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# THE CHANGING ROLE OF INDIAN BANKING

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***Abstract***

*The banking sector is undergoing a rapid change in order to face the challenges posed by the new developments triggered by the entry of private banks and foreign banks into India. The liberalization process, initiated by the Government of India nearly one-and-a- half decades ago, has brought about tremendous changes in the financial services sector. Within the world of banking, customers' needs have changed and so has the basic nature of banking services . Banks in India, in the new era of global competition, have to concentrate on three important areas for sustained development viz., Technology, Customer and Consolidation. The technology has influenced every aspect of banking system . It is largely technology that will transform the face of the banking industry. The key to success is adopting state-of-the-art technology and not just automating antiquated processes. Today's customers have more likings and dislikings, which frequently change to suit the new situations. Unlike in the past, today's customer in India wants Indian banks to offer a variety of products and services to enable him to meet his diversified requirements. Consolidation is only an enabling step towards realization of these synergies. One of the most striking features of the Indian banking sector is the segmentation defined by ownership and geography. With all the developments and new challenges thrown by the economic liberalization policies pursued by the Government of India, the Indian banking sector is poised for stupendous growth and would be able to consolidate itself to provide quality service and better customer satisfaction.*

## Introduction

The banking sector is undergoing a rapid change in order to face the challenges posed by new developments triggered by the entry of private banks and foreign banks into India. The liberalization process, initiated by the Government of India nearly one-and-a- half decades ago, has brought about tremendous changes in the financial services sector. Within the world of banking, customers' needs have changed and so has the basic nature of banking services. The way banks meet these needs and the framework within which they are delivered have, as a result, changed tremendously. Accordingly, the banks have to adopt a host of new phenomena ranging from regulatory issues, risk management and new technology to globalization, consolidation and branding. Banks in India, in the new era of global competition, have to concentrate on three important areas for sus tained development viz., **Technology**, **Customer** and **Consolidation.**

## Role of Technology

The technology has influenced every aspect of banking system. It is largely technology that will transform the face of the banking industry. Banks in India today are not like the ones some ten years back. Today, with the enormous strides that technology in banking has made, we can meet all our banking needs without even visiting any . Most of our transactions can, in fact, be conducted from our desk over the internet. The reason why changes in the banking sector could be very substantial in the years to come is that technology is changing at an unprecedented rate. Technology enables existing services to be provided more efficiently, it enables new services to be offered, it lowers the entry barriers in some areas and it changes the economics of delivery. For instance, an ATM transaction costs just a fraction of what a teller transaction costs. A transaction over telephone is still cheaper and an internet transaction, the cheapest.

Banks have also been able to significantly lower credit risk through the effective use of technology. In the US and some other European countries, for instance, many banks have 'Advanced Credit Analytics Systems' that help them assess consumer behaviour. Technology also has the potential to increase the availability of information and reduce its cost. This is potentially a 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 business, 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 Credit Information Bureau of India Limited (CIBIL) and more extensive disclosure laws will gradually erode some of the traditional information advantages of banks. However, many corporates are looking at the movement of cash from supplier to factory to retailer as a single chain and banks, whose technology platforms enable this integration, will benefit greatly.

With growing competition between banks, adoption of new technology has assumed added importance, especially for the public sector banks. The key to success lies in adopting state-of-the-art technology and not just automating antiquated processes.

**Modern Customer**

Today's customer has more likings and dislikings, which frequently change to suit the new situations. Unlike in the past, today's customer in India wants Indian banks to offer a variety of products and services to enable him to meet his diversified requirements. Customer in the modern world 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 only one choice - either offer the customer all these products or lose him. In order to avoid losing customers to competition, banks in India have to go for universal banking instead of niche banking, at least for some more time. Banks will necessarily have to offer every imaginable financial product to the customers. Banks are expected to facilitate one-stop-shop for the customer's investment and borrowing needs and thus act as a 'financial conglomerate' – a model that we see increasing in a number of banks in the days to come.

Until a few years ago, banking in India was primarily a desk job. But, bankers today need to be out there in the field talking to the customer, finding out and understanding his needs and, more importantly, making sure that they are able to offer him a better deal than the competitors.

At present, the Indian financial system is typified by low financial product penetration. The domestic loan to Gross Domestic Product (GDP) ratio is at only 62.4% while for China, it is 163.3%. Consumer credit in India is still only 7% of GDP compared to US where it is as high as 70%. Only 8% of population in India is currently insured compared to 32% in Malaysia. Only one out of 23 bank account holders in India owns a credit card compared to Thailand where one in every four Thais owns a credit card. Life insurance premiums account for just 2% of household savings. India also lags behind most other emerging markets in retail lending. But the Indian customer of today has become more demanding as a result of which most banks in India now have to offer a full gamut of products to their retail clients.

The focus of banks on third party products has coincided with the rapid growth in demand for these redacts. Mutual Fund Sales in the country have enjoyed a 77% Compounded Annual Growth Rate (CAGR)over the past four years and insurance premiums have also registered a 23% CAGR over the same period. Revenue for banks in these businesses has grown even faster – bank assurance premiums jumped to about Rs.700 crore in financial 2003 –04 from just about Rs.200 crore in 2002-03 and are likely to grow further to over Rs. 1200 crores in current financial year. With rising incomes, growing urban affluence and favorable demographics, the rapid growth of these financial products is not surprising. The demographics of our country will also be a key driver in creating a large retail customer base that banks just cannot afford to ignore with 54% of the Indian population being under 25 years of age.

With banks gaining prominence as distributors of financial products and the shift in household savings to assets like mutual funds and insurance, profitability of both the banks as well as the customers has gone up. Indian banks can potentially replicate the success of Australian banks in the 1990s. Non-interest income as a percentage of total operating income for these banks rose from 34.3% to 45% in 2001 as they focused on such new business streams. While urban customer is most certainly going to account for a substantial part of the retail banking business of banks in India, we cannot overlook the contribution that the rural sector is going to make to the banking system. It would be pertinent to point out that what public sector banks set out to do in the years following the nationalization of the banking industry in India and failed at, banks in the private sector have now got into with a fair degree of success. The Self Help Group- Bank linkage programme, a supplementary credit programme for the rural poor, reaches nearly 17 million households and the cumulative credit disbursed has been to the tune of Rs.4000 crores by March 2004.

A considerable gap exists between demand and supply for all financial services – 70% of the rural poor (marginal/ landless farmers) do not have a deposit account, 87% do not have access to credit and less than 15% of these households have any kind of insurance. Only negligible numbers have access to health insurance (0.4%) and crop insurance (0.2%). Significantly, 56.1% of the poor still borrow from informal sources, including moneylenders, friends and relatives and other sources. All these indicate the enormous business potential that these sectors have and over the next few years, we can expect that more banks will enter into micro-finance which will, hopefully, narrow the gap between banking services provided in urban and rural India.

As the choice before the customer today is far wider, both in the selection of banks as well as products, the future growth largely lies in retail banking. Innovative products backed by superior service, are vital in the creation of 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.

**Consolidation - a strategy**

The entry of new private secretor banks in the mid 90s triggered the huge change in Indian banking that we are witnessing now. While these banks forced all other banks to place the customer above all else, they also acted as a warning to the more complacent public sector banks that they would have to take a relook at the manner in which they did business. Fierce competition in the banking industry has not only resulted in improved service standards but has also sent out a clear signal to the weaker banks – “if you can’t fight them, join them”.

Consolidation is considered to be the panacea for most of the ills faced by the Indian banking sector. It provides five different benefits – economies of scale, economies of scope, potential for risk diversification, personal incentives of management and public policy. Any market driven merger would involve a detailed study of the structure of the prospective partner and the extent to which it holds potential to realize one or more of these objectives. Consolidation may help restore a level playing field between banks and large corporate. Economies of scope could be best exemplified by cross-selling in the retail market. Risk management systems have improved and many banks now follow a structured method that reduces the scope of subjective assessment.

Consolidation is only an enabling step towards realization of these synergies. One of the most striking features of the Indian banking sector is the segmentation defined by ownership and geography. These differences have influenced the internal structures of banks as well as their business policies. However, there are visible similarities across banks within a particular segment as well as differences across segments. Consolidation would tear down the walls that preserve distinct sub-cultures and compel the evolution of a common culture. Bank managements are strongly focused on expectations of investors and consolidation is often seen as a route to stepping up growth and expanding market share. The need for consolidation in the banking sector has become paramount, particularly for the smaller public sector banks and for the relatively weak private sector banks.

**Conclusion**

With all the developments and new challenges thrown up by the economic liberalization policies pursued by the Government of India, the Indian banking sector is poised for stupendous growth and would be able to consolidate itself to provide quality service and better customer satisfaction. However, while the Indian Banking Sector is in reasonable fettle, it needs to further strengthen itself to support higher economic growth and the new investment cycle Indian companies are entering into. Hopefully, the next five years will set the stage for this with a new wave of technology, consolidation and more capital.

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