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BANKING SYSTEM IN INDIA – EVOLUTION AND RECENT CHANGES

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ABSTRACT

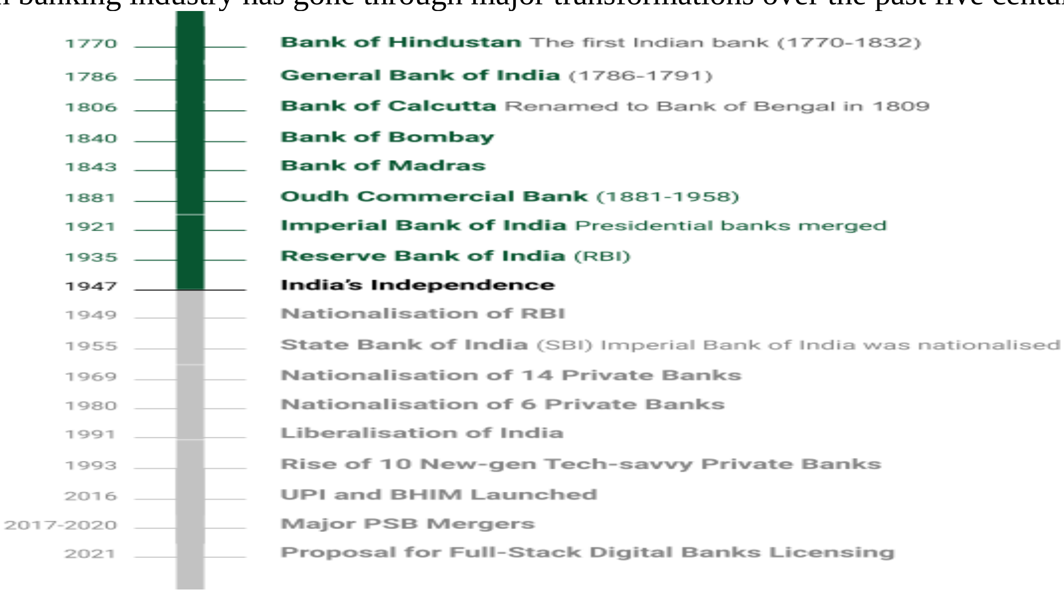
Banks are the major source of finance for any country like wise in India we find that Reserve Bank of India is the main bank which control the monetary supply in the country further banks also provide major source of assistance at the time of crisis. As we all know that Banks act as the backbone of the financial pillar of every country and so it is important to understand the evolution of banking, how the banking industry took place as emergence?, what was the need to introduce banks in the country?, How the banks developed in recent times? What all policies has been implemented for the stronger and transparent functioning of the bank?, we will have the answers to all these questions in this research paper. This research paper will provide the readers a gist of the Indian banking system. There will also study the vast changes which took place overtime in the banking industry as well as we will also get to know what will be the future of banking look like. So it is important to study the banking industry to evaluate ourselves with the trends and changes in the banking industry.

Keywords:- Evolution in Banking, Changes in Banking Industry Overtime in India, Banking Evolution in India.

INTRODUCTION

The banking system is considered almost as old as civilization and has existed in varied forms. Before we deep-dive into the evolution of banking in India, let's take a look at the banking scene in the world. Here's a short video that captures the evolutionary process of banking, with a few pre-historic and mythological elements thrown in as a homage to our curious and imaginative ancestors.

The banking system of a country upholds its economic development. Considering the economic condition of people, the need for financial services, and the advancements in technology that followed, the Indian banking industry has gone through major transformations over the past five centuries.



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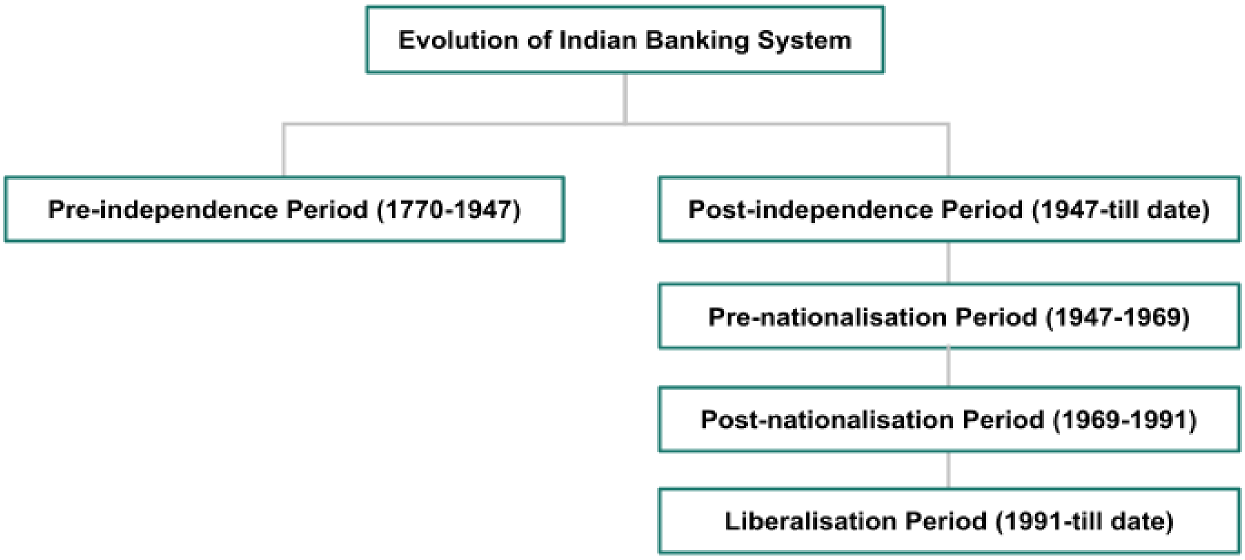
EVOLUTION OF BANKING IN INDIA

Evolution of banking in India from the time the first bank was established in India to the current mobile banking era–what happened in between. The history of banking in India can be broadly classified as:

- Pre-independence Phase (1770-1947)
- Post-independence Phase (1947-till date): To understand this phase better, we'll break it down further into:
- Pre-nationalisation Phase (1947-1969)
- Post-nationalisation Phase (1969-1991)
- Liberalisation Phase (1991-till date)

Let's deep dive into each one of these eras.



The Pre-independence Phase (1770-1947)

The organized banking sector in India dates back to more than a century before independence when the **Bank of Hindustan–the first bank of India** was established in 1770 in the then Indian capital, Calcutta. It failed in due course and was liquidated in 1832. Subsequently, several banks like General Bank of India (1786-1791), and the Oudh Commercial Bank (1881-1958) established during the pre-independence era didn't last very long either.

The Bank of Bengal, Bank of Bombay, and Bank of Madras established by the East India Company during the early to mid-1800s–together known as the **Presidential Banks** were later merged in 1921 to form the **Imperial Bank of India**. It was later nationalised in 1955 and named the **State Bank of India** (SBI). In 1959, the SBI was given charge of 7 subsidiary banks making it India's largest Public Sector Bank (PSB).

Subsidiary banks of SBI

Subsidiary banks of SBI	
State Bank of Bikaner & Jaipur	State Bank of Mysore
State Bank of Hyderabad	State Bank of Patiala
State Bank of Indore	State Bank of Saurashtra
State Bank of Travancore	

Pre-independence banks currently operating in India	
Bank Name	**Year of Establishment**
Allahabad Bank	1865
Punjab National Bank	1894
Bank of India	1906
Canara Bank	1906
Bank of Baroda	1908
Central Bank of India	1911

As many as 600 banks were founded during this period. While many major banks failed to work due to a lack of proper management skills, machines, and technology which led to time-consuming processes and human errors leaving the Indian account holders fraud-prone. A few banks survived the test of time and exist even today:

Pre-independence banks currently operating in India

Between 1906 and 1911, inspired by the Swadeshi movement several local businessmen and political figures established banks for the Indian community. Many of these are still operational.

During the First World War (1914-1918), till the end of the Second World War (1939-1945), and until two years later until the independence of India, the banking system witnessed turbulent times leading to the collapse of a large number of banks.

The Post-independence Phase (1947-1991)

Post-independence, the evolution of the Indian banking system continued when the Government of India (GOI) adopted the approach of a mixed economy in 1948 with an extensive intervention into markets to strengthen the economy. The **Reserve Bank of India** (est. 1935) was nationalised in 1949 and it was empowered to regulate, control, and inspect the banks in India.

Nationalisation in 1969

In the 1960s the RBI had become a large employer and the Indian banking industry had begun playing an important role in supporting economic development. Yet, except for SBI, most banks continued to be run by private entities.

The Government of India issued the **Banking Companies (Acquisition and Transfer of Undertakings) Ordinance, 1969** and nationalized the 14 largest commercial banks at that time.

14 Commercial Banks Nationalized in 1969	
Allahabad Bank (now Indian Bank)	Indian Bank
Bank of Baroda	Indian Overseas Bank
Bank of India	Punjab National Bank
Bank of Maharashtra	Syndicate Bank (now Canara Bank)
Central Bank of India	UCO Bank
Canara Bank	Union Bank of India
Dena Bank (now Bank of Baroda)	United Bank of India (now Punjab National Bank)

Nationalisation in 1980

The second wave of Nationalisation followed in 1980 with 6 more commercial banks.

6 Commercial Banks Nationalised in 1980	
Andhra Bank (now Union Bank of India)	Oriental Bank of Commerce (now Punjab National Bank)
Corporation Bank (now Union Bank of India)	Punjab and Sind Bank
New Bank of India (now Punjab National Bank)	Vijaya Bank (Now Bank of Baroda)

Reasons for nationalisation of banks in India

The nationalisation of Indian banks was a major development in the course of the evolving Indian banking industry. To understand the impact it caused and played a major role in shaping the industry, let's deep-dive into the scenarios that led to it. There was a dire need to:

- Promote the economic development of the country
- Develop confidence in the banking system of India
- Prevent the concentration of economic power in the hands of a select few
- Improve the efficiency of the banking industry
- Create a socio-economic balance
- Mobilize the national savings and channel them into productive purposes
- Sectors such as exports, agriculture, and small-scale industries were lagging behind
- Serve the large masses of the rural population.

Positive impacts of nationalisation

The nationalisation of the Indian banks was a major milestone in the evolution of banking in India that played a major role in guiding its future course. Currently, there are 19 nationalised banks in India. Here're a few benefits that made a difference:

- **Better outreach**: The penetration of banks increased when branches were opened in the remotest corners of the country
- **Increased savings**: With the opening of new branches, since more people had access to banks, the average domestic savings increased twofold
- **Surged public deposits**: The increased reach of banks helped small industries, agriculture, and the export sector grow leading to a proportionate increase in public deposits
- **Increased efficiency**: The added accountability led to improved efficiency and increased public confidence
- **Empowered small scale industries (SSIs):** The SSIs received a boost resulting in considerable growth in the economy
- **Provided employment opportunities:** RBI, post its nationalisation had already set a precedence of becoming one of the largest employers. This continued further with more banks following the lead.
- **Improved agricultural sector:** Marginal farmers could receive credit from banks at economic rates which gave a massive boost to India's agricultural sector

Liberalisation in 1991

In 1991, the GOI adopted economic liberalisation that brought about a massive change in its economic policies to enhance the participation of private and international investments. The RBI approved 10 private banks:

Foreign banks that opened in 1993 following liberalisation in India

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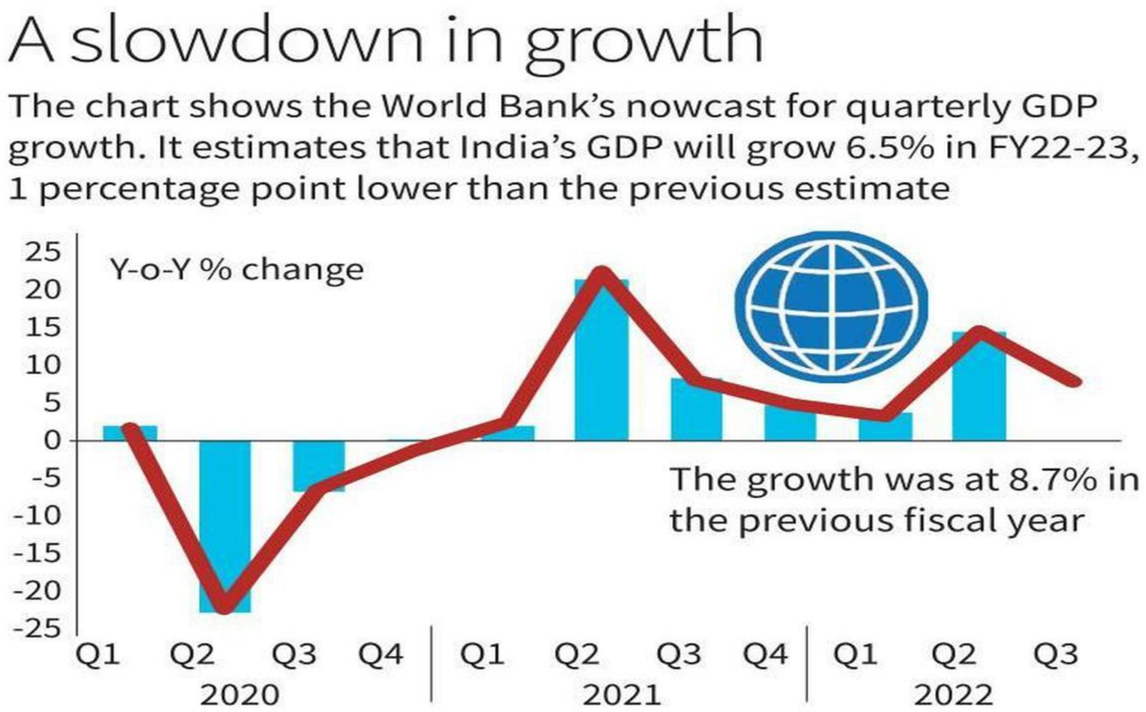
In a few years, Kotak Mahindra Bank (2001), Yes Bank (2004), IDFC (2015), and Bandhan (2015) banks joined the league.

Foreign Banks that Opened in 1993 Following Liberalisation in India	
Global Trust Bank (now Oriental Bank of Commerce)	IndusInd Bank
ICICI Bank	Centurion Bank
HDFC Bank	IDBI Bank
UTI Bank (now Axis Bank)	Times Bank
Bank of Punjab	Development Credit Bank

Positive impacts of liberalisation

Here's how liberalisation revolutionised the Indian banking picture:

- Revitalized the banking sector and led to the rapid and strong growth of government banks, private banks and foreign banks
- A modern and tech-based approach started setting into traditional banks
- Paved path for Payments banks
- Small finance banks came into existence
- The digitalisation of bank transactions and operations became a norm
- Foreign banks such as Bank of America, Citibank, HSBC, etc. set up branches in India. Currently, there are 46 international banks in the country.
- Nationalisation of banks took a pause, instead, the Indian banking sector witnessed several mergers in the public sector banks in the following years:



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RECENT CHANGES IN BANKING SECTOR IN INDIA

India's banking sector has undergone a paradigm shift, especially in the last two decades. It has evolved a lot in terms of asset quality, technology, and regulations. It has shifted from physical banking, which involved customer walk-ins and face-to-face interactions to digital anchors, involving branchless banking made possible by new-age, contactless technologies.

As a banking aspirant, who wants to join the Reserve Bank of India at a managerial level, you should be well-informed about the changes that are taking place in the banking sector, both the immediate change and the transitional ones. We'll here look at the macro picture of how the banking sector has evolved over the last few decades.

PERSPECTIVES ON INDIAN BANKING

In 2009-10 there was a slowdown in the balance sheet growth of scheduled commercial banks (SCBs) with some slippages in their asset quality and profitability. Bank credit posted a lower growth of 16.6 per cent in 2009-10 on a year-on-year basis but showed signs of recovery from October 2009 with the beginning of economic turnaround. Gross nonperforming assets (NPAs) as a ratio to gross advances for SCBs, as a whole, increased from 2.25 per cent in 2008 - 09 to 2.39 percent in 2009 – 10.

Notwithstanding some knock-on effects of the global financial crisis, Indian banks withstood the shock and remained stable and sound in the post-crisis period. Indian banks now compare favorably with banks in the region on metrics such as growth, profitability and loan delinquency ratios. In general, banks have had a track record of innovation, growth and value creation. However this process of banking development needs to be taken forward to serve the larger need of financial inclusion through expansion of banking services, given their low penetration as compared to other markets.

During 2010-11, banks were able to improve their profitability and asset quality. Stress test showed that banking sector remained reasonably resilient to liquidity and interest rate shocks. Yet, there were emerging concerns about banking sector stability related to disproportionate growth in credit to sectors such as real estate, infrastructure, NBFCs and retail segment, persistent asset-liability mismatches, higher provisioning requirement and reliance on short-term borrowings to fund asset growth

The Changing Landscape of Banking Sector in India

The digital revolution has played an important role in shaping the growth trajectory of the banking sector in India—from promising unprecedented customer experiences to ensuring extraordinary gains in productivity.

Especially, if we evaluate the post-demonetization phase, the finance industry has witnessed a significant shift towards digitization; and its stakeholders are now better equipped in using the technology at their disposal.

Next, we will discuss the recent developments in the banking sector:

1.

Financial Inclusion

Financial inclusion refers to the availability and equality of opportunities to access financial services. It acts as a key driver in the economic growth and development of any nation. The Government of India, on pursuance of the RBI, is actively propagating financial inclusion through various schemes. Some of the government-run schemes to enhance the outreach of financial services in India include:

1. Pradhan Mantri Jan Dhan Yojana (PMJDY)
2. Atal Pension Yojana (APY)
3. Pradhan Mantri Vaya Vandana Yojana (PMVVY)
4. Stand Up India Scheme
5. Pradhan Mantri Mudra Yojana (PMMY)
6. Pradhan Mantri Suraksha Bima Yojana (PMSBY)
7. Sukanya Samriddhi Yojana
8. Jeevan Suraksha Bandhan Yojana

2.Use of Technology

Technology is yet another important element that the banking sector in India is leveraging to enhance its productivity. The adoption of Core Banking Solutions (CBS) in 2002 for the incorporation of sophisticated technological solutions was an important step towards using technology to enhance the banking sector. CBS has not only enabled bank-to-client interactions but has also facilitated the calculation of penalties, interests, and maturity, etc. Next, with the coming of the digital age in 2011, technological integration has been raised a notch higher to enable unprecedented customer experience. Some of the current digitally-enabled government-approved banking platforms are:

1. Unified Payment Interface (UPI)
2. Bharat Interface For Money (BHIM)
3. National Unified USSD Platform
4. Aadhar Enabled Payment System

3.Recent Bank Merge

Another change that the banking sector in India is witnessing is structural in nature. The Government is reducing the number of Public Sector Banks by announcing mega-mergers. Subsequently, the number of public sector banks in India has been reduced to 12 from 27.

Here's the list of public sector bank mergers (until April 2020)

1. In April 2019, Vijaya Bank and Dena Bank have merged with Bank of Baroda
2. The 6 SBI associates and Bhartiya Mahila Bank merged with the State Bank of India
3. With effect from April 1, 2020, United Bank of India and Oriental Bank of Commerce have merged with Punjab National Bank making it the second-largest public sector bank in India
4. With effect from April 1, 2020, Syndicate Bank has merged with Canara Bank.
5. With effect from April 1, 2020, Allahabad Bank has merged with Indian Bank
6. With effect from April 1, 2020, Andhra Bank and Corporation Bank of India have merged with Union Bank of India

4.Electronic Payment Services – E Cheques

Now-a-days we are hearing about e-governance, e-mail, e-commerce, e-tail etc. In the same manner, a new technology is being developed in US for introduction of e-cheque, which will eventually replace the conventional paper cheque. India, as harbinger to the introduction of e-cheque, the Negotiable Instruments Act has already been amended to include; Truncated cheque and E-cheque instruments.

5. Real Time Gross Settlement (RTGS)

Real Time Gross Settlement system, introduced in India since March 2004, is a system through which electronics instructions can be given by banks to transfer funds from their account to the account of another bank. The RTGS system is maintained and operated by the RBI and provides a means of efficient and faster funds transfer among banks facilitating their financial operations. As the name suggests, funds transfer between banks takes place on a 'Real Time' basis. Therefore, money can reach the beneficiary instantaneously and the beneficiary's bank has the responsibility to credit the beneficiary's account within two hours.

6. Electronic Funds Transfer (EFT)

Electronic Funds Transfer (EFT) is a system whereby anyone who wants to make payment to another person/company etc. can approach his bank and make cash payment or give instructions/authorization to transfer funds directly from his own account to the bank account of the receiver/beneficiary. Complete details such as the receiver's name, bank account number, account type (savings or current account), bank name, city, branch name etc. should be furnished to the bank at the time of requesting for such transfers so that the amount reaches the beneficiaries' account correctly and faster. RBI is the service provider of EFT.

7. **Electronic Clearing Service (ECS)**

Electronic Clearing Service is a retail payment system that can be used to make bulk payments/receipts of a similar nature especially where each individual payment is of a repetitive nature and of relatively smaller amount. This facility is meant for companies and government departments to make/receive large volumes of payments rather than for funds transfers by individuals.

8. Automatic Teller Machine (ATM)

Automatic Teller Machine is the most popular devise in India, which enables the customers to withdraw their money 24 hours a day 7 days a week. It is a devise that allows customer who has an ATM card to perform routine banking transactions without interacting with a human teller. In addition to cash withdrawal, ATMs can be used for payment of utility bills, funds transfer between accounts, deposit of cheques and cash into accounts, balance enquiry etc.

9. Point of Sale Terminal

Point of Sale Terminal is a computer terminal that is linked online to the computerized customer information files in a bank and magnetically encoded plastic transaction card that identifies the customer to the computer. During a transaction, the customer's account is debited and the retailer's account is credited by the computer for the amount of purchase.

10.Tele Banking

Tele Banking facilitates the customer to do entire non-cash related banking on telephone. Under this devise Automatic Voice Recorder is used for simpler queries and transactions. For complicated queries and transactions, manned phone terminals are used.

11.Electronic Data Interchange (EDI)

Electronic Data Interchange is the electronic exchange of business documents like purchase order, invoices, shipping notices, receiving advices etc. in a standard, computer processed, universally accepted format between trading partners. EDI can also be used to transmit financial information and payments in electronic form.

CONCLUSION

Indian banking system will further grow in size and complexity while acting as an important agent of economic growth and intermingling different segments of the financial sector. It automatically follows that the future of Indian banking depends not only in internal dynamics unleashed by ongoing returns but also on global trends in the financial sectors. Indian Banking Industry has shown considerable resilience during the return period.

The second generation returns will play a crucial role in further strengthening the system. The banking today is re-defined and re-engineered with the use of Information Technology and it is sure that the future of banking will offer more sophisticated services to the customers with the continuous product and process innovations.

Thus, there is a paradigm shift from the seller's market to buyer's market in the industry and finally it affected at the bankers level to change their approach from "conventional banking to convenience banking" and "mass banking to class banking". The shift has also increased the degree of accessibility of a common man to bank for his variety of needs and requirements. Adoption of stringent prudential norms and higher capital standards, better risk management systems, adoption of internationally accepted accounting practices and increased disclosures and transparency will ensure the Indian Banking industry keeps pace with other developed banking systems.

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