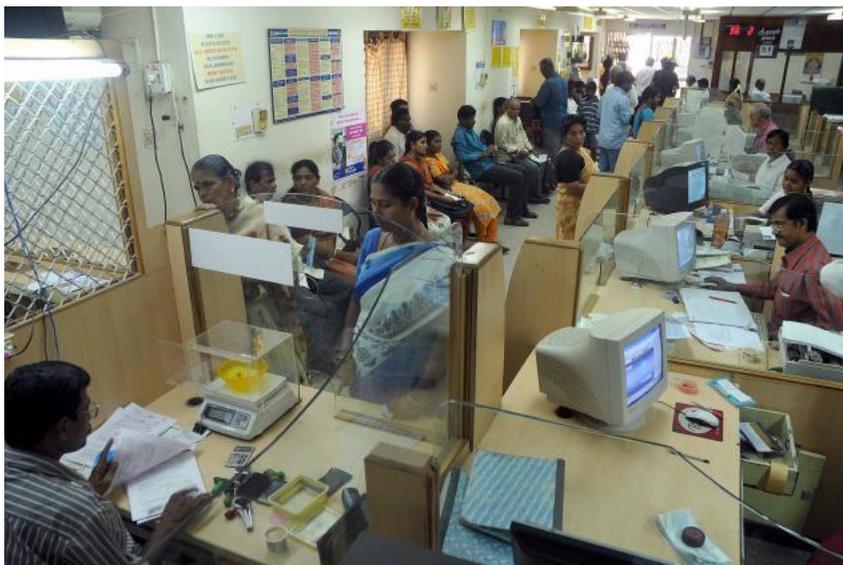


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FINANCIAL SCENE

Diminishing a bank's traditional role

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The traditional role of a bank as a financial intermediary standing between a depositor and an e-borrower is still in tact but the quality and nature of such intermediation is changing. File Photo

A financial intermediary is one that acts as a middleman between two parties in a financial transaction.

The most common intermediary is a bank but the category also includes entities such as insurance companies, mutual funds, brokers, dealers and others.

Traditionally a financial intermediary is one that connects surplus and deficit agents.

In standard economics literature, financial intermediary is typically a bank that aggregates deposits from various sources and converts the funds into loans. The definition of a financial intermediary has expanded further in recent times to cover entities that were originally left out. For instance, home loan companies despite their intermediation function did not qualify. Some of the bigger ones, such as HDFC in India access funds directly in addition to getting facilities from banks.

The categorisation of an institution into a financial intermediary is largely an academic function. For all practical purposes in countries such as India the terms financial intermediaries and banks have become interchangeable.

The traditional role of a bank as a financial intermediary standing between a depositor and an e-borrower is still in tact but the quality and nature of such intermediation is changing. Some say it is an inevitable development propelled by among other things, technology and globalisation.

Many others think that there is a strong case for banks to stick to their knitting -do what they know best and leave the rest to other more specialised agencies.

Are banks becoming less relevant? This conflict between a generalist and a specialist takes place all the time and can never be resolved satisfactorily. The debate has deep implications for a bank's human resources policies. Should we recruit specialist officers? What will be the implications for the rank and file? What career path are you promising for the youngster with special qualifications and so on? Such questions should resonate well with us in India.

Very recently the government decided to fill up top positions in two public sector banks - Bank of Baroda and Canara Bank with those having substantial experience in the private sector. The hope however misplaced, is that seasoned private sector employees will bring a whiff of fresh air to the public sector culture. It might be far fetched but the government is basically reacting to the forces of disintermediation, forces that diminish a bank's traditional role and move to new areas.

Understanding disintermediation is easy, perhaps lots easier than understanding intermediation. Customers, both on liabilities side (depositors) as well as the assets side (borrowers) are prepared to say that the banker's traditional middleman role is becoming less relevant for them. In other words, they are willing to meet directly shunning the traditional intermediation role. This has had enormous consequences not the least on bank profitability as well as on regulation.

Among the important factors driving disintermediation is competition. Such competition has come from within the banking system as well as from the rest of financial sector. This is too vast a subject to dwell on but it is all too visible. For instance, Indian banks were not conditioned to take risks attendant on capital market investment. Yet the forces of competition, essentially from foreign banks forced many government banks to undertake activities they were neither qualified for nor experienced in. This is had disastrous consequences for many government banks as experiences of the infamous securities scam 1991-92 bear out.

Most banks adopted new structures to do specialised activities such as merchant banks (investment banks) and leasing. The objective was as much as to develop specialised skills as to get past regulatory hurdles.

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