A Study of Indian Banking Industry

Sonika Malik (commerce) net

Abstract: Finance and Banking is the life blood of trade, commerce and industry. Now- days, banking sector acts as the backbone of modern business. Development of any country mainly depends upon the banking system. A bank is a financial institution which deals with deposits and advances and other related services. It receives money from those who want to save in the form of deposits and it lends money to those who need it. The banking is one of the most essential and important parts of the human life. In current faster lifestyle peoples may not to do proper transitions without developing the proper network. The banking system in India is dominated by nationalised banks. The objective of this paper is to study about the banking industry of India. This study contains the history, structure, functions and growth of Indian banking industry. This paper is a small contribution to the existing vast knowledge of banking industry and will be useful for bankers, industrialist, policy maker and researchers.

Keywords: Indian Banking Industry, Money Supply, Reserve Bank of India, Finance, commercial banking, Indian economy, empirical, total factor productivity index.

Introduction: As per the Reserve Bank of India (RBI), India's banking sector is sufficiently capitalised and well-regulated. The financial and economic conditions in the country are superior to any other country in the world. Credit, market and liquidity risk studies suggest that Indian banks are generally resilient and have withstood the global downturn well. Indian banking industry has recently witnessed the roll out of innovative banking models like payments and small finance banks. The central banks granted in- principle approval to 11 payments banks and 10 small finance banks in FY2015-2016. RBI's new measures may go a long way in helping the restructuring of the domestic banking industry. In the past three decades, India's banking system has earned several outstanding achievements to its credit. The most striking is its extensive reach. It is no longer confined to metropolises or cities in India. In fact, Indian banking system has reached even to the remote corners of the country. This is one of the main aspects of India's growth story.

1. Needs of banks: before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interst rate were very high. Again there were no security of public saving and no uniformity regarding loans. So as to overcome such problems the organised banking sector was established which was fully regulated by government. The following functions explain the need of the bank and its importance:-

- To provide the security to the savings of customers.

- To control the supply of money and credit.
- To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions.
- To set equal norms and conditions (i.e. rate of interst, period of lending etc) to all types of customers.

2. History of Indian Banking Industry:

The origin of western type commercial banking in India dates back to the 18the century. The story of banking starts from bank of HINDUSTAN established in 1770 and it was 1st bank at CALCUTTA under European Management. It was liquidated in 1830-32.

From bank of HINDUSTAN in 1770, the evolution of banking in India can be divided into four different periods as follows:-

- Phase- 1: Pre- nationalisation phase (prior to 1955).
- Phase-2: Era of nationalisation and consolidation (1955-1990).
- Phase-3: Introduction of Indian financial and banking sector reforms and partial liberalisation (1990-2004).
- Phase-4: Period of increased liberalisation (2004 onwards).

In 1786 General Bank of India was set up. Since Calcutta was the most active trading part in India, mainly due to the trade of the British Empire. It became a Banking sector. Three Presidency banks were set up under charters from the British East India Company-Bank of Madras. These worked as quasi control banks in India for many years.

The Bank of Calcutta established in 1806 immediately became Bank of Bengal. In 1921 these three banks merged with each other and Imperial Bank of India got birth. Imperial Bank of India was letter renamed in 1955 at the State Bank of India. Thus State Bank of India is the bank of India.

In 1939, there was a fruitless effort by Indian Merchants to establish a bank called Union Bank. It failed within a decade. Next came Allahabad Bank which was established in 1865 and working even today. The oldest public sector Bank in India having branches all over India and serving the customers for the last 145 years is Allahabad Bank. Allahabad Bank is also known as one of the India’s oldest Joint Stock Bank. However, the oldest Joint Stock bank of India was Bank of Upper India established in 1863 and failed in 1913.

The 1st bank of India with limited liability to be managed by Indian board was Oudh commercial bank. It was established in 1881 at Faizabad. This bank failed in 1958. The 1st bank purely managed by Indians was Punjab National Bank, established in Lahore in 1895. The Punjab national bank has not only survived till date but also is one of the largest bank in India. However, the 1st India commercial bank which was central bank of India which was established in 1911. So, central bank of India is called India's firstly truly SWADESHI BANK.

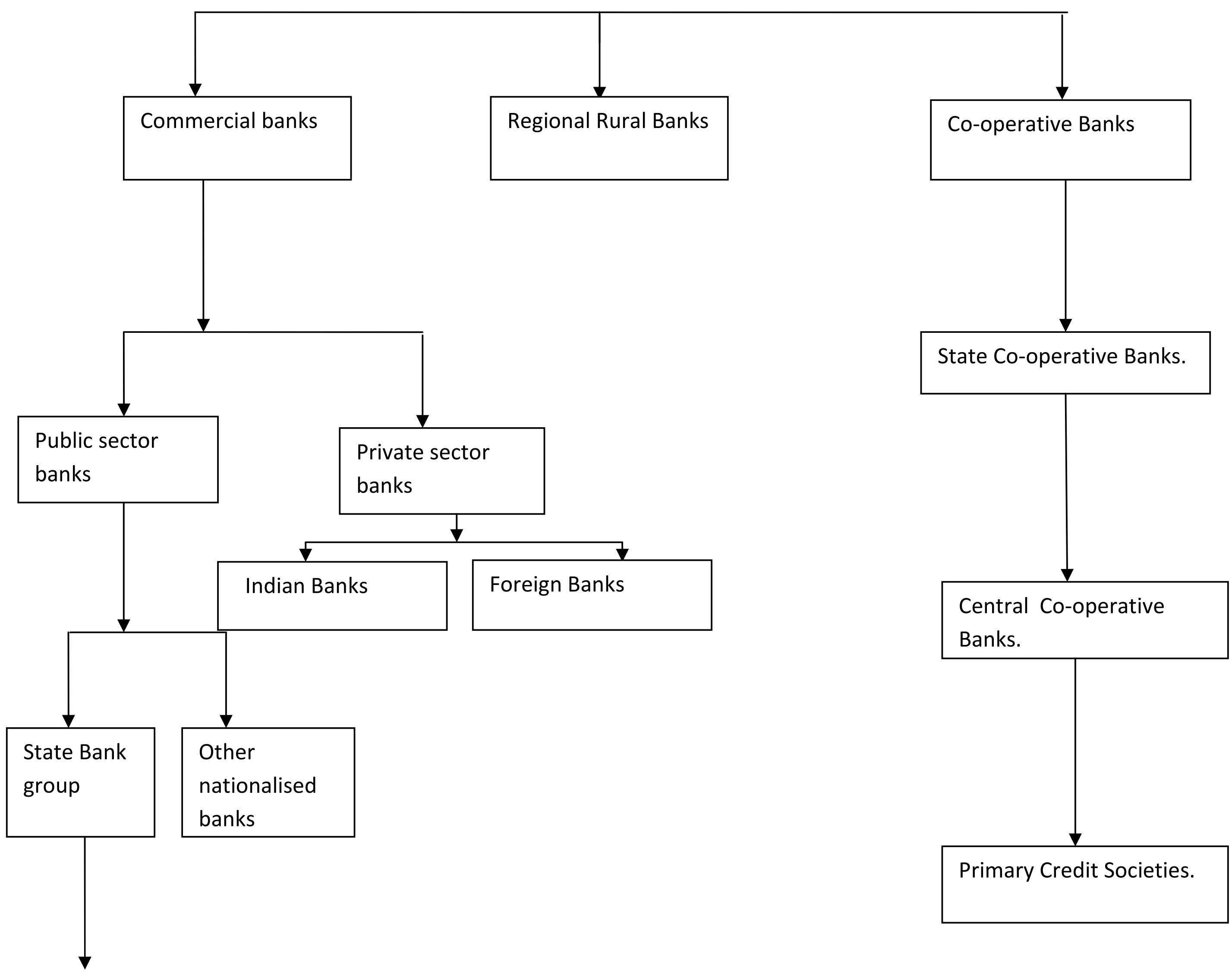
3. Structure of Indian Banking Industry:

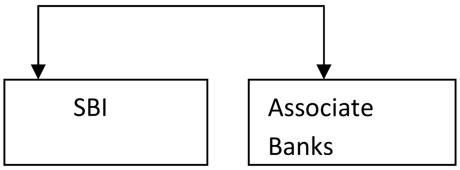
The organised banking system in India can be classified as given below diagram-

INDIAN BANKING SYSTEM

RESERVE BANK OF INDIA (RBI)

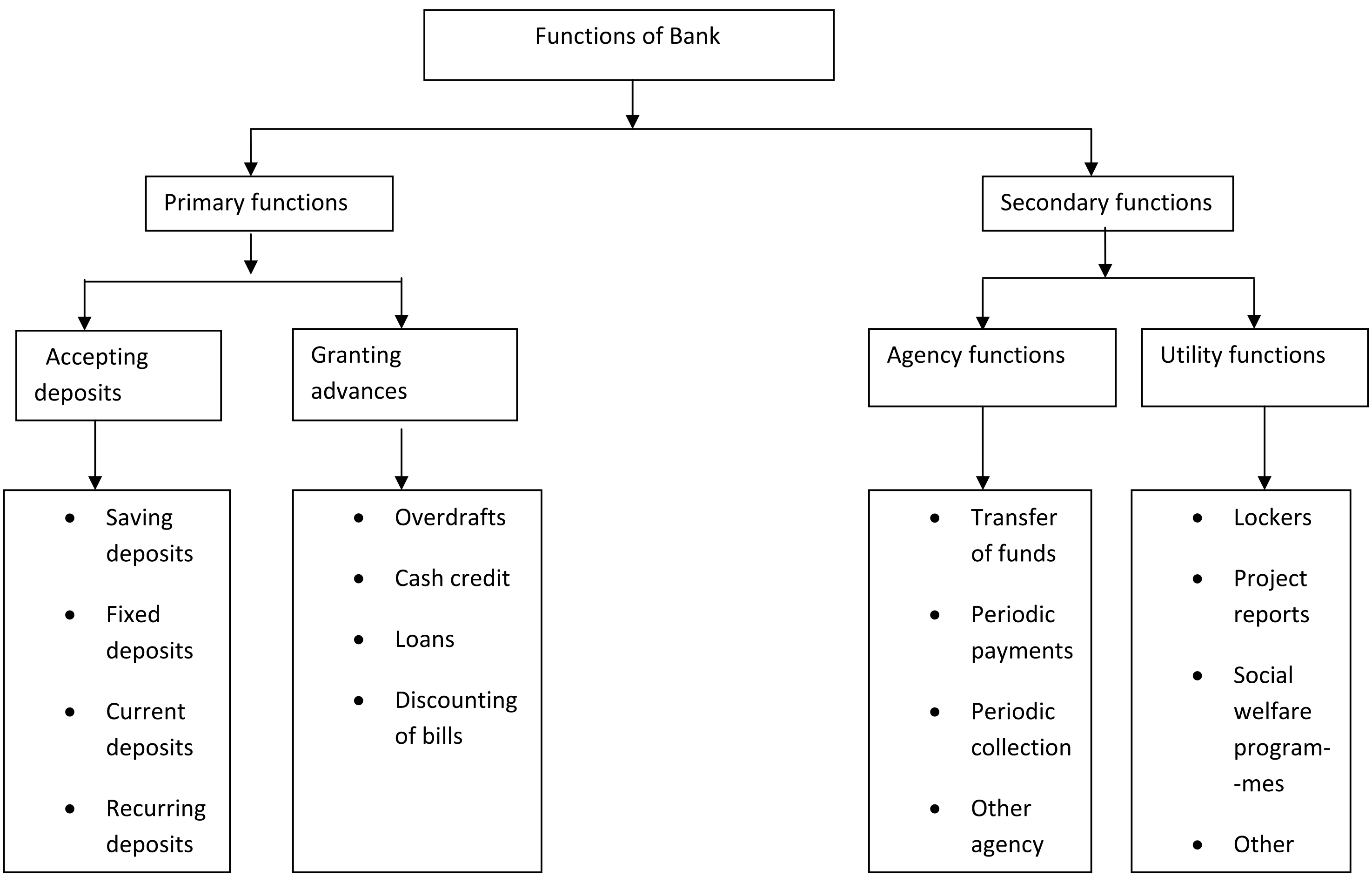
(Central Bank and Monetary Authority)





4. Size of Indian Banking Industry: The Indian banking system consists of 26 public sector banks, 43 foreign banks, 20 private sector banks, 43 foreign banks, 56 regional rural banks, 1,589 urban cooperative banks and 93,550 rural cooperative banks, in addition to cooperative credit institutions. The Indian banking sector's assets reached US$1.8 trillion in FY14 from US$ 1.3 trillion in FY10, with 70 percent of it being accounted by the public sector.

5. Functions of Indian Banking Industry: the functions of Indian banking industry are briefly highlighted by following diagram:-



6. Growth and Development in Indian banking industry: The banking system in India is the most extensive. The total assets volume of the entire banking sector in India is nearly US$270 billion. The total deposit is nearly US$220 billion. Banking sector in India has been transformed completely. Presently the latest inclusions such as internet banking and care banking have made banking operations more users friendly and easy. Zhao, Casu and Ferrari (2008) used a balanced panel data set covering the period of 1992-2004 and employed a Data Envelopment Analysis (DEA) based malmquist Total Factor Productivity (TFP) index.

The empirical study indicated that, after an initial adjustment phase, the Indian banking industry experienced sustained productivity growth, which was driven mainly by technological progress. Banks' ownership structure does not seem to matter as much as increased competition in TFP growth. Foreign banks appear to have acted as technological innovators when competition increased, which added to the competitive pressure in the banking market. Finally, result also indicates an increase in risk-taking behaviour, along with the whole deregulation process.

It was found in the study of Goyal and Joshi (2011) that small and local banks face difficulty in bearing the impact of global economy therefore, they need support and it is one of the reasons for merger. Some private banks used mergers as a strategic tool expanding their horizons. There is huge potential in rural markets of India, which is not yet explored by the major banks. Therefore, ICICI Banks Ltd. Has used mergers as their expansion strategy in rural market. They are successful in making their presence in rural India. It strengthens their network across geographical boundary, improves customer base and market share.

6.1. Banking sector analysis report:

- The Indian economy has been on a relatively sound footing, registering the fastest growth in FY15. However, problems such as a weak investment climate and tepid earnings growth continue to plague the economy. The banking sector, being the barometer of the weak macro-economic variables. The Indian banking system continued to battle falling assets quality issues and the need to maintain capital adequacy in the light of piling bad loans.

- The ownership in the banking sector remained predominantly in the public sector despite a gradual decline in their share in recent years. Public sector banks (PSBs) accounted for 72.1 percent of the total banking sector assets. However, in terms of profits, the share of private banks surpassed that of PSBs. In FY15, PSBs had a share of 42.1 percent in overall profit.

- 1.25 percent. Although banks have reduced base rates but not to the same extent for the full transmission of rates, the RBI has asked banks to follow the marginal cost of funds while setting the base rate.

6.2 Deposit Growth has been steady: total money supply increased at a CAGR of 11.14 percent during FY06-16 between FY06-16, narrow money supply (M1) rare at a CAGR of 7.69 percent to US$ 392.8 billion, broad money supply (M2) increased at a CAGR of 11.14 percent to US$ 1.8 trillion by the end of October'15.

Time deposit with banks have shown highest average growth of 12.9 percent during FY06-16, and stood at US$ 1.44 trillion by the end of October '15.

7. Social and Ethical Aspects: there are some banks, which proactively undertake the responsibility to bear the social and ethical aspects of banking. This is a challenge for commercial banks to consider these aspects in their working. Apart from profit maximization, commercial banks are supposed to support those organizations, which have some social concerns. Benedikter (2011) defines social banks as "banks with a conscience". They focus on investing in community, providing opportunities to the disadvantaged, and supporting banks try to invest their money only in a few. He has also explained the main difference between mainstream banks and social banks that banking implements the triple principle of profit-people-planet.

Conclusion: The world second largest populated country, India, is the apple of the eye for the world now. The world economies are seeing it as their potential market. Indian banking industry is well regulated industry in the world. Future development of India and the growth of India lie in financial inclusion by tapping the rural market through banks. This will not only help corporate in fulfilling their social responsibilities, but is important for fuelling growth in other industries and to keep the economy growing and moving. Truly, there are fortunes at the bottom of the pyramid.

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