CHAPTER- 1

Introduction

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Introduction

1.1 Introduction

Banks were considered as a backbone to the financial system and play an important role in economic development of a nation. They act as intermediaries in channelizing funds from surplus units to deficit units to the fully utilization of the funds. An efficient banking system of nations has significant positive externalities which increase the efficiency of economic transaction in general. There is a major shift in banking system in the policy atmosphere after the introduction of financial sector reform in 1992; these reforms impact the working of commercial banks. As one of the objectives of financial sector reform was to improve the efficiency of banking system in India economy.

The financial system's contributes to the economy depends upon the quantity and quality of its service and efficiency with which it provides them. Financial System of any country consists of financial markets, financial intermediation and financial instruments or financial products. The term "finance" in our simple understanding it is perceived as equivalent to 'Money'. The word "system", in the term "financial system", implies a set of complex and closely connected or interlined institutions, agents, practices, markets, transactions, claims, and liabilities in the economy. The financial system is concerned about money, credit, and finance-the three terms are intimately related yet are somewhat different from each other. Indian financial system consists of financial market, financial instruments, and financial intermediation.

A Financial Market can be defined as the market in which financial assets are created or transferred. As against a real transaction that involves exchange of money for real goods or services, a financial transaction involves creation or transfer of a financial asset. It consist of market for government securities, corporate securities, foreign exchange, derivates, short term finance or money
market and capital market etc. Market for different types of financial instruments may be organized like stock exchange with centralized trading or informally as the over-the counter market. Financial Assets or Financial Instruments represents a claim to the payment of a sum of money sometime in the future and or periodic payment in the form of interest or dividend.

A financial system provides services that are essential in a modern economy. The use of a stable, widely accepted medium of exchange reduces the costs of transactions. It facilitates trade and, therefore, specialization in production. Financial assets with attractive yield, liquidity and risk characteristics encourage saving in financial form. By evaluating alternative investments and monitoring the activities of borrowers, financial intermediaries increase the efficiency of resource use. Access to a variety of financial instruments enables an economic agent to pool, price and exchange risks in the markets. Trade, the efficient use of resources, saving and risk taking are the cornerstones of a growing economy. In fact, the country could make this feasible with the active support of the financial system. The financial system has been identified as the most catalyzing agent for growth of the economy, making it one of the key inputs of development.

The Indian financial system is broadly classified into two broad groups:

i) Organized sector and

ii) Unorganized sector.

"The financial system is also divided into users of financial services and providers. Financial institutions sell their services to households, businesses, and government. They are the users of the financial services. The boundaries between these sectors are not always clear-cut. In the case of providers of financial services, although financial systems differ from country to country, there are many similarities.

(i) Central bank
1. Organized Indian Financial System

The organized financial system comprises of an impressive network of banks, other financial and investment institutions and a range of financial instruments, which together function in fairly developed capital and money markets. Short-term funds are mainly provided by the commercial and cooperative banking structure. Nine-tenth of such banking business is managed by twenty-eight leading banks which are in the public sector. In addition to commercial banks, there is the network of cooperative banks and land development banks at state, district, and block levels. With around two-third share in the total assets in the financial system, banks play an important role. Of late, Indian banks have also diversified into areas such as merchant banking, mutual funds, leasing and factoring.

The organized financial system comprises the following sub-systems:

1. Banking system
2. Cooperative system
3. Development Banking system
   (i) Public sector
   (ii) Private sector
4. Money markets and
5. Financial companies/institutions.
Over the years, the structure of financial institutions in India has developed and become broad based. The system has developed in three areas - state, cooperative, and private. Rural and urban areas are well served by the cooperative sector as well as by corporate bodies with national status. There are more than 4,58,782\(^4\) institutions channelizing credit into the various areas of the economy.

2. Unorganized Financial System

On the other hand, the unorganized financial system comprises of relatively less controlled moneylenders, indigenous bankers, lending pawn brokers, landlords, traders etc. This part of the financial system is not directly amenable to control by the Reserve Bank of India (RBI). There are a host of financial companies, investment companies, and chit funds etc., which are also not regulated by the RBI or the government in a systematic manner.

However, they are also governed by rules and regulations and are, therefore within the orbit of the monetary authorities. As the word 'Bank'\(^5\) is an organization for receiving, storing providing money and other financial mechanism to different players within the economy and assisting them in deploying there funds in productive activities. The state of bank in financial sector could be described as a classical example of financial repression, until the beginning of 1990's.

Banking in India is one of the oldest systems that can well be traced to the initial time of development. These activities are normally performed by upper class of the society by storing valuable wealth in so-called secured places like temples & palaces\(^6\). Though these activities of banking system emerge, that time when no currency were available and only barter system prevails\(^7\). This period can well be termed as the initiation of banking system as we see in today's world, Banking in India originated in the last decades of 18 century. The first bank was the General Bank of India which started in 1786, The Bank of Hindustan, both of which are now defunct. The oldest bank in existence in India is the state Bank
India which originated in the Bank of Calcutta in June 1806 which almost immediately became the Bank of Bengal. This was one of the presidency banks, the other two being the Bank of Bombay and Bank of Madras. All three of which were established under charter from the British East India Company. For many years the Presidency banks acts as a quasi-central banks as did their successors. The three banks merged in 1921 to form the imperial bank of India, which, upon India’s independence, became state Bank of India.

India’s independence marked the end of a regime of laissez faire for the Indian banking. The government of India (GOI) initiated measures to play an active role in the economic eye of the nation, and the Industrial Policy Resolution adopted by the government in 1948 envisaged a mixed economy. Despite these provisions, control and regulations, banks in India except the State Bank of India continued to be owned and operated by private persons. This all changed with the nationalization of major banks in India on 19 July 1967. Additionally there was perception that banks should play a more prominent role in India’s development strategy by mobilizing resources for financial sector that were seen as crucial for economic expansion. As consequences in 1967 the policy of social control over banks was announced. Its own was to cause changes in the management and distribution of credit by commercial bank. Following the nationalization Act 1969, 14 largest public sector banks were nationalized which raised the Public Sector Bank’s (PSB) share of deposits from 31 per cent to 86 per cent. The two main objectives of the nationalization were rapid branch expansion and channeling of credit in line with priorities of the year plan to achieve these goals the newly nationalized bank received quantitative target for the expansion of branch network and for the percentage of credit they had to extend to certain sector and groups in the economy, known as priority s sector, which initially stood 33 per cent. Six more banks were nationalized in 1980 which raised the public sector’s share of deposits to 92 per cent. The second wave of nationalization occurred because of control over the banking system which increasingly more important as a means to ensure priority sector lending to reach the poor through a branch expansion network and to raising public deposit.
In addition to the nationalization of banks, the priority sector lending target were raised to 40 per cent\(^\text{12}\), however, the policies that were supposed to promote a more equal distribution of funds, also led to inefficiencies in the Indian Banking system. To alleviate this negative effect, first wave of liberalization started in the second Half of 1980. The main policy changes were the introduction of treasury bills, creation of money market, and a partial deregulation of interest rates\(^\text{13}\). Besides the establishment of priority sector credit and nationalization of banks the government took further control over bank fund by raising the statutory liquidity Ratio (SLR) and cash Reserve Ratio (CRR). From a level of 2 per cent for the CRR and 25 percent for the SLR in 1960 both witnessed a steep increase until 1991 to 15 percent and 38.6 per cent respectively\(^\text{14}\). India's banking system was an integral part of government spending policies. Through the directed credit rules and statutory pre-emption it was captive sources of funds for the fixed deficits and key industries, through the CRR and the SLR more than 50 percent of saving had either to be deposited with the RBI or used to buy government securities out of the remaining saving 40 percent had to directed to the priority sector that were defined by the government. Besides these restrictions on the use of funds, government had also control over the price of the fund i.e. interest rates on the saving and banks\(^\text{15}\). Earlier banking system was there in the big cities such as Bombay & Madras. There a were few banks such as Bank of Allahabad, National Bank, Oudh Commercial Bank and Canara Bank, Most of them stopped their operation today, while some of them still serving under public sector. Most of the banks during British period have functioned as private or family owned while following the strict guidelines followed by the government, that this practice of family or privately owned banks, Continued for quite few years after 1947 with continuous increase of supervision by the government\(^\text{16}\).

Due to many banks failures and crises over two centuries, and the damage they did under laissez faire conditions; the needs of planned growth and equitable distribution of credit was necessary where privately owned banks was concentrated mainly on the controlling industrial houses and influential borrowers; the needs of growing small scale industry and farming regarding
finance, equipment and inputs; from all these there emerged an inexorable demand for banking legislation, some government control and a central banking authority, adding up, in the final analysis, to social control and nationalization\textsuperscript{17}. Before the liberalization in 1991, there was a little effective competition in the Indian Banking system for at least two reasons, first details prescriptions of RBI concerning. Second, India had strict entry restrictions for new bank, which are the main integrants of competition\textsuperscript{18}, this 1991, New Economic policy brings the spirit of competition among Indian banks with the new players of foreign banks. It has undergone a major structural transformation after the nationalization of 14 banks in 1969. During the last four decades of nationalization, there has been phenomenal expansion of branch network, particularly in the hitherto under banked rural areas. Besides a massive qualitative change in the operation of banking system, our banks have been called upon to assume a great variety of new responsibilities in the area of social banking for which there are precedent or guidelines in the history of modern banking anywhere in the world\textsuperscript{19}. However, the journey has not along been even and smooth. There have been hurdles and impediments, stress and strains but the dynamic fashion in which the banking industry has taken them in its ride and surged ahead only demonstrates its resilience and inherent potentialities as catalytic agent for social economic development\textsuperscript{20} as seven new banks entered the market between 1994-2000. In addition, over 20 foreign banks started operations in India since 1994. By March 2004, the new private sector and foreign banks had a combined share of utmost 20 per cent of total assets\textsuperscript{21}. This benefit the Indian banking sector attained through requirement and setting up a by deregulating entry of new bank operations from improved technology, specialized skills, better risk management practices and greater portfolio diversification\textsuperscript{22}. As Indian banking system has undergone significant structural transformation since the 1991 through this entry of foreign banks became more liberal given in line recommendation of Report of the committee on financial system. ".......freedom of entry into the financial system should be liberalized and Reserve Bank of India should now permit the establishment of new banks in the private sector, provided they conform to the
minimum startup capital and other requirement and set of prudential norms with regard to accounting, provisioning and other aspect of operation\textsuperscript{23}. Another step is taken by government of India in 1998, through another committee. This committee is also chaired by Shri M. Narasimham, pointed in 1998 to review the records of implementation of in financial system reform and to take forward step and start the reform necessary in year at ahead it is observed under committee that one of the most significant measures instituted since 1991 has been the permission for new private banks to be set up, and the more liberal approach towards foreign banks offices bang opened in India. These steps have enhanced the competitive framework for banking system in India, as the new private and foreign banks have higher productivity level based on newer technology and lower level of operating\textsuperscript{24}.

This period ownership in public sector banks were so diversified with the flexible entry norms for private and foreign banks, this changes the scenario of competitions in the banking industry. Competition is itself the sign of progress, this importance is also recognized by Reserve Bank when it observed that competition is sought to foster by permitting new private sector banks, and moiré liberal entry of branches of foreign bank, competition is sought to be fostered in process of autonomy and thus some response to rural and semi urban area also by encouraging Local Area Banks. Some competitive diversification of ownership in selected public sector banks has helped the pressures\textsuperscript{25}.

The competition induced by the new private sector banks has clearly re-energized the Indian banking sector as a whole; new technology is now the norm, new product are being introduced continuously, and new business practices have become common place\textsuperscript{26}.

Present study is to evaluate the degree of competition in the banking sector, with special reference to SBI & ICICI Bank in a globalised era.
1.2 Review of Literature

Banking is a prime mover in the economic development of a nation and research is so essential to improve its working results. The management without any right policy is like "building a house on sand". It means an effective management always needs a thorough and continuous search into the nature of the reasons for, and the consequences of organization. In line with this, some related earlier studies conducted by individuals and institutions are reviewed to have an in-depth insight into the problem and exploring the reformation of banking policy. The main theme and essence of few relevant studies are presented below.

Domar and Timmergen (1946)^27, measured the profitability of banks for the economic development purpose and settled the theoretical framework in expanded form which was first introduced by Jorgenson and Nishimizudin for international economic growth comparison and development.

Sharma (1974)^28 said, "The expansion of banking facilities was uneven and lopsided and banks were concentrating their operations in metropolitan cities and towns. A fairly large number of rural and semi urban centre with reasonable potentialities of growth failed to attract the attention of commercial banks. As far as the deposit mobilization in the rural areas is concerned, much remains to be done." This gives emphasis on the rural and semi urban growth of banks.

Gopal Karkal (1977)^29 said, "Some regions have done well in spreading the banking facilities, while some regions have still very backward. Further, our clients are larger merchants and big industrialists. They approach with their demand for larger loans and advances, and in return give large business. If we transfer our limited resources to small industry, agriculture etc., how can we increase our deposits, advances etc., and how can we survive." As it give emphasis on a policy of planned and systematic branch expansion laying stress not only on opening branches in the underdeveloped and neglected areas but also in the providing additional banking facilities to the growing metropolitan and
urban areas to cope with the ever-increasing requirements of trade, industry and commerce is more desirous.

Raghupathy (1977)\textsuperscript{30}, gave his view on the system of banking sector that “if the objectives are not fully achieved, the fault does not lie entirely with the bankers. The fault lies in our, not being able to integrate all powerful instruments of development into an effective system”.

Shah (1977)\textsuperscript{31}, gave his view regarding bank profitability and productivity. He has expressed concern about increased expenses and overheads. Slow growth in productivity and efficiency is due to wasteful work of the banks. He concludes that the higher profitability can be result from increased spread and innovations have a limited role. He favored written job descriptions for improvement of staff productivity. He also emphasized reduction of costs, creation of a team spirit improvement in the management for improving bank profitability and productivity.

V.N. Saxena (1978)\textsuperscript{32}, analysed that “Improvement in the systems and procedures of inspection of stocks, maintenance of stock register is required. Reforms should be initiated in extension of sponsorship schemes, recovery, and consultancy”. This can be supporting tools for banks.

Desai (1978)\textsuperscript{33}, conducted a study entitled “Measuring Staff Productivity in Bank - A New Approach” in 1981, covering a regional office of a premier bank having 155 branches in the region. Primary objective of the study was to detect and correct staffing imbalances. The study emphasized on providing for the management of productivity related staff development technique. He followed it up with another study of Patna Circle of the bank having 607 branches, in 1982. The main objective again was to provide management with the productivity-based technique for rational manpower development. It identified ‘Labour-Intensive and Less Labour-Intensive’ banking sector and identified pockets of staffing imbalances. He felt that a services industry like banking with wide variations in work mix, a universally applicable and fully scientific formula is difficult to involve in any area of management.
Divatia and Venkatachalam (1978), in their study of operational efficiency and performance. They recognized the problems in creating such a composite index, some of which will be due to understanding of the term: operational efficiency. This study divided the chosen indicators into operational efficiency in terms of productivity, operational efficiency in terms of social objectives, and profitability. The approach was taking to the approach profitability of banks proposed to create a composite index that would explore certain indicators that would suitably represent varied aspects of banks of PEP Committee.

Kulkarni (1979), examined his study on developmental responsibility and profitability of banks stated that while considering banks costs and profits-social benefits arising out of bank operations cannot be ignored. He claimed that profit maximization approach is out of place while referring to profitability of banks. He recognized that while fulfilling the social responsibility, banks should try to make the developing business as successful as possible, to reduce costs, improve banking system and increase the overall productivity.

Venkatachalam (1979), give the reasons for erosion in bank profits and profitability in recent years. This study is purely based on published figures. They argued that there is a trade-off between social obligations to be performed by the banks and increasing profits.

Mumupilly (1980), examined the cost and profitability of commercial banks in India. The study provides an analytical view of the trends in the components of cost of earnings of different groups of Indians commercial banks since nationalization. The study mainly focuses on the cost and profitability of banking industry as whole rather than individual banks.

K.S. Krishnaswamy (1980), Chairman of the Working Group appointed by Reserve Bank of India in his report on the ‘Role of Banks in Priority Sector Lending and the 20-Point Economic Programme’ has suggested modifications in the definition of priority sector lending. It also recommended that the private
sector commercial banks should actively participate in extending assistance under the priority sector and the 20-Point Economic Programme.

Srivastava (1981)\textsuperscript{39}, advocated the use of work measurement principle in banking to test the efficiency by using these concepts in a simple manner. He identified other uses of work measurement, as to adjust current staffing levels, projecting future staffing levels, justifying overtime, determining unit cost and pricing of services, budgeting staff expenses, comparing employee or branch performance, etc. However, practical utility of the application of work measurement concept in banking is questionable.

Subrahmanyam (1982)\textsuperscript{40}, has discussed conceptual issues in productivity measurement approach to inter-bank and inter-temporal productivity comparisons. He has highlighted some of the conceptual issues that are faced in the Total Factor Productivity (TFP) measurement associated with neutral technical progress. Out of a non-parametric index number approach and a parametric production function approach, he confined to economic implications of non-parametric approach. He has examined particularly, the mechanics of Laspeyres and Divisia index number procedures; their affinity to linear and homogenous translong production functions and preferred Divisia index over Laspeyres index. Limitation of Divisia index and index number approach has also been pointed out. He felt that production function approach may be more advantageous as it can handle problems arising due to non-separability of inputs and outputs non-constant return to scales etc. In his paper concentrating on methodological issues involved in the measurement and comparison of productivity levels in commercial banks at the aggregate level, has discussed the use of Kendrick, Solow,

Karkal (1982)\textsuperscript{41}, viewed the concept of profit and profitability the factors that the volume or areas of profit and the techniques used in profit planning. He has suggested some measures to improve the profitability in banks through increasing the margin between lending (advances) and borrowing (deposits) rates, improving the efficiency of staff, and implementation of a uniform maximum
service charge. The study did not touch up the area of cost of banking services, and costing exercises in the banking industry.

Nayan, K. (1982)**, conducted study on the performance evaluation of commercial banks and presented a performance evaluation model on the basis of important quantifiable parameters of performance. The main conclusion were: a) the present system of ranking the banks on the basis of aggregate deposits failed to reflect their overall achievements, b) the existing system of performance budgeting is not suitable at branch level and c) on the basis of all the important and quantifiable parameters of performance. An integrated performance index needs to be developed for evaluating the performance of commercial banks.

Angadi and Devraj (1983)**, study is mainly based on published financial statements instead of their break-up. The authors observed that besides the social responsibilities discharged by the public sector bank, deficiencies, ineffective mobilization of funds at lower costs; attractive retail banking, augmenting earnings from other sources; effective cash and portfolio management have contributed to declaration in productivity and profitability of banks.

Amandeep (1983)**, examined the various factors that affect the profitability of commercial banks with the help of multiple regression analysis. The author has tried to determine the share of each factor that determines the profitability of commercial banks. The trend analysis, ratio analysis, multiple regression analysis has been effectively used to know the profitability of commercial banks. The study is methodologically very sound but the coverage is too small.

Birla Institute of Scientific Research (1983)**, conducted a study to evaluate the performance of nationalized banks in comparison with that of banks in private sector. The emphasis of the study was on the objectives of nationalization and their achievements, relative performance of private sector banks and nationalized banks since 1969 and the effect of nationalization on rest of the banking sector. The study reveals that the growth and development in banking after
nationalization was not just because of transfer of ownership. It was rather because of various incentives and punitive measures that were implemented with more vigilance and care after 1969 by the government and the Reserve Bank of India to make banks fulfill their social responsibilities. Similarly, in the same sphere, even better results were achieved by non-nationalized banks. The performance of private sector banks in the Post-nationalization period was noteworthy, especially because of the odds they faced in securing the growth of the business. The achievement of significantly high growth in deposits, advances, and branches etc. clearly showed the high quality of entrepreneurship and management of these banks.

Verghese (1983)\textsuperscript{46}, explores the profits and profitability of Indian commercial banks in the Seventies. It is a comprehensive study on bank’s profitability. It provides a useful analysis of the income statements of commercial banks during 1970-1979, but some of the concepts used have a limited applicability.

Banker, Charnes and Cooper (1984)\textsuperscript{47}, take into account the effects of returns to scale within the group of DMUs to be analyzed. The purpose here is to point the most efficient scale size for each DMU and at the same time to identify its technical efficiency. To do so, the Banker, Charnes and Cooper (BCC) model introduces another restriction, convexity, to the envelopment requirements. This model requires that the reference point on the production function of DMUs will be a convex combination of the observed efficient DMUs. The BCC model, known as variable returns to scale model, gives the technical efficiency of DMUs under investigation without any scale effect. It is possible to create and estimate models that provide input-oriented or output-oriented projection for both CCR (constant returns to scale) and BCC (variable returns to scale) envelopment. An input-oriented model attempts to maximize the proportional decrease in input variables while remaining within the envelopment space. On the other hand, an output-oriented model maximizes the proportional increase in the output variables, while remaining within the envelopment space.
Humphrey (1985) made a useful distinction between the 'production' approach and the 'intermediation' approach to bank behavior. The production approach views banks as legal estate loans, and installment loans, using capital, labour, and materials to do so. In this case, the number of accounts and loans outstanding provide the appropriate measures of bank output, and total costs include all operating costs incurred in the production of the five outputs. The intermediation approach treats banks as collectors of funds, which are then 'intermediated' into loans and other assets. The dollar volume of deposit accounts and loans is the appropriate measure of bank output under this treatment, and operating costs and interest costs provide the appropriate measure of total cost. Which approach one chooses to adopt depends upon what issues one is attempting to resolve. The production approach is appropriate for studying the cost efficiency of banks since it concerns just the operating costs of banking. The intermediation approach is concerned with the overall costs of banking and is appropriate for addressing questions concerning the economic viability of banks.

Chakrabarty (1986), made a modest attempt to assess empirically the relative performance of each bank in the context of three variables viz, profit, earnings and expenses. In his study, Herfindahl index has been computed to measure the inequality in the sharing of profits, net profits, earnings and expenses by each group of bank. The author has suggested that each scheduled commercial bank should take up some exercise to evaluate the relative performance of each office of the particular bank for profit planning.

Joshi (1986), has examined the various reasons for declining trends in profitability. His study is based on published data. He has suggested profits planning both at micro and macro levels for the banking industry to overcome the declining trends in profitability.

Gupta and Goswami (1986), in their study introduced some radical change in measurement of profitability of commercial banks. They indicated the major cause for declining profitability as the enormous increase in establishment costs. They pointed out that the conventional indications are based on published profits,
which do not reflect the true position. They, therefore, suggested an alternative measure that is based on the cost of mobilizing business, other things being equal elasticity of establishment costs (per unit of business) with respect of staff strength may be used to compare the operational efficiency (and thereby profitability) of different banks.

Godse (1987), in his essay, “Looking Afresh At Banking Productivity” observes that productivity aspect is only at the conceptualization stage in the banking industry. He suggests improvement in productivity through manpower aspects, system and procedures, costing of operations, capital expenditures etc., looking into the future he observed that continued thrust on branch expansion in rural and semi-urban areas at unbanked centres and backward districts could result in a change in the concept of profit as a corporate objective and as the indicator of productivity. All branches may not reach breakeven and a reduction in operational deficit can be a measure of productivity. Godse suggested indicators of productivity that may be used at various levels of management in bank. He further made certain suggestions regarding improvement of productivity. He expressed the view that for preparing banking industry to face the environmental changes including changes in work technology in a systematic manner, an integrated multi-disciplinary and total planning effort is necessary.

Jayanti Lal Jam stated (1987), “The credit deposit ratio in Haryana (69 Per cent), Tamilnadu (76 per cent), and Andhra Pradesh (71 Per cent) is high. And every bank has some states where credit deposit ratio is very high say 90 per cent and the other States where it may be 20. Thus, inter-regional imbalances are quite significant in the deployment of resources mobilized by the banks in spite of massive branch network and multiplicity of banks”.

Balakrishna (1987), gave his view on regional banking disparities. He observed that “disparities cannot be eliminated completely because of differences in topography, population, agricultural development, etc. If commercial banks maintain their tempo in future years also, then these disparities can further be eliminated to a great extent”.

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Ojha (1987)\textsuperscript{55}, in his paper made an international comparison of productivity and profitability of public sector banks of India making comparison on the basis of per employee indicators and taking the example of State Bank of India Group and Punjab National Bank noted that Indian banks are the lowest on all the accounts. However, such an international comparison will not be fair for number of reasons. He also made an inter-bank/inter-country comparison by relating per capita assets in terms of per capita income of the country concerned. However he was not satisfied with the results. Analyzing the productivity of public sector banks he observed that there has been substantial growth in productivity per employee since 1969, calculated at current prices. Analysis indicated an unsatisfactory position in the case of Regional Rural Banks (RRB) and relatively lower productivity in the private sector banks.

Satyamurty (1988)\textsuperscript{56}, stressed the imperative need for improving efficiency, productivity and customer service in banks to help them in accelerating their consolidation process. He suggested the action points that may be paid attention. Satyamurty clarified the concepts of profits, profitability and productivity applicable to the banking industry. It is agreed by the bank managements that the pressure on the profitability is more due to the factors beyond their control. He has suggested the technique of ratio analysis to evaluate the profit and profitability performance of banks. He is of the opinion that endeavors should be made to improve the spread performance through better funds management. In another paper, he has made an attempt to bring out the factors generally affecting efficiency and productivity. It recognized that business per employee and relation of average business to establishment expenses are the most popular indicators of productivity. However, it was favoured a disaggregated approach for measuring the efficiency and productivity of banks. It was favoured that the performance of a bank could be assessed in the different areas of business development at a disaggregated level in terms of profitability, income generated, costs involved and customer services. The level of desegregation may be decided in the light of guidelines of RBI and government of India from time to time.
Subrata Sarkar (1988)\textsuperscript{57}, analysed that “Present day corporate customers value efficiency highly rather than old connections and acquaintances. A well equipped and modern bank which functions smoothly and efficiently would be the first choice of a corporate customer. The bank should create an image of efficiency so as to attract good corporate customers”.

S. Chandran (1989)\textsuperscript{58}, narrated that “Legal action should not be the inevitable last step in the process, branches should be educated to evaluate this option for recovery, like any other option, objectively before launching the same. Building up an information infrastructure at the apex level first and at the lower tiers subsequently should be initiated”.

Ajay Maindiratta (1989)\textsuperscript{59}, in his paper, analysis DEA, which evaluates input savings that could have been affected by a decision-making unit, given its observed task, to inquire into whether even greater savings would be possible if the task were to be optionally apportioned to a number of smaller units. The notion of size efficiency is introduced to measure this potential for further input reductions, and then compared and contrasted to the extent notion of scale efficiency. The existence of a largest radically size-efficient output scale is established as a ray property of the production frontier.

Singh (1990)\textsuperscript{60}, has studied the productivity in the Indian Banking Industry. He has studied Intra-bank, Inter-Bank groups and inter-bank groups productivity of public sector banks and SBI group. He has analyzed branch productivity, per-employee productivity, and financial parameters at constant prices. But his study does not consider nationalized banks and causes of varying productivity in banks.

Related to the branch expansion policy, Satya Sundaram (1991)\textsuperscript{61} stated that, “there are still wide disparities in spread of banking facilities regionally. The lead bank surveys at the district level have identified a number of unbanked rural centers which have potentials for opening branch office”.

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Swami and Subrahmanyam (1993)$^{62}$, emphasised on “Profitability within Public sector banks. The study made an attempt to set benchmarks for laggards of public sector banks in terms of performance”.

Amita Batra (1996)$^{63}$, examined the impact of policy Constraints on the profitability of Indian scheduled commercial banks for the period 1955-87. The profit function approach has been used in the analysis. Previous bank profitability studies have been, in several ways, limited and confined in their scope of enquiry to questions of either ‘operational’ or ‘technical’ efficiency. The study provides a comparative view on pre- and post-nationalization periods of Indian banking. It indicates the importance of loans and advances in the bank asset portfolio as also of policy variables like SLR, CRR and branch expansion in explaining bank profitability.

Mannur (1996)$^{64}$, stated that ‘there was no further need for any policy of branch expansion; and the expansion of branches should be primarily an internally management decision on their assessment of the commercial prospects”.

Murty (1996)$^{65}$, has analyzed various factors that can be helpful to improve the profitability of public sector banks. The study examines the impact of monetary policy and market interest rates on the bank profitability and also suggests various measures to improve the profitability of the public sector banks in India.

Ramappa’s (1996)$^{66}$, argued, “there is nothing inherently non-viable about banking in rural areas. Inadequate management competence in individual bank is a major cause of the non-viability of rural branches of many public sector banks.” The biggest ever-challenge that the banking industry now faces is the phenomenon non-performing assets. However, there is nothing to lose hope about it.

Sarker and Das (1997)$^{67}$, compared performance public, private and foreign banks for the year 1994-95 by using measures of profitability, productivity and financial management. They found that Public Sector Banks compare poorly with
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the other two categories. However, they caution that no firm inference can be derived from a comparison done for a single year.

Abhiman Das (1997), stated that “State bank group is more efficient that the nationalized banks. The main source of inefficient was technical in nature, rather than allocative inefficiency in public sector banks is due to under utilization or wasting of resources rather than incorrect input combination. Public sector banks improved +their allocative efficiency significantly in the post liberalization period”.

Ammanayya (1997), analysis that branch rationalization is more relevant is the context of achieving balanced development; and freedom will be given to the commercial banks in re-locating branches and opening of specialized branches. As per the new policy, “Commercial banks have opened NRI branches, recovery branches, small scale industries branches, professional branches, agricultural finance branches, personal banking branches and so on.

Bhattacharya (1997), analysed the impact of the limited liberalization initiated before the deregulation of the nineties on the performance of the different categories of banks, using Data Envelopment analysis. Their study covered 70 banks in the period 1986-91. They constructed one grand frontier for the entire period and measured technical efficiency of banks under study. Under their study they found public sector banks had the highest efficiency.

Das (1997), compares performance among public sector banks for three years in the post-reform period, 1992, 1995 and 1998. He analysed a certain convergence in performance. He also find that while there is a welcome increase in emphasis on non-interest income, banks have tended to show risk-averse behaviour by opting for risk-free investments over risky loans”.

P.B. Kulkarni (1998), “Nationalization of banks in 1969, no doubt produced a number of desired results but it also created a number of weaknesses and problem’s for the banks and within the system as a whole. They are: (i) deterioration in customer service (ii) development of a culture to please people who mattered for one’s career (iii) publishing of ‘no fair view’ balance sheets to
avoid the stigma of showing losses and (iv) lack of transparency in overall operations”.

N.K. Thingalaya (1998)\textsuperscript{73}, “One major change observed in recent years is the process of de-regulation of the interest rate structure by the Reserve Bank of India. This is certainly a welcome step in improving the competitive efficiency of banks”.

Tapora (1998)\textsuperscript{74}, with great foresight said that “Nationalisation is not the best means of achieving a national institution”.

Rajendra Kumar Jam (1999)\textsuperscript{75}, “The Government must get down to planning a phased programme to remove the burden of non-performing assets from the banking sector. This would not only increase the liquidity of the banks but will also result in a more effective, albeit, slightly, costlier, credit delivery system to the priority sector”.

The Verma Committee (1999)\textsuperscript{76}, identified weak banks, strong banks and potential weak banks based on the study of seven financial performance parameters. These parameters include capital adequacy ratio, coverage ratio, return to assets, net interest margin, operating profits to average working funds, cost to income, and staff cost to net interest income plus other income. Accordingly, UCO Bank, United Bank of India and Indian Bank were identified as weak banks in whose case none of the seven parameters were met. As against this, Oriented Bank of commerce and State Bank of Patiala were identified as strong banks because they satisfied all the parameters. But in respect of six banks, viz. Allahabad Bank, Central Bank of India, Indian Overseas Bank, Punjab and Sind Bank, Union Bank of India and Vijay Bank, most of the parameters i.e. five or six of the total seven parameters were not fulfilled. Hence, they were described as potential weak banks. The main weakness of financial ratio analysis adopted by Verma Committee (1999) is that the choice of a few or a single ratio does not provide enough information about the various dimensions of performance. As a result, a bank that is poorly managed on certain dimensions
may appear to be performing well-as long as it compensates in other dimensions. Furthermore, it is a short run analysis that may be inappropriate for describing the actual efficiency of the bank in the long run, since it fails to consider the value of management actions and investment decisions that will affect future performance. Another problem that may arise is the choice of a benchmark against which to compare a univariate or multivariate score from ratio analysis. Also, commonly used performance ratios fail to consider multiple outputs (services and/or transactions) provided with multiple inputs.

Shri M.S. Verma (1999)^77, Chairman, Working Group on Restructuring Weak Public Sector Banks, Constituted by R.B.I. submitted its report in 1999. MS. Verma, suggested many measures which include a major aspect namely weak PSBs should be allowed for Public issue.

Committee(1999)^78, on Technology Upgradation in the Banking sector, Constituted by R.B.I. with Dr. A. Vasudevan, as Chairman submitted report in 1999. The Committee has strongly advised to adopt latest technology in Banking sector.


A.Gnanadoss(2001)^80, highlighted “the branch expansion statistics from 1969 to 1999 with a clear comparison of rural branch expansion with total branch expansion. The study includes comparison of structural deposits and credits of all scheduled commercial banks from 1950 to 2000. He has compared the performance of scheduled commercial banks in priority sector lending during 1990-2000”.

study has listed various organisational, operational and co-ordinational problems in credit support”.

**Kohli (2001)**, emphasized on the importance of technology an issues emerging from this technology. According to him, technology is emerging as a key-driver of business in the financial services industry. The advancement in computing and telecommunications has revolutionized the financial industry and banking on the net is fast catching on. As e-commerce gets transformed into e-commerce with the increasing use of technologies like WAP, banking business is in for a major overhaul.

**Kaveri (2001)**, examine to extend the study conducted by the Verma Committee more specifically to ascertain whether enough signals of weakness were indicated much before the event. The present, study considers 1998-99 as the year of event when the Verma Committee identified weak banks, strong banks and potential weak banks. This study considers nine efficiency parameters that are computed, based on the data collected from the Reserve Bank of India publications. The parameters include; Capital Adequacy Ratio; Net Non-Performance Assets/Net Adequacy; Net Profit/Total Assets; Gross Profit/Working Funds; Net Interest Income/Total Assets; Interest Expended/Total Assets; Intermediation Cost/Total Assets; and Provisions and Contingencies/Total Assets.

**R. Nambirajan (2001)**, in his study compared gross and net Non Performing Assets of all Public sector banks from 1998 to 2000 and could find marginal increase. The study states that corporation bank has lowest NPAs (1.92 per cent) and Indian bank has highest NPAs (16.18%).

**Anuradha (2001)**, stated that “the need for the change of Indian banks and the forces behind the change like globalization, liberalization, international trade, 11 revolution etc., The study also highlights various consequences that are to be faced by the Indian banks if they remain unchanged”.

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Shri S.R. Mittal (2001)^86, Chairman of Committee on Internet Banking, Constituted by R.B.I. strongly urged to use the fast growing Internet medium in banking transactions. The Government of India set up a nine-member committee under the chairmanship of Narasimham, former Governor of Reserve Bank of India. He is to examine the structure and functioning of the existing financial system of India and suggest financial sector reforms. The report of the committee was tabled in the Parliament on December 17, 1991. The Finance Ministry of Govt. of India appointed once again a committee under the chairmanship of Sri M. Narasimhan to recommend reforms for Indian banking sector. Reviewing the developments that have taken place during the period 1991-98, the committee made recommendations for reforming the banking sector. The Report was submitted in April 1998.

Chowdary Prasad (2002)^87, compared the 1991 economic reforms of India with that of China that took place in 1998. He has stated "Reforms in India have just been a decade old but there have been numerous changes in political set up, industrialization policies, legal reforms, privatization, etc.,"

Indira Rajaraman, Garima Vashishta’s (2002)^88, study “highlights gross and net NPAs of commercial banks from 1996 to 2000. The study tries to identify the relation between Non-Performing Assets and operating efficiency”.

B. Janki (2002)^89, pointed the effect of technology on labor productivity. There is no doubt that banking needs to upgrade technology to improve operating efficiency, and customer services. The study concludes that harnessing employee technology synergy is crucial for unleashing productivity and reaching out to the huge base of retail customers, who are also dispersed in rural and semi-urban areas. Banks can use technology to address customer needs and improve their interaction with customers, keeping in touch through telephone and the Internet. The study predicts that focus on technology will increase like never before to add value to customer service, develop new products, strengthen risk management, asset liability management and improve profitability. But it cautions that technology is only an enabling tool and whether banks actually achieve what
they want to achieve will be determined by the drive and motivation of their work force and response of the staff.

R. Prasad (2002)\textsuperscript{90}, Stated that "Due to the negligence of customers most of the frauds occur. Master card has lost huge amount during 2001-2002 financial year. In India credit card are much higher than that of the entire world".

Rao (2002)\textsuperscript{91}, has analyzed the impact of new technology on banking sector. The advent of technology in terms of both computers and communications has been changing totally the ways and doing of banking business. Technology has opened new vistas and in turn brought new possibilities every day for doing the same work differently and in a most cost-effective manner. Tele banking and Internet banking are making forays such that branch banking may give way to home banking. In order to protect their profitability, the banks need to address urgently the following emerging areas: Product development and marketing skills; Modern credit management skills; new risk management practices; Skills for operating in electronic environment. New internal audit skills in a changing business environment and New focus on customer and his needs.

Kasthuri Nageswara Rao (2002)\textsuperscript{92}, Stated that "Out the six distress zone banks identified by Verma Committee, Vijaya Bank, Indian Overseas Bank and Union Bank of India have gone public and now Indian Overseas Bank still has an adverse coverage ratio. The remaining two banks are in comfortable Position".

K. Shiva Kumar and V. Samyoudha (2002)\textsuperscript{93}, study includes "the ratings given by the respondents in a sample stuffy for various services namely customer responses towards counter services, passbook services, cheque services, demand draft services, depository services, etc. The study states that customers are highly satisfied with the services that are provided by private sector banks when compared with sector and co-operative banks".

M.G. Bhide, A. Prasad, Saibal Ghosh’s (2002)\textsuperscript{94}, study “has identified various weaknesses in banks after second generation of reforms namely interest rate
deregulation, non performing assets, direct lending, ownership structure, legal framework, etc.

Mohd. Azmathullah Mobeen's (2002)\textsuperscript{95}, study identified “various managerial skills to be possessed by the managers at different levels in Public sector banks based on Katz model of management skills and quality, Goldsmith and Boone's five key commitment model (Commitment to the customer, Organization, to self, to people, to the task).”

N. Janardhana Rao (2002)\textsuperscript{96} said, “The new ordinance SARFESI Act 2002 covers three unrelated issues securitization, reconstruction, and perfection of security interests. It would be better if these issues would be addressed specifically and independently. There is no doubt that the ordinance is to run the banking system in India, covering the bad debts is just the beginning. However much remains to be done”.

S.N. Bidani said (2002)\textsuperscript{97}, “Banks should try to list out specific cause which are responsible for increasing NPA’s and evolve strategies and account specific action plan for their removal. Such an approach would not only help them in bringing down the existing NPAs but also check slippage of performing accounts in to this category”.

Suresh Krishna Murthy (2002)\textsuperscript{98} stated, “Technology’ progress has created a segment between the banks, that e techno saved and those that are not. Almost all these, the go old, distinguish with new private sector and old private sector banks continue to thrive. Here is an analysis of the old private sector banks that have seen a decade of evaluation and now it and at a crucial stage of their evolutions”.

Sayuri, Shirai (2002)\textsuperscript{99}, examine the impact of reforms by in the performance of banking sector. He found that the performance of public sector bank improved in the second half of the 1990’s. Profitability (measured by return on assets) of nationalized banks turned positive in 1997-2000 and that of SBI banks have steadily improved their cost efficiency over the reform period. Even through
foreign banks and private sector banks generally performed better than the public sector banks in terms of profitability, earning efficiency (measured by ratio of income to assets), and cost efficiency in the initial stages, such differences have diminished as public sector banks have improved profitability and cost efficiency.

Suresh Krishna Murthy (2003)\(^{100}\) said, “Public sector banks, hither to seen as the Government’s white elephants, have entered into a golden era. Reduced NPAs and better operating practices have turned these enterprises into a force to reckon with”.

Yash Paul Pahuja (2003)\(^{101}\) said, “SBI is one of the fast growing players in the Indian Banking Industry with around 13,000 branches (including its seven associate banks) and 51 foreign offices in 31 countries. These branches handle 25 million transactions a day. The cost of funds is lowest for SBI at 7.6% as compared to others”.

V. Raghunathan (2003)\(^{102}\) stated that, “Convergence in the banking sector assumes increased significance because banks today no longer compete merely with other banks. They in fact compete with altogether different sectors”.

Committee (2003)\(^{103}\), on Micro finance, headed by Shri Vepa Kamesam, suggested various methods of lending to priority sector. He has highlighted the methods of lending especially to agriculture sector. Committee has submitted its report in August, 2003.

Chandra Shekhar (2003)\(^{104}\), stated that “The third and the most important dimension of the banking sector reforms was reduction of the non-performing assets (NPAs). In fact, the whole effort to reform the banking sector would collapse if the banks were not able to contain and reduce their NPAs. It would be impossible for a bank with high NPAs to be either vibrant or competitive. ‘What are these NPAs? These are the assets that do not yield any return”.

Dharmalingam Venugopal (2003)\(^{105}\) stated that, “The future of nationalized banks hinges on their ability to build good quality assets in an increasingly
competitive market while maintaining capital adequacy and prudential norms. Consolidation, to enhance managerial efficiency, and competition, to transform customer service, are the key factors that will impact nationalized banks”.

Aloka Majumdar (2003)\textsuperscript{106}, stated that, “Emerging trends have got a lot to do with the changes in the structure of the banking system. The second and equally important area, where banks are banking on other of their skill, is on the retail side”.

Aditya Pun (2003)\textsuperscript{107} said, “Technology has enabled banks to target customers, and provide customized products and services to match their individual requirements. The winners will be those banks that make optimum utilization of available technology to innovate, offer customized products and services, and make the most of the resources at their disposal”.

K. Eswar (2003)\textsuperscript{108} said, “As our market evolve, so customer requirements change, and hence the positioning strategy needs to be modified. Positioning is not a one-time effort. It is a constant pursuit”.

Pramod Guptha (2003)\textsuperscript{109} said, “Both public and private banks are spending large amounts of money on technology to provide innovative products and services to their customers with more convenience and satisfaction. Technology is reducing the cost of transaction and helping to increase customer base and enable wider reach”.

Abhiman Das and Saibal Ghosh’s (2004)\textsuperscript{110}, study conducted “to know the performance of bank CEOs in the era of corporate governance, tried to identify the adaptability characteristics of CEOs in terms of technology. The study also states that CEOs of poorly performing banks are likely to face higher turnover than CEOs of well performing ones”.

T.Uma Maheshwari Rao and L. Hymavathi (2005)\textsuperscript{111}, stated the importance of internet usage for banking worldwide and its relevance in Indian scenario To compete the present banking business the banks were transforming themselves
and conducting their business electronically. This transformation leads to normal banking to electronic banking, enabled customers to transact online, while saving on various factors. Normal Banking activities still prevails in developing countries like India.

Bhatia (2007)\(^{112}\), found that the amount of NPAs has been seen on a continues increase and had reached an alarming 6 per cent in 2006 which was much higher than 4 per cent benchmark of financial indicators.

Guillen and Tschoegi (2008)\(^{113}\), Traditional banks accepted the change in their functioning in order to be more receptive to the worldwide market demand for new financial product in new competitive market.

"Indian Bank's Association (IBA)\(^{114}\), conducted an all India survey to rate the customer service provided by all the 27 public sector banks aimed at fostering healthy competitive spirit amongst banks to improve upon their customer service. The aim of this study is to ensure the quality of service as perceived by the customers of public sector banks and identify areas where the banks need to improve for achieving higher levels of customer satisfaction. The study has been a massive one covering about 2500 bank branches and about 85,000 customers (respondents) at the all India level. Sample branches in all categories have been randomly chosen by IBA in proportion to the business/the number of branches in a particular category. In addition to bank rating at regional level and all India level, the survey results will also be used for rating each region on the basis of the customer service of all sample branches of the banks' operating in the region".

1.3 Research Gap

Since the new changes bring competition in the present scenario, this present study consist two players for competition were SBI (Public Bank) and ICICI Bank (Private Sector Bank) are studied and analyzed and interested for judging their efficiency and profitability as to know the comparative financial performance of each banks. After going through review of literature related to the
banking industry in India. It is evident that although huge work has been done since the inception of SBI and ICICI Bank on the related topics like the performance of SBI and ICICI Bank individually together with other bank. Therefore as per my knowledge no study or research work conducted by any other researcher/author in this university and other university in this area, that is why I chose the topic, “A Comparative Financial Performance Evaluation of ICICI Bank and SBI”.

1.4 Objectives of Study

The major objectives of the study are to assess the impact of reform measures on the efficiency, profitability and overall performance of SBI and ICICI for the period 2000-2001 to 2011-2012. The specific objectives of the study are;

1. To find out some glaring reasons of lower efficiency in SBI and ICICI banks and suggest ways and means to improve the efficiency of these two banks.


3. To suggest future prospect for these two banks.

4. To analyze the financial performance of State Bank of India.

5. To analyse the financial performance of ICICI bank.

6. To compare State Bank of India and ICICI bank on the basis of their financial performance.

1.5 Hypotheses

H₀:1 There is no significant difference between the bank size of SBI And ICICI Bank.

H₀:2 There is no significant difference between the SBI and ICICI bank in terms of profitability of SBI And ICICI Bank.
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$H_0:3$ There is no significant difference between the SBI and ICICI bank in terms of liquidity of SBI and ICICI Bank.

$H_0:4$ There is no significant difference between the net non-performing assets of SBI and ICICI Bank.

1.6 Research Methodology

The study will be conducted with reference to the data related to State Bank of India and ICICI Bank. These banks have been studied with the belief that they hold the largest market share of banking business in India, in their respective sectors.

This study covers a period of twelve years from 2000-2001 to 2011-2012.

1.6.1 Tools for data collection

The study is purely based on secondary data. The data required for the study will be collected from annual reports of respective banks, journals and reports on trends, newspapers, magazines, and progress of Banking of India, government publications, books and website.

1.6.2 Tools for data analysis

Different scales will be used for data analysis. Various financial ratios, bar charts are used to know financial performance and business model of State Bank of India and ICICI Bank.

1.7 Importance and Significance of the study

The Indian banking industry is passing through a phase of customers market. The customers have more choices in choosing their bank. The competition has been established within the bank operating in India. With stiff competition and advance technology, the service provided by the bank have become more easy and convenient. This Study will give a base to the further research in this field.
1.8 Limitations of the Study

1. The study is primarily based on secondary data. Different tools used for the study may suggest different results as the approach differs. Some changes in accounts procedure by concern may often make financial analysis misleading.

2. It does not consider changes in price level.

3. The study considers data of only limited duration of time.

4. It is based on only on monetary information and non-monetary factors are ignored.

5. It is only study of interim reports of the concern.

6. The study is based on selected schemes therefore limiting the area of research.

7. This analysis is carried on certain assumptions hence the assumptions would be biased.

1.9 Conclusion

This chapter deals with the background and Perspective Framework of the Study which includes, Banking history in India, Indian Banking from its initiation to the present through Review of the literature, Research Gap, Scope and Objectives of the study, Hypotheses of the study, Methodology of the Study, Significance and Need of the Study, Use of Statistical Tools, and References. After going through background and Perspective Framework of the Study, it is necessary to touch upon the conceptual Regulatory Framework of the Indian Banking industry before its assessment. The Conceptual Regulatory Framework of the Indian Banking industry going to be highlighted in the next chapter.
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