CHAPTER 3
INDIAN BANKING INDUSTRY- AN OVERVIEW

The present chapter gives the historical development of commercial banking in India in chronological order. A developed banking system holds the key as well as serves as a barometer of economic health. For the reason, it would be very useful to analyze, its real meaning and Indian banking since its evolution with reference to some distinct phases. The first phase of Indian banking is the period from 1770 to 1947, the second phase from Nationalization of Indian Banks and up to 1991 and the third phase, 1991 onwards. The current period of banking reforms started from 1991. The chapter analyzes the broad structure of the banking industry in India. The banking industry has become a catalyst for growth & development. In the present chapter an attempt has been made to study the present scenario of Indian Banking Industry in terms of certain major indicators. The main objective of the chapter is to set up the ground and the logic for the next coming chapter on operational efficiency in banking sector.

3.1 Introduction to Banking Industry

Literally, a ‘Bank’ means an establishment for receiving, keeping, lending or sometimes, issuing money and making easier the exchange of funds by cheques, notes, etc. But the word ‘Bank’ dates back its origin to antiquities. There is divided opinion in this connection.

The Bank of Venice, established in 1157, in Italy is considered to be the first bank in the history of banking. The word for joint stock fund was ‘banck’ meaning literally a ‘heap’ or ‘mound’. The Italians converted the word into ‘banco’ and used it to denote an accumulation of either stock or money. ‘Banca di Venezia’ was a joint stock venture and meant literally ‘Joint Stock Fund of Venice’. The terms as originally used, therefore, did not imply all of the functions associated with the word ‘bank’ today (Pritchard, 2000).

The word ‘bank’ can be linked to an Italian word ‘banco’ and the French word ‘banque’ meaning ‘bench’ and ‘chest’ respectively. The word ‘banco’ refers to a table or a counter or to a place for transacting business. In context of a bank, the benches consist of a teller’s window, a loan officer’s desk, a bank manager’s cabin desk and so on. The benches provide a medium to the customers to access the bank for making transactions. A chest is a place where various valuable assets are kept; it refers to the safe keeping function. Now days, a modern bank's chest is also its medium of earning assets. These are the silent earners for bank. Thus, these words sum up the two basic functions of commercial banks: (A) Furnishing a place for transacting business in money and (B) Providing safekeeping functions (Ahmad, 1992).

According to Indian Banking Companies Act of 1949, define "Banking Company as a company which transacts the business of banking in India. It defines banking as, accepting money for the purpose of lending or investment of deposited money from the public, repayable on demand or otherwise, and withdrawable by cheque, draft and on order or otherwise". Hence, a bank is the institution which deals in money and credit. In addition to it, it safeguards public savings and issues loans and advances.

3.2 History of Indian Banking Industry

Banking, if equated with money lending, is perhaps as old as the civilization itself. Banking existed as early as 2000 B.C. but not in today's complex form. It was during this period that Babylonians had developed a banking system. Then temples were used for lending at higher rate of interest against the mortgage in terms of gold and silver. In India, banking was in existence during the Vedic period (from 2000 B.C to 1400 B.C.). At that time money was accepted on deposit and given in the form of advances. In second century A.D., Manu, the great Hindu scholar, devoted a part of his works to deposit and pledges, laid down various rules regarding rates of interest to be charged and paid as well as recovery of debt. The laws of Manu gave the wide powers to the creditors for the recovery of the debt. During Ramayana and Mahabharata period, banking, which was earlier a side business, emerged as a full time business activity. During the Smrithi period, the methods of regulation of interest were explained in Smrithis that were used to carry out the banking business. The bankers that time performed various functions like a modern banker these days viz. accepting the deposits, issuing of advances, a banker to the state and managing country's currency. Initially, the banking largely meant lending of money and it was limited a special part of societies working as proprietary firms. During the Mauryan period, indigenous banking was in its prime. In every big and small town, there was a 'Seth', 'Shah' or 'Sahukar' who performed a number of banking functions, played a very important role in money lending , financing foreign trade and commerce.

Kautilya's in his book Arthashastra, which was written in the Maurya period in 4^{th} century B.C., has also made a reference to the banking transactions. These references testify the existence of banking in olden days. Hundi (derived from Sanskrit word 'hund') which is actively used even in today's banking system dates back to the days of Mahabharata. The transfer of fund from one place to another, at a fair distance, took place with the help of Hundis. Not only had this, during Mughal rule, the issue of various kinds of metallic money in different parts of the country provided the indigenous bankers great opportunities for developing the very profitable business of money changing. Those who carried out this business were appointed mini officers, revenue collectors, bankers and money changers to the Government in various parts of the empire. A few of these indigenous bankers were quit famous and wielded great influence in the country. They were known as 'Jagat Sath' (world bankers) and possessed great power as the private bankers of any western country (Kaushal, 1979).

3.2.1 Development of Banking during British Periods

The English traders came to India in the 17^{th} century. They found a reasonably well- established indigenous banking system, but they could not get any advantage from the indigenous bankers mainly due to their ignorance of the latter's language and the latter's experience of the financing of the trade. The East India Company in 1600 A.D. came to India as trader and it established its Agency Houses with no capital of their own but depended totally on deposits. Therefore, the English Agency Houses, which were primarily commercial undertakings, began to conduct banking business also, so as to meet the needs of the company, the members of the services and the European merchants in India.

From this time, the business and power of indigenous bankers began to decline. The continuous wars and chaos that resulted from the breakup of the Mughal Empire also weakened the system of indigenous banking a great deal. Further, they lost their profitable money-changing business from 1835 when a uniform currency was established throughout the country. The decline of indigenous banking and gradual expansion of English trade and power in India led the establishment of banks on Western lines. Though indigenous banks lost their business in the urban areas, they continued to have a separate existence in the rural areas where these modern banks could not penetrate (Chawla and Uppal, 1998).

Not all Agency Houses carried on banking business but many of them performed the three functions of receiving deposits, paying drafts and discounting bills, thus paving the way for the establishment of joint stock banks.

3.3 Phases of Indian Banking System

The growth of Indian Banking System can be classified into three different phases. They are as follows:

- Phase-I Pre-Independence Period (From 1770 to1947)
- Phase-II Post-Independence Pre-reforms Period (During the Nationalization of various Indian Banks and till 1991 which is prior to Indian Banking Sector Reforms).
- Phase-III Post Nationalization of Indian Banking System (From 1991 till date).

3.3.1 Phase I

The first joint stock bank under European direction in India was the Bank of Hindustan which was set up by an Agency House namely, Alexander and Co. in 1770 at Calcutta. Several other such banks were also established but during the crisis of 1829-32, many of the Agency Houses failed due to "gross-mismanagement, wild speculation and extravagant living" on the part of extravagant officials managing the Agency Houses. Between 1800-1858, more than 40 banks were established, but hardly 12 of them survived (Vaswani, 1998).

It was only during the first –half of the 19^{th} century that East India Company made some sincere efforts to establish three banks formally, viz.: (i) The Bank of Bengal in the year 1809 (ii) The Bank of Bombay in 1840 and (iii) Bank of Madras in 1843. These banks were known as Presidency Banks and they functioned well. The Imperial Bank of India Act was passed in the year 1920 and these banks were amalgamated.

To each of these three Presidency Banks, the Government had subscribed Rs. 3 lakh. The bulk of share capital had come from private shareholders, mostly Europeans. These banks were given the monopoly of Government banking. After 1823, they were also given the right to issue notes which was taken back by the Government in 1862.

Imperial Bank of India was established in 1921 to protect these banks against the competition of foreign banks (Kaushal, 1979).

The passing of the Act of 1860 marked a landmark in the history of joint stock banking in India, which permitted the starting of joint stock banks on the basis of limited liability. A large number of banks were established, without any careful plan and objectives. Most of them failed in a short time destroying public confidence in banks. Later in 1865, the Allahabad Bank was established followed by the Alliance Bank of Shimla in 1875 both under British management. The first bank on limited management by Indians was the Oudh Commercial Bank, which was established in the year 1881 in Faizabad. Subsequently through the efforts of Lala Harkrishan Lal, 'The Napoleon of Punjab Finance', The Punjab National Bank was established in 1894 with headquarters at Lahore under the Indian management and is one of the nationalized bank at present. Generally speaking, the period 1860-1900 was characterized by a very slow development of banking. This may be seen from the fact that in the last three decades of the 19^{th} century, the three Presidency Banks together with Indian Joint stock banks added to their capital a mere rupees three crores and to their deposits only rupees fourteen crores. However, uncertainties of exchange were mainly responsible for the slow rate of banking progress. Thus, the Indian joint stock passed through a remarkable phase during the last decade of 19^{th} century. Indian joint stock banks were hardly in existence during the period 1860-80. During the next decade, they gained in size and strength. The Swadeshi Movement which began in 1906 gave a great stimulus to banking. During the period of 1900-13 a number of joint stock banks were started by Indians. Some of the prosperous banks of today, the Bank of India, the Bank of Baroda, the Bank of Mysore, the Central Bank of India, the Canara Bank and the Indian Bank were established during this period (Chakroborty, Rajesh 2006).

During this period, banks no doubt, grew in size and number, but no significant development in customer services took place. Social touch in customer satisfaction was still lacking. Then there came banking crises wiping out many a weak units. During the First World War the period of (1914-18), through the end of Second World War (1939-45) and the years (1948-53) after the independence of India witnessed a lot of bank failures. The reasons evident were wrong policies followed by their management. Undesirable and wasteful competition amongst themselves for speculative or long-term purposes, indiscriminate lending and advancing against undesirable securities and combining banking functions with trade and industry were yet other major reasons responsible for bank failures. The banking crisis of 1948-53 was due to the partition of India. One very serious drawback of the Indian banking system was the absence of any worthwhile control over the activities of commercial banks.

The partition of the country in 1947 gave a further jolt to the banking system of the country. Bank advances declined on account of communal disturbances in several parts of the country. Banks, having their head offices and branches in West Punjab, were hit hard, for they could not transfer their assets of the Indian Union. At such a time, the Reserve Bank came to their rescue by making advances against any security which it thought proper. Thus, the establishment of RBI on April 1, 1935, in accordance with the provisions of the RBI Act, 1934, as the Central Bank of the country filled a big gap in India's banking structure and met one of the necessary conditions for a healthy growth of the banking in the country (Kaushal, 1979).

3.3.1.1 Deficiencies of Indian Banking System before Nationalization

Commercial banks, which were privately managed and owned, on regional basis resulted in banking on ethnic and provincial basis with local outlook. These banks could not play much role in the planned and systematic development of the nation. In first phase the growth was slow and periodic failures of various banks was witnessed between 1913 and 1948. There were approximately 1100 small banks. Deposit mobilization did not gather pace. Public had low confidence in these banks due to frequent failures of these banks and the savings account facility which was provided by postal department was considered safer. Even that saving by commercial banks could not be channelized and utilized for the economical development of the country. Mostly funds were given to large and small traders, which hoarded agricultural produce creating a situation of artificial scarcity, with motives of profit making in selling them at a much higher price later.

3.3.2 Phase II

The phase of banking growth and development started only after independence. Government took major steps after independence. The year 1949 marks the beginning of the new era in the history of the Indian banking as a comprehensive legislation was passed. Under this legislation, the RBI was given wide powers of control and supervision of the activities of other commercial banks. To ensure an increased flow of assistance to the neglected sectors and to extent banking facilities in unbanked and under banked centers, the government floated the idea of nationalization of banks (Nalini and Tripathy, 2005). The All India Rural Credit Survey Committee pointed out that the inability of the Imperial Bank of India was carrying out due to branch expansion programme. The Committee suggested conversion of Imperial Bank of India to State Bank of India. The Government accepted the recommendation and in 1955, '*The Imperial Bank of India'* was nationalized and was renamed as the '*State Bank of India'* which constituted as the principal agent of RBI. Before the nationalization of other Indian Banks, only State Bank of India (SBI) was a nationalized bank. It was nationalized in July 1955 by the State Bank of India Act of 1955. Banks such as - State Bank of Hyderabad, State Bank of Bikaner & Jaipur, State Bank of Travancore, State Bank of Mysore, State Bank of Patiala, State Bank of Saurashtra and State Bank of Indore forming subsidiary of State Bank of India were also nationalized in the year 1959. On 19th July, 1969 major step of nationalization was carried out by the nationalization of 14 commercial banks due to the efforts of then Prime Minister of India*; Mrs. Indira Gandhi* in order to ensure the economic development of the country in desired directions. These 14 major commercial banks had aggregate deposits of Rs. 50 crores or more. At the time of nationalization, these commercial banks had a total of 4,135 branches.

In continuation of this process, 6 more banks having demand and time liabilities amounted to more than Rs. 200 crores were nationalized on 15th April, 1980 when the government wanted the large banks to fall in line with its goal of obtaining national objectives. The second wave of nationalization occurred because control over the banking system became increasingly more important as a means to ensure priority sector lending, to reach to the poor through a widening branch network and to fund rising public deficits. In addition to the nationalization of banks, the priority sector lending targets were raised to 40 percent (Arun and Turner, 2002). In September 1993, the number of nationalized banks came down to 19 as New Bank of India was merged into Punjab National Bank. The Government paid Rs. 185 crores as compensation to the six banking companies in cash or promissory notes or in both (Government of India 1970, Report on Nationalization of Banks).

3.3.2.1 Need of Nationalization

Nationalization was undertaken for imposing social control to cure the basic weaknesses of India's banking system. It was felt that banks were catering the requirements of the large corporate houses and majorly remained beyond the access of the masses. Credit requirements and other needs of the small scale industries, agriculture and export sectors were never given priority. The purpose of nationalization was to set priority to caters the credit requirements of the priority sectors and also this credit facility was to be extended at a subsidized rate i.e., rates of interest were lower than the interest rate charged from larger business units. The objective of Nationalization was to provide the maximum benefit to the larger number of people. Nationalization of the banks had below mentioned six-fold objectives (a) Preventing concentration of economic power, (b) Channel the bank finance to plan-priority sectors, (c) Public confidence in Banking system, (d) Regulation of the flow of National Savings (e) Provision of training and better service conditions for bank's staff and (f) Expansion of banking facilities to neglected rural areas.

3.3.2.2 Impact of Nationalization

- Nationalization of the commercial banks during 1969 and 1980 was a mixed blessing. It brought a drastic change in the priority setting mechanism of Indian banks. There was a transfer of emphasis from industry sector to agriculture sector. Now the banks got transformed from profit oriented privately managed and only urban based banking institution into a public sector banking industry which was based on the principle of social justice and was development oriented.
- Now the, social aspect also became significant after nationalization. It led to transfer Class banking to Mass banking, from wholesale banking to retail banking and from macro-banking to micro banking for socio-economic development of the country.
- Commercial banks also give a special attention on the branch expansion in rural areas. Moreover there was a sustainable effort towards growth of banking particularly in unbanked areas. Banks opened many branches in rural

and semi-urban areas also. After nationalization of banks, the branches of the public sector bank increased to approximately 800% and deposits and advances amount took a huge jump by 11,000%.

3.3.3 Phase III

Before the financial sector reforms, Indian banking operated under structural rigidity and external constraints besides working under a protected environment. Financial sector reforms in India were grounded believing that competitive efficiency in the real sectors of the economy will not be complete unless the financial sector was reformed as well. A process of liberalization of the financial sector was initiated in 1991-92, which aimed at creating a more diversified, profitable, efficient and resilient banking system (Government of India 1991, Narasimham Committee Report -I).

These reforms tried to enhance the viability and efficiency of the banking sector. The financial sector reforms emphasized the need to improve productivity of the banks through appropriate rationalization measures so as to reduce the operating cost and improve the profitability (Shikha Jain, 2010). This had been done for the rapid growth in the economy and to revitalize the Indian banking sector which witnessed rapid growth due to strong contribution from below mentioned sectors of banks. Thus, the principal objectives of the financial reforms was to improve the allocative efficiency of resources and to speed up the growth process of the financial sector by removing structural deficiencies which affected the performance of financial institutions and financial markets. The basic objectives, therefore, of the financial sector reforms process in India initiated in the early 1990's had been to (1) remove financial repression that existed earlier (2) create an efficient, productive and profitable financial sector industry (3) enable price discovery, particularly, by the market determination of interest rates that helps in efficient allocation of resources (4) provide operational and functional autonomy to institutions, (5) prepare the financial system for increasing international competition, (6) open the external sector in a calibrated fashion and (7) promote the maintenance of financial stability even in the face of domestic and external shock (Government of India 1991, Narasimham Committee Report -I).

Commercial banking sector reforms were carried out in two phases. The major aim of the reforms in the early phase, known as first generation of reforms, was to create an efficient, productive and profitable financial service industry operating flexibility and functional autonomy. While these reforms were being implemented, the world economy also witnessed significant changes, coinciding with the movement towards global integration of financial services (Government of India 1998, Narasimham Committee Report-II**).** The focus of the second phase of financial sector reforms starting from the second half of the 1990's therefore has been towards the strengthening of the financial system, introduction of structural improvement and in easing external constraints on the operations, enhancing transparency in various reporting procedures, recapitalizing and restructuring banks and increasing the competitive environment in the market.

Under the financial sector reforms various regulatory frame works of banking have been taken places which are as follows:

- **Structural Regulations**: Structural regulations broadly refer to the norms relating to lowered entry barriers and de-licensing of branches etc. as one of the major objectives of the banking reforms. On the basis of suggestions of Narasimham Committee, the Banking Regulation Act was amended in 1993 and thus the new private sector banks were permitted to enter. Deregulation of entry of new private sector banks both indigenous as well as foreign allow to strengthen the allocation efficiency of system. Increased competition could make the banks more efficient and bring about improvements that would ultimately benefit the masses. Branch licensing has been abolished and the branch expansion norms were relaxed. Banks have been given the liberty to open or shutter down branches as suitable to their operations. Liberalization of the branch licensing policy allowed banks with more freedom to plan branch expansion as per the market needs for increasing competition among various public sector banks.
- **Deregulating the Interest Rates**: Banks now have gained more flexibility in their operations after deregulation of interest rates. Further, the subsidized rates of interest in priority sector lending have been covered up from borrowers of higher credit amounts. The general interest rates were applicable to non-priority sector borrowers. Under deregulation of interest rates banks were free to fix interest rates on the term deposits up to one year and on all advances more than 2 lakhs. The deregulation of interest rates in the recent

years has witnessed the competitiveness in the financial environment and has seen strengthening of monetary policy's transmission mechanism.

- **Capital Adequacy Requirements:** The first capital accord of 1998 evolved by the Basel Committee provided a frame work for a fair and reasonable degree of consistency in the application of capital standards. In order to strengthen the financial position of banks, minimum Capital to Risk weighted Assets Ratio (CRAR) was prescribed at 8% which was further increased to 9% with effect from 31 March 2000. The committee further recommended an increase in the minimum Capital to Risk weighted Assets Ratio to 10% by 2002 from level of 9%. These high standards are expected to strengthen the financial soundness of the banks, while continuing to keep them in line with International standards. In an attempt to stabilize the bank's positions during this transition phase, the Government contributed capital to a few among the weak nationalized banks to strengthen their capital base. It also permitted some of these banks to set off their accumulated losses against their capital. All these measures were taken in order to ensure that the Indian banking system reaches the global standards.
- **Prudential Norms for Income Recognition, Assets Classification and Provisioning:** Prudential norms were introduced to strengthen the bank's balance sheets and enhance transparency. These prudential norms which relate to income recognition, assets classification and provisioning for bad and doubtful debts serve two important purposes- first; the income recognition norms reflect a true picture of the income and expenditure of the bank. The initial reforms measures concentrated on cleaning the balance-sheets of banks. Secondly, the asset classification and provisioning norms helped in assessing the quality of the asset portfolio of the bank. The assets classification norms classified the assets into four categories, like 1.Standard Assets 2.Sub-standard Assets 3.Doubtful Assets and 4.Loss Assets were recommended with appropriate provisioning requirement for each category. The concept of "Past due" date in the identification of NPAs was dispensed with effect from March 2001 and a 90 day norm was also adopted for the classification of non-performing assets with effect from March 2004. The significant measures taken in this regard are implementation of provisioning requirement of 0.25

percent in respect of standard asset (raised to 0.40 percent in mid-term review of annual policy for year 2005), reduction in the period for classification of doubtful assets from 24 months to 18 months with effect from March 31, 2001 and from 18 months to 12 months with effect from March 31, 2005.

- **Reduction in Statutory Requirements:** Cash Reserve Ratio (CRR) and Statutory Liquidity Ratio (SLR) are the reserve requirements and are part of instruments of the monetary policy control by RBI. There has been a shift from the direct monetary control method to the instruments based on market (1991-92). As a result of above changes statutory pre-emption in the form of CRR and SLR has been significantly reduced in phases. The SLR has been continuously brought down from its peak rate of 38.50 percent in February 1992 to the statutory minimum of 23 percent of July 2012. RBI reduced its policy interest rate by a widely expected 25 basis points. On these lines, CRR was also reduced to 4.25 percent with effect from November 03, 2012.
- **Strengthening of Supervisory Mechanism:** is essential for the sound banking system. There has to be an alert mechanism for monitoring compliance with prudential norms and directives of RBI and other regulatory agencies. The system of external supervision has been revamped by the establishment of the board for financial supervision with the operational support of the Department of Banking Supervision of RBI. In tune with international practices of supervision, a Three-Tier supervisory off-site monitoring and a periodical external auditing based on CAMELS (Capital Adequacy, Asset Quality, Management Earnings, Liquidity and Systems Controls) has been put in place. Development Financial Institutions and Non-Development Finance Institutions were also brought into the regulatory territory of RBI. The CAMELS approach has been made applicable to NBFCs also. A department of non-banking supervision has been created to exclusively supervise NBFCs only.
- **Additional Disclosure:** From the year 2002 onwards, the notes to the balance sheets contain information about the movement of provisions for NPAs and also held towards depreciation on investments. Non-SLR investments made through the private placement route should disclose information about the composition of the issuer and non-performing investments in the same

manner. Various efforts were made to detect and to develop and early warning system to indicate any financial crises. The approach is to bring together the use of micro-prudential indicators along with macro-economic indicators to develop a series of aggregate macro-prudential indicators.

- **Benchmarking against International Standards:** To benchmark the Indian banking practices with the international standards. Efforts are being made to ensure that the universally accepted standards and codes are practiced. The leading international agencies like World Bank and IMF are emphasizing on following the global standards. In India process has begun with the regulators and government concentrating on globally acceptable codes and standards for benchmarking the financial systems. With this the private sector can also bring into its purview regarding market disciplinary issue, corporate governance, insolvency procedures and credit rights. The action is necessary at legal policy & procedures and market practices. In December 1999, The Standing Committee on International Standards and Codes was set up to bring objectivity and foresight for study of relevant international codes and standards.
- **Recovery of Bad Loans:** The Reserve Bank of India and Central Government has initiated number of institutional measures to reduce the NPAs. These include Debt Recovery Tribunals (DRTs), Lok Adalat (people's court) and Assets Restructuring (CDR) Mechanism. Number of Settlement Advisory Committee (SACs) have also been set up at the regional and head office levels of commercial banks. Further, the banks can issue notice under the Securitization and Reconstruction of Financial Assets and Enforcement of Security Interest (SARFAESI) Act 2002 for acquisition of assets without intervention of courts.
- **Risk Management Guidelines:** With the progressive deregulation, risk management has assumed greater importance. In October 1999, The Reserve Bank has issued detailed guidelines for risk management systems in banks encompassing credit, market and operative risk. These guidelines also require the banks to evaluate their portfolio on an ongoing basis, rather than at the balance sheet date. As regards off-balance-sheet exposures, the current and potential credit exposures may be monitored on regular basis.

3.3.3.1 Impact of Liberalization

Liberalization has brought about changes in the way the banks operate. Terms like customer relationship and competition among the existing players and the new banks have taken the front seat. The national institutional and international boundaries are becoming less important. The globalization of operations and development of new technologies is taking place at a rapid pace. The reforms have led to the increase in resource productivity, increasing level of deposits, credits and profitability and decrease in non-performing assets (Bodla, B.S. & Verma, Richa 2006).

- **Better Customer Service**: A drastic change has been observed since 1991, long queues and non-cooperative staff have been replaced with service with a smile and single services window at the banks. Rising competition and initiation of Ombudsman Scheme by RBI brought customer service efficiency, quickness and value for money for the customer.
- **Technology up-gradation**: Technical up-gradation strengthen the management information systems which has cleared the way for the speed and accuracy and provided better foresight to get maximum returns on the bank's capital. All the branches have been interlinked nation-wide which have saved the customer from the hassle-off visiting the home branch only.
- **Encouragement of Bank Amalgamation**: Liberalization is the era where survival of fittest is the only condition and too save the small players various small banks were either amalgamated or got merged into other banks. As in 1993 New Bank of India was merged into Punjab National Bank.

3.4 Structure of the Indian Banking Industry

The banking sector in India functions under the control of RBI—the regulatory and the central bank of the country. The Reserve Bank of India was constituted in 1935 as per Reserve Bank of India Act 1934. The Banking Regulations Act passed in 1949 brought the RBI under government control. The whole banking system consists of scheduled and non-scheduled banks.

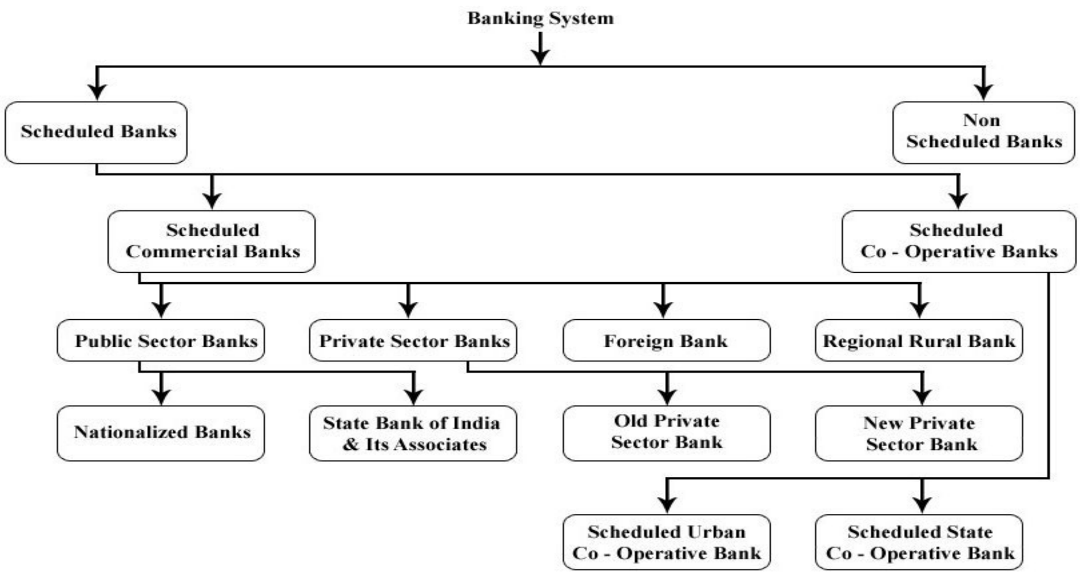

Figure 3.1 Structure of Scheduled Banking in India (As on March 31, 2012)

According to Banking Regulation Act 1965, a scheduled bank is that bank which has been included in the second schedule. These are the banks with a paid up capital and reserves of an aggregate value of not less than Rs. 5 lakhs and which satisfy RBI requirements laid down for this purpose. All commercial banks Indian and foreign, regional rural banks and cooperative banks are scheduled banks. On the other hand non-scheduled banks are those which have not been included in the Second Schedule of RBI Act, 1934. At present, there are few non- scheduled banks in India.

Scheduled commercial banks constitute the dominant section of the banking system. As on March 31, 2012, Indian banking industry composed of 174 scheduled banks. There are 83 Regional Rural Banks and 91 other commercial banks. A detailed list of these 91 commercial banks is given in Appendix- 1. Out of these 91 banks, there are 26 Public Sector Banks (PSBs), 22 Private Sector Banks and 43 Foreign Banks. In the Public sector bank category, there are 20 nationalized banks and 6 are classified as State Bank of India and its Associates. There are two types of private banks existing in India: (a) Old private that are 15 in number and (b) New private sector that are just 7 in number. Most of the Foreign Banks present in the country are functioning either through a complete branch or a subsidiary route presence or they are functioning via. their representative offices.

3.5 Present Scenario of Indian Banking Industry

India has a complex and integrated banking and financial system serving to all the financial intermediatory requirements of customers. The banking system is the most dynamic segment of our financial sector, almost 80% of the funds flow through the financial sector. Macro magnitude of banking indicates the fact that, it is a very big and dynamic sector of the economy. It plays a significant role in the growth of Indian economy. The statistical tables here under show the financial position of the banks as on 31st March, 2012.

3.5.1 Bank's Business Share in Market

In the banking terminology, the volume of business reflects the market share of a bank. Volume of business may be defined as the total of deposits, advances and the investments done by a bank. The overall business in the year 2011-12 by Indian banking industry was Rs. 141,183.90 billions. So, it is not a small sector of Indian economy in any way. A look on the volume of business and its components in the Indian Banking Industry (Table 3.1) is indicative of the fact that 52.49 percent of total business is in the hands of nationalized banks. Next 21.07 percent is with the State Bank of India and its Associates banks. So, in all 73.56 percent of total business is with Public sector banks. Private Banks contributes 18.89 percent of total banking business out of which Old Private Sector banks and New Private Sector bank contribute 4.64 percent and 14.25 percent respectively. The share of foreign banks is 5.00 percent only while Regional Rural Banks have just a 2.55 percent of the total business.

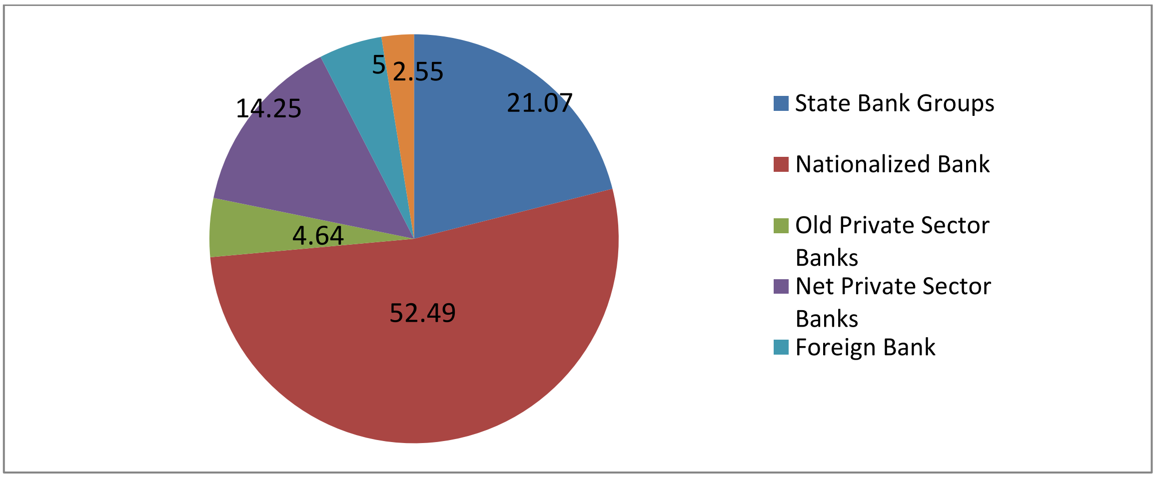

Fig 3.2 Banking Group-Wise Business Share in 2011-12

The break –up of this total business into its components like deposits, advances and investments shows almost the same pattern that is displayed by the total business. Thus public sector banks still form a major chunk of business in the Banking industry in India.

Table 3.1 Structure of Market Shares by various Banking Groups in the Year 2011-12 (In Billions)

Bank Groups	Deposits		Advances		Investments		Total Business	
	Amount	**%age**	**Amount**	**%age**	**Amount**	**%age**	**Amount**	**%age**
1.Public Sector Banks	50020.13	75.33	38783.12	74.76	15040.76	65.66	103844.01	73.56
(a)State Bank Groups	14050.24	21.16	11519.91	22.21	4173.22	18.22	29743.37	21.07
(b)Nationalized Bank	35969.89	54.17	27263.21	52.55	10867.54	47.44	74100.64	52.49
2.Private Banks	11745.87	17.69	9664.18	18.63	5259.82	22.96	26669.87	18.89
(a)Old Private Sector Banks	3158.91	4.76	2300.95	4.44	1093.33	4.77	6553.19	4.64
(b)New Private Sector Banks	8586.96	12.93	7363.23	14.19	4166.49	18.19	20116.68	14.25
3.Foreign Bank	2770.63	4.17	2298.49	4.43	2004.88	8.75	7074.00	5.00
Total Commercial Banks	64536.64	97.19	50745.79	97.82	22305.47	97.37	137587.90	97.45
4.Regional Rural Banks	1863.00	2.81	1130.00	2.18	603.00	2.63	3596.00	2.55
Total of All Banks	66399.64	100.00	51875.79	100.00	22908.47	100.00	141183.90	100.00

Source: Calculated from Annual Accounts of Respective Banks, IBA Bulletin, Jan2013

3.5.2 Bank's Main Financial Results

The structure of the main financial results is given in table 3.2. It gives information about the total income, total expenditure and the net profit. In terms of total share of income of public sector banks, in the total banking industry in year 2011-12, is to the tune of 70.32 percent. The share of Indian private banks is 20.83 percent and the share of foreign banks is just 6.21 percent. The Regional Rural Banks have just a share of 2.64 percent of the total income. The behavior of total expenditure, operating profit and Provisions and contingencies both in value terms and in proportionate share terms is exactly in tune with the total income. The regional rural banks contribute 2.74 percent of total expenditure, 1.87 percent in terms of operating profit and are 1.40 percent in terms of provision and contingencies. Further, a major chunk of profit also goes to the public sector banks. This share is 59.19 percent. The shares of Indian private and foreign banks in the total net profit of the industry are 27.16 percent and 11.27 percent, respectively. As compared to income and expenditure shares, the share of foreign banks in the total profit is slightly higher, that is an indicative of their better efficiency. So Indian Public Sector Banks also form a major share scale–wise.

Table 3.2 Structure of Main Financial Results of Indian Banking Industry in the Year 2011-12 (In Billions)

Bank Groups	Total Income		Total Expenditure		Operating Profit		Prov.& Contingencies		Net Profit	
	Amount	%age	Amount	%age	Amount	%age	Amount	%age	Amount	%age
1.Public Sector Banks	5350.98	70.32	4855.85	71.85	1163.44	65.93	668.31	72.00	495.14	59.19
(a)State Bank Groups	1613.78	21.21	1460.45	21.61	397.87	22.55	244.54	26.35	153.34	18.33
(b)Nationalized Bank	3737.20	49.11	3395.40	50.24	765.57	43.38	423.77	45.65	341.80	40.86
2.Private Banks	1584.78	20.83	1357.6	20.09	383.49	21.73	156.31	16.84	227.18	27.16
(a) Old Private Sector Banks	359.75	4.73	320.51	4.74	69.29	3.93	30.05	3.24	39.24	4.70
(b) New Private Sector Banks	1225.03	16.10	1037.1	15.35	314.20	17.80	126.26	13.60	187.94	22.47
3.Foreign Bank	472.23	6.21	377.97	5.60	184.82	10.47	90.56	9.76	94.26	11.27
Total Commercial Banks	7407.99	97.36	6591.42	97.53	1731.75	98.13	915.17	98.60	816.58	97.61
4.Regional Rural Banks	201.00	2.64	167.00	2.47	33.00	1.87	13.00	1.40	20.00	2.39
Total of All Banks	7608.99	100.0	6758.42	100.0	1764.75	100.0	928.18	100.0	836.58	100.0

Source: Calculated from Annual Accounts of Respective Banks, IBA Bulletin, Jan2013

3.5.3 Structure of Market Reach

In addition to market share, the reach of a service firm also determines its performance. The reach is a function of the number of service points, i.e., number of branches or number of offices and the staff it has in the market. Table 3.3 gives the distribution of total number of branches and the staff in the Indian Banking Industry. The share of nationalized banks in the number of branches is to the tune of 59.79 percent and the share of State Bank of India and its Associate Banks is 23.41 percent. In all 83.21 percent of the total branches are with the public sector banks. The share of private banks in terms of branches is 16.41 percent out of which 6.64 percent goes to Old private sector banks and 9.77 percent is in new private sector banks. The much-cited examples of productivity and efficiency, the foreign banks are just less than half percent in terms of number of branches. Similarly, in terms of staff (table 3.3), 76.22 percent of the total employment of banking industry is with the public sector banks. Private Banks have just 21.18 percent and the foreign banks have 2.60 percent of the total staff of the industry. It gives an illusion as if the public sector banks are overstaffed. Overall industry average staff per branch comes out to be 12. As compared to this benchmark, irrespective of the branch size, the nationalized banks have staff of just 11 per branch as against the 15 per branch in private banks, 18 per branch in new private sector banks and the mark of 81 per branch in foreign banks.

Table 3.3 Distribution of Total Number of Branches and Staff in Indian Banking Industry in Year 2011-12 (In Numbers)

Bank Groups	Branches		Staff		Staff Per Branch
	Number	Percent	Number	Percent	
1.Public Sector Banks	70314	83.21	771388	76.22	11
(a)State Bank Groups	19787	23.41	280256	27.69	14
(b) Nationalized Bank	50527	59.79	491132	48.53	10
2.Private Banks	13868	16.41	214304	21.18	15
(a) Old Private Sector Banks	5610	6.64	62965	6.22	11
(b) New Private Sector Banks	8258	9.77	151339	14.95	18
3.Foreign Bank	324	0.38	26335	2.60	81
Total of all Banks	84506	100.00	1012027	100.00	12

Source- Calculated from Annual Accounts of Respective Banks, IBA Bulletin, Jan2013

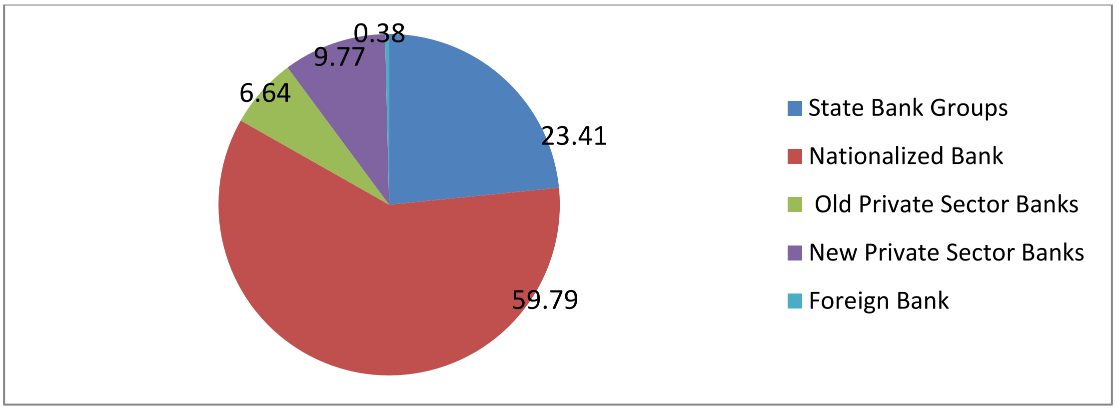

Figure 3.3 Bank–Wise Distribution of Total Number of Branches

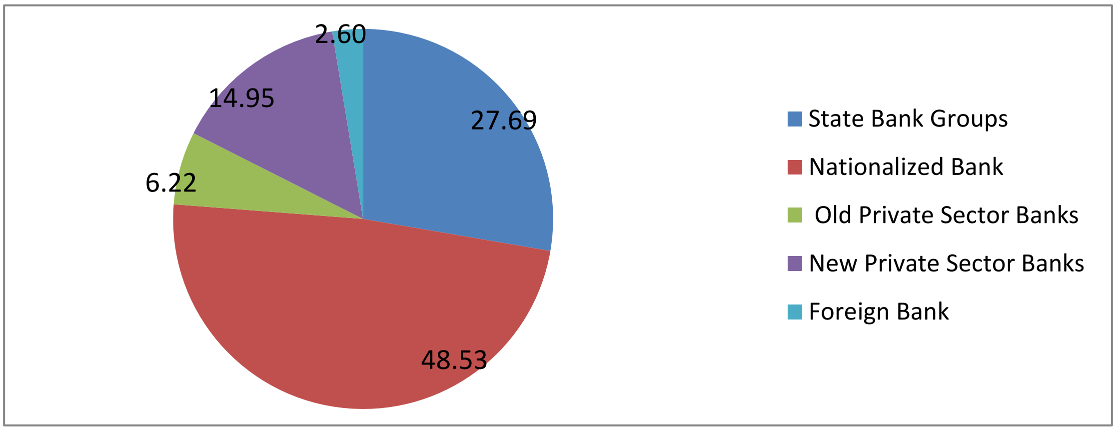

Figure 3.4 Bank-Wise Distribution of Staff

3.5.4 Distribution of Centres and Offices

Population group-wise distribution of centres and offices and centres of commercial banks (table 3.4) shows that number of centres and offices follow a skewed distribution. Centres are evenly distributed among the Central region, Eastern region and the Southern region. In terms of percentage share it comes to be more than 22 percent for each of these regions. In the Northern region there are only 14.7 percent and in the Western region there are just 12.1 percent of the centers. North-Eastern region has just 3.5 percent of the total centres. Distribution of Number of offices also follows the same pattern as that followed by the distribution of centres. Hence, across the length and breadth of the country the banking centres and offices are not evenly distributed. Much of the distribution is skewed in favour of Central, Eastern and the Southern regions.

Table 3.4 Population Group-wise Distribution of Centres and Offices of Commercial Banks in the Year 2011-12 (In Numbers)

Region		Rural		Semi-Urban		Urban		Metropolitan		Total	
		Centres	Offices	Centres	Offices	Centres	Offices	Centres	Offices	Centres	Offices
Northern	**No.**	4761	5939	627	4087	54	3872	5	4089	5447	17987
	%	15.6	16.4	10.3	15.7	14.0	19.0	14.7	21.7	14.7	17.8
North Eastern	**No**	1122	1281	147	694	11	587	0	0	1280	2562
	%	3.7	3.5	2.4	2.7	2.9	2.9	0	0	3.5	2.5
Eastern	**No**	7029	8094	940	3344	90	3071	4	1925	8063	16434
	%	23.1	22.4	15.5	12.9	23.4	15.1	11.8	10.2	21.8	16.2
Central	**No**	7426	8806	1058	4606	80	4023	8	2579	8572	20014
	%	24.4	24.4	17.4	17.7	20.8	19.8	23.5	13.7	23.2	19.8
Western	**No**	3625	4318	791	3674	54	2266	12	5532	4482	15790
	%	11.9	11.9	13.0	14.2	14.0	11.1	35.3	29.3	12.1	15.6
Southern	**No**	6499	7698	2515	9554	96	6516	5	4759	9115	28527
	%	21.3	21.3	41.4	36.8	24.9	32.0	14.7	25.2	24.7	28.2
All India	**No**	30462	36136	6078	25959	385	20335	34	18884	36959	101314
	%	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0	100.0

Notes: 1. Data on No. of Offices include Administrative Offices.
2. Population Group Classification is based on 2001 Census.
Source: Master Office File (Latest updated) on Commercial Banks, Department of Statistics and Information Management, RBI.

Hence to conclude, Public Sector Banks still hold a major share in terms of Volume of Business, Total Income, Operating Profits, Market Coverage and Employment. The private or foreign banks are very small players in the industry. This is a high time to analyze the operational efficiency of Public sector banks so as to avoid the misconceived comparison between big public sector giant with heavy multiple objectives and social responsibilities and a tiny entity having single objective of profit making only.

Now a day, there is a paradigm shift in banking sector in India due to WTO agreement, electronic age, LPG and corporate governance. So, the banks have to be customer centric and proficient in managing risk, technology, assets and liabilities. The banks have to try to increase profitability and productivity by restructuring the banks and efficient recovery process. With the collective efforts of the Government, RBI, Bank officials and customers, the Indian Banking Sector can lead to progress and prosperity compared to the rest of the world.