BANKING SECTOR IN INDIA: PERSPECTIVES AND PROSPECTS

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ABSTRACT
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 an industry report. The face of Indian banking has changed over the years. Banking industry in India has also achieved a new height with the changing time of global banking. The use of technology has brought a revolution in the working style of the banks. In this paper an attempt has been made to identify the general sentiments, challenges and opportunities for the Indian Banking Industry. This article is divided in to three major segments. The first segment includes the introduction and general perspective of Indian banking industry. The second discusses the various growth drivers of Indian banking industry and the last segment threw light upon various challenges and prospects. the author concludes that Indian banking sector, reeling under asset quality pressures, will continue to see difficult times in 2014 due to the weak macro environment, rating agency Fitch has said therefore urgent emphasis is required on the Indian banking product and marketing strategies in order to retain customers and get sustainable competitive edge over the intense competition from national and global banks.

KEYWORDS: Global Banking, Customer Retention, Asset Quality Pressure, Macro Economic Environment, Marketing Strategies.

INTRODUCTION
The Banking industry plays a dynamic role in the economic development of a country. The growth story of an economy depends on the robustness of its banking industry. Banks act as the store as well as the power house of the country’s wealth. They accept deposits from individuals & corporates and lend to the business sector. They use the deposits collected for productive purposes which help in the capital formation in the country.

The Indian banking industry has evolved and transformed itself from a socialist licensed raj business to a liberalized, modernized & technology oriented white elephant of India. Banking industry is the backbone for any economy & is the key indicator to see & analyze the level of development of a country. The banking sector of India has an annual growth rate of 23
percent, contributing nearly 6 percent of GDP & employing nearly 7.4 million people & has outperformed most banking indices in the world with highest total returns to shareholders at 36.76%. The Indian banks even braved the subprime crises that rocked the global financial sector in 2008. The Indian banks ability to protect asset health through prudent lending helped them emerge from this crisis unscathed. The Indian banking sector has a large market still unexplored with the Indian households being one of the highest savers in the world accounting for 69% of India gross national saving of which only 47% is accessed by the banks. The tempo of development for the Indian banking industry has been remarkable over the past decade. It is evident from the higher pace of credit expansion; expanding profitability and productivity similar to banks in developed markets, lower incidence of non-performing assets and focus on financial inclusion have contributed to making Indian banking vibrant and strong. Indian banks have begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling.

PRESENT PERSPECTIVE
The general banking scenario in India has become very dynamic now-a-days. Before pre-liberalization era, the picture of Indian Banking was completely different as the Government of India initiated measures to play an active role in the economic life of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. In the early 1990s, the Narasimha Rao government introduced a policy of liberalization, licensing a small number of private banks. The next stage for the Indian banking has been set up with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions. The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India.

The banking sector has witnessed a rapid growth in India in the past few decades and has come a long way. The major players in Indian banking sector can be categorized as follows:
Major Players in Indian Banking Sector

<table>
<thead>
<tr>
<th>Type of Commercial Banks</th>
<th>Major Shareholders</th>
<th>Major Players</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Banks</td>
<td>Government of India</td>
<td>SBI, PNB, Canara Bank, Bank of Baroda, Bank of India, etc.</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>Private Individuals</td>
<td>ICICI Bank, HDFC Bank, Axis Bank, Kotak Mahindra Bank, Yes Bank etc.</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>Foreign Entity</td>
<td>Standard Chartered Bank, Citibank, HSBC, Deutsche Bank, BNP Paribas, etc.</td>
</tr>
<tr>
<td>Regional Rural Banks</td>
<td>Central Govt., Concerned St. Govt and Sponsor Bank in the ratio of 50:15:35</td>
<td>Andhra Pradesh Grameena Vikas Bank, Uttarakhand Gramin Bank, Prathama Bank, etc.</td>
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Competitive Landscape of Banks in India:
Banking in India is moderately consolidated, with the top 10 players accounting for approximately 60 per cent of the total industry. The Indian banking sector is majorly dominated by public sector banks. Figure 5 describes the market shares of the leading players (based on total credit portfolio), along with the respective shares of government, private and foreign banks.

Source: ICRA, ThomasWhite Report on Indian Banking
The competitive scenario in India is strong, with the landscape primarily dominated by government banks. Market entry at the country level is expected to be tough for new players due to the moderately consolidated nature of the industry and extremely high competition. The key challenges for the industry are to reduce NPAs, increase financial inclusion and raise capital for the Basel III compliance.

**INDIAN BANKING SECTOR: FUTURE OUTLOOK**

During the past few years, the Indian banking sector has demonstrated a very high level of resiliency in the face of high domestic inflation, rupee depreciation and fiscal uncertainty in the US and Europe. In order to stimulate the economy and support the growth of banking sector, the Reserve Bank of India (RBI) adopted severe policy measures such as increasing the key monetary policy rates. Amidst this economic scenario, the key challenge for the Indian banking system continues in improving their operational efficiency and implement prudent risk management practices.

High interest rates, subdued industrial production and domestic consumption impacted the growth of the Indian economy which slowed down from 8.4% in FY11 to 6.5% during FY12. The scheduled commercial banks’ (SCBs) overall credit grew at a slower pace during FY12 at 17% y-o-y as compared to 21.5% registered during FY11. As per the recent RBI data, the non-food bank credit increased by 15.5% in Oct 2012 over its corresponding month previous year, as compared to 18.2% witnessed in Oct 2011 over its corresponding month previous year. Similarly, credit to industry and services sector recorded a slower growth of 15.2% and 13.7% respectively as against 23.1% and 18.4% during the same period. As per RBI's second quarter review of monetary policy for FY13, the GDP growth estimates for FY13 is revised downwards from 6.5% forecasted earlier to 5.8%. Any further slowdown in the Indian economic growth is likely to impact the demand for bank credit.

**Changes in Key Policy Rates:**

Inflation continued to remain sticky and much above the RBI's comfort zone through-out the year. In fact headline inflation as measured by WPI remained above 7.5% from Feb to Oct 2012. As a result the RBI has kept the repo rate at an elevated level, reducing it by 50 basis points only once during 2012, in April-12 to support growth.

However, in order to support the flow of funds to the productive sectors of the economy and ease the liquidity crunch in the banking system the RBI has cut the CRR by 175 basis points.
during the course of the year which stands at 4.25%, as on Nov 2012. Given the easing of international commodity prices, particularly of crude, decline in core inflation as demand conditions moderate, there has been some steady moderation in inflation in the recent period. As a result RBI may decide to ease the policy rates during 2014.

**Strict Monitoring of Asset Quality:**
During the financial year 2012-13 asset quality of banks was severely impaired, as revealed by the steep increase in non-performing assets (NPAs) of SCBs, particularly for public sector banks (PSBs) owing to their significant exposure to troubled sectors such as power, aviation, real estate and telecom. There was a significant increase noted in the NPA levels during FY12. Gross NPAs value recorded a y-o-y growth of 45.3% and net NPAs registered a y-o-y growth of 55.6% during FY12. As per RBI, this increase was due to inadequate credit appraisal process coupled with unfavorable economic situation in the domestic as well as foreign market.

Apart from increase in NPAs, the weakening asset quality trend was also apparent from the significant increase in restructured assets. Restructured standard advances of the SCBs, recorded a y-o-y growth of around 58.5% during FY12 and the ratio of restructured standard advances to gross advances also increased from about 3.5% in FY11 to 4.7% in FY12. As per the recent data available with CDR cell as on Sep 2012, a total of 466 cases have been referred to the cell, with 327 cases amounting to Rs. 1,873.9 bn have been approved since the start of CDR mechanism. Of the total cases referred, 64 cases corresponding to Rs. 311.2 bn were under finalisation of restructuring packages as on Sep 2012 as compared to 34 cases amounting to Rs. 264.5 bn as on Sep 2011.

The slowdown in the economy increases in the risk of default and restructuring of loans can increase which could further lead to deterioration of asset quality. However, implementation of stringent policies could prevent a sharp deterioration in asset quality.

**Emphasis on Fee-Based and NII services:**
Conventionally banks have derived limited income from fee based services such as wealth management, credit card services, treasury services, investment banking and advisory services. However, as the economy is showing signs of slowdown and the demand for credit is slowed banks are struggling to keep their margins intact. Also, with changing times, consumer needs have changed with various avenues of investment available. This is likely to
increase banks focus on offering fee based services as the earnings from such services are more stable than interest bearing products and it also helps in mitigating risk via diversification of products and services.

Financial Inclusion:
As per census 2011, most part of population is still unbanked in India. Only 59 per cent households are utilizing banking services. The remaining 40 percent people belong to either rural areas or low income earners having financial illiteracy. Thus, in recent years, the RBI and Gol have increased its focus on providing formal banking/financial services to the huge unbanked population. It is encouraging banks to develop low cost goods and services designed to suit the requirements of this group of population.

RBI has undertaken several policy initiatives to promote financial inclusion, such as encouraging opening of no-frills accounts, engaging intermediaries to provide financial and banking services. In the course of action, there has been increase in number of no-frill accounts from 50.3 mn in FY10 to 105.5 mn in FY12, registering a CAGR of 44.8% during this period. Similarly, the number of business correspondent (BC) agents also noted a CAGR of 70.2% during the same period.

RBI also advised banks to allocate minimum 25% of the total new branches in unbanked rural centres during a year. In the process, the number of banking outlets in villages with population above 2,000 and less than 2,000 also witnessed a CAGR of 73.5% and 55.7% during FY10 to FY12.

Further, in India there are several micro-finance institutions (MFIs) and self-help groups (SHGs) which lend credit to the LIG. This is expected to play a significant role in achieving financial inclusion by extending credit to the LIG.

E-Banking:
With the adoption of technology, the Indian banking sector has undergone significant transformation from local branch banking to anywhere-anytime banking. Over the past couple of years, there has been huge growth registered in the number of transactions done through mobile devices. As per RBI, there were 49 banks with a customer base of about 13 mn offering mobile banking services as at the end of Mar 2012. During FY12, around 25.6 mn mobile banking transactions valued at Rs. 18.2 bn were transacted, recording a growth of 198% y-o-y and 174% y-o-y respectively. This rapid growth is driven by availability of
3G/4G network, increasing number of smart phones and several telecom companies offering economical data usage packages.

In order to encourage cashless transactions, particularly for small value transactions, the RBI raised the cap on mobile banking without end-to-end encryption from Rs. 1,000 to Rs. 5,000. Further, the transaction limit of Rs. 50,000 per customer per day was removed, by permitting banks to fix the transaction limits based on their own risk perception. In the near term, it is expected to emerge as one of the most preferred medium for banking transactions.

**Expansion in Overseas Market:**
In order to uphold the business growth among highly competitive market, banks are likely to expand in the overseas market. They will try to tap emerging opportunities by expanding into newer markets such as Africa, former Soviet region and other South East Asian countries, in which India has maintained good trade relations. They can set up captive operations or expand through inorganic means by undergoing M&A with banks in foreign countries. However, high capital cost for setting up foreign operations can act a deterrent in the way of expansion.

**Entry of New Players in the Sector:**
In Aug 2011, the RBI drafted guidelines for licensing of new banks in the private sector. Thus, with the entry of new players in the market, competition among banks will increase. This is expected to benefit the consumers in the long-run as with increased competition banks will adopt fresh strategies to retain and attract customers and protect their market share. For instance, increasingly banks are tying up with insurance companies to sell insurance products. In this business model, both bank and insurance companies share the commission. Further, with the deregulation of savings rate in Oct 2011, competition among banks has already intensified.

**Attraction of Foreign Investors:**
He proposal of raising voting rights from 1 percent to 10 percent 1 to private investors in Public Sector Banks, has paved the way for more investments in Public Banks by Foreign Institutional Investors (FIIs), who have been sitting on the sidelines so far in respect to investing in these banks. Similarly, the proposal to increase voting rights from 10 percent to
26 percent for the investors in Private Banks not only increases FIIs interest but also gives them better say in the management decisions. On 18th Dec 2012, the BSE benchmark closed 111 points higher on continued buying of banking stocks after the Banking laws (Amendment) Bill was cleared by the Lok Sabha. The BSE Bankex index had outperformed the market over the past one month till 18 December 2012, surging 9.99 percent compared with the Sensex's 5.76 percent rise. FIIs bought shares worth a net Rs 922.37 crore on the same day, as per provisional data from the stock exchanges (BSE, NSE).

KEY CHALLENGES

- **Introduction of Basel III Norms**
  - Indian Banks will have to bring in an additional capital of Rs 5 Lakhs Crore to meet the Basel III norms. The government on its part has to infuse Rs. 90,000 crore into the state-run banks to maintain majority shareholding under Basel III.
  - Basel III norms will be implemented in a phased manner starting from January 2013 (now pushed to April 2013), to be implemented to the fullest by March 2018.

- **Intensifying Competition**
  - High competition due to a large number of players in the banking industry and other players such as NBFCs (less regulation).
  - Such competition in the industry has decreased the market share of the existing banks.

- **Increasing NPA**
  - Economic slow down and aggressive lending by the banks has turned loans into non-performing assets.
  - This has impacted the profitability of the banks as they are required to have higher provisioning amounts.

- **Licensing Requirement**
  - For commencing a banking business in India, a banking license from the RBI has to be acquired which has served as a associated protocol and formalities.
  - The last licenses issued were to Kotak Mahindra Bank and Yes Bank in 2003 and 2004 respectively (as Kotak Mahindra Bank was earlier a NBFC).

- **Managing Human Resources**
  - Banks have to incur substantial employee costs as the attrition of the employees in this sector is very high.

**Source:** Dinodiacapital.com

6. 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, 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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