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A COMPARATIVE STUDY OF NON-FUND BASED INCOME OF INDIAN PRIVATE SECTOR BANKS AND FOREIGN BANKS OPERATING IN INDIA

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Abstract

It is not only impossible to imagine the current society without banks, but also it was impossible to give the economy a phenomenal growth that it has visited. Banking is no more one of the pillars of the economy but, now it has become the complete foundation of it. With the increase in business the banking activities have also multiplied. This has increased the responsibility of banks not only towards the business but also towards the society as a whole. Indian economy, being multifaceted produces twists and turns for banking operations and banks convert these opportunities for their advantage. Demand for services other than that of finances is one such threat that the banks are trying to convert into opportunity of generating non-fund based income. Current study is based on comparison of non-fund based income of Private Sector Banks and Foreign Banks operating in India. Simple comparison is made with the help of descriptive statistical tools. It was observed that Foreign Banks operating in India are better in providing generation of non-fund based income. it is further observed that they collect non-fund based revenue equivalent to 50% of fund based income.

Introduction

"With the monetary system we have now, the careful saving of a lifetime can be wiped out in an eye blink" Larry Parks, Executive Director, FAME

Could you imagine a world without banks? At first, this might sound like a great thought! But banks (and financial institutions) have become cornerstones of our economy for several reasons. They transfer risk, provide liquidity, facilitate both major and minor transactions and provide financial information for both individuals and businesses.

"Thank God, In Joy and Sorrow, to deposit and borrow, Banks are there Otherwise, The question would be funny, to keep and get money How and Where"

These words indicate the importance of bank. Banking system plays an important role in growth of economy. The banking sector is the lifeline of any modern economy. It is one of the important pillars of financial system, which plays a vital role in the success or failure of an economy. It is a well known fact that banks are one of the oldest financial intermediaries in the financial system. They play a crucial role in the mobilization of deposits from the disbursement of credit to various sectors of the economy. The banking system reflects the economic health of the country. The strength of the economy of any country basically hinges on the strength and efficiency of its financial system, which in turn depends on a sound and solvent banking system.

Challenges In Banking Sector

There has been considerable widening and deepening of the Indian financial system in the recent years. The enhanced role of the Banking sector in the Indian Economy, the increasing levels of deregulation and the increasing levels of competition have placed numerous demands on our Banks. The adverse consequences of malfunction of the Banking system could be more severe than in the past. Hence, focus of RBI, the regulator & supervisor of Indian Banking system is at ensuring greater financial stability. While operating in this highly demanding environment, the banking system is exposed to various risks & challenges few of them are discussed as under:

1 Improving risk management system

2 Rural coverage
3 Technological problems
4 Corporate governance
5 Customer services
6 Branch banking
7 Competition
8 Transparency and disclosures
9 Known your customer guidelines

Problem And Prospect Of Banking In India

During the post reform period and due to the situation of Liberalization, Privatization and Globalization, Indian banking sector is facing some problems and challenges. These are as under:

1 Low Profitability and Productivity
2 Lack of Integrity
3 Increase of Administrative Expenses
4 Survival of loss making branches
5 Scandals
6 Lack of Professional Behavior
7 Lack of professional and friendly approaches with customer
8 Non-performing Assets
9 Customer oriented market
10 Problem of customer satisfaction
11 Depression period running over the country
12 Managing work force
13 Management of technological advancement

However banks have some prospects in present environment. By converting threats into opportunities, the bank can have better advantages these opportunities are as under:

1 Offering of innovative products
2 Door to door service approach
3 Customer relationship management
4 Professional approaches
5 Managerial excellence
6 Marketing and technological advancement
7 Customized and cyber services
8 Branch expansion
9 Deposit Mobilization
10 NPA management
11 Asset reconstruction
12 Motivational HRM policies
13 Change in lending process
14 Merger and acquisition
15 Total quality management concept

Concept Of Income

Edmond Wilson's good quotation about income, "There is nothing more demoralizing than a small but adequate income." Generally the income refers with the financial gain accruing over a given period of time.

Types Of Bank Income

There are two broad sources of bank income or revenues. One is Interest Income or Fund Based Income and second is, Non-Interest Income or Non-fund Based Income.

Fund Based Income/Interest Income

Banks sometimes keep their cash in short term deposit investment such as certificates of deposits with maturities up to twelve month, saving account and money market funds. The cash placed in these accounts earn interest for the business, which is recorded on the income statement as interest income. For others such as an insurance company and financial institutions that generates profit by investing the money it holds for policyholders into interest paying bonds, it is a crucial part of the business.

Components of interest/fund based income

Main components of Interest/ Fund Based Income of banks are as under:

1 Income from lending of money
2 Income from investment (SLR)

Non-Fund Based Income/Non-Interest Income

In the face of declining net interest margins, depository institutions have entered new product areas over the past two decades, moving from traditional lending to Areas that generate Non-fund Based Income. The change is of importance for financial stability. The more unstable is a bank's earning stream, the more risky the institution is. The conventional wisdom in the banking industry is that earnings from fee-based products are more stable than loan-based earnings and those fee-based activities reduce bank risk via diversifications.

Components of non- interest/non- fund based income

Main components of Non-Interest/Non-Fund Based Income of banks are as under:

Income on remittance of business

Apart from accepting deposits and lending money, Banks also carry out, on behalf of their customers the act of transfer of money - both domestic and foreign. - From one place to another. This activity is known as "remittance business". Banks issue Demand

Drafts, Banker's Cheques, and Money Orders Etc. for transferring the money. Banks also have the facility of quick transfer of money also know as Telegraphic Transfer. Faster the mode of transfer, higher will be the charges.

Income from third party product

Commission or income earned on selling other companies' products (or third party distribution business) is emerging as a new revenue source for many banks. Although the fee amounts are still small, they are a valuable contribution to diversifying revenue streams, increasing the mix of non-interest income and also improve profits.

Income on contingent liability

A contingent liability is a liability which may or may not arise in the future depending on the happening or non happening of an event.

Income on government business

In present age apart from rendering all other Personal banking services to its customers/public, every bank in India also works as Agency Bank for undertaking various types of Govt. Business viz.

1 Pension Payment
2 Collection of PPF and Payment of PPF
3 Collection of Government Bonds
4 Collection of Senior Citizen Deposits
5 Collection of Various Taxes, like CBDT, Indirect tax Excise and VAT
6 Receipts/payments work of Postal/Railways
7 Treasury/Sub-Treasury business
8 Franking of Stamps of various documents
9 Collection of Stamp Duty

Income on wealth management

Wealth management is an investment advisory discipline that incorporates financial planning, investment portfolio management and a number of aggregated financial services. High net worth individuals, small business owners and families who desire the assistance of a credentialed financial advisory specialist call upon wealth managers to coordinate retail banking, estate planning, legal resources, tax professionals and investment management. Wealth management can be provided by large corporate entities, independent financial advisers or multi-licensed portfolio managers whose services are designed to focus on high-net worth customers. Large banks and large brokerage houses create segmentation marketing-strategies to sell both proprietary and nonproprietary products and services to investors designated as potential high net-worth customers. Independent wealth managers use their experience in estate planning, risk management, and their affiliations with tax and legal specialists, to manage the diverse holdings of high net worth clients. Banks and brokerage firms use advisory talent pools to aggregate these same services.

Foreign exchange

Banks generated the revenue from foreign exchange transaction**.** Here difference between forward exchange contract transaction and actual Transaction. Foreign exchange refers with the system by which the type of money used in one country is exchanged for another country's money, making international trade easier.

Sale of precious metals

Banks are also generated the income from selling of precious metals like silver and gold coins.

Income from other sources

1 Demat account
2 Dipository participants account

Non-interest income` is derived from the execution/processing business, the advisory business and any principal business that does not appear on the balance sheet. Financial institutions that wish to maximize execution/processing income depend on volume and efficiency for profits. To be successful, the trade center and the back office must be well coordinated and function in an efficient manner. In the face of declining net interest margins, depository institutions have entered new product areas moving from traditional lending to areas that generate non-interest revenues.

Review Of Literature

Trope, David (2000) assumed that among bankers that all one needs to do to combat competitive pressures on bank margins is to diversify into fee-generating activities. By doing so, banks would generate higher levels of non-interest income, which would be sufficient to compensate for the reductions they have been experiencing in their interest income. There may be a further assumption that non-interest income will not be as sensitive as net interest income to changing economic conditions, and that non-interest income in that way will help make a bank's overall income less variable. To reflect this, some banks have imposed specific targets for the level of non-interest income that ought to be earned. The target can be expressed as a ratio of non-interest income to total income (defined to be net of interest expense).

Hundal & Jain (2006) found that mobile banking, then a new challenge, emerged when banking institutions began to consolidate their online activities. The recent advances in telecommunication have enabled the introduction of mobile banking services, which can be seen as an innovation in the financial services industry. Innovation adoption literature suggests that the perceived innovation attributes are the most important determinants of consumers' adoption decisions. This paper evaluates the applicability of Rogers' (1995) innovation attributes constructs in analyzing the adoption of mobile banking. The data was collected in India during January-August, 2005, and includes 222 survey responses. The article articulates the stimulating and Inhibiting attributes in the adoption of mobile Banking services and outlines some managerial implications.

Bhayani, Dr. S.J. (2006). This Paper emphasized on the broad objective of the banking sector. These are reforms in India has been to increase efficiency and profitability of the banks. For this purpose, the banking sector has been opened for new private sector banks. As a result, various new private sector banks have started their banking business. In this paper, the author analyzed the performance of new private sector banks through the help of the CAMEL model. For the purpose, four leading private sector banks - ICICI, HDFC, UTI and IDBI - had been taken as sample. After making an analysis of the CAMEL parameters, the author assigned ranks to all the banks according to their performance in various parameters of CAMEL, and then he assigned them overall ranking. The findings of the study revealed that the aggregate performance of IDBI is the best among all the banks, followed by UTI.

Prakash, A, Ghosh, Saibal (2006) found in their research that competition in the Indian banking sector has increased since the inception of the financial sector reforms in 1992. Using annual data on scheduled commercial banks for the period 1996-2004, the paper evaluates the validity of this claim in the Indian context. The empirical evidence reveals that the Indian banking system operates under competitive conditions and earns revenues as if under monopolistic competition.

Sinh, Rupinder (2006) found in his study that MALAYAN Banking Bhd (Maybank), Malaysia's largest banking group, expects its non-fund based income to contribute one-third of its revenue in one to two years. Non-fund based income comprises fees and service charges collected from customers for various products and services. Chief operating officer Datuk Johar Che Mat said to date; the bank is on track to achieving the target. For its third quarter to March 2006, it saw its non-fund based income surging by RM378 million or 22.7 per cent.

Singh, Y. P., Seth, A. K., Rajput, Bhawna (20008). In this study the researchers tried to examine the link between revenue portfolio and risk adjusted performance of banks in Indian context. Traditionally it is believed that earnings from non-fund based sources are more stable than loan based earning and the increases focus on these activities overall revenue and profitability volatility via diversification effects.

Uppal R. K. (2007). The financial liberalization has changed the behavior of income of the commercial banks in India. Of late, banks have been increasingly diversifying into non-funds based income activities as against traditional banking. In this context, this paper attempted to compare the behavior of interest and non-interest income of all scheduled commercial banks in India. The paper analyzes the contours of interest and non-interest income at bank level, bank group level and also at industry level. It further found some glaring issues related to banks' income and suggests some appropriate strategies to increase non-interest income, which may be helpful to stabilize the total income of the banks in the emerging competition.

Vyas, Ramkrishna, and Dhade, Aruna (2007). In the paper the dominant public sector banks, have been exposed to competition from the new banks set up in the private sector with the latest technology.

This has created a need for the public sector banks to improve their business efficiency and volume, which is a good sign of competitive effectiveness. Induced stiff competition in the banking sector, certainly raises some issues relating to the functioning of domestic banks. The study mainly focused on the State Bank of India (SBI), the premier bank in the Indian banking sector, as to what extent it has been affected by the entry of new private sector banks. The study applied t-test for finding the significant difference in the performance of SBI before and after the entry of private sector banks, with the help of financial ratios selected as the parameters for ascertaining the changes in the business of SBI. The results indicate that the presence of new private sector banks does not pose any threat to SBI at the moment; however, the same cannot be said in the future. The SBI has a strong network as compared to these new banks, and its presence has been for more than hundreds of years in the region. These facts certainly have a major impact on the results of the study.

Anjaly, Vijaykumar & Mercia Selva, Malar (2009) found that the rate of earning non-interest income is very low when compared with the interest income. The commission received from LC, DD etc formed the major chunk on non- interest income of the bank at that time. It is suggested that the unviable loss making branches to be either merged with the nearest branches or closed abruptly to reduce the loss, lockers and be installed at extension counter also. The banks make use of use of the opportunity improve the cross selling and tapping the untapped opportunities in the retail segment. As retail income continues to grow there is an immense opportunity for the banks to raise fee based income.

Biswas, Nigamananda (2009) observed that banking sector reforms in India has undergone a profound transformation over the years particularly after the post liberalization period. The changed operating environment underpinned by globalization, privatization, deregulation (since 1991) and advancement in information technology, has resulted intense competitive pressures. Banking sector has responded to these challenges by diversifying through organic growth of existing businesses. This has exposed the Banking sector to newer risks and posed numerous serious challenges. The present paper has made an attempt to highlight the challenges faced by the Banking sector in India and also suggested some measures to survive in the competitive market.

Barry & Gulasekaran (2010) considered the time series relationship between bank non interest income and bank net interest margins in Australia using panel vector auto regressions. It is found that increase in bank noninterest income are being used to supplement decreases in net interest margin, but that the magnitude of the increase in noninterest income is smaller than the decrease in net interest margin. It is also found that increases in noninterest income pre-date declines in margin income, suggesting that Australian banks were pro-active in the process of disintermediation. The agency risks of increased bank noninterest income are explored from the perspectives of regulators, consumers, bank shareholders, borrowers and bank management

Objective Of Study

There has been a decrease in the interest rates during the UPA – II tenure. This has decreased the fund based income of banks and banks have compelled to increase business which is a big challenge in the competitive market like that of India. The banks may reap the relations with clients and impart non-interest charges in them for services they provide. The main object of the study is to compare the non-fund based income of banks.

Other objects that shall be fulfilled will be:

1 To understand the structure of non-fund based income of the Private Sector Banks and Foreign Banks operating in India.

2 To examine the contribution of non-fund based income in the total income of the Private Sector Banks and Foreign Banks operating in India.

3 To compare the fund based and non fund based income of the Private Sector Banks and Foreign Banks operating in India.

4 To examine the direction of non fund based activities of the Private Sector Banks and Foreign Banks operating in India.

Hypotheses Of The Study

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1 There is no significant difference in the structure of non-fund based income of the Private Sector Banks and Foreign Banks operating in India.
2 There is no significant difference in the contribution made by non-fund based income in the total income of the Private Sector Banks and Foreign Banks operating in India.
3 There is no significant difference in the comparative ratio of fund based income and non fund based income of the Private Sector Banks and Foreign Banks operating in India.
4 There is no significant difference in the direction of non fund based activities of the Private Sector Banks and Foreign Banks operating in India.

Research Methodology

Objective 1 : For understanding the structure of non fund based income of the Private Sector Banks and Foreign Banks operating in India we have taken the balance sheet of the one bank from both the sectors. ICICI bank will represent the Private sector and Standard Chartered Bank will represent the Foreign Banks operating in India Sector. The structure of non-fund based income of both the banks will be analyzed by the observation method.

Objective 2 : Examination of the contribution of non-fund based income in the total income of banks will be done by simple ratio and average method. For the purpose of confidence of the study data for five years has been taken and standard deviation calculated.

Objective 3 : for the purpose of comparison of fund-based and non-fund based income of the Private Sector Banks and Foreign Banks operating in India relevant tables have been formulated and simple average method has been used.

Objective 4 : for examining the direction of non fund based activities of the Private Sector Banks and Foreign Banks operating in India the observation method was used. The observation of past five year's relevant data used with freehand graph revealed the direction of non-fund based activity.

Reason Of The Study And Scope For Future Studies

A study on "*A COMPARATIVE STUDY OF NON-FUND BASED INCOME OF SELECTED PUBLIC SECTOR BANKS & SELECTED PRIVATE SECTOR BANKS IN INDIA*" was conducted by Mr. Nilesh M. Marvaniya in 2011 as his Ph. D. Thesis. In this he compared the public sector banks and private sector banks. In this study he has not taken the Foreign Banks operating in India. The present study tries to fulfill this gap. The present study compares Private Sector Banks and Foreign Banks operating in India because both are less regulated than the public sector banks. Hence the public sector banks were not taken for the study. The time scope of the study of Mr. Marvaniya was limited up to the year 2008. So it was thought to conduct a study to know about the non fund based income of banks after 2008. Present study covers the non fund based income of Private Sector Banks and Foreign Banks Operating in India from the year 2009 – 2013. Since the current study compares the non-fund based income of Private sector Banks and Foreign Banks operating in India only, it leaves a scope for studying the non-fund based income of complete banking sector, which includes the Public Sector Banks, Regional Rural Banks and Cooperative Banks.

Analysis, Findings And Conclusion

Non-Fund Based Income as percentage of Total Income		
Year	ICICI Bank	Standard Chartered bank
2008	22	29
2009	20	37
2010	23	36
2011	20	31
2012	18	31
2013	17	30
Mini.	17	29
Max	23	37
Avg	20	32
STD Dev	2	3
Source : Annual Reports of respective Banks		

We can observe that non fund based income of ICICI bank, on an average is 20% of its total income. However, the Standard Chartered Bank collects 32% of total income as non fund based income. The difference of 12% average is huge. The Standard Deviations for the non fund based income are 2% and 3% respectively for the ICICI Bank and Standard Chartered Bank. The standard deviation suggests that ICICI Bank is more consistent in collection of non fund based income as compared to Standard Chartered Bank.

	ICICI Bank		Standard Chartered Bank	
Year	Interest Income (%)	Non Income (%)	Interest Income (%)	Non Income (%)
2008	78	22	71	29
2009	80	20	63	37
2010	77	23	64	36
2011	80	20	69	31
2012	82	18	69	31
2013	83	17	70	30
Mini	77	17	63	29
Max	83	23	71	37
Avg	80	20	68	32
STD Dev	2	2	3	3

Source: Annual Reports of respective banks

The average Non-fund based income of Private Banks (ICICI) is 25% of their Fund based income (Interest). On the other hand the non-fund based income of Foreign Banks (Standard Chartered Bank) is 48% to their fund based income. Non-fund based income of private banks is more consistent (STD Dev 3%) as compared to that of Foreign Banks (STD Dev 8%). Still the foreign banks earn non fund based income equivalent to almost 50% of their fund based income. This shows that the Foreign Banks are more into non fund based activities as compared to private sector banks of India.

Findings And Conclusion

On the basis of observation of the annual reports of banks (both Private Sector Banks and Foreign Banks operating in India), we can say that basically there is no significant difference in the sources of non fund based income of the banks. However, since the foreign banks operating in India needs to follow international financial reporting system and hence they have more elaborated disclosure norms. On the other hand, the Indian banks are largely governed by the Indian banking companies act and RBI guidelines, their disclosure norms are liberal.

When the question of contribution of non-fund based income to total income comes it is observed that the Foreign Banks have a better contribution ratio of non-fund based income to total income which is 32%. In Private sector Banks this ratio comes to 20% only. This indicates that almost 1/3rd of total income of Foreign Banks come from non-fund based sources.

Fund based income and non-fund based income ratio of the foreign banks comes to 50% on average. The same is 25% in case of Private Sector Banks. This reveals that Foreign Banks collect non-fund based revenue equivalent to half of the fund based revenue. This is indicator of better services to the customer. Non-fund based income is generated out of non-fund based activities. So the ratio of non-fund based income to fund based income also suggests better non-fund based activities of the Foreign Banks operating in India.

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