



## A study on challenges of banking sector

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### Abstract

The Bank sector is currently in a transition phase. On the one hand, the PSBs, which are the main stay of the Indian Banking system, are in the process of shedding their flab in terms of excessive manpower, excessive non-Performing Assets (NPAs) and excessive governmental equity, while on the other hand the private sector banks are consolidating themselves through mergers and acquisitions. PSBs, which currently account for more than 78 percent of total banking industry assets are saddled with NPAs (a mind-boggling Rs 830 billion in 2000), falling revenues from traditional sources, lack of modern technology and a massive workforce while the new private sector banks are forging ahead and rewriting the traditional banking business model by way of their sheer innovation and service. The private players however cannot match the PSB's great reach great size and access to low cost deposits. Therefore one of the means for them to combat the PSBs has been through the merger and acquisition (M& A) route. Over the last two years, the industry has witnessed several such instances. For instance, HDFC Bank's merger with Times Bank ICICI Bank's acquisition of ITC Classic, Anagram Finance and Bank of Madura. Centurion Bank, Indusind Bank, Bank of Punjab, Vysya Bank are said to be on the lookout.

**Keywords:** assets, banking, public, private, account, merger

### Introduction

Banking in India originated in the first decade of 18th century with The General Bank of India coming into existence in 1786. This was followed by Bank of Hindustan. Both these banks are now defunct. After this, the Indian government established three presidency banks in India. The first of three was the Bank of Bengal, which obtains charter in 1809, the other two presidency bank, viz., the Bank of Bombay and the Bank of Madras, were established in 1840 and 1843, respectively. The three presidency banks were subsequently amalgamated into the Imperial Bank of India (IBI) under the Imperial Bank of India Act, 1920 –which is now known as the State Bank of India.

A couple of decades later, foreign banks like Credit Lyonnais started their Calcutta operations in the 1850s. At that point of time, Calcutta was the most active trading port, mainly due to the trade of the British Empire, and due to which banking activity took roots there and prospered. The first fully Indian owned bank was the Allahabad Bank, which was established in 1865. By the 1900s, the market expanded with the establishment of banks such as Punjab National Bank, in 1895 in Lahore and Bank of India, in 1906, in Mumbai – both of which were founded under private ownership. The Reserve Bank of India formally took on the responsibility of regulating the Indian banking sector from 1935. After India's independence in 1947, the Reserve Bank was nationalized and given broader powers.

Indian banking is the lifeline of the nation and its people. Banking has helped in developing the vital sectors of the economy and usher in a new dawn of progress on the Indian horizon. The sector has translated the hopes and aspirations of

millions of people into reality. But to do so, it has had to control miles and miles of difficult terrain, suffer the indignities of foreign rule and the pangs of partition. Today, Indian banks can confidently compete with modern banks of the world. Before the 20th century, usury, or lending money at a high rate of interest, was widely prevalent in rural India. Entry of Joint stock banks and development of Cooperative movement have taken over a good deal of business from the hands of the Indian money lender, who although still exist, have lost his menacing teeth.

### Review of literature

LK Kulkarni (1979) <sup>[9]</sup> in his paper compared developmental responsibility and profitability of banks. He reviewed that one of the important reason for the decline of the profitability of banks in the developmental responsibility under taken by them. He suggested that carrying of developmental business could be possible as well as profitable only by reducing costs, improving systems and improving productivity.

Shannugam, RK. and Das, A. (2004) <sup>[97]</sup> Efficiency of Indian Commercial Banks during the Reform Period", the article contributes to the banking efficiency of banks by achieving regulated environment with interest rate and entry being controlled by Reserve Bank of India (RBI). However, during late 1980 plagued with poor profitability and high proportion of huge administrative expenditures. They estimated technical efficiency of 94 Indian commercial banks for the period 1992-1999 using stochastic frontier analysis. The study showed that large gaps to exist between actual and potential performances of observed banks.

Dr. S. Ganesan (2009) <sup>[115]</sup> in his article on "Deposit

mobilization and Lending Performance of Commercial Banks in India analyses the deposit Mobilization and Lending performance of Commercial Banks of different classifications in India. For the purpose of this analysis the Commercial Banks operating in India are classified as Public Sector Banks (PCBs), Private Sector Banks (PVTBs), and Foreign Commercial Banks (FCBs) operating in India. This study covers a period of 10 years from 1995-96 to 2005-05.

Kruskal –Wallis Test a non-parametric test has been used to compare the performance of commercial Banks of different classification in Deposit Mobilization and Lending activities. The result of Kruskal –Wallis Test indicates that there is a significant difference in the growth rates of deposits of various classifications of CBs. The significant difference in Performance of deposit Mobilization of various classifications of CBs is due to the best performance of PVTBs and the least performance of FCBs during the period under study. There is no significant difference in the growth rates of loans and advances of CBs of different classifications during the Period under study. The lending performance of PVTBs is to some extent better when compared with PCBs and FCBs during the period under study. In Deposit Mobilizations and lending Performance of CBs in India, the performance of PVTBs is better when compared to PCBs and FCB.

Patil. SK. (2014) <sup>[117]</sup> It has been the practice of the Government of India to consult the respective state government in the matter of establishment of the new RRBs, their location and their names. State governments are entitled to nominate two of its officials on the Board of Directors of the RRBs. It is through such nomination that the local aspirations of the people are made known to the RRBs. As the shareholder, the state government is also entitled to receive, within the stipulated period, the annual report and balance sheet of the RRB. Performance of the Regional Rural Banks in the Post-reforms period: As on March 31, 2012, all the 196 RRBs sponsored by 21 banks, had 14475 branches in 451 districts of 23 states.

### **Objectives of the study**

To know the prospective future of banking sector.

To offer findings suggestions and conclusion.

### **Challenges Facing by Banking Industry**

The bank marketing is than an approach to market the services profitability. It is a device to maintain commercial viability. The changing perception of bank marketing has made it social process. The significant properties of the holistic concept of management and marketing has made bank marketing a device to establish a balance between the commercial and social considerations, often considered to be the opposite of each other. A collaboration of two words banks and marketing thus focuses our attention on the following:

- Bank marketing is a managerial approach to survive in highly competitive
- Market as well as reliable service delivery to target customers.
- It is a social process to sub serve social interests.
- Impact of Service Quality on Bank Profitability.
- It is an art to make possible performance-orientation.
- It is a professionally tested skill to excel competition.

### **Bank Marketing Mix and Strategies**

The first task before the public sector commercial Banks is to formulate that. Bank marketing mix which suits the national socio-economic requirements. Some have 4 P's and some have 7 P's of marketing mix. The common four Ps of Marketing mix is as follows:-

#### **Product**

To be more specific the peripheral services need frequent innovations, since this would be helpful in excelling competition. The product portfolio designing is found significant to maintain the commercial viability of the public sector banks. The banks professionals need to assign due weight age to their physical properties. They are supposed to look smart active and attractive.

#### **Price**

Price is a critical and important factor of bank marketing mix due numerous players in the industry. Most consumers will only be prepared to invest their money in search of extraordinary or higher returns. They are ready to pay additional value if there is a perception of extra product value. This value maybe improved performance, function, services, reliability, promptness for problem solving and of course, higher rate of return

#### **Promotion**

Bank Marketing is actually is the marketing of reliability and faith of the people. It is the responsibility of the banking industry to take people in favor through Word of mouth publicity, reliability showing through long years of establishment and other services.

#### **Place**

The choice of where and when to make a product available will have significant impact on the customers. Customers often need to avail banking services fast for this they require the bank branches near to their official area or the place of easy access.

### **Impact of Service Quality on Bank Profitability**

In today's banking environment, banks' profitability levels have been compressed due to increased competition and spread reductions. Banks once relied upon products to make their profit margin in a highly regulated industry, and the customers basically were on the sidelines, but today banks are driven by customers who demand service quality (Stone, 1995). Parasuraman, Zeithaml and Berry (1988) observed that quality of service is very important in separating competing businesses in the retail sector as well as in banking. Banks seeking to maximize profitability have come to realize that good quality helps a bank obtain and keep customers and poor quality will cause customers to leave a bank. It is well and good to recognize this need for implementing the practice of service by all of its employees, but how to carry out the practice and convince the bank's employees of this need is another matter. Lewis (1993) found that service quality was one of the most effective means of establishing a competitive position and improving profit performance. To establish a competitive position, it was noted by Hall (1995) that banks

must measure and determine their level of service quality, if they desire to keep their customers and satisfy their needs. In addition, it should also be pointed out that the only means through which service can be measured is to ask the service recipients. Reinforcing this important research, there have been a large number of researchers who identify service quality as a primary means of providing a competitive advantage to banks, and according to Soteriou and Stavrinides (1997) the importance of service quality has been documented in numerous studies. They found that the advantage was readily identifiable through their research. In some specific studies in four U. S. banks, Morrall (1994) found that the implementation of service quality at First Chicago Bank, Compass Bank, Marquette Bancshares, Inc., and Wachovia Bank gave them a substantial advantage over their competitors. Once banks implemented service quality, their profitability was also noticeably improved.

#### **Art to make possible performance-orientation.**

**Determinants of Bank Performance** Determinants of firm performance are factors that influence or contribute to the success of any firm. A variety of factors ranging from the personal characteristics of the entrepreneur to the economic policy affect firm performance (Schutjens & Waver, 2000). The literature classifies the determinants of firm performance into two main streams; the economic variables that focus on the external factors such as industry growth, concentration, capital intensity, advertising intensity, market share and size and the organizational variables also considered as the internal factors include the decision making practices, communication flow, goal emphasis, HRM practices, leadership, group process and job conditions etc. (Hansen & Wernerfelt, 1989). Both type of variables influence firm profitability, however it is suggested that organizational factors are more effective than economic factors (Hansen & Wernerfelt 1989).

One of the organizational determinants of performance, the human resource practices refer to the organizational activities a firm employs to manage the pool of human capital and to ensure that it is aligned with the organizational goals (Schuler & Jackson, 1987). Compensation and training practices both are marginally related to motivation of operators. To firm performance, appraisal, compensation and selection are strong indicators if paired with the workers participation system. Explaining the relationship of HRM effectiveness and firm performance Huselid, Jackson, Schuler (1997) concluded that strategic HRM effectiveness was significantly associated with firm performance, but technical HRM effectiveness was not associated with it. Age of the firm shows the experience and relationships with customers, financial institutions, investors and suppliers that build goodwill so it influences the firm performance (Inmyxai & Takahashi, 2010). Older firms have more customer base showing large sales volume, more employees and capacity indicates the chances of better performance (Rosa, Carter, & Hamilton, 1996). It is conventionally perceived that the bigger the organization the more its profitability will be. Jim Lee (2009) argues that along with market share, absolute size plays a positive and dominant role as it is significantly correlated with firm profitability. Firm size is an indicator of firm survival and success as it can absorb more shocks than smaller firms. Larger firms enjoy the

benefits of economies of scale, have more access to resources and low cost of capital due to high volume (Mukhtar, 2002; Penrose, 1995). Organizational Structure in terms of ownership affects performance of firm in different dimensions. Highly concentrated and Govt. Owned enterprises as compared to family owned enterprises have more returns (Gursoy & Aydogan, 2002). Another determinant of firm performance which has been widely discussed in the literature during last three decades is market orientation. Simply, market oriented firm is one that focuses on customer needs, competitor's actions and coordination within the internal divisions of firm to be responsive. Market oriented business culture leads to improved business performance by focusing on customers (Slater and Narver, 2000). Market orientation is a significant predictor of innovation effects and is compiled from customer orientation, competitor orientation and inter-functional orientation (Bozic & Radas, 2005). Amirkhani and Fard, (2009) concluded that positive and significant relationship exists between market orientation and firm performance.

#### **Customer Orientation and Firm Performance**

McEachern and Warnaby (2005) define customer orientation as a component of market orientation that focuses on putting the customers at the centre of strategic focus. Cross, Brashear, Rigdon and Bellenger (2007), Ali and Bharadwaj (2010), and Chahal and Kumari (2011) emphasize the need for organizations to move from the level of studying customer segments to shaping separate offers, services and messages to individual customers. Hence such firms may need to collect information on each customer's past transactions, demographics, psychographics, and media and distribution preferences. And they would hope to achieve profitable growth through expenditures by building high customer lifetime value. They further assert that the ability of a company to deal with customers one at a time has become practical as a result of advances in factory customization, computers, the internet and database marketing software. Nakata and Zhu (2006) assert that customer orientation encompasses the analysis of customers' needs, and responsiveness of organization to such needs. But some salient questions have been raised concerning whether customer orientation actually translates to better performance, (Gera, 2011; Ang & Buttle 2006; Avnet & Higgins, 2006; Best, 2005; Anderson, 2003). Traditionally, the literature concerning the marketing concept has assumed that the implementation of the customer orientation would lead to superior organizational performance (Piercy, Harris, & Lane, 2002). And customer orientation is significantly important in enabling firms to understand the market place and develop appropriate product and service strategies to meet customer needs and requirements (Cross et. al., 2007 and Liu, Luo & Shi, 2003). Customer orientation is seen to provide a firm with a better understanding of its environment and customers, which ultimately lead to enhanced customer satisfaction. Empirical studies, offer results that suggest a positive relation between customer orientation and firm performance irrespective of the size. Slater and Narver (1994), Kirca, Jayachandran and Bearder (2005) and Chen and Lin (2011) opine that the logic for expecting a strong link between

customer orientation and performance is based on the concept of a sustainable competitive advantage and a number of researchers have examined the link between customer orientation and performance. Although several studies have supported an association between customer orientation and profitability, most of these studies were conducted in the US, Europe and Asia (Cross *et al.*, 2007; Martin & Grobac, 2003; Slater & Narver, 2000).

### **Competitor Orientation and Firm Performance**

Competitor-oriented firm is firm that regulates practices and activities used to influence the actions and reactions of competitors. In such a situation, company of competitor orientation spend their time on more important issues of the movements of competitors and the market and trying to find policies that can apply against them. Sometimes companies based on their strengths and weaknesses relative to competitors and an analysis of competing strategies are planned (Heiens Richard, 2000). When a business has competitor orientation, the management constantly re-evaluates the strengths and weaknesses of their competitors. This performance evaluation could include manufacturing productivity, pricing, delivery time, customer satisfaction, innovation, and employee retention and market share.

### **Inter-Functional Coordination and Firm Performance**

Inter-functional coordination refers to the degree of cooperation between the different functions/departments within the organization (Tay & Tay, 2007). It is the coordination of all the functions of the organization and operation of customer and market information in order to create value for the customer. Tse & *et al.* (2003) opine that Inter-functional coordination is dissemination of information about customers and competitors among all sections of staff and organizations in order to make a correct understanding of the needs and wishes of the customer and planning to overcome competition. They divided inter functional coordination to four parts: functional integration in strategy, information shared among functions, dissemination of information and coordination among all units towards creating value for the customer. Inter-functional coordination can therefore be seen as the harmonization of all internal functions and processes in a company. It consists of two parts, namely corporate culture and information coordination. Many authors, e.g. Slater & Narver (1995), Harris (1996), Lafferty & Hult (2001), identified inter-functional coordination as a barrier of the implementation of market orientation. The barriers connected with corporate culture are systematic, structural, procedural and communication ones. It is important not to have any weaknesses in a system, a structure, a procedure or a communication in a company. Thus other barriers as too high centralization, formalization or departmentalization can also appear. The second barrier of inter-functional coordination is connected with information coordination. It is important to gain information, analyze it and then use the results in the decision process in a company (Tomaskova, 2009). Inter-functional coordination is aimed at internal environment, however, the effects of inter-functional coordination are connected with internal, external and branch environment as well. According to Tomaskova & Kopf ova (2011)

management has high impact on inter-functional coordination and employees. Improving of management style leads to improving inter-functional coordination. Improvements in internal processes are visible during a short period. Employees can perceive changes very soon. Improvements in branch and external environment need more time.

### **Professionally tested skill to excel competition**

#### **Types of Banks**

- Commercial banks
- Accept deposits
- Fund business requirements
- Transfer funds
- Trustee services

#### **Investment banks**

- Underwriting securities, issuing instruments, broking and trading of government securities, bank and corporate debt securities.
- Research analysis and investment management.
- Corporate advisory services, mergers and acquisitions and corporate restructuring.
- Bridge finance.

#### **Competition in Commercial Banks**

- Reserve Bank of India plays a crucial role in the establishment of banks.
- Competitive nature of a bank is based on size of bank capital, size of deposits mobilized by banks.
- Trust on ability of banks to fulfil its deposit obligations
- Services offered by banks.

#### **Competition in Investment Banks**

Competitive nature of banks are based on

- Types of services offered by banks
- Flexibility of services provided
- Cost of services offered by the banks
- Reputation of the banks
- Confidence in the banks
- Number of clients handled by the banks

#### **Changes in Bank Operations**

New Players [Increased Competition]

New Regulation

[New Rules ]

New Technology [Change Knowledgeable in Efficiency Measure]

Customer [Change in Customer Loyalty]

New Services [ Shift in Structure]

Change in Mindset

[Increased Marketing]

Rebuilding Human Resources [Change in Skills]

New Customer Needs

[Utilizing New Opportunities]

#### **New Players**

- Business opportunities
- Earnings expectation
- Segmented players in the market
- Globalization of banking business

### **New Regulations**

- Changing economic prospects
- Changing Government outlook
- Changes in global banking business expectations
- Increased risks assumed by banks
- Need for assessing and reducing bank risks based on social expectations.

### **New Technology**

- Innovations in banking technology.
- Application of new systems and practices in technologies for the banking system.
- Unprecedented risks requiring technological Interventions.
- Need for improving customer relations and confidence.

### **Knowledgeable Customer**

- Customized banking practices.
- Increased transparency of bank services.
- Large number of bank participants in the market.
- Multiple services offered by banks.
- Scope for reducing banking costs.

### **New Services**

- Complex business practices in the production and service sectors.
- Increased reliance on banks as service providers.
- Innovation in banking practices.
- Need for banks to meet changing economic functions.

### **Changing Mindset**

- Customer relationships.
- Role of marketing practices.
- Need for promotion of banking business.
- Innovative methods of accessing and servicing Customers.

### **Change in Skills**

- Human resource potential.
- Change in human resource practices in banks.
- Need for coping with technological changes.
- Flexible structure of bank operations.
- Need for promoting the banks as market makers besides financial intermediaries.

### **Changed Customer Needs**

- Flexibility requirement of customer banking habits.
- Customization of banking services.
- Types of business ranging from family units, agencies, trusts and corporate houses.
- Changes in evaluation pattern of customers.

### **Managing Competition**

- Introduce new technology through additional investments by the banks to meet the efficiency requirements.
- Bring in efficiency of bank operations by reducing the cost structure and increasing income generation capacity.
- Increase customer base to increase the income possibility of banks and segmenting the customer services to support the bank operations.

### **Managing Competition**

- Improving the bank's processes and people performance

through adoption of advanced methods and systems.

- Enlarge banking operations through service based functions besides core banking functions.
- Introduce new banking products to meet the customer needs.
- Evaluate the risk structure of banking business and identify possible measures of risk management to improve bank performance.

### **Managing Competition**

#### **Optimal Competition**

- Measurement of market concentration.
- Proportion of total assets / deposits / sales by each Bank in the economy.

### **Findings of the study**

To evaluate the impact of liberalization on different banks, profitability is an important indicator of the performance.

An analysis of profitability of a bank provides an insight into its effectiveness in the utilization of funds and its managerial efficiency.

### **Suggestions and Conclusion**

It can be inferred that the banking sector reforms in India have transformed the Indian banking system from an unprofitable, inefficient and financially unsound system to a competitive system driven by forces. The reform period has experienced growth of public sector banks in an environment of operational flexibility. The increased competitiveness has led to improvement in the efficiency of the public banking system and private banking system.

Therefore it is being suggested that all the banks should implement all the recommendations of the first and second Narasimham committee in the true spirit and create the proper work culture to face the global competition efficiently. Time to time, the efficiency of reforms should be evaluated and any deficiency and misunderstanding should be removed. In view of various domestic as well as international developments, that have been taking place, it is extremely important to chalk out a path by reviewing reforms for third time for the efficient functioning of banking in the new millennium.

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