Changing Contours of Banking in India

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Abstract
In the age of competition banking industry is facing increasing competition form not only private banks and International markets. The assumption is made or it is expected that the operational structure of banking in India will be changed in the near future due to the emergence of new private banks. The private banks are more enriched and diversified in spreading the wholesale as well as retail banking. The speedy expansion and diversification of private sector banks has led new challenges in front of the banking sector. Banking sector is coming with new strategies and policies to cope with the changing environment to face the competition. The existing banks getting the benefits of their wide branch network and geographic spread whereas new emerging private banks have the massive capital, lean personnel components expertise to develop financial product and use of state of the act technology. It has become very difficult to maintain balance between efficiency and stability as the banking institutions are increasing in present corporate environment. Banking institutions becoming complex under the impact of deregulation, innovation and technological up gradation. During the last 30 years, since nationalisation tremendous changes have been seen in the financial markets as well as in the banking industry due to the financial sector reform. Now the banks are not more functioning on their traditional functions but

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they are innovating improving and coming out with the new types of services to full fit the emerging need of their customers. This paper explains the developments in the banking sector, significance of banking sector, new reforms, challenges faced by banking sector.

Keywords: Banking system, reforms, Financial Innovations, Technology.

Introduction

Indian banks can confidently compete with modern banks of the world. Before the 20th century, usury, or lending money at a high rate of interest, was widely prevalent in rural India. Entry of Joint stock banks and development of Cooperative movement have taken over a good deal of business from the hands of the Indian money lender, who although still exist, have lost his menacing teeth. In Indian Banking System, Cooperative banks exist side by side with commercial banks and play a supplementary role in providing need-based finance, especially for agricultural and agriculture-based operations including farming, cattle, milk, hatchery, personal finance etc. along with some small industries and self-employment driven activities. Banks have been given greater freedom to frame their own policies. Rapid advancement of technology has contributed to significant reduction in transaction costs, facilitated greater diversification of portfolio and improvements in credit delivery of banks. Prudential norms, in line with international standards, have been put in place for promoting and enhancing the efficiency of banks. The process of institution building has been strengthened with several measures in the areas of debt recovery, asset reconstruction and securitisation, consolidation, convergence, mass banking etc. Gradual deregulation that is being ushered in while stimulating the competition would also facilitate forging mutually beneficial relationships, which would ultimately enhance the quality and content of banking. In the final phase, the banking system in India will give a good account
of itself only with the combined efforts of cooperative banks, regional rural banks and development banking institutions which are expected to provide an adequate number of effective retail outlets to meet the emerging socio-economic challenges during the next two decades. The electronic age has also affected the banking system, leading to very fast electronic fund transfer. However, the development of electronic banking has also led to new areas of risk such as data security and integrity requiring new techniques of risk management.

Review of Literature

Utkarsh Tiwari, (2013) explained that banking sector has become an emerging sector in India, their services are affecting to the human life and their life style. Traditionally banks were providing only saving facility to the public and there were less number of banks is available, now scenario has been changed, there are 171 banks which are working in India, in which some are public sector banks and some are private sector banks. Earlier the banks worked only for urban side of the country, but now they are focusing on the rural side, they are providing much facility for upliftment of their life style and their economic conditions, and it’s happening, how the villagers are producing the crops and they have no fear of money lender, who were made fool them, but a part of these we cannot ignore the technological challenges for every sector, and banking sector are also facing the great challenges.

Seema Malik (2014) stated that Indian banking system touches the lives of millions of people and it is growing at a fast pace. Banking industry in India is facing number of challenges like changing needs and perceptions of customers, new regulations from time to time and great advances in technologies. The pressure of meeting these challenges have compelled banks to change the old
ways of doing business. The research paper focuses on how the technology has transformed the face of banking in India. India’s banking system has seen some major financial innovations in the past decades which lead to tremendous improvements in banking services and operations. The various innovations in banking and financial sector are ECS, RTGS, EFT, NEFT, ATM, Retail banking, Debit and Credit cards, free advisory services, online banking, mobile banking and many more value added products and services.

**Objectives of the Study**

1. To study the current scenario in banking sector.
2. To study Challenges and Opportunities before the banking sector.
3. To study changing face of Indian Banking.
4. To study the new technologies used in banking sector.

**Significance of the Study**

The banking industry is suffering from major changes due to the entrance of large number of private sector banks as well as due to the expansion of financial market. These changes happening in series has have ripple effect on banking industry which is trying to be organised completely. Due to the increased competition profits of the banks are been affected. This study will be helpful to understand the new technologies and policies that can be adopted by banking sector and also to find new challenges and opportunities that are faced by banking sector.

**Current Scenario**

The industry is currently in a transition phase. On the one hand, the PSBs, which are the mainstay of the Indian Banking system are in the process of shedding their flab in terms of excessive manpower, excessive non-Performing Assets and excessive governmental equity, while on the other hand the private sector banks are consolidating themselves through mergers and acquisitions. PSBs,
which currently account for more than 78 percent of total banking industry assets are saddled with NPAs, falling revenues from traditional sources, lack of modern technology and a massive workforce while the new private sector banks are forging ahead and rewriting the traditional banking business model by way of their sheer innovation and service. The PSBs are of course currently working out challenging strategies even as 20 percent of their massive employee strength has dwindled in the wake of the successful Voluntary Retirement Schemes (VRS).

The private players however cannot match the PSB’s reach, size and access to low cost deposits. So, one of the means for them to combat the PSBs has been through the merger and acquisition (M&A) route. Over the last two years, the industry has witnessed several such instances. For Instance, HDFC Bank’s merger with Times Bank ICICI Bank’s acquisition of ITC Classic, Anagram Finance and Bank of Madura. Centurion Bank, INDUSIND Bank, Bank of Punjab, VYSYA Bank are said to be on the lookout. The UTI bank- Global Trust Bank merger however opened a PANDORA’S box and brought about the realisation that all was not well in the functioning of many of the private sector banks.

Private sector banks have pioneered internet banking, phone banking, anywhere banking, mobile banking, debit cards, Automatic Teller Machines (ATMs) and combined various other services and integrated them into the mainstream banking arena, while the PSBs are still grappling with disgruntled employees in the aftermath of successful VRS schemes. Also, following India’s commitment to the WTo agreement in respect of the services sector, foreign banks, including both new and the existing ones, have been permitted to open up to 12 branches a year with effect from 1998-99 as against the earlier stipulation of 8 branches.
Government diluting their equity from 51 percent to 33 percent in November 2000 has also opened up a new opportunity for the takeover of even the PSBs. The FDI rules being more rationalised in Q1FY02 may also pave the way for foreign banks taking the M& A route to acquire willing Indian partners. Meanwhile the economic and corporate sector slowdown has led to an increasing number of banks focusing on the retail segment. Many of them are also entering the new vistas of Insurance. Banks with their phenomenal reach and a regular interface with the retail investor are the best placed to enter into the insurance sector. Banks in India have been allowed to provide fee-based insurance services without risk participation invest in an insurance company for providing infrastructure and services support and set up of a separate joint venture insurance company with risk participation.

**Global Scenario and Indian Banking**

Since the Lehman Brothers declared bankruptcy in 2008, incidences, every now & then, have sustained the concerns over global financial stability. While most emerging market economies (EMEs), including India, have recovered from global financial crisis, advanced countries continue to be plagued with growth figures looking dismal. Euro zone crisis seems to be spreading across the EU countries following ripple effect, political turmoil persists in Middle East & North African (MENA) region, economic stagnation in US augurs no imminent respite from the worsening global situation. Indian banks, however, not only emerged unscathed from the global financial crisis but continued to manage growth with resilience during 2010-11. Presently, domestic demand stays constrained on account of slower pace of growth & high level of commodity prices but favourable demographics and growth potential of Indian economy are expected to mitigate the dampening effect in the long run. As per Census 2011, about 40 % of households still do not avail banking facilities. Banks with their
forward looking strategies, improved customer relationship, diversification of revenue sources etc. are expected to continue their impressive performance.

**Governmental Policy**

After the first phase and second phase of financial reforms, in the 1980s commercial banks began to function in a highly regulated environment, with administered interest rate structure, quantitative restrictions on credit flows, high reserve requirements and reservation of a significant proportion of lendable resources for the priority and the government sectors. The restrictive regulatory norms led to the credit rationing for the private sector and the interest rate controls led to the unproductive use of credit and low levels of investment and growth. The resultant ‘financial repression’ led to decline in productivity and efficiency and erosion of profitability of the banking sector in general. This was when the need to develop a sound commercial banking system was felt. This was worked out mainly with the help of the recommendations of the Committee on the Financial System, 1991. The resultant financial sector reforms called for interest rate flexibility for banks, reduction in reserve requirements, and a number of structural measures. Interest rates have thus been steadily deregulated in the past few years with banks being free to fix their Prime Lending Rates (PLRs) and deposit rates for most banking products. Credit market reforms included introduction of new instruments of credit, changes in the credit delivery system and integration of functional roles of diverse players, such as, banks, financial institutions and non-banking financial companies (NBFC’S). Domestic Private Sector Banks were allowed to be set up, PSBs were allowed to access the markets to shore up their Cars.

**Technology in Banking**
1. Technology will bring fundamental shift in the functioning of banks. It has not only helped them bring improvements in their internal functioning but also enable them to provide better customer service. Technology will break all boundaries and encourage cross border banking business. Banks would have to undertake extensive Business Process Re-Engineering and tackle issues like (a) how best to deliver products and services to customers (b) designing an appropriate organisational model to fully capture the benefits of technology and business process changes brought about. (c) How to exploit technology for deriving economies of scale and how to create cost efficiencies, and (d) how to create a customer-centric operation model.

2. Entry of ATMs has changed the profile of front offices in bank branches. Customers no longer need to visit branches for their day to day banking transactions like cash deposits, withdrawals, cheque collection, balance enquiry etc. E-banking and Internet banking have opened new avenues in “convenience banking”. Internet banking has also led to reduction in transaction costs for banks to about a tenth of branch banking.

3. Technology solutions would make flow of information much faster, more accurate and enable quicker analysis of data received. This would make the decision making process faster and more efficient. For the Banks, this would also enable development of appraisal and monitoring tools which would make credit management much more effective. The result would be a definite reduction in transaction costs, the benefits of which would be shared between banks and customers.

4. While application of technology would help banks reduce their operating costs in the long run, the initial investments would be sizeable. IT spent by banking and financial services industry in USA is approximately 7% of the revenue as against around 1% by Indian Banks.
5. One area where the banking system can reduce the investment costs in technology applications is by sharing of facilities. Similarly, in the coming years, banks and FIs coming together to share facilities in the area of payment and settlement, back office processing, data warehousing, etc. While dealing with technology, banks will have to deal with attendant operational risks.

6. Payment and Settlement system is the backbone of any financial market place. The present Payment and Settlement systems such as Structured Financial Messaging System (SFMS), Centralised Funds Management System (CFMS), Centralised Funds Transfer System (CFTS) and Real Time Gross Settlement System (RTGS) will undergo further fine-tuning to meet international standards. Needless to add, necessary security checks and controls will have to be in place. In this regard, Institutions such as IDRBT will have a greater role to play.

Changing Face of Indian Banking

From traditional banking practices during the British Rule to reforms period, nationalisation to privatisation and to the present trend of increasing number of foreign banks, Indian banking sector has undergone significant transformation. The move from old to new business environment has created newer demands on Indian bank like enhanced work flow, full customer access to banking transactions through electronic mode etc. In the emerging scenario of fierce competition backed by twin force of deregulation and technology, the degree of competition in the Indian financial Sector has increased to unprecedented level. Therefore, the operational efficiency of banks has achieved immense significance for their survival in the present scenario. In contrast to earlier 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning, modern outlook and tech-savvy methods of working for traditional banks has been
ushered. All this has led to the retail boom in India. People are not just demanding more from their banks but also receiving more. With easy credit facilities the banks are transforming the consuming propensity of Indians with everything from microwave ovens to houses on sale at easy monthly installments EMIs. Using information technology, banks have upgraded their systems to provide better customer services. ATMs dispensing any time money are visible in most localities of big cities and consumers are increasingly responding to banking transactions without visiting the banks. Online and mobile banking has brought the banks virtually to their doorsteps. However, all this has exposed the banks to new kinds of risks. The familiarity between bank employees and customers has become increasingly remote. Though, the banks distribute various back end and front end operations to minimise risk and use highly secures socket layers SSLs, digital certificates and facilities like virtual key boards to reduce the risks in online transactions, attacks like phishing and pharming have been on the rise.

Challenges and Opportunities before The Banking Sector

1. **Rural Markets:** Large number of people does not have access to banking facilities due to scattered and fragmented locations. Significant proportion of the same lies in rural areas where private banks have little incentive to invest. As per Census 2011 about 58.7 per cent households in India avail banking facilities. The proportion is less than 50 per cent in case of States like Bihar, Chhattisgarh, Orrisa, West Bengal & North Eastern states like Manipur & Nagaland, Assam & Meghalaya. However, with increasing consumption levels of rural India & cut throat competition in urban markets, rural areas are gaining increasing importance. One example of the trend was the recent merger of Bank of Rajasthan with ICICI Bank Ltd
which the latter resorted to in order to increase its reach in rural market and market share significantly.

2. **Increased competition**: Due to the increased competition between different public and private sector banks. The profits of the banks are being affected. These profits can only be increased by continuously making innovative changes and adopting new policies and practices. Increasing competition, however, might also induce the banks to higher risk taking strategies.

3. **Management of Risks**: Researchers have found that Indian banks risk management capabilities has been improving over time. Although, cyber banking, existing global banking scenario etc. have introduced newer types of risk. International regulatory norms have become more stringent in view of failure of many financial institutions.

4. **Global & Domestic Environment**: Bankruptcy of Lehman Brothers Holdings Inc, fourth largest investment bank in US, in 2008, revealed financial instability in Global markets. Instability of sovereign debt market in Euro zone continues as increasing number of countries in European Union face tough situation. Amidst worsening global scenario, banking rules & regulation framework of India has prevented it from economic crisis. But the stagnation & even recession in some global markets leading to lesser demand and slower pace of growth of Indian economy has constrained the credit uptake. However, Indian financial system is expected to remain robust on account of banks capability to withstand stress. While, a series of stress tests conducted by the Reserve Bank in respect of credit, liquidity and interest rate risks showed that banks remained reasonably resilient. However, under extreme shocks, some banks could face moderate liquidity problems and their profitability could be affected. In the long run, with high
growth potential of the Indian economy and favourable demographics, banks have immense opportunities to further expand their business both with traditional and innovative products and through financial inclusion using technology enabled sustainable business models.

5. **Compliance with International Requirements:** In the background of recent global regulatory developments, Basel III largely aiming at higher and better quality capital; an internationally harmonised leverage ratio to constrain excessive risk taking; 325 capital buffers which would be built up in good times so that they can be drawn down intimes of stress; minimum global liquidity standards; and stronger standards for supervision, public disclosure and risk management, was introduced. A few individual banks may fall short of the Basel III norms and will have to augment their capital. Banks will also face challenges of upgrading risk management systems and meeting the credit needs of a rapidly growing economy even while adjusting to a more demandingregulatory regime. Introduction of International Financial Reporting System (IFRS) to facilitate comparability between enterprises operating in different jurisdictions has also placed additional demands on Indian banks.

**Conclusion**
The banking industry in India is undergoing a major change due to the advancement in Indian economy and continuous deregulation. These multiple changes happening in series has a ripple effect on banking industry which is trying to be organised completely, regulated sellers of market to completed deregulated customers market This continuous deregulation has given rise to extreme competition with greater autonomy, operational flexibility, and decontrolled interest rate and liberalised norms and policies for foreign exchange in banking market. The deregulation of the industry coupled with
decontrol in the interest rates has led to entry of a number of players in the banking industry. Thereby reduced corporate credit off which has resulted in large number of competitors battling for the same pie. As a result, the market place has been redefined with new rules of the game. Banks are transforming to universal banking, adding new channels with lucrative pricing and freebees to offer. New channels squeezed spreads, demanding customers, better service, marketing skills heightened competition, defined new rules of the game pressure on efficiency. Need for new orientation diffused customer loyalty. Bank has led to a series of innovative product offerings catering to various customer segments, specifically retail credit. Excellent efficiencies are required at banker’s end to establish a balance between the commercial and social considerations. Bank need to access low cost funds and simultaneously improve the efficiency and efficacy. Owing to cut throat competition in the industry, banks are facing pricing pressure; have to give thrust on retail assets. Gradual deregulation that is being ushered in while stimulating the competition would also facilitate forging mutually beneficial relationships, which would ultimately enhance the quality and content of banking. In the final phase, the banking system in India will give a good account of itself only with the combined efforts of cooperative banks, regional rural banks and development banking institutions which are expected to provide an adequate number of effective retail outlets to meet the emerging socio-economic challenges during the next two decades. The electronic age has also affected the banking system, leading to very fast electronic fund transfer. However, the development of electronic banking has also led to new areas of risk such as data security and integrity requiring new techniques of risk management.
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