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Non – Interest Income in Indian Banking Sector

Prabha.Ga, Prof. K. Ravichandran, P. Gopinathar

I. Introduction

Banking sector in Indian financial system has undergone a dramatic change in economic and financial sector reforms. Now a day's banks are giving considerable attention to non-interest income. Diversification across various sources of earning is claimed where diversification reduce risk. During the 1990s, the Indian banking sector witnessed more reforms than most other Indian economy.

After the implementation of reforms, the banking sector started to give desired results in their performance. Banking is the sector which was more deeply touched by the process of liberalization, globalization and privatization accompanying with technology advancements. Results of these reforms like liberalization of interest rates and free entry of private and foreign banks have made the banking sector more competitive in the domestic as well as world market.

To meet the competition banking sector was required to be tune with the international norms and practices. In order to meet the challenges of global competition, banks have started to restructure their business. The deregulation of interest rates during the reform has totally changed the income structure of the banking sector.

The banks started to compete in the financial market with almost daily innovative products/services to capture maximum market share and then earn maximum profits. The banks have started to diversify their bank activities in to fee-based activities that earn fee rather interest.

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.

- Interest income / fund based income
- Non-interest income / non-fund based income

Reason for non-interest income

- The deregulation of interest rates decided by the market forces results continuous decrease in interest rates. Due to the falling interest rate there is decrease in interest income which results lower profitability. To overcome this reduction in profit banks started to emphasis more on fee based activity.
- Banks have continuous increase in income from sources of non-interest income; which attracts the banks to go for fee based activity.

Components of Non-Fund Based Income

Name of Non-Fund Based Income	Example
Fiduciary Income	- Administering Investment for others - Gross Income from services rendered by the bank`s trust
Service charges on Deposit Account	- Maintenance of Deposits Account - Failure to meet minimum balance excess check writing - Withdrawals from non transaction Account - Early withdraw or closure fee - Dormant Account - Extensive activity - ATM Usage - Bounced Check Charges and other fee
Trading Revenue	- Net gain or loss from trading cash instrument - Off balance sheet derivatives contracts - Sales of assets and other financial instruments - Revaluation to carrying value of assets and reliabilities due to marking to market - Revaluation of interest rate - Foreign Exchange - Equity Derivatives - Commodity and other contract due to marking to Market - Incidental Income related to purchase and sale of assets and liabilities
Fee and Other Income	- Service Charges - commission - Safe Deposit Boxes

	- Insurance Sales - Bank Draft - Money Order - Bill Collection - Saving bond Redemption - Execution of acceptances and letters of credit - Mortgage Servicing Fees - Notary - Consulting and Advisory Services - Credit Card Fees - Merchant Credit and Charges - Rental Fees - Loan Commitment Fees - Net Gain on Sales of Real Estate - Foreign Transaction

Table – 1 Bank's Non-Interest Income to Total Income for India

DATE	VALUE (%)
1997-01-01	34.44149
1998-01-01	34.40678
1999-01-01	36.26704
2000-01-01	32.84078
2001-01-01	36.87199
2002-01-01	39.39096
2003-01-01	39.88052
2004-01-01	31.36147
2005-01-01	29.53068
2006-01-01	30.13057
2007-01-01	35.37932
2008-01-01	35.68187
2009-01-01	34.62161
2010-01-01	27.80418
2011-01-01	26.27383

Source: World Bank

The above table shows Bank's income that has been generated by non-interest related activities as a percentage of total income (net-interest income plus non-interest income). Non- interest related income includes net gains on trading and derivatives, net gains on other securities, net fees and commissions and other operating income.

Unique characteristics of noninterest income

Banks also seek to increase noninterest income because it is considered to have traits that make it different from interest income and thus desirable. In particular, noninterest income could lead a bank to be less risky if it leads to greater diversification. In addition, noninterest income is typically described as more steady or stable than interest income.

Table - 2 Non-interest Income as Percentage of Total Assets (Per cent)

Year	All Scheduled Comm. Banks	Public Sector Banks	Old Private Sector Banks	New Private Sector Banks	Foreign Banks
1997-98	1.52	1.33	1.71	2.40	2.94
1998-99	1.34	1.22	1.32	1.53	2.43
1999-00	1.42	1.29	1.66	1.58	2.54
2000-01	1.32	1.22	1.23	1.35	2.47
2001-02	1.57	1.43	2.38	1.17	2.88
2002-03	1.86	1.66	2.25	2.58	2.64
2003-04	2.01	1.91	2.01	2.10	2.84
2004-05	1.46	1.36	0.94	1.74	2.52
2005-06	1.35	1.16	0.81	1.63	2.65
2006-07	1.24	0.86	0.98	1.84	2.57
2007-08	1.37	1.06	1.08	1.98	2.89

Source: Report on Trend and Progress of Banking in India, Various issues, RBI.

The above table shows that there is a mixed trend in the ratio of non-interest income as a percentage of total assets. It has also been observed that this ratio was highest during the years 2001-02 to 2003-04 for all the bank groups except foreign banks. It reveals that the ratio shows increase in the year 2007-08 as compared to the previous years. The reason for such improvement is that now banks are focusing more on noninterest income as compared to interest income.

Challenges of Indian banking industry

Banks in Asia, particularly in China have phenomenal size as compared to Indian banks. Liberalization is the main source to the creation of global banks through growth and consolidation. Thus it is essential and important for Indian banks to create a size that would be effective in dealing with the global competition. Indian banking also needs larger amounts of capital to sustain their growth in the future for which they need to step up performance and efficiency that would attract investors.

Other main challenge would be the benefits of technology. Though banks show a good progress, technology solutions integrating the banking operations to derive synergies and efficiencies in Public Sector Banks need to move at a much faster pace. Similarly, Public Sector Banks should facilitate infrastructure related to Real Time Gross Settlement and Electronic Fund Transfer Systems which could benefit their customers. Thus non – interest shows further increase, which will raise profitability and productivity.

According to the announcement there would be significant changes in the banking industry in next two years for the presence of foreign banks in India. Wholly Owned Subsidiaries of the Foreign Banks will also be allowed to list and dilute their stake and will be allowed to enter into mergers and acquisitions with the Private Sector Banks in India. These measures will greatly enhance the opportunities for Foreign Banks that will further intensify the competition for the domestic banks.

Notwithstanding these challenges, the Indian banking industry can look forward to a promising period ahead. With the pace of growing international operations of Indian business, Indian banks have global opportunities in banking. Rising income levels of people will also give scope to design and develop a wide range of personal financial products and fee based services in banking. Focus on infrastructure development and certain key sectors like rural economy, health and education offer exciting business opportunities for the extensive branch network of Public Sector Banks located in the rural and semi-urban areas.

While there are lot of opportunities, responding to them positively and realizing them to a desired extent would be a great challenge. With right strategies in harnessing technology and human resources developing market segments, design of new generation products and services, focus on efficient customer service and pursuing global aspirations can take Indian banks to the next generation banking.

II. Recommendations to increase non-interest income in bank

Increase in the competition in the banking sector, every bank try to adopt new and innovative strategy to increase customers

- Banks should reduce the commission, exchange, brokerage fee to attract more and more customers.
- Can increase more use of Mobile banking and the concept is new in banking operation. This is very customer friendly, safe and secure when compared to internet banking. A customer can also enjoy the services from any mobile number, any brand handset and any network operator
- Offer excellent customer service at the customer where customers are more satisfied with their banking services.
- Open branches in areas where there is large inflow and outflow of non banking activities
- Charge higher commission for issuing drafts of large amount.
- Banks should provide concession for the lockers and safe custody to those customers who have more deposits in their current accounts.
- Banks should offer PLR to borrowers to give the banks substantial non-fund business.
- Banks should give concession to the importers/exporters in issuing drafts, LC, LG etc., and some other concession.
- Service charges for credit cards should be increased at least to the bearable extent.

III. Conclusion

If concerted effort is taken towards promoting the non-interest income, then this would act as a supportive cushion for the banks and help them to deal with the current situation and face the global challenge more confidently. Thus in a changed environment after liberalization of the financial sector there was a total paradigm shift in the business and marketing strategy of banks which made the growth of other income related business almost vitally essential. Further as risk factors are also addressed in the process, this diversification would also place banks on a stronger footing.