CHAPTER 3
OVERVIEW OF THE INDUSTRY

In this chapter a brief overview of the three sectors chosen for study has been discussed. The trends, growth prospects, financial performance and future potential of the sectors have been highlighted.

3.1 INDIAN IT SECTOR

The information Technology (IT) sector is one of the fastest growing sectors in the country, envisaging dimensions of growth and globalisation, achieving new milestones over the last decade. The growth momentum, attained by the overall economy since the late 1990s to great extent can be owed to the IT sector, led by a liberalised policy regime with reduction in telecommunication costs have led to spurt in investments by MNCs as well as domestic companies in the country. The industry’s contribution to India’s GDP has gone up significantly from 1.8% to FY00 to around 5.4% in FY 07. The sector has been growing at a CAGR of 30.3% since FY04.

Indian IT companies have globally established their superiority in terms of cost advantage, availability of skilled manpower and the quality of services. They have been enhancing their global delivery capabilities through a combination of organic and inorganic growth initiatives. Global giants like Microsoft, SAP, Oracle, Lenovo have already established their captive centres in India. These companies recognised the advantage India offers and the fact that it is among the fastest growing IT markets in Asia-Pacific region.

3.2 INDUSTRY STRUCTURE

According to Nasscom, the size of the Indian IT industry, has been estimated to be around US$ 47.8 bn in FY07. The Indian IT industry can be broadly divided into two
market: Domestic market and Exports market. The exports market constitutes the largest segment accounting for around 65.5% of the total revenue generated by the Indian IT industry including Hardware in FY07.

Importantly, in the exports market, IT services segment contributed highest share with 57.5% in FY07, followed by the ITeS-BPO segment with 26.8% share and the rest shared by the software products and engineering services &R&D.

The domestic IT market is broadly classified into the following four segments:

1. IT services
2. Software products, Engineering and R&D services,
3. IT enabled services and Business Process Outsourcing (ITeS –BPO)
4. Hardware.

While IT services accounted for around 34% of the total revenue generated by the domestic market in FY07, the Engineering services, R&D and software products segments together accounted for 9.7% of the revenue. The ITeS-BPO segment, on the other hand, contributed 6.7%. Hardware contributed major share of the domestic market with about 49.7%. Notably, the domestic IT industry grew at a CAGR of 25.7% during FY04-07 to touch US$ 16.5 bn.

According to Manufacturer Association for information Technology (MAIT), the desktop PC market (including notebooks) showed an upward trend totalling over 6.34 mn units in FY07, registering a growth of 25.65% over the same period last fiscal. Desktop sales accounted more than 86.5% of the total sales, while the remaining was shared by notebook sales. This was largely due to the buoyant mood in IT consumption, which saw a significant growth in notebook sales by 97%. MNCs have been increasingly raising their share in Indian desktop market from 35% in FY05 to 39% in FY07, driven by growing domestic demand mainly in notebooks segment, as sales of MNC brands grew by 33% and that of assembled by 22% in FY07.

The high growth in PC sales was accelerated due to increased consumption by industry verticals such as telecom, banking and financial services, manufacturing,
education, retail and BPO /IT enabled services as well as major e-governance initiatives of Central and State Government. The domestic hardware market offers a tremendous potential for hardware companies, thus attracting plenty of domestic hardware as well as MNCs in the domestic market, as few MNCs in the hardware segment have been viewing India as a hub for setting up hardware manufacturing facilities, for instance Dell. Imports of IT hardware which forms a large component of the industry are mainly from Taiwan, China and Korea.

Table 3.1: Indian IT Industry Structure (In US $ BN)

<table>
<thead>
<tr>
<th>Particulars</th>
<th>FY04</th>
<th>FY05</th>
<th>FY06</th>
<th>FY07</th>
<th>CAGR Growth (%)</th>
</tr>
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<tbody>
<tr>
<td>IT services</td>
<td>10.4</td>
<td>13.5</td>
<td>17.8</td>
<td>23.6</td>
<td>31.4</td>
</tr>
<tr>
<td>- Exports</td>
<td>7.3</td>
<td>10</td>
<td>13.3</td>
<td>18</td>
<td>35.1</td>
</tr>
<tr>
<td>- Domestic</td>
<td>3.1</td>
<td>3.5</td>
<td>4.5</td>
<td>5.6</td>
<td>21.8</td>
</tr>
<tr>
<td>ITES-BPO</td>
<td>3.4</td>
<td>5.2</td>
<td>7.2</td>
<td>9.5</td>
<td>40.8</td>
</tr>
<tr>
<td>- Exports</td>
<td>3.1</td>
<td>4.6</td>
<td>6.3</td>
<td>8.4</td>
<td>39.4</td>
</tr>
<tr>
<td>- Domestic</td>
<td>0.3</td>
<td>0.6</td>
<td>0.9</td>
<td>1.1</td>
<td>54.2</td>
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<tr>
<td>Engineering Services, R&amp;D &amp; software products</td>
<td>2.9</td>
<td>3.9</td>
<td>5.3</td>
<td>6.5</td>
<td>30.9</td>
</tr>
<tr>
<td>- Exports</td>
<td>2.5</td>
<td>3.1</td>
<td>4</td>
<td>4.9</td>
<td>25.2</td>
</tr>
<tr>
<td>- Domestic</td>
<td>0.4</td>
<td>0.7</td>
<td>1.3</td>
<td>1.6</td>
<td>58.7</td>
</tr>
<tr>
<td>HARDWARE</td>
<td>5</td>
<td>5.9</td>
<td>7</td>
<td>8.2</td>
<td>17.9</td>
</tr>
<tr>
<td>TOTAL IT INDUSTRY (INCLUDING HARDWARE)</td>
<td>21.6</td>
<td>28.4</td>
<td>37.4</td>
<td>47.8</td>
<td>30.31</td>
</tr>
<tr>
<td>- Exports</td>
<td>13.4</td>
<td>18.2</td>
<td>24.1</td>
<td>31.3</td>
<td>32.68</td>
</tr>
<tr>
<td>- Domestic</td>
<td>8.3</td>
<td>10.2</td>
<td>13.2</td>
<td>16.5</td>
<td>25.74</td>
</tr>
</tbody>
</table>

Source: NASSCOM

3.3. IT SERVICES, ITeS –BPO, ENGINEERING AND R&D SERVICE SEGMENT

The demand for IT across the world is witnessing a tremendous growth, in view of changes in the economic and business environment, rapid technological and
innovation and wide utilisation of internet and globalisation. The market has become more competitive and has forced corporations to take innovative and unique ways of doing businesses. Service Industry has also entered into a new era with growing acceptance of IT based services.

As per Nasscom, Indian IT services both domestic and exports market grew from US$10.4 bn in FY04 to US$ 23.6 bn in FY07. During this period, its contribution to the total IT industry has gone up marginally from around 48.2% to 49.4%. The project oriented IT services contributed around 57.9% in FY 07, while outsourcing IT services accounted for around 32.8% of the total revenues of IT service segment of India.

With in the ITeS –BPO segment, Customer Interaction Services (CIS) accounted for nearly 45-46% of the total ITeS –BPO services exports while finance and accounting contributed for roughly around 40-41%. Human resource and other high-end Knowledge -based processes account for 3% and 11% respectively.

The Software product, Engineering services and R&D segment contributed over 13.8% of the total IT industry in FY07. In addition to these Indian companies offering these services, several foreign companies (both captive and third party) are also setting up base in India to provide these services. Overseas companies operating in sectors like high tech, telecommunication, automobile, aerospace, heavy machinery, construction and industrial products are looking at off-shoring their engineering and R&D related work to India.

3.4. IT-ITeS EXPORTS SHARE TO INDIA’S SERVICES EXPORT

India’s services exports has been growing rapidly over the last couple of years, recorded a CAGR growth of 44.7% during FY04-07. The share of India’s services exports in the world has gone up from 0.6% in 1995 to 2.2% in 2005, largely driven by off shoring of IT and ITes BPO sector. The trend withstands India’s position in the Global IT map, where India remains an attractive destination for IT-ITeS services due to its cost, high quality of product and services, skilled manpower and favourable government policies, etc.
Few important characteristics of the Indian IT sector include:

1) **Export Intensive:** Indian IT industry is predominantly export driven, with exports contributing over 60% of its revenue since FY03.

2) **Concentration on Low-end service:** Low end services such as customised software services and maintenance have been the key offerings of the Indian IT companies. These companies are now however moving up the value chain offering end-to-end solutions to clients.

3) **Fragmented Industry:** D&B in house data base has identified over 8,000 companies which operate in the IT space in India, offering a wide range of software products and services. A large number of these companies are unorganised players.

4) **Skewed concentration:** The revenues of the top four companies, TCS, Infosys, Wipro and Satyam, account for over 25% of the overall industry. The skewness is all the more pronounced in the case of IT services.

### 3.5 EMERGING TRENDS IN THE INDIAN IT SERVICES INDUSTRY

While the global IT players are aggressively scaling up their operations in India, due to the advantages that the Indian industry offers, the Indian IT companies are also preparing to tap the global market. The companies are witnessing significant change with regard to their service offerings and geographic concentration. The companies are expanding their services offerings from application development and maintenance to high end services like testing, consulting and engineering designing, which in a way allows IT companies to de-risk their business from pricing pressures and enter into newer areas which provide them higher growth and profitability.

### 3.6. LARGE DEAL SIZE
Indian IT companies have successfully scaled up operations and made a mark in the global outsourcing market, evident from the large deals bagged by the Indian IT companies in the past one year, including the TCS-AC Nielsen contract valued at US$ 1.2 bn, the Social Security Institute of Mexico (IMSS) –TCS deal worth US$200 mn and the BSNL-HCL Infosystems deal valued at Rs 5.9 bn to name a few.

3.7. GROWING PRESENCE OF MNCS

Cost arbitrage and the availability of a large talent pool have attracted several MNCs to India. Big players like IBM, Accenture, Google, Yahoo, Capgemini and Oracle among others have not only increased their headcounts in India but also outperformed their global performance in terms of revenue growth. Their Indian operations are witnessing strong growth as compared to their global business. Some of the major global companies like Intel IBM and CSC are cutting jobs abroad and shifting their base to India.

In terms of geographical contribution, the US continues to remain the key market for Indian IT companies, accounting for 67.2% of the total IT-ITeS exports from India. However, Europe is also emerging as an important market for the Indian IT industry, considering the fact that the share of exports to Europe from India increased from 22.2% in FY03 to 25.1% in FY07, Indian companies are increasingly enlarging their footprints to countries in Latin America, Eastern Europe, and Asia Pacific region. Mergers and acquisitions has been one of the routes that the Indian companies have adopted to enhance their presence in European market.

3.8. CHANGING GROWTH DRIVERS

There has been a change in the revenue composition of companies in recent years. The revenue contribution of high-growth segments such as infrastructure management services, package implementation, testing & consulting has been witnessing rapid growth over the last couple of years. These newer service lines are not only enabling Indian companies to increase their sales by cross-selling to their existing customers,
but also improve their average billing rates and recognition of being end-to-end service providers. These segments are experiencing high growth rates over the last couple of years. However, the Custom Application Development and Maintenance (CADM) services continue to contribute a larger share towards IT services segment revenue. The CADM accounted for around 39.6% to the total IT services segment revenue of US$23.6 bn in FY07, and it witnessed a growth rate of 35.3% in the same period.

3.9. NEW END USERS

In terms of user industries, the BFSI and hi-tech/telecommunication industries remain the leading verticals for the Indian IT companies. Together, these sectors accounted for around 58% of the IT-ITeS exports. Though these verticals have good growth potential, other sectors such as manufacturing, airlines and transportation, retail, healthcare, utilities etc., are also emerging as promising segments for the Indian IT companies. While the BFSI sector has the potential to provide large sized contracts to the IT companies, the manufacturing sector can provide large number of deals/assignments to the Indian players.

3.10 ISSUES AND CHALLENGES

Indian IT industry has been witnessing several issues and challenges, which can deter the growth in future, despite the fact that demand conditions have been optimistic. Therefore, companies must adopt best practices to address those issues in order to sustain the current growth momentum. Several large and mid sized companies are taking innovative measures to address those issues, for example, in view of continuous rupee appreciation against the US dollar, the companies are keen to expand their business to other emerging markets like Europe, Asia Pacific region, Middle East etc.

- Rising attrition rate
Growth and attrition rate seem to be following a similar trajectory for most Indian Software service companies. Managing attrition in IT sector holds a significant importance because skilled professional form the crux of this knowledge-intensive industry. Apart from loss of skill sets, the cost of recruitment and training is a huge investment for most IT firms. Consequently, as most major players have realised, attrition affects the quality of service, leading to greater expenditure on training and development, thereby affecting the overall performance, including improving utilisation rates of the company.

Major players in the Indian software industry - Tata consultancy Services, Infosys technologies, Wipro and Satyam Computers- are currently witnessing high attrition rates. TCS reported an attrition rate of 11.5% -up from 10.6% a year ago. The attrition rate at Infosys was 13.7% in FY07 – higher than 11.2% recorded in FY06 the rate at Wipro witnessed a surge to17.4% as against 14.6% during the previous fiscal, in its global IT services and product business.

- **Rupee appreciation:**

The rupee gained almost 12.5% against the US dollar in mid-October 2007 vis-à-vis the same period in the previous year, denting the earnings of the IT sector (The industry earns its highest revenue from US). For software firms whose expenses are mostly in the local currency, the rupee appreciation reduces the rupee equivalent of every dollar they earn overseas, thus affecting their margins to a great extent. Margins have already begun to face the effects of the rupee appreciation and most Indian IT players might lose the competitive edge.

- **Emerging new Territories:**

According to an IDC study, three Indian cities rank at the top in the Global Delivery Index today in the top 10 off shore destinations of Bangalore, Manila, New Delhi, Mumbai, Dalian, Shanghai, Beijing, Sydney, Brisbane and Auckland and Asia-Pacific region. However, the India IT industry is gradually facing stiff competition emerging from new territories like China, Malaysia, Philippines and Mexico. The study also states that though Mumbai and Bangalore may be favourite off-shoring destinations as of today, Chinese commercial hubs like Beijing and Shanghai are set to overtake Indian cities by 2011. A similar competitor would be Malaysia having a
stable socio-economic environment, excellent infrastructure, low attrition rates, and skilled talent pool as key advantages.

Though China still faces some challenges in capabilities such as language, risk to intellectual property (IP), and some infrastructure issues, but the country is emerging as an attractive alternate location for outsourcing IT, R&D, and procurement services.

- **End of tax benefits at STPIs:**

Uncertainty about continuation of the tax holiday may slow down future expansion proposals. With dissimilarity in tax regimes, the existing STPI units would opt to reinvest themselves as SEZ units.

<table>
<thead>
<tr>
<th>Positives</th>
<th>Negatives</th>
</tr>
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<tbody>
<tr>
<td>Growth in IT spending</td>
<td>Rupee appreciation</td>
</tr>
<tr>
<td>Opening up of newer geographies like Europe</td>
<td>Anticipated slowdown in the US economy</td>
</tr>
<tr>
<td>Emerging domestic market</td>
<td>Wage inflation</td>
</tr>
<tr>
<td>Increase in offshore spending</td>
<td>Higher attrition rate</td>
</tr>
<tr>
<td>Mergers and Acquisitions to increase reach, clients and offerings</td>
<td>Lack of proper infrastructure</td>
</tr>
<tr>
<td>Building up training and development centres to train fresh entrants</td>
<td>Competition from other low cost countries, such as China, Philippines and Vietnam</td>
</tr>
</tbody>
</table>

### 3.11. Financial Analysis

The financial analysis in this segment provides a review into the current and past financial performance of the top 86 companies listed IT companies in terms of revenue where comparable information is available.  

For the survey the Companies with revenue of >200000 mn has been categorised as large companies, between 2000 to 20000 mn as medium sized companies and companies with turnover of < 2000 mn as small companies.

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21 The financial analysis has been taken from publication by Dun & Bradsteet Information Services India Pvt.Ltd. “India’s top IT companies 2008”
Notably large companies in the sample contributed about 74.4% of the total turnover in the IT sector. The top six companies on the basis of the total income in Rs mn in 2008 were TCS, Wipro Ltd., Infosys Technologies Ltd., HCL Infosystems Ltd, Siemens Information system Ltd. These companies together contribute to over 29.3% of the total IT industry revenue.

- The 86 companies taken in the sample outperformed the industry average by reporting 42.4% growth in revenue for the fiscal 2007. Large, medium and small sized Indian IT companies have recorded a robust growth of around 42.4%, 42.7% and 41% respectively in FY07. The industry reported average growth of 27.8% in FY07. The medium sized and small sized companies reported higher incremental growth compared to large companies during the same period.

- The Profit after Tax of IT companies’ registered strong growth, especially small sized IT companies. Small sized companies registered growth rate of 68.6% in FY07 and 88.7% in FY06.

- The small and medium firms in the sample reported hike in personnel expense ratio, while large firms reported a marginal dip. The personnel expense ratio is calculated as personnel cost as percentage of net sales. The personnel expense ratio for the small and medium firms went up by 110 and 190 basis points respectively in the last two years. On the other hand, the large firms reported marginal dip of 30 basis points. This reflects efforts put in by the small and medium enterprises to retain talent in face of competition from large players. For large firms personnel expenses constitute a significant portion of the overall costs that accounted for 45.8% of the net sales in FY07 (46.1% in FY05), largely driven by wage inflation, basically driven by competition from MNCs in India, scarcity of abundant skilled resources, etc. Another important cost component is travel and communication, which is increasing mainly due to rise in Visa cost, growing onsite remuneration etc. For medium sized firms the contribution of personnel expense as percentage of net sales was lower than large sized firms. Wage cost has increased from around 34.9% in FY05 to 36% in FY07. However, travel and communication expenses have declined from 7.8% to 6.2% in the same period. Personnel expense of small sized companies has gone up from 245 in FY05 to 25.9% in FY07 largely due to growing competition from medium sized and large
sized companies. However, travel and communication expense as a percentage of net sales declined from 5.9% to 4.4% in the same period. This can be attributed to the small, concentrated customers that these firms cater to whereby the client servicing costs are lower. A significant cost component was by way of other expenses that accounted for more than 67% of net sales.

- The small size firms in the sample undertaken for study have shown a drastic improvement in operational efficiencies which is evident from jump in net profit margin (NMP), NMP for small sized companies increased from 9.3% in FY05 to 15.3% in FY07. Similarly, midsized companies NMP has increased from 14.2% to 15.8% in the same period, while NPM remained flat for large sized companies.

- Though the large companies still generate better returns on money invested but small and medium sized companies are fast catching up. Compared on the parameter of return on net worth (RONW) of 37.6% beating small and medium sized companies with a wide margin. However, interestingly the small and medium sized companies have shown rise in RONW over last two years, while for large companies RONW declined by 220 basis points.

### 3.12. FUTURE OUTLOOK

Indian IT industry is riding high with rise in global spending on technology products and related services. According to the International Data Corporation (IDC) estimates, the global spending on technology related services reached US$ 1.58 trillion (excluding R&D and engineering) in 2006 and is expected to grow at CAGR of 7.12% to reach US$ 2.1 trillion by 2010. Notably, IT services segment (excluding BPO) contributed around 29.8% of the total global spending on technology products and related services in 2006.

The success of the global Delivery Model adopted by the global IT companies and increase in offshore spending by the US and European countries would help countries like India to reap rich benefits. Noticeably, the global off shore IT services spending is expected to reach US$29.4 bn by 2010, would grow at a CAGR of 17.5% during
2006-10. The trend underscores opportunities for the Indian IT companies to take significant strides towards global off shore IT services.

Technology adoption by companies across sectors and rapid evolution of technology and applications will significantly drive growth in IT sector. The increase in spending on IT sector will be backed by the growth in offshore spending, preference towards multi-vendor contracts and success of the Global Delivery Model.

According to NASSCOM, Indian IT-ITeS exports would reach US$ 60 bn by 2010. Some key factors supporting this optimism include the growing effect of technology-led innovation, leading the growing demand for global sourcing; favourable policy initiatives; and gradually evolving socio-political attitudes towards the acceptance of IT in professional and social activities. The Global IT spending is likely to be sourced through the global delivery model, which has already opened up various avenues of outsourced services for India.

Rapid evolution of technology and internet applications computing are expected to drive a rapid-quantum growth in technology adoption by businesses and individuals. The proliferation of client devices and end-users or end-use devices at the network end will result in the addition of billions of devices to the network age, which in turn will drive the need for more enterprise systems, to manage and correctly use them. The “Internet generation” entering networking age population is expected to further accelerate technology usage and adoption.

3.13. INDIAN IT-ITeS SECTOR TO REACH RS 4,582.28 BN BY 2011

According to the IDC, the Indian IT-ITeS industry is expected to grow at CAGR of 15.6% to reach Rs 4,582.28 bn during 2008-11. The sector is expected to witness robust growth, as a consequence demand from the domestic market, which is growing steadily over the last couple of years - especially sectors like Telecom, retail logistics and transportation, BFSI, and manufacturing. The domestic ITeS market is expected to reach Rs 362.38 bn by 2011, at a CAGR of 264% during 2008-2011.
3.14. POTENTIAL GROWTH SEGMENT

According to the planning Commission of India, the Indian IT-ITeS sector would create another 2.5mn direct employment opportunities. The sector requires direct investment of US$ 28-30 bn by the end of FY12. There are various potential –rich segments in Indian IT-ITeS sector as given below:

- Infrastructure management services (IMS) is expected to emerge as a key growth driver for the Indian IT industry. According to NASSCOM, the global IMS market is estimated to be worth US$ 86-150 bn, and currently, around 60% of the total IMS projects are delivered via ‘global delivery’ offshore model. Therefore, there is an immense potential for Remote Information Management (RIM), which is estimated to be worth US$ 51-90 bn globally. Notably, in 2006, more than 2,000 clients have collectively awarded US$ 927mn in IMS work to the top six Indian IT players.

- E-commerce in India is gradually picking up; over the next 2 years, the segment is expected to contribute significantly to the country’s IT-ITeS sector.

- Another important booming segment in Indian IT industry—the gamming sector—is expected to reach US$ 300 mn by 2009 from US$ 30 mn in 2005.

- Similarly, e-governance is another upcoming segment with several state governments are increasingly focusing on e-governance services to be made available for its citizens.

- Engineering services are expected to become a key market for the Indian IT-ITeS sector. In 2004, India’s share of global off-shore engineering services was around 12%, which was relatively low as compared with the shares of the IT and BPO segments. As per a NASSCOM study in 2004, it was estimated that the engineering off-shore market would reach US$ 40 bn by 2020, enhancing India’s strategic positioning in the global market in key sectors like defence and aerospace.

Thus, the Indian IT companies are entering into newer geographies to strengthen their business model, reduce dependency on single location and offer end-to-end solution...
to their clients. This expansion is likely to be fuelled through mergers and acquisitions. The industry is poised for a big leap over the next couple of years, focusing on to improve productivity and utilization and move up the value chain. Considering increasing competition from emerging destinations, IT service companies have started to offer new service lines such as R&D engineering and remote network management, package software implementation, systems integration etc.

3.15 FMCG SECTOR

3.15.1. THE INDIAN FAST MOVING CONSUMER GOODS INDUSTRY SNAP SHOT.

FMCG Sector is one of the most important sectors for each and every Economy. It plays a vital role being a necessity and inelastic product, which touches every life in one or the other aspect.

India's FMCG sector is the fourth largest sector in the economy and creates employment for more than three million people in downstream activities. Its principal constituents are Household Care, Personal Care and Food & Beverages. The total FMCG market is in excess of INR 85,000 Crores. It is currently growing at double-digit growth rate and is expected to maintain a high growth rate. FMCG Industry is characterized by a well-established distribution network, low penetration levels, low operating cost, lower per capita consumption and intense competition between the organized and unorganized segments.

The FMCG Industry remained insulated from inflation led demand slowdown. Inflation as measured by the wholesale price index (WPI) shot up to 9.5 per cent in June 2008 quarter and further climbed up to 12.63 per cent in September quarter. In both these quarters, industry sales accelerated by more than 15 per cent backed by healthy growth in off take as well as price hikes affected. During this period, the industry was largely able to hold on to margins through a combination of strategies such as reduction in packaging cost and changes in product mix. Since October, inflation rate has been waning and fell to 5.91 per cent for the week ended 27th December 2008. Thus demand for personal care products is likely to remain buoyant.
According to CMIE Data, aggregate sale of the industry is expected to increase by 19.2 per cent during the December 2008 quarter. Commodity prices after peaking are on the downswing. In September 2008 quarter, palm oil price fell by 13 per cent sequentially. In the subsequent months, palm oil price continued to weaken further and in November 2008 its price ruled 38 per cent lower than the year ago level. This would minimize input cost pressure for soap companies like HUL, Nirma and Godrej Consumer Products. Even fall in crude price is expected to make petroleum derivatives like LAB (key input for detergents) cheaper as well reduce packaging costs.

Even during the slowdown of the economy, the FMCG sector has registered a growth rate of 14.5 per cent for the year 2007-08.

There is a huge growth potential for all the FMCG companies as the per capita consumption of almost all products in the country is amongst the lowest in the world. Federation of Indian Chambers of Commerce and Industry (FICCI) predicted that the Indian FMCG industry sales could grow 16 per cent during 2008-09.

According to CRISIL anticipation, FMCG sector could touch around INR 140,000 Crores by 2015. The key players in FMCG Industry are Hindustan Unilever Limited, Dabur India Limited, Procter & Gamble Hygiene & Health Care Limited, Nirma Limited, Emami Limited, Colgate Palmolive India Limited, Godrej Consumer Products Limited to name a few.

### 3.15.2. PRODUCT CHARACTERISTICS

Products belonging to the FMCG segment generally have the following characteristics:

- They are used at least once a month.
- They are used directly by the end-consumer.
- They are non-durable.
- They are sold in packaged form.
- They are branded.
3.15.3. INDUSTRY SEGMENTS

The main segments of the FMCG sector are:

1) **Personal Care**: This includes oral care, hair care, personal wash (soaps), cosmetics and toiletries, deodorants, perfumes, paper products (tissues, diapers, sanitary), shoe care. Major companies active in this segment include Hindustan Lever, Godrej Soaps, Colgate-Palmolive, Marico, Dabur and Procter & Gamble.

2) **Household Care**: This comprise fabric wash (laundry soaps and synthetic detergents), household cleaners (dish/utensil cleaners, floor cleaners, toilet cleaners, air fresheners, insecticides and mosquito repellants, metal polish and furniture polish). Major companies active in this segment include Hindustan Lever, Nirma and Reckitt & Colman.

3) **Branded and Packaged Food and Beverages**: These include health beverages; soft drinks; staples/cereals; bakery products (biscuits, breads); snack food; chocolate ice cream; tea; coffee; processed fruits, vegetables and meat; dairy products; bottled water; branded flour; branded rice; branded sugar; etc. Major companies active in this segment include Hindustan Lever, Nestle, Cadbury and Dabur.

4) **Spirits and Tobacco**: Major companies active in this segment include ITC, Godfrey Philips, UB and Shaw Wallace.

3.15.4 INDUSTRY CHARACTERISTICS

a. **Branding**: Creating strong brands is important for FMCG companies and they devote considerable money and effort in developing brands. With differentiation on functional attributes being difficult to achieve in this competitive market, branding results in consumer loyalty and sales growth.

b. **Distribution Network**: Given the fragmented nature of the Indian retailing industry and the problems of infrastructure, FMCG companies need to develop extensive distribution networks to achieve a high level of penetration in both
the urban and rural markets. Once they are able to create a strong distribution network, it gives them significant advantages over their competitors.

c. **Contract manufacturing:** As FMCG companies concentrate on brand building, Product development and creating distribution networks, they are at the same time outsourcing their production requirements to third party manufacturers.

Moreover, with several items reserved for the small scale industry and with these SSI units enjoying tax incentives, the contract-manufacturing route has grown in importance and popularity.

d. **Large unorganized sector:** The unorganized sector has a presence in most product categories of FMCG sector. Small companies from this sector have used their locational advantages and regional presence to reach out to remote areas where large consumer products have only limited presence. Their low cost structure also gives them an advantage.

### 3.15.5 Salient Features of the FMCG Sector

The FMCG sector is a key component of India’s GDP and is a significant direct and indirect employer. It is the fourth largest sector in the economy and is responsible for five per cent of total factory employment in the country. The sector also creates employment for three million people in downstream activities, much of which is disbursed in small towns and rural India.

Unlike the perception that the FMCG sector is a producer of luxury items targeted at the elite, in reality the sector meets the every day needs of the masses, across the country. Low-priced products contribute the majority of the sales volume and lower income and lower middle income groups account for over 60 per cent of the sector’s sales. Moreover, rural markets account for 56 per cent of total domestic FMCG demand and FMCG outlets reach more villages than any basic facility such as primary schools or bus facilities.

The FMCG sector has several other salient features. It has strong links with agriculture and 71 per cent of sales come from agro-based products; it is a significant
value creator with a market capitalization second only to the IT sector and it is a key contributor to the exchequer.

3.15.6 SWOT ANALYSIS OF THE FMCG SECTOR:

Strengths:

- Well-established distribution network extending to rural areas.
- Strong brands in FMCG sector.
- Low cost operations.

Weaknesses:

- Low exports levels.
- Small scale sector reservations limit ability to invest in technology and achieve economies of scale.
- Several “too” products.

Opportunities:

- Large domestic market.
- Export potential.
- Increasing income levels will result in faster revenue growth

Threats:

- Imports
- Tax and regulatory structure.
- Slowdown in rural demand.

Key Take Away for Investors

- Robust Growth rate in Future
• Wide distribution network and supply chain
• Customized Product range to suit local market requirements
• Superior processing technology
• Brand building and marketing
• Higher Disposable Income
• Awareness about Nutrition and Hygiene

3.16 BACKGROUND

Although the Indian FMCG sector continues to remain value creating and profitable, a key problem that has dogged the industry in past few years is that it has fallen well short of growth expectations. YoY –line growth actually declined by 3.8% (in real terms) between 2000-2004. Select players such as Godrej Consumer, Dabur and Marico represent key expectations to the overall industry trend - posted strong growth and performance over this period. The industry is showed good signs of revival in 2005 with strong up-tick in growth rates for most categories .It is expected that this uptrend will continue.

Some key reasons for this lack of growth in the past few years have been : ‘lower share of wallet’ due to emergence of competing asset classes in housing ,consumer durables etc; the down trading in brands due to the advent of significant price competition; and rural off takes were actually significantly lower than the previously high expectations. The VAT implementation issues in early 2005 have further impacted the industry’s growth efforts.

At Kearney and Confederation of Indian Industry (CII) conducted a survey of leading FMCG companies in India. The survey insights revealed that the industry has potential to grow at high single-digit low teen rates per annum. It is estimated that the industry can grow at CAGR of 9% p.a. reaching a size of Rs 143,000 crores in 2010 (from the current size of Rs 93,000 crores).
A key component of realising this growth potential is that FMCG companies need to develop more aggressive strategies for both operational efficiency and top line growth.

International Best practise indicate significant potential for further operational efficiency improvement. Some Indian FMCG players, focussing on operational efficiency, have enabled Indian industry on average, to achieve 6% reduction in expense-to-sales ratio. However, International Best practises clients have reduced expense-to-sale ratio upto 16% by applying comprehensive framework of Next generation Cost reduction technique, suggested by AT Kearney.

In pursuit of top line growth, FMCG players have so far been working on three Conventional strategies: Refocusing the portfolio (i.e.“power brands”), Reengineering True marketing Innovation to end the price war doom loop, Expanding Distribution Reach and affordability to mass rural and semi urban customers. While there is undoubtedly room for many companies to improve their execution of these conventional strategies.

In addition, AT Kearney has recommended following five additional Growth strategies as worth considering. Rediscovering and better segmenting Rural India; better Servicing the Urban Affluent Consumer; Collaborating with Organised Retailers; Contract manufacturing for Export markets and; International Expansion. These strategies are undoubtedly more complex than the three conventional growth paths and will require stronger capabilities to develop and execute. However, they are necessary for significant and sustained value creating growth. Indeed some of the strong performers such as Dabur, Marico, GCPL are already working on a number of such initiatives.

To achieve this challenging growth agenda FMCG companies also need to consider organisational initiatives to ensure that they have “high performing team culture” in place in their organisations. This will ensure required agility, customer focus and outcome /result orientation.

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3 Expenses include all operating expenses other than depreciation, amortization and indirect taxes.
• Strong industry support for VAT but a clearer implementation road map is required from government.

➢ The FMCG industry view introduction of VAT as a positive step. But non-uniform implementation poses near term challenges. Companies agree that VAT has immediate placations for their pricing policies. They desire government intervention for clearer roadmap to ensure effective implementation.

➢ In addition, there’s strong support for a medium to longer term move to extend the VAT initiative to a more uniform, national, “total” indirect tax structure that rationalises sale excise, octroi etc. This would enable development of a simpler, more efficient supply chain.

3.17 RECENT UNDERPERFORMANCE OF THE INDIAN FMCG SECTOR

The Indian FMCG sector has performed below expectations in the past five years. This poor performance is amplified when compared to the “real” growth in GDP. While India GDP grew on average to 5.9% p.a. (between FY 00-05), the Indian FMCG sector declined an average 3.8% p.a. in the same period.

The Indian FMCG sector’s decline is in stark contrast to the strong –8% p.a. net growth of the sector in comparable markets such as China, Vietnam and Thailand. The Chinese FMCG sector has out paced India across the board – in food, non-food and urban segments.

Key macro economic reasons for the Indian FMCG sector’s woes as per survey responses by AT Kearney

• “Lower share of wallet” due to emergence of a competing asset class in consumer durables.

• The down trading in brands due to rise of low price choices.
• Rural off takes were actually significantly lower than the previously high expectations.

• Regulatory issues such as the growth of grey market contra brand goods.

3.18 SECTOR REVIVAL IN 2005

After the period of sluggishness, the sector has shown signs of revival in 2005. This return to growth was a cause of cheer for the industry and most of the companies in this sector are optimistic that this up trend can be sustained. However, a change in the taxation structure with the introduction of VAT and subsequent implementation has become a significant issue in FMCG sector.

3.19 POSITIVE FUTURE OUTLOOK

The Indian FMCG sector has the potential to grow by 9% p.a. going forward based on insights of survey done by AT Kearney and CII, it is shared that industry leaders believed in the FMCG sector’s great potential. The current size of the FMCG sector is Rs 93,000 crores. The future outlook suggests:

• As a base case, the FMCG sector is estimated to grow to Rs.114,000 crores in 2010 at a CAGR of 4%

• The sector can, however, grow to Rs 143,000 crores in 2010 at a CAGR of 9%, under favourable conditions.

• This requires a stronger focus on new growth imperatives by the industry players, as well as coordinated policy support from the government enabling the growth of processed foods, FMCG exports and agriculture incomes.

To achieve this FMCG players need renewed efforts both for top line and middle line initiatives.
3.19.1 GROWTH PROSPECTS

- **Large Market**
  India has a population of more than 1.150 Billions, which is just behind China. According to the estimates, by 2030 India population will be around 1.450 billion and will surpass China to become the world largest in terms of population. FMCG Industry, which is directly related to the population, is expected to maintain a robust growth rate.

- **Spending Pattern**
  An increase in spending pattern has been witnessed in Indian FMCG market. There is an upward trend in urban as well as rural market and also an increase in spending in organized retail sector. An increase in disposable income, of household mainly because of increase in nuclear family where both the husband and wife are earning, has leads to growth rate in FMCG goods.

- **Changing Profile and Mind Set of Consumer**
  People are becoming conscious about health and hygiene. There is a change in the mind set of the Consumer and now looking at “Money for Value” rather than “Value for Money”. We have seen willingness in consumers to move to evolved products/brands, because of changing lifestyles, rising disposable income etc. Consumers are switching from economy to premium product even we have witnessed a sharp increase in the sales of packaged water and water purifier.

  Findings according to a recent survey by A. C. Nielsen shows about 71 per cent of Indian take notice of packaged goods' labels containing nutritional information compared to two years ago which was only 59 per cent.

3.20 INDIAN SERVICE SECTOR

It is sector that is at the root of India’s cutting edge in the world today .In 2001, India’s service sector contributed 48.7% to GDP, up from 39.7% before reforms
began in 1990. According to Asian Development Bank (ADB), key indicators for 2002, the service sector contribution to GDP is substantially higher than China’s contribution (33.6%)

3.21 SERVICES SECTOR POWERED JOB GROWTH IN INDIA

The biggest advantage of the service sector lies in its job creating potential. According to industry estimates, in the IT enabled services (ITeS) sector, for every investment of over US$ 2,00,000, between 1,80,000 jobs can be created. Retail consulting firm KSA Technopak estimates that by 2005, the organised retail sector will be employing in excess of 250,000 individuals directly.

At the Asian Conference on Youth Employment in October 2003, India’s Minister for Tourism, Jagmohan stressed, “Few of us Know if you invest US $ 20,000 in some industry you will get 12 jobs; but if you invest the same amount in the tourism Industry you will get 48 jobs- direct or indirect”.

3.21.1 THE HOTEL SPACE:

Currently, Indian tourism contributes 5.6% of total employment in India. In the world the tourism Industry employs 2011 million; the Indian tourism industry employs 25 million and is ranked no. 2 after China. The Hotel sector has clearly been the traditional big-ticket job creator over the years. But it is the IT sector (since the 1990s) and the ITeS sector (2000s) that has set the pace since reforms were started in 1991.

3.21.2 THE IT SPACE:

The ITeS is not capital intensive. IT jobs do not need roads railheads or other expensive infrastructure. All they require is extensive and cheap telecommunications and operating expenses for training and marketing. As a result, ITeS can be undertaken from anywhere, large cities or even small towns like Banglore, Madras and Hyderabad in the South, Bombay in the west and Delhi. Now the BPO industry is cultivating the hinterland for its people resources. Chennai-based recruitment company Ma Foi Consulting, which recruits employees for the sector, has opened...
offices in non metro locations such as Bangalore, Mysore, Vijayawada, Pondicherry, Cochin, Thiruvananthapuram, Nasik and Nagpur.

Out of the total demand of 1.2 million being projected by 2008 the IT services export sector is expected have a demand of 460,000, the domestic IT sector 520,000, and products and technology services at 140,000, as per NASSCOM review. At another level, the financial sector, too, has one of the prime performers in the service sector, especially the insurance and the banking segments.

3.21.3 BANKING BOOM:

With the boom in consumer banking, India’s private sector banks have been furiously ramping up their strengths. According to data on listed companies compiled by the Centre for Monitoring Indian Economy:

- Development Credit bank increased staff strength from 1,280 in 2001 to 1,342 in 2002.

- Global Trust bank increased employee strength from 1,147 in 2002 to 1,368 in 2003.


- Ma Foi Consulting is in the process of recruiting about 150-200 people for Hong Kong and Shanghai Banking Corporation’s Indian operations.

3.21.4 INSURANCE SECTOR:

On an average 15 million new policies are being sold every year, leading to perking up of the insurance sector in India. For private sector insurers, there is a huge market in non-metropolitan and rural areas that is yet to be captured. Industry experts believe that recruitments in this category make up around 90% of total recruitments. The fact that the training cost is borne by the Company on the rolls of which the agents are, is clear evidence of just how serious insurers are.
3.21.5 EDUCATION SPACE:

Students from Nepal, Bhutan and the Middle East have been a regular feature in Indian universities. Efforts are on to raise the profile of the Indian education system in countries like China, Indonesia, Malaysia, Myanmar, Mauritius, Thailand, Ethiopia, Kenya and other African countries. The government keen to develop the country as an education hub as there is considerable job-creation potential in education centres as well. The underlying potential is immense with its vast and developed network of 300 universities of higher learning and over 15000 colleges in the specialised fields of engineering, IT, biotechnology, management, medicine, agriculture, pharmacy and its other numerous options, India has an edge over other developing countries.

Thus, it can be concluded though the global employment prospects still looking bleak, Indian’s services sector is providing welcome silver lining.

3.22 TELECOMMUNICATION SERVICES

3.22.1 OUTLOOK23

Telephone service providers added 8.22 million new telephone connections in November 2007. The total outstanding subscribers connections at 264.9 million and the teledensity reached 23.2%.

Total wireless subscriber base reached 225.5 million at the end of November 2007. Wireless service providers made the highest ever addition of 8.3 million subscribers. Wire line subscribers declined to 39.3 million at the end November 2007 from 39.4 million in the previous month. Total outstanding broadband connection reached 2.87 million in November 2007 with an addition of 0.18 million subscribers.

Fresh investment worth Rs. 11,805.5 crores spread over four projects was announced in the quarter ended December 2007. Total outstanding investment in the sector was 1,30,903.1 crores.

23 The detailed statistics have been taken from CMIE report on Telecommunication services “Indian Industry: A monthly Review” January 2008
3.22.2 GROWTH IN TOTAL SUBSCRIBER BASE:

In November 2007, total subscriber base witnessed a slower growth of 44.3% to 264.8 billion subscribers. In the wireless segment, including WLL (F), Bharti Airtel made the largest additional of 20.5 million subscribers in November 2007 at a growth rate of 4% over October 2007. Reliance made an additional of 1.56 million subscribers followed by Vodafone Essar’s 1.38 million subscribers in November 2007. BSNL added one million subscribers during the month. BSNL’s wire line subscriber base declined by 0.17 million subscribers. Among the other wire line operators, Bharti Airtel’s subscriber base grew by 1.5% to 2.14 million over October 2007. Reliance Communication grew by 3.2% to reach 0.75 million subscribers. Tata Teleservices subscribers grew by 3.1% growth to reach 0.65 million subscribers. Monthly GSM subscribers addition witnessed the slower growth of 21.8% in the last four months. Metros witnessed the highest subscriber growth of 55.5%.

In April 2008, total outstanding subscribers touched 308.5 million with an addition of eight million subscribers during the month. At the end of April 2008, total wireless subscribers stood at 269.3 million with an addition of 8.2 million subscribers. Wireline segment declined by 0.2 million subscribers taking the subscribers base to 39.2 million at the end of April 2008. Uttar Pradesh witnessed the highest addition of 8.7 lakh wireless subscribers followed by Andhra Pradesh, which added 6.2 lakh subscribers in April 2008. Bharti Airtel made the highest addition of 2.4 million subscribers. Vodafone Essar and Reliance Communication added 1.7 million and 1.6 million subscribers, respectively.

Maharashtra witnessed the highest decline in wireline subscribers. It declined by 50 thousand subscribers wireline subscribers in Tamil Nadu declined by 32 thousand subscribers.

BSNL, wireline subscribers declined by 2.5 lakh subscribers while it added 4.7 lakh subscribers in its wireless segment. Bharti Airtel added 0.4 lakh wireline subscribers and 23.9 lakh wireless subscribers making a total addition of 24.2 lakh subscribers in April 2008.
3.22.3 TOTAL SUBSCRIBERS EXPECTED TO REACH 402.4 MILLIONS AT THE END OF 2008-09

In the last two years, the telephone subscriber base witnessed a healthy growth. In 2005-06 and 2006-07, telephone subscribers grew at a robust rate of more than 43% in each of the year. This growth in subscribers was largely on account of the robust growth in cellular subscribers, which grew by more than 65% in each year. The cellular growth was largely fuelled by a more than 70% growth in the GSM segment.

During 2007-08, the total subscriber base touched 300.5 million. The subscriber base reached 261 million. The basic telephone cellular base declined to 39 million.

In 2008-09 total subscribers increased by an estimated 34% to touch 402.4 million subscribers i.e. an addition of around 101.9 million subscribers i.e. an addition of around 101.9 million subscribers over 2007-08.

3.22.4 TELECOM SECTOR SALES GROWTH: 24

In April 2008, the total outstanding telephone subscriber base touched 308.5 million with a net addition of eight million subscribers. The wireless subscriber base rose to 269.3 millions while wireline subscribers touched 39.2 million. For 2008-09 the subscribers base was expected to cross 400 million subscribers on the faster growth in cellular subscribers for the year.

Of the Telecom companies that declared their March 2008 quarter results. Bharti, Airtel and Idea cellular period posted robust growth in sales. Both the companies, however, witnessed a marginal contraction in profitability. Aggregate income of 11 companies that declared their March 2008 quarter results grew by 29% whereas; their net profit grew at a slower rate of 23.7%. Aggregate net margin of these companies stood at 17.7% during the quarter.

During the quarter ending on March 2008 aggregate expenses of 11 companies that declared their results rose by 30.2 % on a year-on-year comparison. Employee cost witnessed a decline of 3.4% as against a 70.3% growth in the year -ago quarter. Network cost grew by a robust 53.8%. The increase in the network cost was fuelled

24 The data has been taken from CMIE report on “Telecommunication services”, Indian Industry : A Monthly Review, June 2008
by Bharti Airtel and Idea Cellular mainly due to hiving off their tower business to Indus tower. Regulatory charges increased by 26.4% over the year-ago quarter. Interest cost for the quarter grew by an exceptional 203.3% over the year-ago quarter largely due to 540.6% growth in case of Bharti. Tax provision for the quarter declined by 40.6% over the year-ago quarter.

Due to a more than proportionate growth in expenses when compared the growth in income for the quarter, net profit grew at a slower rate of 23.7% over the corresponding year ago quarter. As a result, net margins for the quarter contracted by 30 basis points to 17.7%.

3.22.5 TELECOM INCOME STATISTICS

In December 2007, quarter, telecom sales grew at a slower pace by 25% largely due to subdue sales, growth by Reliance Communications (RCom) and declining sales of MTNL and VSNL. A healthy growth in sales of Bharti and Idea, however, aided the aggregate sales growth.

Many of the cellular companies have hived off their tower business. As a result there will be increase in the operational expenses due to increase in lease cost towers. However, the companies will benefit since the increase in cost will offset by a decline in depreciation.

On the expenses front, a 33.9% growth over the year-ago quarter is expected. Major expenses like network cost and regulatory charges are expected to increase by 57.5% and 20.5%, respectively. Net profit for the quarter is estimated to grow by 35% on account of slower growth in expenses when compared to income growth. As a result, aggregate net profit margin of the sector is expected to remain flat at 18.1% for the quarter.

3.22.6 MAJOR INVESTMENTS IN THE TELECOM SECTOR

Telecommunication sector garnered a massive capital investment of Rs. 1,30,913.1 crores till the end of December 2007 quarter. The total outstanding investments are spread over 121 projects. Of these, 75 projects entailing an investment of Rs.106, 412.6 crores are under implementation. Total value of the projects under
implementation accounts for 81.3% of the total outstanding investments. Four new projects were captured by CMIE’s Capex survey during the December 2007 quarter. The projects entailed an investment of Rs. 11805.5 crore.

As per CMIE Capex services, among the top three projects by cost, Bharti Sanchar Nigam’s mobile and broadband service project was the largest expansion undertaken. As per media reports, BSNL plans to invest Rs 60,000 crores in next three years to expand the capacity of its telecom services. The company has planned to invest Rs.20,000 crores every year till 2010 for laying down additional lines for GSM, WLL and broadband.

The other two projects include Data solution GSM services project. Datacom Solutions, a subsidiary of Videocon Industries, plans to make an initial investment of Rs, 6000 crores for rolling out its GSM service network. It plans to commence it service operations in all the 23 circles for which it has received license.

3.22.7 COMPANIES DRIVING THE SECTOR GROWTH

In March 2008 quarter, the Telecommunication sector witnessed a slower yet a healthy growth in net sales. The sectoral growth was largely aided by a healthy growth in net sales of Bharti Airtel and Idea Cellular.

Bharti’s net sales for the March 2008 quarter grew by 42.1% to Rs.7414 crore. Idea too posted a robust growth in net sales by 50.7% to Rs. 1972.4 crore. Reliance communication (RCom), however, recorded a slower growth of 10% to Rs.3455.3 crore affecting the aggregate sales growth. Among the other companies, MTNL’s sale declined by 2.7% mainly due to falling revenue from basic telephone segment. Tata Teleservices (Maharashtra)(TTML) net sales grew by 19.8% as against a 23.9% growth in March 2007. Slower sales growth in Rcom and TTML along with the decline in MTNL’s sales dragged down the aggregate growth.

In the last year, cellular subscriber base grew by 57% to 261 million subscribers. Bharti’s cellular subscribers increased by 67% to 6.2 crores subscribers. Idea’s cellular subscribers grew by 71% to 2.4 crore subscribers. With the increase in subscribers, cellular services usage witnessed an increase. Bharti and Idea witnessed a substantial increase in their total minutes of usage.
Aggregate net profit grew at a slower pace when compared to the year ago quarter mainly due to slower growth posted by top three companies. Bharti’s net profit grew by 39.3% whereas Idea’s net profit grew by 44.6%. Reliance posted a decline of 21% for the quarter.

3.23 BANKING INDUSTRY OVERVIEW

Modern banking in India can be traced back to the establishment of Bank of Bengal (Jan 1809), the first joint stock bank sponsored by Government of Bengal and governed by the royal charter of the British India government. Bank of Bombay (April 1840) and Bank of Madras (July 1843) were the banks that followed. These three banks, known as the Presidency Banks, marked the beginning of the limited liability, joint stock banking in India and were vested with the right of note issue. Following the introduction of the limited liability banking, a few more banks were established, the notable ones being The Allahabad Bank and The Punjab National Bank. The Swadeshi movement that began in the early 1890s gave rise to establishment of indigenous joint stock banking companies such as The Bank of India, The Bank of Baroda, and The Central Bank of India etc. In Jan 1921, the three Presidency banks were merged to form the Imperial Bank of India, which had multiple roles and responsibilities and that functioned as a Commercial bank, a banker to the Government and a banker’s bank. Following the establishment of Reserve Bank of India in 1935, the central banking responsibilities that the Imperial Bank was carrying out came to an end, making it a commercial bank. Banking at the time of Independence was predominately based in urban areas. Following the nationalisation of major banks in 1969 and 1980, the banking network spread significantly, particularly in the rural and the semi-urban areas to pursue social banking activities primarily aimed at enhancing the well-being of economically disadvantaged sections. Economic reforms followed by the banking sector reforms of 1991 changed the Indian banks’ functioning, making them more stable and stronger.

Table 3.3: Structure of Indian Banking (Mar end)

<table>
<thead>
<tr>
<th>Structure of Indian Banking</th>
<th>2002</th>
<th>2003</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
</table>

25 For details on the evolution of banking in India and extent of banking sector reforms, refer to Dun and Bradstreet’s publication, India’s Top banks:2007
<table>
<thead>
<tr>
<th>Number of Commercial Banks</th>
<th>297</th>
<th>292</th>
<th>290</th>
<th>289</th>
<th>222</th>
<th>183</th>
</tr>
</thead>
<tbody>
<tr>
<td>a. Scheduled Commercial Banks</td>
<td>293</td>
<td>288</td>
<td>286</td>
<td>285</td>
<td>218</td>
<td>179</td>
</tr>
<tr>
<td>Public Sector</td>
<td>27</td>
<td>27</td>
<td>27</td>
<td>28</td>
<td>28</td>
<td>28</td>
</tr>
<tr>
<td>Private Sector</td>
<td>30</td>
<td>29</td>
<td>30</td>
<td>29</td>
<td>28</td>
<td>25</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>40</td>
<td>36</td>
<td>33</td>
<td>31</td>
<td>29</td>
<td>29</td>
</tr>
<tr>
<td>b. Non-Scheduled Commercial Banks</td>
<td>4</td>
<td>4</td>
<td>5</td>
<td>4</td>
<td>4</td>
<td>4</td>
</tr>
<tr>
<td>No. of Regional Rural Banks</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>196</td>
<td>133</td>
<td>96</td>
</tr>
<tr>
<td>Number of Bank Offices</td>
<td>68195</td>
<td>68500</td>
<td>69170</td>
<td>70373</td>
<td>71177</td>
<td>73836</td>
</tr>
<tr>
<td>Of which rural</td>
<td>32503</td>
<td>32283</td>
<td>32227</td>
<td>30790</td>
<td>30436</td>
<td>30560</td>
</tr>
<tr>
<td>Semi urban</td>
<td>14962</td>
<td>15135</td>
<td>15288</td>
<td>15325</td>
<td>15811</td>
<td>16434</td>
</tr>
<tr>
<td>Urban</td>
<td>11328</td>
<td>11566</td>
<td>11806</td>
<td>12419</td>
<td>13034</td>
<td>13840</td>
</tr>
<tr>
<td>Metropolitan</td>
<td>9402</td>
<td>9516</td>
<td>9750</td>
<td>11839</td>
<td>12404</td>
<td>12952</td>
</tr>
<tr>
<td>Population per office (Thousands)</td>
<td>15</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
<td>16</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India

One of the major outcomes of the banking sector reforms was the strength and soundness it provided to the system, which made banks adopt prudential norms with respect to capital, income recognition, disclosure and transparency standards, profitability and productivity. While technology advancements enabled efficient distribution, competition brought in product innovation and quality customer service. Today, Indian banking displays robust prospects for growth and compares favourably with other major banks.

### 3.24 COMMERCIAL BANKING

#### 3.24.1 CREDIT DEPOSIT RATIO AND INTEREST RATES

Credit Deposit Ratio (CDR) reached an all time high of 74% as on Mar 2007. CDR of public Sector Banks ranged from 59.6-80% and 52.7-77.7% in respect of Old Private Sector Banks, 60.2-99.3% in case of New Private Sector Banks and 0.9-697% in case of Foreign Banks. The Investment deposit ratio slipped to 30.3%. The share of deposits with one-year maturity increased significantly across all bank groups. There is a general alignment between the maturity of assets and liabilities. According to the
RBI, by end-March 2007, public sector and Old Private Sector Banks had higher proportion of liabilities and assets in the long maturity bucket.

Interest rates firmed up in FY07 with the increase in credit demand. Foreign Banks increased the maximum rate on term deposits by 300 to 375 basis points, followed by public sector banks with 225 to 275 basis points and Private Sector Banks with 175 to 200 basis points. FY 08 has seen further increase in the rates of deposits. Interest rates offered by Public sector banks for over one year deposit rose from 7.25% -9.75% in Apr 2007 to 8-9.50% in Oct 2007. The benchmark Prime Lending Rate (BPLR) of Public Sector banks and Foreign banks were at 12.50-17.25% to 13-16.5%. However, in Feb 2008, several banks began reduction in the rate of interest on housing loans.
Table 3.4: Banks at a Glance: 2006-07

<table>
<thead>
<tr>
<th>Particulars</th>
<th>SBI group</th>
<th>Nationalised Banks</th>
<th>Public Sector Banks</th>
<th>Old Private Sector Banks</th>
<th>New Privates Sector Banks</th>
<th>Foreign Banks</th>
</tr>
</thead>
<tbody>
<tr>
<td><strong>Business growth in%</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Deposits</td>
<td>16.79</td>
<td>24.98</td>
<td>22.90</td>
<td>6</td>
<td>38.8</td>
<td>32.60</td>
</tr>
<tr>
<td>Advances</td>
<td>29.80</td>
<td>31.29</td>
<td>30.20</td>
<td>12</td>
<td>39.90</td>
<td>29.50</td>
</tr>
<tr>
<td>Sensitive Sectors</td>
<td>32.07</td>
<td>40.55</td>
<td>38.23</td>
<td>30.55</td>
<td>53.81</td>
<td>31.95</td>
</tr>
<tr>
<td>Operating Profit</td>
<td>(4.9)</td>
<td>22.30</td>
<td>11.30</td>
<td>34.10</td>
<td>46.70</td>
<td>44.20</td>
</tr>
<tr>
<td>Net profit</td>
<td>10.30</td>
<td>29.2</td>
<td>21.8</td>
<td>29.6</td>
<td>30</td>
<td>49.4</td>
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<tr>
<td>Capital</td>
<td>0.00</td>
<td>.81</td>
<td>.70</td>
<td>4.40</td>
<td>5.60</td>
<td>4.50</td>
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<tr>
<td>Reserves &amp; Surplus</td>
<td>Data not available</td>
<td>20</td>
<td>11.60</td>
<td>17.40</td>
<td>30.60</td>
<td></td>
</tr>
<tr>
<td><strong>Staff</strong></td>
<td>(5.32)</td>
<td>(0.16)</td>
<td>(2.04)</td>
<td>1.95</td>
<td>54.19</td>
<td>25.92</td>
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<tr>
<td>Infrastructure In numbers</td>
<td></td>
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<td></td>
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<tr>
<td>Branches</td>
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<td>49666</td>
<td>4606</td>
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<td>273</td>
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<td>256225</td>
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<td>44829</td>
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<td>ATMs</td>
<td>6441</td>
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<td>16329</td>
<td>1607</td>
<td>8192</td>
<td>960</td>
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<td>Efficiency in%</td>
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<tr>
<td>Net profit/ Assets</td>
<td>.82</td>
<td>.85</td>
<td>.83</td>
<td>.70</td>
<td>.91</td>
<td>1.65</td>
</tr>
<tr>
<td><strong>Asset Quality</strong></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Standard Assets%</td>
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<td>97.30</td>
<td>96.90</td>
<td>98.10</td>
<td>98.10</td>
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</tr>
<tr>
<td>Gross NPAs/Total assets</td>
<td>1.60</td>
<td>1.80</td>
<td>1.10</td>
<td>.80</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Net NPA/Total Assets</td>
<td>.60</td>
<td>.60</td>
<td>.50</td>
<td>.30</td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cumulative provision to Gross NPAs</td>
<td>49.60</td>
<td>58.40</td>
<td>56.80</td>
<td>66</td>
<td>49</td>
<td>51</td>
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<td>Capital Adequacy</td>
<td>12.30</td>
<td>12.40</td>
<td>12.40</td>
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<td>12.00</td>
<td>12.40</td>
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<tr>
<td>Costs and Returns</td>
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<td></td>
<td></td>
<td></td>
<td></td>
</tr>
<tr>
<td>Cost of Funds</td>
<td>Data not available</td>
<td>4.40</td>
<td>4.80</td>
<td>4.50</td>
<td>3.50</td>
<td></td>
</tr>
<tr>
<td>Return on Funds</td>
<td>7.60</td>
<td>8.10</td>
<td>7.70</td>
<td>8.30</td>
<td></td>
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<tr>
<td>Benchmark Prime lending rate</td>
<td>12.50-13.50</td>
<td>13.00-16.50</td>
<td>10.00-15.50</td>
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<td></td>
<td></td>
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<tr>
<td>Market Shares% in%</td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
<td></td>
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<tr>
<td>Deposits</td>
<td>23.50</td>
<td>48.80</td>
<td>73.90</td>
<td>5.10</td>
<td>15.30</td>
<td>5.60</td>
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<tr>
<td>Advances</td>
<td>24.30</td>
<td>45.20</td>
<td>72.70</td>
<td>4.70</td>
<td>16.20</td>
<td>6.40</td>
</tr>
<tr>
<td>Net Profit</td>
<td>21.05</td>
<td>41.50</td>
<td>64.58</td>
<td>3.58</td>
<td>17.11</td>
<td>14.71</td>
</tr>
</tbody>
</table>

**Source**: RBI

Public Sector Banks total includes IDBI Bank Ltd.
A glance at the table shows that in FY 07, Bharat Overseas bank was merged with Indian Overseas Bank. Ganesh Bank of Kurundwad was amalgamated with Federal Bank Ltd. and United Western bank was amalgamated with IDBI Ltd. Consequently, by Mar 2007, the number of Scheduled Commercial Banks (SCBs) declined to 80 as against 82 in the previous year. Moreover UTI bank was renamed as Axis Bank while Chohung Bank was renamed as Shinhan Bank, Sangli Bank Ltd. was amalgamated with ICICI Bank Ltd. and Lord Krishna Bank was merged with Centurion Bank of Punjab in Aug 2007.

The aggregated balance sheet of SCBs in FY07 increased by 24.3% as compared to 18.2% in FY06. The combined balance sheet of the public sector banks rose by 21.1%, Old Private Sector banks by 7.1%, New private sector Banks by 39.5% and Foreign banks by 28.7%. In FY07 the market share of public sector banks in assets declined to 70.5% from 72.3% a year earlier; deposits to 73.9% from 75%; advances to 72.7% from 72.9% and investment to 69.9% from 73.1%, where as that of the New Private sector banks increased from 15.1% to 18% (investments). The share of foreign banks in assets rose from 7.2% to 8% and in deposits from 5.3% to 5.6% and in advances remained same at 6.4%. Old Private sector banks Market share in assets decreased from 5.4% to 4.6%, in deposits from 6% to 5.1% and in advances from 5.5% to 4.7%.

Aggregate deposits of SCBs in FY 07 increased by 24.6% as compared to 17.8% in FY06, whereas Loans and Advances showed a subdued growth of 30.6% as compared to 31.8% in FY06. Investments in government securities rose by 9.3% in FY07 as against a contraction of 1.2% in the previous year. Income of all the SCBs reported a growth of 25.1% in FY07 as compared to 16%, a year earlier.

In the Background of high credit growth, the share of interest income is on rise in the recent period reaching 85.9% in FY07 from 81.9% in FY05. Other incomes increased by 10% making its share 14.1% of the total income for FY07. Though the trading income slowed down, fee income, such as income from foreign exchange operations and miscellaneous income showed growth.

Expenditure too showed sharp rise of 24.9% as compared to 15.9% in FY06. Operating expenses rose at a lower level (12%) in FY07 as compared to the previous fiscal (18.1%). Wage bill registered a lower increase of 8.1% in FY07 as compared
with 13.5% in FY06. Operating profits of the SCBs during FY07 grew by 1.9% as against 2% in the previous year; provisions and contingencies increased by 16.4% as against a marginal decline in FY06. Net profits growth however remained unchanged at 0.9%. Spreads declined marginally from 2.8% in FY06 to 2.7% in FY07. Gross NPAs showed a sizeable decline from 3.1% to 2.4% and Net NPAs from 1.2% to 1% in FY07. The total capital of SCBs increased by 17% from Rs.252bn in FY06 to Rs295 bn in FY07 and reserves showed a robust growth of 20% from Rs1, 579 bn to Rs 1896 bn. Of their revenues, demand deposits formed 13%, savings 23%, and term deposits 63%. In loans, term loans constituted the major segment at 57%.

High growth of retail loans characterised the loan growth in Indian Banking in the recent period. In FY05 retail loans grew at 41.2% and the pace remained the same in FY06. However in FY07, there is a slowdown with the retail loans showing a growth of 29.9%. Retail loans as a percent of the total loans and advances increased from 21.9% in FY04 to 25.8% in FY07. Similarly, credit outstanding in the sensitive sectors comprising of capital market, real estate market and commodities which grew at 22.5% FY04, 35.2% in FY05 and 74.4% in FY06, slowed down to 41.2% in FY07.

### 3.25 OUTLOOK ON THE SECTOR

Indian banking is on a growth mode. In the background of robust economic growth and the financial sector emerging strong, diversified and integrated, Indian Banking could look forward to a long period of substantial growth that could lead it to a significant position in global finance. In view of this, expectation of global markets on the scope and significance of Indian Banking are high and growing.

Indian banks are maintaining momentum in profit growth in the current fiscal. For the third quarter ended Dec 2007, the 37 listed Indian Banks showed a robust 52% growth in net profits, which should augur well for its prospects in FY08.

Not withstanding it strength and strong points, certain vulnerabilities too exist, which merit notice and remedy, Indian Banking is considered too fragmented by global standards with the top 10 banks accounting for about 65% of the banking assets and about 40 banks sharing among themselves 27% of the assets. Given the significance
of scale in global banking industry, too many banks sharing a low market share must lead to inefficiencies that could hinder sustained growth.

Old private Sector banks which fared extremely well in the immediate after math of the banking sector liberalisation began to show growing signs in sustaining growth. Old private Sector Banks are losing market share with in the private sector and also experiencing slowdown in business growth. Deposits of Old Private Sector Banks in FY07 showed a growth of 6% and advances of 12% as against 25% and 31% for the industry average.

While great advances have taken place in regard to technology absorption amongst public sector banks, issues of integration and networking across it universe of branch network remains a major challenge. Banks need to reinforce more focus in harnessing technology on its entire network of business and operations.

Similarly developing and refining skill sets and employees productivity will continue to be a major task for the Public sector banks. Public sector banks have been quite successful in trimming the staff strength, but these banks needs to accomplish a great deal in increasing the employee productivity to regional and global benchmarks.

Public Sector Banks, which account for 70% of the assets, depend mainly on plain vanilla banking. Off balance sheet business is relatively less and so is dealing with the other major alternative asset markets. Though the current regulatory framework might not provide adequate incentives for too much diversification, in the background of sophisticated financial system that is emerging, public sector banks need to take note of the possibilities and potential in designing a more effective composition of business.

Fragmentation calls for consolidation, an issue that has not been addressed adequately in the Indian Banking Industry. Though some distressed banks have been merged are amalgamated with a few existing ones, no major policy initiative in designing an effective structure of the banking industry that would cope with emerging trends in global banking is envisaged. Consolidation is one of the key issues that might emerge as pertinent in the Indian Banking industry in the near term.
Notwithstanding these limitations, Indian Banking is showing great promise and progress. It has been able to impress and influence global markets by its smart turnarounds with relatively low fiscal support, rapid advances in technology, faster pace of growth in business and profitability, increases in efficiency, robust capitalisation higher returns to investors and above all generating rapid pace of growth with lesser levels on non performing assets. An industry that critics predicted would not survive long in 1993 today is in a position to draw attention and admiration of the global finance.

3.26 INDUSTRY INSIGHTS

As discussed in the above section the Indian banking industry is experiencing rapid growth in terms of business, technology, product range and customer service. Competition has been key driver in generating growth and profitability as also innovations in product design and distribution. The banking universe consisting of wide range of players from diverse ownerships, from state to private to foreign is leading to the development of a vibrant and growing banking industry that is focused apart from adapting the best practices and global standards.

3.26.1 BANKS GROUP WISE MAJOR BALACESHEET COMPONENTS

Deposits of PSBs dipped marginally during FY07. Although PSBs had the largest deposit base, it reduced by 1% in FY07. The share of old private sector Banks and foreign Banks in total deposits has come down to 55 from 6% a year earlier. New private Sector banks and foreign banks beat the trend by registering a marginal rise in their total deposits, which went up by 1% each to be at 15% and 6% respectively. The total advances base of both PSBs and Foreign banks remained unchanged at 73% and 6% each respectively in the last two years. However, new Private Sector Banks reported an increase of 1% in total revenues.

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26 The figures presented in this section has been drawn from Dun and Bradstreet’s publication, India’s Top banks: 2008 which includes a survey of top 80 Private, Public and Foreign banks. The list of the constituent banks have been annexed to Annexure II
3.26.2 INVESTMENT GROUP WISE

Total investments of PSBs declined to 70% in FY07 from 73% in the previous fiscal while the share of old private sector banks did not undergo any change, remaining fixed at 5%, New Private Sector Banks and Foreign Banks registered an increase of 2% each in their total investments in FY07 to be 18% and 8% each.

3.26.3 PERFORMANCE: ASSETS, NET PROFIT AND TOTAL INCOME

Table 3.5: Group wise: Top Banks (2006-07)

<table>
<thead>
<tr>
<th>Parameters</th>
<th>Public Sector Banks (Rs. mn)</th>
<th>Private Sector Banks (Rs. Mn)</th>
<th>Foreign bank (Rs. Mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Total assets</td>
<td>State Bank India Rs.5, 665,652</td>
<td>ICICI Bank Rs. 3,446,580</td>
<td>Citi Bank N.A. Rs. 663,583</td>
</tr>
<tr>
<td>Total Income</td>
<td>State Bank Of India Rs.452, 603</td>
<td>ICICI Bank Rs. 289,235</td>
<td>Citi Bank N.A. Rs. 57,295</td>
</tr>
<tr>
<td>Net Profit</td>
<td>State Bank of India Rs. 45,413</td>
<td>ICICI Bank Rs.31, 102</td>
<td>Standard Chartered Bank Rs.13, 643</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India

Amongst PSBs, SBI retained the top slot across all-important parameters namely, total assets, total income and net profits. Amongst Private Sector Banks, ICICI bank Ltd. led the group reporting the highest total assets, net profits and total income. Citi bank N.A. retained the first position among the foreign banks in terms if total assets and total income, Standard Chartered Bank lead the net profit base.

Among bank- groups, income of the private Sector Banks grew at the highest rate (55%) during FY07, followed by foreign banks (41.3%), PSBs (18.3%) and old Private Sector Banks (12.8%). The interest income to total asset ratio private sector banks. Foreign banks and new private sector banks improved during the year, while it declined in the case of PSBs, in particular, for the SBI group.

Table 3.6: Group wise: 80 SCBs (2006-07)

<table>
<thead>
<tr>
<th>Group</th>
<th>Total Assets (Rs mn)</th>
<th>Net Profit (Rs mn)</th>
<th>Total Income (rs mn)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBs</td>
<td>24,399,851</td>
<td>201,523</td>
<td>1,889,796</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>7,414,629</td>
<td>68,101</td>
<td>619,430</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>2,780,166</td>
<td>45,850</td>
<td>249,561</td>
</tr>
</tbody>
</table>

Source: Reserve bank Of India
3.26.4 TOTAL ASSETS

The combined total assets base of all 80 scheduled commercial banks stood at Rs 34,594,646 mn in FY07. PSBs reported the highest share of 70.5% in the total asset. Private Sector Banks and foreign Banks reported a share of 21.43% and 8.03% respectively. Total assets for all the 80 profiled banks have grown at the rate of over 24.3% as compared to the previous year. While total assets of Private Sector Banks grew by 33% in FY06, in FY 07 they grew by 30.39%. The asset base of foreign Banks grew by 39% in FY 07 against 30% in FY06. PSBs on the other hand recorded a growth of PSBs stands on a very high base. Total asset base of SBI was Rs 5,665,652 mn in FY07, way ahead of Canara Bank, the second largest PSB that reported a total asset base of Rs 1659610 mn. Following close on the heels of Canara Bank was PNB that registered a total asset base of Rs 1,624,225 mn. Among Private Sector Banks, ICICI bank Ltd. was the front-runner with a total asset base of Rs 3,446,580 mn, followed by HDFC bank Ltd. and Axis Bank Ltd. respectively.

3.26.5 NET PROFIT

The net profit of all 80 banks featured in our study stood at Rs 315,474 mn in FY 07 PSBs contribute to 63.87% of the total profits generated by all the profiled banks, followed by Private Sector Banks with 21.58% share and Foreign Banks with 14.53% share during the year. The high growth in Net profits was despite a sharp increase in provisions and contingencies of SCBs.

3.26.6 TOTAL INCOME

The total Income for all 80 profiled banks(for the list refer to Annexure II) stood at Rs 2,758,787 mn in FY07 of the above, PSBs held a robust share of 68.5%. Private sector Banks at 22.45% to be followed by 9.04% for foreign Banks, when compared to the previous years total income of all SCBs. In FY06, the total share of the PSBs in total income was to the tune of 72.37%, followed by Private sector Banks at 19.62% and Foreign Banks at 8%.
3.27 GROUPWISE BANK DEPOSITS & ADVANCES- A TWO YEAR COMPARISON

Table 3.7: Growth in deposits and Advances (%)—A comparison

<table>
<thead>
<tr>
<th>Group</th>
<th>Deposits</th>
<th>Advances</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY06</td>
<td>FY07</td>
</tr>
<tr>
<td>PSBs</td>
<td>12.90</td>
<td>28.83</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>36.11</td>
<td>22.90</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>31.70</td>
<td>32.60</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India

3.27.1 DEPOSITS

The total deposits of the 80 profiled banks grew by 24.6% in FY07, while the deposits of Private Sector Banks witnessed a growth of 28.83%, followed by Foreign Banks at 32.6%. PSB deposits grew by 12.9% in PSBs 36.11% in Private Sector Banks and 31.7% in foreign banks.

3.27.2 ADVANCES

Advances for all the profiled banks have grown at 30.60%. Advances of PSBs in FY07 registered a growth of 30% as against 29% in FY06 while that of Private Sector Banks grew by 32.52% as against 41.37% in the previous year. In case of foreign Banks, advances growth remained unchanged in FY07 at 30%.

Table 3.8: Non-interest income

<table>
<thead>
<tr>
<th>Group</th>
<th>Share (in %)</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBs</td>
<td>54</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>28</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>18</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India

For FY07, the non-interest income for all 80 banks profiled in the publication stood at Rs. 389,294 mn when compared to Rs 353,678 mn (for 82 banks) in FY0. For non-
interest income, PSBs contribute to 54% followed by private Sector Banks at 28% and foreign Banks at 18%.

### 3.27.3 LISTED BANKS – NET PROFITS CONTINUE TO GROW

Indian Banking is emerging as one the most profitable among the emerging economies for the third quarter ended December 2007, the 37 banks listed on the stock exchanges reported a jump of 52% in profits as compared to the previous corresponding period.

<table>
<thead>
<tr>
<th>S.No.</th>
<th>Name of the Bank</th>
<th>Net Profit (Rs. mn) December 31 07</th>
<th>% Growth</th>
<th>Net Profit (Rs. mn) December 31 06</th>
</tr>
</thead>
<tbody>
<tr>
<td>1</td>
<td>Axis Bank Ltd.</td>
<td>3068.30</td>
<td>66.20</td>
<td>1846.10</td>
</tr>
<tr>
<td>2</td>
<td>Bank Of Baroda</td>
<td>5010.50</td>
<td>52.23</td>
<td>3291.30</td>
</tr>
<tr>
<td>3</td>
<td>Bank of India</td>
<td>5118.90</td>
<td>100.84</td>
<td>2548.70</td>
</tr>
<tr>
<td>4</td>
<td>Canara Bank</td>
<td>4588.30</td>
<td>26.39</td>
<td>3630.20</td>
</tr>
<tr>
<td>5</td>
<td>HDFC Bank Ltd.</td>
<td>4293.60</td>
<td>45.23</td>
<td>2956.40</td>
</tr>
<tr>
<td>6</td>
<td>ICICI Bank ltd.</td>
<td>12302.10</td>
<td>35.18</td>
<td>9100.80</td>
</tr>
<tr>
<td>7</td>
<td>PNB Bank</td>
<td>54.1450</td>
<td>25.96</td>
<td>4298.70</td>
</tr>
<tr>
<td>8</td>
<td>SBI</td>
<td>24423.10</td>
<td>129.30</td>
<td>10651.00</td>
</tr>
</tbody>
</table>

Source: Stock Exchange /Annual Reports of Banks / Websites

### 3.27.4 INFRASTRUCTURE, BRANCHES, STAFF AND ATMs

All banks, cutting across groups, have shown a rapid growth in their infrastructure. However, PSBs continue to dominate the infrastructure domain in FY07. As of March 2007 the total number of branches of the profiled banks operating in the country was 56,640. PSBs share was 87.7% followed by Private Sector Banks with 11.8% while foreign banks had a share of less than 1% Amongst employees too PSBs dominated with the largest number of employees. Of the total employee strength of 893,356 of all the profiled banks, PSBs had the highest number of employees, reporting a share of 82% of the total employees.
As of March 07, the total number of ATMs installed by the 80 profiled banks stood at 27,088 PSBs once again accounted for the largest network ATMs with 60.3% share followed by Private Sector banks with a 36.2% share (including both old and new private sector) and foreign Banks with 3.5%. It is noteworthy that Foreign Banks despite having a less than 1% share in branches; own 3.5% of the ATMs.

### 3.28 GROWTH IN BUSINESS

Indian banking experienced phenomenal growth since the opening up of the financial sector. Liberalisations and deregulations unleashed intense competition among different banks leading to strong focus on growth and profitability. Since the Banking sector Reforms came into being Indian Banks reported compounded annual growth rates of 19% in capital, 17% in deposits, 18% in advances, 16% in income and 27% in net profits. Simultaneous to pursuing strong growth Indian Banks also made remarkable improvement in reducing the level of its non-performing assets. Net NPAs in Indian Banks are about 1% of the total assets in FY07.

<table>
<thead>
<tr>
<th>Group</th>
<th>Return on equity</th>
<th>Return on assets</th>
</tr>
</thead>
<tbody>
<tr>
<td>SBI</td>
<td>15.41</td>
<td>0.84</td>
</tr>
<tr>
<td>Nationalised Banks</td>
<td>15.97</td>
<td>0.94</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>15.98</td>
<td>2.27</td>
</tr>
<tr>
<td>All SCBs</td>
<td>15.51</td>
<td>1.05</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India

### 3.28.1 RETURN ON EQUITY

Return on Equity (ROE), is an indicator of use of capital by efficiency of banking institutions. All the banks reported similar ROE of 16%. All SCBs combined indicated a ROE of 15.51%.
3.28.2 RETURN ON ASSETS

Return on assets (ROA) is a measure of efficiency with which banks deploy their asset. ROA of SCBs remained almost unchanged at the previous years level. All SCBs together reported ROA of 1.05%. For nationalised banks, their ROA remained at 0.94% while for Foreign banks it was 2.27%. ROA of old Private sector banks and Foreign banks increased significantly during FY07, while that of PSBs increased marginally. However, ROA of New Private sector banks declined marginally.

Table 3.11: NPAs to Net advance ratio

<table>
<thead>
<tr>
<th>Group</th>
<th>Net NPA / Net Advances</th>
<th>Term Deposits /Total deposits</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBS</td>
<td>1.05</td>
<td>27.30</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>0.97</td>
<td>29.85</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>0.73</td>
<td>52.30</td>
</tr>
<tr>
<td>All SCBs</td>
<td>1.01</td>
<td>28.90</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India

3.28.3 NET NPAs TO NET ADVANCES

On an average, the net NPAs / Net advance ratio for the 80 banks was 1.01% in FY07. Of this, the Net NPAs to Net advance for PSBs were at 1.05%, followed by private sector banks at 0.97% . For foreign banks, the ratio was 0.73%

3.28.4 TERM DEPOSIT TO TOTAL DEPOSITS

Among the profiled 80 banks (for the list refer to Annexure B), the ratio of the term deposits/ total deposits for PSBs was 27.3%; private sector banks was 29.85%, while for foreign banks ratio was 52.3%.

3.28.5 CREDIT DEPOSIT RATIO

Table 3.12: Credit deposit ratio

<table>
<thead>
<tr>
<th>Group</th>
<th>Credit Deposit Ratio (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td></td>
<td>FY06</td>
</tr>
<tr>
<td>PSBs</td>
<td>68.20</td>
</tr>
<tr>
<td>Private Sector Banks</td>
<td>73.30</td>
</tr>
<tr>
<td>Foreign banks</td>
<td>85.80</td>
</tr>
<tr>
<td>Aggregate</td>
<td>70.10</td>
</tr>
</tbody>
</table>

Source: Reserve Bank of India
Among the 80 banks profiled (for the list refer to Annexure B), the aggregate Credit Deposit Ratio stood at 73.5% in FY07 as compared to 70.1% in FY06. Among the profiled banks – groups, Foreign Banks had a ratio of 68.6% in FY07, which was slightly lower than that of 85.8% in FY06. An opposite trend has been witnessed with private banks (both old and news), where their Credit Deposit Ratio stood at 75.1% in FY07, higher than 73.3% in FY06. PSBs too showed a growth in their Credit Deposit Ratio at 72.2%, when compared to 68.2% in the previous year.

3.28.6. CAPITAL ADEQUACY

Table 3.13: Capital Adequacy Ratio – Banks Group wise

<table>
<thead>
<tr>
<th>Group</th>
<th>2004</th>
<th>2005</th>
<th>2006</th>
<th>2007</th>
</tr>
</thead>
<tbody>
<tr>
<td>PSBs</td>
<td>13.2</td>
<td>12.9</td>
<td>12.2</td>
<td>12.4</td>
</tr>
<tr>
<td>Old Private Sector Banks</td>
<td>13.7</td>
<td>12.5</td>
<td>11.7</td>
<td>12.1</td>
</tr>
<tr>
<td>New Private Sector Banks</td>
<td>10.2</td>
<td>12.1</td>
<td>12.6</td>
<td>12</td>
</tr>
<tr>
<td>Foreign Banks</td>
<td>15</td>
<td>14</td>
<td>13</td>
<td>12.4</td>
</tr>
<tr>
<td>All SCBs</td>
<td>12.9</td>
<td>12.8</td>
<td>12.3</td>
<td>12.3</td>
</tr>
</tbody>
</table>

The overall capital risk adequacy ratio (CRAR) of SCBs in FY07 remained at the previous year’s level. This indicates that the increase in capital kept pace with rise in risk-weighted assets. A rapid growth in credit resulted in a rise in risk –weighted assets. Increase in risk –weights by the Reserve Bank on certain categories of advances as a measure to protect the balance sheets of banks during phases of rapid credit expansion also led to arise in risk –weighted assets. This ratio has undergone a decline in the past four fiscals ended 2006-07. From a CRAR of almost 13% in FY04 it declined to 12.3% in FY07.

3.29 CHANGING MARKET SHARE

While growth continues to be strong, competition brought in sizeable changes in the market shares of business. Public Sector Banks account for a major share of bank assets, but private Sector Banks; particularly the new Private banks are increasing their market share at a rapid pace. Share of Foreign banks in assets remained largely unchanged. PSBs also account for a large share in banking infrastructure in terms of branches, staff and ATMs.
3.30 FOCUS ON FUTURE

Core Banking Solutions (CBS) were speeded up in the PSBs, with several of them embracing complete CBS. Customer base is on continuous rise. Greater focus is being given to e banking. Axis bank for instance has 4.3mn customers using internet banking. Wide ranges of services are offered through internet banking. PSBs reported a huge spurt in internet banking with number of customers using internet banking showing a growth of 106% in Bank of India, 63% in Canara Bank and 60% in Andhara Bank. Contrary to the general impression on the decline of brick and mortar banking, banks in India are gearing up for massive expansion of branch network. Canara Bank and Axis Bank have plans to open up to 300 branches in the next two years, Central Bank of India 200 branches, Andhara Bank 150 branches, Indian Bank and State Bank of Hyderabad, 100 branches each. Bigger banks have plans of expanding their global operations. Banks generally are the major spenders on technology. With growing requirements on capital adequacy, risk management and profit maximisation banks are increasingly applying technology solutions for designing products and processes. Banks surveyed for the publication indicated that they would be spending 1.5% of the total revenues for investments in technology.

Bank consolidation is an aspect that interests most of the banks, but given the slow pace of it in India in the context of predominant position of the state owned banks, banks are willing to forge alliances and relationships that could boost businesses and bottom lines. Banks find alliances useful for numerous reasons, the most notable being, and common procurement of certain products. Services in the realm of technology that does not affect competition, cross selling, leverage synergies, increase access and reduce vulnerabilities in business.