Indian Banking Industry : An Overview

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Abstract

Banking is today an integral part of our everyday life: At home, at school, at office, at business, on travel everywhere we counter some aspect of banking. The significance of banking in our day to day life is being felt increasingly. Banking and finance is the life blood of trade, commerce and industry. Now a days, banking sector acts as the backbone of modern business. The banks play a major role in the development of the country, the strategic capital formation is possible only through mobilization of funds, such capital formation arises when the habit of saving inculcated among public. It deals with accepting deposits from those who want to save money and it lends money to those who need it.

In today's world, the banking is one of the most essential and important part of human life. Money plays a dominant role in today's life. Forms of money have evolved from coin to paper currency notes to credit cards. Commercial transactions have increased in content and quantity from simple banker to speculative international trading. In current faster life style, people may not do proper transition without developing proper network.

The banking system in India is dominated by nationalized banks. The performance of the banking sector is mainly linked to economy more than any other sector.Banking industry in India has also achieved new height with the changing times. The use of technology has brought a revolution in the working style of the banks. Nevertheless, the fundamental aspects of banking that is trust and confidence of the people on the institution remain the same. The majority of the banks are still successful in keeping with the confidence of the shareholders as also the stakeholders. However with the changing dynamics of banking business also brings new kind of risk exposure.

Evolution of Indian banking industry

'Bank' is mostly used in its commercial sense i.e. Commercial Bank. Germanic is its origin though some persons trace its origin to the French word 'Banqui' and the Italian word 'Banca'. It referred to a bench for keeping, lending, and exchanging of money or coins in the market place by money lenders and money changers. Before1640, there was no such word as banking.The practice of safe keeping and savings was succeeded from the temple of Babylon as early as 2000 B.C. Chanakya mentioned in his book about 300 B.C. about the existence of powerful society of merchant bankers who received deposits and advanced loans and issued letters of transfer. The Jain scriptures mention the names of two bankers who built the famous Dilware Temples of Mount Abu during 1197 and 1247 A.D.

In 1157, the 'bank of Venice' was the first bank in the world which was established in Venice, Italy. This bank was established for the emperor in his wars. The bankers of Lombardy were famous in England. After 1640, the modern banking system began with the English goldsmiths. In India, first bank was " bank of Hindustan" which was introduced by east India company in 1770 which is fully foreign capitalistic bank. But this bank was failed in 1782. Then "Bank of Bangal" was established in 1806 which was one of the presidency bank and first bank in the modern sense.

History apart, it was the 'merchant banker' who first evolved the system of banking by trading in commodities than money. Their trading activities required the remittances of money from one place to another. For this, they issued letters of transfer to remit funds. In India, such merchant bankers were known as 'Seths'.

The next stage in the growth of banking sector was the goldsmith. The business of goldsmith was such that he had to take special precautions against theft of gold and jewellery. If he seemed to be an honest person, merchants in the neighbourhood started leaving their bullion, money and ornaments in his care. As this practice spread, the goldsmith started charging something for taking care of the money and bullion.

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As evidence for receiving valuables, he issues a receipt. Since gold and silver coins had no marks of the owner, the goldsmith started lending them. As the goldsmith was prepared to give the holder of the receipt and equal amount of money on demand, the goldsmith receipt became like cheques as a medium of exchange and a means of payment.

The next stage in the growth of banking is the moneylender. The goldsmith found that on an average the withdrawals of coins were much less than the deposits with him. So he started advancing the coins on loan by charging interest. As a safeguard, he kept some money in the reserve. Thus the goldsmith-money-lender became a banker who started performing the two functions of modern banking, that of accepting deposits and advancing loans.

History of Indian banking system

The story of Indian coinage itself is very vast and interesting, and also throws tremendous light on the various aspects of life during different periods. The Rig Veda speaks only gold, silver copper and bronze and the later Vedic texts also mention tin, lead, iron and silver. Recently iron coins were found in very early levels at AttranjiKheri(U.P.) and Pandu RajarDhibi (Bengal). A money economy existed in India since the days of Buddha.

In ancient India during the Maurya dynasty (321 to 185 BC), an instrument was in use which is called adesha, which was an order on a banker desiring him to pay the money of the note to a third person, which corresponds to the bill of exchange as we understand it in modern language. During the Buddhist period, there was considerable use of these instruments. Merchants in large towns gave letters of credit to one another.

Indigenous banking grew up in the form of rural money lending with certain individuals using their private funds for this purpose. The scriptures singled out the vaishyas as the principal bankers. The earliest form of Indian Bill of Exchange was called “Hundi”. In earliest form of India, barter system is used for export and import.

The origin of "rupee" is found in the word Sanskrit rūpya and also from the word "rupa" meaning silver. The standardisation of currency unit as Rupee in largely due to Sher Shah in 1542. The English traders that came to India in the 17th century could not make much use of the of indigenous bankers, owing to their ignorance of the language as well the inexperience indigenous people of the European trade. Therefore, the English Agency Houses in Calcutta and Bombay began to conduct banking business, besides their commercial business, based on unlimited liability. The Europeans who resigned from civil and military services, organized these agency houses."

Banking in India, in the modern sense, originated in last decade of 18th century. The first bank was the "Bank of Hindustan", established in 1770 and it was fully foreign capitalistic bank and liquidated in 1829–32. After establishment of Bank of Hindustan, East India company established the "General bank of India" in 1786, but failed in 1791.

East India company also established three presidency banks. There were “Bank of Bengal”,2806, “Bank of Bombay” in 1840 and “Bank of Madras” in 1843. The oldest bank in existence in India is the Sate 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 in Calcutta. In 1921, all presidency banks were merged to form a new bank which is “Imperial bank of India”. Imperial bank of India, which after India's independence, became the state bank of India.

For many years, the presidency banks acts as quasi central banks, as did there successors. The Reserve bank of India formally took on the responsibility of regulating the Indian banking sector from 1935. After India's independence in 1947, Reserve bank of India (RBI) was nationalized. This was the first revolution in Indian banking sector to get nationalization of Reserve bank of India on 1 January, 1949. To control the banking system in India, government made the Banking Companies Act, 1949, but subsequently change the name of Banking Companies Act, 1949 , as a Banking regulation Act, 1949. Later Imperial bank of India was nationalized by government and changed the name as the State bank of India on 1 July, 1955. And eight associate banks of State bank of India came in existence. These associate banks are - State bank of Partial, state bank of Bikaner, State bank of Jaipur, State bank of Hyderabad, State bank of Travencore, State bank of Maysore, State bank of Indore and State bank of Saurashtra.

By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the nationalisation of the banking industry. Indira Gandhi, the then Prime Minister of India, expressed the intention of the Government of India in the annual conference of the All India Congress Meeting in a paper entitled "Stray thoughts on Bank Nationalization." The government of India nationalised the 14 largest commercial banks with effect from the midnight of 19 July 1969. These banks contained 85 percent of bank deposits in the country. A second process of nationalisation of 6 more commercial banks followed in 1980. The stated reason for the nationalisation was to give the government more control of credit delivery. With the second process of nationalisation, the Government of India controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalised banks and resulted in the reduction of the number of nationalised banks from 20 to 19.

Government of India took many banking initiatives. These were aimed to provide banking coverage to all section of the society and every sector of the economy. The Industrial Credit and Investment Corporation of India Limited (ICICI) was incorporated at the initiative of World Bank, the Government of India and representatives of Indian industry, with the objective of creating a development financial institution for providing medium-term and long-term project financing to Indian businesses.

Nationalization of Banks

Nationalization of banks in India was an important phenomenon. Despite the provisions, control and regulations of Reserve Bank of India, banks in India except the State Bank of India or SBI, continued to be owned and operated by private persons. By the 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the nationalization of the banking industry. Indira Gandhi, then Prime Minister of India, expressed the intention of the Government of India in the annual conference of the All India Congress Meeting in a paper entitled "Stray thoughts on Bank Nationalization." The meeting received the paper with enthusiasm.

It is the process of transforming private assets into public assets by bringing them under the public ownership of a national government or state. Banking system in India is dominated by nationalized bank. After independence, the first revolution in Indian banking sector to get nationalization of RBI on 1 January, 1949. To control the banking companies Act, 1949, but subsequently change the name of Banking companies Act, 1949, as a Banking regulation Act, 1949.

On 1 July,1955, Imperial bank of India was nationalized by government and changed the name as a State Bank of India. And 8 associate banks of State bank of India. These are State bank of Bikaner and Jaipur, State bank of Hyderabad, State bank of Partial, State bank of Travencore, State bank of Maysore, State bank of Indore and State bank of Saurashtra. The process of nationalization of Banks in India took place in 1969 by Mrs. Indira Gandhi (P.M. of India). The major objective behind the nationalization was spread banking infrastructure in rural areas and make available cheap finance to Indian farmers. 14 banks were nationalized in 1969. Before 1969, SBI was the only public sector bank in India.

The government had in February approach the merger of these five associate banks with SBI. Later in March, the Cabinet approved merger of BMB as well. SBI first merged State bank of Saurashtra with itself in 2008. Two years later, State bank of Indore was merger with it. Later five associates and the BharatiyaMahila Bank became part of the SBI on Saturday, 1 April, 2017, catapulting the country's largest lender to among the top 50 banks in the world.

The merger will also means that all SBI associate bank customers will become SBI customers and all associate bank employees will become SBI Employees. So all associate bank employees will be eligible for the same retirement benefits as SBI employees. SBI employees get 3 retirement benefits (Provident fund, gratuity and pension), while associate bank staff members get 2 retirement benefits.

Liberalisation in the 1990s

The second major turning point in this phase was Economic Liberalization in India. After Independence in 1947, India adhered to socialist policies. The extensive regulation was sarcastically dubbed as the "License Raj". The Government of India headed by Narasimha Rao decided to usher in several reforms that are collectively termed as liberalization in the Indian media with Manmohan Singh whom he appointed Finance Minister. Dr. Manmohan Singh, an acclaimed economist, played a central role in implementing these reforms.

In the early 1990s, the NarasimhaRao government embarked on a policy of liberalisation, licensing a small number of private banks. These came to be known as New Generation tech-savvy banks, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce, UTI Bank (since renamed Axis Bank), ICICI Bank and HDFC Bank. This move, along with the rapid growth in the economy of India, revitalised the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreignbanks.

The next stage for the Indian banking has been set up, with proposed relaxation of norms for foreign direct investment. All foreign investors in banks may be given voting rights that could exceed the present cap of 10% at present. It has gone up to 74% with some restrictions. The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4–6–4 method (borrow at 4%; lend at 6%; go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India. People demanded more from their banks and received more.

Currently (2007), banking in India is generally fairly mature in terms of supply, product range and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. The Reserve Bank of India is an autonomous body, with minimal pressure from the government. The stated policy of the Bank on the Indian Rupee is to manage volatility but without any fixed exchange rate-and this has mostly been true. With the growth in the Indian economy expected to be strong for quite some timeespecially in its services sector-the demand for banking services, especially retail banking, mortgages and investment services are expected to be strong.

Current period

The Indian banking sector is broadly classified into scheduled banks and non-scheduled banks. All banks included in the Second Schedule to the Reserve Bank of India Act, 1934 are Scheduled Banks. These banks comprise Scheduled Commercial Banks and Scheduled Co-operative Banks. Scheduled Co-operative Banks consist of Scheduled State Co-operative Banks and Scheduled Urban Cooperative Banks. Scheduled Commercial Banks in India are categorised into five different groups according to their ownership and/or nature of operation:*.State Bank of India and its Associates*.Nationalised Banks*.Private Sector Banks*.Foreign Banks*.Regional Rural Banks. In the bank group-wise classification, IDBI Bank Ltd. is included in Nationalised Banks. By 2010, banking in India was generally fairly mature in terms of supply, product range and reach-even though reach in rural India still remains a challenge for the private sector and foreign banks. In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region. The Reserve Bank of India is an autonomous body, with minimal pressure from the government.

State Bank of India (SBI) posted quarterly results that indicated the nation's lenders may see a slower build-up of bad loans, but questions remain on how quickly and smoothly they can get rid of $146 billion of such debt that has already piled up. SBI, the nation's top lender with a share of more than fifth of the banking assets, reported on Friday a lower-than-expected profit, but its bad loan additions during the three months to end-September slowed sharply and pushed the overall bad-loan ratio down. SBI, which has the biggest share of the soured loans, merged its five subsidiary banks with itself earlier this year, driving a jump in its non-performing loans as of June to almost 10 percent. That ratio eased to 9.83 percent at end-September, while the additions to bad loans during the quarter was nearly a third of the rise in the previous three months.

Bank of India, the market's sixth-biggest lender by assets which also reported on Friday, posted a better-than-expected 41 percent rise in second-quarter profit and a narrower bad-loan ratio. The banking sector faces a rise in provisions for loan losses after a central bank order to cover at least 50 percent of the loans to companies being sent to bankruptcy court. A dozen of the biggest loan defaulters are already at the bankruptcy court, while nearly 30 more could be headed there after December. SBI shares closed 6.3 percent higher in a Mumbai market that ended up 0.12 percent on Friday. The stock has gained about 30 percent in the past one month to be the second-best performer among the constituents in the main market index.

Conclusion

Banks have come a long way from the temples of the ancient world, but their basic business practices have not changed. The bank accepts deposits from general public who wants to save money and provide loans and advances to whom who need it. Banks issue credit to people who need it, but demand interest on top of the repayment of the loan. Although history has altered the fine points of the business model, a bank's purpose is to make loans and protect depositors' money. The reason behind this study is to provide insight into the Indian banking sector/ industry with focus on nationalization of Bank, both in retrospective and prospective perspectives. The study is build as a humble contribution to achieve the goal. Even if the future takes banks completely off your street corner and onto the internet, or has you shopping for loans across the globe, the banks will still exist to perform this primary function.

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