

A REVIEW ON INDIAN BANKING SECTOR

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Abstract

Recession is an economic phenomenon of decline in macro economic factors of demand for goods and services, production levels, research and development budgets, marketing promotions and so on. Recessions are the result of reduction in the demand of products in the global market. Recession can also be associated with falling prices known as deflation due to lack of demand of products. Again, it could be the result of inflation or a combination of increasing prices and stagnant economic growth in the west. Global economic meltdown has affected almost all countries in the world. Strongest of American, European and Japanese companies are facing severe crisis of liquidity and credit. India's cautious approach towards reforms has saved it from possibly disastrous implications. The truth is Indian economy is also facing a kind of slowdown. The prime reason being, world trade does not function in isolation. All the economies are interlinked to each other and any major fluctuation in trade balance and economic conditions causes numerous problems for all other economies. Subprime borrowers in the US trigger a global financial crisis that results in liquidity getting tight, demand conditions weaken, price of commodities crash, employees and consumers panic. This is because of recession or economic slowdown in the world. This paper looks into the aspects of recession and its impact on banking sector in India.

Financial markets create an environment that helps people trade money for financial assets such as equity shares or commodities like gold or other precious metals. There are different players in the market who take charge of matching capital supply and demand. Investors, both individual and institutional, provide capital to the market in anticipation of returns as promised by the borrowers or users of capital. Banks and other financial intermediaries facilitate the movement of capital between lenders and borrowers. Securities market consists of various financial institutions that collectively support the issuance and trading of securities. These are various channels that create assets pools such as mutual funds and pension funds. Financial markets facilitate allocation of resources over time through a price mechanism such as interest rate, which is affected by forces of supply and demand. In market economies, the interactions between buyers and sellers determine the demand for and supply of resources. Thus the allocation of resources is determined by market forces. Finally, the paper presents findings of a study of 3 different financial institutions in India with respect to what approach they have followed to face the recession and the strategies initiated. A conclusion is drawn at the end in terms of how banking companies have shown an inclination to face the economic decline and march towards the future.

Introduction:

Recession is an economic phenomenon of decline in macro economic factors of demand for goods and services, production levels, research and development budgets, marketing promotions and so on. The globalizations several of the erstwhile command economies, which were driven by the plans prescribed by their respective government, have apparently moved towards market economies. Today, the global financial markets are well integrated and harmonization of the rules and regulations and reduction of barriers to trade have been facilitating free flow of resources between nations as result local companies had to come out their protective cover, provided by the government. The corporate are

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compete for their share of market and resources in the global arena. The developing countries have become highly vulnerable to the speculative capital movements in and out of their economies, several of the emerging markets able to consolidate or improve their competitive position by exploiting the newly created opportunities, by virtue of this several companies from the emerging markets are industry leaders and global market players.

Indian Government has come up with financial stimulus package of around Rs. 30,000 crores by means of lowering taxes, reducing interest rates, increasing money supply, export promotion incentives, investments in infrastructure and other project so that Indian industry shall not be affected much. In Japan unveiled a record 92.29 trillion yen (\$1 trillion) budget Friday for the next fiscal year that is for 2010. The long recessed Japanese economy has been showing some life in recent months, although recent indicators are showing the rally could be running out of steam. To keep things on track, the government of Prime Minister Mr Yukio Hatoyama, in office only 3 months, is planning on injecting major new capital stimulus into the economy. The release of the budget comes at a time when unemployment is climbing and deflation continues to be a major concern, particularly in relation to property prices. The Japanese government is forecasting the economy will grow by 1.40% next year, its first positive forecast in 3 years.

Definition of Recession:

There is no official definition of recession and no official body to decree that one has begun or ended. It is a clear picture of the state of the economy usually comes months or even years later. Recessions are commonly described as two or more quarters of a declining gross domestic product. In economics, a recession is a business cycle contraction, a general slowdown in economic activity over a period of time. During recessions, many macroeconomic indicators vary in a similar way. Production as measured by gross domestic product (GDP), employment, investment spending, capacity utilization, household incomes, business profits and inflation all fall during recessions; bankruptcies and unemployment rate rises. Recessions are generally believed to be caused by a drop in spending. Governments usually respond to recessions by adopting expansionary macroeconomic policies, such as increasing money supply, increasing government spending and decreasing taxation.¹

Many professionals and experts around the world believe that a true economic recession can only be confirmed if GDP (Gross Domestic Product) growth is negative for a period of two or more consecutive quarters. The agency that is officially in charge of declaring a recession in the United States is known as the National Bureau of Economic Research, or NBER. The NBER defines a recession as a "significant decline in economic activity lasting more than a few months." Recession (or contraction) is a natural result of the economic cycle and will adjust for changes in consumer spending and consumption or increasing and decreasing prices of goods and labor.²

'How recession creeps-in?' is a question normally faced by a many. But, the generally accepted answer offered by economists is, an economy which grows over a period of time tends to slow down the growth as a part of the normal economic cycle. A recession normally takes place when consumers lose confidence in the growth of the economy and spends less. This leads to a decreased demand for goods and services, which in turn leads to a decrease in production, lay-offs and a sharp rise in unemployment. Investors spend less as they fear stocks values will fall and thus stock markets fall on negative sentiment.³

Prediction of a recession

Many people often wonder if there is any way that you can predict a recession. The truth of the matter is that there is no exact way to predict a recession, but there are things that you can watch for to see if a possible recession is going to occur. Basically what this boils down to is that there are no predictors that

are totally reliable in telling you whether or not a recession is going to happen, but there are some things that are regarded by many economists as possible predictors to a recession. Here is a list of some of the predictors that economists use to help determine if a recession is going to happen or not:

- Dropping U.S. stock prices drag down markets elsewhere.
- The crisis of the United States subprime mortgage market has pushed up credit costs worldwide. It has also forced European and Asian banks to write down billions of dollars in holdings.
- Three month change in the unemployment rate and initial jobless claims.
- Less spending by the American consumers and American companies reduces the demand for imports, which in turn is going to have an impact on the countries that are making those products that the United States imports from the other countries in the world.

Reaction to recession:

The on-setting of recession has two broad reactions from corporate world. The first one is conservative i.e. defensive in nature. The companies who believe this ideology think in terms of cutting down costs, reducing manpower, reducing production, coming out of business (at the other extreme). The other reaction is positive, indicating here companies consider the recession as an opportunity to try some innovative methods to combat the effect of recession and look for growth in long term by initiating some bold and well thought-out strategies.

Marketers respond to recession in different ways. Faced with slowing demand, cost reduction, and negative sentiments, some marketers react to downturn by withdrawing to a shell. On the contrary there are marketers who become aggressive during these tough times. They come with new ambitious products and offers trying their level best to provoke the customers who postpone their purchases. It is interesting to see how Indian marketers responded to recession. Although there is a perception that Indian marketing practitioners are conservative, this recession proved the skeptics wrong. Many Indian brands reacted aggressively to the downturn determined to ride the storm rather than hiding in a safe place. The possible steps could be introducing new products, new segments, increasing promotional spends, reinforcing best selling brands and repricing.⁵

Strategies to beat recession in Indian Financial Sector: A research study

1. Kotak Mahindra Bank

Some of Indian Financial firm giants have come out with innovative strategies to meet the challenges posed by economic downturn. "Good isn't as good and bad isn't as bad as they look" Mr. Uday Kotak, Executive Vice Chairman & MD, Kotak Mahindra Bank. He says my lessons from the period of 2007-09 is that when things look good they are not as good as they look and when things look bad they are not as bad as they seem to be. In Indian Banking business remain stable in terms of our approach to offering and to customers. All banks are taking deposits at high rates in past years, but we were net lenders in the inter bank market and we had positioned ourselves like that. The cost cutting in senior management is done at on some of the items like changing the cars of senior management is done once in 3 years, now we are doing in 4 years. Anything that was perceived to be a waste was dramatically cut down. Rentals of retail branches and avoided paying extremely high rentals. Finally we tried to do is to make sure that customer facing business didn't face any problems.

2. ICICI Bank

"Reorient Strategy as per the economic reality" Mrs. Chanda Kochhar, MD & CEO, ICICI Bank. Less retail exposure on some of retail banking products, particularly unsecured loan. The unsecured was once as high 9% and planning to bring down by 5% in coming years by tightening credit norms and offering personal loans to existing customers with whom we have alary or deposits account, on the same time less reliance on DSAS (Direct Sales Agents) and attracting customers to our branches

for basic banking that leads to more cross selling of retail banking products like mutual fund, insurance and etc. Reduction in the CASA (Current and Saving Bank Account) and more reliance on wholesale deposit keeping in view with Interest rate fluctuations in the market.

3. HDFC Ltd

“You require prudence and conservatism in any business you do” Mr. Deepak Parekh, Non-Executive Chairman, HDFC Ltd. Sudden change in the economic environment impacted every household and also the corporate sector. Firm should follow prudence and conservatism in any business that firm do. This give of paramount importance for building a strong foundation for the future. If you don't do that it gets reflected in the NPAs (Non Performing Assets) when the business cycle takes a turn. On the other hand firm should keep adequate liquidity and also capital in the business to absorb any shocks that may come in the bad times. The major thrust on retail deposits, so we stepped up our efforts through brokers and branches to mobilize retail deposits. Our lending during the period of October and December 2008 is 90 per cent are through retail deposits. This will give a scope for the growth and profitability. So, the sudden slowdown didn't have much impact on firm. The Capital Adequacy ratio was at 16 per cent of the risk weighted assets as against minimum requirement of 12 per. Business segments, we have been lending mainly to the salaried middle class. Out lending norms are also conservative. The reason for this is salaried segment not interested in multiple homes. Bulk of our lending over 90 per cent is to the salaried middle class. The experience has shown that the non-salaried class is always a relatively riskier segment because loans are generally given to them based on their income tax returns and asset values and not on a cash flow basis. But if you see the self employed and other non-salaried classes rather than the asset prices. Look at all the projects carefully. There could be cases of one project in a good location and another in a not so good area. And avoid a developer if you find excessive leverage. It is always much safer to be on an established developer than a new one. The reputation of a developer is also a key criterion for making any lending decision to the developers.

The following measures can be adopted to tackle the recession:

- Tax cuts are generally the first step any government takes during slump.
- Government should hike its spending to create more jobs and boost the manufacturing sectors in the country.
- Government should try to increase the export against the initial export.
- The way out for builders is to reduce the unrealistic prices of property to bring back the buyers into the market. And thus raise finances for the incomplete projects that they are developing.
- The falling rupees against the dollar will bring a boost in the export industry. Though the buyers in the west might become scarce.
- The oil prices decline will also have a positive impact on the importers.

Various steps taken by RBI to curb the present recession in the economy and counter act the prevailing situation. The sudden drying-up of capital inflows from the Foreign Direct Investment (FDI) which were invested in Indian Financial Market for greater returns vizualizing the Potential Higher Returns flying back is continuing to challenge liquidity management. At the heart of the current liquidity tightening is the balance of payments deficit, and this NRI deposit move should help in some small way.

Conclusion

To curb the liquidity crises the RBI will continue to initiate liquidity measures as long as the current unusually tight domestic liquidity environment prevails. The current step to curb these being lowering of interest rates and reduction of PLR. However, the big-picture story remains unchanged – all countries in the world with current account deficits and strong credit cycles are finding it difficult to bring cost of capital down in the current environment. In total the recession have turned down the

growth process and have set the minds of economists and others for finding out the real solution to sustain the economic growth and stability of the financial market which is desired for the smooth running of the economy.