

Indian Banking Sector – Challenges and Opportunities



Ankur Singh
Assistant Lecturer,
Deptt. of Commerce,
Moulana Azad Institute,
Sitapur

Abstract

Banking in India in the modern sense originated in the last decades of the 18th century. Among the first banks were the Bank of Hindustan, which was established in 1770 and liquidated in 1829-32; and the General Bank of India, established in 1786 but failed in 1791. The largest bank, and the oldest still in existence, is the State Bank of India (S.B.I). It originated as the Bank of Calcutta in June 1806. In 1809, it was renamed as the Bank of Bengal. This was one of the three banks funded by a presidency government, the other two were the Bank of Bombay and the Bank of Madras. The three banks were merged in 1921 to form the Imperial Bank of India, which upon India's independence, became the State Bank of India in 1955. For many years the presidency banks had acted as quasi-central banks, as did their successors, until the Reserve Bank of India was established in 1935, under the Reserve Bank of India Act, 1934.

In 1960, the State Banks of India was given control of eight state-associated banks under the State Bank of India (Subsidiary Banks) Act, 1959. These are now called its associate banks. In 1969 the Indian government nationalised 14 major private banks. In 1980, 6 more private banks were nationalised. These nationalised banks are the majority of lenders in the Indian economy. They dominate the banking sector because of their large size and widespread networks.

The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks. The scheduled banks are those which are included under the 2nd Schedule of the Reserve Bank of India Act, 1934. The scheduled banks are further classified into: nationalised banks; State Bank of India and its associates; Regional Rural Banks (RRBs); foreign banks; and other Indian private sector banks. The term commercial banks refers to both scheduled and non-scheduled commercial banks which are regulated under the Banking Regulation Act, 1949.

Generally banking in India is fairly mature in terms of supply, product range and reach-even though reach in rural India and to the poor still remains a challenge. The government has developed initiatives to address this through the State Bank of India expanding its branch network and through the National Bank for Agriculture and Rural Development with facilities like microfinance.

Keywords: E-Banking, Customer Retention, Economic Reforms, Information Technology, lifestyle, GDP, CRM.

Introduction

The Indian banking can be broadly categorized into nationalized (government owned), private banks and specialized banking institutions. The Reserve Bank of India acts a centralized body monitoring any discrepancies and shortcoming in the system. Since the nationalization of banks in 1969, the public sector banks or the nationalized banks have acquired a place of prominence and has since then seen tremendous progress. The need to become highly customer focused has forced the slow-moving public sector banks to adopt a fast track approach. The unleashing of products and services through the net has galvanized players at all levels of the banking and financial institutions market grid to look anew at their existing portfolio offering. Conservative banking practices allowed Indian banks to be insulated partially from the Asian currency crisis. Indian banks are now quoting a higher valuation when compared to banks in other Asian countries (viz. Hong Kong, Singapore, Philippines etc.) that have major problems linked to huge Non Performing Assets (NPAs) and payment defaults. Co-operative banks are nimble footed in approach and armed with efficient branch networks focus primarily on the 'high revenue' niche retail segments.

The Indian banking has finally worked up to the competitive dynamics of the 'new' Indian market and is addressing the relevant issues

to take on the multifarious challenges of globalization. Banks that employ IT solutions are perceived to be 'futuristic' and proactive players capable of meeting the multifarious requirements of the large customers base. Private banks have been fast on the uptake and are reorienting their strategies using the internet as a medium. The Internet has emerged as the new and challenging frontier of marketing with the conventional physical world tenets being just as applicable like in any other marketing medium. The Indian banking has come from a long way from being a sleepy business institution to a highly proactive and dynamic entity. This transformation has been largely brought about by the large dose of liberalization and economic reforms that allowed banks to explore new business opportunities rather than generating revenues from conventional streams (i.e. borrowing and lending). The banking in India is highly fragmented with 30 banking units contributing to almost 50% of deposits and 60% of advances. Indian nationalized banks (banks owned by the government) continue to be the major lenders in the economy due to their sheer size and penetrative networks which assures them high deposit mobilization. The Indian banking can be broadly categorized into nationalized, private banks and specialized banking institutions. The Reserve Bank of India act as a centralized body monitoring any discrepancies and shortcoming in the system. It is the foremost monitoring body in the Indian financial sector. The nationalized banks (i.e. government-owned banks) continue to dominate the Indian banking arena. Industry estimates indicate that out of 274 commercial banks operating in India, 223 banks are in the public sector and 51 are in the private sector. The private sector bank grid also includes 24 foreign banks that have started their operations here. Under the ambit of the nationalized banks come the specialized banking institutions. These co-operatives, rural banks focus on areas of agriculture, rural development etc., unlike commercial banks these co-operative banks do not lend on the basis of a prime lending rate. They also have various tax sops because of their holding pattern and lending structure and hence have lower overheads. This enables them to give a marginally higher percentage on savings deposits. Many of these cooperative banks diversified into specialized areas (catering to the vast retail audience) like car finance, housing loans, truck finance etc. in order to keep pace with their public sector and private counterparts, the co-operative banks too have invested heavily in information technology to offer high-end computerized banking services to its clients.

Importance of Banking in India

Banking plays a rather remarkable role in Indian Economy. India is not only the world's largest independent democracy, but also a prominent, emerging economic giant. Without a sound and effective banking system, no country can ever have a health economy. Out of the top 10 banking institutions in the world, 3 of them are currently Chinese. Well, how did this happen? This happened because Chinese economy had a history of double digit

growth. Therefore in order to provide Funds, Chinese Banks grew in order to provide credit for China's Economic Development.

Likewise, same things will happen in India if the Indian economy grows in the near future. India will need bigger banks to finance it's government social projects, infrastructure funds like Digital India Initiative, Bullet Train Projects, etc.

Types of Banking System in India

Banking is defined as the accepting purpose of lending or investment of deposits, money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise- this definition is given in Indian Banking Regulation Act (1949). From this definition, we can say that a bank has two main features: (1) the bank accepts deposits of money which are withdrawable by cheques, (2) the bank uses the deposits for lending. To be recognised as bank the institution must use the deposits to give loans to the general public.

If an institution accepts deposits withdraw able by cheques but uses the deposits for its own purpose, such an institution cannot be regarded as a bank. Post office, savings banks are not banks, because they accept chequable deposits but do not sanction loans. In the same way. Lie is not bank because it does not grant loans in general. LITI, LIC, IDBI etc. are regarded as the non- banking financial institutions as they do not create money.

Types of Banks

Some Important Types of Banks in Countries Like India are Discussed Below

(a) Organized and Unorganized Banking

Indian Banking System can Broadly be Classified into Two Categories

1. Organized banking and
2. Unorganized banking.

That part of Indian banking system which does not fall under the control of our central bank (i.e. Reserve Bank of India) is called as un-organised banking. For example, Indigenous banks. Whereas, organized banking system refers to that part of the Indian banking system which is under the influence and control of the Reserve Bank of India. For example. Commercial Banks, Industrial Banks, Agricultural Banks.

(b) Scheduled and Non-Scheduled Banks

Under the Reserve Bank of India Act, 1939, banks were classified as scheduled banks and non scheduled banks.. The scheduled banks are those which are entered in the second schedule of RBI Act, 1939. Scheduled banks are those banks an which have a paid up capital and reserves of aggregate value of not less than Rs 5 lakhs and which satisfy RBI.

All Commercial Banks, Regional Rural Banks, State Cooperative Banks are scheduled banks. On the other hand, non-schedule banks are those banks whose total paid up capital is less than Rs 5 lakh and RBI has no specific control over these banks. These banks are not included in the second schedule of RBI Act, 1934.

(c) Indigenous Bankers

From very ancient days indigenous banking as different from the modern western banking has been organized in the form of family or individual

business. They have been called by various names in different parts of the country as Shroffs, Sethus, Sahukars, Mahajans, Chettis and so on. They vary in their size from petty money lenders substantial shroffs.

(d) Central Bank

In each country there exists central bank which controls a country's money supply and monetary policy. It acts as a bank to other banks, and a lender of last resort. India Reserve Bank of India (RBI) is the Central Bank.

(e) Commercial Bank

A bank dealing with general public, accepting deposits from making loans to large numbers of households and firms. Through the process of accepting deposits and lending, commercial banks create credit in the economy. Some examples (commercial banks in India are State Bank India (SBI), Punjab National Bank (PNB) etc.

(f) Development Banks

Development banks are specialised financial institutions. To promote economic development, development banks provide medium term and long term loans the entrepreneurs at relatively low rate of interest rates. Some examples of development banks in India are Industrial Development Bank of India (IDBI), Industrial Financial Corporation of India (IFCI), Industrial Credit and Investment Corporation of India (ICICI) etc.

(g) Co-Operative Banks

Co-operative banks are organised under the provisions of the Co-operative societies law of the state. These banks were originally set up in India to provide credit to the farmers at cheaper rates. However, the co-operative banks function also in the urban sectors.

(h) Land Mortgage Banks

The primary objective of these banks is to provide long-term loans to farmers at low rates in matters related to land, The land mortgage banks are also known as the Land Development Banks.

(i) Regional Rural Banks

Regional Rural Banks (RRBs) are established in the rural areas to meet the needs of the weaker section of the rural population.

(j) National Bank for Agricultural and Rural Development (NABARD)

This bank was established in 1982 in India in view of providing the rural credit to the farmers. Actually, it is an apex institution which coordinates the functioning of different financial institutions working in the field of rural credit. NABARD has been making continuous efforts through its micro-finance programme or improving the access of the rural poor to formal institutional credit. The self help group (SHG) – Bank linkage programme was introduced in 1992 as a mechanism to provide financial services to the rural poor people on a sustainable basis.

(k) Exchange Banks

These banks are engaged in buying and selling foreign exchange. These banks help the growth of international trade.

(i) Exim Bank

It is popularly known as 'Export Import Bank'. Such banks provide long term financial assistance to the exporters and importers.

Challenges of Banking in India:

As we know, banks expand their strategies for giving their customers the access to their accounts through various services like internet banking, mobile banking etc., they should also deem this emerging podium as a budding catalyst for engendering operational efficiencies & as a vehicle for new revenue sources.

Challenges faced by Indian Banks

The banking sector in India has made quick strides in restructuring & aligning itself to the new gung ho business environment. One of the major challenges that Indian banks are facing today is how to cope with competitive forces in order to strengthen their balance sheet. Nowadays, banks are whimpering with the burden of Non Performing Assets. It is truly felt that these debts, if not recovered, will eat into the very vitals of banks.

High Transaction Costs

High transaction cost of carrying non-performing assets in the books is the major concern of the Indian bank. The development led to strains in the operational efficiency & the accumulation of non-performing assets in loan portfolios.

Revolution of Information Technology

Banks in India are subject to great pressures to perform or else their very survival would be in jeopardy. The application of Information Technology & e-banking is becoming the order of the day with the banking system directing towards virtual banking.

Timely Technological Upgradation

In order to face competition, it is indispensable for Indian banks to soak up the technology & upgrade their services.

Intense Competition

The Reserve Bank of India & Indian Government kept banking industry unbolted for the participants of foreign banks and private sector banks. The foreign banks were also allowed to set up shop in India. Many new players have entered the market such as foreign banks, private banks, non - banking finance companies, etc. For growth and survival in the environment of cut throat competition banks have to follow the prompt and resourceful customer service, which calls for suitable customer centric policies & customer friendly procedures.

Opportunities in Indian Banking System

The Indian banking sector continues to face some structural challenges. We have a relatively large number of banks, some of which are sub-optimal in size and scale of operations. On the regulatory front, alignment with global developments in banking supervision is a focus area for both regulators and banks. The new international capital norms require a high level of sophistication in risk management, information systems, and technology which would pose a challenge for many participants in the Indian banking sector. The deep and often painful process of restructuring in the Indian economy and Indian industry has resulted in asset quality issues for the banking sector; while significant progress is being made in this area, a great deal of work towards resolution of these legacy issues still needs to be done. The Indian banking sector is thus at an exciting point in its evolution. The opportunities are immense – to enter new businesses and new markets, to develop

new ways of working, to improve efficiency, and to deliver higher levels of customer service. The process of change and restructuring that must be undergone to capitalize on these opportunities poses a challenge for many banks. The Indian banking sector is faced with multiple and concurrent challenges such as increased competition, rising customer expectations, and diminishing customer loyalty. The banking industry is also changing at a phenomenal speed. While at the one end, we have millions of savers and investors who still do not use a bank, another segment continues to bank with a physical branch and at the other end of the spectrum, the customers are becoming familiar with ATMs, e-banking, and cashless economy. This shows the immense potential for market expansion. The exponential growth for the industry comes from being able to handle as wide a range of this spectrum as possible. In this complex and fast changing environment, the only sustainable competitive advantage is to give the customer an optimum blend of technology and traditional service. As banks develop their strategies for giving customers access to their accounts through various advanced services like e banking, mobile banking and net banking, they should also regard this emerging platform as a potential catalyst for generating operational efficiencies and as a vehicle for new revenue sources. Banking industry's opportunities includes.

The Aim of Study

1. To promote and develop in India sound and progressive banking principles, practices and conventions and to contribute to the developments of creative banking.
2. To render assistance and to provide various common services to Members and to the banking industry.
 - a. To develop and implement new ideas and innovations in banking services, operations and procedures.
 - b. To organize co-ordination and co-operation on procedural, legal, technical, administrative or professional problems and practices of banks and the banking industry.
3. To initiate advance planning for introduction of new systems or services in the banking industry.
4. To collect, classify and circulate statistical and other information on the structure and working of the banking system.
5. To act as a clearing house for dissemination and exchange of statistical data, information, views and opinions on the systems, procedures and practices, and organization and methods of banks and on the structure, working and operations of the banking system.
6. To explore, plan, co-ordinate and organize detailed surveys on banking, business, resources, personnel and management development programmes of banks and the banking industry.
7. To pool together talents and resources available with members and to organize exchange of expertise and experiences of members for simplifying forms and procedures, for reducing cost of operations, for increasing efficiency and productivity and for such other common purposes as may be necessary or relevant to banks and the banking industry.
8. To organize exchange of credit information and opinions, export information or information and views on any other aspects of interest to banks or the banking industry.
9. To promote education and knowledge of the law and practice of banking.
10. To issue periodical newsletters, bulletins or magazines and publish books, pamphlets or other literature on matters of interest to members and to the banking industry.
11. To project a good public image of banking as a service industry and develop good public relations.
12. To promote harmonious personnel relations in banking industry and to devise ways and means for involving banking personnel in the endeavours of banks for growth and development of banking and the economy of the country.
 - a. To organize, promote and afford facilities for indoor and outdoor games, any form of sports, recreation, sports competitions, events, cultural activities, social activities, fine arts, social meetings, entertainments and to organize meetings for the above purposes and to provide for purposes by purchasing, acquiring, taking on lease, own, hire or otherwise playing fields, grounds, buildings, pavilions and other facilities.
 - b. To give financial assistance to individuals or bodies, from out of its own funds, or by collection from its members, or from any other source, and for the purpose of such collection, to accept grants, donations, etc. in cash or kind from Government, its members, other organizations, members of the public, etc. and to collect subscriptions, membership and other fees and to levy fees or charges for the use of the facilities and to raise funds in any manner to strengthen the financial position of the Association, from time to time, for the purpose of providing education, training and facilities for imparting basic, advance knowledge and techniques in games, sports, cultural activities, social activities, fine arts, etc. and to give donations, technical and other assistance, sports equipments, sports facilities and expert guidance to organizers for this purpose whether its members or not and to conduct, organize, participate or to associate itself in State-Level, Nation, International Tournaments and competitions pertaining to sports, cultural activities, social activities, fine arts, etc., held in or outside India.
 - c. To found, establish, develop and finance a separate body for the promotion of objects contained in Clauses n, nn, nnn, and generally, and to register it as a Society and/or Public Trust, or a Company under the provisions or relevant Acts, as the case may be.
13. To maintain continuous communications with the representatives of bank employees, to conduct

- talks, discussions, and negotiations with them and to arrive at Settlements.
14. To provide assistance and guidance to members in interpretation and implementation of Awards, Settlements, etc.
 15. To assist, advise and guide all members and the smaller members in particular on all their needs, difficulties and problems of growth, development and working.
 - a. To act as an agent or a representative of a member or members in respect of matters connected with any of their operations working or administration.
 16. To maintain close co-ordination and liaison with Reserve Bank of India, All Financial Institutions, Chambers of Commerce, Organisations of Banking Industry, Management or Educational Institutes, Universities and such other Organisations for realizing the subject and purposes of the Association.
 17. Generally to do all and any other thing that may be necessary or relevant for the realization of the objects and purposes of the Association directly or indirectly.
 18. To carry on publicity for the purpose of educating public opinion with regard to the scope, importance and activities of the banking industry, for creative growth and development.

19. To do all and such other things as are incidental or conducive to the attainment of any or all of the above objects.

Conclusion

In general, what banks do is pretty easy to figure out. For the average person banks accept deposits, make loans, provide a safe place for money and valuables, and act as payment agents between merchants and banks. However, other financial institutions exist that are not restricted by such regulations. Such institutions include: savings and loans, credit unions, investment and merchant banks, shadow banks, Islamic banks and industrial banks.

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