

CHANGING SYSTEM OF INDIAN BANKING SECTOR

Harvail Singh

BPEO Mandi Gobindgarh (Fatehgarh Sahib)

ABSTRACT

The process of liberalization has rather started a new economics of our country. Liberalization has offered us a significant opportunity to come forward to learn from the experiences of others, to interact on a Global scale, to build up our own strength, to become world players and to excel . The post liberalization has marked with various economic stabilization measures and structural reforms particularly in industrial and trade policies with the broad objective of stronger export performance through liberalized exports and turning the industrial sector global. For the purpose to import dynamism in the economy, several liberalized measures were brought forth during this period i.e., automatic approved for upto 51 pc foreign equity privatization, no licensing requirements, export promotion schemes with permission to import goods at lower duty rates etc.

REVIEW OF LTERATURE

Aggarwal, A.K., Singh, D. and Chaturvedi, N. (2007-08) analyzed the performance of the banking sector and considered as a proxy for the economy as a whole, due to banks wide spectrum of exposures. The paper argues that to survive and thrive in the long run, banks need to pursuer strategies that enable them to develop resources that are inimitable, rare, durable and superior to competitors, while consolidation and convergence are no doubt necessary to survive, they are by no means sufficient. The most important point is that mergers and acquisitions in the banking sector must be market led rather than prompted by government or regulator. We are sure that our banking institutions, as in the post, shall rise to the occasion and show the required flexibility to absorb and adopt. The institutional changes to consolidate their position in the world market.

Raveendra, P.V. (2007) shows how each step in the roadmap for implementing CRM in financial services creates value for the customer not only the external but also the internal customer which in turn, gives the company a competitive advantage. In this paper an attempt is being made how to build relationship with the customers with special reference to financial services.

Bhushan, A.Y. (2004) concludes that his study will provide comprehensive view on the corporate governance codes of scheduled commercial banks comprising of public sector, private banking companies and foreign banks functioning in the country. This study will highlight the formulation of codes of corporate governance with accountability to provide a firm platform for the banking system policies and procedures implementations, thus enabling fair business practices and a step to compete with the international area industry

OBJECTIVES OF THE STUDY

1. To study and analyze changing system of Indian banking system .
2. To examine the revolutionary phases of Indian banks.
3. To suggest the survival strategies for banks in general and particularly, for public sector banks.

BANKING SECTOR REFORMS UNDER LIBERALIZATION:

First phase of Banking Sector Reforms: - These included the following.

1. Reduction in SLR& CRR.
2. Deregulation Of Interest Rates
3. Transparent Guidelines or Norms for Entry and Exit of Private Sector Banks.
4. Public Sector Banks Allowed For Direct Access To Capital Markets
5. Branch Licensing Policy Has Been Liberalized.
6. Setting Up Of Debt. Recovery Tribunals
7. Asset Classification And Provisioning
8. Income Recognition
9. Asset Reconstruction Fund (ARF)
10. At Least 40 Pc of the total advances should be in Priority Sector.

The first phase of banking sector reforms, tremendous 'Curative' measures, came up with its main objective to improve the operational efficiency of banks. Although, the first phase of banking sector reforms have improved the performance of the banks, but competition has also increased with more liberalization, privatization and globalization.

SECOND PHASE OF BANKING SECTOR REFORMS

Inspite of the optimistic views about the growth of banking industry in terms of branch expansion, deposit mobilization etc, several distortions have still crept into the system which is enumerated as follows:

- Increasing competition
- Increasing NPAs
- Obsolete technology

Hence, while observing above distortions, the Govt. of India appointed second Narasimham Committee in 1998 to review the first phase of banking reforms and chart out a programme for further reforms. After reviewing the performance of banks in light of first phase of reforms and submitted its report with some repaired and some new recommendations. They were:

- Merging of strong unit of banks.
- Adaptation of the 'narrow banking' concept to rehabilitate weaker banks.

As the process of second banking sector reforms is going on since 1999, it has shown improvement in the performance of banks. The wave of Globalization has swept all our lives, be it the day to day products we use, channels we watch on TV or even the clothes we wear. Globalization is the integration of a country's economy with other countries under condition of free flow of trade and capital and movement of persons across borders. In the post banking sector reforms period, there is a wave of Globalization on Indian banking industry. Many banks of public and new private sector banks have started to open their branches into abroad. Particularly PNB, OBC, HDFC have already opened their branches in the foreign countries and many branches of foreign banks are operating in our country. As per the instructions of RBI liberal policies have been adopted to open branches in and out the country. Recently, outsourcing is also taking place in the banking industry.

ROLE OF BANKING INDUSTRY IN INDIAN 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. Money and finance is an important and necessary factor for economic development. Though finance is by no means a substitute for real resources, it has a crucial role in the economic development of the country. Its importance lies in the fact that it places at the command of those who have the technical skill and entrepreneurial talent but lack in other means to acquire the capacity missing factors necessary for development.

The segment of capital and money market dealing with lending and borrowing of funds, 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 importance of commercial banks in the process of economic development has been recognized by all. The commercial banks play an important role in all economies. The role becomes more important in planned or developing economies like India. Banking Industry is the blood vascular system of our economy. It has a positive role to play in the economic development of the country as repositories of people's savings and purveyors of credit, especially as the success of economic development depends on the mobilization of the resources and their investment in appropriate manners. In a country like India, constitutionally committed to socialistic pattern of society- banks have important role to play i.e. in the reduction of regional disparities, which is an important objective of the economic planning. A very significant measure to reduce regional and state-wise disparities would be to reduce the imbalances in the credit-deposit ratios in the various states.

To Quote Bhabha, "Banking is the kingpin of the chariot of economic progress. As such its role in expanding economy of a country like India can neither be under estimated nor overlooked. The success of our plan is depending among other things, on the smooth and satisfactory performance of the role by banking industry of our country.

The performance of bank 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. 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 is some of the major changes undergone.

STRUCTURE OF INDIAN BANKING INDUSTRY

The banking system occupies an important place in a nation's economy. A banking institution is indispensable in a modern society. It plays a pivotal role in the economic development of a country and forms the core of the money market in an advance country. In India though the money market is still characterized by the existence of both the organized and the unorganized segments, institutions in the organized money market have grown significantly and are playing an increasingly important role. Amongst the institutions in the organized sector of the money market, commercial banks and commercial co-operative banks have been in existence for the past several decades. The Regional Rural Banks came in to existence since the middle of seventies. Thus with the phenomenal geographical expansion of the commercial banks and the setting up of the RBIs during the recent past, the organized sector of money market has penetrated into the rural areas as well.

Besides the aforesaid institutions which mainly served sources of short term credit to industry, trade, commerce and agriculture, a variety of specialized financial institutions have been set up in the country to cater to the specific needs of industry, agriculture and foreign trade.

COMMERCIAL BANKS

Among the banking institutions in the organized sector, the commercial banks are the oldest institutions having a wide network of branches, commanding utmost public confidence and having the lion's share in the total banking operations. Initially they were established as corporate bodies with share- holdings by private individuals but subsequently there has been a drift towards state ownership and control. Today 27 banks constitute the strong Public Sector Banks in Indian Commercial Banking. Up to late sixties, they were mainly engaged in financing organized trade, commerce and industry but since then they are actively participating in financing, agriculture, small business and small borrowers also. Foreign commercial banks have the branches in India of the joint stock banks incorporated abroad. These banks besides financing the foreign trade of the country, undertake banking business within the country as well. The RBI Act has divided the banks into two categories:

(a) SCHEDULED COMMERCIAL BANKS

According to RBI Act 1934, a scheduled bank is that bank which has been included in the second schedule of the Reserve Bank of India. To be eligible for this concession a bank must satisfy the following three conditions:-

-it must have a paid up capital and reserves of an aggregate value of at least Rs. 5 lakhs.

-It must satisfy the RBI that its affairs are not conducted in a manner detrimental to the interests of its depositors.

-It must be a corporation and not a partnership or a single owner firm.

RBI gives them credit and many other facilities. These banks can also get their hundies rediscounted from the RBI. Commercial banks have to keep fixed proportions of their demand deposits and time deposits with the RBI. They have to submit deposits of their business to RBI.

(b) NON-SCHEDULED COMMERCIAL BANKS

These are those banks of which the total capital is less than Rs.5 lakhs. These banks are not included in the second scheduled of the RBI. RBI has no specific control upon these banks. But they have to send details of their business to the RBI every month.

PUBLIC SECTOR BANKS

Public sector in Indian banking reached its present position in three stages.

- Firstly, the conversion of the then existing Imperial Bank of India into the SBI in 1955 followed by the establishment of its seven subsidiary banks.

- Secondly, the nationalization of 14 major commercial banks on July 19, 1969.

- Thirdly, the nationalization of 6 more commercial banks on April 15, 1980. One of the New Bank of India was later on merged with PNB. Thus 27 banks constitute public sector in Indian commercial banking. Public Sector Banks includes SBI Subsidiaries of SBI, and 14 Banks Nationalized in 1969 and 6 Banks Nationalized in 1980.

CONCEPT OF PARADIGM SHIFT IN BANKS

It means shift in capital structure, ownership, consolidation, HRM governance, technology banking environment & public policy. Since the launching of economic reforms in 1991, the IBI has been undergoing rapid and comprehensive changes. The effects are profound in all spheres of banking justifying the use of the term paradigm shift to describe the current status. One and half decade of change provides adequate material for meaningful assessment. During the paradigm shift the performance of all bank groups has dynamically changed. The Indian banking sector is passing through a testing challenging and exciting period. One could call the change paradigm shift in Indian banking. It is true that the Indian banks are accustomed to changes. Since independence, they have already gone through three major shifts:-

- (i) A period of consolidation of banks (upto 1966)
- (ii) A period of historic expansion in both geographical and functional terms (from 1966 to mid-1980s)
- (iii) A period of consolidation of branches (from mid-1980s to 1991)

Government of India and RBI have taken several steps to

- (a) Strengthen the banking sector,

- (b) Provide more operational flexibility of banks,
- (c) Enhance the competitive efficiency of banks,
- (d) Strengthen the legal framework governing operations of banks.

The important measures taken to strengthen the banking sector are briefly, the following:-

- Introduction of capital adequacy standards on the lines of the Basel norms;
- Prudential norms on asset classification, income recognition and provisioning;
- Introduction of valuation norms and capital for market risk for investments;
- Enhancing transparency and disclosure requirements for published accounts;
- Introduction of off-site monitoring system and strengthening of the supervisory framework for banks.

Some of the important measures introduced to provide more operational flexibility to banks are:-

- Besides deregulation of interest rate, the boards of banks have been given the authority to fix their prime lending rates. Banks also have the freedom to offer variable rates of interest on deposits, keeping in view their overall cost of funds.
- Statutory reserve requirements have significantly been brought down.
- The quantitative firm-specific and industry-specific credit controls were abolished and banks were given the freedom to deploy credit, based on their commercial judgment as per the policy approved by their boards.
- The banks were given the freedom to recruit specialist staff as per their requirements.
- The degree of autonomy to the Board of Directors of banks was substantially enhanced.
- Banks were given autonomy in the areas of business strategy such as, opening of branches, introduction of new products etc.

Some of the important measures were taken to increase the competitive efficiency of banks are the following:

- Opening up the banking sector for the private sector participation
- Scaling down the shareholding of the Govt. of India in PSBs & of the RBI in State Bank of India.
- Measures taken of the Govt. of India to provide a more conducive legal environment for recovery of dues of banks and financial institutions are.
- Setting up of Debt Recovery Tribunals providing a mechanism for expeditious loan recoveries.
- Constitution of a high power committee under former Justice Shri Eradi to suggest appropriate foreclosure Laws.

- An appropriate legal framework for securitization of assets is engaging the attention of the Govt.
- There is a paradigm shift in the employee productivity and operational productivity in all the bank groups as well as in the Indian banking industry. Deposits per Employee, Credit per Employee, Business per Employee, Total Expenditure per Employee, Established Expenditure per Employee and some other variables have shown paradigm shift in 2006-07
- Similarly, Branch productivity has made remarkable shift in recent years.
- Employee Productivity Index, Branch Productivity Index, Financial Productivity Index and Total Productivity Index have tremendous change in 2006-07.
- Electronic e-channels particularly ATMs are truly effecting the productivity of all bank groups, similarly other channels like credit cards, internet-banking, mobile-banking, tele-banking are truly effecting the productivity of various bank groups.
- Similarly, there is a remarkable change in the profitability of all bank groups. This shows paradigm shift in profitability of all bank groups.
- Now –a –days some new factors (Computerized branches, credit cards, and internet-banking, mobile-banking, tele-banking) are highly and truly affecting the profitability of all bank groups.

STRATEGIES NEEDED FOR PARADIGM SHIFT

Many strategies are needed for our PSBs in particular & IBI in general for paradigm shift.

CAPITAL STRUCTURE

The paradigm shift is observed in capital structure. India will be adopting, by and large, the new framework of Basle II in respect of CAR because it is considered as the best practice and also because it will enable to reach convergence with the international standards. The framework is based on a three pillar approach:

- (i) Assessment of minimum capital requirement,
- (ii) Supervisory oversight reviewing bank's capital adequacy and internal assessment process and
- (iii) Market disciplines.

All three ingredients have implications for the Indian banks. All these aspects require highly sophisticated methods of analysis and evaluation and they are new areas to the banks.

OWNERSHIP

The pattern of present ownership of banks indicates rather multifarious. The govt. of the RBI owns the major segment of commercial banking. The new generation banks are owned mainly by institutions while old private sector banks are owned by certain houses/communities. Parent offices of foreign banks own their branches. The Govt. has announced its decision to reduce its share holding in banks to 33 pc but retain their public characteristics.

The additional capital is to be mobilized from the market. But many banks in PSBs have returned govt. stake & after that their efficiency is quite better.

CONSOLIDATION

Available evidence indicates that, in general, size could input economics of scale and thereby reduce costs in banking. If this reasoning is agreed upon, there is a case for consolidation of banks/ branches besides the establishment of universal banks. Many banks in PSBs, NPSBs have all ready merged. Perhaps, the proposed merger of a development financial institution with its new bank is the beginning of universal banking in India. Such move is likely to have very significant impact on banking in the future.

Equally important is the consolidation of existing branches of banks. Currently, the banks are permitted to consolidate their branches, subject to certain conditions. These are several branches, especially in the rural areas, which are deposit-based. They do not directly generate surplus but provide funds for deployment elsewhere. A good Transfer Price Mechanism should help the banks to identify a loss making branch and an unviable branch, which in turn would help them to take a decision on closure of a branch.

Perhaps, the more important development is the growth of ATMs, e-banking and money substitute instruments like credit cards. Purely from the cost point of view, ATMs are cheaper than the full-fledged branch and e-banking is still cheaper than ATMs. However, their adoption rises certain pertinent issues, such as security, which should be addressed.

HUMAN RESOURCE MANAGEMENT

Being a service industry, the success of banking depends mainly upon its human resources. Having the right person at the right place at the right time is the objective of a successful human resource policy. From this angle, the present position leaves much desired. First, several administrative arrangements in respect of posting, promotion, accountability and responsibility, which are inconsistent with the present changes are still practiced due to certain rigidities. Similarly, there is a mismatch between the available manpower and technology. Besides, there is a feeling that banks, particularly PSBs, are generally over to affect. This aspect requires urgent attention to bring paradigm shift in the banking industry.

GOVERNANCE

The need for good corporate governance could hardly be over- emphasized. Being social institutions, banks require it more than others. The essences of good corporate governance are the segregation of management from ownership and exercising as also monitoring control over management. Given the type of ownership, effective corporate governance is rather difficult to achieve.

TECHNOLOGY SUPPORT FOR ENHANCING CUSTOMER SERVICES

There is no doubt that banks in India, particularly PSBs, will need to use technology to improve operating efficiency and customer service. Harnessing employee technology synergy is crucial for unleashing productivity & reaching out to the huge base of retail customers, who are dispersed in rural & semi-urban areas.

Bank can use technology to address customer needs and improve their interaction with customers, keeping in touch through telephone and internet on their part, customers can view and manage their requirements on the phone and have a host and options for transacting their business. The focus on technology will increase like never before to add value to customer service, develop new products, strengthen risk management and asset liability management and improve profitability. The foreign banks & NPSBs have edge over PSBs regarding use of IT in banks and there is a paradigm shift in three banks.

MERGING E-CONTACT AND EYE-CONTACT

With large manpower and widely dispersed branches, the biggest challenge before PSBs is to raise profitability and increase earnings by harnessing the productive potential of their workforce. The next major challenge is raising stiff productivity.

This is not only, technological challenge but also a whole process and management challenges, a paradigm shift in the way people think and work. The role of human resources is critical for sustained high performance in the face of ever-increasing pressure and rapid change.

STRATEGIES FOR REDEPLOYMENT

In the aftermath of the VRSs introduced by banks, most branches are faced with shortage staff. In the immediate future, therefore, staff will have to be redeployed from administrative offices and sent to work in branches for non-fund based business, recovery efforts, new business areas like selling insurance and mutual fund products and in general instilling the importance of cross –selling products to new potential customers which would help reduce transaction of costs.

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