8. FUTURE OPPORTUNITIES

The rapid transformation in the banking industry over the last decade has made the industry stronger, cleaner, transparent, efficient, faster, disciplined and a lot more competitive. But what we have achieved so far may be only a prelude to the greater things to come. Our banking industry may now compare well with the rest of Asia in areas like growth, profitability and non-performing assets. However, while a few banks have established a good record in terms of innovation, growth and value creation, most others are yet to make much headway. The cost of banking intermediation and extent of banking penetration in India is still lower than other markets. If the banking sector is to support the Indian economy significantly then it has to considerably strengthen itself and adapt to the ever-evolving environment in which it operates. Banking sectors that have failed to respond to changing market realities have historically been a hurdle to the development of the financial sector in many developing countries. In India, while bank lending has been a significant driver of GDP growth, periodical systemic failures have significantly affected the stability of the system.

The future of Indian banking represents a unique mixture of unlimited opportunities amidst insurmountable challenges. On the one hand we see the scenario represented by the rapid process of globalization presently taking shape bringing the community of nations in the world together, transcending geographical boundaries, in the sphere of trade and commerce and even employment opportunities of individuals. All these indicate newly emerging opportunities for Indian banking. But on the darker side we see the accumulated morass, brought out by three decades of controlled and regimented management of the banks in the past. It has siphoned off profitability of the government owned banks, accumulated bloated NPA and threatens adequacy of the banks and their continued stability. Nationalized banks are heavily over-staffed. The recruitment, training, placement and promotion policies of banks leave much to be desired. In the nutshell, the problem is how to shed the legacies of the past and to adapt to the demands of the new age. However, with the advent of economic reforms, the deregulation and opening of the Indian economy to the global market, brings
opportunities over a vast and unlimited market to business and industry in our country, which directly brings added opportunities to the banks.

A successful Bank will have to first meet and address several challenges that the industry currently faces. It will have to be nimble and agile enough to respond to a market that is seeing growth driven primarily by new products and services. This includes opportunities in the retail front such as credit cards, consumer finance, wealth management and private banking and on the whole sale banking front through, fee based income, investment banking and advisory services. This will call for completely new skill set both in terms of new knowledge as well as ability in marketing, areas where the traditional banker have much way to go.

With the booming economy and swelling middle class, the retail banking has been growing explosively over the last 5 years. The segment has grown from $11 bn in 2000 to $66 bn in 2005. The trend will continue in future with even foreign banks returning to this area with their ambitious plans. Also there is huge potential at the bottom of the pyramid for bringing in the large amount of cash used by villagers into the banking system. It calls for some outside the box thinking and cost effective solutions. Sooner, banks may rediscover the rural potential for mobilizing low cost deposits using their e-banking channels cost effectively.

Yet another challenge banks will have to face is the drying up of opportunities to make huge profits, which was hitherto available for the asking in a declining interest scenario. Additionally, with spreads now decreasing on account of competition both on the deposit and credit front, Banks will have to literally battle hard for each rupee to be added to the bottomline.

India’s mixed economy, where both public and private sector co-exist, is going through fundamental changes. Core areas like banking, hitherto, reserved for the public sector, are being thrown open to the private sector in the wake of liberalization and globalization wave sweeping across the world. As regards banking industry, the doors are wide open for foreign banks to set business in India along with private Indian banks. In view of the emerging competition in the banking sector, all banks
whether nationalized or private, have to gear up their operations and style of management to remain in business. The banking sector in India, has already taken strides towards computerization and automation of their operations. The structure of the banking industry influences its performance and efficiency which, in turn, affects the bank’s ability to collect savings and channel them into productive investments. The success of banking sector very much depends on the ownership of banks whether private or public or mixed; and the extent of entry restrictions on new banks; how far it is controlled or regulated in terms of interest rates, difference between deposits and lending rates, and whether service charges are completely determined or regulated by the government or the Reserve Bank.

Perhaps the greatest challenge that the Banking sector will have to face is the one that emanates from the foreign shores. With increased global interest to India, the number of foreign players eyeing the huge Indian market can only increase. It is a well known fact that foreign Banks have been exploring for "good buys" in the Banking sector for some time now. The hurdle in their game plan has been the regulatory issues which effectively debarred them from such activities. With RBI outlining a road map on foreign investment in Bank in India the stage is set for a full fledged presence of foreign players in the Indian Banking market, post April 2009. With the entry of foreign players with their huge resources "size" is bound to be of great importance.

It will help banks to move to an enterprise wide risk management culture. The spirit and the systems of risk management should permeate the whole enterprise, driven by the Board themselves and appreciated and adapted by the lowest functionary. From an intuitive risk management that most of us have been practising hitherto, banks will have to move to institutionalized risk management. An efficient risk management framework coupled with adoption of Basel II practices will also prepare Banks in India to face the impending challenges post 2009, when doors of Indian banking are expected to open for foreign invasion. These players, armed with huge capital resources and easy access to capital funds are expected to bring in cutting-edge technology, international best practices and skilled human capital. Being Basel II compliant would help the Indian banks to face these emerging challenges squarely.
Although the financial system in India has developed considerably over the years, the ratio of bank assets to GDP in India is still low in comparison with that prevailing in several other emerging market economies. This, combined with the fact that India’s economy is growing at a robust rate, would suggest that there is enormous potential for future growth of banking, especially in rural and semi-urban areas.

The liquidity position in the financial sector has been quite comfortable in the recent times. The buoyant capital market coupled with an appreciating rupee vis-à-vis US dollar has been attracting large foreign institutional inflows during the last two years. While we have an all time high foreign exchange reserves of more than $130 billion, high capital inflows pose a big opportunity as well as a challenge to monetary and exchange rate management.

We are slowly but surely moving from a regime of “large number of small banks” to “small number of large banks.” The new era is going to be one of consolidation around identified core competencies. Mergers and acquisitions in the banking sector are going to be the order of the day. Successful merger of HDFC Bank and Times Bank earlier and Standard Chartered Bank and ANZ Grindlays a few years ago has demonstrated that trend towards consolidation is almost an accepted fact. Large scale consolidation in the Banking sector will happen in future. Over time, traditional barriers between banking, insurance and other financial sectors may disappear as it happened in the U.S, resulting in formation of large financial conglomerates. Since 1995 the largest bank in the world has grown more than three-fold in terms of asset size, mainly through mergers. Disappearance of the traditional barriers as mentioned earlier would also result in regulatory issues as different segments in the financial sector have their own regulators.

An enabling environment is also essential for Banks. Legislative actions or regulatory interventions are required as it will have a big role to play in several key factors such as industry structure and consolidation, regulatory coverage, labour reforms, legal mechanisms and support, operational freedom besides others. Availability of capital would be another key factor. It is estimated that if the Banking sector is to support a high growth economy, it would require about Rs. 600 billion (US $ 14 billion) in
capital to fund growth, expected NPA write offs, and investment in IT and other infrastructure upgradations.

Technology has moved from being just a business enabler to being a business driver. Be it customer service, reducing operational costs, achieving profitability, developing risk management systems or otherwise, we turn to technology for providing necessary solution. Technological upgradation was clearly identified as one of the most successful strategy in Customer Acquisition and Retention followed by Expansion of ATM Network, Advertisements and additional sales force. Customer Retention and Customer Satisfaction are quite obviously inter-linked. While consumers may be happy to make payments and interact with their bank through convenient – and cheaper – banking channels, they still expect high standards of service, something which reflects the bank’s brand and image across all channels.

To excel and manage customer relationships is the future of any business, or everybody’s business. Customer focusing is not to be viewed as just a business strategy but should also become a corporate mission. Unless this mission percolates throughout the organization at all levels, the chances are that the attempts to address customer issues will receive only lip sympathy. Building value for customers for banks should be seen as equal to building shareholder value. The challenge for banks will be in area of people (changing their beliefs and attitudes), technology and competition.

A world class support infrastructure is an essential pre-requisite for an efficient and robust payment system, effective and strong assets reconstruction companies, credit bureaus, besides back-office utilities so as to free the Banks and help them focus on core activities. While significant steps are being taken in many of these areas much more needs to be done. Developments of payment systems over the internet and even the ever ubiquitous mobile phones have great potential for the future in extending convenience and reducing cost of transactions.
Technology is a key driver in the banking industry, which creates new business models and processes and also revolutionizes distributional channels. Banks which have made inadequate investment in technology have consequently faced an erosion of their market shares. The beneficiaries are those banks which have made investments in technology. Adoption of technology also enhances the quality of risk management systems in banks. Recognizing the benefits of modernizing their technology infrastructure, banks are taking the right initiatives. With the adoption of technology, they can build a new system themselves, or buy best of the modules, or buy a comprehensive solution or outsource. Thus, banks need to clearly define their core competencies to be sure that they are investing in areas that will distinguish them from other market players and give them a competitive advantage. Banks must ensure that they derive maximum advantage from their investments in technology and avoid wasteful expenditure which might arise on account of uncoordinated and piecemeal, inappropriate, inconsistent and adoption of obsolete technology.

E-banking is connecting business communication and transmission over networks and through computers, especially the buying and selling of the goods and services and the transfer of funds through digital communication. The growth of business on the internet is driven by lower purchasing costs, reducing inventory control, lower product cycle time, efficient customer service. For new markets, smooth business operations and reduced document processing, India needs a framework to encourage and stimulate the growth of e-banking. In service industry, ‘Satisfied Customer Serviced’ is a universal demand of the customer and it has been a matter of concern for all developing economies. The presence of foreign banks along with a few computerized scheduled/commercial banks has immensely influenced the customers of their services. Bank marketing entails the creation and delivery of customer-satisfying services at a profit to the bank. Banks with networks having computers have more important role to play as a catalyst for economic development through channeling the services and deployment of the resources, taking particular care of the under-privileged class of the people. With the liberalization of the economy and new private/foreign banks competing fiercely, the opportunities for an investor to deploy his savings have become wider. Even existing customers are shedding their loyalties to their banks and are shifting to other banks that offer better and competitive
services. Thus, there is a need for banks to position their services and products in clear, distinctive and desirably manner not only to attract new customers but also to retain existing customers. In the post liberalization era, technology is enabling banks to provide the convenience of anytime-anywhere banking to customers. The earlier brick and mortar branch is no longer sufficient, technology is now taking banks to homes or offices, 24 hours a day, 365 days a year through ATMs, telephones and computers. The financial supply chain is undergoing a fundamental strategic change. The trend of Non-Branch Service Delivery in banking started with the growing popularity of Electronic Payment Services in 1970s in the United States. It was a technology push which enabled banking services to be delivered to the customer’s doorstep. It started with Electronic Fund Transfer, Credit Cards, ATMs, and Smart Cards. With the advancement of computing technology, the integration of telephone banking and computing technology has become a powerful medium of delivering banking services. The newest product is internet / Home / Online / E-Banking, which has broken the paradigm of branch banking.

Growing integration of economies and the markets around the world is making global banking a reality. The surge in globalization of finance has also gained momentum with the technological advancements which have effectively overcome the national borders in the financial services business. Widespread use of internet banking has widened frontiers of global banking, and it is now possible to market financial products and services on a global basis. In the coming years, globalization would spread further on account of the likely opening up of financial services under WTO.

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. Let us not forget that the competition is not only on foreign turf but also in the domestic field as well from foreign banks operating in India.
In the wake of the liberalization policies, the traditional and conservative face of Indian Banking has undergone a virtual metamorphosis. The Indian Banking Industry is undergoing a paradigm shift in scope, context, structure, functions and governance. The information and communication technology revolution is radically and perceptibly changing the operational environment of the banks phrases like “technology driven” products have now become common parlance in the corridors of the banking industry. Universal Banking, virtual banking, and Mergers & Acquisitions are increasingly becoming the order of the day. For customers, it was the realization of their “anywhere, anytime, anyway, banking dream”. For the banks, technology has emerged as a strategic resource for achieving higher efficiency, control of operations, productivity and profitability. The recent trend shows that most banks are shifting from a ‘product centric’ model to a ‘customer centric’ approach as they develop their new e-banking capabilities. Banks are now realizing that Internet Banking is most successful if they tailor their websites to their customers’ needs rather than providing and promoting individual products. E-banking made its debut in UK and USA in the 1920s and became prominently popular during 1960s through electronic fund transfers and credit cards.

The economic liberalization process has increasingly exposed the banking sector to international competition. The role of banking in the process of financial intermediation has been undergoing a profound transformation, owing to changes in the global financial system. Consequently, the revolution in information technology has brought sea changes in the way banking transactions are being carried out. The latest trends may be summarized in one word that is “diversification of banking activities”. A major objective of reforms in the financial sector was to develop money market, the government securities market, the foreign exchange market and the capital market. Another important objective of reforms in the financial markets was the elimination of segmentation across markets in order to smoothen the process of transmission of impulses across markets, easing the liquidity management process and making the resource allocation process more efficient across the economy. The strategy adopted for meeting these objectives involved removal of restrictions on pricing of assets, building the required institutional structure and technological infrastructure, introduction of new instruments and fine-tuning of the market
microstructure. The banking development efforts were supported by appropriate changes in the legal framework to remove structural rigidities and improvements in the regulatory design to ensure smooth functioning of banks. Diversification of banks has helped in improving the depth, liquidity and efficiency of banks. Reforms have altered the organizational structure, ownership pattern and domain of operations of banks and has infused competition in the financial sector. The competition has forced the institutions to reposition themselves in order to survive and grow. The extensive progress in technology has enabled banks to graduate from outdated systems to modern market design, thus, bringing about a significant reduction in the speed of trades and transaction costs. While the banking system continues to play a predominant role, it is significant to note that, as a result of various reforms measures, the relative significance of financial markets has increased. This augurs well for the overall stability of the banking system.