CHAPTER 24

BANKS

24.1 **Global Scenario & Indian Banking:** Since the Lehman Brothers declared bankruptcy in 2008, incidences, every now & then, have sustained the concerns over global financial stability. While most emerging market economies (EMEs), including India, have recovered from global financial crisis, advanced countries continue to be plagued with growth figures looking dismal. Euro zone crisis seems to be spreading across the EU countries following ripple effect, political turmoil persists in Middle East & North African (MENA) region, economic stagnation in US augurs no imminent respite from the worsening global situation. Indian banks, however, not only emerged unscathed from the global financial crisis but continued to manage growth with resilience during 2010-11.

24.2 Presently, domestic demand stays constrained on account of slower pace of growth & high level of commodity prices but favorable demographics & growth potential of Indian economy are expected to mitigate the dampening effect in the long run. As per Census 2011, about 40 % of households still do not avail banking facilities . Banks with their forward looking strategies, improved customer relationship, diversification of revenue sources etc are expected to continue their impressive performance.

24.3 **Development of Banking In India - Historical Perspective:** In India, the modern banking system was initiated with the establishment of the Presidency Bank of Bengal in 1806, and the Presidency bank of Madras in 1840.However, the post independence period witnessed the massive growth in the Indian banking sector. Reserve Bank of India, was nationalized on January 1, 1949 under the terms of the Reserve Bank of India Act,1948 . In 1949, the Banking Regulation Act was enacted which empowered the Reserve Bank of India to regularize, control and inspect the banks in India. The Banking Regulation Act also provided the number of new banks or branches of an existing bank would be opened with a license from the Reserve Bank of India.

24.4 The RBI acts as banker, both to the central government and state governments. It manages all the banking transactions of the government involving the receipt and payment of money. In addition, RBI remits exchange and performs other banking operations. RBI provides short-term credit to the central government. Such credit helps the government to meet any shortfalls in its receipts over its disbursements. RBI also provides short term credit to state governments as advances.

24.5 The issue department of RBI is dedicated to issuing currency. All the currency issued is the monetary liability of RBI that is backed by assets of equal value held by this department. Assets consist of gold, coin, bullion, foreign securities, rupee coins, and the government’s rupee securities.

24.6 Before Nationalization of Banks, despite control and regulation by Reserve Bank of India, banks in India except the State Bank of India continued to be owned and operated by private personnel. But by that time the Indian Banking Industry had grown in size and employed a large number of people thus became an important tool for the development of Indian economy. In order to ensure more equitable and purposeful distribution of credit on July 19, 1969 the Government of India issued an ordinance and nationalized 14 largest commercial Banks. In April 1980 six more commercial banks were nationalized. With nationalization of these banks the Government of India controlled an overwhelming majority of the banking business in India.

24.7 Besides the above developments, financial institutions were established for meeting the specialized needs. These include Industrial Development Bank of India (IDBI), Industrial Credit and Investment Bank of India for meeting the long – term financial needs of the large scale operations. Similarly for meeting the requirements of the Small Scale Industries (SSIs), State Financial Corporation (SFC), Small Industries Development (SIDC) and Small Industries Development Bank of India (SIDBI) have been established. The National Bank for Agriculture and Rural Development (NABARD), Land Development Bank (LDB), Regional Rural Bank (RRB) etc. has been established for taking care of the credit needs in the agriculture sector.

24.8 During 1990s India started opening up with changes in the economic policies and introduction of new institutional mechanisms of economic liberalization and financial sector reforms. The government, initially licensed small number of private banks which increased over the years. Now, the next stage for the Indian banking has been set up with the proposed relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks may be given voting rights which could exceed the present cap of 10%, at present it has gone up to 74% with some restrictions.

24.9 **Scheduled Commercial Banks:** The banks, which carry on business of banking in India and which are included in the second schedule to the Reserve Bank of India Act, 1934 are known as Scheduled Banks.

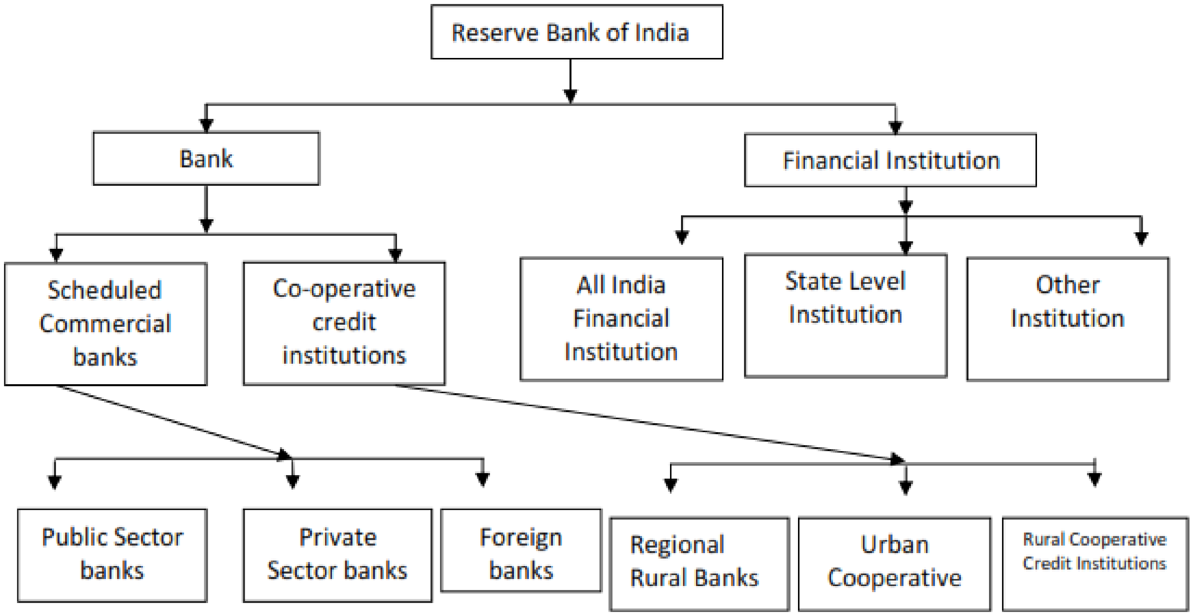
24.10 These include the State Bank of India, other Indian Banks and Foreign Banks.

(i) **State Bank of India:** The State Bank of India was formed in July, 1955 after the nationalization of the Imperial Bank of India.

(ii) **Other Indian Banks:** Indian banks are those who have their registered offices in India. These include Private Sector Banks, Associates of State Bank of India, 19 nationalized and Regional Rural Banks.

(iii) **Foreign Banks:** Foreign banks are those who have their registered offices outside India.

24.11 **Structure of Indian Banking Industry :**



24.12 **Changing Face of Indian Banking :** From traditional banking practices during the British Rule to reforms period , nationalization to privatization and to the present trend of increasing number of foreign banks, Indian banking sector has undergone significant transformation. The move from old to new business environment has created newer demands on Indian bank like enhanced work flow, full customer access to banking transactions through electronic mode etc. In the emerging scenario of fierce competition backed by twin force of deregulation and technology, the degree of competition in the Indian financial Sector has increased to unprecedented level. Hence the operational efficiency of banks has achieved immense significance for their survival in the present scenario. In contrast to earlier 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning, modern outlook and tech-savvy methods of working for traditional banks has been ushered. All this has led to the retail boom in India. People are not just demanding more from their banks but also receiving more. With easy credit facilities the banks are transforming the consuming propensity of Indians with everything from microwave owens to houses on sale at easy monthly installments EMIs. Using information technology, banks have upgraded their systems to provide better customer services. Automatic Teller Machines (ATMs) dispensing any time money are visible in most localities of big cities and consumers are increasingly responding to banking transactions without visiting the banks. Online and mobile banking has brought the banks virtually to their doorsteps. However, all this has exposed the banks to new kinds of risks. The familiarity between bank employees and customers has become increasingly remote. Though the banks distribute various back end and front end operations to minimize risk and use highly secure socket layers SSLs, digital certificates and facilities like virtual key boards to reduce the risks in online transactions, attacks like phishing and pharming have been on the rise .

Challenges & Opportunities Before the Banking Sector :

24.13 **Rural Markets:** Large number of people do not have access to banking facilities due to scattered and fragmented locations. Significant proportion of the same lies in rural areas where private banks have little incentive to invest. As per Census 2011 about 58.7 per cent households in India avail banking facilities. The proportion is less than 50 per cent in case of States like Bihar, Chhattisgarh, Odisha, West Bengal & North Eastern states like Manipur & Nagaland, Assam & Meghalaya. However, with increasing consumption levels of rural India & cut throat competition in urban markets, rural areas are gaining increasing importance. One example of the trend was the recent merger of Bank of Rajasthan with ICICI Bank Ltd which the latter resorted to in order to increase its reach in rural market and market share significantly.

24.14 **Increased competition:** Profits of banks are being affected by increased competition, with different public and private sector banks vying for increased share of customers. But increased competition has also resulted in increased efficiency, improved customer services and profitability in terms of returns on both equity and assets. Banks, now have to continuously innovate their practices to stay ahead in the market. Increasing competition, however, might also induce the banks to higher risk taking strategies.

24.15 **Management of Risks:** Researchers have found that Indian banks risk management capabilities has been improving over time. However cyber banking, existing global banking scenario etc have introduced newer types of risk. International regulatory norms have become more stringent in view of failure of many financial institutions.

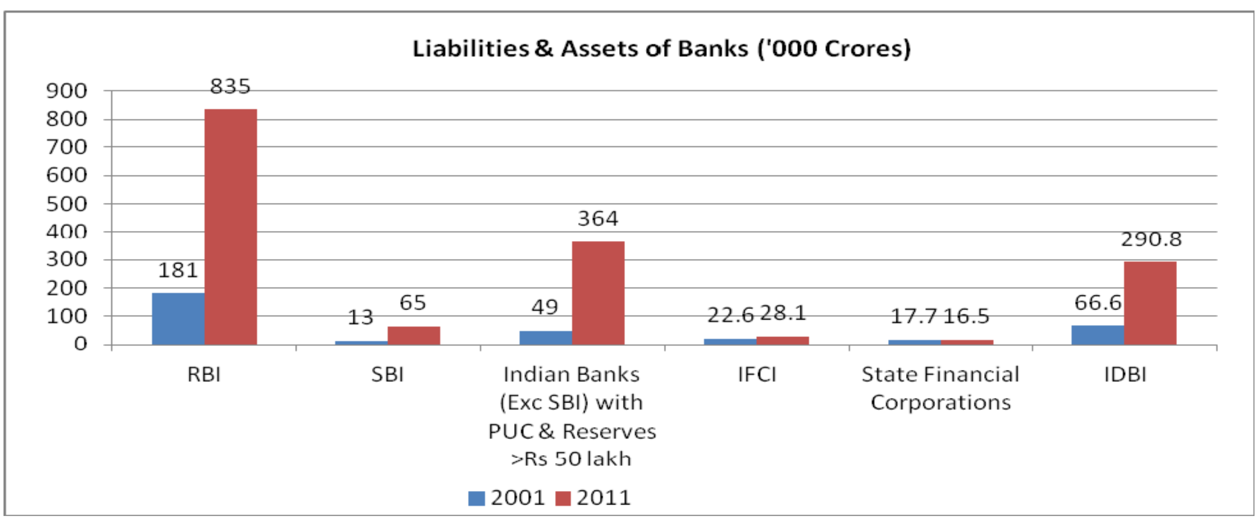
24.16 **Global & Domestic Environment:** Bankruptcy of Lehman Brothers Holdings Inc, fourth largest investment bank in US, in 2008, revealed financial instability in Global markets. Instability of soverign debt market in Euro zone continues as increasing number of countries in European Union face tough situation. Amidst worsening global scenario, banking rules & regulation framework of India has prevented it from economic crisis. But the stagnation & even recession in some global markets leading to lesser demand and slower pace of growth of Indian economy has constrained the credit uptake. However, Indian financial system is expected to remain robust on account of banks capability to withstand stress. However, a series of stress tests conducted by the Reserve Bank in respect of credit, liquidity and interest rate risks showed that banks remained reasonably resilient. However, under extreme shocks, some banks could face moderate liquidity problems and their profitability could be affected. In the long run, with high growth potential of the Indian economy and favourable demographics, banks have immense opportunities to further expand their business both with traditional and innovative products and through financial inclusion using technology enabled sustainable business models.

24.17 **Compliance with International Requirements :** In the background of recent global regulatory developments , **Basel III** largely aiming at higher and better quality capital; an internationally harmonised leverage ratio to constrain excessive risk taking;

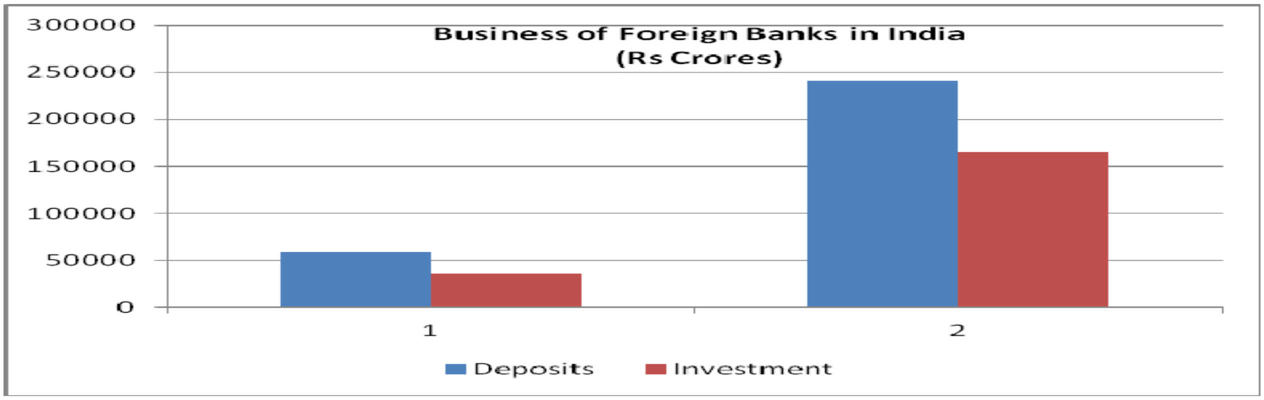
capital buffers which would be built up in good times so that they can be drawn down in times of stress; minimum global liquidity standards; and stronger standards for supervision, public disclosure and risk management, was introduced. A few individual banks may fall short of the Basel III norms and will have to augment their capital. Banks will also face challenges of upgrading risk management systems and meeting the credit needs of a rapidly growing economy even while adjusting to a more demanding regulatory regime. Introduction of **International Financial Reporting System (IFRS)** to facilitate comparability between enterprises operating in different jurisdictions, has also placed additional demands on Indian banks . In order to make the transition to IFRS they would have to handle accounting issues and upgrade their infrastructure including IT & human resource.

24.18 **Performance of Banking Sector :** Since the introduction of financial sector reforms about two decades ago, Indian Banking Industry has grown tremendously in volume & has become increasingly competitive. Considering assets & liabilities as an indicator of the scale of operations, impressive growth has been seen during the last decade except for the Financial Corporations. In fact, State Financial Corporations recorded a decline of about 7 per cent during the last decade. However, on the average, at least threefold increase was observed in case of RBI, SBI , IDBI and other Banks with SBI recording increase in asset & liabilities in 2011 by about four times of those at 2001 and the banks excluding SBI an increase by more than six times.

Assets & Liabilities of banks (Rs thousand Crores)	**2001**	**2011**	% increase
Reserve Bank of India , RBI	181	835	361%
State Bank of India, SBI	13	65	400%
Indian Banks (Excl SBI) with PUC & Reserves >Rs 50 lakh	49	364	643%
Industrial Finance Corporation of India, IFCI	22.6	28.1	24%
State Financial Corporations	17.7	16.5	-7%
Industrial Development Bank of India, IDBI	66.6	290.8	337%



24.19 Number of foreign banks decreased from about 42 in 2001 to 32 in 2011. However, the value of their deposits in India increased by more than three times from Rs 59190 Cr during 2001 to 2,40,689 Cr in 2011. In the same period value of their investment in India also increased by more than 3.5 times from Rs 35,761 Cr to 1,65,499 Cr.



Source of Data on Banking Statistics :

24.20 **Reserve Bank of India(RBI) :** Most of the Banking Sector Statistics flow from Reserve Bank of India, RBI. The database maintained by RBI includes weekly information on Forex reserve, Reserve Money & Bank Money, fortnightly information on Scheduled Banks statement of position in India, quarterly information on Balance of Payments, Banking Statistics – deposits & credits , Statewise & Region wise deployment of ATM's , Annual accounts data of scheduled commercial banks, branch banking statistics, profile of banks etc besides other occasional subjects. RBI brings out various reports on annual (Trend & Progress of Banking in India, Currency & Finance etc) , half yearly (Financial Stability Reports, Macro Economic & Monetary Developments and Report on Forex reserves),quarterly, monthly (RBI Bulletin) & weekly Basis(Weekly Statistical Supplement) .

24.21 The information on performance of State Financial Corporations is maintained by **Small Industries Development Bank of India , SIDBI** . Even though organizations like IFCI, IDBI maintain their own statistics , usually , the consolidated information is usually available with RBI. **National Bank for Agriculture & Rural Development (NABARD)** maintains information on rural credit .

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- Indian Banking Industry – Challenges & Opportunity , Dr K A Goyal & Vijay Joshi, International Journal of Business Research and Management (IJBRM), Volume (3) : Issue (1) : 2012