CHAPTER 4

BANKING INDUSTRY IN INDIA

- History and evolution
- Structure of Banking Industry and challenges faced by it
- Impact of Computerisation on the Workforce
- Features of liberalisation
- Impact of Liberalisation Policies on Banking Industry
CHAPTER 4

BANKING INDUSTRY IN INDIA

➢ **INTRODUCTION**

The banking section will navigate through all the aspects of the Banking System in India. It will discuss upon the matters with the birth of the banking concept in the country to new players adding their names in the industry in coming few years.

➢ **HISTORY AND EVOLUTION**

Without a sound and effective banking system in India it cannot have a healthy economy. The banking system of India should not only be hassle free but it should be able to meet new challenges posed by the technology and any other external and internal factors.

For the past three decades India's banking system has several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main reasons of India's growth process.

4.1
The government's regular policy for Indian bank since 1969 has paid rich dividends with the nationalisation of 14 major private banks of India.

Not long ago, an account holder had to wait for hours at the bank counters for getting a draft or for withdrawing his own money. Today, he has a choice. Gone are days when the most efficient bank transferred money from one branch to other in two days. Now it is simple as instant messaging or dial a pizza. Money has become the order of the day. It has been made possible through e-banking/ ATM facilities and now core banking, to be precise national and global banking transactions have become order of the day.

The first bank in India, though conservative, was established in 1786. From 1786 till today, the journey of Indian Banking System can be segregated into three distinct phases. They are as mentioned below:

Early phase from 1786 to 1969 of Indian Banks

Nationalisation of Indian Banks and up to 1991 prior to Indian banking sector Reforms.

New phase of Indian Banking System with the advent of Indian Financial & Banking Sector Reforms after 1991.

To make this write-up more explanatory, the researcher prefixes the scenario as Phase I, Phase II and Phase III.
Phase I

The General Bank of India was set up in the year 1786. Next came Bank of Hindustan and Bengal Bank. The East India Company established Bank of Bengal (1809), Bank of Bombay (1840) and Bank of Madras (1843) as independent units and called it Presidency Banks. These three banks were amalgamated in 1920 and Imperial Bank of India was established which started as private shareholders banks, mostly Europeans shareholders.

In 1865 Allahabad Bank was established and first time exclusively by Indians, Punjab National Bank Ltd. was set up in 1894 with headquarters at Lahore. Between 1906 and 1913, Bank of India, Central Bank of India, Bank of Baroda, Canara Bank, Indian Bank, and Bank of Mysore were set up. Reserve Bank of India came in 1935.

During the first phase the growth was very slow and banks also experienced periodic failures between 1913 and 1948. There were approximately 1100 banks, mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with The Banking Companies Act, 1949 which was later changed to Banking Regulation Act 1949 as per amending Act of 1965 (Act No. 23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as the Central Banking Authority.

4.3
During those day’s public has lesser confidence in the banks. As an aftermath deposit mobilisation was slow. Abreast of it the savings bank facility provided by the Postal department was comparatively safer. Moreover, funds were largely given to traders.

Phase II

Government took major steps in this Indian Banking Sector Reform after independence. In 1955, it nationalised Imperial Bank of India with extensive banking facilities on a large scale especially in rural and semi-urban areas. It formed State Bank of India to act as the principal agent of RBI and to handle banking transactions of the Union and State Governments all over the country.

Seven banks forming subsidiary of State Bank of India was nationalised. On 1960 on 19th July, 1969, major process of nationalisation was carried out. It was the effort of the then Prime Minister of India, Mrs. Indira Gandhi. 14 major commercial banks in the country were nationalised.

In second phase of nationalisation Indian Banking Sector Reform was carried out in 1980 with seven more banks. This step brought 80% of the banking segment in India under Government ownership.

The following are the steps taken by the Government of India to Regulate Banking Institutions in the Country:
1949: Enactment of Banking Regulation Act.

1955: Nationalisation of State Bank of India.

1959: Nationalisation of SBI subsidiaries.

1961: Insurance cover extended to deposits.

1969: Nationalisation of 14 major banks.

1971: Creation of credit guarantee corporation.

1975: Creation of regional rural banks.

1980: Nationalisation of seven banks with deposits over 200 crore.

After the nationalisation of banks, with the branches of the public sector bank, India rose to approximately 800% in deposits and advances took a huge jump by 11,000%.

Banking in the sunshine of Government ownership gave the public implicit faith and immense confidence about the sustainability of these institutions.

**Phase III**

This phase has introduced many more products and facilities in the banking sector in its reforms measure. In 1991, under the chairmanship of M Narasimham, a committee was set up by his name which worked for the liberalisation of banking practices.
The country is flooded with foreign banks and their ATM stations. Efforts are being put to give a satisfactory service to customers. Phone banking and net banking is introduced. The entire system became more convenient and swift. Time is given more importance than money.

The financial system of India has shown a great deal of resilience. It is sheltered from any crisis triggered by any external macroeconomics shock as other East Asian Countries suffered. This is all due to a flexible exchange rate regime, the foreign reserves are high, the capital account is not yet fully convertible, and banks and their customers have limited foreign exchange exposure.

**Nationalisation of Banks in India**

The nationalisation of banks in India took place in 1969 by Mrs. Indira Gandhi the then prime minister. It nationalised 14 banks then. These banks were mostly owned by businessmen and even managed by them.

Central Bank of India

Bank of Maharashtra

Dena Bank

Punjab National Bank

Syndicate Bank

4.6
Canara Bank

Indian Bank

Indian Overseas Bank

Bank of Baroda

Union Bank

Allahabad Bank

United Bank of India

UCO Bank

Bank of India
STRUCTURE OF BANKING INDUSTRY

Reserve Bank of India

Scheduled Bank in India

Scheduled Commercial Banks

- Public Sector Banks (27)
- Pvt. Sector Banks (30)
- Foreign Banks in India (36)
- Regional Rural Banks (196)

Scheduled Commercial Co-Operative

- Scheduled Urban Co-operative Banks (57)
- Scheduled State Co-operative Banks (16)

Nationalized Banks (19)

State Bank of India & its associates (8)

Table 4.1

4.8
APEX FINANCIAL INSTITUTIONS:

- RBI
- NABARD
- EXIM BANK
- IIBI
- NHB

II) DEVELOPMENT BANKS

A. INDUSTRIAL DEVELOPMENT BANKS:

I.) IDBI
II.) IFCI
III.) ICICI
IV.) SFC's
V.) SIDCO etc.

B. LAND DEVELOPMENT BANKS:

I.) State Level Land Development Banks
II.) Primary Land Development Banks.

For understanding the banking structure in India, it will be essential to first know what constitutes banking activity. The Banking Regulation Act 1949 defines banking as
“accepting for the purposes of lending or investment, deposits of money from the public, repayable on demand or otherwise and withdrawable by Cheque, Draft, and Order or otherwise.” The definition thus rules out from its scope the vast unorganized network of the indigenous village bankers who do not generally accept deposits and the mostly urban-based financial bodies who accept deposits for the purposes of lending, but who do not offer withdrawal either on demand or by cheque and draft. But the fact remains that they do complete vigorously with the banking system in the two of its main activities namely acceptance of deposits and lending credit, and such, have to be reckoned with in any study of Indian Banking System.

**BANKS IN THE INDIAN BANKING SYSTEM**

The banks in Indian Banking System are classified into two categories as Scheduled Banks and Non-scheduled Banks. The scheduled banks are those, which are included in the second schedule of Banking Regulation Act, 1945; others are non-scheduled banks. The state co-operative banks also come under the category or scheduled Banks. To be included in the second schedule of bank.

(a) Must have a paid up capital and reserves of not less than Rs. 5 Lakh.
(b) It must also satisfy the RBI that its affairs are not conducted in a manner detrimental to the interest of its depositors. Scheduled banks are required to maintain a certain amount of reserves with the RBI. They enjoy the facility of financial accommodation and remittance facilities at concessional rates from the RBI.

PUBLIC SECTOR BANKS

The Public Sector Banks include

1. The State Bank Group
2. Nationalized Bank
3. Regional Rural Banks

STATE BANK GROUP

State Bank Group comprises, besides the State Banks of India itself, its seven associates are as follows:

i. State Bank of Bikaner and Jaipur
ii. State Bank of Hyderabad
iii. State Bank of India
iv. State Bank of Mysore
v. State Bank of Patiala
vi. State Bank of Saurashtra
vii. State Bank of Travancore.
The State Bank of India is unique among the public sector banks on two accounts:

(1) The bank was mandated by the Governing Act to extend banking facilities on a large scale and more particularly to rural and semi-urban areas.

(2) The bank has traditionally conducted the treasury operations on behalf of the central and state government and has, therefore, had a close relationship with the government departments and undertakings.

The nationalized banks group originally comprised 20 banks of which 14 were nationalized in 1969 and 6 in 1980 one of them – the New Bank of India, was later on merged with Punjab National Bank. Thus 27 banks constitute public sector in Indian Commercial Banking. With these two rounds of nationalization and with the State Bank of India being already in the ownership of the Reserve Bank of India to the extent of its equity, the organized banking sector has come in the government control barring a very insignificantly small part of it.

The nationalization of the banks was done with a view to serving better the developmental needs of all sectors of the economy in consonance with the national policies and priorities. The broad aim got translated into spreading of banking services, increased mobilization of savings, removal of regional disparities and channelising credit into the weaker sections of the society.

4.12
CHALLENGES FACING BANKING INDUSTRY IN INDIA

The banking industry in India is undergoing a major transformation due to changes in economic conditions and continuous deregulation. These multiple changes happening one after another has a ripple effect on a bank trying to graduate from completely regulated sellers market to completed deregulated customers market.

Table 4.2

4.13
· **Deregulation:** This continuous deregulation has made the Banking market extremely competitive with greater autonomy, operational flexibility, and decontrolled interest rate and liberalized norms for foreign exchange. The deregulation of the industry coupled with decontrol in interest rates has led to entry of a number of players in the banking industry. At the same time reduced corporate credit off take thanks to sluggish economy has resulted in large number of competitors battling for the same pie.

· **New rules:** As a result, the market place has been redefined with new rules of the game. Banks are transforming to universal banking, adding new channels with lucrative pricing and freebees to offer. Natural fall out of this has led to a series of productive offerings catering to various customer segments, specifically retail credit.

· **Efficiency:** This in turn has made it necessary to look for efficiencies in the business. Banks need to access low cost funds and simultaneously improve the efficiency. The banks are facing pricing pressure, squeeze on spread and have to give thrust on retail assets

· **Diffused Customer loyalty:** This will definitely impact Customer preferences, as they are bound to react to the value added offerings. Customers have become demanding and the loyalties are diffused. There are multiple choices, the wallet share is reduced per bank with demand on flexibility and customization. Given the relatively low switching costs; customer retention calls for customized service and hassle free, flawless service delivery.
· **Misaligned mindset:** These changes are creating challenges, as employees are made to adapt to changing conditions. There is resistance to change from employees and the Seller market mindset is yet to be changed coupled with Fear of uncertainty and Control orientation. Acceptance of technology is slowly creeping in but the utilization is not maximised.

· **Competency Gap:** Placing the right skill at the right place will determine success. The competency gap needs to be addressed simultaneously otherwise there will be missed opportunities. The focus of people will be on doing work but not providing solutions, on escalating problems rather than solving them and on disposing customers instead of using the opportunity to cross sell.

**Strategic options with banks to cope with the challenges**

Leading players in the industry have embarked on a series of strategic and tactical initiatives to sustain leadership. The major initiatives include:

- · Investing in state of the art technology as the back bone to ensure reliable service delivery

- · Leveraging the branch network and sales structure to mobilize low cost current and savings deposits
• Making aggressive forays in the retail advances segment of home and personal loans

• Implementing organization wide initiatives involving people, process and technology to reduce the fixed costs and the cost per transaction

• Focusing on fee based income to compensate for squeezed spread, (e.g., trade services)

• Innovating Products to capture customer 'mind share' to begin with and later the wallet share

• Improving the asset quality as per Basel II norms

➢ IMPACT OF COMPUTERISATION ON THE WORKFORCE

Some of the general issues that have concerned unions and employees, especially women, in the wake of the introduction of new technology in the banking and finance sectors have been:

• Prospects of job losses and declining employment levels.

• Increase in workloads.

• Pressure for flexibility.

• Changes in job contents.
• Increase in insecurity in the workplace, and loss of union power.

• Increase in the proportion of 'non-bargainable' staff (i.e. those without an automatic right to unionize) as compared to the 'bargainable' staff.

• Changes in grading and pay.

• Changes in information and control.

• Changes in the autonomy of employees.

• Changes in health and safety conditions

➢ FEATURES OF LIBERALISATION

In the banking sector, which dominates India's financial system, the financial liberalisation has involved three major sets of initiatives. First, those aimed at increasing the credit creating capacity of banks through reductions in the statutory liquidity and cash reserve ratio, while offering them greater leeway in using the resulting liquidity by drastically pruning priority sector lending targets.

The second was to increase competition through structural changes in the financial sector. While the existing nationalised banks, including the State Bank of India, were permitted to sell equity to the private sector, private investors were permitted to enter the banking area.
In addition, foreign banks were given greater access to the domestic market, both as subsidiaries and branches, subject to the maintenance of a minimum assigned capital and being subject to the same rule as domestic banks. Further, a degree of "broad banding" of financial services was permitted, with development finance institutions being allowed to set up mutual funds and commercial banks, and banks themselves permitted to diversify their activity into a host of related areas. The broad trend is towards a form of universal banking.

Thirdly, to render this competition effective in influencing bank functioning, banks have been provided with greater freedom in determining their asset portfolios. They were permitted to cross the firewall that separated the banking sector from the stock market and invest in equities, provide advances against equity provided as collateral, and offer guarantees to the broking community.
IMPACT OF LIBERALISATION POLICIES ON BANKING INDUSTRY

All these initiatives had an immediate impact on the functioning of banks, which chose to modify their credit portfolio and diversify out of their overwhelmingly dominant role as credit-providing intermediaries. To start with, non-food credit itself was increasingly being diverted away from the priority sectors (such as agriculture and the small scale sector), industry and the wholesale trade, to other areas such as provision of loans to individuals for purchases of consumer durables and investment in housing, and towards lending against real estate and commodities. While this shift increased the interest incomes that could be garnered by the banks, it also increased their exposure to the euphemistically termed ‘sensitive’ sectors, where speculation is rife and returns volatile.

Secondly, investment in securities of various kinds gained in importance, bringing in its wake a greater exposure to stock markets. This was indeed a part of the reform effort. As an RBI-SEBI joint committee on bank exposures to the stock market noted: "Globally, there is a shift in the asset portfolio of banks from credit to investments keeping in view the fact that investments are liquid and augment the earnings of banks. The committee feels that banks’ participation would also promote stability and orderly growth of the capital market."
"The impact of this on scheduled commercial banks in India is visible from a rise in "investments" by banks, which to a significant extent is due to bank preference for credit substitutes.

Initially, the investments were largely in safe government and other approved securities. But over the last four years there has been a sharp increase in investments in non-SLR securities with the share within such investments accounted for by loans to corporate against shares, investments in private equity and in private bonds, debentures and preference shares also increasing over time. These trends, however, are based on aggregate and average figures that conceal the differential distribution of such exposure across different kinds of banks. Such differentials have been substantial. Consider, for example, bank lending to sensitive sectors such as commodities, the real estate and the capital market. While, the sum total of such lending is still small, there are some segments of the banking sector, especially the old and new private sector banks that are characterised on average by a much higher degree of such exposure.
REFERENCES


