# Retail loans boom in Indian Banks – effects and efficiency of retail loans

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## Abstract

*The commercial banks in India have been shifting their focus from traditional banking that involved primarily corporate and commercial loans and priority sector advances as mandated by the Reserve bank of India to retail loans in the recent few decades. The share of retail loans has been increasing steadily year on year basis. On an average, the retail loans have been increasing around 30 per cent with a marginal variation for individual banks. The reasons for increase in the extent of retail loans are many such as, low risk of default, easy handling and management, increased demand from consumers, better returns on retail loans, reduced level of non-performing assets etc. The increased level of non-performing assets also enthused banks to seek alternative ways for less riskier and safe financing. The boom started with home loans being provided by the commercial banks on liberal terms and lower costs. This was followed by the vehicle loans, consumer loans, personal loans, credit cards and so on. The pr ivate sector banks' marketing strategies are more aggressive as compared to public sector banks. But many customers still feel to deal with public sector banks for retrial loans on account of more transparency in the transactions and reasonable terms and conditions. This paper attempts to analyze different aspects of retail loans that made this boom to happen, efficiency of retail loans and its impact on banks performance.*


**Keywords:** *Retail loans, non performing assets, efficiency, priority sector, recovery*

## Introduction

The banks are engaged in extending loans and advances to the different segments of the society for various purposes for meeting business and personal requirements. The loans and advances so extended become assets in banks' balance sheet. The banks are required to maintain the efficiency of those assets. This is all the more important as banks are dealing in public money and it becomes their prime responsibility to repay the liabilities to its customers in time. Also, banks are not charitable institutions. Their operations are basically commercial in nature. They are required maintain their financial viability through increased profits and profitability. The composition of assets assumes more significance to banks in terms of safety, efficiency, returns on them etc. The banks have to be more cautious while lending and ensuring an effective ratio between different types of assets.

The lending pattern and direction of loans and advances have undergone many changes with the changes in banking structure, ownership, increased demand etc. over a period of time Historically, the banks used to lent major proportion of their loans and advances to business purposes and more so for the big corporate houses in view of the safety and timely recovery of loan from this segment. A cautious approach of selective loan prevailed before independence in India. It continued even after independence till the government thought of nationalization of commercial banks. Over the years and more particularly after nationalization of commercial banks, there was a little shift of bank loans to the priority sector, where banks were required compulsorily to lend certain percentage of their credit to this segment. This comprises of agriculture, small business, retail trade, small and tiny and cottage units etc. Since these segments were hitherto neglected by banks, there was added focus to extend loans to this sector on liberal terms.

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Unfortunately the priority sector loans did not meet the required purpose in terms of proper utilization proper asset management and timely repayment to banks. Over a period of time majority of priority sector loans extended by banks turned as bad debts. This adversely affected the Banks' Balance Sheet as their profits declined due to large proportion of loan waivers, write offs and non repayment of loans by the larger segment. It ultimately had adverse impact on banks' profitability, their financial performance and viability. In certain cases, their survival was at stake. It was in mid 80's the Reserve Bank of India (RBI) and the Government thought of strategies and brought certain changes in lending activities of banks. The RBI advised the commercial banks to diversify their loan portfolios from traditional landing to retail banking activities such as - Home Loans, Personal Loans, Consumer Durable Loans, Credit Cards, Vehicle Loans and so on. This was thought that this kind of diversification will help the banks to augment their income and overcome the problem non-performing assets (NPAs) to larger extent.

The entry of new Private sector banks in 1994 that were promoted altogether on different footings gave further boost to this concept and they were actively focused to extend loans and advances to the retail segment. The new commercial banks in private sector very aggressively supported this idea and started lending to retail sector in a big way due to the following reasons:-

1) The size of the loan being small. It had lower risk of default.
2) The loans are mostly considered for the individuals who have regular income.
3) The Repayment period ranges from 1-5 years, and it is easy to get back the liability in the Shorter time period.
4) Many of these loans are backed by security and other collaterals.
5) The monetary and fellow- up cost is also less as compared to big corporate loans.
6) The minimum size of NPAs helps the Banks to have minimum capital provision for these loans. The initial process of loan appraisal is also simple.

According to Reserve Bank of India (RBI) data, personal loans increased by 16.5 per cent in June 2015 compared with an increase of 15.2 per cent in the same month last year. On the other hand, credit card outstanding grew to 23 per cent in June this year compared with 16.7 per cent in the corresponding period a year ago.

In all the Banks have lesser NPAs under retail loans as compared to the big size corporate loans and advances. Small retail loans cause minimum provision for NPAs as the level of NPAs is much lower under these loans. Retail loans also provide increased Return on Investments (ROI) to the banks. Of late it is observed that Banks prefer to extend retail loans in larger quantity than to corporate loans.

According to a study, retail loans extended by Private Sector Banks are in the range of 40 to 60 per cent where as in case of Public Sector Banks this comes to 20 to 30 per cent. Besides, there are many advantages of retail loans to the banks in terms of asset quality and performance.

After a long time, we see an improvement in the market share of public banks after consistently losing it since FY2012," Kotak Institutional Equities said in a report. "A large share of this improvement could be driven by the focus on Project Indradhanush wherein public banks would get a higher rating if growth in retail, agriculture and SME portfolio is strong."

SBI Group has raised its retail loans market share to 31% in 2015, from 24% in 2006, says the report citing RBI data. Retail loans are now perceived to low risk than large value corporate loans. Share of all other nationalized banks rose to 35%, from 34% in the same period while for private banks it fell to 27.3%, from 29.6%.

Under the Indradhaniush scheme, the government has set performance parameters for banks to be met so that it can allocate capital. Those banks which grow their retail and farm loans will be given higher capital allocation.

"Private banks have defended their share in housing loans and improved in select unsecured loans, but they lost ground in what appears to be small ticket lending that gets classified under retail," said the report. The share of retail loans is currently at -19.5% from 18.3% in FY2014. Kotak expects retail loans to grow at 17% CAGR over FY2016-20 and their contribution to overall loans to increase to 25% of loans from 18% in FY2014.

One of the biggest advantages probably giving comfort to banks to build their retail platform is stronger consumer balance sheets as compared to corporate balance sheet at this stage, it said.

"Among public banks, we expect SBI to play a dominant role as it has an established business in retail assets, customer base and reach," it said. ``With a large customer base, good execution and strong analytics, we believe frontline private banks can gain market share over time.'' Across the country South India remains dominant in subscribing to retail credit from banks. This part accounts for 39% of the retail loan business growing 14% year-on-year. Retail loans continue to grow even as the demand for bank credit from corporate and industry continues to remain tepid. Within retail, it is especially unsecured lending - personal loans and credit cards - which are outpacing overall bank credit growth.

In view of the above, this study is proposed with the following objectives-

1) Comparative analysis of Retail Loans and corporate loans in the total portfolio of bank Loans and advances.
2) To assess the level of NPAs under retail and corporate loans.
3) An assessment of impact on profitability of retail loans in terms of ROI, Spread, Profits, Provisions and banks' balance sheet.
4) To analyze other benefits of retail loans to banks.
5) To identify major issues and challenges of retail loans.

## Research Methodology

The researchers have adopted descriptive methodology for this study Research has been placed on secondary data sources such as books, journals, newspapers and online database.

## Literature Review

**Table 1: Literature Review on Performance of Retail Loans in Commercial Banks in India**

| Sr. No. | Author | Year | Comments |
|---|---|---|---|
| 1. | Chauhan | 2015 | A paradigm shift in bank financing through innovative products and mechanisms involving constant up gradation and revalidation of the banks' internal systems and processes is called for. |
| 2. | Das | 1999 | Stated that while there is a welcome increase in emphasis on non-interest income, banks have tended to show risk -averse behavior by opting for risk- free investments over risky loans. |
| 3. | Debi | 2010 | Most interestingly it was observed that the proportion of defaulters is higher when there is no collateral as the default percentage is 29 per cent without collateral and only 7 percent in case of loan with collateral. |
| 4. | Ghose | 1990 | Apart from unprecedented growth and functional diversification, there has, in fact, been a change in the concept, precept and outlook of banking. |
| 5. | Gopinath | 2005 | He said that there is a need of constant innovation in retail banking. In bracing for tomorrow, a paradigm shift in bank financing through innovative products and mechanisms involving constant up gradation and revalidation of the banks' internal systems and processes is called for. |
| 6. | Manohar | 2007 | This article addressed the key issues of housing loan frauds. |
| 7. | Misra | 2009 | Retail banking in India has a great potential because of the low penetration. The existing model has been evolving with both banks and borrowers learning from their past experience. |
| 8. | Ninan | 2006 | In his article "Keeping Pace with Demand", observes that the retail banking in India has witnessed a fast growth du e to the introduction of financial reforms. |
| 9. | Prakash | 2006 | Conducted a comprehensive study on "Growth of Retail Banking in India" in which she had focused on high growth pattern of the retail Banking. |

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|---|---|---|---|
| 10. | Puri | 2005 | In his article "A Booming Segment", quotes that leading institutions and banks have evolved their offerings to make the products more attractive for the customers and process from application to disbursement more streamlined. |
| 11. | Rao | 2005 | He has accounted for the loan portfolio of the banking companies consisting industrial loans, retail loans and other purpose loans. |
| 12. | Satpal | 2014 | This study shows that extent of NPA is comparatively very high in public sectors banks as compared to pri vate banks. Although various steps have been taken by government to reduce the NPAs but still a lot needs to be done to curb this problem. |
| 13. | Sodhi | 2010 | Banks now need to use retail as a growth trigger. This requires product development and differentiation, innovation and business process reengineering, micro -planning, marketing, prudent pricing, customization, technological up gradation, home / electronic / mobile banking, cost reduction and cross - selling. |
| 14. | Sreelaxmi | 2007 | Necessary measures like takeover of bad loans, fair assessment of property and employee morale may be taken by the financial institution by improving their performance and avoiding NPAs. |
| 15. | Srinivas | 2006 | The study revealed that banks have also concentrated on housing loans because the housing loans are totally secured as the mortgage on the property securities the loan. |

## A perspective of Retail banking across the globe

According to World Retail Banking report (2013), North America leads in customer experience Index followed by Canada (81%). The other countries that reported comparatively higher gains in relation to positive customer experience include Italy, Saudi Arabia and China. The pace of digital banking, prompt and efficient services and access to variety of information are some of the important factors that boost the growth of retail banking industry. The World Retail Banking Report also includes insights towards customer attitudes in retail banking sector. The study was undertaken through a survey involving more than 18,000 retail banking customers in 35 selected countries. For analyzing retention of retail banking customers, the study included 80 banking services components to assess the impact.

## Trends in retail banking

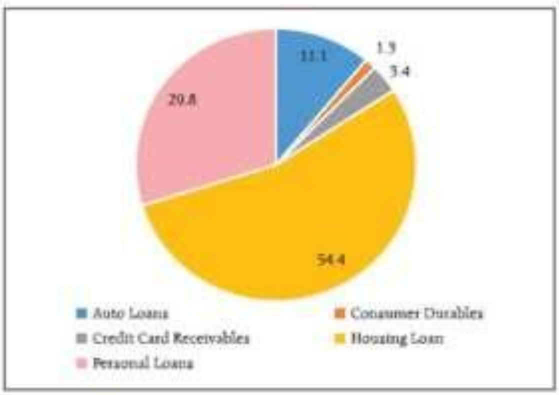
According to the Report's Customer Experience Index, which surveyed over 18,000 bank customers across 35 markets, 10% of retail banking customers is likely to leave their banks in the next six months while an additional 41% say they are unsure if they will stay or go. To re-build the customer-bank relationship, the Report finds banks can become more customer-centric more personal interactions.ATM machines and Internet Banking, many consumers still prefer the personal touch of their neighborhood branch bank. Technology has made it possible to deliver services throughout the branch bank network, providing instant updates to checking accounts and rapid movement of money for stock transfer Retail banking now encompasses not just branches, but also anywhere that banking services can be conveniently provided to consumers. Whether it means a service kiosk in a train station, a mini- branch in a grocery store, a premium branch in a central business district, or a bank-on-wheels that visits corporate workplaces, proximity to targeted customers ultimately matters more than having a traditional bank façade. Flexibility and agility will provide a competitive advantage for bank. Technology is becoming the centerpiece of retail bank executives will expect their IT departments to identify and implement technology-based solutions to enhance the customer experience.

## The Impact of Retail Banking In India

Retail banking in India is not a new phenomenon. It has always been prevalent in India in various forms. For the last few years it has become synonymous with mainstream banking for many banks. The typical products offered in the Indian 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 different banks. As the Report on Trend and Progress of India, 2003-04 has shown that the loan values of these retail lending typically range between Rs.20, 000 to Rs.100 lack. The loans are generally for duration of five to seven years with housing loans granted for a longer duration of 15 years. Credit card is another rapidly growing sub-segment of this product group. In recent past retail lending has turned out to be a key profit driver for banks with retail portfolio constituting 21.5 per cent of total outstanding advances as on March 2004. The overall impairment of the retail loan portfolio worked out much less then the Gross NPA ratio for the entire loan portfolio. Within the retail segment, the housing loans had the least gross asset impairment. In fact, retailing make ample business sense in the banking sector. The following away the retail Banking Contributing service to development of Indian Economy.

## Retail credit

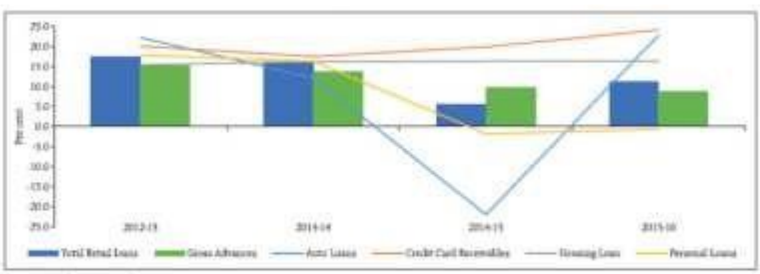
**Banks' retail loan portfolios registered double-digit growth. The housing loan component**




**Source:** RBI Supervisory Returns.

***Figure 1:*** *Composition of Retail Loans in % as at end March, 2016*

which constitutes more than 54 per cent of the total retail loan portfolio of banks increased by 16.4 per cent (Chart 2.12). The personal loans component, which is the second major retail segment and consists of education loans, loans against fixed deposits, shares and bonds, among others, however, continued to witness negative growth. In comparison, the auto loan segment made a smart recovery after registering negative growth during the previous year.



**Source:** RBI Supervisory Returns.

***Figure 2:*** *Growth in Retail Loans*

## Credit Cards

While usage of cards by customers of banks in India has been in vogue since the mid-1980s, it is only since the early 1990s that the market had witnessed a quantum jump. The total number of cards issued by 42 banks and outstanding, increased from 2.69 core as on end December 2003 to 4.33 core as on end December 2004. In view of this ever increasing role of credit cards a Working Group was set up for regulatory mechanism for cards. The terms of reference of the Working Group were fairly broad and the Group was to look into the type of regulatory measures that are to be introduced for plastic cards (credit, debit and smart cards) for encouraging their growth in a safe, secure and efficient manner, as also to take care of the best customer practices and grievances redressed mechanism for the card users. The Reserve Bank has been receiving a number of complaints regarding various undesirable practices by credit card issuing institutions and their agents.

## Housing Credit

Housing credit has increased substantially over last few years, but from a very low base. During the period 1993-2004, outstanding housing loans by scheduled commercial banks and housing finance companies grew at a trend rate of 23 per cent. The share of housing loans in total non-food credit of scheduled commercial banks has increased from about 3 per cent in 1992-93 to about 7 per cent in 2003- 04. Recent data reveal that non-priority sector housing loans outstanding as on February 18, 2005 were around Rs. 74 thousand core, which is, however, only 8.0 per cent of the gross bank credit. It has been seen however the lowest impairment has been in housing credit.

## Impact of Retail loans

The impact of retail loans can be assessed in term of the following parameters.

**a) Increase the Bank Liquid cash**

Treasury income of the banks, which had strengthened the bottom lines of banks for the past few years, has been on the decline during the last two years. In such a scenario, retail business provides a good vehicle of profit maximization. Considering the fact that retail's share in impaired assets is far lower than the overall bank loans and advances, retail loans have put comparatively less provisioning burden on banks apart from diversifying their income streams.

**b) Decline in interest rates**

The interest rates were decreased in Indian money market have also contributed to the growth of retail credit by generating the demand for such credit. The interest rates on retail loans have declined from a high of 16-18%in1995-96 to presently in the band of 7.5-9%. Ample liquidity in the banking system and falling global interest rates have also compelled the domestic banks to reduce it.

**c) Lesser extent of NPAs**

It is also noticed that the level and extent of NPAs is much lesser in case of the retail loans as compared to the corporate loans. This is on account of lesser extent of loan requirement, easy follow up, regularity in repayment by way of Equated Monthly Installments (EMIs), short duration of repayment and availability of physical assets with the borrowers. Further, retail loans are mostly sanctioned to the borrowers who have regular monthly income. This makes the repayments in time.

**d) Higher Net Interest Margin on retail loans**

The net interest margin in banks is explained in terms of difference between interest income and interest expenditure. The rate of interest in retail loans is relatively higher depending on the category of loans. Therefore, this provides a leeway to the banks for the increased margin.

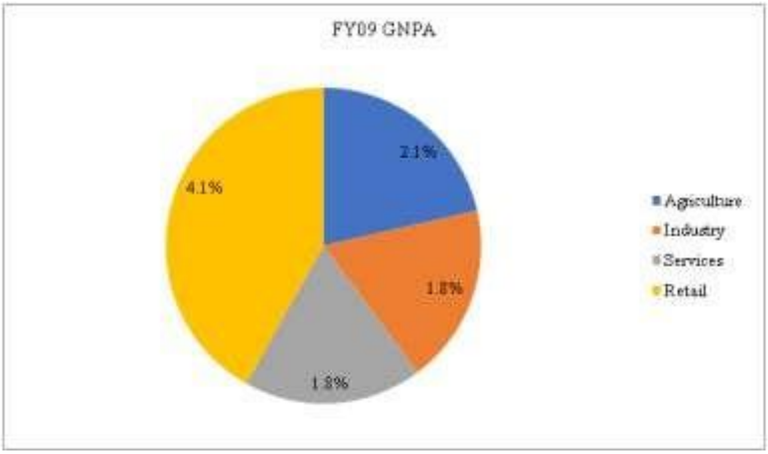
**e) Positive Impact on profitability**

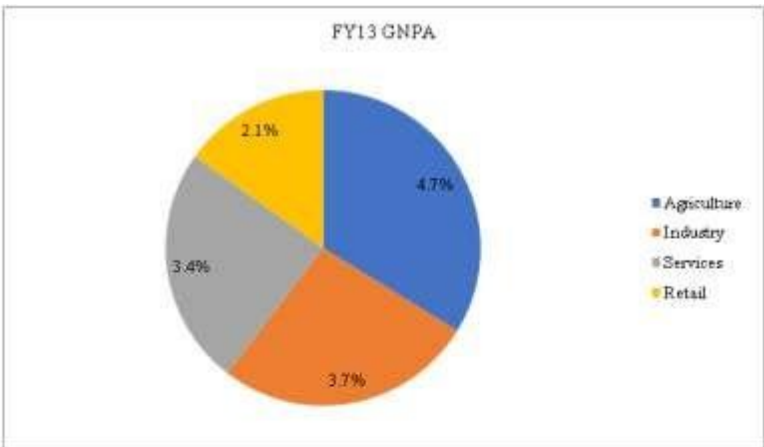
The majority of loans fall under the standard assets category, therefore banks have to make lesser provision on such loans. The lesser extent of NPAs and lesser provision requirements help the banks to have a positive impact on their profits and profitability.

## Challenges and Opportunities of Retail Banking In India

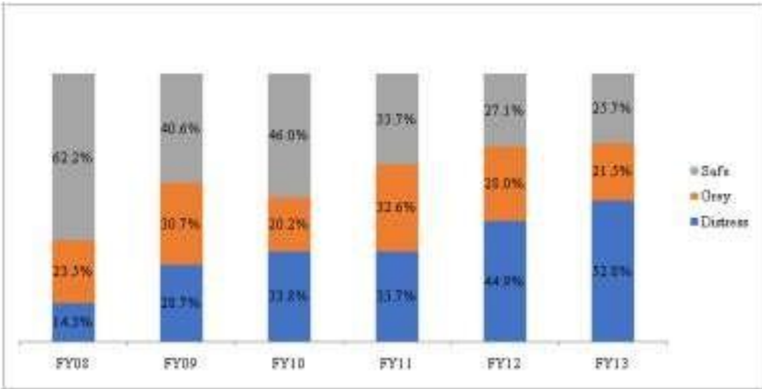
Retail banking in India has vast opportunities and challenges. The rise of the middle class is an important contributory factor in this regard. Improving consumer purchasing power, coupled with more liberal attitudes toward personal debt is contributing to India's retail banking segment. Increase in purchasing power of the younger population would give an immense opportunity. It has been found that younger generation is more comfortable in acquiring debt than the previous generation, thereby improving-purchasing power and liberal attitude towards personal debt, and contributing to India's retail segments.

The entry of new generation private sector banks has changed the entire scenario. The retail segment, which was earlier ignored, is now the most important of the lot, with the banks jumping over one another to give out retail loans. With supply far exceeding demand it has been a race to the bottom, with the banks undercutting one another. The nimble footed new generation private sector banks have been losing business to the private sector banks in this segment. PSBs need to figure out the means to generate profitable business from this segment. Another major challenge in retail banking is attraction as well as retention of customers. In fact, the retention is more difficult in this competitive environment. From the following pie diagram we can understand the opportunities of retail banks in India.




***Source:*** *Reserve Bank of India, Jefferies*
***Figure 3:*** *GNPA*




***Source:*** *Jefferies –Performed on 414 companies out of the BSE 500 Index, making up almost 40% of the total banking system loans*
***Figure 4:*** *Share of Corporate Debt Failing Z-score Levels*

There are clear evidences from the above data that corporate loans have higher share of non- performing assets as compared to retail loans. They also bear the high extent of risk. This is also evident that corporate loans have high distress that is an increasing trend.

## Conclusion

It is evident from the analysis of different components of retail loans that retail loans have shown an increasing trend over the years. The extent of retail loans have increased at a higher rate as compared to corporate loans over the years. The motivating factors for the banks to have added focus on retail loans include increased efficiency of retail loans, lesser extent of NPAs, prompt repayment, lesser extent of loss of assets, easy monitoring and follow up etc. Since, the income level and consumer spending pattern of the young generation will continue to increase so will be the demand for retail loans in future. The banks needs to be cautious while considering retail loans to control the misuse of retail loans as it may create recovery problem apart from increase in inflation. The experience of the banks in providing credit through credit cards has been very miserable and therefore the credits under credit cards need to be monitored closely. The RBI issues directions to monitor and control the retail loans flows from time to time.

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