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Banking Sector: Vital spark in Indian Economy (A Comprehensive Study)

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ABSTRACT

"Everyday is a bank account, and time is our currency. No one is rich, no one is poor, we've got 24 hours each." ― *Christopher Rice*

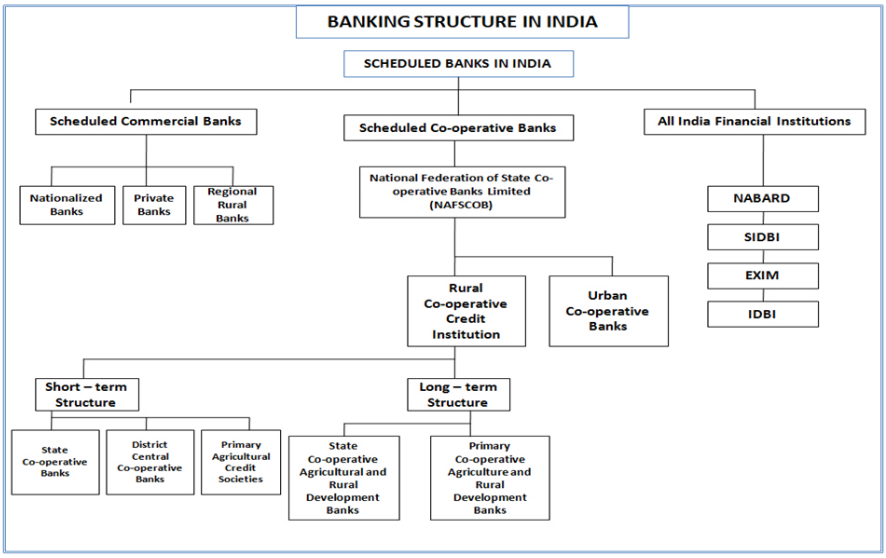
Banking Sector is the backbone of the Indian Economy. The task of banking sector is vital, essential in service sector. In India commercial Banks are the oldest, largest, fastest growing financial Intermediateries. They have been playing a very important role in the process of the development of the country. In reference to economic liberalization and growing trend towards globalization (external liberalization), various banking sector reforms have been introduced in India to improve the operation effectiveness and raise the health and financial soundness of banks. So that Indian banks can meet internationally accepted standards of performance. This paper is an effort to highlight the major reforms of Indian Banking Sector.

Keywords: Analysis, Growth, Performance, Reforms.

Introduction:

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 do proper transitions without developing the proper bank network. The banking System in India is dominated by nationalized banks. The performance of the banking sector is more closely linked to the economy than perhaps that of any other sector. The growth of the Indian economy is estimated to have slowed down significantly. The banking system in India should not only be hassle free but it should be able to meet the new challenges posed by the technology and any other external and internal factors. For the past three decades, India's banking system has several outstanding achievements to its credit. The Banks are the main participants of the financial system in India. The Banking sector offers several facilities and opportunities to their customers. All the banks safeguards the money and valuables and provide loans, credit, and payment services, such as checking accounts, money orders, and cashier's cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies, and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role—accepting deposits and lending funds from these deposits. Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. Again there were no security of public savings and no uniformity regarding loans. So as to overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers.

Structure of Indian Banking System



Objectives of the paper

- To have a brief overview of the reforms initiated in Indian Banking Sector.
- To evaluate the overall scenario of banking system in India
- To study the growth and performance of the banking sector in India.

Research Methodology

This paper is the outcome of a secondary data on Indian Banking Sector with special reference to Indian context. To complete this, annual reports, various books, journals and periodicals have been consulted, several reports on this particular area have been considered, and internet searching has also been done.

Phases of Evolution of Indian Banking Industry

In the evolution of this strategic industry spanning over two centuries, immense developments have been made in terms of the regulations governing it, the ownership structure, products and services offered and the technology deployed. The entire evolution can be classified into four distinct phases.

- Phase I- Pre-Nationalisation Phase (prior to 1955)
- Phase II- Era of Nationalisation and Consolidation (1955-1990)
- Phase III- Introduction of Indian Financial and Banking Sector Reforms and Partial Liberalization (1990- 2004)
- Phase IV- Period of Increased Liberalisation (2004 onwards)

Reforms in Banking Sector

In the Banking Sector reforms were introduced on the basis of the recommendations of different committees:
(i) The first Narasimhan Committee (1991),
(ii) The Verma Committee (1996),
(iii) The Khan Committee (1997), and
(iv) The Second Narasimhan Committee (1998).
The banking sector reforms are directed toward improving the policy framework, financial health and the institutional framework of the banks. The main reforms suggested by first committee are :
(a) Change in Policy Framework:
Improvement in policy framework has been undertaken by reducing the Cash Reserve Ratio (CRR) to the initial standard and phasing out Statutory Liquidity Ratio (SLR), deregulation of interest rates, widening the scope of lending to priority sectors and by linking the lending rates to the size of advances.
(b) Improving Financial Health:
Attempts to improve the financial soundness of the banking sector have been made by prescribing prudential norms. Moreover, steps have been taken to reduce the proportion of Non-Performing Assets (NPAs) in the banks.

(c) Improvements of Institutional Framework:
For improvement in banking framework recapitalize the bank existing capital, creating competitive environment in banks and make provisions for strengthen the supervisory system of banks.
Second Phase Reforms:
After completion of first phase reforms, the second phase reforms which are underway concentrate on strengthening the foundation of the banking system in three ways:
(i) By reforming the structure of the bank industry,
(ii) Technological up gradation
(iii) Human resource development.
The objective of reforms is to maintain the wealth of banks in particular and to ensure the soundness of the financial system in general. It allows much greater scope for the free play of market forces than what is permitted by economic regulations alone.
On the basis of recommendations of the Committee on Banking Sector Reforms, April 1998 (the second Narasimhan Committee) the RBI issued prudential norms. The major objective of setting such norms was to ensure financial safety, soundness and solvency of banks. These norms are directed toward ensuring that banks carry on their operations as prudent entities, are free from undue risk-taking, and do not violate banking regulations in pursuit of profit.The main focus of reforms of committees basically in three areas:
(i) NPAs,
(ii) Capital adequacy, and
(iii) Diversification of operations,

Challenges and Opportunities

- One serious problem faced by the public sector banks in the 1990s was a high proportion of NPAs. An NPA is an asset from which income is overdue for more than six months. According to the second Narasimhan Committee report (1998), "No other single indicator reflects the quality of assets and their impact on banks' viability than the NPA figures in relation to advances."
- 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 also includes:
- A growing economy,
- Banking deregulation,
- Increased client borrowing,
- An increase in the number of banks,
- An increase in the money supply Low government etc.

Conclusion

Developing countries like India, has a huge number of people who don‘t have access to banking services due to scattered and fragmented locations. But if we talk about those people who are availing banking services, their expectations are raising as the level of services are increasing due to the emergence of Information Technology and immense competition between the services and products provided by different banks. Since, foreign banks are playing in Indian market, the number of services of offered has increased and banks have laid emphasis on meeting the customer expectations. India's banking sector has made rapid strides in reforming and aligning itself to the new competitive business environment. The major challenges faced by banks today are as to how to cope with competitive forces and strengthen their balance sheet. Today, banks are groaning with burden of NPA‘s. It is rightly felt that these contaminated debts, if not recovered, will eat into the very vitals of the banks.

Banking sector in the last three years under the Prime Minister Narendra Modi-led government may well have seen some big announcements but going just by the financial numbers in the banking sector may present a dark picture of the performance. However, it may be said that the skeletons were waiting to be out of the cupboard. In an attempt to help banks, especially public sector banks (PSBs) recognize the ashes of high level of non-performing assets (NPAs) and rise like a phoenix, in December 2015, the Reserve Bank of India under the leadership of former Governor Raghuram Rajan, asked banks to set aside a pool of funds in the form of provisioning towards sub-standard assets.

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