International Journal of Trade and Commerce-IIARTC
July-December 2021, Volume 10, No. 2 pp. 317-322
ISSN-2277-5811 (Print), 2278-9065 (Online)

COSMOS (Germany) JIF: 5.135; ISRA JIF: 7.249; ISI JIF: 3.721

An Analytical Study of Universal Banking in India

Richa Aggarwal[a*], Shubhra Garg[b]
[a]*Commerce Department, C.C.S. University, Meerut, U.P., India*
E-mail: richa2820@gmail.com
[b]*Faculty of Commerce and Business Administration, M.M.H. College, Ghaziabad, U.P., India*
E-mail: shubhragarggupta@gmail.com

Abstract

In the Indian banking scenario, Universal Banking is a new concept. It can be said to be a provider for different financial products under a single roof. Other sectors like Business houses, households, etc., can avail many financial services like loans, insurance, stock market investments, etc. while doing routine banking like withdrawal and deposit. In India, too, many opportunities are available and exploited in the banking sector as a universal bank. In this paper, an attempt has been made to study the prospects and impact of Universal Banking in the Indian market. The banking sector in India diligently follows the worldwide trend in global financial developments. It is believed that the concept of global super financial markets could play an essential role in the future by the opening of the Indian Banking sector to foreign players.

Key Words: *Financial Institution, Supermarkets, Universal Banking, Development Financial Institutions(DFI's).*

PAPER/ARTICLE INFO
RECEIVED ON: 07/11/2021
ACCEPTED ON: 03/12/2021

Reference to this paper should be made as follows:

Aggarwal, Richa & Garg, Shubhra (2021), *"An Analytical Study of Universal Banking in India", Int. J. of Trade and Commerce-IIARTC,* Vol. 10, No. 2, pp: 317-322

**Corresponding Author*
DOI: 10.46333/ijtc/10/2/10

1. Introduction

Universal Banks provides many banking and non-banking services like withdrawal, deposit, providing loans, holding off several claims on firms(including equity and debt), participation directly in the firm's corporate governance, and investment facilities. They can rely on the banks for funding or as insurance underwriters. Thus, Universal Banking can be defined as a super specialty house for a massive range of financial products under one roof. Business houses can avail of loans avail other handy services while doing routine banking activities like deposit and borrow.

After initiating a new economic era of liberalization, privatization, and globalization in the Indian economy, banking sector entry was allowed in financial services. Many structural changes of great extent have been observed in global banking systems in the early 1990s, like mergers, amalgamations, and acquisitions among the banks and financial institutions, which results in the growth in size and competitive strengths of the merged entities. The Universal Banking concept thus plays a significant role in making banks more successful and cost-effective in today's scenario. Numerous factors affect Universal banking, be it internal or external resources which could maximize economies of scale and scope by building the production of a financial services organization.

2. Review of Literature

Universal Banking can be defined as a multi-functional and multi-purpose financial super store, i.e., an institution that offers a wide range of banking and financial services like stock, insurance, and real estate brokerage through a single window. According to the World Bank, under Universal Banking, large banks operate a widespread setup of branches that provide different kinds of services, hold several claims on firms (including equity and debt), and sometimes also participate in the Corporate Governance of firms.

In a nutshell, *Universal Banking can be said as a superstore for financial products under one shelter.* Corporate houses can avail loans and other handy financial services while doing the usual banking functions of deposit and borrow. However, in real terms, 'universal banking' can be defined as those banks which provide a vast range of financial services like Credit Cards, Housing Finance, Retail loans, Merchant Banking, Factoring, Auto loans, Investment banking, Insurance, Mutual Funds, etc. It is beyond the usual commercial banking functions of saving and withdrawal. The universal banking concept is most popular and common in European countries. For example, in Germany, commercial banks accept time deposits, lend money, act as investment advisors to large corporations, and underwrite corporate stocks. In the United States, there has never been any distinction between commercial banks and investment banks in Germany.

3. Universal Banking Scenario

After World War II, the importance of universal banking was observed in Germany and Switzerland. The German and Swiss economies suggest three factors will determine the future growth of universal banking.

First, universal banks enjoy many merits over specialized institutions, as these banks can exploit economies of scale and massive scope in banking.

Second, the smaller specialized institutions were doing good business although universal banks have expanded their range of influence; in both Germany and Switzerland, they are successfully competing with the big universal banks. In Switzerland, for example, the specialized institutions are firmly embedded in such areas as real estate lending, securities trading, and portfolio management.

Third, the universality of banking may be gained in various ways. The universal banking systems in Germany and Swiss differ substantially. Like in Germany, without significantly increasing the big banks' market shares, the universality of banks has been gained. Many small organizations have acquired universality through cooperation. These banks have central institutions conducting banking activities that significantly return to scale and scope. But in Switzerland, the cooperative methodology has not worked as well as in Germany.

4. Universal Banking in India- Recent Trends

The deregulation process opened up a much new wide range of opportunities for banks to enhance revenues by diversifying their activities into investment banking, insurance, credit cards, depository services, mortgage financing, securitization, etc. Over time, interest rates have been relaxed, branch licensing procedures have been liberalized, and SLR and CRR reduced.

The financial system has been liberalized and deregulated in India. India has survived much crisis caused due to external macroeconomic shock of the East Asian countries, because of flexibility in India's exchange rate. In recent years, India has been significantly improving in financial sector regulation. Prudential norms have been tightened.

The recommendations of the Khan Working Group and Narsimhan Committee- II reports relating to banks and DFIs were seen when huge banking organizations like ICICI, SBI, IDBI, etc., started proposing plans for taking up the in-demand status of a universal bank. ICICI and many public sector banks setup subsidiaries for providing various financial services.

5. Debate over Universal Banking in India

As per the Banking Regulation Act, 1949, banks in India are allowed to function as universal banks. Many financial institutions are also permitted to operate as universal banks in the international sense but are subject to serve restrictions that are purely Indian. Thus, the debate on universal banking in India can be discussed.

i. **Regulatory Burden:** The concept of universal banking in India has raised the regulatory burden on financial intermediaries. As DFI's (Development Financial Institutions) are also allowed to act as a universal bank, strict regulations need to be imposed on them as implied on commercial banks. This point is not highlighted in the Khan working group. There is a requirement to reconsider the current SLR and CRR as per the new changing scenarios. In India, there is an urgent requirement to lessen the regulatory burden, particularly for banks, if the banks are expected to compete in the free marketplace.

ii. **Maturity and Duration:** The duration of finance between commercial banks and financial institutions is debatable for the universal banking concept. Somehow DFIs are the providers of long-term finance, whereas banks are providers of short-term or medium-term finance. Still, in reality, commercial banks finances in a way that amounts to financing in perpetuity as in general there are no definite maturity dates. The fundamental distinction is the nature of security taken by each entity. DFI stake fixed assets as security which is helpful to them when the case goes to court or when it becomes security dependent. On the other hand, banks have an advantage because of current security and working capital.

iii. **Role of RBI:** RBI governs commercial banks in the Indian banking regime. An appropriate regulatory framework has to be decided by RBI, which enables rather than controlling DFIs to operate as universal banks while also ensuring consistency with monetary policy and prudential standards. The shift of DFIs towards the universal banking concept will be governed by the consumer demands and the response of the concerned banks of DFIs. No time limit is prescribed for a DFI to become a universal bank. Only an individual or ideal time frame has been mentioned in the paper discussion.

iv. **Status of DFI:** For the regulation purpose, the formal, clearly defined, and legally acceptable regulatory framework of the RBI is available basically for banks and non-bank finance companies. DFIs as a category are still not clearly defined, as indicated in a discussion paper. They are still in the way of merger of state or central government level, company or corporate forms with different extents and degrees of public sector ownership and performing refinance, direct finance, and other functions.

v. **Optimal Transition path:** The transition path contains several operational and regulatory issues for information and guidance of DFIs. The S H Khan working group also suggests that DFIs quickly transform themselves into commercial banks.

6. Challenges in Universal Banking

Universal Banks has to face various challenges like:

i. Development finance institutions opting to transform into Universal Banks by adopting merger routes may face certain challenging situations on many grounds. Those grounds are Asset Liability Mismatches, the burden of high NPAs, and differences in regulatory prescriptions applicable to Financial Institutions and banks such as CRR and SLR requirement and priority sector lending.

ii. The regulatory norms for DFI's in India have been historically more minuscule than the banking system norms because DFIs do not form part of the monetary system and partly because they do not have deposits like liabilities.

iii. If DFIs must be transformed into universal banks, they would also be liable to the mandatory reserve requirement. It means that all previous liabilities issued by the DFIs in the past would also be subject to the compulsory reserve requirement since the assets structure of DFIs are primarily of long-term nature. It would be challenging for them to maintain the required SLR and CRR.

iv. A wide range of services for sensitive customers is not enough, but they also want efficiency in cost, time, and convenience.

v. Universal banks must identify, measure and manage various associated risks in the financial sector for invested money.

- **vi.** Universal banks will be dealing in different categories of financial products. They had to adopt different strategies for various financial products because risks and uncertainty would vary. For any institution, it is not feasible to rely only on short-term funds or on long-term funds.
- **vii.** Universal banking in a global market will have to face huge competition, risk, and market uncertainty. It requires building two robust pillars of the banking sector, i.e., human resources and vital IT cells, to meet the demand for specialized banking functions. Special skills are needed in retail banking, treasury, risk management, foreign exchange, etc. will need to be cautiously encouraged and built.

7. Universal Banking- The Road Ahead to India

The commercial banking sector in India is going through an exciting phase, not just economically but also on the policy front. As per the Narasimham committee's recommendation, a significant policy shift is required by that development finance institution (DFIs) ultimately convert into either commercial banks or non-banking finance companies. It, in a way, indicated the new beginning of the end of specialized services from DFIs, and the introduction of universal banks.

Commercial banks have traditionally been prime lenders for working capital loans, and DFIs financed term loans in India. Many development financial institutions are transforming themselves into universal banks by diversifying their investing and financing activities.

In the Indian context, the universal bank will become a one-stop provider for all financial products and activities, like deposits, short-term and long-term loans, insurance, investment banking, etc. The concept of universal banking has been prevailing in many European countries. This sometimes prohibited commercial banks from investment banking activities, taking equity positions in borrowing firms, selling insurance products, etc. The primary purpose was to reduce the risky behavior by checking commercial banks to their traditional activity of accepting deposits and lending. Research on the effects of universal banking has been inconclusive as there is no clear-cut evidence in favor of or against it anywhere.

The idea of the one-stop-shopping solution under universal banking saves a lot of transaction costs and increases economic activity speed. For this, appropriate regulation can be followed, which will ultimately benefit all the participants in the market, including the banks themselves. Though many associated problems are there in the universal banking concept, many interests are expressed by banks and financial institutions in universal banking.

8. Conclusion

Managing finance is essential in all the business houses because all other functions are closely related to it. Various financial products and services offered by banks and financial institutions have penetrated our lives. The world is ever-changing, and financial products and services have to be updated and keep up with the new demands of society and the business sector. In many countries, universal banks, which offer an extensive wide variety of financial services, are more responsive to customer needs and facilitate economic developments.

The financial sector in India is quite bank-oriented, and banks are the primary supplier of financial and banking services. Indian banks, by following the regulatory requirements, are continuously trying to enlarge their scope of financial assistance so that they can meet the global condition of their customers. India's banking sector follows global trends diligently the economic developments.

References

[1] Agarwal, Pragya & Jain, Divya (2016). Contactless Payment System in India: A Study of Mobile Banking. International Journal of Trade and Commerce-IIARTC, 5 (2), 339-345

[2] Balyan, Rachna & Baliyan, Deepa (2014). Electronic Banking Practices of Private Sector Banks in India: A SWOT Analysis. International Journal of Trade and Commerce-IIARTC, 3 (2), 269-274

[3] Sbankaran, S. (2011). Universal Banking by DFI: Handy But no solution to NPA's, Business Line, 2

[4] Rajan, Raghuram, (1992). Insiders and Outsiders: The Choice between Informed and Arm's length debt. Journal of Finance, 47, 1367-1400.

[5] Rajan, Raghuram, (1992). A theory of the costs and benefits of universal banking, mimeo, University of Chicago.

[6] Rajan, Raghuram, (1994). An Investigation into the Economics of Extending Bank Powers, mimeo, University of Chicago.

[7] Rajan, Raghuram (1994). Why Bank Credit Policies Fluctuate: A Theory and Some Evidence. Quarterly Journal of Economics, 109, 399-442.

[8] Roe, M. (1994). Strong Managers, Weak Owners, Princeton University Press, Princeton, N.J.

[9] Rosenbluth, Frances (1989). Financial Politics in Contemporary Japan.

[10] Sharpe, S. (1990). A symmetric Information, Bank Lending, and Implicit Contracts: A Stylized Model of Customer Relationships. Journal of Finance, 45, 1069-1088.

[11] Walter, I. and A. Saunders, Universal Banking in the United States, Oxford University Press, New York.

[12] White, E. (1986). Before the Glass-Steagall Act: An Analysis of the Investment Banking

[13] Approach to Universal Banking. (2007, February). Retrieved January 2012, fromwww.banknetindia.com.

[14] BNV Parthasarathi. Consolidation of Indian Banks challenges. The ICFAI University Press.

[15] Kamal, Sehgal (IIFT). (2011, October). Universal Banking the Road Ahead. Retrieved January 2012, from www.indianfoline.com.

[16] M. Guruprasad. Banking in the New Millennium.

[17] M.S. Gupta. (October 2006). The Universal Banking Introduction concept, pros, and cons. Journal of Professional Banker, 24-27.

[18] RBI (2002). Universal Banking: introduction, RBI rules, and regulation

[19] Universal Banking in India. Retrieved January 2012, from www.banknetindia.com/banking/ubfeature.htm.