

Impact of Universal Banking on Indian Financial Market

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1. INTRODUCTION

Universal banking refers to those banks which offer a wide range of financial services, beyond this amenities commercial banking, investment banking ,insurance etc. Universal bank doing the traditional banking of accepting deposits' and providing loans, will offer insurable products, mutual fund, advisory services, and a number of investment banking products.ICICI BANK,KOTAK MAHINDRA BANK,HDFC BANK LTD these banks have made strategic alliances

with several foreign insurance companies for selling insurance products both in life and general branches .it provide the entire facilities of financial product under one roof and reflect the global convergence is an attempt by bank to fulfill the lifelong needs of the customer by following the concept from candle to grave. All the banking organizations are marching towards universal banking.

OBJECTIVE OF THE STUDY

1. To explore the potential of financial institutions in Indian financial market.
2. To analyze the strength, weakness, opportunity, and threats of universal banking in context to Indian financial market.

RESEARCH METHODOLOGY

The study is carried out by using secondary sources of data were the various websites, published annual reports and literature of the banking companies ,RBI annual report, along with observational method..

EMERGENCE OF UNIVERSAL BANKING IN INDIA

After adaptation of liberalization, privatization and globalization Indian government adopted new economic policy in order to become competitive and world class global market. Thus ,under pressures of international financial liberalization policy correction were made and financial reforms were introduced and adopted to match the pace of growth ,to consolidate and improve their competitive position in both domestic and global market place which was herculean task. now .to cater the need of growing demand of long term resources at concessional terms Indian financial institution comprising development financial

institution and refinancing institutions came to an existence and short term business were catered by commercial banks in general .

To achieve holistic vision and to have vibrant customer oriented universal banking DFIs and commercial banks has been endorsed by the policy maker and for this purpose RBI constituted working committee under shri narsimham and later on Dec 8 1997 under the chairman ship of Shri S.H. Khan to look in to the issue and bring more clarity in the respective roles structure and operation of DFIs and commercial banks for greater harmonization. RBI has asked financial institution which are interested to convert itself in to a universal bank to submit their plans for transition to a universal bank for consideration

SALIENT REGULATORY ISSUES OF RBI TO BE ADDRESSED BY THE FIs FOR CONVERSION INTO A UNIVERSAL BANK

a) **Reserve requirements:-** Compliance with the cash reserve ratio and statutory liquidity ratio requirements (under Section 42 of RBI Act, 1934, and Section 24 of the Banking Regulation Act, 1949, respectively) would be mandatory for an FI after its conversion into a universal bank.

b) Permissible activities:- Any activity of an FI currently undertaken but not permissible for a bank under Section 6(1) of the B. R. Act, 1949, may have to be stopped or divested after its conversion into a universal bank..

c) Disposal of non-banking assets:- Any immovable property, howsoever acquired by an FI, would, after its conversion into a universal bank, be required to be disposed of within the maximum period of 7 years from the date of acquisition, in terms of Section 9 of the B. R. Act.

d) Composition of the Board:- Changing the composition of the Board of Directors might become necessary for some of the FIs after their conversion into a universal bank, to ensure compliance with the provisions of Section 10(A) of the B. R. Act, which requires at least 51% of the total number of directors to have special knowledge and experience.

e) Prohibition on floating charge of assets:- The floating charge, if created by an FI, over its assets, would require, after its conversion into a universal bank, ratification by the Reserve Bank of India under Section 14(A) of the B. R. Act, since a banking company is not allowed to create a floating charge on the undertaking or any property of the company unless duly certified by RBI as required under the Section.

f) Nature of subsidiaries:- If any of the existing subsidiaries of an FI is engaged in an activity not permitted under Section 6(1) of the B R Act , then on conversion of the FI into a universal bank, delinking of such subsidiary / activity from the operations of the universal bank would become necessary since Section 19 of the Act permits a bank to have subsidiaries only for one or more of the activities permitted under Section 6(1) of B. R. Act.

g) Restriction on investments:- An FI with equity investment in companies in excess of 30 per cent of the paid up share capital of that company or 30 per cent of its own paid-up share capital and reserves, whichever is less, on its conversion into a universal bank, would need to divest such excess holdings to secure compliance with the provisions of Section 19(2) of the B. R. Act, which prohibits a bank from holding shares in a company in excess of these limits.

h) Connected lending :- Section 20 of the B. R. Act prohibits grant of loans and advances by a bank on security of its own shares or grant of loans or advances on behalf of any of its directors or to any firm in which its director/manager or employee or guarantor is interested. The compliance with these provisions would be mandatory after conversion of an FI to a universal bank.

i) **Licensing**:- An FI converting into a universal bank would be required to obtain a banking licence from RBI under Section 22 of the B. R. Act, for carrying on banking business in India, after complying with the applicable conditions.

j) **Branch network**:-An FI, after its conversion into a bank, would also be required to comply with extant branch licensing policy of RBI under which the new banks are required to allot at least 25 per cent of their total number of branches in semi-urban and rural areas.

k) **Assets in India**:- An FI after its conversion into a universal bank, will be required to ensure that at the close of business on the last Friday of every quarter, its total assets held in India are not less than 75 per cent of its total demand and time liabilities in India, as required of a bank under Section 25 of the B R Act.

l) **Format of annual reports**:-After converting into a universal bank, an FI will be required to publish its annual balance sheet and profit and loss account in the forms set out in the Third Schedule to the B R Act, as prescribed for a banking company under Section 29 and Section 30 of the B. R. Act.

m) **Managerial remuneration of the Chief Executive Officers**: - On conversion into a universal bank, the appointment and remuneration of the existing Chief Executive Officers

may have to be reviewed with the approval of RBI in terms of the provisions of Section 35 B of the B. R. Act. The Section stipulates fixation of remuneration of the Chairman and Managing Director of a bank by Reserve Bank of India taking into account the profitability, net NPAs and other financial parameters. Under the Section, prior approval of RBI would also be required for appointment of Chairman and Managing Director.

n) **Deposit insurance** :- An FI, on conversion into a universal bank, would also be required to comply with the requirement of compulsory deposit insurance from DICGC up to a maximum of Rs.1 lakh per account, as applicable to the banks.

o) **Authorized Dealer's License**:- Some of the FIs at present hold restricted AD licence from RBI, Exchange Control Department to enable them to undertake transactions necessary for or incidental to their prescribed functions. On conversion into a universal bank, the new bank would normally be eligible for full-fledged authorised dealer licence and would also attract the full rigour of the Exchange Control Regulations applicable to the banks at present, including prohibition on raising resources through external commercial borrowings.

p) **Priority sector lending**:- On conversion of an FI to a universal bank, the obligation for lending to

"priority sector" up to a prescribed percentage of their 'net bank credit' would also become applicable to it.

q) **Prudential norms:-** After conversion of an FI in to a bank, the extant prudential norms of RBI for the all-India financial institutions would no longer be applicable but the norms as applicable to banks would be attracted and will need to be fully complied with.

(This list of regulatory and operational issues is only illustrative and not exhaustive).

PRESENT STATUS OF UNIVERSAL BANKING IN INDIA

Keeping the recommendation of narsimaham committee and of khan working group .RBI facilitated DFIs and commercial banks through legislative amendments to undertake the diversified financial activities .to avail the opportunity and to dominate the market position number of banks set up subsidiaries for merchant banking ,mutual fund and leasing along with commencing factoring and securitization .thus PSBs assumed the character of universal banking during the post reform period .SBI ,ALLAHABAD BANK, PUNJAB NATIONAL BANK ,BANK OF INDIA ,BANK OF BARODA, ORIENTAL BANK OF COMMERCE become pioneer under different categories. Among

private sector banks during the initial period, the ICICI BANK,HDFC BANK,KOTAK MAHINDRA BANK have adopted aggressive approach towards universal banking and they turn himself from term lending in to virtual banking in respect to provide corporate and retail financial services like lending activities ,life and general insurance consumer credit private equity, investment banking, retail credit, credit cards etc. for this they enter in to strategic alliance with several foreign giant insurance companies and banks to sell their products .ICICI and IDBI adopted merger route to convert themselves in to universal banking.

THE ROAD AHEAD TO INDIA

Universal banking is no longer seems attractive. The modern concept of universal banking offers the benefit of diversification, and enables banks to offer a full range of services to their clients. Experience of Universal Banking differs in different parts of the world ,some of the commercial banking are prohibited from selling insurance products, investment activities, taking equity position in borrowing firms etc.The sole idea is to mitigate the risky behavior by restricting commercial banking to their

traditional activities .Market research in respect to universal banking impact has revealed different consequences depending upon nation's economic circumstances and customer perception. In emerging economy like India some commercial economist argue that approach of adoption of universal banking is very slow and some suggest for steady approach ,A question that should India have universal banking .when universal banking is falling in developed economy in spite of this thoughts India is still hold high esteem and customers are preferring one stop supplier for all financial products and activities like deposit, term loan,insurance,bankingetc,so we can promote the universal banking in India with an expectation that it will benefit the entire market participants and enable them to compete in the free market .For better control regulatory bodies and policy maker have to justify the distinction between maturity and duration it is important because DFIs are major supplier of term finance which are of longer duration and carry low interest rate with clearly defined maturity period .it will be wise for India to transform DFIs in to commercial banks in phased manner as its transition path

contain several operational and regulatory issues.

STRENGTHS, WEAKNESS, OPPORTUNITIES AND THREATS (SWOT) OF UNIVERSAL BANKING

STRENGTH

Economies of Scale:-the biggest advantage of universal banking is greater economic efficiency which enables them to exploit economies of scale by improving spread, higher output with better and diversified product range and low operating cost.

Diversion of Surplus:-Through diversification of activities bank can use its overall potential expertise optimally in providing different kind of services and can reduce cost by performing all functions by one entity rather than under separate bodies

Optimally Utilization of Resources:- Banks operating different function under one roof is advantageous it can collect information like market risk, return analysis of client's portfolios and this information can be further used to pursue other activities in order to generate additional business with clients.

Advantage of Brand Name in Marketing:-Banks with established brand have wide network of its branches which become active point for promoting products like insurance, mutual fund etc.it will help bank to reach remote area without any external support.

One Point Shopping: - The ideas of one shopping point helps customer as well as banks in saving transactions and other related cost and improve the economic activities to a great extent which is advantageous to all

Pro Investor Environment and Activities:-Adopting universal banking will lead to diversification of business activities which is ultimately related to customers. and thus required investor's friendly environment. Apart from this another manifestation of universal bank is banks holding stakes in firms.

WEAKNESSES

Regulatory Obstacles:-the road of universal banking is not smooth, but has many regulatory obstacles which are the real hurdles and will hamper its growth .the different regulatory requirements of banks and DFIs distinction between maturity and

duration, their conversion period needed careful examination.

Complex Long Term Lending

Converting in to universal banking will diversify and increase business opportunity but project which have long gestation period require expertise to generate and control long term funds.

NPA a Perpetual Problem

The most serious problem to all banking is to control the bad loans generally most of the .NPAs come from commodity sector loan and advances .using technology cannot solve this problem. Universal banking will add fuel in NPAs growth due to its expansion and diversification in activities without skilled and efficient manpower.

OPPORTUNITIES

IMPROVISE PROFICIENCY AND

PRODUCTIVITY:- Liberalization and globalization has led banks to cross the political boundary and become universal .The main focus will be ultimate profit rather than size of balance sheet .To increase the profit margin banks will prefer more of fee based opportunities rather than mobilizing deposit which will also save cost and paying interest on

deposit. banks have to improve their efficiency and productivity.

GLOBAL PRESENCE AND MARKET:-In comparison to global giant financial institution Indian banks are far behind in term of total asset and net worth. State Bank of India is the only bank which have managed place in the top 100 banks list of fortune 500 based on market value, asset, sales and profit. To secure better position in top 100 banks Indian banks have to multiply their operation volume many fold they have to club traditional function with wide range of modern financial services.

ELIMINATION OF FINANCIAL INEQUALITY AND APARTHEID:-

Society lowest base like fruit and vegetable vendor, petty shop, tea stall etc are unable to avail advantage of banking services .they become the victim of money lender. This is due to India banks policy which is prone towards big entrepreneur and do not want to lend to the entrepreneur of small strata. This can be easily controlled by universal, personal, and retail banking.

THREATS

King of Financial Ring

Universal banking is presentation of banking system in a modified way it is legitimate marriage of DFIs and commercial banks which in relation transformed in to universal banking. Merger and acquisition play an important role in establishing universal banks which is possible only with financial soundness. Size wise universal banks will be the largest banks their asset base, their income level and profitability make them financial empire which ultimately leads to monopoly and manipulation of interest by the banks for profit motive instead of social motive. Due to their diversified expansion the economy of scale will become degradation of product quality. If universal bank did not managed its business prudently then deposit rates could shoot up and thus impact their margin of profits. To increase profit margin banks will switch towards riskier business

UNIVERSAL BANKING IS THE NEED OF MODERN ERA

Now a day, there is a large market of General Insurance and Project Financing. As only a bank is not able to fund it properly, due to insufficient asset base and net worth. So, there is a need of developing a strong domestic financial system to cater the need of the corporate

sector. It is possible if banks have strong capital/asset base. It raises the importance of Universal Banking. Along with that for the Mergers and Acquisitions in the corporate sector, there need of financial assistance as well as consulting. More institutional investors entering in India and several Joint Ventures are being started between domestic companies and global firms. A number of issues may crop up between from the signing up of the sale purchase document and the deal actually coming up. Now International insurers are offering cover in India against the loss arising out of Mergers and Acquisitions and Breakups. (E.g.- Howden India leading International brokers, which has introduced transactional insurance of M & A, is now finding takers for their insurance cover) Indian banking, with the help of Universal Banking has technology edge and better business models, compared to pre-liberalizations era, today they are able to attract and gain more volumes simply because they meet their customers' requirements better than anyone else.

CONCLUSION

Finance and society are two side of a survival coin under the growing commercialization universalisation and globalization numerous financial product and services have emerged and developed perpetual relation in all sphere of life with fast

moving economies' and growing economic appetite it became paramount for banks to adopt matching pace in order to fulfill the global social and economical needs. It has been found that in many developed economies' universal banking have proved their importance and responds efficiently to their customer demand and played vital role in economic development and served as an importance source of external finance for enterprises.

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