

# **GROWTH OF BANKING SERVICES OF INDIAN ECONOMY IN POST-LIBERALIZATION ERA**

*Manish Phalke*

*Patel College of Management, Indore (MP) India  
manish.phalke@gmail.com*

*Hitendra Bargal*

*Patel College of Science and Technology, Indore (MP) India  
f08hitendra@iimahd.ernet.in*

*Ashish Sharma*

*University Institute of Management, RDVV, Jabalpur (MP) India  
ashu72\_sharma@rediffmail.com*

*Rajeev Shukla*

*School of Business Management,  
Shri Vaishnav Institute of Technology and Science, Indore (MP) India  
rajeevujn@sify.com*

*Bhanu Saxena*

*Patel College of Management, Indore (MP) India  
saxena\_bhanu@rediffmail.com*

*Santosh Kumar Yadav*

*Patel College of Management, Indore (MP) India  
Santosh18yadav@gmail.com*

*Nitish Ghune*

*Patel College of Science and Technology, Indore (MP) India  
nitishghune@yahoo.com*

## **ABSTRACT**

The banking sector plays a vital role in the development of one country's economy. The growth of banking sector depends upon the services provided by them to the customers in various aspects. The growing trend of banking services is found significant after the new economic reforms in India. Nowadays banking sector acts as a backbone of Indian economy which reflects as a supporter during the period of boom and recession. From 1991 various trends and developments in banking sector are credited. It also reflects the various reforms were caused to improve their services to satisfy the customers. In this we also discussed the impact of bank decisions on Indian economy. Therefore, the study of growth of banking services is an attempt to focus on the performances of banking sector contributing to the economic development of India.

**Key Words:** Banking Services, Customers, Economic Reforms, Performance & Developments of Banking Sector.

## INTRODUCTION

The world economies are seeing India as their potential market. This has been going on since quite some time now, ever since 1991 reforms of liberalization, globalization and privatization. Indian markets in urban areas have grown appreciably and are on the verge of saturation, so corporate have started tapping rural markets, since more than 60 per cent of India's population lives in rural areas. During this global meltdown and fall of exports, if the Fast Moving Consumer Goods (FMCG) sector has been able to show rising quarterly growths, it is because of the Rural Markets and their rising spending power, which have not been affected by this meltdown. Therefore, consumption trends followed by the rural Indian are considered to be the driver of future growth of companies. And this trend of tapping rural markets is visible across all sectors now, be it FMCG, IT, Banking, education etc. For example, today, India is in better state than China because our GDP is less dependent on exports as compared to them, where maximum revenues come from exporting to the European and US markets. Thus, tapping the rural markets is most important for us to be a self sustaining economy.

India has been considerably shielded from the global recession. Firstly, we are not very dependent on the exports for our GDP and have a good consumer base in India. Secondly, we are a saving prone economy, unlike western economies which are consumption prone. Thirdly, when banks across the world are falling like a pyramid of playing cards; we are safe, steady and strong, with our banks which have acted like a strong backbone of our economy during present turmoil. And just like FMCG sector, there is tremendous growth potential in the banking sector, because firstly, the rural masses have the habit of saving and spending only when needed. Secondly, their small credit requirements for agriculture, cottage industry and marriages etc.

According to researches carried out by the Reserve Bank of India (RBI), on an all India basis, 59 per cent of the adult population in the country has bank accounts and 41 per cent don't. In rural areas, the coverage of banks is 39 per cent, against 60 per cent in urban areas. There is only one bank for a population of 13000. Tapping the rural market by banks becomes all the more important, not only for the banking sector, but all other industrial sectors as well. If there is growth in the banking sector, it benefits the other sectors as well. By this, it is meant that in this sector, the trickledown theory of economic growth or top down approach works, if we keep the banks at the apex in India Inc. Reasons being, as banks promote savings in the economy, they speed up the capital formation and then become the source of finance of trade and credit for the industry. Then they provide credit to enable entrepreneurs in their ventures, which promotes production and employment. This production and employment generates income and consumption and supply and demand, by increasing the spending power of people. And a sum total of all these reduces poverty and better life styles. But the problem is that banks have not been able to reach a vast majority of the rural population; the rural poor have limited access to organized, affordable and transparent financial services such as savings, loans, remittances and insurance services etc. It is important for them to have access to banking services, especially credit and insurance, to enlarge livelihood opportunities and to empower themselves to take charge of their lives. The unorganized sector of lending is believed to be acting as a problem to the growth impetus in these sectors. In several villages, farmers still go to traditional money lenders like zamindars for meager sums of a few hundred or thousand rupees and get into debt trap for their whole lives. As a result, farmer suicides, bonded labor, naxalism and political and social unrest and on top of

it, poor financial management, which if had been done smartly would have helped in economic growth of their own self and economy.

### **PERFORMANCE OF BANKING SECTOR**

Indian banks have compared favorably on growth, asset quality and profitability with other regional banks over the last few years. The banking index has grown 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 notable changes in policy and regulation to help strengthen the sector. These changes include strengthening prudential norms, enhancing the payments system and integrating regulations between commercial and co-operative banks.

However, the cost of intermediation remains high and bank penetration is limited to only a few customer segments and geographies. While bank lending has been a significant driver of GDP growth and employment, periodic instances of the “failure” of some weak banks have often threatened the stability of the system. Structural weaknesses such as a fragmented industry structure, restrictions on capital availability and deployment, lack of institutional support infra-structure, restrictive labor laws, weak corporate governance and ineffective regulations beyond Scheduled Commercial Banks (SCBs), unless addressed, could seriously weaken the health of the sector. Further, the inability of bank managements (with some notable exceptions) to improve capital allocation, increase the productivity of their service platforms and improve the performance ethic in their organizations could seriously affect future performance.

### **PROSPECTS IN BANKING SECTOR**

Challenges must be addressed before success can be achieved. First, the market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. These require new skills in sales & marketing, credit and operations. Second, banks will no longer enjoy windfall treasury gains that the decade-long secular decline in interest rates provided. This will expose the weaker banks. Third, with increased interest in India, competition from foreign banks will only intensify. Fourth, given the demographic shifts resulting from changes in age profile and household income, consumers will increasingly demand enhanced institutional capabilities and service levels from banks.

The interplay between policy and regulatory interventions and management strategies will determine the performance of Indian banking over the next few years. Legislative actions will shape the regulatory stance through six key elements: industry structure and sector consolidation; freedom to deploy capital; regulatory coverage; corporate governance; labor reforms and human capital development; and support for creating large sections of the population gain access to quality banking products. Management is able to overhaul bank organizational structures, focus on industry consolidation and transform the banks into industry shapers. In this scenario we witness consolidation within public sector banks (PSBs) and within private sector banks. Foreign banks begin to be active in M&A, buying out some old private and newer private banks. Some M&A activity also begins to take place between private and public sector banks. As a result, foreign and new private banks grow at rates of 50 percent, while PSBs improve their growth rate to 15 per cent. The share of the private sector banks

(including through mergers with PSBs) increases to 35 per cent and that of foreign banks increases to 20 per cent of total sector assets. The share of banking sector value adds in GDP increases to over 7.7 per cent, from current levels of 2.5 per cent. Funding this dramatic growth will require as much as Rs. 600 billion in capital over the next few years. Evolution: Policy makers adopt a pro-market stance but are cautious in liberalizing the industry. As a result of this, some constraints still exist. Processes to create highly efficient organizations have been initiated but most banks are still not best-in-class operators. Thus, while the sector emerges as an important driver of the economy and wealth in 2010, it has still not come of age in comparison to developed markets. Significant changes are still required in policy and regulation and in capability-building measures, especially by public sector and old private sector banks. In this scenario, M&A activity is driven primarily by new private banks, which take over some old private banks and also merge among themselves. As a result, growth of these banks increases to 35 per cent. Foreign banks also grow faster at 30 per cent due to a relaxation of some regulations. The share of private sector banks increases to 30 per cent of total sector assets, from current levels of 18 per cent, while that of foreign banks increases to over 12 per cent of total assets. The share of banking sector value adds to GDP increases to over 4.7 per cent. Stagnation: In this scenario, policy makers intervene to set restrictive conditions and management is unable to execute the changes needed to enhance returns to share- holders and provide quality products and services to customers. As a result, growth and productivity levels are low and the banking sector is unable to support a fast-growing economy. This scenario sees limited consolidation in the sector and most banks remain sub-scale. New private sector banks continue on their growth trajectory of 25 per cent. There is a slowdown in PSB and old private sector bank growth. The share of foreign banks remains at 7 per cent of total assets. Banking sector value add, meanwhile, is only 3.3 per cent of GDP.

### **BANKING SECTOR AND SOCIAL DEVELOPMENT**

The policy makers need to make coordinated efforts on six fronts: Help shape a superior industry structure in a phased manner through “managed consolidation” and by enabling capital availability. This would create 3-4 global sized banks controlling 35-45 per cent of the market in India; 6-8 national banks controlling 20-25 per cent of the market; 4-6 foreign banks with 15-20 percent share in the market, and the rest being specialist players (geographical or product/segment focused). Focus strongly on “social development” by moving away from universal directed norms to an explicit incentive-driven framework by introducing credit guarantees and market subsidies to encourage leading public sector, private and foreign players to leverage technology to innovate and profitably provide banking services to lower income and rural markets. Create a unified regulator, distinct from the central bank of the country, in a phased manner to overcome supervisory difficulties and reduce compliance costs. Improve corporate governance primarily by increasing board independence and accountability. Accelerate the creation of world class supporting infrastructure (e.g., payments, asset reconstruction companies (ARCs), credit bureaus, back-office utilities) to help the banking sector focus on core activities. Enable labor reforms, focusing on enriching human capital, to help public sector and old private banks become competitive.

### **CONCLUSION**

Management imperatives will differ by bank. However, there will be common themes across classes of banks: PSBs need to fundamentally strengthen institutional skill

levels especially in sales and marketing, service operations, risk management and the overall organizational performance ethic. The last, i.e., strengthening human capital will be the single biggest challenge. Old private sector banks also have the need to fundamentally strengthen skill levels. However, even more imperative is their need to examine their participation in the Indian banking sector and their ability to remain independent in the light of the discontinuities in the sector. New private banks could reach the next level of their growth in the Indian banking sector by continuing to innovate and develop differentiated business models to profitably serve segments like the rural/low income and affluent/HNI segments; actively adopting acquisitions as a means to grow and reaching the next level of performance in their service platforms. Attracting, developing and retaining more leadership capacity would be achieving this and would pose the biggest challenge. Foreign banks committed to making a play in India will need to adopt alternative approaches to win the “race for the customer” and build a value-creating customer franchise in advance of regulations potentially opening up post 2009. At the same time, they should stay in the game for potential acquisition opportunities as and when they appear in the near term. Maintaining a fundamentally long-term value-creation mindset will be their greatest challenge. The extent to which Indian policy makers and bank managements develop and execute such a clear and complementary agenda to tackle emerging discontinuities will lay the foundations for a high-performing sector in 2010.

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