INTRODUCTION

Banking sector is considered as the epicenter of economic development being repositories of community’s savings and as purveyors of credit. The word bank is used in the sense of commercial bank. It is of Germanic origin though some persons trace its origin to the French word ‘Banqui’ and the Italian word ‘Banca’. It referred to a bench for keeping, lending’s and exchanging of money or coins in the marketplace by money lenders and money changers. Chambers Twentieth Century Dictionary defines a bank as an “institution for the keeping, lending and exchanging, etc. of money.” In the present chapter, role of commercial banks in economic development, evolution of commercial banking in India, backdrop of reforms, rationale of banking sector reforms, banking sector reforms and snapshot of major banking developments have been discussed.

1.1 Role of Commercial Banks in Economic Development

Banking sector, considered as the prime driver of economic development, has brought drastic changes in the economic landscape of the nation. Jha, Probodh Kumar (1985) the banks render vital services to the masses belonging to the various sectors of the economy like agriculture, industry whether small scale or large scale. The development of banking sector has been well acknowledged as the life support system for accelerating the economic development of a nation. The banks perform the process of financial intermediation through the institutionalization of savings and investments and foster economic growth. Stulz (2001) the growth potential of a country can be hindered irrespective of adequate resources if the domestic financial intermediation mechanism fails to allocate these savings to available investment opportunities efficiently.

Banks are not just the storehouse of country’s wealth but are the reservoirs of resources necessary for economic development. Schumpeter (1934) the role of banking sector was stressed as a financier of productive investments and thus an accelerator of economic growth. Banking system is also regarded as core determinant of economic system of a country. It provides strength to monetary and credit mechanism through its monetary authority and regulates the entire mechanism to the
requirements of economic system. The banking sector has shown remarkable responsiveness to the needs of planned economy and fostering economic development.

Within the banking institutions, commercial banks are the kingpin of all economic activities. The activities of commercial banks have grown in multi-directional ways as well as multi-dimensional manner, playing a catalytic role in general and backward area development, extended assistance to rural development, helping agriculture, industry and international trade in a significant manner. They have very significant role in enriching the economic and social life of the nation.

Commercial banks have an important role in mobilization of resources which is an integral part of the development process in India. In this process of mobilization, banks are at a great advantage, chiefly because of their network of branches in the country. The banks have to place considerable reliance on the mobilization of deposits from the public to finance development programmes. However, if the banks fail to tap the savings from the public, the money shall be lying idle in the hands of people and could not be of any use for the economic development of the country.

From the economic point of view, the major task of banks and other financial institutions is to act as intermediaries, channeling savings to investment and consumption, through them, the investment requirements of savers are reconciled with the credit needs of investors and consumers. If this process of transference is to be carried out efficiently, it is absolutely essential that the banks are involved. Indeed in performing their tasks they realize important economies of scale; the savings placed at their disposal are employed in numerous and large transactions, adapted to the specific needs of the borrowers. In this way they are able to make substantial cost savings for both savers and borrowers, who would otherwise have to make individual transactions with each others.

Apart from the purely commercial dimension, banks social aspect has also become significant to reach to the poorer section of the society. Keeping in view the motto of social banking, banks have streamlined their credit off-takes not only to meet up the priority sector lending norm but also to carry on their social responsibility. The commercial banks are serving this goal through expansion of their branch network in the rural area. They finance agricultural sector for modernization, marketing of their
produce, irrigational facilities and for high yielding seeds and fertilizers. They also provide financial assistance to the small and marginal farmers, landless agriculture workers, dairy farming, poultry farming, animal husbandry and horticulture.

The industrial sector is also not an exception to this. Commercial banks being the single most important source of credit provide short term, medium term and long term finance to industry. Commercial banks provide working capital finance and other kinds of loans to industry for expansion, modernization and renovation. The role of commercial banks is not only limited to extend only working capital finance but banks play wider role in the revival of sick units by way of preventing and detecting sickness in the early stages. Beyond this, banks also provide finance to retailers, traders and wholesalers in the form of purchasing inventory, transferring goods from one place to other, discounting and accepting bills of exchange, providing overdraft facilities and issuing drafts, etc.

The commercial banks also finance exports and imports by providing foreign exchange facilities to importers and exporters of goods. They arrange pre-shipment credit in the form of loans, cash credit and overdraft facilities, while post-shipment credit is provided in the form of discounting of export bills or granting loans against these bills. This facilitates both internal and external trade of the country and in turn flow of domestic and foreign receipts and payments is developed.

The commercial banks also provide funds to investors and consumers which stimulate both aggregate demand and supply for goods and services. The easy access to finance enhances the demand for raw material and finished goods and ultimately boosts employment opportunities. The commercial banks also provide number of endless services such as remittances, demand drafts, sale and purchase of foreign exchange, safe deposits vaults; guarantee facilities, traveler’s cheques, etc. Besides this, they also undertake the issue of credit instruments like letter of credit, acceptance of bills of exchange, advisory services and acting as a referee to the respectability and financial standing of customers. In the line of services, the bank giro and credit cards deserve special mention. The bank giro is a system by which a banks customer, who has to make many payments for different items, could instruct the bank to transfer to the bank accounts of his creditors, the sum due from him and debit his account with the total amount. Similarly, credit cards have changed the ways of shopping. Shekar,
K.C. (1974) the diversified services provided by the banks help in the promotion of trade and industry.

Apart from the certain traditional services, banks have diversified the range of their activities. The new services provided by the banks include mutual fund, merchant banking activities, portfolio management, corporate counseling, hire purchase finance, venture capital and factoring services. All these activities of banks are promoting the development of trade and industry.

In the area of macro-economic policy concerns, the banks play a very important role. They help in controlling of both inflation and deflation and keep the economy away from the shocks of high prices and low supply. Even the central Bank depends upon commercial banks for the success of its monetary policy. Vashist, Avtar Krishan (1991) the credit policy with regard to volume and direction is subject to the control by Central Banking Authority, still commercial banks can devise new ways and means of mobilizing deposits and granting loans and thus can be innovative in deciding the monetary policy. Banks are functioning more as leaders in development and instruments of national policy than as dealers in money.

Thus commercial banks have become an effective tool of social transformation and rejuvenation. Apart from performing the key functions of providing liquidity and payment services and managing bulk of intermediation process, the banking sector has been contributing to the process of economic development by serving as a major source of credit to all sections of the economy. Banks have successfully created world-class financial products and services catering to the entire gamut of needs of households and businesses. But change and growth are throwing up new opportunities and challenges for the Indian banking and financial services sector in the 21st century.

1.2 Evolution of Commercial Banking in India

According to the Central Banking Enquiry committee (1931), money lending activity in India could be traced to the Vedic period i.e., 2000 to 1400 BC. Banking was fairly varied and catered to the credit needs of the trade, commerce, agriculture as well as individuals in the economy. An extensive network of Indian Banking house existed in the country connecting all cities/towns that were of commercial importance. They had their own inland bills of exchange or hundis which were the major forms of transactions between Indian bankers and their trans-regional connections. The pre-
independence period was largely characterized by the existence of private banks organized as Joint Stock Companies. This phase leading up to independence laid the foundations of the Indian banking system. The western variety of joint stock banking was brought to India by the English Agency houses of Calcutta and Bombay. The first bank of joint stock variety was Bank of Bombay, established in 1720 in Bombay. This was followed by Bank of Hindustan in Calcutta which was established in 1770 by an agency house which was closed subsequently in 1832. In 1786; The English Agency Houses had established the bank of Bengal at Calcutta. This heralded the beginning of modern banking in India.

The first presidency bank was the Bank of Bengal established in Calcutta on 2 June, 1806 with a capital of ₹ 50 lakh. The Government subscribed to 20 per cent of its share capital and shared the privilege of appointing directors with voting rights. The bank was given powers to issue notes in 1823. The bank of Bombay was the second presidency bank established in 1840 with a capital of ₹ 52 lakh and the Bank of Madras, the third presidency bank established in July, 1843 with a capital of ₹ 30 lakh. They were known as presidency banks as they were set up in the three presidencies that were the units of Administrative jurisdiction in the country of the East India Company.

From 1860 to 1900

The first formal regulation for banks was the enactment of the Companies, Act in 1850. This Act stipulated unlimited liability for banking and insurance companies until 1860. In 1860, the concept of limited liability was introduced in banking. As a result, several joint stock banks were floated. Some of the prominent joint sector banks thus established were: The Allahabad Bank, The Alliance Bank of Simla, The Oundh Bank and The Punjab National Bank. Thus by the end of 1900, there were three classes of banks in India: Presidency Banks numbering 3, joint sector banks numbering 9 and Exchange Banks of Foreign Banks numbering 8.

From 1900 to 1950

The Swadeshi movement started in the early 1900s’ gave stimulus to the growth of indigenous joint stock banks. Some of the banks established during the period were: The peoples’ Bank of India, The Bank of India, The Bank of Baroda and The Central Bank of India. In 1921, three presidency Banks were merged and formed The
Imperial Bank of India. On the eve of independence in 1947, there were 648 commercial banks comprising 97 scheduled and 551 non-scheduled banks. The number of offices of the banks stood at 2987 with total deposits at ₹ 1080 crore and advances at ₹ 475 crore.

During this period, the Indian joint stock banks specialized in providing short-term credit for trade in the form of cash credit and overdraft facilities. Foreign exchange business remained the monopoly of foreign banks. Between 1990 and 1925, many banks failed. The Central Banking Enquiry Committee, which was constituted by the Government of India in 1929 to examine the relevance of establishing a central banking authority for India, mentioned some important reasons responsible for the failure of banks. These were: insufficient capital, poor liquidity of assets, combination of non-banking activities, irrational credit policy, incompetent and inexperienced directors.

Table 1.1.1: Bank Failures in India 1913-1921

<table>
<thead>
<tr>
<th>Year (January-December)</th>
<th>Number of Banks failed</th>
<th>Paid-up Capital of failed Banks (₹ 000)</th>
<th>Average Paid-up Capital of failed Banks (₹ 000)</th>
<th>Average Paid-up Capital of reporting Banks in Category A&amp;B (₹ 000)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1913</td>
<td>12</td>
<td>3514</td>
<td>293</td>
<td>1152</td>
</tr>
<tr>
<td>1914</td>
<td>42</td>
<td>10902</td>
<td>260</td>
<td>1195</td>
</tr>
<tr>
<td>1915</td>
<td>11</td>
<td>451</td>
<td>41</td>
<td>1190</td>
</tr>
<tr>
<td>1916</td>
<td>13</td>
<td>423</td>
<td>33</td>
<td>1170</td>
</tr>
<tr>
<td>1917</td>
<td>9</td>
<td>2526</td>
<td>281</td>
<td>1315</td>
</tr>
<tr>
<td>1918</td>
<td>7</td>
<td>146</td>
<td>21</td>
<td>1433</td>
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<tr>
<td>1919</td>
<td>4</td>
<td>403</td>
<td>101</td>
<td>1585</td>
</tr>
<tr>
<td>1920</td>
<td>3</td>
<td>725</td>
<td>242</td>
<td>1675</td>
</tr>
<tr>
<td>1921</td>
<td>7</td>
<td>125</td>
<td>18</td>
<td>1901</td>
</tr>
</tbody>
</table>

Note: Category A: Banks with capital and reserves of ₹ 5 lakh and over. Category B: Banks with capital and reserves of over ₹ 1 lakh and up to ₹ 5 lakh.
Source: RBI Currency & Finance.

On the basis of major recommendations of the Central Banking Enquiry Committee, the Reserve Bank of India Act was passed in 1934 and the Reserve Bank of India (RBI) came into existence in 1935 as the central banking authority of India. In 1949, the Banking Regulation Act (BR Act) was passed which provided the framework for the Reserve Bank of India's regulation and supervision of banks. The Act empowered Reserve Bank of India to regulate, supervise and develop the banking system. Such powers encompassed the establishment of new banks, mergers and amalgamation of existing banks, opening of new branches, closing of existing branches, and shifting of
existing branches to other locations. The Act also empowered Reserve Bank of India to effect on-site inspection of banks. During the period following 1949, Reserve Bank of India attempted to institutionalize the savings of the public and to adapt a credit system suitable to the emerging needs of the economy.

From 1950 to 1969

During this period, two important developments took place. First, the All-India Rural Credit Survey Committee, which examined the issue of credit availability at the rural areas, recommended the creation of a state partnered/sponsored bank entrusted with the task of opening branches in the rural areas. Accepting the recommendation, the State Bank of India Act, 1955 was passed, under which Reserve Bank of India took control of the Imperial Bank of India and renamed it as State Bank of India (SBI). Later, in 1959 the State Bank of India (Subsidiary Banks) Act was passed enabling State Bank of India to take over eight princely-state-associated banks as its subsidiaries. They were: State Bank of Bikaner, State Bank of Hyderabad, State Bank of Indore, State Bank of Jaipur, State Bank of Mysore, State Bank of Patiala, State Bank of Saurashtra and State Bank of Travancore. Later on, State Bank of Bikaner and State Bank of Jaipur were merged into one bank namely State Bank of Bikaner and Jaipur. The conversion of the Imperial Bank of India into State Bank of India and the constitution of the associate banks accelerated the pace of extending banking facilities across country.

Secondly, the need to bring about wider diffusion of banking facilities and to change the uneven distributive pattern of bank lending was realized. In view of the relative priorities of developmental needs and for ensuring an equitable and purposeful distribution of credit, the scheme of Social Control over Banks was announced in the Parliament in December 1967. The measures designed under the Social Control aimed at achieving a social orientation of banking within the framework of the then existing ownership. The National Credit Council was set up in 1968 to assess the demand for bank credit from various sectors of the economy and to determine their respective priorities in allocation.

The period witnessed further consolidation in banking. At the launch of the First Five Year Plan in 1951, there were 566 commercial banks consisting of 92 scheduled and 474 non-scheduled banks. In 1969, total number of banks declined to 89 out of which
73 were scheduled and 16 were non-scheduled. The banking scenario that prevailed in the early independence phase had three distinct features. First, the bank failures had raised the concerns regarding the soundness and stability of the banking system. Second, there was large concentration of resources from deposits mobilization in a few hands of business families or groups. Banks raised funds and lent them largely to their controlling entities. Third, agriculture was neglected in so far as bank credit was concerned. A major development during this period was the enactment of the Banking Regulation Act empowering Reserve Bank of India to regulate and supervise the banking sector.

**From 1969 to 1990: Era of Nationalization**

The Indian banking scene underwent significant changes during this period. Several structural and functional changes took place. Although Indian banking system made considerable progress in the 1950s and the 1960s, its spread was mainly concentrated in the urban areas. The rapid increase in deposits in relation to their owned capital enabled the industrialist shareholders to enjoy immense leverage. It was felt that if bank funds had to be channeled for rapid economic growth with social justice, there was no alternative but to nationalization of at least the major segment of the banking system. Hence in July 1969, the Government of India nationalized 14 major scheduled commercial banks, each having a minimum aggregate deposit of ₹ 50 crore. They were: The Central Bank of India, The Bank of India, The Punjab National Bank, The Bank of Baroda, The United Commercial Bank, The Canara Bank, The United Bank of India, The Dena Bank, The Syndicate Bank, The Bank of Maharashtra, and The Indian Overseas Bank. According to the Bank Nationalization Act, 1969, the objective and reasons for the nationalization, were “an institution such as the banking system which touches and should touch the lives of millions has to be inspired by a larger social purpose and has to sub-serve national priorities and objectives such as rapid growth in agriculture, small industry and exports, raising employment levels, encouragement of new entrepreneurs and the development of the backward areas. For this purpose it was necessary for the government to take direct responsibility for expansion and diversification of banking services and for the working of substantial part of the banking system”. The acquisition of ownership of banks was thus to enable banks to play, more effectively, the role of key agent for the economic growth by extending banking facilities to the most deserving classes.
Again, in 1980, the Government of India nationalized another six banks, each having deposits of ₹ 200 crore and above. They were: The Andhra Bank Ltd., The Punjab and Sind Bank Ltd., The Corporation Bank Ltd., The Oriental Bank of Commerce Ltd., The Vijaya Bank Ltd. and The New Bank of India Ltd., (The New Bank of India Ltd. was merged with Punjab National Bank in the Nineties).

Another important structural development was the formation of the Regional Rural Banks (RRBs). In 1973, the Government of India had set up a Working Group to study the credit availability in the rural areas. The Working Group identified various weaknesses of the co-operative credit agencies and commercial banks and came to the conclusion that they may not be able to fill the regional and functional needs of the rural credit system. Therefore, the study group recommended a new type of institution, which combined the rural touch and experience of cooperatives with the modernized outlook and capacity to mobilize the deposits. Such an institution can carry on banking business within the local limits specified by the Government through notification. The Government of India accepted this recommendation and permitted the establishment of Regional Rural Banks (RRBs). The Regional Rural Banks (RRBs) are state sponsored, region based rural oriented commercial banks and set up under the Regional Rural Banks (RRBs) Act 1976. The ownership vests with the sponsoring commercial bank, the Central Government and the Government of the State in which they are geographically located. Under this approach 196 Regional Rural Banks (RRBs) were set up.

1990 Onwards: Era of Reforms

In 1991, the Government of India launched an extensive economic reform programme. As a part of general reforms, reform measures were introduced in the financial sector. The Financial Sector Reforms were based on the recommendations of the Committee on Financial Sector, 1991 (Narasimham I) and the Committee on the Banking Sector Reform, 1997 (Narasimham II). The main objective of the reform was to promote efficiency of the banking system through competitive forces. The strategy adopted was to improve operational efficiency of the banking system and to impart functional autonomy through reduced regulator’s direct interventions in the working of the institutions.
Reforms measures not only imparted greater transparency in dealing and reporting by the entities but also integrated various segments of the financial system such as money market, debt market, foreign exchange market and capital market.

The country’s approach to reform in the banking and financial sector was guided by ‘Pancha Sutra’ or five principles: cautious and sequencing of reform measures, introduction of norms that were mainly reinforcing, introduction of complementary reforms across sectors, development of financial institutions and development and integration of financial markets.

1.3 Rationale of Banking Sector Reforms

In India, the banking and financial sector reforms were initiated during the last decade of the 20th century as a part of general economic reforms with a view to improving the soundness of the public sector banks and other financial institutions. Public sector banks achieved spectacular success during the post nationalization period but such progress was witnessed in the spread of branch network of banks, mobilization of savings and in creating employment opportunities rather than in the improvement of the services to the customers. Frauds, corruption and misutilization of public money were discovered. The vast expansion and spread of the banking sector resulted in surfacing of several internal deficiencies in the system. Due to these difficulties the customer service was affected badly, work technology remained stagnant and the transaction cost kept on increasing over the years.

The income and profits of banks declined over a period of time and made banking institutions unviable in nature. The overall business and earning capacity of commercial banks was adversely affected and resulted into financial chaos. The high rate of Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR) reduced the overall business capacity of business to the larger extent. The banks were required to keep 38.5 percent of their net demand and time liabilities as SLR in approved government securities and 15 percent of their aggregate demand and time liabilities as CRR. They were also required to invest 10 percent of their total demand and time liabilities accumulated in the banking system during a specified period, as impounded reserve. This directed investment programme diverted 63.5 percent of banks total deposits in meeting statutory obligations and banks were left with only 36.5 percent of
aggregate deposits to look into the interest of other competing sectors. All this eroded banks profits to the considerable extent.

The poor performance of number of corporations and delay in the repayment of loans had further affected the income generation capacity of banks by way of not meeting the credit requirements of the borrowers engaged in productive activities. Over a period of time the proportion of public sector banks investment in government and semi-government securities in the form of shares, debentures and bonds had considerably gone up out of total deposits resulting into poor performance of these banks. Misra, S.N. and Sriram Mishra (2001) the other major reasons for the poor performance of public sector banks were un-competitive environment, lack of operational flexibility, managerial weakness and more importantly lack of autonomy in decision making. The implementation of Directed Credit Programme (DCP) of the government assigned to public sector banks is also held responsible for the inefficiency of banking system. The banks were required to channelize 40 percent of their total credit in favour of targeted priority sectors, to be attained by the year 1985 made banks more vulnerable. Banks were further directed to supply 15 percent to agriculture and allied activities and 10 percent to small scale industries of total priority sectors credit.

In order to have easy access to such banks credit, the rate of interest is kept low to make large number of borrowers to avail loans. The losses in income on account of low rate interests for priority sectors are compensated by charging higher rate of interest from the borrowers belonging to non-priority sectors. This cross subsidization of loans was assumed to be helpful for banks in planning their credit allocation. But this practice could not ensure higher and steady return for the banks.

In the present time, this priority sector lending has become a major reason of financial strain for commercial banks due to delay in repayment, poor recovery and becoming of these loans bad assets. The poor recovery of loans, especially of agricultural loans has seriously aggravated the problem of Non Performing Assets (NPAs). Likewise, considerable amount of banks loans has been locked up in Small Scale Industries (SSI) because of chronic sickness of these units. Therefore, the banks are losing considerable amount, by way of charging low rate of interest on the one hand and the poor recovery of loans resulting into over-dues on the other hand. This is contributing to poor income generation of the banks.
On account of this government directed lending programme, banks have incurred huge losses not on account of only low interest rate and poor recovery but there are certain inherent deficiencies, problems and leakages in the system of priority sector lending. The number of studies have revealed that, in certain cases, the selection of beneficiaries were not appropriate and persons belonging to well off classes did manage themselves to be included in the selection group. Further, it was also noted that the assets provided by the banks were not in accordance with the absorption capacity of beneficiaries. Thus the effectiveness of priority sector lending has continued to be much below the desired level and loans provided to beneficiaries have failed to create any tangible assets. The absence of tangible assets and poor recovery of loans has led to reduction in banks income and poor capital formation.

Furthermore, commercial banks in India have failed to come up to the desired level of performance on account of poor productivity of employees. The lacks of technological up gradation, competitiveness and efficiency in the banks have led to poor productivity of banks even after nationalization. The income of the banks has also not increased in a significant manner, but expenditure continued to grow in the post-nationalization of banks. The growing establishment expenses, large recruitment of staff and setting up of unviable branches made the financial conditions of the banks worst in the post-nationalization era.

The opening up of branches in the rural and unbanked areas as per the target given by RBI had intensified the problem further existing in the form of viability of branches. The customers in such area belonged to poor sections with less income generating capacity led to low deposits and advances. The loans disbursed in such rural areas did not turn productive because of poor absorption capacity and lack of awareness. For many years loans remained unpaid.

Over a period of time the capital position of banks too eroded because of unproductive branches. Sen, Kunal, and R.R.Vaidya (1997) the share of banks own funds and reserves to risk-weighted assets in the post-nationalization era continued to remain as low as 3 to 4 percent identified the poor capital position of the banks.

The frequent strikes and red tapism leading to poor customer services and denting the social image in public sector banks resulted into inefficiencies. Otherwise also the customer services in public sector banks have not been considered excellent with their
counters. The customer services in public sector banks have been adversely affected because of inadequate work space, growing expectation of customers, handling of large number of small accounts, lack of apathy to the clients problems and increased work load due to handling of diversified nature of loan operations.

The competitive spirit was also lacking among public sector banks in the post-nationalized period. The numbers of restrictions were imposed by Government of India and Reserve Bank of India in the form of sanctioning licenses for opening branches. The private sector banks and foreign banks concentrated mainly in metropolitan and port areas. These banks were restricted from undertaking certain activities and only public sector banks were considered to undertake these activities. Misra, S.N. and Sriram Mishra (2001) the priority sector lending was mainly concentrated in public sector banks. Some private sector banks which adopted this programme out of violation, was mainly to safeguard their interests only. And foreign banks enjoyed the privilege of undertaking export credit which was not extended to all public sector banks. This caused inefficiencies and income erosion of public sector banks.

The political interference and bureaucratic controls were also not far behind affecting the performance of banks. The political compulsions led to non recovery of loans, creation of undue perquisites etc. and affected the operational efficiency and profitability of banks. Further, class banking was also transformed into mass banking because of phenomenal branch expansion and created confidence with the government ownership of banks.

Besides branch expansion by public sector banks into rural and semi-urban area, lack of improvement in operational methods and procedures, slower computerization of various operations leading to higher transaction costs etc. also contributed to the lower profitability. Lack of proper disclosure norms led many banks to keep their teething problems under cover. Narasimham, M. (1994) the lack of transparency among the public sector banks has not only affected the scope to increase the income but also shrouded their actual position. The window dressing in the financial statements of banks made it difficult to know the actual position of banks and to derive certain policy conclusions.
Thus, at these backdrops the viability of a number of public sector banks became a matter of grave concern. Some of them were incurring huge losses. The systematic and effective supervision and regulation of the banking and non-banking financial system did not keep pace with the developments in these areas. In order to support the major changes that took place in trade and industrial policies and to protect the depositors and investors, a thorough review of the financial system was felt necessary. The overall performance with respect to efficiency, productivity and profitability continued to be dismal, which required some immediate corrective measures. The quality of services provided by public sector banks has also not been considered better, which also required immediate attention. In this background, the Government of India appointed a high level committee under the chairmanship of M.Narasimham-a former Governor of the Reserve Bank of India in August 1991 to go into all aspects relating to structure, organization, functioning and procedures of the public sector banks and other financial institutions.

1.4 Commercial Banking Reforms in India

Narasimham Committee-I (First Generation Reforms)

The Government of India set up a nine-member committee under the chairmanship of M.Narasimham, former Governor of Reserve Bank of India (RBI), to examine the structure and functioning of the existing financial system of India and suggest financial sector reforms. The report of the committee was tabled in the Parliament on December 17, 1991. The committee recommended a series of measures aimed at changes according greater flexibility to banks operation, especially in phasing out statutory stipulations, directed credit programmes, improving assets quality, institution of prudential norms, greater disclosures and better housekeeping, in terms of accounting practices. In the words of Bimal Jalan (2003) ex-Governor of Reserve Bank of India, “the central plank is a set of prudential norms that are aimed at imparting strength to the financial institutions, and inducing greater accountability and market discipline. The norms include not only capital adequacy, asset classifications and provisioning but also accounting standards, exposure and disclosure norms and guidelines for investment, risk management and asset liability management”. These recommendations are a landmark in the evolution of banking system from a highly regulated to more market-oriented system. Deregulation and liberalization encouraged banks to go in for innovative measures, develop business
and earn profits. **Dutt, Rudra and Sundaram, K.P.M. (2004)** the measures were aimed at ensuring a degree of operational flexibility, internal autonomy for public sector banks in their decision making process and greater degree of professionalism in banking operations”. The Reserve Bank of India (2003) grouped the first phase of reform measures in to three main areas: “enabling measures, strengthening measures and institutional measures.

**Joshi, P.N. (2002)** these reforms can also be classified into five different groups namely prudential norms, competition directed measures, liberalization, supportive measures and other measures.

**Liberalization Measures**

- **Reduction in Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR)**

A major factor affecting the profitability and functioning of commercial banks was massive pre-emption of bank resources in the form of high Statutory Liquidity Ratio (SLR) and Cash Reserve Ratio (CRR). The affecting Cash Reserve Ratio (CRR) has been progressively reduced from 16.5 percent to 14.5 percent in November 1995, 10 percent in May 1999, 8.5 percent in April 2000, 7.5 percent in May 2001 and further to 4.75 percent in November 2002. The elective Statutory Liquidity Ratio (SLR) on incremental net demand and time liabilities has been reduced from 38.5 percent in 1991 to 25 percent at present. These reductions have helped both in augmenting loanable resources of the banks and in improving profitability of banks.

- **Deregulation of Interest Rates**

Prior to reforms interest rates on both deposits and advances of banks were administered by the Reserve Bank of India (RBI). These rates were usually unrelated to market realities. As far as advances are concerned, there were as many as 20 administered rates in 1989-90. In regard to the regulated interest rate structure; the basic thrust of the Narasimham committee was that real rates of interest should be positive and concessional interest rates are a vehicle for subversion. Following reform measures, the various rates of interest are now market determined. Scheduled Commercial Banks have now the freedom to set interest rates on their deposits subject to minimum floor rates and maximum ceiling rates. Banks are now free to set interest rates with two concessive rates on all term deposits of maturity of over 30 days.
Prescriptions of rates of all term deposits and conditions for premature withdrawal have been completely dismantled. The deregulation of interest rates has given a high degree of freedom to banks in determining deposits and lending rates.

The four percent differential interest scheme has been officially withdrawn. Though the committee recommended reduction of target for priority sector advances from 40 percent to total credit to 10 percent, the government did not agree to it. But it diluted the concept of priority sector considerably by including housing loans, educational loans, subscription to bonds and debentures of the infrastructure and development organization, etc. The sub-targets in the priority sector are 10 percent for weaker sections and 60 percent credit-deposit ratio in the rural and semi urban areas have been conveniently forgotten by banks and regulatory authorities. Joshi, P.N. (2002) Selective credit controls have been totally abolished, thus giving banks freedom to lend to even the sensitive sectors.

**Prudential Norms**

Identifying the causes for the deterioration of financial health of banking system over time, the Narasimham committee recommended various remedial measures which include inter alia prudential norms relating to income recognition, asset classification, provisioning for bad debts and capital adequacy which have all been implemented. In April 1992, the Reserve Bank of India issued detailed guidelines on a phased introduction of prudential norms to ensure safety and soundness of banks and impart greater transparency and accounting operations. With a view to improving the financial health and creditability of banks, capital adequacy ratio has been marked up and risk weights have been assigned to different government approved securities.

Measures have been taken for reclassification of the Non-Performing Assets and improvement of the soundness of Commercial banks functions. Assets have been classified in four categories-standard, substandard, doubtful and loss. As for capital adequacy, banks were expected to reach 8 percent capital to risk-weighted asset ratio by March 1996. The State Bank of India and other nationalized banks had reached this norms in 1995-96. In line with the recommendations of the committee, commercial banks had been advised to raise minimum capital to risk-weighted asset ratio from 8 percent to 10 percent from the year ended March 2000.
Competition Directed Measures

Transparent guidelines or norms of entry and exit of private sector banks have been stipulated. An element of competition has been ought to be fostered in financial sector by permitting new private sector banks and more liberal entry of branches of foreign banks. Local area branches have also been encouraged to foster competition in rural and semi-urban areas. Except in maturity pattern of assets and liabilities, movement in provision accounts and Non-Performing Assets (NPAs), transparency and disclosures standards have been enhanced to meet international standards.

Since 1969, no new bank had allowed to be opened in India. That policy changed in January 1993 when the Reserve Bank of India announced guidelines for opening of private sector banks as public limited companies. The criteria for setting up of new banks in private sector were: capital of ₹ 100 crore, most modern technology and head office at non-metropolitan centre. In January 2001, paid-up capital of these banks was increased to ₹ 200 crore which has to be raised to ₹ 300 crore with in a period of 3 years after the commencement of business. The promoters share in bank shall not be less than 40 percent. After the issue of guidelines in 1993, 9 new banks have been set up in the private sector, one of which, Time Bank was subsequently merged with HDFC Bank. Shenoy, P.S. (2000) the new generation private sector banks have brought about a paradigm shift in service standards and set new benchmarks in terms of application of technology, speed in delivery of services, channels, branch ambience and a higher order of marketing orientation. These banks with their updated technology have been providing stiff competition to public sector banks and old private sector banks. Foreign banks have also been permitted to set-up subsidiaries, joint ventures or branches.

Banks have also been permitted to rationalize their existing branches, spinning off business at other centers, opening of specialized branches, convert the existing non-viable rural branches into satellite offices, Banks have also been permitted to close down branches other than in rural areas. Banks attaining capital adequacy norms and prudential accounting standards can set-up new branches without the prior approval of Reserve bank of India.
Supportive Measures

Revised format for balance sheet and profit and loss account reflecting the actual health of scheduled banks were introduced from the accounting year 1991-92. There have also been changes in the institutional framework. The Reserve Bank of India evolved a risk-based supervision methodology with best international practices. New Board of Financial Supervision was set-up in the Reserve Bank of India to tighten up the supervision of banks. The system of external supervision has been revamped with the establishment of Board of Financial Supervision in November 1994 with the operational support of the department of Banking Supervision. In tune with international practices of supervision, a three-tier supervisory model comprising outside inspection, off-site monitoring and periodical external auditing based on CAMELS (Capital Adequacy, Asset Quality, Management, Earnings, Liquidity and System Controls) had been put in place (Price waterhouse Coopers 2004). Special Recovery Tribunals are set-up to expedite loan recovery process. The recent Securitization and Reconstruction of Financial, Assets and Enforcement of Security Interests (SARFAAESI) Act, 2002 enables the regulation of securitization and reconstruction of financial assets and enforcement of security interests by secured creditors. The Act will enable banks to dispose of securities of defaulting borrowers to recover debt.

Other Measures

The Banking Companies (Acquisition and Transfer of Undertaking) Act was amended with effect from July 1994 permitting public sector banks to raise capital up to 49 percent from the public. There are number of other recommendations of the Narasimham Committee such as reduction in priority sector lending's, appointment of special tribunals for speeding up the process of loan recoveries and reorganization of the rural credit structure. The committee proposed structural reorganization of the banking sector which involves a substantial reduction of public sector banks through mergers and acquisitions.

Several recommendations have been accepted and are being implemented in a phased manner. Among these are the reductions in SLR/CRR, adoption of prudential norms for asset classification and provisions, introduction of capital adequacy norms,
deregulation of most of the interest rates, allowing entry to new entrants in private banking sector, etc.

**Impact of First Generation Reforms**

Reddy Y.V. (1999), “The impact of first generation reforms may be summarized as follows:

1) The banking system is well diversified with the establishment of new private banks and about 20 new foreign banks after 1993. The entry of modern, professional sector banks and foreign banks has enhanced competition. With the deregulation of interest rates both for advances as well as deposits, competition between different bank groups and between banks in the same group has become intense. What is more important is that apart from growth of banks and commercial banking, various other financial intermediaries like mutual funds, equipment leasing, hire purchase companies, housing finance companies, etc. are sponsored by banks have cropped up.

2) Finance regulation through statutory preemptions has been lowered while stepping up of the prudential regulations.

3) Steps have been taken to strengthen Public Sector Banks through increasing their autonomy, recapitalization, etc. Based on specified criteria nationalized banks were given autonomy in the matters of creation, abolition, up gradation of posts for their administrative officers up to the level of Deputy General Manager. ₹ 10987.12 crore for capitalization funds were pumped into banks during 1993-95. This indicates the extent of capital erosion faced by the nationalized banks.

4) A set of micro-prudential measures have been stipulated with regard to capital adequacy, asset classification, provisioning, accounting rules, valuation norms, etc. Capital to Risk weighted Asset Ratio (CRAR) of banks stood at 8 percent. The percentage of Non-Performing Assets to Net Advances of Public Sector Banks has declined from 14.1 percent in 1993-94 to 8.5 percent by 1997-98. The prudential norms have been significantly contributed towards improvement in pre-sanction appraisal and post-sanction appraisal and control, the impact of which is clearly seen in decrease in fresh addition of performing accounts into the Non
Performing Asset category. As per Reserve Bank of India-Report on Currency and Finance (2001-02), "consequent upon prudential norms, the most visible structural change has been improvement in asset quality.

5) Measures have been taken to broaden the ownership base of Public Sector Banks by allowing them to approach the capital market. The Government of India, in a major policy announcement, decided to reduce its stake in Public Sector Banks from 100 percent to 51 percent. The Government purposes to reduce further its stake to 33 percent. Moreover, there is a provision for foreign investments to the extent of 20 percent. The net result of the dilution in ownership of Public Sector Banks is that these banks are becoming slowly joint sector banks. A number of Public Sector Banks have gone up for public issue since 1994.

6) Mergers and Acquisitions have been taking place in the banking sector. In the past, due to the existence of a large number of non-viable banks, the Reserve Bank of India encouraged merger of small banks with big banks. Now, market driven mergers between private banks have been taking place.

7) As intense competition becomes a way of doing the banks have to pay attention to customer service. Product innovations and process engineering are the order of the day. Since interest income has fallen with lowering of interest rates on advances, banks have to look for enhancing fee-based income, to fill the gap in interest income. Banks have therefore been moving towards providing value added services to customers. Under the impact of technological up-gradation and financial innovations, banks have now become super markets-one stop shop of varied financial services”.

Jalan, Bimal (1998) the set of measures, coupled with many others, did have a positive impact on the system. There has been considerable improvement in profitability of the banking system. There has been improvement in key financial indicators of all bank groups during the period 1992-98. For example, the net profits of the scheduled commercial banks as a percentage of the total assets has been turned around from a negative figure of 1.0 percent on average during 1992-93 and 1993-94 to a positive of 0.5 percent during 1994-95 to 1997-98. Simply, net profits as a percentage of working funds which was 0.39 percent in 1991-92 and (-) 1.08 percent in 1992-93 turned positive in 1994-95 and reached 0.81 percent by 1997-98.
Second Generation Reforms: (Narasimham Committee-II, 1998)

Rangarajan, C. (1998) the recommendations of Narasimham Committee-I (1991) provided blueprint for first generation reforms of the financial sector. The period 1992-97 witnessed laying of the foundations for reforms of the banking system. It also saw the implementation of prudential norms relating to capital adequacy, asset classification, income recognition provisioning, exposure norms, etc. The difficult task of ushering in some of the structural changes accomplished during this period provided the bedrock for future reforms. Bhide, M.G., Prasad, and A. Ghosh, S. (2002) in fact India withstood the contagion of 1997 (South-East Asia Crisis) indicates the stability of banking system. Against such a backdrop, the report of the Narasimham Committee-II in 1998 provided the roadmap for the second-generation reforms process. Reddy, Y.V. (2000) at this juncture, two points are worth noting. First, the financial sector reforms were undertaken in the early reform cycle, and second, the reform in the financial sector were initiated in well structured, sequenced and phased manner with cautious and proper sequencing, mutually reinforcing measures, complementarily between reforms in the banking sector and changes in the fiscal, external and monetary policies, developing financial infrastructure and developing financial markets.

Government of India (1998) appointed a second high-level committee on Banking Sector Reforms under the chairmanship of M.Narasimham to review the progress of banking sector reforms to date and chart a programme of financial sector reforms necessary to strengthen the Indian Financial System and make it internationally competitive. The Committee in its report (April 1998) made wide-ranging recommendations covering entire gamut of issues ranging from capital adequacy, asset quality, non-performing assets, prudential norms, asset-liability management, earnings and profits, mergers and acquisitions, reduction in government shareholdings to 33 percent in public sector banks, the creation of global-sized banks, recasting banks board to revamping banking legislation.

a. Government of India (1998) the second generation reforms could be summarized in terms of three broad inter-related issues: 

a) Measures to Strengthen the Banking System. 
b) Streamlining procedures, upgrading technology and human resource development. 
c) Structural issues. These would cover the aspects of banking policy, institutional, supervisory and legislative dimensions.
The important recommendations of the committee may be stated as under:

**Measures to Strengthen the Banking System**

**i. Capital Adequacy**

The Committee set new and higher norms of capital adequacy. It recommended that minimum capital to risk asset ratio be increased to 10 percent from its present level of 8 percent in a phased manner, 9 percent is to be achieved by the year 2000 and the ratio of 10 percent by 2002. Capital Adequacy requirement should also take into account market risks also. The Reserve Bank of India should have the authority to rise further in respect of individual banks if in its judgment the situation warrants such increase.

**ii. Asset Quality and Directed Credit**

The Committee recommended that asset should be classified as doubtful if it is in the substandard category for 18 months in the first instance and eventually 12 months and loss asset if it has been identified but not written off. Advances guaranteed by the government should also be treated as Non-Performing Assets. Banks should avoid the practice of 'ever greening' by making fresh advances to the troubled parties with a view to settle interest dues and avoiding such loans treating as Non-Performing Assets. The Committee believes that the objective should be to reduce the average level of net Non-Performing Assets for all banks to below 5 percent by the year 2000 and to 3 percent by the year 2002. For banks with international presence, the minimum objective should be to reduce gross Non-Performing Assets to 5 percent and 3 percent by 2000 and 2002 respectively and net Non-Performing Assets to 3 percent and nil by these dates. For banks with high Non-Performing Assets portfolio, the Committee suggested the setting up of an Asset Reconstruction Company to take over bad debts.

**iii. Prudential Norms and Disclosure Requirements**

The Committee recommended moving to international practice for income recognition and recommended 90 days norm in a phased manner by the year 2002. In future income recognition, asset classification and provisioning must apply even to government guaranteed advances. Banks should pay greater attention to asset liability management to avoid mismatches.
Strengthening Internal Control System and Methods in Banks

The internal control systems which include internal inspection and audit should be strengthened. The submission of controls returns by banks and controlling offices to higher level offices, risk management system, etc. should also be strengthened. There are also recommendations for inducting an additional whole time director on the board of the banks, recruitment of skilled manpower, revising remuneration to persons at managerial level, etc.

Structural Issues

Mergers

The Committee is of the view that there should be convergences of activities between banks and Development Financial Institutions (DFIs). Development Financial Institutions (DFIs) over a period of time convert themselves into banks. There will be only two forms of financial intermediaries i.e., banks and non-bank financial companies.

Mergers between banks and between banks and Development Financial Institutions (DFIs) and Non Banking Finance Companies (NBFCs) need to be based on synergies and location and business specific complementarities of the concerned institutions. Merger of public sector banks should emanate from the management of banks and the government playing supportive role. Mergers should not be seen as bailing out weak banks.

Weak Banks

A weak bank should be one whose accumulated losses and net Non-Performing Assets exceed its net worth or one whose operating profits are less. A case by case examination of weak banks should be undertaken to identify those that are potentially viable with a programme of financial and operational restructuring. Such banks should be nurtured into healthy units by eschewing high cost funds, containment of expenditure recovery initiatives, etc. Mergers should be allowed only after they clean up their balance sheets.

Narrow Banks

Those banks, which have become weak because of high proportion of Non-Performing Assets, the Committee recommended the concept of 'Narrow Banking.
Raswalkar, R.B. (1999) "Narrow Banking implies that the weak banks place their funds in the short-term risk free assets".

New Banks

The Committee also recommended the policy of permitting the entry of new private banks. The foreign banks may also be allowed to set-up subsidiaries or joint ventures in India. They should be treated on par with private banks and subject to same conditions in regard to branches and directed credit as other banks.

Need for Stronger Banks

The Committee made out a strong case for stronger banking system in the country, especially in the context of capital account convertibility, which would involve large inflows and outflows of capital. The Committee therefore, recommended winding up of unhealthy banks and merger of strong and weak banks.

Public Ownership and Autonomy

The Committee argued that the Government ownership and management of banks does not enhance autonomy and flexibility in the working of public sector banks. In this connection, the Committee recommended a review of functions of boards so that they remain responsible to the shareholders. The management boards are to be recognized and there shall not be any government interference.

Review of Banking Laws

The Committee suggested the need to review and amend the provisions of Reserve Bank of India (RBI) Act, State Bank of India (SBI) Act, Banking Regulation Act and Banking Nationalization Act, etc. so as to bring them in line with the current needs of the industry.

Ahulwalia, M.S. (2001) other recommendations pertain to computerization process, permission to establish private sector banks, setting up of Board of Financial Regulations and Supervision and increasing the powers of debt recovery tribunals. Some of these recommendations more or less resemble the recommendation of the Narasimham Committee-I.
1.5 Structure of Indian Commercial Banks

Figure 1.1 Scheduled Banking Structure in India
(As on March, 2010)

Scheduled Commercial Banks → Scheduled Co-operative Banks

- Public Sector Banks (27)
- Private Sector Banks (22)
- Foreign Bank (34)
- Regional Rural Banks (82)

- Old Private Sector Banks (15)
- New Private Sector Banks (07)

- Nationalized Banks (19)
- SBI and its Associates (07)
- Other Public Sector Bank (01)

- Scheduled Urban Co-operative Banks (53)
- Scheduled State Co-operative Banks (16)

* As indicated in the second schedule of the Reserve Bank of India.
* Note: Figures in brackets indicate number of banks in each group.

Banking sector in India has a wide mix, comprising of joint sector (scheduled and non-scheduled banks), nationalized sector (Reserve bank of India, other nationalized commercial banks and post-office savings bank), co-operative sector (co-operative and land development banks) and foreign sector (foreign commercial banks and exchange banks). Indian banking industry consists of 249 scheduled commercial banks, out of which Regional Rural Banks constitute 82 banks as on March 2010. (as shown in figure 1.1). Regional Rural Banks play crucial role in the development of privileged sections of the society. These banks have been set up to meet the credit requirements of rural agricultural labourers, small and marginal farmers and small entrepreneurs, etc. Apart from Regional rural Banks, other commercial banks are 83 in number, comprising of 27 public sector, 22 private and 34 foreign banks as on March 2010. Public Sector Banks category includes nationalized banks (19), SBI and its Associates (7) and 1 other public sector bank. In the financial set-up of the country, public sector banks hold major share in total assets of scheduled commercial banks. Despite some of the operational constraints, public sector banks are still in the
possession of certain core strengths like wide branch network, large customer base and geographical coverage. The major changes occurred in the institutional set-up of commercial banks after Reserve Bank of India made free the entry of private sector and foreign banks to function side by side with public sector banks. Hanson and Kathuria (1999) however foreign banks were allowed to continue in the new milieu, but their expansion was stringently regulated. The entry of private and foreign banks put stiff competition and led to paradigm shift in banking space. Apart from this scheduled co-operative banks comprised of scheduled urban and state co-operative banks. As on March 2010, there were 53 urban and 16 state scheduled co-operative banks. These banks have been set-up on unit banking principle.

Over a period of time, Indian commercial Banking sector had witnessed a structural transformation due to change in economic ideology. This has resulted into change in growth of banking indicators. Some of the banking indicators have slowed down and some are speeding up. Similarly, the entry of private sector banks in the commercial banking space, the respective share of different indicators with respect to different bank groups has changed.

A brief picture of some of the important indicators with respect to different bank groups has been exhibited in table 1.1.2. The table revealed that advances, deposits and total business had registered an impressive growth in terms of percentage for public sector banks.

The share of public sector banks which stood at 92.150 percent, 91.867 percent and 91.977 percent at the end of the year 1980, remained almost at the same level at the end of the year 1990-1991, fallen to 77.245 percent, 77.682 percent and 77.497 percent at the end of the year 2009-10. But the percentage of old private sector and foreign banks in advances, deposits and total business was further improved in the post-reform period. However, public sector banks have witnessed a fall in post-reform period. At the end of the year 2009-10, the percentage share of old private and foreign banks was almost at the same level at the end of the year 1980.

The new private sector banks witnessed a better performance in terms of these indicators with advances, deposits and business share in total share at 13.679 percent, 12.476 percent and 12.986 percent, which was much higher than the starting of their business at the end of the year 1995-96.
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<tr>
<td>PSBs (% age) Share in Total Advances</td>
<td>92.130</td>
<td>92.314</td>
<td>92.383</td>
<td>92.147</td>
<td>92.077</td>
<td>92.322</td>
<td>92.024</td>
<td>92.947</td>
<td>92.458</td>
<td>92.282</td>
<td>92.916</td>
<td>90.164</td>
<td>89.322</td>
<td>87.341</td>
<td>85.829</td>
<td>82.250</td>
<td>79.881</td>
<td>80.058</td>
<td>81.169</td>
<td>79.868</td>
<td>78.907</td>
<td>74.438</td>
<td>74.173</td>
<td>72.221</td>
<td>74.382</td>
<td>72.959</td>
<td>72.697</td>
<td>72.567</td>
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<tr>
<td>NBs (% age) Share in Total Advances</td>
<td>49.927</td>
<td>60.032</td>
<td>59.245</td>
<td>60.500</td>
<td>60.857</td>
<td>61.220</td>
<td>61.034</td>
<td>59.984</td>
<td>58.770</td>
<td>58.325</td>
<td>57.067</td>
<td>56.182</td>
<td>55.109</td>
<td>54.442</td>
<td>54.718</td>
<td>51.287</td>
<td>49.815</td>
<td>50.005</td>
<td>51.449</td>
<td>50.712</td>
<td>50.312</td>
<td>48.950</td>
<td>48.584</td>
<td>47.703</td>
<td>45.632</td>
<td>44.957</td>
<td>42.799</td>
<td>47.212</td>
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<tr>
<td>NPSBs (% age) Share in Total Advances</td>
<td>NE</td>
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Table 1.1.2
Basic Parameters of Banks in India

Contd ................. 27
On account of falling percentage in share of advances, deposits and total business of the public sector banks, share of their income as percentage of total income generated by commercial banks has reduced. The percentage share of public sector banks in total income was slipped to 64.625 percent at the end of the year 1990-91, had remained at the same level showing no improvement further. For old private sector and foreign banks the percentage share in total income has improved. It was 2.930 percent and 5.025 percent at the end of the year 1985 and 1987 was risen to 4.785 percent and 7.353 percent for old private sector and foreign banks.

The new private sector banks have noted significant improvement in percentage share of total income from 1.540 percent at the end of the year 1995-96 to 16.065 percent at the end of the year 2009-10.

The net-interest margin of public sector banks have further slipped to 85.223 percent at the end of the year 1990-91 from almost 100 percent at the end of the year 1980. It was at the level of 65.809 percent at the end of the year 2009-10. However for old private sector banks remained at the same level and for foreign banks witnessed increase to 12.149 percent at the end of the year 2009-10 from 6.933 percent at the end of the year 1987.

The new private sector banks also witnessed a sharp increase from 1.365 percent at the end of the year 1995-96 to 17.526 percent at the end of the year 2009-10.

The percentage share of public sector banks in the total number of workers employed in commercial banks have slipped from 91.601 percent in 1980 to 77.764 percent in 2009-10. For old private sector banks, it remained at the same level of 6 percent but for foreign banks has gone up from 1.748 percent in 1980 to 2.939 percent in 2009-10.

The new private sector banks witnessed a percentage of 13.489 in 2009-10 from 0.171 percent in 1995-96 because of their late entry.

The percentage share of public sector banks in the total number of branches of commercial banks was declined to 85.119 percent from the earlier level of 100 percent. For old private sector banks, percentage share remained at the same level but for foreign banks was slightly improved to 0.363 percent in 2009-10 from 0.334 percent in 1987. For new private sector banks it has risen to 7.330 percent in 2009-10 from 0.168 percent in 1995-96.
1.6 Major Developments in Indian Banking

1967

- Social Control.

1969

- Nationalization of 14 major Indian Banks.

1974

- Setting targets for priority sectors.

1975

- Norms prescribed for lending and fixing working capital limits.

1978

- Demonetization of high denomination notes.

1980

- Nationalization of six more Indian Banks taking the total banks nationalized to 20.

1982-83

- Prof. S. Chakravarty’s report on Monetary System in India.
- Establishment of the National Bank for Agriculture and Rural Development (NABARD).

1985-86

- Introduction of MICR Technology.
- Introduction of Health code System for bank loans.

1987-88

- Permission to banks to float mutual funds.
- Vaghul working group on money market.

1988-89

- Establishment of the Discount and Finance House of India (DFHI) and the National Housing Bank.
- Adoption of Service Area Approach.

1989-90
- Enhancement of access to call money market in terms of number of participants.
- Establishment of the Small Industries Development Bank of India (SIDBI)

1990-91
- Report of the Narasimham Committee on Financial Sector Reforms.
- Introduction of new formats for annual accounts of the banks.

1992-93
- Introduction of rupee convertibility on current account.

1993-94
- Announcement of norms for floating new private sector banks.
- Establishment of State Trading Corporation of India (STCI).
- Introduction of FCNR (B) deposits scheme.
- Introduction of risk-weighted capital adequacy norms, prudential norms for asset classifications, income recognition and provisioning for banks.
- Valuation of investment in government securities on the basis of market prices.
- Constitution of Debt Recovery Tribunals.
- Reduction in the number of prescribed lending rates from six to three.
- Introduction of 365-day treasury Bills with the market related rates.
- Aligning of rates of interest on dated securities of the government with market rates.

1994-95
- Deregulation of interest rates on loans over ₹ 2 lakh.
- Freedom to banks to decide their Prime Lending Rates (PLR) and to link loan rates to their PLR.
• Permission to the Nationalized Banks to raise capital up to 49 percent of equity from capital market.
• Setting up of the Board for Financial Supervision (BFS).
• Amendment to the State Bank of India Act to allow the bank to access equity market.
• Budget provision of ₹ 5700 crore to re-capitalize banks to enable them to meet new provisioning norms.
• Prescription of prudential norms for Non-Performing Assets.
• Establishment of Debt Recovery Tribunals.

1995-96

• Introduction of the Banking Ombudsman Scheme.
• Streamlining of the cash credit system
• Abolishment of Minimum Lending Rates on loans above ₹ 2 lakh.

1996-97

• Implementation of measures to strengthen secondary market in government securities.
• The State Bank of India (SBI) issued Global Depository Receipts (GDR) and became the first Indian Bank to be listed on stock exchanges overseas.
• Six firms, promoted by banks and financial institutions, were granted licence to operate as Primary Dealers (PDs) in the government securities market.

1997-1998

• Operationalization of first shared payment ATM network system.
• Granting of conditional autonomy to the public sector banks.
• Constitution of the Board for Bank frauds.

1998-99

• Report of the Narasimham Committee on Banking Sector Reforms.
• Revision of capital adequacy norms.
• Deregulation of interest rates on term deposits.
• Amendment to the Reserve Bank of India Act empowering it to supervise Non-Banking Financial Companies.

1999-2000

• Issuance of guidelines on asset-liability management.
• Tightening of the provisioning norms for government securities and state government guaranteed loans and assigning risk weights to this category of investment.
• Introduction of Kisan Credit Card Scheme.
• Permission to banks to operate different PLRs for different maturities of loans.
• Merger of the Time Bank with the HDFC Bank.

2000-01

• Introduced a system of off-site surveillance for scheduled UCBs through quarterly returns.
• Given freedom to banks to price loans of ₹ 2 lakh.
• Guidelines issued for compromise settlement of dues of banks and FIs through Lok Adalat.
• Advised banks to formulate policies for recovery/write off/compromise and negotiated settlements with the approval of Boards for old and unresolved cases under NPA category.

2001-02

• Advised to build up Investment Fluctuation Reserve (IFR).
• Guidelines issued for raising subordinated debt for inclusion in Tier II capital by foreign banks operating in India.
• Guidelines issued on Foreign Direct Investment (FDI) in the banking sector.
• Issued guidelines on Market Risk Management.
• The RBI approved the merger of ICICI Ltd. with ICICI Bank Ltd.
• The non-Resident (Non-Repatriable) Rupee Account Scheme and Non-Resident (Special) Rupee Account Scheme discontinued w.e.f. April 1, 2002.
2002-03

- Advised all SCBs including RRBs to maintain with RBI a CRR of 5 percent of NDTL.
- Advised to take penal measures against willful defaulters.
- The Benares state Bank Ltd. merged with Bank of Baroda w.e.f. June 20, 2002.
- Scheme formulated for setting up off offshore Banking units (OBUs) in Special Economic Zones by banks.
- Public sector banks introduced one-time settlement scheme giving opportunity to the borrowers for settlement of their outstanding dues/NPA accounts below a prescribed value ceiling.

2003-04

- RBI gave freedom to banks to determine interest rates on loans and advances for purchase of consumer durables to individuals against shares and debentures/bonds and other non-priority sector personal loans regardless the size of the loans.
- Banks were given freedom to decide all aspects relating to renewal of overdue deposits.
- Prudential guidelines on banks investment in non-SLR securities were issued to contain risks.
- Banks were advised to strictly maintain the confidentiality of information provided by the customer for "Know your Customer" (KYC) compliance.
- Banks were allowed to raise long term bonds with a minimum maturity of five years.
- The RTGS was put in live operation from March 26, 2004.

2004-05

- Banks were advised to inform account holders at least one month in advance by any change in the prescribed minimum balance and the charges that may be levied if the minimum balance is not maintained.
• Banks were advised to ensure strict compliance with the three accounting standards relating to discounting operations, intangible assets and impairment of assets respectively.

• All SCBs were advised that the subsidy under Swarnjayanti Shahari Rozgar Yojana (SJSRY) would be back-ended, with a lock-in period of 2 years.

• SCBs were advised to strictly maintain the confidentiality of information provided by the customer for “Know Your Customer” compliance.

• All Commercial banks advised to implement the measures, announced by the Union Finance Minister, for doubling the flow of credit to agriculture.

• 'Yes Bank Limited' included in the second schedule of the RBI Act, 1934 w.e.f. August 21, 2004.

• Banks to initiate action at their level to get the Master Policy under Personal Accident Insurance Scheme (PAIS) for KCC holders renewed for a period of one year, on the existing terms and conditions.

• Guidelines issued for implementing the revised Model KCC Scheme of NABARD to take care of the investment credit as also working capital for agriculture and allied activities and a reasonable component for consumption needs.

• Industrial Development Bank of India Ltd. included in the second Schedule of the Reserve Bank of India Act, 1934 w.e.f. October 11, 2004.

2005-06

• The vision document on Payment and Settlement System 2005-06 was released.

• Guidelines on One time Settlement Scheme for SME accounts issued to public sector banks for recovery of NPAs below ₹ 10 crore.

• Bank of Punjab Ltd. was merged with Centurion Bank Ltd. with effect from October 1, 2006.
• Banks which have maintained capital of at least 9 percent of the risk weighted assets for both credit risks and market risks for both HFT and AFS category as on March 31, 2006, would be permitted to treat the entire balance in the IFR as Tier 1 Capital.

• Banks were advised to develop appropriate delivery channels of electronic payment services using the payment system developed by the Reserve Bank like RTGS, ECS, EFT and NEFT with no further delay.

• INC Bank N.V. excluded from the second schedule to the Reserve Bank of India Act, 1934 w.e.f. October 28, 2005.

• Guidelines on securitization of standard assets issued to all banks.

2006-07

• Fair Practices Code for Lenders- The banks were advised to modify the Fair Practices Code and the same should be placed on the banks/FIs website and also given wide publicity.

• The revised guidelines were issued on: The Securitization Companies and Reconstruction Companies (Reserve Bank) amendment Guidelines and Directions, 2006, in order to take care of the public interest, to regulate the financial system to the advantage of the country and to prevent the affairs of Securitization Company or Reconstruction Company from being conducted.

• Primary Dealer Business Operational guidelines for banks undertaking proposing to undertake Primary Dealer Business was issued. This was done in order to broad base the primary dealership system. Banks undertaking PD business were advised to comply with the instructions/guidelines issued on August 9, 2006.

• Guidelines on Fair Practices code for Non-Banking Financial Companies-The Reserve Bank of India, prescribed broad guidelines on fair practices that are to be framed and approved by the Board of Directors of all Non-Banking financial companies (including RNCBs). The fair practices code so framed and approved by the Board of Directors should be published and disseminated on the web site of the company.
• The Ganesh Bank of Kurundwad Ltd. (GKB) amalgamated with the Federal Bank Ltd. with effect from September 2, 2006.
• The United Western Bank Ltd. (UWB) amalgamated with IDBI Ltd. This amalgamation came into force from October 3, 2006.
• Sangli Bank Ltd. amalgamated with ICICI Bank Ltd. with effect from April 18, 2007.
• The transfer of undertaking of the Bharat Overseas Bank Ltd. with the Indian Overseas Bank took place with effect from March 31, 2007.
• To improve the credit delivery mechanism revised guidelines on lending to the priority sector were issued.
• Guidelines on ‘When issued’ (WI) trading in ‘Central government Dated Securities’ were prescribed in May, 2006 and this segment commenced from August, 2006.

2007-08
• The final guidelines on the revised capital adequacy framework (Basel II) were issued to banks in India on April 27, 2007.
• Revised guidelines on derivatives were issued on April 20, 2007.
• Two new sections were introduced for the implementation of the ‘fit and proper’ criteria for elected directors on the boards of banks.
• Guidelines on KYC/AML/CFT/ were issued to banks on April 13, 2007. An amendment to the PMLA rules were also notified by the Government on 24 May, 2007.

2008-09
• The Reserve Bank transferred its entire shareholding in the State Bank of India to the Government of India.
• Guidelines on KYC Norms/AML Standards/ combating of Financing of Terrorism (CFT)-Wire transfers issued to SCBs. Similar guidelines were issued to SCBs and DCCBs on May 18, 2007 to UCBs on May 25, 2007 and to NBFCs on April 23, 2008.
• Prudential guidelines on capital adequacy and market discipline-implementation of the new capital adequacy framework finalized for implementation.
• Revised guidelines on lending to priority sector issued to SCBs (excluding RRBs).
• Final guidelines on prudential norms for off-balance sheet exposure of banks were issued to all SCBs.
• The guidelines on Asset-Liability Management system were amended and all commercial banks advised accordingly.
• The finance Minister in his budget speech (2008-09) had announced the debt waiver and debt relief scheme for farmers. A detailed scheme in this regard was notified for implementation by all scheduled commercial banks, besides RRBs and co-operative credit institutions. Banks were advised that the implementation of the debt waiver and debt relief scheme should be completed by June 30, 2008.

2009-10

• CRR of scheduled banks increased by 50 basis points of their NDTL in two stages of 25 basis points each to 7.75 and 8.0 percent (effective from April 26 and May 10, 2008).
• CRR of scheduled banks increased to 8.25 percent with effect from the fortnightly beginning May 24, 2008.
• Special Market Operations were put in place, for smooth functioning of financial markets and for overall financial stability.
• The standing liquidity facilities were made available at the revised repo rate i.e., 8.50 percent.
• The CRR of SCBs, RRBs, Scheduled state co-operative banks and scheduled primary UCBs was increased by 50 basis points to 8.75 percent in two stages (25 basis points each) effective from the fort Knightys July 5, 2008 and July 19, 2008 respectively.
• The interest rate ceiling of FCNR (B) deposits of all maturities was increased with immediate effect by 50 basis points i.e. to LIBOR/SWAP rates minus 25 basis points.
• The interest rate ceiling on NR (E) RA for one to three years maturity was increased, with immediate effect by 50 basis points i.e. LIBOR/SWAP rates minus 50 basis points.
• Scheduled Banks were allowed to avail additional liquidity support under the LAF to the extent of up to one percent of their NDTL and seek waiver of penal interest.

• A special 14 day repo at 9 percent per annum for a notified amount of ₹ 20000 crore was announced with a view to enabling banks to meet the liquidity requirements to mutual funds.

• Banks were allowed to avail of additional liquidity support exclusively for the purpose to meeting the liquidity requirements of mutual funds to the extent up to 0.5 percent of their NDTL purely as a temporary measure.

• The mechanism of SMO for Public Sector Oil Marketing Companies provided in June-July 2008 would be instituted when oil bonds become available.

• State Bank of Saurashtra merged with State Bank of India with effect from August 13, 2008.

• South Indian Co-operative Bank Ltd. merged with Sarswat Co-operative Bank Ltd. with effect from September 1, 2008.

• JSC VTB Bank was included in the second schedule of the Reserve Bank of India Act 1934 with effect from September 19, 2008.

• American Express Banking Corporation was included in the second schedule of the Reserve Bank of India Act 1934 with effect from December 19, 2008.

• UBS AG was included in the second schedule of the Reserve Bank of India Act 1934 with effect from February 2, 2009.

• There were 91 Regional Rural Banks as at end March 2008. However, due to amalgamation, number of such banks came down to 86 as on March 31, 2009 and further down to 84 as on July 20, 2009.

• IDBI bank Ltd has been included in Nationalized Banks.

1.7 Conclusions

The commercial banks have aided the economic development in an effective way in the post independence period. They mobilize savings, lending, investing and related activities and facilitate the economic process of production, distribution and consumption.
Before nationalization, the commercial banks were mainly concentrated in the urban areas or few selected centers. The profitability of the banking sector was very low. On the back of poor profitability, a step towards economic growth, equity and justice was taken in the form of nationalization of banks in the year 1969. The commercial banks made an unprecedented growth during 1980’s and 1990’s. But a shift from ‘class banking’ to ‘mass banking’ coupled with certain statutory conditions in the post-nationalization period led to low profitability. Therefore, deteriorating financial health of the banks became a major concern for the policy makers.

On the back of ill-health of banks and certain inherent problems within the system led to the introduction of banking sector reforms as a part of financial sector reforms. The steps like reduction in statutory liquidity ratio and cash reserve ratio were initiated. In this line, number of reforms in the form of transparency, prudential norms and capital adequacy norms equal to that of international standards were introduced. In order to enhance competitive efficiency, norms for domestic private sector banks and foreign banks were also changed to revive the financial health of commercial banks.
REFERENCES


