Banking in its crude form is an old age phenomenon. It was in existence even in ancient times. Revilpout, a French writer, for instance mentions about banks and bank notes in Babylon in 600 B.C. In India, the reference to money lending business are found in the Manu Smriti also. Chaldean, Egyptian and Phoenician history also records the existence of rudimentary banking in early days. Etymologically, the word 'bank' is derived from the Greek word Banque or the Italian word Banco which means a bench used by money lenders and money changers to display their coins and transact the business in the market.

In Italy the first bank was established in 1157. (Bank of Venice), on the ground, particularly, when the authorities of the state of Venice were in financial trouble due to war. According to Crowther, Modern Banking has three ancestors. Viz., the Merchants, the Goldsmith and the Money lenders.

**The Merchant:** In the words of Crowther, "To day the title" merchant banks is reserved by usage to the older and exclusive banking firms, nearly everyone of which can trace its ancestry back to a trade or commodities more tangible (through hardly more profitable) than money.

**The Goldsmith:** The goldsmith ancestry of the modern banks is purely an English affair. Since goldsmith dealt with precious metals, they necessarily provided secure safe to protect them. In a period when money consisted of gold and silver, people, largely because of the danger of theft, started leaving their precious bullion and coins in the

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custody of goldsmiths. As the practice of safeguarding others' money become widespread, the goldsmiths began imposing charges for the safekeeping service.

The next stage in the development of banking came when the receipt for deposits with goldsmiths began to be used as a means of payment, people started keeping gold, silver and coins with goldsmiths in exchange for warehouse receipts or goldsmith notes (i.e., claims against the deposits), these warehouse receipts became a medium of exchange and a means of payment.

**The Money Lender:** The last stage in the development of modern banking was when the goldsmiths became moneylenders. The goldsmiths realized that it was not necessary to hold hundred percent of the coins deposited with them and the average daily collections were enough to meet the average daily withdrawals and only a contingency reserve was required for the period when withdrawals exceeds its reserve loaned out of remaining deposits on interest, thus the goldsmiths have become moneylenders. In this way, the system of fractional reserve banking was born. Thus, a goldsmith became a banker, he started performing the two major functions of bank i.e., receiving deposits and advancing loans.

**Meaning and Definition:**

The banking sector is the lifeline of any modern economy. It is one of the important financial pillars of the financial system, which plays a vital role in the success / failure of an economy\(^2\).

A bank is a profit-seeking business firm, dealing in money and credit\(^3\). It is a financial institution dealing in money in the sense hat it accepts deposits of money from the public to keep them in its custody for safety. So also, it deals in credit.

\(^2\) Bharathi.V.Pathak, Indian Financial System, Pearson Education.
\(^3\) Mithani & Gordon, Banking & Financial System, Himalaya Publishing House.
According to Sayers "bank is an institution whose debts (bank deposits) are widely accepted in settlement of other people's debt to each other".

According to Crowther "the banker's business is, to take debts of other people, to offer his own in exchange and thereby to create money".

According to Banking Companies Act 1949, "a banking company in India is one which transacts the business of banking which means the accepting, for the purpose of lending or investment, of deposits of money from the public, repayable on demand or otherwise and withdrawable by cheque, draft, order or otherwise".

There are two distinct features of banking institution,
1. Accepting deposits
2. Lending them to others

Even though Post-office saving banks are also accepting deposits (Some of them also introduced the cheque system) from people, they are not regarded as banks in the true sense of the term, since they do not lend money. Similarly, there are some other financial institutions like UTI, LIC, IFCI, IDBI etc., end money to others but not accept chequable demand deposits. Therefore there are not regarded as banks. They are called as non-banking financial institution.

Types of Banks

Financial requirements in a modern economy are of a diverse nature, distinctive variety and large magnitude. Hence, the following different types of banks have been instituted to cater to the varying needs of the communities:

1. Commercial Banks
2. Co-operative Banks
3. Specialised Banks
4. Central Banks

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**Commercial Banks**: A commercial bank may be defined as a financial institution that accepts demand deposits from the public which are chequable and also uses the money with it for lending. They usually give short-term loans and advances. The commercial banks in India are governed by Indian Banking Regulation Act-1948.

**Co-operative Banks**: Co-operative banks are a group of financial institutions organized under the provisions of the Co-operative Societies Act of the states. These banks are essentially Co-operative credit societies organized by the members to meet their short-term and medium-term financial requirements. They are based on the principles of self-reliance and mutual co-operation and provides cheap credit to their members.

Co-operative banking system in India has a three-tier structure, constituted by Primary Credit Societies, Central Co-operative Banks and State Co-operative Banks.

**Specialised Banks**: The following are the specialized forms of banks catering to some special needs with their unique nature of activities.

1. Foreign Exchange Banks
2. Industrial Banks
3. Land Development Banks
4. The Export-Import Banks of India (EXIM Bank).
5. Agricultural Refinance and Development Corporation (ARDC) etc.,

**Central Banks**: A Central Bank is the apex financial institution in the banking and financial system of a country. It is regarded as the highest monetary authority in the country. It is a financial institution primarily concerned with the ordering, supervising, regulating and development of the banking system in the country. In India, Reserve Bank of India (RBI) is the Central Bank, which was established in 1935.
Banking System

According to differences in organisational structures, different types of banking systems have been developed and are in operation in different parts of the world. Some of the important banking systems and practices currently in operation are Branch Banking, Unit Banking, Correspondent Banking, Group Banking, Chain Banking, Deposit Banking, Investment Banking, Mixed Banking.

In Branch Banking System, each commercial bank is a very large institution, having a large number of branches scattered all over the country and even outside. Thus, branch banking is another name for delocalised banking, which carries on business through a number of offices. The best example of branch banking is perhaps British banking but now it has become popular in all other countries of the world.

In the Unit Banking System, the bank's operations are generally confined to a single office only. In this system, independent isolated units perform banking business. The American banking system still represents a typical example of unit banking which is predominantly a localized one. In the USA, unit banks are generally linked together, by the correspondent banking system.

Corresponding Banking System refers to an arrangement with which small banks open account with the banks in the neighbouring cities and these banks in turn have accounts with giant banks in large cities. These banks also open deposit accounts in city banks and city banks in turn in smaller banks.

Group Banking is a system where a group of banks are brought under the control of a holding company. The holding company controls the affairs of the units in the group. But each bank in the group maintains its separate identity. The purpose of group banking is to unify the management of banks, to achieve economic of large-scale operation and to grab more power.
Chain Banking refers to the system where two or more banking companies are controlled by one or few individuals or by the same group of persons through purchase of share of such banks. Control can be exercised through common membership of Board of Directors also.

Banks in Deposit Banking System are confined only to accepting deposits and lending for short periods to industries and trade. The underlying principle of this system is that, banks cannot lock-up their deposits in long-term investments, as the deposits are repayable on demand.

Investment Banking refers to a system where banks provide long-term finance to meet the fixed capital requirements of the industries. Hence it is also called industrial banking.

Mixed Banking System combines deposit banking with investment banking. The mixed banking receives deposits from public and provide short-term, medium-term and long-term loans to the industries.

Structure of Indian Banking System

Commercial banks in India may broadly be classified on the basis of two criteria Statutory and Ownership. On the statutory basis, the banks are of two types viz., Scheduled Banks and Non-Scheduled Banks. On the basis of ownership banks are of two types viz., Public Sector Banks and Private Sector Banks. The chart - 1.1 explains the broad features of the structure of Commercial Banks in India.

Origin and Growth of banking in India:

Banking in India has its origin in Vedic times, that is 2000 to 1400 B.C. Indigenous bankers and Money Lenders have played a vital role for centuries. Modern banking in India emerged between the eighteenth and the beginning of the nineteenth centuries, when European agency houses erected a structure of European controlled banks with limited liability. In 1963, the first bank was setup in Madras by the officer of

For the past four decades Indian banking system has several outstanding achievement to its credit. The most striking is its extensive reach. It is no longer confined to only metropolitans or cosmopolitans in India. In fact Indian Baking system has reached even to the remote corners of the country.
In previous days in India, an account holder has to wait for hours at the bank counters for getting a draft or for withdrawing his own money. To-day he has a choice. Gone are days when the most efficient bank transferred money from one branch to other in two days. Now it is simple as instant messaging or dial a pizza.

**Growth of Indian Banking**

The journey of Indian banking can be segregated into the following three distinct phases.

- **Phase-I**: Indian Banks up to 1969
- **Phase-II**: Nationalisation of Indian Banks (1969-1991) and
- **Phase-III**: Indian Banks after 1991

**Phase - I**

Banking had not developed much in India prior the British Rule. The banking business was generally carried on by the Maharajas and Sahykars in pre-British period. There was perceptible decline in their banking business during the early British Rule. The main reason was that these Maharajas and Sahukars were familiar neither with English language nor with British banking system. The place of these Indigenous bankers was gradually taken over by the modern banks. The East India Company set up some Agency Houses in Bombay and Calcutta in the closing years of the 18th century. These Agency Houses functioned like modern banks, their main functions includes financing the military requirements of the Company; giving loan for agricultural marketing, issue of paper currency and acceptance of deposits from public. These Agency Houses were only being carries on the business of banking in India up to 1806. And they lost their importance due to abolish of commercial rights of East India Company in 1813 by the British Crown.

Later three Presidency banks were setup in India to carryout banking business in Private ownership. The Bank of Bengal was established in 1806, Bank of Bombay in 1840 and Bank of Madras in 1843. (These three presidency banks were amalgamated into the Imperial Bank of India in 1921 and eventually it became the State Bank of India).
The law enacted by the Government of India in 1860 considerably helped in the establishment of joint stock Banks in India such as Alhabad Bank (1865), Alliance Bank of Simla (1881), the Punjab National Bank (1894), Bank of India (1906), Indian Bank (1907), Bank of Baroda (1909), Central Bank of India (1911) and Union Bank of India (1919). The major function of these banks was to finance foreign trade while domestic trade was largely handled by the Multani shroffs and money lenders. There was considerable expansion of banking activities because of Swadeshi Movement, the people of India boycotted foreign banks and started transacting business with Indian banks. This gave much needed stimulus to Indian Banking. Between 1947 and 1969, banks were under private ownership of the Maharajas, or Kings of the Princely States of India.

During the first phase the growth was very slow and banks also experienced periodic failure between 1913 and 1948. There were approximately 1100 banks mostly small. To streamline the functioning and activities of commercial banks, the Government of India came up with Banking companies Act, 1949 which was later changed to Banking Regulation Act, 1949 as per amending Act of 1965 (Act No. 23 of 1965). Reserve Bank of India was vested with extensive powers for the supervision of banking in India as the Central Banking Authority.

During those day’s public has lesser confidence in the banks. As aftermath, deposit mobilization was slow. Abreast of it, the savings bank facility provided by the Postal Department as comparatively safer. Moreover, funds were largely given to traders. The following Table shows Commercial Banking in India at the end of June, 1969.

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5 Dr.P.K. Srinivastava, Banking Teory & Practice, Himalaya Publishing House.
Table - 1.1
Statement showing Commercial Banking System in India
at the end of June, 1969

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Foreign Banks</th>
<th>Private Sector</th>
<th>Public Sector</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td></td>
<td>Indian Scheduled Bank</td>
<td>Non-Scheduled Banks</td>
</tr>
<tr>
<td></td>
<td></td>
<td>Major Banks</td>
<td>Other</td>
</tr>
<tr>
<td>No. of banks</td>
<td>150</td>
<td>14</td>
<td>36</td>
</tr>
<tr>
<td>No. of Offices</td>
<td>130</td>
<td>4130</td>
<td>1324</td>
</tr>
<tr>
<td>Deposits (Rs. Crores)</td>
<td>478</td>
<td>2632</td>
<td>296</td>
</tr>
<tr>
<td>Credit</td>
<td>385</td>
<td>1829</td>
<td>197</td>
</tr>
</tbody>
</table>

Source: Reports on Trends and Progress of Banking in India, Reserve Bank of India

Phase - II

In this phase, Indian Banking Sector had achieved a tremendous growth in all the aspects of banking. Government of India took major steps in Indian banking system after independence by way of Nationalization of Banks. Of course Nationalisation banks begun with the passing of the Reserve Bank (Transfer of Public Ownership) Act, 1948, which became law on the 3rd September, 1948 and continuous to the Nationalization of Imperial bank of India in 1955, its seven Subsidiary banks in 1960. But the major process of nationalization was carried out on 19th July 1969. It was the effort of the, then Prime Minister of India, Mrs. Indira Gandhi, 14 major commercial banks in the country were nationalized. The growth of banking system in India during this period can understood by the following Table.
Table - 1.2
No. of Banks in India

<table>
<thead>
<tr>
<th>Types of Bank</th>
<th>No. of Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled Commercial Banks</td>
<td>73</td>
</tr>
<tr>
<td>Out of which RRB’s</td>
<td>-</td>
</tr>
<tr>
<td>Non-scheduled Commercial Banks</td>
<td>16</td>
</tr>
<tr>
<td>Total:</td>
<td>89</td>
</tr>
</tbody>
</table>

Source: Reports on Trends and Progress of Banking in India, Reserve Bank of India

Table - 1.2 depicts the growth of Indian banking in the second phase. No. of total banks were increased from 89 in 1969 to 276 in 1991 out of which SCBs were increased from 73 in 1969 to 272 and RRBs were 19 at their introducing year in 1976, increased to 196 at the end 1991.

Table - 1.3
No. of Bank Offices In India

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Rural</td>
<td>1833</td>
<td>7690</td>
<td>15105</td>
<td>35206</td>
</tr>
<tr>
<td>Semi-urban</td>
<td>3342</td>
<td>6421</td>
<td>8122</td>
<td>11344</td>
</tr>
<tr>
<td>Urban</td>
<td>1584</td>
<td>3998</td>
<td>5178</td>
<td>8046</td>
</tr>
<tr>
<td>Metro Politan</td>
<td>1503</td>
<td>3111</td>
<td>4014</td>
<td>5624</td>
</tr>
<tr>
<td>Total:</td>
<td>8262</td>
<td>21220</td>
<td>32419</td>
<td>60220</td>
</tr>
</tbody>
</table>

Source: Reports on Trends and Progress of Banking in India, Reserve Bank of India

The number of branch offices was also increased to 60220 in 1991 from 8262 in 1969. This growth is also mainly in the category of Rural and Semi-urban which were increased to 35206 and 11344 in 1991 from 1833 and 3342 in 1969 respectively. So by this analysis we can say that in development of banking is towards rural areas i.e., urban banking to rural banking, class banking to mass banking.
Development of Indian banking system in this phase also analyses through the deposit mobilized by commercial banks which were Rs. 4646 crores out of which Rs. 2104 crores are demand and Rs. 2542 time and were increased to Rs. 201199 crores in 1991 out of which Rs. 38300 crores are demand and Rs. 162898 crores are time deposits. This was happen only because of Nationalisation of commercial banks which created a sort confidence on banking industry among the people.

Growth of Indian commercial banks in terms of credit sanctioned has been explained in Table 1-5 which were Rs. 3599 crores in 1969 and increased to Rs. 121865 crores at the end of 1991 and the priority sector share in total advances was also increased to 37.6 percent in 1991 from 14 percent in 1969. In terms of absolute amount the priority sector advances have increased to Rs. 44,572 crores in 1991 from Rs. 504 crores in 1991. With this we can understand that commercial banking in India actively participated in implementation government policies by providing significant credit to priority sector.

**Table - 1.4**

**Deposits of Scheduled Commercial Banks**

(Rupees in Crores)

<table>
<thead>
<tr>
<th></th>
<th></th>
<th></th>
<th></th>
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</tr>
</thead>
<tbody>
<tr>
<td>Demand Deposits</td>
<td>2104</td>
<td>6106</td>
<td>8290</td>
<td>38300</td>
</tr>
<tr>
<td>Time Deposits</td>
<td>2542</td>
<td>9072</td>
<td>32259</td>
<td>162898</td>
</tr>
<tr>
<td>Total Deposits</td>
<td>4646</td>
<td>15178</td>
<td>40549</td>
<td>201199</td>
</tr>
</tbody>
</table>

Source: Reports on Trends and Progress of Banking in India, Reserve Bank of India
### Table - 1.5

**Credit of Scheduled Commercial Banks**

(Rupees in Crores)

<table>
<thead>
<tr>
<th>Indicator</th>
<th>Year 1969</th>
<th>Year 1976</th>
<th>Year 1981</th>
<th>Year 1991</th>
</tr>
</thead>
<tbody>
<tr>
<td>Credit of SCB’s in India</td>
<td>3599</td>
<td>11476</td>
<td>26551</td>
<td>121865</td>
</tr>
<tr>
<td>SCB’s Advances to Priority Sector</td>
<td>504</td>
<td>2815</td>
<td>9444</td>
<td>44572</td>
</tr>
<tr>
<td>Share of Priority Sector Advances in total credit of SCB’s</td>
<td>14.0</td>
<td>2405</td>
<td>35.6</td>
<td>37.6</td>
</tr>
</tbody>
</table>

Source: Reports on Trends and Progress of Banking in India, Reserve Bank of India

**Phase – III**

In this third phase the commercial banking in India in terms of number of banks has become to 183 at the end of March, 2013 which were 272 in 1991 it means the schedule commercial banks in India has little bid slower down in terms of number of banks. Number of offices are increased to 71839 at the end of March 2013 which were 60220 in 1991. The above indicators show that commercial banking in India even though decreased in terms of number of banks but reached the mass by increasing its number of branch offices. Since 1991 the Commercial Banking in India has not achieved much growth regarding quantity but as par as quality is concerned it had a significant growth in its account.

In the third phase of reforms period Indian banking has achieved a remarkable progress in terms of Total Deposit mobilized. The total deposits collected by the Indian commercial banks were increased from Rs.2,01,199 crores in 1991 to Rs.26,08,309 crores in 2013, whereas. The Deposits per office of Scheduled Commercial Banks in India has reached to Rs. 3,631 lakhs in 2013 from Rs. 334 lakhs in 1991. And per capita deposits of the Scheduled Commercial Banks in India has been increased to Rs. 23,468 in 2013 from Rs. 2,368.
Table - 1.6
Progress of Commercial Banks During Third Phase

<table>
<thead>
<tr>
<th></th>
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<th></th>
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<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>No. of Commercial Banks</td>
<td>276</td>
<td>284</td>
<td>297</td>
<td>301</td>
<td>298</td>
<td>294</td>
<td>291</td>
<td>288</td>
<td>222</td>
<td>183</td>
</tr>
<tr>
<td>a. Scheduled Commercial Banks</td>
<td>272</td>
<td>281</td>
<td>297</td>
<td>296+</td>
<td>294</td>
<td>289</td>
<td>286</td>
<td>284</td>
<td>218</td>
<td>179</td>
</tr>
<tr>
<td>Of which: Regional Rural Banks</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>133</td>
<td>96</td>
</tr>
<tr>
<td>b. Non-Scheduled Commercial Banks</td>
<td>4</td>
<td>3</td>
<td>5</td>
<td>5</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>4</td>
<td></td>
<td></td>
</tr>
<tr>
<td>No. of Bank offices in India</td>
<td>60220</td>
<td>62367</td>
<td>65412</td>
<td>66535</td>
<td>67188</td>
<td>68355</td>
<td>69471</td>
<td>71839</td>
<td></td>
<td></td>
</tr>
<tr>
<td>a. Rural</td>
<td>35206</td>
<td>33004</td>
<td>32734</td>
<td>32562</td>
<td>32380</td>
<td>32303</td>
<td>32121</td>
<td>32082</td>
<td>218</td>
<td>179</td>
</tr>
<tr>
<td>b. Semi-Urban</td>
<td>11344</td>
<td>13414</td>
<td>14407</td>
<td>14597</td>
<td>14747</td>
<td>14859</td>
<td>15091</td>
<td>15403</td>
<td>15556</td>
<td>16361</td>
</tr>
<tr>
<td>c. Urban</td>
<td>8046</td>
<td>8868</td>
<td>10052</td>
<td>10477</td>
<td>10693</td>
<td>10819</td>
<td>11000</td>
<td>11500</td>
<td>12032</td>
<td>12970</td>
</tr>
<tr>
<td>d. Metropolitan</td>
<td>5624</td>
<td>7154</td>
<td>8219</td>
<td>8467</td>
<td>8680</td>
<td>8976</td>
<td>9370</td>
<td>11304</td>
<td>11957</td>
<td>11957</td>
</tr>
<tr>
<td>Population per office (in Thousands)</td>
<td>14</td>
<td>15</td>
<td>15</td>
<td>15</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>15</td>
</tr>
<tr>
<td>Deposits of SCBs in India Rs. In Crore)</td>
<td>201199</td>
<td>386859</td>
<td>851593</td>
<td>989141</td>
<td>1131187</td>
<td>1311761</td>
<td>1542284</td>
<td>1732858</td>
<td>2109049</td>
<td>2608309</td>
</tr>
<tr>
<td>a. Demand</td>
<td>38300</td>
<td>76903</td>
<td>145283</td>
<td>159407</td>
<td>169103</td>
<td>187837</td>
<td>245943</td>
<td>265033</td>
<td>3464640</td>
<td>429137</td>
</tr>
<tr>
<td>b. Time</td>
<td>162898</td>
<td>309956</td>
<td>706310</td>
<td>865594</td>
<td>1124300</td>
<td>1467824</td>
<td>1744409</td>
<td>2179172</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Credit of SCBs in India (Rs. Crore)</td>
<td>121865</td>
<td>211560</td>
<td>454069</td>
<td>529272</td>
<td>609053</td>
<td>746432</td>
<td>865594</td>
<td>1124300</td>
<td>1507077</td>
<td>1928913</td>
</tr>
<tr>
<td>Deposits of SCBs per office (Rs. Lakh)</td>
<td>334</td>
<td>620</td>
<td>1302</td>
<td>1501</td>
<td>1709</td>
<td>1972</td>
<td>2295</td>
<td>2535</td>
<td>3036</td>
<td>3631</td>
</tr>
<tr>
<td>Credit of SCBs per office (Rs. Lakh)</td>
<td>202</td>
<td>339</td>
<td>694</td>
<td>803</td>
<td>920</td>
<td>1122</td>
<td>1288</td>
<td>1645</td>
<td>2169</td>
<td>2685</td>
</tr>
<tr>
<td>Per Capita Deposits of Scheduled Commercial Banks (Rs.)</td>
<td>2368</td>
<td>4242</td>
<td>8498</td>
<td>9758</td>
<td>10994</td>
<td>12554</td>
<td>14550</td>
<td>16091</td>
<td>19276</td>
<td>23468</td>
</tr>
<tr>
<td>Per Capita Credit of SCBs (Rs.)</td>
<td>1434</td>
<td>2320</td>
<td>4531</td>
<td>5211</td>
<td>5919</td>
<td>7143</td>
<td>8166</td>
<td>10440</td>
<td>13774</td>
<td>17355</td>
</tr>
<tr>
<td>Deposits of SCBs as percentage of National Income</td>
<td>48.1</td>
<td>51.7</td>
<td>53.5</td>
<td>58.9</td>
<td>60.7</td>
<td>65.3</td>
<td>68.5</td>
<td>68.3</td>
<td>73.8</td>
<td>79.1</td>
</tr>
<tr>
<td>SCBs Advances to Priority Sector (Rs. Crore)</td>
<td>44572</td>
<td>69209</td>
<td>155779</td>
<td>182255</td>
<td>205604</td>
<td>250989</td>
<td>311335</td>
<td>400775</td>
<td>546774</td>
<td>703756</td>
</tr>
<tr>
<td>Share of Priority Sector Advances in total credit of SCBs (percent)</td>
<td>37.7</td>
<td>33.7</td>
<td>35.4</td>
<td>35.5</td>
<td>34.8</td>
<td>34.6</td>
<td>37.1</td>
<td>36.7</td>
<td>37.2</td>
<td>36.5</td>
</tr>
<tr>
<td>Share of Priority Sector Advances in total Non-Food Credit of SCBs (percent)</td>
<td>39.2</td>
<td>35.8</td>
<td>37.4</td>
<td>38.5</td>
<td>38.2</td>
<td>37.1</td>
<td>38.8</td>
<td>38.1</td>
<td>38.2</td>
<td>37.4</td>
</tr>
<tr>
<td>Credit Deposit Ratio</td>
<td>60.6</td>
<td>54.7</td>
<td>53.3</td>
<td>53.5</td>
<td>53.8</td>
<td>56.9</td>
<td>56.1</td>
<td>64.9</td>
<td>71.5</td>
<td>74</td>
</tr>
</tbody>
</table>

Source: Basic Statistical Returns of Scheduled Commercial Banks in India, RBI.
The total credit sanctioned by the Commercial Banks is also increased to Rs.19,28,913 crores in 2013 from Rs. 1,21, crores in 1991. The Credit per office of the SCBs in India has been reached to Rs. 2,685 lakhs in 2013 from Rs. 202 lakhs in 1991. The per capita credit of the same has also increased to Rs. 17,355 in 2013 from Rs. 1,434 in 1991. The Growth of Indian Commercial banking during this phase is depicted in Table - 1.6.

The phase has also introduced many more products and facilities in the banking sector in India. In 1991, under the chairmanship of M.Narasimham, a committee was setup on his name, which worked for the liberalization of banking practices.

The country is flooded with foreign banks and their ATM stations. Efforts are being put to give satisfactory services to customer. Competition also has been induced to Indian banking system. The major developments are,

**Use of Card Money:** The banking in industry in India is being swept by the wind of change triggered by the economic reforms induced in 1991, coupled with the onslaught of the information technology\(^6\). The following diagram explains the different forms of plastic money in use.

**ATM Card:** This card would be useful only to operate the Automated Teller Machine.

**Debit Card:** This card would be useful to make payments for purchases from Member Establishments (MEs) who have arrangements with the Card issuing bank/agency. All Card Issuers are affiliated to two major issuers - VISA and Master Card.

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\(^6\) Dr.B.Manmohan – “Role of Debit Cards and Credit Cards in Indian Banking Industry”, Banking Finance, May-2007, pp. 13.
Debit-cum-ATM Card: This is the most common form of plastic money used in these days. The same Debit Card can be used to draw cash from ATM and also make payments to shops for purchases. This is a Two-in-One Card.

Credit Card: This card enables the client to obtain goods or services from various shops having arrangements with the issuing agency even when there is no balance in his Savings or Current Account. Normally a limit would be fixed - based on the net worth of the client - up to which the client can use the card. The same card can be used even to draw cash from ATMs within the Cash Limit approved to that client. Normally, at the time of issuing the card, the Bank would intimate the client two limits (Spending Limits) - One the Total Spending Limit (based on the net worth of the client) and the other sub-limit within the total spending limit for the purpose of drawing cash. For e.g., a Card may have a total spending limit of Rs. 1 lakh with a sub limit for Cash Withdrawal of Rs. 20,000/-.

Charge Cards: A Charge card is similar to a credit card with one major difference. With a charge card you have to pay the entire dues within the credit period and cannot carry over any balances like a credit card.

Co-Branded Cards: Some times banks who issue cards enter into agreement with other entities (Airlines, Hotels, Retain Chain Stores, etc.,) so that both are in a win-win situation, that is the number of cards of the issuing bank increased by which their fees based income would go up and the sales of the co-branded companies products would also increased. Co-branded cards which are affiliated with merchants such as Airlines and Retailers use rewards programmes and special offers. Example: ICICI Deccan Card, Indian Oil Citibank Card, Jet Citibank Card, WWF Citibank Card etc.,
Add-On Card: Common to all the above. It is a privilege offered to the spouse, parents or children of the original card holder. For this the bank charges extra amount at the time of issuance. All expenses incurred on Add-on card are billed to the primary card holder.

E-Banking:

Banking activity carried on through other electronic means of communication is called "electronic banking" or e-Banking. As a matter of fact, the world at largest rapidly entering into the "net age" by new millennium. In deed, unprecedented and profound changes in all walks of mans life are promised and anticipated with the extensive and intensive use of global communication net world. The net is changing everything everywhere : methods and mode of communication, work education, research, interface, ideas and perceptions, entertainment, health, habit, taste and preference, lifestyle, so also trade commerce and finance. e-Banking essentially involves electronic funds transfer network technologies of the IT Framework. This is, however not a novel idea in the modern banking. E-Banking expected to result in high productivity and efficiency gain for the bank. E-banking will unleash a revolution in the financial sector of the country. The following are the different forms of electronic banking.

1. PC Banking
2. Internet Banking
3. Phone Banking

New lines of business: Commercial banking in India has moving towards innovative banking from traditional banking and adopting new lines of business with their exhibiting business such as Merchant Banking, Hire Purchase, Mutual Funds, Venture Capital Funds Factoring Services, etc., Merchant Banking is the result of buoyancy in the capital market in 1980's. Some Commercial Banks were set-up their subsidiaries to operate exclusively in Merchant Banking. But Merchant Banking Industry in India was remained almost stagnant and stereotyped for over two decades, witnessed an as tarnishing growth after the process of economic reforms and deregulation of Indian Economy in 1991. All merchant bankers registered with SEBI, which include 50 Commercial Banks, 6 all Indian financial institutions. Hire purchase is a method of
selling goods. In a hire purchase transaction the goods are let out on hire by a finance company to the hire purchase customer. The buyer is required to pay on agreed amount in periodical installments during a given period. The ownership of the property remains with creditor and passes to hire on the payment of last installment. In India, although a notification issued on 07-09-1990 under clause (0) of sub section (1) of section of 6 of the Banking Regulation Act, 1949 the Government of India has permitted banks to engage in hire purchase business.

**Role and Importance of banking in Economic Development:**

The banking sector is an important component of the growth equation in an economy, time and again, history has shown how a weak banking sector has led to the collapse of entire economy. Over the years, banks in India have come to occupy a place of importance in the planned development of the economy in the country. Responding to the emerging requirements of agricultural, industrial and economic growth, they have not only progressively increased the flow of assistance, but also developed a co-ordinated approach to agricultural and industrial financing. To meet the needs of the weaker sections of society, they have introduced many structural changes. Not only new institutions have been established to cater the special needs of the varied sectors, but powers have been decentralized and delegated to the grassroots level. Simultaneously, consistent with their role as catalysts in economic development, the banking institutions have progressively enlarged the scope of their operations - from providing financial assistance to the promotion of agriculture, industry and other activities.

A well-developed banking system is a necessary pre-condition for economic development in a modern economy. Besides providing financial resources for the growth of industrialization, banks can also influence the direction in which these resources are to be utilized.

Banks are one of the oldest financial intermediaries in the financial system. They play an important role in the mobilization of deposits and disbursement of credit

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7 Vasanth Desai, Bank and Institutional Management, Himalaya Publishing House
8 S.N.Maheshwari and R.R. Paul, Banking Theory and Law & Practice, Kalyani Publishers
to various sectors of the economy. In modern economy banks are not only acts as money dealers but they have to be treated as leaders in development, why because they not only stores wealth of the country they provide necessary funds to economic development of the country. Today's developing economics future will also depends upon a well developing banking system. The banking system is the fuel injection system, which spurs economic efficiency mobilizing savings and allocating them to high return investment. Research confirms that countries with a well-developed banking system grow faster than those with weaker one. The banking system reflects the economic health of the country. The strength of economy any country basically depends on the strength and efficiency of the financial system, which in turn depends on a sound and solvent banking system. The Indian banking sectors is dominant as it accounts for more than half of the assets of the financial sector. Banking system helps the economic development of a nation by the following means.

**Capital Formation:** Capital formation is the most important determinant of economic development and banks promote capital formation. Banks play a crucial role in capital formation in the following way 1) They stimulate savings by providing a number of incentives to the savers, 2) By expanding their branches in different areas and giving various incentives. They succeed in mobilizing the savings generated in the economy. They not only mobilize resources they made available these resources to those who have the opportunities of productive investment.

**Encouragement to Entrepreneurial Innovations:** In underdeveloped and developing economies, entrepreneurs generally hesitate to invest in new ventures and undertake innovations, largely due to lack of funds. Facilities of bank loans enable the entrepreneurs to step up their investment and innovational activities, adopt new methods of production and increase productive capacity of the economy.

**Implementation of Monetary Policy:** Economic development needs an appropriate monetary policy. But a well-developed banking system is a necessary pre-condition for the effective implementation of the monetary policy. Control and regulation of credit by the monetary authority is not possible without the active co-operation of the banking system in the country.
Monetisation of Economy: Monetisation of the economy is essential for accelerating trade and economic activity. Banks which are creators and distributors of money allow money to play an active role in the country.

The process of monetisation is in two ways:

1. The monetise, in other words, they buy debts (i.e., securities which are not acceptable as money) and in exchange, create demand deposits (which are acceptable as money)
2. By spreading their branches in the rural and backward areas, the convert, the non-monetised sector of the economy into monetised sector.

Encouragement to Right Type of Industries: By granting loans (particularly medium-term and long-term), the bank can provide financial resources to the right type of industries to secure necessary material, machines and other inputs. In a planned economy it is necessary that the banks formulate their loan policies in accordance with the broad objectives and strategy of industrialization as adopted in the plan. This promotes right type of industrialization in the economy.

Balanced Regional Development: Banks can also play an important role in achieving balanced development of different regions of the economy. They can transfer surplus capital from the developed regions to the less-developed regions, where it is scarce and most needed. This reallocation of funds between regions will promote economic development in the underdeveloped areas of the economy.

Development of Agriculture and other Neglected Sector: Underdeveloped economic are primarily agricultural economies and a majority of the population in these economic live in the rural areas. Therefore, economic development in these economies requires the development of agriculture and small-scale industries in the rural areas. So far, banks, in underdeveloped countries have been paying more attention to trade and commerce and have almost neglected agriculture and industry. Thus, necessary structural and functional reforms in the banking system of the underdeveloped countries should be made in order to encourage the banks to play developmental role in these economies. Thus, banks must diversify their activities not
only to extend credit to trade, but also to provide medium-term and long-term loans to the industry and agriculture.

Problems and Challenges of Indian Banking Sector in the context of Economic Liberalization:

The Changes affecting the banking sector in the wake of globalisation and opening up of the economy in the early nineties has provoked much reflection on ways and means to strengthen the banking system. In the underdeveloped and developing countries, not only the banking facilities are limited to a few developed urban areas, but also the banking activities are limited mostly to trade and commerce, paying little attention to industry and agriculture. Structural as well as functional reforms in the banking system are needed to enable the banks perform developmental role in underdeveloped countries.

A conference of the Chief Executives of banks has identified a number of priorities to make the banking sector sound and vibrant to play a crucial role in the accelerated development of the economy. The banking sector reforms, implemented since 1991, have brought in a near-total metamorphosis of the sector and made the Public Sector Banks serious about the risk-return trade-off on one hand and maximization of the shareholders' value, on the other. Maximizing the shareholders' value has, in fact, assumed paramount importance, particularly for the banks, which have gone public, because these banks are now accountable to millions of their shareholders rather than the Union Government as their single shareholder. This has propelled the Public Sector banks to become conscious of their performance on a continuous basis and shift the focus from expansion (volume) to efficiency (margin).

Technology: The introduction of modern technology such as computers and communication network is essential if the growing volume of transactions is to be handled efficiently. Customers, both as depositors and borrowers, are looking for improved services from the banks and these demands cannot be met if banks stick to the present manual methods. There is manifest need for introduction of new work technologies and these issues need to be looked at in a constructive spirit by staff associations and unions as the existing procedures and work technology have led to sub-optimal performance. The challenge in this regard will e for banks to ensure that
they derive maximum advantage out of their investments in technology and to avoid wasteful expenditure which might arise on account of

a) Uncoordinated and piecemeal adoption of technology;
b) Adoption of inappropriate / inconsistent technology and
c) Adoption of obsolete technology

**Competition:** In deregulated environment, the doors are open for foreign banks. In this context, where the old banks are competing with the new banks and this is the one area where the Indian banks have to work out very hard. The main objective of the banking sector reforms has been to make banks technically sound and to introduce an element of competition assuming that the rest of the things would be automatically done. To expedite the process is a strong need to bring institutional changes so as to change the mind set of the people.⁹

The banking industry is entering a new phase in which it will be facing increasing competition even from non-banks. On the side of mobilization deposits, it will have to face the competition from alternative savings instruments which may offer even more attractive returns than bank deposits. On the lending side, with the increased activity in capital markets, large borrowers may be able to raise their requirements directly from savers. This kind of financial disinter mediation is not peculiar to the Indian banking system. Banks world over have faced such challenges. Indian banks will have to gear themselves up to face the new situation.

**Human Resource Policies:** Indian banking requires major changes in human resource policies followed by the commercial banks in general and public sector banks in particularly. A more professional and flexible performance based set of policies need to be introduced; there is a need to create an incentive compatible system under which all involved have stakes in maintaining an efficient banking system.

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⁹Dr. Saghir Ahmed Ansari & Dr. Nisar Ahmed Khan, Banking Finance, April-2007, Page No.19
At present the human resource policies in banks are mainly guided by the concept of permanent employment and its necessary concomitants of creating career paths, terminal benefits, etc., for the employees. In this fast changing world of worker mobility both horizontally and vertically and value systems, the public sector banks will need the freedom not only to hire the right talent at market related compensation but also to shed surplus manpower. All this calls for a close relook into the Statue Books as well as Management Practice of the banks.

**Efficiency:** Efficiency is also one of the challenges before Indian banking industry. Liberalization has made it necessary to look for efficiencies in the business. Bank need to access low cost funds and simultaneously improve the efficiency. The banks are facing pricing pressure, squeeze on spread and have to give thrust on retail assets.

Liberalization will definitely impact customer preferences, as they are bound to react to the value added offering. Customers have becoming demanding and the loyalties are diffused. There are multiple choices. The wallet share is reduced per bank with demand on flexibility and customization.

**Ethics:** In the context of competitiveness the challenge before the Indian banking industry is that follow of ethics in the business. Conventional instruments of enhancing competition within banking system such as privatization, legal changes in company laws, banking laws, foreign ownerships regulatory changes to facilitate equal treatment to all the banks are necessary but not sufficient conditions. There is a need to create an environment through regulations to prevent collusive behaviour among banks and conglomerate relationship between banks and non-financial groups.

**Basel II implementation:** Basel II is the revised framework for capital adequacy for banks. Implementation of Basel II is seen as one of the significant challenges facing the banking sector in many jurisdictions. With the introduction of capital charge for market risks with effect from the year ended March 31, 2005 banks in India are compliant with all elements of Basel I. Commercial banks in India will start implementing Basel II with effect from March 31, 2007. They will initially adopt the Standardised Approach for credit risk and the Basic Indicator Approach for operational risk. After adequate skills are developed, both by the banks and also by
the supervisors, some banks may be allowed to migrate to the Internal Rating Based (IRB) Approach. Implementation of Basel II will require more capital for banks in India due to the fact that operational risk is not captured under Basel I, and the capital charge for market risk was not prescribed until recently.

With a view to ensure migration to Basel II in a non-disruptive manner, a consultative and participative approach has been adopted for both designing and implementing Basel II in India. A steering Committee comprising senior officials from 14 banks (public, private and foreign) has been constituted wherein representation from the Indian Bank’s Association and the RBI has also been ensured. The Steering Committee had formed sub-groups to address specific issues. On the basis of recommendations of the Steering Committee, draft guidelines to the banks on implementation of the New Capital Adequacy Framework have been issued. Though Basel II implementation is considered as a challenge generally, the above approach has lightened the burden on banks in India.

Finally, transition from old system to the Basel II norms would be very hard sailing for the Indian banks. For the next few years, this may be the greatest challenge for the Indian banking sector.

**Improving Risk Management Systems:** With the increasing degree of deregulation and exposure of banks to various types of risks, efficient risk management systems have become essential. As you are aware, as a step towards further enhancing and fine-tuning risk management systems in banks, Reserve Bank has issued guidelines on asset-liability management and risk management systems in banks in 1999 and Guidance Notes on Credit Risk Management and Market Risk Management in October 2002 and the Guidance Note on Operational risk management in 2005. Though Basel II focuses significantly on risks its implementation should not be seen as an end in itself. It should be seen as a medium whereby the risk management systems in banks are constantly upgraded to address the changing environment.

At the initial stages of development of the risk management systems, banks were managing each risk in isolation. The current business environment demands a more integrated approach to risk management. It is no longer sufficient to manage
each risk independently or in functional silos. Enterprises worldwide are, therefore, now putting in place an integrated framework for risk management which is proactive, systematic and spans across the entire organisation. Banks in India are also moving from the individual silo system to an enterprise wide risk management system. This is placing greater demands on the risk management skills in banks and has brought to the forefront the need for capacity building. While the first milestone would be risk integration across the entity, banks are also aware of the desirability of risk aggregation across the group both in the specific risk areas as also across the risks. Banks would be required to allocate significant resources towards this objective over the next few years.

The Reserve Bank of India has adopted the risk-based approach to supervision since 2003 and have brought about 23 banks under the fold of risk-based supervision (RBS) on a pilot basis. On the basis of the feedback received from the pilot project, the RBS framework has now been reviewed. The risk-based approach to supervision is also serving as a catalyst to banks’ migration to the integrated risk management systems. In view of the relevance of improved risk management systems under the changing circumstances and the larger emphasis placed on risk management systems in banks under Basel II, it is essential that the RBS stabilizes at an early date and serves as an important feedback not only to bank managements but also to RBI. However, taking into account the diversity in the Indian banking system, stabilizing the RBS as an effective supervisory mechanism will be a challenge to the RBI.

**Implementation of new accounting standards:** Derivative activity in banks has been increasing at a brisk pace. While the risk management framework for derivative trading, which is a relatively new area for Indian banks (particularly in the more structured products), is an essential pre-requisite, the absence of clear accounting guidelines in this area is matter of significant concern. It is widely accepted that as the volume of transactions increases, which is happening in the Indian banking system, the need to upgrade the accounting framework needs no emphasis. The World Bank’s ROSC on Accounting and Auditing in India has commented on the absence of an accounting standard which deals with recognition, measurement and disclosures pertaining to financial instruments. The Accounting Standards Board of the Institute of Chartered Accountants of India (ICAI) is considering issue of Accounting
Standards on the above aspects pertaining to financial Instruments. These will be the Indian parallel to International Accounting Standards 32 and 39. The proposed Accounting Standards will be of considerable significance for financial entities and could therefore have implications for the financial sector. The formal introduction of these Accounting Standards by the ICAI is likely to take some time in view of the processes involved. In the meanwhile, the Reserve Bank is considering the need for banks and financial entities adopting the broad underlying principles of IAS 39. Since this is likely to give rise to some regulatory / prudential issues all relevant aspects are being comprehensively examined. Adoption and implementation of these principles are likely to pose a great challenge to both the banks and the Reserve Bank.

Transparency and Disclosures: In pursuance of the Financial Sector Reforms introduced since 1991 and in order to bring about meaningful disclosure of the true financial position of banks to enable the users of financial statements to study and have a meaningful comparison of their positions, a series of measures were initiated.

The disclosure requirements broadly covered the following aspects:

- Capital adequacy
- Asset quality
- Maturity distribution of select items of assets and liabilities
- Profitability
- Country risk exposure
- Risk exposures in derivatives
- Segment reporting
- Related Party disclosure

With a view to moving closer towards international best practices including International Accounting Standards (IAS) and the disclosure requirements under Pillar 3 of Basel II, Reserve Bank has proposed enhanced disclosures which lay a greater emphasis on disclosure of certain qualitative aspects. Transparency and disclosure standards are also recognized as important constituents of a sound corporate governance mechanism. Banks are required to formulate a formal disclosure policy approved by the Board of directors that addresses the bank’s approach for determining what disclosures it will make and the internal controls over the disclosure
process. In addition, banks should implement a process for assessing the appropriateness of their disclosures, including validation and frequency.

**Supervision of financial conglomerates:** In view of increased focus on empowering supervisors to undertake consolidated supervision of bank groups and since the Core Principles for Effective Banking Supervision issued by the Basel Committee on Banking Supervision have underscored consolidated supervision as an independent principle, the Reserve Bank had introduced, as an initial step, consolidated accounting and other quantitative methods to facilitate consolidated supervision. The components of consolidated supervision include, consolidated financial statements intended for public disclosure, consolidated prudential reports intended for supervisory assessment of risks and application of certain prudential regulations on group basis. In due course, consolidated supervision as introduced above would evolve to cover banks in mixed conglomerates, where the parent may be non-financial entities or parents may be financial entities coming under the jurisdiction of other regulators.

The financial landscape is increasingly witnessing entry of some of the bigger banks into other financial segments like merchant banking, insurance etc., which has made them financial conglomerates, Emergence of several new players with diversified presence across major segments and possibility of some of the non-banking institutions in the financial sector acquiring large enough proportions to have systemic impact make it imperative for supervision to be spread across various segments of the financial sector. In this direction, an inter-regulatory Working Group was constituted with members from RBI, SEBI and IRDA. The framework proposed by the Group will be complementary to the existing regulatory structure wherein the individual entities are regulated by the respective regulators and the identified financial conglomerates would be subjected to focused regulatory oversight through a mechanism of inter-regulatory exchange of information. The complexities involved in the supervision of financial conglomerates are a challenge not only to the Reserve Bank of India but also to the other regulatory agencies, which need to have a close and continued coordination on an on-going basis.

**Corporate Governance:** Banks are “special” as they not only accept and deploy large amount of uncollateralized public funds in fiduciary capacity, but they also
leverage such funds through credit creation. Banks are also important for smooth functioning of the payment system. In view of the above, legal prescriptions for ownership and governance of banks laid down in Banking Regulation Act, 1949 have been supplemented by regulatory prescriptions issued by RBI from time to time: In this context, one must remember that profit motive should not be the sole criterion for business decisions. Flow of bank finance for productive purposes must always take priority over the granting of credit for speculative investment no matter how profitable the latter may be. If bank finance flows increasingly to finance speculative activities, it will be to the detriment of real productive investment for research, development and the production of real goods/services. One might conclude that such uncontrolled flow would ultimately affect economic growth. Hence, funding of speculative activities must be subject to prudential limits, even though it might yield attractive returns. This will be a significant challenge to banks where the priorities and incentives might not be well balanced by the operation of sound principles of corporate governance.

**Rural Banking:** Having committed 75 percent of their branch networks to serving rural and semi-urban population, public sector banks have to adopt a financial engineering approach to rural banking. The delivery system has to be made cost effective. Therefore there is a need for redesigning the rural banking system to deliver new products and services and to make the priority sector more receptive and productive. In this connection, the regulatory constraint on banks’ allocation of credit flows also needs to a relook. Commercialised agriculture should be considered as a potential avenue for new business. There is need for a paradigm shift in rural finance and in both mobilization and allocation of resources through other intermediaries.

**Need for the Present Study:**

The financial system in India built a vast network of financial institutions and markets over time, and the sector is dominated by banking sector. Tremendous development has taken place in the banking sector during the 40 years after nationalization. The number of banks branches has increased from 8,262 at the end of June 1969 to 61,129 at the end of March 2013 out of which 19,557 branches are opened in rural areas. Such a rapid expansion resulted into reduction of the average population served by branch from 65,000 in 1969 to 15,000 in 2013. The ratio of
deposits to national income has gone up from 15 percent in 1969 to 79.1 percent in 2013. There was a re-orientation of bank credit from industry and trade to the agriculture and priority sectors including weaker sections which can be understood by the increased share priority sectors including weaker sections which can be understood by the increased share priority sector advances to total credit of 36 percent in 2013 earlier it was only 14 percent in 1969. The banks have also made a significant contribution towards economic development by assuming special area responsibilities under the Lead Bank Scheme and Service Area Approach and initiating area credit planning. They have also made several innovations in the administrative structure and operational procedures. Since, public Sector Banks playing a predominant role in the total banking industry and within the Public Sector Banks group SBI and its Associates and Nationalised Banks are the two sub categories, one from each section i.e., State Bank of Hyderabad from SBI and its Associates category and Andhra Bank from Nationalised Banks category have been selected for the study. An attempt is made to study the operational performance, financial performance and the impact of reforms on profitability of the State Bank of Hyderabad and Andhra Bank.

In the wake of globalization and opening up of economy, the changes affecting the banking sector in the early nineties has provoked much reflection on ways and means to strengthen the banking system. In the underdeveloped and developing courtiers, not only the banking facilities are limited to a few developed urban areas, but also the banking activities are limited mostly to trade and commerce, paying little attention to industry and agriculture. Structural well as functional reforms in the banking system are needed to enable the banks to perform developmental role in underdeveloped countries.

A conference of the Chief Executives of banks has identified a number of priorities to make the banking sector sound and vibrant to play a crucial role in the accelerated development of the economy. The banking sector reforms, implemented since 1991, have brought in a near – total metamorphosis of the sector and made the Public Sector Banks serious about the risk – return trade – off on one hand and maximization of the shareholders’ value, on the other. Maximizing the shareholders’ value has, in fact, assumed paramount importance, particularly for the banks, which have gone public, because these banks are now accountable to millions of their
shareholders rather than the Union Government as their single shareholder. This has propelled the Public Sector Banks to become conscious of their performance on a continuous basis and shift the focus from expansion (volume) to efficiency (margin).

In a deregulated environment, the doors are open for foreign banks. In this context, where the old banks are competing with the new banks and this is the one area where the Indian banks have to work out very hard. The main objective of the banking sector reforms has been to make banks technically sound and to introduce an element of competition assuming that the rest of the things would be automatically done. To expedite the process is a strong need to bring institutional changes so as to change the mindset of the people.

In the process of globalization, our country is flooded with several foreign banks their ATM stations. The foreign banks have introduced various innovative Customer Service such as use of Card Money, E-banking, Merchant Banking, Hire Purchase, Mutual Funds, Venture Capital, Factoring Services etc., which lead to severe competition in the Indian banking System.

Review of Literature:
1) Kapur S.N. (1972)\textsuperscript{10} examines portfolio behavior of commercial banks. The objective of this paper is to demonstrate empirically the determinants of portfolio behavior of commercial banks in India. The study makes general analysis of portfolio behavior articulating a model to test alternative hypothesis regarding portfolio decisions with respect to excess and borrowed reserves, investments in securities and the supply of commercial loans.

2) Varde (1973)\textsuperscript{11} in an empirical study on efficiency of rural branches, mentions that the success of a rural branch has to be judged in relation to the objective of rural banking, which is tow fold: to act as an active catalyst in the integrated

\textsuperscript{10} Kapur S.N. – Portfolio behavior of commercial banks are empirical study, prajnan, I, (October – December, 1982) pp.358-372.

\textsuperscript{11} Varde(1973).“Efficiency of Rural Branches-An Empirical Pilot study Prajnan, II (April-June) PP 187-203
socio-economic development of the area served by the branch, and to become a commercially profitable unit of banking.

3) Patel (1974) studied ‘Problems and challenges of Rural Credit’ and concluded that despite of institutional finance being a subject of major controversy and rural credit presenting inherent difficult problems, the nationalized commercial banks need to be afraid of accepting the challenges of rural development.

4) Patil and others (1975) made a case study on the ‘Framework for Banking Development Program for a State’. In the study the authors pointed out that proper branch expansion and location planning were crucial to the fulfillment of the development objectives of banking system. The study discovered that
   a) The action plan so evolved should clearly indicate the implementation agency and underpin their responsibilities.
   b) The experience of the district co-ordination committee and the state level consultative committee was not very helpful in development of banking in state.

5) Varde (1975) studied branch expansion planning for the banking industry in depth and formulated district wise branch expansion plan for the five year plan period 1971-79. The objective of study is to evolve a branch allocation scheme for branches to be opened, so as to bring maximum reduction in the currently existing disparities in the country, between underdeveloped areas and within each district.

Further the study suggests that if the banks feel that they have some more capacity to open branches, it would not be incompatible to permit then to open remaining branches whatever they wish.

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6) Mampilly\textsuperscript{15} (1975) studies “Performance Budgeting at Branch level”. In this study he discusses how the branches as the basic units of business draw up their business programmes or the performance budget.

7) Bhise (1977)\textsuperscript{16} “Customer service and systems and procedures of banks”. The study identified several causes of slump in the quality of customer service of the banks that has taken place in recent years. The Survey finding indicate that some of the customers’ complaints may be arising on Account of editing systems and procedures.

8) Shah (1979)\textsuperscript{17} in his article, highlighted some aspects of banks profitability. He concludes that profitability cannot and will not improve merely by increasing the margin between lending and borrowing rates or minimum service charges by all banks.

9) Makarand (1979)\textsuperscript{18} in “Social Priority Index of Public Sector Banks” good effort has been made to evaluate the performance of public sector banks in terms of quantitative indicators in different spheres were much was expected of the banking sectors. In the study six indicators viz., branch expansion, priority sector credit, deposit mobilization, export credit and wage costs of business development have been considered to prepare performance index of each of public sector banks.

10) V.S. Kaveri\textsuperscript{19} evaluated the performance of nationalized banks in rural and semi-urban and metropolitan centers by selecting a sample of 1,206 branches. He

\textsuperscript{15} Mampilly Paul – “Performance budgeting at branch level” Prajnan IV (April-June, 1975) pp. 267-300.


comes to the conclusion that branches, which are getting losses had a higher credit-deposit ratios in rural and urban areas.

11) Using inter-regional and inter state banking data for the period 1969-79, Bilgami\textsuperscript{20} studied the growth of public sector banking in India with respect to expansion of bank branches, mobilization of deposits, credit disbursement, credit deposit ratio and the disbursement of credit among the priority sectors. He concluded that though regional or state wise disparities in terms of banking services exist even after 10 years of nationalization, some healthy trends developed during the period would help significantly in minimizing the widening disparities.

12) O.P. Mathur\textsuperscript{21} studies the role of the public sector banks as an instrument for rapid growth of Indian economy in general and working of State Bank of India and its seven subsidiaries in particular.

13) Gosh D.N\textsuperscript{22}, Nanda karni\textsuperscript{23}, Dinest. C\textsuperscript{24}, Bhat V.V\textsuperscript{25}, analyzed the importance of banking in Economic Development and the opportunities and challenges faced by commercial banks in India. They have mentioned that political, economic, social and technological changes have been largely influencing the role of these banks.

14) Kamal Nayan\textsuperscript{26} (1985) study on commercial banks in India, performance evaluation. The overall objective of the study is to evaluate the performance of

\begin{thebibliography}{9}
\item Mathur.O.P. –“Public Sector Banks in India’s Economy, a case study of the State Bank” Sterling Publisher Pvt.Ltd. New Delhi, 1978.
\item C.Dinesh – “Commercial Banks and rural Wealth” The Economic Times, Calcutta, November 28, 1986.
\item V.V.Bhatt-“Trends in banking, Since Nationalisation”, Yojana, New Delhi, July, 1989.
\end{thebibliography}
commercial banks in the nationalized sector with a view to evolve sound criteria for performance appraisal at the bank level as well as branch level. An attempt has also been made to build up an evaluation model that may be conveniently used by the bank management as well as the policy makers for evaluation of performance both at the macro and micro level.

15) Ranga Swamy B\textsuperscript{27} (1985) has made a study on public sector banks in India. The main objective of the study is to see how far the objectives of the nationalized banks are achieved. Expansion of branch network was given importance, since it is one of the objectives of nationalization, viz., advances to priority sectors. Agriculture, small-scale industries, meeting the credit needs of borrowers, housing finance and consumption loans are discussed in detail.

16) Joshi (1986)\textsuperscript{28} has analyzed the trend of gross and net profits of all scheduled commercial banks. He largely holds CRR and priority sectors lending. He found out that there had been lowering yield rate and cost rate year by year which contributed a lot to the declining trend in profitability. He viewed that declining demand from the corporate sector for bank funds had serious implications for bank profitability.

17) Sushila Thakur\textsuperscript{29} (1990) Two decades of Indian Banking, effort has been made to evaluate the performance of commercial banks after nationalization from 1969-1989. The book is divided into six chapters out of these, second chapter deals with the growth of banking in India, with the expansion of branches are taken as parameters to evaluate the growth of banks.

18) Seema Makhija (1990)\textsuperscript{30} in his thesis concluded that in order to serve efficiently our national objectives and priorities, banks have to remain healthy and

\textsuperscript{27} Ranga Swamy.B.-“Public Sector banks in India”, Publication division, Ministry of information and broadcasting, Government of India.

\textsuperscript{28} Joshi-Committee on Productivity, Efficiency and Profitability, Government of India 1997.

\textsuperscript{29} Sushila Takur – “Two decades of Indian banking”, Himalaya Publishers, Bombay.

profitable. They must built up for adequate capital and reserves and plough back profits and reserves to strengthen the inner reserves. Each of the units in the system must have solid bedrock of profitability and viability, for this constitutes a key to its capability to some national priorities and objectives. The problems are poor recovery of loans, deterioration of customer service, low productivity and unsatisfactory house keeping.

19) Ramachandram (1992) observed that profitability of the banks is one the decline. In his paper he traced in brief the causes for declining profitability and suggests possible measures for arresting this trend. The main causes among other traced by the author are
   a) Emphasis on social goal
   b) Increase in establishment cost
   c) Blocking fund in sick unit
   d) Compliance to statutory requirements
   e) Rural branch expansion
   f) Poor cash management and others

20) Goporia (1992)31 in his article had made a general view about the profitability of the banks and maintained that if adequate profit had to flow, following priorities will have to be observed by the banks.
   a) Among fund-based operation the lending operations have to be directed to areas, which would maximize profitability and growth, consistent with the long-term objectives of the institutions, after priorities sector-lending goals are attained.
   b) To promote non-fund based operations.
   c) Charging fees for banks’ services after taking into consideration the cost benefit of service offered etc.,

21) Amandeep (1993) in her study on profitability of commercial banks has attempted to examine the trends in profits and profitability of twenty nationalized commercial banks, with the help of trend analysis, ratio analysis and concentration

indices of the selected parameters. The study focuses at identifying the various factors and empirical testing as to which of the identified factors have significantly contributed towards banks profitability in other direction. Using the multi variable analyses she concluded that it is the efficient management of the burden, which plays a major role in determining the profitability of commercial banks.

22) Sri Manta Panda (1993)\textsuperscript{32}. In his theses on transparency in financial statements of commercial banks concluded that the amounts of advances and investments portfolios among other have been overstated. Assets shown in the balance sheet are contaminated to a extent as a result of every increasing incidence of bad and sticky loans. There is a failure on the part of the banks to classify them uniformly and make provisions there of.

The contexts of financial statements of banks have been eroded played and window dressed over the years. The objectives of the study is to analyze the operations of the commercial banks in India after their nationalization in 1969. Detailed analysis of operation of banks have been done up to 1986-87.

23) Saritha Sharma (1994) studies the profitability of public sector banks and analyses the cause of growth or decline in profits. The basis is operating profit is thin spread became high cost of deposits and low return on advances.

24) Amithab Bhatra (1994)\textsuperscript{33} made an attempt to analyze the impact of policy constraints on all Indian schedule commercial banks for the period extents between 1955-87, pre and post nationalization periods. She concluded that high labour costs as a consequence of over staffing at various levels in the banks emerges as a major drain on profitability. The exercise of branch expansion has proved to be largely un-remunerative in the rural and semi-urban areas. Directed investments have meant large-scale preemption of bank funds. Declining in credit quality in SCB’s has affected the profitability adversely.

\textsuperscript{32} Manta Pande–“Transparency in financial statements of Commercial Banks”, M.Phil., Delhi University, 1993.

The suggestions given are the high cost of structure of banks weaknesses of regular framework and persistent high physical deficits call conspired to turn finance into a burden rather than a source of competitive advantage for our industry. A set of right policies will do the need full for our financial sector. A reduction in the priority sector credit is essential.

25) Mandhakini Bhatnagar (1995)\textsuperscript{34} – Profitability of Indian Private Sector Banks, Delhi University February 1995. In her Ph.D theses studies the profitability of Indian private sector banks. The objectives of the theses are to study the emerging trends in the profitability of Indian private sector banks and to study the emerging trends in the profitability of Indian private sector banks and to make the comparative study of public sector banks and private sector banks for four years 1989-93.

The findings of the study are the profitability ratios revealed that the big banks like Vysya bank, South Indian banks, Federal bank, Cathoric bank and other smaller banks have given satisfactory performance, external and non-controllable factors not withstanding. Thus the analysis relieved that Indian private sector banks have been performing well inrespect to the quantitative parameters with expect of unsatisfactory results for the spread ratio and non interest expenditure as percentage of working funds. The public sector banks have not fared well despite government support and drastic measures are required for effective recovery. The suggestions given are improve computerization and upgradation of technology in order to serve the customers quickly and promptly, which will improve the reputation of banks their business productivity and efficiency.

26) Kishore C. Raut and Santhosh K. Das (1996)\textsuperscript{35}. The profitability analysis of the four sample bank groups have been undertaken by dividing the twelve year period under study into two distinct phases; the first phase covering the initial six years.

\begin{itemize}
\item \textsuperscript{34} Mandhakini Bhatnagar – “Profitability of Indian Private Sector Banks”, Ph.D. Thesis, Delhi University, February 1995.
\item \textsuperscript{35} Kishore and Santhosh K.Das – “Commercial Banks in India – Profitability, growth and development, Kanishka Publishers and Distributors, New Delhi, 1996.
\end{itemize}
The analysis has been done through an analytical framework as to find out the factors affecting profitability in either direction. This framework splits the income and expenditure statement to find out the relation between different components of income and expenditure and its impact on profitability. It is revealed from the analysis that the fall in establishment expenses and increase in other income ratios resulted in the increase in the profitability. Decline in the spread ratio made a negative contribution towards profitability of commercial banks. Increase in volume of business and increase in non-fund based business of the banking sector have a positive impact on the profitability. Under SBI group depicts that profitability ratio during the second phase went up due to a substantial increase in the spread ratio. Thus increase in the volume of business and spread has positively contributed to augment profitability of this bank group. Nationalized bank group also depicts that increase in the spread and decrease in the establishment expenses leads to increase in profitability.

27) Bank Economists’ Conference 97: The Economists Conference – 97 was hosted by Bank of India, at Bombay. The theme of the conference was ‘Second Phase of Reforms’. The discussions were based on four building blocks, which have formed part of the banking sector reforms. They are:
   a) Modifying policy framework
   b) Improving financial soundness and creditability of banks
   c) Strengthening of the institutional framework

28) Bhide M.G. (1997)36. Indian Banking Second Phase of Reforms: The phase of the reforms in deed has been tried in such a way to insure smooth transition of integrating Indian banks with global markets. He stressed that operational efficiency should reflect in terms of lower transaction costs while doing financial inter mediation and organizational effectiveness in terms of pro-activeness in meeting the merging challenges quickly.

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The first phase of reforms include the financial health of the banking system and progress in quite impressive in creating the necessary base for sound and vibrant banking system.

29) The works of Paul Mampily and Garg are a modest attempt on the cost and profitability of commercial banks in India. These studies provide an analytical view of the trends in the components of cost and earnings of different groups of Indian commercial banks since nationalization. These studies mainly focus on the cost and profitability of banking industry as a whole rather than individual bank. In his study Madhukar explained the reasons the major factors for limiting profitability of all scheduled commercial banks for a period of these years. The study is purely theoretical. He suggested some areas for improving profitability through conscious efforts, careful planning and effective monitoring in the banks.

30) The work of Tiku and Radhakrishnan\(^{37}\) presented the factors responsible for declining profitability over the years. The authors opined that there is a need to identify controllable and non-controllable factors both in income and costs so as to maintain a substantial spread between costs and revenues. They have identified the need for efforts from within banks in the form of cost control and from the government and monetary authorities in the form of a distinction between banks commercial role and their social obligations.

31) Amalesh Benerjee and Singh S.K.\(^ {38}\). Review the performance of commercial banks in pre reforms. They have taken the aspects of banking sector reforms and future agenda, problem of non-performing assets, social objectives and priority sector lending, profitability banks, deposit mobilization and regional spread, management challenge and autonomy.


32) Bank Economists Conference 98: The Bank Economists Conference 98 was hosted by Canara Bank at Bangalore. The theme of the conference was sound as strength of Indian Banking. The sessions were organized on banking sector reforms in India some reflections, towards sound and strong banking – systems and strategies, perspectives and best practices.

33) International conference on banking (1999): The International Conference on banking was held at New Delhi, in 1999 organized by Indian Bank Association. The conference was held on the theme of Managing Global Banking and lessons for India. The sub themes are Trends in international banking, trends in regulation and supervision and trends in commercial banking.

34) Chakravorthy P39: the objective of the study is to examine if there is any perceptible difference in the degree of competitiveness among the different bank group between pre and post financial reform periods in the Indian banking system. For the study market share of deposits are taken in SBI and Associates, nationalize banks, Public Sector banks, RRBs etc. The findings are there is lesser change in degree of competitiveness in case of SBI and Associates and that the other bank groups are facing more competition in the market.

35) G.S.Monga and R.K.Sinha (2000)40 have discussed issues on development of banking financial sectors reforms and banking. The book is the collection of different articles on financial sector reforms and banking.

36) Bank Economists Conference 200041: Bank Economists Conference 2000 was hosted by Oriental Bank of Commerce, at New Delhi, on January 2001. The theme of the conference was banking in the New Millennium. The topics covered in the conference were information technology, profitability in banks, banking research in India.

39 Chakravorthy, P-“Competition in Indian bankingpre and post reform period”. Bank Economists Conference 1996.
41 Bank Economists Conference’ 97 – It was held in at Union Bank of India Bombay on second phase of reforms.
37) Ranjana Kumar (2001)⁴²: NPA management for better banking. She discussed causative for loan accounts turning NPA’s subsequent development in present scenario, major hurdles in NPA recovery monitoring and control of NPA’s. The success of NPA management depending upon the factors like monitoring of assets on an on going with intelligence, building a sound and reliable information base through networking, proper controls and mechanism per feedback analysis for corrective action.

38) Rangarajan C⁴³: In the banking industry technology is finding its use in five key areas viz., convenience in product delivery and access, managing productivity and performance, product design, adapting to market and customer needs and access to customer market.

39) Guru Murthy N⁴⁴: has given the history of ATMs and has given International Scene and Indian scene of ATMs. He has explained functions discharged by ATM both cash transactions and non – cash transactions.

40) Srinivas Y. Thakur ⁴⁵: Banks cannot depend on the interest spread any longer for safe guarding their profits. High level of lending rate may be the reason why there is precision in a credit of take by the corporate clients. It is also felt that the continuous high rates will not stand a national economy in good stead and would particularly weaken competitive capacity of Indian products in International markets. High lending rates might also increase the incidence of NPAs and impair banks profitability in the final analysis.

Objectives of the study:

The main objective of this research study is to see how far public sector banks in general and State Bank of Hyderabad and Andhra Bank in particular have adopted the recommendations of the Narasimham Committee, and whether their performance is up to the expectations of the Committee. In other words, this study aims at evaluating the performance of Andhra Bank and State bank of Hyderabad in the post – reform period and to assess how far these banks have been successful in achieving the parameters set by the committee. The specific objectives of the study are as follows:

1. To examine the banking sector reforms in India and performance of commercial banks and challenges before commercial banks in the light of the reforms.
2. To examine the profile of Andhra Bank and State Bank of Hyderabad.
5. To examine the impact of Reforms on Profitability of State Bank of Hyderabad and Andhra bank.
6. To move suggestions in the light of the conclusions emerging out of the study for further improvement of the Andhra Bank and State Bank of Hyderabad and to highlight the potential areas of profitability and betterment.

Source of data:

The proposed research study is primarily based upon the Second data has been collected from the Annual Reports of State Bank of Hyderabad and Andhra Bank, Report on trends and Progress on Banking in India, Basic Statistical Returns of Scheduled Commercial Banks published by Reserve Bank of India and IBA Bulletins etc.

Study Period:

For the purpose of analyzing the performance as well as the profitability position of the select banks a period of 10 years from 2003 – 2004 to 2012 – 2013 has been selected.
Public Sector Banks selected for the Study: Since Nationalised Banks and State bank of India and its Associate Banks are two categories of Public Sector Banks; one from each section have been selected for the study. State Bank of Hyderabad from SBI and its Associates category and Andhra bank from Nationalised Banks Category have been chosen for the present study.

Research Methodology: Keeping in view, the need and objectives of the study, the relevant data has been collected from the official records of the public sector banks and also by way of conducting personal interviews. The data has been tabulated and analysed with the help of various statistical tools. An attempt has been made to present and analyse the banking sector reforms and their impact on profitability of select public sector banks, by taking State bank of Hyderabad and Andhra bank as select public sector banks. The relevant conclusions have been drawn and useful suggestions have been offered to improve the operational, financial performance and profitability of select public sector banks.

Tools and techniques of Data Analysis: The various statistical tools viz., Growth rate, Growth index and percentages etc., are used for analysis of study. Growth rate = (((b-c)/b)X100) Where b = Figure of immediate previous year c = Figure of current year In some cases growth index is calculated using the following formula Growth index = (((b-c)/b x 100) Where b = Base year data c = Current year data
The following formula are also used to analyse the data:

1. Net profit as percentage of Total Assets
   \[
   \text{Net Profit} = \frac{\text{Net Profit}}{\text{Total Assets}} \times 100
   \]

2. Interest income as percentage of total assets
   \[
   \text{Interest income} = \frac{\text{Interest income}}{\text{Total Assets}} \times 100
   \]

3. Interest expended as percentage of total assets
   \[
   \text{Interest expenditure} = \frac{\text{Interest expenditure}}{\text{Total Assets}} \times 100
   \]

4. Interest income as percentage of working funds.
   \[
   \text{Interest income} = \frac{\text{Interest income}}{\text{Working funds}} \times 100
   \]

5. Spread as percentage of total assets
   \[
   \text{Spread} = \frac{\text{Spread}}{\text{Total Assets}} \times 100
   \]

6. Spread to working funds
   \[
   \text{Spread} = \frac{\text{Spread}}{\text{Working Funds}} \times 100
   \]

7. Gross profit as percentage of total assets
   \[
   \text{Gross profit} = \frac{\text{Gross profit}}{\text{Total Assets}} \times 100
   \]

8. Operating profit as percentage of working funds
   \[
   \text{Net profit} = \frac{\text{Net profit}}{\text{Working Funds}} \times 100
   \]
9. Credit deposit ratio = \frac{\text{Total deposits}}{\text{Total credit}} \times 100

10. Non – interest income to total income = \frac{\text{Non – interest income}}{\text{Total income}} \times 100

**Chapterisation of the Study:**

The present study entitled “Impact of Banking Sector Reforms on Profitability of Banks – A Study on Select Public Sector Banks” is presented in seven chapters.

**CHAPTER – I**  INTRODUCTION, REVIEW OF LITERATURE AND RESEARCH METHODOLOGY

**CHAPTER – II**  BANKING SECTOR REFORMS IN INDIA

**CHAPTER – III**  PROFILE OF THE SELECT PUBLIC SECTOR BANKS

**CHAPTER – IV**  OPERATIONAL PERFORMANCE OF SELECT PUBLIC SECTOR BANKS

**CHAPTER – V**  FINANCIAL PERFORMANCE OF SELECT PUBLIC SECTOR BANKS

**CHAPTER – VI**  IMPACT OF REFORMS ON PROFITABILITY OF SELECT PUBLIC SECTOR BANKS

**CHAPTER – VII**  CONCLUSIONS AND SUGGESTIONS
Limitations of the Study

Although all efforts have been made to make the study systematic, objective and reliable it suffers from the following limitations:

1. The study belongs to ten years only.
2. The data for the present analysis is primarily drawn from the secondary sources, viz., Annual Report of the Banks, RBI Reports and IBA Bulletins.
3. The conclusions drawn basing on the quantitative figure made available though published reports may not reveal the clear picture about the performance of the banking industry, especially in respect of the achievements of the social objectives laid down before them.