

Future for Indian Banking System

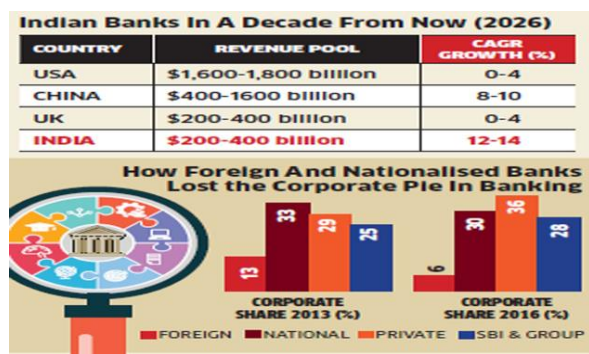
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Abstract - The Banking system India has glorious history, bright future and pleasant present which can be observed by sustaining the recession period from last five years. The Banks are the important organizations in society which require faith of customers to keep their assets in terms of money and gold in banks. The banks have to follow strict policies in terms asset and liabilities management. The banks are using ICT facilities to provide better service to the account holders. The authors have done decent effort to find out the major issues of the banks in India to the readers to update their knowledge. The banks in future will be very sensitive to the changing environment of the world wide customer. The Finance in terms of deposits and advances will depend on the bank policies to lend and take deposits with inter rate which will attract the account holders. The paper deals with the banking history, future and finance safety to customer.

I. INTRODUCTION

Despite the ongoing stress, the Indian banking system is expected to be the world's third-biggest in the next decade. A Boston Consulting Group report pegs the Indian banking revenue pool at close to \$400 billion by 2026. Private banks will continue to outshine as they continue to grab market share from foreign and state-run banks.



RBI on August 27 released a discussion Paper on 'Banking Structure in India - The Way Forward'. The main theme of this paper was how to make Indian banks ready to support future growth of Indian economy and incorporate learning from recent global economic crisis. It has identified certain building blocks for the reorientation of the banking structure with a view to addressing various issues such as enhancing competition, financing higher growth, providing specialized services and furthering financial inclusion. This reorientation is targeted to impart dynamism and flexibility to the evolving banking structure, while ensuring that the structure remains resilient and promotes financial stability. The central bank has invited comments on this discussion paper and after deliberation on feedbacks it will finalize policy direction. We tell you the major areas which this discussion paper is talking about.

Multi layer banking structure

The discussion paper iterates that the reoriented banking structure would comprise four tiers. The first tier may consist of three or four large Indian banks with domestic and international presence along with branches of foreign banks in India. The second tier is likely to comprise several mid-sized banking institutions including niche banks with economy-wide presence. The third tier may encompass old private sector banks, Regional Rural Banks, and multi state Urban Cooperative Banks. The fourth tier may embrace many small privately owned local banks and cooperative banks.

Continuous banking licenses

RBI since liberalization in 1991 has invited application for private banking licenses after interval of about 10 years. However the central bank is now considering continuous banking license as the application window is always open. The discussion paper says "There is a case for reviewing the current 'Stop and Go' licensing policy and consider adopting a 'continuous authorisation' policy, as continuous authorisation keeps the competitive pressure on the existing banks and also does not strain the banking system as the 'block' licensing may do."

Size and conversion of banks

Though RBI prefers to have some very large scale banks from India at global scale it finds merit in existence of small banks due to various factors such as supply of credit to small enterprises and agriculture and banking services in unbanked and under-banked regions in the country. However the central bank also outlines challenges such as issues relating to their size, numbers, capital requirements, exposure norms, regulatory prescriptions, corporate governance and resolution, that needs to be suitably addressed. The discussion paper also talks about exploring the possibilities of converting some UCBs into commercial banks or small banks.

Consolidation of banks

There is a need for consolidation as few Indian banks cater to global needs and the growing corporate and infrastructure funding needs. The discussion paper says "Taking into account the pros and cons of consolidation, it has to be borne in mind that while consolidation of commercial banks with established synergies and on the basis of voluntary initiatives is welcome, it cannot be imposed on banks."

Dilution of government stake in PSBs

The Narasimham Committee had recommended reducing the government ownership in public sector banks to 33 per cent. The idea behind this was that it would help the government to reduce its allocation of scarce funds to recapitalize the banks from time to time. The paper suggests that there is a case for government to reduce its ownership stake in the PSBs. Government could also consider diluting its stake below 51 per

cent in conjunction with certain protective rights by amending the statutes governing the Public Sector banks. Government also has the option of considering setting up Financial Holding Companies as recommended by the Report of the Working Group on Introduction of Financial Holding Company structure in India. India to become the third largest domestic banking sector by 2050 after China and the US, says a recent PwC survey

1. The emerging economies' banking sectors are expected to outgrow those in the developed economies by an even greater margin than we projected before the financial crisis.
2. By 2050 'E7' could have domestic banking assets and profits that exceeding the G7 by around 50%.
3. China could overtake the US in terms of the size of their domestic banking sectors by around 2023.

The combined domestic banking assets of the 'E7' emerging economies of China, India, Brazil, Russia, Mexico, Indonesia and Turkey will exceed those in the 'G7' countries sooner than predicted before the financial crisis, according to PwC's 'Banking in 2050' report published today. The G7 comprises the US, Japan, Germany, the UK, France, Italy and Canada. India's rate of growth by contrast is expected to overtake that of China's in the long run as it has more catch-up potential and its working age population growth will be much stronger in the long-term. India's share of global GDP in \$ terms could therefore increase from only 2% in 2009 to around 13% in 2050 after allowing also for potential real exchange rate increases. This makes it one of the most rapidly growing economies over this time period. However, to sustain these high growth rates India must continue to pursue growth-friendly policies (e.g. invest in infrastructure, open up its markets to increased competition, reduce budget deficits, increase rural education levels particularly for women and reduce bureaucracy). "China and India could have a combined share of around 35% of global banking assets by 2050. The US, Japan and Western Europe are all projected to see large falls in their share of Global global banking assets in the coming decades."

"A fundamental shift in the geography of the world economies will take place during the working lifetime of those at the start of their career with huge implications for job creation, language learning and financial systems. The GDP of the E7 countries is currently well behind that of their G7 counterparts but we'll see them at level pegging within the next two decades and well ahead within the next four. In the banking world, this shift is happening even faster than anticipated and appears to have been accelerated by the financial crisis as emerging market banks have been relatively shielded from the effects of declining asset values. We could now be talking about global banking assets quadrupling to around \$300 trillion by 2050 with banks around the world fighting for a share."

The report indicated that a range of M&A options are available to both emerging and developed market banks and we can expect to see a mix of consolidation, foreign banks entering emerging markets and banks from the E7 expanding overseas. The E7 doesn't need the G7 for capital, decision making or consumers so the established economies will have

to make a strong case to convince new economy policy makers of the benefits of inviting foreign competition in.

Country pairs	Overtaking year (2011 analysis)	Overtaking year (2007 analysis)
E7 overtakes G7	2036	2046
China overtakes US	2023	2043
India overtakes Japan	2033	2041
Brazil overtakes Italy	2045	Beyond 2050
Russia overtakes Italy	2039	2047
Mexico overtakes in Italy	2048	2038
Turkey overtakes Canada	2045	Beyond 2050

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PwC has offices in Ahmadabad, Bangalore, Bhubaneswar, Chennai, Delhi NCR, Hyderabad, Kolkata, Mumbai and Pune. PwC has changed its brand name from PricewaterhouseCoopers to PwC. 'PwC' is written in text with a capital 'P' and capital 'C'. Only when you use the PwC logo is the name represented in lower case. "PwC" is the brand under which member firms of PricewaterhouseCoopers International Limited (PwCIL) operate and provide services. Together, these firms form the PwC network. Each firm in the network is a separate legal entity and does not act as agent of PwCIL or any other member firm. PwCIL does not provide any services to clients. PwCIL is not responsible or liable for the acts or omissions of any of its member firms nor can it control the exercise of their professional judgment or bind them in any way.

Banks constitute the backbone of a nations financial system, performing manifold functions through liquidity, maturity and risk transformation Research work has been undertaken to study the relationship between the financial sector and real sector economic growth. The old model of economic growth as a function of land i.e. capital, labour, technology and entrepreneurship has been modified. The new paradigm of economic growth is that it is a function of savings rate, return on investment and cost of intermediation. We can easily see the role and importance of the financial sector with regard to all of these three factors. Thus while there is consensus about finance having significant impact on the quantity, quality ie productivity and the efficiency of capital, jury is still out in determining whether it is the banks or

capital market which drives economic growth. Research opinions and conclusions are equally divided. Very often the examples of the United States of America and the United Kingdom are quoted to prove that it is the capital market which drives growth. To counter that, the examples of Germany and Japan are quoted to establish that it is the banks which drive the growth. Banks constitute the backbone of a nation's financial system, performing manifold functions through liquidity, maturity and risk transformation. Indeed, it needs no gainsaying that the health of the economy is, in a way, the mirror reflection of the banking system, especially in bank-based financial systems such as ours. Of course, the reverse is also equally true. I am reminded of a saying that a bank is like heart of the human body and the capital it provides is akin to the blood in it. So long as the blood circulates seamlessly, the organs remain sound and healthy. However, if for any reason, the blood were not supplied to any organ, then that part would be rendered useless. Not surprisingly therefore, there is always a conscious attempt on the part of the Reserve Bank to provide adequate liquidity and credit to all productive sectors of the economy.

India has the distinction of long history of both banks and capital market. Economic history of India narrates how both have been vibrant in many important cities, though Mumbai did dominate all others. However, slowly and steadily, especially in the last twenty five years or so after the financial sector reforms, the banking sector has emerged as THE source for investment funding. What has been the actual contribution of banks for engineering investments in the Indian economy? Bank credit increased from Rs. 5 billion as at end March 1951, to Rs. 13 billion by March 1961, Rs. 47 billion by March 1971, Rs. 254 billion by March 1981, Rs. 1164 billion by March 1991, Rs. 5114 billion by March 2001, Rs. 39420 billion by March 2011 and Rs. 52604 billion by March 2013. What has been the contribution of capital market in these years? During the 1970s, while capital market helped raising Rs. 10 billion worth of equity, bonds and debentures, banks extended credit worth Rs. 207 billion in that period. During the 1980s, the corresponding figures were Rs. 233 billion and Rs. 910 billion. In the 1990s, they were Rs. 1172 billion and Rs. 3950 billion respectively and in 2000s they were Rs. 2115 billion and Rs. 34206 billion respectively. In the fiscal 2011 and 2012, Rs. 318 billion by the capital market and Rs. 13284 billion by banks.

While we can lament the lackluster performance of the capital market, a redeeming feature has been the growth of private placement market in the past twenty years. Though the issues thereat had been predominantly in the form of bonds and debentures, the growth in size has been very reassuring. It gained popularity from mid 1990s; from 1995-96 to 2000-01, this market raised Rs. 752 billion, in the next ten years, it helped raise Rs. 7614 billion and in fiscal 2011-12 and 2012-13, this market raised Rs. 2009 billion. These are sets of questions that we need to ponder over and take strategic decisions. 12th Five Year Plan aims to usher in faster, more inclusive and sustainable economic growth. It notes that today, India can sustain a GDP growth of 8 percent a year. Increasing this to 9 or 10 percent will need more mobilization of investment

resources; better allocation of these resources through more efficient capital markets; higher investment in infrastructure through both public and PPP routes; and more efficient use of public resources. Twelfth Plan has ambitious target for investments to usher in high growth rate of 8 percent during 2012-17. It aims to mobilise resources worth Rs. 5.4 trillion. The total public sector investment in infrastructure envisaged in the Twelfth Plan is ` 16 trillion by the Centre and ` 12.89 trillion by the States. Investment by the private sector, which includes PPP projects, makes up the balance of ` 26.83 trillion, which is 48.14 percent of the required investment during the Twelfth Plan, a much higher share than the anticipated 36.61 percent during the Eleventh Plan. Accordingly the Plan aims for an eclectic mix of development of capital market, more specifically debt market, besides exhorting bank finance.

Being from the Reserve Bank, let me ponder more over banks' role in the coming years. These are sets of questions that we need to ponder over and take strategic decisions. 12th Five Year Plan aims to usher in faster, more inclusive and sustainable economic growth. It notes that today, India can sustain a GDP growth of 8 percent a year. Increasing this to 9 or 10 percent will need more mobilization of investment resources; better allocation of these resources through more efficient capital markets; higher investment in infrastructure through both public and PPP routes; and more efficient use of public resources. Twelfth Plan has ambitious target for investments to usher in high growth rate of 8 percent during 2012-17. It aims to mobilise resources worth Rs. 5.4 trillion. The total public sector investment in infrastructure envisaged in the Twelfth Plan is Rs. 16 trillion by the Centre and Rs. 12.89 trillion by the States. Investment by the private sector, which includes PPP projects, makes up the balance of ` 26.83 trillion, which is 48.14 percent of the required investment during the Twelfth Plan, a much higher share than the anticipated 36.61 percent during the Eleventh Plan. Accordingly the Plan aims for an eclectic mix of development of capital market, more specifically debt market, besides exhorting bank finance. Being from the Reserve Bank, let me ponder more over banks' role in the coming years.

Leading economists most often cite the importance of sound financial sector reforms as being central to a healthy banking system that aids economic growth. India is the largest country in South Asia with an extensive financial system characterized by varied financial institutions, comprising of both banks and non-banks. Banks are the mainstay of the financial system with bank assets comprising, on average, around 70 percent of GDP during the post-reform period. The commercial banking segment comprises of 26 public sector banks in which government has majority equity stake, 20 private sector, including 7 de novo (which became operational after initiation of economic reforms in 1991) private banks, although RBI has recently done away with this distinction and over 40 foreign banks, which operate as branches. Prior to the inception of financial sector reforms in 1991, the Indian financial system can best be characterized as highly regulated and financially repressed. The prevalence of high reserve requirements, interest rate controls and allocation of financial resources to pre-designated sectors

adversely affected banks resource mobilization and allocation. The period 1992-97 laid the foundations for reforms in the banking system. The reforms comprised of five major planks: cautious and proper sequencing, mutually reinforcing measures, complementarities between banking reforms and other associated policies (e.g., monetary, external, etc.), developing financial infrastructure and nurturing and developing financial markets. Some of the salient reforms undertaken in the financial system, included, among others, lowering of statutory reserve requirements; liberalizing the interest rate regime, first on the lending side and later, on the deposit side; infusing competition by allowing more liberal entry of foreign banks and permitting the establishment of de novo private banks; institution of prudential measures (capital adequacy requirements, income recognition, asset classification and provisioning norms for loans, exposure norms, accounting norms) and enhanced disclosures and levels of transparency in their annual audited statements to promote market discipline. Over the period of reforms beginning 1992 through 2013, real bank assets have grown at a compound annual rate of about 10%; the growth rate of deposits and credit both in real terms, during the same period has been roughly of the order of 10% and 12%, respectively.

III. CONCLUSION

The Reserve Bank of India last week unveiled a document — “Payments and Settlement Systems in India: Vision 2018” — setting out a plan to encourage electronic payments and to enable India to move towards a cashless society or economy in the medium and long term. The vision document could not have come at a better time. After the first vision document on this subject was released four years ago, electronic payments through the banking system in the form of the Real Time Gross Settlement (RTGS) and the National Electronic Fund Transfer (NEFT) have risen three-fold between 2012 and 2016, while mobile banking transactions rose seven-fold coupled with a surge in the value of transactions relating to use of cards and ATMs. An enabling policy and infrastructure needs to be put in place, keeping in mind the broader goal of reducing the levels of cash transaction in the economy. The central bank hopes to achieve this by focusing on coverage or a wider access to a variety of electronic payment services, ensuring convenience, promoting the integrity and security of operations, convergence, a robust infrastructure, responsive regulation and effective supervision besides addressing customer service and grievances. Policymakers were slow in the beginning to recognise the transformational impact of electronic payments. The emergence of firms in the digital payments segment such as [Paytm](#), Mobikwik, Pay U and the trend of a growing number of consumers taking to paying utility and other bills through electronic platforms may have prompted them to reconsider their stance. There are also other fundamental reasons. The rapid growth in e-commerce and mobile banking channels over the last few years has highlighted the potential for boosting tax revenues, discouraging tax avoidance, and building of a multi-tier national payment infrastructure facility for payment of bills, apart from providing an audit trail and lowering the costs of hand for the central bank. Studies have shown that a higher use of electronic payments leads to improvement in both consumption and also, GDP growth. The often cited case is

that of South Korea, where a raft of measures including preferential tax treatment for customers making payments through cards contributed to a reduction in cash payments with a positive impact on economic growth. Last year, the revenue department had released its draft proposals for facilitating electronic payments, which made out a case for tax benefits to consumers and merchants to encourage greater use of electronic payments. It also nudged government departments and corporates to migrate to electronic payments.

Now that India has the infrastructure —the unified payments interface (UPI), which RBI Governor Raghuram Rajan reckons will revolutionise mobile banking — a growth plan, and a regulatory road map, a policy intervention in terms of incentives could complement moves underway to transform India’s payments landscape. The government must act on it fast.

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