, and employee and customer retentions. Banks are striving to combat the competition. The competition from global banks and technological innovation has compelled the banks to rethink their policies and strategies.

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