Role of Banking sector on Indian Economy

*Dr.B.V.Kapparashetty, Asst Professor of Commerce, C.S.I. College of Commerce, Dharwad.

Abstract

This paper author wants to investigate the role of banking sector in positively affecting the growth of Indian economy over the years and methods of better penetration. In recent time, we has witnessed that the World Economy is passing through some intricate circumstances as bankruptcy of banking & financial institutions, debt crisis in major economies of the world and euro zone crisis. The scenario has become very uncertain causing recession in major economies like US and Europe. This poses some serious questions about the survival, growth and maintaining the sustainable development. However, amidst all this turmoil India’s Banking Industry has been amongst the few to maintain resilience. The tempo of development for the Indian banking industry has been remarkable over the past decade. It is evident from the higher pace of credit expansion, expanding profitability and productivity similar to banks in developed markets, lower incidence of non-performing assets and focus on financial inclusion have contributed to making Indian banking vibrant and strong. Indian banks have begun to revise their growth approach and re-evaluate the prospects on hand to keep the economy rolling. In this paper an attempt has been made to review various challenges which are likely to be faced by Indian banking industry. It was 1960, when RBI was empowered to force compulsory merger of weak banks with the strong ones. It significantly reduced the total number of banks from 566 in 1951 to 85 in 1969. In July 1969, government nationalised 14 banks having deposits of Rs. 50 crores & above. In 1980, government acquired 6 more banks with deposits of more than Rs.200 crores. Nationalisation of banks was to make them play the role of catalytic agents for economic growth. The Narasimha Committee report suggested wide ranging reforms for the banking sector in 1992 to introduce internationally accepted banking practices. The amendment of Banking Regulation Act in 1993 saw the entry of new private sector banks. Banking industry is the back bone for growth of any economy. The journey of Indian Banking Industry has faced many waves of economic crisis. Recently, we have seen the economic crisis of US in 2008-09 and now the European crisis. The general scenario of the world economy is very critical. It is the banking rules and regulation framework of India which has prevented it from the world economic crisis. In order to understand the challenges and opportunities of Indian Banking Industry, first of all, we need to understand the general scenario and structure of Indian Banking Industry.

Keywords— Rural Market, Risk Management, Global Banking, Economy, India

Introduction

Bank of Hindustan was set up in 1870; it was the earliest Indian Bank. Later, three presidency banks under Presidency Bank’s act 1876 i.e. Bank of Calcutta, Bank of Bombay and Bank of Madras were set up, which laid foundation for modern banking in India. In 1921, all presidency banks were amalgamated to form the Imperial Bank of India. Imperial bank carried out limited number of central banking functions prior to establishment of RBI. It engaged in all types of commercial banking business except dealing in foreign exchange. Reserve Bank of India Act was passed in 1934 & Reserve Bank of India (RBI) was constituted as an apex body without major government ownership. Banking Regulations Act was passed
in 1949. This regulation brought RBI under government control. Under the act, RBI got wide ranging powers for supervision & control of banks. The Act also vested licensing powers & the authority to conduct inspections in RBI.

In 1955, RBI acquired control of the Imperial Bank of India, which was renamed as State Bank of India. In 1959, SBI took over control of eight private banks floated in the erstwhile princely states, making them as its 100% subsidiaries. India has made substantial economic progress over the past few decades. The world has made great strides in reducing extreme poverty, and India played a key role in that progress. India cut extreme poverty in half within a generation and is transforming itself into one of the world’s fast-growing economies. That’s very encouraging to us at the World Bank Group, because our mission is to encourage broad-based growth, reduce extreme poverty and boost shared prosperity.

In recent years, the Indian government has carried out important market-oriented reforms. We’ve just released our annual Doing Business report, which measures ease of doing business. For the third year in a row, India is in the top ten in terms of improvements. During that period, it has jumped from 142nd in the Doing Business rankings to 63rd. Per the new report, it’s easier than it was a year ago to file for a new business, get a construction permit and trade goods across the border.

We share your desire to see India’s economy stronger. Prime Minister Modi has set the ambitious goal of turning India into a $5-trillion economy by 2025. Reaching that goal would be good for the people of India—and for the world. It will require even more reforms on taxes, trade, infrastructure and government structures. And it will require a strong, stable financial sector and substantial progress on financial reforms: the subject of my remarks today.

Objective:

This paper intense Author explorers the banking system of India and influence of banking sector on the overall Indian economy its growth exports and other related sectors

BOOSTING GROWTH THROUGH FINANCIAL STRENGTH

India’s banking system is at a crossroads. We recognize important reforms already. You protected home buyers by improving the transparency of funds channeled into real estate. You introduced a system of unique identification numbers that has made it easier to make government transfers. This has especially benefited the poor. And you’ve created a unified bankruptcy and insolvency code. These are welcome developments. Still, the financial sector faces a number of challenges. While there are signs that commercial banks are making progress in clearing non-performing loans, there’s still much work to do.

State-owned banks account for nearly 70 percent of assets in the nation’s banking sector. This heavy involvement of the public sector distorts markets, making it difficult for India to address financing gaps in key areas of development such as infrastructure, small and medium-sized businesses and housing. Non-banking financial companies, sometimes called shadow banks, have emerged as an important new source of credit for businesses and consumers. Yet their growth has also created linkages with the traditional banking sector that present new risks.
The financial sector is wrestling with these issues at a challenging moment for the global economy. Global growth is slowing amid sluggish investment and weakening trade. Like many countries, India’s economy is facing challenges, with consumption softening and investment slowing. Globally, bond yields have fallen into low or negative territory for several top bond issuers, benefiting an increasingly narrow group but leaving the productive investments needed for broad-based growth under-funded, including in India. This creates a difficult backdrop for reform. At the same time, it underscores the need for decisive action to allow faster growth.

The opportunity is tremendous. If the current challenges are addressed, India has the potential to build one of the world’s biggest domestic banking sectors. Faster private-sector credit growth would add directly to GDP, jobs and median income.

The Economic Survey 2017 was tabled in the parliament today by the Union Minister of Finance & Corporate Affairs, Nirmala Sitharaman. The survey highlights for India to become a $5 trillion economy, the dominant public sector banks need to become efficient. The economy wants the PSU Banks to perform to their best abilities and support economic growth rather than pull back on lending leading to a detrimental effect on growth and welfare.

India should at least have 6 banks in the global top 100 than just the current largest PSU Bank which is State Bank of India which is 55th largest global bank. The survey expresses assuming if Indian banks were proportionately big in size in relation to the size of the Indian economy.

The survey observed that over Rs. 4,30,000 crore of tax payers money is invested as the governments equity in public sector banks. In 2017, every rupee of taxpayer invested in the PSU Banks on an average has lost 23 paise which call for urgent attention.

The key drivers to make the banking system efficient are:

- Leveraging favourable demographics
- Modernizing digital infrastructure encompassing JAM & PMJDY
- Uniform Indirect GST

The survey believes, India’s growth path depends on how quickly and productively these growth levers are deployed using a well developed financial system.

In developing countries, state banks generally comprise the minority rather than the majority of market share: closer to 20 percent versus 70 percent.
The financial sector here generates a low level of credit compared with other countries. India’s credit-to-GDP level is 51 percent. That compares with 136 percent in Malaysia and 70 percent in Brazil. This trend has taken hold despite the fact that India’s gross domestic savings rate, at nearly 30 percent of GDP, is in line with peer countries. The savings are sufficient, but the system doesn’t use them effectively.

To reach the goal of building a $5-trillion economy, credit will have to grow at a much brisker pace while maintaining good credit quality and avoiding excessive risk taking.

INVolving the Private Sector

More credit would help meet India’s needs in areas such as housing, SMEs and infrastructure. India’s annual infrastructure finance gap is expected to average 0.7 percent of GDP through 2035, more than twice the global average of 0.3 percent.

Productive credit growth would benefit the poor. Hundreds of millions of Indian citizens, and millions of businesses and entrepreneurs, operate in the informal economy, with only limited access to financial services. Many of them could use credit effectively to build a business or buy a motorbike to get to work.

The experience of other emerging markets and developing countries offers some useful lessons. In the 1980s and 1990s, a wave of developing countries moved to liberalize their financial sectors. Countries in central and eastern Europe privatized large parts of their financial systems in the early 1990s as they moved to restructure their previously centrally planned economies. In Latin America, countries including Mexico liberalized their banking sectors following the debt crisis of the 1980s.

Most, but not all, financial liberalizations were a success. One lesson we can draw: it’s important to have strong, independent regulatory authorities to oversee the transition. The global experience also suggests it’s important to carry out transitions during moments of strength, when macroeconomic conditions are balanced and the nation is on a strong economic and fiscal footing.

Within this context, we recognize India’s recent efforts to shore up the financial system. The Reserve Bank of India has worked hard to monitor asset quality. The government’s plan to consolidate public-sector banks is an opportunity to strengthen governance, supervision, efficiency and risk management.

We hope these steps will form the basis of a broader strategy to reduce the role of the public sector in the financial system. A mix of private-capital injections into state banks and full privatizations would boost the sector’s ability to support credit, would facilitate effective financial intermediation, and would reduce moral hazard and fiscal exposures.
Gradually scaling back the statutory requirement of state banks to provide liquidity, as well as the priority-sector lending policy, would also be helpful. These policies end up doing more to distort markets than to expand them. India is well positioned to take advantage of recent advances in financial technology. India has already established a good foundation for fostering FinTech, including the “regulatory sandbox” set up by the RBI, with help from the World Bank Group. Three of the top FinTech deals in Asia last year were based in India, and 80 percent of India’s people have bank accounts. India is well-positioned to share lessons learned with other countries. India can also continue to tap into its entrepreneurial spirit and allow the private sector to continue to innovate in this area, for example in the mortgage market.

DEEPENING CAPITAL MARKETS

India’s capital markets can play a pivotal role in helping the nation attain its economic ambitions. Equity market capitalization is over $2.2 trillion, up over six percent in 2017-9. However, the debt market remains at a nascent stage of development.

The debt market remains highly skewed toward government securities, while the corporate bond market is dominated by top-rated financial and public-sector issuers. Corporate-bond issuance amounts to roughly 3.94 percent of GDP, much less than in other emerging markets. Funds raised through corporate bonds increased from about $52 billion in fiscal 2012-3 to $101 billion in fiscal 2016-7. Since then, corporate-bond issuance has remained roughly flat.

Deepening India’s capital markets could complement bank financing in fostering growth, helping to create new market niches and attract interest from domestic and foreign institutional investors.

Deeper capital markets can be an important way to increase the flow of long-term finance, especially given the asset-liability mismatches in the banking sector. Around the world, long-term financing is increasingly a major focus of institutional investors such as pension funds, insurance companies, mutual funds and sovereign wealth funds.

We encourage India to revise its guidelines for domestic institutional investors, so more resources can flow to long-term finance. Another useful measure would be to adapt the funding models of your development-finance institutions so they can expand in market-based funding. As capital markets deepen, new infrastructure-finance instruments could attract more institutional investors. Globally, pension funds and other institutional investors hold about $136 trillion in assets. Many of these funds would be able to invest more in India if it had deeper capital markets and the right mix of market instruments.
STRENGTHENING NON-BANK FINANCIAL COMPANIES

The growth of non-bank financial companies (NBFCs) has played an important role in channeling credit to under-served markets through new products. IFC, the World Bank Group’s private-sector arm, has been a supporter of the NBFC sector and has helped channel credit to underserved markets. NBFCs have been a useful complement to commercial banks, helping to meet the nation’s financing needs in infrastructure, and among entrepreneurs and consumers.

The sector has recently experienced a downturn, leading to liquidity issues among some NBFCs. Many of these non-bank banks face asset-liability mismatches, borrowing short term and lending long term. They largely depend on commercial banks and market funds for financing. Thus, some banks have exposure to weakness among NBFCs. Resolving this “twin balance sheet” issue of weakness in NBFCs and related banks will be an important step in strengthening India’s financial system and reinvigorating economic growth.

The recent softness in the NBFC sector is an opportunity for the government and regulators to reconsider the role of these institutions within India’s financial system. We would welcome efforts by the RBI to strengthen its regulatory and oversight framework to capture all licensed financial institutions, including all systemically important NBFCs.

Properly regulated, NBFCs will play an important role in fostering innovations in Fintech. This is why it’s even more important that policymakers ensure NBFCs are properly regulated and adequately capitalized as their role in the financial system continues to evolve.

The RBI has done a commendable job overseeing the growth of NBFCs. Going forward, we would recommend that the authorities view the sector constructively as broad, eclectic coalition of various types of institutions with different business models and risk profiles. You should consider applying the same risk-based approach to supervising NBFCs as you apply to banks, applying more stringent regulations and greater scrutiny to institutions, depending on the risks they present to the financial system.

TOWARD A STRONGER INDIA, TOGETHER

In closing, I want to reiterate the importance of a strong financial system to realizing India’s goal of becoming a $5 trillion economy. Allowing more private sector participation in the financial system, making it easier for funds to flow into capital markets, and properly regulating systemically important NBFCs are all ways for the financial sector to evolve in a direction that can position India for fast, broad-based growth. A modernized financial system is essential to delivering it.
In recent decades, India has made impressive progress in building a financial sector that fits its unique development needs. Yet in a world where payments can be sent with a click of a button from the most basic cell phone, it’s crucial that countries have financial sectors that ensure stability while offering deep, well-regulated markets and being agile enough to respond to rapid innovation in the industry.

At the World Bank Group, we’re proud of our longstanding partnership with India. Our first project in India, which financed agricultural machinery, took place in 1948, a year after the nation achieved independence. Over the years, our support evolved from a focus on infrastructure and agriculture to economic liberalization and poverty reduction. In recent years, we’ve supported the emergence of the housing-finance and microfinance markets. Our financial-sector experts are available to consult with the government as it moves forward with reforms in the banking and financial system. As I said earlier, it’s important to design a program that meets the unique profile of the Indian economy.

Conclusion

The Indian banking system consists of 20 public sector banks, 22 private sector banks, 44 foreign banks, 44 regional rural banks, 1,542 urban cooperative banks and 94,384 rural cooperative banks in addition to cooperative credit institutions. As on January 31, 2017, the total number of ATMs in India increased to 210,263 and is further expected to increase to 407,000 by 2021. The banking industry in India has a huge canvas of history, which covers the traditional banking practices from the time of Britishers to the reforms period, nationalization to privatization of banks and now increasing numbers of foreign banks in India. Therefore, Banking in India has been through a long journey. Banking industry in India has also achieved a new height with the changing times. The Indian banking system consists of 18 public sector banks, 22 private sector banks, 46 foreign banks, 53 regional rural banks, 1,542 urban cooperative banks and 94,384 rural cooperative banks as of September 2017. During FY07–19, deposits grew at a CAGR of 11.11 per cent and reached US$ 1.86 trillion by FY19. Deposits as of Feb 2017, stood at Rs 132.35 lakh crore (US$ 1,893.77 billion).

The use of technology has brought a revolution in the working style of the banks. Nevertheless, the fundamental aspects of banking i.e. trust and the confidence of the people on the institution remain the same. The majority of the banks are still successful in keeping with the confidence of the shareholders as well as other stakeholders. However, with the changing dynamics of banking business brings new kind of risk exposure. In this paper an attempt has been made to identify the general sentiments, challenges and opportunities for the Indian Banking Industry. This article is divided in three parts. First part includes the introduction and general scenario of Indian banking industry. The second part discusses the various challenges and opportunities faced by Indian banking industry. Third part concludes that urgent emphasis is required on the Indian banking product and marketing strategies in order to get sustainable competitive edge over the intense competition from national and global banks. This article is a small seed to existing branch of knowledge in banking industry and is useful for bankers, strategist, policy makers and researchers.
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