CHAPTER-7

FINDINGS AND SUGGESTIONS

7.1 INTRODUCTION

An introspect review of the current study confirms that the Indian banking System has undergone a change after the nationalization of the Banks in 1969/1980. Both the Narasimham Committee (1991 and 1998) had emphatically stressed to enhance the efficiency and viability of the Indian Banking System. The Banking Sector reforms had transformed the Banking System through operational flexibility, functional autonomy and leveraging technology thereby improving efficiency, productivity and profitability of the system.

7.2 MAJOR FINDINGS

The Indian Economy has withstood the shocks of the global meltdown/financial crisis well and none of the key financial parameters point to any discernible vulnerability since 2008-09.

Financial performance of banks came under pressure during 2011-12, mainly due to the increased cost of Deposits in the backdrop of an elevated interest rate environment.

7.2.1 Volume and Size

PSBs have grown their overall business by 110.10 percent from Rs. 376790 cr-Rs. 791631 cr during phase I (1991-92 to 1997-98) and further by 1021.77 percent to Rs. 8880325 cr during Phase II (1998-99 to 2011-12) efficiently with lesser Number of employees, (from 861960 in 1991-92 to 771388 in 2011-142), while Number of Branches have increased by 66.41 percent from 41764 in 1991-92 to 69498 in 2011-12.

Similar performance trend has been observed for Private Sector Banks also. In fact, the performance of Private Banks has been better than Public Sector Banks, which is evidenced from the fact that Private Sector had 4.42 percent of Total Business in 1991-92, and their share in Total Business has increased to 18.79 percent
In 2011-12, while PSBs has 89.39 percent in 1991-92, which has declined to 77.01 percent in 2011-12.

The deeper analysis of the study results revealed that most of the PSBs had faced the problem of excess staffing which had adversely affected their Efficiency and Profitability. However, few of the PSBs (SBI and Punjab National Vijay Bank etc.) in the recent past have faced problem of shortage of staff arising out of large number of retirements besides faster pace of expansion undertaken by the said Banks. It is noteworthy that Private Sector Banks have not faced the issue of staff shortage.

7.2.2 Efficiency

Business per Branch of PSBs were higher than Private Banks during the period 1991-92 to 1994-95. Private Sector Banks were much ahead of PSBs in Business per Branch from 1995-96 onwards. Among PSBs, SBI performed better when compared to the Nationalized Banks and even Associate banks. Old Private Sector Banks also lagged behind New Private Sector Banks in this regard.

A similar trend of better performance of Private Sector Banks in terms of Profit per Branch has been observed as compared to PSBs for the period under study, except for the period from 2007-08 onwards when PSBs have overtaken and performed better than Private Sector Banks till 2011.12.

The performance of Private Sector Banks was much better than those of PSBs when viewed from the 1993-94 onwards till 2008-09. From 2009-10 onwards PSBs are performing better in this regard.

Performance of Private Sector banks with regard to Profit per Employee has been consistently exemplary during the entire period of the study. However, PSBs have tended to rationalize staff cost to contain non-interest expenses. Per employee cost of PSBs has risen due to the changing composition of the staff and increased provisioning towards superannuation liabilities in 2004-05.

PSBs have been able to record higher Operating Profits to Total Assets, when compared to PBs, from 1991-92 till 2005-06 due to high growth of Operating Profit achieved by them mainly on account of substantial increase in Non-interest Income or other Income (largely on account of higher trading income) and a significant containment of expenditure in general coupled with a decline in interest expenses on Deposits in particular. While, Operating Profits of SCBs increased during 2006-07
reflecting largely the impact of higher increase in Interest Income and a lower increase in Operating Expenses. There has been deceleration in growth of profit due to the rising Cost of Deposits and borrowing but declining return on investments in 2008-09. Private Sector Banks have performed better than PSBs in this regard since 2006-07 and have been able to maintain edge over PSBs till 2011-12.

A similar trend is observed in the case of Operating Expenses to Total Assets. The said ratio has gradually declined, indicating improved Efficiency, for PSBs from 1995-96 onwards despite these Banks increased other Operating Expenses such as technological up gradation in view of implementation of Basel II. Operating Expenses to Total Assets for PBs had increased from 1.10 percent in 2004-05 to 2.41 percent in 2005-06 for the said reason.

The study also reveals the Efficiency ratios for both type of Banks (PBs and PBs) an optimistic movement on the expected lines.

The study further brought to light that PSBs have not been technology responsive as much as their counterparts in Private Sector.

It is feared that unless the PSBs address the issue of appropriate technology adoption, it may not be able to meet the challenge posed by the new Private Sector Banks especially in the Retail Banking Segment. Better customer service supported by superior technology and improves their market share at the cost of Public Sector Banks.

This trend may reach an alarming proportion in future when foreign Banks increase their penetration in our country through subsidiary route.

The study has also revealed that PSBs lack appropriate strategic planning when compared to their Private Sector counterparts resulting in lower Operational Efficiency. PSBs need to enhance their skills especially in marketing and sales of products/services, service operations, risk management and the overall performance.

7.2.3 Profitability

During the year 2001-02, there was a significant improvement in the Profitability of the SCBs owing to the rise in trading profits attributable to the softer interest rate regime coupled with the containment in Operating Expenses,
notwithstanding the higher provisions and contingencies. Banks have been able to maintain their profitability by containing Operating Expense.

During the year 2010-11, the RBI has allowed Banks to amortise the total liabilities arising out of this development over a period of five years and as such only one fifth of the total liabilities was charged to the profit and loss account of the said year. Also, a factor which helped the Banking Sector to maintain Profitability, was the regulatory treatment extended to liabilities arising out of re-opening of pension option to employees of PSBs and the enhancement in gratuity limits in February 2011. Despite accelerated growth in Total Income in 2011-12, the consolidated net profit of the banking sector increased at a slower rate compared with the previous year, mainly due to steep increase in interest expended.

Return on asset (ROA) is an indicator of Efficiency with which Banks deploy their assets to ultimately maximize the Profitability. It captures the amount of profits that can be generated from one unit of assets held by the Banking Sector. ROA of PSBs during the initial period of phase I was negative due to marked decline in net profits on account of higher provisions made towards implementation of prudential norms, whereas Private Banks remained in positive territory throughout the period under study. PSBs started earning positive returns from 1996-97 onwards and had maintained edge over the Private Sector Banks till 2004-05, when the ROA started declining for PSBs while it has shown improving trend for Private Sector Banks. Higher ROA was recorded by certain PSBs whose Interest Income had improved as the Reserve Bank allowed banks to recognize income on a accrual basis in respect of some categories of projects under implementation with time overruns. Also, higher ROA was on account of consistent rise in profits, which was primarily driven by two factors: Firstly, there was a significant rise in trading incomes consequent upon the easy liquidity conditions prevailing in the market which boosted 'Other Income' of the Banking Sector. Secondly, as a result of reduction in Deposit rates, the interest expended in general and the interest outgo on Deposits, in particular, was largely contained. ROA of SCBs marginally increased in 2010-11 mainly owing to higher NIM.

Return on Equity (ROE) is an indicator of use capital by Efficiency of Banking Institutions and it reflects Banking Sector's Efficiency in generating profits from every unit of equity.
In case of PSBs, there is a negative variation in ROE during 1995-96, 1998-99, 2000-01, 2004-05, 2005-06, 2009-10 and 2010-11. The cause of said variation is traced mainly to impact of higher capital base, partly by raising fresh capital and partly by ploughing back of profits. Also, the decline reflected lower Profitability during 2004-05 for SCBs and higher provisioning requirements in 2010-11, for housing loans extended by SBI and Associates at teaser interest rates. Even though PSBs have recorded higher ROE when compared to Private Sector Banks for the period 1996-97 till 2010-11, there is a wide variation within both the Banking Groups over the period of study.

The two main indicators of Profitability, i.e., ROA and ROE declined marginally during 2011-12, reflecting deceleration in the Net Profit of Banks caused by increased interest expenditure.

*Net Interest Margin (NIM) (Spread)* defined as the difference between Return and Cost of Funds or between Interest Income and Interest Expenses. It represents cost of financial intermediation.

Significant variations in NIM (spread) across the Bank Groups, due to the varying quantum of fee-based income earned. PSBs had much better Spread than the Private Sector Banks from 1991-92 till 2006-07.

The Foreign Banks however has the highest Spread on account of high share of less expensive CASA Deposits which enabled these Banks to register lower Cost of Deposits and in turn, lower cost funds during the recent years.

A subdued interest rate environment coupled with a low credit off-take partly explains the decline in the NIM of the Banks. The increase in NIM could be due to variations in interest prevalent at different point of time during the year while it may remain unchanged if the overall return on funds and overall cost of funds during the year increases more or less by the same margin. If the spread come under pressure during a year, it may suggest that the benefits of low interest rate have begun to percolate to Banks' borrowers.

Higher NIM contributes to Profitability, also implies higher cost of financial intermediation in the economy, which is considered as a sign of inefficiency. Thus there is a need to bring down NIM to improve efficiency of Financial Intermediation along with increasing the Non-interest Income to maintain growth in Profitability.
**Other Income** of the Banks is the Non-interest Income and sources of such income are as follows:

1. Commission, exchange and brokerage
2. Profit on sale of investments
3. Profit on exchange transaction; and
4. Miscellaneous Income; which includes profit on revaluation of investments, profit on sale of fixed assets such as buildings.

Banks need to increase its other Income, to improve its Profitability as the Spread will be shrinking over the years. Higher the ratio of other Income to total income, better would be the Profitability of the bank.

By and large, **Other Income to Total Income** has been comparatively better for Private Sector banks when compared to PSBs except for the period 1991-92 and 1992-93. Other income of SCBs witnessed a rise in 2001-02, with a significant increase being recorded by Nationalized Banks reflecting the increased diversification undertaken by them fee-based activities.

The composition of 'Other Income' of SCBs underwent a significant change during 2004-05 due to decline in the share of trading income on investments and increase in the share of fee-based income and income from foreign exchange operations and miscellaneous income.

The trend in Non-interest Income has been influenced mainly by the behaviour of trading income, which in turn, was guided by the yield on Government securities in 2006-07.

Other Income of SCBs during 2007-08 increased, reflecting the increasing diversification of sources of income by Banks, whereas it has recorded a lower growth in 2010-11 over the previous year, due to decline in trading income of the Banking Sector, while commission and brokerage recorded higher growth during the year.

Private Sector banks are known for high **Credit Deposit Ratio (CD Ratio)** when compared to their counterparts in Public Sector Banks, as the new Private Sector Banks are lending more aggressively than PSBSs.
The return ratios (ROA, ROE etc.) showed fluctuating trend for PSBs and also the Private Sector Banks.

The analysis of Profitability indicators undertaken in the study reveals that PSBs have shown the downbeat tendency during 1992-97, shown positive trend thereafter in the performance of all the Profitability ratios. However study also reveals reasonable variable drifts.

7.2.4 Asset Quality

The Asset Quality of a bank could be judged by analyzing Gross NPA to Gross Advances and Net NPA to Net Advances.

The share of NPAs, in Gross and net terms, has declined significantly during the period under study due to introduction of prudential norms and the result of several recovery measures adopted by Banks. The incidence of NPAs is higher in case of PSBs than other Bank Groups.

The major factors adversely impacting the Profitability of the Banks are the NPAs. The general cause of rise in NPAs has been largely due to liberal lending norms, cyclical changes in the industries and unique unfavorable position of sectors like Energy, Infrastructure, Mining etc. Also, due to global recessionary trends, both the Bank Groups (PSBs and PBs) have got the hit causing higher NPAs.

Asset Quality of Indian banks had generally seen a steady improvement as evident from a declining level of Gross and Net NPA ratio since 1999-00. During the last few years, writing off of NPAs was an important factor in maintaining the Asset Quality of the Banking Sector at tolerable levels. In fact, Banking Sector has written off almost 10 percent of the outstanding gross non-performing loans in 2010-11. Among Banking Groups, PSBs witnessed deterioration in Asset Quality in 2010-11, mainly due to deterioration in Asset Quality of the SBI Group. SBI Group reported the highest Gross NPA ratio in 2010-11.

New Private Sector banks had substantial addition to their NPAs, reflecting the impact of merger during the year 2001-02. Increased recovery of NPAs, decline in fresh slippages and a sharp increase in Gross Loans and Advances by SCBs, led to a sharp decline in the ratio of Gross NPAs to Gross Advances in 2005-06. NPAs in the Priority Sector increased during 2006-08, mainly due to increase in NPAs in the Agriculture Sector and in the Non-priority Sector, while NPAs in the SSI Sector
declined. The reason attributed for increased NPAs is due to hardening of interest rates, which made the repayment of loans difficult for some borrowers.

During 2008-09, the decline in Priority Sector NPAs was contributed by the Agricultural Sector, partly reflecting the effect of the Debt Waiver Scheme for farmers announced by the Central Government in 2007. The sharp rise in NPAs of Non-priority Sector was reflective of the slowdown in the economy and stressed financial conditions of corporate. Net NPA to Net Advances increased only marginally during 2008-09 and it was less than 2 percent, which suggests overall improvement in the financial health of Indian Banks in recent years.

Slippage ratio, which increased consistently since 2008, witnessed an improvement in 2010-11, broadly reflecting the recovery of growth. The restructuring of Advances, under the special Dispensation Scheme of RBI announced during 2008, undertaken by the Banking Sector, especially PSBs, during the recent years also helped in reducing the Gross NPA ratio of the Banking Sector. New Private Sector Banks relied more on writing off NPA as a measure to contain their NPAs level.

Agricultural Sector contributed 44 percent of the total incremental NPAs domestic Banks in 2010-11. Higher growth registered in the credit to Agricultural Sector (more than 20 percent) during the last four years (2006-07 to 2009-10) might have contributed to the growth in agricultural NPAs in 2010-11 owing to the deterioration in credit quality.

In addition to increase in Gross NPAs at the system level, fresh accretion of NPAs, as captured by the slippage ratio also increased during 2011-12 compared with the previous year. The Recovery ratio of the Banking Sector witnessed an improvement during the year.

During 2011-12, the written-off ratio was significantly lower as compared with the previous year. The accretion to NPAs as captured by the slippage ratio was higher in the case of PSBs and Foreign banks and also their performance was better than PBs.

There has been a steep increase in Gross NPAs during 2011-12, which could be attributed to the slowdown in domestic economy, inadequate credit appraisal and monitoring of credit proposals, besides increase in re-structured advances by PSBs, especially Nationalized Banks.
During 2011-12, nearly half of the total NPAs were attributed to priority sector. The share of agriculture in total NPAs increased marginally. However, despite the subdued industrial performance, the share of micro and small enterprises in total NPAs of the Banking Sector came down as compared with previous year.

7.2.5 Soundness

*Capital to Risk-weighted Asset Ratio (CRAR)* popularly known as *Capital Adequacy Ratio*, is a measure of the Capacity of the Banking System to absorb unexpected losses.

There has been steady increase in CRAR from 1998-99 onwards due to increase in Tier II component. The combined Tier I and Tier II Capital has remained broadly stable thereafter with Tier I component being roughly two-thirds of total CRAR. The sharp increase in the credit portfolio of the Banks in 2004-05, coupled with the higher risk weight made applicable for housing and consumer loans, led to significant rise in the risk weighted assets, which was achieved by raising the capital from domestic and international capital markets.

The Decline in the CRAR during the year 2005-06, is attributed:

2. Sharp increase in risk-weighted assets on account of higher credit growth (driven partly by shifting of risk free assets)
3. Increase in risk weights for personal loans, real estate and capital market exposure.

The overall CRAR of the Banking System was in excess of 13 percent in 2008-09, mainly due to maintenance of high growth rate of Tier II Capital of Banks, notwithstanding deceleration in growth of both rate of both the Tier II Capital of Banks, notwithstanding deceleration in growth rate of both the Tier I Capital and that of risk weighted assets.

CRAR of all Bank Groups (including PSBs and PBs) under Basel I and Basel II, remained well above the required minimum of 9 percent, which implies that in the short to medium term, SCBs are not constrained by capital in extending credit. Besides, Tier I Capital accounted for more than 70 percent of the total capital of
Indian Banks both under Basel I and II, reflecting the sound capital position of Banks as at 31.03.2012 indicating that Indian Banks remained well capitalized.

Significant improvement in the position of CRAR has been observed during the period under study across the Bank groups. All Bank groups are now maintaining CRAR above the stipulated levels. The future financial performance and market share of the Banks will depend on their ability to manage transition to a technology oriented and customer driven institutions. They further need to improve their Asset Quality, further reduce NPA levels and arrest fresh slippages of Assets to NPAs. All these factors would hold the key for better rating of the Banks.

The current study, the results and discussions thereof reveal that PSBs and Private Sector Banks are required to further improve on the several aspects discussed above and they must improve upon their strengths to gain competitive advantage.

7.3. CHALLENGES AHEAD FOR THE BANKING SECTOR IN INDIA:

7.3.(i) Improving profitability: The most direct result of the banking reform/changes is increasing competition and narrowing of spreads and its impact on the profitability of banks. The challenge for banks is how to manage with thinning margins while at the same time working to improve productivity which remains low in relation to global standards. This is particularly important because with dilution in banks’ equity, analysts and shareholders now closely track their performance. Thus, with falling spreads, rising provision for NPAs and falling interest rates, greater attention will need to be paid to reducing transaction costs. This will require tremendous efforts in the area of technology and for banks to build capabilities to handle much bigger volumes.

7.3.(ii) Reinforcing technology: Technology has thus become a strategic and integral part of banking, driving banks to acquire and implement world class systems that enable them to provide products and services in large volumes at a competitive cost with better risk management practices. The pressure to undertake extensive computerisation is very real as banks that adopt the latest in technology have an edge over others. Customers have become very demanding and banks have to deliver customised products through multiple channels, allowing customers access to the bank round the clock.
7.3.(iii) Risk management: The deregulated environment brings in its wake risks along with profitable opportunities, and technology plays a crucial role in managing these risks. In addition to being exposed to credit risk, market risk and operational risk, the business of banks would be susceptible to country risk, which will be heightened as controls on the movement of capital are eased. In this context, banks are upgrading their credit assessment and risk management skills and retraining staff, developing a cadre of specialists and introducing technology driven management information systems.

7.3.(iv) Sharpening skills: The far-reaching changes in the banking and financial sector entail a fundamental shift in the set of skills required in banking. To meet increased competition and manage risks, the demand for specialised banking functions, using IT as a competitive tool is set to go up. Special skills in retail banking, treasury, risk management, foreign exchange, development banking, etc., will need to be carefully nurtured and built. Thus, the twin pillars of the banking sector i.e. human resources and IT will have to be strengthened.

7.3.(v) Greater customer orientation: In today’s competitive environment, banks will have to strive to attract and retain customers by introducing innovative products, enhancing the quality of customer service and marketing a variety of products through diverse channels targeted at specific customer groups.

7.3.(vi) Corporate governance: Besides using their strengths and strategic initiatives for creating shareholder value, banks have to be conscious of their responsibilities towards corporate governance. Following financial liberalisation, as the ownership of banks gets broad based the importance of institutional and individual shareholders will increase.

In such a scenario, banks will need to put in place a code for corporate governance for benefiting all stakeholders of a corporate entity.

7.3.(vii) International standards: Introducing internationally followed best practices and observing universally acceptable standards and codes is necessary for strengthening the domestic financial architecture. This includes best practices in the area of corporate governance along with full transparency in disclosures. In today’s globalised world, focusing on the observance of standards will help smooth integration with world financial markets.
7.4 SUGGESTIONS

On the basis of the current study and findings thereof, the following recommendations are offered.

1. The banks should focus on expanding Retail banking as the same will be immensely benefited from the Indian demographic dividend. The PSBs need to adopt appropriate technology and make use of the same effectively to counter the challenges posed by the new Private Sector Banks in the Retail banking Segment. Banks should make proper use of the technology for introducing innovative products/services and to increase the reach while gaining competitive advantage. Mobile Banking should be accorded a thrust area, as it has got potential scope for Profitable Business, due to its penetration and reach.

2. Since prosperity and wealth lies in the 'Bottom of the Pyramid', Banking System should reorient its approach to 'Going Rural', which should be made new 'Marketing Mantra'. This would not only help in achieving 'Financial Inclusion' for the Banks, but would also help in expansion of banks' business and achieving 'Inclusive Growth' for our economy.

3. The next-Generation customers are expected to be large in number and would expect cost-effective Banking. This will give rise to addition of new Branches and ATMs to serve the huge addition to the said Bankable population. For this purpose, the Banks to adopt low cost Branch network model with smaller size Branches.

4. Banks may evolve new models to serve MSME sector profitably, as exposure to this sector will have adequate risk dispersion, besides growing potential for quality banking business. The success of these initiatives will in turn result in improvement of the respective market share among the Banks.

5. The Banks should initiate necessary steps to provide alternate efficient delivery channels to transform into Digital Banking System for further improvement in their customer services with an objective to achieve customer delight, which will also help in retention of the Customer. Banks to develop appropriate system to ensure monitoring customer perception of its service quality,
identifying causes for deficiency observed in service quality and taking appropriate remedial measures to improve the same, on an ongoing basis.

6. Banks may adopt CRM and cross-selling strategies in a large scale to reduce customer acquisition costs and also to improve their risk management, which may, in the long run, prove to be cost effective.

7. Banks may take advantage of deregulation of savings interest rate and mobilize higher CASA Balances, from select customers segment, to reduce the average cost of funds and thus improving the operating margin. This is one of the strengths of New Private Sector Banks as against the constraints of PSBs playing the role of social responsibility, which call for lower/zero minimum balance in CASA accounts.

8. Banks may initiate appropriate measures to increase their Non-Interest/Fee based income, by increasing their innovative fee based services, including merchant Banking and Investment Banking, which is expected to grow faster as the corporate would demand for more such services to access buoyant Capita Market and simultaneously improve their operating efficiency. This may require specialized skills in Marketing and sales, credit Management, Merchant Banking and other banking operations. bank staff may be suitably trained and reoriented periodically for this purpose.

9. The Human Resources Management needs to be fine-tuned with the dynamic requirement of the Banking Sector. Especially the Public Sector banks to bring in required improvements in their HR practices gradually, in line with their counterparts in new generation Private Sector Banks, particularly towards Specialist-skills orientation. Further, the Public Sector Banks have to focus on **improving their Employees' productivity and reduce establishment costs** with due attention towards marketing needs of the Banks. Banks in India need to focus on the various aspects to build required capabilities in them, to face the challenges posed by the dynamic Banking environment.

10. Banks must **classify their major operating expenses** into controllable and uncontrollable costs and evolve strategies to control the costs without adversely affecting the quality of service. This will ultimately improve the
Profitability. Banks may explore the possibilities of resorting to business Process Re-engineering for this purpose.

11. In order to **minimize** their **operational costs**, banks to encourage:

   (a) **Use of Electronic Payment System** to be encouraged and to minimize use of the Account holders may be kept to a minimum and charges may be levied by the banks beyond this number. Charges may range from moderate to steep (slab rate), depending upon the usage history of the customer. Some amount/value limit for issue of cheques by the Account holders may be fixed. If any cheque is issued beyond the said stipulated limit, charges may be levied at the time of debit of the cheque to the account by the paying bank and such charges should be higher than the charges levied on electronic payments of similar value.

   (b) **Suitable charges** may also be levied for high (both in amount and frequency) cash withdrawals and Deposits to avoid increased dependence or slippage to cash-based transactions.

   (c) **Processing charges** to be levied on every Dividend/Interest warrant deposited in the account to encourage opting for electronic payment (direct credit to the account) by the Investors.

   (d) In case of loans, **the practice of obtaining post-cheques should be completely stopped** and loan repayments should be through electronic payments (ECS) only. Similarly, Credit Cards repayments should also to be made electronically.

12. Banks to undertake financial performance evaluation of its individual Branches from profitability point of view. **Non-viable Branches, either should be merged with the** other Branches, to make the merged entity a viable unit, or to convert the same into viable satellite office.

13. **Bank should revamp their Credit Administration** to ensure that proper macro-economic analysis are being done on an ongoing basis before deciding on sectoral/group/per party credit exposures and take timely remedial measures to safeguard their interest thus avoid slippages to NPAs. Sound credit appraisal, credit risks evaluation and credit monitoring through periodic
interaction with borrowers, off-site and on-site surveillance etc. could be done, to prevent the growth of NPAs.

14. Banks to strategically evolve their revised/upgraded risk management systems which should take into account the huge exposure towards infrastructure sector which may surpass the existing exposure limits of the banks.

15. The banks may scout for increasing share in Wealth Management products/facilities as the same is likely to have rapid accumulations in the years to come, due to the economic prosperity of a section of the society. The PSBs and Private Sector Banks, both to strategize to face challenges posed by the Foreign Banks in this regard and also for sustained growth.

16. The major constituents of Good Corporate Governance would be accountability at all levels, higher transparency and enhancing the image of organization in the eyes of the public. Therefore, the Banks need to pay required attention to Corporate Governance in the context of deregulation, prudential norms, risk-based supervision etc. This may require greater vigilance, more disclosures and strict adherence to prescribed rules, regulations and norms.

17. NIM (Spread) should be gradually bought down in our Country to increase the competitiveness by scaling down the interest rates. For long-term sustainability of the Indian economy, it need to be examined seriously.

18. The Banks should identify the present inconsistencies and gaps their Core Banking Solution (CBS) platform and customize the same to meet the customers/staff requirements for ensuring seamless operations.

19. Banks must focus on mobilizing more of low cost Deposits (CASA) and lend prudently to build up a quality asset portfolio, as these two factors constitute the core of Banking activates while a substantial portion of Banks' income and expenditure is associated with them.

7.5 SUGGESTED AGENDA FOR 3RD GENERATION REFORMS

The Government of India may accord top priority to take further Banking sector reforms to strengthen/consolidate the foundation of the Indian Banking System and make it strong enough to meet the challenges of globalization. The future reform
process need to be so designed that it should focus on ensuring sustained viability and efficiency of the Banking System to enable it to contribute to enhance the competitiveness of the real economy and also to face challenges of an increasingly integrated Global Financial System. The future reforms should contain, among others, the following-

i. **Policy Framework for NPAs** - Suitable change in policy framework need to be introduced with an aim to reduce the level of NPAs. Increasing level of NPAs is the most challenging task faced by the Indian Banking System and the same need to be addressed appropriately.

ii. **Legal Reforms for Faster Recovery** - The Bank Managers to be empowered for recovery of small NPAs has been done by the Revenue Officials, by enforcing the revenue recovery powers by the Bank Managers which would expedite process of adjudicating smaller claims. More number of DRTs to be established. No loan waivers under any circumstances to be undertaken.

iii. **Improvement of Operational Efficiency** - Suitable measures to be introduced, to improve operational efficiencies especially for PSBs these Banks to close/merge the large number of un-remunerative/loss making Branches. Branches with low productivity and excess staffing and old traditional methods of operations/decision making to be replaced by strategic moves to gain competitive advantage.

iv. **Reducing the Entry Barriers of New Private Sector Banks** - The Government should reduce the restrictions for entry of new Private sector Banks in Indian Banking System to generate more competition which will in turn improve the quality of services.

v. **Consolidation of Indian Banking system to create Global Banking** - Given the India's GDP and the future we envision, India must have some large Banks at the global level, competitive and comparable with Global Banks. Our Country also should have some mid-size Banks and some small-sized Banks, which can penetrate more and would help in achieving greater Financial Inclusion and thus higher inclusive growth. To make few of the Indian Banks as a Global Bank, they must be supported for mergers and takeovers, so that
they may consolidate their position, with respect to Capital Adequacy, size of operations and expertise to face the competition posed by the global players.

vi. **Withdrawal of Directed Lending**- The Government/RBI should review their current norms for Banks to lend 40 percent of their loans to priority sector, including agriculture, exports and the weaker sections. Instead a Rural Credit Delivery System could be devised which should not require large subvention, as is required today. Banks should also be motivated through appropriate reward cum recognition system including incorporating the same into their rating cum ranking process.

vii. **Compensation Policy**- A suitable compensation Policy may be evolved by RBI/GOI empowering the Bank Management across all the Banking Groups to offer market driven compensation to attract the required talents in the Banking Industry.

**7.6 CONCLUDING OBSERVATIONS**

PSBs may not be taken-up for privatization in the near future, but their Government holding could definitely be lowered. Nonetheless, over a period of time, there could be a case of privatization due to perceived inefficiency in PSBs when compared to their counterparts in Private Sector. Therefore in this study, an attempt has been made to study, analyze and compare the performance of PSBs and Private Sector Banks.

Due to increasing competition, the policy changes and the operational environment in which the Indian banking system is currently operating, there has been an increased focus on operational Efficiency and Profitability. Most of the PSBs have registered a significant improvement in their profitability, but the Private sector Banks continue to have still better Profitability.

Banking in India has fairly matured in terms of reach, product range with an exception of reach in rural India still remaining a challenge for Private sector and Foreign Banks. The demand for Banking Services particularly Retail Banking, mortgages and investment services are expected to grow at a faster pace. We may see some mergers and acquisitions in the near future towards consolidation of the sector. Competition has been infused into the Banking system through several measures including deregulation of interest rates, granting functional autonomy to PSBs etc.
The future of PSBs would be based on their capacity to have good quality Assets and maintaining required Capital Adequacy backed with stringent prudential norms.

The recent IBA-BCG survey of Banks revealed that the level of confidence in finding profitable solutions for financial inclusion is not very high. The conventional Banking models are reportedly unviable for low ticket size, zero collateral banking Business in this segment. The paradigm shift has been from 'CSR' to 'Economic' Viability'. Banks need to create a Business model for financial inclusion considering the economic imperatives and Government should support Banks with incentives for shared inoperable infrastructure and reimburse for the Government pay outs. The Financial Inclusion is meaningless unless the rural economy is stimulated and rural infrastructure is accordingly developed. NABARD could be repositioned for this role.

PSBs have in their folds most experienced staff. However, in 2010, the average cost per Employee in the Public sector was higher than the new private sector banks. The solution for this does not lie in blind adoption of HR practices from the Private Sector. It certainly requires careful orchestration of the initiatives like steady talent induction, systemic succession planning and career management, structural adjustment in cost, empowering senior and middle management executives, Massive re-skilling, stimulation of non-officers and structured change management.

It is believed that findings of this study and the suggestions thereof given here above will immensely help the PSBs and Private Sector Banks to be more competitive and compatible in the new era of globalization.

The current study and discussions thereon, certainly reveals that the Indian Banking System is moving towards a more cohesive and strong system, capable and responding to the dynamic economy. Indian banking system needs a fresher outlook and keeping in view the various distortions on the system, it is time for the Government to introduce 3rd banking sector reforms expeditiously. For long term sustainable growth of Indian banks, following could be the crucial factors:

i. The banks to have commitment to develop strong long lasting relationship with their customers and to provide them high quality services for their retention.
ii. The management of the Banks should ensure that the policies and environment are so evolved that the staff is well motivated to be more innovative and creative in the professional discharge of their duties.

iii. The Banks to have commitment for sustained growth with profits and consistent management of risks.

The study brings to the light few of the issues, mentioned here below, which needs to be addressed by the Bank management-

a- Banks should fix rigid norms for accountability for performance with desired flexibility to accommodate genuine/uncontrollable reasons of non-performance.

b- Political interference should be totally eliminated for better administration and also improving the loan repayments. This will enable better credit management and asset quality of banks especially PSBs.

c- Private Sector Banks to be encouraged for social banking and to expand in semi-urban and rural areas. They must work for winning public trust.

d- Behaviour of staff of PSBs to be improved along with appropriate marketing strategies.

7.7 SCOPE OF FUTURE RESEARCH

Even though there have been countless researches which have been conducted in Indian and Abroad analyzing the performance of Commercial Banks, there still remains scope for further research in this field. The causes, impact and policy responses to the recent financial crisis also will have a major impact in guiding the scope for future research in Banking. Some of the focal areas in this regard have enumerated here below:

a) Implications of bank strategies for financial sector stability need to be studied in depth. Recent bail outs granted to few of the large banks and/or stimulus packages that have been implemented during post financial crisis, a deeper understanding of the relationship between systemic stability and safety net subsidies would be necessary.
b) Studies, focusing on financial innovation and adoption of new technologies while introducing new products/services, may be undertaken. Taking into account their impact on risk taking, market returns and possible contagion.

c) Overall impact of securitization and other risk management practices on efficiency of Banks and on the allocation of risk may be taken up to evolve appropriate regulatory framework for the Banking sector.

d) Empirical research on the riskiness of alternative ownership and types of governance and their relationship with performance of banks may be undertaken.

e) Research may be carried out to illustrate ways in which Banking regulations need be designed to make capital and provisioning norms less pro-cyclical.

f) Impacts of reforms on the Banks resulting in reorganization of inter and intra-Bank Group mergers and acquisitions and strategic advantages thereof may be studied.