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CHANGING CONTOURS OF BANKING IN INDIA: EXPECTATIONS, OPPORTUNITIES AND CHALLENGES

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Abstract

Today, the banking and financial services sector is at a crossroads: Banks today are obliged to embrace digital technologies. Banking technology providers are the game changers now, leading the banking revolution from the front. Digital platforms do not have geographic barriers. The advancements in technology have made mobile and internet banking services the game changers.Through this paper a small attempt has been made to study the interplay of growing customer expectations in the future, the opportunities that banks can leverage and the challenges they are sure to face on this path. How technology is going to redraw the business horizon for banks, is discussed in this paper.

The paper is divided in four parts. The first part includes the introduction, the current scenario and the Indian Banking sector's achievements till date. The second part talks about the growing customer expectations as a by-product of advancement in technology and the third part talks about the opportunities and challenges ahead. The fourth part concludes the study, highlighting adoption of latest and dynamic technology, customer service, consumer protection and financial inclusion as the main factors that will determine a bank's survival.

Keywords: Banking Technology, Customer Needs, Trust, Security, Compliance, Regulation.

1. Introduction

The start of the Indian banking sector dates back to 1770, when the first bank was set up, the Bank of Hindustan. From then till now, banking in India has gone through three distinct phases: Phase 1: The early phase from 1770 to 1969, Phase 2: Nationalisation and prior to reforms 1969 to 1991, Phase 3: Post 1991, after the banking sector reforms. So, from traditional banking to nationalization, privatisation and the entry of foreign banks, the Indian Banking sector has always been in the midst of change. Over the past two decades, several disruptions have happened in the banking sector, brought in by digitalisation, changing consumer needs and rising expectations.

The major landmarks in the Indian banking industry are:
1949: Enactment of Banking Regulation Act
1955: Nationalisation of SBI
1959: Nationalisation of SBI subsidiaries
1961: Insurance Cover extended to deposits
1969: Nationalisation of 14 commercial banks
1971: Creation of Credit Guarantee Corporation
1975: Creation of Regional Rural Banks
1980: Nationalisation of Banks with deposits over Rs 200 crores

2. Current Scenario

i. Currently there are 12 public sector banks, 53 regional rural banks, 1,542 urban cooperative banks, 94,384 rural cooperative banks, 22 private sector banks and 46 foreign banks, in addition to cooperative credit institutions (FY17 data).
ii. Between FY 2007 to 2018, total lending grew at a CAGR of 10.94 per cent and total deposits over the same period grew at a CAGR of 11.66 per cent.
iii. As of September 2018, the total number of ATMs in India was around two lacs and this number is expected to double by 2021.
iv. At the end of Q2 FY19, total credit extended by commercial banks surged to US$ 1,299.39 billion and deposits grew to US$ 1,866.22 billion.
v. In the last decade, India has seen a good expansion in banks, both in the brick-and-mortar form as well as the electronic form of banking.
vi. India's digital disbursements have increased manifold. It was US$ 75 billion in FY18 and is estimated to reach US$ 1 trillion by FY2023.
vii. Demand for banking in the rural sector is expected to see a huge growth due to rising incomes. Several initiatives have been taken by the government for financial inclusion. As of September 2018, as part of financial inclusion initiative, the government has taken up several initiatives: the Jan DhanDarshak, a mobile app to help people locate financial services in India was launched. The India Post Payments Bank (IPPB)with branches across 650 districts, the RuPay debit card and the Pradhan Mantri Jan Dhan Yojana(PMJDY) scheme have also helped in financial inclusion and banking the poorest of the

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poor. Under the Financial Inclusion Fund by NABARD, 204,000 Point of Sale terminals have been sanctioned. In order to encourage use of debit cards, 1.25 million Point of Sale (PoS) terminals were added by 2017 end. 333.8 million bank accounts have been opened under Pradhan Mantri Jan Dhan Yojana (PMJDY) as on November 2018. [1] [2]

To sum up, the focus has shifted from class banking to mass banking and the government has initiated several steps towards this objective. However, though expansion and inclusion is a very important and relevant objective, in order to become truly global, the banking sector has to recognise the importance of the rise and the inevitability of technology. Rapid changes in technology make today's initiative obsolete tomorrow, thereby keeping the banking sector in the thick of action, having to innovate continuously or run the risk of obsolescence.

3. Changing Customer Expectations

In a study by Ganguli, S. and Roy, S. (2011), the paper studied the importance of service quality in technology-based banking services. Four dimensions were identified, namely, customer service, technology security, technology convenience, technology ease of use and reliability. A good experience in these parameters leads to customer satisfaction and loyalty.[3]

In a study by Luarn and Lin (2005) [4] and Gu, Lee, and Suh (2009), trust was found to be a key factor towards influencing the choice and usage of mobile banking.[5]

Jayanthi and Umarani found that nearly 90 per cent of the customers, who switch between internet and manual banking, prefer internet banking. The main reasons identified were the 24/7 convenience provided and good connectivity, which results in avoiding queues at the bank and saving precious time.[6]

In a research conducted by J. M. Nupur on E-Banking and Customer Satisfaction in Bangladesh, it was inferred that growth of Electronic banking in a developing country depends on several factors, prominent among them being good internet access, new features in online banking, spread of internet usage in the average household, trustworthy services to the customers, which will eventually veer them off manual system of banking.[7]

Even in the 1980s, there were predominantly only four products in banking: Fixed Deposits, Recurring Deposits, Current Account and Savings Account. If the customer needed a fifth product like, for example, a home loan, they would enquire about the rates offered in a few banks by approaching them physically and go for whichever was offering the lower rate. Now it is not so anymore. Customer expectation drives the business. A customer has a plethora of information at his fingertips. He comes for a product like a home loan after doing extensive research by browsing several websites, comparing rates, chatting on social media and so on, loaded with information even while entering the bank. So, banks have to be able to offer something more than the competitor. Customers want concise, capsule form information for quick, but informed decision-making. It is this value addition that can set them apart from competition. More points that will add value and make the customer close the deal –for example, in the case of home loan, information about the builder, track record of builder, information about the locality, availability of movers, information on schools and other facilities nearby, water supply and so on.

In a recent study by Citibankin the USA, 31 per cent of consumers use their mobile banking app more than any other — placing mobile banking behind only social media and weather for most frequented mobile destinations. According to the same study, 91 per cent of mobile banking users prefer accessing their app over going to a physical branch, and 68 per cent of the millennials believe that their physical wallet will eventually be rendered redundant by the smartphone. These trends and statistics will soon catch up in India too. [8]

A McKinsey survey of banks in 2017, in Europe, North America, and Asia Pacific reports 60 per cent of active banking customers use digital channels, both online and mobile, and 80 per cent of all customer touchpoints occur on digital channels, with the millennials leading the way. Despite that, the research uncovered that digital channels still represented a meager 25 per cent of sales. This data confirms that the human touch is still important in banking customer service, especially when it comes to complex products like mortgages or investments. Here, the customer would like expert advice. Following factors came out as most important to customers, in the survey- trust, simplicity, convenient locations and all the millennials most highly prize digital self-service through mobile and internet, in particular, digital payment.[9]

The message is clear, banks must provide stellar customer service, constantly improvising, using the most cutting-edge new technology, keeping in mind the oldest promise of a bank that is, trust, does not erode.

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4. Opportunities

India is in a unique position today, where 62.5% of her population is in the age group of 15-59 years. By 2036, 65% of the population will be in this range. This is also the age group that increasingly only prefers digital banking to the traditional brick and mortar form.

According to the RESERVE BANK OF INDIA's annual report for 2017-18, mobile banking services witnessed a growth of 92 per cent in volume. The number of registered customers rose by 54 per cent from March 2017 to March 2018.[10]

In a study conducted by Reeti Agarwal et al as early as 2009, it was found that e-banking is most popular and frequently used by people in the age group of 31-45 years. This augurs well with the current demographic opportunity that India presents. [11]

Yet another study by Xu and Gutiérrez, 2006 identified the primary success factors of e-banking as convenience, ease of use, universality and trust. [12]

The same factors have been reiterated in another study conducted by Wang et al, 2006, stressing their importance yet again. The study also found that perceived usefulness and self-service rank high on behavioural intentions of customers.[13]

Understanding how their customers conduct their banking can enable banks to offer improved products using their preferred channel. Omni channel is the future. Touchpoints have to be seamlessly connected. This is important because it has been found that clients who use four channels are more profitable than customers who use one.

Small fintech and large techfin companies are rapidly changing the rules of the game by developing technology-based solutions to improve customer experience across product lines. Continuous fintech innovation and new technologies such as block chain are disrupting the market. Banks have understood this and risen to the occasion. Over 50% of banks use at least one fintech firm. [14]

According to various consultancies, these new fintech companies could capture up to 30% of existing banks' revenues in the next 2-3 years. Failing to respond is not an option. Those banks that can leverage big data, advanced analytics and new technology to improve customer experience can build trust, loyalty and revenue.[15]

Optimization of costs-Cost reduction by leveraging intelligent automation and digitalisation reduces bank's operational costs.

Creation of customer needs: The millennials want more convenience, more service. The future of banking is only in being customer-centric; where the bank not only caters to the demands of the customer but can also identify and create a need. An example of this could be when the bank initiates an education deposit for the customer's child at the appropriate age, by providing value added services like advice on choice of institution, based on the customer's financial background, gets the customer's approval and starts the deposit, all at the click of a few buttons.

The full cycle of banking functions executed digitally – from customer on boarding, KYC processes, to product execution and customer relationship management would lead to customer delight. Also, credit scoring, advanced technological deployments like block chain, smart contracts, open application programming interfaces and artificial intelligence; all of it gives superior customer experience.

The RESERVE BANK OF INDIA, has formed a 'New frontiers' committee, which is looking at the possibility of having a Central bank digital currency. This technology, which requires extensive infrastructure, is still in the nascent stage, being discussed in various countries. However, today, advancement in technology has emboldened the banking industry to think on these lines.

5. The Challenge

In a paper on challenges and opportunities in e-banking by Angela kopoulos, G., Mihiotis, A (2011), on the popularity of e-banking in Greece, it was clear that banks offer e-banking services in order to remain competitive as also to take advantage of the benefits of reduction in cost. It identified that customers were relatively slower in responding to the rapid changes in technology. Security and data protection assurance was identified as another hurdle. [16]

Different technology issues like the choice of the right channel, effect of enhanced IT investment in ROI and its justification, security concerns, penetration of IT in rural areas, quick obsolescence of technology are identified as the main challenges.[17]

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Though standard banking services will increasingly be handled through automation, differentiated and more complex services will be expected by customers to be addressed through a personalised approach. [Sannes 2001] [18]. Therefore, in the transformation to e-banking, another challenge for banks is how to differentiate their banking services from other banks. [Wind 2001] [19]. Another way to beat the competition was identified as providing banking experience to customers, tailored to suit their individual needs.

A different angle came up in a study by [Southard and Siau 2004] [20] where differentiation from the competitor was sought to be achieved through showcasing corporate social causes undertaken, offering multilingual services when appropriate and displaying links to sites that address local needs. These factors were seen to directly provide business benefits and a competitive edge to banks.

Two broad types of security challenges remain the scepticism in the customer's mind and those are about content and channel security (Misra and Wickamasinghe, 2004) [21].

Therefore, every change is a challenge. In fact, change and challenge are symbiotic, one leads to the other. The financial system has always risen to the challenge of changing events. Each challenge led to a better system.

The reforms brought in after the global financial crisis included macro prudential supervision and Risk Based Supervision (RBS). These have gained importance with bankers, realising the need to bring regulation and supervision on par with international standards. RBS is a structured process aimed at identifying the most critical risk faced by each bank and allocating resources accordingly. RBS moves away from traditional rules-based compliance to Risk appetite and Risk tolerance and limits.

From all of the above, it can be deduced that the main challenges that lie before the Indian Banking industry can be classified as follows:

1. Response to customer needs– from physical interaction to digital engagement, customer service remains an expectation, an opportunity and a challenge.
2. Creation of new revenue streams-Open banking and use of APIs lead the way here. In Open platform banking, the bank will serve as a platform on top of which third party companies can build their own applications using bank's data.
3. Development of security and compliance systems – customer data is a predominant need, so enhanced security and advanced insights, these are the needs from a compliance as well as trust perspective.
4. Leveraging AI – This can help in customer analysis, thereby helping in positioning products and services. With automation, inefficiencies and errors can be reduced. With Distributed Ledger technology, transactions can be recorded, spread across multiple sites, countries, or institutions at the same time without a central administrator or centralized data storage. Any changes made to these are also copied and reflected to all participants within a matter of minutes. One practical use of this, for example, would be Know Your Customer update. Today, KYC is a MASSIVE job in the back office. Now, the customer no longer has to submit KYC every time for every service or product purchased. Settlements through distributed ledger will also be much easier and quicker.
5. New Asset Quality Review, not only to cover banks but also NBFCs must be conducted. Systemically important entities must be identified and regulated.
6. Changes to the Insolvency & Bankruptcy Code should be made to ensure that participants have incentives to be proactive problem solvers.
7. The two quality assurance pillars of the ecosystem, namely the statutory auditors' ecosystem and the credit rating ecosystem have failed the ecosystem in the recent times. Strict compliance measures and penalties for non-compliance must be prescribed and imposed when required, without clemency.
8. Robotic Process Automation – Its advantages span from reducing administrative cost by 50%, simplifying compliance by keeping complete history of automated processes, generating reports for auditing purposes and eliminating chances of human error.

So, all this technology is available. Regulatory part is being looked into. It is necessary to take up the challenge and emerge successful.

Regulatory reforms will bring with them, cost of compliance. In the year 2015, the Reserve Bank of India introduced the Asset Quality Ratio. After that, Non- Performing Assets increased from 4.3% in March 2015 to 9.3 % in March 2019. Prompt corrective action was taken by banks;however, lending was affected. Funds to NBFCs became more expensive. This, in turn, affected growth.

It is, however, certain that regulations will catch up in capital adequacy, consumer protection, payment system protection and cyber & cloud regulation. Financial Stability has become explicit or implicit objective for most central banks.

6. Conclusion

We can safely apply the motto 'Survival of the fittest' to the Banking sector today. It is only those banks that are willing and able to respond to ever-changing customer needs that are going to survive. The rest will be relegated to history. Customer service and consumer protection will continue to remain the central theme. Virtual will co-exist with brick & mortar banking. The focus has to be on local & inclusive banking, on building trust and solving for local needs. Focus has to be on leveraging credit for small businesses and to build innovative products to improve financial inclusion.

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