CHAPTER – I
INTRODUCTION

1.1 ORIGIN OF BANKS
The Banking, as it exists today, is the result of a transaction that has taken place over many a centuries. Throughout the globe, Banking has been in existence in one form or the other.

The word Bank is said to be of Germanic origin, related with French word Banque and the Italian word, Banca, both meaning bench. It seems, this word may have derived its meaning from the practice of Jewish money-changers of Lombardy (A District in North Italy), who, in the Middle Ages, used to do business sitting on Benches in the market place.

The history of origin of Banks is noticeable in ancient times. The new evidence contains a reference of the activities of money changers in the temples of Jerusalem. As early as 2000 BC, the temples in Babylonia were used as Banks and person acted as financial agents until the public lost confidence as a result of disbelief in religion. In ancient Greece the famous temples of Delphi and Olympia served as the great depositories for the surplus funds of the public and were the main centers of the money lending business. The traces of credit by compensation and by transfer orders are found in Assyria, Phoenicia and Egypt before the growth of the system in its full form Greece and Rome.

The development of Banking in ancient Rome was roughly on Greek pattern. The bankers were called Argentari, Mensarii, collybistoe. The Banks were known as Tabernoe Argentarioe. Some of the Banks were appointed by the Government as its agents to accept taxes while the other used to conduct business independently on their own.

The methodology adopted by these Banks resembled that of modern Banks. The use of cheques, drafts and transfer orders, although in their simple form or content, was common amongst people settle their accounts. The Banking, however, was largely confined to money changing and money lending. Banking suffered unconsciousness after the fall of the Roman Empire in the death of Emperor Justinian in 565 AD. With the revival of trade and commerce in the middle ages, the Banking again took its roots. Early European Banking was carried on by Jews since the Christians were forbidden by the standard Law to lend money to other on interest as it was considered to be a sinful act. Christianity took an indifferent attitude to wealth and Christ's teachings also displayed dislike to wealth. Another reason for the Jews

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having monopolised the business of Banking was that they had to keep their possessions in liquid form because they were not allowed to hold lands. Subsequently, when the hold of church loosened around the thirteenth century, the Christians also entered on the business of Banking coming into direct competition with Jews.

In middle age of Europe the Banking business by and large was undertaken by private individuals and amongst them the Bankers of Lombardy had their own place. A number of prominent Bankers from Lombardy migrated to England and built a street in London and established Banking, among other search, thus making the name of Lombard Street famous. This period also witnessed upsurge of finance companies in Italy whose main activity was to make loans to and to float loans to the Government but subsequently they also started doing Banking business.³

Banking made its first appearance as a public enterprise around the middle of the 12th century in Italy when the Bank of Venice was established in the year 1157⁴. Originally it was not Bank as we see it today, but only in office for the transfer of the public debt. Thereafter, Bank of Barcelona and Bank of Genoa were founded in the years 1401 and 1407 respectively. Out of these, the Bank of Venice and the Bank of Genoa continued to function until the end of the 18th century. The 16th century witnessed the emergence of two important Banks viz. the Bank of Sweden in 1556 and the Banco di Rialto in Venice in 1584, which conducted business both in deposit and exchange branches. The Bank of Sweden which is pioneering in the field of Bank Notes is now known as the State Bank of Sweden.

The establishment of the Bank of Amsterdam in the year 1609 is a great event of the 17th century in the history of Banking.⁵ This Bank held for a long time prominent position in international commerce, though it was initially meant to help the merchants of the city. It accepted all kinds of foreign coins, and damaged coin of the country as its real intrinsic value in the good standard money of the country, deducting only so much as necessary to meet the expenses of management. For the value which remained, after this small deduction, it gave a credit in its books. This credit was called Bank money, which as it represented money exactly according to the standard of the bundle, was always of the same real value and intrinsically worth more than currency money.⁶ These deposits could be withdrawn on demand or transferred from the accounts of one person to another. The Bank also adopted a

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plan under which depositors received a kind of certificate entitling him to withdraw his deposits within 6 months. These written orders, in the course of time, came to be used in the same manner as the modern cheques.

Although the development of Banking in England is certified to the activities of goldsmiths during the reign of Queen Elizabeth I, several other business communities who acted as money changers, money lenders and exchange specialists had overshadowed them. The goldsmiths came to limelight only around the middle of the 17th century when King Charles I seized a large quantity of gold of the merchants of London kept by them in the tower of London. The merchants of London were very much frightened by this incident and they decided to look elsewhere for the safety of their surplus fund even though their seized deposits were restored to them after some time. The London merchants found the goldsmiths to be a safe place to keep their surplus funds / bullion. The goldsmith soon discovered that they could earn profit by lending the merchants money deposited with them. With the passage of time, the goldsmith started paying interest to their depositors so as to attract more deposits. And thus, the goldsmiths became the forerunners of the Commercial Banking system. Banking in the modern sense of the term can be said to have originated in England in the foundation of the Bank of England in the year 1694.

However, full development of modern Commercial Banking in England had to await the passage of the Act of 1833 which permitted the foundation of joint stock Banks, while Banking took roots far early and more rapidly in some countries than in others, it was only in the 19th century that the modern Banking system with joint stock Banks developed in the lending world countries. 

1.2 EARLY HISTORY OF INDIAN BANKING

The origin and growth of Banking in India dates back to Vedic times, which may be taken to range from 2000 BC to 1400 BC. Money lending was regarded as an old art. That it was being practiced even in early Aryans days is evidenced by the reference to money-lending as one of the four honest businesses, the other three being cultivation, trade and harvesting. Debt is often reflected a normal condition prevalent in the Vedic society.

More details pertaining to money lending in the Buddhist period, which is 7th to 2nd century BC, are available from the Buddhist writings called the Jatakas, a large body of stories about the lives of Buddha. Clearly establish the existence of money -lenders called 'Seths' who

8 Panandikar, S.G. (1975), Banking in India, Orient Longman Ltd, PP. 01.
performed the function of Bankers. There is an evidence of remittance of cash and the creation of credit instruments and debt sheets. These sources have also brought to light the existence of trade and merchant guilds engaged in commercial and industrial activities. In the Buddhist period there are several stories of kings receiving financial help from the guilds.\(^9\) The guilds paid interest on deposits they received at the rate fixed by the general assembly of the associations, as a merchant to maintain the standards of their people. From these accounts it is evident that money-lending, Banking and trading were interlinked and the present day combination of money-lending and trading probably date back to the 6\(^{th}\) and 5\(^{th}\) centuries BC.

The problem relates to money-lending assumed considerable importance in the first few centuries of the Christian era (2\(^{nd}\) to the 5\(^{th}\) centuries AD). The importance of money-lending for economic development of the country was recognised and Kautilya's Arthashastra called upon the king to regulate the interest rate and to lay down rules for creditors and debtors. The transition from money-lending to Banking appears to have taken place by the 2\(^{nd}\) or 3\(^{rd}\) century AD. The fact that Manu, the great Hindu jurist devotes separate sections to the 'Recovery of Debt and Deposits and pledges' indicates that problems relating to money lending has assumed importance.\(^10\) During this period people were enjoined upon to make deposits with respectable Bankers. Regarding the rates on advances, elaborate rules were made for safeguarding the interests of the borrower, for instance, at any one time; interest claimed could not exceed the principal more than twice. The Laws of Manu had given wide powers to the creditors for the recovery of the debt. In short, this period is characterised as one in which the activities of the so-called Banker / Money-lender were well controlled and regulated.

There is no live account of indigenous Banking from the 6\(^{th}\) to 16\(^{th}\) centuries. Some lost evidence is there to show that it was a profitable profession from the reference to the wealthy Jaina Bankers, two of whom built the famous Dilwara temples. In the time of Feroz Shah, Bankers were reported to lend large sums of money to the state for the payment to the army. During the Moghul period indigenous Banking was in its prime. There was hardly a village in India without its money-lender or Saraf. Details regarding the systems of indigenous Banking / money-lending are available in the writing of the famous French traveler, J.B. Tavernier and in Mohamedan literature, notably Ain-i-Akbari. These writings reveal the

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existence of multanies and Sarafs who financed trade and commerce, acted as Bankers to the state and performed the additional function of money-changer. The system of currency and money in operation at that time rendered money changing a highly profitable business.\textsuperscript{11}

The Moghul system of coinage afforded yet another occupation to the money-lending class viz. evaluate of precious metals. Beside money-lending and changing, the Bankers of that period financed trade by means of credit instruments.\textsuperscript{12} Foreign trade is reported to have been financed partly in cash and partly by bills drawn on firm payable in two months. Historical records of this period are complete with honor bestowed by the State on Bankers for rendering distinguished services to the State, not only as officers of Royal mints but for putting the Royal Treasury in funds. This was a period in which indigenous Bankers enjoyed a pre- eminent position in society, being the sole source of finance to the community in the absence of Commercial Banks. The dependence of the rulers and the Government on this source of fund appears to have been considerable, with the results; it was not uncommon to appoint indigenous Bankers as revenue collectors and Bankers to the Government. However, the very factors which contributed to their rise when the Moghul Empire was at the height of its glory, were also responsible for their decline with the break-up of the Moghul Empire.\textsuperscript{13}

Nevertheless, when the British came to India in the 17\textsuperscript{th} century, they found a reasonably well-established indigenous Banking system. The English traders, however, could not easily avail themselves of the credit facilities extended by the indigenous system, as the business was conducted in the vernacular languages with which British were not aware. On the other hand, indigenous Bankers were ignorant of the ways and the method of Banking practiced in the west. To overcome these difficulties, English merchant houses were set up which took upon themselves the business of Banking in addition to commercial and trading activities. When the British acquired political control of the country, they realised that the system appointing indigenous Bankers as revenue collectors was damaging to the revenue of the State and hence the system of revenue collection by these agencies was abolished in the year 1778.\textsuperscript{14} The unsettled political conditions prevalent in the country had broke their business there were numerous instance of the claims of indigenous Bankers on the rulers of the Indian States being dishonored. The political disturbance in the country forced people to save their wealth and the deposit business of indigenous agencies was affected.

\textsuperscript{11} Vaish, M.C., “Modern Banking”, Op. Cit, PP. 90.
\textsuperscript{13} Panandikar, S.G., Banking In India, Op. cit, p-2
The establishment of "The Bank of Hindustan" in the year 1770 in Calcutta by lending agency house, M/s. Alexander & Co. Marks the beginning of modern Banking in India on the pattern of European Banks. However, it collapsed in the year 1832 when the firm with which it was associated was distorted.

Other Banks which appeared on the scene during the later half of the 18th century was the Bengal Bank which had been in existence as early as the year 1784. This Bank, unlike the earlier one, was not connected with any agency house. The General Bank of India, which came into existence in the year 1786, was the first Joint - stock Bank in India that issue shares and having limited liability of its shareholders. Subsequently in the year 1787, this Bank was appointed Bankers to the Government. However, it did not survive much and was ultimately dissolved in the year 1791.\(^\text{15}\)

The first presidency Bank known as the 'Bank of Bengal' was established in the year 1806 in Calcutta having a share capital of Rs. 5000000 sicca out of which 20% i.e., Rs. 1000000 sicca was contributed by the East India Company i.e. the state.

A uniform currency was established throughout British India in the year 1835. As a result of this currency reform, indigenous Banking agencies were dealt a hard blow as they were a poor productive source of income starting from the business of money changing. At the same time, to meet both the administrative requirements and demands of trade, the need was felt for credit institutions of the Western type and this led to creation of Government Treasuries and to the formation of two more presidency Banks viz. The Bank of Bombay in the year 1840 and subsequently the Bank of Madras in the year 1843.\(^\text{16}\)

The Government subscribed a part of the share capital of both these Banks. All the three presidency Banks in Calcutta, Bombay and Madras were just like the central Banks in their respective areas of operations for they performed central Banking functions and also acted as Bankers to the Government. The presidency Banks continued to function until the year 1920 and ultimately conclude in the formation of the Imperial Bank of India on 27\(^{\text{th}}\) January, 1921 as an amalgamated Central Bank of the country barring the power to issue Bank notes.\(^\text{17}\)

The first purely Indian Joint Stock Bank was the Oudh Commercial Bank which was established in the year 1881 followed by the Punjab National Bank 1894 and the People's Bank 1901. The Swadeshi movement in the year 1905 gave an impetus to the formation of


number of Joint - Stock Banks in India and many of today's leading banks were established around this time. The Bank of Burma established in 1904, but failed in 1911. In 1906, three more Banks were founded, The Bank of India, The Bank of Rangoon and The Indian Specie Bank, all of which had paid up capital exceeding Rs 15 lakh each. Nevertheless the number of Banks with paid up capital of Rs. 5 Lakhs and over increased from 9 to 36 and those with paid up capital of Rs 1 Lakh to Rs 5 Lakh increased from 23 to 69 and the period from 1900 to 1934, the year in which Reserve Bank of India Act was enacted, witnessed many Banks failures due to economic depression and Indian Banks faced serious crises.  

The establishment of Reserve Bank of India in the year 1935 marked the beginning of a new era in the history of Indian Banking. The Central Banking Enquiry Committee addressed itself to the problems of series of Banks failures and recommended that special Act be passed for regulating the Banking system. No headway, however, could be made in this direction until the enactment of the Banking Regulation Act in the year 1949 which gave wide powers to RBI to regulate, supervise and develop the Banking system. In subsequent years, the efforts of RBI were mainly directed towards institutionalisation of saving, consolidation of Banking structure and re-orienting the credit system to emerging needs of the economy. 

1.3 BANKING SYSTEM IN INDIA

The financial system in India comprises of Commercial Banks including Public Sector, Private Sector and Foreign Banks, Co-operative Banks, Development Finance Institutions (DFIs) and various other institutions in the areas of Insurance, Mutual Funds and Government Securities. Commercial Banks occupy a predominant place in the financial system and payment systems. Banks are 'special' as financial intermediaries critical for mobilising public saving and for deploying them to provide safety and return to savers. The deployment of funds mobilized through deposits involves Banks in financing economic activity and providing a lifeline for the payment system. Given the overwhelming dominance of Banks in the financial system and their systemic importance, reform measures were first introduced for Commercial Banks and subsequently extended to other financial create an enabling environment with greater operational flexibility and functional autonomy for Banks with a view to enhancing their efficiency, productivity and profitability.  

The Indian Banking system is headed by the Reserve Bank of India which is the Monetary Authority of the country and performs the role of Central Banking. Broadly speaking, the Banking system in India may be classified as under.

1.3.1 Reserve Bank of India
The Reserve Bank of India is an apex monetary institution in money market which act as the monetary authority of the country and serves as the Government Bank as well as the Banker's
Bank.\textsuperscript{21} It undertakes major financial operations of the Government, by its conduct of these operations and by other means; it influences the performance of financial institutions to ensure that they support the economic policy of the Government. The Central Banks differ from other financial institutions. First it differs in that it is controlled by the people who are more or less closely connected with the other organs of the Government. Second, it does not exist to secure the maximum profit, which is the principal aim of a Commercial Bank. Third, the Central Bank must have a special relation with the Commercial Banks whereby it may influence the operation of these institutions in the implementation of the Government’s economic policy. In brief, the Central Bank is an organ of the Government which by reason of its operations influences the working of financial institutions of the country.

The main function of RBI is to regulate the monetary mechanism comprising of the currency, Banking and credit systems. For this purpose, the Bank is given wide powers. Another importance of the Central Banks is to conduct the Banking and the financial operations of the Government. The function of the Central Bank of India and the obligation resting upon it are very special character, calling for skill, experience and judgment of a different kind from those required for a Commercial Bank.

\subsection*{1.3.2 Schedule Commercial Banks}
Scheduled Banks are those Banks which are included in 2\textsuperscript{nd} schedule to the Reserve Bank of India Act, 1934.\textsuperscript{22} The Scheduled Banks are entitled to avail of certain facilities from the Reserve Bank such as, obtaining accommodation in the form of refinance and loans and advances, remittance facility at concession rates as also a grant of authorised dealer's license to handle foreign exchange business. Correspondingly, Banks bear certain obligations to the Reserve Bank, like the maintenance of cash reserve as per prescribed levels and submission of fortnightly returns prescribed from time to time under section 42 of the Reserve Bank of India Act, 1934. In terms of section 42(6) (a) of the Reserve Bank of India Act, the following conditions must be fulfilled before Banks included in the 2\textsuperscript{nd} Schedule:

(i) It must have paid up capital and reserve of an aggregate value of not less than Rs.5 lakh. However, presently to start a Commercial Bank, the RBI prescribed a minimum capital of Rs. 100 crore.

(ii) It must satisfy the Reserve Bank of India that its affairs are not being conducted in a manner detrimental to the interest of the depositors; and

\textsuperscript{22} Varshney, P.N.(2010), “Banking Law and Practice”, Sultan Chand and Sons, New Delhi, P 1.15.
(iii) It must be a State Co-operative Bank or a company as defined in the Companies Act, 1956 or an institution notified by the Central Government in this behalf or a corporation or a company incorporated by or under any law in force in any place outside India.23

1.3.3 Non-Schedule Commercial Banks

This category of Banks represents those Joint Stock Banks which are not included in the 2nd Schedule to the Reserve Bank of India Act on account of their failure to comply with the minimum requirements for being Scheduled prior to the independence of the country, the Banking structure consisted of large numbers of Joint Stock Banks which were small and weak and quite a few of them were managed by bad or dishonest management. At the outbreak of Second World War about 1500 Joint Stock Banks were operating in undivided India out of which 1400 were Non-Scheduled Banks24.

Some of these were tiny Banks with a paid up capital of even less than Rs 50000 and had no chance of becoming viable. Consequently, depositors were the victims of a number of Banks failures as a result of their ignorance of the banking business as also due to laxity of the laws. Therefore, the Government pursued the policy of consolidating Banking system in the country through a process of voluntary amalgamations, transfer of liabilities and assets and participation and arrangement of weak and inefficient Banks. As a first step in this direction, the Banking companies Act, 1949 (which was subsequently named as the Banking Regulation Act) was enacted which led to the gradual elimination of the numbers of such Banks as they were not in a position to fulfill various requirements of the Act, especially as regards paid up capital and reserves. The process of elimination was further accelerated after the liquidation of two Scheduled Banks viz. The Laxmi Banks and The Palai Central Banks in 1960 which created a Banking crisis in South India. In order to strengthen the weak units and revive public confidence in the Banking system, a new Section 45 was inserted in the Banking Regulation Act in September 1960, empowering the Government of India, on the recommendation of the Reserve Bank of India to compulsorily amalgamate weak unit with stronger ones.25

These measures, over the years, resulted in reduction of numbers of Banks without affecting, at the same time, the Banking facilities to the public as the stronger Banks continued to

23 RBI Act 1934, Section 42(1).
expand their operations. The last Non- Scheduled Banks viz. Bareilly Corporation Bank was amalgamated with Bank of Baroda with effect from 3rd June, 1999.  

As on 30th June, 2004 only five Non-Scheduled Commercial Banks were operating in the country having 21 branches. RBI currently does not encourage the opening of Non- Schedule Banks efforts are made to merge the only Non- Schedule Bank viz. Sikkim Bank Ltd with Union Bank of India, these are all Local Area Banks.

1.3.4 State Co- Operative Banks

The apex level State Co-operative Banks which act as balancing centers and financing Banks for the Central Co-operative Banks and other State level Co-operatives in a state are expected to function as the leaders of Co-operative movements in their respective States. They have direct access to the money market and to national level institutions such as the Reserve Bank of India, NABARD, etc. Their main function is to assist Central- Co-operative Banks and to create equilibrium in the resources of the latter. There is no direct connection between State co-operative Banks and Primary Credit Co-operative societies. Instead, the Central Co-operative Banks act as intermediaries societies.

The numbers of StCBs as at end March 2009 stood at 31. Most of the StCBs were established prior to March 1, 1966, the date from which the Banking Regulation Act, 1949 was made applicable to the Co-operative Banks. Of these, only 13 StCBs have been granted license by the Reserve Banks since 1966.

The financial position of most of the StCBs does not show any perceptible improvement. The percentage of recovery in demand for StCBs declined to 79 % in 2002-03 from 84% in 2000-01. As on March 31, 2009, the gross NPAs to the gross credit of StCBs declined to 12.0% from 12.4% as at end March 2008.

1.3.5 Central Co-Operative and Primary Credit Societies

The Central Co-Operative Banks are a federation of Primary Credit Societies in a specified area, normally district and usually located at the district headquarters or some prominent town of the district. The lendable resources of Central Co-Operative Banks consist of share capital, deposits, loan from State Co-Operative Banks or where it does not exist, from The

28 www.nafscop.org
Reserve Bank of India or other Commercial Banks. The total deposits and loans outstanding of Central Co-Operative Banks stood at Rs. 43215 Crore respectively as at end March 2000. The numbers of CCBs stood at 367 as at end March 2003 most of which were established prior to March 1, 1996. So far only 73 CCBs have been granted licence by The Reserve Bank since 1966. The performance of CCBs leaves much to be desired. The accumulated losses of CCBs have increased to Rs. 4442 crore in 2002-03 from Rs.3217 crore in 2000-01. The percentage of recovery in demand for CCBs increased to 72 percentages in 2008-09 as from 56 percent in 2007-08. As on March 31, 2009, the gross NPAs to gross advances of CCBs increased to 17.9 percent from 18.50 percent as at end March 2008. Many of these short term rural Co-Operatives did not meet the minimum capital and reserve requirements stipulated under section 11 (1) of the Banking Regulation Act, 1949 (AACS).

1.3.6 Primary Credit Societies

The Primary Credit Societies may be compared to Joint Stock Banks. Primary Agriculture Co-Operative Scarcities as the gross root level arms of short term Co-Operative credit, mediate directly with individual borrowers, grant short- term to medium term loans and also undertake distribution and marketing functions. Their main activity is to lend money to villagers on soft term and is managed by members themselves who work on an honorary basis. Apart from their own resources they may also draw funds from Central Co-Operative Banks.

There were 95633 PACS as on March 31, 2009 with about 132 million members. A large numbers of PACS, however, face severe financial problems primarily due to significant erosion of own fund, deposits and recovery rates. The high level of over dues in many states has made a large number of members ineligible for fresh borrowings. Resources mobilisation continued to be major areas of weakness of the PACS. Various policies have been adopted to improve the financial health of the PACS. NABARD, in particular has been extending funds to develop the infrastructure of PACS.

1.3.7 Commercial Banks

Commercial Banks are playing a positive role in an economic development of a country as depositories of community's saving and as purveyors of credit. Commercial Banks provide a

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29 www.nabard.org.
short term and medium term financial assistance. The short term credit facilities are granted for working capital requirements. The medium term loans are for the acquisition of land, construction of factory premises and the purchase of machinery and equipments.\textsuperscript{31} These loans are generally granted for periods ranging from 5 to 7 years. They also establish letters of credit on behalf of their clients favoring suppliers of raw materials/machinery (both Indian and Foreign)\textsuperscript{32} which extend the Banker's assurance for payment and thus help their delivery. Certain transactions, particularly those with contacts on sale to Government Departments, may require guarantees being issued in lieu of security/earned money deposits for release of advances money, the supply of raw materials for processing, full payment of bills on the assurance of the performance etc. Commercial Banks issue such guarantees also.

1.3.8 Foreign Banks

The Foreign Banks are branches of Banks incorporated outside India. Foreign Banks in India are concentrated in metropolitan centers, certain state capitals and other important cities and thus they are aloof from the National Development programs. These Banks are normally interested in large corporate accounts and offer a whole package of services such as assessing the viability of the joint ventures of Indian firms and companies abroad, information on local taxation and ownership issues and the structuring of project costs.\textsuperscript{33} They are also engaged in the financing of export and imports. Normally, these Foreign Banks do not encourage mass Banking and rather cater to the elite of the society since the cost of their services is comparatively high. The minimum balance required to be maintained in a savings account is Rs.10000 (or even higher in some Private Sector/Foreign Banks) as against only Rs. 300 to Rs. 1000 in case of (domestic Banks) Public Sector Banks. Likewise, the minimum balance requirements for current accounts are Rs. 50000 as against Rs.500 to Rs. 5000 in other Banks.

The total assets of Foreign Banks as at end March 2000 constituted 7.5 % of the total assets of the Scheduled Commercial Banks. Thus, there is no possibility of Foreign Banks affecting the business opportunities of existing Banks.\textsuperscript{34}


The Reserve Bank of India and the Government of India has, in recent years, introduced a number of liberalisation measures which have enlarged the role of Foreign Banks. New Foreign Banks have been allowed to come and existing one permission to open a new branch. The RBI has eased capital norms for New Foreign Banks. Foreign Banks are now required to bring in only $ 10 million when they open the first branch and another installment of equal amount for their second branch. For opening a third branch, another $5 billion has been prescribed. Earlier, Foreign Banks were to bring an initial capital of $25 million at the time of opening their first branch. Their relaxation is in line with the entry norms under the General Agreements on Tariffs and Trade (GATT).

1.3.9 Private Sector Banks
There are other Private Sector Commercial Banks incorporated as Joint Stock companies. As on 31st March, 2010, there were 22 such Banks having 2762 branches all over the country. These Banks vary in size and area of operations to a great extent. Some of the Banks have branches in a number of important cities while others have no branch at all. All Scheduled Private Sector Commercial Banks are required to meet the priority sector lending targets fixed by RBI.

As on the last Friday of March 2010, priority sector advances of Private sector Banks amounted to Rs. 215552 crore accounting for 45.90% of their net Bank credit. While there was no legal ban on entry of New Private Sector Banks, in practice no New Private Banks were licenced by the Reserve Bank of India especially after the Nationalisation of 14 major Commercial Banks in July, 1969.

1.3.10 State Bank of India
The State Bank of India, the flagship of Indian Banking, was established on 1st July, 1955 by acquiring the total assets and liabilities of the Imperial Bank of India. Prior to Nationalisation in 1955, the Imperial Bank of India, which were formed in 1921 by merging of three Presidency Banks in Bombay, Bengal and Madras, occupied a very important place in Banking system of the country as it was assigned some of the functions of a Central Bank until the formation of Reserve Bank of India in 1934. Nearly a quarter of Banking business in the country is with State Bank of India.


1.3.11 Nationalised Banks

It was in 1969 under a dynamic premiership of late Smt. Indira Gandhi, 14 major Banks were Nationalised by an inductive pattern of major share holding of Government of India. In this political decision remained, greed of Government to divert capital flow into untapped rural and semi urban economic spheres. With the Government assuming control in the management of these 14 Nationalised Banks (PSBs), the action plan for rural economic development had been soon enlisted under a banner of 20 point economic programme to be implemented by all Nationalised Banks. From 14 Banks some other more Banks were also brought under Nationalisation and thus those Banks become important tools of Government of India for economic development. With the Government machinery, power and capital in place, all those Nationalised Banks considered the needs on a priority basis for national network expansions and international presence. Thus today most of the Banks have a number of branches across India numbering between 1000 to 5000 branches of each Banks garner business mix ranging between 10000 crore to over 100000 crore depending on the size of each Banks.

1.3.12 Regional Rural Banks

In mid- seventies it was felt that the existing credit agencies viz. the Co-operative Banks and Commercial Banks were not able to meet properly, varied and growing needs of the rural credit. The Government of India, Therefore, appointed in 1975 a working group to examine, in depth, the setting up of a new Rural Banks to cater to the credit needs of rural people. As a sequel to the recommendation of this Group, the Regional Rural Banks were established on 2nd October, 1975. Initially, in the last quarters of 1975, six Regional Rural Banks were sponsored by Public Sector Banks.

The main objective of this Banks is to develop the rural economy by providing the credit and other facility for the purpose of development of agriculture, trade, commerce and industry and other productive activities in rural areas, particularly to the small and marginal farmers, agricultural laborers and small entrepreneurs. The Rural banks have been conceived to combine the strong points of both the Co-operative and Commercial Banks eliminating the

weakness of the both. Thus, the Regional Rural Banks combine the local base and the, rural touch of the Co-operative with the organisational efficiency and financial strength of the Commercial Banking system.

1.4 ROLE OF RESERVE BANK OF INDIA

Reserve Bank of India comes into being as “CENTRAL BANK” of Government of India with primary objectives of issuing and managing currency notes over and above other monetary and regulatory obligations as are generally assigned by any Government to Central Bank. Government of India makes the appointment of Governor after considering the relevant person's track record, academic qualification, work experience and personal competent beside managerial ability to enforce Governance and economic discipline. Governor is suitably backed by the board of directors and a full- fledged management team of professionals having personal and qualifications competence in different areas of regulatory obligation and monetary policy management.

1.4.1 Regulation and Monitoring

As a regulatory body, Reserve Bank of India plays a role of Watch Dog on the entire financial dealing of different financial institutions operating in the country. These include all Banks such as Public Sector Banks, Private Sector Banks, Foreign Banks, Regional Rural Bank's, Gramin Banks, Co-Operative Banks etc. Further Reserve Bank of India also regulates and monitors Foreign Exchange Dealers, Non Banking Financial Companies, Mutual Funds and all those organizations which are in the form of conduit channels for export import business. All these above referred institutions are required to furnish all particulars of their business operations to Reserve Bank of India in one or other stipulated formats of returns to be submitted by them. Periodically on weekly, fortnightly, monthly, quarterly, half yearly and yearly basis. It is through this submission that the Reserve Bank of India assesses controls, regulates and monitors the fiscal and economic conditions in the country. Databases generated on the basis of such returns unfold the liquidity situation, credit flow, fund flow, economic growth, consumption pattern, inflationary and deflationary pressures, and currency and cross currency movements, forex reserves, asset bubbles and every other

monetary and economic condition which can implicate economy of the country. Thus, the Reserve Bank of India discharges its prime responsibility as regulates and monitors from the platform of the Central Bank.

1.4.2 Cash Reserve Ratio
The present Banking system is called as “Fractional Reserve Banking System” as the Banks are required to keep only a fraction of their deposit liabilities in the form of liquid cash with the Central Bank of ensuring safety and liquidity of deposits. The cash reserve ratio refers to this liquid cash that the Banks have to be maintained with the Reserve Bank of India as a certain percentage of their demand and time liabilities.\footnote{Dr. Tondon, B.K. (2012), “Monetary Banking and Financial Development”, Swastik Publications, New Delhi, P- 61.}

The Cash reserve ratio was introduced in 1950 primarily as a measure to ensure safety and liquidity of Bank deposits, however over the years it has become an important and effective control tool for directly regulating the lending capacity of Banks and controlling the money supply in the economy. When the Reserve Bank of India feels that the money supply is increasing and causing an upward pressure on inflation, the Reserve Bank of India has the option of increasing the Cash reserve ratio thereby reducing the deposits available with the Banks to make loans and hence reducing the money supply and inflation.\footnote{Subba Rao P, Khanna P.K(2010), “Principles and Practice of Bank Management”, Himalaya Publishing House, New Delhi, PP. 72-73.}

The Reserve Bank of India has an authority to impose penal interest rates on the Banks in respect of the shortfall of prescribed CRR. According to Master Circular on maintenance of statutory reserves updated up to June 2008, in case of default in maintenance of the CRR requirement on a daily basis, which is presently 70% of the total CRR requirement, the penal interest rate will be recovered at the rate of 3% per annum above the Bank rate on the amount by which the amount actually maintained falls short of the prescribed minimum on that day. If the shortfall continues on the next succeeding days, the penal interest rate will be recovered at 5% per annum above the Bank rate. In fact default continues on a regular then RBI can even cancel the Bank’s licence or force to merge with the large Banks.

The Bank rate\footnote{The Institute of Company Secretaries of India(2010), “ Banking and Insurance Law and Practice”, P. 163.} is the technique used by RBI for monetary control. It is the basic cost of refinance and rediscounting facilities. The Bank rate was confined to the ways and means advances to state Government, advances to Primary Co-operative Banks for SSI, State Financial Corporations beside penal rates on the shortfall in reserve requirements. The
technique of Bank rate and discretionary control of refinance are used to regulate the cost of and availability of refinance and to change the volume of lendable resources of Bank and other financial institution.

In deregulated setup, each of the major Commercial Banks and term lending institutions have begun fixing and announcing their respective PLRs. The PLR is the rate which the lender charges the borrower of a high credit standing or credit rating, the other borrowers charged higher rates than PLR, depending upon the lender's perceived risk in respect of those borrowers.46

The practice of fixing PLR has resulted in the emergence of multiple PLRs. The Banks and Financial institutions have now fixed Short Term Prime Lending Rate, Medium Term Prime Lending Rate, Long Term Prime Lending Rate. From February 1997, the RBI allowed banks to fix two sets of Short Term Prime Lending Rate one for the Cash Credit and another for the Loans. The PLR for cash credit is to usually higher by one percentage point than the PLR for loans. This is expected to encourage borrowers to switch over from cash credit to loan delivery system. The reduction in CRR leads to reduction in PLR also.

1.4.3 Statutory Liquidity Ratio

In addition to Cash Reserve Ratio, the Reserve Bank of India has made several active use of another ratio, namely the SLR. While the CRR enables the Bank to impose primary reserve requirements, the SLR enables it to impose secondary and supplementary reserve requirements, on the Banking system. There are three objectives behind use of SLR.

(1) To restrict expansion of Bank credit.

(2) To augment Bank's investment in Government securities

(3) To ensure solvency of Banks.47

Through variations in the SLR, the Banks are in position to insulate a part of the Government debt from the open market impact because Banks are then prevented from disinvesting Government securities in favor of Commercial Credit.

The SLR is the ratio of cash in hand (exclusive of cash balance maintained by Banks to meet the required CRR, but not the excess reserves) balance on current account with the SBI, its subsidiaries, other Nationalised Banks and the RBI gold and unencumbered, approved securities, i.e. Central and State Government securities, securities of local bodies and

Government guaranteed securities to total demand and term loan of Banks. \(^{48}\) The SLR, like CRR, is applicable to Co-operative Banks, Non- Scheduled Banks, and the RRB’s, but it is maintained at a constant level of 25% in their case. It is also applicable to Foreign Currency (Non Resident) Accounts (FCNRA) and Non Resident (External) Rupee Account (NRERA) deposits, but the levels in their case differ from each other and from the general level. While the SLR defaults do not invite penal interest payment and the loss of interest on cash reserve, they do result in restrictions on the access to refinance from the RBI and in the higher cost of refinance. The RBI is empowered to increase the SLR for Scheduled Commercial Banks up to 40%.

The significant increase in the SLR does not mean that the monetary policy became quite restrictive. An increase in SLR does not restrain total expenditure in the economy; it may restrict only the private sector expenditure while helping the Government to increase expenditure. In a sense, the SLR is not a technique of monetary control, it is only the distribute the Banks resources in favor of the Government Sector.

1.4.4 Regulation and Deregulation of Rate of Interest

Interest rate component, both for credit and deposits denotes a very significant and important tool of RBI which very effectively helps in influencing resources mobilisation and resources deployment. This often implicates inflationary and deflationary conditions. In simple words interest rates determine the rate and volume of fund flow. In a deregulated regime RBI offers full freedom to the financial market in arriving at a market determine interest rate based on repo rate and reverse repo rate being fixed by RBI\(^{49}\). To elaborate this, the RBI fixes repo rate at which Bank park their surplus fund with RBI, as also RBI fixes reverse repo rate at which Banks draws funds from RBI when there are deficit of funds. In other words these two basic rates viz. Repo rate and Reverse repo rate are forming signal basis for Banks to decide their independent interest rates offer able on inviting deposit from public and Benchmark Prime Lending Rate (BPLR)\(^{50}\) for offering credit to the public.

Illustratively when there is abundant liquidity available in the financial market, the assets bubbles are created due to inflationary condition in the market. At such times by reworking repo and reverse repo rate as also by hiking SLR and CRR, the RBI sucks up entire liquidity


\(^{50}\) RBI Report on Trend and Progress of Banking in India, 1999-2000.
from the markets and thus the free flow of money does not remain available for over hitting the economy. Thus, assets bubbles are controlled, over hitting economic growth is moderated and economic slowdown is achieved for the balanced economy stand which is clearly visible in all the monetary steps taken by RBI between January 2008 to November 2008.

1.4.5 Impact of Deregulation on Banking Sector
Deregulation of interest rate is that part of modern economic reform policy which has privileged entire Banking sector in bringing business friendly cost structure of resources mobilisation.\(^{51}\) It is under the periodical monetary policy, RBI signals repo and reverse repo rate which form the policy basis for the entire Banking Sector to decide their basket of interest rate structure on raising deposits and lending advances. Needless to mention that each Banks depend on its own requirements of funds and in line with budgeted corporate plan. It can fix variable interest rates for different maturity patterns of deposits, so also it can fix basic prime lending rate and different rates of interest for different types of advances. Yet so decided deposits and advances rates will be in total alignment with repo and reverse repo rate as may have been signaled by RBI.\(^{52}\) On example basis very recently in October 2008 Bank of India has been offering interest rate of 9.75% per annum for deposits of over 3 years and 10.50% per annum basis for short term of 13 months (400 Days). As against this SBI is offering 10.50% for deposits of 3 years and above (1000 Days). These two Banks on comparable terms revealed that according to budgeted corporate plan of BOI it can pay higher costs for 1 year time but relatively lesser cost for 3 years and above time, whereas budgeted corporate plan of SBI requires payment of higher cost for as many as 1000 days.

1.4.6 Impact on Share Market Due to Deregulation
Whenever liquidity improves in the market there is a general trend that interest rates are softening. A decline in interest rate, both deposits and advances are a clear trigger buoyancy in country economic growth prospects.\(^{53}\) This is because of lower interest rates on advances that cheaper credit availability results in reduction of cost of product and Therefore availability of goods at lower prices attract demand growth in the market. Thus, consumption increase and Therefore supply have also increased which requires an increase in production.


\(^{52}\) www.iba.org.in

Thus, in a simple equation of higher the demand leads to higher the production translates into higher employment and higher services and higher communication and higher transportation and so on. These ripple effects represent buoyancy in economic growth which is finally reflected in the GDP number of economy. The strong growth rate in the GDP number, year over year represent qualitative growth in the top line and bottom line of corporations. Obviously the higher profit would result into higher earnings per share and correspondingly higher earnings per share will boost up the stock price.
Illustratively Bank of India share with earnings per share of Rs.25 in 2005-2006 commanded average pricing between Rs.175 to Rs. 225. However increased profit in 2006-2007 and 2007-2008 translated into earnings per share of above rupees 40 because of which the stock price of the share ranged between Rs250 to Rs. 400. Thus interest rate deregulation does not impact share market of corporate and in turn capital market of the country remain impacted by interest rate deregulation.

1.5 LOAN PROCEDURE IN PUBLIC SECTOR BANKS
All Public Sector Banks in India deployed their mobilise funds by way of loan facilities to different categories of borrowers so that the differential of interest rate by way of of net interest income margin, generates profit in the Banking business54.
Loans are offered for avail meant through broadly defined loan procedure which comprises of few steps as under.
(1) Proponent borrower has to furnished full particulars of himself and his project under a prescribed loan application form. This application form calls for comprehensive detailed information in respect of KYC norms first and then personal details, Bank details showing assets and liabilities of proponents, descriptive project details such as line of activity, type of technology, raw materials supplies, marketing prospects of finished goods, projected 5 years sales figure with breakup of estimated expenditure and resulting net profit estimate, own financial contribution in the project and quantum of loan requirement etc55.
(2) Above referred application form together with fully furnished details is considered for scrutiny and appraisal by competent officers of the Bank who carry out a detailed inspection and verification of the details furnished in the application form.

(3) After such inspection and search report is submitted, the senior officer considered descriptive analytical project appraisal to examine the viability aspects and based on that a comprehensive proposal for project financing is prepared with reports of technical and economic viability containing specific recommendation of senior officer for either considering proposal favorably or declining proposal to the proponent borrower.  

(4) At this stage a meeting takes place between senior officers of the Bank and proponent borrower who discuss the terms and conditions of approving loans in which Bank stipulate their requirements of security aspects including mortgages, personal guarantees, creation of charges, collateral securities, margins etc. and obtained the acceptance of the terms of sanctioned of the proponent borrower.  

(5) Upon sanction of the proposals and its acceptance by the borrower, the borrower is required to comply with all terms of sanctions including creation of mortgages and other securities in favor of Bank.  

(6) Once the securities are created by the borrower and terms and condition of sanction are complied with, then security documents are checked and verify for its correctness by competent officer of the Bank and then sanction proposal together with security verification report, is submitted to next higher authority over sanctioning authority considered proposal for noting and endorses the same as " noted" then such noted proposal is sent to the loan department with instruction to release the loan amount.  

(7) After the loan amount disbursement immediate inspection is carried out by the Bank officer for verification of end use of funds, insurance cover, display of the Bank charges at pledge go down etc. and all findings are recorded as post sanction inspection report and is placed on the file of the borrower in the Bank.  

(8) Hereafter monthly or quarterly inspections are carried out to assess the project working and proposal is considered for its first review on completion of one year after full disbursement of the loan.  

(9) All above referred steps and its compliance are verified and audited from time to time by internal and external auditor of the Bank.

1.5.1 Ratings in Loan Procedure

Rating of proponent borrower is a very important tool for deciding in favor or against the request of the borrowers. Besides the rating is an important input to fix applicable rate of interest on the loan amount. In order to decide rating of the proponent borrower, following parameters are broadly looked into by the Bank:

(1) Type of the borrower in which status of being individual, or corporate partnership or sole proprietor etc. is looked into

(2) Based on status as per (1) above, the net worth of the proponent borrower is assessed which is indicative parameter of liquidity / solvency of the proponent borrower.

(3) Financial history and track record of the past three years together with financial statement like income tax return, Bank account statement, portfolio investment etc. is carefully looking into.

(4) First hand use of precision technology and its competence for value addition to the quality of product is also considered for rating purpose.

(5) Discipline compliance in the area of conduct of accounts, statement of submission, incompliance and adherence to timely repayment of stipulated periodical installment and chargeable interest etc. also quality for improved ratings.

1.6 INDIAN ECONOMY AND NPA's

Undoubtedly the world economy has slowed down, recession is at its peak, global stock market have tumbled and business it is getting hard to do. The Indian economy has been much affected due to the high fiscal deficit, poor infrastructure facilities, sticky legal system, cutting of exposure to emerging markets by financial institutions etc.

Further, international rating agencies like standard and poor have lowered India's credit rating to sub- investment grade such negative aspects often outweigh positives such as an increasing forex reserve and manageable inflation rate.

Under such situation, it goes without saying that Banks are no exception and are bound to face the heat of the global downturn. One would be surprised to know that Banks and

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59 Indian Express (2003), P-10.
financial institution in India hold Non-Performing assets worth Rs. 110000 crore. Bankers have realised that unless the level of NPA's is reduced drastically, they will find it too difficult to survive.

1.7 NPA’S DEFINATION AND ITS RELEVANCE WITH THE CAPITAL ADEQUACY

It was in 1991-1992 that Narsimham committee report unfolds. It was at the first time threats of Non-Performing Assets in the Indian Banking systems. As a matter of facts that it was at the first time educative steps had to be taken to address serious concerns over Non-Performing of Assets in the Banking system NPA's had to be broadly defined and any negligence in its management would how seriously impact the overall health of the Banks had to be highlighted. Most elementary meaning of NPA's thus evolved stated that all money raised by the Banks for its business must remain productively deployed to generate sufficient such income which should service all cost and there after leave reasonable surplus as profit. And any failure of such so deployed funds in forms of assets to productively generate said income would mean that such assets are Non-Performing satisfactory and hence such and assets are NPA's. Further it can be said that Bankers deal in the commodity called money which is most liquid forms of assets and hence most liquid forms of assets and hence most efficient utilisation of money determines success or failure of the Banks.

Under compelling directives of RBI between 1991 to 1993 that Indian Banking systems had to be implement prudential norms in regards to income recognition and assets classification. It was for the first time that the entire assets management system received careful concern and focused attention. The system had evolved to pick up the very initial signal in sick health of loan account by observing regular recovery timetable for loan installment and interest thereto. Borrower's failure even in repayment of single installment within stipulated time and its interest thereto for a period of 90 days for demand confers a status of Non-Performing Assets to such accounts. Once classified as NPA's, all the loan facilities to same borrower will also automatically assume the status of NPA's even if other loan accounts of same borrower are performing assets. Thus, assumption of NPA's status is requiring classification of NPA's into 3 major categories which is substandard, doubtful and loss assets.

Once identify as NPA, the account has to be first categorised as sub standard assets for a period of 12 months from a date of first default. Here in the category of sub standard assets Banks have to make provision of 10% of outstanding loan amount as on that date. This sub standard account remaining NPA’s forever 12 months, it sleeps further to be classified as doubtful assets in which there are three categories with different % of provision which commensurate with the age of NPA’s. Thus the sub classification of doubtful assets according to the age of NPA’s is as under. 100% of the extent to which the advance is not covered by the realisable value of the security to which the Bank has a valid recourse and the realisable value is estimated on a realistic basis. In regards to secure portion, provision may be made on the following basis, at the rate ranging from 20% to 100% of the secured portion depending upon the period for which the assets have remained doubtful:

<table>
<thead>
<tr>
<th>Period for which the advances has remained doubtful category</th>
<th>Provision requirement (%)</th>
</tr>
</thead>
<tbody>
<tr>
<td>Up to one year</td>
<td>20</td>
</tr>
<tr>
<td>One to three years</td>
<td>30</td>
</tr>
<tr>
<td>More than three years</td>
<td>100</td>
</tr>
</tbody>
</table>

Banks are permitted to phase additional provisioning consequent upon the reduction in the transition period from substandard to doubtful asset from 18 to 12 months over a four year period commencing from the year ending March 31, 2005 with a minimum of 20% each year.

Further when NPA account is aging 5 yrs and above, normally the economic life of the asset finance is over and it presumed that the realisable market value of such NPA's is either negligible or is often less than 1 % of the outstanding loan balance Such an assets are classified as loss assets and 100 % provision has to be made in case of NPA's with the status of loss assets. However generally Banks carry out critical inspection of its assets, its economic life and its economic life and its estimated realisable value of security based on market condition and placed their findings in the records on the basis of which assets are classified as loss assets and provision is 100% made. Often auditors are involved in the judicious assessment of the status of loss assets so that decision for making 100 % provisions

remain justify. As may be noted from the above referred assets classification in all the case and categories of NPA’s Banks are mandatory require to make provision on NPA’s at 10%, 20%, 30%, 50%, 100% respectively for substandard, doubtful and loss assets. It is importantly Banks are mentioned here that as per the recent guideline of RBI, require to make 0.25% of provision for agricultural and SME sector and 0.40% for others. So that when they eventually turn potential NPA’s then Banks may have some cautions to service provision requirement. Thus, it may be seems that for complying with prudential norms Banks may have to review health of the credit portfolio at regular intervals and based on assets classification. It should keep building provision reserve to meet with eventual loss that may have absorbed by the Bank in the case where all the efforts including legal actions and sale question of assets finance failed to meet with an outstanding loan amount and interest amount.

With foregoing in the considerable it may be noted that 100% provision amount in case of loss assets can help the Bank write off entire loan outstanding balance against 100% provision reserve which was build from the early stage of NPA’s in proportion of 10% of sub standard to 100% of losses. Such write off is conveniently booked in the balance sheet because of the provision made from time to time out of Banks profit. However in case where the Banks do not have an adequate profit to meet with requirements then such provisions are to be made even by incurring loss. Thus, more NPA’s needs more provision amount result either in diminishing profit or increasing net losses. Needless to mention that Bank balance sheet showing accumulated losses reflects erosion in Banks net worth because net worth means capital reserve less accumulated loss. Therefore in simple words losses accumulated due to the huge provisioning amount of NPA’s finally eat into equity capital and reserve of the Banks. Such consistent status can implicate the Banks (erosion) of the Banks capital structure. Therefore at the time of granting loans and advances, the risk weight age has to be assessed based on stipulated formula guideline and such risk weight age should be equivalent to the total capital structure of the Banks. In simple words Banks entire capital (tier 1 and tier 2) together should be equivalent to the 9% of the total risk weighted as assessed in the credit portfolio of the Banks. Banks having capital structure equivalent to 9% or more of the total credit risk weight age are called as Banks which are Basel I compliant, since this requirement of 9% capital adequacy was recommended by Basel committee.

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Above referred description clearly bring out the relevance of NPA's and its impact on capital adequacy.

1.7.1 Successful Management of Non-Performing Assets and Achieving of Capital Adequacy in Indian Banking System

Pursuant to the Nationalisation of most of the Public Sector Banks, most of the political parties in the Central Government, heavily abused Banks money to create vote Banks and thus achieve their mal political objectives. Owing to Nationalisation status conferred on Public Sector Banks, the majority stakeholders by way of promoters quota was of Government of India and therefore obviously the Banks board of directors including M.D and others appointed by the Central Government. Thus complete management of the Banks remained in the hands of such people (M.D and other Directors) who were assuming the position through political lobbying. It was therefore no surprise as to how and why Banks large chunk of money was utilised and funded various Government pronouns scheme designs for the poverty alleviation programme, IRDP, and many other such schemes. In fact Banks had become financial tools in the hands of Government and under pretext of helping poor people and improving the rural economy, the Banks were pressurised to grant loans for agriculture and SSI, either with adequate security or on highly loose and liberal terms. Even "Loan Mela" were arranged across the country and most of the rural and poor were distributed loan funds which were never repaid. In more urban and metropolitan cities many industrialists had arranged obtaining of loans worth crores of rupees through top brass MLA and MPS/Minister and subsequently such funds were supposed away into the personal property of the borrowers. Leaving industries in a status of total sickness, not repaying the loan availed for PSB's. Such a political abused of PSB's continued for two decades between 1970 and during 1990 during which such political abused created huge NPA's. However Banks continued to survive in spite of 1 lacks crore of NPA's only due to the label of the Government ownership which was viewed more safe from the depositors point of view and on other hand absence of prudential norms like income recognition and provisioning etc. allowed shrewd PSB's management to present Banks rosy picture in manipulated balance sheet. As for example

Banks were booking all interest income in their profit even if the borrowers never repaid such interest charges on his account. Also Banks management prevailed over statutory creditors for not insisting on huge provisions requirement under value of security or convincing them on strength of Banks prospects for secret reserves.

1.7.2 Introduction of Prudential Norms for Income Recognition, Provisioning and Assets Classifications

As earlier stated in to the introduction, the M. Narasimham committee recommendation were considered and as first step towards economic reforms, the Government of India with the help of RBI introduced the prudential norms in the Indian Banking system. Banks were directed to strictly comply with RBI directives for income recognition and provisioning and assets classification. The whole exercise was prescribed for successful implementation in 3 years time during which RBI had also issued very strict guidelines to statutory auditors who were accounted responsible for the desired compliance. All the Public Sector Banks had no option but also require implementing in later in strict norms of income recognition but also requiring identifying NPA’s and making adequate provisioning in a phased manner. The final balance sheet of Banks being subject to statutory audit, the Banks had to evolve a new model or bookkeeping and statutory accounts to make balance sheet more transparent. Presently true picture of the Banks profitability and had debt credit information system backed up by management information system. Finally clean and absolute transparent balance sheet in line with the Basel committee recommendation and thus most of PSB's started presenting clean and transparent balance sheet after 1999. The entire cleaning up of exercise took 5 years time from 1994 onwards during which many PSB's reported huge losses amounting between 500 to 1000 crore. However such an exercise made Bank management aware of serious threats posed before them for managing above 1 lakhs crore of NPA's. Such a magnitude and volume of huge NPA's and for infusing more capital at finally sensitise Government of India which had by that time triggered irreversible economic reforms. The issues of 1 lakhs crore NPA's in Indian Banking system and need for augmenting necessary capital as per prescribed Basel norms, were strongly deliberated between Banking department of (GOI ) Government of India, RBI and (G o M) Group of Ministers in the central cabinet. After seriously pondering over the said issue, the Government of India emerges with the consensus to

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present a bill in the parliament giving substantial autonomy to the management of PSB’s in releasing the blocked funds in the NPA’s account by lawful recovery means as formulated in the forms of Securitisation Act of 2002. For the first time Banks management were equipped with sharp result orienting tools of the Securitisation Act to realise long term NPA’s. Under the Act Banks were authorised to attach immovable properties of the defaulting borrowers and sale through auction of such property, the proceeds of which were directly receivable by the Bank for appropriation in borrowers NPA’s account. Needless to mention that Banks used these tools very effectively between 2002 to 2005, during which Bank's realise their long outstanding dues of NPA's account.\textsuperscript{74} Leveraging on Securitisation Act and on other hand very efficiently manage their treasury operations in the vibrant booming economy of the country, the profit from which were largely servicing provision needs on other hand.\textsuperscript{75} Thirdly the Government on improvement on balance sheet structure permitted Public Sector Banks to offer equity share to the Indian Public and Financial Institution at premium by reducing their own stake to around 55 to 60 \% from 100\% to 80 \%. Thus Government continued to enjoy the status of largest shareholders holding more than 51 \% share on the other hand to enjoy ownership rights, while offer for sale of equity shares at premium helped Bank of raise resources for complying with Basel norms.\textsuperscript{76} In a nutshell, the three pronged strategies of Government as produced the desired result of meeting with the international Banking standard by achieving reductions in NPA's to the tune of less than 5 \% of total credit as also have capital adequacy of 9 \% which is equivalent to the risk weight age in credit portfolio of PSB's.

(i) Securitisation enforcement helped to realise long due of NPA's and thus reduction in NPA's was achieved.

(II) Efficient management of treasury operation generated sufficient profit to the service provisioning requirement of assets classification.

(III) Improved balance sheet could attract a premium on sale of equity shares following decreases of the Government stake to less than 60 \% but more than 51 \% which helped meet with the capital adequacy requirement in lying with Basel 1 norm.

\textsuperscript{74} Yeole, Arun(2004),The Problem of NPA’s”, Yojana, Division Publications, New Delhi, November, P. 35.
1.7.3 Reasons to Study Non-Performing Assets and its relevance With Capital Adequacy Ratio in Public Sector Banks

(1) The Public Sector Banks itself hence legally of being Government enterprises and therefore it has typical loses in all systems with an insensitive approach to important aspects of its core business.
(2) All policy decisions emerging from top brass management are generally lacking in dynamic and aggressive approach and often policy formulation is conservative, orthodox and conventional.
(3) The public sector are largely loss making or less profit generating and hence such a status throw abundant scope to study and find out the reasons of system failure.
(4) Following initiatives taken in economic reform's all financial institutions including PSB's witnessed a compelling transaction face from loose and orthodox loss making enterprises in an active, modern and vibrant profit generating enterprises and therefore such public offer substantial ground to study turnaround story.
(5) Modernisation of PSB's are prepared them to take hold on competition with private sector and thus enabled the Government to fetch substantial value in their investment of long years.
(6) The study of PSB's provides a substantial scope for study on far reaching implication of the huge volume of business which implicate safety and other interest of investing public at large.

1.8 OBJECTIVES AND SCOPE OF STUDY

Pursuant to considering and framing of prudential norms in respect of income recognition, provisioning and assets classification became imperative need for implementation in Public Sector Banks. It is for the first time that such an exercise would help both management and Government to identify obtaining quality and health of an assets and take necessary steps not only to improve the health but also service them structurally so that genuine profit figures are derived and need based capital adequacy is restored with these objectives in consideration, 11

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selected Public Sector Banks with different sizes and volumes have been considered for analysis key parameters. The present study is conducted with the following objectives.

1. To consider an evaluate quality of quantum growth in total advances vis-à-vis status of growth in Gross NPA’s and Net NPA’s.
2. To analyse impact of growth in Gross NPA’s and Net NPA’s over assets quality in credit portfolio of Banks.
3. To examine phases of in different assets classes of the Bank and considered scope to manage them efficiently.
4. To identify risk profile in credit management of Banks.
5. To review percentage growth in both gross NPA and net NPA and its impact on profitability as also capital adequacy.
6. To rate the performance of the Bank on the basis of its efficiently in NPA management.
7. To project impact of mounting NPA’s on potential risk for deposit growth of the Bank.

1.9 RESEARCH METHODOLOGY

The study considered primary data collected through specially arrange visits with official and directors of Centre for Monitoring Indian Economy, Reserve Bank of India, Vaikunth Mehta National Institute of Co-operative Management. Secondary data collected from financial statements, annual reports and electronic media disclosure on internet. The concerned information has been produced with the help of computer. The data collected is tabulated, charts, graphs are prepared to analyses. Appropriate statistical tools like mean, standard deviation, coefficient of correlation, regression analysis and t test have been used to derive the results.

The following t test formula has been used for testing the hypothesis. i.e.

Where,

Level of significance = 5%
Degree of freedom = n - 2
Coefficient of correlation = r
Number of observations = n
1.10 HYPOTHESIS OF THE STUDY

Relation between advances and gross non-performing assets is tasted by using ‘t’ test based on following hypothesis.

1.10.1 **H0**: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Allahabad Bank.

**H1**: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Allahabad Bank.

1.10.2 **H0**: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Bank of Baroda.

**H1**: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Bank of Baroda.

1.10.3 **H0**: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Bank of India.

**H1**: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Bank of India.

1.10.4 **H0**: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Canara Bank

**H1**: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Canara Bank.

1.10.5 **H0**: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Dena Bank

**H1**: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Dena Bank.
1.10.6 H0: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Indian Bank.

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Indian Bank.

1.10.7 H0 : Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Indian Overseas Bank.

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Indian Overseas Bank.

1.10.8 H0 : Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Punjab National Bank.

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Punjab National Bank.

1.10.9 H0 : Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Syndicate Bank

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Syndicate Bank.

1.10.10 H0 : Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of Union Bank of India

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of Union Bank of India.
1.10.11 H0: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of UCO Bank

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of UCO Bank.

The under mention hypothesis for all selected Banks

1.10.12 H0: Null hypothesis
There is no significant relationship between total advances and gross non-performing assets of All Selected Bank

H1: Alternative hypothesis
There is a significant relationship between total advances and gross non-performing assets of All Selected Bank.

1.11 LIMITATION OF THE STUDY

India is since developing economy and financial systems in place are by and large having Public Sector status where Government ownership is responsible for the fate of economy. This apart India has larger coverage of rural geography and hence economic growth is significantly contributed by credit flows in rural and urban economy. This study is limited to only credit management, need for compliance to prudential norms and Basel norms, brought NPA management in spotlight with particular reference to health check of Public Sector Banks in India. The different Public Sector Banks which were dominant player in the different locations of this huge country. Thus, this study is limited to only Public Sector Banks on one hand and within that only limited 11 (eleven) selected Banks which are important in economy of the country. The analysis of this research is based on the secondary data collected from sources like Report on Trends and Progress of Banking in India, RBI Report on Currency and Finance, RBI Statistical Table Relating to Banks in India, IBA Bulletin special issues, Centre for Monitoring Indian Economy (CMIE). This data in itself has got its own limitations. This study is limited to NPA management vis. a vis. credit risk management. Performance of Banking which is significantly impacted by NPA management and this study is limited to only total advances, gross non-performing, net non-performing assets and capital adequacy.
Another limitation of the study is to specific period between 1996-97 to 2009-10 as it was during this period that prudential norms of assets classification, provisioning and capital adequacy were implemented. It was here after that corrective measures were taken in phased manner between 1999 to 2005-06 which provided transparency in balance sheet of Banks and deriving good pictures of the Banks. Thus the time frame selected as limited study between 1996-97 to 2009-10.

1.12 PLAN OF THE STUDY

The study has been divided in six chapters.

Chapter - I
The chapter deals with the introduction of Banking system, reasons, objective and scope, methodology, limitations.

Chapter- II
The chapter concerned with sources which are in the form of circular hand book. Even this chapter covers issued descriptive circular and guideline issued by RBI. Most of daily, weekly, fortnightly and monthly publications carried article in above matters. Thus, IBA Bulletin, RBI guideline, Public Sector Banks hand book and extract from various seminars on the subject corresponds to literature review.

Chapter - III
The chapter highlights profile of Public Sector Banks in the form of financial performance for the period from 1993-94 to 2009-10.

Chapter - IV
The chapter discuss in detail with management of non-performing assets and capital adequacy in selected Public Sector Banks in India from period of 1996-97 to 2009-10.

Chapter- V
The chapters predict analysis and interpretation of collected data during the period under the study.

Chapter - VI
The chapter includes the finding derived from the earlier chapters, analysis, interpretation of data and suggestions. It also covers scope for further extension of the study.
**Profile of Commercial Banks**

**Table 1.1: Profile of Commercial Banks during Period from 1947 to 1966**

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<td>Credit Deposit Ratio(%)</td>
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(Source: RBI, Statistical Table Relating to Banks in India, Various Issues)
Table 1.2: Profile of Commercial banks during period from 1969 to 1977

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(Source: RBI, Statistical Table Relating to Banks in India, Various Issues)
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<td>34.10</td>
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(Source : RBI Statistical Table Relating to Banks in India, Various Issues)
## Table 1.4: Profile of Commercial Banks during Period from 1985 to 1991

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(Source: RBI, Statistical Table Relating to Banks in India, Various Issues)
Table 1.5: Profile of Commercial Banks during Period from 1992 to 1999

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(Source: RBI, Statistical Table Relating to Banks in India, Various Issues)
Table 1.6: Profile of Commercial Banks during Period from 2000 to 2010

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(Source: RBI, Statistical Table Relating to Banks in India, Various Issues)
Table 1.7: Structure of Commercial Banks in India during 1960 – 2010

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<td>Other Scheduled Commercial Banks</td>
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<td>All Commercial Banks</td>
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(Source: Performance Highlights of Banks, IBA Special Issue 2009-2010)
(Figures in Brackets Show Percentage to Total of All Commercial Banks)