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A Study on Globalization and Its Impact on Banking Sector in India - Challenges and Opportunities

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ABSTRACT: The world banking system has gone through many transformations in the last several decades. There have been drastic regulatory changes, banking technologies, the wide spread dominance and acceptance of the market economy by less economies, and the increase and integration of international financial markets and institutions, have created new opportunities and challenges for international banking institutions. Integration of economies leads to integration of financial markets catalyzing the globalization process. The growing role of the financial sector in allocation of resources has significant potential advantages for the efficiency with which our economy functions. This paper helps to know about Globalization and analyzes its impact on Indian Banking Sector. This paper is an attempt to know the Globalization is a challenge as well as opportunity for the Banking sector in India.

Keywords: Globalization, Commercial Banking, Private Banking, Banking technology, International Banking, Banking sector.

I. INTRODUCTION

Globalization is the new concept that has come to dominate the world since the nineties of the last century with the end of the cold war and the break-up of the former Soviet Union. Globalization has brought in new opportunities to developing countries and Greater access to developed country markets and technology transfer hold out promise improved productivity and higher living standard. But globalization has also thrown up new challenges like growing inequality across and with volatility in financial market and environmental deteriorations. Another negative aspect of globalization is that a great majority of developing countries remain removed from the process. Till the nineties the process of globalization of the Indian economy was constrained by the barriers to trade and investment. Liberalization of trade, investment and financial flows initiated in the nineties has progressively lowered the barriers to competition and hastened the pace of globalization.

HISTORICAL BACK GROUND OF BANKING SECTOR IN INDIA

The liberalization of India's economy was adopted by India in 1991. Facing a severe economic crisis, India approached the IMF for a loan, and the IMF granted what is called a "structural adjustment" loan, which is a loan with certain conditions attached which relate to a structural change in the economy. The government ushered in a new era of economic reforms based on these conditions. These reforms can be broadly classified into three areas: Liberalization, privatization and globalization. Essentially, the reforms sought to gradually phase out government control of the market (liberalization), privatize public sector organizations (privatization), and reduce export subsidies and import barriers to enable free trade (globalization).

Until 1991 there has been regulations like administered interest rates and government control etc. upon implementation of recommendations by Narsimha committee led to rapid and radical changes. Now the banking sector offers wide range of services like securitization, leasing and hire purchase, custodial service, depositories, factoring etc. New financial institution, dis-intermediation, greater professionalism and technological innovation have emerged as a result of liberalization, privatization and globalization. In addition to this capital adequacy norms, income recognition and assets classification were introduced in the ambit of banking activities and banks are compelled to cope up with the process of deregulation, competition, asset liability management and globalization.

The enhanced role of the banking sector in the Indian economy, the increasing levels of deregulation along with the increasing levels of competition have facilitated globalization of the

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India banking system and placed numerous demands on banks. Operating in this demanding environment has exposed banks to various challenges. The last decade has witnessed major changes in the financial sector - new banks, new financial institutions, new instruments, new windows, and new opportunities - and, along with all this, new challenges. While deregulation has opened up new vistas for banks to augment revenues, it has entailed greater competition and consequently greater risks. Demand for new products, particularly derivatives, has required banks to diversify their product mix and also effect rapid changes in their processes and operations in order to remain competitive in the globalised environment.

GLOBALIZATION – A CHALLENGE AS WELL AS AN OPPORTUNITY

Banks in India themselves to be ready through adoption of newer technology, strengthening their capital base to become Basel II complaint , reducing their NPA's, bringing down operating costs, enhancing corporate governance and alignment of regulatory and accounting requirements, undertaking organizational restructuring and sharpening their customer-centric initiatives. Banking Industry in India is getting redefined it is facing so many challenges and opportunities is as follows**.**

I. Basel II implementation

Basel II implementation is widely acknowledged as a significant challenge faced by both banks and the regulators internationally. Basel II implementation may be seen as a compliance challenge and in another dimension which offers considerable opportunities to banks like refinement of risk management systems and improvement in capital efficiency.

a. Comprehensive risk management: Under Basel I banks were focused on credit and market risks. Basel II has brought into focus a larger number of risks, besides the increase in the number of risks, banks are now beginning to focus on their inter-linkages with a view to achieve a more comprehensive risk management framework. Basel II implementation, therefore, is being increasingly seen as a medium through which banks constantly endeavor to upgrade the risk management systems to address the changing environment. Further, in the initial stages, banks were managing each risk in isolation. Banks in India are also moving from the individual system to an enterprise wide risk management system.

b. **Capital efficiency**: Basel II prescriptions have ushered in a transition from the traditional regulatory measure of capital adequacy to an evaluation of whether a bank has found the most efficient use of its capital to support its business i.e., a transition from capital adequacy to capital efficiency. In this transition, how effectively capital is used will determine return on equity and a consequent enhancement of shareholder value. In effect, banks may adopt a more dynamic approach to use of capital, in which capital will flow quickly to its most efficient use. This revised efficiency approach is expected to guide the return-on-equity strategy and influence banks' business plans. With the extension of capital charge for market risks to the AFS portfolio this year and the coming into force of Basel II norms in March 2007, banks would need to shore up the capital levels not only for complying with these requirements but also for supporting the balance sheet growth. With a view to enhancing the options available to banks for augmenting their capital levels, the Reserve Bank has recently permitted banks to issue new capital instruments, including perpetual instruments. A notable feature of these instruments is that these are designed to help banks in not only managing their capital effectively but also efficiently.

2. Enhancing corporate governance

The issues related to corporate governance have continued to attract considerable national and international attention in light of a number of high-profile breakdowns in corporate governance. This becomes all the more relevant for banks since they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but also leverage such funds through credit creation. Banks are also important participants in the payment and settlement systems. In view of the above, legal prescriptions for ownership and governance of banks in Banking Regulation Act, 1949 have been supplemented by regulatory prescriptions issued by RBI from time to time.

A good "governance culture" is crucial for financial stability but since it is an 'intangible', rules may not be able to capture its essence effectively. Therefore, banks may have to cultivate a good governance culture building in appropriate checks and balances in their operations.

3. Compliance with international accounting standards

One of the prime international standards considered relevant for ensuring a safe and sound banking system is the 'Core Principles for Effective Banking Supervision' issued by the Basel Committee on Banking Supervision (BCBS). Accounting standards are now a part of the set of twelve standards that have been identified by the Financial Stability Forum as conducive to a robust financial infrastructure.

It is widely accepted that as the volume of transactions increases, which is happening in the Indian banking system, the need to upgrade the accounting framework needs no emphasis. The World Bank's ROSC on Accounting and Auditing in India has commented on the absence of an accounting standard which deals with recognition, measurement, presentation and disclosures pertaining to financial instruments. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) is considering issue of Accounting Standards on the above aspects pertaining to financial Instruments. These will be the Indian parallel to International Financial Reporting Standard 7, International Accounting Standards 32 and 39. The proposed Accounting Standards will be of considerable significance for financial entities and could therefore have implications for the financial sector.

4. Outsourcing risks

Banks are increasingly using outsourcing for achieving strategic aims leading to either rationalization of operational costs or tapping specialist expertise which is not available internally. Typically outsourced financial services include applications processing (loan origination, credit card), document processing, investment management, marketing and research, supervision of loans, data processing and back office related activities etc.

Outsourcing might give rise to several risks including, strategic risk, reputation risk, compliance risk, operational risk, exit strategy risk, counterparty risk, country risk, access risk, concentration risk and systemic risk. The failure of a service provider to provide a specified service, ensure security/ confidentiality, and comply with legal and regulatory requirements can lead to financial losses/ reputational risk for the bank and could also lead to systemic risks for the entire banking system in a country. It would therefore be imperative for the bank outsourcing its activities to ensure effective management of these risks. In this view RBI has issued draft guidelines on outsourcing, which is intended to provide direction and guidance to banks to effectively manage risks arising from such outsourcing activities. The underlying principles for any outsourcing arrangement by a bank are that such arrangements should neither diminish the bank's ability to fulfill its obligations to its customers and the RBI nor impede effective supervision by RBI

5. Application of advanced technology

Technology is a key driver in the banking industry, which creates new business models and processes, and also revolutionises distribution channels. Adoption of technology also enhances the quality of risk management systems in banks. Recognising the benefits of modernising their technology infrastructure banks is taking the right initiatives. In this context banks need to clearly define their core competencies to be sure that they are investing in areas that will distinguish them from other market players, and give them a competitive advantage. A further challenge which banks face in this regard is to ensure that they derive maximum advantage from their investments in technology and avoid wasteful expenditure which might arise on account of uncoordinated and piecemeal adoption of technology; adoption of inappropriate/ inconsistent technology and adoption of obsolete technology.

6. Capacity building

By the changing environment, banks need to focus on appropriate capacity building measures to equip their staff to handle advanced risk management systems and supervisors also need to equally equip themselves with appropriate skills to have effective supervision of banks adopting those systems. A relevant point in this regard is that capacity building should be across the institution and not confined to any particular level or any particular area. The demand for better skills can be met either from within or from outside. It would perhaps be worthwhile to first glean through the existing resources to identify misplaced or hidden or forgotten resources and re-position them to boost the bank's efforts to capitalize on available skills.

In Indian banking Industry, we find that there are 36 foreign banks operating in India, which becomes a major challenge for nationalized & private sector banks. These foreign banks are large in size, technically advanced and having presence in global market, which gives more & better options and services to Indian traders.

II. CONCLUSION

The global challenges which banks face are not confined only to the global banks. These aspects are also highly relevant for banks which are part of a globalised banking system. Further, overcoming these challenges by the other banks is expected to not only stand them in good stead during difficult times but also augurs well for the banking system to which they belong and will also equip them to launch themselves as a global bank. It is evident that post LPG era has spread new colors of growth of India, but simultaneously it has also posted some challenges. The competition from global banks and technological Innovation has compelled the banks to re-think their policies and strategies.

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