COMPETITION IN INDIAN BANKING: ISSUES AND IMPLICATIONS[1]

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It gives me pleasure to deliver the valedictory address at the 19th Bank Economists' Conference 1996 being hosted by the United Western Bank. I have, with much interest, gone through the papers circulated by the organisers. The papers are comprehensive and I am particularly impressed by the coverage, depth of analysis and the innovative ideas that have emerged.

The rapporteurs' succinct and prompt report of the proceedings during the past two days confirms the wide spectrum of issues that were debated and I trust that everyone here will return enriched with ideas.

Governor, Dr. Rangarajan, in his inaugural address referred to competition in an industry as a composite of five competitive forces. All industries are characterised by historical trends and new developments that either gradually or speedily produce changes important enough to require a strategic response from participating agents. The Indian banking industry is no exception. The rapid changes that have occurred during the last few years in the financial sector have increased competition in the banking industry. The issue has gained such predominance, that it warrants brainstorming as in this Conference.

The conditions in the banking industry have changed and are changing all over the world. In our country, economic reform and in particular financial sector reform has altered the atmosphere in which the participants operate.

First, market size - Usually, a small market does not attract too many competitors. The size of the market is so large and with GDP likely to grow at 6.5 per cent in the medium-to long-term, the Indian banking industry has become very attractive-as never before.

Second, industry profitability-higher by the standards of the past or international standards is attracting more new entrants. Hence, increasing competition in the industry.

Third, rapid technological change-This enables not only quicker and more efficient service but advantage to new entrants over existing players.

Fourth, product innovations-Features such as home banking, ATMs are all making the industry to be continuously alert, and fiercely competitive.

Fifth, entry/exit norms-While regulatory barriers have been eased, desirable barriers exist in the form of capital and other requirements. After all banking license cannot be like a driving license. But, entry norms are fairly clear, though exit norms are not clear yet.

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[1] Valedictory Address by Dr.Y.V. Reddy, Deputy Governor, Reserve Bank of India at the 19th Bank Economists Conference at Mahabaleshwar on December 18, 1996.

Sixth, markets are increasingly getting integrated in our country also. Domestic and foreign currency, banking and non-banking are getting closer. Correspondingly, there are institutional innovations and interlinkages, both in ownership and operations - be it in depositories or mutual funds.

Seventh, consumers of banking services are getting increasingly agile, enlightened, cost and quality conscious. They are already forcing the pace of competition on price, product and quality products.

Competition does not mean that banks cannot enter into strategic alliances. The clearing house is one form of strategic co-operation already in place. In fact, such strategic cooperation will give banks a competitive advantage over others. I believe that banks should forge strategic alliance without undermining competition. At the same time, there should not be any element of cartelisation. We can readily think of some areas where banks can enter into strategic alliances.

First, technology related, where interconnectivity would be of great advantage.

Second, marketing related, such as exchange of information on credit record of customers, customer guarantees, inter-bank participation, and of course, syndication.

Third, organisation related, especially in dialogues with the law makers and regulators on the need for changes.

In fact, the scope for self regulation should be actively explored. Perhaps, there should be a Conference to explore avenues for cooperation that will enhance the strengths of banks in relation to others.

Fourth, incidentally, there can be what is termed as segmented alliances also. For example, public sector banks can cooperate, as in fact they are doing now in some cases, to create common supporting services that will help them to capture economies of scale.

At this stage, I would like to quickly respond to some points raised in the technical sessions.

The first technical session rightly focussed on decisive factors in competition, and it includes Government policy. Perhaps, we should more explicitly recognise the growing importance of the stance of the Central Bank. A reference has been made to the need for advance intimation on sequencing of reforms, in the context of international experience. Yes, it would be useful to have a broad idea though there are limits to transparency if anticipatory actions are to be avoided. The Narasimham Committee Report provided an initial framework. Pronouncements by the Governor of RBI have been indicating clearly the direction - both in monetary policy and credit policy.

There is some truth in the statements that competition is yet to penetrate - especially in the rural segments. We believe that the concept of Local Area Bank is meant to tackle this issue, and we feel that it will spur competitive spirit.

There is some reference to duality of control between the RBI and Government - especially the State Governments in the cooperative sector. Admittedly, there are issues which affect autonomy and level playing field that arise out of the nature of organisation, ownership, etc. governed by different laws - cooperatives or nationalised banks.

In the second session, there was a reference to the increasing uncertainties and risks emanating out of competition in banking. This is indeed an area in which we have to improve our perceptions and professional skills. The emerging scope for universal banking has also been mentioned. More important, it is said that government will continue to be a major borrower. But, there should be an answer to the question as to why banks are lending, at least now, more to the government than what they need to under SLR obligations. Is it because the private borrowers do not want to borrow at what they call high interest rates? In fact interest rates are not high compared to sometime in the past, when the industry was worried about availability of credit and not cost. Perhaps, inflationary expectations have come down and the industry does not wasn't to borrow at these rates. Industry also has more avenues for credit from non-banking sources, including the capital market. You may like to think about these.

The third session made very perceptive analysis of core competencies, further steps towards global competition and the special advantages as well as disadvantages of various segments of our banks. We have to recognise the importance of transition. We have to give some reasonable time and opportunity to existing participants to equip themselves to compete on a level playing field overcoming the overhang of the problems of the past. Our goal is clear, viz., competition - but competition does not exist in a vacuum. Competition has to be ensured by the regulatory authorities.

Before concluding, let me share with you what I believe are some emerging issues, though many of them have already been mentioned in the papers circulated and your deliberations.

First, the issue of competition is irrevocably linked with regulatory framework and level playing field. This issue has been constantly raised in different forums and this relates to not only banks but also to other financial intermediaries. The financial sector is still in transition and let me assure you that this is an area that will gain greater attention in the future.

Secondly, all other industries are vocal about the 100 million middle-class. The corporate sector is increasingly talking about exploiting the potential in the rural-semi-urban markets. Perhaps, we should question the relevance of rural-urban dichotomy and look at rural-urban continuum.

Thirdly, when competition intensifies, there has to be inevitable changes such as mergers- what I earlier referred to as exit norms. As one of the Conference papers pointed out, the net result in any field is either the crowding out of the weaker players or their amalgamations with the stronger ones.

Fourthly, in this context, banks should concentrate on study of the success stories as well as bank failures. Internationally, there are elaborate documented studies on bank failures; Barings is just one example. We too need to make an incisive analysis of banks that failed in our country and learn not to commit similar mistakes.

Fifthly, we have to think seriously about the nature of the control that exists. Banks will need to be given more autonomy, and more important, they should assert their autonomy. Here lies the importance of industry associations. The scope for self-regulatory industry norms and banking industry protocol should be explored. This will bring about more flexibility to banks and less regulatory intrusion.

Sixthly, I noticed a suggestion in one of the papers to make Mumbai as an international financial centre. Similarly suggestions have been made in the past and we have some reservations, but we always have an open mind. A number of issues have to be clarified in our minds - whether such a financial centre can be started before we reach international standards? Whether we need to promote such a centre at this stage of financial sector reforms or at a later stage? Please study these issues in a more detailed and formal manner, and then we can take a view.

Seventhly, there is a lot of interest from foreign entities in the opening up of the insurance sector in India. Perhaps, both banks and policy makers need to assess whether domestic banks, particularly larger banks, have an opportunity to enter into either general or life insurance through subsidiaries or collaborations, to take advantage of their existing market penetration. Could this really add to the competitive strength of the banks in financial intermediation?

Friends, as we economists know, competition is not just an end in itself. It is a means. The end result or objective is efficiency. Our objective of reform should be equalling global standards to compete effectively and soon after excelling global standards to make a respectable place for ourselves in the fast progressing global financial sector. Other countries like Japan did it. Why not India? We have the talent. Many sophisticated deals in London or New York are done by young Indians. We have numbers also in our favour. All we need is changing the mindset, impart training and bestowing serious attention to incentive structures. We in the Reserve Bank of India do look forward to your suggestions. Please come up with your ideas on when and how we reach and then set global standards.