

## BANKING MANAGEMENT : THE ROAD AHEAD

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The financial system in India is undergoing structural transformation under the influence of globalization, deregulation, technological advances, and institutional and legal reforms. While the liberalized environment has opened new avenues of business for financial institutions, it has led to intensified competition. To survive in a competitive environment, financial institutions have been diversifying into non-traditional activities, altering their pricing strategies and looking for non-fund based sources of income. As a result, operations of financial institutions are becoming increasingly complex and, correspondingly, exposed to greater risks. In order to ensure that financial institutions grow along sound lines, a robust prudential regulatory framework has been put in place. Financial regulation and supervision has been progressively aligned with international best practices with suitable adaptations. The corporate governance framework in banks has also been strengthened. At the same time, the Reserve Bank has been making consistent efforts to strengthen credit delivery, improve customer service and encourage banks to provide banking services to all segments of the population.

**Indian banking-** Present position and the challenges ahead. The enhanced role of the banking sector in the Indian economy, the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on banks. Operating in this demanding environment has exposed banks to various challenges:

**Globalization:** In recent years, there has been a considerable widening and deepening of the Indian financial system, of which banking is a significant component. With greater liberalisation, the financial system has come to play a much larger role in the allocation of resources than in the past and its role in future can be expected to be much larger than at present. With the increasing levels of globalization of the Indian banking industry, evolution of universal banks and bundling of financial services, competition in the banking industry will intensify further. One of the major objectives of banking sector reforms in India has been to enhance efficiency and productivity.

**Competition:** Various indicators suggest that competition in the banking industry has intensified. New private sector banks and foreign banks with comparative advantage in technology have ushered in highly competitive banking. This has encouraged other banks to devise imaginative ways to maintain their market share. With the ever increasing pace and extent of globalization of the Indian economy and the systematic opening up of the Indian banking system to global competition, banks need to equip themselves to operate in the increasingly competitive environment.

**Technology:** The decade of 90s has witnessed a sea change in the way banking is done in India. Technology has made tremendous impact in banking. Anywhere banking and anytime banking has become a reality. This has thrown new challenges in the banking sector and new issues have started cropping up which is going to pose certain problems in the near future. The new entrants in the banking are with computer background. However, over a period of time they would acquire banking experience. Whereas the middle and senior level people have rich banking experience but their computer literacy is at a low level. Therefore, they feel the handicap in this regard since technology has become an indispensable tool in banking. A few banks, which have impressive branch networks have not been able to meet their customers' expectations due to inefficiencies arising out of inadequate investment in technology and consequently faced an erosion of their market shares. The beneficiaries are those banks, which have invested in technology.

**Basel II implementation:** Basel II is the revised framework for capital adequacy for banks. Implementation of Basel II is seen as one of the significant challenges facing the banking sector in many jurisdictions. With the introduction of capital charge for market risks with effect from the year ended March 31, 2005 banks in India are compliant with all elements of Basel I. Commercial Banks in India will start implementing Basel II with effect from March 31, 2007. They will initially adopt the Standardized Approach for credit risk and the Basic Indicator Approach for operational risk. After adequate skills are developed, both by the banks and also by the

supervisors, some banks may be allowed to migrate to the Internal Rating Based (IRB) Approach. Banks are encouraged to focus on capacity building and undertake impact analyses.

**Implementation of New Accounting Standards:**

It is widely accepted that as the volume of transactions increases, which is happening in the Indian banking system, the need to upgrade the accounting framework needs no emphasis. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) is considering issue of Accounting Standards on the above aspects pertaining to financial Instruments. The proposed Accounting Standards will be of considerable significance for financial entities and could therefore have implications for the financial sector.

**'Know Your Customer' (KYC) Guidelines:** Anti Money Laundering Standards: Banks were advised in 2002 to follow certain customer identification procedure for opening of accounts and monitoring transactions of a suspicious nature for the purpose of reporting it to appropriate authority. These 'Know Your Customer' guidelines were revisited in the context of the recommendations made by the Financial Action Task Force on Anti Money Laundering standards and on Combating Financing of Terrorism. These standards have become the international benchmark for framing Anti Money Laundering and combating financing of terrorism policies by the regulatory authorities. Compliance with these standards both by the banks/financial institutions and the country has become necessary for international financial relationships. Compliance with the above is a significant challenge to the entire banking industry to fortify itself against misuse by anti-social persons/entities.

**Corporate Governance:** Corporate governance lies at the heart of building sound financial institutions. Corporate governance has assumed added significance in the current liberalized environment when the banking sector is expected to function on commercial lines. The governance structure specifies the rights and responsibilities of the Board, the management, the shareholders and other stakeholders. Banks not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. In view of the above, legal

prescriptions for ownership and governance of banks laid down in Banking Regulation Act, 1949 have been supplemented by regulatory prescriptions issued by RBI from time to time.

**Transparency and Disclosures:** Transparency and disclosure standards, which are important constituents of a sound corporate governance mechanism, have been enhanced to align with international best practices. The disclosure requirements broadly covered the aspects like Capital adequacy, Asset quality, Profitability, Country risk exposure, Risk exposures in derivatives, etc. With a view to moving closer towards international best practices including International Accounting Standards (IAS) and the disclosure requirements under Pillar 3 of Basel II, Reserve Bank has proposed enhanced disclosures, which lay a greater emphasis on disclosure of certain qualitative aspects. Transparency and disclosure standards are also recognized as important constituents of a sound corporate governance mechanism.

**Crisis Management:** The financial market events of 2007 (which have continued into 2008) provide yet another opportunity to consider financial crisis management. The financial system, matches savings and investment, fostering economic growth. Indeed, international studies have shown that a major difference between developed and less developed countries is the ability to pool investment capital. It makes sense, then, that problems in the financial markets will cause problems in the labor, capital, and product markets.

**Growth Rate:** Although the financial system in India has developed considerably over the years, the ratio of bank assets to GDP in India is still low in comparison with that prevailing in several other emerging market economies. This combined with the fact that India's economy is growing at a robust rate, would suggest that there is enormous potential for future growth of banking, especially in rural and semi-urban areas.

**Indian banking after 2009:** Post 2009 banking sector scenario will implies new threats as well as opportunities. Capital is going to play a crucial role in the banking sector. Since by then bank need to grow in size of global standard, need to have robust risk management practices, advanced technology, skilled manpower and very sound marketing practices. All these require huge capital investment by Bank. As

per RBI PSU banks in India will require an amount of Rs 2980 billion of additional capital to maintain a CRAR of 12 per cent by March 2010. Basel II implementation will attract a huge investment. By concentrating on high profit areas like trade finance, institutional banking, corporate and investment banking, foreign banks have proved that they are more profitable than their counterpart domestic banks. Post 2009 entry of new players will intensify the competition for domestic banks. Post 2009 in the areas of retail banking also the PSU banks will face great hurdle. A lot of challenges are waiting for PSU bank ahead of 2009. Survival of tech savvy, good global sized, with huge capital and smart skilled manpower bank is guaranteed while a bank having characteristic contrary to this will be acquired by big banks.

**Conclusion**-India's banking industry is at a watershed. It has met and successfully overcome several challenges over the last decade. But bigger challenges lie ahead. A strong performance in the current year, strengthening the positive trends of the past, will certainly improve the short-term risk perception but focus must rest on key structural changes that have to occur if Indian banking is to be a positive force and not a drag on the rest of the economy. There are, however, several challenges in future, which may require new technologies, better processes of credit and risk appraisal, product diversification, robust internal controls and corporate governance, and efficient human resource management. Calibrated deregulation, prudential

regulation and supervision, and a responsive policy environment have resulted in significant improvement in the efficiency, stability and resilience of financial institutions. This is reflected in their profitability, improved asset quality and higher capital levels. As the economy grows and becomes more sophisticated, the banking sector has to develop in a manner that supports and stimulates such growth. Banks are also facing increased market risk uncertainties on account of rising interest rates as a result of growing global financial imbalances. The banking sector, therefore, needs to equip itself to meet these challenges as well as those arising out of introduction of Basel II norms and international accounting standards. Competition, consolidation and convergence are emerging as the key drivers of the banking sector in the years to come. With the increasing levels of globalization of the Indian banking industry, evolution of universal banks and bundling of financial services, competition in the banking industry will intensify further. The banking industry has the potential and the ability to rise to the occasion as demonstrated by the rapid pace of automation which has already had a profound impact on raising the standard of banking services. Strong capital positions and balance sheets place banks in a better position to deal with and absorb the economic shocks. Banks need to supplement this with sophisticated and robust risk management practices and the resolve to face competition without diluting the operating standards.

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