

FUTURE PROSPECTS WITH UNIVERSAL BANKING IN INDIA

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Abstract—Universal Banking is a superstore for financial products under one roof. Corporate can get loans and avail of other handy services, while can deposit and borrow. In India, too, a lot of opportunities are there to be exploited. Banks, especially the financial institutions, are aware of it. And most of the groups have plans to diversify in a big way. Even though there might not be profits forthcoming in the short run due to the switching costs incurred in moving to a new business. In this paper an attempt is made to study the potential of universal banking for Indian market and future prospects with universal banking. India's banking sector follows closely the global trend of financial developments. It is believed that the concept of financial supermarkets could play a significant role in future given that an increasing number of transnational companies have been set up in the region and also by the opening of Indian Banking sector to foreign players.

Key Words — Financial Institution, transnational companies, supermarkets

INTRODUCTION

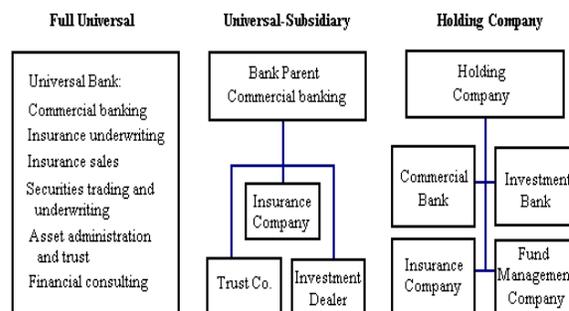
As per the World Bank, "In Universal Banking, large banks operate extensive network of branches, provide many different services, hold several claims on firms (including equity and debt) and participate directly in the Corporate Governance of firms that rely on the banks for funding or as insurance underwriters".

In a nutshell, a Universal Banking is a superstore for financial products under one roof. Corporate can get loans and avail of other handy services, while can deposit and borrow. It includes not only services related to savings and loans but also investments.

The entry of banks into the realm of financial services was followed very soon after the introduction of liberalization in the economy. Since the early 1990s structural changes of profound magnitude have been witnessed in global banking systems. Large scale mergers, amalgamations and acquisitions between the banks and financial institutions resulted in the growth in size and competitive strengths of the merged entities. Thus, emerged new financial conglomerates, which could maximize economies of scale and scope by building the production of financial services organization, called Universal Banking

The Future of Universal Banking

Chart 1: Universal Banks in Different Forms



We have argued that in Germany and Switzerland the importance of universal banking has grown since the end of World War II. Will this trend continue so that universal banks could completely overwhelm the specialized institutions in the future? Are the specialized banks doomed to disappear? This question cannot be answered with a simple "yes" or "no". The German and Swiss experiences suggest that three factors will determine future growth of universal banking.

First, universal banks no doubt will continue to play an important role. They possess a number of advantages over specialized institutions. In particular, they are able to exploit economies of scale and scope in banking. These economies are especially important for banks operating on a global scale and catering to customers with a need for highly sophisticated financial services.

Second, although universal banks have expanded their sphere of influence, the smaller specialized institutions have not disappeared. In both Germany and Switzerland, they are successful coexisting and competing with the big banks. In Switzerland, for example, the specialized institutions are firmly entrenched in such areas as real estate lending, securities trading, and portfolio management. The continued strong performance of many specialized institutions suggests that universal banks do not enjoy a comparative advantage in all areas of banking.

Third, universality of banking may be achieved in various ways. No single type of universal banking system exists. We have shown that the German and Swiss universal banking systems differ substantially in this regard. In Germany, universality has been strengthened without significantly increasing their market shares of the big banks. Instead, the smaller institutions have acquired universality through cooperation. They have set up central institutions conducting

those banking activities that are subject to significant returns to scale and scope. In Switzerland, the cooperative approach has not worked as well as in Germany.

Indian Perspective on Universal Banking

Some argue that the approach is very slow, while some call for steady approach. The debate of universal banking is very much on. Should India have universal banking and if so when? Much has been written about it domestically; however the following are the issues which are key in Indian context.

- **Regulatory burden:** In India there is an urgent need to reduce the regulatory burden, particularly for banks vis-à-vis mutual funds and insurance companies, if the banks are expected to compete in free market place.
- **Regulatory requirements:** Salient operational and regulatory issues of RBI to be addressed by the FI's for conversion into a universal bank
- **Distinction between Maturity and Duration**
This is the issue of debate between long term and short term. Somehow DFIs are the suppliers of term finance, where the maturity is clearly specified which could be between 3 years to 7 years, whereas banks are providers of short-term finance where in reality bank finance in a way amounts to financing in perpetuity since there are in general no definite maturity dates. Usually the deposit base of the banks have are short duration but with a variably high interest rates but its not the case with DFIs. Their funds have a longer duration with less interest rate.
- **Optimal Transition path:** The transition path contains several operational and regulatory issues for information and guidance of DFIs. The S H Khan working group and the discussion paper on the subject prepared by RBI eventually felt that DFIs should transform themselves into commercial banks but in a phased manner.

WHAT UNIVERSAL BANKING CAN RESULT FOR INDIA

The domestic banking sector is going through some interesting times -- not just economically, but on the policy front as well. And the major policy shift was heralded by the Narasimham committee's recommendation that development finance institutions (DFIs) ultimately convert into either commercial banks or non-banking finance companies. This, in a way, spelt the beginning of the end of specialized services from DFIs, and the introduction of universal banks.

In India, banks have traditionally been prime lenders for working capital loans and DFIs financed term loans. Now, with DFIs told to move towards universal banking, banks have been allowed to diversify into investments and long-term financing, and DFIs will lend for working capital.

Starting trouble. In spite of the Narasimham committee's recommendations -- later endorsed by the Khan working group -- the road to universal banking is proving far from smooth. One major impediment for FIs is the fact that they have past liabilities on which reserve requirements -- SLR, CRR and priority sector advances -- have not been met. Meeting this requirement in its current form and level would require FIs to

raise huge resources from the capital market, which could give rise to liquidity concerns. Now, depending on the fiscal and monetary situation, RBI is slated to reduce the CRR requirement to a minimum of 3 per cent.

THE ROAD AHEAD TO INDIA

In Indian context, A universal bank is a one-stop supplier for all financial products and activities, like deposits, short-term and long-term loans, insurance, investment banking etc. Global experience with universal banking has been varied. Universal banking has been prevalent in different forms in many European countries. This prohibited commercial banks from investment banking activities, taking equity positions in borrowing firms, selling insurance products etc. The idea was to mitigate risky behavior by restricting commercial banks to their traditional activity of accepting deposits and lending. Research on the effects of universal banking has been inconclusive as there is no clear-cut evidence in favors of or against it anywhere.

Now, let us turn to the benefits accruing to the customers. The idea of one-stop-shopping saves a lot of transaction costs and increases the speed of economic activity.

To account for this, appropriate regulation can be devised, which will ultimately benefit all the participants in the market, including the banks themselves. In spite of the associated problems, there seems to be a lot of interest expressed by banks and financial institutions in universal banking.

In India, too, a lot of opportunities are there to be exploited. Banks, especially the financial institutions, are aware of it. And most of the groups have plans to diversify in a big way. Even though there might not be profits forthcoming in the short run due to the switching costs incurred in moving to a new business.

REVIEW OF LITERATURE

Universal Banking is a multi-purpose and multi-functional financial supermarket (a company offering a wide range of financial services e.g. stock, insurance and real-estate brokerage) providing both banking and financial services through a single window.

As per the World Bank, In Universal Banking, large banks operate extensive network of branches, provide many different services, hold several claims on firms (including equity and debt) and participate directly in the Corporate Governance of firms that rely on the banks for funding or as insurance underwriters".

In a nutshell, *a Universal Banking is a superstore for financial products under one roof.* Corporate can get loans and avail of other handy services, while can deposit and borrow. It includes not only services related to savings and loans but also investments. However in practice the term 'universal banking' refers to those banks that offer a wide range of financial services, beyond the commercial banking functions like Mutual Funds, Merchant Banking, Factoring, Credit Cards, Retail loans, Housing Finance, Auto loans, Investment banking, Insurance etc. This is most common in European countries. For example, in Germany commercial banks accept time deposits,

lend money, underwrite corporate stocks, and act as investment advisors to large corporations. In Germany, there has never been any separation between commercial banks and investment banks, as there is in the United States.

Case Study: ICICI gearing to become a universal bank

ICICI envisages a timeframe of 12 to 18 months in converting itself into a Universal Bank. ICICI has received favorable response from Indian investors and FIIs on its move to merge with ICICI Bank and become a universal bank. ICICI was the first one to propagate universal banking as an ideal concept for the DFIs to support industries with low cost funds. In August, ICICI executive director Kalpana Morparia said that ICICI has to obtain a separate banking license from RBI for becoming a universal bank. It can avoid the stamp duty burden by first converting ICICI into bank, instead of going for a direct merger of ICICI into ICICI Bank.

“We have created fire walls and functioning as separate legal entities only for complying with statutory obligations,” she noted. There is clear demarcation in the operation of ICICI and the bank. The bank takes care of liabilities of less than one year by offering short-term loans to corporate and personal loans. Medium to long-term products like home loans, auto loans are handled by the parent; absolute coordination between them while marketing the products exists.

Crisil has reaffirmed its triple A rating for ICICI and FIIs also expects its profit margins to improve after the merger due to the access to low cost deposits the scope to increase income from fee-based activities.

She said ICICI has started increasing its international presence and associating closely with NRI community in various countries. ICICI InfoTech is based in US has an office in Singapore. ICICI Securities has been registered as a broking firm in the US.

ICICI Bank is leveraging on strong network of 400 branches and extension counters 600 ATMs for offering products to NRIs; NRIs can transfer their money to 200 locations in India by internet. The payment will be made within 72 hours. It also offers loan products for helping their relatives in India. Besides, the Visa card helps them to withdraw cash through the ATM network.

Morparia said NPA of banks in India are <10 per cent of GDP when compared to emerging economies like China, Korea & Thailand. It should not be compared with developed countries like Europe and US. ICICI’s gross NPA comes to Rs 6,000 crore. Asked about a approach to resolve the problem, she said if the units are viable, it supported financial restructuring, mergers. If these options aren’t possible and the units are not viable, it will go in for one time settlement.

Because of law, once the units are referred to BIFR, the lenders were unable to enforce securities,” she pointed out. purpose and multi-functional financial supermarket (a company offering a wide range of financial services e.g. stock, insurance and real-estate brokerage) providing both banking and financial services through a single window

OBJECTIVE OF THE STUDY

- To study the potential of universal Banking for Indian market.
- To study the future prospects universal banking in India.

RESEARCH METHODOLOGY

Research Design -Descriptive research Design

Research Type - Qualitative

Data collection methods- Primary Data, Secondary Data

Primary source of data - Direct personal interviews, Questionnaire

Sampling size & design-100 individuals

Sampling technique- Convenient

Tabulation of Data- MS- Excel

Analysis of Data- Simple percentage

DATA ANALYSIS AND INTERPRETATION

As per the responses of the respondents, the following results could be interpreted.

Dimension 1: Attractiveness of Universal Banking to potential customers

Ques 1. Concept of Universal Banking attracts me

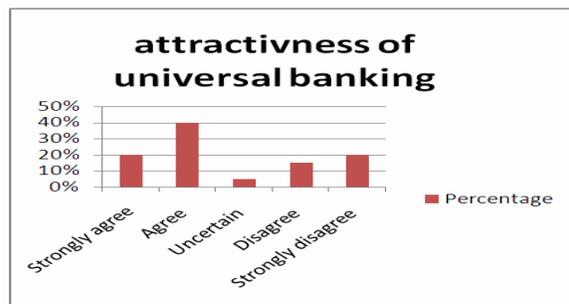


Diagram 1

Thus, the above chart shows 40% of respondents agree to the point that they are attracted towards the concept of Universal Banking. And 15% of the respondents disagree with the point that universal banking tends to be an attractive concept for them.

Ques 2. The concept can become very popular in India.

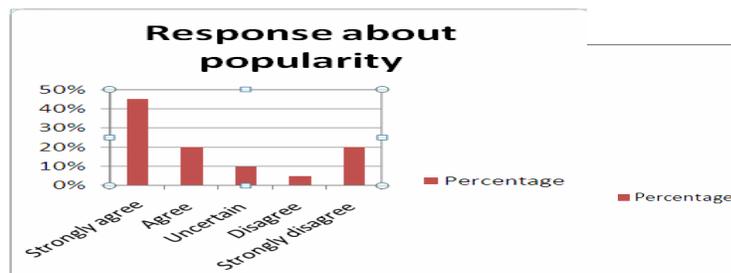


Diagram 2

Thus, the above result shows that the 45% of respondent are strongly agree that concept, if implemented in India, can

become very popular in India. Only 5% disagree with the following result.

Ques 3. Availability of all products information under one roof can make me pay more attention to product details

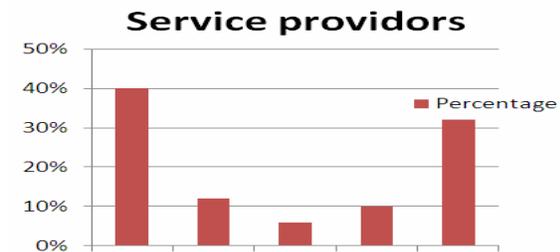


Diagram 6

Thus, the above results shows that the ICICI bank has been voted by the respondents as the most favoured service provider for Universal Banking services, closely followed by largest public sector bank, SBI.



Diagram 3

Hence, by above interpretation can be examined that 36% of respondents are agree that all products under one roof can help people examine and analyze the product details with greater attention.

Dimension 2: Influence of Universal Banking on customer's product choice behavior

Ques1. Idea of 'one stop shopping' may help me to make my investing and financing decisions more wisely.40%

Thus, the above result shows that 40% of the respondents agree to the point that the idea of 'one stop shopping' can help them make their investing and financing decisions more wisely by availing more information about product attributes.

Ques 2. Availability of all products under one roof can help me remember the products with their details

Diagram 5

Thus, the above result 36% of the respondents feel that availability of all products under one roof can help them remember much about the product and its details and thus can prove to be beneficial in planning their financing activities. 12% are strongly disagree about the benefits they can avail through the above concept.

Dimension 3: Service provider which can readily be converted into Universal Bank

FINDINGS

- 40% of respondents agree with the concept that universal banking attracts them.
- 40% of the respondents are agree that the idea of 'one stop shopping' may help them to make their investing and financing decisions more wisely.
- 40% of respondents are agree that universal banking can enhance their awareness of available products.
- 36% of the respondents feel that availability of all products under one roof can help them remember much about the product and its details and thus can prove to be beneficial in planning their financing activities.
- 40% of respondent that the ICICI bank has been voted as the most favoured service provider for Universal Banking services, closely followed by largest public sector bank, SBI.

LIMITATIONS OF THE STUDY

- Time limit
- Sample size
- Possibility of biasness in the scheduled used
- Inexperience of researcher

CONCLUSION

Finance has very close ties with most people. Numerous financial products and services have penetrated our lives. The globe is ever-changing and financial products and services have to keep up with the pace of people's demand. Banks, which assume a leading position in most financial systems, have to be prepared for the growing need of their customers. In some countries, universal banks, which offer a wide range of financial services, have proved responsive to customer demand and helpful in facilitating economic developments. India's financial sector is relatively bank-oriented, and banks are the primary supplier of financial services. With the

regulatory allowance for universal banking, Indian banks continue to expand its coverage of financial services in response to customer demand and profitability concerns. In countries with universal banking system, banks usually serve as an important source of external finance for enterprises.

India's banking sector follows closely the global trend of financial developments. It is believed that the concept of financial supermarkets could play a significant role in future given that an increasing number of transnational companies have been set up in the region and also by the opening of Indian Banking sector to foreign players.

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