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An Analysis of Indian Banking Industry with Special Reference to ICICI Bank

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Abstract: **The last decade has seen many positive developments in the Indian banking sector. The policy makers, which comprise the Reserve Bank of India (RBI), Ministry of Finance and related government and financial sector regulatory entities, have made several notable efforts to improve regulation in the sector. The sector now compares favorably with banking sectors in the region on metrics like growth, profitability and non-performing assets (NPAs). However, improved regulations, innovation, growth and value creation in the sector remains limited to a small part of it. The cost of banking intermediation in India is higher and bank penetration is far lower than in other markets. India's banking industry needs to strengthen itself significantly In this paper, I have mainly focused on the overall analysis of the banking industry through framework like Porter's five forces model. I have also concentrated upon the various developments being done in the industry along with recognizing the upcoming challenges as well as the opportunities to reap the profits even in troubled waters.**

Keywords: **Indian banking industry, Porters five force model, market regulation.**

I. Introduction

The Indian banking industry, which is governed by the Banking Regulation Act of India, 1949 can be broadly classified into two major categories, non-scheduled banks and scheduled banks. Scheduled banks comprise commercial banks and the co-operative banks.In the banking industry analysis the important thing needed is to first look whether we are talking of the investment banking or commercial or retail banking. In each of these areas, the players, competition, customers, suppliers and regulators differ. Similarly there is a difference in the geography and region in which the banks operate. Though owing to globalization there is a shift towards a common banking platform and practices, yet the banking industry in Europe or USA differs widely with that of India or Middle East. In my analysis I have mainly focussed on the commercial or retail banks of India. But I have taken into account the competition in the Indian markets where foreign banks have started playing a major role.

The banking industry in India has a considerable big history attached to it. From the traditional banking practices during the time of britishers to the reforms period, nationalization to privatization of banks and now increasing numbers of foreign banks in India. Therefore, banking in India has gone through a long journey. Banking industry in India has also achieved a new height with the changing times. The use of technology has brought a revolution in the working style of the banks. Nevertheless, the fundamental aspects of banking i.e. trust and the confidence of the people on the institution remain the same. The majority of the banks are still successful in keeping with the confidence of the shareholders as well as other stakeholders.

Before I start analysing the industry, we need to look into the role of the regulator in the Indian Banking industry, the role of the Reserve Bank of India. Reserve Bank of India Act was passed in 1934 & Reserve Bank of India (RBI) was constituted as an apex body without major government ownership. Banking Regulations Act was passed in 1949. This regulation brought RBI under government control. Under the act, RBI got wide ranging powers for supervision & control of banks. From the Nationalization of Banks in the 70s to the advent of liberalization policies of the 90's, banks were mostly under government control without the large presence of private and foreign players.

In the early 1990s, the then NarasimhaRao government embarked on a policy of liberalization, licensing a small number of private banks. The next stage for the Indian banking has been set up with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions. So, my analysis would mainly focus on the private, government as well as the foreign players in the Indian Banking industry.

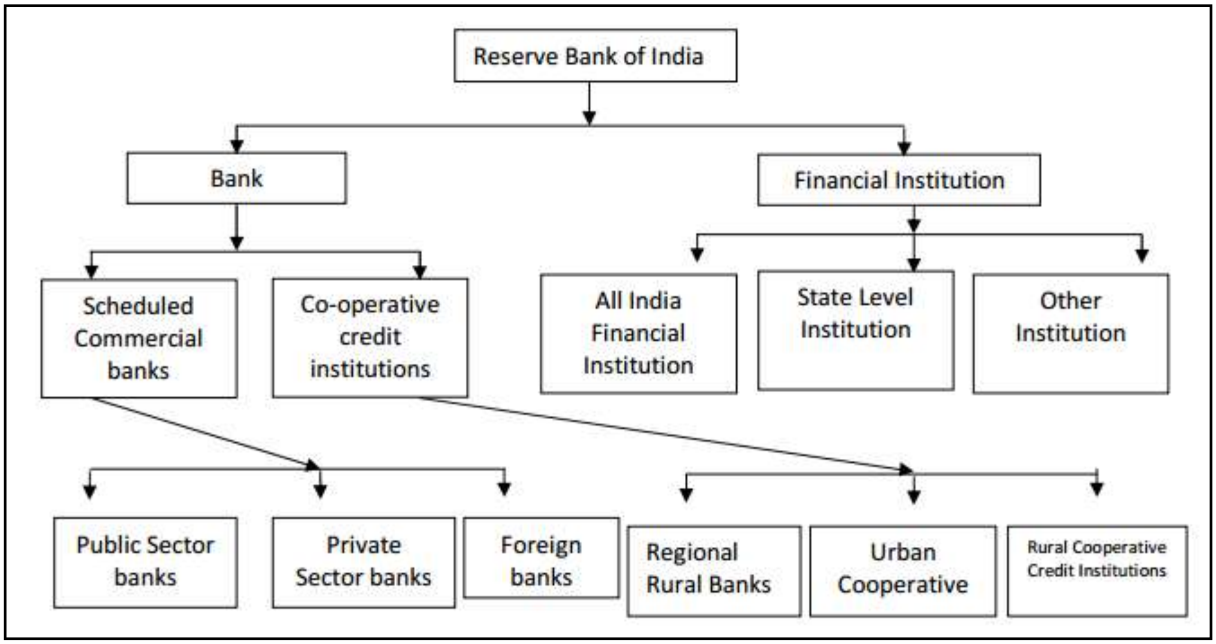

Figure 1. Structure od Indian banking industry

Source:

The market of the Indian Banking industry apart from the above classification as depicted in the above **figure-1**,might also be classified from the demand side as well as the supply side. From the Indian market we will focus on the urban middle class population serviced by the public sector, private sector and foreign banks, or precisely the supplier side.

This paper has kept two broad factors in mind during the study which are :

i. The increasing competition among a broad range of domestic and foreign institutions in providing banking and related financial services.

ii. Financial activity has become larger relative to overall economic activity in the Indian economy. This has meant that any disruption of the financial markets or financial infrastructure has broader economic ramifications than might not have been the case previously.

So overall we would look into the Indian urban consumers and their banking preferences while analysing the demand side. For commercial banking we would also keep in mind the financial requirement of the Indian industries to which the banks supply. On the supply side we would mainly focus on the players like, SBI, PNB, Canara, and other players from the public sector, ICICI Bank, Axis Bank, HDFC, Indus land, Kotak Mahindra and Yes bank from the private sector and also Citibank, Standard Chartered, HSBC, Deutsche, DBS Bank, Barclays, BNP Paribas, and others.

II. Porter's Five Force Analyses For Indian Banking Industry

In this industry analysis notably Five Forces analysis – I have looked at the industry profitability being determined by competition in two markets: product markets and input markets. In the product market I have looked into the services provided by the above mentioned banks and while analysing the input part I have mainly looked into the government of India's and mainly RBI's policies and regulations.

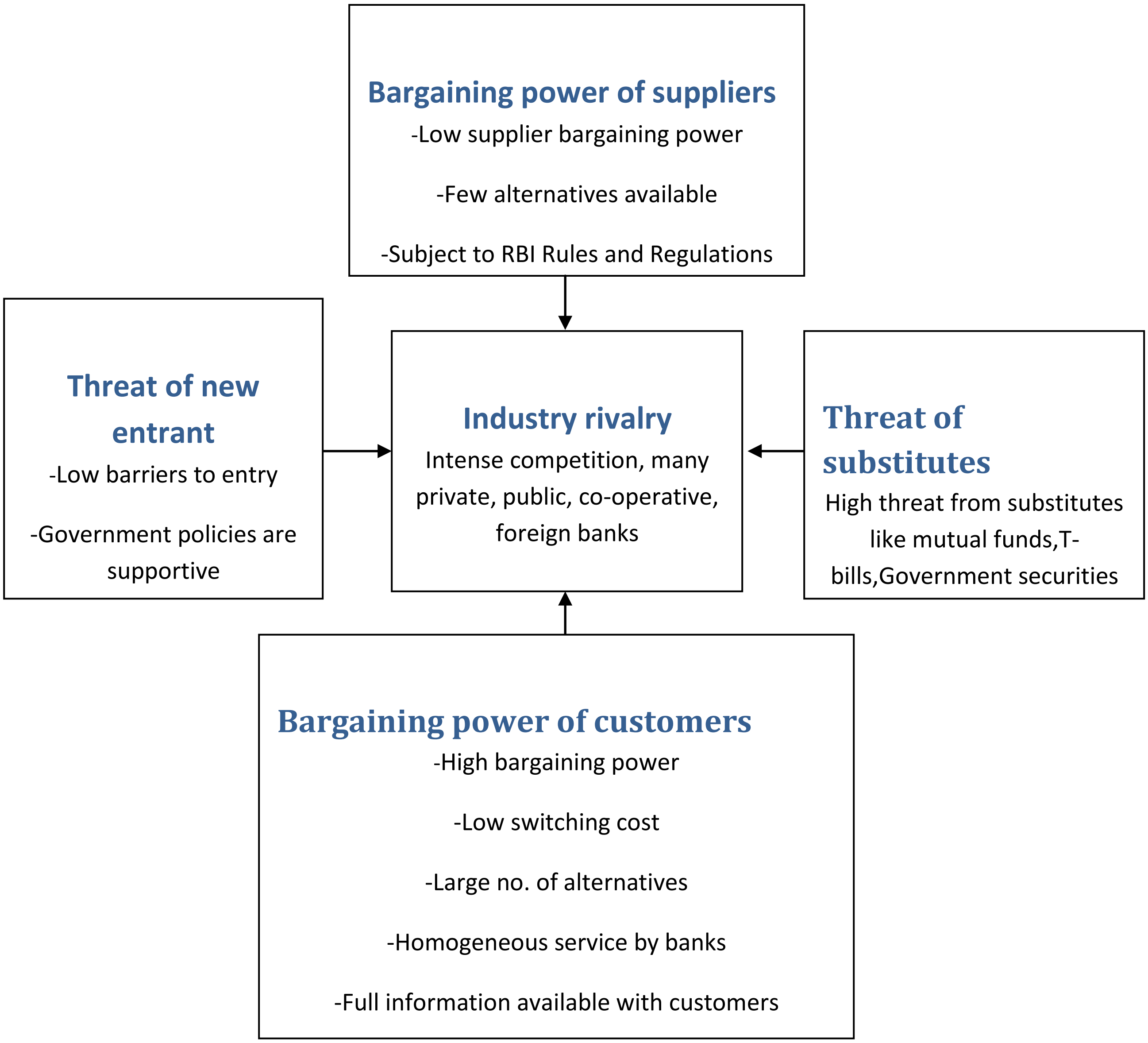

Figure 2. Porter's five force model

Source:

Looking at all of the above points in **figure-2** individually:

Rivalry among the industry: Rivalry in banking industry is very high. There are so many private, public, co-operative and non-financial institutions operating in the industry. They are fighting for same customers. Due to government liberalization and globalization policy, banking sector became open for everybody. So, newer and newer private and foreign firms are opening their branches in India. This has intensified the competition. The factors that have contributed to increase in rivalry are:

- **Number of players:** There are so many banks and non-financial institutions fighting for the same pie which has intensified competition.
- **High market growth rate:** India is seen as one of the biggest market place and growth rate in Indian banking industry is also very high. This has ignited the competition.
- **Low switching cost:** Customer switching cost is very low. They can easily switch from one bank to another bank and very little loyalty exists.
- **Undifferentiated services:** Almost every bank provides similar services. No differentiation exists. Every bank tries to copy each other's services and technology, which increases the level of competition.
- **Low government regulations:** There are low regulations to start a new business due to the LPG policy adopted by India post 1991. So, sector is open for everybody.

Bargaining power of suppliers: Suppliers of banks are depositors. These are those people who have excess money and prefer regular income and safety. In banking industry suppliers have low bargaining power. Following are the reasons for low bargaining power of suppliers:

- **Nature of suppliers**: Suppliers of banks are generally those people who prefer low risk and those who need regular income and safety as well. Bank is best place for them to deposit their surplus money. They believe that banks are safer than other investment alternatives. So, they do not consider other alternatives very seriously, which lowers their bargaining power.
- **Few alternatives:** Suppliers are risk averters and want regular income. So, they have few alternatives available with them to invest like Treasury bills, government bonds. So, few alternatives lower their bargaining power.
- **RBI Rules and Regulations:** Banks are subject to RBI rules and regulations. Banks have to behave in the way that RBI wants. So, RBI takes all decisions relating to interest rates. This reduces suppliers bargaining power.
- **Suppliers are not concentrated:** Banking industry's suppliers are not concentrated. There are numerous suppliers with negligible portion to offer. So, this reduces their bargaining power. If they were concentrated then they can bargain with banks or can collectively invest in other non risky projects.
- **Forward integration:** Forward integration is possible like mutual funds, but only few people now about this. Only educated people can forwardly integrate where as a large number of suppliers are unaware about these alternatives.

Bargaining power of customers: Customers of the banks are those who take loans, advances and use services of banks. Customers have high bargaining power. Following are the reasons for high bargaining power of customers:

- **Large number of players:** Customers have very large number of alternatives. There are so many banks, which fight for the same pie. There are many non-financial institutions which have also jumped into this business. There are foreign banks, private banks, cooperative banks and development banks together with the specialized financial companies that provide finance to customers. These all increase preferences for customers.
- **Low switching cost:** Cost of switching from one bank to another is low. Banks are also providing zero balance account and other types of facilities. They are free to select any bank's service.Switching costs are becoming lower with internet banking gaining momentum and as a result consumers' loyalties are harder to retain.
- **Undifferentiated service:** Banks provide merely similar services. There is not much difference in services provided by different banks. So, bargaining power of customers increases. They cannot be charged for differentiation.

- **Full information about the market:** Customers have full information about the market. Internet has increased the customer's access to information. So, banks have to be more competitive and customer friendly to serve them.

Threat of substitutes: Competition from the non-banking financial sector is increasing rapidly. The threat of substitute products is very high. These new products include credit unions and investment houses. One feature of using an investment house is that the fees that the investment house charges are tax deductible, whereas for a bank it is considered a personal expense, which is not tax deductible. The rate of return with using investment houses is greater than a bank. There are other substitutes as well for banks like mutual funds, stocks (shares), government securities, debentures, gold, real estate etc. so, there is a high threat from substitutes.

Threat of new entrant: Barriers to entry in banking industry no longer exist. So, lots of private and foreign banks are entering in the market. Product differentiation is low and exit is difficult. So, every bank strives to survive in highly competitive market. So, we see intense competition and mergers and acquisitions.

Government policies are supportive to start a new bank. There are less statutory requirements needed to start a new venture. Every bank tries to achieve economies of scale through use of technology and selecting and training manpower.

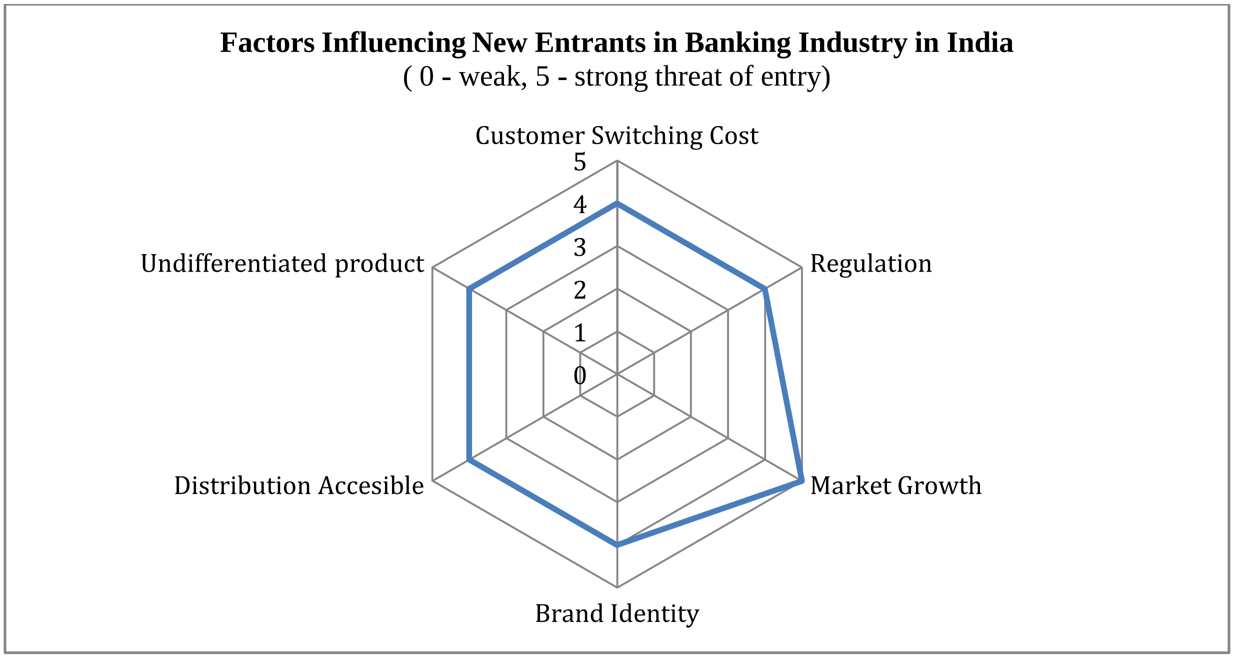

Figure 3. Influential factors to new entrants in Indian banking industry

Source:

The most influential factor for a new entrant to Indian banking industry is market growth as clearly depicted by the above **figure-3** showing five point which is the highest rating as compared to the other factors which fall in the category of 4 pointers.

III. Changes And Dynamics In Indian Banking Industry

The post-liberalized banking sector in India has been witnessing spectacular changes; one among them is bank's foray in to retail banking. Retail banking has emerged as core function of select commercial banks. It is the fastest changing area in commercial banking. The following reasons can be attributable for this change.

Competition: The Reserve Bank of India (RBI), prime regulator of financial sector, has removed several artificial barriers which made the banks and non-bank companies to penetrate in to wide range of financial services. The line dividing the banking, insurance and capital market services is disappearing & the commercial banks are offering these services under one umbrella..

Consolidation: Consolidation is in progress, the huge monolithic organization ICICI is merged with ICICI Bank Ltd. The two public sector entities IDBI and IFCI are on the way. Some time back Twentieth Century Finance Company, a non-banking company is merged with Centurion bank. Public sector giants like Punjab National Bank is spreading its tentacles, its intention acquire Nedugundi Bank is in process.

Computers and Information Technology: Traditionally retail banking is built on the foundation of physical branch network. Now, the technology has emerged as a perfect and, effective substitute to physical branches through ATM's, Call centers, Home banking and Internet banking. Several parallel distribution systems have emerged for delivery of services.

Customer Centric: Due to increased financial market products like Commercial paper and variety of financial instruments big corporate clientele of several commercial banks have shifted their loyalty and have been raising resources from the market directly and commercial banks have become more retail customer centric by offering wide range of services. Banks have identified new customer segments like students, working women, and rich net worth individuals.

IV. Performance And Health Of Indian Banking Industry

Indian banks have compared favorably on growth, asset quality and profitability with other regional banks over the last few years. Policy makers have made some notable changes in policy and regulation to help strengthen the sector. These changes include strengthening prudential norms, enhancing the payments system and integrating regulations between commercial and co-operative banks. However, the cost of intermediation remains high and bank penetration is limited to only a few customer segments and geographies. While bank lending has been a significant driver of GDP growth and employment, periodic instances of the "failure" of some weak banks have often threatened the stability of the system. Structural weaknesses such as a fragmented industry structure, restrictions on capital availability and deployment, lack of institutional support infrastructure, restrictive labor laws, weak corporate governance and ineffective regulations beyond Scheduled Commercial Banks (SCBs), unless addressed, could seriously weaken the health of the sector.

Opportunities and Challenges: The bar for what it means to be a successful player in the sector has been raised. Four challenges must be addressed before success can be achieved.

First, the market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. These require new skills in sales & marketing, credit and operations. Second, banks will no longer enjoy windfall treasury gains that the decade-long secular decline in interest rates provided. This will expose the weaker banks. Third, with increased interest in India, competition from foreign banks will only intensify. Fourth, given the demographic shifts resulting from changes in age profile and household income, consumers will increasingly demand enhanced institutional capabilities and service levels from banks..

Need for Decisive Action by Bank Managements: Management imperatives will differ by bank. However, there will be common themes across classes of banks: PSBs need to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management and the overall organizational performance ethic. The last, i.e., strengthening human capital will be the single biggest challenge. Old private sector banks also have the need to fundamentally strengthen skill levels. New private banks could reach the next level of their growth in the Indian banking sector by continuing to innovate and develop differentiated business models to profitably serve segments like the rural/low income and affluent/ HNI segments; actively adopting acquisitions as a means to grow and reaching the next level of performance in their service platforms. Attracting, developing and retaining more leadership capacity would be key to achieving this and would pose the biggest challenge..

Market Segmentation: The success of retail banking lies on market segmentation, innovation, and pricing of products or services. Banks have to focus on market segmentation to identify differences between groups of potential customers and to decide which products can be served to which groups.. This segmentation is suitable to all emerging Asian Markets.

Figure 4. Four principle market segmentation

Self Directed Planners (22%):	**Simplifiers (21%):**	**Fickle Shoppers (23%):**	**Advice seekers (34%):**
Well educated, slightly above average income, Seek financial information from variety of sources and retain control of financial matters; Frequently use financial products: open to Borrowing; Accept reasonable risk	Less Educated, less affluent, older. Do not seek financial advice often; Use fewer, more basic Products; Prefer local banks; least open to borrowing. Tolerate low risk only. Not sensitive to Price Prefer face to face contact	Average Income, predominantly non-working female; Do not seek financial advice; use fewer, more basic products; open to borrowing, Particularly on credit cards; Accept reasonable risk; not so sensitive to price ; Prefer remote channels- specifically ATM or telephone banking	Well educated, affluent, Predominantly male; Seek Financial Advice; Heavy users of financial products; high transaction frequency Tolerate higher risk, very sensitive to price; Prefer face to face contact

Source: The McKinsey Quarterly, Number 2, 2002, page 57

McKinsey has identified the above four principal segments as shown in above **figure-4**combining personal attitudes to finance and demographic data.

ICICI and its new areas of operations and ventures: An analysis:

The ICICI bank in India has adopted "Life Stage Segmentation Strategy". This approach aims to minimize overlaps between two segments by categorizing customers in to various segments based on the stage of life they have reached. The Bank's philosophy is to have a product ideal for every stage of an individual's life from child hood to retirement and the bank has a wide product range.

ICICI bank is also adopting a strategy of creating a liability based produced along with an asset based product and vice versa. The potential segments which many banks have not explored so far are self-employed people and house wives. Self-employed people due to lack of proper identity (i.e. either salary certificate or PNR Number) are still borrowing at a higher rate and banks are not assessing the credit risk premiums properly. Similarly a suitable banking product is required, which makes the house wife to feel liberated and empowered.

ICICI bank believes that the structure of an organization needs to be dynamic, constantly evolving and responsive to changes both in the external and internal environments. Their organizational structure is designed to support business goals, and is flexible while at the same time ensuring effective control and supervision and consistency in standards across business groups. The ICICI bank is divided into five principal groups – Retail Banking, Wholesale Banking, Project Finance & Special Assets Management, International Business and Corporate Centre.

- The Retail Banking Group comprises ICICI Bank's retail assets business including various retail credit products, retail liabilities (including our own deposit accounts as well as distribution of third part liability products) and rural micro-banking.
- The Wholesale Banking Group comprises ICICI Bank's corporate banking business including credit products and banking services, with separate dedicated groups for large corporate, Government and public sector entities and emerging corporates. Treasury, structured finance and credit portfolio management also form part of this group.
- The Project Finance Group comprises our project finance operations for infrastructure, oil & gas, manufacturing and shipping sectors.
- The Special Assets Management Group is responsible for large non-performing loans and accounts under watch.
- The International Business Group is responsible for ICICI Bank's international operations as well as coordinatingthe international strategies and alliances of its subsidiaries and affiliates.
- The Corporate Centre comprises all shared services and corporate functions, including finance and secretarial, investor relations, risk management, legal, human resources and corporate branding and communications.

ICICI Bank is focusing on harnessing technology for integrating diverse products by unifying the enterprise IT architecture. In January 2002, we commenced implementation of an Enterprise Application Integration initiative in a phased manner. This initiative is aimed at providing a single customer view leading to increased customer satisfaction and employee productivity.

The core banking software was upgraded during the first half of fiscal 2002. New initiatives include, among others, sending customer statements in electronic form over e-mails, facilities to invest in mutual funds through a bank account which could be operated across the delivery channels (ISWEEP) and integration of depository account of corporates with their bank account to facilitate on-line trading in debt instruments. Centralization of branch databases has permitted centralization of cheque-book issuance, account-opening processing, statement generation and printing, ATM card issue and generation of MIS and reports, thereby releasing significant resources at branches. Presently, the bank manages the largest centralized database among all banks in India.

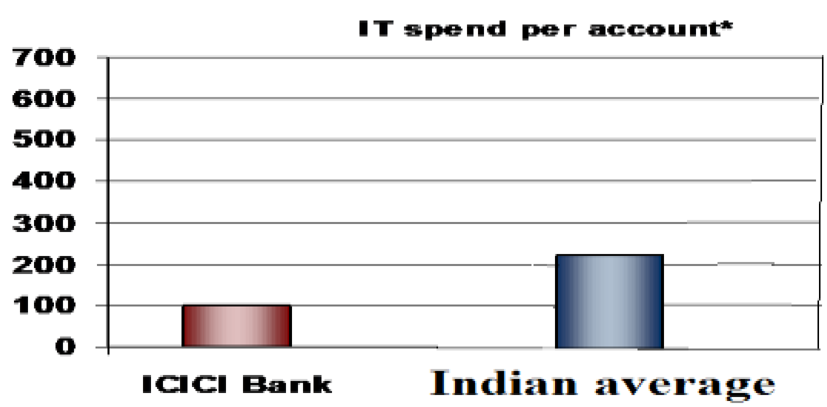

Figure 5. Expenditure on IT by ICICI as compared to all over India average

Source:

The above **figure 5** clearly shows that ICICI spend quite good percentage on information technology if we compare it with an all India percentage expenditure.

A Customer Relationship Management (CRM) solution from Siebel was implemented for the automation of customer handling in all key retail products of the Group. The solution allows customer service agents to track all customer complaints and requests. It also allows target setting and centralized tracking of turnaround times for request fulfillment. The solution went live in phases during fiscal 2002. The Bank has also undertaken a retail data warehouse initiative to achieve customer integration at the back-office. This central view of the total customer relationship is being used extensively for identifying opportunities to cross-sell new products and services to the existing customer base.

HUMAN RESOURCES

ICICI Bank views its human capital as a key source of competitive advantage. Consequently the development and management of human capital is an essential element of our strategy and a key management activity. Human resources management in fiscal 2002 focused on smooth integration of the employees and human resource management systems in the context of the merger, as well as on continuous improvement of recruitment, training and performance management processes.The focus on human resources management as a key organizational activity has resulted in the creation of an exceptional pool of talent, a performance-oriented organizational culture and has imparted agility and flexibility to the organization, enabling it to capitalize on opportunities and deliver value to its stakeholders.

ORGANIZATIONAL EXCELLENCE

ICICI Bank recognizes the importance of organizational excellence in its business. Developing and deploying world-class skills in a variety of areas such as technology, financial engineering, transaction processing and portfolio management, credit evaluation, customer segmentation and product design, and building and maintaining deep and enduring relationships of trust with our retail and wholesale customers are essential elements of our strategy.

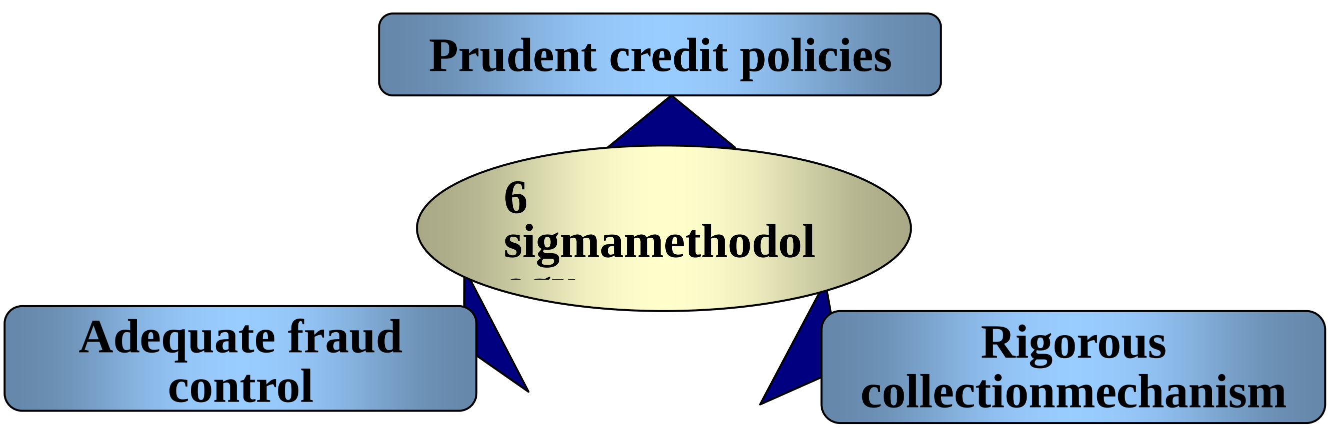

Figure 6. Six sigma methodology used by ICICI group

Source:

Different businesses across the ICICI group have over the past few months used successfully the Six Sigma methodology as depicted in the above **figure-6**to focus on customer satisfaction and enhanced efficiency in operations. Application of Six Sigma techniques in regional processing centers, branch layout and design, and the home finance and demat services businesses have reduced turnaround time and significantly improved operational efficiency. In recognition of the critical importance of excellence in internal processes and delivery to customers, we have set up an Organizational

Corporate excellence through mergers and acquisitions: To attain size-benefits, ICICI Bank, one of the most enterprising ones looked for a marriageable bride for myriad of synergies leading to sustainable competitive advantages. It dared to opt for merger strategy despite umpteen failure stories and a history full of bail-out cases. The merger which took place early in the decade has now become mature for studying pre- and post-merger conditions to determine not only short term but also long-term achievements.

The merger of ICICI Bank and Bank of Madura are path-breaking because they are part of a well-crafted strategy to generate synergistic advantages for the merged entity. It underlines the paradigm shift from mergers at the behest of the government to mergers driven by market forces. The present paper attempts to study the effectiveness of ICICI Bank and Bank of Madura merger based on the objectives laid down before the merger.

The merger with Bank of Madura paved way for:

1. ICICI becoming one of the largest private sector banks in India with Rs.17327crores
2. It has the largest customer base of over 3 million and a network of more than 350 branches and 450 ATM centres across 100 Indian cities
3. Considerable synergies in the operations of the merged entity
4. Benefit the customers and other stake-holders

V. Concluding Views and Recommendations

While the onus for various positive changes lies mainly with bank managements, an enabling policy and regulatory framework will also be critical to their success. The failure to respond to changing market realities has stunted the development of the financial sector in many developing countries. A weak banking structure has been unable to fuel continued growth, which has harmed the long-term health of their economies. In this paper, This is the main reason that in this paper I have emphasized upon the need to act both decisively and quickly to build an enabling, rather than a limiting, banking sector in India. Some of the recommendations that I would like to give through this paper are:

1. To continuefocus on cash management service: With more and more banks preferring to outsource their collection and payment, fee based activity is growing. Given the vast geographical presence of ICICI bank that can be leveraged upon, the bank is better placed to offer these services at a competitive rate as compared to foreign banks.
2. To continue targeting SME segment.ICICI bank got into this segment as a result of their merger with the bank of Madura. The foreign banks have also started targeting this segment. As such leveraging on the expertise of the personnel of bank of Madura, ICICI bank should try to move faster than competition and make use of the first move for merger.
3. Should focus on FX services: FX service is an area that is being concentrated upon only by very few banks. With Indian industries looking for a global presence, the need for this product is likely to grow. ICICI bank should target this product and try to make attractive offerings to the clients in the sector.
4. Should provide advisory services via specialists. The bank should appoint specialists in certain definite industrial sectors who would not only evaluate projects for the bank but would also give advisory services to the clients on the changes that they should make in their investment.
5. Single point interface: one of the complaints that clients usually have against private sector and foreign banks is that, the company has to deal with multiple managers depending upon the products that the company needs. That is, for cash management services there is one relationship manager, while treasury has another. The companies find this highly disconcerting and prefer to deal with a single individual from a bank, which could in turn interact with his colleagues.
6. Decentralization of decision making: Bank should improve its information transfer and approval process. Currently all banks branches have to contact the officials in their head offices before approving clients. Decentralization on behalf of the bank would solve this problem.

7. Flexibility and personalization of services: Some companies prefer sticking on to the public sector banks because of the rigidity and impersonal touch with the foreign and private sector banks. ICICI bank should provide personalized service too.

Thus, if these recommendations are followed , it is expected to give quite good results and it would be very fruitful for a vibrant economy of India.

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