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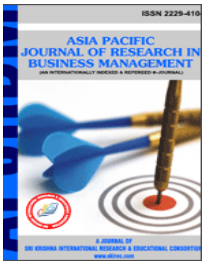

CHANGING SCENARIO OF BANKING SECTOR IN INDIA– ISSUES AND CHALLENGES

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Abstract

The present study is conducted to study the development ,issues and challenges of the banking sector in India. An effort has been made to evaluate the development in banking sector after Liberalisation. Comparison was also made in the working pattern of Private and Public Sector Banks and it was found that there is a significant difference between the functioning and profitability of Private and Public Sector Banks.

Key Words :Banks, Liberalisation, , Private sector ,Public Sector ,Competition, Profitability

INTRODUCTION

The Indian Banking System has undergone a sea change in the past decade with the implementation of the ongoing banking sector reforms. Reforms are continuing as a part of the overall structural reforms aimed at improving the productivity and efficiency of the economy. The role of an integrated financial infrastructure is to stimulate and sustain economic growth.

The Banking sector over the years has become more efficient with the implementation of prudential norms for asset classification and improved thrust on technology advancement. The Public Sector Banks (PSBs) still dominate the sector with 75% of the market share of business and profits. The new private sector banks with their technology driven business model are fast catching up with the PSBs. The last two years has seen banks book windfall gains in treasury profits. With the interest rates hardening up, banks need to focus on core profit growth. The retailisation of the banks' balance sheet has seen banks improve their asset mix with the home loans, auto loans and personal loans.

The Indian Banking System has a large geographic and financial coverage. Presently, the total asset size of the Indian Banking Sector is US$ 270 billion while the total deposits amount to US$ 220 billion with a branch network exceeding 66,000 branches across the country. Revenues of the banking sector have grown at 6% CAGR over the past few years to reach a size of US$ 15 billion. While commercial banks cater to short and medium term financing requirements; national level and state level financial institutions meet long term requirements.

Banking has grown into a technology concentrated and customer friendly model with a focus on convenience. The sector is moving towards the emergence of financial supermarkets in the form of universal banks providing a set of services ranging from retail to corporate banking, industrial lending and investment banking. While corporate banking is clearly the largest segment, personal financial services is the highest growth segment. The recent favourable government policies for enhancing limits of foreign investments to 49% among other key initiatives have encouraged such activity. Larger banks will be able to muster sufficient capital to finance asset expansion and fund investments in technology.

CHANGING SCENARIO

The Indian banking has finally worked up to the competitive dynamics of the new Indian market and is addressing the relevant issues to take on the multifarious challenges of globalization. Banks that employ IT solutions are perceived to be 'futuristic' and proactive players capable of meeting the multifarious requirements of the large customers base. Private Banks have been fast on the uptake and are reorienting their strategies using the Internet as a medium. The internet has emerged as the new and challenging frontier of marketing with the conventional physical world tenets being just as applicable like in any other marketing medium.

The Indian banking has come a long way from being a sleepy business institution to a highly proactive and dynamic entity. This transformation has largely been brought about by the large dose of liberalization and economic reforms that allowed banks to explore streams (i.e. borrowing and lending). The banking in India is highly fragmented with 30 banking units contributing to almost 50% of deposits and 60% of advances. Indian nationalized banks (banks owned by the government) continue to be the major lenders in the economy due to the sheer size and penetrative networks which assures them high deposit mobilization.

The need to become highly customer focused has forced the slow-moving public sector banks to adopt a fast track approach. The unleashing of products and services through the net has galvanized players at all levels of the banking and financial institutions market grid to look anew at their existing portfolio offering. Conservative banking practices allowed Indian banks to

be insulated partially from the Asian currency crisis. Indian banks are now quoting a higher valuation when compare to banks in other Asian countries (viz. Hong Kong, Singapore, Philippines etc.) that have major problems linked to huge Non Performing Assts (NPAs) and payment defaults. Co-operative banks are nimble footed in approach and armed with efficient branch networks focus primarily on the 'high revenue' niche retail segments.

REVIEW OF LITERATURE

There has been a great deal of interest in the banking sector as a result of emerging trends and huge potential of this sector. Some research studies have been carried out on various changes and prospects of this sector. During the period of research libraries, banks and various institutions were visited. The research material and literature available there was studied which proved to be very useful Some relevant abstracts from these studies are briefly discussed below:

Bimal Jalan in his book **'Indian Economy in the new Millennium' (2001)** has opined that there has been progressive intensification of the banking sector reforms, and the banking sector as a whole is more sensitized than before to the need of internal strength and effective management as well as to the overall concerns for financial stability. He further points out that in view of greater disclosure and tougher prudential norms, the weaknesses in our banking system are more apparent than before.

Vepa Kamesam in this paper entitled **'A Tool for New Age Banking' (2004)** has emphasized the importance of computerization of the banking sector. He opines that a holistic approach to computerization will give banks an edge in customer service, better housekeeping and optimal use of funds. The paper points out that this result in stat-of-the-art payment and settlement systems that make for efficient housekeeping in banks, better customer service and overall system efficiency – all based on technology.

P.S. Shenoy in his paper **'Remarkable Turnaround of Public Sector Banks' (2002)** has described that the real impetus to banking reforms has come from the forces of liberalization , privatization, and globalization of the economy. He further points out that these reforms have brought a paradigm shift in the profile of Public Sector Banks. Despite the many constraints still hampering their operations, the banks are still successfully steering through the choppy waters of change.

A.T. Paneer Selvam in his book **'What the Future Holds?' (1999)** has described that the prudential norms have completely changed the face of the banking system. He also points out

that the banks have the two masters to serve – profits and customer needs and steps should be taken to do this.

P.S.V. Chari and **P.S. Narsimhan** in the paper **'Banking: Through the Decades' (2000)** have pointed out that due to sustained efforts to reform Indian Banking System, it is far better equipped to face the future with confidence.

R. Narsimhan has declared computerization as the key to future in his research paper **'The Talisman for PSBs' (2000)**. He opines that Public Sector Banks have a large network of computerized branches, with which they can rewrite the history.

K.P. Padamkumar in his book **'Old PSBs in the Millennium' (2001)** stays positive that even with the presence of the new generation banks and large public sector banks, the old public sector banks have a significant role to play especially in their geographical areas of operation. He suggests that they need to concentrate on serving their niche areas and segments well. Such banks will indeed have to think global and act local so as to stay relevant in the market at all times.

V. Raghunathan in his research paper **'Universal Banking- possibilities and pitfalls' (2003)** describes that convergence in the banking sector assumes significance because banks today no longer compete merely with other banks. They in fact compete with altogether different sectors. According to him the only problem that banking sector is likely to face in the process of integration is the relative lack of service costing culture in the country

G. Sreekumar in the paper **'The New Basel Accord' (2005)** opines that Basel-II may set in process of "re-intermediation" where the better borrowers thanks to the lower risk weights, will rather go to their bankers than access the capital market for their funding requirements

After liberalization, there have been tremendous changes in this sector of the Indian economy but no comprehensive study has been done, to observe the changes and suggest improvements as a whole.

Therefore this study is a modest attempt to analyze the changes, expectations and experiences of customers as well as banks in public and private sector post liberalization.

OBJECTIVES OF THE STUDY

The objectives for the proposed study are as under:

1. To trace out the pattern of development of banking Sector in India in the recent years
2. To evaluate the developments in banking sector after liberalization,
3. To examine the extent of the performance of major banks in public sector and private sector;
4. To study the main problems and challenges faced by the banking sector,

RESEARCH METHODOLOGY

Research methodology is the blue print of the research work. It is essential to anticipate all points which should be undertaken for the completion of research work. These steps are often referred to collectively as the research methodology. The study has been conducted from 2005 onwards as 14 to 15 years duration has already passed since liberalization .

The Indian banking system can be broadly categorized into nationalized banks, private banks, cooperative banks and specialized financial institutions. The Reserve Bank of India acts as a centralized body monitoring any discrepancies and shortcomings in the system.

But after liberalization, private sector and foreign banks have started giving competition to public sector banks. The major differentiating parameter that distinguished these banks from all other banks in public sector was the level of service that was offered to customers. Increased competition compelled the public sector banks to wake up to the demand of the customer and this particular fact revolutionized the banking sector in India. A brief description of the sample design and methods of data collection adopted for the present study consisted of the following steps:-

I. <u>Data collection</u>

The present analysis is based on the primary and secondary data collected from Reserve Bank of India, various nationalized banks and various private sector banks. Data was collected from Banks, Financial Institutions, RBI and SEBI etc. For collecting secondary data various sources like government gazettes, government publications, recent notifications, websites of concerned departments and ministries were used.

II. <u>Survey Methods</u>

For the purpose of this study the banking sector has been divided into two segments viz. Public sector banks and Private sector banks. The study is based on the data collected from the public as well as from private banks. The survey has been conducted through extensive personal interview method. It was deemed essential to pay personal visits to banks to collect such

information which could not have been obtained otherwise. Personal visits helped in collecting first hand information regarding functioning of the banks and their specific problems. It also provided an opportunity to the researcher to have detailed discussion with the people working in the field and with the customers.

III. The Questionnaire

For the purpose of collecting facts and figures related to banking detailed questionnaire, separately for customers and banks covering different aspects of the study were prepared. In order to maintain uniformity, interviews were conducted on the basis of this structured questionnaire. It covered important aspects like customer satisfaction, their experience with the changes in technology i.e. Internet Banking, ATMs, Debit and Credit Cards etc. and the problems resulting from it, trustworthiness of private banks, difference in rates of interest of public and private banks, and changed scenario of loaning.

The questionnaire was prepared for public/private sector banks, which helped in analyzing the aspects like customer satisfaction, deceasing profitability, risk management, sharpening technological and human resources, innovating customized products, responsibilities towards corporate governance, meeting international standards, and feeling of competitiveness towards each other.

The secondary data of the public and private banks were collected from the Reserve Bank of India. Published reports and documents have also been used for the research work..

IV. Techniques of Analysis

The information collected from both primary as well secondary sources was analyzed and interpreted with the help of various statistical tools using SPSS in order to arrive at meaningful conclusions. Statistical tools like Sampling Technique, Analysis of Variance were applied to the collected data to determine its significance and to analyse what significant changes and challenges have been brought by the emerging trends in this sector and how the customers are reacting to them and how banks are planning to manage them.

ANALYSIS OF DATA

In order to check the impact of Liberalisation, an effort was made to compare the following aspects in pre and post Liberalisation Era:

- Deposits
- Loan Disbursement
- Profitability

Separate data was collected as regard to Deposits, Loan Disbursement and Profitability of Scheduled Banks prior and after Liberalisation. The data was run on SPSS.

Null Hypothesis was framed as under:

H0 : There is no impact of Liberalisation on Banking Sector.

t-test was applied on the above three variables one-by-one with the help of SPSS.

p-value in all the three cases came significant, i.e. less than .05

So, Null-Hypothesis stands rejected and Alternate Hypothesis is accepted. It means, Liberalisation affected Deposits, Loan Disbursement and Profitability of Banks.

To examine the difference in performance of major public and private sector banks, data relating to profitability was collected in two groups.

In one group, profitability of 5 public sector banks (i.e. State Bank of India, Punjab National Bank, Canara Bank, Oriental Bank of Commerce, Punjab And Sind Bank) were collected. Similarly, profitability of 5 private sector banks (HDFC, Kotak Mahindra, ICICI, IDBI, and AXIS Bank) were also collected.

Net Profit Ratios were computed to bring the uniformity in comparison. ANOVA Test was applied in SPSS in Net Profit Ratio.

Following Null Hypothesis was framed:

H0 : There is no difference between performance of public and private sector banks.

Having run SPSS for ANOVA, it was found that p-value was less than .05. It means Null Hypothesis was rejected and Alternate Hypothesis was accepted. There was a significant difference in the profitability of public and private sector banks.

PROBLEMS AND SUGGESTIONS

The Indian economy has been witnessing robust growth for quite a few years in succession. In 2006-07, the economy is estimated to have grown by 9.2%, building on 9% growth in the previous year. There are many positive features to this growth, which reinforce its solid foundations: the broad based nature of the growth relying on domestic demand (both investment and consumer) and exports, as well as the sectoral contribution, with manufacturing contributing to the strong growth momentum, not just services. The only exception is the challenge of agriculture. During 2006-07, the manufacturing sector grew by 12.3% against

growth of 9.1% a year ago. The services sector, which has been growing since mid-1990s, is expected to continue to power the Indian economy, as it now accounts for three-fifth of GDP. Within services, trade, hotels, transport and communications and financial services recorded double-digit growth for the last two years. Another positive feature underpinning the current growth phase is the sharp rise in the rate of savings and investment in recent years, with the rate of gross domestic investment having risen sharply to 33.8% and the savings rate to 32.4% in 2005-06. Investment in general, being a forward looking variable, reflects a high degree of business optimism and reinforces the outlook for growth.

The Indian public sector banks face challenges for their existence both in domestic and international markets. During the past few years the RBI has softened its attitude towards private banks in the country. The banks that meet the RBIs capital adequacy requirements can open branches without seeking any prior approval. The private banks are market driven instead of government driven. However, the present Indian public sector banks operate like governments. Better customer services are the key to success in the slogan given by private banks. But public sector banks are burdened with the high non-performing assets and a large work force. Few of Indian public sector banks have small number of branches in foreign countries. These branches generally do not perform well. One of the reasons of deterioration in operations of Indian banks abroad is that their capital base is very weak and do not conform to the international standards. Earnings from operations are not retained in the bank for augmenting the capital base.

The future of Indian banking represents a unique mixture of unlimited opportunities amidst insurmountable challenges. On the one hand we see the scenario represented by the rapid process of globalization presently taking shape bringing the community of nations in the world together, transcending geographical boundaries, in the sphere of trade and commerce and even employment opportunities of individuals. All these indicate newly emerging opportunities for Indian banking. But on the darker side we see the accumulated morass, brought out by three decades of controlled and regimented management of the banks in the past. It has siphoned off profitability of the government owned banks, accumulated bloated NPA and threatens adequacy of the banks and their continued stability. Nationalized banks are heavily over-staffed. The recruitment, training, placement and promotion policies of banks leave much to be desired. In the nutshell, the problem is how to shed the legacies of the past and to adapt to the demands of the new age. However, with the advent of economic reforms, the deregulation and opening of the Indian economy to the global market, brings opportunities over a vast and unlimited market to business and industry in our country, which directly brings added opportunities to the banks.

Nationalization resulted in Reserve Bank of India enforcing uniform rates and service charges among nationalized banks. This caused a lack of competition either amongst the public sector banks or between the public and private banks, which gradually eroded the spirit of competition from the banking sector. This, combined with the labour policies of the public sector employees' salary and promotions not being linked to their job performance, has led to a steady decline in the efficiency, quality of customer service and work culture in the banks.

Political control of public sector banks and the consequent lobbying by various pressure groups has resulted in loans being given without adequate safeguards against default and a lax attitude towards enforcing repayment. Concessional priority sector lending imposes a burden on the rest of the economy which must subsidize the cost of such loans and is faced reduced credit availability to the more productive investments. Thus, the social benefits of priority sector lending have proved to be smaller and cost higher than originally expected. As such, priority sector lending has begun to look increasingly unviable. With the massive branch expansion, the country as a whole and even rural India is now well served by commercial banking facilities.

There is no easier way to pay for purchases than with a credit card. With an available line of credit, one does not have all the hassles of standing in the line in the bank for a cash withdrawal, hunting for a pen to draw a cheque, counting out change or having to worry about overdrawing on your bank account. Instead, with a credit card one can make best use of deals such as cash back offers, shopping incentives, spending points and the goodies they fetch. The main caveat is that one must be careful not to go overboard spending on the card. Else, it could be very disadvantageous. Further, credit bills are paid well in time to avoid penalties.

Most private, foreign banks offer online and phone banking facilities. Mobile banking allows a great amount of flexibility in monitoring and managing one's finances. Phone banking goes hand I hand with internet banking. With a combination of mobile and internet banking one can request and receive information about one's accounts 24x7. One can check one's balance and view statements online, move money between accounts, make credit card /bill payments order cheque books and statements, download account information to analyze on computer. Online/phone banking can be very economical. Banks usually offer online banking at no extra cost. Organized efforts should be made to ensure commercial banks that there is no minimum duplication of efforts in collection of information.

There is a need for integrated costing and financial reporting system in banks. The Management Information System should clearly bring out the inter-relationships between the volume of business, the cost and related income, so that the managerial decision-making may lead to improve profitability. It must be cost-effective.

To achieve competitiveness both in domestic and international market, the banking sector necessarily needs to launch various efforts of innovation.

The financial system would, therefore, not only need to be stable, but would also need to support still higher levels of planned investments by channeling financial resources more efficiently from deficit to surplus sectors. The banks would need to reassess their core banking business to view how best they could undertake maturity transformation to step up lending of resources in support of real economic activity. Competitive pressures as well as prudential regulatory requirements have made banks risk-averse and their investments in relatively risk–free gilt instruments. The behavior and strategies of bank business would need to change from the present so that they can factor in their own risk assessment even while performing their core activities. There is a need to ensure long term finance to support development and growth in the economy, even as restructuring takes place through mergers and universal banking.

The economic liberalization process has increasingly exposed the banking sector to international competition. The role of banking in the process of financial intermediation has been undergoing a profound transformation, owing to changes in the global financial system. Consequently, the revolution in information technology has brought sea changes in the way banking transactions are being carried out. The latest trends may be summarized in one word that is “diversification of banking activities.

Perhaps the greatest challenge that the Banking sector will have to face is the one that emanates from the foreign shores. With increased global interest to India, the number of foreign players eyeing the huge Indian market can only increase. It is a well known fact that foreign Banks have been exploring for "good buys" in the Banking sector for some time now. The hurdle in their game plan has been the regulatory issues which effectively debarred them from such activities. With RBI outlining a road map on foreign investment in Bank in India the stage is set for a full fledged presence of foreign players in the Indian Banking market, post April 2009. With the entry of foreign players with their huge resources "size" is bound to be of great importance.

Receiving customer complaints, listening to the grievances patiently and solving the problems is one of the important areas of customer service which demands attention at all times. A Cliché often used in describing this is – "A Satisfied Customer is the Best Ambassador". What is equally worth noting, however, is that just as a satisfied customer tells other about it, an unhappy customer too tells others about his experience and indeed more so.

Complaints highlight areas of weaknesses in bank services which needs improvement. There should be positive approach to complaints in banks. There should not be any adverse reaction or harassment to customers who make complaints. A satisfied customer of the bank is an unpaid publicity agent for the bank. Since Independence most sectors were governed by the public sector. It was only after the economic reforms of 1991 that the new economic reforms policy allowed private sectors also to enter in major economic activities. But the monopoly of public sector for more than 40 years has conditioned the common man's mind such that in today's free economy, they are not ready to trust the private sector, particularly the financial service.

The concept of employees' public relations should be taken up seriously. A professional network should be established which chalk out different modes of developing employee-public relations and reviewing these relationships on the basis of certain pre-determined parameters. The employees working at the counters of banks or receptionists determine the magnitude of success of the public relations activities. The suitable and attractive media coverage is one of the important tools for developing employee public relations. The advertisement messages, appeals and bank news coverage etc. should regularly be given to public through different powerful media channels.

The Indian Banking System is transforming itself towards more commercial and customer oriented banking system, a clear departure from the time it has expected to play only social and developmental role. The marketing and technology orientation is throwing up new opportunities for the banking system

The PSBs should grab the opportunity and try to install maximum number of ATMs on their respective on site branches as well as other viable off site trading and commercial places.

Technology has moved from being just a business enabler to being a business driver. Be it customer service, reducing operational costs, achieving profitability, developing risk management systems or otherwise, we turn to technology for providing necessary solution. Technological upgradation was clearly identified as one of the most successful strategy in Customer Acquisition and Retention followed by Expansion of ATM Network, Advertisements and additional sales force. Customer Retention and Customer Satisfaction are quite obviously

inter-linked. While consumers may be happy to make payments and interact with their bank through convenient – and cheaper – banking channels, they still expect high standards of service, something which reflects the bank's brand and image across all channels.

The banks should pay more attention towards increasing credit facilities to women. It is almost untapped source disbursing credit. RBI has also taken a serious note of the fact that the most of the nationalized and private banks are not following it guidelines to provide adequate credit to women customers. According to RBI guidelines, the bank should provide at least 4 percent of their total credit to women entrepreneurs and beneficiaries, however the bankers admitted that due to limited demand from women entrepreneurs, the total lending was not more than 1 percent of total credit.

The Indian Banking System is transforming itself towards more commercial and customer oriented banking system, a clear departure from the time it has expected to play only social and developmental role. The marketing and technology orientation is throwing up new opportunities for the banking system. The consolidation phase in 1980s has made it evident that the nationalization gains could not be sustained without substantial cost to the economy. Thus the process of deregulation and liberalization of the financial system emerged during 1990s. It has culminated in rationalization and re-structuring of the banking system as well as conforming to international standards

Banking sector in India has given a positive and encouraging response to the financial sector reforms. Entry of new private sector banks and foreign banks has shaken up public sector banks to competition. Changing financial scenario have opened up opportunities for banks to expand their global presence through self expansion, strategic alliances etc. Banks are diverting their focus on retail banking so as to obtain access to low cost funds and to expand into relatively untapped potential growth areas.

The world over the banking environment has become highly competitive. As a result, the conventional banking has undergone a total transformation. The banks have started increasingly employing marketing approach to sell banking services to their customers. Various new and innovative schemes have been introduced with a view to provide greater satisfaction to the customers and win their franchise. In addition, banks have also started using various marketing tools and techniques such as market segmentation, produce differentiation, product positioning and effective promotion to carve niches for themselves in the banking industry.

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