Impact on the Banking System and the Challenges of Implementation

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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 Britishers 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 general scenario of Indian banking industry. The second part discusses the various challenges and opportunities faced by Indian banking industry. 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 small seed to existing branch of knowledge in banking industry and is useful for bankers, strategist, policy makers and researchers.

INTRODUCTION:

In recent time, we has witnessed that the World Economy is passing through some intricate circumstances as bankruptcy & Financial institutions, debt crisis in major economies of the world and euro zone crisis. passing through some intricate circumstances as bankruptcy of banking & financial institutions, debt crisis in major economies of the world and euro zone crisis.

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. In this paper an attempt has been made to review various challenges which are likely to be faced by Indian banking industry.

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 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 general scenario and structure of Indian Banking Industry.

GENERAL BANKING SCENARIO IN INDIA :

By the 1960s, the Indian banking industry had become an important tool to facilitate the speed of development of the Indian economy. The Government of India issued an ordinance and nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. A second dose of nationalization of 6 more commercial banks followed in 1980. The stated reason for the nationalization was to give the government more control of credit delivery. With the second dose of nationalization, the Government of India controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalised banks from 20 to 19. After this, until the 1990s, the nationalised banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy.

In the early 1990s, the then Narasimha Rao government embarked on a policy of liberalization, licensing a small number of private banks. The next stage for the Indian banking has been set up with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions. The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India. People not just demanded more from their banks but also received more. In India, banks can be classified into three parts: (1) Public sector banks (2) Private Banks and (3) Foreign banks.

CHALLENGES FACED BY INDIAN BANKING INDUSTRY:

- Capital adequacy of banks:

Concerns have been raised about the ability of our banks to raise additional capital to support their business and I would admit that these concerns are not entirely misplaced, especially for the public sector banks. Higher level of capital adequacy is needed due to higher provisioning requirements resulting from deterioration in asset quality, kicking in of the Basel III Capital norms, capital required to cover additional risk areas under the risk based supervision framework as also to sustain and meet the impending growth in credit demand, going forward.

Though at present, the banking system is adequately capitalized, challenges are on the horizon for some of the banks. For the system as a whole, the CRAR has been steadily declining and as at the end of March 2017, it stood at 17.25% as against 14.04% as at the end of March 2018. Our concerns are larger in respect of the PSBs where the CRAR has declined further to 11.24% from 11.40% over the last year.

The poor valuations of bank stocks, especially the PSBs, are not helping matters either, as raising equity has become difficult. When even the best performing PSBs have been hesitant to tap the markets for augmenting their capital levels, it would be difficult for the weaker PSBs to raise resources from the market. There is a constraint on the owners insofar as meeting the capital needs of the PSBs and hence, the underperforming banks are faced with the challenge of looking at newer ways of meeting their capital needs. A singular emphasis on profitability ratios (based on RoA and RoE) perhaps fails to capture other aspects of performance of banks and could perhaps encourage a short term profitability-oriented view by bank management. However, without getting into the merits of this approach, from a regulatory stand point, we feel that some of these poorly managed banks could slide below the minimum regulatory threshold of capital if they don't get their acts together soon enough. Of course, the pressure may lessen somewhat if, going forward, the asset quality improves on account of higher growth, resulting in higher retained earnings for banks. The need of the hour for all banks, and more specifically, in respect of the PSBs, is that capital must be conserved and utilized as efficiently as possible.

Balance sheet management

Over the past few years we have witnessed an increasing propensity to defer or delay provisions in an apparent attempt to post higher net profits. Probably, this short term vision is also in part attributable to short term tenure which the CEOs/ CMDs get. It must be appreciated that CEOs/ CMDs would come and go but the institutions are perpetual entities. The only thing which can perpetuate their existence is a stronger and healthier balance sheet. It must be realized that the first step towards resolving a problem is to acknowledge its existence. The problems which are swept under the carpet for a quarter or two would need to be encountered thereafter, with the issue getting further complicated in the interim.

Making higher provisions would not only add strength to the balance sheet, but also lead to better control over tax out-go and the dividend pay-out, besides adding credibility to the bank's financial statements. While a lower net profit would make headlines for a day or two, believe me the savvy long-term investors / analysts do not read too much into the short term blips. If they understand that the Management is sincere about repairing the balance sheet, they would drive up the valuation of your stocks, which would help you in the long-term. With most banks in dire need of capital, the retained earnings need to increase progressively. As a part of balance sheet management exercise, the Board/Top Management would have to proactively take a call on the likely components of their balance sheets and what shape they would like the balance sheet to take in future. The objective of optimal utilization of capital would have to be necessarily kept in mind while evolving balance sheet management strategies.

Risk management

Risk is inevitable in the banking business and hence, a sound risk management framework is the touchstone of an efficient bank. The risk management effectively aims at balancing the Risk-Return Trade-off which is "maximizing return for a given risk" and "minimizing risk for a given return". The responsibility of setting a risk appetite for the bank as a whole is that of the Board and the Top Management. In practice, however, we seldom see the articulation of an objective risk appetite statement by the PSBs. If you haven't set out a risk limit for each type of risk that the bank runs and an aggregate risk appetite for the bank as a whole, how do you measure and monitor risk? We must understand that risk management is integral to the success of the bank and hence, the Top Management should strive to put in place an efficient risk management framework keeping in view the changing market dynamics and the regulatory prescriptions.

KYC compliance

The instances of fake e-mails soliciting unsuspecting customers to make payments to certain bank accounts as a precursor to receiving prize or lottery winnings from abroad, have become quite rampant. It is surprising that even well-educated individuals are falling prey to such incredulous offers. While spreading financial literacy remains a huge challenge, the banks cannot be absolved of their responsibilities in the sequence of events. Most of this money is being transferred through banking channels and obviously, there is a deficiency in KYC compliance. Money mulling is another common occurrence which highlights deficiencies in risk categorization of customers and monitoring of transactions. We are emphasizing on this issue because banks need to be sensitive to the possibility of regulatory strictures / penalties for non-compliance. Consistent monitoring of transactions is necessary to prevent money mulling. A few banks in the past have already been fined for deficiencies in adherence to KYC norms and with our commitment to comply with the FATF norms; we can only forewarn that the frequency and severity of such penalties would rise in future.

- Treating customers fairly:

Protection of bank customers has been one of the thrust areas for RBI in recent times. As you may be aware, RBI has issued a Charter of Customer Rights based on the global best practices. The Charter comprises of following five rights: Right to Fair Treatment• Right to Transparency, Fair and Honest Dealing• Right to Suitability• Right to Privacy• Right to Grievances Redress and Compensation•

- Technology and its impact

Implementation of information systems innovations theoretically and management challenges continue. Experts have written some basic facts about the implementation of IT systems. Anyone involved in an IT implementation project can provide explanations about stress and frustration at a time when the implementation project exceeds the budgeted costs, the time limit, the expected defect in the expected performance. Various studies provide a lot of significant figures. identified seven key factors affecting the implementation of basic IT systems projects (such as the implementation of an organization's resource planning or core banking system), with collective experiences of more than 100 organizations in this area.

With regard to the literature and discussion of the various methods and procedures of various IT systems and the key factors affecting the implementation of IT projects, it is concluded that the appropriate method for developing and implementing a core banking system as a The information technology system depends on many factors, such as goals, tasks, and timelines. The implementation of a core banking system is very complex, time-consuming. The implementation model has three basic steps, the first step is to focus on the architecture of the system, then think about the platform and then select the appropriate solution. The solution can be construction, purchase (inward or outsourcing) or a combination of both. The first step is to select the bank's mapping, commitment, and governance policies in the implementation of the system .

In the next step, the correct definition of the business and the creation of a common understanding of the impact of that business on the financial performance of the bank is very important. Then, the factors affecting the implementation of the core banking system should be thoroughly investigated and the appropriate solution to be foreseen and by choosing an appropriate strategy for implementation, it is possible to implement a successful core banking system in a bank.

- Globalization of regulation-making process

As it is alluded to a little earlier, banking regulations are getting increasingly globalized, subject of course to certain national discretions. As members of the standard setting bodies like BCBS and FSB, we are committed to implement these regulations in our jurisdictions. There is a process for peer review of regulatory guidelines issued by various jurisdictions to ascertain compliance with the global standards, failure to adhere to which would render the jurisdiction non-compliant to the standards. While we do participate in the regulation making process and suggest modifications to protect the rightful interests of the domestic economy, very often, we have to abide by the larger framework. One example viz. the large exposures regime, for which a consultation paper on new SBL/GBL norms has already been released by RBI.

- Human resource issues

Human resource issues I do not need to emphasize the HR issues in banks. This is a decade of retirement for the PSBs and I am sure those working there are already feeling the pinch of the loss of experienced hands in their day to day operations. While the recruitments would be happening at the junior levels, there would be a virtual vacuum at the middle and senior level for some time to come. The absence of middle management could lead to adverse impact on banks' decision making process as this segment of officers played a critical role in translating the top management's strategy into workable action plans. Some of the major banks are also suffering on account of prolonged leadership vacuums at the top. All banks, including those in the private sector, are witnessing high attrition rates, giving rise to resource gaps. The problem is set to get accentuated further once the banks that have been newly licensed/ likely to be licensed, start hiring. Therefore, bridging resource gaps and managing employee turnover are major challenges that banks need to be prepared to address. The banks need to continuously enhance the skill levels of their employees so as to remain viable and competitive and to take advantage of new opportunities. The banking personnel, across the cadres need to be suitably trained to acquire necessary skill sets to perform their jobs more efficiently.

The biggest challenge is to build capacity at a rate which matches the loss of existing talent and skills to retirement, poaching and resignations. The training initiatives must ensure that the available talent pool in the banks is able to always keep pace with the fast changing ways in which banking is conducted. Of course, in these challenges also lie an inherent opportunity for banks to redraw their organizational profile and to create HR systems and processes best suited to the needs of the future.

- Unhedged forex exposures

The wild gyrations in the forex market have the potential to inflict significant stress in the books of Indian companies who have heavily borrowed abroad. This stress, besides impacting repayment of forex liabilities, eventually hampers their debt repayment capability to the domestic lenders as well. It is precisely with this consideration that RBI has been advocating a curb on the increasing tendency of the corporates to dollarize their debts without adequate risk mitigation. Our supervision of banks' books has highlighted the need for the banks to have more robust policies for risk mitigation on account of unhedged foreign currency exposure of their corporate borrowers.

Inadequacies of data further complicate the impact assessment of such exposures across the banking system. The banks have been advised to factor in this risk into their policies/ pricing decision and also devise means for sharing of information on such exposures amongst themselves. Regulatory guidelines have also since been issued outlining the capital and provisioning requirements for exposure to entities with significant unhedged forex exposures.

Conclusion

As we have noted, these are challenging times for the banking sector but as the clichéd proverb goes "Every cloud has a silver lining". The future leaders in the banking industry would be those who identify this silver lining early and initiate necessary steps to leverage the opportunity. The impending competition from new banks and the large number of new accounts opened under the PMJDY Scheme are two instances that readily come to mind of the challenges that could be turned into opportunities. Besides this, banks as the key players in the country's financial system also carry the responsibility of supporting economic growth, once the economic cycle turns favourable. Banks have to prepare themselves for meeting this responsibility by nurturing a healthier balance sheet. 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 colours 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 retentions. 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.

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