# Issues and Challenges of Indian Banking Sector

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**Abstract:** In order to survive in this competitive environment and to cope with the challenges Indian banking sectors has to undergoes various reforms. Indian Bank is the most important service sector and it plays a very important role in the economic development. Indian banking achieved a new height in the changing times in its long journey. Technological advancements in the banking sector had brought about tremendous changes in its working style, in banking products and services. The present paper describes about various challenges and issues in Indian banks. Secondary data has been collected for this paper. The challenges and opportunities faced by the Indian banking sector while transition, identified in this present paper.

Key words: Banking sector and Reform.

**Introduction**

Indian banks undergoes transformational changes, it covered various difficult terrain, the indignities of foreign rules, partition and various other difficulties for the progress of the country. Indian banking sector is describes as a lifeline of nation, it has developed various vital sector of the economy. Banks in India have been gone through a long journey.

Before 20th century, lending money by money lenders was at very high rate of interest. Rural people were highly exploited. Banking system in India originated in the 18th century. Banks are regulated by RBI. Reserve bank of India is responsible for licensing of banks and its branches. Today, Indian banks can confidently compete with modern banks of the world. Indian economy witnessed the phases of liberalization, Privatization and globalization. During these period public sector banks, had to faces many deteriorating performance. The nationalization outlasts its utility. The public sector banks were in need of advanced and modern technology. So the need for computerization along with networking among the vast branch network was urgently felt. So on the reform path, the first Narasimham Committee on Financial Sector Reforms put forward its recommendations. It gives a new life to public sector banks. About 80% of the businesses are controlled by Public Sector Banks (PSBs). PSBs are still dominating the commercial banking system. The RBI has given licenses to new private sector banks in the liberalization process. Moreover, in view of increased competition, the structure of Indian banking system is expected to undergo a transformation and the main drivers of which will be consolidation, convergence, and technology (Kamath, Kohli, Shenoy, Kumar, Nayak & Kuppuswamy, 2003). As Public Sector Banks (PSBs), dominating the commercial banking sector in India they account for more than 78 per cent of the total banking industry assets but then also they are burdened with excessive Non Performing assets (NPAs), massive manpower and lack of modern technology. On the other hand the Private Sector Banks banking, are ahead in mobile banking, phone banking, ATMs. As far as foreign banks are concerned they are likely to succeed in the Indian Banking Industry.

**Literature Review**

**Ballabh (2001) analyzed challenges in the post-banking sector reforms.** With globalization and changes in technology, financial markets, world over, have become closely integrated. For the survival of the banks, they should adopt new policies/strategies according to the changing environment.

**Kumar (2006) studied the bank nationalization in India marked a paradigm shift** in the focus of banking as it was intended to shift the focus from class banking to mass banking. Internationally also efforts are being made to study causes of financial inclusion and designing strategies to ensure financial inclusion of the poor disadvantaged. The banks also need to redesign their business strategies to incorporate specific plans to promote financial inclusion of low income group treating it both a business opportunity as well as a corporate social responsibilities. Financial inclusion can emerge as commercial profitable business.

**Srivastava (2006)** concluded that in post nationalization period witnessed an unprecedented expansion of banking industry in India. However accompanied inefficiency and poor financial health to overcome this problem and improve the efficiency of banks, various tectonic measures were taken since 1991. This has resulted in improvement in productivity, profitability and strengthening of financial position of the banks so much that they are outshining those of advanced notions .However banks have still o go a long way to sustain their Competitive success. Indian Commercial Banks also need to enhance their system and procedure to international standards and also simultaneously fortify their financial position.

**Shroff (2007) gives a summary of how Indian banking system has evolved over the year.** The paper discusses some issues face by these systems. The author also gives examples of comparable banking system for other countries and the lesson learnt. Indian banking is at the threshold of the paradigm shift. The application of technology and product innovations is bringing about structure change in the Indian banking system.

**Subbaroo (2007)** concludes the Indian banking system has undergone transformation itself from domestic banking to international banking. However, the system requires a combination of new technologies, well regulated risk and credit appraisal, treasury management, product diversification, internal control, external regulations and professional as well as skilled human resource to achieve the heights of the international excellence to play its role critically in meeting the global challenge. This paper mainly concentrates on the major trends that change the banking industry world over, viz. consolidation of players through mergers and acquisitions globalization of players, development of new technology, universal banking and human resource in banking, profitability, rural banking and risk management. Banks will have to gear up to meet stringent prudential capital adequacy norms under Basel I and II, the free trade agreements. Banks will also have to cope with challenges posed by technological innovations in banking.

**Uppal and Kaur (2007)** analysis the efficiency of all the bank groups in the post banking sector reforms era. Time period of study is related to second post banking sector reforms (1999-2000 to 2004-05). The paper concludes that the efficiency of all the bank groups has increased in the second post banking sector reforms period but these banking sector reforms are more beneficial for new private sector banks and foreign banks. This paper also suggests some measures for the improvement of efficiency of Indian nationalized banks. The sample of the study in Indian banking industry which comprises five different ownership groups and the ratio method is used to calculate the efficiency of different bank groups. New private sector banks are compelling with foreign banks for continuous improvement in their performance.

**Objective:** The objective of this paper is to explain the changing banking scenario, to study the challenges and opportunities of Indian banks and to analyze the impact of liberalization, privatization & globalization. In addition to this, an attempt is made to understand the significance of banks in India.

**Research Methodology**

A secondary data on Indian Banking Sector is used in this paper. To complete this, annual reports, various books, journals and periodicals have been consulted and internet searching has also been done.

**Evolution of banks:** Indian banking industry leads its foundations in the 18th century. Bank of India and Bank of Hindustan was the first bank in India. Calcutta was the banking centre. After that Bank of Bengal, Bank of Bombay and Bank of Madras are merged and converted it into Imperial Bank of India. Imperial Bank renamed as state bank of India in 1955. Punjab national bank was purely managed and owned by Indians in1895 in Lahore while first Indian bank owned and managed by Indian was central bank of India established in 1911. The initial days of the industry have private ownership. Public ownership is made with nationalization in 1969 and 1980. In 1935 the Reserve Bank is given responsibility for regulating Indian banking and licensing of banks and branches. Banking institution is becoming complex due to technology advancement, innovation, etc. financial reforms brings various changes in the banking and financial market. The importance of private and foreign players cannot be ignored in this competitive scenario. So the banking industry has moved towards greater liberalization.

**STRUCTURE OF INDIAN BANKS**

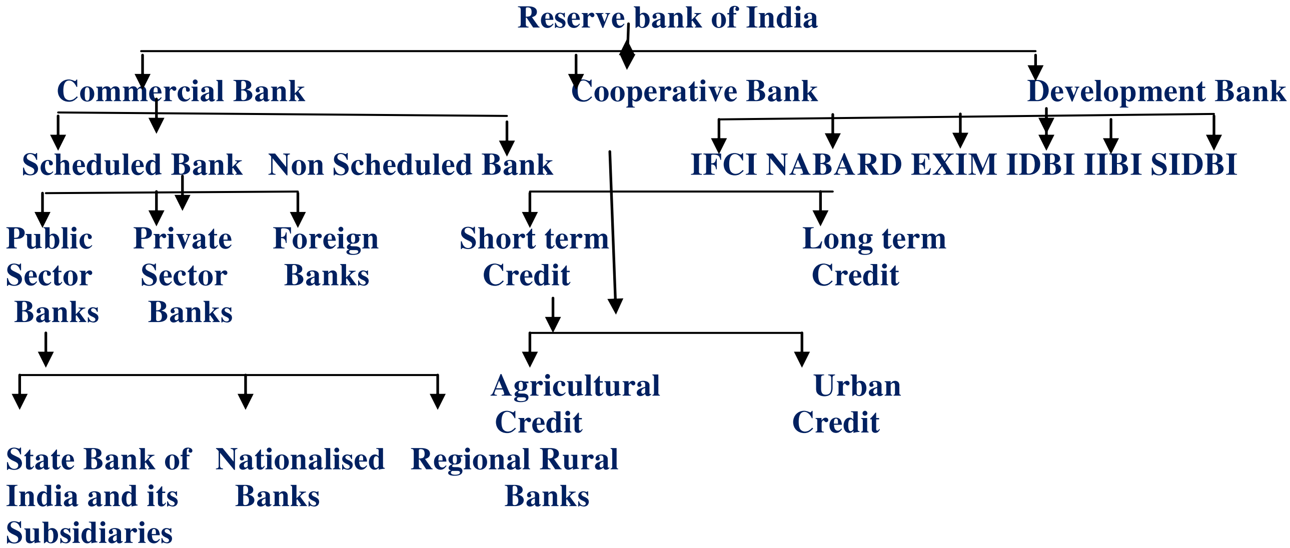


**Figure-1**

**<u>Classification of Banks in India</u>**

**1) The RBI**

The Reserve Bank of India was established on April1935 as the Central Bank of India and nationalized on 1st January, 1949. RBI regulates monitors and controls the financial system in India.

**2) Commercial Banks**

Commercial Bank acts as an integral part of the financial sector. Commercial banks mobilize the savings of the customers.

**Commercial Banks are divided into two main categories:-**

**a.) Scheduled Banks:**

Scheduled banks are those which are included in the Second Schedule of Banking Regulation Act, 1965. These banks have paid–up capital and reserves of not less than Rs. 5 Lakhs. Schedule Banks are further divided into:-

(i) Public Sector Banks

(ii) Private Sector Banks

**b.) Non-scheduled Banks**

Non-scheduled banks are those which are not included in the Second Schedule of Banking Regulation Act, 1965.

**3) Public Sector Banks**

Public sector banks are those banks whose banking business is conducted and owned by the Government. Public Sector Banks are subcategorized into three divisions:-

**State Bank of India & its Associates**

**Nationalized Banks**

14 banks were nationalized by the Government of India in July 1969. Later on in April1980, six more banks were nationalized.

**Regional Rural Banks**
RRB's were set up in 1975 on the recommendation of M.Narasimham under Regional Rural Banks Act, 1976. The main objectives are to provide loan facilities to small and marginal farmers.
**4) Private Sector Banks**
Private sector bank came into existence to bring about competition and to increase productivity in banking sector. It was under private ownership.
Old private banks
New private banks
**5) Foreign Banks**
Foreign Banks are those banks which are registered or incorporated from outside India. These are owned and controlled by foreign promoters.
**6) Co-operative Sector Banks**
A co-operative bank is those that are registered under Co-operative Societies Act. Co-operative banks are both the owner's and the customers of their bank. Co-operative banks generally provide banking and financial services to their members like loans, deposits etc. These banks Co-operative banks are collective efforts of:-
State Cooperative banks
Central co-operative banks
Primary Agricultural credit Societies
Land Development Banks
State land Development Banks
**7) Development Banks**
Development banks provide credit for development and promotion of Industries. These are special industrial financing institutions.
Industrial Finance Corporation of India (IFCI)
National Bank for Agriculture and Rural Development (NABARD)
Industrial Investment Bank of India (IIBI)
Small Industries Development Bank of India (SIDBI)
Industrial Development of India (IDBI)
Export-Import Bank of India (EXIM)
**<u>Services/facilities of provided by the banks</u>**
**1. Electronic Payment Services (E-Cheques):** E-Cheques, replaces the conventional paper 'Cheques'.
**2. Electronic Funds Transfer (EFT):-**EFT is an electronic way of fund transfer. Fund transfer from one account to another electronically.
**3. Real Time Cross Settlement (RTGS):** It is efficient and fast transfer facility. The fund is transfers within 2 hrs from one account to another account.
**4. Electronic Clearing Service (ECS):** ECS is a paperless mode of fund transfer.
**5. Automatic Teller Machine (ATM**): It enables the customer to perform transaction through *ATM* **card.**
**6. Telebanking:** It helps the customer to access information about their account telephonically.
**7. Mobile Banking:** Customers conduct a sequence of financial transactions through use of a mobile phone
**8. Internet Banking: A**lso known as E-Banking or online banking. Internet banking use internet for buying, making payment delivery of banking products and services.
**9. Demateralization:** Demat is dematerialization of shares, it is a process of converting customers' securities from physical to electronic form in the depository system. It helps in trading and settlement of securities safely and quickly.
**10. Credit Card:** In debit card bank pays on behalf of the card holder and later on cardholder has to pay the dues with some interest.

**11. Debit Card:** Debit card cardholder uses it and pays immediately from his saving account.

**Issues and challenges in banking Sectors**

**Asset quality:** Loans taken are not repaid back by the borrower are bad loans or NPAs (Non reforming assets). These high levels of NPAs represent a biggest risk to India's banks. To tackle this problem, various options are available like setting up of Lok Adalats for recovering smaller loans, Reducing the existing NPAs through proper measures, increasing Debt Recovery Tribunals, Complete ban on generalized loan waivers, setting up of Asset Reconstruction Fund (ARF) as recommended by the NC (1991) and to reiterated in its second report (1998).

**Employee:** Due to innovation banks employee are unable to fulfill new expectation which leads to detachment and Replacement of elder, experienced employee of Public-sector banks by young and inexperienced employee by the retirement schemes and it affects the performance of banks . But detachment leads to loss of valuable customer relationships. So the bank industry is concerned about retention of employees. "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," the deputy governor said.

**Technology:** In order to survive in these competitive environment there is need of advanced technology as it provide convenience to customers by offering E-banking, cost effective service, and reduced transaction time ,by the use of effective technology but public sector bank is only 80 pc computerized and are using traditional methods of operation in comparison of private and foreign banks. So in order to survive there is need of complete up gradation of technology.

**Loss making branches and overstaffing:** Loss making branches and overstaffing is also one of the reason for inefficiency of Indian banks.

**Innovative methods:** Innovation in marketing technique is missing in Indian public sector banks which provide competitive edge over foreign banks

**Frauds committed by insiders:** Nowadays fraud is very common in every Indian bank, suitable punishment recommended in order to win the customers faith.

**Poor Asset Quality of public sector banks:** Public sector banks established with aim of social work but it should also concentrate on asset quality and earnings.

**Indian Consumer:** With changing profiles of consumer in terms of income levels and cultural shifts and to gain edge over competitor there is need for bank to become customers centric. With more demanding consumer there is need to offer broad range of services through multiple delivery channels. As in Indian banking system the biggest opportunity is the Indian consumer.

**Capital adequacy:** One of the biggest challenges for bank is fall in capital adequacy ratio means capital owned by bank. In such cases bank has to borrow money or to use depositors' money, which lead to fall in CAR (often called as CRAR or Capital to Risk Assets Ratio). If banks fail to meet the minimum capital requirement set by RBI it will lead to serious issue.

**Intense Competition:** As low entry barrier allows the foreign banks and private banks to set up their branches or subsidiaries in India leads to intense competition to Indian banks.

**Financial Inclusion:** The committee on financial Inclusion has defined it as,

"Financial inclusion denotes delivery of financial services at an affordable cost to the vast sections of the disadvantaged and low-income groups. The various financial services include credit, savings, insurance and payments and remittance facilities. The objective of financial inclusion is to extend the scope of activities of the organized financial system to include within its ambit people with low

incomes. Through graduated credit, the attempt must be to lift the poor from one level to another so that they come out of poverty."
"The process of ensuring access to financial services and timely and adequate credit where needed by vulnerable groups such as weaker sections and low income groups at an affordable cost."
**Social and Ethical Aspects:** Banks are also supposed to fulfill the social obligation, apart from profit maximization. Social banking involves concern for social, environmental, and ethical agendas. They invest money for good cause of society.

**Global banking:** Globalization leads to competition with the global players/ foreign banks. These represent a major challenge for the Indian banks. These foreign banks are large in size, technically advanced and having presence in global market, which gives tough competition to Indian bankers.

**Rural Market:** This working group concluded that the existing agencies, even after necessary restructuring and modification , were unable to meet varied and growing needs of rural credit and on these major premise, recommended establishment of regional rural banks. The working groups envisaged the new institution as one which "combines the local feel and familiarity with rural problems which cooperatives posses and the degree of business organisation, ability to mobilize deposits, access to central money markets and modernized outlook which the commercial banks have"

**WTO & Public Sector Banks:** Various opportunities is provided by free trading environment but lack of awareness regarding agreement and issues related to world trade organization (WTO) leads to shortage of overall benefits to Public sector banks. Knowledge and assimilation of various benefits are essential to keep the organization ahead.

**Management of Risks:** Various threats are also associated with globalization and liberalization. Bankruptcy of foreign banks is very common this day. So management of such risk is very essential. Al-Tamimi and Al-Mazrooei (2007) examined the risk management practices and techniques in dealing with different types of risk. Moreover, they compared risk management practices between the two sets of banks. The study found the three most important types of risk i.e. commercial banks foreign exchange risk, followed by credit risk, and operating risk.

**High Growth rate:** Growth of banking industry led to accumulation of non-performing assets which lead to high transaction cost of carrying NPA and it pull down the efficiency of Indian banks.

**Market Discipline and Transparency:** According to Fernando (2011) transparency and disclosure norms as part of internationally accepted corporate governance practices are assuming greater importance in the emerging environment. Banks are expected to be more responsive and accountable to the investors. Banks have to disclose in their balance sheets a plethora of information on the maturity profiles of assets and liabilities, lending to sensitive sectors, movements in NPAs, capital, provisions, shareholdings of the government, value of investment in India and abroad, operating and profitability indicators, the total investments made in the equity share, units of mutual funds, bonds, debentures, aggregate advances against shares and so on.

**Misaligned mindset:** The hi tech environment demands for changes but employee continues resist for the change and they are unable to adapt to changing environment and their work is far below the satisfactory level in respect of latest technology.

**Deregulation:** deregulation in rules, norms, and liberalized policies and decontrol interest rate all this invite a large number of competitor in the banking industry.

**Balance Sheet management:** In order to remain in competition bank has to show healthier balance sheet they have to show profit in their balance sheet. Many banks have tried to delay setting aside money as provisions (for future bad loans). But Deferring provisioning is harmful in the long term. It reduces the bank's ability to withstand financial pressures.

**Strategic options to cope with the challenges**

The banking environment is rapidly changing and new rules are emerging. Various barriers and challenges are coming in their way of development. So there is need of proper strategies to deal with it. In this fast changing environment an optimum blend of technology and traditional service will be a helpful strategy.

Various strategies have been taken by the Indian banks to cope with the challenges. Some of them are:

- Implementation of advanced technology and proper training to employees.
- Proper management of risk, and high growth rates.
- Insurance of transparency, safety, security and reliable customer service and satisfaction.
- Suitable measures to reduce NPAs
- Better human resource management, motivation of employee for acceptance of changes.
- Innovation in service to capture customer attention.
- Improvement in assets quality to strengthened the balance sheet.
- Proper checks for frauds, loss making branches and suitable measures/punishment to eradicate it.
- Awareness regarding all the agreement, facility, opportunity in favour of Indian banks.

## Conclusion

The banking industry is tremendously changing but it is not sufficient it requires more changes in the future. Banks provides traditional as well as advanced facilities like RTGS, Demat for the shareholders, E-cheques, ETF, ECS, E-banking and M-banking etc. Indian bank is one of the most important financial sectors for financial planning. The banking sector trying to continuously offer better services and more facilities to customers and thus it leads to the increase in competition amongst the banks. Banks provide its service to rural area also. With the new opportunity and facilities bank is also exposed to the risk with avenues generation. So this advancement of technology with deregulation could bring banks to solvency. So therefore need is felt to completely tackle this disastrous and challenges with proper strategy.

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