INDIAN BANKING AND FINANCIAL SERVICES: CHALLENGES AND FUTURE PROSPECTS

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ABSTRACT

The major changes in the Banking and financial services industry is playing positive role in social welfare and economic development in India. Indian financial services sector is in for exciting times, many changes are being proposed and if these get implemented, the sector is in for immense churn. Banking is still considered a popular business segment in India, even many risks and overwhelming regulation. In India only banks can offer savings bank deposits, which work out cheaper than other sources of finance. Over the last decade, Indian banks have enjoyed bumper returns as total industry assets grew from $290 billion in 2001 to over $1,600 billion in 2011. Indian banks did better than their emerging Asia counterparts.

This paper provides a strategic perspective on the opportunities and challenges introduced by the profound changes that the Indian financial industry is experiencing. This paper tries to pull together various conceptual developments that would suggest a framework to improve the Banking and Financial services.

Key Words: Financial Services, Banking Services, Financial inclusion.

JEL Codes: G 17, G21

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Introduction

The financial services industry has changed significantly in the past two decades. It influenced by the rise of global markets, giant advances in technology and change in the investment landscape. Hundreds of banks have been consolidated, restructured, or newly formed. The major changes in the Banking and financial services industry is playing positive role in social welfare and economic development in India. Indian financial services sector is in for exciting times, many changes are being proposed and if these get implemented, the sector is in for immense churn.

Banking is still considered a popular business segment in India, even many risks and overwhelming regulation. This is because of a growing economy will need credit to expand and build new infrastructure. In India only banks can offer savings bank deposits, which work out cheaper than other sources of finance. Since economic liberalisation began in the early 1990s, the Indian banking sector has experienced extraordinary growth along with remarkable improvement in its quality of assets and efficiency.

Over the last decade, Indian banks have enjoyed bumper returns as total industry assets grew from $290 billion in 2001 to over $1,600 billion in 2011. Indian banks did better than their emerging Asia counterparts. In the next ten years, banking revenues in India will likely climb further from $56 billion in 2010 to $250 billion by 2020, contributing to more than 12% of Asia's total banking revenue growth.[1]

The nature of banking and financial services have been transformed and reshaped through major changes in that industry. For Banking and Financial Services Industry, today, the complexity of their product portfolio, expansion beyond their comfort zone, and changes to business both forced and enabled by the Internet, make for an intensely competitive environment, bringing in its wake challenges to build customer trust, drive loyalty, and deliver an optimal customer experience.

New products are being created to meet the changing needs of customers. Global financial institutions are taking the lead in spreading the new products and technologies which can customise as per need of customers. As a result not only a dramatically altered financial intermediation landscape is providing huge opportunities for development but also challenges for policy makers and the markets. Banks have gradually transformed themselves into universal banks. ATMs, Internet banking, mobile banking and social banking have made "anytime anywhere banking" the norm now.

This paper provides a strategic perspective on the opportunities and challenges introduced by the profound changes that the Indian financial industry is experiencing. This paper tries to pull together various conceptual developments that would suggest a framework to improve the Banking and Financial services.

The driving forces shaping the industry

Liberalization paradigm, technological changes, and market participants' drive for innovation appear to be the main driving forces in the transformation of financial intermediation. Technological development, in particular in information processing, has been the last decade's main force of change, not only in financial services, but in all sectors, ranging from education to entertainment through manufacturing and even agriculture. As a result many sectors have changed and are changing their strategies to adapt to the "new economy," and policy makers are facing the challenge to create an enabling environment for newly created business models.

The worldwide liberalization drive and progress in technology provided an enabling environment for an explosion in creativity in the design and supply of financial services responding to the demands of businesses and investors, consumers, traders, and micro and small enterprises.

Across the world, financial services have experienced four major trends like disintermediation, Institutional adaptation, modernization and globalization. In this respect, there are two main developments characterize the modernization of financial systems:

(i) the increased use of information technology for more efficient financial intermediation, in terms of delivery channels, information processing and information disseminations; and

(ii) institutional reforms to ensure financial stability in the form of adoption of prudential regulations in line with international practice.

In turn, the major trends have affected the driving forces influencing liberalization and institutional reforms, adapting new technologies, and inducing more creativity.[2]

Banking and financial services: initiative taken

The RBI Act was enacted in 1934 and is still a 'temporary' piece of legislation. As per RBI's website, "The formulation, framework and institutional architecture of monetary policy in India have evolved around these objectives - maintaining price stability, ensuring adequate flow of credit to sustain the growth momentum, and securing financial stability." Enumerating these can be complicated, they need to be moved around every time the landscape alters. It is also be notable that states also have varying degrees of interest in financial services. These could have a disorderly influence on the normal functioning of financial services.[3]

Traditionally, 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.[4]

Over the past couple of years, the Indian banking sector has displayed a high level of resiliency in the face of high domestic inflation, rupee depreciation and fiscal uncertainty. In order to stimulate the economy and support the growth of banking sector, the Reserve Bank of India (RBI) adopted severe policy measures like increasing the key monetary policy rates such as repo and reverse repo 16 times since April 2009 to Oct 2011.

The Reserve Bank of India has given five years for the gradual achievement of Basel III global banking standard. The challenges of implementing Basel III are further accentuated by the fact that the law mandates the Central government to hold a majority share in public sector banks (PSBs), which control more than 70% of the banking business in India. RBI has been keen on allowing foreign banks a larger role in the Indian banking system since February 2005, when it first issued the road map for presence of foreign banks in India. In May 2012, the government also facilitated the process by proposing to exempt foreign banks from the 30 per cent tax on capital gains and stamp duty while converting branches into a new entity.

RBI has also mandated foreign banks with 20 and more branches to achieve priority sector targets and sub-targets at par with their domestic counterparts. Among the many initiatives, the government's UID project is likely to have significant impact. Given the numbers out of the reach of organised banking, it can prove to be transformational by giving banks an access to a large untapped customer base. The whole range of government payments, under subsidies and benefits of various welfare schemes, will be routed through banks.[5]

Banking and financial services in India: future vision

There is a famous quotation may be considered here, "The future belongs to those who prepare for it today". The changes in the banking landscape will require banks to adapt their new environment. Banks of the future will have to be nimble and lean organisations with technology integrated to support a sustainable and scalable business.

Inclusive financial services

Financial inclusion has been at on priority for regulators and policy makers in India, a country where approximately half of the population still does not have access to banking services.

Thus, in recent years, the RBI and Govt of India have increased its focus on providing formal banking and financial services to the huge unbanked population. It is encouraging banks to develop low cost products 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.

As per census 2011, huge section of Indian population is still unbanked. The overall percentage of households availing banking services in India stood at around 59% as on 2011, which means still over 40% of total households, lacks access to formal banking services. This is largely driven by rural areas or low income group (LIG) population, due to their financial illiteracy, low level of income and savings, lack of collateral and absence of verifiable credit history.[4]

Banks have acted beyond their role of finance providers like Aryavart Gramin Bank, a regional rural bank sponsored by Bank of India, tied up with Tata to finance "Solar Home Lighting System" for village homes in Uttar Pradesh. It extended finance of around Rs 10,000 to be contributed by the beneficiary. In order to serve potential customers in unbanked areas, banks are willing to experiment with various business models to build a scalable and profitable business.[5]

TATA consultancy services provided a value chain transformation of Banking services which shows (in following table) future prospects of Banking and Financial Services in India.

Table No - 1
Value Chain Transformation of Banking Services

	Yesterday	Today	Tomorrow
Customer Relationship	"I approached the Bank:	"Bank approached me"	"Me and My Bank"
Functionality	"Conduct Transactions"	"Eager the customer"	"Customer Benefits"
Prospecting	"Informative"	"Bi-directional and Interactive"	"Bi-directional and Proactive"
Product/Solution	"Conventional"	"Comprehensive"	"Customized"
Broad Objectives	"Cost Reductions"	"Cost Optimization and market Shares"	"Build Brand"

Source: Changing Landscape for Banking and Financial Services – Redefining the Business through Compliance and Connected Marketing, White Paper, TATA consultancy Services

Rather than every bank trying to carry out all the banking functions throughout the country, banks are likely to identify their core competencies and build on those. A bank that avoids "one-size-fits-all products", acts as a knowledge banker, provides all financial needs at a click, is fundamentally strong, manages risk and adheres to global regulations, design better, faster and convenient delivery channels will no doubt be called a successful bank.[5]

They will need to have a flexible organisational structure with decentralised decision making to reduce turnaround time for various processes. This will be especially true when a number of new entities including non-banking finance companies (NBFCs), large corporate houses and microfinance institutions (MFIs) get banking licences.[5]

India Post Bank

India Post has rural reach, track record in mobilising small savings and providing diversified financial services. It has better place than commercial banks in helping to achieve financial inclusion goal. Banks have not been able to penetrate into remote areas due to their several internal and external rigidities. The rural offices of India Post can be consolidated into rural branches of Banks. It has been doing well in providing diversified financial services, such as life insurance, mutual fund, e-money order and forex services. Its deposits plus the capital mobilised can be on-lent to the financially excluded. Already, around 38 crore MGNREGA (Mahatma Gandhi National Rural Employment Guarantee Act) accounts are with India Post through which beneficiaries receive their wages.[6]

Besides savings products, small credit and other remittance services, India Post Bank can render insurance services too as it has vast experience running the Postal Life Insurance (PLI) and Rural PLI schemes. PLI is the first life insurance scheme introduced way back in 1884 and today it has around 46.86 lakh active policies with a sum assured of Rs 64,077 crore. The corresponding figures for RPLI are, respectively, 1.22 crore and Rs 66,132 crore.[6] The following table shows a comparison between India Post and Commercial Banks in India.

Table No - 2
India post and Commercial Banks: A comparison

	India Post	Commercial Banks
No of offices	154866	92690
Rurla Offices (%)	89.78	36.91
Population per office	7814	13100
Rural*	5992	NA
Urban	23828	NA
Area served by one office (sq. Km.)	21.23	35.47

Source: The Hindu, February 24, 2013

Mobile and Internet banking, next major technological leap

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 million offering mobile banking services as at the end of Mar 2012. During Financial Year 2012, around 25.6 million mobile banking transactions valued at Rs. 18.2 billion were transacted. 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.

One way in which information technology has altered financial institutions is in the use of the internet as a delivery channel for financial services. This has led to lower costs and greater competition. The marginal costs of providing on-line financial services are lower than those of traditional delivery channels due to the advent of personal computers and cheap data transmission.[2]

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.[4]

By 2015, India's current online user base of 122 million is likely to touch 350 million, of which 70 million digital high-value consumers will drive a revenue pool of $60 billion to 70 billion by 2020. Capturing this opportunity here and now is critical, because online consumer behaviour is changing faster than financial institutions are responding.[3]

According Intuit 2020 report[7], following four key trend areas are identifies and examines that will transform the financial services industry over the next decade:

A New Playing Field for Financial Services: Regulatory pressures will increase and competition will grow from both traditional competitors and new entrants These forces will lead financial institutions to explore new business models, collaboration and partnerships, and increased consolidation.

Shifting Segments, Changing Markets: Consumer demand for financial services will increase across all age groups. Competition to serve mid-market businesses will intensify, slimming financial institution margins. However, the overall small business sector will continue expanding, with the total number of small and personal businesses increasing by more than 7 million over the next decade.

The New Customer Connection: Technology's role in the customer experience will take centre stage. With increased cost pressures and a growing demand for flexibility, accessibility and personalization, financial services organizations will accelerate their use of technology to meet customer needs.

Reputation and Relationships Rule: Institutions that use technology to serve up useful customer insights will win. Over the next decade, the financial service industry will shift its focus from transactions to customized value-added services. Through a combination of both virtual and brick-and-mortar branches, banks will develop stronger, more personal relationships with businesses and consumers, helping them manage risk, build wealth, plan retirement and anticipate health care expenses.

Conclusion

Developments in the financial services industry are providing immense possibilities for economic development. This sense is gradually becoming part of the general awareness of the role of finance in promoting growth and equity.

There are also views on the potential of financial services to stabilize expectations contributing to an environment more conducive to investment and growth. Finally, there are views on the positive role of financial services in promoting social equity by providing access to opportunities that would otherwise never materialize.[2]

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