CHAPTER -1
COMMERCIAL BANKING IN INDIA

"yat sankhyaih prapyate sthanam
tad yogair apigamyate
ekam sankhyam ca yogam ca
yah pasyati sa pasyati"

["One who knows that the position reached by means of analytical study can also be attained by devotional service(karma-yoga),and who therefore sees analytical study and devotional service to be on the same level, see things as they are".]

--Bhagavad-Gita

1.1. COMMERCIAL BANKING IN INDIA-AN OVERVIEW

Commercial Banks are the major financial intermediaries in any economy. The bank deposits form a major part of the savings in the economy and the bank credit is the most important source of finance for the developmental activities. Despite the advent of new financial instruments for direct channelisation of house hold savings in to the productive sectors of the economy and also the emergence of other financial institutions extending some services like banks, the role and significance of banking has not reduced as the financial transactions of public and other institutions are settled through the banking system.

1.1.1. THE ROLE OF BANKS IN FINANCIAL INTERMEDIATION

The role of banks in the financial intermediation process has always been a topic of great interest to the economists. The fundamental question of why the intermediation is required arises time and again. The answer is simple. In an ideal situation where there is perfect capital markets with full and symmetric information, there is no role for banks and financial intermediaries [Selgin(1996)]. Financial intermediation by the banks and financial institutions links, essentially, the people who have money to lend and the people who have money to borrow, thereby reducing the search costs and transaction costs.

Other advantages include obviating the need for savers to have the knowledge and expertise for identifying the borrower and also the availability of standard products of suitable duration as well as returns. In addition, the financial intermediaries saves the monitoring costs. Once funds are lent to any agency, the lender has to keep monitoring the performance, the value of assets that back the lending etc. An intermediary is often better
placed to ensure verification of the assets and valuation of the assets which require technical expertise [Leland & Pyle (1977)]

The institutions, through a variety of instruments, ensures diversification of risks and also hedging of risks allowing the savers to reduce the risks in offering the funds to others.

The fundamental economic function of an intermediation by a bank or any agency involved in the function can be summarised as below:

<table>
<thead>
<tr>
<th>FUNCTION</th>
<th>PROCESS</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. Liabilities-Assets Transformation</td>
<td>Accepting deposits as a liability and converting them into assets such as loans</td>
</tr>
<tr>
<td>2. Size Transformation</td>
<td>Providing large loans on the basis of small deposits</td>
</tr>
<tr>
<td>3. Maturity Transformation</td>
<td>Offering savers alternate forms of deposits according to their liquidity preferences while providing borrowers with loans of desired maturities</td>
</tr>
<tr>
<td>4. Risk Transformation</td>
<td>Distributing risk through diversification which substantially reduces risk for savers which would prevail while lending directly in the absence of financial transformation</td>
</tr>
</tbody>
</table>

Banking has many facets. As per the theories, no person or body corporate otherwise can be a banker who does not:

(i) take deposit accounts, (ii) take current accounts, (iii) issue and pay cheques, and, (iv) collect cheques, crossed or uncrossed, for its customers. These functions are considered as essential as well as the traditional functions of a bank. In India, the definition of the business of banking and related regulations are given in the Banking Regulation Act 1949 (BR Act). According to section 5 (c) of the BR Act, ‘a banking company is a company which transacts the business of banking in India. Section 5(b) of the Act defines banking as “accepting, for the purpose of lending and investment, of deposits of money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft or otherwise”. Section 7 of the BR Act makes it compulsory for every company carrying on the business of banking in India to use part of its name, at least, one of the following words—"Bank", “Banking” or ‘Banking Company".
Section 6 of the Banking Regulation Act permits a banking company to carry on the following activities apart from doing the main business of banking:

1. The borrowing, raising or taking of money,
2. The lending or advance of money, either upon security or without security,
3. The drawing, making, accepting, discounting, buying, selling, collecting and dealing in bills of exchange, hundies, promissory notes, coupons, drafts, bill of Lading, railway receipts, warrants, debentures, certificates, scrips and other instruments and securities whether transferable or negotiable or not,
4. The granting and issuing of letters of credit, travellers cheques,
5. The selling, buying and dealing in bullion and silver,
6. The buying and selling of foreign exchange including foreign bank notes,
7. The acquiring, holding, issuing on commission, underwriting and dealing in stock, funds, shares, debentures, bonds, obligations, securities and investment of all kinds,
8. The purchasing and selling of bonds, scrip and other forms of securities on behalf of constituents or others,
9. The negotiating of loans and advances,
10. The receiving of all kinds of bonds, scripts or valuables for safe deposit or for safe custody or otherwise,
11. The providing of safe deposit vaults,
12. The collection and transmitting of money and securities,
13. Acting as agents of the government, local authority or person and carrying on agency business, but excluding the business of a secretary and treasurer of a company,
14. Undertaking contracts for public and private loans, negotiation and issue of the same,
15. Effecting, insuring, guaranteeing, underwriting, participating in managing and carrying out of any issue of state, municipal or other loans or of shares, stock, debentures, or stock of companies and lending money for the purpose of any such issue,
16. Transacting every kind of guarantee and indemnity business,
17. Managing, selling and realising any property which may come into its possession in satisfaction or part satisfaction of its claims,
18. Acquiring and holding, and dealing with any property or any right, title or interest in any property which may form the security for any loan or advance (section 9 prohibits a banking company from holding any immovable property, business acquired, except if
required for its own use, for a period exceeding seven years from the acquisitions of the
property and with Reserve Bank permission for a further period of five years),
19. Undertaking and executing trusts,
20. Undertaking the administration of estates as executor, trustee or otherwise,
21. Establishing, supporting and aiding associations, institutions, funds, trusts, etc., for the
   benefit of its present or past employees and granting money for charitable purposes,
22. Acquisition, constructions and maintenance of any building for its own use,
23. Selling, improving, managing, developing, exchanging, leasing, mortgaging, disposing
   of all or any part of the property and rights of the company,
24. Acquiring and undertaking the whole or any part of the business of any person or company, when such business is of a nature described in the Section (6) of the BR Act,
25. Doing all such things which are incidental or conducive to the promotion or advancement of the business of banking, and,
26. Undertaking any other form of business which the central government may specify as a
   form of business in which it is lawful for a banking company to engage in.

1.1.1(1) Business prohibited for a banking company

Section 8 of the BR Act prohibits a banking company from engaging in, directly or indirectly, in trading activities and undertaking trading risk. The act says that no banking shall, directly or indirectly deal in buying or selling or bartering of goods or engage in any trade or buy, sell or barter goods for others. However a banking company is permitted to do so, for the following purposes:

1. To realise the securities given to it or held by it for a loan, if need arises for the realisation of the amount lent, and,
2. To buy or sell or barter for others in connection with bills of exchange received for collection or negotiation and undertaking the administration of estates as, executor, trustee etc.

1.1.1(2) Recent Developments in the Role and Functions of the Banks

In order to permit the banks to undertake activities not permitted in the BR Act, an amendment was made to the BR Act, 1949 by enacting Banking Laws (Amendment Act) in 1983. This Act provides for the banks taking up any activity which the central government
specifies as the lawful activity of a banking company. Subsequently, the banks in India were allowed to undertake activities such as leasing, hire-purchase, factoring, housing, merchant banking etc. Later, in 1994, the banks were allowed to undertake this activity through selected branches as a departmental activity.

1.1.2. BANKING – SOME HISTORICAL PERSPECTIVE

Looking from a historical angle, banking appears to have been one of the oldest professions associated with the development of mankind into a complex and civilised society. Babylonians had developed a banking system in 2000BC, using temples as banks. From those systems, the Greek banking institutions developed. The Romans who conquered Greeks framed the rules and regulations for the conduct of private banking. By 12th century AD some banks were established in some parts of Europe.

The banking system and the laws associated with them followed in many countries, have their origin in England[1]. In earlier days, merchants used to keep large sums of money with goldsmiths of London for safe custody against their signed receipts, known as ‘goldsmiths Notes’, embodying an undertaking to return the money to the depositor or the bearer on demand. Over a period of time, ‘Goldsmith’s notes’ became payable to the bearer and were being exchanged as ‘bank note” payable on demand. The goldsmiths used to lend the money and seeing a profitable business in this area, used to woo the depositors by offering interest on money deposited by them. During the year 1694, England wanted to raise money for the war expenses with France and Bank of England was established. During the year 1833, legislative sanction was given to the establishment of joint stock banks in London. A year later, The London and Westminister bank was started in London, followed by many other big joint stock banks. The bank of England was nationalised in 1947.

As far as history of Banking in India is considered, financing of farmers at high rate of interest by money lenders in rural areas can be traced back to the period before 20th century[2]. The Calcutta agency houses or the trading firms used to take banking operations for their customers. The Bank of Hindustan, a bank launched by a business firm, was the earliest bank started under European direction in India. The banks of this kind suffered problems as they were associated with their parent institution and the
changes in the fortunes of those institutions used to affect the fate of the banks. In 1832, the bank collapsed following the failure of its parent firm.

The second main historical development was the establishment of presidency banks in India. Bank of Bengal, the first presidency bank received its charter in 1809. The bank received the power to issue notes in 1823. In 1839, the bank was given the power to open branches and to deal in inland exchange. Two more presidency banks, Bank of Mumbai and Bank of Madras were established in 1840 and 1843 respectively. These banks had the authority to issue notes in their area of jurisdiction. In 1862, the powers of the presidency banks to issue notes were withdrawn and the currency thereafter was being issued by government itself. The three presidency banks were amalgamated into the Imperial Bank of India[Bagchi(1987)]^6. Though the bank had no power to issue notes etc., bank started managing public debt, maintenance of accounts of the government etc. till the establishment of Reserve Bank of India in 1935. The Imperial Bank of India became State Bank of India through the State Bank of India Act of 1955.

Many state banks were working in the erstwhile imperial geographical jurisdictions. State bank of India (Subsidiary Banks) Act was passed in 1959 to bring all these banks under the umbrella of State bank of India. Thus the Bank of Bikaner Ltd., Bank of Indore Ltd., Bank of Jaipur Ltd., Bank of Mysore Ltd., Bank of Patiala Ltd., Travancore Bank Ltd., Hyderabad State bank and Saurashtra Bank were made subsidiaries of State bank of India. Out of this, the bank of Bikaner and Jaipur were amalgamated to form the State bank of Bikaner and Jaipur while others were renamed as State bank of Indore, State Bank of Mysore, State bank of Patiala, State bank of Travancore, State Bank of Hyderabad and State bank of Saurashtra. These seven banks are referred to as associates of State Bank of India. Some banks were established in the private sector towards the end of 19th century and the beginning of 20th century [Nayak(1993)]^7. In 1985-'86, Allahabad Bank was established. The Punjab National Bank Ltd. was founded in 1895, Bank of India Ltd. in 1906, Canara Bank Ltd. in 1906, Indian Bank Ltd. in 1907, Bank of Baroda Ltd. in 1908 and the Central Bank of India in 1911.

1.1.2(1). **Commercial Banks in India- Social Control and Nationalisation:**
The banking sector in India, prior to nationalisation was dominated by private sector banks which were generally backed by big business houses. These institutions, in general, were confining their lending operations to selected clientele and many sectors of the economy, which were starved of funds for their development, did not benefit from their operations. In order to ensure that the banks become vehicles of development and also that they finance activities which are important to the economy like agriculture, small scale industries etc., Banking Laws (amendment) Act (1969) was passed to introduce changes in the Banking Regulation Act 1949. The major changes introduced are:

1. The banks of comparatively larger size have to be managed by a whole time chairman, with directors possessing special knowledge and practical experience in respect of one or more subjects, such as accountancy, agriculture and rural economy, banking, cooperation, economics, finance, law, small-scale industries, etc.
2. At least two directors have to possess special knowledge and practical experience in respect of agriculture and rural economy, and cooperation or small-scale industry
3. Banks were prohibited from making any loans or advance, secured or unsecured, to their directors, or to any companies in which the directors held substantial interest.

Despite growth in terms of network, strength and stability, the banking system continued to suffer in terms of coverage and credit gaps. The network covered only a single segment of population, mostly in big cities, almost completely excluding rural areas and towns (Khan (1996)). Several official reports investigated into these problems which include the following:

1. Committee on distribution of Income and Levels of Living (Mahalanobis Committee) 1964.
Though, social control expected the banks to make great progress with regard to lending to the hitherto neglected sectors, the result was not encouraging. With the intention of transforming class banking to mass banking, the Central Government decided to nationalise some of the banks.

In the first such initiative, 14 major commercial banks were nationalised with effect from July 19, 1969 by an ordinance of that day. These banks had a deposit base of more than 50 crore and constituted 87.5% of the total deposit of the scheduled banks in the private sector as on 31 December, 1968. These 14 banks were Bank of India, Punjab National Bank, Bank of Baroda, Central Bank of India, United Commercial Bank, Canara Bank, United Bank of India, Dena Bank, Syndicate Bank, Union Bank of India, Allahabad Bank, Indian Bank, Bank of Maharashtra and Indian overseas Bank. The parliament passed a bill nationalising these banks entitled “Banking Companies (Acquisition and Transfer of Undertakings) Act,” 1970. Further, on 15 April, 1980, six more private banks with demand and time liabilities of not less than 200 crores were nationalised. These banks were Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab and Sindh Bank and Vijaya Bank.

Subsequently, in 1993, New Bank of India was merged with Punjab National Bank, making the total number of banks in the category of Nationalised banks in to 19.

1.1.2(2) Objectives of Nationalisation:

The major objectives of nationalisation were:

1. A major initiative was needed to divert the people’s savings for productive purposes in line with the policies of the government with regard to economic development.

2. To have an effective control on the activities of the bank through public ownership.

3. To meet the legitimate credit needs of the hitherto neglected sectors/groups such as farmers, small industries, self employed professional, small traders etc.

4. To foster growth of banking in backward areas of the country.

In order to ensure that the direction of credit and flow of credit are as per the national priorities, Reserve Bank Of India, the central bank of the country took many initiatives and also started monitoring the lending to priority sector.
1.1.2(3). Priority Sector Advances and the Role of Reserve Bank Of India

Reserve Bank is a central bank in an economy which is predominantly agriculture and rural oriented though the contribution of agriculture in GDP has been falling over a period of time. The bank was instrumental in setting up Agricultural Refinance Corporation in 1963 which later became Agricultural Refinance & Development Corporation. Since 1960s, RBI has been involving the commercial banking system to augment the institutional structure existing for rural credit. In 1976, Regional Rural Banks Act was passed and Regional Rural Banks were established to meet the exclusive need of the rural population. The National Bank for Agricultural & Rural Development (NABARD) was established in 1982 to take over and decentralise RBI’s role in rural credit. To enable the RBI to perform its function as the main regulator of credit to rural sector and to discharge the residual functions emanating after the establishment of Nabard (including obligations under section 54 of RBI Act), a department called Rural Planning & Credit Department was formed in Reserve Bank of India.

1.1.2(4). STATUTORY PROVISIONS

(i) Section 54 of RBI Act provides that the bank may maintain expert staff to study various aspects of rural credit and development and in particular may:

(a) tender expert guidance and assistance to NABARD, and, (b) conduct special studies in such areas it may consider necessary to do so for promoting integrated rural development

(ii) Sec 17(E) authorises RBI to make loans and advances to NABARD against security of stocks, funds & securities or any other terms and conditions as the bank may specify.

Under this Section, RBI has sanctioned two facilities as under.

(i) General Line of credit: (GLC-I); (ii) General Line of Credit (GLC-II)

As per the provisions of the RBI Act, the bank has been contributing part of its profit to:

i. National Rural Credit (Long Term Operations Fund), and,
ii. National Rural Credit (Stabilisation Fund)

1.1.3. STRUCTURE OF THE BANKING SYSTEM IN INDIA

Banking system in India has a complex structure and include many institutions [Demetrigades (1991)]^10. The main components are Reserve Bank Of India (the
central bank), Commercial Banks, Development financial institutions (DFIs) and Co-operative banks. The structure of the banking system is given below:

Fig. No. 1

BANKING SYSTEM IN INDIA
RESERVE BANK OF INDIA
(Central bank)

Development Financial
Institutions

IFCI  IDBI  SIDBI  ICICI**  IRBI  NABARD  NHB
EXIM-BANK  STATE
DFIs

Commercial  Regional Rural  Land Dev.
Banks  Banks  Banks

Public Sector  Private Sector
Banks  Banks

State Bank  Nationalised  Central Co-op
Group  Banks  Banks

State Bank- Associate banks
Of India
[* & **: Converted to Banks recently]
{ $ Not Banks }

(Part of Primary Credit Societies)
1.1.3(1). **Commercial Banking in India:**

**Developments & Current Position**

Development of Commercial Banking in the recent past till the year 2005 under various parameters is discussed below:

1.1.3(1)(i). **Branch Expansion**

The branch expansion of commercial banks in India during the period 1951-2005 is given below:

**TABLE: 1**

**BANKS: BRANCH EXPANSION**

<table>
<thead>
<tr>
<th>Year</th>
<th>Scheduled Commercial Banks</th>
<th>Non-Scheduled commercial banks</th>
<th>Regional Rural Banks</th>
<th>Total Bank branches in India</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>92</td>
<td>474</td>
<td>-</td>
<td>4151</td>
</tr>
<tr>
<td>1961</td>
<td>82</td>
<td>210</td>
<td>-</td>
<td>5012</td>
</tr>
<tr>
<td>1969</td>
<td>73</td>
<td>16</td>
<td>-</td>
<td>8262</td>
</tr>
<tr>
<td>1980</td>
<td>75</td>
<td>5</td>
<td>73</td>
<td>32419</td>
</tr>
<tr>
<td>1990</td>
<td>74</td>
<td>4</td>
<td>196</td>
<td>59756</td>
</tr>
<tr>
<td>1996</td>
<td>91</td>
<td>3</td>
<td>196</td>
<td>63092</td>
</tr>
<tr>
<td>1998</td>
<td>104</td>
<td>2</td>
<td>196</td>
<td>64019</td>
</tr>
<tr>
<td>2000</td>
<td>101</td>
<td>-</td>
<td>196</td>
<td>65340</td>
</tr>
<tr>
<td>2004</td>
<td>88</td>
<td>4</td>
<td>196</td>
<td>67313</td>
</tr>
<tr>
<td>2005</td>
<td>88</td>
<td>4</td>
<td>196</td>
<td>68339</td>
</tr>
</tbody>
</table>

**Source:** RBI: Report on Trend & Progress of Banking in India[Various Issues]

The expansion of commercial bank branches to all corners of the country was one of the objectives of nationalisation. It can be seen from the above table that the branch network which grew by just 99% between 1951 and 1969 (pre-nationalisation), showed growth of
680% between 1969 and 1980 and 1546% between 1951 and 2005. The population served per branch, showed significant improvement from 87000 persons per branch in 1951 to 64,000 per branch in 1969 and further to 16,000 per branch in 2005, meeting yet another objective of nationalisation.

The growth of bank branches in the rural areas has resulted in making the banking services available to a large section of the population who did have this facility at their door step earlier. The geographical spread of banks further added to the availability with more bank branches being opened in rural and semi-urban areas of the country.

The data given in Table 2 reveal that by the end of June, 2000, the number of bank branches in rural areas constituted 50% of the total bank branches in the country, whereas the number of branches in semi-urban areas constituted 22%. The number of bank branches under various categories of banks as at the end of June, 2000 and June 2005 is given below:

**TABLE: 2**

**BANK GROUP AND POPULATION GROUP-WISE DISTRIBUTION OF COMMERCIAL BANK BRANCHES (AS ON JUNE 30, 2000)**

<table>
<thead>
<tr>
<th>BANK GROUP</th>
<th>RURAL</th>
<th>SEMI-URBAN</th>
<th>URBAN</th>
<th>METROPOLITAN</th>
<th>TOTAL</th>
</tr>
</thead>
<tbody>
<tr>
<td>1. State Bank Of India (1)</td>
<td>4115</td>
<td>2418</td>
<td>1391</td>
<td>972</td>
<td>8896</td>
</tr>
<tr>
<td></td>
<td>(46.3%)</td>
<td>(27.2%)</td>
<td>(15.6%)</td>
<td>(10.9%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>2. Associate Banks of SBI (7)</td>
<td>1401</td>
<td>1526</td>
<td>790</td>
<td>652</td>
<td>4369</td>
</tr>
<tr>
<td></td>
<td>(32.1%)</td>
<td>(34.9%)</td>
<td>(18.1%)</td>
<td>(14.9%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>3. Nationalised Banks (19)</td>
<td>13913</td>
<td>6773</td>
<td>6349</td>
<td>5386</td>
<td>32421</td>
</tr>
<tr>
<td></td>
<td>(42.9%)</td>
<td>(20.9%)</td>
<td>(19.6%)</td>
<td>(16.6%)</td>
<td>(100.0%)</td>
</tr>
<tr>
<td>4. Indian Private Sector Banks (32)</td>
<td>1137</td>
<td>1679</td>
<td>1169</td>
<td>998</td>
<td>4983</td>
</tr>
<tr>
<td></td>
<td>(22.8%)</td>
<td>(33.7%)</td>
<td>(23.5%)</td>
<td>(20.0%)</td>
<td>(100.0%)</td>
</tr>
<tr>
<td>5. Foreign Banks in India (42)</td>
<td>---</td>
<td>2</td>
<td>14</td>
<td>170</td>
<td>186</td>
</tr>
<tr>
<td></td>
<td></td>
<td>(1.1%)</td>
<td>(7.5%)</td>
<td>(91.4%)</td>
<td>(100.0%)</td>
</tr>
<tr>
<td>BANK GROUP</td>
<td>RURAL</td>
<td>SEMIURBAN</td>
<td>URBAN</td>
<td>METROPOLITAN</td>
<td>TOTAL</td>
</tr>
<tr>
<td>----------------------------------</td>
<td>---------</td>
<td>-----------</td>
<td>----------</td>
<td>--------------</td>
<td>----------</td>
</tr>
<tr>
<td>1. State Bank Of India (1)</td>
<td>4068</td>
<td>2475</td>
<td>1470</td>
<td>1023</td>
<td>9036</td>
</tr>
<tr>
<td></td>
<td>(45.0%)</td>
<td>(27.4%)</td>
<td>(16.3%)</td>
<td>(11.3%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>2. Associate Banks of SBI (7)</td>
<td>1412</td>
<td>1605</td>
<td>864</td>
<td>744</td>
<td>4625</td>
</tr>
<tr>
<td></td>
<td>(30.5%)</td>
<td>(34.7%)</td>
<td>(18.7%)</td>
<td>(16.1%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>3. Nationalised Banks (19)</td>
<td>13587</td>
<td>7291</td>
<td>6935</td>
<td>5812</td>
<td>33625</td>
</tr>
<tr>
<td></td>
<td>(40.4%)</td>
<td>(21.7%)</td>
<td>(20.6%)</td>
<td>(17.3%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>4. Other Public Sector Bank (1)</td>
<td>5</td>
<td>26</td>
<td>68</td>
<td>60</td>
<td>159</td>
</tr>
<tr>
<td></td>
<td>(3.1%)</td>
<td>(16.4%)</td>
<td>(42.8%)</td>
<td>(37.7%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>5. Indian Private Sector Banks</td>
<td>1097</td>
<td>1831</td>
<td>1714</td>
<td>1479</td>
<td>6121</td>
</tr>
<tr>
<td>(32)</td>
<td>(17.9%)</td>
<td>(29.9%)</td>
<td>(28.0%)</td>
<td>(24.2%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>6. Foreign Banks in India (42)</td>
<td>-</td>
<td>1</td>
<td>42</td>
<td>206</td>
<td>249</td>
</tr>
<tr>
<td></td>
<td>-</td>
<td>(0.4%)</td>
<td>(16.9%)</td>
<td>(82.7%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>7. Regional Rural banks (196)</td>
<td>11922</td>
<td>2158</td>
<td>401</td>
<td>20</td>
<td>14501</td>
</tr>
<tr>
<td></td>
<td>(82.2%)</td>
<td>(14.9)</td>
<td>(2.8%)</td>
<td>(0.1%)</td>
<td>(100%)</td>
</tr>
<tr>
<td>8. Non-Scheduled Banks (4)</td>
<td>4</td>
<td>9</td>
<td>10</td>
<td>-</td>
<td>23</td>
</tr>
<tr>
<td>Local Area Banks</td>
<td>(17.4%)</td>
<td>(39.1%)</td>
<td>(43.5%)</td>
<td></td>
<td>(100%)</td>
</tr>
<tr>
<td>TOTAL</td>
<td>32095</td>
<td>15396</td>
<td>11504</td>
<td>9344</td>
<td>68339</td>
</tr>
<tr>
<td></td>
<td>(47.0%)</td>
<td>(22.5%)</td>
<td>(16.8%)</td>
<td>(13.7%)</td>
<td>(100.0%)</td>
</tr>
</tbody>
</table>


It may be observed from the above that more than 47% of the bank branches, as at the end of 2005, are located in rural areas while semi urban, urban and metropolitan branches constitute 22.5%, 16.8%, and 13.7% of the total branches respectively.
1.1.3(I)(ii) Financial Assets In India- Share Of Banks

As institutions handling financial assets, banks, over a period of time, have shown significant growth as far as asset holding is concerned. The financial assets of commercial banks which stood at Rs.46987 crores in June, 1981 increased to Rs.232786 crores in 1991 and further to Rs.508652 crores in 1996 and stood at Rs.888781 crores in 2000. The assets further grew to Rs. 1050276 crores in 2001, Rs.1269034 crores in 2002, Rs.1450854 crores in 2003, Rs. 1696574 crores in 2004 and Rs.2046643 crores in 2005. The share of financial institutions also grew substantially from Rs.16650 crores in 1981 to Rs.127975 crores in 1991, Rs.484329 crores in 1999 and stood at Rs.522466 crores in 2000. The assets of financial institutions, further, grew to Rs.582774 crores in 2001, Rs.555363 crores in 2002, Rs.565813 crores in 2003, Rs.580320 crores in 2004 and Rs.651840 crores in 2005. The share of banks in total financial assets which was 73.8% in 1981 increased to 75.8% in 2005.

1.1.3(I)(iii) Business Growth of Banks

As far as business growth is concerned, the banking sector demonstrated magnificent growth, especially in the post-nationalisation period. The rapid expansion of branch network after nationalisation enabled the banks to tap the deposits from rural and semi-urban areas of the country.

On the other hand, dispensation of credit in these areas increased due to the prescription of targets for lending to priority sector and weaker sections. Further Reserve Bank prescribed some definite credit deposit ratio for semi-urban and rural areas which ensured that certain portion of the deposits raised in the rural areas are disbursed through loans in the same areas. The position of deposits, credit and investments of banks during the period 1951-2005 is given below.

**TABLE: 4**

<table>
<thead>
<tr>
<th>Deposits</th>
<th>Credit</th>
<th>Investment</th>
</tr>
</thead>
<tbody>
<tr>
<td>1951</td>
<td>1969</td>
<td>1974</td>
</tr>
<tr>
<td>859</td>
<td>4079</td>
<td>192542</td>
</tr>
<tr>
<td>1991</td>
<td>1996</td>
<td>433819</td>
</tr>
<tr>
<td>813344</td>
<td>1055386</td>
<td>304</td>
</tr>
<tr>
<td>2000</td>
<td>2001</td>
<td>2002</td>
</tr>
<tr>
<td>1205930</td>
<td>1355880</td>
<td>1051</td>
</tr>
<tr>
<td>2003</td>
<td>2004</td>
<td>2005</td>
</tr>
<tr>
<td>1578450</td>
<td>1836987</td>
<td>1151138</td>
</tr>
</tbody>
</table>

(source: RBI: Report on Trend and Progress of Banking in India: Various Issues)
The percentage growth in deposits, advances and investments during the pre-nationalization period, pre-reforms period, reforms period and during the period 2000-2005 are given below:

**TABLE: 5**

**DEPOSITS, CREDIT & INVESTMENTS: GROWTH**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Deposits</td>
<td>375%</td>
<td>4620%</td>
<td>322%</td>
<td>126%</td>
</tr>
<tr>
<td>Credit</td>
<td>468%</td>
<td>3643%</td>
<td>274%</td>
<td>164%</td>
</tr>
<tr>
<td>Investments</td>
<td>245%</td>
<td>7042%</td>
<td>311%</td>
<td>126%</td>
</tr>
</tbody>
</table>

(Source: RBI: Report on Trend and Progress of Banking in India: Various Issues)

It is evident from the above that the deposits, advances and investments grew substantially in the post-nationalisation period.

1.1.3(I)(iv) **Sectoral Deployment of Credit**

Banking sector has made significant contributions to the development of various productive sectors of the economy. The advances to priority sector which stood at Rs.325 crores in 1968 (pre-nationalisation) increased to Rs.6730 crores and Rs.73391 crores in 1980 and 1996 respectively and stood at Rs.131827 crores as at the end of 2000. The quantum of credit increased to Rs.345627 crores by March, 2005.

The industrial credit to medium and large scale industries increased from Rs.1857 crores in 1968 to Rs.8269 crores and Rs.93108 crores in 1980 and 1996 respectively and stood at Rs.147319 crores in 2000. It further increased to Rs.290186 crores in 2005. Similarly, the credit to wholesale trade also increased from Rs.432 crores in 1968 to Rs.1915 crores and Rs.11933 crores in 1980 and 1996 respectively and stood at Rs.16818 crores as at the end of 2000. The outstanding credit as at the end of 2005 was Rs.33814 crores.
Financing for procurement of food grains etc. to various agencies is one of the important areas where credit deployment is undertaken by the bank. Banks in India have played a major role in supporting this activity of great social consequence [Ghosh (1988)]. The bank finances to food procurement has seen significant growth in the last few decades. The bank credit to food procurement during the period 1968 to 2005 is furnished in the table below:

**TABLE: 6**

**FOOD CREDIT BY BANKS**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit</td>
<td>109</td>
<td>2100</td>
<td>9791</td>
<td>7597</td>
<td>12485</td>
<td>16816</td>
<td>25691</td>
<td>39991</td>
<td>53978</td>
<td>49479</td>
<td>35961</td>
<td>41121</td>
</tr>
</tbody>
</table>

(Source: Report on Trends and progress in Banking in India: various issues)

The pattern of flow of credit has undergone significant changes after nationalization and prescription of targets for priority sectors. The share of industrial credit to large and medium industries out of net bank credit has come down and the share of credit to priority sector and other categories such as personal segment loans, housing finance etc. has increased.

A comparative position showing the sectoral deployment of credit as a percentage of net bank credit is given below:

**TABLE: 7**

**SECTORAL DEPLOYMENT OF CREDIT(%)**

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Priority Sector</td>
<td>11.0</td>
<td>35.2</td>
<td>33.1</td>
<td>33.4</td>
<td>33.1</td>
<td>33.1</td>
<td>32.7</td>
<td>33.1</td>
<td>34.5</td>
<td>35.6</td>
</tr>
<tr>
<td>Industry (Medium and large)</td>
<td>62.8</td>
<td>43.2</td>
<td>42.0</td>
<td>39.5</td>
<td>36.9</td>
<td>34.9</td>
<td>32.2</td>
<td>32.5</td>
<td>32.4</td>
<td>29.9</td>
</tr>
<tr>
<td>Whole sale Trade</td>
<td>14.6</td>
<td>10.0</td>
<td>10.0</td>
<td>4.4</td>
<td>4.2</td>
<td>3.8</td>
<td>3.8</td>
<td>3.6</td>
<td>3.3</td>
<td>3.5</td>
</tr>
<tr>
<td>Others*</td>
<td>11.5</td>
<td>11.6</td>
<td>11.6</td>
<td>19.3</td>
<td>19.8</td>
<td>20.1</td>
<td>21.4</td>
<td>22.9</td>
<td>25.2</td>
<td>26.9</td>
</tr>
</tbody>
</table>

*(includes advances to personal segment, housing finance, loan against deposits etc.)*
1.1.3(I)(v)  **Geographical Dispersion of Credit**

The Reserve bank of India, in addition to controlling the quantum and direction of credit through various policy prescription, also ensures that the deposit raised from semi-urban and rural areas are re-deployed in the same area to the extent possible by prescribing credit-deposit ratio. The ratio indicates the minimum level to which the deposits raised from the public in a geographical area are redeployed through credit in the same area. This prescription prevents the flow of funds raised from the rural areas to urban centres where there is larger demand for funds, depriving those areas the funds required for development. The redeployment is assessed in terms of credit-deposit (C-D Ratio) ratio and also credit + investment to deposit ratio (C+I/D Ratio) for a specific geographical area. The credit-deposit ratio and credit plus investment to deposit ratio during the period 1994 to 2005 for various geographic regions of the country are as below:

### Table 8

**Region-wise Credit-deposit ratio and credit+investment ratio of scheduled commercial banks(%)**

<table>
<thead>
<tr>
<th>Year</th>
<th>North Region</th>
<th>Eastern Region</th>
<th>Central Region</th>
<th>Western Region</th>
<th>Southern Region</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>C-D Ratio</td>
<td>C+I/D Ratio</td>
<td>C-D Ratio</td>
<td>C+I/D Ratio</td>
<td>C-D Ratio</td>
</tr>
<tr>
<td>1993-1994</td>
<td>57.8</td>
<td>64.3</td>
<td>48.6</td>
<td>54.5</td>
<td>67.3</td>
</tr>
<tr>
<td>1994-1995</td>
<td>48.6</td>
<td>54.5</td>
<td>38.9</td>
<td>56.3</td>
<td>69.4</td>
</tr>
<tr>
<td>1995-1996</td>
<td>57.1</td>
<td>53.4</td>
<td>47.1</td>
<td>55.1</td>
<td>71.2</td>
</tr>
<tr>
<td>1996-1997</td>
<td>54.0</td>
<td>48.4</td>
<td>47.1</td>
<td>49.4</td>
<td>80.9</td>
</tr>
<tr>
<td>1997-1998</td>
<td>48.8</td>
<td>54.4</td>
<td>63.2</td>
<td>54.4</td>
<td>69.4</td>
</tr>
<tr>
<td>1998-1999</td>
<td>57.0</td>
<td>38.9</td>
<td>47.1</td>
<td>55.1</td>
<td>71.2</td>
</tr>
<tr>
<td>1999-2000</td>
<td>58.0</td>
<td>38.9</td>
<td>47.1</td>
<td>55.1</td>
<td>71.2</td>
</tr>
<tr>
<td>2000-2001</td>
<td>52.5</td>
<td>57.7</td>
<td>47.6</td>
<td>55.1</td>
<td>71.2</td>
</tr>
<tr>
<td>2001-2002</td>
<td>55.5</td>
<td>50.0</td>
<td>52.4</td>
<td>49.3</td>
<td>71.3</td>
</tr>
<tr>
<td>2002-2003</td>
<td>55.5</td>
<td>50.0</td>
<td>50.3</td>
<td>49.3</td>
<td>71.2</td>
</tr>
<tr>
<td>2003-2004</td>
<td>56.8</td>
<td>50.0</td>
<td>52.4</td>
<td>49.3</td>
<td>71.2</td>
</tr>
<tr>
<td>2004-2005</td>
<td>59.3</td>
<td>50.0</td>
<td>52.4</td>
<td>49.3</td>
<td>71.2</td>
</tr>
</tbody>
</table>

(Source: RBI: Report on trends and progress in banking: Various issues)
The C-D ratios and C+I/D ratios of the Southern and Northern region were comparatively higher while Northeast region lagged behind in absorbing the credit. The low credit absorption capacity of the Northeast region can be traced to the fact that the region is comparatively less developed economically. The position of credit-deposit and credit plus investment ratios of all regions are being constantly monitored by the Reserve Bank of India, the central bank.

1.1.3(I)(vi) Advances to Priority Sector

Advances to priority sector from the banks which stood at Rs.325.00 crores in 1968 (pre-nationalisation era) registered a growth of 40459% and stood at Rs.131827.00 as at the end of 2000. The advances to priority sectors for some selected years by various banks during the period 1969 to 2005 is furnished below:

### TABLE: 9
ADVANCES TO PRIORITY SECTOR BY VARIOUS BANK GROUPS

<table>
<thead>
<tr>
<th>Year</th>
<th>Public Sector Banks</th>
<th>Private Sector Banks</th>
<th>Foreign Banks*</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Amount</td>
<td>% of Net Bank Credit</td>
<td>Amount</td>
</tr>
<tr>
<td>1968-69</td>
<td>441</td>
<td>14.6</td>
<td>-</td>
</tr>
<tr>
<td>1993-1994</td>
<td>53197</td>
<td>37.8</td>
<td>6283</td>
</tr>
<tr>
<td>1995-1996</td>
<td>69609</td>
<td>37.8</td>
<td>11614</td>
</tr>
<tr>
<td>1997-1998</td>
<td>91319</td>
<td>41.8</td>
<td>18019</td>
</tr>
<tr>
<td>1999-2000</td>
<td>127807</td>
<td>43.6</td>
<td>21550</td>
</tr>
<tr>
<td>2000-2001</td>
<td>149116</td>
<td>43.7</td>
<td>25709</td>
</tr>
<tr>
<td>2001-2002</td>
<td>171185</td>
<td>43.1</td>
<td></td>
</tr>
</tbody>
</table>
1.1.3(2). **Profitability of Scheduled Commercial Banks**

The profitability of the scheduled commercial banks for the period 1995-'96 to 2004-2005 is detailed below. During the period under review, the profitability of the scheduled commercial banks showed a fluctuating pattern. The aggregate net profit of the banks which stood at Rs.599151.90 crores in 1996 increased to Rs.2355982.67 crores in 2005. The net profit as percentage of total assets increased from 0.16% to 0.90% during the same period. The details are given below:

<table>
<thead>
<tr>
<th>YEAR</th>
<th>NET PROFIT* (Rs.Cr.)</th>
<th>TOTAL ASSETS* (Rs.Cr.)</th>
<th>NET PROFIT/ TOTAL ASSETS (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996</td>
<td>939.45</td>
<td>599151.90</td>
<td>0.16</td>
</tr>
<tr>
<td>1997</td>
<td>4578.02</td>
<td>672738.56</td>
<td>0.68</td>
</tr>
<tr>
<td>1998</td>
<td>6498.90</td>
<td>795535.50</td>
<td>0.87</td>
</tr>
<tr>
<td>1999</td>
<td>4659.50</td>
<td>950897.97</td>
<td>0.49</td>
</tr>
<tr>
<td>2000</td>
<td>7306.36</td>
<td>950717.74</td>
<td>0.76</td>
</tr>
<tr>
<td>2001</td>
<td>6403.48</td>
<td>1295405.34</td>
<td>0.49</td>
</tr>
<tr>
<td>2002</td>
<td>11572.46</td>
<td>1535513.13</td>
<td>0.75</td>
</tr>
<tr>
<td>2003</td>
<td>17077.22</td>
<td>1699197.46</td>
<td>1.01</td>
</tr>
<tr>
<td>2004</td>
<td>22270.94</td>
<td>1974017.00</td>
<td>1.13</td>
</tr>
<tr>
<td>2005</td>
<td>21320.16</td>
<td>2355982.67</td>
<td>0.90</td>
</tr>
</tbody>
</table>

(Source: Report on Trends and progress in Banking in India: various issues)
The change in profitability in percentage terms is under:

**TABLE: 11**

OPERATING RATIO (Net Profit/Total Assets)

<table>
<thead>
<tr>
<th>PERIOD</th>
<th>% INCREASE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-2000</td>
<td>370%</td>
</tr>
<tr>
<td>1996-2005</td>
<td>460%</td>
</tr>
</tbody>
</table>

The profitability levels has shown considerable improvement during the period covered in the analysis.

1.1.3(3). **Non-Performing Assets (NPA)**

The quality of assets of the Indian banking system has always been a cause of worry during the 80s. The nationalisation accompanied by large scale branch expansion and directed lending to specific target groups and pressure to achieve targets left the monitoring and supervision of advances and recovery efforts comparatively lax. With the financial sector reforms, stringent norms for income recognition, asset classification and provisioning were introduced. The supervision and monitoring of advances and efforts for recovery were strengthened. The position of Gross and Net NPAs during the period 1996-97 to 2004-05 for all scheduled banks is given below:

**TABLE: 12**

GROSS AND NET NPAS OF SCHEDULED COMMERCIAL BANKS

(Amount in Cr.)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>Gross NPAs</th>
<th>Gross NPAs To Gross advances</th>
<th>Gross NPAs To Total Assets</th>
<th>Net NPAs</th>
<th>Net NPAs/Net Advances</th>
<th>Net NPAs to Total Assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>1996-1997</td>
<td>47300</td>
<td>15.70</td>
<td>7.00</td>
<td>22340</td>
<td>8.10</td>
<td>3.30</td>
</tr>
<tr>
<td>1998-</td>
<td>58722</td>
<td>14.70</td>
<td>6.20</td>
<td>28020</td>
<td>7.60</td>
<td>2.90</td>
</tr>
</tbody>
</table>
It may be observed from the above that after the introduction of stringent international standards, the financial position of the banks have improved as indicated by the declining percentage of Gross NPAs and Net NPAs.

1.1.3(3)(i) Frequency Distribution of NPAs

The frequency distributions of NPAs of various categories of banks are given below:

**TABLE: 13**

**PUBLIC SECTOR BANKS:**

<table>
<thead>
<tr>
<th>Year</th>
<th>Upto 10%</th>
<th>Above 10%</th>
<th>Total No. of Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>2</td>
<td>-</td>
<td>27</td>
</tr>
<tr>
<td>1996</td>
<td>19</td>
<td>3</td>
<td>22</td>
</tr>
<tr>
<td>1997</td>
<td>17</td>
<td>2</td>
<td>20</td>
</tr>
<tr>
<td>1998</td>
<td>17</td>
<td>4</td>
<td>21</td>
</tr>
<tr>
<td>1999</td>
<td>18</td>
<td>5</td>
<td>23</td>
</tr>
<tr>
<td>2000</td>
<td>22</td>
<td>3</td>
<td>25</td>
</tr>
<tr>
<td>2001</td>
<td>22</td>
<td>5</td>
<td>27</td>
</tr>
<tr>
<td>2002</td>
<td>24</td>
<td>3</td>
<td>27</td>
</tr>
<tr>
<td>2003</td>
<td>25</td>
<td>2</td>
<td>27</td>
</tr>
<tr>
<td>2004</td>
<td>27</td>
<td>-</td>
<td>28</td>
</tr>
<tr>
<td>2005</td>
<td>27</td>
<td>2</td>
<td>29</td>
</tr>
</tbody>
</table>

**TABLE: 14**

**PRIVATE SECTOR BANKS (OLD):**

<table>
<thead>
<tr>
<th>Year</th>
<th>Upto 10%</th>
<th>Above 10%</th>
<th>Total No. of Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>1995</td>
<td>-</td>
<td>-</td>
<td>25</td>
</tr>
<tr>
<td>1996</td>
<td>22</td>
<td>2</td>
<td>24</td>
</tr>
<tr>
<td>1997</td>
<td>23</td>
<td>4</td>
<td>27</td>
</tr>
<tr>
<td>1998</td>
<td>21</td>
<td>8</td>
<td>29</td>
</tr>
<tr>
<td>1999</td>
<td>17</td>
<td>6</td>
<td>23</td>
</tr>
<tr>
<td>2000</td>
<td>18</td>
<td>7</td>
<td>25</td>
</tr>
<tr>
<td>2001</td>
<td>16</td>
<td>5</td>
<td>21</td>
</tr>
<tr>
<td>2002</td>
<td>17</td>
<td>2</td>
<td>19</td>
</tr>
<tr>
<td>2003</td>
<td>19</td>
<td>2</td>
<td>21</td>
</tr>
<tr>
<td>2004</td>
<td>18</td>
<td>2</td>
<td>20</td>
</tr>
<tr>
<td>2005</td>
<td>20</td>
<td>2</td>
<td>20</td>
</tr>
</tbody>
</table>
TABLE: 15

PRIVATE SECTOR BANKS (NEW):

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 10%</td>
<td>-</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>8</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>9</td>
<td></td>
</tr>
<tr>
<td>Above 10%</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>1</td>
<td>-</td>
<td></td>
</tr>
<tr>
<td>Total No. of Banks</td>
<td>-</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>9</td>
<td>8</td>
<td>8</td>
<td>9</td>
<td>10</td>
<td>0</td>
<td></td>
</tr>
</tbody>
</table>

TABLE: 16

FOREIGN BANKS:

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Upto 10%</td>
<td>-</td>
<td>30</td>
<td>36</td>
<td>34</td>
<td>27</td>
<td>31</td>
<td>31</td>
<td>26</td>
<td>28</td>
<td>27</td>
<td>27</td>
</tr>
<tr>
<td>Above 10%</td>
<td>-</td>
<td>7</td>
<td>1</td>
<td>6</td>
<td>14</td>
<td>11</td>
<td>11</td>
<td>14</td>
<td>8</td>
<td>6</td>
<td>4</td>
</tr>
<tr>
<td>Total No. of Banks</td>
<td>-</td>
<td>37</td>
<td>37</td>
<td>40</td>
<td>41</td>
<td>42</td>
<td>42</td>
<td>40</td>
<td>36</td>
<td>33</td>
<td>31</td>
</tr>
</tbody>
</table>

(Source: Report on Trend and Progress in Banking: various issues)\(^{12}\)

1.1.3(4) **Capital Adequacy:**

The Capital adequacy is the minimum amount of regulatory capital to be maintained by the banks as per the prescriptions of the Central Bank, i.e., Reserve Bank of India. The prescriptions started at a low rate of 6% initially and gradually moved up to the current level of 9\(^{13}\). The Capital adequacy ratio of various bank groups for the period 1998-2005 was as under:
TABLE: 17

CAPITAL ADEQUACY RATIO: BANK-GROUP WISE

<table>
<thead>
<tr>
<th>Group</th>
<th>1998</th>
<th>1999</th>
<th>2000</th>
<th>2001</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
</tr>
</thead>
<tbody>
<tr>
<td>All Scheduled banks</td>
<td>11.5</td>
<td>11.3</td>
<td>11.1</td>
<td>11.4</td>
<td>12.0</td>
<td>12.7</td>
<td>12.9</td>
<td>12.8</td>
</tr>
<tr>
<td>Public Sector banks</td>
<td>11.6</td>
<td>11.3</td>
<td>10.7</td>
<td>11.2</td>
<td>11.8</td>
<td>12.6</td>
<td>13.2</td>
<td>12.9</td>
</tr>
<tr>
<td>Old Private sector</td>
<td>12.3</td>
<td>12.1</td>
<td>12.4</td>
<td>11.9</td>
<td>12.5</td>
<td>12.8</td>
<td>13.7</td>
<td>12.5</td>
</tr>
<tr>
<td>sector banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>New Private sector</td>
<td>13.2</td>
<td>11.8</td>
<td>13.4</td>
<td>11.5</td>
<td>12.3</td>
<td>11.3</td>
<td>10.2</td>
<td>12.1</td>
</tr>
<tr>
<td>sector banks</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>10.3</td>
<td>10.8</td>
<td>11.9</td>
<td>12.6</td>
<td>12.9</td>
<td>15.2</td>
<td>15.0</td>
<td>14.0</td>
</tr>
</tbody>
</table>

(Source: Report on Trend and Progress: Various issues)

The overall position of the strength of the banks, in terms of "Capital adequacy ratio", has shown an ascending trend during the period 1998 to 2005.

The frequency distribution of Capital to Risk Assets ratio (CRAR) of banks in various categories is given below:

TABLE: 18

FREQUENCY DISTRIBUTION OF CRAR

<table>
<thead>
<tr>
<th>Year</th>
<th>Bank Group</th>
<th>Below 4%</th>
<th>4% to 9%</th>
<th>9% to 10%</th>
<th>Above 10%</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>State Bank Group</td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td></td>
<td>-</td>
<td>-</td>
<td>6</td>
<td>1</td>
</tr>
<tr>
<td>1997</td>
<td></td>
<td>-</td>
<td>-</td>
<td>3</td>
<td>4</td>
</tr>
<tr>
<td>1998</td>
<td></td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>6</td>
</tr>
<tr>
<td>1999</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>7</td>
</tr>
<tr>
<td>2000</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>7</td>
</tr>
<tr>
<td>2001</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>8</td>
</tr>
<tr>
<td>2002</td>
<td></td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>8</td>
</tr>
<tr>
<td>Year</td>
<td>Nationalised Banks</td>
<td>Private Sector Bank</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>-------------------</td>
<td>---------------------</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td></td>
<td></td>
<td>Below 4%</td>
<td>4% to 9%</td>
<td>9% to 10%</td>
<td>Above 10%</td>
</tr>
<tr>
<td>1996</td>
<td>5</td>
<td>3</td>
<td>7</td>
<td>4</td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>2</td>
<td>-</td>
<td>6</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>1</td>
<td>-</td>
<td>6</td>
<td>12</td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>1</td>
<td>-</td>
<td>5</td>
<td>13</td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>1</td>
<td>-</td>
<td>4</td>
<td>14</td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>1</td>
<td>1</td>
<td>2</td>
<td>15</td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>-</td>
<td>-</td>
<td>1</td>
<td>18</td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>-</td>
<td>-</td>
<td>2</td>
<td>17</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Old New</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>-</td>
</tr>
<tr>
<td>1996</td>
<td>Old New</td>
<td>3</td>
<td>1</td>
<td>8</td>
<td>13</td>
</tr>
<tr>
<td>1997</td>
<td>Old New</td>
<td>-</td>
<td>-</td>
<td>-</td>
<td>9</td>
</tr>
<tr>
<td>1998</td>
<td>Old New</td>
<td>2</td>
<td>2</td>
<td>6</td>
<td>15</td>
</tr>
<tr>
<td>1999</td>
<td>Old New</td>
<td>2</td>
<td>3</td>
<td>2</td>
<td>18</td>
</tr>
<tr>
<td>2000</td>
<td>Old New</td>
<td>1</td>
<td>2</td>
<td>2</td>
<td>7</td>
</tr>
<tr>
<td>Year</td>
<td>Old</td>
<td>New</td>
<td>Foreign Banks</td>
<td></td>
<td></td>
</tr>
<tr>
<td>------</td>
<td>-----</td>
<td>-----</td>
<td>---------------</td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>2</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>1</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>-</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>-</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1996</td>
<td>-</td>
<td>14</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1997</td>
<td>1</td>
<td>13</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1998</td>
<td>-</td>
<td>12</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>1999</td>
<td>-</td>
<td>3</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2000</td>
<td>-</td>
<td>5</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2001</td>
<td>-</td>
<td>4</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2002</td>
<td>-</td>
<td>2</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2003</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2004</td>
<td>-</td>
<td>-</td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>2005</td>
<td>-</td>
<td>1</td>
<td></td>
<td></td>
<td></td>
</tr>
</tbody>
</table>

(Source: Report on Trend and Progress in Banking in India: Various issues)
1.2. GLOBALISATION AND LIBERALISATION OF INDIAN ECONOMY

"The challenges of development is to improve the quality of life. For the world's poor countries, a better quality of life generally calls for higher income ...and it involves much more. It encompasses as ends in itself, better education, higher standards of health and nutrition, less poverty, a cleaner environment, more equality of opportunity, greater individual freedom and a richer cultural life"

  (World Bank)

1.2. The liberalisation and globalisation of the Indian Economy was ushered in through the economic reforms, which was initiated in a large way from 1991 onwards. Basically, the reforms constituted a movement towards reducing centralized government control of the economy as well as intervention and emphasizing a relatively larger role to the Private Sector. A brief description of the historical background leading to a situation which made the unprecedented economic reforms a necessity in the 1990s is given below:

India became a self-governing republic in 1950. The period 1950-90 witnessed an average annual rate of economic growth of 4%. (Table 19). The growth rate of per capita income was being adversely affected by the population growth rate of over 2.1%. The period showed an average annual growth rate of 2.8% for Agriculture, 5.6% for manufacturing industries, 5.4% for transport, communication and trade, 4.3% in financial and business services and 4.75% in public administration, defence and personal services. The contribution from non-agricultural sectors increased drastically and the share of agriculture in GDP declined from 56.5% in 1950-51 to 33.9% in 1989-90.

<table>
<thead>
<tr>
<th>TABLE: 19</th>
</tr>
</thead>
<tbody>
<tr>
<td>AVERAGE ANNUAL GROWTH RATE OF GNP*</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>PLAN</th>
<th>PERIOD</th>
<th>AVERAGE ANNUAL GROWTH RATE (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>FIRST PLAN</td>
<td>1951-‘56</td>
<td>3.7</td>
</tr>
<tr>
<td>SECOND PLAN</td>
<td>1956-‘61</td>
<td>4.2</td>
</tr>
<tr>
<td>THIRD PLAN</td>
<td>1961-66</td>
<td>2.7</td>
</tr>
<tr>
<td></td>
<td>1966-69</td>
<td></td>
</tr>
<tr>
<td>FOURTH PLAN</td>
<td>1969-74</td>
<td>3.4</td>
</tr>
<tr>
<td>FIFTH PLAN</td>
<td>1974-‘79</td>
<td>5.0</td>
</tr>
</tbody>
</table>
As in many other less developed nations, the development policy followed implied a strong role to the government and this was viewed as a solution to lower growth rate enabling speedy recovery. The industrial policy of the state owning and managing major heavy industrial sectors, infrastructure and financial sectors affected the growth and prevented private enterprise from entering these areas. Further the government intervention in the industrial sector, banking sector and markets dampened the full realization of the economic potential of the country\cite{Dowd1992}. As a result, the annual rate of growth of the economy was far below the rates achieved in many East and Southeast Asian economies. These economies had liberalised the investment regime and controls enabling considerable amount of foreign investments. The industrial sector saw the public sector making limited contributions, while the private sector were under pressure due to regulations. The industrial sickness grew to alarming volumes with large number of units in this sector turning sick. The industrial as well as agricultural growth was adversely affected by the policy framework resulting in all the sectors achieving less than potential growth rates.

I.2.1. Reforms in Other Developing Countries

"Many countries benefited from the fruits of liberalisation, though some countries like Philippines, Argentina, Indonesia, Chile and Uruguay faced some problems consequent to the globalisation and liberalisation of their economies. The main causes of failure of financial liberalisation in some countries were the macro-economic instability as well as the relatively rapid pace of introduction of the measures (Khatkhate 1990)\textsuperscript{14}."

<table>
<thead>
<tr>
<th>Source</th>
<th>Published by Ministry of Finance, New Delhi</th>
</tr>
</thead>
</table>
2. RBI Bulletin: Various issues\textsuperscript{13} | |

(*Gross National Product)
South Korea

The south Korean economy has been managed with regulations involving interest rate ceiling and monitoring of credit allocation in selected thrust areas. The speed of reforms has been gradual. As far as sequencing is concerned, reforms were first introduced in the non-banking sector, which introduced financial innovation and competitive elements in the system. There was privatization of non-banking institutions and gradual entry of foreign financial institutions.

The problem of non-performing assets was handled in a pragmatic manner. The government extended financial support and the Central Bank extended concessional loans to banks facing problems. Tax allowances were granted for writing off bad debts. During the 1970's, inflation generated by oil shocks was high, resulting in negative real rates of interest. During the 1980s, the inflation rate was brought down to one or two per cent and nominal deposit rates remained above 10 per cent. Since capital account was not liberalised, South Korea was able to follow an independent interest rate policy suitable for its growth and stability.

Malaysia

The speed of reform was gradual in Malaysia and the process during the 1980's was only a continuation of that of the 1970's. For example, Malaysia had, even during the 1970s, a flexible exchange rate, market determined interest rates, convertible capital account and autonomous competitive financial institutions. As a part of further reform, the Base Lending Rate (BLR) was introduced. Most of the other lending rates are linked to the BLR. Thus, the level of interest rate, being a tool of monetary policy, is influenced by the authorities, while the structure of interest rates is market determined. The real interest rates have been very high but they did not affect the corporate sector adversely since the debt-equity ratio had been low in Malaysia. Despite capital convertibility, the deposit rates were not particularly sensitive to international rates, since the non-bank public had little access to foreign markets.

The financial system has been competitive and efficient. There is prudent bank management and effective bank supervision. Thus, the quality of bank portfolio has not been infected by non-performing assets.
Sri Lanka
Sri Lanka had, prior to reforms, had modernised financial institutions, but the financial regulations were extensive. The speed of reform has been moderate. As for sequencing, interest rates and exchange rates were first made flexible, while regulated credit system continued. Nominal interest rates have remained above 16 percent and real rates have been positive during the 1980s. Although there was a problem of non-performing assets, prudent management and strict supervision kept the problem in check. Capital market, however, remained under-developed for want of a proper legal framework. Exchange controls were relaxed during the liberalisation process. Foreign Banks were allowed to compete introducing new financial instruments and modern management. Capital movement on external account was made free. The inflow of borrowed resources kept real exchange rates high.

The Philippines
During the 1980s, the Philippines had moderate fiscal deficits (one per cent on an average), but there was double-digit inflation due to oil shocks. The average rate of economic growth during the 1980s was about 6.5 per cent. As a part of the reform process, Philippines introduced universal banking system, which reduced bank concentration. Interest rate ceilings were gradually relaxed and eventually abolished in 1984. This led to a financial crisis. The interest rate on 60 to 90 day’s deposits suddenly jumped from 13.58 per cent in 1983 to 21.17 per cent in 1984. The prevailing inflation rate was 66.5 per cent during that year. The banking system almost collapsed and the Central Bank had to carry out rescue operations. Some private banks were nationalised. However, market determined interest rates came down during the subsequent years and real interest rates became positive. Subsidised credit allocation for selective sectors continued after 1985. The financial intermediation cost remained high due to a heavy tax on bank receipts and the quality of bank portfolio was poor. Macroeconomic instability arising from oil shocks, balance of payment problems and political crisis was the major cause of troubles in the financial sector after liberalisation.
**Indonesia**

Even prior to the reforms of the 1980s, Indonesia had an open capital account on the external front and a fairly developed domestic financial system. However, the restrictive financial regime consisting of interest rate ceilings, detailed credit quotas and subsidised credit to priority sectors continued to prevail in Indonesia. With the deregulation of interest rates, a 6 month deposit rate increased from 6 per cent to 16 per cent in 1984, which changed the situation of positive interest rates to negative rates. Interest rates fluctuated sharply during the 1980s. For some years real interest rates were higher than the productivity of capital. This created problems of financing investment, particular with slow growth of long term deposits. The rising interest cost of deposits and falling average return on loans due to sizeable component of non-performing assets, resulted in the declining profitability of banks.

**Chile**

Chile adopted the approach of rapid reforms. Banks were denationalised and interest controls were relaxed in 1974. Private financial institutions were granted entry into the market. Subsidised credit from the central bank was suddenly stopped. The inflation rate, which was around 150 per cent during the early 1970s was brought down to 15.20 per cent during the 1980s. In spite of the fact that Chile’s performance on the macroeconomic front was good, a financial crisis developed due to the factors like high interest rates, risky lending and worsening quality of bank portfolios. The Government and the Central bank attempted to save the banks facing trouble by providing emergency loans and purchasing their non-performing assets.

**Argentina**

Argentina adopted the approach of rapid reforms after the mid-seventies. The inflation rate generally remained at a three digit level during the 1980s. Real deposit rates remained negative, but the lending rates were positive and high. With high debt-equity ratio among industries, profitability of firms declined. This brought about a crisis in the financial sector. The Central bank extended subsidised credit to the banks facing severe financial troubles.
Uruguay

The financial sector was rigid prior to reforms. Uruguay adopted a moderate pace of liberalisation. The average rate of inflation in two digits during the 1980s. The logical sequence of events lending to the financial crisis was similar to that of Argentina; namely, high lending rates, risky loans, non-performing assets, bank failures and rescue operations by the Central Bank.

1.2.2. Reforms In India-A Major Shift in The Economic Policy

Though the 1980s provided a reasonable growth rate, the strategy of growth pursued needed many modifications. There was undesirable growth in the budget and fiscal deficits which exceeded the plan targets. Fiscal imbalance and the budgetary deficit spilled over into money supply growth and the excess demand fuelled inflationary pressures. The Economic Advisory Council observed in 1989 that the macroeconomic imbalance had spilled over on to balance of payments also. The import liberalisation launched in 1978-79, external Commercial borrowings, borrowings from IMF and World Bank, fall out of gulf war and consequent increase in oil prices, political instability combined with poor growth in exports resulted in Balance of Payment Crisis in the beginning of 1990s. Consequently, the foreign currency reserves which stood at $4.2 billion at the end of 1988-89, fell to a meagre $1.1 billion, barely enough to finance two week’s imports. The GDP growth during 1991-92 was only 1.2% while GNP growth was less than 1% [Rangarajan(1994)]15.

The above mentioned conditions necessitated review of the economic policy of the country and the new government which came to power in June, 1991 brought in a host of measures bringing in large scale reforms in the country’s economic policy. The major measures included:

1. Reduction in central government deficit
2. Reduction in current account deficit
3. Raising of GDP growth to higher levels
4. Introduced tax reforms based on a committee’s recommendations
5. Devalued rupee against dollar
6. New export – import policy with liberalised provisions was brought in
7. New industrial policy introduced with emphasis on decontrol
8. Capital Controls removed and market orientation brought in financial markets
9. Privatisation of government owned companies planned and core sectors such as infrastructure and power opened to private sector
10. Foreign investment in India made easy in manufacturing industries as well markets
11. Major changes brought about in the functioning of financial sector

I.2.3. Financial Sector Reforms

A committee was set up in mid-1991 to look into the reforms in the financial sector. The committee was chaired by Shri. Narasimham, former Governor of Reserve Bank of India. The committee looked into various aspects which needed reforms in the financial sector. The banking sector, which forms a major constituent of the financial sector, had many issues which were affecting their functioning[Narasimham(1991)]

(a). Pre-emption of bank resources:

Banks are obliged to satisfy two ratios, viz., Cash Reserve Ratio(CRR) and Statutory Liquidity Ratio(SLR). These ratios in the pre-reforms period was quite high and consequently the lendable resources were crippled affecting the profitability of the Banks. In 1991, the average CRR was 15% while the SLR was 38.5%. Further there was an incremental CRR of 10%, blocking substantial amount of bank funds in liquid assets.

**TABLE: 20**

<table>
<thead>
<tr>
<th>YEAR</th>
<th>FISCAL DEFICIT (% of GDP)</th>
<th>CRR (% of Net Demand &amp; Time Liabilities)</th>
<th>SLR (% of Net Demand &amp; Time Liabilities)</th>
<th>TOTAL (3+4)(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980-81</td>
<td>6.2</td>
<td>6.0</td>
<td>34.0</td>
<td>40.0</td>
</tr>
<tr>
<td>1981-82</td>
<td>5.4</td>
<td>7.75</td>
<td>35.0</td>
<td>42.5</td>
</tr>
<tr>
<td>1982-83</td>
<td>6.0</td>
<td>7.0</td>
<td>35.0</td>
<td>42.0</td>
</tr>
<tr>
<td>1983-84</td>
<td>6.3</td>
<td>19.0</td>
<td>35.0</td>
<td>54.0</td>
</tr>
<tr>
<td>1984-85</td>
<td>7.5</td>
<td>19.0</td>
<td>36.0</td>
<td>55.0</td>
</tr>
</tbody>
</table>
The amount to be kept as SLR was basically invested in Government securities. Apart from CRR and SLR, the banks were supposed to lend 40% of their lendable resources to borrowers belonging to Priority Sector. Though the rest was available for commercial lending, no discretion was available as far as interest chargeable on the loans was concerned. Thus, the banking sector did not have any discretion over its investment portfolio, either in terms of quantities or prices [Gibson(1994)]18.

(b). Directed credit:

The banks were required to lend a sizeable portion of their funds to priority sectors at concessional rate of interest. The target for priority sector advances was as high as 40%, leaving little funds for commercial lending.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1969</td>
<td>14.6</td>
</tr>
<tr>
<td>1989</td>
<td>43.2</td>
</tr>
<tr>
<td>1990</td>
<td>42.4</td>
</tr>
<tr>
<td>1991</td>
<td>39.3</td>
</tr>
<tr>
<td>1992</td>
<td>38.7</td>
</tr>
</tbody>
</table>

(Source: Economic Survey, 1992-'93 & RBI Bulletins)

The table above shows the percentage of net bank credit allocated to priority sector advances.

<table>
<thead>
<tr>
<th>YEAR</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1986-87</td>
<td>9.0</td>
</tr>
<tr>
<td>1987-88</td>
<td>8.1</td>
</tr>
<tr>
<td>1988-89</td>
<td>7.8</td>
</tr>
<tr>
<td>1989-90</td>
<td>7.8</td>
</tr>
<tr>
<td>1990-91</td>
<td>8.4</td>
</tr>
<tr>
<td>1991-92</td>
<td>6.0</td>
</tr>
</tbody>
</table>

(Source: Economic Survey, 1992-'93 & RBI Bulletins)
The pre-reform period also witnessed large scale borrowings by Government from the banking system. The credit to Government as a percentage of total credit during the pre reform period is given under:

**TABLE: 22**

**CREDIT TO GOVERNMENT**

(As Percentage of Total Domestic Credit)

<table>
<thead>
<tr>
<th>YEAR</th>
<th>PERCENTAGE</th>
</tr>
</thead>
<tbody>
<tr>
<td>1980</td>
<td>42.6</td>
</tr>
<tr>
<td>1983</td>
<td>42.4</td>
</tr>
<tr>
<td>1986</td>
<td>45.4</td>
</tr>
<tr>
<td>1989</td>
<td>46.7</td>
</tr>
<tr>
<td>1990</td>
<td>47.9</td>
</tr>
<tr>
<td>1991</td>
<td>49.9</td>
</tr>
<tr>
<td>1992</td>
<td>47.3</td>
</tr>
</tbody>
</table>

(Source: RBI Bulletin: Various Issues)

(c). **Administered Interest Rates**

Except a few categories under commercial lending, RBI was prescribing interest rates in the case of most of the advances limiting any flexibility on the part of lending banks. Select Interest rates during the administered interest rate regime for selected years during the period 1970-1991 is given below:

**TABLE: 23**

**SELECT INTEREST RATES IN INDIA**


<table>
<thead>
<tr>
<th>Year</th>
<th>Deposit rates(%) (Deposit of 3-5 years)</th>
<th>Advances(%) (Maximum)</th>
<th>Inflation Rate(%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>1970-71</td>
<td>7.0</td>
<td>12</td>
<td>5.24</td>
</tr>
<tr>
<td>1975-76</td>
<td>9.0</td>
<td>17.5</td>
<td>1.09</td>
</tr>
<tr>
<td>1980-81</td>
<td>10.0</td>
<td>19.5</td>
<td>9%</td>
</tr>
</tbody>
</table>
d. **Accounting Standards**

The accounting standards were not up to the international standards. The accounting lacked transparency and clarity. Assets were not classified as per their quality and provisioning made accordingly. There were no prescription of capital adequacy and hence not maintained by banks.

e. **Quality of Assets**

Due to directed lending and ineffective recovery efforts, the quality of assets was below the desirable levels and in the absence of systematic and fine classification, the monitoring was not effective.

f. **Supervision**

There was need for strengthening the supervisory mechanism to ensure the soundness of the banking industry on a sustainable basis.

g. **Low Efficiency levels**

Many banks, especially in the public sector, were showing signs of inefficiency with high operating costs and lower profitability. At the time the banking industry was entering the period of reforms, the public sector banks were showing a peculiar cost structure. One of the reasons for this is that the banking industry, after nationalisation became a vehicle for generating employment, resulting in excess manpower and manual operations[ Uma Kapila (2000)]\(^1\). As long as both deposit rates and lending rates were administered, spread could be set so as to allow the banks to bear the cost of manpower. However when the system of market oriented interest rates were introduced, many banks found their margins diminishing.

With the branch expansion after nationalisation, which saw the number of commercial bank branches growing from 8262 in 1969 to more than 60,000 in 1991, a large retail network, nationwide, was developed. Of these, 60% of the branches were in rural areas. As the soundness of the commercial banks are based on their ability to accurately assess

<table>
<thead>
<tr>
<th></th>
<th>1985-86</th>
<th>1990-91</th>
</tr>
</thead>
<tbody>
<tr>
<td>10</td>
<td>17.5</td>
<td>9.3</td>
</tr>
<tr>
<td>11.0</td>
<td>16.4</td>
<td></td>
</tr>
</tbody>
</table>

(Source: RBI Bulletin: Various Issues)
the borrowers and their credit worthiness etc., the banks faced lot of problems due to lack of proper information systems. The targeted groups, where some funds were directed to, were not repaying in time and many defaulters and their groups had the political backing to protect themselves. The level of profitability at the time of reform was as under:

**TABLE: 24**

**Profitability: Net Profit/Loss**

(As A Percentage of Total Assets)

<table>
<thead>
<tr>
<th></th>
<th>1991-92</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Banks</td>
<td>0.28</td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td>0.57</td>
</tr>
<tr>
<td>New Private Sector Banks</td>
<td>----</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>1.57</td>
</tr>
</tbody>
</table>

**h. Technology**

The mechanisation and computerisation of the existing banks were progressing very slowly and was affecting the quality of services rendered by them.

The committee headed by Shri. Narasimham[^20] submitted its report and most of the recommendations were accepted by the government for implementation.

The underlying objectives of the suggestions made by the committee were to make the banking sector as viable as possible, while ensuring commercial viability. The negative impact of the network on costs prompted the committee to suggest a 3-tier structure for the banking system with Regional Retail Banks, National Wholesale Banks and a top tier of International Banks who would intermediate the transactions with the outside world.

Another significant aspect of the competitive structure of reforms was the significant proposed reduction in pre-emption, both by government and the priority sector. The Statutory liquidity Ratio and Cash Reserve ratios were reduced enhancing the lendable resources of the banking system. Allowing banks to determine their own interest structure was to lead to a situation which benefits the banks with lower operating costs. The number of items where administered interest rates on bank advances were applicable was reduced from 20 in 1990 to 2 in 1994.
The interest rates on loans above Rs. 0.2 million was fully decontrolled. Public sector banks were allowed to tap capital markets.

In prudential regulation category, the main elements were the increase in Capital adequacy and provisioning of bad debts. On adequacy, the system was simply expected to conform to the international standards, reflected in the bank norms. However, in the circumstances existing at that time, it would have required substantial infusion of equity capital for most of the public sector banks [Uma Kapila (2000)]²¹.

The international accounting standards, especially with regard to Income recognition, Asset Classification and Provisioning were introduced. With the reduction of CRR and SLR on one side, increase in interest rates of priority sector advances, combined with stringent risk provisioning measures, the banks had a strong incentive to monitor and recover their lending. Capital adequacy norms were introduced to strengthen the financial condition of the banks. Banks were allowed in the private sector subject to conditions prescribed by the Reserve Bank of India. Banks were also allowed to raise funds from foreign institutional investors. Further, an act was passed in 1993 to set up Special Recovery Tribunals for quicker recovery of Bank loans. Foreign Financial Institutions were allowed to participate in the stock markets with some tax concessions to attract the investors. The project financing pattern was simplified with RBI giving approval for foreign investment under Automatic approval scheme. The projects with more than 51% equity participation would be considered by Foreign Investment Promotion Board. The Capital Issues (Control) Act, 1947 was repealed and the office of Control of Capital Issues was abolished. Securities and Exchange Board of India (SEBI) started controlling all aspects of stock markets including entry. Merchant banking came under the supervision of SEBI and SEBI started taking many initiatives to reform the primary and secondary markets. Malhotra Committee was set up to suggest reforms in the insurance sector and private companies were set up in the insurance sector with the collaboration of foreign partners in most of the cases. For supervising the insurance sector, Insurance Regulatory and Development Authority was set up.

As far as the banking sector is concerned, with regard to reforms, further development took place. After the implementation of the recommendations of the committee on financial sector reforms, it was felt that there is need to examine the position of reforms and further
action is needed to bring in some changes in the functioning of the banking sector. A committee under Shri. Narasimham, (the second Narasimham Committee) was constituted in December 1997 to address these issues[Dutt(2001)]22. As this committee examined, exclusively, the affairs relating to the banking sector, some details with regard to the terms of reference of the committee, its recommendations and the stage of implementation of the recommendations are given below.

1.2.4. Terms of Reference of the Committee

The terms of reference were,

i. To review the record of financial sector reforms of the Narasimham committee-I (1991)23

ii. To suggest remedial measures for strengthening the banking system covering areas of banking policy, institutional structure, supervisory system etc.

1.2.4(1). Major Recommendations & Status of Implementation

The major recommendations can be summarised under three heads. They are: (A) Suggestions for strengthening the banking system, (B) Systems and methods in Banks, and, (C) Structural issues.

A. Strengthening the banking system

A.1. Recommendations relating to Capital Adequacy:

i. Increase capital adequacy ratio (CRAR) to 10% by 2002

ii. 5% risk weight to Govt. Securities

iii. Risk weight on Govt. guaranteed assets as same as that of others.

iv. Foreign Exchange Open position Limit to carry 100% risk weight.

Implementation24

Capital adequacy norms were introduced in the banking system. From the initial prescription of 6%, the prescription has gone up to 9%. Risk weight was introduced for government securities in general and higher risk weight for investment in securities not guaranteed by the government/securities which are not part of the borrowing programme of the government. Higher provision against gold and foreign exchange open position was
also prescribed. The initial prescriptions have been strengthened by amendments to the earlier instructions in this regard.

**A.2. Recommendations relating to Prudential Norms**

i. General provision of 1% on standard assets.

ii. An asset to be classified as doubtful if it is in the substandard category for 18 months and 'loss' if it has been so identified but not written off.

iii. Government guaranteed advances which have turned sticky to be classified as NPAs.

iv. Income recognition/Asset classification & Provisioning to be made applicable to government guaranteed advances.

v. An Asset Reconstruction Company may be established to take over NPA from banks to clean up the balance sheets of loss making banks.

**Implementation**: Provision has been made on standard assets. Norms have been prescribed for identifying Non-performing assets. Unpaid credit, even if guaranteed by government will qualify to be non-performing. The instructions in this regard are reviewed from time to time.

**A.3. System and Network in Banks**

**Recommendations:**

i. Revision of operational manual and its regular updation.

ii. Simplification of documentation process.

iii. Introduction of Computer Audit.

iv. Selection of Statutory Auditors should be with the banks.

v. Reduction of equity holding of Govt. in SBI/ Nationalised banks to 33%.

vi. Steps to be taken to prevent/limit re-emergence of NPAs.

vii. Banks to stop ever-greening.

viii. Need for stringent Disclosure Norms.

ix. Government to Guarantee the Bonds issued by the banks for raising Tier-II Capital.

x. Concentration ratio to monitor exposure to specific industry.

xi. Independent loan review mechanism by banks.
Implementation:

i. Banks were advised to bring out revised operational manual and ensure regular updating.

ii. Banks advised to reduce NPAs and to prevent its re-emergence.

iii. Banks to avoid practice of ever-greening.

iv. More Disclosures to be made in Financial statements.

v. Banks to follow new exposure norms.

vi. Loan review mechanism for monitoring all large loans.

B. Structural Issues

Recommendations

i. The Financial Institutions and banks after entering into each others area should get converted into either banks or non-banks.

ii. Licensing of new private sector banks needs a review for their enhancement.

iii. All appointments of chairmen, managing directors and executive directors of public sector banks to be done by an appointment board.

iv. Minimum Networth of NBFCs to be raised to Rs.2 crores.

v. Prudential and regulatory standards besides new capital norms for Urban co-operative banks.

vi. Operational freedom and market driven salary for banks.

Implementation:

i. Universal Bank concept materialised as two Term lending institutions merged with the commercial banking companies floated by them.

ii. New Non-Banking Financial Companies to have minimum net worth of Rs.2 crores.

iii. Income Recognition/Asset Classification introduced for Urban Banks.


C. Integration Of Financial Markets

1. Only banks and primary dealers should be allowed in the inter-bank and notice money markets.

2. Treasury bill market may be broad based by opening it to foreign institutional investors.
D. **Rural And Small Industrial Credit**

i. Review and Strengthening of the operation of rural financial institutions in terms of appraisal, supervision and follow-up, loan recovery strategies and development of bank-client relationship.

ii. Introduction of Capital Adequacy requirements for Regional rural banks and Cooperative banks.

iii. All regulatory and supervisory functions of Rural credit institutions should rest with Board for Financial regulation and Supervision (BFRS).

E. **Regulation And Supervision**

i. Core Principles propounded by BASLE Committee on Banking Supervision should be considered as the bare minimum.

ii. The authorities for Monetary Policy formulation and banking supervision should be separate. Supervisory/Regulatory function may be entrusted with Board for Financial Regulation and Supervision.

iii. Urban Cooperative banks may be brought under the ambit of Board for Financial Supervision (BFS).

**Implementation**

As required by Bank for International Settlement, Basle (BIS), RBI has already examined the implementation of Core Principles of Banking supervision. An audit by BIS found that RBI is to a great extent conform to the requirements under Core Principles. Co-operative banks have been brought to the ambit of BFS.

F. **Legal And Legislative Framework**

i. RBI Act and B.R. Act to be amended to incorporate constitution of Board for Financial Regulation and Supervision.

ii. An expert committee may look into the need for legal changes in various statute affecting banks.

**Implementation**

Government constituted an committee drawing experts from various fields. The committee has, since, submitted its report and the same is under the consideration of the government.
1.3 IMPACT OF GLOBALISATION AND LIBERALISATION ON BANKING INDUSTRY

"Economic reforms, based on deregulation and liberalisation are expected to improve the efficiency of allocation of resources and raise the levels of output and employment"

-Arjun Sengupta25

In the recent past, the banking industry in India has undergone major changes because of disintermediation, deregulation, liberalisation, globalisation, financial sophistication, technological developments and densification in product and services. Out of these, deregulation, technological innovations and globalisation are significantly affecting the banking services[Kelkar(1996)]26.

Due to liberalisation and deregulation, banks and financial institutions are free to choose (a) their segment (b) products/services and (c) customers. Similarly, customers will also be free to choose products, services from alternative sources. This leads to increased competition as well as risk and for effectively dealing with this, financial institutions will have to be highly innovative.

In view of changed scenario, banks have to pay serious attention to expansion in the range and in activities like insurance, merchant banking and leasing for augmenting their profitability and controlling cost, plugging leakage in income and rationalizing service charges.

Banks, the world over, are becoming financial super markets and are keen on providing wide variety of services and facilities which provides a new horizon divergent from the traditional banking activities they were confined to.

Some of the measures introduced as a part of reforms have put tremendous pressure on the banking industry. They include:

A. Profitability: Due to the stringent accounting standards and income recognition norms, the bottom lines of many banks came under severe pressure.
B. Competition: The entry of the new breed of private sector banks with technology based services and considerable branch network resulted in competition for all existing banks.

C. Performance: As the public sector banks were allowed to approach the capital market to augment their capital resources, there was a need to improve their performance to attract the customers. This put many banks in the public sector to tremendous pressure.

D. Customer Service: The need for providing excellent customer service became a paramount concern for all banks in view of the competition in the industry.

E. Technology upgradation: The banks with conventional operational procedures were forced to initiate measures to improve the use of advanced technology to face the competition.

F. Improvement in Asset Quality: In view of the introduction of new income recognition, asset classification and provisioning norms, there emerged a pressure on the banks to improve the quality of their portfolio.

G. Regulation: With the introduction of the Board For Financial Supervision, the regulatory mechanism became more focussed and effective.

1.4. REGULATION AND SUPERVISION OF BANKING INDUSTRY – MEETING GLOBAL STANDARDS

During the last decade, efforts have been made to bring about major changes in the regulation and supervision function undertaken by the central Bank, ie., Reserve Bank Of India. The reasons for initiating the major changes included the following:

i. The security scam which hit the Banking industry which revealed the need for stringent supervisory measures.

ii. Implementation of the recommendations of the committee on Financial sector Reforms which suggested major changes.
iii. Adoption of international standards prescribed by the international institutions like the Bank for International Settlements, Basle, Switzerland etc.

iv. To ensure that the effectiveness of the supervisory system in the country matches with the best in the world.

A detailed analysis of the Regulation and Supervision of Banks in India, separately, are given below.

A. Regulation Of Banks In India

A. Introduction:

Of the various sectors in the economy, financial sector is all pervading. This sector, therefore, has been traditionally an area of regulatory interest all over the world. The regulatory interest is based on the fact that financial system has to play the central role of financial intermediation in an economy. Banking system is the most important part of financial system, especially in developing countries as debt markets in these countries are underdeveloped [Singh(2001)]27.

The prime objective of regulation, therefore, is to ensure the safety of funds inorder to retain depositors and investors confidence. The objective of regulation, is to ensure the solvency and liquidity of the institutions concerned.

B. Regulation-Legal Framework:

The legislative framework governing the banking sector iclude:

a. RBI Act,1934
b. Banking Regulation Act,1949
c. State Bank of India Act & SBI (Subsidiaries) Act

C. Legal Framework-RBI's Powers

The legal framework gives powers to RBI for the following:

i. Licensing of Banks and branches.

ii. Provisions relating to Control over Management.

iii. Prescription of Minimum Capital & Transfer to Reserve.
iv. Prescriptions of Cash Reserve Ratio/Statutory Reserve Ratio.


vi. Approval of Auditors.

vii. Control over creation of Assets.

viii. Penal action for violation of various provisions.

1.4.1. Regulation and Reforms:

With the introduction of globalisation and liberalisation in the economy, it became necessary to usher in some reforms in the banking sector to make the Indian Banks competitive in the global environment.

A. Major areas of Reforms in Banking sector:

Based on the recommendations of Narasimham committee on Financial Sector Reforms and the second committee on banking sector reforms, several measures of reforms were introduced in the banking sector. The major areas of reforms in banking sector are:

i. Reduction in Statutory Reserve Requirements

ii. Deregulation of interest rates in deposits and advances

iii. Market related coupon on government borrowing programmes

iv. Introduction of Prudential Norms

v. Prescription of Capital Adequacy Ratio

vi. Promoting competition through entry of new Private Banks

vii. Focussed Banking Supervision

A.i. Regulations - Capital

As per the provisions of BR Act, Minimum capital ranges from Rs.5 lakhs to Rs.20 Lakhs. For the new Private Sector Banks, the minimum capital required is Rs 200 lakhs. For foreign banks, the capital requirements will be US$ 10 million. The Capital adequacy prescribed is 9% from March 2000 onwards.

A.ii Regulation-Management:

Various sections of BR Act provides for regulating the management of banks. The salient points are:

i. The share of NRIs and Overseas Banks in new Private Sector Banks limited to 40% of the total share Capital.

ii. Voting rights are limited to 10% irrespective of shareholding.
iii. Transfer of shares -1% of the total or above requires RBI permission.
iv. Management should be 'Fit & Proper'.
v. The Bank's board should be constituted with people having expertise in Agriculture, Industry, Banking etc.
vi. Appointment of CEO of the bank is to be cleared by RBI.

A.iii. Regulation-Asset Creation:
The asset creation capacity of Banks has been qualitatively and quantitatively restricted by the directions from the central bank. Some of the main prescriptions are:
1. Ceiling prescribed for exposure of the bank to borrowers.
2. Investment in shares and advances against shares have been restricted.
3. Advances to directors have been prohibited.
4. The banks should keep subsidiaries at arms length.
5. Avoiding undue exposure in real estate.

A.iv. Regulation: NPA Norms
Income recognition, Asset classification and Provisioning norms have been introduced which ensures the categorisation of the borrowers according to the recovery history and accounting of income based on sound accounting principles. The prescriptions, which are stringent, meet international standards.

A.v. Regulation-Investment Accounting:
The Banks were advised to create Investment Fluctuation Reserve (IFR) as a surrogate for capital charges to market risk. Minimum amount of investment to be held in ‘Available for sale’ and ‘Held to maturity’ category prescribed. Banks were advised to desist from investing in unrated non-SLR securities.

A.vi. Regulation-Disclosure Requirements
Inorder to ensure that the banks in India adopt practices of international standards for accounting and disclosure, many new systems and procedures have been introduced.
1. Uniformity in presentation through prescribed balance sheet format.
2. Banks to disclose:
   i. Capital to Risk Assets Ratio
   ii. Capital-Tier-I & Tier-II
   iii. Amount of Subordinated debt in Tier-II capital
   iv. Investments[Inside & outside India]
v. Gross Value of investments
vi. Provision for Depreciation, and, Net Value of investments
vii. Percentage of Net NPA to Net advances
viii. Provision towards NPAs
ix. **Financial & Operating Ratios:**
The following ratios are to be given in the notes:
1. Interest income as a percentage to average working funds.
2. Non-Interest income as a percentage of average working funds
3. Operating profit as a percentage to average working funds
4. Return on Assets
5. Business(Deposits+Advances) per employee
6. Profit per employee
7. Share holding pattern of Government
x. **Maturity Pattern of:**
   Loans & advances, Investments, Deposits, Borrowings, Foreign Currency assets and liabilities
xi. Movements in NPAs
i. Quantum; ii. Provisions

1.4.2. **Guidelines on Asset-Liability Management (ALM)**
Reserve Bank has issued guidelines on Asset-Liability Management to give directional guidelines to the banking system with regard to Asset-Liability Management in banks.

1.4.3. **Risk Management in Banks**
RBI has also issued guidelines to the banking system for Risk Management in banks. Capital has been prescribed to take care of Market Risk. The guidelines cover the initiatives to be taken by the banks for covering the credit risk, liquidity risk, market risk and operational risks.

1.4.4. **Regulation-Financial Institutions (FIs)**
With substantial growth in the number of Financial institutions, especially the Development Financial institutions, it was considered necessary to exercise some
supervision as they have become major players in the capital market. The major players are IDBI, ICICI, NABARD, NHB, EXIM Bank, IDBI, SIDBI, LIC, GIC, UTI, SFCs etc. A division, namely, Financial Institutions Division (FID) has been formed in the Reserve Bank of India to supervise the FIs. About 40 FIs report to FID.

The division oversees the operations for bringing about:

1. Better Functioning,
2. Coordination between the policies and operations of banks & FIs,
3. Monitoring of assets & Liabilities, Sources & Uses of Funds etc., and,
4. There is also periodical dialogue with top management.

1.4.5. Supervision—On-site inspection

The periodicity prescribed is once in two years. The major areas covered include:

a. Capital adequacy
b. Asset quality & Provisioning
c. Internal control Systems & Management
d. Earnings assessment
e. ALM mismatches
f. Coordinating / supervisory role
g. Developmental role.

An off-site monitoring system, based on periodical statements from banks, has also been introduced.

1.4.6. New Capital Adequacy Framework:

The first Capital accord in 1988 of the Basle Committee on Banking Supervision (BIS, Basle, Switzerland) based on 'COOK COMMITTEE Report' was the first attempt to initiate action for strengthening the Soundness & Stability of banks and to enhance the competitive equality among international banks. The accord, which was accepted by more than 100 countries, had a simple framework and was implemented in India in 1992. Indian banking system became Basle-I compliant from March, 2005.

Across the world, the banking systems and the central banks observed many shortcomings in the Accord of 1988. They include:

i. The terms are inflexible.

ii. It focuses primarily on credit risk.
iii. Uses arbitrary risk categories and risk weights.
iv. Lacks incentives for credit risk mitigation techniques and risk management.
v. It does not cover operational risk.

The present prescriptions have been affected by the rapid growth and complexity of financial transactions and the broad brush approach of prescribing capital based only on the category and not the risk profile.

A new accord became necessary due to the need for a more risk sensitive framework, improvement in risk management system in banks and the need for providing a range of options for estimation of regulatory capital.

The New Capital Adequacy Framework has three main pillars. These pillars attempt:

i. Comprehensive coverage of risk,
ii. Enhancement of risk sensitivity of capital requirement, and,
iii. Menu of options for accurate measurement.

They three pillars are:

i. **The first pillar - (Minimum Capital Requirement)**

   Here the committee is building a Standardised approach for capital requirements at majority of banks. With regard to risk weights to be applied to exposure to sovereigns, the committee proposes replacing the existing approach by a system that would use external credit assessment for determining risk weights. The result will be the reduction of risks for high quality corporates and introduction of risk weight to low quality exposures.

ii. **The Second pillar – (Supervisory Review of Capital Adequacy):**

   The second pillar of the new framework, the Supervisory review of capital adequacy will seek to ensure that the bank's capital position is consistent with overall risk profile and strategy. The banks should have more than the minimum regulatory prescription for capital. The need for capital depends on risk Profile of the credit institutions. Under this the banks are encouraged to develop and use risk management techniques in monitoring and managing risk. The concept recognises that the responsibility of ensuring adequate capital to support risks beyond regulatory capital is with bank management.

iii. **The Third Pillar – (Market Discipline)**

   The third pillar, Market Discipline, will encourage high disclosure standards and enhance the role of market participants in encouraging banks to hold adequate capital. The committee will soon be issuing guidelines on public disclosure that will strengthen the capital framework.
CURRENT POSITION

For implementing the Supervisory Review Process Reserve Bank of India has set up a group with three sub-groups.

1.4.7. SUPERVISION OF BANKS IN INDIA

1.4.7(1) Introduction:

Financial system plays a central role in the economy as it performs the crucial function of financial intermediation [Black(1997)]\(^{28}\). In the financial sector, the banking system is the most important component, particularly in emerging markets. In view of the crucial role played by the sector, they are, traditionally, regulated all over the world. With the sophistication of financial markets and globalisation, of communication facilities and growth in financial institution, the supervision function assumes great challenges.

1.4.7(2) Objective of Regulation & Supervision

Regulatory framework primarily aims at ensuring the safety of funds inorder to retain depositor's and investor's confidence in the system [Ragarajan(1997)]\(^{29}\). The prime Objective of supervision is to ensure compliance with regulatory prescriptions.

1.4.7(3) Legal Framework for Supervision:

The legal frame work for regulatory/supervisory framework is provided by the Banking Regulation Act 1949. The Act vests in RBI extensive regulatory and supervisory powers to fulfil the mandate of promoting sound banking system and protecting the interest of the depositors. Section 35 of the Act confers on the Bank, the general authority to conduct inspection of books and accounts of banks. The bank can also carry out inspections for certain specific purposes under different sections of the BR Act. Under section 27(2) of the Act bank can call for various returns and information from banks.

1.4.7(4) Supervision- Systems

During the pre-reform days, RBI used to conduct inspections at intervals ranging from two(for private & foreign banks ) to four years (for public sector banks). In 1991, Narasimham Committee was formed for the review the working of the financial system. Narasimham committee recommended phased reform in financial as well as
banking sectors. One of the recommendation was to create a separate body for supervision of the banks. Till this time, the regulation as well as supervision were looked after by the Department of Banking Operations and Development. Based on the recommendations of the committee, in December, 1993, a Department called “Department of Supervision” was carved out of the Department of Banking Operations with the express intention of bifurcating the regulatory and supervisory functions. [The department was further bifurcated in July, 1997 into Department of Banking Supervision to supervise the Banking sector and the Department of Non-Banking Supervision to supervise the Non-Banking Financial Companies]. As per the suggestion of the committee, a “Board For Financial Supervision (BFS)” was constituted in November, 1994 as a committee under the Central Board of Directors of the Reserve Bank of India. The reforms suggested included Prudential norms on income recognition, asset classification and provisioning and also new norms for valuation of investments.

1.4.7(5) Constitution and operations of Board for Financial Supervision

BFS is chaired by the Governor of Reserve Bank of India and consists of four non-official Directors co-opted from the Central Board as members besides the Deputy Governors who are ex-officio members. The Deputy Governor in charge of Supervision is nominated as Vice-Chairman. The Chairman, Vice-Chairman and members of the Board jointly and severally exercise the powers of the Board. The Board is required to meet at least once in a month. Three members, of whom one shall be the Chairman or the Vice-chairman form the quorum for the meeting. The board also has an audit sub-committee, constituted in January, 1995 with the Vice-Chairman of the board and two non-official members as the members of the committee. Depending upon the area of discussion, the committee invites specialists to attend their meetings. The sub-committee mainly focuses on upgradation of the quality of the statutory audit, concurrent audit and internal audit functions of the banks, non-banking financial companies and financial institutions, fixing remuneration, approval of the panel of statutory auditors and branch auditors as also the accounting and disclosure standards.

1.4.7(6) New Supervisory Strategy

The key elements of the new supervisory strategy are:
1. Restructuring the system of bank inspections i.e., focus, process, reporting and follow-up.

2. Setting up off-site surveillance system to supplement on-site inspections.

3. Enhancing the role of external auditors in the supervisory process.

4. Strengthening the corporate Governance, Internal Control & Audit functions in the bank.

After the formation of BFS, a working group under the chairmanship of Shri. S. Padmanabhan was set up in 1995 to review the system of on-site inspection of banks in RBI. Major revamping was undertaken in the supervisory system. They are:

A. **On site Inspections:**

A revised Annual Financial Inspection system based on CAMELS model was introduced in July 1998. New inspection manuals based on the revised inspection strategy were introduced. All banks are inspected annually. Portfolio appraisal of International Division of Indian Banks having overseas operations are also done annually.

B. **Rating of Banks:**

A rating system based on CAMELS model has been introduced from 1998-99 cycle of inspections. All Indian Banks will be given rating based on CAMELS and all Foreign Banks will be rated under CACS.

C. **Off-site Monitoring:**

Focussed Quarterly off-site surveillance set up in 1995 for estimating financial condition of bank's domestic operations. The system helps to identify the financial deterioration of the banks, if any, on a regular basis.

It also acts as a trigger for timely remedial measures. The major component of this function is the establishment of a computerised data base system based on a prudential supervisory reporting framework which provides quarterly returns of financial data from banks. In the first tranche of this reporting system, the domestic banks are required to furnish seven reports (DSB-returns) and foreign banks functioning in India five reports with quarterly data on Assets, liabilities and off-balance sheet exposures, risk weights of on & off balance sheet items, Capital Base and CRAR ratios, asset quality, large credit exposures and un-audited operational results. The two additional reports for domestic banks require...
reporting on connected and related lending and profile of ownership, control and management.

1.4.7(7) **Other Supervisory initiatives:**

Some of the major policy initiatives are:

i. **Quarterly Monitoring Visits:**

Such a system has been put in place through on site visits to the newly licensed banks in their first year of operation. Such visits are also undertaken for old as well as new Private sector banks displaying systematic weaknesses.

ii. **Monitoring officers:**

Some of the public sector banks have also been placed under special monitoring, with a senior officer of the concerned Regional Office of DBS entrusted with the task.

iii. **Quarterly Monitoring of Weak Banks:**

Financial data in a prescribed format is called for on a quarterly basis for close monitoring of weak banks.

iv. **Direct Monitoring of certain problems in House-Keeping**

Certain glaring areas of weaknesses in banks i.e., in the reconciliation of inter branch/inter-bank accounts are closely monitored and the progress achieved by the banks are apprised to BFS on a quarterly basis.

v. **External Audit Function:**

Statutory auditors working as an extended arm of supervision dept. and are required to certify certain aspects like adherence to statutory liquidity ratio, prudential norms, capital adequacy and financial parameters disclosed in the balance sheet of the bank.

vi. **Monitoring of Overseas branches of Indian Banks**

The system for monitoring of the overseas branches of Indian Banks was reviewed by a working group and the same has been revised. With effect from June, 2000.

vii. **Uniform Guidelines on write-off/compromise settlements**

Some uniform guidelines on write-off /compromise settlements as recommended by a committee of professional bankers has been put in to effect from July, 1998.
1.5. IMPACT OF NEW REGULATORY MEASURES ON THE BANKING INDUSTRY

The new regulatory norms, focussed essentially on strengthening of the prudential norms to ensure long term viability of the banking institutions. This has been achieved to a great extent with the overall improvement in the health of the banks measured in terms of Capital Adequacy Ratio and Gross and Net Non-performing assets. Second major focus area was ensuring Transparency with regard to accounting to enable the shareholders and depositors to assess the strength of the institution. With the disclosure norms and other prescriptions, this has been more or less achieved. Deregulation enabling more operational freedom to banks was another area of interest.

The banks, in the recent past have been permitted to undertake many new activities which has widened the horizon of their operation. Further this has also opened up new avenues of earning for the banks. This has lead to significant improvement in profitability of the banking institutions.

The regulations have always attempted to preserve the integrity of the banking system. Efforts to avoid inconvenience to the depositors due to financial ill-health has always been made by the regulatory system and such issues were addressed through mergers or take-overs. The financial system has undergone fundamental changes which include evolution of financial conglomerates, establishment of new regulators, co-ordination between regulatory institutions etc.

On the other hand, the introduction of stringent regulatory measures has rendered many banks aware of the profitability concerns as many of them felt the pressures of the prudential norms. One decade down now, the system has stabilised and the profitability has improved. Financial strength improved drastically. The regulatory standards have become close to international standards and the implementation of the prescriptions of the international institutions has been almost complete.

1.5.1. Customer Service and Reforms

Another major area of focus has been customer service. In addition to the implementation of the recommendations of the earlier committees on customer service, major initiatives were taken by the banks to improve the service through automation and computerisation. Reserve Bank of India constituted a committee designated as “Committee on Procedures and Performance Audit of Public Services and Related Issues(CPPAPS)” under the chairmanship of former Deputy Governor of Reserve Bank of India to look in to the
customer service and related issues in the banking industry. The committee had submitted four reports, one each in the area of foreign exchange, government transactions, banking operations and currency management. Action has already been initiated by the concerned departments of the Reserve Bank of India on the recommendations.

A committee has been set up recently termed as “Banking Codes and Standards Board of India” to ensure comprehensive code of conduct for fair treatment of customers are evolved and adhered to by banks. As per the instructions of regulators, banks have constituted Customer Service Committees at board level. Banks have also framed Model Deposit Policy. Adhoc customer service committees were converted into standing committees by banks. The scheme under which Ombudsman (who entertains complaints against banks) operates has been modified to cover more areas of bank’s operations.

References:


12. RBI: Report on Trend and Progress in banking in India (various issues).
13. RBI: RBI Bulletin (various issues).


14(1). Op cit (9)


16. Narasimham Committee on “Financial Sector Reforms”.

17. Economic Survey; 1992-93


21. Kapila Uma, (ed), the new Economic Policy and the role of the State, UBS Publisher Ltd.


24. RBI Newsletters (various issues) and Credit Information Review (various issues).


1.6. CUSTOMER SERVICE IN BANKING INDUSTRY IN INDIA

"Clients don’t care about your stuff. They care about their stuff."

--Mark Bozzini, CEO,
Linkexchange Inc.
Sanfrancisco, USA (2003)

1.6.1. Customer Service – General:

Banking, in its professional form, appeared in the financial horizon of this country in the beginning of 20\textsuperscript{th} Century. In comparison to the standards of customer service and customer expectations of those days, situation is totally different today. Banks have improved the quality of service, but customers have changed the definition of service keeping the banks on tenterhooks.

This section is divided into:

i) Customer Service – General

ii) Customer Service – Developments in India

In the first half of the nineties, in the era of liberalization, deregulation, disintermediation and resultant competition, the face of banking has changed rapidly. The banks faced a turbulent period in terms of falling bottom line, lowering market share, shifting loyalties of the best people and best customers, technological upgradation etc. In a competitive scenario when all other factors become equal, the differentiation lie, only in superior customer service. Competition has been increasing at a tremendous pace and in the process, banks are making efforts to improve their customer service. The emphasis has shifted to improvement in the systems and procedures with technological support and making employees aware of the importance and relevance of delivering better customer service compared to their competitors. The environmental factors emanating from globalisation has brought in the realisation for understanding customers’ needs and delivering quality service to satisfy them constantly.

Banks are in the business of providing service. They are part of the service industry. The organizational culture of banks are, therefore, supposed to be oriented towards delivery of quality service. A strong and well-established culture, which enhances the appreciation for
good service and customer orientation becomes extremely important. This is due to the reason that in the process of the delivery of service, production and consumption simultaneously takes place. Human-involvement in the delivery process makes it difficult to put the quality in water tight compartments as the behaviour of some one who deals with the customers is grossly is unpredictable. The situation varies, and therefore a distinct service-oriented culture is needed which enables them to orient themselves to the situation being faced.

The service components of any bank product have a number of unique characteristics which distinguish them from the more tangible aspects of the product (Berry, 1980). These features influence the consistent delivery of excellent service. Some of them are more difficult to plan as given below:

I. The considerable potential for high variability in the performance of services.

II. The intangible nature of the service components themselves as they cannot be seen, felt, tasted or touched due to lack of any physical form.

III. When a service is rendered, one requirement of that customer is completed except in cases where there is continuous relation between banker and the customer.

The degree to which these characteristics apply to the attributes of any bank product will determine the position of the product of the tangible/intangible continuum (Lawler 1992). Similarly measures of both customer perceived service quality and objective based service quality and visibility of core and peripheral services would result in different evaluation of perceived quality of service. This will affect the nature and quality of service in the service sector (Swartz, Baren and Brown, 1992).

The organisation has to ensure the direct involvement of the top management, senior management, middle management, junior management, back-office employees, front-line employees and subordinate staff (support-staff) in the delivery of quality service. Service-orientation and appreciation of good service among managers and all other employees is an essential requirement as support of all staff is required for its delivery. What is needed is a corporate culture which can be labeled as ‘service culture’ and is described as “a culture where an appreciation for good service exists, and where giving good service to internal as well as ultimate external customers is considered a natural way of life and one of the most important norms by every one.” This definition has many implications for employee behaviour. First, a service culture exists if there is an “appreciation for good service”. Institutions have to look into themselves to find out whether they have any mechanism or system which recognizes and
appreciates delivery of good service. Employees should be made to know the priority, which is good service, is appreciated and valued.

The second important point in this definition is that good service is given to both internal as well as external customers. It is not enough to promise excellent service to external customers; but all employees within the bank also deserve the same kind of service. And finally, in a service culture good service is “a way of life” and it comes naturally because it is an important norm of the organization. Well, the above point suggests that developing a service culture is not an overnight job. Development of a service culture will take time and calls for a lot of internal marketing. For Indian banks, where it had a culture that was not emphasising on service, the task is herculean. Service has to become an “organizational imperative” and the situation has worsened in the context of globalisation.

Service-orientation has been defined by Hogan and others as “a set of attitudes and behaviours that affects the quality of the interaction between the staff of any organization and its customers.” They have also observed that in several studies service-orientation correlates substantially with overall job performance. For a bank, service culture would mean that its employees are service-oriented. It means that service-orientation increase the functional quality dimensions of dealing with customers. That is, service-orientation which is characteristic of service culture improves service quality as perceived by customers. Service-oriented employees take interest in their customers, do more for their customers, are more courteous and flexible, try to find appropriate solutions to customers’ wishes, and go out of their way to recover a situation where something has gone wrong or an unexpected situation has occurred. Hence, service-orientation improves service quality which in turn improves profitability.

Several behavioral scientists have investigated into the requirements of good service and they have widely agreed on four requirements, viz. (a) Strategic requirements; (b) organisational requirements; (c) management requirements, and (d) knowledge and attitude requirement. Development of a long term service strategy with all organisational ingredients like vision, mission and strategies should be the first step towards the strategy for improving customer service. Designing an organisational structure that is conducive for appropriate service delivery is an essential requirement of good customer service.
According to Christopher Fay (1994), in a manufacturing set up for changing a highly production-oriented culture into a service culture, management must be supportive, inspirational and adjustable to the individuals it manages. The banks would require to undergo a paradigm shift from the existing target (figure) oriented performance to service quality (qualitative) oriented performance if they want to compete in today’s environment. The leadership that communicates and musters the support of all will be able to create values that characterize a true service culture.

The nature of the banking products and the market in which they operate are peculiar to the industry. Banks of today are facing an environment where they are mostly dealing in undifferentiated products in an undifferentiated market. Its products are easily substituted. With growing customer awareness about banks and their products and with rising expectations, the only competitive weapon that remains with a bank is its customer service. This is where it can differentiate itself from competitors. Banking industry combines standardized products with highly customized ones. In both the cases, because of the peculiar characteristics of services, where the delivery and consumption of service take place together the approach of the service provider (bank employee) gains more and more importance. Another special characteristic of the service is that as the customer participates in the service delivery process, the customer comes into regular contact with the service provider/s. Such contacts are termed as “service encounters.” This contacts (encounter), which helps in defining the quality of the service in the mind of the customer, has been called the “moment of truth” by Richard Normann. The encounter, often though brief, is a moment in time when the customer is evaluating the service and forming an opinion of its quality.

The service provider (bank employee), therefore, in a service industry like banking becomes the king-pin in ensuring delivery of that quality in the service which differentiates his bank from its competitors (Ghoshroy, 1992). In the process of providing the service he/she ensures that the perceptions of the customer, during the service encounter, exceeds the customer’s expectations. Once this is achieved, the customer treats the service quality as excellent. However, there could be other situations. The delivery of the service provider is such that the perceptions about the service by the customer just matches the expectations. In that case the customer returns merely satisfied. There is a third situation too. If the delivery of service as
perceived by the customer, is below the level of expectations, in that case the customer treats the service as bad or poor. To remain competitive the service provider has to ensure that the quality of delivery of service is perceived by the customer as excellent.

Many learning points have emerged in this context over a period of time. Perhaps the most important lesson learnt is that the customer is the single most important part of banking and that customer service is a fundamental strategic requirement for growth and survival. Customer service remained the number one strategic priority for the 1990s and so it would remain in the twenty-first century. Another lesson learnt is high quality customer can reduce costs. A lack of competency on the party of bank personnel can be an expensive proposition. A single task in banking costs less when it is done right the first time than when it is to be done two or more times. The third lesson learnt by banks are that loyal customers buy and don’t have to be sold. Cost of generating revenues from loyal customers is less than the cost of acquiring new customers; they are more profitable. Loyal customers buy and are easier to sell. The fourth lesson learnt by banks is that poor service is the number one reason for customer defection. Overall, the number one reason customers give for switching banks is poor customer service. The fifth lesson learnt is that negative word of mouth publicity destroys promotional returns. Now if the service delivered is not as per expectation, the customer will give a negative feed back about the bank to others.

1.6.2 High Performance Banks - Some Features:
Some of the features of high performance banks as revealed in many research studies include the following:
1. A well managed bank and a branch has an open culture where the management is receptive of ideas from the subordinates. Despite hierarchies, there are no barriers to the flow of communication between different hierarchies.

2. The open culture in some organisations leads to delay. However, the benefits viz., improvement in quality of decisions, sense of camaradeship, more involvement and confidence, etc. exceed the negative aspects.
3. A better managed bank and branch believes and works for certain values which means that they are clear about what is good or bad, important or unimportant, desirable or undesirable, with regard to a situation.

4. Many service oriented banks/branches have customer obsession.

5. In all the characteristics of organizational excellence, it is the leadership which leads through the right path. A better managed bank and the branch has strong and consistent leadership.

6. Innovative approach and creativity are two major characteristic features observed in high performing systems.

7. The bank emphasizes on the continuous development of its people through training and career planning.

8. The bank branch has a tendency to receive better rating from audit/rating agencies.

9. It is not necessary that in a better managed bank and branch the quality of staff is better than others.

10. Return is not the only objective in a better managed bank and service becomes paramount.

Some deficiencies observed in banks/branches with low performance level include the following:

1. There is no long term perspective about the future of the bank. Business targets are the prime concern and not service quality.

2. In the bank and the branch there are no widely shared beliefs and values leading to unity.

3. Contrasting beliefs held by different groups/individuals in different sections/departments and at branches lead to clashes at times.

4. The management do not provide the directional leadership to the bank/branch activities. There is no central direction.

5. There is no service-orientation and customer consciousness among the staff.

6. The employees of the organization are not a well disciplined group.

7. With various groups and interest flourishing in the organization, sub-cultures too flourish and compete with each other.
Research studies suggest that customers do not perceive quality as a unidimensional concept, that is, customer’s assessment of quality includes perceptions of multiple factors. For example, it has been suggested that the following eight dimensions of quality are applied to all goods and services – performance, features, reliability, conformance, durability, serviceability, aesthetics, and perceived quality (roughly equivalent to prestige).

In another landmark research, the researchers have observed that customers normally identified ten criteria or dimensions for judging service quality. These dimensions are tangibility, reliability, responsiveness, competence, courtesy, credibility, security, access, communication, and understanding the customer. These terms can be explained as below:

1. **Tangibility**: Appearance of physical facilities, equipment, personnel and communication materials.
2. **Reliability**: Ability to perform the promised service dependably and accurately.
3. **Responsiveness**: Willingness to help the customers and provide prompt service.
4. **Competence**: Possession of the required skills and knowledge to perform the service.
5. **Courtesy**: Politeness, respect, consideration and friendliness of contact personnel.
6. **Credibility**: Trustworthiness, dependability, and honesty of the service provider.
7. **Security**: Freedom from danger, risk or doubt.
8. **Access**: Approachability and ease of contact.
9. **Communication**: Keeping customers informed in the language they can understand and listening to them.
10. **Understanding the Customer**: Taking effort to know the customers and their needs.

It is clear from the above findings that out of ten dimensions of service quality, eight (barring “tangibles” and “security” to some extent) are directly dependent on the service provider.

The researchers further consolidated the above ten dimensions into five distinct dimensions, capturing all the ten originally conceptualized dimensions (Parasuraman,
Zeithaml and Berry (1995)\(^7\). These researchers have demonstrated that regardless of the nature of the service component, customers use basically similar criteria when evaluating service quality. These determinants of service quality are:

1. **Reliability**: To provide what was promised, dependably and accurately.
2. **Responsiveness**: The willingness to help the customers and provide prompt service.
3. **Assurance**: The knowledge and courtesy of employees, and their ability to convey trust and confidence.
4. **Empathy**: The degree of caring and individual attention provided to customers; a complete understanding of the needs of the customer.
5. **Tangibles**: The physical facilities, equipments, the appearance of personnel and communication materials. These are the physical evidence of the service delivery. Excellent service occurs, when the perceived service is received, and evaluated in terms of these variables, exceeds the expectations of the perceived service. Any shortfall in the service leads to the following gaps.

(a) **The gap between customer expectations of the service and management perception of those expectations**: This may result from lack of interaction between management and customers, insufficient communication between contact employees and managers or too many levels between contact staff and top management.

(b) **The gap between manager perceptions of customer expectations and service quality specifications**: This may be the consequence of inadequate management commitment to service quality, absence of formal processes for setting quality goals, inadequate standardization of tasks, or a perception of unfeasibility, i.e. customers’ expectations cannot be met.

(c) **The gap between the service quality as specified by management and actual service delivered**: This may happen due to lack of team work, poor employee job match, poor technology-job match, issues relating to compensatory systems, lack of control of personnel, etc.

(d) **The gap between the actual service delivered and the external communications put out by the organization to customers about the service delivery**: This may happen from inadequate communication between either sales and operations people
or between advertising and operations, from differences in policies and procedures across branches or departments, etc.

1.6.3. **Total Quality Management (TQM): A concept to consider**

The concept of total quality was developed in Japan and was the brain child of Deming, Juran and Ishkawa. In Deming’s view management was responsible for 85 per cent of all quality problems and therefore had to provide the leadership in changing the systems and processes that created them. Management needed to refocus attention on meeting customer needs and on continuous improvement to stay ahead of the competition. The concept is covered in the following actions:

1. **Create a stable approach for improvement of product and service.**
2. **Adopt the new philosophy**: There should be continuous refusal (non-acceptance) to allow poor levels of work or delay and lackadaisical service.
3. **Cease dependence on mass inspection**: Inspection is always at the end and quality control and at this stage it is costly. Instead, focus should be on improving the process, systems and procedures.
4. **Stop awarding business on the basis of price**: Focus should shift to place orders for raw-material not solely on the basis of price but on the basis of quality. Reduce the number of vendors, and reward high-quality suppliers with long-term contracts.
5. **Constantly and forever improve the system of production and service**: Search continually for problems in the system, and seek ways for improvement. Waste must be reduced and quality improved in every business activity, front-office and back-office.
6. **Institute modern methods of training on the job**: Training should be restructured to facilitate defining acceptable levels of work.
7. **Institute leadership**: Focus the traditional supervision to provide leadership in helping workers do a better job. Providing tools and techniques to promote pride in one’s work.
8. **Drive out fear**: Fear to be eliminated by encouraging two-way (up-down and between) communication of problems and expressions of suggestions and ideas.
9. **Break down barriers between departments**: Encourage problem-solving through team-work and the use of quality-control circles.
9. **Eliminate slogans, exhortations, and targets aimed at zero-defects and new levels of productivity**: Goals, slogans and posters cajoling workers to increase productivity should be eliminated. Such exhortations cause worker resentment because most of the necessary changes are beyond their control.

10. **Eliminate quotas on the factory floor**: Quotas in production focus on quantity, and they guarantee poor quality in their attainment. Quality goals such as acceptable percentage of defective items do not motivate workers towards improvement. Use statistical methods for continuing improvement of quality and productivity.

11. **Remove barriers that rob people of the right to pride of workmanship**: Workers need feedback on the quality of their work. All barriers to pride in one’s work should be removed.

12. **Institute a vigorous programme of education and self-improvement**: Because of continuous changes in technology and turnover of personnel, all employees need continual training and retraining. All training must include basic statistical techniques.

13. **Put everybody in the company to work on accomplishing the transformation**: Define clearly the management’s permanent commitment to continuous improvement in quality and productivity.

### 1.6.4. **Customer Value – Concept & Implication**

The value based approach is the expansion of the idea of user-based view of quality of “price or costs”. Garvin has suggested that “a quality product is one that provides performance or conformance at an acceptable price or cost. In support of Garvin’s view, other researchers have demonstrated that there is a positive relationship between market share and value-based measures of quality. However lower cost always do not mean higher value to the customer. But then the firm has to decide which end of the customer it is focusing at. To sum up, the customer value concept encompasses all the above definitions of quality and can be defined as, “a combination of benefits and sacrifices occurring when a customer uses a product or service to meet certain needs. Those consequences that contribute to meeting one’s needs are benefits, while those consequences that detract from meeting one’s needs are sacrifices.”

The concept of customer value encompasses the benefits and sacrifices associated with the customer’s use of the product throughout the life cycle of the product ownership. This
becomes relatively more challenging for a bank product. Once a customer opens an account with the bank, it is the responsibility of the bank to offer value all along, on an ongoing basis, for a life time to the customer, to enable him/her not only to retain his/her account but also to bring accounts of his/her relations/friends/acquaintances to the bank. Deming has summarized it by stating that “Quality must be measured by the interaction between the participants: (a) the product itself; (b) the user and how he uses the product, what he was led to expect (by advertisement); and (c) instructions for use, training of customer and training of the service deliverer and the support systems to offer the service”.

The concept of customer value includes all the definitions of quality mentioned so far. A service deliverer, in order to provide customer value has to ensure the following:

(a) **Quality of Design/Redesign**: In case of a bank product it depends on the design of the service – blue print which is designed to offer a particular service. The concept of service blue print is an effective technique to describe the service delivery process in visual form. The service blue print gives managers the opportunity to identify potential failure points and redesign fool-proof procedures to avoid recurrence of failures, thus ensuring the delivery of high quality service. A service blue print is a precise definition of the service concept. The blue print also facilitates problem solving and creative thinking by identifying potential points of failure and highlighting opportunities to enhance customers' perceptions of the service.

(b) **Quality of Conformance**: Once a service delivery system is designed, it is on the service deliverers, alongwith the service blue print, to conform to the blue print and reduce/avoid failure points and to offer customer value.

(c) **Quality of Performance**: Banks customers are life-long customers. They need to be provided with customer-value all through their life. The service offered cannot be erratic – one day excellent and the next day mediocre and the third day down right poor. This is the challenge before bank service deliverers that their quality of performance has to be on an ongoing basis. Any failure to offer quality at any point of time may negate the past performance and may motivate the customer to leave the bank. Thus continuous chain of quality performance is
essential for banks. As human beings are not very consistent in offering quality on an ongoing basis in routine business (standardized products) therefore technology help is sought in offering such continuous quality of performance.

The above dimensions of quality is to be managed through a quality improvement process that enhances customer value. For this, integration of all the functions (say of a bank branch) becomes very important. Each department may excel in providing service, yet if the efforts of all the departments are not integrated, the required customer value may not be offered at all. Quality improvement programmes that are focused on one specific function tend to bring limited results because they are not coordinated with the efforts of others. To achieve customer value on an ongoing basis it requires that the organization’s activities be integrated at every level and across every function. Each manager (officers at all levels) must know how his or her work fits with that of the others.

1.6.5. Benchmarking

The concept of benchmarking as a method of establishing performance goals and quality improvement objectives based on the best industry practices is gradually getting acceptance in the Indian banking spectrum. Efforts are being made to search out the best practices not only from within the industry but from other industries too, and adopt them to have the required competitive advantage. Benchmarking is popularly defined as the “continuous process of measuring products, services, and practices against the toughest competitors or those companies recognized as industry leaders.

Four types of benchmarking exist: internal (against the best internal operations), competitive (against external direct product competitors), functional (against external functional best operations or industry leaders), and generic (against generic functions or processes regardless of industries).

From a bank’s point of view the internal benchmarking opens up various possibilities to improve its practices to ultimately enhance customer value. A bank’s one zone or region or branch or a department can learn from another zone or region or branch or department, the practices which they had followed and have been able to produce very good results.
The *competitive benchmarking* has been witnessed quite frequently in some banks. According to D.Ghosh, the example of State Bank of India coming out with its FAST product, learning from a somewhat similar product of Corporation Bank is a live case. Because of the low entry barrier for products in a banking industry, competitive benchmarking has been in practice since early 1970s. The classic examples include Bank of India’s Monthly Income Certificate Schemes (where interest was paid monthly on Term Deposits) and also Double Benefit Schemes (where interest accumulated in Terms Deposits) which were introduced by the bank in early 1970s. Within a decade, every bank had brought in similar products in the market.

The recent spurt in anytime, anywhere and home banking facilities introduced by the banks is a classic example of *functional benchmarking* against external functional best operations of industry leaders. When a new generation private sector bank introduced these operational and transactional facilities to its customers, the other new generation private sector banks were the first to quickly learn from it and then adopt it. Some of the foreign banks also took it up and so were few public sector banks. With automation and information technology coming up to support such innovations, banks are in for such functional benchmarking.

**1.6.5(1). Objectives Of Benchmarking**

What could be the purpose of benchmarking? The one that first comes to mind is the competitive positioning of the banks in the emerging scenario. Benchmarking helps the banks to establish more credible goals (in satisfying customers) and pursue continuous improvement. It is a means by which the practices needed to reach new goals are discovered and understood. Since customers define standard of performance, it is essential to have an external orientation instead of extrapolating from internal practices and past trends. The external environment is changing rapidly. Therefore, internally focused goal settings will fail to provide customer satisfaction and manage customer expectation. Customer expectations are influenced by the standards set by the competitor banks in the industry and also from experiences (by the customers) from other industries. Thus, the ultimate objective of benchmarking is to help achieve the best (better than the best) performance that fully satisfy the ever increasing customer expectation.
1.6.5(2). Types Of Benchmarking

In the 1990s benchmarking has gained considerable acceptance among managers and frontline employees, sometimes consciously and many a times subconsciously. Basic benchmarking skills are being applied in various and different business situations. Among these applications, three distinct types of benchmarking have emerged. They include (a) process benchmarking, (b) performance benchmarking, and (c) strategic benchmarking.

(a) **Process Benchmarking** focuses on discrete work processes and operating systems, such as making cash payment to a Savings Bank customer; or operating a Safe Deposit Locker; or issuance of a demand draft; appraising, sanction and disbursement of a loan proposal; or even the performance budgeting process or the strategic planning exercise, to name a few. This form of benchmarking seeks to identify the most effective operating practices from many bank-branches/banks, that perform similar work functions. Many of the improvement in the service processes can be referred to such process benchmarking.

(b) **Performance Benchmarking** helps managers/employees to assess their competitive positions through product and service comparisons. Performance benchmarking usually concentrates on elements of price, ancillary product and service features, speed, reliability and return/yield for the customers. Director product or service comparisons is the common technique applied in banks in performance benchmarking.

1.6.5(3). **Fundamentals of Benchmarking**

An organization which embarks on benchmarking activity has to look into the following fundamentals:

- The organization should know its operations thoroughly and assess its strengths and weaknesses. Most banks have documented their work processes. This would definitely help.
- The organization should be aware of its close competitors and also the industry leaders. Knowledge of the strengths and weaknesses of the close competitors and industry leaders would help the organization to know the gaps in capabilities and performances.
• The organization should endeavour to adapt the best practices and processes and gain superiority in the market place. The adaptation and integration of these best practices could be innovative, helping it to achieve leadership position.

1.6.5(4). Committees on Customer Service

The customer service in banks in India had been showing an improving trend over the years. The improved industrial climate coupled with adoption of technology and service consciousness, the Indian Banking system has made enormous progress in this regard. Many efforts were made during the past three decades to bring in improvements in service. Government, Reserve Bank of India as well as Indian Banks’ Association have taken creditable measures including appointment of committees – the recommendations of which were considered for implementation. Some details about these committees are given below:

A. R K TALWAR COMMITTEE (1976)

This report is one of the first exhaustive recommendations made on improving customer service in banks, covering all aspects of banks/branch functioning. In all 176 recommendations were given and all of them were accepted by the Reserve Bank of India and banks were asked to implement these recommendations. About 13 out of 176 recommendations deal with the human factor in the banks. These recommendations have highlighted areas like promotion policies, authority to branch managers to initiate disciplinary proceedings, proper work distribution and work flow involving staff in customer meetings, fear of accountability affecting decision-making, transfer policies directed to give certain continuity in personnel, leadership qualities and managerial effectiveness of branch managers, promoting self-supervision as a motivational tool, job-enrichment, low morale due to monotony of work, customer-orientation of a newly inducted employee and the need for training in banks to be refocused towards developing customer oriented, friendly and helping culture.

B. GOIPORIA COMMITTEE ON CUSTOMER SERVICE

Fifteen years later, M.N. Goiporia Committee on Customer Service in Banks (constituted by the Reserve Bank of India) submitted its report in December 1991. Out of its 97
recommendations, 10 deal with human aspect including job enrichment, training, setting up of quality circles, rewards and recognition, fear psychosis and work methodology in banks and its branches. The remaining recommendations deal with improved systems and procedures, imbibing technology, logistics, etc.

C. OTHERS REPORTS:

A workshop organized by FICCI (Federation of Chambers of Commerce and Industry) in Mumbai, on January 17, 1991, came out with 21 suggestions. It has focussed on training and increased motivation of employees to give that “extra” which makes a difference between an excellent and satisfactory service.

Vijaya Bank, one of the public sector banks, in its exercise on Customer Service Report (April 1988) had sent questionnaires to 4800 customers and had received feedback from 808 customers. From the data received and analyzed, the report suggests 10 recommendations to improve customer service. Only one deals with the employees in the bank. It says that, “Bank should motivate the members of staff to render better customer service through establishing Quality Circles and through training programmes.”

Study”, UCO Bank, (1989); United Bank of India (1987), The Vysya Bank Ltd., (1991), etc. These studies were conducted for internal use only and no formal reports were prepared. However, these studies, in general, mainly focus on the shortcomings of banks in terms of logistics, infrastructural deficiencies and employee attitude in delivering satisfactory customer service.

1.6.6. **Customer Relationship Management (CRM) in Banks**

Retail banking refers to mass-market banking where individual customers typically use banks for services such as savings and current accounts, mortgages, loans (e.g. personal, housing, auto, and educational), debit cards, credit cards, depository services, fixed deposits, investment advisory services (for high net worth individuals) etc.

Before Internet era, consumers largely selected their banks based on how convenient the location of bank’s branches was to their homes or offices. With the advent of new technologies in the business of bank, such as Internet banking and ATMs, now customers can freely chose any bank for their transactions. Thus the customer base of banks has increased, and so has the choices of customers for selecting the banks.

Due to globalization a new generation of private sector banks and many foreign banks have also entered the market and they have brought with them several useful and innovative products. Due to forced competition, public sector banks are also becoming more technology savvy and customer oriented.

Thus, Non-traditional competition, market consolidation, new technology, and the proliferation of the Internet are changing the competitive landscape of the retail banking industry. Today’ retail banking sector is characterized by following:

- **Multiple products** (deposits, credit cards, insurance, investments and securities);
- **Multiple channels of distribution** (call center, branch, Internet and kiosk);
- **Multiple customer groups** (consumer, small business, and corporate);

Today, the customers have many expectations from bank such as:

(i) Service at reduced cost, (ii) Service “Anytime Anywhere”, and,

(iii) Personalized Service
With increased number of banks, products and services, and practically nil switching costs, customers are easily switching banks whenever they find better services and products. Banks are finding it tough to get new customers and more importantly retain existing customers.

According to a research by Reichheld and Sasser\textsuperscript{12} published in the Harvard Business Review, 5% increase in customer retention can increase profitability by 35% in banking business, 50% in insurance and brokerage, and 125% in the consumer credit card market. Therefore, banks are now stressing on retaining customers and increasing market share.

1.6.6(1). \textbf{Banks: Action}

The banks now need to find out what to sell, whom to sell, when to sell, how to sell and how to be different to increase profitability. Banks need to differentiate themselves by adding value-added service, offerings and building long-term relationships with their customers through more customized products, enhanced value offerings, personalized services and increased accessibility. Banks also need to find out the avenues for increased customer satisfaction, which leads to increased customer loyalty. This may be explained better from two initiatives banks took in the past:

1. Earlier what drove many bankers to invest in ATMs was the promise of reduced branch cost, since customers would use them instead of a branch to transact business. But what was discovered is that the financial impact of ATMs is a marginal increase in fee income substantially offset by the cost of significant increases in the number of customer transactions. The value proposition, however, was a significant increase in that intangible called customer satisfaction. The increase in customer satisfaction has translated to loyalty that resulted in higher customer retention and growing franchise value.

2. Bankers invested in Internet banking, believing that the Internet was a lower-cost delivery channel and a way to increase sales. Studies have now shown, however, that the primary value of offering Internet banking services lies in the increased retention of highly valued customer segments. Again customer satisfaction drives the value proposition.
Thus, banks need to retain existing customers with enhanced personalized services and products, which best suits their needs and satisfies them the most.

1.6.6(2). **CRM: Utility**

CRM primarily caters to all interactions with the customers or potential customers, across multiple touch points including the Internet, bank branch, call center, field organization and other distribution channels.

CRM can help banks in the following ways:

**Campaign Management** - Banks need to identify customers, tailor products and services to meet their needs and sell these products to them. CRM achieves this through Campaign Management by analyzing data from bank’s internal applications or by importing data from external applications to evaluate customer profitability and designing comprehensive customer profiles in terms of individual lifestyle preferences, income levels and other related criteria. Based on these profiles, banks can identify the most lucrative customers and customer segments, and execute targeted, personalized multi-channel marketing campaigns to reach these customers and maximize the lifetime value of those relationships.

**Customer Information Consolidation** - Instead of customer information being stored in product-centric designs, (for e.g. separate databases of savings account & credit card customers), with CRM the information is stored in a customer-centric manner covering all the products of the bank. CRM integrates various channels to deliver a host of services to customers, while aiding the functioning of the bank.

**Marketing Encyclopedia** - Central repository for products, pricing and competitive information, as well as internal training material, sales presentations, proposal templates and marketing collateral.

**360-degree view of company** - This means whoever the bank speaks to, irrespective of whether the communication is from sales, finance or support, the bank is aware of the interaction. Removal of inconsistencies of data makes the client interaction processes smooth and efficient, thus leading to enhanced customer satisfaction.

**Personalized sales home page** - CRM can provide a single view where Sales Mangers and agents can get all the most up-to-date information in one place, including opportunity,
account, news, and expense report information. This would make sales decision fast and consistent.

**Lead and Opportunity Management** - These enable organizations to effectively manage leads and opportunities and track the leads through deal closure, the required follow-up and interaction with the prospects.

**Activity Management** – It helps managers to assign and track the activities of various members. Thus improved transparency leads to improved efficiency.

**Contact Center** – It enables customer service agent to provide uniform service across multiple channels such as phone, Internet, email, Fax.

**Operational Inefficiency Removal** – CRM can help in Strategy Formulation to eliminate current operational inefficiencies. An effective CRM solution supports all channels of customer interaction including telephone, fax, e-mail, the online portals, wireless devices, ATMs, and face-to-face contacts with bank personnel. It also links these customer touch points to an operations center and connects the operations center with the relevant internal and external business partners.

**Enhanced productivity** – CRM can help in enhanced productivity of customers, partners and employees.

**CRM with Business Intelligence** - Banks need to analyze the performance of customer relationships, uncover trends in customer behavior, and understand the true business value of their customers. CRM with business intelligence allows banks to assess customer segments to derive customer lifetime value. Customers can be evaluated within a scoring framework. Combining the behavior key figure and frequency to monetary acquisition analysis with a marketing revenue quota can optimize acquisition costs and cut the number of inefficient activities. With such knowledge, banks can efficiently allocate resources to the most profitable customers and reengineer the unprofitable ones. Data warehousing solutions have been implemented in many banks.

A CRM system apart from improving front office operations and customer servicing also helps in coping with many services that do not need manual intervention. These are serviced by channels like IVR, Internet and ATM. Customers can get account information,
information on credit balance, issue instructions for drafts or even transact through these. At the same time there may be a few customers who still prefer the traditional methods of banking. Banks need to be flexible enough to continue to extend the "personal touch" that such customers prefer.

Make changes internally before going for CRM: Many banks have spent a lot of money on CRM, finding it easier to buy CRM technology than to make the major internal changes necessary to really make CRM work for them. Unfortunately for these banks, the software has often failed to deliver.

CRM is Business Transformation: Too often banks have focused on the wrong areas of CRM. CRM is really about business transformation—changing the business from services-centric to customer-centric.

Have defined Objectives - Many CRM implementations have been approved without examining aspects like profitability, turnover etc. CRM implementations should have well defined objectives, such as RoI, Sales etc.

Consider Complete Life Cycle Costs while budgeting - Measurements of profit are often constructed to embrace only the initial cost of sale. This is of little use if the ongoing cost of servicing a customer outweigh the margin of profit that customer is generating. It is critical that banks have recognized and embraced the importance of the trend towards customer development, and that this is reflected in actual marketing budget allocation.

1.6.6(3). CRM Implementation in Banks in India

According to Nasscom report “Strategic Review 2004”, Indian CRM market was estimated at US $14 million and was forecast to grow to US $26 million in 2005. Banking and financial services segment has a high growth potential and accounts for 22 percent of CRM license revenue. Many banks are already using CRM products.

Disciplined work along four dimensions can significantly improve results from CRM initiatives:

Customer Segmentation: Do intensive data analysis and value-based segmentation to highlight the value of different customer segments and the underlying drivers of that value.
Design programs: Design innovative programs focusing on customer acquisition, cross-sell, retention, loyalty, and customer service, based on customer insights, experience and industry best practices.

Design Processes: Design internal and external processes to support and sustain successful programs.

Good Decisions based on Right Information: The information from a CRM program can often guide better operational business decisions at many levels of the organization. Gather customer information at a broader set of touch-points, perform in-depth analysis, and make critical information available to relevant stakeholders.

The retail banking industry is undergoing revolutionary change. There are many players and competition is tough. Customer Relationship Management is an important weapon in this fight. The ability to mass customise the customer experience and refresh the value proposition is necessary to retain the right to do business with the customer. Consolidation and technology would become a must for sustenance and growth. The pressure will be on banks to integrate data from every channel and know what customers say so that the banks deliver what they want. As the competitions increase, banks will require the robust CRM functionalities in order to manage their most valued asset – their customers. According to Sushila Singhal\textsuperscript{13}, “If a branch management wished to assure positive job behaviour of employees, it was necessary that they took steps to evolve policies that would control the job behaviour of employees”

1.6.7. Service Delivery: Planning And Structuring

1.6.7 (1). Challenges in Structuring service Delivery System

As services are intangible, they are difficult to describe and communicate. Besides as services are delivered by people (employees) to customers, they become heterogeneous: rarely two services are alike, or experienced in the same way. These characteristics of services are the heart of the challenge involved in structuring and designing a delivery system for quality service.

Because of the intangibility, heterogeneity and simultaneous production and consumption characteristics of services, very often people have to resort to words in their efforts to describe them. Lynn Shostack, a pioneer in developing design concepts for services has
pointed out four risks of attempting to describe services in words alone. **The first risk is over simplification.**

**The second risk is incompleteness.** In describing services people (customers and employees, both) tend to omit details of the service with which they are not familiar with.

**The third risk is subjectivity.** Whenever people have to describe a service they are often influenced by their own biases which is based on their own personal experiences and degree of exposure to the service.

**The fourth risk of describing services using words alone is biased interpretation.** People (customers and employees) tend to interpret a service in their own way. No two customers will be able to define ‘prompt’ or ‘courteous’ service in the same way.

All the above risks associated with describing a service in words alone makes the job of structuring a delivery system for a service more difficult.

Designing a service delivery system is a creative process. It begins with a service concept and strategy to provide with features to differentiate if from the competitors. The various alternatives for achieving these objectives should be identified and analyzed before decisions can be taken. Designing a service system involves issues such as location, facility design and layout for effective customer service and work flow, procedures and job-descriptions for employees, measures to ensure service quality, extent of customer involvement, equipment (particularly in the area of computerization and mechanization), and adequate service capacity.

**Service Blueprinting:**

Service blueprinting is a technique that addresses the challenges of structuring a service delivery system and specifying intangible service processes. It is an effective technique to describe the service delivery process in a visual form. Using a line of visibility, it differentiates between the front-office and back-office portions of the service delivery system. The front-office portion of the system is where customer contact occurs, with concern for ambience and effectiveness (eg., the branch lobby). The back-office portion of the system is hidden from the customer and is operated as a factory for efficiency (the cheque clearing section of the branch). A service blueprint, thus, is a visual form – a picture map – that accurately depicts the service system so that the different people involved in it can understand and deal with it objectively regardless of their roles or their
individual point of view. Blueprints are particularly useful at the design and redesign stages of service delivery system. A service blueprint visually displays the service by simultaneously depicting the process of service delivery, the role of customers and employees, and the visible elements of the service. It provides a way to break a service down into its logical components and to picturise the steps of tasks in the process, the means by which the tasks are executed, and the evidence of service as the customer experiences it.

1.6.7(2). Components of Blueprint:
The key components of service blueprint are shown as under. They are customer actions, ‘on stage’ contact.

![Components of Blueprint Diagram]

**Fig. 2**

*Components of Blueprint*

<table>
<thead>
<tr>
<th>Customer Actions</th>
<th>Line of Interaction</th>
</tr>
</thead>
<tbody>
<tr>
<td>‘Onstage’ Contact</td>
<td>Employee Actions</td>
</tr>
<tr>
<td>‘Backstage’ Contact</td>
<td>Line of Visibility</td>
</tr>
<tr>
<td>Support Processes</td>
<td>Line of Internal Interaction</td>
</tr>
</tbody>
</table>

---

*Fig. 2* Components of Blueprint

- **Customer Actions**: Depict the actions taken by the customer.
- **Line of Interaction**: The line that separates the customer actions from the employee actions.
- **‘Onstage’ Contact**: The contact between the customer and employees when visible to the customer.
- **Employee Actions**: Depict the actions taken by employees.
- **Line of Visibility**: The line that separates the ‘on stage’ contact from the ‘backstage’ contact.
- **‘Backstage’ Contact**: The contact between employees when not visible to the customer.
- **Support Processes**: Depict processes that support the service delivery, often occurring behind the scenes.
The components include customer action (on stage contact), Employee actions, (back stage contact) and support processes. The customer actions area encompasses the steps, choices, activities and interactions that customer performs in the process of purchasing, consuming and evaluating the service. In a bank branch situation, the consumer actions would include approaching the Customer Relations Assistant, approaching any of the functional counters for service, contacting officials for consultancy/counseling, etc.

Parallel to the customer actions are two areas of contact employee actions. The steps and activities that the contact employee performs that are visible to the customers are the 'onstage' employee action.

The contact employee actions that occur behind the scenes to support the onstage activities are the 'backstage' contact employee actions. The loan processing/appraisal, the cheque clearing/processing are the sections which are examples from the branch banking situation and which falls in the area of backstage contact employee actions.

While designing effective service blueprints, it is imperative that the diagramming start with the customer's view of the process and work backward in to the delivery system. The boxes show that within each action area depict steps performed or experienced by the people (customers and/or employees) at that level. One can visualize from the above figure that the four key action areas are separated by three horizontal lines. First is the line of interaction where customers interact with the bank (its people), a place for the service encounter. The next is the line of visibility. This line separates all those activities in a branch which are visible to the customers with those which are not. The branch can think from the point of view of its customers and their expectations and make its activities more visible (transparent). More visibility may lead to better fulfillment of customers expectation but also adds more responsibility to the behavior and performance of the people at the branch. The third line is the line of interaction separating the support activities from the backstage actions. Whenever this line is breached it represents internal service encounters. (D.Ghoshroy, 1992)\textsuperscript{14}

1.6.7(3). Benefits of Service Blueprinting:

There are several benefits of service blueprinting. They include:
1. It enables the employees in the organization to have a complete picture of the entire service set up (a bank branch in our case) being organized from the viewpoint of the customer and their roles and actions in it.

2. It helps the employees and the managers to find out the point of failures or the weak links in the service set-up. Such weak links can be the targets of continuous quality improvement.

3. The line of interaction helps the branch to know where and at what points actually the service encounters takes place and therefore, can focus on improving the quality of service in such points, which would help in delivering quality service on an on-going basis.

4. The line of visibility helps the branch to decide which actions (functions of the branch) should be visible and which should not.

5. The line of internal interactions helps to know the interactions between different departments at the branch and facilitate continuous quality improvement into the identified points of failure.

6. Since all employees at the branch can have a total view of the branch functions and interactions (either with external customers or with internal customers), it will help them to realize and understand the area which need further improvement.

7. A deeper look at the service blueprint of the branch will facilitate the understanding of over or under deployment or resources (against the results achieved) at any point and cost/return factor of such areas.

8. The service map helps to work out strategies for external and internal marketing functions. It facilitates working out communication strategies and education of customers (both external and internal) and where (at what points) to focus upon. Finally, the service blueprint works out as the background material for quality circle activities, thereby reinforcing the continuous quality improvement at the branch.

1.6.7(4). **Steps in Developing a Service Blueprint:**

**Step 1:**

**Identification of the ‘Service’ to be Blueprinted:** A bank branch may think in terms of preparing a service blueprint afresh for the entire branch. It depends on the factor that whether it wants to reposition itself in its market area or certain customer segment expectations have changed and accordingly it needs to overhaul the entire service delivery system of the branch. This is the starting point for developing a service blueprint.
Step 2:  
**Mapping the Service Process from the Customer's Point of View:** The customers could be external and/or internal. In both the cases, the information and feedback from the customers are important. To understand customers expectations, the RATER model (reliability, assurance, tangibles, empathy and responsiveness) could come handy.

Step 3:  
**Drawing the Line of Interaction:** Drawing the line of interaction will require information and feedback both from customers as well as customer- contact employees. Even the back office employees could be of help to redefine the line of interaction. Therefore, some thought and planning is required to draw the line of interaction in the service blueprint.

Step 4:  
**Drawing the Line of Visibility:** The next step is to define the line of visibility. The customer’s as well as the branch’s point of views have to convey to draw the line of visibility. How far visibility customers would like to have a how far visibility the branch can offer (from its ‘control-need’ angle) has to be decided in drawing this line.

Step 5:  
**Distinguishing Onstage and Backstage Activities:** For a bank branch the job of distinguishing onstage and backstage activities are relatively easy. Historically, certain functions have been part of onstage activities. With changing customer expectations there may be certain activities which were hitherto included as backstage activity may be required to be part of onstage activities.

Step 6:  
**Drawing the Line of Internal Interactions:** the line of internal interactions is then drawn to work out the linkages of the customer contact employees (onstage) and back-office (backstage) employees with the support service employees. This linkages are vital, as they facilitate the delivery of quality service.

Step 7:  
**Linking Customer and Front-line Employees to the Support Functions:** This is an extension of step 6, where the linkages of onstage and backstage employees with the support functions needed to be strengthened.
1.6.8. **Customer Service : The constantly changing scenario**  

As discussed earlier, globalisation and liberalisation has changed the face of the financial system. The entrants – the new generation private banks and many foreign banks – have brought with them several useful and innovative products. The renewed competition, market consolidation, new technology and proliferation of the Internet are changing the landscape of the banking industry. Multiple products and multiple channels of delivery has resulted in cost effective operations and “Anytime Anywhere banking”. With dedicated customer contact persons for each customer, some banks have climbed many steps towards providing quality service which will match the customer expectations to a great extent if not in full.

The major developments relating to customer service in the banking industry in the recent past include the following:

A. **Market segmentation for customer focus:**

Many banks, including the big ones like State Bank of India, has undertaken reorganisation which included market segmentation and focussed attention on customer requirements.

B. **Computerisation:**

Most of the banks have undertaken computerisation of the branches. Many of these systems, though not networked with other branches have helped in improving customer service in the branches.

C. **Automation of Operations:**

Banks undertook, in the last one and half decades, automation of operations through introduction of ATMs which had a great impact on customer service.

D. **Increase in delivery channels:**

Many banks introduced internet banking enabling the customers to view the account and also undertake limited transactions through net. Further, SMS banking, phone banking, etc. added to the already available delivery channels, improving customer service.

E. **Networking:**

While the new generation banks and foreign banks opened their branch network with inter connectivity, the traditional banking institutions have initiated steps to link their branches using networking technology. By 2010, most of these banks will have most of their branches linked through networking.

F. **Range of Products:**
Banks have been offering innovative products based on research and survey among customers. Further, many banks are replicating popular products introduced by other banks. With banks being allowed to deal with other products (e.g., insurance products) and also with their entry into mutual funds, etc., they have become one-stop-shop for many financial products.

G. **Awareness:**
Banks have taken many initiatives including conduct of training and awareness programmes for educating the employees on customer service.

H. **Institutional mechanism:**
In order to protect the consumers' interest, Consumer Protection Act came into existence and also consumer courts for redressing the grievances.

**1.6.9. Customer Service Committee of the Board/ Standing Committee on Customer Service:**
The Reserve Bank of India had constituted a standing committee on Procedures and Performance Audit on Public Services (CPPAPS) {Chairman: Shri S.S. Tarapore}. Keeping in view the recommendations of the CPPAPS, all the public sector banks/private sector banks and select foreign banks were advised to constitute a Customer Service Committee of the Board with a view to strengthening the corporate governance structure in the banking system and also to bringing about ongoing improvements in the quality of customer service provided by banks.

I. **Banking Ombudsman:**
With a view to enhancing the effectiveness of the Banking Ombudsman Scheme, the Customer Service Committee of the Board play a pro-active role with regard to complaints/grievances received by the Banking Ombudsman.

II. **Banking Codes and Standards Board of India:**
The Banking Codes and Standards Board of India has been set up as an independent organisation on the lines of the Banking code of the British Bankers’ Association of the UK in order to ensure that comprehensive code of conduct for fair treatment of customers is evolved and adhered to.
The approach to customer and customer service has undergone a major shift in these days. According to Ghoshroy (1992)\textsuperscript{15}, ‘the paradigm shift of a customer focussed organisation is, where customer is the ruling deity.

References:
14. Op cit (9)
15. Op cit (9)
1.7. ORGANISATIONAL DESIGN OF BANKS IN INDIA

“Nature of organisations is changing dramatically, from the modern vertical structure to post-modern collaborative, network-based structure, providing a healthy balance between control and learning, hierarchies and networks. Such a design facilitates the emergence of intelligence in an organisation.”
--Robin Wood**

1.7.1. General

Every Organisation has its own business policies and strategies and it needs a structure to implement the strategies. This structure is what is normally referred to as the organisational design. It is the organisational strategy which determines the structure required for its implementation. Through the structure, the organisation undertakes resource allocation, assigning of tasks to the employees and prepares procedures, rules and methodologies. The design of the structure can be affected by factors like environment, objectives, strategy, technology, people and culture, age and size, etc. The management style which the firm proposes to have also affects the design. For example, in the case of a multinational corporation, an ‘Ethnocentric’ management style is characterized by strong control by parent company. The organisational structure represents strong centralization in decision making and most of its managerial personnel are home country nationals. ‘Polycentric’ management allows decentralization of authority. In ‘Geocentric’ management, the organisation design is cosmopolitan with little concentration of decision making.

The crucial questions in organisational design are:

How to design the structure of the enterprise to form a coordinated whole (structure)?, and, (2) what task allocation to humans (or groups) ensures that the enterprise will act to satisfy its objectives?. An organisation should conduct a system of activities managed and controlled to satisfy a set of organisational objectives. This requires purposeful behaviour so that the organisation can be characterised as a planning agent. A planning agent determines a course of action to achieve its set of objectives.

Static and Dynamic Organisations:
A static organisation is generally created by the management to establish a capability to achieve certain class of objectives. The organisational design becomes a means of indirect control because it determines the channels of decision making. The organisation responds by actions and provides feedback for management, closing the control loop. Under many conditions, the static organisation is effective and efficient. However, over a period of time the organisation may face several constraints forcing it to consider reorganisation. The dynamic organisation is a configuration of agents designed, built and operated by those involved for a given class of objectives using explicit negotiated commitment and not operating based on a status quo. Individual agents build mutual commitment and abide by established coordination and cooperation rules instead of rigidly segregating the authority to design the organisation from operational tasks. Three requirements for dynamic organisations are:

1. It is necessary to have commonly available proven reference models of dynamic organizations and commonly accepted coordinated protocols that can be adhered to in order to form temporary mutual commitments.

2. It is necessary for the individuals in the enterprise to develop a working knowledge of these models and protocols to enable them to dynamically build the organization themselves.

3. The above requirements need to be complemented by responsibility structures to ensure that lost management functions are substituted to retain control of the organization.

1.7.2. Organising Process and Organisational Design

A key issue in accomplishing the goal identified in the planning process is structuring the work of the organization. Organisations are groups of people with ideas and resources, working toward common goals. The purpose of the organizing function is to make the best use of the organisation’s resources to achieve organizational goals. Organisational structure is the formal decision-making framework by which job tasks are divided, grouped and coordinated. Formalisation is an important aspect of structure. It is the extent to which the units of the organization are explicitly defined and its policies, procedures, and goals are clearly stated. It is the official organizational structure conceived and built
by top management. The formal organization can be seen and represented in chart form. An organization chart displays the organizational structure and shows job titles, lines of authority and relationships between departments.

1.7.3. **Steps in organizing process:**

The steps in the organizing process are:

![Steps in Organising Process](image)

The informal organization is the network, unrelated to the firm’s formal authority structure, of social interactions among its employees. It is the personal and social relationships that arise spontaneously as people associate with one another in the work environment. The supervisor must realize that the informal organization affects the formal organization. The informal organization can pressure group members to conform to the expectation of the informal group that conflict with those of the formal organization. This can result in the generation of false information or rumors and resistance to change desired by management. The supervisor should recognize the existence of information groups, identify the roles members play within these groups, and use knowledge of the groups to work effectively with them. The informal organization can make the formal organization more effective by providing support to management, stability to the environment, and useful communication channels.

1.7.4. **Organisational structure:**

Even though the differences among organizations are enormous, there are many similarities that enable them to be classified. One widely used classification is the twofold system (mechanistic versus organic forms of organizational structure) developed by Tom Burns and G.M.Stalker in their study of electronics firms in the United Kingdom. (See Burns, Tom and G.M.Stalker, Management of Innovation, London: Tavistock Publications, 1961, p.19)
The **mechanistic structure (Moharmun 2003)** is the traditional or classical design, common in many medium- and large-size organizations. Mechanistic organizations are somewhat rigid in that they consist of very clearly delineated jobs, have a well-defined hierarchical structure, and rely heavily on the formal chain of command for control. Bureaucratic organizations, with their emphasis on formalisation, are the primary form of mechanistic structures. According to Max Weber, bureaucracy is a form of organization characterized by a rational, goal-directed hierarchy, impersonal decision making, formal controls, and subdivision into managerial positions and specialization of labor. Bureaucratic organizations are tall consisting of hierarchies with many levels of management. In a tall structure, people become relatively confined to their own area of specialization. Bureaucracies are driven by a top-down or command and control approach in which managers provide considerable direction and have considerable control over others. Other features of the bureaucratic organization include functional division of labor and work specialization.

On the other hand, the **organic structure** is more flexible, more adaptable to a participative form of management, and less concerned with a clearly defined structure. The organic organization is open to the environment in order to capitalize upon new opportunities.

Organic organizations have a flat structure with only one or two levels of management. Flat organizations emphasise a decentralized approach to management that encourage high employee involvement in decisions (J. Galbrieth, 2003). The purpose of this structure is to create independent small businesses or enterprises that can rapidly respond to customers’ needs or changes in the business environment. The supervisor tends to have a more personal relationship with his or her employees.

Rensis Likert has conducted extensive research on a non-bureaucratic organization design referred to as a system 4 (participative-democratic). Management and employees interact in a friendly environment characterized by mutual confidence and trust. (See Likert, Rensis, New York: McGraw-Hill, 1967, pp.4-10).
In the system 4 organisation, the supervisor is a link between his or her unit and the next level. The arrows are the linking pins denoting that the supervisor coordinates the efforts of employees and managers.

**Contingency organization** means that the most appropriate organization structure for each situation depends upon technology, organizational size, goals and strategy, environmental stability and characteristics of the employees. Mechanistic organizations are best suited to repetitive operations and stable environments, while organic organizations are best suited to an uncertain task and a changing environment.

### 1.7.5. Organisation Design:

Designing an organisation involves choosing an organizational structure that will enable the company to most effectively achieve its goals (Rummer G. and Brache, A.)³. Organisation design is the creation of an organization’s structure, traditionally functional, divisional, and/or matrix.

Functions or divisions arrange traditional organizations. In a **functional organization**, authority is determined by the relationships between group functions and activities. Functional structures group similar or related occupational specialities or processes.
together under the familiar headings of finance, manufacturing marketing, accounts receivable, research, etc. Economy is achieved through specialization. However, the organization risks losing sight of its overall interests as different departments pursue their own goals.

In a **divisional organization**, corporate divisions operate as relatively autonomous businesses under the larger corporate umbrella. In a conglomerate organization, divisions may be unrelated. Divisional structures are made up of self-contained strategic business units that each produces a single product. For e.g. General Motors' divisions include Chevrolet, Oldsmobile, Pontiac and Cadillac. A Central headquarters, focusing on results, coordinates and controls the activities and provides support services between divisions. Functional departments accomplish division goals (Raymond Miles, 1978). A weakness however, is the tendency to duplicate activities among divisions.

In a matrix organization, teams are formed and team members report to two or more managers. **Matrix structures** utilize functional and divisional chains of command simultaneously in the same part of the organization, commonly for one-of-a-kind projects. It is used to develop a new product, to ensure the continuing success of a product to which several departments directly contribute, and to solve a difficult problem. By superimposing a project structure upon the functional structure, a matrix organization is formed that allows the organization to take advantage of new opportunities. This structure assigns specialists from different functional departments to work on one or more projects being led by project managers. The matrix concept facilitates working on concurrent projects by creating a dual chain of command, the project (program, systems or product) manager and the functional manager. Project managers have authority over activities geared toward achieving organizational goals while functional managers have authority over promotion decisions and performance reviews. An example is an aerospace firm with a contract from NASA. Matrix organizations are particularly appealing to firms that want to speed up the decision making process. However, the matrix organization may not allow long-term working relationships to develop. Further, using multiple managers for one employee may result in confusion as to manager evaluation and accountability. Thus, the matrix system may elevate the conflict between product and functional interests.
**Boundary less organizations** are not defined or limited by horizontal, vertical, or external boundaries imposed by a predetermined structure (David Leigh, 2001). They share many of the characteristics of flat organizations, with a strong emphasis on teams. Cross functional teams dissolve horizontal barriers and enable the organization to respond quickly to environmental changes and to spearhead innovation. Boundary less organizations can form relationships (joint ventures, intellectual property, distribution channels, or financial resources) with customers, suppliers, and/or competitors. Telecommuting, strategic alliances and customer-organisation linkages break down external barriers, streamlining work activities. Jack Welch, former CEO of General Electric, to facilitate interactions with customers and suppliers, first used this un-structure.

A boundary less environment is required by learning organizations to facilitate team collaboration and the sharing of information. When an organization develops the continuous capacity to adapt and survive in an increasingly competitive environment because all members take an active role in identifying and resolving work-related issues, it has developed a learning culture.

A learning organization is one that is able to adapt and respond to change. This design empowers employees because they acquire and share knowledge and apply this learning to decision-making. They are pooling collective intelligence and stimulating creative thought to improve performance. Supervisors facilitate learning by sharing and aligning the
organization’s vision for the future and sustaining a sense of community and strong culture.

1.7.6. Organising Function:
The organizing function deals with all those activities that result in the formal assignment of tasks and authority and a coordination of effort. The supervisor staffs the work unit, trains employees, secures resources and empowers the work group into a productive team. The steps in the organizing process include (1) review plans, (2) list all tasks to be accomplished, (3) divide tasks into groups one person can accomplish – a job, (4) group related jobs together in a logical and efficient manner, (5) assign work to individuals, (6) delegate authority to establish relationships between jobs and groups of jobs.

The nature and scope of the work needed to accomplish the organisation’s objectives is needed to determine work classification and work unit design. Division of labor, or work specialization, is the degree to which tasks in an organization are divided into separate jobs. Work process requirements and employee skill level determine the degree of specialization. Placing capable people in each job ties directly with productivity improvement. In order to maximize productivity, supervisors match employee skill level with task requirements.

Supervisors should perform workflow analysis to examine how work creates or adds value to the ongoing processes in an organization. Workflow analysis looks at how work moves from the customers or the demand source through the organization to the point at which the work leaves the organization as a product or service to meet customer demand. Thus, workflow analysis can be used to tighten the connection between employees’ work and customers’ needs. Also it can help to make major performance breakthroughs throughout business process reengineering (BPR), a fundamental rethinking and radical redesign of business processes to achieve dramatic improvements in costs, quality, service and speed. BPR uses workflow analysis to identify jobs that can be eliminated or recombined to improve company performance.

A. Departmentalization:
After reviewing the plans, usually the first step in the organizing process is departmentalization. Once jobs have been classified through work specialization, they are grouped so those common tasks can be coordinated. Departmentalisation is the basis on
which work or individuals are grouped into manageable units. There are five traditional methods for grouping work activities.

Departmentalization by function organizes by the functions to be performed. The function reflect the nature of the business. The advantage of this type of grouping is obtaining efficiencies from consolidating similar specialties and people with common skills, knowledge and orientations together in common units (Chopra, S.).

Departmentalization by product assembles all functions needed to make and market a particular product are placed under one executive. For instance, major department stores are structured around product groups such as home accessories, appliances, women’s clothing, men’s clothing and children’s clothing.

Departmentalization by geographical regions groups jobs on the basis of territory or geography. For eg. Merck, a major pharmaceutical company, has its domestic sales departmentalized by regions such as Northeast, Southeast, Midwest, Southwest and Northwest.

Departmentalization by process groups jobs on the basis of product or customer flow. Each process requires particular skills and offers a basis for homogenous categorizing of work activities. A patient preparing for an operation would first engage in preliminary diagnostic tests, then go through the admitting process, undergo a procedure in surgery, receive post operative care, be discharged and perhaps receive out-patient attention. These services are each administered by different departments.

Departmentalization by customer groups the jobs on the basis of a common set of needs or problems of specific customers. For instance, a plumbing firm may group its work according to whether it is serving private sector, public sector, government, or not-for-profit organizations. A current departmentalization trend is to structure work according to customer, using cross-functional teams. This group is chosen from different functions to work together across various department to interdependently create new products or services. For example, a cross functional team consisting of managers from accounting, Finance and marketing is created to prepare a technology plan.

Some sample structures depicting various kinds of organizational designs are given below:
Entrepreneurial Structure (Small Businesses)

1 or 2 people at the top making decisions.

This reflects the authority the entrepreneur has and the control over all aspects of the business and its employees. This structure will usually encourage delegation and empowerment. The positive and negative aspects are as under:

**Appropriate** :- where quick decision making is needed with an element of skill and flair.

**Problems** :- as an organization gets bigger it becomes difficult for the entrepreneur to maintain direct authority on employees and a change in structure is necessary.
B. Functional Structure (Bureaucratic Structure)

The traditional approach was to divide an organization into functional areas such as marketing, production, finance. Each has many layers of hierarchy to reflect the distribution of responsibility and authority.

Fig.7 : Functional Structure

![Functional Structure Diagram]

Features:
- Specialisation between job and department, eg. Finance and marketing.
- Reliance upon formal procedures and paperwork (coordination)
- Clearly marked authority distinctions within the hierarchy and lines of authority.

Appropriate:- To single product firms or firms producing a clearly related group of products.

Problems:- It can be inflexible as there’s an inability to change and meet new demands, for eg. IBM had a function structure with a strict distinction between areas such as marketing and research and development. It was believed that this structure led to delays of up to two years in the introduction of new models and caused IBM’s profits to fall after 1984. IBM has now split up its product range into divisions, each with own production, marketing, etc. staff.

C. Structure by Product (Divisional Structure)

Today many companies have reduced the number of management layers and have re-organised away from functional structure towards a divisional structure. Within each division, marketing, production and other wings work together on same projects.
Features:
- Each division is self contained and operates as a profit center (a firm within a firm).
- Within each division the functional structures tends to be adopted.

Advantages:
- Allows individuals to specialize and gain expertise in specific products and markets.
• Allows a large company to operate as several smaller ones, each with greater identity and autonomy facilitating rapid decision making and unambiguous performance measurement.
• Greater flexibility for growth and expansion (additional profit centers can be grafted only the organization)

Disadvantages:
• Conflict between divisions, eg. Allocation of fixed costs and machines, setting of budgets and available finance)
• There can be higher costs as activities such as marketing will be replicated in different divisions.
• Difficult to coordinate if divisions grow too large.

1.7.7. The systems approach to the Design of Organisations

This structure regards organizations as groups of inter-relating elements that require coordination and information to turn a wide range of inputs into a variety of outputs. This approach acknowledges the dynamic nature of business and recognizes that static organizational structures are at times wholly inadequate for decision making.

Example: The Matrix Structure.

The matrix approach involves organizing the management of a task along lines that cross normal departmental boundaries, eg. A new product development team might be formed from an engineer, a research chemist, marketing manager and a designer. This means that each team member can end up with two bosses; the departmental boss and the project leader. Once the project has been finished the team will usually be divided with the individual members being drafted into other teams or absorbed back into the organizations skeleton structure.
In the matrix individuals have two or more superiors, e.g., a sales manager will report to the marketing director and the product manager.

**Advantages:**

- Ensures the project is better coordinated with four or five departments contributing occasionally.
- If may different project teams are organized, it gives more people an opportunity to use their ability.

**Disadvantages:**

- Individuals may suffer if both bosses make heavy demands on them.
- There is a failure to provide the clear line of accountability present when everyone has only one boss.

1.7.8. **Factors influencing Organisational Structures:**

**Size:** As a business grows it is unlikely to move away from an organizational structure to one where it is passed to other employees. A large firm will tend to have a longer chain of command with more hierarchy.

(i) **View of the owner or leadership style:** If owners wish to retain control in the business, they will want narrow span of control. Owners or managers who wish to motivate employees may delegate decision making to them.
(ii) **Business objectives:** If the business wishes to expand rapidly, perhaps by a merger, it is likely to find it difficult if control gets wider.

(iii) **External factors:** In a period of rising costs or recession, a business may be forced to reduce its command in order to cut costs. Similarly, in a period of growth a firm may employ extra managers and specialists in order to gain economies of scale.

(iv) **Changes in technology:** A new information system could reduce the role of administration.

1.7.9. **Impact of defective organizational structure**

- Decision making can be slow
- Lack of coordination
- Costs can rise
- Failure to share ideas
- Motivation may decrease as people don’t know what is happening or why.

1.7.10. **Reorganisation: Concepts and Process**

There are various circumstances under which restructuring/reorganization of the existing structure becomes important including changes in leadership, a shift in strategy or internal changes in the organization. Reorganisation is an important tool available to senior managers for shaping the direction of their organizations. It can be a key leverage point for directing attention and energy to certain critical activities in an organization.

Strategic Organization Decision is a four phase participative process intended to provide the leaders with a systematic, step-by-step method for examining the structure of their organization in a way which helps accomplish the overall business strategy as well as the day-to-day work.

The **phase I** involves ‘Preliminary analysis to :

1. identify strengths and weaknesses of the existing organization.
2. clarify issues related to business strategy and organisational design.

The **Phase II** of the strategic organization design include the following:

1. **Design Criteria:** Based on the information received from the preliminary analysis, criteria for a new design may be generated.
2. **Grouping:** The organization should generate several design options and evaluate against criteria. The grouping can be undertaken by:
   
   (a) **Grouping by output:** i.e, Product, Service or Project.
   
   (b) **Grouping by activity:** The grouping can also be based on the activity, i.e. Function, Work Processes, Knowledge or Skill.
   
   (c) **Grouping by Customer:** Grouping could be by various customers of the institution, i.e. market segment, customer need or geography.

3. **Linking:** Identify information flow requirement. Select ways to facilitate the flow of information to meet the requirements and evaluate against criteria.

4. **Impact Analysis:** Analyse each option to determine feasibility given the existing leadership skills, power relationships and work environment.

**Phase III** involves carrying out the operational homework necessary to put organisational design in place. Preparation of flow diagrams involving work chart, reporting relationships, information flows, etc. may be commenced at this point.

**Phase IV** involves implementation where the organization will develop a strategy for implementing the new design. The institution has to develop appropriate strategies to manage the transition successfully.

1.7.11. **Organisational Design of banks in India:**

The world over, the organisational design of banks vary from one another depending on the business size, operations, number of branches, etc. In India, the banks are of different types and different historical background with regard to their establishment, area of operation, etc. The banks in India fall in to the categories of: (1) Public Sector Banks, (2) Private Sector Banks, (3) State Bank of India and Associate banks. State Bank of India with about 15000 branches has the biggest and most complicated organisational set up in comparison while the small private sector banks have smaller structures suiting their size and operations. Public Sector banks generally have a medium structure which are generally common to all. In order to have a general view of organisational design of banks in India, the structure of State Bank of India, Public Sector Banks and a Private Sector Bank are given below:
I. State Bank of India: Structure

State Bank of India has, as stated earlier, an elaborate organisational structure. Apart from the Central Office (at Mumbai) each state of India is treated as a Circle and there is a Local Head office controlling the branches in that state. Under the Circle Office, there are modules with each module having a few Regional Offices. A group of branches work under each of these Regional Offices. The detailed organisational structure is given below:

(a) ORGANISATIONAL STRUCTURE AT CENTRAL OFFICE (TIER-I)

![Diagram of organisational structure](image)
Fig. 11
ORGANISATIONAL STRUCTURE-
LOCAL HEAD OFFICE (Tier-II)

Chief General Manager

DGM-Circle Credit & Finance

DGM - vigilance

DGM - Circle Development Officer

DGM - LAW

AGM-BPR Implementation

AGM-Public Relation & Community Services Banking

General Manager-I

General Manager -II

Direct Branches — Modules

NPA Mgt. — CM (GB)

Added Function — CM (P&HR)

Rehabilitation Cell

CM(IB)

Head(AGM)

Personnel Banking)

(SME segment)

( *Will support both GMs)

Modules — Direct branches

NPA Mgt. — CM (GB)

Added Function — CM (P&HR)

Rehabilitation Cell

CM(IB)

Head(AGM)

Head Agriculture*

(Personnel Bkg.)
Fig. 12

ORGANISATIONAL STRUCTURE-TIER III

MODULE

Deputy General Manager

AGM-Operations

Manager MIS(Direct Branches)

Chief manager
Gen. Banking

Chief Manager
Advances, Rehabilitation & NPA Cell

Chief Manager-
Personnel & HRD

Chief manager
Lead Bank Cell

Manger- Discipline

CM-Banking Operations

Security Officer

Chief Manager- Office Administration

All branches headed by AGMs

AGMs - Region

Head-Mortgages Sales

AGM- Retail Assets

AGM (SE security Cell)
II. Structure of a Public Sector Bank:

The term Public Sector banks generally refer to the 20 banks which were nationalized in two instalments (currently 19 banks due to the merger of two banks). These banks generally have a traditional pyramidal structure with Head Office (or Central Office), Regional Offices and branches. These banks used to have an additional layer of Zonal Office between the Regional Office and Head Office though most of the banks have, since, dispensed with the same. The typical structure of one of the banks would be as under:
III. Structure of a Private Bank

The structure of the old private sector banks are more or like that of public sector banks. In the case of new generation banks in the private sector, the design varies from one another. The striking difference between the new generation private sector banks and the public sector banks is that the new banks are generally flatter in nature. However, it may be observed that they are comparatively smaller in size as they have less number of branch and staff to control. Over a period of time these banks will grow in size and it is to be seen at that time as to how the current design will undergo transformation.
As an example, the structure of HDFC Bank showing a few functional areas at the Corporate level (for example) is given below. (The diagram is aimed at describing the functional relationship and does not depict the exact structure of the bank).

![Diagram of HDFC Bank structure]

One of the most important characteristics of the new generation private banks is that the controlling layers viz. Cluster Head, Zonal Head, etc. are small set ups with a few staff members unlike big banks were such set ups are large. The Zonal heads may be officials of different levels (eg. Asst. Vice President – Level-I, Level-II, etc.) and will be handling of business/branches/responsibilities accordingly.

**References:**

2. Galbraith, J., Designing organisations – An executive guide to strategy, structure and process, Jossey – Bass, pp.16


6. Chopra, Suman, Motivation in Management (2002), New Delhi, Sarup and Sons, pp.124-125

7. Website: State Bank of India

1.8 Human Resources Management in Banks in India

“Developments in Human Resources Management are usually evolutionary, and managers often find themselves dealing with issues only after they have become problems and problems after they have become crises. Tomorrow’s crises are already taking shape, but they can be minimised and possibly avoided”.

----Sonja Sackman

This section is divided into two parts:
I. Human Resources Management: General
II. Human Resources Management in Banks in India

1.8.1. Human Resources Management (HRM) - General

In the recent past, Human Resources Management has assumed considerable importance in both theory and practice of the management of organisations. Many firms have been implementing HRM strategies and the claim is often made that considerable financial resources are being utilised for development of Human Resources. In a rapidly changing and competitive environment, HRM is seen as a strategic factor influencing not only the success of companies, but also that of nations (Zhong ming, 1990). This has happened in both developed and developing countries. The HR practices are influenced by the particular traditions and circumstances of the countries in which it is practiced. The diversity in HR practices is well revealed in the statement of Pieper (1990) which states that the industrialised nations of the western world have developed characteristic approaches to HRM which do show some similarities but are different, often contradictory in many respects.

While the opinion on what is HRM varies among the experts (Keenoy 1990). HRM has been defined as consisting of the following elements.

- Traditional Personnel Administration
- A specific management philosophy that values labour as the major assets of an organisation and that regards human beings as being able and willing to grow and develop, and,
The integration of personnel function in the strategic management. 

Beer et al (1985) at Harvard proposed a model which they described as ‘broad causal mapping of the determinants and consequences of HRM policies’. The model, among other things postulated that employees and unions be considered as stakeholders in the organisation. They also postulate individual well being as an important outcome of their HR model. However, the concept of employees and stakeholders being treated as stakeholders have not been well received by all. As noted by Guest (1987) who said that the above concept “owes more to idealism than to realism”. In sharp contrast the researchers of Michigan group [(Devanna et al, (1984) ] argue that strategic HRM should be seen as the overlapping part of both strategic or general management. The unifying feature of all the approaches is that they treat human behaviour as the most important asset of organisation rather than viewing it primarily as a cost factor.

Many attempts have been made to prepare theoretical models to explain HRM. Storey has proposed that there are so called hard and soft ‘versions’ as given below:

“The hard version emphasises the quantitative, calculative and business strategic aspects of managing the head counts resource in a traditional way, as for any other economic factor. By contrast the ‘soft’ version traces its roots to the human relations model. It emphasises communication, motivation and leadership.

1.8.2. Human Resources sub systems –
Man power planning, recruitment and training

Human Resources Management (HRM) consists of many activities that are interdependent. No activity occurs in isolation. Every activity affects every other activity. A Board decision about, say, staffing requirements, can lead to problems in employment. HR activities when involved as a tool, form an organisation’s HRM system. The system consists of two or more parts called sub systems that work together as an organized whole with identifiable boundaries. Complications are bound to be there. These can be recognized through systems thinking. The central challenge is to assist the organization in an ethical and socially responsible way. Using systems perspective is helpful but insufficient. HR department cannot always wait for feedback and then respond. It may prove costly. When decision-makers respond to HR problems that have arisen, it is
reactive HR management. If HR problems are anticipated and corrective action begins before a problem arises, it is pro-active HR management.

The diagram below shows the various sub-systems working in a Human Resources Management model.

**Fig. 16**

**Human Resources Subsystems**

A. **Frameworks and Challenges:**
The central challenge is to assist the organization in improving its effectiveness and efficiency. Challenges also come from within the organization.

B. **Preparation and Selection:**
To build a human resource information system, data are gathered about each job and about the organisation’s future HR needs. Proactive recruitment and selection depend on an estimate of future HR needs.
C. Development and Evaluation:
Once hired employees are oriented to the company's policies and procedures, they need to be developed to suit the changing needs of the organization. They could be evaluated through formal performance appraisals at periodic intervals.

D. Compensation and Protection:
Equitable compensation is needed to retain an effective work force. Modern compensation management goes beyond salary. Benefits are an increasingly important part of compensation. Such benefits retain and improve employee productivity. The employees also need to be protected through health and safety programmes.

E. Employee Relations and Assessment:
Employees need to be motivated and satisfied with their jobs. When employee relations are ineffective they may join together and form self help groups called unions. When this occurs the HR department is responsible for dealing with the problems. Research should be an ongoing process to help uncover future challenges and predict their impact on the organization and its human resources.

F. Man Power Planning:
There are different definitions for man power planning. (1)Man power planning is the process of determining man power requirement and the means for meeting those requirements in order to carry out the incorporated plan of the organization” (Coleman Bruce). (2) “Man Power planning is a process by which a firm ensures that it has the right type of people and the right kind of people at the right place at the right time doing functions for which they are economically most useful. (Edwin B.Geisler). (3) “Man power planning is the strategy for acquisition, utilization, improvement and preservation of an enterprise’s human resources. It relates to establishing job specifications or the quantitative reforms of jobs, determining the number of personnel required and developing sources of man power: (Strainer, G.)
Separate plans called Derivate Plans are required to cover the various functions, maintenance, retention, motivation and employment functions. Every plan should be backed up by programmes. Each programme is a set of activities having a starting time, duration associated with utilization/consumption of resources and finishing time.

G. Classification of Human Resources Planning:
There are different perceptions regarding HRP. Some see it as recruitment and selection, others recognize that it is concerned with all major HR functions. According to Friedman,
“Managers plan in order to be ready for change and to shape changes in a way that relate to achievement of organization, present and future course”. HRP, therefore, is a continuous process. Classification of HRP depends on (i) nature of documentation – formal or non-formal HR plans, (ii) time horizon – long term, medium term and short term plans, (iii) purpose of plan – real time plan, contingency plan or adaptive plan (which triggers), and (iv) level of preparation – national, sectoral, industrial or organisational.

**H. Factors influencing HRP:**

Some important factors that influence HRP are as follows:

i. **Time** – the period should provide sufficient lead time, for preparation of plan depending on the purpose of the plan.

ii. **Economic factor** – per capita income, expenditures on wages/salaries, interest rates, cost of inputs and compensation package.

iii. **Demographic factors** – availability of youth, training facilities, sex ratio, educational level and facilities for professional education.

iv. **Competition** - competitors’ strategies and promotional steps like advertisements, quality of product, distribution channels, pricing, etc.

v. **Technology** – Technological break-through reduces the number of operations and increases the quality of output manifold. Forecast of future man power, therefore, depends heavily on the technology trend. In view of this “technology forecasting’ itself has become a specialized field and assumed great important in modern management.

Growth and expansion of business, management philosophy and leadership as also vision and innovation on the part of management have a bearing on forecasting.

**I. Techniques of forecasting:**

Broadly, there are two categories of techniques, viz. (i) Exploratory survey which includes committee method, expert opinion and consultancy, and (ii) Operations Research Technique (ORT) which includes trend analysis, regression/correlation analysis, frequency distribution analysis and PERT (Performance Evaluation Review Technique).

**J. Recruitment:**

Recruitment forms the first stage of acquisition function. It is the process of locating potential candidates for selection. It is also the process of finding and attracting capable applicants for employment. The first step begins when new recruits are sought and ends
when their applications are received. The result is a pool of applications from which new employees are selected. The process of selecting applicants (to become employees) is the next stage in the recruitment procedure.

Factors affecting recruitment:

Factors affecting recruitment can be broadly categorized as Endogenous and Exogenous.

1. **Endogenous factors** – image of the organization, image of the job, size and growth potential of the organization.

2. **Exogenous factors** - (a) biographic (sex ratio, age group, educational level, etc), (b) economic (per capita income, state of economic development of the area and infrastructure, proximity of other organizations offering employment) (c) industrialization (existence of cluster of similar organizations, geographic concentration, etc) and (d) labour market.

**K. Recruitment Policy:**

It is the guideline for action. Once the policy is laid down, plans and programmes can be worked out and implemented without frequent reference to top management. The policy can be of two types, general and specific. General policy explains the top management philosophy on recruitment (equality and fairness in recruitment). Specific policy indicates recruitment sources (internal or external), and recruitment procedures (advertisement, conditions, etc).

**Objectives:**

Objectives must satisfy policy and must be laid down in specific terms. These are also referred to as targets/goals. Desirable attributes of objectives are clarity, measurability and comprehensiveness.

**L. Principles of Recruitment Policy:**

The principles should be to (i) find and employ the best qualified candidates for each job, (ii) retain the best and most promising ones, (iii) offer promising careers and security, (iv) provide facilities for personal growth on knowledge and skills, (v) provide opportunities for empowerment, and (vi) be compatible with public policy.

There are, however, constraints to good recruitment policy. Poor image of the organization, government requirements, union’s requirements and the budgetary pressures are a few of the constraints that hamper good recruitment policy.

**M. Recruitment Organisation:**
There is no hard and fast rule. It can be either centralized or decentralized.

**N. Functions of Recruitment:**

Recruitment functions include assessment of requirements, fixing standards, advertisement and publicity, preliminary perusal and assessment of applicants, short-listing of probable candidates for selection, selection process (tests and interview), recording, documentation, etc.

Sources of Recruitment:

Internal and external are the two sources of recruitment.

i) **Internal Sources:** By promotion, transfer of existing employee, from out of those who had left the organization in search of better prospects. Recruitment through internal source improves morale of employees and motivates them, improves probability of better selection and better performance, provides career prospects, builds up goodwill to the organization and is less costly. The disadvantages of this source are that “new blood” is prevented, innovations and creativity are inhibited. ‘Seniority’ rather than ‘merit’ gets encouraged. Subjectivity in promotion is higher.

ii) **External Sources** - absorption of new entrants from the market, retired persons with experience, employees from competitors, unscheduled areas/sectors such as housewives, ex-servicemen, returning NRIs, handicapped persons etc. Advantages are many. Knowledge and skill get upgraded with external inputs, philosophy, undergoes change for the better, competitive advantage is sustained and improved. Disadvantages are that it is costly, existing employees get demoralized and probability of employee turnover is higher.

**O. Methods of Recruitment:**

Methods of recruitment depend on sources of recruitment. Method adopted should be capable of attracting maximum number of potential candidates and must be cost effective. Mainly there are two methods – Internal Source Search and External Source Search.

i. **Internal source search:** It is through notice board display, circulation of memoranda, internal publications (bulletins, journal, handouts, etc.) and other methods such as “word of mouth” or “who you know”.

ii. **External source search:** This may be direct, indirect or third party.

(a) **Direct** method comprises scouting and campus recruitment.
(b) **Indirect** method is mostly through advertisements. The effectiveness of advertisements depends on homework done by the organisation. The organisation should visualize the type of applicants it is looking for and select the media considered most appropriate for the same. ‘Blind Advertisement’ is a technique used by some organisations. In this advertisement the organisation’s name is not disclosed. Instead, candidates are advised to submit applications to the consultant firm, or box number of the newspaper/ advertiser. Blind advertisement is resorted to when the organisation does not wish to make its plans known, especially to its competitors, is not popular in the area or it does not want to respond to all those who apply.

(c) **Third party** method is mainly through employment exchange – public or private, Management consultants, professional bodies, placement cells in schools and colleges as also computer data bank services.

Thus, the attributes of a successful recruitment are a well-defined recruitment policy, proper organisational structure, well-defined procedure, most appropriate method and continuous assessment of effectiveness of recruitment and incorporation of suitable modification from time to time.

1.8.3. **Training:**

**A. Basic Concepts:**

Modern industry is skill intensive and knowledge based. Skill and knowledge are gained by human beings. Competitive advantage is, therefore, dependent more on the knowledge and skill possessed by employees than the financial muscle or the market share possessed by the organisation. It is, therefore, necessary to update the knowledge and skill of human resources. Training not only services the purpose of developing the employees but also safeguards organisational objectives of not only success through competitive advantage but its very survival itself. Modern thinking is that expenditure incurred on training is an investment for the development of employees.

Recruitment and selection process provide human resources. Training helps the employees to improve their knowledge and skills. This assists in building their career and improves their loyalty to the organisation and reduce turnover. Better knowledge and skill improve their employability and versatility.

**B. Andragogy:**
The concept and technology of andragogy – adult learning are the basis of training. Unlike Pedagogy, which means the art and science of teaching children, andragogy is the art and science of helping adults to learn. Andragogy is premised on certain crucial assumptions about characteristics of adult learning, that are different from the assumptions about children. The more important assumptions are (1) self concept moves from one of being a dependant personality towards being self directing human being, (2) accumulation of growing reservoir of experience that becomes an increasing resource for learning, (iii) readiness to learn becomes increasingly oriented towards the developmental task of social role, (iv) time perspective changes from one of postponed application of knowledge to immediate of application. Accordingly, self orientation towards learning shifts from one of subject- centredness to one of problem-centredness.

**C. Definition:**

While education is a learning process with a twin purpose of improving intellectual abilities and moral character, training is a short term learning process which is application specific and intended for improving knowledge, sharpening skills and bringing about attitudinal change. Development is the process of transition of an employee from an existing level of ability, skill and knowledge to higher levels. Thus training and development are complementary to each other. The terminology used in modern days is not Training but Training and Development.

**D. Principles of Training:**

Some of the principles of training which are of universal application are:

a) Training must be well planned, pre-designed and ably executed.

b) Training must meet the objectives of the organisation.

c) All employees must enjoy equal opportunity to derive benefit out of training.

d) Training must be appropriate to suit the changing needs of the organisation.

e) Training content must be balanced between theory and practice.

f) Top management support is essential to make training effective.

g) Training must have motivational aspects attached to it like increments, promotion, certificates, etc.

h) For economy of every unit and efficiency, skilled training is considered more appropriate.
i) Programmes must be continuously reviewed at periodic intervals to update in terms of inputs.

1.8.4. **Human Resources Strategy (HRS):**

In the context of organisational performance 'strategy' becomes a key word. Corporate strategy is the establishment of a company’s long-term goals, policies and plans and the adoption of courses of action to achieve these goals. The meaning of strategy, as understood in its military origin refers to choosing means and resources to achieve selected objectives. As noted by Beer and Spector, "A business enterprise has an external strategy, a chosen way of competing in the market place". It also needs an internal strategy, a strategy for how its internal resources are to be developed, deployed, motivated and controlled. External and internal strategies must be linked.

The observation refers to creation of proper link between HR strategy and corporate strategy. The human resources policies and practices should be consistent with overall business strategy and the need for individual components of the package should particularly emphasize team work, flexibility, employee involvement and organisational commitment.

An ‘open approach’ framework of HRS as explained by C. Mabey and G. Solomon (2000)^ is as under:

![Figure 17](source:mabey-and-salaman-2000)
The above model starts with the analysis of the environment within which organisations exist, and which they seek to control or survive in through certain strategies. To achieve the desired results, there should be a particular reaction from the organisation, ie. People in the system. This desired results has to be produced by appropriate “human resources strategies”. For eg., a bank which is initiating a strategic plan to move to a more customer focussed, sales-driven approach, and away from emphasis on bureaucratic and procedure-driven functioning, will have to bring in changes in skill, attitude and behaviour of the staff. This can be brought about by some human resources strategies appropriate to the situation. The adoption of new strategies amount to ‘change’ of some kind.

Dunphy and Stance (1990)\textsuperscript{10} has given the following model showing relations between business strategy and HRM.

\begin{center}
\textbf{The model emphasises the complementary nature of the relation between business strategy, the personnel issues arising from change strategy and the HRM strategy.}
\end{center}

\begin{center}
\textbf{1.8.5 Motivation and Organisational Performance}
\end{center}

\begin{center}
\textbf{A. Motivation:}
\end{center}

Organisations are made of People. Organisations have to be concerned with what should be done to achieve sustained levels of performance through people. This necessitates assigning close attention to ensure how individuals can best be motivated through such means as incentives, rewards, leadership, and importantly, the work they do and the organisational context within which they carry out the work. The objective of developing an appropriate motivational atmosphere is to ensure that the people in the organisation are adequately motivated to deliver performance in accordance with the expectations of the management.
The process of need-based motivation can be diagrammatically shown as below:

![Diagram of need-based motivation](image)

The model suggests (Kurt Hanks, 2000) that motivation is initiated by the conscious or unconscious recognition of unsatisfied needs. This need will lead to the desire for achieving something that will satisfy the need. Goals are established and a behaviour pathway is selected which will achieve the goal. If the goal is achieved, the need will be satisfied and the goal directed behaviour is likely to be repeated for satisfying the same need later.

B. **Intrinsic and Extrinsic Motivation:**

**Intrinsic Motivation:** Refers to the self generated factors which influence people to behave in a particular way or to move in a particular direction. These factors include responsibility, freedom to act, scope to use and develop skills and abilities, interesting and challenging work, opportunities for advancement, etc.

**Extrinsic Motivation:** Efforts made by others to motivate people. This may be for example, reward, punishment, appreciation, etc.

C. **Motivation and Performance:**

In general, requirements for job satisfaction may include comparatively higher pay, an equitable payment system, real opportunities for promotion, considerate and participative management, a reasonable degree of social interaction at work, interesting and varied tasks and a high degree of control over work pace and work methods. The degree of satisfaction obtained by individuals, however, depends largely on their own needs and expectations and the environment in which they work.
The research in this area has not established any strong positive connection between satisfaction and performance. A satisfied worker is not necessarily a high producer, and a high producer is not necessarily a satisfied worker. Though there are claims that a good performance produces satisfaction rather than the other way around, there have not been much empirical evidence based on research.

D. Motivation Strategies:
Motivation strategies aim at creation of a working environment to develop policies and practices which will provide for higher levels of performance from employees. They will be concerned with the following:

1. Measuring motivation:
Measuring is essential to provide an indication where motivational practices need to be improved. Though there are no direct means by which motivation can be measured, indication of the level of motivation can be obtained from attitude surveys, measures of productivity, employee turnover and absenteeism, analysis of the result of the performance reviews, etc.

2. Valuing Employees:
Motivation and commitment are likely to be enhanced if employees feel that they are valued (Larry Axline, 2001). This means investing in their success, trusting and empowering them, giving them the opportunity to be involved in matters with which they are concerned, treating them fairly and as human beings rather than 'resources' to be exploited in the interest of management, and providing them with rewards which demonstrate to the extent to which they are valued.

3. Behavioral Commitment:
Behavioural commitment means that individual will direct their efforts to achieving organisational and job objectives. It can be engendered by getting people involved in setting objectives, giving people more responsibility to manage their own jobs as individuals or as teams (empowerment) and providing for rewards to be clearly related to success in achieving agreed goals.

4. Organisational Climate:
The organisational climate and core values should emphasise the importance of high performance. Managers and team leaders should be encouraged to act as role models of the sort of behaviour expected from employees.
5. **Leadership Skills:**
Managers and team leaders should be helped to learn about the process of motivation and how they can use their knowledge to improve the motivation of their team members.

6. **Job Design:**
Job design should involve the application of motivation theory, especially those aspects of the theory which relate to the needs and intrinsic motivation.

7. **Performance Management:**
Performance Management process involve setting up goals, short terms or long term, and analysing the achievement at the end of the concerned period. A reward system for achievement will reinforce achievement oriented behaviour.

8. **Reward Management:**
Rewarding achievement and competence is one way of keeping high levels of motivation in the organisation. While designing schemes for reward, the lessons from expectancy theory and Equity theory should be taken into consideration.

9. **Employee Development:**
The best form of development is self development. The organisation should provide opportunities for self development of the people.

10. **Behavioural Modification:**
Behavioural modification involve influencing behaviour by its consequences. It involves systematic analysis of the behavioural patterns and modifying people’s behaviour by suitable interventions((Hollingsworth 2001))\(^{13}\). Five steps for this procedure are:

- **Identify the critical behaviour** - What people do or do not do which needs to be changed.
- **Measure the frequency of occurrences** – obtain hard evidence that a real problem exists.
- **Carry out functional analysis** – identify the stimuli that precede the behaviour and the consequences in the shape of rewards or punishment which influence the behaviour.
- **Develop and implement an Intervention Strategy** - This may involve the use of positive or negative reinforcement to influence behaviour (eg. Providing or withholding financial or non-financial rewards)
- **Evaluate the effects of the intervention** - Check whether the interventions were successful. If yes, whether it resulted in the desired result. What further steps are required to be undertaken.
E. Factors affecting Employee Performance:
According to Richard Discenza and H.Z. Smith (2001) the employee’s performance are affected by a host of factors. They have divided them into (1) Individual dimensions, (2) the motivational and compensation climate, (3) Leadership, (4) Group dimensions and (5) Organisational structure. The individual dimension contains the abilities, perceptions, motives, goals, needs and values. Group dimensions include status, norms, cohesiveness and communication. A conducive motivational climate is an important factor which influences employee performance.

F. Factors affecting employee motivation:
The factors affecting motivation have been well discussed in various theories including Expectancy Theory, Maslow’s theory of hierarchy of needs, Herzberg’s two factor theory and a lot of other theories and research. Various aspects which affect human-motivation include:

1. Compensation given for meeting basic needs
2. Career progression / growth prospects
3. Work content.
4. Rewards
5. Recognition
6. Development opportunities
7. Authority and Responsibility
8. Achievement
9. Working conditions
10. Work culture

As observed by Kurt Hanks (2000), needs are at the centre of motivating aspects. The organisation has to take care of various needs which has organisational, individual and environmental dimensions.

1.8.6. Human Resource Management in Banks in India

Considering their historical background, the banks in India are of two types. The first is the Public Sector banks (where the government has a share holding) and Private sector and foreign banks. Among private sector banks there are old private sector banks and new
generation private sector banks. The public sector banks except State Bank of India and Associates were ‘once upon a time’, Private banks which were nationalised under the respective legislations. Operating in the public sector the banks’ Human Resources Management were guided by public sector character rather than professionalism. The major features of various HR functions such as recruitment, training, career progression, performance appraisal, reward systems, etc. in brief, are given below:

A. Recruitment:
Historically, the public sector banks were in private sector and each of them had its own methodology for recruitment which is not of any consequence at this juncture. After nationalisation, the banks used to recruit officers through Recruitment Boards constituted in each region (Northern, Southern, Eastern and Western) and used to approach the concerned Board in their area with their requirement of officers. For example, Bank of India, being in Mumbai will contact Western Board known as ‘Banking Service Recruitment Board (Western Region) with their requirement of officers. The Board, in turn, will combine the requirements of all banks in that region, advertise the vacancies, conduct written examination at the All-India level and select the candidates. The selected candidates will be allocated to the banks as per their requirement. In the case of clerical staff the same procedure is adopted except that the selection process is undertaken at state level and not national level. The national level selection process for officers is conducted with the objective of taking the cream of the society in the banking sector. The process of selection such as preparation of examination material, conduct of examination, etc. is undertaken on behalf of the board by Institute of Banking Personnel Selection (IBPS), Mumbai. In addition, the banks used to recruit specialists such as Agricultural graduates, engineers, law officers, chartered accountants, etc. for certain specific assignments in the bank.

B. Training:
Most of these banks have a Personnel Management/Human Resources Management department attached to their corporate office. The function of training is planned by this department and delivered through the bank’s own training institutions. Some banks have separate training institutions for clerical staff and officers. The public sector banks have invested enormously in building up training system and institutions. Further, they also depute their officers to external institutions including the training colleges run by the
C. Career Progression:
The banks in the public sector have, generally dependent upon internal promotions for filling up levels up to General Manager (GM) while the position of Executive Director (above GM’s position) is filled through public advertisement. The post of Chairman is also open to outsiders. Traditionally, these banks have not been recruiting from outside for internal position which ensured a career path for officials of the bank subject to their past performance and suitability.

D. Performance Appraisal:
These banks had developed, over a period of time an appraisal system suitable to their organisation for various levels. The performance appraisal systems were primarily used while considering an official’s suitability for higher positions.

E. Reward systems:
Being in the public sector, these banks have not been able to introduce any system for rewarding outstanding performers. Normally, such performance features are considered for appraisal and promotion to higher levels. The kind of reward system such as ‘Performance based pay’ ‘Performance based bonus’, ‘Stock options’ etc. are non-existent in the public sector bank scenario. The reward system in the public sector has been confined to issue of appreciation letters, deputing for training, posting in branches abroad, etc.

As far as the Private sector banking scenario is concerned while old generation private banks more or less followed the public sector bank’s pattern, the new private sector banks has come out with totally divergent ‘Human Resources Management’ pattern. The significant features, in contrast to the public sector banks, are given below:

i. Recruitment:
The recruitments are based on immediate requirement and is a continuous process. The employees are picked up from three categories, viz. (I) freshers, (ii) Business schools, and (iii) experienced bankers. These banks also have a system of selecting candidates for specific jobs through a specific selection process.

ii. Training:
In the case of freshers, job oriented trainings are organised. By and large, the training facilities available for other officials are confined to their functional areas.
iii. Career Progression:
Most of these banks do not have a definite policy with regard to career progression for employees. All the positions of the bank are made open to internal and external candidates. While many banks have a system of internal promotions to a few levels in the hierarchy and open recruitment later, some of the banks do not take external candidates beyond a level. There is no specific trend in this regard though it is clear that those organisations do not assure a career path to employees.

iv. Performance appraisals:
These banks have a well designed performance appraisal system encompassing a host of variables. The appraisal system is used for:

a) Promotions
b) Deciding performance based pay
c) Deciding performance based bonus
d) Other rewards

v. Reward Systems:
The new generation banks in the private sector and the foreign banks has highly motivating reward systems. The major reward system include:

a) Promotion for performance
b) Higher pay for performance
c) Bonus for performance
d) Foreign trainings/holidays, etc. as reward

The reward system in the private banks has been a major encouraging factor for the performance of these institutions. To enable the organisations to identify officials for reward, fair and objective appraisal system has been introduced.

References:

1 Sackman, Sonja., Flamholtz,Eric,G., Randle,Y., Personnel Management: The tone of Tomorrow, How to Manage people, Jaico publishing house,Mumbai, pp.33.

2. Zhing, Ming. W, (1990), Human Resources Management in China


11. Hanks, Kurt, How to motivate others, Pustak Mahal, pp.113


“In an era in which computers are affecting virtually every part of a corporate’s operation, it might have been predicted that computerisation would also affect the cultures that guide those operations. In fact, many managers now look to human resource information system (HRIS) to help them influence corporate culture”

---Jane. C.Linder

1.9.1. Background

Commercial banking in India in the current form has been at least a century old. The banking system, over a period of time, has undergone many metamorphic changes. These changes have been forged by many factors including the changes in the political scenario, global developments, market conditions and customer demands. The Indian banking system, which has been following branch banking continued to operate branches as individual units with independent operational and accounting system. While technological development, in terms of information technology, grew leaps and bounds in the last 30 years or so, the traditional banking system in India remained away from the same. The industrial climate in the country, especially in the banking industry was one of the major bottlenecks in the adoption of information technology for banking and also the automation of its operations.

During the seventies and eighties, the customers’ demand on the banks with regard to quality of service saw steep increase(Ghoshroy,1992). It was realized that the banks have to adopt technology for day-to-day operations to operate in line with the other sectors. After prolonged negotiations, the organized sector in the banking industry also gave in. The initiatives for technology adoption in banks moved further from there and made faster progress in the nineties.

1.9.2. Developments

It is a forgone conclusion that the future progress of banking will be dictated by driving forces which include increased competition, deregulation and new technology. From the point of view of banks, the technology will enable in providing customers with attractive and convenient means of obtaining banking services. Further the banks will be able to handle the customer’s accounts more efficiently and cost effectively. Sensing the global
developments in use of technology for betterment of service to customers, Indian banking industry too have been trying to catch up with the rest of world.

The application of technology in banking can be many. They include the following:

1. Networking of branches
2. Internet banking
3. Telephone banking
4. Mobile (SMS) banking
5. Automated Teller Machines (ATMs)
6. Electronic Fund Transfer at Point of sale (EFTPOS)
7. Total Branch Computerization;
8. Image Processing;
9. Smart Cards

The **networking technology** enables the banks to interconnect the branches and have a common platform for operations and accounting. From the customer’s point of view this will enable accessing of accounts from anywhere irrespective of the branch in which the account has been opened. The technology also will help in transferring funds with ease from one account to another though the concerned accounts are in different locations.

**Internet banking** enables the customer to view the account through the internet and also provides certain limited facilities like ordering for a draft, transfer of balances between accounts, payment of credit card bills, utility bills etc.

**Telephone Banking** involves the customer contacting the bank officials on telephone and getting various information and also various services arranged which ranges from balance enquiry to requesting for a draft. Most of the non-cash transactions can be undertaken over phone.

An extension of **telephone banking** is **mobile or SMS** banking where the bank communicates certain account related information on telephone or the customer can ask for some information by messaging. The services offered include balance enquiry, stop-payment of instruments, last five debits or credits, bill payments (utility) etc.

**Automatic teller machines** have made banking services a round the clock affair. With the introduction of Shared Payment Network System (SPNS) in Mumbai under the aegis (initiative) of the Indian Banks’ Association, ATMs have become the most visible type of branch banking technology. The availability of shared network has made the facility of one bank’s customer using another bank’s ATM in other locations, though at a cost.
Many of the banks which do not have own network or not a member of any payment network have established ATMs linked to the branch where the account holders can withdraw cash at non-banking hours. ATMs thus play a key role in any banks’ efforts to use technology as a competitive weapon, as many customers are treating them as the major interface between themselves and the bank. Further by belonging to the shared network, gradually the banks would gain access to such network benefits as international ATM sharing with overseas shared networks. The shared payment network also enables banks to advertise together saving substantial cost. Cost sharing for networks used simultaneously will benefit the banks financially in addition providing the facility on a nation – wide basis.

**Electronic fund transfer at point of sale (EFTPOS)** gives customers the ability to pay for goods and services by presenting a plastic card and verifying the transaction by either keying in a personal identification number (PIN) or signing a receipt. It has drastically changed the payments mechanism, offering customers the advantages of a high degree of convenience, control over their financial affairs, and security against losing cash or having it stolen. To some EFTPOS is another way for banks to make money at the cost of retailers shopping outlets and customers. The basic idea of EFTPOS is for the customer to be issued by his/her bank with a card, debit or credit card, which can be used at the point of sale to initiate a purchase and to pay for the goods or services by the retailers activating the EFTPOS terminal which either connects directly or through an indirect sharing system to the customer’s own bank.

**Total branch computerization** has become the most important source of potential competitive advantage. Total branch computerization aims at improving service, by providing the customer with real time view of their accounts when they carry out a transaction. This results substantial manpower savings and enables the branch to concentrate of business expansion. It also provide management with information in a form that enables them to have better business planning, monitoring and control.

1.9.3. Committee on Technology relating to Payment System, Cheque Clearing, and Securities Settlement in the Banking Industry (W S Saraf Committee)- Report

Against the backdrop of intensive and competitive banking scenario and the need for adopting technology by banks to maintain its competitive advantage, the Reserve Bank of
India, appointed in June 1994, a Committee on Technology issues relating to payment systems, cheque clearing, and securities settlement in the banking industry. The Committee was required to undertake a critical review of the then existing procedures and practices relating to transfer of funds, payment systems and settlement procedures, cheque clearing (and the related work flow) and make recommendations containing action-oriented, step-by-step solutions on the different items, keeping the long-term perspective of widening the use of modern technology in the banking industry.

The terms of reference of the Committee included the following:

1. To review the remittance facilities available to bank customers and propose new procedures for quicker service.
2. To propose screen-based reporting of transactions in the government securities to the major public debt offices for SGL operations.
3. To review the existing procedure of the reporting of government transactions by bank branches to their link offices and the RBI and propose computer-based reporting in a time bound manner.
4. To propose the use of computer and communication technology for daily reporting of currency chest transactions by chest branches to link offices/RBI. Review of operations of SWIFT (Society for Worldwide Inter-bank Financial Transactions), Banknet etc.
5. To review the MICR (magnetic ink code recognition) cheque clearing procedures at the four metropolitan (New Delhi, Mumbai, Chennai and Calcutta) centers and to suggest solutions for back-up arrangements, work decentralization, etc. Recommendations for upgradation of cheque clearing operations at other centers.
6. To draw up training strategy in computer and communication technology for bank personnel and its implementation in various banks, colleges and institutes.
7. To propose a reporting system between banks and the RBI, based on computer-communication network.

The major recommendations of the Committee on the above terms of reference were as under:

1. **Remittance Facilities to Bank’s Customers**
1.1 An electronic Funds Transfer (EFT) System may be set up. The BANKNET communications network may be the carrier. The fund settlement may be effected at the originating and the destination centres through the accounts of banks, maintained at the banks managing the respective clearing houses. The ultimate goal of the EFT is to facilitate funds transfer between two bank branches.

1.2 The scheme may cover all important centres in a phased manner, starting with the 4 metropolitan centres. Banks to install necessary computer and communication infrastructure (a PC/AT, a printer, a modem and direct telephone line) at their service/main branches. They should also have connectivity to BANKNET.

1.3 Steps may be initiated by the Reserve Bank of India to enact suitable legislature on the lines of Electronic Funds Transfer Act 1978 in the USA and Data Protection Act 1984 in the UK.

2. **Reporting of SGL Transactions in Government Securities**

2.1 A Delivery vs Payment System (DVP) in SGL transactions may be introduced at the Public Debt Office, Mumbai. This may later be extended to other major centers. This will cover SGL accounts of all those institutions who are also having current accounts at the Reserve Bank (Deposit accounts Department).

2.1 Settlement may be on the gross basis both for securities (i.e. SGL) transactions in the Public Debt Office and current account (i.e. funds) transactions in the Deposit Accounts Department.

2.2 Relevant provisions in Public Debt Act 1944, Public Debt Rules 1946 and Banker’s Book of Evidence Act 1891 may be amended to empower RBI to revise the SGL transfer form and in due course introduce screen based reporting of such transactions. Once the DVP system stabilizes, the system of screen based reporting of SGL transfer form may be replaced by electronic screen formats.

2.3 The concept of “Clearing Bank” may be introduced for extension of DVP mode to all trading in Government Securities. The bank will be required to maintain a clear distinction between operations on its own account and those on behalf of its clients.

3. **Reporting of Currency Chest Operations**

3.1 RBI may explore the feasibility of using NICNET for electronic reporting of currency chest transactions. Dial-up connectivity through PC modem may also be used.
3.2 The currency chest branches with STD facility may transmit the currency chest data to both the Issue Office of RBI and their respective Link Offices either through NICNET (by dialing the local NICNET node) or through PSTN lines. The branches not having STD facility may report the data by telephone/telegram to their district headquarters branch, which is turn would transmit these data to the Issue Office of the RBI and its Link Office till they acquire the facility.

3.3 RBI will, on a daily basis, make available the currency chest data received during the day to the local Link Offices of the respective banks, before the closing hours.

4. Reporting of Government Transactions

4.1 Fund settlement in respect of Government transactions may be delinked from submission of scrolls and documents (challans/paid cheques) to the Pay and Account Offices (PAO) of Government Departments. Reporting of transactions to RBI for fund settlement and forwarding of scrolls of PAO may take place simultaneously. Bank branches undertaking Government business may communicate the net receipt and payment position by PC modem/telex/telegrams to their respective focal point branches on the same day, for further communication of the consolidated figures electronically to their Link Cells at Nagpur. The Link Cells would consolidate and forward the data files on floppies, tapes or directly to computer to Central Accounts Section, Nagpur before the prescribed time of fund settlement.

4.3 Link cells of all banks at Nagpur, all focal point branches, and State Government Link Offices should be computerized.

5. MICR Clearing at Metropolitan Centres

5.1 Repetitive or low value transactions like interest, dividend, refund of primary issue subscriptions, salary, pension, etc. may be effected electronically, by introducing "Electronic Clearing System". The facility may be extended to all corporate bodies/government departments. Debit clearing should also be introduced for pre-authorized debits for payments like insurance premier, taxes, loan instalments, etc.

5.2 A “Bills Payment System” may be introduced which will enable the customers of utility services to pay their bills by debit to their accounts in the banks. The utility service agencies may redesign the formats of their bills to enable automatic data capture of the paid bills at the debiting branch/bank level. The settlement may be
effected at the RBI on the basis of the data supplied by banks. Suitable costing of the bank’s services may be done for charging the utility agencies.

5.3 Cheque clearing work may be decentralized by introducing “Clearing Bank” concept for efficient cheque processing. Member banks of a clearing house may join one of the clearing banks Groups. Each Group may have its own in-house, cheque processing facilities and other infrastructure. At Mumbai, there should be atleast three clearing Groups while at other MICR Centres, there should be two clearing Groups. “Clearing Banks” will provide mutual backup to each other in case of disaster at any cheque processing site.

5.4 All MICR instruments should be of uniform size MICR code line should be modified to include an additional field to indicate minimum control information (e.g. the scroll number) of the presenting banks.

5.5 At Mumbai, all inter-bank payments which are now settled through inter-bank clearing at the end of the day should be settled by on-line computer links between the RBI and the banks. Such fund transfers may be on a gross basis.

5.8 Cheque Truncation System should be introduced initially for intra-bank cheques of value upto Rs.5,000/- and extended to inter-bank instruments later. Suitable changes in the Negotiable Instruments Act and other relevant acts may be initiated.

6. **Cheque Clearing at Non-Metropolitan Centres**

6.1 MICR clearing should be introduced at Ahmedabad, Bangalore, Hyderabad, Pune, Vadodara and Surat at the earliest and dependable back-up arrangements should be planned right from beginning. Clearing arrangements should be set up at all centres with five, or more banks.

6.2 Cheque clearing centres should be financially self supporting.

6.4 The system of “Floppy Input Clearing” may be introduced as an interim measure pending MICR clearing at these centres.

7. **Collection of Outstation Cheques**

7.1 National clearing cells of RBI may use the BANKNET for reporting the particulars of unpaid items of inter-city clearing on the network to the originating centres and for sending the credit advices to the banks. The collection cycle in RBI’s National Clearing Service can further be reduced by adopting this system.
7.2 Coverage of RBI's national clearing of inter-city cheques may be extended. To start with, the centres which are already connected in one way clearing may be linked for two way clearing.

7.3 State Bank of India may organize inter-city clearing at centres not served by RBI on the lines of National Clearing Services of RBI.

8. **BANKNET**

8.1 The physical reach of the network should be extended to all centres where the RBI has offices and also to other centres which have at least 100 bank offices.

8.2 Branches covered under Total Branch Computerization (TBC) and the service branches of banks should be equipped with BANKNET nodes.

8.3 The 'COMET' (the communication software for BANKNET) should provide for the following additional functionalities including the following:

   (a) Dial-up support;
   (b) File transfer – ASCII and BINARY;
   (c) End-to-end encryption/authentication of messages and files;
   (d) Adoption of CRC/XOR/Checksum feature to ensure data integrity;
   (e) PING (Packet Inter Net Groper) facility;
   (f) Notification for messages;
   (g) Split Screen Visual communication with remote user;
   (h) Batch Input/Output Interface;
   (i) Backup and Restore facility, and,
   (i) Bridge between BANKNET and SWIFT.

8.4 Switch over from voice grade transmission to high speed transmission facilities, like, VSAT technology, fibre optics, radio frequency, etc. may be targeted.

8.5 BANKNET users may keep the BANKNET machines powered up on all working days all the time to facilitate the automode function of COMET to log into the host IBM system at pre-set interval and collect the messages.

8.6 **RBINET**, the communication software developed in-house at RBI may be installed at all RBI offices.

8.7 National Institute of Bank Management (NIBM), Pune may organize training capsules on BANKNET and RBINET on crash basis to train bank officers in the use of the network.

9 **SWIFT**
9.1 All banks and financial institutions authorized by RBI to deal in foreign exchange business (84 at present) may join SWIFT. At present 41 authorized dealers have taken SWIFT membership.

9.2 All “A” category branches (181 in all) of banks authorized to deal in foreign exchanges may be linked to their respective SWIFT operating centres at Mumbai. All “B” category forex dealing branches (1918 in all) may also be connected to the respective SWIFT operating centres at Mumbai in a phased manner.

10. **Credit Card and EFTPOS**

10.1 To promote card culture in India, a Society of Card Issuers may be constituted. The Indian Banks Association may take the initiative in forming such a Society. This Society could be useful to establish proper procedures on prevention of fraud, monitor merchant establishments and make card business more profitable.

10.2 For effective utilization of the resources of the proposed Shared Payment Network System (SPNS), the ATM card to be issued by a multipurpose card. Besides ATM cards this network may also connect Point of Sale (POS) terminals, Branch Teller Machines (BTMs) and Cash Dispensers. The network should also provide connectivity to smart card as also other cards such as VISA, Master Card and AMEX. Electronic Funds Transfer at Point of Sale (EFTPOS) and use of smart cards may be promoted to develop a plastic money/electronic money culture.

11. **Training**

11.1 Training at the work place should be organized for certain routine applications like copying/deleting of files, virus protection, e-mail, etc. Emphasis should be on local presence of the trainers.

11.2 National Institute of Bank Management (NIBM) Pune, may design intensive and specialized training programmes of 4 to 6 months duration for EDP managers, Database Administrators and other specialists. National Centre for Software Technology and National Informatics Centre may also be requested to organize training programmes, specially designed for bank personnel.

11.3 An institute on banking technology may be set up with the objective of imparting high-level technology training to the bankers. It may be an autonomous institute offering professional level courses.
11.4 Banks may sponsor high level academic courses in information technology with specialization in banking technology at the premier institutes of learning such as IIT, IIM, ISI. Sabbaticals for acquiring IT qualifications may be encouraged.

12. **Standing Committee**

12.1 A Standing Committee on Technology Uses in Banks should be set up under the aegis of RBI to periodically review the technology status in the banking industry.

The recommendations of the Saraf Committee had been accepted by the Reserve Bank of India and a decision was taken to implement it in a phased manner. Several of the recommendations have already been implemented and some others (like SPNS) are in the process of implementation. The implementation of the recommendations will help the banking industry not only to address the issues arising out of application of banking technology, but also finding solutions for them. The central focus of all these technological upgradation and adaptation has been customer service and operational efficiency. The shared payment network systems set up in Mumbai, initially, and subsequently spread to other cities in the country provides the following services:

- Cash transactions
- Extended hours of service
- Across the bank payments, Utility payments etc.
- Balance enquiry, Statement of account etc.
- Cheque Deposit, Request for cheque books, standing instruction etc.

The project has been set up, owned and operated by a private vendor. The vendor is owning the switch (the central host) and the network. There is a common card for the entire network. Each participating bank is having a host computer which is connected to the switch. Wherever the branches of the card holders are computerized they are connected to their host which will enable the network to directly debit the card holder’s account. If the branches are not computerized, then the transactions will be terminated at the host level and the branches will update the data base on the host on a daily basis. Besides ATMs, this network will also connect Point of Sale (POS) terminals, Branch Teller Machines (BTMs), cash dispensers, etc. This network will also provide connectivity to international networks such as VISA, Master Card, AMEX and TCB. Banks will pay a transaction fee to the vendor for every transaction that is put through the network. For every transaction from the card holder of another bank, the
acquiring bank (the bank in whose ATM the transaction is put through) will also collect a fee from the issuing bank (the bank which issues the card).

1.9.4. E-Banking: The Future

Consumers choose their banks largely on the basis of how conveniently accessible they are from homes or offices. Being aware of this, banks spend billions of dollars building up their branch networks to secure the most convenient locations in the most attractive communities. Today branches serve as the cornerstone of competitive advantage in the retail banking industry. The internet offers opportunity to gain direct access to consumers, without the attendant costs associated with the maintenance of physical distribution channels - people, bricks and mortar. In the electronic medium competitors can emerge from anywhere in the world. They are not necessarily limited by geography.

Internet banking allows them to maintain the customer relationship or to make it evolving. The basic emphasis of e-commerce is on achieving effective front-line systems to render customer contacts user-friendly. This is possible because the physical presence of the customer is not required. However, the relevant enabling technology and systems need to be in place. The retail bank’s presence is not required. The customer can transact from anywhere in the world with Internet access. Another advantage of Internet banking is that it increases revenues (product catalogues, proactive cross-sell). It also represents a competitive advantage through differentiation of banking services and image improvement.

Finally, Internet banking allows a modular approach for cost effective development and is of course a lower entry cost gate than branch.

Studies in USA have revealed that the technology already exists and estimates that, by the end of the year some 15.7 per cent of the households in the US will use Internet banking (Pressman, 1997). Furthermore, since these customers will be mainly in the upper-income brackets, they will account for some 30 per cent of retail banking profitability. Where the branch network is used, the average payment costs in USA is more than 60p. With telephone banking it is 35p. The cost through committed computer based banking is around 17p. With internet based banking, it is just 8p. Further, the cost-income ratio of the best of the high street banks is around 50 percent - dropping to as low as 15 per cent for Internet banks. These factors add up to a considerable competitive advantage for Internet based banks.
If the consumer can conduct the full range of banking business with a telephone, personal computer or an ATM, the physical location could make little difference in the future. Eventually, the customers will choose the banking services largely on the basis of price considerations. This may lead to the widening of the retail banking market boundaries from regional to national and eventually to international levels.

The electronic movement more generally, could radically change the nature of competition in retail banking, and in retail financial services. Consumers will have access to more information, from more competitors in a speedier manner. Banks and other financial service providers will, to some extent be trying not only to establish sound relationship with the consumers, but also providing services to one another or even perhaps selling each other’s products (Padwal). Globally, many banks are thinking of other ways to compete, cut costs, and gain access to the consumer, at the same time avoiding direct competition. Rather than relying on conventional branches, or setting up Internet sites, and waiting for the consumer to take the initiative and eventually come to the bank in person or electronically, these banks are putting smaller branches in supermarket chains to attract consumers, including the customers of their competitors are virtually certain to come. These banks, are placing self-service, electronic, access devices in these supermarket branches to keep costs as low as possible and manning these branches with one or two bank employees. The developments in the payment systems like RTGS etc. is in the process of changing the payment system scenario (Rajagopal, 1996).

1.9.4(1). Building databases:

Information is the key to all success and Banks have realised that they have a large amount of information about their customers in their electronic data base and are making an effort to consolidate this information into data warehouses so they can target certain customer segments for new product offerings and not waste resources offering the same to other segments that would not be interested. Such information consolidation makes it possible for banks to market their products more efficiently, and it will also enable banks to charge fees for certain financial services. Thus, banks will be able to sell the value of the overall, individually customized relationship in the provision of financial services, thereby preserving their “brand names” in the minds of their customers and preventing defection to non-bank competitors.
1.9.4(2). Internet banking – impact:
From the speed of downloading of images to the ‘tone of voice’ of the written material on a website, the positive or negative experience of any e-commerce transaction will affect the reputation of the providing institution. The bank’s reputation with the individual customer can be influenced by defective technology as easily as by unsatisfactory service provision. Internet banking consumers will be able to switch banks with much greater ease than they can today. These lower switching costs, combined with generic convenience, could result in a dramatic decrease in customer loyalty and stiff price competition. The main impact of hundreds of low-cost internet banking sites will be to ‘commoditize’ convenience, since all internet banks will have the same geographic advantage afforded by a branch network.

1.9.5. TECHNOLOGICAL PROGRESS IN BANKS IN INDIA - RECENT DEVELOPMENTS:
Despite the risks associated with technology based payment system, countries all over are taking initiatives to adopt new technology in view of the efficiency associated with the same (Rajagopal, 1996)6. Several banks have been positioning themselves as a one-stop shop financial service provider with a fairly exhaustive range of products, including deposit products, loans, credit cards, debit cards, depository (customer services), investment advice, bill payments and various transactional services. These apart, banks have also been entering into the business of selling third party products such as mutual funds and insurance to the retail customers. To provide their customers greater flexibility and convenience as well as to reduce servicing costs, banks have been investing to computerise their branches and in new delivery channels such as ATMs, phone banking, internet banking and mobile banking.

<table>
<thead>
<tr>
<th>Sl.No.</th>
<th>Status of computerisation</th>
<th>% of branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>1.</td>
<td>Branches already fully computerised **</td>
<td>60%</td>
</tr>
<tr>
<td>2.</td>
<td>Branches under Core Banking Solution</td>
<td>11%</td>
</tr>
<tr>
<td>3.</td>
<td>Fully computerised branches (1+2)</td>
<td>71%</td>
</tr>
<tr>
<td>4.</td>
<td>Partially computerised branches</td>
<td>21.8%</td>
</tr>
<tr>
<td></td>
<td>** other than branches under Core Banking Solution</td>
<td></td>
</tr>
</tbody>
</table>
The number of ATMs installed in the country as at end March 2005 was 17,642. New Private Sector Banks constituted the largest share of ATMs, followed by the SBI group, nationalised banks, old private sector banks and foreign banks. While nationalised banks and old private sector banks had more on-site ATMs than off-site ATMs, SBI group, new private sector banks and foreign banks had more off-site ATMs than on-site ATMs.

**Table 25**

**ATMs- Statistics**

(March 31, 2005)

<table>
<thead>
<tr>
<th>Bank Group</th>
<th>Number of Branches</th>
<th>No. of ATMs</th>
<th>% of off-site ATMs to total branch</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rural</td>
<td>Semi-Urban</td>
<td>Urban</td>
</tr>
<tr>
<td>Nationalised Banks</td>
<td>13588</td>
<td>7291</td>
<td>6935</td>
</tr>
<tr>
<td>State Bank Group</td>
<td>5480</td>
<td>4080</td>
<td>2334</td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td>994</td>
<td>1499</td>
<td>1150</td>
</tr>
<tr>
<td>New Private Sector Bank</td>
<td>108</td>
<td>348</td>
<td>589</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>-</td>
<td>-</td>
<td>38</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td><strong>20170</strong></td>
<td><strong>13218</strong></td>
<td><strong>11046</strong></td>
</tr>
</tbody>
</table>

Off-site ATMs as percentage to total branches was the higher in the case of foreign banks, followed by new private sector banks, SBI group, old private sector banks and nationalised...
banks. Although cash continues to be used heavily in retail transactions in India, the use of cheques and several other payment instruments such as credit cards, debit cards and smart cards on the whole has been increasing in recent years. The use of payment cards, both in volume and value terms, more than doubled in 2004-05. The use of electronic payments in the form of ECS, EFT and SEFT is also on increase.

Table 26

**Retail Electronic and Card based payments**

<table>
<thead>
<tr>
<th>Year</th>
<th>Retail Electronic@</th>
<th>Card Based#</th>
<th>Total</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Volume</td>
<td>Value</td>
<td>Volume</td>
</tr>
<tr>
<td>2001-02</td>
<td>17770</td>
<td>6123</td>
<td>N.A.</td>
</tr>
<tr>
<td>2002-03</td>
<td>23660</td>
<td>10222</td>
<td>N.A.</td>
</tr>
<tr>
<td>2003-04</td>
<td>29046</td>
<td>29933</td>
<td>185501</td>
</tr>
<tr>
<td>2004-05</td>
<td>57071</td>
<td>79479</td>
<td>362040</td>
</tr>
</tbody>
</table>

N.A.: *Not available*  @ : ECS, EFT, SEFT

#: *Credit cards, Smart cards and debit cards*

As a result of sharp increase in RTGS and other electronic transactions, the proportion of electronic transactions both in volume and value terms has increased sharply. Electronic payments are cheaper as they have lower production cost than paper based instruments. They can also be carried out faster in comparison with paper based transactions. The increased use of electronic payments has thus increased the efficiency of the payment system.

Table 27

**Paper based versus Electronic Transactions**

<table>
<thead>
<tr>
<th>Year</th>
<th>Volume (in millions)</th>
<th>Value (Rs. Crore)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Paper based</td>
<td>Electronic</td>
</tr>
<tr>
<td>2002-03</td>
<td>1014</td>
<td>173</td>
</tr>
<tr>
<td>2003-04</td>
<td>1023</td>
<td>224</td>
</tr>
<tr>
<td>2004-05</td>
<td>1125</td>
<td>432</td>
</tr>
</tbody>
</table>
References:


2. Report of the Committee on Technology relating to payment system, Cheque clearing and securities settlement in the banking industry (W.S, Saraf Committee)


7. Linder, Jame, C., (Quoted in Item 6 above)