Chapter: 3 Overview of Indian Banking

3.1 Introduction
3.2 Banking Industry in India
3.3 Emergence of Private Banks in Banking Sector
3.4 Banking Industry in Post Liberalized Period
3.5 Conclusion
3.1 Introduction

An outstanding financial system is a must for the sound economic development of a country. The Indian economy and its monetary system have been dominated by the rule of varied controls, protective regulations and wide-ranging state interference. Indian economy was sheltered by the state against external competition. The national savings acquired by various administrative and tax measures, were exhausted on financing uneconomical government expenditure and public sector losses. Due to all above reasons, the Indian government was forced to take speedy decision of liberalizing the economy from various types of controls. The year 1980 and the year 1990 have observed many widespread changes in the industrial policy of Indian government. The after effect of liberalization, due to new economic policy on industrial buzz resulted in the rapid growth of consumer durables, faster growth of petro chemicals, growth of service sector, and increase in the infrastructural investment during the 1980s. During the early 1990s there was a set back to the industrial recovery which, was initiated in the 80s but, in the year 1993 -94, the recovery path was again retained. The process of
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Industrialization is bringing significant changes in the industrial structure of the country.

By the beginning of 1990, there was a clear-cut indication of public sector bank's inefficiency to make profits. The real cause for the bank's non-profitability was the social banking goals set for the public sector banks. The factors responsible for the setback were regulated interest rates, lack of profitability approach, no competition, excessive support from government and regulation on organization structure and managerial resources.

In the wake of above discussed causes the Government of India appointed a high level committee on Financial System in July 1991, under the Chairmanship of Shri Narasimham (a former Governor of the Reserve Bank of India), to examine all aspects related to the composition, organization, functions and procedures of financial system. Keeping in mind the recommendations of Narasimham Committee, and also to infuse competition and to improve profitability and efficiency of banks, the Reserve Bank of India allowed the entry of private sector banks in the banking sector.

Before this deregulation and globalization for over 2 decades, no new banks were allowed in the private sector even after nationalization in 1969. On the recommendation of the Narsimham Committee, to liberalize
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and to allow the freedom of entry into the financial system; the RBI permitted the establishment of new banks in private sector. Thus the government set the ball of privatization rolling in banking sector. All together 30 private sector banks are operating currently in India, out of which, 21 banks are old generation private sector banks, while, 9 banks are new generation private sector banks. These banks are able to sustain all the changes brought by policy makers such as competition, capital adequacy norms, assets liability and risk management norms. These banks were also able to make huge investment in technology and total computerization of the banks. All these changes adopted and incorporated by private sector banks put tremendous pressure on the public sector banks in competing with them to remain in the business. It is interesting to note that, out of the 21 old private sector banks, six each have originated in Maharashtra and Tamilnadu, while four are based in Kerala and two are from Karnataka while one each from Rajasthan, Uttar Pradesh and Jammu and Kashmir. Among the new private sector banks, Global Trust bank is based in Hyderabad, Bank of Punjab in Punjab and seven others have headquarters in Mumbai but they are registered elsewhere. The old private sector banks are efficient and show growth in terms of deposit and advances, because of their presence in all over India. As far as new generation private sector banks are concern, they
started their operations about a decade back but caught up with the substantial business with presence all over India, adoption of new technology and product development. One of the indicators of the bank’s health is level of non-performing Assets (NPA’S). As on 2001, total NPA’s of old private sector bank amounted to Rs. 4615.48 cr. And that of the 9 new generation private sector banks is Rs. 5,443.89 cr. HDFC Bank is having Rs.324 Cr. as a gross NPAs inspite of taking over another new generation bank-Times bank in 2001.  

On the basis of recommendations made by Narsimham committee, Government of India allowed the entry of private banks and foreign banks in the Indian Banking Sector. The table 3.1 gives the details of entry of private and foreign banks during 1990 and 1998. The table shows the details such as date of opening, name of the banks which started the operations and ownership details.

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### Table 3.1


<table>
<thead>
<tr>
<th>NAME OF THE BANK</th>
<th>DATE OF OPENING</th>
<th>NATURE OF OWNESHIP</th>
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<tbody>
<tr>
<td>Barclays Bank</td>
<td>8/10/90</td>
<td>Foreign Bank</td>
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<tr>
<td>Sanwa Bank</td>
<td>20/12/90</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>UTI Bank</td>
<td>28/02/94</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>IndusInd Bank</td>
<td>2/04/94</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>ICICI Bank</td>
<td>17/05/94</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>ING Bank</td>
<td>1/06/94</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Global Truest Bank</td>
<td>6/09/94</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>Chase Manhattan Bank</td>
<td>21/09/94</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>State Bank of Mauritius</td>
<td>1/11/94</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>HDFC Bank</td>
<td>5/01/95</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>Centurion Bank</td>
<td>13/01/95</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>Bank Name</td>
<td>Date</td>
<td>Type</td>
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</tr>
<tr>
<td>DBS Bank</td>
<td>15/03/95</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Bank of Punjab</td>
<td>5/04/95</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>Times Bank</td>
<td>8/06/95</td>
<td>Indian Private Bank</td>
</tr>
<tr>
<td>Dresdner Bank</td>
<td>21/8/95</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>IDBI Bank</td>
<td>28/05/95</td>
<td>Indian Private Bank</td>
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<tr>
<td>Bank of Ceylon</td>
<td>30/10/95</td>
<td>Foreign Bank</td>
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<tr>
<td>Commerz Bank</td>
<td>1/12/95</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Siam Commercial Bank</td>
<td>14/12/95</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Bank International Indonesia</td>
<td>6/04/96</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Arab Bangladesh Bank</td>
<td>6/04/96</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>China trust Commercial Bank</td>
<td>8/04/96</td>
<td>Foreign Bank</td>
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<tr>
<td>Cho Hung Bank</td>
<td>6/05/96</td>
<td>Foreign Bank</td>
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<td>Fuji Bank</td>
<td>20/5/96</td>
<td>Foreign Bank</td>
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### Overview Of Indian Banking

<table>
<thead>
<tr>
<th>Bank</th>
<th>Date</th>
<th>Type</th>
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<tbody>
<tr>
<td>Krung Thai Bank</td>
<td>6/01/97</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Overseas Chinese Bank</td>
<td>31/1/97</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Commercial Bank of Korea</td>
<td>12/03/97</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Sumitomo Bank</td>
<td>20/06/97</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Toronto-Dominion Bank</td>
<td>25/01/97</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Hanil Bank</td>
<td>5/07/97</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Bank Muscat International</td>
<td>9/09/98</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>Morgan Guaranty Trust</td>
<td>24/12/98</td>
<td>Foreign Bank</td>
</tr>
<tr>
<td>K.B.C. Bank</td>
<td>15/02/99</td>
<td>Foreign Bank</td>
</tr>
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The above table shows the number of private banks and foreign banks which were established during the period of 1990 to 1998. In the year 1990, it can be seen that there were 2 foreign banks namely, Barclays Bank and Sanwa Bank. In the year 1994 there were 7 banks were started out of which 3 banks were foreign and 4 banks were new generation private sector banks. ICICI Bank was one of the new generation private sector banks to be established in 1994. Then in the year 1995, 10 banks started functioning.
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newly, which included 5 private sector banks and 5 foreign banks. In the year 1996, another 5 banks formed and all were foreign banks. There was addition of 5 more foreign banks which were established in the year 1977. In the year 1998 another 2 foreign banks were formed, followed by 1 more bank establishing in the year 1999.

3.2 Banking Industry in India.

Financial system has important place in a nation’s economy. Indian financial system consists of both organized and unorganized sector. We have seen the growth and progress of organized financial sector at the same time we cannot overlook the part played by unorganized financial sector in providing credit to rural areas.

The Indian financial sector is characterized by Organized and Unorganized sectors which can be seen from the following chart:

I Unorganized sector
II Organized sector.

Chart 3.1

UNORGANISED FINANCIAL SECTOR.

Money Lenders Indigenous Bankers Nidhis, Chit Funds
Unorganized sector consist of moneylenders serving the credit need of rural people. The credit given by unorganized moneylenders consist of secured and unsecured loans. Indigenous bankers are another constituent of unorganized sector. They exist in our system since olden times. They deal in ‘Hundies’ and sometimes they also accept deposits. These moneylenders were known by different names in different places. Multanies, Marwaries, Chetties and Kalidaikurchi are some of the names by which these indigenous bankers are called in various parts of India.

Nidhis are another semi-banking institutions registered under Indian company Act. These institutions receive deposit in monthly installments. There is also ‘Chit funds’ an organization of small number of persons that promote savings and lend money. They price and auction chits. Similarly Indian banking system has organized sector which is more popular and rigidly controlled by the government agencies. It is governed by different enactments relating to the banking sectors. There are several types of banks in organized sector which can be seen from the following Chart
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Chart 3.2 Organized Financial Sector

RBI

Banking Institutions

Commercial Banks
Regional Rural Banks
Co-operative Banks

Public Sector Banks

Private Sector Banks

State Co-op Bank

State Bank Group
Nationalized Banks
Indian Banks
Foreign Banks

District Co-operative Bank

SBI
Subsidiary Banks.
Old Private Sector Banks
New Private Sector Banks

Primary Credit Societies

Primary Agri.- Credit Societies
Primary Urban Co-op. Banks
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Basically the organized sector consists of money market, commercial banks, co-operative banks, and regional rural banks. These banks have contributed a lot for development of banking industry in India.

Reserve Bank of India: Reserve bank of India (RBI) is the central bank of India; it came into effect on April 1935. It was nationalized in 1948. It performs central banking, regulatory and promotional functions.

Commercial banks: Commercial banks can be classified into the following two categories.

i) Public sector banks

Public sector banks includes, banks owned by the Central Government, directly or indirectly through Reserve Bank of India. Public sector banks can be further classified into two groups namely:

a) State Bank group

State Bank of India is the largest commercial bank in India along with its subsidiaries. It is largest in terms of spread of branches, resources and manpower.

b) Nationalized banks.

ii) Private Sector Banks:

The private sector banks can be further classified as a) foreign banks b) private sector banks

a) Foreign banks.

Foreign banks are those banks, which has corporate office outside India, and carrying on business in India. There are 41 foreign banks, from 21 countries operating in India, with 194 branches as on June 30th 2002. While five banks have 10 or more branches and 17 banks are single branch banks. Twelve foreign banks have 367 ATM’s in India.62

b) Indian Private sector banks

In India we had banks, which were working in private sector even before independence. However after independence the Government nationalized these banks in 1969 and 1980. In 1993 Reserve Bank of India allowed the setting up of banks in private sector. We can classify private sector banks in two categories.

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i) Old private banks

Old private sector banks are those private sector banks, which were working before independence and established in private sector. To name a few, we have Vysya Bank, Lakshmi Vilas Bank and Lord Krishna Bank. Most of the old private banks are more than 50 years old.

ii) New generation private sector banks.

New Generation Private Sector Bank, are those banks which are established on the recommendations of the Narsimham Committee. The first bank to be set up in private sector and start its operations was IndusInd Bank Ltd. The other private sector banks, which followed and started, are ICICI Bank, UTI Bank, HDFC Bank. As on February 2003 there are 9 new generation private sector banks. This includes Kotak Mahindra Bank Ltd, which is recently converted from a finance company in to a bank.

Regional Rural banks

These banks have been established under the Regional Rural Bank Act, 1976, with an objective to develop rural economy.
The Co-operative banks

Co-operative banks have 3 tier set up.

i) State co-operative banks

ii) Central co-operative banks or District cooperative bank

iii) Primary credit societies.

The scheduled commercial banks operating in India are classified into public sector banks, old private sector banks, new private sector banks and foreign banks. In the last few years, the new private sector banks have performed better than other three groups.

Between 1995-96 and 1999-2000, the share in assets of public sector banks fell from 84.5 to 80.2 percent, while the share of foreign banks during the same period fell from 7.9 percent to 7.5 percent. The share of the old private sector banks rose modestly from 6.2 percent to 7 percent during the same period, while the new private sector banks increased their share from 1.4 to 5.3 percent.  

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3.3. Emergence of Private Banks in Banking Sector

"Indian Banking fared better than many banking systems among emerging economies both in terms of survival and strength" B.D. Narang

Banks have important role to play in the economic development of a country. Their contributions towards the development efforts are largely depend upon the way banking policies are being formed. Banking in private sector flourished since ancient times to Mughal periods, and from British Rule to 1969 after independence of India. At the time of nationalization of banks, the old private as well as foreign banks were operating in organized financial sector and money lenders and indigenous banks were providing banking services to the society in unorganized financial sector. During the period of 1969 to 1994, no new private bank was allowed to establish under the Indian banking law.

The important objective of nationalization was to provide banking facilities to the ignored areas of society. After 1969 i.e. after nationalization of major commercial banks, there have been changes in the

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banking habits of people. It also helped to increase the deposit base. The Banking system in India has played an important role in Indian economy. It was instrumental in bringing social and economic changes since the nationalization of major banks in 1969. The network of branches increased from 8,262 in the year 1969 to 67,118 in June 2004, reducing the population covered per branch of commercial bank from 66,000 to 16,000. At present 290 banks are operating in the country, consisting of 27 public sector banks, 30 private sector banks, 32 foreign banks, 196 regional banks and 5 non-scheduled local area banks. Private sector banks have share of 8.5 percent in branch network with 5,737 branches of which 50 percent are in urban and metro cities. Over 90 percent branches operating in the country are owned by Public sector banks, out of which 70 percent are located in rural and semi-rural areas. Asset base of scheduled commercial banks was Rs. 19, 75,020/-crores as on 31st March 2004. Their aggregate deposit was Rs. 15, 75,143/-crores and aggregate advances were Rs. 8,64, 000/-crores. Market share in the business is one good indicator to find out the growth rate of banks.

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In spite of all these accomplishment to its credit, the banking system was characterized by lack of efficiency and low profitability. The major problem of Indian public sector banks was low capital base and the belief that government ownership need not worry about a low capital base. Poor quality of customer services was not able to meet the requirement of customers with changing demands. All these reflected in the need for speedy and more efficient banking system. Following table gives the market share in asset, deposit, advances and investment according to the ownership.
### Table: 3.2

Market Share in Assets, Deposits, and Advances & Investments According to Ownership in banks.

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<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Scheduled commercial banks</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
<td>100</td>
</tr>
<tr>
<td>Public sector Banks</td>
<td>80.6</td>
<td>74.5</td>
<td>77.9</td>
<td>73.2</td>
<td>78.0</td>
</tr>
<tr>
<td>Private Sector banks</td>
<td>11.9</td>
<td>18.6</td>
<td>17.0</td>
<td>19.8</td>
<td>16.8</td>
</tr>
<tr>
<td>Old Private sector banks</td>
<td>6.7</td>
<td>6.1</td>
<td>6.7</td>
<td>6.5</td>
<td>5.9</td>
</tr>
<tr>
<td>New Private sector banks</td>
<td>5.2</td>
<td>12.5</td>
<td>10.4</td>
<td>13.3</td>
<td>10.9</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>7.5</td>
<td>6.5</td>
<td>5.1</td>
<td>7.0</td>
<td>5.2</td>
</tr>
</tbody>
</table>

It can be seen from the above table that, there has been increase in the share of assets of private sector banks from 11.9 percent in 2000 to 18.6 percent in 2004, at the cost of public sector banks, which showed a decline in share from 80.6 percent to 74.4 percent. Apart from higher rate of growth of business of private sector banks, merger of Industrial Credit and Investment Corporation of India (ICICI), a term lending institution with ICICI Bank in the year 2002 has contributed to increase in its market share.

For several years, the Indian banking system was highly regulated. State owned banks subjugated the scene, with foreign banks and a few small-sized private sector banks remaining marginal players. In the year 1993, with the opening up of economy, government of India freed the banking sector by announcing the revision of old nationalization policy in banking. The new policy allowed few players to set up banking business in private sector. This set the ball rolling for privatization. When permission was granted, to set up new banks in the private sector from 1995 onwards, there was a transformation in the banking sector. Under the reform, for the first time, the establishment of a new bank was permitted. The criterias for the setting up of a new private sector bank initially were; a) capital of Rs.100 crore b) most modern technology and c) head office at a non-metropolitan center.
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Nine new banks were set up, one of which Times Bank, subsequently merged with HDFC Bank. These banks with their up-to-date technology have been providing good competition to the stressed public sector banks and old private sector banks. The new generation banks came to the scene with better technology, ambience products and faster delivery system. They started acquiring larger market share every year at the cost of mostly the public sector banks. The technological initiatives taken by these banks in respect of online banking through ATMs and Internet, tele-banking services and core banking solutions, have posed a serious challenge to public sector banks and old generation banks, and forced them to modernize and reorient their strategies. Aggressive marketing by the new banks to attract customers have compelled the older banks to improve their marketing skills and the quality of services. The customer has come to occupy center stage and he is the beneficiary of the increasing competition ushered in by the entry of the new generation banks.

In India, most of the banking business is done with Public sector banks, it occupies 80 percent of the banking business, but it is the private sector commercial banks, which contribute to the economic growth

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of our country. Indian financial sector became more aggressive and liberal with the entry of foreign banks and private sector banks. At the end of March 2001, there were 8 new private sector banks like UTI Bank, ICICI Bank, HDFC Bank, IDBI Bank and 23 old private sector banks most of which were established before independence. Though their branches are found in the entire country, they were successful in having regional orientation. They are Jammu And Kashmir Bank from Jammu, Tamilnadu Mercantile bank, Bank of Madura, Karur Vysya bank; Laxmivilas Bank and City Union Bank are from Tamilnadu. Sangli Bank, United Western Bank is from Maharashtra, Karnataka Bank is from Karnataka. Nedungadi Bank, Federal Bank, Dhanlaxmi Bank, Catholic Syrian Bank is from the state of Kerala. Private sector banks are influential in mobilizing the deposits inspite of their not so wide spread branch network in comparison to Public sector banks. Public sector banks and private sector banks provide same services with the only difference were the quality of services provided. Due to regional presence some of the Private sector banks were able to establish good rapport with their customers.

The new generation private sector banks that emerged with the opening of the economy and deregulation are HDFC Bank and ICICI Bank. The Indian banking sector has seen tremendous growth over last 3-4 years.
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“The last three years, among all sectors and industries, the banking sector has recorded one of the fastest growth. It has been one of the few sectors to post a higher than 50 percent growth in profit even after the technology meltdown in 2000 and the recessionary trends thereafter” 69

The new private sector banks have also continued to grow faster and increase their profitability each year. Both HDFC and ICICI Bank saw their bottom line widen by 31 percent and 36 percent respectively in 2004. The ET(Economic Times) and Centre for monitoring Indian Economy (CMIE) Published in December 1998 under the title “Agenda” had undertaken to study the performance of private sector banks. ET-CMIE findings are that for 1997-1998, 10 private sector banks – HDFC Bank, ICICI Bank, Bank of Punjab, IndusInd Bank, Global Trust bank and old private sector banks like Jammu and Kashmir Bank, Karnataka Bank, Karur Vysya Bank, Bank of Madura and Tamilnadu Mercantile Bank, figured in the list of top 20 banks. Foreign banks brought with them, the technologically advanced products and best banking practices, which forced the Indian banking industry to improve its quality of services.

In 1998, it was the initiative of private sector banks which has resulted in the current established and efficient retail-banking network. In

69 Nayak, Indira, “Banking on the future” Economic Times, Mumbai. 8/04/04
the four years, beginning form 1998, the four main private sector banks HDFC Bank, UTI Bank, IDBI Bank and ICICI Bank have gathered over Rs. 67,688 crore of deposits, that makes these bank's share to six percent of the total deposit in the banking system. The new generation private sector banks are attempting to replicate the model, by rapidly diversifying their product range, to encompass the entire range of retail products.

Ranking banks, on as asset-wise scale, we once again found that, State Bank of India (SBI) continues to be the No.1 bank in the country. SBI is more than three times the size of the next largest bank in India, ICICI Bank. In fact the State Bank group alone controls 27.8 percent of banking assets in the country. Central Bank of India at No 7 is the only unlisted bank figuring in the top 10, while ICICI Bank at No 2 is the only Private sector bank in the list. Interestingly, Public sector banks are the biggest banks in the country, when compared with both private sector banks and foreign banks, which are much smaller in size. The largest foreign in India is Standard Chartered Bank, after its merger with ANZ Grindlays bank in 2002 it is known as Standard Chartered Grindlays Bank. Citi Bank and HSBC follow it in asset size. The banking industry grew quite well in the last fiscal year. The total assets under banks, grew by 17.4 percent to 1.97 crore.
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Private sector banks were the fastest growing banks in the year 2003-2004 followed by foreign banks. The private sector bank includes some of the fastest growing and most aggressive banks in industry. HDFC Bank’s balance sheet increased by 39 percent in the last fiscal. While, even ICICI Bank’s loan sales grew by 17 percent. The size of the foreign banks in India is currently quite low. The latest report on Trend and progress of banking in India for 2003-2004, also provides a picture of vigorous and healthy banking sector. It of course tells a credible story of progress, thanks to improvements in macro economic condition and risk mitigation and above all better regulation, a strong approach to regulation and risk mitigation and above all better governance. The report salutes the stock market by stressing the improvement in market valuation of various bank stocks in the recent period. During the year 2003-2004, the growth of credit in retail and housing finance has driven the overall process of banking. Credit to infrastructure increased by 41.6 percent as compared with a growth of 35.3 percent in the previous year. Bank lending to wholesale trade also recorded a growth of 23.7 percent. While housing showed an increase of 42 percent. Regarding lending, one interesting fact is that, non-performing assets (NPA’s) as a percentage of outstanding loans under this sector, which covers housing, consumer durable and credit cards was only 2.8 percent.
Another important aspect of bank's performance during the year has been the higher investment in Government securities. At the end of March 2004, investment in such securities formed 41.3 percent of the total net demand and time liabilities of the bank, as compared with the statutory requirement of only 25 percent. More investment in credit to government then required under the law is partly because of the zero risk weight attached to government securities and lower capital requirements.

The credit/deposit ratio is a widely used banking indicator, which shows how much of the deposit resources of banks are converted as loans and thus contributes to economic growth. The credit/deposit ratio at the end of March 2004 was 58.07 percent. If we take into account the flow of resources in the investment in gilt-edged securities, it will be more.\(^7\) The new generation private sector banks have been driving force behind the winds of change that have swept he Indian Banking sector over the last decade. Their focus on technology and customer convenience has brought about a paradigm shift in the banking business. The new private sector banks have combined the technology driven products and distribution capabilities with a deep commitment to the Indian market and the Indian customer, thus

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\(^7\) Changing Face of Indian Banks, Monthly public opinion Survey, Vol. No 4, 592, Jan 2005, Pp 21-22
achieving a unique positioning in the banking sector. They have brought volume to the retail finance market, making affordable retail credit easily available across the country, enabling the rising middle class to build household assets and meet its life style aspirations thus fuelling economic growth. The private sector banks now need to meet the challenge of global competitions, as India becomes visible as an alternative growth market\textsuperscript{71}.

Major changes have taken place in banking industry, since the banking sector reforms took place in 1992. These reforms were undertaken with certain objectives such as improving the efficiency of banks and making them more competitive.

3.4. Banking Sector in Post Liberalized period.

Government of India has initiated a series of economic and financial reforms in the last fifteen years by adopting the policy of liberalization, with the objective of integrating Indian economy with the world economy. There have been changes in the financial markets and these changes are being driven by globalization.\textsuperscript{72}


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The phrase global has been used to point out multi national or international. The concept of globalization is finding a new meaning in the face of changing international environment. Globalization is the process by which market is expanded to international boundaries. The present economic environment is highly suitable to the growth of private sector banks. Liberalization and de-regulation process, which started in 1991-1992, has made far reaching changes in financial sector. These reforms in financial sector have been highly instrumental in transition of the system from highly regulated to a market economy. The changes brought with them the much-needed competition. The existing banks faced major competition mainly from private sector banks.

Thus the process of Liberalization and Deregulation, which was started in the year 1991-92, was mainly responsible for the major changes that have taken place in the Indian Banking Sector.

India has been growing through a process of economic reform and liberalization since July 1991. During the post liberalized period, the Indian economy was opened up, adopting more liberalized financial policies. After 1990, there has been a change in the approach of the policy makers. This change in the outlook of the policy makers, have made it necessary for almost all the organization, whether manufacturing or service oriented, to
change their policy decisions, to make it dynamic and innovative. In the first phase of reforms, extending over 5 years from 1991 to 1996, bank’s operational efficiency is sought to be toned up through a series of reforms. It involved adoption of income recognition, and provisioning norms aimed at making the balance sheets of banks more transparent, realistic and internationally comparable. But the most important change that has overtaken the nation’s banking industry, relates to the fact that, the competitive forces are sought to be introduced consciously in the financial services sector in general, and banking industry in particular. It was done through the policies of interest rate deregulation and more particularly, through a new liberal policy move to open its doors wider, to facilitate the entry of foreign banks and new private sector banks. Thus exposing Indian Banks to stiff competition from foreign banks are using more sophisticated technology. As on 31 August 1996, there were 36 foreign banks from 20 countries operating in India with a branch network covering 21 centers in 14 states. In addition, there are as many as 23 foreign banks with representative offices in the countries. Apart from the liberal entry for foreign banks within the nation’s banking sector, liberal entry has been permitted to new private sector banks and some 9 new banks have already commenced business. Current economic ambience is highly suitable to the growth of private sector
banks. These reforms in financial sector have been influential in evolution of the system from highly regulated to a market economy. The changes brought with them, the much-needed competition. The existing banks faced competition largely from Private sector banks.

The regulations, governing the banking industries have posed great challenges to it as they brought about revolutionary changes. The regulations that were present in both nationalization era and liberalization era were distinct from each other mainly due to the fact that, the focus was on diverse changes in the banking industry. During the nationalization era, banks were required to ensure economic growth by increasing the volume of credit extended, especially, to the neglected sectors. Profitability and competition took a back seat in this set up of the industry. On the country, supporting economic growth should be the primary aim of the liberalization measures, because at the end, it is the quality of assets and services that actually mattered. The banks need to ensure profitability and that too in a highly competitive environment. Thus the former aimed at a broad and regulated economic growth, the latter advocated market determined economic growth.

The nationalization era commenced in 1969, when the country's 14 major commercial banks were nationalised. Continuing this process, 6
more banks were nationalised in 1980. It was felt that, the banks which have a vital role to play in the economic growth, mostly catered to the credit requirements of large corporate houses only. The credit requirements of small scale sector, agriculture sector and export sector were given little priority. Accordingly, the Banking Companies (Acquisition and transfer of undertakings) Act was enacted, to provide for the acquisition and transfer of 14 banks based on their size, resources, coverage and organization.

In fact, Nationalization paved the way for retail banking and as a result, there has been an all round growth in the branch network, the deposit mobilization, credit disposals and of course employment.

The branch network of the banks increased tremendously in order to enhance, their coverage geographically. The branch network, which was a little over 8,200 in June 1969, reached a level of over 61,000 in June 1993. Out of this, 57 percent were setup in the rural areas and about 19 per cent in the semi-urban areas.

The widened branch network and better techniques of deposit mobilization, has enhanced the number of deposit accounts and also the amount mobilized. The aggregate deposits of scheduled commercial banks stood at Rs. 4,669 crores during July 1969, touched, Rs.5,36,342 crores by the end of March 1997.
The first year, after nationalization, witnessed the total growth in the agricultural loans and the loans made to SSI by 87 percent and 48 percent respectively. The overall growth in the deposits and the advances indicates the improvement that has taken place in the banking habits of the people in the rural and semi urban areas when the branch network has spread. On analysis of the working of banks after nationalization made it clear that the profitability of banks affected.

By the beginning of 1990, the social banking goals set for the banking industry made most of the public sector banks unprofitable. The fact that, majority of the banks were in public sector resulted in the presumption that there, was no need to look at the fundamental financial strength of these banks. Consequently they remained undercapitalized. Revamping this constitution of the banking industry was of extreme importance, as the health of the financial sector in particular and the economy as a whole would be reflected by its performance.

The need for streamlining the banking industry was felt greater with the commencement of the real sector reform process in 1992. The reforms have improved the opportunities and challenges for the real sector making them operate in a borderless global market place. However, to harness the benefits of globalization, there should be an efficient financial
sector to support the structural reforms taking place in the real economy. Hence, along with the reforms of the real sector, the banking sector reformation was also addressed.

The route causes for the lackluster performance of banks, formed the elements of the banking sector reforms. Some of the factors that led to the dismal performance of banks were:

- Weaker fundamental of financial strategies.
- Regulated interest rate structure.
- Lack of focus on profitability.
- The high level of low yielding SLR investments adversely affected the profitability of the banks.
- Rapid branch expansion has been the squeeze on profitability of banks emanating primarily due to the increase in the fixed costs.
- There was downward trend in the quality of service and efficiency of the banks.
- Inefficiency adversely effecting the economic growth.

All these necessitated a review of the role of the banks and their contribution to the financial system. The era of liberalization was initiated in the early 90s. Implementation of BASEL I norms on capital
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adequacy, asset classification, and income recognition, coupled with deregulation measures initiated by RBI, it forced all the commercial banks to have a look at entire portfolio of assets and liabilities and started thinking in terms of innovations and profitability.

With most of the banks, including the private sector banks fast adapting to the latest technologies in banking, the early bird advantage of technological superiority will soon fade away. With most banks providing almost all services under the sun, and the real potential of the retail market now unfolding, most banks operating on similar lines are expected to exhibit more than normal rates of growth in the short term. In the long term, the differentiating factor will, be the ability of these banks to retain their customer base at affordable margins both to itself as well as its clientele.

The Private sector banks include some of the fastest growing and most aggressive banks in the industry today. HDFC bank’s balance sheet increased by 39 percent last fiscal, while ICICI Bank, after loan sales grew by 17 percent. The size of foreign banks in India is currently quite low. There are also reports that new players such as the commonwealth banks of Australia, Royal banks of Scotland, Macquire Bank and USB are exploring
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possibilities to start the operation in India. The new private sector banks have also continued to grow fast and increase their profitability each year. Both HDFC Bank and ICICI Bank saw their bottom line widen by 31 percent and 36 percent respectively in 04. However ICICI Bank has seen a fall in operating profits in the last financial year, its operational profits declined by 8 percent to Rs. 2,372 crore. High net profits in 2004 translated in higher dividends for shareholders. The banking industry consists of Co-operative banks, schedule commercial banks (SCBs) and regional rural banks. The SCBs are the dominant financial intermediaries with total assets worth Rs. 15,355 billion on March 31, 2002.

Public sector banks dominate the industry; in 1993 nine private sector banks were allowed to set up operations as part of banking sector reform process. These aggressive new private sector banks expanded rapidly by setting up over 1000 branches mainly in metros and cities. In addition, they expanded the usage of banking services through ATMs- Automated Teller Machines, home banking, internet banking and tele-banking. These banks, not only gave new options to customers, but forced the public sector

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73 Puri, Aditya, M.D, HDFC Bank “We are the Ones”, ET 500, 2004. Pg 63
banks to improve their services to stay in the competition, as they were left with no option to perform or perish.

3.5 Conclusion

The year 2004-2005 was important from the banking point of view. This year we saw two mergers, first between IDBI Bank Ltd and IDBI Ltd., and second between Bank of Punjab and Centurian bank. The year was also significant because in this year, one more private sector bank was born-‘Yes Bank.’ The deposits of scheduled commercial banks continued to grow at, 16.4 percent (2003-04) and 15.4 percent (2004-05). In this race new generation private sector banks lead with growth rate of over 21 percent with Public sector banks not remaining far behind with growth rate of 15.6 percent.

It is heartening to note that public sector banks are standing up to the challenges of competition put up by private sector banks. While net profit of the banking system as percentage of total assets is 1.01 in the year 2002-03, 1.13 in the year 2003-04 and 0.91 in the year 2004-05 the corresponding figures for public sector banks are respectable at 0.96, 1.12 and 0.89. So is the Net interest Income (spread) at 2.77, 2.88 and 2.84 for banking system and 2.91, 2.98 and 2.92 for the public sector banks.
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The capital adequacy ratio was highest for the United Bank of India, at 18.16 percent, Corporation Bank at 16.23 followed by IOB and State Bank of Patiala at 14.20, in the PSB group. In comparison major new private sector banks have figures at 12.16 percent HDFC Bank, 11.78 percent ICICI Bank and 12.66 percent UTI Bank.

Net NPAs to Net Asset ratio has also been steadily improving for the banking sector and for PSNBs. Major PSBs like SBI 2.65 percent, Canara Bank 1.88 percent PNB 0.20 percent, BOI 92.77 percent have respectable figures, comparable and even better than those of major new private banks like ICICI Bank 1.65 percent, HDFC Bank 0.24 percent and UTI Bank 1.39 percent.

With regard to return on assets, the star performers in the PSB group are Andhra Bank 1.59 percent followed by Vijaya Bank 1.43 percent besides Corporation Bank and OBC at 1.40 percent.

Major private sector banks have corresponding figures at 1.59 percent ICICI Bank, 1.47 percent HDFC Bank and 1.21 percent UTI Bank.76

The new generation private sector banks and foreign banks are more innovative in terms of taking initiative for marketing their services. The first step towards this is designing their branches aesthetically. Some branches of ABN AMRO offer coffee to their customers while discussing their needs and suggesting related products. Citi bank has separate enclosures for children to play who accompany their parents. ICICI Bank has increased working hours 8 a.m. to 8 p.m. to cater to the needs of customers.

In another development, banks have started Customer Care Centres where customer services representative not only attend to the enquiries made by the customers but also provide information about their services. With boom in retail banking and extreme competition among the banks to increase its business has resulted in large disbursement of consumer loans, home loans, loans on credit cards, auto loans, and educational loans on easy term without much inquiry. The result is disastrous in creating large number of cases of defaults in loan repayments thus increasing the banks NPA’s.

The current scenario is such that customer privacy is also affected due to customer services of banks wherein executives ring at untimely hours and at homes, offices, informing about new products of the
banks. Hiring of outside agency for recovery of loan is another factor to be considered in studying the present condition of banking sector in India. The external agency hired by banks for loan recovery, many a times uses forceful means for recovery. Such instances may damage the image of banks under consideration. In fact such instances have led to a lot of protest and litigation. This has forced RBI to pass notifications.

There is a strong competition among all the banks for customer share. In this race, the banks should not forget their objective of providing services. The new generation private sector banks, in order to remain in the rat race and earn profit should not divulge in to unnecessary marketing of services. Marketing with innovative approach is always welcome by the customers but marketing with conditions hidden makes customers feel cheated and go for other alternative.