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Study of Growth and Development of Banking Industry in India

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Abstract:

Banking industries have always been branch of the tête-à-tête to not only set up trust but also to constitute a mechanism for the public private partnerships in an economy. They usually perform the function as lenders and investors in public private partnerships to help community to facilitate economic development deals and they perform that by trying to moderate the greater financial risk involved, for example, they work very attentively with tax credit deals, inexpensive housing developments, service to non-profit organisations that means funding along with servicing on their boards and these banks make a significant and an exceptional impact on our communities and societies. Banks have always played a significant role in economic and community development in our neighborhoods and throughout world. This paper aims at discussing the role and evaluation of banking industry in India.

Key words: Banking Industry, financial environment, economic development, India.

Introduction:

"India Shining" has always been the unofficial catchphrase for India in the 21st century, India managed an average annual GDP growth of 8% in the three years immediately before the recent global financial crisis throughout the world, having population strength of over one billion people, and it is now the 11th largest economy in the world in term of population. Economic development of India depends more on actual factors like the modernization of agriculture sector, industrial and financial development, organization and reconstruction of internal trade and expansion of foreign trade, and less on the monetary factors contributed by banking. Economic planning like laying down of definite targets and apportioning particular sums of money that form the economic policy of the government plays a considerable role as well. Notwithstanding that the importance of banking and the monetary mechanism cannot be ignored.

Objectives of the Study

- To explore role and evaluation of banking industry in India
- To underline the key transformational facts in the Indian Banking Industry.
- To investigate the current Scenario of banking sectors in India.

Methodology:

Present study is based on the secondary data. Indian Banking Industries' data were taken up from Report of RBI and other national agencies. The data were also collected from the different websites, journals, newspapers etc. Data have been analyzed with the help of Statistical tools like Mean, Percentage and IT tools like MS Excel, MS Word.

Review of literature:

A lot of endeavors have been completed so far to study the role and evaluation of banking industry in developed countries (Berger and Humphrey-**1997**, Berger et al.-**1999**, Isik and Hassan-**2002** and Yildirim and Philippatos-**2007**). On the other hand we do believe that studies evaluating the effectiveness of banking industries in developing countries like India are still modest. In their all-embracing international writing survey, Berger and Humphrey (**1997**) mentioned that the gigantic preponderance of the effectiveness literature centered on the banking-sector markets of considerably developed countries with meticulous emphasis on the USA markets. Fethi and Pasiouras (**2010**) provided a widespread survey on efficiency and effective studies of banking industries published in diverse literatures casing period **1998-2008**. They recognized over 151 studies that apply DEA to approximate various dealings of bank competence and efficiency growth, and other 30 studies which endow with parallel estimates at the branch level. More than 75% of the studies spotlight on competence and efficiency issues of banks in well-developed countries. *Rajaraman, India and G. Vasistha* (**2002**) explained the problem of NPA of Public Sector Bank in the Indian Scenareo his study brought into being a substantiation of significant bi-variant relationship between an operating inefficiency indicator and the non performing loans of public sector banks. *K. Kothai* (**2003**) in his paper "Non performing Assets of Scheduled commercial Banks in India: An Analysis", clearly observed a declining trend in the NPA's of SCB's, which was mainly due to writing off bad debts and spreading out the total advances. *S Balasubramanian* (**2007**) in his paper found that private sector banks do take part in an imperative role in development of Indian economy, Post liberalization the banking industry went through major modifications and the economic developments have totally distorted the banking sector. He further disclosed that with use of technology and professional management the situations have altered new generation banks which have now gained a reasonable position in the banking industry. *Singla* (**2008**) made a study on the financial performance of banks in India in view of increasing Globalization and increased competition in the banking industry, he observed that the financial situation of banking sector is logical, debt equity ratio is maintained at a satisfactory level on the other hand NPA's witnessed a declining figure during the study period. *R. Gauba* **(2012)** found that Indian Banks have managed to cultivate with buoyancy during the post reform era. However the Indian banking sector still has a large market to be explored. As per his findings, Indian households are one of the highest savers in the world with 69% of India gross national saving out of which only 47% is accessed by these banks on the other hand more than 50% of the population of India still unbanked with only 55 per cent of the population have a bank account while 9% Indian only have credit accounts.

Banking Industry in India

Banking Industry being a central component of financial institutions plays the essential functions of mobilizing funds from those individual and institution which have surplus funds to those individual and institution which have shortages of funds. Banking industries are dynamic in modern global economy, it consist of commercial banks, finance companies, credit unions, insurance sectors, savings and loan societies, saving banks, pension and mutual funds, and similar financial institutions.

Role of Banks in Indian Economy

Like other developing countries, In India also, the commercial banks have been the leading element in the country's financial and economic system. The Indian banking sector has played the key role of supplying liquidity and payment to the real sector. It has also witnessed to a number of the financial intermediation process. In addition institutionalizing savings the banking sector has added to the advancement of economic development by contributing as the most important source of credit supply to household requirement, government, and business organisations and to weaker and backward sectors of the economy such as village, small scale industries and agricultural sectors. Over 30-40% of gross household savings, have been in the shape of bank deposits while around 60% of the resources of all financial institutions accounted for by commercial banks only over the years. A significant milestone in the expansion of banking sector in India, recent years has been the commencement if reforms following the commendations of the first **"Narasimham Committee"** on Financial System. The Committee, by evaluating the strengths and weaknesses of these banks, recommended numerous measures to convert the Indian banking sector from a highly synchronized to more market oriented system and to make it able to fight effectively in an increasingly globalised environment. Most of the suggestions of **"Narasimham Committee"** especially those which related to rate of interest, an institution of prudential parameter and transparent accounting rules were in line with banking policy reforms executed by a host of developing countries since 1970.

Evaluation of Banking Industry in India

Pre-Independence

The Indian banking industry has flourished tremendously after India's independence. Though the Indian banking industry can be traced back in the year 1806 Bank of Bengal was established yet the industry was in a state of commotion.

Under the British influence, Calcutta observed a surge in trading activities by giving rise to lots of banking establishments during that period in the country, on the other hand a number of banks set up for finance trading, went out of business, for example, Union bank which was formed by Indian merchants, failed due to economic downturn during 1848-49 consequential in depositors losing their invested money. Such events witnessed shifting the control of the industry into the hands of European companies till the early 20th century.

Based on the doctrine of **'Swadesi Movement'** several banks were set up during the year 1906 to1911. Some of the famous ones among these banks are Corporation Bank, Bank of India, Bank of Baroda, Canara Bank, Indian bank, and Central bank of India.

Post-Independence

After India got freedom, the government took stringent steps to regulate the banking industry in the country, for example, in the year 1948, Reserve bank of India was empowered with additional powers and authority to observe the functioning of the whole banking system throughout the country. Banking Regulation Act was passed in 1949 and empowered Reserve Bank of India to further regulate, examine, and control Indian banks.

Nationalization and Liberalization

In the year 1969 and 1991 respectively the nationalization and liberalization of Indian banks also improved the expansion of the banking sector in India; nationalization resulted in 91% of government stake in the banking industry where liberalization paved the way for private leaders to take part in the Indian banking industry.

Nationalization

By the 1960s, All Banks except the State Bank of India (SBI) were owned and controlled by private persons, though they are under the regulations of the Reserve Bank of India. With more than 85% of total deposits with these banks, Indian banking industry was a significant tool to smooth the progress of the development of the Indian economy and it had emerged to be a great employer, what's more a debate started about the nationalization of the banking industry in India. In a paper entitled *"Stray thoughts on Bank Nationalization"* then Prime Minister of India, Indira Gandhi, in 'All India Congress Meeting' expressed the plan of the Government as to nationalization of Indian banking sectors. Thereafter, the Government of India issued an ordinance in the year 1969 and nationalised the 14 largest commercial banks.

A second measure of nationalisation of commercial banks followed in 1980 when 6 more banks were nationalised, which gave to the government more credit control of around 91% of the banking business of the country. In the year 1993, the government New Bank of India was merged with Punjab National Bank which was the only merger between nationalised banks in India, resulted in the diminution of the number of nationalised banks from 20 to 19. After nationalisation, banks achieved growth rate of around 4% till the 1990s which was closer to the average growth rate of the country.

Liberalization

Liberalization policy initiated in the early 1990s with an intention to the licensing a small number of private banks. Setting up New Generation tech-savvy banks was emphasised, Global Trust Bank became the first new generation bank set up under this policy, that later amalgamated with OBC (Oriental

Bank of Commerce), similarly UTI Bank re-named as Axis Bank and licensing ICICI Bank and HDFC Bank. This resulted into rapid and re-vitalised the banking sector in India, now the three sectors of banks - Government banks, Private banks and Foreign banks become backbone of Indian Economy.

Further with the proposed relaxation in the rule for foreign direct investment the the Banking sector in India changed completely. Use of 4–6–4 Model i.e. borrow at 4%; lending at 6% and go home at 4% became popular and new beckon steered in a modern position of tech-savvy methods of functioning.

Private Sectors

After nationalization of most banks in 1969, India slide towards financial communism, with Reserve bank which printed rupees on country's command. After new economic policy implemented in India in the year 1991, a wave of reform in banking sector took place. Today there are several well-run private banks in the country such as ICICI and HDFC but public-sector banks make 75% of all loans while foreign banks' market share is only 5%. RBI is now moderately sovereign, it not only sets the Bank rates but also it still influences the surge of credit to help the government and the poor sector of the country. Now every Bank must invest 23% of their overall deposits with government in form of bonds and has to keep 4% with the Reserve Bank. In this way a captive market is created for public debt. Further a sum of 40% of loans needs to be directed towards "priority sectors" and mainly for agriculture. In this way 58% of the deposits of banks are used according to the preference of the government.

Now Private Banks in India are not charities only, some of them effort to congregate sufficient deposits to flourish. Tremendous expansion of its branches certainly will help them but it might not all the time be profitable. If industrial houses like Reliance Group are licensed they may use their powerful brand image to magnetize a flow of deposits but it might ponder powers in the hands of a selective one and as a result of which may lead to indictment of cronyism.

The Current Scenario

RBI is now trying to reform at a low-point in the economic cycle which has created its own problems. But question arises whether this initiative would really be helpful to cope up with India's bad debts problems? It appears to be tough. If RBI raised interest rates above its CPI, investors would put your hands together but growth would fall in the long run and soon after a financial fright and a dangerous thorn in succumbs, it will be almost impossible for the Reserve Bank to deregulate the bond market in the country. In mid-November of 2013 RBI governor Sri Raghuram Rajan said that RBI will again interfere to put a stop to "liquidity tightness". The Reserve Bank now possesses at least 17% of all central government bonds which is the highest level ever since the crisis years of the early ninetieth and it now possess much of its local bond market in comparison with the Federal Reserve (Figure 1).

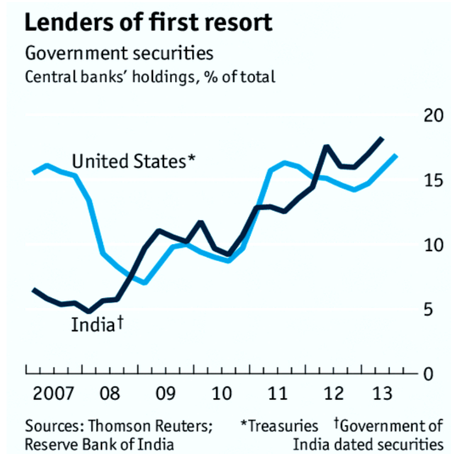

Figure 1

The banks and the financial institutions provide another important need of the society too such as mopping up small savings of individuals at cheap rates with several options available. An individual has the option to invest his savings under a available alternatives, this include the small savings schemes from time to time launched by the government and in bank savings accounts, recurring deposits etc. While to invest in mutual funds or the stock is the other option.

Despite traditional roles mentioned above these institutions also carry out certain modern functions which are probably the result thoughts made of decades ago. Internet and mobile banking enable a consumer to operate and access the account easily at their convenience even without going to the bank. On the other hand ATM facilities and the Debit cards and credit cards has modernized the available choices of customers across the world. These banks also cater to alternative options for making transactions for payment of Income tax, payment of various bills and online purchase through internet. Customers today can directly invest by using internet and online options through their account. In ever changing economy, especially when people have less time to make these transactions by standing in queue. In this way the services provided by banking and financial sectors to the consumers are really commendable.

Conclusion:

Indian banking system and Financial Institutions perform very significant functions in the economy, the first and foremost in this regard, is in the form of serving the need of credit for all the segments of the economy. Almost all the modern economies in the entire world have developed primarily by ensuring best use of the credit availability in their economic systems. An efficient banking system must serve the requirements of high end investors by making high amounts of capital available for crucial projects in the industrial, infrastructural and service sectors of the country. Simultaneously, the medium and small ventures should have credit available to them aiming at new investment and development of the existing units. Indian rural sector can grow up only if cheaper and easy credit is accessible to the farmers for their short term and medium term requirements.

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