Financial Integration & Indian Commercial Banks

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ABSTRACT
A well developed financial sector forms the core of a stable and progressive economy. Irrespective of the development stature it is indispensable for all types of economies. The strategic move of librealisation has caused far reaching impacts on Indian financial sector. The extent of expansion and diversification in financial services clearly indicates this paradigm shift. However, the main thrust is on best adaptation to these forces, both, at national and international, level through sound policy framework to derive optimum benefits. In present times, financial service sector has become very vast in its scope and function. Therefore, for the purpose of carrying out this study, it has been specifically narrowed down to Indian Commercial Banking sector. Since banking sector forms the core of organized financial sector. The phenomenon of integration of financial markets has lead to emergence of Global Financial Markets, which in turn, has opened up vast avenues for banks. A radical change in operations, expansion and orientation of banks is clearly visible over the years. However, opportunities of this type are coupled with its own unique challenges, which call for policy prudence to safeguard the interest of people, stability of the financial sector and economy as a whole. Here, in this paper we strive to find the extent to which factors underlying financial stability of Indian Commercial Banks (both public and private sector) have been explored and the scope of further exploration that lies ahead under this topic.

I INTRODUCTION

The concept of banking has expanded from mere accepting and lending of money to the 'hi-tech anywhere- anytime banking'. Customer stake with the banks is not just confined to the three basic categories of deposit; it has rather become deeper and diverse to the extent that banks are now looked upon as one stop financial service providers. Even the old public sector banks are not left untouched with this changed philosophy pioneered by foreign banks and adapted by new generation private sector banks.

Not only the risk averted customer but customers with varying degree of risk acceptance, approaches banks to diversify their investment. With increase deposit base of the banks altogether banks bear a bigger challenge of using these funds wisely so as to provide adequate safety, rate of return and on-time repayment to its customers along with maximizing their own profits and wealth. Integration of financial markets has opened an arena of avenues for banks to get these objectives fulfilled.

The phenomenon of integration of financial markets (Definition: An open market economy between countries facilitated by a common currency and the elimination of technical, regulatory and tax differences to encourage ree flow of capital and investment across borders.) popularly termed as Global Financial Markets have opened up vast avenues for banks. A radical change in operations, expansion and orientation of banks is clearly visible over the years. However, opportunities of this type are coupled with its own unique challenges, which call for policy prudence to safeguard the interest of people, stability of the financial sector and economy as a whole.

II OBJECTIVES & METHODOLOGY

(a) Objectives

The paper focus on the following major objectives:

(i) To understand the change that has been brought in the functioning and management of Indian Commercial Banks as after the post financial integration.
(ii) To explore the work done with regards to interrelating financial stability and the phenomenon of financial integration and also to explore key concerns underlying financial stability of banks.
(iii) To explore the macroeconomic impact on financial integration process.

(b) Research Methodology

The paper is describing the status quo of the financial integration process and its critical effect on Indian banking sector, so the study is descriptive in nature. For the purpose of study secondary data collection method is being used and research question is being set on in the form of objectives as aforesaid.

III FINANCIAL INTEGRATION & CHANGED PERSPECTIVE OF INDIAN BANKING SECTOR

Indian Banking Sector forms organized financial sector. Banks have come a long way from just being the money lenders in the past to a complete financial service provider under single setup, in the present times. However with the evolution of the term 'Anywhere – Anytime Banking' it serves, irrespective of the time, the basic banking transactions of withdrawal and deposit, and also irrespective of the place, almost all other banking and related services. The concept of 'Bank Customer' has taken over the concept of 'Branch Customer'. These changed terminologies are indicative of the change in banking philosophy, be it the old public sector banks or the new generation private and foreign banks. All this is an outcome of 'opening up', which we are referring as 'integration' of the banking sector to link with the other industries of financial sector, as well as, allowing multinational banks to come in. Coupled with international best practices and modern technology banks are offering finest innovative and customized products efficiently managed through improved processes.

Financial sector liberalization has catalysed India's economic development and led to a transformation of the Indian banking sector over the past two decades. With introduction of diversified ways of banking, the sector has shown promising growth which could be evidently seen through profitability, reach, credit growth and fall in NPAs. All this has made Indian banks emerge as strong financial intermediaries. [Source: http://www.isesec.com]

The picture remained impressive till the time the financial sector world over faced the major crisis of its time called 'the credit crisis'. The global crisis led some international banks into bankruptcy and many reached almost on the verge of it. Impact of the crisis was not significant on Indian banking industry as this industry with a worth of Rs.81 trillion /USD 1.34 trillion, drove the country's economic growth, while the world struggled with economic meltdown.

IV OPPORTUNITIES & CHALLENGES OF INTEGRATED FINANCIAL MARKETS ON INDIAN BANKS

It was always understood that financial integration could have both stabilizing and destabilizing effects. Some of the main stabilising effects were expected to come from increased portfolio diversification. As banks and other investors became more diversified across borders, they could reduce their exposure to domestic shocks, and this would be reflected in greater income and consumption risk-sharing. Indeed, global evidence suggested that financial openness and integration had reduced consumption growth volatility. Another benefit comes from improved allocative efficiency. Large cross-border banks have improve overall economic performance, by making sure that productive capital was channeled towards the most efficient firms. This would in turn reduce the risk of crises stemming from mispriced investment risk.

Destabilizing effects of financial integration, on the other hand, were expected particularly through risk-taking and contagion. Asymmetric information problems associated with cross-border lending could lead to misaligned incentives and increased risk-taking. Similarly, savings imbalances abroad could compress risk premia and lower financing costs, allowing an increase in leverage in the domestic financial[1.]

As highlighted in the above statement integrated markets provided broad base to the banks to stabilize, by absorbing the domestic fluctuations through diversification, thereby, gaining trust of its investors, clearly evident, through increase banking practices by the people in India. But at the same time it has exposed Indian banks to the challenges of destabilization due to global macroeconomic factors originating from circumstances as bankruptcy of banking & financial institutions, euro zone crisis, uncertainty and recession in major economies like US and Europe.[2.]

This poses some serious questions about the survival, growth and maintaining the sustainable development. Inspite of the limited exposure, Indian banks also have to bear the consequences of weak global growth originated from the sovereign debt crisis and related funding deleveraging risk especially for European Banks.[3]

V PERFORMANCE OF INDIAN BANKS POST FINANCIAL INTEGRATION: A KALEIDOSCOPIC VIEW

The far-reaching changes in the Indian economy since liberalization have had a deep impact on the Indian financial services sector. The first phase of economic reforms that started in 1985 focused on increasing productivity, new technology import and effective use of human resources. In the second phase, beginning in 1991-92, the government aimed at reducing fiscal deficit by opening the economy to foreign investments. Financial sector reforms during this period focused on modification of the policy framework, improvement in financial health of the entities and creation of a competitive environment.

These reforms targeted three interrelated issues viz. (i) strengthening the foundations of the banking system; (ii) streamlining procedures, upgrading technology and human resource development; and (iii) structural changes in the system. . During last decade, the Indian financial sector (banking, insurance and capital markets) opened up to new private players including foreign companies. . The consequent competition in the market brought in innovation, better customer service and efficiency in the financial sector in India. These developments have given a strong impetus to the development and modernization of the financial sector in India. Going forward the aim would be to achieve international standards in this area.

As the financial services sector players of the future will emerge larger in size, technologically better equipped and stronger in capital base, one can only hope that the regulatory as well as the self regulatory mechanisms will match up to the best worldwide thereby ensuring that the health of the Indian financial system is not only preserved but improved upon and its ability to withstand shocks, which are inevitable with global integration, remains strong.[4]

India is one of the top 10 economies globally, with vast potential for the banking sector to grow. The last decade witnessed a tremendous upsurge in transactions through ATMs, and Internet and mobile banking. In 2014, the country's Rs 81 trillion (US$ 1.34 trillion) banking industry is set for a greater change. The revenue of Indian banks increased four-fold from US$ 11.8 billion to US$ 46.9 billion during the period 2001–2010. In the same period, the profit after tax increased from US$ 1.4 billion to US$ 12 billion. In 2012–13, Indian banks had 170 overseas branches (163 in 2011–12) while foreign banks had 316 branches in India (309 in 2011–12).Credit to housing sector grew at a compound annual growth rate (CAGR) of 11.1 per cent during the period FY 2008–13. Total banking sector credit is expected to grow at a CAGR of 18.1 per cent (in terms of INR) to touch US$ 2.4 trillion by 2017.

Indian banks operating abroad enjoyed a higher credit growth in comparison to foreign banks operating in India, as per an RBI survey on international trade in banking services for 2012–13. According to the survey, growth of credit extended by Indian banks' branches operating overseas grew by 31.7 per cent to Rs 585,570 crore (US$ 97.36 billion); credit extended by foreign banks based in India increased 27.5 per cent to touch Rs 307,700 crore ($51.15 billion).

India's banking sector has the potential to become the fifth largest banking sector globally by 2020 and the third largest by 2025.[5]

The survey report clearly indicates that there exist tremendous expansion and growth potential of the Banking Industry, in the future years to come. The figures appears very impressive, but, at the same time it calls for serious analyzing the external factors that could cause turbulence in the Indian Banking industry and explore the factors that provides stability to Indian Banks in such uncontrollable adverse environment.

VI FINANCIAL STABILITY

Global financial crisis has again raised the concern to analyse in depth as to what extent monetary policy frameworks should take into account financial stability objectives. It is essential to seek answers to effectiveness of macro prudential policy in maintaining financial stability and effect of monetary policy on risk taking. it is crucial to know whether macro prudential policy framework is the main tool for maintaining financial stability and how closely monetary policy authorities should also keep an eye on financial stability. This will allow the central bank to lean against the wind if necessary, while maintaining its primary focus on the medium term stability concern.[6] There is a significant impact of macro prudential norms of monetary policy on financial stability. The advanced researches conducted particularly on Euro area indicates the emerging paradigm in which both monetary policy and macro prudential policy are used for countercyclical management of price stability and financial stability (respectively).

IMF indicating to volatility and stagnation which persisted in Asia recommended in its report published in 2014 that Asian policy makers must push ahead with structural changes to ensure the region continues to lead global growth and withstand volatility as the U.S. reduces monetary stimulus. Asian economies will face higher interest rates and bouts of volatility in capital flows and asset prices as global liquidity tightens amid a recovery in advanced nations.[7] According to IMF estimates the biggest challenge that lies ahead of Asian countries is global financial volatility. Mentioning India and China as faster growing emerging economies of Asia, sustenance of growth pace becomes extremely crucial task for the policy makers of these countries in not so favourable global economic environment. What makes or will make India financial sector sustain its growth when the volatility poses opposite pressure?

After an extensive search of existing work done by the scholars in India and world over following potential areas have been drawn out where the scope for exploring more exists. It is quite clear that financial integration poses many challenges on the financial sector including the banking sector globally. However, the contribution by the Indian researchers in this area is minimal as only a few relevant research works published could be gathered.

Indian central banking norms have not been studied and compared with the international standards (BASEL). Also the effectiveness of RBI's policy norms have not been analysed so far. Analysis of stability factors underlying Indian banks and their comparative analysis of financial stability during crisis times.

VII CONCLUSION

Presently, India stands promisingly with other developed nations which would likely bring a range of new tie-ups and integrations. This will increase country's exposure and consequently will be a greater challenge for stability. Here, global meltdown is a lesson to learn from, as it has changed financial architecture altogether and imposed challenges to handle risk management in a strategic way.

With its aim to grow as third largest industry by 2020, Indian banking sector has to adopt the best management practices to keep in tune with global developments. It should cover issues such as enhancing transparency, strengthening risk management, a framework including government arrangements in banks and financial institutions, regulating ratings agencies and modifying monetary policy makers' operational frameworks. Finally, there is need for pursuing an effective institutional mechanism that supports equitable and inclusive development by Indian Banks.

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