International Research Journal of Management and Commerce
ISSN: (2348-9766)
Impact Factor 5.564 Volume 6, Issue 4, April 2019
©Association of Academic Researchers and Faculties (AARF)
www.aarf.asia, **Email** : editor@aarf.asia , editoraarf@gmail.com

IMPACT OF BANKING SECTOR IN INDIA

Prof. Farook Ahmed Shaikh
Assistant Professor in Dept. of Commerce.
J.G. College of Commerce, Hubli – 580 025, Karnataka

ABSTRACT

The Indian banking sector has seen unprecedented growth along with remarkable improvement in its quality of assets and efficiency since economic liberalisation began in the early 1990s. From providing plain vanilla banking services, banks have gradually transformed themselves into universal banks. ATMs, Internet banking, mobile banking and social banking have made "anytime anywhere banking" the norm now. In 2011-12, non-cash payments comprised 91 per cent of total transactions in terms of value and 48 per cent in terms of volume. Within noncash payments, too, the share of payments through cheques has come down from 85 per cent to nine per cent in value, and 83 per cent to 52 per cent in volume between 2005-06 and 2011-12. Banks have taken other measures to improve their functioning, too. As a result, there were 20 Indian banks in the UK-based Brand Finance's annual international ranking of top 500 in 2010, as compared to only six in 2007, according to a report in a leading financial daily. The growth is not restricted to the metropolitan or urban areas. Financial inclusion has been at the forefront of regulators and policy makers in India, a country where approximately half of the population still does not have access to banking services. There have been occasions when banks have acted beyond their role of finance providers. India's banking system was probably one of the few large banking systems which remained unscathed by the 2008 global financial crisis. However, there is a lot more to be done to make it a truly world class sector.

Keywords: Origin of Banks, Schedule & Non- Schedule Banks, Evolution of Banks, Growth of Banking system in India, Present Structure, Bank Management Liquidity, Major Problems Faced by India's Nationalized Banks, Innovative in Banking, etc.

INTRODUCTION

A bank is a financial institution which accepts deposits, pays interest on pre-defined rates, clears checks, makes loans, and often acts as an intermediary in financial transactions. It also provides other financial services to its customers. Bank management governs various concerns associated with bank in order to maximize profits. The concerns broadly include liquidity management, asset management, liability management and capital management. The banking system in India notched a whopping one lakh plus Automated Teller Machines (ATMs) in the country, with public sector banks accounting for a lion's share. According to the latest data released by National Payments Corporation of India (NPCI), the total number of ATMs in the country is now 1,04,500 till October. Of these, 61,500 - or 59 per cent - belong to the public sector banks and State Bank of India Group, the NPCI said. Private sector and foreign banks together have installed 41,800 ATMs, or 40 per cent. The remaining one per cent or 1,150 ATMs are of small, co-operative or rural banks. All public sector banks in India are part of the NPCI since June 2010. NPCI said that all the banks put together have plans to install an additional one lakh ATMs over the next two years. This would raise the number of ATMs per million population from the present 85 to about 170 ATMs, or more than double, the NPCI said. NFS facilitates routing of the ATM transactions through inter-connectivity between the bank's systems, thereby enabling the ATM/debit card holders to utilise the services of any ATM of a connected bank. NFS processes over 200 million transactions every month.

ORIGIN OF BANKS

The origin of bank or banking activities can be traced to the Roman empire during the Babylonian period. It was being practiced on a very small scale as compared to modern day banking and frame work was not systematic.

Modern banks deal with banking activities on a larger scale and abide by the rules made by the government. The government plays a crucial role with its control over the banking system. This calls for bank management, which further ensures quality service to customers and a win-win situation between the customer, the banks and the government.

SCHEDULED & NON-SCHEDULED BANKS

Scheduled and non-scheduled banks are categorized by the criteria or eligibility setup by the governing authority of a particular region. The following are the basic differences between scheduled and nonscheduled banks in the Indian banking perspective.

Scheduled banks are those that have paid-up capital and deposits of an aggregate value of not less than rupees five lakhs in the Reserve Bank of India. All their banking businesses are carried out in India. Most of the banks in India fall in the scheduled bank category.

Non-scheduled banks are the banks with reserve capital of less than five lakh rupees. There are very few banks that fall in this category.

EVOLUTION OF BANKS

Banking system has evolved from barbaric banking where commodities were loaned to modern day banking system, which caters to a range of financial services. The evolution of banking system was gradual with growth in each and every aspect of banking. Some of the major changes which took place are as follows −

- Barter system replaced by money which made transaction uniform
- Uniform laws were setup to increase public trust
- Centralized banks were setup to govern other banks
- Book keeping was evolved from papers to digital format with the introduction of computers
- ATMs were setup for easier withdrawal of funds
- Internet banking came into existence with development of internet

Banking system has witnessed unprecedented growth and will be undergoing it in future too with the advancement in technology.

GROWTH OF BANKING SYSTEM IN INDIA

The journey of banking system in India can be put into three different phases based on the services provided by them. The entire evolution of banking can be described in these distinct phases −

Phase 1

This was the early phase of banking system in India from 1786 to 1969. This period marked the establishment of Indian banks with more banks being set up. The growth was very slow in this phase and banking industry also experienced failures between 1913 to 1948.

The Government of India came up with the banking Companies Act in 1949. This helped to streamline the functions and activities of banks. During this phase, public had lesser confidence in banks and post offices were considered more safe to deposit funds.

Phase 2

This phase of banking was between 1969 to 1991, there were several major decisions being made in this phase. In 1969, fourteen major banks were nationalized. Credit Guarantee Corporation was created in 1971. This helped people avail loans to set up businesses.

In 1975, regional rural banks were created for the development of rural areas. These banks provided loans at lower rates. People started having enough faith and confidence on the banking system, and there was a plunge in the deposits and advances being made.

Phase 3

This phase came into existence from 1991. The year 1991 marked the beginning of liberalization, and various strategies were implemented to ensure quality service and improve customer satisfaction.

The ongoing phase witnessed the launch of ATMs which made cash withdrawals easier. This phase also brought in Internet banking for easier financial transactions from any part of world. Banks have been making attempts to provide better services and make financial transactions faster and efficient.

PRESENT STRUCTURE

The current banking framework in India can be broadly classified into two. The first classification divides banks into three sub-categories — the Reserve Bank of India, commercial banks and cooperative banks.

The second divides the banks into two sub-categories — scheduled banks and non-scheduled banks. In both of these systems of categorization, the RBI, is the head of the banking structure. It monitors and holds all the reserve capital of all the commercial or scheduled banks across the nation.

Commercial banks are the foundations that receive deposits from individuals and enterprises and lend loans to them. They generate credit. Commercial banks in India are regulate under the Banking Regulation Act of 1949. These banks are further categorized as −

- Scheduled banks
- Non-scheduled banks

Scheduled banks are banks which are listed in the 2nd schedule of the Reserve Bank of India Act, 1934. Non-scheduled banks are those banks which are not listed in the second schedule of the Reserve Bank of India Act, 1934.

Scheduled Banks

In India, for a bank to qualify as a scheduled bank, it needs to meet the criteria as underplayed by the Reserve Bank of India. The following is a list of the criterions

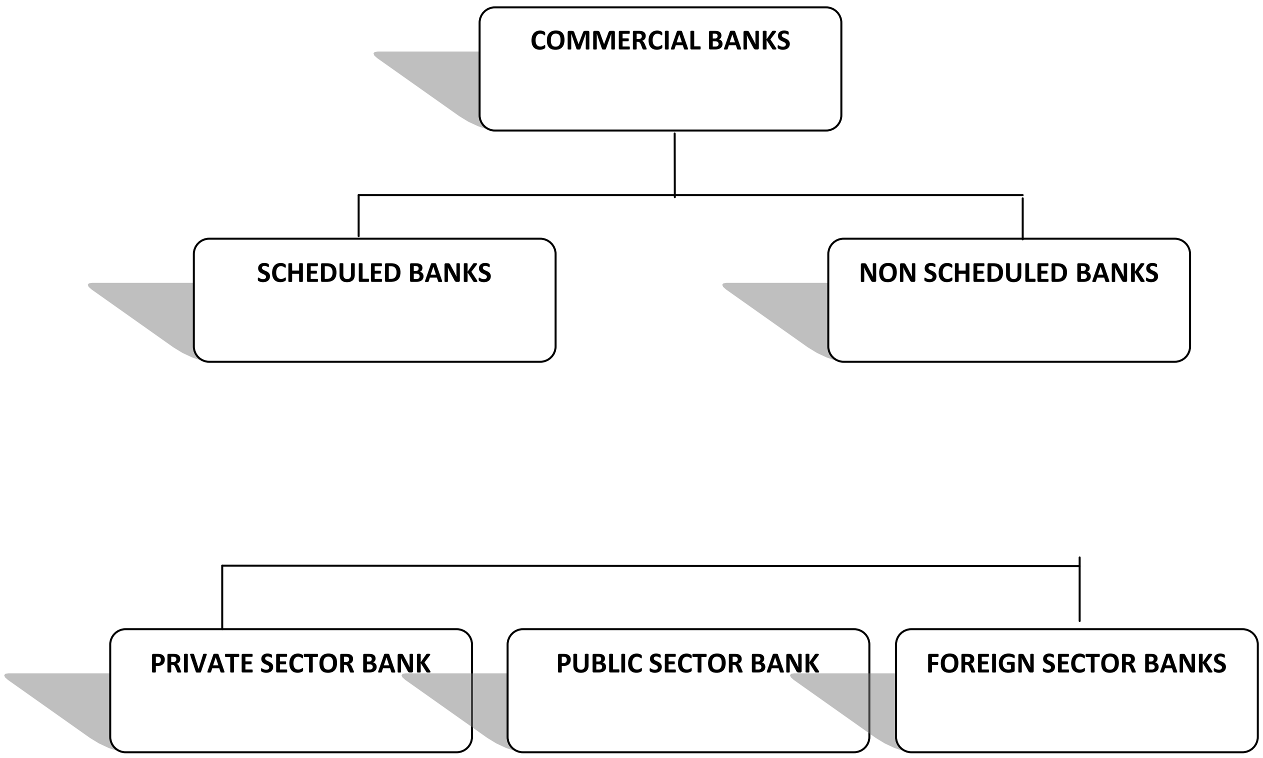
- The banks should carry all their business transactions in India.
- All schedule banks are bound to hold a capital of not less than rupees five lakhs in the Reserve Bank of India.
- In the year 2011, five lakh rupees calculated in terms of dollars amounted to $11,156.

Thus, any commercial, cooperative, nationalized, foreign bank and any other banking foundation that accepts and satisfies these set conditions are termed as scheduled banks but not all schedule banks are commercial banks.

The scheduled commercial banks are those banks which are included in the second schedule of RBI Act, 1934. These banks accept deposits, lend loans and also offer other banking services. The major difference between scheduled commercial banks and scheduled cooperative banks is their holding pattern. Cooperative banks are registered as cooperative credit institutions under the Cooperative Societies Act of 1912.

Scheduled banks are further categorized as −

- Private-sector banks
- Public sector banks
- Foreign sector banks



Private-Sector Banks

These banks acquire larger parts of stake or congruity is maintained by the private shareholders and not by government. Thus, banks where maximum amount of capital is in private hands are considered as private-sector banks. In India, we have two types of private-sector banks −

- Old Private-Sector Banks
- New Private-Sector Banks

Old Private-sector Banks

The old private-sector banks were set up before nationalization in 1969. They had their own independence. These banks were either too small or specialist to be incorporated in nationalization. The following is a list of old private-sector banks in India −

- Catholic Syrian Bank
- City Union Bank
- Dhanlaxmi Bank
- Federal Bank ING
- Vysya Bank
- Jammu and Kashmir Bank
- Karnataka Bank
- Karur Vysya Bank
- Lakshmi Vilas Bank
- Nainital Bank
- Ratnakar Bank
- South Indian Bank
- Tamil Nadu Mercantile Bank

From the above mentioned banks, the Nainital Bank is an auxiliary or branch of the Bank of Baroda, which has 98.57% stake in it. A few old generation private-sector banks merged with other banks. For example, in the year 2007, Lord Krishna Bank merged with Centurion Bank of Punjab. Sangli Bank merged with ICICI Bank in 2006. Yet again, Centurion Bank of Punjab merged with HDFC in 2008.

New Private-sector Banks

Banks which started their operations after liberalization in the 1990s are the new private-sector banks. These banks were permitted entry into the Indian banking sector after the amendment of the Banking Regulation Act in 1993.

At present, the following new private-sector banks are operational in India −

- Axis Bank Development
- Credit Bank (DCB Bank Ltd)
- HDFC Bank
- ICICI Bank
- IndusInd Bank
- Kotak Mahindra Bank
- Yes Bank

In addition to these seven banks, there are two more banks which are yet to commence operation. They got the ‘in-principle’ licenses from RBI. These two banks are IDFC and Bandhan Bank of Bandhan Financial Services.

Bank Management - Liquidity

Liquidity in banking refers to the ability of a bank to meet its financial obligations as they come due. It can come from direct cash holdings in currency or on account at the Federal Reserve or other central bank. More frequently, it comes from acquiring securities that can be sold quickly with minimal loss. This basically states highly creditworthy securities, comprising of government bills, which have short term maturities.

If their maturity is short enough the bank may simply wait for them to return the principle at maturity. For short term, very safe securities favor to trade in liquid markets, stating that large volumes can be sold without moving prices too much and with low transaction costs.

Nevertheless, a bank’s liquidity condition, particularly in a crisis, will be affected by much more than just this reserve of cash and highly liquid securities. The maturity of its less liquid assets will also matter. As some of them may mature before the cash crunch passes, thereby providing an additional source of funds.

Need for Liquidity

We are concerned about bank liquidity levels as banks are important to the financial system. They are inherently sensitive if they do not have enough safety margins. We have witnessed in the past the extreme form of damage that an economy can undergo when credit dries up in a crisis. Capital is arguably the most essential safety buffer. This is because it supports the resources to reclaim from substantial losses of any nature.

The closest cause of a bank’s demise is mostly a liquidity issue that makes it impossible to survive a classic “bank run” or, nowadays, a modern equivalent, like an inability to approach the debt markets for new funding. It is completely possible for the economic value of a bank's assets to be more than enough to wrap up all of its demands and yet for that bank to go bust as its assets are illiquid and its liabilities have short-term maturities.

Banks have always been reclining to runs as one of their principle social intentions are to perform maturity transformation, also known as time intermediation. In simple words, they yield demand deposits and other short term funds and lend them back out at longer maturities.

Maturity conversion is useful as households and enterprises often have a strong choice for a substantial degree of liquidity, yet much of the useful activity in the economy needs confirmed funding for multiple years. Banks square this cycle by depending on the fact that households and enterprises seldom take advantage of the liquidity they have acquired.

Deposits are considered sticky. Theoretically, it is possible to withdraw all demand deposits in a single day, yet their average balances show remarkable stability in normal times. Thus, banks can accommodate the funds for longer durations with a fair degree of assurance that the deposits will be readily available or that equivalent deposits can be acquired from others as per requirement, with a raise in deposit rates.

MAJOR PROBLEMS FACED BY INDIA'S NATIONALIZED BANKS

The following points highlight the major problems faced by India's nationalized banks.

Problem # 1. Losses in Rural Branches:

Most of the rural branches are running at a loss because of high overheads and prevalence of the barter system in most parts of rural India.

With the Reserve Bank of India directing banks to open more brick and mortar branches at village level to facilitate banking facilities at villagers' doorstep, the Haryana government has been way short of its target.

According to norms, the state government decided to open brick and mortar branches in 194 villages in Haryana in its first phase, but only 44 of them could be opened.

The above data was released in State Level Banker's Committee in September, 2017.

A senior bank officer working in Karnal district of Haryana told *Reporters* that banks were not taking keen interest in reaching to rural population due to economical reasons. He observed that a fully operational branch of a bank needs lots of business to sustain but, transactions at rural bank remain limited to few activities, including bad loans, which are another headache for them.

However, Haryana finance minister Capt Abhimanyu Sindhu in a press conference at Chandigarh recently said that the government was committed to extend the benefits of banking till the last man.

Finance minister also added that several government schemes like Direct Benefit Schemes, Pradhan Mantri Fasal Bima Yojana, loans for entrepreneurs and Self Help Groups were not possible with inclusion of rural population.

PNB could complete less than 1/5 of its target

The Haryana finance ministry has directed the banks to open more brick and mortar branches in the villages but most of the banks failed to meet their targets.

Punjab National Bank, one of the largest nationalized banks of country, had a target to open 47 branches in villages having population more than 5,000, but could open only nine by the end of September, 2017.

Similarly, Bank of Baroda was under target to open five brick and mortar branches but they couldn’t even make a beginning.

Central Bank of India was to open nine branches but they could not progress further after opening one branch. Corporation Bank and IDBI were under target to open one branch that remained a non-starter. Oriental Bank of Commerce was to open 18 branches but opened only four. The largest national Bank—State Bank of India too remained short of its target; of 21 branches, it opened only one till September, 2017.

Problem # 2. Large Over-Dues:

The small branches of commercial banks are now faced with a new problem—a large amount of overdue advances to farmers. The decision of the former National Front Government to waive all loans to farmers up to the value of Rs. 10,000 crores has added to the plight of such banks.

Problem # 3. Non-Performing Assets:

The commercial banks at present do not have any machinery to ensure that their loans and advances are, in fact, going into productive use in the larger public interest. Due to a high proportion of non-performing assets or outstanding due to banks from borrowers they are incurring huge losses. Most of them are also unable to maintain capital adequacy ratio.

Problem # 4. Advance to Priority Sector:

As far as advances to the priority sectors are concerned, the progress has been slow. This is partly attributable to the fact that the bank officials from top to bottom could not accept nationalisation gracefully, viz., and diversion of a certain portion of resources to the top priority and hitherto neglected sectors. This is also attributable to the poor and unsatisfactory loan recovery rates from the agricultural and small sectors.

Problem # 5. Competition from Non-Banking Financial Institution:

As far as deposit mobilisation is concerned, commercial banks have been facing stiff challenges from non-banking financial intermediaries such as mutual funds, housing finance corporations, leasing and investment companies. All these institutions compete closely with commercial banks in attracting public deposits and offer higher rates of interest than are paid by commercial banks.

Problem # 6. Competition with Foreign Banks:

Foreign banks and the smaller private sector banks have registered higher increase in deposits. One reason seems to be that non-nationalised banks offer better's customer service. This creates the impression that a diversion of deposits from the nationalised banks to other banks has probably taken place.

Problem # 7. Gap between Promise and Performance:

One major weakness of the nationalised banking system in India is its failure to sustain the desired credit pattern and fill in credit gaps in different sectors. Even though there has been a reorientation of bank objectives, the bank staff has remained virtually static and the bank procedures and practices have continued to remain old and outmoded.

The post-nationalisation period has seen a widening gap between promise and performance. The main reason seems to be the failure of the bank staff to appreciate the new work philosophy and new social objectives.

Problem # 8. Bureaucratization:

Another problem faced by the commercial banks is bureaucratization (*The combined organizational structure, procedures, protocols, and set of regulations in place to manage* *activity*) of the banking system. This is indeed the result of nationalization. The smooth functioning of banks has been hampered by red-tapism, long delays, lack of initiative and failure to take quick decisions.

Problem # 9. Political Pressures:

The smooth working of nationalised banks has also been hampered by growing political pressures from the Centre and the States. Nationalised banks often face lots of difficulties due to various political pressures. Such pressures are created in the selection of personnel and grant of loans to particular parties without considering their creditworthiness.

INNOVATION IN BANKING

Customer experience is often the deciding factor when it comes to banking. Today's customers want personalized interactions, simplified banking and access to their accounts through technology. Banks that can innovate and meet customers' needs have a huge competitive advantage. Few examples of innovative banking customer experiences.

Bank of America Uses A Chat-bot to Connect with Customers

Bank of America recently launched its AI-powered chatbot, Erica, and saw more than 1 million users in the first three months. Erica makes it easy for customers to search transactions, transfer and deposit funds and get advice on financial products. The chatbot is integrated with Bank of America's financial literacy library to quickly provide resources to customers. Erica can understand voice or text commands and gives customers a virtual personal banker in their pocket.

BBVA Helps Customers Set Goals

BBVA has an app feature called Bconomy, which helps customers set goals, save money and track their progress. On top of that, the app also makes suggestions about how to save money and compares prices on things like utilities and groceries. Users can also compare their spending to people like them to see if their financial activity is on track. In just three weeks, Bconomy had half a million users. BBVA and Bconomy make it easy for customers to get personalized financial advice no matter where they are.

Idea Bank Gives Customers a Place to Work

Polish bank Idea Bank makes its products available on the go—literally—with branches and co-working spaces on commuter trains. The Idea Bank cars feature desks and conference spaces, plus free office supplies, Wi-Fi and coffee. Any passenger can use the space while the train is moving, but priority is given to Idea Bank customers. The car is staffed by Idea Bank employees to help with bank transactions. It's all part of the bank's goal to support small business owners by giving them a place to work from the road.

AI-Powered Virtual Assistant Improves Financial Habits

Russian bank Sberbank uses an AI-based tool called Tips to help customers improve their financial habits while saving time and money. Tips analyzes each customer's banking behavior to provide personalized estimates for what will happen in their future. From there, customers can set financial goals and get connected to the best products to reach those goals. The more a customer uses Tips, the better the recommendations. Tips puts everything together in one place for simpler banking.

Barclaycard Turns Phones into Wallets

Instead of having to fumble through a wallet or risk losing a bank card, Barclaycard in the U.K. has a Grab+Go feature that turns customers' smart phones into wallets. Customers can scan items into the app while they shop and then pay for them through mobile checkout without having to wait in line. Grab+Go helps customers streamline their shopping and spend more time doing the things they love.

Conclusion

As the sanctity of ethics and values is getting eroded and challenges and risks faced by banks and borrowers are increasing because of fast changes taking place in business environment and the economy in the context of economic liberalization and globalization, the possibility of some investment failures cannot be rules out both from banks' and borrowers' angle. In such a scenario, the presence of NPAs is unavoidable and the only way to come out of this is to have the suggested Fund built up over a period of time. This will certainly prove to be a win-win situation for all stake holders of banking including the major stake holders the Government. This suggestion on implementation can become an effective Regulatory Tool. It has to be noted that a good violently executed now in better than a perfect future plan. Time is always the enemy, as it increases the repair bill exponentially. We have neither the time nor the money to experiment with the problem of ever growing NPAs.

Reference

1. National Payments Corporation of India.
2. State Level Banker's Committee in September, 2017.
3. Electronic Media (Internet).