

DEVELOPMENTS IN INDIAN BANKING SERVICES

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Abstract:

As the saying goes, change is the only certainty. And it is this change that would govern the banking industry, which is graduating from financial intermediary into risk intermediary. The repetitive and overlapping systems and procedures have given way to simple key-press technology, ensuring accuracy and speed of data flow to improve overall efficiency through Knowledge Management. The emerging Information Technology (IT) facilitates in utilising Knowledge Management effectively and efficiently to improve both product range and service quality in the banking sector.

Technology has the potential to increase the availability and reduce the cost of information. This is a potentially powerful force as it reinforces and at the same time challenges one of the major core competencies of banks - information. Since banks ultimately depend on 'information' to run their businesses, anything that affects its availability, cost and management will always have a decisive influence on their business. A combination of new technology, the increasing role and power of third-party agencies such as the Credit Information Bureau of India Limited (CIBIL) and more extensive disclosure laws will gradually erode some of the traditional information advantages of banks.

KEYWORDS:

Banking Services, Technologies, Online Banking, Internet Banking, Customer, Services, Corporate Finance, Consolidation in Banks.

INTRODUCTION

The choice before the customer today is far wider both in the selection of banks as well as products. The future growth is largely in retail banking. Innovating products backed by superior service are vital to provide the cutting edge. Micro-finance will be the engine that will drive change in the rural sector with the prospect of generating employment for the countless people who are yet to reap dividends from resurgent India.

Within the world of banking, customers' needs have changed and so has the basic nature of banking services that they require. The way banks meet these needs and the framework within which they are delivered have, as a result, changed. Banks have had to adopt to a host of new phenomena ranging from regulatory issues, risk management and new technology to globalisation, consolidation and branding.

There is no denying the fact that the financial services industry has gone through the most change since the process of liberalisation began a little over a decade ago. And while indeed Regulation has played a key role in the transformation of Indian banks, I would include three other broad factors that have been responsible for this change. These are Technology, the Customer and Consolidation.

TECHNOLOGY

Technology has played a vital role in the evolution of banking sector, through speed creation,

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accuracy and efficiency of operation and reduction in the transaction cost. Bankservices are now oriented to "anyhow, anywhere, anytime and any type" banking. The regulatory requirements and compliance regime in post-Basel II scenario and Sarbanes-Oxley Act and Antimoney Laundering requirements, complicates the processing of voluminous data besides the process of their storage and retrieval in the desired form and at desired speed. Banks may have to move on to behaviour analysis approach for fine-tuning their products.

Many financial institutions, particularly banks, may not survive in the new millennium because they are relying on late 1990s surveys to plan third-millennium products and services and thus they may land up with the wrong products, perhaps designed for consumers who no longer exist. Most people see the future as more of the same. Unless one can visualize tomorrow as history so as to perceive what may happen day after tomorrow, perhaps one cannot visualise what will happen a decade or so later.

Technology acts as both a threat and an opportunity to banks. It enables existing services to be provided more efficiently, it enables new services to be offered, it lowers entry barriers in some areas and it changes the economics of delivery. For instance, an ATM transaction costs just a fraction of that of a teller transaction. A transaction over the telephone is still cheaper and an internet transaction the cheapest.

Technology has the power to transform the fundamental economics of any industry and in this respect, banking is no different from other industries which have been transformed by technology.

In India, the challenges of technology are being felt more by public sector banks and old private banks than foreign banks and new private banks. Several of these banks are currently implementing core banking software to link their branches to a centralized database. They need to avoid falling into the trap of automating antiquated and people centric processes. Merely applying IT to a legacy process would mean automating the old process with little improvement in operating efficiency - quite similar to fitting an outboard motor to an old rowing boat when what is really needed is a speedboat.

TYPES OF ONLINE BANKING

A common assumption is that Internet banking is the only method of online banking. However, this is not strictly the case, as several types of services are available:

PC Banking: The forerunner to Internet banking, PC Banking has been around since the late 1980s and is still widely used today. Individual banks provide software, which is loaded onto an SME's office computer. SMEs can then access their bank accounts via a modem and telephone link to the bank. Access is not necessarily via the Internet.

Internet Banking: Using a Web browser, any user can access his/her account, once the bank's application server has validated the user's identity.

Digital TV Banking: Using standard digital reception equipment (set-top box and remote control), users can access their bank account. One of the main selling points is that no account details are transmitted via the Internet.

Text Phone Banking: This service allows customers with cellphones to check their balance, pay bills and transfer money via SMS.

INTERNET BANKING CAN BE CLASSIFIED INTO TWO DISTINCT GROUPS:

Traditional banks use the Internet as an add-on service with which to give business access to their accounts. New Internet-only banks have no bricks-and-mortar presence and therefore have lower overheads, paving the way to offer higher rates of interest on deposits and lower charges on lending activities.

The features available from an online bank account are similar to those available via 'phone banking' or 'visiting the local branch'. Online banking features do differ from bank to bank, but one can typically do the following:

- Transfer funds between accounts;
- Pay bills;
- View balance and statements;
- Create, view and maintain Standing Orders; and
- View direct debits.

The advantages of Internet banking include no queuing, no rushing to the bank before it closes, access to the account 24x7, 365 days a year, low bank charges, faster transmission of funds to settle

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transactions, and any time access to cash. All these result in better financial management.

The main disadvantages are those related to the fear of the unknown. There is some speculation that Internet-only banks will not be able to sustain their high interest rates. Internetonly banking is perceived to be instantaneous for, when a bill is paid, the expectation is that the transaction is complete with immediate effect. However, this is not the case, till the mechanism of Real Time Gross Settlement is fully put in place.

The Customer

Fifteen years ago, a customer would have been content with just a fixed deposit or a recurring deposit in addition to his savings account. Today, he wants to spread his wealth around. He wants to park his savings in equities, fixed deposits, mutual funds, pension products and insurance. The bank has a choice - either offer the customer all these products or lose him.

While there has been a lot of debate on which is a more successful model - niche banking or universal banking - in India, at least for now, it is quite clear that it is the latter and banks will necessarily have to offer every imaginable financial product to the customer to avoid losing him to competition.

The desire, or rather, the compulsion to be a one-stop shop for the customer's investment and borrowing needs, has given birth to what is being termed 'the financial conglomerate' - a model that we are going to see an increasing number of banks adopt.

The Indian customer of today has become more demanding as a result of which most banks in India now offer a full gamut of products to their retail clients. In addition to the plain vanilla deposits, banks are striving to get a larger share of their customers' wallets by undertaking mutual funds and insurance sales.

PRODUCTS

Instead of banking through personal contacts established at the branch premises, banks would offer products through anywhere banking, ATM, the Internet and mobile phones, all enabled by vast electronic devices. These require less mobility on the part of the customer. In fact, banking functions can be called at the press of a few keys in your cellphone. Concepts such as Real Time Gross Settlement, Cheque Truncation and Electronic Funds Transfer enable quick movement of funds. It is unlikely that any significant delay takes place in transferring funds from one bank to another. Client money would move between institutions as fast as data — at the speed of light — with no exceptions. There is absolutely no good reason in the third millennium to settle for anything less.

Instant access to e-mail is essential in a world where late response can spell the difference between signing and losing a high-value contract deal. The trouble is that behaviour is changing faster than lead times for new products and services, and the gap is getting wider. That means market research will be even more useless for future-casting financial services in the next five years, than it has been over the last decade.

Time and again we see institutional blindness, compounded by dangerously misleading survey results. Account holders change their minds about online banking and purchases faster than market research can predict. As a result, non-banking competitors are racing ahead with a wide range of well-developed digital products and alliances. It means parallel planning and preparing for fast response to a variety of outcomes.

Services

In as much as elite customers identify banks to suit their requirement of services, banks may also be choosy about their customers. Large branch network, lack of adequate computerization, mindset of the people, unwieldy customer base spread over large area, high processing cost, etc., are characteristics of present-day banking that would give way to totally electronic-based functioning mode. Hence, addressing all these issues would enable banks to go hi-tech. Giving value and adding value to customer requirements would ensure Economic Value Addition, which ultimately would improve bottom lines.

Corporate Finance at a Mouse Click

Most corporate bankers still assume that the nature of their business will protect them from the most destructive effects of the digital revolution. They say that the client relationship is the most important thing, based on trust, and that this cannot be replaced by an electronic channel.

While this is certainly true in the short-to medium term, the long-term future is far less certain. The lesson of history is that whatever starts to work on a smaller scale tends to have an impact later on larger

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financial arrangements. For small- to medium-sized businesses, it is already clear that online banking is going to alter the decisions they take.

CONSOLIDATION IN BANKS

Restrictions of operations of foreign banks in India, currently enjoying marginal share of less than 10%, are likely to go by 2009, paving way for many changes. We might expect greater breadth of products, depth in delivery channels and efficiency in operation, without losing focus on customer needs of Indian populace. A consolidation exercise in the banking industry cannot be kept in cold storage, if we view it from the following angle:

- a. Due to diversified operations and varying credit profiles of banks, merger and consolidation would serve as a risk mitigation or risk-sharing mechanism, besides increasing the potential for growth.
- b. Owing to greater scale and size, consolidation can help save cost and improve efficiency.
- c. Avenues can be explored for raising capital to meet international Basel II norms.
- d. Distinct geographical presence could come together to leverage respective strengths.

The future of Online Banking

The continued use of online banking by SMEs and individuals will lead to the next generation of online banking. Banks will Endeavour to improve existing services as well as introduce new ones.

Financial institutions are currently developing Short Messaging Service (SMS), Wireless Application Protocol (WAP) and third generation (3G) mobile telephony applications. Some banks are also developing kiosks, which will allow online access. Analysts predict that banks will have to drive services via these new channels to attract customers, and not leave it to the technology.

There are some issues that can be addressed with a simple and straightforward e-commerce solution:

- 1. Cash flow is difficult to manage as there is a large degree of uncertainty as to when their trade debtors would present cheques for payment. To control this, considerable time of senior management is spent in managing the account balance and uncleared cheques.
- 2. Interest charges due to cash flow uncertainty. There is often a delay of several days before funds can be released, restricting the working capital cycle further.

Tangible and proven benefits can encourage the use of e-commerce to automate other manual processes.

Consequent to Internet banking gaining momentum, online banking is slated to increase manifold, according to the Internet and Mobile Association of India (IAMAI). Currently an estimated 46 lakh Net users bank online, and this is estimated to touch 160 lakh by March 2008. Nearly half of the online banking service users are reported to be under 35 and are predominantly male (83%). Access to online banking is almost equally divided between office (48%) and home (42%).

The Future of Internet Banking

The banking industry is in the middle of the most fundamental change it has ever faced. Apart from the increasing change, convergence, globalisation and technological innovations in the financial services sector, changing customer preferences and behaviours are signaling that new strategies to attract and maintain customers are gaining importance for players in the field.

Across the country, the present trend in private banking has seen consumers move from traditional branch banking to more standalone tech-savvy banking — in other words, a move towards using electronic delivery channels such as the Internet, telephone and mobilephones. At present, over 85% of the finished payment transactions are electronic. Moreover, consumers seem to long for more developed electronic delivery, meaning that lifecycles of all banking products/services should be offered via electronic channels. It is worth remembering that the traditional way of doing banking at the branch level has relatively little importance to electronic banking users.

CONCLUSION

We may conclude that every aspect of banking will be transformed by new technology. Customer-

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friendly products, delivery channels, relationship banking, dependency on IT systems and competitive pricing would be the driving forces, but a pressure-cooker atmosphere cannot be avoided. The most successful institutions will be those that combine visionary technology and very competitive pricing with strong relationships and brands built on trust with previous in-depth experience of the client business.

Banks would have adopted the following strategies to move to high-tech banking as a necessity of e-commerce, e-banking, etc.

- a. Identification of select branches from out of the entire spread of the branch network to provide innovative services.
- b. In the scenario of severe competition and escalating expectation of the customers for newer products and improved as well as alternative delivery channels, the nerve centre of banking activities will be redefined.
- c. The key to survival of banks, therefore, is retention of customer loyalty by providing value-added services tailored to their needs, using state-of-the-art technology, instead of relying on outdated practices.

Most Indian banks are initially expected to adopt the Standardised approach, given the additional preparations banks still need to make in developing credit risk grading systems and loss histories that meet the Internal Ratings Based standards. A few banks are in the early stages of developing such systems and building data histories.

The Indian Banking sector is in reasonable fettle certainly versus a number of Asian economies it needs to further strengthen to support higher economic growth and the new investment cycle Indian companies are entering into. The next five years will set the stage for this with a new wave of technology, consolidation and more capital.

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