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INDIAN BANKS AND THE GLOBAL CHALLENGES

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ABSTRACT

Integration of economies leads to integration of financial markets catalyzing the globalisation process. The growing role of the financial sector in allocation of resources has significant potential advantages for the efficiency with which our economy functions. Consequently, the adverse consequences of malfunction of the financial system are likely to be more severe than they used to be in the past. Hence, all our efforts today are focused at ensuring greater financial stability. Given the significance of the Indian banking system, one cannot afford to underplay the importance of a robust and resilient banking system. The enhanced role of the banking sector in the Indian economy, the increasing levels of deregulation along with the increasing levels of competition have facilitated globalisation of the India banking system and placed numerous demands on banks. The last decade has witnessed major changes in the financial sector such as new banks, new financial institutions, new instruments, new windows, and new opportunities - and, along with all this, new challenges. Demand for new products, particularly derivatives, has required banks to diversify their product mix and also effect rapid changes in their processes and operations in order to remain competitive in the globalised environment. In this context an attempt is made to discuss the positive effects in demanding environment has exposed banks to various challenges.

INTRODUCTION

GLOBALIZATION OF FINANCIAL SERVICES

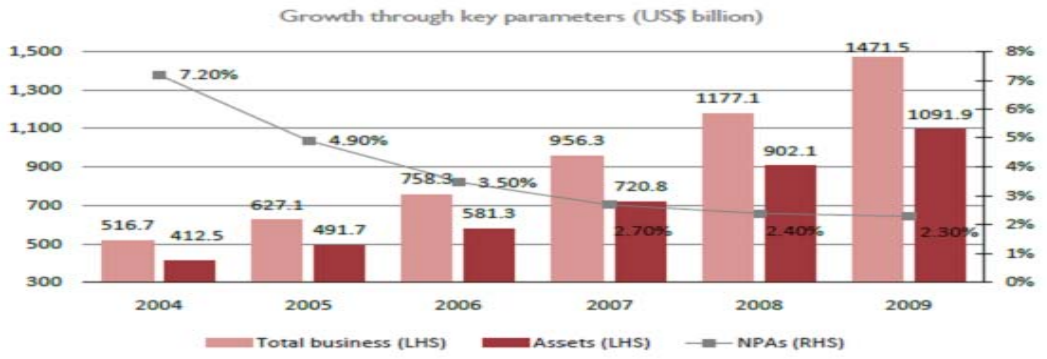
Growing integration of economies and the markets around the world is making global banking a reality. The surge in globalization of finance has also gained momentum with the technological advancements which have effectively overcome the national borders in the financial services business. Widespread 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 (FSA) of 1997. This gives India's financial sector including banks an opportunity to expand their business on a quid pro quo basis.

The financial sector now operates in a more competitive environment than before and intermediates relatively large volume of international financial flows. In the wake of greater financial deregulation and global financial integration, the biggest challenge before the regulators is to avoid instability in the financial system. Specifically, at one extreme, the sector could account for over 7.7 per cent of GDP with over Rs. 7,500 billion in market cap, while at the other it could account for just 3.3 per cent of GDP with a market cap of Rs. 2,400 billion. Banking sector intermediation, as measured by total loans as a percentage of GDP, could grow marginally from its current levels of ~30 per cent to ~45 per cent or grow significantly to over 100 per cent of GDP. In all of this, the sector could generate employment to the tune of 1.5 million compared to 0.9 million today. Amidst the rapid growth of the economy and dazzling banking future, there is growing interest among both global as well as Indian conglomerates in the buoyant banking sector. India, as the world's third largest economy in terms of purchasing power parity (PPP), presents varied opportunities for banking market. Studies indicates that banking landscape in India would emerge as the third largest banking hub in the world by the next couple of decades and could grew faster than chine's banking industry.

GROWTH OF INDIAN BANKING SECTOR: A REALITY CHECK

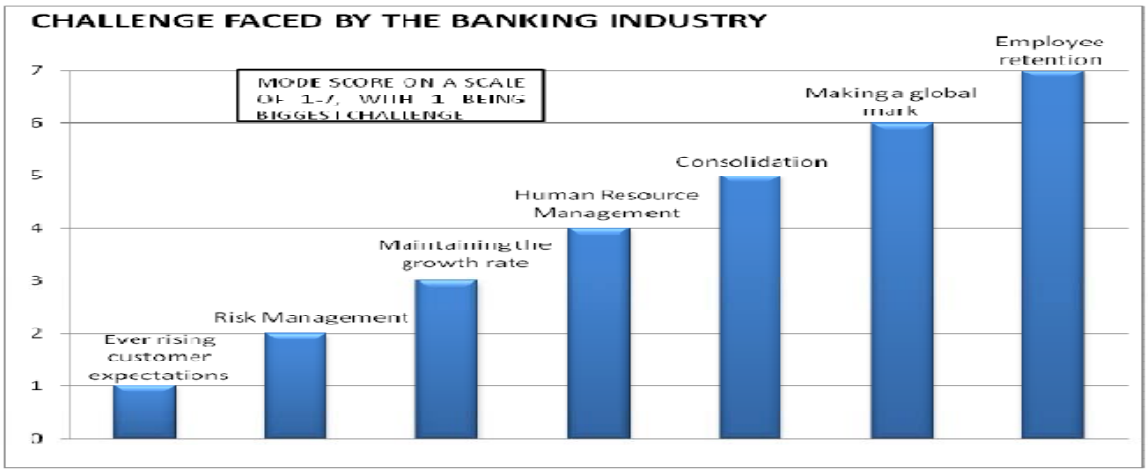
Indian banking industry is currently in its evolutionary phase with growing liberalization, Entry of foreign banks, direct intervention of state, rising technology etc. As per Indian Banks' Association report 'Banking Industry Vision 2010', there would be greater presence of international players in 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. Banking scenario has changed rapidly since 1990s. The decade of 90s has witnessed a sea change in the way banking is done in India. Globalization and liberalization of the Indian economy and the interest of foreign banks to expand their presence in India through the inorganic route have fuelled the growth of banking industry. The banking penetration calculated on the basis of total number of credit accounts to total population which accounts for 9.4 per thousand in 2007-2008.



Source: Report on trends and progress of banking in India 2008-09, RBI website, www.rbi.org.in, accessed on January 12, 2010.

KEY CHALLENGES OF BANKING SECTOR IN INDIA

The banking sector plays a vital role in the economic development of any country. Amidst the rapid growth of the economy and dazzling banking future, there is growing interest among both global as well as Indian conglomerates in the buoyant banking sector. However, the impact of the entry of foreign banks on domestic banks is likely to depend on various factors such as the structure, strength and competitiveness of domestic banks, the share of foreign banks, and the regulatory/supervisory framework. While the entry of foreign banks could definitely improve the competitive environment, and that they are not likely to weaken domestic banks. With better technology and expertise in offering specialized banking products such as derivatives, advisory services, trade finance, etc, the entry of foreign banks can enhance healthy competition and has a positive spillover effect on the domestic banks. The domestic banks would be under peer pressure to improve operational efficiency. It needs, however, to be recognized that the banking system in India is quite competitive with the presence of public, private and foreign banks.

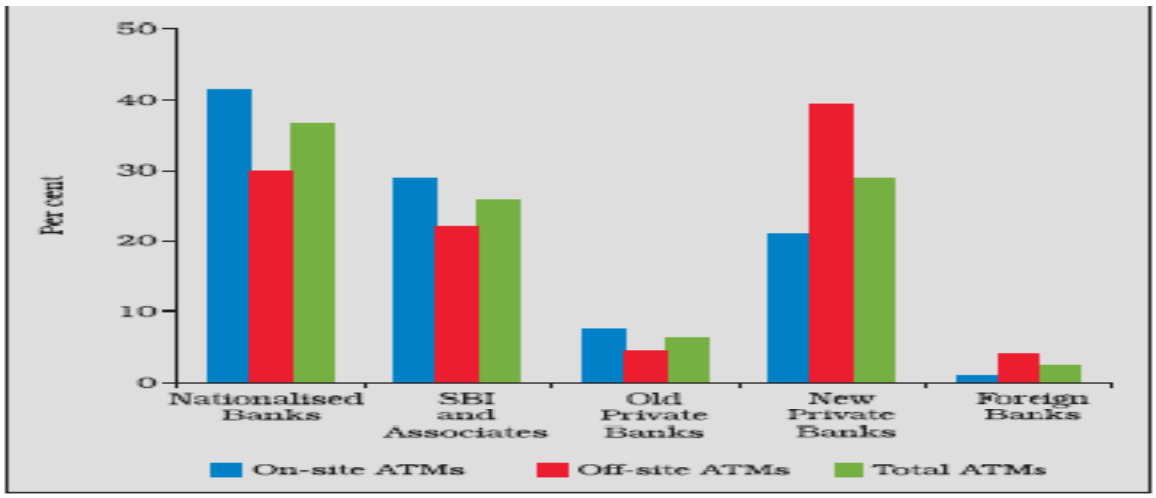


Source: Federation of Indian Chamber of Commerce & Industry (FICCI) Annual Survey 2010

CUSTOMER SERVICE / EXPECTATIONS

In India, the banking sector is facing unprecedented challenges in providing services to a broad range of customers, which varies from sophisticated corporate and high net worth individuals to low-end borrowers. The satisfied customer is the best guarantee for stability of the organization in the long-run. Banks can satisfy their customers only by providing customized, cost effective and timely services. With the help of technology banks are able to provide plethora of products and services to their customers

catering to their needs. Major services provided by the Indian banks that are of international standards are Any time banking, Anywhere banking, Global ATM and Credit Cards, Internet banking facility etc. Banks have added more than 14000 branches and 41000 ATMs to their network in the last decade, besides broadening the scope of delivery channels to internet banking, mobile banking and call centres. Banks have rolled out technology to the advantage of the customers.



Source: Report on Development of Banking in India 2009-10

IMPROVEMENT OF RISK MANAGEMENT SYSTEM

Globalization and liberalization are forcing banks to take more risk to compete effectively in the global market place. One of the important risks is compliance risk. It is the risk to comply with laws, rules and standards such as market conduct, treating customers fairly, etc. To mitigate this risk, banks should develop compliance culture in their organization. It is not only the duty of compliance specialists, but banks can also manage compliance risk by putting in place compliance functions that are in consistence with compliance principles.

Liquidity risk arises when banks unable to meet their obligations when they become due. To manage the mismatch of assets and liabilities, banks should analyze the accounting data both on static as well as dynamic basis. Deposits of higher value are the most important item to be monitored regularly, as sudden withdrawal of these deposits might cause liquidity problem for the bank. Also incentives to these deposits in the time of falling interest rates could create strain on liquidity.

MAINTAINING THE STEADY GROWTH

The growth of Indian banks in the last decade was much higher than its preceding decade and there is no doubt that the present decade would offer even more exciting opportunities. The size of total assets of the Indian banking industry has increased more than five times between March 2000 and March 2010, from US $ 250 billion to more than $ 1.3

trillion, registering a CAGR growth of 18% compared to average GDP growth of 7.2% during the same period. Consequently, the ratio of commercial banking assets to GDP increased to nearly 100 per cent. The business of banks to GDP ratio has almost doubled – from 68% to 135%. The growth has been profitable with improvement in efficiency and productivity.

The return on assets of scheduled commercial banks (SCBs) was 0.6% in 2000-01 and increased to 1.1% by 2009-10. Gross non-performing assets to gross advances declined to 2.5% from 11.4%, reflecting improved asset quality. The capital strength, as measured by the capital adequacy ratio, has also improved from 11.4% in 2000-01 to 14.6% in 2009-10.

SKILLED HUMAN RESOURCE MANAGEMENT

There will be a sea change for employees too. Secure jobs will be replaced by contractual appointments, for a specified period of time. The unions will merge into the shadows and bank managements will turn effective. As a result there will be swifter turn over of personnel in banks. But at the same time, skilled personnel from other disciplines will enter banks in increasing numbers. Factors like skills, attitudes and knowledge of the human capital play a crucial role in determining the competitiveness of the financial sector. The quality of human resources indicates the ability of banks to deliver value to customers. Capital and technology are replicable but not the human capital which needs to be valued as a highly valuable resource for achieving that competitive edge.

CONSOLIDATION

There are a number of very small banks in India which do not create any value either for themselves or the customers. The process of consolidation in India aims at ironing out these deficiencies. The recent acquisitions and re-merger by banks in India is a precursor of the trend. The Indian banking industry may soon be characterized by fewer but very competitive banks. This poses the dual question of future strategies of banks in terms of merging or acquiring as well as forecasting the strategies of their competitors.

Consolidation within the banking industry is imperative. Commoditization of the traditional banking products and the need to invest in technology, marketing and product innovation has made size and scale critical success factors in this industry. Consolidation is imminent, and foreign banks with their large capital and product expertise can play a significant role in this process. The Indian financial system is not yet very strong to take on stiff foreign competition. There is still not a level playing field between Indian banks and foreign banks; the latter does not have developmental obligations like 40% lending to the priority sector where returns are low. Foreign banks are not required to direct more than 32% of their net credit to the "Priority sectors" identified by the RBI, which include agriculture, small-scale industries and exports.

MAKING GLOBAL MARK

Globalisation of domestic banks has also been facilitated by tremendous advancement in information and communications technology. Globalisation has thrown up lot of opportunities but accompanied by concomitant risks. There is a growing realisation that the ability of countries to conduct business across national borders and the ability to cope with the possible downside risks would depend, inter-alia, on the soundness of the financial system and the strength of the

individual participants. Adoption of appropriate prudential, regulatory, supervisory, and technological framework on par with international best practices enables strengthening of the domestic banking system, which would help in fortifying it against the risks that might arise out of globalisation. In India, we had strengthened the banking sector to face the pressures that may arise out of globalisation by adopting the banking sector reforms in a calibrated manner, which followed the twin governing principles of non-disruptive progress and consultative process. Most Indian banks including the PSU banks already have branches abroad, albeit with minimal presence in terms of market share. With ICICI and SBI setting the example, Indian banks are now looking to expand in locations out of India in a huge way. However, meeting disclosure norms and obtaining licenses poses a challenge for Indian Banks.

RETENTION MANAGEMENT

Heightened competition for consumers' banking wallets and increased consumer mobility have elevated retention management to a top-of-mind concern for banks of all sizes, as reflected in recent research conducted by BAI. Customer retention is difficult to manage because there are a multitude of drivers that prompt customers to terminate relationships. Often these key drivers are interconnected, meaning that customers decide to defect due to a combination of circumstances that build up over time. The common controllable drivers of customer attrition include service quality problems, dissatisfaction with product pricing and/or minimum balance requirements, unexpected fees, and the attraction of a competitive product offer.

No matter their size or technological sophistication, all banks rely significantly on front-line staff to implement retention programs. Bankers survey recognize the urgent need to upgrade the skills set and training of their employees — 68% of the surveyed bankers stated that they needed to do a better job of giving front-line employees the tools and training required to identify and react to customers whose accounts are at risk. Successful retention intervention requires employees who can quickly pick up on the cues of a potential defection, formulate a response and effectively communicate a proposal to the customer.

CONCLUSION

Given the new environment, Indian banks can't remain unaffected by the changes around and challenges before them. Therefore Indian banks need to restructure themselves. The following practices need to be adopted on urgent basis;

- Greater professionalism.
- Greater emphasis on diversification and sources on interest income.
- Consultancy services.
- Equipping themselves to operate in the deregulated environment.
- Necessary changes in the legal stipulations.
- Cost management.
- Bench marking of service standards to improve productivity and Proficiency.
- A self- regulatory organization to monitor the activities of banking

With the increasing levels of Globalization, Liberalization, Privatization and new reforms of the Indian banking

sector, competition will intensify further. Further, the financial sector reforms started in this country as part of economic reforms has brought a revolution in the structure of the banking sector. As the deregulation has opened up new opportunities for banks, liberalization has intensified competition within the banking sector by opening new market sectors to foreign and private banks. Lower interest rates reduce debt and the scope for introducing new challenges for the bank, especially public sector banks. Banks need to develop enough to function in a competitive environment. Therefore, the banks who understand the market dynamics, perceive threats, anticipate volatility, show high degree of professionalism and dynamism in their functioning and respond promptly to the market needs would survive and prosper.

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