

## Challenges Ahead In Indian Banking Industry

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### Abstract

Bank is a storehouse of money, for a businessman it is an institution of finance and for a worker it may be a depository for his savings. The accelerate the economic growth of a country and steer the wheels of the towards its goal of “self reliance in all fields”.

One of the major objectives of banking sector reforms in India has been to enhance efficiency and productivity, which were achieved through; -

- Reduction in the pre-emption
- De-regulation of interest rates
- Enhancement of competition through establishment of new banks in private sector.

**KEYWORDS:** Banking, Indian Banking System, Challenges Ahead In Indian Banking, Problems and Prospects of Banking, sustainable competitive edge

## INTRODUCTION

Bank is a storehouse of money, for a businessman it is an institution of finance and for a worker it may be a depository for his savings. Banks cater to the needs of the agriculturists, industrialist, traders and to all other sections of the society. Thus, they accelerate the economic growth of a country and steer the wheels of the towards its goal of “self reliance in all fields”.

In recent years, there has been a considerable widening deepening of the Indian financial system of which banking is a significant component. With greater liberalization, the financial system has come to play a much larger role in the allocation of resources than in the past and its role in future can be expected to be much larger than at present. The growing role of the financial sector in the allocation of resources has significant potential advantage for the efficiency with which our economy functions.

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Recently, the banking industry is concerned with how the new technologies will shape the future of banking industry and what strategies need to be adopted for building a good customer base in the changing scenario.

Most of the young Indians should have access to bank deposits, credit and remittance facilities as well as insurance and mutual fund products in the next decade, and technology will play a big role in this transformation.

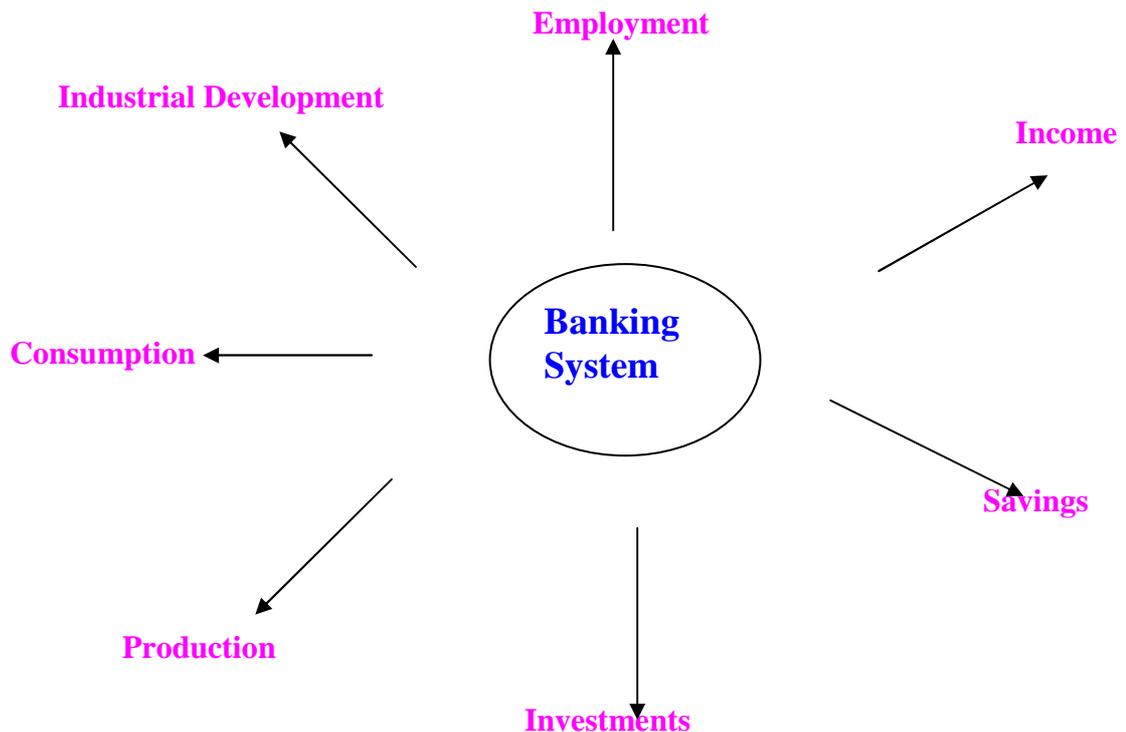
In this context, this paper makes an attempt to study the Bank and Economic Development, New Trends in Banking and Challenges ahead in Indian Banking Industry.

## **BANK AND ECONOMIC DEVELOPMENT**

Banks play a very important role in economic development of every nation. They have control over a large part of the supply of the money in circulation. Through their influence over the volume of bank money, they can influence the nature and character of production in any country.

Economic development is a dynamic and continuous process. Banks are the main stay of the economic progress of a country. Because, the economic development highly depends upon the extent of mobilization of resources and investment and on the operational efficiency of the various segments of the economy. The major roles played by the banks in the development of economy of a Country can be summarized as below

### **Economic Development through Banking System**



## **NEW TRENDS IN BANKING**

Over time a need was felt to enlarge the activities of banking companies. With this purpose in mind, an amendment was made to Banking Regulation Act 1949. By enacting the Banking laws (Amendment) Act 1983. Permitting any other form of business for banks, which the central government specifies the lawful business of a banking company.

After the amendment, commercial banks in India have been permitted to subsidiaries for undertaking any business, which is permissible for banks to undertake. For example, banks can now firm subsidiaries for lease finance, housing finance, factoring service, etc.,

Till recently this new activities permitted for commercial banks through their subsidiary companies but not directly, ie departmentally. From February 1994 the Reserve Bank has advised banks to select certain branches for undertaking these activities directly, subject to an advised bank to select certain branches for undertaking these activities directly, subject to an overall exposure limit of 25 percent of the bank's capital funds to an individual borrower and 50percent to a group of borrowers. Beside, the banks will be subject certain conditions , inter alia , prudential norms on income recognition , assets certification and provisioning , capital adequacy norms, exposure limitof 10 percent of a total advances for each activity and extension of factoring services only against invoice with genuine trade transactions.

## **CHALLENGES AHEAD IN INDIAN BANKING**

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 banks. Operating in this demanding environment has exposed banks to various challenges.

### **1). Customer Service:**

It is no longer adequate for banks to provide only traditional banking services. Apart from providing the conventional banking services, banks have begun offering a bouquet fo financial services to their clients, including cross selling of financial products. The ultimate aim of the bank is to meet the variety of customers financial needs. The establishment of new private sector banks and foreign banks has rapidly changed the competitive landscape in the Indian consumer banking industry and placed greater demands on banks to gear themselves up to meet the increasing needs of customers.

While banks are focusing on the methodologies of meeting the increasing demands placed on them, there are legitimate concerns in regard to the banking practices that tends to exclude rather than attract vast sections of population, in particular pensioners, self-employed and those employed in unrecognized sector. In this context, the governor, reserue bank of India had mentioned in the annual policy statement 2005-06 that RBI will take initiatiues to encourage.

- Geater degree of financial inclusion in the country
- Setting up of a mechanism for ensuring fair treatment of consumers
- Effective redress of customer grievances.

## **2). Branch Banking:**

Branch banking is a system where the banking business is carried on by a single bank with a network of branches throughout the length & breadth of the country. Banks are examining the potential benefits that may accrue by tapping the agency arrangement route & the outsource route. While proceeding in this direction banks ought not to lose sight of the new risks that they might be assuming and hence put in place appropriate strategies and system for managing these new risks.

## **3). Competition:**

With the ever increasing pace & extent of globalisation 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 competition environment. It will help the banks to enhance their systems and procedures to international standards and also simultaneously fortify their financial positions.

## **4). Technology:**

A few banks which have impressive branch networks have not been able to meet their customers expectation due to inefficiencies arising out of inadequate investment in technology & consequently faced an erosion of their market shares. The beneficiaries are those banks which have invested in technology. Recognising the benefits of modernising their technology infrastructure banks are taking the right initiatives.

The challenges in this regard will be for banks to ensure that they derive maximum advantage out of their investments in technology and to avoid wasteful expenditure which might arise on account of :

- Un co-ordination.
- Uncoordinated and placement adoption of technology
- Adoption of inappropriate / inconsistent technology
- Adoption of obsolete technology.

## **5). Improving Risk Management Systems:**

With the increasing degree of deregulation and exposure of banks to various types of risks, efficient risk management systems have become essential.

At the initial stages of development of the risk management systems, banks were managing each risk in isolation. The current business environment demands a more integrated approach to risk management. It is no longer sufficient to manage each risk independently or in functional silos. Enterprises are putting in place an integrated framework for risk management which is proactive, systematic and

spans across the entire organisation. Banks in India are also moving from the individual silo 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.

#### **6). Implementation of New Accounting Standards:**

Derivative activity in banks has been increasing at a brisk pace. While the risk management framework for derivative trading which is a relatively new area for Indian banks, is an essential prerequisite the absence of clear accounting guidelines in this area is a matter of significant concern.

It is widely accepted that as the volume of transactions increases, which is happening in the Indian bank system, the need to upgrade the accounting framework needs no emphasis. The accounting standards board of The Institute of Chartered Accountants of India [ICAI] is considering issue of accounting standards on the above aspects pertaining to financial instruments. Adoption and implementation of these principles are likely to pose a great challenge to both the banks and the Reserve Bank.

#### **7). Transparency and Disclosures:**

The disclosure requirements cover the following aspects.

- Capital adequacy
- Asset quality
- Maturity distribution of select items of assets and liabilities
- Profitability
- Country risk exposure
- Risk exposures in derivatives
- Segment reporting
- Related party disclosures

#### **8). Supervision of Financial Conglomerates:**

The components of consolidated supervision include consolidated financial statement intended for supervisory assessment of risk and application of certain prudential regulation on group basis.

#### **9). Know your customer (KYC) guidelines-Anti money laundering standards:**

Banks were advised in 2002 to follow certain customer identification procedure for opening of accounts and money transaction of a suspicious nature for the purposes of reporting it to appropriate authority.

Compliance with the guidelines 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.

#### **10). Corporate Governance:**

Banks are 'special' as they not only accept and deploy large amount of

uncollateralised public funds in fiduciary capacity but they also leverage such funds though credit creation. Banks are important for smooth functioning of the payment system. The focus should be on enhancing and fortifying operation of the principles of sound corporate governance.

## **PROBLEMS 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 as ;

- 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

## **CONCLUSION**

With the increasing levels of globalization of the Indian banking industry, evolution of Universal and bundling of financial services, competition in the banking industry will intensity further the banking industry has the potential and the ability to rise to the occasion as demonstrated by the rapid pace of automation which has already had a profound impact on raising the standard of banking services.

India's banking industry is at a watershed. It has met and successfully overcome several challenges over the last decade. But bigger challenges lie ahead. Some of these are captured in the distance Indian banking has still to go before it can claim to be at the head of the Asia-Pacific pack. The banks with the computerized operations, networking facilities and with enormous resources can provide needful services to their customers.

## **TO CHANGE, BANKS HAVE TO CHANGE THEIR CUSTOMIZED OPERATIONS**

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