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Banking Sector in India: An overview

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Introduction

India is not only the world's largest independent democracy, but also an emerging economic giant. Without a sound and effective banking system, no country can have a healthy economy. Banks play a vital role in the economic development of a country. They accumulate the idle savings of the people and make them available for investment. They also create new demand deposits in the process of granting loans and purchasing investment securities. They facilitate trade both inside and outside the country by accepting and discounting of bills of exchange. Banks also increase the mobility of capital. For the past three decades, India's banking system has several outstanding achievements to its credit. It is no longer confined to only the metropolitans, but has reached even to the remote corners of the country. This is one of the reasons of India's growth process. Today, the banking sector is one of the biggest service sectors in India. Availability of quality services is vital for the well-being of the economy. The focus of banks has shifted from customer acquisition to customer retention. With the stepping in of information technology in the banking sector, the working strategy of the banking sector has seen revolutionary changes. Various customer-oriented products like internet banking, ATM services, Tele-banking and electronic payment have lessened the workload of customers. The facility of internet banking enables a consumer to access and operate his bank account without actually visiting the bank premises. The facility of ATMs and credit/debit cards has revolutionized the choices available with the customers. Banks also serve as alternative gateways for making payments on account of income-tax and online payment of various bills like the telephone, electricity and tax. In the modern-day economy where people have no time to make these payments by standing in queue, the services provided by banks are commendable. Among the institutions whose role in the development of the less developed regions is well recognised but inadequately emphasised are the development banks. Playing multiple roles, these institutions have helped promote, nurture, support and monitor a range of activities, though their most important function has been as drivers of industrial development.

History

Banking system plays a very significant role in the economy of a country. It is central to a nation's economy as it caters to the needs of credit for all the sections of the society. Money-lending in one form or the other has evolved along with the history of mankind. Even in the ancient times, there are references to the money-lenders, in the form of *sahukars* and *zamindars* who lend money by mortgaging the land property of the borrowers.

Indian Banking System

The Indian banking industry plays an important role in the economic development of the country and is the most dominant segment of the financial sector. Banks help channel savings to investments and encourage economic growth by allocating savings to investments that have potential to yield higher returns.

India's banking system is a robust one and is classified into commercial banks and co-operative credit institutions. Commercial banks include: 1) scheduled commercial banks (SCBs) and non-scheduled commercial banks. SCBs are further classified into public sector banks (PSBs), private banks, foreign banks and regional rural banks (RRBs). Co-operative credit institutions include the various co-operative banks.

As on Mar, 2012 the Indian banking system comprised 87 SCBs, 82 RRBs, 618 Urban Cooperative Banks (UCBs) and 94,531 rural cooperative credit institutions. As on Dec 2012, the Indian banking system comprised 165 SCBs including RRBs.

Importance of Financial Inclusion

Despite considerable expansion, banking penetration remains low in comparison to global markets. In India, a major part of the population is financially excluded. Merely, 40% of the adult population has a bank account; 13% of the people have a debit card and only two percent have credit cards; 25,000 plus villages have a bank branch out of the 600,000 villages in the country. This indicates the scope for expansion for Indian banks.

The average population coverage by a commercial bank branch improved from 14,000 in 2010 to 13,466 in 2011 to 12,921 in 2012 while population per ATM from 19,700 in 2010 to 16243 in 2011. Banks are an important part of the financial sector and play a vital role in promoting financial inclusion. Thus, a bank-led model of financial inclusion has been embraced in the country.

As per the Reserve Bank of India (RBI), financial inclusion is the process of ensuring access to appropriate financial products and services needed by all sections of the society in general and vulnerable groups such as weaker sections and low income groups in particular, an affordable cost in a fair and transparent manner by regulated mainstream institutional players.

The Reserve Bank and the Government of India have taken many steps for inclusive growth and development. RBI encourages the Information Communication and Technology (ICT) model helping banks to counter the barriers of geography and achieve financial inclusion.
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• Business Correspondents (BCs)

In 2006, RBI permitted banks to use business facilitators and business correspondents as intermediaries to provide financial and banking services. BCs act as retail agents representing banks to offer banking services in places other than a bank branch/ATM. The BC model is a low cost alternative to the brick and mortar branches offering limited baking services. The BC model offers doorstep delivery of services especially 'cash in-cash out' transactions in areas closer to the rural population.

In Sept 2010, banks were permitted to engage "for profit" companies as BCs over and above the individuals/ entities permitted earlier. As on Sep 30, 2012 banks have opened 158,159 BC outlets providing banking services in 199,702 villages.

• Setting up of Ultra Small Branches (USBs)

In order to support and mentor the Business Correspondent Agents (BCAs) banks are making sure a range of banking facilities are provided to residents of villages by setting up Ultra Small Branches (USBs) in villages/rural centres covered through BCAs under financial inclusion. A USB is a small area of 100-200 sq ft where the bank officer offers services with a lap-top on pre-decided days. While BCAs provide cash services, the bank officer provides other services, undertakes field verification and follows up on the banking transactions. A total of over 43,000 USBs have been established in India by Dec, 2012.

• UIDAI for increasing financial inclusion

The Unique Identification Authority of India (UIDAI) through its UID number and Aadhaar enabled payment system (AEPS) permits online financial inclusion transactions at PoS (Micro ATM using handheld device) with the BC making use of the Aadhaar authentication. Aadhaar Enabled Payment Systems (AEPS) is a bank-led model which is in alignment with UIDAI's strategy to use the UID number to route government benefit transfer payments to beneficiaries. Aadhaar Payment Bridge System (APBS), a centralised electronic benefit transfer system will help enable direct disbursement of government benefits to the beneficiary's bank account which is aligned to Aadhaar number and biometric authentication resulting in effective and safe disbursement of benefits to beneficiaries and help the Government decrease the administrative costs of the various schemes as well as the leakages in the transfers.

• Mobile Banking

There is growing use and penetration of mobile phones in India. As per the Telecom Regulatory Authority of India (TRAI), the mobile subscriber base in India as on Oct 2012 stood at 904.23 mn including 566.81 mn urban subscribers accounting for 62.68% share and 337.42 mn rural subscribers accounting for 37.32% share. In Oct 2012, 4.44 mn transactions totalling to Rs 4.97 bn were processed against 2.25 mn transactions totalling to Rs 1.61 bn processed in Oct 2011 - a growth of 197% in volume and 308% in value terms. There still further exists huge scope for mobile banking. As on June 2012, 69 banks have been granted approval to offer mobile banking facilities, of which 49 have commenced operations.

Commercial Banks

A commercial bank is a type of bank that provides services such as accepting deposits, making business loans, and offering basic investment products. Commercial bank can also refer to a bank or a division of a bank that mostly deals with deposits and loans from corporations or large businesses, as opposed to individual members of the public. The share of commercial banks in total institutional credit to agriculture is almost 48 percent followed by co-operative banks with a share of 46 percent and RRBs about 6 percent.

Development Banks

Given these features, the financial sector must be designed to include institutions, sources of Finance and instruments that can bridge the significant mismatches in the expectations with regard to maturity, liquidity, risk and interest rates between savers and investors. One way to deal with this problem is to encourage the growth of equity markets. This is seen as attractive because, unlike in the case of debt, risk is shared between the financial investor and the entrepreneur. This enhances the viability of the firm in periods of recession. However, the evidence shows that even in developed countries equity markets play a relatively small role in mobilizing capital for new investments. Even where markets are active, it is the secondary market that is of significance.

Comparison of development and commercial banks

Development banks are in the nature of "universal banks" undertaking a wide range of activities besides those undertaken by commercial banking institutions.

Commercial banks, which mobilise finance through savings and time deposits, acquire liabilities that are individually small and protected from income and capital risk, are of short maturity and are substantially liquid in nature. On the other hand, the credit required for most projects tends to be individually large, subject to income and capital risk and substantially Illiquid in nature. Consequently, commercial banks conventionally focus on providing working capital credit to industry. This is lent against the collateral constituted by firms' inventories of raw materials, final products and work-in-progress. Though this can involve provision of credit in relatively large volumes, with significant income and credit risk and a degree of illiquidity, it implies a lower degree of maturity and liquidity mismatch than lending for capital investment. This makes traditional commercial banks less suited to lending for capital investment.

To cover the shortfall in funds required for long-term investment, developing countries need to and have created development banks with the mandate to provide long-term credit at terms that render such investment sustainable. They tend to lend not only for working capital purposes, but to finance long-term investment as well, including in capital-intensive sectors. Having lent long, they are very often willing to lend more in the future.

Banks and Entrepreneurship Development

From the above discussion it may be concluded that Banks have not been taking the task of entrepreneurial development in all seriousness as is evident from their casual approach to creating awareness amongst potential entrepreneurs as well as providing necessary assistance to the existing borrowers. The smooth running of day-to-day operations of business enterprises as also their ultimate development into self-sustaining systems do not seem to draw sufficient interest from the bankers who have financial stake in the enterprises. With the widespread changes being introduced into the banking sector, it has become important that banks keep a constant vigil over the enterprises being financed by them. On one hand, it has to be monitored that funds are being properly utilized in business, while on the other hand it has to be ensured that the enterprise does not fail because of poor management despite the best intentions of the entrepreneur.

Thus the banks now have to take over the reins of the enterprises and play a constructive role in ensuring the ultimate viability of each enterprise. They have to develop the infrastructure and skill to assist the entrepreneurs. The Banks and the Government may join hands to establish and promote mobile and stationary training institutes equipped with well-designed programs and staff, which could identify homogenous groups of entrepreneurs and impart them the necessary training. This effort would surely result in improved quality of management in business enterprises and ultimately improved quality of assets for banks.

IT is also playing a major role in the banking industry. RTGS, NEFT services are gaining momentum. Emerging markets are here to stay. With changing landscape, onus now lies on emerging markets to step up and spear head the emerging financial developments.

Future Hopes

To conclude, we can say that the modern economies of the world have developed primarily by making best use of the credit availability in their systems. India is on the march; far reaching socio-economic changes are taking place and Indian banks should come forward to play this role in the process. The role of banks has been important, but it is going to be even more important in the future.

The primary growth drivers that will help transform the Indian banking sector include financial inclusion, enhanced payment systems, internet and mobile systems which will lead the banking sector to achieve its aim of expansion and growth.

With one of the reform measures i.e. passing of the Banking Laws (Amendment) Bill, 2011, there will be way for more banks and foreign investments to enter the banking industry. Establishment of new banks will create competition enabling banks to improve their operational efficiency and technology. Given the under penetration of banking services in India, new bank licenses to be issued will also contribute towards financial inclusion and development.

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