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CONTENTS

Indian Banks in the Era of Global Financial Crisis - Emerging Challenges and Opportunities

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ABSTRACT

Financial crisis in U.S gave the birth to global financial crisis. These crisis have created a ripple in the financial market worldwide. Fortunately, Indian financial sector has shown remarkable resilience to these developments. But these developments have emerging many challenges before the Indian banking industry. The present paper briefly touches upon the emerging challenges and possible solutions which are required to be focused by Indian banks in the quest for competitiveness. The study analyzes the parameters like priority sector advances of SCBs, Globalization of Indian banks, credit-deposit ratio, movements in non-performing assets and IT index. On the basis of these parameters the study finds some emerging challenges like Indian banking is far away from the 100 pc globalization, technology is also isolated in the Indian banks especially public sector banks, rising priority sector advances have enlarged the NPA's in Indian banks and human resource management is also poor in the Indian banks. To face these challenges paper also suggest some possible measures like increase the number of Debt Recovery Tribunals to remove NPAs, products should be provided at lower prices to capture market share, banks should adopt latest technology and job training should be provided to inefficient bank staff. All the parameters have been analyzed for the period 2006 and 2007 except IT index. IT index is analyzed for the pre-IT and post-IT period. Ratio analysis is used to analyze all the parameters.

Keywords- Emerging Challenges, Possible Solutions and Implications

INTRODUCTION

Indian financial sector has been undergoing significant transformation as a result of the reform process which began one and half decade ago. Financial sector reforms were kicked off following Narasimham Committee recommendations in 1991. In the first phase of reforms we have seen introduction of prudential norms for capital adequacy, income recognition and asset classification, deregulation of interest rates and withdrawal of micro guidelines on credit and injection of competition in the market. Our move towards globalization has been slow but steady. By and large our banks have become stronger and more competitive at the end of the first decade of changes. After these reforms Indian banking has become strong and organized, capable to set standards and benchmarks for the international market. But as a part of financial system, the banking sector cannot remain isolated from the rest of the financial world which is affecting from the global financial crisis. Thus global financial turbulence has creating many challenges before the Indian banking industry. The challenge before us is to consolidate the gains of the past ten years and to remain globally competitive. Strengthening capital adequacy to reach international standards is going to be a regulatory priority also in the coming years. Our move away from a regulated and protected market brings with it newer types of risks associated with a market economy and we need to be aware of these risks and be prepared to handle them. Technology is spearheading changes and innovations in the way we do banking and our ability to keep pace with these changes is going to decide whether we remain competitive and relevant or not.

Private sector competes both within the country and abroad in the banking scene. The strategy of the private sector may be focus on the creamy layer of the banking. Ultimately those sectors of society and rural areas which are not serviced by the private sector will have to be serviced by the banks which are nationalized banks. Banks should start thinking on the lines of what prof. C.K. Prahalad has been saying: if 33 pc of India is below the poverty line, a better management approach may be to think of this 33 pc as itself a market that can be serviced. Instead of a 25 rupee ice cream, can we have a one rupee ice cream? Instead of ATM being meant only for the well to do, can we think of ATM for daily wage earners? This is a constructive way of looking at challenges for Indian banking especially in the highly competitive market *(Vittal, N. p. 9)*

Banking industry and financial system in the new millennium is facing a series of new challenges. The challenges are manifold and multidimensional, under the influence of globalization, coupled with the adoption of new technology and stiff competition arising out of the changed situation. In order to meet the emerging challenges, there is a dire need to reset an organizational structure, culture, system and procedure etc. to the changes that are pushing the banks into the multilateral arena. This paper also studies the emerging challenges before the Indian banking industry.

SCHEME OF PAPER

The present paper has been divided into six sections. After the brief introduction, section II reviews some related studies. Section III fixes some research objectives, highlights the research methodology and the database. Section IV is devoted to the results and discussions. Section V deals with emerging challenges and their possible solutions. Last section concludes the paper.

II

REVIEW OF RELATED STUDY

Kamesam, V. (2001) examined that the world of banking has assumed a new dimension at the drawn of the new millennium. Technology is playing a crucial role in the day to day working of the banks. Banks that have harnessed and utilized best have a distinct and strategic advantage. It is likely that some of the existing brick and mortar banks will go out of business for failing to respond to the challenges of technology. Banking sector in India is poised to meet the changing global environment. However, the future would belong to those who would be able to offer excellent customer service by keeping pace with changing technology and transparent operations.

Kumar, V. and Savita (2007) examined that Indian banking is passing through a phase of transformation and consolidation. In this phase Indian banking is facing many challenges like profitability, risk management, technology, rural and social banking issues, and human resource management. This paper also suggests some strategies for future to tackle these problems

Nittal, N. (2001) proposed a view that the Indian banks will have to make a SWOT analyses (strength, weakness, opportunities and threats) and then evolve a strategy based on building strength, overcoming weaknesses and exploiting opportunities and guard against threats. The strength of the Indian banks is the pool of human talent it has. Apart from the pool of talent and the human capital it represents, banks are also extremely over manned. VRS initiates that have been taken by the banks have opportunities but they will have to think in terms of also what to do post-VRS. This paper also explains the three types of risk i.e. environment risk, IT operations risk, IT product risk listed by the RBI.

Pai, D.T. (2001) explained that banking in the new millennium will be marked by high expectations of customers who are will informed and possess the technical knowledge to conduct banking transaction from home or office or while on the move. Even though computers are rapidly taking over bank functions, personalized service will continue to have relevance in Indian banking. Therefore, the sum and substance of all banking activity in future will boil down to one simple prescription. Banks can keep growing only if they consciously keep moving from customer satisfaction to customer delight in every aspect of their functioning.

Uppal, R.K. and Guliani, H.K. (2007) viewed that after 14 years of reform period, some sectors have responded admirably, of which financial sector specially banking have accorded a great prominence. It is important to create ability in the banking system to self rectify its deficiencies. The new challenges are not greater or more formidable that we have overcome. The main challenge is to find practical solutions together with the concerned authorities to successfully achieve the avowed objective of reforms for the human face.

Watson, G.J. (2001) discussed that some of the key challenges facing the Indian banking industry today are IT, VRS, strategy, credit and marketing. These challenges will have varying degrees of priority depending upon the bank, but Indian banks as a whole will need to develop suitable strategies which will lead to solutions to these challenges. India is not unique in facing and inevitably addressing, the many issues of moving from a highly regulated to a relatively de-regulated environment. India can quickly and effectively make this transition, if it can leverage the lessons learned by banks in other countries, therby avoiding many of the mistakes and pitfalls.

III

OBJECTIVES, RESEARCH METHODOLOGY AND DATABASE

Objectives

- To study and analyze the emerging challenges before the Indian banking industry.
- To find out the possible solutions for the emerging challenges.

Research Methodology

Reliability of the research findings depends upon the scientific methodology approach. This part spell out the methodology approach that will be followed for the present study.

Research Design

The proposed study is concerned with the emerging challenges before the Indian banking industry. Indian public sector banks are passing from a crucial stage, their efficiency is quite low as compared to the foreign and new generation private sector banks. These banks are becoming threat for them, if they will not improve themselves, their survival will become difficult. This is the main reason that comprehensive study is required regarding the emerging challenges before the Indian banking industry.

Sample Design

The universe of the study is Indian banking industry. In the proposed study major five bank groups will be studied.

- G-I – State Bank and its Associates Banks (08)
- G-II – Nationalized Banks (20)*
- G-III – Old Private Sector Banks (20)
- G-IV – New Private Sector Banks (07)
- G-V – Foreign Banks (29)

* IDBI Bank is also included in this group.

Parameters of Study

- Priority Sector Advances
- Globalization of Indian Banks
- Credit-Deposit Ratio
- Movements in Non-Performing Assets
- IT Index (Average)

All the parameters are analyzed for the period 2006 to 2007 except IT index. IT index is analyzed for the period 1997-2002 and 2002-2007 i.e. pre-IT and post-IT period.

Method

Ratio method is used to analyze all the parameters

Database

- Performance Highlights, Various Issues, IBA, Mumbai, 1997-2007
- Report on Trend and Progress of Banking in India 2006-2007

IV

RESULTS AND DISCUSSIONS

Priority Sector Advances

Priority sector includes agriculture, small scale industries etc. Lending to the priority sector by public, private and foreign bank groups can be seen in table 1. It is clear from the table that advances to the priority sector are more in private sector bank group in the year 2006 and 2007 followed by the public sector bank group. On the other hand advances by the foreign bank group are least. Advances are more in public and private sector bank groups because these bank groups are giving more advances to the agriculture sector while foreign banks do not give any credit to the agriculture.

Table 1

Priority Sector Advances

Per cent

Sector	Public Sector Bank Group		Private Sector Bank Group		Foreign Bank Group	
	2006	2007	2005	2007	2006	2007
Priority Sector Advances	40.3	39.6	42.8	42.7	34.40	33.4
Agriculture	15.3	15.6	13.6	12.8	-	-
Small Scale Industries	8.1	8.0	4.2	3.9	9.5	10.3
Other Priority Sector	16.1	15.3	23.2	22.9	-	-
Export Credit	-	-	-	-	19.6	10.3

Source: Report on Trend and Progress of Banking in India 2006-2007

Globalization of Indian Banks

Table 2 listed the public sector and new private sector banks working at abroad. It is crystal clear from the table that even after the sixteen years of the enactment of the LPG policy, Indian banking industry is far away from achieving 100 pc globalization of its banks. Indian banking industry has 28 public sector banks, but only 13 banks out of it have branches, subsidiaries, representative offices and joint venture banks working in some foreign countries. The present share of public sector banks at abroad is 87 pc and that of new private sector banks is only 13 pc. Out of public sector banks, Bank of Baroda had the largest share (29 pc) in 2006-07, followed by State Bank of India (26 pc) & Bank of India (14.50). These banks have 56, 50 and 28 branches respectively working in some foreign countries.

Table 2

Globalization of Indian Banks

Per cent

Name of Bank	Total Branches		%age Share in global Market	
	2005-06	**2006-07**	**2005-06**	**2006-07**
Public Sector Banks	**151**	**168**	**87.79**	**87.05**
1. Allahabad Bank	1	2	0.58	1.03
2. Andhra Bank	1	1	0.58	0.52
3. Bank of Baroda	51	56	29.65	29.00
4. Bank of India	26	28	15.12	14.50
5. Bharat Overseas Bank	1	N.A	0.58	-
6. Canara Bank	3	4	1.74	2.07
7. Indian Bank	3	3	1.74	1.55
8. Indian Overseas Bank	8	9	4.65	4.66
9. Punjab National Bank	6	7	3.49	3.63
10. State Bank of India	45	50	26.16	25.91
11. Syndicate Bank	1	1	0.58	0.52
12. UCO Bank	5	6	2.91	3.11
13. Union Bank	N.A	1	-	0.52
New Private Sector Banks	**21**	**25**	**12.21**	**12.95**
14. Axis Bank	1	4	0.58	2.07
15. Centurian Bank of Punjab Ltd.	2	1	1.16	0.52
16. HDFC Bank Ltd.	1	1	0.58	0.52
17. ICICI Bank Ltd.	15	17	8.72	8.81

18. Industrial Bank Ltd.	2	2	1.16	1.04
Total	**172**	**193**	**-**	**-**

Source: Same as Table 1

Similarly, among new private sector banks, HDFC Bank had the largest share (8.81 pc); it has 17 branches at abroad. But these numbers of branches are not sufficient to give Indian banking industry the shield of globalized Indian banking industry.

Credit-Deposit Ratio

Credit-deposit ratio reflects the efficiency of banks. Higher the credit deposit ratio, higher will be the efficiency. Table 3 indicates that credit-deposit ratio of all the bank group is increasing except foreign bank group in 2007 still it is the highest i.e. 83.8 pc in foreign bank group. Credit-deposit ratio is also high in new private sector bank group followed by the state bank group. It is least in old private sector bank group. This implies that foreign bank group and new private sector bank group are more efficient than the other bank groups because these bank groups are providing loans at low rate of interest.

Table 3

Credit-Deposit Ratio

Per cent

Bank Group	2006	2007
Scheduled Commercial Banks	70.1	73.5
Public Sector Bank Group	68.2	72.2
Nationalized Bank Group	68.0	70.4
State Bank Group	68.5	76.2
Old Private Sector Bank Group	63.7	67.3
New Private Sector Bank Group	77.2	77.8
Foreign Bank Group	85.8	83.8

Source: Same as Table 1

Movements in Non-Performing Assets

Table 4 shows the movements in non-performing assets of different bank groups in the year 2007. Gross NPAs as a percentage of gross advances are more in old private sector banks i.e. 3.1 pc than other bank groups. It means this bank group is not sound while net NPAs as a percentage of net advances are more in state bank group and very low in foreign banks. It implies that among all the bank groups foreign banks are very sound and strong. Thus high NPAs have become a major challenge before the Indian banking industry in this competitive and globalized era for their survival.

Table 4

Movements in Non-Performing Assets

Per cent

Bank Group	Gross NPAs Percentage to Gross Advances	Net NPAs Percentage to Net Advances
Scheduled Commercial Banks	2.5	1.0
Public Sector Banks	2.7	1.1
Nationalised Banks	2.7	0.9
State Bank Group	2.6	1.3
Old Private Sector Banks	3.1	1.0
New Private Sector Banks	1.9	1.0
Foreign Banks	1.8	0.7

Source : Same as Table 1

IT Index (Average)

IT index includes fully computerization of banks, I-banking, M-banking, Tele-banking, ATM services provided by the different bank groups. In table 5 IT index is divided into two parts pre-IT (1997-2002) and post-IT (2002-2007). It is clear from the table that introduction of IT in 2000 put down a remarkable impact on all the bank groups. In the post-IT era information technology has increased in all the bank groups still it is the highest in foreign bank group i.e. 61.14 pc. Thus table concludes that it is a need of the hour to implement IT completely in all the banks to compete globally.

Table 5

IT Index (Average)

Per cent

Period	SBI & Its Associates Banks	Nationalized Bank Group	Old Private Sector Bank Group	New Private Sector Bank Group	Foreign Bank Group
Pre-IT	40.58	44.37	40.52	53.43	52.87
Post-IT	45.25	49.40	46.75	58.78	61.14

Source: Performance Highlights, Various Issues, IBA, Mumbai, 1997-2007

In a nutshell, priority sector advances especially to the agriculture sector have increased the NPAs in Indian banks. Globalization is also not sufficient in the Indian banks. Technology is developing after the IT era but not fully developed. Low credit-deposit ratio has also decreased the efficiency of banks.

V

EMERGING CHALLENGES AND POSSIBLE SOLUTIONS

Banking scenario has changed rapidly since 1990s. The decade of 90s has witnessed a sea change in the way banking is done in India. Technology has made tremendous impact in banking. 'Anywhere banking' and Anytime banking' have become reality. The financial sector now operates in a more competitive environment than before and intermediates relatively large volume of international financial flows. In the wake of greater financial deregulation and global financial integration, the biggest challenge before the regulators is of avoiding instability in the financial system. 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 to various challenges.

Global Competition

There is a growing realization that the ability of countries to conduct business across national borders and the ability to cope with the possible downside risks would depend on the soundness of the financial system. 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 the banks to enhance their system and procedures to international standards and also simultaneously fortify their financial position as per Indian banks' association report 'banking industry vision 2010', there would be greater presence of international players in Indian financial system and some of the Indian banks would become global players in the coming years. So, the new mantra for Indian banks is to go global in search of new markets, customers and profits.

Possible Solutions

- A cadre experts needs to be built up; personnel should have exposure in functioning in truly global environment.
- Indian banks should make effective and attractive advertisement according to customer's tastes regarding our financial products.
- Indian banks should make some alliances with profit making big houses and companies to capture foreign market.
- At the initial stage Indian banks should provide products and services at comparatively lower prices to capture their market share.

High Level of NPAs

Another challenge emerging before the Indian banking industry is high level of non-performing assets. There are number of factors responsible for high rate of NPAs in Indian scheduled commercial banks like over regulated environment, diversification of funds mostly for expansion/diversification of business or for promoting associate concerns, inefficient management, labour unrest, changes in macro environment like recession, infrastructure bottleneck etc. Higher NPAs will corrupt the efficiency of banks. Thus there is a huge need to recover the NPAs.

Possible Solutions

- Banks should try to introduce a system of internal audit of sanction of loans before disbursement for large averages.
- Banks should be very careful in considering settlement/compromise proposals.
- Banking institution should closely examine their credit management and undertaken institutional development programmes to remedy the deficiencies.
- Exploring avenues of recovering NPAs such as Lok Adalats for recovering smaller loans.
- Increasing the number of Debt Recovery Tribunals.

Technology

Technology is emerging as a key driver of business in the financial services industry. A few banks, which have impressive branch networks, have not been able to meet their customer's expectations due to inefficiencies arising out of inadequate investment in technology. Profitability of the banks are also declining because of lack of technology. The beneficiaries are those banks, which have invested in technology. Another distinct advantage of use of technology is the ability to effectively use quantitative techniques and models, which can enhance the quality of their risk management system. Recognizing the benefits of modernizing their technology infrastructure banks are taking the right initiatives. The challenge in this regard will be for banks to ensure that they derive maximum advantage of their investments in technology and to avoid wasteful expenditure.

Possible Solutions

- Banks should adopt the latest technology to provide e-services as need of the hour.
- Technology should be cost-effective, customer driven and especially implementable in the real working.
- Appoint young employees with fresh and creative mind experts in latest technology and trained the other ones also.
- .Huge investment should be made on technology.

Poor Human Resource Management

The profitability of any organization depends on the productivity of its people as they are the real strength of that organization. New private sector banks and foreign banks have understood this mantra and hence appointing people with fresh and creative minds with full knowledge of latest technology. Approximately 90 pc of their staff is young with fresh brains. But public sector banks are overloaded with much experienced staff but with old hands who never ready to change accordingly. Now days, it is the need of the hour to develop and manage the human resources to make them adaptable to the changing environment. It is a big challenge for these banks that how to manage their human capital to make it productive because unproductive staff is only burden on the business and hence weaken these banks as compare to private sector and foreign banks.

Possible Solutions

- Constitute separate human resource development department in each bank.
- Provide the job training to the inefficient staff to make them capable to understand work with the latest technology.
- Make the recruitment, selection, performance appraisal and control policies transparent.
- Introduce VRS in a planned way.
- Performance of the staff should be evaluated quarterly or monthly to update their knowledge in case of any deficiency.

Profitability

Profitability of Indian banks is less as comparative to foreign banks. Thus it has become a challenge for the Indian banks. Public sector banks should give more stress on profitability.

Possible Solution

- By using efficient technology and quality services, banks can enhance their customer base which return increase the profitability.
- Low profit banks should merge with the high profit banks.
- Bank should lend to those sectors where bank can charge higher rate of interest.
- Plugging of revenue leakages.
- Change in Deposit Mix i.e. increasing low cost deposits, both saving and current.
- Increased other income/fee based income.

Legislation

Slower legal processes are always planned for tardiness in the economic reform process. Though the democratic set up of the country has certainly not proved to be a hurdle, the coalition type of government in a democratic set up with the attending policy drift has definitely caused a slow down in the economic and resulting legal reforms. This is clearly evident from the number of bills awaiting legislative enactment.

Possible Solution

- Banks should think of methods which do not need any legislative reforms.
- Banks can think of looking forward to policies which will take care of concerns arising out of social awareness.
- Banks can assume the responsibility through appropriate policies rather than act under the compulsion of legislation like Lender Liability Act.

IMPLICATIONS

The main implication of the findings is that it is essential for India to carefully monitored the development in both real and financial sector and to modulate her policies in accordance with the global developments so that global integration continues to be a positive sum game for all countries. Adoption of appropriate technological framework on par with international best practices, thus, strengthening domestic banking system. This would also help in fortifying it against the risk that might arise out of globalization.

VI

CONCLUSION

Thus, it is concluded from the above discussion that even after the global financial crisis Indian banking industry is facing many challenges. It is the need of the hour to accept these challenges and fought with planning. Action and vision should combine to fight with these challenges. The new banking scenario should be in line with the expectations of the controlling and regulatory authorities of the country and shall be at par with the kind of banking offered by their peers, worldwide.

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