EVOLUTION OF THE INDIAN BANKING INDUSTRY

Dr. Sandeep Bansal*

ABSTRACT

India's Rs 77 trillion (US$ 1.25 trillion)-banking industry is the backbone to the economy. The sector emerged strong from global financial turmoil and proved its mettle when the developed economies were shaking. India's banking sector is on a high-growth trajectory with around 3.5 ATMs and less than seven bank branches per 100,000 people, according to a World Bank report. The statistics are going to improve in near future as the Government aims to have maximum financial inclusion in the country. Policymakers are making all the efforts to provide a facilitating policy framework and infrastructure support to ensure meaningful financial inclusion. Apart from that, financial institutions are collaborating with other service providers (in the fields of telecom, technology and consumer product providers) to create an enabling environment.

KEY WORDS: Indian Banking, Banking Industry, Challenges, Opportunities

INTRODUCTION

Banking industry in India has also achieved a new height with time. The use of technology has brought a revolution in the working style of the banks. At present banks are of dynamic nature as public, private, foreign banks offering versatile services as commercial banking, agricultural banking. Banking sector plays a pivot role in developing an economy. The market development coupled with the Liberalization and globalization have resulted in transformation of banks in a higher pace with technology. Banking has become the backbone of Indian economy. The life support system of a bank is shareholders and stakeholders.

*Associate Professor, IGN College. Ladwa (Haryana)

Banks are the important component of any financial system .They play important role of channelizing the savings of surplus sector to deficient sector. Indian economy is not an exception to this and banking system in India also plays a important role in the process of economic growth and development The majority of the banks are still successful in keeping with the confidence of the share holders as well as other stake holders. There are various types of banks such as nationalized bank, private banks, public bank, foreign bank, cooperative bank. Banking industry is evolving to be more competitive and pro-active. Banks have started adopting new techniques like mobile and internet to provide their services.

Projections have stated that the Indian banking and securities companies will spend about Rs 41,700 crore (US$ 6.78 billion) on IT products and services in 2013, 13 per cent more than what they spent in 2012. This includes spending on internal IT services (including personnel), software, data centre technologies, devices and telecom services, according to a study by research and analyst firm Gartner.

Another report prepared by KPMG prepared in association with the Confederation of Indian Industry (CII) states that the Indian banking sector is expected to become fifth largest in the world by 2020. The report highlights that India is one of the top 10 economies of the world and with relatively lower domestic credit to gross domestic product (GDP) percentage, their lies a huge scope of growth for the banking sector. Bank credit is expected to grow at a compounded annual growth rate (CAGR) of 17 per cent in the medium term, eventually leading to higher credit penetration in the economy

HISTORICAL BACKGROUND

PRE -INDEPENDENCE

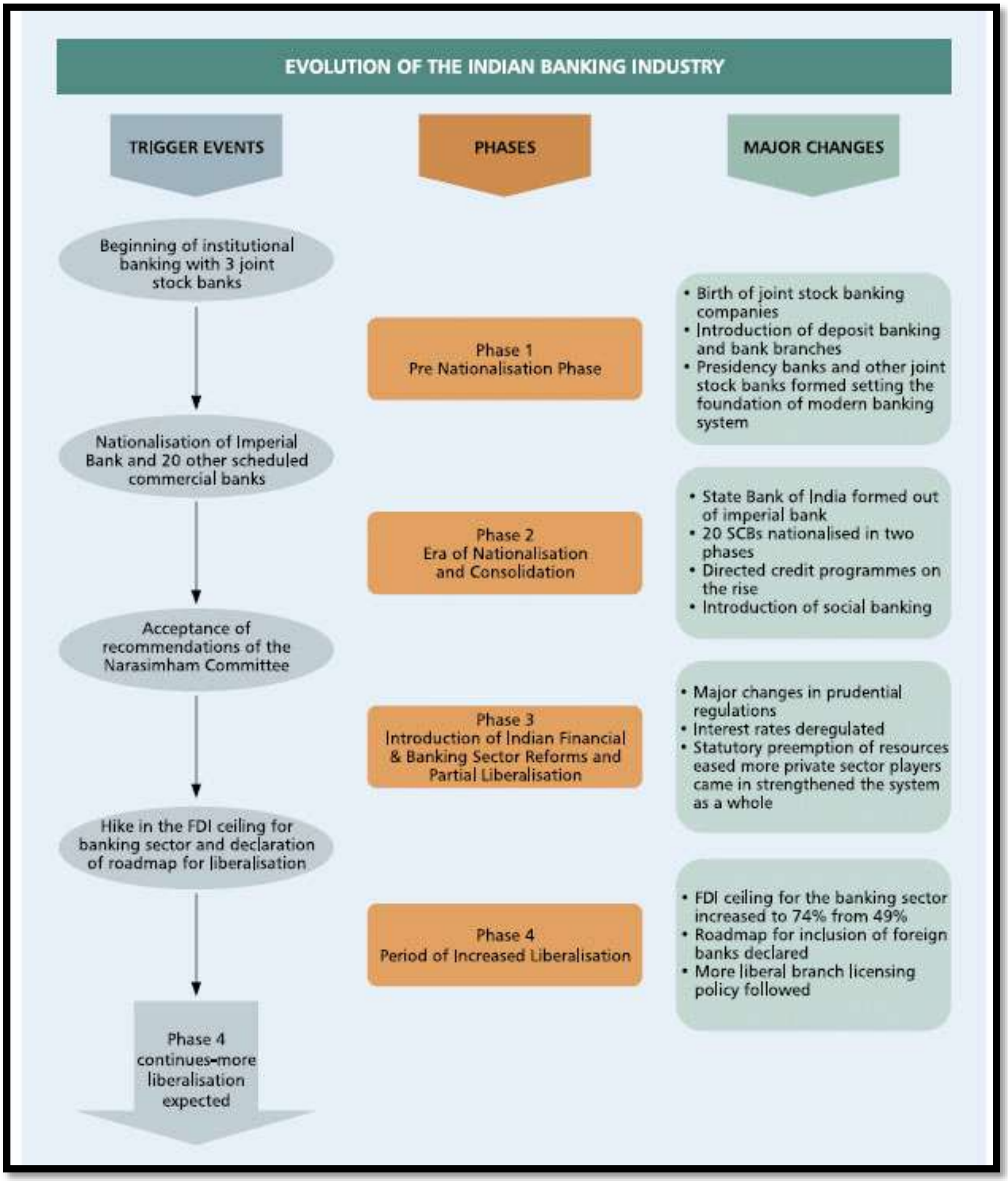
Bank of Hindustan was set up in 1870 . It was the earliest Indian bank. Later three presidency banks under presidency banks act 1876 like bank of Calcutta, bank of Bombay and bank of madas were set up. Im 1921 these banks were amalgamated and a completely new bank was incorporated namely Imperial bank of India. In 1934 RBI was constituted as a apex body but without major government ownership. Banking regulation act was passed in 1949 .This regulation brought RBI under government control.

POST -INDEPENDENCE

In 1955 RBI acquired control of the Imperial bank of India which was re named as state bank of india. On july 1969 14 banks were nationalized with a view to extending credit to all segments of the economy. The banking scenario prevalent during the country 1948 to 1968 presented a strong focus on class banking on security than on purpose. The emphasis on the banking system during this period was on developing a sound banking system for the country .Banking sector which during the pre independence India was catering to the needs of the government , rich individuals and traders ,opened its doors wider and set out for the first time to bring the entire productive sector of the economy. During this period number of commercial period declined remarkably. There were 566 banks as on December 1951, of this number scheduled banks was 92 and remaining 474 were non scheduled banks. There was high expansion banks in 1968 to 1984 .This period also witnesses birth of RRB in 1975 and NABARD in 1982 which had priority sector as their focus of activity. Further the branch expansion from 1969 to 1991 was very vast as there were 8262 branches in total which constituted 1833 in rural and 3342 in semi -urban areas .Further there were 1980 banks with 1505 branches in rural and 8122 branches in semi urban areas. In 1991 there were 35206 rural and 11344 semi –urban branches which in total were 60220.

Evolution of the Indian Banking Industry:

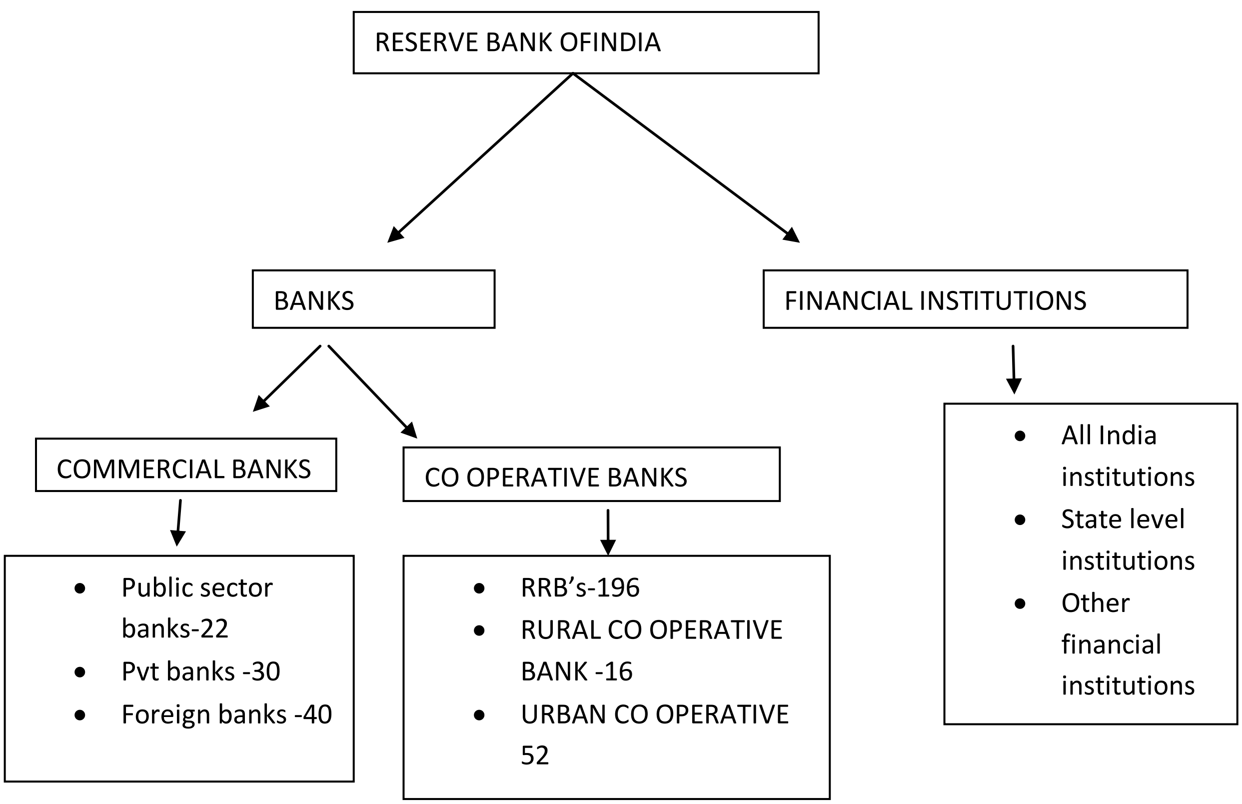
The Indian banking industry has its foundations in the 18th century, and has had a varied evolutionary experience since then. The initial banks in India were primarily traders’ banks engaged only in financing activities. Banking industry in the pre-independence era developed with the Presidency Banks, which were transformed into the Imperial Bank of India and subsequently into the State Bank of India. The initial days of the industry saw a majority private ownership and a highly volatile work environment. Major strides towards public ownership and accountability were made with nationalisation in 1969 and 1980 which transformed the face of banking in India. The industry in recent times has recognised the importance of private and foreign players in a competitive scenario and has moved towards greater liberalisation.



Source:- D & B industry Research Service

Structure of Indian banking Industry

RBI is the sole controller of all the banking and non banking financial institutions and is working as the bank of banks. It issues timely guidelines and parameters to all the banks on which they conduct the function of banking. India's largest bank the state bank of India and its seven associate banks were brought under social control in the mid to late fifties therefore, with two successive nationalization of banks, another 19 banks(14 banks in 1969 & 6 in 1980) were brought in the public sector. Earlier the banking was only confined to metropolitan areas but now it is also introduced in the rural sector further strengthening the economy.



Recent Developments

- Private lender HDFC Bank is planning to launch 500 mini branches, to be handled by one to three people, across India by the end of FY14. The bank has added about

219 mini branches pan-India since 2012. The basic motive behind such a initiative by the bank is to take the formal banking experience to people in unbanked and under-banked areas. A mini branch, manned by one, two or three persons, offers the entire range of products and services including savings and current accounts, fixed deposits, recurring deposits, credit card, instant debit card and also ATM facility. Products such as two wheeler loan, tractor loan, commercial vehicle loan, agricultural and commodities loan among others are also offered.

- Saudi Arabia's National Commercial Bank is said to have signed Tata Consultancy Services (TCS) to make India's largest software exporter implement its core banking platform for the former. TCS offers a plethora of retail banking solutions under BaNCS, a brand of core banking suite. National Commercial Bank intends to develop electronic services and provide technology-based banking solutions to its clients through this initiative.
- On the similar lines, ING Vysya Bank Ltd has appointed IBM and its 'MobileFirst' banking solution for the development of its ING Vysya Mobile - a cost effective, secure and scalable mobile banking application. The new application will help the bank maximise its reach to untapped markets. Moreover, the advanced features will enhance bank's involvement with its clients, facilitating higher availability and convenience.
- According to the Reserve Bank of India (RBI)'s 'Quarterly Statistics on Deposits and Credit of Scheduled Commercial Banks', March 2013, Nationalised Banks accounted for 52.4 per cent of the aggregate deposits, while the State Bank of India (SBI) and its Associates accounted for 22 per cent. The share of New Private Sector Banks, Old Private Sector Banks, Foreign Banks, and Regional Rural Banks in aggregate deposits was 13.6 per cent, 5.1 per cent, 4 per cent and 2.9 per cent, respectively.

  Nationalised Banks accounted for the highest share of 51 per cent in gross bank credit followed by State Bank of India and its Associates (22.7 per cent) and New Private Sector Banks (14 per cent). Foreign Banks, Old Private Sector Banks and Regional Rural Banks had shares of around 4.9 per cent, 5 per cent and 2.5 per cent, respectively.

- Banks' credit (loan) growth increased to 18 per cent for the fortnight ended September 6, 2013, while deposits grew by 13.37 per cent showed the data by RBI. India's foreign exchange reserves increased to US$ 277.73 billion as of October 4, 2013.

FDI in banking

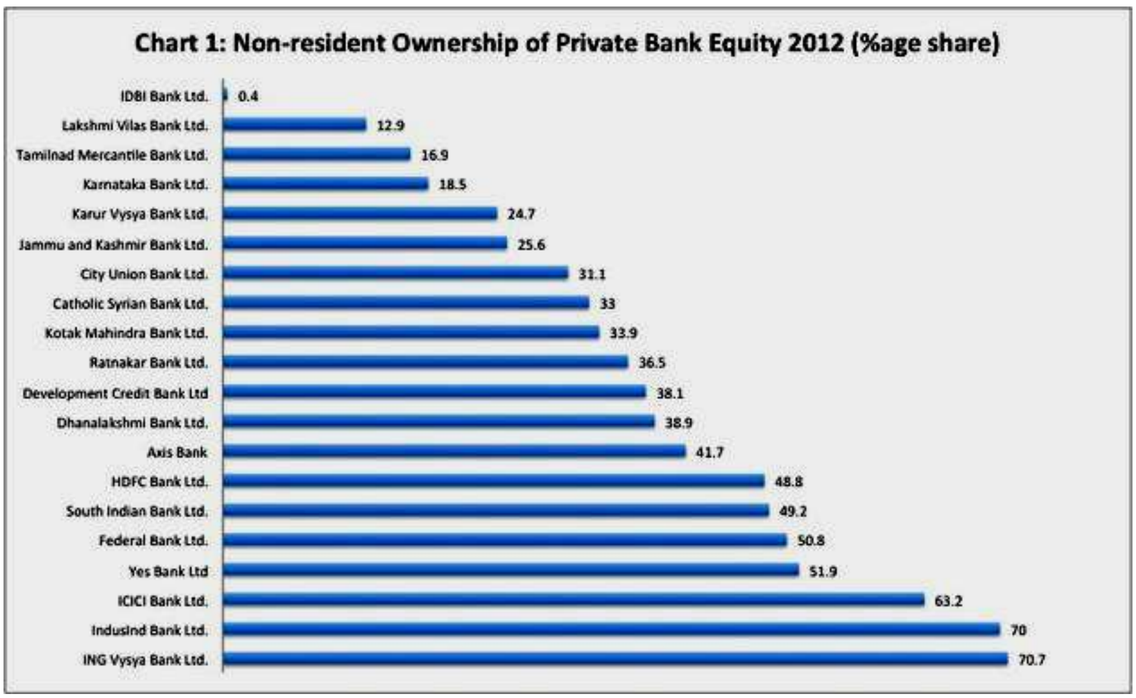
Reserve Bank of India issued a more detailed and comprehensive set of policy guidelines on ownership of private banks. Recognizing that the 5th March 2004 notification by the Union Government had hiked foreign investment limits in private banking to 74 per cent, the guidelines first clarified that this ceiling was applicable to the sum total of foreign investment in private banks from all sources (FDI, Foreign Institutional Investors, Non-Resident Indians).

More importantly, in the interests of diversified ownership the guidelines had declared that no single foreign entity or group could hold more than 10 per cent of equity. There was also a 10 per cent limit set for individual FIIs and an aggregate of 24 per cent for all FIIs, with a provision that this can be raised to 49 per cent with the approval of the Board or General Body. Finally, the 2004 guidelines set a limit of 5 per cent for individual NRI portfolio investors with an aggregate cap for NRIs of 10 per cent, which can be raised to 24 per cent with Board approval.

Finally, in keeping with this more cautious policy, the RBI decided to retain the stipulation under the Banking Regulation Act, Section 12 (2), that in the case of private banks the maximum voting rights per shareholder will be 10 per cent of the total voting rights (1 per cent for public banks). The 10 per cent ceiling on equity ownership by a single foreign entity was partly geared to aligning ownership guidelines with the rule on voting rights.

The response to this from liberalization advocates was that the whole exercise was pointless inasmuch as the ceiling on single investor ownership and voting rights would deter foreign investors. The evidence shows that this expectation has turned out to be completely false. As Chart 1 shows, the share of foreign investors in private bank equity exceeds 50 per cent in five banks and stands at between a third and a half in another eight. Moreover, Chart 2 shows that in a number of instances the share of foreign equity has increased between 2005 (when the guidelines had come into force) and 2012.

Problems arose only in the case of those entities in which single foreign entities held more than 10 per cent equity. This was, for example, true of the Development Credit Bank (which had the Aga Khan Fund for Economic Development as lead shareholder with around 25 per cent of equity) and the Catholic Syrian Bank (in which Surachan Chawla of the Siam Vidhya group from Thailand had acquired 36 per cent shares in the 1990s and has since been able to reduce the total to only 21 per cent). The problem faced by these entities is that of finding buyers willing to acquire small blocks of equity to ensure adequate dilution of lead stakeholder ownership in a bank being run by a dominant foreign shareholder. As a result they have been under pressure for not complying with the RBI’s demand to dilute equity and faced with threats of penal action.



The implication of this is clear. The problem with well-performing private banks is not that it is difficult to attract foreign equity investment. The problem is that current rules do not allow entry of those whose intent is to exercise control over a local bank with an adequate share holding and equivalent voting rights. Hence, if the need is to allow foreign equity infusion to meet prudential requirements such as the Basel norms that is still possible. The case for such regulation of foreign presence had been clearly specified in the past. The RBI has for long strongly advocated diversified ownership of banks. The RBI's Report on Trend and Progress of Banking in India, 2003-04 states: "Concentrated shareholding in banks controlling substantial amount of public funds poses the risk of concentration of ownership given the moral hazard problem and linkages of owners with businesses. Corporate governance in banks has therefore, become a major issue. Diversified ownership becomes a necessary postulate so as to provide balancing stakes."

A more elaborate exposition of the RBI's views on the matter came from Rakesh Mohan, a former Deputy Governor of the RBI. In a speech made at a Conference on Ownership and Governance in Private Sector Banking organised by the CII at Mumbai on 9th September 2004 he remarked:

The banking system is something that is central to a nation's economy; and that applies whether the banks are locally-or foreign-owned. The owners or shareholders of the banks have only a minor stake and considering the leveraging capacity of banks (more than ten to one) it puts them in control of very large volume of public funds of which their own stake is miniscule. In a sense, therefore, they act as trustees and as such must be fit and proper for the deployment of funds entrusted to them. The sustained stable and continuing operations depend on the public confidence in individual banks and the banking system. The speed with which a bank under a run can collapse is incomparable with any other organization. For a developing economy like ours there is also much less tolerance for downside risk among depositors many of whom place their life savings in the banks…Hence diversification of ownership is desirable as also ensuring fit and proper status of such owners and directors. It is evident that the RBI, which is the regulator of the banking sector, had a strong case for issuing elaborate guidelines on bank ownership to ensure diversification. Those reasons retain their relevance even today. So there is no case for altering them, especially if the evidence suggests that accessing foreign equity, if needed, to enhance the capital of banks is possible within the current regulatory framework.

Conclusion

In order to enhance financial inclusion in India, the RBI has taken an important step that has given banks conditional freedom to open branches in tier-I cities without seeking the central bank's approval in each case. Also, the RBI has relaxed the norms for banks borrowing through foreign currency. For bank borrowings exceeding half the unimpaired tier-I capital made on or before November 30, 2013, for availing of RBI's swap facility, the central bank lowered the maturity requirement from three years to a year. The initiative aims to attract foreign inflows, as it is easier to get loans for one year, rather than three years. However, borrowings taken after November 30, would have to have maturity period of three years. Thus we analyse that challenges in such a dynamic environment being faced by the Indian banks needs to be dealt seriously as due to hard core competition .The banks have their own functioning with policies, regulations & directions from RBI which is thriving very hard to combat the competition in the economy .The banks have always been the chord of connectivity of nation with population and after discussing challenges ,opportunities like management of expectations, management of risks we believe banks are still striving sense of stability The competition on global and technical parameters have made banks to rethink and reincorporate their structure and policies .

References

- Michael LaCour-Little, (2007), Economic Factors Affecting Home Mortgage Disclosure Act Reporting, Social Science Research Network.
- Edward Szymanoski , James C. Enriquez , Theresa R. DiVenti (2007), Home Equity Conversion Mortgage Terminations: Information to Enhance the Developing Secondary Market, Social Science Research Network.
- Michael LaCour-Little ,Eric Rosenblatt ,Vincent W. Yao(2009), Home Equity Extraction by Homeowners: 2000-2006, Social Science Research Network.
- Vipin C. Desai (2010), Potential for Mortgage Loan in India: A Survey Among the Senior Citizens of Vadodara, Gujarat, The IUP Journal of Bank Management, Vol. IX
- Gordon W. Crawford , Eric Rosenblatt(1995) : Discrimination and Racial Differences in Home Mortgage Interest Rates, Social Science Research Network.
- Linda E. Johnson, Herman Manakyan, Joel Philhours(1996) **:** Potential for Mortgage Loan in India: A Survey Among the Senior Citizens of Vadodara, Gujarat Social Science Research Network.
- Donald R. Haurin , Patric H. Hendershott , Susan M. Wachter (1996) : Borrowing Constraints and the Tenure Choice of Young Households
- C. Tsuriel Somerville (2002), Does the Lender Matter? Lender Type and Home Office Location and Real Estate Development Lending, Social Science Research Network.
- Michael C. I. Nwogugu, (2005), Prospective Home-Buyers' Propensity-to-Buy in the Housing Industry, Social Science Research Network.
- Signe-Mary McKernan , Ida Rademacher , Caroline E. Ratcliffe , Kasey Wiedrich , Megan Gallagher (2010), Weathering the Storm: Have IDA's Helped Low-Income Homebuyers Avoid Foreclosure?, Housing Policy Debate, Vol. 21, No. 4, 2011.
- Goyal, K. A. And Joshi, V. “A Study Of Social And Ethical Issues In Banking Industry”. International Journal Of Economics & Research, 2011 2(5): 49-57, 2011b.
- Goyal, K. A. And Joshi, V. “Mergers In Banking Industry Of India: Some Emerging Issues”.Asian Journal Of Business And Management Sciences, 1(2): 157-165, 2011a
- Dr. K.A. Goyal & Vijay Joshi International Journal Of Business Research And Management (Ijbrm), Volume (3) : Issue (1) : 2012 18.