CHAPTER 1

Introduction and Research Methodology
Introduction

Finance plays a key role in the present dynamic global business world. Money makes many things in various spheres and in different dimensions. In recent years, innovations in the spheres of information technology and communication and the rapid emergence of a number of financial instruments have led to two distinct changes. First, the integration of the financial sector into a seamless world. Financial players from any location can access financial markets anywhere, at any time, with utmost ease and at very little cost. Second, the integration has rendered the system extremely complex and interdependent. Developments in distant markets get quickly transmitted to major markets across the world. Regulation and supervision have become very skill intensive and national norms are getting aligned to global standards.¹

A strong and efficient financial system is critical to the creating of a market-driven, productive and competitive economy and to support higher investment levels and accentuate growth. Banking is the most dominant segment of the financial system, and is pivotal to the development of a sound economy. A healthy banking system, besides providing the necessary impetus structure for economic growth, also serves as a strong repository of liquidity. The Indian Banking system has traversed a long journey to reach this phase where its health and quality and its contribution for economic development can be compared to international standards. It is really heartening to note that the Indian Banking System has progressed in every aspect from being a financial intermediary to be the vehicle of economic growth. Prior to the financial sector reforms, which were initiated in 1991,
Indian Banking operated under structural rigidity and external constraints besides working under a projected environment.

That has been a significant transformation of the banking industry in India is clearly evident from the changes that have occurred in the financial markets, institutions and products in the country. While deregulation has opened up new vistas for banks to augment revenues, it has also entailed greater competition and consequently greater risks. The cross-border cash flows and entry of new products, particularly derivative instruments, have significant impact on the domestic banking sector forcing banks to adjust to the new financial product mix. They also have brought about rapid changes in their process and operations in order to keep them competitive in the global environment. All these developments have facilitated greater choice for consumers, who have become more discerning and demanding, compelling the banks to offer a broader range of products and services through diverse distribution channels. The traditional face of banks as mere financial intermediaries has altered and risk management has emerged as their priority.

**Indian Financial System—A bird’s eye-view**

The smooth and efficient functioning of the economy depends upon the soundness of the financial system. Its major function is to channel resources from individuals and entities with surplus resources to those with resource deficits. In doing so, it not only satisfies the savings need of the community but also facilitates the accumulation of investment capital that is critical to growth and development. The overall contribution of a financial system can however extend well beyond these primary roles by also
reconciling different risk preferences of individuals and entities. Since the dawn of independence, the economic scene in India has undergone a sea change. There is enormous progress in the economy in several fields. There have been quantitative expansions as well as diversification of economic activities. To strengthen the economy, a number of financial institutions have come into being. The financial system is possibly the most important institution and functional vehicle for economic transformation.

Financial intermediaries are the bridge between the present and the future, whether it is the mobilization of savings or their efficient, effective and equitable allocation for investment. It is the success of their functioning that sets the pace for the achievement of broader national objectives. The Indian financial system is a set of inter-related activities/services working together to achieve a predetermined goal. It includes different markets, institutions, instruments, services and mechanisms, which influence the generation of savings, investment, capital formation and growth. The primary function of the financial system is the mobilization of savings, their distribution for industrial investment and stimulating capital formation to accelerate economic growth. The use of a stable, widely accepted medium of exchange reduces the cost of transactions. It facilitates trade and, therefore, specialization in production. Financial assets with attractive yield, liquidity and risk characteristics encourage savings in financial form. By evaluating alternative investments and monitoring the activities of borrowers, financial intermediaries increase the efficiency of resource use.

The Indian financial system has established a strong link between savings and investments by creating a unique mechanism through which
varied economic activities are created, sustained and developed. Thus it has become the firm and unshakable foundation of our economy. The financial system and the economy are complimentary to each other and have made enormous progress. A strong and resilient financial system and orderly evaluation of financial markets are key requisites for financial stability and economic progress with the vision of an internationally competitive and sound banking system. To broaden prudential norms at internationally recognized standards has been the core approach to financial sector reforms. This has been supported concurrently by heightened market discipline, proactive and comprehensive supervision of the financial system and the orderly development of financial market segments.

Role of Financial Institutions in India

Financial institutions as financial intermediaries provide the means and mechanism of transferring command over resources from those who have an excess of income over expenditure to those who can make use of the same with a view to adding to the volume of productive capital. Functioning as catalytic agents they bring about economic and social change in a country through dynamism and innovativeness in their operations. Sensing the well-established fact that development of physical and social infrastructure is an essential prerequisite for rapid economic advancement and the burgeoning of funds required to execute infrastructural projects, which are beyond the means of any government, financial institutions extend support to the former to finance the projects of national importance. Financial institutions as business organizations that act as mobilisers and depositors of savings, and purveyors of credit or finance. They also provide various other financial services to the community.
Financial institutions are classified variously, according to one classification, they are classified into banking institutions or intermediaries and non-banking institutions or non-intermediaries. Banking institutions have quite a few things in common with the non-banking ones. The term "intermediaries" suggests that banking institutions intermediate between savers and investors; they lend money as well as mobilize savings; their liabilities are to ultimate savers, while their assets are from investors or borrowers. Non-intermediary or non-banking institutions do the loan business but their resources are not directly obtained from the savers. All non-banking institutions also act as intermediaries and when they do so they are known as non-banking financial intermediaries (NBFI). The Unit Trust of India (UTI), Life Insurance Corporation of India (LIC) and General Insurance Corporation (GIC) are some of the non-bank financial institutions in India. The non-intermediary institutions like Industrial Development Bank of India (IDBI), Industrial Financial Corporation (IFC) and National Bank for Agricultural and Rural Development (NABARD) have come into existence because of governmental efforts to provide assistance for special purposes, sectors and regions; their creation as a matter of policy has been motivated by the thought that the credit needs of certain borrowers might not be otherwise adequately met by the usual private institutions.
Chart 1.1
Organisation Structure of Financial Institutions

Functions of Financial Institutions

The major function of financial institutions, whether short-term and long-term, is to provide maximum financial convenience to the public. This may be done in three ways:

i. Promoting the overall savings of the economy by deepening and widening the financial structure;

ii. Distributing the existing savings in a more efficient manner so that those in greater need, from the social and economic point of view, get priority in allotment;

iii. Creating credit and depositing money and facilitating the transactions of the trade, production and distribution in the furtherance of economy.
Chart 1.2

Functions of financial Institutions

- Promoting savings
- Mobilising savings
- Distributing savings
- Creating credit
- Facilitated trade
- Facilitating production
- Franchising
- Providing financial services
- Strengthening financial markets
- Building infrastructure
- Accelerating economic development

Source: Compiled from Various Books relating to Financial Institutions and Markets

Financial System and Economic Development

An efficient financial system makes for economic growth. And government plays an effective role in its smooth running by restoring macro-economic stability, building better legal, accounting and regulatory systems, specifying rules for fuller disclosure of information, levying taxes that do not fall excessively on finance, and by other means. As the Indian financial
system is crucial to India's economic development through the saving-investment process or capital formation. The purpose of financial market as the financial system is also called, is to mobilize savings effectively and allocate the same efficiently among the ultimate users of funds, viz., investors. Economic development is a process whereby there is an increase in the consumption of goods and services of individuals. As Siman Kuznet observes "economic growth is a long-term rise in the capacity to supply increasingly diverse economic goods to a nation's population; this growing capacity is based on advancing technology and institutional and adjustments that it demands". Economic development is a complex and diversified phenomenon with many dimensions. In simple terms it refers to an improvement in the material welfare of those who are really poor. Thus, economic development emphasizes the achievement of the following three broad objectives:

1. To increase the availability and widen the distribution of basic life-sustaining goods such as food, shelter, and protection, which, however, would be possible with a speedy or rapid increase in real per capita income;

2. To raise the level of living including, in addition to higher incomes, the provision of more goods, better education and greater attention to cultural and humanistic values;

3. To extend the range of economic and social choice to individuals and nations by freeing them from servitude and dependence.

In order to achieve the above objectives of economic development, and to reach a specific set of quantitative economic targets, there is a need for
Economic planning. Economic planning is a deliberate governmental attempt to coordinate economic decision-making over the long run and to influence, direct and in some cases even control the level and growth of a nation’s principle economic variables (income, consumption, employment, savings, exports, imports, etc,) to achieve a predetermined set of development objectives.\textsuperscript{14}

Economic development of nation is the function of several determinants or factors of which, capital formation is the most significant. Capital formation is simply in the process by which the stock of capital in an economy is raised. It is the driving force that determines the face of economic development of developing nations like India. Economic development can be registered as a direct function of capital formation. All developing nations have been suffering from the vicious circle of poverty, which implies a circle constellation of forces tending to act and react upon one another in such a way as to keep a poor country in a state poverty\textsuperscript{"}.\textsuperscript{15} This problem can be tackled through adequate capital formation. The economic development of a country depends among other things, on the growth of its financial system. The larger the proportion of financial assets (money and monetary assets) to real assets (physical goods and services), the greater the scope for economic growth in the long run. For growth to take place, investment is necessary which flows from the financial system. Besides, as a scarce factor of production in the less developed countries (LDCs), finance becomes crucial to their economies.
The financial system acts as an efficient conduit for allocating resources among competing users. Its importance and role in economic growth has evolved over time along with the changing patterns. The use of a stable, widely accepted medium of exchange reduces the cost of transaction. One of its important services is to facilitate trade and, therefore, specialization in production. Financial assets with attractive yield, liquidity and risk characteristics encourage savings 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 economic agents to pool, price and encourage risk. Trade, the efficient use of resources, saving, and risk-taking are the cornerstones of a burgeoning economy.

Trends in Economic Development:

There are seven major trends affecting the direction of economic development;

- Technology as a resource,
- Competition in domestic and international markets,
- Role of invention,
- Government as stimulator,
- Entrepreneurial and Intrapreneurial development,
- Innovative capital formation,
- Collaborative relationships.
Chart 1.3

Relationship between Financial System and Economic Development

Economic Development

Savings & Investment or Capital Formation

<table>
<thead>
<tr>
<th>Surplus Spending Economic Units</th>
<th>Deficit Spending Economic Unit</th>
</tr>
</thead>
<tbody>
<tr>
<td>Income Minus (Consumption + Own Investment)</td>
<td>Income Minus (Consumption + Investment)</td>
</tr>
</tbody>
</table>

Surplus or Saving

Deficit or Negative Saving

Financial System

Process of Capital Formation for Economic Development

As capital is the key to economic development, in a developing country in particular, financial institutions help and direct the flow of adequate credit to productive activities of the rural sector of the economy. They do not directly add to the volume of real capital formation, though they are a necessary link between savers and investors in a free enterprise economy. Moreover, by providing facilities for a profitable use of savings and ensuring their safety and liquidity, they facilitate, savings. It is primarily due to the rise in the rate of capital formation that financial institutions contribute to economic development. The process of capital formation is closely bound up with the mobilization of domestic savings available for economic development, and financial institutions are instrumental in mobilizing widely scattered savings and channelling them in productive ways in different regions and sectors of the economy.

The volume of capital formation is determined by the volume of real saving in a country which depends on the ability, willingness and opportunity to save by the public. Financial institutions pool risks, rank alternative investment propositions through appropriate project appraisal criteria, and raise the productivity of investment. They also contribute to the identifying and nurturing of new entrepreneurs.

Commercial banking- An Overview

The banking system has been moving towards greater stability and efficiency after its deregulation. There has been a phenomenal expansion in geographical coverage, effective credit delivery, and accelerated savings and
investments of the people. The introduction of innovative and diversified products and services, coupled with mechanization and computerization has made banking a vital part of our life. Needless to say, everyone is a beneficiary of banking services. However, the system is not free from weaknesses. Greater transparency and stringent conditions for disclosure of assets and liabilities, adequate capitalization and tighter prudential norms are needed to rid the system of its defects. Strong prudential norms are necessary not only to align the Indian banking system with the international best practices, but also for macro-economic stability and efficient conduct of monetary policy.

The government of India, therefore, set up a high level committee under the chairmanship of M. Narasimham to examine all aspects relating to structure, organisation, function and procedure of the financial system in India. The committee submitted its report in November 1991. The prudential norms for income recognition, asset classification and provisioning for advances to the portfolio of banks, introduced by the Reserve Bank of India (RBI) in a phased manner, as per the recommendations of the committee and in line with the best international practices, spearheaded the financial sector reforms, geared to strengthening the entire banking sector including co-operative banks. In order to achieve greater financial stability and operational efficiency the above prudential norms were introduced and implemented in all commercial banks.

Banking System in India—A Historical Perspective

The origin of banking in India is traced back to the Vedic period. It is believed that the transition from money lending to banking must have
occurred even before Manu, the great Hindu Jurist, who has devoted a section of his work to depositors and advances and laid down rules relating the rates of interest. During the Mogual Period, the indigenous bankers played a very important role in lending money and financing foreign trade and commerce. During the days of the East India Company, it was the turn of the agency house to carry on the banking business. The General Bank of India was the first Joint Stock Bank to be established in the year 1786. Later the Bank of Hindustan and the Bengal Bank followed. The Bank of Hindustan is reported to have continued till 1906 while the other two failed in the meantime. In the first half of the 19th century the East India Company established three banks: the Bank of Bengal in 1809, the Bank of Bombay in 1840 and the Bank of Madras in 1843. These three banks, also known as Presidency Banks, were independent units and functioned well. They were amalgamated in 1920 to form the Imperial Bank of India which was established on 27th January, 1921. With the passing of the State Bank of India Act in 1955, the Imperial Bank of India was taken over by the newly constituted State Bank of India. The Reserve Bank, which is the Central Bank, was created in 1935 by passing Reserve Bank of India Act 1935. In the wake of the Swadeshi Movement, a number of banks with Indian management were established in the country namely, Punjab National Bank Ltd., Bank of India Ltd., Canara Bank Ltd., Indian Bank Ltd. On 19th July 1969, 14 major banks of the country were nationalized and on 15th April 1980 six more commercial private sector banks were also taken over by the government. Besides, several foreign banks were allowed to operate as per the guidelines of the RBI. At present, the banking system in India can be classified thus: Public Sector Banks, Private Sector Banks, Foreign Banks, Co-Operative Sector Banks, Development Banks.
Functions of Commercial Banks

A bank is a financial institution that offers certain financial services such as safekeeping of money payable on demand or withdrawable by cheque, draft, order or otherwise, conversion of domestic currency into and from foreign currencies, lending of money of interest and acceptance of bill of exchange, etc. It should be noted that a bank is a financial institution, but all financial institutions need not be a bank. For example, financial institutions like Life Insurance Corporation, Industrial Development Bank of India etc., lend to others but are not banks as they do not accept deposits that can be withdraw by cheque.22

The main functions of commercial banks are: i) Acceptance of deposits (current, saving and fixed account deposits), ii) Giving loans (cash credit, demand loan and short term loan), iii) overdrafts, iv) Discounting bill of exchange, v) Investment of funds. Agency and miscellaneous functions of banks are: i) Transfer and collection of funds on behalf of customers ii) Purchase and sale of shares on behalf of customer iii) Payment of bills and insurance premium iv) Acting as executors and trustees of wills, v) Acceptance of income tax payments and related consultancy, iv) Acting as correspondent, agent or representative of customer vii) Securing documentation for air, sea or land passage viii) Purchase and sale of foreign exchange ix) Issuance of traveler's and gift Cheques x) Safe custody of valuable goods in lockers xi) Underwriting activities and private placement of securities.

Composition of the Indian Banking System

Apart from the categories of Indian banks mentioned earlier, broadly three categories of banks in the Indian banking system may be identified: the
central bank of the country known as the Reserve Bank of India, Commercial Banks and Co-operative banks. The Reserve Bank of India is the supreme monetary and banking authority in the country and has the responsibility to control the banking system in the country. It keeps the reserves of all commercial banks and hence is known as "Reserve Bank". Commercial banks have been in existence in India for many decades. They mobilize savings in urban areas and make them available to large and small industrial and trading units mainly for working capital requirements. After 1969, they were broadly grouped into nationalized or public sector banks and private sector banks. The State Bank of India and its associate banks and 20 other national banks are among the public sector banks. The private sector banks include a small number of Indian scheduled banks that have not been nationalized and the branches of foreign banks operating in India—commonly known as foreign exchange banks.23

Regional Rural Banks (RRBs) came into existence in the middle of 1970s with the specific objective of providing credit and deposit facilities particularly to the small and marginal farmers, agricultural labourers and artisans and small entrepreneurs. The RRB has the responsibility to develop agriculture, trade, commerce and industry in rural areas. They are essentially commercial banks but the area of operation of each rural bank is limited to a particular district. Primary Co-operative Credits Societies (or banks) were originally set up in villages to promote thrift and savings of the farmers and to meet their credit needs for cultivation. To support them, central or district co-operative banks and above them State co-operative banks were established. The funds of the Reserve Bank of India meant for the agricultural sector actually pass through the State co-operative banks and
central co-operative banks. Originally began in the rural sector, the co-operative credit movement has now spread to urban areas also and there are many urban co-operative banks coming under State co-operative banks.

Reserve Bank of India

The Reserve Bank of India Act, 1934 regularized the central banking system in India for the first time. Until then the Imperial Bank of India, which is now known State Bank of India functioned as Central Bank for all purposes. The Reserve Bank of India came into existence on 1st April 1935 and was nationalized on 1st January 1949. It has tow departments, the Issue Department and the Banking Department. The primary functions of the Reserve Bank are issue of paper currency, acting as bankers to Government, controlling the activities of commercial banks, acting as bank of accommodation and lender in the last resort, maintenance of foreign exchange, provision of agricultural credit and collection and publication of monetary and financial information.

The Reserve Bank of India Act classified the banks into scheduled and Non-scheduled banks. The Scheduled banks are those, which are entered in the Second Schedule of RBI Act, 1934. Such banks are those, which have a paid-up capital and reserves of an aggregate value of not less than Rs. 5 lakhs and which satisfy RBI that their affairs are carried out in the interests of their depositaries. All commercial Banks –Indian and foreign, regional rural banks and State co-operative banks are scheduled banks. Non-scheduled banks are those, which have not been included in the Second Schedule of RBI Act, 1934. The Reserve Bank has two fold function; promotional and regulatory. It helps the Government in its developmental
projects by raising loans at low interests and providing funds for deficit financing. Credit control and other monetary directives announced by the Reserve Bank from time to time have had a salutary effect on Indian economy.24

Indian Banking Sector-Post Reform Phase

The liberalisation of the financial sector in India is exposing Indian banks to a new economic environment that is characterised by increased competition and new regulatory requirements. India and foreign banks are exploring growth opportunities in India by introducing new products for different customers segments, many of which were not conventionally viewed as lucrative customers for the banking industry.25 Today, financial systems across the world are in a state of flux. Profound changes mark the global financial market landscape, which includes India too. Innovation, globalization, deregulation and technology are driving changes in the Indian financial markets at a pace, witnessed never before. In the process, financial institutions are getting radically transformed in terms of their structure, process and operating environments.

In the post-economic reforms phase, the Indian banking sector has become strong, stable, vibrant and sound. There are however many challenges confronting it. Indian banks have to consolidate further to face global competition, to meet the needs of huge investments in technology and generally to enhance productivity. While there is vast boom for improvement in corporate governance, whether consolidation will happen as desired is still a hotly debated issue. The RBI follows a consistent policy of low exposure to sensitive sector, so that the bubbles and bursts of economic
activity do not drive the banking sector into financial instability. The service sector in India, which has been growing phenomenally, needs finance through innovative products, while retail credit needs a suitable rating mechanism, efficient pricing and cost effective delivery. Corporate governance standards have to be necessarily very high in banks, which are highly leveraged entities that thrive on public trust. Banks need to offer products and services with customer centricity.

Banks operate in a competitive market each competing with the other with almost similar products and services. They compete not only with one another but also with a host of non-banking financial institutions. Therefore, the competitiveness in the money market is quite intense which induces them to innovate and introduce better products/services to the customer. In India, all banks are operating in a similar atmosphere, offering similar price, location and with similar working hours. But there is a difference in the growth rate among them because of individual bank’s efficiency in customer service and public relations. The purpose of banking reforms, resulting from the Narasimham Committee recommendations was to bring about competitive efficiency. It was felt that the entry of new players would provide the much-needed new ethos and standards of efficiency and lead to a more customer friendly approach. New private sector banks and foreign banks have entered the arena with elegant and spacious banking halls, modern technology, absence of long queues, well-informed and customer friendly staff, flexible and innovative products, simplified procedures, speedy decision-making, aggressive public relations and marketing. These have all combined to provide world class banking services to the customers. Targeting high value and elite customers, they
have been able to mobilize many times more business per branch and per employee as compared to the average branch of public sector bank.

The most important development concerning customer service relates to the advent of new technology. The historic agreement signed by Indian Banks Association (IBA) with trade unions in 1993 paved the way for substantial mechanization and computerization of Indian Public Sector banks. Ambitious programmes have been launched by banks towards computerization and technology up-gradation of branches and offices to turn banking into an efficient, speedy and customer-oriented service. They have started introducing Automated Teller Machines (ATMs), Telebanking services, customers' terminals, anywhere, anytime banking facilities and other technology-based services. Competitiveness has increased in the Indian Banking Sector since the banking sector reforms and in turn it has improved the efficiency of the public sector banks. And it also has increased competition from the Indian private sector banks. The Public sector banks continue to hold a predominant position and accounted for 76.38 percent of the total income and 74.41 percent of the total assets of the Scheduled Commercial Banks in India as on 31st March 2005. There is a general improvement too in the profitability situation in recent years among the scheduled commercial banks. This is reflected in the significant improvement of their asset quality, capital position, profitability and operational efficiency.

The Role of Banking System in Economic Development

The economic well being of a nation is measured by the activities in the real sector, for example, in the production of goods and services,
employment and consumption. Money and credit and the whole spectrum of financial institutions constitute the financial sector, which facilitates activities in the real sector by mobilizing savings, extending credit or making investments. The role of financial institutions is essentially to intermediate between savers and users of surplus funds. In any economy, individuals and households generate savings. By providing a range of saving instruments, various financial institutions offer choices to meet the diverse preferences of savers in regard to return, risk and liquidity. At the other end, as the government, public and private sector companies and corporate enterprises are sectors always in need of funds, financial institutions meet their needs too through a variety of credit instruments. The whole process of mobilizing savings and deploying them into productive channels, in financial intermediation helps to pool together and spread out attendant risks in dealing in money. Financial institutions perform several other functions too. By expressing preferences in lending they help the allocation of resources in accordance with national priorities, and thus raise the overall productivity of investment by appropriate project evaluations and suggesting improvements, thus they contribute to a widening wealth of asset ownership, and help to identify and nurture new entrepreneurs.  

Globalization and the Banking Sector

In this overall scenario, the policy relating to the financial services, and in particular banking, must be considered. It is interesting to note that the WTO negotiations on financial services have been cautious and the commitments of many larger economies in the banking sector are rather particularly limited. In other words, in the context of national ownership of
financial intermediaries, banks appear to have a unique place in public policy. There are several noteworthy features of ownership and control of banks in all major economies—irrespective of whether they are developed or emerging. In almost all cases, banks are either widely held or have substantial state ownership. Furthermore, there are special conditions governing the extent of ownership, the nature of ownership and control, and transfers of such ownership or control through statutory backing. These are justified since the banks are admittedly special. The discussion in the WTO on Commitments relating to the opening of the domestic banking sector to foreign banks/ownership reflects these concerns in most of the major economies.

It is worth recalling what Sir Eddie George, Governor of the Bank of England had said on banks being special: "they remain special in terms of the particular functions they perform - as the repository of the economy's immediately available liquidity, as the core payments mechanism, and as the principal source of non-market finance to a large part of the economy. And they remain special in terms of the particular characteristics of their balance sheets, which are necessary to perform those functions — including the mismatch between their assets and liabilities, which makes banks peculiarly vulnerable to systemic risk in the traditional sense of that term. "The data clearly indicates that banks continue to play a predominant role in financial intermediation in the developing countries. This is understandable for several reasons viz. the savers' eagerness for assured income; inadequate capacity to manage financial risks and the fact that the banking institutions in some sense and in different degrees, enjoy deposit insurance and either implicit or explicit guarantee of the government."
It is important to note that crisis in banks invariably results in heavy costs to the Government, whether they are publicly owned or privately, domestically owned or foreign owned. An important question in this context is whether the role of banks in financial integration in the developed countries is different from that in the emerging market economies. It is useful to assess the significant differences in the structure of the banking industry in the emerging vis-à-vis the developed markets. In most emerging markets, banks' assets comprise well over 80 per cent of the total financial sector assets, whereas these figures are significantly lower in the developed economies. In most emerging market economies, the five largest banks (usually domestic) account for over two-thirds of bank assets. These figures are much lower in the developed economies. Another difference in the banking industry between the developed and emerging economies is the degree of internationalisation of banking operations. Internationalisation defined as the share of foreign-owned banks as a percentage of total bank assets, tends to be much lower in the emerging economies. This pattern is, however, not uniform within world regions.

Finally, a significant feature of banking in the developed versus the emerging economies, especially in recent years, has been the process of consolidation. The most notable difference between the two in the consolidation process is the overwhelming cross-border nature of mergers and acquisitions in the latter that is, two emerging markets. In particular, cross-border merger activity in continental Europe and also between the US and European institutions has been more of an exception than the rule. In contrast, there has been a sharp increase in foreign ownership of some emerging market banks due to the process of privatization often associated with crises.
An important difference in this context has been the role played by the authorities in the financial sector consolidation process. In mature markets, consolidation has been seen as a way of eliminating excess capacity and generating cost savings to the institution. In the emerging markets, on the other, consolidation has been predominantly a way of resolving problems of financial distress, with the authorities playing a major role in the process.29

Present Status of Commercial Banking System in India

The structure of the banking and financial system of a country is neither created at one stroke, nor is it permanent for all times to come. A look at the structure of the Indian banking system would show how various institutions have evolved as and when such a need arose, and both at the instance of the government and on the initiative of the people engaged in financial activities.

The structure of scheduled banking in India consists of banks that are listed in the Second Schedule of the Reserve Bank of India Act, 1934. In the Commercial Banking System in India there were 284 Scheduled Banks (including foreign banks operating in India) and four non-scheduled banks at the end of March 2005. Of them 88 are Commercial Banks, and are 196 Regional Rural Banks specially set up to increase the flow of credit to small borrowers (like Agriculture development) in rural areas. Among the 88 Commercial Banks, 27 are Public Sector, 29 are Private Sector Banks (old 21 & new 8), 31 are Foreign Banks operating in India, and one is Other Public sector Bank (IDBI Bank Ltd from 2004-05). Among the commercial banks (excluding RRBs), the public sector banks are in the higher position with 48,815(88.14%) offices and Total Assets of Rs.16,92,579 crore, Total
Deposits of Rs. 14,20,750 crores, Total Advances of Rs. 8,09,258 crores and Investment of Rs. 6,60,674 crores, Net Profit of Rs. 15,784 crores as at end March 2005. The following table presents these details in a tabular form.

Table No. 1.1
Bank Group-wise Status of Commercial Banks in India at Present
(As on March 2005) (Amount in crores)

<table>
<thead>
<tr>
<th>Bank group</th>
<th>Deposits</th>
<th>Loans and Advances</th>
<th>Investments</th>
<th>Total Assets</th>
<th>Net Profit</th>
<th>Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector Banks</td>
<td>14,20,750</td>
<td>8,09,258</td>
<td>6,60,674</td>
<td>16,92,579</td>
<td>15,784</td>
<td>48,815</td>
</tr>
<tr>
<td></td>
<td>(77.98)</td>
<td>(73.19)</td>
<td>(78.36)</td>
<td>(74.41)</td>
<td>(74.03)</td>
<td>(88.14)</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>3,14,630</td>
<td>2,21,149</td>
<td>1,39,888</td>
<td>4,27,915</td>
<td>3,534</td>
<td>6,321</td>
</tr>
<tr>
<td></td>
<td>(17.27)</td>
<td>(20.00)</td>
<td>(16.59)</td>
<td>(18.81)</td>
<td>(16.58)</td>
<td>(11.41)</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>86,505</td>
<td>75,318</td>
<td>42,518</td>
<td>1,54,128</td>
<td>2,002</td>
<td>245</td>
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<tr>
<td></td>
<td>(4.75)</td>
<td>(6.81)</td>
<td>(5.04)</td>
<td>(6.78)</td>
<td>(9.39)</td>
<td>(0.44)</td>
</tr>
<tr>
<td>All Commercial Banks</td>
<td>18,21,885</td>
<td>11,05,725</td>
<td>8,43,080</td>
<td>22,74,622</td>
<td>21,320</td>
<td>55,381</td>
</tr>
</tbody>
</table>

Source: Report on Trend and Progress of Banking in India 2004-05.
Note: Figures in brackets indicate percentage market share of each group.

Chart 1.4
Structure of Scheduled Commercial Banks in India
(As on March 31, 2005)

Note: Figures in brackets indicate number of banks in each group.
IDBI is treated as other public sector Bank from 2004-05.
Progress of Commercial Banking in India

Table 1.2 indicates the overall progress of commercial banks after nationalisation 1969 to 1991 and as well as in the post reform period from 1991-2005. Table shows that between June 1969 and March 1991, the total number of bank branches increased from 8,262 to 60,220 resulting in the decrease of population per office from about 64,000 in 1969 to 14,000 in 1991. Of the total increase of over 51,000 offices during 1969-1991, about 80% were set up in rural and semi-urban areas leading to a vast geographical expansion of the banks and regional dispersal of branch network in India. This vast branch expansion led to about 43 times increase in the deposit mobilization of the SCBs from Rs.4,646 crore in June 1969 to Rs.2,01,199 crore in March 1991, resulting in per capita deposit increasing from Rs.88 to Rs.2368 over the same period. As a consequence the per capita bank credit also increased from Rs.68 in 1969 to Rs.1434 in 1991. The total bank deposits as percentage of national income also increased from 15.5% in 1969 to 48.1% in March 1991. The share of the priority sector in total non-food credit of the SCBs increased from 15% in 1969 to 39.2% in March 1991. Thus the banking system has acquired a wide reaching in terms of expansion of branches and growth of deposits and credit during 1969-1991.

Throughout the period 1991-2005, the Indian banking sector continued to respond to the emerging challenges of increased competition and uncertainties. While the prudential and supervisory norms were being brought in conformity with the best international practices to further strengthen the stability of the banking system, the ongoing reforms provided greater operational flexibility to the commercial banks. In their business
Table 1.2
Progress of Scheduled Commercial Banks Pre and Post Reforms Period (1969-2005)

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<tr>
<td>1</td>
<td>No. of Commercial Banks of which:</td>
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<tr>
<td></td>
<td>RRBs</td>
<td>73</td>
<td>272</td>
<td>272</td>
<td>272</td>
<td>287</td>
<td>299</td>
<td>297</td>
<td>293</td>
<td>286</td>
<td>285</td>
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<td>2</td>
<td>No. of Bank Offices Of which:</td>
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</tr>
<tr>
<td></td>
<td>Rural and Semi-urban offices</td>
<td>8,262</td>
<td>60,220</td>
<td>60570</td>
<td>63755</td>
<td>64937</td>
<td>66408</td>
<td>67532</td>
<td>68195</td>
<td>69170</td>
<td>70324</td>
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<tr>
<td></td>
<td></td>
<td>5,172</td>
<td>46,550</td>
<td>46625</td>
<td>46500</td>
<td>46814</td>
<td>47130</td>
<td>47357</td>
<td>47465</td>
<td>47516</td>
<td>47766</td>
</tr>
<tr>
<td></td>
<td>Urban and Metropolitan</td>
<td>3,090</td>
<td>13,670</td>
<td>13945</td>
<td>17255</td>
<td>18123</td>
<td>19278</td>
<td>20175</td>
<td>20730</td>
<td>22558</td>
<td>22558</td>
</tr>
<tr>
<td>3</td>
<td>Population per Office('000s)</td>
<td>64</td>
<td>14</td>
<td>14</td>
<td>15</td>
<td>15</td>
<td>14</td>
<td>15</td>
<td>15</td>
<td>16</td>
<td>16</td>
</tr>
<tr>
<td>4</td>
<td>Total Deposits of SCBs (Rs. crore)</td>
<td>4,646</td>
<td>2,01,199</td>
<td>237566</td>
<td>323632</td>
<td>433819</td>
<td>605410</td>
<td>851593</td>
<td>1131188</td>
<td>1504416</td>
<td>1700198</td>
</tr>
<tr>
<td>5</td>
<td>Deposits/National Income (per cent)</td>
<td>15.5</td>
<td>48.1</td>
<td>49.5</td>
<td>47.2</td>
<td>46.3</td>
<td>49.6</td>
<td>53.5</td>
<td>54.4</td>
<td>60.0</td>
<td>60.4</td>
</tr>
<tr>
<td>6</td>
<td>Deposits of SCBs per office (Rs.lakh)</td>
<td>56</td>
<td>334</td>
<td>392</td>
<td>508</td>
<td>668</td>
<td>912</td>
<td>1261</td>
<td>1659</td>
<td>2265</td>
<td>2574</td>
</tr>
<tr>
<td>7</td>
<td>Investments of SCBs (Rs. crore)</td>
<td>1361</td>
<td>75817</td>
<td>90334</td>
<td>133314</td>
<td>164782</td>
<td>218705</td>
<td>311697</td>
<td>437482</td>
<td>677588</td>
<td>739154</td>
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<tr>
<td>8</td>
<td>Total Credit (Rs. Crore)</td>
<td>3,599</td>
<td>1,21,865</td>
<td>131520</td>
<td>166844</td>
<td>254015</td>
<td>324079</td>
<td>454069</td>
<td>609053</td>
<td>840785</td>
<td>1100428</td>
</tr>
<tr>
<td>9</td>
<td>Credit per office (Rs. Lakh)</td>
<td>44</td>
<td>202</td>
<td>217</td>
<td>262</td>
<td>391</td>
<td>488</td>
<td>669</td>
<td>893</td>
<td>1330</td>
<td>1700</td>
</tr>
<tr>
<td>10</td>
<td>Per capita Deposits (Rs.)</td>
<td>88</td>
<td>2368</td>
<td>2738</td>
<td>3596</td>
<td>4644</td>
<td>6270</td>
<td>8542</td>
<td>11008</td>
<td>14089</td>
<td>16281</td>
</tr>
<tr>
<td>11</td>
<td>Per capita Credit (Rs.)</td>
<td>68</td>
<td>1434</td>
<td>1516</td>
<td>1854</td>
<td>2719</td>
<td>3356</td>
<td>4555</td>
<td>5927</td>
<td>8273</td>
<td>10752</td>
</tr>
<tr>
<td>12</td>
<td>Advances to Priority Sector (Rs. crore)</td>
<td>504</td>
<td>44,572</td>
<td>47318</td>
<td>59097</td>
<td>80831</td>
<td>108905</td>
<td>155779</td>
<td>205606</td>
<td>263834</td>
<td>345627</td>
</tr>
<tr>
<td>13</td>
<td>Share of Priority Sectors Advances in total non-food credit of SCBs (per cent)</td>
<td>15.0</td>
<td>39.2</td>
<td>38.6</td>
<td>36.5</td>
<td>32.8</td>
<td>34.6</td>
<td>35.4</td>
<td>34.8</td>
<td>34.5</td>
<td>35.5</td>
</tr>
<tr>
<td>14</td>
<td>Credit-Deposit Ratio</td>
<td>77.5</td>
<td>60.6</td>
<td>55.4</td>
<td>51.6</td>
<td>58.6</td>
<td>53.5</td>
<td>53.3</td>
<td>53.8</td>
<td>55.9</td>
<td>64.7</td>
</tr>
<tr>
<td>15</td>
<td>Investment-Deposit Ratio</td>
<td>29.3</td>
<td>37.7</td>
<td>38.0</td>
<td>41.2</td>
<td>38.0</td>
<td>36.1</td>
<td>36.6</td>
<td>38.7</td>
<td>45.0</td>
<td>43.5</td>
</tr>
<tr>
<td>16</td>
<td>Cash-Deposit Ratio</td>
<td>8.2</td>
<td>17.6</td>
<td>18.2</td>
<td>17.2</td>
<td>12.4</td>
<td>10.1</td>
<td>9.8</td>
<td>7.1</td>
<td>7.2</td>
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</table>

Source: Reserve Bank of India (various years), Statistical Tables Relating to Banks in India

Note: Data containing including Regional Rural Banks
strategy, they exhibited a greater emphasis on product diversification, customer orientation thrust towards retail banking, adoption of information technology for improved service, better management of information systems and risk management and strategic mergers and acquisitions across bank groups.

Statement of the problem

The present undertaking is concerned with the trends in the Commercial banking sector in India. Commercial Banking all over the world has undergone a lot of changes during the last five decades. The very complexion of Indian commercial banking has undergone a thorough change. The changes that have taken place in India have been more significant and radical than elsewhere in the World. Indian Banking which was initially in the private sector moved on to the public sector with the nationalization of banks, first in 1969 and later 1980. Now with the proposed move of the Government to reduce its stake in the banks from 51 to 33 per cent, the Public sector banks are moving in the direction of partial privatization.

Since the liberalization of Indian economy, the trend in its banking system has become entirely different and the reforms have necessitated making structural changes in banking activities. The private and co-operative sector banks are also allowed to participate in the banking business, which is governed by the stringent rules and regulations of the Reserve Bank of India. New private and foreign banks have come into existence. Banks have entered new business adopting innovative financial products in a competitive spirit. This development has paved the way for
innovative financial facilities benefiting the customers, such as ATMs, Retail banking, mobile banking, any-where banking, any-time banking, universal banking etc.,

The Narsimham Committee report suggested wide-ranging reforms in the banking sector in 1992 and to introduce internationally accepted banking practices. When 1991 onwards the winds of liberalization, privatization and globalization started blowing the Indian banking sector received a jolt. Implementation of financial sector reforms and adoption of an internationally accepted accounting system saw most of them drifting into the red. However the process of consolidation and cleansing of balance sheets has strengthened significantly their bottom line since then. The new generation banks have come out with aggressive computer-savvy banking operations, installing the ATMs and providing e-Banking services. Some of them have already made their presence abroad. The public sector banks too are moving east and west and negotiating to purchase banks abroad, reversing the colonial trend. Along with developments, the banking sector is also witnessing or facing many unpleasant developments and issues. It is not free from setbacks and problems of various kinds. In this context, the Commercial banks have to strive hard to improve their profitability and prepare themselves to meet the global challenges in their business operations. All these developments both positive and negative have prompted the undertaking of the present study, "Trends in Commercial Banking Sector – A study of Select Private Sector Banks" to probe into the various aspects of developments and opportunities in the global banking scenario with particular reference to select private sector banks in India.
Review of literature

A selection of empirical and evaluative studies carried out hitherto relevant to the present enquiry are reviewed here briefly to serve as a background for the present study, to obtain an insight into the proposed study, and also identify if there are any gaps to be filled in.

T.A. Vaswani. (1968)\(^{20}\), in his book on commercial banking points out that it is radically different form mere lending. It is far more sophisticated and complicated. Banking institutions today form the 'heart' of the financial structure of a country, whether it is developed or developing, rich or poor, advanced or backward in science and technology.

The Bank Commission (1972)\(^{21}\) examines the developments in the banking system. It is maintained that bankers have the important task of inducing savers to hold their savings in the forms of socially useful assets of which bank deposits are the most important.

Howard Crosse and George Hempel (1973)\(^{31}\) in their book analyse the functions, structure and risks of commercial banks. They describe how banks should attract deposits. They examine the lending and investment polices and procedures of banks in detail.

Herbert V. Prochnow (1974)\(^{30}\) in his book, critically examine the changing character of banking, sources of deposits and planning and control systems for commercial banks. He stresses the social responsibility of banking and analyses the specific weaknesses in bank management.

Dr. B.P. Sharma. (1974)\(^{34}\) in his book pointed out how banks play a crucial role in accelerating the tempo of growth in a developing economy. They
mobilize people's savings and divert them into productive channels. The factors affecting deposits, various tools for mobilizing deposits and credit to different segments are also discussed in the book.

H.N. Agarwal (1979) analyses the social obligations of nationalised banks, their management, branch expansion, deposit mobilization, credit delivery and the role of commercial banks in the developing Indian economy.

Dr. Rangarajan (1982) in his book has focused on the significant changes that have occurred in the Indian banking system since nationalization, particularly in deposit mobilization and credit deployment. In his study, he analyses the impact of interest rate change on the deposits, advances and operational efficiency of Indian public sector banks.

J.N. Mongia. (1982) in his book 'Banking around the world' covers twenty-two countries, including those with highly developed industrial organisations, those with underdeveloped resources, those with small and large proportions of foreign trade etc. An attempt is made, wherever possible, to examine the role of commercial banks, savings institutions, co-operative banks and government credit institutions in financing the credit needs of each nation.

Dr. Vijaya Rathnam (1983) points out that Commercial Banks emphasis has radically shifted from banking of class to banking of masses. But in the words of a prominent banker, the major object of a branch opening, so far as the nationalised banking sector is concerned, has to be contribution to develop the region where branches are opened.
N.S. Toor (1994) advocates the recovery of non-performing assets through the process of compromise by direct talks rather than by the lengthy and costly procedure of litigation. He suggests that by constant monitoring, it is possible to detect the sickly accounts, and the incipient sickness of a unit in the early stages itself and an attempt could be made to review it and put it back on the road to recovery.

K.G. Mallya, (1995) in his book draws attention to an urgent need to create a conducive recovery climate and to make borrowers understand that the funds borrowed from banks are to be repaid in time and in full. He deals with problems relating to non-performing assets in the banking industry and suggests the steps to be taken by the bankers to reduce them. If they are not fully eradicated, they become as dangerous as cancer and ruin the banks.

Puttaswamaiah (1996) identifies and develop a set of composite indicators/parameters to review and rate the branches, divisions and circles of Banks in their service to customers.

Michael Baye and Dennis Jansen (1996) describe the evolution of banks in the U.S.A, interest rates from time to time, the demand and supply of loanable funds, electronic banking etc., there.

Banknetindia.com In view of several developments in the 1990s, the entire banking products and structure have undergone a major change. As part of the economic reforms, the banking industry has been deregulated and made competitive. New players have added to the competition. The information technology revolution has made it possible to make operations easy and flexible to customers. Rapid strides in information technology
have, in fact, redefined the role and structure of banking in India. Further, due to exposure to global trends after information explosion led by the Internet, customers—both Individuals and Corporate are now demanding better services with more products from their banks. The financial market has turned into a buyer’s market. Banks are also changing with time and are trying to become one-stop financial supermarkets. Market focus is shifting from mass banking products to class banking with introduction of value added and customized products.

C.Rangarajan(1997) in his article explains a major role external auditors play in determining the discipline and soundness of the banking system by reflecting a true and unbiased view of the financial position of banks. In an environment of advanced information technology, internal auditors have to adopt a pro-active stand in keeping the internal control system in order, by ensuring higher level of transparency of information so that the balance sheet and profit and loss accounts exhibit a true view of the affairs of the bank.

The Basel Committee on Banking Supervision (1997) in its report listed a set of twenty-five basic principles of banking supervision for a supervisory system to be effective.

Govt.of India, Report on Trend and Progress of Banking in India, (1996-97), points out that banks would need to do proper risk identification, classify risks and develop necessary technical and managerial expertise to assume risks. Banks face mainly four major categories of risks, market risk, credit risk, legal risk and operational risk.
Shivpuje and Dr. Kaveri (1997)⁷ in their study suggest various measures for reducing non-performing assets in a bank for improving its recovery performance.

Govt. of India, Report on Trend and Progress of Banking (1998)⁸ points out those Transparency of Banking operations ensures effective marketing discipline and serves as a potentially crucial mechanism for keeping banks prudent.

Gupta (1998)⁹ in his book maintain that Information Technology and advanced communication channels hold the key to globalization. However, in India, owing to an excess of bureaucratic regulations and delays, and gaps, in technological know-how, research and development, progress has been slow in these areas.

Dr. Y.V. Reddy. (1998)¹⁰ in his article points out the component of reforms involved dismantling certain directed credit programmers, lowering cash and liquidity requirements, reducing barriers to entry in the banking sector, privatizing the public sector banks, improving payment system, adopting international standards for capital adequacy and prudential norms, and improving the legal, regulatory and supervisory infrastructure. The components are packaged in different ways in each country within the overall framework of appropriate pace and sequencing.

Dr. P. Sarada (1998)¹¹ in her work, Handbook on Lending to Priority Sector points out that even before the major banks were nationalised, the need for directing the flow of bank credit to certain segments of the economy had been recognized. Conceptual formalization of priority sectors was done over a period of time widening their coverage and raising the target levels. The
Narasimham Committee recommended the scaling down of the advances from 40 per cent to 10 per cent. Further, the author explains the present position regarding various aspects relating to priority sector lending.

Deepak Lal (1999) points out that the communication revolution encompasses a global information high way, linking millions of personal computers around the world. It also includes satellite television and the declining costs of air and sea freight.

Report on Trend and Progress of Banking in India (1999-2000) reports that the growing complexity of financial institutions coupled with the need for frequent and continuous monitoring has made off-site monitoring an important instrument for supervision. Countries all over the world have embraced off-site surveillance mechanisms in varying degrees.

Basudeb Pal (2000), points out in his article that the customer service of nationalised banks is very poor, compared to these services offered in private and foreign banks. Despite the recommendations of several Committees such as those of Sarayya, Talwar and Goiporia etc., the position in this regard has not really improved.

S.M. Jha (2000) in his book points out that plastic money saves the botheration of carrying cash. It can be flashed at many outlets, and specially in times of emergency, it provides us an opportunity to draw ready cash at any hour of the day.

Tejmani Singh (2001) in his article says that an efficient banking system and a well-functioning capital market capable of mobilizing the savings and channeling them to productive uses, are essential if the efforts at economic restructuring are to succeed.
RBI, Report on Trend and Progress of banking in India (2000-2001)\textsuperscript{77} Points out that bank mergers are a possible avenue for improving the structure and efficiency of the banking industry. It is possible to categorize the motivations for bank mergers into four viz, cost benefits (economics of scale, organizational efficiency, funding costs and risk diversification), revenue benefits (economies of scope, enhancing monopoly rents), economic conditions (mergers after crises or after the upswing of the business cycle) and other motives (private managerial benefits, defense against takeovers etc.).

L. Mayer (2001)\textsuperscript{58} has made a study of the structure and operation of banks, which have undergone a rapid transformation in recent years. Consequent upon the revolution in information technology and the associated increase in competition both at national and international levels, financial intermediaries have become increasingly global in geographical coverage and universal in their financial operations encompassing a wide range of effectives including banking, securities activities and insurance.

D. Himachalam (2002)\textsuperscript{59}, has made a study of the liberalization of Indian Economy since 1991, and the drastic structural changes brought about in all spheres of the economy. The consequent emergence of global competition has brought about a lot of changes in the strategies of various sectors to improve their competitive spirit and performance.

Dr. Asthosh Saxena (2003)\textsuperscript{60} shows how Internet banking creates new challenges for banks as it opens fresh ways of exposure. Internet banking refers to the system that enable bank customers to access accounts and general information on bank products and services through a personal computer (pc) or other intelligent device.
R.A. Almeida (2003) maintains that the success of any institution in retail lending depends on taking each aspect including marketing efficiency, proper appraisal and effective follow up. It is very important to have computer package for follow-up and monitoring for effective recovery mechanism. Retail banking encompasses retail deposit schemes, retail loans, credit cards, debit cards, insurance products, mutual funds, depository services including demat facilitates and a host of other services catering to the needs of individual customers.

Rajesh Sood, Bagchi, and Dr. Meera Sharma (2003) Study in their articles risk based accounting, audit and supervision and look at the major accounting policies pertinent to risk management functions of banks internationally and in India.

Pradeep Kumar Sharma and Sushma Ball (2003) in their C.H. Bhambh Scholarship study, deal with retail lending activities during the last few years which occupy the centre stage in the Indian banking Industry. The authors expect that the trend will continue.

Murthy (2003) expresses the view that by providing cheap access to funds and a wide network of branches, the banks in India find the housing sector as the Non-Potential avenue for trouble-free and secure lending.

G.P. Muniappan (2003) focuses on two areas; firstly, challenges faced by bank management and secondly, management of challenges by banks. Every aspect of the functioning of the banking industry, be it profitability, NPA management, customer service, risk management, human resource development etc., has to undergo the process of transformation to align with
the international best practices. He concludes that the future of Indian banking system needs a long-term strategy, which would broadly cover areas like structural aspects, business strategies, prudential control system, integration of markets, technology issues, credit delivery mechanism, information sharing etc.

Bhavani Shankar (2003) says that Knowledge Management plays a pivotal role in protecting the customer base and broad-basing in the long run. The day is not far off when leading organisations of our country start trying out this concept and meeting with great success.

D.Venugopal (2004) says that as domestic and international competition boost up, banks may have to shift their focus to ‘cost’, which will be determined by revenue minus profits. Cost control in tandem with efficient use of resources and increase in productivity will determine the winners and laggards.

Prof. S.Moharana (2004) in his article expresses that the Indian banking industry in India has witnessed phenomenal changes during the post-economic reforms period. The deregulation of interest rates, the adoption of prudential norms for capital adequacy, asset classification and provisioning, the lowering of SLR and CRR, dilution of Govt. holding in public sector banks, the opening of the sector to private participation, liberalisation of Foreign Direct Investment norms, etc. have provided the much needed impetus for the growth of this sector.

Indian Bankers Association Bulletin (2004) points out that in order to improve productivity by reducing cost per transaction, banks will shift
counter transaction to other self-service delivery channels such as ATM/Cash dispensing machine, terminals for balance enquiry, self-operated pass book updates and phone banking for routine enquires. At this stage most of the repetitious, labour intensive transactions currently handled by tellers will be automated. This not only cuts costs, but also frees the staff to provide more valuable added services.

Leeladhar (2004)\(^7\) says in his contribution to the IBA Bulletin (special issue) that the Indian financial system and banking industry in particular have been the beneficiary of a carefully formulated and meticulously executed reform process operating successfully in a market economy. This calls for a careful restructuring of the industry. Our Banking Industry has demonstrated in the past a capability to transform itself. This capability will enable it to meet the future with confidence. The impact of opening up the banking sector to new generation’s private sector banks and foreign banks has led to introducing a strong element of competition. The new entrants invested heavily in technological delivery channels and infrastructure to offer a new face to retail banking to the high end of the financial consumer market. The public sector banks in turn have embarked on technology initiatives and also imitated strategies to refurbish their traditional image by upgrading delivery channels through technology, designing new products and services and entering into areas of financial services not traditionally associated with banking.

Sastri (2004)\(^8\) in his paper points out that “product innovation” has emerged as the Buzzword in world financial markets including the Indian banking system. A successful product innovation is not only the development of a
new product but also the wide acceptance and adoption of the product by the users. In the banking industry the process of marketing of financial services can be assessed through developing a strategic framework, carrying out a market audit and competitive analysis.

Shenoy (2004) points out in his paper that Banks have strong corporate governance. Corporate Governance involves the manner in which the business and affairs of individual institutions are governed by their board of directors and senior management affecting how banks set corporate objectives with the expectation that banks will operate in safe and sound manner, and in compliance with the application of laws and regulations, and more important, protecting the interest of depositors.

Pathrose (2004) says in his article that the strength of Indian Banking and insurance sectors is their resilience to adapt to the changing times and to the ever-escalating expectations of the customers. Challenges will be many for banks in the tracks to be traversed in a converged financial services scenario. Those having the strength and competence to convert these challenges to opportunities will be the winners.

Syamali (2004) says in her article that banks have to depend more on building ‘Customer Relationship’, which is a permanent asset bringing in regular income rather than mere hardware, which has obsolescence as a critical factor. Technology shall be prudently used more as a means to achieve the end results – ‘The Customer Relation Building’ has to become a Global-leading Bank.
A.K.R. Aggarwal, and D. Metha (2004) in their article, point out that Indian banks are transforming themselves to the customer centric and competitive branch seeing. They have already entered the third wave of banking reforms in their attempt to be closer to international standards. The third generation of reforms is popularly known as the era of regeneration and consolidation. However, it must be kept in mind that not everything is fine by the Indian banking industry or system, though certainly the overall trend is positive and service-oriented and customer-centric.

Raghavan (2004) says in his article that the Basel Committee on Banking Supervision (BCBs), which is a committee of banking supervisory authorities of G-10 countries, has been developing standards to establish a framework for bank supervision towards strengthening the stability of financial institutions in general and banks in particular.

Khandelwal (2005) expressed that the consolidation of Indian banking has to be viewed in the perspective of its progressive integration with global banking.

Kurian (2005) points out that financial convergence is happening, with banks, mutual funds and insurance companies which have been cooperating with each other to boost business and they have become the key financial advisors for customers.

Dr. N.K. Thingalaya (2005) in his article expressed when customers are not satisfied with all the progress made to evolve customer friendly service modes, it is reported that bankers are now planning to have 24 hours banking in certain branches. Many innovations have been made into his sphere, with
limited success before computers came on the scene. Sunday banking, special evening counters mobile branches, and extension counters, both permanent and temporary are some of them. May I help you counter came up in all big branches, ostensibly to help the harried customers.

Economic Survey (2004-2005) in its survey observes: With the liberalisation and growing integration of the Indian financial sector with the international market, the supervisory and regulatory role of the RBI has become critical for the maintenance of financial stability. The RBI has been continuously fine-tuning its regulatory and supervisory mechanism in recent years to match international standards.

Pearson (2005) It is pointed out in the manual that India has made significant progress in the payment system by introducing modern payment media viz., smart/credit cards, electronic funds transfer, debit/credit clearing, e-banking etc., The RBI would soon put in Place Real Time Gross Settlement System (RIGS) to facilitate efficient funds management and mitigating settlement risks.

Manoranjan Sharma (2005) points out that the traditional face of banks as mere financial intermediaries has changed because of the paradigm shifts from balance sheet to off balance sheet intermediation, from capital adequacy to capital efficiency, and pure banking to financial services.

Gupta (2005) says in his article that with the consolidation of Banks and Technology up-gradation of the banking platform, Internet Banking is bound to grow by leaps and bounds and will emerge as the most popular Banking delivery channel, within the next few years. With greater emphasis laid on e-
governance, the Internet Banking Channel will be a key-facilitator with about 40-50% of the total banking and financial transactions to be done through the Internet.

Objectives of the study

The present study purports to review the latest trends in the modern banking system particularly in the private sector banks, which came into existence since the financial sector reforms, and to assess their efficiency, and profitability, and the facilities provided by them to the customers. It has the following specific objectives:

1. To study the origin and development of the Indian banking sector since independence and to analyse its performance;

2. To review the Financial Sector reforms and their impact on banking development;

3. To analyse the present trends in the private sector banks including Indian banks and Foreign private banks operating in India since the advent financial sector reforms and assess their performance;

4. To study modern business innovations, financial products and strategies adopted by the sample banks, and

5. To examine the problems confronting the banks in the private sector in several and to suggest possible ways and means to tone up their performance in the global business environment.
Methodology

The Research Methodology adopted in the present enquiry into the business operation and financial performance of the private sector banks, both Indian and foreign, is explained below.

The present study is based on Primary and the Secondary data for analysis and to draw inferences. It uses a one-way approach focusing on the selected banks in the private sector, both Indian and foreign. The data pertaining to the various aspects of their business operations and performance is collected from the official records of the sample banks. Additional information pertaining to their overall banking development, their progress and performance over a period of time is extracted from major sources of secondary data, such as published reports, documents, journals, statistical reports of the RBI, Indian Banks Association Bulletin (IBA) etc., The study has extensively utilised the information regarding the later developments available through websites of various Foreign and Indian institutions. All the data, is analysed scientifically through well-known financial and statistical tools and techniques.

Sample Design

To collect data a multi-stage sample design has been used. There are 88 banks in India with a branch network of 55,381 as on 30 the June 2005. There are 27 banks in the Public sector, 29 in the private sector (old 21 and new 8) 31 foreign banks, which are operating in India and one Other Public Sector Bank (IDBI Bank from 2004-2005, but data of this bank excluded from this study). All of them are invariably governed by the new rules and
regulations of the RBI. Keeping in view the time and operational constraints, two private sector banks and two foreign banks operating in India are chosen as a sample banks for an in-depth study: The ICICI Bank and HDFC Bank in the Indian private sector and the Citibank, N.A and HSBC Ltd among the foreign banks operating in India are the samples for this study. To collect data concerning the selected banks, a simple random sampling method has been adopted.

Data Collection

The Primary data is collected by consulting the officials of the sample banks. Through interviews correct information is collected from them about the various products and services of the banks. The information thus collected is also confirmed by getting clarifications from the officials concerned of the sample banks. In addition, structured and unstructured interviews are also conducted with experts in the field and persons who are involved directly and indirectly in the operations of the sample banks.

The secondary data has been collected from various publications of the Reserve Bank of India, both audited and un-audited reports and other publications of the banks. The publications of the RBI include Statistical Tables Relating to Banks in India, Report on Trend and Progress of Banking in India, Basic Banking Statistical Returns, Report on Currency and Finance, Annual Reports of Reserve Bank of India and relevant issues of Reserve Bank of India Monthly Bulletins. The relevant materials for the study at the Government level have also been collected from the Economic Survey of India, from various books relating to financial institutions and commercial banks, different Committee Reports relating to financial system and banks,
different websites of banks, Indian Banks Association Monthly and Special Bulletins, Journal of Banking Finance etc. The information pertaining to business operations, financial products, the business strategies and performance in various kinds of business activities, is also collected from various reports, journals, and banking websites. Further, data is also collected from the published and un-published records and various reports of research project-reports to supplement the other data.

Tools / Techniques for Analysis

To analyse scientifically and interpret the collected data, financial tools and techniques and various statistical tools are applied wherever necessary. The following are the tools and techniques used: 1) Financial Ratios, 2) Percentages, 3) Linear growth rate and 4) Compound growth rate 5) Averages 6) Standard Deviation 7.) Coefficient of variance analyses 8) Tests of significance etc. these have been used for the analysis of the data. The SPSS software package version 7.5 for calculations has been used.

Significance of the present study

India has a sound network of financial institutions, which are governed by the rules and regulations of the Reserve Bank. The Reserve Bank, as the central bank of the country, closely monitors development in the whole financial sector. It is, however, the deposit-taking institutions and development financial institutions, which directly come under the regulatory ambit of the Reserve Bank.

Globalization has brought about a massive change in the attitude and performance of the banking sector in India. Increasing competition has
improved the product range, enhanced delivery channels and quality of service, lowered costs and kept up pressure on the banks to adopt state-of-the art technology. In the changing economic scenario, the focus of banks is increasingly shifting from long-term industrial loans to high yielding retail loans. However, for years, retail banking had not picked up because of the bank's inability to cross-sell and its poor service attitude. With the advent of the customer-centric approach the very definition of retail banking activities has changed.

The private sector banks took the initiative to establish an efficient retail-banking network. Seeing the huge potential that the retail base entailed, the public sector banks also have taken the plunge. Be it in the public sector or the private sector, every bank is innovating and offering newer products, which are driven by customer requirements. Retail banking is all about superior product range catering to every individual need of the customer. The ability to create product differentiation by offering superior product features will help the banks emerge as a leading provider of high quality financial products and services. The huge competition has brought about an interest rate war that has benefited the customer to a large extent. Having built a deposit base and more and more bank products and services being introduced to cater to the diverse needs of customers, there is an increased need for cross sales. As cross selling entails huge investment and technology there is need for deflecting the branch customer to other electronic channels like the ATMs, Tele banking and Internet banking.
In view of the significant role of commercial banking in the economic development of the country, the present critical study of the various aspects of commercial banks particularly from the dimension of operational efficiency, innovation in financial products and services will be without doubt significant. This type of study will go a long way to improve further the performance of banks in their financial management and operational capabilities and skills, in satisfying the customers.

The present study “Trends in Commercial Banking Sector – A study of Select Private Sector Banks” will be surely relevant to the needs of society for more than one reason. First of all such a study has not been conducted in the State of Andhra Pradesh. Secondly, the banking sectors from the viewpoint of their performance efficiency and the new financial services expected to be rendered in the liberalised environment at the global level have yet to make their impact. Some banks are doing extremely well in their business operations and some others not so well, in terms of profitability, asset creations, branch expansion and rendering services to customers who expect more and better services and facilities.

Limitations of the study

As the study of banking operations is very vast, it is a Herculean task to cover all aspects of all categories of banks and their operations. Therefore the study is restricted to certain aspects of banks so that the study can be carried out in depth some categories of banks working in India. Time and facilities available, which are linked, have necessitated the diverting of its scope to only private and foreign banks operating in India. Though an overview of the banking sector from its inception is given, the detailed
analysis is focussed on financial sector reforms only, as these new banks, both private and foreign banks, came into existence since the financial sector reforms in India were initiated. The study covers some years of the post-reform era (1995-2005). While analyzing the data for assessing the performance only certain parameters like Deposits, Loans and Advances, Investments, Total assets, Income, Expenditure, Profit, Spread, Branch Expansion, NPAs, Capital adequacy ratio and also some other variables relating to improving the efficiency and profitability have been undertaken.

Plan of the thesis

The thesis is organised in seven chapters.

Chapter-I deals with Introduction and Research Methodology. It traces the Origin and development of the Banking Sector in India, outlines the policy measures, and the regulatory framework of the RBI, performance of the banks in the overall economic development of the country. And the issues arising from them are explained. A review of literature relevant to the present enquiry is presented. The problem of research undertaken, its scope and limits, and the Research Methodology adopted and the plan of the thesis are outlined.

Chapter-II: This chapter presents a bird's eye view of the Development of Banking Sector in India. It surveys briefly the development of policy measures of the government. The growth and performance of the Banking Sector and its operational issues are also dealt with in the chapter.

Chapter-III: This chapter deals with Financial Sector Reforms - A Backdrop. It outlines the need for Financial Sector reforms. It gives a
brief account of the Narsimham Committee recommendations-I & II, the emergence of new banking systems, and also presents the measures of Financial Sector Reforms undertaken.

Chapter-IV: This chapter presents the Profiles of the Sample Banks (ICICI, HDFC, Citibank, and HSBC) traces the origin, growth and development, organisational structure, branch Expansion, and innovative financial products and services of these Banks.

Chapter-V: This chapter examines in detail the Growth and Performance of Sample Banks.

Chapter-VI: This chapter covers the Innovations in Financial Products and Services. It examines the new trends in banking activities since the financial sector reforms were initiated, and the merits and demerits of the services are offered.

Chapter-VII: Summary and Suggestions: This concluding chapter summarises the arguments developed in the previous chapters, draws certain conclusions and also suggest some practicable suggestions for improving the performance of the banks.
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