

BANKING INDUSTRIES OPPORTUNITIES & CHALLENGES IN INDIA – AN OVERVIEW

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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. In these circumstances, this Paper is an attempt to review the banking system in our country.

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 IV (2019 onwards)-Merger and Acquisition of Public Sectors Banks

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 India Company. 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 next several decades until the beginning of the 20th century. Foreign banks too started to arrive, particularly in Calcutta in the 1860s. 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 work in the rural areas and make available cheap finance to Indian farmers.

Phase III (1991 onwards) Liberalization and its Aftermath: Today, Indian banking sector is 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. 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. There are currently 27 public sector banks in India out of which 19 are nationalized banks and 6 are SBI and its associate banks,

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 II 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).
- (vi) New Era of Banking-Payments Banks wef March 2017.(15)

The following is the list of active payments banks:^[20]

1. Airtel Payments Bank

2. India Post Payments Bank
3. Fino Payments Bank
4. Jio Payments Bank^[21]
5. Paytm Payments Bank
6. NSDL Payments Bank^[22]

Phase IV (2019 onwards)-Merger and Acquisition of Public Sectors Banks: The Indian banking system has achieved various milestones in a relatively short amount of time. This is the world's largest and most diverse democracy which itself is a challenge as the companies have to cater to such a diverse customer base. It is part and parcel of the agenda of the government to reform the banking sector by repositioning and integrating it into the global financial system. In the past years, there have been various reforms and successful mergers which have had a positive impact on the banking sector.

Example:

1. Punjab National Bank taking over "Oriental Bank of Commerce and United Bank of India".
2. The merger of Indian bank and Allahabad Bank.
3. The merger of Canara Bank and Syndicate Bank.
4. The merger of Union Bank of India with Andhra Bank and Corporation Bank.

As of August 2019, there were 27 public sector banks, but due to this practice of M&A, the number was reduced to 12. The merger of Punjab National Bank with Oriental Bank of Commerce and United Bank of India is considered to be the second-largest merger in the public sector undertakings.

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.

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 .
- **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.

- **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 device in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a device that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller.
- **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.
- **Tele - Banking:** It facilitates the customer to do entire non-cash related banking on telephone. Under this device 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:

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. 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.
- **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. 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, phishing etc. 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.. 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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