CHAPTER - 4

ROLE OF PUBLIC SECTOR BANKS AND PRIVATE SECTOR BANKS IN INDIAN ECONOMY

4.1 ROLE OF PUBLIC SECTOR BANK IN INDIAN ECONOMY

4.1.1 Definition and inception of public sector banks

- Public Sector Banks (PSBs) are banks where a majority stake (i.e. more than 50%) is held by a government. The shares of these banks are listed on stock exchanges. There are a total of 26 PSBs in India.

- Emergence of public sector banks:

  - The Central Government entered the banking business with the nationalization of the Imperial Bank Of India in 1955. A 60% stake was taken by the Reserve Bank of India and the new bank was named as the State Bank of India. The seven other state banks became the subsidiaries of the new bank when nationalised on 19 July 1960.[3] The next major nationalisation of banks took place in 1969 when the government of India, under prime minister Indira Gandhi, nationalised an additional 14 major banks. The total deposits in the banks nationalised in 1969 amounted to 50 crores. This move increased the presence of nationalised banks in India, with 84% of the total branches coming under government control.

  - The next round of nationalisation took place in April 1980. The government nationalised six banks. The total deposits of these banks amounted to around 200 crores. This move led to a further increase in the number of branches in the market, increasing to 91% of the total branch network of the country. The objectives behind nationalisation where:

    - To break the ownership and control of banks by a few business families,
    - To prevent the concentration of wealth and economic power,
    - To mobilize savings from masses from all parts of the country,
    - To cater to the needs of the priority sectors
4.1.2 Public sector banks before economic liberalization

India's Pre-reform period scenario-

Since 1991, India has been engaged in banking sector reforms aimed at increasing the profitability and efficiency of the then 27 public-sector banks that controlled about 90 per cent of all deposits, assets and credit. The reforms were initiated in the middle of a “current account” crisis that occurred in early 1991. The crisis was caused by poor macroeconomic performance, characterized by a public deficit of 10 per cent of GDP, a current account deficit of 3 per cent of GDP, an inflation rate of 10 per cent, and growing domestic and foreign debt, and was triggered by a temporary oil price boom following the Iraqi invasion of Kuwait in 1990.

India’s financial sector had long been characterized as highly regulated and financially repressed. The prevalence of reserve requirements, interest rate controls, and allocation of financial resources to priority sectors increased the degree of financial repression and adversely affected the country’s financial resource mobilization and allocation. After Independence in 1947, the government took the view that loans extended by colonial banks were biased toward working capital for trade and large firms (Joshi and Little 1996). Moreover, it was perceived that banks should be utilized to assist India’s planned development strategy by mobilizing financial resources to strategically important sectors.

Banking Sector Reforms

As the real sector reforms began in 1992, the need was felt to restructure the Indian banking industry. The reform measures necessitated the deregulation of the financial sector, particularly the banking sector. The initiation of the financial sector reforms brought about a paradigm shift in the banking industry. In 1991, the RBI had proposed to form the committee chaired by M. Narasimham, former RBI Governor in order to review the Financial System viz. aspects relating to the Structure, Organisations and Functioning of the financial system. The Narasimham Committee report, submitted to the then finance minister, Manmohan Singh, on the banking sector reforms highlighted the weaknesses in the Indian banking system and suggested reform measures based on the Basle norms. The guidelines that were issued subsequently laid the foundation for the reformation of Indian banking sector.
The main recommendations of the Committee were:

Banking Sector Reforms

- Reduction of Statutory Liquidity Ratio (SLR) to 25 per cent over a period of five years
- Progressive reduction in Cash Reserve Ratio (CRR)
- Phasing out of directed credit programmes and redefinition of the priority sector
- Stipulation of minimum capital adequacy ratio of 4 per cent to risk weighted assets
- Adoption of uniform accounting practices in regard to income recognition, asset classification and provisioning against bad and doubtful debts Imparting transparency to bank balance sheets and making more disclosures Setting up of special tribunals to speed up the process of recovery of loans Setting up of Asset Reconstruction Funds (ARFs) to take over from banks a portion their bad and doubtful advances at a discount
- Restructuring of the banking system, so as to have 3 or 4 large banks, which could become international in character, 8 to 10 national banks and local banks confined to specific regions. Rural banks, including RRBs, confined to rural areas
- Abolition of branch licensing
- Liberalising the policy with regard to allowing foreign banks to open offices in India
- Rationalisation of foreign operations of Indian banks
- Giving freedom to individual banks to recruit officers
- Inspection by supervisory authorities based essentially on the internal audit and inspection reports
- Ending duality of control over banking system by Banking Division and RBI
- A separate authority for supervision of banks and financial institutions which would be a semi-autonomous body under RBI
- Revised procedure for selection of Chief Executives and Directors of Boards of public sector banks
- Obtaining resources from the market on competitive terms by DFIs
- Speedy liberalisation of capital market
4.1.3 Economic Reforms of the Banking Sector in India

- Indian banking sector has undergone major changes and reforms during economic reforms. Though it was a part of overall economic reforms, it has changed the very functioning of Indian banks. This reform has not only influenced the productivity and efficiency of many of the Indian Banks, but has left everlasting footprints on the working of the banking sector in India. Let us get acquainted with some of the important reforms in the banking sector in India below with a graph.

- Reduced CRR and SLR: The Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) are gradually reduced during the economic reforms period in India. By Law in India the CRR remains between 3-15% of the Net Demand and Time Liabilities. It is reduced from the earlier high level of 15% plus incremental CRR of 10% to current 4% level. Similarly, the SLR is also reduced from early 38.5% to current minimum of 25% level. This has left more loanable funds with commercial banks, solving the liquidity problem.

- Deregulation of Interest Rate: During the economics reforms period, interest rates of commercial banks were deregulated. Banks now enjoy freedom of fixing the lower and upper limit of interest on deposits. Interest rate slabs are reduced from Rs.20 Lakhs to just Rs. 2 Lakhs. Interest rates on the bank loans above Rs.2 lakhs are full decontrolled. These measures have resulted in more freedom to commercial banks in interest rate regime.

- Fixing prudential Norms: In order to induce professionalism in its operations, the RBI fixed prudential norms for commercial banks. It includes recognition of income sources. Classification of assets, provisions for bad debts, maintaining international standards in accounting practices, etc. It helped banks in reducing and restructuring Non-performing assets (NPAs).

- Introduction of CRAR: Capital to Risk Weighted Asset Ratio (CRAR) was introduced in 1992. It resulted in an improvement in the capital position of commercial banks, all most all the banks in India has reached the Capital Adequacy Ratio (CAR) above the statutory level of 9%.

- Operational Autonomy: During the reforms period commercial banks enjoyed the operational freedom. If a bank satisfies the CAR then it gets freedom in opening
new branches, upgrading the extension counters, closing down existing branches and they get liberal lending norms.

➢ Banking Diversification: The Indian banking sector was well diversified, during the economic reforms period. Many of the banks have stared new services and new products. Some of them have established subsidiaries in merchant banking, mutual funds, insurance, venture capital, etc which has led to diversified sources of income of them.

➢ New Generation Banks: During the reforms period many new generation banks have successfully emerged on the financial horizon. Banks such as ICICI Bank, HDFC Bank, UTI Bank have given a big challenge to the public sector banks leading to a greater degree of competition.

➢ Improved Profitability and Efficiency: During the reform period, the productivity and efficiency of many commercial banks has improved. It has happened due to the reduced Non-performing loans, increased use of technology, more computerization and some other relevant measures adopted by the government.

➢ Prior to the economic reforms, the financial sector of India was on the crossroads. To improve the performance of the Indian commercial banks, first phase of banking sector reforms were introduced in 1991 and after its success; government gave much importance to the second phase of the reforms in 1998. Uppal (2011) analyzes the ongoing banking sector reforms and their efficacy with the help of some ratios and concludes the efficacy of all the bank groups have increased but new private sector and foreign banks have edge over our public sector bank. The efficient, dynamic and effective banking sector plays a decisive role in accelerating the rate of economic growth in any economy.

4.1.4 Working of public sector banks

The following concepts and regulations about Government accounts need to be kept in mind :-

(a) Government Account is kept on cash basis. Most transactions take place by cheques drawn on accredited Public Sector Banks which also receive money on behalf of the Government. Reserve Bank of India is the main banker of the Government and other authorised Banks function as its agents while handling Government transactions. Transactions through Banks have their final impact on Government ‘Cash Balance’ in course of time. Prior to that certain
intermediary/adjusting heads are operated and the bookings there under are to be finally adjusted at the earliest to reflect Government's receipts and expenditure accurately.

(b) The terms 'debit' and 'credit' are inevitably used in all accounts. They connote 'expenditure' and ‘receipt’ of cash.

(c) The intermediary heads referred to above are:

- 8670 Cheques and Bills
- 8658 Suspense Accounts -108 PSB Suspense
- 8675 Deposits with Reserve Bank- 101 Central Civil

While the head 'Cheques and Bills' accounts for the amount of cheques drawn, the heads 'PSB Suspense' and 'Deposits with Reserve Bank' reflect transactions taking place at the Banks. Thus, these do not represent income/expenditure of Government and hence credits and debits under these heads do not connote the usual meaning that these terms carry. Credit and debit under these heads conform rather to the principles of double entry book keeping. The head 'Cheques and Bills' is credited by the amount of cheques drawn and corresponding debit is given to the head to which the expenditure relates; the difference, if any, is credited to the appropriate receipt heads like GPF, Income Tax etc. Heads 'PSB Suspense' and 'Deposits with Reserve Bank' have their mirror image in Bank books. A debit to 'PSB Suspense' in Government books represents amount owed by PSBs to Government, whereas a debit under 'Deposits with Reserve Bank' represents amounts owed by RBI to Government. Conversely, credits under these heads would represent amounts owed by Government to PSBs/RBI, as the case may be. Detailed explanation of transactions under these heads will be found in the chapter dealing with these heads separately. Briefly, the amount of Government receipts in a Public Sector Bank (PSB) when reported to Government through a receipt scroll along with relevant challans is debited to 'PSB Suspense'. Conversely, the amounts paid by a PSB against cheques drawn by a Pay and Accounts Officer or a Departmental Officer, when reported through a payment scroll along with paid cheques, will be credited to 'PSB Suspense'. The head 'Cheques and Bills' as well as 'Suspense' and 'Remittance' heads are intermediary accounting devices for initial record of transactions which are to be cleared/withdrawn in due course. Thus, credits under 'Cheques and Bills' are cleared in the Pay and Accounts Office on receipt of payment scrolls with paid cheques from the Banks. Debits and
credits under 'PSB Suspense' are cleared by cash settlement between the PSB and the RBI by debit or credit as the case may be, to the head 8675 Deposits with Reserve Bank-101 Central-Civil. Such a clearance is affected in the accounts by booking minus entries. Thus, while original entries are positive (credit or debit) clearing entries are negative i.e. minus credit or minus debit. This is a special feature of government accounts. This expedient of minus transactions enables a linkage between original entries and clearing entries and keeps the balance amounts smaller than would have been the case otherwise

4.1.5 SBI Group as the biggest bank of India and other public/private sector banks

State Bank of India, with its seven associate banks command the largest banking resources in India. SBI and its associate banks are:

- State Bank of India
- State Bank of Bikaner & Jaipur
- State Bank of Hyderabad
- State Bank of Indore
- State Bank of Mysore
- State Bank of Patiala
- State Bank of Saurashtra
- State Bank of Saurashtra

After the amalgamation of New Bank of India with Punjab National Bank, currently there are 19 nationalized banks in India:

- Allahabad Bank
- Andhra Bank
- Bank of Baroda
- Bank of India;
- Bank of Maharashtra
- Canara Bank
- Central Bank of India
- Corporation Bank
- Dena Bank
- Indian Bank
- Indian Overseas Bank
- Oriental Bank of Commerce
- Punjab & Sind Bank
Punjab National Bank
Syndicate Bank
Union Bank of India
United Bank of India
UCO Bank
Vijaya Bank

4.1.6 Private sector banks

- Axis Bank (formerly UTI Bank)
- Bank of Rajasthan
- Bharat Overseas Bank
- Catholic Syrian Bank
- Centurion Bank of Punjab
- City Union Bank
- Development Credit Bank
- Dhanalakshmi Bank
- Federal Bank
- Ganesh Bank of Kurundwad
- HDFC Bank
- ICICI Bank
- IDBI Bank
- Indusind Bank
- ING Vysya Bank
- Jammu & Kashmir Bank
- Karnataka Bank Limited.
- Karur Vysya Bank
- Kotak Mahindra Bank
- Lakshmi Vilas Bank
- Lord Krishna Bank (now Centurion Bank of Punjab)
- Nainital Bank
- Ratnakar Bank
- Rupee Bank
- Saraswat Bank
- SBI Commercial and International Bank
- South Indian Bank
- Tamilnad Mercantile Bank Ltd.
Thane Janata Sahakari Bank
Bassein Catholic Bank
United Western Bank
YES Bank

4.1.7 Some of the prominent foreign banks

- ABN AMRO Bank N.V.
- Abu Dhabi Commercial Bank Ltd
- American Express Bank
- Antwerp Diamond Bank
- Arab Bangladesh Bank
- Bank International Indonesia
- Bank of America
- Bank of Bahrain & Kuwait
- Bank of Ceylon
- Bank of Nova Scotia
- Bank of Tokyo Mitsubishi UFJ
- Barclays Bank
- BNP Paribas
- Calyon Bank
- ChinaTrust Commercial Bank
- Cho Hung Bank
- Citibank
- DBS Bank
- Deutsche Bank
- HSBC (Hongkong & Shanghai Banking Corporation)
- JPMorgan Chase Bank
- Krung Thai Bank
- Mashreq Bank
- Mizuho Corporate Bank
- Oman International Bank
- Societe Generale
- Standard Chartered Bank
- State Bank of Mauritius
- Scotia
- Taib Bank
4.1.8 The Rise, Reprieve, and Fall of State Banks in Africa (A case of Up’s and Down’s at global level)

“... Where the same strong interests that derailed earlier reforms still dominate a country’s politics, outcomes from bank privatization will tend to be disappointing ...

Most African countries opted to create at least one large state bank after independence to support indigenous industries and state ventures and to make banking services available for the broad population, including those in rural areas. In many countries, these big state banks still dominate the banking sector and, after decades of politicized management and soft budget constraints, have been difficult to restructure or privatize. The disappointing results from restructuring and the problems in privatization can be seen from three [African] countries that attempted banking reform programs during the 1990s: Ghana, Tanzania, and Uganda.

- Ghana

Ghana started economic reforms in the early 1980s after a politically unstable period of heavy state involvement in the economy. The state owned three commercial banks, three development banks, and the Cooperative Bank. There were also two foreign banks and a merchant bank. All the state owned banks were restructured and recapitalized under the financial reforms that started in 1987, with bad loans removed to an AMC. Management was improved through extensive technical assistance. Both before and after restructuring, the primary function of the Ghanaian banks has been funding the deficit of central government and public enterprises (this averaged 73 percent of domestic credit in the 1990s). The very high T Bill yields received by the banks helped offset the continued loan losses from other lending.

Bank privatization has been a stop go process, being held up, for example, by disagreement between the privatization agency and external estimates of values on the price. With the program years behind schedule, the government decided to sell some shares in two state commercial banks domestically even before finding a strategic investor. This made it difficult subsequently to reduce the price to attract a strategic investor. Eventually, in late 1996, the government dropped its requirement that the strategic buyer should be a bank, and managed to sell the Social Security Bank to a consortium of foreign investment funds. By 1998, this newly privatized bank had about 13 percent of total banking system assets.
The largest bank, Ghana Commercial Bank (GCB), continued to have problems even after the restructuring of the late 1980s. With the failure of a planned sale in 1996 to a Malaysian manufacturing firm, it remains government controlled, with just 41 percent held by Ghanaians after the initial public offering (IPO). In preparation for privatization in the mid 1990s, it was found that there were serious reconciliation problems in the accounts and shortcomings in management, and some of the loss making branches had never been closed. In 1997, the senior management of GCB had to be removed in the wake of a check fraud scandal.

Though Tanzania

Twelve banks had been nationalized in 1967 and merged into a dominant commercial bank, National Bank of Commerce (NBC), which had a virtual monopoly for 25 years. The only other financial institutions were a small state cooperative bank ... and a few specialized state banks for housing. By the mid 1980s, the NBC was insolvent, illiquid and losing money at an alarming rate. Restructuring moved a significant portion of the NPIs out of the bank, closed some loss making branches, and retrenched staff, but operating costs as a percentage of assets doubled and spreads became negative in 1992. The bank was recapitalized in 1992, but as the losses continued to mount, restructuring intensified - with an "action plan" in 1994 that changed the board of directors, curtained lending and laid off further staff. However, the salaries of the remaining staff were doubled by the new board of directors, thus offsetting the reductions in costs. The benefits from removing bad loans to the AMC were short lived. By 1994, 77 percent of the remaining loans were nonperforming. In 1995, another attempt to restructure failed. Finally, National Commercial Bank (NBC) was split in November 1997 into two banks and a holding company. The NBC holding company took the nonbanking' assets, for example, staff housing and the training center. The business bank, NBC 1997, took all lending and 45 percent of the deposits, and a service bank took the remainder of the deposits. The National Microfinance Bank was to provide basic depository services to the general population, and took the small deposits but no lending. The decision to set up a microfinance bank that would keep the rural branch network may have softened some of the political opposition to the privatization of the business bank. The separation proved difficult. Poor financial and operational controls led to the need for significant provisions on
unreconciled balances, and there was a significant delay in producing financial statements after the split.

NBC 1997 was sold to the South African bank, Amalgamated Banks of South Africa Group (ABSA) in late 1999 with IFC participation. The microfinance bank ... [could not be sold. With the support of donors, an international development agency was contracted to manage and restructure the banks (Dressen, Dyer, and Northrip, 2002). It] is now focusing on the provision of payments and savings services [and some microcredits] in its 95 branches [and doing relatively well].

➢ Uganda

By the early 1990s, the government had stakes in all nine commercial banks, and owned the largest two: Uganda Commercial Bank (UCB), with about 50 percent of the market, and the Cooperative Bank. As of late 1991, about one third of the loans of UCB were non performing, and the negative net worth of the bank was estimated at $24 million. Timid restructuring efforts started. Loss making branches were converted into agencies rather than being closed. The AMC that was to take bad loans was not created untill 1996 and, even then, there was a significant lag in transferring bad loans. There was a performance agreement in 1994 between the Ministry of Finance and the bank's board of directors, but the strategy pursued was to try to reduce the proportion of NPLs by growing the loan portfolio. Bank supervisors did not monitor compliance. Every improvement in profitability was temporary and losses continued to mount. By mid 1996, the financial position had deteriorated so that its negative net worth tripled from earlier estimates.

While the government's intention was that the restructuring would culminate in privatization, management of the UCB was actively opposed to sale. Eventually, after three years of unsuccessful attempts to restructure the bank, it was agreed that a reputable merchant bank be selected t~ implement the sale, giving the buyer greater freedom to define which assets and branches were to be purchased. Again, there was a lag, and the merchant bank was finally hired in February 1996 and, at its request, top management was finally changed in July 1996. Losses were mounting throughout the delay, and UCB was losing market share. Audited financial statements for 1997 showed another fall in interest income, wiping out the core profits advertised to investors six months earlier. With few expressions of interest, a sale agreement was signed in late 1997 with a Malaysian industrial and real estate company, by
December, 1998, however, the deal had unraveled amid allegations of corruption.”
Source: World Bank, 2001

Without these changes in restructured banks, business continues undisturbed in its basics and new bad loans may increase rapidly. In addition to the unchanged operations, bad loans tend to increased because (a) there is often political pressure to begin lending again (because the bank crisis may be associated with the need for a stabilization program that constrains other expansionary measures) and (b) a public bank can raise deposits for lending because the implicit government guarantee limits market discipline. As a result reformed public sector banks often return to bankruptcy in 11 low years, as seen m the experience in Africa and the Transition countries (Sherif, Borish and Gross, 2003, Zoli, 2001., and Tang, Zoli, and Klytchinikova, 2000).

4.1.9 The few cases where restructurings have been more successful support the importance of the changes described above. Specifically:

- The government should define a simple objective usually privatization over a short time horizon-and gives the management “the power to say no” to requests outside that objective. In other words, the government needs to avoid intervention, except for failure to meet the well defined objective. If privatization is the objective, but timing is left vague, then restructured banks tend to revert to their earlier status.
- The new management should be chosen for their capacity to manage. All of the successful cases drew managers from reputable international banks, either a bank itself, a twining arrangement with an international bank, or citizens who had worked in such banks, though this alone is not sufficient for good results. In some cases, the management (or twining bank) was given an incentive for good performance, based on the results of the privatizations, for example in Poland.
- Information systems should be put in place to allow the new management to monitor developments frequently with a short time lag, and to allow the finance ministry and the central bank to evaluate the progress toward the objective. If lending is aimed at targeted groups, then the information systems should also make clear the success in reaching these beneficiaries and the full costs of doing so, including interest rate subsidies and non-performance rates.
New lending should be constrained, especially large loans, to limit new non-performing loans.

The bad loans typically were removed from the banks, although in the case of Poland they were left in the banks to be resolved by the new management before privatization (Kwalec and Kluza, 2003), and replaced by government recapitalization bonds.

In India, where state banks continue to dominate, bank managers were given the objective to reduce their nonperforming loans after the small recapitalizations done in 1994 and 1995 (about 2 percent of GDP). Generally the banks succeeded in that goal, through a combination of more careful lending, higher provisions than other banks (out of higher margins), increasing their purchases of new government debt more than other banks, and debt restructurings that were encouraged by regulatory changes and helped by falling interest rates (Hanson 2003).

Nonetheless, the non-performing loans before provisioning remain about 10 percent of loans, remained undercapitalized for many years and the state banks continue to have relatively high margins; high costs (despite saving on wage costs brought about by the a self-financed voluntary retirement scheme in 2000/01); and profits on lending that are too low to maintain the ratio of capital to un-risk weighted assets (Hanson, 2003, Reserve Bank of India, Trend and Progress in Banking, various years).

There has been no consolidation within the state banks, even among those that experienced problems and required multiple capital injections, and information technology has been a problem (Verma, 2000). Some of the private banks, including some of the 9 licensed in 1994, also have experienced problems, as India's information and legal frameworks for lending remained weak. A new, large private bank, ICICI created recently through the merger of ICICI bank and an old private bank and then the reverse merger of ICICI development bank into that bank—may put the public sector banks under more pressure.

4.2 ROLE OF PRIVATE SECTOR BANK IN INDIAN ECONOMY

4.2.1 Introduction

Private-sector banks have been functioning in India since the very beginning of the banking system. Initially, during 1921, the private banks like bank of Bengal,
bank of Bombay and bank of Madras were in service, which all together formed Imperial Bank of India.

- Reserve Bank of India (RBI) came in picture in 1935 and became the centre of every other bank taking away all the responsibilities and functions of Imperial bank. Between 1969 and 1980 there was rapid increase in the number of branches of the private banks. In April 1980, they accounted for nearly 17.5 percent of bank branches in India. In 1980, after 6 more banks were nationalised, about 10 percent of the bank branches were those of private-sector banks. The share of the private bank branches stayed nearly same between 1980 and 2000.

- Then from the early 1990s, RBI's liberalisation policy came in picture and with this the government gave licences to a few private banks, which came to be known as new private-sector banks.

There are two categories of the private-sector banks: "old" and "new".

- The old private-sector banks have been operating since a long time and may be referred to those banks, which are in operation from before 1991 and all those banks that have commenced their business after 1991 are called as new private-sector banks.

- Housing Development Finance Corporation Limited was the first private bank in India to receive license from RBI as a part of the RBI's liberalization policy of the banking sector, to set up a bank in the private-sector banks in India.

### 4.2.2 Private sector banks-evolution

- Historically, the private sector banks played a crucial role in the growth of joint stock banking in India. The first half of the 20th century witnessed enominal growth of private sector banks. As a result in 1951, there were 566 private banks of which 474 were non-scheduled and 92 scheduled classified on the basis of their capital size. The role of private sector banking started declining when the Government of India entered banking business with the establishment of State Bank of India in 1955 and subsequently two rounds of bank nationalization one in July 1969 (14 major banks), another in April 1980 (take over of 6 banks). Consequently, the presence of public sector banks has increased.

- At present, there are 32 private banks comprising of 24 old banks, which existed prior to 1993-94 and eight new private banks, which were established during 1993-94 and onwards after the RBI announced guidelines in January 1993 for
establishment of new banks in private sector following the recommendations of Narasimham Committee-I (1991). Compared to New private sector banks, the old banks are smaller in size. For example, at end March 2000, the average net worth of the 24 Old Private Banks (OPBs) was Rs.179.67 Crore per OPB compared to that of the New Private Bank (NPB) at Rs. 479.88 Crore per NPB. The OPBs are essentially regional in character although some of them have scattered presence in areas other than in and around the areas of their origin. The number of branches of the NPBs was 999 at end March 2003, while those of OPBs 3491. The NPBs are extremely cautious in expanding their branch network and business because their managers, mostly drawn from the public sector banks, know very well the ills of unbridled expansion of branches by public sector banks in the postnationalization era.

The Narasimham Committee-I, that advocated competition in the banking industry, made unequivocal recommendation to allow private and foreign banks into the industry. Acting on the recommendations of the committee, the RBI laid down guidelines for the establishment of the private 191 sector banks on January 1993. The guidelines prescribed that the private banks should be established as public limited companies under the Indian Companies Act: 1956. The paid-up capital shall not be less than Rs. 100 Crore. The new guidelines issued in 2001 raised the minimum paid-up capital to Rs. 200 Crore, which shall be enhanced to Rs. 300 Crore within three years after the commencement of business. The promoters’ share shall not be less than 40 per cent and the voting right of a shareholder shall not exceed 10 per cent. The new banks should avoid shortcomings such as unfair preemption, concentration of credit, cross-holding of industrial groups, etc. Those banks which intent to establish main office in a center where no banking is having such office is to be preferred. These banks are required to observe priority sector lending targets as applicable to other domestic banks. The guidelines aim at ensuring that the new entrants are ab initio financially viable and technologically up-to-date. While granting approvals for OPBs, one of the considerations before the RBI was that the new banks would start functioning in a professional manner giving clear signals to the effect that would improve the image of commercial banking system and give confidence to the depositing public. Accordingly, nine banks were set-up in private sector
including some by development financial institutions. Prominent among them are ICICI Bank, GTB, HDFC and IDBI bank. Another interesting development was merger of some banks. Bareilly Corporation Ltd merged with Bank of Baroda in 1999, Times Bank merged with HDFC Bank in 1996, Bank of Madura Ltd merged with ICICI bank in 2001 and Nedungadi Bank Ltd merged with Punjab National Bank in 2003. With regard to branch expansion, banks attaining capital adequacy norms and prudential accounting standards can set up new branches without the prior approval of RBI. Banks have the freedom to rationalize their existing branch network by relocating branches, opening of specialized branches, spinning off business, setting up of controlling offices, etc.

- In terms of size, there are Goliaths and Davies among the banks. On one extreme, there is the omnipresent big bank like the SBI (Public Sector Bank) 192 with 9017 branches. On other extreme, there is the small private sector bank; the Ganesh Bank of Kurundwad Ltd. located in an obscure town in Maharashtra operating with only 30 branches. The youngest bank is the United Bank of India established in 1950. It has been struggling to improve its market share. The Benares State Bank Ltd. is the oldest. bank established in 1871 in the holy city of Varanasi. It remained smaller in size compared to the youngest NPBs. The Bharat Overseas Bank Ltd, which came into being in 1973 is the only private bank having a branch abroad. Between the two extremes, there are 21 banks, which are regional in character and operate with different levels of efficiency.

- The New Private Sector Banks started publishing balance sheets since 1995-96. In that year the share of OPBs in total assets was 6.2 per cent while that of NPBs was 1.4 per cent. The NPBs had improved their market share to 5.3 per cent by 1999-2000 at the cost of PSBs. The share of private sector banks in the total number of branches in 1992-93 was only 8.33 percent. In 2002-03, the share of private sector banks in total bank branches is 8.75 per cent. Table 6.1 shows the trend in the number of branches of PBs, during the period 1992-93 to 2003.

4.2.3 Changing Role of Banks in India

- The role of banks in India has changed a lot since economic reforms of 1991. These changes came due to LPG, i.e. liberalization, privatization and globalization policy being followed by GOI. Since then most traditional and outdated concepts, practices, procedures and methods of banking have changed.
significantly. Today, banks in India have become more customer-focused and service-oriented than they were before 1991. They now also give a lot of importance to their rural customers. They are even willing ready to help them and serve regularly the banking needs of country-side India. The changing role of banks in India can be glanced in points depicted below.

The following points briefly highlight the changing role of banks in India.

1. Better customer service,
2. Mobile banking facility,
3. Bank on wheels scheme,
4. Portfolio management,
5. Issue of electro-magnetic cards,
6. Universal banking,
7. Automated teller machine (ATM),
8. Internet Banking,
9. Encouragement to Bank Amalgamation
10. Encouragement to Personal Loans
11. Marketing of Mutual Funds
12. Social Banking
8. Internet banking,
9. Encouragement to bank amalgamation,
10. Encouragement to personal loans,
11. Marketing of mutual funds,
12. Social banking, etc.

The above-mentioned points indicate the role of banks in India is changing. Now let's discuss how banking in India is getting much better day after day.

1. **Better Customer Service**

Before 1991, the overall service of banks in India was very poor. There were very long queues (lines) to receive payment for cheques and to deposit money. In those days, some bank staffs were very rude to their customers. However, all this changed remarkably after Indian economic reforms of 1991.

Banks in India have now become very customer and service focus. Their service has become quick, efficient and customer-friendly. This positive change is mostly due to rising competition from new private banks and initiation of Ombudsman Scheme by RBI.

2. **Mobile Banking**

Under mobile banking service, customers can easily carry out major banking transactions by simply using their cell phones or mobiles.

Here, first a customer needs to activate this service by contacting his bank. Generally, bank officer asks the customer to fill a simple form to register (authorize) his mobile number. After registration, this service is activated, and the customer is provided with a username and password. Using secret credentials and registered phone, customer can now comfortably and securely, find his bank balance, transfer money from his account to another, ask for a cheque book, stop payment of a cheque, etc. Today, almost all banks in India provide a mobile-banking service.

3. **Bank on Wheels**

The 'Bank on Wheels' scheme was introduced in the North-East Region of India. Under this scheme, banking services are made accessible to people staying in the (remote) areas of India. This scheme is a generous attempt to serve banking needs of rural India.
4. Portfolio Management

In portfolio management, banks do all the investments work of their clients. Banks invest their clients' money in shares, debentures, fixed deposits, etc. They first enter a contract with their clients and charge them a fee for this service. Then they have the full power to invest or disinvest their clients' money. However, they have to give safety and profit to their clients.

5. Issue of Electro-Magnetic Cards

Banks in India have already started issuing Electro-Magnetic Cards to their customers. These cards help to carry out cash-less transactions, make an online purchase, avail ATM facility, book a railway ticket, etc. Banks issue many types of electro-magnetic cards, which are as follows:

1. Credit cards help customers to spend money (loaned up to a certain limit as previously settled by the bank) which they don't have in hand. They get a monthly statement of their purchases and withdrawals. Along with the transacted amount, this statement also includes the interest and service fee. The entire amount (as reflected in the statement of credit card) must be paid back to the bank either fully or in installments, but before due date.

2. Debit cards help customers to spend that money which they have saved (credited) in their individual bank accounts. They need not carry cash but instead can use a debit card to make a purchase (for shopping) and/or withdraw money (get cash) from an ATM. No interest is charged on the usage of debit cards.

3. Charge cards are used to spend money up to a certain limit for a month. At the end of the month, customer gets a statement. If he has a sufficient balance, then he only had to pay a small fee. However, if he doesn't have a necessary balance, he is given a grace period (which is generally of 25 to 50 days) to repay the money.

4. Smart cards are currently being used as an alternative to avail public transport services. In India, this covers Railways, State Transport and City (Local) Buses. Smart card has an integrated circuit (IC) embedded in its plastic body. It is made as per norms specified by ISO.

5. Kisan credit cards are used for the benefit of the rural population of India. The Indian farmers (kisans) can use this card to buy agricultural inputs and goods for self-consumption. These cards are issued by both Commercial and Co-operative banks.
6. Universal Banking
In India, the concept of universal banking has gained recognition after year 2000. The customers can get all banking and non-banking services under one roof. Universal bank is like a super store. It offers a wide range of services, including banking and other financial services like insurance, merchant banking, etc.

7. Automated Teller Machine (ATM)
There are many advantages of ATM. As a result, many banks have opened up ATM centres to offer convenience to their customers. Now banks are operating ATM centres not only in their branches but also at public places like airports, railway stations, hotels, etc. Some banks have joined together and agreed upon to set up common ATM centres all over India.

8. Internet Banking
Internet banking is also called as an E-banking or net banking. Here, the customer can do banking transactions through the medium of the internet or world wide web (WWW). The customer need not visit the bank's branch. Through this facility, the customer can easily inquiry about bank balance, transfer funds, request for a cheque book, etc. Most large banks offer this service to their tech-savvy customers.

9. Encouragement to Bank Amalgamation
Failure of banks is well-protected with the facility of amalgamation. So depositors need not worry about their deposits. When weaker banks are absorbed by stronger banks, it is called amalgamation of banks.

10. Encouragement to Personal Loans
Today, the purchasing power of Indian consumers has increased dramatically because banks give them easy personal loans. Generally, interest charged by the banks on such loans is very high. Interest is calculated on reducing balance. Large banks offer loans up to a huge amount like one crore. Some banks even organise Loan Mela (Fair) where a loan is sanctioned on the spot to deserving candidates after they submit proper documents.

11. Marketing of Mutual Funds
A mutual fund collects money from many investors and invests the money in shares, bonds, short-term money market instruments, gold assets; etc. Mutual funds earn income by interest and dividend or both from its investments. It pays a dividend to subscribers. The rate of dividend fluctuates with the income on mutual fund
investments. Now banks have started selling these funds in their own names. These funds are not insured like other bank deposits. There are different types of funds such as open-ended funds, closed-ended funds, growth funds, balanced funds, income funds, etc.

12. Social Banking
The government uses the banking system to alleviate poverty and unemployment. Many social development programmes are initiated by the banks from time to time. The success of these programmes depends on financial support provided by the banks. Banks supply a lot of finance to farmers, artisans, scheduled castes (SC) and scheduled tribe (ST) families, unemployed youth and people living below the poverty line (BPL).

4.2.4 Progress in liberalisation of the banking sector
On the liberalisation side of banking sector reforms significant progress has been achieved in several areas, especially interest rate liberalisation and reduction in reserve requirements, but not in the matter of directed credit.

(i) Interest Rate Liberalisation

- Interest rates in the banking system have been liberalised very substantially compared to the situation prevailing before 1991. With effect from October 1997 interest rates on all time deposits, including 15 day deposits, have been freed. Only the rate on savings deposits remains controlled by RBI. Lending rates were similarly freed in a series of steps. The Reserve Bank controls only the interest rate charged for export credit, which accounts for about 10% of commercial advances. Interest rates on loans upto Rs. 2,00,000, which account for 25% of total advances, are subject to a hybrid control - the rate is not fixed at a level set by the RBI, but is constrained to be no higher than the prime lending rate (PLR) which is determined by the Boards of individual banks. The rationale for liberalising interest rates in the banking system was to allow the banks greater flexibility and encourage competition. Banks were able to vary rates charged to borrowers according to their cost of funds and also to reflect the credit worthiness of different borrowers. Flexibility to discriminate among borrowers has helped create a more competitive situation. Flexibility on deposit rates has proved to be irregular. Banks are able to raise rates when inflation increases but they are not able to lower deposit rates when
inflation declines. This became obvious in 1995 and 1996 when inflation varied between 4 and 5% but bank deposit rates remained high. Some observers have attributed this to the fact that expectations of inflation had not fallen even though inflation declined, but a more reasonable explanation is that rate of interest available on postal savings schemes, which are fixed by the Central Government, have been maintained at high levels. As postal savings are close substitutes for bank deposits, banks find it difficult to lower rates on deposits as long as postal savings rates are not adjusted downwards.

Looking ahead, the cross controls on lending rates can be phased out at an early date. The desire to control interest rates for small loans reflects an understandable desire to help small borrowers, but we must recognise that these controls may actually discourage banks from lending to these sectors or alternatively they may encourage corruption in determining access to such loans. There is irresistible evidence that what matters for low income borrowers is timely availability of recognition rather than low interest rates and a policy which keeps rates low but impedes the flow of credit does not help the target group. Banks forced to charge unprofitably low interest rates may also seek to protect their profitability by improving credit quality by insisting on higher levels of collateral than would otherwise be the case, thus effectively excluding precisely the groups which interest rate controls are meant to favour. Some segments of the banking system have already been freed from restrictions on lending rates. Cooperative Banks were free from all controls on lending rates in 1996 and this freedom was extended to Regional Rural Banks and private local area banks in 1997. As the system gets used to higher rates being charged on smaller sized loans by these institutions, it should be possible to take the next step and remove existing controls on lending rates in other commercial banks.

(ii) Reserve Requirements

Another important area where some liberalisation has taken place relates to the cash reserve requirement (CRR) and the separate requirement for mandatory investment in government securities through the statutory-liquidity ratio (SLR). At one stage, the CRR applicable to incremental deposits was as high as 25% and the SLR was 40%, thus pre-empting 65% of incremental deposits.
These ratios were reduced in a series of steps after 1992. The statutory liquidity ratio is 25%, but its distortionary effect has been greatly reduced by the fact that the interest rate on government securities is increasingly market determined. In fact, most banks currently hold a higher volume of government securities than required under the SLR reflecting the fact that the attractive interest rate on these securities combined with the zero risk-weight, makes it commercially attractive for banks to lend to the government. However, the CRR was at one stage reduced to 10% but is currently at 11%. This is high by international standards and constitutes a tax on financial intermediation in the terminology of the financial repression literature.

The key constraint on reducing the CRR is the continuing high level of the fiscal deficit which cannot be financed entirely from the market and therefore requires substantial support from the RBI. The earlier practice of automatic monetisation of the deficit through issue of adhoc Treasury Bills has been abandoned but as long as the fiscal deficit is not controlled, this only forces the RBI to resort to market borrowing with a Hobsons choice - either the RBI has to accept higher interest rates or provide support by picking up securities, which implies monetisation of the deficit. Reducing the CRR is not a viable option in this situation because the expansionary impact on money supply via the money multiplier (which is a function of the CRR) would need to be offset by a contraction elsewhere. In effect, the RBI would have to refrain from monetising the deficit to the extent that it does at present. Interest rates on Government securities would therefore have to be allowed to rise because of loss of RBI support. The lower CRR would of course reduce the tax on the banking system enabling banks to reduce rates on commercial advances. The high CRR is therefore the cost imposed on the banking system to allow the fiscal deficit to be financed at a lower cost to the government than would otherwise prevail. Financial repression is indeed a tax on financial intermediation, but if we want to remove this tax we must find some other way of either raising tax revenues or cutting expenditure so that the fiscal deficit can be reduced. Failure to do so will only push the system into an inflationary spiral, which could be worse than the distortions introduced by financial repression.
(iii) Directed Credit

- An area where there has been no liberalisation thus far relates to directed credit. Directed credit policies have been an important part of India’s financial strategy under which commercial banks are required to direct 40% of their commercial advances to the priority sector which consists of agriculture, small scale industry, small scale transport operators, artisans etc. Within this aggregate ceiling there are sub-ceilings for agriculture and also for loans to poverty related target groups. The Narasimham Committee had recommended reducing the 40% directed credit target to 10%, while simultaneously narrowing the definition of the priority sector to focus on small farmers and other low income target groups. This recommendation was not accepted by the government and the directed credit requirement continues unchanged.

- Should directed credit requirements be phased out? This is an important and potentially controversial question. Directed credit in support of export generating industries was a part of East Asia's financial policy during the period miracle growth of these economies and while these policies have generally been regarded as successful this is not so for all cases of directed credit. Prevailing international perceptions of best practice in banking are generally against directed credit. The shortcomings of directed credit policies in India are well known and are reflected in the fact that the proportion of NPAs in priority sector portfolio of the banks is significantly higher than in the non-priority sector. However, abandonment of directed credit is unlikely to be a practical option in India in the near future especially because directed credit in India relates mainly to lending to agriculture, small scale industry and poverty groups. If the present level of directed credit has to continue for some more time, we should at least consider ways of ameliorating the adverse consequences of this policy as much as possible.

- A step in the right direction would be to eliminate the present concessional interest rates applicable to loans below Rs. 2,00,000 most of which fall in the priority sector. If priority sector credit does involve a higher cost to the banks we should reflect this in the interest rate allowed to be charged. This would increase the willingness of banks to lend to the priority sector and make the directed credit target less onerous. Another desirable step would be to expand
the list of activities eligible under the priority sector as this would increase the range of economically viable activities for the deployment of priority sector credit and thus help improve the quality of the portfolio. We should also consider redefining the priority sector target as a percentage of the total assets of the banking system and not as a percentage of commercial advances as at present. This is because the share of commercial advances in total assets is likely to increase over time as reserve requirements are reduced. Fixing the priority sector target as a percentage of commercial advances means a rising percentage of total assets going to the priority sector which may be too onerous.

The quality of directed credit could also be improved if the identification of the beneficiaries was left solely to the banks. This is perhaps the most important reform which should be implemented. At present recipients of priority sector credit under various anti-poverty schemes (which also involve a government subsidy) are identified primarily by the district administration which administers these schemes and the credit requirements of these beneficiaries are then processed by the banks. Even where bank officials are involved in the pre-selection their involvement is perfunctory and the attitude is one of having to meet targets of lending rather than undertaking serious credit appraisal. Part of the problem is that many (though not all) of the priority sector schemes oriented towards micro-enterprises have dubious economic viability but banks find it difficult to reject loan applications. Many borrowers tend to view credit extended as part of official anti-poverty programmes as form of government largesse where repayment is not really intended making it all the more difficult to fit these schemes within normal banking activity.

A somewhat theoretical sounding possibility, but one which should be examined, is the possibility of introducing “trading” of priority sector performance among banks so that banks which exceed their targets of priority sector lending may be able to "trade" the excess to the credit of other banks which are falling short. To the extent that some banks are relatively more efficient in priority sector lending than others (e.g. because of a broader spread of certain banks in agriculturally prosperous areas), it would enable the
banking system as a whole to achieve the priority sector target at lesser cost.
This would be especially so if interest rate ceilings are relaxed.

4.2.5 Various reforms in banking system

Regulatory reform of the banking system

- The regulatory side of banking sector reform has also seen significant progress. Prior to 1991 India’s banks did not follow uniform accounting practices for income recognition, classification of assets into performing and non-performing, provisioning for non-performing assets, and valuation of securities held in the banks portfolio. Nor were they subject to uniform capital adequacy requirements.

(i) Establishment of uniform prudential norms

- The Narasimham Committee recommended the establishment of uniform prudential norms and standards broadly along the lines recommended by the Basle Committee on Banking Supervision. These recommendations were implemented in a phased manner over a period of three years with the new norms becoming fully operational from 31.3.96.
- Indian banks have adjusted well to the new standards and are in a stronger position today than they were in 1991. Very few banks had a capital adequacy ratio upto the 8% level prior to 1991. By March 1998 only one of the 28 public sector banks fell short of this standard and many banks were significantly above that level. Admittedly the increase in capital in many cases was achieved only through additional contribution of capital by the Government, and to that extent does not reflect an improvement in operational performance, but there were also substantial contributions from internal reserves resulting from improved profitability. Some banks were also able to raise capital from the market reflecting their ability to attract private investors. The new prudential norms and the greater transparency they impart to bank balance sheets have also increased consciousness of the need to improve asset quality. Efforts to reduce non-performing assets show encouraging results with the ratio of net non-performing assets (i.e. net of provisions) to total advances declining from 16.3% at the end of 1991-92 to 8.2% at the end of 1997-98.
- These are impressive improvements but it is also true that following the collapse in East Asia, and the subsequent problems in Russia and elsewhere,
the standards being demanded for regulating banking systems in developing
countries have risen significantly. In anticipation of this development the
government, in December 1997, appointed the Committee on Banking Sector
Reforms (CBSR) to review the progress made in reform of the banking sector
and to chart a course for the future. The Committee has since submitted its
report outlining a comprehensive agenda for the second stage of banking
sector reforms.

(ii) Aligning prudential norms with international practice

➢ The obvious next step is to align prudential norms as closely as possible to
international practice. The CBSR has documented various deficiencies in this
regards. For example, loans are classified as sub-standard when payments
become overdue for a period exceeding two quarters, whereas the international
norm is one quarter. Similarly sub-standard assets are downgraded to doubtful
if they remain sub-standard for two years instead of one year internationally.
Loans with government guarantees are treated as zero-risk assets and are also
not classified as non-performing even if there is a payment default. Government
securities are treated as zero-risk assets whereas they are subject
to interest rate risk and a modest risk weight is therefore appropriate. No
provisions are required to be made for assets classified as standard whereas it
would be more prudent to make a small provision even in these cases. Finally
the capital to risk weighted assets ratio is only 8% whereas internationally
banks are now aiming at higher levels, especially in view of the greater risks
to which banks in developing countries are subject.

➢ The CBSR has made specific recommendations to upgrade standards in these
areas. The first step has been taken with the RBI's recent announcement that
the capital adequacy ratio must be raised to 9% by 31st March 2000,. The
CBSR had recommended a 10% level, which will presumably be enforced
over a longer time period. A risk weight of 2.5% has also been attached to
investments in government securities - half the level recommended by the
CBSR. Other recommendations of the CBSR to tighten prudential norms,
especially regarding criteria for classifying NPAs, also need to be
implemented in a phased manner. It is sometimes argued that NPA recognition
norms in India cannot be equated with international norms because the slow
pace of the legal system in enforcing bank claims on collateral security makes it inevitable that assets will remain non-performing for a longer time. While this may be true, this represents a real cost in the system and must be explicitly recognised as such. There may be a case for phasing the transition over time but it does not justify accepting lower standards.

- Implementation of tighter norms will have an impact on the banking system. It will raise the level of non-performing assets and force a higher level of provisioning which in turn would erode the surplus over the minimum capital requirement currently enjoyed by some banks and would increase the capital deficiency in other cases. Banks are likely to complain that the shrinkage in the capital base will limit their ability to expand commercial credit forcing some of them to become "narrow banks". The credit restraining effect is indeed a genuine problem for the affected banks, but credit for the system as a whole may not be affected if enough banks have surplus capital, as these banks would expand at the expense of those constrained by capital deficiency. If the net result is a gain in market share for better performing banks at the expense of the others it is clearly desirable from the efficiency point of view.

More generally, we need to recognise that regulatory forbearance in the form of lax prudential norms is not in the interest of the banking system. The experience with banking crises in other countries shows that understatement of NPA levels because of inadequately stringent norms and weak supervision only lulls banks into complacency, making them more vulnerable to crises when they arise. The balance of advantage lies in an early announcement of the internationally acceptable norms to which banks must finally adhere, while allowing a reasonable period of time to reach these norms in a phased manner.

**Capital Market Reforms**

- Reform of the capital market was an important part of the agenda of financial sector reforms and action has been taken in this area parallel with reforms in banking. India has a long tradition of functioning capital markets - the Bombay Stock Exchange is over a hundred years old - but until the 1980s the volume of activity in the capital market was relatively limited. Capital market activity expanded rapidly in the 1980s and the market capitalisation of companies registered in the Bombay Stock Exchange rose from 5% of GDP in
1980 to 13% in 1990. However the market remained primitive and poorly regulated. Companies wishing to access the capital market needed prior permission of the government which also had to approve the price at which new equity could be raised. While new issues were strictly controlled, there was inadequate regulation of stock market activity and also of various market participants including stock exchanges, brokers, mutual funds etc. The domestic capital market was also closed to portfolio investment from abroad except through a few closed ended mutual funds floated abroad by UTI which were dedicated to Indian investment.

- Following the recommendations of the Narasimham Committee process of reform of the capital market was initiated aimed at removing direct government control and replacing it by a regulatory framework based on transparency and disclosure supervised by an independent regulator. The first step was taken in 1992 when the Securities and Exchange Board of India (SEBI), which was originally established as a non-statutory body in 1988, was elevated to a full fledged capital market regulator with statutory powers. The requirement of prior government permission for accessing capital markets and for prior approval of issue pricing was abolished and companies were allowed to access markets and price issues freely, subject only to disclosure norms laid down by SEBI.

(i) The regulatory framework

- Over the years SEBI has put in place a modern regulatory framework with rules and regulations governing the behaviour of major market participants such as stock exchanges, brokers, merchant bankers, mutual funds etc. It has also sought to regulate activities such as takeovers and insider trading which have implications for investor protection. The governing structure of stock exchanges has been modified to make the Boards of the Exchanges more broad based and less dominated by brokers. The new regulatory framework seeks to strengthen investor protection by ensuring disclosure and transparency rather than through direct control. SEBI acts as a supervisor of the system undertaking supervision of the activities of various participants including stock exchanges and mutual funds and violations of the rules are punishable by SEBI.
The regulatory framework is as yet new and will need to be refined in the light of experience gained and also as gaps and inadequacies are identified. In some areas SEBI needs to be further strengthened and its punitive powers enhanced. However, there is no doubt that a good start has been made.

(ii) Opening the Capital Market to Foreign Investors

An important policy initiative in 1993 was the opening of the capital market to foreign institutional investors (FIIs) and allowing Indian companies to raise capital abroad by issue of equity in the form of Global Depository Receipts (GDRs). Over 500 FIIs are now registered with SEBI, of whom about 150 are active investors, and there has been a cumulative inflow of around $ 9 billion into the capital market through this route up to 1997-98. The GDR route has also seen an inflow of about $ 6 billion.

The cumulative investment of around $ 15 billion in Indian stocks through FIIs and GDRs has effectively linked India's domestic capital market with world markets and has important implications for macro economic management. Domestic liquidity conditions and asset prices are now affected by international market perceptions and this must be taken into account in formulating monetary policy. A large inflow of portfolio investment can lead to a sharp increase in domestic liquidity and asset prices as happened in 1994 to 1996 and a reversal can lower asset prices as in 1998. Exchange rate behaviour is now as much determined by developments in the current account as on the capital account. Since capital flows are affected by international perceptions, and these perceptions can be triggered not just by developments in India but also by contagion effects from developments abroad, management of the exchange rate has to take these linkages into account. The economy is not as vulnerable to volatile flows as it would be with full capital account convertibility, and this is one reason why India's currency markets were not seriously disrupted in the Asian crisis. but it is certainly more so because of FII and GDR flows. The potential volatility of these flows must be accepted and strategies for exchange market management should take this into account.

(iii) Modernisation of Trading and Settlement Systems

Major improvements have taken place in trading methods which were highly antiquated earlier. The National Stock Exchange (NSE) was set up in 1994 as
an automated electronic exchange enabling brokers in 220 cities all over the country to link up with the NSE computers via VSATs and trade in a unified exchange with automatic matching of buy and sell orders with price time priority thus ensuring maximum transparency for investors. The introduction of electronic trading by NSE generated competitive pressure which forced the Bombay Stock Exchange also to introduce electronic trading in 1995.

- The settlement system was antiquated, involving physical delivery of share certificates to the buyer who then had to deliver them to a company registrar to record the change of ownership after which the certificates had to be returned to the buyer. This process was very time consuming and also created significant risks for investors. The first step towards paperless trading was put in place by enacting legislation which allowed dematerialisation of share certificates with settlement by electronic transfer of ownership from one account to another within a depository. The National Securities Depository Ltd. (NSDL) opened for business in 1996. In June 1997 only 48 companies, with a market capitalisation of Rs.94,000 crores, had signed up enabling dematerialisation of their securities. By June 1998 this had increased to 198 companies with a market capital of Rs.2,88,000 crores. The value of securities actually held in the depository has increased from Rs. 2518 crores in June 1997 to Rs.35,000 crores in June 1998. It is expected that the volume of settlements taking place through the depository will expand rapidly.

(iv) **Futures Trading**

- An important lacuna in India's capital market at present is the lack of futures markets. A well functioning market in index futures would help in risk management and provide greater liquidity to the market. A decision to introduce futures trading has been taken and the legislative changes needed to implement this decision have been submitted to Parliament. Futures trading is expected to commence in 1999 and with this a major deficiency in the capital market will have been corrected.

(v) **Some Problems in the Capital Market**

- Despite these important improvements in the regulatory framework and trading and settlement systems, the functioning of the capital market in the post reform period has been the subject of much criticism. Investors,
especially small investors who entered the market in the early stages of liberalisation, have not found their investments to be good value. There is a widespread perception that many unscrupulous companies took advantage of the removal of government control over issue prices to raise capital at inflated prices, at the expense of inexperienced investors. Merchant bankers and underwriters involved in these issues, some of which were among the better known names in the business, are seen to have misled investors. Nor is disappointment confined to ill-informed small investors greedily venturing into risky investments which they should never have undertaken in any case. Investors who invested in a wide range of blue chip stocks or in mutual funds, including funds managed by some of the best known international names, have also fared poorly because the Sensex has fluctuated widely since 1993 with a dominantly bearish trend in 1997 and 1998. Part of the problem is the change in sentiment among FIIs in this period reflecting a contagion effect from East Asia. Part of it may also reflect the slowing of industrial growth after 1996.

- Investor disappointment has led to a withdrawal of ordinary investors from equity markets. The volume of capital (both debt and equity) mobilised from the primary market increased substantially in the initial years of the reforms and reached a peak in 1995-96. The next two years saw a sharp decline in the volume of equity raised in the primary market with offsetting increase in resources raised through debt. This switch away from equity, following the poor experience of investors with equity investment, can be explained as a corrective process but it has created problems for financing of new projects which were begun in the expectation of easier availability of equity.

- These problems have focussed attention on the need to restore confidence among small investors and this is indeed an important issue. However, the solution does not lie, as is sometimes supposed, in extending a variety of tax incentives to lure small investors back into the market. To some extent it will happen automatically when the industrial cycle shows an upturn. However, it also requires deeper rooted institutional changes. Studies conducted by the Society for Capital Market Research and Development show that part of the reason for the reluctance of small investors to enter the market is the low level of confidence about corporate governance in many listed companies. A pre-
condition for healthy capital markets which is well recognised in industrialised countries is the existence of institutions which ensures high levels of corporate governance. These include high standards of accountancy to ensure transparency in financial performance, active involvement of institutional investors in monitoring performance based on good quality equity research inputs and also codes of corporate governance which are designed to ensure that managements are subjected to effective oversight by boards and that shareholder interests are protected. India's capital market is as yet far from this ideal. Some corrective processes are however at work. Companies wishing to access capital markets in future will have to price IPOs more reasonably. They will also have to show improvements in corporate governance in line with the growing consciousness of our deficiencies on this score.

- Issuers of capital must also realise that the capital market should not be viewed as a passive source of equity capital which can be tapped by companies at will to raise equity on favourable terms. Cross country studies have shown that stock markets in developing countries have been a more important source for financing of new investments through IPOs than in developed countries where financing of new investment has relied mainly on internal generation of surpluses. New companies raising funds have typically relied on venture capital or private placement rather than public issues. To some extent this is made possible by the existence of institutional investors such as insurance and pension funds willing to invest in the capital of new companies based on their own due diligence.

- Does the emergence of these problems indicate that the broad thrust of reforms in the capital market has been inadequate? The view is sometimes expressed that perhaps the removal of direct control on issue prices in the primary market was premature and should have been implemented only after greater experience had been gained with regulation of the secondary market. It is difficult to be certain on this issue, but it can be argued that a more drawn out process would not have made much difference. It would certainly not make sense to retain price controls on domestic issuers of capital while also opening up the markets to foreign investors. The solution for protecting the interest of small investors lies less in price control and more in investor education.
Inevitably, some of education comes through actual experience which is not always pleasant.

- **Insurance Sector Reform**

No review of financial sector reforms in India can be complete without reference to the need for reforms in the insurance sector. India is one of only four countries - the other three being Cuba, North Korea and Myanmar - where insurance is a public sector monopoly! The rationale of liberalising the banking system and encouraging competition among the three major participants viz. public sector banks, Indian private sector banks and foreign banks applies equally to insurance. There is a strong case for ending the public sector monopoly in insurance and opening it up to private sector participants subject to suitable prudential regulation.

- Cross country evidence suggests that contractual savings institutions are an extremely important determinant of the aggregate rate of savings and insurance and pension schemes are the most important form of contractual savings in this context. Their importance will increase in the years ahead as household savings capacity increases with rising per capita incomes, life expectancy increases and as traditional family support systems, which are a substitute for insurance and pensions, are eroded. A competitive insurance industry, providing a diversified set of insurance products to meet differing customer needs, can help to increase savings in this situation and to allocate them efficiently. The insurance and pensions industry typically has long term liabilities which it seeks to match by investing in long term secure assets. A healthy insurance is therefore an important source of long term capital in domestic currency which is especially for infrastructure financing. Reforms in insurance will therefore strengthen the capital market at the long term end by adding new players in this segment of the market, giving it greater depth or liquidity.

- It is relevant to ask why these developments are less likely if insurance remains a public sector monopoly. One reason is that the industry suffers from a relatively high requirement for mandatory investment in government securities. However this implies that it is the mandatory requirement and not the public sector monopoly which is the real constraint. The fact is that the
insurance industry does not fully utilise even the flexibility available at present for investment in corporate securities. This is principally because lack of competition in the insurance sector means there is no pressure to improve the return offered to the investor. Competition will increase the pressure to improve returns and push insurance companies to move out of government securities to seek higher returns in high quality corporate debt. Needless to say, the process would be greatly expedited if the fiscal deficit is also reduced resulting in a fall in the interest rate on government securities. Reforms in insurance are therefore more likely to create a flow of finance for the corporate sector if we can simultaneously make progress in reducing the fiscal deficit.

The Malhotra Committee had recommended opening up the insurance sector to new private companies as early as 1994. It has taken time to build a consensus on this issue but a proposal to open up insurance, allowing foreign equity upto 26%, has now been submitted to the Cabinet. If approved it will require legislation to remove the existing government monopoly and the earliest that this can be done is some time in 1999. This means new licenses to competing insurers can only be issued by the end of 1999 and since the new entrants will have to build up their business from scratch, it will take 5 to 10 years before private insurance companies, even with foreign partners, can reach significant levels. The sooner we start the sooner we will get the benefit of better service for the consumer, and the sooner it will be possible to finance infrastructure from the capital market.

4.2.6 Other Issues in Banking Reforms

Bringing prudential norms to international standards is only one part of the reform agenda. The more difficult part is to change the way banks function in practice so that their performance comes up to the heightened requirements of the new regulatory environment. This means banks must function in a manner which brings NPAs down to acceptable levels while simultaneously showing sufficient profit to ensure growth of reserves to support additional lending. The challenge is all the greater because economic reforms and liberalisation in the economy means that bank borrowers now face greater competition (domestic and international) which increases the risk of commercial failure
compared to the situation when banks were lending to clients operating in a protected economy. Banks have to upgrade their credit appraisal methods to ensure that the activities for which they lend are economically viable in the new more competitive environment. A more open economy also implies greater volatility in exchange rates and interest rates and banks must allow for the direct impact of these uncertainties on their balance sheets because of their own exposure and also the indirect effect via the impact on their clients. Banks will have to make changes on several fronts to deal with these challenges including the upgradation of human skills, induction of information technology, an understanding with labour unions to phase out outdated work practices, etc.

(i) The role of competition

- The role of competition in accelerating change is especially important. Banks are more likely to change if they are faced with competition which forces them to become more efficient change in order to survive. The creation of a more competitive environment in banking was one of the explicit objectives of the reform and the degree of competition has increased to some extent. Some of the competition has come from outside the system. Because of the development of capital markets and access to international sources of funds, the most creditworthy corporate clients are able to obtain funds from other sources and this puts pressure on the banks to improve the cost and quality of their service or risk losing credit worthy clients. Competition within the banking system has also increased. Several new private banks have started operations and foreign banks have also been allowed to expand their branches more liberally than in the past. As a result the share of business of private banks and foreign banks together increased from 10.6% in 1991-92 to 17.6% in 1996-97. Public sector banks still remain in a dominant position, but foreign banks and some of the new private sector banks are ahead of the public sector banks in the use of information technology and this will enable them to compete effectively for a larger business share, especially in the high income segment of the market, without having a very wide branch network. Competition among public sector banks is also increasing and this also generates pressures for greater efficiency.
If competition leads to a general improvement in efficiency of all public sector banks, strengthening them all equally, we would have an ideal outcome in which all participants gain in the process. In practice, it is more likely that individual banks will respond differently, reflecting long standing differences in their managerial culture and work practices, and some banks will pull ahead at the expense of others. The weaker banks are in any case likely to be held back by enforcement of capital adequacy requirements which will automatically limit the extent to which they can expand credit. This is likely to produce a restructuring of the banking system, with the better banks gaining market share at the expense of others, and this should be accepted as a natural outcome of competition, even though it may intensify the problem of weak banks.

(ii) The problem of weak banks

How to deal with the weak public sector banks is a major problem for the next stage of banking sector reforms. It is particularly difficult because the poor financial position of many of these banks is often blamed on the fact that the regulatory regime in earlier years did not place sufficient emphasis on sound banking, and the weak banks are, therefore, not responsible for their current predicament. This perception often leads to an expectation that all weak banks must be helped to restructure after which they would be able to survive in the new environment.

The usual recipe for revival of weak banks is to take care of the inherited burden of non-performing assets through some mechanism, such as for example an Asset Reconstruction Company recommended by the CBSR, and then let the "restructured" banks with a cleaned up balance sheet compete with other banks. This approach may be worth trying in some cases but it must be recognised that it does not guarantee revival. Even if the backlog of NPAs is taken care of, many of the weak banks will also need to cut costs by closing loss making branches and reducing excess staff if they are to have any hope of surviving in competition with other banks in the more competitive environment of the future when margins will be under pressure. In short, revival may be possible only if it is preceded by a willingness to slim down
and cut overheads drastically. It may also need a major overhaul of top and middle management which is not easy to achieve in a public sector bank.

- Even after such downsizing some weak banks may not be able to survive in competition against stronger banks which have better management cultures, stronger human skills, and better labour relations. In such a situation we must beware of repeated efforts at restructuring aimed at keeping chronically weak banks alive. The CBSR has recommended that such cases should be handed over to a Restructuring Commission, which can then decide on suitable solutions, including merger with other banks or even closure. Merger in this context should not mean a mere arithmetical aggregation of the weak bank with all its staff and branches into another financially sound bank. Mergers have the advantage that they protect depositor interests, which is an important consideration, but they make economic sense only if they are preceded by a sufficient effort to reduce cost by further downsizing before the merger. In the competitive environment expected in the future, strong banks are unlikely to be willing to accept merger with a weak bank unless these issues are resolved.

(iii) Government majority ownership of banks

- Perhaps the most difficult issue for the future is whether government should retain majority control over public sector banks. The prevailing international consensus is definitely against it and many developing countries are actively engaged in privatising government banks as part of financial sector reform. Privatisation is obviously not a guarantee against bad banking, as is evident from the many banking crises involving private banks in both developed and developing countries. However this argument is usually countered by conceding that while privatisation alone is definitely not sufficient, and must be accompanied by improved regulation and supervision, it is nevertheless necessary because Government ownership involves " politicisation" and "bureaucratisation" of banking.

- The CBSR considered this issue and has recommended that the government/RBI holding in the public sector banks/State Bank of India be reduced to 33%. Two reasons have been given by the Committee. One is that the capital requirement of the banks will expand substantially because of the
combined effect of growth of lending and enhanced capital adequacy requirements, and the additional capital needed is much larger than the likely growth of reserves through plough back of profit. Additional capital will, therefore, have to be contributed and maintaining a 51% share in equity for the Government will require large contributions from the Budget which, the Committee felt, could not be justified given the many other demands for budgetary funds. The Committee therefore recommended that the additional capital needs of the banks should be met by bringing in new private equity, diluting the government's share below 51%. The second reason given by the CBSR is more fundamental and is based on the view that the degree of functional autonomy required for the exercise of sound banking may not be possible as long as Government retains a majority share.

- Majority Government ownership of the public sector banks has been an article of faith in many circles in India and it is important to consider carefully whether it is in fact inconsistent with sound banking. Vaghul (1998) has sought to finesse the problem by suggesting that Government could retain majority ownership but the management of the bank must be entrusted entirely to a Board of eminent professionals, which would appoint (and presumably also remove) the Chief Executive, and exercise all the functions of supervision over the management. In this arrangement the management would be responsible to the Board and the Government would deal with only the Board which would not include any government officials. The arrangement will appeal to those who retain a preference for public ownership on principle but are willing to delegate power in practice. However, the degree of independence envisaged may not be feasible in practice.

- Government accountability to Parliament makes it unlikely that government would be willing to distance itself sufficiently from management by delegating all powers of supervision to an entirely independent non-government Board of Directors. In any case, since the Board must reflect the interests and perception of shareholders, it is difficult to envisage a Board acting completely independently of the government as long as the government is the majority shareholder. In fact, there is a real danger that such an arrangement might degenerate into one which gives an appearance of independence but allows
informal and unstructured interference in practice. This would only continue
the relationship of dependence without the transparency and formal
procedures involved when Government is formally responsible.

- Majority ownership also imposes certain statutory constraints. For example, it
implies that majority owned banks will be treated as the State under Article 12
of the Constitution which implies that action can be taken against the bank on
grounds of "natural justice", a feature which limits the freedom available to
managements in dealing with matters of recruitment and promotion. It also
implies that the government's anti-corruption machinery has jurisdiction over
bank officials in the same way as for government officials. The Central
Bureau of Investigation (CBI) can therefore initiate investigation of bank
officials for suspected malafide actions without complaints from the
management and indeed even if the management or the Board of the bank is
satisfied that the impugned actions do not merit investigation. The agencies
can also prosecute in such cases even though management may have a
different view of the culpability of the action. Since investigations typically
take a long time bank officials involved suffer significant costs in the process,
including possible suspension and denial of promotion. Vulnerability on this
score encourages multiple layers of decision making because bank officials
find comfort in concurrence from others. This creates cumbersome systems in
which negative views expressed at any stage are unlikely to be countered, all
of which introduces rigidity and an unwillingness to take reasonable
commercial risks. It is difficult to imagine Indian public sector banks engaging
in innovative banking under these constraints.

4.2.7 Progress of commercial banks after Nationalization

Commercial banks in India have made significant progress in different directions
since nationalization in 1969. This would be clear from the following points:

1) Number of Scheduled Banks:

- The scheduled banking structure in India consists of banks that are listed in the
second schedule of the Reserve Bank of India Act, 1934. These scheduled
banks comprise of commercial banks, regional rural banks, urban co-operative
banks and state co-operative banks. The total number of all schedule
commercial banks in 1951-52 was 94 while that of non-schedule commercial
banks was 442. However, at the end of March 2010, the number of scheduled banks was 88 and that of non-scheduled banks it was just 04. the phenomenal decline in the number of non-scheduled banks during this period was due to the fact that quite a few banks had gone into liquidation and many of such non-scheduled banks had merged with other banks. Likewise, the decline in the number of scheduled banks was due to merger of these banks with one another.

(2) Phenomenal Increase in the Number of Bank Branches:

➢ The number of branches of the commercial banks which was just 2,689 in 1951-52 increased to 8262 at the end of June, 1969. After the nationalization of 14 major commercial banks in July, 1969 and six more banks in April, 1980, there has been a phenomenal increase in the number of bank offices, particularly in the rural and semi-urban areas. Thus, for example, the total number of bank offices which was 8,262 in June, 1969 increased to 80,369 at the end of June, 2009. Thus, there has been more than 9 fold increase in the number of bank offices in the post-nationalisation period; the share of the public sector banks in this increase has been estimated at about 70 per cent.

➢ It should also be noted here that of the new offices opened since bank nationalization, more than 60 per cent of these offices have been opened in unbanked centers, particularly in rural areas. Thus, for example, in 1969; the number of rural branches of the banks was just 1860, which formed about 22 percent of the total branches; it increased to 31,796 at the end of June, 2009 which accounted for about 40 percent of the total branches.

➢ The branch expansion programme of the banks, is thus, highly encouraging; as a result, the average of population per bank office has progressively declined from 65,000 in June, '1969 to about 14,000 at the end of June, 2010.

(3) Growth of Bank Deposits and its Composition:

There has been a marked increase in bank deposits of the commercial banks during the planning period and more so since bank nationalization. Thus, for example, the aggregate deposits of the scheduled banks which were just Rs. 4,645 crores in June, 1969 increased to about Rs. 44,92,826 crores in 2009-2010. The-main reasons for the rapid growth in deposits are:

(i) Rise in the money incomes of the people.
(ii) Increase in the number of bank offices.

(iii) Special efforts for deposit mobilisation by the scheduled banks by introducing innovative schemes for savings and the offer of various types of incentives to the customers.

A study of the composition of the bank deposits has shown that time deposits account for more about 86 percent and demand deposits 14 percent of the aggregate deposits.

(4) Phenomenal Expansion of Bank Credit:

- There has been a phenomenal increase in the bank credit during the planning period and more so in the post-nationalization period. Thus, for example, the total scheduled bank credit which was just Rs. 580 crores in 1951-52 increased to Rs. 3,599 crores in June, 1969 and further to about Rs. 37,44,788 crores during the year 2009-2010.

- Apart from this quantitative expansion of bank credit, there has been a significant qualitative change in the lending policies of the commercial banks, particularly after their nationalisation. Thus, prior to bank nationalisation, a substantial part of the bank credit was given to trade, commerce and industry which according to one estimate formed about 86 per cent of the total bank credit, while the share of agriculture was hardly 2 per cent. Likewise, small scale industry, retail trade, self-employed persons etc. also received a raw deal in so far as the bank credit was concerned.

- However, after nationalisation, a fundamental and qualitative change has taken place in the composition of bank credit. The concept of social banking has come to be widely accepted, which refers to that policy under which banks provide credit on a preferential basis to the priority sectors of the economy and to the weaker sections of the society. The concept of social banking makes the banks aware, about their ‘social responsibilities.’

- Likewise, the concept of priority sector ensures that the assistance from the banking system flows in an increasing manner to those sectors of the economy which, though accounting for a significant proportion of the national product, have not received adequate support from the institutional finance in the past.

(5) Assistance to Sick Industrial Undertakings:

- Public sector banks have been providing assistance to sick industrial undertakings. For this purpose, the sick industrial Undertakings cell has been
constituted in the Reserve Bank of India since November 1976. The cell monitors the banks performance in identifying sick units and taking remedial action "besides bringing about co-ordination in the efforts of banks, financial institutions, Government' and other agencies in the rehabilitation of sick units.

(6) Innovative Banking:

- In recent years, public sector and private sector banks as also offices of the foreign banks have been adopting the strategy of innovative banking in their business operations. Innovative banking implies the application of new techniques, new methods and novel schemes in areas of deposit mobilization, deployment credit and bank management.

(7) Technological Up gradation:

- In years to come, banking is going to be more and more technology driven. Revolution in information and communication technologies make it imperative for the banks to adapt these at a fast speed. Accordingly, in recent years, mechanization and computerization has made considerable headway in the banking system with a view to provide quick and efficient services to the customers. Facilities for Advanced Ledger posting Machines (ALPM) and computers are being extended to cover more and more branches. Likewise, Magnetic Ink Charter Recognition (MICR) cheque processing centers have been extended to new centers. Similarly, scheme of electronic clearing has been introduced to provide simple, faster and cost-effective solution for repetitive payment such as salary, pension, interest, dividend etc. by companies, corporations and government departments.

(8) Diversification in Banking Operations:

(i) In recent years, there has been a considerable diversification in the functions and business operations of the banks. Thus, for example:

(ii) A number of banks have set up merchant banking divisions and are underwriting new issues, especially preference shares and debentures. Many banks have set up their own subsidiary companies to strengthen the organizational and managerial capabilities and to offer more specialized services with professional expertise and skill like the SBI Capital Market Ltd. formed by the State Bank of India, Can Bank Financial Services Ltd.
by Canara Bank, BOB Capital Market Ltd. promoted by Bank of Baroda etc.

(iii) Many banks have floated mutual funds like SBI Mutual Fund, Indian Bank Mutual Fund, PNB Mutual Fund, Bank of Baroda Mutual Fund etc.

(iv) Likewise in recent years, a number of banks have introduced "stock invest scheme", "credit card scheme" etc. and have also been given, approval to set up "money market mutual funds." Now; factoring, retail banking; anywhere banking, internet banking etc are being undertaken.

(9) **Training Facilities**

- The rapid expansion of banks' branches and the increasing diversification of their activities requires a trained staff at all organizational levels. Accordingly, a number of training centers and institutions have been set up which impart training and professional skill in bank management. Thus, for example, the National Institute of Bank Management, Mumbai; Bankers' Training College, Mumbai; Reserve Bank Staff College, Chennai; College of Agricultural Banking, Pune; Zonal Training Centres at New Delhi, Kolkata, Mumbai and Chennai etc. are providing training facilities, skill and expertise to various categories of bank staff and officers' cadre.

(10) **Core Banking Solution (CBS)**:

In recent years, many banks have launched core Banking solution Branches. Bank Customers get the following benefits under core banking solution:

1. Bank Services I facilities are available at any bank branch.
2. Online real time balances and Status.
3. Access to multiple delivery channels.
4. 2.4 x 7 banking
5. Better reach and accessibility to information and accounts.
6. Consistent customer information and service.
Table – 3
Performance and progress parameter’s of public and private sector banks.

<table>
<thead>
<tr>
<th>NPA Data</th>
<th>As on March 31, 2013</th>
<th>(Amount in Million)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Banks</td>
<td>Gross NPAs</td>
<td>Gross Advances</td>
</tr>
<tr>
<td>(1)</td>
<td>(2)</td>
<td>(3)</td>
</tr>
<tr>
<td><strong>Public Sector Banks</strong></td>
<td></td>
<td></td>
</tr>
<tr>
<td>State Bank of India</td>
<td>511894</td>
<td>10785571</td>
</tr>
<tr>
<td>State Bank of Bikaner and</td>
<td>21195</td>
<td>584737</td>
</tr>
<tr>
<td>State Bank of Hyderabad</td>
<td>31860</td>
<td>920231</td>
</tr>
<tr>
<td>State Bank of Mysore</td>
<td>20806</td>
<td>459805</td>
</tr>
<tr>
<td>State Bank of Patiala</td>
<td>24530</td>
<td>754598</td>
</tr>
<tr>
<td>State Bank of Travancore</td>
<td>17499</td>
<td>683885</td>
</tr>
<tr>
<td><strong>SBI and its Associates</strong></td>
<td><strong>627784</strong></td>
<td><strong>14188827</strong></td>
</tr>
<tr>
<td>Allahabad Bank</td>
<td>51370</td>
<td>1309363</td>
</tr>
<tr>
<td>Andhra Bank</td>
<td>37145</td>
<td>1001378</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>79826</td>
<td>3328113</td>
</tr>
<tr>
<td>Bank of India</td>
<td>87653</td>
<td>2929679</td>
</tr>
<tr>
<td>Bank of Maharashtra</td>
<td>11376</td>
<td>763972</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>62602</td>
<td>2439358</td>
</tr>
<tr>
<td>Central Bank of India</td>
<td>84562</td>
<td>1762337</td>
</tr>
<tr>
<td>Corporation Bank</td>
<td>20482</td>
<td>1193540</td>
</tr>
<tr>
<td>Dena Bank</td>
<td>14525</td>
<td>664569</td>
</tr>
<tr>
<td>IDBI Bank Limited</td>
<td>64500</td>
<td>2001347</td>
</tr>
<tr>
<td>Indian Bank</td>
<td>35655</td>
<td>1071559</td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>66080</td>
<td>1643665</td>
</tr>
<tr>
<td>Oriental Bank of Commerce</td>
<td>41840</td>
<td>1301862</td>
</tr>
<tr>
<td>Punjab and Sind Bank</td>
<td>15369</td>
<td>518434</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>134658</td>
<td>3152440</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>29785</td>
<td>1494227</td>
</tr>
<tr>
<td>UCO Bank</td>
<td>71301</td>
<td>1315691</td>
</tr>
<tr>
<td>Union Bank of India</td>
<td>63138</td>
<td>2119111</td>
</tr>
<tr>
<td>United Bank of India</td>
<td>29638</td>
<td>697081</td>
</tr>
<tr>
<td>Vijaya Bank</td>
<td>15329</td>
<td>705135</td>
</tr>
<tr>
<td><strong>Nationalised Banks $</strong></td>
<td><strong>1016834</strong></td>
<td><strong>31412861</strong></td>
</tr>
<tr>
<td><strong>Public Sector Banks</strong></td>
<td><strong>1644618</strong></td>
<td><strong>45601688</strong></td>
</tr>
<tr>
<td>Item</td>
<td>Public sector banks</td>
<td>Private sector banks</td>
</tr>
<tr>
<td>------</td>
<td>---------------------</td>
<td>---------------------</td>
</tr>
<tr>
<td>1</td>
<td></td>
<td></td>
</tr>
<tr>
<td>1. Capital</td>
<td>-4.2</td>
<td>4.3</td>
</tr>
<tr>
<td>2. Reserves and Surplus</td>
<td>24.4</td>
<td>15.5</td>
</tr>
<tr>
<td>3. Deposits</td>
<td>14.4</td>
<td>14.9</td>
</tr>
<tr>
<td>3.1 Demand Deposits</td>
<td>-6.3</td>
<td>16.8</td>
</tr>
<tr>
<td>3.2 Savings Bank Deposits</td>
<td>12.1</td>
<td>14.4</td>
</tr>
<tr>
<td>3.3 Term Deposits</td>
<td>18.2</td>
<td>14.8</td>
</tr>
<tr>
<td>4. Borrowings</td>
<td>17.2</td>
<td>19.8</td>
</tr>
<tr>
<td>5. Other Liabilities and Provisions</td>
<td>-7.5</td>
<td>15.4</td>
</tr>
<tr>
<td>Total Liabilities/Assets</td>
<td>14.1</td>
<td>15.3</td>
</tr>
<tr>
<td>1. Cash and Balances with RBI</td>
<td>-20.5</td>
<td>-0.2</td>
</tr>
<tr>
<td>2. Balances with Banks and Money at Call and Short Notice</td>
<td>40.7</td>
<td>38.0</td>
</tr>
<tr>
<td>3. Investments</td>
<td>12.8</td>
<td>16.7</td>
</tr>
<tr>
<td>3.1 Government Securities</td>
<td>16.5</td>
<td>13.5</td>
</tr>
<tr>
<td>3.2 Other Approved Securities</td>
<td>-65.1</td>
<td>-26.2</td>
</tr>
<tr>
<td>3.3 Non-Approved Securities</td>
<td>-2.1</td>
<td>33.3</td>
</tr>
<tr>
<td>4. Loans and Advances</td>
<td>17.3</td>
<td>15.4</td>
</tr>
<tr>
<td>4.1 Bills Purchased and Discounted</td>
<td>25.7</td>
<td>20.8</td>
</tr>
<tr>
<td>4.2 Cash Credits, Overdrafts, etc.</td>
<td>17.8</td>
<td>16.9</td>
</tr>
<tr>
<td>4.3 Term Loans</td>
<td>16.1</td>
<td>13.5</td>
</tr>
<tr>
<td>5. Fixed Assets</td>
<td>5.9</td>
<td>11.2</td>
</tr>
<tr>
<td>6. Other Assets</td>
<td>14.9</td>
<td>2.8</td>
</tr>
</tbody>
</table>

Source: Balance Sheets of respective banks.
### Table-5

**Growth in Credit & Deposits during 1991 to 2011**

<table>
<thead>
<tr>
<th>Banks</th>
<th>As on 1991.03.31</th>
<th>As on 2011.03.31</th>
<th>CAGR (1991-2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs.crore</td>
<td>Rs.crore</td>
<td>%</td>
</tr>
<tr>
<td>Credit by SBI and its associates</td>
<td>34716</td>
<td>892260.7</td>
<td>17.62</td>
</tr>
<tr>
<td>Credit by nationalised banks</td>
<td>71402.4</td>
<td>2159802.7</td>
<td>18.59</td>
</tr>
<tr>
<td>Credit by foreign banks</td>
<td>9358.9</td>
<td>199553.6</td>
<td>16.53</td>
</tr>
<tr>
<td>Credit by regional rural banks</td>
<td>3750.6</td>
<td>98118.8</td>
<td>17.73</td>
</tr>
<tr>
<td>Credit by private sector banks</td>
<td>4975.1</td>
<td>725911.2</td>
<td>28.29</td>
</tr>
<tr>
<td>Credit by all scheduled commercial banks</td>
<td>124203</td>
<td>4075647</td>
<td>19.07</td>
</tr>
</tbody>
</table>

<table>
<thead>
<tr>
<th>Banks</th>
<th>As on 1991.03.31</th>
<th>As on 2011.03.31</th>
<th>CAGR (1991-2011)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>Rs.crore</td>
<td>Rs.crore</td>
<td>%</td>
</tr>
<tr>
<td>Deposits of SBI and its associates</td>
<td>53314.4</td>
<td>1154020.8</td>
<td>16.62</td>
</tr>
<tr>
<td>Deposits of nationalised banks</td>
<td>122283.8</td>
<td>2864924</td>
<td>17.08</td>
</tr>
<tr>
<td>Deposits of foreign banks</td>
<td>11387.9</td>
<td>234760.5</td>
<td>16.33</td>
</tr>
<tr>
<td>Deposits of regional rural banks</td>
<td>4849.7</td>
<td>163694.5</td>
<td>19.24</td>
</tr>
<tr>
<td>Deposits of private sector banks</td>
<td>8732.6</td>
<td>972151.4</td>
<td>26.57</td>
</tr>
<tr>
<td>Deposits of all scheduled commercial banks</td>
<td>200568.4</td>
<td>5389551.3</td>
<td>17.89</td>
</tr>
</tbody>
</table>

#### 4.3 CONCLUSION:

- It could be noted that there has been no banking crisis at the same time, efficiency of banking system as a whole, measured by declining spread has improved. This is not say that they have no challenges. There are emerging challenges, which appear in the forms of consolidation; recapitalization, prudential regulation weak banks, and non-performing assets, legal framework etc needs urgent attention. The paper
concludes that, from a regulatory perspective, the recent developments in the financial sector have led to an appreciation of the limitations of the present segmental approach to financial regulation and favors adopting a consolidated supervisory approach to financial regulation and supervision, irrespective of its structural design.

- In the post-era of IT Act, global environment is continuously changing and providing new direction, dimensions and immense opportunities for the banking industry. Keeping in mind all the changes, RBI should appoint another committee to evaluate the on-going banking sector reforms and suggest third phase of the banking sector reforms in the light of above said recommendations. Need of the hour is to provide some effective measures to guard the banks against financial fragilities and vulnerability in an environment of growing financial integration, competition and global challenges. The challenge for the banks is to harmonize and coordinate with banks in other countries to reduce the scope for contagion and maintain financial stability. It is not possible to play the role of the Oracle of Delphi when a vast nation like India is involved. However, a few trends are evident, and the coming decade should be as interesting as the last one.