International Journal of Advanced Research in Commerce, Management &Social Science (IJARCMSS)
ISSN :2581-7930, Impact Factor : 6.986, Volume 07, No. 02(I), April-June, 2024, pp 157-164

A STUDY OF FINANCIAL SUSTAINABILITY IN INDIAN BANKING INDUSTRY

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ABSTRACT

Financial sustainability has become a catch line in the modern financial systems. This has become a matter of concern in all economies worldwide. Financial sustainability ensures stable and resilient financial health. This comprehensive approach supports the banking sector in generating more revenue, and its strategic planning system is conducive to reducing the level of non-performing assets by managing costs. This allows the financial system to achieve its strategic goals by effectively managing borrowing and credit. Strategic investment decisions help evade financial strain and mitigate probable financial pitfalls. This makes the system more viable and resilient, allowing banks to achieve long-term goals in a zestful environment of financial threats and opportunities. The concept of financial sustainability is a new term in the Indian banking system. Banks are trying their best to adopt and implement it, but are still lagging. To date, only a few banks have incorporated them successfully. Financial sustainability offers many benefits to banks in the form of high productivity, effective management of interest rate fluctuations, controlled non-performing assets, cost reduction, better customer satisfaction, and risk control. Indian banks have acknowledged the significance of financial sustainability and are now committed to achieving it. Banking regulators must incorporate and implement the goal of financial sustainability in the Indian banking system on a priority basis. This study highlights the need to adopt the goal of financial sustainability in the Indian banking industry. Further, the strategies made by the RBI in this direction have been analyzed along with the challenges that banks face during the implementation of these strategies in the real world.

KEYWORDS: *Sustainable Development, Financial Sustainability, Forensic Audit*

Introduction

Globalization helps most regions of the world to become increasingly interconnected in different dimensions, such as economically, culturally, and socially. Globalization gives access to each one of us to all types of goods, services, and technology that belong to other countries and thus helps in increasing the standard of living, which in turn contributes to the development of a nation. This has facilitated the rapid integration of global economies. In this era of globalization, where everything becomes perfect and easily available, one of the most important things that we are losing and badly going to miss is natural greenery. The general public, environmentalists, and intellectuals are raising this issue and showing their concern to save the natural environment. Worldwide economies are concerned about the depletion of the natural environment. They began changing their way or style of work. These economies are opting for eco-friendly practices that ensure the well-being of the Earth's planet and promote sustainability in a broader aspect. These sustainable practices have ensured the effective distribution and utilization of resources. This idea of resource conservation ensures the balanced use of resources by meeting present needs and carrying them forward for future generations, thus facilitating sustainable development.

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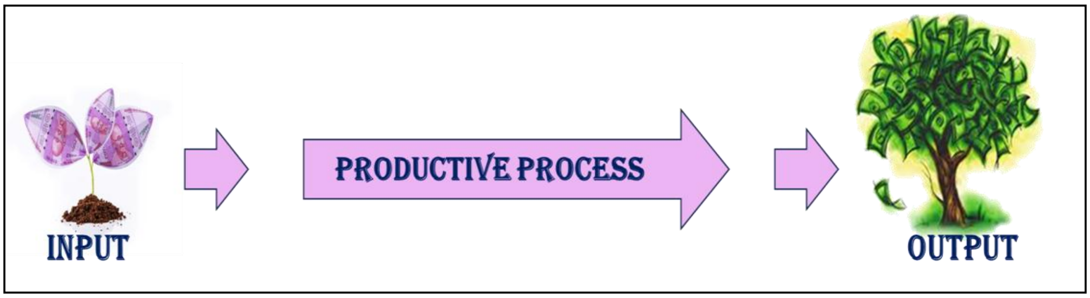
Sustainable Development has several aspects and perspectives. Sustainability refers to the ability to be sustained or endured. Sustainable development refers to the ability to perform all economic activities without depleting natural resources. It helps maintain a steady level of growth without causing any damage to the diversity and vitality of Earth. With this notion of sustainable development, economies can fulfil their present needs without jeopardizing the requirements of generations to come. Sustainable development is an absolute necessity, as this is the only way to provide respect and care for all forms of life. Sustainable development refers to the ability to sustain itself in every domain of the economy, such as ecological, socio-political, or cultural..

Financial Sustainability

Financial sustainability is a novel phenomenon in the Indian financial sector. It has become the aspiration of every institution, organization, government, and country, and to achieve it is their soul aim. In the present scenario, the biggest challenge to an organization is to acquire critical financial resources to carry on their economic activities. This difficult situation is faced by every organization as well as by the government at all levels. Considering business organizations, financial sustainability can be defined in terms of inputs and outputs from an accounting perspective. It is the ability of a business organization to achieve the end results, that is, its extensive goals with the given level of inputs. This should ensure the endurance of the business and organization.



Financial sustainability has become a catchline in the modern financial systems. This has become a matter of concern in all economies worldwide. Financial sustainability ensures stable and resilient financial health. This comprehensive approach supports the banking sector in generating more revenue, and its strategic planning system is conducive to reducing the level of non-performing assets by managing costs. This allows the financial system to achieve its strategic goals by effectively managing borrowing and credit. Strategic investment decisions help evade financial strain and mitigate probable financial pitfalls. This makes the system more viable and resilient, allowing banks to achieve long-term goals in a zestful environment of financial threats and opportunities. Maintaining trustworthy relationships with all stakeholders is the primary goal of all the banks. It requires comprehensive, flexible, innovative, adaptable, integral, robust, sustainable, accountable, and transparent. These elements help stakeholders obtain a precise picture of financial health and make suitable decisions. Financial sustainability is kept informed, and enables them to track changes in the banking sector. Financial sustainability is crucial for maintaining a diversified, competitive, and profitable financial environment.

Review of Literature

Rao (2023) highlights the key role played by the financial sector in providing finance to different economic activities and influencing them. The Indian economy is growing at a rapid rate, and it needs to resolve many issues, such as climate change, for which active participation of the banking sector is necessary. A sustainable financial system is a prerequisite to sustainable economic development.

Ali (2022) studied the financial soundness of banks in the public and private sectors in India and found a significant difference. To write off NPAs, banks need to generate maximum possible net profits, and they need to focus more on their current and saving account strategies.

Vydhyam and Nair (2022) aim to determine the importance of green banking. It further points out the need to incorporate green banking along with its green products in the banking sector to achieve the target of financial sustainability in Andhra Pradesh. It studied the various initiatives taken by public and private banks around green banking and the impact of these initiatives to achieve the goal of green banking.

Joshi (2021) highlighted the need for an independent system of financial sustainability in all sectors of the economy for all-round economic development. This study analyzes the status of financial sustainability at different levels of municipal corporations and discusses its prospects.

Kumar and Prakash (2020) aim to determine the status of the Indian Banking System in accepting sustainable development practices and strategies. It covers both public- and private-sector banks. The study concluded that public sector banks respond more slowly than their counterparts.

Dogra and Dogra (2019) study two basic areas of corporate social responsibility in the banking sector: ethical banking and sustainable banking, along with the mega scam that was reported in the Punjab National Bank. The research paper attempts to forecast NPAs in this bank by 2025 and finds terrifying results.

Naina (2019) highlights the need to improve financial sustainability in the banking sector. The entire banking system is required to follow the rules and practices introduced by the RBI and the government from time to time. The biggest obstacle is burgeoning NPAs in public and private banks, which need to be dealt with efficiently.

Dipika (2015) attempted to understand the nature and scope of green banking. The study highlighted the problems faced by banks in implementing strategies specifically designed to achieve the goal of sustainable development. This study focuses on making the financial system more sustainable and environmentally friendly.

Objectives

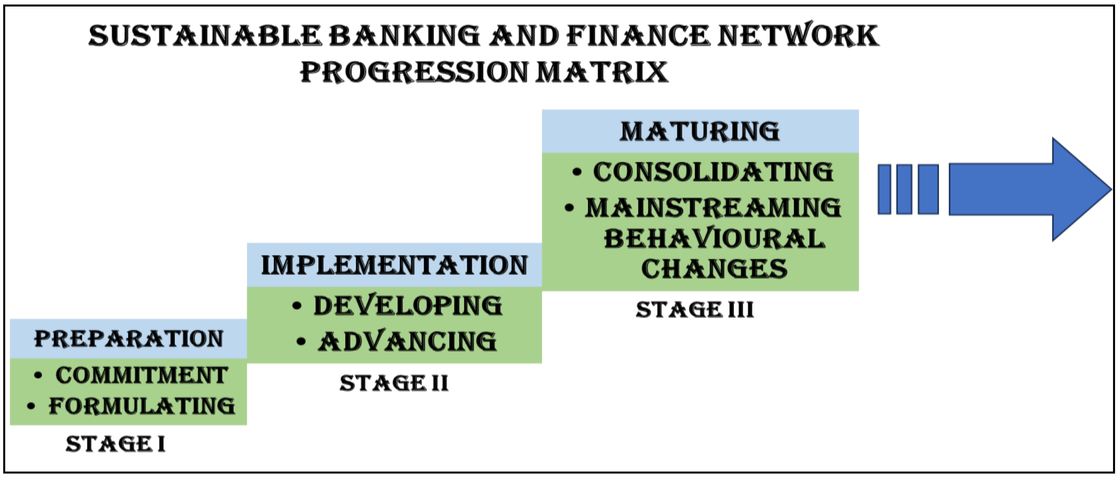
- Mark the eminent role and concerns of financial stability in'sdia the banking sector.
- To explain the initiatives taken by the RBI as regulators of the Indian Banking Sector to make the financial system more sustainable.
- To study the challenges faced by the Banking Sector in implementing effective strategies for achieving financial stability and the way forward.

Research Methodology

Financial sustainability has become a central point of interest in the Indian banking industry. Every bank is trying to attain the goal of financial sustainability, as it will help in achieving all other objectives. This research article is purely qualitative. The information was gathered from different relevant secondary sources, such as statistical reports published by the Reserve Bank of India and by the Government of India, journals, business magazines, and conference proceedings, various national and international banking surveys, and academic research papers.

Role Concern of Financial Stability in the Banking Sector

India has been a member of the Sustainable Banking and Finance Network since 2016 and has advocated the aim of Sustainable Banking. The sustainable Banking and Finance Network Progression Matrix (SBFNPM) divides the overall progress of a country into three main stages, with each stage having two further sub-stages. A diagram depicting the different stages and sub-stages is shown below.



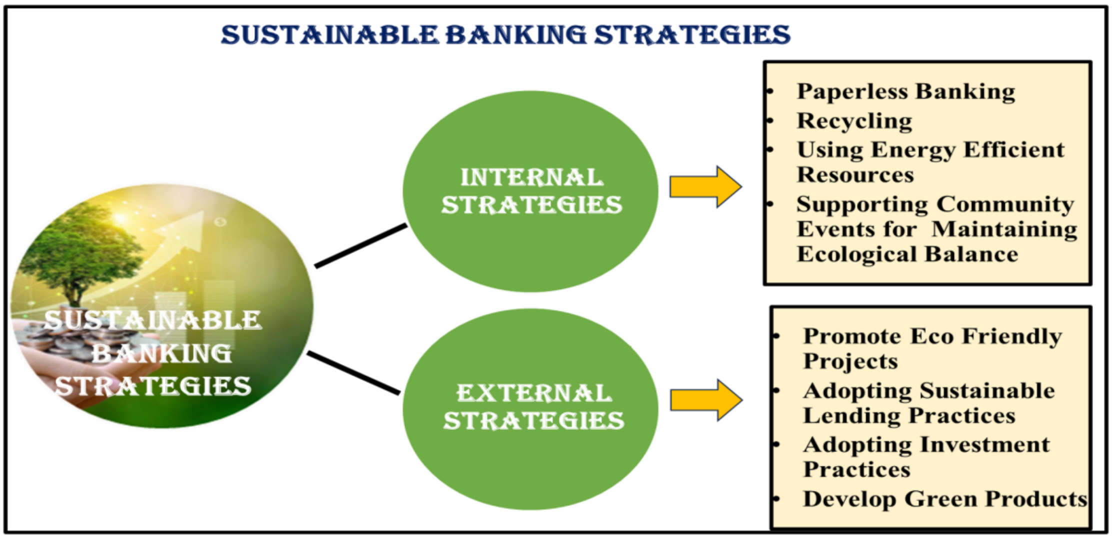
Indian authorities have shown a keen interest in sustainable development and have formulated various task committees to achieve it. These task forces are diverse groups of people from various ministries that work on the single agenda of achieving and maintaining a sustainable financial system in the Indian economy. To promote and implement it effectively, the Indian Banking Regulator (RBI) is a member of the Network of Central Banks and Supervisors for Greening the Financial System at the beginning of 2021. Similarly, SEBI, The Stock Market Regulator, implemented regulations for listed companies to support financial sustainability. These comprehensive approaches helped India become part of the IInd Stage. Before 2021, India was part of 'Formulating sub-stage' of Stage I. However, in 2022, India shifted up and was mapped to"the II' developing sub-stage of Stage II.

As India is shifting upward from one stage to another, it needs to have a stable financial system which should be able to meet the requirements of a growing economy. Banks are facilitating agents that play a significant role in carrying out all economic activities necessary for development. To meet the booming financial demands of a growing economy, banks must formulate sustainable strategies, which in turn would lead to a sustainable financial system. Sustainable banking offers many benefits to banks, such as effective cost management, proper handling of interest rate fluctuations, asset liability supervision, enhancing profitability, accelerating productivity, non-performing asset monitoring, adhering to regulatory frameworks, and maintaining long-lasting customer relationships. More importantly, it supports business strategies that are social- and environment-friendly.

The strategies used by banks to achieve the financial sustainability target can be categorized into two parts, as shown in the diagram below:

Internal Strategies: It includes the different steps taken by banks internally to enhance sustainability, such as social engagement, paperless banking, and maintaining a healthy corporate culture.

External Strategies: This includes the steps taken by banks to support all organizations that contribute to sustainability, such as sustainable lending and investment practices and promoting green culture.



Financial Sustainability ensures the financial soundness of the banking sector, an essential pre-requisite for running all businesses and their operational activities. Sustainable banking mitigates all the financial threats posed to the business community.

Currently, among all the significant world economies, the Indian economy is growing rapidly. India is expected to become the 5th largest economy in terms of GDP at the global level by 2025. India's GDP is growing consistently, and is expected to be one of the highest among world economies in the years to come. As the economy grows, so does the status of India at the international level. Earlier, the per capita income of India was low, so it belonged to low-income economies. However, with the increase in income level, it has shifted up to a middle income (lower) economy, as per the records published by the World Bank. As this is a positive change, but on the other hand, the level of concessional loans would decrease. The World Bank provides concessional loans to low-income countries. These are given at concessional terms, that is, at zero or negligible interest rates with a grace period of 5–10 years. From 1945 to 2015, the highest borrowing was by the Indian Government from World Bank. The absence or reduction in this multilateral grant will create a difficult situation for India to fill its financial gaps. The only solution for this financial strain is Financial Sustainability. Thus, the current need is to develop a Sustainable Financial System. However, in India, it is still in its embryonic stage and much needs to be done.

Initiatives taken by RBI to Make Financial System Stable

The covid pandemic, the continual Ukraine-Russia war, and recent collapse in Europe and the US banking sector have again forced the government and financial regulators to reconsider the financial soundness and resilience with higher intensity. A fresh assessment of existing regulatory and supervisory norms has been established by the authorities. The financial system of a country, along with its constituent elements, must be resilient and effective around the clock.

The system should be sufficiently strong to bear the financial stress of global economies. Keeping these facts into consideration, The Indian Banking Regulator (RBI) has remarkably nourished the regulatory and supervisory norms of the banking sector to increase the resilience and smartness of the entire financial system. The RBI had left no stone unturned to make the financial sector stronger and healthier, so that it could successfully face unwarranted situations and continue to act as a crucial pillar of economic growth. Some notable initiatives taken by the RBI to strengthen the banking sector are as follows.

Implementation of Monetary Policy: The smooth functioning of the banking sector is necessary for the successful transmission mechanism of monetary policy. Its successful transmission shows that central banks perform all their primary and secondary functions, such as liquidity management, interest rate regulation, and other supervisory functions. All these regulatory frameworks ensure the smooth functioning of the banking sector and thus promote the culture of responsible and amenable behavior among different financial entities.

Scrutiny of Bank's Existing Business Models: A financial and operationally resilient bank able to maintain capital buffers along with good earnings in times of financial crisis. Resilience depends on the strategies and business models of banks. Any flaw in the business model can eventually flicker a financial crisis. Therefore, the RBI has started closely supervising the business models accepted by banks, apart from prescribing different norms such as capital adequacy ratios and liquidity ratios. This provides a buffer to the nudge banks to prepare for future financial strain scenarios.

Macroprudential Policy: Apart from prudential norms, the RBI has introduced a macroprudential policy for banks that allows them to maintain moderate fund flows under adverse economic situations and thus facilitates liquidity buffers against financial shocks. It restrains banks from giving excessive loans during economic upturns (booms) and makes them more resilient during economic downturns (busts), and is thus less likely to create financial strain. Thus, the RBI supports banks in making them financially more resilient, sustainable, and stronger.

Information Technology Guidelines: The operational resilience of the banking sector helps deliver crucial services during disruptions. Cyber threats are risks that affect banks' operational efficiency. Nowadays, banks are making extensive use of outsourcing, and so dependency on third parties is increasing day by day. To address this, the RBI introduced and implemented a slew of norms. These norms are based on the latest technology and incorporate tools, such as phishing simulations. To safeguard all Regulated Entities from third-party risks, the RBI has opted robust cyber reconnaissance activities for banks to enhance their predictabilities. It has prepared extensive guidelines on the outsourcing activities of banks, specifically in the case of information technology.

Early Warning Systems (EWS): To strengthen the safety of banking systems, RBI has introduced many supervisory analytics, such as data analytics at the macro and macro levels. It helps banks in the early detection of fraud, addresses existing vulnerabilities and risks at the initial stage, and takes timely action. Now, the RBI has opted for advanced analytical technologies such as Machine Learning and Artificial Intelligence to make the banking sector more advanced and super-tech savvy. Early Warning systems and stress tests are conducted persistently for individual organizations and systems.

Comprehensive Employee's Development in the Reserve Bank: To cope with the current challenging scenario, the RBI emphasizes the comprehensive development of employees to make them more resilient and efficient. Proficiency and sensible judgments must be made for effective supervision. RBI is concentrating on making the training programs more fruitful by including hard practical and case-based teaching and training sessions for new trainees. Through these balanced training programs, employees would be able to develop their technical and emotional expertise. With these advanced capabilities, employees are able to effectively face the emerging challenges of the modern financial system.

Forensic Audit: The RBI introduced a forensic audit for banks with the aim of cleaning up the Indian banking system in 2015. This will help the RBI to determine the actual reason behind the poor performance of banks. Banks’ performance is affected by many factors, such as stressed loans, slow economic progress, wrong policies, and NPAs. Forensic audits will help banks take precautionary steps in advance by detecting fraud at the initial stage.

Comprehensive Digital Lending Guidelines: The RBI introduced detailed digital lending guidelines in 2022 for the concerned financial institutions (Regulated Entities) that offer digital loans through any digital system. The basic aim is to make digital lending activities transparent, prudent, and accountable. This will shield financial institutions from the threats and challenges of modern digital lending.

The Reserve Bank of India is committed to being ready for the future and has adopted and offered all the required assistance to maintain a sustainable resilient banking system in India. The RBI joined many international agencies to achieve the aim of a sustainable banking system. It has taken some pre-emptive actions such as paperless banking, launching of green bonds, encouraging and lending to green projects, diminishing e-waste, discouraging lofty greenhouse gas emission projects, supporting high environmental rating industries, promoting e-signatures, digital processing, varied digital wallets, mobile banking, and so on. These new policies and their effective implementation are conducive to achieving the financial sustainability target in the Indian banking industry.

Key Challenges in Implementing the Strategies

Although many initiatives have been taken by banking regulators to ensure stable financial soundness, it is still in its budding stage and is facing several bottlenecks in implementing the formulated strategies. Some specific impediments to the implementation of these strategies are outlined below.

Ambiguous Term: Sustainable banking or green banking has become a new notion, but we still lack a precise definition and scope. The Indian banking sector has started its journey towards it, but its just beginning and bigger picture is still left. Authorities and policymakers are defining this concept from different perspectives and measuring them in different ways. This may create confusion and conflict among the stakeholders.

Measuring and Reporting: Financial sustainability requires effective methods and precise reporting. Banks need to collect comprehensive data, analyze it, and then conduct reporting. It is a significant challenge for banks to have such broad facts and figures. The available data are generally tangled, fragmented, and thus a challenging task for banks.

Lack of Taxonomy: A universally recognized taxonomy for financial sustainability is not available. Although the Indian banking industry is moving in the direction of sustainability, it is not able to make a comparison with banking industries at the global level because of a lack of universal standards. This may explain the lack of suitable policies in this direction.

Capacity Strengthening: Sustainability has changed the working style of financial institutions from 'good to have ' to 'required to have'. Employee support is critical to achieving the ultimate objective of financial sustainability. Only well-trained and developed employees can understand the significance of sustainability in finance, and so may be proven as an asset in its implementation. Banks must organize effective training and development programs for their employees to make them more fruitful.

Stakeholders Pressure: Another biggest challenge for banks is to face unbearable pressure from their stakeholders. Where customers want to have access to more and more options in the form of sustainable banking products, investors pressurize banks to adopt effective sustainable practices. Stakeholders are increasingly putting pressure on financial institutions to introduce sustainable financial practices and products. Banks must handle this pressure efficiently by trying to meet the expectations of their stakeholders, as they must retain and attract present and prospective customers.

Volatile Regulations: Financial sustainability is a new and versatile phenomenon in the Indian banking industry. Globally, many legal directives have been formulated, and the latest are still to come. Banking regulators consider banks to be front combatants in the transitional phase of sustainable banking. Banks must be resilient to adopting and implementing these changes on a regular basis.

Diversification: The objective of financial sustainability forces banks to examine their customers using certain sustainable strategies. It restrains the banking business to qualify organizations and thus limits the profitability level. It will confine access to the financial system to all individuals and business entities, and will thus work as a deterrent to the goal of financial inclusion. The access of finance to selected customers will again prove to be an impediment in the path of economic development.

Recommendations

- Indian Banks must avoid the disorderly allocation of loans to selected esteemed customers without investigating or verifying their earning capacity.
- Proper disclosure of the NPAS must be done otherwise, which may adversely affect banks by slowing down their growth and profitability.
- A forensic Audit must be implemented effectively to neaten the Indian banking system and to unearth the disparities in the financial records of banks.
- Banks should have efficient cost and management expertise. Professional experts, such as Cost and Management Accountants (CMAs), may be appointed who have expertise and play a significant role in controlling NPAs.
- Banks must conduct a time-to-time strategic analysis of longstanding business models to ensure their effectiveness.
- Sizeable investments in data analytics must be made to ensure an effective reporting system.
- Customers should be aware of the availability and benefits of sustainable financial services. This Knowledge gap may prove injurious to banks' financial health.
- Banks are required to redesign their core traditional products and link new ones with sustainability in the banking system.
- Banks must diversify their sources of income. Different income sources, such as funding from different national and international governments, international NGOs, big corporate houses, and household consumers, would decrease the chances of vulnerability.

Conclusion

Financial sustainability offers many benefits to banks in the form of high productivity, effective management of interest rate fluctuations, controlled non-performing assets, cost reduction, better customer satisfaction, and risk control. Indian banks have acknowledged the significance of financial sustainability and are now committed to achieving it. Banking regulators must incorporate and implement the goal of financial sustainability in the Indian banking system on a priority basis.

The concept of financial sustainability is a new term in the Indian banking system. Banks are trying their best to adopt and implement it, but are still lagging. To date, only a few banks have incorporated them successfully. Indian banks need to conduct an in-depth analysis of the global financial system to play a leading role in this transformation journey. The concerned banking regulators are now developing effective strategies in this direction, but their fruitful implementation is still lacking.

Way Forward

Thus, attaining financial sustainability is no longer a dream. It has become both a prerequisite and moral imperative for Indian banks. It demands continuous considerable effort and excellent teamwork to attain financial sustainability in the banking system. The banking sector needs to have a longstanding commitment, proper coordination, effective leadership, constructive management, and a flawless strategic plan of action. Banks must invest substantial time and money to achieve this goal. Indian Banks must be creative and futuristic. Therefore, they are required to incorporate advanced strategies and techniques to increase their potential. Financial sustainability is a buffer against financial crises and will help banks achieve other goals.

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