



## Finance Management

*Elixir Fin. Mgmt.* 32 (2011) 2095-2099

**Elixir**  
ISSN: 2229-712X

# Innovative management practices of banking industry during global financial meltdown – a case study of selected Indian banking companies

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## ARTICLE INFO

### Article history:

Received: 10 February 2011;

Received in revised form:

26 February 2011;

Accepted: 3 March 2011;

### Keywords

GFM: Global Financial Meltdown,  
NPAs: Non Performing Assets,  
CAR: Capital Adequacy Ratio.

### ABSTRACT

Today world economy is more concerned about a disease which is much dangerous than swine flu, know as Global Financial Meltdown. The impact of GFM experienced by financial and economic systems around the world. The rising defaults on sub-prime mortgages in the US had triggered a global crisis for the financial markets. Many of the world's leading investment banks have collapsed. The crisis has become one of the most radical reshaping of the global banking sector, as governments and the private sector battle to shore up the financial system following the disappearance of Lehman and Merrill as independent entities. The impact was so severe that it brought about new challenges for corporate around the world and were forced to initiate measures which left employees jobless and morale nose diving. The measures like salary cut, retrenchment /layoff became tools to tackle GFM.

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## Introduction

The banking, sector is the one among many sectors who are victims of GFM. As a result of this banking sector suffered from liquidity crisis leading to lack of additional bank credit for corporate India. Indian banking industry is facing profitability pressure, asset quality pressure, declining interest spread, lower profit on investment sales, downgrading of ratings, etc. The default risk rate has gone up due to the shaky job market and pink slips in some the sectors of the economy. There is panic set in among banks fearing that non performing assets may shoot up. The possibility of non attainment of Non Performing Assets (NPA) guidelines stipulated by RBI is very high. According to K C Chakrabarty, chairman and managing director of Punjab National Bank, the gross NPAs of the banks would increase and some banks might be reluctant for lending. The capital adequacy ratio of banks has increased from 9% to 13%, which indicates inefficiency in use of capital. Corporate lending has come down as banks are preferring to invest in bonds and debentures instead of lending. Banks have invested huge fund in government securities. According to RBI sources, large number of depositors is moving from private sector banks to public sector banks during the last few months. Due to increase in deposits with banks, the banks are demanding increase in insurance cover for deposits. Presently, deposit with banks up to Rs.100000 per depositor was covered by insurance coverage offered by Deposit Insurance and credit Guarantee Corporation, a RBI wing.

### The Banking Industry In Troubled Waters

The ICICI Bank's profitability has come down to was Rs.1,071 crores during fourth quarter compared to Rs.1,343 crores for the third quarter 2008-09 due low level of fee income. The lower level of fee income was due to poor performance in retail financial products, reflecting the adverse conditions in global and Indian financial markets.

However some companies shown extremely creative approach by way of adopting sensible management practices to

tackle this economic swine flu. The various strategies initiated by Indian banking companies have saved them from worsening situation.

So, GFM proved as a good opportunity to emulate innovative management practices for Indian banks. In the backdrop of this development a study was conducted to highlight some of the innovative practices do adopted by selected Indian public and private sector banks to manage economic downturn effectively.

### Abbreviation:

GFM: Global Financial Meltdown

NPAs: Non Performing Assets

CAR: Capital Adequacy Ratio

### Objectives

The present study was undertaken with the following objectives:

- 1) To study innovative management practices adopted by selected Indian public and private sector banks.
- 2) To deduce about innovative management practices.
- 3) To offer suggestions based on conclusions drawn.

### Methodology

The information for the study has been collected from secondary sources and observations. The study is descriptive in nature.

### Period of the study

The period of study has been confined to July 2008 to May 2009.

### Meaning of key words used

**Economic Recession:** A temporary downturn in economic activities. Recession involves at least two consecutive quarters of falling GDP. It is characterized by falling industrial production, unemployment, fall in personal income, consumer spending, stock prices, commodity prices and business spending, corporate bankruptcies, etc.

**Global Financial Meltdown:** Crisis in debt market, sub-prime mortgage market, currency market, banking industry,

Mutual fund industry and capital market crashes in US, European and Asian countries is called as GFM.

**Innovation:** The term innovation means a new way of doing something. It may refer to incremental, radical, and revolutionary changes in thinking, products, processes, or organizations.

**Management:** The process of designing and maintaining an environment in which individuals, working together in groups, efficiently accomplish selected aims.

**Non-Performing Assets:** It is a loan where interest and or installment of principal remain overdue for a period of more than 90 days in respect of a term loan.

**Capital Adequacy Ratio:** A measure of a bank's capital. It is expressed as a percentage of a bank's risk weighted credit exposures.

**Restructured Loans:** It refers to postponement or rescheduling of loan by banks in order to accommodate borrowers who are in financial difficulties.

#### **Management practices of banking industry during economic downturn**

One of the sectors whose bottom line has been hit by global financial meltdown is banking. But, the best practices adopted by Indian banks and strong regulatory mechanism have saved the Indian banks from collapse. To beat economic recession, the banking companies in India have initiated various innovative measures such as higher provisioning for NPAs, restructuring of loans, parking fund with RBI, etc.

#### **Punjab national bank**

Punjab National Bank, a nationalized bank has more than 4600 branches spread throughout the country. The bank has over 38 million customers.

The bank has been ranked as the 3rd largest bank in the country (after SBI and ICICI Bank). It has been ranked as one of India's top service brands. Apart from offering banking products, the bank has also entered the credit card & debit card business; bullion business; life and non-life insurance business, Gold coins & asset management business, etc. with GFM taking firm grip over Indian banking sector, PNB along with other banks have been a victim of GFM. In order to face the challenges of GFM the bank has resorted to various innovative measures to manage the slump. The major innovative measures adopted by the bank include as under:

#### **Car Loan ..... at Lower Interest**

Punjab National Bank (PNB) has lowered interest rates for car loans by 50 basis points (11-11.5 percent to 10.5-11 percent) with effect from 1<sup>st</sup> March 2009.

In order to provide an added facility of car finance to its customers, Punjab National Bank has entered into an understanding with Tata Motors for financing Nano car. As per the agreement the bank will offers car loans up to 90% of invoice, for tenure ranging up to 7 years, at a very competitive rate of 10.5% to 11%.

This facility will be available at all 4604 branches of Punjab National Bank and 329 sales touch points of Tata Motors. This tie-up will provide a single window for both cars as well as car loans and will make car buying easier for customers.

#### **NPA Management .....Better Management of Resources**

Punjab and National Bank is giving emphasis on arresting slippages, recovery and up-gradation of NPA accounts. There was drop in NPAs from 4.57 per cent in September last year to 2.37 per cent, by the end of September 2008 as a result of this initiative.

#### **Market Development ..... Student Focus**

PNB has launched campaign for school students to inculcate banking and saving habits in them. As a part of this campaign, school students are being persuaded through special camps and other promotional activities to open savings accounts. The bank is offering zero balance saving accounts for students of the age of 10 years and above. Students above 18 years of age are also eligible for overdraft facility.

#### **Global Expansion Strategy..... To Grab International Opportunities**

The Punjab National Bank is seeing downturn as good opportunity to become international bank. It is planning to expand its operations to Norway, Canada and Bhutan. The bank is waiting for regulatory approvals from the host countries. The bank aims at becoming a household brand in India with global expertise.

#### **Icici bank**

ICICI Bank is India's second-largest bank with network of over 1400 branches and over 4,800 ATMs in India and presence in 18 countries. ICICI Bank offers a wide range of banking products and financial services to corporate and retail customers through a variety of delivery channels and through its specialised subsidiaries. ICICI Bank's equity shares are listed in India on Bombay Stock Exchange and the National Stock Exchange of India Limited and its American Depositary Receipts (ADRs) are listed on the New York Stock Exchange (NYSE). ICICI bank was able to manage the downturn by initiating various innovative measures. Some of these measures are as follows:

#### **Cost Rationalization**

ICICI Bank has taken cost rationalization measures which have helped it in reducing operating expenses (including direct marketing expenses) by 14 percent year-on-year basis. The cost/average asset ratio for 2008-09 was 1.8 percent compared to 2.2 percent for 2007-08 indicating reduction in operating cost.

#### **Deposit mobilization Strategy .....Pooling Resources**

The ICICI Bank has adopted a deposit mobilization strategy which has helped the bank to increase the number of current and savings account to the tune of 28.7 percent by March 31, 2009 against 26.1percent in March 31, 2008.

#### **Liquidity Management .....Instilling Confidence**

*Liquidity risk* is one of the major risks faced by Indian Banks. Liquidity Management is an ability of bank to fund the increased demand for loan and ability to meet its obligation as and when they become due.

The ICICI bank has adopted a sound liquidity management system to manage Liquidity risk. The Managing Director of ICICI bank came out with press statement in backdrop of increasing fear and rumours about liquidity crunch, that bank is not facing any liquidity problem and has Rs.12000 Crores liquidity. He further stated that in international market the bank is not using rupee liquidity to fund the growth of its international operations also mentioned that all the loans are secure and bank has enough cash against them. He asked its customers not to panic. The bank is managing its liquidity by adopting asset liquidity management measures.

#### **Risk Containment Strategy .....Payment Risk**

ICICI bank is the leading issuer of credit cards in India. Because of global economic meltdown, the bank was facing default risk i.e. increase in risk associated with credit cards. In other words, it was witnessing increased amount of outstanding advances under the credit cards segment ever since the

meltdown became aggressive. According to Managing Director of the bank the loss ratio on its credit card business has reached double digits in this year. To prevent the risk associated with credit cards, the ICICI bank has adopted a strategy called as risk containment strategy. The objective of this strategy is to check delinquency by slowing down on the credit card business. As a part of this strategy, bank has been slowing down in issuing of the credit cards. The bank has also brought down the credit limit to 1.5-2 times of monthly income from 2-3 times in order to arrest the increased delinquencies in credit card payments. The bank has also withdrawn the Xpress Rewards Programme (it is a reward program that allows cardholders to earn up to 10 reward points for every Rs.200 spent. The cardholders are required to collect a minimum of 500 points now. These points will be redeemed in the form of gifts). The bank has also increased interest rate on credit cards in June 2008 from 2.4 percent to 3.4 percent per month. Risk containment strategy has helped the ICICI bank to bring down the credit card business. Credit card business has shrunk from Rs.8,100 crores in the first nine months of 2007-08 to Rs.7,800 crore during April-December 2008. The bank has also changed its loan mix by consciously cutting down on retail lending and concentrating more on corporate lending. The retail lending of ICICI bank has come down from 58 percent in 2007-08 to 49 percent in 2008-09.

#### **Strong Capital Adequacy Ratio (CAR)**

The bank has taken measures to improve Capital Adequacy Ratio (CAR) which has helped bank to improve capital adequacy ratio from 13.97 percent during fourth quarter of 2007-08 to 15.53 percent during fourth quarter of 2008-09 enabling smooth conduct of business.

#### **Expansion ..... Organic Growth**

The Bank in order to expand its network has planned to invest in expansion of its branch network to enhance its deposit franchise and create an integrated distribution network for both asset and liability products. The branch network of the Bank has increased from 755 branches at March 31, 2007 to 1,438 branches by April 24, 2009. The Bank is also in the process of opening 580 new branches which would expand the branch network to about 2,000 branches, giving the bank a wide distribution reach in the country.

#### **Restructuring NPA**

There is a feeling among financial experts that rising non-performing assets will be the main risks for Indian banks causing serious damage to the banks. ICICI bank which is slowing lending to check rising defaults saw its bad debts surging to 2.07 percent of net advances from 1.5 percent a year-ago. On March 31, 2009, the Bank's net non-performing asset ratio was 1.96 percent. The Bank has restructured loans aggregating to Rs.1,115 crore in 2008-09. This has enabled bank to classify the advances as standard assets (for which there was a general provision of a minimum of 0.25 percent) though there may be some delay in servicing of debt. The restructuring has helped the bank to minimize worsening NPAs. The bank has also increased provision for NPAs to Rs.1048 crores from Rs.947 crores.

#### **State bank of india**

State Bank of India one of the oldest and leading public sector banks in India was set up with an objective of serving banking needs of community with social touch and social welfare. It has branches throughout the country. It is premier bank in terms of balance sheet size, number of branches and

market capitalisation. Under the influence of GFM NPAs of the bank have increased, the bottom-line got affected. To manage GFM more effectively the bank has initiated various measures. The bank is able to manage the downturn well as it is evident from the fact that its net profit has increased from Rs.6729 crores in 2007-08 to Rs.9121 crores in 2008-09 (35 percent growth). This can be attributed to various measures initiated by the bank. Some of the prominent innovative management practices embraced by SBI to beat the downturn are as mentioned below:

#### **Management of NPA**

State Bank of India's NPA was increased by 28.66 percent (year on year basis - January to March 2008-09). To over come from this pressure the bank is making higher provision for NPAs. Further, the bank has adopted a *rephasing, rehabilitation and nursing* strategy to manage NPAs. Restructuring, rescheduling and rephasing of the repayment schedule of loan would render the account as a non-performing asset.

**a) Rescheduling and Rephasing of Loan:** SBI has re-scheduled its advances. The Bank is rephasing or rescheduling certain term-loans as the customers are in need of re-scheduling of term-loans mainly on account of the slowdown. This is a win-win strategy for both bank as well as the borrowers.

**b) Loan Restructuring -** The Reserve Bank had given regulatory concession on restructuring that will provide a breather to the corporate India suffering from liquidity crunch, also to banks in arresting the rise of NPAs.

**c) SBI is restructuring major advances as the corporate India is facing some cash flow problems on account of the economic meltdown.** The bank has implemented a Loan restructuring Policy to help healthy small and medium enterprises (primarily in textiles and garments sector) facing challenges owing to the global meltdown. This includes both working capital and term loans.

**d) The bank has received proposals for restructuring from other sectors which have been hit hard on account of the slowdown, include SMEs (small and medium enterprises), textiles, gems & jewellery and other export oriented units.** The Bank has received 46000 restructuring application from SME units, out of it around 26000 unit's loans were restructured. The Bank is considering another 15000 applications for loan reconstruction.

The above mentioned strategies have helped bank to prevent such accounts from turning into NPAs.

#### **Treasury Investment..... Towards Improving Profitability**

The economic meltdown has a negative impact on bank's (SBI) profitability. To improve its profitability, the bank has invested huge fund in treasury bills as it was evident from the fact that net profit rose 45.6 per cent to Rs.2,742.31 crore during the quarter ended March 2009 mainly on account of a rise in treasury and other incomes.

#### **Aggressive Lending Policy**

The SBI has adopted aggressive lending policy which has helped bank to grab 16.03 per cent share of the market, compared with 15.20 per cent at the end of March 2008.

#### **Deposit Mobilization Strategy**

The SBI has adopted Deposit Mobilization Strategy which has helped bank to mop up deposits to the tune of Rs.1000 crores a day, which helped it increase market share from 15.44 per cent at the end of March 2008 to 17.72 per cent at the end of March 2009.

### Financing SMEs – Product Development

The State Bank of India has slashed interest rates on loan for newly started small and medium enterprises with a view to improve credit flow to the fund-starved sector. The reduced lending rates will be 8 percent up to Rs.5 Lakhs for new loans to SMEs and that for loans of Rs.5 to Rs.25 lakhs will be 10 percent. Earlier, SBI used to offer SMEs loans up to Rs.5 Lakhs for 8.5-10.5 per cent and loans of Rs.5-25 lakh for 9-11 per cent. The interest rate reductions option will be available for the next two years and will be applicable for working capital and term loans. After two years bank will review the rates according to the prevailing market conditions. SBI has also extended the schemes such as SMEs Help and SMEs care, under which it offers loans to SMEs at 8 percent till September 2009.

### Education Loan..... Target customer Focus

State Bank of India has slashed lending rates for education loans by 0.25 percent, enabling students who take loans from 1 May to 30 September 2009, avail the benefit of reduced rates. The idea is to help students aspiring for higher studies with adequate financial support. SBI was previously offering education loans for rates ranging from 11.75 percent to 13.25 percent. Female students can avail loans for a 0.5 percent less rate across all categories. Education loans up to Rs.4 lakh do not require any collateral security. The loan between Rs.4 lakh and Rs.7.5 lakh would require a third-party guarantee. For loans above Rs.7.5 lakh and up to Rs.20 lakh, borrowers will have to produce some tangible assets such as a house or land as security. The loan re-payment period ranges from five to seven years.

### Risk Containment Strategy

Because of global economic meltdown, SBI was witnessing increased amount of outstanding advances under the credit cards segment ever since the meltdown. To over this problem bank has implemented a risk containment strategy. It has increased the interest rate on credit card from 3.1 percent to 3.35 percent.

### Business Expansion & Job Creation .....

Worldwide the major financial institutions are announcing job cuts to survive in the economic slowdown. But, India's largest bank, SBI has announced that it would create 25000 jobs in the clerical and staff level during the year 2009-10. The bank is planning to expand its business operation by adding 15000 branches and 6000 ATMs across the country.

### CRM Transformation.....

SBI has put its feedback system on its website to ensure excellent services to its customers. The bank is also planning to recruit around 1300 customer relationship executives.

### Conclusion

➤ The Indian banking industry is banking on traditional practices such as loan to value ratio, debt service ratio, loan purpose, verification of documentary evidences of income and assets of borrowers, continuous monitoring process, etc. and Indian banking culture which is different from US banking system has saved Indian banking system from collapse.

➤ Punjab National Bank has entered into an understanding with Tata Motors for financing Nano. The bank is giving emphasis on arresting slippages, recovery and up-gradation of NPA accounts. The bank is offering zero balance saving accounts for students of the age of 10 years and above. PNB is offering students above 18 years of age overdraft facility. It is planning to expand its operations to Norway, Canada and Bhutan.

➤ ICICI Bank has taken cost rationalization measures which have helped it in reducing operating expenses (including direct

marketing expenses). The bank has also taken measures to increase the number of current and savings account to the tune of 28.7 percent. To prevent the risk associated with credit cards, the ICICI bank has adopted a strategy called as risk containment strategy as a part of this strategy, bank has been slowing down in issuing of the credit cards. The bank has also brought down the credit limit to 1.5-2 times of monthly income from 2-3 times in order to arrest the increased delinquencies in credit card payments. Bank has increased its branches from 755 in March 31, 2007 to 1,438 by April 24, 2009.

➤ SBI has adopted a rephasing, rehabilitation and nursing strategy to manage NPAs. To improve its profitability, the bank has invested huge fund in treasury bills. The State Bank of India has slashed interest rates on loan for newly started small and medium enterprises. The Bank has slashed lending rates for education loans by 0.25 percent.

➤ The new car loan product launched by SBI has helped the bank to generate business worth Rs.9000 crore. The Bank has accounted for almost 50 percent of the total loan bookings made by the customers. This has resulted in increase of SBI's auto loan portfolio by 36 percent.

### Suggestions

✓ The banks of economic recession hit countries are using statistical models such as stress tests (such as scenario test and sensitivity test) to identify the financial risks, analyze, measure, communicate and manage these risks. Stress test helps to identify vulnerability of events in financial variables. Sensitivity test is used to assess the impact of change in one variable on the banks financial position. Scenario test include simultaneous moves in a number of variables based on single event experienced in the past or event that has not yet happened. The RBI has also made stress testing operational from March 2008. In this regard it was suggested that the Indian banks need to understand risk in its totality.

✓ ICICI bank which has international exposure and adopted aggressive retail lending, aggressive credit card strategy should put in place a framework for stress testing (if not yet adopted) in the areas like credit risk, operational risk, liquidity risk, credit concentration test, price risk, foreign currency risk, model risk, macro economic risk, etc.

✓ The SBI should also design its own stress testing framework in the areas like interest rate risk, price risk, model risk, foreign currency risk, operational risk, NPAs risk, etc. The stress test will help the banks to understand risk profile, find out limits, develop diagnostic tool & appropriate internal control system and design contingency plan. This will in turn help banks to meet stress situations and absorb shocks.

✓ The Indian banks including SBI & ICICI move away from risk averse zone i.e. parking their surpluses in safe havens. They should not curtail corporate lending as it may be harmful to the economy.

✓ The study conduct by the authors entitled "ATM cum Debit Cardholders Opinion about ATM Services in Dharwad City" has revealed that debit card may increase cardholders spending habits. There is no chance of wrong or excessive consumption. Further, debit card also does not put cardholders in neither debt trap nor leads to bankruptcy. The discussion with officials of Big Bazar has revealed that the retail Malls have benefited by the introduction of plastic money including debit card, which has brought more business for them. So, in this regard it is suggested that Indian banks should promote purchase through debit cards as it has zero default risk rate. The banks have to design strategy

to boost usage of debit cards. For instance, SBI has launched cash back campaign during 2008 (July) to encourage ATM cum debit cardholders to go for making payments through debit cards. As per the scheme the cardholders will get cash back for making payments for Rs.501 or above up to 5 percent. It is surprise to note that the bank has launched such scheme during inflation pressure and forgotten to re-launch the same during a period when the credit card default rate is high.

✓ Indian banks should use credit derivatives products such as credit default swaps, interest rate swaps, currency swaps carefully to manage risk as these products are the main route cause for collapse of US financial system.

✓ As investors are looking for safe and steady income investment option and banks have enough liquidity, they should think of cutting deposit rates below repo rate. Further, they should deploy surplus fund with RBI at reverse repo rate to improve their bottom-line.

✓ Banks should also look into outsourcing some of their activities to minimize operational cost.

✓ ICICI Bank should focus on adopting customer centric models to retain existing customers.

The Indian banks have initiated various measures to deal with the global financial meltdown. The rephasing, rehabilitation and nursing strategy proved quiet effective in managing NPAs. Indian banking sector can use this downturn as an opportunity to expand and grow rather than seeing it as threat to business. The Indian banks should look for servicing customers a new way, cost rationalization measures and thereby reducing operating expenses. If implemented above suggestion with true spirit, the ability of banking industries to manage global financial meltdown will improve which in turn helps to improve their business performance and profitability.

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