CHAPTER - I
INTRODUCTION

The focus of financial sector reforms has been on the banking sector. The most important of these reforms was about “Income Recognition and Asset Classification” (IRAC) norms for Banks, as recommended by Narasimhan Committee in its report on “Financial Sector Reforms”. Implementation of IRAC norms has removed “subjectivity” element in income recognition and asset classification practices of all Scheduled Commercial Banks. The process of financial intermediation supports increasing capital accumulation through the institutionalization of savings and investment. The gains to the real sector of the economy depend on how efficiently the banking sector performs the basic functions of financial intermediation. A distinction is often made in the literature between operational efficiency and allocation efficiency. The predecessor explains the transaction cost, the latter deals with the distribution of mobilized deposit among competing demands. Banks play a vital role in discharging the social responsibility through poverty eradication, employment generation, development of agriculture and industry, redistribution of wealth and balanced regional development. Banks inculcate savings habit among the public, accelerate capital formation, and promote entrepreneurial activities and employment opportunities. The competition among commercial Banks has intensified in recent times and technology has been playing a key role in meeting not only the ever increasing expectations of the customers, but also for back office automation and regulatory compliance. The more dynamic commercial Banks which adopted new technologies are able to increase their efficiency, especially with regards to

1. Significantly increasing the non face to face banking transactions, thereby reducing the customer foot falls at the branches.
2. Back office automation.
3. Technology backed liability products.
4. Identification of NPAs and monitoring of advances.
5. 24 X 7 availability of a significant share of banking services to the customers.
1.1 BANKING EVOLUTION

The development of “Banking” is evolutionary in nature. The origin of the word “Bank” in the modern sense is derived from German word “Banck” which means, heap or mound or joint stock fund. The Latin word “Banco” means heap of money. Initially, the bankers, the Jews in Lombardy, transacted their business in the market place.

1.2 BANKING SYSTEM IN INDIA

The role of the banking system in fostering economic development is determined primarily by the economic system of a country. In a capitalist economy, with little amount of control over economic activities, banking as an instrument of development will not have a very significant role to play. On gaining political independence in 1947, the Government of India opted for a socialistic pattern of development.

The banking system in India after independence comprised broadly (i) the Reserve Bank of India at the apex, (ii) Commercial banks of different sizes, (iii) the Co-operative credit institutions, and (iv) the indigenous bankers. There were very little purposive control and direction over these institutions. The developmental function of banks was almost non-existent, and they were generally catering to the needs of only groups of people. A large segment was completely beyond the Reserve Bank’s purview. Soon after independence, measures began to be taken for strengthening the system and giving it a proper direction.

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1.2.1 The Reserve Bank of India

The first important step was the nationalization of Reserve Bank of India (RBI) in January 1949, which was originally started as a private shareholders bank in 1935, through the Reserve Bank (Transfer to Public Ownership) Act, 1948. The Act empowered the Central Government “to issue such directions to the Bank as it might after, consultation with the Governor of the Bank consider necessary in the public interest”. Under the Act, all Directors of the Central Board, including the Governor and Deputy Governors, and all members of the local boards were to be appointed by the Central Government. The nationalization was a legal recognition of the well accepted principle, that the policies pursued by the Central banking institution have to sub serve the social and economic objectives of its government.

The next important step was the passing of the Banking Companies Act in March 1949, renamed the Banking Regulation Act in 1966. Under the Act, the RBI was conferred a wide range of regulatory and supervisory powers relating to the establishment of a bank and maintenance of a certain minimum operating standards.

1.2.2 Commercial Banks

India has registered phenomenal development in all fields in the last two decades. This development could be seen in particular in trade, production, export, finance etc., a concomitant to this has been the exceptional growth of the banking sector.

Banks have a crucial role in mobilizing funds for capital formation, towards this purpose a number of branches have been opened to cover all geographical areas, also specialized services have been covered through merchant banks, land mortgage banks, small scale industries banks, export-import bank etc., Some of the banks have been asked to spread out in the rural areas so as to tap the savings of these people. New schemes like the Lead Bank scheme have been promoted.
1.3 DIFFERENT TYPES OF COMMERCIAL BANKS

The commercial banks in India were classified into two types – scheduled and non-scheduled – on the basis of control that could be exercised by the RBI.

1.3.1 Scheduled Commercial Banks

The second schedule of the Reserve Bank of India Act contains a list of Banks which are described as “Scheduled Banks”\(^3\), a Bank in order to be designated as a Scheduled Bank, should have a paid up capital and reserves as prescribed by the Act. In terms of Sec. 42(6) of the RBI Act, 1934, the required amount is only Rs.5 lakh. However, presently to start a commercial bank, the RBI prescribed a minimum of Rs.100 Crores and its business must be managed in a manner which, in the opinion of Reserve Bank of India, is not detrimental to the interests of its depositors. The Scheduled Banks are also required to maintain with the Reserve Bank of India a deposit in the form of Cash Reserve Ratio, based on its net demand and time liabilities at a prescribed rate.

The scheduled banks enjoy several privileges. An account with a scheduled bank carries a greater assurance of safety and prestige value than an account with a Non-scheduled bank. It is entitled to receive refinance facility as applicable. It may also get currency chest facility. In times of urgent need, it may obtain finance from the Reserve bank of India to help it tide over temporary financial difficulties. Furthermore, the settlement of accounts between scheduled banks is facilitated by the use of the Bankers’ “clearing house procedure”. On the other hand, scheduled banks have to submit several returns to the Reserve Bank of India and are obliged to comply with the directions received from the Reserve Bank. Some of these returns have to be submitted in each week, usually on Friday. The affairs of Scheduled Banks are closely watched and largely controlled by the Reserve Bank of India, in order to safeguard the general health of the banking industry as a whole.

\(^3\) Batra, A.K., Village Adoption by the State Bank of India, Genesis and Experience, State Bank of India Monthly Review (SBIMB), April 1977.
The scheduled banks can again be grouped into a few types. The State bank of India (SBI) is a class by itself. It was established in July 1955 by transferring the entire share of capital of the Imperial Bank of India to the RBI. The Bank was constituted according to the preamble to the State Bank of India Act with one of the main objectives as, “the extension of banking facilities on a large-scale, more particularly in the rural and semi-urban areas”. The Act itself provided that not less than 400 branches should be opened within the first five years of its working. An Integration and Development Fund was created to meet a portion of the losses that might be incurred on this account. The size of the SBI, from the start itself was gigantic in relation to other schedule banks. Its relative share in the total of paid-up capital and reserves for all Indian scheduled banks stood at 20 per cent in 1961, and rose to 39 percent in 1977, and 47 percent in 1983.

Another group originated in 1950, when the SBI took over eight state-owned or state-associated banks as its subsidiaries. The State Bank of Hyderabad became the first subsidiary in October 1959 and the remaining seven banks – State bank of Jaipur, the State Bank of Indore, the State Bank of Bikaner, the State Bank of Travancore, the State Bank of Mysore, the State Bank of Patiala and the State Bank of Saurashtra – became the subsidiaries in the following year. In 1963, the State Bank of Bikaner and the State Bank of Jaipur were amalgamated. These seven banks, as envisaged in the statute, were transacting Government business as agent of SBI. Subsequently State Bank of Saurashtra and Sate Bank of Bikaner & Jaipur were merged with State Bank of India - Other scheduled commercial Banks include Public Sector Banks, Private Sector Banks etc.

1.3.2 Non-Scheduled Commercial Banks

The commercial banks, not included in the Second Schedule of the RBI Act are known as Non-Scheduled Banks. They are not entitled to get facilities like refinance

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4 Baviskar, B.S., Co-operatives and Politics, Economic and Political Weekly (EPW), 23 March 1968
and rediscounting of bills, etc., from RBI. They do not get the prestige like Scheduled banks. They are mainly engaged in lending money, discounting and collecting bills and various agency services. They insist higher security for loans. As on December 1999, there was only one non-scheduled bank viz. Sikkim Bank Ltd is in operation. RBI currently does not encourage the opening of non-scheduled banks. Efforts are being made to merge the only non-scheduled bank viz. Sikkim Bank Ltd, with Union Bank of India

1.4 NATIONALIZATION OF COMMERCIAL BANKS

The expansion in banking and changes in mode of operation that came in mid-sixties were found to be very unsatisfactory and some serious thinking started on how to make the commercial banks function according to our national priorities. The policy of social control was introduced in December 1967 and in July 1969, 14 banks with deposit of Rs.50 crores and above were nationalized. In April 1980, six more were added to the nationalized sector. The nationalized banks came to occupy a very important position in Indian banking.

1.4.1 Reason for Nationalization

The banks are nationalized during the tenure of the then Prime Minister Smt. Indira Gandhi and she quoted the following reasons for the nationalization.

1. The removal of control by a few.
2. Provision of adequate credit facilities to agriculture, small industry and exports.
3. The giving of professional bent to bank management.
4. The encouragement of new classes of entrepreneurs and
5. The provision of adequate training as well as reasonable terms of service for bank staff.
1.4.2 Achievements of Nationalized Banks

Nationalization of banks in India did a wonderful job, particularly in the following areas and spheres of activities:

1. Taking banking service to rural and remote areas.
2. Awakening the rural masses about the need and usefulness of banking Service.
3. Helping enormously speedy transfer of funds from one place to another.
4. Providing thousands of job opportunities to educated youth
5. Making credit available to neglected people like agricultural labourers, small traders at reduced interest rate.
6. Helping to free the rural poor from the clutches of money lenders.
7. Ensuring adequate and timely credit for agricultural activities and farming Operations.
8. Priority sector advances ensured adequate supply of credit to weaker Sections of the society like village artisans, laborers, scheduled caste and Tribes.
9. Helping export sector to obtain cheap credit.
10. Ensuring even-supply of credit to various industrial activities.
11. Avoiding diversion of funds to harmful activities like speculation in Shares, hoarding of essential commodities etc.
12. Ensured use of public money for social and desirable purposes.
13. Removing regional disparities in economic development.
14. Removing concentration of wealth in the hands of few industrialists.
15. Helping implementation of various welfare measures formulated by Government.
1.5 NPAS OF SCHEDULED COMMERCIAL BANKS

The importance of financial institution promoting economic development has come to be increasingly accepted in recent years by policy-makers in developing economies, even though their role in economic growth has been recognized in the Economic literature for quite some time. Financial institutions can help development process by influencing both savings and investments. Financial intermediaries help to raise the level of savings by enabling economic units to hold their surpluses in assets, which are of stable money value and of negligible risk of default. In the absence of such assets, the ultimate lenders may have to channel the surpluses into riskier assets, which can act as a disincentive for savings.

For directing the community’s saving towards preferred activities as per the planned objectives, the Government has first to ensure that it gets hold of the largest share of savings. In this pursuit, the banking system has a very important role to play. By devising various target groups among different segments of the population and through establishing a close relation of mutual benefit the banks can play a really useful role in mobilizing savings.

1.6 NPAS OF SCHEDULED COMMERCIAL BANK IN TAMILNADU

Tamilnadu has its due share in the economic development of the nation. It has also provided funds for capital formation by exploiting the savings potential of the people.

There are a variety of institutions that approach the public for funds. There are the co-operative banks, scheduled banks, rural banks, foreign banks etc. Post office savings is another institution inviting deposits. Non-banking finance companies are also in the race for funds.
All these organizations do business in Tamilnadu through lending operations. They offer loans for land development, housing, education; business, manufacturing etc. The rate of interest varies with respect to different schemes offered by these organizations.

The scheduled commercial banks have a special role to play. They have their operations not only in the urban areas, but are also compelled to operate in rural areas in Tamilnadu. To manage the operations successfully, these banks are duty bound to mobilize the deposits from the customers in the form of savings. The co-operative banks also have an important role to play in resource mobilization, particularly in rural areas of Tamilnadu. Until recent years these were the only organized institutions available there.

The interest rates for deposits that they could offer were regulated by the Reserve Bank of India. In lending operation also, they were not free to operate. They have to follow Government’s guidelines and also the restrictions of Reserve Bank of India. Further there is also the competition from other institutions viz., Government organizations and companies and Private and Non-banking finance companies which limit the potential of their performance in Tamilnadu. Liberalization in its wake has brought in competition from foreign banks. Life Insurance Corporation, Private sector insurance companies, General Insurance Corporation, Mutual Fund Companies etc., mop off a portion of savings of the public.

Under these conditions, it would be proper and fitting to study the functioning of the scheduled commercial banks in Tamilnadu both in NPAs and advances. During the last of ten years Tamilnadu has contributed significantly for both advances and NPAs.
1.7 ADVANCES OF SCHEDULED COMMERCIAL BANKS

The basic function of credit, whether provided by scheduled commercial banks or by other sources, is to enable individuals and business enterprises to purchase goods and/or services ahead of their ability or desire to pay. Demand for credit by business firms arises because of the time consuming nature of the productive and distributive processes. Consumers demand credit to acquire goods in advance for which they pay in future. The time gap between production, distribution and consumption gives scope for the wide use of credit and with the development of the economy and its complexities, a number of financial institutions have come to birth – general and specialized. Credit demands are accommodated by savings, but the demand for credit for productive purposes outstrips savings, and hence the need for additional funds from financial institutions. Commercial banks fill the credit demands that are not accommodated by the savings process and other financial institutions. As a result, the commercial banking system is a residual supplier of credit.

The resources obtained by banks through deposits and borrowings have to be deployed properly to get the maximum return from it, in terms of profit and the socio-economic objectives of the Government. A substantial part of the resources is, however, pre-empted by the cash reserve and statutory liquidity ratio requirements. Of the remaining resources also a large chunk is subject to RBI’s regulation. The credit policy of the Government and the rigidly with which it is implemented determines the amount of deployable resources available to a bank and also the areas where it can be profitably deployed.

1.8 ADVANCES OF SCHEDULED COMMERCIAL BANKS IN TAMILNADU

The advances of scheduled commercial banks in Tamilnadu are growing at a rapid pace. The scheduled commercial banks are aggressively lending for the development of the economic condition of the people of Tamilnadu by means of giving loans for productive purposes. The loans are given especially to small-scale industries, weaker sections, women, physically handicapped, SC/ST, agriculture and allied activities and industries etc.
In Tamilnadu, the scheduled commercial banks are disbursing the loans to the people living in rural areas, semi urban and urban areas to meet the requirement of agricultural sector and industrial sectors.

1.9 NEED AND IMPORTANCE OF THE STUDY

Commercial banks essentially being commercial organizations, the profit factor cannot be ignored at all, and Profitability of banking operation is very important if banking sector is not to end up as a millstone round the neck of our growing economy. The banking sector has to keep the costs low and optimize their earnings and profitability, so that they retain their vitality and innovativeness. Therefore, in the changing economic environment of competitiveness, efficiency and productivity, profits are not a taboo for the banking industry. Thus, maintaining continued viability and profitability could be considered as the greatest challenge before banks during this decade. Against such a backdrop, the need for a systematic study of the profitability performance of scheduled commercial banks and the impact of movement of lending’s and NPAs on profitability is considered as important.

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1.10 SCOPE OF THE STUDY

The components of reform involved dismantling certain directed credit programmes, lowering cash and liquidity requirements, reducing barriers to entry in the banking sector, minority ownership by private entities/individuals in the public sector banks, improving payments system, adopting international standards for capital adequacy and prudential norms and improving the legal, regulatory and supervisory infrastructure. The impact of financial liberalization can broadly be generalized as under: (i) Improved efficiency in the allocation of credit, Despite weaker economic conditions, private investment has grown and financial constraints have been erased; (ii) financial dependence has increased; (iii) the impact of liberalization on saving and/or consumption is mixed; (iv) the immediate impact on interest rates has been disparate, with rates sometimes rising and in some countries falling; (v) Financial liberalization has generally resulted in more effective monetary control. So this study has got good scope for the microscopic research in banking with focus on trends of profitability, advances and NPAs.

1.11 OBJECTIVES OF THE STUDY

- To study the NPAs of scheduled commercial banks in Tamilnadu.
- To study the advances of scheduled commercial banks in Tamilnadu.
- To identify the population served by scheduled commercial banks and the public opinion about the performance of Banks in handling NPAs and advances of scheduled commercial banks in Tamilnadu.
- To offer suggestions and recommendations for differently handling the trinity of profitability, advances and NPAs.
1.12 HYPOTHESES

**Null Hypothesis 1:** There is no significant difference in the NPAs of region wise scheduled commercial banks in the span of ten years.

**Alternative Hypothesis 1:** There is a significant difference in the NPAs of region wise scheduled commercial banks in the span of ten years.

**Null Hypothesis 2:** There is no significant difference in the advances of region wise scheduled commercial banks in the span of ten years.

**Alternative Hypothesis 2:** There is a significant difference in the advances of region wise scheduled commercial banks in the span of ten years.

**Null Hypothesis 3:** Government policies and directives of RBI do not affect the NPAs and advances of scheduled commercial banks in Tamilnadu.

**Alternative Hypothesis 3:** Government policies and directives of RBI affect the NPAs and advances of scheduled commercial banks in Tamilnadu.

1.13 METHODOLOGY

This study is based on both primary data and secondary data. The primary data is obtained in the form of response of customers of scheduled commercial banks through properly framed questionnaire. This questionnaire consists of personal and occupational details of customers, their awareness on NPAs and advances of scheduled commercial banks. Most of the questions are of an optional type and statement types with Likerts 5-point scale from strongly agree to strongly disagree. The secondary data is obtained from statistical handbooks and brochures published by Reserve Bank of India. The collected data is subject to statistical treatment to obtain a torrent of results.
1.13.1 Pilot Study and Pre Testing

A preliminary investigation was undertaken by contracting fifty customers of different banks in and around Chennai city and a convenient random sampling method was applied to test the reliability of statements in the questionnaire. The purpose of the pilot study was to test the quality of items in the questionnaire and to confirm the feasibility of the study. The Cronbach alpha method of reliability is used to find the reliability of statements using hotelings t-test.

<table>
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<th>Statement Numbers</th>
<th>Cronbach Alpha value</th>
<th>Hoteling t-square value</th>
<th>Significance</th>
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<td>01 to 10</td>
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<td>0732.42</td>
<td>0.000</td>
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<td>11 to 16</td>
<td>0.818</td>
<td>1826.81</td>
<td>0.000</td>
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<td>17 to 25</td>
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<td>0.571</td>
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<tr>
<td>41 to 47</td>
<td>0.449</td>
<td>0563.91</td>
<td>0.000</td>
</tr>
</tbody>
</table>

The above clearly revealed that the statements in the questionnaire are highly reliable at 5% level of significance for the research.

1.13.2 Sampling

A sample of 612 customers of scheduled commercial banks in rural, semi urban and metropolitan city areas in Tamilnadu are interviewed in a rational and random sampling method and they are requested to express their response through the reliable and perfect questionnaire. Out of these samples only 516 samples are found usable for statistical analysis. Hence, exact number of samples of the study was 516. The random sampling method enables to reveal the characteristic features of population perfectly.
1.13.3 Statistical tools used

1. Factor analysis with varimax rotation is used to reduce the number of variables into major factors in primary data.
2. K-means cluster analysis is exploited to classify the samples into heterogeneous groups.
3. Karl Pearson’s coefficient of correlation is used to find the relationship between the variables.
4. Linear multiple regression analysis is brought to bear upon the problem of identifying the impact of independent variables on dependent variable.
5. Parametric paired sample t-test, analysis of variance (ANOVA) is used to find the significant difference among means of the variables.
6. Non-parametric chi-square test is used to find the association between the variables.

1.14 LIMITATIONS OF THE STUDY

This study is limited to scheduled commercial banks in Tamilnadu, the core of the study concentrates only on two aspects NPAs and advances. This study is restricted to the time limit of 10 years from 2003-04 to 2012-13. A sample of 516 customers is considered for the study. Any generalization of this study for all types of bank in India may lead to misleading results. This result may not be considered profoundly for all the years in past and future. Analyzing a various aspects of banking industry may also give various results different from this study. The collection of more samples from different districts and regions may also give different results.
1.15 CHAPTER ARRANGEMENT

Chapter-1 gives a brief introduction about banking industry and its development in all India level and Tamilnadu, need and importance of the study, objectives of the study, hypothesis, methodology, and sampling, statistical tools used chapter arrangement and limitation of the study.

Chapter-2 deals elaborately with review of related literature about banking industry, banking development, and its impact on Indian economy.

Chapter-3 deals with NPAs of scheduled commercial banks in all India level and Tamilnadu.

Chapter-4 deals with an elaborate account on advances of scheduled commercial banks in all India level and Tamilnadu.

Chapter-5 transparently expounds the developmental trends of scheduled commercial banks.

Chapter-6 explains about customer awareness on NPAs and advances of scheduled commercial banks.

Chapter-7 gives the detail of summary of findings, conclusions and suggestions.

CONCLUDING COMMENTS

This chapter has given a brief introduction about commercial banks and their objectives of service according to the direction of RBI, objectives of the study, research methodology and chapters presented in the study. The next chapter analyses thoroughly the research works of different researchers in this area and also reveals how this study differs from other studies significantly.
REFERENCES


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Baviskar, B.S., Co-operatives and Politics, Economic and Political Weekly (EPW), 23 March 1968


