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Prospects and Problems in Retail Banking in India

[National Conference on Management of Emerging Sectors: April 15 & 16, 2005 Organised by Bapuji Institute of Management Studies, Davanagere – 577 004]

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NATIONAL CONFERENCE ON MANAGEMENT OF EMERGING SECTORS: NEW PARADIGMS AND PERSPECTIVES: APRIL 15 & 16, 2005 ORGANISED BY BAPUJI INSTITUTE OF MANAGEMENT STUDIES, DAVANGERE-577 004

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Abstract: Retail Banking has gained enormous momentum in the Indian Banking Scene during last five years. The reasons are : (1) Introduction of Technology, (2) increased competition among different types of banks, (3) opening of new generation private banks, (4) inviting of more foreign banks in post WTO era, (5) focus on productivity and profitability, (6) deregulation of interest rates, (7) drive towards low Non-Performing Assets, (8) tilt towards more consumerism and life style spending by working / middle class, (9) innovation of new products and services, (10) implementation of Prudential Norms, Risk Management and ALM mechanisms, (11) closure / re-locating of loss making branches, (12) Voluntary Retirement of surplus staff, (13) sourcing of cheaper funds by corporate clients from global markets and resultant excess liquidity, (14) revival of mutual fund market, (15) opening up of insurance market, (16) revitalizing of stock market, (17) increase in the life-span expectancy due to modern health care facilities, (18) increasing contribution (over 50 per cent) to GDP from the Services sector, (19) Change in Government policy towards FDI in retail sector, (20) thrust on Infrastructure Development, etc.

While prospects have been mani-fold for such an explosion in Banks in India resorting to Retail Banking, they can not do away with problems in such a short span after having been in a regulated and directed / protected environment for over three decades. Not all the customer groups (like rural population) are fully techno-savvy and could afford to lead new life styles availing consumer, housing or auto-loans. Necessary back up in infrastructure like power, roads, communications and technology have not yet reached in full scale to non-Metro cities. Prompt loan repayment culture has not yet set in many sectors of society. Legal systems and laws like SARFAESI Act, 2002 are still in the process of stabilizing.

Key Words: Retail Banking, Internet Banking, ATMs, Credit Cards, Customer Focus, Technology in Banking, Marketing of Financial Services and Segmentation of Bank Customers

1. Introduction: It is by now well recognized that India is one of the fastest growing economies in the world after over a decade of financial and banking sector reforms since 1991. Evidence from across the world suggests that a sound and evolved banking system is required for sustained economic development. India has a better banking system in place vis-à-vis other developing countries, but there are several issues that need to be ironed out. The course of banking evolution and growth has gone through innumerable twists and turns in the post independence era. Retail banking segment in the banking industry is continuously undergoing innovations, product reengineering, adjustments and alignments. Given the size advantages, diverse customer base and scope for future expansion, there is a need for evolving a systematic approach to retail banking.

2. Retail banking- Meaning and Scope:

Most of the Indian banks have been retail banks in their business composition. The term 'Retail Banking' encompasses various financial products (different types of deposit accounts, housing-consumer-auto and other types of loan accounts, demat facilities, insurance, mutual funds, Credit and Debit Cards, ATM and other technology-based services, stock-broking, payment of utility bills, reservation of railway tickets, etc.,) catering to diverse customer groups, offering a host of financial services, mostly to individuals. Simply speaking, it takes care of the diverse banking needs of an individual.

The purpose if this paper is to try and identify the parameters on which the retail banking thrives and try to build insight into *the dynamics of the various parameters* and how they can pose a prospect or a problem in future.

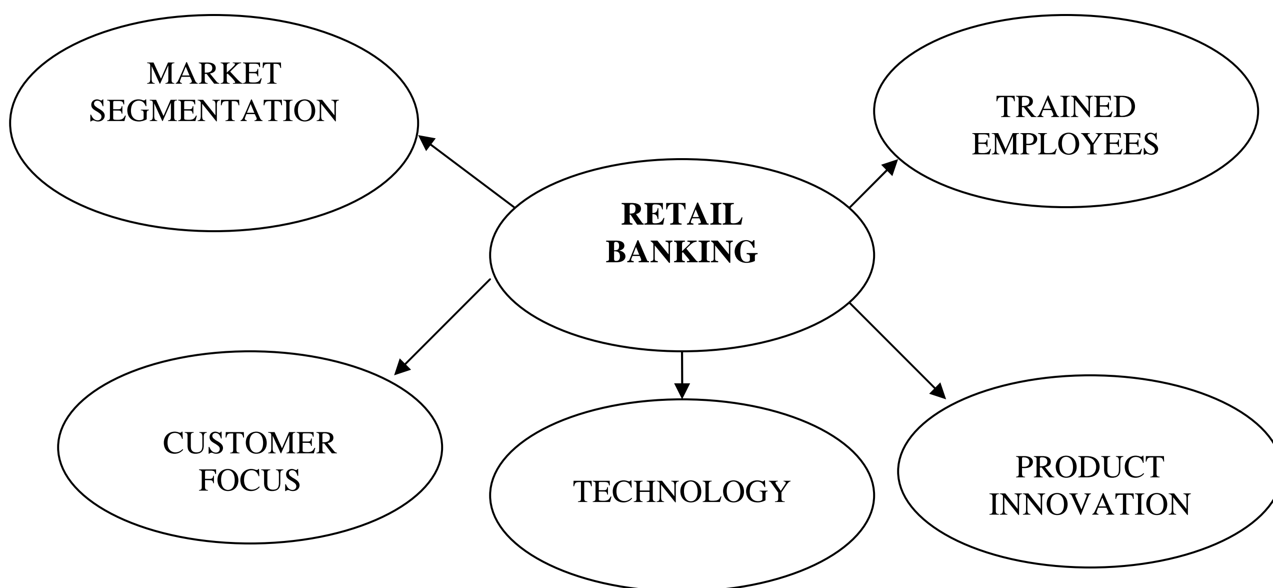


Fig No. 1 : Factors influencing Retail Banking in India

The number of personal loan accounts with Scheduled Commercial Banks (SCBs) in India went up by almost 50 per cent between March 1997 and March 2002, as per CMIE data. Personal loan outstanding, however, went up by more than 130 per cent during the same period. The result was that the average personal loan outstanding increased from Rs. 24,668 in 1997 to Rs. 47,000 in 2002. Housing Loans, which accounted for about 28 per cent of personal loans outstanding in 1997, went up to 40 per cent in 2002. The following table gives a clear picture of the above:

Table No. 1 : SIZE AND COMPOSITION OF PERSONAL LOANS

	31st March 1997		**31st March 2002**	
Particulars	**Accounts**	**Outstanding**	**Accounts**	**Outstanding**
Total SCB Credit	55.6	284.4	56.4	656.0
Total Personal Loans	11.4	28.0	17.6	82.5
Of which				
Total Per. Consumer Durables	0.8	0.9	1.2	3.2
Total Per. Housing Loans	1.0	7.9	1.8	32.8
Total Per. Other Loans	9.6	19.2	14.6	46.5

Source: CMIE data A/cs in Millions O/s in thousands of crores of rupees

Total personal loans outstanding increased from Rs. 28,000 crores in 1997 to more than Rs. 82,000 crores in 2002. On account of these personal loans, as distinct from loans to agriculture, trade, and industry, shot up from a little more than 20 per cent in 1997 to over 31.2 per cent in 2002. And that too over a period when total SCB outstandings shot up from Rs. 284,000 crore to Rs. Rs. 656,000 crores; an increase of more than 130 per cent. Data on Credit Cards are probably not included, given that there is no evidence that anyone, either in the RBI or in the Ministry of Finance, keeps track of credit cards. This, if true, is surprising news since credit cards account for a large and rapidly growing share of 'money supply', which RBI closely monitors in order to keep inflationary pressures in check.

RBI's Report on Trend and Progress of Banking in India, 2003-04 reveals some new trends in growth of credit. There is an upsurge in retail credit as against corporate advances, which may reveal itself in accumulating non-performing assets in banking sector and may accentuate the indebtedness of households in the medium term. However, with several counter-cyclical measures in place and a vigilant central bank , there is little need for alarm, as per Minna Kumar of Sify Finance in his study titled "Retail lending takes the lead" in November 2004.

Retail lending has been the key profit driver for banks in recent times with retail portfolio constituting 21.5 per cent of the total outstanding advances as on March 2004. On the other hand, stronger corporates strengthened their balance sheets by resorting to sizeable accruals as well as external commercial borrowings.

Current Scenario in Indian Retail Lending: Even though non-performing assets in the banking industry fell from 4.4 per cent in 2003 to 2.9 per cent in 2004, a hike in the percentage of retail lending may also pose a risk of poor asset quality of banks given that bad or 'impaired loans from from 2.5 per cent of total loans outstanding. Of the total retail loans, impaired housing loans constituted 1.9 per cent. The highest was in the consumer durable segment at 6.6 per cent.

The retail segment's share in total loans for the period stood at 21.5 per cent, with housing loans constituting 48 per cent of the retail portfolio. The share of the housing loan portfolio out of total loan book of banks has grown from 3 per cent in 1993 to 7 per cent 2004. The following table gives details of Bank Credit to Retail Sector.

Table No. 2 Variation of Retail Loans during 2002-3 and 2003-4

Advances (Rs in Crores)	Variation in 2003-04	Variation in 2002-03
Retail Loans	41,811	26,188
Of which Housing Loans	15,394	12,308
Consumer Durables	1,055	-111
NBFCs	2,675	4,399
Loans to individuals against Shares, Bonds and Debentures	19	242
Real Estate Loans	-317	502
Other Personal Advances	7,260	2,687
Advances against Fixed Deposits	3,638	1,458
Tourism	841	266

Nowadays, retail lending is the buzzword in banks in India. According to RBI's latest monetary policy, out of the total credit flow between April and August 2004, two-thirds had gone to retail loans. Most banks have retail loans of around 20% of their total lending portfolio and these loans are growing at an unnatural rate of 30 to 35% per annum. Housing loans constitute around 50% of the retail lending portfolio. Despite the fact that the housing loans portfolio grew only at 42% in 2003-04 compared to 55% the previous year, one analyst said "Due to shortage of around 1.9 million housing units, demand for the housing loans may shoot up significantly in the near future".

However, the rate at which the banks are disbursing the housing loans etc., caused concern to the Reserve Bank of India as this might lead to increase of bad loans. In its latest Trend and Progress of Banking in India 2004, RBI mentioned "The rising proportion of retail loans in the total lending portfolio may impair the quality of assets in this segment, thus, increase in the NPAs". To avoid any such bubble in this segment, RBI has increased the risk weightage on Home Loans from 50 to 75% and for Consumer Loans including Personal Loans and Credit Cards, from 100 to 125%.

Around 2.5% of the retail loans are bad debts as on March 31, 2004 while this average is at 7.4% for all types of loans. It is even less for Housing Loans at 1.9%, and the obvious conclusion is that Retail Loans are safer. But, to maintain this level of quality and avoid any kind of bubble in the making, banks should adopt sufficient risk management strategies. The following table gives more data on this aspect.

Table No. 3 : Retail Portfolio of Banks as at the end of March 2004

SNo	Retail Loan Items	Amount outstanding (Rupees in Crores)	Impaired Credit as % of o/s loans	Net NPAs as % of Outstanding loans
1.	Housing Loans	89,449	1.9	1.4
2.	Consumer Loans	6,256	6.6	4.0
3.	Credit Card dues	6,167	6.3	2.4
4.	Other Personal Loans	87,170	2.6	1.6
5.	Total Retail Loans	1,89,041	2.5	1.6
6.	Total Loans & Advances	8,59,092	7.4	2.8

Source: Reserve Bank of India

3. The Potential for Retail Banking in India:

An insight into the following paragraphs will justify the immense underlying potential for the Indian retail baking industry.

While the total outstanding retail loans in Taiwan is around *41% of its GDP*, the figure in India stands at *less than 5%.* The comparison with the West is even more staggering. Another situation that is natural when comparing retail sectors is the use of credit cards. Here also, the potential lies in the fact that of the consumer expenditure in India in 2001, *less than 1%* was through plastic, the corresponding US *figure standing at 18%.*

Hence, The Indian players are bullish on the retail business and this is not totally unfounded. *Two primary reasons are as follows*:

It is now undeniable that the face of the Indian consumer is changing. This is reflected adequately in a change in the urban household income pattern. The direct fallout of such

a change will be the consumption patterns and hence the banking habits of Indians, which will now be skewed towards Retail products.

a) Going by international standards, a large portion of the Indian population is simply not "bankable" - taking profitability into consideration. On the other hand, the financial services **market is highly over-leveraged** in India. Competition is fierce, particularly from local private banks such as HDFC Bank and ICICI Bank, in the business of home, car and consumer loans. There, precisely lie the pitfalls of such explosive growth. All banks are targeting the fluffiest segment i.e. the upwardly mobile urban salaried class. Although the players are spreading their operations into segments like self- employed and the semi-urban rich, it is an open secret that the big city Indian yuppies form the most profitable segment. Over-dependence on this segment is bound to bring in inflexibility in the business. Hence the challenge for various banks is to tap the underlying potential of the tapped and specifically the untapped market by developing sophisticated financial behaviour and spreading the scope to all over the country.

4. Prospects of Retail Banking in India:

The conventional scenario of Banks is fast changing. The Banking Institutions have started revisiting their Visions. Should they have thousands of C class Accounts or a few A and B class Accounts? They have come to the conclusion that it is not economical to service the C class Accounts. Even in India, banks are raising the bar on deposits. Some Banks have even increased the minimum balance in Savings accounts so that they are out of reach of the small man.

Why is this so? This is a natural corollary to the competencies that are being built up at a significant speed in all banks. Examining them one by one will help us know where the banks are heading, in the near future.

4 a. Customer Focus:

All along, the word "Customer" used to denote any person who is having an account with a branch of a Bank or using the services of a Branch. Now, we are seeing a new definition for customer. A customer is no more a customer of the Branch; he is the Customer of the BANK. With the advent of ***'AAA Banking' (Anytime, Anywhere,***

Anyhow Banking) the new definition of customer has become relevant. Technology enables the customer to "help himself" through Internet Banking, ATM Banking, Telephone Banking, Online Banking, Mobile Banking, or e-Banking, etc. Moreover the concept like ***Know Your Customer (KYC)*** reinforced when Reserve Bank of India recently urged banks to improve customer focus as a strategic initiative for effective management of profitability, risk and customer satisfaction as well as customer delight!

4 b. Segment focus:

Banks are obviously for customer service. But banks are finding that they too need to segment and target High Networth Individuals (HNIs) and companies if they have to satisfy the needs of their stakeholders. Therefore, Banks are generally moving towards products that are focused on their targeted end customers. And this target is specifically the high end customers; as they do not find any leverage from the small accounts. But there is a strong trend in terms of consolidation in terms of the business segmentation. The general pattern of the banks is to cater to all segments – from agriculturists to high net worth individual to corporate banking to international banking. An analysis of the current scenario indicates that in future, each bank will decide on its core competency and cater only to selected segments. For example, the Deutsche Bank in India operates only in the corporate banking and it has turned as a market leader in this segment.

4 c. Product focus:

Banks have been offering various asset products (Loans) and liability products (Deposits), taking the customers' general needs like fixed amount loans or running Cash Credit / Overdraft accounts or Fixed Deposit or Cumulative Deposit or Recurring Deposit as liability products. Now, the time has come for the Customer to demand a product that is not currently available in the Banker's kitty and the Bank has to literally create customer-specific products. Here comes the Banker in the role of a Financial Engineer.

Financial Services: Then and Now

Old Economy	New Economy
Confined market place	Unlimited market space
Competition between banks	Competition from brands
Limited product line	Extensive product breadth
One-size-fits-all products	Customisation and innovation
Branch-focused	e-Enabled, multi-channel players
Focus on business growth	Focus on revenue growth as well as cost-reduction
Revenues through margin	Revenue generated through fees and value-added services

Existing products and services are changing way for value-added ones thanks to the one-upmanship game among competing banks, sparked off by soaring consumer-demands.

4 d. Technology focus:

As banks face the mutually interdependent forces of competition, regulation, technology, and customer expectations, a picturesque setting for the tremendous upheaval and opportunity emerges. This interdependency, in turn, is built upon mutually dependent technological trends.

- *Increase processing power*
- *Increase in networking*
- *Increase in flexibility in defining business standard*:
- *Increase in modularity of software*

These four trends are impacting irreversibly the business of banking, outsourcing, insourcing, analytics, and payment systems. Given these factors the banks are being more technology focused and driving the use of internet to help meet the requirements of their customers through segmentation.

- **(i) Internet banking**

The trend in banking is changing from computerization of branches to laying a uniform platform by having core banking solution in all the branches. At the same time, banks are looking at internet banking. While a start has been made in the Internet banking in India, the number of transactions through this mode is extremely negligible (less than 1%). A study group appointed by the RBI has suggested that for Internet banking, there should be robust system keeping a log of all network activities and analyzing the same. RBI has gone on to suggest various technical features essential for having such a robust system. This should be in place within the next 2 years. Hopefully, the retail banks will see a surge/splurge in the usage from 1% to at least 10% in the next couple of years. Passing of Information Technology Act, 2000 gave enough relief to the users assuring of proper use of technology in banking.

- **(ii) Shared ATMs**

Till the year 2003, each bank was interested in opening its own ATMs to provide access and anytime banking to its customers. Cost of Installation of ATM is about Rs. 15 lacs with an additional maintenance cost of Rs.1.5 lacs per month. To break even, 300 transactions are to be put through each ATM per day. The cost of transaction in the branch of the Bank is approximately Rs. 60 while it is Rs. 10 if carried out through an ATM. To take advantage of this lower transaction cost, there is need for banks to induce customers to use more and more ATMs. In view of the huge investment cost of ATMs, Banks have now come to an understanding by which the customer of one Bank can use the ATMs of other Bank/s. This is in the right direction. Already SBI, HDFC Bank, ICICI Bank and others have started offering such a facility at a nominal payment per transaction, for which the customers are readily agreeable.

- **(iii) Outsourcing**

The challenge of managing the diverse services in a networked environment has caused the banks to introspect on what should be considered as their core skills and primary roles.

In future, banks will need to focus on value-differentiating services by keeping in-house their competitive advantages while partnering with others who complement its services-making the argument for best-of-breed integration a necessity.

- **(iv) In sourcing**

In sourcing is a model wherein banks perform operations that are originally done by their customers/other banks. Corporate clients may outsource activities like receivable management, accounting and risk management of corporate investments to banks. New product offerings will emerge as a combination of existing products and the new in sourced activities Banks, with their established processing capacities, are ideal partners for insurance and other financial service firms in their pursuit of customer reach and service provision.

- **(v) Analytics**

As they realize that product and related services by themselves cannot provide sustainable competitive advantage, banks are paying more attention to relationship with their customers and the way they manage risk, determine price, and allocate capital.

Hence, going forward, banks will attempt to augment their behavioral and economic views of the customer, preferably captured at the “Point of Contact” in addition to existing transactional and demographic data (in-house and external). Banks will require use of analytics to effectively manage their customer relationships, conduct detailed analysis that help more accurately model, and predict future customer behaviour and lay a quantified foundation for strategic decision-making.

On the other hand, banks often face the tricky task of asset allocation and pricing. In the last decade, investments in risk management and related systems have increased multifold, albeit made with a compliance objective towards identifying, measuring and funding risk. The future will see increasing investments in risk analytics as part of an integrated framework supporting asset pricing, performance measurement, and asset allocation models.

- **(vi) Payment systems**

In recent years, alternate money transmission avenues, especially the development of electronic money schemes, have been gaining currency. Gradual expansion of Western Union Money Transfer in India through alliances with Banks, Post Offices, etc., is a thing to note in this direction. While electronic money has the potential to take over from cash for making small-value payments, making such transactions are becoming easier and cheaper for both consumers and merchants. This raises policy issues for central banks in its role as the guardian of the payment network and implementer of the monetary policy. The emergence of peer-to-peer money transmission mechanisms poses a challenge to current role of banks as gatekeepers to traditional payment systems. Robust payment systems, therefore, are a key requirement in maintaining and promoting financial stability with technology playing both a facilitating and disruptive role in them.

- **(vii) Real Time Gross Settlement (RTGS)**

In the last one decade, thanks to continuous thrust on computerization in the banking system, RBI took initiative for bringing in Electronic Funds Transfer (EFT), Electronic Clearing System (ECS), ATMs and Internet Banking. Cross selling of various financial products has been possible due to ATMs and Internet Banking. Investment climate has also geared up in volumes with Dematerialisation facility introduced by setting up of NSDL and CDSL after formation of National Stock Exchange in Mumbai. Clearing Corporation of India Ltd., (CCIL) has also made remarkable impact on funds settlement mechanism. Very soon Cheque Truncation system is going to be spearheaded by RBI in a phased manner.

RTGS is a payment system in which processing and settlement takes place in real-time (continuously). In this system, funds would flow freely from one market to another leading to better integration of the Domestic Financial Markets among themselves, and

with International Financial Markets as well. RTGS, as a settlement process will minimize settlement risks by settling individual payments in real time in the books of accounts held by the RBI. RTGS will be a mode for large value Inter-Bank settlement, to be widely used, for enhancing risk control measures, for faster and efficient settlement of liabilities for better customer services for the ultimate users in the value chain. RTGS would eliminate the time lag between the debit to an account of customer and its corresponding credit to another customer in a different bank. RTGS requires implementation of a 2 Level Gateway- one at the individual bank level and the other at the RBI level. Significant contribution made by Institute for Development and Research in Banking Technology (IDRBT), Hyderabad in this regard is commendable.

4 e. Employee focus:

Earlier, there were premises where the branch of a Bank is located and there were three categories of staff to attend to the customers viz., Supervisory, Clerical and Sub-ordinate staff. With the disappearance of big ledgers and registers, the need for Sub-ordinate staff is also getting reduced. The role of supervisory staff would increase and not in the sense of controlling the staff working with them but in different areas of delivering competitive services. Awareness about productivity, customer focus, competition, grievance/ complaint redressals, market surveys, etc among the bank staff has gone up very high.

The VRS scheme introduced in the year 2000 by the Banks was to reduce the redundant staff consequent to computerization. It is felt that one more VRS would be needed for the Banks to shed their excess flab and make them fit and trim. Henceforth, the role for clerical staff would have to undergo a change from sitting under the roof in a branch to moving into the field and market various financial services offered by their Bank and not only attract new customers and retain existing clientele but also retrieve the customers lost to competitors. In a nutshell the trend is towards sophisticated well trained customer orientation.

- **Banking Hours:**

Bank hours were fixed so far. Now the fact is that almost all banks are moving towards any time/any where/home banking. Again, a closer look at this will reveal that Banks are moving away from the traditional customer to the customer who is extra busy. Who is this? Again, the high net worth individual and the highly profitable companies. For example ICICI bank has started 8 to 8 banking where the banking hours are 8 a.m. to 8 p.m. looking at this competitive market we may witness *24 hours banking*, very soon.

4 f. Others:

- **(i) The Basel II effect:**

Essentially, the rules evolved by Basel Committee for Bank Supervision (BCBS) and adopted by RBI tell the banks how much capital the banks should have to cover up for the risk that their loans might go bad. The rules set out by Bank for International Settlements (BIS) in 1988 led the banks to differentiate among the customers it lent out money to. Different weightages were given to various forms of assets, with zero percentage weightings being given to cash, deposits with the central bank/govt etc, and 100 per cent weighting to claims on private sector, fixed assets, real estate etc. The summation of these assets gave us the risk-weighted assets. Against these risk weighted assets the banks had to maintain a (Tier I + Tier II) capital of 9 per cent i.e. every Rs100 of risk assets had to be backed by Rs 9 of Tier I + Tier II capital. To put it simply, the Indian banks had to maintain a Capital Adequacy Ratio (CAR) of 9 per cent as at present.

The problem with these rules is that they do not distinguish within a category i.e. all lending to private sector is assigned a 100 per cent risk weighting, be it a company with the best credit rating or company which is in the doldrums and has a very low credit rating. This is not an efficient use of capital. The company with the best credit rating is more likely to repay the loan vis-à-vis the company with a low credit rating. So the banks should be setting aside a far lesser amount of capital against the risk of a Company with the best credit rating defaulting vis-à-vis the company with a low credit rating.

With the rules being revised by BCBS and RBI, BASEL-II norms are to take place in the year 2007, the banks can decide on the amount of capital to set aside depending on the credit rating of the borrowing company.

Credit risk is not the only type that banks face in course of their business. These days, the operational risks that banks face are huge. The various risks that come under operational risk are competition risk, technology risk, casualty risk, crime risk etc. The original BASEL rules did not take into account the operational risks. Besides, there are other risks like Interest Rate Risk, Exchange Risk, etc. As per the BASEL-II norms, banks will have to set aside 15 per cent of net income to protect themselves against operational risks.

So to be ready for the new BASEL rules, the banks all over including in India will have to set aside more capital because the new rules could lead to Capital Adequacy Ratios of the banks falling. How the banks plan to go about meeting these requirements is something that remains to be seen. A few banks are planning initial public offerings / share issues to have enough capital on their books to meet these new norms. Recent examples are Dena Bank, Punjab National Bank, SBI, Andhra Bank, ICICI Bank, etc.

- **(ii) Consolidation –the future wave**

In the recent past, there has been a lot of talk about Indian Banks lacking in scale and size. The State Bank of India is the only bank from India to make it to the list of Top 100 banks, globally. Most of the PSBs are either looking to pick up a smaller bank or waiting to be picked up by a larger bank. The buzz word in banking circles these days is, in particular, consolidation (mergers) of Public Sector Banks for good although facing stiff resistance from various corners.

The central government also seems to be game about the issue and is seen to be encouraging PSBs to merge or acquire other banks. Global evidence seems to suggest that even though there is great enthusiasm when companies merge or get acquired, majority of the mergers/acquisitions do not really work. So in the zeal to merge with or acquire another bank, the PSBs should not let their common sense take a back seat. Before a merger is carried out cultural issues should be looked into. A bank based

primarily in North India might want to acquire a bank based primarily in South India to increase its geographical presence but their cultures might be very different. So the integration process might become very difficult. Technological compatibility both for software and hardware, besides trained work force, is another issue that needs to be looked into in detail, before any merger or acquisition is carried out.

The banks must not just merge because everybody around them is merging. As Keynes wrote," *Worldly wisdom teaches us that it's better for reputation to fail conventionally than succeed unconventionally*". Banks should avoid falling into this trap.

5. The Problems of Retail Banking in India:

Now, we shall try and look into the challenges that the banking sector in India faces:

5 a. Customer focus:

The retail banks in future will try to aggressively market their products. To market these products, there will be innovative modes to reach customers like SMS, internet, and mobile phones. Some banks are also engaging the services of Direct Selling Agents (DSAs), Franchisees, etc for sourcing and appraisal of loan proposals, issue of Credit Cards, selling of insurance and mutual fund products, etc. Such methods may some times displease/disturb the customer. Moreover, banks generally pitch on higher levels of service but if the banks do not match up to what they have claimed, this may lead to *unsatisfied customers* and *higher customer attrition rate*.

5 b. Product focus:

The challenge here will be to design and innovate the financial products which cater to the target segment needs. In future, retail banking scenario will see a huge proliferation of products. This will in turn require devising product which is easy to understand and at the same time meet the financial goals of the customers. The problem that lies ahead is to gain a mindshare for one's product given a wide range of products.

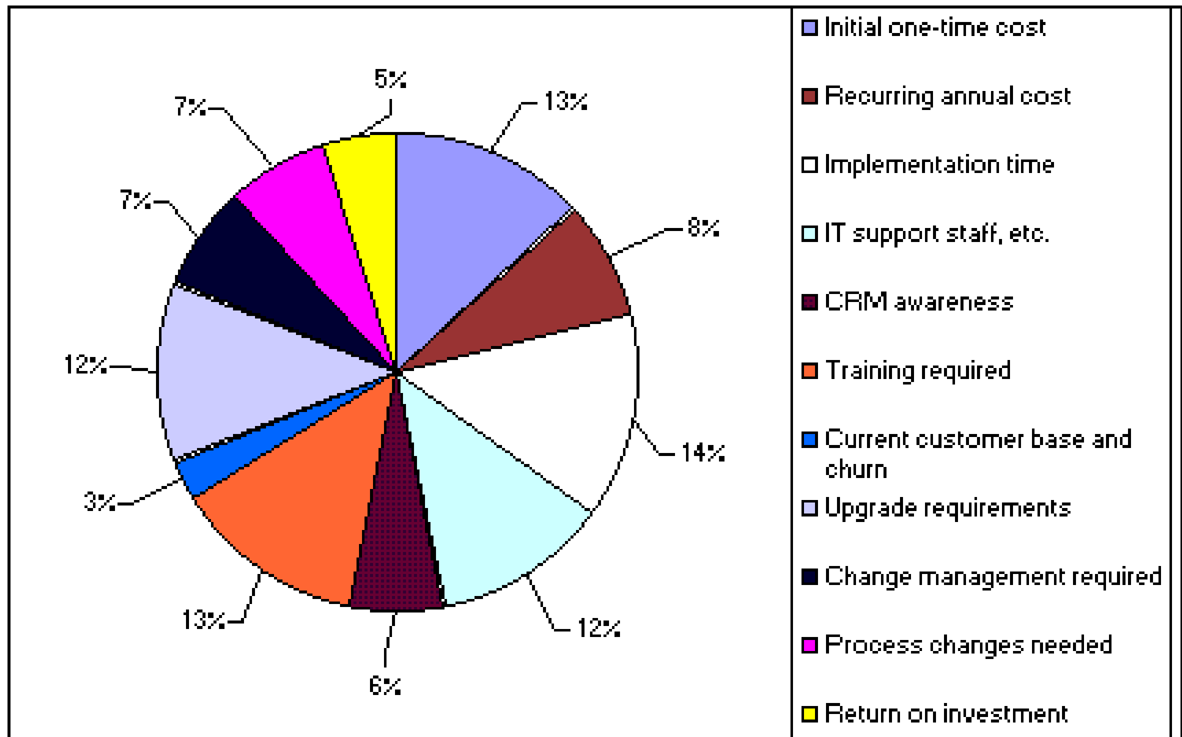
5 c. Technology focus:

Technology in India has been in India for over seven years now. But its penetration in the Industry in general and that in the financial services market has been rather uninspiring despite its professed advantages. The surprising aspect that came out from the study was that though the banks were aware of the technology's benefits, they are skeptical about its applicability to their organization. The root cause for this is the astonishing growth that the banks are experiencing at the moment. Most of the Retail banks are witnessing a tremendous expansion in their customer base: one bank even claim to be adding over 100% customer on y-on-y basis. However, on the other front there is increasing menace of hacking, phishing and farming through which scamsters are creating havoc indulging in cyber crimes on a large scale.

Apart from this, there are many other factors that have undermined the acceptance of Customer Relations Management (CRM). The chart shown below enlists the various factors (and their relative weightages on a scale of 1 to 5) that are believed to have played a role in the sluggish penetration of CRM in the retail-banking sector:

(Source: www.coolavenues.com)

The above chart clearly shows that it is the implementation time that has affected the way people in banks look at CRM the most. In order to further CRM in this segment, it is of paramount importance to reduce the implementation time to minimum possible. This factor makes CRM on Demand (web based CRM services offered by service providers) a particularly attractive alternative. The second important parameter that came out from the study was the cost. To sum up, Indian retail banking players want *less risk and faster returns at lesser costs*.



(Source : www.coolavenues.com)

Since, banks generally can't do with an investment that takes a long time to get running, implementation time figures as the top-most criteria closely followed by initial costs and training required.

5 d. Employee Focus:

In a service based industry the value can be delivered at the moment of interaction with the customers. It is vivid from the above chart that there needs to be focus on the employees and upgrading their skills as they at the front end would be the face of the bank. Hence, training requirement factor figures prominently in the case of banks due to the fact that these banks generally make do with just the required amount of manpower and it is very difficult for them to spare them. That will immediately start affecting their operations.

Banks, in a drive to carry on with tremendous expansion in terms of customer base, need to have requirements of the employees who are well informed about the products as well as have the necessary soft skills to deal and satisfy the customers. In future there may be

a problem of getting manpower or in specifics customer care executives with enhanced skills, knowledge and attitude. Hence, it challenges for the bank to *upgrade their existing manpower* and *retain* or lock in the best talents for having competitive edge in terms of human resources.

5 e. Others:

(i) Interest Rate Risk

Interest rate risk can be defined as exposure of bank's net interest income to adverse movements in interest rates. A bank's balance sheet consists mainly of rupee assets and liabilities. Any movement in domestic interest rate is the main source of interest rate risk.

Over the last few years the treasury departments of banks have been responsible for a substantial part of profits made by banks. Between July 1997 and Oct 2003, as interest rates fell, the yield on 10-year government bonds (a barometer for domestic interest rates) fell, from 13 per cent to 4.9 per cent. This will make it difficult to show huge profits from treasury operations. This concern becomes much stronger because a substantial percentage of bank deposits remain invested in government bonds.

Banking in the recent years had been reduced to a trading operation in government securities. Recent months have shown a rise in the bond yields which has led to the profit from treasury operations falling. The latest quarterly reports of banks clearly show several banks incurring losses on their treasury operations. If the rise in yields continues, the banks might end up posting huge losses on their trading books. Given these facts, *banks will have to look at alternative sources of investment.*

(ii) Non-Performing Assets

The best indicator of the health of the banking industry in a country is its low level of NPAs. Given this fact, Indian banks seem to be better placed than they were in the past. A few banks have even managed to reduce their net NPAs to less than one percent (before the merger of Global Trust Bank into Oriental Bank of Commerce, OBC was a zero NPA bank). But as the bond yields start to rise, the chances are the net NPAs will also start to go up. This will happen because the banks have been making huge provisions

against the money they made on their bond portfolios in a scenario where bond yields were falling.

Reduced NPAs generally gives the impression that banks have strengthened their credit appraisal processes over the years. This does not seem to be the case. With increasing bond yields, treasury income will come down and if the banks wish to make large provisions, the money will have to come from their interest income, and this in turn, shall bring down the profitability of banks. The shaping up of newly formed Credit Information Bureau of India Ltd., (CIBIL) is much desired in the years to come so that entire MIS of banks depositors and borrowers is available on line. Credit decisions will be quicker, efficient and of quality both in respect of individuals and institutions.

(iii) Competition

The entry of new generation private sector banks during mid-1990s has changed the entire scenario. Earlier the household savings went into banks and the banks then lent money to corporates. Now they need to sell banking. The retail segment, which was earlier ignored, is now the most important of the lot, with the banks jumping over one another to give out retail loans. The consumer has never been so lucky with so many banks offering so many products to choose from with varying terms and conditions, rates of interest, etc. With supply far exceeding demand it has been a race to the bottom, with the banks undercutting one another. A lot of foreign banks have already burnt their fingers in the retail game and have now decided to get out of a few retail segments completely. Notable examples are Bank Paribas and Oman International Bank in India.

The nimble footed new generation private sector banks have taken a lead on this front and the public sector banks are trying to catch up. The PSBs have been losing business to the private sector banks in this segment. PSBs need to figure out the means to generate profitable business from this segment in the days to come.

6. Conclusion:

Over the last few years, the falling interest rates gave banks very little incentive to lend to projects, as the return did not compensate them for the risk involved. This and a host of other technological, legal, financial, structural changes/developments led to the banks getting into the retail segment in a big way. It also led to a lot of banks playing it safe and putting in most of the deposits they collected into government bonds. Now, with the bond party over and the bond yields starting to go up, the banks will have to concentrate on their core function of lending with reasonable spreads and safety of funds.

Furthermore, the banking sector in India needs to tackle these challenges successfully to keep growing and strengthen the Indian financial system. Moreover the interference of the central government with the functioning of PSBs should stop. A fresh autonomy package for public sector banks has been announced recently. The package seeks to provide a high degree of freedom to PSBs on operational matters. This seems to be the right way to go for PSBs function in a professional manner and face stiff competition from Private and Foreign players. Productivity, Profitability and Pricing of products are at the top of the priority list of the banking system today.

With the economy experiencing respectable growth rates at around 7 – 8 per cent, it is incumbent on the part of the banks to fall in line to offer best quality services to their customers. Retail Banking deals with the lives of a vast majority of the population in the age bracket between 25 and 60 years with disposable incomes. Regulators and Policy makers shall take on their responsibility of facilitating the banks discharge their responsibilities in an efficient manner. Problems enumerated above are not surmountable. The growth of the banking sector will be one of the most important inputs that shall go into making sure that India progresses and becomes a global economic super power.

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