EMPEROR INTERNATIONAL JOURNAL OF FINANCE AND MANAGEMENT RESEARCH
[EIJFMR]

ISSN: 2395-5929

Volume-III	Special Issue - V	September - 2017

UGC Approval Jr. No. 45308

Impact Factor: 1.14

Published by
Mayas Publication®
Tamilnadu | Kerala | Karnataka | New Delhi
www.eijfmr.com

NEW ECONOMIC POLICY AND INDIAN BANKING SECTOR

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I. INTRODUCTION

The banking system in India is significantly different from that of other Asian nations because of the country‘s unique geographic, social, and economic characteristics. India has a large population and land size, a diverse culture, and extreme disparities in income, which are marked among its regions. There are high levels of illiteracy among a large percentage of its population but, at the same time, the country has a large reservoir of managerial and technologically advanced talents. Between about 30 and 35 percent of the population resides in metro and urban cities and the rest is spread in several semi-urban and rural centers. The country’s economic policy framework combines socialistic and capitalistic features with a heavy bias towards public sector investment. India has followed the path of growth-led exports rather than the ―export led growth of other Asian economies, with emphasis on self-reliance through import substitution. These features are reflected in the structure, size, and diversity of the country’s banking and financial sector.

The banking system has had to serve the goals of economic policies enunciated in successive five year development plans, particularly concerning equitable income distribution, balanced regional economic growth, and the reduction and elimination of private sector monopolies in trade and industry. In order for the banking industry to serve as an instrument of State policy, it was subjected to various nationalization schemes in different phases (1955, 1969, and 1980). As a result, banking remained internationally isolated (few Indian banks had presence abroad in international financial centers) because of preoccupations with domestic priorities, especially massive branch expansion and attracting more people to the system. Moreover, the sector has been assigned the role of providing support to other economic sectors such as agriculture, small-scale industries, exports, and banking activities in the developed commercial centers (i.e., metro, urban, and a limited number of semi-urban centers). preferred avenues of employment. In the current decade, this has emerged as a resurgent Sector in the Indian economy.

Reserve Bank of India And Financial Institutions

RBI is the banker to banks—whether commercial, cooperative, or rural. The relationship is established once the name of a bank is included in the Second Schedule to the Reserve Bank of India Act, 1934. Such bank, called a scheduled bank, is entitled to facilities of refinance from RBI, subject to fulfillment of the following conditions laid down in Section 42 (6) of the Act, as follows:

- It must have paid-up capital and reserves of an aggregate value of not less than an amount specified from time to time; and
- It must satisfy RBI that its affairs are not being conducted in a manner detrimental to the interests of its depositors.

The classification of commercial banks into scheduled and non-scheduled categories that was introduced at the time of establishment of RBI in 1935 has been extended during the last two or three decades to include state Cooperative Banks, Primary Urban cooperative banks, and RRBs. RBI is authorized to exclude the name of any bank from the Second Schedule if the bank, having been given suitable opportunity to increase the value of paid-up capital and improve deficiencies, goes into liquidation or ceases to carry on banking activities. A system of local area banks announced by the Government in power until 1997 has not yet taken root. RBI has given in principle clearance to five applicants.

Specialized Development Financial Institutions (DFIs) were established to resolve market failures in developing economies and shortage of long-term investments. The first DFI to be established was the Industrial Finance Corporation of India (IFCI) in 1948, and was followed by SFCs at State level set up under a special statute. In 1955, Industrial Credit and Investment Corporation of India (ICICI) were set up in the private sector with foreign equity participation. This was followed in 1964 by Industrial Development Bank of India (IDBI) set up as a subsidiary of RBI. The same year saw the founding of the first mutual fund in the country, the Unit Trust of India (UTI).

(1). Banking Developments

The moderation in GDP growth following monetary tightening by RBI affected business growth of banks, which is reflected in slowdown in their deposit and credit growth. While deposit growth of All Scheduled Commercial Banks (ASCB) decelerated to 13.4% in FY‘12 from 15.9% FY‘11 despite increase in interest rates, growth in ASCB credit was lower at 17.0% in FY‘12 than 21.5% in FY‘11 reflecting slower growth in the economy.

(2). Opportunities and Threats

The Government is increasing investment in agriculture and rural development, expanding financial inclusion and pushing for investment in manufacturing and infrastructure, which will translate into growth opportunities for several sectors such as steel, cement, aluminum, etc. To boost growth, RBI is likely to cut rates further during FY‘13, though the extent of rate cuts will be contingent on the inflation trajectory. All this will provide an opportunity for banks to increase fund and non-fund business in a wide range of areas. Banks will be required to cut interest on credit in tandem with cut in key policy rate by RBI.

(3). Risks and Concerns

The main risks to the outlook are slowing global growth as the Euro zone sovereign debt crisis continues. High international oil and commodity prices could also dampen growth. As a result of the vast pools of liquidity injected by central banks of advanced countries to stimulate growth and prevent bank deleveraging, India will need to guard against volatile capital flows and build-up of asset bubbles. The situation could be exacerbated by the return of risk aversion and deleveraging by banks in developed economies. Monsoons, inflation including food inflation and suppressed inflation on account of fuel prices, widening current account deficit, and fiscal slippage leading to higher fiscal deficit are major risk factors.

Growth Drivers Of The Banking Sector

(1). High growth of Indian Economy

The growth of the banking industry is closely linked with the growth of the overall economy. India is one of the fastest growing economies in the world and is set to remain on that path for many years to

come. This will be backed by the stellar growth in infrastructure, industry, services and agriculture. This is expected to boost the corporate credit growth in the economy and provide opportunities to banks to lend to fulfill these requirements in the future.

(2). Rising per capita income

The rising per capita income will drive the growth of retail credit. Indians have a conservative outlook towards credit except for housing and other necessities. However, with an increase in disposable income and increased exposure to a range of products, consumers have shown a higher willingness to take credit, particularly, young customers. A study of the customer profiles of different types of banks reveals that foreign and private banks share of younger customers is over 60% whereas public banks have only 32% customers under the age of 40. Private Banks also have a much higher share of the more profitable mass affluent segment.

(3). New channel – Mobile banking is expected to become the second largest channel for banking after ATMs

New channels used to offer banking services will drive the growth of banking industry exponentially in the future by increasing productivity and acquiring new customers. During the last decade, banking through ATMs and internet has shown a tremendous growth, which is still in the growth phase. After ATMs, mobile banking is expected to give another push to this industry growth in a big way; with the help of new 3G and smart phone technology (mobile usage has grown tremendously over the years). The IBA-FICCI-BCG report predicts that mobile banking would become the second largest channel of banking after ATMs.

(4). Financial Inclusion Program

Currently, in India, 41% of the adult population doesn‘t have bank accounts, which indicates a large untapped market for banking players. Under the Financial Inclusion Program, RBI is trying to tap this untapped market and the growth potential in rural markets by volume growth for banks. Financial inclusion is the delivery of banking services at an affordable cost to the vast sections of disadvantaged and low income groups. The RBI has also taken many initiatives such as Financial Literacy Program, promoting effective use of development communication and using Information and Communication Technology (ICT) to spread general banking concepts to people in the under banked areas.

Major Developments

The Monetary Authority of Singapore (MAS) has provided qualified full banking (QFB) privileges to ICICI Bank for its branch operations in Singapore. Currently, only SBI had QFB privileges in country. The Indian operations of Standard Chartered reported a profit of above US$ 1 billion for the first time. The bank posted a profit before tax (PAT) of US$ 1.06 billion in the calendar year 2009, as compared to US$ 891 million in 2008.Punjab National Bank (PNB) plans to expand its international operations by foraying into Indonesia and South Africa. The bank is also planning to increase its share in the international business operations to 7 per cent in the next three years. The State Bank of India (SBI) has posted a net profit of US$ 1.56 billion for the nine months ended December 2009, up 14.43 per cent from US$ 175.4 million posted in the nine months ended December 2008.

The Most Important Reforms Follows

(1). Statutory pre-emotions

The degree of financial repression in the Indian banking sector was significantly reduced with the lowering of the CRR and SLR, which were regarded as one of the main causes of the low profitability and high interest rate spreads in the banking system.

(2). Priority sector lending

Besides the high level of statutory pre-emptions, the priority sector advances were identified as one of the major reasons for the below average profitability

of Indian banks. The Narasimham Committee therefore recommended a reduction from 40% to 10%. However, this recommendation has not been implemented and the targets of 40% of net bank credit for domestic banks and 32% for foreign banks have remained the same.

(3). Interest rate liberalization

Prior to the reforms, interest rates were a tool of cross-subsidization between different sectors of the economy. To achieve this objective, the interest rate structure had grown increasingly complex with both lending and deposit rates set by the RBI. The deregulation of interest rates was a major component of the banking sector reforms that aimed at promoting financial savings and growth of the organized financial system.

(4). Entry barriers

Before the start of the 1991 reforms, there was little effective competition in the Indian banking system for at least two reasons. First, the detailed prescriptions of the RBI concerning for example the setting of interest rates left the banks with limited degrees of freedom to differentiate themselves in the marketplace. Second, India had strict entry restrictions for new banks, which effectively shielded the incumbents from competition.

Finance Structure in India

Financial Structure

The Indian Financial system comprises the following institutions

1. Commercial Banks

a) Public sector

b) Private sector

c) Foreign banks

d) Co-operative institutions

i. Urban co-operative Banks

ii. State co-operative Banks

iii. Central co-operative Banks

2. Financial institutions

a) All-India Financial institutions(AIFIs)

b) State financial corporation's (SFCs)

c) State industrial development corporations (SIDCs)

3. Nonbanking finical companies(NBFCs)

4. Capital market intermediaries.

About 92 percent of the country's banking segment is under State control while the balance comprises private sector and foreign banks. The public sector, Commercial banks are divided into three cries.

Bank's Business Share in Market

In the banking terminology, the volume of business reflects the market share of a bank. Volume of business may be defined as the total of deposits, advances and the investments done by a bank. The overall business in the year 2011-12 by Indian banking industry was Rs. 141,183.90 billions. So, it is not a small sector of Indian economy in any way. A look on the volume of business and its components in the Indian Banking Industry (Table 3.1) is indicative of the fact that 52.49 percent of total business is in the hands of nationalized banks. Next 21.07 percent is with the State Bank of India and its Associates banks. So, in all 73.56 percent of total business is with Public sector banks. Private Banks contributes 18.89 percent of total banking business out of which Old Private Sector banks and New Private Sector bank contribute 4.64 percent and 14.25 percent respectively. The share of foreign banks is 5.00 percent only while Regional Rural Banks have just a 2.55 percent of the total business. The break –up of this total business into its components like deposits, advances and investments shows almost the same pattern that is displayed by the total business. Thus public sector banks still form a major chunk of business in the Banking industry in India.

Table 1 Structure of Market Shares by Various Banking Groups

Bank groups	Deposits		Advances		Investment		Total Business	
	Amount	%age	Amount	%age	Amount	%age	Amount	%age
1.Public Sector Banks	50020.13	75.33	38783.12	74.76	15040.76	65.66	103844.01	73.56
(a)State Bank Groups	14050.24	21.16	11519.91	22.21	4173.22	18.22	29743.37	21.07
(b)Nationalized Bank	35969.89	54.17	27263.21	52.55	10867.54	47.44	74100.64	52.49
2.PrivateBank	11745.87	17.69	9664.18	18.63	5259.82	22.96	26669.87	18.89
(a)Old Private Sector Banks	3158.91	4.76	2300.95	4.44	1093.33	4.77	6553.19	4.64
(b)New Private Sector Banks	8586.96	12.93	7363.2	14.19	4166.49	18.19	20116.68	14.25
3.Foreign Bank	2770.63	4.17	2298.49	4.43	2004.88	8.75	7074.00	5.00
Total Commercial Banks	64536.64	97.19	50745.79	97.82	22305.47	97.37	137587.90	97.45
4.Regional Rural Banks	1863.00	2.81	1130.00	2.18	603.00	2.63	3596.00	2.55
Total of All Banks	66399.64	100.00	51875.79	100.00	22908.47	100.00	141183.90	100.00

Source: Calculated from Annual Accounts of Respective Banks, IBA Bulletin, And Various Years.

Figure 1
Banking Group - Wise Business Share

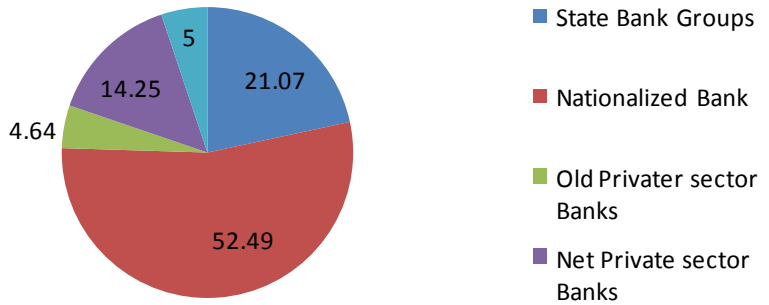


Table 2 Distribution of Total Number of Branches and Staff in Indian Banking Industry

Bank groups	Branches		Staff		
	Number	%age	Number	%age	Staff Per Branch
1.Public Sector Banks	70314	83.21	771388	76.22	11
(a)State Bank Groups	19787	23.41	280256	27.69	14
(b)Nationalized Bank	50527	59.79	491132	48.53	10
2.PrivateBanks	13868	16.41	214304	21.18	15
(a)Old Private Sector Banks	5610	6.64	62965	6.22	11

(b)New Private Sector Banks	8258	9.77	151339	14.95	18
3.Foreign Bank	324	0.38	26335	2.60	81
Total of All Banks	84506	100.00	1012027	100.00	12

Source- Calculated from Annual Accounts of Respective Banks, IBA Bulletin, and Various years

Figure 2
Bank–Wise Distribution of Total Number of Branches

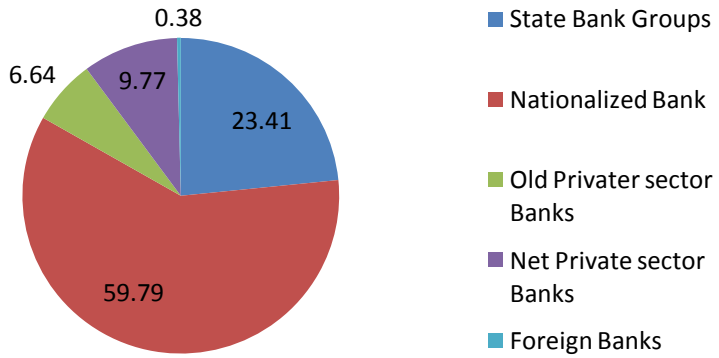
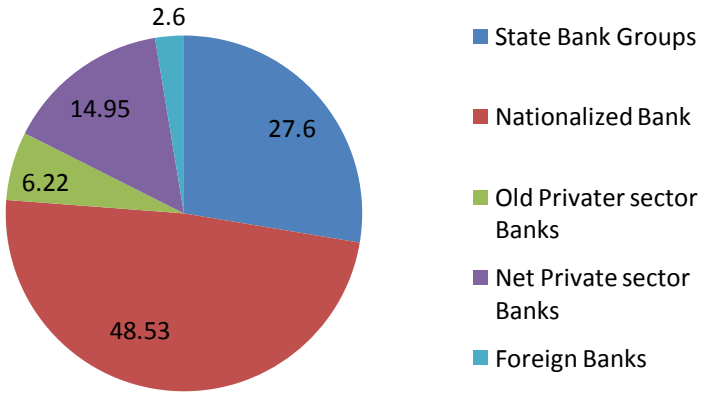


Figure 3
Bank-Wise Distribution of Staff



II. Conclusion

With the increasing levels of globalization of the Indian banking industry, evolution of universal banks and bundling of financial services, competition in the banking industry will intensify further. The banking industry has the positional and ability to rise to the occasion as demonstrated by the rapid pace of automation which has already had a profound impact on raising the standard of banking services. Indian corporate finds themselves equipped to operate in highly competitive and financial market place they will have only themselves to blame.

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