Background Paper – Indian Banking

16 November 2006

Executive Summary

The banking industry is one of the prominent indicators of the health of an economy. A bank's ability and freedom to borrow from other banks and lend to corporates has a great impact on the growth rate of the economy. Deregulation of US banks in the 1970s was followed by a drastic change in US banking – banks became larger and better diversified. Soon banks of other developed nations also began to operate in more competitive markets. Developing countries also followed suit in the last decade of the 20th century.

Similar to the US, the Indian banking industry too has undergone several changes since the initiation of financial sector reforms in 1992. Deposits and credit have grown at a fast pace driven by the booming economy, increasing disposable income and increased corporate activity; credit penetration has increased significantly though it remains way below the numbers in developed markets; and foreign banks have set the trend in product and service innovation

The future of Indian banking looks quite exciting with

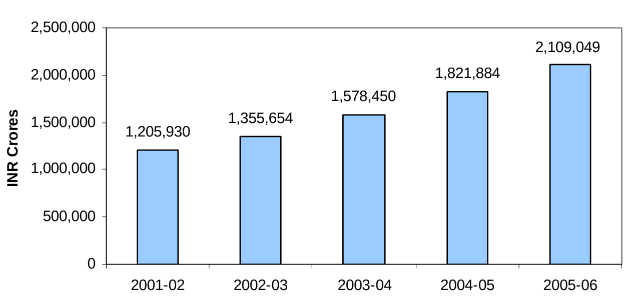
- Competition intensifying which would lead to consolidation, though foreign banks are likely to jump into the fray only by 2009
- New regulations pertaining to corporate governance and BASEL II coming into effect which would make the banking infrastructure more robust and transparent
- Technology being adopted aggressively by banks to make processes efficient and cost-effective, provide services 24X7 and analyse customer data to offer products and services tailor-made to suit their tastes new segments emerging which would enable banks to tap into new markets and offer new products and services product and service innovation by banks (both foreign and Indian), offering the customer greater choice

Background Paper – Indian Banking

Indian Banking – An Overview

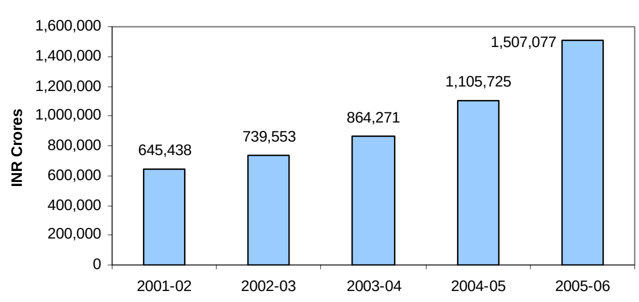
Post-liberalisation, the banking industry in India has grown at a fast pace. Increased economic activity coupled with de-regulation has further strengthened the position of Indian banks. By the end of March 2006, the total deposits held by the scheduled commercial banks stood at INR 21 lakh crores, a growth of 15.8 percent over 2005 and a compound annual growth rate (CAGR) of 14.9 percent since 2001-02. Moreover, the growth has not been restricted to any specific sector, all sectors (public sector, private sector and foreign) have shown good growth. The total loans and advances offered by commercial banks grew by 36 percent between March 2005 and March 2006 to reach INR 15 lakh crores, recording a CAGR of 23.6 percent since 2001-02.

Figure 1: Total Deposits



Source: RBI

Figure 2:Total Loans and Advances



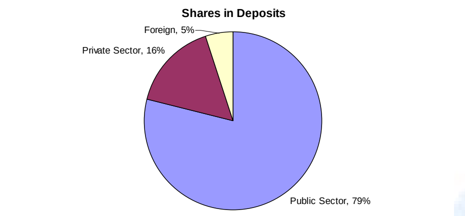
Source: RBI

By the end of fiscal year 2005-06, there were 26 public sector banks (including seven associates of the State Bank of India), 29 private sector banks (21 old and 8 new private banks) and 30 foreign banks as Scheduled Commercial Banks (SCBs) in India. As more foreign banks and aggressive new private banks are looking towards increasing their footprints in an already crowded Indian banking industry, the competition for nationalised banks is likely to escalate.

In fact, some of the private banks, such as ICICI Bank and HDFC Bank, have already been successful in leveraging new technologies and aggressive marketing strategies to emerge as leading banks in India.

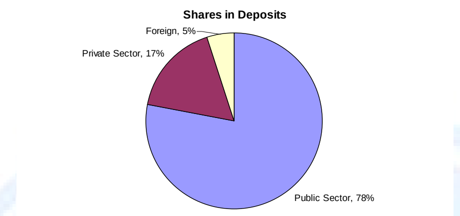
Though their share in total deposits has remained almost constant over the last three years, foreign banks are making their presence felt by delivering high quality services and innovative products using the latest technologies. On the other hand, private banks have been more aggressive in opening up new branches and installing ATMs. Their share in total deposits increased from 16 percent in 2004 to 20 percent in 2006. This has been at the expense of public sector banks. (Figures 3, 4 & 5)

Figure 3: Shares in Deposits (2004)



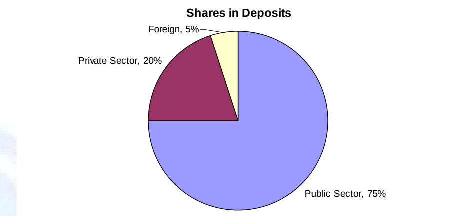
Source: RBI

Figure 4: Shares in Deposits (2005)



Source: RBI

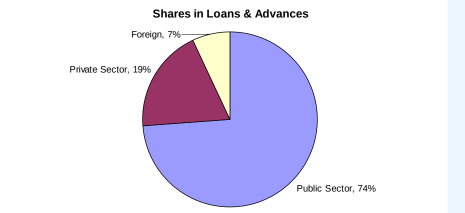
Figure 5:Shares in Deposits (2006)



Source: RBI

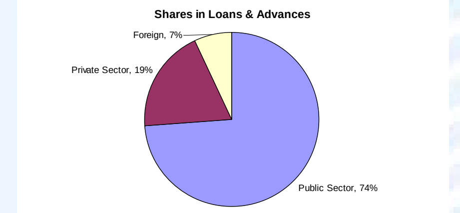
The share of the various banks in loans and advances has been almost constant with all the banks growing at almost the same rate as the total pie.(Figures 6, 7 & 8)

Figure 6: Shares in Loans (2004)



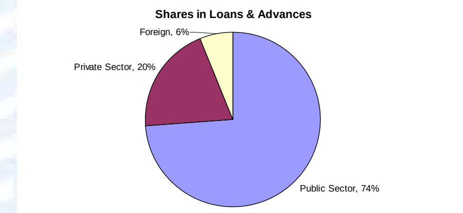
Source: RBI

Figure 7: Shares in Loans (2005)



Source: RBI

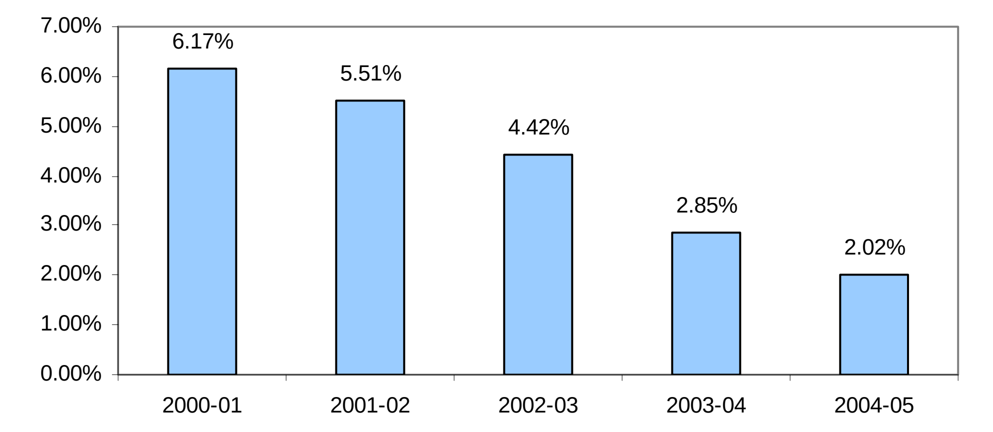
Figure 8: Shares in Loans (2006)



Source: RBI

Banks have witnessed a significant decline in NPAs over the last few years (Figure 9). This trend is visible for almost all categories of banks. This is primarily due to the stringent lending norms implemented by banks and their better knowledge of Indian customers. Moreover, the RBI has been tightening norms in line with the best international practices in recent years.

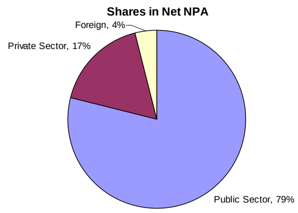
Figure 9: Trends in Net NPAs



Source: RBI

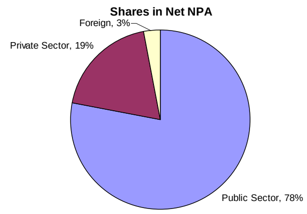
Figures 10, 11 and 12 show that the shares of the various banks have remained almost constant, the decrease in the size of the total pie notwithstanding.

Figure 10: Shares in Net NPAs (2004)



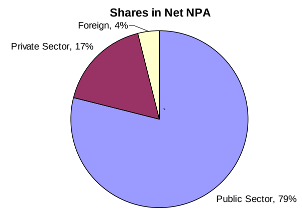
Source: RBI

Figure 11: Shares in Net NPAs (2005)



Source: RBI

Figure 11: Shares in Net NPAs (2006)



Source: RBI

Regulatory Framework

Corporate Governance

Over a period of time, the importance of corporate governance in different industries has increased manifold. Owners, small or big, want to know everything about the company they have invested in. The emergence of corporate governance in the banking industry reflects changes in monetary policy, regulatory environment and structure. Though it is important for all industries, the significance of corporate governance in the banking industry is higher as it is directly in the business of managing and growing citizen's savings, and offering them finances. These have a direct impact on the country's financial health.

The Reserve Bank of India (RBI) is the central bank and lays down guidelines for all Indian banks. It is gradually liberalising the industry, giving more freedom to banks to make decisions; however, the process is long and it will be quite some time before all the changes are implemented. Old nationalised banks in India occupy a dominant position in the nation's financial system, and are extremely important engines of economic growth. They are important sources of finance for a majority of firms looking to leverage the growing economy and making inroads into the growing markets, not only in India, but foreign countries as well. Moreover, they provide general modes of payments and act as the main depository for the economy's savings.

Keeping this in light it becomes imperative for governing bodies to put in place standardised corporate governance practices for the banking industry. This will ascertain that there is information symmetry between internal and external stakeholders, making banking operations more transparent. The government in India plays the role of the inspecting body by appointing members to the Boards of nationalised banks, giving them some autonomy to act in the interests of all stakeholders, which forms the basis of corporate governance. This makes Indian banks heavily regulated, giving them less space to compete with independent foreign banks.

Strong corporate governance guidelines are necessary for Indian banks to get their act together and face the challenges that are arising out of deregulation and liberalisation. It will enable addressing the problem of concentrated shareholding in Indian banks, particularly in private banks. Ownership concentration has led to a moral hazard as owners of banks sometimes develop unsavoury linkages with the business. The failure of Global Trust Bank, Lord Krishna Bank, etc., emphasises the importance of such guidelines.

Basel II

The banking community of leading economies released the Basel Capital Accord in 1988. It is a commitment by regulatory authorities within the G-10 countries to specify a minimum capital requirement for banks, which was later implemented by countries outside the G-10 as well. Basel II deals with risk management policies of banks, guiding them by the Three Pillars Approach that has been briefly explained below.

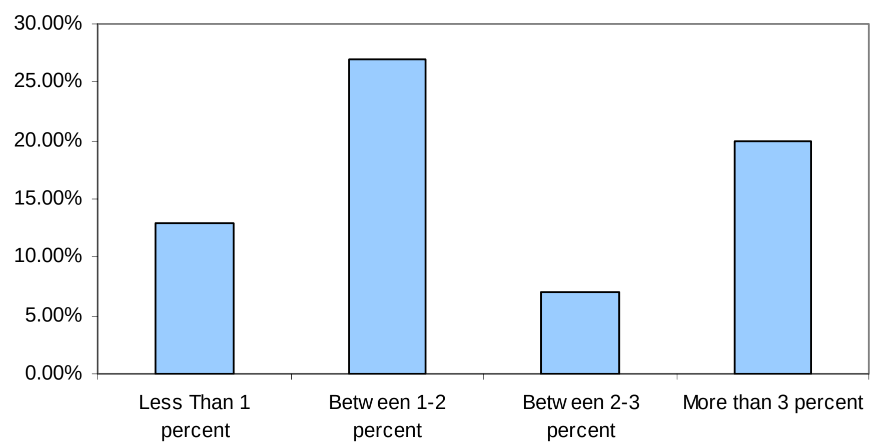
- Pillar 1 lays down guidelines to align the minimum capital requirements of the bank with the bank's actual risk of economic loss.
- Pillar 2 lays down guidelines for supervisors to evaluate the activities and risk profiles of individual banks and ascertain whether banks should maintain more than minimum capital requirement as specified in Pillar 1 and also whether they should take suitable remedial actions, if required.

- Pillar 3 describes 'Market Discipline' to encourage prudential management practices by banks and bring in transparency in banks' public reporting to shareholders and customers.

For the Indian banking industry, it is a challenge to meet the 31 March 2007 deadline for implementing the required capital adequacy norms according to Basel II. There are some issues that need to be addressed before India enters the implementation stage of Basel II norms.

- **Technological Challenge:** Approximately 54 percent of the banks are technologically equipped to face the future challenges posed by the Basel II norms. They have core banking solutions in place. Leading private (predominantly new private banks) and foreign banks have built their technological infrastructure keeping the basics of networking of bank branches in place. However, legacy nationalised banks are still in the process of computerising and networking their branches.
- **Additional Capital Requirement:** Banks need to have Management Information Systems (MIS) in order to comply with Basel II Market Discipline requirements, which mean additional capital investment. According to a survey conducted by FICCI covering banks in India, the incremental capital required for complying with Basel norms vary from less than 1 percent to more than 3 percent.

Figure 13: Capital Increment During Implementation Stage



Source: FICCI

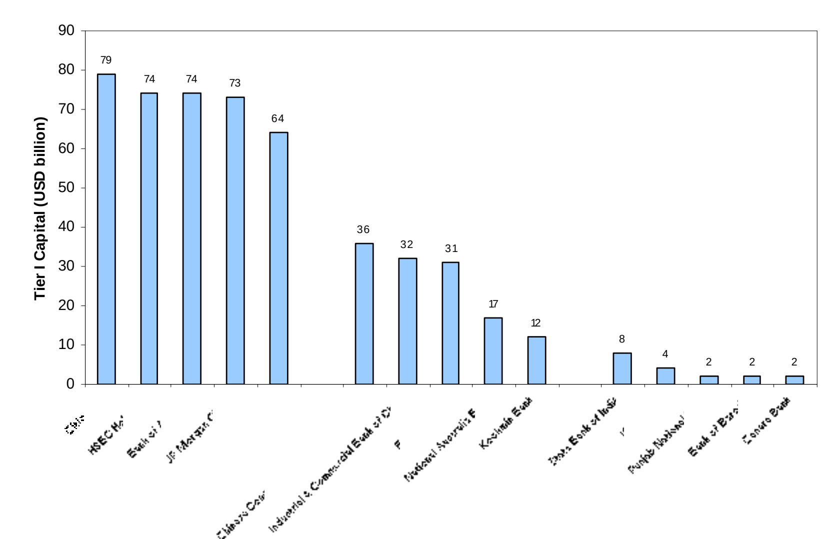
- **Uniform Implementation of Norms:** In February 2005, the RBI released a document "Draft Guidelines for Implementation of the New Capital Adequacy Framework", according to which the Capital Accord is applicable only to scheduled commercial banks. This may lead to charging higher price for banking activities by SCBs and the ultimate shift of customers to institutions providing cheaper services.

The Road Ahead

Consolidation in the Indian Banking Industry

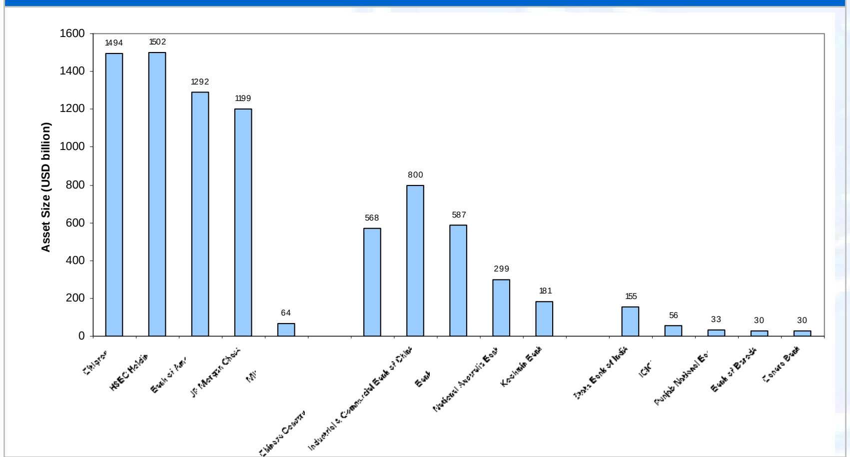
Indian banks are smaller in size and scale, compared to their international counterparts. This can be gauged from the fact that India's largest bank, SBI, stands 72nd among the top 1000 banks in the world (according to a list published by "The Banker" in 2006) and its Tier I capital is roughly 1/10th the size of the world's biggest bank, Citigroup. Moreover, SBI does not find a place in the top ten banks even in Asia. On the contrary, there are six Chinese banks that feature in the list of the top 25 banks in Asia. Only two Indian Banks, SBI and ICICI, are among the top 25 Asian Banks. Figure 13 shows the comparison of the top 5 Indian banks with the top 5 banks in the world and the top 5 banks in Asia according to their Tier I capital in 2005. Figure 14 shows the comparison of the top 5 Indian banks with the top 5 banks in the world and top 5 banks in Asia according to their asset size in 2005.

Figure 14: Comparison of Banks according to Tier I capital



Source: The Banker, Indiafact

Figure 15: Comparison of Banks according to Asset size (2005)



Source: The Banker, Indiafact

The lack of size and scale acts as a major inhibitor to the Indian banks competing against the foreign banks. Currently, the banking sector is very strictly regulated, limiting the growth of foreign banks in India. Indian banks require approval from RBI for expanding overseas. These measures have shielded the Indian banks from competing with foreign banks. With India strongly pushing for liberalisation and globalisation, this situation is bound to change. The RBI has proposed opening the banking sector and providing a level playing field to foreign and national banks in 2009. This has spurred the Indian banks to consolidate to achieve size and scale comparable to foreign banks. Further, the pressure on capital structure to meet prudential capital adequacy norms as prescribed by Basel II necessitates the need for consolidation in the banking industry.

CBoP's acquisition of LKB

Centurion Bank of Punjab (CBoP) is currently in the process of acquiring Lord Krishna Bank (LKB) with the boards of both the banks approving the merger.

The Centurion Bank of Punjab (CBoP) came into existence on 1 October 2005 with the merger of Centurion Bank and the Bank of Punjab. The Bank of Punjab (BoP) was about the same size as Centurion Bank with Centurion Bank having deposits of INR 3530 crores and total loan disbursements of INR 2194 crores while the same figures for BoP were INR 4137 crores and INR 2228 crores, respectively. Centurion Bank was present mainly in Western India, while BoP was present mainly in northern India. Further, both were new generation banks with no trade unions and both used core banking systems. These factors made BoP a perfect fit for Centurion Bank. The results of the merged entity, CBoP, have been excellent. Net profits have gone up from INR 23.27 crores in October-December 2005 to INR 28.7 crores in April-June 2006. Net NPA's are down and capital adequacy ratio has improved.

LKB, though a smaller bank than CBoP (its merger will add only 20 percent to the balance sheet of CBoP), has several advantages.

- It has 124 branches in South India where CBoP currently draws a blank. The merger will give CBoP an opportunity to have a pan-India presence.
- Half of LKB's branches are in Kerala, but they account for only a quarter of its business which indicates their underutilisation.
- Both CBoP and LKB are community-based banks and the experience of the management in successfully integrating the Centurion Bank and the Bank of Punjab can prove to be useful in this.
- Both banks use core banking systems.

LKB has a large NRI business in Kerala, which can be used by CBoP by using its Bank of Muscat's ties.

However, certain problems do surface such as opposition of trade unions and higher cost of funds of LKB.

Besides achieving scale and size, consolidation can reduce the cost of operations through economies of scale, for example, the effective use of manpower and offering multiple products using the same infrastructure. The larger banks are in a better position to manage credit risk by spreading it across geographies and multiple product range. The bigger entities are also in a better position to attract customers and provide diversified products to the customers.

Mergers and acquisitions in the banking industry is a global phenomenon. The mergers have sometimes been triggered by a crisis in the economy and the financial sector, for example, Indonesia witnessed large-scale infusion of public funds into the banking system through a specialised restructuring agency. Consolidation among banks was actively encouraged and the FDI limit was up to 99 percent. Post restructuring, the banks are now healthier and their branch network and coverage has increased significantly. However, the mergers are also aimed at creating banking behemoths which can take on any competition. For example, the merger of the Bank of Madura with ICICI Bank and the reverse merger of ICICI with the ICICI bank are voluntary efforts by banks to consolidate and grow.

Table 1: List of mergers in Indian Banking Industry

Serial No.	Banks/Entities Merged		Time of Merger
1	United Western Bank	IDBI Bank	September 2006
2	Lord Krishna Bank	Centurion Bank	August 2006
3	Ganesh Bank of Kurundwad	The Federal Bank	January 2006
4	IDBI Bank	IDBI Limited	April 2006
5	Bank of Punjab	Centurion Bank	June 2005
6	Global Trust Bank	Oriental Bank of Commerce	July 2004
7	Nedungadi Bank	Bank of Punjab	December 2002
8	Benares State Bank	Bank of Baroda	June 2002

Serial No.	Banks/Entities Merged		Time of Merger
9	Bank of Madura	ICICI Bank	March 2001
10	ICICI Limited	ICICI Bank	January 2000
11	Times Bank	HDFC Bank	December 1999
12	Sikkim Bank	Union Bank	December 1999
13	Bareilly Corporation Bank	Bank of Baroda	June 1999

Source: Rediff.com

Several reports like the Narasimhan Committee one on financial sector reforms and the Tarapore Committee one on Capital Account Convertibility (CAC) have favoured consolidation of the banking industry in India. The merger of banks in India will, however, face several impediments due to the difference in technology platforms used, the lack of proper infrastructure and electronic connectivity, etc. HR issues could also prove to be a major impediment. Political will and guidelines of the RBI will be important factors which will determine the success of consolidation of Indian banking.

Product Innovation and Emerging Segments

Banks in India have now moved on from offering traditional banking products, such as savings accounts, current accounts, term deposits, cash credits, term loans, etc., to innovative products wherein they offer different services in collaboration with organisations in other industries. A few examples are as follows:

- ABN-Amro Bank offers “Café in a Bank” service, where customers and also non-customers can come to the branch after office hours for banking and also to learn about new products. Barista Coffee Company has set up cafés in the branches and serves coffee to these walk-in customers.
- “Flexi Finance” is a personal credit card offered by HSBC that enables customers to get overdraft facility to the limit of five times their monthly salary, which can be drawn on as and when required.
- The State Bank of India (SBI) offers the ’Super Suraksha’ scheme. It is a group insurance programme for account holders in SBI.
- ICICI bank’s ’Mutual Fund Sweep Account’ enables the current account holders of the bank to invest their short-term funds into liquid mutual funds.

Besides innovative products, banks are also giving importance to emerging business segments.

Private Banking

Private banking is seen as a major growth area in the Indian banking industry. HSBC and HDFC Bank are the biggest players in private banking in India.

The following factors are driving the emergence of Private Banking as a lucrative segment:

- The number of High Net-worth Individuals (HNIs), i.e., individuals with financial assets of INR 4.5 crore and above1) in India is increasing. There has been a spurt in the number of millionaires in India over the last decade with the number of HNIs growing by 19.3 percent in the year 2005 to 83,000 compared to 2004.
- The spread of HNIs in different cities is increasing. Emerging as major outsourcing destinations for a wide range of services, many cities in India have witnessed an increase in per capita income in the last few years. With more and more foreign companies setting up their bases in India or outsourcing their work to India, experienced individuals in these industries have seen a rise in their pay packages. In addition, private entrepreneurship in India has also been on the upswing with more SMEs being set up. These have led to an increase in the number of HNIs in Tier II and III cities in India.
- Private Banking clients are offered a holistic package which includes advisory services such as advice on taxation and legal issues. These require expertise. Today banks are well equipped to handle such services as

[1] As defined by Merrill Lynch and Cap Gemini in their report” 2005 World Wealth Report”

they have professionals with the requisite expertise in different domains. Many banks such as ABN AMRO have a separate Private Banking Division in order to provide a strategic focus to this segment.

- Investment options are also increasing. With the Indian economy growing at a healthy rate over the last few years, the capital markets have been on a roll and have been providing very high returns. Related financial products such as Mutual Funds and unit-linked insurance products are also providing significantly high returns. Besides these, there are other investment options which have opened up. As a result, there has been a rise in the amount invested by HNIs in these instruments.

Rural banking

Out of the total 67,897 bank branches in the country (in 2002), 32,443 or 47.7 percent were in rural India. However, a big market still remains untapped – in 2002, 58 percent of the rural households did not have a bank account, more than 70 percent of marginal farmers had no deposit account and 87 percent had no formal credit. With 70 percent of the Indian population depending on agriculture for their livelihood and the rural population accounting for 72.2 percent of total Indian population, one can imagine the potential of rural banking. The facts mentioned below clearly bring out the potential of rural banking in India:

- The amount of deposits in rural India was only 14 percent of the total deposits of the system in 2002 (INR 159,423 crores out of INR 1,123,393 crores).
- There were 2.51 crore rural advance accounts in the year 2002, which formed 44.5 percent of the total accounts. However, the share of rural areas in the total credit portfolio was only 14 percent (INR 92,789 crore out of INR 655,993 crore). The situation improved marginally in 2005. Rural credit accounted for 15 percent of total bank credit in the year 2005. Out of a total lending of INR 1,124,300 crores, INR 160,479 crores were lent to rural India.
- Overall, 18 percent of the rural population had bank accounts in 2002. The corresponding figure for urban India was 103 percent.
- The per capita deposit in rural areas stood at INR 2,150 or around 10 percent of the national per capita income in 2001. On the other hand, in urban India, it was INR 33,780 or around 160 percent of per capita GDP.
- The credit per person in rural India was INR 900, i.e., 4 percent of the national per capita GDP, compared to INR 20,600 for urban centres, i.e., 100 percent of national per capita GDP in 2001.
- The number of credit accounts in rural areas relative to the total rural population is only 3.4 percent against around 10 percent in urban areas.

When it comes to financing (lending), the figures are biased against the rural population, due to a number of factors – the cost of funding to rural areas is higher, the credit risk of customers is higher and banks do not the have the requisite credit infrastructure to lend to rural India.

However, the situation is changing now. Banks are coming up with innovative products, such as Internet kiosks in local languages, ATMs, etc. to penetrate the rural segment. They are looking for different routes to enter the market. Some banks are working in partnership with other institutions such as non-government organisations and Micro-Finance Institutions (MFIs) to penetrate the segment. ICICI Bank is using this partnership model by developing two products – buying out existing portfolios of the MFIs and offering loans.

Banking at the Bottom of the Pyramid

"You ought to have a commercial justification for doing a business," K.V. Kamath, ICICI Bank's chief executive, said in an interview. **"You ought to then be able to scale it up."**

At a time when MNC banks such as HSBC and Citibank were focussing on the emerging "consuming class" of India, which accounts for 50 million households, local banks such as ICICI bank were picking up in 'banking services deprived' rural India. ICICI Bank understands the scope of rural banking in India and made rural banking a separate division.

ICICI Bank started its journey in rural banking by tapping rural India with innovative new business models and technologies. The bank serves clients who are too remotely situated to have access to basic amenities. It uses chip-embedded cards that can verify a depositor's identity offline by storing their thumbprint (rural population in India largely being illiterate). It understands the fact that it can sell its products to rural Indians if it could position banking services and products as consumer products. Extending this concept, the bank sells personal accident insurance at its rural branches for USD 2 (approx INR 90) a year. The payout is close to USD 2,200 (INR 100,000) in case of death and USD 1,100 (INR 50,000) in case of debilitating injury.

The company employs cheap, customised, India-made software to reduce back-office costs and facilitate the process of small transactions. Rural kiosks are another addition to ICICI Bank's achievement in rural banking. The bank trains the locals on the functioning of the kiosks which are connected to the Internet. It used this channel to sell its products.

Innovations don't end here. The company is offering farmers rainfall insurance wherein it pays the farmer if it does not rain. The premiums are affordable for small farmland owners. It varies from 2.5 percent of the payout for 30 days of coverage, to 8-12 percent for coverage for the period of three to four months. It also offers farmers with bridge loans which give them the option of selling the last season's harvest when prices are most lucrative and simultaneously buying the seeds for next season. It offers such loans at 9-11 percent per year compared to 2 percent per month lent by local moneylenders.

This is just the first step. However, ICICI Bank is well on its way in becoming one of the largest players in rural banking.

International Banking

Increasing competition in India, over-dependence on the Indian market and the lucrative NRI market overseas are compelling Indian banks to look outside India to expand. Indian banks have taken up both organic and inorganic routes to establish their presence in international markets. These initiatives help the banks to cater to the NRI population besides getting international accounts.

The State Bank of India (SBI) acquired banks in Mauritius, Indonesia and Kenya last year and is working towards acquiring a small or medium-sized bank in Bangladesh. It is also planning to start its operations in Singapore soon.

The Bank of Baroda has 39 overseas branches in 20 countries. The bank has set up an International Merchant Banking Cell at its international division for arranging funds from international markets for Indian corporates. European countries such as the UK have a large NRI population, who remit large amounts to India; the bank tapped this market. Its online international money transfer scheme for NRIs and loan syndication services has been highly successful in the UK.

The ICICI Bank set up the International Banking Group (IBG) in 2002 to implement a focussed strategy for its international banking business. The bank is currently present in 14 locations worldwide and has subsidiaries in the United Kingdom, Canada and Russia, and branches in Singapore, Bahrain, Hong Kong, Sri Lanka and Dubai. It has representative offices in several other countries. ICICI offers the facility of transferring funds to ICICI bank accounts in India in an efficient and cost-effective manner. The bank has more than 0.4 million NRI customers and has substantially increased its market share in inward remittances into India. In Canada, the bank has grown beyond the NRI segment and is emerging as a recognised brand in the local financial services segment. The importance of the IBG in ICICI's scheme of things can be gauged from the performance in the quarter ended 30 September 2006. The loan portfolio of its international branches increased by 56 percent to INR 15,000 crores in the quarter ended 30 September 2006 compared to the same period last year and the loan portfolio of its international banking subsidiaries increased 129 percent to INR 9,400 crores in the same period. The bank's remittance volumes grew 74 percent in H1 2007 over H1 2006.

Post 2009 scenario

In 2006, the RBI presented a roadmap for foreign banks in India. It paves the way for opening up of the banking sector to foreign players by providing them with a level playing field with national and private banks. The roadmap is divided into two phases: the first phase between March 2005 and March 2009, and second phase post march 2009. Table 2 summarises the roadmap and various changes which will take place over the course of three to four years.

Table 2: Roadmap to Opening up the Banking sector post-2009

Announced Reforms	Prior to March 2005	2005-2009	2009 Thereafter
Structure of foreign bank presence in India	Branches Only	Branches or wholly-owned subsidiaries	Full national treatment, including IPO, subject to 26 % of paid-in capital being held by resident Indians
Aggregate foreign direct investment limit in private banks	49%	74% for banks identified as distressed by RBI	74%
Foreign voting rights limit	10%	Proposed amendment to allow voting rights to reflect ownership level	
Branching limit per year	12	12 subject to RBI approval	
UNCHANGED			
Five percent foreign investment limit in private banks by individual foreign banks.			
Ten percent foreign investment limit in private banks by foreign institutional investors or individual corporate entities.			
			Source: Asian Focus,2005

The roadmap is bound to improve the efficiency of state-owned banks and ensure growth of competitive services and products in the banking industry. This will also lead to consolidation of public and private sector banks.

Technology

Technology plays an important role in every industry. In order to improve their top line and reduce operational costs, leaders in an industry are always looking to employ the latest technology and increase efficiency and productivity. The banking industry is no exception. Different countries are in different phases of technology adoption and implementation. Japan has a complete wired transfer set-up, wherein all payments are made using inter-bank network without using physical currency. The Euro region in Europe has an Automated Clearing House (ACH) set-up for making payments, and efforts are being made to add more countries in the network. The use of technology in banking operations helps to reduce the cost of operations, introduce anywhere-anytime banking for customers, facilitate provision of multiple distribution channels for banking products, and improve the overall efficiency. Foreign banks in India are streets ahead of their competitors when it comes to technology adoption. As more foreign banks and new private banks are entering the industry, they are introducing innovative technology in India.

Core Banking Solutions

Efficient and 24X7 banking entails automated systems which are capable of maintaining and updating the transaction details of accounts in real-time. This requires huge infrastructure in the form of large database servers, leased lines, VSATs, radio-links, ISDN, etc., networked with various distribution channels across India. The integration of various banking solutions across channels of distribution is known as core banking. Core banking solutions consist of all those elements which go into enabling a bank to offer centralised banking services and enable the bank management to get a real-time view of the business. These systems have a general ledger as the accounting backbone and various surround infrastructure services, such as interest and charges, interfaces to payment systems and various channels like ATMs. These systems handle all customer account transactions and close each account on a daily basis. For example, ICICI has implemented Finacle, the universal banking solution from Infosys as its core banking platform, which integrates multiple applications such as credit cards, mutual funds, brokerage, call centre and data warehousing systems.

Multiple Distribution Channels

The increasing use of technology has enabled banks to put in place multiple distribution channels which include the following:

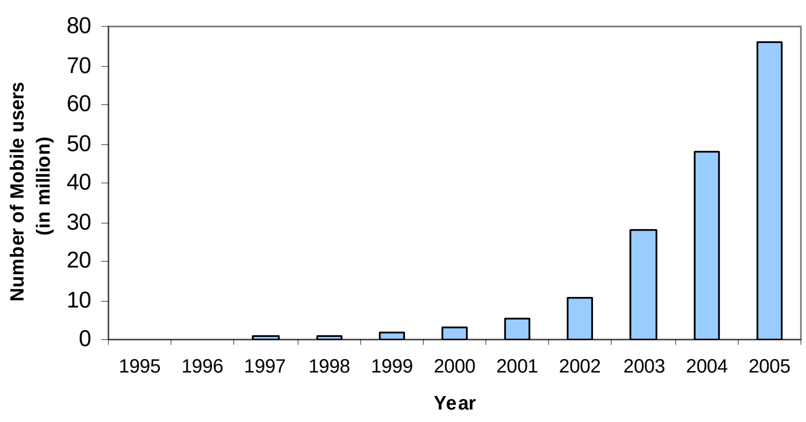
- **ATMs:** The advent of ATMs in India has changed the banking habit of Indians. ATMs provide access to cash any time and anywhere. It is highly successful in urban India and banks are looking to replicate its success in rural India. Banks are now trying to localise the services being offered by them. For instance, ICICI Bank introduced ATMs which use the local language.

- **Internet Kiosks:** Some banks have also introduced Internet kiosks which work on wireless local loop technology using fibre optic cables. Branch banking in rural India is a loss-making proposition and existing regulations prevent the entry of agents mobilising deposits or selling loans, thus using kiosks and ATMs can be a profitable way of doing business in rural India. For example, a network of about 4,300 rural Internet kiosks provides access to a range of financial services and products at the village level. These kiosks, owned and run by rural entrepreneurs, act as the last-mile link for the rural customers. In addition to the bank's financial services, kiosks also provide services related to health, education and e-governance.

- **Internet Banking:** The concept of 24X7 banking has been carried forward by Internet banking. This allows the customer to perform transactions, payments, etc., over the Internet through a bank secure website. Almost all the services which can be carried out at the branch of a bank can be carried out on the Internet. Internet banking is provided by many foreign and private banks in India. Nationalised banks are also gearing up to provide Internet banking facilities to its customers.

- **Mobile Banking:** Another service which permits 'anytime banking' is mobile banking, which uses the mobile phone as an instrument for making banking transactions. This service holds out huge potential with the burgeoning usage of mobile phones in India (Figure15). The services which can be offered through mobiles can be transaction-based or enquiry-based. Transaction-based services include fund transfer, bill payment and other financial services like share trading. Enquiry-based services include account balance enquiry, cheque status enquiry, etc. Currently, these services are implemented using the following technologies – IVR (Interactive Voice Response), SMS (Short Messaging Service), and WAP (Wireless Access Protocol). Standalone Mobile Application Clients in India, several foreign and private banks have started providing mobile banking services. For example, ABN Amro provides its customers with the facility of mobile banking where the customer can avail alert facility and request facility.

Figure 16: Increase in Mobile Users in India



Source: TRAI

Though technology is seen as a key factor in enabling anywhere, anytime banking, it entails its own costs. Interoperability, fraud and security are the major concerns.

Customer Relationship Management

The customer is at the centre of every business. Every business needs to understand the needs, spending and consumption patterns of customers to remain competitive in the market. Banks collect a wide range of data from the transactions carried out by their customers. CRM solutions help in carrying out an in-depth customer analysis and also in making fact -based decisions in areas ranging from acquisition to risk management to cross selling and portfolio management. ICICI Bank, in the year 2002, implemented a CRM solution that helped its call centre agents track all customer complaints and requests. HDFC, another private sector bank, has deployed a CRM Analytics solution that has provided the bank with a consolidated view of its customers, allowing it to cross-sell and up-sell to the existing customer base.

Intellectual Property

In the current scenario of intense competition, banks are coming up with new and innovative financial products and services. In order to protect these from being copied by the competitors, the banks have started filing patents related to 'Business Methods'. In the US, patenting activity among financial services started in late 1990s with about 927 patent applications for various methods of processing financial and management data. In 2005, the figure rose to 6,226. India being a signatory to TRIPS has come up with a new patent legislation. The increasing competition in the banking industry and the opening of the banking sector to foreign banks will force the banks to patent their innovative products and services. Patenting would enable the banks to differentiate themselves, maintain their competitive edge and also earn revenues through licensing and infringement litigations.

Credit Information Bureau

With the rapid growth of the credit market in India, there is an urgent need of comprehensive credit information on corporates and retail consumers. In developed countries, such information is easily accessible from credit reporting bureaus, such as Experian and Trans Union which compile data on consumers' credit habits and sell the information to creditors.

Credit information bureaus facilitate increased lending opportunities for credit granting organisations more efficiently and cost-effectively and also provide easier access to loans for customers, both corporate and retail. Credit bureaus in developed economies have facilitated increased penetration of credit to the tune of 66 percent of GDP compared to 3 percent in India and has also brought down non-performing loans appreciably to about 1 percent of the outstanding credit.

The advantages of a credit bureau can be summed up as follows:

- **Manage Credit Portfolio Quality:** The credit histories of borrowers provided in the credit information reports (CIR) published by credit bureaus enable the credit organisations to measure the risk of potential borrowers. Concurrent borrowers and serial defaulters can be easily weeded out, thereby reducing recovery and write-off costs. Lenders can then judiciously balance relationship-based lending and information-based lending.
- **Speed and Cost:** The CIRs would enable lenders to process loan applications faster and cheaper by eliminating the need to conduct a separate verification at their end.
- **Differential Pricing:** Due to a lack of comprehensive information about the credit histories of borrowers, lenders charge all borrowers a flat interest rate, irrespective of their credit histories. Hence, borrowers with a good history are forced to pay the price applicable to borrowers with high risk. A credit bureau with its comprehensive CIRs would enable lenders to differentiate between borrowers with different levels of risk, and hence, provide differential pricing which would differentiate their products in a competitive market.

Borrowers with a good credit history would enable them to negotiate better prices from lenders and defaulters would be able to improve their credit history and hence access cheaper rates.

Thus, credit bureaus would help both lenders and borrowers.

India took a step in formalising a credit bureau with the incorporation of the Credit Information Bureau (India) Ltd. (CIBIL) in 2000. According to the CIBIL website, *"CIBIL's aim is to fulfil the need of credit granting institutions for comprehensive credit information by collecting, collating and disseminating credit information pertaining to both commercial and consumer borrowers, to a closed user group of Members. Banks, Financial Institutions, Non Banking Financial Companies, Housing Finance Companies and Credit Card Companies use CIBIL's services. Data sharing is based on the Principle of Reciprocity, which means that only Members who have submitted all their credit data, may access Credit Information Reports from CIBIL. The relationship between CIBIL and its Members is that of close interdependence."(http://www.cibil.com/web/overviewin.htm)*

The formation of CIBIL is a step in the right direction; however, there is a considerable distance to travel. In a mature market like the US, credit bureaus have been active for the last few decades. With the rapid growth in the Indian credit market, the importance of credit bureaus cannot be denied for very long.

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EVS Contact
EVS Media Relations
Tel: +91 124 4154000
pr@evalueserve.com