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INDIAN BANKING SECTOR: ISSUES AND CHALLENGES

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ABSTRACT

Indian Banks are the platform of Indian economy. Banks are the lifeblood of the economy, acting as a catalyst to activate and sustain economic growth, particularly in developing nations such as India. It is critical that banks maintain their financial health. Otherwise, a country may face a financial crisis, resulting in a recession. The last decade has seen one of the most significant revolutions in financial institution culture and operations. The introduction of digital technology has opened the industry to new problems, rivals, and working methods. Banks in India are dealing with a variety of issues and challenges that have impacted their profitability and financial stability. The paper attempts to identify issues and challenges for the Indian banking system using secondary data.

Keywords: Financial institution, Economy, Indian Banking Sector, Challenges, Issues.

1. INTRODUCTION

The Indian banking and financial system have come a long way since its early days. As of 2022, the total assets across all banking sectors (public and private banking) crossed $trillion. India has one of the world's largest retail banking and financial services institutions – with 12 public sector banks 22 private banks, 46 foreign banks, 56 regional rural banks, 1485 urban cooperative banks, and 96000+ rural cooperative banks, along with other credit institutions. This is a long jump from its pre-independence or post-independence phases. Before we got independence, India had just 600 banks, with the Bank of Hindustan founded in 1770 in Calcutta being the very first established bank in the country.

Prominent among these is the Imperial Bank of India, which was formed by merging three existing banks in 1921. The Imperial Bank of India was nationalized in 1955 and became the State Bank of India, which is today the largest public sector bank in India.

Similarly, if we look at the post-independence scenario, the banking system in India focused majorly on providing financial services to the poor and rural populations, which largely depended on local money lenders for financial assistance. With this aim, the Government of India nationalized the banks under the Banking Regulation Act of 1949, and a total of 14 nationalized banks were present, including the Reserve Bank of India (RBI).

However, the most significant push to India's financial system came in 1991, when the government invited private players to invest in India. This led to the liberalization of the banking system in India and led to the formation of the top private banking institutions like HDFC Bank, Axis Bank, ICICI Bank, DCB, and IndusInd Bank. Going by this trend, the

future of financial services in India is on a solid growth trajectory, with India now surpassing the UK to become the 5th largest economy globally.
In recent years, the Indian financial system has expanded and deepened significantly. The increased prominences of the banking sector in the Indian economy, and increased competition have placed several pressures on our banks. The negative implications of a banking system failure might be more severe than in the past. As a result, the RBI, the regulator, and supervisor of the Indian banking industry are focusing on guaranteeing stronger financial stability. While operating in this extremely demanding environment, the banking system is vulnerable to a variety of challenges. The introduction of digital technology has opened the industry to new problems, rivals, and working methods. Banking technology has advanced significantly during the last two decades. The digital revolution has accelerated information transfer and payment processing, but it has also increased customer expectations. For consumers who use financial services, their expectations are rising as the quality of services improves owing to the rise of information technology and competition. Since foreign banks entered the Indian market, the number of services available has expanded, and banks have placed a greater focus on matching client expectations. This implies that banks face new problems every year in order to keep their procedures running smoothly and their customers satisfied.

2. OBJECTIVE

- To know the challenges in the banking sector of India.
- To know the issues related to the Indian banking sector.

3. RESEARCH METHODOLOGY

For the study, secondary data was used from different sources like websites, articles, research papers, etc.

ISSUES AND CHALLENGES OF THE INDIAN BANKING SECTOR

- **AUTHENTICATION AND SECURITY:** When a new technological solution is introduced, someone attempts to hack it. Despite the increased popularity of mobile banking, security breaches remain a major concern.
- **ASSET QUALITY:** The growth in bad loans poses the greatest threat to India's banks. The recent economic slump has resulted in an increase in bad loans or non-performing assets (NPAs). These are debts that the borrower does not repay. As a result, they constitute a loss for the bank.
- **BALANCE SHEET MANAGEMENT:** Many banks have attempted to postpone putting aside money as provisions in recent years (for future bad loans). One explanation for this is that bank CEOs has a short term during which they seek to increase net profits and cheer investors.
- **BRANCH BANKING:** Banks have always attempted to grow their branch network in order to increase their business. Foreign banks and new private sector banks have been permitted to develop their operations in various ways. Banks are looking into the potential benefits of adopting an agency structure and outsourcing channels. Banks should not lose sight of the heightened risks that outsourcing may involve when going in this direction. As a result, they must develop appropriate strategies and processes for dealing with this new risk.
- **COMPETITION:** With the Indian economy's globalization accelerating and the Indian banking sector is gradually opened to global competition, banks must prepare to compete in an increasingly competitive environment. This will need banks to upgrade their systems and procedures to international standards while also strengthening their financial standing.
- **CAPITAL ADEQUACY:** Setting money aside as a 'provision' is one method a bank tries to safeguard itself from poor loans. This money is not to be used for anything else, including loans. As a result, banks have less capital to utilize for their different operations. The Capital Adequacy Ratio assesses a bank's capital. When this lowers, the bank is forced to borrow money or lend using depositors' funds. This money, on the other hand, is riskier and more expensive than the bank's own capital.
- **CUSTOMER COMPLAINTS:** In view of competitive forces, rapidly changing lifestyles and values of customers who are now better informed, have a wide choice of banking and non-banking intermediaries to choose from, are becoming more demanding and their expectations in terms of products, delivery, and price are increasing, PSBs lacking in customer orientation are finding it difficult to even retain their highly valued customers, let alone attract new clients, particularly when the foregoing is the case.

- **CORPORATE GOVERNANCE:** Profit cannot be the only factor in making company decisions. It is a big difficulty for banks because goals and incentives may not be adequately balanced by the application of solid Corporate Governance standards. If internal imbalances are not quickly corrected, the correction may occur through external pressures, which may be painful and costly to all parties. As a result, the emphasis should be on improving and reinforcing the functioning of strong corporate governance principles.
- **CUSTOMER SUPPORT:** Banks are supposed to provide fair banking services to all groups of the community. Furthermore, consumers' interests are not always fully protected, and their complaints are not always adequately addressed by banks. Banks are supposed to promote greater financial inclusion in the country by establishing a process to ensure fair treatment of customers and effective resolution of customer concerns.
- **CUSTOMER DIVERSITY:** Another significant problem that PSBs confront is managing two ends of the financial service spectrum. PSBs, unlike their private-sector counterparts and international banks, have two sides: a commercial side and a non-commercial side, each with different strata. In a nation like India, where people's demands, standards, and ways of life vary greatly from area to region, banks are required to handle these inequalities across their whole footprint without neglecting or underperforming any of them.
- **CONSUMER EXPECTATIONS:** Nowadays, it is all about the client experience, and many banks are under pressure because they are not providing the kind of service that customers want, particularly in terms of technology. As mobile phone usage rises and younger consumers want more simplicity, the banking and financial industry must adapt.
- **EMPLOYEE AND TECHNOLOGY:** Employees at public-sector banks are retiring in greater numbers these days. As a result, younger employees are replacing older, more experienced personnel. This, however, occurs at the junior levels. As a result, at the intermediate and senior levels, there would be a virtual void. Furthermore, banks, particularly government-owned banks, must embrace technology in order to provide better goods. This will also aid in the efficiency of banks.
- **FINANCIAL TECHNOLOGY FIRMS:** Financial technology (FinTech) firms are often start-ups that use software to deliver financial services. The growing popularity of FinTech startups is upending established banking practices. This is a significant problem for conventional banks since they are unable to adapt rapidly to changes in technology, operations, culture, and other aspects of the sector.
- **IMPROVING MOBILE EXPERIENCE:** Consumers have become accustomed to the ability to perform practically anything from their phones. Banks that want to remain competitive must prioritize a simplified mobile experience, either by designing one in-house or contracting with a software vendor to design one for them. Most major banks already have customer applications, but many of them have limits and flaws that upset users. Those looking to grow their market share might do so by investing more in a high-quality mobile app with a wide feature set.
- **LOW PRODUCTIVITY:** Another formidable difficulty confronting the Indian banking sector is low productivity. Low productivity has resulted from a large surplus of personnel, a lack of positive work culture, and a lack of employee commitment to the business.
- **NEW REGULATION:** As technology advances in the banking business, new regulations are put in place to guarantee that innovation does not come at the expense of customer protection. These policies address a wide range of possible concerns, including data security and customer privacy. As these requirements become more complicated and far-reaching, banks will need to raise their compliance spending to stay up.
- **NON-BANKING FINANCIAL INSTITUTIONS:** When it comes to depositing mobilization, commercial banks have been up against severe competition from non-banking financial institutions such as mutual funds, home financing corporations, leasing, and investment firms. All these entities compete with commercial banks for public deposits and pay greater interest rates than commercial banks do.
- **PROFITABILITY:** The greatest difficulty that the Indian banking sector has faced in recent years is the strain on its profitability. The continuous expansion of the number of branches and manpower, the emphasis on social and rural banking, the maintenance of higher research ratios, the waiver of loans under ARDR type concessions, repayment default by large industrial corporate and other borrowers, and other factors all had a significant impact on the bank’s profitability.
- **QUALITATIVE CHANGES IN BANKING PARADIGMS:** The greatest problem that Indian banks face is instilling• change in the thoughts and attitudes of their personnel. As previously stated, bank personnel in India are increasingly skeptical and unmotivated, with a declining commitment to their jobs. They are unconcerned about their

production and Jack's cost concerns. Strong and aggressive trade unions that oppose any organizational change and an outmoded management strategy have also been hurdles to bank expansion.

- **RURAL COVERAGE:** A local bank in India, particularly state bank has high coverage and many branches in rural regions. But there is a lack of technological advancement. The services accessible in cities are not available to rural branches, which are required if banks are to compete today.
- **TECHNICAL ISSUES:** Indian banks have already begun computerized operations and have undergone several technical upgrades. Indian local banks have strong similar technology in metro cities, however, that cannot be supported and comparable by the entire network of smaller cities and village branches.

The Standing Committee on Finance (Chair: M. Veerappa Moily) submitted its report on the Banking Sector in India – Issues, Challenges and the Way Forward on August 31, 2018. Credit and deposit growth in banks have recently been slow. High volumes of non-performing assets (NPAs) in banks have eroded their capital base, and restricted their ability to lend. Key observations and recommendations of the Committee include:

4. RECOMMENDATIONS OF THE COMMITTEE INCLUDE

NPAS OF PUBLIC SECTOR BANKS: The Committee noted that the problem of high loan write-offs and NPAs, combined with low asset growth, is more severe for public sector banks (PSBs) than private banks. However, it stated that once most of the larger NPAs get resolved as per the Insolvency and Bankruptcy Code or other mechanisms, the situation will become better for PSBs. In this regard, the Committee observed that the present crisis is transient and should not warrant privatization of public sector banks.

LOWERING OF CAPITAL TO RISK-WEIGHTED ASSETS RATIO (CRAR) REQUIREMENT: The Committee noted that RBI's requirement of a minimum CRAR of 9%, to prevent banks from becoming highly leveraged, is 1% higher than the Basel III norms for internationally active banks. This is applicable to all PSBs, even though nine of them do not operate internationally. The Committee observed that such a high CRAR requirement is impractical for these banks, and a relaxation would (i) release capital of approximately Rs 5.34 lakh crore, (ii) grow loans and generate an additional Rs 50,000 crore of income annually, and (iii) avoid the need for capital infusion in these banks.

Banks under Prompt Corrective Action (PCA): The Committee observed that 11 PSBs have been placed under the PCA framework by the RBI based on factors such as capital inadequacy and high NPAs. These banks have restricted lending and deposit-taking capabilities as a result.

PERFORMANCE OF THE NATIONAL COMPANY LAW TRIBUNALS (NCLT): The Committee noted that resolution of larger NPAs under the Insolvency and Bankruptcy Code (IBC) have been taking much longer than the stipulated time period of 270 days. It recommended that NCLTs' resources be increased to enable them to dispose of such cases swiftly.

POWERS OF THE RBI IN CASE OF PSBS: The Committee noted that the RBI had stated that some powers available to the RBI under the Banking Regulation Act, 1949 are not available in the case of PSBs. These include: (i) removing and appointing Chairman and Managing Directors of banks, (ii) superseding the Board of Directors, and (iii) granting licenses.

INCENTIVES FOR PSB EMPLOYEES: The Committee recommended that higher remuneration be given to senior management of PSBs, as there exists a wide gap with their private sector counterparts. Further, an overlap should be provided between tenures of successive CEOs to facilitate smoother transition.

5. CONCLUSION

In this paper, we discuss various challenges like assets quality, authentication and security, branch banking, capital adequacy, competition, corporate governance, customer complaints, customer's diversity, consumer expectation, customer support, employee and technology, fintech firms, mobile experience, low productivity, regulations, profitability, rural coverage, technical issues, non-banking financial institution, banking paradigms, balance sheet management, etc. One bank product is comparable to another, and the processes are similar among banks with some minor differences, but the differentiation is ultimately made by people. A client will either suggest a bank because of the service they received or become the bank's worst ambassador because of the lack of care and concern shown to him/her. All actions taken by anyone in the bank at any given time should have just one goal in mind: to please the end, client. Like the hospitality and service industries, a bank needs quality products, transparent processes, and skilled and welcoming employees.

CONFLICT OF INTERESTS

None.

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