Chapter –1
Sustainability of Banks in India
– An Overview
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1.1 Introduction

A bank is a financial institution that provides banking and other financial services to its customers and public. A bank is generally understood as an institution which provides fundamental banking services such as accepting deposits and providing loans to the needy persons\(^1\).

Banking industry in India has undergone evolutionary and revolutionary changes. In the 21\(^{st}\) century banking is a significant part of a nation’s growth story. The financial vibrancy of a nation depends on the effective and meaningful role played by the banking industry. The Bank as a financial intermediary has redefined its way of doing business. The paradigm shift in the structure, technology, people and activities in terms of products and services has brought in new role and responsibilities for the banks operating in India. The banking sector reforms have opened up new challenges, issues, opportunities and benefits to Indian banking industry both for Indian banks and foreign banks.

With the advent of new technologies in to the banking sector, the products, services and way of doing business changed significantly, phenomenally and drastically. In the post reforms scene there is stiff competition in Indian banking industry. It is period of survival of the fittest. Only innovative banks will survive and sustain in the present changed business paradigms\(^2\).

Indian banks positively changed and adapted to the new business challenges and opportunities considerably. This is in spite of huge constraints, checks and balances of the government and the regulatory agency Reserve Bank of India. Indian public sector banks necessarily implement the policy of the government in so far as the

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\(^1\) KPM Sundaram, *Indian Banking* - TMH publication, New Delhi-2013 p21  
\(^2\) S.S. Mundra, Deputy Governor, Reserve Bank of India (2015) web source: www.rbi.ac.in
priority sector lending and complying with statutory liquidity ratio; cash reserve ratio, prime lending rates and capital adequacy, Capital, Asset, Managerial Skill, Efficiency and Liabilities and so on.

Indian public sector banks cater to wholesale and mass banking along with retail banking, whereas Indian private sector banks and foreign banks operating in India cater to retail banking and corporate customers banking requirements and they are not brought under priority sector lending fold. Indian public sector bank is a agency and vehicle to implement government sponsored schemes like, Mahatma Gandhi National Rural Employment Guarantee Act, Jawahar Rojgar Yojana (JRY), Pradhan Mantri Jandhan Yojana (PMRY) and pension schemes. There is a political interference in the public sector banking sector operations. Private Banks and foreign banks are not subject to these shackles, obstacles and regimentation.

In today’s competitive business environment, banks crave for their sustainability. There is financial sustainability, human resource sustainability, social and environmental sustainability, internal and external sustainability that are to be taken care by the banks operating in India in turbulent business environment. Private Banks and Foreign banks sustainability is managed by them rigorously apart from complying with the norms of the regulatory agency. For this purpose they invented new products and services most of them are customized. Public sector banks despite the constraints are moving forward to achieve and sustain the multiple sustainability paradigms.

The present Ph.D research programme is all about knowing and analyzing sustainability banks operating in India encompassing public sector, private sector and foreign banks. Let us understand the concept sustainability of banks.
1.2 Sustainability and Sustainable Banking – Defined

- According to Webster’s New World Dictionary (2003) Sustainability is defined as “to keep in existence; maintain or prolong”. Sustainability would seem to mean maintaining the status quo for everything found in the world, both living and non-living.

- Sustainability, however, is more than just the interconnectedness of the economy, society, and the environment. Sustainability may be something more grand and noble, a dynamic, a state of collective grace, a facet of Gaia, even of Spirit (1998)

- An organisation is said to be ‘sustainable’ if its people are willing to bring a change and embrace the change ultimately leading towards sustainable organizational design (1997)

- Sustainability is meeting “the needs of the present without compromising the ability of future generations to meet their own needs” (1987).

- Sustainability in banking business is a dynamic state that occurs when a banking company creates ongoing value for its shareholders and stakeholders, which creates sustainable value (2009)

- Sustainable banking means, “Using money to bring about positive and lasting change; placing value on people and planet, as well as profit. Sustainable banking demands complete transparency about how we use our customers’ money.”

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3 Webster’s New World Dictionary (2003) (p. 650)  
4 Alan Fricker, Measuring Up to Sustainability (1998)  
5 Srivastava and Director (1997)  
6 UN World Commission on Environment & Development (Brundtland Commission) (p.2)  
7 Jean Francois Laugel & Chris Laszlo
- Banks’ Sustainability is ‘the identification of value, defining values stream, determining flow, defining pull and improving process, such as marketing of banking products, finance and internal management.’

- ‘Sustainability is about ensuring long-term business success while contributing toward economic and social development, a healthy environment, and a stable society.’

- Sustainable banking can be defined as a decision by banks to provide products and services only to customers who take into consideration the environmental and social impacts of their activities. (2001)

- Sustainability of the banking institution and its client-companies is important so that they can continue to make a long-term contribution to development, concern for the welfare of communities, and respect for key human rights.

- Sustainability applied to banking institutions encompasses four dimensions of good business performance.
  - The sustainability of the Banking institution and its Customers, so that they can continue to make a long-term contribution to development.
  - The economic sustainability of the projects and companies, the Banking institution finances, through their contribution to host economies.
  - Environmental sustainability through the preservation of natural resources.
  - Social sustainability through improved living standards, poverty reduction, concern for the welfare of the communities and respect for key human rights.

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9 - Bouma, Jeucken, and Klinkers (2001)
These considerations, taken together, aim to capture a fuller range of factors that influence the decisions, activities, products, and services of the three sample banking institutions, including the social and environmental impacts of their work.

In essence, sustainable banking is a philosophy that underpins everything about banking, a value system that says a bank’s commercial activities must not only benefit its staff and shareholders, but also its customers and the wider economy, while at the same time preventing, or at least minimizing, any undue effects on society and the natural environment. It also requires banks, where appropriate, to be proactive and take steps to improve society and the environment. Banks can play an influential role in encouraging the shift to a low-carbon society – providing access to capital and measuring risk of investments. Considering environmental and social factors in those investment decisions can have a significant role in shifting the global economy toward sustainable business practices (2010).\(^\text{11}\)

1.3 Structure of Banks in India

The organisation structure of Banks operating in India as shown in the following diagram are classified into two categories, namely scheduled banks \(\text{which are listed in the 2nd Schedule of the Reserve Bank of India Act, 1934}\) and unscheduled banks \(\text{which are not listed in the 2nd Schedule of the Reserve Bank of India Act, 1934}\). Under scheduled banks there are two categories namely Commercial banks and Cooperative Banks. Commercial banks are classified into four categories/sectors such as, public sector banks (26), private sector banks (21), foreign banks (36) and regional rural banks (82), In total commercial banks are 165 numbers. Under cooperative banks, there are two categories namely urban cooperative and rural cooperative banks.

\(^{11}\) Alastair Sim, Senior Director for Global Marketing, and Michael Imeson, Contributing Editors
1.4 Changing phase of Indian Banks - a big shift

From Traditional functions to Modern/Online Banking activities, banks role has been changed in a phased manner as listed below\(^2\)

<table>
<thead>
<tr>
<th>Traditional Banks</th>
<th>Modern Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>- The Primary function is to act as receiving and payment agent for customers and to borrow and</td>
<td>- Allows customers to conduct banking transactions of all rational functions</td>
</tr>
</tbody>
</table>

\(^2\) KPM Sundaram, *Indian Banking*-TMH publication, New Delhi-2013 p101
<table>
<thead>
<tr>
<th>Lend money.</th>
<th>View/print the account details</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ Account opening</td>
<td>▪ Track schedule of funds transfer</td>
</tr>
<tr>
<td>▪ Keeping &amp; renew fixed deposits</td>
<td>▪ Inquire about cheques status</td>
</tr>
<tr>
<td>▪ Request for a cheque/demand draft</td>
<td>▪ Inquire Tax deduction</td>
</tr>
<tr>
<td>▪ Apply for loans</td>
<td>▪ Stop payment of Cheques</td>
</tr>
<tr>
<td>▪ Getting information about limited avenues for investments</td>
<td>▪ Safe deposit locker facility</td>
</tr>
<tr>
<td>▪ Transfer funds between accounts within the bank</td>
<td>▪ ECS/RTGS facility</td>
</tr>
<tr>
<td>▪ More time consuming, incomplete and slow</td>
<td>▪ Authorise Electronic bill payments (ECS)</td>
</tr>
<tr>
<td>▪ More problems to both the bankers and customers</td>
<td>▪ Transfer of funds between account</td>
</tr>
<tr>
<td>▪ Lower size in activities and number of branches and regional concentration.</td>
<td>▪ Send and receive secure messages to and from the bank</td>
</tr>
<tr>
<td>▪ Widened Banker-Customer relationship</td>
<td>▪ Request for accounts statement through emails</td>
</tr>
<tr>
<td>▪ High cost of transactions</td>
<td>▪ M-banking facility</td>
</tr>
<tr>
<td>▪ Lower technological applications</td>
<td>▪ Face book backing facility</td>
</tr>
<tr>
<td>▪ Unskilled and traditional manpower facility.</td>
<td>▪ Less time consuming, completed within minimum time and very fast</td>
</tr>
<tr>
<td>▪ Lack of awareness to customers about banking facilities.</td>
<td>▪ More number of activities, anywhere and all time banking facility, spreads across the region</td>
</tr>
<tr>
<td>▪ Too much regional concentration with a majority of private banks and local money lenders</td>
<td>▪ Good and improved customer-banker relationships</td>
</tr>
<tr>
<td></td>
<td>▪ Low cost of transactions</td>
</tr>
<tr>
<td></td>
<td>▪ Technological advancement</td>
</tr>
<tr>
<td></td>
<td>▪ Expert and skilled manpower</td>
</tr>
<tr>
<td></td>
<td>▪ Well educated and informative customers.</td>
</tr>
</tbody>
</table>
All the above factors lead to a big shift from traditional banking system to modern banking system, which helps both the bankers and customers in a big way, but opening up numerous challenges and poses verities of threats to both the bankers and also the customers.

1.5 Need for Banks Sustainability

- The banks are the lifelines of the economy and play a catalytic role in activating and sustaining economic growth, especially, in developing countries like India. In the present juncture Indian banking system is facing significant challenges from several quarters. These challenges, if not addressed quickly and adequately, may result in loss of opportunities in faster growing economic status. In the sense that, it has implications for both the banks as well as for the economy as a whole, because a strong banking system is one of the essential pre-requisites in the pursuit for growth.

- Pressure from regulators and customers’, financial players to discover a virtuous cycle of creating value for their stakeholders in ways that create additional (often hidden) value for their shareholders, Such a process will help banks to regain confidence in the survival dialogue they are currently having with economic, regulatory, environmental and social stakeholders.

- Sustainability in the banking sector is ‘increasingly understood as the creation of not just banking and economic value but also long-term environmental and social value for wide range of stakeholders including shareholders, employees, customers, suppliers, communities, and public-sector partners – with particular consideration for the needs of future generations’.
The global importance of sustainability is reflected in changing consumer expectations and emerging national and international legislation. Banks' chances of operating successfully and engaging in international trade depend more and more on their ability to mitigate social and environmental risks and to capitalize on opportunities for innovation.

Sustainability has become an essential element of Banks' competitive advantage and something banking businesses can no longer ignore.

Recognizing this trend, many banks are looking to integrate sustainability into their banking businesses. For many, the first challenge is knowing where and how to start. The next is getting the necessary inflows of capital to begin transforming their operations.

Financial crisis is forcing the entire banking sector to integrate sustainability into the core of its value creating activities.

1.6 Changing Landscape for Banking

The sub-prime crisis (2008 Sept.)\textsuperscript{13} and the Bear Stearns impulisions as well as the Lehman Brothers bankruptcy are pushing banking institutions, the hard way to swap their old business models with new more sustainable ones. The existing business model in investment banking centered on the roll-out of financial assets with limited global value creation is one of the Western world has lived to its detriment. The sub-prime crisis was destroyed shareholders value, erodes customer wealth, impacting market confidence and altering the relations between banks and regulatory bodies.

Banking institutions desperately need to reach a game change level to survive. Only a sustainable value creation process will bring them to a

\textsuperscript{13} - K Muthukumar, The Indian Banker, vol.no.11, Nov.2011, pp48-50.
dynamic balance among stakeholders to reach a virtuous cycle of value creation. The present financial crisis is an opportunity for a new sustainable value creation process in financial institutions.

- Banking institutions, as the providers of finance for businesses of all shapes and sizes, have a pivotal role to play in promoting sustainability across industries, sectors, and communities. Sustainability also offers vast potential for banking institutions to improve their own products and services to enhance the banks sustainable value.

1.7 Sustainable Value Creation process- a Model

<table>
<thead>
<tr>
<th>Stage-1</th>
<th>Stage-2</th>
<th>Stage-3</th>
<th>Stage-4</th>
</tr>
</thead>
<tbody>
<tr>
<td>Core-resources</td>
<td>Game changing</td>
<td>Quick wins</td>
<td>Public relation-window dressing</td>
</tr>
<tr>
<td>Investment and loans policy</td>
<td>Changes beyond best of breed cost</td>
<td>Green Buildings</td>
<td>Sustainability report</td>
</tr>
<tr>
<td>Green Banking</td>
<td>New products and innovation based on sustainability</td>
<td>Community outreach</td>
<td>Identification of stakeholders</td>
</tr>
<tr>
<td>Application of Carbon principles</td>
<td>Re-engineering of process internationalization of outsourced processes</td>
<td>Help and assistance to NGO’s</td>
<td>Green Communication</td>
</tr>
<tr>
<td>Deep understanding of Customers needs</td>
<td>Deep understanding of stakeholders needs (beyond customer expectations)</td>
<td>Stakes in developers of emissions-cutting projects</td>
<td>Respect for the customer pushed at the centre of the communication</td>
</tr>
<tr>
<td></td>
<td></td>
<td></td>
<td>Other environmental and social issues</td>
</tr>
</tbody>
</table>

(Source: Sustainable value Partners-2008)
Core resources stage refers to reorganizing the existing value chains representing the core activities like lending, investments, asset management, project financing etc. of the banks and to align these activities with the expectations of key stakeholders. Besides the basic functions, banks started to widen the reach of their sustainability initiatives to involve lateral resources like investment in green buildings with leadership with energy and environmental design (LEED), assisting non-governmental organisations (NGOs) in support of social causes and community outreach programmes, environmental and social philanthropy.

Banking institutions desperately need to reach a game change level to survive. Only a sustainable value creation process will bring them to a dynamic balance among stakeholders to reach a virtuous cycle of value creations. The financial crisis is an opportunity for a new sustainable value creation process in banking institutions.

Going beyond the core resources stage, requires the leadership of the company to consider sustainability as a powerful driver of competitive advantage and differentiation. After re-engineering, lean organisation and six sigma, sustainability is already proving to be an enduring engine of business transformation for banks. It is opening up new portfolio of sustainable activities, helping to foster product and business model innovations, and reasserting the societal contributions of financial services.

The main risk for the banks is to consider sustainability actions only in protective and defensive terms. Competitors who take a proactive value creation approach will surpass those who only play defense. Banking companies need to discover how to create value for both shareholders and other stakeholders. In order to become viable and sustainable, sustainability needs to help to create shareholders value. Otherwise, it will stay as marginal within the banking companies or be a flavour-of-the-day ready to be replaced by the next management fashion.
Publication of sustainability report\textsuperscript{14}, focused on communicating green issues as well as on acknowledging new-found respect or the customer is the core issue. As banks identify their key stakeholders and develop a clear communication plan, this step is the fundamental steps for any banking company desiring to move forward on the sustainability journey.

Indentifying the leverage and creating value in banking through sustainability requires banks to go through the value chain to determine the issues for each business activity. Retail banking with mortgage, savings private equity, life insurance, pension fund, group insurance, the sustainability issues are numerous and specific to each business.

To understand the impact of sustainability of each of the above banking business activities, it is necessary to move through all four stages of sustainable value creation.

1.8 Determination of Sources of Sustainable Value

The Sources of sustainable value must be determined for each business activity of the value chain. These sources can be synthesized through the six levels of strategic focus moving from inside-out (the operations view) to outside-in (the global environment and all the stakeholders) as seen in the below diagram;

\footnote{Sustainable value Partners-2008 by IFC}
Banking sector includes commercial and investment banks, leasing companies, microfinance institutions, and other related financial institutions. All these forms of banking institutions are united by the fact that they intermediate banking flows by borrowing funds from individual depositors or a wide range of organizations and channel these resources to individual and corporate borrowers, mainly in the form of business and commercial lending.

Compared to institutions that invest in the equity of companies (private or listed equity institutions), institutions that lend usually offer banking services to their customers on a shorter-term basis and charge fees for providing their banking resources. For deposit-taking banking institutions, minimizing risk and finding new ways to attract customers are major business goals that guide the entire flow of their operations.

Commercial banks are the most important banking intermediaries in the economy in most countries, as they link savings and investments. In recent years, commercial banks have converged with the functions of other banking service providers, such
as investment banks, leasing companies, and microfinance institutions, and have broadened their lines of business to become more competitive. Commercial banks now engage in money market operations, project finance, and insurance business, leasing operations, mortgage finance securities trading, and banking advisory work.\textsuperscript{15}

Through the portfolios of their customers, banks are exposed to a more diverse set of social and environmental issues than the average business and, to a certain extent, than other banking institutions. Accordingly, banks and other financial institutions are shifting their focus and reorienting their activities. They are increasingly moving from avoiding risks to creating opportunities: from defensive banking - where environmental management is seen as an additional cost - to sustainable banking - where sustainable development is seen as an advantage and an opportunity for growth.

Such a shift requires a fundamental change in perspective: a focus on creating long-term value. The new approach stands in contrast to earlier and narrower management systems that deal with social and environmental risk. For instance, systems such as ISO 14001 focus on process conformance, where the main target is compliance with necessary regulations imposed by relevant authorities. By contrast, a comprehensive approach to sustainability focuses on process performance, where the focus is on creating value in the process of achieving the banking institution’s business goals.\textsuperscript{16}

Sustainability is now increasingly recognized as central to the growth of emerging market economies. For the Banking sector, this represents both a demand for greater social and environmental responsibilities as well as a new landscape of business opportunity. Banks are moving from defensive banking-where management of social and environmental impacts is seen as an additional cost, to sustainable banking-where sustainable development is seen as an advantage and an opportunity for growth.

\textsuperscript{15} Vasantha Desai, Development Banking, HPH, 2012 Edition, p.91
\textsuperscript{16} E.Gordon and K.Natarajan, Theory, Law and Practice of Banking, HPH, 2008 p.125
The Banking sector has been responding to this trend and is emerging as an important driver across all sectors in an economy. Further new standards and codes of conduct to promote corporate accountability, transparency, and consideration of impacts on environment and society are being taken into consideration. The social and environmental performance standards are adopted by an increasing number of banks that operate in developing countries, including India.

The global banking industry has experienced a significant transformation in which social and environmental responsibility has become increasingly central to business performance. Devising bank-specific sustainability is determined by their business goals combined with the sustainability trends and factors in the markets and sectors in which they operate.

The Banking & Financial Sector in India underwent a significant liberalization process in the early 1990’s which led to reforms in the banking and financial sector and changed the Indian Banking structure. Liberalization of Interest rates where banks are allowed to fix lending rates (during 1992-1997)\textsuperscript{17}, reduction in Cash Reserve Ratio and Statutory Liquidity Ratio. As a sequel to these reforms, new private sector banks were allowed entry in the market, which brought new technologies, started product innovation and competition, which poses number of challenges in the banking sector.

1.9 Challenges for Indian Banks

Sustainability is no longer optional for a bank; this has been learnt from the lessons of the financial crisis of 1998 and 2008, with in a gap of 10 years. Banks have to prove that the model adopted is sustainable and it gives positive contribution to sustainable growth and development. Banks have to show that, awareness of sustainability issues is deeply embedded in the way they run the business.

Since the inception of the Financial Crisis in 2008, the global economy has continued to face rough weather and the Indian economy and our banking system

\textsuperscript{17} Report on trend and progress of banking in India, RBI bulletin, 2012
have not remained susceptible. Recovery has been moderate and sometimes uneven. Different jurisdictions continue to be tormented by financial fragilities and macroeconomic imbalances. Geopolitical risks surrounding oil prices and the uneven effects of currency and commodity price movements also pose significant threat to economic stability. Sustenance of highly accommodative monetary policy in the Advanced Economies has also created monetary policy challenges in emerging markets like India.  

The challenging backdrop of the banking system in India has been operating for a relatively long period of time which has resulted in an adverse impact on the asset quality, capital adequacy and profitability of our banks and so on. But the tough situation in which the banking system finds itself is also attributable in a large measure to the bankers’ inexperience and aggression.

- **13 Key Challenges of Banks Operating in India**

The Reserve Bank of India recently identified eighteen key challenges faced by banks operating in India. These challenges are affecting the banks in a big way and that have to be addressed strategically to achieve the sustainability of banks. The Challenges are as follows;

1) Asset Quality
2) Capital Adequacy of Banks
3) Liquidity coverage ratio (LCR) Framework
4) Unhedged Forex Exposures
5) Human Resource Issues (decade of retirement-pinching the loss of experienced hands)
6) Revision to the Priority Sector Lending Guidelines
7) Prime minister Jan Dhan Yojana (PMJDY) and beyond
8) Globalization of Regulation- making process
9) Technology and its impact

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19 Dr. V. Leeladhar, Deputy Governor - the challenges ahead, BIS review, Nov. 2005
10) Treating Customers Fairly (Protection of bank customers has been one of the thrust areas
- Right to Fair Treatment
- Right to Transparency, Fair and Honest Dealing
- Right to Suitability
- Right to Privacy
- Right to Grievances Redress and Compensation

11) Know your Customer/ Anti Money Laundering (KYC/AML) Compliance

12) Balance Sheet Management (stronger and healthier balance sheet)

13) Risk Management (sound risk management framework is the touchstone of an efficient bank)

1. Asset Quality

Reserve bank of India (RBI) data for March 2015 clearly shows that asset quality has seen sustained pressure due to continued economic slowdown. The levels of gross non-performing advances (GNPAs) and net non-performing advances (NNPAs) for the banking system have been elevated. Where the GNPAs have increased to 4.45 percent for the system as a whole, the NNPAs have also climbed up to 2.36 percent. Stressed Assets Ratio (Gross NPA+ Restructured Standard Advances to Gross Advances) stood at 10.9 percent as at the end of March 2015. The level of distress is not uniform across the bank groups and is more pronounced in respect of public sector banks. The Gross NPAs for Public sector banks (PSBs) as on March 2015 stood at 5.17 percent while the stressed assets ratio stood at 13.2 percent, which is nearly 230 bps more than that for the system.20

As per the observations made in the Global Financial Stability Report (GFSR)21 released by International Monetary Fund (IMF) recently on the high levels of corporate leverage; the report highlights that 36.9 percent of India’s total debt is at

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20 Dr. Y. V. Reddy Former Governor - Banking sector reforms in India – an overview May, 2005
risk, which is highest among the emerging economies while India’s banks have only 7.9 percent loss absorbing buffer, which is among the lowest.

To improve the banking system’s ability to deal with corporate and financial institution distress, the RBI has initiated remedial measures which includes, an independent validation, regardless of that it underscores the relative riskiness of the asset portfolio of the Indian banks. The issuance of guidelines on "Early Recognition of Financial Distress, Prompt Steps for Resolution and Fair Recovery for Lenders: Framework for Revitalising Distressed Assets in the Economy, detailed guidelines on formation of Joint Lenders’ Forum (JLF), Corrective Action Plan (CAP), ‘Refinancing of Project Loans’, ‘Sale of NPAs by Banks’ and other regulatory measures, which emphasized the need for early recognition of financial distress and for taking prompt steps for rectification, restructuring or recovery, thereby ensuring that interests of lenders and investors are protected.

2. Capital Adequacy of Banks (CRAR)

Concerns have been raised about the ability of banks in India to raise additional capital to support their business especially for the public sector banks. Higher level of capital adequacy is needed due to higher provisioning requirements resulting from deterioration in asset quality, to meet 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.²²

Though the banking system is adequately capitalized at present, challenges are on the horizon for some of the banks. For the banking system as a whole, the Capital Risk Adjusted Ratio (CRAR) has been steadily declining and as at the end of March 2015, it stood at 12.70 percent as against 13.01 percent as at the end of March 2014. The concerns are larger in respect of public sector banks, where the CRAR has declined further to 11.24 percent from 11.40 percent over the last year.

Raising equity has become difficult due to poor valuations of bank stocks in public sector banks (PSBs). When 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. 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 return on assets and return on equity- 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 standpoint, 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.

3. Liquidity Coverage Ratio (LCR) Framework

The Liquidity Coverage Ratio (LCR) is a ratio of High Quality Liquid Assets (HQLA) to the Total Net Cash Outflows prescribed to address the short term liquidity risk of banks and the banks would be required to maintain a stock of HQLAs on an ongoing basis equal to the Total Net Cash Outflows. The Liquidity Coverage Ratio (LCR) regime has kicked in for the banks from January 1, 2015 with a minimum requirement of 60 percent to be gradually increased to 100 percent by January 1, 2019 in a phased manner.23

Banks have been asking for reduction in Statutory Liquidity Ratio (SLR) citing the implementation of the Liquidity Coverage Ratio (LCR) framework. To a certain extent their request has merit. SLR essentially serves the same purpose as the

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LCR. However, SLR does not assume certain outflow rates for liabilities while outflow and inflow rates under the LCR framework are based on certain assumptions of stress. Presently, apart from maintaining LCR at 60 percent, the banks have to maintain SLR of 21.5 percent of the NDTL. Going forward, as the LCR requirements gradually increase, it may be desirable to reduce the SLR progressively. Presently, there is a special dispensation wherein RBI has permitted banks to reckon up to 7 percent of the SLR towards LCR (2 percent of MSF and 5% under FALLCR).

4. 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 is advocating a curb on the increasing tendency of the corporates to dollarize their debts without adequate risk mitigation.\(^\text{24}\)

The 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.

\(^{24}\) KC Chakrabarty (2011) Deputy Governor RBI, , titled ‘RBI monthly bulletin July 2011, Pp1039-1046
5. **Human Resource Issues - Rise to Resource Gaps**

2015-16 is a decade of retirement for the Public Sector Banks (PSBs) and those people working there are already feeling the pinch of the loss of experienced hands on 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.

6. **Revision to the Priority Sector Lending Guidelines**

The revised priority sector lending guidelines released last week states that, Lending to a few new sub-sectors like renewable energy, social infrastructure and to

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the medium enterprises would now be treated as priority sector lending. Concept of a tradable Priority Sector Lending Certificate (PSLC) has also been introduced, which would enable the ‘deficit’ banks to buy these certificates from ‘surplus’ banks to meet their targets.²⁶

There is also readjustment in some sub-targets, whereby the banks are now required to progressively achieve 8% of lending to Small and Marginal Farmers and 7.5% to the micro enterprises among the medium scale enterprises (MSEs) in a phased manner. This has been brought about with an underlying objective of making available finance to the neediest and the most alienated of the borrowers. This may probably pose a bit of a challenge initially but I believe with proper planning, these targets could be achieved sooner rather than later.

7. Pradhan Mantri Jan DhanYojana (PMJDY) and beyond

The Indian banking sector has been wholeheartedly complimented for the success of the Pradhan Mantri Jan DhanYojana (PMJDY) scheme. The numbers can speak for themselves that more than 14.5 crores accounts have opened. That leads to the question- what next? Flow of individual savings, albeit howsoever small combined with flows from Direct Benefit Transfer (DBT) would be crucial to give an initial push to keep these accounts active while extending productive/need-based credit would be the second crucial step. The onus is upon all of us to ensure that the window of opportunity that has been presented by the opening of such a large number of accounts is not put to waste by allowing the accounts to turn inactive.²⁷

The credit absorption capacity of the farmers can be enhanced through consolidation of fragmented landholdings by ushering in land reforms or through pooling of land holdings in a Self-Help Group (SHG) format. Similarly, customers may also be trained to undertake non-farm activities. Efforts to enhance the credit absorption capacity must also be supplemented through financial literacy and vocational training initiatives. Improved financial literacy would aid the inculcation of

²⁷ V.Leeladhar (2011) Deputy Governor RBI, , titled ‘RBI monthly bulletin July 2011, Pp1039-1046
a savings culture and investment habit amongst the customers, which can be leveraged by the banks by offering suitable small savings, investment and pension products.

A major challenge for the banks would be to manage their banking correspondent model effectively. The problems relating to their viability, governance, cash management, linkage and oversight from a base branch need to be quickly addressed. The entire financial inclusion ecosystem must progressively develop, if the momentum gathered under the PMJDY exercise has to be sustained for all-round benefit of all stakeholders.

8. Globalization of Regulation- making process

As we know that, the banking regulations are getting increasingly globalized, subject of course to certain national discretions. Banks as members of the standard setting bodies like Basel Committee on Banking Supervision (BCBS) and Financial Settlement Board (FSB) are committed to implement these regulations in their jurisdictions. The 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 the banks do participate in the regulation making process and suggest modifications to protect the rightful interests of the domestic economy, very often, they have to abide by the larger framework. To quote an example namely the large exposures regime, for which a consultation paper on new single borrower limit and group borrower limit (SBL/GBL) norms has already been released by RBI.\textsuperscript{28}

9. Technology and its impact

All Public Sector Banks (PSBs) are now on Core Banking Solutions (CBS) platform and have developed capabilities to offer anywhere banking. Few banks have also started offering basic banking transactions on mobile for their customers. But this is

\textsuperscript{28} V.Leeladhar (2011) Deputy Governor RBI, , BIS review Nov.2005
just scraping the surface as the technology can be leveraged for a far greater effect. PSBs must be able to leverage technology for building data warehouses and then be able to do data mining and analytics. The goal should be to use data for effective decision making at various levels, including product customization, developing business models and delivery channels, etc.

Public Sector Banks (PSBs) must be able to pitch suitable products for their customers through internet and mobile banking channels. Traditional businesses are slowly moving on-line and e-commerce is the preferred choice of the gen-next customer. The challenge before the Public Sector Banks (PSBs) is to upscale their capabilities, train their employees on the new technologies to benefit from the possibilities that adoption of technology can open up.

A good thing going for the banks is the current recruitment of youngsters in the work force. This new-generation staff is tech-savvy and can quickly connect with technology. The enterprising among them must be accorded freedom to experiment and suggest ways in which the bank could reengineer its processes for its own benefit and that of its customers. This would require a change in mind-set of the senior / Top Management and this must happen if the Public Sector Banks (PSBs) have to compete efficiently and effectively with the private sector counterparts in future.\(^{29}\)

10. **Treating Customers Fairly**

Protection of bank customers has been one of the thrust areas for Reserve Bank of India (RBI) in recent times; RBI has issued a Charter of Customer Rights\(^{30}\) 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

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\(^{29}\) V.Leeladhar (2011) Deputy Governor RBI, , BIS review Nov. 2005

\(^{30}\) Dr.Y.Y.Reddy, Banking Sectors Reforms In India, May, 2005
- Right to Privacy
- Right to Grievances Redress and Compensation

A model customer rights policy jointly prepared by Indian Bank’s Association (IBA) and Banking Codes and standards board of India (BCSBI) incorporating these rights has been circulated to all banks by IBA. The banks have been advised to prepare a Board Approved Policy (BAP) based on the model policy before July 31, 2015. Reserve Bank of India (RBI) may review the policies framed by the banks and their implementation as part of our supervisory assessment over the next 12-18 months.

11. Know Your Customer(KYC) /Anti Money Laundering (AML) Compliance

Another very important issue, which is equally challenging for the private sector banks as well and is compliance with the Know Your Customer (KYC) /Anti Money Laundering (AML) norms. A majority of the enforcement action by the banking sector regulator in the recent past has been on account of these violations.

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 Know Your Customer (KYC) compliance. Money mulling is another common occurrence which highlights deficiencies in risk categorization of customers and monitoring of transactions.

To emphasize on this issue because banks need to be sensitive to the possibility of regulatory strictures / penalties for non-compliance to know Your Customer (KYC) /Anti Money Laundering (AML) guidelines. 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 know Your Customer (KYC) /Anti Money Laundering (AML) norms and with our commitment to comply with the Financial Assessment Task Force (FATF) norms.  

12. Balance Sheet Management

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 to understand the savvy long-term investors or 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.

13. Risk Management

Risk is inevitable in the banking business and hence, a sound risk management framework is the touchstones 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. If the banks 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

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31 Dr. Y, V Reddy, *Banking Sectors Reforms in India*, May, 2005
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.

It is to be noted that, these are challenging times for the banking sector but as the original 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 Pradhan Mantri Jandhan Yojana (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.\textsuperscript{33}

\textbf{1.10 Gearing up for the Challenges}

The Indian banks still suffer from under-penetration and any new bank entering the market is likely to make money, only those banks will excel which focuses on building strong brands, developing innovative new products and aim to provide higher standards of service quality by putting the customer at the center of everything they do.

For this both old and new private sector banks will continue to strive, offer cost effective strategies, efficient services to their customers, strengthening service quality and cross-selling of products/services, usage of technology, better utilization of manpower, adopting corporate governance principles, leveraging competitive abilities through conglomerate and consolidate their business operations (M&As).

\textsuperscript{33} V.Leeladhar (2011) Deputy Governor RBI, , BIS review Nov.2005
1.11 Capitalizing on Banking Industry Trends

Banks in industrialized countries have recognized that, sustainable banking can bring sizable business benefits. In emerging markets, the following global trends and factors are strengthening the case for sustainable banking as a means of differentiating banks in increasingly competitive markets. The banking sector is using innovation to play a role in addressing global concerns. Significant environmental threats and growing demand for action on social issues are causing both private and public sector banks to seek new ways of doing business.

Market-based mechanisms are gaining more power to stimulate investments in sustainability of Banks. Rising oil and gas prices are stimulating a move to new sources of energy. The Kyoto Protocol, which came into force in 2005, is creating commercial value from energy efficiency and renewable energy initiatives. Consumer demand for more sustainable products and services, as well as tighter restrictions on imports by developed markets are driving improvements in the technologies and business models used by producers in the developing world.34

Concerned NGOs are turning more attention to banks. Rather than simply criticize, NGOs are increasingly seeking to collaborate and advocate change in banks’ social and environmental policies and practices. In addition, a variety of industry trends and factors are leading to greater integration of the world’s banking markets and intensifying the move toward sustainable banking.

Liberalization of banking sector and heightened competition in traditional markets has increased pressure on major international banks to find new areas for growth. The result has been a rapid increase in external capital flows and acquisition of emerging market banks by large international banks.

34 V.Leeladhar (2011) Deputy Governor RBI, , BIS review Nov.2005
Rapid credit growth and higher risk exposure. Such rapid growth may cause deterioration in credit quality. It signals a need for tighter risk management in general and more diligent credit risk assessment and stronger supervision in particular.

Technology transfers and innovations in banking products and processes, such improvements often accompany the entry of foreign banks and result in more competitive pricing and a more efficient allocation of credit in the banking sector as a whole.

As global players increase their presence in the banking sector in emerging markets, the sector will become more complex and competitive and thus more vulnerable to banking as well as non-banking risks. As competitive pressure from large foreign banks intensifies, finally, the scope of responsibility for banking institutions in emerging markets is widening: from environmental to social inclusion. Alleviating poverty and protecting human rights banks in emerging markets are reassessing business practices, including local lending and risk assessment practices, remain top priorities in emerging markets. As a result, local banking institutions are being called upon to help address a variety of social concerns through their core services, such as labor practices, protection of indigenous populations, and preservation of cultural heritage.

The present research programme sought to gain an insight into some of the most prominent business opportunities in fast-growing areas of banking services to low-income, underserved groups and priority sectors.

1.12 Types of Bank’s Sustainability

Bank’s Sustainability can be broadly sub-divided into financial sustainability, internal sustainability, external sustainability and social and environmental sustainability. Financial sustainability includes compliance of Reserve Bank of India (RBI)

35 V.Leeladhar (2011) Deputy Governor RBI, , BiS review Nov.2005
Guidelines, BASEL norms, prudential norms, CAMEL compliance, and bank governance by applying different modes and drivers of financial sustainability and by sustaining transaction cost of Human Resource (HR), technology, infrastructure and fee based services. Internal sustainability includes Human Resource Sustainability, Technological sustainability, Infrastructure and Institutional building sustainability and also integrated sustainability, Competitive Edge and Long-term growth.

External sustainability includes RBI guidelines, regulatory and legal requirements, Social and Environmental sustainability, customer, competition, meeting external benchmarks. Social and Environmental Sustainability (SES) of banks includes, Social and Environmental Sustainability (SES) compliance, Social and Environmental Sustainability (SES) drivers, Social and Environmental Sustainability (SES) model, Social and Environmental Sustainability (SES) strategy, Social and Environmental Sustainability (SES) risk components, Equator Principles and Sustainability Balanced Score Card etc.,

A. Financial Sustainability of Banks

Financial stability and sustainability should go hand in hand. This is well maintained by complying Reserve Bank of India (RBI) Guidelines, BASEL norms, Prudential Norms, CAMEL compliance, and Bank Governance, by applying different modes and drivers of financial sustainability and by sustaining transaction cost of Human Resource (HR), technology, infrastructure and fee based services. The key component variables are listed below;\(^{36}\)

<table>
<thead>
<tr>
<th>A. RBI Guidelines, Prudential Norms and CAMEL compliance</th>
<th>B. Transaction Cost and Financial Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>▪ CAMEL Compliance</td>
<td>▪ HR Cost per transaction</td>
</tr>
<tr>
<td>▪ Bank Governance and Leadership</td>
<td>▪ Infrastructure cost per transaction</td>
</tr>
<tr>
<td>▪ Prudential and</td>
<td>▪ Technology cost per transaction</td>
</tr>
</tbody>
</table>

\(^{36}\) [http://www.rbi.org.in-monthly bulletins-2012-14](http://www.rbi.org.in-monthly bulletins-2012-14)
<table>
<thead>
<tr>
<th>C. Drivers of Financial Sustainability</th>
<th>D. Modes of Financial Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>Interest rate fluctuation</td>
<td>Deposit Schemes</td>
</tr>
<tr>
<td>Competition and profitability</td>
<td>Background Verification</td>
</tr>
<tr>
<td>Pricing of banking products</td>
<td>Sustained Profits</td>
</tr>
<tr>
<td>Interest rate war</td>
<td>Sustained Spread</td>
</tr>
<tr>
<td>Retaining valued customers</td>
<td>Short-run and Long-run financial Sustainability</td>
</tr>
<tr>
<td>Banking frauds</td>
<td>Sustained CAGR</td>
</tr>
<tr>
<td>Bank liability and claims</td>
<td>Managing NPAs</td>
</tr>
<tr>
<td>Political intervention</td>
<td>Technological impact</td>
</tr>
<tr>
<td>Sustainability &amp; Strategy</td>
<td>Long-term results</td>
</tr>
<tr>
<td>Entry of global players and banks’ vulnerability</td>
<td>Aligning Banks’ Business Goals</td>
</tr>
</tbody>
</table>

**B. Internal Sustainability of Banks**

Internal sustainability of banks includes those variables which are affecting the banking business within the ambit of banks organisation design, which mainly includes:

1. Human Resource (HR) sustainability,
2. Technological sustainability,
3. Infrastructure and sustainability,
4. Institution building sustainability,
5. Integrated sustainability, Competitive Edge and Long-term growth.

1. **Human Resource (HR) sustainability** of banks is based on the influence of number of functions that the banking institution has to take care for the smooth flow of banking operations and to attain sustainability in the long run. Such factors are as follows;
- Human Resource (HR) Competency states that Banks human resources should be knowledgeable & competent to achieve sustainability.
- Human Resource Planning for taking care of surplus/shortage of workforce,
- Human Resource (HR) Supply should be adequately available for all times,
- Human Resource (HR) Demand should meet the present and future work pressure and burden,
- Universal Banking and Workload put Human Resource in a position to have sufficient to handle different product mix and their work pressure,
- Contract Employees are necessary to handle non-core functions like credit cards and customer care transactions,
- Competency based Training and Development is required to avoid depletion in skill, knowledge, ability and competency,
- Human Resource Functions like Human Resource planning/policy operations are crucial in achieving sustainability.
- Challenges of Human Resource as Internal Sustainability factor to keep competent Human Resource and to reduce cost of service,
- Human Resource Cost per Transaction should be at economical/affordable to both,
- Change management and organizational design is essential to achieve sustainability.
- Individual and collective competency and
- Autonomy and accountability is essential to bring and embrace the change ultimately leading to sustainable organizational design.

2. **Banks internal sustainability** is based on the strong and vibrant Technological products and services. Such variables include,
- e-transfer of funds National Electronic Fund Transfer (NEFT) and Real Time Gross Settlement (RTGS),
- e-transactions ( for cost reduction and quick payments),
- e-based banking services( like e-marketing/e-commerce),
- m-Banking and Payments (a gateway to e-payments),
- enhanced m-Banking and Customer base to meet the global challenges and competition,
- Core banking system for technological intervention in doing banking business.
- Value added services like sending alert messages, pass book extract and statements on customers’ cell-phones are the routes of banks technological sustainability,
- Internal Technology for all banking functions from log in to log-out,
- Liaisoning of Government Schemes (like ADHAR LINKAGE/KYC/DBT) through online,
- Technological Hitch (central server system to avoid server breakdowns),
- Up gradation of Technology (with new apps) and reduced Technological Cost per Transaction etc.

3. **Infrastructure sustainability** factors include the type of building (owned/leased), size and design of building for ease ambience, adequacy of staff and sub-staff, ease accessibility, adequacy of e-resources like computers, printers, counting machines, Automatic Teller Machines (ATMs), UPSs, LAN-WIFI; internal office equipments like furniture’s for both staff and customers, adequacy of facilities and amenities, adequacy of Space, adequacy of Energy Resources, utilization of Energy requirements, economical Infrastructure Cost per Transaction etc.

4. **Institution Building and Sustainability** of Banks depends on number of variables like; Expansion of Branches in rural/urban & foreign countries, deposit mobilization, Fee-based and Fund-based Transactions, Personal and Auto Loans, Universal Banking Products (like mutual fund, insurance, housing, factoring, merchant banking, venture capital, foreign trade), compliance with BASEL Norms (Basel-III), Cumulative Annual Growth Rates (CAGR), Automatic Teller Machines(ATMs), Networking base, Corporate achievements, Leadership and Management Skills, Ethics in Business and the like.
5. Integrated sustainability, Competitive Edge and Long-term growth lead to banks sustainability, which is based on the accomplishment of number of variables. Integrated Sustainability in the Banking business combines structure, task, people, technology and competition. This is possible through, evaluation, dialogues and customized indicators; value management is possible through identification of value, defining values stream, determining flow, defining pull and improving process, such as marketing of banking products, finance and internal management; continuous seeking of sustained quality behavior, keeping sustainability mission and sustainability as an integral part and achieving Long-term growth and maximizing required market value.

C. External Sustainability of Banks

External sustainability factors/parameters are those factors, which are influencing the normal and routine banking functions externally and where the banks have to comply with, includes the following sustainability variables;

1. Reserve Bank of India (RBI) Guidelines Prudential Norms, BASEL-III Norms and other Regulatory Norms and sustainability of Banks
2. Technology status and External Sustainability of Banks
3. Competition and External Sustainability of Banks
4. Customers orientation and External Sustainability of Banks
5. Economic Parameters for Banks’ External Sustainability
6. Drivers & Benchmarks of External Sustainability

1. RBI Guidelines on Prudential Norms, BASEL-III Norms and other Regulatory Norms, notifications, inflationary and deflationary measures are complied with, RBI guidelines on Primary Lending Rates (PLR), Cash Reserve Ratio (CRR), Statutory Reserve Ratio (SLR), Repurchase Agreements (REPO) Rates, interest rate fluctuations, priority sector lending, Non-performing Assets (NPA) management etc. are to be taken care to achieve external sustainability of banks.
2. **Technological status and external sustainability of banks** are overlapping concepts at present juncture. This component includes the following variable;[^37]

<table>
<thead>
<tr>
<th>● Cutting-edge Technology</th>
<th>● Technology cost per transaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>● Cost, speed and delivery</td>
<td>● Technology and fee based Services</td>
</tr>
<tr>
<td>● CRM Strategy</td>
<td>● Retraining and Redeployment</td>
</tr>
<tr>
<td>● Top Management Support</td>
<td>● QoS and VAS</td>
</tr>
<tr>
<td>● Digitalization</td>
<td>● Brand Value</td>
</tr>
<tr>
<td>● Mobility of accounts</td>
<td>● Customized Banking</td>
</tr>
</tbody>
</table>

The cutting-edge technology has changed the way of doing banking business today. Banks have to spend the necessary amount on up gradation and modernization of technology to reduce the cost, increase the speed and delivery including the vast customer base.

Technology enabled banks to attract and retain the customers through an effective customer relationship management strategy. Top management support, encouragement and participation helped the bank to have in place the current technology. The Banks are moving towards paperless banking on account of digitalization and computerization of records and transactions. Technology impacted the cost of transaction both for the bank and the customers. Fee-based services improved on account of technological innovations and novel banking products. Technology in banking made the management to retrain and redeploy the existing employees, thus avoiding the redundancy of skills. The Quality of services and value added services increased on account of technological intervention. Technology increased the brand value of the Banks and enabled Customized Banking.

[^37]: An empirical Study on Technology Adoption by Indian Banks, IBA publication May 2012
3. Competition and External Sustainability of Banks includes the following variables\textsuperscript{38}

<table>
<thead>
<tr>
<th>Intense Competition</th>
<th>Attention to quality of service and value of service (QoS and VoS)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Innovative banking products</td>
<td>New Banking licenses</td>
</tr>
<tr>
<td>Competition induced Customer Relationship Management (CRM) Strategies</td>
<td>Pricing of Banking products</td>
</tr>
<tr>
<td>Bottom-line</td>
<td>Interest Rate War</td>
</tr>
</tbody>
</table>

Bank’s external sustainability is jeopardized on account of severe competition in the industry. To combat severe competition, banks have formulated and implemented innovative banking products and services. Competition pressurized the banks to go in for CRM strategies and impacted on the bottom line (profit and customer loyalty) of the banks. Quality of services and value added services received much attention on account of severe competition in the banking industry. The Banking licenses to private companies by RBI would further augment the competition in the banking industry. Pricing of banking products and services is risky in the competitive world. Interest Rate war among the banks is the biggest competitive factor that impacts the banking business.

4. Customer Oriented Variables of External Sustainability includes the following variables\textsuperscript{39}

<table>
<thead>
<tr>
<th>Changed customer preferences</th>
<th>Brand image</th>
</tr>
</thead>
<tbody>
<tr>
<td>Diverse needs</td>
<td>Banks claims and liabilities</td>
</tr>
<tr>
<td>Valued Customers</td>
<td>Legal bottlenecks</td>
</tr>
<tr>
<td>Know Your Customer</td>
<td>Banking Products</td>
</tr>
<tr>
<td>Instant Banking</td>
<td>Knowledge Customers and loyalty</td>
</tr>
<tr>
<td>Innovations and Creativity</td>
<td>Political intervention</td>
</tr>
<tr>
<td>Banking Frauds</td>
<td>Govt. sponsor schemes</td>
</tr>
<tr>
<td>Customer Satisfaction and Profitability</td>
<td></td>
</tr>
</tbody>
</table>

\textsuperscript{38} Chakraborty, deputy governor, article titled ‘financial analysis of banks highlights of performance of banks India, IBA, Nov.2012 pp39

\textsuperscript{39} Chakraborty, deputy governor, article titled ‘financial analysis of banks highlights of performance of banks India, IBA, Nov.2012 pp42
Customer expectations and preferences are undergoing changes; the challenge is to meet those requirements. Meeting diverse needs of the customers is a challenge for the present banks and Retaining cash-cow (profitable) customers such as high net-worth individuals (HNI) and corporate customers (CC) is very difficult. Know-your customer strategy of the bank serves the bank to know the profile and to secure good business. Meeting instantaneous requirements of the customers and creating innovative products for the customers is a challenge for the banks.

Addressing the frauds in the banking business is also challenge for external sustainability of Banks in India. Handling defaulting customers, court cases and NPA are the bottlenecks for the bank’s external sustainability. Retaining IT, BT, BPO, Some Women customers and knowledge workers is cumbersome on account of their hopping pattern to seek the new from other banks. In rural areas there is a high political intervention on behalf of the customers to provide various loans. Providing loans under micro-financing, micro-credit and Self-Help Groups (SHGs) for the empowerment of the women borrowers is mandatory under the government sponsored schemes.

5. Economic Parameters for Banks’ External Sustainability

Banks’ external sustainability is affected by the following economic parametric variables

<table>
<thead>
<tr>
<th>Changing Business Cycle</th>
</tr>
</thead>
<tbody>
<tr>
<td>Macro-Economic Variables</td>
</tr>
<tr>
<td>Economic Factors Impact</td>
</tr>
<tr>
<td>Growing service sector</td>
</tr>
<tr>
<td>Globalization</td>
</tr>
<tr>
<td>Government schemes and customer base</td>
</tr>
<tr>
<td>low capital formation</td>
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</tbody>
</table>

Inflation and deflation in business cycle result in fluctuating trend in banking business. Hence banks should take necessary precautions by adjusting the interest rates; cash reserve ratio (CRR) and statutory liquidity ratio (SLR) rates. The macro

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40 Corporate catalyst article on ‘banking and finance sector in India- financial performance of leading IFs for FY-2009
economic variables such as, gross domestic product (GDP), Disposable Personal Income (DPI), Human Development Index (HDI), Poverty and Unemployment will have an impact (positive or negative) on the external sustainability of banks.

The poor monsoon, low agricultural and industrial output, increasing wholesale price index and consumer price index impacted the external sustainability of banks. Growing services sector is contributing to the improved banking business. Globalization of businesses has been contributing to enhanced banking businesses. Government sponsored loan schemes enabled public sector banks to increase the banks customer base. Low capital formation and savings is the impediment for the enhanced bank's business.

6. Drivers and Benchmarks of External Sustainability

<table>
<thead>
<tr>
<th>Drivers of External Sustainability</th>
<th>Benchmarks of External Sustainability</th>
</tr>
</thead>
<tbody>
<tr>
<td>• Sustainability &amp; Value Drivers</td>
<td>• avoiding conflict of interest</td>
</tr>
<tr>
<td>• short-term and long-term goal</td>
<td>• integrating environmental and social issues</td>
</tr>
<tr>
<td>• Risk management</td>
<td>• creating competitive advantage</td>
</tr>
<tr>
<td>• Investor demand</td>
<td>• global benchmarks</td>
</tr>
<tr>
<td>• economic performance</td>
<td>• Market-based mechanisms</td>
</tr>
<tr>
<td>• impact of sustainability banking</td>
<td>• measuring the benefits of sustainability</td>
</tr>
<tr>
<td>• foreign competition impact</td>
<td>•</td>
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</tbody>
</table>

External Sustainability drivers included under banking system creates value drivers in the form of products and services leading to better image of the Bank. Competitiveness via vis sustainability of banks, inflation risk, interest risk, NPA risk and business risk, Compliance with government regulations, competitive pressure from large foreign banks, emerging markets trends, local lending and risk assessment practices etc will have an influence on banks sustainability. The impact of the above all drivers on sustainability banking paradigms are helping the banks
to differentiate themselves from competitors, improve their reputation among key customers and stakeholders, attract new capital, and generate goodwill and support from stakeholders. As competitive pressure from large foreign banks intensifies, banks in emerging markets are reassessing business practices, including local lending and risk assessment practices.

Benchmarks of external sustainability include; satisfying all its stakeholders without the conflict of interest, addressing the issue of sustainability by considering firstly environmental and the social issues and attempting to incorporate them by established policies for the environment and society, increasing the competitive advantage by pursuing a sustainability strategy – and in the process create long-term value for themselves and their clients, building customer loyalty and meet new market demands to sustain their market share, banks are increasingly adopting global standards in risk management, international standards of openness in reporting and accountability, and more effective strategies for product development, Market-based mechanism to stimulate investments, and Recognizing and measuring the benefits of sustainability as a competitiveness strategy is an important part of ensuring long-term buy-in from shareholders and stakeholders alike.

**Social and Environmental Sustainability (SES) of Banks**

Social, Economic and Environmental Sustainability are like a “Tripod” which represents a banks’ sustainability mainly focuses on three aspects namely, Economic Growth, Social Progress and Environmental Protection. (Munier-2006). Sustainability of Banks’ encompasses economic growth, social progress and environmental protection dimensions. The banks which provide products and services only to those customers who take into consideration the environmental and social impacts of their activities are said to be Sustainable.

- **Social and Environmental Sustainability (SES) Compliance**

Banks’ have to face a numerous challenges such as economic, social, cultural, technological, political, legal and other interests. Under this circumstance a bank
has to comply with all these external requirements to stay sustainable and competitive.

Under Economic Sustainability dimension of a bank, poverty alleviation is incredibly important through loans and advances to priority sector. Banks are to implement more socially and environmentally responsible lending policies.

Reputation and branding has become the top reason for many banks to integrate sustainability considerations into their management practices. There is a need to increase banks credibility and reputation which form the main reason to consider social and environmental issues.

Banks for their sustainability are providing loans for environmental improvements in waste collection and treatment as well as microfinance to rural communities and women. Banks are adopting best practice measures to assess social and environmental risk in their projects, and publish a sustainability report.

Banks have to commit high standards for managing social and environmental risk in its private sector investments. Social and environmental considerations are becoming vital in ensuring competitiveness and differentiating banks in increasingly competitive markets.

- **Social and Environmental Sustainability (SES) Drivers**

The banking sector is using innovation to play a role in addressing global concerns. Significant environmental threats and growing demand for action on social issues are causing both private and public sector banks to seek new ways of doing business. Environmental and Social management systems (SEMS) are integrated into overall banking business objectives. The global banking industry has experienced a significant transformation in which social and environmental responsibility has become increasingly central to business performance.

Social and environmental risk management improves the quality of a bank’s portfolio and lowers insurance liabilities and compensation claims. Pursuing innovative financial solutions and products generates direct profits in new markets
with new clients. Sustainable banking practices by the banks improve brand value and reputation, including improved community relations.

- **Social and Ethical issues**

Social responsibility fuels the sustainability of a bank because the financial interest and social interest go together for long-term development. Banks’ are socially responsible and therefore should develop ethical policies combining environmental and social aspects. This ensures their sustainability. Non-Governmental Organizations (NGOs) are turning more attention to banks. Rather than simply criticize, Non-Governmental Organizations (NGOs) are increasingly seeking to collaborate and advocate change in banks’ social and environmental policies and practices.

Pressing environmental issues as well as the need to alleviate poverty and protect human rights remain priorities in bank’s sustainability programmes. The scope of responsibility for banking institutions is widening from environmental protection to social inclusion of underprivileged groups and consideration of other social issues, such as labor practices, protection of indigenous populations, and preservation of cultural heritage.

A growing cluster of opportunities has evolved and includes renewable energy, energy efficiency, cleaner production processes and technologies, biodiversity conservation, microfinance, financial services targeted to women, and low-income housing. Virtually now a days the commercial banks consider social and environmental issues, either by managing risks, developing business opportunities, or both.

- **Social and Environmental Management System-SEMS Model**

To manage both risks and opportunities strategically and comprehensively, banks need to integrate a systematic approach—a Social and Environmental Management System (SEMS)—into their processes and operations. To be truly effective, a social and environmental management system (SEMS) must become a part of a banks’
overall management system. Banks need to take their social and environmental management systems beyond written policies to achieve tangible results.  

- **Strategy for creating long-term value through Sustainable Banking**

![Diagram showing the strategy for creating long-term value through Sustainable Banking]

(Source: IFCs Sustainability survey of financial institution-2005)

- **Social and Environmental Risk Components**

For banking institutions, sustainability has two components.

1) Managing social and environmental risks in strategic decision-making and lending and  
2) Identifying opportunities for innovative product development in new areas related to sustainability

The first component is managing social and environmental risks in strategic decision-making and lending. Banking institutions can strengthen their portfolio by systematically evaluating these risks in the loan or investment appraisal process. In this way, they can focus investments on those borrowers and projects with high environmental, social, and banking performance. Doing so can help protect their

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41 Jouni Martti Eerikainen, IFC, 2005
asset portfolio by decreasing nonperforming loans, thereby increasing banking stability and protecting the banks reputation.

The second component is identifying opportunities for innovative product development in new areas related to sustainability. This entails creating banking products and services that support commercial development of products or activities with social and environmental benefits. A growing cluster of these opportunities has evolved and includes renewable energy, energy efficiency, cleaner production processes and technologies, biodiversity conservation, microfinance, banking services targeted to women, and low-income housing.

- **A Measurement Tool for Social and Environment Sustainability**

  - **Equator Principles**

The Equator Principles are voluntary set of social and environmental guidelines developed by International Finance Corporation (IFC) (2014)\(^{42}\) the World Bank’s private-sector investment arm, for managing social and environmental issues related to the financing of development projects. These principles are used by about 80 percent of the project finance market worldwide. The Principles provide the ideal risk-management framework for banks, whether they invest in their own country or abroad.

The Equator Banks (signatories to these principles) are committed to put in place their internal policies and processes in consistent with these principles. This process involves the following sequence of activities;

a) The Bank should screen the level of social and environmental risks and assigns a risk category

b) The Borrower should complete an environmental assessment and has to prepare an action plan, that describes and prioritizes the actions needed to implement mitigation measures or corrective actions and monitoring measures

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\(^{42}\) IFC (2014)- the World Bank’s private-sector investment arm, for managing social and environmental issues related to the financing of development projects report.
c) The Borrower should disclose impacts and consult with affected groups.
d) The Borrower covenants to comply with the action plan and report on compliance.

In adopting the Equator Principles, a bank undertakes to provide loans only to those projects whose sponsors can demonstrate to the satisfaction of the bank, their ability and willingness to comply with comprehensive processes aimed at ensuring that projects are developed in a socially responsible manner and according to sound environmental management practices.

- **Sustainability Balanced Score Card**

To become sustainable leaders, there is a need for integrating sustainable strategies, processes, services and products into their business policies and operational business. (Springett, 2003). Further analysis is necessary to measure the impact of integrating sustainability into the business strategies of financial sector; these strategies reach beyond pure financial success measurement and integrate the impact on sustainable development [Edwards et al., 2002] along with the existing tool/approach 'sustainability balanced scorecard.[Figge et al, 2002].

**1.13 Advantages of Bank’s Sustainability**

Business models that address sustainability dimensions are yielding number of advantages to the banking institutions like:

- Sustainability gives new clients and markets
- Sustainability helps banking institutions to differentiate themselves from competitors
- Sustainability improve their reputation among key customers and stakeholders

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43 (Springett, 2003 Centre of for sustainable management, university of Luneburg, Germany,
44 Edwards et al., 2002 Centre of for sustainable management, university of Luneburg, Germany,
45 Figge et al, 2002). Centre of for sustainable management, university of Luneburg, Germany,
Sustainability attracts new capital, and generates goodwill and support from stakeholders
Sustainability results in Values/Benefits
Sustainability is a part of banking sector but independent itself
Sustainability analogy: like a wheel which is moving ........
Unsustainability is like a wooden log, which is stagnant
Sustainability requires ‘employee’s autonomy/freedom
Sustainability is achieved through harmonious balance: win-win situation between all customers
Competence development may contribute to sustainability in terms of addressing the complexities and differentials
Banking culture and sustainability are correlated
Individual competency and collective competency results in sustainability

1.14 Significance of Bank’s Sustainability

Sustainable banking is a continuous process. It will always be a journey, never a destination. A bank may get close to reaching its sustainability objectives, but because we live in a dynamic world with ever-changing internal and external forces, it will never achieve all its objectives. Success criteria will change, and new challenges and new goals will emerge. However, as long as a bank takes care of all the sustainable factors in all its operations, it will be able to keep on top of its sustainability commitments.

- High impact on Cost/Benefit ratio
- Easy integration into existing or ganisational and management systems, leading to improved risk control
- Better communication, resulting in improved public relations, greater stakeholder dialogue and credible commitment toward staff and external stakeholders
- Improved access to international capital markets and funding from multilateral institutions and development banks
• Improved brand value and reputation
• Developed new business
• Improved community relationships
• Reduced cost and savings
• Better quality of work/regulations
• Increased Revenues
• Developed new products and services
• Systematic and consistent approach to social and environmental issues

1.15 Measuring the Benefits of Bank’s Sustainability

The best approaches to sustainability are ones that meet the needs of stakeholders while strengthening a banking business’ own operations and bottom line. Recognizing and measuring the benefits of sustainability as a competitiveness strategy is an important part of ensuring long-term buy-in from shareholders and stakeholders alike.

There is growing evidence that innovative approaches to sustainability can bring substantial benefits to a bank’s overall business performance.

- Performance indicators of Banks’ Sustainability
- Greater and higher long-term returns by financing more sustainable projects and businesses
- Reduced transaction cost
- Reduced NPAs
- Reduced risk
- New business development through new products and services
- Increased market share in sustainability-driven sectors
- Technology driven customer service delivery
- Enhanced reputation and better brand value
- Better access to capital from international banking organizations
- Increased value to shareholders as well as stakeholders
1.16 Drivers of Banks Sustainability

- Reputation and branding has become the top reason for many banks to integrate sustainability considerations into their management practices.
- Banks credibility and reputation which form the main reason to consider social and environmental issues.
- Investor demand is the critical factor for a bank to consider the social and environmental projects lending.
- Compliance with government regulations, although important, is no longer the top driver. Instead, other incentives include increased value to shareholders, lower risk and better returns and client demands are the reasons for the banks sustainability initiative.
- For banking institutions, the process of continual improvement means integrating better standards as well as expanding the view of what generates long-term value for themselves, for their clients, and for society.

1.17 Models of Sustainable Banking

The Dynamic Business model for Sustainable Banking in Emerging Markets including India is as follows,

To achieve the greatest long-term benefit, individual banks must devise their own unique approach and business case for sustainability. This is determined by how they want to align their business goals with trends in the markets and sectors in which they operate. The different approaches that are pursued by banking organizations for achieving specific goals in different markets are as follows:⁴⁶

1. Developing An Approach

Banks are devising their own business case by identifying the risks as well as the opportunities offered by their markets and lines of business, and assessing how these can support growth for their clients as well as themselves.

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⁴⁶ A survey of banks carried out by IFC (2005) in the Article ‘Banks find Profit in Morality and Sustainability’ - Emerald group publishing company Ltd. ISSN 0258-0543, vol.23, No.6,2007 pp 35-38
Examples of new markets and areas of business include energy efficiency and renewable energy, cleaner production, finance, biodiversity, conservation, developing sustainable supply chains, and providing banking resources to underserved groups.

2. **Integrating Environmental and Social Management Systems**

The next step is to implement changes to more systematically minimize risks and capture opportunities. This means adopting a series of organizational innovations, including formal social and environmental management systems and improvements in corporate governance. Resources are needed and allocated to support these innovations and train and hire staff as required.

Good corporate governance, both for banking institutions and companies in which they invest, is a requisite for sustainability Innovations. This area includes a greater emphasis on openness, transparency, and accountability, and engagement with a wider range of stakeholders.

3. **Stimulating Wider Change**

Encouraged by the success of pioneers, the uptake of sustainability by a much wider range of banks is strengthening and reinforcing the business case. This is particularly true for risk management. In recent years, voluntary industry frameworks such as the Equator Principles have helped build an international consensus around the need for and benefits of social and environmental standards. Adherence to such standards is gradually becoming standard banking practice. To maximize the competitive advantage of sustainability, banks are now turning to the new frontier of innovation in products and services.

4. **Corporate Social Responsibility (CSR) Models**

The research article furnishes examples of good practices in the banking sector compared to the other sectors. The authors have given highlights of three Corporate Social Responsibility (CSR) models namely, Socio-Economic Model, Stakeholders Model and Triple Bottom Line (TBL) Model. The first model ‘Socio-Economic Model’ takes into consideration only two aspects of the business- ‘Profitability and Social
Responsibility, neglecting the environmental dimension. The Stakeholders Model considers the environment as a non-market stakeholder. The third model, Triple Bottom Line (TBL) Model captures the essence of sustainable development and illustrates the interrelationship between all the components of the business social, environmental and economical.

1.18 Banks Sustainability: Evidence of the Business Case

Are banks in emerging markets including India actually strengthening their ability and undertaking more initiatives to manage risk and pursue opportunities through sustainability?

The result indicates the following trends:

- Banks in emerging markets have increased their awareness about the risks and potential benefits associated with social and environmental issues. Virtually now a days the commercial banks consider social and environmental issues, either by managing risks, developing business opportunities, or both.
- The business case for sustainable banking is strong. There are positive changes as a result of steps taken by the banks to integrate social and environmental issues in their business.
- The integration of sustainability into management systems and practices brings tangible benefits, including new lines of business, new clients, greater access to financing, greater shareholder value, and improved reputation and goodwill.
- There is a reduction in risk as a result of considering social and environmental issues by the Commercial banks. As a result of the bank’s sustainability practice, there is improved access to international capital, improved brand value and reputation, new business, and improved community relations.

\[47\] IFC & IBA January 2008 web articles, [www.ifc.ac.in](http://www.ifc.ac.in)
- Reputation and branding is the top reason that banks in emerging markets integrate social and environmental considerations into their management practices. Compliance with government regulations, although important, is no longer the top driver.

- There is a need to increase Banks’ credibility and reputation which is the main reason to consider social and environmental issues. So also the investor’s demand is a critical factor for bank’s sustainability.

- Banks increasingly see the potential for lending in areas such as sustainable energy, cleaner production, biodiversity conservation, and good corporate governance.

- There is a greater opportunities for commercial Banks’ to strengthen their portfolios by providing loans for environmental projects, getting access to new markets, developing new business in sustainability-driven sectors, and providing loans/advisory services for eco-efficiency and cleaner production. There is a greater need for diversified assistances such as, information, technical assistance and advisory services under sustainability banks.