

The Impact of Increasing Investments in the Stock Market by Indian Citizens on Commercial Banks

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Abstract: *This study examines the implications of the growing trend of stock market investments among Indian citizens on the operations and profitability of commercial banks. As more individuals allocate a portion of their savings to equities, it creates a ripple effect through the financial system. The research explores the positive impacts, such as increased deposits, enhanced loan demand, and new revenue streams from investment banking services. However, it also addresses potential risks, including market volatility, credit risk, and regulatory challenges. The study concludes by highlighting the importance of effective risk management, product innovation, customer education, and regulatory compliance for banks to navigate this evolving landscape and maximize the benefits of the growing stock market.*

Keywords: growing trend of stock market.

I. INTRODUCTION

Stock market

The Indian stock market, a vibrant and dynamic ecosystem, has emerged as a significant force in the country's economy. It serves as a platform for businesses to raise capital and for investors to participate in the growth of various industries. The market is primarily regulated by the Securities and Exchange Board of India (SEBI), which ensures fair practices, transparency, and investor protection.

The Indian stock market comprises two major exchanges: the National Stock Exchange (NSE) and the Bombay Stock Exchange (BSE). These exchanges facilitate the trading of equities, derivatives, and other financial instruments. The market has witnessed significant growth in recent years, driven by factors such as economic liberalization, increased investor participation, and technological advancements.

COMMERCIAL BANKS

Commercial banks in India play a pivotal role in the country's financial system, providing a wide range of services to individuals, businesses, and the government. These institutions are regulated by the Reserve Bank of India (RBI), which sets monetary policy and supervises the banking sector.

Commercial banks in India can be broadly classified into public sector banks, private sector banks, foreign banks, and regional rural banks. Public sector banks are owned and controlled by the government, while private sector banks are owned by private entities. Foreign banks are subsidiaries or branches of foreign banks operating in India. Regional rural banks are specialized banks focused on providing financial services to rural areas.

Commercial banks offer a variety of financial products and services, including savings and current accounts, fixed deposits, loans, credit cards, and investment services. They also provide ancillary services such as remittances, locker facilities, and insurance. The specific products and services offered by a bank may vary depending on its size, ownership structure, and target market.

Commercial banks play a crucial role in promoting economic growth and development in India. They provide credit to businesses, which helps them expand their operations and create jobs. They also facilitate trade and commerce by providing payment and settlement services. Moreover, commercial banks contribute to financial inclusion by providing banking services to the unbanked and underbanked population.

Hypothesis: The impact of stock market investments on Indian commercial banks is more pronounced during periods of economic growth compared to economic downturns.

PURPOSE

Conduct in-depth case studies of specific Indian commercial banks to examine their investment strategies, risk management practices, and performance during different economic conditions.

Case study 1:

A Review of Research on the Impact of Stock Market Investments on Commercial Banks

The relationship between stock market investments and commercial banks is complex and multifaceted. While the stock market can provide opportunities for banks to generate revenue and manage risk, it can also pose significant challenges. This review will explore existing research on the topic, both globally and specifically in India.

Global Research

Positive Impacts:

- Revenue Generation: Banks can generate revenue through investment banking activities, such as underwriting, brokerage, and wealth management.
- Risk Management: Stock market investments can be used to diversify portfolios and hedge against other risks.
- Economic Growth: A strong stock market can stimulate economic growth, leading to increased demand for bank loans.

Negative Impacts:

- Market Volatility: Stock market fluctuations can impact bank profitability, especially if banks have significant holdings in equities.
- Credit Risk: Banks that lend to investors for stock market purchases face credit risk if the market declines.
- Regulatory Challenges: Increased regulation of the financial sector can impose additional costs on banks.

Research on India

Positive Impacts:

- Economic Growth: The Indian stock market has played a significant role in the country's economic growth.
- Financial Inclusion: Increased access to the stock market has led to greater financial inclusion.
- Innovation: The stock market has encouraged innovation and entrepreneurship.

Negative Impacts:

- Market Volatility: The Indian stock market can be highly volatile, impacting bank profitability.
- Credit Risk: The risk of loan defaults is higher in India due to factors such as economic uncertainty and lack of credit history.
- Regulatory Challenges: The Reserve Bank of India (RBI) has imposed regulations on bank investments in the stock market.

CASE STUDY 2 :

Declining Bank Deposit Percentage in India

Introduction

The Indian banking sector has witnessed a significant shift in recent years, with a noticeable decline in the growth of bank deposits. This trend has raised concerns among policymakers, regulators, and industry experts, as it could potentially impact the stability and functioning of the financial system. This paper aims to explore the factors contributing to the decreasing bank deposit percentage in India, analyze its implications, and propose potential solutions.

Factors Contributing to Declining Bank Deposits

Several factors have contributed to the decline in bank deposits in India:

- Rising Interest Rates: Higher interest rates offered by alternative investment avenues, such as mutual funds and government bonds, have made bank deposits less attractive to investors.

- Digitalization and Financial Inclusion: The increasing penetration of digital banking and financial inclusion initiatives have provided consumers with more options for their savings and investments.
- Shift in Consumer Preferences: Changing consumer preferences have led to a preference for more flexible and liquid investment options.
- Economic Uncertainty: Economic uncertainty and volatility have made investors more cautious about their savings, leading them to seek safer and more liquid alternatives.
- Regulatory Changes: Certain regulatory changes, such as the introduction of taxes on interest income from bank deposits, have discouraged savings.

Implications of Declining Bank Deposits

The declining bank deposit percentage has several implications for the Indian banking system:

- Liquidity Concerns: A decline in deposits can lead to liquidity concerns for banks, as they may struggle to meet their funding needs.
- Impact on Lending: A reduction in deposits can limit banks' ability to lend, which can hinder economic growth.
- Financial Stability Risks: A significant decline in bank deposits could pose risks to financial stability.
- Reduced Revenue for Banks: Lower deposit levels can reduce banks' revenue from interest income.

Potential Solutions

To address the declining bank deposit percentage, several measures can be considered:

- Interest Rate Competitiveness: Banks can offer more competitive interest rates to attract deposits.
- Product Innovation: Banks can introduce innovative products and services to meet the evolving needs of customers.
- Digital Transformation: Banks can leverage technology to enhance customer experience and convenience.
- Regulatory Reforms: The government can consider regulatory reforms to make bank deposits more attractive to investors.
- Financial Literacy: Promoting financial literacy can help consumers make informed decisions about their savings and investments.

Conclusion

The declining bank deposit percentage in India is a complex issue with multiple contributing factors. While it presents challenges for the banking system, it also offers opportunities for banks to innovate and adapt to changing market dynamics. By addressing the underlying factors and implementing appropriate measures, banks can mitigate the risks associated with declining deposits and ensure the stability of the financial system.

CASESTUDY 3:

Banks should offer innovative products, service to garner deposits: Governor Shaktikanta Das.

How Real are the Governor's Fears?

Experts say, theoretically, banks could face liquidity concerns if the credit-to-deposit divergence widens. But this does not appear to be happening within most of India's banks. "The problem would be if a bank is raising short-term deposits to back an asset with a longer tenure maturity, and the deposit is not renewed. Then the bank needs funds to pay those deposits," says a banking analyst with a private research house, declining to be named. But India's large and mid-sized banks do not face this concern.

So while an asset-liability mismatch may not happen, the one problem which banks face will be an impact on margins and profitability. They will have to borrow at a higher cost which might impact profitability in coming quarters. "Household deposits form 61 percent of total deposits and growth picked up to 12 percent after two soft years. This may reflect reallocation of savings to capital markets and consumption growth. Within household deposits, share of savings deposits fell to a seven-year low of 41 percent with money moving to term deposits, hence may be peaking."

Jefferies India analysts Prakhar Sharma and Vinayak Agarwal said in a July 1 note to clients. This reflects the fact that household savings are moving away from bank deposits towards assets which have generated better returns.

“Within deposits, term deposits grew fastest at 19 percent, taking share from savings (up just six percent). Savings deposit growth for PSU and private sector banks has converged that is a potential risk for private sector banks, from ability to mobilise lowcost deposits” the Jefferies analysts said.

For investors who rode the Indian equities journey late, passive and exchange traded funds (ETFs) have been amongst the most popular in the last few years. Those with a higher risk-taking ability have ventured into F&O (Future and Options) trade, where the regulator Securities and Exchange Board of India (Sebi) has already clamped down, due to massive intraday losses which traders have suffered in the past two years.

Data compiled by Forbes India shows that while the top four banks in India (SBI, HDFC Bank, ICICI Bank and Axis Bank) by asset size, have seen a rise in deposits and advances (see graphs), the pace of growth has been higher for advances over the past one year.

For SBI, credit growth has risen by around 15.9 percent while total deposits for the standalone bank have risen by around 8 percent in the one year from June-ended 2023 quarter to June-ended 2024 quarter. For Axis Bank, credit growth (14 percent) outpaced deposit growth (12 percent) in the same period. ICICI Bank has also seen loans edging out deposits in the same period.

II. IMPACT OF INDIVIDUAL STOCK MARKET INVESTMENTS ON BANKS

The rise of individual investors directly participating in the stock market has significant implications for banks. Here are some of the key impacts:

Reduced Deposit Growth

- **Direct Investment:** As individuals invest directly in the stock market, they may allocate a larger portion of their savings to these investments, reducing the amount available for bank deposits.
- **Alternative Investment Vehicles:** The growth of online brokerage platforms and other investment avenues provides individuals with more options to invest their money outside of traditional bank deposits.

Increased Competition for Investment Services

- **Competition from Brokerages:** Online brokerages and other financial technology (fintech) companies offer competitive rates and a wider range of investment products, challenging banks' traditional dominance in investment services.
- **Pressure on Fees:** Banks may need to lower fees for their investment products to remain competitive, impacting their revenue.

Potential for Increased Risk

- **Investor Behaviour:** Individual investors may be more susceptible to market volatility and irrational behaviour, leading to potential losses.
- **Bank Exposure:** If banks are exposed to these investments through loans or derivatives, they may face increased credit and market risks.

Shift in Bank Business Model

- **Focus on Value-Added Services:** Banks may need to shift their focus toward providing value-added services, such as financial planning, wealth management, and risk management, to differentiate themselves from online brokerages.
- **Digital Transformation:** Banks may need to invest in digital transformation to enhance their online and mobile platforms, providing a seamless customer experience and competing with fintech companies.
- Overall, the trend of individuals investing directly in the stock market presents both opportunities and challenges for banks. While it can lead to reduced deposit growth and increased competition, banks can also capitalize on the trend by offering innovative investment products and services, focusing on value-added offerings, and leveraging digital technologies.

III. SOLUTIONS FOR BANKS TO OVERCOME THE CHALLENGES OF INDIVIDUAL STOCK MARKET INVESTMENTS

Given the significant impact of individual stock market investments on banks, it is crucial for financial institutions to adopt strategies to mitigate challenges and capitalize on opportunities. Here are some potential solutions:

Enhanced Investment Services

- Value-Added Services: Banks can differentiate themselves by offering comprehensive financial planning, wealth management, and risk management services.
- Personalized Investment Advice: Leveraging advanced analytics and technology, banks can provide tailored investment recommendations based on individual investor risk profiles and goals.
- Educational Initiatives: Educate customers about the stock market, investment strategies, and the risks involved, fostering trust and loyalty.

Digital Transformation

- User-Friendly Platforms: Invest in robust online and mobile banking platforms that offer intuitive interfaces, seamless transactions, and access to investment tools.
- Integration with Investment Platforms: Partner with fintech companies to provide integrated investment services within the bank's ecosystem.
- Data Analytics: Utilize data analytics to gain insights into customer behavior and preferences, enabling personalized offerings and targeted marketing.

Risk Management

- Diversified Investment Strategies: Encourage customers to diversify their investments across different asset classes to mitigate risk.
- Stress Testing: Conduct regular stress tests to assess the potential impact of market fluctuations on the bank's portfolio and risk exposure.
- Regulatory Compliance: Ensure strict adherence to regulatory guidelines to protect customers and maintain trust.

Fee Optimization

- Transparent Pricing: Communicate fee structures clearly and transparently to customers.
- Value-Based Pricing: Consider alternative pricing models that align with the value provided to customers, such as performance-based fees or subscription models.
- Bundle Offerings: Offer bundled products and services to provide cost savings to customers.

Partnership and Collaboration

- Fintech Partnerships: Collaborate with fintech companies to leverage their technological expertise and innovative solutions.
- Strategic Alliances: Form strategic alliances with other financial institutions to expand product offerings and reach a wider customer base.
- Industry Associations: Actively participate in industry associations to stay informed about regulatory changes, market trends, and best practices.

By implementing these solutions, banks can position themselves to thrive in the evolving landscape of individual stock market investments, providing value to customers, managing risks effectively, and driving sustainable growth.

Future Directions for Banks to Overcome Challenges in the Era of Individual Stock Market Investments

As the landscape of individual stock market investments continues to evolve, banks must adapt their strategies to remain competitive and relevant. Here are some future directions:

Enhanced Digital Capabilities

- AI-Powered Investment Advice: Utilize artificial intelligence to provide personalized investment recommendations based on real-time market data and individual investor preferences.
- Robo-Advisors: Offer automated investment services that cater to a wider range of investors, including those with smaller investment amounts.
- Gamification: Incorporate gamification elements into investment platforms to make the experience more engaging and accessible to younger generations.

Focus on Sustainability and ESG

- Sustainable Investment Products: Develop and offer sustainable investment products that align with environmental, social, and governance (ESG) factors.
- ESG Integration: Integrate ESG considerations into all investment decisions, including risk assessment and portfolio management.
- Transparent Reporting: Provide clear and transparent reporting on the ESG performance of investments.

Strengthened Risk Management

- Scenario Analysis: Conduct advanced scenario analysis to assess the potential impact of various economic and market conditions on the bank's portfolio.
- Cybersecurity: Invest in robust cybersecurity measures to protect customer data and prevent cyberattacks.
- Operational Resilience: Build resilience into the bank's operations to ensure continuity of services in the face of disruptions.

Customer-Centric Approach

- Personalized Experiences: Leverage data analytics to deliver highly personalized customer experiences, tailored to individual needs and preferences.
- Customer Education: Continue to invest in customer education programs to empower individuals to make informed investment decisions.
- Feedback Mechanisms: Implement effective feedback mechanisms to gather customer insights and continuously improve products and services.

Strategic Partnerships

- Fintech Collaborations: Partner with fintech companies to access innovative technologies and solutions.
- Strategic Alliances: Form strategic alliances with other financial institutions to expand product offerings and reach a wider customer base.
- University Partnerships: Collaborate with universities to conduct research and develop new investment products.
- By embracing these future directions, banks can position themselves to thrive in the dynamic landscape of individual stock market investments, offering innovative solutions, managing risks effectively, and delivering exceptional value to their customers.

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Figure:-1

Financial Assets of the Indian Households (2012-22) (in Rs Crore & at approx current prices)					
Year	Bank Deposits	Non-Banking Deposits	Life Insurance Funds	Provident & Pension Funds	Shares & Debentures
2012-13	575,080	27,911	179,949	156,479	17,027
2013-14	639,304	22,816	204,469	177,841	18,930
2014-15	579,272	28,915	299,322	190,883	20,364
2015-16	622,364	18,082	264,177	290,729	28,356
2016-17	938,574	34,856	354,321	325,539	174,466
2017-18	510,174	16,538	343,959	369,445	177,324
2018-19	744,156	34,086	258,529	396,348	77,789
2019-20	827,901	56,677	338,572	452,789	94,742
2020-21	1,200,642	39,787	569,485	444,984	107,184
2021-22	779,303	46,575	444,984	562,217	214,191

Figure:-2

Structure of Average Bank Interest & Lending Rates (in %)					
Financial Year	Savings Rate	Deposit Rates for			MCLR (1 year)
		1 - 3 Years	3 - 5 Years	> 5 Years	
2012-13	4%	8.75 to 9	8.75 to 9	8.5 to 9	-
2013-14	4%	8.75 to 9.25	8.75 to 9.1	8.5 to 9.1	-
2014-15	4%	8.5 to 8.75	8.5 to 8.75	8.25 to 8.5	-
2015-16	4%	7.25 to 7.5%	7 to 7.5	7 to 7.3	-
2016-17	4%	6.75 to 7	6.5 to 6.9	6.5 to 6.75	8 to 8.5
2017-18	3.50-4.00	6.4 to 6.75	6.25 to 6.7	6.25 to 6.75	8.15 to 8.3
2018-19	3.50-4.00	6.25 to 7.25	6.25 to 7.25	6.25 to 7.25	8.45 to 8.8
2019-20	3.00-3.50	5 to 6.2	5.7 to 6.4	5.7 to 6.4	7.75 to 8.2
2020-21	2.70-3.00	4.90-5.30	5.25-5.35	5.25-5.50	7.00-7.40
2021-22	2.70-3.00	5.00-5.20	5.05-5.45	5.05-5.60	7.00-7.30
2022-23	2.70-3.00	5.30-5.60	5.35-6.10	5.35-5.90	7.60-7.90
2023-24	2.70-3.00	6.00-7.10	6.50-7.00	6.00-6.90	8.55-8.95

* 2023-24 Data as on 1st Sep 2023
* Deposit & Lending rates are for Five Major Banks
* Base Rate System effective from July 1, 2010 was replaced by the MCLR System effective from April 1, 2016. MCLR will be replaced by External Benchmarks Rate from Oct 2019

