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IMPACT OF GLOBALIZATION ON INDIAN BANKING SECTOR

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INTRODUCTION

There are three distinct spells of development of Banking industry in post independent India, the pre-nationalization era from 1947 to 1969, the post-nationalization cum pre-liberalization era from 1969 to 1991 and the neo-liberalization era from 1991 onwards. The first phase was mostly city-centric private Banking marked by frequent failures and liquidation of Banks and consequent pauperization of numerous poor and middle class depositors and loss of jobs for the employees. The post-nationalization era saw a sea-change in the Banking scenario : financial stability of Public Sector Banks (PSBs) controlling more than 84% of Banking business of the country, PSBs commanding trust and confidence of the Banking-public, expansion of Branch net-work of Banks – particularly in hitherto unbanked rural and semi-urban centres, opening up the banking services accessible to the rural poor, expansion of credit to agriculture, small scale industries and small entrepreneurs, artisans – even to the marginal farmers, small shop-owners, vegetable vendors etc. Such expansion of Branch network, coupled with such mass-banking, created considerable job opportunities on the one hand, and, on the other, it helped a green revolution on the agricultural sector, obviating dependence of import of food grains, as also a spurt in the development of Small and Medium Scale Industries. It also rescued a vast section of the rural poor from the exploitation by village-money-lenders. By tapping the hitherto untapped huge rural savings, the PSBs could help the growth of large-scale and capital intensive industries too. Even the most ardent critics of Public Sector too have had to recognize and appreciate the laudable role of PSBs towards development of economic self reliance. During this post nationalization era, Regional Rural Banks (RRBs) were established in 1975 onwards under the auspices of PSBs to cater to the credit needs of rural-India. Till 1990, priority sector lending constituted over 70% of the advance portfolio of RRBs giving further fillip to the rural economy. During the last four decades of their productive existence, the PSBs have taken up the services of employees and the liability of depositors of a number of Private Banks going on liquidation due to mismanagement by and the greed of their private owners.

With the onset of World Bank-IMF dictated reforms, euphemistically called liberalization, successive Governments at the centre have consistently been trying to undo all the good work of the PSBs as also to dismantle and privatize the PSBs altogether. On 14th August 1991, the Government of India (GOI) appointed a Committee headed by Mr.M. Narashimham (called "Narashimham Committee – I") to suggest the modus operandi for reforms of the Banking Sector. On 16th November 1991, the said Committee submitted its

Repost suggesting downsizing of PSBs through closure of Branches, merger of PSBs, reduction of priority sector lending from the then prevailing 40% to 10% of total advance portfolio, abolition of Banking Service Recruitment Board, granting of more autonomy to PSBs in respect of both financial and administrative matters, to reduce the supervisory and regulatory control of Reserve Bank of India (RBI), the Central Bank of the country, and, to top it all, dilution of Government Holding in PSBs through suitable amendment of relevant legislations. Thereafter, a number of committees, such as Narashimham Committee – II, Khan Committee, Verma Committee, S.C.Gupta Committee, Raghuram Rajan Committee, Anwarul Hoda Committee, to name a few, have been appointed to assess the progress in implementation of the Recommendations of the "Narashimham Committee – I" as also to suggest measures for carrying forward the reforms of the Banking Sector further as per dictates of the World Bank-IMF.

Challenges to the Banking Sector

Banking business in Indian is getting redefined it is faced with myriad challenges and opportunies, especially beyond 2009 when they would be fully exposed to competition. Banks in India are bracing themselves to be ready through adoption of newer technology strengthening their capital base to survive in the competitive environment, Reducing their NPAs, Bringing down operating costs, enhancing corporate governance and alignments, undertaking organizational restructuring and sharpening their customer-centric initiatives. Consolidation of merger and acquisition rout to effective compete with large global banks may not be far off, when viewed against such preparedness and positive signs from regulators. Technology is clear a prerequisite fro growth and scale. Some of the challenges banks are facing today are as under:

- Changing needs of customers.
- Coping with regulatory reforms.
- Thinning spread.
- Maintaining high quality assets.
- Management of impaired assets.
- Keeping pace with technology up gradations.
- Sustaining healthy bottom lines and increasing shareholder value.

Technology Infusion and Up Gradation Challenges

Unlike the global banks, banks in India have hooked on to the computerization drive rather late i.e. by the 1980s and 1990s. Having started with PC-based system, they moved on to total branch automation and later to networking and implementation of centralized/core banking solution (CBS). However, the transition of CBS has not been smooth in many of the traditional banks. Reluctance to adopt the best practices envisaged by the standard CBS packages has forced them to resort to heavy customization, leading to reduced effectiveness and efficiency of the solution. Again, many large banks have confined the CBS facility to only 20% or 30 % of their branches with the justification that it will cover 70 to 80 % business of the bank. This has deprived the fruits of modern technology to the mass customers of rural and smaller branches. Further the banker's employees have been using the new system without adequate training in many cases, resulting the delays and customers of

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rural and smaller branches. Further, the bank employees have been using the new system without adequate training in many cases, resulting in delays and customer inconvenience, also they have to deal with dual systems and the overhead involved in reconciliation between them.

Underutilized and unknown to many, there exists a huge potential at the bottom of the pyramid for banks. It is a proven fact that convenient and any-time banking channels like ATMs serve as good avenues for the banking system to procure the large amount of cash stacked by the rural folk. It calls for some out-of the box thinking and applying the Indian IT ingenuity to achieve cost-effective result. Smart cards, etc., can come to the help of the remote villages. Very soon banks will rediscover the rural potential for mobilizing low cost deposit through their e-banking channels cost-effective. Perhaps the true spirit of financial inclusion can be achieved only when banks use modern technology extensively.

The benefits Vis -a Vis costs: To derive maximum advantage from technology investments, banks will need to use technology as a strategic resource and align it well with their business strategies and objectives. The strategic plan should clearly spell out how much business value it can enhance and it should not be used as a mere publicity stunt. It is crucial that experts who have sufficient exposure in both banking and technology domains formulate the strategic planning.

It is difficult to measure productivity in financial services unlike in the rest of the service sector, since the quality of service in this sector is constantly improving due to greater convenient, speed and lower risk. Morever, measuring the inputs used to produce outputs is not easy. Lack of consistent data also hampers researchers from analyzing the cost and benefits reliably. However, investment in IT is justified by most CEOs as the cost for retaining good customer, if not attracting new ones, and the better competitive advantage it provides.

Banking and service quality: The emergence of technology-intensive new delivery channels has liberalized the customers from the constraints of the time and space. Thanks to the high level of service quality and standard, the ATM channel has transformed the way customer's carry out their banking transactions. The glitch is that the service is not yet free from occasional disruptions like communication link failure, on-replenishment of cash on time, etc., despite the implementation of CBS solution, the flip side is that the quality of service at different braches varies widely. Without or teller system, customers have to spend considerable time at the branch counters to complete their transactions. Initiatives like six sigma quality level implementation can go a long way to control this variance to ensure uniform customer experience.

Now a day's banking is not in its traditional way, with the advancement of technology it's focusing on more comfort of customer providing services such as:

1. Automated Teller Machines cards (ATM)
2. Credit card
3. Debit card
4. Internet banking
5. Tele banking

6. Corporate cash Management
7. SWIFT Banking
8. Very small Aperture Terminals
9. Mobile banking
10. Home Banking
11. Demand Draft
12. Safe Deposit vault
13. Night safe
14. Rupee Travelers' cheque

Outsourcing vs. in sourcing: Normally, organization across the world outsources non-core activities to achieve cost advantage. In fact, for banking and financial services, technology can no longer be treated as a non-core activity it has emerged as a strategic resource. However, banks in Indian are finding it extremely difficult for attracting and retaining IT expert internally, as the opportunities abroad are many for these people. This is forcing many banks to entrust this vital role to vendors. But, this process entails high risk, as the vendors may not have the requisite awareness in the banking domain. Further, they may not be familiar with the cultural nuances of individual banks to frame the most appropriate technology strategies and architecture to suit the unique requirements of each bank. A fortiori, the only feasible solution is to have independent advisors and consultants with proven track record of expertise in the domains of banking and technology.

Productivity enhancement-experience so far and lessons learnt; Infusion of technology in the banking system has helped in enhancing productivity despite many constraints such as non-flexibility in restraining and redeployment of staff, resistance to changing the processes, etc. It may be unrealistic to expect a revolution rather than an evolution in personnel productivity in the short-term, considering the sensitivity of labour reduction and displacement in the Indian context. There is much to be learnt from e-channels like internet banking telebanking, smart cards, etc many of these channels have been instituted to automate the existing processes, but the challenge of fundamentally changing the process from start to finish has proved daunting. This is in part because many of services that banks are attempting to automate currently are extraneous-the production or service depends on the inputs or behaviors of many players outside of the bank. Many banks with net banking have discovered that they have to use the savings in "Brick and mortar" operating costs to pay much higher interest rates to attract customers apart from incurring substantial expenses on brand building and operating call centers to address the large number of customer queries.

Technology as a Differentiator

In India, the foreign banks and the new generation banks had early move advantage of using technology as a differentiator in enhancing customer convenient and to remain competitive. However, over time, others caught up with them and the playing field has become flatter with most of the banks having now migrated to industry standard CBS solutions, however there is adequate scope for banks to use technology as a differentiator through innovative products and services to face the aggressive competition in the market. Foreign banks tend to use information technology more intensively and practice niche banking. As for efficiency

ladder has been driven almost exclusively by the new private banks - ICICI, UTI, HDFC etc- that have followed the foreign bank-type staffing practices and business model with lower clerical and subordinate staff strength. All these features have important policy implications for the debate concerning restructuring and privatizing of public sector banks. There is also the view however that ownership per se does not affect the operational efficiency of banks. It is the discipline of stock markets that make the traded private companies more efficient than public sector banks.

The Problems Areas

Banks have to realize that their business has to drive technology and not vice versa. All technology strategies and plans should be based on the principle that any investment in IT should add business value to the bank and these customers. Being a strategic resource, IT governance has to be top in the agenda of a bank's board. The fast changes in technology and the faster turnover of IT personnel make it all the more difficult for banks to manage their technology infrastructure and risks effectively. The operational risks emanating from the large-scale dependence of technology in banking operations also have to be mitigated to acceptable level through appropriate business continuity plans.

The Impact on Customers

The shift from branch counter to e-channels has indeed enhanced customer service and convenience. The dream of anytime, anywhere banking is a reality now. With facilities like mobile alerts, customers get real time information about transactions in their accounts. However, customers' experience in resolving their problems through interactive voice response systems/call centers has not been satisfactory in most cases. The warmth and human touch is missing in these mechanical media, leaving many a customer to contemplate the benefits of talking to the good old banker. Also, in the absence of channel integration, customers are unable to get identical information about their accounts across the channels. The silver lining for customer is that they can shift to competitor's banks easily if they are not satisfied with the services from the present bank.

Innovation and Branding the Product

Expert has given opinion that innovation is the key to the future sustained growth of the banking industry. However, innovation cannot be limited to products and brand alone. Successful financial service players are required to embed innovation in every aspect of their functioning, ranging from products and processes to even people, system and business partners. However, product innovation would also be important and such innovative products would need to be tailor-made for different customer segments, e.g. products could be specific to age groups, regions and so on. However, moving further ahead to integrated innovation in it's functioning, a bank needs to develop a clear vision on the various parameters of innovation. Subsequently, the organization structure needs to be realigned around this vision through engagement of employee and fine-tuning of the technological infrastructure.

Growth Prospects under Retail Finance

The Indian retail finance market is expected to continue growing due to:

1. Change in psychology of the Indian consumer who is no longer credit averse.

2. Paradigm shift in the lenders' profit mainly from NBFCs to commercial banks, which able to offer not only much better rates but also an entire product suite to customer needs.
3. Increase in household incomes in the backdrop of surge in the Indian economy growing at a rate of 8% within the retail finance market, housing loan is the biggest component, which would continue to grow due to the following factors.
4. Credit culture has added more and more people to the loan taker basket.
5. Demographic changes like age of the borrower, higher middle-class urban population, and etc. Have expanded the number of loan takers.
6. Rising income/aspiration levels
7. Rates though on the uptrend are still way below what they were five years ago.
8. Change in attitude of bankers in providing credit to individuals to spread risk unlike in the past.

Banks are responding to the huge loan growth momentum through innovative and customized products and flexibility to the customers through different options.

Interest rates; likely scenario; Interest rates are currently on the rise mainly on account of higher oil and commodity process. Also problems due to erratic monsoon and its corresponding effect on agriculture production, rising international interest rate, along with higher than anticipated money supply growth, are putting an upward bias to the yield curve across maturities. The impact of this rising interest rates on the banks will depend upon the interest rates sensitivity of the bank's portfolio. The rising interest rate scenario will generally lead to re-pricing of the portfolio of the banks on both asst and liability sides. It is seen that the banks' net interest margin may be affected, as liabilities in general get re-priced faster than its assets. This impact however can be minimized if the banks have prudent planning. As a whole, banks need to incorporate a short, midium and loan-term view on interest rates in their corporate planning exercise, wherein adverse impact of a rising interest rate scenario can be taken care of through advance planning. Such measures would vary from bank to bank depending on the composition of the portfolio. According, on a case-by-case basis, banks can try to increase interest rates on fixed rate loans following increase in their cost of borrowings.

Risk management practices; the acceptance and management of financial risk are inherent to the business of banking and bank's roles as financial intermediaries. Risk management as commonly perceived does not mean minimizing risk, rather the goal of risk management is to optimize-reward trade off. Expanding business arenas, deregulation and globalization of financial activities, emergence of new financial products and increased level of competition have necessitated a need for an effective and structured risk management in Indian banks. Indian banks are in the process of implementing Basel II framework, covering all risk areas. They are continuously evolving the risk management systems and process with the objective of not just conforming to the framework prescribed by RBI but many of them are proactively going beyond and adopting advanced risk management systems.

Growth rate could be increased: Overt the decades the sector has grown steadily in size, measured in terms of total deposits, at a fairly uniform average annual growth rate of about 18 %.

Opportunity for private sector: This the most visible changes in Indian financial system. Emergence of new private sector banks as well as the entry of several new foreign banks, as in other sectors, Indian banking is quickly getting interacted in to globalize financial system.

Emphasis on professionalism: the spirit of competition and the emphasis on profitability are also driving public sector banks towards greater profit-orientation in departure from the socialistic approach followed for decades. In general, it seems that the emergence of new private banks and the increased participation of foreign banks have increased professionalism in the banking sector as a whole.

Healthy competition would increase: Competition has clearly increased with the Herfindahi index for advances and assets dropping by over 28% and about 20% respectively 1991-92 and 2000-2001.Over the period SBI, the largest Indian bank witnessed a decline in asset market share from 28 to 24% while its loan market share dropped from 27 to 22%. The deposit share, on the other hand stayed pretty much the same at 23%. The asset, loan and deposit shares of the top 10 banks all fell from close to 70% to below 60%. Nevertheless, the public sector banks still enjoy a preeminent position in Indian banking to day, accounting for over 80% of deposits and credit.

Performance needs to increase: On a value or profitable basis the foreign banks as a group have been considerable more efficient than all other bank groups followed by Indian private bank. From a quantity perspective or on the basis of volume of deposits and credit created with given input levels, however Indian private banks have been the best performers while foreign banks worst performers. This suggests that the foreign banks have been cherry-picking-"lucrative segments of bank's measure of bank performance and efficiency is provided by the difference between the interest charged and interest paid by the banks as proportion of total assets of the banks The net interest margin. Foreign banks appear to enjoy a considerable advantage over the other bank categories on this criterion. The relatively lower NIM of private banks seems to suggest that they are gaining market share by reducing margins.

Another measure of efficiency of the banking sector is the productivity of its personnel. This is clearly not total factor productivity, kind of measure but rather just a measure of how well the human resources are exploited by the banks. Clearly, this figure would depend crucially with expenditure on non-human inputs that complement the efforts of the employee. A measure of labour productivity in the banking sector is the ratio of turnover of the total business generated as the sum of total deposits and advances to the total number of employees. There has been improvement across all categories since liberalation. However the foreign banks' turn over per employee is about five times that of the nationalized banks. Equally impressive has been the relative surge of the private banks on this metric, from below par when compared to the public sector banks at the beginning of the public sector banks at the beginning of the decade to over twice as efficient as the nationalized banks in later years. Much of the relative poor performance of the public sector banks stems from the fact that they are required to have branches in rural areas all over the country that are largely cost centers though public sector banks are overstaffed even when their metro and urban area branches are considered. When we look at the banks' turnover as a multiple of their employee cost rather than number of employees, the difference is less marked. Clearly the new private sector banks have been more successful in keeping their employee costs down while raising turnover. Both the foreign and private banks hire fewer but more expensive employees than their public sector counterparts.

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CONCLUSION

To accomplish total globalization, a common currency must be established which will ease the entry of foreign banks into domestic markets that can contribute to more efficiency through increased competition. In the other hand, a currency crisis in an emerging market would exaggerate this situation. Dome tic borrowers, including banks, that obtain funds from abroad, usually borrow in a foreign currency such as the dollar to give foreign investors some reassurance about the value of their investments. The effect of financial globalization, therefore, on domestic financial fragility is not simple. Foreign direct investment both lowers the incidence of banking crises and shortens its duration.

Overall the Indian banking sector is stronger and healthier today than it was a decade ago. The recent focus of some of the banks on micro finance and lending to SME firms are welcome changes both for the banking sector as well as the economy and society as a whole. Finding opportunities at the bottom of the pyramid rather than regulator loan-pushing is likely to help better distribution of the economic gains as well as opportunities. Managing the risk in banking through the implementation of global standards like Basel II is likely to be an important step fort Indian banking sector in the coming year. Banks and financial institution will continue to experiment with new technologies and electronic, information-based services to serve their customers better. The potential is great, yet the return on investment will be realized only in the long-term. Proper alignment of technology strategies with business goals will only ensure commensurate value addition to banks. Also banks are rediscovering the need for more brick and mortar branches as the most effective touch points for building relationships, marketing and selling. Technology advances like data mining and business intelligence will enable and empower branch personnel to realize higher customer life cycle value. The information-intensive nature of banking and financial services is unlikely to change. Banks will continue to find newer and innovative ways to put technology to their customers 'best use and will have to manage technology and business risks associated with these investments proactively.

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