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BANKING SECTOR CHALLENGES

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Abstract : India is one of the top 10 economies in the world, where the banking sector has tremendous potential to grow. The last decade saw customers embracing ATM, internet and mobile banking. 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. Banks are now reaching out to the masses with technology to facilitate greater ease of communication, and transactions are carried out through the Internet and mobile devices.

Keywords: Banking

INTRODUCTION :

India is one of the top 10 economies in the world, where the banking sector has tremendous potential to grow. The last decade saw customers embracing ATM, internet and mobile banking. 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. Banks are now reaching out to the masses with technology to facilitate greater ease of communication, and transactions are carried out through the Internet and mobile devices.

A bank is a financial institution that provides banking and other financial services to their customers. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans. There are also nonbanking institutions that provide certain banking services without meeting the legal definition of a bank. Banks are a subset of the financial services industry. A banking system also referred as a system provided by the bank which offers cash management services for customers, reporting the transactions of their accounts and portfolios, throughout the day.

THE MAJOR STEPS TO REGULATE BANKING INCLUDED:

- In 1948, the Reserve Bank of India, India's central banking authority, was nationalized, and it became an institution owned by the Government of India.
- In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India."
- The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors.
- The nationalization of 14 major banks in India on 19th July 1969.
- A second dose of nationalization of 6 more commercial banks followed in 1980. With the second dose of nationalization, the GOI controlled around 91% of the banking business of India.

The Indian banking sector has witnessed wide-ranging changes under the influence of the financial sector reforms initiated during the early 1990s. The approach to such reforms in India has been one of gradual and non-disruptive progress through a consultative process. The emphasis has been on deregulation and opening up the banking sector to market forces. Since 1991, India has been engaged in banking sector reforms aimed at increasing the profitability and efficiency of the then 27 public-sector banks that controlled about 90 per cent of all deposits, assets and credit. The reforms were initiated in the middle of a "current account" crisis that occurred in early 1991.

The 1991 report of the Narasimham Committee served as the basis for the subsequent banking sector reforms. The objective of banking sector reforms was in line with the overall goals of the 1991 economic reforms of opening the economy, giving a greater role to markets in setting prices and allocating resources, and increasing the role of the private sector. In the following years, reforms covered the areas of (1) liberalization including interest rate deregulation, the reduction of statutory pre-emptions, and the easing of directed credit rules; (2) Stabilization of banks; (3) partial privatization of state-owned banks; (4) changes in the institutional framework, and (5) entry deregulation for both domestic and foreign banks.

The new policy shook the Banking sector in India completely. 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. People not just demanded more from their banks but also received more.

The Reserve Bank of India has permitted commercial banks to engage in diverse activities such as securities related transactions (for example, underwriting, dealing and brokerage), foreign exchange transactions and leasing activities. Banks need to obtain implicit rents in order to provide discretionary, repetitive and flexible loans. In addition, banks attempt to reduce the extent of information asymmetry by processing inside information on their clients and monitor in their performance. This diversification gives bank opportunity o earn the profit. It also helps to maintain the healthy relationship with their client. As many foreign and private banks are competing with each other on the basis of their performances these activities makes their position stronger.

OBJECTIVE:-

The objective of this paper is to explain the changing banking scenario, to analyze the impact of liberalization, privatization & globalization and to study the challenges and opportunities of national and commercial banks in changing banking scenario. In addition to this, an attempt is made to understand the significance of banks in India.

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.

CHANGES IN RECENT YEARS:-

Indian federal government has opened up banking sector doors through FDI for foreign banks upto 49% through "Automatic route". As stated earlier banking sector is facing stiff competition from the banks all over the world. Many private and foreign banks are attracting the customer with advanced technology, new products, new services etc. the public sector banks have to compete with them even though they have large infrastructure with them. Many private and foreign banks have entered in the market with their technology, skilled human resources, new products & services and challenged public sector banks. Information technology is part and parcel of today's banking system. E banking is the key word of the whole banking system. Internet has changed the business system with e-business, e-commerce, e-marketing and to carry out the financial activities came e-banking. The market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. Strengthening financial systems has been one of the central issues facing emerging markets and developing economies. This is because sound financial systems serve as an important channel for achieving economic growth through the mobilization of financial savings. The 1994 amendment of the Banking Act allowed banks to raise private equity up to 49 per cent of paid-up capital. Consequently, public-sector banks, which used to be fully owned by the government prior to the reform, were now allowed to increase nongovernmental ownership. So far, only eight public-sector banks out of 27 have diversified ownership.

As at end-March 2013, there were 155 commercial banks including 151 scheduled commercial banks (SCBs) of which Regional Rural Banks were 64. The total number of bank offices at end-March 2014 is estimated to have reached 1,15,014 and the population per office, 1,10,052. In terms of the regional spread of the bank offices, while North Eastern region accounted for about 2 per cent (2,785 bank offices), Southern region accounted for about 28 per cent (30,925 bank offices). Despite such vast expansion of banking network, banking penetration still remains relatively low. According to the CRISIL's financial inclusion index, Inclusive, which covers three parameters of branch penetration, deposit penetration and credit penetration, at all India level, the index is placed (on a scale of 100) at 40.1 in 2011, reflecting under penetration of formal banking facilities in most part of the country. While the Southern region witnessed highest financial inclusion with index at 62.2, North-Eastern region registered lowest with 28.5. Under-penetration is evident in terms of number of ATMs and POS per million populations also. In India, it stood at about 94 and 695 respectively as compared to, say, 1200 and 4853 respectively in Russia. The credit to GDP ratio is at around 53 per cent, which is low compared to the credit-GDP ratio of many advanced & developing economies. Hence, there is a need for much greater banking and credit penetration going forward. This is so because despite efforts to develop the corporate bond market, the Indian financial system remains bank-dominated with commercial banks accounting for over 60 per cent of the financial sector assets. It is, therefore, essential for the Indian economy, striving for an accelerating, sustainable and inclusive growth in the medium to long-term, to have a healthy and growing banking system.

Use of ATM, credit card, debit card, Electronic fund transfer, Electronic clearing services, mobile banking, Shared payment network banking, Corporate banking terminals, Point of sale terminal, electronic data interchange become essential feature of banks. Core banking becomes part & parcel of banks system. Customers in real sense become king of the market. Previously as there was no competition services provide were not upto the mark. Information technology and internet has provided various options to the customer from all over the world. Customer is aware of his rights, rules and regulations of the banks so compares the services provided by various banks and charges charged by them & choose the best option for them. The banking sector serves as an intermediary between providers and users of capital in an economy. In a market-oriented banking system, banks will try to channel capital to the ventures with the best risk-return trade-off in order to minimize credit losses and maximize profits, which will ensure an efficient allocation of capital in the economy. Currently, 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. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate-and this has mostly been true.

With the growth in the Indian economy expected to be strong for quite some time-especially in its services sector-the demand for banking services, especially retail banking, mortgages and investment services are expected to be strong. One may also expect M & As, takeovers, and asset sales. Various financial services like insurance, mutual funds, easy loan availability to the customers, underwriting, depository services etc are provided by the banks.

CHALLENGES AND OPPORTUNITIES:-

1. Deregulation:-

This continuous deregulation has given rise to extreme competition with greater autonomy, operational flexibility, and decontrolled interest rate and liberalized norms and policies for foreign exchange in banking market. The market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. These require new skills in sales & marketing, credit and operations.

2. Diffused customer loyalty:

Attractive offers by MNC and other nationalized banks, customers have become more demanding and the loyalties are diffused. Value added offerings bound customers to change their preferences and perspective. These are multiple choices; the wallet share is reduced per bank with demand on flexibility and customization. Given the relatively low switching costs; customer retention calls for customized service and hassle free, flawless service delivery.

3.Misaligned mindset:

These changes are creating challenges, as employees are made to adapt to changing conditions. The employees are resisting to change and the seller market mindset is yet to be changed. These problems coupled with fear of uncertainty and control orientation. Moreover banking industry is accepting the latest technology but utilization is far below from satisfactory level.

4. Efficiency:

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 cutthroat competition in the industry, banks are facing pricing pressure; have to give thrust on retail assets.

5.Improve risk management mechanism:

Strategies to combat the problem of high risk perception must be taken up by banks on priority basis. Increased usage of rating services must be employed to reduce risk. Besides, SME specific risk management procedures must be setup to make the business more viable, as the risk perception associated with lending to small enterprises is generally very high. Further, the banks would also be required to acquire skill for managing emerging risks resulting from innovations in financial products as well as technological advancements.

6.Technology adoption:

The problem of resistance from workforce has largely been neutralized over the years, but the primary issue involved with the adoption and rapid integration of technological processes within banks still related to human resources- the availability of technically skilled resources is scarce. Technology is not among the core competencies of financial institutions, which necessitates outsourcing. Banks in India are different from banks in many other countries, in ways that they have a very large branch network and varied needs specific to regions and customers. Most off the shelf solutions are not exactly in conformity to the needs of the banks, which makes room for large customizations. Besides, a serious concern in implementing complex technologies is protection against frauds and hackings. Security concern slows down technology adoption significantly for the banking industry. A fast pace of development of security systems is imperative to the adoption of large scale innovations in the industry.

7.Safety and security of payment transactions

Last but not the least is the consideration towards safety and security of payment transactions. This goes a long way in influencing customer behavior in the choice of payment methods. While the Reserve Bank has mandated many requirements to strengthen security and enhance risk mitigation standards for the electronic transactions, it is essential that these are implemented not only in letter but also in spirit. Further, with the increased volume of transactions, the need for Straight Through Processing (STP) becomes essential. Hence, while catering to large volumes, certain procedural changes would need to be made. For example, there is the requirement under NEFT and RTGS where the credit is afforded to the beneficiary customer's account solely on the basis of the account number given in the remittance request by the sender. While the intention behind this policy is to facilitate easier handling of growing volumes at banks through STP, the risk-based approach to handle customer grievance should not be lost sight of and banks should also seek to proactively address of the payee and redress customer issues emanating from such electronic transactions. Customer as well as frontline staff awareness and education is crucial in ensuring not only acceptability of the payment products but also their assurance in terms of safety and security.

8.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.

9.Market discipline and transparency:-

Transparency and disclosure norms as part of internationally accepted corporate governance practices are assuming greater importance in the emerging environment. Banks are expected to be more responsive and accountable to the investors. Banks have to disclose in their balance sheets a plethora of information on the maturity profiles of assets and liabilities, lending to sensitive sectors, movements in NPAs, capital, provisions, shareholdings of the government, value of investment in India and abroad, operating and profitability indicators etc.

10. Financial inclusion

Leveraging technology enabled payment system for electronic transactions provides challenges and opportunities to the banks by expanding outreach in terms of expanding customer base, offering multiple product choices, achieving cost efficiency, providing assurance in terms of standardization, safety and safety. Despite the impressive growth in the volume and value of electronic transactions the same is concentrated in metros and big cities, thus widening the digital divide. This imbalance is reflected along various parameters, be it the deployment of ATMs, or the POS infrastructure, mobile banking services, etc. Needless to state, the vision of financial inclusion, aided through the payments path, cannot be achieved unless the rural and semi-urban areas find an equal footing in the policy horizon for banks.

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-a-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 an valuable asset for them.

CONCLUSION

This Paper 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. The biggest challenge for banking industry is to serve the mass and huge market of India. Companies have become customer centric than product centric. 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-a-days they need internet banking, mobile banking and ATM services.

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