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Title

BURGEONING CONFRONTS IN INDIAN BANKING

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ABSTRACT:

The contemporary economic circumstances present numerous prospects and confronts to the existing banks. It is up to the banks to influence the opportunities to meet up the challenges to the best of their abilities. Banking Industry has observed a lot of chaos owing to the global financial crisis. The Reserve Bank of India (RBI), Ministry of Finance and other regulatory authorities has made various remarkable efforts to get better regulation in the sector. Many of large banks operating in the market have exploited the changed regulations (viz., change in CRR and interest rate) to give better choices to prospective customers. Acceptance of fresh practices to accommodate to the challenging economy situation has enabled the banks to meet up the varying customer necessities. As compare to other regional banks, over the last few years, Indian banks have achieved favorably on growth, asset quality and profitability. This paper would throw light on latest development in area of banking with emphasis on confronts or challenges faced by Indian banking industry.

Key Words: International financial reporting standards, financial inclusion.

OBJECTIVE OF STUDY:

Primary Objective

1. To explain the various confronts faced by the Indian banking sector in the global arena.

Secondary Objective

2. To understand the requirement of the banking industry to face the new challenges.
3. To analyze the need of a change emerged because of the introduction of international financial reporting standards.
4. To study the impact of various challenges in the form of technological advancement, new rating procedures, non performing assets, human capital and financial inclusion on the Indian banking sector.

INTRODUCTION:

The improved function of the banking sector in the Indian economy, the growing levels of deregulation beside the escalating levels of competition have assisted globalization of the India banking system and placed plentiful burden on banks. Working in this demanding environment has uncovered banks to various challenges. The last decade has observed key transformation in the financial sector - new banks, new financial institutions, new instruments, new windows, and new opportunities. While deregulation has unlocked new outlooks for banks to expand revenues, it has caused greater competition and consequently greater risks. Demand for new products, particularly derivatives, has necessitated banks to diversify their product mix and also effect rapid changes in their processes and operations in order to remain competitive in the globalize environment. During 2010, Indian banks have improved favourably on growth, asset quality and profitability with other regional banks over the last few years. The banking index has developed at a compounded annual rate of over 51 per cent since April 2001 as compared to a 27 per cent growth in the market index for the same period. Policy makers have made some remarkable modification in policy and regulation to facilitate the strengthening of the sector. These changes include spiraling prudential norms, improving the payments system and incorporating regulations between commercial and co-operative banks.

There is enough space for the banking industry to grow at large in the future.

The following challenges must be addresses before stepping towards the success:

CAPITAL REQUIREMENT:

The first and primary is the obligation of large quantity of capital. As per an estimate, Indian banking will necessitate about US $ 18-20 billion of capital each year for the next five years, to meet with the credit expansion and inclusion requirements to meet the economic growth at 7.5-8.5% level. In addition, this requisite of capital will also be critical to sustain capital adequacy ratio at the current level. As on 30th June 2010, the Capital to risk weighted assets ratio (CRAR) of the Indian banking system was 14.4% (Source RBI). Around 80% of this capital will be required by public sector banks. Almost 50% of the public sector banks have reached this doorsill and cannot hoist capital without Govt. support. Execution of the Basel II will entail gigantic investments in technology. According to estimates, Indian banks, especially those with a sizeable branch network, will necessitate to spend well over $ 50-70 Million on this.

INTERNAL RATING PROCEDURE:

Since improved risk management and measurement is needed, it aims to give thrust to the use of internal rating system by the international banks. More and more banks may have to use internal model developed in house and their consequence is vague. Most of these models necessitate minimum historical bank data that is a tiresome and high cost process, as most Indian banks do not have such a database. Under the IRB (internal rating based) approach, distinctive methodical frameworks will be given for different types of loan exposures. The structure permits (i) a foundation method in which a bank estimate the probability of default associated with each borrower, and the supervisors will supply the other inputs and (ii) an advanced IRB approach, in which a bank will be permitted to supply other required inputs as well. Under both, the foundation and advanced IRB approaches, the series of risk weights will be far more diverse than those in the standardized approach, resulting in greater risk sensitivity.

AUTOMATION OF BANKS:

The technology infrastructure in terms of mechanization is still in a nascent stage in most Indian banks. Computerization of branches, especially for those banks, which have their network spread out in far-flung areas, will be a daunting job. Diffusion of information technology in banking has been successful in the urban areas, unlike in the rural areas where it is insignificant.

Information Technology has essentially been used under two special avenues in Banking. One is Communication and Connectivity and other is Business Process Reengineering. Information technology allows refined product development, better market infrastructure, and execution of dependable modus operandi for control of risks and aids the financial intermediaries to reach geographically remote and diversified markets.

In view of this, technology has changed the forms of three main functions performed by banks, i.e., access to liquidity, transformation of assets and monitoring of risks. Further, Information technology and the communication networking systems have a vital bearing on the efficiency of money, capital and foreign exchange markets. The early 90s saw the plunging hardware prices and dawn of cheap and inexpensive but high-powered PCs and servers and banks went in for Total Branch Automation (TBA) Packages. The middle and late 90s witnessed the cyclone of financial reforms, deregulation, globalization etc together with rapid revolution in communication technologies and fruition of novel concept of 'convergence' of computer and communication technologies, like Internet, mobile / cell phones etc.

NPA MANAGEMENT:

The escalating and devastating effect of NPA on the economy has made the problem of NPA as issue of public debate and of national priority. Therefore, any gauge or reform on this facade would be insufficient and incomprehensive, if it fails to make a dent in NPA reduction and freeze their growth in future as well. At macro level NPAs have blocked off the supply line of credit to the prospective borrowers, thereby having venomous consequence on capital creation and striking the economic activity in the country. At the micro level, the indefensible level of NPA has gnarled the profitability of banks through reduced interest income and provisioning requirement, besides limiting the recycling of funds leading to serious asset liability mismatches.

ENHANCING CORPORATE GOVERNANCE:

The subjects related to corporate governance have continued to draw extensive national and international awareness in light of a number of high-profile breakdowns in corporate governance. This becomes all the more significant for banks as they not only accept and arrange large amount of uncollateralized public funds in fiduciary capacity, but also leverage such funds through credit creation. In view of the magnitude of the banking system for financial stability, sound corporate governance is not only pertinent at the level of the individual bank, but is also a grave component at the system level.

A good “governance culture” is vital for financial steadiness but because it is an ‘intangible’, rules may not be able to detain its quintessence efficiently. Therefore, banks may have to develop a good governance culture building in appropriate checks and balances in their maneuvers. There are four important forms of oversight that must be included in the organisational structure of any bank in order to make sure appropriate checks and balances: (1) oversight by the board of directors or supervisory board; (2) oversight by individuals not involved in the day-to-day running of the various business areas; (3) direct line supervision of different business areas; and (4) independent risk management, compliance and audit functions.

COMPLIANCE WITH INTERNATIONAL ACCOUNTING STANDARDS

The prologue of IFRS in India will engross "significant challenges" for the banking system. There is a call for to improve consciousness and construct technical capability for the accounting and auditing profession on IFRS. The RBI has been organising seminars to educate its staff on IFRS. The execution of International Financial Reporting Standards (IFRS) for Indian Banks has been postponed to April 2012. Despite of extended timeline, the implementation challenges for convergence with IFRS for the banks in India would be frightening. The financial impact on the balance sheet and P&L account of banks would also be significant on account of convergence with IFRS particularly in areas relating to loan provisioning and fair value accounting of financial Instruments. . IFRS needs increased use of management verdict and wide use of fair valuation inputs & assumptions. The regulatory review & control process needs to be adjusted to factor in the inherent judgments involved in the application of IFRS. Additionally, application of IFRS may also result in higher loan impairment losses, thereby unfavorably impacting the available capital and capital adequacy ratios of banks.

FINANCIAL INCLUSION:

In the recent times all the banks are facing an important challenge which is globally known as financial inclusion. In India the focal point of the financial inclusion at present is restricted to *ensuring a bare minimum access to a savings bank account without frills, to all.* Financial inclusion is *delivery of banking services at a reasonable cost to the huge segments of* *underprivileged and low income groups*. By financial inclusion we mean the stipulation of affordable financial services, viz., access to payments and remittance facilities, savings, loans and insurance services by the formal financial system to those who tend to be excluded.

Indian banking industry need to find out the solution to major confronts i.e financial inclusion and human resource framework. The first challenge requires remarkable innovation and experimentation, the second warns to cripple the talent of the largest segment of the banking industry from being able to innovate and remain competitive. The Financial Inclusion Task Force in UK has recognized *three priority* regions for the purpose of financial inclusion, viz., *access to banking, access to affordable credit and access to free face-to-face money advice.* UK has established a Financial Inclusion Fund to promote financial inclusion and allocated accountability to banks and credit unions in eliminating financial exclusion.

Financial inclusion is a vital pre-condition to structure standardized economic expansion, both spatially and temporally, and accompanying in greater economic and social equity. The micro-credit programme instigated through frequent Non Government Organizations has proved to be an exceptional tool to bring in better equity through financial inclusion

HUMAN CAPITAL CHALENGES:

The core function of HRD in the banking industry is to ease performance improvement, measured not only in terms of definite financial indicators of operational efficiency but also in terms of quality of financial services provided. The skill level, attitude and knowledge of the staff play an important role in determining the competitiveness of a bank. Banks have to recognize that the capital and technology-considered to be the most important pillars of banking - are replicable, but not human capital, which needs to be viewed as a precious reserve for the achievement of aggressive advantage. The primary concern of the bank should be to bring in proper assimilation of human resource management strategies with the business strategies. It must faster consistent team work and create obligation to improve the competence of its human capital. More than operational skills today's banking call for these `soft skills' to attend the needs and requirement of the customers at the counter. The call for to adopt global best practices to financial sector regulation and supervision and adopt them to the domestic environment, places a finest skills and proficiency of the bank human resources

CONCLUSION:

For the various confront that banking industry is facing in current scenario, the banks will need to innovate and devise newer methods of including households having greater levels of discretionary incomes. The micro-credit and the Self Help Group movements are in their infancy and they still need to congregate power. Modernization in the form of business facilitators and correspondents will be needed for banks to augment their outreach for banks to ensure financial inclusion. With increasing global pressure and higher economic growth, the job of banking sector is poised to increase in the financing pattern of economic activities within the country. To meet the growing credit demand, the banks need to mobilize resources from a wider deposit base and extend credit to activities which were, till now, not financed by banks. The global challenges which banks face are not confined only to the global banks. These aspects are also highly relevant for banks which are part of a globalised banking system. Further, conquering these confronts by the other banks is expected to not only stand them in good stead during difficult times but also portends well for the banking system to which they fit in and will also furnish them to commence themselves as a global bank. Technology product innovation, sophisticated risk management systems, generation of new income streams, Building business volumes and cost efficiency will be the key to success of the banks in the new era. In the present environment where change is invisible, it is not enough if bank change with the change, but they have to change before the change.

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