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CHANGING SCENARIO OF INDIAN COMMERCIAL BANKING: AN OVERVIEW
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Banks are the most important constituents of the financial infrastructure of a country. They play an imperative role in bringing about desired change in the economic development of the country. Banks provide to the saver a convenient avenue for investment of surplus funds, and to the investor a source to finance (Desai, Vasant 1991). Commercial banking in India has undergone several structural changes during last three centuries. Indian banking system, over the years has been marked by substantial growth, innovation, diversification, complexity and integration (Das & Chakrabarty, 2003). A brief account of it has been given by the researcher in this chapter.

Evolution of Commercial Banking in India

Origin

Banking in India originated in the first decade of 18th century with the General Bank of India coming to existence in 1786, this was followed by Bank of Hindustan, both these banks are now defunct. The oldest bank in existence in India is the State bank of India being established as “The Bank of Calcutta” in Calcutta in June 1806. At that point of time, Calcutta (presently Kolkata) was the most active trading port, mainly due to the trade of British Empire and at that time banks were regulated and supervised by East India Company’s Government, Royal Charter and Government of India. There was no special regulation act.

In 1913 a banking crisis occurred that has shown the weaknesses of the banking system. Banks were maintaining low cash; unsecured advances were given to the directors of the bank and to the companies of the director’s favor. In some banks undesirable activities and practices were also noticed. The condition was worst in West Bengal. There 4 scheduled commercial banks and many non scheduled
banks failed. Than a committee called, Indian Central Banking Enquiry committee (1929-31) was set up to investigate the reasons of failure. The Report of the Indian Central Banking Enquiry Committee have suggested for enacting a special Bank Act, which should cover the organization, Management, Audit and Liquidation of banks.

In 1934 Reserve Bank of India Act came into effect. According to that Act, an important function of the Reserve Bank was to hold the custody of the cash reserves of the banks granting them accommodation in a discretionary way and regulating their operations in accordance with the needs of the economy through instruments of credit control. (Report on currency and finance 04-05). For the first time efforts were made to include a separate chapter on provisions related to banking companies, in the Indian companies Act, 1936, but these provisions were not sufficient for regulating problems of banking sector. This is the reason about 588 banks have been failed in India during the period of 1939-1949.

RBI again felt the need for special Bank Act, as a result of that a proposal was sent to the govt. of India in Nov. 1939 for the same, but local boards of the bank were not of the opinion to bring a special bank legislation. Again efforts were made for a comprehensive bank act in 1945, and after several amendments Banking Regulation Act was passed on Feb 17, 1949. After the enactment of Banking Regulation Act (BR Act) RBI got specific powers to inspect accounts books and mode of operations of various banks, now RBI wanted to give a structured and proper banking system to the country which can fulfill the requirements of the nascent economy.

**From 1969 to 1990: Era of Nationalization**

The Indian banking scene underwent significant changes during this period. Several structural and functional changes took place. In July 1969, the Government of India nationalized 14 major scheduled commercial banks, each having a minimum aggregate deposit of Rs.50 Crore.

RBI’s aim is to build banks as the backbone of the economic development of the country and so several measures have been taken by RBI such as, expansion of
the banking system in India especially the rural India. In 1973, the Government of India had set up a Working Group to study the credit availability at the rural areas. The Working Group identified various weaknesses of the cooperative credit agencies and commercial banks and recommended formulation of an institution which can carry on banking business within the local limits specified by the Government through notification. As a result of this recommendation Government of India permitted the establishment of Regional Rural Banks. The Regional Rural Banks (RRBs) are State sponsored, region based, rural oriented commercial banks, set up under the Regional Rural Banks Act, 1976.

Again, in 1980 the Government of India nationalized another six banks, each having deposits of Rs. 200 Crore and above. This brought 80% of the then banking segment in India under Government ownership. The purpose of acquisition of ownership of banks was to enable them to play, more effectively, the role of key agent for the economic growth by extending banking facilities to the most deserving classes.

1990 onwards- Era of Reforms

The Decade of the 1990’s was a watershed in the history of the Indian financial system in general and the banking system in particular (Report on currency and finance, RBI, 2004-05). Banking System was facing certain problems and as a result of that efficiency and productivity of banks dipped due to over staffing, lack of advanced technology and improper organizational structure, its functional efficiency was also affected. It became very important for RBI to deal with such issues on an urgent basis, and so in order to improve the financial sector a committee was formulated in 1991, under the chairmanship of M. Narasimham.

On the basis of the recommendations of the committee, Department of Banking Supervision (DBS) in 1993 and Board for Financial Supervision (BFS) was formulated in 1994. These boards were constituted with a view to strengthen the institutional framework. Committee also recommended entry of private banks, as a result of that licenses were given to a small number of private banks, which came to be known as new generation tech savvy banks which included banks like ICICI bank and HDFC bank.
One of the major objectives of banking sector reforms is to promote efficiency of the banking system through competitive forces. Reform measures imparted greater transparency and also integrated various segments of the financial system such as money market, debt market, foreign exchange market and capital market. With the growth of the complicated financial sector and pressure to walk hand in hand with the global financial players, it became important for RBI to give special attention to the regulatory mechanism and as a result of that RBI has adopted many supervisory approaches such as on-site monitoring, offsite, internal control system and use of external auditors.

RBI also endeavored to give International best banking practices to Indian banking sector and so in India the capital adequacy norms adopted in 1992 following the Basel accord, 1988. (Report on Trend and Progress 04-05) The earlier accord in (Basel-I) focused only on credit risk and so a new accord named Basel-II was introduced in 2004 which will be able to manage both operational and markets risks of the banks.

Composition of Indian Commercial Banking System

The Indian Commercial Banking System includes the scheduled commercial banks and the regional rural banks which operate in rural areas. The present composition of Indian commercial banking system can be classified as:

(I) Public Sector Banks
   (i) SBI (State Bank of India and its 5 Associate Banks)
   (ii) Nationalized Banks (20 in number)
   (iii) RRBs (Regional Rural Banks, sponsored by Public Sector Banks)

(II) Private Sector Banks
   (i) Old Private Sector Banks (13 in number)
   (ii) New Private Sector Banks (7 in number)
(III) **Foreign Sector Banks (41 in number)**

These banks function under the top monetary authority, viz., Reserve Bank of India. The names of these banks are as follows:

**Public Sector Commercial Banks**

(i) State Bank Group and its Associates
   - State Bank of India
   - State Bank of Bikaner and Jaipur
   - State Bank of Hyderabad
   - State Bank of Mysore
   - State Bank of Patiala
   - State Bank of Travancore

(ii) Nationalized Banks
   - Allahabad Bank
   - Andhra Bank
   - Bank of Baroda
   - Bank of India
   - Bank of Maharashtra
   - Canara Bank
   - Central Bank of India
   - Corporation Bank
   - Dena Bank
   - Indian Bank
   - Indian Overseas Bank
   - Oriental Bank of Commerce
   - Punjab and Sind Bank
   - Punjab National Bank
   - Syndicate Bank
   - UCO Bank
   - Union Bank of India
   - United Bank of India
   - Vijaya Bank
   - IDBI Bank Ltd.
Private Sector Commercial Banks

(i) Old Private Sector Banks

(ii) New Private Sector Banks

- Axis Bank Ltd.
- Development Credit Bank Ltd.
- HDFC Bank Ltd.
- ICICI Bank Ltd
- IndusInd Bank Ltd
- Kotak Mahindra Ltd.
- Yes Bank Ltd.

Foreign Banks

- AB Bank Ltd.
- Abu Dhabi Commercial Bank Ltd.
- American Express Banking Corp.
- Antwerp Diamond Bank NV
- Australia and New Zealand Banking Group Ltd.
- BNP Paribas
- Bank International Indonesia
- Bank of America National Association
- Bank of Bahrain & Kuwait B.S.C.
- Bank of Ceylon
- Bank of Nova Scotia
- Barclays Bank PLC
- Chinatrust Commercial Bank
- Citibank N.A.
- Commonwealth Bank of Australia
- Credit Agricole Corporate and Investment
- Credit Suisse AG
- DBS Bank Ltd.
- Deutsche Bank (Asia)
- First Rand Bank
These banks are working in our country covering rural, semi–urban and urban/metropolitan areas through their vast number of branches. This is obvious from the fact that out of 81,240 bank branches, rural areas claim 23776 branches, semi–urban areas have 22,468 branches, urban areas have 17,878 branches and metropolitan cities have 17,118 numbers of branches at the end of March 2012.

**Achievements of the Indian Banking Services**

India’s banking system has several outstanding achievements to its credit. There has been appreciation for India for weathering the financial crisis relatively intact. Much of it hinged on the sound and resilient banking system in the country. The foundation for the banking sector resilience was laid with the introduction of the
financial sector reforms in 1991 with focus on prudential regulation and increased competition. These reforms resulted in a comprehensive transformation of the banking sector. The reforms had a major impact on the overall efficiency and stability of the banking system. The outreach of banks increased in terms of branch / ATM presence. An equally important achievement is the close association of our banks with the country’s developmental efforts. The balance sheets and overall banking business also grew in size. The financial performance and efficiency of Indian banks improved with increased competition, as reflected in their profitability and net interest margins. Some of these achievements are mentioned below.

(i) **Correction of Regional Imbalances: Development in the Field of Branch Banking**

Branch expansion of banks has been aimed at correcting the regional imbalances in banking development. After nationalization there has been instigated the tremendous expansion of the network of branches to the under banked areas of the country. The number of bank branches rose from 6,600 in 1966, to 12,555 in 1976 bringing down the average population served per bank office from 65,000 to 26,000. By 2002 there were 66,186 branches of commercial banks. Most of the branch expansion occurred in the rural and semi-urban areas and today there is a bank office in almost all the 5,000 odd development blocks in the country. By 2002 rural branches accounted for 49.1 percent of all the branches. The purpose of opening new branches in rural areas is to increase the flow of credit to rural occupations and agriculture.

(ii) **Development of Banking Habits**

The banking system of the country made a momentous contribution in the development of the banking habits in the country. Constant efforts have been made by banks to persuade people to keep a part of their savings as bank deposits and to expand and diversify their lending portfolio to cover a considerably large amount of borrowers than ever before. An appraisal to the development of banking habit is provided by the growth in the volume of banking transactions in relation to gross domestic product. In 1969, deposits amounted to 13 per cent of GDP and advances 10 per cent. By 2002, deposits as a proportion of GDP has risen to around 50 per
cent and advances above 25 per cent, demonstrating the extent to which the banking system has been helpful in spreading banking habits in the country. Growth of deposits of rural branches has been much faster than that of total deposits, extensive use of cheques and growth in bank credit are the indicators of rapid development of banking habits in the country.

(iii) Emergence of Retail Banking

With financial sector reforms gathering impetus, the banking system is facing increasing competition from non-banks and the capital market and this is the reason banks are focusing so much on retail deposits. According to one of the survey, the category of households in India with annual income of Rs. 2 lakh and above is growing at the rate of 30 per cent per annum. This holds so much opportunity for retail banking to grow.

Banks with vision and insight are tapping retail customers through innovative products, services, technology and marketing methods. In order to develop the retail market, banks are extending privileges to the customers in the form of fixed and unfixed deposits, centralized database for ‘any branch banking’, tele banking network, extended banking time, courier pick-up for cheques and documents etc. It can be said that in the bold new world of retail banking the customer is treated as king.

(iv) Universal Banking

A universal bank can be called as ‘financial services super market’ as it is a combination of commercial banking, investment banking and various other activities including insurance. A universal bank offers entire range of financial services within the bank or through subsidiaries. Many of them have entered into the field of merchant banking services, factoring services, asset management services, insurance services etc. A major step towards universal banking has been the merger of ICICI with ICICI bank ltd. Now a days Indian Banking System is following recent trend of converting themselves into ‘financial services supermarkets’ by diversifying banking activities either by themselves or through the subsidiary route.
Virtual Banking

The practice of banking has undergone momentous transformation in the 1990s. Nowadays, customers are moving away from traditional branch banking and are seeking convenience of electronic banking services. And even within the broad continuum of electronic banking, the aspect of banking which has gained prevalence is virtual banking. Virtual banking signifies the provision of banking and related services through extensive use of information technology without direct recourse to the bank by the customer. Some of the major types of virtual banking services are Automated Teller Machines (ATMs), Shared ATM networks, Electronic Funds Transfer at Point of Sale (EFTPoS), Smart Cards, Stored-Value Cards, Phone Banking, and internet banking.

Virtual banking is becoming very popular in the Indian banking system. ATMs (Automated Teller Machines) have been installed by almost all the major banks in major metropolitan cities. The Shared Payment Network System (SPNS) has already been installed in Mumbai. EFT (Electronic Funds Transfer Mechanism) has been initiated by major banks. Banking Institutions are now in a position to provide wide range of services to the customers promptly and accurately at their convenience without direct physical access to bank branches.

Challenges Ahead before Indian Commercial Banks

Though the growth of Indian Banking System and the pace of branch expansion have been quite impressive but at the same time banks have forfeited certain qualitative aspects of this growth. Despite the fact that prudential regulations have helped to ensure systematic stability in banking sector, it need to be recognized that prescription of norms alone does not necessarily ensure an improvement in the functioning of the banks. In order to remain competitive and for enhanced efficiency it is important for the banks to make improvements in certain areas. These are not far to seek.
(i) **Revamping financial legislation**

Evolution of legislative framework is an interesting area. Laws are made keeping in mind the prevailing circumstances. However, if the circumstances change, the legal framework can become inadequate. This is more so in the financial world because the pace of change is very fast. Currently in the financial sector, we have about 60 Acts and multiple rules and regulations. The incremental changes made to these Acts over a period have made the laws ambiguous and complex. Government has taken an initiative by setting up a Financial Sector Legislative Reforms Commission (FSLRC) which seeks to rewrite and streamline the financial sector laws, rules and regulations to bring them in harmony with India’s fast growing financial sector.

(ii) **Recovery Management**

The key to stability of banking sector is recovery management. Indian banks have done a remarkable job in containment of non-performing loans (NPL) considering the overall difficult environment. In fact recovery management is also linked to the banks interest margins. It must be recognized that the cost and recovery management supported by enabling legal framework hold the key to future health and competitiveness of Indian banks. In India improving recovery management is an area requiring expenditures and effective actions in legal, institutional and judicial processes.

(iii) **Financial inclusion**

It is estimated that in spite of the widespread extension of the banking sector, about 40% Indians still lack access to even the simplest kind of formal financial services. Such an extent of financial exclusion can severely hinder the Indian growth story, both by blocking a major portion of the Indian population from participating in the economic mainstream and by, possibly, generating social tensions. As such, moving towards Universal Financial Inclusion is both a national commitment and a policy priority. RBI and the Government of India have taken several initiatives in this direction such as mandating opening of ‘no frills’ accounts coupled with provision of small overdraft facility, introduction of a General Credit Card (GCC), relaxation of KYC norms for small value accounts, allowing general permission for
opening branches in Tier 2 to Tier 6 centers with population of less than 1,00,000, allowing use of Business Facilitator (BF) and Business Correspondent (BC) models, etc. in providing financial and banking services. Despite some improvement as a result of these initiatives in recent years, real financial inclusion still eludes us and major challenges remain.

(iv) Management of NPAs

The level of NPAs (Non Performing Assets) is an important indicator of the performance of the banks, as it reflects on the quality of loan portfolio. Although the net NPAs of the banks in India have witnessed a decline over the past few years they are still high as compared to developed country standards of around 2 percent. NPA have become a first charge on banks’ funds for provisioning. These affect banks’ performance by eating into their profitability. The most important condition for improvement in the profitability of banks is the reduction in the level of NPAs. A recent landmark development which should have a favorable impact in reducing the level of NPAs is the passage of the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest Act, 2002.

(v) Corporate Governance Deficit

Corporate Governance sets up the “rules of the game” to deal with issues arising from separation of ownership and management so that the interests of all stakeholders are protected. Empirical evidence shows that businesses with superior governance practices generate bigger profits, higher returns on equity and larger dividend yields. This is all the more true in respect of banks, which, in their fiduciary capacity deal with public money on one hand and on the other, enjoy government/central bank support due to their centrality in the overall financial system. Over the last one decade, the governance requirements have been considerably enhanced in India. Good governance has to be a continuous and ongoing process. In particular, the Board of Directors and the senior management have a great oversight responsibility in ensuring that the respective banks lay down robust compliance culture and corporate governance framework which is reviewed periodically for its efficacy and efficiency.
(vi) **Risk Management, Technology and HR Development**

In view of the current dynamic business scenario of increasing financial sophistication and innovative financial tools, banks are faced with complex risks. Thus, robust enterprise wide risk management systems are the fundamental requirement for banks to be able to survive in the long run. Banks with proper risk management systems would not only gain competitive advantage but would also add value to the shareholders and other stakeholders. Banks, therefore, have to endeavor for integrated risk management systems, both within the bank and also across the group. Such integrated risk management architecture would be currently difficult due to disconnect between the businesses, risk managers and IT systems across the organizations in their existing set-up.

Indian banks have achieved most of the computerization under the Core Banking Solution (CBS). This may not, however, prepare them adequately for the necessary MIS and analytical tools for risk management. In order to upgrade the risk management systems, banks need to upgrade their technology proportionately so that the MIS and the analytical tools for risk management are available. This will entail large investments in technology particularly for those banks who have to migrate to the advanced approaches under Basel II. Further, with the explosive growth of the internet, mobile and wireless tools, the way both the economy and business are conducted today has been revolutionized and as such, the technological needs of banks are not confined to only risk management requirements. The need for technological innovation in the context of financial inclusion is of high priority. Technology has evolved as the integrator and holds the key to the future success of any corporate entity and more so for the banks. Speed, accuracy and quality in operations and delivery mechanism as also cost efficiency are some of the known benefits that would accrue to both: banks and their customers. However, enhanced usage of technology also poses severe challenges for banks both, in terms of keeping pace with the fast growing /changing technological demands so as to maintain an edge on the profitability, delivery and quality fronts as also with regard to the recognition, understanding, management and mitigation of risks inherent in the use of technology.
The Reserve Bank of India, on its part, has taken several initiatives in this direction which include formulation of the IT Vision document 2011-17 which sets the priorities for commercial banks for moving forward from the core banking solutions to enhanced use of IT in areas like MIS, regulatory reporting, overall risk management, financial inclusion, customer relationship management and enhancing automated data flow within banks and to RBI without any manual intervention, etc. Measures are afoot to setup Next Generation RTGS (NG-RTGS) system taking into account the latest developments in the areas of technology, messaging and networking, etc.

On the part of banks, there is an imperative need for a three-pronged action agenda, viz., first, technology upgradation coupled with its integration with the overall business strategy to achieve an edge in respect of services provided to their constituents, better housekeeping, optimizing the use of funds and building up of MIS for decision making, better management of assets & liabilities and the risks assumed which in turn have a direct impact on the balance sheets. Second, a more dynamic and challenging work culture to meet the demands of customer relationships, product differentiation, brand values, reputation, corporate governance and regulatory prescriptions. Third, focus on internal controls, risk mitigation systems and business continuity plans to effectively mitigate possible operational risks arising out of adoption of technology which could have a potential bearing on the overall financial stability.

(vii) Customer Service

Banking is predominantly a customer oriented business and good customer service is the key to banks’ growth and stability. With enhanced competition amongst banks, customer service becomes the sole differentiating factor to be leveraged to stay relevant and to forge ahead in the business. However, in pursuit of returns and profits, customer service is often ignored if not totally forgotten. As the customer awareness grows, banks would be required to gear up for providing more efficient and at the same time, cost effective services leveraging the technological capabilities. Customer retention is going to be the key factor for banks going ahead.
The efficiency of a bank is judged by its customers in relation to the courtesy extended and the speed and accuracy with which their transactions are completed.

It has been observed that in spite of RBI taking various steps for providing hassle-free services to the customers, the number of complaints have been raised against banks. It is the high time to analyze the causes for the dilution of the quality of customer service and take up steps to remedy them. Poor customer service reflects in a variety of factors: insufficient managerial attention to service issues, poor motivation, lack of innovative products, inadequate technology etc. In order to come up to the customers’ expectations the best way would be to obtain regular feedback from them and filling the gaps wherever they exist. The Board of banks should review the policies concerning customer service. Complaints redressal mechanism should be quick, responsive and prompt. Banks also need to strengthen their organizational systems and introduce new management techniques in order to provide better services to an expanding clientele.