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New Generation bank setting trends in Indian Banking Industry

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Abstract

When the new generation private sector banks started operations in 1993, they had to compete against established players, some of whom had been in business for over a century. The market was dominated by the state-owned banks, which had strong branding as well as a widespread branch network stimulating for opening the foreign banks operating in India. While the foreign banks were not big in terms of the branch network, they had innovative products and a very customer focused approach to the business. The new generation **private sector banks** had to carve out a niche for themselves within this framework.

Thus the first decade was spent focusing on the corporate banking model. The second decade - post 2000 - saw them scaling up the retail banking and consumer lending businesses. Now questions are-

What impact have the **new banks** had? Today, they have a market share of 20 per cent in deposits and advances. This has been achieved in a growing market, indicating that private sector banks have successfully capitalized on the growth of the Indian economy. But more than acquiring market share, the real contribution of private sector banks has been to transform the way banking is done in India. In the late 1990s, there would have been maybe a few hundred ATMs. We take an example from private bank that at **ICICI Bank** decided to set up 2,000 ATMs in two years. In those days it seemed like a big innovation, but today, every bank has a large network of ATMs. The expansion of ATM networks has transformed customer experience. We went on to encompass Internet banking, phone banking and mobile banking.

The new banks developed the concept of direct selling agents who reached out to customers with credit products, taking loans to the customer's doorstep. Not only did the private sector banks expand in this manner, their example forced public sector banks to also adopt similar strategies. It can also be said that the new private sector banks in general, and ICICI Bank in particular, catalyzed India's economic growth. In the post-2000 period, India's growth was driven by the growth in consumption. It was not the industrial sector but the new services-led economy, the age demographics and rising incomes that fuelled growth. It was banks like ICICI or HDFC or CITI Bank or many others which made sure that housing loans and other kinds of loans were made available in hundreds of cities and towns in India. It is one thing to say that the demand existed, but what were also required were products and the distribution network to reach those products to the people. This was a major contribution of the new generation private sector banks. The Indian market is a growing market and to keep succeeding one has to explore the existing opportunities well. The banking sector is expected to grow at 2.5 to three times the country's GDP growth rate. For individual banks, a lot will depend on their underlying business strategy. The differentiator will be a bank's efficiency and innovation. How well it manages risk - and, therefore, profitability - will also be a key factor.

Key Statistics

According to the Reserve Bank of India (RBI)'s 'Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks', March 2013, Nationalized Banks accounted for 52.4 per cent of the aggregate deposits, while the State Bank of India (SBI) and its Associates accounted for 22 per cent. The share of New Private Sector Banks, Old Private Sector Banks, Foreign Banks, and Regional Rural Banks in aggregate deposits was 13.6 per cent, 5.1 per cent, 4 per cent and 2.9 per cent, respectively.

Nationalized Banks accounted for the highest share of 51 per cent in gross bank credit followed by State Bank of India and its Associates (22.7 per cent) and New Private Sector Banks (14 per cent). Foreign Banks, Old Private Sector Banks and Regional Rural Banks had shares of around 4.9 per cent, 5 per cent and 2.5 per cent, respectively.

Banks' credit (loan) growth increased to 18 per cent for the fortnight ended September 6, 2013, while deposits grew by 13.37 per cent showed the data by RBI. India's foreign exchange reserves increased to US$ 277.73 billion as of October 24, 2013.

Indian Banking Sector: Brief Introduction

India's Rs 77 trillion (US$ 1.25 trillion)-banking industry is the backbone to the economy. The sector emerged strong from global financial turmoil and proved its mettle when the developed economies were shaking. India's banking sector is on a high-growth trajectory with around 3.5 ATMs and less than seven bank branches per 100,000 people, according to a World Bank report. The statistics are going to improve in near future as the Government aims to have maximum financial inclusion in the country. Policymakers are making all the efforts to provide a facilitating policy framework and infrastructure support to ensure meaningful financial inclusion. Apart from that, financial institutions are collaborating with other service providers (in the fields of telecom, technology and consumer product providers) to create an enabling environment.

Online Banking

'Do-it-yourself' is the new banking norm. Just an access to high-speed internet and user-friendly smart-phone applications have made people shift to alternative channels of banking. Many banks have adopted new-age internet tools to reach out to their clients to facilitate easy and comfortable banking.

For instance, in **ING Vysya Bank**, 80 per cent of demand draft volumes generate through real time gross settlement (RTGS) and national electronic funds transfer **(NEFT)** while for HDFC Bank, 82 per cent of all transactions come from non-bank channels, with net banking and mobile banking accounting for 44 per cent of all transactions.

"Most online transactions are real-time and do not involve paper-based transactions, thus saving customer time. We are witnessing rapid customer adoption for net banking over and above their normal account related transactions. They are now viewing net banking as a single stop for all their banking requirements," said Tejas Maniar, Head, net banking, **HDFC Bank.**

Some banks like **ICICI Bank** have endeavored to take a step further and introduce social media-based banking apps. 'Pockets' by ICICI allows its customers to have the convenience of banking while they are on Face book.

Similarly, **Kotak Mahindra Bank** is working on online personal finance management tools, shopping cart and an e-relationship manager.

Bankers reveal that customers use their net-banking facility for non-account related matters like bills payment, viewing credit card statements, ticket booking etc.

For banks, online banking helps save costs too. The cost of doing a transaction at a teller counter ranges from Rs 40 to Rs 50 (US$ 0.65- 0.81) per transaction while in the case of net banking this lowers significantly to Rs 2 to Rs 3 (US$ 0.032-0.048) per transaction.

Recent Developments

- Private lender HDFC Bank is planning to launch 500 mini branches, to be handled by one to three people, across India by the end of FY14. The bank has added about 219 mini branches pan-India since 2012.
- The basic motive behind such a initiative by the bank is to take the formal banking experience to people in unbanked and under-banked areas. A mini branch, manned by one, two or three persons, offers the entire range of products and services including savings and current accounts, fixed deposits, recurring deposits, credit card, instant debit card and also ATM facility. Products such as two wheeler loan, tractor loan, commercial vehicle loan, agricultural and commodities loan among others are also offered.
- Saudi Arabia's National Commercial Bank is said to have signed Tata Consultancy Services (TCS) to make India's largest software exporter implement its core banking platform for the former. TCS offers a plethora of retail banking solutions under BANCS, a brand of core banking suite.
- National Commercial Bank intends to develop electronic services and provide technology-based banking solutions to its clients through this initiative.
- On the similar lines, ING Vysya Bank Ltd has appointed IBM and its 'Mobile First' banking solution for the development of its ING Vysya Mobile - a cost effective, secure and scalable mobile banking application. The new application will help the bank maximize its reach to untapped markets. Moreover, the advanced features will enhance bank's involvement with its clients, facilitating higher availability and convenience.

The Bank Race

People have roll Royce, A Bentley and a BMW in garage now they want a bank. It seem banking license is a passport for the Gen – next banker. The many industrialists The Birla, the TATA the Hamara Bajaj, The Anil Ambani recently interested to join a clutch of non banking finance companies of varying vintage and pedigree- Shriram Capital, LIC Home Finance, IDFC, L& T Finance, JM Financial, India Bulls, Religare, Edelweiss all are in the race for one. On 1st of the July 2013was the dead line to submit the applications for new banking licenses and total number of submission added up to 26; it is around number, but a few squares also think they fit in.

10 Licenses were green lighted in earlier 2 more in 2003 and of the first lot, 5 banks are still around- ICICI bank, IDBI Bank, Axis Bank, IndusInd Bank, ; plus an upgrade from an Urban cooperative bank, Development credit bank. Other could not keep up. From the second lot, both are at the crease- Kotak Mahindra Bank and Yes Bank. But what this survival rate of 58.53% does not tell that after 2 decades of existence, the share of new private banks in deposits and assets is barely 15.2% and 15.7%, respectively. What is surprise that despite o regulatory curb on growth, foreign banks or global private banks have not fared badly; 6.8%share of deposits and 7% of assets. Presently we have 1798 banks in India27 state run, 21 private,(7 new and 14old) 41 foreign bank. All these island of banks created a hope and they help to address the particular segment of consumer needs, but the experience is filed somehow. So can is it handful of new banks do what all those who make up the numbers could not by way of financial inclusion 66 years after independence.

We try to explain the banking opportunity we have. The success of some NBFCs is testimony ot it. The suitable example and understanding the Aditya Birla group has of Greater India through its various businesses is unpatrolled. We feel a new lot of private banks sign up for business and it will push existing banks to grid up their lions. The RBI entry norm of private banks for both the earlier rounds was just a page long and it runs into 20 pages now. Submitted drafts and clarifications are 237 pages. 127 pages clarifications, 34 individuals and entry had posted 443 enquiries which the RBI replied to. Uncharitable view as mentioned by expert that diligent response was aimed at keeping a lot many at bay, after all it is actually aware of the few wrong calls it made in the past.

These are the final applicants: -

- Aditya Birla Nuvo
- Bajaj Finance
- Bandhan Financial services
- Edelweiss Financial services
- IDFC
- IFCI
- India bull Housing finance
- India Post
- India info line
- NMACS Management services
- Janlaxmi financial services
- JM financial
- LIC housing finance
- L& T housing finance
- Magma finacorp
- Muthoot Finance
- Reliance capital
- Religre enterprise
- Shriram Capital
- Smart global Venture
- SREI Infrastructure Finance
- Tata Sons
- Tourism Financial corporation of India
- UAE Exchange of India
- Videocon Industries

For getting the bank license following are need as:-

- Applicant need to set up a wholly owned non operative financial holding company NOFHC that will hold stakes in the bank and all other financial vehicles.
- Require to have a sound track record of consecutive 10 years.
- Applicant must have to pass mint road cross checks with other regulators', enforcement and investigative agencies.
- Need to put up 500 crores capital.
- NOFHC will hold minimum 405 of paid up voting equity capital of the bank.

- After locking a 5years applicant will have to cut the NOFHC stakes to 15% for the first 5 years.
- Applicant bank will have the list within 3 years of operation.
- Bank cannot have an NRI shareholding of more than 40% for the first 5years.
- At least 50% of the Directors of NOFHC must be independent.
- Bank cannot avail of credit from the NOFHC of the bank.
- Applicant need to give a plan for financial inclusion in advance.
- Applicant need to open at least 25% of the branches in unbanked rural and remote areas population up to 9999.

A tough Transition

State run banks had 95% market share but were not responsive to fast changing India. The newbie's clean states, however, were soon filled with squiggles- they were manned by state run banks staffers and it was not really fresh blood. Loan doled out in haste piled up as dud assets as the mid 1990s high interest rate regime started to bite. This time too things many not be very different. After all there is no banking model in the world that is new in the strict sense of the world. But what unique about the current round of licenses is that the new banks may mostly be converts from NBFCS unlike 1993.

Many of the experts like group director of Shriram group suggested that the name of the game will be demonstrated expertise in financial inclusion, trusted brand equity across the country and healthy risk appetite. A huge untapped potential exist in the MSME space in urban and semi urban areas as well the retail space in rural are.

Another expert UAE exchange want to build on bottom of the pyramid plot as they need our biggest strength is working closely with remitters who send money in the Rs. 15000 - 18000 ranges. In the census 2011 only 59% household availed of bank services. It is due to our rural and low income populace – financial literacy. Certainty a moot point then is if it is within a bank remit to set right a societal dirge.

A price water houses cooper India view on reality check that we were successful as an NBFC because the business model was different but it does not automatically ensure success as a bank. So the customer friendliness of an NBFC will no longer be in play. It s one thing to service a trucker with a 180 days bad loan norm, and another when the limit is 90 days exceed. The desire among the NBFC for bank license is also partly triggered by report as given by Usha Throat, deputy Governor of RBI which may lead to shakeout among NBFC.

Thus, it make sense that for an NBFC to become a bank as that will give it cheap access to current and saving account – CASA. But the twist in the tale is that as individual components, the growth of current and saving accounts at the systematic level grew by minus 1.8% and 13.1% in 2011. To the extent, the share of the state run banks in deposits in the highest at the 55%, it goes to prove that having a large number of branches does not mean an ever-growing CASA. In the case of new banks, CASA can be built up only by offering higher rates to wean depositors.

Even if an NBFC get this far, it has to get it math right. The central bank has made it clear that an NBFC will have to convert into a bank right from the day one – to set funds aside for reserves – cash reserve ratio or CRR of 4% and statuary liquidity ratio, or SLR of 23%.It means that of every Rs. of 100 by way of deposits, Rs 27 will locked away.

This is scarce for NBFC as their fund sources are high cost fixed deposits or debenture compare to the bank which has access to cheap CASA. This is one of the reasons that Mahindra has withdrawn their application. The regulations require that CRR and SLR norm be applicable from inception, even through building of CASA will take some time for newly converted banks. This anomaly will impose an undue penalty on large assets financing NBFC suggested by Mahindra and Finance spokesman. While another one suggest that it could still work if a new bank to follow an NBFC assets profile of small ticket size – higher margin. **IndusInd bank** say that many people can continue to lend from NBFC than bank, and as when anyone morph in to the bank will have to come into the less margin. And thus, why should anybody can do?

Apart from the steep reserve requirement, there is the rule that 25% of the new banks branches have to be going in rural areas with population of 10000 and without existing banking services. It's no help if the central bank says that NBFC can convert its all branches in to bank branches. A branch in semi urban is rural area cost Rs 40-50 lakh per annum. A **Ratnaker bank** example is pays about Rs 1.6 crores for a 2000 sq. ft. branches zonal in New Delhi, Connaught place and similar branches in Mumbai pays in Parel Rs 2.00 crores. The 25% rural branches rules is to ensure that the country unbanked area are penetrated. But if anyone take the agricultural loan under the priority sector as a surrogate for financial inclusion it get worse. In report on the trend and progress of banking in India – 2011-12, RBI suggested that only one fourth of agricultural credit reach small and marginal farmer. Importantly, 13.6% of it was absorbed by corporate, partnership firms and an institution engages in agriculture. Banks lay safe and lend to the big fish in the priority pool. This tendency is explained by the fact that the agriculture loan will be accounted for 50% of the dud loan pile at the end of financial year.

Worse data on priority sector loan shows 16 of 26 state run banks failed to meet the target of 405. 15 state run banks did not meet the sub target for agriculture and 11 for the weaker sections. Among the private banks 6 could not meet the priority sector target of 40% and 13 for sub target in agriculture. As far loans to MSME, the balance is title in favor of the larger borrowers. As reported by banking statement only 21.1% was disbursed to micro manufacturing sectors with investment up to 5lakh and other micro service sectors up to 2 lakhs as against the prescribed target of 40 % that is very less.

Once in NBFC becomes Bank…..?

- It can accept current and saving bank deposits.
- It becomes part of the payment and settlement system.
- It can issue cheque drawn on it.
- It deposits will covered by the deposit insurance and credit guarantee corporation.
- On every Rs. 100 it had as an NBFC, it will have to lock up Rs. 27 in reserve.
- A loan will become a dud if not serviced in 90 days instead of 180 days as an NBFC.
- It will have to give 40% of its credit to the priority sector.
- It can borrow and lend in the call market.

India and new bank license

The bank will have to deal with the bigger headache; they will require to be capitalized at Rs 500 crores. The capital adequacy ratio is pegged at 9% a new bank can build a book of Rs 4500 crores none time of the leverage and then it has to bring a fresh funds. Rs 4500 crores are the kind of bulk a medium sized bank put on in its single quarter. The minimum capital of Rs 500 crores is good for the starter but it require Rs 5000 – 7000 crores in the short term to run the banks. Such numbers turn the idea of more banks to service the unbanked through inexpensive mean on its head. It's a pure baloney to say new banks will or can do or think something that we cannot do, resultantly, the cost of regulation is high.

Estimation by the RBI state run banks will need Rs 1.5lakhs crores in common equity to achieve full implementation of Basel- III norms by 20018 plus another Rs 2.75 lakh crores in non equity capital. For big private banks it will be Rs. 25000 crores and Rs 50000 crores, the higher capital mean inducing investors to accept a lower return on equity (RoE). The questions are- will investors wait? It takes 10 years to get an RoE of 10% for any private banks. Its better o put that kind of money in bank deposits rather than set a bank?

Many countries like- Australia, Canada, Germany France and the U.K. do not specifically bar industrial houses from setting a banks, but limit the voting rights and controlling position a shareholders can obtain. The U.K. allows industrial groups in banking- a Tesco bank is example. In the U.S. this is not allowed and the regulatory framework is designed to protect a bank from risk posed by the activities or conditions of the parents and the non banks arms to maintain a Chinese wall between banking and commerce. But the GM, GE, BMW, Volkswagen and Volvo own Industrial loan companies to support their global financial operations.

Said above are to bring us this questions that what is in it for big Desi corporate houses? Given that after lock in 5 years they will have to cut their stake to 15% within 12 years and that they can not avail this of credit from their banks. Truthfully, a new banks that harshness technology and understands rural India can deliver - in SME agriculture credit and retail banking. It may be admire for the kind of cross selling does but few will admit that there are ego to play by set such banks. The grapevine has it that many aspirants have already sounded out small banks for merger?

On a ceteris paribus a bank promote dby a large industrial group or an established NBFC will be able to foster financial inclusion. But this white paper had highlighted the pitfalls. A model tilting towards financial inclusion may not be able to provide commensurate return to banks to enable them to compete with others; cross subsidization with the gain is not possible. It will creates in un even playing field vis-a –a vis existing banks. In case a banks deviates from it's propose business model particularly of its earnings are low enough to threaten its viability, there may not be any regulatory remedy. The thrust on financial inclusion will thus be lost in such cases. The Rolls Royce the Bentley and the BMW may move out of the garage and think on – what about the banks?

To sum up

India has robust banking system – it ha s27 state owned banks 21 private banks and over 3 dozen foreign banks and these are the purely commercial banks. It also has regional rural banks and urban cooperative banks. Put all of them together we have over 1700 banks of various descriptions.

At the same time, India is also an unbanked country. Only about 60% of its population avails of banking services accordingly to the Census figure 2011.

The urban rich and middle class spoilt for choice when it in to banking services. The poor both urban and rural have little or no access for the formal banking system. The urban poor often do not avail of the banking services because of the documentation and cost involved. I remote rural area banking services are still not available. Some year ago, the Reserve bank of India tried to bridging the access problem by allowing banking correspondents. However, the experiment ha s shown mixed result and it is still in progress as we are doing.

Opinion varies on the best way to promote the financial inclusion. Some fee that the current numbers of banks in India is enough they just need to grow bigger and set up more branches in rural areas. Other fee that goal of financial inclusion will be better served by allowing new bank to be set up with the stipulation that they will have a certain percentage of branches in rural areas.

As the RBI gear up the grant new license a decade after last two licenses given out, 26 applications have thrown their hat in the ring. How many get license I is not certain. But the stiff conditions that the license will have to comply with all make it far tougher for new entrant to build business than the older private banks that got license in 1993- 2003. It need to be examine whether and how it's are beneficial for our country. In this context, India Economic policy and macroeconomics issues need to be examined correctly along with best business opportunity that we are thinking.

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