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# Indian Banking Industry: Challenges and Opportunities

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## ABSTRACT

The banking industry in India has a huge canvas of history, which covers the traditional banking practices from the time of Britisher's to the reforms period, nationalization to privatization of banks and now increasing numbers of foreign banks in India. Therefore, Banking in India has been through a long journey. Banking industry in India has also achieved a new height with the changing times. The use of technology has brought a revolution in the working style of the banks. Nevertheless, the fundamental aspects of banking i.e. trust and the confidence of the people on the institution remain the same. The majority of the banks are still successful in keeping with the confidence of the shareholders as well as other stakeholders. However, with the changing dynamics of banking business brings new kind of risk exposure.

In this paper an attempt has been made to identify the general sentiments, challenges and opportunities for the Indian Banking Industry. This article is divided in three parts. First part includes the introduction and structure of Indian banking industry. The second part discusses the various challenges and opportunities faced by Indian banking industry with problems and prospects of banking in India. Third part concludes that urgent emphasis is required on the Indian banking product and marketing strategies in order to get sustainable competitive edge over the intense competition from national and global banks.

This article is a useful for researchers, bankers, strategist, and policy makers.

***Key words*:** Rural Market, Risk Management, Global Banking, Employee and Customer Services

## 1) INTRODUCTION

In recent time, we has witnessed that the World Economy is passing through some intricate circumstances as bankruptcy of banking & financial institutions, debt crisis in major economies of the world and euro zone crisis. The scenario has become very uncertain causing recession in major economies like US and Europe. This poses some serious questions about the survival, growth and maintaining the sustainable development.

However, amidst all this turmoil India's Banking Industry has been amongst the few to maintain resilience. The tempo of development for the Indian banking industry has been remarkable over the past decade. It is evident from the higher pace of credit expansion, expanding profitability and productivity similar to banks in developed markets, lower incidence of non- performing assets and focus on financial inclusion have contributed to making Indian banking vibrant and strong. Indian banks have begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling. In this paper an attempt has been made to review various challenges which are likely to be faced by Indian banking industry economy rolling.

## 2) HISTORICAL BACKGROUND:-

Bank of Hindustan was set up in 1870; it was the earliest Indian Bank. Later, three presidency banks under Presidency Bank's act 1876 i.e. Bank of Calcutta, Bank of Bombay and Bank of Madras were set up, which laid foundation for modern banking in India. In 1921, all presidency banks were amalgamated to form the Imperial Bank of India. Imperial bank carried out limited number of central banking functions prior to establishment of RBI. It engaged in all types of commercial banking business except dealing in foreign exchange.

Reserve Bank of India Act was passed in 1934 & Reserve Bank of India (RBI) was constituted as an apex body without major government ownership. Banking Regulations Act was passed in 1949. This regulation brought RBI under government control. Under the act, RBI got wide ranging powers for supervision & control of banks. The Act also vested licensing powers & the authority to conduct inspections in RBI.

In 1955, RBI acquired control of the Imperial Bank of India, which was renamed as State Bank of India. In 1959, SBI took over control of eight private banks floated in the erstwhile princely states, making them as its 100% subsidiaries.

It was 1960, when RBI was empowered to force compulsory merger of weak banks with the strong ones. It significantly reduced the total number of banks from 566 in 1951 to 85 in

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1969. In July 1969, government nationalised 14 banks having deposits of Rs. 50 crores & above. In 1980, government acquired 6 more banks with deposits of more than Rs.200 crores. Nationalisation of banks was to make them play the role of catalytic agents for economic growth. The Narasimha Committee report suggested wide ranging reforms for the banking sector in 1992 to introduce internationally accepted banking practices. The amendment of Banking Regulation Act in 1993 saw the entry of new private sector banks.

Banking industry is the back bone for growth of any economy. The journey of Indian Banking Industry has faced many waves of economic crisis. Recently, we have seen the economic crisis of US in 2008-09 and now the European crisis. The general scenario of the world economy is very critical.

It is the banking rules and regulation framework of India which has prevented it from the world economic crisis. In order to understand the challenges and opportunities of Indian Banking Industry, first of all, we need to understand the structure of Indian Banking Industry.

### 3) INDIAN BANKING STRUCTURE:-

The banks play a stellar role in the development of the nation with its high social content and commitment. The banks act as a development agency and are the source of hope and aspirations of the masses. Banking and finance is like oxygen to any democracy. The structure of the banking system is determined by two basic factors – economic and legal. The development of the economy and the spread of banking habit calls for increasing banking services. The demand for these banking services affects the banks‟ structure and organisation. National objectives and aspirations result in government regulations, which have a profound influence on the banking structure.

**These regulations are basically of two types:–**

**(i)** First, regulations which result in the formation of new banks to meet the specific needs of a group of economic activities and

## BANKING STRUCTURE IN INDIA

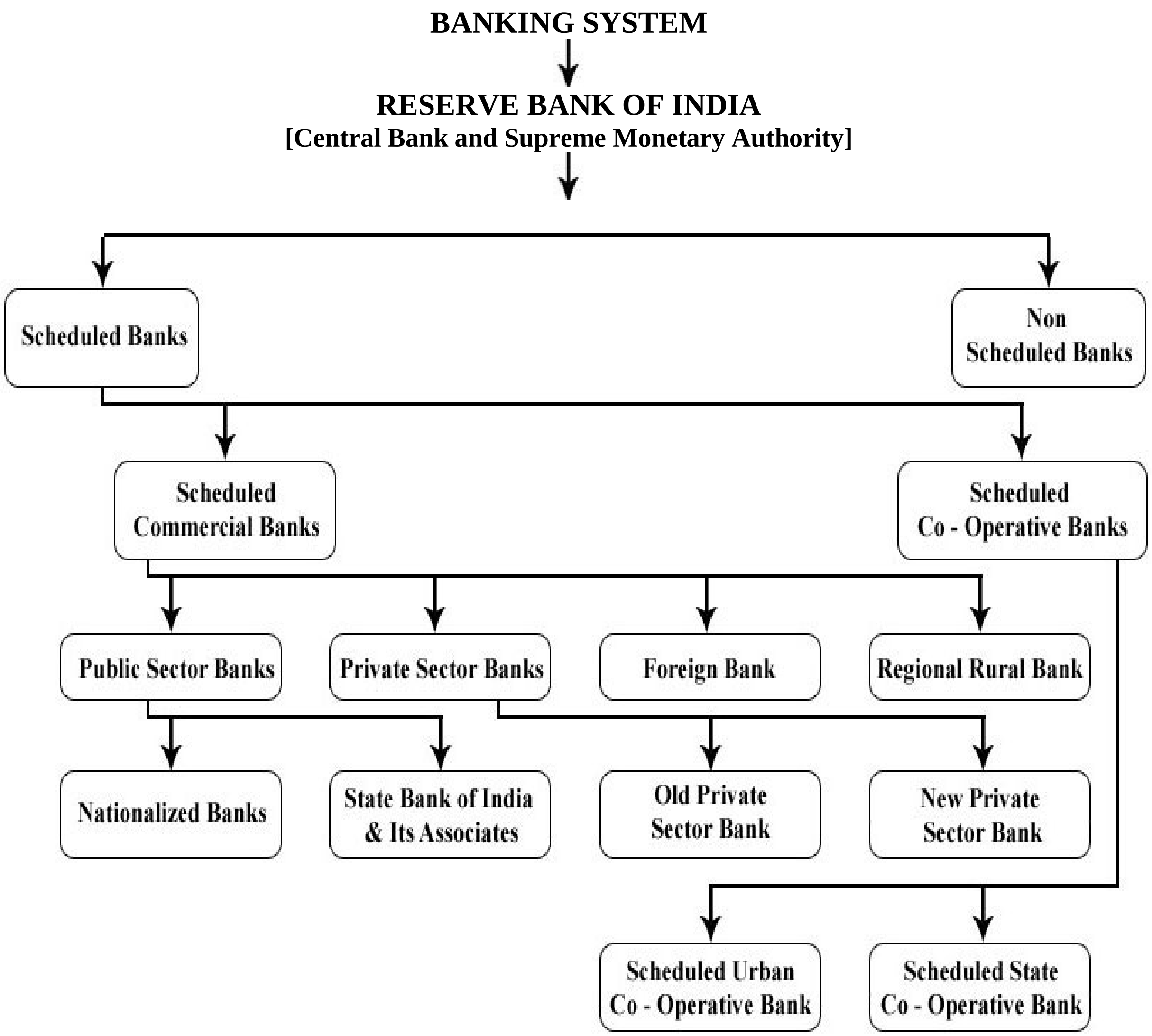


**Chart 1**: Role of banking structure in the growth of Indian economy

**(ii)** Secondly, legislation that affects the structure by means of nationalisation, mergers or liquidation.

It is no exception in case of India as banking is one of the most heavily regulated businesses in the world. The Indian banking system has come from a long way from being a sleepy business institution to a highly proactive and dynamic entity. Indian economy is having a vibrant banking sector, powered by both improved-efficiency public sector banks and growth-hungry private ones.

Banking Segment in India functions under the umbrella of Reserve Bank of India - the regulatory, central bank. India follows a bank-based financial system with a multilayered network consisting of scheduled and non-scheduled banks. These scheduled and non-scheduled banks functions under different categories consisting of: large state-owned banks, old private banks, new private banks, foreign banks, regional rural banks, cooperative banks, non-banking finance companies (NBFCs) and development financial institutions. The viable banking structure, extremely useful and indispensable, playing a substantial role in the growth of Indian economy is shown in **the Chart 1.**

## 4) CHALLENGES IN BANKING SECTOR :-

There has been considerable widening and deepening of the Indian financial system in the recent years. The enhanced role of the Banking sector in the Indian Economy, the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on our Banks. The adverse consequences of malfunction of the Banking system could be more severe than in the past. Hence, focus of RBI, the regulator & supervisor of Indian Banking system is at ensuring greater financial stability. While operating in this highly demanding environment, the banking system is exposed to various risks & challenges few of them are discussed as under:

### 4.1. Improving Risk Management System

RBI had issued guidelines on asset liability management and Risk Management Systems in Banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance note on Operational Risk Management in 2005. Though Basel II focuses significantly on risks it implementation cannot be seen as an end in itself. The current business environment demands an integrated approach to risk management. It is no longer sufficient to manage each Risk Independently. Banks in India are moving from the individual segment system to an enterprise wide Risk Management System. This is placing greater demands on the Risk Management skills in Banks and has brought to the forefront, the need for capacity building, while the first priority would be risk integrating across the entire Bank, the desirability of Risk aggregation across the Group will also need attention. Banks would be required to allocate significant resources towards this objective over the next few years.

### 4.2. Rural Coverage

Indian local banks specially state bank groups having a good coverage and many branches in rural areas. But that is quite lacking technical enhancement. The services available at cities are specifically not available to rural branches, which are necessary if banks want to compete now a day.

### 4.3. Technological Problems

That is true that Indian banks were already started computerized workings and so many other technological up gradation done but is this sufficient? In metro cities Indian local banks are having good comparable technology but that cannot be supported and comparable by the whole network of other cities and village branches.

### 4.4. Corporate Governance

Banks not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. Profit motive cannot be the sole criterion for business decisions. It is a significant challenge to banks where the priorities and incentives might not be well balanced by the operation of sound principles of Corporate Governance. If the internal imbalances are not re-balanced immediately, the correction may evolve through external forces and may be painful and costly to all stakeholders. The focus, therefore, should be on enhancing and fortifying operation of the principles of sound Corporate Governance.

### 4.5. Customer Services

There are concerns in regard to the Banking practices that tend to exclude vast sections of population, in particular pensioners, self employed and those employed in unorganized sector. Banks are expected to oblige to provide Banking services to all segments of the population, on equitable basis. Further, the consumers interests are at times not accorded full protection and their grievances are not properly attended to by Banks. Banks are expected to encourage greater degree of financial inclusion in the country setting up of a mechanism for ensuring fair treatment of consumers; and effective redressed of customer grievances.

### 4.6. Branch Banking

Traditionally Banks have been looking to expansion of their Branch Network to increase their Business. The new private sector banks as well as the foreign banks have been able to achieve business expansion through other means. Banks are examining the potential benefits that may accrue by tapping the agency arrangement route and the outsourcing route. While proceeding in this direction banks ought not to lose sight of the new risks that they might be assuming in outsourcing. Hence they have to put in place appropriate strategies and systems for managing these new risks.

### 4.7. Competition

With the ever increasing pace and extent of globalization of the Indian economy and the systematic opening up of the Indian Banking System to global competition, banks need to equip themselves to operate in the increasingly competitive Environment. This will make it imperative for Banks to enhance their systems and procedures to international standards and also simultaneously fortify their financial positions.

### 4.8. Transparency and Disclosures

In order to bring about meaningful disclosure of the true financial position of banks to enable the users of financial statements to study and have a meaningful comparison of their positions, a series of measures were initiated by RBI. It covered a No. of aspects such as capital adequacy, asset quality, profitability, country risk exposure, risk exposures in derivatives, segment reporting and related party disclosures etc. With a view to moving closer towards international best practices and International Accounting Standards and the disclosure need under pillar 3 of Basel II, RBI has proposed enhanced disclosures of certain qualitative aspects. Banks are required to formulate a formal disclosure policy that addresses the banks' approach for determining what disclosures it will make and the internal controls over the disclosure process.

**4.9. Known Your Customer Guidelines**

The guidelines were revisited in the context of the recommendations made by the financial action task force on Anti Money Laundering Standards and on Combating Financing of Terrorism. Compliance with these standards both by the banks/financial institutions and the country has become necessary for international financial relationships. Compliance with this requirement is a significant challenge to the entire banking industry to fortify itself against misuse by anti social persons / entities and thus project a picture of solidarity and financial integrity of the Indian Banking system to the international community.

## 5) PROBLEM AND PROSPECT OF BANKING IN INDIA :-

During the post reform period and due to the situation of Liberalization, Privatization and Globalization, Indian banking sector is facing some problems and challenges. These are as under

a. Low Profitability and Productivity
b. Lack of Integrity
c. Increase of Administrative Expenses
d. Survival of loss making branches
e. Scandals
f. Lack of Professional Behavior
g. Lack of professional and friendly approaches with customer
h. Non-performing Assets
i. Customer oriented market
j. Problem of customer satisfaction
k. Depression period running over the country
l. Managing work force
m. Management of technological advancement

However banks have some prospects in present environment. By converting threats into opportunities, the bank can have better advantages these opportunities are as under:-

1. Offering of innovative products
2. Door to door service approach
3. Customer relationship management
4. Professional approaches
5. Managerial excellence
6. Marketing and technological advancement
7. Customized and cyber services
8. Branch expansion
9. Deposit Mobilization
10. NPA management
11. Asset reconstruction
12. Motivational HRM policies
13. Change in lending process
14. Merger and acquisition
15. Total quality management concept

## 6) CONCLUSION:-

Over the years, it has been observed that clouds of trepidation and drops of growth are two important phenomena of market, which frequently changes in different sets of conditions. The pre and post liberalization era has witnessed various environmental changes which directly affects the aforesaid phenomena. It is evident that post liberalization era has spread new colors of growth in India, but simultaneously it has also posed some challenges.

This article discusses the various challenges and opportunities like rural market, transparency, customer expectations, management of risks, growth in banking sector, human factor, global banking, environmental concern, social, ethical issues, employee and customer services. 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.

## 7) 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.

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.

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