Trends, Implications and Prospects of Retail Banking in India

by Dr. Sukanya N[a]

Abstract

Retail banking/Personal banking, involving the collection of deposits from individuals and households and financing their credit-needs in small amounts, is emerging as a growing and lucrative field of banking activity in India in recent years with implications to the expansion of the commercial banking system and to the level of economic activity in the country and to its rapid economic development. This paper analyses the expansion of this sector of commercial banking in India since 2001 with a focus on retail financing by the banks. It outlines its implications and also points out the precautions to be adopted by the banks while expanding their activity in this field.

Key words: Retail banking; Personal banking; Credit economy; Inclusive banking; Credit assessment.

[a] Dr. Sukanya N,
Lecturer in Economics,
Sri Ramakrishna College,
Mangalore- 575 003
Karnataka, India
Phone: Cell- +91 9448083509
E-mail: sukanya130176@gmail.com

1. Introduction:

1.1. The economic growth of a country is encouraged, and is also accompanied, by financial development. The rapid growth of the commercial banking system of a country and its diversification is an index of such financial development in a country that facilitates the mobilisation of resources for productive investment purposes, which accelerates the rate of economic development of the country and raises the level of economic activity, employment and income in the country. The volume of bank credit and its distribution among the different sectors of the economy and types of economic activity in the economy assume importance in the process.

“Aanu bhadraa krathavo yanthu vishwathaha” - “Let the noble thoughts come to all from all directions”. Page No.1

Acme Intellects Research Center- A wing of Help to Help Charitable Trust®
1.2. Diversification of Banking Activity: The diversification of banking activity in the course of economic development has opened up new fields for lucrative banking activity in recent years. While the commercial banks were traditionally concentrating on financing trade and commercial activities, from which the name ‘commercial banks’ originated, they have enlarged their field of lending activities in recent years and now finance, besides commercial activities, industrial activities, medium and long term investment projects, housing and infrastructure projects, consumption activities, education and many other purposes which gave rise to the concept of universal banking. Modern commercial banks are universal banks and not pure commercial banks, as their name connotes and as they were originally conceived.

1.3. Retail Banking: The new fields of bank lending that have emerged in recent years, and which involve relatively small amounts of finance, have given rise to the concept of Retail Banking, which is slowly becoming a growing and lucrative field for commercial banking activity in India, as elsewhere. It also has potential for expanding the banking network and inclusive banking in the country.

1.4. The objective of this paper is to analyse the recent trends in retail lending by commercial banks in India and to discuss their implications. The paper is divided into seven sections. After this introductory section, section-II presents a brief review of certain related literature. Section –III gives the meaning of ‘retail banking’ and the approach of the Reserve Bank of India to the aspect of retail banking in India. Section-IV contains the recent trends in retail banking in India, and Section-V presents their implications to banking development and inclusive banking in the country and to its economic development. The precautions to be adopted by banks while retail lending are outlined in Section-VI and a formal conclusion of the discussion is presented in the concluding section, Section-VII of the paper.
2.1. Related Literature Survey: The role of bank credit in raising the level of economic activity in a country, and in promoting the rapid development of its economy, was stressed by many writers in the models of economic growth put forward by them from time to time.

2.2. Schumpeter (1961) pioneered the discussion on the role of bank credit in economic development through innovations financed by bank credit. The World Bank (1996) stressed the role of a developed and efficient financial system in promoting rapid economic growth of developing countries. Besides, a balanced distribution of bank credit among the different sectors of an economy is crucial to its rapid development and this stress is inherent in the Credit Authorisation Scheme for banks introduced in India in 1965, and in the scheme of Social Control over Banking introduced in 1968 (Government of India 1972). The nationalisation of the fourteen major commercial banks in India on the 14th of July 1969 was a decisive step in attaining the objective of a balanced distribution of credit among the different sectors and subsectors of the economy, as was stressed by the Prime Minister of the country in her broadcast to the nation announcing nationalisation of the banks (Government of India 1972a).

2.3. The Reserve Bank of India (2004) uses the phrase ‘retail portfolio of banks’ in its Report on Trend and Progress of Banking in India for the year 2003-04 and gives a tabular presentation of the retail portfolio of banks in P.59 of the report. Iyengar (2007) gives a succinct definition of retail banking and points out that the phrase retail banking is not restricted to only lending but includes activities of banks on the assert side as well as on the liability side of their activities.

2.4. Gopinath (2005) explains the salient features of retail banking and points out that retail banking should include, in its purview, not only the lending or asset side, but also the deposit mobilisation or liability side of banking activity.

2.5. Thingalaya (1968) explains the salient features of a pioneering retail banking scheme, the Pigmy deposit scheme, introduced by Syndicate Bank in 1928, covering the deposit mobilisation as well as the financing aspects of banking, that targets the banking needs of the retail traders, wage earners and self-employed persons undertaking productive activities of different types on a small scale. A brief presentation of the origin of the Pigmy deposit scheme is also found in Thingalaya (1997).
2.6. Sethuraman explains in a book prepared for the Indian Institute of Banking and Finance, Bombay, the nature of retail banking, its volume and components and scope for expansion in India. Rao (2014) discusses the nature of retail banking and its role in Indian commercial banking and stressed the need for constant innovation in devising retail loan products and their delivery and points out the precautions needed, so that such retail lending does not result in increasing NPAs of the banks. The role of sectoral balance in the deployment of bank credit among the different sectors of the economy in raising the productivity of bank credit in an economy was brought out by Bhat (1986) and Sukanya (2014).

III

3.1. **Meaning of Retail Banking:** The term retail banking can be viewed as banking transactions, receiving deposits as well as granting loans, that involve relatively small amounts in a single account or in an individual account, unlike corporate or wholesale banking that involves relatively large amounts of transactions in a single account or in an individual account. Viewed in this sense accepting deposits such as savings deposits, term deposits, recurring deposits and other specialised deposits from individuals and granting loans to individuals for such purposes as the purchase or building of houses, purchase of motor cars, scooters, purchase of other durable consumer goods, granting educational loans and other personal loans, that involve relatively large amounts and hence cannot be met by their current income and savings, can be termed as retail banking.

3.2. The term retail banking naturally points to its counterpart, namely wholesale banking or corporate banking that involves large amounts in a single transaction or account in the name of business or industrial corporations. A convenient criterion of defining retail banking, as distinguished from corporate or wholesale banking, would, therefore, be to consider banking transactions, receiving deposits as well as granting loans, in the name of individuals and households that involve relatively small amounts as retail banking, and banking transactions in the name of business corporations that involve relatively large amounts in a single account as wholesale banking or corporate banking. The amount or size of transaction in a single account is important while considering it as wholesale or retail banking since the banking transaction of an individual can, at times, be of a considerably large size.
3.3. However, retail banking is banking that meets the banking transactions of individual customers. Hence, the term can be interpreted as personal banking or personal banking transactions that involve consumption expenditure on current consumer goods, and durable consumer goods, like motor cars or the construction or purchase of houses, or meeting other financial commitments of individuals and households. Hence, retail banking can also be called personal banking. When interpreted in this sense the term retail banking or personal banking can include the bank accounts that are now opened in the country under the Jan Dhan Yojana, launched in 2014, for promoting inclusive banking or financial inclusion in the country.

3.4. Though the term retail banking is usually associated, in the annual reports of the Reserve Bank of India with the lending or financing aspect of banking, like meeting the credit card operations of individuals, lending for house building by individuals, for purchase of consumer durables, motor vehicles and other consumer items that involve large amounts, which individuals with limited income find difficult to mobilise in a lump sum and hence purchase with bank credit repayable in monthly installments, and granting other personal loans, the term should rightly be interpreted to include both lending and receiving deposits, the deposits received being in relatively small amounts from individuals and households. The savings deposits, term deposits, recurring deposits, and other specialised deposits received by banks from individuals and households that involve relatively small amounts, therefore, come within the category of retail banking.

3.5. Approach of The Reserve Bank of India: Though it is easy to conceptualise retail banking as above, there might be practical difficulties in the strict quantification of the magnitude of retail banking due both to the nature and purpose of the banking transactions that can be grouped under retail banking.

3.6. The Reserve Bank of India presents, in recent years, data pertaining to certain transactions of the banks under retail banking or under the retail portfolio of the banks and the analysis presented in this paper will be confined to such lending transactions of the banks as presented in the annual reports on trend and progress of banking in India published by the Reserve Bank of India.

3.7. The Reserve Bank of India (2004a) in its Report on Trend and Progress of Commercial Banking in India for the year 2003-04 presents, for the first time, item-wise details of the advances made by the commercial banks in the country in the form of a table with the
caption ‘retail portfolio of banks’ in Page 59, though the phrase ‘retail credit’ had appeared in earlier reports, and points out its potential for lucrative expansion of commercial banking activity in the country.¹ The report (The Reserve Bank of India 2004b) states “The retail banking portfolio encompasses deposit and asset linked products as well as other financial services offered to individuals for a variety of personal consumption and investment purposes. Retail banking is increasingly viewed by banks as an attractive market segment with opportunities for growth. The expansion of the retail banking segment can be attributed to the growing middle class with high disposable income, wider choices of consumer durables available to be financed by the banks, increased acceptance of credit cards and increased demand for housing loans spurred by attractive tax breaks”. The report (The Reserve Bank of India 2004c) further observes “The typical products offered in the retail banking segment are housing loans, consumption loans for purchase of durables, auto loans, credit cards and educational loans. The loans are marketed under attractive brand names to differentiate the products offered by banks. The loan values typically range between Rs.20,000 to Rs.100 lakh. The loans are generally for duration of five to seven years with housing loans granted for a longer duration of 15 years. Credit cards is another rapidly growing sub segment of this product group”.

3.8. Security and Mode of Repayment: The security against such retail loans raised by the individuals is usually the durable item of consumption like the house constructed with the proceeds of the loan, or the consumer goods purchased, the motor car purchased with the proceeds of the loan etc. The security offered against such retail or personal loans can also be other tangible items like gold, as in the case of gold loans, Government securities, stocks of industrial houses or other negotiable instruments acceptable for the banks as securities against loans.

3.9. The loans are usually repaid in convenient monthly installments. Arrangements are also made to pay the monthly installments at source by the pay-disbursing officers in the case of salaried consumers. This reduces the risk of loans getting delinquent. It is also convenient to the borrowers since the loan gets automatically repaid, almost without the knowledge of the borrowers.

3.10. Emergence of a Credit Economy: The increasing volume of the retail portfolio of commercial banks in a country is an indicator of the emergence of a credit economy in the country. The current consumption expenditure of individuals and families are generally met by
the level of their current disposable income or by using their past savings. The presence of banks and other financial institutions in an economy that finance the consumption expenditure of individuals and families has prompted people to meet their present consumption expenditure with borrowed money which they hope to repay in future with their expected future income. The repayment of such loans is usually in equated monthly installments so that the borrower can service and repay the loan in small monthly installments without landing himself in defaults with regard to the servicing and repayment of the loan. The permanent income hypothesis (Friedman 1957) of consumption expenditure and the life cycle hypothesis (Ando, Modigliani and Brumberg 1955, 1957) of consumption expenditure which link the consumption expenditure of individuals to their permanent income or life-time income explain this type of consumption expenditure by individuals. Such consumption expenditure of individuals against their expected future income is made possible by the willingness of the commercial banks to grant loans for such purposes. Since such consumption expenditure is credit financed, the growing volume of such bank credit in the country in recent years is the indicator of the emergence of a credit economy in the country.

IV

4.1. Retail Lending by Commercial Banks in India –the Recent Trends: The volume of retail lending by commercial banks in India has been increasing in recent years with implications to both commercial banking in the country and to the economy as a whole. Table-I presents the data pertaining to the volume and trends in retail lending by commercial banks in India since the year 2000-2001

Table-I

4.2. The data in Table-I show that retail lending by commercial banks in India has been increasing in recent years, in terms of both absolute volume and its share in the aggregate volume of credit extended by the banks in the country. The volume of retail loans advanced by the commercial banks in India increased from Rs.1,89,041 crore as at the end of March 2004 to an amount of Rs. 10,095 billion as at the end of March 2013. As a percentage share in the total loans and advances of the commercial banks in the country, retail loans formed 20.7 percent in 2013 as against 21.9 percent in 2004. The share of retail loans in total loans and advances of the banks was a high of 25.8 percent in 2007 and then tended to decrease, reaching 19.9 percent in 2011, and then increased to 20.7 percent in 2013.
4.3. Among the sub-sectors of retail loans, it is housing loans that form the major component of retail loans, forming 47.3 percent of total retail loans in 2004 and 47.1 percent in 2013. The other major parts of the retail advances of the commercial banks are loans against consumer durables, credit card receivables and auto loans. The data, thus, show that retail lending offers a growing opportunity for banks to increase their activity in the field of retail banking in the country.

V

5.1. Implications to Commercial Banking: As the economic development of the country occurs with growing employment and spendable income in the hands of the people, consumption expenditure is bound to increase in the country. A peculiar characteristic of consumption expenditure is that as the people become richer, the pattern of consumption expenditure changes in such a way that the share of consumption expenditure on durable consumer goods tends to increase. Hence, the financing of such consumption expenditure offers an expanding field for bank lending in the country. Further, the easy availability of consumption-loans from the banks will induce further increase in consumption expenditure in the country. The demand for retail loans of the banks is bound to increase as a consequence. This is also borne out by the trends in the growth of such demand for bank credit in the country as can be seen from the data contained in Table-I.

5.2. Implications to Inclusive Banking: Retail banking, targeting the banking needs of households and individuals for the safe and income yielding investment of their savings and for raising the resources needed for meeting their financial commitments in times of need, offers immense scope for bringing about banking inclusion in the country. When the major part of the domestic saving in the country comes from the household sector, tapping these savings requires extension of the banking sector of the economy so as to bring all the households within the banking sector. Retail banking can be an effective tool for bringing about such banking inclusion in the country. The Jan Dhan Yojana launched in the country in 2014 with the objective of bringing all the households of the country within the banking network is essentially an aspect of retail banking or personal banking.

"Aano bhadraa krathavo yanthu vishwathaha" - "Let the noble thoughts come to all from all directions". Page No.8
Acme Intellects Research Center- A wing of Help to Help Charitable Trust®
5.3. Entrepreneurship and Innovations Needed: The full exploitation of this growing business opportunity by the banks requires entrepreneurial sagacity, the commercial banks being monetary entrepreneurs (Bhat 1977), on their part in devising and introducing new lending schemes and loan products that suit the needs of the consumers with different levels of income and repaying capacities and different tastes and consumption expectations. Such lending schemes or loan products should not only meet fully the credit needs of the individuals going in for such loans, but should also include provisions for the repayment of such loans conveniently by the borrowers so that they can service and repay such loans conveniently without making such loans doubtful assets or non-performing assets to the banks. Evidently, such loan products should be flexible in nature and be capable of being modified to suit the needs of individual borrowers. Any rigid scheme of lending that is not capable of being modified according to the needs of individual borrowers will not be successful in exploiting fully the business opportunities for the banks in the field of retail lending in the country.

5.4. Implications to the Growth of the Economy: Increasing retail lending by the commercial banks in the country has implications to the growth of the country’s economy. Aggregate demand drives economic activity. Increasing demand for different types of manufactured consumer goods in the country financed through bank credit will increase aggregate demand in the economy through the inter-industry and inter-sectoral linkages that exist among the different sectors of the economy and will lead to higher levels of economic activity in the country thereby accelerating the rate of its economic growth. The phenomenon of consumption led economic growth will set in giving rise to a cumulating process of self-sustained economic growth of the country.

VI

6.1. Need for Precautions: Increased lending by the commercial banks for consumption and other forms of economic activity has advantages to the economy and will accelerate its growth. Care should, however, be taken to see that such lending by the banks, on a competitive basis, does not result in increasing credit over-dues and non-performing assets to the banks, which is increasing in the Indian commercial banking system in recent years.
6.2. The following are certain issues that have to be addressed by the banks for enhancing the productivity and usefulness of retail banking in the country.

i) The credit history of the borrowers have to be carefully examined by the banks in order to assess the suitability of an applicant for bank credit and to assess the risks involved for the bank in lending to the borrower for the purpose for which financial assistance is sought. As the Reserve Bank of India (2004d) observes “An important characteristic of retail banking assets is the comparatively low loan values. In order to appraise such loans, banks are using more refined credit assessment methods. These include credit scoring techniques, automated application processing, behavioral scoring models and income surrogate models. In addition, banks are also using data sharing as a means of improving the selection of customers and reduction of credit losses”.

ii) The present level of income and expected future level of income of the applicant have to be looked into in order to assess the amount of loan that he can easily bear and service in time.

iii) A proper and objective assessment of the credit-need of the project to be financed has to be made so as to avoid over-financing the project, particularly when it is a purely consumption project like building a house that does not lead to an increase in the future level of income of the borrowers, except saving the rent they are paying at present. The would be borrowers have to be properly advised on the suitability of the purpose for bank finance and the additional burden of credit that the borrower can easily bear to decide that the proposed project is within his economic reach.

iv) A proper follow up of the loan and its end use supervision has to be made so that the amount realised through the loan is not diverted to other uses, and that the loan is serviced according to schedule. It is important to realise that the role of the financing bank does not end with just the disbursement of the loan, but extends till the end of the life time of the loan so as to ensure its productive use and timely servicing and repayment.

v) A realistic interest rate regime on different types of personal or individual deposits, retail deposits, that offers a fair positive real rate of interest to the individual depositors should form an essential ingredient of retail or personal banking in order to encourage savings and to attract the savings to the banking system as deposits. It should be noted that for
the majority of the individual savers entrusting their savings to the banks or financial institutions is the only way of keeping their savings for the future other than keeping them in idle cash form. Since the alternative form of holding savings that is available for majority of individual savers is to hold them as cash which is idle, any positive money rate of interest can be said to be favourable to the savers and this may be taken as an alibi for keeping the money rates of interest offered by the banks on deposits at low levels.

This, however, is a policy that is exploitative in nature and should be eschewed by the banks particularly when the Government is the major player in the Indian banking system and which should avoid such exploitative policies. The money rates of interest of the banks on deposits should be high enough in order to ensure a fair real rate of interest on the deposits which the individuals entrust with the banks so as to encourage savings in the economy.

vi) Besides the above, effective action is also necessary at the policy making or Governmental level to ensure that easy availability of bank finance for the purchase of durable consumer goods does not result in an increase in the price of such goods of a profiteering magnitude. As often happens, the prices of goods often go up in the market when their purchase is easily financed by the banks. This is also true in the case of goods which are subsidised by the Government with the hope that such subsidisation will benefit their consumers. The suppliers, however, preempt such benefits to the consumers by raising their prices so that, in effect, the benefit of the subsidy is appropriated by the suppliers of the goods. The abnormal rise in the prices of real estate units in the country is an instance of this nature. Such increase in prices will result in an artificial increase in the amount of bank finance required by the consumers of such items and will lead to an increase in their debt burden that may cause bad debts and non-performing assets for the banks, besides the aggravating effect on inflation of such price-raising practices of the suppliers and of the credit induced consumption expenditure in the country.
VII

7.1. Conclusion: Retail banking, particularly retail lending by commercial banks, has great potential for the banks in the country for expanding their sphere of activity and volume of business. It has also the macro benefit of raising the level of economic activity in the country resulting in higher rates of economic growth of the country. The potential of retail banking for banking activity and for the economic growth of the country can, however, be realised fully only if sufficient precautions are taken to ensure that the retail loans lent by the banks are serviced and repaid according to schedule so that such lending does not result in increasing bad debts and nonperforming assets to the banks, with adverse implications to the profitability of the banking system and its sustainability, and also to the economy at large.

8. References:


9) Iyengar, Vijayaragavan (2007)- Introduction to Banking, Ch. 15, New Delhi, Excel Books.


18) Sethuraman, J. - Retail Banking- Models, Strategies, Performances and Future- The Indian Senario; The Indian Institute of Banking and Finance, Bombay.


22) Thingalaya, N.K. (1997) - Banking Development in Independent India, Syndicate Bank, Manipal, India
### Table-I
Retail Portfolio of Commercial Banks in India (Amount in Rs. Crore)

<table>
<thead>
<tr>
<th>Items</th>
<th>As at the end of March</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Total Loans and Advances of SCBs</td>
<td>8,64,271</td>
</tr>
<tr>
<td>2. Retail Loans:</td>
<td></td>
</tr>
<tr>
<td>2.1 Housing Loans</td>
<td>89,449</td>
</tr>
<tr>
<td></td>
<td>(47.3)</td>
</tr>
<tr>
<td>2.2 Consumer Durables</td>
<td>6,256</td>
</tr>
<tr>
<td></td>
<td>(3.3)</td>
</tr>
<tr>
<td>2.3 Credit Card Receivables</td>
<td>6,167</td>
</tr>
<tr>
<td></td>
<td>(3.3)</td>
</tr>
<tr>
<td>2.4 Auto Loans</td>
<td>Nil</td>
</tr>
<tr>
<td></td>
<td></td>
</tr>
<tr>
<td>2.5 Other Personal Loans</td>
<td>87,170</td>
</tr>
<tr>
<td></td>
<td>(46.1)</td>
</tr>
<tr>
<td>Total Retail Loans</td>
<td>1,89,041</td>
</tr>
<tr>
<td></td>
<td>(100.0)</td>
</tr>
<tr>
<td>Retail Loans as Percentage of Total Loans and Advances</td>
<td>21.9</td>
</tr>
</tbody>
</table>

Notes: 1. SCBs: Scheduled commercial banks.
2. Nil.: Amount included in ‘other personal loans’.
3. Figures within brackets indicate percentages to respective totals.
4. Amounts for 2011 and onwards are in Rs. Billion.

Notes:

1. Though the term retail portfolio, retail credit, retail banking was specifically used in 2003-lending by banks for purposes now included under retail lending was done by banks even earlier in such names as personal loans or loans to individuals, advances against fixed deposits, loans for consumer durables, housing loans, etc. See for details: Reserve Bank of India- Report on Trend and Progress of Banking in India, 1998-99, Table-II.2 in P.47.

Table-A presented below shows the volume-wise details of personal banking advances made by the banks in India during the three years from March 1996 to March 1998 as an illustration. The report on Trend and Progress of Banking in India for the year 2003-04 of The Reserve Bank of India reads as follows: “the flow of credit to various other sectors including retail loans recorded stronger growth of 23.7 per cent during 2003-04 as compared to growth rate of 11.5
percent recorded in 2002-03. Thus, retail banking, mainly in the form of housing and personal loans attracted an increasing share of banks’ loan portfolio”. PP. 57-58 of the Report.

An analysis of the security-wise distribution of the advances made by commercial banks in India during the 1950s and 1960s shows that even as early as 1951, the commercial banks in India were granting secured advances against such securities like Government and Trustee Securities, gold ornaments, shares of joint stock companies and fixed deposits, etc. which rightly come under retail banking or retail lending. See for details: data for security-wise distribution of scheduled commercial bank advances in India for December, 31, 1951 in Reserve Bank of India Bulletin, April 1953.

Table-A:
Personal and Other Commercial Bank Advances to Individuals in India, 1996-1998. (Amount in Rs. Crore)

<table>
<thead>
<tr>
<th>Purpose</th>
<th>Amount as on 29-Mar-96</th>
<th>28-Mar-97</th>
<th>27-Mar-98</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Gross Bank Credit</td>
<td>2,31,860</td>
<td>2,58,991</td>
<td>3,00,283</td>
</tr>
<tr>
<td>2. Public Food Procurement Credit</td>
<td>9,791</td>
<td>7,597</td>
<td>12,485</td>
</tr>
<tr>
<td>3. Personal Advances</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>3.i) Housing Loans</td>
<td>6,303</td>
<td>7,773</td>
<td>9,057</td>
</tr>
<tr>
<td>3.ii) Consumer Durables</td>
<td>1,476</td>
<td>2,297</td>
<td>2,527</td>
</tr>
<tr>
<td>3.iii) Loans to Individuals</td>
<td>1,933</td>
<td>2,066</td>
<td>1,904</td>
</tr>
<tr>
<td>3.iv) Advances Against Fixed Deposits</td>
<td>N.A.</td>
<td>1,505</td>
<td>11,815</td>
</tr>
<tr>
<td>Total (3.i to 3.iv)</td>
<td>9,712</td>
<td>13,641</td>
<td>25,303</td>
</tr>
<tr>
<td>4. Personal Advances as Percentage of (1)</td>
<td>4.2</td>
<td>5.3</td>
<td>8.4</td>
</tr>
</tbody>
</table>

Source: RBI- Report on Trend and Progress of Banking in India.
Note: Figures within brackets indicate percentage to Gross Bank Credit.