Universal Banking – Conceptual Framework & Emerging Trends in India

Mr. Ankur Tayal
Head Operations
Technical Construction Company
Muzaffarnagar
Uttar Pradesh, India.

Mrs. Ridhima Tayal
HR Head
Technical Construction Company
Muzzaffarnagar
Uttar Pradesh, India.

Abstract

In present economic environment and rapid technological developments, to strike equilibrium between demand and supply, there is a need to bring revolution in banking industry to efficiently mobilize and productively utilize public savings. Thus, Universal Banking emerged as a financial market place where many financial products are available at one place. One can easily get loans, can deposit funds and can avail a number of services from these financial institutions. The name universal banking is given to an institution in which all kinds of loans are provided to all types of customers irrespective to their sector. Anyone can approach any bank branch for a credit. This enables the customers to avail credit from a bank for any purpose. The primary focus of this paper is on the benefits of universal banking with respect to Indian market. It is assumed that this modern concept of banking in financial supermarkets will help in bridging the financial gap. This paper also sheds light on strength and weaknesses of Universal Banking as well as its opportunities and threats in order to compete in global financial market.

Keywords

Financial Institution, Banking Industry, Universal Banking, Financial Super-markets, Commercial Banking, Investment Banking.

1. Executive Summary

Universal banking is solution to all financial investments problems. It also provides services of commercial banking (collecting deposits and providing loans) and Investment banking (issuing, underwriting and trading in securities) under one roof besides providing multiple financial services beyond commercial and investment banking. ICICI bank is the flag bearer of universal banking as it is the first universal bank in India.

In 1990s the deregulation of banking sector emerged as a threat to development financial institutions which necessitated the need to establish universal banks. Then in 1995, ICICI emerged as a DFI which made many changes to meet the challenges of tough competition from local and foreign banks.

Universal Banking comprises of financial entities like commercial banks, DFIs, and NBFCs. This banking provides many financial activities under one roof, thus creating a multi-functional financial supermarket providing both banking as well as financial services through a single window. It generally takes one of these forms:

1. In-house Universal banking. Example – Germany, Switzerland.
2. Through separately capitalized subsidiaries. Example – England, Japan.
3. Operations carried through a holding company. Example – USA.

The term 'Universal Banks' refers to those banks that offer a wide range of financial services, beyond commercial banking and Investment banking, Insurance, Merchant banking, Mutual Funds, Credit Cards, Retail Loans, Housing Finance, Auto Loans, etc. It is largely found in different countries in different forms. Universal Banking covers formal banking activities such as receipt of deposits, advances, merchant banking, investing and trading in all types of securities, advisory services on mergers, underwriting, and acquisitions by the corporate sector and so on.

2. Introduction

After independence as the Indian economy evolved the banking industry underwent a rapid transformation. A universal bank is a multi-functional bank in which an individual can perform various financial transactions such as commercial banking, investment planning, various insurances, stock trading, and all other financial activities. The concept of universal banking re-emerged in India in year 2000, when ICICI gave a proposal to RBI regarding the options for transforming itself into a universal bank. Since then universal banking sector is facing cut throat competition. Every bank is now chasing another in competition for increasing its business. The ongoing reforms process, growing use of technology, increased competition and product innovation have all made the banking sector to move for a change to attain growth. However, significant challenges lie ahead for the banks in the country as they gear unto embrace international standards. Indian banking, with the help of Universal Banking has technology edge and better business models, compared to pre-liberalizations era. However, there is a need for constant innovation in universal banking. This requires product development and differentiation, micro-planning, marketing, prudent pricing, customization, technological upgradation, home/ electronic/ mobile banking, effective risk management and asset liability management techniques.

3. Activities of Universal Bank

The concept of universal banking is, presently, catching up the entire banking industry. It is spreading like a wild fire and, in an environment of cut throat competition, everyone seems to be transforming itself into it. Technology forms the basis of universal banking as it helps the bank to adapt, absorb and achieve the main aim of business. A bank can call itself a universal bank, particularly in India, if it can provide the following services and perform the following activities:

1. Credit services
2. Consumer services
3. Savings account services
4. Money market
5. Capital market
6. Forex market
7. Commodities market
8. International transactions
9. Merchant banking
10. Investment banking
11. Insurance market
12. Factoring
13. Credit cards, debit and Smart cards services
14. Pension market
15. Project financing
16. Venture capital
17. On-line share broking
18. Internet banking

19. Telephone banking
20. Mobile banking
21. Securitizations

Almost all banks aspiring to be a universal bank are providing all the services mentioned above.

4. Universal Banking: Indian Perspective

After independence, the Indian banks followed British norms to operate in a safe economy. But the banks faced a lot of problems such as loss of profits, excess of NPAs and many more. Due to these problems banks were unable to serve their customers fully and thus to overcome these problems DFIs came into light. DFIs are development financial institutions which offer loans to a specific sector of the economy such as automobile, agriculture, construction etc., fulfilling the need of a specific customer. During 1991, banks started to provide more customized services. At this time the FIs provided term loans to specific customer and commercial bank performed working capital financing.

On Dec 8, 1997 RBI made a committee under the leadership of Shri S. H. Khan to throw light on the roles of FIs and banks respectively. The reports of Narasimham Committee and S.H. Khan Committee came to a conclusion that there should be integration of many financial activities in banks. That is, at one place availability of many financial activities.

In 2000, ICICI bank gave a proposal to RBI for its conversion into Universal Bank. Then on March 31, 2002 RBI declared ICICI as the first Universal Bank in India. Also RBI declared its rules and regulations suggesting swift conversion of DFIs into Universal Banks.

Then many other DFIs showed their interest in their conversion into universal bank. Some of them are IDBI, IFCI and IIBI.

5. Strengths, Weaknesses, Opportunities & Threats (SWOT) of Universal Banking

Strength

1. **Economies of Scale:** The main advantage is increased productivity with better and enlarged range of products along with low operating cost.

2. **One Point Shopping:** This concept helps individuals as well as banks in saving transaction and improves the economic activities to a greater extent. It enhances profitability of the bank through sale of different financial products.
3. **Advantage in Marketing:** Bank with established brand name have wide network of branches which helps in promoting products like insurance, mutual funds, etc.
4. **Optimal Utilization of Resources:** Banks operating different functions under one roof can easily collect information regarding market trends, risks, etc. and use this information to pursue many other activities.
5. **Diversification:** Through diversification of activities bank can easily use its overall expertise in providing different kind of services and can easily reduce cost by performing all functions at one place rather than different entities.

Weaknesses:

1. **Regulatory obstacles:** The main issues that need attention are distinction between maturity and duration and many more.
2. **Complex long-term Lending:** Long-term Projects which requires long term borrowing which then requires permission, expertise to generate and control long term funds, thus becoming a complex procedure.
3. **Non-Performing Assets (NPA), a perpetual Problem:** The most serious problem to all banking and financial institution is to control the bad loans or NPA.

Opportunities:

1. **Increase proficiency and productivity:** While offering multiple financial services under one roof banks can save on manpower, infrastructure and other cost. This helps in improving its productivity and proficiency. Also the onset of liberalization has enabled the banks to cross political boundaries of country and thus focus on profits rather than balance sheets.

2. **Global Presence and Market:** On the basis of market value, assets and profit SBI holds its position in top 100 of 'Fortune 500'. It has also managed second rank in 'Forbes 2000' list of all Indian companies. Universal banking with its special features can help Indian banks to focus of different verticals of financial market and focus on their profits from one or multiple areas. This will enable more banks to break into the list of fortune 500 banks and compete on global platform.

3. **Elimination of Financial Inequality:** Nearly 60% of the Indian population lives in rural areas where multimodal banking is not there. Banking is limited only to financial superior individuals and thus holistic development of the economy takes a back seat. A universal bank in these areas can improve financial inclusion among financially deprived individuals.

Threats:

1. **Victim of its own size:** A universal bank's size can turn into its disadvantage as if it did not manage its house properly and diversify effectively then deposit rates could shoot up and thus their profit margins can dip.

6. Salient Operational & Regulatory Issues of RBI to be Addressed by the FI for Transforming into a Universal Bank

1. **Reserve Requirements:** When a FI wants to convert into Universal bank, then it has to accept the CRR and SLR requirements under section 42 of RBI Act and section 24 banking regulation act respectively.
2. **Permissible Activities:** If an FI converts into a universal bank then those activities which an FI can perform but not a bank then those activities have to be halted by an FI to become a universal bank.
3. **Sale of Non-Banking Assets:** Since a universal bank can hold only banking assets then FI will have to dispose of any asset of that type in stipulated time period.
4. **Composition of the Board:** An FI will have to change its board composition according to the rules of RBI. It has to follow the minimum requirement to have at least 51% of its directors to possess special knowledge and experience.

5. **Restriction on Investments:** If a bank hold shares in any company that is exceeding 30% of company's share capital then bank will have to relieve the excess quantity of shares of that company.
6. **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.
7. **Licensing:** The FI would require obtaining a license from RBI to carry business of banking in India and has to comply with the applicable conditions.
8. **Branch Network:** The FI would need to comply with the existing branch licensing policy of RBI which requires allotting of at least 25% of their total number of branches in semi-urban and rural areas.
9. **Assets in India:** As per the requirements of the RBI an FI will have to maintain its assets in India which are valued at least 75% of its total liabilities.
10. **Format of Annual Reports:** Format of annual report also will have to be changed by FIs to follow the norms stipulated in the third schedule to the B.R. act.
11. **Deposit Insurance:** As applicable to all banks an FI after converting into a universal bank will have to fulfil the requirement of maintaining compulsory deposit insurance from DICGC of maximum Rs. 1,00,000/- per account.
12. **Prudential Norms:** In a nutshell an FI will have to fulfil all the requirement set out by the different acts in India and shed all its activities it was performing as an FI.

7. Conclusion

To meet the global, technical, social and economic needs banks have to accept the changes as soon as possible. In many developed economies, this banking has shown positive results by efficiently responding to the customer's demand. Indian financial sector is bank-oriented which in turn are the suppliers of financial services. But slowly this scenario is changing its pace in India.

The Indian banking is trying its best to introduce innovation in its working. These new banks could play a drastic role bringing economic and social development in our country. To ensure that all financial services are available to all sections of population at affordable costs, Government of India would have to introduce some regulations.

Undoubtedly, Universal banking is the fastest growing sector in India. But, it is facing a lot of competition as all banks are trying to take a benefit from this concept. If one financial vertical of the bank is not performing then the bank can depend on another vertical to gain profits and report healthy balance sheets. This unique advantage of universal banking of offering multiple solutions under one roof has helped banks to improve their productivity and proficiency. However, there is a need for constant improvement and diversification in its services otherwise a universal bank can fall victim of its own advantage. This also requires proper use of technology and offering different modes of banking such as phone banking, net banking, ATMs and other such services at minimal cost to make it available to each and every section of the society.

References

1. www.banknetindia.com/banking/ubfeature.htm : Universal banking: Introduction, universal banking in India
2. www.answers.com/topic/universal-banking: Universal Banking: Definition
3. http://banknetindia.com/univensalbanking : RBI Rules and Regulations
4. www.scribd.com/doc/30833630/ : Ahmed Gulzar, *"Impact of Universal Banking on the operations of bank"*
5. https://ideas.repec.org/a/eaa/eerese/v5y2005i5_1.html: Chaitnya, Krishna V.*, "Universal Banking-The Indian Perspective"*
6. https://www.researchgate.net/publication/266281735/ : Dhond Arvind A., *"Banking Sector in India: Changing Practices in the Global Scenario"*.
7. Ganesan S.& Pria Shanmuga S. (2007), *"Universal Banking in India: Strategies for Successful Implementation"* edited by Uppal R. K. and Rimpi jatana, New cwntury Publications, New Delhi, P. 81
8. Khanna Anurag (CEO Banknet India), *"Universal banking: An Overview"* P. 207