

# Indian Banking Industry: Growth and Challenges

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## Abstract

*The Indian banking sector is going through a major transformation with the changing policies. The role of banking industry is very important and essential service sector. The significant role of banking industry is to enhance economic development. Banks play an important role in the economic development by investing in various sectors*

*The changing economic policies of globalization, liberalization and privatization have given rise to new blend of players in the banking industry - public sector banks, private banks, and foreign banks- having their branches in India taking in view satisfaction of customers needs and requirement thereby ensuring customer satisfaction. The emerging competition has generated new expectations from customers. Innovative products have to be therefore introduced in a cost effective manner inline with the technological advancements. With the increasing income levels, customer's requirements also increase. All these factors lead to a growing demand for competitive, refined retail banking services. This paper explains the changing banking scenario briefly highlighting the challenges and opportunities of Indian banking sector*

**Keywords :** Technological advancements, E-Banking, Customer relationship management,

## Introduction :

India is one of the top 10 economies in the world, where the banking sector has tremendous potential to grow. The Indian Banking sector is on an increasing trend showing continuous growth. With the increase in the disposable income and earnings of the individuals in the country, has been an advantage to the banking sector in India. There has also been an increase in various transactions on account of technological advancements resulting in increase of internet based banking activities, mobile banking activities, ATM services. During the last decade customers utilized the ATM, internet and mobile banking services extensively. All the banks in India such as the Public sector banks, Private sector Banks and the Foreign banks having branches in India have shown a considerable increase in their activities thus

enhancing their customer reach. India's banking sector is currently valued at Rs. 81 trillion (US\$ 1.31 trillion). It has the potential to become the fifth largest banking industry in the world by 2020 and the third largest by 2025, according to an industry report. The face of Indian banking has changed over the years. Banks are now reaching out to the masses with technology in order to facilitate greater and faster communication, and ensuring that all the transactions are carried out through the Internet and mobile devices accurately.

In the current era, banking industry has undergone lot of transformation with the introduction of information technology and introducing multiple delivery channels to the customers in providing banking services by way of Online banking, internet based banking, electronic Transfers through NEFT and RTGS, Debit Card, Credit card etc. This has enabled customer convenience through effective and efficient delivery of the requests placed and reduced considerable amount of time and costs involved in physical transfer of currency.

## Objective of the Paper :

The objective of this paper is to understand the evolution, growth and changes in banking sector, and study the challenges and opportunities of the banks in this changing scenario

## Methodology :

The paper has been a study of a secondary data on Indian Banking Sector with special reference to Indian context. To complete this, certain annual reports, various books, journals and periodicals have been referred to, several other reports on this sector through the internet search has also been considered

## Phases of Evolution of Indian Banking Industry

A brief diagram shows the evolution of the Indian banking industry beginning from the nationalization phase, consolidation phase and introduction of the Indian financial and banking reforms and partial liberalization phase. In the evolution of this Banking Industry, there have been considerable developments in introduction and implementation of the regulations governing, the ownership structure of the banking

industry, and various products and services being offered and the technological advancements introduced and used. The entire evolution can be classified into four distinct phases.

- Phase I- Pre-Nationalization Phase (prior to 1955)
- Phase II- Era of Nationalization and Consolidation (1955-1990)
- Phase III- Introduction of Indian Financial & Banking Sector Reforms and Partial Liberalization (1990-2004)
- Phase IV- Period of increased Liberalization (2004 onwards)

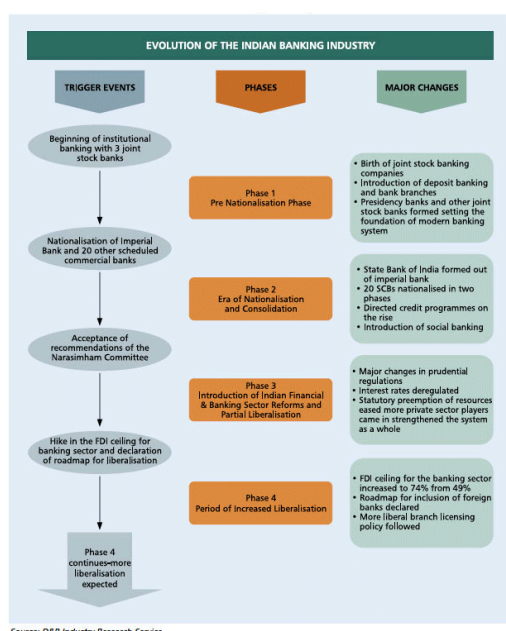


Fig 1. Evolution of Indian Banking Industry

The figure 1, above shows the evolution and growth of the Indian banking industry determining the four phases which started with the nationalization of the banks and introduction of deposit banking and introduction of bank branches. The second phase was of further nationalization and consolidation and increase in the credit programmes in banks and introduction of social banking. The third phase comprised of introduction of banking sector reforms and the entry of private players. The fourth phase was a period of increased liberalization with the increase of FDI in banking sector and more liberal branch licensing policy followed.

### Growth and Developments in the Banking Sector:

The Indian Banking Sector Comprises of 28 public Sector Banks with majority stake and control by

the Government, 23 Private Sector Banks and 27 Foreign Banks having branches in India. The first Nationalization of the Banks took place in the year 1969. With the Liberalization and the privatization policies changes, there were lot of major developments that took place after 1990 by establishing and easing out regulations of various private sector banks and Foreign banks branches in India. The Nationalized banks were allowed to obtain funds through the stock market upto 49% of the paid of capital.

The entire operations of banking being classified into four main categories –

- wholesale banking- mainly comprises of big exposures and primarily relating to services to corporate,
- retail banking – comprising of individual customers and small companies;
- Treasury operations mainly comprising of debt market, equity market trading, mutual funds investments, derivatives and foreign exchange related activities ;
- Other banking activities are those which do not fall under any category mentioned above.

The products of the banking industry broadly include deposit products, credit products and customized banking services, Retail fee based services which also include remittances and payments, wealth management, trading facilities. Corporate fee based services include letter of credit, factoring, foreign exchange services etc.

### Challenges and opportunities in banking sector:

Indian banking in future is expected to grow exponentially supported by technology intensive processes and customer friendly models with focus on customer convenience and cost effectiveness. The present situation in the banking industry gives a lot of importance to their customers, who have increased expectations in terms of services from the banks. The competition in the banking industry has increased.

With the liberalization, many private sector banks and foreign banks have established giving competition to each other. The changing technological advancements have immense potential for market expansion. The customers therefore have to be given the optimum mix of the products and services in terms of technology and banking services, thereby ensuring customer loyalty and retention, thereby impacting the profits of the banks.

**Some of the major challenges in the banking sector are as follows:**

**Increasing technological advancements :**

Managing technology is the key challenge for the Indian banking industry. The right technology must ensure customer convenience and also must be cost effective. The Indian rural population may not have adequate facilities for accessing and availing the banking services. Hence reaching the rural markets, itself is an opportunity for the banking industry. The effective use of technology will ensure efficient risk management for Banks offering increasing and complex products and services. There has been Increasing competition among the private sector banks, nationalized banks and the foreign banks, on account of the technology based services provided to the customers. E Banking is becoming the order of the day and the banking industry is moving more towards virtual banking. Ebanking which means an automated delivery of traditional banking products and services directly to the customers through electronic and interactive communication channels. Efficient and effective technology enables accurate and timely management of the increased transactional volume which comes from a large customer base.

**Rising Non Performing Assets and risk management :** The rising competition increases the competitiveness among the banks, but this may also pose as a threat in the form of bankruptcy. Effective and efficient appraisal techniques must be adopted for effective delivery of credit products to the customers. Writing off NPA's has an adverse effect on the profit. NPA Management is therefore most important challenge for the banking industry. Effective risk management practices taking view credit risk, operating risk, foreign exchange risk and market risk must be adopted. This will enhance the asset quality and increase operational efficiency thereby reducing on the Non performing assets.

**Customer retention and loyalty:** Customer retention is also a major challenge for the banking industry. The service quality parameters in terms of services features and services provided and problems faced by the customers have to be evaluated. This has an impact on the customer satisfaction. Effective customer relationship management practices will enhance customer retention and loyalty for the banks.

**Corporate Governance Practices:** This aims at disclosure of all the aspects in the balance sheet which provides details of investments; profile of

assets, NPA related details, lending details etc. This ensures accountability towards the investors. Thus banking industry must ensure market discipline and transparency by following all the norms to adhere to the corporate governance practices.

**Impact of liberalization and globalization:** With the liberalization and globalization policy, many foreign banks established their branches in India, giving competition to the nationalized and the private sector banks in India. The foreign banks are technically advanced and have a presence world over. The globalization itself is therefore a challenge for the Indian banking industry to compete with the foreign players.

**Employee Retention:** With increasing number of banks and technology give rise to various opportunities for the employees. The retention of employees is a challenge for the bank. Due to the transformation and the rapid changes in the banking industry, it is changing effective customer service and aggressive environment with an importance and focus on increasing revenue and competition. The demanding environment affects the morale of the employee thereby impacting the revenue. Effective Human Resource Management Practices will enhance employee retention.

**Conclusion:**

Some of the challenges which the banking industry is facing were studied through this paper. A brief study on the evolution, growth and development of the banking industry was studied. The focus of the banks must be customer centric to meet the requirements and needs of the customers. Banks must also have the ability to shift from the traditional banking services to new and innovative banking products and services. This will help them survive competition. Technological advancements and up gradations at the right time is also a major challenge. As customer's awareness has increased, banks have to effectively manage through Customer relationship management practices with the objective of customer retention. People trust Nationalized Banks; hence they must effectively utilize the brand value in providing services which will lead to customer satisfaction thereby leading to customer retention.

The other Challenges Non Performing asset management, Customer Retention, Impact of Globalization, Employee Retention, Corporate Governance Practices were also studied.

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