INDIAN BANKING:
GLOBAL PERSPECTIVES AND CHALLENGES

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ABSTRACT

Indian banking system is very dynamic, fast changing in its dimension and understand the complex environment in its right perspective. Money is a means of payment and an indicator of a country's economic wealth. Globalization of banking has also facilitated by its tremendous advancement like information technology, adoption of appropriate prudential, regulatory and supervisory on par with international best practices enables strengthening of the Indian banking system. Inspite of that there are various challenges like cost management, recovery management, risk management and technology related problems. It is a responsibility of managerial personals in the banking system to maintain check and balance in it and to provide right direction to the Indian banking system.

Keywords : Indian banking, Globalization, Perspectives and Challenges, Technological Innovation.

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INTRODUCTION

Strictly speaking, globalization refers to doing business abroad while adopting international business standards for conducting business transactions with others. The term globalization is widely used, but indistinctly defined, in recent years. It is almost a buzzword in all business conferences globally. While some thinkers considers it as international, multinational, or transnational business, Theodare Levitt visualised "the globalisation market" (1983). Though globalization, of business can include all such aspects, it is very distinct from any of these approaches.

Globalization of business is a business Philosophy of viewing one's business in a global perspective in terms of global outlook, using globally viable technology, offering the products of services which can better satisfy the customer needs in a global environment, maintaining the quality' in adherence to global standards in identify of global corporate citizen, and ultimately fostering a means that globalization by business necessitates to practice a globally viable strategy though the business is locally operated. A global corporation may have a global policy though it operates locally.[1] As such, the interdependence of countries under globalization help to promote cross boarder flow of goods and services, capital and technology.

The Banking sector is the pillar of any economy. Banking sector plays a very important role in the development of the nation.[2] It is the life-blood of a country. It is responsible for the flow of credit and for maintaining the financial balance of the economy.[3] Banking means the accepting for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise.[4]

Banking is an organizational basically of the people, by the people and for the people. Hence the need and importance of human element in a bank can never be ignored. After the announcement of new industrial policy on 24th July, 1991 and the initiation of liberalization, Privatization and Globalization process in economic policy, banking structure underwent sea changes. Initiation of financial sector reforms also created a competitive environment for the efficient allocation of limited physical, technological, financial and human resources.[5] Technology has made tremendous impact in banking 'Anywhere banking' and 'anytime banking' have become a reality.[6] Now knowledge and skills are required to manage the new challenges, due to deregulation, globalization, I.T. revaluation, and introduction of prudential norms and international standards of the Banking Practices in the Indian banking sector.[7] The human resources development in the banks have a play for greater in transforming the mind-set and attitude of the banking people for taking the change in their stride.

PERSPECTIVES

Following are the some perspectives that have been considered significant for ensuring the presence of effective globalization of Banking Sector:

I. Status of Indian Banking Sector

The status of the Indian Banking sector is not similar with other countries, recognizing the differences between the developed and the emerging economies. In the world top 1000 banks, there are many more large and medium sized domestic banks from the developed countries than from the emerging economies.[8] Illustratively according to the Banker 2004, out of the top 1000 banks globally, over 200 are located in USA, Just above 100 in Japan, over 80 in Germany, over 40 in Spain and around 40 in the U.K. Even China has as many as 16 banks within the top 1000, out of which, as many as 14 are in the top 500. India, on the other hand, had 20 banks within the top 1000 out of which only 6 were within top 500 banks.[9] This is perhaps reflective of difference in size of economics and the financial sectors.

II. The Share of Bank Assets in the Aggregate Financial Sector Assets

In most emerging markets, banking sector assets comprised well over 80% of the total financial sector assets, where these figures are much lower in the developed economics. In India, the share of banking assets in total financial sector assets is around 75%, as of end march 2004. There is no doubt, merit in recognizing the importance of diversification in the institutional and instrument – specific aspects of financial intermediation in the. interests of wider choice, competition and stability. However, the dominant role of banks in financial inter-mediation in emerging economies and particularly in India, will continue in the medium term; and banks will continue to be “special” for a long time.[10]

III. Internationalization of Banking Operations

The foreign controlled banking assets, as a proportion of total domestic banking assets, increased significantly in several European countries (Austria, Ireland, Spain and Germany) but increases have been fairly small in some others (UK and Switzerland). Amongst the emerging economies, while there was marked increase of foreign controlled ownership in several Latin

American economies, the increase has, at best, been modest in the Asian economies. Available evidence seems to indicate some correlation between the extent of liberalization of capital account in the emerging markets and the share of assets controlled, by foreign banks. As per evidence available the foreign banks in India, which are present in the form of branches, seem to enjoy greater freedom in their operations including retail banking, in the country on par with domestic banks, as compared with most of the other developing countries. India continues to grant branch licenses more liberally than the commitments made to the World Trade Organization.

IV. The Share of State owned Banks in total Banking Sector Assets

Emerging economies, with predominantly government owned banks, tend to have much higher state ownership of banks compared to their developed counterparts. While many emerging countries chose to privatize their public sector banking industry after a process of absorption of the overhang problems by the government. We have encouraged state-run banks to diversify ownership by indicating private share capital through public offerings rather than by strategic sale and still absorb the overhang problems. The process has helped reduce the burden on the government, enhance transparency, encourage market discipline and improve efficiency as reflected in stock market valuation, promote efficient new private sector banks, while drastically reducing the share of the wholly government owned public sector banks in a rapidly growing industry. Our successful reform of public sector banks is a good example of a dynamic mix of public and private ownership in banks.

V. Globalization of Financial Services

Growing integration of economies and the markets around the world is making global banking a reality. The surge in globalization of financial has also gained momentum with technological advancements which have effectively overcome the national borders in the financial services business. Widespread use of internet banking has widened frontiers of global banking, and it is now possible to market financial products and services on a global basis. In the coming years globalization would spread further on account of the likely opening up of financial services under WTO. India is one of the 104 signatories of Financial Services Agreement of 1997. This gives India's financial sector including banks an opportunity to expand their business on a quid pro quo basis.[11]

VI. Indian Banks at the Global Stage: A Reality

There would be grater presence of International Players in Indian Financial System and some of the Indian Banks would become global players in the coming years. So the new mantra for Indian banks is to go global in search of new markets, customers and profits. We not forget that the competition is not only on foreign turf but also in the domestic field as well from foreign banks operating in India.[12]

VII. Move towards Universal Banking

We are slowly but surely moving from a regime of "large number of small banks" to "small number of large banks".[13] Another notable change that has taken place in banking environment of the country is the introduction of "Universal Banking", which refers to cross-selling of financial products and enables a bank to act as a one stop financial supermarket. It is also helping transformation the financial institutions in the country, that were facing bleak prospects as their traditional sources of lending dried up and became virtually non-existent. Further, it is attracting existing banks. Today many banks have begun to migrate to the Universal Banking Model, which has opened up new avenues of growth for them. Several banks are now attempt into areas such as credit cards, insurance, demat services, mortgage financing, investment banking, securitization, mutual funds, etc. Thereby offering different services to their customers under one roof. This is also fueling the growth of these banks.

CHALLENGES : While moving ahead the banking sector face following challenges:

I. Cost Management

Cost containment is a key to sustainability of bank profit as well as their long term viability. In 2003, operating costs of banks as proportion of total average assets in the UK were 2.12%, for those in Switzerland they were 2.03% and less than 2% in major European economics like Sweden, Austria, Germany and France. In India however, in 2003 operating costs as proportion of total assets of scheduled commercial banks stood at 2.24%.[14]

II. Recovery Management

This is a key to the stability of the Banking Sector. There should be no hesitation in stating that Indian Banks have done a remarkable job in containment of non-performing loan considering the overhand issues and overall difficult environment. In 2004, the net ratio for the Indian scheduled commercial banks at 2.9% is ample testimony to the impressive efforts being made by our banking system. In fact, recovery management is also linked to the bank interest margins. We must recognize that cost and recovery management supported by enabling legal framework hold the key in future health and competitiveness of the Indian banks. No doubt, improving recovery management in India is an area requiring expeditious and effective actions in legal institutional and judicial processes.

III. Technology

Technology has thrown new challenges in the banking sector and new issues have started cropping up which is going to page certain problems in the near future. The new entrants in the banking are with computer background. However, over a period of time they would acquire banking experience. Whereas the middle and senior level people have reach banking experience but their computer literacy is at a low level. Therefore, they feel the handicap in this regard since technology has become an indigenes able tool in banking.[15]

Foreign banks and the new private sector banks have embraced technology right from the inception of their operations and therefore, they have adopted themselves to the changes in the technology easily. Whereas the Public Sector Banks and the old Private Sector Banks (barring a very few of them) have not been able to keep pace(step) with these development. In this regard, one can cite historical, political and other factors like work culture and working relations as main constraints.[16]

IV. Risk Management

Securitization of long-term debt is another important risk management product. Long-term interest rate risk is typically taken off a lending institution's balance sheet by packaging and selling the loans to the capital market through a financial intermediary. Investors in these securities – known as asset-backed or more specially mortgage backed securities – get a rate of return linked to the return on the underlying mortgages.[17]

R.B.I. guidelines have been issued for putting in place risk management system in banks. Risk Management Committees in banks address credit risk, Market Risk and Operational Risk.[18] Banks have specialized committees to measure and monitor various risks and have been upgrading their risk management skills and systems.

V. Corporate Governance

Corporate governance means as a 'set of relationship between company's management, its board, its share holders and other stake holders.[19] With growing emphasis on the part of listed companies worldwide on creating shareholder's wealth; domestic banks, which are seeing a dilution in government ownership, will come under intense pressure to be more transparent in their operations and improve disclosure and reporting practices. Hence, these banks will have to gear up to meet the stock market demands, and improve their corporate governance practices.

Increased integration with the global economy, and the fast changing banking environment in the country along with reforms process will be an overwhelming challenge for the banking sector. Factor such as cost competitiveness, growing emphasis on acquiring and leveraging technology capabilities to deliver services, strong balance sheet, better risk management skills, and perhaps, a global presence, will hold key to the success of banks in the future.[20]

VI. International Best Practices

If the banks in the country have to complete with international banks, they will have to gear up to embrace international best practice and standards in terms of operating, reporting and disclosure norms. This has consequently meant the adoption of a strong and transparent, prudential, regulatory, supervisory, technological and institutional framework in the financial sector on per with international best practices.[21]

VII. Banking Regulatory Framework

In the midst of all these initiatives arid challenges, a major challenge for the Reserve Bank has been to ensure that the overarching banking regulatory framework facilities banking services reaching the common man. The Reserve Bank has appointed an External Committee on Procedures and Performance Audit on Public Services headed by Dr. S.S. Tarapore and this committee has in one of its reports focused on depositor's accounts and other banking facilities relating its individuals – the common man. Subsequently, Governor Dr. Y.V. Reddy has addressed on the Chairmen of banks reminding them of the trust reposed by the common person in the nature and quality of customer service rendered by banks. Banks must recognize that if there is disenfranchisement of the depositor they may wake up to find slippages on the liability side of their balance sheet.[22]

What is being done to prepare Indian Banks to meet Global Challenge?

Indian Banking sector has already implemented internationally followed prudential accounting norms for classification of assets, income recognition and loan loss provisioning. The scope of disclosure and transparency has also been raised in accordance with international practices. India has complied with almost all the Core Principles of Effective Banking Supervision of the Basel Committee.

Some of the Indian banks are also presenting their accounts as per the US Generally Accepted Accounting Principal. The roadmap for adoption of Basel II is also under formulation. All these factors give Indian banks much needed confidence for overseas operations. But earlier overseas operations is one thing and competing against the global players in the international market is quite another. And Indian banks have a lot of catching up to do before they can emerge as truly global players.

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