PART 1

INTRODUCTION

AND

RESEARCH METHODOLOGY
Part 1
(Introduction and Research Methodology)

STATEMENT OF PURPOSE AND RATIONALE BEHIND THE STUDY:

“TIMES CHANGE AND WE WITH TIME”

The only permanent aspect in this world is change. Change results in growth and development and it is perhaps the only characteristic that is widely felt in all spheres of development of a nation—be it social system, the economic system, the legal system or the political system. One of the areas that have witnessed a change in the economic system of our country is the banking sector. The developments and changes that are taking place in the banking sector affect the development and growth of the nation.

A nation’s development is also influenced by the developments that take place in the manufacturing sector, agricultural sector, health sector, education, infrastructure etc. These sectors can survive and thrive well only if finances are readily made available to them. As a matter of fact the Common financial player who ensures the availability of funds at the right time is the banks. So, it is very essential that the banks stay in sound health to support the other sectors of the economy.

In fact the energy stability of the banking sector indicates the health and prosperity of a nation. It has been observed that the energy levels are reducing of late due to the low recovery rate of credit, mounting operational costs, poor management practices, pressures from trade unions etc. This problem of Non recovery of advances after a certain period when it becomes due is commonly referred as Non performing asset in banking terminology. In fact this problem of NPA may be compared to the disease of diabetes in the human system. This disease is not fatal immediately, but it cripples the functioning of other vital organs, albeit slowly. It stays, spreads, and finally if left uncontrolled, it may prove fatal. In this context, NPAS may also be referred as the “Banking sector diabetes”.

NPAs not only affect the profits but also hamper the financial position. The following excerpt from news item of Indian Express dated Nov 9th 2010 will substantiate the need for this study:
The Reserve Bank of India has cautioned that, management of non-performing assets (NPAs) and liquidity will become critical for banks, according to its ‘Report on Trend & Progress of banking in India 2009-10’ released on Monday. Going forward liquidity management will become critical for banks as monetary policy stance responds to the macroeconomic developments,” the RBI said.

The non performing assets is giving jitters to the banking sector slowly and is posing a Great Problem. Hence this study.

PROBLEM STATEMENT:
TO ANALYSE THE PRESENT SCENARIO OF NPAS, EXISTING REMEDIES AND HOW TO MOVE FORWARD IN TACKLING THESE NPAS.(IN SHORT, HOW TO MANAGE NPAS?)

APPROACH TO THE PROBLEM (RESEARCH METHODOLOGY):

A research is an endless quest for knowledge and unending search for truth. The knowledge obtained by research is scientific and objective and is matter of rational understanding, common verification and experience.

A research methodology is an overall action plan for research. Methodology is the logic or series of steps that connects a given set of research questions (uncertainties or gaps in our knowledge about the social world, about human behaviour) to the conclusions arrived at. It encompasses the selection of research methods, the design of data gathering instruments like interview or self-administered questionnaire schedules, gaining access to the research site, sampling, research ethics and data analysis.

Types of Research:

Research is a methodology that combines action and research to examine specific questions, issues or phenomena through observation and reflection, and deliberates intervention to arrive at logical conclusions.

Applied research is research undertaken to solve practical problems rather than to acquire knowledge for knowledge’s sake.
**Basic research** is experimental and theoretical work undertaken to acquire new knowledge without looking for long-term benefits other than the advancement of knowledge.

**Qualitative research** is research undertaken to gain insights concerning attitudes, beliefs, motivations and behaviours of individuals to explore a social or human problem and include methods such as focus groups, in-depth interviews, observation research and case studies.

**Quantitative research** is research concerned with the measurement of attitudes, behaviours and perceptions and includes interviewing methods such as telephone, intercept and door-to-door interviews as well as self-completion methods such as mail outs and online surveys.

**Descriptive:** When a study is designed primarily to describe what is going on or what exists. Public opinion polls that seek only to describe the proportion of people who hold various opinions are primarily descriptive in nature. For instance, if we want to know what percent of the population would vote for a BJP or Congress in the next election, we are simply interested in knowing a phenomenon.

**Relational:** When a study is designed to look at the relationships between two or more variables. A public opinion poll that compares what proportion of males and females say they would vote for a BJP or Congress candidate in the next election is essentially studying the relationship between gender and voting preference.

**Causal:** When a study is designed to determine whether one or more variables (e.g., a program or treatment variable) causes or affects one or more outcome variables. If we did a public opinion poll to try to determine whether a recent political advertising campaign changed voter preferences, we would essentially be studying whether the campaign (cause) changed the proportion of voters who would vote BJP or Congress (effect).

**Time** is an important element of any research design. The most fundamental distinctions in research design nomenclature: cross-sectional versus longitudinal studies. A cross-sectional study is one that takes place at a single point in time. In effect, we are taking a 'slice' or
cross-section of whatever it is we’re observing or measuring. A longitudinal study is one that
takes place over time -- we have at least two (and often more) waves of measurement in a
longitudinal design.

A variable is any entity that can take on different values. Anything that can vary can be
considered a variable. For instance, age can be considered a variable because age can take
different values for different people or for the same person at different times. Similarly,
country can be considered a variable because a person’s country can be assigned a value.
There is a distinction between an independent and dependent variable. In fact the
independent variable is what you (or nature) manipulates -- a treatment or program or
cause. The dependent variable is what is affected by the independent variable -- your effects
or outcomes. For example, if you are studying the effects of a new educational program on
student achievement, the program is the independent variable and your measures of
achievement are the dependent ones.

A hypothesis is a specific statement of prediction. It describes in concrete (rather than
theoretical) terms what you expect will happen in your study. Not all studies have
hypotheses. Sometimes a study is designed to be exploratory.

RESEARCH DESIGN:

A) The research design that was used is Descriptive Research and Exploratory research

- Involves gathering data that describe events and then organizes, tabulates, depicts, and
describes the data.

- Uses description as a tool to organize data into patterns those emerge during analysis.

- often uses visual aids such as graphs and charts to aid the reader.

- using of hypothesis testing.

The study is descriptive as it throws light on the phenomenon of NPA`s together with the
RBI norms.
It is also Exploratory as it tries to investigate into the causes of NPA`s and suggest remedial
measures,
B) Objectives of the study:

- To highlight the concept of Non-performing Assets.
- To understand the profile of select Pvt Sector banks and Public Sector Banks.
- To have an idea about the banking developments and developments in the other sectors of Chhattisgarh.
- To analyse the pattern of NPAs of individual banks.
- To undertake a comparative study of NPA pattern of select Pvt Sector banks and Public Sector Banks to find out if any significant differences exist in the NPA levels of the Private Sector Bank.
- To rank the best performing banks on the basis their Npas (in India) and also in C. G.
- To identify the causes of Non–Performing Assets in banks in Chhattisgarh region.
- To throw light on the customer point of view regarding non payments.
- To compare NPA levels of Chhattisgarh with all India levels.
- To analyse the relation between macroeconomic indicators like interest rates, GDP and Npas.
- To analyse the credit flow to C. G as a % of all India credit.
- To highlight the remedial measures adopted by the banking industry to tackle these NPA`s.
- To gain an insight on the management of “Stressed Assets”
- To list the recent RBI norms as far as NPA management is concerned and to clarify the Basel 2 norms on Capital adequacy.
- To describe the effectiveness of recovery tribunals vs SARFAESI Act in the recovery of debts.

C) Scope of the Study and its limitations:

1. The Study centers around the NPA`s of the banks.
2. It tries to fill in the gaps in the earlier studies made in the topic which did not address the present remedial measures apart from identifying the causes.
3. Foreign banks have been excluded in the study.
4. The analysis of NPA levels for various banks is done at the national or at the apex level for 9 years (5 public and 5 Pvt).

Initially, the study was restricted to all India levels due to unavailability of data, but repeated approaches to the authorities made them sensitive to
the problem and a data for 3 years could be retrieved for C. G during the last stages in the progression of the thesis. Even in this data, ICICI and Indus Ind have reported incorrect data to SLBC (C. G). So, an extended study has been made by comparing 3 years data for 8 banks (5 public and 3 pvt).

5. The data at some places are available only for the last 2 years or one year. Hence, the analysis is restricted only to those common years. (in restructuring)

6. It is really distressing to note that in the state of C. G, the data relating to NPAs are very scanty. More so, the NPAs have also not been quantified sector wise on the lines of Reserve Bank by the individual banks. The fact was brought to the notice of SLBC (STATE LEVEL bankers Committee) conveners. The bank acted on it, though the results were not very promising.

7) The causes for NPA`s are studied with reference to Chhattisgarh Region (comprising of Raipur, Bilaspur, Durg, Raigarh, Korba and Rajnandgaon districts)

D) HYPOTHESIS:

Hypothesis 1 deals with the study of NPA levels of various Public and Pvt Sector banks at the national level.

Hypothesis 2 deals with the Causes and remedies for NPA`s. Therefore, the following hypotheses have been framed.

For Hypothesis 1 (NPA levels),

Ho (Null Hypothesis): There is no significant difference between the NPA levels of Pvt Sector Banks and Public Sector banks. (H_0: \( \mu_1 = \mu_2 \))

H1 (Alternate Hypothesis): There is a significant difference between the NPA levels of Public and Pvt Sector banks. (H_1: \( \mu_1 \neq \mu_2 \))

For Hypothesis 2, (Reasons)

The major cause for the occurrence of NPA`s is business failure due to lack of entrepreneurial skills on the part of borrower.

E) Type of Data:

The data Collected was a Combination of Primary data as well as Secondary data. Secondary sources were used to analyze the pattern of NPA`s. The Primary source Method would be adopted for enquiry into the reasons for occurrence of NPA`s.
F) Techniques of Data Collection: -
Among the Primary sources, the Questionnaire method and Personal interview method would be used. Personal interviews with experts highlighted the actual problems faced by banks.
For the Secondary data, data from published sources (Banking journals, annual reports, newspaper updates and E reports and articles) would be used.

G) Period of Study: -
The NPA’s were analyzed for the period 1.4.2000 to 31.03.2009

H) Sample details:
The Selection of Sample was made on a Random basis.
a) Out of 27 Public sector banks and 22 Pvt Sector Banks in India, a study was made on 20 banks (5 from the Pvt Sector and 5 from Public sector) for analyzing the pattern of NPA’s.
b) The Questionnaire was administered on 396 respondents in Chhattisgarh for analyzing the causes of NPA’s. These respondents comprised of bankers and defaulting borrowers from various sectors.

I) Testing of Hypothesis:
Testing of hypothesis was done in the following way:
For NPA levels, Student’s t distribution was used because of the following reasons:
a) The sample size was less than 30.
b) The population standard deviation is not known.
For Reasons for NPAS, the information collected through questionnaire was tabulated and analyzed to reach a conclusion.

J) Beneficiaries of the study:
The outcomes analyzed from this study would be beneficial to various sections such as:
1) Banks: This study would definitely benefit the individual banks in a way that directs them as to which sector should be given priority for lending money.

2) Further Researchers: The major beneficiaries from the project would be the researchers themselves as this study would enhance their knowledge about the topic. They get an insight of the present scenario of this industry as this is the emerging industry in the financial sector of the economy.

3) Students: To get the understanding of NPA concept as a whole

The whole study has been presented in systematic chapters.
CHAPTER 1-
OVERVIEW OF INDIAN BANKING SCENARIO
(EVOLUTION, FUNCTIONS AND STRUCTURE)
CHAPTER 1- OVERVIEW OF INDIAN BANKING SCENARIO
(EVOLUTION, FUNCTIONS AND STRUCTURE)

A HISTORICAL BACKGROUND OF BANKING INSTITUTIONS IN INDIA.

1.1.1 TIMES CHANGE AND WE WITH TIME
The only permanent aspect in this world is change. Change results in growth and development and it is perhaps the only characteristic that is widely felt in all spheres of development of a nation. be it social system, the economic system, the legal system or the political system. One of the areas that have witnessed a change in the economic system of our country is the banking sector. From money lending in Manu’s period to mobile banking in the current period, banking operations have come a long way. Before we go ahead with understanding today’s banking scenario, we need to peep into our past to know the background of banking institutions in our country.

1.1.2: Credit in the Ancient Economy
There’s plenty of evidence to show that even prior to the advent of occidental ideas, India was not a stranger to concept of Banking. Loan and Usury (high rate of interest loans to farmers against mortgage of standing crop) were prevalent during the time of Rishis, Munis and Manus period. In fact, Manu has devoted a special section to the subject of deposits and pledges in the book of “Manu Needi Shastra”. There were also verses by Rishis like Gautama Brihaspati, etc regarding calculations of Interest. But in those times, banking basically meant money lending and finalising kings and wars. No doubt, the early banker was highly esteemed and was regarded as a worthy specimen of commercial morality.

1.1.3: Chronology of Evolution of Banking:
a) First Public Banking Institution in the world: - Bank of Venice at Italy in 1157.
b) Bank of Barcelona (Spain) in 1401 and Bank of Geneva (1407)
c) Bank of Amsterdam -1609
d) In England, Bank of England was the first to be established in 1694.
e) European Bank in 1784, General Bank in 1786 were set up in India, but failed. A number of Quasi govt Banking Institutions (after the failure of above banks) were set up with the main motto of helping the British. They were Bank of Bengal (1806), Presidency Bank of
Bombay (1840) and Presidency bank, Madras (1840). All later amalgamated to Imperial Bank.

f) Passing of Banking Act in 1833 developed Banking in England.

g) In India, the first Joint Stock Company Act of 1850 was a legislative enactment that provided corporate sector to come into banking businesses.

h) In India, the first was Oudh Commercial Bank in 1881 at Faizabad, followed by PNB in 1895 at Lahore and People’s bank in 1901. The period between 1906 and 1911, saw the establishment of banks inspired by the Swadeshi movement. The Swadeshi movement inspired local businessmen and political figures to establish banks of and for the Indian community. A number of banks established then have survived to the present such as Bank of India, Corporation Bank, Indian Bank, Bank of Baroda, Canara Bank and Central Bank of India. The two world wars left a negative impact on the functioning of banks as around 93 Banks were closed down as the combination of running a commercial enterprise apart from a banking business was virtually fatal.

i) After Independence, in 1948, the Reserve Bank of India, India’s central banking authority, was nationalized, and it became an institution owned by the Government of India.

j) In 1949, the Regulation Act was enacted which empowered the Reserve Bank of India (RBI) "to regulate, control, and inspect the banks in India." The Banking Regulation Act also provided that no new bank or branch of an existing bank could be opened without a license from the RBI, and no two banks could have common directors. However, despite these provisions, control and regulations, banks in India except the State Bank of India, continued to be owned and operated by private persons. This changed with the nationalization of major banks in India on 19 July, 1969.

k) Nationalization: By 1960s, the Indian banking industry had become an important tool to facilitate the development of the Indian economy. At the same time, it had emerged as a large employer, and a debate had ensued about the possibility to nationalize the banking industry. Indira Gandhi, the-then Prime Minister of India expressed the intention of the GOI in the annual conference of the All India Congress Meeting in a paper entitled "Stray thoughts on Bank Nationalization." The paper was received with positive enthusiasm. Thereafter, her move was swift and sudden, and the GOI issued an ordinance and
nationalised the 14 largest commercial banks with effect from the midnight of July 19, 1969. Within two weeks of the issue of the ordinance, the Parliament passed the Banking Companies (Acquisition and Transfer of Undertaking) Bill, and it received the presidential approval on 9 August, 1969. There was also establishment of the Banking commission with R. G. Saraiya as the chairman to enquire into the policies, practices financial needs, banking structure etc.

Second phase of Nationalisation began in 1980 with the nationalisation of 6 banks (Andhra Bank, Corporation Bank, New Bank of India (merged with PNB in 1993), Oriental bank of Commerce, Punjab and Sind Bank, Vijaya Bank

With the second dose of nationalization, the GOI controlled around 91% of the banking business of India. Later on, in the year 1993, the government merged New Bank of India with Punjab National Bank. It was the only merger between nationalized banks and resulted in the reduction of the number of nationalized banks from 20 to 19. After this, until the 1990s, the nationalised banks grew at a pace of around 4%, closer to the average growth rate of the Indian economy. The nationalised banks were credited by some, including Home minister P. Chidambaram, to have helped the Indian economy withstand the global financial crisis of 2007-2009.

I) Liberalization: In the early 1990s, the then Narasimha Rao government embarked on a policy of liberalization, licensing a small number of private banks. These came to be known as *New Generation tech-savvy banks*, and included Global Trust Bank (the first of such new generation banks to be set up), which later amalgamated with Oriental Bank of Commerce. Privatisation of the Banking Sector in 1991 led to the establishment of private Banks like HDFC Bank, ICICI Bank, Tamilnadu Mercantile bank, Axis Bank (earlier UTI) etc and the establishment of foreign banks like ABN Amro Bank, Citi Bank, etc. This move, along with the rapid growth in the economy of India, revitalized the banking sector in India, which has seen rapid growth with strong contribution from all the three sectors of banks, namely, government banks, private banks and foreign banks. The next stage for the Indian banking was the relaxation in the norms for Foreign Direct Investment, where all Foreign Investors in banks were given voting rights of 10%. At present it has gone up to 49% with some restrictions.
The new policy shook the Banking sector in India completely. Bankers, till this time, were used to the 4-6-4 method (Borrow at 4%; Lend at 6%; Go home at 4) of functioning. The new wave ushered in a modern outlook and tech-savvy methods of working for traditional banks. All this led to the retail boom in India, one which has made fund management a click away...........

In short, the above may be summarized into 5 phases as under in order to have proper understanding of NPA menace.

**Preliminary phase:** Series of births and deaths of banks in the first five decades of twentieth Century.

**Business phase:** Laying of solid and sound foundation for banking business took place between 1949 and 1969 by enacting Banking Companies’ Regulation Act 1949.

**Branching out phase** (1969 to 1985): When 19 major commercial banks were nationalized in two phases and these banks have reached larger mass of population through opening of branches and lead bank schemes.

**Consolidation phase:** During this phase (1985 – 1991) weaknesses and defects of mass branching were identified and attended through various committees’ investigation.

**Reforms and strengthening stage** (1991 to till Date): In fact first dose of reforms started with Narasimham Committee report in 1991. The Narasimham committee reports (First report) recommendations are the basis for initiation of the process, which is still continuing. These reforms helped many of the sick banks to come out of the red after repeated doses of fund infusions. But a few of the banks are still in the red and efforts are on to resuscitate them. The bigger challenge at the moment is to deal with the worsening financial health of the banking sector. The important financial institutions like Industrial Finance Corporation of India (IFCI) and Industrial Development Bank of India (IDBI) were also not in the pink of health, and required government support for revitalizing themselves. The important aspect of the banking sector reforms is relating to liberalization of norms and guidelines for making
the whole sector vibrant and competitive. It is futile to say that there are no controls but they are much lesser as compared to the controls that existed before the initiation of banking reforms. This was a gradual process undertaken with utmost care to prevent a disruption of the banking sector.

1.1.4 Developments and performance of the banking sector in 2009.

While the balance sheet of public sector banks maintained their growth momentum, the private sector banks and foreign banks did not. During 2008-09, the growth rate of banks’ lending to industries, personal loans and services sector witnessed a deceleration, while growth rate of banks’ lending to agriculture and allied activities increased substantially. The public sector banks’ share in aggregate assets, deposits, advances and investments increased as at end-March 2009 vis-a-vis last year, while the shares of private sector banks registered a decline. This was mainly on account of the strong balance sheet growth registered in case of public sector banks against the backdrop of deceleration in growth rate of other bank groups.

Growth in deposits: The growth rate of aggregate deposits of SCBs decelerated to 22.4 per cent as at end March 2009 from 23.1 per cent as at end March 2008 and that of 24.6 per cent in the previous year. The importance of Certificates of Deposit (CDs) as means of raising resources continued during 2008-09, albeit with some deceleration in growth rate. CDs outstanding as percentage of aggregate deposits stood at 4.7 per cent.

Growth rate of loans and advances: The growth rate of loans and advances of SCBs, which was as high as 33.2 per cent as at end-March 2005 has been witnessing a slowdown since then. In continuation of the trend, the growth rate of aggregate loans and advances of SCBs decelerated to 21.2 per cent as at end-March 2009 from 25.0 per cent in the previous year. Apart from cyclical factors which led to slowdown in growth after a period of high credit growth, the deceleration was accentuated this year due to the overall slowdown in the economy in the aftermath of global financial turmoil. Notwithstanding the deceleration in growth of the term loans, their share in investment in the economy increased to 81.0 per cent in 2008-09 from 77.8 per cent in the previous year.

Sectoral Deployment of Bank Credit: The deceleration in bank credit growth witnessed during 2007-08 continued in 2008-09 as well mainly reflective of the slowdown in real economy as also cautious approach adopted by banks against the backdrop of growing uncertainties. The data suggests that growth rate of bank’s lending to industries, personal
loans and services sector witnessed a deceleration, while bank’s lending to agriculture and allied activities increased. Growth of income of SCBs during 2008-09 decelerated to 25.7 per cent from 34.3 per cent in the previous year, but was higher than the growth rate of 24.4 per cent in 2006-07. The Income to assets ratio improved marginally to 8.8 per cent from 8.5 per cent last year. Reflecting the lower lending rates, growth of interest income of SCBs as at end March 2009 decelerated to 26.0 per cent as compared with 33.2 per cent in the previous year. Expenditure of SCBs decelerated to 26.0 per cent as at end March 2009 as compared with 33.9 per cent in the previous year. Among the major components of expenditure of SCBs, growth rate of interest expended decelerated sharply to 26.5 per cent as compared with 46.0 per cent growth in the previous year. Noninterest or operating expenses also decelerated while provisioning increased sharply.

The operating profits of public sector banks increased sharply but that of private sector banks and foreign banks witnessed a slowdown. The operating profits to Provisions for NPAs increased by 43.0 per cent, as compared to 28.4 per cent last year. The growth in net profits of SCBs decelerated to 23.5 per cent during 2008-09 from 36.9 per cent in the previous year. This was mainly on account of sharp increase in the provisions and contingencies

**Soundness Indicators:**

The Capital to Risk-weighted Assets Ratio (CRAR) of SCBs, a measure of the capacity of the banking system to absorb unexpected losses, improved further to 13.2 per cent at end-March 2009 from 13.0 per cent at end-March 2008.

The other vibrant dimension of the banking sector is to reduce the Non – performing assets (NPA). The asset quality of banks in India has been improving over the past few years as reflected in the declining NPA to advances ratio. The trend of improvement in the asset quality of banks continued during the year. Indian banks recovered a higher amount of NPAs during 2008-09 than that during the previous year. Though the total amount recovered and written-off at Rs.38,828 in 2008-09 was higher than Rs.28,283 crore in 2007-08, it was lower than fresh addition of NPAs (Rs.52,382 crore) during the year. As a result, the gross NPAs of SCBs increased across all the bank groups (Table IV.25). In this context, it may be noted that in the present context of financial turmoil, some slippage in NPAs could be expected. Nevertheless, it may be noted that this slippage was moderate as compared to the problems faced by banks all over the world.
Among the various channels of recovery available to banks for dealing with bad loans, the SARFAESI Act and the Debt Recovery Tribunals (DRTs) have been the most effective in terms of amount recovered. The amount recovered as percentage of amount involved was the highest under the DRTs, followed by SARFAESI Act. The recovery rate (percentage of recovery to demand) of direct agricultural advances of public sector banks has been declining for last couple of years. In line with this trend, the recovery rate declined to 75.4 per cent for the year ended June 2008 from 79.7 per cent a year. It is noteworthy that while the share of NPAs in ‘doubtful’ and ‘loss’ category remained more or less static, the share of ‘sub-standard’ category witnessed some variations. As per the asset classification norms, a sub-standard asset is one which has remained NPA for a period of up to 12 months. Thus, the above-mentioned increase in the share of sub-standard category is indicative of deterioration of the assets in last one year.

A more detailed study would follow in the succeeding chapters.

1.2: FUNCTIONS AND STRUCTURE OF BANKS:

1.2.1 Banking Regulation Act of India, 1949 defines Banking as "accepting, for the purpose of lending or investment of deposits of money from the public, repayable on demand or otherwise and withdraw able by cheques, draft, and order or otherwise". Deriving from this definition and viewed solely from the point of view of the customers, Banks essentially perform the following functions:

1. Accepting Deposits from public/others (Deposits)
2. Lending money to public (Loans)
3. Transferring money from one place to another (Remittances)
4. Credit creation.
5. Acting as trustees
7. Investment Decisions and analysis
8. Government business
9. Other types of lending and transactions.
1.2.2 In addition to providing a safe custodian of money, banks also loan money to businesses and consumers. A large portion of a bank’s business is lending. The money to lend comes from depositors who intend to save a portion of their wealth. Banks acting as intermediaries use these deposits as loans to prospective borrowers.

1.2.3. The objective of commercial banks like any other organization is profit maximization. This profit generally originates from the interest differential between borrowers and lenders. In the present day, however, the banking operation has extended much beyond simple lending exercise. So there are other different channels of profit like alternate investments of deposits. However, it should be mentioned in this context that the entire deposit held by a bank cannot be given as loans as the Central Bank retains a portion of this money in the form of cash-reserve for unforeseen circumstances.

1.2.4. Banks create money in the economy by making loans. The amount of money that banks can lend is directly affected by the reserve requirement set by the Central Bank. The reserve requirement is currently 6% percent of a bank’s total deposits. This amount can be held either in cash on hand or in the bank’s reserve account with the Reserve Bank. To see how this affects the economy, think about it like this. When a bank gets a deposit of Rs 100, assuming a reserve requirement of 10 percent, the bank can then lend out Rs 90. That Rs 90 goes back into the economy, purchasing goods or services, and usually ends up deposited in another bank. That bank can then lend out Rs 81 of that Rs 90 deposit, and that Rs 81 goes into the economy to purchase goods or services and ultimately is deposited into another bank that proceeds to lend out a percentage of it

1.2.5 Other Services Offered by Banks
Credit Cards, Personal Loans, Home and Car Loans, Mutual Funds, Business Loans, Safe Deposit Boxes, Debit Cards, Trust Services, Signature Guarantees, and many other investment services.
1.3 BANKING SECTOR IN INDIA.

1.3.1 Central Bank: A central bank, reserve bank, or monetary authority is the entity responsible for the monetary policy of a country or of a group of member states. Its primary responsibility is to maintain the stability of the national currency and money supply, but more active duties include controlling subsidized-loan interest rates, and acting as a lender of last resort to the banking sector during times of financial crisis (private banks often being integral to the national financial system). It may also have supervisory powers, to ensure that banks and other financial institutions do not behave recklessly or fraudulently.

1.3.2 Commercial Banks: A commercial Bank performs all kinds of banking functions such as accepting deposits, advancing loans, credit creation & agency functions. They generally advance short term loans to their customers, in some cases they may give medium term loans also. Industrial Banks: Ordinarily, the industrial banks perform three main functions: Acceptance of Long term deposits: Since the industrial bank give long term loans, they cannot accept short term deposits from the public.

Meeting the credit requirements of companies: Firstly the industries require finances for purchasing land to erect buildings and purchase heavy machinery. Secondly the industries require short term loans to buy raw materials & to make payments of wages to workers. Other Functions - The industrial banks tender advice to big industrial firms regarding the sale & purchase of shares & debentures

1.3.3. Agricultural Banks: As the commercial & the industrial Banks are not in a position to meet the Credit requirements of agriculture wholly, there arises the need for setting up special types of banks to finance agriculture. Firstly, the farmers require short term loans to buy seeds, fertilizers, ploughs and other inputs. Secondly, the farmers require long term loans to purchase land, to effect permanent improvements on the land to buy equipment & to provide for irrigation works.

1.3.4 Foreign Exchange Banks: Their main function is to make international payments through the Purchase and sale of exchange bills. As is well known, the exporters of a country prefer to receive the payment for their exports in their own currency. Hence there arises the problem of Converting the currency of one country into the currency of another. The foreign exchange banks try to solve this problem. These banks specialize in financing foreign trade. Nowadays, most of the banks perform this function apart from their regular business.
1.3.5 **Indigenous Banks**: According to the Indian Enquiry Committee, “Indigenous banker is a Person or a firm which accepts deposits transacts business in hundies and advances loans etc”. They do not come under the direct supervision of RBI and form the unorganized sector in Banking.

**Banks - Public/ Private and Foreign banks functioning in India.**

- **Public Sector Banks**
- **Private Sector Banks**
- **Foreign Banks in India**

### Public Sector Banks (27)

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<td>Indian Overseas Bank</td>
<td>Allahabad Bank</td>
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<td>Bank of India</td>
<td>Punjab National Bank</td>
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<td>Union Bank</td>
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<td>State Bank of India, Indore</td>
<td>Punjab &amp; Sind Bank</td>
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<td>Vijaya Bank</td>
<td>State Bank of Mysore</td>
<td>IDBI Bank</td>
</tr>
<tr>
<td>UCO Bank</td>
<td>Corporation Bank</td>
<td>United Bank</td>
</tr>
<tr>
<td></td>
<td>Central Bank of India</td>
<td>State bank of Patiala</td>
</tr>
<tr>
<td></td>
<td>Corporation Bank</td>
<td></td>
</tr>
<tr>
<td>Private Sector Banks (22)</td>
<td>Foreign Banks in India (33)</td>
<td></td>
</tr>
<tr>
<td>-----------------------------------------------</td>
<td>-------------------------------------------------------</td>
<td></td>
</tr>
<tr>
<td>South Indian Bank</td>
<td>Standard Chartered Bank</td>
<td></td>
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<tr>
<td><strong>IndusInd Bank</strong></td>
<td>American Express Bank</td>
<td></td>
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<tr>
<td><strong>HDFC Bank</strong></td>
<td>Banque Nationale De Paris</td>
<td></td>
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<tr>
<td>Jammu &amp; Kashmir Bank</td>
<td>AB Bank</td>
<td></td>
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<tr>
<td>Nainital Bank</td>
<td>Abudhabi Coml Bank</td>
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<tr>
<td>Development Credit Bank</td>
<td>Antwerp Diamond Bank</td>
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<tr>
<td>Ratnakar Bank</td>
<td>Bank International Indonesia</td>
<td></td>
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<tr>
<td>Yes Bank</td>
<td>Bank of America</td>
<td></td>
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<tr>
<td></td>
<td>Sonali Bank</td>
<td></td>
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<tr>
<td></td>
<td>State Bank of Mauritius</td>
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<td></td>
<td>Citi Bank</td>
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<tr>
<td></td>
<td>ABN Amro Bank</td>
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<tr>
<td></td>
<td>Asian Development Bank</td>
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<tr>
<td></td>
<td>Bank of Bahrain and Kuwait.</td>
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<td></td>
<td>Bank of Ceylon</td>
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<tr>
<td></td>
<td>Bank of Nova Scotia</td>
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<tr>
<td></td>
<td>Bank of Tokyo Mitsubishi</td>
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<td></td>
<td>Barclay’s Bank</td>
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<tr>
<td></td>
<td>BNP Paribas</td>
<td></td>
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<tr>
<td></td>
<td>Ceylon Bank</td>
<td></td>
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<tr>
<td></td>
<td>UBS AG</td>
<td></td>
</tr>
<tr>
<td></td>
<td>Oman International</td>
<td></td>
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<tr>
<td></td>
<td>China Trust Commercial Bank</td>
<td></td>
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<tr>
<td></td>
<td>DBS Bank</td>
<td></td>
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<tr>
<td></td>
<td>Deutsche Bank</td>
<td></td>
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<tr>
<td></td>
<td>HSBC</td>
<td></td>
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<tr>
<td></td>
<td>Morgan Chase JP</td>
<td></td>
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<tr>
<td></td>
<td>Krung Thai</td>
<td></td>
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<tr>
<td></td>
<td>Mashreq Bank</td>
<td></td>
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<tr>
<td></td>
<td>Mizuho Corp</td>
<td></td>
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<tr>
<td></td>
<td>Shinhan Bank</td>
<td></td>
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<tr>
<td></td>
<td>Societe Generale Bank</td>
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</table>
1.4 PERFORMANCE OF INDIAN BANKING SECTOR POST REFORMS

We now look into the different aspects of bank performance which have been targeted by the reforms. These are:

1) Deposit Mobilization
2) Portfolio Choice
3) Competition
4) Efficiency.
5) Capital adequacy
6) Profitability
7. NPA’s.

1) Deposit Mobilization: Estimates of trends in real deposit growth post reforms reveal that the rate of growth has fluctuated, slackening between 1994-5 and 1995-6 but picked up during later years.

In a nutshell, the present banking scenario with respect to deposits and advances can be observed from the following table:

**Table 1.1: Comparative Deposits, Advances position and GDP of country.**

<table>
<thead>
<tr>
<th>Year</th>
<th>% increase in deposits</th>
<th>% increase in advances</th>
<th>% growth in GDP</th>
</tr>
</thead>
<tbody>
<tr>
<td>99-00</td>
<td>19.23</td>
<td>31.5</td>
<td>9.59</td>
</tr>
<tr>
<td>00-01</td>
<td>17.2</td>
<td>30.93</td>
<td>7.53</td>
</tr>
<tr>
<td>01-02</td>
<td>14.26</td>
<td>23.6</td>
<td>7.8</td>
</tr>
<tr>
<td>02-03</td>
<td>13.02</td>
<td>15.12</td>
<td>10.94</td>
</tr>
<tr>
<td>03-04</td>
<td>16.47</td>
<td>16.93</td>
<td>13.6</td>
</tr>
<tr>
<td>04-05</td>
<td>16.6</td>
<td>30.99</td>
<td>13.88</td>
</tr>
<tr>
<td>05-06</td>
<td>17.8</td>
<td>33.2</td>
<td>15.15</td>
</tr>
<tr>
<td>06-07</td>
<td>24.6</td>
<td>30.6</td>
<td>13.12</td>
</tr>
<tr>
<td>07-08</td>
<td>23.1</td>
<td>25</td>
<td>8.72</td>
</tr>
<tr>
<td>08-09</td>
<td>21.94</td>
<td>21.25</td>
<td>6.65</td>
</tr>
</tbody>
</table>

Source: RBI Trend and progress of banking in India various issues, IMF reports
Competition: With the entry of new private banks, the market shares of public sector banks have declined by close to 4% points from around 90% in 1991-92 to around 85% in 1995-96. This kind of competition has led to adoption of newer banking practices like ATM, Online transactions and others to fit in the global competitive market.

Efficiency: An increase in competitive pressures is expected to improve efficiency levels. However in this regard, there has been phenomenal improvement especially in the public sector banks which have stepped up their services and increased access to the customer base.

Capital Adequacy: Almost all banks have maintained the capital adequacy norms of 9%, according to Basel I norms. From the year 2007, Banks are following Basel 2 norms relating to Capital adequacy to ensure transparency, effective risk management etc. Information about Basel 2 norms follows in the succeeding chapters.

**Nonperforming Assets:**

In 1993-94, the average percentage of NPA’s to total advances for 27 public sector banks was 21.89 which declined to 9.8% of total advances in 1996-97. Gradually, stricter norms and provisioning have reduced the NPA s considerably as is evident from the following tables.

**Table 1.2: Gross NPAs of Banks (gross NPA/total assets)**

<table>
<thead>
<tr>
<th>Name of bank</th>
<th>2000-01</th>
<th>2001-02</th>
<th>2002-03</th>
<th>2003-04</th>
<th>04-05</th>
<th>05-06</th>
<th>06-07</th>
<th>07-08</th>
<th>08-09</th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector banks</td>
<td>5.3</td>
<td>4.9</td>
<td>4.2</td>
<td>3.5</td>
<td>2.7</td>
<td>2.1</td>
<td>1.6</td>
<td>1.3</td>
<td>1.2</td>
</tr>
<tr>
<td>Pvt sector banks</td>
<td>2.1</td>
<td>3.9</td>
<td>3.8</td>
<td>2.4</td>
<td>2.1</td>
<td>1.4</td>
<td>1.2</td>
<td>1.4</td>
<td>1.7</td>
</tr>
</tbody>
</table>
Table 1.3: Net NPA’s of Banks (Net NPA/ total assets)

<table>
<thead>
<tr>
<th></th>
<th></th>
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<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
<th></th>
</tr>
</thead>
<tbody>
<tr>
<td>Public Sector banks</td>
<td>7.3</td>
<td>7.1</td>
<td>5.5</td>
<td>3.8</td>
<td>1.0</td>
<td>.7</td>
<td>.6</td>
<td>.6</td>
<td>.6</td>
</tr>
<tr>
<td>Pvt sector banks</td>
<td>1.2</td>
<td>2.1</td>
<td>2.2</td>
<td>1.1</td>
<td>1.0</td>
<td>.6</td>
<td>.5</td>
<td>.6</td>
<td>.7</td>
</tr>
</tbody>
</table>


The table above depicts a bird’s eye view of NPA’s of public and private sector banks. In the past 5 years, it is clear that NPA’s are showing a decreasing trend especially the gross NPA’s due to the stringent norms by RBI on asset classification. The latest measures to reduce credit risks like Corporate debt Restructuring, stricter classification etc have helped banks reduce their NPA’s in a considerable manner.

1.5 S.W.O.T. ANALYSIS OF INDIAN BANKING INDUSTRY

1.5.1 Strengths:
- Indian banks have compared favorably on growth, asset quality and profitability with other regional banks in the continent over the last few years. The banking index has grown at a compounded annual rate of over 51 per cent since April 2001 as compared to a 27 percent growth in the market index for the same period.
- Policy makers have made some notable changes in policy and regulation to help strengthen the sector. These changes include strengthening prudential norms, enhancing the payments system and integrating regulations between commercial and co-operative banks.
- Bank lending has been a significant driver of GDP growth and employment.
- The vast networking & growing number of branches & ATMs has increased the reach of Indian banking system even to the remotest corners of the country.

- The government's regular policy for Indian bank since 1969 has paid rich dividends with the nationalization of 14 major private banks of India.

- In terms of quality of assets and capital adequacy, Indian banks are considered to have clean, strong and transparent balance sheets relative to other banks in comparable economies in its region.

- As at end-March 2009, SCBs comprised 27 public sector banks (that is with the Government of India holding a stake) viz (State Bank of India and its six associates, 19 nationalised banks and the IDBI Bank Ltd.), 7 new private 15 old private sector banks (these do not have government stake; they may be publicly listed and traded on stock exchanges) and 31 foreign banks.

- They have a combined network of over 53,000 branches and 17,000 ATMs. According to a report by ICRA Limited, a rating agency, the public sector banks hold over 75 percent of total assets of the banking industry, with the private and foreign banks holding 18.2% and 6.5% respectively.

- Foreign banks have the opportunity to own up to 74 per cent of Indian private sector banks and 20 per cent of government owned banks.

1.5.2 Weaknesses:

- PSBs need to fundamentally strengthen institutional skill levels especially in sales and marketing, service operations, risk management and the overall organizational performance ethic & strengthen human capital.

- Old private sector banks also have the need to fundamentally strengthen skill levels.
• The cost of intermediation remains high and bank penetration is limited to only a few customer segments and geographies.

• Structural weaknesses such as a fragmented industry structure, restrictions on capital availability and deployment, lack of institutional support infrastructure, restrictive labour laws, weak corporate governance and ineffective regulations beyond Scheduled Commercial Banks (SCBs), unless industry utilities and service bureaus.

• Refusal to dilute stake in PSU banks: The government has refused to dilute its stake in PSU banks below 51% thus choking the headroom available to these banks for raining equity capital.
• Impediments in sectoral reforms: Opposition from Left and resultant cautious approach from the North Block in terms of approving merger of PSU banks may hamper their growth prospects in the medium term.

1.5.3 Opportunity:

• The market is seeing discontinuous growth driven by new products and services that include opportunities in credit cards, consumer finance and wealth management on the retail side, and in fee-based income and investment banking on the wholesale banking side. These require new skills in sales & marketing, credit and operations.

• Banks will no longer enjoy windfall treasury gains that the decade-long secular decline in interest rates provided. This will expose the weaker banks.

• With increased interest in India, competition from foreign banks will only intensify.

• Given the demographic shifts resulting from changes in age profile and household income, consumers will increasingly demand enhanced institutional capabilities and service levels from banks.
• New private banks could reach the next level of their growth in the Indian banking sector by continuing to innovate and develop differentiated business models to profitably serve segments like the rural/low income and affluent/HNI segments; actively adopting acquisitions as a means to grow and reaching the next level of performance in their service platforms. Attracting, developing and retaining more leadership capacity

• Foreign banks committed to making a play in India will need to adopt alternative approaches to win the “race for the customer” and build a value-creating customer franchise in advance of regulations potentially opening up post 2009. At the same time, they should stay in the game for potential acquisition opportunities as and when they appear in the near term, maintaining a fundamentally long-term value-creation mindset.

• Reach in rural India for the private sector and foreign banks

• With the growth in the Indian economy expected to be strong for quite some time especially in its services sector-the demand for banking services, especially retail banking, mortgages and investment services are expected to be strong.

• The Reserve Bank of India (RBI) has approved a proposal from the government to amend the Banking Regulation Act to permit banks to trade in commodities and commodity derivatives.

• Liberalization of ECB (External Commercial Borrowings) norms: The government also liberalized the ECB norms to permit financial sector entities engaged in infrastructure funding to raise ECBs. This enabled banks and financial institutions, which were earlier not permitted to raise such funds, explore this route for raising cheaper funds in the overseas markets.

• In an attempt to relieve banks of their capital crunch, the RBI has allowed them to raise perpetual bonds and other hybrid capital securities to shore up their capital. If the new instruments find takers, it would help PSU banks, left with little headroom for raising equity. Significantly, FII and NRI investment limits in these securities have been fixed at 49%, compared to 20% foreign equity holding allowed in PSU banks.
1.5.4 Threats:

- Threat of stability of the system: failure of some weak banks has often threatened the stability of the system.
- Rise in inflation figures which would lead to increase in interest rates.
- Increase in the number of foreign players would pose a threat to the PSB as well as the private players.
- Rise of inflation levels leading to lower real income levels, crunch of liquidity, higher NPAs, which is posing a major threat to the Indian banking system.

The situation would be further clear from the forthcoming pages when NPA would be analysed in detail.