

*Full Length Research Paper*

# Growth pattern, reforms and operational innovations in Indian banking

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**Banks play very dynamic role in economic development of a country by identifying profitable activities, exerting corporate governance and extending credit to corporate world. Initially, Government of India has nationalized the banks to meet the diversified development needs of the country. But with the initiation of liberalization, privatization and globalization process, the Indians banks have undergone rigorous changes to cater for the needs of the economy in changing globalised environment. Present paper unfurls the growth pattern, reform measures and operational innovation in Indian banking in the changed globalised world. The paper pinpoints advantages and dangers of reforms and operational innovations in a conceptual way.**

**Key words:** Banking, innovation, growth, economy, credit.

## INTRODUCTION

Bank is an institution which deals in money and credit. For a common man, it is a storehouse; for a businessman, it is an institution of finance; and for a day to day customer, it is deposit house for his savings but in actual sense bank is a business organization which facilitates business and industry by identifying profitable activities, exerting corporate governance and extending credit to corporate world. Banks play an important role in development of economy as it collect savings from public and mobilize them in to productive channels. Thus, a bank acts as intermediary between depositor and investor in the flow of money and credit.

In the past, bank finds a very little attraction in Indian economy due to low level of economic activities. In the year 1935, SBI was established to extend the credit facility and to monitor the banking activity. In 1949, RBI was set up as central banking to control and regulate the supply of money and credit in the country. Fourteen banks were nationalized in 1982 to meet the growing demand of the economy. All these measure helped a lot in the development of banking system in India which in

turn contributed considerably in the manifold development of the economy.

## Growth and development of banking sectors

The development of India in terms of branch expansion, deposit and credit is been depicted in exhibit below. Table 1 depicts that nationalization of banks has increased the scope of banking operation substantially. There was 89 in 1969 which increases to 290 in 2004; but after it started decreasing and got to 183 in 2007. The reduction in numbers of banks was due to decrease in the number of Rural Regional Banks and schedule commercial banks (RRBs) by 100 from 2005 to 2007 and by 118 from 200 to 2007. Whereas NSBs (Non Scheduled Banks) declined by 12 from 169 to 2007. The banks drastically declined due to process of amalgamation, mergers and consolidation of banks. The number of banks offices has stepped up from 8262 in 1969 to 73836 in 2007. It is evident from the table that aggregate

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**Table 1.** Growth and development of banks in India

	June	March	March	March	March	March	March	March	March
Indicators	1969	2000	2001	2002	2003	2004	2005	2006	2007
Number of Commercial Banks	89	298	300	297	292	290	289	222	183
(a) Scheduled Commercial Banks	73	297	296	293	288	286	285	218	179
Regional Rural Banks	—	196	196	196	196	196	196	133	96
Non-Scheduled Commercial Banks	16	2	5	4	4	5	4	4	4
Number of Bank Offices in India	8262	67868	67937	68195	68500	69170	70373	71685	73836
(a) Rural	1833	32852	32585	32503	32283	32227	30790	30436	30560
(b) Semi-Urban	3342	14841	14843	14962	15135	15288	15325	15811	16484
(c) Urban	1584	10994	11193	11328	11566	11806	12419	13034	13840
(d) Metropolitan	1503	9181	9316	9402	9516	9750	11839	12404	12952
Population per Office (in thousands)	64	15	15	15	16	16	16	16	16
Aggregate deposits of Scheduled Commercial Banks in India (Rs. crore)	4646	851593	989141	1131188	1311761	1504416	1700198	2109049	2608309
(a) Demand deposits	2104	145283	159407	169103	187837	225022	248028	364640	429137
(b) Time deposits	2542	706310	829734	962085	1123924	1279394	1452171	1744409	2179172
Credit of Scheduled Commercial Banks in India (Rs. crore)	3599	454069	529271	609053	746432	840785	1100428	1507077	1928913
Investments of Scheduled Commercial Banks in India (Rs. crore)	1361	311697	367184	437482	547546	677588	739154	717454	790431
Deposits of Scheduled Commercial Banks per office (Rs. lakh)	56	1255	1456	1659	1925	2265	2574	3047	3675
Credit of Scheduled Commercial Banks per office (Rs. lakh)	44	669	779	893	1143	1330	1700	2209	2757
Per capita Deposit of Scheduled Commercial Banks (Rs.)	88	8542	9770	11008	12253	14089	16281	19130	23382
Per capita Credit of Scheduled Commercial Banks (Rs.)	68	4555	5228	5927	7275	8273	10752	13869	17541
Deposits of Scheduled Commercial Banks as per centage to Gross National Product at factor cost (at current prices)	15.5	53.5	56	54.4	58.8	59.4	60	65.4	70.1
Scheduled Commercial Banks' Advances to Priority Sectors (Rs. crore)	504	155779	182255	205606	254648	263834	381476	510175	632647
Share of Priority Sector Advances in total credit of Scheduled Commercial Banks (per cent)	14	35.4	31	34.8	35.1	34.5	36.7	35.3	34.3
Credit-Deposit Ratio (per cent)	77.5	53.3	53.5	53.8	56.9	55.9	62.6	70.1	73.5
Investment-Deposit Ratio (per cent)	29.3	36.6	37.1	38.7	41.3	45	47.3	40	35.3
Cash-Deposit Ratio (per cent)	8.2	9.8	8.4	7.1	6.3	7.2	6.4	6.7	7.2

Source – Trend and progress of Indian Banks RBI.

deposits of schedule commercial banks in India has gone up to Rs2608309 cores in 2007 as against Rs4646 cores in 1969. There is continuous growth in deposit of Schedule Commercial Banks per office. It witnessed the growth by 3619 from 1969 to 2007. The credit of Scheduled Commercial Banks per office has increased over the year. It increased to Rs.2757lakhs in 2007 as against only Rs.44 lakh in 1969. The investment by Scheduled Commercial Banks in India has grown faster. In 1969, it was Rs.1361 crore, whereas in 2006, it increased to Rs790431 cores. The data clearly highlight that banks are important constituents of Indian Financial System and Indian economy. The Ratio of bank deposit to GNP has been increased from 15.5 (1969) to 70.1 (2006). Table 2 depicts that among the banks groups, the balance sheets of foreign and new private sector banks expanded at a higher rate as compared to other bank groups. As a result, the combined share of foreign and new private sector bank groups in total assets of SCBs increased further to 25.6% at the end of March 2008 from 24.8% at the end of March 2007. The growth rates in the assets of public sector banks and old private sector banks during 2007-08 at 23.9 and 21.2%, respectively, were higher than those during the previous year. However, their assets grew at a lower rate than those of SCBs as a whole.

Historically, in Indian set up commercial banks largely met the short term working capital requirement of business enterprises while state and national level financial institution looked after long term project finance requirements. As a result, India suffered a lot of fragmented banking system for more than four decades. It is only in recent years that commercial banking also started offering finance for long term project. In the earlier year, banks were tightly protected by rules regulations. Banks have experienced multidimensional development and challenges. With the initiation of revolution process, banks were finally opened up for the private sector. The initiation of economic and financial sector reform has strengthened the fundamental of Indian economy and transformed the operating environment for banks and financial institution in the country. The most important endeavor of financial sector reform has been significant improvement in the financial health of commercial bank in terms of capital adequacy, profitability and assets quality as also greater attention to risk management. Further, deregulation process increased commercial banks to increased revenues by diversifying into investment banking, insurance, credit cards, depository services, mortgage financing, securitization etc. In today's competitive world, there is more disclosure and transparency in bank balance sheet and also focus on corporate governance. At the same time, the globalisation and liberalisation process of economies have created a number of challenges before banks in the new millennium (Gopalakrishan 2004). As a result, the Indian banking system has been subjected to rigorous reform again. The

major reforms undertaken for the upliftment of financial health of commercial banks in India are enumerated below.

## MAJOR REFORMS IN BANKING SECTOR

1. Interest rate on deposit and lending has been deregulated with the banks enjoying greater freedom to determine their rates.
2. Government equity in banks has been reduced and banks were made to access capital market for raising additional capital. With this, banks have more freedom in terms of opening and swapping of branches (Purwar 2003).
3. New private and foreign banks have been set up and expanding their operation to subsidiaries in India. Banks are allowed to setup offshore bank unit in special economic zones (SEZ)
4. Banks have now been allowed to deal in new financial services like insurance, credit cards, infrastructure financing, leasing, gold banking, besides, of course, investment banking, assets management and factoring.
5. Banks are now using new financial instrument like interest rate swaps, forward rate agreement, cross currency forward rate etc. For greater flexibility and better risk management, banks have specialized committees which monitor continuously credit risk, market risk and operational risk.
6. Limits for investment in overseas market by banks have been liberalized.
7. Universal banking has been introduced with banks permitted to diversify in long term finance (Khandelwal 2006).
8. Information technology has become central to banking. Technology infrastructure for payment and settlement system in the country has been strengthened with electronic transfer.
9. Credit delivery mechanism has been reformed to increase the flow of credit to priority sectors through focus on micro credit and self help group. Now priority has been widened to include food processing, cold and storage, software up to 1 core etc.
10. The limit for foreign direct investment in private banks has been increased from 49 to 74% and caps on voting right have been abolished; whereas the limit for FII in private banks is 49%
11. Adoption of prudential norm in the term of capital adequacy, assets classification, income recognitions and provisioning are more close to global standard. Significant progress has been made in the past year to bring the Indian banking system nearer to international standards. Best international practices are being adopted in accounting system, corporate governance and settlement.

With these major reforms in banking system, banks have experienced many advantages. Banking sector reforms have increased profitability, productivity and

**Table-2:** Financial Performance of Schedule Commercial Banks

<b>Growth of Balance Sheet of Scheduled Commercial Banks - Bank Group-wise</b>											
<b>(Per cent)</b>											
<b>Item</b>	<b>As at end-March</b>										
	<b>2007</b>					<b>2008</b>					
	<b>Public Sector Banks</b>	<b>Old Private Sector Banks</b>	<b>New Private Sector Banks</b>	<b>Foreign Banks</b>	<b>All SCBs</b>	<b>Public Sector Banks</b>	<b>Old Private Sector Banks</b>	<b>New Private Sector Banks</b>	<b>Foreign Banks</b>	<b>All SCBs</b>	
<b>1</b>	<b>2</b>	<b>3</b>	<b>4</b>	<b>5</b>	<b>6</b>	<b>7</b>	<b>8</b>	<b>9</b>	<b>10</b>	<b>11</b>	
1. Capital	0.7	4.4	5.6	45.4	17.3	5.2	1.8	14.6	71.0	35.0	
2. Reserve and Surplus	20.0	11.6	17.4	30.6	20.0	31.3	47.1	97.9	35.0	45.4	
3. Deposits	22.9	6.0	38.8	32.5	24.6	23.1	19.8	23.1	26.8	23.1	
3.1. Demand Deposits	19.3	3.9	36.7	19.3	21.1	20.4	23.4	38.6	28.3	24.6	
3.2. Saving Bank Deposits	15.0	6.7	33.3	16.3	16.4	14.9	16.2	40.5	20.2	17.8	
3.3. Term Deposits	27.3	6.1	40.6	47.1	28.7	27.0	20.2	16.0	27.7	24.8	
4. Borrowings	5.7	22.3	42.8	33.0	19.6	24.1	8.0	26.1	14.2	22.4	
5. Other Liabilities and Provisions	16.3	16.1	51.1	72.4	28.1	28.5	21.3	17.5	65.5	30.8	
<b>Total Liabilities/Assets</b>	<b>21.1</b>	<b>7.1</b>	<b>38.7</b>	<b>37.6</b>	<b>24.2</b>	<b>23.9</b>	<b>21.2</b>	<b>27.5</b>	<b>32.7</b>	<b>25.0</b>	
1. Cash and Balances with RBI	26.1	25.9	93.7	49.8	35.2	61.5	74.4	74.3	81.2	65.4	
2. Balances with Banks and Money at Call and Short Notice	26.8	5.8	91.9	41.9	35.9	-31.7	-20.2	-33.7	-25.1	-30.3	
3. Investments	4.9	-3.6	26.4	36.4	9.7	20.2	23.1	31.3	38.4	23.7	
3.1 Government Securities (a+b)	3.6	-2.2	33.0	37.5	9.3	20.5	20.0	21.8	47.5	22.7	
a. In India	3.6	-2.0	32.9	37.5	9.4	20.3	20.0	21.9	47.5	22.6	
b. Outside India	-8.6	-100.0	125.0	0.0	-5.9	58.3	0.0	-53.6	0.0	49.3	
3.2 Other Approved Securities	-7.8	-30.9	-10.3	0.2	-8.5	-16.7	-20.7	12.0	-60.9	-17.0	
3.3 Non-Approved Securities	13.8	-7.6	11.4	32.8	13.3	22.6	37.7	57.0	5.2	30.5	
4. Loans and Advances	30.2	12.0	39.9	29.5	30.6	24.8	20.2	26.4	27.5	25.0	
4.1 Bills Purchased and Discounted	22.4	-15.4	20.7	21.3	19.9	16.3	36.9	36.8	36.5	21.5	
4.2 Cash Credits, Overdrafts, etc.	25.6	11.6	42.3	20.9	25.6	24.3	20.3	31.0	33.8	25.3	
4.3 Term Loans	34.6	16.5	40.7	38.7	35.3	26.2	18.3	24.6	21.2	25.2	
5. Fixed Assets	37.7	-5.6	4.2	24.4	25.0	42.6	26.2	15.9	32.3	35.2	
6. Other Assets	7.1	0.7	33.9	72.9	22.5	31.2	-1.5	28.1	67.0	38.3	

Source – Trend and progress of Indian Banks RBI.

efficiency of banks. Technology has become strategic part of banking, helps the banks to

acquire and implement world class system that enables them to provide service at competitive

cost. With adoption of new technology, banks have competitive edge over other. Best

international practices and universally acceptable standard is necessary for making strong domestic financial architecture. In today's globalised world, focusing on the observance of standards will help both integration with world financial market.

However, with experiencing advantage, banks are facing challenges simultaneously. Reform initiative has brought greater competition not only among banks (foreign banks and domestic banks) but also from mutual funds, NBFCS, post office etc. Increased number of global players has intensified competition which is reflected in decline in bank concentration. The share of top 5 banks assets declined from 51.7% in 1991-92 to 43.5% in 2001-02 while its share in profit fell from 54.5% to 41.4% in the same period. Rising competition has great bearing on customers' preference as they react to value added offering. Customers' retention calls for customized service and hassle free delivery (Saravan 2004). In order to survive in competitive environment, banks will have to attract and retain customer by introducing innovative products, enhancing the quality of customer services and marketing a variety of products through diverse channels. The far-reaching changes in the banking and financial sector entail a fundamental shift in set of skills required for banking. To cope with increasing competition, demand for specialised banking function is set to go up. Special skills in retail banking, treasury risk management etc is required. Thus, skillful human resources and motivation among human resources have to be strengthened in banking sector. In addition to being exposed to credit risk, market risk and operational risk, the business of bank would be susceptible to country risk. For this banks need to upgrade their credit assessment and risk management skill and retraining staff (Sanjay 2005).

## OPERATIONAL INNOVATION IN INDIAN BANKING

There are many strategic options with banks to face challenge and sustain leadership.

1. With the entry of private sector into retail banking, the banking system underwent phenomenal changes. New concept added in banking is retail banking. Retail banking is typical mass-market banking where individual customer uses local branches of larger commercial banks. Most of the private and foreign banks have opened up their branches, enabling a customer to operate his account from anywhere even from different cities.
2. Computerized facility and network system made available by bank have enabled customers to execute transactions from his home. Using credit facilities available, he can order for an ice-cream or a pizza while sitting on an arm chair at his house.
3. The bank would accommodate shopping centre in their premises. So, those customers at single visit do shopping besides banking.

4. Today, ATMS are themselves turning into quasi bank as they offer value added service. Now, public sector banks also have opened up ATM service. Now, banks are taking transaction to doorstep of customer with mobile ATM. During the recent monsoon havoc in Mumbai, ICICI bank provided a mobile ATM van in surburan kaliaan.

5. New concept introduced by private is 12 h banking. Some of the private sector banks have recently begun 8 a.m. to 8 p.m., but some private banks even offer 24 h banking at their branch located at strategic place like airport.

6. Customer in rural and semi urban areas has been enabled to access banking services. It is rural banking in which government sponsored or assisted banks which are privately engaged and largely private owned that provide credit facilities on reasonable terms to farmer merchants or to cooperative of farmers and merchants, or in general to the people of rural community. The RBI has asked (Regional Rural Bank) to offer credit facilities as a measure aimed at banking services to the common man. RRBS can also set up ATMs, issues debit and credit cards and also handle pension.

7. If credit and debit cards have made cash redundant, co-branded cards are changing the customer's spending pattern and lifestyle. HSBC and Tata Group Company have launched star credit, India's first private label holder of these cards will eligible for exclusive star India Bazaar discount programs. Most credits card also offer health and insurance cover. SBI has tied up with four NGOs viz The Cancer Patients Aid Association, The National Association for Blind, SOS Children's Villages Of India and World-Wide Fund For Nature India. The SBI social cards allow cardholders donate to such NGOs every time they use it. CITI BANK has tied up with CRY and WWF.

8. Wealth Management is new concept, which is becoming popular. It includes all financial services like tax management, legal solution and transmission of wealth to next generation from 'cradle to grave'

## Conclusion

Indian banking industry has experienced considerable growth in terms of number of branches, deposit and credit. Since inception, a number of reform measures have been introduced in banking sector for the operational and financial upliftment of banking industry in India. As a result of reform measures, the Indian banking has come to the global standards. Now banks in India offer a variety of services to meet the diversified need of customers. Simultaneously, there is a fear the reform measures and operational innovations introduced may create some problems in Indian environment. Thus, there is a strong need for monitoring and regulating the banking industry on continuous basis for healthy survival of Indian banks in a changing globalized world.

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