CHAPTER I

Introduction

1.1 Background of the Study

India has embarked on the process of economic reforms in 1991 in the wake of an exceptionally severe balance of payment crisis. In that year the Government of India signaled a systematic shift towards a more open economy with greater reliance upon market forces, a larger role for the private sector including foreign investments and a restructure of the role of the government. The economic reforms launched since 1991 may be categorised under two broad areas: first, major macro-economic management reforms and secondly, structural and sector specific economic reforms (Wadhva, 2005). The economic reforms started in early nineties have brought infrastructural changes in power, road and rail connectivity, telecommunications, air transport, ports, etc. and as a follow up of these policy changes some reforms in the financial sector have become necessary (Ahluwalia, 2000).

Strengthening financial system has been one of the central issues of the economic reforms in India. This is because sound financial system serves as an important channel for achieving higher economic growth through the mobilisation of financial savings and putting them to productive uses (Jayaratne and Strahan, 1996). The banking sector being the life line of the economy has been the major target of the financial sector reforms in India. The Reserve Bank of India has taken a series of reform measures to strengthen the banking sector of the country since the start of the process.
As a result of these reforms, the banking sector of India is supposed to experience some changes in the various aspects of banking. These changes are more likely in the case of Scheduled Commercial Banks (SCBs) operating in the country as the reforms are mainly targeted towards them.

1.2 Banking Sector Reforms- A Background

In continuation of the economic reforms, a series of banking sector reforms is initiated with focus on principle of corporate governance, observation of global accounting standards, business process re-engineering in terms of innovative bank products and services, adherence to the prudential norms, diversification of product portfolio, mandatory risk management, use of IT related technology, rigorous monitoring, auditing and supervision of the sector and transparency in the banking industry.

The reform measures emanates out of a series of reports submitted by various committees at different times. To achieve effective operation of the long term vision of the Indian banking industry, as described in the Indian Bankers Association Report, Vision: 2010, there is a clear need “to evolve the Banking Industry in to a strong, sound and competitive financial system, providing integrated services to customers of all segments, leveraging on technology and human resources, adopting the best accounting and ethical practices and fulfilling corporate and social responsibilities towards all stakeholders”. In this respect a comprehensive strategy towards business risk minimization coupled with proper management of the non performing assets (NPAs) of the banks will go a
long way for achieving long term economic growth by the Indian banking industry. For modernisation of the banking industry, as also to capture good amount of market share, IT based technology including e-banking and integrated approach to retail banking are fast assuming prime place in banking industry as a major business strategy in a competitive market environment (Sarkar, 2005).

It has been normally observed that the banking industry in Assam has been weak compared to other regions of India. A strong, inclusive and sound banking system can contribute towards the economic development of the region. The banking sector reforms have cleared the road for the new private sector banks to open branches in the state. Though the number of private banks operating in the state is less compared to North Indian and Western Indian states but the number is fast increasing. This will definitely create a sense of competition among the banks operating in the area.

It has been 18 years since the beginning of banking sector reforms and some changes may have taken place during these years. Therefore, efforts should be made to capture the changes in the banking sector of Assam as a result of the reform measures specially in the backdrop of the entry of private sector banks which has not been done yet. Hence, with this background the issue has been taken up for research under the title “Impact of Banking Sector Reforms in Assam with Special Reference to Entry of Private Sector Banks”.

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1.3 Banking Structure in India

As per the Indian banking structure the Reserve Bank of India (RBI) is the apex body of the overall banking sector for monitoring, regulating and guiding the industry. The scheduled banks are those which are included in the Second Schedule of the RBI Act, 1934.

Chart 1.1: Scheduled Banking Structure in India

The scheduled banks are divided into two broad categories—scheduled commercial banks and scheduled co-operative banks (Chart 1.1). The scheduled commercial banks are further sub-divided into public sector banks, private sector banks, foreign banks (FB) and Regional Rural

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Banks (RRBs). The public sector banks are formed by the State Bank of India (SBI) and its associate banks called SBI Group and the Nationalised Bank (NB) Group includes all the nationalised banks other than SBI Group. Similarly, the private sector banks are divided into old private sector banks (OPSB) and the new private sector banks (NPSB). The new private sector banks are those which are established after 1991. On the other hand the scheduled co-operative banks are sub-grouped in to two, viz., Urban Co-operative Banks and State Co-operative Bank.

1.4 Banking set up in Assam

The network of scheduled commercial banks delivering banking services in Assam is grouped under Nationalised Banks group, State Bank of India group, Regional Rural Banks, domestic private sector banks (DPSB) and Foreign Banks. Besides these commercial banks there is one state co-operative bank called Assam State Co-operative Apex Bank Limited which is also rendering services in the state with 68 branches. Again the Assam State Co-operative and Rural Development Bank (ASCARDB) is working as an apex institution in the state with 33 branches. But it is not extending any credit in the state since 1995-96. The North East Development Financial institution (NEDFi) also extends credit to industry and service sector in rural and urban areas of the state. As on March 2008, there are 28 commercial banks operating in Assam having a network of 922 branches and 2 RRBs are working with branch strength of 396 (Table 1.1) Majority of bank branches (59.67 percent) are situated in the rural areas.
Table 1.1: Banking set up in Assam
(As on end March 2008)

<table>
<thead>
<tr>
<th>Name of Banks</th>
<th>Number of banks</th>
<th>Number of branches</th>
<th>Branches in rural areas</th>
</tr>
</thead>
<tbody>
<tr>
<td>Commercial banks</td>
<td>28</td>
<td>922</td>
<td>473</td>
</tr>
<tr>
<td>Regional Rural banks</td>
<td>2</td>
<td>398</td>
<td>331</td>
</tr>
<tr>
<td>State Co-operative Bank</td>
<td>1</td>
<td>68</td>
<td>18</td>
</tr>
<tr>
<td>District Co-operative Bank</td>
<td>1</td>
<td>1</td>
<td>nil</td>
</tr>
<tr>
<td>ASCARDB</td>
<td>1</td>
<td>17</td>
<td>17</td>
</tr>
<tr>
<td>Total</td>
<td>33</td>
<td>1406</td>
<td>839</td>
</tr>
</tbody>
</table>

Source: SLBC Report, Assam and State Focus Paper, Assam

As on March 2008, out of the 28 scheduled commercial banks operating in the state 7 belong to domestic private sector banks and one foreign bank. Further among the seven domestic private sector banks one is old private sector bank whereas remaining six are new private sector banks. Though the first new private sector bank in India was set up way back in 1994 but the same came to the state in 2000 only. One significant change in the banking set up of Assam took place in 2006 when four out of five RRBs are merged in to one single entity named Assam Gramin Vikash Bank (AGVB) making it the single largest bank in terms of number of branches.

1.5 Review of Literature

There are few studies that assess the impact of India's banking sector reforms at different levels from different perspectives. Some of them as mentioned below have been gone through during the study.
Sen and Vaidya (1997) have examined the reforms in the sectors like commercial banking, development financial institutions and the market since the reforms of mid-1991 for the first four years and have tried to throw light on the possible future path for Indian financial system. The book studies the whole issue of regulatory regime pertaining to banks in the light of Narasimham Committee Report. They have suggested that an optimal regulatory framework is important in present time compared to the pre-reformed period. The regulatory framework known as “Prudential Regulation” is extremely necessary and it would help commercial banks to improve certain performance indicators like NPAs, capital to risk asset ratio (CRAR), market structure, etc.

Sarkar, Sarkar and Bhaumik (1998), based on data from 1993-94 and 1994-95, have shown that foreign banks are more profitable than public sector banks. The domestic private banks are similar to that of foreign banks, but domestic private banks spend more resources on provisions for NPAs. They have also shown that foreign banks are more efficient than domestic private and public sector banks.

Sarkar and Bhaumik (1998), based on data from the period 1980 to 1997-98, have shown that foreign banks, despite the superior quality they offer, have not been a competitive threat in Delhi, West Bengal and Maharastra where their presence is the largest. Domestic private sector banks have gained some market share in these regions, but the impact on public sector banks is small and has gained at the expense of foreign banks. In Uttar Pradesh, Madhya Pradesh, Bihar, Orissa, Gujarat and Punjab, Public
sector banks have been predominant before and after the reforms. Thus no apparent impact from new entries is observed. In Tamilnadu, Kerala, Andhra Pradesh, Karnataka, Jammu and Kashmir and Rajasthan private domestic banks have been more concentrated than in other regions and have experienced an increase in market share at the expense of public sector banks but the presence of foreign banks is small.

Hansen and Kathuria (1999) have provided a good overview of banking sector reforms in India while getting ready for the twenty-first century. The book also throws light for the next round of reforms in the banking sector along with current status in the context of the globalised environment. It has also gone in to the need and the problems in regulatory and supervision issues of Indian banking industry under the liberalised environment specially under the Basel I agreement.

Kapila and Kapila (2000) in their edited book of four volumes have provided a detail account of financial and banking sector reforms in recent years. The authors like Bimal Jalan, Y. V. Reddy and N. A. Majumdar have put their distinct perspective regarding the banking sector reforms in India since 1991. The literatures in the book have suggested some financial architecture for future like international experience and domestic requirements should guide universal banking approach, RBI should concentrate only in regulatory and supervision of commercial banks, there should be only banks and NBFCs and so on.

Shirai (2001) has made assessment of India's banking sector reforms from the perspective of the governance of the banking system by examining
seven hypotheses. She has found that some large public sector banks appear to have performing reasonably well in the post reform period. This could be attributed to the entry of well-capitalised new banks. The new domestic private banks and the foreign banks have helped to improve the quality and variety of services, efficiency of bank management and prudential supervisory capacity of the overall banking sector. She has opined that foreign and new private sector banks have maintained a higher profitability (about 1-2 percent) than public sector and old private sector banks during 1995-2000. This suggests that ownership of the banks does matter and the entry of foreign banks has a positive impact on the restructuring of the banking sector. Further, it says that by engaging in the non-traditional activities banks have able to improve profitability, cost and earning efficiency. The study has concluded that profitability of banks has turned positive, cost efficiency has improved over the reform period and the gap of performance with the foreign banks has diminished. 

Talwar (2003) has viewed that financial sector reforms has provided the banks the operational flexibility and functional autonomy which have helped them to raise the level of performance. The public sector banks have become conscious about the need for higher level of efficiency and profitability showing positive impact on India's financial market. The entry of foreign banks has definitely improved the competitive environment but they are not likely to weaken domestic banks with better technology and expertise. On the contrary the entry of foreign banks could have positive spillover effect on domestic banks through healthy competition.
Mohan (2004) has gone in to the financial sector reforms in India and analyses the performance. He has captured the different types of reforms in the banking sector of India since 1991 and the performance of the industry in the light of the reforms. The literature studies the impacts of reforms upon market structure of banks in terms of capital position, asset quality, NPAs, income and expenses of banks, etc. and also provides a comparative study of the different bank groups. It is empirically shown that commercial banking sector has achieved improvements during the reform period in the field of priority sector lending, growth of assets and liabilities, overall capital position and asset quality of banks with new private sector banks and the foreign banks are at the top. The public sector banks though lagging behind but they are also showing an improving trend in recent years. Another major outcome of reforms that Mohan has pointed out is that reform has able to bring changes in the business strategy of banks in India.

Kohli (2005) has documented India's experience in managing its capital account liberalisation since 1991. The discussion in the book highlighted the strength and weaknesses of the Indian financial system with a focus on assessing its capacity to cope with the rapidly increasing capital mobility. It is commented that the process of privatisation and restructuring of banking sector has been half hearted and the result is also far from the expectation. She has studied a host of indicators such as NPAs, provisioning against losses, income, operational cost, staff cost, etc. of the different bank groups and has conclusively proved that in all the indicators foreign and new
private sector banks are at the top with public sector banks coming at the last.

Mohan (2006) has shown that a good deal of financial growth has accompanied the recent acceleration of economic growth. He also observes that a sufficient part of credit growth has gone towards consumption and housing sector suggesting widening of financial system.

Mohan has also examined the present Indian picture of financial inclusion and the impact of exclusion upon the economy as a whole. It concludes that total number of saving accounts, regarded as a better indicator of banking penetration, as a percent of number of households for urban and rural India has not improved during 1991-2005. He provides empirical presentation of present banking coverage in terms of branch expansion, population per branch, number of savings accounts and credit accounts per 100 persons and shows that the North Eastern Region is far behind than the all India figure in respect of the above indicators.

Chakraborti (2006) has put forward a detail analysis of financial sector reforms in India in recent years. The book is a collection of empirical analysis and surveys on topics concerning the Indian financial sector that has assumed importance in the years since liberalisation. The essays included in the volume take an in-depth look at some of the issues that have emerged out of the transformation in the banking industry. He has made a good effort to study the performance of commercial banks in India during the post reform period. The study has tried to compare the performance of the different bank groups in terms of efficiency, profitability,
NPAs and capital adequacy ratio. It has found that foreign banks are the most profitable and productive among the different bank groups in India during the post reform period and the public sector banks are the least profitable and productive. But the new private sector banks are catching up the foreign banks by following their style of functioning and using latest information technology. In NPAs front public sector banks have higher NPAs compared to the other two but in recent years the new private sector banks are facing problems from the rising NPAs. He has outlined the present status and level of microfinance in India and shown that the phenomenon of microfinance is strongly biased towards the south India. Andhra Pradesh has emerged as the largest beneficiary of microfinance with 42 percent of the total SHGs linked with banks in India.

Sarma (2006) has made an analysis of the performance of commercial banks in Assam during post-1991 period. She has studied different aspects like level of deposit mobilisation, volume of credit disbursement, C:D ratio, branch expansion, etc. of the commercial banks and RRBs after 1991. The study has found that there has not been much change taken place in Assam in the commercial banking business. All the indicators of the banking sector show that Assam is not been able to catch up the all India level despite the reforms. But the study does not undertake a comparative study of these indicators for the different bank groups operating in the state.

Mittal and Dhade (2007) have tried to make a comparative study (1999-2004) about profitability and productivity between the public sector banks
and the private sector banks in India. They used the tool of Ratio Analysis as it helps to summerise large data to draw qualitative judgments. The ratio used to calculate the profitability are interest earned ratio, interest paid ratio, non-interest income ratio, other operating expenses ratio and establishment expenses ratio. In the profitability category foreign banks top the list followed by the domestic private sector banks and the public sector banks. But the profitability of the public sector banks is improving in the last 5 years. To find out the productivity of the two groups of banks they use the ratios of deposit per employee, advances per employee, total business per employee, deposit per branch, advance per branch and total business per branch. They have commented that the public sector banks are lagging behind in terms of productivity compared to private sector banks and the foreign banks. They further argue that though the public sector banks have some social orientation but that is not strong enough to ignore the level of low productivity.

1.6 Objectives and Research Questions
The specific objectives of the research are –

❖ To know the changes in the networking pattern of scheduled commercial banks in terms of branch expansion in the state following the reforms.
❖ To know the performances of public sector banks and the private sector banks in respect of deposit mobilisation, credit disbursements, C:D ratio and business performances.
❖ To know the credit allocation towards different sectors such as agriculture, industry, service and personal loan by both public and private sector banks and also their role in micro finance in the state.
❖ To measure the quality of service of scheduled commercial banks as perceived by the retail customers.

The research questions pursued in the study are as follows-

➢ What is the penetration of private sector banks in terms of shares in deposit and credit volumes?
➢ What is the status and growth of Financial Inclusion in Assam during the reform period?
➢ How has the reform process affected credit supply towards economically poor, needy and weaker sections of the society?

1.7 Methodology

The methodology that has been used for the research is mentioned in details below-

1.7.1 Coverage of the Study

The present study covers the changes in the banking sector of Assam for the period from 1991 to 2008. The study includes only the scheduled commercial banks operating in the state which includes State Bank of India group, Nationalised Banks group, Regional Rural Banks and the private sector Banks. The study has also taken the first three categories of banks under the public sector bank group while domestic private sector
banks and the foreign banks comprise the private sector banks group. The study does not take into account the co-operative banks of the state.

1.7.2 Data Source

The main source of the data for the research has been the secondary sources. The major sources of secondary data are the various publications of the Reserve Bank of India. Data are also gathered from the publications by the banks, previous research works and articles, reports, research institutions, journals, etc.

Secondary data is sufficient for the fulfillment of the first, second and third objectives of the research. The data from the secondary sources are also sufficient to get the answers for all the three research questions taken in the study. But the secondary data has not been able to provide the information required to fulfill the fourth objective. To fill up this gap primary data has been collected through a sample survey from the customers of the banks which provides information to fulfill the 4th objective. The sample survey has been carried out to collect the necessary data to measure service quality of scheduled commercial banks. The sample design is given in details in chapter V.

1.7.3 Outline of Analysis

The secondary data collected from the various sources have helped to study the changes in the pattern of branch networking of SCBs following the banking sector reforms in Assam. The changes in banking network are
measured through indicators like total number of branches, population covered by per branch, spatial distribution of branches, etc. Analysis has been done in terms of both public and private sector banks. The changes in the deposit and credit of the banks are measured by looking at figures for overall changes in deposit and credit, changes in per capita and per branch deposit and credit, spatial distribution of deposit and credit, etc. The study has been done for both public and private sector banks.

The business performance of SCBs is studied through the indicators of business per employee, business per branch and volume of non-performing assets. The credit allocation towards different sectors of the economy of Assam is studied through the ratio of total credit going to these sectors for both public and private sector banks. Similarly, the credit allocation towards the Weaker Section Advance (WSA) and Priority Sector Advance (PSA) under the directed credit policy is discussed on the basis of percentage share of total credit going to these sectors. The status and growth of financial inclusion is captured through indicators, among others, like number of savings and current accounts per 100 of adult populations, number of credit accounts per 100 of adult populations, area and population covered by per branch, number of “No Frills” accounts opened and number of General Purpose Credit Cards issued, etc. The involvement of the commercial banks in micro finance in Assam through SHG-Bank linkage programme is assessed through the number of SHG linked with the banks and the amount provided to them. Finally, the service quality for the
different bank groups have been studied and compared to find out the level of service quality of the scheduled commercial banks in the state.

Analysis of the secondary data has been done by calculating ratios and averages, graphs, estimating annual compound growth rates and through tabular presentation.

Service quality of SCBs is measured using Service Quality Index (SQI), which has been named as MSP (Modified SEVPERF). To analyse the variations in the index, an econometric model has been estimated.

1.8 Structure of the Thesis

The whole thesis has been divided into six chapters containing different aspects of the study.

The first chapter of the thesis is devoted to the introductory part of the study. The chapter contains the background of the study followed by a brief background of the banking sector reforms in the country. It also takes into consideration the banking set up of Assam and the objectives and the research questions of the study. Finally, the chapter discusses the similar works done by the different scholars at various times followed by the structure of the thesis.

The second chapter of the thesis looks at the various reform measures for the banking sector taken by the government and the RBI at different points of time. It mainly discusses, besides others, the two reports submitted by the Narasimham Committee which are considered as the corner stones of the banking sector reforms in India. Besides the reform
measures, the chapter also includes a brief discussion on the broad impacts of those reforms upon the banking industry of India.

The third chapter of the work is fully used to study the changes in the commercial banking business in Assam as a result of the banking sector reforms. Various indicators of banking business are selected and a thorough study is carried out. These indicators are branch network, deposit mobilization, credit disbursement, business performances and use of technology. This chapter also includes the involvement of commercial banks of the state in the field of micro finance and the other non traditional channels of commercial banking.

The fourth chapter covers the changes in the banking penetration in the state. The chapter analyses the changes in the field of financial inclusion in the state. It also discusses the C:D ratio of the banks operating in the state in order to know the level of availability of liquidity. Besides, the chapter tries to capture the sector wise credit delivery and the changes in the priority sector advance of the banks during the reform period. Finally, an effort is made to see whether credit availability has increased or not towards the weaker sections of the people.

The fifth chapter is dedicated to the discussion made regarding the measurement of service quality of commercial banks in the state. The chapter discusses the service quality in terms of public and private sector banks and different categories of banks and makes a comparison among them. It also analyses the impact of factors like gender, location and occupation of the customers upon the quality of service of the banks.
Finally, a regression line is fitted to study the variations in the service quality of banks due to the different bank categories, gender, location and occupation.

The sixth chapter has included the summery of the findings of the study followed by broad inferences and policy implications.