

A Study on Contemporary Challenges and Opportunities of Retail Banking in India

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Abstract

The landscape of India's financial sector is changing. Anytime, anywhere banking, using differentiated channels and technology, will enable a multi-fold increase of reach in rural and remote areas. Coupled with the emergence of a new class of banks—the small and payments banks—one of the biggest impacts of technology adoption will be rapidly accelerating financial inclusion by making last-mile access more cost effective and expanding the reach of banking to the unbanked. Powerful forces are reshaping the banking industry. Customer expectations, technological capabilities, regulatory requirements, demographics and economics are together creating an imperative to change. Banks need to get ahead of these challenges and retool to win in the next era. Banks must not only execute on today's imperatives but also radically innovate and transform themselves for the future.

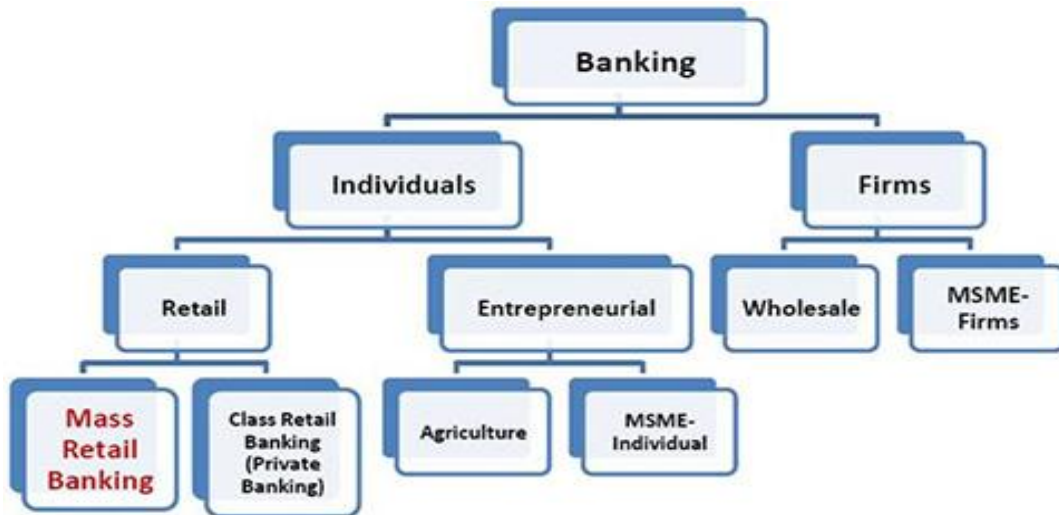
India's banking and financial sector is expanding rapidly. The Indian Banking industry is currently worth Rs. 81 trillion (US \$ 1.31 trillion) and banks are now utilizing the latest technologies like internet and mobile devices to carry out transactions and communicate with the masses. The Indian banking sector consists of 26 public sector banks, 20 private sector banks and 43 foreign banks along with 61 regional rural banks (RRBs) and more than 90,000 credit cooperatives. According to the global perspective it has potentials to become the fifth largest bank industry in the world by 2020 and third largest by 2025. The present study aims to focusing on the contemporary challenges and opportunities of the Retail Banking sector in India.

Keywords: Retail Banking, Regional Rural Banks, Digital Innovation, Digital channel

INTRODUCTION

Retail Banking is also known as Consumer Banking is the delivery of services by a bank to individual consumers, rather than to companies, corporations or other banks. Services offered include savings and transaction accounts, mortgages, personal loans, debit cards, and credit cards. India too experienced a surge in retail banking after the financial sector reforms in early nineties. There are various pointers towards this. Retail banking in India has fast emerged as one of the major drivers of the overall banking industry and has witnessed enormous growth in the recent past. Retail banking is the cluster of products and services that banks provide to consumers and small businesses through branches, the Internet, and other channels. In recent years, retail banking has become a key area of strategic emphasis in the Indian banking industry, as evidenced by rising trends in retail loan and deposit shares on commercial bank balance sheets and a continuing increase in the number of bank branches. Across the globe, retail lending has been a spectacular innovation in the commercial banking sector in recent years.

A graphical representation of the positioning of mass retail banking vis-à-vis other segments of banking is as under:



THE EVOLUTION OF RETAIL BANKING

Powerful forces are transforming the retail banking industry. Growth remains elusive, costs are proving hard to contain and ROEs remain stubbornly low. Regulation is impacting business models and economics. Technology is rapidly morphing from an expensive challenge into a potent enabler of both customer experience and effective operations. Non-traditional players are challenging the established order, leading with customer-centric innovation. New service providers are emerging. Customers are demanding ever higher levels of service and value. Trust is at an all-time low.

In the developed markets, banking over the years has evolved through following three distinct phases. These three phases broadly coincide with the level of development in the real economy in the respective jurisdictions.

- a) Initial Phase: During this phase the banks were primarily engaged in offering the basic intermediation service i.e. provision of savings facilities and credit for productive purposes and also facilitate payment services including remittances
- b) Intermediate Phase: Apart from providing the services offered in the initial phase, the banks additionally moved into lending for consumption purposes. The banks also started offering certain para-banking services like insurance etc. The demand for such services arises primarily on account of a transition of the economy from an investment (production) led growth phase to a consumption led growth phase. At this stage of development of the economy and the society, retail banking becomes relevant.
- c) Advanced Phase: Apart from providing the services offered in the intermediate phase, the banks have additionally started providing high-end savings & investment products, wealth management products, and structured products to both individuals and corporates. In other words, in this phase, the banking system additionally starts supporting the speculative activities over and above for the production and consumption activities. Private banking, an advanced version of retail banking for 'classes', becomes relevant at this stage.

GROWTH OF RETAIL BANKING IN INDIA

To gauge the evolving importance of retail banking, one would ideally examine a single, comprehensive measure of retail banking activity that could be calculated for individual banks and for the industry as a whole. Potential candidates might be the share of revenue or profit derived from retail activities or the share of risk capital allocated to these business units. The growth in retail banking has been facilitated by the growth in banking technology and automation of banking processes that enable extension of reach and rationalization of costs. ATMs have emerged as an alternative banking channel, which facilitate low-cost transactions vis-à-vis traditional branches. It also has the advantage of reducing the branch traffic. It also enables banks with small networks to offset the traditional disadvantages by increasing their reach and spread. Moreover growth of retail lending, especially, in emerging economies, is attributable to the rapid advances in information technology, the evolving macroeconomic environment, financial market reform, and several micro-level demand and supply side factors.

GROWTH IN MONEY SUPPLY OVER PAST FEW YEARS (US\$ BILLION)



Source: RBI, TechSci Research FY16: as of May 29

OBJECTIVES OF THE STUDY

The objective of this paper is to explain the changing banking scenario, to analyze the opportunities and challenges of Retail Banking in India. In addition to this; an attempt is made to understand the significant priorities of banks in India. The main objectives of the study are:

1. To analyse the competition prevailing in Retail Banking Service
2. To highlight various Opportunities & Challenges to Retail Banking in India
3. To give suggestions to expand Retail Banking in India

RESEARCH METHODOLOGY

This paper is the outcome of a secondary data on Retail Banking Sector with special reference to Indian context. To complete this, annual reports, various books, journals and periodicals have been consulted, several reports on this particular area have been considered, and internet searching has also been done.

OPPORTUNITIES AND CHALLENGES OF RETAIL BANKING IN INDIA

Retail banking has immense opportunities in a growing economy like India. As the growth story gets unfolded in India, retail banking is going to emerge a major driver. The rise of the Indian middle class is an important contributory factor in this regard. The percentage of middle to high income Indian households is expected to continue rising. The younger population not only wields increasing purchasing power, but as far as acquiring personal debt is concerned, they are perhaps more comfortable than previous generations. Further increased competitions for retail deposits and tighter regulations have created challenges, but also opportunities for banks able to adapt

quickly to the new banking environment. While retail banking offers phenomenal opportunities for growth, the challenges are equally daunting. How far the retail banking is able to lead growth of the banking industry in future would depend upon the capacity building of the banks to meet the challenges and make use of the opportunities profitably.

The combination of the above factors promises substantial growth in the retail sector, which at present is in the nascent stage. Due to bundling of services and delivery channels, the areas of potential conflicts of interest tend to increase in universal banks and financial conglomerates. Some of the key policy issues relevant to the retail banking sector are: financial inclusion, responsible lending, and access to finance, long-term savings, financial capability, consumer protection, regulation and financial crime prevention.

CHALLENGES OF RETAIL BANKING IN INDIA

The economic downturn has resulted in a number of challenges facing the retail banking industry, including increased regulatory pressure, low interest rates, a shift toward digital, and a clear decline in trust and loyalty. In reaction, there's a drive toward customer centricity. The focus needs to be on the relationship with customers, factoring in technologies such as interconnectivity, digital living, cloud, mobility, and social influence. Increasing proliferation of digital channels and evolving customer preferences – the two key factors influencing banking trends, have necessitated retail banks to rethink their business strategy. Transforming their business processes to take advantage of these trends can help retail banks deliver differentiated products, and faster and more efficient services. Thus, helping them stay relevant by enhancing customer's experience, and improving market competitiveness.

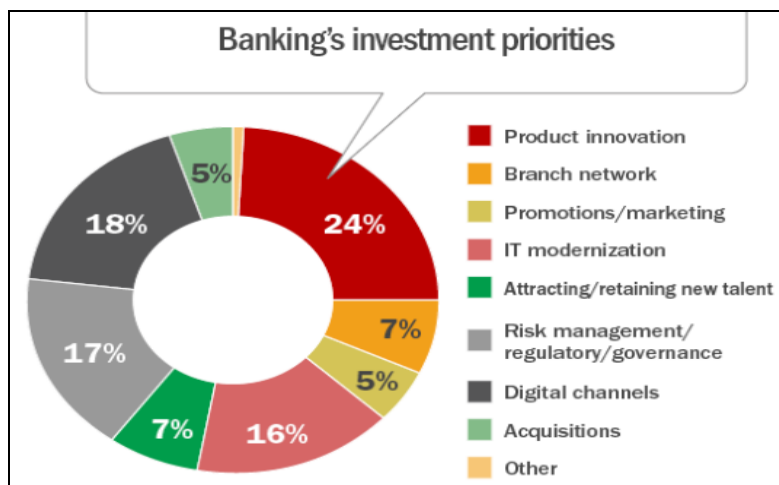
Retail banks are currently facing an unprecedented challenge – how best to engage with the digital consumer to provide great cross-channel customer experiences that build lasting, meaningful relationships. Banks need to get ahead of these challenges and retool to win in the next era of competition. This is imperative, and also a tremendous opportunity. Banks need to make hard choices about which customers to service, how to win and where not to play. They need to rebuild their organizations around the customer, simplify and structurally reduce cost. They need to learn to be agile, innovative and adaptable in order to execute effectively.

First, Today's challenges Unsurprisingly, nearly all bankers surveyed view retention and attracting new customers as one of their top challenges over the next two years – banks are hungry for growth, and finding new customers is the first response of a good product banker. Service quality in retail banking is a critical factor to customer satisfaction which aid in customer retention. Customer complaint redressal systems have to be robust and should be handled carefully. Further in the more rapidly developing India as an emerging market, where big, established banks have less dominance, bankers report that attracting talent and retaining existing customers in face of fierce competition and new market entrants are also top challenges. However,

banks also recognise the need to deepen their customer relationships and focus more on specific customer outcomes. Hence, enhancing customer service is the number one investment priority for banks, globally.

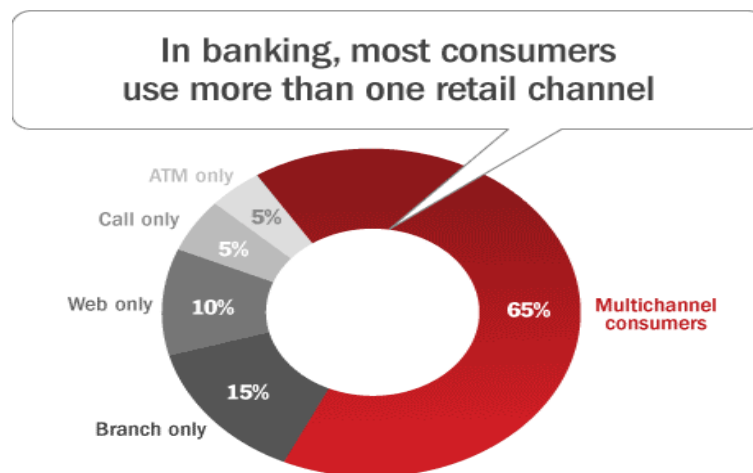
Second, the biggest challenge faced by the Indian banks in the field of retail banking is going to be the rising indebtedness. Consumer debt is growing fast in India. Middle class not only wields increasing purchasing power, but also has an evolving appetite to take on debt for acquisition of assets and supporting their aspiring lifestyle. Significant growth has been witnessed in the financing of automobiles, mortgages, white goods and consumer durables. However, India has massive room for high growth in all these areas, as the level of retail credit penetration is extremely low compared to other developed and developing economies. From a demand side perspective, rising incomes, asset ownership aspirations and low perception of risk is fuelling the rapid growth in demand for retail credit. On the other hand India's retail banking industry is one of the major beneficiaries of the country's ascendant economic power. Improving consumer purchasing power, coupled with more liberal attitudes toward personal debt, is fuelling India's explosive banking segment.

Third, Key emerging technology trends that are changing the way banks do business. Technological Advancement poses both opportunities and challenges. Demographic changes will provide opportunities for growth and will require innovation to develop new products and services. Innovation will be the single most important factor driving sustainable top- and bottom line growth in banking over the next five years. Digital innovation, Mobile banking and Technical innovation are the greatest opportunity for the retail banking to differentiate themselves from their competitors. The evolution of internet-based banking, particularly the promotion and sale of products represents an area of noteworthy opportunity, particularly for more flexible challenger banks. Customers favour internet banking for simple transactions. The pace of innovation will continue to increase, and leading banks will need to enable or leverage this innovation. Technology will change everything – becoming a potent enabler of increased service and reduced cost; innovation is imperative.



Further Digitalization is both a threat and an opportunity for retail banks. To succeed, they need to transform their branch networks to address the Internet age, and overhaul their internal processes and systems to better deliver the service and technology their customers want. More importantly, digitalization means rethinking, redesigning and refining the customer experience – and investing in change management for the bank management and staff.

Fifth, Direct/digital channels and retail banking is one of the predominant drivers and challenges in retail banking across the globe is the ongoing evolution towards direct models and channels, predominantly digital channels. The rise of direct and digital channels in retail banking, with an increasingly important role for mobile, obviously does not stand alone. Consumers are channel-agnostic and it's clear that retail banks as a result need to align their channel distribution approach and move from multi-channel to omnichannel distribution strategies. With face-to-face interaction and the “human touch” in retail banking remaining important, the customer-oriented channel mix is essential, looking at the customer life cycle rather than at individual behaviour. Furthermore, the cost-efficiencies associated with digital channels must be exploited to build a sustainable multi-channel business. Building trust in digital channels will be a prerequisite for this medium to expand its product footprint. By 2020, banks will manage distribution holistically. Products will not be built-into, or serviced through, the channel: rather, banks will develop shared platforms that distribute products across all channels.



REASONS FOR EXPAND RETAIL BANKING IN INDIA

Every bank needs to develop a view of the future landscape, and the uncertainties surrounding it. Every bank needs a clear view of its own unique strengths and challenges. And every bank needs to develop its posture against this evolving and uncertain future. Priorities for 2020 However, the pace of change is increasing and banks need to do even more to ensure they are well-positioned to succeed in the future.

Banks universally agree that they are hindered from addressing these priorities by financial, talent, technology and organisational constraints. Banks need to take aggressive action to ease these constraints, and manage them in a more agile manner to enable innovation and transformation, while preserving their optionality to capitalise on market opportunities and address unexpected challenges

Banks will organize themselves around customers instead of products or channels - They will offer a seamless customer experience, integrating sales and service across all channels. They will develop the ability to view customers as a 'segment of one', recognizing their uniqueness, and tailoring their offerings so that customers view banks as 'meeting their needs' not 'pushing products'. Customer expectations are being shaped by their interactions outside of the banking industry – they increasingly want the type and quality of service they receive from industries that place significant focus on customer experience. Customers are also increasingly connected to others across social, geographic and demographic boundaries. This 'social world' augments close friends and family as the primary source of information, opinion and recommendation.

Social media will be the media - One of the biggest challenges for the banks are to understanding and harnessing the power of social media. Today, social media is coexisting alongside traditional media. By 2020, social media will be the primary medium to connect, engage, inform and understand the customers (from the mass 'social mind' to the minutiae of each and every individual), as well as the place where customers research and compare banks' offerings. Several banks today are connecting to customer through various social media platforms. Mastery of social media will be a core competency. And, as today, information and opinion (good or bad) can be amplified, creating new risks and opportunities. Opportunities include greater engagement and proactive risk management.

Customer trust will be returning - Customer trust is at an all-time low, and they want their banks to be more socially responsible. The new middle class is likely to be fickle in its banking relationship – given the very low costs of, and multiple available options for, switching. The key to building and profiting from a long term relationship with this segment will be the ability to build trust over a series of transactions. They are also concerned about privacy and security, as more of their personal information and financial life migrates online. Some banks will benefit significantly from taking a leadership role in the public debate. The leading firms will have reclaimed at least some of the high ground they lost in the financial crisis and begin to reshape public opinion. They will inform and educate – from mass offerings on basic financial skills, culture and economics, are of the fundamental benefits of banking to society. However, banks also recognize the need to deepen their customer relationships and focus more on specific customer outcomes. Banks must target a level of trust in the service akin to that held by branches. Hence, enhancing customer trust is the number one investment priority for banks, globally.

Cyber security is paramount to rebuilding this trust – winners will have invested significantly in this area. There are now higher expectations about security of information and privacy among clients, employees, suppliers and regulators. By 2020, leading banks will have developed cyber-security strategies that are aligned with their business objectives, risk-management protocols and regulatory requirements. Many banks lack the resources to tackle these issues on their own, and will have partnered with third parties.

Enhanced capital and risk management - Global regulation of capital, liquidity and related stress-test requirements, as well as enhanced prudential standards, will continue to evolve and eventually force globally active and/or systematically important banks to meet even higher stringent and binding standards. These requirements are making a compelling case to seek alignment of risk appetite, capital planning and adequacy assessment, recovery and resolution planning, liquidity risk management, stress testing and overall enterprise risk management activities. Establishing a common thread of consistency to support a sound, robust and integrated enterprise risk framework will be key to meeting regulatory expectations from both micro- as well as macro-prudential perspectives.

Customer experience: Understand how customer loyalty and retention is affected by a mix of superior digital experiences and human interaction, and how delivering this mix is the primary challenge. Customer experience is defined as the end-to end interaction of a customer with a company or product and it has reached a level of paramount importance in recent years for across industries and sectors. Nowhere is the changing landscape of customer expectations and technology more evident than Retail Banks are shifting their focus away from rationalizing product offering towards a cohesive, simple and personalized customer experience. Customers' growing use of digital channels for banking and their demand for an individualized experience have forced many banks to revisit their customer service efforts. In the face of increasing competition from emerging digital banks, which are redefining customer experience and luring younger customers, traditional banks must leverage digital channels to create a more rewarding customer experience. For a successful transition to digital banking, banks must formulate a strategy focused on six key areas: customer, mobile and online capabilities, use of customer data, social media, modernized branches/ATMs and provision for a seamless experience across all channels.

PRIORITIES OF THE NEW MILLENNIUM

Each bank needs to develop a clear strategy to deal with this transforming landscape. To succeed in this rapidly changing landscape, banks need to have a clear sense of the posture they wish to adopt – whether to shape the industry, rapidly follow the leaders, or manage defensively, putting off change. They need to create agility and optionality, to adapt to rapid change and future uncertainty. Yet, whatever the chosen strategy, success will come from successfully executing the right balance across the following six priorities.

The following six priorities for retail banks to win in 2020:

1. Developing a customer-centric business model.
2. Optimising distribution.
3. Simplifying business and operating models.
4. Obtaining an information advantage.
5. Enabling innovation and the capabilities required to foster it.
6. Proactively managing risk, regulations and capital.

CONCLUSION

The financial services industry is going through dramatic changes as a consequence of changing customer behaviour, increasing expectations, channel proliferation, disruption, innovative use and adoption of new technologies and the digitization of business and society in general. Cost reductions, increasing top-line revenue and mitigating risk remain the key drivers, also in retail banking. 90% of consumers prefer online banking services, regardless of age, income, place of residence or type of bank. However, much of the landscape will change significantly in response to the evolving forces of customer expectations, regulatory requirements, technology, demographics, new competitors and shifting economics. Since retail banking requires mass production techniques, the advent of technology has enabled the banks to design appropriate technology-based delivery channels. Retail banking has also received a thrust from the regulators/policymakers' push for inclusive growth in the wake of the global financial crisis. The Governments across the world view banks as the key component in furthering the cause of financial inclusion. And they need to have a clear strategy to deal with these challenges and address these priorities, including considering partnerships with third parties and applying lessons from other industries. The Retail banks need to do even more to ensure they are well-positioned to succeed in the future.

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