CHAPTER 1
INTRODUCTION

1.1 INTRODUCTION

"Man has discovered something remarkable in every field of knowledge. In technology, he has invented a wheel, in science, he has discovered fire, in political science, he has found out the system of voting. In the same way, in economics, money is an important discovery."

---Prof. Crowther

Economic growth depends on the mobilization of resources, men and material and their utilization in a planned manner. A country’s development can be achieved only through economic growth which is dependent on the prevailing financial system. The role played by the adopted ‘Financial System’ is crucial and it intermediates between the flow of funds belonging to those who save a part of their income and those who invest in productive assets. The major function of the financial system is provision of money and monetary assets for the production of goods and services. A strong financial system is crucial to fulfill the objective of strengthening the real economy and for its healthy and orderly growth.

Financial system is a complex, well-integrated set of sub-systems of Financial Institutions, Markets, Instruments and Services which facilitates the transfer and allocation of funds, efficiently and effectively. The formal financial system consists of four segments or components namely – (1) Financial Institutions, (2) Financial Markets, (3) Financial Instruments and (4) Financial Services. These constitute the financial system and act as a conduit for the transfer of financial resources from net savers to net borrowers i.e. from those who spend less than they earn to those who earn more than they spend.

Financial institutions provide maximum financial convenience to the public. Financial institutions promote overall saving of the economy by deepening and widening the financial structure. They also distribute the available savings in a more efficient

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manner. They also create credit and deposit money, production and distribution in furtherance of the economy.

The major function of the financial system is the provision of money and monetary facilities for the production of goods and services. Efficient and sound financial system of a country plays an important role in nation’s economic development\(^2\). The financial system performs the basic economic function of intermediation essentially through the following four transformation mechanisms:

- **Liability-asset transformation** i.e. accepting deposits as a liability and converting them into assets such as loans.
- **Size transformation** i.e. providing large loans on the basis of assorted large medium and small deposits.
- **Maturity transformation** i.e. offering savers deposits according to their liability preferences while providing borrowers with loans of required maturities and
- **Risk transformation** i.e. distributing risks through diversification which substantially reduces risks for savers, which would prevail while lending directly in the absence of financial intermediaries

Bank and banking are the most important and major factors in today’s world economy. Each and every transaction is routed through banking. Not a single business is possible without banking activity. The bank and business are both interrelated. The activities and facilities provided by the banks such as collection of deposits from small investors, lending, finance and leasing, cash credit, letter of credit, routine transaction are very important for economic growth on the whole.

Banks are essential instruments of accelerated growth in a developing economy. In fact banks are nerve centers of the economy. The primary task of banking institutions is to mobilize the diffused and thinly scattered savings of a poor and populous community and to direct them into productive investment. Mobilization of saving in the form of deposits & lending finance to the seekers of fund is one of the important roles of banking sectors. The banking system reflects the economic health of the country.

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The turning point for strength and efficiency of financial system is nothing but the economical strength of the country. And economical strength depends on a sound banking system. A sound banking system efficiently arranges the saving in creative sectors and it ensures that the bank is capable of meeting its debt to the depositors. The banking sector is leading in India as it accounts for more than 50% of the total assets of the financial sectors.

The financial systems of most developing countries are characterized by coexistence and co-operation between the formal and informal financial sectors. The Indian financial system can also be broadly classified into formal (organized) financial system and informal (unorganized) financial system.

In India, the financial sector comprises of banking and non-banking financial institutions. Banking institutions simply accept the long term deposits from the public and then lend to the borrowing community. Banking institutions are creators and purveyors of credit. While the liabilities of banks are part of the money supply, this may not be true of non-banking financial institutions. There is no hard and fast rule to distinguish between banking and non-banking institutions.

The banking system is the heart of the financial system. The Indian financial system comprises of a large number of commercial and cooperative banks and specialized developmental banks for industry, agriculture, external trade and housing, social security institutions, collective investment institutions, etc.

A developing country faces many problems like poverty, scarcity of capital, lack of entrepreneurship, etc. There is a high dependence on agriculture and at the same time agriculture is not modernized and the means of transport is underdeveloped. There are inter-regional and inter-sectoral disparities. There is also unequal distribution of wealth.

Banks play a very useful and dynamic role in the economic life of every modern state. They are important constituents of the money market and their demand deposits serve as money in the modern community. Banks can work as catalytic agents of

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growth by following the right kind of policies in their working, depending upon the socio-economic conditions prevailing in a country. It is realized that since banks have the required investment potentiality, they can make a significant contribution in eradicating poverty, unemployment and they can bring about progressive reduction in inter-regional, inter-state and inter-sectoral disparities through rapid expansion of banking services.

Banking system is also referred to as a system provided by the bank which offers cash management services for customers, reporting the transactions of their accounts and portfolios throughout the day. The banking system in India should not only be hassle free but also be able to meet the new challenges posed by the technology and any other external and internal factors. For the past three decades, India’s banking system has had several outstanding achievements to its credit. The Banks are the main participants of the financial system in India. Although deregulation and liberalization in the banking sector have resulted in enhanced efficiency and systematic resilience, they have also raised legitimate concerns with regard to the quality of customer services provided by banks. The Banking sector offers several facilities and opportunities to their customers. All the banks safeguard the money and valuables and provide loans, credit and payment services, such as checking accounts, money orders and cashier’s cheques. The banks also offer investment and insurance products. As a variety of models for cooperation and integration among finance industries have emerged, some of the traditional distinctions between banks, insurance companies and securities firms have diminished. In spite of these changes, banks continue to maintain and perform their primary role - accepting deposits and lending funds from these deposits.

Bank as a development agency are the source of hope and aspirations of the masses. Then banks help the agricultural sector in a number of ways. They provide directly to agriculturists for marketing their produce, for modernization and mechanization of forms, for developing land etc. Banks also play an important role in development of the industrial sector by providing short term and long term loans to industries. Banks grant loans to small-scale industrial units for expansion, modernization and renovation and also provide them with working capital finance.

Commercial banks have come to play a significant role in the development of countries. The two basic functions of commercial banks are mobilization of the savings of the people and disbursement of credit according to direction. The world over, banking system is the focal point in the financial setup of any developing country. In India too economic development has evolved around the banking system.

The experience of Indian banking system since nationalization has brought to the fore front the immense potential of banking as a level of socioeconomic development. Since banking development and economic development are closely associated with each other, it would be pertinent to have a comprehensive study of the activities of the public sector banks and private sector banks in the field of socio-economic development in India. It is necessary to examine the extent to which the banks have moved towards their social goal. The present study is an attempt to study the functional and operational efficiency and profitability and productivity measurement for selected unit of public sector banks and private sector banks for particular period. The purpose of this study is, thus to make an in-depth study of what the public sector banks and private sector banks in India have done during the period of last 11 year.

1.2 NEED FOR THE BANK

"Bank is a place where they lend you an umbrella in fair weather and ask for it back again when it begins to rain" - Robert Frost

Before the establishment of banks, the financial activities were handled by money lenders and individuals. At that time the interest rates were very high. The interest rate charged by them is higher than the interest charged by other banking institutions. Again there was no security of public savings and no uniformity regarding loans. So as to overcome such problems the organized banking sector was established, which was fully regulated by the government. The organized banking sector works within the financial system to provide loans, accept deposits and provide other services to their customers. While banks play a critical role in financial intermediation and in the creation of money,

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baking’s primary focus is the satisfaction of customers’ needs. The following functions of the bank explain the need of the bank and its importance:

- To provide the security to the savings of customers.
- To control the supply of money and credit.
- To encourage public confidence in the working of the financial system, increase savings speedily and efficiently.
- To avoid focus of financial powers in the hands of a few individuals and institutions. To set equal norms and conditions (i.e. rate of interest, period of lending etc) to all types of customers.

Banks are not only useful for innovation and wealth generation; they also make excellent scapegoats when things go wrong. Banks in many countries are already required to hold more capital and the current tsunami of new regulation, new laws and new taxes will mean that banks will become more constrained than they are now.

1.3 ORIGIN & GROWTH OF COMMERCIAL BANKS IN INDIA

Banks play a pivotal role in mobilizing the nation’s savings and channelizing them into high investment priorities. But due to liberalization, globalization and privatization (LPG), the whole scenario of the banking sector has undergone a tremendous change. This has opened a new door for the Indian banking sector through which India has to enter the era of adopting new technologies, core banking system and universal banking. Hence the scope of working of the Indian banking sector has gone through a change beyond our imagination, especially during the last three decades. In this topic, attempts have been made in detail, the origin and growth of commercial banks in India. Indian Banks made remarkable progress in the 80s and 90s. They met the credit requirements of the industry, trade and agriculture on a large scale than before. Class banking got transformed into mass banking with the nationalization of 14 scheduled commercial Banks in 1969 and subsequently in 1980s, which are considered to be the major constituent of the structure of Indian banking.

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7 http://blogs.hbr.org
1.3.1 ORIGIN OF THE WORD “BANK”

There seems no uniformity amongst the economist about the origin of the word “Bank”. According to some authors the word “Bank”, itself is derived from the word “Bancus” or “Banque” that is a bench. The early bankers, the Jews in Lombardy, transacted their business on benches in the market place, when, a banker failed, his ‘Banco’ was broken up by the people; it was called ‘Bankrupt’. This etymology is however, ridiculed by mcleod on the ground that “The Italian Money changers as such were never called Banchier in the middle ages.”

It is generally said that the word "BANK" has been originated in Italy. In the middle of 12th century there was a great financial crisis in Italy due to war. To meet the war expenses, the government of that period a forced subscribed loan on citizens of the country at the interest of 5% per annum. Such loans were known as 'Compare', 'minto' etc. The most common name was 'Monte'. In Germany the word 'Monte was named as 'Bank' or 'Banke'. According to some writers, the word 'Bank' has been derived from the word 'Monte'. It is also said that the word 'bank' has been derived from the word 'Banco' which means a bench. The Jews money lenders in Italy used to transact their business sitting on benches at different market places. When any of them used to fail to meet his obligations, his ‘Banco' or banch or bench would be broken by the angry creditors. The word 'Bankrupt' seems to be originated from broken Banco. Since, the banking system has been originated from money leading business; it is rightly argued that the word 'Bank' has been originated from the word 'Banco'. Whatever be the origin of the word ‘Bank' as Professor Ram Chandra Rao says, “It would trace the history of banking in Europe from the middle Ages.”

Today the word bank is used as a comprehensive term for a number of institutions carrying on certain kinds of financial business. In practice, the word 'Bank' means which borrows money from one class of people and again lends money to another class of people for interest or profit.

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Actually meaning of bank is not specifies in any regulation or act. In India, different people have different type of meaning for bank. Normal salary earner knows means of bank that it is a saving institution, for current account holder or businessman knows bank as a financial institutions and many other. Bank is not for profit making, it creates saving activity in salary earner.

1.3.2 MEANING & DEFINITIONS OF BANK

A Bank is an institution which accepts deposits from the general public and extends loans to the households, the firms and the government. Banks are those institutions which operate in money. Thus, they are money traders, with the process of development functions of banks are also increasing and diversifying now, the banks are not nearly the traders of money, they also create credit. Their activities are increasing and diversifying. Hence it is very difficult to give a universally acceptable definition of bank

Indian Banking Regulation Act 1949 section 5 (1) (b) of the banking Regulation act 1949 Banking is defined as. “Accepting for the purpose of the landing of investment of deposits of money from public repayable on demand or other wise and withdraw able by cheques, draft, order or otherwise.”

“Bank means a bench or table for changing money “

“Bank is an establishment for custody of money received from or on Behalf of its customers. It’s essential duty is to pay their drafts unit. Its profits arise from the use of the moneyleft employed them.”

“Bank is an institution which traders in money, establishment for money, as also for making loans and discounts and facilitating the transmission of remittances from one place to another.”

“Bank means the place when money is kept safely, open an account with any bank and make Transaction with that bank is simply called as bank”

“A bank is an establishment which makes to individuals such advances of money or other means of payment as may be required and safely made and to which individuals entrust

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11 www.ibid.org.in
13 www.ibid.org.in
money or means of payment when not required by them for use.”

- Prof. Kinely

“Bank as institutions which collects money from those who it to spare or who are saving it out of their income and lends out to those who required it”

- Prof. Crowthers

“A banker is defined as a person who carries on the business of banking, which is specified as conducting current accounts for his customers, paying cheques drawn on him, and collecting cheques for his customers.”

- English common law

“A Bankers is one who is the ordinary course of his business honors drawn upon him by person from and for whom he receives money on current account”

- Dr H. L. Hert

“A Banker is a Person who is willing to make a loan if you present sufficient evidence to show you don’t need it.”

- Herbert V. Prochnow

“Banks is an institution whose debts (bank deposits) are universally acceptable for the debts of other individuals”.

- According to Sayers

1.3.3 HISTORY OF BANKING

The first banks were probably the religious temples of the ancient world, and were probably established sometime during the third millennium B.C. Banks probably predated the invention of money. Deposits initially consisted of grain and later other goods including cattle, agricultural implements, and eventually precious metals such as gold, in the form of easy-to-carry compressed plates. Temples and palaces were the safest places to store gold as they were constantly attended and well built. As sacred places, temples presented an extra deterrent to would-be thieves. There are extant records of loans from the 18th century BC in Babylon that were made by temple priests/monks to merchants. By the time of Hammurabi’s Code, banking was well enough developed to justify the promulgation of laws governing banking operations.

(A) EVOLUTION OF BANKING

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15 United Dominions Trust Ltd Vs Kirkwood, 1966, English Court of Appeal, 2 QB 431
16 Giuseppe, F and Guido, L. Genoa and the history of finance: A series of firsts? (the book can be downloaded at www.giuseppefelloni.it)
ANCIENT STAGE OF BANKING

Banks play a very crucial role in the development of economy. They are like blood vessels nourishing a part of the economy by acting as intermediary between savers and investors. Historically, banking is as old as authentic history and the origins of modern commercial banking are traceable in ancient times. The New Testament mentions about the activities of money changers in the temples of Jerusalem. In ancient Greece, the famous temple of Delphi and Olympia were used as depositaries for people’s surplus funds and money lending transaction. Traces of credit by compensation and by transfer order are found in Assyria, Phoenicia and Egypt before the system attained full development in Greece and Rome.

BANKING AFTER 12th CENTURY

The Bank called “Bank of Venice” made it first beginning round the middle of the twelfth century in Italy. The Bank of Venice was founded in 1157 to finance the monarch in his wars. Following its establishment, the Bank of Barcelona and the Bank of Genoa were set up in 1401 and 1407 respectively. The Bank of Venice and the Bank of Genoa continued to operate successfully until the end of eighteenth century. Public banks like the famous Bank of Amsterdam were founded in 1609. The principal function of these banks was to help in the development of trade and commerce by receiving the heterogeneous metallic money in terms of weight, which was considered as the then currency. After that Bank of England was established in the year 1694 with a view to finance the government to continue the ongoing war with France.

(B) BANKING IN ANCIENT INDIA

“The famous Jain dahera delavada were built on top of the Mount Abu, a curator and Tejpal, for temple construction costs nagarseth of Ahmedabad was written Hundi of Rs. 10crore.” This shows that the development of banking in India was in ancient times. According to L.C. Jain, in his book “Indigenous Banking in India”.

BANKING DURING VEDIC PERIOD

Admittedly, the banker has been an indispensable pillar of the Indian society. India evolved and worked the principles of banking prior to the Western countries. The

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coinage and currency system has its deep roots in the Indian history. The use of gold coins and coins of other metals finds mention in Aryan Granthas was as old as 3000 to 5000 BC. Evidences are also found in the literature of the Vedic times i.e., 2000 to 1400 BC regarding the existence of money-lending operations in India. In the 1300 Century when “Hundi” i.e. bill of exchange was used as a medium of exchange for the first time. Banking was a side business during the Vedic period and this became a full-time business activity of people during the Ramayana and the Mahabharata era.

**BANKING DURING SMRITI PERIOD**

During the Smriti period, which followed the Vedic period and the Epic age, banking was carried on by the Vaishya community. From the laws of Manu, the great Hindu Jurist, it appears that deposits, pledges, policy of loans and rates of interest from a banking business was known in India in ancient times. However, the transaction from the money lending to banking must have occurred before Manu, who have devoted a special section to the subjects of deposits and pledges, where he says, “A sensible man should deposits his money with a person of good family of good conduct, well-acquainted with the law, veracious having many relatives, wealthy and honorable (Arya)”. According to B.K. Bhargava, the banker in the Smriti period performed most of the functions which modern banks perform. According to Shukra and Yajnavalka, the greatest writers of the Smriti period, banker used to maintain a regular system of accounts and borrowers used to sign the loan deeds (Rnapatras).

**BANKING DURING BUDDHIST PERIOD**

During the Buddhist period, banking system was decentralized and Brahmin and Kshatriyas were also permitted to take banking as their profession. The literature of the Buddhist period supplies ample evidence of the Shresthis, or banker, in all the important trade centers and of their widespread influence in the life of the community. Their chief activity was to lend money to traders, to merchants, adventurers who went to

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21 Cited in Vaish, M.C., op. cit., p. 89
22 Ibid., pp. 89-90
foreign countries, to explorers who marched through forests to discover valuable materials and to kings who were in financial difficulties due to war and other reasons, against the pledge of movable or immovable property or personal surety.\textsuperscript{23} Chanakya in \textit{Arthashastra} in about 300 B.C. mentioned about the existence of powerful guilds of merchant bankers who received deposits, advanced loans and hundis, treasury keeping, cash and credit policies, rate of interest, etc.

\textbf{(C) BANKING IN MEDIEVAL INDIA}

\textbf{BANKING DURING MUSLIM PERIOD}

During Muslim period banking received a great setback as the Muslim rulers believed in the Quranic Injunctions according to which the taking of byaj or interest was a great sin (haraam). Political instability also was another factor behind this setback. However, banking business was made possible during the secular and settled reign of Emperor Akber. Private banking was further developed during Jahangir’s reign. During Shah Jahan’s reign, banking prospered without interruption and large banking houses were established. During fanatic Aurangzeb’s reign, banking, which had somewhat revived during the reigns of his ancestors, again suffered a great setback. A staunch practitioner of the Quaranic injunction, Aurangzeb adopted a negative approach towards money lending and banking.\textsuperscript{24}

\textbf{TRANSACTION DURING MUGHAL PERIOD}

After all, during the Mughal rule the issues of various kinds of metallic money in different parts of the country gave the indigenous bankers great opportunities for developing the very profitable business of money-changing. And the most important among them were appointed mind officers, revenue collectors, bankers and money-changers to government in various parts of the empire. Many of them wielded great influence in the country, and those among them who came to be known as \textit{Jagat Seths} (world bankers) in the 17\textsuperscript{th} and 18\textsuperscript{th} centuries possessed a great power as the private bankers of any Western countries.\textsuperscript{25}

\textbf{(D) BANKING IN INDIA IN THE 18\textsuperscript{th} AND 19\textsuperscript{th} CENTURY}

\textsuperscript{23} Panandikar, S.G. (1975), Banking in India, Orient Longman Ltd., p. 1.
\textsuperscript{24} Vaish, M.C., Modern Banking, op. cit., p. 90.
\textsuperscript{25} Panandikar, S.G., Banking in India, op. cit., p. 2.
BANKING IN INDIA IN THE 18th CENTURY

Banking in India originated in the first decade of 18th century with the General Bank of India, which came into existence in 1786. The first commercial bank of India was the Hindustan bank, which was set up by Alexander and co., an English agency house in Calcutta in 1770. However, it closed down in 1832 when the firm with which it was connected got collapsed. A couple of other banks that were established during this period met similar challenges. The origin of modern commercial banking in India can be associated with the setting up of the first presidency bank, viz., the Bank of Bengal in Calcutta in 1806.26 In 1840, the Bank of Bombay and in 1843 the Bank of Madras were also set up with their capital being Rs.52 lakh and Rs. 30 lakh respectively. Few decades later, some foreign banks like Credit Lyonnaise started their Calcutta operations in 1850s. At that point of time, Calcutta was the most active trading centre mainly due to the trade of the British Empire, for which banking activity took roots there and prospered. The first fully Indian owned bank was the Allahabad Bank, which was established in 1865 with European management. The first bank that was established with Indian ownership and management was the Oudh Commercial Bank in 1881, followed by the Ayodhya Bank in 1884, the Punjab National Bank in 1894 and subsequently Nedugadi Bank in 1899.

BANKING IN INDIA IN THE 19th CENTURY AND FORMATION OF IMPERIAL BANK

By the 19th century, the market expanded with the establishment of another five banks. During the period 1901-1914, twelve more banks were established. The prominent among which were the Bank of Baroda (1906), the Canara Bank (1906), the Indian Bank (1907), the Bank of India (1908) and the Central Bank of India(1911). During the First World War period (1914-1918) the Indian banks forced serious crises and no commercial bank was established. However, the conditions prevailed during the First World War period (1914-1918) emphasized the need for a unified banking institution. As a result of this, the Imperial Bank of India was set up in 1921. The Imperial Bank of India was established on 27 January, 1921 in pursuant to the Imperial Bank Act of 1920 by amalgamating the three Presidency Banks – Bengal, Bombay and

Madras. The Imperial Bank being the biggest commercial bank with enormous resources was expected to extend its branches throughout the country and conduct banking business by inspiring public confidence.

**(E) ROLE OF IMPERIAL BANK**

However, up to 1935, the Imperial Bank of India played the role of a quasi central bank. It combined the functions of both a commercial bank and a central bank. The role of the Imperial Bank was envisaged as “to extend banking facilities, and to render the money resources of India more accessible to the trade and industry of this country, thereby promoting financial system, which is an indisputable condition of the social and economic advancement of India.”27 The Reserve Bank of India (RBI) formally took on the responsibility of regulating the Indian banking sector from 1935 as the central bank of the country.

1.3.4 BANKING AFTER INDEPENDENCE IN INDIA

**(A) PRE-NATIONALISATION ERA (1947-1968)**

**CONVERSION OF IMPERIAL BANK OF INDIA TO STATE BANK OF INDIA**

After India’s independence in 1947, the banking scenario prevalent in the country was that there were 654 scheduled, non-scheduled and exchange banks operating in the country with a network of 5009 offices with deposits advances of Rs. 1153.45 crore and Rs. 520.29 crore respectively. At this time, banking was concentrated in metro cities and port towns with a large proportion of total advances going to trade.

**Fig. 1.1 : State Bank Group**

In this backdrop, for strengthening the Indian banking system, the Imperial Bank of India was nationalized in 1947 and renamed as State Bank of India (SBI). (See Fig. 1.1) Banking Regulation Act was passed in 1949 to conduct and control operations of the commercial banks in India. However, under this period there was also some exchange banks operated in India for financing the subcontinent’s burgeoning foreign trade. Such banks chartered by British Parliament or incorporated in Europe included the chartered Bank of India, Australia and China, the Chartered Mercantile Bank of India, London and China, the Hong Kong and Shanghai Banking Corporation, the Comptoir d’Escompte de Paris and so on. All these banks operated in different segments of the economy. (See Fig. 1.2)

Fig. 1.2: Banking Scenario during Pre-Nationalization Era (1947-1968)

STATE BANK OF INDIA AND ITS ASSOCIATES

By the end of 1960s, the State Bank has submitted a proposal to the state associated banks for undertaking them as subsidiary banks and accordingly State Bank of India (Subsidiary Banks) Act, 1959 was passed. As per the provisions of the Act, the

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eight state-associated banks were taken over by the State Bank of India as its subsidiaries such as State Bank of Hyderabad, State Bank of Bikaner, State Bank of Jaipur, State Bank of Saurashtra, State Bank of Patiala, State Bank of Mysore, State Bank of Indore, State Bank of Travancore. The separate entity of those banks was retained in the form of subsidiaries so as to enable them to serve the local needs in their respective areas. Compared to other commercial banks, the performance of State Bank of India can be attributed to a more satisfactory because Mrs Indira Gandhi nationalized banks but decades ago, State Bank of India was serving as nationalized bank. Usually working in the public sector organizations that have huge losses at that time the performance of State Bank of India was more appreciate. For such attribute is given to The Union finance ministry and the Banking industry. Several factors who opposed to the nationalization of banks were likely startled with such Statistics information. In short the theory of nationalization is not wrong but it is not mandatory for such elements who are not trying to adopt a genuine so it is reached at failure limit. This is one of the oldest central bank in the country is a perfect example of efficiency and honesty.

(B) POST-NATIONALISATION ERA (1969-1991)

SOCIAL CONTROL SCHEME

National Credit Council was set up in February 1968 to coordinate credit planning with economic planning and to ensure allocation of credit to priority sectors, which became the cornerstone of the social control scheme. The objectives of social control were: (i) removal of control by a few; (ii) provision of adequate credit for agriculture and small-scale industry and exports; (iii) providing professional bent to management; (iv) encouragement of new classes of entrepreneurs and (v) the provision of adequate training as well as terms of service for bank staff.

PROCESS OF NATIONALISATION OF FOURTEEN BANKS

Thereafter, the Government of India (GOI) issued an ordinance and nationalized the 14 largest commercial banks with effect from July 19, 1969. The Government of India promulgated an ordinance; the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, 1969 in terms of which the Central Government acquired the undertaking of the 14 biggest commercial banks which had deposits of not less than Rs. 50 crore each and having among themselves aggregate
deposits of Rs. 2632 crore with 4130 branches. The names of the fourteen major commercial banks were Allahabad Bank, Bank of Baroda, Bank of India, Bank of Maharashtra, Canara Bank, Central Bank of India, Dena Bank, Indian Bank, Indian Overseas Bank, Punjab National Bank, Syndicate Bank, Union Bank of India, United Bank of India and United Commercial Bank. The reason for the nationalization was to give the government more control of credit delivery.\(^{29}\) (See Annexure 1.1)

**Fig. 1.3: Banking Scenario during Post-Nationalization Era (1969-1991)**

On 15\(^{th}\) April 1980, six more banks were nationalized. These banks were; Andhra Bank, Corporation Bank, New Bank of India, Oriental Bank of Commerce, Punjab & Sind Bank and Vijya Bank. On 4\(^{th}\) September, 1993 the Government merged the New Bank of India with Punjab National Bank and as a result of this the total number of nationalized bank got reduced from 20 to 19.\(^{30}\) With the nationalization, the GOI has controlled around 91 \% of the banking business of India. After this period, the nationalization of banks grew at a pace of around 4 \% closer to the average growth rate of Indian economy (See Annexure 1.2). There were some effects and achievements of


\(^{30}\) PNB Monthly Review, New Delhi, Vol. 29, No. 2, February page no 18
nationalized banks. However, there are some problems relating to NPAs, competition, competency, overstaffing, inefficiency etc. for the nationalized bank.\(^\text{31}\) There was a change from “Security Orientation” to “purpose Orientation” in extending credit. Commercial banks were turned from mere moneylenders to development bankers and there was emergence of “mass banking” in place of “class banking”. (See Fig. 1.3)

The first expansion leading to accelerated promotion of staff resulted in the decline of quality of manpower that turn to lack of professionalism, indiscipline in the cadre, poor customer service, poor credit discipline, directed credit, concessional rate of advance, interference at political and bureaucratic level in credit decisions, which ultimately led to serious problems in productivity and profitability of banks.\(^\text{32}\)

**(C) REFORM ERA (1992-93 AND ONWRDS)**

Recognizing above problems, the Government of India (GOI) constituted a high power committee under the Chairmanship of M. Narasimham, Deputy Governor of RBI in August 1991 to examine all aspects relating to the structure, organization, functioning and problems of the financial system. It was also aimed at recommending measures to improve efficiency and Effectiveness of Indian financial system. (See Fig. 1.4) However, for the movement towards global focus on the need for adequate regulation and supervision of banks; the Basel Committee and Second Narasimham Committee (1998) paved the way for the second generation reforms in the Indian banking industry. At the same time, the Working Group headed by S.H. Khan recommended for harmonizing the role and operations of Development Financial Institutions (DFIs) and banks with relation to more towards universal banking, mergers between banks and DFIs and harmonizing the role operations and regulatory aspect, etc. The M.S. Verma Committee (1999) recommended for revival issues of weak public sector banks (PSBs), Basel Norms-II and next generation committee on banking sector (2008) are those insisting the reform era 1991-92 onwards. These reforms were intended to impact on enhanced efficiency productivity and profitability into the system. (See Annexure 1.3)

(D) PERFORMANCE OF COMMERCIAL BANKS IN INDIA AFTER REFORM ERA

Banks have been undergoing considerable transformation since 1960s. With nationalization of banks, the era of social banking began, wherein rural and semi-urban bank branches predominated, side-by-side with social lending targets. The growth of the capital markets in the 80s added depth to the financial system. During 90s the reforms of banking sector has begun with a view to deregulation, income recognition, assets classification, provisioning, transparency in balance sheets, up gradation of technology and entry of private sector banks. However, in recent times certain private sector banks were taken over by public sector banks. However, a number of measures have been taken over by Reserve Bank of India (RBI) and the Ministry of Finance aimed at strengthening the banking system. The priority sector comprising agriculture, small-scale industries, small traders, artisans, self-employed persons and similar other weaker sections of society, etc. financing by Commercial Banks in India. The commercial banks in India
have introduced a number of special schemes such as Integrated Rural Development Programme (IRDP), Twenty-Point Economic Programme (TPEP) and Drought Prone Areas Programme (DPAP), etc., which received the central attention of the banks.\textsuperscript{33}

**E) PERFORMANCE OF PUBLIC SECTOR BANKS AFTER REFORM ERA**

Competition, upgradation of technology, customer satisfaction and profit consideration, which are needed for the survival and growth of PSBs in India. The important factors to measure the performance of public sector banks (PSBs) after reform era, namely, total assets indicates the banks health position, total deposits speaks the capacity of the bank, number of branches reveal the expansion of business, total number of staff explains the efforts taken in developing the human resources and the financial indicators, which indicate the strength of the PSBs in India during reform period. The year of establishment along with their head office is presented in Table 1.

**Table 1.1: Year of Establishment and Head Offices of Public Sector Banks**

<table>
<thead>
<tr>
<th>Name of the Public Sector Bank</th>
<th>Year of Establishment</th>
<th>Head Office</th>
</tr>
</thead>
<tbody>
<tr>
<td>Andhra Bank</td>
<td>1923</td>
<td>Hyderabad</td>
</tr>
<tr>
<td>Allahabad Bank</td>
<td>1865</td>
<td>Kolkata</td>
</tr>
<tr>
<td>Bank of Baroda</td>
<td>1908</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Bank of India</td>
<td>1906</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Bank of Maharashtra</td>
<td>1935</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Canara Bank</td>
<td>1906</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Central Bank of India</td>
<td>1911</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Corporation Bank</td>
<td>1906</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Dena Bank</td>
<td>1938</td>
<td>Mumbai</td>
</tr>
<tr>
<td>Indian Bank</td>
<td>1907</td>
<td>Chennai</td>
</tr>
<tr>
<td>Indian Overseas Bank</td>
<td>1936</td>
<td>Chennai</td>
</tr>
<tr>
<td>Oriental Bank of India</td>
<td>1936</td>
<td>Chennai</td>
</tr>
<tr>
<td>Punjab National Bank</td>
<td>1895</td>
<td>Delhi</td>
</tr>
<tr>
<td>Punjab and Sind Bank</td>
<td>1908</td>
<td>New Delhi</td>
</tr>
<tr>
<td>Syndicate Bank</td>
<td>1925</td>
<td>Manipal</td>
</tr>
<tr>
<td>Union Bank of India</td>
<td>1919</td>
<td>Mumbai</td>
</tr>
<tr>
<td>United Bank of India</td>
<td>1950</td>
<td>Kolkata</td>
</tr>
<tr>
<td>United Commercial Bank</td>
<td>1943</td>
<td>Kolkata</td>
</tr>
<tr>
<td>Vijaya Bank</td>
<td>1980</td>
<td>Bangalore</td>
</tr>
<tr>
<td>State Bank of India</td>
<td>1955</td>
<td>Mumbai</td>
</tr>
<tr>
<td>State Bank of Bikaner and</td>
<td>1963</td>
<td>Jaipur</td>
</tr>
</tbody>
</table>

(F) **PRIVATE SECTOR COMMERCIAL BANKs IN INDIA**


The opening of the banking sector to private as well as foreign banks has been a major milestone in the history of the industry in the country. As a result of the deregulation of the sector, a host of new generation private sector banks have entered the scene. The entry of new generation private sector and foreign banks is rewriting the rules of banking in the country. Today, there is a greater emphasis on customer convenience, which is the key to success. Technology has emerged as a key enabler to achieve this objective and is now an integral component of any banks core strategy.  

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FOREIGN COMMERCIAL BANKS IN INDIA


From India’s point of view, the entry of foreign banks has several benefits. The most important thing that the Indian banks have been forced to become more competitive as they have to compete with extremely efficient services provided by the foreign banks. Moreover, foreign banks have great access to the international network which facilitates import of ideas and systems regarding the financial environment available internationally and the extent to which it can be adopted in the host country. The foreign banks can also have positive impact on the levels of foreign investment in India. Foreign investors ‘usually rely on bankers’ judgment for overseas investment. Such banks are an important medium for projecting the country’s image abroad. Thus foreign banks have provided Indian operations access to foreign collaborations as well as introduced foreign companies to Indian bankers. Presence of foreign banks also helps Indian corporations and government agencies to have access to international capital markets.

OPERATION OF FOREIGN BANKS IN INDIA-COUNTRY-WISE
Thus, on the whole, the operation of foreign banks in India has direct bearing on the domestic public sector as well as giving the private banks to become efficient and globally competitive.\textsuperscript{35} Table 2 depicts 29 foreign banks were operating in India with 273 branches at the end of October 2007. These banks originated from 19 countries. In addition, 34 foreign banks operated in India representative offices. During the period from July 2006 to June 2007, approvals were given to seven foreign banks to open representative offices in India.

**OPERATION OF INDIAN BANK’S ABROAD**\textsuperscript{36}

Indian banks continued to rapidly expand their existence abroad. During 2006-07, nine public sector banks and two new private sector banks opened with ten branches, two subsidies, six representative offices and one joint venture unit mainly in the Asian and Middle-East countries. Sixteen Indian banks (11 from public sector 5 from private sector operated a network of 192 offices, seven joint ventures and 21 subsidiaries) abroad at the end October, 2007.

Table 1.2: Operation of Foreign Banks in India-Country-Wise (As on October 2007)

<table>
<thead>
<tr>
<th>NAME OF THE BANK</th>
<th>COUNTRY OF INCORPORATION</th>
<th>NO. OF BRANCHES IN INDIA</th>
</tr>
</thead>
<tbody>
<tr>
<td>ABN-AMRO Bank N.V.</td>
<td>Netherlands</td>
<td>28</td>
</tr>
<tr>
<td>Abu Dhabi Commercial</td>
<td>UAE</td>
<td>2</td>
</tr>
<tr>
<td>Arab Bangladesh Bank Ltd.</td>
<td>Bangladesh</td>
<td>1</td>
</tr>
<tr>
<td>American Express Bank Ltd.</td>
<td>USA</td>
<td>7</td>
</tr>
<tr>
<td>Antwerp Diamond Bank N.V.</td>
<td>Belgium</td>
<td>1</td>
</tr>
<tr>
<td>Bank International Indonesia</td>
<td>Indonesia</td>
<td>1</td>
</tr>
<tr>
<td>Bank of America</td>
<td>USA</td>
<td>5</td>
</tr>
<tr>
<td>Bank of Bahrain and Kuwait BSC</td>
<td>Bahrain</td>
<td>2</td>
</tr>
<tr>
<td>Bank of Nova Scotia</td>
<td>Canada</td>
<td>5</td>
</tr>
<tr>
<td>Bank of Tokyo-Mitsubishi UFJ Ltd.</td>
<td>Japan</td>
<td>3</td>
</tr>
<tr>
<td>BNP Paribas</td>
<td>France</td>
<td>8</td>
</tr>
<tr>
<td>Bank of Ceylon</td>
<td>Sri Lanka</td>
<td>1</td>
</tr>
<tr>
<td>Barclays Bank PLC</td>
<td>UK</td>
<td>4</td>
</tr>
<tr>
<td>Calyon Bank</td>
<td>France</td>
<td>5</td>
</tr>
<tr>
<td>Citi Bank NA</td>
<td>USA</td>
<td>39</td>
</tr>
<tr>
<td>China trust Commercial Bank</td>
<td>Taiwan</td>
<td>1</td>
</tr>
</tbody>
</table>

\textsuperscript{35} Sobti. R. (2003), Banking and Financial Services in India, New Century Publications, New Delhi, pp. 128 -130
\textsuperscript{36} (2006), Report on Trend on Progress of Banking in India, RBI, Mumbai
<table>
<thead>
<tr>
<th>Bank Name</th>
<th>Country</th>
<th>Branches</th>
</tr>
</thead>
<tbody>
<tr>
<td>Deutsche Bank</td>
<td>Germany</td>
<td>11</td>
</tr>
<tr>
<td>DBS Bank Ltd.</td>
<td>Singapore</td>
<td>2</td>
</tr>
<tr>
<td>HSBC</td>
<td>Hong Kong</td>
<td>47</td>
</tr>
<tr>
<td>J.P. Morgan Chase Bank Ltd.</td>
<td>USA</td>
<td>1</td>
</tr>
<tr>
<td>Krung Thai Bank Public Co. Ltd.</td>
<td>Thailand</td>
<td>1</td>
</tr>
<tr>
<td>Krung Thai Bank Public Co. Ltd.</td>
<td>Thailand</td>
<td>1</td>
</tr>
<tr>
<td>Mizuho Corporate Bank Ltd.</td>
<td>Japan</td>
<td>2</td>
</tr>
<tr>
<td>Mashreq Bank PSC</td>
<td>UAE</td>
<td>2</td>
</tr>
<tr>
<td>Shinhan Bank</td>
<td>South Korea</td>
<td>2</td>
</tr>
<tr>
<td>Oman International Bank SAOG</td>
<td>Sultanate of Oman</td>
<td>2</td>
</tr>
<tr>
<td>Standard Chartered Bank</td>
<td>UK</td>
<td>83</td>
</tr>
<tr>
<td>Societe Generale</td>
<td>France</td>
<td>2</td>
</tr>
<tr>
<td>State Bank of Mauritius</td>
<td>Mauritius</td>
<td>3</td>
</tr>
<tr>
<td><strong>Total</strong></td>
<td></td>
<td><strong>273</strong></td>
</tr>
</tbody>
</table>

*Source: RBI, Report on Trend and Progress of Banking in India, 2006-07.*

The Bank of Baroda had the largest overseas presence (43 branches, eight subsidiaries, four representative offices and one joint venture bank in 20 countries), followed by State Bank of India (33 branches, six subsidiaries, seven representative offices and four joint venture banks in 29 countries) and Bank of India (22 branches, two subsidiaries, three representative offices and one joint venture bank in 14 countries).

### 1.3.5 TYPES OF BANK

In 1935, ‘The State Bank of India Act, was passed, accordingly, ‘The Imperial Bank of India’ was nationalized and State Bank of India emerged with the objective of extension of banking facilities on a large scale, specifically rural and semi-urban area and for various of the public purposes. In 1969, fourteen major Indian Commercial Banks were nationalized and in 1980, six more were added on to constitute the public sector banks. Commercial Banks in India are classified in Scheduled Bank and Non Scheduled Banks. Scheduled Banks are including nationalized Bank, SBI and its subsidiaries, private sector banks and foreign banks. Non Scheduled Banks are those included in the second Scheduled of the RBI Act, 1934.

### 1. SCHEDULED BANKS

The second scheduled of RBI act, create a list of banks which are described as “Scheduled Banks” In the terms of section 42 (6) of RBI act, 1934, the required amount is only Rs. 5 Lakh. The Scheduled Banks enjoy several privileges. It means that
scheduled banks carries safety and prestige value compared to non scheduled banks. It is entailed to receive refinance facility as applicable.

2. NATIONALIZED BANKS

The nationalized banks include 14 banks nationalized on 19th July, 1969 and the 6 more nationalized on 15th April, 1980. They are also scheduled banks, after this nationalization the governments try to implement various welfare schemes. There are two main objective of nationalization.

(a) To provide banking services to rural areas as well as the neglected sections of society such as agriculture & small scale industries.
(b) To mobilize the saving and flow of credit to neglected sectors of the society.

3. NON SCHEDULED BANKS

The commercial banks not included in the 2nd schedule of the RBI act are known as non scheduled banks. They are not entitled to facilities like refinance and rediscounting of bills etc, from RBI. They are engaged in lending money discounting and collection bills and various agency services. They insist higher security for loans.

4. OLD PRIVATE BANKS

These banks all registered under Companies Act, 1956. Basic difference between Co-operative bank and Private Banks is its aim. Co-operative banks work for its member and private banks are work for own profit.

5. NEW PRIVATE BANKS

These banks lead the market of Indian banking business in very short period because of its variety of services and approach to handle customer and also because of long working hours and speed of services. This is also registered under the Company Act 1956. Between old and new private banks there is wide difference. The RBI considered the recommendations of the Narasimham Committee in June 1992, and allowed banks to be set up in the private sector to be known as “New Private Sector Banks”.

6. FOREIGN BANKS

37 ibid, Page No-19
Foreign Banks mean multi-countries bank. In case of Indian foreign banks are such banks which open its branch office in India and their head office are outside of India. E.g. HSBC Bank, City Bank, Standard Chartered Bank etc. The minimum capital requirement of Foreign Banks operating in India is 25 millions USD divided into three branches in the form of 10 USD each for first & second Branch & 5 USD for 3rd Branch. After considering performance of existing

8. CO-OPERATIVE BANKS

Co-operative Banks another component of the Indian bank with the enactment of the Co-operative Credit Societies were sated owing to the increasing demand of Co-operative Credit, a new Act of the 1994, which provide for the increasing demand of Co-operative Central banks by a union of primary credit societies or by a union of primary credit socialites and individuals.

1.3.6 ROLE OF RESERVE BANK OF INDIA

The Reserve Bank of India (RBI) is the central banking system of India and controls the monetary policy of the Rupee as well as currency reserves. The central bank is the apex bank in India. The institution was established on 1 April 1935 during the British Raj in accordance with the provisions of the Reserve Bank of India Act, 1934 and plays an important part in the development strategy of the government. It is a member bank of the Asian Clearing Union. The Reserve Bank of India was constituted under the reserve Bank of India Act, 1934 to regulate the issue of bank notes and the maintenance of reserves with a view to securing the monetary stability in India and generally to operate the currency and credit system of the country to its advantage.38

The central bank was founded in 1935 to respond to economic troubles after the First World War. The Imperial Bank of India was established on 27 January, 1921 in pursuant to the Imperial Bank Act of 1920 by amalgamating the three Presidency Banks – Bengal, Bombay and Madras. Though primarily a commercial bank, it performed certain central banking functions, such as activity as banker to the Government. In 1926, The Hilton Young Commission suggested the establishment of the Reserve Bank of India to

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act as a central Bank. In 1929, The Central Banking Enquiry committee again made a forceful suggestion for the establishment of the Reserve Bank. Consequently the Reserve Bank of India Act was passed in 1934 and the act of Bank implemented from 1st April, 1935.

The Preamble of the Reserve Bank of India describes the basic functions of the Reserve Bank as to regulate the issue of bank notes, to keep reserves with a view to securing monetary stability in India and generally to operate the currency and credit system in the best interests of the country. The Central Office of the Reserve Bank was initially established in Kolkata, Bengal but was permanently moved to Mumbai in 1937. The Reserve Bank continued to act as the central bank for Myanmar till Japanese occupation of Burma and later up to April 1947, though Burma seceded from the Indian Union in 1937. After partition, the Reserve Bank served as the central bank for Pakistan until June 1948 when the State Bank of Pakistan commenced operations. Though originally set up as a shareholders’ bank, the RBI has been fully owned by the government of India since its nationalization in 1949.

Between 1950 and 1960, the Indian government developed a centrally planned economic policy and focused on the agricultural sector. The administration nationalized commercial banks and established, based on the Banking Companies Act, 1949 (later called Banking Regulation Act) a central Bank regulation as part of the RBI. Furthermore, the central bank was ordered to support the economic plan with loans. As a result of bank crashes, the reserve bank was requested to establish and monitor a deposit insurance system. It should restore the trust in the national bank system and was initialized on 7 December 1961. The Indian government founded funds to promote the economy and used the slogan Developing Banking. The Gandhi administration and their successors restructured the national bank market and nationalized a lot of institutes. As a result, the RBI had to play the central part of control and support of this public banking sector.

Between 1969 and 1980 the Indian government nationalized 20 banks. The regulation of the economy and especially the financial sector was reinforced by the Gandhi administration and their successors in the 1970s and 1980s. The central bank became the central player and increased its policies for a lot of tasks like interests, reserve
ratio and visible deposits. The measures aimed at better economic development and had a huge effect on the company policy of the institutes. The banks lent money in selected sectors, like agri-business and small trade companies.39

The branch was forced to establish two new offices in the country for every newly established office in a town. The oil crises in 1973 resulted in increasing inflation, and the RBI restricted monetary policy to reduce the effects. A lot of committees analyzed the Indian economy between 1985 and 1991. Their results had an effect on the RBI. The Board for Industrial and Financial Reconstruction, the Indira Gandhi Institute of Development Research and the Security & Exchange Board of India investigated the national economy as a whole, and the security and exchange board proposed better methods for more effective markets and the protection of investor interests. The Indian financial market was a leading example for so-called "financial repression" (Mackinnon and Shaw). The Discount and Finance House of India began its operations on the monetary market in April 1988; the National Housing Bank, founded in July 1988, was forced to invest in the property market and a new financial law improved the versatility of direct deposit by more security measures and liberalization.

The national economy came down in July 1991 and the Indian rupee was devalued. The currency lost 18% relative to the US dollar, and the Narsimham Committee advised restructuring the financial sector by a temporal reduced reserve ratio as well as the statutory liquidity ratio. New guidelines were published in 1993 to establish a private banking sector. This turning point should reinforce the market and was often called neo-liberal The central bank deregulated bank interests and some sectors of the financial market like the trust and property markets.

The National Stock Exchange of India took the trade on in June 1994 and the RBI allowed nationalized banks in July to interact with the capital market to reinforce their capital base. The central bank founded a subsidiary company—the Bharatiya Reserve Bank Note Mudran Limited—in February 1995 to produce banknotes. The Foreign Exchange Management Act from 1999 came into force in June 2000. It should

improve the foreign exchange market, international investments in India and transactions. The RBI promoted the development of the financial market in the last years, allowed online banking in 2001 and established a new payment system in 2004 - 2005 (National Electronic Fund Transfer). The Security Printing & Minting Corporation of India Ltd., a merger of nine institutions, was founded in 2006 and produces banknotes and coins.  

1.3.7 FUNCTION OF RESERVE BANK OF INDIA

As a central bank, the Reserve Bank has significant powers and duties to perform. For smooth and speedy progress of the Indian Financial System, it has to perform some important tasks. Among others it includes maintaining monetary and financial stability, to develop and maintain stable payment system, to promote and develop financial infrastructure and to regulate or control the financial institutions.

[A] TRADITIONAL FUNCTIONS

Traditional functions are those functions which every central bank of each nation performs all over the world. Basically these functions are in line with the objectives with which the bank is set up. It includes fundamental functions of the Central Bank. They comprise the following tasks.

(i) ISSUE OF THE CURRENCY NOTES

The RBI has the sole right or authority or monopoly of issuing currency notes except one rupee note and coins of smaller denomination. These currency notes are legal tender issued by the RBI. Currently it is in denominations of Rs. 2, 5, 10, 20, 50, 100, 500, and 1,000. The RBI has powers not only to issue and withdraw but even to exchange these currency notes for other denominations. It issues these notes against the security of gold bullion, foreign securities, rupee coins, exchange bills and promissory notes and government of India bonds.

(ii) BANKER TO THE BANKS

The RBI being an apex monetary institution has obligatory powers to guide, help and direct other commercial banks in the country. The RBI can control the volumes of banks reserves and allow other banks to create credit in that proportion. Every

commercial bank has to maintain a part of their reserves with its parent's viz. the RBI. Similarly in need or in urgency these banks approach the RBI for fund. Thus it is called as the lender of the last resort.

(iii) BANKER TO THE GOVERNMENT

The RBI being the apex monitory body has to work as an agent of the central and state governments. It performs various banking function such as to accept deposits, taxes and make payments on behalf of the government. It works as a representative of the government even at the international level. It maintains government accounts, provides financial advice to the government. It manages government public debts and maintains foreign exchange reserves on behalf of the government. It provides overdraft facility to the government when it faces financial crunch.

(iv) EXCHANGE RATE MANAGEMENT

It is an essential function of the RBI. In order to maintain stability in the external value of rupee, it has to prepare domestic policies in that direction. Also it needs to prepare and implement the foreign exchange rate policy which will help in attaining the exchange rate stability. In order to maintain the exchange rate stability it has to bring demand and supply of the foreign currency (U.S Dollar) close to each other.

(v) CREDIT CONTROL FUNCTION

Commercial bank in the country creates credit according to the demand in the economy. But if this credit creation is unchecked or unregulated then it leads the economy into inflationary cycles. On the other credit creation is below the required limit then it harms the growth of the economy. As a central bank of the nation the RBI has to look for growth with price stability.

(VII) SUPERVISORY FUNCTION

The RBI has been endowed with vast powers for supervising the banking system in the country. It has powers to issue license for setting up new banks, to open new branches, to decide minimum reserves, to inspect functioning of commercial banks in India and abroad, and to guide and direct the commercial banks in India.

[B] DEVELOPMENTAL FUNCTIONS
Along with the routine traditional functions, central banks especially in the developing country like India have to perform numerous functions. These functions are country specific functions and can change according to the requirements of that country. The RBI has been performing as a promoter of the financial system since its inception. Some of the major development functions of the RBI are maintained below.41

(i) DEVELOPMENT OF THE FINANCIAL SYSTEM

The financial system comprises the financial institutions, financial markets and financial instruments. The sound and efficient financial system is a precondition of the rapid economic development of the nation. The RBI has encouraged establishment of main banking and non-banking institutions to cater to the credit requirements of diverse sectors of the economy.

(ii) DEVELOPMENT OF AGRICULTURE

In an agrarian economy like ours, the RBI has to provide special attention for the credit need of agriculture and allied activities. It has successfully rendered service in this direction by increasing the flow of credit to this sector. It has earlier the Agriculture Refinance and Development Corporation (ARDC) to look after the credit, National Bank for Agriculture and Rural Development (NABARD) and Regional Rural Banks (RRBs).

(iii) PROVISION OF INDUSTRIAL FINANCE

Rapid industrial growth is the key to faster economic development. In this regard, the adequate and timely availability of credit to small, medium and large industry is very significant. In this regard the RBI has always been instrumental in setting up special financial institutions such as ICICI Ltd. IDBI, SIDBI and EXIM BANK etc.

(iv) PROVISIONS OF TRAINING

The RBI has always tried to provide essential training to the staff of the banking industry. The RBI has set up the bankers' training colleges at several places. National Institute of Bank Management i.e. NIBM, Bankers Staff College i.e. BSC and College of Agriculture Banking i.e. CAB is few to mention.

(v) COLLECTION OF DATA

41 URL/Http: //Finance India market.com/investment. In-India/RBI.Htm
Being the apex monetary authority of the country, the RBI collects process and disseminates statistical data on several topics. It includes interest rate, inflation, savings and investments etc. This data proves to be quite useful for researchers and policy makers.

(vi) PUBLICATION OF THE REPORTS

The Reserve Bank has its separate publication division. This division collects and publishes data on several sectors of the economy. The reports and bulletins are regularly published by the RBI. It includes RBI weekly reports, RBI Annual Report, Report on Trend and Progress of Commercial Banks India., etc. This information is made available to the public also at cheaper rates.

(vii) PROMOTION OF THE BANKING HABITS

As an apex organization, the RBI always tries to promote the banking habits in the country. It institutionalizes savings and takes measures for an expansion of the banking network. It has set up many institutions such as the Deposit Insurance Corporation-1962, UTI-1964, IDBI-1964, NABARD-1982, NHB-1988, etc. These organizations develop and promote banking habits among the people. During economic reforms it has taken many initiatives for encouraging and promoting banking in India.

(viii) PROMOTION OF EXPORT THROUGH RE-FINANCE

The RBI always tries to encourage the facilities for providing finance for foreign trade especially exports from India. The Export-Import Bank of India (EXIM Bank India) and the Export Credit Guarantee Corporation of India (ECGC) are supported by refinancing their lending for export purpose.

[C] SUPERVISORY FUNCTIONS

The reserve bank also performs many supervisory functions. It has authority to regulate and administer the entire banking and financial system. Some of its supervisory functions are given below.

(i) GRANTING LICENSE TO THE BANKS

The RBI grants license to banks for carrying its business. License is also given for opening extension counters, new branches, even to close down existing branches.
(ii) BANK INSPECTION

The RBI grants license to banks working as per the directives and in a prudent manner without undue risk. In addition to this it can ask for periodical information from banks on various components of assets and liabilities.

(iii) CONTROL OVER NBFIS

The Non-Bank Financial Institutions are not influenced by the working of a monitory policy. However RBI has a right to issue directives to the NBFIs from time to time regarding their functioning. Through periodic inspection, it can control the NBFIs.

(iv) IMPLEMENTATION OF THE DEPOSIT INSURANCE SCHEME

The RBI has set up the Deposit Insurance Guarantee Corporation in order to protect the deposits of small depositors. All bank deposits below Rs. One lakh are insured with this corporation. The RBI work to implement the Deposit Insurance Scheme in case of a bank failure.42

1.3.8 TRADITIONAL BANKING FUNCTIONS

In very general terms, the traditional functions of a commercial bank can be classified under following main heads: (See Fig. 1.5)

1. RECEIVING OF MONEY ON DEPOSIT

This is the most important function of banks, as it is largely by means of deposits that a bank prepares the basis for several other activities. The money power of a bank, by which it helps largely the business community and other customers, depends considerably upon the amounts it can borrow by way of deposits. The deposits of a bank can take the form of fixed, savings or current deposits.

2. LENDING OF MONEY

This function is not only very important but is the chief source of profit for banks. By lending money banks place funds at the disposal of the borrower, in exchange for a promise of payment at a future date, enabling the borrowers to carry on their Business/productive activities and meet their other requirements. Banks thus, help their clients to meet their needs with the money lent to them and return the money with interest

as per agreed terms. The advances of a bank can take the form of loans, cash, credits, bills purchase / discount facilities.\textsuperscript{43}

3. TRANSFERRING MONEY FROM PLACE TO PLACE

This function is also one of the important functions of banks. Banks allow the facilities of transfer of funds by issuing demand drafts, Telegraphic / Telephonic Transfers, Mail Transfer etc.

4. MISCELLANEOUS FUNCTIONS

Safe custody of valuables, issue of various forms of credits e.g. letters of credit, traveler’s cheques and furnishing guarantees on behalf of customers and providing fee based services are also important functions performed by banks.

1.3.9 FUNCTIONS OF COMMERCIAL BANKS

[A] PRIMARY FUNCTION

(i) ACCEPTANCE OF DEPOSITS

An important function of commercial banks is to attract deposit from the public. Those people who have cash account and want their safety; they deposit that amount of banks. Commercial banks accept deposits every class and source and take responsibility to repay the deposit in the same currency whenever they are demanded by depositors.

(ii) LENDING

Another function of commercial banks is to make loans and advance out of the deposit receive in various forms. Bank Apply the accumulated public deposits to productive uses by way of loans and advances, overdraft and cash credits against approved securities.

(iii) INVESTMENTS

Now-a-days commercial banks are also involved in Investment. Generally investment means long term and medium term investments.

\textsuperscript{43} Dr. Bhattacharya, K. M. And Agarwal, O. P. “Basics of Banking and Finance” Published by Himalaya Publishing House, 2006 Page – 20
[B] SECONDARY FUNCTIONS

(i) AGENCY SERVICES

Collection and Payment of Cheques, Standing Instruction, Acting as correspondence, collecting of bills- electricity, gas, WASA, telephone etc. Purchase and Sales of stocks/ share-act as a banker to issue

(ii) MISCELLANEOUS OR GENERAL SERVICES

Safe Custody, Lockers-trustee, Remittance facilities –DD, TT, MT and Advisory services Providing Credit reports, Opening L/C, Demand in Forex/ Travers Cheque only Authorized Dealer branches, Complete service in Foreign Trade, Other Services: Debit Card, Credit Card, On-line banking SMS banking, Creation of Credit: a multiplier effect, Deposit creates credit and credit creates deposits Derivative. Beside
these activities, commercial bank may perform further tasks; all its activities are guided by its authority for the betterment of the company or for society.\textsuperscript{44} (See Fig. 1.5)

1.3.10 BANKING PRODUCT PORTFOLIO

1. DEPOSITS

There are many products in retail banking like Fixed Deposit, Savings Account, Current Account, Recurring Account, NRI Account, Corporate Salary Account, Free Demat Account, Kid’s Account, Senior Citizen Scheme, Cheque Facilities, Overdraft Facilities, Free Demand Draft Facilities, Locker Facilities, Cash Credit Facilities, etc. They are listed and explained as follows

(i) FIXED DEPOSIT

The deposit with the bank for a period, which is specified at the time of making the deposit, is known as fixed deposit. Such deposits are also known as FD or term deposit. FD is repayable on the expiry of a specified period. The rate of interest and other terms and conditions on which the banks accepted FD were regulated by the RBI, in section 21 and 35A of the Banking Regulation Act 1949. Each bank has prescribed their own rate of interest and has also permitted higher rates on deposits above a specified amount. RBI has also permitted the banks to formulate FD schemes specially meant for senior citizen with higher interest than normal.

(ii) SAVING ACCOUNT

Saving bank account is meant for the people who wish to save a part of their current income to meet their future needs and they can also earn in interest on their savings. The rate of interest payable on by the banks on deposits maintained in savings account is prescribed by RBI. Now-a-days the fixed deposit is also linked with saving account. Whenever there is excess of balance in saving account it will automatically transfer into fixed deposit and if there is shortfall of funds in savings account, by issuing cheque the money is transferred from fixed deposit to saving account. Different banks give different name to this product.

(iii) CURRENT ACCOUNT

\textsuperscript{44} URL http://bbamba.info/Articles/Business/Functions-of-Commercial-Banks.html
A current account is an active and running account, which may be operated upon any number of times during a working day. There is no restriction on the number and the amount of withdrawals from a current account. Current account, suit the requirements of a big businessmen, joint stock companies, institutions, public authorities and public corporation etc.

(iv) **RECURRING DEPOSIT**

A variant of the saving bank a/c is the recurring deposit or cumulative deposit a/c introduced by banks in recent years. Here, a depositor is required to deposit an amount chosen by him. The rate of interest on the recurring deposit account is higher than as compared to the interest on the saving account. Banks open such accounts for periods ranging from 1 to 10 years. There curing deposit account can be opened by any number of persons, more than one person jointly or severally, by a guardian in the name of a minor and even by a minor.

(v) **NRI ACCOUNT**

NRI accounts are maintained by banks in rupees as well as in foreign currency. Four types of Rupee account can be open in the names of NRI (a) Non Resident Rupee Ordinary Account (NRO), (b) Non Resident External Account (NRE), (c) Non Resident ( Non Reportable Deposit Scheme ) ( NRNR), (d) Non Resident ( special)Rupee Account Scheme ( NRSR)\(^{45}\) Apart from this, foreign currency account is the account in foreign currency. The account can be open normally in US Dollar, Pound Sterling, and Euro. The accounts of NRIs are Indian millennium deposit, Resident foreign currency, housing finance scheme for NRI investment schemes.

(vi) **CORPORATE SALARY ACCOUNT**

Corporate Salary account is a new product by certain private sector banks, foreign banks and recently by some public sector banks also. Under this account salary is deposited in the account of the employees by debiting the account of employer. The only thing required is the account number of the employees and the amount to be paid them as salary. In certain cases the minimum balance required is zero. All other facilities available in savings a/c is also available in corporate salary account

\(^{45}\) URL: Http://www.sendmoney.org/different type of bank account php
(vii) **KID’S ACCOUNT (MINOR ACCOUNT)**

Children are invited as customers by certain banks. Under this, an account is opened in the name of kids by parents or guardians. The features of kid’s account are free personalized cheque book which can be used as a gift cheque, internet banking, investment services etc.

(viii) **SENIOR CITIZENSHIP SCHEME**

Senior citizens can open an account and on that account they can get interest rate somewhat more than the normal rate of interest. This is due to some social responsibilities of banks towards aged persons whose earnings are mainly on the interest rate.

2. **LOANS AND ADVANCES**

The main business of the banking company is lending of funds to the constituents, mainly traders, business and industrial enterprises. The major portion of a bank’s funds is employed by way of loans and advances, which is the most profitable employment of its funds. There are three main principles of bank lending that have been followed by the commercial banks and they are safety, liquidity, and profitability. Banks grant loans for different periods like short term, medium term, and long term and also for different purpose.

(i) **PERSONAL LOANS**

This is one of the major loans provided by the banks to the individuals. There the borrower can use for his/her personal purpose. This may be related to his/her business purpose. The amount of loan is depended on the income of the borrower and his/her capacity to repay the loan.

(ii) **HOUSING LOANS**

NHB is the wholly own subsidiary of the RBI which control and regulate whole industry as per the guidance and information. The purpose of loan is mainly for purchase, extension, renovation, and land development.

(iii) **EDUCATION LOANS**

Loans are given for education in country as well as abroad.
(iv) VEHICAL LOANS

Loans are given for purchase of scooter, auto-rickshaw, car, bikes etc. Low interest rates, increasing income levels of people are the factors for growth in this sector. Even for second hand car finance is available.

(v) PROFESSIONAL LOANS

Loans are given to doctor, C.A, Architect, Engineer or Management Consultant. Here the loan repayment is normally done in the form of equated monthly.

(vi) CONSUMER DURABLE LOANS

Under this, loans are given for acquisition of T.V, Cell phones, A.C, Washing Machines, Fridge and other items.

(vii) LOANS AGAINST SHARES AND SECURITIE

Finance against shares is given by banks for different uses. Now-a-days finance against shares are given mostly in demat shares. A margin of 50% is normally accepted by the bank on market value. For these loans the documents required are normally DP notes, letter of continuing security, pledge form, power of attorney. This loan can be used for business or personal purpose.

1.3.11 RETAIL BANKING SERVICES

1. CREDIT CARDS

A credit card is an instrument, which provides immediate credit facilities to its holder to avail variety of goods and services at the merchant outlets. It is made of plastic and hence popularly called as Plastic Money. Such cards are issued by bank to persons with minimum income ranging between RS 50000 and RS 100000 per annum and are accepted by a variety of business establishments which are notified by the card issuing bank. Some banks insist on the cardholder being their customers while others do not. Few banks do not charge any fee for issuing credit cards while others impose an initial enrolment fee and annual fee also. If the amount is not paid within the time duration the bank charges a flat interest of 2.5%. The Rangrajan Committee which was appointed by Indian Government in 1989 recommended RBI for issuing Credit Card in India. According to such recommendation in 1990 Central Bank of India started first time Credit Card system in India. Leading Indian Banks such as: SBI, BOB, Canara Bank,
ICICI, HDFC and a few foreign banks like CITI BANK; Standard Chartered etc are the important issuers of credit card in India.

2. DEBIT CARDS

It is a new product introduced in India by Citibank a few years ago in association with MasterCard. A debit card facilitates purchases or payments by the cardholder. It debits money from the account of the cardholder during a transaction. This implies that the cardholder can spend only if his account permits.46

3. NET BANKING

This facilitates the customers to do all their banking operations from their home by using the internet facility. With Net Banking one can carry out all banking and shopping transactions safely and with total confidentiality. With Net Banking one can easily perform various functions like Check Account Balance, Download Account Statement, Request for a stop payment of a cheque, Request for a new cheque book, Access demats account, Transfer funds, Facilitate bill Payments, Pay Credit Card dues instantly.

4. MOBILE BANKING

Using mobile banking facility one can – Check Balance, Check last three transactions, Request for a statement, Request for a cheque book, Enquire on a cheque status, Instruct stock cheque payment, View FD details, Transfer funds, Pay Utility Bills.

5. PHONE BANKING

It helps to conduct a wide range of banking transactions from the comfort of one’s home or office. Using phone banking facility one can - Check Balance, Check last three transactions, Request for a cheque book, Transfer funds, Enquire on a cheque status, and much more.

6. ANYWHERE BANKING

One can deposit or withdraw cash from any branch of a Particular bank all over the country up to a prescribed limit. One can also transfer funds. Private Sector banks provide “Anytime and Anywhere banking” services to customers faster than

Public Sectors & Nationalized banks in India. Now Public Sector banks have to decides that “We want you to able to bank with us 24 hours a day, Seven days a week, 365 days a year, anytime you want to form anywhere you want to”.47

7. AUTOMATED TELLER MACHINES (ATM)

ATMs feature user-friendly graphic screens with easy to follow instructions. The ATMs Interact with customers in their local language for increased convenience. ICICI Bank’s ATM network is one of the largest and most widespread ATM network in India. Some Bankers also call it “Any Time Money” or “All Time Money”. Following are the features available on ATMs which can be accessed from anywhere anytime - Cash Withdrawal, Cash Deposit, Balance Enquiry, Cheque Book Request, Transaction at various merchant establishments.48

8. SMART CARD

The smart card, a latest additional to the world of banking and information technology has emerged as the largest volume driven end-product in the world due to its data portability, security and convenience. Smart Card is similar in size to today’s plastic payment card; it has a memory chip embedded in it. The chip stores electronic data and programmes that are protected by advanced security features. When coupled with a reader, the smart card has the processing power to serve many different applications. As an access-control device, smart Cards make personal and business data available only to appropriate users. To ensure the confidentiality of all banking service, smart cards have mechanisms offering a high degree of security. These mechanisms are based on private and public key cryptography combined with a digital certificate, one of the most advanced security techniques currently available. In fact, it is possible to connect to the web banking service without a smart card. It prevents were & tear of currency. E-Banking has greatly facilitated our lives. It has proved a boon for the banking system.

1.3.12 BANKING SERVICES

48 URL: Http://www.gii.in/India/Hidtory of ATM
In this changing scenario, the role of banks is very important for the growth and development of customers as well as economy. Banking Sector is offering traditional and other service as under - Regular Saving and current accounts, Regular fixed deposits, ATM services, Credit cards, Demat cards, Student banking, Special NRI Services, Home loan, Vehicle loan, Tele and internet banking, Online trading, Business multiplies A/Cs, Insurance, Relief bonds & mutual fund, Loans against shares, Retail banking, Special deposit scheme, Senior citizen – special deposit scheme, Other facilities for customers.

1.3.13 INNOVATIVE STRATEGY FOR THE SUCCESS

Innovative strategy is not a new word today, to being in current market with increasing market share need some extraordinary workout. As per our opinion these following strategy can help banks to sustain and can increase their market share.

A. DEVELOPING CUSTOMIZED SERVICES

Top management should focus on customer expectation and demands of existing customer and new target audience. By customer survey and employee’s suggestion bank should introduce new innovative / customized services to create a loyal customer and that loyal customer will base to stand in tough competition. Also allocate some additional power to branch manager to create and provide a unique service for their customer as per local needs.

B. IMPROVE RURAL NETWORK

In India, rural banking have its own advantages due to its own characteristics, like need of village people, micro finance, small savings etc., debit cards, credit cards, ATM. and micro finance and many more services are demanding a special attention. Moreover “India is living in village” that sentence creates an idea of potential customer.

C. MERGER AND CONSOLIDATION

The smaller banks with firm financials as well as the large ones with weak income statements would be the obvious targets for the larger and better compatible banks. The pressure on capital structure in particular is expected to trigger a phase of consolidation in The Banking Industry. This trend already started in India ex. Punjab National Bank and Centurion Bank merged and now it’s Centurion Bank of Punjab ltd.

C. FLEXIBILITY IN OPERATION
For flexibility in operation banks should give certain operational freedom to its branches to face certain situation let us see example or Types of loans and relative documentation of loans should be less complicated like, to a get personal loans how can a farmer (non IT payer) can show IT returns? Other relative property documents hold be considered. In short this point focuses on bank should decrease inflexibility with security.  

1.3.14 ONLINE BANKING

(A) HISTORY

The precursor for the modern home online banking services were the distance banking services over electronic media from the early 1980s. The term online became popular in the late '80s and referred to the use of a terminal, keyboard and TV (or monitor) to access the banking system using a phone line. ‘Home banking’ can also refer to the use of a numeric keypad to send tones down a phone line with instructions to the bank. Online services started in New York in 1981 when four of the city’s major banks (Citibank, Chase Manhattan, Chemical and Manufacturers Hanover) offered home banking services using the videotex system. Because of the commercial failure of videotex these banking services never became popular except in France where the use of videotex (Minitel) was subsidised by the telecom provider and the UK, where the Prestel system was used.

The UK's first home online banking services was set up by Bank of Scotland for customers of the Nottingham Building Society (NBS) in 1983[3]. The system used was based on the UK's Prestel system and used a computer, such as the BBC Micro, or keyboard (Tandata Td1400) connected to the telephone system and television set. The system (known as 'Home link') allowed on-line viewing of statements, bank transfers and bill payments. In order to make bank transfers and bill payments, a written instruction giving details of the intended recipient had to be sent to the NBS who set the details up on the Home link system50. Typical recipients were gas, electricity and telephone companies and accounts with other banks. Details of payments to be made were input into the NBS system by the account holder via Prestel. A cheque was then sent by NBS to

49 Dr. Ajmera: –“Enhancing Banking Competitiveness through Innovative Strategies” (2007)
50 Ceonin, Mary.J. “Banking and Finance on the Internet” Publisher John Wiley and Sons, 1997
the payee and an advice giving details of the payment was sent to the account holder. BACS was later used to transfer the payment directly. Stanford Federal Credit Union was the first financial institution to offer online internet banking services to all of its members in October 1994. Today, many banks are internet only banks. Unlike their predecessors, these internet only banks do not maintain brick and mortar bank branches. Instead, they typically differentiate themselves by offering better interest rates and online banking features.

(B) MEANING

Online banking (or Internet banking) allows customers to conduct financial transactions on a secure website operated by their retail or virtual bank, credit union or building society.

(C) FEATURES

Online banking solutions have many features and capabilities in common, but traditionally also have some that are application specific.

TRANSACTIONAL
(e.g., performing a financial transaction such as an account to account transfer, paying a bill, wire transfer and applications apply for a loan, new account, etc.)

Electronic Bill Presentment and Payment (EBPP), Funds transfer between a customer's own checking and savings accounts, or to another customer's account, Investment purchase or sale, Loan applications and transactions, such as repayments of enrolments

NON-TRANSACTIONAL
(e.g., online statements, check links, co browsing, chat)

Bank statements, Financial Institution Administration, Support of multiple users having, varying levels of authority, Transaction approval process Wire transfer

1.4 INTRODUCTION TO RESEARCH PROBLEM

1.4.1 TITLE OF THE PROBLEM

My research topic is on the basis of Indian banking industry. Now-a-days in India banking sector plays a very important role in the growth of Indian economy. Indian banking industry have been running and working successfully and providing a world
class services to the customer at their door. But a major threat of banking sector is prevalence of **Non-Performing Assets (NPAs)**. I have to study all these aspect very deeply and clearly which is related to NPA. And I got proper idea of my research. My topic is on the basis of.......

“A COMPARATIVE ANALYSIS ON NON-PERFORMING ASSETS OF SELECTED PUBLIC AND PRIVATE SECTOR BANKS”

1.4.2 NON-PERFORMING ASSETS (NPAs)

Authentic history of banking tells that it deals with lending and collection of money. However, it followed the basic law of demand and supply where persons having excess money lent to persons who needed it for more productive purposes and were willing to pay a price for this. The operations were limited to the money lender knowing every person he lent money to.

Banks role in the economy of any country is very significant. They play intermediate function in that they collect money from those who have excess and lend it to others who need it for their investment. Availing credit to borrowers is one means by which banks contribute to the growth of economies. Banks play a pivotal role in mobilizing the nation’s savings and channelizing them into high investment priorities. But due to liberalization, globalization and privatization (LPG), the whole scenario of the banking sector has undergone a tremendous change.

Like any other business, success of banking is assessed based on profit and quality of asset it possesses. Even though bank serves social objective through its priority sector lending, mass branch networks and employment generation, maintaining asset quality and profitability is critical for banks survival and growth.

A major threat of banking sector is prevalence of **Non-Performing Assets (NPAs)**. The accumulation of huge non-performing assets in bank has assumed great importance. The debt of the problem of bad debts was first realized only in early 1990s. NPAs represent bad loans, the borrowers of which failed to satisfy their repayment obligations.

The concept of Non-Performing Assets (NPAs) was introduced for the first time in the Narasimham Committee on “Financial System Reforms” that was tabled in Parliament on December 17th, 1991. The Committee studied the prevailing financial
system, identified its short comings and weaknesses and made with ranging suggestions and recommendations in line with internationally accepted norms. Based on the recommendations of the Committee on “Financial System Reforms”, the RBI evolved prudential norms on Income recognition, Asset classification and Provisioning and issued revised instructions to banks in April 1992. While conveying non-performing category and their anxiety to present rosy picture of their affairs the above instructions to banks also advised them that as per practice followed internationally, income on NPAs is not to be recognized on accrual basis but is to be looked only when it is actually realized because an asset becomes non-performing when it ceases to generate income. The above instructions of RBI have since been implemented by banks from the financial year ended March 1998.

The problem of NPAs is linked to the function of lending money. The lending of money collected from the public, for interest, instead of one’s own money, was the beginning of banking. When loans are not repaid, the bank loses both its income stream, as well as its capital. Lending is always accompanied by the credit risk arising out of the borrower’s default in repaying the money. The level of nonperforming loans is recognized as a critical indicator for assessing banks’ credit risk, asset quality and efficiency in allocation of resources to productive sectors. The most calamitous problem facing commercial banks all over the world in recent times is spiraling non-performing assets which are affecting their viability and solvency and thus posing challenge to their ultimate survival. So the problem of NPAs should be nipped in the bud. It is possible only if the check is placed on NPAs from the very beginning.

The major cause for the NPA can be attributed to Improper selection of borrower’s activities, Weak credit appraisal system, Industrial problem, Inefficiency in management of borrower, Slackness in credit management & monitoring, Lack of proper follow up by bank, Recession in the market, Due to natural calamities and other uncertainties. The major reason for this situation was that the threat of NPAs was being

surveyed and summarized by Reserve Bank of India (RBI) and Government of India with a bird’s eye-view of the banking industry, independent from the rest of the economy.

1.4.3 SIGNIFICANCE OF THE PRESENT STUDY

The major drag on the banking system in India is the slow progress in the management of non-performing assets (NPAs). The banks have much higher levels of NPAs than average and low capital. To support the weak public sector banks, the government injected substantial amount of capital before the banks were allowed to tap the capital market. NPA is a double edged weapon. On the other hand bank cannot recognize interest on NPA account and on the other; it is a drain on the banks profitability due to funding cost. To add the woes, profit earned has to be diverted to loan loss provisions as per income reorganization and asset classification (IRAC) norms recommendation by Narasimham Committee. Higher NPA ratio shakes the confidence of investors, depositors, lenders etc. It also causes poor recycling of funds which in turn will have deleterious effects on the deployment of credit. The non-recovery of loans effects not only further availability of credit but also financial soundness of the credit organization. Further, a high level of NPAs can result eroding the viability of credit system as whole.

The NPA concept presently in vogue was introduced by RBI for implementing in the banks, in the year 1993 based on the recommendations of the committee on the financial system, in line with internationally accepted norms.

With the implementation of the revised norms on asset classification, income recognition and provisioning on NPA’s in the 1993 while are well defined with little scope for different interpretations; many banks went into the red in the first year. Further, the remaining few which had shown marginal profits were also not quite sure as to whether they could be able to sustain the profits in the years to come. Naturally, such a situation shocked not only the banks but also those connected with the banking industry.

In India, the magnitude of the problem of bad debts was first realized only in early 90s, subsequently, following the recommendations of Narasimhan Committee (1991, 1998) and Verma Committee (1999), some steps have been taken to solve the problem of old NPAs. Though concern regarding the reduction of NPAs in the balance sheets of the banks, particularly Public Sector Banks (PSBs) continues to be expressed
from every corner, there has hardly been any systematic evaluation of the best way of tackling the problem. There seems to be no unanimity in the proper policies to be followed in resolving this problem. There is also no consistency in the application of NPA norms, ever since these have been recognized. Several prudential, payment, integrating and provisioning norms have been introduced, and these are pressurizing banks to improve efficiency and trim down NPAs to improve the financial health of the banking system. It is among the best in the world because Indian banks are favorable on growth, asset quality and profitability; RBI and Government have made some notable changes in policies and regulations to strengthen the sector.

Many such studies have been taken up so far on the management of NPAs. However, the main focus was laid only on identifying causes of NPA’s and extending suggestions in the form of some measures to be taken at micro level, that too specific to some individual banks. Therefore, there is every need to conduct a study on management of NPA’s of Schedule Commercial Banks in both Public and Private Sectors.

The main aim behind making this study is to know how public and private banks are operating their business and how NPAs play role to the operations of these banks. My study is also focusing upon existing system in India to solve the problem of NPAs and comparative analysis to understand which bank is playing what role with concerned to NPAs. The present study has been attempted to make a comparative study of Public sector and Private sector commercial banks with regard to their NPA situation and management in terms of the operational performance of four banks, two each selected from Public and Private Sectors Thus the study will help the decision maker to understand the financial performance and growth of the concern banks as to compare to the NPAs.

1.4.4 OBJECTIVES OF THE STUDY

The Indian banking sector especially the PSBs have been facing the big challenge of NPAs. NPA is an important parameter in the analysis of financial performance of banks. Reduction of NPA is necessary to improve profitability of the banks and comply with capital adequacy norms. To solve the problem of existing NPAs, quality of appraisal, supervision and follow up should be improved. The present study is conducted with the following objectives:
1. To understand the performance of the public and private sector banks during the last decade.
2. To make a comparative study of the magnitude and dimensions of NPA’s in the Public and private sector banks.
3. To examine the causes for incidence and trends of NPA’s in the public and private sector banks.
4. To examine the recovery measures and strategies followed for reducing the burden of NPAs by the public and private sector banks and
5. To make suitable suggestions for the public and private sector banks to effectively handle the challenge posed by the NPAs

1.4.5 HYPOTHESES OF THE STUDY

The study aims at testing the following hypotheses on the basis of the secondary data collected exclusively for undertaking this research work.

H01: The financial health and credibility of Banks is not similar in Public and Private Sectors

H11: The financial health and credibility of Banks is similar in Public and Private Sectors

H02: There has been a steady improvement in the management of NPA’s in Banks with Considerable variation between the public and private sector banks

H12: There has been a no improvement in the management of NPA’s in Banks with Considerable variation between the public and private sector banks

H03: The recovery measures are better followed in Private sector banks when compared To the Public sector banks

H13: The recovery measures are better followed in Public sector banks when compared To the Private sector bank

1.4.6 STUDY DESIGN

The present study is designed to be a narrative study with appropriate analytical discussions presented in tune with the proposed objectives. For the present purpose, two banks from public sector and two from the private sector have been selected purely considering the bank’s profitability based on the recent performance figures of the
banks. In each sector, one bank from the high performing group and the other from the low performing group has been picked up on random basis. Accordingly, Bank of Baroda and Canara Bank from the public sector, while HDFC Bank and Karur Vysya Bank from the private sector have been selected and performance figures of these four banks have been used for the comparative analysis.

1.4.7 DATA BASE

The data will be used in the present analysis is confined to the past one decade (12 years to be exact) from 2001-2002 to 2012-2013. With regard to the study, comparable financial performance of the selected public and private sector banks and data pertaining to the 12 year reference period (2001-2002 to 2012-2013) for analyzing the NPA’s has been considered.

1.4.8 METHODOLOGY

For my study I have utilized almost totally the secondary data. For the study, secondary data have been collected using annual report of “Reserve Bank of India” publication including “Trend & Progress of banking in India”, RBI bulletins, RBI Reports on Currency and Finance, RBI Reports on statistical Tables Relating to Banks in India, The data has been collected from Annual Reports of selected Banks and accounts of Public Sector Banks and Private Sector Banks. Conferences, Articles and papers relating to NPA published in different journals, magazines, newspaper, periodicals on banking have been studied and data have been taken from 2001 to 2013, Case Study, Court Decisions, Relevant Sections of the Provisions of Banking Regulations Act, SARFEASE ACT, Basel Accord, Recommendations and Conclusions of various Committees/Studies undertaken as well as PhD thesis also have been used.

The secondary data have also been collected from IBA (Indian Banking Association) publication- IBA Bulletin (Monthly) IBA Indian Banking year books, Special Annual Issues and IBA publication on: Performance Highlights of Public Sector Banks and Performance Highlights of Private Sector Banks.

1.4.9 ANALYSIS OF DATA

The obtain data have been analyzed using appropriate statistical measures/techniques like percentages (%), averages and financial ratios. While analyzing the incidence and trends of NPA’s, usual statistical techniques like percentages and ratios
have been used ‘t – test’ and ‘F – test’ have been used to determine the significance of difference in averages between public sector and private sector banks and among the four banks study in the present study. For Impact of the Gross NPAs (GNPA) and Net NPAs (NNPA) the Correlation Coefficient Values (r) has also been used. The analysis is done with the help of SPSS Program. The reference period is from 2001-02 to 2012-13 and we have data for these 12 years hence here N becomes 12.

A set of specific Accounting Ratios can also be used to calculate to describe trends in the performance of banks as—Return on total asset, Total costs to total asset, Operating cost to Total Asset, Interest Cost to Total Asset, Revenue to Total Asset Ratio, Return on Equity, Capital Adequacy Ratio, Business per Employee Profit per employee etc...

1.4.10 LIMITATION OF THE STUDY

The analysis of this research endeavour is based on the secondary data collected from different sources. This data in itself has got its own limitations. In such case, the study carries all the limitations inherent with the secondary data and financial information.

➤ The percentage and averages are adjusted to the nearest decimal points, so they as tools of analysis lack absolute accuracy.

➤ Since here the analysis has been limited to four banks, the inferences may not hold good hundred percent for other banks and also when looked at individual branch level.

➤ Only Public and Private sector’s study of the causes and analysis of NPA’s is taken into consideration and the foreign banks are not taken into consideration.

➤ For reducing NPA, Preventive measures which are initiated by the select banks are not available to the researcher. So the statistical data relating to the same which are published by RBI from time to time are used.

➤ The study measured the impact of NPAs on the limited parameter of financial performance of select banks.

1.5 ORGANIZATION OF THE THESIS

The study has been broadly divided into two parts. The first part of the study deals with the theoretical discussions on public sector commercial banks concerning their
origin, growth and development in India, problems, challenges of public sector banks in the post-reforms era, financial sector reforms in India with special reference to banking sector and the level of NPA and their management in relation to banks. The second part contains the empirical analysis of collected data. The present thesis has been organized into Seven Chapters including the present Chapter. Contents of each Chapter are outlined below:

Chapter - I: Presents a brief introduction about banking, need for banks, brief history & growth of Indian Banking, banking system in India, role of banks in Indian economy, NPAs, significance of the Present study, objectives of the study, study design and methodology etc.

Chapter - II: Comprises of a review of past studies in the area of research i.e. management of NPAs.

Chapter - III: In this chapter SWOT Analysis of Public Sector Banks after Reform era is described and Highlights the problem & challenges of public sector commercial banks in India.

Chapter - IV: Profile of the Selected Banks

Chapter - V: Presents a detailed account of the concept of NPAs, its impact on banking, remedial measures Such as different reforms, different strategies and measures for recovery followed etc.

Chapter - VI: Comprises the analysis of data and presentation of the observations.

This Chapter is divided into three sections:


Section-3: Management of NPAs.

Chapter - VII: Presents a summary of findings, conclusions and suggestions for better management of NPAs.