Perception of Indian Banks in 2020

Banking the world over is undergoing a rapid and radical transformation, thanks to the all-pervasive influence of Information Technology, telecommunication and Electronic Data Processing. India is no exception. This article attempts to visualise the perception of banks in India in the year 2020, taking into account the initiatives taken in Liberalisation, Privatisation and Globalisation (LPG).

As the saying goes, change is the only certainty. And it is this change that would govern the banking industry, which is graduating from financial intermediary into risk intermediary. The repetitive and overlapping systems and procedures have given way to simple key-press technology, ensuring accuracy and speed of data flow to improve overall efficiency through Knowledge Management. The emerging Information Technology (IT) facilitates in utilising Knowledge Management effectively and efficiently to improve both product range and service quality in the banking sector.

Definitely by 2020, the vast and enormous differences in the ambience presently noticed between public sector banks and the new-generation private sector as well as foreign banks would be noticeably narrowed down. But the dominance of public sector banks, which accounts for nearly 80% share in the banking sector, is likely to reduce considerably by 2020.

Technology has played a vital role in the evolution of banking sector, through speed creation, accuracy and efficiency of operation and reduction in the transaction cost. Banking services are now oriented to "anyhow, anywhere, anytime and any type" banking. The regulatory requirements and compliance regime in post-Basel II scenario and Sarbanes-Oxley Act and Anti-money Laundering requirements, complicates the processing of voluminous data besides the process of their storage and retrieval in the desired form and at desired speed. Banks may have to move on to behaviour analysis approach for fine-tuning their products.

— R S Raghavan

(The author is a member of the Institute working as Chief Manager, Risk Management Department, at Vijaya Bank HO in Bangalore. He can be reached at rsraghavan007@yahoo.co.in)

Many financial institutions, particularly banks, may not survive in the new millennium because they are relying on late 1990s surveys to plan third-millennium products and services and thus they may land up with the wrong products, perhaps designed for consumers who no longer exist. Most people see the future as more of the same. Unless one can visualise tomorrow as history so as to perceive what may happen day after tomorrow, perhaps one cannot visualise what will happen a decade or so later. The likely key drivers in the banking industry are as follows:

CHANNELS

Instead of merely providing what the bank concerned could offer from its fold, banking may encompass extension of all the services that are required and dictated by customers. Clients should get services from the banks on a 24x7 basis on an online ATM connected to the network. Whosoever the banker may be, a customer should be able to access his or her bank account through a PC/laptop/mobile or an ATM around the corner. The time spent by the bank with customers would be reduced, thereby improving profitability through low operational cost that would ensure time saving for the customers, as a by-product.

A large branch network is generally considered to be the fountainhead of administrative problems. But with IT making inroads into the functioning of banks in the form of virtual banking, e-banking,

Internet banking etc., banks would be able to offer banking at customers' doorsteps. The new-generation banks started off with all branches fully networked and, in fact, some of them now operate with a fully centralised database that optimises costs compared to inter-connection of distributed database in widespread branches. Many banks, including PSU banks, would have online ATMs, phone banking, virtual banking, e-banking, Internet banking, etc. by 2020.

In the last five years, most large financial institutions, particularly banks, underestimated the likely role of the Internet in various spheres of business and administrative functions. There has been solid growth in the number of people going online, as well as in the value of financial services conducted, in the breadth of financial products traded and in the depth of relationships conducted using digital channels.

The next conspicuous mistake made by financial institutions is the failure to recognise the power of the digital economy to make a deeper transformation of corporate and wholesale finance. The digital economy has consistently caught financial institutions off-balance, lurching from one leg to another, each time trying to correct a previous mistake. Market research only tells us about today and reveals nothing about tomorrow.

We should not rely too much on market research and lose sight of the future. Fundamental changes were taking place in three areas. E-mail replaced fax and people began to expect near-instant answers. No one has time to go through a detailed note but prefers to have interactive presentations on PowerPoint. High-flying schedules of many executives resulted in laptops being the prime luggage of many frequent fliers.

Types of Online Banking

A common assumption is that Internet banking is the only method of online banking. However, this is not strictly the case, as several types of services are available:

- **PC Banking:** The forerunner to Internet banking, PC Banking has been around since the late 1980s and is still widely used today. Individual banks provide software, which is loaded on to an SME's office computer. SMEs can then access their bank accounts via a modem and telephone link to the bank. Access is not necessarily via the Internet.
- **Internet Banking:** Using a Web browser, any user can access his/her account, once the bank's application server has validated the user's identity.
- **Digital TV Banking:** Using standard digital reception equipment (set-top box and remote control), users can access their bank account. One of the main selling points is that no account details are transmitted via the Internet.
- **Text Phone Banking:** This service allows customers with cellphones to check their balance, pay bills and transfer money via SMS.

Internet banking can be classified into two distinct groups:

- Traditional banks use the Internet as an add-on service with which to give business access to their accounts.
- New Internet-only banks have no bricks-and-mortar presence and therefore have lower overheads, paving the way to offer higher rates of interest on deposits and lower charges on lending activities.

The features available from an online bank account are similar to those available via 'phone banking' or 'visiting the local branch'. Online banking features do differ from bank to bank, but one can typically do the following:

- Transfer funds between accounts;
- Pay bills;
- View balance and statements;
- Create, view and maintain Standing Orders; and
- View direct debits.

The use of online banking gives an SME power to control finances on a day-to-day basis. SMEs have the ability to transfer funds to a savings

account, maximise interest on this surplus, as well as move money back into the account to cover any shortfalls, and avoid paying any bank charges, so to say a sort of 'flexi-deposit account'.

The advantages of Internet banking include no queuing, no rushing to the bank before it closes, access to the account 24x7, 365 days a year, low bank charges, faster transmission of funds to settle transactions, and any time access to cash. All this results in better financial management.

The main disadvantages are those related to the fear of the unknown. There is some speculation that Internet-only banks will not be able to sustain their high interest rates. Internet-only banking is perceived to be instantaneous for, when a bill is paid, the expectation is that the transaction is complete with immediate effect. However, this is not the case, till the mechanism of Real Time Gross Settlement is fully put in place.

The majority of banks do not charge fees for Internet banking though there are some associated costs. One of the main concerns with online banking is that of security. Fraudulent and accidental security breaches may happen. Banks employ many systems and procedures in order to prevent these incidents. As a result they invest considerable time and money in developing systems that can prevent fraud and unauthorised access. If a security breach is discovered, the bank is liable for all money stolen and, as a result, insures against the possible loss.

The security used in online banking is a combination of technology and user authentication. The weakest link of online banking is user authentication. Typically, the user has to supply a set of answers to questions, which they have previously entered upon registration, as well as a username and password. The banks place the responsibility of keeping these answers secure with the user and if any of them is disclosed and money stolen, the liability lies solely with the account holder and not the bank.

The future of Online Banking

The continued use of online banking by SMEs and individuals will lead to the next generation of online banking. Banks will endeavour to improve existing services as well as introduce new ones.

Financial institutions are currently developing Short Messaging Service (SMS), Wireless Application Protocol (WAP) and third generation (3G) mobile telephony applications. Some banks are also developing kiosks, which will allow online access. Analysts predict that banks will have to drive services via these new channels to attract customers, and not leave it to the technology.

There are some issues that can be addressed with a simple and straightforward e-commerce solution:

1. Cash flow is difficult to manage as there is a large degree of uncertainty as to when their trade debtors would present cheques for payment. To control this, considerable time of senior management is spent in managing the account balance and uncleared cheques.
2. Interest charges due to cash flow uncertainty. There is often a delay of several days before funds can be released, restricting the working capital cycle further.

Tangible and proven benefits can encourage the use of e-commerce to automate other manual processes.

Consequent to Internet banking gaining momentum, online banking is slated to increase manifold, according to the Internet and Mobile Association of India (IAMAI). Currently an estimated 46 lakh Net users bank online, and this is estimated to touch 160 lakh by March 2008. Nearly half of the online banking service users are reported to be under 35 and are predominantly male (83%). Access to online banking is almost equally divided between office (48%) and home (42%).

The Future of Internet Banking

The banking industry is in the middle of the most fundamental change it has ever faced. Apart from the increasing change, convergence, globalisation and technological innovations in the financial services sector, changing customer

preferences and behaviours are signalling that new strategies to attract and maintain customers are gaining importance for players in the field.

Across the country, the present trend in private banking has seen consumers move from traditional branch banking to more standalone tech-savvy banking — in other words, a move towards using electronic delivery channels such as the Internet, telephone and mobile phones. At present, over 85% of the finished payment transactions are electronic. Moreover, consumers seem to long for more developed electronic delivery, meaning that lifecycles of all banking products/services should be offered via electronic channels. It is worth remembering that the traditional way of doing banking at the branch level has relatively little importance to electronic banking users.

PRODUCTS

Instead of banking through personal contacts established at the branch premises, banks would offer products through anywhere banking, ATM, the Internet and mobile phones, all enabled by vast electronic devices. These require less mobility on the part of the customer. In fact, banking functions can be called at the press of a few keys in your cellphone. Concepts such as Real Time Gross Settlement, Cheque Truncation and Electronic Funds Transfer enable quick movement of funds. It is unlikely that any significant delay takes place in transferring funds from one bank to another. Client money would move between institutions as fast as data — at the speed of light — with no exceptions. There is absolutely no good reason in the third millennium to settle for anything less.

Instant access to e-mail is essential in a world where late response can spell the difference between signing and losing a high-value contract deal. The trouble is that behaviour is changing faster than lead times for new products and services, and the gap is getting wider. That means market research will be even more useless for future-casting financial services in the next five years, than it has been over the last decade.

Time and again we see institutional blindness, compounded by dangerously misleading survey results. Account holders change their minds about online banking and purchases faster than market research can predict. As a result, non-banking competitors are racing ahead with a wide range of well-developed digital products and alliances. It means parallel planning and preparing for fast response to a variety of outcomes.

Reverse Mortgage

In normal mortgage finance, the equity portion increases with simultaneous reduction in loan component during the tenure of loan. This is the traditional method of financing against mortgage.

In the case of reverse mortgage, the mortgager can get lump sum or partially with annuity mechanism for a specified period and amount, and as time passes, the equity portion reduces as the loan component increases with future cash flows, thereby slowly and steadily reducing the equity portion of a customer to nil. Though it is associated with a banking retail product, we can expect similarly imaginative solutions for small-to-medium corporate banking needs over the next decade.

In the case of mortgage loan (housing loan), a mechanism may be devised by which a borrower can sign an authority to his/her broker permitting the broker to place the housing loan wherever the interest rates are the most favourable, on identical repayment and contractual terms, without further contact with the borrower.

SERVICES

In as much as elite customers identify banks to suit their requirement of services, banks may also be choosy about their customers. Large branch network, lack of adequate computerisation, mindset of the people, unwieldy customer base spread over large area, high processing cost, etc., are characteristics of present-day banking that would give way to totally electronic-based functioning mode. Hence, addressing all these issues would enable banks to go hi-tech. Giving value and adding value to customer requirements would ensure Economic Value Addition, which

ultimately would improve bottomlines.

Corporate Finance at a Mouse Click

Most corporate bankers still assume that the nature of their business will protect them from the most destructive effects of the digital revolution. They say that the client relationship is the most important thing, based on trust, and that this cannot be replaced by an electronic channel.

While this is certainly true in the short-to-medium term, the long-term future is far less certain. The lesson of history is that whatever starts to work on a smaller scale tends to have an impact later on larger financial arrangements. For small- to medium-sized businesses, it is already clear that online banking is going to alter the decisions they take.

CONSOLIDATION IN BANKS

Restrictions of operations of foreign banks in India, currently enjoying marginal share of less than 10%, are likely to go by 2009, paving way for many changes. We might expect greater breadth of products, depth in delivery channels and efficiency in operation, without losing focus on customer needs of Indian populace.

A consolidation exercise in the banking industry cannot be kept in cold storage, if we view it from the following angle:

a. Due to diversified operations and varying credit profiles of banks, merger and consolidation would serve as a risk mitigation or risk-sharing mechanism, besides increasing the potential for growth.

b. Owing to greater scale and size, consolidation can help save cost and improve efficiency.

c. Avenues can be explored for raising capital to meet international Basel II norms.

d. Distinct geographical presence could come together to leverage respective strengths.

PROJECTED INDICATORS OF BANKS IN INDIA IN 2020

Consequent to nationalisation in 1969 and economic liberalisation in 1991, banks in India are on fast-track growth in size, technology and deliverables to customers. In view of paradigm shift in banking focus, there cannot be any reasonable estimate of the financial figures that banks are slated to achieve. Nevertheless, an attempt has been made to translate the trend and expectations into financials on the following broad assumptions:

- The GDP growth rate is around 7 to 8 per cent per annum with good industrial growth in the manufacturing sector, which is expected to fuel higher need for bank credit — at the corporate, trade and individual levels.
- The country is graduating from a low-income regime to a middle-income one, with large expendable resources/money and disposable income.
- Increased percolation of technology applications from metro and urban centres to semi-urban and rural areas.
- There are many macro-level factors such as government policies dictated by political constraints, technology innovations, enhancements in human skill, increase in real-sector production, national income, etc.
- With international best practices in risk management penetrating into the Indian banking system, the system is growing into a mighty financial network with strong capital base and robust risk management system.
- Apart from competition from foreign banks, the Indian postal department is also exploiting its network and entering commercial banking operations.
- Growth in owned funds are in the range of 15% to 20%, annual credit deployment is about 12%, and fixed assets are going up by 5%.
- Owned funds of banks in India need to be strengthened as they embrace international best practices on risk management and

adopt the recommendations of Basel Committee on Banking Supervision (BCBS).

- Cost of funds and yield on advances hovers around 4.5% and 6.0% respectively, and other income stands at around 15%.

Based on the above assumptions and on the basis of trend analysis in the past, back-of-the-envelope calculations may reveal growth in select performance indicators, rounded off to the nearest thousand crores, as detailed in Table A, while extrapolating the data likely to be achieved by 2020.

Table A (Rs in cr.)				
Performance Indicators	**March 2005***	**March 2010**	**March 2015**	**March 2020**
Branches (nos)	70,324	73,000	75,000	76,500
Employees	8,50,000	7,50,000	6,50,000	5,75,000
Fixed Assets	22,161	32,000	40,000	50,000
Capital	25,183	1,00,000	4,00,000	12,00,000
Reserves	1,18,326	3,75,000	11,00,000	30,00,000
Owned Funds	1,43,509	4,75,000	15,00,000	42,00,000
Deposits	18,21,884	39,00,000	80,00,000	1,50,00,000
Advances	11,05,725	25,00,000	53,00,000	1,06,00,000
Investments	8,13,081	15,00,000	25,00,000	42,00,000
Interest Income	1,58,438	3,15,000	6,75,000	13,00,000
Other Income	34,831	85,000	2,00,000	4,00,000
Total Income	1,93,269	4,00,000	8,75,000	17,00,000
Interest Exp.	91,537	1,63,000	3,20,000	6,10,000
Est. Expenses	29,032	50,000	90,000	1,60,000
Operating Exp.	21,016	52,000	1,20,000	3,10,000
Total Expenses	1,71,949	3,45,000	7,00,000	13,50,000
Operating Profit	51,684	1,25,000	2,65,000	5,30,000
Net Profit	21,320	45,000	1,00,000	2,50,000
** Based on the Trend & Analysis report of RBI, as published by IBA*				

Conclusion

We may conclude that every aspect of banking will be transformed by new technology by 2020. Customer-friendly products, delivery channels, relationship banking, dependency on IT systems and competitive pricing would be the driving forces, but a pressure-cooker atmosphere cannot be avoided. The most successful institutions will be those that combine visionary technology and very competitive pricing with strong relationships and brands built on trust with previous in-depth experience of the client business.

Banks would have adopted the following strategies to move to high-tech banking as a necessity of e-commerce, e-banking, etc.

a. Identification of select branches from out of the entire spread of the branch network to provide innovative services.

b. In the scenario of severe competition and escalating expectation of the customers for newer products and improved as well as alternative delivery channels, the nerve centre of banking activities will be redefined.

c. The key to survival of banks, therefore, is retention of customer loyalty by providing

value-added services tailored to their needs, using state-of-the-art technology, instead of relying on outdated practices.

d. With the identified select number of branches for creating hi-tech banking, an ideal centralised solution can be considered. A countrywide network of computers could offer banking products to select corporate clients and high net worth individuals.

e. Needless to say, flawless security and seamless integration of operations through untiring efforts of employees and cohesive support from the management would be the key factors that will enable banks to make successful inroads into e-enabled 'New Age' banking.

f. Once the centralised topography is put in place, the infrastructure required for e-banking and e-commerce (with the necessary security) can be built to provide state-of-the-art innovative services.

g. Flexi-work atmosphere with banking officials working out of their homes, without the need to go to offices, may be put in place. Instead of intra-bank cross-country transfers, there may be inter-bank movement of senior officials in the public sector domain, if at all it remains so.

h. Allocation of capital for each product/service and also borrower-wise capital allocation, as far as credit, market and operational risks are concerned, through sophisticated risk management techniques.

i. All performance measurements shall be risk-adjusted, as Risk Adjusted Performance Measurement (RAPM) plays a key role in assessing the effectiveness. Risk-adjusted salary packages cannot be ruled out.

j. In the case of settlement in the retail segment, extensive usage of debit card by the public and acceptance by merchant establishments would replace cheque cutting habit of customer, as currency/paperless financial deals would dominate.

There is no way banks can remain lukewarm in their attitude and lackadaisical in their approach to hi-tech banking and yet hope to grow. It is clearly a choice of either survival or extinction, and that which survives would provide core commercial activity, instead of providing just financial services.

The Internet would be the engine of the banking revolution in the decade to come, and e-commerce its fuel. An April 2005 survey by the IAMAI indicates that the total value of e-business in India could grow from Rs 570 crore in 2004-2005 to Rs 2,300 crore by 2006-07. As e-commerce would involve banking facilities, one can imagine how much turnover would be put through the banking system.

Business to Business (B2B) involving business organisation as buyer and seller; Business to Consumer (B2C) involving physical retailing; Consumer to Consumer (C2C) involving consumer as seller and buyer; and Consumer to Business (C2B) involving customisation of business would all pave way for a radical change in the banking habits of the Indian consumer. E-commerce through client and server and M-commerce through Mobile Agent would fuel the change in banking requirements.

Companies need visionary leadership; mere management skills are not enough. What's the point of managing people and products well — but in the wrong direction? Visionaries in large organisations are often marginalised because by definition they are constantly challenging fundamental assumptions about the future. It is better to bring forth the vision, and infuse fresh and independent thinking. Quality people often need more than money to relocate themselves.

Nearly four decades ago, man landed on the moon. Within a decade and a half from now, perhaps man can avail of banking services there, if the exponential technology boom both in the art and science of banking can be taken as an indicator. ❐