PARADIGM SHIFT IN BANKING

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The emerging scenario is challenging the concepts and definition of banking. In fact the winds of change are already being seen. From being a mere supplier of money for a large part of 20th century, the retail customer has emerged as an extremely profitable business segment for banks. Banking will no longer be confined to serving up traditional banking products. Now the offerings include a variety of mutual funds and insurance and savings products. Customer retentin and maximising shareholder value will be the two key drivers of the banking business in the near future. In the future paradigm of banking, a combination of synergistic mergers, ability to provide one-stop financial solutions and the ability to spread costs by leveraging on technology is what will determine the winners in banking battle.

The banking system in India has recorded spectacular progress since nationalisation, Simultaneously it has suffered serious decline in productivity and efficiency leading to erosion in profitability. Two major causes for the sorry state of affairs in nationalised banks have been directed investments and directed credit programmes. The approach of banks due to these programmes, has not been that of taking risks and doing business but merely following directions to meet the target. It seems that nationalisation has brought more than the fair share of ills to the system. A new approach, requiring a new mindset, therefore, is needed to overcome the impediments to the movement of strengthening the banking sector. Banking sector should not be confined to serving up traditional banking products if it has to emerge as strong pillar of financial system of the country.

Recommendations of the high-level committee headed by Narasimham in 1991, have brought important reforms in the banking system. The important among these have been introduction of new accounting and prudential norms relating to income recognition, provisioning and capital adequacy, deregulation of interest rates both for deposits and advances of the commercial banks, except for very small loans and asset-liability management. But a lot more is further required in the direction of strengthening the financial system.

Banking organisations should offer a variety of asset management, insurance and savings products distributed through multiple delivery

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channels. Customer retention and maximising shareholders value are the two key aspects (objectives) which will drive the banking business in the new millennium. Three important moves (which are in the beginning stage) synchronising with the future paradigm of banking are:

(i) Adoption of internet technology

(ii) Universal banking

(iii) Synergistic mergers.

ADOPTION OF INTERNET TECHNOLOGY

Knowledge riding on the back of technology will perhaps be the most significant change in near future. In the new millennium there will come into existence virtual banks, i.e. banks which do not have any physical brick and mortar branches but service all the requirements of their customers through alternative delivery channels like the Internet telephone, kiosks etc. These virtual banks having low operating costs will be able to provide products and services at lower costs and thus help to retain the customer. According to R. Ravi Mohan, managing director of the rating agency CRISIL. "There will be tremendous focus on technology, the speed of transactions will increase which in turn will drive up volumes". Moreover, the advent of Internet technology will help the banks to be more transparent and efficient.

Now-a-days the biggest challenge for the banks is not on assets side but in raising deposits. This is because the revival of popularity of mutual fund sector which has already commenced attracting the depositors with products and liquidity similar to banks coupled with better services. According to Aditya Puri, MD of HDFC bank, "You have to be anytime and anywhere on customer demand and he will keep on demanding more and also better services". Internet Banking is the effective way to achieve the objective of customer retention and satisfying their increasing demands. There are a variety of ways that the Internet is going to affect the paradigm of banking industry in the future. Windows based touch screen and web based PC Video conferencing which link customers to call centre offering facilities like opening accounts, loans investments etc. is one such trend. Application for loans, mortgages. IPO, secondary market investments are likely to become web based. TV Banking using set top boxes that provide access to the Internet will be another method of accessing banking services. Most interesting of these technologies could be modex enabled screen telephones that allow customers to down load electronic cash onto a smart card and deduct from their current accounts.

India has just about made the first transition from physical cash to anytime money and anywhere money. Various banks have introduced the facilities of credit cards and ATMs. This trend is more pronounced among private banks and foreign banks. Credit cards and ATMs are only the first step away from physical cash. The next major step will be the introduction of Internet banking which is likely to be the most important trend of future. Some private sector banks (like ICICI) are entering the realm of Internet banking while other foreign banks are ready to join the race.

UNIVERSAL BANKING

Another major paradism shift is likely to be in the move towards universal banking. Universal banking is a way to dismantle the barriers between the traditional dichotomies of financial services. In other words, the herald of universal banking is eulogised as harmonisation of the roles and operations of development financial institutions and banks.

By permitting FIs to foray into working capital financial compartments in the Indian financial system have been dismantled. Universal banking goes a step further. The subtle differences between activities like banking, industrial lending, investment banking and insurance will cease to exist and the trend will be towards one stop solutions by financial supermarkets with the introduction of universal banking. Thus, the advent of universal banking has shifted the accent from 'omnipresent banks' to 'omnipotence banks' having multifarious functions and selling many modern banking services.

Khan Committee is highly important in that it recommended the setting up of universal banks. Preference was given to FIs which could provide a whole range of corporate financial solutions under one roof which would include term lending, working capital finance, project advisory services as well as allied services like cash management etc. The Khan working group, in its report submitted in may 1998, also recommended the development of an enabling regulatory framework for this purpose. Initially, it suggested that DFIs may be permitted to have a banking subsidiary (with holding upto 100 percent. ICICI has emerged as the first FI in India which has made an attempt to convert itself into a true universal bank. And it has skilfully employed the mergers routs to reach this end. The merger of ITC classic finance provided ICICI with a huge deposits base in the East while the merger of Anagram Finance provided ICICI with a huge retail network in the West. ICICI Bank has already emerged as a leader among new private sector banks and most likely it will also be merged into ICICI making it the retail end of the value chain for ICICI.

SYNERGISTIC MERGERS

The mid-1990's saw the RBI opening the gates of competition by issuing private bank licences to new entrants. Inorder to compete with the new entrance effectively, Indian commercial banks need to posses matching financial muscle that is reflected in competitive size. A perception that the size of bank's branch network reflects its strength is not valid in these days of virtual banking with the ongoing revolution in information technology. A bank's size is really to be determined by the size of its balance-sheet. Mergers and acquisitions route provides a quick step forward to acquire a competitive size by offering opportunities to share synergies and reduce the cost of product development and delivery.

Mergers should not be forced mergers if they are to be successful. The past experience of merging New Bank of India with Punjab National Bank corroborates this idea. This example has shown that a marriage of unequals is eminently unsuccessful. Mergers in the banking sector should be driven by the concept of synergy. Synergies of merger mainly arise either from cost reduction through elimination of overlaps or through greater reach at more commercial costs. The recent merger between Times Bank and HDFC Bank can be called synergistic merger as it provides benefits in the form of improving return on assets. The success of strategic business acquisition move by HDFC banks has directed several Bank chief to follow the suit and speed up the consolidation moves.

Narasiham Committee has also

recommended that the emphasis of mergers (as a tool to strengthening banking sectors) should be on consensus rather than on market orientation. For instance, a bank with a lower capital base may merge with a bank with a larger capital base to shore up its capital adequacy. For a larger bank it makes sense to merge with a smaller bank if the small capital base of target bank ensures a high return on equity.

Expansion through mergers in near future, is inevitable keeping in view the upcoming trends. This is because of various reasons. Firstly, advent of technology has added a new dimensions to bank merger.

Information technology has a huge upfront cost in banks but over a period of time the benefits far outweigh the costs involved. Reliance on information technology helps banks to reduce the physical scale of their operations and spread costs of technology over a longer base through mergers. Secondly, with increased disintermediation and the revival to interest in mutual funds, the ability of the banks to expand through deposit route is going to be restricted. This leaves the banks with the option to expand through mergers. There exist, however, legal and social constrant to these moves at present but one can foresee that market compulsion will soon force their removal.

To conclude, Indian banking needs a new high. The emerging scenario indicates that efforts have been made and are being made to meet the challenges posed against banking sector. Strategic moves towards synergistic mergers, universal banks and adoption of Internet technology will go a long way to strengthen the banking sector. Inability to visualise these future trends on the part of Indian banks, will no doubt be catastrophic.