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A Review of Banking Sector in India

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Abstract – Today, the banking industry in our country is stronger and capable of withstanding the pressures of competition. It withstood Global Financial Crisis (2008). In the era of Globalization Banking Sector in India is rapidly changing since 1990s due to technological innovation, financial liberalization with entry of new private and foreign banks, and regulatory changes in the corporate sector. Indian banking industry is gradually moving towards adopting the best practices in accounting, internationally accepted prudential norms, with higher disclosures and transparency, corporate governance and risk management, interest rates have been deregulated, while the rigour of directed lending is being progressively reduced. In our country, currently we are having a fairly well developed banking system with different classes of banks – public sector banks, foreign banks, private sector banks – both old and new generation, regional rural banks and co-operative banks with the Reserve Bank of India as the leader of the system. In the banking field, there has been an unprecedented growth and diversification of banking industry and our banks are now utilizing the latest technologies like internet and mobile devices to carry out transactions and communicate with the masses.

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OBJECTIVES OF THE STUDY:

1) Brief History of Banking in India
2) Structure of Banking in India
3) Banking Reforms in India
4) Recent Trends in the Banking System
5) Implications & Challenges
6) Future Outlook & Conclusion

METHODOLOGY:

The Study is based on information and secondary data accessed from reputed Journals, RBI & Various Official Committees Reports and authentic Websites.

Brief History of Banking in India: The history of Indian banking can be divided into three main phases.

Phase I (1786- 1969) - Initial phase of banking in India

Phase II (1969- 1991) - Nationalization, regularization and growth

Phase III (1991 onwards) - Liberalization and its aftermath

Phase I (1786- 1969)Initial phase of banking in India: The first banks were The General Bank of India, which started in 1786, and Bank of Hindustan, both of which are now defunct. The oldest bank in existence in India is the State Bank of India, which originated in the "The Bank of Bengal" in Calcutta in June 1806. This was one of the three presidency banks, the other two being the Bank of Bombay and the Bank of Madras. The presidency banks were established under charters from the British East IndiaCompany. The three banks merged in 1921 to form the Imperial Bank of India. For many years the Presidency banks acted as quasi-central banks, as did their successors. The first fully Indian owned bank was the Allahabad Bank, established in 1865. However, at the end of late 18th century, there were hardly any banks in India in the modern sense of the term. Banking in India remained the exclusive domain of Europeans for nextseveral decades until the beginning of the 20th century. Foreign banks too started to arrive, particularly in Calcutta in the 1860s. The Comptoired'Escompte de Paris opened a branch in Calcutta in 1860, and another in Bombay in 1862; branches inMadras and Pondicherry, then a French colony followed. Calcutta was the most active trading port in India,mainly due to the trade of the British Empire, and so became a banking center.The Reserve Bank of India formally took on the responsibility of regulating the Indian banking sector from 1935. After India's independence the Reserve Bank was nationalized on 1st January 1949 under the RBI Act 1948 and given broader powers. Before 1969, State Bank of India (SBI) was the only public sector bank in India. Under the first phase of nationalization of banks, it was nationalized in 1955 under the SBI Act of 1955.

Phase II (1969- 1991) Nationalization, Regularization and Growth: After India's independence, the Imperial Bank of India became the State Bank of India in 1955. The second phase of nationalization of banks took place in 1969. Fourteen banks were nationalized in this year by the then Prime Minister of India Mrs. Indira Gandhi. In the year 1980, six more banks were nationalized with deposits over 200 crores. The major objective behind nationalization was to spread banking net workin the rural areas and make available cheap finance to Indian farmers. Until the 1990s, the nationalized banks grew at a pace of around 4%, closer tothe average growth rate of the Indian economy.

Phase III (1991 onwards) Liberalization and its Aftermath: Today, Indian banking sectoris mature with banks having strong and transparent balance sheets. The major growth drivers are increase in retail credit demand, proliferation of ATMs and debit-cards, decreasing NPAs due to securitization, improved macroeconomic conditions, diversification, interest rates, regulatory and policy changes (e.g. amendments to the Banking Regulation Act).Certain trends like growing competition, product innovation and branding, focus on strengthening risk management systems, emphasis on technology have emerged in the recent past. Larger banks would have a relatively advantages, hence **recently the Union Cabinet on 15-02-2017 approved the merger of State Bank of India with five of its associate banks including State Bank of Bikaner and Jaipur, State Bank of Hyderabad, State Bank of Mysore, State Bank of Patiala, and State Bank of Travancore.** The merger is likely to result in recurring savings, estimated at more than Rs 1,000 crore in the first year, through a combination of enhanced operational efficiency and reduced cost of funds. Existing customers of subsidiary banks will benefit from access to SBI's global network. There are currently **27** public sector banks in India out of which **19** are nationalized banks and **6** are SBI and its associate banks, **and rest two are IDBI Bank and BharatiyaMahila Bank, which are categorized as other public sector banks, 23 private sector banks and 46 foreign banks with 325 branches (as on 31st Dec. 2015), 61 regional rural banks (RRBs) and more than 90,000 credit cooperatives.**

Structure of Banking in India: As per Section 5(b) of the Banking Regulation Act 1949, "Banking" means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawal by cheque, draft, order or otherwise."All banks which are included in the Second Schedule to the Reserve Bank of India Act, 1934 are scheduled banks. These banks comprise Scheduled Commercial Banks and Scheduled Cooperative Banks. Scheduled Commercial Banks in India are categorized into five different groups according to their ownership or nature of operation. These bank groups are:

(i) State Bank of India and its Associates,

(ii) Nationalized Banks,

(iii) Regional Rural Banks,

(iv) Foreign Banks and

(v) Other Indian Scheduled Commercial Banks (in the private sector).

Banking Reforms in India: In August 1991, the Government appointed a committee under the chair of M. Narasimham, which worked for the liberalization of banking practices. The aim of this Committee was to bring about "operational flexibility" and "functional autonomy" to enhance efficiency, productivity and profitability of banks. The Committee submitted its report in November 1991 and the following recommendations were given:

- Establishment of a four-tier hierarchy for the banking structure consists of three to four large banks with SBI at the top.
- The private sector banks should be treated equally with the public sector banks and government should contemplate to nationalize any such banks.
- The ban on setting new banks in private sector should be lifted and the licensing

policy in the branch expansion must be abolished.

- The government has to be more liberal in the expansion of foreign bank branches and foreign operations of Indian banks should be rationalized.

- The Statutory Liquidity Ratio and Cash Reserve Ratio should be progressively brought down from 1991-92.

- The directed credit program should be re-examined and the priority sector should be redefined to comprise small and marginal farmers, the tiny industrial sector, small business operators and weaker sections.

- Banking industry should follow BIS (Bank for International Settlement) / Basel norms for capital adequacy within three years.

- Interest rates should be deregulated to suit the market conditions.

- The government should tighten the prudential norms for the commercial banks.

- The competition in lending between DFIs (Development of Financial Institutions) and banks should be increased and a shift from consortium lending to syndicated lending should be made.

- In respect of doubtful debts, provisions should be created to the extent of 100 percent of the security shortfall.

- The government share of public sector banks should be disinvested to a certain percentage like in case of any other PSU.

- Each public sector banks should setup at least one rural banking subsidiary and they should be treated at par with RRBs.

In order to initiate the second generation of financial sector reforms, a committee on Banking Sector Reforms (BIS), again under the Chairmanship of M. Narasimham submitted its report on 23rd April 1998 to the Finance Minister of Govt. of India. Narasimham committee II report had observed that RBI's role should be separated from being monetary authority to that of regulator of the banking sector. The major recommendations of the second Narasimham II report were as follows:

- The committee favored the merger of strong public sector banks and closure of some weaker banks if their rehabilitation was not possible.

- It recommended corrective measures like recapitalization is undertaken for weak banks and if required such banks should be closed down.

- The committee had also suggested an amicable golden handshake scheme surplus banking sector staff.

- Suggesting a possible short term solution to weak banks, the report observed the narrow banks could be allowed as a mean of facilitating their rehabilitation.

- Expressing concern over rising non-performing assets, the committee provides the idea of setting up an asset reconstruction fund to tackle the problem of huge non-performing assets (NPAs) of banks under public sector.

Government had also taken into account the establishment of the Board for Financial Supervision (BFS) as the apex supervisory authority for commercial banks, financial institutions and non-banking financial companies rating system, corporate governance, enhanced due diligence on important shareholders, fit and proper tests for directors; and setting up of Indian Financial Network (INFINET) as the communication backbone for the financial sector, introduction of Negotiated Dealing System (NDS) for screen-based trading in government securities and Real Time Gross Settlement (RTGS) System.

Recent Trends in the Banking System:

- **Electronic Payment Services – e – Cheques:** In the recent days we are aware of e-governance, e-mail, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e-cheque, which will eventually replace the conventional paper cheque. India, as harbinger to the introduction of e-cheque, the Negotiable Instruments Act has already been amended to include; Truncated cheque (a substitute electronic form for paper cheque) and E-cheque instruments.

- **Real Time Gross Settlement (RTGS)**: Real Time Gross Settlement system, introduced in India since March 2004, is a system through which with the help of internet instructions can be given by banks to transfer of funds from one bank account to the another bank account . The RTGS system is maintained and operated by the RBI and provides a means of efficient and faster funds transfer among banks facilitating their financial operations. As the name suggests, funds transfer between banks takes place on a 'Real Time' basis. Therefore, money can reach the beneficiary instantly and the beneficiary's bank has the responsibility to credit the beneficiary's account within two hours.

- **Electronic Funds Transfer (EFT)**: It is a system whereby anyone who wants to make payment to another person/company etc. can approach his bank and make cash payment or give instructions/authorization to transfer funds directly from his own account to the bank account of the receiver/beneficiary. Complete details such as the receiver's name, bank account number, account type (savings or current account), bank name, city, branch name etc. should be furnished to the bank at the time of requesting for such transfers so that the amount reaches the beneficiaries' account correctly and faster. RBI is the service provider of EFT.

- **Electronic Clearing Service (ECS):** It is a retail payment system that can be used to make bulk payments/receipts of a similar nature especially where each individual payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make/receive large volumes of payments rather than for funds transfers by individuals.

- **Automatic Teller Machine (ATM):** It is the most popular devise in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a devise that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller. In addition to cash withdrawal, ATMs can be used for payment of utility bills, funds transfer between accounts, deposit of cheques and cash into accounts, balance enquiry etc.

- **Point of Sale Terminal:** It is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer. During a transaction, the customer's account is debited and the retailer's account is credited by the computer for the amount of purchase.

- **Tele - Banking:** It facilitates the customer to do entire non-cash related banking on telephone. Under this devise Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.

- **Electronic Data Interchange (EDI)**: It is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving advices etc. in a standard, computer processed, universally accepted format between trading partners. EDI can also be used to transmit financial information and payments in electronic form.

- **Net Banking**: It is done through internet by individuals and firms for transfer of funds, booking rail tickets, shopping, purchasing cinema tickets, purchasing shares etc.

- **Mobile Banking: Mobile banking** is a service provided by a **bank** or other financial institution that allows its customers to conduct a range of financial transactions remotely using a **mobile** device such as a **mobile** phone or tablet, and using software, usually called an app, provided by the financial institution for the purpose.

Amalgamation of Banks: The consolidation of banks is known as amalgamation of banks. **Recently the Union Cabinet on 15-02-2017 approved the merger of State Bank of India with five of its associate banks for efficient** enhanced operational efficiency and reduced cost of funds.

IMPLICATIONS:

- The banks were quickly responded to the changes in the industry; especially the new generation banks.

- The continuance of the trend has re-defined and re-engineered the banking operations as whole with more customization through leveraging technology.

- As technology makes banking convenient, customers can access banking services and do banking transactions any time and from any ware.

- The importance of physical branches is going down.

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CHALLENGES:

The major challenges faced by banks today are:

- **Non – Performing Assets (NPAs):** Today, in the era of globalization banks have cope with the competitive forces and strengthen their balance sheet. Now a days, banks are groaning with burden of NPAs. If NPAs are not recovered, they will destroy the very vitals of the banks. Another major concern before the banking industry is the high transaction cost of carrying Non Performing Assets in their books. The resolution of the NPA problem requires greater accountability on the part of the corporate, greater disclosure in the case of defaults, an efficient credit information sharing system and an appropriate legal framework pertaining to the banking system so that court procedures can be streamlined and actual recoveries made within an acceptable time frame. The banking industry cannot afford to sustain itself with such high levels of NPA's thus, **"lend, but lent for a purpose and with a purpose ought to be the slogan for salvation".**

- **Information technology (IT) in Banking:** Indian banking industry, today is in the midst of an IT revolution. A combination of regulatory and competitive reasons has led to increasing importance of total banking automation in the Indian Banking Industry. Information Technology has basically been used under two different avenues in Banking. One is Communication and Connectivity and other is Business Process Reengineering. Information technology enables sophisticated product development, better market infrastructure, implementation of reliable techniques for control of risks and helps the financial intermediaries to reach geographically distant and diversified markets. **The Indian banks today are subject to tremendous pressures to perform or perish as otherwise their very survival would be at stake.** Information technology (IT) plays an important role in the banking sector as it would not only ensure smooth passage of interrelated transactions over the electric medium but will also facilitate complex financial product innovation and product development. The application of IT and e-banking is becoming the order of the day with the banking system heading towards virtual banking. Training the banking staff with the latest software skills is also a challenge.

- **World Wide Banking (WWB):** As an extreme case of e-banking World Wide Banking (WWB) on the pattern of World Wide Web (WWW) can be visualized. That means all banks would be interlinked and individual bank identity, as far as the customer is concerned, does not exist. There is no need to have large number of physical bank branches, extension counters. There is no need of person-to-person physical interaction or dealings. Customers would be able to do all their banking operations sitting in their offices or homes and operating through internet. This would be the case of banking reaching the customers. This is also another challenge for our banking system.

- **Cyber Crimes:** Today, the major **cybercrimes** which plague the **banking sector** are ATM frauds, hacking of bank accounts, Denial of Service, Credit Card frauds, phishingetc. are challenges to the banking industry. The rapid growth to global electronic crime and the complexity of its investigation requires a global presence.

FUTURE OUTLOOK:

Banking landscape is changing very fast. The Reserve Bank in its bid to move towards the best international banking practices will further sharpen the prudential norms and strengthen its supervisor mechanism. There will be more transparency and disclosures. In the days to come, banks are expected to play a very useful role in the economic development and the emerging market will provide ample business opportunities to harness. Although, the adoption of technology in banks continues at a rapid pace, the concentration is perceptibly more in the metros and urban areas. The benefit of Information Technology is yet to percolate sufficiently to the common man living in his rural hamlet. More and more programs and software in regional languages could be introduced to attract more and more people from the rural segments also. Standards based messaging systems should be increasingly deployed in order to address cross platform transactions. The surplus manpower generated by the use of IT should be used for marketing new schemes and banks should form a 'brains trust' comprising domain experts and technology specialists.

CONCLUSION:

Indian banking system will further grow in size and complexity while acting as an important agent of economic growth and intermingling different segments of the financial sector. It automatically follows that the future of Indian banking depends not only in internal dynamics unleashed by ongoing returns but also on global trends in the financial sectors.

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