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CONCEPT OF BANKING INDUSTRY AND ITS ROLE IN INDIAN ECONOMY: RECENT CONSEQUENCES

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***Abstract*—Banks are the institutions and are facility provider to various local levels for inhabitant of countries and for global levels for the various other countries and financial institutions. The primary activity is accepting deposits for the purpose of lending and investment.**

Keywords - banks; finance; Indianeconomy; growth; devolopment; public banks; private banks; Commercial banks.

INTRODUCTION

Finance is an important and necessary factor for economic development. The segment of capital and money market dealing with lending and borrowing of money, essentially for short-term purposes, is represented by commercial banking institutions. Commercial banks act as financial intermediaries, i.e. intermediaries of saving and investment. Savings intermediations are a process by which flow of savings of the community is allocated to finance investment in the economy. The banking system which constitutes the core of the financial sector plays a critical role in transmitting monetary policy impulses to the entire economic system (Kaur, 2010).

Banking is the kingpin of the chariot of economic progress of country. The banking system occupies an important role in a nation's economy and plays a pivotal role in the economic development and simultaneously forms the core of money market in a developing country. The role becomes more crucial in planned or developing economies, like India and other SAARC countries (Afghanistan, Bangladesh, Bhutan, Maldives, Nepal, Pakistan, and Sri Lanka). Banking industry is designated as blood vascular system of Economy and Finance. The performance of banks is completely linked to the growth of the economy, while the nature and quantum of growth is, in turn, linked to the availability of bank credit (Uppal, 2006).

The structure of the Indian Banking System has undergone numerous changes since independence. Two phases of nationalization (1969 and 1980), introduction of Regional Rural Banks in 1975, and permission to New Private Sector Banks and set-up operations since 1993-94 are some of the major changes undergone (Debasish, 2006).

MEANING OF BANK

Dictionary Meaning: The Oxford Dictionary defines a bank as an establishment for the custody of money which it pays out on a customer's order. It has emphasized the deposit taking and payment making functions of a bank to the total exclusion of its money creation role.

Legal Meaning: Section (5) (1) (b) of the Banking Regulation Act 1934, defines banking as "the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawal by cheque, draft, order or otherwise . Section 5 (1) (c) defines banking company as "any company which transacts the business of banking in India". The essential characteristics of the banking business as defined in Section 5 (b) of the Banking Regulation Act are as follows:

- Acceptance of deposits from the public
- For the purpose of lending or investment
- Repayable on demand or otherwise
- Withdrawal by means of any instrument whether a cheque or otherwise.

Two important functions of commercial banks emerge from the definition given above: acceptance of deposits and lending of funds. For centuries, banks have borrowed and lent money to business, trade and people, charging interest on loans and paying interest on deposits. These two functions are the core activities of banking (Hussain, 1986).

FUNCTIONS OF BANKS

The functions essentially performed by the banks are detailed as under (Bansal, 2010):

- Accepting Deposits
- Lending Money to the Public
- Transfer of Money
- Trustee Business
- Safe-Keeping
- Government Business

ROLE OF BANKS IN ECONOMIC DEVELOPMENT

- Economic Development through Banking System
- Helpful in Capital Formation
- Creator of Money
- Act as a Link between the Organized and Unorganized Sectors
- Effective Implementation of Monetary Policy
- Development of Agriculture and Industries
- Act as Catalyst in Social Change
- Development of Entrepreneurship
- Flow of National Savings
- Helpful in Mitigating the Effects of Trade Cycles
- Facilitate in Maintaining the Positive Balance of Trade (Fig. 1 and 2)

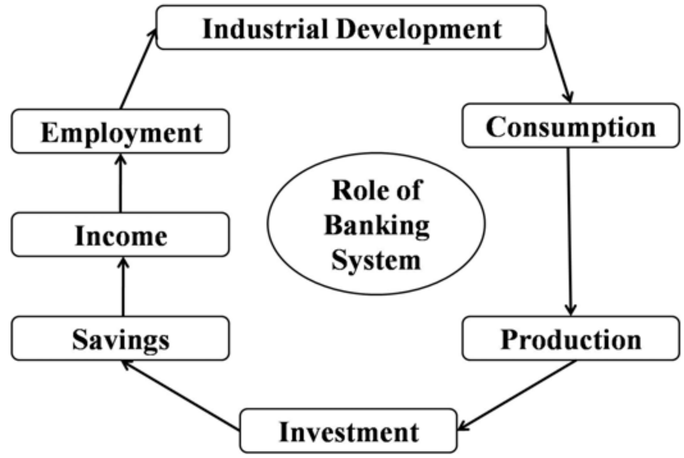

Figure 1: Role of Banking System.

ROLE

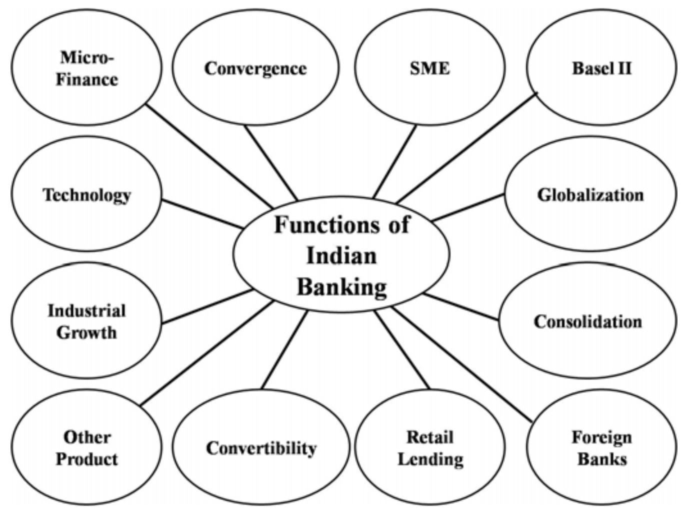

Figure 2: Various Functions Performed by Indian Banks

STRUCTURE OF COMMERCIAL BANKS:

Indian commercial banks comprise of various types of entities. They are different on the basis of functions they perform. So, it will be more appropriate to classify these banks on the basis of functions performed by them (Fig. 3). The constituents of the Indian banking system can be listed as follows (Aggarwal, 2003).

- SCHEDULED COMMERCIAL BANKS
- PUBLIC SECTOR BANKS
- STATE BANK GROUP
- NATIONALISED BANKS
- PRIVATE SECTOR BANKS
- FOREIGN BANKS

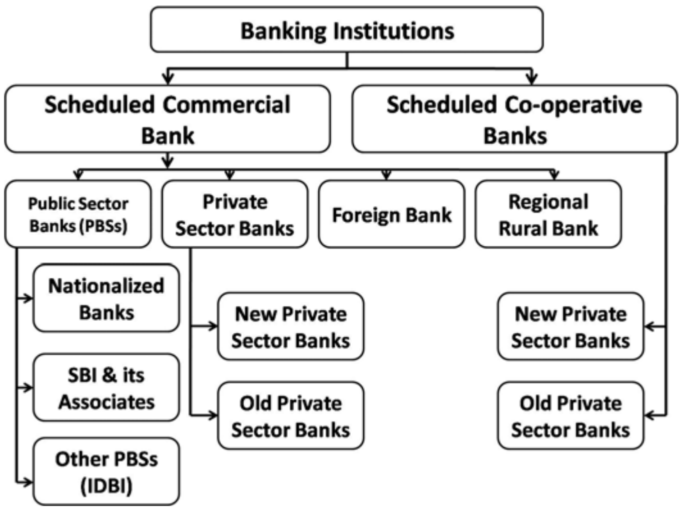

Figure 3: Schematic Diagram of Structure of Commercial Banks in India

GROWTH OF BANKS IN INDIA

On the eve of independence, Indian Banking inherited 2,876 branches, serving an average population of 82,000 with Rs. 860 crore deposits and Rs. 760 crore advances along with the responsibility of recuperating the war-torn economy saddled with poverty and unemployment. Banking system has made a tremendous progress since then.

NATIONALISATION OF COMMERCIAL BANKS

In 1969, 14 banks were nationalised to promote macro-economic objectives such as economic growth and better regional balance of economic activities. The nationalization was effected by an ordinance, which was later replaced by an Act of parliament known as the Banking Companies Act, 1970. The banking sector was identified as key instrument for economic development. Fourteen erstwhile private sector banks were nationalized on July 19, 1969, and another six, viz. Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab & Sind Bank and Vijaya Bank with deposit liabilities of Rs. 200 crore and above in 1980.

One of the objectives of nationalization was to extend the reach of organized banking services to rural areas and to neglected sectors of the society. With a view to achieving these objectives, the policy-makers imposed a strict credit rationing approach, prescribed formula-based lending and high-directed credit obligations. It is expected that the Indian banking system will emerge as strong and efficient in the new millennium (Pathak, 2011).

Banks play a significant role in financing the economic needs of the country. To compete effectively in present day competitive world, banks have been permitted to undertake new activities such as investment banking, securities trading, insurance business, etc. Angadi and Devraj (1983) measured productivity of Indian banks for the period 1970-80. They took total working funds (deposits and credits) as output indicator while establishment expenses as input indicator.

METHODOLOGY

Present Study is based on secondary data sources of information from various research publications, published newspapers, journals-online & printed, magazines, websites and books. The information is collected from libraries and websites. The literature is cross checked and validated to gives the latest information from the Annual Reports of various banks and RBI, Government of India. Graphical presentation of data also present for making the present study effective.

BANKING INDUSTRY: HISTORICAL AND RECENT CONSEQUENCES

Verghese (1983) evaluated the profits and profitability of Indian commercial banks during the period 1970 to 1979. He measured the profitability of commercial banks in terms of gross profit, net profit, and operating margin, gross yield on assets, spread and spread ratios. Nayan (1985) conducted a study on the performance evaluation of commercial banks and presented a performance evaluation model on the basis of important quantifiable parameters of performance. Ojha (1987) made international comparison with respect to productivity of banks between countries like India, Iraq, Japan, United States of America, Britain, Australia, Brazil and Pakistan for the year 1985.

Chawla (1988) analyzed the development and growth of banking activities after nationalization especially in the Punjab state during the period 1969-83. The study found that nationalization of major commercial banks in 1969 made a highly positive impact on deposit mobilization, credit deployment and branch expansion in the state. Nyong (1989) examined the impact of managerial effectiveness on profitability of Nigerian Banks.

Singh (1990) examined the trends and changes in productivity in Indian banking industry in relation to employee productivity and branch productivity. Kaur (1991) studied the profits and profitability of 20 Public Sector Banks during the period 1976 to 1985. Vashisht (1987) evaluated the performance of public sector banks on the basis of branch expansion, deposits, credit, priority sector advances, differential rate of interest (DRI) advances and net profit over the period pertaining to 1971-83.

Nayar (1992) studied the profitability and profit planning of nationalized banks for the years 1970 to 1986. Singh (1992) carried out a comprehensive study to analyze the trends in the productivity of the Indian banking industry since nationalization of 14 major banks in 1969 till the year 1985. Vyas (1992) made an attempt to measure, compare and analyze the profitability of public sector banks, private sector banks and foreign sector banks operating in India. Kaur (1993) studied the trends in profitability in commercial banks and examined the factors responsible for the erosion of bank profitability. Kaushik (1995) studied the social objectives and profitability of public and private sector banks during the period 1973 to 1991. He compared the public and private banks with the help of various profitability and productivity indicators through ratios, average, correlation, regression and factor analysis.

Das (1997) examined the efficiency of public sector banks in India since nationalization by using longitudinal data. The data considered was related to the years 1969, 1970, 1984, 1990 and 1996. Ramamoorthy (1997) measured the productivity of Indian commercial banks for the period 1991 to 1996 using business per employee as the measure of productivity.

Sarkar and Das (1997) examined the inter-bank performance differences in the efficiency of the banking sector with respect to various indicators of profitability, productivity and financial management for the year 1994-95. Chen and Yeh (1998) measured the operating efficiency of Taiwan's commercial banks for the year 1996. Data relating to seven Public Sector Banks and twenty-seven Private Sector Banks has been analyzed.

Chandan and Rajput (2002) evaluated the performance of banks on the basis of profitability analysis. The researchers analyzed the factors determining the profitability of banks in India with the help of multiple regression technique. Cheema and Agarwal (2002) analyzed the productivity of commercial banks in India and compared the performance of public sector banks, private sector banks and foreign banks in India. Kumar (2002) analyzed the impact of information technology on growth and performance of Indian banks in terms of profitability and productivity for the period ranging from 1995 to 2000. Sangmi (2002) analyzed the profitability of ten selected commercial banks in India. Five best performing banks were taken in Class-1 and five poor performing banks were taken in Class-2 categories. The period of study was from 1991-92 to 1997-98.

Kumari (2003) studied the profitability and productivity of both public and private sector banks in India. The study primarily based on the secondary data covering the time period from 1980 to 1999 by taking into account the 50% of total public and private sector banks in India. Qamar (2003) examined 100 scheduled commercial banks including 42 foreign banks, 8 new private sector banks, 23 old private sector banks and 27 public sector banks in terms of endowment factors, risk factors, revenue diversification, profitability and efficiency parameters.

Aggarwal (2005) measured the relative productivity of Public Sector Banks. Productivity of all the existing twenty-seven Public Sector Banks for the year 2003 has been calculated. Arora and Verma (2005) studied the banking sector reforms in India and evaluated the performance of public sector banks during the reforms period. The data of 27 public sector banks, i.e., 19 nationalized banks, and State Bank of India and its seven associates for the year 1992 has been taken.

Reddy and Rao (2005) made an attempt to identify factors in context of financial sector reforms which could lead to change the position of different bank groups i.e. public sector banks, private sector banks and foreign banks in terms of their share in overall banking industry. Singla and Arora (2005) measured the financial performance of two nationalized banks, i.e., Canara Bank and Indian Bank; and the comparison has been made about the performance of selected banks. Arora and Kaur (2006) reviewed the financial performance of Indian banks during post-reform era. For the analysis banks were categorized on the basis of ownership, i.e., Foreign Sector Banks, Private Sector Banks, Nationalized Banks, and State Bank of India and its seven associates.

Bodla and Verma (2006), in their paper, evaluated and compared the performance of two banks in India, one from the public sector, i.e., State Bank of India and the other from the private sector, i.e., ICICI Bank. Debasish (2006) measured the relative performance of Indian banks over the period 1997-2004 by using output-oriented data envelopment analysis model. Kohli and Chawla (2006) made an attempt to analyze the emerging trends in profits and profitability. The study related to four banks, two each from the public sector and private sector banks.

Maji and Day (2006) examined the productivity and profitability of the banks in India, selecting five banks each from the public and private sector banks. Shukla (2009) aimed at examining the recent trends in Indian Banking System and its impact on cost and profitability of 27 public sector banks, 27 private sector banks, and 29 foreign banks in India during the period 1991-06.

Bansal (2010) studied the impact of liberlization on productivity and profitability of public sector banks in India. The study has been conducted on the basis of primary as well as secondary data for the period 1996-07. Uppal (2010) studied the extent of mobile banking in Indian banking industry during 2000-07. Prasad and Ravinder (2011) analyzed the profitability of four major banks in India, i.e., State Bank of India, Punjab National Bank, ICICI Bank and HDFC Bank for the period 2005-06 to 2009-10.

CONCLUSION

In the era of globalization banks become more crucial as they providing not only the financial services at various levels but also they provide e-banking, insurance services, e-wallets; Accepting Deposit; Advancing of Loans; Overdraft; Discounting of Bills of Exchange; Cheque Payment; Collection and Payment Of Credit Instruments; Foreign Currency Exchange; Consultancy; Bank Guarantee; Remittance of Funds; Credit cards; ATMs Services; Debit cards; Home banking; Online banking; Mobile Banking; Accepting Deposit; Priority banking; Private banking etc. Thus, the role of banks in Indian scenario increasing day by day and recent consequences supports the importance of banks in economic development of the country.

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